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Report No: 126148-MF

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT

ON A

PROPOSED GRANT

IN THE AMOUNT OF SDR 7.60 MILLION
(US$11 MILLION EQUIVALENT)

TO THE

FEDERATED STATES OF MICRONESIA

FOR A

PROJECT FOR STRENGTHENING PUBLIC FINANCIAL MANAGEMENT

May 8, 2018

Governance Global Practice
East Asia and Pacific Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective March 31, 2018)

Currency Unit =	United States Dollar (US$)
SDR 0.68782 =	US$1
US$1.45386 =	SDR 1

FISCAL YEAR

October 1 - September 30

ABBREVIATIONS AND ACRONYMS

ADB	Asian Development Bank
ADB-TA	Technical Assistance from the Asian Development Bank
CIU	Central Implementation Unit
COTS	Commercial-Off-The-Shelf
CPF	Country Partnership Framework
CTA	Customs and Tax Administration
DA	Designated Account
DFAT	Department of Foreign Affairs and Trade
DoFA	Department of Finance and Administration
ESMP	Environmental and Social Management Plan
EU	European Union
FM	Financial Management
FMIS	Financial Management Information System
FSM	Federated States of Micronesia
GDP	Gross Domestic Product
GRS	Grievance Redress Service
HR	Human Resource
ICT	Information and Communication Technology
IFR	Interim Financial Report
IMF	International Monetary Fund
IPF	Investment Project Financing
IT	Information Technology
MOU	Memorandum of Understanding
ODA	Overseas Development Assistance
ONPA	Office of the National Public Auditor
PACTAM	Pacific Technical Assistance Mechanism
PDO	Project Development Objective
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PFTAC	Pacific Financial Technical Assistance Centre
PIC	Pacific Island Country
PIC9	Nine Pacific Island Countries
PIM	Project Implementation Manual
PIU	Project Implementation Unit

PPA	Programmatic Preparation Advance
PPSD	Project Procurement Strategy for Development
PSC	Project Steering Committee
RFB	Request for Bids
RMI	Republic of Marshall Islands
RMS	Revenue Management System
RPF	Regional Partnership Framework
STEP	Systematic Tracking of Exchanges in Procurement
TTL	Task Team Leader

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BASIC INFORMATION

Country(ies)	Project Name	
Micronesia, Federated States of	Project for Strengthening Public Financial Management	
Project ID	Financing Instrument	Environmental Assessment Category
P161969	Investment Project Financing	B-Partial Assessment

Financing & Implementation Modalities

[ ] Multiphase Programmatic Approach (MPA)	[ ] Contingent Emergency Response Component (CERC)
[ ] Series of Projects (SOP)	[✓] Fragile State(s)
[ ] Disbursement-linked Indicators (DLIs)	[✓] Small State(s)
[ ] Financial Intermediaries (FI)	[ ] Fragile within a non-fragile Country
[ ] Project-Based Guarantee	[ ] Conflict
[ ] Deferred Drawdown	[ ] Responding to Natural or Man-made Disaster
[ ] Alternate Procurement Arrangements (APA)	

Expected Approval Date	Expected Closing Date
30-May-2018	25-Sep-2023

Bank/IFC Collaboration

No

Proposed Development Objective(s)

The objective of the project is to improve tax administration and the completeness, reliability and timeliness of financial reports of the National and State Governments.

Components

Component Name	Cost (US$, millions)
Strengthening the PFM Environment	0.35

Financial Management Information System (FMIS)	5.14
Revenue Management System (RMS)	1.95
Change Management and Human Resource Development	1.36
Project Management	2.20

Organizations

Borrower: The Federated States of Micronesia

Implementing Agency: Department of Finance and Administration

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	11.50
Total Financing	11.50
of which IBRD/IDA	11.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	11.00
IDA Grant	11.00

Non-World Bank Group Financing

Counterpart Funding	0.50
Borrower	0.50

IDA Resources (in US$, Millions)

	Credit Amount	Grant Amount	Total Amount
National PBA	0.00	11.00	11.00
Total	**0.00**	**11.00**	**11.00**

Expected Disbursements (in US$, Millions)

WB Fiscal Year	2018	2019	2020	2021	2022	2023	2024
Annual	0.30	1.72	2.58	2.82	2.00	1.03	0.56
Cumulative	0.30	2.02	4.60	7.41	9.41	10.44	11.00

INSTITUTIONAL DATA

Practice Area (Lead)

Governance

Contributing Practice Areas

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Gender Tag

Does the project plan to undertake any of the following?	
a. Analysis to identify Project-relevant gaps between males and females, especially in light of country gaps identified through SCD and CPF	Yes
b. Specific action(s) to address the gender gaps identified in (a) and/or to improve women or men's empowerment	Yes
c. Include Indicators in results framework to monitor outcomes from actions identified in (b)	Yes

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	Substantial
2. Macroeconomic	Moderate
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial

6. Fiduciary	Substantial
7. Environment and Social	Low
8. Stakeholders	Substantial
9. Other	
10. Overall	Substantial

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [✓] No

Does the project require any waivers of Bank policies?

[ ] Yes [✓] No

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01	✓	
Performance Standards for Private Sector Activities OP/BP 4.03		✓
Natural Habitats OP/BP 4.04		✓
Forests OP/BP 4.36		✓
Pest Management OP 4.09		✓
Physical Cultural Resources OP/BP 4.11		✓
Indigenous Peoples OP/BP 4.10		✓
Involuntary Resettlement OP/BP 4.12		✓
Safety of Dams OP/BP 4.37		✓
Projects on International Waterways OP/BP 7.50		✓
Projects in Disputed Areas OP/BP 7.60		✓

Legal Covenants

Sections and Description
Project Steering Committee

Section I.A.2 of Schedule 2

To this end, the Recipient shall maintain until the Closing Date, the Project Steering Committee, chaired by its Secretary of Finance (or such other person which the Association has confirmed in writing to the Recipient as acceptable to the Association), and comprised of the directors, or their representatives, of each of the State Finance Offices, and with an institutional framework, functions, and resources satisfactory to the Association as shall be required for the Project.

Sections and Description
Project implementation Unit

Section I.A.5 of Schedule 2

The Recipient shall maintain until the Closing Date the Project Implementation Unit within the National Department of Finance and Administration with mandate, composition and resources satisfactory to the Association, which shall be responsible for providing day to day management of Project implementation. Without limitation to the generality of the foregoing, the Project Implementation Unit shall be supported by specialists within the Central Implementation Unit, and shall include the following key staff, each with terms of reference, qualifications and experience satisfactory to the Association: (a) a Project manager; (b) a Project assistant; and (c) additional technical specialists as may be needed.

Sections and Description
Centralized Implementation Unit

Section I.A.6 of Schedule 2

6. The Recipient shall maintain until the Closing Date the Central Implementation Unit with mandate, composition and resources satisfactory to the Association, which shall be responsible for providing fiduciary, monitoring and coordination of development partner funded projects. Without limitation to the generality of the foregoing, the Central Implementation Unit shall include staff performing the following key functions, each with terms of reference, qualifications and experience satisfactory to the Association: (a) program management; (b) procurement; (c) safeguards; (d) communications; (e) monitoring and evaluation; and (f) financial management.

Sections and Description
Dated Covenants

Mid-term Review

Section II.2 of Schedule 2

The Recipient shall: (a) not later than January 31, 2021 (or such other date as the Association may agree in writing), prepare and furnish to the Association a mid-term report, in such detail as the Association shall reasonably request, documenting progress achieved in the carrying out of the Project during the period preceding the date of such report, taking into account the monitoring and evaluation activities performed pursuant to paragraph 1 of this Section II, and setting out the measures recommended to ensure the continued efficient carrying out of the Project and the achievement of its objective during the period following such date; and (b) review with the Association such mid-term report, on or about the date one month after its submission, carry out a mid-term review of the Project, and thereafter take all measures required to ensure the continued efficient implementation of the Project and the achievement of its objectives, based on the conclusions and recommendations of the mid-term report and the Association's views on the matter.

Sections and Description
Intergovernmental PFM Working Group

Section I.A.4 of Schedule 2

To this end, the Recipient shall establish, by no later than three (3) months after the Effective Date, and maintain until the Closing Date, the Intergovernmental PFM Working Group, chaired by the Assistant Secretary of Treasury (or such other person which the Association has confirmed in writing to the Recipient as acceptable to the Association), and comprised of members of the respective Technical Working Groups and other technical leads from, inter alia, the offices of the National Government and State Governments with finance, budget and information technology functions, and with an institutional framework, functions, and resources satisfactory to the Association as shall be required for the Project.

Conditions

Type	Description
Disbursement	Project Implementation Manual Section I.B.1 of Schedule 2 The Recipient shall prepare and, through its Project Steering Committee, adopt a manual, in form and substance acceptable to the Association, setting forth the arrangements and procedures for implementation of the Project, including: (a) the institutional arrangements for day to day execution of the Project; (b) the arrangements for the implementation of the Environmental and Social Management Plan; (c) budgeting, disbursement, and financial management arrangements; (d) procurement arrangements and the Procurement Plan; (e) Project monitoring, reporting, and evaluation arrangements; (f) performance indicators for the Project; (g) the division of responsibilities and cooperative arrangements between the National Department of Finance and Administration, State Finance Offices, Project Steering

	Committee, Intergovernmental PFM Working Group, Technical Working Groups, Project Implementation Unit, and Central Implementation Unit; and (h) the procedures and arrangements for identifying and involving additional public offices as may be required for the Project ("Project Implementation Manual"). And Section III.B.1.(b) of Schedule 2 Notwithstanding the provisions of Part A above, no withdrawal shall be made:… (b) under Category (1) until the Recipient has adopted the Project Implementation Manual in accordance with Section I.B of Schedule 2 to this Agreement, to the satisfaction of the Association.

THE FEDERATED STATES OF MICRONESIA,
PROJECT FOR STRENGTHENING PUBLIC FINANCIAL MANAGEMENT

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I. STRATEGIC CONTEXT

A. Country Context

1. **The Federated States of Micronesia (FSM) is a small, remote, geographically dispersed Pacific Island Country (PIC).** Like many PICs, the FSM faces significant inherent structural challenges to developing an economy that can sustain government functions and effective service delivery. The FSM has a population of approximately 102,453 scattered over an ocean area of 3.0 million square kilometers. The country is heavily reliant on external assistance, with on-budget grant income estimated to account for 47.4 percent of total revenues (32.6 percent of gross domestic product [GDP]) in 2016. The FSM has few resources, and exports are heavily concentrated on fish. High import dependency exposes the country to global economic shocks and price spikes. The FSM is particularly vulnerable to accelerated sea-level rise and is prone to natural hazards. Like other PICs, the FSM suffers from gender inequalities in terms of access to economic opportunities and markets, access to endowments, women's voice and agency, and vulnerability to emerging risks.[1] The PIC governments, in partnership with the development community, are working in various ways to reduce these gender inequalities; however, overall analysis and policy making with respect to poverty reduction and shared prosperity in the nine Pacific Island Countries (PIC9) are severely constrained by the paucity and low quality of data, particularly gender-disaggregated data.

2. **A sovereign country since 1986, the FSM is a federation that gives significant power to the four state governments—Pohnpei, Chuuk, Kosrae, and Yap.** Each state has its own executive and legislative bodies and exercises considerable autonomy to manage its domestic affairs. Most public services are delivered at the state level. The FSM maintains deep ties and a cooperative relationship with the United States through the Compact of Free Association. Due to the federal structure and large geographical distances, accomplishing policy decisions at the national level is complex, as consensus across the national and the state governments is required.

3. **While domestic revenue has grown in recent years, mainly driven by higher fishing royalties, the FSM remains heavily dependent on aid—primarily through the Compact of Free Association—to meet both recurrent and development financing needs.** As mentioned earlier, grants contributed 47.4 percent of total revenue in 2016. By comparison, they contributed 55.6 percent in 2004. Since 1986, the Compact has provided large external financial transfers to support the Government in delivering key services, particularly education and health and substantial public sector investment at the state level. Under an Amended Compact agreement, the FSM has been receiving payments of an inflation-adjusted US$92.7 million per year starting in 2004, with US$76.2 million in the form of grants, US$16.0 million to be placed in a Compact Trust Fund, and US$0.5 million for an annual audit. After the Amended Compact expires in 2023, investment income from the Trust Fund is expected to replace the grants.

4. **The Government of the FSM is currently facing a challenging socioeconomic and fiscal situation**. This is characterized by a decreasing population due to out migration, which has had an impact on the supply of a skilled labor force; limited economic growth prospects; and real reductions in the Amended Compact grant fund flows, culminating in limited opportunities for domestic revenue generation. Even under optimistic growth projections, the FSM will still face a significant shortfall in public finances from FY2024 due to reduced funding of the Compact Trust Fund. An additional fund, the FSM Trust Fund, was

[1] World Bank. "Consolidated Country Gender Action Plan for Nine Pacific Island Countries FY17–21."

created by Congress in 1999. The National Government has made significant contributions to the FSM Trust Fund over the last three years as it has become clear that the Compact Trust Fund will not provide sufficient income in FY2024 to replace the Compact sector grant funding levels. Helping address this situation through strengthening public financial management (PFM) and increasing domestic revenues will be crucial for the FSM's long-term fiscal sustainability.

B. Sectoral and Institutional Context

5. **Public Financial Management (PFM) systems, processes, and institutions in the FSM are decentralized.** The FSM constitution is the supreme law of the land. Each state has its own constitution, legislature, and governor, as well as separate legislative and judicial systems.[2] Their compositions/structures vary. Expenditure responsibilities at the national level are primarily concerned with policy making, the regulatory environment, national functions, and oversight. Key national PFM legislation includes the Financial Management Act, Budget Procedures Act, Public Contracts Act, Income Tax Law, Revenue Administration Act, Customs Act, National Public Service System Act, and National Public Auditor Act. The Finance Management Act is supplemented by regulations, manuals, and operating procedures. The main agencies responsible for National Government PFM are the Department of Finance and Administration (DoFA); Overseas Development Assistance (ODA), Compact Management Division, and Personnel under the President's Office; Congress; and the Office of the National Public Auditor (ONPA). Similar arrangements exist in the states, each having its own PFM legislation (including the Financial Management Act, regulations, and procedures); a State Public Auditor; and offices for the delivery of finance, administration, and budget functions. Customs and Tax Administration (CTA) in the DoFA is responsible for national tax collection and compliance and has four state field offices. Each state has its own revenue division for the administration of local taxes. National and state regulations include both common and unique requirements. For example, accounting and control requirements are similar while procurement thresholds differ for every government.

6. **Raising domestic revenues is critical to secure FSM's fiscal sustainability.** With one of the lowest tax to GDP ratios[3] in the Pacific, there is significant scope to increase domestic revenues through tax administration and policy reforms. The FSM has a simple tax system and current legislation consists of two main laws: (a) the FSM Income Tax Law 1983 that includes a wage and salary tax and a gross revenue tax and (b) the Customs Act 1996 that covers customs and excise duties. Sales tax are being collected at the state level on goods, and there is no tax on services. Modernization of the current legislation and introduction of new tax laws would contribute significantly to domestic revenue mobilization efforts. Similarly, efficiency of tax administration is constrained by outdated information systems and manual processes.

7. **Improving budget execution processes and systems is required for better oversight of public finances that can contribute to fiscal sustainability**. Recent assessments, including the 2016 Public Expenditure and Financial Accountability (PEFA) assessment[4] of the National Government and a 2015

[2] World Bank Federated States of Micronesia: Public Expenditure Analysis, June 2016.
[3] Last five-year tax revenue to GDP ratio for the FSM: 11.6 percent (2012), 12.1 percent (2013), 18.9 percent (2014), 12.3 percent (2015), and 12.9 percent (2016). The sudden increase in 2014 was largely due to a one-off payment of US$22 million by a captive insurance company.
[4] PEFA self-assessment conducted by the DoFA in 2016. The report has not undergone quality assurance processes. Scores assessed for 14 of the 30 indicators were below satisfactory level, that is, 'C' or 'D'.

performance audit by the ONPA identified critical shortcomings in the current PFM systems and processes, particularly the financial management information system (FMIS) in use. A commercial accounting software, FundWare, was implemented across the five governments between 2006 and 2008, but it is operated as five discrete systems without any integration. The system is being phased out by its supplier and is no longer available for purchase. Each government has separate support contracts with an individual consultant and requests for enhancements and additions have not been favorably met. Concerns over the current FMIS include limited use of available functionalities due to lack of user capacity, no monitoring of user access rights, lack of disaster recovery plans, and inadequate security protocols. The National Government and the state governments are unable to reap expected benefits of an FMIS in the form of timely availability of comprehensive information that can support planning, budgeting, monitoring, and most importantly intergovernmental coordination on resource allocation. In-year budget reports for submission to Congress, as required by the Financial Management Act, cannot be produced. Preparation of information to respond to budget execution-related queries from Cabinet, Congress, or line departments is a laborious manual process using only some basic reports from FundWare. Similarly, production of government statistics is also not supported by information from the system in the absence of appropriate budget classification. All five governments have been meeting the single audit submission requirement[5] with considerable external support, but the auditor's reports have consistently noted errors in application of certain accounting treatments, absence of required disclosures, and deficiencies in internal controls leading to identification of questionable costs. Missing documentation and outstanding reconciliation among various records are the most common observations.

