REPUBLIC OF THE MARSHALL ISLANDS

PUBLIC FINANCIAL MANAGEMENT PERFORMANCE REPORT

AND PERFORMANCE INDICATORS

FINAL REPORT

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Notes

1. Fiscal year: 1 October-30 September. Fiscal year 2010 refers to 1 October 2009 - 30 September 2010.

2. Assessment period for many of the indicators covers fiscal years (FY) 2008/09 (FY09), 2009/10 (FY10), and 2010/11 (FY11).

3. Currency Unit: US dollar (US$).

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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
TCMI	Trust Company of the Marshall Islands, Inc. (Ship Registry)
TRAM	Tax and Revenue Reform and Modernisation Commission
WAM	Waan Aelon in Majel (Canoes in the Marshall Islands) – NGO

Summary Assessment

The purpose of this assessment has been to evaluate the current status of the Public Financial Management (PFM) systems in the Republic of the Marshall Islands (RMI) in terms of the main systemic strengths and weaknesses and in accordance with the PEFA framework. It is important to underline that the purpose has not been to assess different institutions or responsible individuals in the Government but to focus on the PFM systems themselves.

(i) Integrated assessment of PFM performance

The PFM system is centered on a basic legislative framework for financial management, summarized in the RMI Code. There is not yet in place an up-to-date set of financial management regulations to accompany the Financial Management Act. In general, there is a lack of accompanying regulations to support PFM legislation (e.g. in taxation, procurement, and expenditure management), and this serves to undermine the overall clarity and comprehensiveness of the underlying processes.

Measured along the 6 core dimensions of public financial management, the PFM systems in the Marshall Islands may be summarized as follows:

Credibility of the budget

Over the last three years, domestic revenue receipts were for the most part higher than projected in the budget, reflecting an appropriately conservative approach. In line with accurate domestic revenue projections and stable levels of external support (mainly reflecting the stability of Compact and other US funding flows), aggregate expenditures over the past three years have been largely in line with the levels planned in the budget.

However, at the level of line ministries and agencies, actual expenditures have differed significantly from those planned in the budget. This is likely to reflect weaknesses in expenditure controls, as well as unclear rules for moving expenditures between appropriations, both of which were found by the assessment.

Comprehensiveness and transparency of the budget

Limited fiscal information is available to the public in the form of audited annual financial statements and compliance audits available on the Nitijela's website. In addition, while the PAC hearings are open to the public, their reports on the subject of the hearings (i.e. the audit reports) are not published.

However, in the absence of widespread use of websites (e.g. for MoF), it has been difficult to provide easy access for the public to key fiscal information. In particular, it is not possible for members of the public to get copies of the budget documents or audit reports without specifically requesting a copy from government staff. In addition, the budget documents are not comprehensive, with key information lacking, including macroeconomic assumptions and fiscal policy objectives, and at least a three-year run of budget data (e.g. data on the previous year's actual spending, followed by revised spending estimates for the current year, as well as that for the proposed budget).

Another key issue affecting accountability is the fact that the highest level for budget appropriation is the source of funding rather than the relevant agency (administrative classification). This undermines ministry/agency-level accountability for the use of these funds by not clearly conveying in an integrated manner how all funds may come together to finance particular services.

Furthermore, significant amounts of public resources are not included in the budget information provided to the Nitijela (Parliament) for their scrutiny. The budget discussed with the Nitijela does not include all government spending from extra-budgetary funds (e.g. social security) or any discussion of potential fiscal risks from public enterprises, other off-budget operations, or sub-national government over the medium-term.

Policy-based budget

On the positive side, the budget process has been relatively disciplined, with the Appropriation Act promulgated before the beginning of the fiscal year, and with Cabinet having a role early on during budget preparation.

On the other hand, the assessment found weak links between sector plans and budgets, and budgets are, in the main, not actively planned within a multi-year framework. Some line ministries (e.g. the Ministry of Health) have prepared supplemental budget submissions on the basis of policy objectives and have included forward estimates. However, those ministries are the exception. With separate institutional responsibilities for recurrent and investment budgets, there is no explicit linkage between the two processes.

Predictability and control in budget execution

The use of paper-based information systems (e.g. for tax administration) and limited staffing levels contribute to weaknesses in tax compliance and enforcement.

On the expenditure side, the lack of a regular and timely routine for reconciling data (payroll, other expenditures, and banking data), combined with limited segregation of duties for controls, potentially weaken the effectiveness of expenditure controls. While a formal commitment control system is in place, in practice, there is a greater reliance on more informal procedures. Formalizing internal control procedures (e.g. through publishing and disseminating a comprehensive Standard Operations Manual) would provide a framework within which to enforce controls.

The lack of an operational internal audit function (meeting international standards) means that management does not have access to its own mechanism to monitor and provide assurance on the performance of internal control and other systems. As with tax appeals, there is no independent review process or body established to enable respondents to a tender to appeal procurement decisions prior to the signing of a contact.

Formal criteria for identifying and assessing fiscal risk are not yet in place.

Accounting, recording and reporting

Over the past few years, only limited in-year budget execution reports have been issued, thereby providing insufficient information to management to monitor budget performance.

GRMI does not prepare its own completed unaudited annual financial statements; the externally-contracted audit firm does the final preparation of the statements, based on the trial balances provided by MoF, which the audit firm subsequently audits. This represents an important weakness in the chain of accountability and is inconsistent with international auditing standards relating to the separation of duties.

While a financial management information system (FMIS) is in place, it is not used to provide comprehensive information, e.g. on arrears, even though it appears to be technically capable of doing so.

External scrutiny and audit

While audit coverage is comprehensive, severe staffing constraints in the Audit Office limit its ability to perform many of its own audits, including special investigations and other non-statutory audits.

The Nitijela plays a relatively structured role in scrutiny of the budget and of audit reports. Standing Committees (Appropriations and Public Accounts) hold public hearings on their reviews of the draft Appropriation Bill and on audit reports, respectively.

However, in the absence of a more policy-oriented basis for the budget, scrutiny by the Nitijela is limited to reviewing line items, and they spend relatively limited time doing so. The Appropriations Committee does not get involved prior to the detailed preparation of Estimates.

Follow-up actions taken by the audited entities to address findings and recommendations in both audit and PAC reports are very limited.

Donor practices

US Compact and Federal funding dominate development partner support to GRMI. While data on Compact funding and some Federal grants administered through the Department of the Interior are comprehensive, information on the value of external support from other donors, as well as some US programs administered directly by other Federal agencies, is not.

Development partner agencies do not report to GRMI on the disbursements provided, and this, combined with the lack of comprehensive information on the total amount of US support, makes reporting on, and reconciling of, government data with that from the US difficult. Comprehensive reports from each donor reflecting all aid they provide to all RMI entities are particularly important because of the current weak reporting to the central GRMI from SOEs and sub-national governments.

(ii) Assessment of the impact of PFM weaknesses

As public financial management concerns the efficiency and effectiveness of the use of public resources, the interdependence of the components of the budget cycle means that weaknesses in one part can adversely affect other parts and thereby constrain the achievement of better budgetary outcomes; conversely, improvements in one area which are not matched by corresponding changes in other areas can undermine the initial reforms. The strengths and weaknesses of the PFM system found in the assessment have an impact on the three measures of budget effectiveness[1] – aggregate fiscal discipline, allocative efficiency and technical (operational) efficiency – as follows (Box SA-1).

The analysis highlights the government's ability to achieve its broader fiscal and service delivery objectives. In particular, the achievement of broad fiscal goals is strengthened through the effective management of fiscal aggregate parameters. On the other hand, limited tax compliance and the enforcement of compliance reduce potential tax collections and potentially constrain the government's ability to achieve its specific policy objectives.

In terms of ensuring that resources are allocated (in plan and in fact) appropriately to meet desired policy goals, a good starting point has been established with the introduction of portfolio budgets (e.g. health). However, while these budgets may assist with planned allocations, they are just the start, as they are not operational in all sectors. There continues to be a weak relationship between planning and budgeting, with limited consultation between the two during budget preparation and policy planning.

Weaknesses in the ability of stakeholders to hold government to account, e.g. for the achievement of policy priorities, are found in the insufficient dissemination of timely information, such as on budget implementation and audit reports, to/from stakeholders, including the public. This results in part from inadequate record-keeping, and may reflect the lack of importance attached to documenting and disseminating information. On the other hand, the increasing role played by the PAC on ex-post oversight of expenditures is a positive note.

[1] These three measures are described in detail *inter alia* in Allen, Tommasi (eds), Managing Public Expenditure: A Reference Book for Transition Countries, OECD, 2001.

The efficiency of the use of resources may potentially be monitored through the use of the financial management information system. Nonetheless, the ability to act on this information, including the underlying reasons for inappropriate or inefficient expenditure management, is currently hampered by weaknesses in systematic record-keeping and reconciliations (which potentially undermine data accuracy), in internal controls, in the absence of internal audit, and in inadequate follow-up to audit and PAC recommendations.

Box SA-1: Links between the six dimensions of an open and orderly PFM system and the three levels of budgetary outcomes[1]

	Aggregate fiscal discipline	**Strategic allocation of resources**	**Efficient service delivery**
Budget credibility	*Positive factors*: Accurate domestic revenue projections and relatively stable external financial flows provide, at the outset of the fiscal year, a realistic base for aggregate expenditure plans. *Challenging factors*: On the other hand, weaknesses in expenditure controls may undermine budget credibility at the disaggregated level and hence fiscal discipline, and the lack of information on expenditure arrears also has a potentially negative impact on maintaining aggregate fiscal discipline	*Challenging factors*: Budgets that are not executed as planned across line ministries potentially undermine strategic resource allocation.	*Challenging factors*: Frequent in-year changes to the budget may not permit the detailed external scrutiny necessary to ensure that the changes do not undermine spending efficiency.
Comprehen-siveness and transparency	*Positive factors*: Some ex-post scrutiny of budget performance (including in aggregate) is possible through accessibility of external audit reports. *Challenging factors*: Non-comprehensiveness of budget documents, significant unreported operations, and limited active oversight of potential fiscal risks from public enterprises and sub-national governments**.**	*Positive factors*: Some ex-post scrutiny of budget performance (including for allocations between sectors/line ministries) is possible through accessibility of external audit reports. *Challenging factors*: Significant government spending which is not shown in or alongside the budget documents (e.g. social security) constrain the legislature's ability to examine the proposed budget in its overall policy context. Limited policy and medium-term information in the budget has the same effect.	*Challenging factors*: Limited availability of fiscal information to the public potentially weakens the ability of stakeholders to check if resources are being used most efficiently.

	Aggregate fiscal discipline	Strategic allocation of resources	Efficient service delivery
Policy-based budgeting	*Challenging factors*: The underlying fiscal policy objectives and macroeconomic assumptions are not explicit in the budget documents. This potentially limits the Nitijela's role in ensuring that the fiscal parameters underpinning the budget are sustainable.	*Challenging factors*: Weak links between the planning and budgeting processes (i.e. the ability to allocate resources to achieve government priorities as set out in costed and agreed sectoral expenditure strategies).	*Challenging factors*: Limited policy information reduces the legislature's ability to review budgetary decisions in terms of the likely efficiency of spending. The lack of a true medium-term perspective to the budget may contribute to weaknesses in budgetary planning, particularly for investment decisions.
Predict-ability and control in budget execution	*Positive factors*: Revenue projections in the budget provide a realistic base for the originally appropriated budget. *Challenging factors*: However, weaknesses in internal controls, cashflow planning, and commitment controls potentially put pressure on the originally-planned budget and thereby on control of aggregate budgetary discipline.	*Challenging factors*: Frequent budget reallocations potentially weaken any links that there might be between policies and inter-ministerial/sectoral budgetary allocations as planned.	*Challenging factors*: Weaknesses in internal controls, cashflow planning, and commitment controls potentially put the originally-planned budget under pressure and hence may potentially undermine spending efficiency through disruptions in smooth budget execution by line ministries.
Accounting, recording and reporting	*Positive factors*: Timely preparation of annual end-year financial statements provides the legislature with the opportunity to examine ex-post the sustainability of the most recent budget. *Challenging factors*: Lack of systematic issuance of in-year budget execution reports hinders active aggregate budget management.	*Challenging factors*: There is limited information on budget implementation to enable managers to monitor budget execution during the year.	*Challenging factors*: Limited in-year information on budget monitoring and ex-post valuation may constrain managers' ability to improve the efficiency of spending in future budgets.

	Aggregate fiscal discipline	**Strategic allocation of resources**	**Efficient service delivery**
Effective external scrutiny and audit	*Positive factors*: Timely preparation of audit reports provides the legislature with the opportunity to examine ex-post the sustainability of recent budgets. *Challenging factors*: However, the limited role for the Nitijela in examining fiscal policy before appropriation (ex ante) reduces its role in ensuring underlying parameters are sustainable.	*Challenging factors*: The relatively limited focus of legislative budget scrutiny on the link between government policies and budgetary allocations (as opposed to the greater focus on line items) reduces its ability to monitor how well resources are allocated to achieve the government's policies.	*Positive factors*: The involvement of PAC in scrutinizing audit reports (including public hearings) provides pressure on audited entities to address audit findings, including practices which are likely to affect spending efficiency. *Challenging factors*: However, to date, there has been little evidence of action taken by the audited entities to address audit findings.
1. The format of this analysis follows the PEFA Guidelines (Appendix 1)			

(iii) Prospects for reform planning and implementation

For the successful implementation of the reform program, the buy-in and involvement of stakeholders in the PFM system is crucial. 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.

Summary of PFM Performance Indicators[2]

PFM Performance Indicator		Scoring Method[3]	Dimension Ratings[4]				Overall Rating	Explanation of Scores (Page Number)
			i	Ii	iii	iv		
	A. PFM-OUT-TURNS: Credibility of the budget							
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1	B				**B**	7
PI-2	Composition of expenditure out-turn compared to original approved budget	M1	D	A			**D+**	7
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	B				**B**	8
PI-4	Stock and monitoring of expenditure payment arrears	M1	NR	D			**NR**	9
	B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency							
PI-5	Classification of the budget	M1	D				**D**	10
PI-6	Comprehensiveness of information included in budget documentation	M1	D				**D**	12
PI-7	Extent of unreported government operations	M1	D	D			**D**	13
PI-8	Transparency of inter-governmental fiscal relations	M2	A	B	D		**B**	15
PI-9	Oversight of aggregate fiscal risk from other public sector entities	M1	D	D			**D**	18
PI-10	Public access to key fiscal information	M1	D				**D**	20
	C. BUDGET CYCLE							
	C(i) Policy-Based Budgeting							
PI-11	Orderliness and participation in the annual budget process	M2	C	A	A		**B+**	21
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	D	D	D	D	**D**	23
PI-13	Transparency of taxpayer obligations and liabilities	M2	B	D	D		**D+**	25
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	D	NR	C		**NR**	29
PI-15	Effectiveness in collection of tax payments	M1	NR	A	D		**D+**	30

2 The measurement of the scores in this table follows closely the PEFA Guidelines (see www.pefa.org for a description of the calibration of scores for each indicator). For indicators with more than one dimension, a separate score is given for each dimension, and the overall score for the indicator is shown in bold.

3 Scoring method M1 is used for indicators where poor performance on one dimension of the indicator is likely to undermine the impact of good performance of other dimensions of the same indicator. Scoring method M2 is used where a low score on one dimension of the indicator does not necessarily undermine the impact of a high score on another dimension of the same indicator.

4 Each indicator includes one or more dimensions. A separate score is given for each dimension. Where there is more than one dimension, the overall score for the indicator is arrived at by combining the dimension ratings according to the prescribed methodology (M1 or M2) for the indicator.

