



Project Information Document/ Integrated Safeguards Data Sheet (PID/ISDS)

Concept Stage | Date Prepared/Updated: 22-Sep-2017 | Report No: PIDISDSC23029



BASIC INFORMATION

A. Basic Project Data

Country Micronesia, Federated States of	Project ID P161969	Parent Project ID (if any)	Project Name Strengthening budget execution and financial reporting systems in the Federated States of Micronesia (P161969)
Region EAST ASIA AND PACIFIC	Estimated Appraisal Date Mar 12, 2018	Estimated Board Date May 30, 2018	Practice Area (Lead) Governance
Financing Instrument Investment Project Financing	Borrower(s) The Federated States of Micronesia	Implementing Agency Department of Finance and Administration	

Proposed Development Objective(s)

The Development Objective of the proposed project is to improve reliability and timeliness of financial reporting of the National and State Governments of the Federated States of Micronesia.

Financing (in USD Million)

Financing Source	Amount
Borrower	0.50
IDA Grant	8.50
Total Project Cost	9.00

Environmental Assessment Category C-Not Required	Concept Review Decision Track II-The review did authorize the preparation to continue
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Other Decision (as needed)

B. Introduction and Context

Country Context

1. The Federated States of Micronesia (FSM) is a small, remote, geographically dispersed Pacific Island country (PIC). Like many PICs, FSM faces significant inherent structural challenges to developing an economy that can sustain



government functions and effective service delivery. FSM has a population of approximately 104,460¹ scattered over an ocean area of 1.6 million square kilometers. The country is heavily reliant on external assistance, with on budget grant income estimated to account for 29.3% of GDP in 2015, and the 10-year average for 2006-2015 is 37.8%. FSM has few resources, and exports are heavily concentrated on fish. Its import dependency exposes the country to global economic shocks and price spikes. FSM is particularly vulnerable to accelerated sea-level rise and is prone to natural hazards.

2. A sovereign country since 1986, FSM is a federal democracy that gives significant power to the four State governments – Pohnpei, Chuuk, Kosrae and Yap, but maintains deep ties and a cooperative relationship with the United States of America (USA) through the Compact of Free Association (CFA). The loosely federated character of the country makes policy decisions at the national level a complex task, as consensus across the national and the state governments is required.

3. While domestic revenue has grown, FSM remains heavily dependent on aid, primarily through the CFA, to meet both recurrent and development financing needs. Grants contributed 44.1% of total revenue in 2015, compared to 55.7% in 2004. Since 1986, the Compact has provided large external financial transfers to support the Government in delivering key services and substantial public sector investment at the State level. Under an Amended Compact II agreement, FSM receives payments of approximately US\$92.7 million per year, with US\$76.2 million in the form of grants, US\$16.0 million to be placed in a trust fund, and US\$500,000 for an annual audit. After Compact II expires in 2023, investment income from the Trust Fund is expected to replace the grants, but current financial trends indicate that the Trust Fund will not provide the same level of funding.

4. The Government of the FSM is currently facing a challenging socioeconomic and fiscal situation 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 the underfunding of the Compact Trust Fund. Addressing this situation partially through strengthening public financial management, will be a priority for the FSM in the coming years.

5. Climate change screening has confirmed that this project is not exposed to climate and geohazards now or in the future. Improving financial management capacity may slightly improve the country's resilience to prepare for and respond to future disasters.

Sectoral and Institutional Context

6. In 2015, the Government set out the FSM 2023 Action Plan to address their fiscal and economic challenges leading up to and post 2023. The implementation of the Public Financial Management (PFM) Roadmap is a key component of the Action Plan, and the PFM Reform Program focuses on capacity building and supporting institutional, policy and legislative changes. Sharing information with the public and enhancing fiscal transparency are also key elements of the Action Plan under Regulatory Reform initiatives.

¹ In 2015 according to government figures. See http://www.fsmstats.fm/?page_id=605 "Population" file.



