Eighth Parliament of
the Democratic Socialist Republic of Sri Lanka
(First Session)

Parliamentary Series No. 109

Report
of the
Committee on Public Enterprises

which functioned as a Special Committee to look into
financial irregularities which have occurred in issuing
of Treasury Bonds from February 2015 to May 2016
by the Central Bank of Sri Lanka

Presented to Parliament by

Hon. Sunil Handunnetti

Chairman of the Committee on Public Enterprises

on 28 October 2016

Committee on Public Enterprises

1. Hon. Sunil Handunnetti (Chairman)
2. Hon. Rauff Hakeem
3. Hon. Anura Priyadarshana Yapa
4. Hon. Dayasiri Jayasekara
5. Hon. Lakshman Seneviratne
6. Hon. Ravindra Samaraweera
7. Hon. Sujeewa Senasinghe
8. Hon. Wasantha Aluvihare
9. Hon. Lasantha Alagiyawanna
10. Hon. Dr. Harsha De Silva
11. Hon. Ajith P. Perera
12. Hon. Ranjan Ramanayake
13. Hon. Ashok Abeysinghe
14. Hon. Anura Dissanayake
15. Hon. Chandrasiri Gajadheera
16. Hon. Mahindananda Aluthgamage
17. Hon. Bimal Rathnayake
18. Hon. Weerakumara Dissanayake
19. Hon. Mawai So. Senadhiraja
20. Hon. Abdullah Mahruf
21. Hon. S. Sritharan
22. Hon. M.A. Sumanthiran
23. Hon. Hector Appuhamy
24. Hon. (Dr.) Nalinda Jayathissa
25. Hon. Harshana Rajakaruna
26. Hon. Gnanamuttu Srinesan

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Report

As the Chairman of the Committee on Public Enterprises of the Eighth Parliament, I wish to present to Parliament today, the Report of the Committee on Public Enterprises which functioned as a Special Committee to look into financial irregularities which have occurred in issuing of Central Bank Bonds from February 2015 to May 2016 by the Central Bank.

The following 15 Members of the Committee agreed to the Report of the Committee in general without the footnotes.

1. Hon. Sunil Handunnetti (Chairman)
2. Hon. Rauff Hakeem
3. Hon. Anura Priyadarshana Yapa
4. Hon. Dayasiri Jayasekara
5. Hon. Lakshman Seneviratne
6. Hon. Lasantha Alagiyawanna
7. Hon. Anura Dissanayake
8. Hon. Chandrasiri Gajadheera
9. Hon. Mahindananda Aluthgamage
10. Hon. Bimal Rathnayake
11. Hon. Weerakumara Dissanayake
12. Hon. S. Sritharan
13. Hon. M.A. Sumanthiran
14. Hon. (Dr.) Nalinda Jayathissa
15. Hon. Gnanamuttu Srinesan

The following 9 Members of the Committee agreed to the Report of the Committee in general without the foot notes.

1. Hon. Ravindra Samaraweera
2. Hon. Sujeewa Senasinghe
3. Hon. Wasantha Aluvihare
4. Hon. Dr. Harsha De Silva
5. Hon. Ajith P. Perera
6. Hon. Ashok Abeysinghe
7. Hon. Abdullah Mahruf
8. Hon. Hector Appuhamy
9. Hon. Harshana Rajakaruna

All the members of the Committee unanimously agreed to the Recommendations given at the end of the Report.

Sunil Handunnetti
Chairman of the Committee on Public Enterprises

Chairman's Note

The task of investigating the issuing of Treasury Bonds by the Central Bank between February 2015 and May 2016 assigned to the Committee on Public Enterprises was a highly complex investigation that carried great responsibility. This investigation was not only a test of subject knowledge of the Members of the Committee, but it was also a test of their conscience.

This bond transaction in the Central Bank is not an average financial transaction similar to those which occur in other public enterprises; this is an issue that has arisen concerning the Central Bank which is the bank of all other banks and is directly responsible to the General Treasury. Furthermore, the loss that the government has incurred or may potentially incur as a result of this transaction is a matter that reaches beyond financial value and affects the continuation of the country's financial management. Additionally, a political dialogue that transcends the boundaries of the Committee was created regarding this bond issue controversy in the country through media. As a result, all members of the Committee representing different political parties rallied around this common objective of formulating a formal report that would enable the revealing of corrupt individuals behind the Central Bank bond issue controversy, bringing them to justice and taking legal action against misappropriation of public funds. It was a challenge that posed many complexities and difficulties. However, it was a priceless political experience.

Sovereignty of the people is vested in Parliament by the people for the purpose of execution. Power of the people assigned to Parliament for the purpose of fiscal control is executed by us through the Committee. This investigation into bond transactions is a test of the power of the people. It is a test of sovereignty. Hence, the task we executed was not that of fulfilling the needs of individuals but an execution of the will of the people. Therefore, after long hours of debate and argument, the conclusion of our investigation is thus presented to Parliament in a manner that is fair by the tax payers. As I directed this investigation, the fact that we are bound only to the obligation of serving justice to sovereignty of people and not to the aspirations of individuals and the extent of power they wield remained a constant in my mind until the very end of this investigation. I was able to complete this trying endeavor successfully at the last moment. It marks a historic moment in which Parliament emerged victorious from the battle against corruption. This would undoubtedly give strength to all forces against corruption in Sri Lanka.

It is the ultimate responsibility of all Members of Parliament to not allow for the weakening of Parliament's control over public finance. We considered it our first responsibility to investigate whether officers of the Central Bank have acted in a manner that ensures minimum cost and minimum risk for the Central Bank through this bond transaction too. Furthermore, observations and conclusions made by the Auditor General were considered as a basis for this purpose.

I ask the public to carefully scrutinize this report tabled today along with all evidence attached. Then, you will be able to find out who are corrupt and who are protecting the corrupt. Today, we have concluded the investigation into the corrupt bond transaction. My responsibility was to direct and conclude this investigation successfully so that its effect reaches all public enterprises and government financial institutions. Based on my conscience and knowledge in the subject matter, I am satisfied that it has been executed successfully.

I wish to extend my gratitude to all those who expressed views at their discretion, all those who encouraged us providing criticism externally, the Auditor General and his staff who extended their support to complete this process as well as the Hon. Speaker and staff of the Parliament Secretariat.

Sunil Handunnetti
Chairman of the Committee on Public Enterprises

Report Prepared by the Committee on Public Enterprises on the Issuing of Treasury Bonds by the Central Bank of Sri Lanka within the Period from February 2015 to May 2016

This report is a summary of the facts revealed in the special audit report prepared by the Auditor General on the issuing of Treasury Bonds by the Central Bank of Sri Lanka during the year 2015 -2016, the answers obtained from the Governor of the Central Bank on that report, the answers given to the questionnaires sent by COPE to the Ministry of Finance and Central Bank of Sri Lanka, the statements made by the officers in the Ministry of Finance and the Ministry of National Policies and Economic Affairs and the oral evidence taken from the officers in the Central Bank by summoning them before the Committee.

1 Introduction

A motion was included in the addendum attached to the Order Book No. 14(1) issued on 08th May 2015 as a no date motion signed by a number of Members of Parliament including Prof. G.L. Pieris, M.P., collectively forcing the government to remove the then Governor of the Central Bank Mr. Arjun Mahendran saying that irregularities have taken place in the Sri Lanka Central Bank's issue of a 30 – year bonds on February 27, 2015 incurring a huge financial loss to the government and the country.

Hon. Prime Minister appointed a tri partite Committee consisting of Lawyer Gamini Pitipana, Lawyer Mahesh Kalugampitiya and Lawyer Chandimal Mendis to look into this matter and report.

The tri partite Committee report was tabled by Hon. Lakshman Kiriella on 19th May 2015 in Parliament. That report is attached as **Annexure 2** in this report.

Hon. Speaker stated in Parliament on 20 May 2015 that it would be more appropriate to conduct a full investigation about the aforesaid motion included in the Order Paper by a sub Committee of the Committee on Public Enterprises.

Accordingly, the Committee on Public Enterprises of the Seventh Parliament that met on 22nd May 2015 appointed the following sub Committee consisting of 13 members from the Committee to conduct a full investigation in this regard.

Special Sub Committee of Committee on Public Enterprises

- Hon. D.E.W. Gunasekara (Chairman)
- Hon. (Dr.) Rajitha Senarathne
- Hon. Rosy Senanayake
- Hon. Iran Wickramarathne
- Hon. Sujeewa Senasinghe
- Hon. Lasantha Alagiyawanna
- Hon. Arjuna Ranathunga
- Hon. A.D. Susil Premajayantha
- Hon. Weerakumara Dissanayake
- Hon. Sunil Hadunnetti
- Hon. M.T. Hasan Ali
- Hon. (Prof.) Rajiva Wijesinghe
- Hon. E. Saravanapavan

The aforesaid special sub Committee conducted 14 meetings from the day it first met on 22 May 2015 and in 11 meetings out of it oral evidence was taken from 42 witnesses. The list of names of the witnesses is as follows.

The officers summoned before the sub Committee of the Seventh Parliament to get oral evidence in 2015.

Date summoned	*Name, Position and Institution*
26.05.2015	
	Dr. R.H.S.Samaratunga, Secretary to the Treasury
	Dr. M.S.D. Ranasiri, Director General, Treasury Department
29.05.2015	
	Mr. Ronald C. Perera, PC, Chairman, Bank of Ceylon (BOC)
	Mr. J.D.K. Dharmapala, Chief Dealer, Bank of Ceylon
	Mrs. U.L. Muthugala, Actg. Superintendent, Public Debt Dept., Central Bank of Sri Lanka (CBSL)
	Dr. M.Z.M. Azim, Addl. Superintendent, Public Debt Dept., CBSL
03.06.2015	
	Mr. H.A.Karunaratne, Secretary, Monetary Board and Asst. Superintendent, CBSL
	Mr. R.A. Jayatissa, Members of the Monetary Board, CBSL
	Mrs. Manohari Ramanathan, Members of the Monetary Board, CBSL
	Mr. D.M. Gunasekera, General Manager, Bank of Ceylon
	Mr. A.D.B. Talwatte, Counting Managing Partner, Earnest & Young Company Ltd
	Mr. H.M.A. Jayasinghe, Partner, Earnest & Young Company Ltd
	Mrs. Y.A. de Silva, Partner, Earnest & Young Company Ltd
	Mr. W.W.D. Pradeep L. Perera, Senior Manager, Earnest & Young Company Ltd

Mr. P.G. Tissere, Former Asst. General Manager, Bank of Ceylon

04.06.2015

Mr. Aswin de Silva, Chairman, National Savings Bank (NSB)

Mr. S.D.N. Perera, CEO/General Manager, NSB

Mr. P.A. Lionel, Head of Treasury, NSB

Mr. D.L.P. Abeysinghe, Dealer, NSB

Mrs. B.P.J. Gunasekara, Deputy General Manager/CEO, NSB Fund Management Ltd.

Mr. Nihal Jayamanne, P.C., Chairman, Seylan Bank

Mr. Somadasa Palihawadana, Chief Dealer, Seylan Bank

Mr. N. Wasantha Kumar, General Manager, People's Bank

Mr. Clive Fonseka, Head of Treasury, People's Bank

Mr. R.A.A. Jayalath, Superintendent, Employees Provident Fund

Mr. M.S.K. Dharmawardena, Addl. Superintendent, Employees Provident Fund

Mr. J.D.S.J. Nanayakkara, Deputy Superintendent, Employees Provident Fund

Mr. S.Pathumanapan, Asst. Superintendent, Employees Provident Fund

Mr. Kasun Palisena, Chief Executive Officer, Perpetual Treasuries (Pvt) Ltd

Mr. Harin Nishantha, Marketing Manager, Perpetual Treasuries (Pvt) Ltd

05.06.2015

Mr. B.D.W.A. Silva, Deputy Governor, CBSL

Mr. P. Samarasiri, Deputy Governor, CBSL

09.06.2015

Mrs. C.M.D.N.K. Seneviratne, Superintendent, Public Debt Department, CBSL

Dr. M.Z.M. Azim, Addl. Superintendent, Public Debt Dept., CBSL

10.06.2015

Mr. D.L.P. Abeysinghe, Executive Officer, Government Securities Dealing, NSB

Mr. W.M.R.B. Weerakoon, Senior Manager (Dealing), NSB Fund Management Co. Ltd.

Mr. Kavinda Mewan Gunawardena, Senior Trade Rates, HSBC

Mr. D.N.R. Siriwardena, Registrar General of Companies

11.06.2015

Mr. Ajith Nivard Cabral, Former Governor, CBSL

17.06.2015

Mr. J.K.D. Dharmapala, Former Chief Dealer, Bank of Ceylon

Mr. N.W.G.R.D. Nanayakkara, Director, Financial Sector Research, CBSL

Mrs. L.S. Fernando, Manager, Public Debt Department, CBSL

Dr. P.N. Weerasinghe, Deputy Governor, CBSL

Mr. D.N.R. Siriwardena, Registrar General of Companies

Mr. Arjun Joseph Aloysius, Director, Free Lanka Trading Co. Pvt. Ltd.

18.06.2015

Mr. Arjun Mahendran, Governor, CBSL

Mrs. M.S.M.P. Fernando, Senior Manager, Public Debt Department, CBSL

23.06.2015

Mr. Arjun Mahendran, Governor, CBSL

25.06.2015

The Committee deliberated

26.06.2015

The Committee deliberated

After that the Committee considered the drafted report prepared with the support and participation of the Auditor General and other officers after taking into consideration the evidence submitted in the 11 meetings and a number of other related documents but due to the difficulties in arriving into a consensus and dissolution of Parliament on 26.06.2015 that report couldn't be submitted.

