

Forensic Audit of Central Bank (2019): Assessment of losses to the EPF

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Briefing Note

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OVERVIEW

This report examines two of the five forensic audit reports conducted on the Central Bank of Sri Lanka with regard to irregular/corrupt transactions involving the EPF. It sets out clearly the losses to the EPF as has been identified through this particular audit process. It also calculates losses from unlisted equity investments that are not calculated in the audits and highlights the limitations of the audit in identifying the full extent of losses caused to the EPF due to the limitation of the duration covered and the methodology followed.

INTRODUCTION

The Employees' Provident Fund (EPF) is the largest fund in Sri Lanka, with employee savings totalling LKR 3.9 trillion as of 2023.¹ The EPF is a mandatory defined contribution retirement scheme for employees in the private and semi-government sectors who do not have pension benefits. In this scheme, both the employee and employer make regular contributions into individual accounts—8% from the employee and 12% from the employer. In the defined contribution scheme of the EPF, the final benefits to the employees depend on the total contributions and the investment returns accumulated over time, unlike a defined benefit scheme, which guarantees a specific payment upon retirement. Therefore, the EPF's investments and the returns on them directly affect the welfare of most workers in Sri Lanka. The Central Bank of Sri Lanka, as the custodian, is responsible for investing the funds and is expected to make those investments in the best interest of the EPF members.

However, EPF investments have a record of being abused and have been embroiled in scandals since 2011. A previous analysis by Verité Research² revealed that the EPF's returns from investments in the equity (stock) market were less than 5 percent in 2009 and 2010, while the All Share Price Index (ASPI) indicated overall stock market returns of around 100 percent. There was a growing concern, later proved by forensic audits, that this poor performance was caused by large losses from pump-and-dump schemes, where external counterparties pumped up the price of low value stocks and dumped them to the EPF at highly inflated prices, after which the price fell back to the actual level, causing massive losses to the EPF³

Another scandal that received major public and political attention is what came to be known as the "bond scam" in February 2015. It was centred around a particular primary auction in which the Central Bank's Public Debt Department engaged in irregular behaviour, resulting in windfall profits to certain private entities. Initial investigations by parliamentary committees and the Presidential Commission of Inquiry revealed that parties that benefited from the bond scam made large sums of money by offloading their stock on the EPF.

This recognition of major corruption, in various forms, in the management of EPF funds, led to requesting a forensic audit of the CBSL, which included scrutinising the EPF's historical transactions in the bond market and also the equity market. The forensic audit produced five reports. Two were focused entirely on the EPF's transactions – one on equity market transactions and the other on bond market transactions. This note examines these two forensic

1 Central Bank of Sri Lanka, Annual Economic Review 2023 at https://www.cbsl.gov.lk/sites/default/files/cbslweb_documents/publications/aer/2023/en/06_Chapter_01.pdf [last accessed 21 August 2024].

2 Verité Research, Employees' Provident Fund Special Report (March 2012) at <https://www.veriteresearch.org/wp-content/uploads/2019/06/Employees-Provident-Fund-Special-Report.pdf> [last accessed 27 May 2024].

3 Sri Lankan pump-and-dump offenders must be brought to book: Jafferjee' Sunday Times, 15 February 2015 at <https://www.sundaytimes.lk/150215/business-times/sri-lankan-pump-and-dump-offenders-must-be-brought-to-book-jafferjee-135180.html> [last accessed 21 August 2024].

audit reports on the EPF to set out what these audits have been able to identify decisively with regard to the losses to the EPF through irregular/corrupt transactions. The report is in three sections.

Section one reviews the bond market losses set out in the forensic audit report titled "Investigation on primary and secondary market transactions of Employees Provident Fund involving treasury bonds issued /transacted during the period from 1 January 2002 to 28 February 2015". It is referred to in this note as "Forensic audit on EPF bond market transactions". The audit findings unearth a loss of LKR 9,826 million in bond market transactions by the EPF from January 2002 to February 2015. These losses arose from the EPF acquiring bonds at unfavourable prices in both the primary and secondary markets, and at times, after refraining from making lower priced purchases in the primary market.

Section two reviews the EPF's equity (share) market losses set out in the forensic audit report titled "Project Diamond Final report: The Monetary Board of Central Bank of Sri Lanka (November 2019)". It is referred to in this note as "Forensic audit on EPF share market transactions". The audit findings unearth a loss of LKR 9,859 million in the equity market from January 1998 to December 2017. This quantum of identified losses arose primarily through irregular investments in listed companies, but also include losses from the irregular purchase of unlisted shares.

Section three highlights a major limitation of the forensic audit, which did not expose the majority of the losses in the bond market. There are two major limitations. First, the forensic audit on the bond market losses only cover the period prior to February 2015. However, other investigations show that the EPF is likely to have had large losses in the bond market after the 'bond scam' scandal that received media attention – that is, from March 2015 onwards. Second, the audits identify only those transaction where there is documentable violation/anomaly in the conduct of the transaction. A full enumeration of losses may never be possible because of missing data as well as the significant latitude and discretion that exists for deciding on EPF transactions – preventing many bad faith and corrupt transactions being identified decisively as irregular from an audit perspective.

For example, the EPF investments in the stock market returning less than 5% when the market index increased by over 100% is not identifiable as a loss in the forensic audit methodology. Only transactions that can be traced to pump-and-dump schemes or are identified as violating the investment guidelines are identified as causing losses. Such limitations significantly reduce the scope of what can be estimated on the losses incurred by the EPF – making what has been enumerated by these forensic audits akin to the visible tip of the iceberg.

