TIMOR-LESTE

PLANNING AND FINANCIAL MANAGEMENT CAPACITY BUILDING PROGRAM

MID-TERM REVIEW MISSION – MAY 24th TO JUNE 4th, 2010

AIDE MEMOIRE

1. A World Bank mission with AusAID participation visited Timor-Leste from May 24 to June 4, 2010, to work with the Ministry of Finance (MOF) and development partners on the Mid-Term Review (MTR) of the Planning and Financial Management Capacity Building Program (PFMCBP/the program). The main mission objectives were to: (i) review PFMCBP achievements and challenges to date; (ii) agree priorities for the remainder of the program; (iii) explore ways to support MOF's efforts to finalize its Strategic Plan (SP); and (iv) agree next steps, if any, on possible support to MOF post-July 2011 when PFMCBP closes. The MTR also looked at ways to strengthen the partnership and policy dialogue between the Government and donors around the PFM reform agenda.

2. This Aide Memoire summarizes the main mission findings, recommendations and agreements. **Annex A** provides a list of mission members and **Annex B** a list of people met; **Annexes C to G** summarize findings and recommendations by program component; **Annex H** summarizes progress against the PFMCBP Results Matrix; **Annex I** summarizes the proposed additional support from development partners; **Annex J** looks at strengthening PFM in line ministries; **Annex K** provides an overview of and recommendations on the Professional Development Program (PDP); **Annex L** summarizes the mission's initial comments on the SP; **Annexes M and N** cover program procurement and financial management; **Annex O** is a summary status of program funds; and **Annex P** sets out preliminary actions for the evaluation phase of the program.

3. The mission would like to express its sincere gratitude for the support and guidance of: H.E. Mme Emilia Pires, Minister of Finance; H.E. Mr. Rui Manuel Hanjam, Vice-Minister of Finance; MOF Directors-General, Directors, Staff and Advisers; the PFMCBP Program Implementation Officer, Senior Program Manager, and staff of the Program Implementation Unit; and development partners (AusAID, European Commission, Irish Aid, New Zealand Aid, and Norway). The mission consulted with the IMF on the Public Expenditure and Financial Accountability (PEFA) review and the Fiscal ROSC; and with JICA and the ADB on debt management. The mission participated in workshops with MOF management and advisers, and briefed development partners on the MTR's preliminary findings and recommendations.

PFMCBP ACHIEVEMENTS AND CHALLENGES

4. There have been significant achievements since 2000 in building up capacity across all the core functions of MOF. PFMCBP has been the main coordinating instrument around PFM since 2007, when MOF's workload leaped with petroleum receipts and the 2006 crisis. Whilst there are many factors to the success of PFM reforms, the mission found that technical assistance has been an important – and sometimes the crucial – factor in helping the Government respond to urgent needs. The program has also helped to address long-term objectives with a major reorganization of MOF in 2008/09; introduction of an Integrated Financial Management Information System (IFMIS); strengthening revenue administration; and the development of a policy analysis capability. These reforms have led to increased clarity over roles and responsibilities, and greater communication across MOF, with management and staff growing in

confidence. Although the program is now focused on MOF, it has also had a positive impact on engagement with the line ministries, the Council of Ministers, and the Parliament.

5. Such a large agenda however has meant poor progress on some key program objectives such as capacity development of national staff; the focus on the quality of spending; policy dialogue with donors; and monitoring and evaluation of program activities. This is in part due to deliberate choices over sequencing and priorities and the need to get basic systems in place. It also due to the complexity of the program, a post-crisis context, and the absence of an overarching PFM reform and institutional development strategy. MOF has recently completed a draft SP, which highlights a number of challenges including: gaps in human resources; language barriers; the lack of confidence to work independently; the limited transfer of skills from consultants to staff; and the instability in laws and regulations. Following discussions with the Minister, the Vice-Minister, MOF counterparts, and Advisors the mission agreed that the SP should be the key entry point for shaping the approach and activities of PFMCBP over the remainder of the program and any of technical assistance beyond the program.

PRIORITIES TO JULY 2011

6. The mission discussed three major areas of focus for the remainder of the program: (i) Priorities for the next stage of PFM reforms; (ii) Priorities for the next stage of capacity development; and (iii) Strengthening program management.

Priorities for the next stage of PFM reforms

7. Ensure effective and well managed decentralization of spending and procurement controls: The rapid decentralization of controls to line ministries (and eventually to districts) entails significant risks and requires MOF support to help ensure discipline and adherence to fiduciary standards. These risks are heightened by the absence of internal and external audit capacity. The mission recommended to prioritize capacity development of internal audit in MOF and a strategy to build capacity for this across government. The mission recommended that MOF extend client services in critical areas such as Treasury, Internal Audit and Asset Management (including training and standards setting), emulating the experience of Budget, and help coordinate external assistance to PFM across the government. While IFMIS upgrades have started to significantly improve the efficiency and transparency of PFM processes, a priority within the Directorate General of State Finances (DGSF) will be to effectively implement the extensive system developments planned under the new Free Balance contract. The mission recommended to appoint a dedicated Director and an IFMIS consultant with proven experience in IT systems contract management and associated change management. Finally, the changes to the Procurement regime in particular require urgent attention to address any confusion over mandates and to ensure that newly created institutions are adequately resourced. The mission recommended that MOF, the Vice-Prime Minister's Office (VPMO) and donors coordinate urgently to exchange information, in particular on possible support to the VPMO.

8. Continue to improve core tax and customs administration functions: Strengthening and stabilizing core tax administration functions will help to address tax avoidance and contribute to the Government's objective of strengthening non-oil revenue mobilization. The mission recommended a number of short-term measures to improve registration, return/payment processing, audit, collections, and automation. These measures should focus on strengthening capacity and identifying specific milestones for the coming twelve months. Secondly, PFMCBP has rightly scaled up its support to the Petroleum Tax Directorate. However, for the past eighteen months, the Directorate General of Revenue and Customs (DGRC) has been unable to perform any field audits of petroleum companies. The mission recommended that MOF consider securing the services of international tax auditors beyond the life of PFMCBP.

Customs have received relatively less support from PFMCBP but have a clear agenda of reform with a number of initiatives already underway. The mission recommended that priority be given to only addressing the most urgent issues such as streamlining import procedures, which will reduce clearance times for imported goods.

9. Consolidate progress on strengthening policy analysis capability: With the establishment of an Economic Policy and Investment Agency, it is important to ensure that MOF maintains a strong policy analysis capability. It could otherwise compromise its role in promoting macroeconomic stability; the effective use of public resources; and probity, transparency and external accountability for the stewardship of public finances. Progress to date in building the capability of the Macro Directorate provides a good basis to deepen skills for medium-term fiscal analysis. The mission recommended to explore additional support from development partners for a Medium-Term Fiscal Framework (MTFF), which would build on MOF's macro model and help to forecast major expenditure items and financing options. Closely linked to this is the need to continue strengthening macro data capacity by completing the work on a framework for the compilation National Accounts. Finally, the rapid increase in infrastructure spending calls for strengthening policies on public investment management. The mission proposed some ideas for conducting analysis of public investments with additional support directly from development partners. The MTFF and the proposed work on public investment management will need to be closely coordinated with the Expenditure Review Unit to help further strengthen budget analysis and preparation.

Priorities for the next stage of capacity development

10. The mission recommended a shift in the program's approach on capacity development, from a focus on individual competencies towards emphasizing the development of organizational capacity of the Ministry to achieve its goals and objectives. The mission recommended that Corporate Services continue to play a leadership role in this area, building on the achievements made so far in relation to the draft SP, merit-based staff recruitments, the restructuring of the Ministry, and ongoing client surveys. The program should in this regard increase the relative priority given to resourcing Corporate Services - particularly in relation to its Human Resources Unit, its strategic planning function, and its professional development function. The mission recommended that organisational development should be front and centre in the Strategic Plan. In particular, given the stage of evolution of Timor-Leste's MOF, it was recommended that the changed approach to capacity development be one of the highest priorities of the senior management team, under the leadership of the Minister and the Vice Minister. The mission recommended a new "Strategic Planning Group" be established in Corporate Services to help drive the implementation of the SP, and to help make capacity development a central focus of SP implementation in the Directorates. The mission recommended that the Institutional Development Capacity Building Plan (IDCBP) be fully integrated into the Ministry's own strategy and plans. It is proposed that a brief submission be prepared for the Minister setting out the key elements of the strategy proposed for improving the organizational effectiveness of MOF.

11. The mission recommended that a new strategy be prepared for the Professional Development Program that prioritizes professional training in MOF focused on foundation courses such as management, numeracy, and English skills as well as customized technical training based on Directorates' standard operation procedures. The mission recommended that practical steps be taken to address the challenges presented by language issues, starting with an official circular from Corporate Services providing guidance on how to implement the official language policy in the Ministry of Finance. Other suggestions included a 'language audit' to identify key laws and regulations, policy papers and circulars that are not yet available to Ministry of Finance staff in a language (Tetum or Bahasa) that they can understand. The mission recommended that immediate steps be taken to establish the Internal Audit Unit in Corporate Services. And finally, the mission noted that there are several important issues where Corporate Services needs to actively engage with the Civil Service Commission to improve performance

outcomes. These include: the performance regime; the special career regime; the formalization of temporary staff; and the possible introduction of a graduate program in MOF.

Strengthening program management

12. Strengthen program management and governance: PFMCBP has a three-tier governance structure. *First tier:* Strategic management is through the MOF Consultative Council on Financial Management (CCFM). The MTR agreed, at the Minister's invitation, that one donor representative will attend the weekly CCFM meetings. *Second tier:* Overall monitoring of program implementation and progress against program objectives is through a Supervisory Committee (SC), chaired by the Minister of Finance, and including the World Bank and development partners. The MTR agreed on quarterly meetings and recommended that the SC's work program till July 2011 is clearly defined. The MTR also recommended that the World Bank should host monthly meetings for the development partners to report on PFM-related issues. *Third tier:* Day-to-day management is the responsibility of the Program Implementation Unit, which has played a critical role in ensuring timely inputs; providing administrative and logistical support; and monitoring program results. This is however a complex operation. The mission discussed a number of areas where program management could be strengthened. The mission recommended that the recruitment of additional staff (Deputy Program Manager; Procurement; Financial Management) be given priority in the coming months.

FINALISING THE MOF STRATEGIC PLAN

13. MOF has prepared a draft SP, which is a very positive step forward. The SP provides a clear vision statement, starts to develop a sequencing of reform measures, and addresses issues of organizational structure and staffing. The SP should enable more attention on the key constraints to PFM system performance, simplify management by focusing on priorities, and strengthen capacity development to deliver more concrete results.

14. The mission noted that the SP provides an excellent basis for the policy dialogue and partnership around PFM between the Government and development partners. It can help to coordinate support from a wide range of stakeholders, not just PFMCBP donors. The SP could as a result serve as a fundraising document for support post-July 2011. MOF sought support from the development partners to complete the SP. This would involve:

- Identifying weaknesses in core business processes and the next stages of PFM reforms;
- Developing detailed plans for this year and beyond for each Directorate;
- Integrating capacity building plans for Directorates with the MOF wide SP;
- Establishing key performance indicators to track progress and results;
- Clarifying roles, responsibilities and accountabilities for achieving results down the hierarchy of management and across the advisers.

15. The mission agreed that the development partners will revert back quickly with a specific proposal on how they can support the SP process, and a timeline, to be developed jointly with the DG of Corporate Services. This will be prioritized given that it is a prerequisite for much of the other work. The

mission also recommended that a full-time Senior PFM/Strategy Adviser be appointed to provide technical oversight and quality assurance across PFMCBP, and to ensure alignment with the SP.

16. To complement the support on finalizing the SP, the mission also agreed that development partners will provide direct support through technical assistance or analytical input in some of the high priority areas highlighted above including: the career regime; expenditure analysis; Medium-Term Fiscal Framework; and Public Investment Management (Annex H).

POSSIBLE OPTIONS FOR POST-JULY 2011 SUPPORT

17. The MTR has set out an important agenda, which should help MOF and the development partners think through possible options for post-July 2011 support. The mission agreed that the SP should articulate a clear PFM reform and institutional development strategy, which would form the basis of discussions on where MOF will require support going forward. The next Supervisory Committee provides a good point at which to stake stock of these issues, and decide how to proceed in order to ensure that, if necessary, the development partners have sufficient time to make preparations for the next stage of support. The mission recommended that support should be provided immediately to assist with developing the SP, and that a short note outlining the status of the SP and outstanding issues be tabled at the next Supervisory Committee, along with possible options for support post-July 2011.

ANNEX A: MTR MISSION MEMBERS

Anne Morant: AusAID consultant and senior PFM Specialist, who previously worked in the Budget Directorate of the Timor-Leste MOF, advised on issues in the Directorate General of State Finances.

Christine Wong: WB Operations Specialist advised on program management and governance issues (M&E, reporting, Financial Management) and the performance of the Project Implementation Unit (PIU).

David Hook: WB Governance Specialist advised on issues in the Directorate General of Revenue and Customs and the Directorate General of Corporate Services, including the Professional Development Program.

Graham Scott: WB consultant and senior PFM Specialist (former Secretary to the New Zealand Treasury) advised on the finalization of the MOF Strategic Plan and on issues in the Directorate General of Policy Analysis and Research.

Habib Rab: WB Economist and TTL for PFMCBP led the mission working to Rob Taliercio and Vivek Suri (WB Lead Economist) and advised on issues in the Budget Directorate and the Directorate General for Policy Analysis and Research.

Heather Baser: WB consultant and senior specialist on capacity development advised on issues in the Directorate General of Corporate Services and strengthening the approach to capacity development.

Kanthan Shankar: Manager (Portfolio and Operations, EACNF) joined the mission during the first week and provided overall guidance on the performance of the program in the context of WB's country strategy and client engagement.

Paul Keogh: AusAID Governance Specialist advised on issues in the Directorate General of State Finances and PFM capacities in line ministries.

Rick Fisher: WB consultant and senior specialist on tax administration (previously IMF Resident Tax Expert in Indonesia) advised on issues in the Directorate General of Revenue and Customs.

Rob Taliercio: WB Lead Economist provided overall guidance and technical advice to the mission, including advice on strengthening the dialogue and partnership around PFMCBP.

Vin Ashcroft: AusAID Assistant Director General joined the mission during the second week and provided guidance and technical advice to the mission.

In addition to the above, Financial Management and Procurement reviews were conducted by **Kylie Coulson** (WB Senior FM Specialist), **Stephen Hartung** (WB FM Specialist) and **Evelyn Villatoro** (WB Senior Procurement Specialist). **Roland Rajah** (AusAID Policy Analyst) provided inputs on program management and governance issues ahead of the MTR mission. **Guida Freitas** (WB Program Assistant) coordinated mission meetings and logistics.

