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Project Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 13-Nov-2024 | Report No: PIDIA00875

Public Disclosure Authorized

BASIC INFORMATION

A. Basic Project Data

Project Beneficiary(ies)	Region	Operation ID	Operation Name
Micronesia, Federated States of	EAST ASIA AND PACIFIC	P181237	Strengthening Public Financial Management II
Financing Instrument	**Estimated Appraisal Date**	**Estimated Approval Date**	**Practice Area (Lead)**
Investment Project Financing (IPF)	07-Oct-2024	13-Dec-2024	Governance
Borrower(s)	**Implementing Agency**		
The Federated States of Micronesia	Department of Finance and Administration		

Proposed Development Objective(s)

To improve fiscal management practices and increase fiscal transparency at the national government level.

Components

Component 1 Improve fiscal management practices and controls
Component 2 Expand Core Financial Management Information Systems
Compinent 3 Enhance Human Resource Capacity, Communications and Change Management
Project Management

PROJECT FINANCING DATA (US$, Millions)

Maximizing Finance for Development

Is this an MFD-Enabling Project (MFD-EP)?	No
Is this project Private Capital Enabling (PCE)?	No

SUMMARY

Total Operation Cost	**13.00**
Total Financing	**13.00**
of which IBRD/IDA	**13.00**
Financing Gap	**0.00**

DETAILS

World Bank Group Financing

International Development Association (IDA)	13.00
IDA Grant	13.00

Environmental And Social Risk Classification

Low

Decision

The review did authorize the team to appraise and negotiate

Other Decision (as needed)

B. Introduction and Context

Country Context

1. The Federated States of Micronesia (FSM) is a small and geographically dispersed Pacific Island country (PIC) that gained its independence in 1986. FSM comprises four states, namely: Yap, Chuuk, Pohnpei, and Kosrae. The capital city is Palikir, situated on the island of Pohnpei. FSM has a population of about 114,164 persons in 2022 (WDI, 2023). The population is diverse, and English is the official language, though each state also has its own local languages. Prior to independence, FSM was administered by the United States as part of the Trust Territory of the Pacific Islands. While it has its own government and constitution, the country also maintains a close relationship with the United States (US) through a Compact of Free Association ("Compact"). The FSM maintains deep ties and a cooperative relationship with the United States through the Compact and receives yearly financial transfers, a source of revenue to the government[1]. Between FY2017 and FY2019, for instance, the Compact contributed about 23 percent to total revenues on average[2].

2. The FSM faces anemic economic growth and poverty reduction due to structural challenges. FSM is reported to have the highest estimated rates of poverty among the nine small remote islands (PIC9[3]) covered in the World Bank Regional Partnership Framework (RPF) for FY17 to FY21[4]. Tax revenue (% GDP) averaged 10.6 percent between 2012 and

[1] "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. © World Bank, Suva, Fiji. Government of the Federated States of Micronesia. 2022. FSM Economic and Fiscal Update 2022.
2 Available at: https://pitiviti.org/storage/dm/2023/10/3fas-infosesssion-dc-sep2023-v3-20231010215501123.pdf
[3] The nine Pacific Island Countries (PIC9) include: Republic of Kiribati, the Republic of the Marshall Islands (RMI), the Federated States of Micronesia (FSM), the Republic of Nauru, the Republic of Palau, the Independent State of Samoa, the Kingdom of Tonga, Tuvalu, and the Republic of Vanuatu.
[4] Report number 120479 extended by the Board of Executive Directors on February 6, 2020 to FY23.