After that the Eighth Parliament that elected on 01.09.2015 discussed this matter and agreed to conduct the investigation again by the Committee on Public Enterprises of the Eighth Parliament.

Committee on Public Enterprises of the Eighth Parliament

1. Hon. Sunil Handunnetti (Chairman)
2. Hon. Rauff Hakeem
3. Hon. Anura Priyadarshana Yapa
4. Hon. Dayasiri Jayasekara
5. Hon. Lakshman Seneviratne
6. Hon. Ravindra Samaraweera
7. Hon. Sujeewa Senasinghe *(Appointed on 7 July 2016)*
8. Hon. Wasantha Aluvihare
9. Hon. Lasantha Alagiyawanna
10. Hon. Dr. Harsha De Silva
11. Hon. Ajith P. Perera
12. Hon. Ranjan Ramanayake
13. Hon. Ashok Abeysinghe
14. Hon. Anura Dissanayake
15. Hon. Chandrasiri Gajadheera
16. Hon. Mahindananda Aluthgamage *(Appointed on 17 May 2016)*
17. Hon. Bimal Rathnayake
18. Hon. Weerakumara Dissanayake

19. Hon. Mawai S. Senadhiraja
20. Hon. Abdullah Mahruf *(Appointed on 7 April 2016)*
21. Hon. S. Sritharan
22. Hon. M.A. Sumanthiran
23. Hon. Hector Appuhamy
24. Hon. Velu Kumar *(Resigned on 05 July 2016)*
25. Hon. (Dr.) Nalinda Jayathissa
26. Hon. Prasanna Ranatunga *(Appointed on 7 April 2016 and resigned on 17 May 2016)*
27. Hon. Harshana Rajakaruna
28. Hon. Gnanamuttu Srinesan

Accordingly, it was passed in the meeting held on 06.05.2016 that the Committee on Public Enterprises should look into the Central Bank bond issue that took place in the first quarter of the year 2015 and every other matters related to it and a report should be submitted to the Parliament in this regard.

Accordingly, Auditor General studied the facts and investigated in this regard based on the advice given by the Committee and submitted a report to the Hon. Speaker on 29.06.2016 including 'sensitive' facts from the Auditor General and the report without the 'sensitive' facts was submitted to the Committee on the same day. Hon. Speaker has handed over the full report with those sensitive facts to the Committee on 23.09.2016 after having a lengthy study. The complete report is attached to this report as a separate volume.

Mr. Arjuna Mahendran, the Governor of the Central Bank during the period of controversial bond issue of Central Bank was not re- appointed to the post due to the expiration of the term of office and Dr. Indrajith Kumaraswami was appointed as the Governor of the Central Bank of Sri Lanka.

The Committee on Public Enterprises in the Eighth Parliament discussed this at length and further oral evidence were taken from 23 witnesses including the Governor of the Central Bank. The list of names of the witnesses who gave evidence before the Committee on Public Enterprises are as follows:-

Date	Name of the Officers summoned
2016-06-08	
	Mr. M. I. M. Rafeek, Secretary, Ministry of National Policies & Economic Affairs
	Mr. U. G. Rathnasiri, Additional Secretary, M/ National Policies & Economic Affairs
	Mr. S. M. Chandrapala, Chief Finance Officer, M/ National Policies & Economic Affairs
	Mr. W. M. R. Dissanayake, Chief Accountant, M/ National Policies & Economic Affairs
	Mrs. P. A. Kanthi, Chief Audit Officer, M/ National Policies & Economic Affairs
	Dr. R. H. S. Samarathunga, Seretary, Ministry of Finance
	Mr. M. S. D. Ranasiri, Director General, Ministry of Finance
	Mr. Arjun Mahendran, Governor, Central Bank of Sri Lanka (CBSL)
	Dr. P. N. Weerasinghe, Deputy Governor, CBSL
	Mr. P. Samarasiri, Deputy Governor,CBSL
	Mr. S. Lankathilake, Deputy Governor, CBSL
	Mr. T.H.B. Sarathchandra, Superintendent of Public Debt, CBSL
2016-06-29	
	The Committee deliberated.
	Discussion on the special audit report on Treasury Bonds submitted to the Committee by the Auditor General
2016-07-07	
	Dr. R. H. S. Samarathunga, Secretary to the Treasury
	Mr. M. I. M. Rafeek, Secretary, Ministry of National Policies & Economic Affairs
	Mr. U. G. Rathnasiri, Addl.Secretary, Ministry of National Policies & Economic Affairs
	Mr. S. M. Chandrapala, Chief Finance Officer, M/National Policies & Economic Affairs
	Mr. W. M. R. Dissanayake, Chief Accountant, M/National Policies & Economic Affairs
	Mrs. P. A. Kanthi, Chief Audit Officer, M/National Policies & Economic Affairs
	Mr. M. S. D. Ranasiri, Director General, M/National Policies & Economic Affairs
	Dr. Indrajith Kumaraswami, Governor, Central Bank of Sri Lanka
	Mrs.Manohari, Ramanathan, Appointed member, Monetary Board, CBSL
	Dr. P. N. Weerasinghe, Deputy Governor, CBSL-
	Mr. P. Samarasiri, Deputy Governor, CBSL
	Mr. S. Lankathilake, Deputy Governor, CBSL
	Mr. S.S. Rathnayake, Assistant Governor, CBSL
	Mr. K.D. Ranasinghe, Assistant Governor, CBSL
	Mr. R.A.A. Jayalath, Assistant Governor, CBSL
	Mr. P.W.D.N.R. Rodrigo, Director / Domestic Operations, CBSL
	Mrs. C.M.D.N.K. Senevirathne, Director / Information Technology, CBSL
	Mr. T.H.B. Sarathchandra, Superintendent of Public Debt Department, CBSL
	Mr. K.M.M. Siriwardena, Assistant Governor & Director of Economic Research, CBSL
	Mrs. U.L. Muthugala, Additional Superintendent, Public Debt Department, CBSL
	Dr. M. Z.M. Azeem, Additional Director, Statistics, CBSL:
	Mr. K. G. P. Siri Kumara, Deputy Director, Legal & Complaints, CBSL
2016-08-12	
	Dr.R.H.S. Samarathunga, Secretary to the Treasury,
	Mr. Shantha Bandara, State Secretary, Ministry of National Policies and Economic Affairs
	Mr. U.G. Rathnasiri, Additional Secretary, M/ National Policies and Economic Affairs
	Mr. S.M. Chandrapala, Chief Financial Officer, M/ National Policies and Economic Affairs

Mr. W.M.R. Dissanayake, Chief Accountant, M/National Policies and Economic Affairs
Ms. P.A. Kanthi, Chief Internal Auditor, M/ National Policies and Economic Affairs
Mr. Indrajith Coomaraswami, Governor, Central Bank of Sri Lanka
Mrs. Manohari Ramanathan, Appointed member, Monetary Board, CBSL
Mr. C.P.R. Perera, Appointed member, Monetary Board, CBSL
Dr. P.N. Weerasinghe, Deputy Governor, CBSL
Mr. P. Samarasiri, Deputy Governor, CBSL
Mr. S. Lankathilake, Deputy Governor, CBSL
Mr. C.J.P. Siriwardena, Assistant Governor, CBSL
Mr. S.S. Rathnayake, Assistant Governor, CBSL
Mr. K.D. Ranasinghe,Assistant Governor, CBSL
Mr. R.A.A. Jayalath, Assistant Governor, CBSL
Mr. K.M.M. Siriwardena, Assistant Governor & Director of Economic Research, CBSL
Mr. P.W.D.N.R. Rodrigo, Director / Domestic Operations, CBSL
Mrs. C.M.D.N.K. Senevirathne, Director / Information Technology, CBSL
Mr. N.W.G.R.D. Nanayakkara, Director / Financial Sector Research, CBSL
Mr. T.H.B. Sarathchandra, Superintendent of Public Debt, CBSL
Mrs. K.N.N.M. Bandara, Supirntendent of EPF, CBSL
Mrs. U.L Muthugala, Additional Superintendent of Public debt, CBSL
Dr. M.Z.M. Azim, Additional director/ statistics, CBSL
Mr. K.G.P. Sirikumara, Deputy Governor /Legal and contliantee, CBSL
Mr. S. Obeysekara, Senior Manager, Public Debt Department, CBSL
Mr. S. Pathumanapan, Senior Manager, Public Debt Department, CBSL
Mr. W.G.R.Harshappriya, Senior Assistant Superintendent, CBSL

2016-08-23

The Committee deliberated. To discuss about the proposed procedure to prepare the COPE report on the Central Bank Bonds.

2016-09-08

Dr. Indrajith Kumaraswami, Governor, Central Bank of Sri Lanka

2016-09-23

The Committee deliberated. To discuss about the information report prepared by the COPE.

2016-10-05

The Committee deliberated. To discuss about the information report prepared by the COPE.

2016-10-20

The Committee deliberated - to consider and approve the final Draft Report

2016-10-21

The Committee deliberated - to consider and approve the final Draft Report

2016-10-24

The Committee deliberated - to consider and approve the final Draft Report

2016-10-26

The Committee deliberated - to consider and approve the final Draft Report

Documents which were used to prepare this report and the verbatim reports containing the oral evidence elicited from the officers who were summoned before the Committee in relation to the issue concentrated to have been presented along with this report as annexures, as follows.

1. **Annexure 01** - Report incorporating the updates of the details uncovered by the Committee on Public Enterprises and to examine the accuracy of each passage of the Auditor General upto 23rd September 2016 form the issue of the Special and it report on 29th June 2016 in relation to the issue of treasury bonds by the Public Debt Department of the Central Bank of Sri Lanka from February 2015 to May 2016. (From page ……. to… page……)
2. **Annexure 02** - Report of the three Member Committee appointed by the Hon. Prime Minister to inquire into and report on the issue of Treasury bonds by the central bank.
3. **Annexure 03** - Presentation made by the Auditor General to the Committee on Public Enterprises on the issue of Treasury bonds by the central bank, on 07.05.2016. (From page ……. to… page……)
4. **Annexure 04** - Oral evidence provided by the offices of the Central Bank who were summoned for the Committee on 07th July 2016 (upto page……)
5. **Annexure 05** – Oral evidence provided by the officers of the Central Bank who were summoned before the Committee on 12th August 2016. (upto page……)
6. **Annexure 06** – Oral evidence provided by the officers of the Central Bank who were summoned before the Committee on 8th September 2016. (upto page……)
7. **Annexure 07** – Papers of the Monetary Board and the minutes of monetary Board of the Central Bank of 7th January 2008 and 07th October 2008. (upto page……)
8. **Annexure 08** – Extracts of the operational manual of the Public Debt Management Department of the Central Bank. (upto page……)
9. **Annexure 09** – Proposed future plan of action for presenting the report of the Committee on Public Enterprises on the issue of Treasure Bonds by the Central Bank in 2015 and 2015, to Parliament. (From page ……. to… page……)
10. **Annexure 10** – Comments of the Auditor General to the reply sent by the governor of the central bank to the special report of the Auditor General on the issue of Treasury Bonds by the public debt department of the Central Bank of Sri Lanka from February 2015 to May 2016. (upto page……)
11. **Annexure 11** – Questionnaire sent to the Central Bank by the Committee and the replies to it. (upto page……)
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13. **Annexure 13** – Oral evidence provided by the officers of the Central Bank who were summoned before the Committee on 08.06.2016. (upto page……)
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15. **Annexure 15** – Verbatim report of the meeting of the Committee held on 05.10.2016. (upto page……)
16. **Annexure 16** – First draft report of the Committee on Public Enterprises on the issue of Treasury Bonds by the Central Bank of Sri Lanka from February 2015 to May 2016 which was presented to the Committee on 23rd September 2016. (page……)
17. **Annexure 17** – Financial statement of the Perpetual Treasuries Company that appeared in the Sunday observer of 25th September 2016.
18. **Annexure 18** – Audit report presented by the Earnest and Young company on the involvement of the central bank for purchasing central Bank bonds on behalf of M/s Perpetual Treasuries Ltd.
19. **Annexure 19** – Verbatim report dated 20.10.2016
20. **Annexure 20** – Verbatim report dated 21.10.2016
21. **Annexure 21** – Verbatim report dated 24.10.2016
22. **Annexure 22** – Verbatim report dated 26.10.2016
23. **Annexure 23** – To get a clarification on monetary board decision of the Central Bank for 2008/basic features of the bonds appeared on the website of the Central Bank
24. **Annexure 24** – Report on bonds of 27 February 2015
25. **Annexure 25** – Evidence of Dr. Azim (Verbatim Report)

2 Report of the three member Committee appointed by the Hon. Prime Minister to inquire into the issue of Treasury Bonds – (Annexure 2)

The Hon. Prime Minister who also holds the portfolios of policy planning, Economic Affairs, Child and Youth Affairs and Cultural Affairs appointed three-member Committee headed by Mr. Gamini Pitipanam Attorney-at-Law with Mahesh Kalugampitiya and Chandimal Mendis, Attorneys-at-Law being the other two members to inquire into and report on the factor that led to the announcement of the issue of Treasury bonds worth of Rs. 1 billion by the Public Debt Department of the Central Bank and the series of events and statistics relating to that and to monitor and inquire into the financial demand of the country from 01st of January 2012 to the date of the inquiry, issue of treasury bonds, auctioning and so on. The report prepared by the said three member Committee was tabled in the House by Hon. Lakshman Kiriella on 19.05.2015 (**Annexure 2**)

The following matters had been specifically highlighted by the inquiry conducted by the aforesaid three member Committee

- The need to conduct a comprehensive audit by a proper state Authority as purchasing 50% of approved bids at this juncture is an unusual phenomenon given the bidding pattern of Perpetual Treasuries.
- The board of directors of the Bank of Ceylon should conduct a forensic audit of the activities taking place at the dealer room of the Bank of Ceylon.
- A formal mechanism to undertake proper monitoring of activities taking place among the primary dealers over functions of the public debt Department of the Central Bank should be established without delay.
- It has been observed by the Committee that documents containing sensitive information of the central bank has become public according to the views expressed by many primary dealers and a full inquiry must be conducted by a proper authority to ascertain the truth of the above proposition and to inquire into the activities of the officers of the Central Bank.

