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கணக்காய்வாளர் தலைமை அதிபதி திணைக்களம்  
**AUDITOR GENERAL'S DEPARTMENT**



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எனது இல. } BAF/H/GEN/66  
My No. }

ඔබේ අංකය  
உமது இல. }  
Your No. }

දිනය  
திகதி } 30 September 2016  
Date }

Chairman,  
Committee on Public Enterprises.

The Special Audit Report updated in accordance with the information discovered up to 23 September 2016 by the Committee on Public Enterprises and The Auditor General since the release on 29 June 2016 of the Special Audit Report on the Treasury Bonds issued by the Public Debt Department of the Central Bank of Sri Lanka during the period from February 2015 to May 2016.

At the COPE meeting held on 23 September 2016 in connection with the investigation of the aforesaid subject, I have expressed my consent to update the special audit report presented to the committee on 29 June 2016, based on the information discovered following 29 June 2016.

02. The said report is furnished herewith.

Sgnd : H.M.Gamini Wijesinghe

Auditor General

The Special Audit Report updated in accordance with the information discovered up to 23 September 2016 by the Committee on Public Enterprises and The Auditor General since the release on 29 June 2016 of the Special Audit Report on the Treasury Bonds issued by the Public Debt Department of the Central Bank of Sri Lanka during the period from February 2015 to May 2016.

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**1. The Background for the issuance of the above Special Report and the Nature of the Report**

This Report is presented in accordance with the instructions given to the Auditor General at the meeting of the Committee on Public Enterprises held at 1430 hours on 06 May 2016 to forward a report on the issuance of Treasury bonds in the past and the present and the concurrence reached in that connection. The letter of the Auditor General relating to this subject submitted to the Committee on Public Enterprises which met on 08 June 2016 (Annexe i) is forwarded herewith. The opinion of the Attorney General (Annexe ii) expressed on 12 February 2004 on the safeguarding of the confidentiality of the information obtained from the Central Bank of Sri Lanka for purposes of audit due to the sensitive nature of information and a letter of the Governor of Central Bank (Annexe iii) referring to that opinion is also referred to. As it is assumed that certain documents included in this Report as the Annexes are the documents of which confidentiality should be safeguarded, a Report without certain Annexes will be forwarded to your Committee while a Report with the said Annexes will be forwarded to Hon'ble the Speaker of Parliament.

(However, upon the request made by the Hon. Speaker's secretarie's by the letter dated 09 September 2016, twenty six copies of the Report with the said Annexes were forwarded to the Hon. Speaker for distribution to the Hon. Members of the Committee on 15 September 2016)

Subsequent to forwarding the Special Audit Report without the Annexes, the Committee held meetings on the following days, to hold discussions based on that report.

Date	Participants		
	Members of the Committee	Auditor General's Department	Central Bank of Sri Lanka and Related Ministry Officials
29 June 2016	√	√	X
05 July 2016	√	√	X
07 July 2016	√	√	√
12 August 2016	√	√	√
23 August 2016	√	√	X
08 September 2016	√	√	Only governor of the central bank.
23 September 2016	√	√	X

The Committee that met on 23 September 2016 considered the matters collected after 29 June 2016, and the Auditor General agreed to the special update Audit Report submitted to the committee on 29 June 2016, based on those information collected and forwarded to the Committee on Public Enterprises. Accordingly, action was taken as agreed to forward this updated Audit Report to the Committee on Public Enterprises.

The documents which were deemed to protect the confidentially relating to this report had been forwarded to the members of the Committee at the request of the Hon. Speaker by now, thus the said matters had been included in this report.

Due to matters revealed after 29 June 2016, only paragraph 5.1.9 and 5.1.11 in the special report issued on that date had been revised. Because of such amendments there was no any effect to the conclusion of the report.

**2. The following methodologies were followed in the preparation of this Report.**

**2.1 Examination of the following documents.**

**(Up to 29 June 2016)**

- 2.1.1 The Operational Manual followed by the Central Bank of Sri Lanka in the issuance of Treasury bonds.
- 2.1.2 The oral submissions of the investigation held by the Special sub-committee of the Committee on Public Enterprises on the issue of Treasury bonds on 27 February 2015.
- 2.1.3 The Report of the Three Member Committee appointed to examine and report on the bond issue referred to in paragraph 2.1.2 above. (This Report was tabled in Parliament on 19 May 2015 by Hon. Mr. Lakshman Kiriella, Member of Parliament).
- 2.1.4 Investigation Report on the issuance of bonds referred to in paragraph 2.1.2 by a retired Judge of the Supreme Court.
- 2.1.5 Monetary Law Act, No. 58 of 1949 together with its amendments.
- 2.1.6 The relevant decisions of the Domestic Debt Management Committee and tender committee.
- 2.1.7 Information and data published in the web site of the Central Bank of Sri Lanka.

**(After 29 June 2016)**

- 2.1.8 The written explanations received from the Central Bank of Sri Lanka for the Special Audit Report forwarded to the Committee on Public Enterprises on 29 June 2016.
- 2.1.9 The notes on the Oral evidence given at the meetings of the Committee on Public Enterprises held on 07 July 2016, 12 August 2016 and 08 September 2016.
- 2.1.10 The replies received to the Questionnaire issued by the Committee on Public Enterprises to the Central Bank of Sri Lanka and the Ministry of Finance.

## **2.2 Other Examinations**

- 2.2.1 Analysis of information received from different sources.
- 2.2.2 Examination of certain information relating to the primary market.
- 2.2.3 Examination of certain information relating to the secondary market.
- 2.2.4 Evaluation of information supplied by the Central Bank of Sri Lanka.
- 2.2.5 Discussions with the relevant parties.

## **3. Limitations of Scope**

It is emphasized that in arriving at the conclusions through the observations highlighted in this Report, my scope was subjected to the following limitations.

- 3.1 Even though it was stated that the Central Bank of Sri Lanka acted in accordance with certain guidelines contained in the Operational Manual, I am made to understand that this has not been approved by the Monetary Board of the Central Bank of Sri Lanka or any other authorized Institution(Annexes iv and v)
- 3.2 Existence of a considerable period between the date on which the Auditor General was assigned the function of examining the relevant subject and the dates on which the incidents occurred.
- 3.3 Lack of adequate time for obtaining the services of financial and economic specialists with an extensive knowledge of the relevant matters and the problematic nature of obtaining of such services due to the confidentiality constraints referred to in the first paragraph of this Report.
- 3.4 Even though the Central Bank has such consultants referred to the paragraph 3.3, above obtaining their services impartially being a problematic issue.
- 3.5 Lack of a mandate for the Auditor General to obtain information on the secondary market, which is very important to the subject, direct from such third parties or obtain confirmation thereof.

- 3.6 Inability to ascertain whether the Central Bank of Sri Lanka had the ability to exert any significant influence the primary dealers referred to in (Annexe vi) this Report.
- 3.7 Inability to ascertain whether there was any significant influence among the primary dealers and between the Governor of the Central Bank and the primary dealers.
- 3.8 Inability to examine the discussions between the officials of the Central Bank of Sri Lanka and the primary dealers as those discussions had not been recorded.
- 3.9 Non-examination of recorded visual proceedings during the conducted of the auction on 27 February 2015 regarding the above auction.
- 3.10 According to the reply received from the Governor of Central Bank of Sri Lanka for the request made to him to identify correctly the confidential and sensitive information in the information supplied by the Central Bank of Sri Lanka for the preparation of this Report, the need to consider all information supplied as confidential (Annexe iii).

#### **4. Introduction of the Issuance Process of Treasury Bonds by the Central Bank of Sri Lanka**

- 4.1 The Central Bank of Sri Lanka, established with the primary objective of maintaining the economic and price stability of Sri Lanka functions under the Governor of the Central Bank who is also the Head of the Monetary Board of the Central Bank comprising 05 members (Annexe vii). In addition, in terms of Section 19(1) of the Monetary Law Act, the Governor of the Central Bank is also the Chief Executive Officer of the Central Bank of Sri Lanka (Annexe viii). The Central Bank of Sri Lanka holds the responsibility for the issuance of Treasury securities, that is, Treasury bills and Treasury bonds to fulfil the future monthly cash requirements of the Government as notified by the Department of Treasury Operations of the General Treasury (Annexe ix). Treasury bills are issued for

maturity less than one year and the Treasury bonds are issued for maturities over one year. The face value of a bond is Rs.100. In this case, the Central Bank obtains money on behalf of the Government and, according to the Section 106(1) of the Monetary Law Act (Annexe x), the Central Bank of Sri Lanka functions as an agent of the Government. Sixteen institutions had been registered as qualified institutes for the purchase of bonds by the end of the year 2015 and one institution had withdrawn in the year 2016 (Annexe vi). Those institutions include both state institutions and private institutions. These institutions are known as primary dealers. In addition, the Employees Provident Fund is also permitted for the purchase of Treasury bonds from the primary market.

The Central Bank of Sri Lanka had followed two methodologies up to 27 February 2015 for the issuance of Treasury bonds, of which the first method was to invite bids from the primary dealers by publication of a notice for the issuance of Treasury bonds and fulfill the cash requirements through the auction of the bonds. The second method was the direct placement or private placement of bonds to the primary dealers. The second method provided for the primary dealers to purchase bonds at the weighted average yield rate declared by the Public Debt Department of the Central Bank of Sri Lanka. In this case, the weighted average yield rate is computed under two methods. One method is to apply the weighted average yield rate of a bond of a similar maturity as determined in the most recent Treasury bond auction. The other method is to compute a yield rate based on the prevailing yield rates for similar maturities in the secondary market. The direct placement is open on every working day other than the days of auction and the primary dealers who wish to purchase bonds at the predetermined yield rate of the Public Debt Department can apply for the purchase the bonds for the remaining tenure. The procedure to be followed in an issuance of Treasury bonds appears in the Operational Manual of the Public Debt Department.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 02 to 04 in Annexe)

- 4.2 Treasury bonds are issued at fixed interest rate / coupon rate for different periods of maturity. The Government pays interest half yearly on the face value of the bonds(Annexe xi). At the bond auction, dealers submit bids at different prices based on the coupon rate declared by the Central Bank. Those bids are submitted at a premium price, that, is at a value above the face value, at a par value, that is a value equal to face value and at a discount price that is, at a value less than the face value. If they bid at premium price, the yield rate on the bond will be less than the coupon rate, the yield rate on a bid at equal price will be equal to the coupon rate and the yield rate on discount price will be higher than the coupon rate. Thus any yield rate above the coupon rate indicates that the bond is issued at discount rate (discount price) when the coupon rate and the yield rate are equal the bonds are issued at the face value and when the yield rate is below the coupon rate, bonds are issued at a premium price above the face value. As such, a premium price is received from the issue of bonds at a yield rate below the coupon rate and the Government receives an additional financial benefit therefrom. Similarly the issue of bonds at a yield rate above the coupon rate, that is, a discount rate, the Government incurs a financial loss. The issue of bonds at a yield rate equal to the coupon rate would not result in an additional benefit or loss.