1. BOND MARKET LOSSES

Exhibit 1: Summary of EPF Losses in the Bond Market (1 January 2002 to 28 February 2015)

No	Cause of Loss	Loss to EPF (LKR Millions)
1	Losses in the Primary Market – benefiting government	8,973
2	Losses in the Secondary Market – benefiting third parties	734
3	Losses due to non-participation in Auctions and Direct Placements despite available cash	119
Total		9,826

Source: Page 29 and 30, BDO (2019b) – Forensic audit on EPF’s Bond Market transactions

1.1. Losses in the Primary Market (Through Private Direct Placements)

The majority of the EPF’s bond market losses, identified totalling LKR 8,973 million, stem from transactions in the primary market where government securities are bought through direct placement from the Public Debt Department (PDD) of the Central Bank. In this transaction method, the yield of the securities is fixed through an offer made by the PDD, unlike in auctions where the prices are determined through competitive bidding among multiple investors. The offers can be public and the same for all market participants, but it has in the past also been private and different to different market participants. This private offer arrangement is not transparent and prone to abuse. The EPF is particularly vulnerable as the Central Bank that offers the debt through its PDD (as the agent of the government) can also be the buyer through its EPF department (as the custodian of the EPF). The standard practice for deciding the yield of a security sold through direct placement has been to base it on the weighted average market price of the previous auction. The forensic audit evaluates cases where the EPF faced losses from purchasing direct placements at off-market prices. See Box 1 for the forensic audit methodology in calculating the losses.

BOX 1 – FORENSIC AUDITS METHOD FOR CALCULATING PRIMARY MARKET LOSSES AND GAINS

The loss from any quantity purchased in direct placement, is calculated as the difference between the price paid and the weighted average price of the previous Auction (if within two weeks) or the current Secondary Market price (if not within two weeks).

The gain from any quantity purchased in direct placement, is calculated as the difference between purchase yield and the base yield defined by the monetary board. This is base rate yield is defined as the higher of either the cut-off rate of the preceding auction or the secondary market rate plus 5bps.

Source-Page 136, BDO (2019b) – Forensic audit on EPF’s Bond Market transactions

The audits reveal that the EPF has obtained bonds at an adverse off-market price (higher price, lower yield) in 140 out of 549 direct placement transactions (see table 1 in the annexure for details).⁴

But the EPF has also been party to transactions where it received favourable off-market prices. Another report from the forensic audit titled, Investigation on Issuance of Treasury Bonds from 1 January 2002 to 28 February 2015, highlights that the Treasury lost LKR 6,417 million due to selling government securities to the EPF at favourable off-market prices.⁵

When reconciling this, it becomes clear that while the EPF incurred losses of LKR 8,973 million from purchasing securities at lower yields, it also benefited LKR 6,417 million from purchasing at higher yields with the government. As a result, the net loss for the EPF in the primary market from its transactions with the government comes to LKR 2,657 million.

1.2. Losses in the Secondary Market (From Irregular Transactions)

The EPF engaged in irregular investment and divestment with private parties instead of the government through the secondary market. The audit report indicates the EPF incurred a substantial loss of LKR 752 million in the secondary market – LKR 621 million was lost in investments, and LKR 95 million was lost in divestment. The investment loss occurred due to buying government securities at a lower yield rate from third-party individuals or organisations who already held securities issued by the Public Debt Department earlier in the primary market at a higher yield. The divestment loss occurred due to selling government securities held by the EPF at a higher yield rate (lower price) to the counterparty.

These secondary market losses to the EPF accrued as benefits not to the government but to private parties. When government benefits at the cost of the EPF it is akin to surreptitious tax, but when private parties benefit at the cost of the EPF it is a more serious indication of grand corruption.

BOX 2 – CRITERIA USED IN FORENSIC AUDITS FOR CALCULATING SECONDARY MARKET LOSSES

1. Investment Loss

The loss was calculated as the price difference between EPF's buying yield and the average buying yield in the Secondary Market for the bond bought on that transaction date. In this analysis, the EPF's buying price being higher than that of the other market participants would be counted as a loss to the EPF.*

Source- Page 180, BDO (2019b) - Forensic audit on EPF's Bond Market transactions

2. Divestment Loss

The loss was calculated as the price difference between the EPF's selling yield and the average selling yield in the secondary market for the bond sold on that transaction date. In this analysis the EPF's selling price being lower than that of the other market participants would be counted as a loss to the EPF.*

** where transaction date is not known the settlement date is used.*

Source- Page 232, BDO (2019b) - Forensic audit on EPF's Bond Market transactions

⁴ Page 142 and 144, BDO (2019b) - Forensic audit on EPF's bond market transactions

⁵ BDO (2019a) - Forensic audit on Government's bond market transactions

The audit identifies some of the counter-parties that benefited from these transactions, at the expense of the EPF. Among the beneficiaries of these secondary market losses, one organisation stands out. The audit reports show that LKR 223 million, or 36%, of the secondary market investment losses to the EPF accrued directly and through an intermediary, to an organisation named Perpetual Treasuries Limited.⁶

The audits also identify a particular period during which these losses take place. 94% of the purchase (investment) losses and 80% of the sale (divestment) losses occurred in 2013 and 2014.⁷ According to the audit report, this period was marked by a substantial increase in the EPF's secondary market activities, based on directives from the Central Bank Governor to the Investment Committee and senior EPF management. This active participation led to an escalation of secondary market total investment value by 400% in 2013 and 533% in 2014, compared to the annual average investments from 2002 to 2012.⁸

1.3. Losses from non-participation in auctions and direct placements despite available cash

The audit highlights significant losses to the EPF due to the EPF's failure to participate in auctions and direct placements, even when the fund had more than sufficient cash to engage.