The three-member Committee headed by Attorney-at-Law Gamini Pitipana, through its report has held that there is no obstacle for the government, Parliament or any other organization working for public interest to enquire whether the country has sustained any loss owing to the above processed while pointing out the fact that it is prudent to observe the digital Foot prints of the officers of the central bank to ascertain whether the Central Bank of Sri Lanka has fulfilled the aspirations of the people of Sri Lanka with regard to fiscal control and integrity.

Based on the above facts, the three-member Committee appointed by the Hon. Prime minister and the Minister of policy planning and Economic Affairs has concluded that the full-scale supervision must be conducted by a proper State Authority on the bond issue of the Central Bank of Sri Lanka.

3 Introducing the process of issuing of treasury bonds by the Central Bank of Sri Lanka.

The Central Bank of Sri Lanka established with the main objective of maintaining the economic and prices stability is govern by the governor of the Central Bank who is also the head of the monetary board of the Central Bank. (see Annex vii of **Annexure 1** - page 67) in terms of section 19 (1) of the Finance Act, the governor of Central Bank is also the chief executive officer of the Central Bank of Sri Lanka.

The Central Bank of Sri Lanka bears the responsibility of issuing treasury Securities known as treasury bills and treasury Bonds in order to meet the financial requirement of the country for the coming months on the installation of the treasury operations Department of Central Bank (see Annex ix of **Annexure 1** - page 69).

Treasury Bonds are two types; Treasury bonds that mature within a period of less than a year and Treasury Bonds that mature after a year. The face value of a bond is Rs 100/=.

The Central Bank raises money for the government and in that Exercise Act as a representative of the government in terms of section 106(1) of finance Act. (See Annex x of Annexure 1 - page 70)

By the end of 2015, 16 qualified institutions had been registered to purchase these Securities while one institution had withdrawn in 2016. (See Annex vi of Annexure 1 - page 65).

These includes both government and private institutions.

They are known as Primary Dealers further employees Provident fund too has been permitted to purchase treasury Bonds in the primary Market.

3.1 Methods employed by Central Bank of Sri Lanka for issuing bonds

Central Bank of Sri Lanka has employed two methods up to 27 February 2015 for the issue of treasury bonds.

3.1.1 First method (Auction Method)

Calling quotations from the aforesaid registered primary dealers through a public notice on the issue of treasury bonds and meeting the fund requirements through the auctioning of bonds accordingly.

3.1.2 Second method (Direct Method/ Private Placements)

The second method is the direct issue of securities to primary dealers which is also known as private issue. Under the second method, opportunity is afforded to primary dealers to purchase bonds on the weighted average yield rate declared by the Public Debt Department of Central Bank.

The weighted average yield rate is calculated using two methods. One of them is to afford the opportunity to primary dealers to purchase bonds on the basis of yield rates fixed for bonds with a similar maturity period at the auction conducted during the immediately preceding period. The second is to recalculate the yield rates on the basis of bond yield rates with similar maturity period in the secondary market.

The direct issue method is open on every working day except for the day of the auction and the primary dealers willing to purchase bonds could apply to purchase bonds available for sale at yield rates predetermined by the Public Debt Department. The process adopted by the Public Debt Department in the issue of treasury bonds is set out in the **Operations Manual of the Public Debt Department**.

3.2 Issue of bonds and the impact of Interest rate on financial market

Treasury bonds with varying maturity periods are issued at coupon rates/interest rates. The government makes interest payments biannually as per the face value of the bonds thus issued *(See Annex xi of* ***Annexure 1 -*** *page 71)*. At bond auctions, bids are submitted by dealers at different prices based on interest rates declared by the Central Bank. Such bids are submitted at premium value, i.e. a price above the face value, par value, i.e. a price equal to the face value and discount value, i.e. a price lower than the face value. If the dealers applied for premium value, the interest rate too takes a higher value. Accordingly, when there is a yield rate above the interest rate, bonds are issued at a discount value lower than the face value and when the interest rate and the yield rate are similar, bonds are issued at face value and when the interest rate and the yield rate is below the interest rate, bonds are issued at a price lower than the face value. Accordingly, by issuing bonds at a yield rate lower than the interest rate, a premium price is received and the government gains an additional financial benefit. Conversely, the government is in for a financial loss by issuing bonds at a yield rate above the interest rate, i.e. discount rate. By issuing bonds at a yield rate equal to the interest rate, the government does not incur any financial loss or gain.

Hon. (Dr.) Harsha De Silva, Hon Ajith P. Perera, Hon. Ashok Abeysinghe, Hon. Sujeewa Senasinghe, Hon. Hector Appuhamy, Hon. Wasantha Aluvihare and Hon. Harshana Rajakaruna stated that they were not in agreement with paragraph 3.2 and instead agreed upon the following amendment to the paragraph.

They stated that they could not concur with the assertion that "by issuing bonds at discount rate that the Government incur a financial loss".

In general, the statement to the effect that the government incurs a loss on all occasions through the issue of bond at a discount price cannot be agreed upon. The reason for this is that a bond of less than one year is a bill (a Treasury Bill) can never be sold at face value. If an interest or coupon is attached to a bond with more than one year maturity, it can only be sold at a face value of Rupees One Hundred only on one occasion, i.e. only if the interest received for a bond is equal to the interest received for it during the same period of time in the secondary market. If there are previously issued unsold bonds in the market similar to this bond and if the yield rate that such bonds receive in the secondary market is higher than these bonds, the bond can only be sold at a discount. Whether the face value is above or below hundred is determined by the interest rate relevant to this bond and the yield rate for similar bonds in the market.

4. Policies, action and legal background adhered to by the Central Bank in respect of issuing treasury bonds

4.1 Documents on which the Central Bank base its policy whether to issue bonds through auction method or direct method

The Central Bank has first issued bonds in the year 1997.

The Auditor General’s report on the issue of treasury bonds in 2015-2016 points out that as per board paper MB/PD/05/18/97 (See Annex xii of **Annexure 1** – Page 72) of the monetary board of the Central Bank a decision has been taken to issue treasury bonds to primary dealers through auctions from March 1997 and to use the Employees’ Provident Fund when sufficient capital is not available in the market or when there is an unlimited increase in the interest rate.

4.1.1 The report of the Auditor General further notes that through monetary Board Paper No MB/PD/1/26/2008 (07.01.2008) (**Annexure 07**), it has been decided in the year 2008 to meet the funding requirements through the direct method[1] and subsequently through the Monetary Board Paper No. MB/PD/25/20/2008 (07.10.2008) (**Annexure 07**) it has been recommended to establish market liquidity by issuing bonds with interest rates 0.05 percent higher than the prevailing interest rates in the secondary market to the Employees' Provident Fund. [2]

4.1.2 The Committee queried the Central Bank officials as to how the term 'Other Captive Sources' came to be included in the decision of the Monetary Board Paper No. MB/PD/25/20/2008 (07.10.2008) and it was pointed out that it was decided that not only the Employees' Provident Fund but other sources (Other Captive Sources) which could be utilized to meet the funding requirements of the country during the relevant period too should be taken into account. [3]

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[1] For a period of 3 months

[2] It has been mentioned in the Monetary Board Paper No. MB/PD/01/26/2008 that *"The Monetary Board Approval is sought for the proposed rate structure to be used for direct placements of treasury bonds and rupee loans in respect of captive investors such as EPF, NSB, and ETF during January – April 2008."*

It has been mentioned in the Monetary Board Paper No. MB/PD/11/16/2008 of 02.05.2008 that *"The Monetary Board Approval is sought for the proposed rate structure to be used for direct placements of treasury bonds in respect of captive type large investors such as EPF, NSB, and ETF during May to December 2008."*

The letter faxed by the Director of the Public Debt Department to the Committee held on 24th October 2016 has shown that the approval of the monetary board for the interest rates paid to issue treasury bonds for the captive sources as mentioned above has been given only for the period of May to December 2008. That letter has further shown that the time has not extended after December 2008.

(Annexure 23 - The letter dated 24th October 2016 signed by a Superintendent of the Domestic Debt Management Department.)

[3] It has been stated that *"Except for the EPF, all other captive sources need to come to the auction through a primary dealer"* and it is not stated the primary dealers have the permission for their transactions through direct placements.

4.2 The use of the Operations Manual of Public Debt Department of the Central Bank in respect of the implementation of the policy decisions for the issue of bonds by the Central bank of Sri Lanka [4]

The officials of the Central Bank pointed out that this manual is studied by the Operations Manual of Public Debt Department of the Central Bank in the implementation of policy decisions in respect of the issue of treasury bonds and added that it was last updated on 31 July 2013. [5] The officials of the Central Bank further noted that this operations manual was either revised or updated after having conveyed the policy decisions relevant to the activities of the Central Bank approved by the Monetary Board of the Central Bank to the Department of Public Debt Management.

The relevant extracts of the operations manual applied in connection with the policy decision to decide whether to adopt the direct method or the auction method in issuing bonds by the Central Bank is attached hereto as **Annexure 08**.

However, upon a query made by the Committee, the officials of the Central Bank admitted that the operations manual had hitherto not been updated as per the Monetary Board paper dated 07 October 2008. However, the Governor of the Central Bank, in response to a question posed by the Committee, stated that he was of the opinion that the said decision of the Monetary Board was covered by the applicable sections of the Operations Manual.

The officials of the Central Bank of Sri Lanka were questioned by the Committee about the manner in which the Direct Placement method and the Auction method in issuing bonds given in B(i) on page 8 of this manual and it was pointed out by the officials of the Central Bank that “as much as possible through auctions” therein decided the volume of bonds to be issued through the auction method and that it was decided based on cost and risk. Further clarifying the point, the officials of the Central Bank mentioned that cost and risk were determined as per the guideline mentioned in Medium Term Debt Management Strategy of the borrowing programme of the Department of Public Debt Management of the Central Bank. It was further pointed out by the officials of the Central Bank that despite the mentioning of:

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[4] The procedure with regard to the issuing of bonds in the page 8 under B1 of the Operations Manual of the Local Debt Management Department.

“Front Office has to make arrangements to meet financing needs as much as possible through auctions. The balance fund requirements of the government as indicated in the approved Borrowing program may be arranged through private placements with PDs.” There was no evidence that the approval of the Monetary Board was given to that.

[5] It was observed that it has not been timely updated accordingly.

a. Auctions

b. Private Placements

c. Rupee Loans

as methods of financing on page 3 of the Operations Manual of Public Debt Department, there was no order specifying the adoption of auction method firstly, private placements secondly and rupee loans thirdly to be followed.

Further, citing *"The front office of the PDD is mainly responsible for mobilizing required funds for the government at the lowest possible cost with a reasonable degree of risk through implementation of domestic borrowing programme approved by the Monetary Board",* it was pointed out by those officials that the fund requirement of the government had to be financed at the minimum cost. It was also pointed out that the fund requirement had to be financed without causing any disadvantage to the government and the process of the Central Bank. [6]

[6] As per the methodology adopted by the Monetary Board and as it is mentioned in the Operational Manual a major portion of the requirement of the funds shall be fulfilled through Auction System whereas the rest shall be obtained through Private Placement System. However, the Auditor General mentions that Private Placement System has been considered as the correct system according to the facts available at that time and it seems that Private Placement System has been cited as the accepted system in the report submitted by Auditor General to this inquiry.

As per Monetary Board Papers Nos. MB/PD/01/26/2008 and MB/PD/11/16/2008, Private Placement System is allowed for a period of 12 months in an emergency (initially for 4 months and thereafter for 8 months). These two Monetary Board Papers have given permission thus protecting the rights of EPF, ETF, NSB owners and also considering the inflation. It had been specifically mentioned that Direct Placements (Captive Sources) shall be given to the Government or the institutions like EPF, ETF, NSB which are coming under the purview of the government. It is not clearly mentioned in any document whether permission has been granted to provide the aforesaid private placements to primary dealers.

Therefore, whether opportunity has been provided to private dealers during the period from 2008 up to 2015, has to be examined.

4.3 Analysis of manner in which the fund requirement of the government was met by issuing bonds from January 2014 to May 2016

An analysis of the manner in which the fund requirement of the government was met by issuing bonds using the auction method and the direct placement method from January 2014 up to May 2016 is presented by the Auditor General in relation to Central Bank bonds 2015-2016 as follows.

Year and Month	*Method of issuing bonds and value*			*As a percentage of value issued*	
	Auction	*Direct Placement*	*Total*	*Auction*	*Direct Placement*
	Rs. Billion	*Rs. Billion*	*Rs. Billion*	*%*	*%*
January 2014	5.500	32.718	38.218	14	86
February 2014	3.050	80.088	83.138	4	96
March 2014	5.000	130.117	135.117	4	96
April 2014	-	120.373	120.373	0	100
May 2014	5.950	62.745	68.695	9	91
June 2014	-	126.210	126.210	0	100
July 2014	5.300	109.483	114.783	5	95
August 2014	-	44.230	44.230	0	100
September 2014	2.950	72.458	75.408	4	96
October 2014	-	22.617	22.617	0	100
November 2014	-	13.788	13.788	0	100
December 2014	4.000	18.148	22.148	18	82
January 2015	-	69.923	69.923	0	100
February 2015	10.058	23.524	33.582	30	70
March 2015	171.659	14.144	185.803	92	8
April 2015	44.306	-	44.306	100	0
May2015	35.730	-	35.730	100	0
June 2015	82.900	-	82.900	100	0
July 2015	99.575	-	99.575	100	0
August 2015	100.578	-	100.578	100	0
September 2015	57.576	-	57.576	100	0
October 2015	55.811	-	55.811	100	0
November 2015	20.594	-	20.594	100	0
December 2015	29.545	-	29.545	100	0
January 2016	61.119	-	61.119	100	0
February 2016	38.959	-	38.959	100	0
March 2016	135.667	-	135.667	100	0
April 2016	30.440	-	30.440	100	0
May2016	114.335	-	114.335	100	0

According to the above table it is observed that months in which only the direct placement method was used, months in which only the auction method was used and months in which both these methods were used had existed within the 15 month period from January 2014 up to April 2015 when the decision to temporarily suspend the direct placement method was fully implemented. However, it is further observed that more than 80% of the total volume of bonds issued within that 15 month period had been issued using the direct placement method.

