

ASIAN DEVELOPMENT BANK

TAR: FSM 35443

TECHNICAL ASSISTANCE

TO THE

FEDERATED STATES OF MICRONESIA

FOR THE

IMPLEMENTATION OF PERFORMANCE-BASED

BUDGET MANAGEMENT

November 2001

CURRENCY EQUIVALENTS

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

ABBREVIATIONS

ADB	–	Asian Development Bank
BPS	–	budget preparation software
CPM	–	Country Programming Mission
DOFA	–	Department of Finance and Administration
EMPAT	–	Economic Management Policy Advisory Team
FMIS	–	financial management information system
FSM	–	Federated States of Micronesia
PSMA	–	public sector management adviser
TA	–	technical assistance

NOTES

- (i) In this Report, "\$" refers to US dollars.
- (ii) The fiscal year (FY) of the Government ends on 30 September. FY before a calendar year denotes the year in which the fiscal year ends, e.g., FY2002 begins on 1 October 2001 and ends on 30 September 2002.

I. INTRODUCTION

1. During the 2001 Country Programming Mission (CPM) of the Asian Development Bank (ADB), the Government of the Federated States of Micronesia (FSM) requested further advisory technical assistance (TA) for performance-based public finance management. The CPM visited FSM from 18 to 31 July 2001 to determine the objectives, scope, implementation arrangements, budget, and detailed terms of reference for the TA.¹ The TA framework is in Appendix 1, and the terms of reference for considerations are in Appendix 2.

II. BACKGROUND AND RATIONALE

2. In 1995, the FSM Government initiated its policy reform program aimed at strengthening the economy. ADB, through its Public Sector Reform Program (PSRP) loan² and associated TA,³ has been supporting these reforms. The ADB-financed PSRP succeeded in bringing about required fiscal adjustments in the national Government and four state governments.⁴

3. State governments expressed interest in the performance-based budgeting system. The national Government then requested a follow-on TA to maximize the benefits from the new budgeting approach, such as the establishment of policy linkages, embedding of related modern management concepts, enhanced financial control, and effective reporting systems and procedures.

4. TA 2983 was the second phase of an envisioned six-year TA program for institutional capacity building for effective and efficient public resource management.⁵ The TA was to complement the formulation of a strategic economic management framework undertaken under TA 3024-FSM: Economic Management Policy Advisory Team (EMPAT) II.⁶ TA 2983 was to improve the management of public resources through development and implementation of a performance-based public resource management system. The achievement under TA 2983 achieved the following: (i) performance-based budgeting was introduced in the national Government and in four state governments; (ii) new budget procedures were introduced; and improvements in accounting procedures were suggested; (iii) measures for improving performance monitoring were recommended; and (iv) on-site training and international study tours were conducted.

5. TA 3431 commenced in October 2000, and had as its purpose improving the capacity for performance-based public finance management implementation⁷ in the national Governments and four state governments. Extensive formal training⁸ was carried out in the line departments and budget offices in all the governments, and the budget preparation software (BPS) was significantly rebuilt and updated. The activities under TA 3431 (i) provided training to approximately 400 individuals throughout the five FSM governments, resulting in significant

¹ The TA was first listed in *ADB Business Opportunities* in 22 August 2001.

² Loan 1520-FSM: *Public Sector Reform Program*, for SDR12,979,000, approved on 21 April 1997.

³ TA 2294-FSM: *Policy Advisory Team for Economic Management*, for \$540,000, approved on 31 January 1995.

⁴ An interdepartmental Task Group reviewed the Public Sector Reform Program in FSM in February 1999 and confirmed that it had achieved successful fiscal adjustments. See Knapman, Bruce and Saldanha, Cedric, *Reforms in the Pacific*, 1999 Pacific Studies Series, No. 17.

⁵ TA 2983-FSM: *Performance-Based Public Resource Management*, for \$988,000, approved on 26 January 1998.

⁶ TA 3024-FSM: *Economic Policy Reform and Management*, for \$2,877,000, approved on 2 June 1998.

⁷ TA 3431-FSM: *Improving Capacity for Performance-Based Public Finance Management Implementation*, for \$500,000, was approved in April 2000.