(As it is not possible to agree with the written reply submitted by the Governor of the Central Bank of Sri Lanka in view of the matters contained in the following reference, the above paragraph is included in toto in the updated Audit Report.)

(Reference : Page Numbers 04 to 05 in Annexe)



4.3 The following table depicts the fulfilment of the Government cash requirements through the issuance of bonds under the auction method and the direct placement method from January 2014 and May 2016.

Table 1: Methodology of issuance of bonds and value (January 2014 to May 2016)

Year and Month	Methodology of Issue of Bonds			As a Percentage of the Issued Value	
	Auction Method	Direct Placement	Total	Auction Method	Direct Placement
	Rs.B.	Rs.B.	Rs.B.	%	%
2014 January	5.500	32.718	38.218	14	86
2014 February	3.050	80.088	83.138	4	96
2014 March	5.000	130.117	135.117	4	96
2014 April	-	120.373	120.373	0	100
2014 May	5.950	62.745	68.695	9	91
2014 June	-	126.210	126.210	0	100
2014 July	5.300	109.483	114.783	5	95
2014 August	-	44.230	44.230	0	100
2014 September	2.950	72.458	75.408	4	96
2014 October	-	22.617	22.617	0	100
2014 November	-	13.788	13.788	0	100
2014 December	4.000	18.148	22.148	18	82
2015 January	-	69.923	69.923	0	100
2015 February	10.058	23.524	33.582	30	70
2015 March	171.659	14.144	185.803	92	8
2015 April	44.306	-	44.306	100	0
2015 May	35.730	-	35.730	100	0
2015 June	82.900	-	82.900	100	0

2015 July	99.575	-	99.575	100	0
2015 August	100.578	-	100.578	100	0
2015 September	57.576	-	57.576	100	0
2015 October	55.811	-	55.811	100	0
2015 November	20.594	-	20.594	100	0
2015 December	29.545	-	29.545	100	0
2016 January	61.119	-	61.119	100	0
2016 February	38.959	-	38.959	100	0
2016 March	135.667	-	135.667	100	0
2016 April	30.44	-	30.440	100	0
2016 May	114.335	-	114.335	100	0

(The above Table is included in the updated Audit Report dated 26 June 2016 after the rectification of the typing errors.)

Even though both methods referred to above had been used up to 27 February 2015, since that date, the Central Bank of Sri Lanka had commenced following the primary auction method by temporarily moving out of the direct placement method.

(As the Central Bank of Sri Lanka has not raised any objections to the above values and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 05 to 06 in Annexe)

- 4.4 It was observed that during the 15 month period from January 2014 to April 2015, in which the decision to temporarily suspend the direct placement was effective, there were months in which only the direct placement or only the auction method or both methods were applied. Nevertheless, it was further observed that out of

the overall bond issues during a period of 15 months, over 80 per cent had been issued under direct placement method.

(The written reply submitted by the Central Bank of Sri Lanka for the above paragraph as appearing in the following reference and according to the oral evidence obtained by the COPE, the above paragraph is confirmed and as such it is included in toto in the updated Audit Report.)

(Reference : Page Numbers 06 to 22 in Annexe)

## **5. Observations**

The observations on the matters revealed at the audit test check of the process of the issuance of Treasury bonds relating to the period from 27 February 2015 and how their nature is highlighted will be dealt with under three sub-headings as shown below.

- (a) Bonds issued on 27 February 2015
- (b) Bonds issued on 29 March 2016
- (c) The trends created by the changes made to bonds issuance methodology on 27 February 2015.

### **5.1 Treasury bonds issued on 27 February 2015**

5.1.1 According to the Board Paper No. MB/PD/05/18/97 (Annexe xii) of the Monetary Board of the Central Bank, a decision had been taken for the issuance of Treasury bonds to the primary dealers through auction with effect from March 1997. It also contained recommendation that in instances of inadequacy of money in the market or when the interest rates rise significantly, the Employees Provident Fund should be made use of for the supply of funds which could not be raised from auctions. Thus it was observed that the Central Bank of Sri Lanka had deployed the direct placement method as a mechanism for the control of the interest rate.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference: Page Numbers 22 to 24 in Annexe)

5.1.2 In addition, the Monetary Board had, after considering the matters in the Board Paper No. MB/PD/1/26/2008 (Annexe xiii) and the increase in the interest rate on Government securities, decided in the year 2008 to fulfill the funds requirements through the direct placement method. According to the Board Paper No. MB/PD/25/20/2008 (Annexe xiv) the Monetary Board had, subsequently recommended that bonds carrying an interest about 0.05% (5 basis points) above the interest rate in the secondary market should be issued to the Employees' Provident Fund for creating market liquidity.

(As the Central Bank of Sri Lanka has not raised any objection to the above paragraph and as per the verbatim and other matters, the paragraph as it is included in toto in the updated Audit Report.)

(Reference : Page Numbers 24 to 35 in Annexe)

5.1.3 Accordingly to the letter No TO/DG/CFS/03 dated 20February 2015 of the Director General of the Department of Treasury Operation of the General Treasury addressed to the Superintendent of the Public Debt Department of the Central Bank of Sri Lanka (Annexexv), the cash requirement of the Month of March 2015 according to the Cash Flow of March 2015 amounted to Rs. 172 billion, The cash requirement only for 02 March 2015 amounted to Rs. 13.550 billion. The Domestic Debt Management Committee which met at 1300 hours on 27 February 2015 (Annexexvi) has recommended that Rs. 1 billion out of the cash requirement should be supplied from auction and the balance Rs.12.550 billion out of the cash requirement should be supplied from auction and the balance Rs.12.550 billion should be supplied from primary placement. The responsibility of this committee comprising a representative of the Ministry of Finance and 4 officers of the Central Bank is the maintenance of the domestic borrowing cost and the risk at the minimum level (Annexe xvii).Nevertheless, the most important matters in this connection is that the representative of the Ministry of Finance has not participated in this meeting. Informational in support that the concurrence of the absent member had been obtained through alternative means that is, at least

over the telephone was not revealed. Thereafter, the approval of the Governor, Central Bank for this decision had been obtained on 2 March 2015 (Annexe xvi) (According to the written reply submitted by the Central Bank of Sri Lanka for the above paragraph as appearing in the verbatim and matters obtained by the Committee of Public Enterprises, the above paragraph is confirmed and included in to the updated Audit Report.)

(Reference : Page Numbers 35 to 43 in Annexe)

- 5.1.4 The Domestic Debt Management Committee which met at 1300 hours on 27 February 2015 had recommended the Government Borrowing Programme for the fulfillment of the Government overall cash requirement for the March 2015 amounting to Rs.261.683 billion by issuing Treasury bills and bonds (This included Treasury bills amounting to Rs.89.683 billion reissued during the year as well). According to that programme, decision had been taken to supply Rs.89.683 billion from the issue of Treasury bills, a sum of Rs.172 billion from Treasury bonds and obtain Rs.1 billion out of the said Rs.172 billion by auction and balance from direct placement.

Even though this approval had been conveyed to the Superintendent of Public Debt through the Deputy Governor (SM) of the Central Bank (Annexe xvi) it was observed that the matter had not been executed in the same manner as only a sum of Rs.14.143 billion out of the total sum of Rs.185.802 billion fulfilled during March 2015 had been fulfilled through the direct placement method (According to table at paragraph 4.3)

(As the Central Bank of Sri Lanka has not raised any an objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 43 to 45 in Annexe)

- 5.1.5 The bonds planned for issue on 27 February 2015 had been bonds maturing in 30 years and the Central Bank had not expected the ordinary investors to participate

for such long term bonds and that the Bank had expected the participation of the foreign investors (Annexe xviii). Nevertheless, achievement of that expectation is doubtful as the Annual Report for the year 2015 established that the foreign investors had sold their investments (Annexe xix).

(As the Central Bank of Sri Lanka has not raised any objection to the above paragraph and as per the verbatim and other matters the above paragraph is confirmed and as such it is included in toto in the updated Audit Report.)

(Reference : Page Numbers 45 to 46 in Annexe)

- 5.1.6 The average yield rate for 30 year bonds in the secondary market prior to the date of issue had been 9.48 per cent(Annexe xx) **and the examination of the oral submissions of the Special Sub- Committee of the Committee on Public Enterprises which investigated bond issue revealed that the Public Debt Department expected that the issuance will be made at a rate closer to that rate (Annexe xxi)In addition to the sale of the bonds at a premium at the expected yield rate** the Government could have obtained a higher amount of money as shown at 4.1 above. According to the notice published in the Internet and the newspaper on 25 and 26 February 2015 respectively bids had been invited from the 16 dealers for the issue of Treasury bonds for Rs. 1 billion maturing in 30 years at a coupon rate of 12.5 per cent (Annexe xxii)

The examination of the records on bids received in this connection (Annexe xxiii) revealed that 16 primary dealers and the Employee Provident Fund had submitted bids totaling Rs. 20.708 billion. Further it was observed that one primary dealer had submitted bids for Rs. 15.531 billion representing 75 per cent of that amount by him and through Bank of Ceylon, another primary dealer.

(However, no enquiry was made on the matters in the underlined sentence of the above paragraph after 29 June 2016 as such those matters were not reconfirmed. Accordingly, if it is needed, the audit observations could be eliminated from the

paragraph. Such elimination does not make any impact on the conclusion of the Special Audit Report.)