4.4 Provisions in the Monetary Law Act in relation to the issue of securities by Central Bank

When inquiries were made by the Committee in this regard, it was pointed out by the Secretary to the Ministry of Finance and the officials of the Central Bank that the power to take decisions regarding the issue of bonds is vested with the Monetary Board of the Central Bank of Sri Lanka as per the provisions of the Monetary Law Act (Annex vii of **Annexure 1**) and that the Monetary Board acted on the financial policy of the government proposed by the incumbent government and the minister of Finance.

It was informed that when the financial policy proposed to be followed in the country was communicated, the Monetary Board acted to meet the fund requirement of the country following the most correct and appropriate method based on that. In the course of extensive questioning by the Committee, it was pointed by the Central Bank officials that the financial policy could be communicated to the Monetary Board in writing or verbally and it was pointed out that in any case, the power to grant the final approval in relation to the financial policy presented by the government was vested with the Monetary Board of the Central Bank.

It was revealed to the Committee that no decision had been taken by the Monetary Board regarding the transaction in question but only informing the Monetary Board on 2nd March 2016 of the decision that had been implemented earlier had been done.

4.5 Monetary board of the Central Bank

As per section 8.1 of Monetary Law Act the governor of the Central Bank shall be the chairman of the Monetary Board and then Monetary Board is comprised of the Secretary to the Ministry of Finance and three members appointed by the President upon the recommendation of the Minister of Finance with the concurrence of the Constitutional Council.

As per the provisions of the Monetary Law Act, the financial policy of the country is communicated to the Monetary Board of the Central Bank by the Secretary to the Ministry of Finance, who is also a member of the Monetary Board. The Committee discussed at length the manner in which the policy of the government related to the methodology adopted in issuing Central Bank Bonds was communicated to the Monetary Board of Sri Lanka due to the fact that Central Bank was under the purview of the Ministry Policy Making, Economic Affairs Child and Youth Affairs and Culture coming under the Prime Minister and not under the purview of the Ministry of Finance during the period of time which is relevant to the disputed bond issue.

4.6 Intervention of the Ministry of Finance into the process of fulfilling the Monetary requirement of the country by way of issuing securities by the Central Bank of Sri Lanka.

4.6.1 Cash Flow Committee

The Cash Flow Committee meets under the Chairmanship of the Secretary to the Treasury and the Secretary to the Ministry of Finance pointed out to the Committee that all Deputy Secretaries, Heads of all departments of the Treasury, a few officers of the Treasury Operations Department and a few persons, who transact with the Central Bank and have knowledge on this subject, participate in the meetings of the aforesaid Committee. The Secretary to the Ministry of Finance further pointed out that the government's income and expenditure within a moth is discussed in the meeting of this Committee and plans are made to obtain the outstanding amount between the income and expenditure from the Treasury, subject to the existing debt limits.

4.6.2 The Committee inquired whether any follow up review is carried out by the Ministry of Finance in regard to the manner in which the Central Bank makes borrowings to fulfill the monetary requirement of the country. The Secretary to the Ministry of Finance pointed out that such a follow up review is not necessary and, if a need arise, it could only be carried out under the provisions of Monetary Law Act related to the issue of bonds. He also pointed out that attention has been paid by now to carry out a follow up review in that regard based on the recommendations given by the Auditor General in connection with the disputed bond issue. [7]

[7] Even though it has been mentioned as per the Operations Manual of the Monetary Board that funds should be raised as much as possible through the auction method and the balance should be raised through the private placement method, it has been pointed out that the private placement method has been considered as the correct method as mentioned in the Auditor General's report and that submissions have been made by the Auditor General's report taking the private placement method as the accepted order.

5 Issue of bonds on 27th February 2015

5.1.1. The Domestic Debt Management Committee and its Functions.

This Committee is comprised of 5 members including a representative of the Ministry of Finance and the responsibility of this Committee is to maintain the borrowings expected to be made from the domestic money market, the expenditure and the risk at a minimal level and make necessary recommendations for it.

5.1.2. Recommendation of the Public Debt Management Committee for fulfilling the monetary requirement of the Country in March 2015.

The report prepared by the Auditor General with regard to the issue of Central Bank Bonds for the period 2015-2016 points out that the total monetary requirement of the government in March 2015, which should be fulfilled by way of issuing Treasury Bills and Bonds was 261.683 billion rupees and the Public Debt Management Committee which met on 27th February 2015 had decided and recommended to obtain 89.683 billion rupees out of the aforesaid amount from Treasury Bills and to obtain 172 billion rupees from the said amount from Treasury Bonds whereas 1 billion rupees form the aforesaid 172 billion rupees would be obtained through primary auction of Treasury Bonds and the remains amount would be obtained through the direct method.

Accordingly, bids were called through advertisements published in the internet and in public newspapers on 25th and 26th February 2015 respectively to issue to the 16 primary dealers treasury bonds worth 1 billion rupees at an interest rate of 12.5%, which will mature in a period of 30 years. (The reports of the bids placed in that repaired it given in Annex xxiii in **Annexure I**) [8]

[8] 5.1.1.1 Tender Board of the Central Bank and its duties

The Front Office prepares reports to be submitted to the Tender Board after all auctions of Treasury Bills and Treasury Bonds, and the Tender Board determines how much of Bonds to be purchased with least cost and risk.

5.2 Behavior of the Market during the Period Imminent to Issue of Bonds on 27th February 2015.

A general yield rate of 9.48% existed for 30 year bonds in the secondary market during the week prior to the date on which these bonds were issued. (See Annex xx of **Annexure I** – page 108) [9]

5.3 The manner in which Central Bank Bonds were issued on 27th February 2015 can be explained as follows as per the oral evidence given by the officials of the Central Bank before Committee on Public Enterprises in regard to the aforesaid issue of Bonds. [Extract – Oral Evidence] [10]

- The fact that the former Governor of the Central Bank arrived at the Public Debt Management Department at about 10.45 a.m. on that day and inquired of the information such as the demand received from the auction.

[9] It became obvious that this rate of interest of 9.48% was not a rate that was determined independently in the market based on the rate of interest decided upon by the Central Bank through direct method.

[10] In the morning of 27 February 2015, the Market Operations Committee had reduced the 3 day rule restriction that had been in effect up to that time, i.e. the rate of interest that should be paid if a bank parked funds in the Central Bank more than on three days a month, from 6.5% to 5%. This reduction was scrapped through this decision and it was brought back to the normal rate of 6.5%.

- The fact that though the auction of bonds should have ended at 11.00 a.m. on this day, but the auction was extended up to 11.05 a.m. upon a request from a primary dealer. [11], [12]

[11] It is noticed that only one applicant had submitted bids after 11.00 a.m. and this bid is Rs.100 million, and that the applicant that had submitted bids at 11.04.26 was HSBC.

[12] It is stated in the evidence that, on a day prior to the auction in question, the officials of the Central Bank had telephoned the primary dealers about the auction and had enquired about their willingness to purchase about Rs.10 billion. It has been stated that the representative of Perpetual Treasuries, too, had received that telephone call. Further, the officials of the Central Bank have confirmed it, too.

- Perpetual Treasuries had instructed the Bank of Ceylon through e-mail at 10.48 a.m. on 27 February 2015 to bid at the auction Rs.3.0 billion at 12.5%, Rs.5.0 billion at 12.75% and Rs.5.0 billion at 13% to invest 2015. Those bids from the Bank of Ceylon had been received by the Central Bank at 10.57.22, 10.57.41 and 10.57.57 respectively. It had been noted in the record which indicates the bid times. HSBC had submitted bids at 11.06 a.m.

- The fact that a report was prepared to submit to the Tender Committee, the recommendation to the effect that bonds worth 2.6 billion rupees should be issued, which was included in the report prepared by the front office of the Public Debt Management Department with 07 optional methods after considering the demand for bonds in the aforesaid auction.

- The fact that the former Governor of the Central Bank arrived at the Public Debt Bank arrived at the Public Debt Management Department along with two Deputy Governors [13] at about 12.30 p.m. and inquired of the information related to the auction of bonds. [14]

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[13] Dr. Nandalal Weerasinghe and Mr. Ananda Silva

[14] It is stated in the original draft report (fact report) like this. The former Governor of the Central Bank along with two Deputy Governors, Dr. Nandalal Weerasinghe and Ananda Silva, came in to the Public Debt Management Department again around 12.30 p.m. and in quired about the Bond auction.

It was revealed that the tender board was represented by the Chairman of the tender board Deputy Governor Mr. P. Samarasiri, Assistant Superintendent of the Public Debt Department Mr. S.S.Adikari, Assistant Governor of the Economic Research Department Mr. C.P.A. Karunatilake, Superintendent of the Public Debt Department Mrs. C.M.D.N.K. Seneviratne, Director of the Economic Research Department Mrs. Gunarathne and two other superintendents on that day.It was also revealed that the Governor of the Central Bank is not a member of the tender board.

Chairman of the Tender Board Mr. P. Samarasiri stated that the decision to raise Rs. 01 billion to Rs. 10 billion was a collective decision taken by the above mentioned officers on professional judgment.

However, the evidence given by Mrs. Seneviratne, the Superintendent of the Public Debt Department requires special consideration. The Committee pointed out that Mrs. Seneviratne stated that the Governor never ordered her to “do it” but only inquired as to why she did not go for 10. (Why don’t you go for ten). The Report of the Auditor General too has not stated any other thing than the question the Governor is said to have asked her (Why don’t you go for ten).

Mrs. Senevirathna stated that she seeks the forgiveness for the fact that she was unable to state that in the previous Committee meetings.

Further, Dr. A.Z.M Azeem (Deputy Debt Superintendent) also stated that the decision, concerned was also a Committee decision.

“According to the evidence that was given by Dr. Azeem, it is clear that, prior to the date of 27th February 2015, the higher management of the Central bank had been negotiating on shifting towards auction system, deviating from direct placement. The suggestion that was made in the negotiation was to resort to Full scale public auctions .This fact had been discussed on the day before the auction and Dr Azeem and the others had been informed that a decision will have to be taken in that regard .Dr Azeem , giving evidence ,further stated that since bids were placed for a 20 times higher amount than that of the advertised amount of Rs.1 Billion, it had been an ideal opportunity to raise funds by way of the public auction”. Therefore, the decision was taken to purchase the entire extent, amounting to Rs. 10 Billion, by way of the public auction on that day. (see Annexure 25)

The evidence revealed the fact that aforesaid decision had been communicated to Governor of the Central Bank by the Tender Committee.

- The fact that the former Governor examined at this moment the list which included the bids placed by primary dealers.
- The fact that the former Governor pointed to the place in which 20 billion was mentioned in the list and asked why 20 billion rupees itself would not been obtained.
- The fact that the former Governor suggested to the officials to obtain 20 billion rupees itself when the officials informed that a demand up to 20 billion rupees had been received.

  (The Superintendent of Public Debt Management Department stated in the meeting of the Committee held on 12.08.2016 that the former Governor of the Central Bank came to the Public Debt Management Department and ordered her to obtain the aforesaid amount by saying the words “Do it” However on an earlier occasion she has mentioned in giving evidence the former Governor submitted a suggestion with the words “why don’t you go for ten?”)
- The fact that the officials pointed out to the former Governor the adverse effects which may be created in the financial market if the amount of 20 billion rupees is obtained.
- The fact that the former Governor at this juncture inquired of the weighted ratio of the 30 year bonds issued in September 2014.
- The fact that officials mentioned that the aforesaid rate was 11.75 and then the former Governor inquired why action is not taken based on that financial market ratio.
- The fact that the former Governor later on pointed with his hand to the place in which 10 billion rupees was mentioned in the aforesaid list and gave instructions to the officials to obtain 10 billion rupees.
- The fact that a separate report was prepared by the Debt Management Department to obtain 10 billion rupees as per the instructions given by the former Governor.
- That the Superintendent of the Public Debt Management Department placed a note to obtain 10 billion rupees upon the instruction given by the former

Governor and informed it to the front office. *("Governor instructed to place price up to Rs. 10 billion taking into consideration of additional fund requirements of the Government")* [15]

- That the aforesaid recommendation of 10 billion rupees was brought to the Tender Committee and the Superintendent of the Public Debt Management Department Stated to the officials of the Tender Committee that the former Governor instructed to obtain 10 billion rupees.

(Tender Board of the Central Bank)

(The function of the Tender Board of the Central Bank is to take decisions in regard to the implementation of the recommendations submitted by the Public Debt Management Department for issuing bonds. The members of the Tender Committee as at 27th February 2015 were Mr. P. Samarasiri, Deputy Governor of the Central Bank (chairman), Mr. S.S. Adikari, Assistant Superintendent of Public Debt Department, Mr. C.P.A. Karunathilaka, Assistant Governor of Economic Research Department, Mrs. C.M.D.N.K. Seneviratne, Superintendent of Public Debt Department, Mrs. Gunaratne, Director of Economic Research Department and two other additional Superintendents).

