FINANCIAL ANALYSIS

A. Introduction

1. Financial due diligence of the Mid-Level Skills Training (MLST) Project supporting the technical and vocational education and training (TVET) sector in Timor-Leste was undertaken in accordance with the Asian Development Bank's (ADB's) *Financial Management and Analysis of Projects*.[1]

2. The financial sustainability of the project was assessed at the national and project levels. The analysis was undertaken to evaluate the impact of the proposed project investment given current and projected TVET-sector funding levels. This included an assessment of the government's ability to absorb the proposed project investment expenditure and an analysis of the government's capacity to sustain project outcomes, which would require sufficient financial resources to cover the additional recurrent cost of providing additional teachers and materials for training centers due to the increase in courses and student numbers as a result of project activities. The analysis indicates that the government has the capacity to absorb and sustain the benefits of the project investment. It is anticipated that the funds will be made available from the Consolidated Fund and the Human Capital Development Fund (HCDF). In order to ensure sustainability, the project will support institutional strengthening of the Secretariat of State for Vocational Training and Employment (SEFOPE) by providing technical assistance, especially in financial management.

3. A financial management assessment was undertaken, including an identification of risks with appropriate mitigating actions, which are outlined in the Risk Assessment and Risk Management Plan.[2] The assessment recommends a project management unit (PMU) with adequate financial and procurement expertise to strengthen capacity within SEFOPE and ensure compliance with ADB policies and procedures.

4. SEFOPE is the executing and implementing agency for the project. The major goals of the project are to (i) increase and enhance the quality of training for certificate levels 2–4 at specified training institutes, and (ii) increase the number of highly skilled Timorese workers in the construction and automotive trades. This will be achieved through the implementation of five project outputs, which include (i) provision of mid-level skills training for construction and automotive trades, (ii) improving technical teacher training, (iii) enhancing labor market linkages of TVET, (iv) strengthening SEFOPE financing and support for TVET, and (v) ensuring efficient project implementation and management.

B. Financial Sustainability

1. Institutional Arrangements

5. The sustainability of the proposed project is assessed through the government's ownership of the activities initiated under the project, and the establishment of permanent institutional and funding arrangements to support those activities. The government has a national Strategic Development Plan 2011–2030 (SDP) that identifies social capital, infrastructure development, and economic development as strategic priority areas.[3] The education sector is emphasized in the SDP for the long-term development of Timor-Leste. The

[1] ADB. 2005. *Financial Management and Analysis of Projects*. Manila.
[2] Available from the list of linked documents in Appendix 2.
[3] Government of Timor-Leste. 2010. *Strategic Development Plan 2010–2030*. Dili.

plan also emphasizes technical and vocational training, as the country faces acute skills shortages in many technical and vocational fields while having inadequate institutional training capacity and infrastructure.

2. The Technical and Vocational Education and Training Sector

6. The SDP identifies vocational training providers as critical to the development of the TVET sector while recognizing that these providers do not currently have the capacity to provide the extensive and wide-ranging vocational training programs that can support development strategies. The project will initially support three training providers—the Tibar Training Center, Don Bosco at Comoro, and Dili Institute of Technology (DIT) Baucau—to enhance the capacity of each training provider, which will in turn support the government's SDP. The main goals identified in the SDP for the TVET sector include (i) continued development and funding of the training system, (ii) government's commitment to providing training opportunities for all Timorese, (iii) investment in training facilities and people, and (iv) development of a national TVET plan.

7. The TVET plan is currently under development with support from the government of South Australia. The national training framework will include a requirement for national qualification standards and curricula development as well as a system to allow registered government, community, and nongovernment training providers to deliver accredited training. In addition, establishment of the HCDF in 2011 demonstrates the government's commitment to education and TVET; the fund was established with a $25 million contribution and is expected to grow significantly over the next 5 years. The SDP states the fund will grow to $175 million by 2015, but national budget documents prepared by the Ministry of Finance anticipate the fund will grow to $45 million by 2015. Even the lower figure represents significant fund growth and demonstrates the government's commitment to the TVET sector.

8. SEFOPE is responsible for the overall TVET sector development and is the executing agency of the project. It is a relatively small government agency with an annual budget of approximately $2.5 million. While medium-term budgets are not available for SEFOPE over the next 4 years, projections for the national consolidated fund are shown in Table 1. It is assumed that the SEFOPE annual budget will grow in accordance with the national average. In 2011, about 61% of the recurrent budget for SEFOPE had been consumed with 67% of the financial year elapsed; hence the budget appears to be realistic. Based on current projections and taking inflation into account, it appears that there is some capacity to cover additional recurrent costs from the SEFOPE annual budget. It would, however, be prudent to assume that recurrent costs associated with the project will be supplemented from the HCDF, as discussed below.