(As the Central Bank of Sri Lanka has not raised any objection to the above paragraph and as per the verbatim the paragraph is confirmed and as such it is included in toto in the updated Audit Report.)

(Reference : Page Numbers 46 to 48 in Annexe)

- 5.1.7 The Domestic Debt Management Committee had recommended the issuance of bonds valued at Rs.1 billion through the auction. The Treasury bond tender committee which held meeting No. 2/2015 on 27 February 2015 between 1230 hours and 1310 hours had after the auction, decided to accept bids exceeding tenfold to Rs.10.058 billion (Annexe xxiv). The most important matter observed in this connection is that the above decision was taken after holding the auction. This is a complete deviation from the decision of the Domestic Debt Management Committee referred to in paragraph 5.1.3 above for the fulfillment of Rs.12.550 billion through direct placement. In such circumstances, even though it was expected to earn a sum of Rs.10.058 billion through the issuance of bonds maturing in 30 years<sup>14</sup> primary dealers who had submitted bids at weighted average yield rates from 9.3510 to 11.7270 (Annexe xxv). Only Rs.9.658 billion had been raised due to issuance at the discount rate. The most important matter observed in this connection is that the sum of Rs.0.371 billion that could not be supplied (Rs.10.058 billion – Rs.9.687) had to be supplied through another short term source.

(As the Central Bank of Sri Lanka has not raised any objection to the above paragraph and the paragraph was confirmed as per the verbatim and other matters the above paragraph is confirmed and as such it is included in toto in the updated Audit Report.)

(Reference : Page Numbers 48 to 96 in Annexe)

5.1.8 The most important matter observed from the above paragraph is the recommendation of the Domestic Debt Management Committee for the cash requirements for March 2015 including the cash requirement of Rs.13.550 billion for 02 March 2015, the approval of Governor of the Central Bank and the recommendation and approval for the Borrowing Programme of the Domestic Debt Management Committee had been obtained after the close of the auction and obtaining the approval of the tender committee even by the time of conducting the auction from 0830 to 1100 hours at 27 February 2015.

(In view of the facts set out in the reference below it is not possible to agree with the written explanation given by the governor of the Central Bank about the aforesaid observations contained in the paragraph. The said observation has been confirmed by the verbatim and other facts. Hence the paragraph has been included in toto in the Updated Report.)

(Reference : Page Numbers 49 to 96 in Annexe)

The Superintendent of Public Debt Department had made a hand written note in the Bid Summary Report (Annexe xxvi) that the Tender Committee decision referred to in the above paragraph had been taken in accordance with the instructions given by the Governor of the Central Bank to the Public Debt Department (an Extract of the Instructions is given below). (The Superintendent concerned had orally confirmed that the note was made by her (Annexe xxvii). No other written evidence in support of obtaining the sum of Rs.10.058 billion through the bonds by auction itself, other than the above note was not revealed to audit.

*“Governor instructed to raise funds up to Rs.10 billion, taking into consideration additional fund requirement of the Government”*(Annexe xxvii)

(As the Central Bank of Sri Lanka has not raised any an objection the above observation and as per the verbatim and the other facts which were obtained after



the 29 June 2016, observation is confirmed and as such it is included in toto in this Updated Report.)

(Reference : Page Numbers 49 to 96 in Annexe)

- 5.1.9 The Public Debt Department **had recommended** to the Domestic Debt Management Committee that it is appropriate to follow option 05 out of the 07 options prepared after subjecting the bids submitted by the primary dealers to the methodology in the operational manual and to obtain Rs.2.608 billion through auction (Annexxxvi)

(The Central Bank of Sri Lanka has not raised any objection to the above observation. Even though the Public Debt Department had prepared a report recommending that it is appropriate to earn a sum of the Rs. 2.608 billion from the auction it was revealed from the notes on oral evidence that there was no occasion to submit the report (according to the matters appearing in reference page numbers 96 to 98) as, by that time, the Governor of the Central Bank of Sri Lanka had made the proposal for obtaining Rs. 20 billion from the auction. The displeasure expressed by the officers of the Public Debt Department for obtaining a sum of Rs. 20 billion, and the fact that a report in accordance with the statement made by the Governor of the Central Bank of Sri Lanka to obtain Rs. 10 Billion was forwarded by the Front Office of the Public Debt Department to the Tender Board were revealed therein. Accordingly, the underlined sentence appearing in the above paragraph of the Special Audit Report are replaced by the words a report for recommending had been prepared” in the updated report.)

(Reference : Page Numbers 96 to 98 in Annexe)

- 5.1.10 The Government Borrowings Programme for March 2015 which included the particulars of the auction conducted at 1110 Hours on 27 February 2015 had been approved by the Domestic Debt Management Committee which met at 1300 Hours on the same day (Annexe xvi). The Governor of Central Bank of Sri Lanka

had given the approval on 2 March 2015 by making a note to make enquiries from the Employee Provident Fund, The National Saving Bank Fund Management Company and Sri Lanka Insurance Corporation for stabilizing the rates and for the issuance of bonds to raise Rs.40 billion through the issue of bonds of 20, 30 and 50 years of Rs. 10 billion each. That approval did not indicate any information on the suspensions of the direct placement method. Those notes are shown as (a) and (b) below.

- (a) Raise Rs.40 billion through issue of 20, 30, 50 years of T-bonds Rs.10 billion each.
- (b) EPF/NSB/SLIC to be asked to stabilize rates

(Even though the Governor of the Central Bank had made the note for the issue of bonds maturing in 50 years as in (a) above it was observed that the Central Bank of Sri Lanka had not issued bonds of maturity period exceeding 30 years at anytime since inspection and the composition therein did not total to Rs. 40 billion)

(The Central Bank of Sri Lanka has not raised any objection and there are written evidence with related to the (a) and (b) in the above paragraph and there was no disagreement there to through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 98 to 99 in Annexe)

5.1.11 Even though the Governor of the Central Bank had approved on 02 March 2015 the issue of a long term maturing bonds under the direct placement method for fulfilling the cash requirement of Rs.40 billion (Annexe xvi) it was observed that the series of incidents during the period 27 February to 06 March 2015 did not agree with those recommendations. That is, the entire amount required had been supplied through the auction on 27 February 2015 and that was approved by the Treasury Bonds Tender Committee. Further, the Monetary Board of the Central Bank of Sri Lanka had not approved the temporary suspension of the direct

placement method even up to 06 March 2015. According to the Monetary Board Paper No. MB/ER/5/3/2015 dated 06 March 2015 (Annexe xxviii), the notification made by the Governor of the Central Bank on the temporary suspension of the direct placement used in the issue of Treasury bonds had been ratified on the same day.

Further, according to the Minutes of the meeting of the Monetary Board dated 23 February 2015 (Annexe xviii). Any information other than instructing the Public Debt Department to conduct an auction of Treasury bonds of 30 years maturity, the Monetary Board evidence of any decision taken by to use the auction method deviating from the Direct Placement was not revealed.

(The Central Bank of Sri Lanka had not raised objections to the above paragraph. It had been noted in the Special Audit Report submitted on 29 June 2016 that there is a ratification on the temporary stoppage of the direct system and it has been confirmed from the notes and oral evidence that there is no ratification (matters appearing in reference page numbers 100 to 101) even for that stoppage. The notes and oral evidence further confirm that such a decision should be discussed and approved by the Monetary Board. Accordingly, the underlined sentence appearing in the above paragraph should be eliminated and the following sentence should be replaced and included in the updated report “**Although informed, even a ratification had not been obtained for the stoppage of the direct system unless obtaining a ratification to a decision made by the CBSL to change the policy interest rate**”.)

(As the Central Bank of Sri Lanka has not raised any an objection to the above paragraph and as per the verbatim and other facts obtained after the 29 June 2016 observation is confirmed. Hence, the paragraph has been included in toto in this updated report.)

(Reference : Page Numbers 99 to 133 in Annexe)

5.1.12 If the auction of bonds had been limited to Rs.1 billion as previously approved by the Domestic Debt Management Committee, it could have been possible to fulfill the sum of Rs. 1 billion from the following dealers at a weighted yield rate less than 10.4652 by the classification of the bids received from the auction from the lowest weighted yield rate to the highest weighted yield rate. If so limited, the yield rate would not have increased to 11.7270 as shown in paragraph 5.1.7

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference: Page Numbers 133 to 134 in Annexe)

5.1.13 That above position is revealed from the Table prepared from the information in the Option Sheet (Annexe xxv) showing the alternate systems. (Those institutions are denoted by English letters in order to avoid identification of the relevant dealers for the safeguarding of the confidentiality referred to in paragraph 01 above)

Table No. 02 – Data relating to the First Seven Bids

<b>Number</b>	<b>Dealer</b>	<b>Face value of Bonds Rs.</b>	<b>Amount Received from Auctions Rs.</b>	<b>Weighted Average Yield Rate (WAYR)</b>
1	B Institution	8,000,000	9,546,736	9.3510
2	A Institution	50,000,000	56,005,000	9.9063
3	F Institution	100,000,000	110,954,800	10.0278
4	B Institution	500,000,000	546,966,000	10.1970
5	E Institution	50,000,000	52,253,650	10.2339
6	H Institution	100,000,000	104,507,300	10.2959
7	EPF	500,000,000	522,536,500	10.4652
	<b>Total</b>	<b>1,308,000,000</b>	<b>1,402,769,986</b>	

If the auction had been limited to Rs. 1 billion as shown above, the above table clearly shown all the dealers up to the Company K referred to in the paragraph 5.1.15 below who had made bids for Rs.20.708 billion equal to 75 per cent of all bids made, would not have been able to purchase bonds. Due to the decision taken to increase the expected issue of Rs.1 billion from auction on that date to Rs.10.058 billion the opportunity open to the Company K which is not included in the above mentioned 07 dealers, to purchase 50 per cent of the value of the bonds issued on that day, that is, Rs.5 billion, is a noticeable point (Annexe xxv). That institution had taken action to obtain Rs.2 billion out of that Rs.5 billion directly and the balance Rs.3 billion indirectly through another dealer, that is, Bank of Ceylon.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference: Page Numbers 134 in Annexe)

- 5.1.14 Another important matter that had occurred during the issue of Treasury bonds is that the Employees' Provident Fund subject to the supervision of the Central Bank of Sri Lanka, had as an institution capable of purchasing bonds from the auction had obtained a lesser number bonds of high yield rate (Annexe xxix a), while purchases with low yield rate had been made in secondary market from private dealers, thus foregoing the financial gain.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference: Page Numbers 134 to 135 in Annexe)

5.1.15 As the overall cash requirement for March 2015 specifically showing the cash requirement for the settlement of installments of the Public Debt as shown in paragraph 5.1.6 had been received by the Central Bank of Sri Lanka on 20 February 2015, it was observed that the Central Bank had an adequate time for the generation of that cash by utilizing suitable methodologies.

