

# **Republic of Marshall Islands**

## **PUBLIC FINANCIAL MANAGEMENT REFORM ROADMAP 2014-2016**

**August 2014**

## Foreword by the Minister of Finance

As a government and a fledging nation, the Republic of the Marshall Islands has committed itself to improving public services for all its citizens. In his inaugural address in January 2011, H.E. President Christopher Jorebon Loeak had reminded us of his administration's forward commitment toward improving public service delivery. In presenting this Public Financial Management (PFM) Reform Roadmap, may I once again remind us of this commitment and the need to re-double our efforts to ensure that all citizen of the Republic are enjoying the full benefits our development efforts.

Efficient service delivery and effective poverty reduction rely on a well-functioning PFM system. While effective service delivery requires much more than strong PFM, in particular it relies on sensible sectoral policies and human resources, but once policies and resources are in place it does require systems that deliver funds reliably and on time. For RMI in particular a robust PFM system will catalyse the links amongst national strategies, sectoral policies, human resources, and international standards and requirements.

In this context, I am pleased to share Government's plans to strengthen our PFM systems. For the first time, we have prepared a consolidated reform plan, that identifies priority actions. The PFM Reform Roadmap is ambitious, yet achievable, as it lays out priority targets in a structured manner, one which is cognisant of our resource endowments and our context.

With co-operation of all Government stakeholders, development partners, and civil society, we can effectively implement strategies and meet the performance targets contained in this Plan to ensure prudent use of government's resources and improve service delivery.

The launching of the first PFM Reform Roadmap for RMI cannot happen at a better timing. It parallels the completion of the National Strategic Plan and the second Development Partners Meeting. Thus, the timing of the launch also provides a good opportunity to engage Partners in critiquing some of the concepts and plans contained in the Roadmap. It also provides a good opportunity for partnering on some of the envisaged initiatives.

The Ministry of Finance will continue to play an active role in facilitating sustainable growth and prudent management of financial resources to ensure fiscal stability and at the same time achieve national development goals. As a key step towards a planned reform to necessary areas of PFM, the Ministry presents this PFM Reform Roadmap as a tool to guide implementation. The Roadmap, captures all key aspects of PFM systems and identifies necessary areas for reform, based on priorities set out by the Ministry as well as other line Ministries.

Let me close by thanking the Pacific Financial and Technical Center (PFTAC) and the Pacific Islands Center for Public Administration (PICPA) for their assistance in the framing of the PFM Reform Roadmap.

Kommol-tata.

## Statement of Commitment and Responsibility

We, the key stakeholders of this Public Financial Management (PFM) Roadmap are committed to facilitating and improving the current financial management systems of government to ultimately ensure effective and efficient service delivery to the people of the Republic of Marshall Islands (RMI).

As agents of improvements to our PFM systems we commit to:

- Improving our performance ratings for PFM systems to be measured as part of the Public Expenditure and Financial Accountability (PEFA) Assessment due in 2015;
- Undertaking actions identified in the Roadmap effectively within the context of RMI;
- Being advocates of this Roadmap;
- Incorporating these actions into our annual Program Descriptions for 2013, 2014 and 2015;
- Monitoring and reviewing the PFM Roadmap at regular points during the roadmap's timeframe;
- Facilitating development training and up-skilling programs to improve the financial service capacity of all departments to ensure long-term sustainability of governments' financial services;

We will commit to include this plan of specific actions into our annual Program Descriptions, Program Estimates and associated documents in order to deliver on these agreed actions by the next PEFA assessment in 2015.

Cabinet endorsement as per Cabinet Minute, CM No.???

|                                                                             | Date | Signature |
|-----------------------------------------------------------------------------|------|-----------|
| Minister of Finance                                                         |      |           |
| Secretary of Finance (MOF)                                                  |      |           |
| Assistant Secretary, Budget, International Assistance and Procurement (MOF) |      |           |
| Assistant Secretary, Accounting and Administration (MOF)                    |      |           |
| Assistant Secretary, Revenue (MOF)                                          |      |           |
| Assistant Secretary, Ebeye                                                  |      |           |
| Chief Secretary                                                             |      |           |
| Chair of the Public Service Commission                                      |      |           |

We, the independent government agencies, support and commit to achieving the specific actions allocated to us respectively in the PFM Roadmap:

|                                                      |  |  |
|------------------------------------------------------|--|--|
| Speaker of Nitijela (Parliament)                     |  |  |
| Chair of the Parliamentary Public Accounts Committee |  |  |
| Chair of the Parliamentary Appropriations Committee  |  |  |
| Auditor General                                      |  |  |

## Table of Contents

|                                                                                                |     |
|------------------------------------------------------------------------------------------------|-----|
| Foreword by the President .....                                                                | 2   |
| Foreword by the Minister of Finance.....                                                       | 2   |
| Foreword by the Finance Secretary .....                                                        | 3   |
| Statement of Commitment and Responsibility .....                                               | 4   |
| Acronyms and Abbreviations .....                                                               | 5   |
| Executive Summary .....                                                                        | 6   |
| Introduction.....                                                                              | 12  |
| Context for the PFM Roadmap .....                                                              | 13  |
| Proposed Medium-Term PFM Reform Roadmap for RMI .....                                          | 16  |
| PFM Reform Roadmap – Indicative Resourcing.....                                                | 34  |
| Institutional Arrangements for Leadership and Co-ordination of Roadmap<br>Implementation ..... | 35  |
| Communicating the Roadmap.....                                                                 | 38  |
| <br><b>Annexes</b> .....                                                                       |     |
| Annex A. Linkage between the 2012 PEFA and the PFM Roadmap .....                               | 39  |
| Annex B. Summary of results of the 2012 PEFA.....                                              | 44  |
| Annex C. List of Stakeholders Met.....                                                         | 113 |
| <br><b>Tables</b>                                                                              |     |
| Table 1: Sequencing of PFM Roadmap by PFM Reform Area.....                                     | 12  |
| Table 2: Proposed Medium-Term PFM Reform Roadmap .....                                         | 16  |
| Table 3: RMI: PFM Reform Plan – Indicative Resourcing.....                                     | 34  |
| <br><b>Figures</b>                                                                             |     |
| Figure 1. Proposed Governance structure for PFM Reform Implementation .....                    | 37  |
| <br><b>Boxes</b>                                                                               |     |
| Box.1. Summary of 2012 PEFA Assessment for RMI .....                                           | 15  |

## Acronyms and Abbreviations

|         |                                                                                       |
|---------|---------------------------------------------------------------------------------------|
| ADB     | Asian Development Bank                                                                |
| BCC     | Budget Co-ordinating Committee                                                        |
| CAP     | Comprehensive Adjustment Program (Government expenditure control program)             |
| CG      | Central Government                                                                    |
| CM      | Cabinet Minute (documenting a decision taken by Cabinet)                              |
| CRP     | Comprehensive Recovery Plan                                                           |
| CP      | Cabinet Paper (Proposal presented to Cabinet)                                         |
| EPPSO   | Economic Policy, Planning and Statistics Office (under the President's Office)        |
| FY      | Fiscal year                                                                           |
| GPPO    | Government Public Procurement Office                                                  |
| GRMI    | Government of the Republic of the Marshall Islands                                    |
| IAS     | International Accounting Standards                                                    |
| IFRS    | International Financial Reporting Standards                                           |
| IMF     | International Monetary Fund                                                           |
| ISSAI   | International Standards for Supreme Audit Institutions                                |
| KALGOV  | Kwajalein Atoll Local Government                                                      |
| LG      | Local government                                                                      |
| LRA     | Land Registration Authority                                                           |
| MALGOV  | Majuro Atoll Local Government                                                         |
| MDA     | Management Discussion and Analysis (as used in GRMI audit reports)                    |
| MDA     | Ministries, Departments and Agencies (as used in PEFA Guidelines)                     |
| MEC     | Marshall Islands Electricity Company                                                  |
| MICNGOs | Marshall Islands Council of NGOs                                                      |
| MIRC    | Marshall Islands Revised Code                                                         |
| MISSA   | Marshall Islands Social Security Administration                                       |
| MoF     | Ministry of Finance                                                                   |
| MTBIF   | Medium Term Budget and Investment Framework                                           |
| NDP     | National Development Plan                                                             |
| NA      | Not applicable                                                                        |
| N/A     | Not available                                                                         |
| NR      | Not rated                                                                             |
| OCI     | Office of Compact Implementation                                                      |
| ODA     | Official Development Assistance (as used by OECD-DAC)                                 |
| OIDA    | Office of International Development and Assistance (co-division, with Budget, of MoF) |
| OIEDF   | Outer Islands Economic Development Fund                                               |
| PA      | Personnel Action                                                                      |
| PC      | Procurement Code                                                                      |
| PEFA    | Public Expenditure and Financial Accountability                                       |
| PFM     | Public Financial Management                                                           |
| PFM-PR  | Public Financial Management Performance Report                                        |
| PFTAC   | Pacific Financial Technical Assistance Centre (of the IMF)                            |
| PIFS    | Pacific Islands Forum Secretariat                                                     |
| PO      | Purchase order                                                                        |
| PR      | Purchase requisition                                                                  |
| PSC     | Public Service Commission                                                             |
| PSCROP  | Public Sector Comprehensive Reform Program                                            |
| RMI     | Republic of the Marshall Islands                                                      |
| RMITC   | Republic of Marshall Islands Trust Company (Ship Registry)                            |
| ROC     | Republic of China (Taiwan)                                                            |
| SN      | Sub-national (government)                                                             |
| SOE     | State-owned enterprise                                                                |
| SOP     | Standard Operating Procedures                                                         |
| SPC     | Secretariat of the Pacific Community                                                  |
| TA      | Technical assistance                                                                  |
| TRAM    | Tax and Revenue Reform and Modernisation Commission                                   |
| WAM     | Waan Aelon in Majel (Canoes in the Marshall Islands) – NGO                            |

## Executive Summary

The PFM Roadmap sets out a program of actions to be taken over the medium-term to improve PFM Systems in RMI. The starting point for this analysis was the 2012 Public Expenditure and Financial Accountability (PEFA) study. The PEFA study reviewed the Government's PFM framework, assessed the strengths and weaknesses, and assigned ratings for each PFM area, in accordance with the international PEFA scoring methodology.

The PFM Roadmap was developed through detailed discussions with the key divisions of the Ministry of Finance and related stakeholders including the Chief Secretary, Public Service Commission, Parliamentary Committees, Auditor General, line ministries, local governments, NGOs and civil society.

As a result of the detailed discussions and consultations, the PFM Roadmap Working formulated a comprehensive PFM reform plan comprising thirty components. Twenty-eight of the reform components represent elements of the Government's PFM framework that could be further strengthened and improved, and the last two components – PFM reform project governance and a reform program communications and training strategy – are considered to be critical to support the implementation of the key reform components. A summary of the proposed PFM reform program components is set out below:

### **1. Strengthened PFM Legal and Policy Framework**

- Review of PFM Legislation, with reference to RMI Constitution
- Introduction of PFM regulations
- Finalization and promulgation of PFM Policy and Operations Manual
- Review and updating of PFM systems User Guides

### **2. Improved Budgeting Framework**

- Development of a national strategic plan
- Comprehensive corporate and sector planning processes;
- Linkage of strategic planning documents with budgets
- Closer integration of capital budgeting with recurrent budgets for ongoing operating and maintenance costs.
- Expand Budget classification to include functional and program/outcome/output dimensions. Possibly geographic dimension.
- Improve Budget documentation including budget comparatives, forward year estimates, macroeconomic outlook, macrofiscal targets and strategy, sector strategies, new policy initiatives, savings measures, fiscal risks, commitments, guarantees and other contingent liabilities, program objectives, performance indicators etc.
- Prepare a new schedule to the Budget summarizing funding for each LM and agency from each funding source.
- Prepare a new schedule to the Budget summarizing funding for each LG from each funding source.
- Expanded institutional and transactional coverage of the Budget, including extra-budgetary funds, special revenues and donor projects.
- LM and LG own revenues to be included in budgets and fiscal reports
- Adoption of portfolio budgets.
- Introduction of program budgeting.
- Introduction of a Medium Term budgeting framework.

### **3. Strengthened Accounting Systems**

- A monthly reconciliation checklist of all balance sheet items to be completed each month; some on a quarterly basis.

- Electronic payment of suppliers and employees;
- Automated bank reconciliations;
- Automated age analysis of supplier payment liabilities. Automated reporting of payment arrears.

#### **4. Strengthened Fiscal Reporting**

- Build capacity and systems for automated in-house production of monthly financial reporting;
- Build capacity and systems for automated production of annual financial statements

#### **5. Annual Reporting by LMs**

- Strengthen annual reporting by LMs and agencies: to table an annual report of operations and finances
- Harmonization of Compact reporting with annual reporting to Nitijela.

#### **6. Creation of GRMI Web Portal and webpage for MOF and LMs**

- Creation of GRMI Portal for MOF and LMs.
- Publication of budget and fiscal reports on the MOF webpage

#### **7. Improved Cash Management**

- Build capacity in line departments to do monthly cash flow forecasting of receipts and payments.
- Build an automated cash flow forecasting system, integrated with the core IFMIS. The forecasting system would provide online access to line departments to submit their forecasts, and consolidation and reporting functionality for DFA.
- Review Government account bank overdraft group and group set off arrangements (incl. extra budgetary funds) with transactional banks to ensure that the Government's overnight cash position is maximized;
- build a system to perform a daily consolidation and reporting of the Government's overnight cash position;
- Examine feasibility of maintaining a cash buffer, or automatically linkage to investments account (through overdraft group arrangements ) to provide automatic funding for ST cash deficits and prevent accidental overdraft, and to offset poor forecasting by line departments;
- Examine feasibility of introducing a 30 day payment policy.

#### **8. Strengthened Procurement Management**

- Undertake MAPS assessment (OECD-DAC Methodology for Assessing Procurement Systems).
- LMs and LGs to have online access to view status of individual procurement actions, at each stage of procurement cycle, including requisition, tender, PO/contract, delivery, invoice, payment.
- Need an automated commitment control system to support management and control of budget execution and maintain fiscal discipline.
- LMs and LGs to have online access to view status of each appropriation line: including original budget, revised budget, encumbrances, commitments, deliveries, invoices and payments, and available budget.
- Need automated generation of **recurring POs and payments** – need facility for electronic approval of contracts with fixed recurring payments e.g. landowner payments, leases, cleaning contracts, quarterly drawdowns to LGs etc.
- Configure the electronic purchasing system to record classification of each procurement by procurement category: tender, single supplier, 3 Quotations, minor purchase (<\$500).

- Record supplier performance in the purchasing system. Produce whole-of-Government supplier reports, including top 10 suppliers by value, top ten suppliers by sector, top ten by line item, supplier performance rating, top ten single suppliers by value, single suppliers by sector, by line item etc.
- Review and update procurement procedures manuals.
- Strengthening procurement capacity through LM and LG training on procurement policies and procedures, including procurement planning.
- Publication of procurement plans.
- Publication of contract awards.
- Introduction of independent appeals mechanisms for tenders.
- Linkage between purchasing/payment and taxpayer performance systems, including offset arrangements.

## **9. Improved HR and Payroll Management**

- Undertake a complete establishments audit of all GRMI agency organization structures, duty statements and salary levels
- Review feasibility of using 4Gov to support the Government's HR functions
- Implementation of a new HRMIS – possibly 4Gov?
- Automation of all HRM processes
- Automatic integration/interface between the new HRMIS and the MOF payroll system
- Automated reconciliation each fortnight between the HRMIS and payroll systems
- Payroll audits to be conducted at least every six months

## **10. Implement a Government-wide intranet system for email and automated FMIS/HRMIS workflow**

- Implement GRMI intranet system for email
- Integrate the FMIS (4Gov) and HRMIS systems with the email system to facilitate automated workflow (automatically sending and receiving procurement and HR requests/approvals via email).

## **11. Strengthened Asset Management**

- Strengthen integration/reconciliation between asset registers and FMIS
- Automated asset registration and valuation, and recording of complete life cycle including acquisition, transfers, depreciation, maintenance and disposal.
- Capital planning and budgeting for life cycle management, including asset maintenance, utilization, refurbishment and replacement;

## **12. Strengthened Inventory Management**

- Automated inventory registration and valuation, and recording of complete life cycle including acquisition, transfers, usage and disposal.
- Capital planning and budgeting for life cycle management, including inventory optimal levels, re-order points, aging, utilization etc.

## **13. Automated Costing of Government Outputs, Outcomes and Programs**

- Automated costing of GRMI outputs, outcomes and programs.
- Review accuracy of LM input costs in budget

## **14. Introduction of a performance based management framework**

- Introduction of a performance based management framework, based on program budgeting.

**15. Improved SOE Oversight**

- Improved framework for SOE governance and oversight
- Review structure of Government, including classification of SOEs and Trust Funds.

**16. Improved LG Financial Management**

- Improved financial management of Local Governments

**17. Improving management of GRMI Embassy imprest accounts**

- Develop standardized imprest management arrangements, including Embassy financial management systems, procedures and standard forms.
- All RMI embassies to be trained on new systems, policies and procedures.

**18. Improved Tax Administration**

- Implementation of new taxes (consumption tax, net profits tax, new income tax etc.);
- Undertake a complete survey of all RMI taxpayers and businesses
- Improved taxpayer registration;
- Automation of tax and customs processes;
- Strengthening of tax compliance, tax audit and data matching
- Strengthened tax arrears management
- Enhanced communications and PR strategy
- Introduction of independent tax appeals processes
- Examine feasibility of automated interface between the new tax/customs systems and the 4Gov supplier systems

**19. Strengthened Management of Non-Tax and Special Revenues**

- Review of non tax and special revenue charges
- Should special revenues lapse at year end?
- Revenue sharing arrangements with LMs

**20. Improved Debt Management**

- Review of public debt policy and management framework, including review of loan approval process by SOEs and LGs.
- Undertake debt sustainability analysis
- Closer linkage of debt management with forecasting and accounting processes.

**21. Strengthened management of trust funds and other managed financial investments**

- Undertake review of asset allocation strategy, policy and practice
- Review financial performance of the managed funds
- Implement improved managed framework

**22. Improved management of contingent liabilities**

- Review of policy on contingent liabilities, including loan guarantees to LGs and SOEs, and issuance of indemnities.
- Strengthened registration and control of contingent liabilities.
- Assessment of insurable Government risks and development of policy on insurance of risks.

**23. Review of Social Security framework**

- Review demographic and associated liability forecasts and valuations
- Review asset forecasts and valuations
- Formulate reform options for improving the financial position of the social security system over time

**24. Establish Internal Audit function**

- Establishment of an internal audit function, including performance auditing;
- Establish internal audit charter, establishment of IA Unit, risk management approach, audit program setting, audit committee, reporting, follow-up, produce IA procedures manual etc.

**25. Strengthen External Audit Function**

- Development of the Audit Office performance audit program.
- Gradual increase in scope of compliance and financial audit by Audit Office

**26. Strengthen oversight by Public Accounts Committee**

- Improved effectiveness of the Public Accounts Committee, including hearings and reports on agency compliance, financial sustainability and efficiency and effectiveness of service delivery.

**27. Quarterly follow-up of IA, EA and PAC recommendations**

- Establish secretariat within MOF to support the Audit Findings Resolution Committee
- Quarterly follow-up by MOF of recommendations of internal audit, external audit and PAC

**28. Strengthened Aid Coordination**

- Improved integration of donor project planning and project commitments with central planning and budget processes.
- Improved monthly capture of donor disbursements, including direct payments and in-kind projects.
- Provide a legal mandate through the revised PFM legislation for MOF central coordination of donor projects and funding.

**29. PFM Reform Project Governance**

- Establishment of PFM Reform Program governance and project management arrangements

**30. PFM Reform Communications and training**

- Design and implementation of a PFM Reform Program communications and training strategy

In order to determine the priority of the various planned actions, the PFM Roadmap Working Group used a number of criteria, including the 2012 PEFA assessment, priorities set out in RMI Vision 2018, political priorities, and resource availability. This process identified the highest priority areas for attention over the medium term as well as identifying areas for longer-term attention. The proposed sequencing of the reform program components is set out in Table 1 below.

The PFM Roadmap will be submitted to Cabinet for their guidance and endorsement, and then it will be presented to Parliament for their information. The document will be made public after approval by Cabinet and presentation to Parliament.

**Table 1: Sequencing of PFM Roadmap by PFM Reform Area**

| <b>PFM Reform Component</b>                                                                 | <b>2013</b> | <b>2014</b> | <b>2015</b> | <b>Beyond</b> |
|---------------------------------------------------------------------------------------------|-------------|-------------|-------------|---------------|
| 1. Strengthened PFM Legal and Policy Framework                                              | X           | X           |             |               |
| 2. Improved Budgeting Framework                                                             | X           | X           | X           |               |
| 3. Strengthened Accounting Systems                                                          | X           | X           |             |               |
| 4. Strengthened Fiscal Reporting                                                            | X           |             |             |               |
| 5. Annual Reporting by LMs                                                                  |             | X           |             |               |
| 6. Creation of GRMI Web Portal and MoF/LM webpages                                          | X           |             |             |               |
| 7. Improved Cash Management                                                                 | X           | X           |             |               |
| 8. Strengthened Procurement Management                                                      | X           | X           | X           | X             |
| 9. Improved Payroll Management                                                              | X           | X           |             |               |
| 10. Strengthened Asset Management                                                           | X           | X           |             |               |
| 11. Strengthened Inventory Management                                                       |             |             | X           |               |
| 12. Automated Costing of Government Outputs, Outcomes and Programs                          |             |             | X           |               |
| 13. Introduction of a performance based management framework                                |             |             |             | X             |
| 14. Improved SOE Oversight                                                                  | X           |             |             |               |
| 15. Improved LG Financial Management                                                        | X           | X           |             |               |
| 16. Improved Tax Administration                                                             | X           | X           | X           | X             |
| 17. Improving management of GRMI Embassy imprest accounts                                   | X           |             |             |               |
| 18. Implement a Government-wide intranet system for email and automated FMIS/HRMIS workflow | X           | X           |             |               |
| 19. Strengthened Management of Non-Tax Revenue                                              | X           |             |             |               |
| 20. Improved Debt Management                                                                | X           |             |             |               |
| 21. Strengthened management of trust funds and other managed financial investments          |             |             |             | X             |
| 22. Improved management of contingent liabilities                                           | X           |             |             |               |
| 23. Establish Internal Audit function                                                       |             | X           | X           |               |
| 24. Strengthened External Audit Function                                                    | X           | X           |             |               |
| 25. Review of Social Security framework                                                     | X           |             |             |               |
| 26. Strengthen oversight by Public Accounts Committee                                       | X           | X           |             |               |
| 27. Quarterly follow-up of IA, EA and PAC recommendations                                   | X           | X           |             |               |
| 28. Strengthened Aid Coordination                                                           | X           |             |             |               |
| 29. PFM Reform Project Governance                                                           | X           | X           | X           | X             |
| 30. PFM Reform Communications and Training                                                  | X           | X           | X           | X             |

## Introduction

This PFM Reform Roadmap outlines the actions to be undertaken over the medium term and beyond in order to improve key components of the Government's PFM framework. The proposed actions are linked to the Government's medium-/long-term strategic development plan framework, 'Vision 2018' and other related areas that have been identified as priorities to be achieved.

The Roadmap is based on the Government's 2012 PEFA assessment which identifies the strengths and weaknesses of the PFM systems. . It provides stakeholders with a transparent and prioritized path to achieving improved PFM outcomes, through strengthening the underlying PFM systems, with the ultimate objective of improving outcomes for service delivery and development. In this way, a PFM Roadmap provides a bridge between the strengths and weaknesses in a PEFA assessment and implementation of PFM reforms.

While the PEFA shows a snapshot of a country's PFM systems, it is not a menu for reform, not least because it is not linked to a country's broader priorities and strategies. A PFM reform roadmap is important since efficient and effective PFM systems are crucial to achieving both macro-fiscal stability and service delivery objectives and commitments, including Millennium Development Goals and national development goals. In other words, strong PFM systems can encourage growth and reduce poverty.

In addition, better PFM is essential for increased budget support. For RMI, the large flow of Compact funding support underscores the need for strengthening PFM. The roadmap can also facilitate government's dialogue with development partners on the reform program.

### Approach

The steps and analysis that were undertaken in formulating the roadmap include the bottom-up approach, top-down approach, and the finalization of priorities. The bottom-up approach required respective Departments within MOF analysing their main weaknesses, underlying causes, including determining whether these issues were under their control or outside their control, assessing capacity to address the issues, prioritizing and sequencing the actions, policy actions, and the risks associated in achieving their planned outputs.

The top-down approach involved the assessment of linkages of PFM weaknesses to Vision 2018, other Government priorities, linkages to other PFM areas, and consideration to PFM indicators with low PEFA scores.

Extensive consultations were conducted with stakeholders from the Ministry of Finance, line ministries and civil society as the roadmap was drafted. The final prioritization includes consideration at technical, senior executive and political levels on the final list of PFM priorities. Stakeholders consulted are listed in Annex C.

In each of the PFM areas in the PEFA assessment, stakeholders reviewed the results and used them as the basis for an analysis of the underlying causes for the weaknesses identified. The extent of capacities available to address the weaknesses and other issues affecting sequencing were also assessed. From these analyses, stakeholders agreed on specific reform actions which would need to be undertaken to address each weakness.

The PFM reform roadmap reflects the likely extent of reform that will be achievable taking account of competing priorities and resource availability. The extensive discussions with key

stakeholders assisted to form realistic targets and expectations, and account for local capacity to achieve sustainable results. A key feature of the PFM reform roadmap was to identify, and account for, the likely human and financial resources likely to be available to support PFM reforms across the Ministry of Finance and involved line agencies and development partners. Additional factors such as time taken to progress change through government's decision making processes, e.g. powers vested with the Secretary of Finance to implement change will be relatively a shorter process compared to those tasks that require political or parliamentary approvals.

As noted in the 2012 PEFA report, for the successful implementation of the reform program, the buy-in and involvement of stakeholders in the PFM system is crucial. More so, critical factors for successful reforms include: (i) consensus on the appropriate level of reforms and identification of what specific measures will be required, and in what order they should be undertaken, to strengthen existing PFM systems; (ii) visible and active top management and political support for reforms; (iii) government ownership of the reform process; and (iv) cross-cutting elements, such as sufficient physical and human resource capacities, including access to trained financial expertise.

## **Context for a PFM Roadmap**

The Government's medium-/long-term strategic development plan framework, "Vision 2018", includes governance, strengthening the financial and fiscal situation, and improving resource allocation as three of its key broad strategies. In conjunction with this plan, the Government is undertaking a number of PFM reform measures. Short-term measures are mainly centred on budget policy, including reductions in the wage bill and measures to increase domestic revenue. Longer-term systemic changes include performance-based budgeting for the Compact ministries (e.g. education), and strengthening of external audit. The strengths and weaknesses identified by the 2012 PEFA assessment provided the starting point for preparation of the PFM roadmap.

The primary strengths in PFM systems were identified as: (i) adherence to budget discipline at the aggregate level; (ii) transparency of inter-governmental fiscal relations; (iii) orderliness and participation in the annual budget process and (iv) predictable amounts of direct budget support provided by external development partners.

The major challenges which were highlighted included: (i) non-timely issuance of in-year budget execution reports and annual financial statements and the consequential effect on the timeliness of annual audits; (ii) timeliness in reconciling accounts; (iii) weaknesses in payroll and other internal expenditure controls; (iv) limited follow-up by the audited entities to audit and PAC recommendations; (v) weak relationship between planning and budgeting; (vi) limited consultation for budget preparation and policy planning; (vii) limited tax compliance and enforcement; and (viii) lack of monitoring of potential fiscal risk.

A summary of the results is shown in Box 1.

