



Project Information Document (PID)

Concept Stage | Date Prepared/Updated: 07-Feb-2023 | Report No: PIDC33880

**BASIC INFORMATION****A. Basic Project Data**

Country Sri Lanka	Project ID P178432	Parent Project ID (if any)	Project Name Sri Lanka Public Financial Management Strengthening Project (P178432)
Region SOUTH ASIA	Estimated Appraisal Date Mar 06, 2023	Estimated Board Date Mar 24, 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 transparency in procurement and strengthen the institutional capacity of the National Audit Office of Sri Lanka

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

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

DETAILS**Non-World Bank Group Financing**

Trust Funds	7.60
Miscellaneous 1	7.60



Environmental and Social Risk Classification

Low

Concept Review Decision

Track II-The review did authorize the preparation to continue

B. Introduction and Context

Country Context

- 1. Sri Lanka faces an unsustainable debt and a severe balance of payment crisis due to several exogenous shocks and poor policy choices.** The country experienced a political crisis in 2018 and the Easter Sunday bombing in 2019. The Novel Coronavirus Disease 2019 (COVID-19) pandemic exerted a profound, long-lasting impact on output, the labor market, and poverty. Combined with pre-existing fiscal imbalances, tax cuts in 2019 contributed to rapid growth in debt to unsustainable levels. A restrictive trade regime, weak investment climate, episodes of loose monetary policy, and an administered exchange rate had contributed to external imbalances. The crisis deepened in 2022. The economy is projected to have contracted by 9.2 percent in 2022 amid supply disruptions and a lack of inputs (fertilizer, fuel, and other industrial inputs). Annual average inflation reached an unprecedented 45.9 percent in December 2022, due to the impact of high global commodity prices, partial monetization of the fiscal deficit, and currency depreciation. Official reserves dropped from US\$7.6 billion in 2019 to less than US\$400 million (excluding a currency swap equivalent to US\$1.4 billion with China) in October 2022. Amid depleted usable reserves, Sri Lanka announced a suspension of external debt service payments in April 2022 and later commenced debt restructuring.
- 2. On September 1, 2022, the International Monetary Fund (IMF) and the Government of Sri Lanka (GoSL) reached a Staff Level Agreement (SLA) on a 48-month Extended Fund Facility (EFF) arrangement of about US\$2.9 billion.** The objectives of the EFF are to restore macroeconomic stability and debt sustainability while safeguarding financial stability, protecting the vulnerable, and stepping up structural reforms to address corruption vulnerabilities and unlock Sri Lanka's growth potential. The IMF Board's approval would require financing assurances from official creditors and progress to reach a collaborative agreement with private creditors, in addition to carrying out the identified reforms.
- 3. World Bank's technical discussion with the GoSL has been underway, to inform the GoSL's comprehensive reform program.** The reform dialogue of the World Bank complements the stabilization measures of the IMF program, including improved tax administration, stronger fiscal oversight and transparency, improved debt and public financial management, and strengthening financial sector stability. The World Bank also supports growth-enhancing structural reforms including trade, foreign direct investment (FDI), and state-owned business enterprises (SOBE) reforms, as well as Social Safety Net measures to protect the poor and vulnerable during economic difficulties

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 a sound medium-term fiscal framework (MTFF) and medium-term expenditure framework (MTEF) result in the preparation of an inflated annual budget and ineffective expenditure management. This results in large budget out-turn, especially in capital/development and



transparency – Sri Lanka ranked 60th among 115 countries on the 2017 Open Budget Index with a score of 44 – budget credibility and predictability in budget execution. In summary, fiscal sustainability, strategic allocation of resources, and operational efficiency are not adequately interlinked. However, some of the strengths in 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.¹

5. **Public procurement in Sri Lanka requires efficiencies, as the delays in the procurement process, contract awards, and implementation adversely affect expenditure efficiency.** Procurement data from Bank funded projects show a time lag of up to one year between the Invitation for Bids for goods and works, and the signing of a contract. 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, target adequate supplier and contractor markets, and in its ability to monitor the efficiency and timeliness of the procurement process, have information on commitments to support 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 three broad areas of reform: Developing a strategy for the Regulatory Framework implementation; improving the professional skills of procurement staff; and leveraging technology through the introduction of e-procurement and data analytics.
6. **Modernizing 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 to a great extent by provisions of Article 153 and 154 of the Constitution. To further strengthen accountability, the Parliament approved the National Audit Act which was passed in July 2018 and the 19th amendment to the Constitution created an independent NAOSL and expanded the scope of the audit. The Audit Act reinforces the powers and responsibilities that the Auditor General enjoys under the Constitution of Sri Lanka. This, in effect, created a new, independent Supreme Audit Institution (SAI), the NAOSL, and provided for its predecessor, the Auditor General’s Department of Sri Lanka (AGDSL) to be reconstituted as the new NAOSL. NAOSL has identified its capacity-building priorities to meet the enhanced mandate and anticipated demand from the Government. The NAOSL has carried out an assessment using the SAI-Performance Management Framework (SAI-PMF) and has prioritized areas for reform/capacity building. However, the NAOSL needs to enhance its institutional capacity, especially in areas of procurement, environment, and other specialized audits to strengthen the overall accountability framework.

