ADB

Progress Report on Tranche Release

Program Number: 36168
Loan Number: 2130
May 2008

Sri Lanka: Fiscal Management Reform Program

Asian Development Bank

CURRENCY EQUIVALENTS
(as of 1 May 2008)

Currency Unit	–	Sri Lanka rupee/s (SLRe/SLRs)
SLRe1.00	=	$0.01
$1.00	=	SLRs107.88

ABBREVIATIONS

ADB	–	Asian Development Bank
APRC	–	All Party Review Committee
BOI	–	Board of Investment
FMRA	–	Fiscal Management (Responsibility) Act
FMRP	–	Fiscal Management Reform Program
GDP	–	gross domestic product
HRMP	–	human resource management plan
IRD	–	Inland Revenue Department
MOFP	–	Ministry of Finance and Planning
PAFMIS	–	public accounting and financial management information system
PC	–	provincial council
PSC	–	Public Service Commission
RAMIS	–	revenue administration management information system
SAD	–	State Accounts Department
TA	–	technical assistance
TFTS	–	Treasury Fund Transfer System
TIN	–	tax identification number
VAT	–	value-added tax

NOTES

(i) The fiscal year of the Government ends on 31 December.
(ii) In this report, "$" refers to US dollars.

Vice President	L. Jin, Operations 1
Director General	K. Senga, South Asia Department (SARD)
Director	A. Sharma, Governance, Finance and Trade Division, SARD
Team leader	B. Carrasco, Principal Economist (Financial Sector), SARD
Team member	S. Hashizume, Young Professional, SARD

CONTENTS

I. INTRODUCTION

1. The Asian Development Bank (ADB) approved the Fiscal Management Reform Program[1] (FMRP) loan for the equivalent of $70 million on 14 December 2004. The FMRP comprises (i) a program loan of $45 million to support fiscal management policy reforms; (ii) a project loan of $15 million for the Modernization of the Revenue Administration Project, mainly to procure a revenue administration management information system; and (iii) a technical assistance (TA) loan of SDR6,672,000 (equivalent of $10 million) for the Institutional Strengthening of Fiscal Management Institutions Project. The FMRP was prepared based on the findings of a project preparatory TA.[2]

2. The objective of the FMRP is to strengthen public finances by improving public resource and expenditure management systems, promoting fiscal discipline, and supporting fiscal decentralization. In particular, it seeks to create an enabling environment to foster mobilization of tax revenues, improve effectiveness of public expenditures, and ultimately place public finances on a sustainable path. Accordingly, the FMRP supports the Government of Sri Lanka's strategy of fiscal consolidation compatible with medium-term fiscal sustainability as enshrined in the Government's Fiscal Management (Responsibility) Act of 2003 (FMRA).

3. The reforms under the FMRP were to be implemented over 3 years from December 2004 to December 2007, with the program loan divided into three equal tranches of $15 million. The first tranche was released upon loan effectiveness on 21 December 2004. The release of the second tranche, which required compliance with 21 policy actions, was originally targeted for June 2006, or 18 months after loan effectiveness. However, program implementation was disrupted significantly due to (i) the impact of the December 2004 tsunami on an already stretched civil service, particularly the Ministry of Finance and Planning (MOFP); (ii) presidential elections in November 2005; and (iii) a change in the program director in December 2005. These led to delays in the release of the second tranche until 22 December 2006.[3]

4. The release of the third tranche, which requires compliance with 15 policy actions, was originally targeted for December 2007 or 36 months after loan effectiveness. Due to the delayed fulfillment of some of the second tranche policy actions, release of the second tranche, and the resulting carryover to third tranche policy actions, the release of the third tranche of the program loan has also incurred delays.

5. The counterpart funds of the tranche release will serve to meet adjustment costs estimated at approximately $48 million over the program period. These costs are directly related to implementation of the FMRP, such as the modernization of revenue administration, including implementation of human resource and information technology strategies.[4] Major items funded from counterpart funds include (i) recruitment of 1,500 new staff for the Inland Revenue Department (IRD) in 2007 and 107 for the Customs Department in 2008; (ii) purchase of four container scanners by the Customs Department in 2007 and now operating at the Colombo port and airport; (iii) civil works for the building of a taxation office and a one-stop shop call center;

[1] ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Fiscal Management Reform Program.* Manila.
[2] ADB. 2002. *Technical Assistance to the Democratic Socialist Republic of Sri Lanka for Preparing the Public Sector Resource Management Project.* Manila (TA 3906-SRI, approved on 23 August, for $500,000).
[3] ADB. 2006. *Progress Report on Tranche Release of the Fiscal Management Reform Program.* Manila.
[4] The costs of adjustment exclude approximately $20 million for the procurement of public accounting and financial management information system which will now be phased in over the medium term.

(iv) procurement of ASYCUDA World[5] software for the Customs Department; and (v) development of a Treasury Fund Transfer System (TFTS) software for the Treasury and of connectivity with partner banks. Appendix 1 provides a breakdown of these costs.

6. Inception and loan review missions in 2005–2008 (corresponding to 3.05 person-months) monitored loan implementation (Appendix 2). The release of the third tranche is justified based on confirmed progress in overall program implementation, including satisfaction of the first and second tranche conditions, compliance with third tranche policy actions, and attendant assurances. Third tranche policy actions and compliance status are in Appendix 3. Nontranche policy actions and compliance status are in Appendix 4. Program assurances and compliance status are in Appendix 5. Status of the task list for modernization of revenue administration is in Appendix 6.

II. RECENT MACROECONOMIC AND POLITICAL DEVELOPMENTS

7. The economy of Sri Lanka grew robustly during the 2005–2007 program implementation period. Annual gross domestic product (GDP) growth was 6.8% in 2007, 7.7% in 2006, and 6% in 2005. Economic growth in 2007 was broad-based led by industry at 7.6% and buoyed by strong performance in construction. This was followed by services at 7.1%, because of strong growth in transshipment and telecommunications. Agriculture contributed more modestly to GDP growth at 3.3%.

8. Gross domestic investment in 2007 reached 27.9% of GDP from 28% in 2006, reflecting a continuation of robust capital spending for infrastructure development. Gross domestic saving increased to 17.6% of GDP from 17% in 2006 mainly reflecting a decline of public dissavings[6] from the Government's continued fiscal consolidation effort.

9. On the external front, exports increased by 12.5% in 2007 and imports by 10.2% thereby containing the expansion of the trade deficit to 11% of GDP. Despite the large increase in petroleum import costs, the 6% average depreciation of the Sri Lanka rupee to the dollar contained the growth of imports. The current account deficit improved to 4.2% of GDP in 2007 from 5.3% in 2006, while the overall balance of payments surplus increased to 1.6% of GDP in 2007 from 0.8% in 2006. While tourism receipts were constant in 2007 compared with 2006 (tourist arrivals declined by 11.7% in 2007); remittances from out-of-country workers continued to grow strongly reaching 7.7% of GDP in 2007. Gross official reserves increased to $3.1 billion in 2007 (equivalent to 3.3 months of imports of goods and services) from $2.5 billion (or 3 months of import) in 2006. Reserves were buffered by a $500 million international sovereign bond issuance in October 2007 resulting in a yield of 8.25% for a 5-year maturity.

10. Inflation has been running very high with the consumer price index averaging more than 17.5% and the 2007 GDP deflator at 14.0%. This reflects a combination of factors including high oil prices and the elimination of fuel subsidies, their eventual pass-through into the domestic economy, together with an increase in minimum wages from SLRs3,000 to SLRs5,000 per month and higher food prices. In addition, fiscal stimulus and a somewhat passive tightening monetary policy cycle resulting in a late but rapid increase of treasury securities rates by 500

[5] Automated System for Customs Data (ASYCUDA) is a computerized customs management system that covers most foreign trade procedures including manifests and customs declarations, accounting procedures, transit, and suspense procedures.

[6] Public dissaving refers to the public sector's revenue to expenditure shortfall.

basis points in 2007. Growth of broad money peaked at more than 22% in August 2007 before declining to 16.6% by the end of 2007.

11. The fiscal deficit improved to an estimated 7.7% of GDP in 2007 from 8.2% in 2004 continuing the declining trend observed during program implementation. Revenue augmentation efforts, including the strengthening of tax administration and broadening of the tax base, led the fiscal consolidation drive. Total expenditure and lending declined to 23.5% of GDP in 2007 from 24.3% in 2006. This curtailment took place against a backdrop of robust capital spending to support the Government's infrastructure financing program. Government debt as a share of GDP declined to 85.8% of GDP by the end of 2007 from 93% in 2006, reflecting the fiscal consolidation drive and effects of inflation and strong GDP growth.

12. External factors, including the impact of the tsunami, high oil prices, and continued escalation of conflict, led to a breach of the fiscal targets under the FMRA. The targets included a fiscal deficit of 5% of GDP in 2006 and external debt of less than 85% of GDP. However, the Government under its FMRA reporting requirements has committed to meet these targets by 2010. In that effort, the Government has submitted, alongside the 2008 budget, a revised medium-term fiscal framework, which indicates the achievement of a surplus on the current balance of 0.9% of GDP in 2008—a first in over 20 years—and a fiscal deficit of 4.8% by 2011. The fiscal performance analysis and assessment is reported in Appendix 7.

13. In the political arena, President Mahinda Rajapakse has followed a strategy of rebuilding a majority in Parliament to secure a strong Sri Lanka Freedom Party government while keeping unrelenting military pressure on the Liberation Tigers of Tamil Eelam to return to the negotiations. The majority in Parliament was achieved on January 2007 when more than 20 opposition members of parliament crossed the floor, providing an important cushion to the governing party. The nominal ceasefire agreement between the Government and Liberation Tigers of Tamil Eelam came under greater strain in 2006 with violence increasing throughout 2006 and 2007 and leading to the formal end of the ceasefire in January 2008. While the Government currently appears to have some degree of control over the military conflict, having regained control of territory in the East, the outlook for the protracted conflict continues to be uncertain.

III. STATUS OF PROGRAM IMPLEMENTATION

14. The third tranche of the FMRP comprises 15 policy actions and 3 nontranche release policy actions. The FMRP design is based on the principle that institutional reforms would address the more acute constraints impeding key fiscal management institutions and, particularly, the revenue administration from effective delivery of their institutional mandates. Institutional reform, in turn, was built around developing and implementing strategic institutional action plans to serve as the blueprint for the modernization drive, and supported by reforms to human resource management and automation. While policy actions focused on design and initiation of plans and reforms up to the second tranche release, the third tranche actions mainly envisaged their implementation. This section supplements the appendixes on third tranche policy actions, nontranche actions and assurances, and their compliance status (Appendixes 3–5).

A. Improving Effectiveness of Tax Administration

15. **Supporting Full Implementation of the Task List.** As part of FMRP efforts to strengthen revenue administration, the program loans supports a comprehensive modernization

drive based on implementation of the task list for modernization of revenue administration. The list comprises 31 key result areas with 148 tasks across the three revenue departments targeting institutional strengthening based on best international practices. Significant achievements include (i) appointment of a tax ombudsman; (ii) setting up of the taxpayer service department; (iii) creation of internal audit units; (iv) preparation and dissemination of code of ethics, taxpayer charter, and customs charter; (v) consolidation of the tax administration code; and (vi) development of a risk-based cargo clearance system. By their very nature, many of the activities are considered ongoing, as opposed to one-time activities. Stop-filer[7] and nonfiler[8] identification programs are included in the task list. While their design and initial implementation are complete, full implementation of the stop-filer program has not been possible due to the sudden discovery of limited capacity of existing IRD computer data servers. These servers are to be replaced as part of automating the revenue administration and funded under the project loan;[9] full implementation will be concluded by August 2008. The transfer of the Excise Special Provision Unit from the Customs Department to the Excise Department has not been implemented. This reflects staffing constraints and the costly implications of developing a network of excise branches throughout the country, which would be required by the transfer. Accordingly, the Government decided to keep the unit under the Customs Department. With these two exceptions, the task list is effectively implemented. Appendix 6 provides detailed status of each task.

16. **Supporting Full Implementation of Strategic Plans.** The three revenue departments prepared and approved strategic plans in 2005, in compliance with the second tranche release condition. The plans consist of key strategic directions and major goals over the coming 3 years. They have been implemented over the course of the program loan. Revenue collection targets are included and updated to support achievement of fiscal targets determined in the Medium Term Fiscal Framework in support of the fiscal consolidation objectives set forth under the Fiscal Responsibility Act. The targets under the strategic plans were last updated in early 2008 to take account of the latest developments. The strategic plans are to be complemented by detailed human resource management and integrated information technology development plans (paras. 17–20).

17. **Supporting Full Implementation of Human Resource Management Plans (HRMPs).** The creation of HRMPs for each of the revenue departments has been a major and critical thrust of the FMRP. Work in this area reflects strong inputs from the TA loan consultants. While implementation of the plans will continue beyond the life of the program loan, major achievements to date include (i) establishment of a staffed human resource division within each revenue department, (ii) elaboration of terms of reference for professional positions, (iii) establishment of the performance evaluation scheme, (iv) filling of staff vacancies, and (v) implementation of training programs. The Revenue Board has approved the HRMP in principle and is implementing many components, including skills upgrading through a comprehensive training program (Appendix 2). However, formal approval of the HRMP for the Customs Department is pending concurrence by the Public Service Commission. The commission, an independent institution, has been reviewing the possibility of applying the human resource development plans designed under the FMRP to the Customs Department as a model to be adopted by the civil service. Due to the greater implications of the sanctioning of these plans, the Public Service Commission has yet to give its final approval to the July 2007 request. MOFP

[7] Registered taxpayers who stop submitting tax returns to the Revenue Department.
[8] Individuals who are liable for tax filing but who are not registered or outside the tax net.
[9] Modernization of the Revenue Administration project loan under ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Fiscal Management Reform Program.* Manila (Loan 2132-SRI, approved on 14 December, for $15 million).

has done everything within its powers to comply with this policy action and is confident that a favorable resolution will eventually be reached. Indeed in early March 2008, the National Salaries and Cadres Commission endorsed the Customs Department's performance evaluation scheme that includes the assessment of personal competencies, incentives criteria and determination of incentives. Accordingly, the new promotion schemes and merit-based performance appraisal schemes will be rolled out for the first time on 1 July 2008 to be followed on a regular semi-annual basis in January and July of each year. The design and implementation of the HRMPs under the FMRP has been instrumental in reducing confrontation between union representatives and management of the revenue departments. It has also paved the way for a more transparent, objective and accountable incentives system in the revenue departments. In particular, the commitment to merit-based appointments and introduction of effective grievance reporting systems has strengthened staff morale and improved staff performance. As part of the skills up-grading needs under the HRMP, IRD has recruited over 1,500 new staff in 2007 and Customs Department has recruited 107 in early 2008. The training program under the HRMP has been very effective in developing ownership of the reforms by the department cadres and contributed to institutionalizing change management.

18. **Supporting an Integrated Information Technology Development Plan.** The FMRP includes a major thrust to automate revenue administration. The two main components of the information technology development plan include development of a revenue administration management information system (RAMIS), to be supported by the project loan, and a public accounting and financial management information system (PAFMIS) to be funded under a bilateral agreement outside the FMRP. The proposed RAMIS would leverage the institutional and human resource reforms to enhance timely and reliable information sharing across revenue departments, and improve administrative efficiency. The PAFMIS would cover accounting, planning, budgeting, and treasury reporting.

