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This action is funded by the European Union

ANNEX

of the Commission Implementing Decision on the Special measure 2017 in favour of Sri Lanka to be financed from the general budget of the Union

1. Title/basic act/ CRIS number	Strengthening Public Financial Management and Accountability in Sri Lanka CRIS number: ACA/2017/039-843 Financed under Development Cooperation Instrument			
2. Zone benefiting from the action/location	Sri Lanka The action shall be carried out at the following location: Colombo.			
3. Programming document	Multi-annual Indicative Programme for Asia 2014 – 2020 (using Special measures foreseen under Article 12 of Regulation (EU) No 233/2014 in conjunction with art 2 of Regulation (EU) No 236/2014).			
4. Sector of concentration	Public Finance Management	DEV. Aid: YES ¹		
5. Amounts concerned	Total estimated cost: EUR 71 000 000 Total Amount of EU budget contribution: EUR 10 000 000 The contribution is for an amount of EUR 10 000 000 from the general budget of the European Union for 2017. This action is co-financed in parallel co-financing by: The World Bank (WB) for an indicative amount of USD 68 500 000			
6. Aid modality(ies) and implementation modality(ies)	Project Modality: Indirect management with the World Bank			
7 a) DAC code(s)	15111 Public Finance Management			
b) Main Delivery Channel	The World Bank – 44001			
8. Markers (from CRIS DAC form)	General policy objective	Not targeted	Significant objective	Main objective
	Participation development/good governance	<input type="checkbox"/>	<input type="checkbox"/>	X
	Aid to environment	X	<input type="checkbox"/>	<input type="checkbox"/>

¹ Official Development Aid is administered with the promotion of the economic development and welfare of developing countries as its main objective.

	Gender equality (including Women In Development)	<input type="checkbox"/>	X	<input type="checkbox"/>
	Trade Development	X	<input type="checkbox"/>	<input type="checkbox"/>
	Reproductive, Maternal, New born and child health	X	<input type="checkbox"/>	<input type="checkbox"/>
	RIO Convention markers	Not targeted	Significant objective	Main objective
	Biological diversity	X	<input type="checkbox"/>	<input type="checkbox"/>
	Combat desertification	X	<input type="checkbox"/>	<input type="checkbox"/>
	Climate change mitigation	X	<input type="checkbox"/>	<input type="checkbox"/>
	Climate change adaptation	X	<input type="checkbox"/>	<input type="checkbox"/>
9. Global Public Goods and Challenges (GPGC) thematic flagships	N.A.			
10. SDGs	SDG 16: Promote peace, justice and strong institutions			

Summary

The Government of Sri Lanka has shown strong commitment to the economic development, reform agenda and has engaged with international partners in pursuing its national development priorities. Citizens have high expectations of the Government to create conducive conditions for growth and jobs, enhance budget transparency and improve service delivery. The Government's capacity to address these priorities however, is constrained by weak institutional capacity and inefficiencies in public expenditures on the one hand, and severely limited fiscal space and stagnating revenue collection on the other hand.

The Public Sector Efficiency Strengthening Programme (PSESP) is being designed by the Government with the WB to support the Government's key governance and Public Finance Management (PFM) reforms aimed at improving the efficiency of public programmes and services, at strengthening transparency, accountability and oversight and enhancing institutional capacity across central government beneficiary institutions. The PSESP has an indicative cost estimate of EUR 71 million, which includes the EUR 10 million EU contribution.

The **overall objective** of the programme is to achieve more sustainable and inclusive economic growth, social development and good governance.

The **specific objective** is to contribute to enhancing efficiency, transparency, accountability in use of public resources and fiscal sustainability.

The programme is designed around three pillars:

R.1: Allocative efficiency of public investments, programmes and debt management is strengthened;

R.2: Operational efficiency and controls in budget execution and procurement is improved and;

R.3: Governance, transparency and efficiency of public services critical for investment is strengthened.

1 CONTEXT

1.1 Sector and Country context

Sri Lanka is an island nation with a land area of 65 610 km² that holds a diverse and multicultural population of 21 million. Over the past decade, Sri Lanka has shown a high growth rate and ascending per capita GDP; as a result the country graduated from a low-income to a lower-middle income country in 2010. Moreover, Sri Lanka also succeeded in achieving most of the Millennium Development Goals (MDG) targets set for 2015. However, key challenges for sustainable growth and development lie ahead, as the high growth rates were predominantly spurred by public investment on infrastructure development, reconstruction and public recurrent spending. At this juncture it is crucial that Sri Lanka undertakes structural reforms while ensuring the macro-economic stability and the equal distribution of the benefits of the growth.