The Forensic Audit considers EPF to have sufficient cash if it had at least 30% of the amount offered by the PDD. Their rationale would be to indicate a significant liquidity level that could be a sizable portion of the bids if the EPF chose to participate.⁹

The lack of engagement resulted in financial setbacks, given that the funds were eventually invested either in the direct placement or secondary market but at lower yields than the auction.¹⁰ The financial implication of this inaction is a loss of LKR 119 million.¹¹

EPF not Participating in the Auctions

Between 2003 and February 2015, the EPF missed 190 out of 465 bond auctions. That is, on average it failed to participate in 41% of the bond auctions, and thereby missed those investment opportunities for its funds. This is a very high rate of non-participation. In 2003, 2007, 2008, and 2009, non-participation rates were even higher, exceeding 60%. In 2014, the non-participation rate was 47%.

The financial impact calculated to the EPF by the forensic audit does not look at lost days of investment due to the failure to participate in the primary auction. What it has looked at instead is the higher price paid immediately after the primary market auction, to make purchases in the secondary market on the same or similar bonds as was able at the primary market auction.

6 Page 189, BDO (2019b) - Forensic audit on EPF's bond market transactions

7 Page 183 and 25, BDO (2019b) - Forensic audit on EPF's bond market transactions

8 Page 176, BDO (2019b) - Forensic audit on EPF's bond market transactions

9 The selection of a 30% threshold to define "sufficient cash" warrants cautious interpretation, as it relies on measuring liquidity as a proportion of the auction amount offered. This methodology may lead to ambiguity and inconsistency: for instance, having LKR 3 billion available for a LKR 10 billion auction meets the audit's criteria, whereas the same LKR 3 billion would not for a LKR 20 billion auction—even though the EPF could still potentially invest in the latter scenario. Relying on auction size as a basis for liquidity assessment might not fully capture the EPF's actual capacity to invest. We present this observation here to reflect the approach used in the audits.

10 Page 84-88, 132-135, BDO (2019b) - Forensic audit on EPF's bond market transactions

11 Page 16 and 18, BDO (2019b) - Forensic audit on EPF's bond market transactions

By foregoing these auction opportunities, the EPF incurred an estimated loss of LKR 95.66 million. According to a forensic audit, the majority of this loss was due to subsequent investments in the primary market (auctions and direct placements), with LKR 16 million attributed to secondary market activities (see Exhibit 2 for details).¹²

Exhibit 2: Losses arising due to non-participation in the auctions (Jan 2003 to Feb 2015)

Type of Loss	Loss Amount (LKR Million)
Losses from Subsequent Auction Purchases (Primary Market):	
- Same ISIN at Auctions (5 instances)	12.31
- Different ISINs at Auctions (3 instances)	31.73
Subtotal (Auction Purchases)	44.04
Losses from Subsequent Direct Placements (Primary Market):	
- Same ISIN via Direct Placements (11 instances)	13.5
- Different ISIN via Direct Placements (4 instances)	22.04
Subtotal (Direct Placements)	35.54
Losses from Subsequent Secondary Market Purchases:	
- Treasury Bonds Purchased in the Secondary Market (15 instances)	16.08
Subtotal (Secondary Market Purchases)	16.08
Overall Total Loss Due to Non-Participation	95.66

EPF not Participating in the Direct Placements

An in-depth analysis of the Employees' Provident Fund (EPF) investment activities, covering the period from January 2003 to February 2015, revealed a significant trend of missed direct placement opportunities. During this time, the EPF opted out of direct placements in 230 instances.¹³ It was found that the EPF held cash reserves exceeding 30% of its total funds in 96 cases (56% of the evaluated 171 instances with cashflow statements), amounting to LKR 62,237 million.

Of the LKR 62,237 million cash reserve not invested in direct placement, only LKR 20,160.63 million (32%) was returned to EPF members as refunds. The remaining funds were primarily reinvested, with LKR 26,216 million (42%) allocated to secondary market purchases and LKR 15,860.09 million (25.48%) invested in the primary market.

¹² Page 84-88, and 128-132 BDO (2019b) - Forensic audit on EPF's bond market transactions

¹³ Page 128,129, BDO (2019b) - Forensic audit on EPF's bond market transactions

By foregoing these direct placement opportunities, the EPF incurred an estimated loss of LKR 22.85 million. According to a forensic audit, the majority of this loss was due to subsequent investments in the primary market, with only LKR 0.99 million attributed to secondary market activities (see Exhibit 3 for details).