⁸ The training was conducted for administrative officers, and middle and senior management, the primary objective being to build capacity in basic strategic planning, quantifying targets, and costing outputs and activities.

improvement in levels of understanding of performance-based budgeting concepts and terms⁹; (ii) provided technical assistance in strategic planning to 90% of all national and state government departments; (iii) helped the five governments identify costs associated with performance items; (v) significantly improved the BPS system by enhancing software functionality; (vi) created and delivered a budget manual with step-by-step instructions for developing a performance budget; (vii) conducted a partnership workshop for senior officials; and (viii) drafted quarterly performance report formats for Yap and Pohnpei States. The TA was completed in August 2001. Lessons learned during implementation of this TA include the following:

- (i) The introduction of performance-based budget management in FSM was (a) recognized as an important and increasingly accepted step in improving public sector planning and accountability in public finances, and (b) realistically expected to take several iterations before it would be fully developed and institutionalized. Several years will be needed to effectively introduce a performance-based budget system through progressive understanding and improvements.
- (ii) There is a need for a sustained effort to gain the extended support of key government officials and acceptance by all FSM governments. By making the necessary technical improvements in the budget and financial management computer software, many of the major constraints to institutionalizing performance management will have been overcome.
- (iii) Training in the concepts and operations of performance budgeting and management is an ongoing continuously needed process. Every attempt should be made to institutionalize course offerings in strategic planning and management, performance budget preparation, and monitoring and reporting through the College of Micronesia. The approach will increase internal understanding and support for performance management, and lead to a decrease in the need for externally hired management trainers.
- (iv) Proper sequencing of TA activities and inputs is necessary to maximize impact.

6. The CPM was informed by a number of national and state government officials of FSM's support and commitment to the performance-based budget management system. Having raised the capacity of many mid- and senior level public servants in TA 3431, the leaders of the respective governments have indicated their readiness to incorporate its concepts and tools into the management culture of government.

7. The very decentralized and complex system of government in FSM has meant that ADB assistance through the strategic application of performance budgeting cannot be done simply by installing it at the national government level; rather it needs to be done uniquely on a government-by-government basis. While TA 2538,¹⁰ TA 2938, and TA 3431 have put in place foundations for performance-based public finance management, there still remain a number of important technical and behavioral aspects required to complete the installation and institutionalization of performance-based public finance management. The financial management

⁹ This conclusion was based on pre-and post-training tests conducted during TA 3431-FSM.

¹⁰ TA 2538-FSM: *Improved Budget Management*, for \$480,000, approved on 14 March 1996.

information systems (FMISs)¹¹ need to be properly programmed and operated to provide accurate, timely revenue and expenditure data, and to interface with BPS. The BPS must be further enhanced so that it can interface with FMIS to import fiscal data or export budget data, and provide a range of financial and economic reports for use as a management tool (paras. 10, 11). In budget planning, the fundamental linkages between establishing performance targets and the budgeting process need to be enhanced. While FSM economic summit meetings on the national economy have provided the necessary policy framework, there continues to be a need to introduce systematic linkages between these policies and objectives in the respective governments' annual budgets.

8. Also, while the ultimate objective of introducing performance-based public finance management is to improve the quality and effectiveness of resource management, the performance-based budgeting system and supporting software is still being used primarily for budgeting. A fundamental next step is to use the system for management purposes, which requires a demonstrated commitment by the leadership in each of the governments.

9. In the deliberations on the FY2002 budget in the FSM National Congress, the new budgeting approach was extensively discussed. Although the report indicated continued frustration with the process and product, an overall commitment to the concept and the need for the performance-based budget management system was reaffirmed. Congress has indicated that the financial management legislative framework drafted in 1999 will be considered for adoption when the overall systems and procedures associated with performance budgeting and management have taken hold and are operationalized, and its practical use in the management of government is demonstrated. Adoption of the legislative framework is not viewed as a necessary prerequisite to institutionalization in the public sector.