The election of Maithripala Sirisena as President in January 2015 and the formation of a National Government in August 2015 paved the way for a significant political, institutional and social transformation. The Government of Sri Lanka has shown strong commitment to the economic development, reform agenda and has engaged with international partners in pursuing its national development priorities. Citizens have high expectations towards the Government to create conducive conditions for growth and jobs, enhanced budget transparency and improved service delivery. The Government's capacity to address these priorities however, is constrained by weak institutional capacity and inefficiencies in public expenditures on the one hand, and severely limited fiscal space and stagnating revenue collection on the other hand. Further, the large number of Cabinet Ministries (51) with overlapping mandates and policy inconsistency add to the complexity of the institutional set up of the Government. The Government is aware that addressing these challenges is important to ensure that the public sector can effectively deliver services in an inclusive manner and carry out regulatory functions, thereby contributing to the country's competitiveness². For these reasons the Government has requested international development partners to provide support to improve its Public Finance Management (PFM).

1.1.1 Public Policy Assessment and EU Policy Framework

During the previous Government, main policy directions were penned in the National Strategy: "*Mahinda Chintana*". The political leadership in the country, after the presidential elections, in January 2015, has brought however, a new set of policy priorities³ evidenced by strategic choices and new approach to governance. While the previous Government exhibited strong public interventions in development activities relying mostly on loans with limited external support from the development partners, for the new Government – elected on the basis of an agenda for Good Governance – questions of constitutional and political reforms

² "In future, from 2017 onwards, when making budget allocations, it will be based on identifying financial needs on a gender basis, enabling women to have better access to opportunities at all levels." (<http://www.news.lk/features/item/10674-economic-policy-statement-made-by-prime-minister-ranil-wickremesinghe-in-parliament>).

³ President Manifesto: http://www.priu.gov.lk/presidential_manifestos/Manifesto-EN.pdf. Speech of the President at the opening session of the new Parliament: <http://www.president.gov.lk/news/policy-statement-delivered-by-president-maithripala-sirisena-addressing-the-8th-parliament-of-sri-lanka-on-september-1-2015/>. Speech of the Ministry of Finance for the presentation of the budget 2016: <http://www.treasury.gov.lk/news-and-events/676-budget-2016.html>.

have been the main preoccupations. The key priorities of the Government as stated in the President's Manifesto include:

- Stop the decline in the export performance by improving productivity and competitiveness of industries;
- Carry out reforms in the relevant institutions and policies including, fiscal, exchange rate and trade policies, promoting inflow of foreign investment;
- Put a higher share of Government resources for upgrading the quality of human resources;
- To promote equity in the economic and social spheres and minimizing the remaining regional disparities and poverty pockets.

The Government has identified three structural weaknesses in the fiscal position namely: (1) low and declining fiscal revenues; (2) insufficient spending on key public goods and services, particularly for human development; and (3) inefficiencies in the public sector.

The 2015 Annual Report⁴ of the Ministry of Finance highlights particular areas where PFM needs to be strengthened, including: revising the structural and policy framework for taxation, better allocation and management of public expenditures, budget formulation in line with policy priorities, procurement rules and standard practices.

As an indication of its commitment to the reform the Government has already undertaken several concrete actions to improve the PFM system in the country, especially addressing upstream budget aspects and debt management. The 19th constitutional amendment for instance, which was passed by a majority of the Parliament on 28 April 2015, introduced:

- The reform on procurement regulations and setting up of a National Procurement Commission at a constitutional level;
- The enhancement of scope of Auditor General's mandate and configuration of an Audit Commission to provide administrative and financial autonomy;
- The Right to Information Act (RTI);
- The Code of Conduct for Civil Service;
- The reinvigoration of the Commission to Investigate Allegations of Bribery or Corruption (CIABOC), Financial Crimes Investigation Department (FCID), Special Task Force on the Recovery of Assets (STARTS), and the Commission of Inquiry.
- National Action Plan for the Open Government Partnership (OGP) was passed by the Cabinet in October 2016.

Other notable on-going reforms and interventions include:

- Ministry of Finance is currently rolling out the Integrated Treasury Management Information System (ITMIS)⁵, which received Technical Assistance (TA) and funding from the Asian Development Bank (ADB), and the Inland Revenue Department is in the process of rolling out the Revenue Administration Management Information System (RAMIS), which was supported by the IMF, that has already introduced a modernisation of budget processes and procedures; and has strengthened systems of revenue administration;

⁴ <http://www.treasury.gov.lk/documents>

⁵ The system is currently being implemented with support of ADB is called Integrated Treasury Management Information System (ITMIS) which falls into the FMIS category. This is expected to be fully rolled out by December 2017.

- Audit Act to support the 19th constitutional amendment;
- Preparation of a Public Finance Management Act, which will strengthen the framework for Public Finances, is expected to be presented at the Parliament by December 2017 and will be adopted by the Ministry of Finance;
- Re-establishment of the practice of prioritised Public Investment Programme 2017-2019 (PIP), which is regarded as a medium-term framework for annual capital budget. The PIP has been drawn up to reflect closely the socio-economic vision and strategy of the Government;⁶
- Preparation of prioritized strategic plans for key sectors namely education, health, power and energy, transport, vocational training and environment;
- Preparation of Medium-Term Macro Fiscal Framework (MTFF) that will identify allocations for key sectors and going forward the sector strategies are expected to be aligned with the MTFF;
- Development of Medium-Term Debt Strategy, carry out debt sustainability analysis and establishment of a Debt Management Unit within the Ministry of Finance;
- Preparation of guidelines to strengthen Public Investment Management (PIM);
- Inland Revenue Act passed by Parliament in June 2017;
- Public Debt Act expected to be passed by the Parliament by summer 2017.