Exhibit 3: Losses arising due to non-participation in the Direct Placement (Jan 2003 to Feb 2015)

Type of Loss	Loss Amount (LKR Million)
Losses from Subsequent Auction Purchases:	
- Same ISIN at Auctions	0.02
- Different ISINs at Auctions	8.68
Subtotal (Auction Purchases)	8.7
Losses from Subsequent Direct Placements:	
- Same ISIN via Direct Placements	4.53
- Different ISIN via Direct Placements	8.63
Subtotal (Direct Placements)	13.16
Losses from Subsequent Secondary Market Purchases:	
- Treasury Bonds Purchased in the Secondary Market	0.99
Subtotal (Secondary Market Purchases)	0.99
Overall Total Loss Due to Non-Participation	22.85

BOX 3 – CRITERIA USED IN FORENSIC AUDITS FOR CALCULATING NON-PARTICIPATION LOSSES DESPITE AVAILABLE CASH

The availability of cash was determined if the computed cash on the settlement date of an auction exceeded 30% of the cumulative amount offered by the Public Debt Department.

The loss is calculated in two ways for the same ISIN and different ISINs:

- 1. Same ISIN (auction and direct placement):** If the EPF purchases the same ISIN subsequent to the auction/direct placement date they did not participate in, the subsequent purchase's yield is compared with the initial weighted average yield of the auction/direct placement not participated in.
- 2. Different ISIN (auction only):** If the EPF purchases a different ISIN after the auction date, the subsequent purchase yield is compared with the selling yield from the secondary market. If secondary market rate information is not available on the date of purchase, the yield two days prior is used if available
- 3. Different ISIN (direct placement):** If the EPF purchases a different ISIN after the direct placement date, and if the securities purchased have a different maturity period, the loss is not calculated

Source- Page 77-79, BDO (2019b) - Forensic audit on EPF's Bond Market transactions

2. LOSSES IN THE EQUITY MARKET

2.1. History of Equity Investments

Since its inception in 1958, the EPF has primarily invested in government securities. However, starting in 1998, the EPF began investing in equities, mainly via the stock market, after the Monetary board issued a paper on March 3, 1998, approving investments into the equity market. Initially, the fund's exposure to equity was minimal, i.e. below 1.5 per cent. However, from 2010 onwards, the EPF increased its equity exposure to over 5 per cent of the fund, reaching a high of 7.7 per cent in 2011. Since 2014/5, the fund halted its equity investments following a series of equity market losses, allegations of financial misconduct and court cases by the members.¹⁴ However, it re-entered the stock market in 2018 with limited exposure. In 2019, equity consisted of 3% of the fund's total investment.¹⁵

Exhibit 4: Summary of EPF Losses in the Share Market (1 January 1998 to 31 December 2017)

#	Equity Investments	Loss to EPF (LKR Millions)
1	Losses from investments in listed companies	9,470
2	Losses from investments in unlisted companies	389
Total		9,859

Source: Pages 46,47,57,59, KPMG (2019) - Forensic audit on EPF's Share Market transactions

2.2. Losses in Listed Companies

The forensic audits revealed significant financial losses resulting from the EPF's investments in listed shares between 1998 and 2017. During this period, the EPF incurred a total loss of LKR 9,470 million from its listed equity investments. The audit focused on 19 selected investments with transaction values above LKR 10 million. Out of these, 17 investments were found to be loss-making, while two (despite not being classified as loss-making) were highlighted in the Presidential Commission's report for allegations on pumping and dumping and market manipulations involving EPF.

The criteria for classifying an investment as loss-making included either an impairment loss recorded in the financial statements or a realised loss from the sale of investments.¹⁶

1. **Impairment Losses:** An impairment loss occurs when the value of an asset decreases significantly and must be permanently reduced in the financial statements. The total impairment losses amounted to LKR 9,198.5 million which amounts to around 12% of the equity portfolio value.¹⁷ There were four major investments incurring losses exceeding LKR 1 billion each. These include Colombo Dockyard (LKR 1,869 million), Bukit Darah (LKR 1,707 million), Carson Cumberbatch PLC (LKR 1,626 million), and Brown & Company PLC (LKR 1,304 million).

14 EPF/ETF barred from investing in stocks until cleared of pump and dump allegations' Sunday Times 12 February 2017 at <https://www.sundaytimes.lk/170212/business-times/epf-ETF-barred-from-investing-in-stocks-until-cleared-of-pump-and-dump-allegations-227872.html> [last accessed 27 February 2025].

15 Employees' Provident Fund, *Annual Report 2022*.

16 Page 52, KPMG (2019) - Forensic audit on EPF's Share Market transactions

17 Equity value considered here is the average investment value in equities from 2011 to 2020.

2. **Realised Losses:** Profits and losses were calculated based on the stock's price on the date of sale, considering the number of units held before the transaction. The EPF used the weighted average method to calculate profit and loss on each transaction. Realised losses from the sale of investments totalled LKR 271 million, predominantly from the sale of John Keells shares (resulting in a loss of LKR 228 million) and PC House shares (resulting in a loss of LKR 43 million).

A significant share of these losses is attributed to a "pump and dump" strategy employed by external entities to exploit EPF funds. This tactic involves artificially inflating (pumping) share prices to attract additional investors and subsequently selling off (dumping) the shares, resulting in a significant price drop and substantial losses for subsequent investors.