19. Despite a workshop in March 2005 to review experience in applying information technology solutions in government, the Government was unable to reach a consensus on how to implement the information technology development plan until the third year of the program loan. This reflected limited capacity in MOFP and the revenue departments in information technology development and applications. The TA loan provided international experts to support the Government in reviewing options and benefits of the proposed automation process. However, even this was insufficient to expedite a decision. An agreement was finally reached in March 2007 to undertake a phased approach to automation of the revenue and treasury departments. Accordingly, the third tranche action requiring completion of implementation of the information technology development plan has been substantially complied with.

20. The approach comprises three phases: Phase 1 - interim hardware and software development project (2007–2008), Phase 2 - local area and wide area network infrastructure development project (2008–2010), and Phase 3 - RAMIS (2009–2011). Phase 1 is being implemented and seeks to enhance the existing computerized system until the RAMIS is fully implemented. IRD servers are currently being replaced, databases are being cleansed of information for deceased individuals or liquidated firms, e-filing is being improved, e-TIN (tax identification number) procedures are to be developed, and software applications are to be introduced to implement risk-based audit selection systems and apply the stop-filing program (see footnote 7). The request for proposal for the phase 2 turn-key procurement was advertised on 2 January 2008; four bids were received. Adjudication is expected by July 2008. Full implementation is scheduled for December 2009. For the Customs Department, the plan includes continuing to upgrade ASYCUDA to ASYCUDA World and incorporate developments in automating risk-based cargo clearance systems and applications, including improvements to

the electronic date interchange system. The Excise Department has limited scope for automation at this early stage and awaits development of interfacing under phase 3.

21. **Strengthening Tax Collection and Compliance.** The TIN system is in place and, more importantly, enforced in IRD and Customs Department tax filing operations to include corporations, value-added tax registrants, and traders. Commercial banks are now requiring submission of TIN for banking transaction activities. For non-value-added tax registrants or traders, the Sri Lankan national identity card number issued by the Registry of Persons is used. This identity card number is used by outside entities such as banks. The improved enforcement of TIN use is an important achievement for the monitoring of tax compliance and serves as the basis of the management information system.

22. While TIN enforcement has strengthened tax compliance, the full benefits of TIN implementation have not yet materialized. A single taxpayer database using an updated and cleansed TIN list has been delayed following difficulties with servers (para. 15). Establishment of the new database will be prioritized following the purchase of two servers and is expected to be in place by August 2008.

23. In 2006, the Customs Department set up the Risk Management Committee, chaired by the head of the department, to identify and analyze risks involved in the customs clearance process, and take effective measures to address them. Based on the assessment of the Risk Management Committee, the department identified factors for identifying high-risk importers and revised customs clearance processes to reflect the new criteria. At the same time, it introduced a “star class” facilitation mechanism for importers with low-risk profiles. Low-risk importers are awarded a special status for simpler customs clearance processes. These reforms are expected to contribute to increasing the number of detections while reducing the number of inspections, thereby improving customs clearance efficiency.

B. Improving the Budget Framework

24. **Rationalizing Expenditures.** As part of ongoing efforts to rationalize expenditures, second tranche policy actions called for the submission of restructuring plans for five ministries and Western Province, while third tranche actions require their implementation. The five key ministries are (i) education, (ii) finance and planning, (iii) foreign affairs, (iv) health care and nutrition, and (v) railways and transport. The plans seek to identify cost-cutting measures through (i) internal reorganization, (ii) devolution of responsibilities vertically to subnational governments or horizontally across newly created ministries, and/or (iii) outsourcing to the private sector and/or civil society. In some ministries, such as MOFP, measures have gone beyond the proposed action, with the reorganization being fully implemented. The Ministry of Finance and Ministry of Planning were merged to integrate planning and budgeting under one authority. In addition, MOFP was restructured into four departments, namely, policy development, budget and treasury management, tax administration and development, and administration and finance. This will lead to better coordinated and faster decisions submitted for the secretary’s consideration. MOFP established the Operations and Review Unit to monitor implementation of large projects, and the Revenue Administration Unit to ensure effective oversight functions of IRD, Customs Department, and Excise Department. Most critically, the three revenue departments were restructured (Supplementary Appendix A).

25. The Ministry of Education has undertaken restructuring to support more effective aid coordination, project implementation, and policy formulation. Another pilot restructuring plan for the education sector was prepared in Western Province to address gaps and overlaps between

the central Government and the provincial councils and to improve management of expenditure responsibilities. However, no restructuring plans were submitted for health care and nutrition, railways and transport, and foreign affairs. The reasons for this can be traced to various factors. On health care and nutrition, the Government raised issues with the findings and recommendations of the 2006 public expenditure review undertaken by the World Bank. The review was to provide justification for expenditure containment measures. Furthermore, recommendations related to addressing duplication of expenditure assignments between central and provincial governments have been put on hold until political deliberations of the All Party Review Committee (APRC) are concluded. The Ministry of Railways and Transport does not support the restructuring process. The reform-minded secretary of the Ministry of Foreign Affairs moved on, leaving no champion of reform to carry out restructuring of the ministry. Consequently, this policy action has been partially complied with.

C. Improving Public Expenditure Management and Control Systems

26. **Strengthening Management of Off-Budget Expenditure and Borrowing.** Off-budget fiscal activities such as independent ministerial funds, other contingent government liabilities such as guarantees, and even direct liabilities such as pension payments can seriously undermine fiscal management. As part of third tranche policy actions, the Government through the issue of Public Finance Circular No. PF. 423 of 12 October 2006 requested all ministries and departments to declare information on all nonstatutory funds. The information was collected and analyzed, and approved in November 2006 based on MOFP guidelines. The Government identified funds to be closed and ones to be made statutory. According to the 24 October 2007 status report, of 91 funds reviewed, 7 were reported as nonstatutory. Of these 7 nonstatutory funds, the Government heeded a decision in January 2008 on Public Finance Department recommendations and closed 2 funds: the Railway Fine Fund of the Ministry of Transport and the Benevolent Fund of the Ministry of Posts and Telecommunications. The funds were transferred to the Government's consolidated account. Of the remaining funds, 3 are recommended for regularization through their own statutes and 2 require further analysis before a decision can be made.

27. In compliance with the policy actions requiring development of an action plan on funding and liquidating government liabilities, in June 2006 the treasury secretary established the High Level Officials Committee on Contingent Liabilities. The committee's recommendations identify four categories of liabilities: (i) government loan guarantees, (ii) likely liabilities of public enterprises, (iii) pension liabilities, and (iv) pending court cases seeking compensation from the Government and/or public enterprises. The report submitted in October 2007 comprises a list of government guarantees, information on liabilities of government-owned enterprises, and tentative computation of pension liabilities. The list of guarantees is reported in the Fiscal Management Report 2008 and Ministry of Finance annual reports for 2005 and 2006 and reflects the Government's significant effort to enhance fiscal reporting (para. 34). Total outstanding loan guarantees amounted to approximately $350 million as of September 2007, representing 1.3% of GDP, well below the threshold of 4.5% determined in the FMRA.

28. The Public Enterprise Reforms Commission reports that it has 31 institutions under its Liquidation Unit with contingent liabilities totaling less than $300,000. To date, 25 have been liquidated (Appendix 8) and the companies removed from the Registrar of Companies. Another form of direct liabilities includes payment arrears by both ministries and public enterprises. These are estimated at $7.6 million and are usually redeemed within the first 6 months of the new budget year. The State Accounts Department has included a dedicated table in the

Treasury website that includes information on arrears by spending unit of ministries. It is working to reduce the average duration of arrears.

29. The High Level Officials Committee reviewed estimates of pension liabilities, the largest direct liability to the Government. It identified tentative computation of government pension liabilities through to 2011. Pension payments from the budget are expected to almost double from $465 million in 2005 to $916 million in 2011, reflecting rapid accrual rates and growing number of pensioners. The committee recognizes the unfunded nature of pension liabilities and importance of addressing measures to contain expansion of the liability. However, given the complexity of the exercise, the committee recommended that an actuarial analysis be undertaken as a first step in determining the magnitude of the problem. Undertaking an actuarial analysis of pension liabilities was an unfulfilled second tranche action under the FMRP. The Government recognizes the importance of addressing pension liabilities given the (i) aging population structure, (ii) likely rising costs of pension payments over the medium term, and (iii) importance of moving to a defined contribution pension system. Accordingly, policy dialogue will continue with a view to including a dedicated ADB program over the medium term.

30. Liabilities resulting from pending court cases are minor and reported upon under likely liabilities of public enterprises.

31. **Improving Budgetary Cash and Asset Management System.** Procurement, installation, and initial operations of the PAFMIS were to have been undertaken with direct funding and support of operations from the Government of the Republic of Korea. However, despite initial agreements including preparation of a feasibility study, the project was cancelled. At the Government’s request, ADB agreed to provide support for the PAFMIS under the FMRP. However, due to subsequent delays in the procurement process (paras. 19 and 20), and the Government recommendation for a phased approach to automation of the revenue and treasury departments, the Government decided to delay the procurement of the PAFMIS to 2009. However, in the meantime, the Government has worked to improve automation and adopted a centrally managed TFTS to strengthen the Treasury Department's cash management. The automated system builds on the existing comprehensive integrated accounting software and consolidates 658 Government accounts with Bank of Ceylon and another 294 with People's Bank under two main accounts. Information technology development, which is now fully completed, allows for direct interfacing of the two banks with the Treasury Department and is expected to lead to substantial savings by reducing the number of idle accounts and unnecessarily recurring overdrafts. Other significant benefits of TFTS include increasing the speed in collecting and processing receipts and increasing supervisory and control capabilities at the Treasury and the ministry and department levels. Consequently, this policy action is partially complied with. The Government has asked ADB for support for a phase 2 of the FMRP and to include an investment component to support procurement of servers and other equipment to extend TFTS into a Treasury Single Account System as a stepping stone to PAFMIS.

D. Strengthening Fiscal Discipline

32. **Improving Budget Estimates.** To more accurately reflect actual payments undertaken by spending agencies and other Government departments, the FMRP calls for developing monitoring mechanisms to better manage commitments and ensure improved disclosure. To address this action, the State Accounts Department prepared and distributed a template to each ministry and department seeking information on commitment arrears, project-by-project and program-by-program. Based on this work, the State Accounts Department introduced a system

that compiles information on the commitments of each budget head as of the end of the budget year with a special focus on highlighting undisbursed commitments falling beyond the end of the budget year. MOFP posted information for the year ending on 31 December 2006 on its website in January 2008;[10] and again for the year ending on 31 December 2007 in May 2008. The Government has agreed to continue this process on a regular basis to ensure greater discipline on timely disbursements on the part of spending agencies. State Account Department is beginning work to develop a similar reporting system for Government receipts payables.

33. More generally, as part of the results-based indicators under the FMRP, significant achievements were confirmed in the budget planning and execution process. Effective budget planning has to be anchored on reliable budget estimate procedures. This reflects a strengthening of MOFP including the creation of the positions of senior economic, financial and tax advisors as well as the strengthening of the fiscal policy and national budget departments and, in particular, greater budget consultation and coordination across key fiscal management institutions. From the perspective of expenditures, it reflects increased effectiveness of the expenditure ceilings framework supported under the FMRP. Prior to the FMRP, the trend was for total actual revenue collected to fall significantly short of original estimates, whereas, total expenditure incurred exceeded the estimate. For example, actual total revenue in 2004 was only 91.5% of the original budget estimate. This tendency has improved and by 2006 actual revenue attained 98.6% of budget estimate, while actual expenditure was contained at 97.5% of the budget estimate. This improvement leads to greater budget predictability enabling the Government to make more effective use of the budget as the Government's main policy instrument and improve on budget performance.

34. **Increasing Fiscal Transparency through Improved Reporting Procedures.** Major achievements have been attained in terms of enhanced fiscal reporting. In addition to the list of outstanding government guarantees (para. 27), the Fiscal Management Report submitted with the budget speech includes the medium-term fiscal framework, a variance analysis of the Government's revenue and expenditure between 2007 and 2006, and assumptions for the 2008 budget estimation. A different variance analysis that compares actual and budget estimates is included in MOFP's annual report. These are important steps in terms of transparency of the budget and accountability of the fiscal authorities, thereby increasing the private sector's ability to assess the Government's fiscal position and improve decision making over the medium term.

35. **Reducing Distortions.** One of the more significant policy actions under the FMRP includes full implementation of tax filing requirements. The major obstacles that undermined full implementation of tax filing requirements included (i) privileges extended to Board of Investment (BOI) registered companies that, through repeated extensions of tax holidays, were effectively not paying corporate income tax; and (ii) lack of enforcement of the Revenue Act leading to many individuals being out of the tax net at no cost to themselves.

36. As a second tranche release action, the FMRP required the amendment of the BOI Act to ensure that all exemptions and other tax holidays were consistent with the tax code. MOFP decided to use a different approach to meet the objective in this policy action. Instead, it amended the provisions of the Revenue Act in March 2006, curtailing the discretionary powers of BOI to grant income tax incentives in excess of those listed in the act. According to the amendment, income tax holidays and corporate tax rate concessions would be granted only if they are consistent with the new Inland Revenue Act. To strengthen enforcement, in late 2006, MOFP prepared draft BOI regulations to stop BOI from issuing any new tax exemptions. In addition, FMRP consultants prepared a policy paper to close loopholes in the generous

[10] Available: http://www.treasury.gov.lk/EPPRM/sad/pdfdocs/liabilities2006.pdf.

incentive regime targeting customs duty exemptions. More importantly, the paper called for moving away from income tax holidays in favor of investment and depreciation allowances.

37. In the 2008 Budget, and based on the recommendations of the paper, the Government took another important step by announcing a 3-year limit on tax holidays other than to flagship investments, and investments in lagging regions and low-income housing to a maximum of 3 years. Tax holidays already granted will not be extended once they expire. This is a major achievement in reducing tax distortions in Sri Lanka and should begin a turnaround in corporate income tax collection, which is presently among the lowest in Asia. To further contain the culture of tax incentives, the Government approved the Strategic Development Projects Act in February 2008. Under the Act, strategic development projects are more specifically defined and the approval process is tightened as these projects will require both Cabinet and Parliamentary approval.

38. The nonfiler program (see footnote 7) has achieved significant success. According to the 2008 Budget, more than 79,000 new tax files have been opened since 2006; the majority are income tax files. This is a major contribution to broadening the Government's tax base. Almost 4,000 of the new tax files are those of public servants reflecting effective implementation of the removal of tax exemption privileges given to government employees, which was an important policy action under the FMRP.

E. Improving Fiscal Coordination

39. **Strengthening Fiscal and Macroeconomic Coordination.** The restructuring of MOFP has been critical in strengthening fiscal and macroeconomic coordination as it has integrated two key ministries—planning and finance—under one authority. As part of improvements in business processes supported under the FMRP, the Fiscal Policy Department initiated a comprehensive system of stakeholder consultation in the preparation of budget estimates with other government departments and nongovernment representatives, including chambers of commerce and the taxation cluster group. Institutional linkages are effectively operating with the Central Bank of Sri Lanka on the GDP forecasts based on their modeling and simulation exercise. Similarly, the Fiscal Policy Department, National Budget Department, National Planning Department, and Department of External Resources are increasingly sharing feedback as part of the Fiscal Policy Committee to help prepare the development budget. The appointment of senior advisors to the Secretary of the Treasury (para. 33) has further improved the coordination process. On the expenditure side, the Fiscal Policy Department coordinates the activities of the Fiscal Policy Committee on matters relating to treasury cash flow to estimate Government borrowing requirements and propose the timing of bond issuance. Finally, funding for the *Mahinda Chinthana*[11] program is to be developed under the medium-term expenditure framework.