In order to address the fiscal pressures, the International Monetary Fund (IMF) in June 2016, approved a 36-month extended arrangement under the Extended Fund Facility (EFF) for an amount equivalent to USD 1.5 billion to support Sri Lanka's economic reform agenda. The proposed programme aims to anchor macroeconomic stability and structural reforms, while strengthening external resilience in a challenging global environment.⁷ In addition, the Development Policy Loan⁸ (DPL) of USD 300 million funded by the WB and the Japanese International Cooperation Agency (JICA) was approved in July 2016. DPL's key pillars/performance indicators cover actions aimed at (i) enhancing private sector competitiveness; (ii) enhancing transparency and public sector management; and (iii) strengthening measures to improve fiscal sustainability⁹. The World Bank is in the process of planning the second DPL for 2018.

The Public Sector Efficiency Strengthening Programme (PSESP) is being designed by the Government with the World Bank to support the Government's key governance and PFM reforms aimed at improving the efficiency of public programmes and services. The programme is designed around three indicative pillars supporting notably the implementation of the DPL reforms¹⁰ that is expected to span over five years with an indicative cost estimate

⁶ <http://www.ft.lk/article/457613/UNF-showcases-5-point-economic-action-plan>

⁷ To achieve these objectives, the program envisages the implementation of a set of reforms under six pillars: fiscal consolidation, revenue mobilisation, public financial management reform, state enterprise reform, transition to flexible inflation targeting under a flexible exchange rate regime, and reforms in the trade and investment regime.

⁸ Development Policy Loans (DPLs) are programmatic loans that largely fund policy reform, often through rapidly-disbursed budgetary support, rather than project-based physical investments.

⁹ The DPL support reforms to enhance transparency & public sector management by the RTI Act, Audit Act and Public Finance Management Act and establishment of a Debt Management Office in MOF.

¹⁰ Adopting a strategic approach to budgeting, strengthening financial reporting and internal auditing, developing and implement e-government procurement, establishing the framework for procurement, upgrading the skills of public officials involved in public procurement, upgrading the audit capacity of the audit office and the financial oversight capacity of the Parliament and professionalise the public finance function.

of EUR 71 million. Two WB-led joint scoping missions were held together with the EU Delegation in October 2016 and in February 2017, to identify the existing bottlenecks and possible interventions required to strengthen PFM and accountability in Sri Lanka.

Supplementing the measures and support to address the fiscal stress, development partners are supporting the Government in its efforts to reform the PFM. Some of these include USAID's short-term technical assistance to the National Procurement Commission, developing framework for Public-Private Partnership (PPP) and e-procurement; the US Treasury is providing support in debt and cash management and in treasury operations to Ministry of Finance (MoF) and the WB's technical support in drafting of the Public Finance Act and capacity building in debt management. Similarly the EU is working with the Government to pave the way for introducing a sector reform contract (SRC) by 2019 to support rural development (indicative period). Key areas for dialogue and cooperation are linked to the eligibility criteria for SRC.

Sri Lanka has joined the Open Government Partnership in October 2015. The National Action Plan 2015-2017 includes number of commitments to promote transparency, accountability and public participation in the thematic areas of health, education, information and communication technology, environment, anti-corruption, local Government, right to information and women's issues.¹¹

1.1.2 Stakeholder analysis

The institutional framework of the public finance sector is complex and multi-layered. The current Government is composed of 51 Ministries and the public finance is mainly managed by the Ministry of Finance or the Treasury.

The Ministry of Finance formulates national economic and financial policies, the medium-term fiscal framework of the country, defines fiscal policy and is responsible for preparing and maintaining the national budget. A debt management unit is being set in the MoF, which will manage public debt and contingent liability portfolio¹² and certain aspects of debt management might be transferred to the MoF from the Central Bank and External Resource Department. There is a lack of technical capacity at the Ministry of Finance (MoF) at all levels, although there is strong commitment at the top levels. As a result, execution of policy decisions in the reform process are either delayed or at a standstill. Therefore, the MoF will be the main beneficiary of the PFM programme including capacity building support on medium term budget formulation, cash and debt management and tax policy.

The Ministry of National Policies and Economic Affairs: Within this Ministry the *National Planning Department* is in charge of policy development, planning and implementation, to accelerate Sri Lanka's economic growth and social progress. *National Planning Department* will be targeted through upgrading its capacity to implement guidelines and manuals in public investment management. Also, the *National Planning Department* will be involved in linking the development agenda and the medium term budgeting process. The *External Resources Department* (ERD) will be responsible in coordinating the steering committee that will be set up for the PFM reform programme.