10. The budget preparation system now includes functions such as (i) standardized budgeting process in all five governments; (ii) linked performance-based budget and line-item budget modules; (iii) ability to enter performance-based budget inputs, outputs, and unit costs; (iv) enhanced ability to handle changes in organizational structures; (v) ability to handle supplementary budget submissions; (vi) expanded reporting capabilities; and (vii) a Users Manual. The new BPS maintains the look and feel of the original BPS program that people were familiar with. With these considerable improvements, the BPS is a well-developed, useful budget preparation software, understood and used in all five governments. The BPS needs further development, however, including further revenue information, categories for economic and fiscal analysis, the ability to track and report on results, and the ability to interface with the respective FMIS in each of the governments.

11. The effectiveness and relevance of the BPS depends in large part on its capability to interface with the existing financial management information systems (FMIS). Each system needs to access data to integrate and produce reports that can accurately track expenditures and performance, compare revenues with expenditures, and provide on-demand, accurate 'real time' budgetary information.

12. The TA primarily addresses good governance issues in FSM and is expected to have significant effects on resource management and allocation, as well as on the level of transparency in public financial management. The ensuing efficiency gains will contribute to

¹¹ There are three FMIS currently used in the FSM: National, Chuuk, and Kosrae use FOCUS; Pohnpei uses DILOG; Yap uses American Fundware.

poverty alleviation through greater specificity of inputs and outputs, and accountability for program delivery.

III. THE TECHNICAL ASSISTANCE

A. Objective

13. To keep up the momentum in implementing performance-based public finance management systems, this TA aims to (i) audit and analyze current systems and procedures related to financial accounting and reporting, to address the respective deficiencies in and between FMIS and BPS; (ii) improve the technical systems to ensure proper monitoring; and (iii) develop performance budget management capability. While it must be acknowledged that capacity building and further skills development are not linear in nature but require repeated, continuous effort and support, the accomplishment of the stated objectives will provide the necessary underpinnings for a continuous, self-sustaining performance management and budgeting system and process in the FSM, and reduce significantly the need for additional TA support. The TA will assist the governments of the FSM in strengthening the implementation of performance-based public finance management and putting it on a self-sustaining basis. The TA will strive to build upon and achieve an acceptable level of support and self-sustainability for the performance-based budgeting system now in its fourth year of implementation at the national Government and in each of the four state governments.

B. Scope

14. The TA will finance the provision of consulting services and training activities. It will comprise the following components (i) audit and analysis of the systems and procedures, (ii) improving the budget software, (iii) implementing the integration of the budget software and financial management systems, (iv) human resources development, and (v) performance management to derive full benefits from performance-based public finance management. The five separate components of the TA need to be carried out in the proper sequence: step one must be completed in order to determine the applicability of the other steps. Steps two and three may be done in sequence or concurrently, while steps four and five should preferably commence after some initial work has taken place under steps two and three.

15. The continuing focus of the TA activities will be on the transfer of knowledge to relevant local staff and the development of the internal institutional training capability at the College of Micronesia, to enable them to handle on their own all crucial aspects related to performance-based public finance management.

C. Cost Estimates and Financing Plan

16. The TA is estimated to cost \$465,000, including foreign exchange costs of \$340,000 and \$125,000 equivalent in local currency costs. The Government has requested ADB to finance on a grant basis \$350,000 equivalent, covering the entire foreign exchange cost and \$10,000 equivalent of the local currency cost. The Government will contribute \$115,000 equivalent for office space, counterpart staff, local transportation, interstate travel of seminar participants, and other services. The detailed cost estimates are in Appendix 3.

D. Implementation Arrangements

17. The Department of Finance and Administration (DOFA) will be the Executing Agency. The Budget Office director of the national Government, assisted by the EMPAT public sector management advisor, will be in charge of TA implementation and everyday supervision of the consultants. The Steering Committee will consist of an individual from the Office of the President, the Deputy Secretary of Economic Affairs, and the Deputy Secretary of Finance and Administration.