## Box 1 – Summary of 2012 PEFA Assessment for RMI

### Summary of 2012 PEFA Assessments for RMI

The indicators that showed the weakest PFM performance (score D, D+) were:

- Composition of expenditure out-turn compared to original approved budget (PI-2)
- Classification of the budget (PI-5)
- Comprehensiveness of information included in budget documentation (PI-6)
- Extent of unreported government operations (PI-7)
- Oversight of aggregate fiscal risk from other public sector entities (PI-9)
- Public access to key fiscal information (PI-10)
- Multi-year perspective in fiscal planning, expenditure policy and budgeting (PI-12)
- Transparency of taxpayer obligations and liabilities (PI-13)
- Predictability in the availability of funds for commitment of expenditures (PI-16)
- Recording and management of cash balances, debt and guarantees (PI-17)
- Effectiveness of payroll controls (PI-18)
- Transparency, competition and complaints mechanism in procurement (PI-19)
- Effectiveness of internal controls for non-salary expenditure (PI-20)
- Effectiveness of internal audit (PI-21)
- Timeliness and regularity of accounts reconciliation (PI-22)
- Quality and timeliness of in-year budget reports (PI-24)
- Availability of information on resources received by service delivery units (PI-23)
- Legislative scrutiny of the annual budget law (PI-27)
- Financial information provided by donors for budgeting and reporting on project and program aid (D-2)
- Proportion of aid that is managed by use of national procedures (D-3)

The indicators that indicated weak PFM performance (score C, C+) were:

- Scope, nature and follow-up of audit (PI-26)
- Legislative scrutiny of external audit reports (PI-28)

The indicators that were found as having above-average PFM performance (score B, B+) were:

- Aggregate expenditure out-turn compared to original approved budget (PI-1)
- Aggregate revenue out-turn compared to original approved budget (PI-3)
- Transparency of inter-governmental fiscal relations (PI-8)
- Orderliness and participation in the annual budget process (PI-11)

The indicators that suggested the strongest PFM performance (score A) were:

- Donor predictability of Direct Budget Support (D-1)

The following indicators were shown as Not Rated (N/R):

- Stock and monitoring of expenditure payment arrears (PI-4)
- Effectiveness of measures for taxpayer registration and tax assessment (PI-14)
- Effectiveness in collection of tax payments (PI-15)
- Quality and timeliness of annual financial statements (PI-25)

## Proposed Medium-Term PFM Reform Roadmap for RMI

The PFM Roadmap Working Group formulated a proposed timeframe for the implementation of the key activities within each of the thirty PFM reform components. The proposed sequencing of the key activities within each of the reform components is set out in Table 2 below:

**Table2. RMI: Three-Year PPFM Reform Plan**

| Action                                                |                                                                                                                                                                                                                                                                      | 2013             | 2014     | 2015            | Beyond 2015 |
|-------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|----------|-----------------|-------------|
| <b>1. Strengthened PFM Legal and Policy Framework</b> |                                                                                                                                                                                                                                                                      |                  |          |                 |             |
| 1.                                                    | Review of PFM Legislation                                                                                                                                                                                                                                            | <b>X</b>         |          | <b>TA</b>       |             |
| 2.                                                    | Introduction of PFM regulations, including Fiscal Responsibility Regulations                                                                                                                                                                                         | <b>X</b>         | <b>X</b> | <b>TA (ADB)</b> |             |
| 3.                                                    | Finalization and promulgation of PFM Policy and Operations Manual                                                                                                                                                                                                    | <b>X</b>         | <b>X</b> |                 |             |
| 4.                                                    | Review and updating of PFM systems User Guides                                                                                                                                                                                                                       | <b>X</b>         | <b>X</b> |                 |             |
| <b>2. Improved Budgeting Framework</b>                |                                                                                                                                                                                                                                                                      |                  |          |                 |             |
| 1.                                                    | Development of a national strategic plan                                                                                                                                                                                                                             | <b>X (TA)</b>    |          |                 |             |
| 2.                                                    | Introduce comprehensive corporate and sector planning processes                                                                                                                                                                                                      | <b>X (TA)</b>    | <b>X</b> |                 |             |
| 3.                                                    | Linkage of strategic planning documents with budgets                                                                                                                                                                                                                 | <b>X</b>         | <b>X</b> |                 |             |
| 4.                                                    | Integrate investment and recurrent budgets                                                                                                                                                                                                                           | <b>X</b>         | <b>X</b> |                 |             |
| 5.                                                    | Implement Fiscal Responsibility Act                                                                                                                                                                                                                                  | <b>X (TA)ADB</b> |          |                 |             |
| 6.                                                    | Expand Budget classification to include functional and program/outcome/output dimensions. Possibly geographic dimension                                                                                                                                              | <b>X</b>         | <b>X</b> |                 |             |
| 7.                                                    | Improve Budget documentation including budget comparatives, forward year estimates, macroeconomic outlook, macrofiscal targets and strategy, sector strategies, new policy initiatives, savings measures, fiscal risks, commitments, guarantees and other contingent | <b>X</b>         | <b>X</b> |                 |             |

| Action                                    |                                                                                                                                             | 2013 | 2014 | 2015 | Beyond 2015 |
|-------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------|------|------|------|-------------|
|                                           | liabilities, program objectives, performance indicators etc.                                                                                |      |      |      |             |
| 8.                                        | Prepare a new schedule to the Budget summarizing funding for each LM and agency from each funding source.                                   | X    |      |      |             |
| 9.                                        | Prepare a new schedule to the Budget summarizing funding for each LG from each funding source, including own revenues.                      | X    |      |      |             |
| 10.                                       | Expanded institutional coverage of the Budget, including extra-budgetary funds and accounts.                                                | X    | X    |      |             |
| 11.                                       | Introduce Portfolio budgeting across GRMI                                                                                                   | X    |      |      |             |
| 12.                                       | LM and LG special and non-tax revenues to be included in budgets and fiscal reports                                                         | X    |      |      |             |
| 13.                                       | Introduction of a medium-term budgeting framework                                                                                           |      |      | X    | X           |
| <b>3. Strengthened Accounting Systems</b> |                                                                                                                                             |      |      |      |             |
| 1.                                        | A monthly reconciliation checklist of all balance sheet items to be completed each month                                                    | X    |      |      |             |
| 2.                                        | Electronic payment of suppliers and employees                                                                                               | X    | X    |      |             |
| 3.                                        | Automated bank reconciliations                                                                                                              | X    |      |      |             |
| 4.                                        | Payment arrears recording and reporting                                                                                                     | X    |      |      |             |
| <b>4. Strengthened Fiscal Reporting</b>   |                                                                                                                                             |      |      |      |             |
| 1.                                        | Build capacity and systems for automated in-house production of monthly financial reporting                                                 | X    |      |      |             |
| 2.                                        | Build capacity and systems for automated production of annual financial statements                                                          | X    |      |      |             |
| 3.                                        | Include all extra-budgetary entities and transactions in fiscal reports, including SAGAs, trust accounts, special funds and donor projects. |      |      |      |             |

| Action                                        |                                                                                                                                                                                                                                               | 2013     | 2014     | 2015 | Beyond 2015 |
|-----------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|------|-------------|
| <b>5. Annual Reporting by LMs</b>             |                                                                                                                                                                                                                                               |          |          |      |             |
| 1.                                            | All LMs and agencies to table an annual report of operations and finances                                                                                                                                                                     |          | <b>X</b> |      |             |
| <b>6. Creation of GRMI Website and Portal</b> |                                                                                                                                                                                                                                               |          |          |      |             |
| 1.                                            | Creation of GRMI Portal for MOF and LMs.                                                                                                                                                                                                      |          |          |      |             |
| 2.                                            | Creation of a MOF webpage on the GRMI Portal                                                                                                                                                                                                  |          |          |      |             |
| 3.                                            | Publication of budget circulars, budget documents, fiscal reports, financial regulations, PFM policies and procedures and other information on the MOF website                                                                                |          |          |      |             |
| <b>7. Improved Cash Management</b>            |                                                                                                                                                                                                                                               |          |          |      |             |
| 1.                                            | Build capacity in line Ministries to do monthly cash flow forecasting of receipts and payments.                                                                                                                                               | <b>X</b> | <b>X</b> |      |             |
| 2.                                            | Build an automated cash flow forecasting system, integrated with the core IFMIS.<br>- The forecasting system would provide online access to line departments to submit their forecasts, and consolidation and reporting functionality for DFA | <b>X</b> | <b>X</b> |      |             |
| 3.                                            | Review Government bank account group and set off arrangements (incl. extra budgetary funds) with the transactional banks to ensure that the Government's overnight cash position is maximized                                                 | <b>X</b> |          |      |             |
| 4.                                            | Build a system to perform a daily consolidation and reporting of the Government's                                                                                                                                                             | <b>X</b> |          |      |             |

| Action                                        |                                                                                                                                                                                                                                                                                 | 2013   | 2014 | 2015 | Beyond 2015 |
|-----------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|------|------|-------------|
|                                               | overnight cash position                                                                                                                                                                                                                                                         |        |      |      |             |
| 5.                                            | Examine feasibility of maintaining a cash buffer, or automatically linkage to investments account (through overdraft group arrangements) to provide automatic funding for ST cash deficits and prevent accidental overdraft, and to offset poor forecasting by line departments | X      |      |      |             |
| 6.                                            | Examine feasibility of introducing a 30 day payment policy                                                                                                                                                                                                                      | X      |      |      |             |
| <b>8. Strengthened Procurement Management</b> |                                                                                                                                                                                                                                                                                 |        |      |      |             |
| 1.                                            | LMs and LGs to have online access to view status of individual procurement actions, at each stage of procurement cycle.                                                                                                                                                         | X      | X    |      |             |
| 2.                                            | Need automated generation of <b>recurring POs and payments</b> – need facility for electronic approval of contracts with fixed recurring payments e.g. landowner payments, leases, cleaning contracts, quarterly drawdowns to LGs etc.                                          | X      | X    |      |             |
| 4.                                            | Need an automated commitment control system to support management and control of budget execution and maintain fiscal discipline.                                                                                                                                               | X      |      |      |             |
| 5.                                            | LMs and LGs to have online access to view status of each budget line: including original budget, revised budget, encumbrances, commitments, deliveries, invoices and payments, and available budget.                                                                            | X      |      |      |             |
| 6.                                            | Undertake MAPS assessment (OECD-DAC Methodology for Assessing Procurement                                                                                                                                                                                                       | X (TA) |      |      |             |

| <b>Action</b>                         |                                                                                                                                                                                                                                                                                                             | <b>2013</b>   | <b>2014</b>   | <b>2015</b> | <b>Beyond 2015</b> |
|---------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|---------------|-------------|--------------------|
|                                       | Systems).                                                                                                                                                                                                                                                                                                   |               |               |             |                    |
| 7.                                    | Configure the electronic purchasing system to record classification of each procurement by procurement category: tender, single supplier, 3 Quotations, minor purchase (<\$500).                                                                                                                            | <b>X</b>      |               |             |                    |
| 8.                                    | Record supplier performance in the purchasing system. Produce whole-of-Government supplier reports, including top 10 suppliers by value, top ten suppliers by sector, top ten by line item, supplier performance rating, top ten single suppliers by value, single suppliers by sector, by line item etc.   | <b>X</b>      |               |             |                    |
| 9.                                    | Strengthening of procurement capacity through LM and LG procurement training and updated procurement procedures manuals.                                                                                                                                                                                    | <b>X</b>      | <b>X</b>      |             |                    |
| 10.                                   | Publication of contract awards                                                                                                                                                                                                                                                                              | <b>X</b>      |               |             |                    |
| 11.                                   | Publication of procurement plans                                                                                                                                                                                                                                                                            | <b>X</b>      |               |             |                    |
| 12.                                   | Introduction of appeals mechanisms for tenders.                                                                                                                                                                                                                                                             |               |               |             | <b>X</b>           |
| <b>9. Improved Payroll Management</b> |                                                                                                                                                                                                                                                                                                             |               |               |             |                    |
| 1.                                    | Undertake a complete establishments audit of all GRMI agency organization structures, duty statements and salary levels                                                                                                                                                                                     | <b>X (TA)</b> | <b>X (TA)</b> |             |                    |
| 2.                                    | Review feasibility of using 4Gov to support the Government's HR functions                                                                                                                                                                                                                                   | <b>X</b>      |               |             |                    |
| 3.                                    | Implementation of an HRMIS. The HRMIS should automate all standard HRM processes and support the following functions: <ul style="list-style-type: none"> <li>• Establishments and duties</li> <li>• Vacancies, applications and recruitment</li> <li>• Salary and allowances</li> <li>• Overtime</li> </ul> | <b>X (TA)</b> | <b>X (TA)</b> |             |                    |

| Action                                                                                                        |                                                                                                                                                                                                                                                                                                                                                    | 2013 | 2014 | 2015 | Beyond 2015 |
|---------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|------|------|-------------|
|                                                                                                               | <ul style="list-style-type: none"> <li>Higher duties allowance</li> <li>Leave entitlements</li> <li>Superannuation and pensions</li> <li>Workers compensation</li> <li>Promotions and salary increments</li> <li>Transfers</li> <li>Training and development</li> <li>Performance contracts and appraisal</li> <li>Succession planning.</li> </ul> |      |      |      |             |
| 4.                                                                                                            | Automatic integration/interface between the HRMIS and the MOF payroll and accounting systems                                                                                                                                                                                                                                                       | X    | X    |      |             |
| 5.                                                                                                            | Automated reconciliation each fortnight between the HRMIS and MOF payroll/accounting systems                                                                                                                                                                                                                                                       | X    | X    |      |             |
| 6.                                                                                                            | Payroll audits to be conducted at least every six months                                                                                                                                                                                                                                                                                           |      | X    | X    |             |
| <b>10. Implement a Government-wide intranet system for email and automated FMIS/HRMIS workflow management</b> |                                                                                                                                                                                                                                                                                                                                                    |      |      |      |             |
| 1.                                                                                                            | Implement GRMI intranet system for email                                                                                                                                                                                                                                                                                                           | X    |      |      |             |
| 2.                                                                                                            | Integrate the FMIS (4Gov) and HRMIS systems with the email system to facilitate automated workflow (automatically sending and receiving procurement and HR requests/approvals via email).                                                                                                                                                          | X    | X    |      |             |
| <b>11. Strengthened Asset Management</b>                                                                      |                                                                                                                                                                                                                                                                                                                                                    |      |      |      |             |
| 1.                                                                                                            | Automated asset registration and valuation, and recording of complete life cycle including acquisition, transfers, depreciation, maintenance and disposal.                                                                                                                                                                                         | X    | X    |      |             |

| Action                                                                    |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 | 2013 | 2014   | 2015 | Beyond 2015 |
|---------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|--------|------|-------------|
| 2.                                                                        | Examine feasibility of using 4Gov FA module                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                     | X    |        |      |             |
| 3.                                                                        | Capital planning and budgeting for life cycle management, including asset maintenance, utilization, refurbishment and replacement                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                               |      | X (TA) |      |             |
| <b>12. Strengthened Inventory Management</b>                              |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |      |        |      |             |
| 1.                                                                        | Automated inventory registration and valuation, and recording of complete life cycle including acquisition, transfers, usage and disposal.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |      |        | X    |             |
| 2.                                                                        | Capital planning and budgeting for life cycle management, including inventory optimal levels, re-order points, aging, utilization etc.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                          |      |        | X    |             |
| <b>13. Automated Costing of Government Outputs, Outcomes and Programs</b> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |      |        |      |             |
| 1.                                                                        | <p>To provide the tools needed by LMs to undertake automated Program Costing (costing of Programs, Outcomes, Outputs, Activities etc.) using primary and secondary cost allocation methods:</p> <ol style="list-style-type: none"> <li>1. Develop Program Costing (PC) implementation plan.</li> <li>2. Confirm agreed Program Costing policies and methodologies, including agreed cost center structures, agreed cost drivers for allocation of LM support services and overheads, cost absorption methodologies, maintenance of primary and secondary cost views etc.</li> <li>3. Document PC functional and technical requirements.</li> <li>4. Develop and document PC system design.</li> <li>5. Undertake PC system configuration.</li> <li>6. Undertake testing of PC system.</li> <li>7. Document PC system</li> </ol> |      |        | X    |             |

| <b>Action</b>                                                       |                                                                                                                                                              | <b>2013</b> | <b>2014</b> | <b>2015</b> | <b>Beyond 2015</b> |
|---------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|-------------|--------------------|
|                                                                     | policies and procedures.<br>8. Conduct user training.                                                                                                        |             |             |             |                    |
| <b>14. Introduction of a Performance Based Management Framework</b> |                                                                                                                                                              |             |             |             |                    |
| 1.                                                                  | Establish Performance Management Framework Working Group.                                                                                                    |             |             |             | <b>X</b>           |
| 2.                                                                  | Formulate and validate program structure for each LM.                                                                                                        |             |             |             | <b>X</b>           |
| 3.                                                                  | Formulation and validation of metric performance indicators for each LM program.                                                                             |             |             |             | <b>X</b>           |
| 4.                                                                  | Assign accountability for LM Program delivery (Outcomes, Outputs and Activities) to responsible organizational units within each LM.                         |             |             |             | <b>X</b>           |
| 5.                                                                  | For each LM Program, agree on methodology for collection and validation of non-financial performance data.                                                   |             |             |             | <b>X</b>           |
| 6.                                                                  | Formulate and sign performance agreements.                                                                                                                   |             |             |             | <b>X</b>           |
| 7.                                                                  | Put in place formal systems for collection, validation and reporting of non-financial performance data.                                                      |             |             |             | <b>X</b>           |
| 8.                                                                  | At the end of each year, assist LMs to prepare and publish a formal report of their activities and performance for the year, including financial statements. |             |             |             | <b>X</b>           |
| 9.                                                                  | MOF to undertake regular and special Public Expenditure Reviews (PERs) to assess efficiency and effectiveness of LM Programs.                                |             |             |             | <b>X</b>           |
| 10.                                                                 | Internal Audit function to undertake performance audits of MDA                                                                                               |             |             |             | <b>X</b>           |
| 11.                                                                 | Central Audit Agency to further develop formal performance audit function                                                                                    |             |             |             | <b>X</b>           |
| 12.                                                                 | Provide guidance to Parliamentary Committees overseeing public financial management and the Budget to conduct inquiries into MDA                             |             |             |             | <b>X</b>           |

| Action                            |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  | 2013     | 2014     | 2015 | Beyond 2015 |
|-----------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|----------|------|-------------|
|                                   | Program performance, using the performance plans published in the MDA PBSs and the MDA Annual Reports of operational performance and results.                                                                                                                                                                                                                                                                                                                                                                                                                                    |          |          |      |             |
| 13.                               | Establish framework for MOF to carry out a quarterly follow up of MDA implementation of CAA performance audit recommendations.                                                                                                                                                                                                                                                                                                                                                                                                                                                   |          |          |      | <b>X</b>    |
| 14.                               | MOF to use LM performance information to assist with budget allocation decisions during the Budget formulation process.                                                                                                                                                                                                                                                                                                                                                                                                                                                          |          |          |      | <b>X</b>    |
| <b>15. Improved SOE Oversight</b> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |          |          |      |             |
| 1.                                | <p>MOF to establish an SOE Oversight Unit to provide advice to the RMI Government on SOE performance management.</p> <p>The Unit's primary tasks in relation to SOEs would be to:</p> <ul style="list-style-type: none"> <li>• provide strategic and analytical advice, by engaging with the SOEs, analysing their operations and their environment, and consulting with stakeholders;</li> <li>• action the Government's decisions on SOEs including communicating objectives; and</li> <li>• ensure that there is a robust and sound governance framework in place.</li> </ul> | <b>X</b> |          |      |             |
| 2.                                | MOF to put in place strengthened framework for SOE governance and oversight, including corporate governance policies, performance policy and targets, financial policy, dividend policy, risk                                                                                                                                                                                                                                                                                                                                                                                    | <b>X</b> | <b>X</b> |      |             |

| <b>Action</b> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                   | <b>2013</b> | <b>2014</b> | <b>2015</b> | <b>Beyond 2015</b> |
|---------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|-------------|--------------------|
|               | management, reporting, monitoring and evaluation and accountability.                                                                                                                                                                                                                                                                                                                                                                                                                                              |             |             |             |                    |
| 3.            | MOF to produce SOE performance management manual and guidelines for reviewing PE operating and capital budgets and financial statements, evaluating PE financial performance, capital structure, corporate governance, risk management etc.                                                                                                                                                                                                                                                                       | <b>X</b>    |             |             |                    |
| 4.            | <p>To enable greater public accountability, SOEs will be required to prepare an annual corporate plan in consultation with Shareholder Ministers.</p> <ul style="list-style-type: none"> <li>- The corporate plan will focus on the purpose and corporate outlook of an SOE, and expresses the plans of its management in relation to future financial and non-financial performance.</li> </ul>                                                                                                                  | <b>X</b>    | <b>X</b>    |             |                    |
| 5.            | <p>MOF to put in place an improved framework for reporting and oversight of the financial and non-financial performance of the GBE; including reporting and accountability arrangements that facilitate active oversight by the shareholder;</p> <p>Under the accountability framework:</p> <ul style="list-style-type: none"> <li>• SOE management autonomy will be balanced with regular reporting of performance to shareholders; and</li> <li>• SOE boards are accountable to shareholders for SOE</li> </ul> | <b>X</b>    | <b>X</b>    |             |                    |

| Action                                                           |                                                                                                                                                                                              | 2013 | 2014 | 2015 | Beyond 2015 |
|------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------|------|------|-------------|
|                                                                  | performance, and shareholders are accountable to Parliament and the public.                                                                                                                  |      |      |      |             |
| <b>16. Improved LG Financial Management and Embassies</b>        |                                                                                                                                                                                              |      |      |      |             |
| 1.                                                               | Establish Local Administration and Embassy Financial Management Reform Working Group                                                                                                         | X    |      |      |             |
| 2.                                                               | Put in place the technical platform required to support the implementation of an IFMIS at the LGs and embassies.                                                                             | X    | X    |      |             |
| 3.                                                               | Put in place national and local government communications platforms required to support connectivity of LG financial management systems across Local Administrations and across the country. | X    | X    |      |             |
| 4.                                                               | Organise LG GFMIS implementation teams to undertake IFMIS Certification Training.                                                                                                            | X    | X    |      |             |
| 5.                                                               | Organise LG system administrators to undertake systems administration certification training - Database and Network Management Training.                                                     | X    | X    |      |             |
| 6.                                                               | Design and deliver Advanced Financial Management training program for local administration staff:                                                                                            | X    | X    |      |             |
| 7.                                                               | Enhance capacity in revenue policy and tax administration at LGs                                                                                                                             | X    | X    |      |             |
| <b>17. Improving management of GRMI Embassy Imprest Accounts</b> |                                                                                                                                                                                              |      |      |      |             |
| 1.                                                               | Develop standardized imprest                                                                                                                                                                 | X    | X    |      |             |

| Action                                                |                                                                                                                     | 2013   | 2014 | 2015 | Beyond 2015 |
|-------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------|--------|------|------|-------------|
|                                                       | management arrangements, including Embassy financial management systems, procedures and standard forms.             |        |      |      |             |
| 2.                                                    | All RMI embassies to be trained on new systems, policies and procedures.                                            | X      | X    |      |             |
| <b>18. Improved Tax Administration</b>                |                                                                                                                     |        |      |      |             |
| 1.                                                    | Implementation of new taxes (consumption tax, net profits tax, new income tax etc.)                                 | X (TA) | X    | X    | X           |
| 2.                                                    | Undertake a complete survey of all RMI taxpayers and businesses                                                     | X      |      |      |             |
| 3.                                                    | Improved taxpayer registration                                                                                      | X      |      |      |             |
| 4.                                                    | Automation of tax and customs processes                                                                             | X (TA) | X    |      |             |
| 5.                                                    | Strengthening of tax compliance, tax audit and data matching                                                        | X      | X    | X    | X           |
| 6.                                                    | Strengthened tax arrears management                                                                                 | X      | X    |      |             |
| 7.                                                    | Introduce an independent tax appeals mechanism                                                                      |        |      |      | X           |
| <b>19. Strengthened Management of Non-Tax Revenue</b> |                                                                                                                     |        |      |      |             |
| 1.                                                    | Establish Non Tax Revenue Unit within MOF.                                                                          | X      |      |      |             |
| 2.                                                    | Review legal framework for NTR administration, and amend as required.                                               | X      |      |      |             |
| 3.                                                    | Develop NTR Policies and Operating Guidelines.                                                                      | X (TA) |      |      |             |
| 4.                                                    | Develop standard forms and systems for NTR decision support, including a database of NTR submissions and decisions. | X      |      |      |             |
| 5.                                                    | Develop methodologies and systems for costing of NTR activities.                                                    | X (TA) |      |      |             |
| 6.                                                    | Incorporate detailed NTR data into annual budget estimates and                                                      | X      |      |      |             |

| <b>Action</b> |                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                            | <b>2013</b>   | <b>2014</b>  | <b>2015</b> | <b>Beyond 2015</b> |
|---------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|--------------|-------------|--------------------|
|               | monthly forecasting frameworks and systems.                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |               |              |             |                    |
| 7.            | <p>Make changes to Accounting and Reporting Framework. Changes will include:</p> <ul style="list-style-type: none"> <li>- processes and systems for separate classification of the different categories of NTRs e.g. commercial goods and services, commercial licences, fines and penalties, cost recovery fees, cost recovery levies etc.</li> <li>- processes for accounting and reporting of each individual NTR fee within each LM; and</li> <li>- processes and systems for production of “activity statements” for each NTR, showing activities undertaken, cost and charges collected, and surplus/deficit for each fee within each LM.</li> </ul> | <b>X</b>      |              |             |                    |
| 8.            | <p>Undertake fundamental review of existing NTRSC in accordance with new NTR Policies and guidelines.</p> <p>The review should include:</p> <ol style="list-style-type: none"> <li>a. Determination of scope of activities within LMs and SOEs to be covered by the NTR.</li> <li>b. Assessment of the cost of the chargeable activities to be covered by the NTR.</li> <li>c. Establish policy intent for NTR.</li> <li>d. Determine funding model for each NTR – including determine scope of services to be charged using CR, levies, fines and penalties, general</li> </ol>                                                                           | <b>X (TA)</b> | <b>X(TA)</b> |             |                    |

| <b>Action</b>                       |                                                                                                                                                                                                                                                                                                                                                                                                             | <b>2013</b>   | <b>2014</b> | <b>2015</b> | <b>Beyond 2015</b> |
|-------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|-------------|-------------|--------------------|
|                                     | revenue budget,<br>commercial licences,<br>commercial charges etc.<br>e. Examine case for change in fee structure on basis of cost and policy intent – including efficiency and effectiveness in achieving policy objectives.<br>f. Examine case for abolition of fees.<br>g. Examine case for rationalization of large numbers of small related charges.<br>h. Examine potential for additional NTR bases. |               |             |             |                    |
| 9.                                  | Formulate preliminary proposal for rebased NTR fees across each LM, and projected fiscal impact. Prepare formal NTR statements for each LM.                                                                                                                                                                                                                                                                 | <b>X (TA)</b> | <b>X</b>    |             |                    |
| 10.                                 | For each NTR fee, determine how the recommended adjustment should be implemented e.g. immediately, or phased in over several years.                                                                                                                                                                                                                                                                         | <b>X</b>      | <b>X</b>    |             |                    |
| 11.                                 | Submit fundamental NTR review and price adjustment plan to Cabinet for approval.                                                                                                                                                                                                                                                                                                                            | <b>X</b>      | <b>X</b>    |             |                    |
| 12.                                 | Design and deliver NTR Reform Communications and Training Strategy.                                                                                                                                                                                                                                                                                                                                         | <b>X</b>      | <b>X</b>    |             |                    |
| 13.                                 | Review whether special revenues should lapse at year-end                                                                                                                                                                                                                                                                                                                                                    | <b>X</b>      |             |             |                    |
| 14.                                 | Review revenue sharing arrangements with LMs.                                                                                                                                                                                                                                                                                                                                                               | <b>X</b>      |             |             |                    |
| <b>20. Improved Debt Management</b> |                                                                                                                                                                                                                                                                                                                                                                                                             |               |             |             |                    |
| 1.                                  | Development of public debt policy and management framework                                                                                                                                                                                                                                                                                                                                                  | <b>X (TA)</b> |             |             |                    |
| 2.                                  | Undertake debt sustainability analysis                                                                                                                                                                                                                                                                                                                                                                      | <b>X(TA)</b>  |             |             |                    |

| Action                                                                                    |                                                                                                                                                                                      | 2013   | 2014   | 2015 | Beyond 2015 |
|-------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------|--------|------|-------------|
|                                                                                           |                                                                                                                                                                                      |        |        |      |             |
| 3.                                                                                        | Closer linkage of debt management with forecasting and accounting processes.                                                                                                         | X      |        |      |             |
| <b>21. Strengthened management of trust funds and other managed financial investments</b> |                                                                                                                                                                                      |        |        |      |             |
| 1.                                                                                        | Undertake review of asset allocation strategy, policy and practice.                                                                                                                  |        |        |      | X (TA)      |
| 2.                                                                                        | Review financial performance of the managed funds.                                                                                                                                   |        |        |      | X           |
| 3.                                                                                        | Implement improved managed framework.                                                                                                                                                |        |        |      | X           |
| <b>22. Improved management of contingent liabilities</b>                                  |                                                                                                                                                                                      |        |        |      |             |
| 1.                                                                                        | Review of policy on contingent liabilities, including loan guarantees to LGs and SOEs, and issuance of indemnities.                                                                  | X (TA) |        |      |             |
| 2.                                                                                        | Strengthened registration and control of contingent liabilities.                                                                                                                     | X      |        |      |             |
| 3.                                                                                        | Assessment of insurable Government risks and development of policy on insurance of risks.                                                                                            | X      |        |      |             |
| <b>23. Review of Social Security Framework</b>                                            |                                                                                                                                                                                      |        |        |      |             |
| 1.                                                                                        | Conduct actuarial review of demographic and associated liability forecasts and valuations.                                                                                           |        | X (TA) |      |             |
| 2.                                                                                        | Conduct actuarial review of asset forecasts and valuations.                                                                                                                          |        | X (TA) |      |             |
| 3.                                                                                        | Formulate reform options for improving the financial position of the social security system over time.                                                                               |        | X(TA)  |      |             |
| <b>24. Establish Internal Audit function</b>                                              |                                                                                                                                                                                      |        |        |      |             |
| 1.                                                                                        | Establishment of an internal audit function, including performance auditing                                                                                                          |        | X      | X    |             |
| 2.                                                                                        | Establish internal audit charter, establishment of IA Unit, risk management approach, audit program setting, audit committee, reporting, follow-up, produce IA procedures manual etc |        | X      | X    |             |

| Action                                                           |                                                                                                                                                                                                                                                                                                                       | 2013          | 2014          | 2015 | Beyond 2015 |
|------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------|---------------|------|-------------|
| <b>25. Strengthened External Audit Function</b>                  |                                                                                                                                                                                                                                                                                                                       |               |               |      |             |
| 1.                                                               | Strengthen independence of external audit (strengthen MOF capacity in accounting and financial report production to allow external audit to function independently of GRMI management processes).                                                                                                                     | <b>X</b>      |               |      |             |
| 2.                                                               | Gradually increase institutional scope of Auditor General's audit program                                                                                                                                                                                                                                             | <b>X (TA)</b> | <b>X (TA)</b> |      |             |
| 3.                                                               | Further development of the Audit Office performance audit program                                                                                                                                                                                                                                                     | <b>X</b>      | <b>X</b>      |      |             |
| <b>26. Strengthen oversight by Public Accounts Committee</b>     |                                                                                                                                                                                                                                                                                                                       |               |               |      |             |
| 1.                                                               | Improved effectiveness of the Public Accounts Committee, including hearings and reports on agency compliance, financial sustainability and efficiency and effectiveness of service delivery.                                                                                                                          | <b>X (TA)</b> | <b>X (TA)</b> |      |             |
| 2.                                                               | Establish full-time PAC Secretariat function. Tasks will include planning and supporting an annual program of regular PAC inquiries into the Government's PFM framework and performance by LMs.<br><br>The new secretariat could be initially supported by an attachment from an experienced PAC secretariat officer. |               |               |      |             |
| <b>27. Quarterly follow-up of IA, EA and PAC recommendations</b> |                                                                                                                                                                                                                                                                                                                       |               |               |      |             |
| 1.                                                               | Establish secretariat within MOF to support the Audit Findings Resolution Committee.                                                                                                                                                                                                                                  | <b>X</b>      |               |      |             |
| 2.                                                               | Quarterly follow-up by MOF of recommendations of internal audit, external audit and PAC                                                                                                                                                                                                                               | <b>X</b>      | <b>X</b>      |      |             |
| <b>28. Improved Aid Coordination</b>                             |                                                                                                                                                                                                                                                                                                                       |               |               |      |             |
| 1.                                                               | Improved integration of donor                                                                                                                                                                                                                                                                                         | <b>X</b>      |               |      |             |

| <b>Action</b>                            |                                                                                                                                                                 | <b>2013</b> | <b>2014</b> | <b>2015</b> | <b>Beyond 2015</b> |
|------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------|-------------|-------------|--------------------|
|                                          | project planning and project commitments with central planning and budget processes.                                                                            |             |             |             |                    |
| 2.                                       | Improved monthly capture of donor planned projects, commitments and disbursements, including direct payments and in-kind projects                               | <b>X</b>    | <b>X</b>    |             |                    |
| 3.                                       | Provide a legal mandate through the revised PFM legislation for MOF central coordination of donor projects and funding.                                         | <b>X</b>    |             |             |                    |
| <b>29. PFM Reform Project Governance</b> |                                                                                                                                                                 |             |             |             |                    |
| 1.                                       | Establish PFM Reform Program Steering Committee.                                                                                                                | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 2.                                       | Establish full-time dedicated Project Manager for the PFM Reform Program.                                                                                       | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 3.                                       | Establish Component Working Groups, and Component Implementation Teams.                                                                                         | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 4.                                       | Put in place independent Quality Assurance arrangements                                                                                                         | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 5.                                       | Put in place structures, methodologies and processes for the efficient and effective planning, coordination, oversight and management of the PFM Reform Program | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 6.                                       | Monthly reporting by Project Manager to Steering Committee of overall progress against project targets                                                          | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 7.                                       | Monthly reporting by Component team leaders to Component Working Groups of achievement against project targets.                                                 | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 8.                                       | Quarterly assessment and reporting by the independent quality assurance expert.                                                                                 | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |

| <b>Action</b>                                     |                                                                                                              | <b>2013</b> | <b>2014</b> | <b>2015</b> | <b>Beyond 2015</b> |
|---------------------------------------------------|--------------------------------------------------------------------------------------------------------------|-------------|-------------|-------------|--------------------|
| <b>30. PFM Reform Communications and training</b> |                                                                                                              |             |             |             |                    |
| 1.                                                | Design and implementation of a PFM Reform Program communications and training strategy                       | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 2.                                                | Establishing Communications Unit                                                                             | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 3.                                                | Producing key PFM publications and materials                                                                 | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 4.                                                | Engage key stakeholders at political and executive levels                                                    | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 5.                                                | Engaging senior staff at MoF and line ministries                                                             | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 6.                                                | Raising awareness more broadly of PFM program: objectives and plans: LMs, LGs, Civil Society, donors, media. | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 7.                                                | Conducting workshops and seminars progressively through implementation period                                | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |
| 8.                                                | Designing and updating MoF Website page on PFM Reform Program plans and progress                             | <b>X</b>    | <b>X</b>    | <b>X</b>    | <b>X</b>           |

**Table 3. RMI: PFM Reform Plan – Indicative Resourcing**

|     | Component                                                                                          | Activity | Output | Timeline<br>(36 months) | Input | Unit Cost | Activity<br>Costs | Component<br>costs |
|-----|----------------------------------------------------------------------------------------------------|----------|--------|-------------------------|-------|-----------|-------------------|--------------------|
| 1.  | Strengthened PFM Legal and Policy Framework                                                        |          |        |                         |       |           |                   |                    |
| 2.  | Improved Budgeting Framework                                                                       |          |        |                         |       |           |                   |                    |
| 3.  | Strengthened Accounting Systems                                                                    |          |        |                         |       |           |                   |                    |
| 4.  | Strengthened Fiscal Reporting                                                                      |          |        |                         |       |           |                   |                    |
| 5.  | Annual Reporting by LMs                                                                            |          |        |                         |       |           |                   |                    |
| 6.  | Creation of GRMI Web Portal and MOF Webpage                                                        |          |        |                         |       |           |                   |                    |
| 7.  | Improved Cash Management                                                                           |          |        |                         |       |           |                   |                    |
| 8.  | Strengthened Procurement Management                                                                |          |        |                         |       |           |                   |                    |
| 9.  | Improved Payroll Management                                                                        |          |        |                         |       |           |                   |                    |
| 10  | Implement a Government-wide intranet system for email and automated FMIS/HRMIS workflow management |          |        |                         |       |           |                   |                    |
| 11. | Strengthened asset Management                                                                      |          |        |                         |       |           |                   |                    |
| 12. | Strengthened Inventory Management                                                                  |          |        |                         |       |           |                   |                    |
| 13. | Automated Costing of Government Outputs, Outcomes and Programs                                     |          |        |                         |       |           |                   |                    |
| 14. | Introduction of a performance based management framework                                           |          |        |                         |       |           |                   |                    |
| 15. | Improved SOE Oversight                                                                             |          |        |                         |       |           |                   |                    |
| 16. | Improved LG Financial Management                                                                   |          |        |                         |       |           |                   |                    |
| 17. | Improving management of GRMI Embassy Imprest Accounts                                              |          |        |                         |       |           |                   |                    |
| 18. | Improved Tax Administration                                                                        |          |        |                         |       |           |                   |                    |
| 19. | Strengthened Management of Non-Tax Revenue                                                         |          |        |                         |       |           |                   |                    |
| 20. | Improved Debt Management                                                                           |          |        |                         |       |           |                   |                    |
| 21. | Strengthened management of trust funds and other managed financial investments                     |          |        |                         |       |           |                   |                    |
| 22. | Improved management of contingent liabilities                                                      |          |        |                         |       |           |                   |                    |
| 23. | Review of Social Security Framework                                                                |          |        |                         |       |           |                   |                    |

|     | Component                                             | Activity | Output | Timeline<br>(36 months) | Input | Unit Cost | Activity<br>Costs | Component<br>costs |
|-----|-------------------------------------------------------|----------|--------|-------------------------|-------|-----------|-------------------|--------------------|
| 24. | Establish Internal Audit function                     |          |        |                         |       |           |                   |                    |
| 25. | Strengthened External Audit Function                  |          |        |                         |       |           |                   |                    |
| 26. | Strengthen oversight by Public Accounts Committee     |          |        |                         |       |           |                   |                    |
| 27. | Quarterly follow-up of IA, EA and PAC recommendations |          |        |                         |       |           |                   |                    |
| 28. | Improved capture of Donor Data                        |          |        |                         |       |           |                   |                    |
| 29. | PFM Reform Project Governance                         |          |        |                         |       |           |                   |                    |
| 30. | PFM Reform Communications and training                |          |        |                         |       |           |                   |                    |

## **Institutional Arrangements for Leadership and Co-ordination of Roadmap Implementation**

The PFM Roadmap will be submitted to Cabinet for their endorsement and guidance, and then it will also be presented to Parliament for their information.

