PROJECT INFORMATION DOCUMENT (PID)  
APPRaisal STAGE

Report No.: PIDA3790

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<th>Maldives: PFM Systems Strengthening Project (P145317)</th>
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I. Project Context

Country Context

Until recently, Maldives has been a development success story. In the early 1980s, the Maldives had a population of 156,000 and was one of the world’s 20 poorest countries. Today, with a population of over 326,000, it is a middle-income country with a GDP per capita income of US $7,177. Showing continuous improvement over the years, Maldives remains the best-ranked country in the UNDP Human Development Index in South East Asia (2011). Poverty rates, as measured by the headcount ratio of 15 Maldives rufiyaa per person per day, have fallen steeply from 21 percent in 2003 to 15 percent in 2010. Vulnerability and inequality are still a concern when considering a significant number of people are one shock below falling into poverty, and the disparities remain substantial between remote, sparsely populated islands and the capital Malé region. Despite this vulnerability, Maldives has good health and education indicators. Life expectancy is 74.8 years. For children under age 5, mortality is 11 out of 100,000. The maternal mortality ratio is higher at 37 out of 100,000. Adult literacy stands at 98.4 percent. Public expenditures on combined health and education stand at 17.86 percent of GDP. Growth moderated to 3.4 percent in 2012 from 7.1 percent in 2010, but the outlook is positive at over 4 percent for 2014.
The Maldives has however been in a difficult economic situation over the last years. The underlying imbalance in the Maldives’ public finances is spending beyond its means. Trends over the past five years show an increasing gap between revenues and expenditures, financed by unsustainable levels of public debt at increasingly high interest rates. The fiscal deficit increased from around 11.3 percent of GDP (including grants) in 2008 to 13.5 percent of GDP in 2012 — purely in cash terms. When one includes payment arrears, the deficit is considerably higher and is estimated to be 16.5 percent of GDP. This is the result of higher-than-budgeted expenditures from increased subsidies, social welfare payments, and transfers to state-owned enterprises (SOE).

Public finance imbalances in Maldives seem to lie on the expenditure side rather than on the revenue side. Sources of government revenues changed considerably during the last few years primarily due to the introduction of new taxes, which now account for 40 percent of total revenues. Tourism Goods and Services Tax and General Goods and Services Tax collectively represent 26 percent of total revenues in 2012. Maldives also introduced income tax in 2012; this tax brought in 14 percent of total revenues in 2012. These new measures increased the total revenues to 29 percent of GDP in 2012 (the highest in the South Asia Region) from 25 percent in 2003.

The economy is vulnerable to external shocks as witnessed by the economic recession following the tsunami of December 2004. The economy is largely dependent on tourism and fisheries. Since 2008, tourism has taken a hit from weaker demand from Europe, the country’s largest market. Fortunately, the growing Chinese tourist segment is compensating for the weaker volume of arrivals from Europe. The non-tourism sectors, such as construction, communications, and fisheries, will remain dynamic with a positive contribution to the economy.

Compared to international standards, Maldives public spending is high at 42 percent of GDP in 2012, up from 28 percent in 2003. The public sector wage bill at USD 290 million, or 14 percent of GDP in 2012, is unsustainably high. The public service, employing 11 percent of the population, is large by international standards. Consequently, the public sector debt dynamics worsened, reaching about 80 percent of GDP in 2012 and is estimated to rise further to 86 percent. Domestic financing is increasingly unavailable; Treasury bill auctions have routinely been undersubscribed, particularly for longer maturities. Debt repayments doubled from 2007 to 2011 and in 2013 stand at 3 percent of GDP. Current account deficit is over 25 percent of GDP and gross international reserves have fallen to around two months of imports. The serious cash flow constraint faced by the Government has severely compromised macro fiscal stability. Increasing the quality of service provision to a standard commensurate with the country’s income levels is a challenge in this environment. The country’s politics also underwent major changes in the past decade in line with the economic transformation and changes in demographics, reflecting the needs and aspirations of Maldivians. The adoption of a new Constitution in August 2008, paved the way for the country’s first-ever multiparty presidential and parliamentary elections. The politics of the Maldives take place in the framework of a presidential representative democratic republic, whereby the President is the Head of Government. Executive power is exercised by the Government. The President heads the executive branch and appoints the Cabinet. Political parties in the Maldives were legalized on 2005, which allowed a multiparty system to contest in presidential and parliamentary elections. The archipelago’s first multiparty presidential election was held in October 2008, ending 30 years of autocracy. In the run-up to the elections, public spending increased considerably to reach 63 percent of GDP in 2008 from 36 percent of GDP in 2004. The public service wage bill increased by over 150 percent from 2004 to 2008, and the public service came to represent one-third of the labor force. In February 2012 the first democratically elected president of the Maldives, President
Mohamed Nasheed, resigned under disputed circumstances. Vice President Mohammed Waheed Hassan Manik was sworn in as the new president of Maldives. His presidential term ended in November 2013 and Mohamed Yameen of the Progressive Party of Maldives overcame Mohammed Nasheed of the Maldives Democratic Party to become the new President of Maldives.