ANNEX B: LIST OF PEOPLE MET

NAME	TITLE
MOF: DIRECTORATE GENERAL OF REVENUE and CUSTOMS	
Cancio de Jesus Oliveira	Director General for Revenue & Customs
National Directorate of Domestic Revenue	
Uldarico Rodrigues	National Director
Terry Greenwood	Taxation Compliance Adviser, PFMCBP
Stretton Jones	SIGTAS User Support Adviser, PFMCBP
National Directorate of Customs	
Rosa Maria Cruz da Silva	Head of Commercial Compliance
Lourenco Carvalho	Compliance Enrich Management
Valente Antonio Freitas	Deputy Director (Operations)
Tony O'Connor	Lead Customs Adviser, PFMCBP
Alan Wilson	Customs HR Adviser, PFMCBP
National Directorate of Petroleum Revenue	
Helga Sarmento	Head of Petroleum Revenue
David Castiglione	Lead Petroleum Revenue Adviser, PFMCBP
Abdur Rahman Khan	Petroleum Tax Audit Adviser, PFMCBP
Bobby Boyd	Adviser funded by Norway
Legal Department	
Maria Fatima	Head of Legal Department
Roger Maguire	Revenue Legal Adviser, PFMCBP
MOF: DIRECTORATE GENERAL OF STATE FINANCES	
Francisco da Costa Soares	Director General for State Finances
Robert Vardy	SMA, PFMCBP
National Directorate of Procurement	
Manuel Monteiro	Director of Procurement
Deonisio dos Santos	National Procurement Adviser, PFMCBP
Samuel Marcal	National Procurement Adviser, PFMCBP
Aniceto do Rosario	National Procurement Adviser, PFMCBP
Miroslav Alilovic	Lead Procurement Adviser, PFMCBP
John Peachey	Procurement Reform Adviser, PFMCBP
National Directorate of Treasury	
Sarah Lobo Brites	National Director
Hari Nayer	IMF Lead Treasury Adviser
Subodh Kumar Mathur	Accounts & Payment Technical Adviser
Jose Alexandre Carvalho	Chief of FMIS
Amra Srdanovic	FreeBalance Training Adviser, PFMCBP
Arun Srivastava	Treasury Adviser, PFMCBP
National Budget Directorate	
Agostinho Castro	Budget Director
Peter Wild	Budget Adviser, PFMCBP
National Directorate of State Assets	
Januario da Gama	Director of Asset Management
Simon Whitehead	Asset Management Adviser, PFMCBP
National Directorate of Autonomous Public Authorities	
Thomas da Silva	Director of Autonomous Public Authorities

NAME	TITLE
MOF: DIRECTORATE GENERAL OF CORPORATE SERVICES	
Santina J.R.F Viegas Cardoso	Director General for Corporate Services
Dr Rui M. Araujo	SMA, PFMCBP
Minister's Office	
Ramon Oliveros	Executive Office Advisor
HR Team	
Manuela Neila Carvalho Alin	Chief of Human Resources
Jeff Cane	HR & Capacity Development Senior Adviser, PFMCBP
Valter Vicente Anacleto	Legal Adviser, PFMCBP
IT Team	
Uday Kolhatkar	Applications Management Adviser
Southun Thay	Network Management Adviser
Andre Felix Marques	National Network Management Adviser, PFMCBP
Justo Fernandes	National Applications Management Adviser, PFMCBP
PIU	
Santina J.R.F Viegas Cardoso	Project Implementation Officer
Marlon Lezama	Senior Program Manager, PFMCBP
Idrisiyah Sagran	National Financial Management Adviser, PFMCBP
Livio Soares	Finance Officer
MOF: DIRECOTRATE GENERAL OF POLICY ANALYSIS & RESEARCH	
Antonio Freitas	Director General for Policy Analysis and Research
Joao Saldanha	SMA, PFMCBP
National Directorate of Statistics	
Elias dos Santos Ferreira	National Director of Statisctics
Tigran Terlemezian	National Accounts Adviser, PFMCBP
Directorate for Policy Analysis & Research	
Epifanio de Jesus Carvalho	Chief of Income Distribution Department
Directorate of Macroeconomy	
Martinho Sequeira	Chief Directorate of Macroeconomy
Kannapiran Chinna	Macroeconomy Adviser, PFMCBP
Sarah Harper	ODI Economist
Barra O Fianail	ODI Economist
DEVELOPMENT PARTNERS	
Sarah Wong	Head of NZAID
Constantinos Tsilogiannis	Minister-Counselor/ Head of Operations, EC
Hans Peter Christophersen	Head of Mission, Norway
Eoghan Walsh	Resident Representative, Irish Aid
Ali Gillies	Minister- Counselor, AusAid
Enomoto Hiroshi	Resident Representative, JICA
Michiko Hayashi	JICA
Laurence Pochard	Resident Representative, ADB
Holger Van Eden	IMF

ANNEX C: STRENGTHENING CAPACITY IN THE DIRECTORATE GENERAL OF STATE FINANCES

ACHIEVEMENTS

1. **Advisory Input.** The program has made significant contributions over the past eighteen months to building the DG's functional capabilities and the Ministry's overall capacity. In addition, the various training components have contributed to the much needed development of skills and competencies across Government. From a cost-benefit perspective, the Advisers' contributions to negotiation of the new IFMIS contract and the reclaiming of significant revenues alone (see below), have more than out-weighed the total cost of the PFMCBP since inception.

2. **Legislative Framework.** The program provided short-term TA to redraft the Budget and Finance Management Law (BMF), which was approved by Parliament in November 2009. More recently, the program, with external legal assistance, helped draft the three Decree Laws on Procurement supporting the Council of Ministers (COM) decisions to increase levels of devolved expenditure authorizations, special procedures for awarding construction contracts to local companies, and the establishment of the Procurement Monitoring Commission (PMC) and the Procurement Technical Secretariat (PTS).

3. **Integrated FMIS.** A key element of the program is the establishment of an integrated FreeBalance (FB) FMIS accessible to all users. Due to ongoing technical and functional problems, and supplier delays in the implementation of core modules, DGSF advisers have been instrumental in resolving issues and more recently, developing specifications for an upgrade of the system and infrastructure.[1] The technical assessment of the proposal and subsequent renegotiations resulted in re-scoping and significant cost reductions. In the interim, Treasury has established remote access to FB in a number of Line Ministries (LM) to enable the direct processing of Commitment Payment Vouchers (CPVs). For other LMs, to work around remote access connectivity problems, dedicated FB terminals have been established within Treasury. The FMIS Unit provided an extensive training program for LMs on the processing of CPVs, which has been widely acknowledged as producing impressive results.

4. **2010 Budget.** For the first time in a number of budgets, the 2010 State Budget was framed within a COM endorsed macro-framework and fiscal envelope. Funding of the final State Budget presented to Parliament was consistent with the macro-framework. This was a major achievement given the original level of budget bids and the complexities of the decision making processes. In addition, PFMCBP Advisers played a central role in designing technical specifications for the FB Performance Budgeting (PB) module, supported by a redesign of the Chart of Accounts (CoA). Training provided by the program enabled LMs to input 2010 Budget Submission information directly into the system, which significantly streamlined quality control and the preparation of the Budget Law and the Budget Books.

5. **Improved Processes.** The backlog of outstanding bank reconciliations since 2005 has been cleared, numerous unauthorized or idle accounts closed, and action initiated to transfer a significant level of related monies into the Single Treasury Account. Regular reconciliation of government bank accounts is now undertaken. Significant efficiencies have also been achieved through the introduction of electronic salary and wages payments for the majority of government employees. In addition, the Program has supported the development of a number of policy and procedural manuals on asset management, control of vehicles and procurement best practice. These have been supported by a number of training programs for LM staff.

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[1] IFMIS problems encompassed; interface problems with the Performance Budgeting System (PBS); technical problems with the Bank Reconciliation module; difficulties in establishing remote site connections; and ongoing delays in the implementation of the Procurement Module.

6. **Improved budget execution**: Overall spending and budget execution have accelerated rapidly since 2007/08. This was a chronic problem in the past. Annual government spending has gone from $180 million in 2006/07 to around $600 million in 2009, and budget execution from 49% in FY06 to nearly 90% in FY09. Budget execution, both overall levels and virements are monitored closely by MOF as a measure of performance, and reported at the Council of Ministers.

CHALLENGES AND PRIORITIES

7. **Increasing complexity and pace or reform**. As in any country with a loose coalition of parties, Government decision making processes have become increasingly complex and unpredictable. In addition, the pace of Government institutional and policy reform has increased, for example with the escalation of fiscal decentralization. Pressures to reform will remain particularly as the Government moves to implementing the new Strategic Development Plan, and new capabilities are needed to deal with more complex challenges. Careful sequencing will help to avoid excessive pressure on existing capacity.

8. **Timely Implementation of the IFMIS**. Establishing the capacity within the IFMIS Unit to effectively manage implementation of the new FB contract and coordinate development of the associated supporting procedures, processes and Decree Laws is one of the highest priorities in the DGSF. Similarly, the IFMIS will require a large training component. Its effectiveness will depend on the level of understanding and skills of staff that use it. The Unit requires the appointment of a dedicated Director and the support of a senior consultant with proven experience in IT systems contract management and associated change management.

9. **Strengthening Planning and Medium Term Budgeting**. While the State Budget is comprehensive, the linkages between planning and budgeting are limited by the evolving roles of the key players, weak budgeting capacity in LMs, the separate development of capital and recurrent budgets and the lack of reliable expenditure forecasts at the program/project level (e.g. recurrent costs of capital projects, implications of new career regimes, social protection programs). This reduces BRC/COM capacity to be fully informed on the ongoing expenditure implications of policy decisions. The Government is clearly committed to strengthening these linkages through the development of a top-down MTFF and establishment of the Economic Policy and Investment Agency (EPIA), which is expected to lead the planning, design, budgeting and implementation of the SDP. This would have major implications for MOF, which will need to be defined in the National SDP and the MOF's SP.

10. **Maintaining State Budget Credibility**. The increasing size of the annual State Budget and Rectification Budget increase pressure on budget credibility. The 27% increase in the 2010 Rectification Budget, coupled with the loosened virement regime, can reduce LM incentives to prepare quality budgets. Should the level of virements result in significantly different outcomes to the initial appropriations, it has the potential to undermine approved budgets. Individual Ministers should be held to account by Parliament for variations. But MOF is accountable for the credibility of the State Budget as a whole, and therefore has an important role in promoting discipline and fiduciary compliance.

11. **Improving capital budgeting and expenditure analysis**. In the past two years, the Government has prioritized capital spending in an effort to readdress the country's major infrastructure gap. For the 2010 Budget, whilst the capital budget formulation process was quite systematic, there was a lack of actual project appraisal and limited information submitted on individual projects to enable informed decisions. The pending appointment of the Adviser to the ERU provides an opportunity for the Unit to work closely with the Public Investment Analysis Unit (PIAU) in the DGPAR. The mission's recommendations include capital expenditure analysis to identify patterns and issues that need to be dealt with most urgently, and the development of improved guidelines for the preparation of capital expenditure proposals in the future.

12. **Building operational skills in Treasury**. Discussions with the Director of Treasury and Advisors highlighted the need to develop the generic skills of operational staff. Due to eligibility criteria, many staff will never qualify for programs under the Professional Development Program (PDP). As such, they require local programs that focus on the development of core skills such as, numeracy, accounting concepts, comprehension, problem solving and written communication. This was a common need identified by the Directors across DGSF and in discussions with the Minister.

13. **Decentralization of Treasury operations**. There has been very rapid decentralization of spending controls and delegation of authority to LMs. This topic is covered in more detail in Annex J. There is also pressure to expand Treasury Operations to the Districts. A significant amount of analysis and planning work will be required to further develop this proposal, including consultations with the LMs. It is recommended to revive the Working Group established earlier on this issue between MOF and the Ministry of State Administration.

14. **Development Decentralization Package**. Under the Decree Law 2/2010, the ranking of local companies for the awarding of construction work up to $250,000 is to be done by a Joint District Team (JDT) comprising representatives from the Ministries of Infrastructure and Finance, the Ministry responsible and a district representative. The MOF/NPD is well placed to take a lead role in promoting the effective operation of JDTs through the provision of further guidance/standards on the company ranking criteria and JDT's procedures and reporting.

15. **National Procurement Directorate (NPD**). There are significant long-term challenges in building adequate Government procurement skills and a culture of compliance with laws and procedures. This is exacerbated in the short term by the unresolved mandate and resourcing issues relating to the PMC and the PTS, as well as delays in the implementation of the FB Procurement module. The proposal for the reorganization of the NPD in support of its revised role highlights significant regulatory, system and procedural issues that need to be resolved and implemented. It is recommended that MOF, the Vice-Prime Minister's Office (VPMO) and donors coordinate urgently to facilitate exchange of information, in particular on possible support to the VPMO.

16. **Development of a Procurement Manual and Competency Based Learning**. The Best Practice Guides provide a principles based approach to procurement, but given low capacity in LMs, there is no substitute for a detailed procedural manual to promote consistency in procurement activity across the Government. To give effect to the Manual, it should be supported by an appropriately tailored competency based learning program that links face to face instruction with on the job practice, mentoring and support, followed by formal work based assessment of competence. The FB Training is a good example of the first two elements of this approach, and could usefully be extended to Procurement.

17. **Assets Management**. The new FB contract includes fixing the FMIS connectivity issues, the updating of the Assets Module data and migration to the next version, and completing module testing and training. This should enable LM access to the Asset Register and enable the Assets Directorate to proceed with plans to devolve responsibility based on a two stage accreditation process. There will be a large training component, underpinned by the Inventory and Movable Assets Management Manual. Whilst this training is likely to be less complex than that for procurement, the provision of on-the-job follow-up support will be an important component of sustainability.

18. **Autonomous Public Agencies Directorate**. Although not currently covered under the PFMCBP, the Directorate requires technical support in the drafting of a Decree Law and to assist in the establishment of administrative, procedural and technical functions. MOF is considering options for sourcing bilateral technical support, though this is not looking very promising at this stage.