Exhibit 5: EPF's equity investment losses in listed companies

#	Equity Investments	Loss to EPF (LKR Millions)	Amount of loss as per books of accounts (LKR million)
1	Colombo Dockyard	Impairment loss	-1,869
2	Bukit Darah	Impairment loss	-1,701
3	Carson Cumberbatch PLC	Impairment loss	-1,626
4	Brown & Co PLC	Impairment loss	-1,304
5	Ceylon Grain Elevators	Impairment loss	-652
6	Galadari Hotels (Lanka) PLC	Impairment loss	-621
7	Ceylon Hotels Corporation PLC	Impairment loss	-378
8	Ceylon Guardian Investment PLC	Impairment loss	-282
9	John Keells Holdings Limited	Realised loss	-228
10	Tal Lanka Hotels PLC	Impairment loss	-225
11	The Finance Company	Impairment loss	-179
12	Hayleys Fabric PLC	Impairment loss	-139
13	Eden Hotels Lanka PLC	Impairment loss	-130
14	Raigam Wayamba Saltern Ltd	Impairment loss	-64
15	PC House PLC	Realised loss	-43
16	Mackwood Energy PLC	Impairment loss	-17
17	Dialog Telekom	Impairment loss	-6
18	Laugfs Gas PLC	No Loss booked	-
19	Piramal glass Ceylon PLC	No Loss booked	-
Total			9,464

Notable Investment Loss Cases

1. Colombo Dockyard PLC

Among all EPF investments that resulted in losses, the biggest loss originated from the investments in Colombo Dockyard PLC, amounting to LKR 1,869 million. Since beginning investments in Colombo Dockyard in 1998, the EPF has invested a total of LKR 2,855 million.¹⁸

However, 78% of these funds were concentrated on two major purchases in 2010. On 30 June 2010, the EPF purchased shares to the value of LKR 1,929 million at LKR 280 per share. Then again on 24 November 2010 it purchases additional shares to the value of LKR 291 million at LKR 292 per share. These investments were made when the share price was at its peak. The share price, which had climbed from LKR 116.25 in 2009 to a high of LKR 315.5 in February 2010, subsequently dropped below LKR 83 by 2016. It was in 2016 that the EPF classified these investments as impaired, formalising the substantial losses.¹⁹

A particularly troubling aspect was the 30 June 2010 transaction. The EPF purchased those shares worth nearly 2 billion from Horizon Representation of Companies LLC, a subsidiary of the UAE-based Horizon Energy Group. This transaction was executed without prior approval from the Investment Committee (IC), bypassing standard governance procedures. This is highlighted in the forensic audit as a transaction of serious concern. While the majority of the EPF's 41 transactions in Colombo Dockyard adhered to internal approval protocols, four transactions were carried out without IC approval – but these four transactions represented over 72 % of the total investment in Colombo Dockyard PLC.²⁰

2. Brown and Company PLC

The EPF invested a total of LKR 1,888 million across both trading and investment portfolios in Brown and Company PLC. In a classic “pump and dump” scenario, the EPF purchased 2.54 million shares when the price peaked at LKR 290 in July 2011, after having risen from LKR 17.5 in April 2009. Subsequently, the share price plummeted back to its original levels, leading to a substantial loss (see exhibit 6). The EPF recognised an impairment loss of LKR 1,304 million on this investment in 2015 and 2017, losing 69% of the investment value.

This investment was also executed without required approval from the Investment Committee, lacking proper analysis and necessary documentation. The investment proceeds were mostly concentrated in 2011, accounting for 95% of the total, with an initial transaction on 27 July making up 43.19% of the total investment. The counterparty to this transaction was Mr. S.H.M. Rishan, a high-net-worth individual and promoter of PC House PLC, which was later delisted in July 2019.²¹

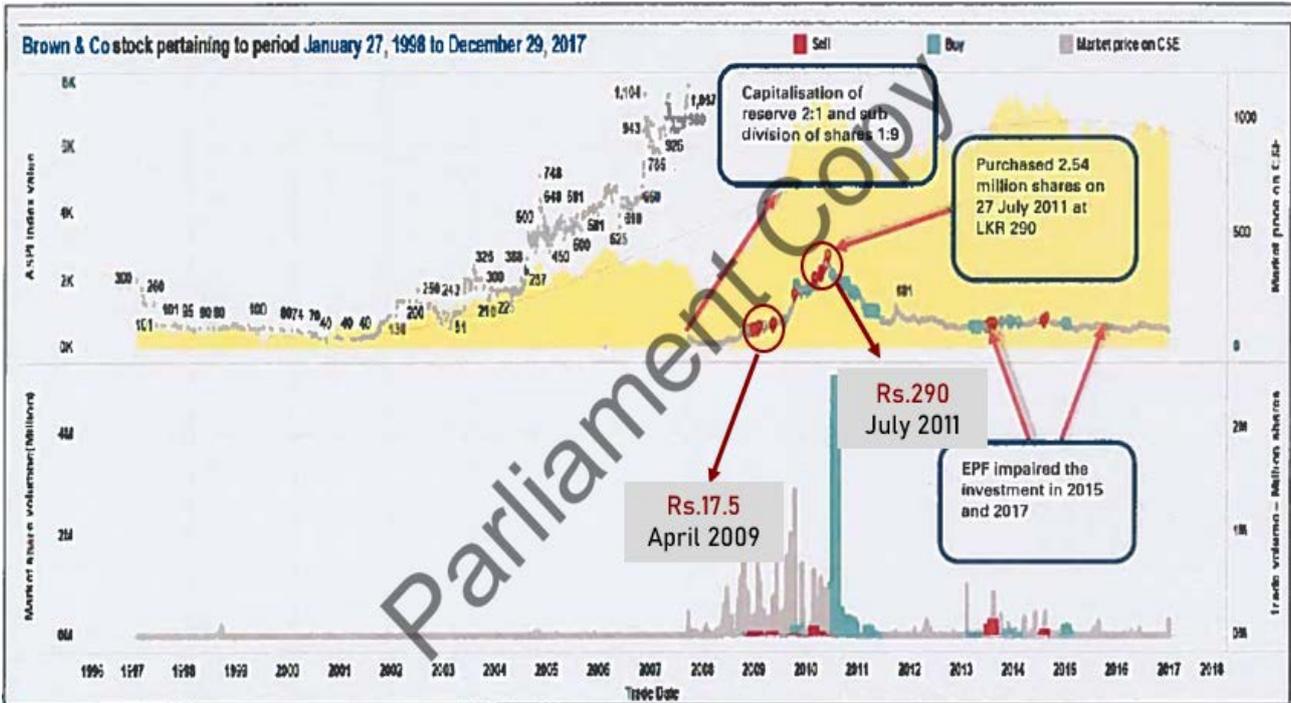
18 Page 115, KPMG (2019)-Forensic audit on EPF's share market transactions