2020, compared to the PIC-9 average of 24.5 percent in 2020 (WDI, 2023). In FY2024, of the 88.5 percent of the total revenue projected to be generated domestically, Fishing Access Fees comprise about 51.7 percent, with Tax Revenue making up 14.9 percent of total revenue (Citizen-friendly Budget, 2024). Heavy concentration on the fishing sector coupled with import dependency exposes the country to global economic shocks and price spikes, as well as climate shocks.[5]

3. Negative net migration has driven a decline in the population in the past decade, resulting in an acute shortage of skilled labor. Between 2012 and 2022, FSM's population size declined by about 10 percent, with outbound migration playing a central role (IMF Article IV, 2023; FSM FY22 Economic Statistics[6]). Citizens of FSM are granted visa-free access to live, work and study in the US under the provisions of the Compact, enabling ease of outward migration. The resulting capacity constraint in skilled labor creates overdependency on foreign experts and culminates in limited opportunities for domestic revenue generation and economic growth.

4. Fragility also constrains FSM's development potential, with limited progress in systematically addressing its drivers. In FY2022, the World Bank classified FSM as a "high-level institutional and social fragile situation". The 2017 Regional Risk and Resilience Assessment (RRA) for the PIC-9 identified extreme geography (which tends to increase cost of public service delivery), thin institutional capacity and governance, as well as vulnerability to exogeneous shocks, including climate change, disasters, and global economic shocks as key sources of fragility. FSM is very vulnerable to natural disasters and climate change and has suffered significant adverse environmental, social, and economic losses because of hazards induced by climate change.[7] COVID-19 exacerbated these challenges by diverting the government of FSM (GoFSM)'s attention and resources away from other long-term development priorities. Throughout the COVID-19 crisis, FSM's vulnerability to external economic developments generated significant negative impacts on the economy. The international travel restrictions and closed national borders further contributed to limited human resources and made the thin administrative capacity more visible.

Sectoral and Institutional Context

5. In FSM, each state government 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 framework for public financial management (PFM) is guided by separate constitutions at the national and state level. The national and state governments each have their own public financial management legislative frameworks, with separate acts and regulations in force in each jurisdiction. The fiscal relationship between the national government and the four states is reflected in revenue sharing of certain taxes and revenues in the form of grants to the four states. Due to the federal structure and large geographical distances, accomplishing policy and reform decisions at the national and state level is challenging, as consensus across the national and the state governments is required.

6. The Department of Finance and Administration (DOFA) is the key Department in the FSM responsible for policy and strategic advice, as well as financial management for the National Government. DOFA's mission is to provide financial oversight and support to whole of GoFSM to ensure fiscal responsibilities and sound financial management systems are carried out in a sustainable manner, and to ensure financial and performance accountability across GoFSM. DOFA is organized across five divisions, including: Treasury; Customs and Taxes; Investment and International Finance Budget and Economic Management.

7. The capacity constraints arising from acute skilled labor shortages and elevated levels of outbound migration adversely impact GoFSM's ability to effectively carry out public financial management. FSM suffers from a shortage of

[5] Imports of goods and services in FSM constituted about 76% of GDP in 2022 (WDI, 2023).
[6] FSM FY22 Economic Statistics published by the US Graduate School in March 2024 is available at: https://pitiviti.org/fsm
[7] For example, in 2015, Typhoon Maysak, affected about 29,000 people and caused US$8.5 million in direct damages. United States Agency for International Development, Micronesia – Typhoon Maysak Fact Sheet #3, Fiscal Year (FY) 2015. Available at: https://www.usaid.gov/document/typhoon-maysak-fact-sheet-3-04-22-2015

accounting, finance and procurement skills and prolonged staff vacancies persist in DOFA[8]. Limited tertiary or professional education programs are available locally to develop these skills. As a result, DOFA is largely dependent on expatriate consultants for public finance expertise and outsources the preparation of annual financial reports in accordance with principles set out by the US Government Accounting Standards Board (US GASB), which GoFSM has adopted as its national accounting framework. This challenge of attracting and retaining skilled workers has the potential for a long-term negative impact on the public financial management capacity of GoFSM. An Accounting Technician Program currently under development by the College of Micronesia (COM)-FSM's Career and Technical Education Center (CTEC) aims to mitigate this challenge and will provide the basis for the first professional qualification for accounting offered in the country.

