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IDA/R2018-0402/1

December 21, 2018

Closing Date: Thursday, January 17, 2019 at 6:00 p.m.

FROM: Vice President and Corporate Secretary

Sierra Leone - Financial Inclusion Project

Project Appraisal Document

Attached is the Project Appraisal Document regarding a proposed credit to Sierra Leone for a Financial Inclusion Project (IDA/R2018-0402), which is being processed on an absence-of-objection basis.

Distribution:
Executive Directors and Alternates
President
Bank Group Senior Management
Vice Presidents, Bank, IFC and MIGA
Directors and Department Heads, Bank, IFC, and MIGA

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Report No: PAD3145

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROJECT APPRAISAL DOCUMENT
ON A
PROPOSED CREDIT

IN THE AMOUNT OF US$12 MILLION

TO THE

REPUBLIC OF SIERRA LEONE

FOR A

FINANCIAL INCLUSION PROJECT

DECEMBER 17, 2018

Finance, Competitiveness And Innovation Global Practice
Africa Region

CURRENCY EQUIVALENTS

(Exchange Rate Effective November 30, 2018)

Currency Unit =	SLL (Sierra Leonean Leone)
SLL 8,549.43 =	US$1
US$ 1.38 =	SDR 1

FISCAL YEAR
January 1 - December 31

Regional Vice President:	Hafez M. H. Ghanem
Country Director:	Henry G. R. Kerali
Acting Sr. Global Practice Director:	Sebastian Molineus
Practice Manager:	Douglas Pearce
Task Team Leader(s):	Rinku Chandra, Nicholas Timothy Smith

ABBREVIATIONS AND ACRONYMS

ACH	Automated Clearing House
AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
ATM	Automated Teller Machines
B2P	Business to Person
BSL	Bank of Sierra Leone
CB	Community Bank
CBA	Core Banking Applications
DFS	Digital Financial Services
FSA	Financial Service Association
FSDP	Financial Sector Development Plan Support Project
G2P	Government to Person
GDP	Gross Domestic Product
GRS	Grievance Redress Service
ICR	Implementation Completion Report
IFC	International Finance Corporation
IFR	Interim Financial Report
IMF	International Monetary Fund
IPF	Investment Project Financing
ITAS	Integrated Tax Administration System
M&E	Monitoring and Evaluation
MFD	Maximizing Finance for Development
MFI	Microfinance Institution
MNO	Mobile Network Operators
MoF	Ministry of Finance of Sierra Leone
MSME	Micro, Small, and Medium Enterprise
NATCOM	Telecommunications Commission
NPL	Non-performing Loan
NRA	National Revenue Authority
P2B	Person to Business
P2G	Person to Government
PDO	Project Development Objectives
PFM	Public Financial Management
PFMU	Project Fiduciary Management Unit
PIU	Project Implementation Unit
PIM	Project Implementation Manual
POS	Point of Sale
PPSD	Project Procurement Strategy for Development
RTGS	Real Time Gross Settlement
SCD	Systematic Country Diagnostic
WAMZ	West Africa Monetary Zone
UNCDF	United Nations Capital Development Fund
USSD	Unstructured Supplementary Service Data

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DATASHEET

BASIC INFORMATION

Country(ies)	Project Name	
Sierra Leone	Sierra Leone Financial Inclusion Project	
Project ID	**Financing Instrument**	**Environmental Assessment Category**
P166601	Investment Project Financing	C-Not Required

Financing & Implementation Modalities

[ ] Multiphase Programmatic Approach (MPA)	[ ] Contingent Emergency Response Component (CERC)
[ ] Series of Projects (SOP)	[ ] Fragile State(s)
[ ] Disbursement-linked Indicators (DLIs)	[ ] Small State(s)
[ ] Financial Intermediaries (FI)	[ ] Fragile within a non-fragile Country
[ ] Project-Based Guarantee	[✓] Conflict
[ ] Deferred Drawdown	[ ] Responding to Natural or Man-made Disaster
[ ] Alternate Procurement Arrangements (APA)	

Expected Approval Date	Expected Closing Date
11-Jan-2019	30-Jun-2025

Bank/IFC Collaboration
No

Proposed Development Objective(s)

The objective of the project is to increase the interoperability of digital payments and access to financial services.

Components

Component Name	Cost (US$, millions)
Enhancing Interoperability of Digital Payments	7.80
Ensuring the Viability of the Payments System through Increasing Usage	3.50
Project Implementation Support	0.70

Organizations

Borrower:	Republic of Sierra Leone
Implementing Agency:	Bank of Sierra Leone

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Project Cost	12.00
Total Financing	12.00
of which IBRD/IDA	12.00
Financing Gap	0.00

DETAILS

World Bank Group Financing

International Development Association (IDA)	12.00
IDA Credit	12.00

IDA Resources (in US$, Millions)

	Credit Amount	Grant Amount	Total Amount
National PBA	12.00	0.00	12.00
Total	**12.00**	**0.00**	**12.00**

Expected Disbursements (in US$, Millions)

WB Fiscal Year	2019	2020	2021	2022	2023	2024
Annual	0.25	3.16	1.91	2.13	2.32	2.23
Cumulative	0.25	3.41	5.32	7.45	9.77	12.00

INSTITUTIONAL DATA

Practice Area (Lead)

Finance, Competitiveness and Innovation

Contributing Practice Areas

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Gender Tag

Does the project plan to undertake any of the following?	
a. Analysis to identify Project-relevant gaps between males and females, especially in light of country gaps identified through SCD and CPF	Yes
b. Specific action(s) to address the gender gaps identified in (a) and/or to improve women or men's empowerment	Yes
c. Include Indicators in results framework to monitor outcomes from actions identified in (b)	No

SYSTEMATIC OPERATIONS RISK-RATING TOOL (SORT)

Risk Category	Rating
1. Political and Governance	Substantial
2. Macroeconomic	Substantial
3. Sector Strategies and Policies	Substantial
4. Technical Design of Project or Program	Substantial
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	Substantial
7. Environment and Social	Low

8. Stakeholders	● Moderate
9. Other	
10. Overall	● Substantial

COMPLIANCE

Policy

Does the project depart from the CPF in content or in other significant respects?

[ ] Yes [√] No

Does the project require any waivers of Bank policies?

[ ] Yes [√] No

Safeguard Policies Triggered by the Project	Yes	No
Environmental Assessment OP/BP 4.01		✓
Performance Standards for Private Sector Activities OP/BP 4.03		✓
Natural Habitats OP/BP 4.04		✓
Forests OP/BP 4.36		✓
Pest Management OP 4.09		✓
Physical Cultural Resources OP/BP 4.11		✓
Indigenous Peoples OP/BP 4.10		✓
Involuntary Resettlement OP/BP 4.12		✓
Safety of Dams OP/BP 4.37		✓
Projects on International Waterways OP/BP 7.50		✓
Projects in Disputed Areas OP/BP 7.60		✓

Legal Covenants

Sections and Description

Financing agreement, Schedule 2, Section I, A.4. a): The Recipient shall not later than two months after project effectiveness establish and thereafter maintain throughout the implementation of the Project, a Project Steering Committee (PSC) comprising representatives from the BSL departments, private sector representative and other key stakeholders in charge of implementing various activities.

Sections and Description
Financing agreement, Schedule 2, Section I, A.5. a): The Recipient shall not later than two months after the Effectiveness Date establish and thereafter maintain throughout the implementation of the Project, a Private Sector Committee (PStC) comprising of stakeholders from the private sector.

Sections and Description
Financing agreement, Schedule 2, Section IV, A: The Recipient through the PFMU shall not later than one month after the Effectiveness Date: (1) prepare and adopt a Financial Management Manual, and (2) customize the existing accounting software to meet the needs of the Project, all in a manner satisfactory to the Association.

Sections and Description
Financing agreement, Schedule 2, Section IV, B: Except as the Recipient and the Association shall otherwise agree, the Recipient through BSL shall: (1) not later than three (3) months from the Effectiveness Date open an account ("Escrow Account") for the Project, in the BSL on terms and conditions satisfactory to the Association; (2) deposit into said Escrow Account the revenue derived from the RPS; and (3) ensure that funds deposited into the Escrow Account in accordance with paragraph (2) of this Section shall be used exclusively to finance expenditures in connection with the RPS.

Conditions

Type	Description
Effectiveness	Financing agreement, Article IV, 4.01. a): the Recipient has prepared a Project Implementation Manual in accordance with Section 1. B of Schedule 2 to this Agreement in form and substance satisfactory to the Association

Type	Description
Effectiveness	Financing agreement, Article IV, 4.01. b): the Recipient has established a Project Implementation Unit within BSL in accordance with Section I.A.2 of Schedule 2 to this Agreement.

I. STRATEGIC CONTEXT

A. Country Context

1. **Sierra Leone is a low-income post-conflict country located in coastal West Africa with a population of 7.56 million inhabitants.** Urbanization has increased significantly in recent decades, with the share of the population living in urban areas doubling from 21 percent in 1967 to 40 percent in 2015. The country is also young and growing rapidly, with 45.8 percent of the population under the age of 15 and 74.8 percent below 35. Sierra Leone has abundant natural resources, including forests, fisheries, and minerals (e.g., diamonds, gold, iron ore).

2. **The economy of Sierra Leone grew significantly from 2002-14, but in 2015 the country was impacted by the Ebola outbreak and the downturn in iron-ore prices.** Between 1991 and 2001, the country experienced a civil war that led to an economic contraction of 3.4 percent on average per year during this period. This civil war resulted in an estimated 50,000 deaths and widespread displacement. The economy expanded significantly in the post-war years, with economic growth averaging 5.9 percent from 2002 to 2015 and driven primarily by agriculture and mining. In 2015, the economy contracted by 21.1 percent due to the Ebola outbreak and downturn in iron ore prices.

3. **The economy began to recover in 2016 when the country was declared Ebola free.** The economy grew by 6.4 percent in 2016. In 2017, growth moderated to 3.8 percent reflecting weak recovery of mineral production, particularly iron ore. Despite this growth, the country continues to face balance of payments challenges. The current account deficit increased during this period driven by increased private consumption of imported items and sluggish export growth. This put pressure on international reserves, and in response the Bank of Sierra Leone (BSL) reduced its intervention in the foreign exchange market, leading to a significant depreciation in the exchange rate. This, along with increased foreign direct investment, International Monetary Fund (IMF) resources, and higher portfolio investment have allowed the country to manage the current account deficit.

4. **Monetary policy was initially loosened to support the recovery that began in 2016, but it has tightened in response to growing inflationary pressures.** The inflation rate declined to 15.3 percent in December 2017 down from 17.4 in December 2016 due to relative stability of the exchange rate, reinforced by the tight monetary policy stance of BSL. Food inflation also declined slightly as food supply constraints eased moderately during 2017. The BSL raised the monetary policy rate by 50 basis points to 14.5 percent in December 2017 to further contain inflation. This followed three consecutive 100 basis-point increases in March, June, and September, respectively. The tighter policy stance of BSL has led to tight liquidity conditions in money markets with some commercial banks facing increased liquidity constraints. Domestic credit has grown significantly due primarily to an increase in the claim on the central government. This is due to the government's reliance on substantial borrowing from commercial banks to finance the persistent fiscal deficit.

5. **The country faces significant fiscal challenges due to shortfalls in revenue mobilization and spending overruns.** The overall budget deficit including grants deteriorated to 9.4 percent of GDP from 8.1 percent in 2016, as revenue mobilization failed to keep pace with the rapid growth in expenditure in recent years. The increase in total government expenditure was driven by spending overruns in wages, transfer of goods and services and domestic capital expenditure. The recent shortfalls in revenue mobilization were driven by a decline

in foreign aid, the lack of implementation of fuel price liberalization, and excessive duty waivers. The deficit was financed by external loan disbursements and grants as well as domestic borrowing, mainly from the banking system, which exceeded the 2.0 percent of GDP limit that is part of the government's medium-term fiscal program. The worsening fiscal position of the government and the underperformance of domestic revenue mobilization has led to a sharp rise in the stock of public debt. However, the most recent Debt Sustainability Analysis (June 2017) indicates that Sierra Leone remains at a high risk of debt distress.

6. **Economic growth is projected to rise from 3.8 percent in 2018 to 5.4 percent by 2020.** Growth is expected to be driven by increased private sector investments in agriculture and mining, coupled with improved spending on road construction and energy, as well as investment climate reforms. The fiscal deficit is expected to narrow to 3.8 percent of GDP by 2020 due to fiscal consolidation, implementation of government's medium-term revenue mobilization strategy and new public financial management reforms. The BSL is expected to continue its tight monetary policy stance, complemented by fiscal consolidation, to bring down inflation to 9 percent over the medium-term. The current account deficit is projected to steadily decline to 11.1 percent of GDP by 2020 due to the positive outlook of commodity prices which is expected to support export growth. Nonetheless there remain significant downside risks which could impede the growth outlook. The main risks to Sierra Leone's growth outlook are the persistent fiscal deficits, adverse debt dynamics, weaknesses in the banking sector, and the volatility of economic growth.

7. **Based on the most recent household survey, the incidence of poverty has declined by 12.6 percent from 2003 to 2011.** The 2011 Sierra Leone Integrated Household Survey estimated the incidence of poverty to be 53.8 percent. However, the total number of poor remained relatively constant at 3.3 million people due to the increase in population. Poverty is also disproportionally rural, with the most recent household survey indicating that more than three-quarters of the poor live in rural areas.

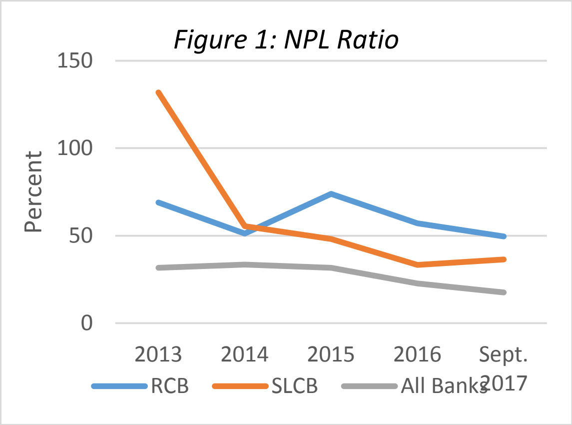
B. Sectoral and Institutional Context

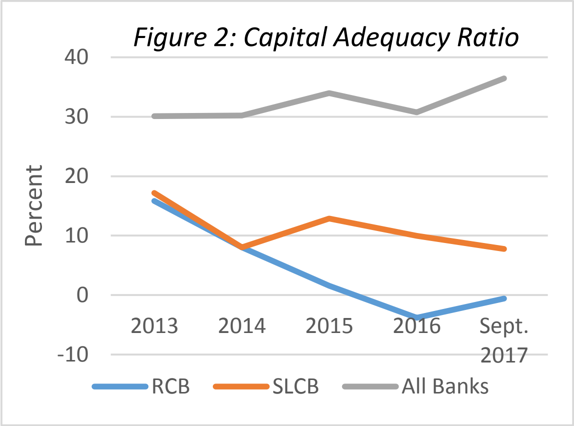
8. **The financial sector in Sierra Leone is amongst the shallowest in the region, and has been declining.** Credit to the private sector declined from 7.5 percent of GDP in 2011 to 5.8 in 2016 and to 5.1 in 2017. The major driver of this has been increased lending from the banking sector to the central government, which increased from 5.5 percent in 2011 to 16.18 in 2016 and 17.6 percent in 2017.