Table 1: Consolidated Fund Projections for Timor-Leste 2010–2015
($ million)

Item	2010	2011	2012	2013	2014	2015
Recurrent budget	550.6	563.4	564.4	583.2	602.7	622.9
Capital budget	287.3	118.3	106.8	111.0	115.4	120.1
Total	**837.9**	**681.7**	**671.2**	**694.2**	**718.1**	**743.0**
Yearly change in total budget (%)			-1.54%	3.43%	3.44%	3.47%
Yearly change in recurrent budget (%)		2.32%	0.18%	3.33%	3.34%	3.35%

Source: Government of Timor-Leste, Ministry of Finance. 2011. *State Budget 2011: Book 1 Budget Overview.* Dili, and Asian Development Bank estimates.

3. The Human Capital Development Fund

9. The HCDF was established under Article 32 of Law No. 13/2009 (21 October 2009) on Budget and Financial Management. It was created to fund multi-year programs and projects to improve the training of Timorese professionals in strategic development sectors such as justice, health, education, infrastructure, and agriculture. The fund is managed by an Administration Council consisting of the Prime Minister, ministers for Education, Justice, Finance and the Secretary of State for Natural Resources, and other government representatives from institutions that receive funds from the HCDF. The Administration Council is authorized to change appropriations issued to programs within the overall appropriation authorized by the Parliament, provided that the purpose of the funding is maintained.

10. In 2011, $25 million was allocated for the HCDF and budget projections are for this fund to grow to $45 million by 2015. In 2011, SEFOPE had an appropriation of $2.6 million from the fund for six projects. Budget projections are made on an annual basis. It is assumed that SEFOPE will retain its current allocation from the HCDF. The funding SEFOPE may have access to, if it retains its overall share (currently 10.4%) of total funding over the next five years, is in Table 2.

Table 2: Human Capital Development Fund Projections Based on 2011 Budget Allocation
($ million)

Institution	% of total	2011	2012	2013	2014	2015
Ministry of Education	44.00	11.0	13.2	15.4	17.6	19.8
Ministry of Finance	10.00	2.5	3.0	3.5	4.0	4.5
Secretariat of State for Natural Resources	10.00	2.5	3.0	3.5	4.0	4.5
SEFOPE	10.40	2.6	3.1	3.6	4.2	4.7
Ministry of Health	9.60	2.4	2.9	3.4	3.8	4.3
Ministry of Justice	7.60	1.9	2.3	2.7	3.0	3.4
Institute of Public Administration	4.40	1.1	1.3	1.5	1.8	2.0
F-FDTL for training abroad	2.19	0.5	0.7	0.8	0.9	1.0
Youth training	1.36	0.3	0.4	0.5	0.5	0.6
Others	0.45	0.1	0.1	0.2	0.2	0.2
Total Fund		**25.0**	**30.0**	**35.0**	**40.0**	**45.0**

F-FDTL = Timor-Leste Defense Force, SEFOPE = Secretariat of State for Vocational Training and Employment.
Note: Totals may not add up exactly due to rounding.
Source: Government of Timor-Leste, Ministry of Finance. 2011. *State Budget 2011: Book 1 Budget Overview.* Dili, and Asian Development Bank estimates.

11. Table 2 illustrates that HCDF funding for SEFOPE will increase by approximately $2.1 million over the next four years if SEFOPE's percentage of the overall fund allocation remains constant. Table 3 shows SEFOPE's use of HCDF funding in 2011, with projections for 2012–2015. If the six programs are continued over the next four years, SEFOPE could still receive an additional $500,000 per year to undertake additional programs. The recurrent expenditure for the proposed project is estimated at $100,000 per year for the Tibar Training Center from 2013. Additional costs for providing training through nongovernment training providers are estimated at $150,000–$200,000 per year starting in 2014, covering teacher salaries and center operational costs. If the overall fund value increases as expected, SEFOPE will be able to maintain the additional recurrent expenditures for project activities. It is

recommended that funds be earmarked within the Consolidated Fund and the HCDF to support the future recurrent costs that the project will generate until more permanent financing arrangements are developed (expected in the TVET strategic plan).

