



# Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 21-Mar-2023 | Report No: PIDA35492



**BASIC INFORMATION**

**A. Basic Project Data**

Country Sri Lanka	Project ID P178432	Project Name Sri Lanka Public Financial Management Strengthening Project	Parent Project ID (if any)
Region SOUTH ASIA	Estimated Appraisal Date 31-Mar-2023	Estimated Board Date 28-Apr-2023	Practice Area (Lead) Governance
Financing Instrument Investment Project Financing	Borrower(s) Democratic Socialist Republic of Sri Lanka	Implementing Agency Ministry of Finance, Economic Stabilization and National Policies - Public Finance Department, National Audit Office of Sri Lanka	

Proposed Development Objective(s)

To enhance the institutional capacity and transparency in procurement and external audit

Components

Improving the operational efficiency and transparency in public expenditures through e-procurement  
Enhancing accountability and institutional capacity of NAOSL  
Project Management, implementation support, evaluation and audit

**PROJECT FINANCING DATA (US\$, Millions)**

**SUMMARY**

<b>Total Project Cost</b>	7.60
<b>Total Financing</b>	7.60
<b>of which IBRD/IDA</b>	0.00
<b>Financing Gap</b>	0.00

**DETAILS**

**Non-World Bank Group Financing**



Trust Funds	7.60
Miscellaneous 1	7.60

Environmental and Social Risk Classification

Low

Decision

The review did authorize the team to appraise and negotiate

## B. Introduction and Context

### Country Context

**1. Sri Lanka’s longstanding structural weaknesses, which were elevated by several exogenous shocks and ill-timed tax cuts, plunged the country into a severe economic crisis.** A restrictive trade regime, weak investment climate, episodes of loose monetary policy and an administered exchange rate, and poor governance contributed to macroeconomic imbalances in the last two decades. The fiscal indiscipline, linked to low revenue collections, led to high fiscal deficits and large gross financing needs. These weaknesses were masked by rapid growth, particularly after the end of the civil war in 2009, spurred along by a risky commercial debt-driven, increasingly inward-oriented economic model. Combined with these pre-existing imbalances, the tax cuts in 2019 further eroded weak fiscal buffers and led to a rapid growth in debt to unsustainable levels. Moreover, several external shocks contributed to the significant macroeconomic deterioration. The country experienced a political crisis in 2018 and then the Easter bombings in 2019, followed by a 4.6 percent economic contraction amid the Novel Coronavirus Disease 2019 (COVID-19) pandemic in 2020. Sri Lanka lost access to international financial markets in 2020 in the face of significant external debt services, following credit rating downgrades. Amid depleted reserves, Sri Lanka announced an external debt service suspension in April 2022, pending debt restructuring.

**2. The economic crisis deepened in the second half of 2022.** A delayed response by the authorities to the macroeconomic imbalances allowed the crisis to spread to all key sectors. The economy contracted by 7.8 percent (y-o-y) in 2022 due to sharp contractions in Q3 and Q4 2022. The Colombo Consumer Price Index (CPI) based headline inflation (y-o-y) decreased to 50.6 percent in January 2023, easing from an unprecedented high of 69.8 percent in September 2022. Due to the economic contraction, national poverty is projected to have doubled to 25 percent and urban poverty is estimated to have tripled to 15 percent in 2022. Inequality also increased and half a million jobs were lost in industry and manufacturing. Effects of severe foreign exchange liquidity constraints have been felt across the economy, causing severe shortages of essential household items and inputs needed for economic activity.

**2. In response to the deepening crisis, Sri Lanka sought support from the International Monetary Fund (IMF) and announced several important structural reforms.** In March 2023, the IMF Executive Board approved a 48-month Extended Fund Facility (EFF) of approximately US\$3 billion to support the



government's reform program. This followed a Staff-Level Agreement (SLA) reached between the authorities and IMF staff in September 2022 and sufficient financing assurances from all major official creditors. The EFF intends to restore macroeconomic stability and debt sustainability, safeguarding financial stability, enhancing governance, and stepping up structural reforms to unlock Sri Lanka's growth potential. Several structural reforms have been announced or initiated, including new revenue measures, the reform of state-owned enterprises (SOEs), cost-reflective pricing of utilities and better debt management, all of which aim to improve economic governance and enhance competitiveness.