40. **Strengthening Fiscal Decentralization.** To enhance activities of the Finance Commission as the main arbiter in national–-provincial financial relations, the program loan called for the establishment of a new Finance Commission Act as a second tranche release action. Although the bill was prepared and submitted to the President's Office in December 2005, it has been put on hold since then due to the creation of the APRC. The APRC is tasked to review the existing administrative structure in Sri Lanka and make recommendations on improvements to the current system. The recommendations could have implications for the Finance Commission and, for thus no further action was taken with respect to the proposed bill.

[11] *Mahinda Chintana,* the Government's comprehensive strategic development plan for 2006–2016, sets out a vision to ensure Sri Lanka's long-term economic development and poverty reduction objectives.

In January 2008, the President received the parties' recommendations; no decision has been taken.

41. Notwithstanding this delay, implementation of performance or result-based indicators has proceeded. The Finance Commission, in association with National Budget Department and key line ministries, has developed a system of result-based indicators that, while at a pilot stage, is to provide an important step toward implementation of a broader agenda of strengthening service delivery in Sri Lanka. Result-based indicators for three pilot central ministries namely, education, health, and road transport have been finalized, and the Government has prepared and issued guidelines on extending the use of the indicators to the provincial councils as the basis for incorporating national indicators for provincial activities.

42. Following concerns regarding the role of provincial councils in service delivery, the FMRP called for a review of intergovernment transfers to clarify the current status from the viewpoint of efficiency, transparency, simplicity, equity, and predictability, and to develop a plan to proceed with decentralization. Consultants from India's National Institute for Public Finance and Policy assisted the Finance Commission in preparing a final report, which was submitted in November 2007. Based on the report and December 2007 stakeholder consultation workshop, the Finance Commission prepared a position paper with proposals for improving the intergovernmental transfer system. The report identifies the expenditure incurred by provincial councils as only about 3% of GDP and 12% of total expenditures in 2006. Provincial councils are highly dependent on central Government grants as their own revenues are almost negligible. Based on such observations, the Finance Commission recommendations include (i) merging the matching grants scheme with the criteria-based transfer system; (ii) simplifying the criteria-based transfer system to increase the focus on major subnational spending categories, such as education and health; (iii) decreasing Finance Commission management on the use of funds by provincial councils; (iv) revising the methodology for calculating block grant schemes based on normative estimates of revenue and expenditure; and (v) integrating line ministry discretionary funds and foreign-funded projects that contribute to the province-specific development grant into the medium-term expenditure framework. The Government has requested ADB support for implementation of some of these recommendations in light of the expected APRC recommendations under the proposed phase 2 of the FMRP (FMRP2).

IV. CONCLUSION

43. The FMRP has effectively supported the Government in its bid to transform and modernize public finance institutions in Sri Lanka. Despite setbacks due to a host of external factors including tsunami, elections, floods, high oil and food prices, fragile political coalitions and ongoing internal conflict in the country, the Government has made a deliberate and successful effort to institutionalize reforms complying with 51 of 55 policy actions under FMRP. Of the various components under FMRP, the greatest achievement has been the transformation of the revenue administration. Targeted FMRP support toward developing and implementing strategic plans and organizational restructuring, human resource development plans, and incipient automation of the revenue administration has led to more professional and more effective tax administration. From an initial situation of internal divisions, trade union strife, and other sources of disruptions, revenue administration has become more professional and conducive toward attaining its institutional goal of revenue collection. Moreover, indicators across a range of criteria confirm this transformation including tax collection, opening of tax files, tax call center enquiries, etc.. While deviations from the recommended structure occurred in the case of the Revenue Board, the intended objective of coordination of activities across the three revenue departments has improved significantly. Indeed, implementation of the task list on the

modernization of revenue administration—which covered approximately 148 measures—is a tribute to the dedication and effort of the revenue departments to the reform agenda. Capacity development has been instrumental in realizing the change; this will continue through to 2009 based on the extension of the TA loan (para. 1). Automation, while appreciably delayed, has made remarkable inroads; three procurement packages are being designed and/or implemented, culminating in the procurement of the RAMIS contract expected in mid-2009.

44. Against a series of challenges and external factors, including the impact of the tsunami on the budget, measures to strengthen national security and rising international commodity prices, fiscal performance has continued to follow an improving trend albeit more slowly than earlier envisaged. Moreover, this was achieved against a backdrop of a successful revamping of physical infrastructure through increases in capital spending. Salient features of the improved fiscal performance include (i) fiscal deficit reduced from 8.2% of gross domestic product (GDP) in 2004 to 7.7% in 2007, (ii) current balance deficit reduced from 3.9% of GDP in 2004 to 1.6% of GDP in 2007; (iii) total outstanding debt decreased from 105.4% of GDP in 2004 to 85.8% in 2007. The fiscal performance is on track to achieve further successes in line with the Government's continued commitment to its fiscal consolidation drive, with the current balance now expected to be in surplus at 0.9% of GDP in 2008, a first in over 20 years. According to estimates under the revised medium-term fiscal framework (MTFF), MOFP is targeting a fiscal deficit of 5.2% of GDP and total outstanding debt of 82% of GDP by 2010 thereby just about meeting the objectives set forth in the FMRA.

45. Compliance with the third tranche release actions is summarized as (i) 10 policy actions complied with, (ii) 3 policy actions substantially complied with, and (iii) 2 policy actions partially complied with.

46. **Implementation of Restructuring Plans for Six Ministries.** The first partially complied-with action involves implementation of restructuring plans for six ministries with the objective of rationalizing recurrent expenditures. Two ministries—Ministry of Finance and Ministry of Education—have successfully implemented restructuring plans. The former consolidated the Ministry of Finance with the Ministry of Planning and reorganized the ministry and revenue departments. The latter included reprioritizing activities consistent with reassigning expenditure on basic education from the central ministry to the provincial counterparts. Western Province is in the process of identifying areas that according to the Constitution would be within the competence of subnational governments, and discussing this with central line ministries to avoid duplication. Limited progress in the second tranche action requiring preparation of restructuring plans for the same ministries together with political imperatives resulting in an increase in ministries has prevented effective compliance with this action. Indeed the Government's intention to consolidate and restructure ministries was diverted in the interest of seeking a more stable coalition in Parliament that could begin to address pending economic and administrative reforms. The underlying objective of these restructuring plans will be targeted under proposed FMRP2 (see para. 52 below) through alternative means. This includes revisiting public expenditure reviews in combination with developing a service delivery framework for designated sectors to ensure that rationalization measures will need to take place while, not simply safeguarding but, strengthening service delivery. In addition, support for management audits will be pursued under FMRP2 with the objective of reducing expenditures in key ministries.

47. **Establishment of the PAFMIS.** The second partially complied-with policy action refers to MOFP establishing a computerized and fully integrated PAFMIS. Due to the Government's decision not to proceed with the funding and feasibility plans prepared through a bilateral funding agreement with the Government of the Republic of Korea, a change in scope was

approved to include these activities under the FMRP. However, given the magnitude of the work and the limited capacity available for project management of this nature and in such a specialized area, procurement of PAFMIS has been delayed. Indeed as supported by the technical experts and the ADB Mission, the Government decided to undertake a phased and measured approach to reflect capacity constraints, and has initially prioritized procurement and installation of RAMIS. Based on the experience and lessons learned with RAMIS, the Government will subsequently plan for PAFMIS. However, notwithstanding this delay the Government has successfully managed the implementation of a centrally managed TFTS to strengthen the Treasury Department's cash management in the interim. The automated system builds on the existing comprehensive integrated accounting software and consolidates 658 Government accounts with Bank of Ceylon and another 294 with People's Bank under two main accounts. Information technology development, which is now 90% complete, will allow the two banks to directly interface with the Treasury Department and is expected to lead to substantial savings from reduction of idle accounts and unnecessarily recurring overdrafts, and improved efficiency of drawing and disbursing offices. The Government has indicated its keen interest to build on TFTS by developing a Treasury Single Account as well as to undertake the preparatory work for the procurement of PAFMIS under FMRP2.

48. **Full Implementation of the Task List.** Of the substantially complied-with actions, the first action entails full implementation of the task list for the modernization of revenue administration. While the majority of the actions have been fulfilled (para. 15), some items have not yet been implemented due to limitations of the existing hardware, including implementation of the stop-filer and nonfiler programs, which is currently being procured; and because of suboptimal recommendations under the task list for the transfer of the Excise Special Provisioning Unit from the Customs Department to the Excise Department.

49. **Full Implementation of the HRMP.** The second substantially complied-with action refers to completion of the HRMP. Although the Revenue Board approved the plans for the department, and management of the revenue departments have agreed, a combination of weak capacity and strongly guarded independence of the Public Service Commission have led to delays in formal approval of the plans. Notwithstanding these regulatory hurdles, progress has been very good. With support from the TA, human resource management reforms have been implemented including establishment of human resource divisions under each revenue department, elaboration of terms of reference for professional positions, establishment of a performance evaluation scheme, completion of staff vacancies at IRD including 520 assessors and 460 tax officers, and 107 customs officers in Customs Department and completion of induction training programs.

50. **Full Implementation of the Information Technology Development Plan.** The final substantially complied-with action refers to the completion of implementation of the information technology development plan. The Government went through a period of limited commitment to the procurement package under the FRMP project loan reflecting limited ownership of this component and limited capacity and understanding of the full benefits of automation (paras. 19-20). In 2007, a breakthrough was reached that led to a phased approach to procurement and progress has been significant. Procurement and installation of the RAMIS is expected by mid-2009 onward.

51. **Pending Second Tranche Actions.** On 20 December 2006, the Board approved the release of the second tranche of the program loan on the basis that two partially complied-with actions pending from the second tranche release would be complied with prior to the release of the third tranche. The first action refers to the preparation of restructuring plans for the ministries

and is linked to the pending action on implementation of such plans. The action remains pending for the reasons given in para. 45. However, as indicated, the underlying objective of expenditure rationalization will be pursued under FMRP2 using an alternative approach. The second pending action refers to the finalization of the actuarial analysis of contingent liabilities. Despite the recommendations of the High Level Official Committee, appointed to report on unfunded pension liabilities, that "the assumptions and criteria that were used for the computation of future liabilities are to be examined by the Actuarial expert before implementation," the Government has yet to appoint the expert. Discussions with MOFP have revealed that while it is an important issue, and even if the actuarial analysis were to proceed, there is limited fiscal space to begin provisioning for these unfunded liabilities. Accordingly, agreement was reached to address this issue under a more accommodating fiscal position and is targeted under FMRP3 programmed for 2011 (para. 29).

52. **Follow-Up Operation.** Based on the overall positive assessment of FMRP, the Government has requested ADB to process FMRP2 in 2009 in order to provide continuity in fiscal management reforms. Japan Special Fund financing of a project preparatory technical assistance was approved on 15 April 2008. Based on advanced discussions with the Government, FMRP2 will cover (i) continuity of reforms initiated under FMRP (i.e., strengthening revenue effort at selected provincial councils); (ii) deepening of reforms following FMRP (i.e., application of public expenditure reviews developing a Treasury Single Account System), and (iii) complementary reforms following FMRP (i.e., developing capacity for management audits, developing foundations of a service delivery framework).

V. RECOMMENDATION

53. In view of the substantial progress made in implementing the Fiscal Management Reform Program, as evidenced by (i) compliance with 10 tranche release conditions; (ii) substantial compliance with 3 tranche release conditions; and (iii) partial compliance with 2 tranche release conditions, the President recommends that the Board approve, on a no-objection basis:

(i) the waiver of full compliance for two tranche release conditions based on the achievement of partial compliance under the third tranche and another two tranche release conditions based on the achievement of partial compliance under the second tranche; and

(ii) the release of the third tranche in the amount of $15,000,000 for the Fiscal Management Reform Program in Sri Lanka.

GOVERNMENT EXPENDITURE IN IMPLEMENTING THE FISCAL MANAGEMENT REFORM PROGRAM

($ '000)

Item	Amount
A. Inland Revenue Department	
Information and Communication Technology Advisor Remuneration	27
Information technology Hardware/Software Upgrade	
Metropolitan Branch Establishment at Jawatta	3,000
Training Center and Call Center of IRD	1,000
Tax Payer Services Facilities Upgrade	
Payment of Salaries of Newly Recruited Staff	3,000
Training Related Expenses from Department Budget in 2005, 2006, and 2007	400
Servers (2) + Personal Computers + Connectivity + Software Civil Works	10,000
Subtotal (A)	**17,427**
B. Customs Department	
Procurement of Scanner	15,600
Upgrade of ASYCUDA to ASYCUDA World	940[a]
Other Information Technology Hardware/Software Upgrade	180
New Office Construction-Related Expenditure	10,600
Training Related Expenses from Department Budget in 2005, 2006, and 2007	380
Payment of Salaries of Newly Recruited Staff	500
Subtotal (B)	**28,200**
C. Excise Department	
Establishment of Information Technology Laboratory (Department Budget)	27
Upgrade of Facilities in Regional Training Centre	6
Remuneration of Information Technology Consultant	7
Training Related Expenses from Department Budget in 2005, 2006, and 2007	65
Publications	7
Subtotal (C)	**112**
D. Treasury Department	
Upgrading and Civil Works for Training Auditorium at MOFP	300
Training	4
Development of a Treasury Fund Transfer System	49
Integrated Aid Management Information System	2,000
Subtotal (D)	**2,353**
Total	**48,092**

IRD = Inland Revenue Department; MOFP = Ministry of Finance and Planning

[a] To be incurred in 2008.

Source: Government of Sri Lanka.

FISCAL MANAGEMENT REFORM PROGRAM: CHRONOLOGY, DISBURSEMENTS, AND TRAINING

Table A2.1: Chronology of Fiscal Management Reform Program

Mission Type	Dates	Mission Duration (days)	No. of Travelers	Total Field Days	Person-Months
Inception	23–26 Feb 2005	4	4	16	0.53
Review	21–22 Jul 2005	2	1	2	0.07
Review	24–30 Aug 2005	7	2	14	0.47
Review	29–30 Aug 2005	2	1	2	0.07
Review	24–26 Nov 2005	3	1	3	0.10
Subtotal (2005)				**37**	**1.24**
Review	25–28 Jan 2006	4	2	8	0.27
Review	24–26 Apr 2006	3	1	3	0.10
Review	1–3 Aug 2006	3	2	6	0.20
Second Tranche Review	31 Oct–3 Nov 2006	4	2	8	0.27
Subtotal (2006)				**25**	**0.84**
Review	7–9 Mar 2007	3	1	3	0.10
Review	21–25 May 2007	5	1	5	0.17
Third Tranche Review	3–7 Dec 2007	5	3	15	0.50
Subtotal (2007)				**23**	**0.77**
Review	30 April-2 May 2008	3	2	6	0.20
Subtotal (2008)				**6**	**0.20**
Total				**91**	**3.05**

Source: Asian Development Bank.