8. **Improvements are needed in the legal and institutional framework governing the PFM systems.** Recent technical assistance from the Asian Development Bank (ADB-TA) has supported a review of the financial management (FM) regulatory framework for the National Government to align with the requirements of the Uniform Guidance.[6] The work led to identification of substantial gaps and needed updates in several areas including, for example, treasury, revenues, procurement processes (including increased thresholds), and modernization to allow for electronic bank transfers and off-site storage of financial records through cloud technology. Amendments and updates to the Financial Management Act, regulations, and DoFA standard operating procedures are in various stages of approval.[7] FM regulatory framework in the states is similarly in need of review for which the DoFA anticipates technical assistance from the European Union (EU).

9. **There is a shortage of skilled staff to effectively manage the PFM systems.** Over the past few years, the DoFA has experienced staff turnover. Training opportunities for staff are very limited on both the operation of the system and on technical topics regarding accounting and financial reporting. The resulting loss of institutional knowledge is evident, especially in the quality of data input and in the lack of consistent application of accounting principles in basic operations.

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[5] A single audit is due for submission to the U.S. Department of the Interior's Office of Insular Affairs within nine months of the end of fiscal year.

[6] The FSM Government has adopted accounting principles generally acceptable in the United States (US GAAP) and adheres to the requirements set by the Governmental Accounting Standards Board of the United States (US GASB). The external auditor is required to report on compliance with the 'Uniform Guidance' regarding Compact funds, that is, U.S. Office of Management and Budget *Compliance Supplement* and *Title 2 US Code of Federal Regulations Part 200, Uniform Administrative Requirements, cost Principles and Audit Requirements of Federal Awards*.

[7] Proposed amendments await Congress approval. The revised FM regulations are undergoing a process of public consultation.

10. **In January 2015, the FSM States and National Leadership Conference endorsed the FSM 2023 Action Plan (2023 Action Plan) to address the fiscal and economic challenges leading up to and post FY2023.** It is based around the mutual principles of the Amended Compact which are to 'promote the economic advancement, budgetary self-reliance, and economic self-sufficiency' of the FSM. The Action Plan includes a long-term fiscal reform strategy and a long-term sustainable growth strategy with the emphasis on private sector-led growth. Without any reforms, the states in the FSM will face serious fiscal deficits from FY2024 onwards. The 2023 Action Plan recognizes that 'effective PFM is central to creating a relationship of mutual trust and shared consensus between government and citizens. Sharing information with the public and enhancing fiscal transparency are key efforts of the 2023 Action Plan. The main components of fiscal transparency include (a) development of clear roles, responsibilities, structures, and functions of the Government; (b) public availability of fiscal information at clearly specified times; (c) an open budget process covering preparation, execution, and reporting; and (d) assurance of integrity in the quality of information through independent assessment.

11. **In addition, a PFM Road Map was formulated and finalized in 2017 for implementation in 2018–2020.** The PFM Road Map sets out plans to improve overall governance, reduce corruption, and improve efficiency and effectiveness of financial systems and procedures. The National Government aims to improve current systems, better align resources and accountability toward development results, and present a sound basis for development partners to provide general budget support. The actions identified for achieving these objectives are (a) implementing a new FMIS (including integrating a budget module and automating customs and tax systems), (b) undertaking a complete review of the FM regulations, (c) improving reporting standards (including developing a new website), and (d) continuing to devote efforts to staff capacity development. The implementation and monitoring of the PFM Road Map is led by the division heads in the DoFA. Implementation of the PFM Road Map has been included as a component of the 2023 Action Plan. On the revenue side, several reforms are under way following recommendations from International Monetary Fund-Pacific Financial Technical Assistance Centre (IMF-PFTAC).[8] These include the reorganization of the CTA toward a function-based revenue administration and the implementation of compliance improvement measures.[9]

C. Higher Level Objectives to which the Project Contributes

12. **The project is aligned with the objectives of the World Bank Group's Regional Partnership Framework (RPF) FY17–21 for PIC9,[10] including the FSM.** The following focus areas are identified in the RPF for the World Bank Group's support: (a) fully exploiting the available economic opportunities, (b) enhancing access to employment opportunities, (c) protecting incomes and livelihoods, and (d) strengthening the enablers of growth and opportunities (macroeconomic management, infrastructure, and addressing knowledge gaps). Specifically, the proposed project supports objectives under the fourth focus area which calls for improving fiscal management. Improving public expenditure management is

[8] IMF/PFTAC Technical Assistance Report, April 2017.
[9] A pilot focusing on excise tax risk of the tobacco sector has proven to be a success. Excise on cigarettes increased by 86.58 percent in 2015 and continued to increase by a further 13.36 percent in 2016.
[10] World Bank Group. 2017. Regional Partnership Framework: For Kiribati, Republic of Nauru, Republic of The Marshall Islands, Federated States of Micronesia, Republic of Palau, Independent State of Samoa, Kingdom of Tonga, Tuvalu, and Vanuatu, FY17-FY21. Report No. 100997-EAP

one of the 12 high priority areas identified through the Systematic Country Diagnostic[11] underpinning the RPF. Given the important role and disproportionately large size of the public sector in the PIC9, sound public expenditure management is essential to the achievement of most of the PIC9 objectives. Strengthening public sector capacity, PFM, and transparency and accountability are some of the channels identified in the RPF to support a more effective government. As noted in the RPF, the FSM faces the additional challenge of adjusting revenue and expenditures in anticipation of a more constrained fiscal environment after the scheduled termination of Compact grants in 2023.

13. **The proposed project will contribute to fiscal sustainability by improving tax administration and will support public expenditure management by strengthening the underlying public financial systems and procedures, which are 'key to improving the management and efficiency of public expenditure' as noted in the RPF.** The FMIS constitutes a fundamental part of public expenditure management. Automation of government FM processes has become an integral part of most public expenditure management reform programs because the availability of timely and accurate information is critical to the economic management of government finances. The assistance will be coordinated with the other development partners, including the Asian Development Bank (ADB), International Monetary Fund (IMF), EU, and the U.S. Government, and will focus on providing support in areas where the World Bank has a comparative advantage.

14. **The proposed project will address project-specific gaps in relation to the participation and progression of women in the workforce.** Gender-disaggregated data on skills and competencies will be compiled and assessed to inform policies that promote equal opportunity for advancement of staff both in the DoFA at the national level and finance positions at the states level. The project supports the World Bank Group's Twin Goals of ending extreme poverty and boosting shared prosperity as it contributes to strengthening voice and agency for disadvantaged groups through increased transparency of budget and spending by ensuring that citizens can provide feedback through the DoFA website. Substantive changes to systems and procedures will establish platforms for the collection of gender-disaggregated data to inform key PFM processes.

15. **The 2023 Action Plan includes the PFM Road Map as a component of the actions required to meet the upcoming fiscal challenge.** Currently, the fiscal policy is formulated individually by the National Government and the state governments, with separate expenditure and revenue policies. All five governments will need to undertake both revenue and expenditure reforms. The 2023 Action Plan notes that a major part of fiscal adjustment will need to come from revenue increases to avoid jeopardizing social service delivery at the state level. The project will facilitate this process by supporting improvements in tax administration and the acquisition of a single integrated FMIS for the National Government and the state governments to facilitate data sharing and consolidation essential for informed decision making, planning, and management of public funds.

II. PROJECT DEVELOPMENT OBJECTIVES

[11] World Bank Group. 2016. Systematic Country Diagnostic for the Eight Small Pacific Island Countries: Priorities for Ending Poverty and Boosting Shared Prosperity. Report No. 102803-EAP

A. PDO

16. The objective of the project is to improve tax administration and the completeness, reliability and timeliness of financial reports of the National and State Governments.

B. Project Beneficiaries

17. Project beneficiaries include the DoFA, the CTA—a division of the DoFA, line departments and the ONPA in the National Government, and the Finance Departments of the four state governments.[12] Viewing and limited data-entry access will be provided to line departments depending on need and volume. The project will contribute to strengthening the Government's capacity to manage public resources efficiently and support those responsible for fiscal management thereby benefitting the citizens of the FSM at large through improved allocation and utilization of resources and potential efficiency in government services.

C. PDO-Level Results Indicators

18. The achievement of the Project Development Objective (PDO) will be measured through the following PDO-level results indicators.

- In-year budget reports prepared and published by National and all four State governments to meet quality and timeliness criteria of "B" score for PI-28 based on PEFA Framework[13]
- Revenue Management System installed and in use by CTA for improved accounting for revenue to meet criteria of "B" score for PI-20.3 based on PEFA Framework
- New FMIS used for preparation of budget and recording of revenue and expenditure transactions by National and all State governments

III. PROJECT DESCRIPTION

A. Project Components

19. The project is designed to respond to the Government's most urgent needs under the PFM Road Map in collaboration with support being provided by other development partners. The project will be implemented under five complementary components briefly described in the following paragraphs. A detailed project description is provided in annex 1.

Component 1: Strengthening the Public Financial Management Environment (US$350,000)

20. The objective of this component is to strengthen the PFM environment by ensuring that the legal and regulatory framework and the procedural guidance for business processes governing budget formulation, budget execution, and financial reporting for revenues and expenditures are internally

[12] Pohnpei State Department of Treasury and Administration, Chuuk State Department of Administrative Services, Yap State Office of Planning and Budget, Yap State Office of Administrative Services, and Kosrae State Department of Administration and Finance.
[13] https://pefa.org/sites/default/files/PEFA%20Framework_English.pdf

consistent, aligned with the applicable accounting guidance, and streamlined for efficiency. The scope will include all five governments, each of which has its own set of regulations and procedures. The U.S. Government reporting has specific requirements. However, there are well-established guidelines and frameworks in place which can serve as a resource when updating the government procedures and regulations.

21. The project will finance the (a) review of the legal and regulatory framework leading to preparation of a proposal for amendments to existing laws and regulations or new guidance, as required, for approval by the competent authority at both national and state level; (b) formulation of a new chart of accounts with appropriate structure and classification to facilitate management, statistical and fiscal reporting across the National Government and the state governments; and (c) updates to existing Procedures Manuals in each government, to the extent necessary, to lay out functional roles and responsibilities including specific responsibilities related to the operation of the FMIS. In the design of the new chart of accounts, necessary provisions will be made to allow tracking of special programs such as those directed at encouraging gender parity. To support ongoing efforts in medium-term budgeting and performance monitoring, the new FMIS will include capabilities to support data collection on outputs and beneficiaries, including gender-disaggregated information.

Component 2: Financial Management Information System (FMIS) (US$5,145,000)

22. The objective of this component is to implement a new FMIS that will support effective management of public resources and improve financial reporting for management and accountability. Project scope will include the DoFA office of the National Government in Palikir and its branch offices in each state, state finance offices, and one line ministry, either at the national or state level. The extent of functions to be decentralized to line ministries and the identification of line ministries will be determined by the Steering Committee in accordance with the procedures detailed in the Project Implementation Manual (PIM) and with the prior written agreement of the Association. Given the low capacity environment, a gradual, incremental sequencing strategy will be used in building up the new system which will include modules for budget preparation, commitment control and cash management, general ledger, payroll, fixed assets, accounts payable, accounts receivable, and financial reporting.

23. The project will finance (a) the conduct of a system requirements study to determine technical and functional specifications for a new FMIS; (b) the procurement and implementation of the FMIS (commercial-off-the-shelf, [COTS] package) at key sites including a document management system; (c) site preparation; (d) hardware, including servers, personal computers, networking and other accessories; (e) data center[14] arrangements for primary and disaster recovery centers;[15] (f) end user training on system usage and technical support; (g) subscriptions for Service Level Agreement with telecom provider; (h) preparation of a policy framework (policy, standards, and guidance) for security and usage of information

[14] Data center is a facility used to house computer systems/servers and associated components, such as telecommunications and storage systems. It generally includes redundant or backup power supplies, redundant data communications connections, environmental controls (for example, air conditioning, fire suppression), and various security devices.

[15] A disaster recovery center is a location where an organization can relocate following a disaster, such as fire, flood, security threat, or other disruptive event. This is an integral part of the disaster recovery plan and wider business continuity planning of an organization. A backup, or alternate, site can be another data center location operated by the organization or contracted through a company that specializes in disaster recovery services.

technology (IT) assets (hardware, software, and Internet) in government offices; and (i) technical consultants on PFM, IT security, networking, and technical support.

Component 3: Revenue Management System (RMS) (US$1,945,000)

24. The objective of this component is to improve the efficiency and effectiveness of revenue management for the National Government of the FSM.

25. There is a clear need for modernization of the IT system if the CTA is to improve its efficiency and effectiveness in revenue management. In the absence of an ongoing revenue modernization program, a phased approach is proposed. Discussions with the CTA and the DoFA confirmed that the immediate priority is the automation of tax accounting, and as capacity is increased, the expansion of automation to compliance and taxpayer services. In the first phase of project activities, the project will finance the procurement and implementation of an RMS using a COTS solution developed by specialized RMS providers. Implementation of the RMS is usually independent from the FMIS. However, parallel implementation of the RMS and the FMIS will facilitate smoother integration of the RMS into the larger FMIS. The scope includes the central CTA office and its branch offices in the states.

26. Modules to be implemented in the first phase include the following: (a) Taxpayer Registration, (b) Payments Processing, (c) Returns Processing, (d) Taxpayer and Revenue Accounting, and (e) Debt Management. By implementing these five core modules first, a solid foundation will be in place that can meet the immediate needs of the DoFA in revenue accounting management. This foundation will enable the CTA staff to identify and implement business process improvements enabled by the RMS and automate a large volume of work currently being carried out manually, such as returns processing and reporting. However, strong technical assistance from an experienced tax administration specialist will be required to achieve these benefits. The second phase, to be initiated in consultation with the DoFA, will include the implementation of compliance-related activities and new taxpayer services opportunities. Eventually, there will be a need to undertake a comprehensive institutional, policy, and administrative assessment to identify opportunities for revenue gains.

27. The project will finance (a) the conduct of a system requirements study to determine technical and functional specifications for an RMS; (b) the procurement and implementation of an RMS COTS package at CTA central and branch offices in the states; (c) site preparation; (d) hardware, including servers, personal computers, networking, and other accessories; (e) end user training on system usage and technical support; and (f) technical consultants on tax administration.

Component 4: Change Management and Human Resource Development (US$1,360,000)

28. The objective of this component is to support the successful implementation of the FMIS and the RMS with active stakeholder engagement and development of individual competencies and institutional capacity needed to sustain FMIS and RMS operations and related PFM functions. The project will support capacity building in the DoFA and other agencies with key roles in the PFM cycle such as the ONPA. This component will have two subcomponents.

Subcomponent 4.1: Change Management (US$860,000)

29. The introduction of an FMIS, especially the replacement of an existing system, is a disruptive change affecting stakeholders across the public sector. During the implementation stage, service delivery is likely to deteriorate before it improves as understanding of the new system increases. This subcomponent will support the preparation and implementation of a communications and change management strategy. A local agent for change will be based in each state finance office to facilitate the implementation of the project, monitor progress, and arrange for appropriate response to any issues as they arise. A senior official in each government will be designated as the change champion to lead the transition. Regular outreach activities will be conducted to inform stakeholders of progress and upcoming activities. With support from the communications specialist in the Central Implementation Unit (CIU), communications material using traditional and social media will be produced for dissemination, seeking feedback, and establishing user forums.

30. The project will finance (a) preparation of a gender-sensitive communications and change management strategy; (b) the design, production, and delivery of communication materials using traditional and social media; (c) outreach events to disseminate information regarding the project interventions; (d) establishment of user forums and feedback platforms; and (e) update of the DoFA website and establishment of web presence for each state to facilitate information dissemination.