Therefore it was observed that the Central Bank of Sri Lanka had the opportunity of utilizing the following options, if necessary, for the supply of the funds necessary without allowing discounts unnecessarily and without opening opportunities for increase in the interest rates of the market.

- (i) By using the overdraft facilities already available from the Peoples Bank and the Bank of Ceylon and subsequent settlement by the issue of Treasury bonds of short term maturity.
- (ii) If the Employees' Provident Fund, had surplus funds, obtaining cash from those institutions on direct placement.

A sum of Rs.3 billion approximately had been collected by 27 February 2015 from the Direct Placement and the reasons for the inability to collect the balance requirement as at 2 March 2015 also from the direct placement had not been supported by evidence. (As it was observed that the issue of bonds on the direct placement method operated from the year 1997 had not failed, further resorting to the direct placement for obtaining the funds requirement)

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference: Page Numbers 135 in Annexe)

5.1.16 As the following matters were observed in connection with this transaction it was observed as a suspicious transaction.

- (i) Bids placed on Rs.13.60 billion out of Rs.20.708 billion, during the last stage of the auction, that is, in the last 8 minutes.
- (ii) Out of the sum of Rs.13.60 billion shown above Rs.13.00 billion had been placed for K institution.
- (iii) Acceptance of bids up to Rs.10.058 billion when bids had been invited only for Rs. 1 billion.
- (iv) The Bank of Ceylon had presented bids for Rs.13 billion on behalf of primary dealer K institution and that had been the first occasion of a primary dealer submitting bids on behalf of another primary dealer.
- (v) Even though bids had been called for Rs. 1 billion the K institution had submitted bids for Rs.15 billion comprising Rs. 2 billion direct by K institution and Rs. 13 billion through the Bank of Ceylon. Submitting bids fifteen times the bids invited being an unusual situation.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference: Page Numbers 136 in Annexe)

5.1.17 Three alternative systems of issuance of bonds on 27 February 2015 and the estimated gains and losses thereof are given below.

- (i) If the bonds issuance of 27 February 2015 had been limited to Rs. 1 billion as expected, according to the bids received to cover that value, and the bonds were issued up to a value of a bond Rs.104.5073 a sum of Rs.1,403 million could have been earned. The Government had incurred an estimated

loss of Rs.889 million as shown in the Table due to the failure to limit the issuance of bonds up to that value.

Table 3 : Estimated loss due to failure to limit the issuance to Rs. 1 billion

Number	Dealer	Bid Price Rs.	Face Value of Bids (Government Liability) Rs.	Accumulated Value Payable Rs.	Loss Rs.
7	<b>Employees Provident Fund</b>	<b>104.507</b>	<b>500,000,000.00</b>	<b>1,402,769,986.00</b>	-
8	E	103.116	50,000,000.00	1,454,327,886.00	695,750.00
9	J	102.207	100,000,000.00	1,556,535,086.00	2,300,100.00
10	H	102.207	100,000,000.00	1,658,742,286.00	2,300,100.00
11	<b>Employees Provident Fund</b>	102.207	1,000,000,000.00	2,680,814,286.00	23,001,000.00
12	G	102.207	50,000,000.00	2,731,917,786.00	1,150,150.00
13	H	101.758	100,000,000.00	2,833,675,786.00	2,749,300.00
14	G	99.999	50,000,000.00	2,883,675,286.00	2,254,150.00
15	<b>Employees Provident Fund</b>	99.999	500,000,000.00	3,383,670,286.00	22,541,500.00
16	K	97.878	250,000,000.00	3,628,365,286.00	16,573,250.00
17	K	95.8394	250,000,000.00	3,867,963,786.00	21,669,750.00
18	M	95.8074	1,250,000,000.00	5,065,556,286.00	108,748,750.00
19	P	93.879	50,000,000.00	5,112,495,786.00	5,314,150.00
20	K	93.879	500,000,000.00	5,581,890,786.00	53,141,500.00
21	K	91.9928	1,000,000,000.00	6,501,818,786.00	125,145,000.00



22	P	90.177	50,000,000.00	6,546,907,286.00	7,165,150.00
23	N	90.177	100,000,000.00	6,637,084,286.00	14,330,300.00
24	I	90.177	250,000,000.00	6,862,526,786.00	35,825,750.00
25	C	90.1769	100,000,000.00	6,952,703,686.00	14,330,400.00
26	B	90.1699	3,000,000,000.00	9,657,800,686.00	430,122,000.00
	<b>Total</b>				<b>889,358,050.00</b>

- (ii) Bonds valued at Rs. 2.608 billion recommended in the Option Sheet submitted to the tender committee by the Public Debt Department could have been issued at the bid value of Rs. 102.20720 per bond. The Government had incurred an estimated loss of Rs.0.688 billion due to issuance of bonds up to Rs.10.058 billion without doing so.

Table 4 : Loss caused due to exceeding the recommended Rs. 2.608 billion

Number	Dealer	Bid Price Rs.	Face Value of Bids (Government Liability) Rs.	Accumulated Value Payable Rs.	Loss Rs.
12	G	102.21	50,000,000.00	2,731,917,786.00	-
13	H	101.76	100,000,000.00	2,833,675,786.00	449,000.00
14	G	100.00	50,000,000.00	2,883,675,286.00	1,104,000.00
15	<b>Employees Provident Fund</b>	100.00	500,000,000.00	3,383,670,286.00	11,040,000.00
16	K	97.88	250,000,000.00	3,628,365,286.00	10,822,500.00
17	K	95.84	250,000,000.00	3,867,963,786.00	15,919,000.00
18	M	95.81	1,250,000,000.00	5,065,556,286.00	79,995,000.00

19	P	93.88	50,000,000.00	5,112,495,786.00	4,164,000.00
20	K	93.88	500,000,000.00	5,581,890,786.00	41,640,000.00
21	K	91.99	1,000,000,000.00	6,501,818,786.00	102,142,000.00
22	P	90.18	50,000,000.00	6,546,907,286.00	6,015,000.00
23	N	90.18	100,000,000.00	6,637,084,286.00	12,030,000.00
24	I	90.18	250,000,000.00	6,862,526,786.00	30,075,000.00
25	C	90.18	100,000,000.00	6,952,703,686.00	12,030,100.00
26	B	90.17	3,000,000,000.00	9,657,800,686.00	361,113,000.00
	<b>Total</b>				<b>688,538,600.00</b>

(iii) If the bonds had been issued as proposed by the Governor of Central Bank for Rs. 20 billion instead of limiting to the issuance to Rs. 1 billion as referred to in paragraph 5.1.18 (ii) an estimated loss of Rs. 2.730 billion could have been incurred by the Government as computed in table 5 below.

Table 5: The estimated loss if the proposal of the Governor of the Central Bank had been implemented.

Number	Dealer	Bid Price Rs.	Face Value of Bids (Government Liability) Rs.	Accumulated Value Payable Rs.	Loss Rs.
7	Employees Provident Fund	104.5073	500,000,000	1,402,769,986	-
8	E	103.1158	50,000,000	1,454,327,886	695,750
9	J	102.2072	100,000,000	1,556,535,086	2,300,100
10	H	102.2072	100,000,000	1,658,742,286	2,300,100

11	Employees Provident Fund	102.2072	1,000,000,000	2,680,814,286	23,001,000
12	G	102.207	50,000,000	2,731,917,786	1,150,150
13	H	101.758	100,000,000	2,833,675,786	2,749,300
14	G	99.999	50,000,000	2,883,675,286	2,254,150
15	Employees Provident Fund	99.999	500,000,000	3,383,670,286	22,541,500
16	K	97.878	250,000,000	3,628,365,286	16,573,250
17	K	95.8394	250,000,000	3,867,963,786	21,669,750
18	M	95.8074	1,250,000,000	5,065,556,286	108,748,750
19	P	93.879	50,000,000	5,112,495,786	5,314,150
20	K	93.879	500,000,000	5,581,890,786	53,141,500
21	K	91.9928	1,000,000,000	6,501,818,786	125,145,000
22	P	90.177	50,000,000	6,546,907,286	7,165,150
23	N	90.177	100,000,000	6,637,084,286	14,330,300
24	I	90.177	250,000,000	6,862,526,786	35,825,750
25	C	90.1769	100,000,000	6,952,703,686	14,330,400
26	B	90.1699	3,000,000,000	9,657,800,686	430,122,000
27	I	88.428	150,000,000	9,790,442,686	24,118,950
28	B	88.4074	5,000,000,000	14,210,812,686	804,995,000
29	B	86.769	5,000,000,000	18,549,262,686	886,915,000
30	D	86.7428	50,000,000	18,592,634,086	8,882,250
31	I	86.7425	100,000,000	18,679,376,586	17,764,800
32	A	86.74	100,000,000	18,766,116,586	17,767,300
33	D	86.0851	50,000,000	18,809,159,136	9,211,100
34	O	76.4803	50,000,000	18,847,399,286	14,013,500
35	O	74.2125	50,000,000	18,884,505,536	15,147,400

36	L	62.6216	100,000,000	18,947,127,136	41,885,700
	<b>Total</b>				<b>2,730,059,050</b>

(The typing mistakes of the “Cumulative Value Payable” column of the above table presented on 29 June 2016 were corrected and updated.)