Performance Indicators Summary (cont'd)

	PFM Performance Indicator	Scoring Method[5]	Dimension Ratings[6]				Overall Rating	Explanation of scores
			i	ii	iii	iv		
	C(ii) Predictability and Control in Budget Execution							
PI-16	Predictability in the availability of funds for commitment of expenditures	M1	D	D	D	D	**D**	31
PI-17	Recording and management of cash balances, debt and guarantees	M2	D	C	C		**D+**	33
PI-18	Effectiveness of payroll controls	M1	D	D	C	D	**D+**	35
PI-19	Competition, value for money and controls in procurement	M2	C	D	D	D	**D**	37
PI-20	Effectiveness of internal controls for non-salary expenditure	M1	C	D	D		**D+**	39
PI-21	Effectiveness of internal audit	M1	D	D	D		**D**	42
	C(iii) Accounting, Recording and Reporting							
PI-22	Timeliness and regularity of accounts reconciliation	M2	D	D			**D**	43
PI-23	Availability of information on resources received by service delivery units	M1	D				**D**	43
PI-24	Quality and timeliness of in-year budget reports	M1	B	D	C		**D+**	44
PI-25	Quality and timeliness of annual financial statements	M1	NR	B	A		**NR**	45
	C(iv) External Scrutiny and Audit							
PI-26	Scope, nature and follow-up of external audit	M1	C	C	C		**C**	46
PI-27	Legislative scrutiny of the annual budget law	M1	C	C	C	D	**D+**	48
PI-28	Legislative scrutiny of external audit reports	M1	A	B	C		**C+**	50
	D. DONOR PRACTICES							
D-1	Predictability of Direct Budget Support	M1	A	A			**A**	52
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	M1	D	D			**D**	53
D-3	Proportion of aid that is managed by use of national procedures	M1	D				**D**	53

[5] Scoring method M1 is used for indicators where poor performance on one dimension of the indicator is likely to undermine the impact of good performance of other dimensions of the same indicator. Scoring method M2 is used where a low score on one dimension of the indicator does not necessarily undermine the impact of a high score on another dimension of the same indicator.

[6] Each indicator includes one or more dimensions. A separate score is given for each dimension. Where there is more than one dimension, the overall score for the indicator is arrived at by combining the dimension ratings according to the prescribed methodology (M1 or M2) for the indicator.

1. Introduction

Objective of the PFM-PR

The overall objective of the assessment is to produce a comprehensive Public Financial Management Performance Report (PFM-PR) prepared according to the PEFA methodology. It aims to establish the baseline for the current performance of PFM processes and systems in the Republic of the Marshall Islands (RMI), in terms of an integrated assessment of relative strengths and weaknesses. The assessment covers the fiscal years 2008/09, 2009/10, and 2010/11, and the information is assessed as of October 2011. The PFM-PR is expected to provide an important input into the preparation of a roadmap for PFM reform measures, and the government aims to repeat the exercise after 3-4 years.

Process of Preparing the PFM-PR

The PFM-PR was prepared by a team comprising RMI government staff and international facilitators. IMF/PFTAC[7] was the lead donor, and provided funding for an external consultant. Donor co-ordination included involving a representative of the Pacific Islands Forum Secretariat (PIFC) to the team. Other development partners, including the US, ROC and ADB, were active participants in assessment meetings.

The government team comprised senior officials from the Ministry of Finance (MoF). A large number of government officials were involved in participating in stakeholder interviews providing information and documentary evidence. Quality assurance involved informal high-level meetings with senior management from MoF, Cabinet Secretariat and the Office of the Auditor-General, and a formal workshop to present the initial findings to a high-level group of stakeholders.

Methodology for Preparation of the Report

The assessment methodology involved: (i) pre-assessment collection and analysis of existing documentation on PFM in RMI; (ii) an initial stakeholder workshop; (iii) in-country collection of data, information and other evidence; (iv) interviews with government stakeholders with key responsibilities within the PFM system; (v) triangulation of data and information from complementary interviews, including from representatives of the private sector and civil society, and/or from available recent reports; and (vi) a debriefing stakeholder workshop.[8] The two stakeholder briefings were conducted to discuss key issues and build consensus. The first discussed the assessment's methodology, while the second presented the initial results from the assessment.

Thereafter, the draft report was submitted for review to GRMI, the main development partners (including IMF/PFTAC and PIFS), and the PEFA Secretariat. The current, final, report reflects comments received.

Scope of the assessment

The public sector in the Marshall Islands comprises central government, local government, and state-owned public enterprises. Within the central public sector, central government expenditures cover just over 50% of consolidated (central public sector) expenditures,[9] with the balance representing autonomous government agencies (AGAs)[10] (see Table 1.1). This PEFA assessment focuses on public financial management systems of central government.

Table 1.1: Structure of the Public Sector

Institutions	Number of entities	% of public expenditures[2]
Central government[1]	18	52.3%
Autonomous government agencies	22	47.7%
Local government	24	N/A

1. Includes ministries, and line agencies
2. Total expenditures for public sector exclude local government expenditures due to lack of available data.
Source: FY10 audited accounts

7 Pacific Financial Technical Assistance Centre
8 The in-country analytical work took place during October and November 2011.
9 Excluding local government due to lack of available data
10 AGAs cover both commercially-oriented and non-commercially-oriented enterprises (e.g. regulatory authorities and tertiary educational institutions)

2. Background

2.1 Description of Country Economic Situation

Country context

The Republic of Marshall Islands (RMI) is located in the Pacific Ocean, just west of the international dateline and just north of the Equator. In 1986, independence was attained under a Compact of Free Association with the United States, and an amended Compact was entered into force in May 2004. The country consists of 29 atolls and 5 isolated islands. The atolls and islands form two groups: the Ratak Chain and the Ralik Chain (meaning "sunrise" and "sunset" chains). 24 of the atolls are inhabited.

According to the 1999 census, RMI has a population of around 61,100, and a natural rate of population growth of around 3.6%. The population of the RMI has doubled in the last 26 years. In recent years however, emigration has absorbed the annual increment. Most of the people in RMI live in the urban areas on Majuro and Kwajalein atolls. Less then one-third of the population live in the rural areas, that is, the other atolls and islands. Marshallese comprise 97% of the population. While results from the 2011 census have not yet been fully analysed, preliminary estimates indicate a growing population. With growth concentrated in only a few sectors, rising unemployment and financial hardship, especially in outer islands, have driven migration to the urban atolls and to the US.

The RMI's economy is small and open, making it highly vulnerable to external shocks. Over the last decade several major shocks have affected growth and development prospects, including several natural disasters, the recent global economic and financial crisis and higher international food and fuel prices. The public sector remains the major employer and has increased its share in recent years due to the addition of teachers to the civil service rolls and increased investments in health and education infrastructure since 2004. However, the private sector, employing around 40% of the employed workforce, has become more diversified than in past decades. Important private sector industries include fisheries, construction and tourism, as well as employment at the U.S. Army base at Kwajalein Atoll.

Nearly all land in the country is held privately, under the traditional land tenure system. Therefore, most government-occupied land, including land used for public offices, schools, the main hospital, the national airport, and portions of Kwajalein Atoll that are used by the US for its missile testing program, are only accessible through lease arrangements. Disputes over lease terms are growing increasingly common, including over the multi-million dollar Kwajalein Land Use Agreement. GRMI set up a voluntary land registry system in 2003 in an effort to improve accessibility to and security of land for development purposes.

Overall Government reform program

GRMI ran an expansionary fiscal policy between 2004 and 2008, with spending increases in health, education, environmental protection and management, and infrastructure development and maintenance. However, such expenditure increases were not sustainable in the medium term because of the annual decrements to the amended Compact's sector grant funding, and efforts were made to increase domestic revenue. With the effect of the global financial crisis, GMRI's ability to maintain an adequate and balanced budget became even more challenging from 2008. Thus, in 2010, the Government agreed to two major reform programs. On the revenue side, the Cabinet adopted the Tax Reform and Modernisation program (TRAM), with the main element being the movement toward a value-added tax. On the expenditure side, the Cabinet adopted the Comprehensive Adjustment Program (CAP), which calls for wholesale cuts over the medium term in civil service positions and related costs, reductions in government allowances and support costs, reduction or elimination of grants and subsidies, and organization and facilities consolidation.

Rationale for PFM reforms

The Government of the Republic of the Marshall Islands (GRMI) is currently facing a challenging socioeconomic and fiscal situation characterised by:

- a growing population placing demand on social services such as education and health and more use by the population of these services;
- limited economic growth prospects; and
- reductions in the most recent (2003) U.S.-RMI Compact of Free Association (known as the Compact) flows in grant funds and some, but limited, opportunities for domestic revenue generation.

GRMI recognizes the urgent need for PFM reform, particularly in response to the impending reductions in Compact grant funds, with the Association agreement due to end in 2023, and the significant resulting reductions in external assistance.

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 centered 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.

2.2 Budgetary Outcomes

Fiscal performance

Budgetary performance over the last three years has reflected the aftermath of the external shock in FYs 2008 and 2009, resulting from the global financial crisis, and the relative decline in grants from external partners. These have resulted in real reductions in expenditures as expressed in terms of GDP. As required by law, the budget did not show a deficit.

Table 2.1: Central government budget (in percent of GDP)			
	FY09	**FY10**	**FY11**
Total revenue	69.2	67.0	63.6
- Own revenue	*24.9*	*24.7*	*24.1*
- Grants	*44.3*	*42.3*	*39.5*
Total expenditure	67.8	62.4	62.1
- Non-interest expenditure	*67.2*	*61.8*	*61.5*
- Interest expenditure	*0.6*	*0.6*	*0.6*
Aggregate surplus (incl. grants)	1.4	4.6	1.5
Primary surplus	2.0	5.2	2.1
Source: IMF			

Allocation of resources

Expenditures by economic item are dominated by wages and salaries and spending on goods and services, which account for around 33-34% of the total budget each (Table 2.2). A stable share of the budget spent on interest payments is the result of limited new net borrowing. The increase in the share of subsidies and transfers during the last three years reflects *inter alia* greater assistance to public enterprises.

Table 2.2: Actual budgetary allocations by economic classification (as a percentage of total expenditures)			
	FY09	FY10	FY11[1]
Current expenditures	**83.5%**	**82.9%**	**83.1%**
- *Wages and salaries*	*33.3%*	*34.4%*	*32.5%*
- *Goods and services*	*36.4%*	*32.8%*	*33.9%*
- *Interest payments*	*0.9%*	*0.9%*	*0.8%*
- *Transfers*	*5.5%*	*8.3%*	*11.1%*
- *Others*[2]	*7.3%*	*6.6%*	*4.8%*
Capital expenditures	**16.5%**	**17.1%**	**16.9%**
Notes: 1. Estimated. 2. Subsidies. Source: IMF			

2.3 Legal and Institutional framework for PFM

The legal framework

The Marshall Islands' legal framework for public financial management is centered on the Constitution (Articles VII and VIII), which sets out the fiscal roles of the executive, legislative and judicial branches and provides the basis for the raising of resources and their expenditure. Within the framework of the Constitution, the laws governing the management of public funds include the Financial Management Act (FMA), the Auditor-General Act, the Income Tax Act, Import Duties Act, and the Local Government Act.

The legislative framework sets out the basic budget and accountability structures, including: (i) the requirement that all revenues and other resources raised or received by the government be paid into the General Fund, out of which only legally approved expenditures can be made; (ii) appropriate oversight by the legislature; (iii) clear statement of the powers and duties for the key players, including MoF, and the Auditor-General; and (iv) the delegation of responsibility and accountability for public resources to specified stakeholders.

The Constitution creates the Office of the Auditor General and requires it to audit and report on the public accounts of the state and all public offices. The Auditor General Act specifies the responsibilities of the Auditor General and the scope and time frame of the audits.

The institutional framework for PFM

The Marshall Islands is a Constitutional democracy in free association with the US, centered on the 1986 Constitution. A system of checks and balances provides for power sharing between the executive, legislature, and an independent judiciary.

Legislature

The Nitijela (legislature) consists of a single 33-seat chamber, with members elected by popular vote. In terms of PFM, it is responsible for passing the Appropriation Act, based on the scrutiny of the Appropriations Committee. The legislature's Committee on Public Accounts is responsible for reviewing the audit reports.

In addition, under the Constitution, the Council of Iroij (Council of Chiefs) is a 12-member advisory body composed of tribal chiefs. The Iroij advises the Cabinet on matters affecting customary law and practice and may request the reconsideration of any bill affecting customary law, traditional practice, land tenure, or any related matter, but does not have a statutory role on PFM.

The Judiciary

Judicial power is independent of the legislative and executive powers and is vested in a Supreme Court, a High Court, and a Traditional Rights Court.

The Executive

The President is both the head of State and the head of government. Executive authority of the Marshall Islands is vested in the Cabinet, whose members are collectively responsible to the Nitijela. Members of the Cabinet are selected by the President from among the members of the Nitijela.

The main central agencies responsible for PFM for central government are the Ministry of Finance (MoF), the President's Office, the Office of the Chief Secretary, the Office of the Auditor General, and the Public Service Commission (PSC). Under the President's Office, the Economics Policy, Planning and Statistics Office (EPPSO) has primary responsibility for planning and statistics. The Office of the Chief Secretary, as head of the Public Service and the chief administrative and advisory officer of the Government, houses the Chief Public Procurement Officer.

The Auditor General manages the external audit function. This is a constitutional body accountable to Parliament and whose function is to inspect, audit and report on the public accounts and on the control of, and transactions with, public resources.

The Public Service Commission is responsible for the recruitment, promotion, and dismissal of employees, the approval of organizational structures, and overseeing remuneration, job sizing, and job descriptions.

Key Features of the PFM System

The PFM system in the Marshall Islands is highly centralized, with a relatively limited local government sector. The Ministry of Finance is the central agency responsible for PFM. The fiscal year runs from October 1 to September 30. Section 3 below provides details for each element of the PFM system.

3. Assessment of PFM System, Processes and Institutions[11]

This section provides details of the main findings of the assessment by indicator. For each indicator, the scores should be read in conjunction with the accompanying narrative explanation.

3.1 Budget Credibility

The budget is the central mechanism for controlling expenditure in accordance with amounts set out in Appropriation Acts as passed by Parliament. The ability to implement budgeted expenditures as planned is an important factor in supporting the government's ability to deliver on its national policy priorities. Budget credibility requires both actual budgetary releases to be similar to voted budgets and the means to enforce appropriate fiscal discipline to be in place.

[11] The measurement of the scores in this section follows closely the PEFA Guidelines (see www.pefa.org for a description of the calibration of scores for each indicator). For indicators with more than one dimension, a separate score is given for each dimension, and the overall score for the indicator is shown in bold and box-framed.

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

Over the last three years, domestic revenue receipts were for the most part higher than projected in the budget, reflecting an appropriately conservative approach. In line with accurate domestic revenue projections and stable levels of external support (mainly reflecting the stability of Compact and other US funding flows), 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.

Deviations between budgeted and actual expenditures for central government were calculated based on the information provided in the '134p' reports, extracted from the MoF's Financial Management Information System (FMIS), as this was regarded as the most consistent source of comparable information on budgeted and actual expenditures; the figures correspond to those in the audited annual accounts. Debt service payments were excluded from the calculations, as these were statutory obligations, as were externally financed project expenditures.[12] The resulting 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.

However, caution should be used in the interpretation of these figures. As mentioned earlier, figures for the three fiscal years were extracted from the 134p reports produced by the Financial Management System at the Ministry of Finance and not the audit reports. At the same time, while comprehensive information is not available on arrears (see PI-4 below), anecdotal evidence from stakeholder consultations suggests that they are significant. In line with US GAAP standards, encumbrances (outstanding commitments) which are in place at the end of the year are not accounted for as expenditures. Thus, it is possible that the variance between budgeted and actual expenditures would be affected if it were possible to take these into account.

The detailed data for this indicator are contained in Annex D.