The country’s existing Strategic Action Plan, prepared under former President Nasheed, still serves as Maldives’ operating development framework. The detailed development strategy of the government of President Yameen has not yet been made public. Priorities center on the following: macroeconomic reform to support private sector-led economic growth, streamlining the public sector for more efficient and effective government service delivery, strengthening democratic institutions and processes to cement the new democracy, investing in human resource development to deliver on social development commitments, and pursuing climate change mitigation and adaptation.

**Sectoral and institutional Context**

The fiscal challenges are linked to institutional weaknesses in public financial management (PFM) in addition to the politics and populism that has taken a significant toll on the whole of budget policy and management. Part of the solution is reforms (e.g., civil service reforms, wage cuts, cutting expenditures, SOE reforms, devaluation of the rufia). Part of the solution is technical, which the proposed PFM Systems Strengthening Project aims to support.

Many of the identified weaknesses in the PFM system add significantly to the level of fiscal risk. These weaknesses undermine the government’s capacity to undertake necessary fiscal adjustments in an efficient manner. The Public Expenditure and Financial Accountability (PEFA) assessment carried out by the IMF jointly with the World Bank and the Government of Maldives in May 2010 underscores the need for significant improvements in its PFM systems, namely in the broad PFM areas of budget credibility; predictability; and control in budget execution and accounting, recording, and reporting.

The Government of Maldives put together a comprehensive adjustment program in 2009 to address severe fiscal and external imbalances. The international community came together in 2010 to provide budget support and technical advice to allow the democratic government of President Nasheed the ability to make the needed changes to address an acute episode of macro-economic instability that began with the tsunami of 2004 and was later aggravated in the wake of the 2008 financial crisis. Based on the respective mandates, the IMF budget support program (US$92.5 million) focused on supporting the aspects of the government’s reform program related to short-term macro-economic imbalances, while the smaller World Bank development policy credit (US$8.5 million) focused on supporting aspects of the government’s reform program related to the PFM structural problems and public enterprises that constrained fiscal adjustment and protection of the vulnerable during the recovery. The Asian Development Bank (ADB) followed with an Economic Recovery Program (ERP) for US$35 million of budget support and US$3 million of technical assistance. These operations were organized around areas and actions that were part of the Government’s own program, and close donor coordination ensured complementarity in operations. Unfortunately, the programmatic series of the IMF and World Bank lapsed before most of the objectives could be realized as the Government of Maldives at the time lacked the political capacity to convince stakeholders of the need for reforms and the technical capacity to follow through on the program’s actions.
The Government on the other hand was successful in meeting the triggers to receive both tranches of the ADB-supported ERP. With the first tranche released in October 2010 and the second in September 2012, the ERP support helped to accomplish the following: (a) enactment of the Fiscal Responsibility Act that identifies medium-term fiscal objectives, (b) preparation of a debt management strategy, and (c) establishment of internal audit units and preparation of an audit charter and guidelines and manual. While these have been great initiatives, a significant amount of capacity building remains to be done together with the basic foundations of PFM processes for these initiatives to be sustainable.