9. **The banking sector is dominated by commercial banks.** The banking sector in Sierra Leone includes 14 commercial banks, 17 community banks, 59 financial services associations (FSA), 18 microfinance institutions (MFIs) (3 deposit taking and 15 credit only), and three mobile money operators. The commercial banking sector accounts for 99 percent of all financial sector assets. Total assets of the commercial banking sector are Le5.29 trillion, and account for over 99 percent of the assets in the financial system. Foreign banks account for more than 60 percent of the industry's total assets.

10. **Outside of the two state-owned banks, the banking system is broadly stable.** The Capital Adequacy Ratio for the banking system increased from 30.7 percent to 34.1 percent in 2017, indicating that the system has adequate buffers in the case of losses. Asset quality has also improved in recent years, although the absolute level remains problematic. The level of non-performing loans (NPLs) peaked at 33.4 percent at end-2014 and declined to 23 percent at end-2016 and 18 percent at end-2017. Profitability has also improved, with return on

assets increasing from 2.9 percent at end-2016 to 5.3 percent at end-2017 and return on equity increasing from 22.3 percent at end-2016 to 25.6 percent at end-2017. Commercial banks are also growing, with new deposit accounts growing on average in recent years partially due to an increasing branch network.





11. **Two large state-owned banks pose challenges to financial stability.** Despite the entrance of a number of foreign banks over the past decade, the two state-owned banks (Rokel Community Bank and Sierra Leone Commercial Bank) continue to be key players with 28.6 percent of assets, 36.2 percent of deposits, and 23.8 percent of credit. Both Rokel Community Bank and Sierra Leone Commercial Bank had to recognize large and long-standing asset problems in 2014, which resulted in an erosion of their capital base and measures by the authorities to initiate their restructuring. This was the major driver of the system-wide NPL increase mentioned previously. The BSL has intervened in the banks and has temporarily taken over management of the two institutions and has put in place mechanisms to limit new corporate lending. However, the underlying questions about their business model and their viability remains and needs to be addressed. The government is currently determining how to proceed with the restructuring of these two banks. The outcome of this restructuring will have significant impact on the financial stability of the country, which amongst other things, will likely increase risk taking amongst banks and decrease the cost of finance overall for enterprises.

12. **The two large state-owned banks also pose challenges to increasing access to finance, and in particular for the enterprise sector. To finance the budget deficit, government borrowing from the banking sector has increased in recent years, which has limited the credit available to the private sector.** Credit to the private sector declined from 7.5 percent of GDP in 2011 to 5.8 in 2016 and to 5.1 in 2017. At the same time, credit to the central government increased from 5.5 percent in 2011 to 16.8 percent in 2016 and 17.6 percent in 2017. The major driver of this decreased lending to the private sector and increased lending to the central government has been the two state-owned banks. In addition, government securities that are purchased by these two state-owned banks often have terms that are more advantageous than securities sold more broadly to the market. In making the choice to prioritize financing to the government, the government is effectively making a choice that limits access to finance, and in particular for the enterprise sector. The outcome of the planned restructuring of these two banks has the potential to greatly increase the funding available to the private sector and could be a major driver of increased access to finance for the enterprise sector.

13. **The 17 community banks, 59 FSAs, 3 deposit-taking, and 15 credit only MFIs are the primary branch based financial service providers in rural areas.** These institutions account for about 1 percent of financial

sector assets, but have a wide geographic reach. Community banks, FSAs, and MFIs primarily cater to micro and small enterprises (MSME) and entrepreneurs. These institutions also have a significant focus on agricultural lending and on rural areas. Women also make up a significant portion of loan recipients, 44.05 percent in the case of FSAs.

14. **Access to finance is very limited in Sierra Leone.** The 2018 Doing Business Report ranks Sierra Leone at 159th out of 190 countries in getting credit. Financial intermediation is very low and has been decreasing in recent years as indicated earlier due to the increasing reliance on government borrowing from the banking sector. Additionally, credit is scarce, particularly for MSMEs and entrepreneurs. A multitude of factors explain the low level of access to finance for entrepreneurs. First, Sierra Leone's nascent collateral movable registry has experienced little uptake. This situation precludes the securitization of loans and the guarantee for lenders on recovering assets in the event of default. As a result, lending is largely concentrated on corporate entities and trade as banks are less willing to lend to entrepreneurs and the agricultural sector due to their high perceived risk. Second, Sierra Leone lacks a modern credit registry, which is critical to ensuring financial institutions can obtain consumers' credit history to assess their risk profile. The current Excel-based credit registry is prone to human error, susceptible to fraud, and time intensive, among others. Third, commercial banks do not offer products and services tailored to SMEs.

15. **Access to financial services remains low, at less than half the Sub-Saharan average.** According to Financial Inclusion Database (FINDEX) 2017, only 19.8 percent of the adult population has an account with a formal institution or mobile money provider, compared to 42.6 and 34.9 percent for the Sub-Saharan and low-income countries averages, respectively. Further, there has been little improvement in the level of financial inclusion since 2011 (15.3 percent), highlighting the need to put in place the requisite financial sector infrastructure, policies, and investments, among others to help drive financial inclusion. Financial inclusion levels are lower for women (15.4 percent), the poorest 40 percent (12.9 percent), and those living in rural areas (14.4 percent). Access to financial services is even lower if one excludes mobile money, with accounts at financial institutions at 12.4 percent of the population, while 11 percent have mobile money accounts.

16. **Usage of formal financial services also remains very low.** In terms of credit, only 5.2 percent of adults borrowed from a financial institution or used a credit card, while 29.1 percent borrowed from a family or friend. Similarly, only 5.2 percent saved at a financial institution, while 33.6 percent saved with a club or person outside the family, and 54.2 percent did not save at all. In terms of remittances, 10 percent of the population sent or received remittances through an account, 7.7 percent through an over the counter service, and 14.5 percent as cash. Regarding digital payments such as mobile money, 15.6 percent made or received digital payments, 3.1 percent used an account to pay utilities, 4.1 percent used the internet to buy something or pay bills, and 9.8 percent used a mobile phone or the internet to access an account.

17. **Although there has been only limited improvement overall in the level of financial inclusion in recent years, usage of mobile money has increased notably.** There are now 1.9 million customers using mobile cash-in cash-out transactions, with about 94,000 mobile wallet customers. This has grown rapidly in recent years and is likely to be the largest source of improving access to finance in the coming years. In particular, the migration of cash-in cash-out customers to other types of accounts and the development of other digital finance products than those currently available in the market. In order to drive this there is a need to allow for transactions between digital finance service providers and all other financial service providers (also known as interoperability).

Box 1: The importance of interoperability
Interoperability between financial service providers allows for users of the financial system, including households, enterprises, and the government, to make payments to anyone else in a convenient, affordable, fast, seamless and secure way. Interoperability of retail payments is done through the creation of a payments switch through which all financial service providers are able to channel transactions between customer accounts. Effective interoperability requires a concerted effort to structure rules and processes, and there are often disincentives for larger market players to facilitate interoperability due to the fear of a loss of market share by creating a level playing field. On the other hand, interoperability has been shown to drive innovation in the financial service marketplace, especially in digital finance, as it creates a level playing field. There are both private sector and public sector led switches. The creation of switches is usually driven by an industry association, private sector companies, or central banks. Private sector solutions are preferred as it ensures that these are not top-down driven mandates that create intransigence on the part of providers. However, in countries with shallow financial systems, the level of investment required to develop a payments switch is unviable for private sector actors unless fees charged by the switch are extremely high. In these cases, public sector solutions are preferred, but the development of the switch has to be done in close consultation with financial service providers and with appropriate governance and oversight mechanisms that ensure that the systems are value-added for financial service providers and customers.

18. **Access to financial services is concentrated in urban areas with limited access points and varieties of financial services.** Community banks, FSAs, deposit taking MFIs, credit only MFIs, and mobile money providers have a greater presence in rural areas than banks. Overall mobile money comprises 75 percent of access points, while MFIs and banks comprise only 7 and 6 percent respectively. Commercial bank branches are primarily located in urban areas while community banks, FSAs, and MFIs are primarily located in rural areas. There are also large parts of the country with no access points. The 2017 BSL geospatial mapping survey highlights that that 41.5 percent of chiefdoms in the country do not have any financial service access points, including mobile money.

19. **The BSL is implementing a financial inclusion strategy that aims to promote financial sector development and inclusion.** This development and implementation of the National Strategy for Financial Inclusion which was launched in 2016, focuses on six strategic areas: 1) Responsive Policy, Regulations, and Coordinated Action; 2) Client-centric Products and Services; 3) Digital Financial Services (DFS); 4) Access to Finance for Micro, Small, and Medium Enterprise in Growth Sectors; 5) Financial Literacy, Financial Education and Consumer Protection; and 6) Data and Measurement. The strategy is also supported by working groups, with more to be established. The BSL is also working with a number of development partners to bolster the regulatory environment to facilitate financial sector development, including the development of Agent Banking regulations to promote financial inclusion.

20. **As part of its strategy for financial inclusion, one of the key priorities is ensuring interoperability (see box 1) amongst financial service providers.** The development of an efficient payments system is one of the basic foundations of financial inclusion and development (see Box 2). The BSL began an effort to modernize the payments system in 2009, and has already made significant progress in modernizing the payments system. An efficient payments system includes a real time gross settlement system (RTGS) for the settlement of interbank

transactions, an automated clearing house (ACH) system for processing retail payments; instruments, and a retail payment switch that can interface with different systems (e.g., automated teller machines (ATMs), mobile money, etc.) and consolidate all electronic transactions to one or more payment processers.

Box 2: The linkages between payments systems and financial inclusion

The World Bank's Group Universal Financial Access (UFA) 2020 initiative's goal is to ensure that all working-age individuals and businesses can have access to at least one transaction account operated by an authorized and/or regulated payment service provider. The World Bank Group and the Committee on Payments and Markets Infrastructure of the Bank for International Settlements convened a task force on Payment Aspects of Financial Inclusion to comprehensively examine how payments system and services affect financial inclusion efforts. The task force found that efficient payments system is one of the basic foundations for financial inclusion[1] and that there are strong linkages between an efficient payment system and an increase in transaction accounts. Amongst the many reasons are that efficient payments systems can provide value added products. This includes digitizing social transfer payments that reduce travel and wait time for recipients receiving funds and convenience in transferring funds via mobile wallet products. These transaction accounts then serve as an entry point into the formal financial system and the opportunity for customers to receive additional value-added products, such as credit and insurance products.

21. **Sierra Leone introduced an RTGS system in 2013, which currently includes participation by all 14 commercial banks operating in Sierra Leone.** The system is responsible for processing large value transactions of above SL 50 million or approximately US$6 million.[2] According to payment system statistics published by the BSL, 124,788 transactions at a total value of US$3.2 billion moved through the RTGS in 2015.

22. **The ACH became operational in 2013.** The system is an interbank system for retail payments (of less than SL 50 million). All commercial banks in the country participate in the ACH system. However, to date, usage of the system has been very low. A very small proportion of GDP flows through the ACH (0.2 percent), and the lack of volume is likely the result of the very low levels of bank account penetration in the country. Direct credit transactions totaled 126,481 in 2015, with a total value of US$7.6 million. While the ACH can facilitate direct credit; direct debit payments are yet to go live in Sierra Leone. Activating direct debit payments through the ACH has been delayed for a number of years, with a continued lack of momentum on defining agreements, mandate forms and other procedural and regulatory factors.

23. **The automated check processing which was introduced as part of the ACH system brought about efficiencies in check processing** and significantly reduced the check clearing cycles from T+9 to T+1. In 2015, over 227,000 checks with a total value of US$17,114,744, were cleared through the system. The average value of each check was US$75. Given that a large percentage of government payments are made using check, it is likely that public sector payments make up a significant proportion of the reported volumes and values reported by the BSL.

[1] As well as other infrastructures such as identification infrastructure, credit reporting and data-sharing platforms, and a robust communications and power supply system.

[2] August 23, 2018 exchange rate

24. **While Sierra Leone has put in place an RTGS and ACH system, a retail payment switch to facilitate interoperability is a missing element of the payments system.** With the exception of a few banks, which are connected to each other through bilateral agreements and the various institutions connected by ACH, financial service providers, including banks, MFIs, and mobile network operators (MNO) are not connected to each other. Concretely this means most consumers cannot transfer money between a bank account and their mobile wallet or send money from a MFI savings account to a family member whose only form of financial access is a mobile phone. For example, for the market vendor who would like to transfer funds from their mobile money account to their bank account, they can only do so if the two institutions have integrated with each other to facilitate such a transaction. This is especially important in areas that are not serviced by banks. For a teacher who is paid his/her salary at an FSA, the only point of access to these funds is the FSA alone which itself means many teachers have to walk long distances or pay for transport to collect their salaries, while other potentially more convenient locations, such as a mobile money agents or ATMs, are not currently possible. The BSL sees the switch as a solution to this problem by creating a common platform through which all service providers can have access to the payments system. This would allow for interoperability and ultimately contribute to financial inclusion and deepening.

25. **The lack of access points and interoperability, and the resulting poor customer experience when using formal financial services, is further compounded by a significantly under-developed retail payment landscape with limited payment instruments available to the customer.** Consumers face significant challenges paying bills given the lack of payment gateways available in the market. Secondly, many financial institutions do not issue domestic cards and for those that do, these tend to be domestic cash cards that are limited to cash withdrawals in Sierra Leone and cannot be used as a means of payment. The few banks that offer debit card services and/or cards do so through their membership with international cards schemes, and these solutions tend to be very expensive for the consumer.

C. Relevance to Higher Level Objectives

26. **The proposed project is aligned with and supports several of the nine priorities identified in the Systematic Country Diagnostic (SCD).** These priority areas are also expected to be reflected in the Country Partnership Framework for the period 2019-2023, which is currently under preparation.

27. **In particular, the project would directly support the achievement of Priority Area** 4 -- Improving access to infrastructure (energy, transport, ICT, and credit) and improving labor market regulations. The SCD notes that enterprises face significant challenges gaining access to credit, which is critical to stimulating the investment for private sector led growth. The project aims to increase the efficiency of the financial system by promoting the interoperability of financial services, which should increase usage and lower costs.