Indicator (M1)	Score	Brief Explanation
A. Credibility of the Budget		
PI-1. Aggregate expenditure out-turn compared to original approved budget	**B**	The percentage deviations between actual and budgeted primary expenditures as a proportion of the original approved budget were: FY09: 6.7% FY10: 5.4% FY11: 10.4% Thus, actual expenditures varied by more than 10% over the original budget in only one of the last three years. *Sources of data: See annex C*

PI-2: Composition of expenditure out-turn compared to original approved budget

(i) Extent of variance in expenditure composition

This 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%,

[12] Externally-financed budget support is included in the analysis.

respectively.[13] The same caution about the figures as described in PI-1 apples to the analysis of composition variance.

The detailed data for this indicator are contained in Annex D.

(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.

Indicator (M1)[14]	Score	Brief Explanation
PI-2. Composition of expenditure out-turn compared to original approved budget	**D+**	
(i) Extent of the variance in expenditure composition during the last 3 years	*D*	The variances in the composition of primary expenditures across budget heads (excluding contingency) were: FY09: 17.9% FY10: 25.7% FY11: 9.6% Thus, the variance in expenditure composition was more than 10% over the original budget in two of the last three years. *Sources of data: See annex C*
(ii) Average amount of expenditure actually charged to the contingency vote over the last 3 years	*A*	Expenditures charged to contingency vote was less than 1% (0.4%) on average over the last three years, as follows: FY09: 0.3% FY10: 0.6% FY11: 0.3% *Sources of data: See annex C*

PI-3: Aggregate revenue out-turn compared to original approved budget

Actual domestic revenue receipts as a proportion of budgeted revenue projections were 116%, 107% and 98% in FY09, FY10, and FY11, respectively.[15] Conservative revenue projections helped actual revenue receipts to outperform the budgeted amounts in two out of the three years. Revenue

13 The sources of data include: Appropriation Acts (original), FYs 2008, 2009, 2010, 2011, Annual Audited Accounts, FYs 2008, 2009, 2010, and Preliminary accounts, FY 2011.

14 Uses the revised PEFA methodology (January 2011)

15 The sources of data include: Appropriation Acts (original), FYs 2008, 2009, 2010, 2011, Annual Audited Accounts, FYs 2008, 2009, 2010, and Preliminary accounts, FY 2011. The actual data used in the calculations are set out in Annex D.

forecasting is undertaken with input from both EPPSO (under the Office of the President) and the budget section in MoF.

Factors affecting the modest growth of revenues in recent years include reduced economic activity, due in part to the impact of the global financial crisis on its open economy, including in the tourism sector, and reductions in US Compact funding. Overall, although domestic revenue generation has increased (i.e. tax receipts), it has not done so at a rate to replace the annual reductions in Compact funding.

The detailed data for this indicator are contained in Annex D.

Indicator (M1)[16]	Score	Brief Explanation
PI-3. Aggregate revenue out-turn compared to original approved budget	**B**	Actual domestic revenue receipts as a proportion of budgeted domestic revenue for the last 3 years were: FY09: 116% FY10: 107% FY11: 98% Thus, actual domestic revenue was between 94% and 116% of budgeted domestic revenue in two of the last three years. *Sources of data: See annex C*

PI-4: Stock and monitoring of expenditure payment arrears

(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.[17] This 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 possible to calculate the stock of arrears. Thus, there are no reliable data for monitoring the stock of expenditure payment arrears.

16 Uses the revised PEFA methodology (January 2011)
17 General Fund only. Data from audited annual accounts.

Indicator (M1)	Score	Brief Explanation
PI-4. Stock and monitoring of expenditure payment arrears	**NR**	
(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	*NR*	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	*D*	Central government does not collect data on payment arrears or on the age profile of outstanding payments.

3.2 Transparency and Comprehensiveness

PI-5: Classification of the budget

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"[18]; 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.[19] This structure for budget presentation and appropriation (expenditures) is summarized in Box 3.1. The economic classification is used for execution and reporting but it is not shown in the budget documents. No functional or sub-functional classification is used.

18 See further discussion in PI-16(ii) below about the specificity of the term "program area".

19 It is noted that the Budget Statement contains a matrix showing the administrative classification by fund, but this is for information only (contained in an annex), not appropriation.

Box 3.1: Appropriations (Expenditures) by Schedule[1]

Schedules and sub-schedules	Explanation of source of funds
Schedule 1 - General Fund *Administrative units (e.g. ministries, commissions (e.g. PSC)), and other (e.g. catch-all category for special appropriations)* Sub-entity (e.g. particular office or autonomous government agency) or types of services (e.g. administration)	Domestic revenues and direct budget support Used for recurrent expenditures
Schedule 2 - Compact Sectoral Grants *Administrative units or sector (e.g. environmental sector) or type of grant (e.g. Supplemental Education Grant or Compact Capital Fund)* Facility (e.g. specific school) or type of expenditure (e.g. secondary textbooks) or agency (e.g. Majuro Atoll Waste Company)	Funds (grants) provided under the US Compact Agreement for designated sectors
Schedule 3 - Special Revenue Expenditure *Individual administrative unit own-source revenue accounts (e.g. Ministry of Internal Affairs)*	Own-source revenues of administrative units
Schedule 4 - US Federal Grants expenditure *Type of grant (e.g. MoE Federal Grants, 4-Atoll Feeding Program)*	Funds (grants) provided under the US Federal Grants program
Schedule 5 - Other donors *Individual donor* Project	Funds (project grants) provided by other (non-US) development partners.
Note: 1. Based on the FY11 Appropriation Act	

The key question for the assessment of this indicator is the extent to which the budget classification and chart of accounts are directly aligned such that government accounts, budget execution reports and other budget execution data may be produced with a break-down that corresponds to the documentation for the proposed and approved budget.[20] Thus, although the Chart of Accounts is likely to be more detailed (e.g. for reporting purposes), the documentation for the proposed and approved budget (in terms of budget classification) should set out at least the administrative and economic classifications.[21]

In the RMI case, there are two key issues shaping the assessment of this question. Firstly, the administrative (organizational) structure of the Chart of Accounts is organized at the primary (highest) level by funding source (e.g. General Fund, Special Revenues, etc.). In other words, the funding source is the top code in the structure (rather than the top code being the highest level of administrative unit, such as a ministry). The funding source structure is typically separate (mutually exclusive) from the administrative structure. This means that the fund structure cuts across ministries. In the approved budget, the top-level accountability is to funds, rather than to ministries, and below the level of funds (the top level in the administrative structure), the approved budget immediately below the top level is shown as a mixture of ministries, sectors, types of funds, and projects (hence implying a level of inconsistency across the organizational structure)[22]. Given that the approved budget cuts across ministries, this makes it more difficult to compare data on actual spending by ministries with the approved budget, as shown in the documentation for the appropriated budget.

[20] Source: PEFA Secretariat's latest Clarifications to the PEFA Framework (March 2012).
[21] This is the criterion for a score above a D.
[22] which is reflected in the Chart of Accounts.

Secondly, whilst the Chart of Accounts incorporates both an administrative (organizational) and an economic structure (for detailed reporting), only the former (organizational structure, whose highest level, funding source, cuts across ministries, as explained immediately above) is incorporated explicitly into the approved budget. However, as indicated above, the administrative (organizational) classification at lower levels (i.e. in its disaggregation) is not consistent across the classification.

In practice, both of these mean that the budget classification does not in practice incorporate the administrative and economic classifications such that it allows data comparisons to be consistent with the documentation for the proposed and approved budget.[23] In this way, the requirements for a higher score are not met.

Indicator (M1)	Score	Brief Explanation
B. Comprehensiveness and Transparency		
PI-5. Classification of the budget	**D**	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. The criteria for a higher score are not met.

PI-6: Comprehensiveness of budget documentation

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).

[23] The criterion for a score above a D.

Box 3.2: Completeness of Budget Documentation[1]

Item	Included in budget documentation?	Comment
Macro-economic assumptions (aggregate growth, inflation, and exchange rate)[2]	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) 2. RMI uses the US dollar as its currency; thus, the explicit exchange rate policy is 1:1 correspondence with the US dollar.		

Indicator (M1)	Score	Brief Explanation
PI-6. Comprehensiveness of information included in budget documentation	**D**	None of the information listed is provided in the Budget document

PI-7: Extent of unreported government operations

(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).[24] 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

[24] The assessment notes that this dimension excludes-externally-provided project resources; the information in this paragraph is for information only.

US$15 mn of expenditure in FY11, representing approximately 15% of total GRMI expenditures.[25] 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; 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.[26] In addition, autonomous government agencies[27] 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-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.

[25] Data are taken from FY10 annual audited accounts. Total expenditures are for central government (GRMI) and include all governmental funds.

[26] The omission of the fiscal activity of these funds is noted in notes to the annual financial statements

[27] In the RMI context, autonomous government agencies include state-owned organizations with either a non-commercial or a commercial remit. Despite concerted attempts to do so, it was not possible to separate the two groups distinctly, but the inclusion of the latter group does not affect the score of this dimension.

Indicator (M1)	Score	Brief Explanation
PI-7. Extent of unreported government operations	**D**	
(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: Inter-governmental fiscal relations

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[28], 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.

(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

28 Not all atolls are inhabited, so some atolls share a local government.

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.[29] 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.

Box 3.3 contains a summary of the grants from central government to local governments.

[29] Funds are available for the purchase of building materials, heavy equipment, sea vessels, freight or contractual services.

Box 3.3: Overview of central government grants to local governments

Name of grant	Form of grant	Provided to which LGs	Criteria for horizontal allocation among LGs	Source of documentation on criteria	Meets PI-8i criterion for transparency and objectivity in horizontal allocation to LGs?
Local Government Fund	Unconditional grant	All	1. Equal share 2. Share based on population	CM (1987)	Yes
Grant-in-aid	Matching grant	All	*Eligibility* – equal amounts across all LGs *Actual grants* – based on proposals by local governments	CM147 (2005)	Yes (based on equal maximum grants to each LG)
Outer Islands Economic Development Fund	Conditional (project) grant	All	1. Equal share 2. Share based on population	CM197 (2009), CM230 (2000)	Yes
Other[1]	USDA Special Feeding Program, Single Audit	Specific LGs as agreed with donor	N/A	Individual MoUs	Not included in assessment
Notes: 1. Includes USDA Special Feeding Program, Single Audit					

(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).[30]

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

[30] 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.

Table 3.1: Overview of central government transfers to local governments

Grant type	Aggregate budgetary allocations from CG to Local Governments (US$ '000)			
	FY09	**FY10**	**FY11**	**% of total CG grants[3]**
Local Government Fund	396.6	396.6	374.8	15.1%
Grant-in-aid	242.0	242.0	228.7	9.2%
Outer Islands Economic Development Fund	N/A[2]	1,989.9	N/A[2]	75.7%
Other[1]	N/A	N/A	N/A	N/A
Total	N/A[2]	**2,628.5**	N/A[2]	**100.0%**
Notes: 1. Includes USDA Special Feeding Program, and Single Audit. As described in the text, these are excluded from the assessment. 2. The exact aggregate amount was not available. 3. Based on FY2010 Source: Annual Appropriations Acts				

(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.

Indicator (M2)	**Score**	**Brief Explanation**
PI-8. Transparency of Inter-Governmental Fiscal Relations	**B**	
(i) Transparency and objectivity in the horizontal allocation among Sub National Governments	*A*	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	*B*	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	*D*	No consolidation of general government sector is undertaken, and no such annual fiscal reports are prepared

PI-9: Oversight of aggregate fiscal risk

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 autonomous government agencies (AGAs) do not prepare them. At least one AGA has prepared a preliminary strategic plan but this plan was not officially endorsed by the Board.

End-of-year reporting by AGAs consist of annual financial statements and annual reports. These are submitted to the relevant AGA'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, AGAs who request subsidies are requested to include their most recent annual reports. In the FY12 budget process, fewer than 10 AGAs provided their annual reports to MoF, representing less than 40% (by number) of all AGAs.[31] 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 AGAs' overall fiscal risk.

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

Recently, Cabinet approved a list of six principles covering proposed regulations for AGAs, 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.

31 In RMI, AGAs 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 (M1)	Score	Brief Explanation
PI-9. Oversight of aggregate fiscal risk from other public sector entities.	**D**	
(i) Extent of central government monitoring of AGAs/PEs	*D*	No central government entity, including the MoF, systematically receives Annual Financial Statements or Annual Reports from the majority of AGAs, nor does any entity prepare a report on the associated fiscal risk.
(ii) Extent of central government monitoring of SN governments' fiscal position	*D*	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 fiscal information

Access to timely, accurate, comprehensive and useful information on a country's fiscal activities helps ensure accountability of the government to its population.

While some fiscal documents (e.g. the budget and audited annual financial statements) are in theory available from government staff on request[32], 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).

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.

[32] Testing this would require assessing the extent to which an ordinary member of the public has access in practice (including likely obstacles); however, in general, there was reportedly insufficient demand (such requests) for such documents so by default it was not possible for the team to conclude that public access was provided in practice.

Box 3.4: Public Access to Fiscal Information[1]

Item	Document issued?	Does public have access?	Meets PEFA criteria?
1. Annual budget documentation	Yes	Only on request from MoF[33]	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[34]	No
4. External audit reports	Yes	Only on request from Office of Auditor General[35]	No
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 even on request	No
Note: 1. Information based on most recent fiscal year (FY2011)			

Indicator (M1)	Score	Brief Explanation
PI-10. Public access to key fiscal information	D	Government provides independent access to the public for 0 of the 6 types of information listed.[36] The requirements for a higher score are not met.

3.3 Policy-based Budgeting

PI-11: Orderliness and participation

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; the main steps are set out in Box 3.5. 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.

33 Ibid
34 Ibid
35 Ibid
36 Ibid. The requirements for a higher score are not met.

Box 3.5: Timetable for main steps in budget preparation[1]

Step	Timing
Dissemination of budget call circular by MoF to line ministries	End-April, May or June
Submission of line ministry budget requests to MoF	May/June
Budget Co-ordinating Committee hearings with line ministries	June
Cabinet approves draft budget for submission to Nitijela	August
Consideration of draft budget (Appropriation Bill) by Appropriations Committee of Nitijela	August/September
Approval of Appropriation Bill by Nitijela.	September
Beginning of fiscal year	1 October
Notes: 1. Based on budget processes for FY10, FY11, and FY12	

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. The specific timings of approval for the last three budgets are summarized in Box 3.7.

Box 3.7: Approval of Appropriation Bill, FY09-FY12

Fiscal year	Date of Parliamentary (Nitijela) approval[2]
FY09	29 September 2008
FY10	21 September 2009
FY11	22 September 2010
FY12	29 September 2011
1. The dates shown indicate when the Bill became an Act (i.e. with the signature of the Speaker of the Nitijela). Source: MoF	

Indicator (M2)	Score	Brief Explanation
C(i) Policy-Based Budgeting		
PI-11. Orderliness and participation in the annual budget process	**B+**	
(i) Existence of, and adherence to, a fixed budget calendar	*C*	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	*A*	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	*A*	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

(i) Multi-year fiscal forecasts and functional allocation

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 called a rolling Medium Term Budget and Investment Framework (MTBIF), and it is 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.[37] 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.[38] 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

[37] See Compact of Free Association Amendments Act of 2003 between the governments of the US and the Marshall Islands.

[38] 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.

Framework Paper are identical to the proposed budget year (i.e. in the FY08-FY12 MTBIF[39], the aggregate fiscal parameters for FY10, 11 and 12 are identical).[40]

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 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.

[39] The most recent one available to the assessment team.

[40] In other words, as the MTBIF does not, in practice, comprise meaningful forward estimates as part of the wider budget process, it is not considered applicable to this dimension.