19 Page 116-118, KPMG (2019)-Forensic audit on EPF's share market transactions

20 Page 120-123, KPMG (2019)-Forensic audit on EPF's share market transactions

21 Page 61 - 71, KPMG (2019) - Forensic audit on EPF's Share Market transactions

Exhibit 6: EPF’s equity investment losses in listed companies



Source: Pages 46,47,57,59, KPMG (2019) - Forensic audit on EPF’s Share Market transactions

3. Ceylon Grain Elevators Limited

In 2011, the EPF invested LKR 1,051 million in Ceylon Grain Elevators Limited (CGE) without prior analysis or Investment Committee approval, resulting in an impairment loss of LKR 652 million. This investment also followed a “pump and dump” pattern, where CGE’s share price surged from LKR 93.5 in January 2011 to LKR 265 by February, before crashing back to around LKR 100 by December. The bulk of the EPF’s shares were purchased at the peak price of LKR 205 in March 2011.²²

This decision was influenced by a meeting between the EPF Superintendent and the Central Bank Governor, despite opposition from the Deputy Governor, who criticised the lack of proper approval and oversight.²³ Perpetual Capital (Private) Limited (PCPL) was the seller of 95% of the shares acquired by the EPF. The Forensic audit estimate that PCPL earned a profit of approximately LKR 302.56 million through this sale, based on weighted average prices from 2010. However, the exact purchase price of the securities by PCPL is unknown. Notably, Ms. Siromi Noel Wickramasinghe, one of the directors of PCPL, is the sister of the then-Governor, Mr. Ajith Nivard Cabraal, raising serious concerns about potential conflicts of interest.²⁴

22 Page 72-74, KPMG (2019)-Forensic audit on EPF’s share market transactions
 23 Page 260, KPMG (2019)-Forensic audit on EPF’s share market transactions
 24 Page 77, KPMG (2019)-Forensic audit on EPF’s share market transactions

2.3. Losses in Unlisted Companies

Between January 1998 and March 2017, the Employees' Provident Fund (EPF) invested a total of LKR 11,042 million in 17 companies that are not listed in the stock exchange. Very little of this investment, just 2.5%, occurred prior to 2008. The practice accelerated from 2008-2017 accounting for 97.5% of the investments made in unlisted entities.

The audit also revealed that unlisted equity investments made prior to 2007 amounting to a total of LKR 278 million, generated positive dividends and capital gains. In contrast, investments made from 2007 onwards largely failed to produce returns and often resulted in losses.

The EPF's largest unlisted equity investments were LKR 5,000 million in Canwill Holdings (Pvt) Limited in 2013, followed by LKR 2,975 million in West Coast Power (Pvt) Limited in 2007, LKR 1,000 million in preference shares of Sri Lankan Catering in 2010 and LKR 500 million in Sri Lankan Airlines Limited (See exhibit below).²⁵

The Canwill Holdings investment has been particularly underperforming, providing only LKR 5 million in dividends since 2013, despite an initial investment of LKR 5,000 million. That's a total return of 0.1% after five years! Meanwhile, investments in Cargills Agricultural and Commercial Bank Private Limited, Weligama Hotel Properties Limited, and Jetwing Symphony Limited have not generated dividends. The situation with Sri Lankan Airlines Limited is the most severe, with the initial investment of LKR 500 million completely written off as an impairment loss.²⁶ Notably, only the investments in West Coast Power and preference shares of Sri Lankan Catering Preference yielded significant returns after 2007.

Forensic audits have evaluated that the EPF incurred a net loss of LKR 389 million from acquiring unlisted equities. This loss is primarily due to the complete write-off of the LKR 500 million Sri Lankan Airlines investment, with some gains from investments made before 2007 partially offsetting that loss.

However, as explained earlier, the accounting approach and documentation based approach taken in the forensic audits limit the discovery of losses. For example, while the audits capture losses due to depletion of the value of capital invested, they don't capture losses due to off-market low returns. For instance, the 0.1% return in Canwill holdings after five years is not counted as a loss, since it is still a positive return though woefully less than what the return would have been by investing in even a low return instrument such as government treasuries.

Therefore, for the investment in unlisted companies from 2007 onwards we have independently calculated the losses. Our calculations compare the net return on the investment in all unlisted entities from 2007 onwards against the return that the EPF would have got from investing in one year treasury bills of the government. This is a conservative (low) estimate, since the EPF being a retirement fund usually invests in treasury bonds that have a higher return than treasury bills.