Central Bank of Sri Lanka is currently managing the public debt by raising adequate resources to meet the cash flow needs of the Government at the minimum cost, by developing a broad

¹¹ <http://www.opengovpartnership.org/country/sri-lanka>

¹² Including loan guarantees and risks emanating from PPP's (currently debt is being managed largely outside the MoF)

funding and investor base. Therefore the debt management department will be targeted for capacity building.

The Auditor General's Department provides an external review of the performance and accountability of the public sector institutions and reports to Parliament. The recent constitutional amendment together with a new audit bill once passed will establish an external audit office with financial and administrative autonomy in line with INTOSAI standards on SAI independence. Auditor General's Department will be targeted through capacity building on upgrading the audit capacity.

The Parliament has two financial oversight committees, namely the Committee on Public Enterprises (COPE) and the Committee on Public Accounts (COPA). The oversight function of Parliament relating to PFM is restricted to financial oversight. Through the COPE and COPA financial oversight capacity of the Parliament will be upgraded.

Civil Society is currently not actively engaged in PFM dialogue in the country. Potential civil society actors' capacity will be strengthened to actively engage in PFM in the future.

Ministry of Women and Child Affairs works towards creating a Sri Lankan society that is sensitive to the needs of women and children. Their role and capacities would need to be strengthened in the PFM process to drive the MoF towards gender responsive budgeting.

1.1.3 Priority areas for support/problem analysis

In the absence of an overall PFM reform strategy, the current context of PFM reform in Sri Lanka is an evolving process. As an entry point, the programme expects to address the immediate needs, which will eventually lead to the development of an overall PFM reform plan.

The Public Expenditure and Financial Accountability (PEFA) assessment carried out in 2012 by the World Bank (WB), identified both strengths and weaknesses in PFM performance. Strengths include comprehensiveness and transparency of the budget, budget credibility, and control in budget execution. Weaknesses are related to monitoring and reporting of payment arrears, oversight on aggregate fiscal risk, public access to key fiscal and financial information, taxpayer registration and tax collections, internal audit and payroll controls, procurement procedures and transparency, predictability in the availability of funds, and external audit. Even though the PEFA report was never officially approved and published, there is consensus among development partners that the assessment is still valid and can be used as a baseline for the problem analysis.

The initial draft of the PFM Act covers the roles and responsibilities of the stakeholders¹³, budget preparation and approval, financial management, accounting, reporting and internal audit, entity accountability, enforcement, and consequential amendments. The Act is still in its drafting process and it is likely to be adopted by end of 2017. It will provide the legal basis for the Reform Strategy and Policy/Plan and to serve as the backbone to the PFM Strategy. Consequently, the proposed interventions under the PSESP will set the platform to jointly collaborate with the Government to support the PFM reform agenda with its Performance Assessment Framework (PAF).

¹³ The President's Office, The Parliament, Prime Minister, Cabinet of Ministers, Line Ministers, The Minister, Secretaries, Ministry responsible for Finance and Secretary of Treasury, Chief Accounting Officers, Accounting Officers, Revenue Accounting Officers, Delegation by Minister and others, Ministerial Directives to Chief Accounting Officers and Accounting Officers.

There are a number of binding constraints and challenges that Sri Lanka has to tackle. The most important are:

- Insufficient fiscal space: Sri Lanka has a low revenue to GDP ratio (14.3% of GDP in 2016¹⁴), which is constraining public investment needed to support its socio economic goals and transition to a middle income economy. Increasing tax revenue is a priority for the Government and is the centre of IMF's programme;
- The allocative efficiency of scarce public resources, which is constrained by the absence of an integrated public investment management framework prioritizing high impact, sustainable and mature projects;
- The financing of critical infrastructure and development expenditures is constrained by the rising public debt since 2012 as well as by Sri Lanka's graduation from concessional financing;
- The efficiency of the budget execution is hampered by insufficient predictability of revenues and expenditures, delays and uneven capacity in public procurement including absence of an e-procurement system, largely paper-based procedures and controls in the absence of a fully effective ITMIS¹⁵. Likewise, the absence of an effective and real time management decision support system hampers timely decision making;
- Transparency and accountability of the public sector is perceived as limited and affecting trust and performance as the recent major policy reforms enshrined in the 19th constitutional amendment have yet to be fully implemented. These policy changes are therefore not yet reflected in the World Wide Governance Indicators where Sri Lanka is still lagging behind the upper middle income countries;
- The fast changing external and internal environment in which central financial institutions operate has important implications in terms of adaptation of their functions, organization, processes and skills mix.

Based on these challenges, the Government has worked with the WB to identify priority areas for support under PSESP in the next five years:

The first priority area is "**spending better**": this area tackles the problem of limited predictability of resources, allocative inefficiencies of public investments, risky and costly debt and lack of performance focus.

The second priority area is "**more efficient budget execution**": this area tackles the problems of delays and cost overrun in public procurement, incomplete financial reporting, lack of commitment controls and monitoring of arrears.