SUMMARY OF ISSUES AND RECOMMENDATIONS

Issues	Recommendations	Suggested Next Steps
Timely Implementation of the IFMIS	The Director of the IFMIS Unit be appointed on a full time basis. Appointment of a Lead IFMIS Adviser as a matter of priority.	Decision for the Minister in consultation with DGSF/SMA. Agree whether the TA needs can be accommodated under the Program or source alternative support.
Strengthening Planning and Medium Term Budgeting	Define MOF's role in ensuring improved linkages within the context of the national SDP initiatives. Develop methodologies to improve the bottom-up preparation of program/project forward estimates. Priority recruitment of the two Budget Advisors.	MOF's role and inter-relationship with the EPIA defined as part of the SDP and the SP. PIU and Budget Directorate agree with DGPAR and WB. The PIU to action in consultation with the Director General and SMA
Maintaining Budget Credibility	MOF to monitor virements and advise COM on significant shifts as part of budget execution reporting.	Core function of ERU.
Improving capital budgeting and expenditure analysis	Appointment of ERU Adviser. Estimate unit costs for key capital expenditure types, leveraging off the work of the ADB TA to MOI, and strengthen the requirements set out in the Budget Circular. The ERU and PIAU undertake a review of capital projects funded in 2008 and the 2009 budgets comparing basic project outturn (costs, timelines, project adjustments) against budget and plans to identify key issues and make recommendations.	PIU to action. DGSF/ERU and DGPAR to action. DGSF/ERU and DGPAR to action.
Building internal audit capacity	Appointment of the Internal Audit Advisory support to assist in the development of Government policy and procedures, the establishment of MOF Internal Audit institutional arrangements, and the training of Treasury internal audit staff.	PIU to action in consultation with DGs of Corporate Services and Director of Treasury. SMASF progress discussions with local accounting firms and international auditing bodies.
Strategy for decentralization of Treasury operations to LMs and intended expansion in district operations	To be defined within the context of finalizing the Ministry's SP, including strategies for strengthening the operations of existing LM and District FOs functions.	DGSF to work with Advisers to prepare an issues paper. Engage with IMF mission looking specifically at Treasury strategy (August).
Resolution of National Procurement Directorate issues	COM resolution of issues relating to overlaps of mandate between the NPD, PMC and PTS and the staffing and resourcing issues. MOF executive consideration of proposal for new organizational structure for NPD. New Decree Law drafted for COM consideration TA support be secured to assist in the development of the supporting regulatory, system and procedures.	MOF, VPMO and donors to coordinate urgently for exchange of information and mobilization of support. The DGSF and SMA discuss with the PIU associated TA priorities, ToRs and funding options.
MOF's role in Development Decentralization Package.	MOF to take a lead role in the establishment and effective operation of the JDTs.	The NPD draft guidance/standards on the company ranking criteria and JDT's procedures and reporting for consideration by CoMs.

ANNEX D: STRENGTHENING CAPACITY IN THE GENERAL DIRECTORATE OF REVENUE AND CUSTOMS

ACHIEVEMENTS

1. The Directorate General of Revenue and Customs (DGRC) was established as part of the reorganization of MOF. Most senior positions in the DG have now been filled through merit-based recruitment processes. A new tax and duties act was adopted in 2008 and several other tax laws are in the process of being amended as well as a new customs law. This was all supported by TA under PFMCBP, which has contributed to increased capacity of DGRC management and staff.

2. **Domestic Tax**: Steps were taken to formulate, develop and implement an effective taxation compliance strategy and to strengthen the management of the tax system. There has been an increase in the number of taxpayers registered, and access to third party data has facilitated the desk audit of taxpayers. Educational campaigns were launched to increase taxpayers' understanding of requirements and obligations. A combination of these initiatives has led to an increase in domestic revenue. A new version of SIGTAS has been introduced and will provide a web-based platform to improve access to information. Finally DGRC undertook a client survey to seek feedback, and improve its services.

3. **Petroleum Tax**: Advisers have provided critical in-line support to desk audits, tax administration, management of outstanding debts, and written opinions to taxpayer representatives. A draft Memorandum of Understanding for the Australian Tax Office to enable field audits of petroleum companies could not be concluded. The Government has instead asked companies to bring their books to Timor-Leste for auditing. Training was provided in book keeping and accounting, and steps are being taken to build compliance capacity.

4. **Customs**: Despite relatively less support to Customs under PFMCBP compared to other areas, much has been achieved in Customs. A training framework has been prepared and is expected to be approved shortly. The automation of customs procedures has improved with progressive introduction of ASUCUDA modules and a communication link between Batugade and the international airport. There has also been progress in improving the time required to approve duty and tax exemptions at the airport, streamlining of customs declaration processing, and risk assessment procedures to improve the selection of shipments for inspection.

CHALLENGES AND PRIORITIES

5. **Strategic Plan for DGRC**: As part of the Ministry's Strategic Planning process, it is recommended DGRC develop a strategy and implementation plan at the Directorate-level. This should provide a strategy for tax and customs over the next five to ten years and include a more detailed twelve-month implementation plan and supporting key performance indicators (KPIs). The MTR recommends that the immediate priority over the next 12 months is to focus on stabilizing the core tax administration functions and to limit the number of reform measures in customs. Furthermore, the Minister has made it clear that the government wishes to see a significant increase in the domestic tax take as a result of improved compliance. Priority actions for the next 12 months are summarized below.

6. **Field audit of petroleum companies**: The DGRC has been unable to perform any field audit of petroleum companies for the past 18 months. This poses risks in terms of the behavior of petroleum companies. The Government has written to all companies asking them to bring their books to Timor-Leste so that they can be audited. This process has already started. The mission recommended that MOF consider securing the services of international tax auditors beyond the life of PFMCBP.

7. **Taxpayer registration**: The DGRC is responsible for maintaining an up-to-date register of taxpayers, though there are currently inactive taxpayers on the register and several businesses that are not yet registered. The mission recommended to: (i) assign staff to ensure that the taxpayer register is up-to-date; (ii) launch a campaign to ensure that all existing businesses are registered; (iii) begin to undertake simple compliance checks of newly registered taxpayers. One suggestion is to make use of students to undertake a geographical survey to see if some businesses have avoided the requirement to register.

8. **Filing of tax returns and payments**: Stop-filers (businesses who do not file expected tax returns) are currently not automatically detected and sent a reminder letter. The IT system (SIGTAS) can identify stop-filers, however, since the taxpayer register is not up-to-date, the list produced by the system is not useful. DGRC needs to take steps in the short term to increase its efficiency in detecting stop-filers. It will need to identify those taxes where the tax administration expects monthly returns. The mission recommended to begin issuing letters once the taxpayer register has been updated.

9. **Taxpayer audits**: DGRC has taken important steps in 2009 to increase its ability to detect under-reported income from domestic taxpayers by trying to match data received from customs with that reported on tax returns. Over the medium/long-term, it is important to go beyond desk audits. Existing auditors in DGRC noted that much more training is needed before they could do more complex audits. But one option is to begin very simple targeted field audits, which would send an important signal to companies that DGRC is going beyond "financial audits." For example, existing staff could start auditing the wage tax by visiting business premises and verifying actual employees against reported employees. The mission recommends identifying the areas where targeted field audits could be useful and provide necessary training.

10. **Collection of tax arrears**: Currently, tax arrears in domestic tax is approximately USD $3.5 million and it is estimated that approximately USD $800,000 is unrecoverable. Priority is being given to prosecuting large defaulters, but there may be more merit in strengthening capacity to recover arrears without having to go to court. The mission recommended: (i) to review existing collection enforcement procedures manual and update where necessary; (ii) to provide follow up training to all tax collectors; (iii) that management review that staff are using the full set of collection enforcement procedures; and (iv) to group all tax collectors (small business, large business and petroleum) into one team.

11. **Automation and MIS reports**: While the current version of SIGTAS supports basic tax administration needs, modifications can make the product even more user-friendly. The current version does not provide reports on the efficiency and effectiveness of each core tax administration function. Whilst the information can be extracted, the system should be able to automatically generate meaningful reports without having to rely on several experts. The mission recommended: (i) that DGRC review how other tax administration use SIGTAS (e.g. recruit a SIGTAS expert from another country to conduct an independent review of Timor-Leste's SIGTAS version); and (ii) Establish a small working group to review sample management reports and identify which reports would be of value in Timor-Leste.

12. **Customs clearance procedures**: DGRC has taken steps under PFMCBP to reduce clearance times for import/export of goods at the Dili port, but a number of additional measures could help to further improve efficiency. The mission recommended to: (i) reduce the number of inspections by introducing random sampling of shipments; (ii) monitor the results of inspections and ensure information is captured into ASYCUDA.

13. **Post- clearance audit function**: This is a relatively new function and considered an effective approach to monitoring customs operations at the different entry points. It will take time before it is fully established but the Directorate will be receiving support from New Zealand Customs. It will be important to take small practical steps. For example, in 2010, staff could review a sample of import declarations with duty and excise exemptions to review if proper authorization had been secured, review results of inspections to determine any trends, and review valuation of goods. The mission recommended to develop a post-clearance audit plan.

14. **Customs import/export statistics**: ASYCUDA is a powerful system but when it comes to report generation, it is expected that each country will determine its own needs. Priority should be given to ensuring existing reports are complemented by a more comprehensive set of import/export reports, which should at least provide the standard set of reports needed by any customs administration.

SUMMARY OF ISSUES AND RECOMMENDATIONS

Issues	Recommendations	Suggested Next Steps
Identify medium to long-term priorities for Revenue and Customs	As part of the Ministry's Strategic Planning process, develop a strategy and plan for Revenue and Customs, supported by key performance indicators (KPIs).	Recruit SMA to work with existing tax/customs advisors, with responsibilities for developing the strategy and plan Discuss short term technical inputs into the strategy and plan with World Bank Review adviser resourcing requirements as part of Annual Report and Procurement Plan process, due first week September
Field audits of petroleum companies	Progress on finalizing MOU between DGRC and Australian Tax Office. Explore option of contracting the services of international tax auditors beyond the life of PFMCBP.	
Immediate priorities on domestic tax	Stabilize core tax administration functions by: - Updating taxpayer registration - Increasing efficiency in detecting stop filers - Identifying areas for targeted field audits - Reviewing collection enforcement procedures to strengthen collection of arrears - Reviewing how other tax administrations use SIGTAS to improve functionality	Develop an action plan for tasks to be focused on over the next 6 months to December 2010. Modify SIGTAS to make it more user-friendly for the Directorate Initiate short term TA to: Assist with risk assessment targeting non-compliance Develop an internal audit strategy
Immediate priorities for Customs	Focus on short-term priorities including: Improving efficiency of Customs clearance procedures. Develop a post-clearance audit plan. Ensuring existing trade reports are complemented by a more comprehensive set of import/export reports.	Initiate short term TA to assist with risk assessment targeting non-compliance
Capacity development.	Develop a training framework for revenue and approve the draft customs training framework (framework will provide a "blueprint" of all training courses and course outline needed for each tax and customs functions --- this could be used to secure additional donor support beyond this current program).	Short term TA to assist in developing training framework.
Language issues limit staff ability to access information	Seek advice from Corporate Services on office circular providing guidance on implementation of official language policy	Translate key laws & regulations in Revenue and Customs into Tetum or Bahasa.

ANNEX E: STRENGTHENING CAPACITY IN THE GENERAL DIRECTORATE OF POLICY ANALYSIS AND RESEARCH

ACHIEVEMENTS[2]

1. **Establishing DGPAR:** The program has helped to establish DGPAR from a zero base to a DG that has already started to play an important role in informing fiscal policy and the Government's development strategy. The program helped to set up the legal and institutional frameworks for DGPAR and to run competitive selection processes for senior management. Strategic staffing plans have been prepared for the rest of the DG and recruitments are expected over the coming months.

2. **Strengthening capacity for macro monitoring and analysis:** MOF has made good progress in developing a macro model, particularly given the data and capacity limitations. A real effort has been made to keep the model updated, which was developed jointly with the IMF, and to start collecting data on domestic production, to substitute for the lack of national accounts. There is also the start of good debate on macro issues within the Ministry, but also with the BPA and at the Council of Ministers during budget preparation. The macroeconomic framework played a critical role in informing both the 2009 and 2010 budget preparation processes. In addition the Macro Directorate has worked closely with the Prime Minister's Office on the preparation of the Strategic Development Plan.

3. **Compilation and dissemination of key economic and social statistics:** There is evidence that statistics are playing a greater role in policy making. There are efforts underway to disseminate data and promote greater use of quantitative information in policy discussions (including at the Council of Ministers). The allocation of increased budgetary resources to the Statistics Directorate (SD) is an important indication of commitment to strengthening statistical capacity. One particular area where there has been good progress is in developing the source statistics needed to compile national accounts. This has generated additional data on hospitality services, construction activity, agricultural production and other economic activity. In addition to its earlier reports on CPI and trade, SD has started to publish every quarter a summary of key economic and social statistics.

CHALLENGES AND PRIORITIES

4. **Consolidating progress and strengthening DGPAR functions:** With the creation of an Economic Policy and Investment Agency, it is critical to ensure that MOF is not stripped of its policy analysis capability. This will require DGPAR to keep up its efforts to stabilize and upgrade its core business processes to support development planning, and monitoring and reporting both at macro and sector levels. It will also need to keep building networks of stakeholders in the MOF mandate and improving the content of the dialogue using better information. The mission recommended to deepen in-house capacities in high priority areas (macro analysis and monitoring; Petroleum Fund policy management; micro policy on public investments) and to explore additional assistance from the World Bank and development partners to achieve this.

5. **Staff and institutional capacity development:** DGPAR is one of the more difficult areas to staff and institutionalize given the breadth of its responsibilities, and the specialized economists' and policy skills that it requires. The immediate challenges in DGPAR are to retain the necessary staff numbers and skills to build on progress. There is a lot of reliance on short term contract staff, which negatively impacts on sustainability and scarce training capacity. The DGPAR staffing plan sets out recruitment for over 130 new staff. The recruitment processes are likely to take longer because they are now centralized in the Civil Service Commission. The mission recommended to prioritize these efforts but also to continue accessing external support for highly technical work.

[2] This summary does not cover the Petroleum Fund Directorate under DGPAR.

6. **Medium-Term Fiscal Framework (MTFF):** The macro model has been useful to assess the impact of different expenditure scenarios on budget financing, in particular impacts on the Petroleum Fund. This provides a strong basis to deepen the analysis and develop an MTFF, which would help to look at fiscal sustainability. This is an area that would benefit from further discussion and analysis, particularly now that the government is considering to borrow externally. Although fiscal sustainability is not a problem in the short-term, given the build-up of petroleum savings, it is an important issue for the medium-term in light of rapidly growing non-discretionary spending and a large non-oil deficit. The mission recommended to explore options for additional assistance in this area from the development partners.

7. **Public Investment Management:** A high priority for the Government is to strengthen its Public Investment Management (PIM) capacity given the rapid rise in spending on infrastructure. There is currently a lack of project appraisal, scrutiny of public investment plans, monitoring of physical implementation, and ex-post assessments. MOF has a critical role to play in promoting better PIM across the Government and determining whether capital project proposals meet minimum standards for inclusion in the budget. It can help to develop guidance for line ministries for preparing capital budget submissions, including appraisal techniques such as cost-benefit analysis. The mission recommended that DGPAR work with the Expenditure Review Unit to strengthen capacity in the Micro Department for this work, including with additional assistance from the development partners.