- The fact that the Chairmen of the Tender Committee inquired from the former Governor over the phone of the reason for giving instructions to obtain 10 billion rupees.
- The fact that the former Governor pointed out two reasons for it.
    1. That the government requires a huge amount of funds.
    2. That it was pointed out that the Special Standing Deposit Facility Rate which was at 5% would be amended and lifted next week and that the interest rate would then be increased. (that the interest rate would go to the same level as it was at the issuance of bonds in the month of September, 2014

(However, it was pointed out by the Committee, quoting item number two of Monetary board paper dated 23rd February 2015 that a decision has been taken by the Central Bank monetary board which met on 23rd February, prior to the issuance of bonds on 27th of February, to maintain the interest rates as they were until the Monetary Board meets next month.)

<u>- Item No.02 of the Board Paper dated 23 February 2015 -</u>

"Given the rising trend of the market interest rates and rising growth of private sector credit and decided to maintain the policy interest rates at current level until the next month's monetary policy review"

[15] For further fund requirements

(It was observed that a decision has been taken by the former governor of Central Bank to change the interest rates in spite of the fact that such a decision had been taken by the Central Bank Monetary Board)

- That the former Governor has attended the Market Operation Committee in the morning of 27th February and that he has advised to increase the Special Standing Deposit Facility Rate which was at 5% up to 6.5% and that the governor is not a member of the said Committee.
- That a circular has been issued on the same day by the Market Operation Committee and enlightened the financial market on the aforesaid interest rate.
- That the former Governor of the Central Bank granted the relevant approval on February 27th itself
- That the decision taken to change the aforesaid interest rates was implemented only with effect from 03rd March.
- That the aforesaid decision taken by the former Governor of the Central Bank [16] was subjected to ratification at the Monetary Board which was held on 06th March 2015. [17]

[16] With Dr. Nandalal Weerasinghe, Chairman of the Market Operation Committee

[17] Decision taken at the Market Operation Committee

5.4 Table prepared as per the Bid Acceptance Information Sheet for Central Bank bonds on 27th February 2015 -

(Dealer)	Face value of Bonds (Rs.)	Amount received at the auction (Rs.)	Weighted Average Yield Rate (WAYR)
Bank of Ceylon	8,000,000	9,546,736	9.3510
Acuity Securities Ltd	50,000,000	56,005,000	9.9063
First Capital Treasuries Ltd.	100,000,000	110,954,800	10.0278
Bank of Ceylon	500,000,000	546,966,000	10.1970
Entrust Securities PLC	50,000,000	52,253,650	10.2339
NSB Fund Management Company Ltd.	100,000,000	104,507,300	10.2959
EPF	500,000,000	522,536,500	10.4652
Total	1,308,000,000	1,402,769,986	

It is pointed out by the Auditor General's report that the Treasury Bonds Tender Committee which met on 27.02.2015 has decided to accept bids up to a value of 10.058 billion Rupees which is more than ten times of the amount in spite of the fact that it has been recommended only to purchase bonds with a value of Rs. 1 billion from the primary Auction by the Domestic Debt Management Committee (Refer annex xxiv of **Annexure 1** - page 112). Although it was expected to earn Rs.10.058 billion by issuing 30 year treasury bonds to 14 dealers who had submitted bids as per a Weighted yield rate from 9.3510 to 11.7270 at the auction held on that day, it had only been possible to earn Rs.9.658 billion as a result of issuing them at a discount rate (Refer annex xxv of **Annexure 1** - page 114). The Auditor General's report further points out as another important factor which was disclosed here that the amount of Rs.0.371 billion (Rs. 10.058 billion – Rs. 9.687 billion) which could not be obtained as above had to be recovered from some other short term source.

5.5 Placement of bids by Perpetual Treasuries Company at the issuance of bonds held on 27th February 2015

It is explicit from the above table that other than the 07 primary dealers stated above, there had been no opportunity for other dealers including Perpetual Treasuries who had offered bids for an amount of 75% out of all the bid offerings at a value of Rs.20.708 billion to purchase bids, had the above mentioned primary auction been limited to Rs.1 billion. The auditor general's report points out that as a result of deciding to increase the expected amount of Rs.1 billion up to 10.058 billion the

Perpetual Treasuries company which was not even among the seven primary dealers stated above got the opportunity to purchase 50% of the total bond value i.e. Rs.5 billion and also that here, the said company had made arrangements in such a way to obtain 2 billion out of 5 billion directly and to get 3 billion indirectly through BOC which is another primary dealer. *(Refer annex xxv of Annexure 1 - page 114)*

5.6 Behavior of Bank of Ceylon at the auction of bonds in the financial market on 27th February 2015 –

BOC has offered 03 bids at the rates of 12.50%,12.75% and 13% up to 13 billion on behalf of Perpetual Treasuries company on request made by the said company at the auction of bonds which took place on this date. It was disclosed at the investigations conducted by the Committee that this has been the first instance where one primary dealer has offered bids for central bank bonds on behalf of another primary dealer.

The chairman of BOC made submissions to the Committee that the investigation pertaining to this transaction was entrusted to Earnest and Young Company since he was not aware of this transaction and that he was not satisfied with the written submission made when the Chief dealer related to the central bank bonds transaction section of BOC who was mainly behind this transaction when inquired in this regard.

Accordingly, the report presented by Earnest and Young Company having investigated the contribution of BOC in this particular transaction has been presented as **Annexure 18** of this report.

5.7 Performance of Tender Committee at the auction of bonds on 27th February 2015.

Bonds with a value of only 1 billion rupees was recommended to be issued at the primary auction by the Domestic Debt Management Committee.[18] However, the Treasury Bond Tender Committee number 2/2015 which was held from 12.30 to 13.10 after conducting the auction on 27th February 2015 has decided to accept bids with a value of Rs.10.058 billion which is more than ten times the aforesaid amount. (Annexure xxiv in **Annexure 01**). The most important factor which was observed here was that the above decision has been taken only after the auction. This is completely an exclusion from the decision which has been earlier taken by the Domestic Debt Management Committee to obtain Rs.12.550 billion through direct placements as mentioned in above paragraph 5.1.3.

[18] The decision of the Debt Committee on this day was to obtain Rs. 1 billion from the auction and to acquire the balance 172 billion out of direct placements.

The most important contradiction which was observed here was the decision taken by the Tender Committee to obtain Rs.10.058 billion after the termination of the auction having called Rs.1 billion out of it. Further, the decision which was previously taken to obtain Rs. 1 billion out of the auction and the balance through direct placements was confirmed by the Debt Department.

6. An analysis on three alternative methods through which bonds could have been issued on 27th February 2015 and the estimated advantages and disadvantages of those alternatives are presented through the special audit report of the Auditor General on the Central bank bond issue of 2015-2016 [19]

6.1. Estimated loss if the bond issue had been limited to Rs.1 billion

(i) Rs. 1,403 million could have been obtained had bonds been issued only up to a bid value of Rs.104.5073 per bond If the bond issue of 27th February 2015 had been limited to Rs.01 billion as expected, as per the amount of bids placed covering the aforesaid value.

[19] In considering this question, the evidence given under oath by Dr. Azim is very important. (see footnotes No.14)

For not limiting the issue of bonds to the said value, there was an estimated loss of Rs. 889,358,050/-for the government. [20], [21]

Dealers	*Bidding price* Rs.	*Face value of bond (Government liability)* Rs.	*Accumulative value to be paid* Rs.	*Loss* Rs.
EPF	**104.507**	**500,000,000.00**	**1,402,769,986.00**	**-**
Entrust Securities PLC	103.116	50,000,000.00	1,454,327,886.00	695,750.00
Peoples Bank	102.207	100,000,000.00	1,556,535,086.00	2,300,100.00
NSB Fund Management Co. Ltd	102.207	100,000,000.00	1,658,742,286.00	2,300,100.00
EPF	102.207	1,000,000,000.00	2,680,814,286.00	23,001,000.00
Natwealth Securities Ltd	102.207	50,000,000.00	2,731,917,786.00	1,150,150.00
NSB Fund Management Co. Ltd	101.758	100,000,000.00	2,833,675,786.00	2,749,300.00
Natwealth Securities Ltd	99.999	50,000,000.00	2,883,675,286.00	2,254,150.00
Employee Provident Fund	99.999	500,000,000.00	3,383,670,286.00	22,541,500.00
Perpetual Tresuries Ltd	97.878	250,000,000.00	3,628,365,286.00	16,573,250.00

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[20] This loss has been calculated only within an environment of using direct placement method as a correct procedure. But this calculation has been done within the context that direct placement is used as the correct system. But checking of all the documents and the Manual revealed that after 1997 when the bonds have been introduced auction has been introduced as a rule and direct placements can be used as an exception. Further when the direct placement is used Monetary Board should do it through a special board paper. But after 2008 we did not get any evidence of such an approval by the Monetary Board. In those board papers of the Monetary Board it has been mentioned clearly that government funds should be used for that. Further certain conditions have been included in those board papers to protect those funds. According to the Monetary Board Paper dated 07 January 2008 no. MB/PD/01/26/2008 they have mentioned five possible implications of using direct placement. Therefore, it is very clear that direct placement is an exception that can be used with the approval of the Monetary Board during an unstable situation in the country or when it is essential. When the loss is calculated it is not correct to come into the hypothesis that the direct placement can be or should be used. It is not correct to consider the direct placement as a base to calculate the loss.

[21] The Committee at that time did not agree to this principle of calculating. If this bond auction had been limited to Rs. 1 billion, the loss incurred to the government would have been a hypothetical loss calculated on the original calculation done by the Auditor General. The reason for this is the increase of the total market interest rate by 1 1/2 as a result of changing the 3 day rule in the morning of 27th February 2015. We have not included that incident in to this hypothesis. Therefore, it not actually possible to state the interest rate payable for obtaining this amount through the direct method. (It had been disclosed that only Rs. 3 billion could be obtained through the direct method on the preceding days in the week of the auction.)

Perpetual Tresuries Ltd	95.8394	250,000,000.00	3,867,963,786.00	21,669,750.00
Seylan Bank PLC	95.8074	1,250,000,000.00	5,065,556,286.00	108,748,750.00
Wealth Trust Securities Ltd	93.879	50,000,000.00	5,112,495,786.00	5,314,150.00
Perpetual Tresuries Ltd	93.879	500,000,000.00	5,581,890,786.00	53,141,500.00
Perpetual Tresuries Ltd	91.9928	1,000,000,000.00	6,501,818,786.00	125,145,000.00
Wealth Trust Securities Ltd	90.177	50,000,000.00	6,546,907,286.00	7,165,150.00
The Hongkong and Shanghai Banking Corporation Ltd	90.177	100,000,000.00	6,637,084,286.00	14,330,300.00
Pan Asia Banking Corporation PLC	90.177	250,000,000.00	6,862,526,786.00	35,825,750.00
Capital Alliance Ltd	90.1769	100,000,000.00	6,952,703,686.00	14,330,400.00
Bank of Ceylon	90.1699	3,000,000,000.00	9,657,800,686.00	430,122,000.00
Total				**889,358,050.00**

6.2 Loss incurred as a result of exceeding Rs. 2.608 billion recommended by the Public Debt Management Committee of the Central Bank of Sri Lanka

There was a possibility to issue bonds worth Rs. 2,608 million (so that bid value of a bond would be Rs. 102.20720) as recommended in the option sheet furnished to the Tender Board by the Public Debt Department. Issuing bonds up to the value of Rs. 10.058 billion instead of doing so, has an estimated loss of Rs. 688,538,600 as calculated in the table below: [22]

Dealer	Bid Price Rs.	Face Value of Bond (Government Liability) Rs.	Cumulative Payable Value Rs.	Loss Rs.
Natwealth Securities Ltd	**102.21**	**50,000,000.00**	**2,731,917,786.00**	**-**
NSB Fund Management Co. Ltd	101.76	100,000,000.00	2,833,675,786.00	449,000.00
Natwealth Securities Ltd	100.00	50,000,000.00	2,883,675,286.00	1,104,000.00
Employee Provident Fund	100.00	500,000,000.00	3,383,670,286.00	11,040,000.00
Perpetual Tresuries Ltd	97.88	250,000,000.00	3,628,365,286.00	10,822,500.00
Perpetual Tresuries Ltd	95.84	250,000,000.00	3,867,963,786.00	15,919,000.00
Seylan Bank PLC	95.81	1,250,000,000.00	5,065,556,286.00	79,995,000.00
Wealth Trust Securities Ltd	93.88	50,000,000.00	5,112,495,786.00	4,164,000.00
Perpetual Tresuries Ltd	93.88	500,000,000.00	5,581,890,786.00	41,640,000.00
Perpetual Tresuries Ltd	91.99	1,000,000,000.00	6,501,818,786.00	102,142,000.00
Wealth Trust Securities Ltd	90.18	50,000,000.00	6,546,907,286.00	6,015,000.00
The Hongkong and Shanghai Banking Corporation Ltd	90.18	100,000,000.00	6,637,084,286.00	12,030,000.00
Pan Asia Banking Corporation PLC	90.18	250,000,000.00	6,862,526,786.00	30,075,000.00
Capital Alliance Ltd	90.18	100,000,000.00	6,952,703,686.00	12,030,100.00
Bank of Ceylon	90.17	3,000,000,000.00	9,657,800,686.00	361,113,000.00
Total				**688,538,600.00**

[22] If this bond auction had been limited to Rs.26 billion, the loss incurred to the government would have been a hypothetical loss calculated on the original calculation done by the Auditor General. Facts mentioned in footnotes 20 and 21 are also relevant to the calculation made above.