Relationship to CPF

7. The operation is aligned with the objective of improving PFM under pillar one: macro-fiscal stability and competitiveness of the Country Partnership Framework (CPF) FY17-20, No. 104606-LK, discussed by the Board on June 28, 2016, and, extended to FY21 by the Performance and Learning Review (PLR).² The establishment of the standalone RETF operation has been approved by the South Asia Regional (SAR) Vice President on December 13, 2021.

¹ The annual financial statement for the 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.

² Subsequently, a new CPF was deferred until the end of FY22, by an OPCS guidance in consideration of the COVID-19 pandemic. A new CPF for the period FY 23-26 is under preparation.



C. Proposed Development Objective(s)

8. To enhance transparency in procurement and strengthen the institutional capacity of the National Audit Office of Sri Lanka

Key Results (From PCN)

9. Progress towards achievement of the Project Development Objective (PDO) will be measured by the following results indicators:
 - Increase in electronically available information in the public domain on procurement opportunities and contract awards.
 - Increased number of specialized audits carried out by the NAOSL that are made publicly available.

D. Concept Description

10. **The project is 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 in key service delivery ministries, and the enhancing the institutional capacity building of the NAOSL, which will contribute to efficiency, transparency, and enhanced parliamentary and, potentially, citizen oversight of public finances. These are critical building blocks, which in the medium term, will enhance management of the public sector in a fiscally sound and accountable manner, to ensure macro-economic 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 the World Bank, which will be formulated into a comprehensive set of reform packages to be implemented by the GoSL. This alignment between the ongoing reform discussion among the GoSL and international partners, which will be anchored in within the IMF program and a possible budget support program of the World Bank, 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:
11. **Component 1: Improving the operational efficiency and transparency in public expenditures through e-procurement:** 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). This component will provide TA and capacity building 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 need, including an emergency procurement manual, which countries are facing with more frequency. The rollout of new modules will be focused on key service delivery ministries and agencies such as health and education.
12. **Component 2: Enhancing accountability and institutional capacity of NAOSL:** 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; (iii) enhance capacity for specialized auditing (procurement and environment) and auditing SOEs, including by leveraging private auditors; and (iv) develop and pilot test a framework for participatory auditing, that involves the citizens in the audit process.



13. **Component 3: Project management, implementation support, evaluation, and audit:** This component will finance the Project Teams (PTs) established at MoF, 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 of the PT, as well as consultants to support the PT with project procurement and fiduciary management.

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

Summary of Screening of Environmental and Social Risks and Impacts

14. **The grant operation is classified to have low Environmental and Social risks at the concept stage, after considering, in an integrated manner the project location, types of activities the project will support.** The project will mainly support TA and capacity development focusing on improving the operational efficiency and transparency in public expenditures through e-procurement and enhancing the accountability and institutional capacity of NAOSL. Based on the project components identified at the concept stage, the overall risks of the project are expected to be low. No physical interventions or studies focused on the delivery of infrastructure, such as feasibility assessments, will be undertaken under project financing nor will it involve construction or other activities that involve physical interventions to the environment to be undertaken via the use of project financing. Activities proposed under Components 1 and 2 under the project may include purchasing and/or replacement of IT hardware but this will be assessed and confirmed further during project preparation.

15. **A positive impact is that the project will support the NAOSL develop their capacity on Environmental Auditing, very much in line with the guidance of ESF and thus support to capacity building initiatives in line with the ESF on best practice on environmental auditing will be integrated to the ESF support to the grant operation.** The project will also enhance collaboration between citizens, civil society and NAOSL to engage in auditing processes involving public finance management. While project will create positive impacts, there could be possible risks associated with a) exclusion of key officials benefiting from capacity building initiatives and b) inadequate representation of key citizens groups and interested parties participating in audit processes piloted by the project due to lack of inclusive procedures and systems in selection of trainees and engaging of citizens groups and their organizations. With regard to the SEA/SH risk level of the project, it 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.

16. **The MoF and the NAOSL have experience working on the Bank's former safeguards policies but limited experience on implementing the ESF.** In line with the ESF the implementing agencies will prepare an Environmental and Social Commitment Plan (ESCP), which will incorporate 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) will be prepared. The ESCP and SEP will be disclosed prior to project appraisal.



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APPROVAL

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