PARLAMENTO NACIONAL
República Democrática de Timor-Leste

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NATIONAL PARLIAMENT

Democratic Republic of Timor-Leste

COMMITTEE ON PUBLIC FINANCES

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Excellency,
President of the National Parliament
Dr. Vicente da Silva Guterres

Date: December 4, 2012

Ref. No.: 59 / 1a/III/Com. C

Subject: Submission of the Report and Opinion on the General State Accounts, 2011

Pursuant to Article 178.1 of the Rules of Procedure of the National Parliament, I refer to you the Annual Report and Opinion on the General State Accounts for 2011.

Accept, Mr. President, the assurances of my highest esteem and consideration.

The acting President of the Committee,

Izilda Manuela da Luz Pereira Soares

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ANNEXES

- Opinion of the Court of Appeal
  http://www.laohamutuk.org/econ/OGE11/CGA11/TRConta2011en.pdf
- Written contributions received (Ministry of Agriculture, Ministry of Education, UNTL and NGO La'o Hamutuk http://www.laohamutuk.org/econ/OGE11/CGA11/LHtoComCGSA2011En.pdf)

I. Constitutional and legal framework

Under Article 129.3 of the Constitution of the Democratic Republic of Timor-Leste, the High Administrative, Tax and Audit Court (or until its installation, the Court of Appeal) reviews the legality of public accounts and judges the state accounts. The Court plays an important role in this process, since technical advice underpins the assessment policy of the National Parliament.

Meanwhile, pursuant to Article 95.3 and Article 145.3 of the Constitution, it is for Parliament to decide on the National State Budget and supervise the execution of the State budget.

The General State Accounts for the year 2011, organized in accordance with Law no. 13/2009, of 21 October (Law on Budget and Financial Management) and the Law no. 9/2011, of 22 October (Organic Law of the Chamber of Accounts), was referred by the Court of Appeal to the National Parliament, together with its Opinion on the General State Accounts for 2011, on 22 October 2012. By order of His Excellency the President of the National Parliament, it was distributed to the Committee on Public Finance (Committee C) on 24 October, so that it could rule on the matters within its jurisdiction and provide an opinion according to Article 178 the Rules of Procedure of the National Parliament.

The National Parliament's Rules of Procedure establishes the internal parliamentary process of assessment of the General State Accounts, which translates into the following: the Public Finance Committee prepares a opinion and recommendations, whether they may be, following the completion of a parliamentary debate , with a maximum duration of one day, opened by the main opposition party and ended with a speech from the Government (Article 180 of Parliamentary Rules).

Article 48 of Law no. 13/2009 of 21 October, states that for the purpose of effecting any financial or criminal liability arising from the execution of the State Budget, the Plenary of the National Parliament may decide to refer the opinion of the High Administrative, Tax and Audit Court to relevant entities.

Under the rules, this Committee held public hearings from 14 to 26 November 2012, which heard from the following entities:

- ✓ The President of the Court of Appeal;
- ✓ The Government, in the person of the Minister of Finance and Ministers of State Administration, Commerce, Industry and Environment and Public Works and the Deputy Minister of Health and Deputy Ministers of Agriculture and Education, representing the respective Ministers.
- ✓ Those responsible for the Major Projects Secretariat, the National Procurement Commission (CNA), the National Development Agency (ADN), President of the Civil Service Commission and the Rector of the National University of Timor-Leste (UNTL);
- ✓ Non-governmental organizations, FONGTIL, Luta Hamutuk and Lao Hamutuk;

Written contributions received in the course of these hearings, were incorporated as appendices to this report and opinion.

The Committee on Public Finance considers that it has jurisdiction in the matter, to analyze and appreciate the General State Accounts relating to the financial year 2011, with horn fundamental support of the Report of the General State Accounts 2011 and the corresponding Report prepared by the Court of Appeal. The complexity and length of the document under review, the Committee determines that the Public Finance to rule on the aspects considered essential. Due to its importance and authority, fulfills the indispensability of grading Opinion of the Court of Appeal, in assessing the Account by the National Parliament.

Deputy Florentina Pereira da Conceição Martins Smith of FRETILIN Parliamentary Caucus was designed as Rapporteur.

II. Macroeconomic Overview

The projections that framed macroeconomic policy in 2011 and served as a basis for the development of this chapter, are found in two documents prepared by the Ministry of Finance, which reflect different moments of the budget process, the first the State Budget (OGE 2011), approved by Parliament on 28 January 2011 and the second, the General State Budget for 2012 (OGE 2012), approved by Law no. 16/2011 of 21 December, which saw developments in major macroeconomic aggregates by the end of 2011.