A comprehensive legislative framework and robust organizational structures for PFM institutions — two key pillars for creating an enabling PFM environment — are still lacking in the country. Several pieces of PFM legislation passed in recent times, some in an uncoordinated manner without the involvement of key stakeholders, have resulted in gaps, overlaps, and inconsistencies in the PFM legislative framework, and its interpretation has led to an undermining of budget discipline and financial controls. In particular, the de facto wide discretion made provision for expenditures without proper appropriation due to the absence of appropriation legislation. It will be timely to review the entire legal PFM framework to provide a sound foundation for an efficient PFM architecture.

As part of the process of strengthening public financial management in Maldives, it is important to strengthen the organizational structure of the Ministry of Finance and Treasury (MOFT). There are many positive features in the existing MOFT organization but also areas needing improvements. With around 180 staff, MOFT is quite large when compared with finance ministries of other small countries with comparable functions. There are however shortages of skilled professional staff in critical areas. Recent policy initiatives such as the Fiscal Responsibility Law, revenue collection measure, Decentralization act are likely to add pressure on the analytical capacity of MOFT. Shortages of skilled staff are also found in critical areas such as debt management, procurement, finance, and accountancy. A comprehensive medium-term strategy for developing the MOFT human resources (HR) is not in place. A pay review board is being set up to review pay scales across the board with an aim to rationalize remuneration. Creation of a separate accountancy cadre is also under discussion. The Maldivian Governments pleased with the non-lending technical assistance support extended by the World Bank in FY13 aimed at improving MOFT capacity on budget formulation and cash flow projections. This work will provide a good start for the activities planned under the proposed PFM Systems Strengthening Project.

Some concerns are prevalent in the area of budget credibility. Noted in the PEFA report, the budget documents do not provide clear linkages between budget figures and underlying policies, and there was no explicit multi-year perspective in fiscal planning. Directly linked to this are the significant variations in the ministerial allocation of expenditures. More recently, the 2012 budget deficit estimate was 6 percent, but the actual budget deficit in 2012 was over 16.4 percent, indicating a serious concern in budget credibility.

The Cabinet approved the medium-term debt-management strategy in June 2012. The strategy will be aligned with the now enacted Fiscal Responsibility Act. Support is required by the newly created middle office of the Department of Debt to meet the following requirements of the Act: (a) the national debt shall be maintained at sustainable levels and (b) a national debt strategy shall provide the required information, which determines the steps being taken by the Government to repay and
maintain national debt in an efficient manner, to the People’s Majlis once every financial year. This strategy is underpinned by the PEFA and the Debt Management Performance Assessment (DeMPA) diagnostic studies that point to many weaknesses in the management of government cash, debt, and guarantees. These areas are fragmented, public reporting is limited, and there is no systematic disclosure of the sizable risks involved. DeMPA identifies 4 key reform areas: (a) institutional framework, (b) debt management strategy, (c) cash management, and (d) domestic debt market development.

A public accounting system (PAS) is widely recognized as a tool for better budget execution through strengthened internal control, cash management, accounting, and financial reporting. PAS implementation in the Maldives is an area that has received continuous support from the World Bank, first as a component under the Post-Tsunami Recovery and Reconstruction Project and currently as a component of the Bank-financed Pension and Social Protection Administration Project. The Maldives public accounting system has been successful in providing the technical foundation needed to implement a treasury single account (TSA) payments system, part of the solution to manage cash and address the severe cash constraints that the country faces. A treasury single account has been successful in minimizing idle funds with the closure of 1,500 bank accounts. With the support of PAS strengthening components, an accounts-payable module has been rolled out across all agencies to facilitate centralized payments.

Despite these successes, the full benefit of the public accounting system has not yet been realized due to disruption in project management and high turnover of expert staff. As a result, the key modules are not yet fully rolled out to all agencies and have not yet, for example, been capable of producing commitment reports or generating consolidated financial statements to be audited by the Auditor General. A recent World Bank study reveals that the level of payment arrears is high and there is no systematic monitoring or reporting on payment arrears. In addition, the public accounting system represents a core treasury information system only. It is not integrated with revenue, budget systems, personnel databases, or debt management systems. At present, the Maldives Inland Revenue Authority (MIRA) uses the SAP accounting system to maintain their revenue databases with no links to the public accounting system. Budget is prepared on Excel spreadsheets. In-house IT systems are used to maintain personnel and pension data; and the Common Wealth Debt Recording and Management System (CDRMS) is used to maintain a record of debt. A seamless integration of these systems would considerably enhance the integrity of the data in the public accounting system.