8. **Complete the Framework for Compilation of National Accounts:** Establishing a system of national accounts is a high priority for Timor-Leste as it provides a framework for measuring economic activity. It provides essential information for economic policy makers and MOF. The last time national accounts were compiled and used to estimate Gross Domestic Product (GDP) in Timor-Leste was in 2003. It is a highly technical area, which will require sustained support, not only to ensure the capacity to manage the data collection exercises, but also to oversee the quality and consistency of the process. SD has followed the recommendations in the Statistics Work Plan to undertake Household Income and Expenditure Surveys, Business Activity Surveys and Agriculture Production Surveys to compile national accounts. Important progress has been made particularly on HIES.[3] However, the mission recommended that SD should look at how to institutionalize these processes, including through capacity development of staff, or follow on support from consultants, to ensure that the surveys are not one off exercises.

9. **Continue to implement Statistics Work Plan:** Some of the key issues identified in the SWP will take time to address, including technical capacity of staff and ad hoc surveys displacing existing capacity from the more regular work program of SD. The census and various surveys (e.g. Demographic Health Survey, Labor Force Survey) are no doubt also contributing to staff capacity in survey design, data collection, analysis and reporting. But there is heavy reliance in SD on temporary staff. Efforts are being made to recruit more permanent staff but this is likely to take time.

10. The program review last year had recommended to recruit consultants to assist with institutional strengthening and updating the Statistics Law. These are areas that will be covered by TA provided by the ADB. This additional input will be important to help the Director of Statistics and the newly appointed Director General to coordinate a very heavy agenda. The mission also recommended, as in other countries, to have a multi-agency advisory committee, which sets priorities on what information needs to be collected and by whom.

[3] The Bank has submitted comments separately on the survey design and indicated that the current design cannot be used for purposes of updating the 2007/08 poverty analysis.

SUMMARY OF ISSUES AND RECOMMENDATIONS

Issues	Recommendations	Concrete Next Steps
Medium/Long-Term priorities for DGPAR	Deepen in-house capacities in high priority areas and agree strategy to source external assistance in other areas.	Complete SP with implementation plan for a clear set of core business processes around Macro, PIM, PF policy, and Statistics. Review possible additional support to strengthen coordination with the SDP.
Staffing	Prioritize recruitment process for DGPAR.	
Budget financing trade-offs.	Develop Medium-Term Fiscal Framework, which forecasts fiscal aggregates, and helps to assess trade-offs of different financing options.	Additional TA from development partners to work with Macro Department.
Capital budgeting.	Promote better public investment management across the Government by strengthening project appraisal.	Additional TA from development partners to work with Micro Department. Work with ERU to analyze capital expenditure.
National Accounts	Institutionalize the process for compiling national accounts through the development of a Formalized Framework, and ensure adequate staffing.	Completion of Formalized Framework by Summer 2010. Completion of capacity development plan by September 2010.
Implementation of Statistics Work Plan.	Prioritize remaining actions under SWP and assist Director and DG to coordinate the agenda. Update Statistics Law. Establish multi-agency advisory committee on Statistics.	ADB to provide additional TA to address these issues.

ANNEX F: STRENGTHENING CAPACITY IN THE GENERAL DIRECTORATE OF CORPORATE SERVICES

ACHIEVEMENTS

1. Corporate Services has made significant progress in developing its capacity, and helping to steer MOF through a period of major changes. The development of knowledge and analytical capacity in MOF's leadership and management has been significant, and this has had a positive influence not only on MOF staff and productivity but also on other ministries.

2. **Restructure of the Ministry:** DGCS led the restructuring of the Ministry. An Organic Law for the Ministry of Finance (Decree Law N. 13/09 of 25 February 2009) was promulgated, establishing four Directorates-General: Corporate Services, Policy Analysis and Research, Revenue and Customs, and State Finances. Ministerial Diplomas were introduced to define the mandates of the DGs. Corporate Services is the support arm of the Ministry in the areas of human resources, information technology, building management and logistics, translation services, media functions, documentation and records management, and internal audits.

3. **Recruitment of Management Positions**: As part of the restructure, DGCS managed the merit-based recruitment of four Directors General, eight National Directors, and over thirty Heads of Department. The process for selection followed the Regime for Selection Processes for Recruitment, Appointment and Promotion of Staff in the Civil Service, Decree Law N. 34/08 of 27 August 2008.

4. **Strategic Plan**: DGCS led the development of the draft Strategic Plan, convening workshops and preparing background papers. The draft Strategic Plan provides an excellent basis to set out priorities for the next phase of the Ministry's development. The draft Strategic Plan is discussed further in **Annex J**.

5. **Special career regime**: DGCS has prepared a draft special career regime for the Ministry of Finance, to help it recruit technical staff such as accountants, economists, statisticians, lawyers, and IT specialists. The Civil Service Commission is reviewing the implications of the proliferation of special regimes on the main Career Regime and trying to assess the cost implications for the national budget.

6. **Human Resources**: DGCS has started to establish the Ministry's human resource function. Achievements includes: initial workforce planning; a Training Needs and Processes Analysis; establishment of an HR database at the Civil Service Commission; investigation of staff misconduct; and support for the implementation of the Civil Service Act and related regulations.

7. **Information Technology:** Information Technology support services have been established with PFMCBP support. International consultants have now been absorbed under the State Budget. Progress includes: maintenance of network operating system; development of hardware specifications and standards for MOF; introduction of IT security systems; support for IT applications (FreeBalance, ASYCUDA, SIGTAS, GRIMS, PMIS), which includes updating technical manuals; introduction of fiber optic connections to the Customs wharf.

8. **Other Ministry-wide support**: The program has helped prepare ministerial guidelines and circulars on vehicle management, recruitment of contractual staff, procurement, and nomination of staff for training courses. Other routine activities include logistical support for the management of the vehicle fleet, refurbishment of office space, and the new Customs and Taxes building.

CHALLENGES AND PRIORITIES

9. **Challenges on Capacity Development**: DGCS plays a central role in the Ministry's efforts to strengthen staff and organizational capacity. Due to the increasing pressures on the Ministry of Finance in recent years, for example the ten-fold increase in the state budget since 2005, and consequent impacts on staff workloads, the Ministry has not made the progress desired in developing the capacity of Timorese civil servants, and it remains highly dependent on externally financed consultants. Corporate Services thus needs to make a major push to get a variety of activities underway that are critical not only for itself but for other parts of the Ministry.

10. The Ministry, however, noted that this was not just due to work pressures. MOF's approach explicitly recognizes that strengthening individuals' capacities needs to be preceded by the establishment of a minimum set of systems and processes. MOF has drawn on technical assistance, and focused on building up a strong cadre of senior managers to help deliver this. For example, MOF cannot train staff to become auditors unless the necessary system of controls and associated procedures has been established. Once these are in place, appropriate job descriptions can be developed, and capacity assessed against those. Further, the Ministry noted that providing training in the absence of this would not produce results.

11. **Taking an Organizational Development Approach**: One of the key recommendations of the Mid-Term Review is that the program revises its approach to capacity development by sharpening its focus on the capacity of the Ministry of Finance as an organization to achieve its goals and objectives. This contrasts with an approach to capacity development that focuses primarily on the capacity of individuals, which is often characterized by an adviser / counterpart model to skills transfer that has generally proven ineffective (see Box).

12. This is in line with the steps already taken in reorganizing the Ministry and putting in place some basic systems, which are needed for a well functioning MOF. The Ministry noted that the MOF's experience showed that without this, it is not possible to embark on organizational capacity development. One of the purposes of the reorganization was to clarify functions and mandates, which would then define the human resource capacity needed to deliver results. To do this, expertise was needed to design the organization, identify needs, and assess existing capacity. This has been partially done. In three years, the process has gone down to the level of Heads of Department. But given the enormity of the task, more is needed. For example, the performance contracts and individual capacity development plans of those that have gone through merit-based recruitment processes are not yet in place. To drive this process, the program needs to strengthen the capacity in Corporate Services.

13. **Increasing the Resourcing of Corporate Services**: Corporate Services has a critical role to play in helping the Ministry to strengthen its organizational capacity. Many of the key achievements of the program highlighted above - relating to strategy, structure, staffing, and systems – have been driven by Corporate Services. Some key Corporate Services functions have received insufficient attention under the program: human resources management was neglected; important posts, including covenant positions such as the HRCD adviser, were left vacant for extended periods. Many good initiatives, for example human resources planning (Q3 2009), did not start until very late in the life of the program. Whilst staff resources assigned to these activities have been inadequate, this has begun to change, in part because of the attention bestowed on DGCS by the Minister. It is now critical to ensure that the Directorate, and in particular the Human Resources Unit and Strategic Plan Group has adequate resources to support the implementation of the Strategic Plan.

14. **Making Organizational Development central to the Strategic Plan**: The themes of corporate reform and organizational development should be front and centre in the Strategic Plan. For a Ministry of Finance at the stage of evolution of Timor-Leste's, strengthening the capacity of the organization to fulfill its mandate ought to be one of the highest priorities of the senior management team, and fully reflected in its Strategic Plan. At present, whilst capacity development is mentioned many times in the draft Strategic Plan, the document tends to stress individual competencies at the expense of organizational development and a discussion of how various elements of the Ministry – systems and processes, management, incentives, learning processes, relationships, staff and TA – can better interact to more effectively deliver the MOF mandate. The Ministry noted that this would need to be revised in re-drafts.

15. **Responsibilities of Senior Management for Capacity Development**: Changing the focus of capacity development away from individual competencies towards strengthening the Ministry of Finance as an organization will also require the senior management team to take the lead on capacity development, with continuing overall leadership from the Minister and the Vice Minister: discussing the issue with the CCFM on a weekly basis, participating in team meetings with Directors, Heads of Department and their staff to help everyone understand the priorities and improve communication at all levels of the Ministry. It is particularly important that middle managers (Directors and Heads of Department) are encouraged to demonstrate leadership on implementation of the Strategic Plan in general, and capacity development in particular. A Management Course for middle management is a high priority for the PDP in 2010.

16. **Establishing A New Strategic Planning Group**: The MTR recommends that a "Strategic Planning Group" be established in Corporate Services to help the senior management team drive the implementation of the Strategic Plan within the Ministry of Finance, and to support the senior management team in making capacity development a central focus at the levels of the Directorates General and Directorates. The Group should report regularly to the Minister of Finance. It is anticipated that the Strategic Planning Group would primarily draw upon existing staff and consultant resources in Corporate Services. The World Bank has offered to provide some supplementary resources in this area.

17. **Mainstreaming the Institutional Development Capacity Building Plan**: The IDCBP is listed in the Results Matrix as a high level performance indicator against the program objective. It is important however that the IDCBP not be treated as a "stand alone" document and that instead it is fully integrated into the Ministry's own strategy and plans. The MTR recommends therefore that the Strategic Plan should include a section setting out the approach to developing organizational capacity in the Ministry; and the Directorates-General Implementation Plans will then include a section setting out their own plans for developing organizational capacity at the level of the Directorates. Corporate Services has already completed key elements of the IDCBP including the Staff Mapping. Wherever possible, the IDCBP will use existing documentation. It is proposed therefore that the IDCBP as a deliverable would simply consist of a brief submission to the Minister and the senior management team setting out the key elements of the strategy proposed for improving the organizational effectiveness of the Ministry of Finance, with attachments that would include the proposed text to be included in the Strategic Plan, excerpts at a later date from the Implementation Plans, the Staff Mapping, and a strategy over the medium term to reduce the reliance on externally financed consultants. In general, the IDCBP should discuss issues such as attracting high quality technical staff to the Ministry through the special regime; training priorities for new and existing staff; introducing effective performance management systems in the Ministry; and human resource planning, including exploring options to recruit specialist skills through the state budget.

18. **Acknowledging Language as a Major Constraint on Capacity Development.** There is one issue that tends not to be addressed in the capacity development strategies discussed, perhaps because it is so fundamental and yet so intractable. This is the question of language. The Ministry of Finance uses four languages: Portuguese, English, Tetum, and Bahasa. Most educated Timorese civil servants are literate in

Bahasa, the preferred language for reading and writing. Most Timorese civil servants tend to converse in Tetum. English and Portuguese language skills are extremely limited. And yet English and to a lesser extent Portuguese are the most influential languages in the Ministry of Finance when it comes to high level policy, planning and legislative work that involves the international adviser cadre. This limits greatly the ability of most Timorese civil servants to participate fully in the work of the ministry. During the MTR, language was repeatedly raised as the single most important constraint to developing an effective civil service in Timor-Leste. The Mid Term Review would therefore like to make some practical recommendations in relation to language:

- Increased access to the services of translators and interpreters funded by the program;
- An 'audit' to identify key laws and regulations, as well as policy papers and office circulars, that need to be translated from Portuguese &/or English immediately for civil servants to understand their day to day responsibilities. Staff would often benefit from having a glossary of terms too;
- An identification of civil service positions that require special language skills for the effective performance of those roles – and the targeting of language training towards those positions;
- A continuation of efforts to recruit consultants with relevant language skills, as well as encourage long-term consultants to acquire and extend their language skills;
- An office circular that sets out how the Ministry intends to operationalise Timor-Leste's official language policy in practice by providing guidance on where it is appropriate to use translators / interpreters in the Ministry to ensure staff have access to essential information.

Box 1: Recent International Experience on Approaches to Capacity Development

Recent international reviews of what works in approaches to capacity development in fragile states highlights two important issues:

First, there is often a lack of clarity of **definition** related to capacity development, with much of the discussion not defining the "capacity" to be developed nor with whom. Graham Teskey, in a recent paper entitled *Notes on capacity development with a focus on fragile and conflict-affected states* presented to the World Bank, has proposed that the following terminology might provide some clarity:

- Individuals have skills and *competencies;*
- Groups within organizations and organizations have *capabilities* to do functional things such as manage people, account for funds, adapt to change and build relationships; and
- More broadly, organizations have *capacity* which is often defined in terms such as legitimacy and responsiveness. This capacity derives or emerges from the quality of the interrelationships among competencies and capabilities together with context.

The ultimate focus should be on the capacity of the organization and how this supports the organizational mandate and goals. In other words, what capacity is needed to carry out key functions and how should this be developed? This is in contrast to many approaches to capacity development, which focus on set activities like training and TA without a clear understanding of how they contribute to increases in capacity.

Secondly, the TA-counterpart model has been ineffective in most countries and consequently dropped in many. Besides being expensive, this one-on-one relationship is usually not very effective because it depends on many different factors working well, including the rapport between the TA and the counterpart, the interests of the various stakeholders and the values, informal decision-making processes and communication styles of the organization concerned. Most donors now focus on the relationship between the TA person and the organization more broadly. Effectively, a TA person has the organizations as a whole as his or her counterparts and is expected to develop activities such as training sessions and mentoring for a groups rather than one individual.

19. **Establishing Internal Audit capacity:** This is an important area for promoting a culture of accountability not only within the Ministry but elsewhere within the civil service. It ought to be seen as an integral part of the development of the organization, and would benefit from program support.

20. **Training centre:** The Ministry proposes to establish a training centre to offer courses for its staff in areas such as accounting, finance, and taxation. The centre should also organize training for line ministry personnel with responsibility for these functions, as well as those functions that have been decentralized. The centre would also want to ensure that the components of finance and accounting in the INAP supervisor and manager courses meet the standards of the responsible directorates in the Ministry.