None of these documents (the State Budget for 2011 and the State Budget for 2012) was expected awarded by the Government to assess the impact of deviations from macroeconomic scenarios set for the year 2011, which would bring to the economy of Timor-Leste, conditioning as a result, the fiscal policy of the Government for this and subsequent years.

According to the Government's macroeconomic projections for the year 2011, the world economy began to recover from the financial crisis that erupted in September 2008 and it was expected that global production would grow 4.1%, also the risk of a collapse of global strong economic activity was reduced and finally an overall real economic growth for Timor-Leste in double digits, with a relatively low inflation rate in the order of 4%. Domestic revenue would continue on its growth trajectory and oil revenue remains high for this year.

But the global financial crisis, the deepest since the beginning of twentieth century, continued to dominate, in a durable and consistent way, at the end of 2011 and in the future continued to be very uncertain. The negative impact on the Eurozone and especially in the economies of Greece, Spain, Ireland, Italy and Portugal led to increased unemployment, reduced demand and negative growth rates, leading to a slowdown in global aggregate demand. Pressure on the euro has led to the devaluation of that currency against the U.S. dollar and the average unemployment rate in Europe in September 2011 was already nearly 10%, while the United States had a similar unemployment rate of 9.1%.

Notwithstanding predictions that the need for energy and minerals would remain stable, in 2011 there were doubts as to its supply, especially with regard to oil, due to social and political upheavals caused by the "Arab Spring" and the negative effect of contamination from other economies, the earthquake in Japan and a weaker than expected activity of the United States. In the first quarter of 2011, with supply disruptions in the Middle East, oil prices rose to more than $100 per barrel. After reaching the peak, prices fell slightly in the second quarter. Demand and prices continued to rise after the third quarter of 2011 (despite the crisis in Europe and the United States) and, towards the end of the year, the drop in activity was reflected in lower energy demand, leading to a decline in oil prices. The average price of a barrel of oil was $104 for the year under review.

The Southeast Asia and Pacific region has shown an over-exposure to global markets and inflation has been a major concern in the region. Prices have been rising steadily and the problem is exacerbated by the devaluation of the U.S. dollar and pressure from speculation on derivatives.

In 2011, the Australian dollar continued to appreciate against the U.S. dollar, but the behavior of the exchange rate of that currency was unstable throughout the year (and it was valued against the U.S. dollar by 20% in first half, the trend reversed in the second half to reach a rate similar to that seen earlier in the year). As for the evolution of the exchange rate of the Indonesian rupiah, the currency of another major economic partner of Timor-Leste, presented a consistent appreciation against the U.S. dollar, reaching 4% in December 2011).

The growth of non-oil GDP of Timor-Leste was mainly driven by spending in the public sector, which stimulated demand and supply, contributing to considerable growth rates in the private sector. In 2011, non-oil GDP in Timor-Leste obtained an average growth rate of about 10%, according to IMF estimates. The increase in state spending in 2011 had a significant weight in the Gross Domestic Product (GDP) as well as the enormous weight of imports.

At the end of 2011, inflation in Timor eventually far exceeded the 4% estimated by the 2011 State Budget, the average real rate of inflation was 13.5%. Inflation thus continued to be a serious problem in Timor-Leste, as major trading partners / suppliers are located mainly in Asia, where inflationary pressures as noted above, are quite strong and inflation has increased. The inflation rate in Timor-Leste is revealed as particularly high compared to other countries in the region, and the demand far exceeds domestic production capabilities. In the case of food, the inflation rate in Timor-Leste even reached 19.8%, representing almost 60% of the market basket used to calculate the Consumer Price Index (CPI). As Timor-Leste is mainly an importing country, the impact of rising global food prices is particularly worrying in Dili, and the food and drinks that weigh more in the calculation of the Consumer Price Index.

The high inflation rates have the effect of immediately reducing the power to purchase food to satisfy the basic needs of the population, while increasing the cost of imports. Furthermore, the actual price of rice produced in 2011 Timor also increased due to heavy rainfall which damaged the production of 2010.

