

## **Public Financial Management Strengthening Project - Project - Component 01 for the period from July 2023 to 31 December 2024**

The audit of the financial statements of the Public Financial Management Strengthening Project - Component 01 for the period from July 2023 to 31 December 2024 was carried out under my direction in pursuance of provisions in Article 154(1) of the Constitution of the Democratic Socialist Republic of Sri Lanka read in conjunction with provisions of the LK PFM Grant Number TF0C1642 dated 30 June 2023 entered into between the Democratic Socialist Republic of Sri Lanka and the International Development Association. My comments and observations which I consider should be reported to Parliament appear in this report.

### **1.2 Implementation, Objectives, Funding and Duration of the Project**

According to the Grant Agreement of the Project, the Ministry of Finance, Planning and Economic Development is the Executing Agency and the Department of Public Finance is the Implementing Agency of the Project. The objective of the Project is to enhance the institutional capacity and transparency in procurement. As per the Grant Agreement, the estimated total cost of the Project was US\$ 4 million equivalent to Rs.1,200 million which was agreed to be financed by International Development Association. The Project had commenced its activities on 07 June 2023 and scheduled to be completed by 30 November 2026.

### **1.3 Opinion**

In my opinion, the accompanying financial statements give a true and fair view of the financial position of the Project as at 31 December 2024, statement of the financial performance and its cash flow for the period from July 2023 to 31 December 2024 in accordance with Sri Lanka Public Sector Accounting Standards.

### **1.4 Basis for Opinion**

I conducted my audit in accordance with Sri Lanka Auditing Standards (SLAuSs). My responsibilities, under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### **1.5 Responsibility of the management and those charged with governance for the Financial Statements**

Management is responsible for the preparation of financial statements that give a true and fair view in accordance with Sri Lanka Public Sector Accounting Standards and for such internal control as management determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Those charged with governance are responsible for overseeing the Project's financial reporting process.

## **1.6 Auditor's Responsibilities for the audit of the Financial Statements**

My objective is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with Sri Lanka Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

As part of an audit in accordance with Sri Lanka Auditing Standards, I exercise professional judgment and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control of the Project.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

I communicate with those charged with governance regarding, among other matters, significant audit findings, including any significant deficiencies in internal control that I identify during my audit.

## 2. Financial Performance

### 2.1 Financial progress of the activities of the Project

|     | <b>Audit Issue</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                | <b>Response of the Management</b> | <b>Auditor's Recommendation</b>            |
|-----|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|--------------------------------------------|
| (a) | Out of the foreign funding allocation of Rs.80,000,000 provided for the period from July 2023 to December 31, 2023, to strengthen Public Financial Management, an amount of Rs.11,640,606 was spent during the period, leaving a balance of Rs.68,359,394. This remaining balance represented 85 percent of the budgeted allocation.                                                                                                                                                              | Agreed                            | Grant fund should be utilized effectively. |
| (b) | Under this project, a provision of Rs.10,000,000 was allocated as domestic funds and an amount of Rs.410,000,000 was allocated as foreign funds for the year 2024. During the year 2024, a total of Rs.668,300 had been spent out of domestic funds and Rs.74,615,689 from foreign funds, leaving a balance of Rs.9,331,700 (domestic funds) and Rs.335,384,311 (Foreign Fund) in the provisions. These remaining balances represented 93% and 82%, respectively, out of the budgeted allocation. | Agreed.                           | Grant fund should be utilized effectively. |

## 3. Physical Performance

### 3.1 Physical Progress of the activities of the project

|     | <b>Audit Issue</b>                                                                                                                                                             | <b>Response of the Management</b> | <b>Auditor's Recommendations</b>                    |
|-----|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|-----------------------------------------------------|
| (a) | Although a primary agreement was signed on November 25, 2019, with a Company for the development of the Electronic Government Procurement (e-GP) system at a contract value of | Agreed.                           | The Project management should strengthen contractor |

Rs.71,500,000, by December 31, 2021, the contractor had not demonstrated satisfactory performance. Despite this, an addendum to the original contract was signed on March 22, 2023, with the same company to develop the system within a period of 20 months, increasing the contract value by Rs.81,370,000, bringing the total contract value to Rs.152,870,000 for the development of new versions of the system.

performance evaluation procedures and ensure that contractors possess.