Subcomponent 4.2: Human Resource Development (US$500,000)

31. The objective of this subcomponent is to support the usage of the FMIS and sustainability of project interventions through a human resource (HR) development strategy to build a pool of staff possessing the competencies needed to achieve desired outcomes from PFM systems, processes, and institutions. The U.S. Government's competency frameworks established for accountants and other finance professionals will be a useful resource. The strategy will include a review of the HR management policy environment relevant to the project objectives—for example, staff incentives, position descriptions, career development, scholarships—and recommended areas for improvement. The project activities will build upon work done on HR management under a recent ADB-TA for the National Government and Pohnpei State.

32. A competency framework will be developed to benchmark the minimum skill sets required in each job function (both in the DoFA and for equivalent finance roles across other departments) followed by a rapid skill gap assessment to form the basis of a training plan. Training will cover key areas, such as budgeting, accounting, and reporting, to equip the staff with a range of skills to fully and effectively utilize the enhanced functionality of the new system. Gender-disaggregated data will be captured for project beneficiaries for which activities will be designed to ensure that female employees are not disadvantaged, that is, providing equal opportunities for education and training to the current and potential employees and developing associated HR policies that promote gender parity.

33. Training will include end user training in the use of the FMIS, technical training for administration and management of the FMIS (information security, networking, and application software), and training on the use of information from the system for fiscal analysis and planning. Use of embedded trainers and development of e-learning courses will be considered in addition to partnerships with local, regional, and

international institutions for delivery of certification and degree courses in required areas of competencies and tailored courses for PFM.

34. The project will finance (a) preparation of a competency framework for PFM-related roles across the state governments and the National Government, (b) preparation of a training plan for existing staff in national and state finance offices, (c) development of training partnerships and bespoke training courses with local and international institutions, (d) short-term technical assistance to build capacity in selected areas, and (e) engagement of a firm for internal audit and capacity building to start working in the fifth year of project life.

Component 5: Project Management (US$2,200,000)

35. The objective of this component is to support overall project management and coordination. Because design and rollout of the FMIS will cause disruption across the respective governments, strong leadership will be critical. The Project Steering Committee (PSC) will need to play a proactive role to serve as a trusted forum to allow sharing of information and achieving collaboration and coordination across various stakeholders. A Project Implementation Unit (PIU) will be established with specific responsibilities to support and coordinate implementation of project activities. This component will also support the strengthening of the CIU in the DoFA which will monitor and coordinate all development partner-funded projects. A technical adviser has been engaged to serve as the Program Manager for the CIU which will include staff with skills necessary for fiduciary, communications, safeguards, and institutional development to enhance the ability of the DoFA to manage project funds and ensure that these are used efficiently for intended purposes. Costs of such services will be shared among the development partner-financed projects through a simple mechanism acceptable to the World Bank. The PIU will work in coordination with the CIU for FM, procurement, safeguards, communications, and monitoring. The project will finance (a) contract staffing for the project, (b) consultancies and non-consultancies, (c) office and other equipment, (d) travel and operational costs, and (e) training and workshops.

B. Project Cost and Financing

36. The project will be financed by an IDA grant using the Investment Project Financing (IPF) lending instrument. An amount of SDR7.6 million (US$11 million equivalent) has been allocated for the project. Counterpart funds in the amount of US$500,000 include staff time, office space, utilities and supplies, secretarial assistance, and other in-kind contributions funded by the Government. A Programmatic Preparation Advance (PPA) is in place with the National Government for carrying out activities related to the preparation of World Bank-supported projects, their effectiveness, and implementation readiness and to support the preparation of strategies, studies, and documents required for project implementation. This project will benefit from the PPA to cover expenditures incurred until the effectiveness of the project.

Project Components	Project Cost (US$)	IDA Financing (US$)	Counterpart Funding (US$)
1. Strengthening the Public Financial Management Environment	400,000	350,000	50,000

Project Components	Project Cost (US$)	IDA Financing (US$)	Counterpart Funding (US$)
2. Financial Management Information System (FMIS)	5,245,000	5,145,000	100,000
3. Revenue Management System (RMS)	2,045,000	1,945,000	100,000
4. Change Management and Human Resource Development	1,510,000	1,360,000	150,000
4.1 Change Management	910,000	860,000	50,000
4.2 Human Resource Development	600,000	500,000	100,000
5. Project Management	2,300,000	2,200,000	100,000
Total Costs	11,500,000	11,000,000	500,000
Total Project Costs	11,500,000	11,000,000	500,000
Front End Fees	—	—	—
Total Financing Required	11,500,000	11,000,000	500,000

C. Lessons Learned and Reflected in the Project Design

37. **The project design has benefitted from the World Bank's extensive experience in projects supporting modernization of PFM systems, processes, and institutions particularly the implementation of an FMIS.** Lessons learned from World Bank experience with similar projects in the past[16], and incorporated in current project design are the following:

(a) Consider absorptive capacity of the government and be pragmatic rather than ambitious in scope and timeline.

(b) Adopt a phased approach focusing first on priority areas with high level of commitment from the government.

(c) Investments in information systems should be informed by a review of business processes to identify opportunities for process reengineering and recognize the institutional, technological, and connectivity aspects in designing the appropriate solution and level of automation.

(d) Start implementation of core systems to establish budget control before moving on to support more advanced reforms.

[16] World Bank Study. 2011." Financial Management Information Systems: 25 Years of World Bank Experience on What Works and What Doesn't."
Hashim, Ali. 2014. *A Handbook on Financial Management Information Systems for Government: A Practitioners Guide for Setting Reform Priorities, Systems Design, and Implementation*. Africa Operations Services Series, Washington, DC: World Bank.

(e) Avoid complex project design. Use of simple off-the-shelf software packages using flexible procurement approaches works well for small island economies and low-capacity settings

(f) Strong government ownership is essential, which can be achieved through close coordination with the government in the design of project activities that should be responsive to the government’s declared priorities.

(g) For large system investments, change management needs to be embedded in the project planning and implementation from the beginning rather than being added on after commencement of rollout.

(h) Building HR skills to operate and manage systems during the life of the project is critical to sustainability.

(i) Coordination is essential for proper sequencing of government efforts and support from development partners.

IV. IMPLEMENTATION

A. Institutional and Implementation Arrangements

38. **The National Department of Finance and Administration (DoFA) is the implementing agency.** Within the DoFA, the PIU established under the Assistant Secretary of Treasury will be responsible for managing the project, including coordination with other development partner-funded projects and activities. In addition, the CIU under the Assistant Secretary for International Investment and Finance will be responsible for supporting and monitoring development partner-funded projects. Staffing in the CIU will be augmented to build a fungible pool of skills for FM, procurement, and safeguards expertise as well as other technical cross cutting-skills such as communications. In addition to a technical adviser to serve as the Program Manager for the CIU, a dedicated Project Manager is being recruited for the PFM PIU. Detailed implementation arrangements are described in annex 2.

39. Three main bodies constitute the project governance arrangements: (a) a Steering Committee to provide strategic guidance and decisions for the implementation of the project; (b) an Intergovernmental Working Group comprising technical leads in finance, budget, and IT functions from the National Government and each of the state governments for horizontal coordination across all; and (c) a PIU housed in the DoFA to be responsible for the day-to-day operations and supervision of project consultants and to support the proceedings of the Steering Committee and the Intergovernmental Working Group. Within each government, a Technical Working Group of users will be the forum for detailed discussions on aspects specific to each department. The PIU is to facilitate the coordination across and within governments. Together, these bodies should provide platforms for intergovernmental collaboration, two-way communication of information among stakeholders at each level of government, and coordination among departments and agencies to be affected by the changes.

40. A task force to oversee the implementation of the PFM project, notably the new FMIS, was established through a resolution in the 2016 Finance Conference held in Kosrae, and this intergovernmental body also serves as the PSC, given the close coordination and collaboration required

among the National Government and the four state governments to implement the project. An Intergovernmental Working Group will be established for detailed deliberation on system design, features, functionality, and so on, which can ensure harmonization and horizontal coordination across all governments and will prepare and recommend issues for decision to the Steering Committee. Representatives in the Intergovernmental Working Group shall be drawn from Technical Working Groups formed in each government, including at least one regular representative and additional participants relevant to the agenda of each meeting.

41. For project management, the PFM PIU and the CIU will work closely under the supervision of the Assistant Secretary for Treasury and Assistant Secretary for Investment and International Finance respectively. The Project Manager to be recruited for the PFM PIU will be responsible for coordination with the CIU, which will manage shared project services, such as procurement and FM, and with other development partner initiatives supporting PFM modernization efforts, such as the ADB and the EU. Costs of services provided by the CIU will be shared among the World Bank-funded projects.

42. A PIM, including detailed descriptions of the roles and responsibilities of each government office with an implementation role, as well as an agreed modality of cooperation between the National Government and the state governments, shall be prepared. Approval and adoption of the PIM through the PSC has been included as a disbursement condition.

B. Results Monitoring and Evaluation

43. Progress toward the PDO will be monitored through reporting on the PDO-level and intermediate-level results indicators. A Results Framework with project-specific indicators and actionable monitoring arrangements has been developed jointly with the DoFA and other stakeholders. This will be used for monitoring of implementation progress and results of project implementation. Overall monitoring and coordination of project activities will be performed by the DoFA as the implementing agency. The PIU will have overall responsibility for monitoring and evaluating the different components/activities in accordance with the indicators included in the Results Framework (section VII). The PIU will gather data for monitoring and evaluation from the relevant units in the National Government and the state governments. No later than 45 days after each semester, the PIU will submit semester progress reports to the World Bank, covering all project activities, including procurement and financial summary reports. Baselines will be determined during the first year of implementation. The project will also submit an Annual Work Plan and Budget for the World Bank's no-objection.

44. The World Bank will monitor implementation progress during biannual implementation support missions (the first one to take place six months after effectiveness) which will provide a detailed analysis of implementation progress toward achieving the PDOs and include an evaluation of FM and a post-review of procurement activities. During the missions, the World Bank will work with the DoFA to obtain feedback on progress and consider any adjustments to ongoing activities.

45. No later than January 2021 (or such other date as agreed with the World Bank), the DoFA will carry out a midterm review of the project and prepare and furnish to the World Bank a midterm report documenting progress achieved in the implementation of the project during the period preceding the date of such report, taking into account the monitoring and evaluation activities performed and setting out the measures recommended to ensure the continued efficient implementation of the project and the

achievement of its objectives during the period following such date. It will also review the midterm report with the World Bank, on or about one month after its submission, and thereafter take all measures required to ensure the continued efficient implementation of the project and the achievement of its objectives. At the end of the project, the World Bank will prepare an Implementation Completion and Results Report to evaluate the project and draw lessons. This report will include an assessment of the project by the Government.

C. Sustainability

46. **Strong ownership is in place for PFM reforms across the National Government and the state governments.** The project has been designed to respond to the most urgent needs of the Government as expressed in the national PFM Road Map and through request for support to the World Bank. The Secretary of Finance has led the discussions on project preparation which have included stakeholders within the DoFA and the Finance Departments in each state who are represented on the Steering Committee. Especially, the need for a new FMIS and related capacity development has been articulated in the Finance Conference held in 2016 and again in 2017.

47. **Avoiding a potential 'fiscal cliff' in 2024 is a strong motivation for implementation and sustainability of PFM reforms.** The Government of the FSM has a sizeable Trust Fund which was established as part of the Compact to replace the Compact grants upon their expiration. As per current projections, income from the Trust Fund is unlikely to fully replace the grants. Leading up to the end of the current Compact period in 2023, a critical challenge for the Government is to build the capacity to plan, manage, and monitor revenue and expenditures such that an appropriate balance is maintained between using some of the increased revenue to address current development challenges, building fiscal buffers to be able to deal with volatility, and saving for the future. Better resource management will lead to greater fiscal space. The project will contribute to this agenda by strengthening financial reporting for better decision making and transparency.

48. **Project design includes measures for sustainability.** Change management and HR development have been included to address the underlying causes of failure of the FMIS currently in use. Ease of use and reliable vendor support will be essential criteria in the selection of the new FMIS. The Government is aware of and has committed to finance the annual maintenance and support costs for the FMIS and the RMS as well as related expenses such as subscriptions for stable Internet connectivity from budgetary resources after the project closing date. A cloud architecture and COTS is recommended to minimize the need for high-level technical expertise within the Government which is likely to remain in short supply. External consultants will be playing an important role during implementation. The engagement of a firm to provide internal audit and capacity-building support is included in project activities. The firm will commence its work in the last year of project when it is anticipated that the new FMIS implementation will be substantially complete and a cohort of trained staff will be available in the DoFA to manage and operate the system.

D. Role of Partners

49. **Several resources are available to the Government for supporting its PFM reform agenda.** The coordination and monitoring of the national PFM Road map will be led by the PFM task force within the

DoFA of the National Government. The Division of ODA within the Office of the President is responsible for coordinating capacity-building support from development partners and financing of external reviews.

50. **Alongside the World Bank, key partners supporting PFM reforms include the ADB, IMF-PFTAC, EU, and the Governments of Australia and the United States.** Details are provided in annex 2. The ADB has recently funded the services of a consultant to help review FM regulations and other relevant issuances at the National Government. The EU has recently approved a regional program to support PFM strengthening initiatives across the Pacific, largely implemented through PFTAC. The U.S. Department of Interior and PFTAC continue to make technical assistance available for PFM in selected areas. The PIU will work in close coordination with other partners for harmonization of support to PFM reforms and avoid duplication of activities.

V. KEY RISKS

A. Overall Risk Rating and Explanation of Key Risks

51. The overall risk rating is Substantial primarily due to the limited technical capacity of the implementing agencies, limited experienced with World Bank and other multilateral development partner operations, and the need to coordinate among several stakeholders across the National Government and the state governments. Strong buy-in and commitment of the states are required to implement the project, as well as their active participation in the Steering Committee and Working Group deliberations.

52. This is also a new engagement for the World Bank, both in the sector and in the country. Lack of prior engagement and the logistical challenges of travel to the country for face-to-face dialogue affect the frequency and cost of implementation support missions.

53. **Political and governance risks that may affect the achievement of the PDO are Substantial.** Elections are due to be held in the country in 2019 leading to a new government by June of that year. Appointment and confirmation of secretaries can at times be a lengthy process. Several decisions require approval of the legislature which includes representation from the four states with a lot of heterogeneity.

54. The project requires political commitment from the highest level of both the four state governments and the National Government. The project objectives are in line with the government's priorities especially regarding the need to improve planning, management, and monitoring of public funds to prepare for the anticipated expiration of Compact sector grants. These priorities are likely to be maintained across the political transition.

55. **Institutional capacity risks for implementation and sustainability are Substantial.** There is a substantial likelihood that weak institutional capacity for implementing and sustaining the operation may adversely affect the PDO. This risk is primarily relevant for Component 2. Persons with skills and experience in finance and accounting are in high demand from both the public and private sector. Sustainability of the project interventions is dependent on the ability of the Government to recruit, train, and retain staff with skills necessary to operate and maintain the FMIS. Interventions through Subcomponent 4.2 are targeted toward mitigating this risk. Sustainability also relies on continued support to reforms under the PFM Road Map from other development partners.

56. Connectivity of sufficient quality will be critical for the operation of the FMIS. Mitigation measures include the use of creative technical solutions in the architecture of the FMIS such as cloud-based systems and the execution of a service-level agreement with the telecom provider to secure the required level of service.

57. **Fiduciary risk is Substantial.** FM and procurement for the project will be the responsibility of the CIU which is under the Assistant Secretary for International Investment and Finance in the DoFA. The CIU and the PIU is just being established and hence has limited experience working on World Bank-financed projects. Existing centralized FM support for World Bank projects in the FSM has been reliant on one Finance Officer. The system for retrieval of documentation for Withdrawal Applications is cumbersome with a high risk of error. Hence, the FM risk is substantial until a more sustainable CIU model is developed. Risks related to procurement are primarily due to the lack of experience of the DoFA with implementing procurement following World Bank procedures which is exacerbated by the nature and size of contracts to be processed under this project. A Finance Officer is already on board and recruitment of a Project Manager, a Procurement Specialist, and two other Finance Officers is under way. CIU and PIU staff will be continuously provided with relevant procurement training and implementation support by the World Bank task team. A PIM will be prepared and its adoption will be a condition of disbursement.