Exports were almost irrelevant in the context of national accounts in 2011, and the total value of exports of goods and services in Timor-Leste has not exceeded $100 million, while imports of goods and services reached the $1,864 million, made possible by oil revenues. Exports of Timor-Leste were almost exclusively coffee and mainly concentrated in the second half of 2011, representing the year under review, about $1.9 million, a significant drop from the previous year. *[This is incorrect. Coffee exports in 2011 were $11.9 million, down from $16.0 million in 2010. – LH]*

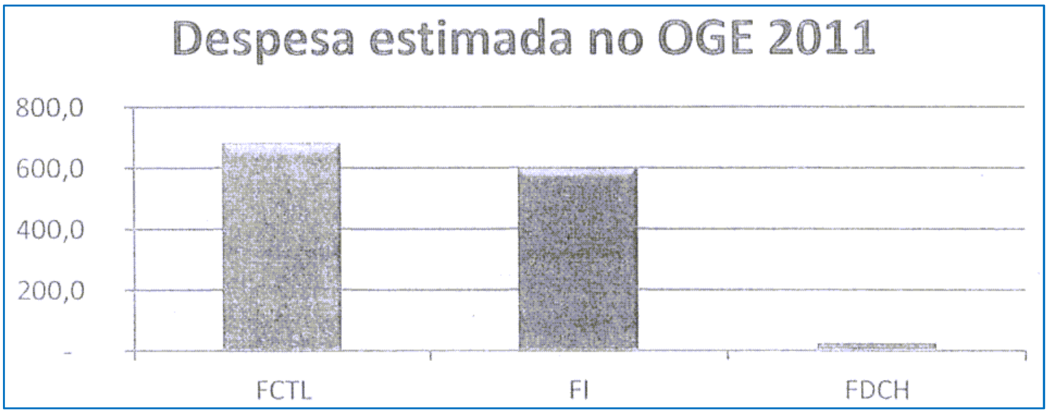
Timor-Leste has a fast-growing working-age population, with high levels of unemployment and underemployment recorded in 2011. The private sector employs less than 10% of the workforce, as well as the public sector, and most of the population lives on subsistence economy, with low levels of productivity.

III. State Budget for 2011

The State Budget (OGE) for 2011, which was approved by the National Parliament - Law no. 1/II, of February 14, 2011, included the following appropriations:

Total Expenses: 1,306 million U.S. dollars, distributed as follows:

Table 1 - Estimated expenditure on OGE 2011



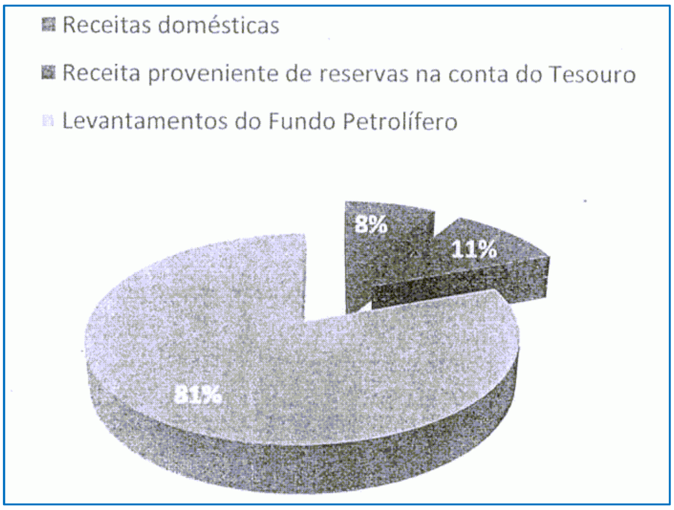
- **$681.7 million** to the Consolidated Fund of Timor-Leste (FCTL), corresponding to 52% of the State Budget for 2011;
- **$599.3 million** to Infrastructure Fund (FI), corresponding to 46% of the State Budget for 2011;
- **$25.0 million** Fund for Human Capital Development, corresponding to 2% of the State Budget for 2011.

The Infrastructure Fund (IF) and the Fund for Development of Human Capital (FDCH) were created under Article 32 of the Budget and Financial Management Law and established in March 2011, and therefore the Treasury prepared Financial Statements for these funds for the 2011 General State Accounts.

During the 2011 financial year there were no changes to the global initial expense amounts in any of the three funds, they kept their allocations unchanged.

Total Revenue: The total revenue estimated at the headquarters of the General State Budget for 2011 stood at 1,306 million of U.S. dollars:

Table 2 - Estimated revenue in 2011 state budget



- **$1,196 million,** representing 95% of overall revenue budget, of which $1,055 million from oil revenue (oil and gas) and $140 million from the Consolidated Fund of Timor-Leste.
- **$110.7 million** tax and non-tax domestic revenue, or approximately 5% of total budget revenue.

Because, during the financial year 2011, there have been no budgetary adjustments on the revenue side, the final revenues budget was also maintained for all of the Funds, their allocations unchanged.

The Government referred the accounting documents for the three Funds separately, but was done after the delivery date currently required by law, that is, 5 months after the end of the financial year (current wording of Article 45.0 of the Budget and Financial Management Law).