## Sectoral and Institutional Context

**4. There are significant gaps in Sri Lanka's public financial management (PFM) framework, procedures, and institutional capacity.** Unrealistic revenue estimates and the absence of sound medium-term fiscal framework (MTFF) and medium-term expenditure framework (MTEF) have resulted in the preparation of inflated annual budgets and consequently ineffective expenditure management. This has resulted in significant budget out-turns, especially in capital/development expenditures. Similarly, fiscal sustainability, strategic allocation of resources, and operational efficiency are not adequately interlinked. An integrated treasury management information system has been under implementation for over six years, and, as such, there is a lack of an effective system to monitor/control commitments against the budget and report on payment arrears. Sri Lanka scores a low of 30 in the measure of budget transparency<sup>1</sup> and is ranked 93<sup>rd</sup> among 120 countries in the 2021 Open Budget Survey. However, some of the strengths of PFM include relatively high-quality financial information in the Government's annual financial statements and timely audit of the same and its presentation to the Parliament.<sup>2</sup>

**5. Public procurement in Sri Lanka requires efficiencies, as the delays in the procurement process, contract awards, and implementation adversely affect expenditure efficiency.** In Sri Lanka, public procurement was estimated to account for approximately 15 percent of the annual government spending (prior to the economic crises). The public sector is the largest purchaser of goods, works, and non-consulting services in the domestic market, and public contracts include a wide range of procurement of low-cost consumables, to large-scale infrastructure, goods, and complex consultancies. The procurement is often delayed and the underlying causes of delays are cumbersome and outdated procedures and processes, limited understanding of market approaches, and lack of capacity and empowerment among procurement decision-makers causing decisions to be elevated to senior management. In the absence of procurement plans and an e-procurement system, the Government misses out on opportunities to aggregate demand to leverage economies of scale, and in its ability to monitor the efficiency and timeliness of the procurement process, have information on commitments to inform budget and cash management, and disclose procurement opportunities and contract awards in the public domain. The Government is conscious of these challenges and aims to address them through the following areas of reform: developing a strategy for the regulatory framework implementation; and leveraging technology through the introduction of e-procurement and data analytics.

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<sup>1</sup> This measures the public access to information on how the central government raises and spends public resources and assesses the online availability, timeliness, and comprehensiveness of eight key budget documents. In the 2019 Open Budget Survey Sri Lanka scored 47.

<sup>2</sup> The annual financial statement for the Government of Sri Lanka (GoSL) is prepared within three months and the audited financial statements are presented to the Parliament within five months of the end of the financial year.



**6. There's a need to strengthen and modernize the National Audit Office of Sri Lanka (NAOSL).**

Established in 1799, the NAOSL plays an important role in providing an independent assurance that governmental activities are carried out and accounted for, consistent with Parliament's intentions. The independence of the Auditor General is preserved by provisions of Articles 153 and 154 of the Constitution. To further strengthen accountability, the Parliament, in July 2018, approved the National Audit Act, which, in effect, created an independent Supreme Audit Institution (SAI). The 19<sup>th</sup> amendment to the Constitution expanded the mandate of the NAOSL to include the audit of State-Owned Business Enterprises (SoBE's) in which GoSL has fifty-one percent holding. The scope of the NAOSL has also been widened to include a wide range of audits, such as performance, procurement, environment, forensic, and other technical audits. Although over the years NAOSL has taken a range of initiatives to improve processes, procedures, manuals, and methodologies of audits, these have not been fully adopted and/or adhered to consistently across the organization. Thus, at the institutional level, there remain important shortcomings that impact the overall performance of the NAOSL and its ability to make a valuable contribution to stronger governance, greater accountability, and improved transparency. NAOSL has identified its capacity-building priorities to meet the enhanced mandate and anticipated demand from the Parliament. The NAOSL carried out an assessment using the Supreme Audit Institution-Performance Management Framework (SAI-PMF) in 2018<sup>3</sup> and has prioritized areas for reform/capacity building. Based on the SAI-PMF assessment findings, the NAOSL needs to enhance its institutional capacity, especially audit planning, quality assurance, staff capacity, and improved communications with stakeholders and other specialized audits to strengthen the overall accountability framework.