The third priority area is "**a more open and accountable public sector**": this area tackles the problems of mismatch between public sector and citizens expectations in terms of responsiveness, openness and quality of services, limited fiscal transparency and strengthen existing accountability institutions and nascent accountability institutions created by the 19th constitutional amendment.

¹⁴ Central Bank of Sri Lanka (2016), Annual Report.

¹⁵ MoF is currently in the process of implementing the ITMIS with the support from ADB and it is expected to be fully rolled out by December 2017.

2 RISKS AND ASSUMPTIONS

The experience of PFM programmes in other countries shows that these programmes can face a wide range of challenges during the implementation. Further, there are a number of important country, sector and project risks associated with each work area. Even though the mitigating measures will help to lower overall project risks, they will not be able to eliminate the risks entirely.

The overall risks that remain include:

Risks	Risk level (H/M/L)	Mitigating measures
PFM reform hampered by political interference	L	The PFM programme will be strategically supported by the actions included in the already approved DPL.
Possible overlap and duplication of activities among development partners	L	Use of common arrangements and procedures and use of transparent performance assessment frameworks. Use of the PFM working group to ensure coordination and share of information. Use of a Performance Assessment Framework (PAF) agreed with the Government and the World Bank. Advocacy towards the Government, especially the Ministry of Finance, in taking the lead in coordinating the support of its partners.
Weak capacity of targeted institutions, corruption and insufficient prioritisation will hamper the achievement of the programme results	M	The programme will adopt a sequenced approach based on specific needs and requests made by the Government to ensure absorption. A strong focus of the programme will be on capacity strengthening.
Political fragility due to the post-conflict situation will impact on the achievement of the programme results	M	The EU and other development partners will continue to work on peace-building and reconciliation measure and thereby improve political stability and resilience.
<p>Assumptions: The PFM Act is approved and provides the strategic framework for PFM reform; The Audit Bill is submitted to and approved by Parliament; The Government takes lead in coordinating the efforts of its development partners; The country does not show any risks of facing major external shocks that could adversely affect its macroeconomic stability framework; The Government gathers political consensus to pursue critical reforms in the area of PFM.</p>		

3 LESSONS LEARNT, COMPLEMENTARITY AND CROSS-CUTTING ISSUES

3.1 Lessons learnt

A number of development partners are supporting the PFM sector in Sri Lanka in a dispersed manner. The existing sectoral donor coordination needs to be improved not only for the sake of coordination but also to ensure synergy and donor alignment to Government's financial management reform programmes. Key lessons learnt from other EU PFM programmes in South Asia, as well as from the WB and ADB shall be incorporated in the programme such as:

- Need for strong ownership, a clear vision and sequencing of the actions by the Government is essential to the success of the PFM reform programme. The proposed programme to be supported under the Trust Fund aligns with the Government objectives and funding will be linked to the Government's objectives and will be based on specific requests from the Government;
- Need to support outreach: Working on the demand side of PFM in parallel is equally important to create demand for various supply side system improvements;
- Need for strong analytical and research support: As PFM reform gathers speed, there is a need to analyse emerging issues and offer practical solutions based on international best practice and standard tools;
- Need for institutional capacity building: Accountability institutions often lack the resources and skills required to sustain institutional reform.

In Sri Lanka, most of the previous EU development cooperation projects have been implemented through International Organisations (IOs) and Non-Governmental Organisations (NGOs) with limited consultation with the Government especially at central level. There is a need for a more long-term approach of empowering and strengthening the institutions. This is now possible as the new Government is open to receive support to strengthen the overall PFM system, human resource capacity and its accountability. These can be key drivers of structural reforms in the country. It is also vital to strengthen the capacities of the actors in charge of the implementation of national policies in the country.

It is imperative to take into account the complexity of the governance system, with a large number of Cabinet Ministries with overlapping mandates and lack of policy coherence, when formulating the interventions aimed at strengthening the capacity of public officials at all levels as well as the information system and coordination among actors.

The proposed programme will establish the platform to facilitate the dialogue and strengthen the relationship with the Government, to move to sector wide approaches and will contribute to prepare the foundation for sector reform operations.

3.2 Complementarity, synergy and donor coordination

Sri Lanka's graduation to a Lower-Middle Income Country has led to change of the composition and the form of external development financing in the country. This has ultimately resulted in a drop in investments undertaken by development partners. Key development partners in the country include ADB, JICA, WB and the Agence Française de Developpement (AFD) as development financing institutions (DFIs) and Australia, Canada, Germany, EU, India and the USA as bilateral partners. DFIs focus mainly on infrastructure projects with emphasis on energy, transportation and water. Australia, Germany, and USA

have bilateral country allocations with grant projects focusing on Governance and Reconciliation as well as on economic development and growth.

A Development Partner Forum (DPF) meets regularly to share information on strategies and programmes related to development cooperation, however there is no official link with the Government. At the same time, representatives of Ministry of National Policies and Economic Affairs as well as line ministries attended some DPF meetings since 2015. Several thematic subgroups have been established in the areas of public finance management, water, private sector development, social integration and vocational training.