The accounting documents include receipts and expenditures of the ministries and their services, as well as "autonomous institutions under the control of the entity." However, these documents did not include receipts and expenditures of the National Petroleum Authority and the Agency for the Management of Participation in Games.

- **Revenue Budget Execution**

A "non-tax revenue" from the sale of rice and interest stood at 10% of what was predicted, and no justification was justification for that poor execution, contrary to "Cash Basis IPSAS."

The auditor made a "reservation" to the accounts of 2011, given the existence of the numbers from "sale of rice" and revenue from the National University of Timor-Leste that was used in making expenses prior to accounting and may therefore , have revenues and expenses are not reflected in the financial statements.

- **Expenditure Budget Execution**

The auditor noted the existence of significant amounts of payments of wages and salaries in cash and included a "reservation" to the accounts, considering that the accuracy and completeness of the beneficiary population of such payments was unreliable, and it was not possible to conclude the validity of all payments made. In turn, the auditor identified in 2011 and 2010, cases of payments to non-existent employees and officials who had already ceased their employment relationship.

- **Overall budget execution**

The State Budget for 2011 estimated a total expenditure of $681.7 million to the Consolidated Fund of Timor-Leste, offset by revenues of $110.7 million from domestic revenues, $431 million to be paid from the Petroleum Fund and $140 million to transfer money from reserves in the Treasury Account.

Domestic revenues collected in 2011 were up by $105.76 million (96% execution) and the Government transferred as planned to the Consolidated Fund of Timor-Leste, $1,055 million. However the government increased to $5.291 million of cash reserves it held in Treasury Account, instead of the $140 million that was projected as the base of OGE 2011.

IV. Annual Consolidated Financial Statements - Fiscal Year 2011

The annual consolidated financial statements prepared by the National Treasury, Ministry of Finance, have been prepared in accordance with the Modified Cash Method of International Public Sector Accounting (IPSAS).

The Modified Cash Method considers the existence of a normal financial period (1 January 2011 to 31 December 2011) and a supplementary period (1 January 2012 to 29 February 2012, a period in which the State can make payments, still on behalf of the State Budget (OGE) for 2011, for goods and services that were received by 31 December 2011.

According to the annual consolidated statements on budgetary execution in 2011 for the three funds were considered as made in the year, payments made between 1 January 2011 and 29 February 2012 (thus including the additional period from 1 January to 29 February), for goods and services that were received by 31 December 2011.

- **Revenue Execution**

Table 1 - Execution of Revenue in 2011

(Unit: million USD)

Source of Revenue	Revenue estimated in OGE 2011	Revenue collected in 2011	Difference between estimated and collected revenue
Domestic revenues	110.7	105.8	-4.90
Revenue from reserves in Treasury account	140.31	5.3	-135.01
Transfers from the Petroleum Fund	1,055.0	1,049.7	-5.29
Overall revenues received	**1,306.0**	**1,160.8**	**-145.20**

The execution of overall revenues amounted to $1.1608 billion, accounting for an execution of approximately 90%.

Domestic revenues collected amounted to only $105.8 million (96% execution), not the $110,7 million expected when drafting the State Budget for 2011.

The state chose to withdraw only $5.291 million, out of $140.318 million that was projected to be withdraws from the cash reserves deposited in the Treasury Account. This savings option has not been the most appropriate in view of Committee C, the Government choosing to burden the Petroleum Fund instead. However, the Committee does not have information from Government to allow it to analyze the opportunity costs of both solutions.

- **Expenditure Execution**

Table 2 - Expenditure Execution in 2011

(Unit: million USD)

Expenditures by Fund	OGE estimated expenditure in 2011	Actual expenditure in 2011	Difference between the estimated and actual expenditure
FCTL	604.7	604.7	-77.00
FI	599.3	474.4	-124.90
FDCH	25.0	16.8	-8.20
Overall Expense	1,306.0	1,095.91	-210.10

<u>The overall expenditure made on behalf of the Consolidated Fund of Timor-Leste</u> amounted to $604.7 million, reflecting an execution rate of 89%.

<u>Budget execution from the Infrastructure Fund</u> was $474.4 million, representing an execution rate of 79%.

<u>The execution of the Development Fund for Human Capital</u> was $16.8 million, representing an execution rate of 67.2%.

- **Treasury balances**

<u>The cash balance of the Consolidated Fund of Timor-Leste</u> in the Central Bank of Timor-Leste, on December 31, 2011, was $202.6 million U.S., and, on February 29, 2012, it was $182.037 million.