Table A2.2: Disbursements under the Technical Assistance Loan[a]

Particulars		PCSS	Amount of Contract		Disbursements	Status
			SLRs	$	$	
Loan 2131:SRI						
2131	Deputy Director	0001		42,407	42,407	Contract terminated.
2131	Pricewaterhouse-Coopers Ltd	0002		2,744,270	1,609,544	Consulting activities terminated in February 2008; the Government is asked to process final payments to Pricewaterhouse-Coopers Ltd.
2131	Training (Various)	0003 0005 0007 0008 0009 0012 0013		1,964,120	1,860,794	Ongoing. Several training sessions are expected to be held in 2008.
2131	Sanjay Saxena	0004		7,425	7,425	Contract closed.
2131	B. Pollock	0006		14,800	14,766	Awaiting confirmation on contract variation.
2131	C. Perera	0010	300,000	2,733	1,780	Awaiting confirmation on contract variation.

Particulars		PCSS	Amount of Contract		Disbursements	Status
			SLRs	$	$	
2131	National Institute of Public Finance and Policy	0011		160,000	120,000	Ongoing.
	Total		**300,000**	**4,710,210**	**3,095,599**	
Loan 2132:SRI						
2132	Aprico Interiors	0001	207,337	1,913	1,915	Fully disbursed.
2132	Metropolitan Computers	0002	2,498,880	23,051	23,051	Fully disbursed.
2132	M/S Seram Builders (Civil works for IRD and MOFP)	0003	6,783,732	50,491	21,034	Ongoing.
2132	Penthouse Interiors (Procurement of supply and installation of auditorium furniture for MOFP conference hall)	0004	2,528,300	23,655	21,107	Ongoing.
2132	Swedish Audio Visual Pvt Ltd. (Procurement of computers and equipment for MOFP conference hall and IRD training center and call center	0005	7,683,690	71,293	0	Ongoing.
2132	Procurement of local area network					Contract amount expected to be approximately $9.5 million. MOFP received the bids by 31 March 2008. Awaiting evaluation report of technical proposals.
	Total			**170,403**	**67,107**	
Other Matters						
2131 2132	Loan Closing Date Extension					Loan closing date has been extended to 30 June 2009.

IRD = Inland Revenue Department, MOFP = Ministry of Finance and Planning.
[a] ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Fiscal Management Reform Program*. Manila.
Source: Asian Development Bank.

Table A2.3: Training Under the Technical Assistance Loan[a]

Name of the Institution	Name of the Training Program	Nature of the Program	Amount (SLRs)	No of Participants
ASYCUDA Headquarters, Malaysia	Integrated Government Financial Management Information System	Study tour to study the ASYCUDA system to develop a PAFMIS and RAMIS in Sri Lanka.	244,800.00	2
Inland Revenue Authority, Singapore	Auditing Techniques using Computers, Investigation and Computer Forensic	Laws relating to investigation, planning and conducting investigation, introduction to CAATs, computer systems, data formats, data downloading, computer evidence for investigators and auditors, etc.	10,692,879.58	60
IBFD International Tax Academy, Netherlands	Comparative and International Taxation	National tax systems, role of treaties, sources of international tax systems, passive income, residence and immigration, introduction to transfer pricing, European Commission tax law	2,445,741.16	3

Name of the Institution	Name of the Training Program	Nature of the Program	Amount (SLRs)	No of Participants
		aspects for profit allocation to permanent establishments, employment income, European VAT, interpretation of treaties, business structures and planning.		
Sixteenth Tax Conference, Tokyo, Japan	Sixteenth Tax Conference	Tax reforms (ways and means of policy, legislative and institutional reforms), VAT implementation and improvements and emerging issues on taxation.	233,974.48	1
Revenue Department Thailand	Inland Revenue Modernization	Exposure to reform and tax administration in Thailand.	1,375,764.00	15
National Institute of Public Finance and Policy, India	Practical Issues of Tax Policy and Tax Administration in Developing Countries	Critical challenges for tax reform, policy, and administration in a global environment, the administrative dimension of tax reform, managing tax reform.	86,357,919.51	800
National Institute of Public Finance and Policy, India	Fiscal Decentralization	Medium Term Fiscal Framework: Working with the concept, fiscal decentralization in India and Sri Lanka: history and overview of issues, revenue assignment and mobilization in Sri Lanka Expenditure assignment and service delivery, tax administration options for reforms, review of the transfer system in Sri Lanka, tax administration options for reforms, fiscal decentralization, and human development.	13,658,110.84	80
National Academy of Direct Taxes, Nagpur, India	Investigation and Management	Audit and investigation, investigation of accounts, gathering of evidence in audit, voluntary compliance and widening and deepening of tax base through nonintrusive techniques, introduction to international taxation, principles of international taxation, permanent establishment, and attribution of profits to permanent establishment, business connection, transfer pricing and e-commerce, effective supervision, decision making, conflict resolution, preventive vigilance, handling grievances, performance appraisal.	28,092,520.79	89
Asian Institute of Technology Bangkok	Project Planning and Management Techniques	Introduction to project planning, financial accounting and budgeting, computer applications in project management and financial analysis and project monitoring and control.	8,755,167.79	28
Duke University, USA	Budgeting and Financial Management in the Public Sector	Budget and the national economy, budget processes and frameworks, budgeting and financial management techniques and public sector reforms.	4,570,737.28	04
China Association for International Exchange of Personnel, Beijing	Public Finance and Government Budget Management	Framework of public finance management for the PRC, compilation and management of the PRC's government budgeting, management of national treasury and government accounting, appraisal of public sector projects and financing, reform of government expenditure management,	18,728,003.09	27

Name of the Institution	Name of the Training Program	Nature of the Program	Amount (SLRs)	No of Participants
		macroeconomic plan and government's midterm budgeting framework.		
Association of Government Accounting organization of South Asia, India	Experience sharing program	Evolving trends in public expenditure management, setting of appropriate accounting and IAS, implementation road map of accrual accounting, transition to performance and risk based audit and corporatized model of internal control.	443,016.00	04
National Institute of Financial Management	Accounting and Audit in Government Fiscal Planning and Management	Fundamentals, contemporary issues, best systems available, USGAAP, IAS and the contemporary framework of government accounting, challenges facing public auditors, and the role and responsibilities of public auditors. Fiscal planning, management and reforms, corporate financial management, public enterprise management, information systems, standard rules and procedures of the ADB for procurement of goods, works, and services for ADB-funded projects.	18,902,498.06	35 36
Inland Revenue Department of Hong Kong, China; and Internal Revenue Department of the Philippines	Study tour: Inland Revenue Department of Hong Kong, China; and Internal Revenue Department of the Philippines	Study the systems in Hong Kong, China and Philippines in relation to the automation aspects of the Inland Revenue Department in Sri Lanka.	1,630,448.00	07
National Institute of Financial Management	Fiscal Challenges in Sri Lanka, Accounting and Financial Management in Government, Forecasting Economic Indicators	Capacity building program of the Fiscal Management Reform Program to be engaged in decision making and industrial and commercial transformation.	11,200,000.00	240
Change Management at MOFP	A Positive Tomorrow[b]	Owning up to increasing responsibilities, improvements in multi-tasking, strengthening leadership, promoting teamwork.	1,035,000.00	450
Total			**208,366,580.58**	**1,881**

ADB = Asian Development Bank, CAAT = Computer-assisted Audit Techniques, IAS = International Auditing Standards, IBFD = International Bureau of Fiscal Documentation, PAFMIS = Public Accounting and Financial Management Information System, PRC = People's Republic of China, RAMIS = Revenue Administration Management Information System, USGAAP = United States Generally Accepted Accounting Principle, VAT = value-added tax.

[a] ADB. 2004. *Report and Recommendation of the President to the Board of Directors on a Proposed Loan to the Democratic Socialist Republic of Sri Lanka for the Fiscal Management Reform Program*. Manila.

[b] One out of six scheduled sessions has been completed as of 7 May 2008 with 75 participants. The remaining five sessions are scheduled to be completed by end-June 2008.

Source: Asian Development Bank

POLICY MATRIX: STATUS OF THIRD TRANCHE RELEASE ACTIONS

Focus of Reform	Policy Actions to Be Taken Before Third Tranche	Comments
A. Improving Effectiveness of Tax Administration		
1. Supporting the creation of the RB	RB to have fully implemented (i) task list; (ii) strategic plans for inland revenue, customs, and excise departments; and (iii) completed the implementation of human resource development plan and IT development plan.	(i) **Substantially complied with.** Key tasks including appointment of Tax Ombudsman, setting up of taxpayer service department, creation of internal audit units, preparation and dissemination of code of ethics, taxpayer charter and customs charter, consolidation of tax administration code, and developing a risk-based cargo clearance system are examples of activities that have been fully implemented. Developing stop-filer and nonfiler identification programs have been designed and implemented. However, identification of technical constraints related to overcapacity of existing servers at IRD has led to delays in the full implementation of stop-filer program. Upon review of staffing constraints, the transfer of the Excise Special Provision Unit with Customs to the Excise Department, was deemed suboptimal and a decision was made to keep it under Customs Department. See Appendix 6 for detailed status of each task. (ii) **Complied with.** The three revenue departments have prepared strategic plans approved in 2005 and consisting of key strategic directions and major goals over the coming 3 years. These included the restructuring of the revenue departments which has been attained. These plans have been updated in early 2008 to account for the latest revenue targets and other developments. The plans henceforth include targets in revenue collection to support fulfilling the objectives set forth under the revised targets under the Fiscal Responsibility Budget Management Act and means to achieve these targets. It also includes automation of the revenue administration as set forth under FMRP as a major focus of the strategy. (iii) **Substantially complied with (Human Resource Development Plan).** A common template of human resource development plan across the departments has been developed while implementation has been taking place individually. Although RB has approved the plans for all the departments, their implementation status varies across departments. With support from the TA, human resource management reforms have been implemented including establishment of human resource divisions under each revenue department, elaboration of terms of reference for all professional positions, establishment of performance evaluation scheme, completion of staff vacancies at IRD including 520 assessors and 460 tax officers, and completion of induction training programs. In Customs Department, delays in the Public Service Commission's (PSC) approval of the Human Resource Management Plans - implementation of Customs Department's commitments under this action including proposed organizational cadre, cadre requirements and staff schedule, and recruitment schemes and grievance management procedure - has resulted in implementation delays. However, in January 2008, Customs Department proceeded to recruit over 100 new staff as part of their upgrading in line with their HRMP. In addition, in early March 2008, the National Salaries and Cadres Commission endorsed the Customs Department's performance evaluation scheme that includes the assessment of personal competencies, incentives criteria and determination of incentives. Accordingly, the new promotion schemes and merit-based performance appraisal schemes will be rolled out for the first time on 1 July 2008 to

Focus of Reform	Policy Actions to Be Taken Before Third Tranche	Comments
		be followed on a regular semi-annual basis in January and July of each year. The design and implementation of the HRMPs under the FMRP has been instrumental in reducing confrontation between union representatives and management of the revenue departments. It has also paved the way for a more transparent, objective and accountable incentives system in the revenue departments. The revenue departments have taken all actions within their authority and have proceeded to implement the proposed HRMP although still awaiting the formal endorsement from PSC. Weak capacity at PSC combined with the fact that the Customs Department HRMP is being considered as a model for adoption in the civil service are believed to be behind the delays. **Substantially complied with (IT Development Plan).** IT development plan mainly comprises RAMIS/PAFMIS and procurement components. While RAMIS/PAFMIS are envisaged to cover all the revenue departments, procurements will focus on IRD over the medium term. IRD has prepared and begun implementing a 5-year time bound development plan based on a phased approach to include Phase 1—Interim Hardware and Software Development Project (2007–2008); Phase 2— Local Area Network/Wide Area Network Infrastructure Development Project (2008–2010); and Phase 3—RAMIS (2009–2011). Difficulties in obtaining Government consensus on this major investment led to significant delays over scheduled programmed procurement. Phase 1 is under implementation and seeks to enhance the existing computerized system until RAMIS is fully implemented. Servers at IRD are 15 years old and running at 95% capacity and these are currently being replaced. The IT strategy for IRD under Phase I also develops task specific activities under implementation including database cleansing, *e*-filing improvements, developing *e*-TIN procedures, developing automated risk-based audit selection and developing automation of stop-filing program. The Request for Proposal for the Phase 2 turn-key procurement was advertised on 2 January 2008 and award of contract is expected in June 2008. Full implementation is scheduled for December 2009. In Customs Department, the plan includes continuation of upgrading of ASYCUDA to ASYCUDA World and further developments in automation of risk-based cargo clearance systems and applications including improvements to the EDI system. These are also in anticipation of RAMIS. Excise Department has limited scope for automation in this early stage and awaits development of interfacing under Phase 2.
2. Strengthening tax collection and tax compliance	MOFP to have fully implemented (i) TIN system, and (ii) risk management system for cargo clearance.	(i) **Complied with.** While the TIN system was introduced before FMRP, it was not effectively functioning. Under FMRP, reforms have been undertaken such that a TIN issued by IRD is now used by IRD and Customs Department for all corporations, VAT registrants and traders. For individuals who are not VAT registrants or traders, the uniform number is the identity card number issued by the Registry of Persons. This identity card number is also used by outside entities such as banks. Steps to cleanse the TIN database have been initiated. However, due to capacity limitations of the current computer data servers at IRD, the cleansing of the master database can only be undertaken following the installation of new servers scheduled in the 2nd quarter of 2008. (ii) **Complied with.** In August 2006 Customs Department set up a Risk Management Committee to identify the risks involved in the Customs Clearance process, analyze such risks and take effective measures to address such risks. The risk management system for cargo clearance currently in process is based on the Committee's recommendations and includes (a) the

Focus of Reform	Policy Actions to Be Taken Before Third Tranche	Comments
		application of an automated selection criteria to identify consignments or group of commodities defined as high risk; (b) item (a) is complemented by random checks to assess the compliance level by any importer or declarant based on any major deviation reported by the automated system; (c) item (b) is complemented by additional inspections to the high risk category based on the recommendation by the Committee. In addition, to facilitate customs clearance of importers and declarants who have solid track records, a "star" class facilitation program has been introduced—based on gold card issuance to low risk tax and duty payers—in order to increase the number of detections while improving the efficiency of the clearance process.
B. Improving the Budget Framework		
1. Rationalizing expenditure	**Key ministries and Western Province to have implemented restructuring plans.**	**Partially complied with.** The Ministry of Finance and the Ministry of Planning were merged to integrate planning and budgeting under one roof. In addition, MOFP was consolidated from four to three departments namely, Economic Policy, Treasury Operations, and Administration and Finance. This will lead to better coordinated decisions submitted for the Secretary's consideration. A new Operations and Review Unit has been established to monitor implementation of large projects. A Revenue Administration Unit was also established to ensure effective oversight functions of IRD, Customs Department, and Excise Department. The Ministry of Education has also been undertaking restructuring in order to allow more effective donor coordination, project implementation, and policy formulation. The work is to continue with focus on general education and towards more integration with provincial levels. As for the Western Province, FC has prepared a "pilot" restructuring plan for the education sector to identify and address the gaps and overlaps between the Central Government and the PCs which is under implementation. Progress in other key ministries has not materialized and reflects limited Government ownership of earlier findings of PER and that were supposed to highlight areas of duplication across central line ministries and between central and sub-national governments.
C. Improving Public Expenditure Management and Control Systems		
1. Strengthening management of off-budget expenditures and borrowings	MOFP to consolidate non-statutory funds through closure and mergers.	**Complied with.** Upon PFD's official request to all Ministries and Departments, vide Public Finance Circular No. PF. 423 dated 12 October 2006, information on all departmental non-statutory funds has been collected and analyzed. Consequently, according to a progress report dated 24 October 2007, seven non-statutory funds have been identified with the following recommendations: (a) closure of two, namely the Railway Fine Fund and the Benevolent Fund of the Ministry of Posts and Telecommunications; (b) regularization of three, namely, the Samurdhi Social Security Fund to be converted into either a Trust Fund or governed by its own act, and the President's Fund for Inventors and Innovators and the Helaveda Punaruda Development Fund to be governed under separate parliamentary acts; and (c) a further study of two, namely the Shipping Development Fund and Fisheries Development and Benevolent Fund, before proposing actual closure of the funds or regularization. The closure process of the two funds in item (a) commenced in January 2008.