8. Historically, assessments of public financial management performance have indicated weaker performance in the FSM compared with regional, income group and global averages. A Public Expenditure and Financial Accountability (PEFA) assessment completed in 2012[9] reflects this finding. FSM's performance was assessed as significantly weaker than regional, income group and global averages, particularly in Credibility of the Budget[10], Comprehensiveness and Transparency, Policy-Based Budgeting, Predictability and Control in Budget Execution, and Accounting, Recording and Reporting. Scores for Budget Classification and Comprehensiveness were assessed at C and D respectively, while the score for Public Access to Information was assessed at a C level. A 2016 PEFA self-assessment reflected some improvements in these areas, however, the results were not independently verified. It should be noted that while PEFA does provide useful insights into performance, capacity constraints in the smaller PICs limit their potential to meet "best or good practice" and there is a high correlation between population and PEFA scores (Haque, Knight, and Jayasuriya - 2015).

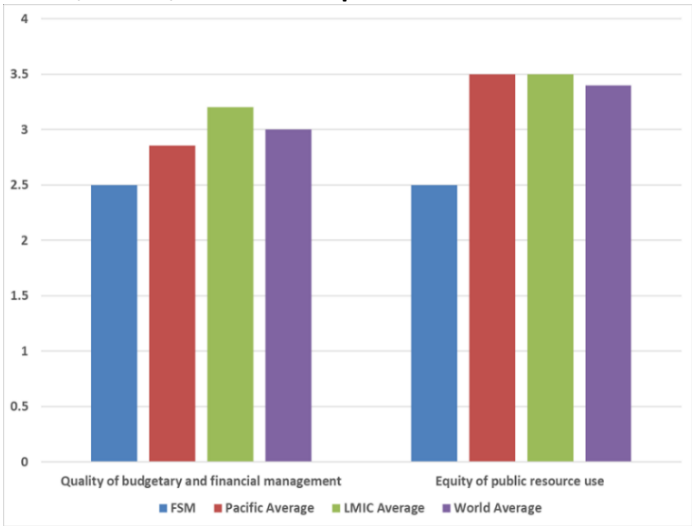
More recent assessments of governance indicators measured in the World Bank's Country Policy and Institutional Assessments (CPIA) continue to show mixed performance for FSM when compared with Pacific, Income Group and Global Averages. The most recent CPIA scores from 2022 highlight weaker performance for FSM compared with Pacific, Income Group and Global Averages across indicators related to *Quality of Budgetary and Financial Management* and *Equity of Public Resource Use* (see Figure 1.)**Figure 1: Relevant CPIA Indicators 2022**

[8] The vacancy rate in DOFA as of October 2024 is 14%

[9] The 2012 PEFA has not been published.

[10] Credibility of the budget is affected the highly variable nature of fishing revenue and the legislated requirement to present a balanced budget proposal to Congress. As a result, very conservative estimates of revenues are presented in the original budget and supplemental budgets are passed throughout the year, resulting in significant variances between budgeted vs actual revenues and expenditures. Policy-level reforms are required to effectively address this issue.

– FSM, Pacific, Income Group and Global



9. PFM reform in FSM is guided by the PFM Roadmap 2023-2026, which sets out the vision for achieving better PFM outcomes at both National and State level and has strong political support. Priorities in the roadmap include: i) an improved budget system that is more comprehensive and open; ii) timely budget recording and reporting, including improved in year budget reporting; ii) procurement efficiency, management and supervision; iv) increased availability of information to the public; v) improved financial records and information; vi) strengthened arrangements for the control and supervision of the use of funds; viii) improved internal compliance; and ix) enhanced capacity development, focusing on ensuring DOFA can lead the reform agenda. The roadmap was developed under the previous administration but endorsed by the newly elected President. Quarterly updates are required to be prepared showing progress against the roadmap – the first of these was published on the DOFA website in July 2023. The strong political support for PFM reform is reinforced by external drivers creating demand for overall public financial management reform and strengthening, including complying with US GASB reporting requirements. While the roadmap has only been in place for one year, some progress has already been made against the stated priorities.

