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HIGH-LEVEL SUMMARY TECHNICAL ASSISTANCE REPORT

SRI LANKA

Preparing a Fiscal Risk Statement

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High-Level Summary Technical Assistance Report
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The *High-Level Summary Technical Assistance Report* series provides high-level summaries of the assistance provided to IMF capacity development recipients, describing the high-level objectives, findings, and recommendations.

ABSTRACT: The International Monetary Fund (IMF) provided technical assistance to Sri Lanka to prepare a Fiscal Risk Statement (FRS) as part of its broader public financial management reforms. In response to the recent fiscal crisis, the authorities have implemented reforms to mitigate fiscal risks. While fiscal risk situation has improved, fiscal risks in areas such as macroeconomic shocks, state-owned enterprises, guarantees, public-private partnerships, financial sector, and natural disasters remain substantial. Recommendations focused on establishing clear roles and responsibilities, enhancing data quality and analysis, planning clear public communication to ensure timely preparing the 2025 FRS and improving it over time.

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Background

At the request of the Ministry of Finance (MoF) of Sri Lanka, a team from the IMF's Fiscal Affairs Department (FAD) in collaboration with World Bank staff visited Colombo during the period January 15–28, 2025 to conduct a capacity development mission on preparing a fiscal risk statement. The team was led by Mr. Guohua Huang (Senior Economist of FAD) and comprised Mr. Raju Sharen (IMF Resident PFM Advisor at Colombo), Ms. Marie-Hélène Le Manchec, and Mr. Matt Crooke (both IMF Experts), and Mr. Sebastian Michael Essl (Senior Economist of the World Bank). Ms. Martha Tesfaye Woldemichael, IMF's Resident Representative in Sri Lanka, participated in the closing meeting.

Summary of Findings

Sri Lanka has faced significant fiscal challenges in recent years, exacerbated by the realization of fiscal risks. In response, the authorities have implemented reforms to mitigate these risks. These reforms include the introduction of cost-recovery pricing for fuel and electricity, a reduction in the ceiling on the stock of guarantees, and the enactment of the Public Financial Management Act (PFMA) and the Public Debt Management Act (PDMA), both of which incorporate robust provisions for fiscal risk management. While fiscal risk situation has improved, it appears that fiscal risks remain substantial in macroeconomic shocks, public debt, state-owned enterprises, guarantees and on-lending, public-private partnerships, financial sector, and natural disasters.

The Government of Sri Lanka (GoSL) aims to publish its first Fiscal Risk Statement (FRS) by June 2025, as mandated by the PFMA. This marks a significant step towards enhancing fiscal transparency and accountability.

However, several challenges exist in preparing the FRS. Data availability and quality are relatively limited, and the depth of analysis conducted for different types of fiscal risks varies. Furthermore, fiscal risk information is scattered across ministries, departments, and agencies (MDAs), and a systematic information exchange mechanism has not been established. There is also a lack of clarity regarding roles and responsibilities among MDAs for preparing the FRS.

Summary of Recommendations

Considering the constraints of data availability, staff capacity, and a tight timeline, the preparation of the first FRS needs to balance credibility and feasibility. While the macroeconomic risks, public debt, SOEs, natural disasters, financial sector, guarantees and on-lending, and PPPs should be covered due to their significance, the depth of analysis may vary depending on data availability and analytical capacity. For those sources of risks, if data are not available in the near term, a qualitative description of the risks can be prepared for the first FRS.

The FRS should be focused and closely coordinated with other publications. It should convey key strategic points and quantify risks wherever possible to support informed decision-making and prioritization. It should clearly communicate risk management efforts, specifying actions taken to mitigate

and manage relevant fiscal risks. Additionally, the FRS should ensure consistency and complementarity with respect to other official publications related to fiscal risks.

To ensure close coordination among MDAs and smooth preparation of the FRS, a near-term priority is to clearly allocate roles and responsibilities among them. A Treasury Circular should be issued to delineate these roles and responsibilities, specifying tasks, timelines, and reporting protocols to ensure timely data supply and output achievement. The Department of Fiscal Policy (FPD) is well-positioned to lead and coordinate the FRS preparation, given the close linkage between fiscal risk analysis and the FPD's mandate on macroeconomic and fiscal assessment and policy analysis. Relevant departments of the MoF should prepare the sections of the FRS for those risks under their responsibility, and line ministries/agencies should be responsible and accountable for identifying, assessing, and monitoring specific fiscal risks that fall within their functions.

Clear communication with stakeholders is critical to ensure support and avoid potential misunderstandings. The authorities should convey to politicians and the public that comprehensive reporting of fiscal risks, based on robust analysis, can help governments respond to a range of potential future economic and fiscal shocks. A better understanding of fiscal risks, greater transparency, and effective risk management practices can reduce the magnitude of negative effects on fiscal balances and the economy.

In the medium term, a phased strategy should be adopted. The authorities should strengthen the legal framework relevant to fiscal risk management (e.g., PPP Act, financial regulations); improve the coverage and quality of fiscal risk datasets (e.g., SOEs, PPPs, natural disasters); enhance analysis of fiscal risks (e.g., stress testing and sensitivity/scenario analysis, credit risk assessments for guarantees); and strengthen mitigation measures (e.g., limiting fiscal exposure to PPPs, insurance and risk transfer, financial stability fund). As these reforms progress, the FRS can be enhanced with expanded coverage (e.g., adding sub-national governments and legal claims) and deepened analysis.