



# Project Readiness Financing Report

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Project Number: 55009-001  
October 2021

## Federated States of Micronesia: Preparing the Sustainable Road Infrastructure Investment Project

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Asian Development Bank

**CURRENCY EQUIVALENTS**  
(as of 05 October 2021)

The currency of the Federated States of Micronesia is the United States dollar.

**ABBREVIATIONS**

ADB	–	Asian Development Bank
COVID-19	–	coronavirus disease
DOFA	–	Department of Finance and Administration
DTC&I	–	Department of Transportation, Communications and Infrastructure
EMP	–	environmental management plan
FMA	–	financial management assessment
FSM	–	Federated States of Micronesia
km	–	kilometer
PAM	–	project administration manual
PMU	–	program management unit
PRF	–	project readiness financing

**NOTE**

In this report, "\$" refers to United States dollars.

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## PROJECT READINESS FINANCING AT A GLANCE

<b>1. Basic Data</b>		<b>Project Number:</b> 55009-001	
<b>Project Name</b>	Preparing the Sustainable Road Infrastructure Investment Project	<b>Department/Division</b>	PARD/PATC
<b>Country</b>	Micronesia, Federated States of	<b>Executing Agency</b>	Department of Finance and Administration
<b>Modality</b>	Project Readiness Financing (Grant)		
<b>Recipient</b>	Micronesia, Federated States of		
<b>Country Economic Indicators</b>	<a href="https://www.adb.org/Documents/LinkedDocs/?id=55009-001-CEI">https://www.adb.org/Documents/LinkedDocs/?id=55009-001-CEI</a>		
<b>Portfolio at a Glance</b>	<a href="https://www.adb.org/Documents/LinkedDocs/?id=55009-001-PortAtaGlance">https://www.adb.org/Documents/LinkedDocs/?id=55009-001-PortAtaGlance</a>		
<b>2. Sector</b>	<b>Subsector(s)</b>	<b>ADB Financing (\$ million)</b>	
✓ <b>Transport</b>	Road transport (non-urban)		2.50
	Transport policies and institutional development		1.00
	Urban roads and traffic management		1.50
	<b>Total</b>		<b>5.00</b>
<b>3. Operational Priorities</b>		<b>Climate Change Information</b>	
✓ Addressing remaining poverty and reducing inequalities		GHG reductions (tons per annum)	0.000
✓ Tackling climate change, building climate and disaster resilience, and enhancing environmental sustainability		Climate Change impact on the Project	Low
✓ Making cities more livable			
✓ Strengthening governance and institutional capacity			
		<b>ADB Financing</b>	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
		<b>Cofinancing</b>	
		Adaptation (\$ million)	0.00
		Mitigation (\$ million)	0.00
<b>Sustainable Development Goals</b>		<b>Poverty Targeting</b>	
SDG 9.1, 9.4		Geographic Targeting	✓
SDG 11.2			
<b>4. Risk Categorization:</b>	Low		
<b>5. Safeguard Categorization</b>	<b>Environment: B Involuntary Resettlement: C Indigenous Peoples: C</b>		
<b>6. Financing</b>			
<b>Modality and Sources</b>		<b>Amount (\$ million)</b>	
<b>ADB</b>		<b>5.00</b>	
Sovereign Project Readiness Financing (Grant): Asian Development Fund		5.00	
<b>Cofinancing</b>		<b>0.00</b>	
None		0.00	
<b>Counterpart</b>		<b>0.50</b>	
Government		0.50	
<b>Total</b>		<b>5.50</b>	
<b>Currency of ADB Financing:</b> US Dollar			

## I. PROJECT READINESS FINANCING

### A. Rationale

1. The Government of the Federated States of Micronesia (FSM) and the Asian Development Bank (ADB) prioritized support to the transport sector for the first time in ADB's country operations business plan for 11 small Pacific island countries, 2021–2023.<sup>1</sup> The FSM heavily relies on the United States and development partners for investments in the transport sector and has traditionally also received funding from the government of the People's Republic of China, international financial institutions such as the World Bank, and United Nations-affiliated organizations such as the International Organization for Migration and the Adaptation Fund. However, this assistance is insufficient to meet all of the FSM's infrastructure needs. ADB is well positioned to bridge this funding gap and strengthen the transport sector in the FSM by leveraging its unique experience and knowledge of the infrastructure constraints and opportunities in the Pacific. ADB's flexible financial instruments, such as the project readiness financing (PRF) facility, will ensure that the project delivery approach is tested and the ensuing project is implementation-ready before committing scarce public resources.