The computation of the above estimated losses appears in Annexe xxx.

Further the estimated losses given above arisen / that could arise immediately at that date and if the long term effect is taken into account, the possibility of further increase in the optional losses cannot be ruled out.

(The reply given by the Central Bank of Sri Lanka for the above paragraph does not make an impact on the paragraph and as per the verbatim and other facts above paragraph is confirmed. Hence the paragraph has been included in toto in the updated Audit Report.)

(Reference : Page Numbers 136 to 139 in Annexe)

5.1.18 In view of the following oral submissions of the respective officers given at the investigation of the bond issue carried out by the Sub-Committee of the Committee on Public Enterprises revealed that the action of the Governor of the Central Bank had severely impacted the decision to accept bids up to Rs.10.058 billion as against the bond value of Rs. 1 billion expected to be obtained from this auction.

- i. Even after closing the bids for the conduct of the auction, enquiries had been made from Mrs.C.M.D.N.K.Senevirathne, the Superintendent of Public Debt as to why the total amount of bids received amounting to Rs.20 billion is not obtained.

- ii. The Superintendent of Public Debt Mrs.C.M.D.N.K.Senevirathne and the Additional Superintendent of Public Debt Dr.M.Z.M.Azim had emphasized to the Governor of the Central Bank that if bonds are issued up to Rs. 20 billion the interest rate would be very high and that it is not appropriate.
- iii. Thereafter the Governor of the Central Bank has asked the Superintendent of Public Debt “Why don’t you go for 10 billion” and even at that point it was emphasized that it is also too much.

(The written replies of the Governor of the Central Bank of Sri Lanka had not raised any objection to the above paragraph and verbatim obtained after 29 June 2016 further confirm the observations appearing in the above paragraph. As such, that paragraph is included in toto in the updated Audit Report.)

(Reference : Page Numbers 139 to 153 in Annexe)

5.1.19 The average secondary market yield rate of 9.48 rate that existed in the preceding year should have been made the basis for deciding on a fixed interest rate for 27 February 2015, the date set for the conduct of the auction. Instead of that, 12.5 per cent fixed interest rate had been declared for the auction. Further the average secondary market yield rate of the week ended two days before the date of auction, that is 25 February 2015 had been only 10.03, as such the manner of justification of the computation of 12.5 as the fixed interest rates was not revealed in audit. Similarly, the 30 year long term additional cost to the Government resulting from the high interest rate should be concluded as a loss to the Government. The most important matter observed in that a financial loss is caused even by such small increase in the interest rate of a bond with long term maturity of 30 years.

(The reply given by the Central Bank of Sri Lanka for the above paragraph does not make an impact on the paragraph and as there is no disagreement thereto

through verbatim and any other information, that paragraph is included in toto in the updated Audit Report.)

(Reference : Page Numbers 153 to 155 in Annexe)

## 5.2 Bond Issue of 29 March 2016

Out of the occasions of bond issuances exceeding the value of bonds invited made subsequent to the issue of bonds referred to in paragraph 5.1 above, the issue of bonds on 29 March 2016 was highlighted due to the high value involved that was subjected to special examination.

5.2.1 The two auctions conducted on 10 and 24 March 2016 for the sale of bonds had been rejected as the bonds had been applied for by giving rates exceeding the expected rates (Annexe xxxi) made for obtaining the funds.

Nevertheless, evidence of any attempts made on those occasions for obtaining funds from the direct placement was not revealed.

The rates considered for the rejection referred to above are given separately in the following Table.

Table 6 : Weighted Yield Rate excluding Tax

<b>Date of Auction</b>	<b>Maturity Period</b>	<b>ISIN International Securities Identification Number</b>	<b>Weighted Yield Rate excluding Tax</b>
2016.03.10	Years 03Month08	LKB00819K017	11.4498-12.2625
	Years 05 Month 05	LKB00821H019	11.8503-12.6855
	Years 07 Month 10	LKB01024A014	12.2004-12.9879
2016.03.24	Years 04 Month 01	LKB00520E014	12.5000-14.1570

	Years 05 Month 06	LKB00721J157	12.6999-14.4099
	Years 06 Month 06	LKB00922J011	12.8997-14.8950
	Years 08 Month 11	LKB01025C157	12.9996-14.7510

Subsequently invitations for bids had been made on 29 March 2016 for 04 bonds of Rs.10 billion each totaling Rs.40 billion of different maturity periods as referred to in (b) above.

The bids received and accepted in connection with the bids invited for 04 bonds had been as follows.

Table 7 : Bids received and accepted

<b>Number</b>	<b>ISIN International Securities Identification Number</b>	<b>Value of Bids invited Rs.Billions</b>	<b>Bids Received Rs. Billions</b>	<b>Value of Bids accepted Rs. Billions</b>
01.	LKB00520E014	10	27.022	10.272
02.	LKB01025C157	10	36.915	21.475
03.	LKB01226F014	10	32.560	17.010
04.	LKB01530E152	10	45.925	28.975
T	<b>Total</b>	<b>40</b>	<b>142.422</b>	<b>77.732</b>

The important point observed in this connection is the invitation of bids for a limit of Rs.40 billion and the issue of bonds up to Rs.77.732 billion (face value) including additional bonds of Rs. 37.732 billion (face value) issued at the same bid. Out of these bonds issued exceeding the expected limit, 60 per cent had been obtained by K institution. During an analysis of the 04 types of bonds acquired by that institution at different interest rates revealed that the K institution which had acquired 0.5 per cent of the first bond of the lowest yield rate, had acquired 35 per cent to 44 per cent of the other bonds issued at higher yield rates. That is a larger amount of bonds had been obtained when the discount increased.

Table 8 : Quantities obtained by K Institution due to accepting bids exceeding Rs. 40 billion

<b>Number</b>	<b>International Securities Identification Number (ISIN)</b>	<b>Percentage Obtained</b>	<b>Yield Rate</b>
01	LKB00520E014	0.5%	<b>12.6909</b>
02	LKB01025C157	39.3%	<b>13.0689 - 13.7979</b>
03	LKB01226F014	44.7%	<b>13.2984 - 13.9311</b>
04	LKB01530E152	35.6%	<b>13.1823 - 14.0742</b>

Even though the increase in the yield rate which formed the base for the rejection of both auctions held prior to this issuance date, existed in the same manner even in this auction, these bonds had been issued at the highest yield rates, that is, 14.0742 per cent. The most important matter revealed in this connection was that the yield rates which exceeded the rates rejected previously had been accepted.

Even though it was decided for the issuance of the above 04 bonds to obtain face value of Rs.77.73 billion only a sum of Rs.59.325 billion had been received due to the issuance of bonds at discount rates. As such the balance of Rs.18.407 billion had to be fulfilled through a short term source.



Table 9 : Fulfilment of the balance not realized due to issuance of bonds at discount rates through a short term credit sources

<b>Date of auction</b>	<b>International Securities Identification Number (ISIN)</b>	<b>Date of Maturity</b>	<b>Total amount auctioned Rs. Billion</b>	<b>Total amount paid Rs. Billion</b>	<b>Difference Rs. Billion</b>
2016.03.29	LKB00520E014	10 Y 2 M	10.272	8.734	1.538
	LKB01025C157	8 Y 11 M	21.475	16.250	5.225
	LKB01226F014	4 Y 1 M	17.010	13.161	3.848
	LKB01530E152	14 y 1 M	28.975	21.180	7.794
	Total		77.732	59.325	18.407

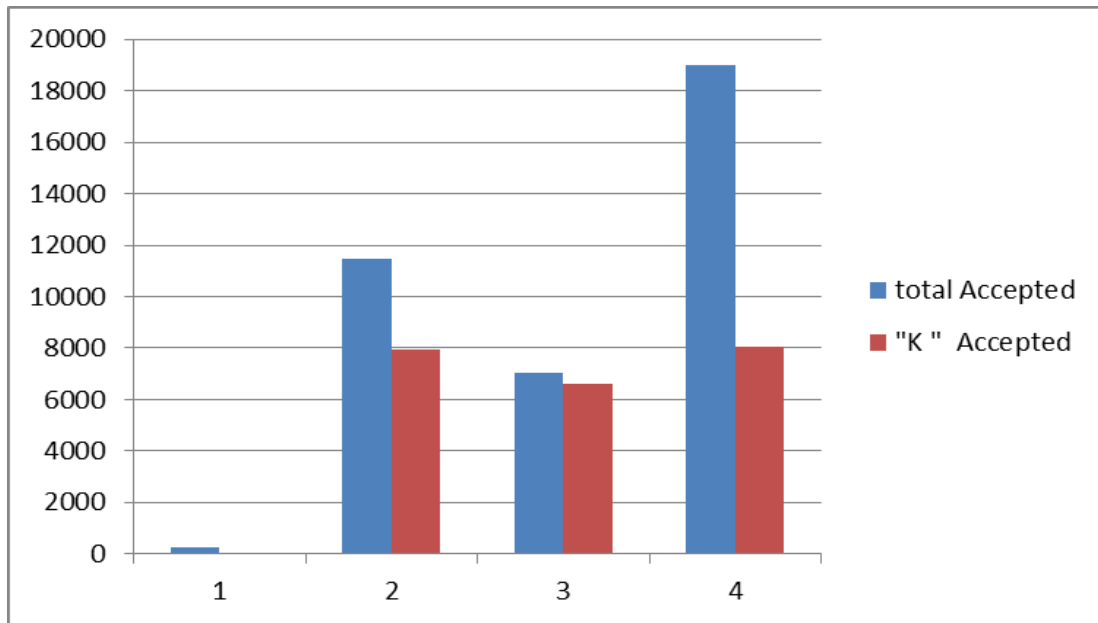
It was revealed that except for the acceptance of bids up to Rs.10.058 billion exceeding Rs. 1 billion for which bids were invited on 27 February 2015 and acceptance of Rs. 77.73 billion by calling for bids fo Rs. 40 billion on 29 March 2016, no other issuance of bonds exceeding the expected limits had taken place during the period considered.

As such the noticeable improvement of opportunities open to K institution to acquire the excess amount is depicted in the following Table and Graph.