- (b) According to observations made by the Information and Communication Technology Agency of Sri Lanka (ICTA) and the World Bank, several shortcomings contributed to the issues in the original agreement and the development of the system. These included: the failure to properly document requirements as per the original agreement; the lack of clear definition of testing and deployment procedures in the initial contract; significant delays in transitioning the system from its initial version to version 3; the restructuring of the system architecture from monolithic to micro services based on ICTA feedback; pricing determined on the basis of monthly rates for officials employed by the contractor; the need for further system improvements as identified by international consultants during evaluation; the lack of a clearly defined project scope in the original contract; and the necessity to deploy more experts than initially agreed upon in the original agreement.

Agreed.

The Project management should ensure that contracts incorporate a well-defined scope, comprehensive technical specifications, and detailed testing procedures. Pricing structures should be based on agreed deliverables and measurable performance milestones.

- (c) By March 31, 2025, the system had been developed solely for procurement activities under the pricing mechanism. By June 17, 2025, only about 753 out of the expected

It was delayed due to numerous stakeholder-requested changes requiring formal processing.

Periodic monitoring and feedback mechanisms should be established to identify and address barriers.

3,000 institutions had registered on the e-GP system for conducting procurement activities. Furthermore, institutions using the e-GP system under the market pricing mechanism were not utilizing the system for all of their procurement activities.

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|-----|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| (d) | According to the main agreement signed with the International Development Association, 60% of national-level institutions were expected to conduct procurement under the market pricing mechanism by December 31, 2024. However, among the institutions registered in the system, only about 358 national-level institutions were actively conducting procurement through the system, which accounted for 11% of the total.                                                                                                                                                                                             | We assume that once this made mandatory these targets could be achieved. e-GP system development for both Version 2 and 3 has not been completed.                         | The Project management should take corrective measures to capacity-building programs, awareness initiatives, policy enforcement, and necessary system enhancements. |
| (e) | According to the Project implementation plan, as of the audit date, May 31, 2025, the System Release submitted by the system developer related only to Sprint 3 and 4 for National Competitive Bidding (NCB)/ International Competitive Bidding (ICB) goods remained at the testing stage. Sprint 5 was planned to be completed by March 2024, but as of May 27, 2025, the tasks had not been finished. Although the Works Procurement components of Sprints 3, 4, and 5, as well as Sprints 6, 7, and 8, were scheduled to be completed by December 2024, those activities had not yet been initiated by May 30, 2025. | Despite a contract extension to October 31, 2025, deliverables for Works, Shopping, and later Sprints are delayed. Even the Goods Procurement module is still incomplete. | The Project management should take promptly actions to expedite the completion of project activities.                                                               |

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|-----|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------|
| (f) | According to the above audit observations, although five years had passed since entering into the initial agreement to develop an electronic procurement system for public sector e-procurement, and two years since the commencement of the Project during which Rs. 19,180,250 had been spent from Project funds, the project management had failed to complete even 50% of the system development plan.                                                          | Agreed.                                                                                                                                                                                                                     | The Project management should take immediate corrective action to accelerate project activities to achieve desired project objectives. |
| (g) | Despite the low performance of the initially selected system developer during the original agreement period, a new agreement was entered into with the same developer. Under the new agreement, it became impossible to achieve the expected deliverables from the developer. As a result, the Project failed to meet its objectives within the expected timeframe. Project management was unable to take appropriate corrective actions in relation to this issue. | Although SIP committed to completing development by December 31, 2024, it requested an extension to October 31, 2025. Persistent delays from SIP have been the main reason for not achieving the expected project outcomes. | The Project management should take immediate corrective action to accelerate project activities to achieve desired project objectives. |