2. The FSM's population is served by 200 kilometers (km) of sealed and 15 km of unsealed primary roads over a combined land area of 700 square kilometers dispersed across the four semiautonomous states of Chuuk, Kosrae, Pohnpei, and Yap. Because of urban migration for job opportunities, especially to Pohnpei where the country's capital Palikir is located, about 56% of population lives on the four main islands. The remaining 44% lives on the outer islands. As is typical of many Pacific small island developing states, primary roads in the FSM provide access to public facilities, economic infrastructure, and job opportunities along the coastlines, where most of the population resides. These roads are a vital means for coastal communities to access public goods and services. Geographic remoteness and dispersion, environmental fragility, and climate change impacts pose major challenges for infrastructure delivery, and even threaten the physical viability of some areas of the main islands and the more remote outer islands of the FSM.<sup>2</sup>

3. Each of the four FSM states has only one primary circumferential route on the main island. These are two-lane roads with carriageways ranging in width from 5.5 meters to 7.3 meters. Most of these roads are in good to fair condition with some sections in poor or very poor condition. Furthermore, extreme weather in undulating terrain and a general lack of adequate drainage and routine maintenance severely hamper all-weather access. Even a few bad or very bad sections or crossings can seriously impede the flow of people, goods, and services. This limited connectivity and lack of alternative access means that the road network is essentially nonexistent.

4. The FSM's vehicle fleet increased by 30% from 8,500 in 2015 to 11,800 in 2019.<sup>3</sup> Main roads carry as few as 400 vehicles per day in the rural areas and as many as 8,000 vehicles per day on the heavily traveled urban roads. Pohnpei State is estimated to have more than 60% of the vehicle fleet. About 60% of these vehicles are privately owned older models that are expensive to operate and maintain and emit more greenhouse gases, particularly on roads in poor condition. While economic activity is likely to remain suppressed in 2021 due to continuing impact of

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<sup>1</sup> ADB. 2020. [Country Operations Business Plan: Eleven Small Pacific Island Countries, 2021–2023](#). Manila.

<sup>2</sup> The FSM has more than 600 islands scattered over about 2.6 million square kilometers located between Palau and the Philippines to the west, and the Marshall Islands to the east.

<sup>3</sup> FSM Statistics. [Transportation. Registered Vehicles, FSM: 2010–2020](#). (accessed 10 April 2021).

coronavirus disease (COVID-19) pandemic, a return to normalcy is expected to bring more economic activity and, with it, an increase in traffic flows.<sup>4</sup>

5. The FSM's institutional makeup is challenging with the national government taking the responsibility for policy, planning, and funding and the four semiautonomous states responsible for the execution and operation and maintenance of infrastructure assets. At the national level, the Department of Transportation, Communications and Infrastructure (DTC&I) implements the FSM Infrastructure Development Plan, 2016–2025.<sup>5</sup> It provides technical assistance to the state governments for project management, resource mobilization, and institutional strengthening. The DTC&I coordinates the planning and delivery of major infrastructure projects and programs through a program management unit (PMU) staffed with professional engineers and support staff.

6. The road network in each of the four states is owned and managed by the state government through the department responsible for infrastructure. In Chuuk State, this is the Department of Transport and Public Works; in Kosrae State, the Department of Transport and Infrastructure; in Pohnpei State, the State Office of Transport and Infrastructure; and in Yap State, the Department of Public Works and Transport. An infrastructure planning and implementation committee in each state is responsible for reviewing, approving, and monitoring infrastructure projects. State-level project management offices manage United States-supported infrastructure projects. The absence of effective institutional arrangements and lack of adequate funding have resulted in the progressive deterioration of the roads and lack of adequate network coverage to integrate all communities into the economic mainstream and provide access to social services. This problem is particularly severe in the states of Chuuk and Kosrae.