18. ADB will engage a team of international individual consultants, and will provide approximately 16 person-months of consulting services: (i) audit/analysis of current financial management and reporting systems (2 person-months), (ii) improvements made in the BPS software (2 person-months), (iii) integration of BPS and FMIS in each government (3 person-months), (iv) formal and informal training to selected individuals and groups identified in (i) above (5 person-months), and (v) activation of performance management systems and procedures (4 person-months). The consultants will be selected and engaged in accordance with ADB's *Guidelines on the Use of Consultants*. The consultants will collaborate closely with the ADB-financed EMPAT II and any other ongoing ADB financed and other externally-assisted projects related to reforms of public enterprises, to achieve maximum utilization of resources and avoid duplication of effort.

19. The TA will be implemented over a period of two years, commencing January 2002 and to be completed no later than January 2004. Each consultant will prepare a brief progress report monthly setting out actual achievement against the terms of reference and other agreed benchmarks. A draft final report by each consultant will be signed off by DOFA and ADB before the final payment is issued for the consulting services.

IV. THE PRESIDENT'S DECISION

20. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance, on a grant basis, to the Government of the Federated States of Micronesia, in an amount not exceeding the equivalent of \$350,000, for the purpose of Implementation of Performance-Based Budget Management, and hereby reports such action to the Board.

TECHNICAL ASSISTANCE FRAMEWORK

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
Goal Improved management of public resources through more transparent and accountable public sector operations	<ul style="list-style-type: none"> • Measurable improvements in government service delivery • More efficient utilization of government's financial, material, and human resources 	Economic performance reports, budget and legislative documents	
Objective/Purpose Full-fledged operation and use of performance budgeting and management in all 5 FSM Governments by FY04	<ul style="list-style-type: none"> • Use of performance-based targets in the budget preparation, review, and decision making process in all five governments by June 2002 • A fully operational budget software installed and being used in all 5 FSM governments by June 2002 • A financial reporting system regularly producing up-to-date, accurate expenditure and output data by 12/02 • Actual use and application of performance management procedures by the senior management of all five governments by 9/02 • A transparent, structured decision-making process in allocation of capital and operational budgets of government by FY04 • More cost-efficient, transparent management and budgeting system being used in all 5 FSM governments by FY04 	<p>Assessment of government budget-related documents and timeliness of preparation</p> <p>Consultant reports, On-site observations, feedback from Government, the public at large, and aid providers</p>	<p>Executive leadership gives full operational commitment to improving management and budgeting of government resources through establishing, tracking, and measuring output performance</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
<p>Outputs</p> <p>1. Problem Identification Activities for this output: Audit and analysis of the current systems and procedures related to the financial management (FMIS and BPS) and reporting systems in national and 4 state governments.</p> <p>2. Technical System Improvements Activities for this output: Amend the BPS software.</p> <p>3. Implement the integration of the BPS and FMIS in the national and 4 state governments.</p> <p>4. Budget and Data Management Skills Development Activities for this output: Human resources development, formal and on-the-job training</p> <p>5. Performance Management</p>	<p>1a. Expenditure and revenue data entry, recording, and reporting process and procedure analysis completed by 6/02</p> <p>1b. Capability of financial management systems to provide accurate real time data to enhance performance budget management, fiscal analysis, and regular reporting functions determined by 4/02</p> <p>1c. Capabilities assessed for improving interface between BPS and FMIS by 7/02</p> <p>By April 2002: Revenue information</p> <p>Categories added for economic and financial analysis</p> <p>Performance and expenditure reporting</p> <p>BPS and FMIS are sharing information as the basis for an expanded reporting facility by FY04</p> <p>3 weeks targeted training to national Government</p> <p>3 weeks targeted training carried out in each of the 4 state governments</p> <p>Develop and introduce course at College of</p>	<p>1a. Assessing revised FMIS and BPS</p> <p>1b. Consultant reports</p> <p>1c. Confirmation, orally or in writing, from each of the 5 governments</p> <p>Consultant reports</p> <p>Independent expert assessment</p> <p>Reports from users</p> <p>On-site observations</p> <p>Consultant reports</p> <p>Independent expert assessment</p> <p>Reports from users</p> <p>On-site observations</p> <p>Consultant reports</p> <p>Interviews with trainees</p> <p>Confirmation from government officials</p> <p>Consultant report</p>	<p>Government is receptive and supportive of TA efforts.</p>