A PFM Reform Steering Committee will be formed to lead, co-ordinate and monitor overall progress of the Roadmap. The Steering Committee, similar to the Budget Co-ordinating Committee, will be chaired by the Chief Secretary and will include the following representation: Finance Secretary, Auditor General, and Chair of the Public Service Commission, the Attorney General, and representatives each from the Office of the President and EPPSO. Line ministry representatives from the Ministry of Education, Ministry of Health, Ministry of Foreign Affairs and Ministry of Internal Affairs can be co-opted as needed. The MOF will provide Secretariat support to the Steering Committee. This Committee will meet quarterly and will:

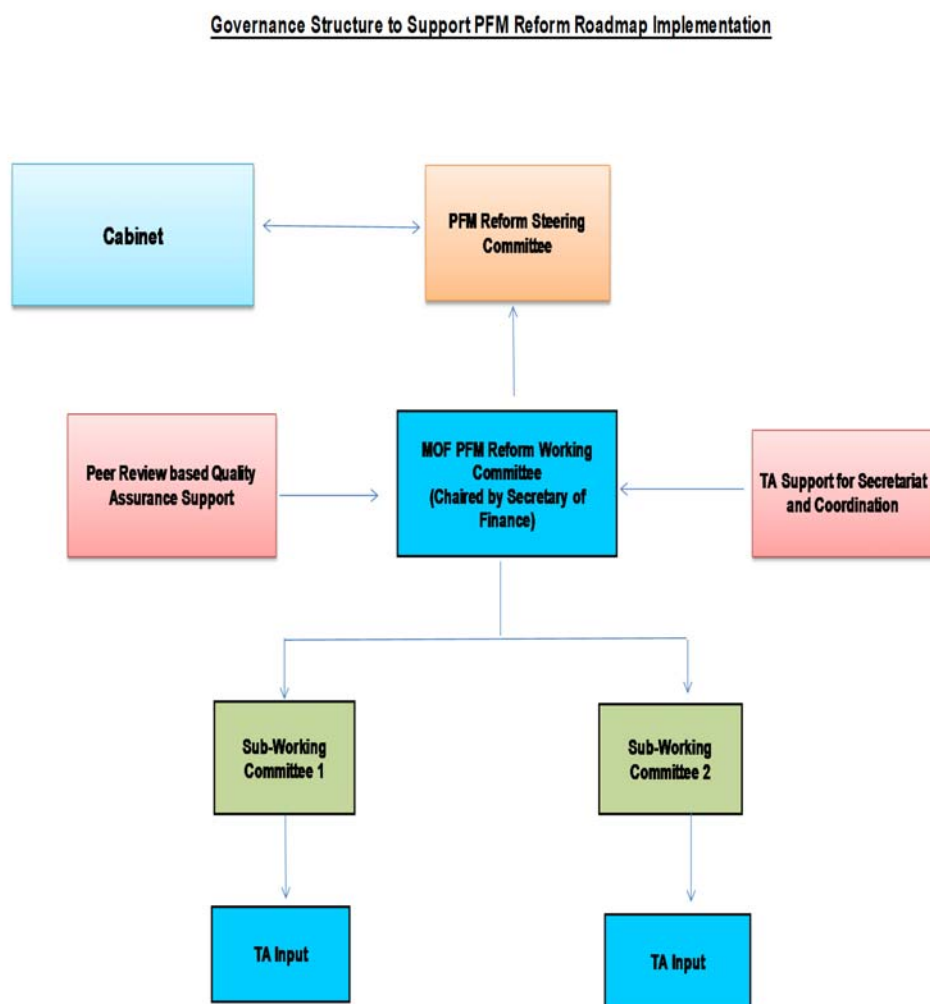
- Review progress reports from the PFM Working Group;
- Advise on policy issues, problems and constraints raised by MoF PFM Reform Working Committee (MOF PFMRWC);
- Review recommendations put forward by the MOF PFMRWC;
- Approve amendments and future phases of the PFM Roadmap;
- Provide guidance and support to the MOF PFMRWC to enable achievement of the Roadmap objectives;
- Assist in identifying additional resources for implementation as required; and
- Ensure the reform work is clearly integrated into, and supportive of, any restructuring and reform programs of government.

A PFM Reform Working Committee chaired by the Secretary of MOF will be responsible for managing the implementation of the PFM Roadmap. The Working Committee will consist of Assistant Secretary of Budget/ OIDA, Assistant Secretary for Tax/Customs/Revenue and Assistant Secretary for Accounting, with relevant consultants/ subject matter experts and other MOF staff co-opted as necessary. This Committee will meet once a month and will:

- Define the actions required for implementation of the PFM Roadmap;
- Maintain work plans and schedules;
- Coordinate access to resources, including facilitating peer review on technical matters as necessary;
- Evaluate the work of consultants;
- Co-ordinate training needs associated with reforms as required;
- Disseminate information to all stakeholders regarding the PFM Roadmap;
- Monitor progress by implementing agencies and advise on action to overcome problems;
- Establish and monitor work of Sub-Working Committee's should they be substantive reform projects. Less complex reforms could be discussed by the MOF PFMRWC without the need for establishing specific Working Committee's; and
- Ensure cohesion and consistency between various initiatives and the effective use of external support to the Roadmap process.

The MOF PFMRWC will require additional support (perhaps a long-term technical assistant) to help co-ordinate and prepare meeting papers and follow-up actions in consultation with Chairperson, the Secretary of Finance. In addition to possible technical assistance support, development partners could also peer review technical outputs as deemed necessary by the MOF PFMRWC. A schematic representation of the governance structure is set out in Figure 1 below.

**Figure 1. Proposed Governance structure for PFM Reform Implementation**



Notes: 1. MoF, Secretariat for PFM Reform Steering Committee

2. Membership of PFM Reform Steering Committee, same as budget Committee and to include relevant Line Ministry representatives.

3. Possible Sub-working Committees could include:

- \*\* Aid coordination;
- \*\* Tax Reform;
- \*\* Accounting, Reporting, FMIS;
- \*\* Procurement;
- \*\* HRMIS/Payroll; and
- \*\* NSDP

4. Sub-Working Committees formed on a needs basis. Straightforward type reform actions could simply be discussed and agreed to at MoF PFM Reform Steering Comr

5. Sub-Working Committee, could be chaired by relevant Assistant Secretaries.

## Communicating the Roadmap

The PFM Roadmap will be a public document. After Cabinet endorses the Roadmap it is planned to table the document in Parliament. The Roadmap will then be available for public consumption.

A crosscutting issue is how to provide widespread public access to PFM documents including the Roadmap. One of the major themes of the Roadmap is increasing transparency of Government PFM through the provision of PFM information including budget and fiscal performance. One of the measures contained in this Roadmap is the creation of a MoF website on which to publish the Roadmap. This website should also be the site for all the public information foreshadowed in the Roadmap.

Regular public relations tasks will also be envisaged during the course of the reforms, with relevant publications and communication material prepared for dissemination.

## Annex A

### Linkage between the 2012 PEFA findings and the PFM Roadmap 2013-2015

A PEFA assessment for RMI was completed in 2012. The PEFA methodology assesses the strengths and weaknesses of the country's PFM framework across 31 indicators, comprising 28 indicators that relate to core PFM functions and three indicators that relate to donor activities. Many of the indicators consist of multiple sub-indicators, and many of the sub-indicators have multiple dimensions.

The PEFA assessment is considered to be a substantive baseline for the development of the PFM Roadmap. The purpose of this section is to show the linkage between weaknesses identified in the 2012 PEFA assessment and the PFM Reform Roadmap 2013-15.

Each of the PEFA areas is set out in Table 4 below. The table shows how the PFM Roadmap will address weaknesses identified within each of the PEFA indicators.

**Table 4. Linkage between the 2012 PEFA findings and the PFM Roadmap**

| PFM Performance Indicator                                              |                                                                                   | Dimension Ratings |    |     |    | Overall Rating | Addressed in Roadmap           |
|------------------------------------------------------------------------|-----------------------------------------------------------------------------------|-------------------|----|-----|----|----------------|--------------------------------|
|                                                                        |                                                                                   | i                 | ii | iii | iv |                |                                |
| PI-1                                                                   | Aggregate expenditure out-turn compared to original approved budget               | B                 |    |     |    | <b>B</b>       | No Action Required             |
| PI-2                                                                   | Composition of expenditure out-turn compared to original approved budget          |                   |    |     |    | <b>D+</b>      |                                |
|                                                                        | (i) Extent of variance in expenditure composition                                 | D                 |    |     |    |                | Components 2, 3, 4, 5, 7 and 8 |
|                                                                        | (ii) Average amount of expenditure charged to the contingency vote                | A                 |    |     |    |                | No Action Required             |
| PI-3                                                                   | Aggregate revenue out-turn compared to original approved budget                   | B                 |    |     |    | <b>B</b>       | No Action Required             |
| PI-4                                                                   | Stock and monitoring of expenditure payment arrears                               |                   |    |     |    | <b>NR</b>      |                                |
|                                                                        | (i) Stock of expenditure payment arrears                                          | NR                |    |     |    |                | Component 3                    |
|                                                                        | (ii) Availability of data for monitoring the stock of expenditure payment arrears | D                 |    |     |    |                | Component 3                    |
| <b>B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency</b> |                                                                                   |                   |    |     |    |                |                                |
| PI-5                                                                   | Classification of the budget                                                      | D                 |    |     |    | <b>D</b>       | Component 2                    |
| PI-6                                                                   | Comprehensiveness of information included in budget documentation                 | D                 |    |     |    | <b>D</b>       | Component 2                    |
| PI-7                                                                   | Extent of unreported government operations                                        |                   |    |     |    | <b>D</b>       |                                |
|                                                                        | (i) Level of extra-budgetary expenditures which is unreported                     | D                 |    |     |    |                | Component 2                    |

|       |                                                                                              |    |  |  |  |           |                        |
|-------|----------------------------------------------------------------------------------------------|----|--|--|--|-----------|------------------------|
|       | (ii) Income/expenditure information on donor-funded projects included in fiscal reports      | D  |  |  |  |           | Components 2, 4 and 28 |
| PI-8  | Transparency of inter-governmental fiscal relations                                          |    |  |  |  | <b>B</b>  |                        |
|       | (i) Transparency and objectivity in the horizontal allocation among sub national governments | A  |  |  |  |           | No action required     |
|       | (ii) Timeliness and reliable information to SN governments on their allocations              | B  |  |  |  |           | No action required     |
|       | (iii) Extent of consolidation of fiscal data for general government                          | D  |  |  |  |           | Component 4            |
| PI-9  | Oversight of aggregate fiscal risk from other public sector entities                         |    |  |  |  | <b>D</b>  |                        |
|       | (i) Extent of central government monitoring of AGAs and PEs                                  | D  |  |  |  |           | Component 15           |
|       | (ii) Extent of central government monitoring of SN governments' fiscal position              | D  |  |  |  |           | Component 16           |
| PI-10 | Public access to key fiscal information                                                      | D  |  |  |  | <b>D</b>  | Component 6            |
| PI-11 | Orderliness and participation in the annual budget process                                   |    |  |  |  | <b>B+</b> |                        |
|       | (i) Existence of and adherence to a fixed budget calendar                                    | C  |  |  |  |           | No action required     |
|       | (ii) Guidance on the preparation of budget submissions                                       | A  |  |  |  |           | No action required     |
|       | (iii) Timely budget approval by the legislature                                              | A  |  |  |  |           | No action required     |
| PI-12 | Multi-year perspective in fiscal planning, expenditure policy and budgeting                  |    |  |  |  | <b>D</b>  |                        |
|       | (i) multi-year fiscal forecasts and functional allocations                                   | D  |  |  |  |           | Component 2            |
|       | (ii) Scope and frequency of debt sustainability analysis                                     | D  |  |  |  |           | Component 20           |
|       | (iii) Existence of costed sector strategies                                                  | D  |  |  |  |           | Component 13           |
|       | (iv) Linkages between investment budgets and forward expenditure estimates                   | D  |  |  |  |           | Component 2            |
| PI-13 | Transparency of taxpayer obligations and liabilities                                         |    |  |  |  | <b>D+</b> |                        |
|       | (i) Clarity and comprehensiveness of tax liabilities                                         | B  |  |  |  |           | Component 18           |
|       | (ii) Taxpayers' access to information on tax liabilities and administrative procedures       | D  |  |  |  |           | Component 18           |
|       | (iii) Existence and functioning of a tax appeals mechanism                                   | D  |  |  |  |           | Component 18           |
| PI-14 | Effectiveness of measures for taxpayer registration and tax assessment                       |    |  |  |  | <b>NR</b> |                        |
|       | (i) Controls in the taxpayer registration system                                             | D  |  |  |  |           | Component 18           |
|       | ii) Effectiveness of penalties for non-compliance with registration and tax declarations     | NR |  |  |  |           | Component 18           |
|       | (iii) Planning and monitoring of tax audit programs                                          | C  |  |  |  |           | Component 18           |
| PI-15 | Effectiveness in collection of tax payments                                                  |    |  |  |  | <b>NR</b> |                        |

|  |                                                                                                                                        |    |  |  |  |  |                    |
|--|----------------------------------------------------------------------------------------------------------------------------------------|----|--|--|--|--|--------------------|
|  | (i) Collection ratio for gross tax arrears                                                                                             | NR |  |  |  |  | Component 18       |
|  | (ii) Effectiveness of transfers of tax collections to the Treasury by the revenue administration                                       | A  |  |  |  |  | No action required |
|  | (iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury | D  |  |  |  |  | Component 18       |

|       | <b>C(ii) Predictability and Control in Budget Execution</b>                                                                   |   |  |  |  |           |                      |
|-------|-------------------------------------------------------------------------------------------------------------------------------|---|--|--|--|-----------|----------------------|
| PI-16 | Predictability in the availability of funds for commitment of expenditures                                                    |   |  |  |  | <b>D</b>  |                      |
|       | (i) Extent to which cash flows are forecast and monitored                                                                     | D |  |  |  |           | Component 7          |
|       | (ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure                              | D |  |  |  |           | Components 7 and 8   |
|       | (iii) Frequency and transparency of adjustments to budget allocations which are decided above the level of management of MDAs | D |  |  |  |           | Components 7 and 8   |
| PI-17 | Recording and management of cash balances, debt and guarantees                                                                |   |  |  |  | <b>D+</b> |                      |
|       | (i) Quality of debt data recording and reporting                                                                              | D |  |  |  |           | Component 20         |
|       | (ii) Extent of consolidation of the government's cash balances                                                                | D |  |  |  |           | Component 7          |
|       | (iii) Systems for contracting loans and issuance of guarantees                                                                | C |  |  |  |           | Components 20 and 22 |
| PI-18 | Effectiveness of payroll controls                                                                                             |   |  |  |  | <b>D+</b> |                      |
|       | (i) Degree of integration and reconciliation between personnel records and payroll data.                                      | D |  |  |  |           | Component 9          |
|       | (ii) Timeliness of changes to personnel records and the payroll                                                               | D |  |  |  |           | Component 9          |
|       | (iii) Internal controls of changes to personnel records and the payroll.                                                      | C |  |  |  |           | Component 9          |
|       | (iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.                                         | D |  |  |  |           | Component 9          |
| PI-19 | Competition, value for money and controls in procurement                                                                      |   |  |  |  | <b>D</b>  |                      |
|       | (i) Transparency, comprehensiveness and competition in the legal and regulatory framework                                     | C |  |  |  |           | Component 8          |
|       | (ii) Use of competitive procurement methods                                                                                   | D |  |  |  |           | Component 8          |
|       | (iii) Public access to complete, reliable and timely procurement information                                                  | D |  |  |  |           | Component 8          |
|       | (iv) Existence of an independent administrative procurement complaints system                                                 | D |  |  |  |           | Component 8          |
| PI-20 | Effectiveness of internal controls for non-salary expenditure                                                                 |   |  |  |  | <b>D+</b> |                      |

|       |                                                                                                  |    |  |  |  |           |                    |
|-------|--------------------------------------------------------------------------------------------------|----|--|--|--|-----------|--------------------|
|       | (i) Effectiveness of expenditure commitment controls.                                            | C  |  |  |  |           | Component 8        |
|       | (ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures. | D  |  |  |  |           | Component 3        |
|       | (iii) Degree of compliance with rules for processing and recording transactions.                 | D  |  |  |  |           | Component 3        |
| PI-21 | Effectiveness of internal audit                                                                  |    |  |  |  | <b>D</b>  |                    |
|       | (i) Coverage and quality of the internal audit function                                          | D  |  |  |  |           | Component 24       |
|       | (ii) Frequency and distribution of reports.                                                      | D  |  |  |  |           | Component 24       |
|       | (iii) Extent of management response to internal audit findings.                                  | D  |  |  |  |           | Component 24       |
|       | <b>C(iii) Accounting, Recording and Reporting</b>                                                |    |  |  |  |           |                    |
| PI-22 | Timeliness and regularity of accounts reconciliation                                             |    |  |  |  | <b>D</b>  |                    |
|       | (i) Regularity of bank reconciliations                                                           | D  |  |  |  |           | Component 3        |
|       | (ii) Regularity of reconciliation and clearance of suspense accounts and advances                | D  |  |  |  |           | Component 3        |
| PI-23 | Availability of information on resources received by service delivery units                      | D  |  |  |  | <b>D</b>  | Component 19       |
| PI-24 | Quality and timeliness of in-year budget reports                                                 |    |  |  |  | <b>D+</b> |                    |
|       | (i) Scope of reports in terms of coverage and compatibility with budget estimates                | B  |  |  |  |           | Component 4        |
|       | (ii) Timeliness of the issue of reports                                                          | D  |  |  |  |           | Component 4        |
|       | (iii) Quality of information                                                                     | C  |  |  |  |           | Component 4        |
| PI-25 | Quality and timeliness of annual financial statements                                            |    |  |  |  | <b>NR</b> |                    |
|       | (i) Completeness of the financial statements                                                     | NR |  |  |  |           | Component 4        |
|       | (ii) Timeliness of submission of the financial statements                                        | B  |  |  |  |           | Component 4        |
|       | (iii) Accounting standards used                                                                  | A  |  |  |  |           | No action required |
|       | <b>C(iv) External Scrutiny and Audit</b>                                                         |    |  |  |  |           |                    |
| PI-26 | Scope, nature and follow-up of external audit                                                    |    |  |  |  | <b>C</b>  |                    |
|       | (i) Scope/nature of audit performed                                                              | C  |  |  |  |           | Component 25       |
|       | (ii) Timeliness of submission of audit reports to legislature                                    | C  |  |  |  |           | Component 25       |
|       | (iii) Evidence of follow-up on audit recommendations                                             | C  |  |  |  |           | Component 25       |
| PI-27 | Legislative scrutiny of the annual budget law                                                    |    |  |  |  | <b>D+</b> |                    |

|                           |                                                                                                                                                                                               |   |  |  |  |    |                    |
|---------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---|--|--|--|----|--------------------|
|                           | (i) Scope of the legislature's scrutiny.                                                                                                                                                      | C |  |  |  |    | No action          |
|                           | (ii) Extent to which the legislature's procedures are well-established and respected.                                                                                                         | C |  |  |  |    | No action          |
|                           | (iii) Adequacy of time for the legislature to provide a response to budget proposals                                                                                                          | C |  |  |  |    | No action          |
|                           | (iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.                                                                                                  | D |  |  |  |    | No action          |
| PI-28                     | Legislative scrutiny of external audit reports                                                                                                                                                |   |  |  |  | C+ |                    |
|                           | (i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years).                                                                         | A |  |  |  |    | Component 26       |
|                           | (ii) Extent of hearings on key findings undertaken by the legislature.                                                                                                                        | B |  |  |  |    | Component 26       |
|                           | (iii) Issuance of recommended actions by the legislature and implementation by the executive.                                                                                                 | C |  |  |  |    | Component 26       |
| <b>D. DONOR PRACTICES</b> |                                                                                                                                                                                               |   |  |  |  |    |                    |
| D-1                       | Predictability of Direct Budget Support                                                                                                                                                       |   |  |  |  | A  |                    |
|                           | (i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature. | A |  |  |  |    | No action required |
|                           | (ii) In-year timeliness of donor disbursements.                                                                                                                                               | A |  |  |  |    | No action required |
| D-2                       | Financial information provided by donors for budgeting and reporting on project and program aid                                                                                               |   |  |  |  | D  |                    |
|                           | (i) Completeness and timeliness of budget estimates by donors for project support                                                                                                             | D |  |  |  |    | Component 28       |
|                           | (ii) Frequency and coverage of reporting by donors on actual donor flows for project support                                                                                                  | D |  |  |  |    | Component 28       |
| D-3                       | Proportion of aid that is managed by use of national procedures                                                                                                                               | D |  |  |  | D  | No action          |

## ANNEX B

### RMI – PEFA 2012: Summary of PFM Performance Indicators

#### Budgeting Credibility

##### PI-1. Aggregate expenditure out-turn compared to original approved budget

###### *The Importance of Aggregate Expenditure Out-turn*

The ability to implement the budgeted expenditure is an important factor in supporting the government's ability to deliver the public services for the year as expressed in policy statements, output commitments and work plans. The indicator reflects this by measuring the actual total expenditure compared to the originally budgeted total expenditure (as defined in government budget documentation and fiscal reports), but excludes two expenditure categories over which the government will have little control. Those categories are:

- a. debt service payments, which in principle the government cannot alter during the year while they may change due to interest and exchange rates movements, and
- b. donor funded project expenditure, the management and reporting of which are typically under the donor agencies' control to a high degree.

###### *Current situation in RMI*

Aggregate expenditures over the past three years have been largely in line with the levels planned in the budget, with only modest differences between the two. This reflects accurate domestic revenue projections and stable levels of external support - mainly reflecting the stability of Compact and other US funding flows. The analysis for fiscal years 2009, 2010 and 2011 shows that at the aggregate level, actual primary expenditure deviated from original budgeted primary expenditure by 6.7%, 5.4% and 10.4% respectively. Debt service payments and externally financed expenditures are excluded from the calculations. It should be noted that while comprehensive information is not available on arrears (see PI-4 below), anecdotal evidence from stakeholder consultations suggests that they are significant. It is possible that the variance between budgeted and actual expenditures would be affected if it were possible to take these into account.

###### *RMI's most recent PI-1 Score:*

RMI's most recent score in this area is set out in Table 1.

**Table 1: Aggregate expenditure out-turn – 2012 PEFA score**

| Indicator                                                                        | Score    | Brief Explanation                                                                                                                                                                                                                                                                                                     |
|----------------------------------------------------------------------------------|----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                          |          |                                                                                                                                                                                                                                                                                                                       |
| <b>PI-1. Aggregate expenditure out-turn compared to original approved budget</b> | <b>B</b> | <p>The percentage deviations between actual and budgeted primary expenditures as a proportion of the original approved budget were:</p> <p>FY09: 6.7%</p> <p>FY10: 5.4%</p> <p>FY11: 10.4%</p> <p>Thus, actual expenditures varied by more than 10% over the original budget in only one of the last three years.</p> |

## **PI-2. Composition of expenditure out-turn compared to original approved budget**

### ***The Importance of Expenditure Composition Out-turn***

Where the composition of expenditure varies considerably from the original budget, the budget will not be a useful statement of policy intent. Measurement against this indicator requires an empirical assessment of expenditure out-turns against the original budget at a sub-aggregate level. As budgets are usually adopted and managed on an administrative (ministry/agency) basis, the administrative basis is preferred for assessment, but a functional basis is an acceptable alternative. At administrative level, variance shall be calculated for the main budgetary heads (votes) of ministries, independent departments and agencies, which are included in the approved budget. If functional classification is used, it should be based on the GFS/COFOG ten main functions.

Changes in overall level of expenditure (assessed in PI-1) will translate into changes in spending for administrative (and functional) budget lines. This indicator (PI-2) measures the extent to which reallocations between budget lines have contributed to variance in expenditure composition beyond the variance resulting from changes in the overall level of expenditure. To make that assessment requires that the total variance in the expenditure composition is calculated and compared to the overall deviation in primary expenditure for each of the last three years.

Variance is calculated as the weighted average deviation between actual and originally budgeted expenditure calculated as a percent of budgeted expenditure on the basis of administrative or functional classification, using the absolute value of deviation. In order to be compatible with the assessment in PI-1, the calculation should exclude debt service and donor funded project expenditure.

### ***Current situation in RMI***

#### ***(i) Extent of variance in expenditure composition***

This sub-dimension assesses the extent to which there is a re-allocation of expenditure among administrative heads (i.e. line ministries), above the overall deviation in aggregate expenditure as defined in PI-1. If the composition of the actual expenditures varies considerably from that appropriated in the original budget, the budget will not be a useful indicator of planning and intent on behalf of RMI. Actual expenditures have differed significantly from those planned in the budget. This most likely reflects weaknesses in expenditure controls, as well as unclear rules for moving expenditures between appropriations, as shown in the rest of Section 3. Specifically, the analysis for FY09, FY10 and FY11 shows that, at the line ministry level, variances in the composition of primary expenditures across budget heads (excluding contingency) amounted to 9.6%, 25.7% and 17.9%, respectively. The same caution about the figures as described in PI-1 applies to the analysis of composition variance.

#### ***(ii) Average amount of expenditure charged to the contingency vote***

Article VIII, Section 9 of the RMI Constitution allows for the establishment of a Contingencies Fund for expenditure of an “urgent and unforeseen” nature. This Section stipulates that use of resources from the Contingencies Fund should be appropriated through a Supplementary Budget or through the next year’s appropriation, and included in the annual accounts. There are no supplementary guidelines for determining what constitutes “urgent and unforeseen”.

In line with the provision in Section 9, the Appropriation Act (FY12) establishes a Contingencies Fund and authorizes up to \$220,000 for inclusion in the Contingencies Fund (to be advanced against the General Fund for purposes of the Contingencies Fund); this is appropriated under the Special Appropriation heading of the General Fund. There is also a contingency fund line established in the Appropriation Act under the Republic of China

(ROC) Capital Project heading. Finally, the Appropriation Act also provides authority for any unanticipated income provided to GRMI during the year for “urgent and unforeseen need” to be added to the Contingencies Fund.

In practice, the contingency fund has not been drawn down during the past three years, with expenditures charged to total contingency averaging less than 1% of total expenditures.

***RMI’s most recent PI-2 Score:***

RMI’s most recent score in this area is set out in Table 2.

**Table 2. Composition of expenditure out-turn compared to original approved budget – 2012 PEFA score**

| Indicator                                                                                         | Score     | Brief Explanation                                                                                                                                                                                                                                                                  |
|---------------------------------------------------------------------------------------------------|-----------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                           |           |                                                                                                                                                                                                                                                                                    |
| <b>PI-2. Composition of expenditure out-turn compared to original approved budget</b>             | <b>D+</b> |                                                                                                                                                                                                                                                                                    |
| (i) Extent of the variance in expenditure composition during the last 3 years                     | <i>D</i>  | The variances in the composition of primary expenditures across budget heads (excluding contingency) were:<br>FY09: 17.9%<br>FY10: 25.7%<br>FY11: 9.6%<br>Thus, the variance in expenditure composition was more than 10% over the original budget in two of the last three years. |
| (ii) Average amount of expenditure actually charged to the contingency vote over the last 3 years | <i>A</i>  | Expenditures charged to contingency vote was less than 1% (0.4%) on average over the last three years, as follows:<br>FY09: 0.3%<br>FY10: 0.6%<br>FY11: 0.3%                                                                                                                       |

### **PI-3. Aggregate revenue out-turn compared to original approved budget**

#### ***The importance of Aggregate Revenue Out-turn***

Accurate forecasting of domestic revenue is a critical factor in determining budget performance, since budgeted expenditure allocations are based upon that forecast. A comparison of budgeted and actual revenue provides an overall indication of the quality of revenue forecasting.

External shocks may however occur, that could not have been forecast and do not reflect inadequacies in administration, they should be explained in the narrative. The calibration allows for a top score even if during one year in the last three the outturn is substantially different from the forecast e.g. as a result of a major external shock occurring during budget execution.

For this indicator, information from budget execution reports or final government accounts should be used to the extent available (rather than data from other sources such as a revenue authority or the central bank). The narrative should explain the sources of data and any concerns regarding consistency or reliability, which may also be highlighted by assessment of revenue data reconciliation in PI-14.

#### ***Current situation in RMI***

Actual domestic revenue receipts as a proportion of budgeted revenue projections were 116%, 107% and 98% in FY09, FY10, and FY11, respectively. Conservative revenue projections by MoF helped actual revenue receipts to outperform the budgeted amounts in two out of the three years.