58. **The risk that stakeholders may object to the project activities and may adversely affect its successful completion is considered Substantial.** The project stakeholders include all five governments. The DoFA and the state finance departments will be updating their rules and procedures and rolling out a new system that will cause a period of disruption affecting services to the rest of the Government and eventually to the general public. Delays and disruptions may lead to resistance and even active opposition to the changes. Component 4 is designed to include activities directly targeted at managing and mitigating these risks. Although the DoFA is the implementing agency for the project, the state governments have a key role in implementing project activities. The project governance structure includes representation from all five governments to encourage consultation, information sharing, and inclusive decision making. There is a risk associated with having project activities implemented by the state governments in the absence of a binding state commitment to the project. The mechanisms for state government consultation and involvement are the PSC and its adoption of the PIM that will detail state roles and responsibilities. Staff will be hired as 'Change Agents' to be placed in each state Finance Department to facilitate communication among participating agencies. The communication strategy will include outreach activities and regular dissemination of progress updates and key milestones through various user platforms to gather the comments and concerns to be addressed.

59. The PFM reform agenda is supported by several development partners and will require close coordination. The World Bank team will maintain active contact with other development partner agencies, both at the project and the regional level to avoid duplication of activities.

VI. APPRAISAL SUMMARY

A. Economic and Financial (if applicable) Analysis

60. The economic and financial justification of the proposed project rests on its contribution to economic governance through improved public expenditure management. The potential of the FMIS in

the Government to improve effective service delivery and increase participation, transparency, and accountability to citizens, their elected representatives, and creditors is widely recognized by the literature and practitioners.[17] Introduction of the RMS will provide the CTA the ability to achieve revenue gains through efficiencies in tax administration. Governments traditionally finance PFM reforms, including the implementation of FMIS and RMS, using public-sector financing, and private sector financing is not relevant for these core government systems. In the case of developing and fragile countries, this public-sector financing is often augmented by funds sourced from development partners, such as the World Bank. The World Bank has extensive experience in projects supporting modernization of PFM systems, processes, and institutions particularly the implementation of FMIS and RMS.

61. Capacity-building programs embedded in the project, aimed at sustaining the reforms, will also ensure the availability of the right type of human resources to pursue evolving reform actions needed to manage the macrofiscal position of the country in the medium to long term. For the FSM, improvement in quality and timeliness of financial reporting is particularly important because failure to do so can affect the ability of the Government to access funds from the United States under the Compact. The project will directly support the capacity of the Government to achieve such improvement.

62. The major benefits of the project—in strengthening oversight and management of the budget that can lead to greater transparency and performance in Government operations—are difficult to quantify and measure. While the costs are identifiable, the benefits are largely indirect and will continue to be realized beyond the project life. The effective return on investments will ultimately be in the form of better performing public institutions and more effective and efficient use of financial and human resources. Additionally, second-tier benefits will accrue to the private sector (contractors/suppliers) and to the public at large from improvements in the efficiency, effectiveness, and accountability of public spending and public services.

B. Technical

63. **The project is strategically relevant toward the realization of the broader development goals of the Government.** A key bottleneck to economic growth stems from the inefficiencies in the current PFM systems, processes, and institutions. The project activities will contribute toward removing these inefficiencies and supporting the overall capacity development of those responsible for fiscal management and economic governance. There is explicit recognition in the country's development plan of the need to introduce reforms that support sound, accountable, and transparent public finance, which are at the core of the project design.

64. **The project is considered technically sound**. It is designed to address critical weaknesses and gaps in the core PFM architecture of the country and aspires to build a sound foundation to support the development of the FSM. Experience with a similar project in the FSM or the North Pacific countries either

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[17] a) Chan, James L. and Qi Zhang. 2013. Government Accounting Standards and Policies. In Richard Allen, Richard Hemming and Barry H. Potter. The International Handbook of Public Financial Management. New York: Palgrave Macmillan: 742-766; b) Dener, Cem, Joanna Watkins, and William Leslie Dorotinsky. 2011. Financial Management Information Systems: 25 Years of World Bank Experience on What Works and What Doesn't. A World Bank Study. Washington, DC: World Bank; c) Hashim, Ali. 2014. A Handbook on Financial Management Information Systems for Government: A Practitioners Guide for Setting Reform Priorities, Systems Design, and Implementation. Africa Operations Services Series. Washington, DC: World Bank.

by the Government, the World Bank, or another development partner is lacking. The project design includes flexibility to adjust to actual progress. The focus of the project is the new FMIS. Once the major procurement packages are awarded, the allocation of funds to project activities will be revisited and scaled up or limited as required. Sustainability of project activities is also a key concern in the project design.

C. Financial Management

65. An FM assessment of the DoFA, which is the implementing agency, and the CIU, which will be responsible for fiduciary aspects, was carried out in accordance with the 'Principles Based Financial Management Practice Manual' effective March 1, 2010. Under the World Bank's Directive: Investment Project Financing (Directive), the borrower and implementing agencies are required to maintain FM systems, including accounting, financial reporting, and auditing systems, adequate to ensure accurate and timely information regarding the project resources and expenditures. Overall, the assessment found that the FM arrangements satisfy the requirements as stipulated in the Directive subject to implementation of agreed actions and mitigating measures. The CIU is responsible for the FM arrangements for the whole project. The CIU is being established within the DoFA and currently has limited capacity and experience in implementing the FM requirements for World Bank-supported projects. A Finance Officer located in the DoFA currently provides FM support for development partner-funded projects in the FSM. To provide support for this project and other World Bank-supported projects, it is agreed that an additional Finance Officer be recruited in the CIU using funding available from the PPA. The sharing of services with other World Bank-supported projects will require processes to ensure that expenditures are properly recorded and documented and associated funds flows are monitored. The PIM will contain concise instructions on project-specific aspects of the FM arrangements, in addition to guidance in the FSM FM regulations.

D. Procurement

66. Procurement under this project will follow the World Bank Procurement Regulations for IPF Borrowers (dated July 2016 and revised November 2017, Procurement Regulations) and the provisions stipulated in the Financing Agreement. Key risks related to procurement will largely be mitigated with the recruitment of a Procurement Specialist in the CIU to provide technical assistance to the project. The World Bank task team will provide relevant procurement training and implementation support and the Systematic Tracking of Exchanges in Procurement (STEP) application will be used to prepare, clear, and update Procurement Plans and conduct all procurement transactions for the project. Accordingly, all the procurement activities under the proposed project will be entered, tracked, and monitored online through the system. The PIM will include a Procurement Module to guide the project in procurement implementation. The detailed procurement arrangements are in annex 2.

E. Social (including Safeguards)

67. Social impacts from technical advisory, capacity building, the FMIS, and the RMS are considered low. Physical works related to cable laying and renovations are likely to be no more than a nuisance and good consultation is proposed to mitigate impacts. Physical works will avoid private or customary land where possible, and voluntary land owner agreement will be sought before cable laying where it cannot be avoided. No resettlement will be necessary. A grievance redress mechanism is included in the Environmental and Social Management Plan (ESMP).

F. Environment (including Safeguards)

68. Climate change screening has confirmed that this project is not exposed to climate and geohazards now or in the future. Technical solutions for the FMIS include provisions for 'climate proofing' the system, that is, an off-site disaster recovery center, the use of cloud-based architecture, and an electronic document management system to digitally secure data and documents. Improving FM capacity may slightly improve the country's resilience to prepare for and respond to future disasters.

69. Most impacts from the proposed physical works (minor building renovations and underground network cabling to improve the Government's connectivity) have been assessed as minor in the ESMP. Moderate impacts could occur from uncontrolled runoff from cabling and from poor waste management. The project is classified as Category B and an ESMP dated March 24, 2018 has been prepared in accordance with OP 4.01 Environmental Assessment. The mitigation measures will manage the potential impacts from the small-scale works, including a consultation plan and instructions for the contractor's bid documents. The ESMP was disclosed on the Bank's external website and in country on March 27, 2018.

70. The DoFA will recruit a full-time Environmental and Social Specialist into the CIU supporting the World Bank portfolio. This person will be responsible for managing safeguards on this project. The adviser will have the skills to undertake consultations, manage contractors, and obtain any environmental permits necessary from the state environmental protection agencies.

G. Other Safeguard Policies (if applicable)

71. The project does not envisage any resettlement or additional land requirement. Resettlement or land acquisition activities are not eligible for funding under this Project.

72. **Citizen engagement.** The project will help establish tools and systems that can provide a foundation for citizen engagement. One of the overarching objectives in the PFM Road Map is 'further engaging the public into the annual budget process and debate'. The existing website for the DoFA will be upgraded to serve as a platform for dissemination of information on budget and expenditures once reliable financial reports are available. Web presence will also be established for each state finance office. The budget is seen as an anchorage for citizen engagement. The disclosure of information on the use of public funds to facilitate citizen participation and awareness on key financial information are potential entry points for citizen engagement in the PFM arena. Over the project life, the website will establish functionality to serve as an active two-way portal for citizen outreach—gathering citizen feedback on public services leading to participatory budgeting mechanisms.

73. **Gender.** The project will invest in two gender-specific activities. The first will seek to further enhance equal opportunities for advancement of women and men in the DoFA and the state finance offices. The labor force participation rate for women in the FSM is 39.9 percent.[18] In the DoFA at the national level, female employees constitute 58.54 percent of the current staff which is higher than the national average. The project will target training to female employees to further build and maintain the necessary interpersonal and management skills across the range of job functions. Gender-disaggregated

[18] Treva Braun. ed. 2012. *Stocktake of the Gender Mainstreaming Capacity of Pacific Island Governments: Federated States of Micronesia*. Noumea, New Caledonia: Secretariat of the Pacific Community.

data will be collected for the DoFA and the state finance offices and targeted interventions will be introduced to ensure equitable opportunities are provided to encourage female employment and career advancement from induction at entry level through to management positions.

74. Second, to support ongoing efforts in medium-term budgeting and performance monitoring, the new FMIS will include capabilities to support data collection on outputs and beneficiaries, including gender-disaggregated information. These project interventions will help address the current lack of available gender data and be critical for informing a dialogue on investments for reducing existing gender gaps. It will lay the foundation for transformational and targeted interventions for reducing a range of gender gaps in the FSM, for example, through instruments such as gender-based budgeting in the next phase of PFM reforms.

H. World Bank Grievance Redress

75. **Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS).** The GRS ensures that complaints received are promptly reviewed in order to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit *http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service*. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

VII. RESULTS FRAMEWORK AND MONITORING

Results Framework

Project Development Objective(s)

The objective of the project is to improve tax administration and the completeness, reliability and timeliness of financial reports of the National and State Governments.

PDO Indicators by Objectives / Outcomes	DLI	CRI	Unit of Measure	Baseline	End Target
To improve completeness, reliability and timeliness of financial reports of National and State Govts					
PDO-1: In-year budget reports prepared and published by National and all four State governments			Text	In-year budget reports not prepared and not published	In-year budget reports prepared and cleared for publication by all five Govts meeting criteria for timing, accuracy, coverage and comparability to meet criteria of “B” score for PI-28 based on PEFA Framework
PDO-3: New FMIS used by all five govts for recording and reporting budget, revenue and expenditure			Text	FundWare accounting system being phased out	New FMIS used for preparation of budget for FY2024 and recording of revenue and expenditure transactions by National and all State governments
To improve tax administration					
PDO-2: Revenue Management System installed and in use by CTA for improved revenue accounting			Text	“C” score in 2016 self-assessment for PI-20.3	Criteria for “B” score of PI-20.3 met

Intermediate Results Indicators by Components	DLI	CRI	Unit of Measure	Baseline	End Target
Strengthening the Public Financial Management Environment					
IR-1: New chart of accounts for all govts for better management, financial and statistical reporting			Text	"C" score in 2016 self-assessment. Functional classification lacking.	“A” score criteria for PI-4 met
IR-2: Procedures Manuals updated with detailed guidance for all five governments			Text	Operations Procedure not covering all required areas	Procedures Manuals in place with detailed guidance for budget formulation, accounting, internal controls, payroll, fixed assets, cash management and financial reporting
Financial Management Information System (FMIS)					
IR-3: Financial data integrity maintained to meet			Text	“B+” score for PI-27 in 2016 self-assessment	“B+” score for PI-27 maintained
Revenue Management System (RMS)					
IR-4: Taxpayer accounting in Customs and Tax Administration (CTA) automated			Text	No RMS in place	All modules of RMS implemented and in use
Change Management and Human Resource Development					
IR-5: Competency framework specifying minimum skillsets adopted and used for all PFM related jobs			Text	No competencies defined for PFM related roles	Competency framework specifying minimum skillsets required adopted for PFM related jobs across National and State governments and used for recruitment and training to build gender-balanced workforce
IR-6: External training program partnerships for PFM related certification and degree courses			Text	No external training program partnerships in place	Four (4) external training program partnerships for certification and

					degree courses in PFM related disciplines
IR-7: Number of staff completing external training programs in PFM related disciplines			Number	0.00	50.00
IR-8: Gender-sensitive communication conducted for the project for awareness and building ownership			Text	No communication strategy; regular updates and information not released for government staff and citizens	DoFA website enhanced and regularly updated with information for government staff and citizens with functionality developed for capturing and summarizing feedback
IR-9: Transparency and citizen engagement in budget preparation and execution by National government			Text	DoFA website exists but does not provide platform for receiving citizen feedback.	DoFA website includes functionality to capture citizen feedback. Information on budget preparation stages, final budget and quarterly updates on budget execution posted regularly including: a) summary presented in a citizen-friendly format understandable by non-technical audience; b) summary of citizen-feedback received and government response.

Monitoring & Evaluation Plan: PDO Indicators

Indicator Name	PDO-1: In-year budget reports prepared and published by National and all four State governments
Definition/Description	In-year budget reports prepared and published by National and all four State governments to meet quality and timeliness criteria of "B" score for PI-28 based on PEFA Framework. Criteria for "B" score in PI-28: PI-28.1: Coverage and classification of data allows direct comparison to the original budget with partial aggregation. Expenditures made from transfers to de-concentrated units within central government are included in the reports PI-28.2: Budget execution reports are prepared quarterly, and issued within four weeks from the end of each quarter PI-28.3: There may be concerns regarding data accuracy. Data issues are highlighted in the report and the data is consistent and useful for analysis of budget execution. An analysis of the budget execution is provided on at least a half-yearly basis. Expenditure is captured at least at payment stage
Frequency	Annual progress monitored against following targets: Yr1: Template for in-year budget reports prepared and adopted by Project Steering Committee Yr2: In-year budget reports prepared for at least two calendar quarters by National and two States Yr3: In-year budget reports prepared for at least two consecutive calendar quarters by National and three States meeting criteria for accuracy and coverage and comparability for "C" score of PI-28.1 and PI-28.3 Yr4: In-year budget reports prepared and cleared for publication for at least two consecutive calendar quarters by National and three States meeting accuracy, coverage and comparability criteria for "B" score of PI-28.1 and PI-28.3 and timeliness for "C" score for PI-28.2
Data Source	National and State Finance Departments
Methodology for Data Collection	Joint assessment by Government and World Bank based on PEFA framework for assessing public financial management (www.pefa.org)

Responsibility for Data Collection	Project Implementation Unit

Indicator Name	PDO-3: New FMIS used by all five govts for recording and reporting budget, revenue and expenditure
Definition/Description	New FMIS used for preparation of budget and recording of revenue and expenditure transactions by National and all State governments.
Frequency	Bi-annual progress monitored against following end of year targets: Yr1: Requirements for new FMIS defined and procurement completed Yr2: a) FMIS rollout initiated in National DoFA and two States for recording expenditure and revenue; b) FMIS budget module rollout initiated in National DoFA Yr3: a) FMIS rollout initiated in two further States for recording expenditure and revenue; b) FMIS budget module rollout initiated in two States Yr4: a) Line departments identified for FMIS rollout and testing initiated for recording expenditure and revenue; b) FMIS budget module rollout initiated in two further States
Data Source	National and State Finance Departments
Methodology for Data Collection	Project Progress reports and financial reports generated from FMIS
Responsibility for Data Collection	Project Implementation Unit

Indicator Name	PDO-2: Revenue Management System installed and in use by CTA for improved revenue accounting
Definition/Description	Revenue Management system installed and in use by CTA for improved accounting for revenue to meet criteria of "B' score for PI-20.3 based on PEFA Framework (www.pefa.org). Criteria would require that CTA undertake complete reconciliation of assessments, collections, arrears, and transfers to Treasury and other designated agencies at least half-yearly within eight weeks of the end of the half-year.
Frequency	Annual progress monitored against following targets: Yr1: Specifications for RMS determined and procurement initiated Yr2: RMS procured and installation initiated Yr3: RMS installation completed in CTA central office and all branch offices in States Yr4: RMS in use by CTA staff for revenue accounting
Data Source	Joint assessment by Government and World Bank based on PEFA framework for assessing public financial management (www.pefa.org)
Methodology for Data Collection	
Responsibility for Data Collection	DoFA, CTA