6.3 Estimated Loss in the event the suggestion by the Governor of the Central Bank to obtain Rs.20 billion had been executed

If bonds worth Rs.20 billion had been issued as suggested by the Governor of the Central Bank, instead of limiting the issuance to Rs.1 billion, the government would have to incur a loss of Rs. 2,730,059,050 as calculated in the table given below: [23]

[23] This is only a hypothetical assumption as Rs.20 billion was not obtained

Dealer	Bid Price Rs.	Face Value of Bond (Government Liability) Rs.	Cumulative Payable Value Rs.	Loss Rs.
Employee Provident Fund	**104.5073**	**500,000,000**	**1,402,769,986**	**-**
Entrust Securities PLC	103.1158	50,000,000	1,454,327,886	695,750
People's Bank	102.2072	100,000,000	1,556,535,086	2,300,100
NSB Fund Management Co. Ltd	102.2072	100,000,000	1,658,742,286	2,300,100
Employee Provident Fund	102.2072	1,000,000,000	2,680,814,286	23,001,000
Natwealth Securities Ltd	102.207	50,000,000	2,731,917,786	1,150,150
NSB Fund Management Co. Ltd	101.758	100,000,000	2,833,675,786	2,749,300
Natwealth Securities Ltd	99.999	50,000,000	2,883,675,286	2,254,150
Employee Provident Fund	99.999	500,000,000	3,383,670,286	22,541,500
Perpetual Tresuries Ltd	97.878	250,000,000	3,628,365,286	16,573,250
Perpetual Tresuries Ltd	95.8394	250,000,000	3,867,963,786	21,669,750
Seylan Bank PLC	95.8074	1,250,000,000	5,065,556,286	108,748,750
Wealth Trust Securities Ltd	93.879	50,000,000	5,112,495,786	5,314,150
Perpetual Tresuries Ltd	93.879	500,000,000	5,581,890,786	53,141,500
Perpetual Tresuries Ltd	91.9928	1,000,000,000	6,501,818,786	125,145,000
Wealth Trust Securities Ltd	90.177	50,000,000	6,546,907,286	7,165,150
The Hongkong and Shanghai Banking Corporation Ltd	90.177	100,000,000	6,637,084,286	14,330,300
Pan Asia Banking Corporation PLC	90.177	250,000,000	6,862,526,786	35,825,750
Capital Alliance Ltd	90.1769	100,000,000	6,952,703,686	14,330,400
Bank of Ceylon	90.1699	3,000,000,000	9,657,800,686	430,122,000
Pan Asia Banking Corporation PLC	88.428	150,000,000	9,790,442,686	24,118,950
Bank of Ceylon	88.4074	5,000,000,000	14,210,812,686	804,995,000
Bank of Ceylon	86.769	5,000,000,000	18,549,262,686	886,915,000
Commercial Bank of Ceylon PLC	86.7428	50,000,000	18,592,634,086	8,882,250
Pan Asia Banking Corporation PLC	86.7425	100,000,000	18,679,376,586	17,764,800
Acuity Securities Ltd	86.74	100,000,000	18,766,116,586	17,767,300
Commercial Bank of Ceylon PLC	86.0851	50,000,000	18,809,159,136	9,211,100
Union Bank of Colombo PLC	76.4803	50,000,000	18,847,399,286	14,013,500
Union Bank of Colombo PLC	74.2125	50,000,000	18,884,505,536	15,147,400
Seylan Bank PLC	62.6216	100,000,000	18,947,127,136	41,885,700
Total				**2,730,059,050**

Estimated losses given above are merely the immediate losses that the government would have to incur by the given date. But the Report of the Auditor General point out that if long term effects of such action were taken into consideration, the above loss alternatives would increase further.

7. Rejecting the 2 bond auctions held on 10th and 24th March 2016

Report of the Auditor General points out that the two bond auctions held on 10th and 24th March 2016 were rejected citing that bids that were offered contained rates higher than the expected yield rates (*Annex xxxi* of Annexure 1)

8. Issuing of bonds by the Central Bank on 29th March 2016

Report of the Auditor General points out that bids had been called for issuing 04 bonds of Rs. 10 billion each with different maturity periods, i.e., bonds worth Rs. 40 billion on 29 March 2016.

8.1 Report of the Auditor General points out following facts regarding the purchasing of bonds up to 35% to 44% by Perpetual Treasuries in the aforementioned deal

At this point, bids had been called up to the limit of Rs.40 billion and based on the bids received, additional bonds worth Rs. 37.732 (face value), i.e., bonds with a total face value of Rs. 77.732 had been issued. 60% of the bonds issued in addition to the value of the bids that were called initially, were acquired by Perpetual Treasuries. Aforementioned institution had acquired only 0.5% of the initial bond issue under the lowest yield rates but was successful in acquiring 35% to 44% of the bonds issued under higher yield rates. In other words, they have obtained a greater volume of bonds when the commissions increased. [24], [25]

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[24] There was no evidence placed before this Committee that the former Governor of the Central Bank Mr. Arjun Mahendran or Dr. Nandalal Weerasinghe and Mr. Ananda Silva, Deputy governors were consulted or have interfered with when the auction relating to this transaction was held or when the decision taken by the Tender Board. This has to be given special consideration.

[25] As observed by the Committee, in this bond issue more low interest rate bonds and less high interest rates bonds should have been purchased by the government. But there are no facts revealing such information. Therefore, this Committee observes that a detailed investigation is required about the bond issue on that day.

The ground for rejecting the two auctions held prior to this particular auction was higher yield rates which is a commonality observed in this auction as well. Yet, in this instance, bonds had been issued at yield rates as high has 14.0742.

Although a decision had been made to issue bonds to gain a face value of Rs.77.73 billion through the issuing of 4 bonds, only Rs. 59.325 billion could be sourced from this auction. Balance Rs. 18.407 had to be sourced from other short term credit sources. It was revealed that such action had to be taken due to the disadvantageous effect of the aforesaid decision.

Report of the Auditor General points out that issuing bonds exceeding the anticipated value by a large margin, i.e., accepting bids up to Rs. 10.058 billion at the bond auction held on 27 February 2015 to source Rs. 1 billion and accepting bids up to Rs. 77.73 billion at the bond auction held on 29 March 2016 after calling for bids to source obtain Rs. 40 billion has provided Perpetual Treasuries Ltd with the opportunity to acquire the share that exceeded the initially anticipated value.

It was also observed that rejection of bids submitted by Perpetual Treasuries was at a lower rate when compared with the number of occasions where bids submitted Ltd by primary dealers had been rejected and the number of occasions where tenders submitted by other primary dealers had been rejected.

Whether the fact that profits after tax for the years 2014/2015 and 2015/2016 of Perpetual Treasuries Ltd being as massive as Rs.0.959 billion and Rs.5.124 billion respectively while the stated capital for the said years had been Rs.310.3 million according to the audited financial statements of Perpetual Treasuries Ltd that had been given in the advertisement published by that Company in the Sunday Observer of 25 September 2016 (**Annexeure 17**) had resulted from what has been pointed out in the aforesaid audit observations cannot be disregarded.

The market behaviour of Perpetual Treasuries Ltd as per 27/02/2015 in the financial market has been described in the report of the Auditor General as follows:

(i). Receiving from Perpetual Treasuries Ltd bids amounting to Rs.13.60 billion out of the total bid value of Rs.20.708 billion immediately before the auction ended, i.e., during the last 08 minutes before the auction ended.

(ii). Submitting bids amounting to Rs.13.00 billion on behalf of Perpetual Treasuries within the aforesaid amount of Rs.13.60 billion.

(iii). Accepting bids up to Rs.10.058 billion while bids for a value of Rs.1.00 billion had been invited.

(iv). Bank of Ceylon had submitted bids for bonds for a value of Rs.13 billion on behalf of Perpetual Treasuries and it had been the first time that a primary dealer had submitted bids on behalf of another primary dealer.

(v). While bids had been invited for Rs.1.0 billion, Perpetual Treasuries had submitted bids for a total of Rs. 15.0 billion by way of Rs. 2.0 billion directly and Rs.13.0 billion through Bank of Ceylon and it is unusual that bids had been submitted for a value that is 15 times greater than the value of bids that had been invited. [26]

[26] M/s Perpetual Treasuries Ltd has obtained this large profit through selling these Bonds in the Secondary Market which bonds they obtained at the primary market. It should be specially investigated that whether these bonds were purchased from the M/s Perpetual Treasuries Ltd. By the funds like EPF that belongs to the government, and to find out the reasons for them to so engage in such a transaction. Further the ability of the EPF to purchase bonds in the primary market and the reason to purchase bonds in the secondary market at a higher price should be investigated.

8.2 The estimated loss of Rs. 784,898,755 that has been caused by the issue of bonds on 29 March 2016 as pointed out by the Auditor General .

Instead of the nominal value of Rs.40 billion that had been expected through the issue of these bonds, up to Rs.77.732 billion had been accepted. However, it has been pointed through the report of the Auditor General that the estimated loss of Rs. 784,898,755/- which has been calculated in the table given below, could have been prevented if the issue of bonds had been limited to its face value of Rs.40 billion without doing as described above. [27]

Dealer	Bid Price Rs.	Face Value of the Bond (Government Liability) Rs.	Cumulative Payable Value Rs.	Loss Rs.
	84.3512	800,000,000	**8,733,875,000**	-
Total				**-**
People's Bank	**75.57580**	**120,000,000**	7,886,053,130	**-**
Natwealth Securities Ltd	75.4451	100,000,000	7,961,498,230	130,700
People's Bank	75.4451	120,000,000	8,052,032,350	156,840
People's Bank	75.3147	120,000,000	8,142,409,990	313,320
Perpetual Treasuries Ltd	75.2279	50,000,000	8,180,023,940	173,950
People's Bank	75.2279	160,000,000	8,300,388,580	556,640
Perpetual Treasuries Ltd	75.2279	200,000,000	8,450,844,380	695,800
People's Bank	75.1845	120,000,000	8,541,065,780	469,560
People's Bank	75.0547	120,000,000	8,631,131,420	625,320
People's Bank	74.9253	120,000,000	8,721,041,780	780,600
Seylan Bank PLC	74.8393	100,000,000	8,795,881,080	736,500
Perpetual Treasuries Ltd	74.7961	50,000,000	8,833,279,130	389,850
Perpetual Treasuries Ltd	74.7961	100,000,000	8,908,075,230	779,700
Wealth Trust Securities Ltd	74.7961	100,000,000	8,982,871,330	779,700
People's Bank	74.7961	120,000,000	9,072,626,650	935,640
Perpetual Treasuries Ltd	74.7961	250,000,000	9,259,616,900	1,949,250
Seylan Bank PLC	74.7959	160,000,000	9,379,290,340	1,247,840
Capital Alliance Ltd	74.7959	200,000,000	9,528,882,140	1,559,800
Perpetual Treasuries Ltd	74.3678	50,000,000	9,566,066,040	604,000
People's Bank	74.3678	200,000,000	9,714,801,640	2,416,000
Perpetual Treasuries Ltd	74.3678	250,000,000	9,900,721,140	3,020,000

[27] The Auditor General has submitted information about 25 purchases from the bond market from January 2014 to May 2016 and this Committee has not taken any evidence on 23 auctions out of those 25 auctions. Further no detailed evidence has been taken about the bonds on 29.03.2016. A detailed investigation has been conducted only on the bond issue that took place on 27 February 2015. Not making an inquiry on the other 23 auctions has made it difficult to take a correct decision in this investigation. Therefore, in a future investigation a detailed investigation should be conducted on all the bond issues and the use of auctions and direct placements. Especially a forensic auditing is essential when such investigations are conducted. The facts in foot note 20 and 21 are also relevant here.