#### ***RMI's most recent PI-3 Score:***

RMI's most recent score in this area is set out in Table 3.

**Table 3. Aggregate revenue out-turn compared to original approved budget – 2012 PEFA score**

| Indicator                                                                    | Score    | Brief Explanation                                                                                                                                                                                                                                                        |
|------------------------------------------------------------------------------|----------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                      |          |                                                                                                                                                                                                                                                                          |
| <b>PI-3. Aggregate revenue out-turn compared to original approved budget</b> | <b>B</b> | Actual domestic revenue receipts as a proportion of budgeted domestic revenue for the last 3 years were:<br>FY09: 116%<br>FY10: 107%<br>FY11: 98%<br>Thus, actual domestic revenue was between 94% and 116% of budgeted domestic revenue in two of the last three years. |

## **PI-4: Stock and monitoring of expenditure payment arrears**

### ***The importance of monitoring payment arrears***

Expenditure payment arrears are expenditure obligations that have been incurred by government, for which payment to the employee, supplier, contractor or loan creditor is overdue, and constitutes a form of non-transparent financing. A high level of arrears can indicate a number of different problems such as inadequate commitment controls, cash rationing, inadequate budgeting for contracts, under-budgeting of specific items and lack of information. Expenditure arrears assume that the outstanding payment is due under a specific legal obligation or contractual commitment, which the government has entered, and may include due but unpaid claims for salaries, pensions, supplies, services, rents, interest on domestic and external debt. Delays or reductions in transfers of subsidies and grants to autonomous government agencies and other levels of government would not constitute arrears unless they are part of a legal obligation (specifying amount and timing of each payment) or contractual agreement. A provision for a transfer in the annual budget law or appropriations act would not in itself constitute a legal obligation. Unpaid amortization of loan principal is not considered an arrear for this indicator, since amortization is not expenditure, but a financing transaction.

Local regulations or widely accepted practices may specify when an unpaid claim becomes in arrears. If such a local practice is applied in measuring the stock of arrears, then its content and basis should be described in the narrative. The default for the assessment, however, would be internationally accepted business practices according to which a claim will be considered in arrears if payment has not been made within 30 days from government's receipt of supplier's invoice/claim (for supplies, services or works delivered), whereas the failure to make staff payroll payment or meet a deadline for payment of interest on debt immediately results in the payment being in arrears.

This indicator is concerned with measuring the extent to which there is a stock of arrears, and the extent to which the systemic problem is being brought under control and addressed. While special exercises to identify and pay off old arrears may be necessary, this will not be effective if new arrears continue to be created (payments due during the last year but not made). Most fundamentally, however, is the assessment of the existence and completeness of data on arrears, without which no assessment can be made.

### ***Current situation in RMI***

#### ***(i) Stock of expenditure payment arrears***

There is no statutory period after which an outstanding payment becomes an arrear. Data from the audited accounts for FY09 and FY10 indicate that creditor (payable) days for non-personnel (operational) payments were approximately 47 days and 55 days, respectively, at year-end.<sup>1</sup> This sub-dimension has not been given a specific score, as it was not possible to estimate the exact proportion of all invoices which were not paid within a 30-day time period (as specified in the PEFA Guidelines) and all other payments upon falling due (e.g. for salary and debt service payments), either currently or in recent years. However, consultations with private sector suppliers suggest that public sector agencies take significantly longer than 30 days to settle their invoices.

#### ***(ii) Availability of data for monitoring the stock of expenditure payment arrears***

Under RMI's accruals system, outstanding payments are treated as payables under current liabilities. However, MoF does not collect data on the age of outstanding payments. While MoF include in the Appropriation Act an expenditure line for the settlement of prior-year liabilities, this allocation represents a flow (i.e. as opposed to a stock) item, and, in the absence of data on the proportion that it represents of the total stock of arrears, it is not

---

<sup>1</sup> General Fund only. Data from audited annual accounts.

possible to calculate the stock of arrears. Thus, there are no reliable data for monitoring the stock of expenditure payment arrears.

**RMI's most recent PI-4 Score:**

RMI's most recent score in this area is set out in Table 4.

**Table 4. Aggregate revenue out-turn compared to original approved budget – 2012 PEFA score**

| Indicator                                                                                                                                                 | Score     | Brief Explanation                                                                                                                     |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|---------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                                                                                   |           |                                                                                                                                       |
| <b>PI-4. Stock and monitoring of expenditure payment arrears</b>                                                                                          | <b>NR</b> |                                                                                                                                       |
| (i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and a recent change in the stock | <i>NR</i> | No data on the stock of arrears are available, and it was not possible to estimate such arrears, either currently or in recent years. |
| (ii) Availability of data for monitoring the stock of expenditure payment arrears                                                                         | <i>D</i>  | Central government does not collect data on payment arrears or on the age profile of outstanding payments.                            |

## **PI-5. Classification of the budget**

### ***The importance of budget classification***

A robust classification system allows the tracking of spending on the following dimensions: administrative unit, economic, functional and program. Where standard international classification practices are applied, governments can report expenditure in GFS format and track poverty-reducing and other selected groups of expenditure. The budget will be presented in a format that reflects the most important classifications (usually administrative combined with economic, functional and/or programmatic) and the classification will be embedded in the chart of accounts to ensure that all transactions can be reported in accordance with any of the classifications used.

In countries where a poverty reduction strategy is a core element in the government's overall policy framework, the definition of poverty reducing expenditure is normally linked directly to the classification of the budget.

The international standard for classification systems is the Government Finance Statistics (GFS) which provides the framework for economic and functional classification of transactions. Under the UN-supported Classification of Functions of Government (COFOG), which is the functional classification applied in GFS, there are ten main functions at the highest level and 69 functions at the second (sub-functional) level.

No international standard for programmatic classification exists, and this type of classification is used in widely deviating ways across countries. However, program classification can be an important tool in budget formulation, management and reporting (ref. indicator PI-12), and the way in which it is applied should be explained in the narrative if the highest score is assigned on this basis.

### ***Current situation in RMI***

The annual budget is officially formulated, appropriated, executed and reported in the primary instance by source of funds (e.g. General Fund for recurrent expenditures, Compact Fund, US Federal Funds), shown in the Appropriation Act under "Schedules". The five expenditure Schedules in the Appropriation Act are organized according to the source of funds, and, within each Schedule, by a sub-categorization specific to each source of fund. As indicated in the Appropriations Act, for General Fund (domestic revenues), Compact Funds, Special Revenue Funds and US Federal Funds (Schedules 1-4), expenditure appropriations are shown by what is termed "program areas"<sup>2</sup>; which, for expenditures from the General Fund (Schedule 1), are equivalent to administrative units (ministries and departments). Expenditure appropriations for other sources of funds may be shown by administrative unit or by type of grant. Nonetheless, to the extent that other sources of funds (e.g. Compact Funds or Federal Grants) provide resources managed by ministries, there is no summary of appropriations by administrative unit. The economic classification is used for execution and reporting but it is not shown in the budget documents, and it is not used for formulation and appropriation. No functional or sub-functional classification is used.

### ***RMI's most recent PI-5 Score:***

RMI's most recent score in this area is set out in Table 5.

**Table 5. Classification of the budget – 2012 PEFA score**

---

<sup>2</sup> See further discussion in PI-16(ii) below about the specificity of the term "program area".

| Indicator                                 | Score    | Brief Explanation                                                                                                                                                                                                                                                                                                  |
|-------------------------------------------|----------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                   |          |                                                                                                                                                                                                                                                                                                                    |
| <b>PI-5. Classification of the budget</b> | <b>D</b> | <p>The administrative classification is used for preparation, execution and reporting. The economic classification is used for execution and reporting, but not for preparation and appropriation. No functional or sub-functional classification is used.</p> <p>The criteria for a higher score are not met.</p> |

## **PI-6. Comprehensiveness of information included in budget documentation**

### ***The importance of comprehensive budget documentation***

Annual budget documentation (the annual budget and budget supporting documents), as submitted to the legislature for scrutiny and approval, should allow a complete picture of central government fiscal forecasts, budget proposals and out-turn of previous years. In addition to the detailed information on revenues and expenditures, and in order to be considered complete, the annual budget documentation should include information on the following elements:

1. Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate.
2. Fiscal deficit, defined according to GFS or other internationally recognized standard.
3. Deficit financing, describing anticipated composition.
4. Debt stock, including details at least for the beginning of the current year.
5. Financial Assets, including details at least for the beginning of the current year.
6. Prior year's budget outturn, presented in the same format as the budget proposal.
7. Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal.
8. Summarized budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-5), including data for the current and previous year.
9. Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.

### ***Current situation in RMI***

The annual budget documents laid before Parliament mainly consist of the Appropriation Bill, which consists of 5 expenditure schedules, organized according to the source of funds, specifically: (1) recurrent general appropriations; (2) appropriated expenditures from Compact sectoral grants; (3) appropriated expenditures from special revenues (line ministries' own-source revenues); (4) appropriated expenditures from US Federal grants; and (5) appropriated expenditures from other donors (primarily from ROC project grants). Schedules 6 to 9 set out the revenue sources in terms of, respectively, the General Fund (for domestic revenues), line ministries' own-source revenues (from fees and charges), Compact revenues, and other (specifically, US Federal Funds, and ROC grants).

In addition, an analytical document, the Budget Statement, accompanies the Appropriation Bill. The FY12 Budget Statement contains a brief narrative statement on macro-economic events during the previous year (e.g. GDP growth rate), an explanation of principles guiding the proposed budget, and very brief explanations of the bases for the budget's revenue estimates (including by fund), and expenditure allocations.

However, neither the Appropriation Bill nor the Budget Statement provides comprehensive information on the macroeconomic context, revenues, expenditures, and financial assets, nor systematic information on prior year's outturns or a detailed analysis of the fiscal implications of new policies (see Box 3.2).

**Box 3.2: Completeness of Budget Documentation<sup>1</sup>**

| Item                                                                                                                                                                                                   | Included in budget documentation? | Comment                                                                                             |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|-----------------------------------------------------------------------------------------------------|
| Macro-economic assumptions (aggregate growth, inflation, and exchange rate) <sup>2</sup>                                                                                                               | No                                | No forward assumptions. In Budget Statement, only actual GDP growth rate for previous year is shown |
| Fiscal deficit (IPSAS standards)                                                                                                                                                                       | No                                |                                                                                                     |
| Deficit financing (includes anticipated composition)                                                                                                                                                   | No                                |                                                                                                     |
| Debt stock (includes detail for current year)                                                                                                                                                          | No                                |                                                                                                     |
| Financial assets (includes detail for current year)                                                                                                                                                    | No                                |                                                                                                     |
| Prior year's budget outturn                                                                                                                                                                            | No                                | In Budget Statement, only aggregated sources of funds and revenues are shown for two previous years |
| Current year's budget, presented in the same format as the budget proposal                                                                                                                             | No                                |                                                                                                     |
| Summarized budget data                                                                                                                                                                                 | No                                |                                                                                                     |
| Explanation of budget implications of new policy initiatives                                                                                                                                           | No                                |                                                                                                     |
| Notes: 1. Information based on current year budget documents (FY 2012)<br>2. RMI uses the US dollar as its currency; thus, the explicit exchange rate policy is 1:1 correspondence with the US dollar. |                                   |                                                                                                     |

**RMI's most recent PI-6 Score:**

RMI's most recent score in this area is set out in Table 6.

**Table 6. Comprehensiveness of budget documentation – 2012 PEFA score**

| Indicator (M1)                                                                 | Score    | Brief Explanation                                                 |
|--------------------------------------------------------------------------------|----------|-------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                        |          |                                                                   |
| <b>PI-6. Comprehensiveness of information included in budget documentation</b> | <b>D</b> | None of the information listed is provided in the Budget document |

## **PI-7. Extent of unreported government operations**

### ***The importance of unreported government operations***

Annual budget estimates, in-year execution reports, year-end financial statements and other fiscal reports for the public, should cover all budgetary and extra-budgetary activities of central government to allow a complete picture of central government revenue, expenditures across all categories, and financing. This will be the case if:

- 1) extra-budgetary operations (central government activities which are not included in the annual budget law, such as those funded through extra-budgetary funds), are insignificant or if any significant expenditures on extra-budgetary activities are included in fiscal reports, and if
- 2) activities included in the budget but managed outside the government's budget management and accounting system (mainly donor funded projects) are insignificant or included in government fiscal reporting.

While donor project funding is partially outside government control (particularly for inputs provided in-kind i.e. supplied and paid under contracts to which the government is not a party), MDAs in charge of implementing donor funded projects should at least be able to provide adequate financial reports on the receipt and use of donor funding received in cash. Donors' assistance to the government in providing full financial information on project support (including inputs in-kind) is assessed in indicator D-2.

### ***Current situation in RMI***

#### ***(i) Level of extra-budgetary expenditures which is unreported***

Fiscal reports (specifically, the Appropriation Bill and the audited annual accounts) include information on expenditures sourced from the General Fund (comprising domestic revenues and ROC general budget support grants), the Compact Fund (assistance from the US under the Compact Funding Agreement), Special Revenue and other external support (e.g. US Federal grants and ROC projects).<sup>3</sup> The audited financial statements provide comprehensive information on balance sheet items and monetary flows (equivalent to an income and expenditure statement in international public sector accounting standards) to/from these sources, as well as for other GRMI funds (e.g. "fiduciary" [extra-budgetary] and other funds).

However, planned annual spending from extra-budgetary funds (e.g. the Marshall Islands Social Security Administration [MISSA], and the Marshall Islands Health Fund are not reported within the budget documents, or in supplementary information provided to the legislature (Nitijela) to accompany the Appropriations Bill. MISSA activities alone are significant, totalling around 15 mn of expenditure in FY11, representing approximately 15% of total GRMI expenditures.<sup>4</sup> Other un-reported government operations, which are not appropriated or reported comprehensively in fiscal reports (including the annual audited accounts), include income and expenditure activity and Statements of Financial Position (balance sheets) for other funds, such as the Communication Regulation Fund, the Historic Preservation Fund, and the Marshallese Language Trust Fund; quasi-fiscal activities of SOEs (e.g. Marshalls Energy Company [MEC]; as well as smaller expenditures, such as school registration fees, school bus fees, and fees for service collected by health clinics in the outer islands.<sup>5</sup> In addition, SOEs have social service obligations, which are not clearly defined or valued/reported. Although it was not possible to get an estimate of the value of the un-

<sup>3</sup> The assessment notes that this sub-dimension excludes-externally-supported project resources; the information in this paragraph is for information only.

<sup>4</sup> Data are taken from FY10 annual audited accounts. Total expenditures are for primary central government (GRMI) and include all governmental funds.

<sup>5</sup> The omission of the fiscal activity of these funds is noted in notes to the annual financial statements

reported government activities listed above, these activities clearly represent more than 10% of total central government expenditures (based on the activities of MISSA alone).

*(ii) Income/expenditure information on donor-funded projects included in fiscal reports*

GRMI fiscal reports do not comprehensively include information on donor-funded projects, for neither loans nor grants. For loans, GRMI's external portfolio contains loans exclusively from ADB, including new loans contracted during the past three years. The Appropriations Bill does not have a section on budget financing (below-the-line) and it does not include external loans. Specifically, during the past 3 years, GRMI has signed one loan agreement with one disbursement (in an amount of \$9.5 mn) in FY10, but this was not included in the Appropriation Act. The amount was disclosed in the annual financial statements.

In terms of grants, the Appropriations Bill contains information on planned expenditures for grants from the US in the form of the Compact and US Federal grants (those administered by the US Department of the Interior), and from ROC, in the form of budget support and capital grants. The annual financial statements also include expenditures from these grants made during the year.

Expenditures from other grants (e.g. those administered by US government departments other than the US Department of the Interior) are not presented comprehensively in either the budget documents or the annual financial statements, and these are estimated by officials to be significant. ROC's contribution to RMI's Trust Fund is also not shown (e.g. in FY11). A key reason for the lack of inclusion of grant-financed data in fiscal documents is the difficulty in obtaining relevant information on likely disbursements.

***RMI's most recent PI-7 Score:***

RMI's most recent score in this area is set out in Table 7.

**Table 7. Extent of unreported government operations – 2012 PEFA score**

| Indicator                                                    | Score    | Brief Explanation                                                                                                                                                                                                                                                          |
|--------------------------------------------------------------|----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                      |          |                                                                                                                                                                                                                                                                            |
| <b>PI-7. Extent of unreported government operations</b>      | <b>D</b> |                                                                                                                                                                                                                                                                            |
| (i) Level of unreported extra-budgetary expenditure          | D        | There are significant extra-budgetary funds which are not reported in some of the fiscal documents (specifically, the Budget document). These non-reported amounts are estimated to be greater than 10% of total central government expenditures.                          |
| (ii) Income/expenditure information on donor-funded projects | D        | Comprehensive information on loan-funded external assistance is not included in some fiscal information. Specifically, during the past 3 years, GRMI has signed one loan agreement with a single disbursement in FY10, but this was not included in the Appropriation Act. |

## **PI-8. Transparency of Inter-Governmental Fiscal Relations**

### ***The importance of transparent inter-governmental fiscal relations***

While the performance indicator set is focused on PFM by central government, Sub-National (SN) Governments<sup>8</sup> in many countries have wide-ranging expenditure responsibilities. In federal states, the fiscal relationship between the central (federal or union) government and the individual states is typically established in the Constitution of the Union or Federation. In other cases, specific laws determine the layers of SN government, the expenditure responsibilities and revenue sharing arrangements. Transfers falling in these categories are usually unconditional grants, the use of which will be determined by SN governments through their budgets. In addition, central government may provide conditional (earmarked) grants to SN governments to implement selected service delivery and expenditure responsibilities e.g. by function or program, on a case by case basis. The overall level of grants (i.e. the vertical allocation) will usually be budget policy decisions at the central government's discretion or as part of constitutional negotiation processes and is not assessed by this indicator. However, clear criteria, such as formulas, for the distribution of grants among SN government entities (i.e. horizontal allocation of funds) are needed to ensure allocative transparency and medium-term predictability of funds available for planning and budgeting of expenditure programs by SN governments. It is also crucial for SN governments that they receive firm and reliable information on annual allocations from central government well in advance of the completion (preferably before commencement) of their own budget preparation processes.

Given the increasing tendency for primary service delivery to be managed at sub-national government levels, correct interpretation of sectoral resource allocation and actual spending effort require tracking of expenditure information at all levels of government according to sectoral categories (which may or may not correspond to the GFS functional classification), even when this is not the legal form in which the budget is executed. Generation of a full overview of expenditure allocations by general government requires that SN government can generate fiscal data with a classification that is comparable to central government and that such information is collected at least annually and consolidated with central government fiscal reports. SN governments may not have obligations to report directly to central government. Collection and consolidation of fiscal data for general government, therefore, may not necessarily be undertaken by central government, but rather by a national statistical office. For the coverage to be meaningful, the consolidated reporting of fiscal information should be of a reasonable quality, include all tiers of general government, and be presented on both an ex-ante (budgeted) and an ex-post (actual) basis. Ex-post information should be sourced from routine accounting systems.

### ***Current situation in RMI***

Article IX of the Constitution specifies one level of sub-national government, local government. There are 24 local governments, covering the 5 islands and 28 atolls<sup>6</sup>, each headed by a Mayor who is accountable to an elected Council. These local governments are regulated by the Local Government Act (1980), contained in Title 4 of the MIRC, which establishes the legal status of local governments, and sets out the requirements for local government Constitutions, including their arrangements for budget and accounts, arrangements for elections, grants to local governments, and relations with central government. Chapters 2 and 3 of Title 4 of the MIRC contain legislation on taxes and other revenue matters for local governments.

---

<sup>6</sup> Not all atolls are inhabited, so some atolls share a local government.

(i) *Transparency and objectivity in the horizontal allocation among sub national governments*  
Central government provides significant amounts of funding to local governments in the form of transfers. There is wide variation among the LGs, with some relying almost completely on CG transfers and others having significant alternative sources of funds, such as the trust funds from the Nuclear Claims Tribunal. In the absence of auditable accounts for many local governments, it was not possible to get comprehensive information on local revenue sources, and figures on the share of total local government revenues represented by central government transfers were not available.

The assessment of this indicator includes both domestic resources and those from ROC which are provided to central government and on-granted by central government to local governments, but not funding provided by external sources for specific purposes, e.g. USDA Special Feeding Program, which may be considered to be donor aid projects whose allocations are specified by the relevant donor agency rather than by central government.

The transfers made by central government to local government include:

- **Local Government Fund (LGF)** = single fund separate from the General Fund to deposit central government resources for local governments; considered under the Act to be the primary channel for providing central government grants to local governments. The allocation among LGs is made, for one part, on an equal fixed amount for each local government, and for the other part, on an equal per capita (population) amount for each local government. In terms of the *transparency and rules-based nature of central government transfers to local governments*, the amounts to be allocated to each local government and the criteria (rules-basis) on which these are based (i.e. the fixed amount per LG and the per capita amount for each LG) are set out in a CM.
- **Grant-in-aid (GIA)** = program of matching grants to local governments for “development and public” projects. It is administered by the Ministry of Internal Affairs. The maximum grant available to local governments is the same across all local governments. For eligible projects (based on criteria set out in the CM), central government provides 75% of the total (up to the maximum grant), and the remaining 25% comes from the community. Funds are available for purchase of materials, equipment, supplies, shipping or technical assistance for: (i) projects that affect community’s health/sanitation; (ii) projects to help develop local community’s economy/infrastructure; (iii) community-based education-related projects; or (iv) community-based transport-related projects. Any unused potential grant amounts (i.e. not applied for or used by local governments) by the application deadline are then available to any community to submit an application. Any remaining unused funds lapse at the end of the fiscal year. In terms of *transparency of, and rules-basis for, the grants to each local government*, the aggregate GIA amount appropriated each year (including for FY11) to be allocated equally to each local government is set out in CM 147 (2005).
- **Outer Islands Economic Development Fund (OIEDF)** – the OIEDF was established by Cabinet, as a means of providing developmental support to the outer islands. The current Rules and Procedures for the OIEDF are set out in CM 230 (2000). The source of funding for the OIEDF is an annual grant from ROC to central government, which is then on-granted on a conditional (project) basis to LGs through the Ministry of Internal Affairs. The aggregate amount available each year is allocated to LGs partly on a fixed basis (equal for all LGs) and on an equal per capita basis. In other words, the horizontal allocation of the OIEDF among LGs (budgeted and actual) is based on a fixed and a variable amount, with the latter share being based on each LG’s population. Thus, regarding the *transparency and rules-based*

*nature of the grants to each local government*, the amounts to be allocated to (and with the potential to be used by) each local government, and the criteria on which these allocations are based, are set out each year in a CM.

In-year disbursement of OIEDF funds is managed centrally. LGs submit applications for eligible projects to the Ministry of Internal Affairs in the sectors of human resource development, infrastructure development, physical capital, inter-island transport, fisheries, small-scale support for NGOs, rest houses and community centers, and agriculture. Provided that the applications are consistent with the criteria set out in the Rules and Procedures, they are approved, and the funds may be used.<sup>7</sup> A separate account for each local government is held at MoF. Once an LG's application for the use of the resources has been approved, the funds are released for local government's use. However, procurement of goods and services is undertaken centrally.

- **Other** (e.g. USDA special feeding grant, single audit) = specific grants are allocated by external donor agencies for specific purposes, such as to cover the cost of conducting an audit for local governments receiving US grants (the audit known in RMI as a single audit). These grants may be considered to relate to donor aid projects since the allocations to local governments are specified by the relevant donor agency rather than by central government and are thus excluded from the assessment.

*(ii) Timeliness and reliable information to SN governments on their allocations*

As indicated above, for all three types of grants (LGF, GIA, and OIEDF), the criteria for determining the distribution of the aggregate grant amounts to each local government (i.e. each LG's share) are stable and set out in CMs. The amounts to each local government in US\$ terms depend on the aggregate grant amounts. For LGF and GIA, the aggregate amounts may not change from year to year (e.g. FY 09 and FY10, and FY11 and FY12 were the same, respectively); however, in FY11 (the basis for the assessment), the aggregate grant amounts for both types of transfers did change from the previous year. Thus, the final confirmation of the aggregate grant amounts for LGF and GIA is contained in central government's Appropriation Act, in September, just before the beginning of the fiscal year. For OIEDF, the aggregate amounts (and the allocations to each local government) are set out in a CM each year, circulated each December, nine months prior to the coming budget year.

Local governments begin their budget preparations in June or July each year and their budgets are approved in August or September, prior to the beginning of the coming fiscal year. When local governments begin their budget preparations, they have information on approximately 75% of the value of their likely transfers from central government since the amount of OIEDF transfers are communicated to them by the end of the calendar year prior to the coming budget year (see Table 3.1 for the percentage share of total grants represented by OIEDF).<sup>8</sup>

For LGF and GIA, local governments are communicated the aggregate grants amounts (and, since the allocation formulae are stable, also their individual local government share) in August of each year, with the Cabinet Minute approving the draft budget to be submitted to Nitijela. While subsequent changes to the total grant amounts by the Nitijela are possible, they are not likely. In practice, particularly given the fact that changes in the aggregate grant amounts are relatively small, local government stakeholders indicated that they consider the

---

<sup>7</sup> Funds are available for the purchase of building materials, heavy equipment, sea vessels, freight or contractual services.

<sup>8</sup> Although the aggregate amount for the OIEDF was not available for FY11 (Table 3.1), triangulation amongst stakeholders indicated that the distribution of the FY11 aggregate amount amongst local governments was made on the basis of a fixed amount per local government and an amount based on population.

transfers from central government to be stable and that they have sufficient information in a timely manner to prepare their budgets.

*(iii) Extent of consolidation of fiscal data for general government*

Fiscal information for local governments as a whole is not available. In practice, the lack of auditable accounts for many local governments would make this difficult. No consolidation of fiscal information for the general government sector is undertaken, and hence no annual reports of such are prepared.

**RMI's most recent PI-8 Score:**

RMI's most recent score in this area is set out in Table 8.

**Table 8. Transparent inter-governmental fiscal relations – 2012 PEFA score**

| Indicator                                                                                    | Score    | Brief Explanation                                                                                                                                                                                                                                                                                                                                                                          |
|----------------------------------------------------------------------------------------------|----------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                      |          |                                                                                                                                                                                                                                                                                                                                                                                            |
| <b>PI-8. Transparency of Inter-Governmental Fiscal Relations</b>                             | <b>B</b> |                                                                                                                                                                                                                                                                                                                                                                                            |
| (i) Transparency and objectivity in the horizontal allocation among Sub National Governments | <i>A</i> | The allocation of all three types of transfers to LGs is governed by fixed criteria, which are clearly set out in Cabinet Minutes.                                                                                                                                                                                                                                                         |
| (ii) Timeliness and reliable information to SN governments on their allocations              | <i>B</i> | The majority of central government transfers to local governments are communicated to local governments prior to the beginning of their budget preparations. The score reflects the fact that some minor adjustments to the final figures may be communicated during budget preparation, but that local governments have sufficient time to incorporate these changes before finalization. |
| (iii) Extent of consolidation of fiscal data for general government                          | <i>D</i> | No consolidation of general government sector is undertaken, and no such annual fiscal reports are prepared                                                                                                                                                                                                                                                                                |

## **PI-9. Oversight of aggregate fiscal risk from other public sector entities**

### ***The importance of overseeing public sector fiscal risks***

Central government will usually have a formal oversight role in relation to other public sector entities and should monitor and manage fiscal risks with national implications arising from activities of sub-national (SN) levels of government, autonomous government agencies (AGA) and public enterprises (PE), including state-owned banks, but may also for political reasons be obliged to assume responsibility for financial default of other public sector entities, where no formal oversight role exists. Fiscal risks can be created by SN government, AGAs and PEs and *inter alia* take the form of debt service defaulting (with or without guarantees issued by central government), operational losses caused by unfunded quasi-fiscal operations, expenditure payment arrears and unfunded pension obligations.

Central government should require and receive quarterly financial statements and audited year-end statements from AGAs and PEs, and monitor performance against financial targets. AGAs and PEs often report to parent line ministries, but consolidation of information is important for overview and reporting of the total fiscal risk for central government. Where SN governments can generate fiscal liabilities for central government, their fiscal position should be monitored, at least on an annual basis, again with consolidation of essential fiscal information.

Central government's monitoring of these fiscal risks should enable it to take corrective measures arising from actions of AGAs, PEs and SN governments, in a manner consistent with transparency, governance and accountability arrangements, and the relative responsibilities of central government for the rest of the public sector.

### ***Current situation in RMI***

As indicated in Section 1 above, state-owned enterprises (SOEs) represent a significant part of the public sector. The legal framework governing SOEs is weak. There is no overarching legislation regulating the financial practices of SOEs as a whole nor their fiscal relationship with government. Not every SOE has its own legislation; for example, Tobolar, the copra-processing company, has one in Title 4 of MIRC, but other SOEs visited (e.g. AMI and MEC) did not. Oversight is the responsibility of a Board of Directors, with the Prime Minister appointing each of the Board's members, including the Chairperson. There is no government entity charged with oversight of SOEs. The government's interests are represented by the relevant Minister's being the Chair of the Board, as well as many of the board members being from government.

#### ***(i) Extent of central government monitoring of AGAs and PEs***

There is no statutory body with oversight authority for the agencies managing the extra-budgetary funds (e.g. MISSA), and no systematic process to identify risks associated with these agencies or to monitor follow-up actions in order to ensure appropriate accountability to central government.

In the absence of relevant legislation, there are no statutory reporting requirements. Strategic plans, operational and business plans are not required to be prepared as a matter of routine, and most SOEs do not prepare them. At least one SOE has prepared a preliminary strategic plan but this plan was not officially endorsed by the Board.

End-of-year reporting by SOEs consist of annual financial statements and annual reports. These are submitted to the relevant SOE's Board but they are not lodged with the Ministry or Finance or other government body. The annual financial statements are audited and are sent to the Nitijela but not to central government.

As part of their budget submissions, SOEs who request subsidies are requested to include their most recent annual reports. In the FY12 budget process, fewer than 10 SOEs provided their annual reports to MoF, representing less than 40% (by number) of all SOEs.<sup>9</sup> At the same time, the objective of submitting these reports is to inform MoF's analysis to recommend (or not) budgetary subsidies as part of the draft budget to the Nitijela, rather than on-going monitoring of SOEs' overall fiscal risk.

Thus, in practice, there is very limited oversight of the fiscal risk posed by SOEs, although such risks may be significant. While the government provides substantial subsidies to some SOEs, no reports of fiscal risk represented by SOEs (including agencies managing extra-budgetary funds) are prepared.

Recently, Cabinet approved a list of six principles covering proposed regulations for SOEs, which is being reviewed with a view to forming the basis for overarching SOE legislation.

*(ii) Extent of central government monitoring of SN governments' fiscal position*

There is little systematic central government oversight of local government fiscal risk. The Ministry of Internal Affairs is the central government agency responsible for local government. According to the Act, its role is limited primarily to co-ordination. The Ministry of Finance does not have a statutory or explicitly-mandated role vis-à-vis local governments, despite the fact that the former provides the majority of funding for some (but not all) local governments and that local governments have the potential to generate fiscal risk for central government. According to the Local Government Act, local governments are allowed to borrow with the approval of the Councils but without recourse to a review of debt sustainability. Local governments are not required to inform the Ministry of Finance or the Ministry of Internal Affairs. Central government does not compile fiscal information on local governments, and no fiscal reports on the local government sector, annual or otherwise, are prepared. Local governments are not required (and do not do so, in practice) to forward their fiscal information (e.g. on budgeted and actual revenues and expenditures) to central government. Thus, in practice, central government does not monitor local governments' fiscal position.

***RMI's most recent PI-9 Score:***

RMI's most recent score in this area is set out in Table 9.