Until recently there was limited policy dialogue with Government around PFM and there was a strong need to improve donor coordination. PFM Working group was established in May 2015 to promote a more harmonised approach to PFM policy dialogue and enhance donor coordination. The group is chaired by the World Bank and active members include EU, ADB and USAID. ERD has organised a coordination meeting with development partners in January 2017 in order to coordinate their initiatives to strengthen PFM and has agreed to conduct these meetings on a regular basis.

The IMF is supporting the tax policy reform of Government that includes capacity building on tax administration, revenue forecasting and expenditure analysis. Therefore, revenue mobilization will not be focused under PSESP. The action will be closely coordinated with the IMF and in particular with the Training and Technical Assistance Centre for Economic Capacity Building in South Asia (SARTTAC).

3.3 Cross-cutting issues

This programme will address gender equality and women empowerment (GEWE) through a Gender-responsive budgeting (GRB) to incorporate a gender equality perspective into the budgetary process to ensure an efficient allocation of resources based on identified needs, and restructure revenues and expenditures. Also, by improving the management of public funds, the programme is expected to positively impact the Government's capacity to deliver public services and participation notably to vulnerable communities by enhancing gender sensitive approaches thus contributing more specifically to the objectives under thematic priority 'Political and civil rights – Voice of Participation of the EU Gender Action Plan 2016- 2020, in particular with regard to indicator 17.7 "gender-responsive budgeting at local and national level with EU support".

The role of civil society will be critical for enhancing budget transparency and accountability. Civil Society institutions will be strengthened in the framework of the activities under specific objective 3.

Owing to its nature, this project is not expected to have any negative environmental impact. In fact, through better fiscal planning and better budget oversight mechanisms, the environment, including climate change adaptation measures could potentially benefit ("collect more, spend better").

4 DESCRIPTION OF THE ACTION

4.1 Objectives and results

The **overall objective** of the programme is to achieve more sustainable and inclusive economic growth, social development and good.

The **specific objective** is to contribute to enhancing efficiency, transparency, accountability in use of public resources and fiscal sustainability.

This programme is relevant for the Agenda for Sustainable Development 2030. It contributes primarily to the progressive achievement of SDG 16: Promote peace, justice and strong institutions. This does not imply a commitment by Sri Lanka benefiting from this programme.

The programme is designed around three pillars, which cover the overall cycle of the PFM.

R.1: Allocative efficiency of public investments, programs and debt management is strengthened;

R.2: Operational efficiency and controls in budget execution and procurement is improved; and

R.3: Governance, transparency and efficiency of public services critical for investment is strengthened.

4.2 Main activities

The following indicative activities will be carried out.

A.1.1: Strengthen the public investment management and efficiency;

A.1.2: Technical assistance for the establishment of an integrated debt management office (front, middle and back office)

A.1.3: Strengthen fiscal planning, budget preparation and performance

A.1.4- Increase the efficiency of excises

A.2.1: Implement the revised public procurement policy and e-procurement system;

A.2.2: Technical assistance to the roll out all ITMIS functionalities across the public sector;

A.2.3: Enhance financial reporting by supporting transition to accrual based reporting;

A.2.4: Modernize the valuation department in order to improve pace of execution of capital projects and public investment.

A.2.5: Support the optimization of public assets.

A.3.1: Strengthen the fiscal transparency and the business environment through the implementation of the Right to Information (RTI) reform;

A.3.2: Strengthen institutional capacity of accountability institutions, such as the auditor general and the attorney general.

In the framework of the programme it is envisaged to conduct a number of system diagnostics to be identified and agree with the government, e.g. PIMA, PEFA, Supreme Audit Institutions Performance Measurement Framework, functional review of treasury, assessment of the procurement system.

4.3 Intervention logic

The logic behind the intervention is to support the Government's key governance and public financial management reforms aimed at improving the efficiency of public programs and services to citizens and firms. It builds on enhancing the effective use of public resources and alignment of expenditures with national priorities to improve Government's service delivery and spur economic growth. The proposed intervention is an integrated approach to maximize impact and synergies of different governance and PFM reform levers, both upstream and downstream. This also aims to support the implementation of the reform in key line ministries providing services to citizens and firms.

Considering the high level of Government ownership over the PSESP, the proposed action to support core PFM reforms will lead to build confidence among the citizens of Sri Lanka on public finance management, particularly with regard to the budget process. The institutional and capacity building are not only instrumental for the success of the action but also for fiscal sustainability of the country. This action should help preparing future EU budget support operation. All components of the programme will be accompanied by joint EU/WB policy dialogue.

5 IMPLEMENTATION

5.1 Financing agreement

In order to implement this action, it is foreseen to conclude a financing agreement with the partner country, referred to Article 184(2)(b) of Regulation (EU, Euratom) No 966/2012.

5.2 Indicative implementation period

The indicative operational implementation period of this action, during which the activities described in section 4.2 will be carried out and the corresponding contracts and agreements implemented, is 60 months from the date of entry into force of the financing agreement.