<u>The cash balance of the Fund for Infrastructure</u> in the Central Bank of Timor-Leste on 31 December 2011 was $165.676 million and at the end of the additional period, on February 29, 2012 it was $146.134 million.

As for the <u>cash balance of the Fund Human Capital Development</u> at the end of the accounting period was $10.232 million to 31 December 2011, but only $9.665 million on February 29, 2012 (due to payments made during the complementary period).

V. Independent Auditor's Report

The National Directorate of Treasury referred to the Court of Appeal and the National Parliament the Annual Financial Statements and Audited Accounts for Financial year 2011 on the Consolidated Fund of Timor-Leste (FCTL), Infrastructure Fund (IF) and the Human Capital Development Fund (FDCH) separately.

Regarding the Consolidated Fund of Timor-Leste, the Independent External Auditor, issued its opinion with reservations in the seat of its Audit Report on the Accounts of State 2011:

"Except for the possible effects of the matters described in the preceding paragraphs, the financial statements present fairly, in all material respects, the cash balances at December 31, 2011 of the Consolidated Fund and its receipts and payments for the year then ended according to the International Public Sector Accounting Standard, cash basis financial reporting."

<u>The basis for the qualified opinion</u> of the Independent External Auditor on the Consolidated Fund of Timor-Leste were as follows:

- The Government of Timor-Leste has received a significant amount of support from third parties, it was not possible for the Independent Auditor to confirm the completeness and accuracy of external support accounted for Consolidated Fund.
- The Consolidated Fund received a significant amount of cash. Part of it, resulting from the sale of rice and revenues from the National University of Timor-Leste, was used to make payments before being accounted for. It was not possible for the auditor to confirm that cash receipts recorded

were complete and that payments from these receipts were complete and valid.

- The Consolidated Fund paid significant amounts of wages and salaries in cash. The Government has identified situations in relation to 2011 (and now also on the previous year) payments to nonexistent employees and / or who had ended their labor ties with the State. For these reasons it was not possible for the Independent Auditor to conclude the validity of all payments made.

For the Infrastructure Fund, the (unreserved) opinion issued by the Independent External Auditor in his audit report to the Accounts of the State of 2011 was that the financial statements present fairly, in all material respects, the cash balances in December 31, 2011 of the Infrastructure Fund and its receipts and payments for the period then ended in accordance with International Public Sector Accounting Standard, cash basis financial reporting.

Regarding the Human Capital Development Fund, (unreserved) opinion issued by the Independent External Auditor in his audit report to the State's accounts, 2011 was also the financial statements present fairly, in all material respects , the cash balances at 31 December of 2011 of the Human Capital Development Fund and its receipts and payments for the period then ended in accordance with International Public Sector Accounting Standard, cash basis financial reporting.

Special note to highlight from the Independent Auditor in relation to the Consolidated Fund of Timor-Leste and the Infrastructure Fund, the <u>failure occurred during the period covered by the audit, the Decree-Law of Supply and Guide of Best Practices for part of some public entities,</u> creating uncertainty about the objective of optimizing procurement expenses.

VI. Opinion of the Court of Appeal

- ✓ **The Court of Appeals issued the following Opinion on the accounts of the Consolidated Fund of Timor-Leste:**

  Legality: *Observance of the Law on Budget and Financial Management, despite the limitations mentioned in this report, <u>with regard to the principles of budgetary annuality, unity and universality and not compensation, it is considered that it was generally fulfilled.</u>*

  Financial correction: *Notwithstanding the conclusions and recommendations made in this report and opinion, as well as the possible effects that the "reviews" of the independent external auditor may have on the financial statements in relation to "external support accounted for, the existence of revenue cash from sales of rice and the National University of Timor-Leste and expenses not accounted for, and the risk associated with the existence of "significant payments" of wages in cash, <u>the Court considers validly given FCTL accounts relating to the financial year 2011.</u>*

- ✓ **The Court of Appeals issued the following opinion on the accounts of the Infrastructure Fund:**

  Legality: *The findings of the independent external auditor in its report on the financial statements of the Infrastructure Fund after "review" made by it to the procurement procedures developed together of 13 public entities realize the significant breach of procurement legislation and "Good Practice Guides", has raised further questions about compliance with the principles of economy, efficiency and effectiveness that should guide the execution of public expenditure. <u>During the year 2011, in general, the Law on Budget and Financial Management was complied with.</u>*

  Financial correction: *Given the conclusions drawn in this report and opinion and the recommendations made, the Court of Appeal, <u>judges validly given Infrastructure Fund accounts relating to the financial year 2011.</u>*