Focus of Reform	Policy Actions to Be Taken Before Third Tranche	Comments
	MOFP to develop an action plan to support the recommendations of the feasibility study on funding and liquidating government liabilities.	**Complied with.** A High Level Officials Committee on Contingent Liabilities was established by the Secretary of Treasury in June 2006 to examine the impact of the various liabilities (Note pension liabilities are a direct liability and were included under the committee's mandate). The recommendations of the committee were presented in May 2007. The recommendations identify four categories of liabilities namely (a) government loan guarantees, (b) likely liabilities of public enterprises, (c) pension liabilities, and (d) pending court cases seeking compensation from the Government and/or public enterprises. Loan guarantees as of September 2007 totaled to approximately, $350 million or 1.3% of GDP and are within the limitations set forth under FMRA. The Government reports on these liabilities under its Fiscal Management Report. The PERC reports that it has 31 institutions under its Liquidation Unit with contingent liabilities totaling under $300,000. To date, 25 of them have been liquidated and the companies struck off the Registrar of Companies. Another form of direct liabilities includes payment arrears by both ministries and public enterprises. These are estimated at $7.6 million and are usually redeemed within the first 6 months of the new budget year. SAD has included in the Treasury website, a dedicated table to include information on arrears by spending unit. The committee has also identified tentative computation of government pension liabilities through to 2011. Pension payments from the budget are expected to almost double from $465 million in 2005 to $916 million in 2011 reflecting rapid accrual rates and a growing number of pensioners. The recommendations call for the Government to undertake an actuarial analysis of pension liabilities to identify the true value of these liabilities over a longer horizon and to be followed by implementation of a funding plan. Liabilities resulting from pending court cases were minor and reported upon under likely liabilities of public enterprises.
2. Improving budgetary cash and asset management system	MOFP to establish computerized and fully integrated public accounting and financial MIS to include: (i) payroll, (ii) civil service pensions, (iii) drawing and disbursing offices, (iv) capital projects budget, and (v) public sector borrowing requirements.	**Partially complied with.** Due to the problems with the initial bilateral financing for PAFMIS, subsequent delayed procurement process indicated under A.1 above, and the Government recommendation for a phased approach to automation of the revenue and treasury departments, procurement of PAFMIS has been pushed back to 2009. However, the Government has adopted a centrally managed single bank account system to strengthen Treasury's cash management in the interim. The automated system builds on the existing CIGAS and consolidates 658 Government accounts with the Bank of Ceylon and another 294 with People's Bank under two main accounts. IT development which is now 90% completed will allow for direct interfacing of the two banks with the Treasury Department and is expected to lead to substantial savings from reduction of idle accounts and unnecessarily recurring to overdrafts and improved efficiency of drawing and disbursing offices.
D. Strengthening Fiscal Discipline		
1. Improving budget estimates	SAD to (i) develop mechanisms (i.e., guidelines, report procedures, and declarations) to monitor all commitments accumulated by government departments, (ii) prepare and update registrar on	**Complied with.** SAD sent out a “template” to each Ministry and Department seeking information on the commitment arrears, project-by-project and program-by-program. The template consists of two tables including (i) statement of claims under reimbursable Foreign Aid; and (ii) statement of provision transferred to the Deposit Account in terms of FRR 215 (3) (b) and (c). SAD has compiled information on the commitments of each budget head for 2006 and 2007. This information was published on the Government’s website in January and May 2008, respectively.

Focus of Reform	Policy Actions to Be Taken Before Third Tranche	Comments
	such commitments, and (iii) publish the commitment details on the Government's website.	
2. Reducing distortions	IRD to fully implement enforcement of tax filing requirements.	**Complied with.** Two key measures implemented under FMRP to enforce the tax filing requirements include the elimination of BOI loopholes on corporate income tax and extension of the tax net. On the BOI regime, the Inland Revenue Act (IRA) was amended to ensure that BOI incentives under the BOI Act had to fall squarely within the tax filing requirements under the IRA. This was further strengthened by A Government announcement in the 2008 Budget, and based on the recommendations of a paper commissioned under FMRP, that standard 3-year tax holidays would not be extended under most circumstances. On the extension of the tax net, IRD has embarked upon a stop filer and non-filer program towards enforcing tax filing requirements. While in the past, it was rather simple to abscond from tax filing responsibilities, over the past 2 years IRD has undertaken significant efforts to increase tax registration. According to the Budget for 2008, over 79,000 new tax files opened since 2006. Furthermore, nearly 4,000 of the new tax files were those of public servants reflecting effective implementation of the removal of tax exemption privileges given to government employees and removed under FMRP. These two measures are expected to lead to a significant improvement in income tax collection over the medium term.
E. Improving Fiscal Coordination		
1. Strengthening fiscal and macroeconomic coordination	MOFP to improve prioritization of development needs by creating institutional and operational linkages in order to integrate the annual budgetary process with (i) the macroeconomic forecasting and planning exercise, (ii) Sri Lanka development strategy action plans, and (iii) the public investment program.	**Complied with.** The FPD has initiated a comprehensive system of stakeholder consultation in the preparation of budget estimates with other Government departments and non-Government representatives including chambers of commerce and the taxation cluster group. Institutional linkages are effectively operating with the Central Bank of Sri Lanka on the GDP forecasts based on their modeling and simulation exercise. Similarly, there is increasing feedback between FPD, National Budget Department, National Planning Department, and Department of External Resources as part of the Fiscal Policy Committee for the purpose of preparing the development budget. On the expenditure side, FPD coordinates the activities of the Fiscal Policy Committee on matters relating to treasury cash flow for purpose of estimating Government borrowing requirements and proposed timing. Finally, funding for the *Mahinda Chinthana* program is to be developed under the medium-term expenditure framework.
2. Strengthening fiscal decentralization	Government to extend the use of national standards and performance indicators to PCs with the objective of strengthening service delivery system.	**Complied with.** Under the TA, FC subcontracted to NIPFP of India to carry out the review of the current status of the fiscal decentralization framework. On the basis of the review and stakeholder consultation at a workshop with participants from PCs held on 7 December 2007, FC has prepared a position paper. A main lesson learned is that results-based monitoring divorced from budgeting will have limited impact as witnessed in the past in Sri Lanka. Similarly, RBIs should be closely anchored to a comprehensive service delivery framework which takes into account of managerial capacity on the ground and institutional capacity particularly at the sub-national level. These may be considered as part of the pre-requirements to develop greater public sector accountability for provision of services to citizens. To date, RBIs for four pilot ministries

Focus of Reform	Policy Actions to Be Taken Before Third Tranche	Comments
		(Highways, Health, Education, and Water) have been finalized and following consultations between NBD and FC on implementing and operationalizing RBIs, FC has issued a circular to PCs on guidelines to introduce a result orientation to provincial service deliveries as the basis for incorporating national level indicators at the provincial level.
	FC to review inter-government transfers criteria and report on the optimality of the current arrangement based on principles of efficiency, transparency, simplicity, equity, and predictability.	**Complied with.** Following on from the NIPFP work indicated above, FC has prepared a position paper with proposals for improving the intergovernmental transfer system and which was discussed with central government and PC representatives at a workshop in December 2007. The recommendations include (i) merging the matching grants scheme with criteria based transfer system; (ii) simplifying the criteria-based transfer system to have greater focus on the major sub-national spending categories namely education and health; (iii) relax FC management on use of funds by PCs; (iv) Revise methodology for calculating block grant schemes based on normative estimates of revenue and expenditure; (v) integrate into the MTEF line ministry discretionary funds and foreign funded projects that contribute to the provincial specific development grant.

ASYCUDA = Automated System for Customs Data, CIGAS = Computerized Integrated Government Accounting System, EDI = electronic data interchange, FC = Finance Commission, FMRA = Fiscal Management Responsibility Act, FMRP = Fiscal Management Reform Program, FPD = Fiscal Policy Department, FRR = financial rules and regulations, GDP = gross domestic product, IRD = Inland Revenue Department, IT = information technology; MOFP =, Ministry of Finance and Planning, MTEF = medium-term expenditure framework, NIPFP = National Institute of Public Finance and Policy, NSCC = National Salaries and Cadres Commission, PAFMIS = Public Accounting and Financial Management Information System, PC = provincial council, PER = public expenditure review, PERC = Public Enterprise Reforms Commission, PSC = Public Service Commission, RAMIS = Revenue Administration Management Information System, RB = Revenue Board, RBI = results-based indicator, SAD = State Accounts Department, TA = technical assistance, TIN = tax identification number, VAT = value added tax.
Source: Asian Development Bank.

POLICY MATRIX:
STATUS OF NONTRANCHE RELEASE ACTIONS

Focus of Reform	Non-Tranche Release Actions	Comments
A. Improving Effectiveness of Tax Administration		
1. Strengthening tax collection and tax compliance	RB to prepare (i) evaluation of performance of modernized revenue administration based on these findings, and (ii) a policy paper to deepen integration of revenue administration.	**Compliance ongoing.** A variance analysis of government revenue as well as other revenue administration assessments have been presented under the Fiscal Management Report. MOFP has also submitted an internal assessment of the Program, including outline of follow-up activities. Further integration of revenue administration is subject to implementation of RAMIS and PAFMIS which will be undertaken in a phased manner. Also see A1 and C2 of the STATUS OF THIRD TRANCHE RELEASE ACTIONS.
	MOFP to establish computerized and fully integrated revenue administration MIS to include integrated revenue information across all three revenue departments with linkages to BOI and public accounting and financial MIS.	**Compliance ongoing.** Contingent on the implementation of RAMIS which is ongoing. The implementation of RAMIS and PAFMIS will be undertaken in a phased manner, and Government of Sri Lanka and ADB have agreed to have an interim program to enhance capacity of existing system during the third tranche period toward full implementation of RAMIS which is to be completed by December 2009. Also see A1 and C2 of the STATUS OF THIRD TRANCHE RELEASE ACTIONS.
B. Improving Fiscal Coordination		
2. Strengthening fiscal decentralization	FC to publish an annual report and detailed explanatory memorandum to Parliament outlining key recommendations and status of implementation of recommendations.	**Compliance ongoing.** FC published an Annual Report for 2004 in 2005. It is in the process of completing its Annual Reports for 2005 and 2006, to be finalized by July 2008. The status report on the implementation of Finance Commission's recommendations of the NIPFP study will be the next step, and FC plans to submit a consolidated report to the Parliament.

ADB = Asian Development Bank, BOI = Board of Investment, FC = Finance Commission, MIS = management information system, MOFP = Ministry of Finance and Planning, PAFMIS = Public Accounting and Financial Management Information System, RAMIS = Revenue Administration Management Information System, RB = Revenue Board.
Source: Asian Development Bank.

PROGRAM ASSURANCES

The Government has given program and project loan assurances, which must be complied with during the Fiscal Management Reform Program period. The attached assurances (Table A4) are not related to the second tranche release requirements.

Table A4: Program Assurances

Achievements Action	Implementation Status
A. Program Loan	
1. The Government shall effectively adhere to a fiscal consolidation adjustment path in accordance with its medium-term fiscal program and its fiscal consolidation strategy.	**Complied with.** The Government has established the Fiscal Committee, which is operating to ensure coordination of activities in preparation of the budget. The main assumptions for revenue estimation were published as part of the 2006 budget, as well as the fiscal responsibility requirements under the section, and technical details to the budget estimates for 2005 and 2006. The fiscal consolidation adjustment has been pursued in line with the medium-term fiscal program and its fiscal consolidation strategy.
2. The MOFP will produce semiannual comprehensive statements of the general Government's financial position in the budget, showing all financial assets and liabilities, including commitments, guarantees, and contingent liabilities by 15 March and 15 September of each year.	**Substantially complied with.** The Government has published a consolidated statement of financial performance for the year ended 31 December 2006, which includes outstanding amount of funded debts or loans, and of any sinking funds. Moreover, the statement describes assets and liabilities directly related to receipts and payments as of the end of the year. A midyear report has also been published which includes information for the first 4-5 months in 2007. The consolidated statement will be prepared on a continual basis.
3. The Government will stop tax exemptions under BOI schemes to be transferred to IRD.	**Complied with.** The Government has amended the consolidated Inland Revenue Act. The IRA amendment refers to any concession of tax exemptions, and is consistent with the tax code under the IRA. In the 2008 Budget, the Government has announced a 3-year limit on tax holidays other than to flagship investments, investments in lagging regions and low income housing. Tax holidays already granted will not be extended once they expire.
4. The Government will stop providing tax amnesties.	**Complied with.** The Government has provided no new tax amnesties during program implementation.
5. MOFP will set up an FMRP interagency implementation and coordination committee to meet every quarter to coordinate and ensure the effective implementation of the proposed reforms.	**Complied with.** The PSC has been set up, and the members are meeting frequently to coordinate and ensure the effective implementation of the program and project reforms. The program manager and her team members are functioning as the secretariat for the PSC in close consultations with other departments and agencies.
B. Project Loans	
6. The Government will provide counterpart staff and financing to implement the projects.	**Complied with.** The Government has designated counterpart staff of the department concerned, and has provided office, desks, telephones, and other equipments for the consultants to work efficiently for the timely and satisfactory implementation of tasks.
7. The EA will submit a report to ADB annually, or more frequently if warranted, on project implementation and overall assessment of the quality of inputs.	**Complied with.** The EA has submitted to ADB a report on project implementation and an overall assessment of the quality of inputs on a quarterly basis. This has enhanced the timely assessment of the project implementation, and ensured appropriate feedback and inputs from ADB.

ADB = Asian Development Bank, BOI = Board of Investment, EA = Executing Agency, FMRP = Fiscal Management Reform Program, FMRP = Fiscal Management Reform Program, IRA = Inland Revenue Act, IRD = Inland Revenue Department, MOFP = Ministry of Finance and Planning, PSC = program steering committee.
Source: Asian Development Bank.