Table 10 – Quantity acquired by K institution

<b>Number</b>	<b>International Securities Identification Number (ISIN)</b>	<b>Total value of bonds issued Rs. Billion</b>	<b>Quantity acquired by K institution Rs. Billion</b>
01	LKB00520E014	0.272	-
02	LKB01025C157	11.475	7.950
03	LKB01226F014	7.010	6.600
04	LKB01530E152	18.975	8.075

Diagram 1 - Table 10 –Total acquired by K institution



(The reply given by the Central Bank of Sri Lanka for the above paragraph does not make an impact on the paragraph and as there is no disagreement thereto through verbatim and any other information, that paragraph is included in toto in the updated Audit Report. )

(Reference : Page Numbers 155 to 158 in Annexe)

5.2.2 An examination of the instances of failures of the bids submitted by this primary dealer and the instances of the failures of bids of other primary dealers indicate that as compared with the instances of failures of the above company as compared with the other dealers had been less.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 158 to 159 in Annexe)

5.2.3 The very important matter revealed in this connection is that the Employees' Provident Fund permitted to function as a primary dealer had, obtained on 29 March 2015 bonds relating to the above bond valued at Rs.9.736 billion (Annexe xxix a) from the secondary market within yield rates ranging from 12.20 per cent to 12.5 per cent. That is clearly show in the information in Annexe xxix b. The Employees' Provident Fund had submitted bids for this bond to the primary market on 29 March 2015 only for a small number of bonds(Annexe xxix b) and all those bids had been successful. But the purchases of the balance bonds from the secondary market instead of purchase directly from the Primary Market is a questionable issue. Further, the failure of the Central Bank to pay attention to such actions of the Employees' Provident Fund which is under the trusteeship of the Monetary Board of the Central Bank is also a questionable issue.

Table 11 –Success of the Employees' Provident Fund

<b>Number</b>	<b>Bids Submitted Rs. Billions</b>	<b>Value of Bids accepted Rs. Billions</b>
01	-	-
02	1.000	1.000
03	0.500	0.500
04	1.000	1.000
<b>Total</b>	<b>2.500</b>	<b>2.500</b>

Instead of the nominal value of Rs.40 billion expected from the issuance of this bond up to Rs.77.732 billion had been accepted. If the bond issuance was limited to the face value of Rs.40 billion without so doing, the estimated loss of Rs.784,898,755 computed in the Table below could have been prevented.

Table 12 -Estimated loss due to acceptance exceeding the limit

Number	Dealers	Bid Price Rs.	Face value of Bonds (Government Liability) Rs.	Cumulative Value Payable Rs.	Loss Rs.
31	B	84.3512	800,000,000	<b>8,733,875,000</b>	-
	<b>Total</b>				-
<b>63</b>	<b>J</b>	<b>75.57580</b>	<b>120,000,000</b>	<b>7,886,053,130</b>	-
64	G	75.4451	100,000,000	7,961,498,230	130,700
65	J	75.4451	120,000,000	8,052,032,350	156,840
66	J	75.3147	120,000,000	8,142,409,990	313,320
67	K	75.2279	50,000,000	8,180,023,940	173,950
68	J	75.2279	160,000,000	8,300,388,580	556,640
69	K	75.2279	200,000,000	8,450,844,380	695,800
70	J	75.1845	120,000,000	8,541,065,780	469,560
71	J	75.0547	120,000,000	8,631,131,420	625,320
72	J	74.9253	120,000,000	8,721,041,780	780,600
73	M	74.8393	100,000,000	8,795,881,080	736,500
74	K	74.7961	50,000,000	8,833,279,130	389,850
75	K	74.7961	100,000,000	8,908,075,230	779,700
76	P	74.7961	100,000,000	8,982,871,330	779,700
77	J	74.7961	120,000,000	9,072,626,650	935,640
78	K	74.7961	250,000,000	9,259,616,900	1,949,250
79	M	74.7959	160,000,000	9,379,290,340	1,247,840
80	C	74.7959	200,000,000	9,528,882,140	1,559,800
81	K	74.3678	50,000,000	9,566,066,040	604,000

82	J	74.3678	200,000,000	9,714,801,640	2,416,000
83	K	74.3678	250,000,000	9,900,721,140	3,020,000
84	K	73.943	50,000,000	9,937,692,640	816,400
85	K	73.943	500,000,000	10,307,407,640	8,164,000
86	B	73.9345	250,000,000	10,492,243,890	4,103,250
87	C	73.732	100,000,000	10,565,975,890	1,843,800
88	P	73.7319	100,000,000	10,639,707,790	1,843,900
89	K	73.5216	50,000,000	10,676,468,590	1,027,100
90	J	73.5216	250,000,000	10,860,272,590	5,135,500
91	K	73.5216	750,000,000	11,411,684,590	15,406,500
92	K	73.1036	50,000,000	11,448,236,390	1,236,100
93	M	73.1036	180,000,000	11,579,822,870	4,449,960
94	K	73.1036	750,000,000	12,128,099,870	18,541,500
95	M	72.6891	100,000,000	12,200,788,970	2,886,700
96	C	72.6891	100,000,000	12,273,478,070	2,886,700
97	P	72.68902	100,000,000	12,346,167,090	2,886,780
98	K	72.689	50,000,000	12,382,511,590	1,443,400
99	F	72.689	100,000,000	12,455,200,590	2,886,800
100	K	72.689	750,000,000	13,000,368,090	21,651,000
101	B	72.656	180,000,000	13,131,148,890	5,255,640
102	K	72.483	2,000,000,000	14,580,808,890	61,856,000
103	M	72.2778	100,000,000	14,653,086,690	3,298,000
104	K	72.2777	50,000,000	14,689,225,540	1,649,050
105	J	72.2777	160,000,000	14,804,869,860	5,276,960

106	K	72.2777	2,000,000,000	16,250,423,860	65,962,000
	<b>Total</b>				<b>258,828,050</b>
<b>70</b>	<b>C</b>	<b>75.91150</b>	<b>200,000,000</b>	<b>8,012,848,545.00</b>	
71	J	75.821	60,000,000	8,058,341,145	54,300
72	J	75.6858	60,000,000	8,103,752,625	135,420
73	K	75.6858	500,000,000	8,482,181,625	1,128,500
74	K	75.2376	750,000,000	9,046,463,625	5,054,250
75	K	74.7933	100,000,000	9,121,256,925	1,118,200
76	C	74.7933	200,000,000	9,270,843,525	2,236,400
77	K	74.7933	750,000,000	9,831,793,275	8,386,500
78	K	74.134	500,000,000	10,202,463,275	8,887,500
79	K	74.0904	500,000,000	10,572,915,275	9,105,500
80	K	74.0468	500,000,000	10,943,149,275	9,323,500
81	K	74.0032	500,000,000	11,313,165,275	9,541,500
82	K	73.9597	500,000,000	11,682,963,775	9,759,000
83	K	73.9162	2,000,000,000	13,161,287,775	39,906,000
	<b>Total</b>				<b>104,636,570</b>
<b>88</b>	<b>K</b>	<b>73.71470</b>	<b>1,000,000,000</b>	<b>8,185,426,680.00</b>	-
89	M	73.7146	50,000,000	8,222,283,980	50
90	P	73.4701	100,000,000	8,295,754,080	244,600
91	K	73.2268	25,000,000	8,314,060,780	121,975
92	P	73.2268	50,000,000	8,350,674,180	243,950
93	P	73.2268	100,000,000	8,423,900,980	487,900
94	K	73.2268	1,000,000,000	9,156,168,980	4,879,000

95	M	73.2267	20,000,000	9,170,814,320	97,600
96	C	72.9849	100,000,000	9,243,799,220	729,800
97	P	72.9848	150,000,000	9,353,276,420	1,094,850
98	P	72.9848	500,000,000	9,718,200,420	3,649,500
99	P	72.9848	600,000,000	10,156,109,220	4,379,400
100	K	72.7441	25,000,000	10,174,295,245	242,650
101	J	72.7441	40,000,000	10,203,392,885	388,240
102	P	72.7441	100,000,000	10,276,136,985	970,600
103	K	72.7441	1,000,000,000	11,003,577,985	9,706,000
104	H	72.744	10,000,000	11,010,852,385	97,070
105	H	72.2665	10,000,000	11,018,079,035	144,820
106	K	72.2665	25,000,000	11,036,145,660	362,050
107	M	72.2665	40,000,000	11,065,052,260	579,280
108	P	72.2665	100,000,000	11,137,318,760	1,448,200
109	K	72.2665	1,000,000,000	11,859,983,760	14,482,000
110	P	72.0296	250,000,000	12,040,057,760	4,212,750
111	H	71.794	10,000,000	12,047,237,160	192,070
112	J	71.794	60,000,000	12,090,313,560	1,152,420
113	M	71.794	100,000,000	12,162,107,560	1,920,700
114	C	71.794	100,000,000	12,233,901,560	1,920,700
115	P	71.794	550,000,000	12,628,768,560	10,563,850
116	P	71.794	550,000,000	13,023,635,560	10,563,850
117	M	71.3266	60,000,000	13,066,431,520	1,432,860
118	P	71.3265	100,000,000	13,137,758,020	2,388,200
119	K	71.0946	1,000,000,000	13,848,704,020	26,201,000

120	K	71.0484	1,000,000,000	14,559,188,020	26,663,000
121	K	71.0022	1,000,000,000	15,269,210,020	27,125,000
122	K	70.9561	1,000,000,000	15,978,771,020	27,586,000
123	K	70.9561	1,000,000,000	16,688,332,020	27,586,000
124	J	70.864	80,000,000	16,745,023,220	2,280,560
125	P	70.86395	100,000,000	16,815,887,170	2,850,750
126	P	70.63451	500,000,000	17,169,059,720	15,400,950
127	P	70.63451	500,000,000	17,522,232,270	15,400,950
128	C	70.6345	100,000,000	17,592,866,770	3,080,200
129	M	70.4065	15,000,000	17,603,427,745	496,230
130	M	70.4065	80,000,000	17,659,752,945	2,646,560
131	I	70.4063	5,000,000,000	21,180,067,945	165,420,000
	<b>Total</b>				<b>421,434,135</b>
	<b>Grand Total</b>				<b>784,898,755</b>

(The typing mistakes of the “Cumulative Value Payable” column of the above table presented on 20 June 2016 were corrected and updated.)