Monitoring & Evaluation Plan: Intermediate Results Indicators	
Indicator Name	IR-1: New chart of accounts for all govts for better management, financial and statistical reporting
Definition/Description	New Chart of Accounts (COA) to facilitate management, financial and statistical reporting issued for uniform adoptionh across all five governments meeting "A" score criteria for PI-4. Criteria for "A" score in PI-4 on Budget Classification as per PEFA Framework: Budget formulation, execution, and reporting are based on every level of administrative, economic, and functional classification using GFS/COFOG standards or a classification that can produce consistent documentation comparable with those standards. Program classification may substitute for sub-functional classification if it is applied with a level of detail at least corresponding to sub-functional classification.
Frequency	Bi-annual progress to be monitored against the following end of year targets: Yr1: Requirements for uniform COA across all governments determined and first draft prepared Yr2: New COA adopted by Project Steering Committee for use across all five governments Yr3: New COA in use for budget execution and use for budget formulation piloted Yr4: New COA in use for budget formulation, budget execution and financial reports
Data Source	National and State Finance Departments
Methodology for Data Collection	Joint assessment by Government and World Bank based on PEFA framework for assessing public financial management
Responsibility for Data Collection	Project Implementation Unit

Indicator Name	IR-2: Procedures Manuals updated with detailed guidance for all five governments
Definition/Description	Updates to Procedures Manual to include detailed guidance for budget formulation, accounting, internal controls, payroll, fixed assets, cash management and financial reporting
Frequency	Bi-annual progress to be monitored against following end of year targets: Yr1: Update to Procedures Manual prepared for National government Yr2: Update to Procedures Manual adopted by National government. Update drafted for two States. Yr3: Update to Procedures Manuals adopted by two States. Update drafted for two further States. Yr4: Updated Procedures Manual adopted and in use by all five governments.
Data Source	National and State Finance Departments
Methodology for Data Collection	Project progress report
Responsibility for Data Collection	Project Implementation Unit

Indicator Name	IR-3: Financial data integrity maintained to meet "B" score for PI-27
Definition/Description	Criteria for "B" score for PI-27: PI-27.1: Bank reconciliation for all active central government bank accounts takes place at least monthly, usually within 4 weeks from the end of each month. PI-27.2: Reconciliation of suspense accounts takes place at least quarterly within two months from the end of each quarter. Suspense accounts are cleared in a timely way, no later than the end of the fiscal year unless duly justified. PI-27.3: Reconciliation of advance accounts takes place at least quarterly within two months from the end of each quarter. Most advance accounts are cleared in a timely way PI-27.4: Access and changes to records is restricted and recorded, and results in an audit trail.
Frequency	Annual progress to be monitored against following indicators: Yr1: New FMIS procured and procedures for achieving data integrity drafted. Yr2: Criteria for "B" score for PI-27.1, 27.2, 27.3 fully met Yr3: Access and changes to financial records is restricted and recorded, and results in an audit trail Yr4: Criteria for "B" score for PI-27 fully met
Data Source	National and State Finance Departments
Methodology for Data Collection	Joint assessment by the Government and World Bank based on PEFA framework for assessing public financial management
Responsibility for Data Collection	Project Implementation Unit

Indicator Name	IR-4: Taxpayer accounting in Customs and Tax Administration (CTA) automated
Definition/Description	
Frequency	Bi-annual progress to be monitored against following end of year targets: Yr1: RMS procurement initiated Yr2: RMS procured and vendor mobilized; First phase of implementation initiated Yr3: RMS in use by CTA central office and four branch offices Yr4: Second phase of implementation initiated
Data Source	CTA, DoFA
Methodology for Data Collection	Project progress reports
Responsibility for Data Collection	Project Implementation Unit

Indicator Name	IR-5: Competency framework specifying minimum skillsets adopted and used for all PFM related jobs
Definition/Description	Competency framework specifying minimum skillsets (education, knowledge, experience) adopted for all PFM related jobs and used for gender-informed recruitment and training plans
Frequency	Bi-annual progress to be monitored against following end of year targets: Yr1: Draft prepared listing PFM related roles, minimum desired competencies for each and targets for a gender-balanced work force Yr2: Competency framework adopted by Project Steering Committee for all PFM related jobs in FSM Yr3: Skill gap assessment completed on the basis of Competency framework for National and all State Finance departments and training plans formulated with targets to increase female employment at technical and managerial level Yr4: Competency framework mandatory for recruitment to PFM related roles across National and State governments and used for annually updating training plans with targets to increase female employment at technical and managerial level
Data Source	National and State Finance Departments
Methodology for Data Collection	Project progress report
Responsibility for Data Collection	Project Implementation Unit

Indicator Name	IR-6: External training program partnerships for PFM related certification and degree courses
Definition/Description	Number of external training program partnerships for certification and degree courses in PFM related disciplines
Frequency	Bi-annual progress to be monitored against following end of year targets: Yr1: Competency framework to form basis of defining training needs drafted Yr2: Identification of training needs Yr3: Two (2) external training program partnerships for certification and degree courses in PFM related disciplines Yr4: One (1) further external training program partnership for certification and degree courses in PFM related disciplines
Data Source	National and State Finance Departments
Methodology for Data Collection	Project progress report
Responsibility for Data Collection	Project Implementation Unit

Indicator Name	IR-7: Number of staff completing external training programs in PFM related disciplines
Definition/Description	Gender disaggregated data to be captured for number of staff receiving training.
Frequency	Bi-annual progress monitored against following end of year targets: Year 1: 5.00 Year 2: 10.00 Year 3: 15.00
Data Source	National and State Finance Departments
Methodology for Data Collection	Project progress report
Responsibility for Data Collection	Project Implementation Unit

Indicator Name	IR-8: Gender-sensitive communication conducted for the project for awareness and building ownership
Definition/Description	Gender-sensitive communications conducted for the project for awareness and building ownership and used to gather and respond to citizens and direct project beneficiaries.
Frequency	Bi-annual progress to be monitored against following end of year targets: Year1: Gender-sensitive change management and communication strategy adopted Year2: 1) Three (3) project outreach events conducted and report summarizing feedback received published; 2) Media Collaterals prepared and distributed. Year3: DoFA website enhanced and launched with gender-sensitive content and design, including functionality to capture feedback from beneficiaries Year4: DoFA website regularly updated with relevant information. Summary of feedback received published quarterly with government response. Web presence, similar to DoFA, established for the four State governments.
Data Source	DoFA website
Methodology for Data Collection	Project progress report and review of website
Responsibility for Data Collection	Project Implementation Unit

Indicator Name	IR-9: Transparency and citizen engagement in budget preparation and execution by National government
Definition/Description	Transparency and citizen-engagement in planning and utilization of public funds by the National government as evidenced by timely publication of information in citizen-friendly format, platforms for receiving feedback operational and summary of feedback received published with government response.
Frequency	Bi-annual progress to be monitored against the following end of year targets: Year 3: DoFA website enhanced to include functionality for capturing feedback from project beneficiaries (government staff and citizens) Year 4: DoFA website regularly updated with information on budget preparation stages, final budget and quarterly updates on budget execution posted regularly including: a) Summary presented in a citizen-friendly format understandable by non-technical audience; and b) Summary of citizen-feedback received and government response.
Data Source	DoFA website
Methodology for Data Collection	Review of website; Updates in Project Progress Reports.
Responsibility for Data Collection	Project Implementation Unit

ANNEX 1: DETAILED PROJECT DESCRIPTION

COUNTRY: The Federated States of Micronesia
Project for Strengthening Public Financial Management

1. **The proposed project is designed to support the implementation of selected measures in the Government's PFM Road Map 2017–2020.** The proposed project is organized into five components with IDA grant financing of US$11 million: (a) Strengthening the Public Financial Management Environment, (b) Financial Management Information System (FMIS), (c) Revenue Management System (RMS), (d) Change Management and Human Resource Development, and (e) Project Management.

Component 1: Strengthening the Public Financial Management Environment (US$350,000)

2. The objective of this component is to set the foundation for and create an enabling environment for a sound PFM system covering revenues and expenditure in the National Government and four state governments.

3. The legal and regulatory framework and the procedural guidance for business processes governing budget formulation, budget execution, and financial reporting for revenues and expenditures will be reviewed and updated with the objective of ensuring internal consistency, aligned with the applicable accounting guidance and streamlined for efficiency. Authorizing environment and guidance for the operation of an FMIS need to be in place for project activities to successfully proceed. The U.S. Government's reporting requirements are very specific and complex. However, there are well-established guidelines and frameworks in place which can serve as a resource when updating the government procedures and regulations.

4. The ADB-TA has supported a review of the FM regulatory framework for the National Government. The work led to the identification of gaps and amendments have been proposed in the legislation which are being reviewed by Congress. A similar activity is planned to be undertaken for the states with support from the EU.

5. Each state has its own regulations and procedures that contain both common and unique requirements. Examples of the latter included different procurement thresholds. The state FM legislation is largely out of date. Similarities across the national and state regulations include common accounting and control requirements. Flexibility will be retained to accommodate the requirements of each state within a uniform framework. Internal controls across the budget cycle will be an area of focus, particularly for payroll. Currently, in the absence of checks and controls in the system, detailed manual review of payroll is conducted which is laborious and prone to error. Personnel records often do not reconcile with payroll.

6. A firm will be engaged to perform these activities. Outputs include draft amendments or new directives for approval by the competent authority. Areas covered include the following:

   (a) Ensuring legal basis of new FMIS architecture, for example, provisions for use of digital signatures, digital storage of documents, and bank transfers for payment.

(b) Update of Procedures Manuals to the extent necessary to ensure inclusion of sufficient guidance regarding functional roles and responsibilities including specific responsibilities related to processes in the FMIS. Procedures should ensure the establishment of a strong internal control framework across the budget cycle. There should be changes in workflows, as required, to ensure compliance with regulatory requirements in an efficient manner. This will include revisions that may be required to include requirements and guidance specific to the selected FMIS.

(c) New chart of accounts for compliance with latest Government Finance Statistics classification and appropriate structure to facilitate management and financial and statistical reporting. This should also allow tracking of sectoral expenditures and projects and special programs such as those directed at building climate change resilience, improving nutrition, and encouraging gender parity.

Component 2: Financial Management Information System (FMIS) (US$5,145,000)

7. The objective of this component is to implement a new FMIS that will support effective management of public resources and improve financial reporting for management and accountability. Project scope will include the DoFA office of the National Government in Palikir and its branch offices in each state, state finance offices, and one line ministry, either at the national or state level. The extent of functions to be decentralized to line ministries will be determined by the PSC.

8. A system requirements study will be conducted to determine the technical and functional specifications of a new FMIS. Based on these requirements, an FMIS will be selected. While detailed requirements will be determined through the formal system requirements study, the scope and salient features of the required FMIS include (a) a simple COTS application with minimal customization to manage complexity, cost, user skill requirements, and availability of technical support; (b) cloud-based architecture to reduce implementation and operational cost of the system; and (c) inclusion of an electronic document management system. The application should support the Government’s current efforts to introduce medium-term budgeting and performance monitoring. The scope will include modules for budget preparation, commitment control and cash management, general ledger, payroll, fixed assets, accounts payable, accounts receivable, and financial reporting.

9. Stable connectivity is essential for the operation of a cloud-based architecture. The DoFA has faced difficulty in securing the required service and none of the state finance offices are connected to the fiber-optic cable yet. The project will fund subscriptions for a service-level agreement with the FSM Telecommunications Corporation to assure the required level of service.

10. Necessary arrangements, to the satisfaction of the PSC, will be required in the design of the FMIS to ensure that the access to Government records is limited to authorized personnel only and the risk of leakage and destruction is minimized. None of the activities under this component will entail new construction. Space for facilities and equipment will be provided within existing government buildings.

11. Given the low capacity environment, a gradual, incremental sequencing strategy will be used in building up the new system, starting with a manageable system component, stabilizing it, evaluating and improving it, and then building lessons learned into the next component. Another important issue is

financial sustainability of the reforms and systems after project completion. Experience from other countries shows that the initial cost of an FMIS is relatively small compared with the total cost of ownership over the useful life of the system. The Government is committed to meeting these expenses through its budgetary resources. The project activities will also include support for the Government to prepare a policy framework (policy, standards, and guidelines) for security and usage of IT assets (hardware, software, and Internet) in government offices.

Three Country Solution

12. Both the FSM and the RMI are signatories to the Road Map for strengthening PFM for application as part of the tools for implementing the Forum Compact on Strengthening Development Coordination in the Pacific, signed in 2010. In January 2018, the heads of finance in the Governments of Republic of Palau and the FSM met in Palau to discuss their common requirement for a new FMIS. The RMI's Minister of Finance was unable to join. A memo was issued to document the agreements made and the countries committed to formulate a memorandum of understanding (MOU) to allow the three governments and their funders to share relevant documents and information related to the procurement of a new FMIS without restricting the timing or procurement process of any one country. Each government also agreed to appoint a focal person to facilitate the implementation of the MOU. The cooperation will be across the definition of requirements, vendor search and vetting, and maintenance and support.

13. It is clearly understood that each country will establish its own contract and legal relation with the selected vendor. Information that may be shared includes the following:

(a) Documents such as requirements analysis, request for proposals, formats, and vendor demo scripts

(b) Status of the government's process

(c) Major events where another government may participate, such as vendor demonstrations

(d) Feedback from references and other information on probable vendors

14. Should the three countries select a common vendor, it would provide a strong incentive to the vendor for the establishment of a maintenance and support center in one of the countries for timely incident response. In addition, the countries may share costs for a disaster-recovery site as well.

Component 3: Revenue Management System (RMS) (US$1,945,000)

15. The objective of this component is to improve the efficiency and effectiveness of tax administration for the National Government of the FSM. The immediate priority for the Government is the automation of tax accounting and, as capacity is increased, expand to compliance and taxpayer service components.

16. Procurement and implementation of an RMS using a COTS solution developed by specialized RMS providers will be the main activity. Implementation of the RMS is usually independent from the FMIS. However, parallel implementation of the RMS and the FMIS will facilitate smoother integration of the RMS into the larger FMIS.

17. The adoption of an RMS would automate many functions in the CTA enabling improved productivity of the staff. This would also allow the CTA to utilize the taxpayer data and information collected for risk analysis purposes. Amendment to the gross revenue tax in 2015 has changed it toward a profit tax, where certain deductions such as wages and utilities expenses are allowed from the taxable business turnover. Such information could be used to establish risk criteria to assess taxpayers' behaviors. In addition, customs data could also be used for matching of returns automatically, thus reducing the need to manually verify each return submitted. Keeping in line with the immediate priorities of the DoFA and in the absence of an ongoing revenue modernization program, a phased approach is recommended for the project activities which is described in the following paragraphs.

18. **Phase one.** It is recommended that only 5 of the 10 core modules usually found in the RMS are implemented in the first phase. These are (a) Taxpayer Registration, (b) Payments Processing; (c) Returns Processing, (d) Taxpayer and Revenue Accounting, and (e) Debt Management. The implementation of these five core modules will meet the immediate needs of the DoFA in revenue accounting management. This foundation will enable the CTA staff to identify and implement business process improvements enabled by the RMS. These modules will automate a large volume of work currently being carried out manually, such as returns processing and reporting. However, as in the introduction of the FMIS, the RMS will be a disruptive change requiring considerable change management and HR development, as outlined in Component 4.

19. **Phase two.** Implementation of compliance-related activities and new taxpayer services opportunities. This includes the implementation of the remaining five core modules: (a) Returns Management; (b) Case Management; (c) Audit Support; (d) Taxpayer Services; and (e) Revenue Reporting and Forecasting.

20. Technical assistance will be essential to support development of the CTA capacity in risk management and improving taxpayer services to maximize the benefit of the RMS. This could start with the development and implementation of an annual compliance plan to systematically address taxpayer risks using a range of treatments from education, facilitation to criminal prosecution. Support will also be needed for improving on-time filing, payment, management of arrears and outstanding returns, development of risk assessment criteria for audit selection and planning, and exploring the usage of third-party data such as bank information for risk assessment.