TASK LIST FOR MODERNIZATION OF REVENUE ADMINISTRATION

Item	Description of Task	Status
Revenue Board 1: Create internal audit units at headquarters of all departments to report directly to department head		
1.	Revise organization structure to ensure unit reports directly to head.	Done. IRD, customs, excise.
2.	Revise functional work of unit to ensure it exclusively deals with internal audit of systems and staff.	Done. IRD, customs, excise.
3.	Develop operating procedures for the unit and position descriptions for staff.	Ongoing. IRD, customs, excise (operating procedures drafted, subject to approval).
4.	Develop an annual work plan for the unit.	Done. IRD, customs, excise.
5.	Train staff in internal audit techniques and staff for investigating irregularities.	Ongoing. IRD, customs, excise (training on internal audit is being organized).
Revenue Board 2: Prepare, publish, and disseminate a code of ethics **for employees, tax practitioners, and the public**		
6.	Draft a code of ethics.	Done. IRD, customs, excise.
7.	Publish the code through posters and leaflets available at all revenue dept offices.	Done. IRD, ongoing. Customs, excise (posters are under preparation for customs and excise).
8.	Give each employee a copy and ensure employee signs for receipt.	Done. IRD, customs, excise.
Revenue Board 3: Design and deliver a program of education for employees on ethics and integrity		
9.	Design short seminar for all employees.	Done. IRD code of ethics and integrity are part of training of tax officers and assessors.
10.	Train managers in delivery of seminar.	Ongoing. Local training by British Council has commenced for IRD and is going to be extended to customs and excise.
11.	Managers to deliver seminar to all employees.	Done. IRD (seminars were held at least up to director commissioner level). Ongoing. Customs, excise.
Revenue Board 4: Selected employees to make a declaration of assets and liabilities		
12.	Design declaration of assets and liabilities.	Done. IRD, customs, excise.
13.	Develop confidential secretariat to oversee and store declarations for commissioner secretaries and senior officers.	Done. IRD, customs, excise.
14.	Develop procedures for all operations staff to submit "open" declaration.	Done. IRD, customs, excise.
15.	Internal audit staff to analyze declarations and make inquiries where necessary.	Done. IRD, customs, excise.
Revenue Board 5, 7, 8, 9: Create a dedicated customer service department within each revenue department and a pilot joint "one-stop" shop		
16.	Revise operating structure to establish dedicated CSD.	Done. IRD, customs. CSD will not be established at excise due to its staffing nature.
17.	Staff department with appropriate personnel and develop position descriptions.	Done. Job descriptions written at management level. Generic job descriptions at other levels.
18.	Develop policies and procedures for CSD.	Done. IRD, customs.
19.	Train personnel in customer service techniques	Done. IRD. Ongoing. Customs.

Item	Description of Task	Status
20.	Draft leaflets and brochures for public distribution.	Done. IRD, customs, excise.
21.	Initiate a proactive taxpayer and trader education program.	Done. IRD (Public seminars are conducted on an ongoing basis. Some information is available on the web site). Customs (functional web site serving as repository of information); excise (web site was established after careful study of composition of other jurisdictions' web sites). Ongoing. IRD (update information on web site on a timely basis).
22.	Create a pilot one-stop shop in Colombo with staff from all departments.	Done.
23.	Create dedicated customer service desks in all department offices dealing with the public.	Done. IRD (an information window is functional on the ground floor of the IRD office with dedicated staff). Customs (a customs information center on the ground floor of the Customs Department with dedicated staff).
24.	Create a call center to provide information and consultation to taxpayers.	Done. IRD, customs, excise.
Revenue Board 6: Develop and publish a taxpayer charter and customs charter		
25.	Draft taxpayer charter and customs charter.	Done.
26.	Publish in media and through posters at all offices open to the public.	Done.
Revenue Board 10: Establish consultative committees		
27.	Establish high-level consultative committees for tax, customs, and excise to include membership from accounting, legal, and trade bodies, as well as from all revenue departments.	Done. IRD, customs, excise.
28.	Feedback from committees to be passed to modernization teams.	Done. IRD, customs, excise.
Revenue Board 11, 12: Centralize issue of rulings and ensure dissemination		
29.	Create a unit responsible for drafting and consolidating all rulings.	Done. IRD (ruling committee established early in 2005); Customs (unit responsible for issuance of classification of advanced rulings).
30.	Unit to publish and disseminate rulings to all operations staff and make such available publicly.	Done. IRD (IR Act rulings available on web site); customs (classification of advanced rulings issued for 6 months). Ongoing. IRD (update website to include rulings issued after 2005); Customs (issue valuation rulings as required under Kyoto convention and WCO guidelines); Excise (reestablish the printing of notifications in the Excise Gazette).
Revenue Board 13, 14, 15: Develop a streamlined appeals process across all revenue departments		
31.	Establish an independent administrative panel to review appeals and make recommendation to MOFP.	Done. IRD (an independent appeals division was created), Excise (the excise ordinance provides for appeals to be submitted to MOFP). Ongoing. IRD (reexamine the independence status and amend procedures to meet the independence criteria; Customs (approval of the new organization is pending).
32.	Develop procedures for a transparent and independent appeals process.	Ongoing. IRD (the existing appeals process has been documented); customs (comprehensive appeals procedure has been drafted).

Item	Description of Task	Status
33.	Draft clear and comprehensive guidelines to be disseminated to all staff and public.	Ongoing. IRD, customs.
Revenue Board 16, 17: Establish a comprehensive and integrated management information system		
34.	Interview functional heads and establish information requirements.	Ongoing. IRD, customs, excise.
35.	Review information inputs (declarations, etc.) and establish deficiencies.	Ongoing. IRD, customs, excise.
36.	Revise information inputs to correct deficiencies.	Ongoing. IRD, customs, excise.
37.	Develop functional specifications for an automated MIS, supported by appropriate performance indicators.	Ongoing. IRD, customs, excise.
Revenue Board 18: Establish a comprehensive human resource development program for IRD, customs, and excise		
38.	Assess human resource needs based on (i) greater integration of revenue administration functions, (ii) implication of automation on workplace; and (iii) competency-based and skills acquired staffing.	Done. IRD, customs, excise.
39.	Consolidate benefits and payment into basic wages in a transparent manner.	Done. IRD, customs, excise.
40.	Develop a human resource development program to be approved by the Revenue Board and MOFP with appropriated performance indicators.	Done. IRD, customs, excise (Revenue Board approved human resource management plans).
Revenue Board 19: Develop strategic plans for all revenue departments		
41.	Draft strategic plans for all functional units.	Done. IRD, customs, excise.
42.	Draft strategic plans for each department.	Done. IRD, customs, excise.
43.	Prepare institutional performance indicators for each functional unit or department.	Done. IRD, customs, excise.
Revenue Board 20: Establish a joint MOFP revenue departments group to examine all proposed changes to the revenue legislation		
44.	MOFP to establish a consultative group comprising representatives from all revenue departments to ensure legislative changes are thoroughly considered for administrative input and are introduced on a timely basis.	Done. IRD, customs, excise.
HR 15, 16, 17, 18: Establish a revenue administration training unit		
45.	Establish core training team through competitive selection process.	Done. IRD, customs, excise (training divisions have been established in IRD, excise, and customs, which are integrated with the human resource management divisions).
46.	Establish joint training facility in Colombo to include information technology laboratory.	Substantially done. Joint training facility for all departments was found not to be feasible to implement. Individual training facilities have been expanded and created in the three departments.
47.	Develop core training curriculum by priority.	Done. As part of training plan.
48.	Establish three regional training units.	Done. Excise. Ongoing. IRD, Customs.
49.	Complete training needs assessment for all staff within the revenue departments.	Done. Training needs assessment of all employees completed, and a computerized inventory of skills established.

Item	Description of Task	Status
50.	Develop an interim training plan.	Done. Draft training plans for the three departments being finalized.
51.	Complete train-the-trainer courses.	Substantially done. Under implementation.
52.	Develop an annual training plan for each department.	Done. Draft training plans being finalized.
53.	Implement training plan	Substantially done. Under implementation.
IRD1, Customs Department 10, IT9: Create a single taxpayer database operating on a unique and unified taxpayer identification number and used for all revenue activities		
54.	Form a working group to improve the registration process in all departments, identify requirements for a separate trader database, and develop an integrated master file of all revenue payers based on tax identification number.	Ongoing.
55.	Cleanse the master file to update all records that are inactive, and to ensure that the same individual or company is not registered twice.	Ongoing. Cleansing of the database is scheduled in the second quarter 2008.
IRD 2, 12: Develop simplified tax processes and procedures		
56.	Create a tax procedures simplification unit.	Done.
57.	Draft and agree on TOR, reporting requirements, and deliverable schedule for the unit.	Done.
58.	Fully document all current processes.	Done.
59.	Develop new simplified processes, making best use of automation.	Substantially done. Further simplification possibilities can be explored after implementation of the RAMIS.
IRD 14: Identify and register taxpayers operating outside the tax net (nonfilers)		
60.	Create an RMU to draft procedures for nonfiler program.	Done.
61.	Draft and agree on program, including the setting of targets for district offices.	Done.
62.	Review and agree on program and select pilot sites.	Done.
63.	Implement program in pilot sites.	Ongoing. The program is under implementation.
64.	Review program and revise if necessary.	Ongoing. The program is under implementation.
65.	Roll out program for all district offices to implement.	Ongoing. The program is under implementation.
IRD 13: Identify taxpayers who fail to provide tax returns (stop-filers) and resolve		
66.	RMU to draft procedures for stop-filer program.	Done. A committee was appointed to identify stop-filers and bring them back into the system.
67.	Draft and agree on program, making full use of current automation.	Done. Procedures to be used by all relevant staff have been finalized and approved.
68.	Review and agree on program, and select pilot sites.	Done. The VAT Branch identified stop-filers and started implementation.
69.	Implement program in all offices with adequate automation.	Ongoing. Targets have been established for regions other than LTU and corporate taxpayers. Further implementation subject to the local area network/wide area network.
70.	Roll out program to all offices as automation improves.	Ongoing. Targets have been established for regions other

Item	Description of Task	Status
		than LTU and corporate taxpayers. Further implementation subject to the local area network/wide area network.
IRD 4, 5, 6, 7, 9, 10: Review the audit process and develop new streamlined and efficient procedures		
71.	RMU to review and modernize the audit process within IRD.	Done. A committee was appointed to modernize the audit process and streamline procedures.
72.	Draft and agree on TOR, reporting requirements, and deliverable schedule for the working group.	Done. Individual functional division heads provided inputs for identifying simplification opportunities.
73.	Draft report with recommendations on, at a minimum, (i) audit selection methodology, (ii) case selection, assignment, and (iii) management of coordinated audits.	Done. Ratios to identify risk and an automated audit selection system based on risk analysis have been developed. Ongoing. Further implementation subject to the computerization of the system.
74.	Review and approve recommendations.	Done.
75.	Draft new procedures to be included within a comprehensive audit manual.	Done.
76.	Implement new procedures, including training.	Done.
IRD 5, 6: Improve the efficiency and effectiveness of LTU		
77.	Audit of large taxpayers should be conducted in coordination with audit of company directors.	Done.
78.	Audit of large taxpayers should be done using a team concept.	Done.
79.	Provide training to auditors in LTU for computer audit skills.	Done.
80.	Draft procedures to streamline the data entry system in LTU to provide for timely data input, which would permit effective monitoring of compliance.	Done. VAT data entry of batched returns has been streamlined.
81.	Develop and implement an electronic tax filing and transaction database for comparative purposes.	Done. E-filing for VAT was enabled. Ongoing. An automated data transfer to the database from the electronically filed returns is under design and will be implemented. The electronic VAT return form is being modified to reflect recent changes.
82.	Regulate requirement for all taxpayers to report transaction values above a certain limit.	Ongoing.
83.	Develop a database of transactions to be used for audit selection and comparative purposes, and ongoing review of transaction value.	Ongoing.
84.	Extend the procedure to all large taxpayers outside LTU.	Ongoing.
Customs Department 1, 2: Develop simplified customs processes and procedures		
85.	Create a CMU headed by deputy director general that will review and recommend actions regarding the following tasks.	Substantially done. The Procedures and Facilitation Committee and the Process Reengineering Group have been assisting in developing, simplifying, and harmonizing customs procedures and procedures.
86.	Draft and agree on TOR, reporting requirements, and deliverable schedule for the task force.	Substantially done.

Item	Description of Task	Status
87.	Fully document all current processes.	Ongoing. Simplification and automation work is in progress as due consideration would be given to functions/activities of new functional units proposed in the restructured organization. Reengineering of the sea cargo clearance process has been undertaken and a document on the same has been submitted.
88.	Develop and implement new simplified processes, making best use of automation.	Ongoing.
Customs Department 3: Facilitate the payment of customs duties and fees at commercial banks		
89.	CMU to work in collaboration with departments, ICT agency, and commercial banks to establish a payment process for taxes and customs duties and electronic transfer of that information.	Substantially done. A system for exporters and importers to maintain deposit accounts in commercial banks allows the debit of customs duties. The department is exploring ways to enable e-payments; this is expected to be feasible with the ASYCUDA World system.
90.	Draft and agree on TOR, reporting requirements, and deliverable schedule for CMU. .	Substantially done.
91.	Develop action plan.	Substantially done.
92.	Approve action plan.	Substantially done.
93.	Develop procedures and necessary automated support.	Substantially done.
94.	Institute new payments system.	Substantially done.
Customs Department 4, 5, 6, 8: Introduce a full risk management system for cargo clearance, including the introduction of a "star" class facilitation program and other facilitation measures		
95.	CMU to take responsibility for the following tasks.	Substantially done. As per a paper submitted by the Customs Department. In August 2006, the Customs Department set up a risk management committee to identify and analyze risks involved in the customs clearance process, and take effective measures to address them. The committee consists of 11 members and meets fortnightly with the Director General of Customs as the chairperson.
96.	Draft and agree on TOR, reporting requirements, and deliverable schedule for CMU.	Done.
97.	Evaluate current operating test of ASYCUDA selectivity module.	Done.
98.	Develop selectivity structure using three channel system: red, yellow, and green.	Done.
99.	Approve the introduction of the new selectivity system as a pilot.	Done.
100.	Evaluate the pilot, and after any amendments approve nationwide rollout.	Done.
101.	Develop "star" class[a] facilitation program.	Done. Importers identified as low risk are awarded "gold card" status. The Risk Management Committee periodically evaluates compliance of the selected high risk importers and declarants.
102.	Select traders to participate in star class program.	Done.
103.	Approve introduction of star class program.	Done.

Item	Description of Task	Status
104.	Devise procedures and policies for random spot checks.	Done.
105.	Approve procedures and policies for random spot checks.	Done.
106.	Introduce random spot checks.	Done.
107.	Devise procedures and policies for preimport rulings.	Done.
108.	Approve procedures and policies for preimport rulings.	Done.
109.	Introduce preimport rulings.	Done.
Customs Department 7: Improve the customs valuation database		
110.	CMU to enhance valuation database	Substantially done. The Customs Valuation Division has developed a database of items that are considered risky.
111.	Draft and agree on TOR, reporting requirements, and deliverable schedule for the CMU.	Done.
112.	Develop content and procedures for maintenance of valuation database, including specifications for automation.	Done.
113.	Approve development of valuation database.	Ongoing. The ADP Division has developed software to establish and maintain the computerized valuation database. Selected data on values gathered from the available sources are sent to the ADP Division for capturing, with effect from November 2006. A paper on the inadequacies of the presently adopted customs valuation database has been prepared.
114.	Complete development work.	Ongoing.
115.	Roll out valuation database to all customs posts.	Ongoing.
Customs Department 11: Complete an equipment needs assessment		
116.	Complete an equipment (noninformation technology) needs analysis for customs with a draft report that includes (i) identified needs in excess of current inventory, (ii) justification for equipment needs, (iii) specifications for identified equipment needs, (iv) estimated costs, and (v) identification of any subsequent training needs.	Done.
117.	Review and consider assessment, and prepare budgetary projections accordingly.	Done.
Customs Department 12: Complete a review of examination and storage facilities, and consider introducing dry ports		
118.	CMU to review the examination and storage facilities currently in use.	Done.
119.	Draft and agree on TOR, reporting requirements, and deliverable schedule for CMU.	Done.
120.	Draft report with recommendations to improve facilities, and include consideration of the use of dry ports. The latter to include location, costs, and operating procedures.	Done.
121.	Review and approve recommendations.	Ongoing.

