

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

September 2024

**Briefing Note**



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## OVERVIEW

This note examines the bond and equity market forensic audit reports to ascertain the scale of the EPF's losses in the past. It also highlights a significant underestimation of the actual losses, as the forensic audit omitted the period after the February 2015 bond scam from the bond market forensic report. These losses largely stemmed from significant governance failures within the CBSL's processes and undue influence from its top management. However, this note does not delve into the reasons behind these losses, which will be addressed in a future publication.

## INTRODUCTION

The Employees' Provident Fund (EPF) is the largest fund in Sri Lanka, with employee savings totalling LKR 3.5 trillion as of 2022.<sup>1</sup> The EPF is a mandatory defined contribution retirement scheme for employees in the private and semi-government sectors who do not have pension benefits. In this scheme, both the employee and employer make regular contributions into individual accounts—8% from the employee and 12% from the employer. In the defined contribution scheme of the EPF, the final benefits to the employees depend on the total contributions and the investment returns accumulated over time, unlike a defined benefit scheme, which guarantees a specific payment upon retirement. Therefore, the EPF's investments and the returns on them directly affect the welfare of most workers in Sri Lanka. The Central Bank of Sri Lanka, as the custodian, is responsible for investing the funds, and is expected to make those investments in the best interest of the EPF members.

However, EPF investments have a record of being misused and have been embroiled in scandals since 2011. A previous analysis by Verité' Research<sup>2</sup> revealed that the EPF's returns from investments in the equity (stock) market were less than 5 percent in 2009 and 2010, while the All Share Price Index (ASPI) indicated overall stock market returns of around 100 percent. The general consensus in the press was that these losses were a result of a pump-and-dump strategy, where external counterparties sold stocks to the EPF at very high prices.<sup>3</sup> Another scandal that received major public and political attention is what came to be known as the "bond scam" in February 2015. It was centred around a particular primary auction in which the Central Bank's Public Debt Department engaged in irregular behaviour, resulting in windfall profits to certain private entities.

1 Employees' Provident Fund, *Annual Report 2022* at <https://epf.lk/wp-content/uploads/2024/05/Annual-report-English-2022.pdf> [last accessed 21 August 2024].

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

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

Initial investigations by parliamentary committees and the Presidential Commission of Inquiry revealed that parties that benefited from the bond scam made large sums of money by offloading their stock on the EPF. This led to a comprehensive forensic audit of the CBSL, scrutinising the EPF's historical transactions in the bond market and also the equity market. The forensic audit produced five reports. Two were focused entirely on the EPF's transactions –one on equity market transactions and the other on bond market transactions. This note examines these two reports to understand the EPF's losses and their source.

The first section reviews the bond market losses set out in the forensic audit report titled "Investigation on primary and secondary market transactions of Employees Provident Fund involving treasury bonds issued /transacted during the period from 1 January 2002 to 28 February 2015" (referred to as "Forensic audit on EPF's Bond Market transactions in this note"). The audit findings indicate a significant loss of LKR 9,826 million in bond market transactions by the EPF from January 2002 to February 2015. These losses arose from the EPF acquiring bonds at unfavourable prices in both the primary and secondary markets, or at times, refraining from making purchases despite having sufficient cash to purchase.

The second section examines the EPF's equity (share) market losses stated in the report titled "Project Diamond Final report: The Monetary Board of Central Bank of Sri Lanka (November 2019)". This report highlights the investments of EPF in equities/shares from 01 January 1998 to 31 December 2017 and covers transactions (listed and unlisted shares including preference shares) with a value exceeding LKR 10 million on a single day. (referred to as "Forensic audit on EPF's Share Market transactions in this note"). The findings indicate a significant loss of LKR 9,859 million in the equity market between 1998 and 2017, primarily through investments in listed companies.

The third section highlights a major limitation of the forensic audit, which did not expose the majority of the losses in the bond market. The EPF was said to have lost a larger sum of money in the bond market after the major bond scam in February 2015. However, the forensic audit on the bond market losses only covers the period before February 2015, and leaves out the period after. This omission reduces significantly the scope of what can be estimated on the losses incurred by the EPF.