Indicator (M2)	Score	Brief Explanation
PI- 12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	**D**	
(i) multi-year fiscal forecasts and functional allocations	*D*	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	*D*	No debt sustainability analyses have been carried out in recent years (including in the last 3 years)
(iii) existence of costed sector strategies	*D*	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	*D*	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

3.4 Predictability and Control in Budget Execution

PI-13: Transparency of taxpayer obligations and liabilities

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)[1]

Tax type	Taxable base	Tax rate
Wages and salaries tax	Wage income: 0-$1,560 $1,560-$5,200 $5,200-$10,400 >$10,400	0% 8% (first $1,560 exempted) 8% (no exemption for first $1,560) 12%
GRT	Gross revenue <$10,000 Gross revenue >$10,000	$80 3% of gross income
Import duties	Standard rate Food & public transport Fuel Motor vehicles Tobacco Alcohol	8% 5% (some basic foods exempt) $0.25/gal (gas); $0.08/gal (jet, diesel) Higher of $1,500 or 15% of Kelly's Blue Book value Rates according to schedule 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 Employee Self-employed	7% of gross wage and salary 7% of gross wage and salary 14% of presumed wage
Health Fund contribution	Employer Employee Self-employed	3.5% of gross wage and salary 3.5% of gross wage and salary 7% of presumed wage

Notes: 1. Excludes local government sales tax (Kwajalein) and copra tax.
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

	Tax revenue receipts (FY10) US$'000	As % of total
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[1]	617	2.4%
Total Taxes	**25,243**	**100.0%**
Above taxes as % of GDP	15.5%	
Total domestic revenue receipts as % of GDP[3]	**24.7%**	
1. Data exclude receipts from MISSA withholding tax and copra tax. 2. Includes non-resident workers' fees (penalty & interest), and tax audit adjustment 3. Data are from IMF and include all sources of domestic revenues. Source: MoF		

The most recent IMF Article IV report[41] 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[42] 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.

41 IMF Country Report 11/339, November 2011.

42 Specifically, wages and salaries (income) tax, customs duties, business gross revenue tax, immoveable 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.[43]

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.[44]

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 a functioning system with documented administrative procedures established. In practice, the tax appeal system is based on recourse to the general legal system, which does not include a special court established to hear such cases.[45]

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43 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.

44 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.

45 See the PEFA Secretariat's latest Clarifications to the PEFA Framework (March 2012) on this dimension.

Indicator (M2)	Score	Brief Explanation
PI-13. Transparency of taxpayer obligations and liabilities	**D+**	
(i) Clarity and comprehensiveness of tax liabilities	*B*	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	*D*	Taxpayers do not have easy access to information on tax liabilities and administrative procedures
(iii) Existence and functioning of a tax appeals mechanism	*D*	A functioning tax appeals system with documented administrative procedures is not in place.

PI-14: Effectiveness of measures for taxpayer registration and tax assessment

(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 dimension should be a C or a D.

Table 3.3: Value of total penalties charged by year (US$)[1]			
	FY09	FY10	FY11[2]
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. 2. Estimated 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.

Indicator (M2)	Score	Brief Explanation
PI-14. Effectiveness of measures for taxpayer registration and tax assessment	**NR**	
(i) Controls in taxpayer registration system	*D*	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	*NR*	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	*C*	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

(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[1] (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. 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.[46]

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.

Indicator (M1)	Score	Brief Explanation
PI-15. Effectiveness in collection of tax payments	**D+**	
(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

(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

46 However, it is noted that the single audit does not look systematically at this issue.

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; [47] 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.[48]

(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.[49]

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 Nitijela 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

[47] Based on the January 2011 MoF memo.

[48] See reports from recent PFTAC missions.

[49] 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).

against clearly-set out criteria). Data were not available on the percentage of adjustments to total expenditures during the most recent fiscal year, but ministry consultations indicated that such adjustments are done frequently during the year.

Indicator (M1)	Score	Brief Explanation
PI-16. Predictability in the availability of funds for commitment of expenditures	**D**	
(i) Extent to which cash flows are forecast and monitored	*D*	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	*D*	While, in theory, a line ministry may commit up to one-quarter of its annual allocation each quarter, in practice, other implicit or *ad hoc* 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	*D*	In-year budget adjustments are made frequently and their basis is not transparent.

PI-17: Recording and management of cash balances, debt and guarantees

(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.[50] 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 eight 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[51], including the payroll account, are calculated on an individual basis, and most (but not all) are done

50 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.

51 GRMI operates approximately 35 accounts in total, with many being savings or investment accounts.

regularly, specifically, at least monthly.[52] 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 place. 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 one loan contracted (by the ADB, for on-lending to state-owned enterprises (SOEs)), and no government guarantees were issued.[53]

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.

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[54] 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).

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

53 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.

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

Indicator (M2)	Score	Brief Explanation
PI-17 Recording and management of cash balances, debt and guarantees	**D+**	
(i) Quality of debt data recording and reporting	*D*	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	*C*[55]	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	*C*	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.

PI-18: Effectiveness of payroll controls

(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).

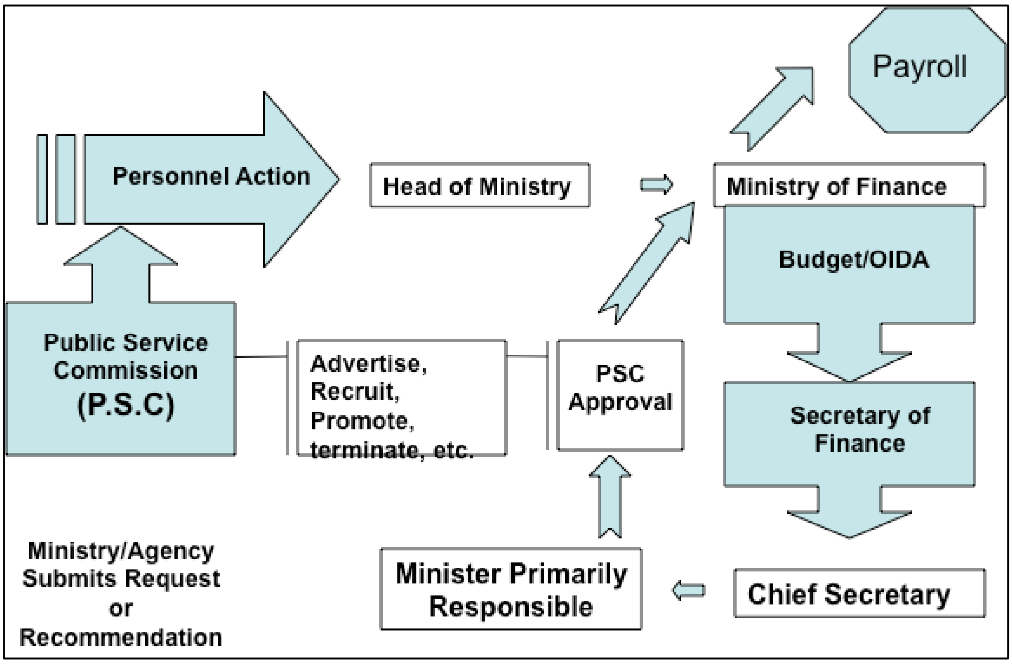
Public entities maintain three lists of personnel and payroll records: (i) payroll, maintained exclusively by MoF; (ii) personnel records (staff records), maintained by the line ministries; and (iii) establishment list (ministry structure with all posts), maintained by PSC. The 3 databases are separate,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

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

Figure 3.1 sets out the stages of the process required to make changes to personnel records and the payroll, including the incorporation of newly-hired personnel to more minor changes (e.g. changes in salary levels). This process is centered on the Personnel Action (PA) document and involves activity by the PSC, the initiating institution (e.g. school), the initiating line ministry (e.g. Ministry of Education), and the Ministry of Finance.

[55] This change in rating reflects a clarification to the PEFA Guidelines set out in the latest version from the PEFA Secretariat (March 2012, after the draft of this assessment was circulated). There is no change in the overall rating..

Figure 3.1: Stages required to make personnel and payroll changes



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,[56] 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.[57] 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)[58] and the lack of an international-standard

56 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.

57 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.

58 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.

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.[59] It focussed exclusively on studying options for rationalising public sector expenditure and improving performance in three ministries (Health, Education, and Public Works).[60]

Indicator (M1)	Score	Brief Explanation
PI-18. Effectiveness of payroll controls	**D+**	
(i) Degree of integration and reconciliation between personnel records and payroll data.	*D*	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	*D*	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.	*C*	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.	*D*	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

(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.[61]

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) and on the University of the South Pacific (USP)'s Pacific Islands Legal Information Institute (www.paclii.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).

[59] Lanki and Pitkin (2009), *Public Service Commission Limited Personnel Audit*.

[60] 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.

[61] 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.

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

Item[1]	**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[1]	**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.

Indicator (M2)[62]	**Score**	**Brief Explanation**
PI-19. Competition, value for money and controls in procurement	**D**	
(i) Transparency, comprehensiveness and competition in the legal and regulatory framework	*C*	The Procurement Code contains three of the items listed
(ii) Use of competitive procurement methods	*D*	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	*D*	The government does not systematically provide the public with the key procurement information listed.
(iv) Existence of an independent administrative procurement complaints system	*D*	No independent procurement complaints mechanism exists.

PI-20: Effectiveness of internal controls for non-salary expenditure

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. It has not been communicated officially with line

62 Uses the revised PEFA methodology (January 2011)

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.

The authorisation process set out in Figures 3.2 and 3.3 applies to the issuance of, respectively, purchase requisitions and purchase orders for goods and services, including capital goods. 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[63] and through delays in the approval of spending commitments (through the issuance of a Purchase Order).

Figure 3.2: Authorization process for Purchase Requisition

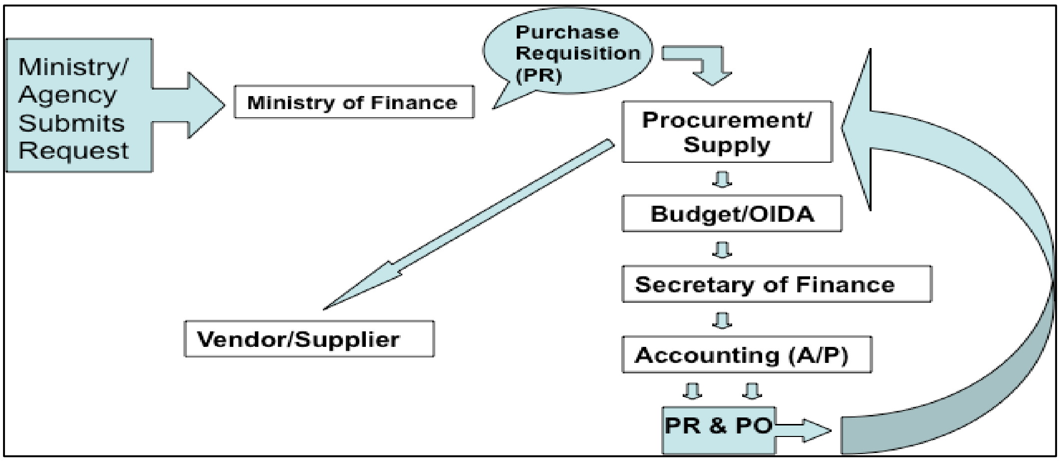
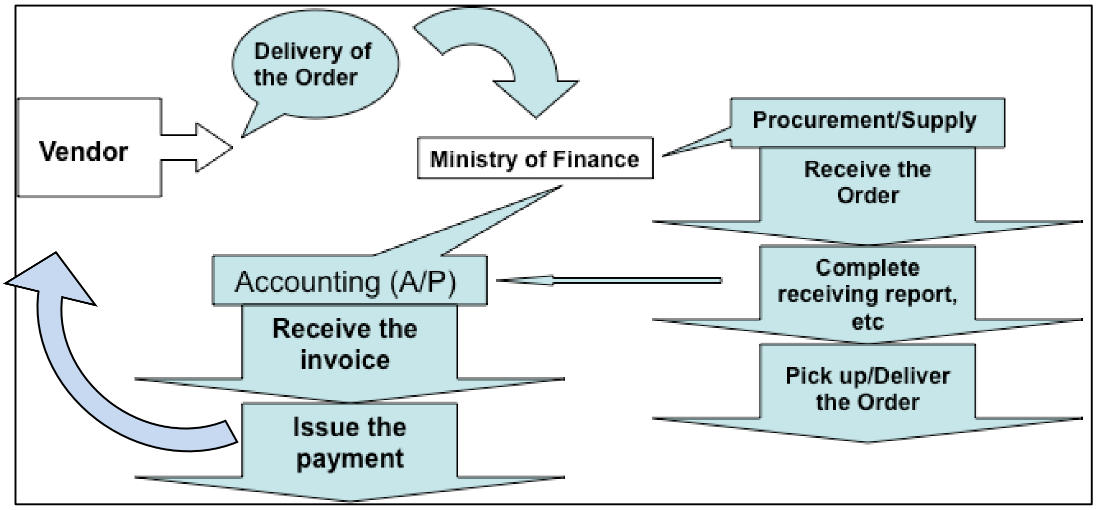


Figure 3.3: Authorization process for Purchase Order



63 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.

Thus, controls on non-salary expenditure commitments by line ministries do exist. However, evidence, including from recent external audit reports[64], shows that there are instances where 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.[65] 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[66] 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[67], 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[68] 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.

64 See, for example, 2010 Audit, RMI Compliance Audit.
65 As stated in the memo, it was issued in response to the discovery of potential fraud involving government funds.
66 See, for example, 2010 Audit, RMI Compliance Audit.
67 The *de facto* (non-codified) procedures, as used in RMI, are distinguished from *de jure* (codified) ones, which are currently not in place.
68 See, for example, 2010 Audit, RMI Compliance Audit.

Indicator (M1)	Score	Brief Explanation
PI-20. Effectiveness of internal controls for non-salary expenditure	**D+**	
(i) Effectiveness of expenditure commitment controls.	*C*	Expenditure controls exist but evidence shows that they are not followed on occasion.
(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures.	*D*	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.	*D*	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

GRMI does not have an internal audit function in the sense of that which is understood by international internal auditing standards.[69] 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".[70] 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.

Indicator (M1)	Score	Brief Explanation
PI-21. Effectiveness of internal audit	**D**	
(i) Coverage and quality of the internal audit function	*D*	There is little or no internal audit within central government which focuses on monitoring of systems
(ii) Frequency and distribution of reports.	*D*	No internal audit reports have been issued in recent years.
(iii) Extent of management response to internal audit findings.	*D*	There is no evidence of internal audit having been either issued or acted upon by management.

69 Nonetheless, GRMI requested that this indicator be included in the assessment.

70 IPSAS standard on internal auditing, International Auditing and Assurance Standards Board, 2010.

3.5 Accounting, recording and reporting

PI-22: Timeliness and regularity of accounts reconciliation

(i) Regularity of bank reconciliations

As discussed in PI-17 above, the RMI Government manages four main bank accounts for central government operations[71] 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[72] 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 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.

Indicator (M2)	Score	Brief Explanation
PI-22. Timeliness and regularity of accounts reconciliation	**D**	
(i) Regularity of bank reconciliations	*D*	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	*D*	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

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.

[71] Including payroll.

[72] See, for example, 2010 Audit, RMI Compliance Audit.

Indicator (M1)	Score	Brief Explanation
PI-23. Availability of information on resources received by service delivery units	**D**	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

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

As discussed under dimension PI-24 (ii) below, GRMI does not issue official in-year budget execution reports. Consequently, this first 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 produced on an on-demand basis.

(iii) Quality of information

As indicated above, with GRMI not issuing official in-year budget execution reports, this 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[73], some important issues have not been systematically highlighted in the reports to facilitate managerial action.[74] 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 the data in the accounts, and thus these problems do not undermine the basic usefulness of the accounts.