7. The government has directed the DTC&I to implement the FSM's Pave the Nation Program to address the pressing social and economic infrastructure needs. The government accords high priority to the program and estimates that investments of more than \$400 million will be needed for physical infrastructure and institutional development to support the expansion of the productive sectors, reduce poverty, and improve living standards. A post-COVID-19 economic stabilization strategy will place heavy emphasis on stimulating the construction industry as the primary engine of growth in the short term.

8. The World Bank approved the \$40 million Prioritized Road Investment and Management Enhancement Project in 2021 to (i) improve the FSM's road network through climate resilient upgrades to primary road sections and water crossings, (ii) provide technical assistance to create an enabling environment for asset management systems, and (iii) provide planning tools for prioritizing road investments.<sup>6</sup> Guided by Strategy 2030,<sup>7</sup> ADB's support is essential to bridge the infrastructure funding gap; partner with the World Bank and other financiers to deliver coordinated assistance; and provide knowledge support for institutional, technological, and human resources development. Given that the FSM is a small island developing state and is classified as a fragile and conflict-affected situation, project development will take a country-focused approach to strengthen state ownership and effective communication between national government and

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<sup>4</sup> An assessment by the FSM and the International Monetary Fund in 2021 suggests that the COVID-19 pandemic caused a 1.6% decline in gross domestic product in 2020, widening to 3.7% in 2021.

<sup>5</sup> Government of the FSM, DTC&I. 2015. [Federated States of Micronesia Infrastructure Development Plan FY2016–2025](#). Palikir.

<sup>6</sup> World Bank. [Federated States of Micronesia. Prioritized Road Investment and Management Enhancement Project](#). Washington, DC (approved on 17 May 2021).

<sup>7</sup> ADB. 2018. [Strategy 2030: Achieving a Prosperous, Inclusive, Resilient, and Sustainable Asia and the Pacific](#). Manila.

states while seeking to use advanced technologies with a primary focus on building long-term sustainability for operation and maintenance of the road assets.

## **B. Outputs and Activities**

9. **Output 1: Scope of sector policies, strategies, and investments identified.** Building on the World Bank’s assessment of the primary road network (para. 8),<sup>8</sup> the PRF will undertake project pipeline development and sector studies to identify policies, strategies, and investments to be supported by ensuing and subsequent projects. The scope of the sector studies will include primary, secondary, and urban roads in the four states of the FSM. The PRF will critically review the FSM’s road policies, strategies, and investment plans to identify opportunities for more efficient sector operation and maintenance and better funding that aligns with Strategy 2030 (footnote 7). The PRF will develop a long-term plan for sustainable sector funding and operation focusing on climate resilience; disaster risk management; environmental sustainability; innovation; and inclusive practices in project development, finance, and delivery. The PRF will hold thorough consultations on the long-term plan with the FSM’s four state governments and a wider group of stakeholders including civil society organizations. The PRF will subject the priority investments identified for ADB-financing to technical, economic, gender, social, and environmental viability assessments and rank them according to their intended sector outcomes.<sup>9</sup>

10. **Output 2: Detailed engineering designs and bidding documents prepared and implementation contracts procured.** The PRF will conduct all necessary engineering surveys and investigations for the priority investments and develop engineering designs with a focus on climate and disaster resilience, inclusive development, and road safety. It will undertake strategic procurement planning and prepare bidding documents for the road works proposed under the ensuing project following ADB’s Guidance Note on Procurement.<sup>10</sup> One or two road sections will be included from each state within the available financing. Where there is potential for land acquisition, land surveys will be coordinated with the relevant land management authorities and carried out as needed. The designs, procurement plan, and bidding documents will be prepared in sufficient detail so that bids can be invited as soon as the ensuing project’s fact-finding mission is completed.

11. **Output 3: Innovative tools for road rehabilitation works in the Federated States of Micronesia piloted.** Responding to the need for climate resilience and long-term sustainability, the PRF will undertake small-scale pilot-testing of two innovative construction methods: (i) full-depth reclamation and recycling of pavement materials to reduce construction waste and carbon emissions during construction, and (ii) intelligent compaction for better coverage and quality of road compaction operations. The study will be implemented on selected segments of the FSM road network and will include participation by representatives of the FSM states. The PRF will procure equipment and materials for the pilot study and provide a report on the potential for upscaling the pilot study to all states under the ensuing project.