The calculation shows that the investments in unlisted entities from 2008 onwards, if invested instead in one year treasury bills would have yielded a return of **LKR 18,777 million by 2017 (the year up to which the forensic audits calculate the losses)**.²⁷ Instead, the EPF received only LKR 6,395 million in dividends by the end of 2017 from these investments. This computes to an additional loss of LKR 12,382 million that is not computed in the forensic audits.

²⁵ Page 46, KPMG (2019) - Forensic audit on EPF's Share Market transactions.

²⁶ Page 46, KPMG (2019) - Forensic audit on EPF's Share Market transactions.

²⁷ This increases to LKR 37,142 million potential return if calculated for up to the end of 2024

Following are additional details from the forensic audit regarding the two most serious loss making investments:

1. **Sri Lankan Airlines (LKR 500 million):** Despite the airline's ongoing losses in 2010, the EPF invested without conducting any analysis or obtaining approval from its investment committee. The audits revealed that this decision was made based on directives from top management and the government. They reported cited the airline's national importance and government support to ensure its continued operations, even in difficult periods.²⁸ In 2015, the full value of the LKR 500 million investment was impaired, with only a residual value of LKR 100 remaining on the books. The justification for the impairment was recorded as "uncertainties regarding the feasibility of divestment and the scale of accumulated losses, amounting to LKR 128.24 billion".²⁹
2. **Canwill Holdings Private Limited (LKR 5,000 million):** In 2013, the EPF invested LKR 5,000 million in the construction of the luxury Hyatt hotel. This investment was made based on a directive from the Ministry of Finance and Planning, instructing the EPF to participate in the project, despite several concerns raised by the Investment Committee and the Middle Office about the financial and legal aspects. Additionally, this investment violated the 10% limit for investing in a single company, as the EPF acquired 42% of the company's issued share capital.

Exhibit 7: EPF Losses from equity investment in unlisted companies

#	Name of the Company	Year	Held/ Disposed	Total Investment (LKR/million)	Dividends Received (LKR/ million)	Capital Gain/ (Loss) (LKR/ million)	Opportunity Cost (Till 2017)
1	Kandurata Development Bank	1998	Disposed	12	6	6	-
2	Rajarata Development Bank	1998	Disposed	12	5	13	-
3	Ruhunu Development Bank	1998	Disposed	12	8	30	-
4	Uva Development Bank	1999	Disposed	12	3	11	-
5	Fitch Ratings Lanka Limited	1999	Held	0.6	2	-	4
6	Sabaragamuwa Development Bank	1999	Disposed	12	6	10	-
7	Wayamba Development Bank	1999	Disposed	12	9	33	-
8	NDB Housing Bank Limited	2001	Disposed	30	-	9	-
9	Commercial Bank 13% preference shares	2006	Disposed	100	9	-	-
10	Commercial Bank 11.25% preference shares	2006	Disposed	75	20	-	-
11	West Coast Power (Pvt) Limited	2007	Held	2,975	5,341	-	7,693

28 Page 20, KPMG (2019) - Forensic audit on EPF's Share Market transactions

29 Page 254, KPMG (2019) - Forensic audit on EPF's Share Market transactions.

#	Name of the Company	Year	Held/ Disposed	Total Investment (LKR/million)	Dividends Received (LKR/ million)	Capital Gain/ (Loss) (LKR/ million)	Opportunity Cost (Till 2017)
12	Sri Lankan Airlines Limited	2010	Held	500	-	-500	885
13	Sri Lankan Catering 15% Preference shares	2010	Held	1,000	1,047	-	1,769
14	Canwill Holdings (Pvt) Limited	2013	Held	5,000	5	0	6,804
15	Cargills Agricultural and Commercial Bank Private Limited	2014	Held	495	-	-	622
16	Weligama Hotel Properties Limited	2014	Held	405	-	-	509
17	Jetwing Symphony Limited	2014	Held	390	-	-	490
Total				11,043	6,462	-389	18,777

Note: The opportunity cost reflects the potential earnings had the invested amount been placed in government securities yielding an annual 10% yield. These calculations compound returns from the original investment date through 2017, the latest year included in the audits.

3. FORENSIC AUDIT COVERS ONLY THE TIP OF THE ICEBERG

The forensic audit, conducted in 2019 based on recommendations from the Presidential Commission of Inquiry (PCOI) into Treasury Bond issuance, examined transactions only from 1 January 2002 to 28 February 2015, excluding the activity after February 2015, when activity related to the bond-scam was expected to have been high – based on other information revealed in the PCOI documents. Therefore, EPF losses in the bond market between 2015–2017 are not explored in the forensic audits, and it would require another forensic audit to do so.

The PCOI, which reviewed Treasury Bond activities from 1 February 2015 to 31 March 2016, stated:³⁰

“In view of these circumstances, we do not intend to examine the Transactions entered into by the EPF, in detail, with a view to quantifying the loss to EPF or identifying all individuals responsible for such loss.”

“We trust that the Monetary Board and the CBSL will carry out a full and complete investigation into the Transactions entered into by the EPF and identify the loss caused to the EPF and, if so, identify the persons responsible and seek to recover such loss from them.”