10. In recent years, GoFSM has taken a number of steps to strengthen institutional capacity to carry out core public finance functions. With assistance provided by the WB *Project for Strengthening Public Financial Management (P161969, "PFM I" hereafter)* and other development partners, new Financial Management Regulations (FMRs) were enacted at FSM national level and for three out of the four states (Pohnpei, Kosrae and Yap) between 2021 and 2024 which include additional provisions on the responsibilities of key stakeholders, planning and budgeting processes, revenue collection, procurement, fixed assets and financial reporting. The Budget Division developed Standard Operating Procedures to guide the preparation, adoption, implementation and evaluation of the budget. With support from PFM I, a new unified Chart of Accounts (CoA) is being prepared across governments to align with Government Finance Statistics reporting and US GASB, the implementation of a Revenue Management System is well underway to digitize tax administration and taxpayer payments, and a new Financial Management Information System (FMIS) is being implemented across national and the four state governments to support budget execution and reporting. The development of updated procedural manuals is also underway to capture reengineered business processes aligned with these reforms and modernized information technology systems. PFM I further supported DOFA in the development of a new gender-informed competency-based framework and targeted competency-based training and partnerships have been established. and training program has been developed as well. A restructuring of DOFA is underway to redefine job descriptions with core competencies. To

increase availability of information to the public, DOFA has launched a website and published its first Citizens' Budget in 2024. DOFA has also developed a gender sensitive change management and communications strategy to support PFM reforms.

11. Despite recent improvements, gaps continue to exist in fiscal management practices and controls related to budgeting, financial reporting and procurement. Budgeting weaknesses in FSM relate to comprehensiveness of budget documentation and classification of the budget, which impact overall budget quality. Additionally, the Budget Procedures Act 1981 requires modernization to address challenges in forecasting highly variable domestic revenues and "carry over" budgets. These foundational weaknesses limit the ability to advance GoFSM's budgeting process maturity to a more advanced level which would enable effective performance budgeting and linkages with policy priorities. A lack of in-house capacity to generate US GASB financial statements has necessitated annual financial reporting to be outsourced. However, outsourcing this function has become unsustainable due to cost and timeliness issues. No procurement manual is in place which details GoFSM's approach to processing procurement and there is no clear assessment criteria nor systematic approach for evaluating bids. Procurement and contract management processes are performed manually and are not carried out uniformly across Departments. Procurement is regulated through the FMR 2021, but these are not currently aligned with international public procurement standards. Additionally, while initial steps to create positions for an internal audit unit have been taken, technical assistance is required to operationalize the unit.

12. Implementation of the new FMIS is ongoing and further expansion of core financial management information systems is required. Operational acceptance of the new FMIS is expected to take place in July 2025, with broader rollout across government Departments and agencies in subsequent years. The FMIS will facilitate, *inter alia*, budget preparation and execution, accounting, financial control, and in-house preparation of financial reports. Continued rollout of the FMIS requires dedicated ongoing support and technical assistance to effectively use financial data to supervise, manage and monitor budget execution. An assessment is required to identify functional and technical requirements for further automation of public finance in priority areas such as procurement. There is no systematic use of online tendering, limited publication of large, international selections online, and limited publicly disclosed information on annual procurement spending and other reporting. Conducive to these efforts, connectivity across FSM is expected to improve in the coming years through the support of the *Digital Federated States of Micronesia Project (P170718)*, which aims to strengthen the enabling environment for digital government.