Design Summary	Performance Indicators/Targets	Monitoring Mechanisms	Assumptions and Risks
	<p>Micronesia</p> <p>Instructions issued in executive branch to produce regular performance-expenditure reports by 3/02</p> <p>Departments, agencies, divisions producing and submitting quarterly performance-expenditure reports by 6/02</p> <p>Budget review committees' roles expanded to include within year performance monitoring FY02 and 03</p>	<p>Review of government documents and confirmation from each government</p>	
<p>Inputs</p> <p>1. Consulting Services:</p> <p>For Output 1, consulting services for 2 months</p> <p>For Output 2, consulting services for 2 months upon completion of output 1</p> <p>For Output 3, consulting services for 3 months upon completion of output 1</p> <p>For Output 4, consulting services for 5 months upon completion of output 1;</p> <p>For Output 5, consulting services for 4 months commencing upon completion of output 1 and to be spread throughout the two year period.</p>	<p>Selection and appointment of consultants</p>	<p>Consultant contracts</p> <p>Consultant reports</p>	<p>1. Consultants are competent and reliable.</p> <p>2. Consultants are available.</p> <p>3. TAs take place in proper sequence and are not rushed.</p> <p>4. EMPAT PSMA allocates sufficient time to this effort in all five FSM governments.</p>

FSM = Federated States of Micronesia, TA = technical assistance, BPS = budget preparation software, FMIS = financial management information systems, EMPAT = Economic Management Policy Advisory Team, PSMA = public sector management advisor.

TERMS OF REFERENCE FOR CONSULTANTS

A. Scope and Work Program

1. The principal purpose of the technical assistance (TA) is to improve the systems and procedures for proper management of public resources. The TA will strive to achieve an acceptable level of support, full activation, and self-sustainability for the performance-based budget preparation and management system now in its fourth year of implementation at the national Government and in each of the four state governments of the Federated States of Micronesia (FSM).

2. The TA will field individual specialists for the following activities (person-months in parentheses): (i) perform an audit and analysis of the current financial management and reporting systems in the national and four state governments (2), (ii) make improvements in the budget preparation software (BPS) (2), (iii) implement the integration of BPS with national and state financial management systems (3), (iv) conduct formal and on-the-job training to specifically targeted individuals and groups (5), and (v) actively support the establishment and use of performance management systems and procedures in the 5 governments (4). To facilitate the successful implementation of the TA, each of the five FSM governments will (i) designate one or more individuals as principal counterpart to the TA, and (ii) make sufficient office and training facilities available to the TA for its duration, prior to the commencement of the TA activities.

B. Specific Terms of Reference

1. Financial Management and Reporting Systems Specialist (2 person-months)

4. The specialist should combine a thorough understanding and knowledge of financial management and reporting systems, with experience and demonstrated capability to audit, analyze, offer technical advice, and give on-site operational support to targeted staff and departments in the executive and legislative branches of the five FSM governments. During a period commencing no later than February 2002 and concluding by the end of April 2002, this specialist will work with the financial management and budget offices at national government and in each of the four states to

- (i) analyze the Financial Management Information Systems (FMIS) in each of the 5 FSM governments for the purpose of better understanding the financial data recording, reporting processes, and procedures;
- (ii) assess the capabilities of the BPS to incorporate required enhancements and to interface with FMIS;
- (iii) determine the feasibility and estimate the cost and time of successfully interfacing the BPS and FMIS to facilitate sharing of data and the timely provision of information and reports;
- (iv) write specification for changes to BPS and FMIS to facilitate and improve the interface between the two systems;

- (v) determine changes to business process and procedures and human resource development requirements necessary to achieve a real time financial management and reporting process.