[73] See, for example, the compliance volume of the single audit for FY10.

[74] 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)..

Indicator (M1)	Score	Brief Explanation
PI-24. Quality and timeliness of in-year budget reports	**D+**	
(i) Scope of reports in terms of coverage and compatibility with budget estimates	*B*	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	*D*	Official in-year budget execution reports (e.g. quarterly reports) are not formally issued.
(iii) Quality of information	*C*	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.

PI-25: Quality and timeliness of annual financial statements

(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[75] and thus a breach of accountability. Consequently, the dimension has not been rated, as the assessment team deemed that the assessment result would be misleading.

[75] Refer to International Standards for Supreme Audit Institutions (ISSAI) 20, 21 and 30, particularly principles 4 and 5.

(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 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 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.

Indicator (M1)	**Score**	**Brief Explanation**
PI-25. Quality and timeliness of annual financial statements	**NR**	
(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.

3.6 External scrutiny and audit

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

(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.[76] 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. The reports identify some significant issues (e.g. with compliance) but do not highlight them. 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 the separate letter.[77] 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.[78] 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[79] in line with this time period.

However, the submission of such reports to the Nitijela (the subject of this 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.[80]

(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

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

77 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.

78 As indicated above, in the RMI context, SOEs cover both autonomous government agencies and public enterprises.

79 Either the Auditor-General's office or, in most cases, the external audit firm contracted to the Auditor General.

80 As indicated above, the Auditor-General's office carries out only financial audit and compliance audits.

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 dimension reflects the situation for the single audit since these are the main types of audit.

Indicator (M1)	Score	Brief Explanation
PI-26 Scope, nature and follow-up of external audit	**C**	
(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

(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. 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, in summary, the Nitijela (including the Committee on Appropriation) 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) which are not set out in 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 Means81, 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. In summary, 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 for this 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.[82] 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).[83]

However, the rules in the Constitution and the FMA for making changes to the appropriations are not clear. In neither document is the term 'program area' defined (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'.[84] 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[85] (described in the previous paragraph), about which changes may be made by the Cabinet, and which must be approved by the Nitijela.

81 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"

82 While these rules were set out in PI-16 above, they are repeated here for ease of reference.

83 Section 5 of Article VIII of the Constitution provides for Cabinet's collective responsibility over all public expenditures.

84 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.

85 Section number from FY2011 Appropriation Act

Indicator (M1)	Score	Brief Explanation
PI-27 Legislative scrutiny of the annual budget law	**D+**	
(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*[86]	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 *ex ante* by the legislature are not clear.

PI-28: Legislative scrutiny of external audit reports

(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.

[86] Note the PEFA Guidelines for this 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 dimensions. In this case, since at least one of the other 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.

(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.

Indicator (M1)	Score	Brief Explanation
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*	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.	*B*	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.	*C*	The SCPA makes recommendations but evidence indicates that these are not acted upon by the executive.

3.7 Donor Practices

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.

Table 3.5: Disbursements of Reported ODA by Development Partner, 2007-2010[1,2]

	US$ mn			
	2007	2008	2009	2010
United States[3]	N/A	80.6	79.4	81.4
Republic of China	13.3	14.5	14.5	15
Japan	2.1	2.4	8.3	N/A
Australia	0.7	0.5	1.6	N/A
EU institutions	1.4	1.7	1.4	N/A
Germany	-	-	0.1	N/A
Korea	0.11	-	0.1	N/A
Norway	-	0.1	0.1	N/A
Canada	-	-	0.0	N/A
New Zealand	0.1	0.2	-	N/A
Other bilaterals	0.1	0.1	-	N/A
ADB	N/A	N/A	N/A	N/A
UN agencies	N/A	N/A	N/A	N/A
TOTAL ODA	**97.7**	**100.1**	**105.5**	**96.4**[5]
As % of total budget[4]	97.7%	96.9%	100.8%	92.4%

1. Data shown are by calendar year. Information was not available on a consistent basis for 2010.
2. Data exclude non-DAC donors not listed and private donors. However, the excluded amounts are likely to be very small.
3. Figures include Compact grants, Federal grants, TA grants, USDA rural housing grants as well as Trust fund grants and Kwajalein rental payments. Amounts are approximate.
4. Total expenditures as shown in the annual accounts. Due to the non-inclusion of some external assistance in the budget, the denominator does not include the total ODA shown here, and thus the % of the total budget is over-stated.
5. Data from other sources are not available, thereby perhaps understating the total.
Sources: GRMI audited accounts, OECD-DAC, EPPSO, donor agencies

D-1: Predictability of Direct Budget Support

GRMI receives direct budget support each year only from the Republic of China (ROC).[87] 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[88] during the last three years.

Indicator (M1)	Score	Brief Explanation
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*	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.

87 Grant funds from the US under the Compact agreement do not constitute direct budget support.

88 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.

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

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

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.

Indicator (M1)	Score	Brief Explanation
D-2 Financial information provided by donors for budgeting and reporting	**D**	
(i) Completeness and timeliness of budget estimates by donors for project support	*D*	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	*D*	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

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.

Indicator (M1)	Score	Brief Explanation
D-3 Proportion of aid that is managed by use of national procedures	**D**	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.

4. Government Reform Process

4.1 General Description of Recent and On-Going Reforms

The Government has demonstrated its commitment to improving its public financial management system in recent years through a series of measures aimed at improving the efficiency of resource use. The most recent reforms have built on those achieved as part of the measures introduced under Cabinet Minute or Executive Directive between 2008 to date, intended to strengthen the enabling environment for private sector growth. Assistance is currently provided mainly by ADB and PFTAC (IMF).

Tax and Revenue Reform and Modernization (TRAM) was endorsed by the Cabinet in June 2010 to strengthen RMI tax administration and enforcement, provide ways and means to ensure fiscal sustainability and promote sustainable private sector growth. At the time of this assessment, the assessment team was told that the Bill would be introduced in the January 2012 session.

Weak financial positions among the SOEs triggered the government to develop a reform plan. GRMI adopted a comprehensive recovery plan (CRP) for the energy company and six good practice principles under SOEs reform in 2010. In the meantime, recognizing the need to control subsidies to the SOEs, GRMI has decreased its aggregate annual subsidies in FY11 and FY12.

Although Vision 2018 was adopted as the national development plan in 2001, the document does not identify priorities, sequence or estimates. Cabinet had approved a National Development Plan (NDP) working group in May 2010. Two consultants have worked with Economic Planning, Policy, Statistics Office (EPPSO) in the meantime. Active consultation and drafting is due to commence after the new government is established. UNDP is providing an advisor for this exercise. The availability of a sound NDP is expected to allow better budgeting and planning.

Public Sector Reform as recommended by the 2010 Comprehensive Adjustment Program (CAP) report indicated 13 expenditure areas of focus. The Advisory Group recommended various expenditure reductions to be implemented over three years that could, when fully implemented, achieve a fiscal saving of $7-8 million annually. In line with such, a Bill to amend and decrease Parliament's contribution had been introduced in the August session, then subsequently deferred. The civil service assessment TA has been secured through ADB, with a consultant scheduled to work in RMI during December 2011. The budget for electricity allowances was also cut by half, anticipating another ADB TA to review easement payments to landowners resulting in roughly a 50% difference in expenditure. The Public Service Commission is also reviewing the current cost structure of housing privileges, as a maximum of $750 per month is charged by all leasers irrespective of size, location, and condition. Other selective items are also targeted with control mechanisms to decrease pubic expenditures.

Recognized Public Financial Management (PFM) weaknesses resulted in a number of measures, intended to strengthen the legislative framework and improve oversight of the use of public sector resources, initiated by the Ministry of Finance. The Financial Management Act and Procurement Code are on the frontline to be reviewed. Improved oversight and legislative scrutiny is also evidenced by the strengthened and more active role of the Public Accounts Committee (PAC). The Lean team initiative also has commenced in an attempt to build a more efficient procurement and PFM system. System upgrade of the Financial Management Information System upgrades have started, with the conclusion of phase one in mid 2011, to be followed by the second phase mid-2012. The PEFA assessment is expected to be followed by the preparation of a roadmap to improve PFM systems. Initiatives on a Debt Management Strategy and Fiscal Responsibility Legislation are also in the pipeline through the assistance of ADB. The development of medium-term budgeting is also planned to start in 2012, with the MoF co-ordinating the formulation of a Three Year Strategic Plan.

At the December 2010 Development Partners' Meeting, RMI had pushed for assistance in Aid Coordination and Management, intending to streamline and effectively manage aid and other assistance benefiting the country. The Secretariat of the Pacific Community (SPC) and PIFS had responded in mid 2011, with the plan to progress in 2012 an Aid Management Policy and legislative changes to transfer ODA mandates from EPPSO to the Ministry of Finance Office of International Development and Assistance (OIDA).

Reform is also visible at the Office of the Auditor General. With the newly appointed Auditor General, the Government had supported an aggressive restructuring and additional budget support to strengthen supervision and scrutiny of financial and performance audits of the government, local governments, and SOEs. Partnership with the MoF to conduct internal investigations and non-performance reviews illustrates a promising improvement in the PFM system.

4.2 Institutional Factors Supporting Reform Planning and Implementation

The Government has an agenda to reform its public sector and encourage private sector growth to meet its overarching target of better accountability and transparency. It has recognized that this target will require overcoming potentially significant institutional challenges. In his 2011 Budget Statement, the Minister of Finance addressed a number of these challenges directly, including the need for leadership on accountability and transparency, overcoming low implementation capacity, and co-ordinating the reforms, all to begin in early 2012, with the results expected to become visible beginning in 2013.

Government ownership and leadership of reform program

The achievement of recent improvements in the PFM system provides evidence of government commitment to the reforms under the leadership of the Minister of Finance Jack J Ading, and the Cabinet and Parliament members. At present, leadership for the PFM reforms appears strongest in the MoF. The Government is developing plans to introduce and monitor medium term budgeting to ensure results are monitored and accounted for.

More accountable institutions improve the incentives for good leadership, and the Government has recognized that this implies changes in work ethics, structure, and behaviour. Similarly, enhanced legislative and external scrutiny is recognized as a vehicle of improved accountability and transparency. In this way, the increased emphasis on participation by the public in the budget and audit reports is welcomed.

Overcoming low implementation capacity

The pace of reform is potentially hampered by constraints in implementation and absorptive capacity, leading to delays in the execution of projects and programs. This issue is exacerbated by weaknesses in technical capacities as higher salaries in the SOEs or off-island opportunities attract other professionals with marketable skills. While expatriate consultants and experts are easily attainable through assistance from development partners, local sustainability is questioned when participation and capacity of local counterparts are insufficient. The recruitment and retention of qualified officials will be particularly important to sustain the reform programs under way. As a response, GRMI has introduced a Cabinet Minute to set SOE pay scale so as to match that of the Public Service Commission's.

Co-ordination of reforms

The Ministry of Finance and the Office of the President EPPSO are at the core of the public sector reform program. Although the Government has introduced a series of CMs, this does not appear to be sufficient to act as a road map for reforms since the plans do not contain a sequenced and costed work plan with realistic timelines. There is a need for MoF to set priorities and expected results, identify timelines for the medium-term, monitor implementation, and ensure good communication and coordination between central and line ministries and respective stakeholders to ensure self-sustainability post 2023, when the Compact of Free Association with the United States is expected to expire.

List of Annexes

Annex A

List of Stakeholders Met

Name	Position	Institution
Hon. Minister Jack J Ading	Minister of Finance	Ministry of Finance
Alfred Alfred, Jr	Secretary of Finance	Ministry of Finance
Kayo Yamaguchi-Kotton	Assistant Secretary	MoF Budget/Procurement/Aid
Clarence Samuel	Director	Budget
Itibo Tofinga	Acting Assistant Secretary	MoF Customs, Revenue, Tax
Boris Anni	Assistant Secretary	MoF Accounting and Admin
Oliver Gonzalez	Consultant – Accountant	MoF Accounting Div
Netha Gideon	Fiscal Officer	Ministry of Public Works
Mina Cheng	First Secretary, Economic Advisor	ROC Embassy, Majuro
Mabel Peter	Chief of Local Gov Bureau	Ministry of Internal Affairs
Gee Leong Bing	Director	Office of Compact Implementation, MoFA
Savenaca Narube	Consultant	ADB
John Henry	Statistician	EPPSO
Rejene Capital	Fiscal Officer	Ministry of Internal Affairs
Casten Nemra	Chief Secretary	Office of the Chief Secretary
Edward O'Brien	Fiscal Officer	Public Service Commission
Reynaldo Sunga	PMU (Project Mgt Unit) - Infrastructure	Ministry of Public Works
Risa Perez	Chief Accountant	Ministry of Health
Maybelline Andon Bing	Assistant Secretary	Personnel, Finance, Administration, MoH
Lincoln Mea	Tax Auditor	MoF Tax, Revenue, Customs Div
Sorry Riklon	Personnel Director	MoH
Daniel Timothy	Chief of Customs	MoF Tax, Revenue, Customs Div
Gether Lodge	Deputy Commissioner	Public Service Commission
Peter Anjain	Personnel Officer	Ministry of Education
Patrick Langrine	Chief Accountant	MoF Accounting
Senator Frederick Muller	Senator, Chair of Public Accounts Committee	Nitijela (Parliament)
Alvin Jacklick	Speaker of RMI Parliament	Nitijela (Parliament)
Isle Rusin	Assistant Legal Counselor	Nitijela (Parliament)
Mayor James Matayoshi	Mayor	Rongelap Atoll Local Gov
Antonio Reyes	Chief Accountant	Rongelap Atoll Local Gov
Victon Balico	CFO	Air Marshall Islands
Ricky Kurn	Finance Officer	Utrik Atoll Local Gov
Erickson Laipto	Fiscal Assistant	Rongelap Atoll Local Gov
Wilfredo Candillas	Chief Tech Officer	Tobolar (Copra processing authority)
Elmo Astroga	Chief Accountant	Tobolar
Andy Chen	General Manager	Officemart (private sector)
Alan Fowler	DOI	US Embassy
Andrew Zvirvanovich	DOS Economic Advisor	US Embassy
Ben Graham	Consultant	ADB
Stephen Philips	President	Chamber of Commerce
Kathryn Hutton	Director	NGO WAM (Waan Aelon in Majol)

Name	Position	Institution
Lezil Gana	Finance Officer	WAM
Maybelline Ipil	Director	NGO Marshall Islands Epidemiology (MI-EPI)
Giff Johnson	Editor	Marshall Islands Journal
Baldwin Robert	Principal	Delap Elementary School
Waylon Muller	Chief of Procurement	MoF Procurement/Supply Div
Junior Patrick	Auditor General	Office of the Auditor General
Saeko Shoniber	Internal Auditor	MEC (SOE)
Edison Isaiah	Revenue Supervisor	Tax, Revenue, Customs MoF
Yolanda Jowell	Revenue Officer	Tax, Revenue, Customs MoF
Antila Masha	Treasurer	MoF Treasury Division
Jimmy Kemem	Assistant Secretary	Ebeye MoF (tel conference)
Bryan Edgar	Compliance Officer	Marshall Islands Social Security Authority
Yumi Ichikura	Economic Advisor	Japanese Embassy
Fumiyoshi Kashima	Charge de Affairs	Japanese Embassy
Hilma Lanwi	LES	Japanese Embassy