21. **Civil Service Commission:** There are several issues where DGCS needs to engage in regular dialogue with the Civil Service Commission: temporary staff; performance regime; special regimes; possible introduction of a pilot graduate program. On the first issue, over 40% of the staff in the Ministry are temporary. This can undermine capacity in the medium to long term, because these staff are sometimes excluded from training opportunities, and are likely to take the first opportunity available to become permanent civil servants - leaving with the competencies they have acquired over the course of their employment. On the last issue, the introduction into the Ministry of a pilot graduate program would see an annual intake of talented graduate economists recruited into the Ministry and prepared through a special induction program for a career with the department.

SUMMARY OF ISSUES AND RECOMMENDATIONS

Issues	Recommendations	Next Steps
Capacity dvpt activities tend to focus on individuals rather than MOF as a whole	Shift focus of CD efforts from individual to organizational level. Ensure adequate resourcing of DGCS Increase the effectiveness of the TA-counterpart relationship	Develop process indicators or pointers to track organizational capacity Redefine the counterpart as the group or organization within which the TA works Investigate introducing a course like AusAID's *Making a Difference* for TA and counterparts
Revised approach to capacity dvpt requires increased focus on Corporate Services	Increase focus of program on Corporate Services due to its central role in strengthening organisational capacity in Ministry	Provide short-term consultancy support in strategic planning, M&E and CD
Risk that Strategic Plan has insufficient focus on Org. Dev.	Make organisational development a central focus of the Strategic Plan	(Provide short-term consultancy support in strategic planning, M&E and CD – as above) Ensure that senior management (CCFM) take responsibility for capacity development in their Directorates
Risk that Strategic Plan will not be implemented at departmental level	Establish a new Strategic Planning Group in DGCS to drive corporate change agenda in the Strategic Plan	Minister to nominate members of Strategic Planning Group, drawn primarily from within DGCS, to report to the CCFM
Institutional Development and Capacity Building Plan not implemented	Mainstream IDCBP as part of Ministry's Strategic Plan and Implementation Plans	HR&CD to prepare ministerial submission, and STCs to assist with mainstreaming in the Strategic Plan, Implementation Plans, and other workforce planning documents
Language issues limit staff ability to access information	Develop office circular on how to operationalise Timor-Leste's official language policy in practice in the Ministry of Finance	Increase immediately the number of interpreters / translators in the Translation Unit of DGCS. Translate key laws & regulations and other essential Ministry documents. Identify staff positions where special language skills required, and provide targeted training Recruit consultants with relevant language skills and encourage consultants to extend skills.
No audit unit	Establish an audit unit	Provide at least one international TA and one national TA
Training centre	Establish an in-service training centre	Provide international training specialist for a minimum of six months
On-going rollout of FreeBalance system	Continue to support on-going rollout of system	Provide international TA to assist in decentralizing FreeBalance to line ministries and to train national consultants

ANNEX G: PROGRAM IMPLEMENTATION

1. Day-today program management is overseen by a dedicated Program Implementation Unit (PIU) lodged within DG Corporate Services. This has remained under the leadership of the Program Implementation Officer (PIO) who is currently also the Director General of Corporate Services. The program restructuring approved by the World Bank Board of Executive Directors on February 11, 2010 focuses on five areas of change including: *the adjustment of the program's implementation arrangements, to ensure the continued control of fiduciary risks and to strengthen monitoring and evaluation (M&E) and reporting.*

2. **Program Management**: The PIU has achieved notable progress in managing the considerable administrative workload since the beginning of the program. The PIU has played a critical role in program achievements by ensuring that the program receives timely and quality inputs (i.e. recruiting the experts needed to support MOF's reform agenda); providing administrative and logistical support; and ensuring that the program's results are properly monitored.

3. Despite these achievements, there are a number of areas that need strengthening. PFMCBP is a complex operation that involves over ten Directorates and Departments within MOF. The PIU has to coordinate a large number of individual consultants and their contracts to ensure alignment with program objectives and adherence to Bank operational requirements. The management of individual consultants is done through a hierarchical structure down through the SMAs. But given the complexities more effort is needed to systematically monitor and evaluate the performance of consultants against program objectives. Progress is being made since the appointment of the Senior Program Manager, and issues around Reporting, Procurement and Financial Management are covered in more detail below.

4. **The PIU Organizational Structure:** The MTR found that the organizational and reporting structure within the PIU need to be clarified, and the guidance provided in the draft Program Operational Manual (POM) strengthened. This is understandable as key positions to support the PIU have only been recently filled (see para. 5 below). The MTR agreed that the SPM will draft reporting and other personnel management procedures within the PIU and for other areas of the program as soon as possible, and no later than August 31, 2010. To the extent possible, the role of the PIO should remain at the strategic level. Administrative matters should be handled directly by the PIU. These draft guidelines, after endorsement by the PIO, will be shared with the WB for comments and thereafter integrated into the POM.

5. **Staffing at the PIU**: Two critical positions, that of the Senior Program Manager (SPM) and the Senior Adviser, Human Resource Capacity Development (SA-HRCD) have now been filled in November 2009 and May 2010 respectively. The draft organizational chart of the PIU has been developed and is included in the MTR report. This chart shows the staff in place as well as positions urgently needed for the remainder of the program to ensure proper and efficient program management. The MTR recommends that the recruitment of additional staff (see table below) to manage the program be prioritized in the coming months.

6. **Program Operations Manual (POM):** The purpose of the PFMCBP POM is to set out in one document the guidelines and procedures for the management and implementation of the program. The manual is intended to serve as a generic guide. A preliminary version of the POM has been drafted by former consultants to the PIU. Many revisions are now necessary to update the program changes since restructuring and to strengthen the guidelines on accountability and responsibility. The MTR discussed the draft manual with the SPM and SA-HRCD and agreement was reached to revise the manual in specific areas. These updates will be done sequentially, and each update will be reviewed and endorsed by the relevant stakeholders, as they are completed. The priority areas that need to be addressed are:

- Management and evaluation of the Professional Development Program (PDP);
- The financial management sections of the manual will be revisited to clarify responsibilities and accountability and strengthen the internal control mechanism;
- A note on the strategic approach to the Institutional Development and Capacity Building Plan;
- Monitoring and evaluation as well as reporting with linkages to the revised program indicators;
- The program governance structure; and
- Flow diagrams to illustrate systems and processes.

7. The SA-HRCD will lead on the revisions to the manual with the collaboration and inputs from the SPM and the WB operations specialist. The first priority segment to be updated will be the PDP program management.

8. **Governance arrangements**: The success of the program depends much on sound governance structures, which may be redefined as necessary during project implementation. The development partners have noted that policy dialogue is one element of the governance structure that needs to be strengthened. The MTR agreed a number of ways to achieve this through the PFMCBP's three-tier governance structure.

- *First tier*: MOF is responsible for the strategic management of PFMCBP, through its Consultative Council on Financial Management (CCFM). During the MTR, the Minister invited a representative of the development partners to attend the weekly CCFM.
- *Second Tier*: A Supervisory Committee (SC), chaired by the Minister of Finance and comprising the World Bank and development partners, monitors the progress with program implementation and makes recommendations to the CCFM. This committee is supposed to meet bi-annually. The MTR agreed on quarterly meetings and recommended that the SC's work program till July 2011 is clearly defined.
- *Third Tier*: The DG of Corporate Services, through its PIU, is responsible for day to day management including the fiduciary aspects of the program. The WB is responsible for providing the support and guidance to the DGCS to implement the program in compliance with the legal documents. These fiduciary principles have been reiterated during the MTR and the recommendation is to include and update relevant sections in the POM to clarify those principles.

9. **Disclosure**: The PIU has been under pressure from stakeholders to provide detailed information on remuneration paid to consultants under PFMCBP given heightened press attention to the general issue. The MTR discussed ways of responding to legitimate requests whilst keeping transaction costs at a minimum. At the moment, the budget allocation for consultancy contracts and spending on signed contracts are reported at an aggregate level. This data (for reasons that are related to the setting up of the project chart of accounts) does not allow for a detailed view by line items. The WB team will work with Treasury and the PIU to ensure that reporting prepared allows for expenditures disaggregation at all lowest level possible. This will ensure that the information on remuneration communicated to those concerned are adequately represented.

10. **Reporting:** The MTR also discussed with the PIU several aspects for the improvement of reporting (including financial reports) so as to establish better linkages between expenditures and program indicators. Consultants currently report on a monthly basis, but the MTR agreed that it would be better to move to quarterly reporting, with clear linkages between the consultant's activities and the overall program. The MTR agreed a revised format for the quarterly reports. The format for the quarterly financial reports, which will be finalized once the FreeBalance is up and running, will also include other critical aspects of program implementation.

SUMMARY OF ISSUES AND RECOMMENDATIONS

Issues	Recommendations	Suggested Next Steps
PIU staffing	Advertise the position for the international advisor for procurement. Recruit a Senior Financial (SFMA) Management Advisor for the remainder of the program. Recruit an M&E specialist to assist the PIU in collecting the data for the evaluation of the program and collaborate in setting up the framework for program evaluation at closing.	SPM will draft TORs for 2 and 3 and send to the WB TTL for approval.
Internal reporting matrix within the PIU	Draft clear internal procedures and guidelines.	SPM will submit draft for review to the Bank by August 31, 2010.
Improve quarterly reporting	The quarterly report should be improved to establish better linkages with program results indicators – and highlight the quality of spending.	Treasury to finalize the customized FreeBalance software to be used for PFMCBP by end August 2010, to enable management of projects funds electronically. SPM and HR Advisor to discuss the new format for reporting with advisors and implement by end July 2010.
Professional Development Program	Draft clear guidelines for the management of PDP and include in POM	HR advisor in collaboration with PDP secretariat.
Program Operations Manual	Improve the format of the POM and introduce flow and relationship diagrams to make the document user friendly. Updates to be done in sequence.	First priority segment: update the management of PDP Second priority segment: update the FM.

ANNEX H: PFMCBP RESULTS MATRIX

PDO	Project Outcome Indicator	Progress
Capacity in the MoF strengthened for prudent, effective and accountable planning and management of public finance to promote growth and poverty reduction	Institutional Development and Capacity Building Plan implemented and ongoing needs identified.	Institutional Development & Capacity Building Plan implemented in part. Agreed it will be finalised as part of Strategic Plan process to December 2010.

Intermediate Outcomes	Intermediate Outcome Indicators	Progress
1. General Budget of the State is prepared in accordance with the budget timetable based on enhanced coordination, quality and realism of line ministry submissions, reflecting government priorities and medium-term fiscal sustainability	• Budget: prepared with three-year fiscal forecasts, submitted to Parliament 45 days before the end of the current fiscal year, and approved before the start of the new fiscal year. • Projected non-oil fiscal deficit < 90% of non-oil GDP for the 2010 central government budget and < 80% of non-oil GDP for the 2011 central government budget. • Aggregate revenue and expenditure outturn ≥ 80% of budget in the last two years.	• Quality of forward estimates needs to be strengthened. Budget submitted by 15 October as per Budget and Financial Management Law. • Macro forecasts not yet finalized, but withdrawals from the PF have been rising. • Revenue outturn is over 90% in 2009, compared to around 75% in 2008. Expenditure outturn in 2009 is close to 90%.
2. Treasury and procurement functions managed efficiently and transparently with due regard to accountability and quality of expenditure.	• Quarterly publication of budget execution reports within two months of the end of the quarter. • Daily reconciliation of government bank accounts using FMIS. • Publication of annual audited financial accounts within 30 days after its presentation to the Prime Minister (or within 30 days after the end of parliamentary recess, should it be closed on the date the report is delivered to the Prime Minister).	• Reports have been submitted on time to Parliament. MoF has adopted modified cash accounting system. Quarterly reports submitted on time. • Full reconciliation of accounts 2005-09 ($850mn in receipts and $800mn in payments). • Annual Audited Accounts for 2008 are published as required though with some delay because of change in auditors.
3. Government revenue functions administered efficiently and transparently, with improved revenue performance in line with economic developments and	• Improving results from public perception surveys, for each Directorate, of efficiency, effectiveness, ethics and integrity. • Increasing domestic tax collections as a % of non-oil GDP.	• In 2010, first survey by Asia Foundation shows a poor public perception of Customs, slightly better for Revenue. • In 2009, domestic tax was 9% of non-oil GDP, an increase from 8% in 2007. • In 2010, Petroleum Revenue compliance still

Intermediate Outcomes	Intermediate Outcome Indicators	Progress
compliance.	• Additional revenue collected from Petroleum Revenue compliance activities (difference between submission and collection). • Improving average time taken to clear green line Customs declarations - from time of entry lodgement with Customs to the issue of a delivery advice by customs.	does not include field audits. • In 2010, reported that average time taken for goods to clear green line Customs declarations has improved. No further data provided.
4. Government policies and budget decisions are better informed by timely economic analysis and projections based on reliable data.	• National accounts published by the Statistics Directorate and three staff trained as national accounts specialists by July 2011. • Statistics Work Plan agreed by MoF and other stakeholders, with implementation plan agreed and funding secured by end-2010. • Macroeconomic framework sets annual budget ceilings starting in 2009, with four staff able to update and interpret the framework by July 2011.	• Source data for national accounts being established, and efforts under way to appoint staff. SD have set April 2011 to publish national accounts and GDP estimates. • Key elements of SWP being implemented (HIES, BAS and APS). Additional funding secured from ADB. • A macro framework has started to set the annual budget ceilings. The model is gradually being updated and refined. At this stage it seems unlikely that four staff will be able to update and interpret the framework by July 2011.
5. Strengthened accountability, integrity and service culture through improved performance of core corporate support functions, and enhanced sustainability of MoF operations.	• 75% of leadership and management positions rated as sufficient and above in performance. • 75% of Grade B and C positions rated as occupied with qualified staff. • 75% of Grade D and E positions rated as occupied with qualified staff. • 5 qualified staff appointed to the audit unit and at least 3 audit reports issued. • 3 qualified staff appointed to the legal unit and at least 10 legal opinions issued. • 80% of IT cases logged have been resolved.	• Performance management review of leadership and management positions not yet conducted. • No assessment yet of whether Grades B and C staff qualified. • No assessment yet of whether Grades D and E staff qualified. • **Nil** qualified staff appointed to the audit unit and **nil** audit reports issued. • **Nil** qualified staff appointed to the legal unit and **nil** legal opinions issued. • 39% of IT cases logged have been resolved.
6. The Program is effectively implemented, through maintenance of operational standards, monitoring and evaluation, and regular reporting on results.	• ≥ 80% of Procurement Plan target implemented at every six monthly review. • Improved project supervision rating on implementation progress, procurement and financial management.	• 50% of Procurement Plan implemented (delays due to earlier funding shortfalls). • Improvements in all aspects of program implementation though more work needed on FM, M&E, and reporting.