2. Budget Preparation Software Specialist (2 person-months)

5. The specialist should have a thorough understanding of software systems development, in particular the software currently being used in the five FSM governments, with some knowledge of public sector performance-based budgeting concepts and practices. The consultant will

- (i) develop enhancements to the current BPS to include, but not be limited to, revenue reporting capabilities, financial and economic analysis categories, performance and expenditure reporting;
- (ii) enable the BPS to incorporate standard IMF Government Financial Statistics (GFS) classification and codes;
- (iii) develop the capability for the BPS to upload data from the financial management system;
- (iv) develop a facility to enable the BPS to export data to the FMIS;
- (v) develop an “export facility” for both BPS and FMIS to “Excel” spreadsheet software, with filter options to enable tailor-made reports to be prepared “in-house” by the FSM;
- (vi) liaise with the FMIS specialist to ensure successful interfacing of the two systems.

3. Financial Management Information’s Systems Software Specialist (3 person-months)

6. This position requires someone who is a FMIS software specialist and programmer and who has previously and successfully applied these skills in developing financial management information systems, preferably but not necessarily in the FSM. The FMIS specialist should have a knowledge of FOCUS software and American Fundware. The consultant will

- (i) enhance the FMIS enabling it to incorporate the necessary capacities for performance management, importing data from the BPS;
- (ii) develop a facility to enable the FMIS to export data to the BPS;
- (iii) provide the basis for accurate and regular reporting on expenditures against performance targets;
- (iv) develop a proper tracking and reporting format; and
- (v) liaise with the BPS specialist to ensure successful interfacing of the two systems.

**4. Financial and Performance Management Training Specialist(s)
(5 person-months)**

7. The specialist(s) should have an excellent knowledge of performance budgeting and management and be a proven management trainer. Previous work in the FSM on this topic, although not a prerequisite, is desired. Building on the audit and assessment carried out in the initial part of this TA, the consultant(s) will

- (i) develop training materials in accordance with the new business processes, systems, procedures, and HRD requirements determined in step 1;
- (ii) conduct formal training, based on (i) above for targeted individuals and groups in each of the five governments;
- (iii) provide on-the-job training and support to targeted individuals and groups to enhance their capabilities to provide real-time financial information on the basis of the enhanced BPS and FMIS;
- (iv) select a small group of individuals to be trained as trainers using the materials developed in (i) above.

5. Performance Management Specialist (4 person-months)

8. Working with the Office of the President, Department of Finance and Administration, and executive branches in the four state governments, the individual will

- (i) provide ongoing technical capacity-building, advice and support to cabinet members, budget review and management committees, department and division heads, and others in effort to implement regular monitoring and reporting on expenditure and performance targets;
- (ii) assist the Executing Agency in overall coordination of the TA in order to ensure its timely and successful implementation; and
- (i) provide additional training to support implementation of performance management processes and procedures, in collaboration with para. 4 above.

D. Reporting Arrangements

9. The following reports will be prepared by each consultant and submitted to the Office of the President and Secretary of the DOFA of the Government, relevant state officials, and ADB, as follows:

- (i) Inception Reports. Each consultant will prepare a detailed work schedule with measurable outputs for agreement within two weeks of the start of the TA implementation. An inception meeting, if necessary, will be held.
- (ii) Interim Reports. Each consultant will submit monthly progress reports (as appropriate) to compare actual achievement with agreed work schedules.

- (iii) Final Report. A final report will be prepared by each consultant one week before the end of the consultancy. The report set out the agreed work schedule and actual achievement. Final payment will be made when DOFA and ADB sign this report.

COST ESTIMATES AND FINANCING PLAN
(\$)

Item	Foreign Exchange	Local Currency	Total Cost
A. Asian Development Bank Financing^a			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants	285,000		285,000
ii. Domestic Consultants	0		0
b. International and Domestic Travel	35,000	10,000	45,000
c. Reports and Communications	5,000		5,000
d. Training	5,000		5,000
2. Miscellaneous Administration and Support Costs	5,000		5,000
3. Contingencies	5,000		5,000
Subtotal (A)	340,000	10,000	350,000
B. Government Financing			
1. Office Accommodation and Transport		30,000	30,000
2. Remuneration and Per Diem of Counterpart Staff		30,000	30,000
3. Local Travel (Car Hire)		15,000	15,000
4. Others		40,000	40,000
Subtotal (B)		115,000	115,000
Total	340,000	125,000	465,000

^a ADB-funded TA program.

Source: Staff estimates.