Perpetual Treasuries Ltd	73.943	50,000,000	9,937,692,640	816,400
Perpetual Treasuries Ltd	73.943	500,000,000	10,307,407,640	8,164,000
Bank of Ceylon	73.9345	250,000,000	10,492,243,890	4,103,250
Capital Alliance Ltd	73.732	100,000,000	10,565,975,890	1,843,800
Wealth Trust Securities Ltd	73.7319	100,000,000	10,639,707,790	1,843,900
Perpetual Treasuries Ltd	73.5216	50,000,000	10,676,468,590	1,027,100
People’s Bank	73.5216	250,000,000	10,860,272,590	5,135,500
Perpetual Treasuries Ltd	73.5216	750,000,000	11,411,684,590	15,406,500
Perpetual Treasuries Ltd	73.1036	50,000,000	11,448,236,390	1,236,100
Seylan Bank PLC	73.1036	180,000,000	11,579,822,870	4,449,960
Perpetual Treasuries Ltd	73.1036	750,000,000	12,128,099,870	18,541,500
Seylan Bank PLC	72.6891	100,000,000	12,200,788,970	2,886,700
Capital Alliance Ltd	72.6891	100,000,000	12,273,478,070	2,886,700
Wealth Trust Securities Ltd	72.68902	100,000,000	12,346,167,090	2,886,780
Perpetual Treasuries Ltd	72.689	50,000,000	12,382,511,590	1,443,400
First Capital Treasuries Ltd	72.689	100,000,000	12,455,200,590	2,886,800
Perpetual Treasuries Ltd	72.689	750,000,000	13,000,368,090	21,651,000
Bank of Ceylon	72.656	180,000,000	13,131,148,890	5,255,640
Perpetual Treasuries Ltd	72.483	2,000,000,000	14,580,808,890	61,856,000
Seylan Bank PLC	72.2778	100,000,000	14,653,086,690	3,298,000
Perpetual Treasuries Ltd	72.2777	50,000,000	14,689,225,540	1,649,050
People’s Bank	72.2777	160,000,000	14,804,869,860	5,276,960
Perpetual Treasuries Ltd	72.2777	2,000,000,000	16,250,423,860	65,962,000
Total				**258,828,050**
Capital Alliance Ltd	**75.91150**	**200,000,000**	8,012,848,545.00	
People’s Bank	75.821	60,000,000	8,058,341,145	54,300
People’s Bank	75.6858	60,000,000	8,103,752,625	135,420
Perpetual Treasuries Ltd	75.6858	500,000,000	8,482,181,625	1,128,500
Perpetual Treasuries Ltd	75.2376	750,000,000	9,046,463,625	5,054,250
Perpetual Treasuries Ltd	74.7933	100,000,000	9,121,256,925	1,118,200
Capital Alliance Ltd	74.7933	200,000,000	9,270,843,525	2,236,400
Perpetual Treasuries Ltd	74.7933	750,000,000	9,831,793,275	8,386,500
Perpetual Treasuries Ltd	74.134	500,000,000	10,202,463,275	8,887,500
Perpetual Treasuries Ltd	74.0904	500,000,000	10,572,915,275	9,105,500
Perpetual Treasuries Ltd	74.0468	500,000,000	10,943,149,275	9,323,500
Perpetual Treasuries Ltd	74.0032	500,000,000	11,313,165,275	9,541,500
Perpetual Treasuries Ltd	73.9597	500,000,000	11,682,963,775	9,759,000
Perpetual Treasuries Ltd	73.9162	2,000,000,000	13,161,287,775	39,906,000
Total				**104,636,570**
Perpetual Tresuries Ltd	**73.71470**	**1,000,000,000.00**	8,185,426,680.00	**-**
Seylan Bank PLC	73.7146	50,000,000	8,222,283,980	50
Wealth Trust Securities Ltd	73.4701	100,000,000	8,295,754,080	244,600
Perpetual Treasuries Ltd	73.2268	25,000,000	8,314,060,780	121,975
Wealth Trust Securities Ltd	73.2268	50,000,000	8,350,674,180	243,950
Wealth Trust Securities Ltd	73.2268	100,000,000	8,423,900,980	487,900
Perpetual Treasuries Ltd	73.2268	1,000,000,000	9,156,168,980	4,879,000
Seylan Bank PLC	73.2267	20,000,000	9,170,814,320	97,600
Capital Alliance Ltd	72.9849	100,000,000	9,243,799,220	729,800

Wealth Trust Securities Ltd	72.9848	150,000,000	9,353,276,420	1,094,850
Wealth Trust Securities Ltd	72.9848	500,000,000	9,718,200,420	3,649,500
Wealth Trust Securities Ltd	72.9848	600,000,000	10,156,109,220	4,379,400
Perpetual Treasuries Ltd	72.7441	25,000,000	10,174,295,245	242,650
People's Bank	72.7441	40,000,000	10,203,392,885	388,240
Wealth Trust Securities Ltd	72.7441	100,000,000	10,276,136,985	970,600
Perpetual Treasuries Ltd	72.7441	1,000,000,000	11,003,577,985	9,706,000
NSB Fund Management Co. Ltd	72.744	10,000,000	11,010,852,385	97,070
NSB Fund Management Co. Ltd	72.2665	10,000,000	11,018,079,035	144,820
Perpetual Treasuries Ltd	72.2665	25,000,000	11,036,145,660	362,050
Seylan Bank PLC	72.2665	40,000,000	11,065,052,260	579,280
Wealth Trust Securities Ltd	72.2665	100,000,000	11,137,318,760	1,448,200
Perpetual Treasuries Ltd	72.2665	1,000,000,000	11,859,983,760	14,482,000
Wealth Trust Securities Ltd	72.0296	250,000,000	12,040,057,760	4,212,750
NSB Fund Management Co. Ltd	71.794	10,000,000	12,047,237,160	192,070
People's Bank	71.794	60,000,000	12,090,313,560	1,152,420
Seylan Bank PLC	71.794	100,000,000	12,162,107,560	1,920,700
Capital Alliance Ltd	71.794	100,000,000	12,233,901,560	1,920,700
Wealth Trust Securities Ltd	71.794	550,000,000	12,628,768,560	10,563,850
Wealth Trust Securities Ltd	71.794	550,000,000	13,023,635,560	10,563,850
Seylan Bank PLC	71.3266	60,000,000	13,066,431,520	1,432,860
Wealth Trust Securities Ltd	71.3265	100,000,000	13,137,758,020	2,388,200
Perpetual Treasuries Ltd	71.0946	1,000,000,000	13,848,704,020	26,201,000
Perpetual Treasuries Ltd	71.0484	1,000,000,000	14,559,188,020	26,663,000
Perpetual Treasuries Ltd	71.0022	1,000,000,000	15,269,210,020	27,125,000
Perpetual Treasuries Ltd	70.9561	1,000,000,000	15,978,771,020	27,586,000
Perpetual Treasuries Ltd	70.9561	1,000,000,000	16,688,332,020	27,586,000
People's Bank	70.864	80,000,000	16,745,023,220	2,280,560
Wealth Trust Securities Ltd	70.86395	100,000,000	16,815,887,170	2,850,750
Wealth Trust Securities Ltd	70.63451	500,000,000	17,169,059,720	15,400,950
Wealth Trust Securities Ltd	70.63451	500,000,000	17,522,232,270	15,400,950
Capital Alliance Ltd	70.6345	100,000,000	17,592,866,770	3,080,200
Seylan Bank PLC	70.4065	15,000,000	17,603,427,745	496,230
Seylan Bank PLC	70.4065	80,000,000	17,659,752,945	2,646,560
Pan Asia Banking Corporation PLC	70.4063	5,000,000,000	21,180,067,945	165,420,000
Total				**421,434,135**
Grand Total				**784,898,755**

[28]

9. The Committee took into consideration the following facts that are contained in the report of the Auditor General about the impact on the money market of this country

[28] However, if this auction was limited Rs.40 billion, the loss to the government shall be only a hypothetical loss calculated according to the initial calculations of the Auditor General. Matters submitted under footnotes 20 and 21 are relevant in this occasion too.

and the advantages and disadvantages that resulted from issuing of bonds by the Central Bank during 2015 – 2016.

9.1 The financial loss caused to the Employees' Provident Fund

Another significant fact about the issue of these bonds is that the Employees' Provident Fund, which is a body that functions under the supervision of the Central Bank and which has the capacity to purchase bonds from the primary auction, had purchased a comparatively lower amount of bonds from the primary market which has a greater yield and had missed the opportunity of gaining the financial benefits due to the purchasing from the secondary market with a lower yield. [29]

It has also been pointed out through the report of the Auditor General that it is questionable as to why they had purchased bonds from the secondary market even without applying for purchasing directly from the primary market the remaining amount of bonds they had needed.

Auditor General's report points out the fact that it is questionable that the Central Bank has not drawn its attention towards this conduct of the Employees Provident Fund which is an institution, coming under the Monetary Board of central bank.

9.2. Disappointments with regard to purchasing of Central bank bond by foreign investors.

In its investigations that were conducted by the Committee, it was revealed that bonds of 30 year maturity were scheduled for 27th February 2015, and although the Monetary Board of central bank had expected that the foreign investors would come forward to purchase long term bonds, there had not been such thing.

9.3 The impact on financial market due to the determination of a higher interest rates

The secondary market General yield ratio of the previous week which was the foundation in determining a stabilized interest rates, to the date of 27th February

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[29] During the period of last six years, a situation of utilizing the funds of EPF for obtaining unnecessary advantages for the primary dealers has been observed. It can be seen that the said situation further continues. Therefore, special provisions have to be formulated on investing the funds available in the EPF in a more productive manner. Further, funds which are available with the EPF are the funds saved by the workers of this country on behalf of their future as per the law of the country. There is a requirement to formulate more productive methodologies of investing such funds also further legal provisions regarding the security of those funds. It is the view of the Committee that several members leveled allegations against the occurrence of this process in the same manner in the share market from 2010 to 2013 and that it should be subjected to inspection.

2015, was 9.48. [30] In such circumstances, a stabilized interest rate of 12.5% had been declared for the respective auction. And also, two days prior to the auction, before 25th of 2015, the secondary market General Yield ratio of previous week was only 10.03. Accordingly, it was not revealed of the manner in which the stabilized interest rate of 12.5 % was determined for the auction on 27th February 2015.And also it is determined that the additional cost that has to be borne by the government for a long term like 30 years for higher interest rates, is also should be taken as a loss for the government. An important fact that was observed here was the tendency of the government to become a subject of losses even with a trivial increase of the interest rate of the 30 year, long term bonds.

9.4 Primary Dealers' capability of having profitable grounds in Money market, by reason of shifting in to auction system [31]

Auditor General's report is extensive in pointing out the fact that, the government has to incur an additional cost as the General Yield Ratio takes a higher value since primary market transactions has been shifted to Auction system .The Auditor General's report observes that the primary dealers are able to sell bonds in the secondary market with a higher profit margin as the secondary market value of the bonds, is in a higher price though the bonds have been sold to the primary dealers, with a discounted value and a profitable ground which could have been gained for the government is shifted to the primary dealers. [32]

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[30] It has been stated by the officers of the Central Bank to the Auditor General that it was for a survey that an interest rate of 12.5% was indicated as a formula in the notice published on 25.12.2015 on the aforesaid auction and further on 25.02.2015, on which the aforesaid newspaper notice was published, the yield rate for 30 year bonds by the Central bank was 10.14%. It should be subjected to special attention.

[31] on the argument put forward by the Auditor general on the view of the Committee that …..

[32] However, as detailed in it, it is observed by the Committee that the auction is the practice as per the accepted procedure of law indicated in Section B1 of the Handbook.

9.5 Successful outcome from the Government institutions had been weakened by reason of shifting in to auction system in bond issues.

Auditor General's report observes that with the changes of the system from 27th February 2015, the state institutions, which are the primary dealers such as the Employees Provident Fund, National Savings Bank Fund Management Company, Peoples bank, and Bank of Ceylon in Treasury Bond Issuances, had become weak in achieving successful outcomes.

9.6 Refusal of Bond auctions in the context of determining Higher interest rates

The auditor general's report points out that there had been 5 occasions in which the bond auctions were completely refused during the time 2015- 2016 may, due to biding for higher interest rates and there had been a tendency that the primary dealers biding even higher values, exceeding the value that was expected by the Central bank.

10. Recommendations of the Special audit report, on Central bank bond issue 2015-2016, compiled by Auditor General

(i) In entering in to policy decisions, changing existing systems and introducing new systems, respective decisions should be taken, taking the long term and short term impact on the objectives of the Central Bank and positive or negative impact on the country, in to consideration and evidence should be maintained, enabling them to be produced, when and where it is necessary.

(ii) in the context that the Central bank doesn't possess sufficient data to Monitor the secondary market, maintaining all data by central bank, in order to prevent the failure of successful manipulation and the monitoring of the financial market.

(iii) maintaining the data with regard to the ownership and the manner of the transaction up to the point of the maturity of the bonds issued by the central bank and until they are submitted to get money.

(iv) as the confidence on a central bank of a country rests upon the integrity of the decisions that are taken by the officials, and since aforesaid confidence should be maintained locally and internationally, working in a manner that is transparent, under certain limitations, enabling the demonstration of the integrity of the decisions with the ability to convince in time.

(v) taking measures by the Higher management of the Central bank to act in good faith with proper revelations, if there are conflicts of interests within the central bank officials who can influence the Management decisions of the Central Bank of Sri Lanka and the institutions related, though there could be various interpretations and exceptions, with regard to the legal grounds and Accounting standards, not confining in to them.

(vi) As most of the decisions of the Central bank have a long-term impact on entire economy of the country and it is very much important to scrutinize those decisions by the independent parties as to whether such decisions are taken on correct grounds in taking such important, complex and sensitive decisions, for the reason that the public will have to face the positive or negative outcomes of those decisions. Accordingly, section 45 of the Monetary law act should be amended in a proper way, restricting the use of confidentiality provisions that obstructs the furnishing of information to the institutions that are vested with power to investigate whether such complex decisions have simply been taken, instantly without formal evaluation and it has brought about unfavorable results.

(vii) a request was made from the governor of central bank, in writing, asking to highlight the confidential and sensitive information which was among the information that was provided by the Central bank of Sri Lanka and (see Annexure xxxiv of annexure 1) all the information that was provided as the reply (Annexure iii of Annexure 1) has to be considered as confidential. Therefore, it has to be mentioned that state audit has taken measures not to include such information which was identified, as it is, in the report and such information will be submitted to Hon, speaker of the parliament.

(viii) A proper methodology should be introduced, by the guidelines, to monitor the inter transactions within the primary dealers that are taking place in respect of bonds.

(ix) in respect of the bond auctions, the extension of the closing date and the time of the public auctions, in certain situations, had been approved and such extensions should be confined in to the facts that are unavoidable and justifiable.

(x) Although the employees Provident fund is not a registered primary dealer, it has been permitted to purchase bonds from the primary market as in the case of primary deals. However, it has been observed that there is a tendency of Employees Provident fund, purchasing bonds in secondary market from other primary dealers, as an alternative to purchasing bonds from the primary market. Making, the employees provident fund that comes under the supervision of Central bank of Sri Lanka presently, a primary dealer who can work independently, free from the supervision of central bank.

(xi) Presently, central bank obtains the requirement of the coming month from the treasury and extending it at least up to 3 months.

(xii) As mentioned above, the treasury to pre-determine the manner in which the requirement can be collected.

(xiii) Monitoring primary dealers adequately by central bank. Recently by reason of the bankruptcy of one primary dealer, the government as well as the other investors who dealt with him also had been inconvenienced. Requirement of having an adequate supervision on their financial capabilities and behaviors, to avoid such situations.