**C. Proposed Development Objective**

Development Objective

- 7. To enhance the institutional capacity and transparency in procurement and external audit.

Key Results

- 8. Progress towards achievement of the PDO will be measured by the following PDO-level results indicators:
  - (i) Information available in the public domain on procurement opportunities and contract awards
  - (ii) Procurement contracts awarded within the original bid validity period
  - (iii) Specialized audits carried out by the NAOSL that are made publicly available
  - (iv) Participatory audits carried out by NAOSL

**D. Project Description**

- 9. **The project is fully aligned with and supports the governance reforms prioritized by GoSL.** The key reform areas to be supported by the project include the development and rollout of the e-procurement system in key service delivery ministries (such as health and education), and enhancing of the institutional capacity of the NAOSL, which will contribute to efficiency, transparency, and enhanced

<sup>3</sup> [http://www.auditorgeneral.gov.lk/web/images/public\\_news\\_agdsl/SAI-PMF-Assesment-INTOSAI/SAI-PMF-assessment-of-SAI-Sri-Lanka-FINAL-with-IR--27-June-2018.pdf](http://www.auditorgeneral.gov.lk/web/images/public_news_agdsl/SAI-PMF-Assesment-INTOSAI/SAI-PMF-assessment-of-SAI-Sri-Lanka-FINAL-with-IR--27-June-2018.pdf)



parliamentary and, potentially, citizen oversight of public finances. These are critical building blocks, which in the medium term, will contribute to the management of the public sector in a fiscally sound and accountable manner to support macroeconomic stability. The project interventions are aligned with the broader macro-fiscal and public finance reforms that have been agreed upon with the IMF and are under discussion with other international development partners, as a comprehensive set of reforms to be implemented by the GoSL. This alignment between the ongoing reform discussion among the GoSL and international development partners, which will be anchored within the IMF program would ensure a strong commitment of the GoSL to the implementation of the proposed scope of reforms under this project. The project components are given below:

**Component 1: Improving the operational efficiency and transparency in public expenditures through e-procurement (US\$4 million):**

**10.** The project will support the improvement of procurement outcomes through technical assistance (TA) to the Public Finance Department (PFD) of the Ministry of Finance (MoF). Under the PFD, an e-Government Procurement Secretariat (e-GP Secretariat) has been created, as the technical unit responsible for the management (development and roll-out) of the e-procurement system. This component seeks to improve the operational efficiency of public expenditures by supporting: (i) the further development, enhancement, roll out, and implementation of new modules and functionalities in the existing e-procurement system with open contracting standards to enhance transparency and accountability; and (ii) developing dedicated procurement procedures for procurement in situations of urgent needs, including an emergency procurement manual, which Sri Lanka is facing more frequently. The existing e-procurement system, which covers only the shopping procurement, is proposed to be enhanced to include open competitive bidding, support management information, and basic data analytics, which will enable sharing of procurement opportunities and contract award information in the public domain. The rollout of new modules will be focused on key service delivery ministries and agencies. The activities will include support by way of information technology (IT) goods, consulting, and non-consulting services, training, and capacity building to support the rollout in selected line agencies and related operating costs.

**Component 2: Enhancing accountability and institutional capacity of NAOSL (US\$3.50 million):**

**11.** The transformation of the Auditor General's Department into a modern SAI, capable of meeting its constitutional mandate and delivering audits in line with international standards will require sustained investment in institutional strengthening. Based on the 2018 SAI-PMF, a detailed five-year Development Action Plan (DAP) has been prepared by the NAOSL. This component will provide TA and capacity-building support to NAOSL, to: (i) support NAOSL in the implementation of the development action plan; (ii) build institutional and human resource capacities with a focus on enhancing the planning and risk assessment function and capacity by using of automated tools and solutions, and report writing skills and solutions to improve the quality, timeliness, and consistency is reporting; (iii) enhance capacity for specialized auditing (procurement and environment) and auditing SOBEs; and (iv) develop and pilot test a framework for participatory auditing, that involves the citizens in the audit process, with a specific focus on female participation. The activities will include support by way of procurement of IT goods, audit tools/audit software, consulting and non-consulting services, training and capacity building, and related operating costs.