**Table 9. Oversighting public sector fiscal risks – 2012 PEFA score**

---

<sup>9</sup> In RMI, SOE is the term used to refer both to commercially-oriented entities (e.g. MEC) as well as to those with less of a commercial orientation (e.g. the Marshall Islands Visitors Authority).

| Indicator                                                                          | Score    | Brief Explanation                                                                                                                                                                                                                                                    |
|------------------------------------------------------------------------------------|----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                            |          |                                                                                                                                                                                                                                                                      |
| <b>PI-9. Oversight of aggregate fiscal risk from other public sector entities.</b> | <b>D</b> |                                                                                                                                                                                                                                                                      |
| (i) Extent of central government monitoring of AGAs/PEs                            | <i>D</i> | No central government entity, including the MoF, systematically receives Annual Financial Statements or Annual Reports from the majority of state-owned enterprises, nor does any entity prepare a report on the associated fiscal risk.                             |
| (ii) Extent of central government monitoring of SN governments' fiscal position    | <i>D</i> | No central GRMI entity actively monitors the fiscal position of local governments, who potentially may generate fiscal risk for central government (through their ability to borrow). GRMI does not produce any analytical or other reports on fiscal risk from LGs. |

## **PI-10. Public Access to key fiscal information**

### ***The importance of access to fiscal information***

Transparency will depend on whether information on fiscal plans, positions and performance of the government is easily accessible to the general public or at least the relevant interest groups.

The narrative of the assessment should comment on the quality of information made available (e.g. understandable language and structure, appropriate layout, summarized for large documents) and the means used to facilitate public access (such as the press, websites, sale of major documents at no more than printing cost and notice boards for mainly locally relevant information). The extent to which the means are appropriate depends on the nature of the documentation and the characteristics of the relevant interest or user groups, such as access to different media.

Elements of information to which public access is essential include:

1. Annual budget documentation: A complete<sup>10</sup> set of documents can be obtained by the public through appropriate means when it is submitted to the legislature.
2. In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.
3. Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit.
4. External audit reports: All reports on central government consolidated operations are made available to the public through appropriate means within six months of completed audit.
5. Contract awards: Award of all contracts with value above approx. USD 100,000 equiv. are published at least quarterly through appropriate means.
6. Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics).

### ***Current situation in RMI***

While some fiscal documents (e.g. the budget and audited annual financial statements) are available from government staff on request, none of the documents listed are systematically made available to the public (i.e. such that a member of the public may obtain the document independently of interacting with government staff). None of the documents are available to purchase, nor are they posted in a public space (e.g. the Post Office, library, or a notice board in the Nitijela building). Neither the Ministry of Finance nor the Auditor-General's Office has a website. The Ministry of Finance has indicated that it plans to establish a website in the near future.

None of the key central government entities, such as the Ministry of Finance or the Office of the Auditor-General, operates a website, although both have indicated that they intend to establish one in the near future. The Nitijela does have a website, with downloadable information, including audit reports, from the sub-section operated by the Public Accounts Committee (PAC), but it is not up-to-date (the most recent audit report on the site was posted in 2008).

---

<sup>10</sup> 'Complete' means that the documents made publicly available contains the all of information listed under indicator PI-6, to the extent this information exists.

The status of fiscal information available to the public is summarized in Box 3.4. In practice, however, for those outside of Majuro, particularly those on the Outer Islands, public access to fiscal information (even on request) is minimal.

**Box 3.4. Public Access to Fiscal Information**

| Item                                            | Document issued?                                       | Does public have access?                                           | Meets PEFA criteria? |
|-------------------------------------------------|--------------------------------------------------------|--------------------------------------------------------------------|----------------------|
| 1. Annual budget documentation                  | Yes                                                    | Only on request from MoF                                           | No                   |
| 2. In-year budget execution reports             | No (flash and other reports are for internal use only) | N/A                                                                | No                   |
| 3. Year-end financial statements                | Yes                                                    | Only on request from MoF                                           | No                   |
| 4. External audit reports                       | Yes                                                    | On Office of Auditor General Website                               | Yes                  |
| 5. Contract awards                              | No                                                     | N/A                                                                | No                   |
| 6. Resources available to primary service units | No – information not produced                          | As information is not produced, it is not available to the public. | No                   |

***RMI's most recent PI-10 Score:***

RMI's most recent score in this area is set out in Table 10.

**Table 10. Public access to key fiscal information – 2012 PEFA score**

| Indicator                                      | Score    | Brief Explanation                                                                                |
|------------------------------------------------|----------|--------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                        |          |                                                                                                  |
| PI-10. Public access to key fiscal information | <b>D</b> | Government provides independent access to the public for 0 of the 6 types of information listed. |

**PI-11. Orderliness and participation in the annual budget process**

***The importance of an orderly annual budget process***

While the Ministry of Finance (MOF) is usually the driver of the annual budget formulation process, effective participation in the budget formulation process by other ministries, departments and agencies (MDAs) as well as the political leadership, impacts the extent to which the budget will reflect macro-economic, fiscal and sector policies. Full participation requires an integrated top-down and bottom-up budgeting process, involving all parties in an orderly and timely manner, in accordance with a pre-determined budget formulation calendar.

The calendar should allow for passing of the budget law before the start of the fiscal year as well as for sufficient time for the other MDAs to meaningfully prepare their detailed budget proposals as per the guidance. Delays in passing the budget may create uncertainty about the level of approved expenditures and delays in some government activities, including major contracts. Clear guidance on the budget process should be provided in the budget circular and budget formulation manual, including indicative budgetary ceilings for administrative units or functional areas.

In order to avoid last minute changes to budget proposals, it is important that the political leadership is actively involved in the setting of aggregate allocations (particularly for sectors or functions) from an early stage of the budget preparation process. This should be initiated through review and approval of the allocation ceilings in the budget circular, either by approving the budget circular or by approving a preceding proposal for aggregate allocations (e.g. in a budget outlook paper).

### ***Current situation in RMI***

The FMA provides the legislative framework for the budget process. Responsibility for budget preparation is under the authority of the Budget/OIDA & Procurement & Supply Division of MoF. In March 2011, Cabinet established a Budget Co-ordinating Committee (BCC) to oversee the budget process. The high-level inter-ministerial BCC is chaired by the Chief Secretary and includes the Secretary of Finance, the Assistant Secretary of Finance (Budget/OIDA), the Attorney General, the Deputy Commissioner of PSC, and representatives each from the Office of the President, the Office of Compact Implementation, and EPPSO.

#### ***(i) Existence of and adherence to a fixed budget calendar***

The FMA does not contain a fixed (legislated) budget calendar nor is such a fixed calendar set out in other legislation or regulations. A simple annual budget calendar is set out in the budget circular disseminated each April or May for the coming budget year. As the timing is reasonably similar each year, it may be considered to be stable in practice. There are delays in its implementation, however, as line ministries are frequently late in submitting their detailed budget requests, in part because the calendar gives them only around two weeks to complete their submission from receipt of their budget ceilings (contained in the budget circular). In other aspects (e.g. dissemination of the budget circular, and Cabinet approval of the ceilings), the budget preparation schedule is adhered to. The timing given to line ministries for preparation of their budget submissions for the most recent three fiscal years is set out in Box 3.6.

### **Box 3.6: Timeframe for Line Ministries to Complete their Budget Estimates**

| Budget year | Circulation of Budget Instructions by MoF to Line Ministries | Deadline for Line Ministry Submission of Completed Estimates to MoF | Number of Weeks given to Line Ministries for Submission of Estimates |
|-------------|--------------------------------------------------------------|---------------------------------------------------------------------|----------------------------------------------------------------------|
| FY10        | 28 April 2009                                                | 15 May 2009                                                         | 2.4                                                                  |
| FY11        | 7 June 2010                                                  | 16 June 2010                                                        | 1.3                                                                  |
| FY12        | 17 May 2011                                                  | 31 May 2011                                                         | 2.0                                                                  |

#### ***(ii) Guidance on the preparation of budget submissions***

The main guiding document for line ministry budget preparation is the Budget Call Circular, which is usually circulated during the third quarter of the preceding fiscal year, before most line ministries have begun to prepare their budget submissions. The Budget Call Circular contains: (i) a brief overview of the assumptions for the coming budget year's economic outlook and fiscal policy; (ii) details and accompanying explanation of the main (aggregate) revenue parameters by fund; (iii) the main (aggregate) expenditure parameters, including budget ceilings for line ministries for the coming (annual) budget year; (iv) details of the information and formats required from line ministries in preparing their budget submissions, and (v) the budget preparation timetable. Accompanying the budget circular is a compact disk (CD) with the required forms (on spreadsheet) to be filled in by line ministries.

The information in the Circular is considered to be clear and comprehensive. Prior to its circulation to line ministries, the Budget Call Circular, including the line ministry ceilings, is approved by Cabinet.

*(iii) Timely budget approval by the legislature*

For each of the last four years (FY09, FY10, FY11, and FY12), the Appropriation Bill was approved by the Nitijela before the beginning of the fiscal year. There have been no supplementary budgets in this period.

**RMI's most recent PI-11 Score:**

RMI's most recent score in this area is set out in Table 11.

**Table 11. Orderly annual budget process – 2012 PEFA score**

| Indicator                                                                | Score     | Brief Explanation                                                                                                                                                                                                                                                                                                               |
|--------------------------------------------------------------------------|-----------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                  |           |                                                                                                                                                                                                                                                                                                                                 |
| <b>PI-11. Orderliness and participation in the annual budget process</b> | <b>B+</b> |                                                                                                                                                                                                                                                                                                                                 |
| (i) Existence of, and adherence to, a fixed budget calendar              | <i>C</i>  | The FMA or other legislation/regulations does not contain a fixed budget calendar. The annual budget calendar is set out in the budget circular disseminated in April or May of each year. It does not give LMs sufficient time to complete their budget estimates on time, leading to delays in the calendar's implementation. |
| (ii) Guidance on the preparation of budget submissions                   | <i>A</i>  | The budget circular is clear and comprehensive, and it contains ceilings for LMs for the coming budget year. These are approved by Cabinet before the budget circular (with ceilings) is disseminated to line ministries.                                                                                                       |
| (iii) timely budget approval by the legislature                          | <i>A</i>  | The Appropriations Bill has been passed by the legislature before the beginning of the new fiscal year in each of the last 3 years                                                                                                                                                                                              |

## **PI-12. Multi-year perspective in fiscal planning, expenditure policy and budgeting**

### ***The importance of multi-year budgeting***

Expenditure policy decisions have multi-year implications, and must be aligned with the availability of resources in the medium-term perspective. Therefore, multi-year fiscal forecasts of revenue, medium term expenditure aggregates for mandatory expenditure and potential deficit financing (including reviews of debt sustainability involving both external and domestic debt) must be the foundation for policy changes.

Expenditure policy decisions or options should be described in sector strategy documents, which are fully costed in terms of estimates of forward expenditures (including expenditures both of a recurring nature as well as those involving investment commitments and their recurrent cost implications) to determine whether current and new policies are affordable within aggregate fiscal targets. On this basis, policy choices should be made and indicative, medium-term sector allocations be established. The extent to which forward estimates include explicit costing of the implication of new policy initiatives, involve clear, strategy-linked selection criteria for investments and are integrated into the annual budget formulation process will then complete the policy-budget link.

Countries that have effectively introduced multi-annual program budgeting are likely to show good performance on most aspects of this indicator. In this regard, assessors could substitute ‘programs’ for ‘functions’ in dimension (i) and for ‘sector strategies’ in dimensions (iii) and (iv) of the indicator.

### ***Current situation in RMI***

GRMI prepares two sets of outputs containing notional medium-term fiscal information, both of which are prepared to comply with the requirements of the Compact of Free Association with the US (as amended in 2003). The first is a rolling Medium Term Budget and Investment Framework (MTBIF), prepared by the Economic Policy, Planning and Statistics Office (EPPSO) under the Office of the President. The MTBIF comprises a 5-year budget and investment cycle, covering the previous fiscal year, the current fiscal year, the proposed budget year plus two forward fiscal years.<sup>11</sup> The estimates are shown by line ministry and fund source (e.g. General Fund, Compact funding, US Federal funds). An overview of the MTBIF is contained in the MTBIF Policy Framework Paper.

However, in reality, the MTBIF is not used and does not form part of the budget process (annual or otherwise); consultations with stakeholders indicated that the MTBIF has no link with the annual budget. The MTBIF is revised after, not before, each stage of the budget process (e.g. approved budget) to reflect the agreed budget parameters, and thus it effectively involves filling in a spreadsheet ex post with the updated budget data.<sup>12</sup> The MTBIF is not approved by Cabinet, and it does not guide the budget process. The “forward estimates” shown for the coming two years in the MTBIF Policy Framework Paper are identical to the proposed budget year (i.e. in the FY08-FY12 MTBIF<sup>13</sup>, the aggregate fiscal parameters for FY10, 11 and 12 are identical).

The second set of outputs containing medium-term fiscal information is the performance-related budget statement, known as a portfolio budget, prepared by those ministries receiving Compact grants (Ministries of Health, Education, PMU Office within the Ministry of Public

---

<sup>11</sup> See Compact of Free Association Amendments Act of 2003 between the governments of the US and the Marshall Islands.

<sup>12</sup> However, it is not clear that it is updated in a timely fashion, as the PEFA team were provided the MTBIF for FY08-12 (effectively, relating to the budget year FY10), prepared in August 2009.

<sup>13</sup> The most recent one available to the assessment team.

Works, and the Environmental Protection Agency). These portfolio budgets, prepared in line with the requirements of the Compact agreement, contain performance information for the relevant ministries, including its goals, a breakdown of the overall budget by output (and, within output, by fund and economic item), an explanation of the priority activities to be funded for each output, and the likely impact of these activities. However, they do not include forward expenditure estimates. While the portfolio budgets are provided to the Nitijela (including to the Appropriation Committee), as information during the budget scrutiny process, they are not considered systematically by the Committee as part of its review of the budget.

Thus, in practice, GRMI operates an annual, rather than a multi-year, budget process, and no forward estimates of fiscal aggregates for any category of expenditure classification are prepared.

*(ii) Scope and frequency of debt sustainability analysis*

No analyses of debt sustainability have been undertaken, either by government or by an external partner, in the last 3 years. During FY12, MoF has committed to working with external partners to address the issue of debt sustainability in more detail.

*(iii) Existence of costed sector strategies*

Updated 3-year rolling plans are available only for the Ministry of Education and the Environmental Protection Agency. Neither has been fully costed, with estimates given only for the coming budget year and within the budget ceiling as part of the budget process. Thus, in practice, there are no sector or ministerial medium-term strategy documents which reflect complete costings for recurrent and investment expenditures.

*(iv) Linkages between investment budgets and forward expenditure estimates*

In practice, the processes for preparing recurrent and capital (investment) budgets are separate. Ministerial responsibilities for planning and managing capital expenditures are split between the Ministry of Works, which is responsible for construction and maintenance for all of central government and the line ministries themselves (e.g. the Ministry of Health), which are responsible for the procurement of goods and services and routine maintenance.

In practice, in the absence of a medium-term focus for the budget process and of a mechanism to calculate forward costs, the impact of likely future recurrent costs of investment projects is not factored into future line ministry budgets.

***RMI's most recent PI-12 Score:***

RMI's most recent score in this area is set out in Table 12.

**Table 12. Multi-year perspective – 2012 PEFA score**

| Indicator                                                                                  | Score    | Brief Explanation                                                                                                                                                                               |
|--------------------------------------------------------------------------------------------|----------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                    |          |                                                                                                                                                                                                 |
| <b>PI- 12. Multi-year perspective in fiscal planning, expenditure policy and budgeting</b> | <b>D</b> |                                                                                                                                                                                                 |
| (i) multi-year fiscal forecasts and functional allocations                                 | <i>D</i> | GRMI operates an annual, rather than a multi-year, budget process, and no forward estimates of fiscal aggregates for any category of expenditure classification are prepared.                   |
| (ii) scope and frequency of debt sustainability analysis                                   | <i>D</i> | No debt sustainability analyses have been carried out in recent years (including in the last 3 years)                                                                                           |
| (iii) existence of costed sector strategies                                                | <i>D</i> | A small number of updated strategies have been prepared (e.g. for health and EPA), but none has been costed.                                                                                    |
| (iv) linkages between investment budgets and forward expenditure estimates                 | <i>D</i> | The budgeting processes for recurrent and investment spending are separate, and recurrent implications of investment spending are not considered for inclusion in LMs' future recurrent budgets |

## **PI-13. Transparency of Taxpayer Obligations and Liabilities**

### ***The importance of transparent taxpayer obligations***

Effective assessment of tax liability is subject to the overall control environment that exists in the revenue administration system (ref. PI-14) but is also very dependent on the direct involvement and co-operation of the taxpayers from the individual and corporate private sector. Their contribution to ensuring overall compliance with tax policy is encouraged and facilitated by a high degree transparency of tax liabilities, including clarity of legislation and administrative procedures, access to information in this regard, and the ability to contest administrative rulings on tax liability.

A good tax collection system encourages compliance and limits individual negotiation of tax liability by ensuring that tax legislation is clear and comprehensive and that it limits discretionary powers (especially in decisions on tax assessments and exemptions) of the government entities involved, such as e.g. the revenue administration (RA), the ministry of finance and investment promotion agencies.

It should be noted that a country's RA may comprise several entities, each of which has revenue collection as its principal function (e.g. an Inland Revenue Agency and a Customs Authority). All of those entities should be included in the assessment of the revenue related indicators PI-13, PI-14 and PI-15, where it is relevant.

Taxpayer education is an important part of facilitating taxpayer compliance with registration, declaration and payment procedures. Actual and potential taxpayers need easy access to user friendly, comprehensive and up-to-date information on the laws, regulations and procedures (e.g. posted on government websites, made available through taxpayer seminars, widely distributed guidelines/pamphlets and other taxpayer education measures). Potential taxpayers also need to be made aware of their liabilities through taxpayer education campaigns.

Taxpayers' ability to contest decisions and assessment made by the revenue administration requires the existence of an effective complaints/appeals mechanism, that guarantees the taxpayer a fair treatment. The assessment of the tax appeals mechanism should reflect the *existence* in practice of such a system, *its independence* in terms of organizational structure, appointments and finance, *its powers* in terms of having its decisions acted upon as well as its *functionality* in terms of access (number and size of cases), efficiency (case processing periods), and fairness (balance in verdicts).

### ***Current situation in RMI***

The main sources of domestic tax revenues are: (i) import tax (customs); (ii) income tax (wages and salaries tax); (iii) business gross revenue tax (GRT); (iv) immovable property tax; (v) hotel and resort tax; and (vi) non-resident gross income tax. Of these six, wages and salaries tax, import duties, and GRT represent the overwhelming majority of domestic revenue receipts. A separate tax, levied on the value of all copra delivered for processing, is collected by Tobolar, RMI's copra processing authority. This tax is used exclusively for local governments and is considered a local government tax; for this reason, this assessment will concentrate on the first six types of tax revenues listed above, which are used to fund central government's activities.

A summary of the current tax structure is set out in Box 3.8. Income tax is applied to wages and salaries at graduated rates. Business tax is applied to gross revenues of service-related enterprises generated anywhere in RMI, except on Kwajalein, where a sales tax is applied. Import taxes are generally ad valorem; duties range from 5% to 75%, with an average rate of 10%. Specific duties apply to cigarettes, soft drinks, beer, spirits, wine, gasoline, and other gases and fuels. Finally, a fuel tax is in place.

**Box 3.8: Overview of RMI current tax system (central government)<sup>1</sup>**

| <b>Tax type</b>                                                                                 | <b>Taxable base</b>                                                                          | <b>Tax rate</b>                                                                                                                                                                                       |
|-------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Wages and salaries tax                                                                          | Wage income: 0-\$1,560<br>\$1,560-\$5,200<br>\$5,200-\$10,400<br>>\$10,400                   | 0%<br>8% (first \$1,560 exempted)<br>8% (no exemption for first \$1,560)<br>12%                                                                                                                       |
| GRT                                                                                             | Gross revenue <\$10,000<br>Gross revenue >\$10,000                                           | \$80<br>3% of gross income                                                                                                                                                                            |
| Import duties                                                                                   | Standard rate<br>Food & public transport<br>Fuel<br>Motor vehicles<br><br>Tobacco<br>Alcohol | 8%<br>5% (some basic foods exempt)<br>\$0.25/gal (gas); \$0.08/gal (jet, diesel)<br>Higher of \$1,500 or 15% of Kelly's Blue Book value<br>Rates according to schedule<br>Rates according to schedule |
| Immoveable property tax                                                                         | Gross income from leased property                                                            | 3%                                                                                                                                                                                                    |
| Hotel and resort tax                                                                            | Daily room rate                                                                              | 8%                                                                                                                                                                                                    |
| Non-resident gross income tax                                                                   | Gross income earned on non-resident contracts                                                | 10%                                                                                                                                                                                                   |
| Retirement Fund contribution                                                                    | Employer<br><br>Employee<br>Self-employed                                                    | 7% of gross wage and salary<br><br>7% of gross wage and salary<br>14% of presumed wage                                                                                                                |
| Health Fund contribution                                                                        | Employer<br><br>Employee<br>Self-employed                                                    | 3.5% of gross wage and salary<br><br>3.5% of gross wage and salary<br>7% of presumed wage                                                                                                             |
| Notes: 1. Excludes local government sales tax (Kwajalein) and copra tax.<br>Source: TRAM report |                                                                                              |                                                                                                                                                                                                       |

Data on tax collections by revenue type for FY10 are contained in Table 3.2. According to the TRAM report, the percentage of tax receipts as a share of GDP is among the lowest in the Pacific region.

**Table 3.2: Overview of types of tax revenues collected by central government**

|                                                                                                                                                                                                                                                                                      | <b>Tax revenue receipts<br/>(FY10)<br/>US\$'000</b> | <b>As % of total</b> |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------|----------------------|
| Wages and salaries tax (income tax)                                                                                                                                                                                                                                                  | 10,812                                              | 42.8%                |
| Customs duties                                                                                                                                                                                                                                                                       | 7,722                                               | 30.6%                |
| Business Gross Revenue Tax (GRT)                                                                                                                                                                                                                                                     | 5,682                                               | 22.5%                |
| Immovable Property Tax                                                                                                                                                                                                                                                               | 242                                                 | 1.0%                 |
| Hotel and Resort Tax                                                                                                                                                                                                                                                                 | 70                                                  | 0.3%                 |
| Non-resident Gross Income Tax                                                                                                                                                                                                                                                        | 99                                                  | 0.4%                 |
| Other <sup>1</sup>                                                                                                                                                                                                                                                                   | 617                                                 | 2.4%                 |
| <b>Total Taxes</b>                                                                                                                                                                                                                                                                   | <b>25,243</b>                                       | <b>100.0%</b>        |
| Above taxes as % of GDP                                                                                                                                                                                                                                                              | 15.5%                                               |                      |
| <b>Total domestic revenue receipts as % of GDP<sup>3</sup></b>                                                                                                                                                                                                                       | <b>24.7%</b>                                        |                      |
| <sup>1</sup> . Data exclude receipts from MISSA withholding tax and copra tax.<br><sup>2</sup> . Includes non-resident workers' fees (penalty & interest), and tax audit adjustment<br><sup>3</sup> . Data are from IMF and include all sources of domestic revenues.<br>Source: MoF |                                                     |                      |

The most recent IMF Article IV report<sup>14</sup> indicates that some immediate steps have been taken to improve tax collection, but that the current tax structure is now considered to be largely outdated. A full review of the tax system is scheduled for 2012, and tax reforms are planned from the latter part of the current fiscal year (FY12).

*(i) Clarity and comprehensiveness of tax liabilities*

Legislation covering RMI tax liabilities and procedures for the taxes listed in Box 3.8 above are set out in the Taxation Act (MIRC Title 48), the Social Security Act (MIRC Title 49), the Health Fund Act (MIRC Title 7), and the Copra Tax Act (MIRC Title 4), (see Box 3.9). There are no supplementary procedures documented. Responsibility for tax administration for the main types of taxes<sup>15</sup> is under the authority of the Revenue & Taxation, Customs and Treasury Division of MoF.

The assessment of this indicator focuses on the two main tax laws, the Income Tax Act 1989 (providing for wage and salary tax, gross revenue tax and hotel tax) and the Import Duties Act 1989, which are collated as Chapters 1 and 2, respectively, under Title 48 in the MIRC (as shown in Box 3.8 above). In terms of its comprehensiveness, the legislation is simple and covers the main points, and the liability for taxes is reasonably simple and clear. The legislation makes reference in a number of places to the Minister's ability to issue regulations. However, as there was no evidence of any regulations supporting these Acts in place, this absence (of regulations) adversely affects the clarity of procedures; regulations serve to address procedural issues and thereby help ensure procedures for all tax types are comprehensive and clear.

Administrative discretion is fairly limited in the legislation for the main tax types. There is limited discretion to grant exemptions or other relief from tax payable other than as specified in the legislation. There do not appear to be any extra statutory exemptions granted. Anecdotal evidence suggests that administrative discretion by revenue officers appears to be applied to waivers and penalties at times, providing an illustration of some lack of clarity in the legislation in the absence of regulations, as indicated above. However, this anecdotal evidence on discretion in practice does not alter the basic fact that the legislation provides for reasonably limited administrative discretion.

<sup>14</sup> IMF Country Report 11/339, November 2011.

<sup>15</sup> Specifically, wages and salaries (income) tax, customs duties, business gross revenue tax, immovable property tax, hotel and resort tax, and non-resident gross income tax.

Comprehensive changes to the fiscal policy framework from 2012 have been proposed, which will see the tax base broadened to include a net profits income tax and a value added tax. This will be accompanied by new tax administration legislation.<sup>16</sup>

### Box 3.9: Types of taxes, RMI

| Tax type                            | Relevant legislation                                        |
|-------------------------------------|-------------------------------------------------------------|
| Wages and salaries tax (income tax) | Income Tax Act 1989 [MIRC Title 48, Chapter 1], Part II     |
| Customs duties                      | Import Duties Act 1989 [MIRC Title 48, Chapter 2], Part III |
| Business Gross Revenue Tax (GRT)    | Income Tax Act 1989 [MIRC Title 48, Chapter 1], Part III    |
| Immovable Property Tax              | Income Tax Act 1989 [MIRC Title 48, Chapter 1], Part V      |
| Hotel and Resort Tax                | Income Tax Act 1989 [MIRC Title 48, Chapter 1], Part XI     |
| Non-resident Gross Income Tax       | Income Tax Act 1989 [MIRC Title 48, Chapter 1], Part VI     |
| Retirement Fund contribution        | Social Security Act [MIRC Title 49, Chapter 1], Part V      |
| Health Fund contribution            | Health Fund Act [MIRC Title 7, Chapter 2], Part III         |
| Copra Tax                           | Copra Tax Act 1992, [MIRC Title 4, Chapter 3]               |
| Source: MIRC                        |                                                             |

#### *(ii) Taxpayers' access to information on tax liabilities and administrative procedures*

There is no systematic process for providing information on tax liabilities to the public. The legislation is not available on-line, and there are no brochures available to guide taxpayers. Some very limited information is provided on the back of the income tax forms on how to fill them out. The dispersed nature of the population among geographically spread-out islands and the lack of budgetary resources mean that in practice it is difficult to provide information to the population as a whole. For those on the outer islands, in particular, it is very difficult to get information on tax liabilities; limited staffing in the Revenue Division mean that tax officers are not able to make periodic visits to the outer islands to carry out tax awareness and education.<sup>17</sup>

In practice, people wishing to seek clarification or find out basic information on tax liabilities and procedures are required to come into the MoF Customs, Revenue and Tax Division to do so. Given the number of people doing this, it would suggest that clear information on tax liabilities and administrative procedures is not easily accessible elsewhere and would appear to indicate a significant appetite for information that is more easily accessible. The Customs, Revenue and Tax Division does not systematically carry out tax awareness and education campaigns. The media are not used systematically. There is a lack of relevant tax information in other languages, particularly Chinese, which is significant, since many of the major businesses are Taiwanese. Triangulation with stakeholders confirmed that, for new businesses starting up, including those from overseas, it was difficult for taxpayers to understand the tax system and their tax obligations and to know where to get help.

#### *(iii) Existence and functioning of a tax appeals mechanism*

The legislation does not provide for an independent system of appeal of tax assessments. For taxes on wages and salaries, gross revenue, immovable property and non-resident income tax, the legislation (Section 130 of the Income Tax Act 1989) indicates that, in the first instance, the taxpayer can object to an assessment directly to the Secretary of Finance. Thereafter, the taxpayer may lodge an appeal with the High Court. In the Import Duties Act 1989, Section 214 sets out the conditions for the review of taxable amounts as relating to the granting of refunds, e.g. for lost or damaged goods, authorizable by the Secretary of Finance. In neither case is there an independent mechanism established specifically for tax appeals, either in legislation or in practice. Thus, a tax appeals system with documented administrative

<sup>16</sup> As discussed in the Tax and Revenue Reform and Modernization Commission's (TRAM) Report: "Republic of the Marshall Islands: A Holistic Approach to Reforming the Tax and Revenue System", 2009.

<sup>17</sup> It is true that the value of economic activity in these remote communities is low, and, given the high cost of travel, it would not necessarily represent value-for-money given scarce resources.

procedures is not in place.

It was not possible to get annual data on the number of appeals of tax assessments and the result of these appeals.

***RMI's most recent PI-13 Score:***

RMI's most recent score in this area is set out in Table 13.

**Table 13. Transparency of taxpayer obligations and liabilities – 2012 PEFA score**

| Indicator (M2)                                                                       | Score     | Brief Explanation                                                                                                                                                                                                                                       |
|--------------------------------------------------------------------------------------|-----------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                              |           |                                                                                                                                                                                                                                                         |
| <b>PI-13. Transparency of taxpayer obligations and liabilities</b>                   | <b>D+</b> |                                                                                                                                                                                                                                                         |
| (i) Clarity and comprehensiveness of tax liabilities                                 | <i>B</i>  | Tax legislation is clear and comprehensive for most major tax types, with fairly limited discretionary powers, but the lack of regulations to accompany the legislation reduces the legislation's clarity. The criteria for a higher score are not met. |
| (ii) Taxpayer access to information on tax liabilities and administrative procedures | <i>D</i>  | Taxpayers do not have easy access to information on tax liabilities and administrative procedures                                                                                                                                                       |
| (iii) Existence and functioning of a tax appeals mechanism                           | <i>D</i>  | No tax appeals system with documented administrative procedures is in place.                                                                                                                                                                            |

## **PI-14. Effectiveness of measures for taxpayer registration and tax assessment**

### ***The importance of taxpayer registration and assessment***

Effectiveness in tax assessment is ascertained by an interaction between registration of liable taxpayers and correct assessment of tax liability for those taxpayers.

Taxpayer registration is facilitated by control mechanisms introduced by the revenue administration (RA). Maintenance of a taxpayer database based on a unique taxpayer identification number is an important element of such a control system, but is most effective if combined with other government registration systems that involve elements of taxable turnover and assets (such as e.g. issue of business licenses, opening of bank accounts and pension fund accounts). In addition, RAs should ensure compliance with registration requirements through occasional surveys of potential taxpayers e.g. by selective, physical inspection of business premises and residences.

Ensuring that taxpayers comply with their procedural obligations of taxpayer registration and tax declaration is usually encouraged by penalties that may vary with the seriousness of the fault. Effectiveness of such penalties is determined by the extent to which penalties are sufficiently high to have the desired impact, and are consistently and fairly administered.

Modern RAs rely increasingly on self-assessment and use risk targeted auditing of taxpayers as a key activity to improve compliance and deter tax evasion. Inevitable resource constraints mean that audit selection processes must be refined to identify taxpayers and taxable activities that involve the largest potential risk of non-compliance. Indicators of risk are the frequency of amendments to returns and additional tax assessed from tax audit work. Collection and analysis of information on non-compliance and other risks is necessary for focusing tax audit activities and resources towards specific sectors, and types of taxpayers have the highest risk of revenue leakage. More serious issues of non-compliance involve deliberate attempts of tax evasion and fraud, which may involve collusion with representatives of the RA. The ability of the RA to identify, investigate and successfully prosecute major evasion and fraud cases on a regular basis is essential for ensuring that taxpayers comply with their obligations.