Component 4: Change Management and Human Resource Development (US$1,360,000)

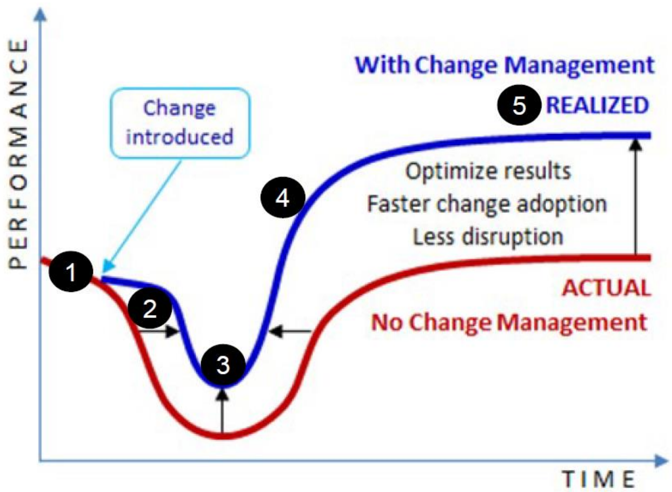
21. The objective of this component is to support the successful implementation of the FMIS and the RMS with active stakeholder engagement and development of individual competencies and institutional capacity needed to sustain FMIS, RMS, and related PFM functions. The project will support building capacity in the National Government and state governments for Finance Departments and other agencies with key roles such as the ONPA and State Public Auditors.

Subcomponent 4.1: Change Management (US$860,000)

22. The journey to secure the adoption of change to achieve results and reduce disruption is often referred to as a change journey as illustrated in Figure 1.1. The change journey can be mapped to the stages of the project, with the corresponding challenges identified and change management activities

proposed to meet these challenges. It is critical to determine and apply the level of change management effort needed to secure the required results and return on investment to fulfil the project objectives.

Figure 1.1. Purpose of Change Management and Change Journey



As these relate to the FMIS project stages, they include
❶ mobilization,
❷ solution design, development, testing and training,
❸ start of rollout,
❹ end of rollout and
❺ monitoring and evaluation of the change.

Source: Change Management for Governance and Public Sector Reform Projects, World Bank Group e-learning Module, September 2014.

23. The activities proposed under this subcomponent are to design and implement a change management and communications strategy for the project. A local agent for change will be based in each state finance office to facilitate the implementation of the project, monitor progress, and arrange for appropriate response to any issues as these arise. A senior official in each government will be designated as the change champion to lead the transition. Regular outreach activities will be conducted to inform stakeholders of progress and upcoming activities. Supported by the communications specialist in the CIU, communications material using traditional and social media will be produced for dissemination, seeking feedback and establishing user forums. The activities will also include update of national DoFA website including the creation of links/pages for each state to facilitate information dissemination.

Subcomponent 4.2: Human Resource Development (US$500,000)

24. As learned from experience in supporting the FMIS[19] and other IT interventions in other countries, it is essential to recognize that any system can only deliver on expected benefits of technology if it is supported by an appropriate legal, regulatory, and monitoring framework and required human resources are in place to operate the system to achieve desired benefits. A HR development strategy will be developed and implemented. The objective is to build a pool of staff possessing the competencies needed to deliver the required PFM functions. Training builds development capacity only when trainees have adequate resources and incentives to implement learning in the workplace. This includes nonmonetary incentives such as merit-based promotion systems and opportunities to pursue professional development. The strategy will include a review of the HR management policy environment relevant to

[19] World Bank Study. 2011. "Financial Management Information Systems: 25 Years of World Bank Experience on What Works and What Doesn't."

the project objectives, for example, staff incentives, position descriptions, and career development, and recommend areas for improvement.

25. Under the ADB-TA for the National Government, proposals have been presented to Congress on the design of a new job grade structure, design of a new compensation structure, and other related issues. The ADB-TA also supported Pohnpei State in the preparation of a medium-term public sector reform plan covering HR management. The project activities will build upon the existing work done.

26. As part of the training initiatives, this subcomponent would also provide support to enhance capacity for fiscal analysis and planning, which can contribute to improved project evaluation and prioritization. Strengthened fiscal analysis and expenditure management is important, as authorities manage the transition due to the expiration of Compact sector grants in 2023.

27. A competency framework will be developed to specify the minimum skill sets required in each job function both in the finance offices and for equivalent roles across the government. The US Government's competency frameworks established for accountants and other finance professionals will be a useful resource in developing the framework for the FSM. This can serve as a lever for implementing a change in mindset and must be future-oriented with respect to the desired structure and performance standards. Preparation of the framework will be followed by a rapid skill gap assessment to form the basis of a training plan. The resulting capacity-building program will have sufficient flexibility to include customized interventions, when required. The flexible approach is needed in a dynamic environment to meet needs that emerge or address priorities which change.

28. Training will cover key technical areas, such as budgeting, accounting, and the application of the U.S. Uniform Guidance to equip staff with skills to fully and effectively utilize the new systems. Training for the FMIS and the RMS will include end user training to all potential users, technical training for system administration and management (information security, networking, and application software), and training on the use of information from the system for fiscal analysis and planning.

29. Partnerships with local, regional, and international institutions will be developed using a cost-effective partnership model that incorporates adequate incentives for the learning institutions to sustain the engagement beyond the life of the project. The Island Governments Finance Officers Association provides a couple of training events each year on emerging technical topics. Locally, the College of Micronesia can institutionalize the delivery of certification and degree courses including tailored courses for PFM. The American Association of Government Accountants has a presence in the South Pacific and offers online resources for training and technical updates. Use of embedded trainers and development of e-learning will also be considered. The objective is to establish mechanisms for enabling new entrants into the civil service to perform their functions in PFM-related roles and perpetuate the supply of suitably trained staff well beyond the life of the project.

30. As part of the project activities, the following outputs will be prepared and approved by the PFM Steering Committee:

(a) Change management and communications strategy

(b) Competency framework for PFM roles across the government

(c) Training partnerships: in-country and external

(d) Staff training plans

31. The project will support the engagement of an international consultant with expertise in HR development during the first two years of project life. The consultant will work with the stakeholders to prepare the proposed strategy, framework, and training plan. The team will work with the Government on capturing gender-disaggregated data for those receiving training and capacity building under the project and ensure that the interventions do not disadvantage female employees, that is, providing equal opportunities for education and training to the current and potential employees.

32. As part of the activities for capacity building, the project will support the engagement of a firm for internal audit and capacity building to be mobilized in the fifth year of project life. The firm will conduct quarterly reviews at the national and state level and will provide during each visit (a) a report on gaps that need to be addressed in preparation of the external audit and (b) training for staff on topics identified by each government. The government representatives in the PSC may use these quarterly reports for raising issues of common interest in PSC meetings.

Component 5: Project Management (US$2,200,000)

33. The objective of this component is to support overall project management and coordination. Because design and rollout of the FMIS will cause disruption across the government, strong leadership will be critical. The PSC will need to play a proactive role to serve as a trusted forum to allow sharing of information and achieving collaboration and coordination across various stakeholders. A PIU will be established with specific responsibilities to support and coordinate implementation of project activities. This component will also support the establishment and strengthening of the CIU in the DoFA, which will monitor and coordinate all development partner-funded projects. A technical adviser has been engaged to serve as the Program Manager for the CIU, in addition to fungible skills necessary for fiduciary, communications, safeguards, and institutional development to enhance the ability of the DoFA to manage project funds and ensure that these are used efficiently for intended purposes. Costs of such services will be shared among the development partner-financed projects through a simple mechanism acceptable to the World Bank. The PIU will work in coordination with shared services from the CIU for FM, procurement, safeguards, communications, and monitoring. Project Manager and technical consultants will be recruited internationally. The cost for international consultants in the North Pacific is unusually high, including a premium for full-time assignments due to geographic isolation, poor connectivity, and low capacity in-country. Technical specialists will be engaged for full-time support in the initial years of the project with part-time support in the later half for knowledge transfer to and hand-holding of government staff. The project will finance (a) contract staffing for the project, (b) consultancies and non-consultancies, (c) office and other equipment, (d) travel and operational costs, and (e) training and workshops.

ANNEX 2: IMPLEMENTATION ARRANGEMENTS

COUNTRY : The Federated States of Micronesia
Project for Strengthening Public Financial Management

Project Institutional and Implementation Arrangements

1. The DoFA of the National Government is the implementing agency for the project. Within the DoFA, the project will support the CIU placed under the Assistant Secretary for Investment and International Finance and the PIU placed under the Assistant Secretary for Treasury, both of whom report to the Secretary of Finance.

2. The CIU will comprise existing resources in the DoFA for management of development partner-funded projects and strengthened with the engagement of a technical adviser to serve as the Program Manager. It is planned that this CIU will provide support to all development partner-funded projects across the Government. Staffing in the unit will be augmented to build a fungible pool of skills for FM, procurement, safeguards, communications, and monitoring and evaluation. Both national and international staff will be recruited, with the objective of building the skills and capacity for the national staff. Project Managers for various projects will work with and be housed in the relevant implementing agencies. They will coordinate with the CIU Program Manager for accessing the shared support services from the CIU. Costs of such services will be shared among the projects based on a simple cost-sharing mechanism acceptable to the World Bank.

3. The DoFA being the implementing agency for this project, a PIU responsible for the PFM project activities will be established. This will include a dedicated Project Manager, supported by an assistant. Additional support will be recruited on need basis.

4. The project will finance (a) full-time and part-time specialists (including a Program Manager and staff with skills in finance, procurement, safeguards, communications, and monitoring and evaluation) to establish the capacity of the CIU to manage and monitor the Government's portfolio of development partner-funded projects and (b) full-time and part-time specialists (including a Project Manager and Project Assistant) and incremental operating costs to support the PIU for this project.

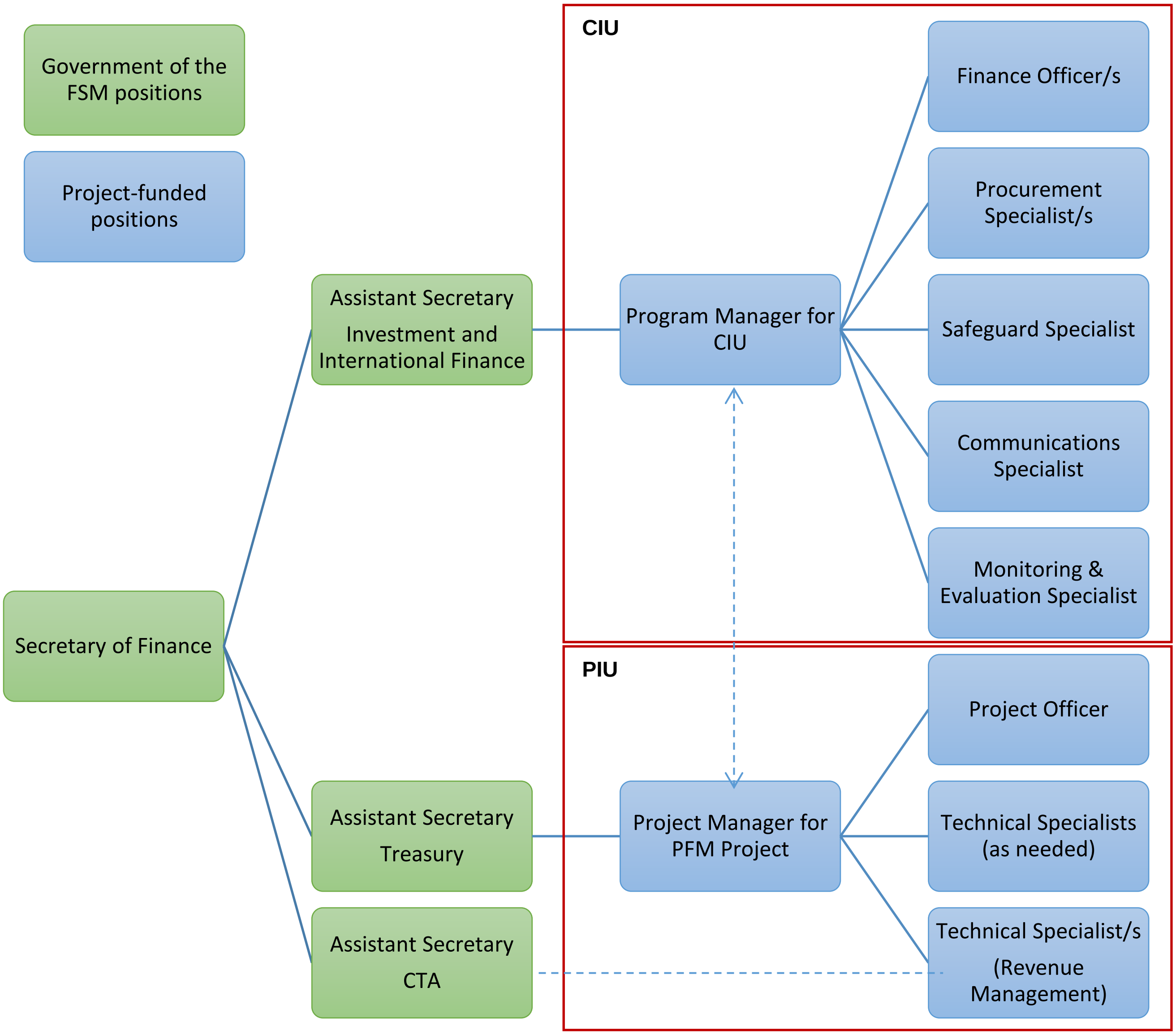
5. A full-time Project Manager will oversee day-to-day implementation, monitoring, and reporting of project activities, including coordination with relevant national and state government institutions as well as with other support to PFM reforms by development partners, organization of Steering Committee and Intergovernmental Working Group meetings, procurement of goods and consultancies with support from the Procurement Specialist in the CIU, and monitoring and reporting on results achieved by activities financed under the project. An assistant will provide secretarial support to the PIU. Technical specialists may be engaged as needed during implementation. The Project Manager will be supervised by the Assistant Secretary in the DoFA for Treasury.

6. Specifically, for Component 3 on Revenue Management System, the Assistant Secretary for CTA will be the focal point responsible for implementation. The Technical Working Group for this component will comprise the relevant technical staff from the CTA division in the headquarters as well as the branch offices of the DoFA in the states.

7. A PIM, to be prepared by the DoFA and adopted through the PSC, will set out (a) the institutional arrangements for day-to-day execution of the project; (b) the implementation arrangements for the ESMP; (c) budgeting, disbursement, and FM arrangements; (d) procurement arrangements and the Procurement Plan; (e) project monitoring, reporting, and evaluation arrangements; (f) performance indicators for the project; (g) the division of responsibilities and cooperative arrangements between the project entities, including the Steering Committee, the Intergovernmental Working Group, the Technical Working Groups, the PIU, the CIU, the DoFA, and finance departments of the state governments; and (h) the procedures and arrangements for identifying and involving additional public offices as may be required for the project.

8. The Division of ODA within the Office of the President is responsible for coordinating capacity-building support from development partners and financing external reviews. The CIU will work with this unit to provide necessary information, especially for monitoring and evaluation of ongoing and completed projects.

Figure 2.1: Project Management Structure in DoFA



9. For overseeing the implementation of this project, the Government has established a task force at the Finance Conference held in Kosrae in November 2016. This intergovernmental body comprising heads of finance from the National Government and all state governments will serve as the PSC for key decisions and monitoring. Close coordination and collaboration is required among the National Government and the four state governments to implement this project. A formal intergovernmental coordination mechanism is established at two levels as described in the following paragraphs.