7. The Government is in the process of finalizing a Public Expenditure and Financial Accountability (PEFA) self-assessment for the national government, which provides an overview of the current performance of PFM systems, processes and institutions. The areas where performance has initially been assessed as weak include the following:

- i. Composition of expenditure out-turn compared to original approved budget;
- ii. Aggregate revenue out-turn compared to original approved budget;
- iii. Classification of the budget;
- iv. Public investment management;
- v. Macroeconomic & fiscal forecasting;
- vi. Fiscal strategy;
- vii. Medium-term perspective in expenditure budgeting;
- viii. Predictability of in-year resource allocation;
- ix. Expenditure arrears;
- x. Payroll controls;
- xi. Procurement;
- xii. Internal audit;
- xiii. In-year budget reports;
- xiv. External audit;
- xv. Legislative scrutiny of audit reports;

8. The above is an extensive list and selectivity is essential to match the breadth of interventions with absorptive capacity and resources. The government is drafting a PFM Roadmap to lay out its vision for achieving better outcomes. The emerging objectives over the next five-year period, 2017-2022 are to:

- achieve better value for money in priority development areas;
- provide avenues for citizen participation in budget formulation; and
- achieve necessary standard of performance to access budget support from Development Partners.

Financial Management Information System (FMIS)

9. The financial management information system (FMIS) allows the automation and integration of integral underlying processes around budget formulation and execution. The government has identified the need to upgrade its current FMIS as a critical element for achieving the objectives of the draft PFM Roadmap. In its current form, the National and State governments are unable to benefit from the timely availability of information necessary for supporting planning, budgeting, monitoring and most importantly inter-governmental coordination on resource allocation.

10. The governments in FSM have been using a commercial accounting software, called Fundware, as the government's financial management information system (FMIS). While the Fundware system is used by all five governments, they are operated as five discrete systems and there is no integration. It is possible that connectivity issues between the island states at the time of installation of Fundware may have limited the options for any integration. Connectivity through Submarine cable is available in Pohnpei. Under a World Bank financed project, a cable is expected to be in place for Yap and Chuuk by the end of 2017 with Kosrae planned to be connected in mid-2019.

11. In 2015, the Office of the National Public Auditor (ONPA) conducted a performance audit of the FMIS, with the objectives to:

- Determine whether all the needed features of the existing FMIS were fully implemented and if yes, whether the functional, information and reporting needs of the users were satisfied; and



- Determine whether the operation of the FMIS provided adequate access control and contingency planning.

12. The main findings for the performance audit stated that the needed modules and features were yet to be fully implemented; Users' requirements were yet to be satisfied by the implemented modules; Incomplete contingency planning provided no assurance of quick recovery and business continuity in times of disaster; and User rights granted to access the system could lead to potential problems like undetected fraud and financial misstatements. Most notable were the aspects of the system that remain unimplemented. As a result, the full benefits of the system were not maximized in terms of reengineering the operation to match the system and improving the operational efficiency and effectiveness in financial management.

13. Significant concerns are raised in the audit report regarding the lack of a system administrator and limited user capacity due to inadequate training and staff turnover. This has been the major underlying cause of underutilization of the existing system features. Integrity of the in-built internal controls has also been compromised as certain necessary features are not used and user access rights are not being monitored for segregation of duties. This raises the need to be cautious in the replacement of the FMIS to avoid repetition of the same situation resulting in loss of potential benefits of the significant investment of resources in FMIS.

14. The Fundware software is being phased out by its supplier, Blackbaud and it will no longer be available for new purchase after December 31, 2017. Support is available for the software and will continue to be available for the foreseeable future. The current system can continue to operate and provide the necessary information for government operations for a few years, despite the operational challenges faced in its usage. This would provide the time for a new system to be procured, installed and successfully transitioned. For the migration of legacy data and to ensure a smooth transition, it is important that the current system should be operating effectively before it feeds into any new system.