Extensions of the implementation period may be agreed by the Commission's authorising officer responsible by amending this decision and the relevant contracts and agreements; such amendments to this decision constitute technical amendments in the sense of point (i) of Article 2(3)(c) of Regulation (EU) No 236/2014.

5.3 Implementation modalities

5.3.1 Indirect management with an international organisation

This action may be implemented in indirect management with the WB in accordance with Article 58(1)(c) of Regulation (EU, Euratom) No 966/2012. This implementation entails the management of a Trust Fund on PFM reform. This implementation is justified because:

The WB is formulating a USD 68.5 million investment programme to strengthen the public sector efficiency in Sri Lanka that aligns with the Government priorities. The WB is a likeminded donor with extensive experience in working with the Government and through sector approaches and programmes. The Government has specifically requested the WB to provide support in a number of reforms in the area of Public Finance Management. The WB is one of the key partners of the EU in the area of PFM worldwide. The WB and the EU have a long history of cooperation in the area of PFM and the WB is considered as one of the main

actors in the sector and a key counterpart of Governments in developing countries. In Sri Lanka, the WB has a preferential dialogue with the Ministry of Finance and is seen by the Government as the main partner for all PFM reforms. The WB has an office in Colombo and a pool of long-term experts working on different sub-areas related to PFM (procurement, governance, public-private partnerships). The WB has also an extensive network of experts that can be mobilized for short-term support. The WB loan and the EU funds could thus be complementary and reinforce each other.

The entrusted entity would carry out the following budget-implementation tasks, consisting of: launching calls for tenders and for proposals; definition of eligibility, selection and award criteria; evaluation of tenders and proposals; award of grants, contracts and financial instruments; acting as contracting authority concluding, monitoring and managing contracts, carrying out payments, and recovering moneys due.

For the budget implementation tasks not yet pillar assessed, the entrusted international organisation is currently undergoing the ex-ante assessment in accordance with Article 61(1) of Regulation (EU, Euratom) No 966/2012. The Commission's authorising officer responsible deems that, based on the compliance with the ex-ante assessment based on Regulation (EU, Euratom) No 1605/2002 and long-lasting problem-free cooperation, the international organisation can be entrusted with budget-implementation tasks under indirect management.

5.4 Scope of geographical eligibility for procurement and grants

The geographical eligibility in terms of place of establishment for participating in procurement and grant award procedures and in terms of origin of supplies purchased as established in the basic act and set out in the relevant contractual documents shall apply, subject to the following provisions.

The Commission's authorising officer responsible may extend the geographical eligibility in accordance with Article 9(2)(b) of Regulation (EU) No 236/2014 on the basis of urgency or of unavailability of products and services in the markets of the countries concerned, or in other duly substantiated cases where the eligibility rules would make the realization of this action impossible or exceedingly difficult.

5.5 Indicative budget

	EU contribution (amount in EUR)	Indicative third party contribution, in USD
5.3.1 – Indirect management with an international organisation - the World Bank	9 800 000	68 500 000
5.8 and 5.9 – Evaluation and Audit	200 000	N.A.
Totals	10 000 000	68 500 000

5.6 Organisational set-up and responsibilities

The EU contribution will be managed under the institutional responsibilities and arrangements designed for the implementation of the WB investment programme, as follows:

The Ministry of Finance (MoF) - Project Coordination Unit (PCU) to be chaired by the Secretary to the Treasury, with the participation of all implementing stakeholders at national level.

The External Resources Department (ERD) will be responsible in coordinating the steering committee that will be set up for the PFM reform programme.

Overall coordination of the programme

The EU will be a full member in the steering mechanism established under the PSESP and fully associated to all missions. In addition, working groups for the different components of the programme are foreseen.

5.7 Performance monitoring and reporting

The impact (overall objective) will be measured with the following indicator: Change in domestic revenue mobilisation as a percentage of GDP (EU Results Framework #13). The outcome (specific objective) will be measured with the voice and accountability indicator that is part of the world governance indicators. The outputs (results) will be measured with the following indicators: i) recording, reporting and management of public investments, debt and guarantees, ii) payroll controls, internal audit and procurement management, iii) budget oversight indicators (OBI). A more detailed monitoring framework (PAF) will be part of the project appraisal document (PAD) of the WB.

The day-to-day technical and financial monitoring of the implementation of this action will be a continuous process and part of the implementing partner's responsibilities. To this aim, the implementing partner shall establish a permanent internal, technical and financial monitoring system for the action and elaborate regular progress reports (not less than bi-annual) and final reports. Every report shall provide an accurate account of implementation of the action, difficulties encountered, changes introduced, as well as the degree of achievement of its results (outputs and direct outcomes) as measured by corresponding indicators, using as reference the log-frame matrix.. The report shall be laid out in such a way as to allow monitoring of the means envisaged and employed and of the budget details for the action. The final report, narrative and financial, will cover the entire period of the action implementation.