28. **The project will support two other priority areas identified in the SCD**: Priority 8 -- Strengthen health institutions for service provision and resilience to public health emergencies; and Priority 9 -- Improve quality and access to education. The project aims to facilitate the digitization of government payments to improve the efficiency of payments vis-à-vis the establishment of a retail payment switch. This digitization can support the achievement of these two priority areas through an increase in the efficiency of the delivery of public services. For example, the digitization of payments can help achieve these efficiency gains through various mechanisms, including: i) decreasing government employee absenteeism caused by the need to travel long distances to

collect salaries; and ii) improving accuracy of human resource records and reduce cases of ghost workers. The project will also help facilitate access to collect government payments by stimulating access point development (such as electronic portals) and ensure consumers utilize such innovative and new services.

29. **The project will support objectives of other World Bank Global Practices' projects, such as Governance and also Social Protection, through its activities on digitizing government payments and improving the efficiency of social payments, respectively**. The World Bank Public Financial Management and Improvement Project (P133424) aims to "improve budget planning and credibility, financial control, accountability and oversight in government finances in the Recipient's territory". A core part of the project is the implementation of the Integrated Tax Administration System (ITAS) system to become the main vehicle for processing business taxes, including value added tax, employer pay as you earn (PAYE), and relevant contracts tax. Implementing a retail payments switch will facilitate for these payments from banks, mobile wallets, and electronic methods through the interoperability provided by the switch rather than at National Revenue Authority (NRA) locations themselves or via bilateral agreements between the NRA and individual financial providers. The project also includes complementary activities that focus on ensuring the success of the ITAS system via ensuring that the functionality provided by the retail payments switch facilitates the efficiency of government payments and also via activities directly with financial service providers aimed at increasing the volume of NRA transactions.

30. **The project will also support other key critical higher-level objectives.** The project's support to the retail payment switch and to promote the supply and demand of financial services, will support progress towards the World Bank's Universal Financial Access 2020 goal. Access to financial services will also help progress towards the achievement of the Sustainable Development Goals, as such services enable households to invest in income generating activities, save, insure against risk (insurance), and pay for affordable healthcare and education. Financial inclusion can also promote women's social and economic empowerment.

31. **The project will contribute to the development of a digital economy, which can generate widespread benefits for Sierra Leone.** A digital economy can be more inclusive for low income individuals, for example, by reducing information asymmetries which disproportionately affect poor or rural households and firms, widening (and lowering the cost of) access to public and private sector services, opening up new business opportunities, and by fostering entry into the productive labor force of women and younger workers. Shifting government payments, remittances, SME payments, and social protection payments from cash into accounts represents an important opportunity to expand financial access and enable participation in the digital economy.

32. **The project aims to support the country's National Strategy for Financial Inclusion's "strategic interventions".** As indicated earlier one of the key priorities for the BSL in implementing the financial sector development reform program is to accelerate the payments system modernization process that began in 2009. While the BSL has been able to implement improvements in several core parts of the payments system (e.g., RTGS and ACH) it has been attempting to implement a retail payments switch for several years, but has been unsuccessful in these efforts.

II. PROJECT DESCRIPTION

A. Project Development Objective

PDO Statement

33. **The objective of the project is to increase the interoperability of digital payments and access to financial services.**

34. **The project will allow for the interoperability of digital payments and access to financial services for individuals through:** i) implementing the required hardware, software, and institutional improvements to payments system to allow for interoperability between financial service providers; ii) ensuring the usage and viability of that payments system; and iii) facilitating usage of the payments system in those areas that are underserved and where financial inclusion is particularly low.

PDO Level Indicators

35. **PDO level indicators are:**

- Interoperability: Cumulative number of transactions processed through the retail payments switch
- Access: Number of financial institutions connected to and utilizing the retail payments switch

B. Project Components

36. **The project was designed to increase the interoperability of digital payments and access to financial services**. The design of the project was informed by the country and sectoral context presented earlier: in particular the shallow financial system, low levels of financial inclusion, and dominance of mobile money operators and MFIs in rural areas. Facilitating interoperability between financial service providers will support an increase in usage of the financial system and innovation.

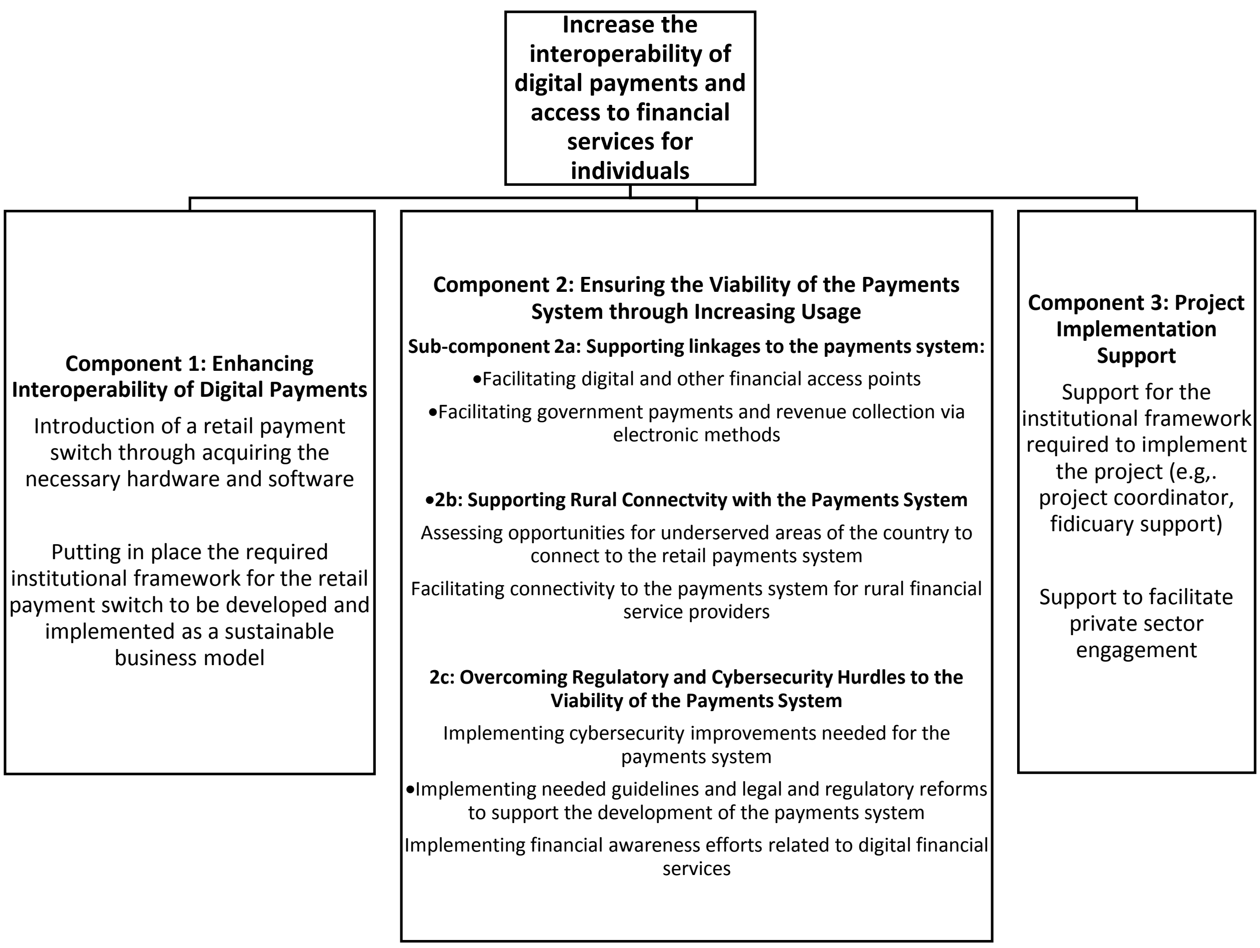
37. **The project was designed to ensure sufficient usage in order to increase the sustainability of the improvements made to payments system and the project's impact on financial inclusion.** The Payments and Financial Inclusion report that was produced jointly by the World Bank and the Bank for International Settlements highlights that improvements in the payments system need to be financially viable and have sufficient usage in order to facilitate broader adoption of usage and transaction accounts and in general higher levels of financial inclusion. Considering the shallow financial sector and low levels of financial inclusion, the project includes a component aimed at driving usage of the payments system, as well as a focus on facilitating usage of the payments infrastrucutre in those areas where financial inclusion levels are particulary low.

38. **The project design also took into account the role of interopability in improving government payments in Sierra Leone, as well as the efforts within the Public Financial Management (PFM) reform that is underway in the country.** Digitizing government payments has been shown to have a significant savings for the government due to a reduction in transaction costs. It also has been shown to, in conjunction with other PFM reforms, to improve planning, managing, and monitoring of domestic resource allocation and use. The government is in the process of a broad range of PFM reforms, including through the World Bank Public Financial Management and Improvement Project. The design of the project factored in the ongoing PFM reforms, and the opportunity to scale up the impact of these broader reforms.

39. The proposed project is a US$12 million investment project financing (IPF) comprised of three components:

- *Component 1 - Enhancing Interoperability of Digital Payments:* finances the hardware, software, and consulting services required to successfully implement a switch.
- *Component 2 – Ensuring the Viability of the Payments System through Increasing Usage:* supports the increased usage of the payments system through financing access points for the switch, including point of sale (POS) terminals, mobile wallets, and government payments. The component has a special emphasis on increasing areas of the country with particularly low levels of financial inclusion, and in particular rural areas. The component also supports other barriers to the usage of the payments system, including legal and regulatory barriers and financial awareness.
- *Component 3 – Project Implementation Support:* finances a project coordinator and oversight mechanisms for the project to ensure private sector stakeholder involvement.

Figure 3: Project Overview



Description of activities by component	Amount (US$ millions)
Component 1: Enhancing Interoperability of Digital Payments:	**7.8**
• Introduction of a retail payment switch through acquiring the necessary hardware and software • Putting in place the required institutional framework for the retail payment switch to be developed and implemented as a sustainable business model	
Component 2: Ensuring the Viability of the Payments System through Increasing Usage	**3.5**
Sub-component 2a: Supporting Linkages to the Payments System:	*1.35*
• Facilitating digital and other financial access points • Facilitating government payments and revenue collection via electronic methods	
Sub-component 2b: Supporting Rural Connectivity with the Payments System	*1.45*
• Assessing opportunities for underserved areas of the country to connect to the retail payments system • Facilitating connectivity to the payments system for rural financial service providers	
Sub-component 2c: Overcoming Regulatory and Cybersecurity Hurdles to the Viability of the Payments System	*0.7*
• Implementing cybersecurity improvements needed for the payments system • Implementing needed guidelines and legal and regulatory reforms to support the development of the payments system • Implementing financial awareness efforts related to digital financial services	
Component 3: Project Implementation Support	**0.7**
• Facilitating the successful implementation of the project through putting in place the institutional framework required (e.g., project coordinator, etc.) • Facilitating private sector involvement in the project through the creation of a private sector committee	
TOTAL	**12**

<u>Component 1: Enhancing Interoperability of Digital Payments</u>
Estimated Cost: US$7.8 million

40. **Recognizing the limitations in the current electronic payment system landscape in Sierra Leone and the significant constraint this has on improving the delivery of electronic payments in the country, the Ministry of Finance and BSL have requested support from the World Bank to establish a retail payment switch at the BSL with various functionalities.** The three primary goals of the retail payment switch are to: 1) help address issues of interoperability of electronic payments, including government to person (G2P) payments, 2) connect MFIs and MNOs to the country's payments system, and 3) improve the convenience and user experience for customers transacting electronically. The switch has positive implications for access point development and financial inclusion in financially excluded regions as it will help enable these institutions provide new financial services and have more income generating services to be more viable entities.

41. **The switch is to be initially owned, operated, and housed by the BSL, as is the case with central banks in other contexts.** To operate the switch, the BSL will need to establish a switch unit within the payments system unit and hire additional staff to operate the switch. The switch unit will operate just as a switch company would in other contexts, helping to manage the switch and promote obtaining volume on it. Initially, the BSL will have majority ownership, but there are plans to dilute its shareholding over time with the private sector eventually having majority ownership. In order to help facilitate this, the profits of the switch will be segregated and will

only be utilized to invest in continuing modernatization and improvements of the payments system[3].

Box 3: Maximizing Finance for Development

The Maximizing Finance for Development (MFD) approach aims to leverage the private sector and optimize the use of scarce public resources, as well as crowd-in private sector solutions working with development partners to achieve the SDGs. A core question involved in determining whether a public-sector solution is appropriate is whether there is a sustainable private sector solution. In this case there is not, as the low levels of financial sector usage in the country initially make the investments required unattractive for the private sector. While there is a plan for the government to divest from the retail payment switch and transfer responsibility to the private sector, this will require several years until the usage of the system is adequate enough for the private sector to consider investing in the system. The project will crowd-in the private sector through facilitating private sector investment in the retail payment switch, which will help facilitate further investments in the modernization of the payments system until the government divests from its ownership stake. The public-sector investment in improving the payments system will also help spur private sector investment in new payments products and services that utilize the switch, which will promote financial sector inclusion and deepening.

42. **This component will finance the needed hardware, software, and services required to introduce the retail payments switch.** It will also ensure that the necessary institutional framework and requirements are in place in order to drive the successful introduction and operation of the retail payments switch. Considering the previous issues with procurement of the retail payments switch, the component will also provide procurement support in order to ensure the success of this component and the World Bank will devote additional resources to overseeing the procurement involved in this component.

43. **The World Bank's involvement in the implementation of a retail payment switch is important for its successful procurement and implementation, considering the past unsuccessful attempts at procurement and the World Bank's technical and procurement expertise in this area.** There have been two previous unsuccessful procurement attempts for the switch. In light of this, the BSL has requested World Bank support to help ensure that the procurement and installation of the switch are done according to international best practices. Through its expertise on payments system and switches, the World Bank's involvement will also help ensure that the improvements in the payments system facilitate increased financial inclusion and ensure that the system is run in a manner that makes it sustainable in the long term. This is especially important considering the issues related to the performance of the ACH following its installation in 2013.

44. **As the retail payment switch is a new piece of the payment system in Sierra Leone, the project will also finance other aspects required to operationalize, manage, and supervise a switch.** Expertise will be required to: i) develop plans to manage the switch; ii) prepare a business plan that outlines the business case and revenue potential for the switch given the needs of the financial sector and broader public (i.e., supporting digitizing government payments and the development of products and services that utilize the switch). This plan will help ensure the financial sector is ready to utilize the switch and to develop a plan to get volume on the switch (i.e., activities from government payments to support the development of products/services that utilize the switch); iii) support dialogue on requisite changes to the regulatory work needed to facilitate operationalization of the switch; iv) help the switch go live; v) build BSL capacity and organizational structure to supervise switch activities;

[3] These profits are primarily based on annual and per transaction fees from the financial service providers that are members of the retail payments switch.

and vi) build a secure and compliant retail payment switch entity.