Annex B

List of Documents Consulted

2008 Audit, RMI Compliance Audit
2008 Audit, RMI Financial Statements
2009 Audit, RMI Compliance Audit
2009 Audit, RMI Financial Statements
2010 Audit, RMI Compliance Audit
2010 Audit, RMI Financial Statements
ADB Loan Movement Schedule, FY11
Annual Tax Audit Plan, 2011 and 2012
Annual summary report 2010
Appropriation Act FY2008
Appropriation Act FY2009
Appropriation Act FY2010
Appropriation Act FY2011
Auditor-General's semi-annual reports, FY 09 and FY10
Bases of tax calculations
Cabinet Minutes, various
Cabinet Papers, various
CAP report
College of the Marshall Islands Proposed Budget, FY12
Control measures on General Fund purchases
Corporate Plan, Nitijela
Data from development partners
Data on tax arrears
Data on tax penalties collected
EPPSO RMI Economic Outlook
FMIS reports – 101p, 102p, 134p, 240p
FY 12 line ministry budget submissions
FY 12 SOE budget submissions (subsidies)
FY 2012 Budget Consultation Appointment Schedule & Memo
FY10 Budget Circular for Fiscal Officers
General Fund log
GIA Policies Act
IMF RMI Article IV Report, November 2011
In-house Procedures and Policy – MoF memo on strengthened internal control procedures
Initial Budget Circular For Fiscal Year 2012
Lean team memo
List of tax rates and filing dates; withholding tax tables
Local Government Funds Act
Minister's Budget Speech, FY 2012
Ministry of Health FY12 Proposed Budget (Compact, General, HCRF, and HF Funds)
MIRC, Volumes 1 and 2
MISSA Benefit Explanation
MISSA Biannual Report FY 2008 & 2009
MOE Strategic Plan
MoF Budget Circulars, FYs 2009, 2010, 2011, 2012
MoF Flowcharts, personnel and non-personnel expenditure processes
MoF memo on expenditure cap
MoH FY2012 FINAL Portfolio Budget
MOH MT Strategy
MTBIF 2009-13
Nitijela's Rules of Procedure
OIEDF Policy, ROC funds
Output from OECD-DAC database

RMI Budget Statement, FYs 2010, 2011, 2012
RMI Compact FPA
RMI Constitution
RMI Decrement Strategy
RMI Economic Statistics Tables, 2009
RMI Procurement Code
RMI Procurement Report
RMI SOE Reform document
RMI Vision 2018
Tax filing forms
TRAM report

Annex C

Evidence Used for Indicators

Indicator	Specific Documentary Information Sources Used[1]
A. Credibility of the Budget	
1. Aggregate expenditure out-turn compared to original approved budget	Appropriation Acts (original), FYs 2008, 2009, 2010, 2011 Annual Audited Accounts, FYs 2008, 2009, 2010 Preliminary accounts, FY 2011
2. Composition of expenditure out-turn compared to original approved budget	Appropriation Acts (original), FYs 2008, 2009, 2010, 2011 Annual Audited Accounts, FYs 2008, 2009, 2010 Preliminary accounts, FY 2011
3. Aggregate revenue out-turn compared to original approved budget	Appropriation Acts (original), FYs 2008, 2009, 2010, 2011 Annual Audited Accounts, FYs 2008, 2009, 2010 Preliminary accounts, FY 2011
4. Stock and monitoring of expenditure payment arrears	Stakeholder discussions
B. Comprehensiveness and Transparency	
5. Classification of the budget	RMI Chart of Accounts
6. Comprehensiveness of information included in budget documentation	Budget schedules, FYs 2009, 2010, 2011, 2012
7. Extent of unreported government operations	Annual Audited Accounts, FYs 2008, 2009, 2010
8. Transparency of Inter-Governmental Fiscal Relations	Annual Audited Accounts, FYs 2008, 2009, 2010
9. Oversight of aggregate fiscal risk from other public sector entities	Annual Audited Accounts, FYs 2008, 2009, 2010
10. Public access to key fiscal information	Stakeholder discussions
C(i) Policy-Based Budgeting	
11. Orderliness and participation in the annual budget process	Budget Call Circular, FYs 2009, 2010, 2011, 2012 Appropriation Acts, FYs 2009, 2010, 2011, 2012 MIRC
12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	MIRC Budget Schedules, FYs 2009, 2010, 2011, 2012 Strategic Development Program Vision 2018 Health Sector Plan Education Sector Plan
C (ii) Predictability and Control in Budget Execution	
13. Transparency of taxpayer obligations and liabilities	Income Tax Act Customs Act
14. Effectiveness of measures for taxpayer registration and tax assessment	Income Tax Act Customs Act Data on penalties collected Tax audit plan Tax audit criteria
15. Effectiveness in collection of tax payments	Stakeholder discussions
16. Predictability in the availability of funds for commitment of expenditures	MIRC Control measures on General Fund purchases Stakeholder discussions

Indicator	Specific Documentary Information Sources Used[1]
17. Recording and management of cash balances, debt and guarantees	MIRC Debt management worksheet List of bank accounts Report on bank balances
18. Effectiveness of payroll controls	PSC Act Examples of Personnel Action forms (filled-in) General Fund log
19. Competition, value for money and controls in procurement	MIRC Procurement Code
20. Effectiveness of internal controls for non-salary expenditure	MIRC Annual compliance audit reports, FYs 2008, 2009, 2010 In-house Procedures and Policy – MoF memo on strengthened internal control procedures
21. Effectiveness of internal audit	N/A
C (iii) Accounting, Recording and Reporting	
22. Timeliness and regularity of accounts reconciliation	Bank reconciliation statements Bank balances log
23. Availability of information on resources received by service delivery units	Stakeholder discussions
24. Quality and timeliness of in-year budget reports	Expenditure Reports from FMIS Stakeholder discussions
25. Quality and timeliness of annual financial statements	Annual audited accounts, Single Audit, FYs 2008, 2009, 2010
C (iv) External Scrutiny and Audit	
26. Scope, nature and follow-up of external audit	Auditor-General's Semi-Annual Reports, FYs 2009, 2010 Single audits, compliance reports and management letter
27. Legislative scrutiny of the annual budget law	Nitijela's Rules of Procedure Discussion with Nitijela stakeholders
28. Legislative scrutiny of external audit reports	Nitijela's Rules of Procedure Discussion with Nitijela stakeholders
D. Donor Practices	
D-1 Predictability of Direct Budget Support	Data from ROC
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	OECD-DAC database
D-3 Proportion of aid that is managed by use of national procedures	Stakeholder discussions
Note: 1. Supplemented by detailed interviews with stakeholders	

Annex D

Background Data for PI-1 to PI-3

Data for year =	2011					
administrative head	**budget**	**actual**	adjusted budget	deviation	absolute deviation	percent
President & Cabinet	1,904,854	1,495,718	1,710,168	-214,450	214,450	12.5%
Chief Secretary	645,816	460,705	579,810	-119,105	119,105	20.5%
Special Appropriation	9,619,499	9,687,032	8,636,338	1,050,694	1,050,694	12.2%
Council of Iroij	402,010	424,054	360,923	63,131	63,131	17.5%
Nitijela	1,870,010	1,695,185	1,678,886	16,299	16,299	1.0%
Auditor General	351,189	394,103	315,296	78,807	78,807	25.0%
Foreign Affairs	2,344,755	1,795,438	2,105,109	-309,671	309,671	14.7%
Public Service Commission	462,258	430,856	415,013	15,843	15,843	3.8%
Judiciary	884,581	759,113	794,172	-35,059	35,059	4.4%
Attorney General	739,497	599,084	663,917	-64,833	64,833	9.8%
Health	2,980,025	2,613,712	2,675,451	-61,739	61,739	2.3%
Environmental Protection Agency	191,344	166,997	171,788	-4,791	4,791	2.8%
Education	3,695,573	3,249,159	3,317,867	-68,708	68,708	2.1%
Transportation & Communication	624,940	451,144	561,068	-109,924	109,924	19.6%
Resources & Development	664,496	574,560	596,581	-22,021	22,021	3.3%
Internal Affairs	2,185,464	1,519,607	1,962,099	-442,492	442,492	20.2%
Justice	2,740,456	2,446,482	2,460,368	-13,886	13,886	0.5%
Finance	2,000,465	2,097,497	1,796,007	301,490	301,490	15.1%
Public Works	1,069,539	900,640	960,227	-59,587	59,587	5.6%
20			0	0	0	
21 (= sum of rest)			0	0	0	
allocated expenditure	35,376,771	31,761,086	31,761,086	0	3,052,531	
contingency	200,000	99,177				
total expenditure	35,576,771	31,860,263				
overall (PI-1) variance						10.4%
composition (PI-2) variance						9.6%
contingency share of budget						0.3%

Data for year =	2010					
Administrative head	**budget**	**actual**	adjusted budget	deviation	absolute deviation	percent
President & Cabinet	1,950,719	1,817,381	2,055,449	-238,068	238,068	11.6%
Chief Secretary	683,403	578,837	720,094	-141,257	141,257	19.6%
Special Appropriation	7,979,270	7,203,913	8,407,661	-1,203,748	1,203,748	14.3%
Council of Iroij	407,337	411,006	429,206	-18,200	18,200	4.2%
Nitijela	1,697,412	1,630,620	1,788,543	-157,923	157,923	8.8%
Auditor General	371,629	566,061	391,581	174,480	174,480	44.6%
Foreign Affairs	2,444,184	2,840,319	2,575,407	264,912	264,912	10.3%
Public Service Commission	489,162	462,932	515,424	-52,492	52,492	10.2%
Judiciary	925,604	468,868	975,298	-506,430	506,430	51.9%
Attorney General	712,536	608,981	750,791	-141,810	141,810	18.9%
Health	3,053,466	2,584,021	3,217,400	-633,379	633,379	19.7%
Environmental Protection Agency	202,480	164,177	213,351	-49,174	49,174	23.0%
Education	3,953,488	3,694,299	4,165,743	-471,444	471,444	11.3%
Transportation & Communication	661,313	510,705	696,818	-186,113	186,113	26.7%
Resources & Development	660,996	604,897	696,484	-91,587	91,587	13.9%
Internal Affairs	2,412,662	1,928,164	2,542,193	-614,029	614,029	25.5%
Justice	2,878,954	2,929,900	3,033,519	-103,619	103,619	3.6%
Finance	2,096,894	6,474,767	2,209,472	4,265,295	4,265,295	203.4%
Public Works	1,131,787	1,097,134	1,192,550	-95,416	95,416	8.4%
20			0	0	0	
21 (= sum of rest)			0	0	0	
allocated expenditure	34,713,296	36,576,982	36,576,982	0	9,409,374	
contingency	200,000	212,144				
total expenditure	34,913,296	36,789,126				
overall (PI-1) variance						5.4%
composition (PI-2) variance						25.7%
contingency share of budget						0.6%

Data for year =	2009					
Administrative head	**budget**	**actual**	adjusted budget	deviation	absolute deviation	percent
President & Cabinet	1,878,719	1,960,527	1,998,241	-37,714	37,714	1.9%
Chief Secretary	669,963	660,690	712,585	-51,895	51,895	7.3%
Special Appropriation	6,147,614	8,029,600	6,538,718	1,490,882	1,490,882	22.8%
Council of Iroij	407,337	450,219	433,251	16,968	16,968	3.9%
Nitijela	1,684,932	1,626,284	1,792,125	-165,841	165,841	9.3%
Auditor General	455,744	655,476	484,738	170,738	170,738	35.2%
Foreign Affairs	2,572,184	2,643,884	2,735,823	-91,939	91,939	3.4%
Public Service Commission	467,062	447,825	496,776	-48,951	48,951	9.9%
Judiciary	957,229	868,456	1,018,127	-149,671	149,671	14.7%
Attorney General	827,961	600,098	880,635	-280,537	280,537	31.9%
Health	3,059,851	2,568,631	3,254,515	-685,884	685,884	21.1%
Environmental Protection Agency	202,480	170,430	215,362	-44,932	44,932	20.9%
Education	4,148,459	3,766,912	4,412,379	-645,467	645,467	14.6%
Transportation & Communication	689,238	558,537	733,087	-174,550	174,550	23.8%
Resources & Development	705,996	586,356	750,911	-164,555	164,555	23.3%
Internal Affairs	2,385,447	2,384,112	2,537,206	-153,094	153,094	6.4%
Justice	2,899,954	2,662,606	3,084,446	-421,840	421,840	14.5%
Finance	1,946,939	3,554,805	2,070,801	1,484,004	1,484,004	76.2%
Public Works	1,142,787	1,169,767	1,215,490	-45,723	45,723	4.0%
20			0	0	0	
21 (= sum of rest)			0	0	0	
allocated expenditure	33,249,896	35,365,215	35,365,215	0	6,325,184	
contingency	0	101,285.60				
total expenditure	33,249,896	35,466,501				
overall (PI-1) variance						6.7%
composition (PI-2) variance						17.9%
contingency share of budget						0.3%

Results Matrix

year	for PI-1 total exp. deviation	for PI-2 (i) composition variance	for PI-2 (ii) contingency share
2011	10.4%	9.6%	0.4%
2010	5.4%	25.7%	

PI-3: Domestic Revenues

	FY09	FY09	FY10	FY10	FY11	FY11
Taxes & Fees	Appropriation	Actual	Appropriation	Actual	Appropriation	Actual
Customs duties	8,464,307	7,138,075	8,383,373	7,721,629	8,348,373	7,266,506
Wages and salaries tax	10,555,406	11,203,742	10,402,885	10,811,629	10,298,360	9,854,149
Business Gross Revenue Tax (GRT)	4,662,307	5,147,177	4,926,716	5,682,345	4,879,716	3,902,049
Immovable Property Tax	484,095	397,043	406,145	242,017	406,145	1,116,500
Hotel and Resort Tax	56,832	66,913	69,752	70,074	69,754	19,924
Non-resident Gross Income Tax	132,875	51,472	82,516	98,944	82,516	94,930
Other(Penalty& Interest)	137,701	77,133	-	89,896	95,000	68,834
Tax Audit Adjustments	150,000	247,196	150,000	526,797	150,000	127,214
Non-Resident Workers' Fees	174,631	213,564	300,000	284,725	300,000	318,027
Other (collected but not-yet booked)						2,300,000
Subtotal	24,818,154	24,542,315	24,721,387	25,528,056	24,629,864	25,068,133
Non Revenue Taxes						
Fishing Rights	2,000,000	1,500,000	2,000,000	2,000,000	2,000,000	2,000,000
Ship Registry	2,000,000	3,250,000	3,000,000	3,000,000	3,750,000	3,750,000
Others	606,374	4,786,671	1,291,910	2,731,622	1,696,909	567,241
Subtotal	4,606,374	9,536,671	6,291,910	7,731,622	7,446,909	6,317,241
Grand Total	29,424,528	34,078,986	31,013,297	33,259,678	32,076,773	31,385,374
Actual revenues/appropriated revenues		1.158182928		1.072432834		0.978445494

Annex E

Terms of Reference

PEFA Assessment in the Republic of the Marshall Islands

Draft Concept Note [89]

1. Background and context

The Government of the Republic of the Marshall Islands (GoRMI) is currently facing a challenging socioeconomic and fiscal situation characterized by:

- o stagnant or limited economic growth prospects;
- o a growing population placing demand on social services such as education and health and more use by the population of these services; and
- o actual reductions in amended Compact of Free Association grant funds flows and some, but limited, opportunities for domestic revenue generation.

The RMI's economic performance since 2000 has been positive except for a 1.6 percent decrease in GDP in 2008 and a 2.1 percent decrease in 2009. The positive factors of growth throughout the decade have been the stable input of funds provided through the amended U.S.-RMI Compact of Free Association (hereinafter, the Compact), some private sector growth led by the fisheries and construction sectors, and more stable fiscal planning as opposed to previous practices during the late 1980s and 1990s.

The RMI's economy, since amended Compact implementation, has weathered regional and international economic impacts including regional health and natural disaster crises in the 2003-07 period, worldwide inflation in 2008 that severely impacted the energy sector and energy and consumer goods costs, and worldwide recession since late 2008 that has severely handicapped all aspects of the RMI economy, resulting in the negative growth rates for 2008 and 2009. Economic stagnation continued into 2010 with more positive prospects anticipated in FY11 and over the medium term given improved global and regional economic performance and measures taken by the Government to implement tax and expenditure reforms.