12. **Output 4: Capacity of executing and implementing agencies and implementation arrangements tested.** Based on the recommendations of output 1, the PRF will test the project delivery approach to determine the most effective organizational and implementation arrangements. It will ensure that improvement of selected roads and bridges from all states are

<sup>8</sup> World Bank-funded vulnerability assessment study and climate resilient road strategy documents are expected to become available by 2022.

<sup>9</sup> The tentative list of potential investments to be supported by the PRF was discussed and included in the PRF Consultant’s terms of reference as guidance for undertaking the prioritization of investments.

<sup>10</sup> ADB. 2018. [Strategic Procurement Planning: Guidance Note on Procurement](#). Manila.



planned and implemented in a coordinated and efficient manner. This output will ensure that the ensuing project is adequately resourced and organizational relationships are structured to manage the project risks effectively. It will also establish an effective internal and external stakeholder communication strategy for the ensuing project.

### C. Ensuing Project

13. The ensuing project supported by the facility will include improvement of priority road sections and bridges from each state to be selected using the agreed selection criteria.<sup>11</sup> Tentative amount of financing needed is about \$30 million with expected approval in 2024. The key features of the ensuing project will be improved connectivity and access, climate and disaster resilience, inclusive development and infrastructure sustainability.

### D. Cost Estimates and Financing Arrangements

14. The PRF is estimated to cost \$5.5 million (Table 1). Detailed cost estimates by expenditure category and by financier are included in the project administration manual (PAM).<sup>12</sup>

**Table 1: Summary Cost Estimates**  
(\$ million)

Item	Amount <sup>a</sup>
<b>A. Base Cost<sup>b</sup></b>	
1. Output 1: Scope of sector policies, strategies, and investments identified	1.20
2. Output 2: Detailed engineering designs and bidding documents prepared and implementation contracts procured	2.00
3. Output 3: Innovative tools for road rehabilitation works in the Federated States of Micronesia piloted	1.30
4. Output 4: Capacity of executing and implementing agencies and implementation arrangements tested	0.76
<b>Subtotal (A)</b>	
<b>B. Contingencies</b>	<b>0.24</b>
<b>Total (A+B)</b>	<b>5.50</b>

<sup>a</sup> Includes taxes (3% gross revenue tax) and duties. Such an amount does not represent an excessive share of the project cost. Taxes will be financed under the project, while customs duties will be financed via exemption. The total project amount and the government's contribution do not include the estimated amount of exemption by the government. The government will finance costs associated with project management through salaries and operational expenses of the project management unit.

<sup>b</sup> In mid-2021 prices.

Source: Asian Development Bank estimates.

15. The Government of the FSM has requested a grant not exceeding \$5 million from ADB's Special Funds resources (Asian Development Fund) to help finance project preparation and design activities.

16. The summary financing plan is in Table 2. ADB will finance the expenditures in relation to consulting services, surveys, pilot-testing equipment and works, and audit fees. The government will finance the equivalent of \$0.5 million for salaries and operating expenses of the implementing agency.

<sup>11</sup> Project selection criteria (accessible from the list of linked documents in the Appendix).

<sup>12</sup> Project administration manual (accessible from the list of linked documents in the Appendix).

**Table 2: Summary Financing Plan**

Source	Amount (\$ million)	Share of Total (%)
Asian Development Bank Special Funds resources (Asian Development Fund grant)	5.0	91.0
Government	0.5	9.0
<b>Total</b>	<b>5.5</b>	<b>100.0</b>

Source: Asian Development Bank estimates.

## E. Implementation Arrangements

17. The implementation arrangements are summarized in Table 3 and described in detail in the PRF PAM (footnote 11). Procurement will follow the ADB Procurement Policy (2017, as amended from time to time) and the Procurement Regulations for ADB Borrowers (2017, as amended from time to time).