- ✓ **And finally, the Court of Appeals issued the following opinion on the Human Capital Development Fund accounts:**

Legality: *During the year 2011 was, in general, complied with the Law on Budget and Financial Management.*

Financial correction: *Given the conclusions drawn in this report and opinion and the recommendations made, the Court of Appeal judges validly given the accounts of the Fund for Development of Human Capital, for the financial year 2011.*

VII. Conclusions and Recommendations of the Court of Appeals

✓ Recommendations regarding the Consolidated Fund of Timor-Leste (FCTL):

The Court of Appeal considers and recommends (under Article 29.3 of the Organic Law of the Chamber of Auditors), the adoption by the Government of the following measures, in the process of accountability, budget execution expenditure and revenue and the overall budget execution (pp. 26-28 of the Opinion on the General State Accounts, 2011):

1. *Compliance with deadlines in Budget and Financial Management Law and Organic Law of the Chamber of Auditors for the transmission of the General State Accounts and reports on the evolution of the budget to the Court of Appeal;*
2. *A clear definition of the scope of consolidation of accounts, with details of entities included in FCTL, of all excluded entities and underlying criteria;*
3. *Greater control over the collection of revenue in cash, in particular, from the sale of rice and the National University of Timor-Leste, to avoid the existence of unaccounted income and expenses and ensure compliance with the budgetary principles of unity and universality and no compensation;*
4. *Presentation of justification for all material differences between the original budget, the final and execution of revenue and expenditure;*
5. *Reduction in payments of wages and salaries in cash to situation where it is strictly necessary and there is no alternative hypothesis;*
6. *Disclosure in the "Notes to Financial Statements" of information about the debts of all public entities to suppliers, resulting from the provision of goods and services, and the execution of works, existing at year end;*
7. *Development of additional efforts at public institutions with responsibilities for the conduct of procurement processes in order to be assured of compliance, as well as the "best practice guides" produced by the Ministry of Finance, which should include the strengthening of human resource training;*
8. *Annual assessment of compliance of procurement and "good practice guides" issued by the Ministry of Finance;*
9. *Preparation and inclusion of "Annual procurement" ("Guide to Good Practice 8") in the annual documents of FCTL.*

✓ Recommendations regarding the Infrastructure Fund (FI):

The Court of Appeal considers and recommends (under Article 29.3 of the Organic Law of the Chamber of Auditors), the adoption by the Government of the following measures (pp. 42-43 of the Opinion on the General State Accounts, 2011):

1. *Compliance with deadlines in Budget and Financial Management Law and Organic Law of the Chamber of Auditors for delivery of account documents and reporting on budget developments to the Court of Appeal;*
2. *Adjustment of the amount of $16.0 million transferred in excess, for 2011, for the Infrastructure*

Fund and the amount paid by the Human Capital Development Fund on behalf of Infrastructure Fund;

3. *Inclusion in the "Notes to Financial Statements" of information on all situations that limit or restrict the use of "cash balances";*
4. *Disclosure in the "Notes to Financial Statements" of information about debts to suppliers, resulting from the provision of goods and services and the execution of works, existing at year end;*
5. *Development of additional efforts at public institutions with responsibilities for the conduct of procurement processes, in sense of being assured compliance with the law, as well as "best practices" developed by the Ministry of Finance, which will include the strengthening of human resource training;*
6. *Annual assessment of compliance of procurement and "Guide: Best Practices" issued by the Ministry of Finance;*
7. *Development and inclusion of "Annual Procurement" ("Guide to Good Practice 8"), documents the provision of annual accounts of the Infrastructure Fund;*
8. *Included in the account documents information on the results achieved, in particular relation to the physical execution of projects, as well as related changes to the amounts of investment envisaged for their implementation (including in subsequent years).*

✓ **Recommendations regarding the Human Capital Development Fund (FDCH):**

The Court of Appeal considers and recommends (under Article 29.3 of the Organic Law of the Chamber of Auditors), the adoption by the Government of the following measures (pp. 53-54 of the Opinion on the General State Accounts, 2011):

1. *Compliance with deadlines in Budget and Financial Management Law and Organic Law of the Chamber of Auditors for delivery of documents and accountability reports on the development of the budget to the Court of Appeal;*
2. *Adjustment of the amount of $1.4 million, in excess transferred in 2011 to Human Capital Development Fund and the amount paid by the Infrastructure Fund on behalf of the Human Capital Development Fund;*
3. *Disclosure in the "Notes to Financial Statements" for information on debts to third parties existing at the end of the year;*
4. *Included in the account documents information on the results achieved.*

VIII. Findings and Recommendations of the Committee on Public Finance

The report and opinion on the General State Accounts must be submitted to the National Parliament by the High Administrative, Tax and Audit Court (or until its installation, the Court of Appeal) by the end of the year following that in respect of Account, pursuant to Article 29.4 of its Organic Law (LOCC). The Court of Appeal referred its report and opinion on the General State Accounts for 2011 to the National Parliament on 19 October 2011 *(sic, actually 2012)*, thus fully complying with the deadlines prescribed by law.