### ***Current situation in RMI***

#### ***(i) Controls in the taxpayer registration system***

All taxpayers of direct and indirect taxes administered by the Customs, Revenue and Tax Division are supposed to register with Division, and they are given a unique taxpayer number. The systems for managing information for each type of tax are primarily manual, with liability and payment information for GRT and personal income tax entered into a stand-alone Access database. The management of other types of taxes is not yet automated. There are no direct linkages or systematic sharing of information between the business (GRT) and personal income taxes managed by the Customs, Revenue and Tax Division and the wage-based social security taxes collected by MISSA. Any sharing of information between the two agencies is ad hoc and stakeholders indicate that such requests for information are not received regularly.

There are no systematic checks in place to ensure that all relevant taxpayers have in fact registered. There are no direct linkages with any government business registration databases, and no systematic indirect reconciliation mechanisms, such as checks of local newspapers or websites to identify unregistered potential taxpayers in order to supplement taxpayer registration system controls.

#### ***(ii) Effectiveness of penalties for non-compliance with registration and tax declarations***

The individual Acts covering legislation for each of the main types of tax set out penalties for

not complying with rules for registering and submitting returns. Penalties are charged in accordance with the Income Tax Act (1989) (for all taxes covered by the Act) on late payment, at the rate of 2% of the tax amount for late filing and a further 1% interest (charged monthly until the tax is paid) on the same amount. This compares to the banking sector's commercial lending rate of around 9%. Other taxes, specifically, customs duties, are required to be paid prior to the receipt of bonded goods, and therefore no penalties apply. Penalties are determined manually, and, given limited resources, active follow-up of collections may be focused relatively more on the largest debts, but may not be systematic.

It was impossible to determine the extent to which the cost of compliance is significant enough to deter non-compliance. A concerted effort was made to collect documentary evidence to determine the effectiveness of penalties on the level of compliance. Penalties exist and are collected (see Table 3.3), but the lack of enforcement (weak control environment) means that levels of compliance are likely to be poor. However, there was insufficient information to determine the degree of impact that the current penalty regime has on non-compliance and thus whether the score for this sub-dimension should be a C or a D.

| <b>Table 3.3: Value of total penalties charged by year (US\$)<sup>1</sup></b>                             |        |        |                   |
|-----------------------------------------------------------------------------------------------------------|--------|--------|-------------------|
|                                                                                                           | FY09   | FY10   | FY11 <sup>2</sup> |
| Penalties collected                                                                                       | 77,133 | 89,896 | 68,834            |
| Penalties as % of total tax revenue                                                                       | 0.3%   | 0.4%   | 0.3%              |
| 1. For all taxes, excluding customs, MISSA withholding tax, and copra tax.<br>2. Estimated<br>Source: MoF |        |        |                   |

*(iii) Planning and monitoring of tax audit programs*

For gross revenue tax, the Tax, Revenue and Customs Division of MoF manually prepares a list of companies to audit, mainly for GRT, over the coming two years (e.g. one was prepared at the beginning of 2011 to cover both 2011 and 2012). However, no clear criteria are documented for how companies to be audited are selected. In practice, they tend to be selected on the basis of size of business and ease of access to information on company records. Limited staff capacity means that approximately 15 audits are carried out each year, which is a very small proportion of the total number of companies liable for GRT. No other audits (e.g. for other types of taxes) are systematically carried out.

In practice, there is insufficient staff capacity for tax auditors to make regular or even periodic visits to the outer islands to undertake audits or fraud investigations or to carry out tax awareness and education. These visits are irregular because of the high cost of travel to, and the low value of, economic activity in these remote communities. At the same time, staff numbers are insufficient to undertake post-customs clearance inspections.

**RMI's most recent PI-14 Score:**

RMI's most recent score in this area is set out in Table 14.

**Table 14. Taxpayer registration and assessment – 2012 PEFA score**

| Indicator                                                                                        | Score     | Brief Explanation                                                                                                                                                                                                                                                                    |
|--------------------------------------------------------------------------------------------------|-----------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                          |           |                                                                                                                                                                                                                                                                                      |
| <b>PI-14. Effectiveness of measures for taxpayer registration and tax assessment</b>             | <b>NR</b> |                                                                                                                                                                                                                                                                                      |
| (i) Controls in taxpayer registration system                                                     | <i>D</i>  | There are no linkages between the taxpayer record system, the receipts database, and other government registration or licensing systems. No surveys of potential taxpayers have been carried out. The requirements for a higher score are not met.                                   |
| (ii) Effectiveness of penalties for non-compliance with registration and declaration obligations | <i>NR</i> | Sufficient information to assess fully the effect of penalties on compliance was not available.                                                                                                                                                                                      |
| (iii) Planning and monitoring of tax audit and fraud investigation programs                      | <i>C</i>  | The Treasury, Taxation, Revenue and Customs Division of MoF manually prepares a list of companies to audit for the coming one or two years. However, no clear criteria are documented for how companies to be audited are selected. The requirements for a higher score are not met. |

## PI-15. Effectiveness in collection of tax payments

### *The importance of effective tax collection*

Accumulation of tax arrears can be a critical factor undermining high budgetary outturns, while the ability to collect tax debt lends credibility to the tax assessment process and reflects equal treatment of all taxpayers, whether they pay voluntarily and need close follow up. The level of tax arrears itself does not necessarily correlate to the effectiveness of the tax collection system, since a major tax assessment drive may substantially increase tax arrears. However, the RA's ability to collect the taxes assessed is critical, unless the overall level of arrears is insignificant. Part of the arrears collection effort relates to resolution of tax debt in dispute. In some countries, tax arrears in dispute constitute a significant part of the total tax arrears, for which reason there may be a major difference between gross and net arrears (including and excluding disputes respectively).

Prompt transfer of the collections to the Treasury is essential for ensuring that the collected revenue is available to the Treasury for spending. This may take place either by having a system that obliges taxpayers to pay directly into accounts controlled by the Treasury (possibly managed by a bank) or, where the RA maintains its own collection accounts, by frequent and full transfers from those accounts to Treasury controlled accounts (time periods mentioned do not include delays in the banking system).

Aggregate reporting on tax assessments, collections, arrears and transfers to (and receipts by) the Treasury must take place regularly and be reconciled, where appropriate, in order to ensure that the collection system functions as intended, that tax arrears are monitored and the revenue float is minimized.

### *Current situation in RMI*

#### *(i) Collection ratio for gross tax arrears*

Table 3.4 sets out the opening and closing balances (the stock) of tax arrears. Most of the closing balance of tax arrears of 3.7 mn is more than six years old, and beyond the statute of limitation; however, there is no procedure for writing off old debts.

While data on the stock of arrears are available, the Tax, Revenue and Customs Division does not systematically collect annual data on the flow (i.e. in-year changes) of overdue tax payments (arrears), specifically the generation of new arrears and the settlement (clearance) of arrears each year, and it was not possible to get this data on an ad hoc basis. Thus, it was not possible to determine the collection ratio for gross tax arrears and thus the appropriate score for the indicator.

**Table 3.4: Stock of tax arrears<sup>1</sup> (US\$)**

|                                                                                                | FY09      | FY10      | FY11      |
|------------------------------------------------------------------------------------------------|-----------|-----------|-----------|
| Stock of arrears – opening balance                                                             | N/A       | 3,082,177 | 3,560,833 |
| In-year generation of new arrears                                                              | -         | -         | -         |
| In year clearance (settlement) of arrears                                                      | -         | -         | -         |
| Stock of arrears – closing balance                                                             | 3,082,177 | 3,560,833 | 3,713,968 |
| Closing arrears as % of tax revenues                                                           | 12.7%     | 14.1%     | 16.5%     |
| 1. All sources of tax revenues except customs, for which no data are available.<br>Source: MoF |           |           |           |

#### *(ii) Effectiveness of transfers of tax collections to the Treasury by the revenue administration*

All tax collections are made at the Majuro and Ebeye offices of the Ministry of Finance. Revenues collected are transferred to the Treasury (the cashier) on a daily basis, at least by the day following receipt. Audit reports over the last three years have not indicated any

issues with the banking of revenue collections.<sup>18</sup>

There can be a delay in the reconciliation of the cash books for the two MoF offices and the revenue collection data in the FMIS, since the Ministry of Finance in Ebeye does not have a live systems link to the FMIS (due to limited bandwidth). The synchronisation of the systems can be delayed due to staff travel or communications problems.

*(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury*

No evidence was provided to show that complete reconciliations of tax accounts are carried out each year. This conclusion is strengthened by the fact that tax and payment records are maintained in separate, un-linkable systems, which would require manual reconciliation.

#### **RMI's most recent PI-15 Score:**

RMI's most recent score in this area is set out in Table 15.

**Table 15. Effective tax collection – 2012 PEFA score**

| Indicator                                                                                                                                                  | Score     | Brief Explanation                                                                                   |
|------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|-----------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                                                                                    |           |                                                                                                     |
| <b>PI-15. Effectiveness in collection of tax payments</b>                                                                                                  | <b>NR</b> |                                                                                                     |
| (i) Collection ratio for gross tax arrears, being percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year | NR        | Data on arrears collection ratios are not available                                                 |
| (ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration                                                            | A         | Collections for all revenues are transferred to the Treasury daily.                                 |
| (iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury                     | D         | There was no evidence of complete reconciliations of tax accounts being systematically carried out. |

#### **PI-16. Predictability in the availability of funds for commitment of expenditures**

##### ***The importance of predictable availability of funds***

Effective execution of the budget, in accordance with the work plans, requires that the spending ministries, departments and agencies (MDAs) receive reliable information on availability of funds within which they can commit expenditure for recurrent and capital inputs. This indicator assesses the extent to which the central ministry of finance provides reliable information on the availability of funds to MDAs, that manage administrative (or program) budget heads (or votes) in the central government budget and therefore are the primary recipients of such information from the ministry of finance. The MDAs concerned in this indicator are the same as those concerned in indicator PI-11.

In some systems, funds (commitment ceilings, authority to spend or transfers of cash) are released by the ministry of finance in stages within the budget year (monthly, quarterly etc). In others, the passing of the annual budget law grants the full authority to spend at the

<sup>18</sup> However, it is noted that the single audit does not look systematically at this issue.

beginning of the year, but the ministry of finance (or other central agency) may in practice impose delays on ministries in incurring new commitments (and making related payments), when cash flow problems arise. To be reliable, the amount of funds made available to an entity for a specific period should not be reduced during that period.

Predictability for MDAs in the availability of funds is facilitated by effective cash flow planning, monitoring and management by the Treasury, based on regular and reliable forecasts of cash inflows and of major, atypical outflows (such as the cost of holding an election and discrete capital investments) which are linked to the budget implementation and commitment plans for individual MDAs, and incorporates the planned in-year borrowing to ensure adequate liquidity at any time.

Governments may need to make in-year adjustments to allocations in the light of unanticipated events impacting revenues and/or expenditures. The impact on predictability and on the integrity of original budget allocations is minimized by specifying, in advance, an adjustment mechanism that relates adjustment to the budget priorities in a systematic and transparent manner (e.g. protection of particular votes or budget lines that are declared to be high priority, or say 'poverty related'). In contrast, adjustments can take place without clear rules/guidelines or can be undertaken informally (e.g. through imposing delays on new commitments). While many budget adjustments can take place administratively with little implication for the expenditure composition outturn at the more aggregate level of budget classifications, other more significant changes may change the actual composition at fairly aggregate administrative, functional and economic classification levels. Rules for when the legislature should be involved in such in-year budget amendments are assessed in PI-27 and not covered here.

The adherence of MDAs with the ceilings for expenditure commitment and payments is not assessed here, but is covered by indicator PI-20 on internal controls.

### ***Current situation in RMI***

#### ***(i) Extent to which cash flows are forecast and monitored***

While some cash planning takes place by MoF, in the form of in-year revenue projections, line ministries do not provide MoF with their in-year (e.g. monthly or quarterly) cash requirements for the year, either at the beginning of, or during, the fiscal year. This lack of information on line ministries' cash needs, particularly for large and/or lumpy spending (e.g. capital), inhibits MoF from undertaking annual cash planning and monitoring.

#### ***(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment***

For General Fund expenditures, MoF does not provide line ministries with explicit (documented) commitment ceilings (e.g. each month or quarter by line item, in accordance with cash availability [or non-availability], as happens in some other countries). Instead, the FMA stipulates that a ministry may commit up to one-quarter (3/12) of its annual allocation each quarter. However, this limit is automatic and is not based on cash availability.

In practice, cash-related restrictions on line ministry expenditures from the General Fund are provided in two ways: (i) in an aggregate form to all line ministries through ad hoc MoF memoranda on control measures for General Fund purchases in response to in-year expenditure deficits (e.g. the MoF memo issued in January 2011 set out a freeze on requests for travel and purchases of materials and supplies); and (ii) as a form of implicit commitment control, through slowing down approvals of spending commitments (through the process of issuing Purchase Orders). Thus, in reality, expenditure limits for line ministries are lower than the theoretical one-quarter amount.

The assessment notes that the aggregate (i.e. not specific to individual line ministries)

restrictions on expenditures affect line ministries' in-year expenditure planning in the following manner: (i) the aggregate MoF-documented expenditure control measures have tended to be communicated to the line ministries with only one week's advance notice;<sup>19</sup> and (ii) because the MoF-communicated restrictions are not specific to individual line ministries nor, in the case of implicit commitment controls, is it made explicit to individual line ministries the extent to which there will be delays in issuing their own purchase orders, they are, in practice, unable to plan in advance with certainty.

GRMI is currently working with PFTAC to develop a commitment control manual, which may subsequently lead to the establishment of a formal GRMI commitment control system.<sup>20</sup>

*(iii) Frequency and transparency of adjustments to budget allocations, decided above the level of management of MDAs*

Both the Constitution and the FMA have sections on the "re-programming" of expenditures (adjustments to budget allocations above the level of line ministry management). In the former, Section 7 of Article VIII, in referring to transfers of money appropriated for one program area to be spent in another program area, stipulates that Cabinet (not MoF) has the authority to authorize such re-programming, provided that the total amount reprogrammed does not increase or decrease by more than 10% the total funds appropriated for the relevant program areas.<sup>21</sup>

The FMA reiterates that the Cabinet has the authority to reprogram budgeted estimates in accordance with Section 7 of Article VIII the Constitution. It further stipulates that, with the approval of the relevant minister in charge of the affected program area, funds which have been authorized by appropriation of the Nitjela or by Cabinet approval of anticipated or reprogrammed expenditures and which have been allocated to sub-categories of program areas may be transferred among subcategories within the same program area. Furthermore, it provides for the Secretary of Finance to promulgate regulations to govern when such funds can be transferred; there was no evidence that such regulations are in place.

In terms of transparency of in-year budget adjustments, in the absence of regulations setting out the requirements (including documentation and justification criteria) for such reprogramming requests and in the absence of such documented justification for changes (no such evidence was provided), it is reasonable to assume that the adjustments are not done transparently (e.g. documented as justified against clearly-set out criteria). Stakeholder consultations indicated that such adjustments are done frequently during the year.

***RMI's most recent PI-16 Score:***

RMI's most recent score in this area is set out in Table 16.

**Table 16. Predictable availability of funds – 2012 PEFA score**

<sup>19</sup> Based on the January 2011 MoF memo.

<sup>20</sup> See reports from recent PFTAC missions.

<sup>21</sup> In summary, the Executive is not permitted to approve spending of more than 10% above the total amount appropriated, as this requires approval by Parliament (this is assessed under PI-27 below).

| Indicator (M1)                                                                                                                | Score    | Brief Explanation                                                                                                                                                                                                                                                                                                         |
|-------------------------------------------------------------------------------------------------------------------------------|----------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                                                       |          |                                                                                                                                                                                                                                                                                                                           |
| <b>PI-16. Predictability in the availability of funds for commitment of expenditures</b>                                      | <b>D</b> |                                                                                                                                                                                                                                                                                                                           |
| (i) Extent to which cash flows are forecast and monitored                                                                     | <i>D</i> | Line ministries do not provide MoF with their annual cash requirements, either at the beginning of, or during, the fiscal year, thus hampering annual cash planning and monitoring by MoF.                                                                                                                                |
| (ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure                              | <i>D</i> | While, in theory, a line ministry may commit up to one-quarter of its annual allocation each quarter, in practice, other implicit or <i>ad hoc</i> restrictions mean that line ministries have reliable information on amounts to commit less than one month in advance. The requirements for a higher score are not met. |
| (iii) Frequency and transparency of adjustments to budget allocations which are decided above the level of management of MDAs | <i>D</i> | In-year budget adjustments are made frequently and their basis is not transparent.                                                                                                                                                                                                                                        |

#### **PI-17. Recording and management of cash balances, debt and guarantees**

##### ***The importance of managing cash balances, debt and guarantees***

Debt management, in terms of contracting, servicing and repayment, and the provision of government guarantees are often major elements of overall fiscal management. Poor management of debt and guarantees can create unnecessarily high debt service costs and can create significant fiscal risks. The maintenance of a debt data system and regular reporting on main features of the debt portfolio and its development are critical for ensuring data integrity and related benefits such as accurate debt service budgeting, timely service payments, and well planned debt roll-over.

An important requirement for avoiding unnecessary borrowing and interest costs is that cash balances in all government bank accounts are identified and consolidated (including those for extra-budgetary funds and government controlled project accounts). Calculation and consolidation of bank accounts are facilitated where a single Treasury account exists or where all accounts are centralized. In order to achieve regular consolidation of multiple bank accounts not held centrally, timely electronic clearing and payment arrangements with the government's bankers will generally be required.

Critical to debt management performance are also the proper recording and reporting of government issued guarantees, and the approval of all guarantees by a single government entity (e.g. the ministry of finance or a debt management commission) against adequate and transparent criteria.

Undertaking of debt sustainability analyses is covered under multi-year perspectives in PI-12, whereas monitoring of liabilities arising from guarantees issued is covered under fiscal risk oversight in PI-9.

##### ***Current situation in RMI***

###### ***(i) Quality of debt data recording and reporting***

Responsibility for debt recording and reporting is that of the Ministry of Finance. There is no separate debt management office, although there are plans to establish one. GRMI borrows from external sources only (there is no domestic borrowing), and, during the last several

years, concessional loans have been provided exclusively by the Asian Development Bank (ADB). There is no specific Debt Management Office, and active management of external debt is limited, due in part to the limited number of external loans. A simple spreadsheet is used to record and monitor debt payments and data on the debt stock. Given the limited nature of the debt portfolio, this process is relatively simple in practice. No analytical or statistical reports are systematically produced. An analysis of the debt information has revealed non-comprehensiveness in the data.<sup>22</sup> No evidence was provided to show that reconciliation of records beyond updating the spreadsheet after each debt service payment, i.e. with records from lending institutions, is undertaken systematically (including annually).

*(ii) Extent of consolidation of government's cash balances*

The government's cash resources are held at 8 commercial banks. The main General Fund (for domestic revenues and all central government's non-payroll operational spending) is held in part at the Bank of Guam and in part (for Ebeye) at the Bank of Marshall Islands. The payroll account for both Majuro and Ebeye are held at the Bank of Marshall Islands. Compact funds are held at the Bank of Guam, under the terms of the Compact agreement. Line ministries do not hold their own accounts or sub-accounts within the General Fund. Cash balances from the two General Funds (the Treasury accounts, including a separate one for Ebeye) are calculated every day. The balances from each of the other operational accounts<sup>23</sup>, including the payroll account, are calculated on an individual basis, and most (but not all) are done regularly.<sup>24</sup> All ending balances are provided to the Secretary of Finance regularly (in some cases, on a daily basis). However, there was no evidence that consolidation (as distinct from calculation of balances) of all Treasury's accounts (including accounts covering payroll and operations) take places at least each month. At the same time, the domestic banking system in the Marshall Islands does not facilitate the consolidation of bank balances, and thus the calculation of consolidated bank balances is not carried out systematically.

*(iii) Systems for contracting loans and issuance of guarantees*

The legislation relating to the contracting of loans and the issuance of guarantees is provided in Chapter 10 of Title 11 of the MIRC. It grants the authority for entering into loan agreements and for issuing loan guarantees (e.g. to a public corporation) to the Minister of Finance, with the agreement of Cabinet.

In practice, GRMI contracts only very limited numbers of loans and issues relatively few guarantees. In the two most recent fiscal years (FY10 and FY11), there was only 1 loan contracted (by the ADB, for on-lending to SOEs), and no government guarantees were issued.<sup>25</sup>

Prior to the most recent loan, a Cabinet Paper (CP) was prepared, setting out the rationale for the loan, and its terms and conditions. An analysis of the fiscal impact of the loan was provided by MoF as an input into the CP. Upon Cabinet approval of the proposal, and the official issuance of a Cabinet Minute (CM), the loan was approved. No other loans have been entered into in recent years, including in the last fiscal year.

---

<sup>22</sup> For example, it was not possible to identify the inflow (disbursements) of new loans, such as that concluded with the ADB in FY10 but whose first tranche disbursement is referred to in the IMF's Article IV report of November 2011 as taking place in early FY11.

<sup>23</sup> GRMI operates approximately 35 accounts in total, with many being savings or investment accounts.

<sup>24</sup> One exception has been embassy accounts, whose balances may not be calculated regularly (in some cases, every quarter, during account reconciliation).

<sup>25</sup> The audited annual accounts include a list of guarantees issued by GRMI. All refer to arrangements made more than 3 years ago. One of the most recent government guarantees was issued in FY 2007, relating to a \$12 mn loan to MEC, for which the GRMI pledged a portion of the tax revenues from the General Fund.

In terms of government guarantees, despite the fact that SOEs require significant government support, this support primarily takes the form of direct subsidies from the budget, rather than government loan guarantees. One recent (FY11) proposed guarantee was presented to, and discussed by, Cabinet for a loan by the Export-Import Bank of the ROC to MEC and MIDB. Following Cabinet discussions, no sovereign guarantees were given. Instead, Cabinet approved the two SOEs to negotiate separately with the ExIm Bank for loans without government guarantees.

Thus, on the basis that the Cabinet may be considered a single responsible entity (on the basis of collective responsibility for Cabinet decisions under the President, as head of the government and Cabinet), the assessment concludes that the GRMI's system for contracting of loans and guarantees is always approved by a single responsible government entity.

At present, there are no documented guidelines, setting out clear criteria or overall ceilings, for the approval of loans and guarantees. A start on setting financial limits was made in June 2010, with the issuance of a Cabinet Minute indicating a freeze on new borrowing by government, including SOEs. However, this may be considered an ad hoc measure (restrictions on the flow of loans), rather than an overall permanent ceiling amount (overall ceiling on stock of loans). The Government's Comprehensive Adjustment Program (CAP) Advisory Group recommended in its final report<sup>26</sup> that GRMI prepare an external debt management strategy. GRMI has recognized that it needs to strengthen its sovereign liability and risk management, and has plans to work with the IMF on this in the current FY (FY12).

#### ***RMI's most recent PI-17 Score:***

RMI's most recent score in this area is set out in Table 17.

**Table 17. Recording and management of cash balances, debt and guarantees – 2012 PEFA score**

| Indicator                                                                   | Score     | Brief Explanation                                                                                                                                                                                                                                                                                          |
|-----------------------------------------------------------------------------|-----------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                     |           |                                                                                                                                                                                                                                                                                                            |
| <b>PI-17 Recording and management of cash balances, debt and guarantees</b> | <b>D+</b> |                                                                                                                                                                                                                                                                                                            |
| (i) Quality of debt data recording and reporting                            | <i>D</i>  | There are material omissions in the debt records. No analytical or statistical reports are produced. There is no evidence that reconciliation of records is carried out systematically (including annually). The requirements for a higher score are not met.                                              |
| (ii) Extent of consolidation of the government's cash balances              | <i>D</i>  | Cash balances for the main government accounts (General Fund O&M – Majuro and Ebeye) are calculated regularly (i.e. at least weekly), but for most other accounts the calculation is undertaken less regularly (monthly or less frequently). Consolidation of Treasury or bank balances is not undertaken. |
| (iii) Systems for contracting loans and issuance of guarantees              | <i>C</i>  | All loans and guarantees are approved by Cabinet. However, no documented guidelines or criteria for such loans/guarantees yet exist, nor are there total limits within which loans/guarantees should be made (beyond a freeze on new borrowings). The requirements for a higher score are not met.         |

#### ***Strategic Objectives in this Area:***

<sup>26</sup>

Final report, Comprehensive Adjustment Program Advisory Group, September 2009.

## **PI-18. Effectiveness of payroll controls**

### ***The importance of effective payroll controls***

The wage bill is usually one of the biggest items of government expenditure and susceptible to weak control and corruption. This indicator is concerned with the payroll for public servants only. Wages for casual labor and discretionary allowances that do not form part of the payroll system are included in the assessment of general internal controls (PI-20). However, different segments of the public service may be recorded in different payrolls. All of the more important of such payrolls should be assessed as the basis for scoring this indicator, and mentioned in the narrative.

The payroll is underpinned by a personnel database (in some cases called the “nominal roll” and not necessarily computerized), which provides a list of all staff, who should be paid every month and which can be verified against the approved establishment list and the individual personnel records (or staff files). The link between the personnel database and the payroll is a key control. Any amendments required to the personnel database should be processed in a timely manner through a change report, and should result in an audit trail. Payroll audits should be undertaken regularly to identify ghost workers, fill data gaps and identify control weaknesses.

### ***Current situation in RMI***

#### ***(i) Degree of integration and reconciliation between personnel records and payroll data***

Title 5, Chapter 1 of the MIRC sets out the Public Service Act, which governs the civil service. The employees of the majority of ministries and agencies operate under the rules and framework of the Public Service Commission (PSC). PSC’s role is to oversee human resource management, including the recruitment, promotion, and dismissal of employees, the approval of organizational structures, maintenance of the establishment list and the personnel database for all public servants under its remit, management of remuneration, job descriptions and job sizing as per the organization’s structure. Five ministries or agencies operate outside of the PSC’s aegis, including the Ministries of Police, Public Safety, and Judiciary, and the Land Registration Authority (LRA).

Public entities maintain three lists of personnel and payroll records: (i) payroll, maintained exclusively by MoF; (ii) personnel records (staff records), maintained by the line ministries; and (iii) establishment list (ministry structure with all posts), maintained by PSC. The 3 databases are separate, and there is no evidence of any reconciliation among the 3 lists.

#### ***(ii) Timeliness of changes to personnel records and the payroll***

The process of changing personnel records, including hiring and salary changes, is centered on the Personnel Action (PA) document and involves activity by the PSC, the initiating line agency and the Ministry of Finance.

Evidence, including from the logs maintained of changes to PAs, indicates that, while simple administrative changes may be completed in a relatively short time, other types of changes can take significantly longer. In particular, it can take more than 3 months (significantly more in some cases) to process changes to the payroll, particularly for new hires, resulting in regular and widespread retroactive changes. Extensive triangulation supports this assessment.

Problems affecting the timely completion of changes to payroll records throughout the process include errors in filling out the paperwork, requiring the request to be returned to the requesting ministry; the number of signatures required from senior management, who if they are unavailable due to travel out of the country may delay the process for some time; and a requirement for Cabinet approval for some changes.

The Ministry of Finance has recently begun an initiative known as Lean,<sup>27</sup> which has involved identifying the steps and the time taken in processing payments (e.g. payment requisitions or travel allowances), and analyzing how both the number of steps and the time may be reduced (see Section 4 below).

*(iii) Internal controls of changes to personnel records and the payroll*

While the process in Figure 3.1 sets out the procedures used in practice for updating personnel records and reflecting changes in the payroll, no formal documented internal control procedures are officially in place for payroll and personnel changes.<sup>28</sup> In terms of preparing the regular payroll, timesheets are submitted on behalf of the institution concerned by the relevant line ministry to MoF who makes payments directly into employees' respective accounts on a fortnightly basis.

Weaknesses in the internal control environment, including the lack of segregation of duties, increase the risk to the integrity of personnel and payroll data. The reliance on single personnel to make changes at each stage of the process, combined with the lack of regular or systematic reconciliation of information among the four institutions involved (specifically, PSC, the requesting service delivery unit (e.g. school), the requesting institution, and MoF)<sup>29</sup> and the lack of an international-standard internal audit function, mean that there are insufficient controls in place to guarantee the accuracy and integrity of the changes made to the databases. Stakeholder consultation corroborates this assessment.

*(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers*

There have been no comprehensive payroll or personnel audits undertaken in recent years, including not in the last 3 years. A limited personnel audit was carried out in 2009, with funding from an ADB technical assistance loan.<sup>30</sup> It focussed exclusively on studying options for rationalising public sector expenditure and improving performance in three ministries (Health, Education, and Public Works).<sup>31</sup>

**RMI's most recent PI-18 Score:**

RMI's most recent score in this area is set out in Table 18.

**Table 18. Effectiveness of payroll controls – 2012 PEFA score**

---

<sup>27</sup> The term was first associated with Taiichi Ohno, Vice President of Manufacturing at Toyota Motor Corporation. See Womack J, and Jones D (2003), *Lean Thinking: Banish Waste and Create Wealth in Your Corporation*, Free Press, New York.

<sup>28</sup> The Standard Operating Procedures manual developed by MoF, which has a section on payroll, has not been circulated and is not yet officially in place.

<sup>29</sup> For example, the fortnightly timesheets should be as part of the regular reconciliation process of providing checks and balances for changes to the personnel to payroll records, but there is no evidence that this reconciliation among the 4 institutions is done systematically.

<sup>30</sup> Lanki and Pitkin (2009), *Public Service Commission Limited Personnel Audit*.

<sup>31</sup> Its terms of reference were to (i) to identify examples of duplication in roles, responsibilities and activities between positions; (ii) to examine the accuracy of job descriptions in describing the key responsibilities and tasks of positions; and (iii) to identify any examples of misalignment between categorizing positions and remuneration received by position holders.

| Indicator                                                                                | Score     | Brief Explanation                                                                                                                                                                                                  |
|------------------------------------------------------------------------------------------|-----------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                  |           |                                                                                                                                                                                                                    |
| <b>PI-18. Effectiveness of payroll controls</b>                                          | <b>D+</b> |                                                                                                                                                                                                                    |
| (i) Degree of integration and reconciliation between personnel records and payroll data. | <i>D</i>  | The payroll and personnel databases at MoF, PSC and the line ministries are not linked, and no reconciliations are done amongst the three systems, thereby resulting in data whose quality is seriously deficient. |
| (ii) Timeliness of changes to personnel records and the payroll                          | <i>D</i>  | It can take more than 3 months (significantly more in some cases) to process changes to the payroll, particularly for new hires, resulting in regular and widespread retroactive changes.                          |
| (iii) Internal controls of changes to personnel records and the payroll.                 | <i>C</i>  | Non-officially-documented internal controls exist for changes to the payroll and personnel databases but the control environment is insufficient to ensure the integrity of the data.                              |
| (iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.    | <i>D</i>  | No payroll audits have been undertaken in recent years (and not in the last 3 years).                                                                                                                              |

#### **PI-19. Competition, value for money and controls in procurement**

##### ***The importance of effective procurement management***

Significant public spending takes place through the public procurement system. A well-functioning procurement system ensures that money is used effectively and efficiently. Open competition in the award of contracts has been shown to provide the best basis for achieving efficiency in acquiring inputs for and value for money in delivery of programs and services by the government. This indicator focuses on the quality and transparency of the procurement regulatory framework in terms of establishing the use of open and fair competition as the preferred procurement method and defines the alternatives to open competition that may be appropriate when justified in specific, defined situations.