The RMI's population has historically increased but, in recent times, the growth rate has decreased. While results from the 2011 census have not yet been fully analyzed, preliminary estimates indicate a still growing population. There is a notable increase in statistics showing a demand for more education and health services from increases in the youth population and old age population. Increased investments in these sectors have been made since the early 2000s. Based on net air passenger movements, there has been an increase in movement of people out of the RMI during periods of economic downturn. The movement is believed to be due to citizens leaving to find employment or for education purposes, mainly in the United States given amended Compact immigration provisions.

The labor force has witnessed swings in the relative opportunities available in the public and private sectors. The public sector remains the major employer. But, the private sector has become more resilient and diversified than in past decades. The private sector over the past decade has employed 55-57 percent of the employed workforce. But, the public sector share has increased in recent years,

[89] This note incorporates material from an earlier note originally drafted by Mary Betley (Advisor to PFTAC, May 2011) and subsequently modified by Ron Hackett. Portions of the current note relating to the macroeconomic and fiscal context were adapted from documents prepared by the GoMI in March 2011. The prior version of this note was discussed briefly with the Assistant Secretary for Budget during my September Mission to the Marshalls for the Self-Assessment Exercise. The original version was reviewed with the Finance Secretary at the end of Mary Betley's April training visit.

because of the addition of teachers to the civil service rolls and because increased investments in the health and education infrastructure since 2004 have resulted in more jobs in those sectors. Declines in the fisheries, construction, and tourism industries, as well as cutbacks in Marshallese employment at the U.S. Army base at Kwajalein Atoll (USAKA), have affected many Marshallese, and resulted in very high unemployment for youth.

The only instrument available to the Government to impact the economy is its use of the budget. The RMI's budget during the period 2004-08 was expansionary with spending increases in health, education, environmental protection and management, and infrastructure development and maintenance. Most of the increased infrastructure investment was in the education and health sectors along with a major U.S. Federal Aviation Administration project to upgrade the Amata Kabua International airport.

Since it was known that such expenditure increases would not be sustainable in the medium term because of the annual decrements to the amended Compact's sector grant funding, effort was made to increase domestic revenue. But, external economic circumstances placed the RMI in a fiscally untenable position. The ability to maintain an adequate and balanced budget became more challenging from 2008 to the present time. Because of this, in 2010, the Government agreed to two major reform programs.

On the revenue side, the Cabinet adopted the Tax Reform and Modernization program (TRAM) with the main element being the movement toward a value-added tax. When implemented (planned for 2012), the reform is forecast to be revenue neutral but can be more positive if more production and services are captured and there is improved administration.

On the expenditure side, the Cabinet adopted the Comprehensive Adjustment Program (CAP). The CAP calls for wholesale cuts over the medium term in civil service positions and related costs, reductions in government allowances and support costs, reduction or elimination of grants and subsidies, and organization and facilities consolidation.

A roadmap for PFM reform for Pacific Island countries was produced in 2010. It sets out the key principles which should guide sustainable PFM reforms in the region and provides a broad framework within which these principles may be applied. It recognises the importance of government ownership and leadership of the process. It also highlights the role that PEFA assessments can play in identifying critical weaknesses and in building consensus around the PFM reform agenda.

The FY11 budget was the first budget to take into account these reforms. Various aspects of the CAP reductions were included along with across-the-board expenditure cuts. At the same time, the Government committed to (as part of an Asian Development Bank loan package) the Public Sector Comprehensive Reform Program (PSCRP), and agreed to set aside funds for an RMI contribution to the Compact Trust Fund. The FY11 budget reflects these changes and commitments.

The FY09-14 Medium Term Budget and Investment Framework (MTBIF) takes into account the FY11 budget changes as well as future commitments and prospects for the FY12-14 period. With these forecasts, the RMI believes it can maintain a stable budget environment if expenditures are reduced in certain areas while maintaining or increasing investments in priority areas.

The medium term outlook for revenue anticipates relative stability from conservative economic growth prospects. Some growth in domestic tax revenue is anticipated from increases in fees and charges such as for the Ship Registry and possibly for fishing licenses. In addition, an expected increase in amended Compact Ebeye Specials Needs funding as of FY14 will help stem the reduction in amended Compact sector grant funding. However, current regional and international economic and natural disaster factors may hinder domestic tax generation once again.

With regard to expenditures in the medium-term, the GOMI expects to continue applying the CAP reforms. While preliminary steps have been taken, the government believes more wholesale application is warranted over the medium term. Such application of the reforms will help to free up funds to maintain or increase investments in the priority sectors of health and education (which also have to obtain efficiencies and apply reforms) as well as maintain infrastructure and related maintenance investments.

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 wagebill 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 Government believes that with a conservative growth path and the application of substantive expenditure reforms, the RMI can generate budget surpluses which can be used to increase investments in priority sectors or be investment into the Compact Trust Fund.

The Government intends to put together its own roadmap to guide the next phase of its reforms of PFM systems and practices and aims to use the PEFA framework as an important input into the process. This Concept Note outlines the objectives, methodology, timetable and inputs for a PEFA assessment and preparation of a PFM Performance Report for RMI.

2. Purpose of assessment

The assessment will have a triple purpose: (i) to measure the current performance of the public financial management (PFM) systems using an objective, internationally-recognised standard; (ii) to set a baseline for future monitoring of progress against this standard; and (iii) to give country officials experience in using the PEFA tool so that they can periodically apply the criteria for good practice on which it is built to conduct their own stock-take. It will contribute to the preparation by government of its PFM reform roadmap.

3. The PEFA Framework

The PEFA program was established to provide a framework, based on international experience and widely accepted good practices, to assess and monitor the performance of public financial management (PFM) of countries[90]. It has been developed by the PEFA partners, in collaboration with the OECD/DAC Joint Venture on PFM, as a tool to provide reliable information on the performance of their PFM systems, processes and institutions – and deliver progress reports thereof over time.

The PEFA Performance Measurement Framework includes a set of 28 high level indicators (listed in Annex 1) and sixty-nine measurement dimensions, which measure the performance of PFM systems, processes and institutions and a PFM Performance Report (PFM-PR) that reports on PFM performance as measured by the indicators. The indicators are structured into three categories:

(i) **PFM system out-turns**: these capture the immediate results of the PFM system in terms of actual expenditures and revenues by comparing them to the original approved budget, as well as level of and changes in expenditure arrears.

(ii) **Cross-cutting features of the PFM system**: these capture the comprehensiveness and transparency of the PFM system across the whole of the budget cycle.

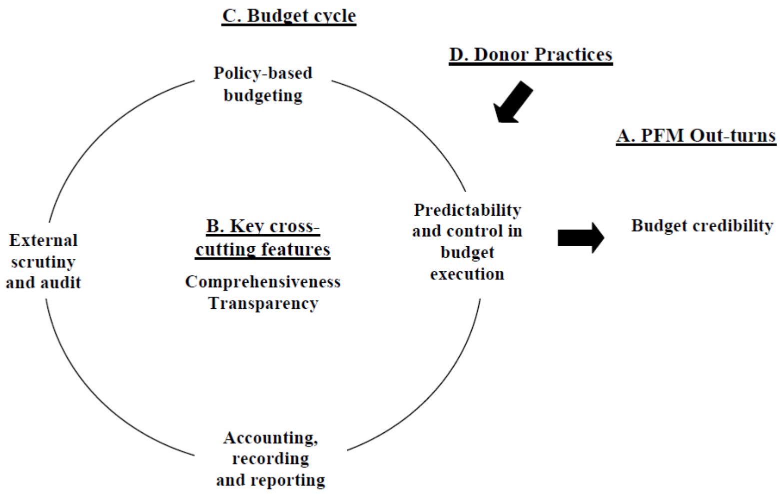
[90] See www.pefa.org

(iii) **Budget cycle**: these capture the performance of the key systems, processes and institutions within the budget cycle of the central government.

In addition to the indicators of country PFM performance, this framework also includes

(iv) **Donor practices**: these capture elements of donor practices which impact the performance of country PFM system.[91]

The following diagram illustrates the structure and coverage of the PFM system measured by the set of high level indicators and the links with the six core dimensions of a PFM system as identified by the Framework – credibility of the budget, comprehensiveness and transparency, policy based budgeting, predictability and control in budget execution, accounting, recording and reporting, and external scrutiny and audit:



More information on the PEFA Framework is found in Annex 2.

[91] The complete list of indicators is attached in Annex 1.

4. Methodology

PFTAC has been asked by Pacific Forum Economic Ministers as well as donors in the region to coordinate PEFA Assessments. The model that PFTAC is applying to the current assessment, and which it plans to apply to future assessments will involve two phases:

- Phase I (Conducted in the RMI in mid- September by PFTAC's PFM Advisor) will be a self-assessment. This phase:
  - identified key senior staff (and persons from other organizations) relevant and knowledgeable about each of the PFM processes/procedures to be assessed;
  - reviewed with them each indicator, the criteria that need to be met for each rating level for the indicator, the required supporting documentation, and the scoring procedures;
  - assembled essential supporting documentation; and
  - produced staff generated self-assessments for each indicator (the results of which will be discussed in a forthcoming report prior to the Phase II formal assessment).
  - introduced the assessment team to the OECD-MAPS (procurement assessment)

  This phase is intended as an educational/preparatory engagement for staff on the specifics of each indicator and as an information gathering effort. During these sessions participants will be encouraged to consider using the indicators to do their own regular stock-take of operations to monitor progress toward PFM reforms. Copies of the self-assessments will be collected by the PFTAC PFM advisor for input into Phase II.

  This Phase is also particularly important for identifying regional PIC talent for participation in future PEFA assessment missions.

- Phase II, occurring roughly 1 month after Phase I (tentatively scheduled to start Oct 24 in RMI), will be conducted by a joint national-consultant assessment team. The national-consultant team will be lead by a consultant with experience in undertaking PEFA assessments[92]. This methodology ensures a government-led approach that is, at the same time, externally validated. The approach will involve a series of team-wide consultations with relevant stakeholders. Ensuring that all team-members are actively involved in each of the meetings will promote joint ownership of the findings, provide inter-agency challenge and triangulation of stakeholders' responses, and overcome possible negative incentives from interviewing colleagues. The consultant(s) will provide quality assurance of the team's use of the PEFA framework[93] as well as independent (external) validation of the findings as they emerge. The procurement expert is expected to incorporate the OECD-MAPS assessment items (or the modified draft WB-Australian version of the OECD-MAPS instrument) into his work as a supplemental guide for the disciplined gathering of comprehensive information needed to complete the procurement items in PEFA

The scope of the RMI assessment will focus on the PFM systems for Central Government, including any transfers that are made from central government to the municipalities and SOE's. The assessment will examine financial reporting from the SOE's and municipalities to the Central Government, but will not include a detailed review of the all aspects of the FM systems for those entities.

Likely sources of information are summarised in Annex 3 and a generic list of stake-holders is found in Annex 4.

[92] As of October 6 we have confirmation that the lead consultant will be Mary Betley. She will be supported by ??a procurement expert from the Commonwealth Pacific Governance Facility (Mose Saitala) ?? and by Sanjesh Naidu, an Economic Advisor from the Pacific Islands Forum Secretariat with regional PFM experience

[93] In April 2011 PFTAC sponsored a workshop in Majuro for GoMI officials on the PEFA Framework. Some of this content was repeated during the Phase I Self-assessment effort.

5. Implementation schedule, timetable and deliverables

Work on the PEFA assessment started with the April training and continued in September with the Phase I self-assessment. Phase II is tentatively scheduled to begin around late October. The assessment is expected to be completed by December, including 1-2 weeks for stakeholder video-conference consultations. Annex 5 shows a detailed implementation schedule and the responsible party.

The methodology for Phase II provides for two distinct strands of the assessment team's joint working:

- stakeholder consultations (field visits), which are expected to take around two weeks. In order to ensure that this time is used efficiently, significant preparatory work will be undertaken beforehand.
- Report finalization after the circulation of the draft report and the receipt of comments. This would be expected to take up to one week.

As indicated above, Phase II will start with an initial one-day preparation/review workshop prior to the stakeholder consultations in order to review with key stakeholders the materials presented in the earlier training and self-assessment exercise. This workshop would be for both senior government officials and for those to be interviewed. Near the end of the consultations, a half-day workshop to discuss preliminary findings will be held. Finally, a half-day dissemination workshop (likely via video-conference) will be held after the draft report has been circulated in order to discuss stakeholders' comments and to faciliate finalization of the report.

The main deliverable will be the PFM-Performance Report (PFM-PR), drafted in accordance with the PEFA Guidelines (updated to include the three revised indicators).

The major risk to the successful completion of the PEFA Assessment would be turnover of key officials who have already been through the PEFA training and Self-Assessment exercise. While such an occurrence is not likely because of the upcoming elections, the mitigation strategy would either involve lengthening the mission to include an education session for the new officlals, or rescheduling the effort to a latter time.

6. Stakeholders involved

National stakeholders will be involved at two levels. An **oversight group** will provide the overall oversight of the exercise. It would be sufficiently high-level to facilitate senior government ownership of the PEFA. The group is likely to be comprised of the following members:

- o Alfred Alfred, Jr., Secretary of Finance,
- o Chief Secretary
- o Clerk of Cabinet
- o Secretary of Foreign Affairs
- o Senator Frederick Muller, Chair of Public Accounts Committee, and
- o Junior Patrick, Auditor- General.

The team is expected to be led by the Secretary of Finance. The group will be convened initially during the Concept Note/preparatory stage and subsequently will be briefed by the assessment team regularly during the assessment. It will provide the senior management framework for dissemination and practical follow-up of the results.

The government-led joint **assessment team** will be responsible for undertaking the assessment itself. From the government/national side, the team will comprise some or all of the following:

- o Kayo Yamaguchi-Kotton, Assistant Secretary (Budget, OIDA, Procurement/Supply)), Ministry of Finance (assessment team leader);

- o Boris Anni, Assistant Secretary for Accounting and Administration, Ministry of Finance;
- o Deputy Auditor-General;
- o Gee Leong Bing, Director, Office for Compact and Integration (OCI), Ministry of Foreign Affairs;
- o ??, Acting Assistant Secretary (Revenue), Ministry of Finance;
- o Waylon Muller, Director of Procurement Department, Ministry of Finance;
- o representative from the Office of Environmental Policy, Planning and Co-ordination (OEPPC);
- o representative from the Grant-writer's Office;

- o Director, EPPSO , Office of the President
- o Maybelline Anton Bing, Assistant Secretary of Finance, Administration and Personnel, Maybelline Andon Bing
- o Reynaldo Sunga, PMU Head, Ministry of Public Works
- o Antonio Elliou, Chief Secretary's Office

At this time it is expected that the first 4 members of this group will participate in the assessment discussions for all indicators. Others will be involved for the indicators most relevant to their responsibilities. This covers all of the main government stakeholders, including expenditures, revenue, procurement, accounting/reporting, and audit, as well as those working in aid co-ordination.

Other stakeholders

Involvement of stakeholders outside of government will be critical to ensure the credibility of the assessment. In particular, the views will be sought by those in the legislature, civil society representatives, the local Chamber of Commerce, and the Editor of the local newspaper (Marshall Islands Journal). The latter two are are particularly important in order to triangulate the information from government sources, including the public and private sector's perceptions of the efficiency of government services. In addition, the views of the Budget Co-ordinating Committee (BCC) will be sought.

Development partners (DPs)

Development partners will be involved through their participation in the stakeholder workshops and through consultation with the assessment team, particularly on the indicators related to donor practices.

A summary of stakeholders likely to be consulted is contained in Annex 4.