For the third consecutive year the National Parliament is assessing the General State Accounts, supported by the report and opinion prepared by the Court of Appeal and the input received during the public hearings held by the Committee on Public Finance (Committee C) covering the 2011State Accounts.

Committee C notes once again its concern about technical limitations that the Court of Appeal continues to invoke in respect of the budgetary oversight process and the judgment of the General State Accounts that it is empowered to do. The entry into force of the Organic Law of the Chamber of Accounts for the

Administrative, Tax and Audit Court, Law no. 9/2011 of 17 August, made his way to the Court of Appeal and could quickly overcome the limitations that have evinced in its Report and Opinion on the 2010 General State Accounts. The Committee welcomes, however, the significant increase in the technical training of the Court of Appeal and the highly complex work that was developed.

Given the constraints identified by the Court of Appeal (TR) in the level of its skilled human resources in economic and financial aspects, the Public Finance Committee recommends that since the Court lacks internally the human assets that it needs, it should appoint an independent auditor to examine the audited State accounts.

Subject to the advice and recommendations contained in the Report and Opinion of the Court of Appeal, which this Committee fully supports, however, it is necessary to reinforce the call for attention to a number of situations that require urgent regularization, some of which also underlined by non-governmental organizations that were heard by the Committee C sitting in a public hearing, to attain more transparent, effective and efficient management of public money.

- **Recommendations**

The following are the recommendations made by Committee C, which are expected to come to enrich the debate in plenary on the 2011 General State Accounts.

1. It is recommended that the Government refers to the National Parliament prior to the debate on the State accounts, their completed audit reports.
2. It is recommended that the government be more judicious in the use of contingency funds and taking attention its use must be exceptional. Expenditure incurred by the Contingency Fund in 2011 totaled $29.5 million, almost reaching the ceiling of 5% of global spending of the General State Budget allowed by Article 37 of the Budget and Financial Management Law.

   The law is clear when it states that the expenses that may be supported by the Contingency Fund shall be undelayable, urgent and unpredictable. Unfortunately the analysis of the extensive listing of expenditures from the contingency fund (pages 73 to 80 of the Annual Financial Statements and Accounts of the Consolidated Fund of Timor-Leste for the year 2011 by the Director-General of the Treasury), needs a fix from Committee C from the path that has been followed by the Government in recent years, given that the vast majority of the expenditures from the Contingency Fund in 2011 are operating expenses, which should have been planned and timely entered in the General State Budget that was submitted to National Parliament.

   It will be advisable for the Government to proceed now on the budgetary adjustments it deems necessary throughout each exercise within the same category of expenditure in the light of the actual execution verified for each Ministry in the various categories listed, and thus avoid the need for systematic, unjustified contingency amounts.
3. It is recommended that the Government review its strategic options and prioritize future investments in the health sector, taking into account the serious shortcomings in this area and the fact that, in 2011, appropriations for this purpose were only 6% of total spending from the Consolidated Fund of Timor-Leste.
4. The "reviews" performed by an independent external auditor of the procurement procedures used by a number of public entities, following the decentralization of the procurement system, allow us to see that the creation of laws and regulations were insufficient, making it necessary to complement them with an effective system of internal and external control, and enforcement of sanctions on those who do not obey the law. Committee C recommends to the Government urgently to ensure the establishment and monitoring of an effective control system, to look into responsibilities and sanction those responsible for breaches of procurement law and the possible mismanagement of public funds.
5. It is recommended to the Government be more realistic and cautious about the projects it wants to

implement. It is noted that a large amount of investment in infrastructure projects scheduled for 2011, covered by the Infrastructure Fund and technical training by the Human Capital Development Fund, obtained zero or practically zero execution. It is important that the government make a consistent analysis of the reasons that delayed the implementation of these projects and provide to the National Parliament sufficiently disaggregated information about the multiannual projects covered by the Special Funds and hold responsible those responsible for weak enforcement, where blame can be assigned.

6. It is recommended that they be resolved in advance, serious problems detected at the programming level of the computer application "Free Balance" of the Transparency Portal, since the values it extracts have a very low reliability (for example, no items of expense with execution above 100%, expenditures for items never mentioned in any budget line throughout the year, reinforcements of appropriations made by budget changes after that are not included in the final budget (because they were not properly added to the initial appropriation).