15. *Development Partner Assistance.* The government is receiving support from several development partners around public financial management. Pacific Financial Technical Assistance Centre (PFTAC) of the IMF is providing technical assistance and training in selected areas like the PEFA assessment and related Roadmap for reform, revenue forecasting, tax compliance, tax audit, GDP calculation and medium-term budgeting. US Graduate School under contract from the USA Department of Interior is annually allocating around 5 weeks of technical support to the national and 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. Draw down of the technical support is on demand from the governments. ADB has also been providing some assistance in previous years. For 2017, the ADB is funding a compliance advisor in Treasury for six months. The EU is providing support for energy sector and plans to make technical assistance available. Some part of this assistance could potentially be directed to support the PFM Roadmap.

Relationship to CPF

16. The project is in line with the Regional Partnership Framework (RPF) FY17-21 for 9 Pacific island countries (PIC9), including FSM, which identified the following Focus Areas for the World Bank's support, namely: (i) Fully exploiting the available economic opportunities; (ii) Enhancing access to employment opportunities; (iii) Protecting incomes and livelihoods; and (iv) Strengthening the enablers of growth opportunities (macroeconomic management, infrastructure and addressing knowledge gaps). Specifically, the project supports the fourth, cross-cutting Focus Area with the objective to *develop and maintain frameworks to improve fiscal management*. The project will help put in place and strengthen the necessary underlying public financial systems, which are "key to improving the management and efficiency of public expenditure" as noted in the RPF, and would help the government achieve fiscal sustainability. The



assistance will be coordinated with other Development Partners and focus on providing support in areas where the Bank has a competitive advantage.

C. Proposed Development Objective(s)

17. The Development Objective of the proposed project is to improve reliability and timeliness of financial reporting of the National and State Governments of the Federated States of Micronesia.

Key Results (From PCN)

18. Project beneficiaries include the Department of Finance & Administration (DoFA), line departments and the Office of the National Public Auditor (ONPA) in the national government, and the Finance Departments of the four State governments. Viewing and limited data-entry access will be provided to line departments depending on need and volume. The project will support improvement in systems, processes and procedures around budget formulation and execution covering internal controls, procurement, accounting and financial reporting. This will include building human resource capacity and strengthening human resource management functions in the DoFA and the State Finance departments. The project will contribute to strengthening the government's capacity to manage public resources efficiently and effectively to deliver services.

19. The tentative list of key development performance indicators is:

- In-year budget execution reports are prepared and published for every quarter.
- Annual financial statements are prepared and submitted for audit within 4 months of year-end.
- New Financial Management Information System (FMIS) implemented and used for producing information to support budget formulation, financial reporting and monitoring of internal controls.
- Reduction in costs classified as "questionable" in audit findings.
- Manuals providing functional responsibilities and competency requirement for various user roles are prepared and adopted.
- Training program for all user roles related to new FMIS established.
- Capacity of International Finance Unit for project management strengthened.

D. Concept Description

20. While the overarching priority is to enhance the underlying Financial Management Information System (FMIS) and the capacity to use it, the project will be an opportunity to holistically support better PFM outcomes. The FMIS is the primary tool used for recording, monitoring and reporting budget execution.

21. Achievement of the objectives in the draft PFM Roadmap will require more than a change in hardware and software. As learnt from experience² in supporting several governments in FMIS interventions across the world, it is essential to recognize that any FMIS can only deliver on expected benefits of technology if it is supported by an appropriate legal, regulatory and monitoring framework.

² [World Bank Study](#): "Financial Management Information Systems: 25 Years of World Bank Experience on What Works and What Doesn't", April 2011.



22. Under the federated system, State governments have considerable power in budgetary matters, but the Department of Finance and Administration confirmed that all five governments (National and four States) want a common system which can easily interface and share information. This will require close coordination and collaboration on issues of data access and information security, as well as a uniform chart of accounts across the governments to allow consolidation and comparability. While interfacing is required for harmonized financial reporting, each of the governments also wants to maintain the integrity of their data and restrict access for other governments such that any information sharing is strictly as per agreed protocols.