10. The Intergovernmental Working Group will support the Steering Committee. The Intergovernmental Working Group will serve as the forum for detailed deliberations on the development of system design, features, and functionalities. This group will also be the one finalizing terms of reference, conducting technical evaluation of proposals, and reviewing consultant deliverables. Based on its

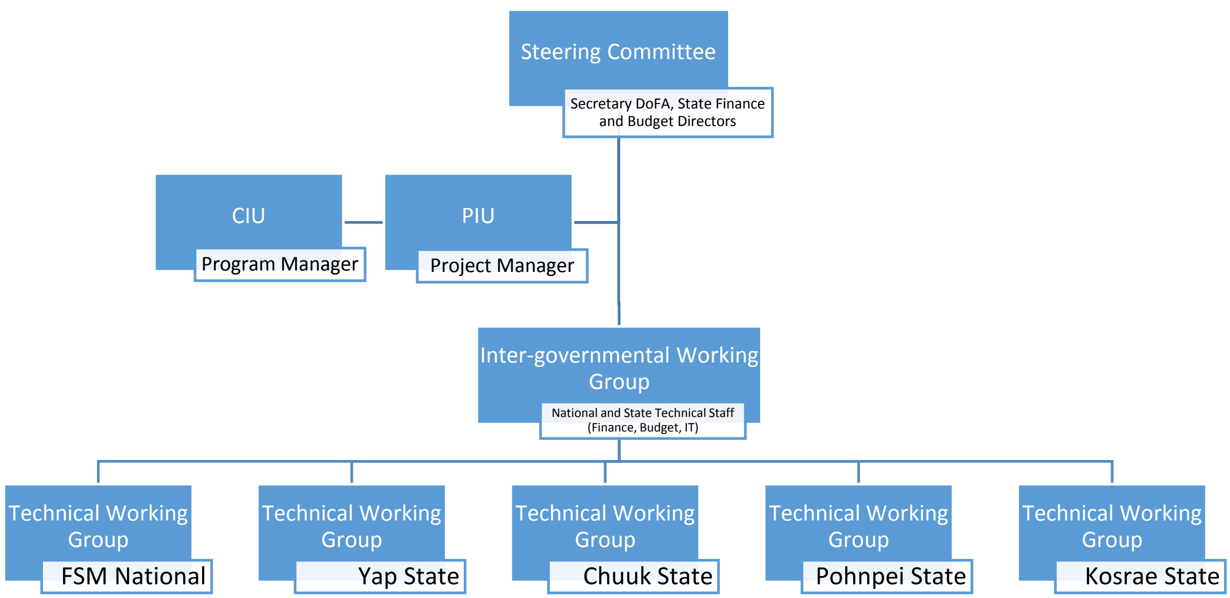
discussions, the Intergovernmental Working Group shall prepare the recommendations to be taken up by the Steering Committee for decision.

11. The Intergovernmental Working Group shall comprise representatives drawn from Technical Working Groups established by each of the five governments. Relevant officials will be consulted for specific topics such as revenue and payroll, as required. As the FMIS is developed, input will also be sought from line departments such as health and education for the National Government and the state governments, as well as other users including Offices of the National Public Auditor and the State Auditors. Within each government, the nominated representatives shall be responsible for seeking inputs from relevant stakeholders to understand user needs and build buy-in.

12. As and when needed, the project will support the formation of working groups around specific topics such as revenue, payroll, and generation of reports, which will establish support among those performing similar functions across the five governments. These will be tapped into for advice and consultation when the relevant parts of the FMIS and associated procedures are being developed. Social media tools may be used to encourage regular information sharing and consultation among these user groups.

13. These bodies are to facilitate collaboration among the National Government and the state governments, two-way communication of information across the levels of government, as well as coordination among relevant departments and agencies which will be affected by the changes and new systems.

Figure 2.2: Project Governance Arrangements



14. Roles and responsibilities in relation to the project:

- PSC

(a) Chair: Secretary of Finance

(b) Membership: State Finance and Budget Directors

(c) Functions of the Steering Committee are to (i) review progress reports from the Intergovernmental Working Group, (ii) take decisions on policy issues and address problems and constraints raised by the Intergovernmental Working Group, (iii) review recommendations put forward by the Intergovernmental Working Group, (iv) provide guidance and support to the Intergovernmental Working Group to enable achievement of the project objectives, (v) monitor and direct necessary implementation actions to be taken by offices outside of the DoFA, and (vi) ensure the project work is clearly integrated into, and supportive of, the PFM Road Map implementation

(d) The committee will meet on a quarterly basis

- Intergovernmental Working Group

(a) Chair: Assistant Secretary for Treasury

(b) Membership: Representatives of national and state finance, budget, and IT functions

(c) Functions of the working group are to (i) finalize terms of reference, conduct technical evaluation of proposals, and review consultant deliverables for the project; (ii) conduct detailed deliberations and user consultations on the development of FMIS and RMS design, features, and functionalities; and (iii) prepare the recommendations to be taken up by the Steering Committee for decision.

(d) The Working Group will meet (virtually/physically) on a monthly basis.

- Technical Working Groups

(a) Chair: To be determined by each government

(b) Membership: Staff representing treasury, budget, revenue, investment, and IT functions

(c) Functions of each Technical Working Group are to (i) review and give comments specific to each government on terms of reference and consultant deliverables for the project and (ii) conduct detailed deliberations and user consultations within each government on the development of FMIS design, features, and functionalities

(d) Frequency of meetings for Technical Working Groups will be determined by each government

- PIU DoFA

(a) Head: Project Manager reporting to the Assistant Secretary for Treasury

(b) The functions of the PIU are to (i) provide day-to-day project planning and implementation, (ii) provide secretariat support to operationalizing and running the Steering Committee and Intergovernmental Working Group, (iii) procure and supervise technical consultants, and (iv) monitor and evaluate project progress, including reporting.

- CIU DoFA

(a) Head: Program Manager reporting to the Assistant Secretary for Investment and International Finance

(b) The functions of the CIU are to (i) provide shared services (finance, procurement, safeguards, communications) to development partner-funded projects and (ii) monitor and evaluate overall portfolio of development partner-funded projects.

Financial Management

15. An FM assessment was conducted in accordance with the 'Principles-Based Financial Management Practice Manual' issued by the Board on March 1, 2010. The assessment found that the proposed project FM arrangements meet the FM requirements stipulated in Policy Directive for Investment Project Financing. The FM risk is assessed as Substantial primarily because the DoFA is relatively inexperienced with managing World Bank projects and the capacity of the CIU to manage the FM aspects of multiple projects is unknown until these projects come onstream and are under implementation. The main mitigation measure is the recruitment of an additional FM resource in the CIU. Also, the PIM will contain concise instructions on project-specific aspects of FM arrangements in addition to guidance in the FSM FM regulations.

16. **Budgeting arrangements.** The Finance Officer will work with the Project Manager and the DoFA officers in the preparation and regular reviews of the project budget. Foreign-assisted projects are reviewed by Congress[20] for approval by resolution, if they are not included in the appropriation bill. When the appropriation bill is passed, allotments against appropriations are entered into the government accounting system.

17. **Accounting arrangements.** The Government maintains financial accounts in FundWare, a software with the following fully integrated modules: accounts payable, accounts receivable, payroll, and

[20] In February 2017, the FSM Congress amended the rules on the approval of grants with a view toward simplifying the procedures, summarized as follows:

- U.S. federally funded program grant awards under US$100,000 do not require approval by Congress by resolution. All other (non-U.S.) foreign financial assistance in any amount requires approval by Congress by resolution.
- Foreign financial assistance of up to US$10,000 may be disbursed by the President in accordance with the terms and conditions of the assistance. Should the Congress not approve such agreement by resolution before either adjournment of the first regular session following the President's submission of the agreement to Congress, that agreement shall be deemed disapproved. (§210(2)(b))
- Any first-time application for foreign financial assistance shall require the approval by Congress through a resolution.
- The President or the President's designee shall notify the Congress of the receipt of foreign financial assistance, the amount thereof in U.S. dollars, and, where applicable, the deposit or such assistance into the fund, no later than the first session of Congress, be it regular or special, convened subsequent to such receipt.

general ledger. The chart of accounts enables classification by state, funding source, department, and division program number. A new chart of accounts will be developed for the new FMIS and the project accounts will be incorporated in therein. The transactions will be entered by a Finance Officer from the CIU. The current FM resources, one Finance Officer within the CIU, are inadequate to provide assurance that all FM requirements for this project will be met. Recruitment of a second Finance Officer is under way and should provide the required additional support. In addition, the Finance Officers will need training to be able to adapt to changing of the FM systems and maintain accounts on parallel accounting systems for a short time. They will also require skills to identify variances in the information produced from the two parallel systems.

18. The DoFA has experience with integrating development partner-financed projects in the accounting system, each with its own assigned program number and own Designated Account (DA). Project accounts will be maintained within the DoFA and integrated in the government accounting system. The new FMIS will include capability to account for the World Bank projects and it is anticipated that there will be a transition period during which the existing FundWare system will need to produce timely and accurate transaction recording, commitment control, and reporting until the new FMIS has been fully implemented and tested after which the FundWare system will be decommissioned.

19. **Internal controls.** The FSM FM regulations dictate the government's internal control framework and provide adequate segregation of duties, asset controls, and approval and authorization controls. The PIM will provide guidance on project internal controls either specifically required for the project or not covered in sufficient detail in the regulations. The PIM will be reviewed by the World Bank to ensure that controls are adequate for meeting World Bank requirements.

20. **Financial reporting.** The project will prepare interim financial reports (IFRs) in U.S. dollars in the format agreed with the World Bank and submitted no later than 45 days after the end of each semester. The reports will initially be produced from the existing FundWare system and will ultimately be generated from the new FMIS. The current IFRs being generated from FundWare barely meet World Bank reporting requirements despite necessary functionality being available in the system. Supplementary records may be required to be maintained on spreadsheets until reports generated from the new FMIS are acceptable.

21. **External audit.** Audit of project funds will be part of the auditing of National Government accounts as project funds will be fully integrated therein. Audited National Government accounts will be submitted to the World Bank within nine months of the end of each fiscal year. A separate project audit will not be required, provided the following note is included in the national accounts produced during the life of the project:

"Note ***X***. World Bank Financing

(a) The Government of the Federated States of Micronesia received financial support from the World Bank IDA Grant ***No. XX dated mm/dd/yy*** to support implementation of [describe].

Summary information on transactions taking place during the year is as follows:

	Current Year	**Preceding Year**	**Cumulative**
	US$	**US$**	**US$**

Amounts received during the year	X	X	X
Expenditures during the year	(X)	(X)	(X)

(b) The total amounts received from World Bank IDA Grant ***No. [xx]*** since its commencement were [xx] as at September 30 [xx].

(c) The proceeds of the World Bank grant have been expended in accordance with the intended purposes as specified in the Grant Agreement."

The World Bank reserves the right to request additional information to supplement information provided in the National Government accounts and to request a project audit if the required note is not included in the National Government accounts

Disbursements

22. **Flow of funds.** Disbursements under the project may be under any of the following methods: (a) advances into and replenishment of the DA, (b) direct payment, (c) reimbursement, and (d) special commitment. Direct payments will be used solely for large contracts.

23. Project funds will be disbursed directly into a DA in a commercial bank, acceptable to the World Bank. The DA will be operated on an advance basis and the initial advance will be made through the completion and submission of a Withdrawal Application. The DA will be held in U.S. dollars. Subsequent replenishments will be made through the submission of Withdrawal Applications, along with details on the use of funds previously advanced, based on Statements of Expenditures and bank reconciliation of the DA.

24. Table 2.1. shows categories of expenditure and amounts eligible for financing and are also to be found in the Legal Agreement. Note that in the case of discrepancy, the version referred to in the legal agreement takes precedence over table 2.1.

Table 2.1. Financing Agreement Disbursement Categories and Amounts

Category	Amount of the Financing Allocated (expressed in SDR)[21]	Amount of the Financing Allocated US$	Percentage of Expenditures to be Financed (inclusive of taxes)
(1) Goods, works, non-consulting services, consulting services, Training and Workshops, and Operating Costs except for Parts 2(i), 3(i) and 5 of the Project	5,800,000	8,400,000	100%
(2) Goods, non-consulting services, consulting services, Training and Workshops, and Operating Costs for Parts 2(i), 3(i) and 5 of the Project	1,350,000	1,950,000	100%

[21] Exchange rate as of March 31, 2018—SDR 1.0 to US$1.45386.

Category	Amount of the Financing Allocated (expressed in SDR)[21]	Amount of the Financing Allocated US$	Percentage of Expenditures to be Financed (inclusive of taxes)
(3) Refund of Preparation Advance	450,000	650,000	Amount payable pursuant to Section 2.07 (a) of the General Conditions
TOTAL AMOUNT	**7,600,000**	**11,000,000**	

Procurement

25. **Applicable procurement procedures.** For contracts financed in whole or in part by the IDA grant, procurement would be carried out in accordance with the World Bank's Procurement Regulations dated July 2016 and revised November 2017 and the provisions stipulated in the Financing Agreement. Under the proposed project, the World Bank planning and tracking system, STEP, will be used to prepare, clear, and update Procurement Plans and conduct all procurement transactions for the project. Accordingly, all the procurement activities under the proposed project will be entered into, tracked, and monitored online through the system.

26. **Procurement capacity and risk assessment.** Procurement capacity and risk assessment for the DoFA was conducted during various project preparation missions (September 2017 and January 2018). The procurement risk is assessed as High. The DoFA has not implemented World Bank-financed projects using the Procurement Regulations and has limited experience in procurement of major contracts similar in nature and size to this project. It also has limited staffing and capacity in procurement processing. To mitigate the above identified risks and strengthen the procurement capacity of the DoFA, CIU, and PIU, the following measures have been established and agreed to be implemented: (a) the DoFA, under the CIU shared specialist-resources arrangement, is recruiting a Procurement Specialist to provide technical assistance to the project, among others; (b) other critical staff such as the Project Manager, Procurement Officer, Finance Officer will be hired; (c) DoFA, CIU, and PIU staff will be continuously provided with relevant procurement training and implementation support by the World Bank task team; (d) the STEP system will be used to prepare, clear, and update Procurement Plans and conduct all procurement transactions for the project; and (e) the PIM shall include a Procurement Module to guide the project in the procurement implementation.

27. **Procurement strategy.** Based on the project requirements, operational context, economic aspects, technical solutions, and market analysis, a Project Procurement Strategy for Development(PPSD) has been developed for the project. The PPSD identified the following major and critical types of activities: (a) contract for the supply and installation of a new FMIS, including various software licenses, servers, computers, and associated accessories (approximately US$2.8 million); (b) contract for the design, supply, and installation of an RMS, including related software licenses (approximately US$1.06 million); and (c) several long-term and critical technical specialists to support the implementation of the two major systems under the project (approximately US$1.4 million). For the procurement of the FMIS, which will be a simple COTS software application with minimal customization, and RMS, the strategy would be to approach the international market in an open competition. This approach will be revisited once the result of the system requirements studies for the respective systems are known. Procurement of the various

software licenses and goods will be combined under the FMIS and RMS supply and installation contracts above. In the case of technical specialists, the international market will be approached through either open or limited competition.

28. The PPSD also indicates a number of potential risks that may affect the success of the procurement process including (a) limited staffing and capacity for procurement implementation, (b) substantial delays in the procurement process, and (c) lack of response from qualified vendors. A number of risk mitigation measures as well as allocation of risks to the party that is in best position to take the risks are also proposed including (a) strengthening DoFA procurement capacity by hiring procurement specialist/consultant and officer, and other critical specialists, and continuous training of staff, implementation support from the World Bank's task team; (b) detailed planning of key steps including time-bound Procurement Plan with clear assignment of responsibility, with the use of STEP and in accordance with the PIM; and (C) wider publication using mediums targeting specific vendors and direct invitation to known qualified vendors for open competition.

29. **Procurement Plan.** Based on the PPSD, the initial Procurement Plan for the first 18 months for the project was prepared with the DoFA and agreed by the World Bank at negotiation. For the FMIS and RMS supply and installation contracts, Request for Bids (RFB) is the method to be used. For consulting services, Quality- and Cost-Based Selection, Quality-Based Selection, Selection under a Fixed Budget, and Least-Cost Selection with the most appropriate market approach will be used. For the individual consultants, these will be selected based on open competition, unless limited competition and direct selection present a more fit-for-purpose approach. The Procurement Plan will be updated at least annually by the DoFA, and agreed with the World Bank to (a) reflect project implementation updates, (b) accommodate changes necessary, and (c) add new packages as needed for the project. All Procurement Plans, their updates or modifications shall be subject to the World Bank's prior review and no-objection. Details for the procurement arrangements are to be provided in the PIM. The project Procurement Plan identifies the risk for each activity and prior review threshold of these activities is set based on the performance and risk rating. Contracts not subject to prior review will be subject to post review. The World Bank will carry out procurement post reviews on an annual basis with an initial sampling rate of 20 percent, which will be adjusted periodically during project implementation based on the procurement performance.