The procurement system benefits from the overall control environment that exists in the PFM system, including internal controls operated by implementing agencies and external control undertaken by external audit, ref. PI-20, PI-21, PI-22 and PI-26.

Unique to the public procurement process, however, is the direct involvement of participants from the private sectors who, along with citizens, are direct stakeholders in the outcome of the procurement process. A good procurement system uses the participation of these stakeholders as part of the control system by establishing a clear regulated process that enables the submission and timely resolution of complaints submitted by private sector participants. Access to the process and information on complaints allows interested stakeholders to participate in the control of the system.

##### ***Current situation in RMI***

###### ***(i) Transparency, comprehensiveness and competition in the legal and regulatory framework***

The legislation covering procurement is set out in the Procurement Code (PC), found in Title 44 of the MIRC (2004 revised Code). The PC gives responsibility for procurement to the Office of the Chief Secretary and provides for the post of the Chief Procurement Officer under the Chief Secretary's Office. Although Section 120 of the Code provides for the establishment of separate regulations, there was no evidence that any such regulations have

been prepared or are in place.<sup>32</sup>

In terms of coverage of the legal/regulatory framework for each of the listed items, establishment of hierarchy and precedence is assumed through the fact that the legislative and regulatory framework is enshrined in a single Code. The Code is freely accessible to those with internet access on the Marshall Islands' Chamber of Commerce ([www.marshallislandschamber.net](http://www.marshallislandschamber.net)) and on the University of the South Pacific (USP)'s Pacific Islands Legal Information Institute ([www.pacii.org](http://www.pacii.org)) websites. In practice, there may be a significant proportion of the population, particularly in the outer islands, who do not have ready Internet access and/or for which English is not its first language. At the same time, since both websites hosting the Code are external to the executive, legislative, and judicial branches of RMI, it is in theory possible that the posting of the Code may not be sustained. However, neither of these points changes the fact that the Code is in practice freely available.

The Code stipulates that open competitive bidding is the default method of procurement (Section 124), and the situations in which alternative methods can be used are stated (Sections 127-130). These exceptions include: (i) procurement of small purchases of less than \$25,000; (ii) situations where there is a single supplier; and (iii) emergencies affecting public health, welfare or safety.

In terms of the scope of the legislative framework, Section 106 (2) of the Code exempts contracts between the Government and its political subdivisions and other governments. It may not be likely that Government will place procurement contracts with either its own political subdivisions or other governments, but it is possible. The Code therefore does not apply to all procurement undertaken using government funds. At the same time, the PC does not apply in full to procurement of purchases funded under the Compact agreement with the US, as a higher threshold exists for the use of less than openly competitive procurement methods than under the PC.

In terms of the legislation's provision for public access to specific types of procurement information, the publication of bidding opportunities is provided for (Sections 125 (3), 126 (3) and 158 (2)). Sections 125 (4) and 126 (4) provide for records of bid opening, including the bids themselves, to be open to public inspection, but contract awards are not mentioned. However, Section 143 states that details of all contracts let under sole source and emergency procurement arrangements should be available for public inspection. Finally, no independent administrative procurement complaints review process is provided for in the legislative and regulatory framework (Section 164).

As summarized in Box 3.10, RMI's procurement procedures meet three of the six PEFA criteria. The Cabinet has recently agreed to form a Working Group to review GRMI's existing procurement processes and make recommendations for improvement.

### **Box 3.10: Overview of Comprehensiveness of Procurement Legislative Framework**

---

<sup>32</sup> This information on the lack of regulations is based on conversations with stakeholders and a recent review of procurement procedures in RMI. See Mose Saitala, *Review of Government Procurement Policies and Practices*, May 2009.

| Item <sup>1</sup>                                                                                                                                                                                     | Covered in Legislative Framework? |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------|
| (i) be organized hierarchically and include clearly-established precedence                                                                                                                            | Yes                               |
| (ii) freely and easily accessible to the public                                                                                                                                                       | Yes                               |
| (iii) apply to all procurement undertaken using government funds                                                                                                                                      | No                                |
| (iv) make open competitive procurement the default method of procurement and define clearly the situation in which other methods can be used and how this is to be justified                          | Yes                               |
| (v) provide for public access to all of the following procurement information: government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints | No                                |
| (vi) provide for an independent administrative procurement review process for handling procurement complaints by participants prior to contract signature                                             | No                                |
| 1. Refers to criteria listed in PEFA manual under PI-19 (i)                                                                                                                                           |                                   |

*(ii) Use of competitive procurement methods*

As indicated above, the Procurement Code provides for the use of non-competitive methods of procurement (Sections 127-130). However, reliable data on the total number of procurement contracts and the percentage of those contracts awarded by alternative competitive methods are not available. At the same time, there is some ambiguity concerning the applicability (and hence appropriate justification) of the use of non-competitive methods, as supplementary regulations are not in place, as provided for in Sections 128-129 of the Code (e.g. the conditions under which emergency procedures are applicable). As a result, reliable information to enable proper scoring of this dimension is lacking.

*(iii) Public access to complete, reliable and timely procurement information*

Public access to procurement information is not comprehensive nor complete (see Box 3.11). Government does not produce or publish procurement plans. Information on bidding opportunities is not systematically advertised publicly. When a contract is awarded, there is no requirement to have an official notice to publicize the award of a tender. There is also no reporting of complaints as there is not an official complaints procedure provided for in the policies and procedures manual (see next paragraph).

**Box 3.11: Overview of Public Access to Procurement Information**

| Item <sup>1</sup>                            | Public Provided Timely Access? |
|----------------------------------------------|--------------------------------|
| Government procurement plans                 | No                             |
| Bidding opportunities                        | No                             |
| Contract awards                              | No                             |
| Data on resolution of procurement complaints | Not available                  |
| Note: 1. Refers to PEFA criteria in PI-19.   |                                |

*(iv) Existence of an independent administrative procurement complaints system*

As indicated above, the legislative framework does not include an independent administrative procurement review process for handling procurement complaints by participants prior to contract signature, nor has there been any other such system established in practice. Individuals or companies with a grievance may register complaints only with the Chief Procurement Officer or the Head of the Purchasing Agency – Section 164 (1). If the complaint is rejected at this level the only remaining recourse for the complainant is court action – Sections 164 (5) and 171 (1). If any tenderer or supplier wishes to make a complaint, s/he would be expected to do so directly to the Office of the Chief Secretary, which would investigate, and then advise the complainant of his/her decision. If the complainant is not

satisfied with this decision, it must pursue further action through the law courts.

***RMI's most recent PI-19 Score:***

RMI's most recent score in this area is set out in Table 19.

**Table 19. Competition, value for money and controls in procurement – 2012 PEFA score**

| Indicator                                                                                 | Score    | Brief Explanation                                                                                                                                                           |
|-------------------------------------------------------------------------------------------|----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                   |          |                                                                                                                                                                             |
| <b>PI-19. Competition, value for money and controls in procurement</b>                    | <b>D</b> |                                                                                                                                                                             |
| (i) Transparency, comprehensiveness and competition in the legal and regulatory framework | <i>C</i> | The Procurement Code contains three of the items listed                                                                                                                     |
| (ii) Use of competitive procurement methods                                               | <i>D</i> | No reliable data exist on the value of contracts awarded by methods other than open competition which are/are not justified in accordance with relevant legal requirements. |
| (iii) Public access to complete, reliable and timely procurement information              | <i>D</i> | The government does not systematically provide the public with the key procurement information listed.                                                                      |
| (iv) Existence of an independent administrative procurement complaints system             | <i>D</i> | No independent procurement complaints mechanism exists.                                                                                                                     |

## **PI-20. Effectiveness of internal controls for non-salary expenditure**

### ***The importance of internal controls for supplier expenditures***

An effective internal control system is one that:

- a. is relevant (i.e. based on an assessment of risks and the controls required to manage the risks),
- b. incorporates a comprehensive and cost effective set of controls (which address compliance with rules in procurement and other expenditure processes, prevention and detection of mistakes and fraud, safeguard of information and assets, and quality and timeliness of accounting and reporting),
- c. is widely understood and complied with, and
- d. is circumvented only for genuine emergency reasons.

Evidence of the effectiveness of the internal control system should come from government financial controllers, regular internal and external audits or other surveys carried out by management. One type of information could be error or rejection rates in routine financial procedures.

Other PEFA indicators cover controls in debt management, payroll management and management of advances. This indicator, therefore, covers only the control of expenditure commitments and payment for goods and services, casual labor wages and discretionary staff allowances. The effectiveness of expenditure commitment controls is singled out as a separate dimension of this indicator due the importance of such controls for ensuring that the government's payment obligations remain within the limits of projected cash availability, thereby avoiding creation of expenditure arrears (ref. indicator PI-4).

### ***Current situation in RMI***

There are currently no official, documented government-wide operating procedures in place for spending on non-personnel items. A comprehensive procedures manual, the Standard Operating Procedures (SOP), intended for use by all line ministries, has been prepared but it has been in draft (consultation) form for the past several years. The SOP is currently being reviewed but it has not been promulgated to line ministries. The SOP sets out administrative control procedures for spending on personnel, travel advances, goods and services.

#### ***(i) Effectiveness of expenditure commitment controls***

As indicated above, GRMI does not yet have in place a comprehensive, government-wide and fully documented commitment control system in the sense of (ideally, automated) systemic checks and system blocks of proposed commitments which are not within the budgetary appropriations, MoF- expenditure ceilings/cash releases, and Treasury fund availability. A comprehensive commitment control system would also (ideally, automatically) monitor outstanding commitments and ensure the prompt clearance of payment arrears. As indicated above (see PI-16), GRMI is currently working with PFTAC to develop a formal government-wide commitment control system.

In the absence of the issuance of regular (e.g. monthly) cash ceilings by MoF (see PI-16 above), cash-related restrictions to line ministry expenditures are provided through ad hoc Cabinet Minutes<sup>33</sup> and through delays in the approval of spending commitments (through the issuance of a Purchase Order).

Thus, controls on non-salary expenditure commitments by line ministries do exist. However, evidence, including from recent external audit reports, shows that there are instances where

---

<sup>33</sup> PI-16 above referred to the MoF memo issued in January 2011 which set out a freeze on requests for travel and purchases of materials and supplies.

they are not followed.

*(ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures*

Part IV of the FMA (found in Chapter 11 of the MIRC) deals with internal controls for expenditures on non-salary items, including sections on the keeping of books and records, authorisation for the Secretary of Finance to examine books, procedures for the issuance of cheques, and the handling of petty cash. There is provision in the Act for the Secretary of Finance to direct the preparation of supplementary rules to accompany the Act's provisions.

However, at present, there is no official documentation currently in place which sets out comprehensive internal controls (e.g. covering risk assessment, the control environment, and monitoring of the control environment) applicable to central government for expenditure on non-salary items. Thus, procedures are based on historic practice. A draft Standard Operating Procedures (SOP) manual, which is only part of an internal control system, has been prepared, but it has not been approved officially or circulated widely, e.g. to line ministries. In December 2010, the Secretary of Finance issued a 7-page memo to staff of the Ministry of Finance comprising a list (reminder) of strengthened expenditure control procedures.<sup>34</sup> These covered procedures for purchase requisitions, purchase orders, certification of invoices for payment, and record keeping. However, they do not represent comprehensive internal control procedures.

Internal control rules and procedures, as largely based on historic practice (non-codified), are non-comprehensive in significant ways. In particular, recent findings in the compliance audits refer explicitly to the lack of adequate internal control policies and procedures, and to the lack of segregation of duties.

In terms of the extent of understanding of the rules and procedures, MoF officials indicate that there are frequent errors in the paperwork accompanying requests for payments for non-salary items. In addition, a repeated audit finding is the absence of supporting documents to accompany the processing of expenditures. These would suggest that the procedures are not necessarily widely understood.

Finally, in terms of efficiency of the *de facto* procedures<sup>35</sup>, as part of the Lean initiative (see PI-18), MoF has begun to analyze the efficiency of time taken to process purchase requisitions and purchase orders and, with the analysis indicating that there is room for improvement, will be using Lean to improve the efficiency of these two processes.

*(iii) Degree of compliance with rules for processing and recording transactions*

As discussed above, senior management of the Ministry of Finance issued a directive containing "in-house procedures and policies" for expenditures in December 2010 for FY11. The text of the directive referred explicitly to the non-compliance by various staff to rules and procedures and thereby necessitated the issuance of such a directive. In addition, recent audit findings refer to the non-compliance with relevant procedures for processing and recording non-salary expenditure transactions. Thus, it may be understood that instances of non-compliance to the core set of rules are reasonably widespread.

**RMI's most recent PI-20 Score:**

RMI's most recent score in this area is set out in Table 20.

---

<sup>34</sup> As stated in the memo, it was issued in response to the discovery of potential fraud involving government funds.

<sup>35</sup> The *de facto* (non-codified) procedures, as used in RMI, are distinguished from *de jure* (codified) ones, which are currently not in place.

**Table 20. Internal controls for supplier expenditures – 2012 PEFA score**

| Indicator                                                                                        | Score     | Brief Explanation                                                                                                                                                                                                                                                                                                                                         |
|--------------------------------------------------------------------------------------------------|-----------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                          |           |                                                                                                                                                                                                                                                                                                                                                           |
| <b>PI-20. Effectiveness of internal controls for non-salary expenditure</b>                      | <b>D+</b> |                                                                                                                                                                                                                                                                                                                                                           |
| (i) Effectiveness of expenditure commitment controls.                                            | <i>C</i>  | Expenditure controls exist but evidence shows that they are not followed on occasion.                                                                                                                                                                                                                                                                     |
| (ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures. | <i>D</i>  | Clear, officially documented, comprehensive government-wide internal controls are lacking. There appears to be a widespread lack of clear understanding about the de facto (rather than de jure) rules and procedures for internal controls, even with those who are directly involved in applying them. The requirements for a higher score are not met. |
| (iii) Degree of compliance with rules for processing and recording transactions.                 | <i>D</i>  | Evidence, including from external audit, suggests that the rules are not complied with in more than a significant minority of cases. The requirements for a higher score are not met.                                                                                                                                                                     |

## **PI-21. Effectiveness of internal audit**

### ***The importance of Internal Audit***

Regular and adequate feedback to management is required on the performance of the internal control systems, through an internal audit function (or equivalent systems monitoring function). Such a function should meet international standards such as the ISPPA11, in terms of:

- a. appropriate structure particularly with regard to professional independence,
- b. sufficient breadth of mandate, access to information and power to report,
- c. use of professional audit methods, including risk assessment techniques.

The function should be focused on reporting on significant systemic issues in relation to: reliability and integrity of financial and operational information; effectiveness and efficiency of operations; safeguarding of assets; and compliance with laws, regulations, and contracts. Internal audit functions are in some countries concerned only with pre-audit of transactions, which is here considered part of the internal control system and therefore assessed as part of indicator PI-20.

Specific evidence of an effective internal audit (or systems monitoring) function would also include a focus on high risk areas, use by the SAI of the internal audit reports, and action by management on internal audit findings. The latter is of critical importance since lack of action on findings completely undermines the rationale for the internal audit function.

The internal audit function may be undertaken by an organization with a mandate across entities of the central government (such as government inspection general or IGF) or by separate internal audit functions for individual government entities. The combined effectiveness of all such audit organizations is the basis for this indicator.

### ***Current situation in RMI***

GRMI does not have an internal audit function in the sense of that which is understood by international internal auditing standards.<sup>36</sup> The International Public Sector Accounting Standard (IPSAS)'s definition of internal audit refers to independent "assurance and consulting activities within an entity designed to evaluate and improve the effectiveness of the entity's risk management, internal control, and governance processes".<sup>37</sup> Furthermore, it indicates that the scope of internal audit should cover financial systems, managerial systems (e.g. strategic planning, performance monitoring), and operational systems. Thus, internal audit as concerned with systems as a whole, rather than simply transaction-testing, does not currently take place in RMI's central government.

GRMI does not have internal audit legislation or an administrative framework in place, nor are any internal auditors appointed in line ministries. MoH has just launched the process to hire an internal auditor, but it is not clear within what regulatory framework s/he will operate.

No internal audit reports are issued, and hence there have been no responses by management to findings.

### ***RMI's most recent PI-21 Score:***

RMI's most recent score in this area is set out in Table 21.

**Table 21. Internal Audit – 2012 PEFA score**

---

<sup>36</sup> Nonetheless, GRMI requested that this indicator be included in the assessment.

<sup>37</sup> IPSAS standard on internal auditing, International Auditing and Assurance Standards Board, 2010.

| Indicator                                                       | Score    | Brief Explanation                                                                                     |
|-----------------------------------------------------------------|----------|-------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                         |          |                                                                                                       |
| <b>PI-21. Effectiveness of internal audit</b>                   | <b>D</b> |                                                                                                       |
| (i) Coverage and quality of the internal audit function         | <i>D</i> | There is little or no internal audit within central government which focuses on monitoring of systems |
| (ii) Frequency and distribution of reports.                     | <i>D</i> | No internal audit reports have been issued in recent years.                                           |
| (iii) Extent of management response to internal audit findings. | <i>D</i> | There is no evidence of internal audit having been either issued or acted upon by management.         |

## **PI-22. Timeliness and regularity of accounts reconciliation**

### ***The importance of accounts reconciliation***

Reliable reporting of financial information requires constant checking and verification of the recording practices of accountants – this is an important part of internal control and a foundation for good quality information for management and for external reports. Timely and frequent reconciliation of data from different sources is fundamental for data reliability. Two critical types of reconciliation are:

- a. reconciliation of accounting data, held in the government's books, with government bank account data held by central and commercial banks, in such a way that no material differences are left unexplained; and
- b. clearing and reconciliation of suspense accounts and advances i.e. of cash payments made, from which no expenditures have yet been recorded.

Advances would include travel advances and operational imprests, but not budgeted transfers to autonomous agencies and SN governments which are classified as expenditures when they are effected, even if reporting on any earmarked portion of the transfers is expected periodically.

### ***Current situation in RMI***

#### ***(i) Regularity of bank reconciliations***

As discussed in PI-17 above, the RMI Government manages 4 main bank accounts for central government operations<sup>38</sup> across two commercial banks, the Bank of Guam and the Bank of the Marshall Islands. Line ministries do not manage their own operating bank accounts. The main operating accounts include separate accounts for salaries for central Majuro personnel, operational expenses for Majuro, salaries for Ebeye, and operational expenses for Ebeye. Many of the remaining accounts are savings (fund holding) accounts.

In the absence of a regulatory framework, there is no stipulated time period requirement within which bank accounts will be reconciled. Reconciliation of some of the main operational accounts tends to take place at least quarterly, but some accounts may be reconciled less regularly. Indeed, evidence from external audit reports indicates that bank reconciliations, including for some key central government expenditure accounts, are not undertaken regularly (in some cases, not more than once per year, if at all).

#### ***(ii) Regularity of reconciliation and clearance of suspense accounts and advances***

According to information provided by staff in MoF's Accounting Division, the reconciliation

<sup>38</sup> Including payroll.

of suspense accounts, which consist mainly of travel advances, takes place at the end of the year. Evidence from audit reports suggests that the clearance of these accounts may take longer than two months.

***RMI's most recent PI-22 Score:***

RMI's most recent score in this area is set out in Table 22.

**Table 22. Internal Audit – 2012 PEFA score**

| Indicator (M2)                                                                    | Score    | Brief Explanation                                                                                                                                                                                                                                                          |
|-----------------------------------------------------------------------------------|----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                           |          |                                                                                                                                                                                                                                                                            |
| <b>PI-22. Timeliness and regularity of accounts reconciliation</b>                | <b>D</b> |                                                                                                                                                                                                                                                                            |
| (i) Regularity of bank reconciliations                                            | <i>D</i> | Evidence, including from external audit reports, suggest that bank reconciliations, including for some key CG expenditure accounts, are not undertaken regularly (in some cases, not more than once per year, if at all). The requirements for a higher score are not met. |
| (ii) Regularity of reconciliation and clearance of suspense accounts and advances | <i>D</i> | The clearance of suspense accounts and the reconciliation of these accounts tends to take place at the end of the year but to take longer than two months.                                                                                                                 |

### **PI-23. Availability of information on resources received by service delivery units**

#### ***The importance of information about the receipt of resources by service units***

Problems frequently arise in front-line service delivery units providing services at the community level (such as schools and health clinics) in obtaining resources that were intended for their use, whether in terms of cash transfers, distribution of materials in kind (e.g. drugs and school books) or provision of centrally recruited and paid personnel. The intended resource provision may not be explicit in budget documentation, but is likely to form part of line ministries internal budget estimates preparation. Front line service delivery units, being furthest in the resource allocation chain, may be the ones to suffer most when overall resources fall short of budget estimates, or when higher level organizational units decide to re-direct resources to other (e.g. administrative) purposes. There may be significant delays in transfers of resources to the unit whether in cash or in kind. Tracking of such information is crucial in order to determine, if the PFM systems effectively support front-line service delivery.

Information about the receipt of resources by service units is often lacking. The accounting system, if sufficiently extensive, reliable and timely, should provide this information, but frequently information on expenditures in the field is incomplete and unreliable and the flow of information disrupted by different and unconnected systems being used at different levels of government (most primary service delivery units typically being the responsibility of sub-national governments). Routine data collection systems, other than accounting systems (i.e. statistical systems), may exist and be able to capture the relevant information along with other service delivery information. Public Expenditure Tracking Surveys, inspections, audits (whether by internal or external auditors) or other ad hoc assessments may constitute alternative information sources.

#### ***Current situation in RMI***

There are no data available on the resources received by schools and primary health facilities. Schools and health facilities do not receive resources directly from central government; all recurrent and capital expenditures on their behalf are made centrally. They do not prepare their own accounts nor do they record data on resources received in-kind. No Public Expenditure Tracking Surveys (PETS) in either health or education have been carried out recently, including in the last 3 years.

#### ***RMI's most recent PI-23 Score:***

RMI's most recent score in this area is set out in Table 23.

**Table 23. Information on resources received by service delivery units – 2012 PEFA score**

| Indicator                                                                                 | Score    | Brief Explanation                                                                                                                                                                                                                      |
|-------------------------------------------------------------------------------------------|----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                   |          |                                                                                                                                                                                                                                        |
| <b>PI-23. Availability of information on resources received by service delivery units</b> | <b>D</b> | Data on the resources received (including those received in-kind) by primary service units (schools and health clinics) are not available, and there is no mechanism at the primary service unit level for recording such information. |

### **PI-24. Quality and timeliness of in-year budget reports**

#### ***The importance of in-year fiscal reporting***

The ability to “bring in” the budget requires timely and regular information on actual budget performance to be available both to the ministry of finance (and Cabinet), to monitor performance and if necessary to identify new actions to get the budget back on track, and to the MDAs for managing the affairs for which they are accountable. The indicator focuses on the ability to produce comprehensive reports from the accounting system on all aspects of the budget (i.e. flash reports on release of funds to MDAs are not sufficient). Coverage of expenditure at both the commitment and the payment stage is important for monitoring of budget implementation and utilization of funds released. Accounting for expenditure made from transfers to deconcentrated units within central government (such as provincial administrations) should be included.

The division of responsibility between the ministry of finance and line ministries in the preparation of the reports will depend on the type of accounting and payment system in operation. The role of the ministry of finance may be simply to consolidate reports provided by line ministries (and where applicable, from deconcentrated units) from their accounting records; in other cases the ministry of finance may undertake the data entry and accounting for transactions in which case the role of the line ministry is reduced, perhaps to reconciling ministry of finance data with their own records; in yet other cases ministry of finance can generate reports out of integrated, computerized accounting systems. The important requirement is that data is sufficiently accurate to be of real use to all parties.

### ***Current situation in RMI***

#### ***(i) Scope of reports in terms of coverage and compatibility with budget estimates***

As discussed under sub-dimension PI-24 (ii) below, GRMI does not issue official in-year budget execution reports. Consequently, this first sub-dimension is assessed in terms of the data contained in the financial management information system (FMIS). The FMIS captures expenditure data for both commitments (known as encumbrances) and payments. The accounts classification used for accounting allows direct comparison to the budget in most cases. One exception which makes it more difficult to compare in-year expenditures directly with the budget is the difference in treatment of Compact funding, which doesn’t lapse at the end of the year, compared to General Fund resources (largely, domestic revenues), which do.

#### ***(ii) Timeliness of the issue of reports***

GRMI does not issue official in-year budget execution reports (e.g. quarterly reports), comparing and providing analysis of expenditures to date with the appropriated budget by the classification of appropriation, as is standard practice in some other countries. The Ministry of Finance provides an annual report to the Nitijela at the end of the fiscal year, which sets out both progress made during the year and plans for the coming year for each of the Ministry’s divisions. Internal budget monitoring reports from the FMIS are also produced regularly.

#### ***(iii) Quality of information***

As indicated above, with GRMI not issuing official in-year budget execution reports, this sub-dimension has been assessed on the basis of the quality of the data in the annual budget reports, i.e. the annual financial statements. Whilst potential problems with the accuracy of some data have been raised as an issue in the latest year-end compliance audit reports<sup>39</sup>, some important issues have not been systematically highlighted in the reports to facilitate managerial action.<sup>40</sup> However, overall, the non-qualification of the annual accounts for the past several years (the central government’s accounts have not been qualified since FY07) suggests that the auditors do not believe that there are fundamental (material) problems with

---

<sup>39</sup> See, for example, the compliance volume of the single audit for FY10.

<sup>40</sup> Whilst potential questions about the verification, and thus accuracy, of some reported data are mentioned in the reports, the discussion of such issues is not necessarily prominent, including with major potential issues (see recent US General Accountability Office reports).

the data in the accounts, and thus these problems do not undermine the basic usefulness of the accounts.

***RMI's most recent PI-24 Score:***

RMI's most recent score in this area is set out in Table 24.

**Table 24. In-year fiscal reporting – 2012 PEFA score**

| Indicator (M1)                                                                    | Score     | Brief Explanation                                                                                                                                                                                                                                                                                                                                                    |
|-----------------------------------------------------------------------------------|-----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                           |           |                                                                                                                                                                                                                                                                                                                                                                      |
| <b>PI-24. Quality and timeliness of in-year budget reports</b>                    | <b>D+</b> |                                                                                                                                                                                                                                                                                                                                                                      |
| (i) Scope of reports in terms of coverage and compatibility with budget estimates | <i>B</i>  | The accounts classification used allows direct comparison to the budget in most cases; one issue affecting direct comparisons is the difference in treatment of Compact funding, which doesn't lapse as does the General Fund for domestic revenues. The information system captures both commitments and payments. The requirements for a higher score are not met. |
| (ii) Timeliness of the issue of reports                                           | <i>D</i>  | Official in-year budget execution reports (e.g. quarterly reports) are not issued.                                                                                                                                                                                                                                                                                   |
| (iii) Quality of information                                                      | <i>C</i>  | External audit (compliance) reports indicate some issues of data accuracy but such issues are not necessarily systematically highlighted for management. However, this fact does not detract from the basic usefulness of the information.                                                                                                                           |

***Strategic Objectives in this Area:***

To build in-house capacity and systems to automatically produce highly accurate in-year budget execution reports fully compatible with the budget classification, covering all budget entities and transactions, in a timely fashion.

**PI-25. Quality and timeliness of annual financial statements**

***The importance of annual financial statements***

Consolidated year-end financial statements (for French heritage countries: 'le loi de reglement' supported by 'les comptes de gestion' or 'CGAF') are critical for transparency in the PFM system. To be complete they must be based on details for all ministries, independent departments and deconcentrated units. In addition, the ability to prepare year-end financial statements in a timely fashion is a key indicator of how well the accounting system is operating, and the quality of records maintained. In some systems, individual ministries, departments and deconcentrated units issue financial statements that are subsequently consolidated by the ministry of finance. In more centralized systems, all information for the statements is held by the ministry of finance. Validation of the financial statements through certification by the external auditor is covered in indicator PI-26. Submission of annual financial statements from AGAs that are part of central government are covered in indicator PI-9.

In order to be useful and to contribute to transparency, financial statements must be understandable to the reader, and deal with transactions, assets and liabilities in a transparent and consistent manner. This is the purpose of financial reporting standards. Some countries

have their own public sector financial reporting standards, set by government or another authorized body. To be generally acceptable, such national standards are usually aligned with international standards such as the International Federation of Accountants' International Public Sector Accounting Standards (IPSAS), of which some are relevant for countries that adopt accrual based accounting, while others are relevant for cash-based systems.

### ***Current situation in RMI***

#### ***(i) Completeness of the financial statements***

A consolidated annual financial statement is prepared each year for the accounts of central government (incorporating all funds, including the main extra-budgetary resources) and SOEs. These include the financial position and the results of operations by fund, each of which is considered a separate accounting entity. The operations of each fund include complete information on revenue, expenditures, financial assets, liabilities, and fund equity. Separate financial statements are provided for governmental funds and fiduciary funds, but the latter are excluded from the government-wide financial statements. The accounts are prepared on an accrual basis in accordance with US GAAP. There is also information on borrowings and contingent liabilities (e.g. government guarantees).

Thus, the consolidated financial statements provide good coverage of central government and SOE fiscal operations with the exception of some minor omissions from bank balances where reconciliations have not been carried out recently. In total, the accounts of 23 entities are included in the most recent audited financial statements, including the central government's primary account (the centralized account for line ministries), and 22 autonomous government agencies and SOEs.

The annual financial information is audited by an externally-contracted (private sector) auditor. However, the external auditor is, at the same time, also involved in finalizing the annual financial statement through: (i) informing the Ministry of Finance which financial information to provide and in what format (i.e. which individual schedules to provide [e.g. statement of revenue and expenditure]); (ii) undertaking end-of-year adjustments; (iii) pulling together the statements into a compiled single set of annual financial statements; and (iv) undertaking the consolidation of the financial information for the annual statements, since the statements cover both central government and state-owned enterprises, but central government and SOEs send the information separately to the externally-contracted auditor. Thereafter, the externally-contracted auditor audits this statement (which they have helped to compile). In other words, there is not a separate document (stage of preparation) containing the unaudited financial statements (signed by the head of the Ministry of Finance) as would be considered normal (and good) practice. While it may not be unusual in cases where there are significant capacity limitations for a single external auditing firm both to finalize the accounts and subsequently to audit them, it represents a clear breach of the proper separation of accounting/audit duties<sup>41</sup> and thus a breach of accountability. Consequently, the sub-dimension has not been rated, as the assessment team deemed that the assessment result would be misleading.

#### ***(ii) Timeliness of submission of the financial statements***

The FMA sets the statutory deadline for the completion of the financial statements for external audit at 9 months following the end of the financial year (i.e. 30 June). During the most recent fiscal year to be audited, FY10, the annual financial statements were finalized within this time period (the completed statements were submitted to the Auditor-General's Office by the externally-contracted auditor by 28 June 2011). It is to be noted that the external audit firm contracted to finalize and audit the government's annual accounts does not formally submit the finalized statements to the Auditor-General's Office (for the Auditor-General subsequently to submit the finalized statements officially to the external auditing

<sup>41</sup> Refer to International Standards for Supreme Audit Institutions (ISSAI) 20, 21 and 30, particularly principles 4 and 5.

firm) before beginning its audit. Thus, there is no formal interval step of issuing the completed financial statements before beginning the audit that it is difficult to separate the two steps meaningfully. Consequently, the assessment of this sub-dimension has been based on the date of issuance of the completed financial statements.

*(iii) Accounting standards used*

GRMI's accounts are prepared on the basis of the standards of US Generally Accepted Accounting Principles (GAAP). These standards cover both central government's accounts and those of SOEs. There is currently an on-going process of general convergence and transition from US GAAP to International Accounting Standards (IAS) and Financial Reporting Standards (IFRS); however, this issue is not yet being actively addressed in RMI.

**RMI's most recent PI-25 Score:**

RMI's most recent score in this area is set out in Table 25.