13. Publicized budget hearings and the recent publication of the Citizen's Budget provide a degree of transparency over public finances, but public engagement remains limited throughout the budget cycle. Specifically, information on budgets, procurement and financial reports are generally not available to the public, and there is limited citizen engagement on planning, budgeting, and government programs' design. The 2022 GovTech Maturity Index placed FSM in the lowest quartile of the global distribution (D-group) in the Digital Citizen Engagement dimension, with a score of 0.41 out of 1 (the maximum attainable score).

14. DOFA has the further objective to become a Green Climate Fund (GCF) accredited entity, which would require it to meet certain criteria as set out in the GCF fiduciary accreditation standards. These standards encompass various aspects relating to budgeting, such as performance budgeting and establishing strong linkages between budgeting and policy priorities, accounting, public investment management, asset management, internal and external audit, procurement, transparency and accountability. However, to accomplish these goals, GoFSM must first establish strong public finance foundations to lay the groundwork for future reforms in this area.

C. Proposed Development Objectives

15. **PDO Statement:** To improve fiscal management practices and increase fiscal transparency at the National government level.

Key Results

17. **PDO Level Indicators** Progress toward the achievement of the PDO will be assessed using the following PDO-level results indicators: (i) improved quality of the budget, measured by comprehensiveness and classification; and (ii) improved timeliness of key fiscal documents made publicly available[11].

D. Project Description

18. **Project description.** The Project builds on the key PFM reforms achieved and investments implemented under the PFM I project to support the achievement of key strategic areas defined in GoFSM's 2023-2026 PFM Reform Roadmap (defined in par. 12), by addressing challenges in core institutional public finance capacity. Specifically, the project supports strengthened practices over public finance at the National level, the expansion of the core FMIS to line departments and other agencies, and improvements in systems and processes over budget formulation and execution, procurement, treasury functions, internal controls and financial reporting. This will include building human resource capacity and strengthening technical competencies in DOFA. The project will also provide technical assistance to review existing PFM legislation and make recommendations to support reform areas envisioned in the PFM Roadmap 2023-2026. The project is envisioned to establish the public finance foundations necessary to lay the groundwork for second generation reforms such as climate-informed PFM and improved revenue forecasting. The readiness for second generation reforms will be assessed during the mid-term review to determine whether they could be included in the project.

19. **Project Components.** The project's main components are: (i) improved fiscal management practices and controls; (ii) expanded core Financial Management Information Systems; (iii) enhanced human resource capacity, communications, and change management; and (iv) project management. The total project amount is US$13,000,000.

20. **Component 1: Improve Fiscal Management Practices and Controls ($4,625,000).** This component will support the improvement of practices to carry out budgeting, financial reporting, internal audit (IA) and procurement within DOFA. The activities are designed to address the weaknesses noted in budget quality, financial reporting and procurement, and introduce related internal controls, which will have the greatest impact on improving fiscal management practices in these areas. The component will support the review, development or update of procedures and templates for fiscal management related to these areas and provide on-the-job learning to support their implementation. It will also provide technical assistance for a legislative review to identify revisions which may be necessary to support envisioned reforms.

21. ***Sub-component 1.1: Strengthen budgeting and reporting practices ($3,195,000).*** The objective of this sub-component is to: i) improve classification and comprehensiveness of the budget; ii) establish in-house financial reporting capability to produce annual consolidated financial reports, and iii) upskill and transform the existing internal compliance unit to carry out an internal audit function, thereby enhancing internal controls. To support achievement of these objectives, activities will include: i) technical assistance to review the public financial management legislative framework and preparation of draft updated legislation, as needed; ii) reviewing and updating guidelines, procedures, and templates to improve the quality of budget documentation, and preparation of annual consolidated financial statements; iii) preparation of an internal audit mandate, charter, risk-based methodology, audit plan, audit manual, programs, and reports; iv) on-the-job training to support implementation of these activities; and v) internal government consultations and awareness activities to inform and roll out changes to manuals and procedures. A review of the Budget Procedures

[11] The key fiscal documents are those from PEFA Indicator PI-9 that are fully within the control of DoFA. These are: i) annual executive budget proposal documentation; ii) in-year budget execution reports; iii) annual budget execution reports; iv) prebudget statements; and v) summaries of the budget proposal (or citizen's budgets).