The computation of the above estimated loss is depicted in Annexe xxxii.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference: Page Numbers 159 in Annexe)



### **5.3 The Situations that had arisen from the Temporary Ceasing of Issuance of Bonds on Direct Placement from 27 February 2015**

Since the temporary ceasing of the direct placement from 27 February 2015 as referred to in paragraph 5.1.11 above, every bond issuance from April 2015 up to date had been made under the auction method and the following observations are made in this connection.

- 5.3.1 In most bond issuances since 27 February 2015, from the first instance of submitting bids, bids had been received for the issuance of bonds at discounted prices, that is, at a value less than the nominal value. This results in an additional cost to the Government (giving discounts to investors). That is even if the bond valued at Rs.100 is sold at a lower value with a discount, the amount of discount becomes an additional liability of the Government on the date of sale itself as the payment at Rs.100 should be made on the maturity of the bond. Even though the bond is sold to the primary dealer at a discounted price, it is possible for the primary dealers to obtain a higher profit margin by selling those bonds in the secondary market due to the higher prices in the secondary market. In the circumstances it was observed that the benefit that could have obtained by the Government had passed on to the primary dealer. Even in this background the Central Bank of Sri Lanka accepted the bids submitted by the primary dealers for fulfilling the full cash requirement and issued bonds through auctions with discounts.

(The reply given by the Central Bank of Sri Lanka for the above paragraph does not make an impact on the paragraph and as there is no disagreement and thereto through notes on any other information, that paragraph is included in toto in the updated Audit Report.)

(Reference : Page Numbers 159 to 160 in Annexe)

- 5.3.2 It was observed that since changes in the methodology after 27 February 2015, obtaining positive results from those auctions by the primary dealers of Treasury bonds such as the Employees' Provident Fund, the National Savings Bank Fund

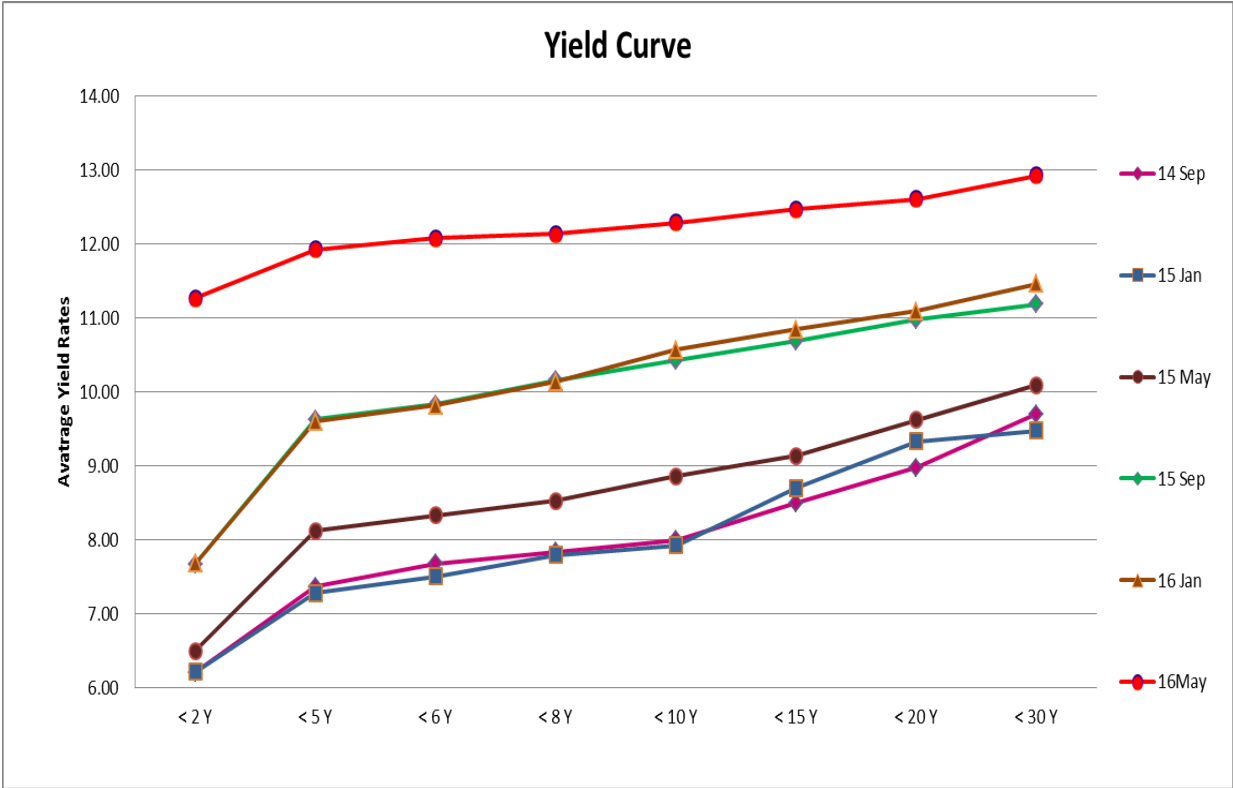
Management Company, Peoples Bank and the Bank of Ceylon had been weakened.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 160 in Annexe)

5.3.3 In addition instances, the auctions had been totally rejected due to submitting bids with high rates of interest. Even though 5 auctions during the period from the year 2015 to 31 May 2016 had been totally rejected, under these circumstances such rejections had not been reported in the year 2014. Accordingly, it was observed that since the change of the methodology effected in the year 2015, a trend has been created among the primary dealers to submit bids at rates higher than as compared with the rates prevailing in the Secondary Market.

Diagram 2 - Impact on the Yield rate due to use of only the auction method



Even though it was observed that the above trend had been created due to the effect of different factors, it is not questionable to surmise that the policy decision on the issuance of bonds taken on 27 February 2015 also had an influence.

(The reply given by the Central Bank of Sri Lanka for the above paragraph does not make an impact on the paragraph and as there is no disagreement and thereto through notes on any other information, that paragraph is included in toto in the updated Audit Report.)

(Reference : Page Numbers 160 to 162 in Annexe)

## **6. Systems Weaknesses**

- 6.1 Information in support that the Central Bank of Sri Lanka had carried out an analysis of the operation of the auction systems without operating the direct placement and that such decision was taken on the results of the study and recommendations was not revealed.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 162 in Annexe)

- 6.2 The primary dealers purchase bonds at the minimum price from the auction and expect the immediate sale of those bonds in the secondary market at a higher price. That deprives the Government a benefit that could have been obtained. This was observed as an artificial manipulation of the interest rates of the market by parties outside the Central Bank of Sri Lanka and that causes the baseless fluctuation of the interest rate. There was no evidence that the Central Bank of Sri

Lanka which is responsible for the control of that situation had taken necessary action in that connection.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 162 in Annexe)

- 6.3 Even though the Central Bank of Sri Lanka should maintain a methodology for the capture of all data relating to movement patterns of the financial market as referred to in paragraph 3.1 above, whether the Central Bank of Sri Lanka could properly execute that function is questionable due to the following observations.

(According to the written reply submitted by the Central Bank of Sri Lanka for the above paragraph as appearing in the following reference, the above paragraph is confirmed and as there is no disagreements thereto through any other information, that paragraph is included in to in the updated Audit Report.)

(Reference : Page Numbers 162 to 163 in Annexe)

- 6.4 An International Security Identification Number prepared based on their maturity dates has been used for the identification of the bonds issued by the Central Bank of Sri Lanka. It was reported to audit that the date of issue of each bond cannot be identified due to the use of the same International Security Identification Number is used for several bonds maturing on the same day are issued from time to time.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 163 in Annexe)

- 6.5 For the purpose of recording the transactions in the secondary market the Central Bank of Sri Lanka obtains only the International Security Identification Number, the face value of the bonds and the date of transaction and that the audit was informed that the Central Bank of Sri Lanka is not in possession of the data on secondary market sales value and the yield rates.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there is no effect to the audit paragraph from the replies received to the questionnaire issued by the committee to the Central Bank and as there was no disagreement there to through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 163 to 164 in Annexe)

- 6.6 It is not clear whether the decision taken for the fulfillment of the full amount referred to the paragraph 5.1.7 by auction had been taken after considering the matters including interest percentage control responsibility of the Central Bank of Sri Lanka as referred to in paragraph 5.1.1 above.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report. )

(Reference : Page Numbers 164 in Annexe)

- 6.7 Whether attention to the matters and decisions in paragraph 5.1.2 had been paid in arriving at the decision at paragraph 5.1.7 above not being clear.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report. )

(Reference : Page Numbers 164 to 165 in Annexe)

6.8 Even though a decision had been taken to suspend the direct placement method and implement the auction method as referred to in paragraph 2.1.1 above it was not revealed to audit whether the Governor of the Central Bank has the discretion to take such extremely important, complex and sensitive decisions according to the Guidelines referred to in paragraph 1 above or any other written law.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report. )

(Reference : Page Numbers 165 in Annexe)

6.9 Even though a period exceeding one year had elapsed since taking the decision referred to in paragraphs 5.1.7 above, information whether any study on the direct or indirect impact on such decision to the financial market had been carried out to make such temporary suspension, permanent, eliminate or reconsider the decision or whether any other follow up or a study had been carried out for the selection of any other direct placement on auction method on a specific rate was not revealed to audit.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report. )

(Reference : Page Numbers 165 in Annexe)

6.10 Information whether the Central Bank of Sri Lanka had taken action carry out any study or for the collection of the data required to carry out such study to ascertain whether the primary dealers who had obtained bonds at discounts get huge profits by selling them immediately in the secondary market and whether a benefit that could have been obtained by the Government had been passed on to another party had not been revealed to audit.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report. )

(Reference : Page Numbers 165 to 166 in Annexe)

- 6.11 Information whether the Central Bank of Sri Lanka had taken action to ascertain the reasons for the success of the primary dealers in the government sector becoming minimized and the success of the private sector in that directions and carry out necessary regulatory process ensuring collection of funds for the Government at minimum cost.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report. )

(Reference : Page Numbers 166 in Annexe)

- 6.12 Information whether the bonds obtained at discount prices by the primary dealers in the private sector had been purchased by the government sector primary dealers and institutions within very short periods at very low percentages had been examined and if so whether the necessary regulatory action to minimize the finance loss to the Government had been taken was not revealed in audit.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there is no effect to the audit paragraph from the replies received to the questionnaire issued by the committee to the Central Bank and as there was no disagreement there to through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 166 to 168 in Annexe)

- 6.13 Whether the action had been taken to consider the losses or gains accruing to the state sector and the private sector from the purchase bonds by the primary dealers

in the private sector action to minimize the cost to the Government or to introduce regulatory action was taken was not revealed in audit.