Item	Description of Task	Status
Excise Department 1: Transfer the Excise Special Provisions Unit within customs to the Excise Department		
122.	Create an EMU	Ongoing. Implementation of this task has been reconsidered since it may undermine effectiveness of customs and excise operations considering their organization and staffing practices.
123.	Draft and agree on TOR, reporting requirements, and deliverable schedule for the EMU.	Ongoing.
124.	Draft report from working group with analysis and recommendations.	Ongoing.
125.	Evaluate and approve recommendations.	Ongoing.
126.	Fully integrate staff, resources, and work within the Excise Department.	Ongoing.
Excise Department 3: Develop simplified excise processes and procedures		
127.	EMU to review and simplify excise tax procedures.	Done. Excise notifications and departmental circulars are being updated/amended.
128.	Draft and agree on TOR, reporting requirements, and deliverable schedule for the EMU.	Done.
129.	Fully document all current processes.	Done.
130.	Develop new simplified processes, making best use of automation.	Done.
131.	Review and endorse new procedures when completed.	Done.
Legislative Issues: Draft a new administrative code		
132.	Complete a comparative study of tax administration procedures in all the relevant statutes.	Done. The existing Establishment Code was updated and it applies to all government departments. The comparative study for harmonization of rules and regulations across the three revenue department is an ongoing process. However, there is actually no need for a 'new' Administrative Code since necessary amendments are effected in the respective Acts/Ordinance.
133.	Draft a uniform tax administrative code.	Done.
134.	Review and approve draft with revenue departments and other stakeholders.	Done.
135.	Review and approve draft.	Done.
136.	Submit draft to MOFP, Cabinet, and Parliament.	Done.
137.	Draft regulations and rules for implementation.	Done.
138.	Review and adopt implementing procedures.	Done.
Customs Department 20: Review and revise current customs legislation		
139.	CMU to oversee customs legislation.	Done. Customs legislation gets updated regularly based on identification of required changes from time to time.
140.	Review and approve draft amendments.	Done.
141.	Submit draft to MOFP, Cabinet, and Parliament.	Done.
142.	Draft regulations and rules for implementation.	Done.

Item	Description of Task	Status
143.	Review and adopt implementing procedures.	Done.
Excise Department 7: Review and revise current excise legislation		
144.	EMU to oversee the excise legislation.	Done. A subcommittee deals with legislative changes.
145.	Review and approve draft amendments.	Done. A workshop was conducted and information is collected on laws in other countries.
146.	Submit draft to MOFP, Cabinet, and Parliament.	Done. Required amendments have been identified and forwarded to MOFP.
147.	Draft regulations and rules for implementation.	Done.
148.	Review and adopt implementing procedures.	Done. Excise legislation gets updated regularly based on identification of required changes from time to time. The currently identified amendments are expected to be undertaken following the required procedures.

ASYCUDA ++ = Automated System for Customs Data, CMU = customs modernization unit, CSD = customer service department, EMU = Excise Modernization Department, ICT = information and communication technology, IRD = Inland Revenue Department, LTU = Large taxpayer Unit, MIS = management information system, MOFP = Ministry of Finance and Planning, RAMIS = revenue administration information system, RMU = Revenue Modernization Unit, TOR = terms of reference, VAT = value--added tax.

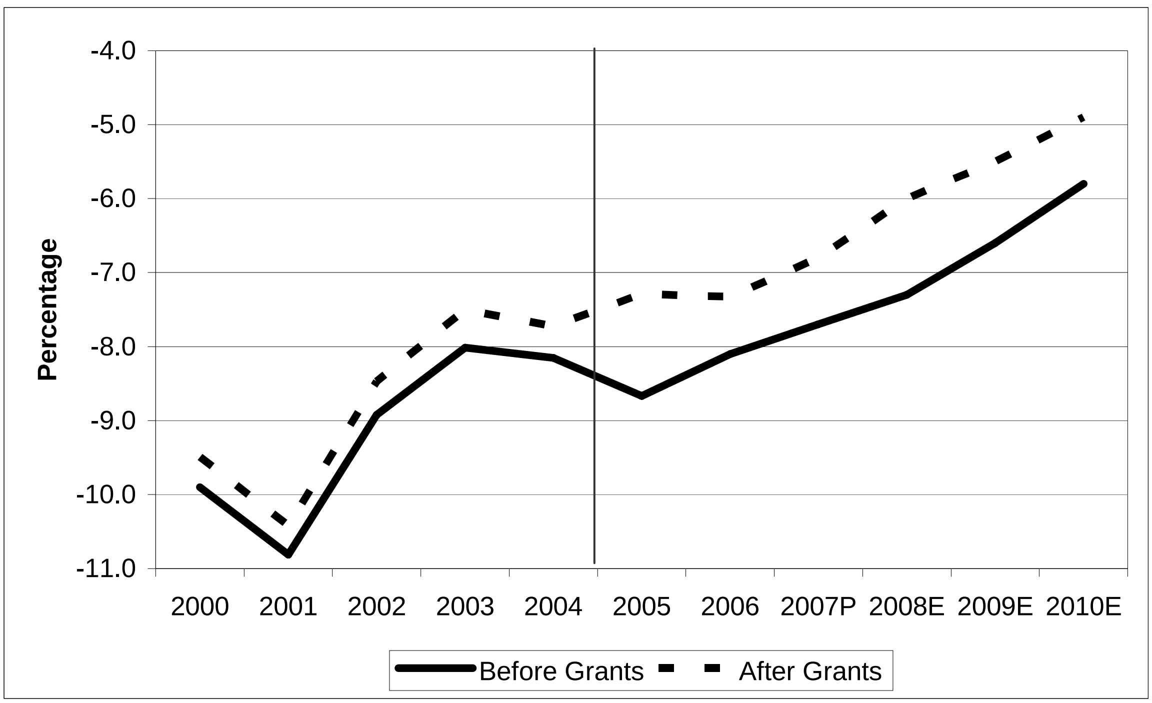
[a] Importers that have a recognized excellent track record with respect to strict and regular adherence to customs clearance procedures and who in turn, may avail of certain customs clearance benefits.

Source: Asian Development Bank.

FISCAL PERFORMANCE IN SRI LANKA

1. This appendix provides a brief analysis of the Government of Sri Lanka's fiscal performance for implementing the Fiscal Management Reform Program (FMRP) from 2005 to 2007. Against a series of challenges including measures to strengthen national security, rising international commodity prices and revamping physical infrastructure, the fiscal sector has continued to follow an improving trend albeit more slowly than earlier envisaged. Salient features include (i) fiscal deficit reduced from 8.2% of gross domestic product (GDP) in 2004 to 7.7% in 2007, (ii) current balance deficit reduced from 3.9% of GDP in 2004 to 1.6% of GDP in 2007; (iii) total outstanding debt decreased from 105.4% of GDP in 2004 to 85.8% in 2007. According to estimates under the revised medium-term fiscal framework (MTFF), the Government's fiscal performance is on track to achieve a fiscal deficit of 5.2% of GDP and total outstanding debt of 82% of GDP by 2010 thereby just about meeting the objectives set forth in the FMRA.

Figure A7.1: Fiscal Deficit, 2000–2010[a]



[a] 2007 based on provisional figures, and years 2008–2010 based on the Government of Sri Lanka's Medium-Term Fiscal Framework 2007–2010.

Sources: Central Bank of Sri Lanka. Available: http://www.cbsl.gov.lk/info/08_statistics/s_4.htm.
Central Bank of Sri Lanka Annual Report 2007.
Ministry of Finance and Planning, Fiscal Management Report 2008.

2. Figure A7.1 shows the fiscal deficit from 2000 to 2010 as a percent of GDP. The fiscal deficit is shown with and without the effects of grants.[1] By excluding grants, the deficit

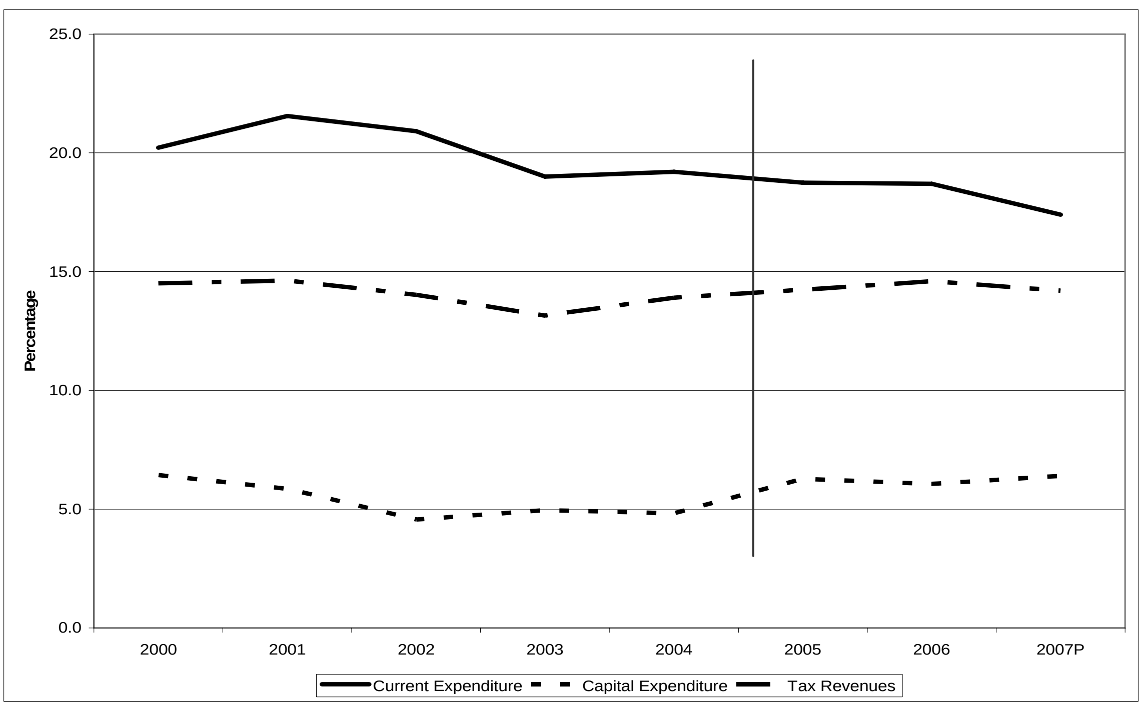
[1] Throughout this section, receipt of grants is excluded from all the measures on deficits otherwise mentioned. The Manual on Government Finance Statistics (GFS) of the International Monetary Fund is commonly used for fiscal analyses of developing countries. It groups grants together with revenues so that grants are included in deficits in the GFS framework. However, since the reports published by the Central Bank of Sri Lanka as well as the Ministry of Finance and Planning do not include grants in the deficit measures, their methodology is used in this appendix to ensure consistency.

deteriorated in 2005 to 8.7% of GDP from 8.2% in 2004; this is attributed to tsunami reconstruction and subsidies to buffer high oil prices. In addition, the fragile government coalition, dependent on the Marxist JVP party during 2005 and 2006, limited the Government's scope for more deep-rooted reforms including fiscal reforms. If grants are considered, the deficit actually improved in 2005 following a 275% annual increase in grants to SLRs32.6 billion and traced to tsunami rehabilitation.

A. Expenditure

3. Total expenditure as a share of GDP during 2004–2007 marginally declined to 23.8% in 2007 from 24.0% in 2004. This reflects a decline in current expenditure to 17.4% in 2007 from 19.2% in 2004 and an increase in capital expenditure to 6.4% of GDP in 2007 from 4.8% in 2004 (Figure A7.2). Higher spending on salaries and wages, pensions, fuel subsidies, national security, and humanitarian relief limited expenditure containment measures. Salaries and wages increased by 26.4% per annum on average, led by the recruitment of 40,000 new staff, salary increases, and introduction of a new allowance. Interest payments grew at an average of 15.1%, although they declined from 5.9% to 5.1% as a share of GDP. Building on *Mahinda Chinthana*[2] and the drive to improve public infrastructure, capital expenditure in 2007 is estimated to have increased to 6.4% of GDP from 6.1% in 2006. The projected increase in capital expenditure is expected to curtail the slow deterioration of social and physical infrastructure and overall public services of the country and lead to a buildup of productive and taxable assets.

Figure A7.2: Expenditure and Revenue as Share of GDP, 2000–2007[a]



[a] 2007 based on provisional figures.
Source: Central Bank of Sri Lanka. Available: http://www.cbsl.gov.lk/info/08_statistics/s_4.htm.
Central Bank of Sri Lanka Annual Report 2007.
Ministry of Finance and Planning, Fiscal Management Report 2008.

[2] The Government's comprehensive strategic development plan, 2006–2016, sets out a vision to ensure Sri Lanka's long-term economic development and poverty reduction objectives. Infrastructure development combined with development of a knowledge economy is at the core of the strategy.

Table A7.1: Expenditure Summary, 2004–2007
(SLRs million)

Item	2004	2005	2006	2007[a]
Total Current Expenditure	389,679	443,350	547,960	622,758
Salaries and wages	106,187	138,603	175,031	214,160
Interests	119,782	120,159	150,778	182,681
Foreign	13,904	6,995	16,990	21,311
Domestic	105,878	113,164	133,787	161,370
Pension	36,444	46,782	58,006	68,822
Total Capital Expenditure	83,807	140,154	162,213	206,161
Total Expenditure	476,905	584,783	713,147	841,604

[a] Provisional figures.
Sources: Ministry of Finance and Planning, annual reports 2005 and 2006.
Central Bank of Sri Lanka Annual Report 2007.

B. Revenue

4. Total revenue as a share of GDP during 2004–2007 marginally increased by 0.5 percentage points to 15.8% of GDP from 15.3%. It improved by 0.7 percentage points during 2004-2006, and subsequently declined by 0.5 percentage points in 2007. The decline in the growth of revenue collection was traced to the value-added tax, which declined by 0.4 percentage points, followed by excise tax and import duties, which declined by 0.5 and 0.2 percentage points, respectively. The provision of tax concessions on essential imported commodities for countering the rising cost of goods and services, and the lower quantity and total value of vehicle imports are assessed to be the main reasons behind underperformance of tax revenue. Income tax, on the other hand, increased by 0.3 percentage points in 2004–2007. This reflects reforms such as modernization of the tax administration, improved enforcement and public awareness campaigns, broadening the tax net by opening up new tax files, and removing exemptions and deductions. The Government, supported by the FMRP, has adopted a compliance-based taxpayer system building on facilitating services and backed by stronger enforcement measures to ensure healthy discipline on the part of taxpayers. Since 2006, more than 79,000 new tax files have been opened with the majority comprising income tax files, which should result in increased revenue collection.