18. The Department of Finance and Administration (DOFA) will be the executing agency for the PRF. The DTC&I through the PMU will be the implementing agency in charge of coordinating all PRF activities at the national level, specifically with the DOFA and the departments responsible for infrastructure in each state government. The PMU under the DTC&I coordinates the delivery of infrastructure programs (e.g., those supported by the World Bank and the governments of the People's Republic of China and the United States). For major infrastructure projects, such as the World Bank-funded FSM Maritime Investment Project, PMU has project implementation units. Similar arrangements will be made with the PRF's increased resources. The government established a project steering committee for World Bank-funded projects, led by the secretary of the DTC&I, to engage all states effectively in decision-making on crucial issues. It will expand the committee to include coordination of ADB and World Bank support. The PMU will elevate and seek decisions from the committee on critical issues for effective and efficient implementation of PRF activities.

**Table 3: Implementation Arrangements for Project Readiness Financing**

Aspects	Arrangements		
PRF implementation period <sup>a</sup>	December 2021–December 2023		
Estimated PRF completion date	31 December 2023		
Estimated PRF closing date	30 June 2024		
Management			
(i) Oversight body	Project steering committee—chair: Secretary of DTC&I; members: DTC&I, DOFA, state governor's offices, PMU, consultants		
(ii) Executing agency	DOFA		
(iii) Key implementing agency	DTC&I through the PMU		
Consulting services	Quality- and cost-based selection	50 person-months	\$3.20 million
	Individual consultant selection	24 person-months	\$0.26 million
Procurement <sup>b</sup>	Request for quotation	1 contract (civil works)	\$1.00 million
	Request for quotation	1 contract (goods)	\$0.30 million
Advance contracting	Advance contracting will be used to commence consultant recruitment before approval and to accelerate consulting services.		
Disbursement	Disbursements under PRF will follow ADB's <i>Loan Disbursement Handbook</i> (2017, as amended from time to time) and detailed arrangements agreed between the government and ADB.		

ADB = Asian Development Bank; DOFA = Department of Finance and Administration; DTC&I = Department of Transportation, Communications and Infrastructure; PMU = program management unit; PRF = project readiness financing.

<sup>a</sup> Assuming international travel restrictions because of the COVID-19 pandemic allow international firm to mobilize to the FSM.

<sup>b</sup> Amounts inclusive of taxes.

Source: Asian Development Bank and government estimates.

19. **Consulting services.** The government has requested advance action and ADB assistance to select the PRF consultant (firm). ADB will select the PRF consultant, with participation from the DTC&I, following the ADB Procurement Policy and the Procurement Regulations for ADB Borrowers. The DTC&I will negotiate and sign the contract with the first-ranked firm and administer the contract. Detailed terms of reference and a matrix of the delegated consultant recruitment process were agreed and attached to the PRF PAM. ADB has advised the government that approval of advance contracting does not commit ADB to finance the PRF.

20. The PRF consultant's services will include construction supervision as part of a single consulting services package. Supervision services will be financed by the ensuing project if performance is achieved. To ensure the transfer of knowledge and lessons learned from pilot-testing high-level technologies and the replication of overall project delivery approach to implementation of the ensuing project, a single package for PRF and construction supervision services is required. This will also help reduce project start-up delays, which are often associated with mobilizing the project consultants to the project sites.

21. The DTC&I will engage national consultants, particularly to manage the PRF's overall coordination and development of ensuing project. The consultants will have expertise in project management, procurement planning, financial management, and safeguards planning and implementation. To maintain flexibility to mobilize the expertise needed to support the executing and implementing agencies, the terms of reference for the individual consultants will be agreed during PRF implementation.

## II. DUE DILIGENCE

22. **Technical.** The PRF calls for the use of cutting-edge technology for road construction. Full-depth reclamation and intelligent compaction methods, which are widely used in advanced economies such as the United States and Western Europe, are among the proposed technologies. These technologies reduce emissions related to road construction by recycling the road pavements in place and optimizing road compaction operations using real-time measurement system, thereby reducing the need to source and transport the raw materials from quarries to the project site. They have been shown to speed up project implementation, improve quality, and reduce traffic disruptions. The costs of pilot-testing these technologies under the PRF are low relative to PRF budget. A road reclaimer costs less than \$300,000 and intelligent compaction systems cost about \$50,000. The pilot-testing will include acquisition of these technologies and construction of a suitable 1–2 km road section by a qualified national civil works contractor. The PRF consultant will (i) design the pilot works and support procurement of equipment and civil works to carry out the pilot-testing of the technologies following the ADB Procurement Policy and Procurement Regulations for ADB Borrowers, and (ii) supervise the application of these technologies from acquisition to full pilot-testing.