ANNEX I: SUMMARY OF PROPOSED ADDITIONAL SUPPORT FROM THE DEVELOPMENT PARTNERS

Issues	Recommendations	Concrete Next Steps	Lead	Within
A: Strengthening Capacity in the General Directorate of State Finances				
• Transition to new procurement regime.	• MOF, VPMO and donors to coordinate and exchange information.	• Discuss among key stakeholders and agree way forward.	• MOF, VPMO with WB support	• 3 months
• PFM capacity in line ministries.	• Improve coordination between PFMCBP and other support to line ministries.	• Agree ways to strengthen PFM support as part of Health and Education MTRs.	• AusAID/WB	• 3 months
B: Strengthening Capacity in the General Directorate of Revenue and Customs				
• DGRC Strategic Plan	• Stabilize core tax administration functions.	• TA to support 12-month action plan, and completion of DGRC SP.	• WB	• 3 months
C: Strengthening Capacity in the General Directorate of Policy Analysis and Research				
• Macro-fiscal analysis to inform SDP.	• Develop MTFF with forecasts of major expenditure items and financing options.	• Concept note linked to ongoing work (macro model, debt sustainability analysis) for discussion with DGPAR.	• WB	• 6 months
• Public Investment Management policy.	• Public investment analysis, guidelines for public investment appraisal e.g. cost-benefit analysis.	• Complete analysis of 2008-09 capital expenditure, and develop guidelines for capital budgeting.	• WB	• 6 months
D: Strengthening Capacity in the General Directorate of Corporate Services				
• Finalization of MOF Strategic Plan.	• Agree remaining work to finalize SP and Directorate work plans including capacity development plans.	• Prepare a concept note for support to finalizing Strategic Plan to be agreed with DGCS, CCFM and donors.	• WB with AusAID support	• 3 months
E: Program Implementation				
• Program Operations Manual.	• Update all sections to reflect new program management arrangements.	• WB to work with PIU on updating PDP, FM, M&E and flow diagrams for systems and processes.	• WB	• 6 months
• Financial Management.	• Address recommendations on FreeBalance and strengthening expenditure controls.	• Additional implementation support from WB.	• WB	• 3 months

ANNEX J: STRENGTHENING PFM IN LINE MINISTRIES

1. There has been major decentralization of spending controls and delegation of authority to line ministries (LMs). Key changes include: authority to enter all Cash Purchase Vouchers (CPVs) into FreeBalance; procurement delegation up to $1 million; increased flexibility for virements; and allotment of LM's entire year's appropriation at the start of the year, meaning that cash management is performed at the LM level, rather than through periodic release of funds throughout the year from the Treasury. The only functions that remain centralised are payment processing and accounting[4].

ACHIEVEMENTS

2. The decentralization process has progressed relatively smoothly, although the most significant changes were introduced in early 2010 and the full impact will only be known over time. MoF has supported the process in two ways: i) building internal capacity to provide a stable and effective operating platform with which LMs can engage; and ii) enhancing its client focus and outreach efforts to support LMs. MoF has made considerable efforts to strengthen its 'client focus' with some examples below.

3. **FreeBalance Training and enhanced client focus in Treasury:** This consists of 7-10 days of formal training in the use of FB followed by four to six months of closely supervised on-the-job training in Treasury. Participants are benchmarked and progress monitored. It is widely acknowledged to be producing impressive results. Treasury staff have also been coached in active problem solving with LM staff. This has resulted in improved processing time within the Treasury (reportedly around one week). MOF now intends to apply the training model for the implementation of the Performance Budgeting and Procurement modules of the IFMIS.

4. **Procurement Training**: The National Procurement Directorate launched a large scale procurement training program for LMs. The training is provided by procurement advisors (national and international, through translation) and each course takes approximately 20 days.

5. **Ministry restructure with focus on client service**: The Procurement directorate established the Client Services Support Unit, where procurement officers acted as the point of contact for individual LMs to facilitate faster processing. The Budget Directorate has appointed LM specific focal points to provide support and guidance in the preparation of submissions. PFMCBP advisers have set up a coordination group with budget and financial management advisers in LMs.

6. **Expenditure review**: MOF has, in cooperation with LM staff, undertaken a number of expenditure reviews to build government wide capacity to analyse budget trends and outcomes. An Expenditure Review Advisor will work to identify and improve data sources, and feed findings back into the budget process for 2011.

CHALLENGES AND PRIORITIES

7. **Clear vision for decentralization in the Strategic Plan:** In the absence of a clear reform vision it is difficult to know whether or not the system that is evolving is the most suitable for Timor-Leste. It is recommended that the SP include a holistic vision of where the PFM system will be in five to ten years. This would require joining analysis at the central/ macro level (i.e. PEFA/ Fiscal ROSC reports) with detailed analysis of how systems are operating at the LM and service delivery level (through for example sector Expenditure Analysis and Public Expenditure Tracking Surveys in large spending ministries such as health, education and infrastructure).

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[4] It is not expected that accounting functions will be devolved until LMs have developed sufficient capacity.

8. **Extend client focus and outreach**: MOF should explore ways to enhance its client service structure/ culture such as those that have been implemented in the Directorates of Budget and Procurement. LM support functions could be strengthened and extended to other areas such as the Directorates of Treasury and Asset Management. This would enable MOF to fulfill its role as custodian of the PFM system through clear financial instructions, reporting guidelines, procurement manuals etc.

9. **Extend FreeBalance access:** Not all LMs have remote access to FreeBalance. In most cases, Finance officers need to go to MOF to a shared facilities room where they can log onto the system and generate a series of basic reports. MOF have contracted FreeBalance to reactivate the fiber optic network that was installed by the UN but is now no longer operational. Additionally, given limited capacity to replicate capacity building activities across LMs, centralised training and work placement within the MOF may be warranted in some areas. It is recommended to have reduced focus on formal training and increased focus on work placement. This means placing LM trainees in a structured work environment where they can continue to undertake their assigned duties, but under the supervision and support of experienced and trained operators. This model could be extended to areas such as internal audit, procurement and asset management.

10. **Procurement:** There are few civil servants capable of undertaking complex procurement in LMs. The confusion around the institutional mandates of the new Procurement Secretariat and MOF has destabilised the procurement system. LMs now have no central unit from which to seek advice and support, and the policy, legislative, regulatory and administrative framework remains unclear. The Ministry of Finance, however, has noted that these areas remains MOF's responsibilities. The mission recommended to address this urgently (see paragraph 15 of Annex C).

11. **Expenditure tracking:** For many major expenditure items (such as medicines) it is not possible to track expenditure on a Directorate or service delivery unit level. Account codes are now significantly improved since the introduction of a unified chart of accounts, although issues remain in some sectors where significant expenditure items, such as medicines, are bundled with operational supplies or other generic codes. Reporting on budget execution has improved, but more reporting on physical implementation is essential to tackle quality of spending.

12. **Accounting:** Treasury are responsible for issuing quarterly and annual budget execution reports presented on a modified cash basis, but agencies are legally responsible for keeping separate records to verify the information coming from Treasury. Most ministries are unable to maintain a complete set of accounts and rely extensively on the Treasury for budget management information. The Ministries of Health and Education are seeking amendments to the Chart of Accounts to enable the move in the 2011 Budget to program based budgeting, including more detailed sub-line item budgeting. This is a positive move in terms of improved monitoring and reporting on actual service delivery. However, the MTR team's discussions with the finance officers in these agencies highlighted a lack of clarity about how to progress this issue.

13. **Financial instructions:** LMs do not have access to financial instructions. Practice is based on a series of circulars issued by MOF, although none of the finance officers consulted had a complete set of these on hand. Many ministries have developed their own systems. The existence of comprehensive and clear set of Treasury instructions is an important component for building LM's understanding of requirements and improved operational capacity. Whilst Treasury had initiated some TA to work on development of a Treasury Manual, the task has not progressed as far as intended and should be revived.

14. **Asset management:** Previously MOF ran a central supply unit responsible for receiving and inspecting all government assets. LMs are now responsible for this process, although they do not yet have a process for registering assets on the central MOF database. Some LMs have separate databases, but these are often not comprehensive. This is going to be addressed through the Free Balance project.

15. **Internal Audit:** In an increasingly devolved operating environment, in which LM expenditure management systems and staff skills are rudimentary, the establishment of effective internal audit functions is a critical management control tool. Whilst the MOF is responsible for development of policy and operational guidelines for the establishment of internal audit functions in all Ministries, there has been little progress to date given other priorities. Similarly, both Treasury and LM internal audit capacity remains weak.

16. **MOF to coordinate PFM related support across government:** The mission found that in most ministries the effectiveness of PFM-related support is not constrained by the number of advisors, but the degree to which advisors are trusted. The review also found that there may be an overemphasis of advisors providing 'strategic planning advice' and less support for budget management, procurement, contract management and audit – i.e. the focus is on the upstream aspects of PFM rather than the implementation, reporting and accountability functions.

17. MOF can play a critical role in strengthening the effectiveness of PFM-related support in LMs. This could include clear guidance on the structures that each LM must have in place to effectively undertake their newly assigned functions, and guidance on what kind of support LMs require through sector programs. In light of recent changes to the PFM system, sector programs should undertake an assessment of the capacity of LMs to execute their delegated functions and then realign programs accordingly. This could be coordinated through an MOF led working group. Through this working group other donors should look at the profile of support that is being provided, to rationalize the use of high level 'strategic' advisors and to strengthen focus on core downstream budget execution functions. New forms of support should be based on MOF taking a lead in methodical training of LM civil servants in basic transaction level work before moving to more complex functions.

SUMMARY OF ISSUES AND RECOMMENDATIONS

Issues	Recommendations	Suggested Next Steps
Technical guidance and support for LMs executing newly acquired delegated responsibilities.	Explore options to extend client focus and outreach in core areas such as Treasury and asset management. Prioritize issuance of consolidated financial instructions, procurement manual, asset manual and other core guidance.	Through SP process for each DG, highlight areas in which client services could be enhanced. PFMCBP advisors work with directors in MOF and LMs to do a stocktake of pending and priority guidance/ manuals/ instructions etc
Staff in audit, procurement and asset management in LMs operating without sufficient knowledge or guidance.	Where practical and appropriate establish centralised training programs modelled on the FreeBalance FA training model for LM staff in other critical functions including asset management and procurement (through implementation of the new FreeBalance Module), and internal audit.	Through PFMCBP Professional Development Program develop designs for training programs. Use PFMCBP resources to engage dedicated specialists to deliver training programs.
Effectiveness and adequate targeting of donor programs providing PFM support in sectors across government.	MoF to lead/ coordinate PFM related support across government. MoF to develop core guidance on forms of support	MOF to establish a working group with directors of finance units and lead PFM advisors from LMs. Allocate resources from PFMCBP, other donor source or state budget to set up and maintain coordination mechanism (e.g. working group secretariat)
Poor understanding of the PFM systems and processes that are evolving at LM level	MoF to revise approach to decentralisation through Strategic Plan Undertake analysis of funds flow in key service delivery agencies to better understand bottlenecks and impediments to service delivery	MOF to examine the risks and opportunities of decentralised PFM framework, and identify priority areas for revision or clarification DGSF/ERU to work with LMs and development partners on diagnostic work in selected LMs
CoA program Budgeting and sub-Line Item capability	Discussions be held with Finance officials in the Ministries of Health and Education to advise how the CoA can accommodate their requirements for the 2011 Budget.	Budget and Treasury officials to initiate the meetings.
Comprehensive Treasury instructions to support devolved operations	Development of a Treasury Manual and associated training program	The DGSF to discuss with the PIU options for engaging a short-term TA to draft a Treasury Manual or source alternative bilaterally support.

ANNEX K: PROFESSIONAL DEVELOPMENT PROGRAM

ACHIEVEMENTS

1. The Professional Development Program (PDP) was introduced by the Ministry of Finance as part of the program restructuring exercise in April 2009 to package many of the various capacity development initiatives identified in the initial *Project Appraisal Document* (2006). In January 2009 a Secretariat was established, chaired by the Director General Corporate Services and including several heads of department and three advisers.

2. So far, PDP expenditure has focused almost exclusively on scholarships, with four Ministry staff being chosen this year for master's level courses in Australia. One has completed his requisite language training and is about to begin an accountancy program. The other three will start their master's degrees as soon as they reach the required level of language competency, probably in 2011. Nineteen secondary school graduates have recently begun language training in preparation for degree programs at Flinders University in Adelaide. They will likely require between 40 and 70 weeks of training.

CHALLENGES AND PRIORITIES

3. **The PDP is not at present guided by a formal strategy**, which sets out the rationale for priority activities and expenditure based on a staff needs assessment. Instead, the PDP is guided by two papers, which were prepared by advisers working in DGCS though never formally adopted. The first paper was titled Initial Proposal for Professional Development Program. It recommends how a scholarship program might be set up but also foresees activities in areas such as workplace skills, foundation courses, management and conceptual thinking. The second paper - Institutional Development & Capacity Building Plan – proposes a holistic approach to strengthening Ministry capacity with the objective of reducing the need for TA. It looks at both the broad attitudinal changes required to make the public service more effective and at specific training modules that could be undertaken by staff while continuing to work. The MTR recommends that a formal PDP Strategy be prepared, and submitted to the Minister.

4. **The PDP expenditure has so far focused on scholarships**, in part because of staff constraints and uncertainties about the tendering process for foundation and customized courses. Although costing for the full period of the scholarships already awarded is not available, the period to June 2011, which will be largely language upgrading, is budgeted at $1,013,778.82. Extrapolating from this figure, each scholarship at the undergraduate level is worth between $200,000 and $250,000 over five years (one or more years for language training, one year for foundation or bridging courses and at least three years for a degree). The total cost of the scholarships awarded to date is likely to be $4 - 5 million, well in excess of both the total program budget and its timeframe. Language training alone represents about one third of the total budget allocated under the PFMCBP for the PDP.

- **The PDP Secretariat has entered into financial commitments on behalf of the Ministry of Finance for scholarship expenditures beyond July 2011** but has not yet secured financing for these commitments. If donors do not agree to fund the commitments, then the necessary financial approvals will need to be sought for funding from the state budget. The MTR recommends that the PDP Secretariat consider how it proposes to finance the scholarships beyond July 2011.
- **The PDP Secretariat will need to review its procedures on financial management**. Confusion may have been created in the case of scholarships because the PIO also chairs the PDP Secretariat in her capacity as DG Corporate Services. The MTR recommends that in future, all financial proposals be submitted first to the Senior Program Manager, who will then provide advice to the Program Implementation Officer as the financial delegate for the PFMCBP.

5. **The PDP scholarships are in effect akin to a general scholarship program** with no guarantee that graduates will return to the Ministry or even to Timor Leste. The undergraduate students have signed contracts saying they will work with the Ministry for at least seven years after graduation. However whilst these contracts may exercise some moral suasion, it is uncertain whether these agreements could be legally enforced.