45. **The activities of component 1 will aim to:**

i. Introduce retail payment switch through acquiring the necessary hardware and software
ii. Put in place the required institutional framework for the retail payment switch to be developed and implemented as a sustainable business model.

<u>Component 2: Ensuring the Viability of the Payments System through Increasing Usage</u>
Estimated Cost: US$3.5 million

46. **This component would seek to help increase the usage and viability of the retail payment switch and pre-existing payments system (i.e., ACH, mobile money, etc.)** through activities in three sub-components: a) supporting linkages to the payments system; b) supporting MFI's connectivity to the payments system; and c) overcoming regulatory and cybersecurity hurdles to the viability of the payments system.

<u>Component 2a: Supporting Linkages to the Payments system</u>
Estimated Cost: US$1.35 million

47. **To help facilitate the usage of investments in the retail payment switch, the project aims to support the expansion of access points linked to the switch.** This will include POS terminals, mobile wallets and other digital access points that facilitate government and other payments. An expanded number of POS will facilitate a variety of services for Sierra Leoneans that provide volume for the retail payment switch, including: merchant transactions with credit and ATM cards linked to the switch and from Visa and Mastercard, the collection of government revenues via card payments and other electronic mechanisms, and the roll out of the agent banking model as agents can utilize POS to process transactions as agents on behalf of financial institutions.

48. **The project will support increased digital access points, which can be a major driver of usage of the payments system and financial inclusion.** Digital financial services have been shown to be particularly effective for improving financial inclusion, especially in hard to reach rural areas. Thus, the project includes support to further enhance the spread of mobile wallets and other digital payments products.

49. **The project will support an increase in electronic government payments.** As a switch can facilitate interoperability between financial service providers, it stands to play a significant role in supporting government (and other) payments across financial institutions**.** To facilitate government payments via the retail payment switch, it is necessary to digitize government payments and connect government human resource payments system. The government is currently investing in the hardware and software necessary to allow for the digitization of government payments through the World Bank Public Financial Management and Improvement Project. While the retail payments switch will improve the efficiency of the improvements made in the government payments system, this subcomponent focuses on introducing needed functionality in the payments system and financial service providers to facilitate the desired increase in digital government payments.

50. **The activities of component 2a will finance:**

(i) Facilitate digital and other financial access points
(ii) Facilitate government payments and revenue collection via electronic methods.

Sub-component 2b: Supporting rural connectivity and Linkages to the Payments System
Estimated Cost: US$1.45 million

51. **Rural connectivity to the payments system will require additional efforts.** As indicated earlier, access to finance in rural areas is particularly low. MFIs are particularly important branch based financial service providers in these areas. Without connectivity to the payments system, MFIs cannot receive or process ACH payments nor can they be connected and benefit from the investment in the retail payment switch, and thus they will remain isolated institutions in which consumers cannot process transactions between different institutions. For example, a member of a FSA cannot currently access their funds at another FSA, or at a MFI, CB, or commercial bank. Consequently, MFI members (almost 190,000 across all four types of MFIs) remain dependent on cash transactions since they cannot process transactions between other financial institutions.

52. **This subcomponent will provide support to rural financial service providers to properly connect to the country's payment systems infrastructure.** This includes digital financial service providers as well as MFIs. Activities proposed include supporting Apex Bank, which is responsible for the 17 community banks and 59 FSAs, via needed hardware/software and consulting services to facilitate connectivity to the retail payments switch for the community banks and FSAs. It will also directly support FSAs and community banks in utilizing the retail payments switch, including via training on how to effectively utilize core banking applications (CBAs). Support in connecting other rural service financial service providers to connect to the payments system will also be provided (including the 2 deposit taking MFIs, 12 credit only MFIs and digital financial service providers).

53. **The activities of component 2b will aim to:**

(i) Assess opportunities for underserved areas of the country to connect to the retail payments system
(ii) Facilitate connectivity to the payments system for rural financial service providers.

Sub-component 2c: Overcoming Regulatory and Cybersecurity Hurdles to the Viability of the Payments System
Estimated Cost: US$0.7 million

54. **This subcomponent will support needed improvements in the security of the payments system at the BSL.** The successful implementation and acceptance of the payments system will require assurances in the security of the system. Thus, the project will finance a cybersecurity assessment and activities to put in place changes in the systems and policies needed to decrease cybersecurity risks.

55. **Needed improvements in the legal and regulatory framework for the payments system will also be supported, including:**

a. Guidelines for licensing and supervising money transfer operations: With regard to remittances for example, the BSL could clarify that non-bank financial institutions can facilitate the termination of inbound remittances onto mobile money, thus providing an opportunity for this large inflow of funds to improve financial inclusion throughout the country. In the absence of this clarity, none of the providers have partnered with money transfer operators to facilitate the termination of transactions onto a mobile wallet. By allowing mobile money providers to participate in the market, the BSL would significantly increase the pay-out options for international remittances customers in Sierra Leone, given the number of mobile money agents throughout the country. For non-mobile money customers, who receive international remittances, allowing termination onto a mobile wallet, that can then be cashed out at an agent location, could encourage this market segment to open new accounts given the increased convenience gained from a broader network of payout locations. For countries such as Kenya and Ghana, where the termination of international remittances transactions onto a mobile wallet is permitted, growth in this use case has been significant. Thus, it is important to work with BSL to develop effective guidelines for licensing and supervising money transfer operators offering services to Sierra Leone.

b. Development of Unstructured Supplementary Service Data (USSD) regulations and guidelines: The design of basic transaction accounts and access to them is limited by the fact that banks struggle to access USSD channels for delivering financial services via mobile phones. Banks continue to report challenges with gaining access to USSD channels, citing this as potentially uncompetitive behavior on the part of the Telco's. Telecommunications Commission (NATCOM) has acknowledged the issue and is keen to develop guidelines in the short-term to improve access for non-MNO-linked financial services. In the medium term, NATCOM plans to develop specific regulations on access, use, and security.

c. Development and implementation of guidelines, reforms, and other measures on electronic payments system and DFS, along with the BSL capacity building on electronic payments and DFS: BSL would benefit from capacity building to support reforms in the legal and regulatory space surrounding electronic payments system, advancing DFS, and strengthening the oversight of retail payments system. At present, timeframes for reviewing new products and services by the BSL were also described by financial sector stakeholders as prohibitive and inconsistent. A number of providers, namely banks and fintechs, requested that standardized response times for new proposals be adopted to improve communication between the BSL and applicant firms.

56. **A key constraint to the demand for financial services is the low level of financial awareness of digital financial services in Sierra Leone.** Consultations with financial sector stakeholders highlighted low levels of financial and digital literacy as major barriers to the uptake of financial services, including basic transaction accounts. A lack of understanding of how mobile money works remains a major barrier to usage, with the prevailing perception that cash remains the safest way to transact. This is further compounded by a limited knowledge of how formal financial services can assist in achieving financial independence and stability. In order to address this, the project will finance a select number of pilot studies that will aim to increase financial awareness in areas that could drive increased usage of the payments system.

57. **The main activities to be financed by component 2c include:**

i. Implement cybersecurity improvements needed for the payments system
ii. Implement needed guidelines and legal and regulatory reforms to support the development of the payments system
iii. Implement financial awareness efforts related to digital financial services.

Component 3: Project Implementation Support
Estimated Cost: US$0.7 million

58. **Hiring of a project coordinator is critical to the successful implementation of this multi-dimensional project.** The main project coordinator will support the overall project and will work closely with the implementing entity, the BSL. More specifically, the project coordinator will work under the BSL unit in charge of implementing the project. The project coordinator will help manage the day-to-day affairs, such as unlocking bottlenecks in implementation, procurement, and coordination. This position will also serve to help build BSL's capacity to oversee and implement a World Bank project.

59. **A technical lead will support implementation of component 2,** which aims to increase usage of the payments system. Unlike subcomponent 1 that primarily involves only the BSL, the second subcomponent involves dealing with a wide range of stakeholders, including rural finance providers and government agencies. A technical lead with expertise in these areas will help ensure that there is appropriate attention to implementing this component.

60. **The project will also provide support for the establishment of a private sector committee under the broader project's governance framework.** This committee will help facilitate a fully functioning switch as it will provide a forum for private sector stakeholders to regularly meet, discuss challenges, and devise solutions for a fully functioning switch and the broader project. More broadly, the project also presents an opportunity for a forum to facilitate public-private financial stakeholder dialogue and increase cooperation between BSL and Ministry of Finance (MoF) on related matters, where relevant.

61. **The activities of Component 3 will aim to**:

i. Facilitate the successful implementation of the project through putting in place the institutional framework required (e.g., project coordinator, etc.)
ii. Facilitate private sector involvement in the project through the creation of a private sector committee

C. Project Beneficiaries

62. **The primary beneficiaries of this project are individuals residing in Sierra Leone, including both financially excluded and included individuals.** Through support to the Bank of Sierra Leone and MoF, the project's components will ultimately benefit the following:

a. Retail services utilizing POS systems.
b. Financial institutions utilizing the retail payment switch, POS systems, and those that receive support for connectivity and core banking application. It is also believed the regulatory work will directly benefit financial institutions (and consumers).
c. Consumers benefitting from the new products and services available under the project. It is also envisioned that this project will have a relatively significant impact on residents of rural areas, through financing for MFI's connectivity and core banking applications, as well as for POS terminals.
d. BSL through capacity building, its new role driving the switch and the revenues therefrom.
e. MoF through the project's financing of the private sector committee.
f. NRA through investments to increase their capacity to collect revenue electronically and make digital payments.

D. Results Chain

Activities	*Outputs*	*Outcomes*	
<u>1. Enhancing Interoperability of Digital Payments</u> • Introduction of a retail payment switch through acquiring the necessary hardware and software • Putting in place the required institutional framework for the retail payment switch to be developed and implemented as a sustainable business model	A switch is launched and operational	Enhanced interoperability between retail payments system (ATM, POS system, mobile payment system, internet-based portals, etc.) to allow cross network acceptance of payments **(Interoperability)**	
<u>2a. Supporting linkages to the payments system</u> • Facilitating digital and other financial access points • Facilitating government payments and revenue collection via electronic methods	Increased number of access points for the retail payments system installed in targeted areas and capacity building provided System for electronic Government payments and the collection of government revenues installed, and capacity building provided	Increased access points for the retail payments system **(Access)** Increase efficiency of government payments **(Access)**	• **Increased usage of digital payments** • **Increased access to financial services**
<u>2b. Supporting Rural Connectivity with the payments system</u> • Assessing opportunities for underserved areas of the country to connect to the retail payments system • Facilitating connectivity to the payments system for rural financial service providers Needs assessment to identify opportunities for rural financial institutions to connect to the retail payments system, including for Apex Bank	Rural financial service providers connected to the payment system (e.g., ACH, Switch)	Consumers in rural areas able to transfer between bank account, mobile wallet, and MFI saving accounts **(Access)**	
<u>2c. Overcoming Regulatory and Cybersecurity Hurdles to the Viability of the Payments Systems</u> • Implementing cybersecurity improvements needed for the payments system • Implementing needed guidelines and legal and regulatory reforms to support the development of the payments system • Implementing financial awareness efforts related to digital financial services	• Cybersecurity improvements installed • Money transfer licensing and operations guidelines developed and adopted • USSD regulations and guidelines and other measures developed and adopted • Financial literacy modules developed and disseminated	Increased level playing field, allowing all players (banks, MFIs, e-money providers) to participate in the digital finance space, thus fostering competition and enhanced services Consumers increased knowledge on financial products, and DFS **(Access)**	

E. Rationale for Bank Involvement and Role of Partners

63. **The implementation of improvements in the payments infrastructure supported by the project are likely to facilitate notable development gains, and spur private sector investment.** The retail payments switch stands to help increase the usage and efficiency of the delivery of financial services through facilitating interoperability between financial service providers, including banks, mobile money operators, and MFIs. This is likely to lead to an increase in account usage in the country, and gains in financial inclusion. The introduction of a retail payment switch will also spur investment in the private sector as it will help create opportunities to extend financial services to remote locales and better connect microfinance institutions and mobile money operators to the electronic payments system allowing for increased financial flows and services by these institutions. The retail payment switch functionality will include the ability to provide access for other digital and innovative payment methods, thus providing an avenue for the development of innovative private sector solutions. The switch will also lower the cost of and increase the viability of ecommerce, therefore making ecommerce business models more profitable. As this project contributes to the development of the digital economy, this would also spur private sector investments via an expansion of digital entrepreneurship and digital financial services.

64. **Given the importance of the financial sector to economic development, there is a strong rationale for World Bank involvement in helping provide public financing to overcome a critical market failure (lack of a switch) and stimulate private sector investment in the sector.** As noted earlier, the private sector investment potential in improving the payments system is limited due to the low level of usage of the overall system. The improvements in the payments system that are financed by the project can only be made viable if there is a significant volume of transactions. Thus the project design that includes mechanisms for increasing usage will be a critical driver of the sustainability of the investments made in the payments system.

65. **The project will leverage World Bank international experience in payment system's development as well as procurement expertise.** The World Bank has vast experience in retail payment switch projects, which will help ensure that the switch is designed and implemented in line with international good practices. The World Bank's procurement expertise is also a critical driver of the rationale for World Bank involvement in the project as there have been two previous procurement attempts for the retail payment switch, both of which were unsuccessful. The World Bank has a long-standing engagement with the BSL, so it is aware of the problems faced during the last failed procurement of the switch. In addition, World Bank IT procurement expertise will help design the project and provide support in such a way as to minimize the risks of another failed procurement.

66. **The World Bank's complementary support for digitizing government payments is also a significant rationale for World Bank involvement**. The project will coordinate its activities with the World Bank Public Financial Management and Improvement Project and other efforts aimed at digitizing government payments. This will help to ensure that the retail payments switch includes the necessary functionality to digitizing government payments. Furthermore, the project's focus on financial institutions connectivity is in line with the Regional Connectivity and Transformation Project, which aims to "deepen reforms for connectivity and to extend the benefits of connectivity to people regionally using enabling ICT applications."

67. **The project reflects key BSL priorities, including helping with their and United Nations Capital Development Fund's (UNCDF) ongoing efforts in implementing their National Strategy for Financial Inclusion and faciliting innovation in digital financial services.** The retail payment switch is a long standing top prority of the BSL and was a key request of the previous Governor and the Deputy Governor at the FY18 Annual and Spring Meetings, respectively. As previously noted, UNCDF has supported the BSL with the development of the Strategy for National Financial Inclusion, which aims to promote: interoperability, government payments and other,

access to financial services, financial capacity, among others, all of which are the basis of this project.