Act 1981 and national government FMR will be completed to identify revisions necessary to support envisioned reform areas. The FMR review will be conducted with a view toward simplification, such as moving procedural information to subsidiary guidelines and procedures. The review will also support DOFA in considering whether establishment of a revised Procurement Code and Regulations is warranted. These activities will be supported by an external consultancy, equipment and advisors who will also facilitate on-the-job learning of local staff and consultants in close coordination with the human resource development activities and formal training under Component 3.

22. ***Sub-component 1.2: Strengthen procurement practices ($1,430,000).*** The objective of this sub-component is to strengthen procurement practices and transparency. To support achievement of the objective, activities will include: i) technical assistance to review the procurement framework and support preparation of draft procurement legislation and/or regulations as needed, and a procurement procedures manual for carrying out procurement in national government; ii) advisory support and on-the-job training to strengthen procurement processes and provide guidance on applying value for money and sustainability principles, annual procurement planning and reporting; and iii) support for transitioning from a manual system to automated procurement processing through the implementation and rollout of an online tendering portal under Component 2.2. These activities will be supported by external consultancies and advisors who will also facilitate the reforms and provide on-the-job learning of local staff and consultants in close coordination with the human resource development activities and formal training under Component 3.

23. **Component 2: Expand Core Financial Management Information Systems ($4,325,000).** This component will support increased efficiency and automation of public finance processes through the expanded use of the FMIS implemented under PFM I to additional government Departments and agencies. Activities will also focus on expanding automation of procurement, internal audit and other selected public finance areas, thereby improving overall operational efficiency, transparency, and timeliness in managing public resources.

24. ***Sub-component 2.1: Continue rollout of core public finance system ($3,225,405).*** The objective of this sub-component is to support the continued use and rollout of the FMIS installed under PFM I to additional Departments and agencies. The FMIS strategy and system leverage a cloud based and local disaster recovery solution designed to recover and protect financial data, ensure the continuity of financial operations, and support the rapid resumption of services after a climate-related event. This is a crucial climate adaptation measure which mitigates risks associated with FSM's significant vulnerability to natural disasters and climate change and allows GoFSM to manage and disburse funds effectively during recovery efforts. The FMIS additionally provides for electronic document management to digitally secure data and documents, thereby securing data in the event of a climate disaster, as well as decreasing the use and waste of paper. It also includes ensuring redundancy is built into the design of the ICT infrastructure and is envisioned to leverage the new telecommunications infrastructure under development in the country to further enhance disaster recovery solutions. To support achievement of the objective, activities will include: i) FMIS training to line Departments and agencies; ii) recurrent costs for FMIS licenses, hosting and cloud services, beyond the current contract, i.e. in the last two years of the project; iii) procurement of hardware and telecommunication costs - this will include purchase of equipment such as scanners, laptops, etc. needed for the FMIS rollout to line Departments and agencies; iv) support for the continued rollout of the FMIS to line Departments and agencies, liaising with the FMIS vendor as needed, through an FMIS Advisor; and v) support to GoFSM on IT matters related to the FMIS through an IT Advisor.

25. ***Sub-component 2.2: Expand public finance systems ($1,099,595).*** The objective of this sub-component is to support further digitization of public finance systems to include platforms supporting procurement and internal audit. To support achievement of the objective, activities will include: i) a needs assessment, to define the scope and functional and technical requirements of PFM processes to be digitized, beyond what is already included in the scope of the FMIS and the current contract with the vendor; ii) procurement and implementation of an online tendering portal, which would allow the government to advertise and receive tenders online; and iii) procurement and implementation of an internal audit platform. Specifications for off-the-shelf standalone systems or customizable modules will be developed based on

functional and technical needs. The subcomponent will also support leveraging the use of data captured in the FMIS to support budgeting and transparency initiatives identified in Components 1 and 3.