Table A7.2: Revenue Summary, 2004–2007
(SLRs million)

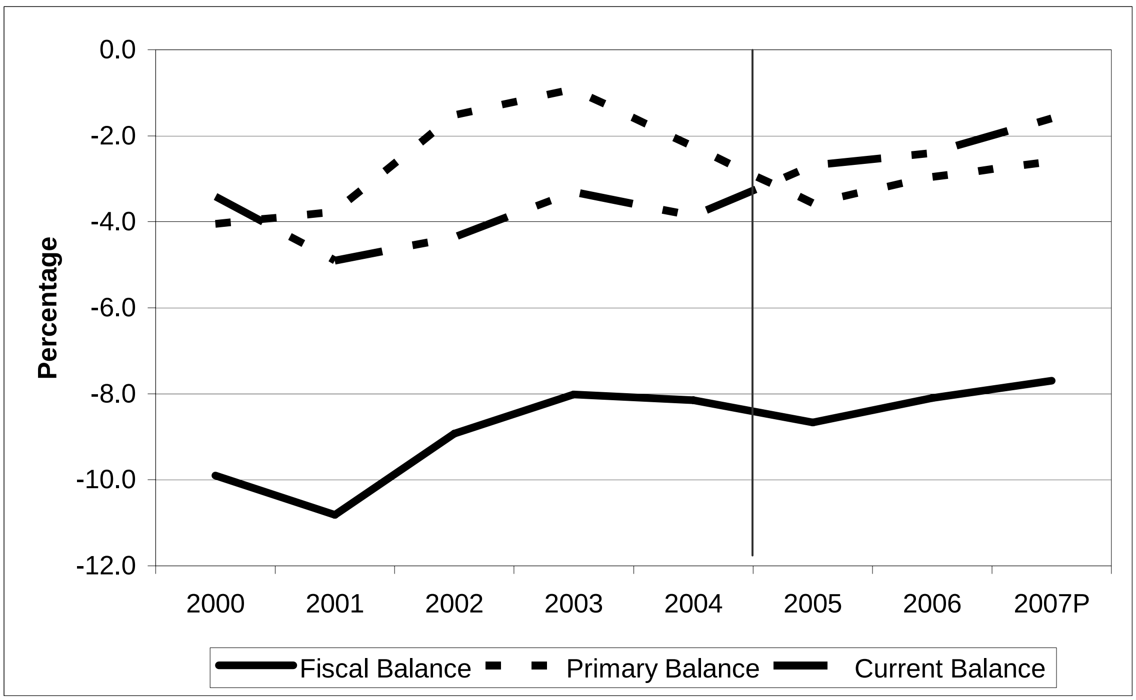
Item	2004	2005	2006	2007[a]
Total Tax Revenue	281,552	336,829	428,378	508,947
Income tax	41,372	52,536	80,483	107,168
Value-added tax	120,622	138,660	164,555	187,452
Excise tax	65,790	76,978	92,845	96,675
Import duties	41,096	45,390	52,681	55,986
Total Nontax Revenue	29,921	42,917	49,456	56,104
Total Revenue	311,473	379,746	477,334	565,051

[a] Provisional figures.
Sources: Ministry of Finance and Planning, annual reports 2005 and 2006.
Central Bank of Sri Lanka Annual Report 2007.

C. Fiscal Performance

5. Under the Fiscal Management (Responsibility) Act of 2003, the original target budget deficit for 2006 was 5.0% of GDP. However, the target was revised under the MTFF following the tsunami disaster. Reflecting fiscal consolidation for revenue and expenditure, the fiscal deficit is estimated to decline to 7.7% of GDP in 2007 from 8.1% in 2006 and 8.7% in 2005 (Figure A7.3). The primary deficit, which excludes interest payments from the conventional fiscal deficit, provides a more precise indicator of the Government's fiscal consolidation effort. The primary deficit declined from 3.6% in 2005 to 2.6% in 2007. Finally, the current balance (deficit), which measures the difference between (current) revenue and current expenditure, is often used as a measure of government saving as it excludes capital spending, which many governments like to preserve from cutbacks. The current balance has improved consistently with FMRP implementation. It declined from 2.7% in 2005 to 2.4% in 2006, and is estimated at 1.6% in 2007. The Government's overall fiscal performance during the last 2 years of the FMRP has been good, particularly as fiscal pressures from the tsunami rehabilitation were overcome.

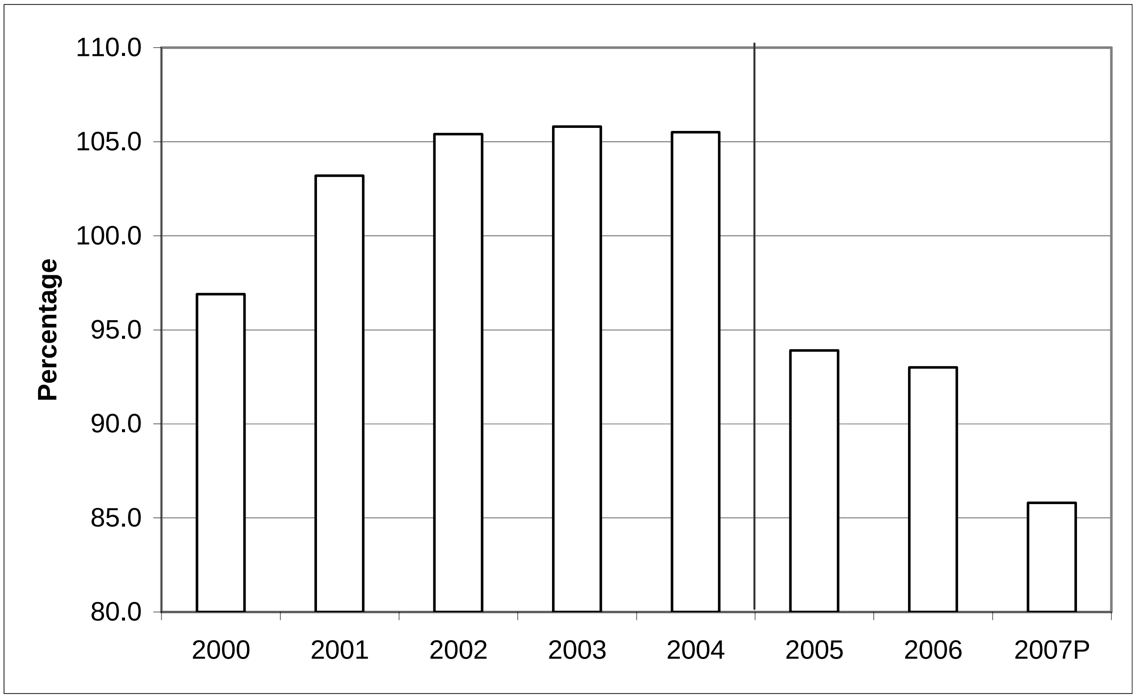
Figure A7.3: Primary, Current, and Fiscal Balances, 2000–2007[a]



[a] 2007 based on provisional figures.
Sources: Central Bank of Sri Lanka. Available: http://www.cbsl.gov.lk/info/08_statistics/s_4.htm.
Central Bank of Sri Lanka Annual Report 2007.

6. Debt as a share of GDP improved steadily over the course of FMRP implementation and reversed the steady increases of the past. Debt increased by SLRs384 billion and SLRs462 billion in 2006 and 2007, respectively, which resulted in total debt outstanding of SLRs3.1 trillion at end of 2007. However, as a share of GDP, debt decreased from 105.5% in 2004 to 93.0% in 2006, and is projected at 85.8% for 2007. The decline is mainly due to high nominal GDP growth, comprising inflation and real GDP growth. The appreciation of the Sri Lanka rupee in 2005 contributed to the reduction in that year through a decline in the rupee value of foreign debt.

Figure A7.4: Debt as Share of GDP, 2000–2007[a]



[a] 2007 based on provisional figures.
Sources: Central Bank of Sri Lanka. Available: http://www.cbsl.gov.lk/info/08_statistics/s_4.htm.
Central Bank of Sri Lanka Annual Report 2007.

Table A7.3: Actual versus Budget Estimate, 2004–2007
(actual % of estimate)

Item	2004	2005	2006	2007[a]	2005-2007 Average
Revenue					
Total Tax Revenue	93.7	95.9	98.4	94.1	96.1
Income tax	67.2	94.9	106.9	104.9	102.3
Value-added tax	96.0	97.2	94.4	92.7	94.8
Excise tax	111.9	100.1	108.8	89.9	99.6
Import tax	97.6	82.8	81.6	79.4	81.2
Total Nontax Revenue	75.0	111.8	100.8	95.3	102.6
Total Revenue	91.5	97.5	98.6	94.2	96.8
Expenditure					
Total Current Expenditure	108.9	105.8	107.5	104.4	105.9
Salaries and wages	101.0	98.6	103.8	104.7	102.4
Interest	99.2	93.9	99.7	108.0	100.5
Total Capital Expenditure	90.3	108.6	73.1	79.4	87.0
Total Expenditure	101.7	104.3	97.5	93.7	98.5

[a] Provisional figures.
Sources: Compiled from final budget position reports for 2004 and 2005,
Ministry of Finance and Planning, annual reports 2005 and 2006.
Central Bank of Sri Lanka Annual Report 2007.

7. Table A7.3 shows the improvement of the Government's ability to effectively target budget revenues since the launch of the FMRP in 2005. Actual total revenue was only 91.5% of the budget in 2004. This increased to 96.8% on average during 2005-2007 so that now the

budget can be planned based on a reliable estimation. Some tax items show even more dramatic improvement. For instance, actual income tax was only 67.2% of the estimated figure in 2004; this ratio has increased to 102.3% (which means actual tax collection was more than estimated) on average. On the expenditure side, expenditure management needs to be improved. In 2006 and 2007, total expenditure was below the projection; actual capital expenditure was only 87.0% of the original ambitious estimations on average during 2005-2007. On the other hand, current expenditure consistently exceeded the estimated budget throughout 2004-2007.

D. Subnational fiscal performance

8. In 2007, the overall fiscal performance of Provincial Councils (PCs) improved. Total revenue collection increased by 33% mainly due to the increase in revenue from turnover taxes and stamp duties. The main reason behind the increase in revenue from turnover taxes is the Government's decision to transfer some taxation authority from Excise Department to PCs as part of fiscal decentralization efforts. As a result, PCs were allowed to increase the turnover tax rate applicable to tobacco and cigarettes to 5% from 1%, which accounted for 87% of the total revenue. On the other hand, however, excise tax at the central government level which has relinquished some of its revenue sources to PCs recorded only a marginal increase by 4.1% in 2007, as compared to an average 18.8% increase during 2004-2006.

E. Budget 2008

9. Parliament passed the 2008 Budget on 19 November 2007 with a vote of 118–102. Although political turmoil resulted in crossovers between the ruling coalition and the opposition parties, the Government managed to secure a majority for the final approval on 14 December 2007. The budget marks continuity of the Government's commitment to reform and, in particular, to reduce the fiscal deficit and overall government debt by expanding revenue and implementing expenditure management measures supported by the FMRP. Total revenue is expected to reach 18.0% of GDP in 2008, of which tax revenue accounts for 16.2%. An explicit and significant reduction of the tax holiday regime under the Board of Investment Act supported by the FMRP and announced in the 2008 Budget is an important achievement. This reduction in tax leakage has the potential to increase corporate income tax collection, which is currently among the lowest in Asia. On the expenditure side, the budget estimates current expenditure at 17.1% of GDP, which would be a 0.3 percentage point decline over 2007. These measures would result in a budget deficit of 7.0% of GDP. More critically, the 2008 Budget envisages a surplus on the current balance of 0.9% of GDP. This would be a very positive achievement since the current balance has not had a surplus for decades.

F. Fiscal Management Report 2008 (MTFF 2007–2010)

10. The updated MTFF for 2007–2010 was presented in the Fiscal Management Report of 7 November 2007. According to the new MTFF, total revenue as a percentage of GDP is projected to reach 19.0% by 2010, mainly led by a 3.1 percentage point improvement in tax revenue. The projection of total expenditure is more modest; it is envisaged to remain stable at 24.0% of GDP for the next 3 years. While deepening of expenditure cutbacks may have achieved faster fiscal consolidation, the Government plans to increase capital expenditure. Henceforth, the projection of overall government spending appears to be less aggressive. Current expenditure is expected to decline from 17.4% of GDP in 2007 to 16.5% in 2010. This would result in a current balance surplus of 2.5% in 2010. However, a potential issue for the feasibility of the current MTFF may be that it provides little flexibility for downside risks. The

projected reduction in recurrent expenditure in the next 3 years is almost the same as achieved in the past 3 years. A similar achievement is envisaged on the revenue side. Since incremental reductions/increases in the latter stage are generally more difficult to attain than in the initial stage, linear projections may have to be carefully reviewed in the coming years.

11. With respect to total debt, the target of the Fiscal Management (Responsibility) Act was to reduce its share to 85% of GDP by the end of 2006. This target was revised and postponed under the current MTFF; it is projected to achieve 82.0% by 2010.

G. Fiscal Reporting

12. In addition to the fiscal objectives, the Fiscal Management (Responsibility) Act enhances the Government's reporting responsibility. This includes publication of the fiscal management report, midyear fiscal position report, final budgetary position report, preelection budgetary position report, and statements of responsibility. These are being published in a timely manner, and their content has improved. For instance, in addition to the MTFF, the November 2007 Fiscal Management Report includes a list of outstanding government guarantees, a variance analysis of the Government’s revenue and expenditure between 2007 and 2006, and assumptions for the 2008 Budget estimation. This is an important step in terms of transparency of the budget and accountability of the fiscal authorities, thereby, increasing the private sector’s ability to assess the Government’s fiscal position and improve decision making over the medium term.[3]

[3] For example, according to the list of guarantees, an assessment can be made that while the total guarantee amounts to SLRs37 billion as of June 2007, as % of GDP it is only 1.3% which is still well below the threshold of 4.5% determined in the FMRA.

LIST OF LIQUIDATED PUBLIC ENTERPRISES
(2005–2006)

1. Air Ceylon Ltd.
2. Borwood Ltd.
3. Building Materials Manufacturing Corp.
4. CEATO
5. Ceylon Silks Ltd.
6. Colombo Commercial (Teas) Ltd.
7. Investment Monitoring Board
8. Lanka Machine Leasers Ltd.
9. Libra Industries Ltd.
10. National Insurance Services
11. National Milk Board
12. National Packaging Materials Corp.
13. National Textiles Corp.
14. River Valleys Development Board
15. Self Employment Project
16. Sri Lanka State Trading (Marketing) Corp.
17. Sri Lanka Tobacco Industries Corp.
18. State Fertilizer Manufacturing Corp.
19. State Flour Milling Corp.
20. Weaving Supplies Corp.
21. Wellawatta Spinning and Weaving Mils Ltd.
22. Consolidated Commercial Agencies Ltd.
23. Sathosa Printers Ltd.
24. Sea Lion Express Ltd.
25. Tile Factories (Noorani, Shaw, Wijaya)

Source: Public Enterprise Reforms Commission