The existing control environment is insufficient to ensure effective control of the fiscal aggregates. Internal controls and internal audit are weak. The existing Financial Regulations are dated and incomplete, for example, containing only a draft chapter on procurement. In the absence of comprehensive and up-to-date Financial Regulations, standard operating procedures have been drafted (but not finalized and formally approved or implemented). The critical need for service charters and an accounting manual has been identified as the guidance required by staff who are currently unable to fully adhere to procurement and financial management regulations, policies, and directives. Further, thePEFA report indicates that the internal audit function has hardly developed in the Maldives. Since the time of the PEFA, internal audit positions have been created in the Ministry of Finance and Treasury (9 filled, 3 vacant positions), the Ministry of Local Government Authority (1 filled), Ministry of Education (3 filled, 5 vacant) and the Ministry of Defense; and the internal audit function has received support from ADB and from the Kuwait Fund. In particular, an internal audit charter and internal audit manual were designed, and training on the internal audit manual
An assessment of existing procurement arrangements was carried out during 2008-09 under an IDF grant. The aim of the assessment was to develop and implement an action plan for the modernization and improvement of a sustainable country procurement system. An action plan, draft country-specific standard bidding documents, and a draft public procurement chapter were completed for inclusion in the Financial Regulations. Some specific recommendations include:

(a) Development of detailed procurement guidelines and instructions;
(b) Development of specialized standard bidding documents for standard goods, works and consulting services in addition to the need for developing document for harbor works etc.;
(c) Development and staffing the procurement-specific website managed by dedicated staff;
(d) Maldivian Government to explore the possibility of centralized procurement for common use items;
(e) Maldivian Government to introduce measures to professionalize public procurement, including introducing a professional career path for procurement staff and helping build a training facility within the country; and
(f) Maldivian Government to create procurement policy section within MOFT to ensure that the procurement standards are continuously being monitored and improved to ensure effective procurement systems.

The Government has shown great interest in implementing the procurement action plan in order to make public procurement a more effective tool of public expenditure through increased human development and ensuring good governance. The positive expected outcomes are efficient, effective, fair, and transparent procurement, including value for money and budgetary savings.

The key lesson from the Bank’s development policy credit (DPC) was that the operation’s design was overly complex and ambitious for the limited political and technical capacity of the new and inexperienced Government. Lack of close coordination among MOFT divisions is seen as a failure on the part of the borrower. High staff turnover and the replacement of almost all key political heads in the Ministry affected the performance of the borrower.

On the ADB-funded ERC, both the Maldivian Government and ADB consider the technical support extended to MIRA has been quite successful for revenue management under the technical assistance grant while other support has been less satisfactory. Support to (a) budgeting, (b) debt management, (c) project management, and (d) internal audit has been partially satisfactory in building sustainable capacity within MOFT in order to continue the already-commenced initiatives to meet the triggers successfully. The successes of the technical assistance grant were primarily attributed to how the consultancy support was structured — where more longer-term onsite support by individual consultants proved more willing than consultancy firms to transfer knowledge — and ownership and interest of the staff to work in close collaboration with the consultants and gain on-the-job knowledge. The technical assistance grant completion date was December 31, 2013; and given the success in the revenue side, ADB’s follow-up operations will only support this area of PFM. The Maldivian Government indicated the need for continuous consultancy support and
capacity building to take forward and further strengthen the initiatives that started under the Economic Recovery Program such as (a) medium-term budgeting, (b) complying with provisions of the Fiscal Responsibility Act, (c) medium-term debt management strategy, and (d) implementing the internal audit manual.

The World Bank carried out a rapid assessment of the PFM systems in May 2013 in planning the scope of the proposed Maldives PFM Systems Strengthening Project. This scoping exercise also included consideration of a progress review of the 2010 PFM Action Plan put forth by the Government of Maldives in 2010 based on the PEFA report prioritizing PFM actions into immediate and urgent reforms and longer-term reforms. The review revealed that most of the basic and urgent PFM actions identified in the PFM action plan are still not fully implemented.