7. Reporting

The main output of the assessment will be the PEFA PFM-Performance Report. It will follow the guidance provided by the PEFA Secretariat and have the following structure:

- *A Summary Assessment* will provide a brief overview of the ratings.
- *An Introductory Section* will present the context and the process of preparing the report and specify the share of public expenditures captured by the report.
- *A Section presenting Country Background Information* will provide the context for the indicator-led and overall assessment of PFM performance. It will include a brief review of the country economic situation, a description of the budgetary outcomes as measured by achievement of aggregate fiscal discipline and strategic allocation of funds and, an analysis of the legal and institutional PFM framework highlighting gaps which are impacting on the reform process.
- *The Narrative or Main Body of the Report* will assess the current performance of PFM systems, processes and institutions based on the indicators**,** and describe the sources of evidence used in completing the scores.

- *A Section on Government Reform Process* will briefly summarize recent and ongoing reform measures implemented by Government and assess the institutional factors that are likely to impact reform planning and implementation in the future. Where necessary reference may be made to policy recommendations already contained in recent Bank and donor reports.
- *Annex 1* will contain a Performance Indicator Summary.
- *Annex 2* will list the sources of information.

During stakeholder consultations an interim output will be produced, comprising an initial draft of the indicator scores and brief justification for each and the summary assessment. This aide-memoire will be presented and discussed during a stakeholder workshop at the end of the stakeholder consultation (field) phase. Following the stakeholder workshop, the Assessment Team will prepare the draft report, and copies of this draft will be circulated to members of the Oversight Group.

After circulation of the draft report, Government and development partners will be invited to give comments through the PFTAC PFM Advisor over a period of 3 weeks. The report will be sent to the IMF Fiscal Affairs Department, and then to the PEFA Secretariat for their comments and quality assurance. Following the comment period, the Assessment Team will reconvene via video-conference to discuss the comments in a consultative workshop, consider any additional data provided, and amend the draft as necessary into a final report.

The final report will be disseminated to members of the Oversight Group, and copies will be made available to the directors of those departments represented on the Assessment Team. In addition, copies will be disseminated to the legislature, the Auditor-General's office, and those who were interviewed. Finally, the report will be posted on the Ministry of Finance's website for the general public.

8. Consultation and follow-up

In order to ensure sufficient understanding and government ownership of the exercise, the methodology will ensure that sufficient time is given to engaging regularly with as wide a group of stakeholders as possible. This will include: (i) a familiarisation/training workshop on the principles and application of the PEFA framework (conducted April 2011); (ii) a self-assessment exercise (conducted September 2011); (iii) circulation and discussion of the Concept Note (April 2011 and September 2011); ; (iv) participatory stakeholder consultations; (v) a briefing workshop for both government and other public officials, and development partners near the end of the stakeholder consultation (field) phase; and (vi) a video workshop to discuss the draft performance report.

Following the assessment (which has been requested by the Finance Secretary), it is expected that the PEFA report will provide an important input into developing the Government's PFM reform roadmap. It will also provide a shared (common) source of information on PFM which will be used by all development partners.

It is likely that a follow-up PEFA assessment would be undertaken after three years.

9. Team composition and inputs

The assessment team, comprising both government stakeholders and an external consultant(s) with experience of conducting PEFA assessments, described above, will carry out the assessment. The composition of the team covers the main skills required by PEFA, including budget, accounting, revenue, procurement, and audit.

The total number of working days for the team includes:

1. team leader: up to 5 days for preparation, up to 10 days for the consultation phase, up to 5 days for report-writing. [Note: Draft contract (copied from Cook's contract): Mission days-

not to exceed 14 days; travel days- not to exceed 4; post-mission work-not to exceed 3; total – not to exceed 21 days]

2. other team members: up to 2 days for preparatory work, up to 14 days for the consultation phase, up to 2 days for report-writing, and a maximum of 5 days for the final workshop and report finalisation stage.
3. external consultant(s): up to 5 days for preparation, up to 10 days for the consultation and report-writing (???some of which may be home-based, depending on schedule ???) .

Management of the team will be the responsibility of the team leader, with the assistance of the external consultant(s). The oversight group will provide high-level oversight of the exercise and assist with senior management's understanding and ownership of the emerging results. PFTAC will provide back-stopping from Suva.

Annex 1: Overview of the PEFA Indicator Set

PFM Performance Indicator	
A. PFM-OUTTURNS: Credibility of the budget	
PI-1	Aggregate expenditure outturn compared to original approved budget
PI-2	Composition of expenditure outturn compared to original approved budget
PI-3	Aggregate revenue outturn compared to original approved budget
PI-4	Stock and monitoring of expenditure payment arrears
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency	
PI-5	Classification of the budget
PI-6	Comprehensiveness of information included in budget documentation
PI-7	Extent of unreported government operations
PI-8	Transparency of inter-governmental fiscal relations
PI-9	Oversight of aggregate fiscal risk from other public sector entities
PI-10	Public access to key fiscal information
C. BUDGET CYCLE	
C (i) Policy-Based Budgeting	
PI-11	Orderliness and participation in the annual budget process
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting
C (ii) Predictability and Control in Budget Execution	
PI-13	Transparency of taxpayer obligations and liabilities
PI-14	Effectiveness of measures for taxpayer registration and tax assessment
PI-15	Effectiveness in collection of tax payments
PI-16	Predictability in the availability of funds for commitment of expenditures
PI-17	Recording and management of cash balances, debt and guarantees
PI-18	Effectiveness of payroll controls
PI-19	Competition, value for money and controls in procurement
PI-20	Effectiveness of internal controls for non-salary expenditure
PI-21	Effectiveness of internal audit
C (iii) Accounting, Recording and Reporting	
PI-22	Timeliness and regularity of accounts reconciliation
PI-23	Availability of information on resources received by service delivery units
PI-24	Quality and timeliness of in-year budget reports
PI-25	Quality and timeliness of annual financial statements
C (iv) External Scrutiny and Audit	
PI-26	Scope, nature and follow-up of external audit
PI-27	Legislative scrutiny of the annual budget law
PI-28	Legislative scrutiny of external audit reports
D. Donor Practices	
D-1	Predictability of Direct Budget Support
D-2	Financial information provided by donors for budgeting and reporting on project and program aid
D-3	Proportion of aid that is managed by use of national procedures

Annex 2: The PFM Performance Measurement Framework

1. Introduction and background

The PFM Performance Measurement Framework is an integrated monitoring framework that allows measurement of country PFM performance over time. It has been developed by the PEFA partners, in collaboration with the OECD/DAC Joint Venture on PFM as a tool that would provide reliable information on the performance of PFM systems, processes and institutions over time. The information provided by the framework would also contribute to the government reform process by determining the extent to which reforms are yielding improved performance and by increasing the ability to identify and learn from reform success. It would also facilitate harmonization of the dialogue between government and donors around a common framework measuring PFM performance and therefore contribute to reduce transaction costs for partner governments.

The PFM Performance Measurement Framework is one of the elements of a strengthened approach to supporting PFM reforms1. It is designed to measure PFM performance of countries across a wide range of development over time. The Performance Measurement Framework includes **a set of high level indicators**, which measures and monitors performance of PFM systems, processes and institutions and **a PFM Performance Report (PFM-PR)** that provides a framework to report on PFM performance as measured by the indicators.

2. Scope and coverage of the framework

A good PFM system is essential for the implementation of policies and the achievement of developmental objectives by supporting aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. An open and orderly PFM system is one of the enabling elements for those three levels of budgetary outcomes:

- Effective controls of the budget totals and management of fiscal risks contribute to maintain aggregate fiscal discipline.
- Planning and executing the budget in line with government priorities contributes to implementation of government's objectives.
- Managing the use of budgeted resources contributes to efficient service delivery and value for money.

The Performance Measurement Framework identifies **the critical dimensions of performance of an open and orderly PFM system** as follows:

1. **Credibility of the budget -** The budget is realistic and is implemented as intended
2. **Comprehensiveness and transparency** - The budget and the fiscal risk oversight are comprehensive, and fiscal and budget information is accessible to the public.
3. **Policy-based budgeting -** The budget is prepared with due regard to government policy.
4. **Predictability and control in budget execution -** The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds.
5. **Accounting, recording and reporting –** Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes.
6. **External scrutiny and audit -** Arrangements for scrutiny of public finances and follow up by executive are operating.

Against the six core dimensions of PFM performance, the set of high-level indicators measures **the operational performance of the key elements of the PFM systems, processes and institutions** of a country central government, legislature and external audit. In addition, the PFM-PR uses the indicator-based analysis to develop an integrated assessment of the PFM system against the six critical dimensions of PFM performance and evaluate the likely impact of PFM weaknesses on the three levels of budgetary outcomes.

The set of high-level indicators captures **the key PFM elements** that are recognized as being critical for all countries to achieve sound public financial management. In some countries, the PFM-PR may also include an assessment of additional, country specific issues in order to provide a comprehensive picture of PFM performance.

It is expected that the repeated application of the indicator tool will provide information on the extent to which **country PFM performance is improving or not**. In addition, the PFM-PR recognizes the efforts made by government to reform its PFM system by describing recent and on-going reform measures, which may not have yet impacted PFM performance. The report does not, however, include any recommendations for reforms or assumptions as to the potential impact of ongoing reforms on PFM performance.

The focus of the PFM performance indicator set is the public financial management at central government level, including the related institutions of oversight. Central government comprises a central group of ministries and departments (and in some cases deconcentrated units such as provincial administrations), that make up a single institutional unit. In many countries, other units are operating under the authority of the central government with a separate legal entity and substantial autonomy in its operations (in this document referred to as autonomous government agencies) and also constitute a part of central government operations. Such units would be used for the purpose of implementing central government policy and may include non-profit institutions, which are controlled and mainly financed by central government.

Operations of other levels of general government and of public enterprises are considered in the PFM performance indicator set only to the extent they impact the performance of the national PFM system and its linkages to national fiscal policy, **formulated and monitored by central government.** Other parts of general government include lower levels with separate accountability mechanisms and their own PFM systems (e.g. budgets and accounting systems). Such sub-national governments may include state, provincial, and regional government at a higher level and local government (including e.g. districts and municipalities) at a lower level. In addition to general government, the public sector includes public corporations or enterprises, created for the purpose of providing goods and services for a market, and controlled by and accountable to government units. Public corporations can be non-financial or financial, the latter including monetary corporations such as the central bank3. Additional information on other levels of government and public enterprises may be included in the section on country specific issues of the PFM-PR.

The focus of the indicator set is on revenues and expenditures undertaken through the central government budget. However, activities of central government implemented outside the budget are covered in part by the some indicators. Typically, this includes expenditure executed by central government units and financed from earmarked revenue sources (whether domestic or external, the latter often being only nominally on-budget), and by autonomous government agencies.

The Performance Measurement Framework does not measure **the factors impacting performance**, such as the legal framework or existing capacities in the government. In particular, the set of high-level indicators focuses on the operational performance of the key elements of the PFM system rather that on the inputs than enable the PFM system to reach a certain level of performance.

The Performance Measurement Framework does not involve **fiscal or expenditure policy analysis**, which would determine whether fiscal policy is sustainable, whether expenditures incurred through the budget have their desired effect on reducing poverty or achieving other policy objectives, or whether there is value for money achieved in service delivery. This would require detailed data analysis or utilization of country-specific indicators. The framework rather focuses on assessing the extent to which **the PFM system is an enabling factor** for achieving such outcomes.

3. The set of high level performance indicators

The selected 28 indicators for the country's PFM system are structured into three categories:

A. **PFM system out-turns**: these capture the immediate results of the PFM system in terms of actual expenditures and revenues by comparing them to the original approved budget, as well as level of and changes in expenditure arrears.

B. **Cross-cutting features of the PFM system:** these capture the comprehensiveness and transparency of the PFM system across the whole of the budget cycle.

C. **Budget cycle:** these capture the performance of the key systems, processes and institutions within the budget cycle of the central government.

In addition to the indicators of country PFM performance, this framework also includes

D. **Donor practices**: these capture elements of donor practices which impact the performance of country PFM system.

Annex 3: Indicative List of Documents to Be Supplied By The Government [94]

Constitution
Legislation:
- Organic Budget Law (Public Finance Act)
- Financial Instructions/ Financial Manual
- Procurement Law
- External Audit Law
- Internal Audit Law
- Public Service Act

Budget appropriations (Annual Budget Laws) for the last 3 fiscal years
Budget books for the last 3 fiscal years
Budget policy statements
Audited annual accounts for the last 3 fiscal years
Chart of Accounts/Budget code
Audit reports
- Most recent reports, including compliance audits and performance audits (in addition to financial audit/audited accounts)
- Any audit reports on procurement, tax/revenue, state-owned enterprises (public enterprises), other funds outside of the General Fund (e.g. funded from hypothecated taxation)

Latest financial statements (audited or unaudited) for other funds (e.g. funded from hypothecated taxation)
Sector strategies for largest spending ministries
Last 2 budget circulars, including sector ceilings
Cabinet memoranda on the budget - latest budget
Public Investment Programme
Parliamentary rules
Data on budget support (commitments and disbursements) for the last 3 fiscal years
Data on external project support for the last 3 fiscal years
Debt management reports - latest
Debt sustainability analysis - latest
Any PFM assessments recently carried out (during the last 3 years)

[94] As of the writing of this Concept Note (Sept 25, 2011) the majority of these documents were gathered during the Self-Assessment (Phase I) exercise. Any outstanding will be requested from the GOMI Assessment Team Leader prior to start of the Phase II Assessment

Annex 4: Indicative List of Stakeholders

Ministry of Finance
Budget
Planning
Debt management
Treasury (including payroll accountant)
Finance/Accountant General

Other government
Revenue agencies for all taxes (income, customs, VAT), including entity responsible for tax audit, and any tax public information office
Auditor-General's office
Entity responsible for sub-national governments
Entity responsible for oversight of state-owned enterprises/public enterprises
Entity responsible for payroll and for personnel database if different
Budget or finance officers of major sub-national governments
Public Procurement Authority/Central Tender Board
Cabinet/Chief Secretary's Office
Budget/planning officers within key spending ministries
Finance officers within key spending ministries
Procurement officers in large spending ministries
Entity in charge of internal audit (oversight) (may be in MoF)
Any internal audit units within key spending ministries
Statistics office

Other public authorities
Major state-owned enterprises/public enterprises
Clerk to Parliament
Chair of Public Accounts Committee in the legislature
Chair of Budget Committee in the legislature
Ombudsman, if in post

Non-government
Governance NGOs, e.g.
Transparency International
Chamber of Commerce
Taxpayer groups
Association of NGOs

Development partners (DPs)
DPs giving general budget support
DPs of 5 largest projects
Any PMUs of these large projects

Annex 5: Assessment Work Plan and Indicative Timetable

Assessment step	Indicative timing	Responsible Person
PEFA concept familiarisation (stakeholder preparation): circulation and discussion of Concept Note (objectives, scope, justification)	April (initial training); early September (Self-Assessment Exercise)	Betley Hackett
Gather initial documentation and data	September (Phase I Self-Assessment)	Hackett
Identification of oversight/reference team	September	Hackett/Alfred/ Yamaguchi-Kotton
Drawing up of TORs	September	Hackett
Identification of team to carry out work, including external consultant(s)	October	Hackett/Alfred/ Yamaguchi-Kotton
Contract external consultant(s)	October	Hackett
Undertake familiarisation/training workshop (1 day) for stakeholders	late October	Betley
Undertake programme of stakeholder consultations and gathering of data (include triangulation)	Late October/early November	Betley
Hold regular meetings of oversight group	Late October/early November	Betley
Present initial table of scores and justification to oversight group and government and development partner stakeholders at roundtable meeting for comments	early November	Betley
Write-up full report and circulate for comments	Mid-November	Betley
Final workshop for final questions before report finalisation	December	Hackett/Betley
Finalise report and disseminate (publish on MoF website?)	December	Betley/Alfred