26. Component 3: Enhance Human Resource Capacity, Communications and Change Management ($2,300,000). This component aims to build on the initiatives to strengthen human resource capacity, foster communications and carry out change management established under PFM I by continuing competency development activities, engaging in continued internal and external communications, and carrying out in citizen engagement activities. The component will support capacity building for core PFM functions and processes within DOFA, continue change management and transparency initiatives and increase citizen engagement in the budget cycle.

27. *Sub-component 3.1: Enhance Human Resource Capacity for Public Finance ($1,630,000).* The objective of this sub-component is to strengthen human resource capacity for public finance. To support achievement of the objective, activities will include: i) delivery of training programs established under PFM I and additional targeted certification programs in key areas (US GASB, Procurement, IA[12], Budgeting); ii) establishment of training partnerships to support the development of competencies; and iii) support establishment of an accreditation function to provide oversight of a recognized certification framework. The project will support formal recognition of certifications, including within the remuneration framework of DOFA. A partnership will be established with the College of Micronesia, Career and Technical Education Center and National Public Auditor to support the establishment of the Accounting Technician program currently under development. The accreditation programs will target a gender balanced delivery to provide equal opportunities to increase competencies in targeted areas. Formal training will be complemented by on-the-job learning under Component 1 to maximize learning outcomes.

28. *Sub-component 3.2: Change Management, Communications and Citizen Engagement ($670,000).* The objectives of this sub-component are to: (i) support the management of change associated with reforms under the project and (ii) increase access to key fiscal documents and procurement and improve public finance awareness of citizens. To support achievement of the objective, activities will include: i) updating the Gender Informed Change Management and Communications Strategy and developing a Transparency and Citizen Engagement Strategy, with special provisions for targeting female citizens; ii) enhancements to the DOFA website to facilitate publication of fiscal documents and responses to citizen feedback; and iii) support for DOFA to conduct citizen engagement activities on PFM, including the development of media content in local languages where appropriate and public awareness campaigns to help citizens, civil society and the media to better understand public finance and the role of DOFA. The project will support the preparation and publishing of reports summarizing feedback from citizens and responses/actions taken. The sub-component will also support the management of change associated with the reform and improve reform awareness of internal and external stakeholders. These activities will be supported by an advisor who will support DOFA in drafting strategies and during implementation.

29. Component 4: Project Management ($1,750,000). The objective of this component is to support overall project management and coordination. The implementation agency for the project will be DOFA. The project implementation arrangements envisage a Project Implementation Unit (PIU) to support DOFA in daily activities. The PIU will include a project manager and a project officer. Procurement and Financial Management Officers will be added based on need. The project will finance the required office equipment and IT facilities at DOFA to enable and facilitate implementation. Specifically, the project will fund the purchase of computers, printers, and other required equipment and office furniture related to project management. It will also finance external audit fees for the project, as needed.

[12] The Internal Audit certification is expected to draw on the internationally recognized framework of the Institute of Internal Auditors.

Legal Operational Policies	Triggered?
Projects on International Waterways OP 7.50	No
Projects in Disputed Area OP 7.60	No