23. The proposed project will have four components and tentatively USD 7 million IDA financing:

- **Component 1: Improvement in PFM processes.** The objective of this component is to strengthen the PFM environment i.e. the processes, procedures and regulations governing budget formulation, execution and financial reporting across the five governments. The component would support review of Chart of Accounts, existing legal framework for PFM, existing financial management (FM) regulations and effectiveness and efficiency of internal controls. This would lead to either the design of new documents such as chart of accounts or amending existing procedures such as accounting manuals etc. An ADB funded consultant is already conducting a review of the legal framework for PFM. The output from this review will inform the scope of work required to be done under the project.
- **Component 2: FMIS design and implementation.** The objective of this component is to implement a new financial management information system (FMIS) which will support effective management of public resources in each of the five governments. The component would support specification, procurement and implementation of FMIS. In addition to a new software, the project will fund the required hardware including a data center, generators and a disaster recovery site for operational continuity.
- **Component 3: Human Resource Management and Capacity Building.** The objective of this component is to address capacity constraints created largely due to frequent staff turnover and difficulty in retention of qualified technical staff in both finance and IT skills. The project will support the implementation of a holistic strategy for capacity building and the optimum use of resources available, both under the project as well as from other sources i.e. government and development partners. In addition to the DoFA, the project will support the strengthening of the human resource management function for the Office of the National Public Auditor (ONPA).
- **Component 4: Project Management.** The objective of this component is to support overall project management and coordination. There will need to be strong change management, especially for the roll-out of the new FMIS. Since design and roll-out of FMIS will cause disruption across the government, strong leadership will be critical. The PFM Task Force and Inter-government coordination body 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. An operational focal point within each agency will be responsible for implementation within the National and each of the State governments. In addition to the support for managing the project, this component will also support the strengthening of existing International Finance Unit which manages all foreign-funded projects. A dedicated project manager is to be engaged in addition to fungible skills necessary for fiduciary, communications, safeguards and institutional development to enhance the ability of the Department of Finance and Administration (DoFA) to manage project funds and ensure that these are used efficiently for intended purposes.



SAFEGUARDS

A. Project location and salient physical characteristics relevant to the safeguard analysis (if known)

The project will provide technical assistance to the National and four State Departments of Finance & Administration (DoFA), line ministries and the Office of the National Public Auditor (ONPA). All work will be carried out within Government offices.

B. Borrower’s Institutional Capacity for Safeguard Policies

The National and State Departments of Finance and Administration have no in-house capacity for safeguards and have not been involved with the preparation or implementation of instruments to date.

C. Environmental and Social Safeguards Specialists on the Team

- Wolfhart Pohl, Environmental Safeguards Specialist
- Gerardo Pio Francisco Parco, Environmental Safeguards Specialist
- Penelope Ruth Ferguson, Environmental Safeguards Specialist
- Ross James Butler, Social Safeguards Specialist

D. Policies that might apply

Safeguard Policies	Triggered?	Explanation (Optional)
Environmental Assessment OP/BP 4.01	No	This project will not support the drafting of policies, strategies, laws and/or regulations which are likely to have environmental and social impacts when implemented through future programs or projects or involve the design and/or provision of capacity building to support the DoFA or any other agencies to carry out activities that have potentially significant social and environmental impacts. There will be no engineering designs or construction of physical infrastructure as a result of this project. This project is classified as Category C and no safeguards instruments will be prepared for appraisal or during project implementation.
Natural Habitats OP/BP 4.04	No	
Forests OP/BP 4.36	No	
Pest Management OP 4.09	No	



Physical Cultural Resources OP/BP 4.11	No
Indigenous Peoples OP/BP 4.10	No
Involuntary Resettlement OP/BP 4.12	No
Safety of Dams OP/BP 4.37	No
Projects on International Waterways OP/BP 7.50	No
Projects in Disputed Areas OP/BP 7.60	No

E. Safeguard Preparation Plan

Tentative target date for preparing the Appraisal Stage PID/ISDS

Feb 12, 2018

Time frame for launching and completing the safeguard-related studies that may be needed. The specific studies and their timing should be specified in the Appraisal Stage PID/ISDS

No specific safeguards-related studies are required and no safeguards instrument will be prepared.

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APPROVAL

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