F. Lessons Learned and Reflected in the Project Design

68. **The design of this project reflects lessons from two key experiences:** the previous World Bank financial sector project in Sierra Leone, Financial Sector Development Plan Support Project (FSDP) (2011-2017) (P121514) and past attempts by the BSL to procure a retail payment switch by itself.

69. **The project reflects lessons learned from the previous financial sector project in Sierra Leone FSDP.** Key among the lessons, were the need for a simple project design that focused resources and reflected BSL priorities, a robust governance structure to ensure decisions are made, implementation bottlenecks are addressed, and coordination takes place between the project's stakeholders, and limited client capacity to implement a World Bank project.

70. **Reflecting on these lessons, the project includes significant support to ensure project implemention.** The component that finances the retail payments switch also supports activities that are needed beyond the hardware and software to ensure the successful implementation of the retail payments switch. Project implementation support also includes not only an overall project coordinator, but also a a technical lead for those activities related to component 2 that focuses on increasing usage of the payments system and involves a broader set of stakeholders.

71. **The project also introduces a robust governance structure based on the lessons learned from previous projects.** FSDP had envisioned governance structures within BSL (steering committee) to support project implementation. However, the governance structure envisaged was not operational and met just twice, in part due to frequent changes in BSL leadership. This resulted in key decisions not being made or delayed significantly. The project also envisaged a separate steering committee to support interaction between the BSL and the private sector, but this steering committee never met. In light of this, the project includes a dedicated project support to implementing the needed governance structures, both within the BSL and with private sector project stakeholders.

72. **The difficulties in procurement during previous projects have also been factored into the design of the project.** FSDP faced challenges in procurement, resulting in intended tasks not being carried out effectively. Consequently, the project has allocated resources to support the highest risk procurement items; this includes for the hardware and software necessary for the retail payment switch. Additionally, procurement (and Financial Management) will be led by MoF with support from the BSL, as MoF has extensive experience implementing World Bank projects.

73. **The project also reflects the issues that occurred due to the broad scope of the FSDP project.** FSDP attempted to support reforms in various areas of the financial sector which were not prioritized (in part due to frequent changes in BSL leadership) and thus decisions on key activities to be funded faced challenges and took time. Additionally, activities were not sequenced reflecting priorities, and this resulted in a reduced logic to the ordering of the array of activities implemented in different areas. This project is designed to support a more cohesive and focused set of activities that are part of a key BSL priority (the retail payment switch). It also includes sequenced activities intended to help make the switch and other electronic payments systems more financially viable, and to maximize impact for beneficiaries and the economy.

III. IMPLEMENTATION ARRANGEMENTS

A. Institutional and Implementation Arrangements

74. **The BSL will be the implementing agency, with support from consultants, and procurement and financial management will be led by MoF's PFMU.** Project implementation will be mainstreamed into the work program of various BSL departments and units with overall coordination by the Financial Sector Development (FSD) unit. MoF's PFMU, which has experience with World Bank projects, will oversee procurement and financial management and will be provided with support through this project. Given BSL's limited human resources and experience with World Bank projects, BSL will be supported by a Project Coordinator with relevant experience. Furthermore, the retail payment switch component (component 1) will be supported by an array of relevant experts, including a consultant to help provide inputs on procurement, get the switch up and running, and help it become viable by ensuring adequate growth in electronic payments systems using the switch. A technical lead will focus on implementing component 2 that aims to increase usage of the financial system.

75. **The project will have a steering committee to ensure that critical decisions are made, oversight, and coordination between different stakeholders.** A key challenge in BSL's previous project, FSDP, as identified in its ICR, was that it did not have an effective governance framework, which precluded coordination and critical decisions being made to support implementation of the project. Consequently, a project steering committee that includes representatives of key Ministries, Departments, and Agencies will be established. These will include representatives from BSL departments and units, the MoF, NRA, NATCOM, and the Directorate of Science and Technology (Office of the President). It will also include representatives from the private sector, including the Sierra Leone Association of Commercial Banks. Meetings will be held on a monthly basis and will aim to ensure that key decisions are made with respect to the project in a timely and regularized manner.

76. **The project will also have a consultative private sector committee to facilitate dialogue between financial institutions and project management.** Given that the project will finance investments that the private sector will utilize (e.g., the switch) and other investments directly for the sector (e.g., connectivity for MFIs), it is critical that project implementation is informed by BSL-private sector interaction to ensure that the project is meeting the latter's needs.

B. Results Monitoring and Evaluation Arrangements

77. **Monitoring and Evaluation (M&E) will be undertaken by the BSL FSD unit in cooperation with implementing units at BSL.** The project M&E framework will follow the PAD's results framework. The primary source of data will be the reporting that is collected from the payments system at the BSL. The project will also facilitate the disaggregation of this data to be able to better monitor the impact of the project activities on financial inclusion, digital payments, and government payments. Data related to gender will be collected via Findex.

78. **M&E data will be collected and analyzed in a quarterly report.** To ensure progress on project implementation, an M&E report will be produced and be a primary subject of discussion at the regular steering committee meetings. In parallel, as part of its supervision, the World Bank will also conduct Implementation Status Reports every six months, a mid-term review will be conducted half-way through project effectiveness, and an ICR will be completed within six months of the project closing.

C. Sustainability

79. **As previously noted, the project has strong country ownership as it is designed to help provide implementation support of the country's financial inclusion strategy, reflects the key request of the central bank during the 2017 Annual Meetings, and supports the country's SCD (expected to be reflected in the Country Partnership Framework) with the World Bank.** In particular, the project will directly support all five of the six "Strategic Areas" of the National Strategy for Financial Inclusion, while indirectly supporting the sixth (M&E of financial inclusion activities). Secondly, the retail payment switch was the key request of the Governor at the 2017 Annual meetings and reiterated by the Deputy Governor in 2018 Spring Meetings. The project also draws its justification from the country's SCD. In particular, the project will also support access to credit (Priority Area 4) through improving consumer capacity to demand financial products and services with a full knowledge of how they work through the financial capability activities. The project also stands to support strengthening of health institutions for service provision and resilience to public health emergencies (Priority Area 8) and improve quality and access to education (Priority Area 9) through bolstering the infrastructure to facilitate government payments and directly supporting such efforts, which stands to increase the payment of health and education civil servants, which has positive implications for their quality of work and attendance.

IV. PROJECT APPRAISAL SUMMARY

A. Technical, Economic and Financial Analysis

80. **The proposed project is expected to increase efficiency in financial services, access to finance, and financial inclusion, all of which contribute to positive outcomes in support of economic development.** This project aims to increase efficiency in financial services through an array of activities such as promoting interoperability through the financing of a switch and activities aimed at driving usage of the payments system. This will have significant economic benefits for individuals, businesses, financial institutions and the government. For example, the retail payments will enable more convenient, cheaper, and/or alternative options for making or receiving payments, which has direct cost savings for individuals. The improvements in the payments system will also lower the cost of and increase the viability of ecommerce, therefore making ecommerce business models more profitable. As this project contributes to the development of the Digital Economy, this would also spur private sector investments via an expansion of digital entrepreneurship and digital financial services. The project will facilitate easier access to accounts through mobile phones, including for teachers, which will reduce teacher absence and the cost and risks of physically accessing salaries, among many other benefits. This project will also help support efficient services by easing the transactional burden of paying taxes and promoting the digitization of government payments. The project will also support financial inclusion through an array of activities from helping develop access points to helping bolster consumer demand for formal financial services. Increasing financial inclusion is critical to ensure that households and businesses are able to save and invest for future needs while having the tools to manage their financial lives, including mitigating against financial risks. The increase in the digitization of government payments will also likely result in cost savings to the government.

81. **The project has been designed in line with international best practices for public sector solutions for retail interoperability.** As indicated earlier, private sector solutions to facilitate interoperability are preferred, and are usually led by industry associations or private sector companies. This is due to the risks of top-down

public-sector mandates that create intransigence on the part of providers. In Sierra Leone, efforts to facilitate private sector solutions have not materialized, in part due to the level of investment required to develop a retail payment switch and the benefits that will mainly accrue to smaller financial service providers. The investment required to implement a private sector retail payment switch is unlikely to be viable due to the relatively small number of customers relative to the size of the country, the primarily cash-based economy, and low levels of trust in the formal financial system. Thus, within the context of Sierra Leone there is a clear rationale for a public-sector solution to facilitate interoperability at this time. The project has also been designed to minimize the risks of a government mandated top-down solution that is not accepted by financial service providers. This has been done through inclusion in the project for support of a private sector committee that will ensure buy-in by financial service providers. The project also has been designed to facilitate the public-sector exit and transfer of responsibility for ensuring interoperability to financial service providers by including in parallel a focus on increasing overall usage of the payments system in order to make private sector investments viable in the future.

B. Fiduciary

(i) Financial Management

82. **The Bank conducted a Financial Management (FM) assessment to determine the adequacy of the financial management systems of the Project Fiduciary Management Unit (PFMU) of the Ministry of Finance.** The assessment concluded that the FM systems of the PFMU of the MoF meet the Bank's minimum requirements for the administration of projects funds under Bank Policy/Directive for Investment Project Financing.

83. **The PFMU is headed by a Team Lead who is responsible for ensuring the overall direction of work at the Unit.** Under the direction and supervision of the Team Lead, the entire PFMU financial management team that is comprised of the Finance Management Specialist (a qualified accountant), Finance Officer, Assistant Finance Officer, a Finance Assistant and two Administrative Finance Assistants is responsible for all the day-to-day financial management functions of specified donor funded projects.

84. **The PFMU has satisfactory planning and budgeting, accounting, internal controls, financial reporting and external auditing processes in place that will support the effective and efficient utilization of resources for the proposed project.** The related operational costs of maintaining the staff during the life of the project, including computer hardware, stationery, mailing withdrawal applications, and printing project FM reports will form part of the costs that the project shall bear as part of project management costs.

85. **The PFMU will open a USD denominated Designated Account (DA) at a commercial bank approved by the Bank.** The project will use report-based disbursements through the submission of quarterly Interim Financial Report (IFRs) on the sources and uses of project funds. A forecast of the first 6 months' expenditures will form the basis for the initial withdrawal of funds from the Credit, and subsequent withdrawals will be based on the net cash requirements.

86. **The project will follow a cash basis of accounting and financial reporting and will submit, within 45 days of each Government of Sierra Leone (GoSL) fiscal quarter, quarterly interim financial reports (IFRs) of the project activities.** At a minimum, the constituents of the IFRs will be: (a) A statement of sources and uses of funds for the reported quarter and cumulative period from project inception, reconciled to opening and closing

bank balances, (b) A statement of uses of funds (expenditures) by project activity/component, comparing actual expenditures against budget, with explanations for significant variances for both the quarter and cumulative period, and (c) Designated Account Reconciliation Statement.

87. **The annual audited financial statements of the project shall be submitted to IDA within 6 months of the end of the GoSL's fiscal year (i.e. by June 30 each year).** The external auditors will conduct the audits on the project financial statements on terms of reference as agreed with the Bank.

88. **Based on the assessment conducted, the overall FM risks were rated as 'High' before mitigation.** If the planned risk mitigation measures are properly implemented, the residual FM risk is anticipated to be rated as 'Substantial.' A detailed description of the FM assessment is included in Annex 3.

(ii) Procurement

89. **Procurement under the proposed project will be carried out** in accordance with the World Bank's (a) "Procurement Regulations for IPF Borrowers" (Procurement Regulations) dated July 2016 and revised in November 2017 and August 2018, (b) the "Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants", dated July 1, 2016, and (c) other provisions stipulated in the Financing Agreements.

90. **Implementation arrangements:** Procurement under this project shall be carried out by the Project Fiduciary Management Unit (PFMU) that is under Ministry of Finance. The government of Sierra Leone has established a single fiduciary management unit called Project Fiduciary Management Unit (PFMU) under the Ministry of Finance to manage all Bank finance projects.

91. **Procurement Planning:** A Procurement Plan was prepared by the government and agreed upon by the Bank detailing the activities to be carried out during the first 18 months reflecting the actual project implementation needs and the plan was submitted before negotiations.

92. **Use of Country Systems:** For procurements involving Procurement Procedures below the defined thresholds, national procurement systems may be used as defined by the Project Procurement Strategy for Development (PPSD). Open competitive approach to the market will be the Bank preferred approach as it provides all eligible bidders/proposers with timely and equal opportunity to provide the required goods or services.

C. Safeguards

(i) Environmental Safeguards

93. **The project activities do not have a physical footprint and project activities are expected to have negligible environmental impact; hence the policies on environmental assessment are not triggered for this project.** Project activities are limited to promoting interoperability between financial services, facilitating access points to the retail payments switch, connecting MFIs to the payments system, and supporting needed cybersecurity and regulatory reforms to ensure the viability of the improvements supported in the payments system. Hence there are no safeguards instruments required for this project, however the team will continue

to monitor project activities to ensure that project activities remain within the scope as determined during appraisal. The team will ensure that the safeguards approach is reviewed should any change in project activities or scope occur during implementation.

(ii) Social Safeguards

94. The project does not trigger any of the social safeguards policies. There are no physical works that will likely result in land acquisition or any form of displacement or resettlement. Project activities are limited to promoting interoperability between financial services, facilitating access points to the retail payment switch, connecting MFIs to the payments system, and supporting needed cybersecurity and regulatory reforms to ensure the viability of the improvements made in the payments system.

(iii) Gender and Social Inclusion

95. **Access to financial services remains low overall in Sierra Leone, 19.8 percent of the adult population have an account with a formal institution or mobile money provider and even lower for those living in rural areas (14.4 percent) and** women (15.4 percent). In Sierra Leone, 53.5 percent of farming businesses and 63.8 percent non-farm businesses are run by women, yet women largely use informal financial services (6 percent of women in rural areas own a bank account). Some of the barriers that restrict women's ability to access financial services include limited financial awareness and literacy levels, limited physical outreach, etc. Persons with disabilities face greater barriers that limit their access to financial services, such as a lack of physical access, absence of braille signs and audio services for ATMs and sale terminals, etc. There are also disparities in geographical location of banking services. Financial services are concentrated in Freetown, thus excluding the bulk of the rural populations of the country.

96. **The project design will include a focus on underserved segments of the financial system.** This will be accomplished by:

- Facilitating branch based and digital financial service products in rural areas;
- Ensuring data collection on access to financial services for women as part of the M&E framework;
- Design guidelines and interventions for electronic payments system to ensure the use of accessible technologies according to universal design principles;
- Roll out of point of sale terminals in locations that provide ease of access.