Table 2.2. Procurement Plan for first 18 months

Description	Procurement Category	Procurement Method	Estimated Amount (US$, '000)	Bank Financed %	Review Type	Planned Start Date (mm/dd/yy)
Component 1: Strengthening PFM Environment						
System Requirements Study for FMIS	CS	CQS	300	100	Post	07/01/18
Component 2: Financial Management Information System (FMIS)						
Network Specialist	CS	INDV	500	100	Prior	03/01/19
FMIS Specialist	CS	INDV	500	100	Prior	03/01/19
Supply and Installation of FMIS	GO	RFB	2,800	100	Prior	02/01/19

Description	Procurement Category	Procurement Method	Estimated Amount (US$, '000)	Bank Financed %	Review Type	Planned Start Date (mm/dd/yy)
• *Site Preparation and Renovation, Furniture and Fixture (for FMIS and RMS)* • *FMIS and related software licenses* • *Electronic Document Management System licenses* • *Servers, computers, and accessories (FMIS and RMS)*						
Networking for FMIS and RMS (FSMTC)	NC	DIR	205	100	Post	08/01/19
Component 3: Revenue Management System (RMS)						
System Requirements Study for RMS	CS	INDV	100	100	Post	08/01/18
Supply and Installation of RMS	GO	RFB	1,060	100	Prior	03/01/19
• *RMS software Licenses*						
Tax Admin Specialist	CS	INDV	400	100	Prior	04/01/19
Component 4: Change Management and Human Resource Development						
Communications Strategy Specialist	CS	INDV	50	100	Post	10/01/18
HR Development Specialist	CS	INDV	150	100	Post	10/01/18
Change Agents (4) for all four states	CS	INDV	560	100	Prior	06/01/18
PFM Project Manager	CS	INDV	750	100	Prior	06/01/18
PFM Project Officer	CS	INDV	160	100	Post	07/01/18
CIU Program Manager	CS	INDV	500	100	Prior	03/01/18
Finance Officer	CS	INDV	87.5	100	Post	07/01/18
Equipment	GO	RFQ	50	100	Post	06/15/18

Note: CS = Consulting services; NC = Non-consulting services; GO = Goods, CQS = Selection Based on the Consultants' Qualifications; INDV = Individual consultants; DIR = Direct Contracting; RFQ = Request for Quotations; RFB = Request for Bids.

Environmental and Social (including safeguards)

30. Safeguards will be managed by the CIU Safeguards Adviser who will be full time and based in the CIU team in the DoFA. The recruitment process is under way and this person should be on board by June 2018.

Monitoring and Evaluation

31. Progress toward the PDO will be monitored through reporting on the PDO-level and intermediate-level result indicators. A Results Framework with project-specific indicators and actionable monitoring arrangements has been developed jointly with the DoFA and other stakeholders. This will be used for monitoring of implementation progress and results of project implementation. Overall monitoring and coordination of project activities will be performed by the DoFA as the implementing agency. The PIU will have overall responsibility for monitoring and evaluating the different components/activities in accordance with the indicators included in the Results Framework (Section VII). The PIU will gather data for monitoring and evaluation from the relevant units in the National Government and the state

governments. No later than 45 days after each semester, the PIU will submit semester progress reports to the World Bank, covering all project activities, including procurement and financial summary reports. Baselines will be determined during the first year of implementation. The project will also submit an Annual Work Plan and Budget for the World Bank's no-objection.

32. The World Bank will monitor implementation progress during biannual implementation support missions (the first one to take place six months after effectiveness) that will provide a detailed analysis of implementation progress toward achieving the PDOs and include an evaluation of FM activities and a post-review of procurement activities. During the missions, the World Bank will work with the DoFA to obtain feedback on progress and consider any adjustments to ongoing activities.

33. No later than January 2021 (or such other date as agreed with the World Bank), the DoFA will carry out a midterm review of the project and prepare and furnish to the World Bank a midterm report documenting progress achieved in the implementation of the project during the period preceding the date of such report, taking into account the monitoring and evaluation activities performed and setting out the measures recommended to ensure the continued efficient implementation of the project and the achievement of its objectives during the period following such date. It will also review the midterm report with the World Bank, on or about one month after its submission, and thereafter take all measures required to ensure the continued efficient implementation of the project and the achievement of its objectives. At the end of the project, the World Bank will prepare an Implementation Completion and Results Report to evaluate the project and draw lessons. This report will include an assessment of the project by the Government.

Role of Partners

34. Several resources are available to the Government for supporting its PFM reform agenda. The coordination and monitoring of the PFM Road Map will be led by a PFM task force chaired by Secretary and comprising the division heads in the DoFA. The Division of ODA within the Office of the President will be responsible for coordinating capacity building support from development partners and financing of external reviews.

35. Alongside the World Bank, key partners supporting the PFM reform agenda include the ADB, IMF-PFTAC, EU, and the Governments of the United States and Australia. Summary of support being provided by other development partners around PFM is as follows:

(a) The ADB has recently funded the services of a consultant to help review FM regulations and other relevant issuances at the National Government. There is also ongoing technical assistance being provided to the National Government and the state governments on the public service sector reform plan covering the HR management system, such as design of new job grade and compensation structures.

(b) The EU has recently approved a regional program to support PFM strengthening initiatives across the Pacific, largely implemented through the PFTAC. A proposal for a technical assistance of EUR 400,000 from the EU is being prepared to support the PFM Road Map. The emphasis has been on replicating the work done for the National Government, that is, a review of the legal and regulatory framework for PFM in the state.

(c) The PFTAC of the IMF is providing technical assistance and training in selected areas such as the PEFA assessment and related PFM Road Map for reform, revenue forecasting, tax compliance, tax audit, GDP calculation, and medium-term budgeting.

(d) U.S. Graduate School under contract from the U.S. Department of Interior is annually allocating around five weeks of technical support to the National Government and the state governments. It convenes a conference of finance executives twice a year. The content is driven by current and emerging issues in accounting and financial reporting. Drawdown of the technical support is on demand from the governments.

(e) Australia Department of Foreign Affairs and Trade (DFAT), the official aid agency of the Australian Government, has a liaison office in Pohnpei and has been funding various initiatives in the past. For more than a decade, DFAT supported revenue modernization efforts and the consolidation of official development assistance funds through the engagement of consultants. Under an initiative called the Pacific Technical Assistance Mechanism (PACTAM), highly skilled technical advisers are placed within the PICs, with the aim being to provide technical advice on the design and delivery of an effective development assistance program. The PACTAM advisers have previously been provided to the National Government.

ANNEX 3: IMPLEMENTATION SUPPORT PLAN

COUNTRY : The Federated States of Micronesia
Project for Strengthening Public Financial Management

Strategy and Approach for Implementation Support

1. The strategy for implementation support has been developed based on the nature of the project and its risk profile. The aim is to make implementation support to the client flexible and efficient.

2. The overall risk rating for this project is Substantial primarily due to the limited technical capacity of the implementing agencies, limited experience with World Bank and other multilateral development partner operations, and the need to coordinate among several stakeholders across the National Government and state governments. This is also a new engagement for the World Bank, both in the sector and in the country. Lack of prior engagement and the logistical challenges of travel to the country for face-to-face dialogue affect the frequency and cost of implementation support missions.

3. Given substantial risks identified on both institutional capacity and fiduciary aspects, the implementation support requirements are envisaged to be intensive, especially at the early stage of implementation, as well as at critical junctures, such as FMIS and RMS design, testing, or rollout. The World Bank team will also maintain active contact with other development partners supporting the PFM reform agenda, both at the project and the regional level to ensure synergy among activities and avoid duplication.

4. The Task Team Leader (TTL) will provide ongoing support by coordinating with the client and among World Bank staff who will provide implementation support on technical, fiduciary (FM and procurement), and safeguards aspects.

5. The World Bank will field supervision missions at least twice yearly, and in collaboration with government counterparts, monitor progress against the indicators in the Results Framework. The World Bank will flexibly conduct additional technical missions as required. The World Bank will also monitor risks and update the risk assessment and risk management measures as needed.

6. A midterm review will be conducted in January 2021, or such other date as agreed with the client, to take stock of performance under the project. Based on the assessment of progress at the midpoint of the project, recommendations for improvements/changes to the project will be considered by the Government and the World Bank.

Implementation Support Plan and Resource Requirements

Time	Focus	Skills Needed
First 12 months	• Inception • FMIS procurement • FMIS design and implementation plan • RMS procurement	• TTLs • FM • Procurement • Safeguards

Time	Focus	Skills Needed
	• RMS design and implementation plan • Change management strategy • Competency framework	• Technical (FMIS, tax/revenue, HR, and so on)
12–48 months	• FMIS implementation • RMS implementation • Change management activities • Setting up training partnerships	• TTLs • FM • Procurement • Safeguards • Technical (FMIS, tax/revenue, HR, and so on)

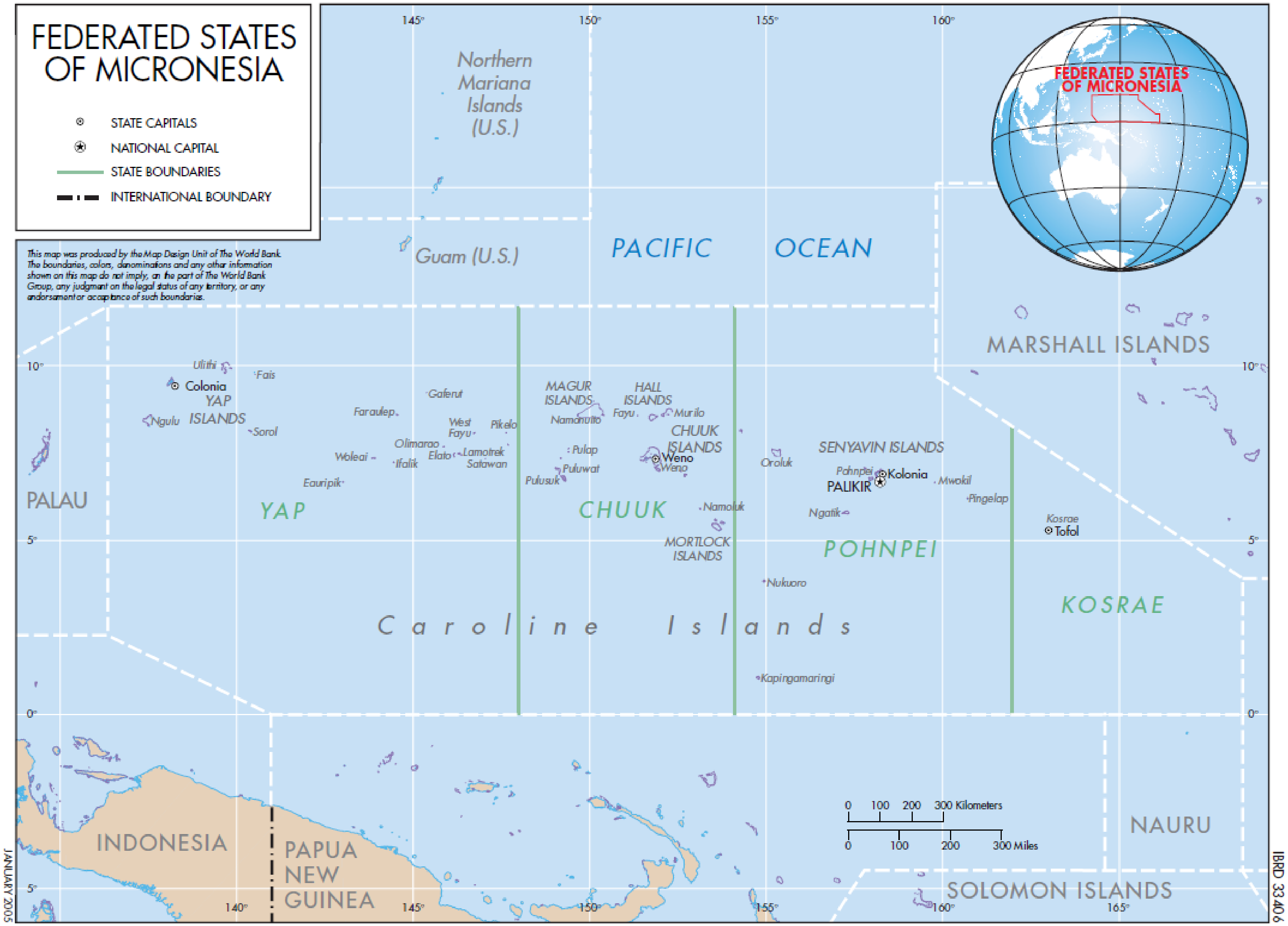
Skills Mix Required			
Skills Needed	**Number of Staff Weeks**	**Number of Trips (per year)**	**Comments**
Co-TTLs	20	3	Manila/Sydney
FM	6	2	Sydney
Procurement	6	2	Manila
Safeguards	1	1	Sydney
Technical Specialists (FMIS, tax/revenue, HR, and so on)	12	4	DC/Hanoi/Manila/other

ANNEX 4: SELECTED INDICATORS FOR THE FEDERATED STATES OF MICRONESIA

Table 4.1. Selected Indicators for State and National Government (FY2016 unless otherwise indicated)

	Chuuk	Pohnpei	Yap	Kosrae	National	FSM
Geography and Population						
Land area (km^2)	127	346	118	110	—	702
% of total	*18.1*	*49.3*	*16.8*	*15.7*	—	*100.0*
Number of outer Islands	24	5	18	0	—	47
Population (estimate)	46,688	37,893	11,645	6,227	—	102,453
% of total	*45.6*	*37.0*	*11.4*	*6.1*	—	*100.0*
Population density (per km^2)	368	110	99	57	—	146
Economic						
GDP (current price, US$, million)	93.1	163.4	52.3	21.0	—	329.9
% of total	*28.2*	*49.5*	*15.9*	*6.4*	—	*100.0*
GDP/capita (current price, US$, million)	1,994	4,313	4,495	3,376	—	3,220
Headcount food poverty (% of population, 2013 estimate)	15.2	5.9	4.7	1.6	—	9.7
% of total	*72.4*	*21.1*	*5.6*	*0.9*	—	*100.0*
Government expenditure (US$, million)	35.5	31.7	19.4	13.5	63.3	163.3
Expenditure/capita	*760*	*836*	*1,664*	*2,161*	*618*	*1,594*
Compact receipts (US$, million)	28.3	19.5	10.3	6.9	8.1	73.1
Share of Compact receipts (%)	*39*	*27*	*14*	*9*	*11*	*100*
Employment						
Number of employees	4,128	7,690	2,260	1,261	—	15,339
Private sector	1,907	3,462	957	461	—	6,786
% of total employment in the jurisdiction	*46.2*	*45.0*	*42.3*	*36.5*	—	*44.2*
Public sector	1,908	3,646	1,226	721	—	7,500
% of total employment in the jurisdiction	*46.2*	*47.4*	*54.2*	*57.2*	—	*48.9*
National govt	81	545	54	37	—	717
State govt	1,707	1,468	975	588	—	4,738
Municipalities	20	340	0	26	—	386
Public enterprises and govt agencies	101	1,292	197	70	—	1,659
Other	313	583	78	79	—	1,053
% of total employment in the jurisdiction	*7.6*	*7.6*	*3.4*	*6.3*	—	*6.9%*

Sources: Graduate School USA. 2017. *Federated States of Micronesia Fiscal Year 2016 Statistical Appendix*. Hawaii: Graduate School USA.
World Bank. 2017. *Federated States of Micronesia Public Expenditure Review: Getting Ready for 2024*. Washington, D.C.: World Bank.


FEDERATED STATES OF MICRONESIA
STATE CAPITALS
NATIONAL CAPITAL
STATE BOUNDARIES
INTERNATIONAL BOUNDARY
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Northern Mariana Islands (U.S.)
Guam (U.S.)
PACIFIC OCEAN
FEDERATED STATES OF MICRONESIA
MARSHALL ISLANDS
PALAU
YAP
Ulithi
Fais
Colonia
YAP ISLANDS
Ngulu
Sorol
Faraulep
Gaferut
West Fayu
Pikelo
Olimarao
Woleai
Ifalik
Elato
Lamotrek
Satawan
Eauripik
MAGUR ISLANDS
HALL ISLANDS
Namonuito
Fayu
Murilo
CHUUK ISLANDS
Weno
Pulap
Puluwat
Pulusuk
CHUUK
Namoluk
MORTLOCK ISLANDS
Oroluk
SENYAVIN ISLANDS
Pohnpei
Kolonia
PALIKIR
Mwokil
Pingelap
Ngatik
POHNPEI
Nukuoro
Kapingamaringi
Kosrae
Tofol
KOSRAE
Caroline Islands
INDONESIA
PAPUA NEW GUINEA
NAURU
SOLOMON ISLANDS
0 100 200 300 Kilometers
0 100 200 300 Miles
145° 150° 155° 160° 165° 140°
10° 5° 0° 5°
JANUARY 2005
IBRD 33406