6. **Proposed expenditure under the PDP** is as follows:

PDP Activities	2008	2009	2010*	2011*	Total
Scholarships	**Nil**	**Nil**	**$922,500**	**$922,500**	**$1,845,000**
- Masters (o/s)	-	-	405,000	405,000	
- Undergraduate (o/s)	-	-	262,500	262,500	**51%**
- Undergraduate (TL)	-	-	255,000	$255,000	
Overseas Study Visits	**Nil**	**Nil**	**$52,500**	**$52,500**	**$105,000**
- Malaysia	-	-	15,000	15,000	
- Singapore	-	-	12,500	12,500	**3%**
- Australia	-	-	12,500	12,500	
- New Zealand	-	-	12,500	12,500	
Customised Training	**$87,000**	**Nil**	**$300,000**	**$450,000**	**$837,000**
- Financial Management	-	-	100,000	150,000	
- Revenue and Customs	-	-	100,000	150,000	**24%**
- Statistics	-	-	100,000	150,000	
- Microsoft	43,500	-	-	-	
- CISCO	43,500	-	-	-	
Foundation Courses	**Nil**	**$30,000**	**$420,000**	**$350,000**	**$800,000**
- English	-	30,000	90,000	180,000	
- Numeracy	-	-	330,000	170,000	**22%**
TOTAL	**$87,000**	**$30,000**	**$1,695,000**	**$1,775,000**	**$3,587,000**

* Projected expenditure

7. **PDP expenditure data submitted to the Mid Term Review by the PDP Secretariat diverges from forecasts in the Procurement Plan**. The MTR recommends that priority be given to submitting an accurate statement of PDP expenditure as part of the Annual Report and attached Procurement Plan, to be submitted September 2010.

8. **The proposed allocation of PDP expenditure is heavily skewed towards scholarships**. The most recent Procurement Plan proposes that Scholarships account for 51% of total PDP Expenditure; Overseas Study Visits for 3%; Customised Training for 24%; and Foundation Courses for 22%. The MTR recommends that the revised PDP Strategy review the allocation of expenditure and consider increasing the allocation for foundation courses and customized courses relative to scholarships.

9. **The non-scholarship components of the PDP have been slow to move forward**. Budget execution is low for overseas study visits (0%), customized training (10%) and foundation courses (0%). And yet these are the types of training which offer more immediate returns in terms of increasing the efficiency of the Ministry as opposed to a minimum of a five-year investment in a high school graduate. The MTR recommends that additional consultant and staff resources be allocated to the PDP to ensure that activities are developed and the budget is executed.

10. **Overseas study visits or placements have to be carefully designed** to successfully meet training needs. These are also resource intensive to manage. The Ministry of Finance has made some initial contacts about possible placements with firms and the public service in Australia. The MTR recommends that the Ministry ensure that study visits and placements are consistent with the objectives of the PDP Strategy rather than supply-driven.

11. **Standard operating procedures should be the basis for training** conducted by long term advisers about basic work area functions. However, SOPs are still not available for all areas; the HR&CD Advisor is working on a standard format to codify SOPs. A model for this approach is the training provided on "Free Balance" by a consultant in State Finances to staff in line ministries. This kind of training requires is extremely important, even though it is not at present captured by the PDP Strategy. The MTR recommends that the HR&CD adviser discuss with other consultants opportunities to provide this kind of training, and include reference to it in the Training Plan that is under preparation.

12. **Foundation Courses are a high priority and it should be possible to fast track training** in critical areas such as management; practical capacity building for advisers and counterparts; and numeracy. Draft terms of reference already exist for a Ministry of Finance numeracy course; INAP has recently developed a management course with assistance from the Public Service Capacity Building Program; and AusAID have sponsored a course called 'Making a Difference' that could provide a template for practical capacity building for advisers and counterparts.

SUMMARY OF ISSUES AND RECOMMENDATIONS

Issues	Recommendations	Concrete Next Steps
PDP Strategy	Prepare a PDP Strategy linked to the Strategic Plan and based on the IDCBP.	Review capacity development needs across MOF and prepare a PDP Strategy, which sets out how the four components of PDP can help deliver these, with proposed resource allocation. Reallocate remaining funds from scholarship component of PDP to other three components to finance activities which can be completed within timeframe of PFMCBP
Guidelines for PDP Management	Draft guidelines for the management of PDP and include in Operations Manual	Task HR&CD advisor to work with PDP Secretariat to draft guidelines and to ensure that PDP staff understand them.
PDP Financial Management	Improve financial management of PDP (Annex G, paragraph 6; and Annex M paragraph 17).	All expenditure proposals to be submitted to the Senior Program Mgr, who will provide advice to the PIO – the financial delegate for the program Revised PDP expenditure statement prepared as part of Annual Report and Procurement Plan due September 2010
PDP Staffing	Increase both number of staff and resources available to support management of PDP	Engage additional staff and consultants to help manage scholarships and get non-scholarship components underway
Scholarships	Review this component thoroughly before offering more awards	Review the strategy for the program, including guidelines on who should benefit and in what kinds of institutions Review the guidelines to ensure transparency of decision making Help MOF develop a strategy to finance scholarships awarded in 2010 post June 2011

ANNEX L: MINISTRY OF FINANCE STRATEGIC PLAN

1. The draft Strategic Plan for MOF is a very positive step forward. It provides an excellent basis to prepare and implement the next stage of PFM reforms and associated capacity development activities. The plan was prepared with UNDP support. The process engaged front line staff through workshops. The Minister and MOF management noted that further work is needed to turn the SP into the main vehicle for lifting capacity and improving service delivery. This note summarizes the initial comments and ideas on the SP that the mission discussed with MOF.

2. **Benefits of SP**: There have been significant achievements since 2000 in building up capacity across all the core functions of MOF. The last three years in particular have seen very rapid changes. Some of these were driven by short-term needs. But there has also been progress in tackling longer-term issues. The SP provides a good opportunity to take stock and build on achievements. The SP should simplify management by enabling a clearer focus on priorities. It should strengthen capacity development to deliver results and facilitate collaboration with development partners (DPs) who would all support the same program, i.e. the MOF plan. The SP would serve as a 'fundraising' document for post-July 2011.

3. **The role of MOF going forward**: One of the over-arching issues to be addressed in the SP is the role of MOF in the state apparatus going forward. The creation of a development agency in the PM's Office, the decentralization of financial authority and control to line ministries and the plan to decentralize to local communities and possibly local governments after the elections, risk stripping back MOF functions, capability and authority. If this happens the MOF may not be able to play its role in promoting macroeconomic stability, the most effective use of public resources, probity, transparency and external accountability for the stewardship of public finances.

4. As part of the SP, and the national Strategic Development Plan, MOF must maintain its 'brain power' and not risk becoming a data processing operation. A well functioning MOF must have the capacity to be effective in debates over macro-fiscal policies and resource allocation. It has a responsibility to be the guardian of the financial resources of the state through advice and operations. To give effect to this stewardship it:

- Provides multi-year forecasts of available resources based on a macro-economic developments.
- Provides advice on raising revenue with analysis of microeconomic impact. Many MOFs also administer the collection of revenues.
- Operates a stable and transparent budget process to facilitate resource allocation to economic and social priorities in accordance with national development goals.
- Implements the State budget efficiently through the treasury system.
- Establishes financial management systems that promote efficiency and transparency in resource use.
- Manages the government's financial assets, liabilities, cash and its financial risks.
- Prepares external reports on the government's financial affairs in conformity with laws and good practices of transparency and accountability.

5. **Diagnostics**: Core diagnostics such as the PEFA and the Fiscal ROSC help to analyze issues against agreed standards across the breadth of the PFM system. The reviews understandably highlight a range of limitations against those standards, but this does not imply that the system has to conform to concepts of 'best practice'. The systems and processes must work well enough to meet the demands on them and work in concert to give the Government, the Parliament and citizens, rising confidence in MOF's stewardship of public finances.

6. **Developing platforms/stages of the reform program**: To help ensure that the systems and processes are working well enough, the SP will need to sharpen the prioritization and sequencing of key reforms. This could be done through a platform approach, which aims to implement a package of measures to help achieve increasing levels ('platforms') of PFM competence over a manageable timeframe. Each platform can be defined in terms of improved outcomes.

7. To illustrate this, the mission gave the following examples as operational weaknesses that may be holding back the overall PFM system in the short-term:

- Decentralization of spending controls and delegation of authority have not stabilized yet;
- Monitoring and reporting systems do not yet provide adequate information to management on quality of budget execution;
- Low level of PFM capacity in line ministries to pursue policy priorities;
- Weaknesses in compliance management in tax and customs administration;
- Lack of debt management capacity.

8. On the basis of this, <u>platform 1 (from mid-2010 to end 2011)</u> could be to: Strengthen quality of budget execution such that budget holders in line ministries and districts use decentralized authority appropriately and effectively. The <u>package of measures to deliver this</u> could be:

- Stabilize procurement regime (MOF, VPM's Office roles and responsibilities).
- Strengthen capacity of LM and DA budget holders (training, guidelines, MOF staff role).
- Enhance monitoring and reporting on budget execution (FB procurement module; spending reports from LMs and DAs; accurate, timely, and widely disseminated financial reports; physical execution reports).
- Strengthen compliance in revenue while reducing compliance and administrative costs.
- Develop MOF internal audit function.

9. <u>Platform 2 (from 2012 to 2015)</u> could be: To establish a fully affordable national strategic agenda by enhancing policy-budget linkages. <u>The package of reforms to deliver this</u> could be:

- Introduce MTFF as part of annual budget process.
- Develop cost-benefit analysis capability to appraise capital investment project proposals.
- Strengthen expenditure review capacity.
- Enhance budget classification to capture activity and organizational information in selected LMs.
- Further develop FMIS (integrated budget module)
- Develop debt management capacity

10. **Directorate level action plans**: The above are examples to illustrate. The key is that the longer-term vision is supported by clearly defined platforms/stages of reforms, which in turn are implemented through detailed action plans at Directorate level. These spell out the practicalities for the first level of management and at the front line, including for capacity development and performance management. The Annual Action Plans (AAPs) and quarterly reports provide an excellent basis to take this work forward. The action plans will need to be deeply embedded in MOF with a strong buy-in at all levels if it is to realize its potential and should help integrate the top down and bottom up processes of strategic planning.

11. As part of the process, it is important to set realistic objectives and measure progress. The SP could use a sub-set of PEFA indicators to measure short term impact and also link quarterly performance targets in the AAPs to PEFA indicators. The monitoring and evaluation framework should clarify roles responsibilities and accountabilities for achieving results.

12. **Full-time PFM/Strategy Advisor**: The mission recommended to appoint a full-time Senior PFM/Strategy Advisor who would provide technical oversight and quality assurance across the program, and ensure that the program is aligned with the SP. This would also assist in making decisions about the trade-off day by day in production and investment activities.

13. **Possible next steps:** The draft SP provides a strong basis to take forward some of the issues highlighted above. DG Corporate Services is the lead on the SP, but will require a core team of management, staff and advisers across MOF to ensure progress. The mission agreed that the development partners will revert back with a specific proposal on how they can support the SP process, and a timeline, to be developed jointly with the Director General of Corporate Services. This will include how best to integrate the recent PEFA and Fiscal ROSC into the SP process.

ANNEX M: FINANCIAL MANAGEMENT

1. The Bank FM team reviewed progress against recommendations made on Financial Management of program funds during its last mission in November 2009. It also highlighted additional issues that came to light during the MTR supervision. While there is still some way to go, there was a clear improvement in the financial records for the project, and staff are to be commended for their efforts. There were major improvements in the monitoring of consultants and commitments, although there is still scope for improvement, and bank reconciliation statements are completed monthly. There was also improvement in the appropriate usage of petty cash and progress on the implementation of FreeBalance.

2. There is additional work required on the IFR format, maintenance of leave records, the assets register and the use of "please Pay Cash" cheques. Other issues identified include reconciling the cash book, IFRs and Client Connection. To ensure the accuracy of all reports this issue needs to be urgently addressed and all reports should be reviewed by the Program Manager for reasonableness and accuracy. <u>Another FM Supervision will take place within three months to review progress.</u>

REPORT ON PROGRESS AGAINST PREVIOUS RECOMMENDATIONS

3. **Finding 1: FreeBalance Accounting Software not used in project.** While FreeBalance is not yet implemented, there has been some progress. During the FM supervision, advice was given on suggested structure of the Chart of Accounts. It is recommended that once FreeBalance is "live" it is used concurrently with spreadsheets for at least two months to ensure the accuracy of the FreeBalance data. Reconciliations should be performed each month between the two systems to ensure cash at bank, total expenditure and total income are the same. Reports from FreeBalance can be compared to information from spreadsheets to determine accuracy and appropriateness. There will also need to be a review of the FreeBalance commitments information to ensure it meets project requirements.

4. **Finding 2: Inadequate Monitoring of Consultant Payments.** This issue has been addressed through the creation of a commitments register. (see Finding 3)

5. **Finding 3: No recording of commitments.** There was a marked improvement with the creation of a commitments register using a spread sheet to monitor most consultant contracts. While the structure of the spreadsheet was appropriate, there are a number of recommendations/findings that would ensure more timely and accurate information.

- It was noted that some contracts had been completed and any unspent amounts from the contract remained as a commitment. This leads to an overstatement of commitments. As contracts are completed and all payments made this commitment should be cancelled.
- One contract was originally for $669,060 but had been revised to $582,600, however the change was not reflected in the commitments register. To ensure the commitments register accurately reflects project commitments all changes to contracts must be promptly updated in the register.
- While accurately recorded in the commitments register, it was noted that project tax obligations were in arrears. It is recommended this is paid promptly.
- When comparing cash book payments to the commitment register it was identified that some national staff were not included on the register. While the amount was not material, it is recommended that all contracted staff are included on the commitments register.
- It is also recommended consideration is given to ensuring there is a mechanism to identify specific consultants to the restructured components.
- Finally, it is recognized that much of this information may be obtained from Freebalance when it is finally implemented, however, the above recommendations should still be taken into account when entering information into Freebalance.

6. **Finding 4: The supervision was unable to sight any bank reconciliation statements.** Bank reconciliations are now being regularly undertaken.

7. **Finding 5: Purchase Orders were not completed for the purchase of goods and services.** Only one item (photocopier) has been purchased since the last supervision that required a purchase order. A purchase order was created for this purchase.

8. **Petty Cash:** There was a brief review of the petty cash and it was noted that there were no payments above the agreed threshold. There were no major payments or payments for wages identified in this review. One petty cash reimbursement was reviewed and while the documentation could be found for all transactions, some issues arose and are summarized in the table below.