23. **Governance.** The financial management assessment (FMA) was prepared in April 2021 in accordance with ADB's 2015 technical guidance note on financial management assessment and 2009 *Financial Due Diligence: A Methodology Note*.<sup>13</sup> The FMA covers the FSM's DOFA as the executing agency and the DTC&I as the implementing agency. Project activities are planned to be carried out in the four states. A PMU established within the DTC&I will manage day-to-day activities of project management and coordination, while the central implementation unit under DOFA will oversee the financial aspects of project implementation. The FMA assessed the

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<sup>13</sup> ADB. 2015. [Financial Management Assessment](#). Manila; ADB. 2009. [Financial Due Diligence: A Methodology Note](#). Manila.

financial management capacity of the executing and implementing agencies including funds flow arrangements, staffing, accounting and financial reporting systems, and internal and external auditing arrangements. The pre-mitigation financial management risk for DOFA is *low*. For the DTC&I, the pre-mitigation risk is *substantial* because of the absence of a financial management unit. The overall pre-mitigation financial management risk is *substantial* because of the identified implementing agency's absence of a financial management unit and internal audit function. The PRF will provide a financial management specialist for the PMU to mitigate these risks. The executing and implementing agencies agreed to actions to strengthen project financial management.

24. **Safeguards.** The PRF is classified B for environment and C for involuntary resettlement and indigenous people. Pilot-testing of the civil works approach will be strictly within the confines of the existing road footprint. The civil works entail excavation and repaving of a 1–2 km road section with limited sourcing of materials from quarries or borrow pits. No land will be acquired, and social and environmental impacts will be limited to noise, dust, and temporary traffic disruptions. An initial environmental examination has been conducted and an environmental management plan (EMP) has been prepared to manage the temporary impacts. The EMP will be updated after further detailed design and recommended additional impact assessments and surveys are carried out in early implementation.<sup>14</sup> The updated EMP will form part of the construction contract documents, and the contractor will be required to prepare a construction environmental management plan based on the project EMP. The impacts of the pilot-testing are anticipated to be minor, localized, and largely confined to the construction phase. They can be managed to acceptable levels if the mitigation measures set out in the EMP are incorporated into design and implemented properly by the contractor. The PRF consultant will support the PMU to ensure adequate implementation of the safeguards requirements. The PRF consultant will provide on-the-job training to the staff of PMU and the state governments' transport departments on ADB's Safeguard Policy Statement (2009) requirements. With the assistance of the PRF consultant, the PMU will establish a grievance redress and public communication strategy as part of the PRF to facilitate stakeholder consultations and inform the design of the ensuing project.

25. **Procurement risk category.** The PRF procurement is classified as *high* because the implementing agency lacks experience in procurement for and implementation of ADB-financed transport projects. This is the first ADB-financed road transport project in FSM. To mitigate the risk, the government requested ADB assistance to procure PRF consulting services following the delegation matrix attached to the PRF PAM. All procurement, including of consulting services, will be conducted in accordance with the ADB Procurement Policy and follow the Procurement Regulations for ADB Borrowers.

### III. PRESIDENT'S DECISION

26. The President, acting under the authority delegated by the Board, has approved the grant not exceeding \$5,000,000 to the Federated States of Micronesia from the Special Funds resources (Asian Development Fund) of the Asian Development Bank, for Preparing the Sustainable Road Infrastructure Investment Project, on terms and conditions that are substantially in accordance with those set forth in the draft grant agreement; and hereby reports this action to the Board.

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<sup>14</sup> Initial environmental examination (accessible from the list of linked documents in the Appendix).

**LIST OF LINKED DOCUMENTS**

<http://www.adb.org/Documents/LinkedDocs/?id=55009-001-PRF>

1. Grant Agreement
2. Project Administration Manual
3. Project Selection Criteria
4. Initial Environmental Examination

**Supplementary Document**

5. Brief Description of Road Conditions