The Commission may undertake additional project monitoring visits both through its own staff and through independent consultants recruited directly by the Commission for independent monitoring reviews (or recruited by the responsible agent contracted by the Commission for implementing such reviews).

5.8 Evaluation

Having regard to the importance of the action, a mid-term and a final evaluation will be carried out for this action or its components via independent consultants contracted by the Commission.

The mid-term evaluation will be carried out for problem solving and learning purposes, in particular with respect to the implementation modality, in view of potential future EU support to PFM reform.

The final evaluation will be carried out for accountability and learning purposes at various levels (including for policy revision), taking into account in particular the fact that by the time of the evaluation a PFM strategy has been formulated and the country is eligible to receive sector budget support. Lessons learnt will be taken into account for any future support to PFM reform.

The Commission shall inform the implementing partner at least one month in advance of the dates foreseen for the evaluation missions. The implementing partner shall collaborate efficiently and effectively with the evaluation experts, and inter alia provide them with all necessary information and documentation, as well as access to the project premises and activities.

The evaluation reports shall be shared with the partner country and other key stakeholders. The implementing partner and the Commission shall analyse the conclusions and recommendations of the evaluations and, where appropriate, in agreement with the partner country, jointly decide on the follow-up actions to be taken and any adjustments necessary, including, if indicated, the reorientation of the project.

Indicatively, two contracts for evaluation services shall be concluded under a framework contract in 2020 and 2023.

The European Union Delegation will also take part in the evaluations to be contracted under the WB programme.

5.9 Audit

Without prejudice to the obligations applicable to contracts concluded for the implementation of this action, the Commission may, on the basis of a risk assessment, contract independent audits or expenditure verification assignments for one or several contracts or agreements.

Indicatively, one contract for audit services shall be concluded under a framework contract in 2020.

5.10 Communication and visibility

Communication and visibility of the EU is a legal obligation for all external actions funded by the EU. This action shall contain communication and visibility measures which shall be based on a specific Communication and Visibility Plan of the Action, to be elaborated at the start of implementation and supported with the budget indicated in section 5.5 above.

In terms of legal obligations on communication and visibility, the measures shall be implemented by the Commission, the partner country, contractors, grant beneficiaries and/or entrusted entities. Appropriate contractual obligations shall be included in, respectively, the financing agreement, procurement and grant contracts, and delegation agreements.

The Communication and Visibility Manual for European Union External Action shall be used to establish the Communication and Visibility Plan of the Action and the appropriate contractual obligations.

APPENDIX - INDICATIVE LOGFRAME MATRIX (FOR PROJECT MODALITY) ¹⁶

The activities, the expected outputs and all the indicators, targets and baselines included in the logframe matrix are indicative and may be updated during the implementation of the action, no amendment being required to the financing decision. When it is not possible to determine the outputs of an action at formulation stage, intermediary outcomes should be presented and the outputs defined during inception of the overall programme and its components. The indicative logframe matrix will evolve during the lifetime of the action: new lines will be added for including the activities as well as new columns for intermediary targets (milestones) for the output and outcome indicators whenever it is relevant for monitoring and reporting purposes. Note also that indicators should be disaggregated by sex whenever relevant.

	Results chain	Indicators	Baselines (incl. reference year)	Targets (incl. reference year)	Sources and means of verification	Assumptions
Overall objective: Impact	Achieve more sustainable and inclusive economic growth, social development and good governance by supporting the Government of Sri Lanka in improving the collection, allocation, utilisation and control of public resources	Change in domestic revenue mobilisation as a percentage of GDP (EU RF #13)	11.8% (2016) Source (IMF Article IV report June 2016)	14.6% (2020)	IMF Article IV report (tax revenue)	GoSL commitment to overall policy reforms Political and macro-economic stability
Specific objective: Outcome	Contribute to enhancing efficiency, transparency, accountability in use of public resources and fiscal sustainability, by strengthening PFM systems and capacities.	Voice and accountability indicator (WGI)	35.96 (2015)	40 (2022)	WGI	Government remains committed to governance reforms

¹⁶ Mark indicators aligned with the relevant programming document mark with '*' and indicators aligned to the EU Results Framework with '**'.

Outputs	R.1: Allocative efficiency of public investments, programs and debt management is strengthened	Recording, reporting and management of public investments, debt and guarantees	Limited capacity in managing public investments, debt and guarantees (2017)	Improved management of public investments, debt and guarantees (2022)	Budget, debt management strategy, public investment programme	Government remains committed to PFM reform agenda
	R.2: Operational efficiency and controls in budget execution and procurement is improved	Payroll controls, internal audit and procurement management	Limited capacity in managing payroll controls, internal audit and procurement (2017)	Improved payroll controls, internal audit and procurement management (2022)	Budget, internal audit strategy, procurement statistics	
	R.3: Governance, transparency and efficiency of public services critical for investment is strengthened	Budget oversight indicators (OBI)	Budget oversight by legislature: 37/100 (2015) by auditor: 67/100 (2015)	50/100 (2022) 75/100 (2022)	OBI	