Summary of Screening of Environmental and Social Risks and Impacts

30. The project will finance activities to enhance the public financial management (PFM) in FSM. The project will finance activities to enhance PFM, expand core financial management information systems (FMIS), enhance human resource capacity and capabilities, and support project management. The project is not expected to support any physical activities, or feasibility studies/technical design for future investment projects. All the activities of the project are technical assistance type of activities. Through Component 1, the project will review and update legislative frameworks, guidelines, and procedures to address existing weaknesses and integrate environmental and social considerations into public financial management, and strengthen institutional capacity to carry out budgeting, procurement, treasury and internal audit functions. Component 2 will support the continuation of implementation of the FMIS to optimize its use across government. Component 3 aims to build on the human resource capacity, strengthen communications and change management established under PFM I by continuing competency development activities, fostering continued internal and external communications, and engage in citizen engagement activities. Component 4 will support the overall project management (i.e. office equipment and furniture) of the PIU. These technical assistance activities are expected to have minor or negligible environmental and social impacts. Furthermore, it is expected to further enhance the environmental and social sustainability of country's public financial management through integration of ES considerations into budgeting and procurement. The environmental and social considerations will be integrated into the TORs for all project tasks. The projects will also adhere to existing labor contract management under Bank procurement's guidelines and process. ESCP will be developed to ensure the implementation of these commitments. Overall, based on the initial screening, the project is considered to have low environmental and social risks, and does not require further environmental and social assessment.

E. Implementation

Institutional and Implementation Arrangements

31. The project implementing agency, DOFA, has broad experience implementing donor-funded projects and engaging with donor partners. DOFA, supported by a Project Implementation Unit (PIU), is the implementing agency for PFM I and has satisfactorily carried out project management to navigate critical legislative, technical, and procurement hurdles. DOFA will be the implementing agency for the proposed Project and will coordinate efforts with other key institutions including sectoral Departments and State governments, as applicable. However, DOFA has limited absorptive capacity to implement and coordinate the project effectively.

32. To address the implementing agency capacity gap, DOFA will continue to be supported by a PIU and the project will benefit from a significantly simplified design. The project design has undergone significant simplification from the previous project. The PIU will include a project manager and a project officer to support project implementation, including coordination with relevant national and state government institutions. The PIU will oversee the day-to-day implementation, monitoring, and reporting of project activities, carrying out financial management and procurement of goods and consultancies with support from the Central Implementation Unit (CIU), and monitoring and reporting on

results achieved by activities financed under the project. The CIU, established in DOFA, will provide additional advisory and implementation support related to procurement, financial management, communications, monitoring and evaluation, and environmental and social safeguards functions for the Project. Prior to project approval, DOFA will prepare a Project Operations Manual (POM) which will set out the institutional and implementation arrangements for day-to-day project execution. The PIU of the existing project, as well as the CIU, will support project preparation activities. Establishment of the PIU and the appointment of key staff are expected shortly after project effectiveness. Before the PIU members are recruited, it is expected that the implementing agency, with support from the CIU and the PIU of the existing PFM I project, will directly manage project implementation to avoid delays in key activities.

33. A Project Steering Committee (PSC) will be maintained to enhance project coordination and oversee project implementation and results, and a Treasury Working Group (TWG) will be established to support coordination. To eliminate redundancies and enhance engagement of the PSC, the Intergovernmental Working Group (IWG) maintained under PFM I will be eliminated and State Finance Directors will participate in the PSC. The TWG will comprise technical focal points to support the FMIS rollout to line ministries under subcomponent 2.1 and coordination of US GASB implementation under subcomponent 1.1.

CONTACT POINT

World Bank

Bonnie Ann Sirois
Senior Financial Management Specialist

Elena Georgieva Georgieva-Andonovska
Senior Public Sector Mgmt. Specialist

Borrower/Client/Recipient

The Federated States of Micronesia

Implementing Agencies

Department of Finance and Administration
Rose Nakanaga
Secretary of Finance
rose.nakanaga@dofa.gov.fm

FOR MORE INFORMATION CONTACT

The World Bank
1818 H Street, NW
Washington, D.C. 20433
Telephone: (202) 473-1000
Web: http://www.worldbank.org/projects

APPROVAL

Task Team Leader(s):	Bonnie Ann Sirois, Elena Georgieva Georgieva-Andonovska

Approved By

Practice Manager/Manager:	Patrick Piker Umah Tete	14-Aug-2024
Country Director:	Stephen N. Ndegwa	13-Nov-2024