Table 3: Use of Funding Support from the Human Capital Development Fund by the Secretariat of State for Vocational Training and Employment
($'000)

Program description	2011	2012	2013	2014	2015
Training of Manpower Abroad	801	801	801	801	801
Counterpart with Brazil	434	434	434	434	434
Training Support Centre	250	250	250	250	250
Tibar Centre	511	511	511	511	511
Training of Trainers	242	242	242	242	242
Training of Civil Construction	344	344	344	344	344
Unallocated	18	18	18	18	18
Other	0	500	1,000	1,600	2,100
Total	**2,600**	**3,100**	**3,600**	**4,200**	**4,700**

Source: Government of Timor-Leste, Ministry of Finance. 2011. *State Budget 2011: Book 6 Special Funds.* Dili, and Asian Development Bank estimates.

4. Project Financing

12. The total project cost is $13 million, including investment costs of $11.11 million, recurrent costs of $0.44 million, and contingencies of $1.44 million. The proposed investment will focus on institutional strengthening in SEFOPE and providing support to training providers. The investment cost covers civil works to upgraded facilities in training institutes and purchase of equipment for the upgraded facilities. It also includes an allocation of $2 million to provide support to expand mid-level skills training once the TVET strategic plan is finalized. Other significant investment costs include consultancy services to manage the project finances and procurement, develop skills standards and training curricula for level 3–4 training in construction and automotive trades, strengthen technical capacity of TVET trainers, and improve links between training providers and employers. It is anticipated that a single contractor will be engaged to develop skills standards and curricular materials (output 1) and upgrade technical teacher skills according to approved training standards (part of output 2).[4]

13. During the project's peak investment years (2013–2015), it is anticipated that investment expenditure could average $3.3 million per year. There is some risk that the government may have difficulty in managing this level of expenditure, as the current capital budget of SEFOPE is approximately $170,000 per year. It is therefore recommended that a procurement and finance specialist be engaged to build capacity within the SEFOPE procurement department and support the procurement activities during this peak investment period. It is anticipated that the proposed measure will mitigate the potential risk in SEFOPE's management of a high level of investment expenditure. The recurrent costs associated with the project activities could be funded from the HCDF in the medium term, until the national TVET plan is approved; the national TVET plan will provide more specific directions on the longer-term sector funding arrangements.

[4] It is anticipated that the International Labor Organization will be engaged to manage these outputs, given their institutional experience and proven track record in delivering similar project outputs for SEFOPE.

C. Financial Management Assessment

14. A financial management assessment was undertaken of SEFOPE as the executing and implementing agency for the project. This is the first ADB-funded project in SEFOPE and no previous PMU has been established. However, valuable lessons can be learned from the ongoing AusAID-supported project implemented in SEFOPE.[5] This assessment identifies the main financial risks and appropriate mitigating actions that were discussed with key stakeholders. The detailed risk assessment is included in the Risk Assessment and Risk Management Plan.[6] The assessment recommends establishing a PMU staffed with adequate finance and procurement expertise to (i) ensure compliance with ADB policies and procedures; and (ii) where possible, strengthen the procurement and financial management capacity of SEFOPE.

15. Country Public Financial Management (PFM) systems were most recently assessed in June 2010 through the Public Expenditure Financial Accountability (PEFA) PFM Performance Measurement Framework.[7] The assessment was led by the International Monetary Fund and ADB participated in the assessment process. The assessment concluded that progress has been made in strengthening PFM systems, with improvement recorded in 12 out of 29 performance indicators since the previous (2007) assessment. However, further improvements are required since overall PFM systems remain weak despite some progress. The weakness is due to poor budget coverage, preparation, and execution, particularly in line ministries. The basic arrangements are in place but implementation weaknesses mean that systems and procedures cannot be relied upon to produce accurate and timely financial information. Moreover, an independent supreme audit institution has not yet been established and internal audit was found to be weak.

16. The project will not use country PFM systems during project implementation, but support will be provided to the finance and procurement departments of SEFOPE to help build its capacity. A PMU will be established and one international finance and procurement specialist will be engaged to establish appropriate financial management procedures for the project, where possible, by adopting government procedures for processing financial transactions and preparing financial statements. The consultant will ensure compliance with ADB policies and procedures. A national financial consultant will be engaged by the project for the PMU. The international consultant will develop the financial management and procurement capacity of national consultants and counterpart staff, who will be familiarized with ADB policies and procedures.

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[5] AusAID. 2010. *Youth Employment Promotion Programme: Independent Mid-Term Evaluation.* Canberra.

[6] See footnote 2.

[7] International Monetary Fund. 2010. *Public Financial Management – Performance Report*. Washington, DC.