**Table 25. Quality and timeliness of annual financial statements – 2012 PEFA score**

| Indicator                                                           | Score     | Brief Explanation                                                                                                                                                                                                                                                                                                                                                                  |
|---------------------------------------------------------------------|-----------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                             |           |                                                                                                                                                                                                                                                                                                                                                                                    |
| <b>PI-25. Quality and timeliness of annual financial statements</b> | <b>NR</b> |                                                                                                                                                                                                                                                                                                                                                                                    |
| (i) Completeness of the financial statements                        | NR        | While the coverage and completeness of the consolidated (CG+SOEs) annual financial statements meet the criteria for a reasonably high score, the statements are completed, compiled and subsequently audited, by the government's externally-contracted auditor, which undermines accountability. The assessment team decided that assessing on this basis would be inappropriate. |
| (ii) Timeliness of submission of the financial statements           | B         | For the most recent FY to be audited (FY10), the completed annual financial statements were dated 28 June 2011, which is within 9 months of the end of the FY.                                                                                                                                                                                                                     |
| (iii) Accounting standards used                                     | A         | US GAAP accounting standards are applied to central government's accounts, including budgetary (for ministries and agencies) and extra-budgetary funds, as well as to SOEs. These standards are disclosed in the notes to the Financial Statements.                                                                                                                                |

**PI-26. Scope, nature and follow-up of external audit**

***The importance of external audit***

A high quality external audit is an essential requirement for creating transparency in the use of public funds. Key elements of the quality of actual external audit comprise the scope/coverage of the audit, adherence to appropriate auditing standards including independence of the external audit institution (ref. INTOSAI and IFAC/IAASB), focus on significant and systemic PFM issues in its reports, and performance of the full range of financial audit such as reliability of financial statements, regularity of transactions and functioning of internal control and procurement systems. Inclusion of some aspects of performance audit (such as e.g. value for money in major infrastructure contracts) would also be expected of a high quality audit function.

The scope of audit mandate should include extra-budgetary funds and autonomous agencies. The latter may not always be audited by the Supreme Audit Institution (SAI), as the use of other audit institutions may be foreseen. The scope indicates the entities and sources of funds that are audited in any given year. Where SAI capacity is limited, the audit program may be

planned by the SAI in line with legal audit obligations on a multi-year basis in order to ensure that most important or risk-prone entities and functions are covered annually, whereas other entities and functions may be covered less frequently.

While the exact process will depend to some degree on the system of government, in general the executive (the individual audited entities and/or the ministry of finance) would be expected to follow up of the audit findings through correction of errors and of system weaknesses identified by the auditors. Evidence of effective follow up of the audit findings includes the issuance by the executive or audited entity of a formal written response to the audit findings indicating how these will be or already have been addressed. The following year's external audit report may provide evidence of implementation by summing up the extent to which the audited entities have cleared audit queries and implemented audit recommendations.

### ***Current situation in RMI***

#### ***(i) Scope/nature of audit performed***

The Constitution (Article VIII, Section 13) establishes the position of Auditor-General. The duties of the Auditor-General are set out in Article VIII, Section 15, and in the Auditor-General Act 1986 (set out in Chapter 9 of the MIRC). The Office holder is mandated to audit and report on the accounts and financial statements of all public funds and accounts, including departments or offices of the legislative, executive and judicial branches as well as statutory authorities and public corporations. In practice, the Auditor-General's mandate covers a total of 23 entities, representing nearly 100% of central government expenditures, including the main extra-budgetary funds. These audit reports are required to be submitted to the Nitijela for examination and follow-up on recommendations. In addition, the Compact Agreement with the US Federal Government stipulates that the funds provided by the US under this agreement (known as Compact grants) must be audited annually by an external auditor, covering audit of the funds' financial statements as well as a compliance audit (this is known as the Single Audit). In practice, GRMI has requested that the externally-contracted auditor apply these requirements to all public funds. The RMI Audit Office follows US GAAP auditing standards.

The Audit Office currently undertakes only financial and compliance audits (either directly or by contracting out to an external auditor, as indicated above). Audit Office records show that these 23 entities in the Auditor-General's mandate are indeed audited each year. The only expenditures excluded from audit are small, unreported activities at the school level (e.g. parent-teachers' associations) and non-major governmental funds (e.g. Communication Regulation Fund) due to an absence of account balances, whose omission the external auditor considers non-material. In practice, significant capacity constraints (3 auditors in the Audit Office) mean that virtually all of the entities' audits are conducted by the externally-contracted auditor.<sup>42</sup> The Audit Office is planning to begin to undertake performance audits in the near future.

The compliance audit conducted by the externally-contracted auditor (as part of the Single Audit) does not look comprehensively at (or express an opinion on) the effectiveness of GRMI's internal control systems. The notes to the audit report explicitly indicate that the audits involve transaction testing and do not cover systemic issues, e.g. of compliance. While the reports identify some significant issues (e.g. with compliance), these issues are summarized and highlighted only in a separate (non-attached) letter to the Secretary of Finance. In the compliance audit report itself, findings that are non-material, material, and potentially serious are afforded the same treatment in the text. Thus, management must read the entire report to identify potentially serious issues or the report must be read together with

<sup>42</sup>

In FY10, the Audit Office undertook the audit of 3 entities.

the separate letter.<sup>43</sup> Given that the most recent letter shown to the assessment team was for FY08 (the most recent audited report was for FY10), it may be that the management letters are difficult to locate.

*(ii) Timeliness of submission of audit reports to legislature*

According to the Constitution, the Auditor-General is required to report once per year to the Nitijela, detailing his/her activities for the year; in practice, the Auditor-General produces two such reports per year, which include financial and compliance audits for selected SOEs.<sup>44</sup> There is no statutory obligation to table audit reports; however, all audit reports are submitted to the Public Accounts Committee but are not officially tabled. In terms of deadlines, the annual audited accounts and compliance audit reports as part of the Single Audit are required to be completed by 30 June of the year following the year for which the accounts are being audited (i.e. within 9 months of the end of the fiscal year). In practice, audit reports have been completed by the external auditor<sup>45</sup> in line with this time period.

However, the submission of such reports to the Nitijela (the subject of this sub-dimension) depends on the timing of the Nitijela's sessions since the reports are not submitted (tabled) when the Nitijela is not in session. During the most recent fiscal year to be audited, FY10, evidence from the external auditor and from the Nitijela indicate that the audited accounts, including the accounts for each central government entity and the consolidated central government accounts, were finalized and submitted to the Nitijela within 10 months from the receipt of the accounts by the external auditor, excluding those audits delayed by on-going fraud investigations. The compliance audits for each audited entity were finalized and submitted to the Nitijela within 9-10 months from the end of FY10 (i.e. the end of the period audited). There were no other audit reports submitted to the Nitijela during the period being assessed.<sup>46</sup>

*(iii) Evidence of follow-up on audit recommendations*

With the single audit, for each of its compliance findings (known as a "questioned cost"), the management prepares a simple (not detailed) formal response (e.g. 1-2 sentences or, at most, a paragraph), which is incorporated into the auditor's report before it is finalized and published. The formal response is provided in a timely fashion (before the audit report is finalized). However, thereafter, there is evidence of only limited follow-up by the management of audited entities, as evidenced in the audit reports, which provide details of actions taken on previous findings, and which, based on the past three years' audit reports, show significant numbers of findings are not addressed from one year to the next. An Audit Resolution Committee has been formed in an effort to improve the response to the audits but it has not been active, and there was no evidence of any output.

With audits other than the single audits (of which there are relatively few at present), there appears to be no formal or informal follow-up to audit reports and the findings contained therein. No response from the audited entities is stipulated in legislation, and there is no evidence of any responses being received by the Auditor-General for the most recent fiscal year audited. The scoring of this sub-dimension reflects the situation for the single audit since these are the main types of audit.

***RMI's most recent PI-26 Score:***

RMI's most recent score in this area is set out in Table 26.

---

<sup>43</sup> The recent discovery of significant amounts of potential fraud going back over a number of years bears witness to the importance of highlighting such issues more clearly for management.

<sup>44</sup> As indicated above, in the RMI context, SOEs cover both autonomous government agencies and public enterprises.

<sup>45</sup> Either the Auditor-General's office or, in most cases, the external audit firm contracted to the Auditor General.

<sup>46</sup> As indicated above, the Auditor-General's office carries out only financial audit and compliance audits.

**Table 26. In-year fiscal reporting – 2012 PEFA score**

| Indicator                                                     | Score    | Brief Explanation                                                                                                                                                                                                                                                                                                                                                                                                                            |
|---------------------------------------------------------------|----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                       |          |                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| <b>PI-26 Scope, nature and follow-up of external audit</b>    | <b>C</b> |                                                                                                                                                                                                                                                                                                                                                                                                                                              |
| (i) Scope/nature of audit performed                           | C        | In the single audits, coverage is comprehensive, with all central government entities and SOEs audited annually. The reports themselves identify but do not highlight significant issues. Systemic issues are explicitly not addressed.                                                                                                                                                                                                      |
| (ii) Timeliness of submission of audit reports to legislature | C        | For the most recent fiscal year (FY10), the audited accounts for central government entities, including the consolidated central government accounts, were submitted to the legislature within 12 months of the receipt of the accounts by the external auditor. All compliance audits were submitted to the legislature within 12 months of the end of the audited period, excluding those audits delayed by on-going fraud investigations. |
| (iii) Evidence of follow-up on audit recommendations          | C        | For single audits, a timely but brief (often not detailed/thorough) formal response is made by the audited entity but there is limited or no follow-up actions taken thereafter. For other audits, there is no evidence of formal responses or follow-up to the findings and recommendations contained in the audit reports.                                                                                                                 |

#### **PI-27. Legislative scrutiny of the annual budget law**

##### ***The importance of legislative scrutiny of the annual budget***

The power to give the government authority to spend rests with the legislature, and is exercised through the passing of the annual budget law. If the legislature does not rigorously examine and debate the law, that power is not being effectively exercised and will undermine the accountability of the government to the electorate. Assessing the legislative scrutiny and debate of the annual budget law will be informed by consideration of several factors, including the scope of the scrutiny, the internal procedures for scrutiny and debate and the time allowed for that process.

Adequacy of the budget documentation made available to the legislature is covered by PI-6.

In-year budget amendments constitute a common feature of annual budget processes. In order not to undermine the significance of the original budget, the authorization of amendments that can be done by the executive must be clearly defined, including limits on extent to which expenditure budgets may be expanded and re-allocated and time limits for the executive's presentation of amendments for retro-active approval by the legislature. These rules must also be adhered to.

##### ***Current situation in RMI***

###### ***(i) Scope of the legislature's scrutiny***

Division 4 of the "Rules and Procedures of the Nitijela" sets out responsibilities for budget and financial scrutiny by the Nitijela. According to the document, two out of the Nitijela's 7 Standing Committees are explicitly tasked with reviewing the government's proposed budget information. Specifically, (i) the Committee on Appropriations is responsible for scrutinising public expenditures (including budget estimates and supplementary estimates) and financial administration for both central and local governments; and (ii) the Committee on Ways and Means is given responsibility for scrutinising revenues and revenue administration.

While greater detail for legislative scrutiny of annual appropriations is not given in the "Rules and Procedures" document, beyond giving priority to its scrutiny, in practice, the process works as follows: (i) the Minister of Finance presents the draft Appropriation Bill to the

whole Nitijela, accompanied by his Minister's Speech, and this process is considered to be the Bill's First Reading; (ii) the draft Bill is referred to the Committee on Appropriations for its review; (iii) following its review, including calling relevant line ministry representatives before the Committee, it prepares its report and presents it to the whole Nitijela; (iv) the Nitijela briefly debates the Appropriation Bill (Second Reading); and then (v) approves it (Third Reading), usually on the same day. It is customary for the Nitijela to pass the Bill as it was presented at the draft stage during the First Reading (unless there is an obvious mistake, as occurred only once in recent years, including the last 3 years). According to Nitijela stakeholders, the draft Budget presented is considered to be the Cabinet's budget, and hence for Parliament to approve as presented. In other words, the Nitijela reviews the budget at the point where it is in its detailed, final form.

*(ii) Extent to which the legislature's procedures are well-established and respected*

The process outlined above involves relatively simple procedures (e.g. there are no sectoral sub-committees under the main Appropriations Committee [which, given the size of the Nitijela, would pose practical problems] and the extent of debate is relatively limited). However, the process outlined is established by convention rather than in official, documented form. The documented rules covering budget scrutiny as set out in the Nitijela's Rules and Procedures effectively merely establish the principle of Parliamentary scrutiny of the budget. The rules consist of a single sentence each for the Committees on Appropriations and on Ways and Means<sup>47</sup>, and there are no detailed accompanying procedures, such as official Committees' Terms of Reference. As such, there is nothing regulating each new Committee Chair from establishing new procedures. Thus, the rules are too broad to be comprehensive. The criteria for a higher score for this sub-dimension are not met.

*(iii) Adequacy of time for the legislature to provide a response to budget proposals*

Nitijela records indicate the dates for each of the three Parliamentary readings of Appropriations Bill and thus the amount of time spent at each stage. In the last fiscal year considered by Parliament (FY12), the basis for the assessment, Nitijela had just over four weeks to review the budget proposals.

*(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature*

Rules for in-year amendments to the budget without ex-ante approval by the legislature are contained in the Constitution, the FMA, and the annual Appropriation Act.<sup>48</sup> As indicated above (see PI-16), Section 7 of Article VIII of the Constitution stipulates that Cabinet may authorize reprogramming of expenditures provided that the revised (reprogrammed) amounts do not cause the expenditures in the relevant program areas to be 10% higher or lower than the original funds appropriated for these program areas. The FMA stipulates that over-expenditures or over-obligations by line ministries can only be made as in accordance with Article VIII of the Constitution, and indicates that the Minister of a relevant ministry may authorize the transfer of funds between sub-programs within an overall program area total. The FMA also states that the Secretary of Finance may promulgate regulations which govern when funds may be transferred between program areas; however, no such regulations are in place, and there are no regulations stipulating what documentation or justification must be given for reprogramming requests. In addition, in the Annual Appropriation Act, there is a blanket provision that stipulates that any expenditure other than in accordance with Schedules 1,2,3,4 or 5 of the Appropriation Act is to be approved by Cabinet (in accordance with Article VIII, Section 5 [not Section 7] of the Constitution).<sup>49</sup>

<sup>47</sup> Specifically, "The Committee [on Appropriations] shall consider and report on all Bills, Resolutions, motions, and other matters relating to public expenditure or to financial administration of the Marshall Islands and local government finance, including budget estimates and supplementary estimates, that are referred to it by the Nitijela"

<sup>48</sup> While these rules were set out in PI-16 above, they are repeated here for ease of reference.

<sup>49</sup> Section 5 of Article VIII of the Constitution provides for Cabinet's collective responsibility over all public expenditures.

However, the rules in the Constitution and the FMA for making changes to the appropriations are not clear. The term ‘program area’ is not defined in either document (and hence the basic unit which is the basis for reprogramming is not defined). The Constitution does not define the term at all, while the FMA defines a program area to be ‘the program areas set forth in the Annual Appropriation Bill’, but, besides being a circular argument, the Appropriation Bill does not contain the term ‘program area’.<sup>50</sup> Even if one implicitly assumes the term to refer to the lowest level of classification as set out in the Appropriation Act, there appears to be a contradiction (or, at least, some lack of clarity), between the provision in the Constitution on expenditures different to those appropriated (Article VIII, Section 7, described above) and the blanket provision in Section 12 of the Appropriation Act<sup>51</sup> (described in the previous paragraph), about which changes may be made by the Cabinet, and which must be approved by the Nitijela.

### **RMI’s most recent PI-27 Score:**

RMI’s most recent score in this area is set out in Table 27.

**Table 27. Legislative scrutiny of the annual budget law – 2012 PEFA score**

| Indicator                                                                                                                                                                                                                                                                    | Score           | Brief Explanation                                                                                                                                                                                        |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                                                                                                                                                                                                      |                 |                                                                                                                                                                                                          |
| <b>PI-27 Legislative scrutiny of the annual budget law</b>                                                                                                                                                                                                                   | <b>D+</b>       |                                                                                                                                                                                                          |
| (i) Scope of the legislature’s scrutiny.                                                                                                                                                                                                                                     | C               | The legislature’s review covers the details of revenues and expenditures at the point where they are in their detailed, final form                                                                       |
| (ii) Extent to which the legislature’s procedures are well-established and respected.                                                                                                                                                                                        | C               | Few procedures are set out to govern the review of the government’s budget proposals by the legislature, and these do not include details of such scrutiny. The criteria for a higher score are not met. |
| (iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined). | C <sup>52</sup> | Documentary evidence from Nitijela records indicates that the legislature has just over four weeks to review the budget proposals.                                                                       |
| (iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.                                                                                                                                                                                 | D               | The rules for which changes may be made by the executive and which must be decided <i>ex ante</i> by the legislature are not clear.                                                                      |

<sup>50</sup> In the annual Appropriation Act, a similar circular definition is shown, with a ‘program area’ defined as ‘program areas set out in Schedule 1 to Schedule 4 as indicated by the headings in those schedules’ but without any headings in Schedules 1 to 4 referring to program areas.

<sup>51</sup> Section number from FY2011 Appropriation Act

<sup>52</sup> Note the PEFA Guidelines for this sub-dimension (PI-27ii) indicate that, if the situation meets the criteria for a B/C score (i.e. the legislature has at least one month to review budget proposals), whether or not it is a B or a C depends on the scores of the other sub-dimensions. In this case, since at least one of the other sub-dimensions (PI-27iii) is a C, then the score for PI-27ii is also a C (rather than a B). Source: Clarification to PEFA Guidelines, October 2008.

## **PI-28. Legislative scrutiny of external audit reports**

### ***The importance of Legislative scrutiny of external audit reports***

The legislature has a key role in exercising scrutiny over the execution of the budget that it approved. A common way in which this is done is through a legislative committee(s) or commission(s), that examines the external audit reports and questions responsible parties about the findings of the reports. The operation of the committee(s) will depend on adequate financial and technical resources, and on adequate time being allocated to keep up-to-date on reviewing audit reports. The committee may also recommend actions and sanctions to be implemented by the executive, in addition to adopting the recommendations made by the external auditors (ref. PI-26).

The focus in this indicator is on central government entities, including autonomous agencies to the extent that either

- a. they are required by law to submit audit reports to the legislative or
- b. their parent or controlling ministry/department must answer questions and take action on the agencies' behalf.

Timeliness of the legislature's scrutiny can be affected by a surge in audit report submissions, where external auditors are catching up on a backlog. In such situations, the committee(s) may decide to give first priority to audit reports covering the most recent reporting periods and audited entities that have a history of poor compliance. The assessment should favourably consider such elements of good practice and not be based on the resulting delay in scrutinizing reports covering more distant periods.

### ***Current situation in RMI***

#### ***(i) Timeliness of examination of audit reports by the legislature***

According to the "Rules and Procedures of the Nitijela", the Standing Committee on Public Accounts (SCPA) is given responsibility for the examination of the accounts of RMI's governments (central and local), public corporations and statutory authorities, including the Auditor-General's reports on these accounts.

The Committee, chaired by the opposition, has been relatively active in reviewing the audit reports in recent years. The Auditor-General's reports are submitted to the Speaker of the Nitijela, who forwards them to the SCPA. Based on evidence provided in SCPA reports produced following the Committee's hearings on audit reports, scrutiny by the SCPA of FY08, FY09 and FY10 audit reports (the last three completed fiscal years for which there were audit reports) was completed within three months of their receipt by the Nitijela.

#### ***(ii) Extent of hearings on key findings undertaken by the legislature***

The Nitijela's Rules and Procedures set out the broad scope of the work of the Committee on Public Accounts, but they do not set out detailed procedures for its scrutiny. Nonetheless, the Committee, led by the Chairman, has established its own procedures for scrutiny. In practice, the Committee organizes public hearings on each audit report presented to it. Based on evidence from the hearings themselves, the assessment has concluded that they are in-depth in nature and involve calling to appear at the hearings the management personnel in most (but not all) of the audited entities which form the subject of the audit reports.

#### ***(iii) Issuance of recommended actions by the legislature and implemented by the executive***

The SCPA makes recommendations in its reports. However, there is no evidence that the executive takes follow-up actions in response to these, and the SCPA reports reveal repeated recommendations over time.

***RMI's most recent PI-28 Score:***

RMI's most recent score in this area is set out in Table 28.

**Table 28. Legislative scrutiny of external audit reports – 2012 PEFA score**

| Indicator                                                                                                             | Score     | Brief Explanation                                                                                                                                                                   |
|-----------------------------------------------------------------------------------------------------------------------|-----------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                                               |           |                                                                                                                                                                                     |
| <b>PI-28 Legislative scrutiny of external audit reports</b>                                                           | <b>C+</b> |                                                                                                                                                                                     |
| (i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years). | <i>A</i>  | Scrutiny of the audit reports by the legislature (SPCA) is completed within three months of their receipt by the legislature                                                        |
| (ii) Extent of hearings on key findings undertaken by the legislature.                                                | <i>B</i>  | The SCPA conducts regular, in-depth hearings on the findings in the audit reports, which involve calling senior officials from many, but not all, audited entities to give evidence |
| (iii) Issuance of recommended actions by the legislature and implementation by the executive.                         | <i>C</i>  | The SCPA makes recommendations but evidence indicates that these are not acted upon by the executive.                                                                               |

**D-1. Predictability of Direct Budget Support**

***The importance of predictable direct budget support***

Direct budget support constitutes an important source of revenue for central government in many countries. Poor predictability of inflows of budget support affects the government's fiscal management in much the same way as the impact of external shocks on domestic revenue collection. Both the shortfalls in the total amount of budget support and the delays in the in-year distribution of the in-flows can have serious implications for the government's ability to implement its budget as planned.

Direct budget support consists of all aid provided to the government treasury in support of the government's budget at large (general budget support) or for specific sectors. When received by the government's treasury, the funds will be used in accordance with the procedures applying to all other general revenue. Direct budget support may be channeled through separate or joint donor holding accounts before being released to the treasury.

The narrative should explain possible reasons for the observed deviation between forecasts and actual disbursements, which could include non-implementation or delay of actions agreed with the government as condition for disbursement.

***Current situation in RMI***

The US, ROC, and Japan accounted for virtually all of ODA provided to the Marshall Islands during the last three years (Table 3.5). Together, ODA from these countries represented 97% of total reported ODA in 2009, as measured by disbursements. As the largest provider of aid, the US, under the 2003 Compact of Free Association, provides GRMI with a base grant which is divided by GRMI across the priority sectors of health, education, environmental protection and enhancement, and infrastructure development and maintenance. Under separate agreements, it also provides other US Federal grants.

Aid management is split between the MoF's Office of Compact Implementation (OCI) and

the Economic Policy, Planning and Statistical Office (EPPSO) under the President's Office.

GRMI receives **direct budget support** each year only from the Republic of China (ROC). ROC aid has been a stable and predictable source of budget support for GRMI. During the last three years, the actual amounts of budget support received matched the amounts appropriated in full. Budget support is disbursed quarterly before or during the relevant quarter, and there have been no delays in disbursements of budget support resources<sup>53</sup> during the last three years.

***RMI's most recent D-1 Score:***

RMI's most recent score in this area is set out in Table 29.

**Table 29. Predictability of Direct Budget Support – 2012 PEFA score**  
***Strategic Objectives in this Area:***

| Indicator                                                                                                                                                                                     | Score    | Brief Explanation                                                                                      |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------|--------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                                                                                                                       |          |                                                                                                        |
| <b>D-1 Predictability of Direct Budget Support</b>                                                                                                                                            | <b>A</b> |                                                                                                        |
| (i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature. | A        | Actual budget support provided by ROC has exactly matched the amount budgeted during the last 3 years. |
| (ii) In-year timeliness of donor disbursements.                                                                                                                                               | A        | There have been no delays in disbursements of budget support during the last 3 years.                  |

**D-2. Financial information provided by donors for budgeting and reporting on project and program aid**

***The importance of information on donor projects and programs***

Predictability of disbursement of donor support for projects and programs (below referred to only as projects) affect the implementation of specific line items in the budget. Project support can be delivered in a wide range of ways, with varying degrees of government involvement in planning and management of resources. A lower degree of government involvement leads to problems in budgeting the resources (including presentation in the budget documents for legislative approval) and in reporting of actual disbursement and use of funds (which will be entirely the donor's responsibility where aid is provided in-kind). While the government through its spending units should be able to budget and report on aid transferred in cash (often as extra-budgetary funding or through separate bank accounts), the government is dependent on donors for budget estimates and reporting on implementation for aid in-kind. Donor reports on cash disbursements are also important for reconciliation between donor disbursement records and government project accounts.

***Current situation in RMI***

***(i) Completeness and timeliness of budget estimates by donors for project support***

<sup>53</sup> This is distinct from the disbursement of assistance for capital projects for local governments, for which some delays in the disbursement occurred in FY11, due mainly to delays in the receipt of GRMI reports required prior to release of the next quarter's tranche of funds.

None of the development partners giving project support to GRMI provides estimates of their likely disbursements for the coming year to any GRMI entity (including MoF) in advance of budget formulation.

*(ii) Frequency and coverage of reporting by donors on actual donor flows for project support*

None of the donors giving support to GRMI provides quarterly reports to any GRMI entity (including MoF) on their actual project aid disbursements.

**RMI's most recent D-2 Score:**

RMI's most recent score in this area is set out in Table 30.

**Table 30. information on donor projects and programs – 2012 PEFA score**

| Indicator (M1)                                                                               | Score    | Brief Explanation                                                                                                                                                                  |
|----------------------------------------------------------------------------------------------|----------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                                      |          |                                                                                                                                                                                    |
| <b>D-2 Financial information provided by donors for budgeting and reporting</b>              | <b>D</b> |                                                                                                                                                                                    |
| (i) Completeness and timeliness of budget estimates by donors for project support            | <i>D</i> | None of the development partners providing project support provides estimates of their likely disbursements for the coming year to the government in advance of budget formulation |
| (ii) Frequency and coverage of reporting by donors on actual donor flows for project support | <i>D</i> | No reports on disbursements (quarterly or otherwise) are provided to government by development partners                                                                            |

**D-3. Proportion of aid that is managed by use of national procedures**

***The importance of using national procedures for aid funds***

National systems for management of funds are those established in the general legislation (and related regulations) of the country and implemented by the mainstream line management functions of the government. The requirement that national authorities use different (donor-specific) procedures for the management of aid funds diverts capacity away from managing the national systems. This is compounded when different donors have different requirements. Conversely, the use of national systems by donors can help to focus efforts on strengthening and complying with the national procedures also for domestically funded operations.

The use of national procedures mean that the banking, authorization, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds. All direct and un-earmarked budget support (general or sector based) will by definition use national procedures in all respects. Other types of donor funding such as e.g. earmarked budget support, basket funds and discrete project funding may use some or no elements of national procedures.

***Current situation in RMI***

Direct budget support from ROC uses national procedures. Support from the US in the form of Compact funding and Federal grants uses donor-specific procedures for preparation, appropriation, procurement, recording, and reporting. Given that this US funding represents more than 70% of total external support, it may be calculated that, even if all other donor support uses national procedures (which is unlikely), less than 50% of external finance uses national procedures in practice.

***RMI's most recent D-3 Score:***

RMI's most recent score in this area is set out in Table 31.

**Table 31. Using national procedures for aid funds – 2012 PEFA score**

| Indicator                                                                  | Score    | Brief Explanation                                                                                                                                                                                                                                                                      |
|----------------------------------------------------------------------------|----------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>2012 PEFA Rating</b>                                                    |          |                                                                                                                                                                                                                                                                                        |
| <b>D-3 Proportion of aid that is managed by use of national procedures</b> | <b>D</b> | Significantly less than 50% of external resources use all national procedures for their expenditures. In reality, only budget support (provided by ROC) fulfils this condition. Expenditures from all other external sources of finance require separate and/or additional procedures. |

## Annex C

### List of Stakeholders Met

| <b>Name</b>                   | <b>Position</b>                                | <b>Institution</b>                     |
|-------------------------------|------------------------------------------------|----------------------------------------|
| Hon. Minister Dennis Momotaro | Minister of Finance                            | Ministry of Finance                    |
| Alfred Alfred, Jr             | Secretary of Finance                           | Ministry of Finance                    |
| Kayo Yamaguchi-Kotton         | Asst Secretary                                 | MoF Budget/Procurement/OIDA            |
| Clarence Samuel               | Asst Secretary                                 | MoF Accounting and Admin               |
| Bruce Bilimon                 | Asst Secretary                                 | MoF Customs, Revenue, Tax              |
| Jimmy Kemem                   | Asst Secretary                                 | MoF Ebeye                              |
| Catalino Kijiner              | Budget Director                                | MoF Budget/Procurement/OIDA            |
| Casten Nemra                  | Chief Secretary                                | Office of the Chief Secretary          |
| Hon. Senator Kenneth Kedi     | Senator, Chairman of Public Accounts Committee | Nitijela (Parliament)                  |
| Hon. Senator Jack Ading       | Senator, Member of Appropriation Committee     | Nitijela (Parliament)                  |
| Kino Kabua                    | Secretary of Foreign Affairs                   | Ministry of Foreign Affairs            |
| Gary Ueno                     | Secretary of Education                         | Ministry of Education                  |
| Justina Langidrik             | Secretary of Health                            | Ministry of Health                     |
| Daisy Momotaro                | Secretary of Internal Affairs                  | Ministry of Internal Affairs           |
| Divine Waiti                  | Legal Counselor                                | Nitijela                               |
| Jessio Latrick                | Asst Secretary                                 | Ministry of Foreign Affairs            |
| Richard Bruce                 | Asst Secretary                                 | Ministry of Education                  |
| Wallace Peter                 | Asst Secretary                                 | Ministry of Internal Affairs           |
| Maybelline Bing               | Asst Secretary                                 | Ministry of Health                     |
| Patrick Junior                | Auditor General                                | Office of Auditor General              |
| Marie L Maddison              | Chairperson                                    | Public Service Commission              |
| Alson Kelen                   | Director                                       | Waan Aelonin Majol (NGO)               |
| Giff Johnson                  | Editor                                         | Marshall Islands Journal               |
| Atmita Jonathan               | Assistant Auditor General                      | Office of Auditor General              |
| Waylon Muller                 | Chief of Procurement/Supply                    | Procurement and Supply, MoF            |
| Gee Leong Bing                | Director                                       | Office of Compact Implementation, MoFA |
| Dennis Yate                   | Manager                                        | Wellness Center (NGO)                  |
| Molly Helkena                 | Asst Secretary                                 | Ministry of Internal Affairs           |
| Titus Bien                    | MoH Finance Director                           | Ministry of Health                     |
| Ayako Eliou                   | Performance-Based Budgeting Coordinator        | Ministry of Health                     |
| Winder Loeak                  | Fiscal Officer                                 | Ministry of Health                     |
| Almo Momotaro                 | Commissioner                                   | Public Service Commission              |
| Raynard Gideon                | Commissioner                                   | Public Service Commission              |
| Amram Mejbon                  | Deputy Commissioner                            | Public Service Commission              |
| Anderson Kattil               | Mayor, Vice President-MIMA                     | Lae Atoll Local Government             |
| Rufina Jack                   | Mayor, Secretary- MIMA                         | Ailuk Atoll Local Government           |
| Ione Debrum                   | Mayor, Member of MIMA                          | Ebon Atoll Local Government            |
| Tommy Leban                   | Mayor, Member of MIMA                          | Mili Atoll Local Government            |
| Aeto Bantol                   | Proxy to Kwajlein Mayor                        | Kwajlein Atoll Local Government        |

| <b>Name</b>  | <b>Position</b>               | <b>Institution</b>            |
|--------------|-------------------------------|-------------------------------|
| Miram Ankeid | Proxy to Jaluit Mayor         | Jaluit Atoll Local Government |
| Isle Rusin   | Assistant Legislative Counsel | Nitijela (Parliament)         |
|              |                               |                               |