The Maldivian Government has an unfinished PFM strengthening agenda. It is evident that a comprehensive PFM strengthening program is needed to address the country’s immediate and medium- and long-term needs. An incremental approach to PFM strengthening is suited for Maldives given the many challenges it faces. The Government places priority on the following:

- Developing a credible annual budget. It will be necessary to carry out fiscal planning beyond one business cycle that determines (i) the overall resource envelop available to the budget that is compatible with overall macro-economic balance in the economy and any resulting debt levels that is sustainable over the longer term; and (ii) how this overall envelop is to be divided among the different sectors/ministries to meet policy priorities. In terms of PFM processes, this entails the development of improved macro-economic and fiscal forecasting, accurate reports on fiscal aggregates, medium-term fiscal frameworks, and debt sustainability analysis.

- Achieving the fiscal aggregates as planned. Systems must be in place that ensure resource allocation decisions are complied with, monitored, and reported. This will rest on an adequate legislative and institutional framework; transparency based on good accounting; supporting IT; centralized cash management (a treasury single account); a regular budget calendar; regular reports; strong internal controls, including commitment controls; and an active external audit function reporting to the legislature.

The proposed project aims to leverage ongoing PFM work. This PFM work is unfinished; the proposed project will enable a renewed focus on these immediate — indeed urgent — requirements that have the traction of the Maldivian Government. These basics once achieved will underpin and provide the stage for the Government to move to the second phase of PFM development that focuses more on outputs and results. In some of these areas there has already been some initial work. However, given the many immediate priorities, it is not advisable to put too many resources into these areas at this stage. The proposed Project therefore will focus only on the first phase of PFM development and thereby set the foundation for the second phase of PFM development.

During the second phase, the Government would be advised to focus on a medium-term budget framework with credible indicative allocations supported by detailed, costed sector strategies. The MOFT has taken an important first step toward a more medium-term budget system. However, given the current fiscal situation and the many weaknesses in the PFM system, these indicative allocations have limited credibility. Once the public accounting system is strengthened and reliable financial information is available, there is significant scope for gradually strengthening the quality of the medium-term budget estimates over time.

Keeping in step with performance orientation, the Government can move toward program-based
budgeting in its second phase of the PFM strengthening program. While some initial attempts have been made to move toward program budgeting, extensive support will be needed to develop a proper program structure and transition to program budgeting.

Progression to accrual-based statements should also occur during this second phase of PFM development once adequate computerized accounting systems are rolled out; commitment accounting and controls are established; and the Government complies with cash basis IPSAS with notes providing other information on assets, liabilities, and contingent liabilities as required by the Public Finance Act.

Establishment of an effective and modern risk-based internal audit focused on performance to commensurate with the rest of the developments in PFM is another activity for consideration during the second phase. To underpin the second phase of PFM strengthening, a PEFA update should also be considered by the Maldivian Government.

II. Proposed Development Objectives
The proposed project development objectives (PDO) are to enhance budget credibility, transparency, and financial reporting of central government finances.

III. Project Description
Component Name
Contingency
Comments (optional)

Component Name
Strengthening the PFM Environment
Comments (optional)

Component Name
Strengthening Budget Execution
Comments (optional)

Component Name
Project Management
Comments (optional)

IV. Financing (in USD Million)

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V. Implementation
The proposed project will be mapped to the office of the MOFT Permanent Secretary and implemented by the relevant MOFT departments. The heads of each relative department have been identified as focal persons responsible for the implementation of subcomponents and together form the project’s Technical Committee. The Technical Committee will be headed by a project director. In addition, a high-level PFM project Steering Committee, chaired by the advisor to the Minister of Finance and represented by a broad range of stake-holders, has been constituted to provide strategic direction and monitor progress. In addition the MOFT –specifically the office of the Permanent Secretary will act as a coordinating unit and as a central point of contact for all coordinating and monitoring project activities. Project coordination will be supported by (a) the MOFT Permanent Secretary as project director; (b) an international Management Implementation Support Consultant (MISC); and a local project coordinating and M&E consultant; (c) Financial Controller and her team at TPAD for financial management activities; and (d) Head of the Tender Division and his team for procurement activities. The communication and change management that will cut across all components of the project will also be coordinated by the PD with support from the MISC and local project coordinator.

VI. Safeguard Policies (including public consultation)

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Comments (optional)

VII. Contact point

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