ADDITIONAL ISSUES FROM THE MTR SUPERVISION

11. **FM Staffing in the PIU:** The current FM staffing and responsibilities do not correspond to requirements in the POM, which indicates 3 FM staff with clear delegation and segregation of responsibilities. There are currently only 2 FM staff at the PIU: one FM advisor (FMA, national consultant) and one FM bookkeeper (FOB, government staff). Given the workload, among other factors, there were occasions when internal controls were neglected. The MTR agreed that the recruitment of an international senior FMA was necessary, given the complexity of the program and the issues to be addressed. The incumbent will oversee FM functions and also backstop the SPM and contribute to the evaluation of the program. The SPM will draft the TOR and submit to the WB for no objection by July 15, 2010 and adjust the TOR for the existing FM staff to ensure that all tasks are appropriately handled.

12. **Internal processes and approvals:** The weaknesses identified on internal controls were discussed with the SPM. A key issue is that the role and responsibility of the SPM in FM is nowhere defined. Examples provided: All expense vouchers (EVs) are prepared by the FOB, signed by the FOB, then passed on directly to the PIO and Treasury. In many instances, these EVs are not properly checked for accuracy. While waiting for the PIU to be fully staffed, it was agreed that the SPM will review and sign off on these EVs.

13. **Audit report and management letter**: The external audit for the period July 1 2007 to 31 December 2008 was received by the Bank on September 24 2009, nearly 3 months late. The Management Letter was received in April 2010 (almost 10 months late). There were no additional issues raised in the Management Letter that required additional review in this supervision.

14. **Transaction review:** There are limited transactions outside of consultant and PDP (scholarship) payments. The recent purchase of a photocopier had all relevant paperwork complete and attached to the payment. Reviews were also done of the documentation for payment of tuition fees direct to the educational institution in Australia, and also of the two-monthly living allowance transfers to scholarship students. All payments reviewed appeared consistent with the contract terms and conditions, and copies of the contracts between the students and the PDP program were provided as attachments to the payments.

15. **Over claim of leave:** Whilst there was some improvement in leave records, these were still not satisfactory. The detailed examination of Leave Monitoring Sheet revealed: entitlements accruing while consultant was on leave without pay, leave without pay recorded paid leave taken causing a negative accrued leave balance. This was not identified by staff and hence there is some concern over the effectiveness of this system as a control mechanism. It was also noted the records were not up to date but it was explained that records are only updated when leave (annual or sick) is taken. Leave records will now be updated on a monthly basis.

16. **"Pay Cash" cheques made to local consultants:** The finance staff advised that this was at the request of the ANZ Bank, so that cheques made out to people who did not have bank accounts could be cashed. (Note: this is likely due to the fact that the ANZ cheques are automatically printed with "Not negotiable", which means that the cheque cannot be cashed. By including "Pay cash" as part of the payee instructions, this can be avoided). While this may be necessary, finance staff are advised to cross out the words "or bearer" when making out a cheque to an individual or company, to ensure only the intended recipient can cash or bank the cheque.

17. **Advances for training and workshops and scholarships as part of the PDP**: The same issues identified on the pay "cash" cheques are repeating for advances provided to students. It was agreed that the management of the PDP will be fully documented in the POM. The contract for scholarships program will be reviewed with an instructional annex on cash advances and other benefits.

18. **Fixed asset register:** A copy of the fixed asset register was reviewed and appeared to be incomplete. Often it did not provide details of the cost of the assets. For example, registration numbers for vehicles are not recorded, and listed the total cost of vehicles was US$10,000 which is incorrect. The register needs to be updated to reflect current project assets.

19. **Reconciliation of IFR to cash receipts and Client Connection:** Currently, the project is not reporting in the required quarterly IFR format. A reconciliation was made between the financial information contained in the quarterly project progress report, and cash receipt information in the cash book and Client Connection. A number of errors were found, such as year-to-date information being presented as quarterly information, and a quarterly figure containing six months of disbursements, rather than three. All financial reports have to be accurate to ensure proper management decisions. All reports should be reviewed by the Senior Project Manager for reasonableness and accuracy.

20. **Petty Cash Account (revolving fund):** The limit of the petty cash a/c is $5000. The FMA has advised the mission that the petty cash account is currently at $2500 and this amount is kept in a safety deposit box at the PIU. The FOB is the only one who has the key to this safety box and although there is a clear segregation of duties on the management of the petty cash account in the FM manual, in reality there is no verification by FOA (as this person does not exist) on the use of the petty cash.

21. **GOTL Chart of Accounts and integration of Project Financial Data into FreeBalance**: The new COA has been approved and translated into English; a copy was provided to the MTR. The MTR has provided guidance on the mapping of the GOTL COA to the project categories of expenditures. The MTR and PIU also met with FreeBalance experts at Treasury to agree next steps.

22. **Calculation of taxes**: Taxes are at 10% **-** however, the fees for international consultants are negotiated in net terms. And when the gross is applied, then, in most cases, the calculation of the taxes on the gross yield decimal figures – resulting in discrepancies in reconciliation of cumulative amounts.

SUMMARY OF ISSUES AND RECOMMENDATIONS

Issues	Recommendations	Suggested Next Steps
Lack of FM staffing in PIU.	Appoint International Senior FM Adviser to oversee FM functions and backstop SPM.	SPM to draft TOR, and review TOR of existing FM staff, and submit to WB for no objection.
Weaknesses in internal processes and approvals	Clarify the role and responsibilities of the SPM in relation to FM. Before PIU is fully staffed, SPM will review and sign off on Expense Vouchers.	PIU in consultation with WB to revise FM sections of POM. Revise EV Form to include SPM as verifier before submission to PIO and Treasury.
Over claim of leave.	Regularly update leave records.	Update all leave records and monitor on a monthly basis.
"Pay cash" cheques to national consultants risks cash handover to third parties.	Reduce risk that cash can be handed over to a third party.	Cross out the words "or bearer" when making out a cheque to an individual or company, to ensure only the intended recipient can cash or bank the cheque.
"Pay cash" cheques for training and scholarship advances.	Fully document the management of the PDP in the POM. Keep cash transactions to a minimum (e.g. cheques can be issued to the consulate section of the relevant embassy for issuance of visas).	PIU in consultation with WB to update PDP sections of POM. PIU, will discuss with ANZ Bank, perhaps, to setup small ATM accounts for students going abroad. Review contract for scholarships program with an instructional annex on cash advances and other benefits.
Insufficient maintenance of asset register.	Maintain updated register for project assets.	The assets register to be updated by PIU to reflect current project assets and maintained in future.
Reconciliation of IFR to cash receipts and Client Connection.	Ensure that all financial reports are accurate to ensure proper management decisions. All reports should be reviewed by the Senior Project Manager for reasonableness and accuracy.	FMA to complete IFR for March 2010 in the required format with reconciliation to the cash book and Client Connection.
Petty Cash Account (revolving fund).	Ensure better oversight on the use of petty cash.	Account (ceiling to be agreed) could be introduced. PIU to open a bank account to manage this PA and the delegation of responsibility would be under the SPM and FMA. And a smaller petty cash account of about $200-$300 could be maintained.
GOTL Chart of Accounts and integration of Project Financial Data into Free Balance.	Complete transfer of program finance management to FreeBalance.	PIU will provide data and framework to Treasury staff for the design of the PFMCBP account structure and IFR reports. Finalization of the IFR for financial data will be agreed with the Bank TTL.
Calculation of taxes	Ensure that there are no discrepancies in reconciling cumulative amounts as a result of tax calculations on consultants' fees.	It was agreed that taxes would be rounded to two decimal points.

ANNEX N: PROCUREMENT

1. The Bank Procurement team reviewed progress against recommendations made on Procurement under the program during its last mission in May 2009. It also highlighted additional issues that came to light during the MTR supervision.

ACHIEVEMENTS

2. **Procurement Plan (PP):** The last review noted that the agreed PP went through frequent changes. Whilst it is important to maintain flexibility, too many changes can lead to a lack of discipline in program implementation. This impacts negatively on progress against objectives and financial planning. In response, MOF prepared last July a detailed twelve-month Annual Implementation Action Plan linked to program objectives and clear deliverables, setting out the required consultancy inputs over the same period. This in turn translated into the PP agreed in August 2009. Since then changes have been kept to a minimum, and the PP has been used as a management tool. All changes to the PP (mostly minor) were agreed with the Bank, had clear justification and have been recorded systematically. A report on progress with implementation of the PP was provided to the Bank in February 2010.

3. **Clarity of Terms of Reference and selection criteria:** The quality of TOR needed improvement. In particular the selection criteria and consultants' deliverables could be a lot more specific. On selection criteria, educational qualifications and work experience requirements needed to be clearer to avoid ambiguity and ensure that the Government is getting high quality services. On deliverables, the review recommended to spell out more specifically the consultants' expected outputs, particularly for short-term consultants. The PIU has now revised the format of consultants' TORs, which set out more clearly the required qualifications, the scope of work, and expected deliverables. These are reported on every month (changing to every quarter at the MTR's recommendation), and the MTR has conducted a thorough review of outputs over the past 18 months.

4. **Selection reports:** Previously the selection reports did not explicitly address the selection criteria. However, the program now provides detailed reports on the qualification of individual consultants against each of the criteria, and the relative strength of each interviewed candidate.

5. **Consultancy fees:** This was a major issue last year in light of political and press attention. Whilst there is no specific guidance for clients on negotiating individual consultants' fees, the approach taken under the program is to look at salary history for similar assignments to determine a fair rate. This may not always be sufficient or appropriate. Based on existing contracts under the program, it is possible to determine average ranges across different grades and technical expertise of consultants. This provides a rough indication of whether the proposed fees are within appropriate margins.

6. **Procurement, Financial Management and Legal consultants**: The last review clarified that any procurement, FM or legal consultants will need to be no objected by the relevant specialists in the Bank (from TOR to selection). This has been done since the last review.

7. **Frequent contract extensions**: In the past the program frequently extended consultants' contracts. These impact on program discipline and the credibility of the planning process. In addition, there are clear requirements around contract extensions. Any amendment that leads to a greater than 15% change to the original contract amount will require no objection from the Bank.

CHALLENGES AND PRIORITIES

8. **Procurement Advisor in the PIU**: The program has still not recruited a Procurement Advisor in the PIU. There have been three attempts to recruit a national advisor, but these have not been successful. The TOR for the position has already been cleared, and the MTR recommended to recruit an international procurement advisor.

9. **Publication of PP**: The PP updated in August last year has still not been published on the Bank website as required. This needs to be done as soon as the revised PP (i.e. reflecting planned activities for the coming twelve months) has been cleared.

10. **Procurement of training activities**: The last PP did not include details of training activities. The program was meant to prepare a training plan, identifying possible procurement activity, with budgets and mode of procurement. This is still pending, and should be completed with the work on the PDP.

SUMMARY OF ISSUES AND RECOMMENDATIONS

Issues	Recommendations	Concrete Next Steps
Procurement Advisor in PIU	Recruit international Procurement Advisor.	Advertize cleared TOR and complete selection process to be cleared by Procurement Team.
Publication of PP	Finalize PP based on recommendations from the MTR.	Complete IAP process, prepare PP, clear with WB and publish.
Procurement of training activities.	Prepare PDP strategy and training plan, identifying what activities need procurement.	Update Capacity Development worksheet as part of PP revisions for the coming twelve months.

ANNEX O: SUMMARY OF PROGRAM FUNDS AS OF MTR

Initial allocations and expenditures for FY2006-FY2008

Initial Program Components	Allocation FY06-FY08	Disbursed IDA Funds	Balance transferred to restructured Program components
1A. Public Expenditure Management	$ 958,101.00	1,554,000.79	$ (595,899.79)
2B. Revenue Administration and Macroeconomic Management	$ 659,189.00	144,503.53	$ 514,685.47
3C. Program-wide Activities	$ 1,561,454.00	1,621,772.35	$ (60,318.35)
4D. Support for Improvement in Governance and Management	$ 2,532,929.00	1,671,246.64	$ 861,682.36
5E. Program Implementation Unit	$ 679,116.00	740,255.57	$ (61,139.57)
CONTINGENCIES for remaining program	$ 609,211.00		$ 609,211.00
TOTAL	**7,000,000.00**	**5,731,778.88**	**1,268,221.12**

MONITORING OF PROGRAM ALLOCATIONS UNDER RESTRUCTURING

Restructured Program Components	IDA Balance	CY2009	CY2010	CY2011	TOTAL PROGRAM ALLOCATION CY09-CY11
A. Strengthening Capacity in the General Directorate of State Finances	$ (595,899.79)	$ 2,937,192.00	$ 1,582,417.00	$ 525,303.00	$ 4,449,012.21
B. Strengthening Capacity in the General Directorate of Revenue and Customs	$ 514,685.47	$ 1,935,808.00	$ 1,631,953.00	$ 803,170.00	$ 4,885,616.47
C. Strengthening Capacity in the General Directorate of Policy Analysis and Research	$ (60,318.35)	$ 878,703.00	$ 711,562.00	$ 336,000.00	$ 1,865,946.65
D. Strengthening Capacity in the General Directorate of Corporate Services	$ 861,682.36	$ 2,148,956.00	$ 3,593,280.00	$ 2,340,740.00	$ 8,944,658.36
E. Program Implementation Unit	$ (61,139.57)	$ 1,176,477.00	$ 678,917.00	$ 367,802.00	$ 2,162,056.43
CONTINGENGIES	$ 609,211.00			$ (148,280.00)	$ 460,931.00
TOTAL ALLOCATIONS	**$ 1,268,221.12**	**$ 9,077,136.00**	**$ 8,198,129.00**	**$ 4,224,735.00**	**$ 22,768,221.12**

ANNEX P: PRELIMINARY ACTIONS FOR THE PREPARATION OF THE EVALUATION PHASE OF THE PROGRAM

1. As a general rule, an implementation completion and results report (ICR) is prepared for all investment operations within six months of project closing. This ICR is an integral part of the World Bank's drive to increase development effectiveness, through a continuous process of self-evaluation, lesson learning and application, sharing of knowledge, and being accountable for results. The lessons learned from ICRs improve the quality and effectiveness of Bank loans/credits/grants, especially for follow-on operations, while borrower/stakeholder participation in the ICR process enhances later designs, preparation, and implementation.

2. The IDA Grant H2100 and the MDTF TF093959 supporting the development objectives of PFMCBP will close on July 10, 2011. The MTR team discussed the requirements for the closing phase of the program and the responsibility of the MOF in the preparation of the Recipient's Report which will be an integral part of the ICR.

3. The findings of the MTR already provide substantive and relevant inputs that will be included in the ICR. It is also recommended (see Annex G), to hire an M&E specialist within the upcoming months to assist the DGCS in compiling the data and designing an analytical framework to evaluate the program's results.

4. The preparation of this ICR should be done in a spirit of participation from all stakeholders. In this respect, the WB will field a mission separately, or as part of the next implementation support mission to discuss and fine tune the requirements. A workshop could be organized which could include representative/s from each DG to work alongside the ICR core team (TBD) to launch the evaluation phase of the program and agree on the specific areas the report will cover.