**Component 3: Project management, implementation support, evaluation, and audit (US\$0.10 million):**

12. This component will finance the Project Coordination Teams (PCTs) established at MoF and NAOSL, Project Monitoring and Evaluation (M&E), as well as the communications and change management strategy to maximize effectiveness. This component will finance the operating costs and consultancies of the PCTs, including on project procurement and fiduciary management, environmental and social safeguards, and M&E.

Legal Operational Policies

	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Areas OP 7.60	No

Summary of Assessment of Environmental and Social Risks and Impacts

13. The grant operation is classified to have low environmental and social risks. The project will support technical assistance and capacity development. No physical/civil works interventions or studies focused on the delivery of infrastructure, such as feasibility assessments, will be undertaken under project financing. Activities proposed under Components 1 and 2 include the purchase and/or replacement of IT hardware in limited amounts which will lead to some limited generation of E-waste over the useful life of the assets. The Central Environmental Authority of Sri Lanka has a well-established system for E-Waste management within the country with registered collectors and vendors. In addition, as part of ESF support to the grant operation and in line with Good International Industry Practices (GIIP) on environmental & participatory auditing, technical input will be provided to NAOSL to develop their capacity for Environmental and Participatory Auditing.

14. While the project will enhance accountability and transparency in the management of public finance and engage citizens & civil society in auditing processes, there could be possible risks associated with a) exclusion of some government/private institutions that lack adequate digital infrastructure or staff with IT literacy required to access the e-procurement services, and b) inadequate representation of key citizens groups in the development of the participatory audit framework and pilot thereof, including key officials in capacity building initiatives. To mitigate these risks, the project will put in place inclusive policies & procedures when targeting training and provide adequate capacity building to key stakeholders to enable access to e-procurement services and ensure meaningful participation of citizen groups in audit processes. With respect to sexual exploitation and abuse (SEA) and sexual harassment (SH), the SEA/SH risk level of the project is rated as low, since the project does not involve any civil works that could result in labor influx or close interactions with communities, however, appropriate measures will be in place to address potential workplace harassment issues in line with ESS2.

15. The MoF and the NAOSL have experience working on the Bank’s former safeguards policies but limited experience in implementing the ESF. In line with the ESF, the implementing agencies have prepared an



Environmental and Social Commitment Plan (ESCP), which incorporates the measures to be implemented in line with ESS1 Assessment and Management of Environmental and Social Risks and Impacts, ESS2 on Labor and Working Conditions and ESS3 on Resource Efficiency and Pollution Prevention and Management. In line with ESS10 on Stakeholder Engagement, a Stakeholder Engagement Plan (SEP) has been prepared. The ESCP and SEP have been disclosed prior to project appraisal.

## **E. Implementation**

### Institutional and Implementation Arrangements

**16. The project implementation arrangements are integrated within the GoSL administration.** The two components of the project will be implemented by PFD (with its technical unit, the e-procurement secretariat) and NAOSL respectively. The participating department/agency will carry out project activities within their mandates, with overall coordination and management by the External Resource Department (ERD).

**17. Project Steering Committee (PSC).** Two PSCs, one at the MoF for the e-procurement component and one at the NAOSL for the audit component, will be established. The PSCs will convene at least twice a year to review overall project progress and implementation performance, providing strategic guidance on project activities and oversight for the project implementation; ensure effective coordination and communication among the project stakeholders; review the progress of the project; and provide directions/remedial solutions, as appropriate.

**18. Project Coordination Team (PCT).** A Project Coordination Team (PCT) be established at the PFD (e-procurement secretariat), which will be responsible for the e-procurement development and roll-out. Further, a similar PCT will be established within the NAOSL to implement and coordinate project activities implemented by the NAOSL. Each PCT will be supported by staff designated from the respective agencies. ERD will be the overall coordinating department for the project responsible for consolidating and submitting the semi-annual progress reports to the World Bank. The PCT will be led by a designated Project Coordinator and will be responsible for the day-to-day project management, coordination, and planning of project activities, including fiduciary, procurement, and M&E functions.

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**APPROVAL**

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