(The reply given by the Central Bank of Sri Lanka for the above paragraph does not make an impact on the paragraph and as there is no disagreement thereto through notes on oral evidence and any other information, that paragraph is included in toto in the updated Audit Report.)

(Reference : Page Numbers 168 in Annexe)

- 6.14 Information whether an adequate analysis had been undertaken to ascertain whether the decision referred to in paragraph 5.1.7 above had been a direct or indirect reason for the trend of gradual increase in the interest observed in Paragraphs 5.3.3 above was not revealed in audit.

(As the Central Bank of Sri Lanka has not raised any objections to the above paragraph and as there was no disagreement thereto through any other information, that paragraph is included in toto in this updated Audit Report.)

(Reference : Page Numbers 168 to 169 in Annexe)

## **7. Recommendations**

- 7.1 When the Central Bank of Sri Lanka takes policy decisions and when changes are made to the prevailing methodologies and in the introduction of new methodologies, the need for taking such decisions by taking into account the positive or negative impact thereof on the economy of the country and the objectives of the Central Bank of Sri Lanka on the long and short terms basis is emphasized while evidence of such action taken should be maintained for examination when required.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there was no disagreement thereto through any other information, that recommendation is included in toto in this updated Audit Report).

(Reference : Page Numbers 169 in Annexe)



7.2 The need for the Central Bank of Sri Lanka to maintain all necessary Data as lack of adequate data with the Central Bank of Sri Lanka for the regulations of the Secondary Market results in the inability to regulate the Financial Market.

(As the Central Bank of Sri Lanka has not raised any an objection to the above recommendation and the recommendation was confirmed as per the verbatim and other matters the above recommendation is confirmed and as such it is included in toto in the updated Audit Report.)

(Reference : Page Numbers 169 to 175 in Annexe)

7.3 The need for the maintenance of the information on the bonds issued by the Central Bank of Sri Lanka to cover all transactions from the date of issue to the date of producing it to the Bank for encashment on maturity.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there was no disagreement thereto through any other information, that recommendation is included in toto in this updated Audit Report. )

(Reference : Page Numbers 175 in Annexe)

7.4 The confidence of a Central Bank of a country depends on the honesty relating to the decisions taken by its officers and that probity should be maintained locally as well as internationally unsullied, acting such manner subject to certain limitations or transparency in order to convincing the probity of such decisions.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there was no disagreement thereto through any other information, that recommendation is included in toto in this updated Audit Report. )

(Reference : Page Numbers 175 in Annexe)

7.5 Even though there are various interpretations and exceptions in legal provisions and Accounting Standards, the Senior Management of the Central Bank of Sri Lanka should act in good faith and with proper exposure without being limited by such interpretations and exceptions in case of any conflicts in this connection between the officers of the Central Bank who can influence the management decisions and the institutions connected with the Central Bank.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there was no disagreement thereto through any other information, that recommendation is included in toto in this updated Audit Report.)

(Reference : Page Numbers 176 in Annexe)

7.6 Most of the decisions of the Central Bank of Sri Lanka have a long terms impact on the overall economy and whether such important, complex and sensitive decisions have been taken on the correct basis should be subjected to review by an independent party as the good and bad impacts generated by them would be faced by the general public. The information required to ascertain whether such complex decisions taken immediately without proper evaluation and unfavorable results should be provided to those institutions with the mandate for the purpose without being shielded by the requirement of safeguarding confidentiality appearing in Section 45 of the Monetary Law Act and the need for taking action for the amendment of the Section 45 suitably.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there was no disagreement thereto through any other information, that recommendation is included in toto in this updated Audit Report.)

(Reference : Page Numbers 176 in Annexe)

7.7 Even though a written request was made to the Governor of Central Bank to correctly identify by the confidential and sensitive information in the information supplied by the Central Bank of Sri Lanka for the preparation of this report (Annexxxxiv) according to the reply given (Annexei)all information supplied

had to be considered as confidential. Accordingly the State Audit has to state that the information sorted out therefrom will be supplied to Hon'ble the Speaker of Parliament without being included as it is in this Report.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there is no effect to the audit recommendation from the replies received to the questionnaire issued by the committee to the Central Bank and as there was no disagreement there to through any other information, that recommendation is included in toto in this updated Audit Report.)

(Reference : Page Numbers 176 to 177 in Annexe)

- 7.8 A methodology for regulation of the inter-transactions of bonds among primary dealers should be introduced through the Guidelines.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there is no effect to the audit recommendation from the replies received to the questionnaire issued by the committee to the Central Bank and as there was no disagreement there to through any other information, that recommendation is included in toto in this updated Audit Report.)

(Reference : Page Numbers 178 in Annexe)

- 7.9 The extensions of last date and time of auctions of bonds published had been made in certain instances. Such extensions should be limited to unavoidable and justifiable matters only.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there was no disagreement thereto through any other information, that recommendation is included in toto in this updated Audit Report. )

(Reference : Page Numbers 178 in Annexe)

- 7.10 Even though the Employees' Provident Fund is not a registered primary dealer, it has been permitted to perform primary transactions and purchase of bonds from the primary market. But the Employees Provident Fund shows a tendency to purchase of bonds from other primary dealers in the secondary market as an

alternative to the purchase of bonds from the primary market. The need for the Employees' Provident Fund to be made a primary dealer capable of functioning independently as a primary dealer without such supervision.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there is no effect to the audit recommendation from the replies received to the questionnaire issued by the committee to the Central Bank and as there was no disagreement there to through any other information, that recommendation is included in toto in this updated Audit Report.)

(Reference : Page Numbers 179 to 180 in Annexe)

- 7.11 Even though the monthly cash requirements of the ensuing month only is obtained up-to-date by the Central Bank of Sri Lanka from the Treasury, it needs to be extended to a period of 3 months.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there was no disagreement thereto through any other information, that recommendation is included in toto in this updated Audit Report.)

(Reference: Page Numbers 180 in Annexe)

- 7.12 The collection of such cash requirement obtained from the Treasury should be decided well in advance.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there was no disagreement thereto through any other information, that recommendation is included in toto in this updated Audit Report. )

(Reference : Page Numbers 180 to 181 in Annexe)

- 7.13 The need for the Central Bank of Sri Lanka to carry out an adequate supervision primary dealers. That is, a certain primary dealer who had been declared bankrupt in the past, had embarrassed the Government including the Investors who had transactions with him. The Central Bank of Sri Lanka should carry out an

adequate supervision of the primary dealers with regard to their financial stability and conduct in order to avoid such situations.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there was no disagreement thereto through any other information, that recommendation is included in toto in this updated Audit Report. )

(Reference : Page Numbers 181 in Annexe)

- 7.14 Requests were made to the Secretary to the Ministry of Finance to identify the information of which the confidentiality should be safeguarded. In response, a Deputy Secretary to the Treasury had informed that the role of the Treasury is limited for informing the Central Bank of Sri Lanka the monthly funds requirements of the Government within the limitations set out in the Appropriation Act on monthly basis. But in view of the Central Bank of Sri Lanka functioning under the supervision of the Ministry of Finance, it is not possible in Audit to agree with the contention that the Treasury supervision amounts to such simple function. Therefore it is not possible to concur in audit that the role of the Treasury as an institution responsible for the supervising of the Central Bank of Sri Lanka can be limited to such a simple function.

(As the Central Bank of Sri Lanka has not raised any objections to the above recommendation and as there was no disagreement thereto through any other information, that recommendation is included in toto in this updated Audit Report. )

(Reference : Page Numbers 181 in Annexe)

## **8. Conclusions**

- 8.1 It is concluded that the authorities concerned should be responsible for the avoidable losses totaling Rs.1,674,256,805 incurred in the two auctions of issuance of Treasury bonds on 27 February 2015 and 29 March 2016 comprising the avoidable estimated loss of Rs.889,358,050 referred to in paragraph 5.1.17

above and the avoidable loss of Rs.784,898,755 as referred to in paragraph 5.2.3 above.

Further, the possibility of increase of the estimated gains or losses relating to the other issuance of bonds from 27 February 2015 to May 2016 are considered, cannot be ruled out.

8.2 In view of the matters revealed to the Auditor General during the course of preparing this report and in view of the matters emphasized in the foregoing paragraphs, it was established that the Governor of the Central Bank had not acted with Professional Due Care in the performance of his functions, expected of a Governor of a Central Bank.

8.3 It is emphasized that in the preparation of this Report the Auditor General has acted within his powers, Functions and the scope. As matters of criminal nature and those unlawful activities not falling within the powers and scope of the Auditor General have not been dealt with in this report and if such investigations are considered necessary, it is concluded that the assistance of the specialized institutions should be obtained.

Sgnd : H.M Gamini Wijesinghe  
Auditor General,  
At the Auditor General's Department

➤ The areas that had been specifically investigated by the Committee of Public Enterprise during this investigation and the relevant references are as follows.

- Policy decisions (Reference: Page from 204 to 224)
- Operating Manual ((Reference: Page from 225 to 257)
- Composition of the Auction method and Direct Placement method (Reference: Page from 257 to 264)
- Respective Minister (Reference: Page from 265 to 267)
- Duties of the Ministry of Finance (Reference: Page from 267 to 270)
- Secondary Market (Reference: Page from 270 to 276)
- Employees Provident Fund (Reference: Page from 276 to 283)
- Earning Money on much as possible through the auction (Reference: Page from 283 to 290) (As much as possible)