(xiv) the secretary to the treasury was asked to highlight the confidential documents which were among the information that was provided to the Auditor general by Central bank of Sri Lanka .A deputy secretary to the treasury, in reply, had informed that the functions of the treasury in respect of the issuance of treasury bonds, is confined to inform the central bank of the loan requirement of the government on monthly basis, within the limits that are permitted by the annual budget .However the fact that the function of the treasury as a major institution with which the supervision of the central bank is entrusted with, cannot be agreed upon in the auditing process .

10.1 the conclusions of the special audit report, on the Central Bank bond issue 2015-2016, compiled by Auditor General.

(i) it is concluded that the authorities are responsible for not avoiding Rs. 1,674,256,805 of total estimated loss which could have been avoided in two bond auctions which were held on 27th February 2015 and on 29th March 2016; namely the estimated loss of Rs. 889, 358,050 that was pointed out in Auditor General's report which could have been avoided and the estimated loss of Rs. 784,898, 755 that was mentioned in paragraph 5.2.3 of that could be avoided.

further, it is concluded that if the estimated loss or profit is calculated even in relation to the bond issues that had taken place from 27th February 2015 to May 2016, during the period in which the decision to suspend the issue of bonds by direct placements was taken, it cannot neglect the fact that the tendency of escalating aforesaid estimated loss, further.

(ii) According to the facts that was revealed with the Auditor general in compiling this report and facts reveled by aforesaid paragraphs, it is concluded that the Governor of the Central Bank had not observed professional due care, up to the level that is expected from a governor of a central bank in performing his task.

(iii) It is emphasized that Auditor general has performed his task within the powers and within the subject area he is entitled to, in compiling this report. Since no investigations were carried out to see whether there are criminal or illegal activities that are not coming within the purview of the Auditor General and if it is felt that there should be such an investigation, it is concluded that it is suitable to seek the assistance of the specialized institutions, in that regard. [33]

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[33] The Committee observes the following with regard to the aforesaid conclusions: It has been explained in the report of the Auditor General that the scope of the Department of the Auditor General with regard to this audit had been limited as follows:

3. Limitation of the scope (As contained in the report of the Auditor General which includes the updates made to his special audit report as per the information disclosed by him) It is emphasized that my scope had been subjected to the following limitations when arriving at conclusions through the observations that have been highlighted in this report:

3.1 Although it had been mentioned that action should be taken in accordance with the practices given in a certain Operations Manual of the Central Bank with regard to the process in question, the fact that it had been reported to me that the said Operations Manual was not an overall manual that had been approved by the Monetary Board of the Central Bank or by some other body with proper authority.

3.2 That there was a considerable time gap between the dates on which the said happenings had taken place and the date on which the Auditor General was assigned with the task of carrying out an examination into the process in question.

3.3 Lack of sufficient time to get the assistance of experts in finance and economics who possess a wide, subjective knowledge on the process in question and obtaining such assistance being problematic due to the problem of confidentiality stated in the first paragraph of this report.

3.4 Even though such experts referred to in paragraph 3.3 are available at the Central bank, the fact that it had been problematic as to whether their services could be obtained in an impartial manner.

3.5 Lack of authority for the Auditor General to directly obtain from or to get confirmed from the said third party the information regarding the secondary market that is crucial with regard to the relevant issue.

3.6 Having no capability of disclosing whether the Central Bank had the capacity to quantitatively influence the primary dealers that have been referred to in this report.

3.7 Having no capability of disclosing whether the primary dealers themselves or the Governor of the Central Bank and Primary dealers had the capacity to quantitatively influence one another.

3.8 As the telephone conversations that had taken place between the officials of the Central Bank and primary dealers had not been recorded, having no possibility of examining such conversations.

3.9 Not physically examining the recordings of live proceedings of the affairs related to the auction that took place on 27 February 2015.

3.10 Despite that a written request had been submitted to the Governor of the Central Bank requesting that the confidential and sensitive information available among the information that was provided by the Central Bank for the purpose of preparing the report be identified correctly, all the information that had been provided had to be considered confidential as per the reply given by the Governor, and therefore having restrictions in reporting information.

- The Auditor General has arrived at the aforesaid conclusions i, ii and iii due to constraints of the scope, other weaknesses in the process related to issuing of bonds, non performance of a forensic audit and on the basis of the principle that the accepted rule for the issuance of bonds is to adopt the auction method while direct placement method is the exception to the rule but this is assumption made as a result of the unavailability of all required documents at the time of preparation of the aforesaid report. Furthermore, Superintendent of the Public Debt Department of the Central Bank was called before the Committee on Public Accounts during the investigation in order to clarify matters which came up during the discussion on the Draft report. It appears that the Auditor General did not have access to information contained in letters dated 21-10-2016 and 24-10-2016. These are the latest information. These two letters too must be included in this report as annexes. Accordingly, it is evident that the Auditor General has arrived at aforementioned conclusions i, ii, and iii subject to constraints faced by the Auditor General regarding the bonds in question and the non provision of accurate information by the Central Bank while the aforesaid report was being prepared by the Auditor General. While this is not an accusation leveled against the Auditor General, it is the view of the Committee that the Auditor General did not have required facts at the initial stage to arrive at an accurate conclusion based on factual information.
- It is appropriate to quote the fact mentioned in the letter dated 21-10-2016 and the facts mentioned in the letter dated 24-10-2016 in its original form in the report. Accordingly, it is clear that direct placement process mentioned in the Manual has not been extended by the Central Bank after the end of 2008. It is the view of the Committee that bonds issued on direct placement basis after the end of 2008, i.e., 2009-2014 years have been issued outside the law. It is essential that a formal investigation is carried out regarding the effects of the aforesaid illegal issuing of bonds on the country.
- Therefore the Committee is of the view that the conclusion of the Auditor General is against the due facts, the relevant legal conditions and the evidence submitted before the Committee.
- Furthermore the Committee opines that if a due audit is conducted in the future in regard to the bond issued during the period from the year 2008 up to 2016, a correct conclusion can be reached in regard to the impact by it to the country.
- It is important to provide the necessary power to the Auditor General to reach a comprehensive conclusion is regard to private firms which are related to the financial activities of the government. Especially the Auditor General shall be given full Authority to look in to the transactions of primary dealers and the institutions which operate in the secondary market. The Committee bears the opinion that it is opportune to formulate new laws in that regard.
- Similarly another important point to be noted in regard to this bond issue is that not only one officer but also all the officers connected to this process should be held responsible for it individually or collectively. The Deputy Debt Superintendent

Mr. A.Z.M. Azim has mentioned in his evidence that the aforesaid loss has been caused by a singular decision of one individual.

- The evidence revealed in the investigation has created doubts about the extent to which the persons who know the confidential facts with regard to the bond trade within the Central Bank keep that information as confidential. Not only the primary dealers who have connections to the bond auction but also other external persons were aware of the facts related to the incidents that took place on 27.02.2015 and an employee of the Central Bank has made a request for bonds that cost Rs 7.5 laks and according to the conversations he has had with the other employees in the Central Bank revealed that information that is considered to be confidential has been spread among many people. Special investigation should be conducted to find out the officers who released such information and whether each of those officers were responsible for that. To find out that information the digital foot prints of the officers of the Central Bank should be checked. That step should be taken to ensure the credibility of the Central Bank with regard to the issuing of treasury bonds in the future and with regard to the incident that occurred in the past.
- Private dealers have earned profits due to the leaking out of inside information. There is reasonable doubt that the Perpetual Treasuries received such information.
- The observation of the Committee is that the Primary dealers, certain officials of the Central bank, the Employees Provident fund, and certain officials of the banks including Bank of Ceylon, have engaged in malpractices, working as a rogue ring in order to earn undue profits within the bond issuing process. Unless the measures to prevent this situation are taken immediately, the country experiencing losses, is unavoidable, no matter the bond process is carried out by way of direct placement or auction system. Accordingly, once the measures are taken to rectify the faults in time to come, both direct placement and the auction system should be taken in to consideration.
- In the morning session on 27.02.2015, due to the difference maintained in order to regulate the Interest rates which was termed as 3rd rule, the interest rate in the market increased from 5% to 6.5%, recording an increase of 1.5%. This is a fact that effects seriously on market interest rates. These information was publicized in the evening. That is after the disputed auction. If those information had been made available for all primary dealers prior to the auction, they could have had a level playing ground and this issue wouldn’t have surfaced.
- All the primary dealers, could have had access to the information, provided the decision that had been taken to purchase sovereign bonds to the value of USD 3 billion on the date of 29.03.2016, had been notified to the dealers, rather than notifying it subsequent to the auction. If so, possibly, the interest rates could have had taken a low rate.

- Obtaining Rs. 10 billion when the auction is held for 1 billion has been subject to criticism. The reason for that was the idea that other primary dealers except for the Perpetual Treasuries did not expect such a situation. If the other primary dealers were aware of that situation there could have been a more fair competition. Recommendations to prevent such a situation has been included in the recommendation part of this report. Accordingly, the tender board is also responsible for the problem that created by obtaining an unexpectedly higher amount of money compared to the amount that has been mentioned in the advertisement.

  As to how the Central Bank supplied money directly to the Perpetual Treasuries since the Perpetual Treasuries did not have the money to pay for the bonds obtained by them in the auction held on 29.03.2016 has no proper explanation. There is no submission from the Central Bank about that transaction. The Perpetual Treasuries who purchased bonds that cost Rs. 29 billion at the auction on 29.03.2016 has obtained a loan from the Central Bank at a low interest rate. It has been observed that the Perpetual Treasuries has obtained some undue advantage from this process. This specific fact should be investigated and those who were responsible for that should be identified and the loss they incurred should be calculated and it should be charged from the persons who are responsible for this.

The Committee accepts and approves all recommendations and conclusions of the Auditor General and submits to Parliament to take action accordingly

11. General recommendations of the Committee

In the issuing of Bonds by the Central Bank of Sri Lanka in 2015 and 2016, the Committee observes that evidence or facts have surfaced before the Committee, which are likely to cause reasonable suspicion that the former Governor of the Central Bank, Mr Arjuna Mahendran has made an intervention and influenced at the issuing of bonds at the transactions held on 27 February 2015.

The Committee observed that at the investigation and examination of evidence conducted by the Committee, evidence or facts, likely to cause reasonable suspicion that certain transactions lack minimum transparency and that the manner in which the Central bank acted at these transactions has resulted in its credibility being eroded, have surfaced before the Committee.

Further, the Committee observes that one institution, Perpetual Treasuries out of the primary dealers has made enormous financial dividends through the bond transactions that have taken place during that period.

Therefore, -

The Committee emphasizes that parliament should directly intervene to,

- Recommend punishments or other orders that should be imposed against the other officials of the Central Bank and institutions so responsible for these transactions.
- While it is recommended that the loss incurred by the government and the general public as a result of those irregular activities should be recovered from those persons or institutions, the Committee emphasizes that necessary legal actions should be initiated against them
- Oversee and ensure that the recommended punishments and orders are implemented to the letters and do the necessary follow up
- Implement all steps and checks and balances that should necessarily be taken to ensure such activities will not recur in future
- Oversee and ensure that such checks and balances are enforced by the Central Bank in the proper manner and do the necessary follow up ass it is the basic responsibility of Parliament in regard to financial control.

The Committee emphatically recommended that it is the responsibility of the Parliament to recover all the losses incurred by it through the above activities and act under the prevailing laws.

Also,

the Committee also recommended that the central bank of Sri Lanka and its affiliated institutions should assure parliament that steps will be taken to prevent the recurrence of such a situation in future by establishing suitable mechanisms in them.

01. Since action taken by officers of the Central Bank has pave way for Perpetual Treasuries to earn an undue advantage as an individual organization, and since action taken by Perpetual Treasuries also were carried out with the objective of utilizing the advantage given to them, it poses a gravely detrimental effect on the transparency and credibility of fiscal management of the Central Bank. Therefore, it is recommended that an extensive investigation be carried out in this regard by a recognized institution with legal authority and that action be taken to prevent the repetition of similar situations in future.
02. The Committee recommends that priority be given to state financial institutions which are able to fulfill urgent financial requirements of the government when sourcing funds required for the country through the process of issuing bonds and recommends that clauses to provide for the above be inserted into the Operations Manual of the Central Bank and other relevant documents.
03. Perpetual Treasuries, which is the institution involved in the bond issue in question, has earned exorbitant profit within a very short span of time, hence, it is necessary to investigate the aforesaid process of profit earning by a competent mechanism and it is the firm belief of the Committee that ascertaining immediately whether their action has resulted in any financial loss to the Central Bank and the Government is the responsibility of the Central Bank.
04. Establishment of a mechanism to conduct post-analysis of the market activities of primary dealers and functioning of the secondary market with the intervention of the Ministry of Finance is recommended to prevent occurrence of similar financial irregularities in future. Then, the Ministry of Finance too will be able to carry out follow-up activities on action by the Central Bank to source funds for financial requirements of the government.

05. Operations Manual of the Public Debt Management Department which has not been updated up to now, should be updated without delay and it is further recommended that provisions to give priority to capable state financial organizations when sourcing funds through bonds to fulfill requirements of the government be inserted into it.
06. Mr. Arjun Mahendran is directly responsible for the bond transaction in 2015-2016 and taking legal action against him and other relevant officers as well as recovering from him the loss incurred is recommended.
07. It is recommended that a mechanism be established to maintain transparency in such transactions and to safeguard credibility of the Central Bank.

The Committee believes that it is a key responsibility of the Committee to present all documents, details and evidence (despite the fact that some of those details are said to be sensitive) to the august assembly which is vested with the total control of state finances in terms of Article 148 of the Constitution of the Democratic socialist republic of Sri Lanka.

On the basis of the aforementioned responsibilities, this report comprising of following recommendations is submitted to Parliament and it is the recommendation of this Committee that an open discussion regarding the report be carried out in Parliament after the report is submitted.