(iv) Stakeholder Engagement

97. While the project presents minimal social risks, the project design has been informed by significant stakeholder engagement during project preparation. The World Bank has engaged not only public institutions such as BSL and MoF, but also private sector stakeholders, including banks, MFIs (FSAs, CBs, and deposit and non-deposit taking MFIs), and MNOs. This stakeholder engagement will continue during project implementation, primarily via the private sector committee that the project supports. The number of private sector committee meetings is included as a results indicator. The project will also ensure BSL establishes a forum for citizen engagement regarding the project and will finance information and outreach campaigns plan aimed at deepening public engagement and receipt of complaints feedback of the project activities. The project steering committee and consultative private sector committee will review the results of these outreach campaigns, including complaints received, and ensure that they are incorporated into the project during implementation.

(v) Grievance Redress Mechanisms

98. **Communities and individuals who believe that they are adversely affected by a World Bank (WB) supported project may submit complaints to existing project-level grievance redress mechanisms or the WB's Grievance Redress Service (GRS).** The GRS ensures that complaints received are promptly reviewed to address project-related concerns. Project affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit *http://www.worldbank.org/en/projects-operations/products-and-services/grievance-redress-service*. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org.

V. KEY RISKS

Table 2: Risk Rating Summary Table

Risk Categories	Rating
1. Political and governance	Substantial (S)
2. Macroeconomic	S
3. Sector strategies and policies	S
4. Technical design of project	S
5. Institutional capacity for implementation and sustainability	S
6. Fiduciary	S
7. Environment and Social	Low
8. Stakeholders	Moderate
9. Other	
Overall	S

99. **The overall project risk is substantial.** The following risks are rated as substantial: political and governance; macroeconomic; sector strategies and policies; technical design of the project; institutional capacity for implementation and sustainability; and fiduciary.

100. **The Political and Governance risk is rated as substantial.** The main political and governance risk from this project is the frequent changes in the BSL leadership. The previous World Bank project, FSDP, was negatively impacted by frequent changes in the BSL leadership (e.g., five different BSL Governors in the course of the seven years the project was operating), in which key decisions to support project implementation and restructuring were not made by management. During the preparation of this project, there also has been turnover in the Governor of the BSL. To mitigate against this risk, the project will provide support to a steering committee for the project to ensure that support for the project is broad based and is not dependent on any one individual.

101. **Macroeconomic risk is substantial.** Macroeconomic situation remains challenging following a significant slowdown in economic growth in 2017, to 3.8 percent from 6.4 percent in 2016. Economic growth is expected to remain stagnant at 3.7 percent in 2018, revised downwards from an initial projection of 5.1 percent, reflecting the closure of the main iron ore mine early in the year. After declining from 15.3 percent in December 2016 to

14.9 percent in March, inflation rose sharply to 16.5 percent in June 2018, reflecting increased volatility of the exchange rate and food supply constraints during the rainy season and the holy month of Ramadan (Islamic fasting period). The Leone came under sudden pressure in June, depreciating respectively by 7.0 percent and 8.1 percent (YoY) in the official and parallel markets. The current account is also expected to widen to 25.5 percent of GDP due to the anticipated fall in exports following the suspension of iron ore production. Inadequate budget revenue and spending overruns have led to a considerable increase in the stock of budget arrears over the last year, representing the main threat to near-term macroeconomic stability. The government has recorded persistent fiscal deficits over the last three years which are financed mainly by borrowing from the banking system and the accumulation of suppliers' arrears, a type of forced financing which hurts the economy by reducing the confidence of private agents in the government, squeezing liquidity of banks, and increasing cost of capital projects. Total arrears accumulated in 2017 and 2018 stood at Le 0.81 trillion while financing by the banking system stood at Le 0.20 trillion in the first half of 2018. As a result, the banking system's stability remains fragile though stable while NPLs were above 15 percent of total loans in December 2017. In addition, the tighter policy stance of BSL to control inflation has led to tighter liquidity conditions in money markets with some commercial banks facing increased liquidity constraints. Private sector credit growth also declined to 4.9 percent from 16.7 percent in 2016 reflecting the slowdown in economic activities, increased credit risks and limited investment opportunities for banks.

102. **Sector strategies and policies risks are substantial.** The current project supports a core part of the BSL's Strategy for Financial Inclusion related to improvements in the payments system. The alignment with the BSL's strategy minimizes the risks to this project. However, the sector strategies and policies risk remain substantial due to the financial stability risks in the sector, primarily related to the poor performance of two state-owned banks that combined account for 28.6 percent of assets, 36.2 percent of deposits, and 23.8 percent of credit. Beyond the stability risks posed by these two banks, they are primarily utilized to provide low cost financing for the government, and therefore can limit access to finance for the private sector and households. However, the government has committed to efforts aimed at improving the performance of these institutions and limiting their usage as a vehicle for low cost financing of the government and has requested World Bank technical assistance to support these efforts.

103. **The risks associated with the technical design of the project are substantial.** Considering the low levels of usage of the financial system in Sierra Leone and the requirements for significant usage to make the necessary improvements in the payments system viable, the technical design risks are substantial. Although the retail payments switch will be cash flow positive, additional investment will be needed in order to make necessary hardware and software upgrades that the project will not finance. The assumption is that this will be needed in 6-7 years. The project includes a mechanism for segregating the profits of the retail payments switch in order to ensure that they can only be utilized for operating expenses or capital improvements required. However, the necessary resources when substantial hardware and software upgrades will be needed will only be realized if there is an increase in usage of the payments system through the activities supported by this project materializes. The project has been designed to facilitate the necessary usage to mitigate against this risk. However, considering the small number of customers relative to the size of the country, the primarily cash-based economy, and low levels of trust in the formal financial system, there is the potential for the required usage to not materialize. In that case additional public-sector resources will need to be provided that cannot be assured.

104. **The subtstanial rating for the technical design risks is also driven by the telecommunications**

infrastructure in the country, which could pose challenges to implementation. Banks are connected to the RTGS and ACH systems using a microwave link, but reliability is an issue as BSL has to align the line of site of the microwave link periodically to keep it working. While the robustness of this connectivity is sufficient for the ACH/RTGS systems (as the services are required only during banks' working hours) and the switch, the switch's connectivity link should be more reliable (i.e., use a fiber optic network) with minimal disruptions to allow for 24-/ services, to encourage usage. While the project can be successful without improvements in the telecomunications infrastructure, additional improvements would help increase confidence and usage in the payments system. In this respect, the project will seek to work with the Regional Connectivity and Transformation Project, to see if the latter has scope for support to the telecommunications infrastructure needed to bolster connectivity for electronic payment systems, including the switch.

105. **Institutional capacity risk is substantial.** As the FSDP ICR highlighted, the BSL lacked experience and capacity to implement a World Bank recipient-executed project. To help mitigate this risk, the project will hire a project coordinator to ensure effective project implementation along with key experts to support efforts around the retail payments switch. A technical lead will also be chosen as part of the project implementation arrangements to support activities related to rural connectivity and government payments. The FSDP ICR noted that the absence of an effective governance structure and frequent changes in BSL leadership had a significant impact on project implementation. Given that the project will require high-level decisions to be made by BSL management, and coordination is required across multiple BSL units and with MoF, having a robust governance framework is imperative. Thus, BSL will establish an effective Steering Committee with direct lines of communication to the Deputy Governor and Governor. The World Bank will also strengthen its supervision efforts during project implementation, and the project includes support for the steering committee and a private sector committee.

106. **The fiduciary risk is substantial.** The substantial fiduciary risk reflects the fact that previous attempts by the government to procure a retail payment switch have not been successful. To mitigate the procurement risk, the BSL has requested extensive World Bank involvement in the procurement process, and the team will liaise with World Bank procurement to develop a procurement strategy commensurate to the high risk. At the same time, the MoF's PFMU will manage financial management and procurement for the project and the World Bank will directly pay large transactions to competitively selected vendors.

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Results Framework

COUNTRY: Sierra Leone
Sierra Leone Financial Inclusion Project

Project Development Objectives(s)

The objective of the project is to increase the interoperability of digital payments and access to financial services.

Project Development Objective Indicators

Indicator Name	DLI	Baseline	End Target
Increased interoperability of digital payments			
Cumulative number of transactions processed through the retail payments switch (Number)		0.00	1,000,000.00
Increase access to financial services			
Financial Institutions connected to and utilizing the retail payments switch (Number)		0.00	14.00

Intermediate Results Indicators by Components

Indicator Name	DLI	Baseline	End Target
Enhancing Interoperability of Digital Payments			
Percentage of commercial banks connected to and utilizing the retail payments switch (Percentage)		0.00	75.00
Cumulative value of transactions processed through the retail payments switch (Amount(USD))		0.00	5,000,000.00

Indicator Name	DLI	Baseline	End Target
Ensure usage and viability of the payments system through increasing usage			
Percentage of mobile money operators (MMOs) connected to and utilizing the retail payments switch (Percentage)		0.00	75.00
Percentage of deposit-taking MFIs connected to and utilizing the retail payments switch (Percentage)		0.00	20.00
Number of POS installed (Number)		200.00	1,200.00
Cumulative number of POS transactions via the retail payments switch (Number)		0.00	200,000.00
Cumulative number of NRA collections or other government payments processed through the payments system (Number)		0.00	50,000.00
Number of guidelines, laws and regulations implemented (Number)		0.00	3.00
Number of Private Sector Committee meetings held (citizen engagement) (Number)		0.00	40.00
Female account ownership at a financial institution or mobile money service provider (Percentage)		15.00	18.00

Monitoring & Evaluation Plan: PDO Indicators

Indicator Name	Definition/Description	Frequency	Datasource	Methodology for Data Collection	Responsibility for Data Collection
Cumulative number of transactions processed through the retail payments switch	Cumulative number of transactions processed through the switch	Annualy	BSL	National Switch Reports	BSL
Financial Institutions connected to and utilizing the retail payments switch	Number of financial institutions connected to	Bi-annual	BSL	National switch reports	BSL

	and utilizing the switch				

Monitoring & Evaluation Plan: Intermediate Results Indicators					
Indicator Name	**Definition/Description**	**Frequency**	**Datasource**	**Methodology for Data Collection**	**Responsibility for Data Collection**
Percentage of commercial banks connected to and utilizing the retail payments switch	Percentage of commercial banks that are connected to the national switch	Bi-annual	BSL	National switch reporting	BSL
Cumulative value of transactions processed through the retail payments switch	The value of transactions processed through the switch	Bi-annual	BSL	National switch reports	BSL
Percentage of mobile money operators (MMOs) connected to and utilizing the retail payments switch	Number of mobile money operators connected to and utilizing the switch	Annually	BSL	National switch reporting	BSL
Percentage of deposit-taking MFIs connected to and utilizing the retail payments switch	Number of deposit taking MFIs connected to and utilizing the retail payments switch (includes both direct and indirect connections)	Bi-annual	BSL	National switch reporting	BSL
Number of POS installed	The number of POS installed (traditional POS and digital alternatives such as mobile POS and pos-QR)	Bi-annual	BSL	National switch reporting	BSL
Cumulative number of POS transactions via the retail payments switch	The number of transactions generated on switch POS (traditional + pos-QR code)	Bi-annual	BSL	National switch reporting	BSL
Cumulative number of NRA collections or other government payments processed through the payments system	The number of NRA collections or other government payments	Bi-annual	BSL and NRA	National Switch Reporting	BSL and NRA

	facilitated by electronic means (e.g., retail payments switch, ACH, etc.)				
Number of guidelines, laws and regulations implemented	The number of payments related laws, regulations, and guidelines implemented as part of the project.	Bi-annual	BSL	BSL M&E reports	BSL
Number of Private Sector Committee meetings held (citizen engagement)	The number of Private Sector Committee meetings held as part of the project governance structure	Bi-annual	BSL	BSL M&E reports	BSL
Female account ownership at a financial institution or mobile money service provider	Account ownership at a financial institution or with mobile-money service provider, female (% of population age 15+) from Finscope		Finscope	Finscope	BSL

ANNEX 1: Implementation Arrangements and Support Plan

COUNTRY: Sierra Leone
Sierra Leone Financial Inclusion Project

Project Institutional and Implementation Arrangements

1. **The BSL will be the implementing agency, with support from consultants, and procurement and financial management will be led by MoF's PFMU.** Project implementation will be mainstreamed into the work program of various BSL departments and units with overall coordination by the Financial Sector Development (FSD) unit. MoF's PFMU, which has experience with World Bank projects, will oversee procurement and financial management and will be provided with support through this project. Given BSL's limited human resources and experience with World Bank projects, BSL will be supported by a Project Coordinator with relevant experience. Furthermore, the retail payment switch component (component 1) will be supported by an array of relevant experts, including a consultant to help provide inputs on procurement, get the switch up and running, and help become viable by ensuring adequate growth in electronic payments system using the switch. A technical lead will focus on implementing component 2 that aims to increase usage of the financial system.

2. **The project will have a steering committee to ensure that critical decisions are made, oversight, and coordination between different stakeholders.** A key challenge in BSL's previous project, FSDP, as identified in its ICR, was that it did not have an effective governance framework, which precluded coordination and critical decisions being made to support implementation of the project. Consequently, a project steering committee that includes representatives of key Ministries, Departments, and Agencies will be established. These will include representatives from BSL departments and units, the MoF, NRA, NATCOM, and the Directorate of Science and Technology (Office of the President). It will also include representatives from the private sector, including the Sierra Leone Association of Commercial Banks. Meeting will be held on a monthly basis and will aim to ensure that key decisions are made with respect to the project in a timely and regularized manner.

3. **The project will also have a consultative private sector committee to facilitate dialogue between financial institutions and project management.** Given that the project will finance investments that the private sector will utilize (e.g., the switch) and other investments directly for the sector (e.g., connectivity for MFIs), it is critical that project implementation is informed by BSL-private sector interaction to ensure that the project is meeting the latter's needs.

Financial Management and Disbursement Arrangements

Summary of the Financial Management Assessment

4. A financial management assessment of the Project Fiduciary Management Unit (PFMU) of the Ministry of Finance (MoF) was conducted in accordance with Financial Management Manual effective on March 1, 2010 and as last revised on February 10, 2017.

5. The objective of the assessment is to determine whether the PFMU has acceptable FM arrangements. The arrangements include the PFMU's system of planning and budgeting, accounting, internal controls, funds flow, financial reporting, and auditing. The entity's arrangements are acceptable if they are considered capable of recording correctly all budgets, transactions and balances, supporting the preparation of regular and reliable

financial statements, safeguarding the entity's assets, and are subject to auditing arrangements acceptable to the Bank. The assessment was conducted in accordance with the Financial Management Manual effective March 1, 2010 as last revised on February 10, 2017.

6. **The overall FM risk for the project at preparation was assessed as High, but with the expected risk mitigation measures when adequately implemented, the residual FM risk is rated as Substantial.**

7. **Country Issues:** According to the 2014 Public Expenditure and Financial Accountability (PEFA) which included an analysis of Sierra Leone's Public Financial Management strengths and weaknesses, the government has taken considerable actions to improve its public financial management since 2010.