The forensic audit of bond market transactions references this recommendation, noting that it was made in conjunction with the CBSL’s internal examination for the period from 1 February 2015 to 31 March 2016.³¹ The report states:

“Referring to the CBSL’s internal examination, the Presidential Commission of Inquiry (‘PCOI’) stated that the PCOI, during its inquiry, identified several areas of concern about the manner in which the EPF operated and transacted upon Treasury Bonds. PCOI recommended, inter alia, that the investigation by the Monetary Board of CBSL should carefully examine the transactions entered into by the EPF, identify whether a loss was caused to the EPF and, if so, identify the persons responsible...”

The failure to investigate the 2015–2017 losses is significant. The PCOI report indicated that Perpetual Treasuries Limited realised gains of approximately LKR 6,400 million from its dealings with the EPF between February 2015 and March 2016. In contrast, the forensic audit identified only an LKR 223 million loss related to Perpetual Treasuries Limited, primarily during 2013–2014. By focusing solely on events before 2015, the audit underestimates the potential losses incurred after that period, leaving a substantial gap in understanding the full extent of financial losses.

There is a second limitation. That is, the audits identify only those transactions where there is documentable violation/anomaly in the conduct of transactions. That means the audit is also limited by missing data and inability to make a clear attribution of irregularities. Many bad-faith and corrupt transactions would not be identifiable as irregular from an audit perspective, even if they can be revealed to be so from the consequences of the investment return – as in the case of equity investment in unlisted entities, where the loss has been calculated and shown in this report, in addition to the losses calculated by the forensic audits.

The losses listed in the forensic audits which are set out in this report, therefore, should be read as a partial, and not full, enumeration of losses caused to the EPF from weak and corrupt management that has been identified by the forensic audits.

30 Page 804 and 916, Presidential Commission Report on CBSL

31 Page 13, BDO (2019b) - Forensic audit on EPF’s bond market transactions

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ANNEXURE

Table A1: Detailed Losses of the EPF in the Bond Market from January 2002 to February 2015

	Cause of Loss	Loss to EPF (LKR Millions)
1	Losses in the Primary Market – Lower	8,973
1.1	PDD offered rate in direct placement was lower than the weighted average yield rate of previous Auction	256
1.2	PDD offered rate in direct placement was lower than the Secondary Market yield rate on the placement date	8,716
2	Losses in the Secondary Market	734
2.1	Investment loss - EPF purchase price was higher than the market price	621
2.2	Treasury bonds sold from the HTM portfolio and Trading Portfolio at lower price compared to the market price	95
3	Non-Participation in Auction and Direct Placement despite available cash	119
3.1	Non-Participation in Auction and Excess amount was paid in subsequent Auctions/Direct Placement for same/different ISIN	80
3.2	Non-Participation in Auction and Excess amount was paid in subsequent investment in Secondary Market for same ISIN	16
3.3	Non-Participation in Direct Placement Excess amount was paid in subsequent Auctions/ Direct Placement for same/different ISIN	22
3.4	Non-Participation in Direct Placement and Excess amount was paid in subsequent investment in Secondary Market for same ISIN	1

Table A2: EPF Losses from equity investment in listed companies

	Name of the company	Details of loss	Amount of loss as per books of accounts (LKR million)
1	Brown & Co PLC	Impairment loss	-1,304
2	Ceylon Grain Elevators	Impairment loss	-652
3	Galadari Hotels (Lanka) PLC	Impairment loss	-621
4	Laugfs Gas PLC	No Loss booked	-
5	Piramal glass Ceylon PLC	No Loss booked	-
6	Colombo Dockyard	Impairment loss	-1,869
7	Bukit Darah	Impairment loss	-1,701
8	Carson Cumberbatch PLC	Impairment loss	-1,626
9	Ceylon Hotels Corporation PLC	Impairment loss	-378
10	Ceylon Guardian Investment PLC	Impairment loss	-282
11	John Keels Holdings Limited	Realised loss	-228

	Name of the company	Details of loss	Amount of loss as per books of accounts (LKR million)
12	Tal Lanka Hotels PLC	Impairment loss	-225
13	The Finance Company	Impairment loss	-179
14	Hayleys Fabric PLC	Impairment loss	-139
15	Eden Hotels Lanka PLC	Impairment loss	-130
16	Raigam Wayamba Saltern Ltd	Impairment loss	-64
17	PC House PLC	Realised loss	-43
18	Mackwood Energy PLC	Impairment loss	-17
19	Dialog Telekom	Impairment loss	-6
Total			(9,470)

Table A3: EPF Losses from equity investment in unlisted companies

	Name of the company	Year	Capital gain/loss (LKR/million)
1	Kandurata Development Bank	1998	6
2	Rajarata Development Bank	1998	13
3	Ruhunu Development Bank	1998	30
4	Uva Development Bank	1999	11
5	Fitch Ratings Lanka Limited	1999	-
6	Sabaragamuwa Development Bank	1999	10
7	Wayamba Development Bank	1999	33
8	NDB Housing Bank Limited	2001	9
9	Commercial Bank 13% preference shares	2006	No capital gain as preference shares
10	Commercial Bank 11.25% preference shares	2006	No capital gain as preference shares
11	West Coast Power (Pvt) Limited	2007	-
12	Sri Lankan Airlines Limited	2010	-500
13	Sri Lankan Catering 15% preference shares	2010	-
14	Canwill Holdings (Pvt) Limited	2013	-
15	Cargills Agricultural and Commercial Bank Private Limited	2014	-
16	Weligama Hotel Properties Limited	2014	-
17	Jetwing Symphomy Limited	2014	-
Total			(389)



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