8. The adoption of a number of new laws has had a positive impact on the regulatory framework for Public Finance Management (PFM). The new PFM Law that has replaced the Government Budgeting and Accountability Act (GBAA) 2005, and the Public Debt Law passed in 2011 are two important legislations contributing to the enhanced legislative framework. The establishment of the Procurement Directorate and the Public Investment Planning Unit of Ministry of Finance; and capacity increases and improvements in the number and quality of staff within the Ministry of Finance, the Accountant-General's Department and the Office of the Auditor-General are positive developments in the PFM environment.

9. A weakening of budget credibility and predictability for both expenditures and revenues (underestimated); minor gains in comprehensiveness not impacting on fiscal management challenges; weaknesses in expenditure control (including payroll); and low levels of transparency are weaknesses to be addressed as the government considers moving the system to a level that is capable of directing resources to priority areas and supporting high quality expenditure outcomes.

10. PFM reform in Sierra Leone is directed at all the dimensions of the PFM system. The PFM Reforms Strategy 2014-2017 seeks to develop the basis for the Government of Sierra Leone to accelerate PFM reforms and establish an efficient, effective and transparent PFM system that minimizes opportunities for corruption.

11. The Strategy is being pursued under the following four themes:

- Budget Planning Comprehensiveness, and Credibility; its primary aims are to establish a credible and stable budget process, particularly to establish a transformational and development fund, public investment program and link investment to recurrent operations and maintenance spending through the MTEF process.
- Financial Control and Accountability, Service Delivery and Oversight; the most critical objective of which is to complete the roll-out of IFMIS to major spending ministries and agencies and bring all CG public accounts--including sub-vented accounts and DP project accounts--on to IFMIS.
- Revenue Mobilization; whose two objectives will be (1) to establish more effective tax and control regimes for extractive industries through the Extractive Industries Revenue Act and the Oil Exploration Act and (2) improving the system for recording and reconciling payment and receipts.
- Strengthening Local Governance Financial Management through Local Councils for Effective Decentralization; a critical objective shall be the consolidation of the implementation of the PETRA Accounting Package in all local councils including the real-time processing of transactions by selected councils.

12. The PFM Strategy if successfully implemented will put in place appropriate structures and processes to promote transparency and accountability and mitigate the fiduciary risk of utilizing public funds both at the country and project levels as well as have positive impact of aggregate fiscal discipline, the strategic allocation of resources and the efficiency of public service delivery. The PFM reform is being supported through a donor financed PFM (PFMICP) project which include DFID, AFDB and IDA.

13. The bulk of external assistance in terms of programming has been channeled off-budget both in the sense that resource allocations are not reflected in the government's budget documents and those funds are not disbursed through country Treasury systems. This lack of information and absence of effective instruments to guide the allocation of external financing seriously undermine the integrity and effectiveness of the budgetary system. There is insufficient transparency in public finances. The budget process is not yet transparent. The PFMRP project being currently implemented aims at addressing all the above weaknesses by mobilizing funds from a number of donors to finance a comprehensive public financial management overhaul of the respective integrated systems and ensure an inclusion of donor funded projects in government chart of accounts and budgets so that eventually they are able to use existing country systems.

14. **Project Risk Assessment and Mitigation.** This section presents the results of the risk assessment and identifies the key FM risks and the related risk mitigating measures.

Table 1: Risk Rating Summary Table

	Risk	Risk rating	Risk mitigating measures	Residual Risk rating
	INHERENT RISKS			
1	**Country Level** Weaknesses in legislative scrutiny, low human capacity, declining revenues and energy challenges affecting timely and adequate intergovernmental fiscal transfers.	H	Efforts are being made to help GoSL substantially resolve and enhance revenue management framework in the medium term. The Public Financial Management Improvement and Consolidation Project seeks to address the human capacity issues including FM capacity and improve process aspects.	H
2	**Entity Level** The political arm of the Entity and / or Management may unduly interfere with, and/or override, project financial management controls.	H	An independent project financial management unit with officers paid by the Project will manage the fiduciary aspects of the project to ensure independence. An independent external audit will be carried out annually under the project. The design of the project will include an enhanced accountability framework to ensure control of soft expenditures from possible abuse. Initially, regular FM reviews will be conducted by the Bank team to provide support.	S
3	**Project Level** Weak FM capacity could result in slow execution of the project and delayed reporting could impact on progress.		PFMU will be manned by qualified personnel that will handle the day to day management for the Government of Sierra Leone. The performance of the staff hired in the Unit will be reviewed annually to act as a basis for renewal of their individual contracts.	S

4	**Budgeting** Budget and annual work plan preparations may be delayed and may not be comprehensive. Risk of cost overruns and adverse variations in expenditure could arise due to potential slow implementation and padding of the related unit costs of goods and services entailed in the implementation.	M	The Project budget will be finalized prior to negotiation. The AWP would be submitted annually before implementation starts for review by the Bank team which would ensure it is realistic and unit cost estimates are reasonable based on industry and global experiences gathered in some jurisdictions that have undertaken similar operations and also cross check the same with the local market. Also, budget execution reporting through quarterly IFRs will be routinely monitored by IDA with variations in unit costs tracked to ensure major deviations are followed up and investigated. The Budget Office will also monitor budgeted activities to ensure effective use of budgets	L
5	**Accounting** Government Accounting System not yet installed at the Unit. Use of manual accounting system not generating reliable, accurate and timely accounting information for project appropriate decision making acceptable to the Bank.	H	PFMU will use a customised accounting system. The Financial Procedures Manual is being revised to take into account peculiar design of the project. The Bank's team will provide support to relevant project staff at PFMU	S
6	**Internal Control** Internal Control Project funds not being used for intended purposes because of inadequate internal control by management and lack of control measures pertaining to soft expenditures and usage of executive override. This may give rise to non-compliance with internal control procedures.	S	Adequate Internal Control (IC) over the disbursement and accountability of funds for eligible expenditures will be further strengthened by the adoption of an enhanced accountability framework for the project and internal audit oversight on the Project at PFMU will be instituted. The internal auditors will be required to generate periodic internal audit reports which should be shared with relevant stakeholders including the Bank. The internal controls will also be documented in the FM manual for the Project. Internal and external auditors would be expected to clearly identify and report any cases of breach of internal control procedures by the project management.	M
7	**Fund Flow** Possible delays in processing withdrawal applications leading to problems in honoring payments to third parties. Submission of Withdrawal Applications delayed.	S	The PFMU will be responsible for preparing and submitting withdrawal applications, and acceptable service standards for settlement of bills will be established. IDA funds will be disbursed through the USD-denominated Designated Account to be opened by the PFMU Simplified flow of funds arrangements will be included in the Project Implementation	M

			Manual.	
8	**Financial Reporting** Delays in the preparation and submission of un-audited interim financial reports (IFRs) and/or unreliable IFRs submitted.	M	IFRs shall be submitted to the Bank within 45 days after end of each calendar quarter. The content of the IFR will include Sources and Uses of Funds, Uses of Funds by Category, bank accounts reconciliation and a schedule of amounts drawn.	L
9	**Auditing** Delays in the submission of audit reports and the timeliness of management follow up on audit issues.	S	The audit TOR will be agreed and a qualified and acceptable auditor appointed with relevant input of Audit Service Sierra-Leone. Continuous satisfactory performance of auditors will be basis for continuous engagement. The audit would be done in accordance with International Standards on Auditing and, International Public-Sector Accounting Standards. The audited financial statement is expected to be submitted to the Bank not later than 6 months after the end of each fiscal year. The TOR for the external auditors has to be cleared by the Bank. The Bank will liaise closely with implementing agencies to ensure that management takes corrective actions on identified weaknesses.	M
	OVERALL RISK RATING	H		S

H —High, S — Substantial, M — Moderate and L — Low.

15. A summary of the key findings of the financial management assessment as well as the FM arrangements under the project as conducted is presented as hereunder.

16. **Planning and Budgeting.** The respective entities' Annual Work Plans and Budgets (AWPB) will be prepared and approved based on the policy guidelines and strategy planning as laid-out in the Project Implementation Manual (PIM) to be developed, and consistent with the provisions of the Government Budgeting and Accountability Act 2005.This budget will be activity based and in line with the cost tables of the project. The AWPB is expected to be prepared in a participatory way and will be approved before each new financial year begins. The financial part will be monitored during project implementation using unaudited interim financial reports. PFMU will ensure timely preparation, review, consolidation, and approval of the annual work program.

17. **Accounting Policies, System and Procedures.** The PFMU will set up and maintain books of accounts specifically for this project. Books of accounts will include a main cash book, and ledgers, fixed asset registers, and contracts register. The PFMU will use a customized FM system (TOM2PRO) and will ensure that codes for the transactions are adequately reflected in its books.

18. The accounting systems will contain: (a) a chart of accounts and a coding system capable of capturing transactions classified by project components and IDA disbursement categories; (b) use of the cash or modified cash method of accounting; (c) a double entry accounting system; and (d) the production of annual financial statements and quarterly unaudited IFRs in a format acceptable to IDA.

19. An accounting policies and procedures manual will be prepared to include the project financial

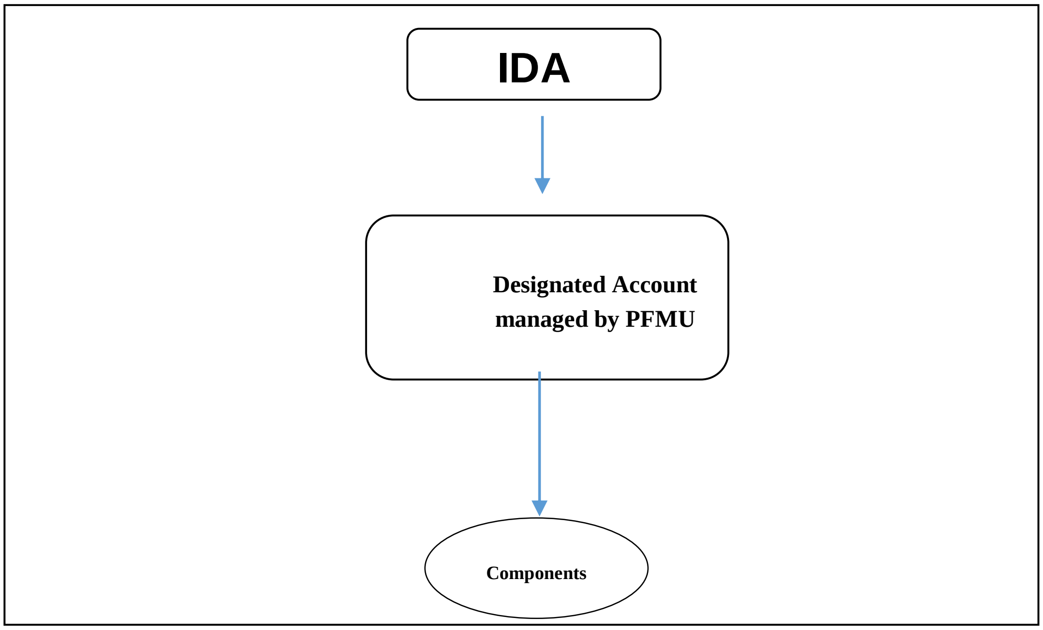
transactions procedures at each of the implementing agencies. The Manual will contain the necessary internal controls including internal checks and segregation of duties.

20. **Internal Audit and Control.** Adequate Internal Control (IC) over the disbursement and accountability of funds for eligible expenditures will be further strengthened by the adoption of an enhanced accountability framework for the project and internal audit oversight on the Project at PFMU will be instituted. The internal auditors will be required to generate periodic internal audit reports which should be shared with relevant stakeholders including the Bank. The internal controls will also be documented in the FM manual for the project. Internal and external auditors would be expected to clearly identify and report any cases of breach of internal control procedures by the project management. The Internal Audit Unit of MoFED will carry out periodic internal audit reviews of activities carried out in the implementation of the project and share copies of their report with the Bank.

21. Segregation of duties, and full compliance with the provisions of the PIM, especially as pertaining to internal control aspects, will remain a key ingredient in the implementation of the expenditure processing activities at the PFMU and the executing agencies during the life of the project.

22. **Governance and Anti-Corruption.** The Bank's Anti-Corruption Guidelines *("Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants",* dated October 15, 2006 and revised in January, 2011) apply to this operation. Sections of these guidelines, especially those relating conflict of interest, procurement and contract administration monitoring procedures, procedures undertaken for replenishing the Designated Account and use of the project's asset shall be provided as an annex to the Project's Financial Procedures Manual. Additional mitigation measures will include advocating good governance, close monitoring and spot checks by the internal audit units of the implementing entities, as well as enhanced social responsibility by the GoSL and implementing entities.

23. **Flow of Funds.** The flow of funds will be as follows:



24. Designated *Accounts* (DA). To facilitate funds flow to the Government of Sierra Leone, a segregated designated accounts (DA) will be opened in US Dollars at a commercial bank acceptable to the Bank and managed by PFMU. The DA will cater to the implementation requirements for all the components.

25. *Disbursement Arrangements.* Disbursement will be made in accordance with the Disbursement Guidelines for IPF dated February 2017. Upon effectiveness, an initial advance up to the ceiling of the DA will be disbursed to the DA. The DA will be replenished based on submission of Withdrawal Application supported with quarterly unaudited IFRs evidencing the use of the previous advance. In addition to the "advance method", the project provides for the use of ', reimbursement, direct payment, and special commitments' as applicable disbursement methods; and these will be specified in the disbursement letter.

26. Supporting documentation will be retained by the implementing agencies for review by the IDA missions and external auditors.

27. **Financial Reporting Arrangements.** PFMU will be responsible for the preparation and submission of quarterly Interim Financial Reports for the project, to be submitted within 45 days after the end of the quarter to which they relate. It will also be responsible for the preparation of the annual financial statements for the fiscal period to which they relate and having them audited. The information in these reports will be clearly linked with the chart of accounts for the Project.

28. The following quarterly IFRs and annual Financial Report will be produced:

(a) a statement of sources and uses of funds for the reported quarter and cumulative period from project inception, reconciled to opening and closing bank balances.
(b) A statement of uses of funds (expenditures) by project activity/component and expenditure category, comparing actual expenditures against budget, with explanations for significant variances for both the quarter and cumulative period.

29. The Financing Agreement requires the submission of audited financial statements to the Bank within six months after the end of each financial year. These Financial Statements will comprise:

(a) a Statement of Sources and Uses of Funds/Cash Receipts and Payments, which recognizes all cash receipts, cash payments, and cash balances controlled by the project entities and separately identifies payments by third parties on behalf of the project entities;
(b) a Statement of Affairs/Balance Sheet as at the end of the financial year, showing all the assets and liabilities of the Project;
(c) The Accounting Policies Adopted and Explanatory Notes. The explanatory notes should be presented in a systematic manner with items on the Statement of Cash Receipts and Payments being cross-referenced to any related information in the notes. Examples of this information include a summary of fixed assets by category of assets and a summary of Withdrawal Schedule, listing individual withdrawal applications; and
(d) A Management Assertion that IDA funds have been expended in accordance with the intended purposes as specified in the financing agreement.

30. Indicative formats of these statements will be developed in accordance with fiduciary requirements and agreed with the Country Financial Management Specialist.

31. **External Audit.** The Audit Service Sierra Leone (ASSL) is by law responsible for the audit of all government finances and projects. However, in view of the prevailing capacity constraints, it is likely that the ASSL could outsource such service to a private firm of auditors with qualifications and experience acceptable to the IDA

32. PFMU will be responsible for preparing the project financial statements on which the auditor will issue a single opinion covering project accounts, the usage of statement of expenditures, and the management of designated accounts. In addition, a management letter outlining any internal control weaknesses will also be issued by the external auditor together with the audit report.

33. The annual financial statements should be prepared in accordance with International Public-Sector Accounting Standards (which inter alia include the application of the cash basis of recognition of transactions)

34. The project financial statements will be audited annually in accordance with International Standards on Auditing (ISA) by independent auditors acceptable to IDA based on TORs acceptable to IDA as above annotated. The auditors should be appointed prior to the first audits period to allow the auditors able to submit the audit report within the due date. The audited financial statements will be submitted to IDA within six months after the end of each fiscal year. The cost of the audit will be financed from the project proceeds. In accordance with the World Bank's disclosure policy, the government is required to make the audited financial statements publicly available in a manner acceptable to IDA. The World Bank will also publish the audited financial statements on its website.

35. **Fraud and Corruption.** Inefficient service delivery due to poor governance practices and weak PFM environment is an inherent issue. Possibility of circumventing the internal control system such as colluding practices, bribes, abuse of administrative positions, mis-procurement among other considerations are critical risks that may arise. Other internal control incidences that may expose the project to fraud and corruption include but are not limited to (a) late submission of supporting documents; (b) poor filing and records; (c) lack of work plans and or budget discipline; (d) unauthorized commitment to suppliers, and (e) bypassing budget and expenses vetting procedures. The project shall mitigate these potential fraud and corruption related risks through (i) strengthened project monitoring; ii) specific aspects on corruption auditing will be included in the TORs for the external audit; (iii) targeted FM Procedures and internal control mechanisms across the project activities shall be detailed in the PIM; (iv) strong FM staffing arrangements; (v) periodic FM supervisions; and vi) IFRs reviews and monitoring.

36. **Implementation Support Plan.** As the overall FM risk rating of the project is substantial, implementation support of project financial management will be performed at least twice a year. The implementation support of the project will closely monitor the FM aspects, and will include but not be limited to operation of designated accounts, evaluation of the quality of budgets, project financial monitoring and management reviews of financial reports, quality of IFRs, relevancy of the FM Manual, internal controls, work and document flow and quality of financial records, and follow up of audit and mission findings. The review will also conduct random reviews of the statements of expenditures, and compliance with covenants. Based on implementation support result, the risk will be re-assessed, and the frequency of supervision recalibrated.

37. **Financial Management Action Plan.** Table 2 below shows the financial management action plan for the Project.

Table 2: Agreed Action Plan

	Action	Date due by	By Whom
i.	Preparation/update of the FM manual to be annexed to the Project Implementation Manual incorporating the financial management policies and procedures	One month after effectiveness	PFMU
ii.	Customize the existing accounting software to meet the needs of the new project.	Not later than one month after project effectiveness	PFMU
iii.	Recruit the external auditor	Not later than 6 months after project effectiveness	PFMU
iv.	The adoption of an enhanced accountability framework for the project and internal audit oversight on the Project at PFMU will be instituted.	Not later than 6 months after project effectiveness	PFMU
v.	Submission of internal audit reports to the Bank	Quarterly	PFMU

38. **Conclusion.** The conclusion of the assessment is that the FM systems of the PFMU meet the Bank's minimum requirements for the administration of projects funds under Bank Policy and Procedure for IPF. The overall FM risk is rated as 'High' before mitigation. If the planned risk mitigation measures are properly implemented the overall FM residual risk of the Project will be **'substantial'**.

Procurement

39. Procurement under the proposed project will be carried out in accordance with the World Bank's (a) "Procurement Regulations for IPF Borrowers" (Procurement Regulations) dated July 2016 and revised in November 2017 and August 2018, (b) the "Guidelines on Preventing and Combating Fraud and Corruption in Projects Financed by IBRD Loans and IDA Credits and Grants", dated October 2006, and revised in January 2011 and as of July 1, 2016, and (c) other provisions stipulated in the Financing Agreements.

40. **Implementation arrangements**: Procurement under this project shall be carried out by the Project Fiduciary Management Unit (PFMU) that is under ministry of Finance. The government of Sierra Leone has established a single fiduciary management unit called PFMU under the Ministry of Finance to manage all Bank finance projects. A highly qualified and experienced head of procurement department will be hired and experienced Team Leaders will be recruited. It is proposed that all procurement staff handling Bank financed projects will be transferred to PFMU, these staff have a reasonable track record of implementing Bank funded projects.

41. The procuring entity as well as bidders, and service providers, i.e. suppliers, contractors and consultants shall observe the highest standard of ethics during the procurement and execution of contracts financed under the project in accordance with Section I and Section II of the Procurement Regulations.

42. **Preparation of PPSD:** As part of the preparation of the project, the Borrower prepared a Project Procurement Strategy for Development (PPSD) which describes how procurement activities will support project operations for the achievement of project development objectives and deliver Value for Money (VfM). The procurement strategy is linked to the project implementation strategy ensuring proper sequencing of the activities. The PPSD considers institutional arrangements for procurement; roles and responsibilities; thresholds, procurement methods, prior review, and the requirements for carrying out procurement. It also includes a detailed assessment and description of Project Implementation Unit (PIU) capacity for carrying out procurement and managing contract implementation, within an acceptable governance structure and accountability framework. Other issues considered in the PPSD include the behaviors, trends and capabilities of the market (i.e. Market Analysis) to respond to the procurement plan.

43. **Procurement Planning**: A Procurement Plan which is the output of the PPSD and outlines the procurement procedures to be used to plan and monitor implementation of investment activities was prepared and agreed upon by the Bank and Government. The Procurement Plan for the project is prepared detailing the activities to be carried out during the first 18 months reflecting the actual project implementation needs.

44. **Use of Country Systems**: For procurements involving Procurement Procedures below the defined thresholds, procurement systems may be used as defined by the PPSD. The project activities will also require strong technical capability to prepare proper technical specifications to avert lack of, or inadequate, market response, this capability or a plan to enhance it will be described in the procurement strategy. Open competitive approach to the market will be the Bank preferred approach as it provides all eligible bidders/proposers with timely and equal opportunity to provide the required goods or services.

45. **Procurement Management Risk Assessment:** The procurement management risk assessment found that even though the current staff in PFMU are doing procurement in Bank funded projects, (i) The capacity of the existing pool of staff remains low despite several training and capacity building workshops being conducted by the Bank; (ii) substantial delays in internal approvals on procurement decisions since the technical teams are in different project implementing ministries and agencies and procurement team is in PFMU; (iii) limited knowledge in the Bank's Procurement Regulations and use of the Bank's Systematic Tracking of Exchanges in Procurement (STEP); (iv) The implementing agency that will manage technical aspect of the project has never managed ant Bank funded project; (v) Need for establishment of the record keeping system; (vi) Inefficiencies and delays in procurement process; (vii) Insufficient competition in procurement and (viii) Weak complaint redress system. The procurement management risk for this project is rated **High**, which after mitigation is expected to reduce to **Substantial**. To address the risks and weaknesses identified, mitigation measures have been discussed and agreed with the PIUs respectively as shown in the table below and the recommendation of the PPSD that was submitted by the government and approved by the Bank.

46. **Procurement Post Reviews (PPRs) and Independent Post Reviews (IPRs) by the World Bank**: Based on the assessed agency implementation risk for procurement, which is high Risk, the Bank will carry out annual PPRs or IPRs for all contracts based on the approved procurement plan not having been subject of prior review by the Bank using a sample of 20 percent. Based on continuing assessment of risk and the success of risk mitigation measures implemented, the sample size will be reduced as risk mitigation measures are successfully implemented. Note that based on risk rating the sample sizes for the PPRs or IPRs are as follows: 5 percent for Low Risk rating, 10 percent for Moderate Risk rating, 15 percent for Substantial Risk rating and 20 percent for High Risk rating.

Table 3: Project Procurement Risk Factors and Mitigation Measures

Risk Factor	Mitigation Measure
Capacity building of procurement staff	• Attend training in WB procurement procedures • Regular supervision, support and monitoring
substantial delays in internal approvals on procurement decisions	• Conduct regular meeting to identify delays and the causes and provide solutions. • Technical and procurement teams to work together regardless of the structures and chain of command in different ministries and agencies.
limited knowledge in the Bank's Procurement Regulations and use of STEP	• Conduct routine procurement clinics on new WB procurement procedures by the Bank • Hand-holding the team on use of STEP
Record keeping and documentation	• The implementing agency will establish and maintain all procurement records duly catalogued and indexed that will facilitate easy access to information
Inefficiencies and delays in procurement process	• Regular monitoring through procurement plan in STEP.
Insufficient competition in procurement	• Aggregation of smaller contract packages wherever feasible • Sensitization of private sector to bid for public tenders.
Weak complaint redress system	• Disclosure of complaint redress procedure. • Bi-annual report of all complaints received and action taken.
Fraud and corruption risks [including collusion and outside interference] in contracting process	• Disclosure of procurement plan • Disclosure of contract awards • Creating awareness on effects of fraud and corruption • Regular reviews such as PPR, internal Audit, external audit etc.

Table 4: Procurement Action Plan

No.	Action	Date due by	Responsible
1	Train designated Procurement Officers and PIU staff in World Procurement Regulations for Borrowers.	Three months after effectiveness	WB
2	Strengthen capacity on the use of Systematic Tracking of Exchanges in Procurement (STEP) tools, which is being used to manage all procurement transactions and related documentation.	Continuous handholding as the PFMU staff have been trained.	WB
3	Develop a Project Implementation Manual to include procurement procedures and implementation arrangements for the project along with the standard and sample documents to be used.	Effectiveness	PFMU/PIU
4	Develop records and contract management systems to ensure efficient and effective contract management.	Three months after effectiveness and continuous monitoring	PFMU/PIU

ANNEX 2: Overview of Retail Payment Switch

COUNTRY: Sierra Leone
Sierra Leone Financial Inclusion Project

1. **An efficient payments system includes**:
- a real time gross settlement system (RTGS) for the settlement of interbank transactions;
- an automated clearing house (ACH) system for processing retail payments; instruments; and
- a retail payment switch that can interface with different systems (e.g., ATMs, mobile money, etc.) and consolidate all electronic transactions to one or more payment processers.

2. **While Sierra Leone has put in place an RTGS and ACH system, a retail payment switch to facilitate interoperability is a missing element of the payments system.** The introduction of a retail payment switch will enable the following:

(a) **Interoperability among financial institutions (i.e., Banks, MFIs, MNOs, and other payment institutions, including their agents)**
- This key functionality allows interoperable transfers among financial institutions using digital channels and enables all customers of member institutions to utilize all ATMs and POS of participating banks.

(b) **Growth in the number and use of ATMs (note: ATMs are not funded by the project) and POS in the market, through the provision and management of terminals facilitating the development of a card acquiring market in the country**
- This functionality will enable BSL to deploy switch ATM and POS services in areas where financial institutions do not provide such services or it has been determined that the introduction of such a service would not distort the market. Also, the switch can facilitate other institutions benefitting from switch ATM and POS services without investing in expensive system.

(c) **Provide electronic bill payment services, which allows financial institution customers to pay utility bills through various payment channels**
- The development of electronic bill payment services will help customers make online payments of utility services in the country. Financial institutions can integrate bill payment services into their own payment service channels (e.g., mobile banking, ATM, POS, etc.) easily.

(d) **Card hosting services for financial institutions to issue domestic debit cards and provide card personalization services, along with mobile money and mobile/internet banking solutions**
- This enables BSL's switch unit to issue EMV or non-EMV cards for members institutions, such as international card scheme (like Visa or Mastercard) debit cards, domestic debit cards, and prepaid cards if they do not have card management systems capabilities. The same service can be used by those institutions who do not have real time host connectivity with switch and can provide card authorization services on their behalf. Also, a switch can provide personalization of cards to member institutions.
- Mobile money and mobile/internet banking solutions would allow for the development of independent non-bank acquiring institutions, white label POS, and white-label ATM operators.

(e) **Connectivity between domestic cards and international card schemes to facilitate domestic cards international usage**

- This service will enable those with domestically issued cards to be used abroad using the interface from the switch to the international card schemes. The same service can facilitate allowing international cards to be accepted at domestic ATMs and POS.

(f) **Payment gateway services for merchants to accept online payments (i.e., e-commerce)**

- This will allow banks to offer service for merchants to accept online payments.

(g) **Connect and facilitate Fintech solutions with financial institutions' transactional services**

- This functionality will enable innovative fintech solutions to access banking/MNO transactional services if needed through the switch (if they have appropriate service agreements with corresponding financial institutions). Examples of such services that could be enabled through the switch include, mobile POS, QR code-based payments, API based-payments, and "Request to Pay" functionalities.

(h) **Provide non-bank financial services providers with access to the payment system**

- Despite playing a very critical role in the provision of financial services, non-banks such as MFIs often struggle to meet the requirements of participating in payments system. The retail payment switch provides an opportunity for such entities to interface with the payment system and thus achieve some level of efficiency and convenience for their customers.

(i) **Facilitate instant payments (P2P; P2G and G2P) and provide payment gateway services for online payment of revenue collection**

(j) **Transaction Fraud monitoring and control**

- The functionality would enable the switch to monitor transactions for fraudulent behavior and initiate preventive measures.

(k) **Daily settlement of financial transactions of the switch (if the financial institutions use the RTGS and ACH system)**

- This will enable the settlement of all transactions on the switch with member institutions and net settlement will be processed through RTGS and ACH system.

(l) **Dispute resolutions of transactions routed through the switch**

- This will allow the switch unit to facilitate the resolution of disputes among financial institutions using the switch and would provide infrastructure to raise and resolve disputes and provide the financial adjustment related to the disputes.

(m) **Mandating transactional limits and fees among inter-operable transactions**

- The functionality would help to enforce and manage switch-wide fees and charges and control the financial exposure of members in utilizing switch functionalities. This feature is important to manage members who don't have direct RTGS settlement arrangement like mobile money operators.