   Data presented by the State are not totally reliable and reduce the validity of any serious analysis which is intended to be based on that same data. It will be also necessary to solve the problem of monetary units used in budget execution tables (e.g. Is one million, one hundred and twenty and one thousand U.S. dollars – 1,121 million with a comma to separate decimal places, then the value of $500,000 will be presented in the tables as 0,500 and not as 500 as is happening).

7. It is recommended that the Government timely present and submit account documents to the National Parliament and the Court of Appeal. The elections at the end of the first half of 2012, may partly justify the delay in delivery, but not the nearly five months that have ensued.

8. It is recommended that the Government jointly with the General State Accounts, present to the National Parliament studies of economic, social and environmental impact and economic-financial viability of the amount of all projects financed with State Budget resources, and subsequent evaluation (in the General State Account) of the contribution to the realized expenditures for them for real improvements in people's quality of life.

9. The control of inflation is of paramount importance to any economy. In 2011, inflation reached record values that perhaps would advise adopting specific budget adjustments, in order to minimize their effects at domestic levels. The estimates used in the design of the State Budget in 2011 pointed to inflation rates around 4%, but the real rate, reached in December 2011, was 17.4%, representing an average annual rate of inflation of 13.5%.

   The rising cost of living in 2011, especially in Dili, resulting from the increase of 17.4% on most goods and services included in the Consumer Price Index (CPI), should have caused the government to take further fiscal and economic measures with corresponding budget translations. It is important that the government adjust its current investment policy and perhaps temporarily slow down the pace of infrastructure construction, to reduce imported inflation.

10. It is recommended that the General State Accounts include charts of unpaid debts to suppliers of goods and services at the end of the year and again request the Ministry of Finance to provide to this Committee by the end of this year, a listing of all contracts awarded in 2011 by direct agreement.

11. It is recommended that the National University of Timor-Leste (UNTL) find other ways to increase its cash flow, with the goal of becoming less dependent on the State coffers.

12. It is recommended that the Government avoid resorting to the Petroleum Fund revenues above the Estimated Sustainable Income (ESI) to support the non-oil deficit, in order to safeguard the future of coming generations. Additionally, because it turns out that the most suitable option for financing the State Budget is using balances carried over from the Consolidated Fund, as the opportunity cost (cost of money) of this solution will be lower than the opportunity cost of the Petroleum Fund. The tendency to increase the weight of the budget deficit over GDP, indicates the unsustainability of public finances

in the long term.

13. It is recommended that the Government review its current purchasing policy, particularly with regard to office supplies and explore the possibility of establishing something like a "central shop" for the purchase of large quantities to cover the annual needs to all Ministries, with the aim of reducing the overall costs to the State, by achieving economies of scale and increased leverage with suppliers.
14. It is recommended to carry out a similar study to make more expeditious acquisition of airline tickets, which will prioritize, where possible, domestic travel agencies.
15. It is recommended to the Government to provide timely audit reports to all Ministries audited in the General State Accounts, so that they have the ability to adequately prepare for hearings to be convened by the National Parliament.
16. Finally, taking into account recent experience (audit "review" of procurement procedures performed in 2012), it is believed that it would be useful to the Finance Ministry to think about future decentralization of other functions to the various ministries in a phased manner, starting by testing decentralized procedures in only two or three pilot ministries and only expanding to other ministries after validating the system and certifying the procedures.

- **Opinion**

Committee C is of the opinion that the National Parliament must report, for investigation, to the Prosecutor-General of the Republic, evidence of fraud found by the Independent Auditor in the process of "reviewing" the procurement procedures decentralized to ministries, and that the Opinion of the Court of Appeal should be sent also to the Anti-Corruption Commission to clean up any responsibility for a situation that has been going on since 2010, payments to non-existent employees.

Committee C commends the Government for providing to the Court of Appeal the duly audited State accounts and for requesting "review" audits of the procurement procedures used by various public entities, after the start of the decentralization process and believes that Ministers should be given to the term of one year to implement corrective measures in procurement systems of the ministries in charge which were criticized by the independent auditor and then hold politically accountable the ministers who are not able to deliver on time.

IX. Voting

The Report and Recommendations of the Committee on Public Finances were discussed and approved on December 3, 2012, with 9 votes in favor, 0 against, and 0 abstentions, reserving to the parliamentary benches their political positions for plenary debate.

Dili, National Parliament, on December 3, 2012

The Reporting Deputy
/s/
(Florentina Pereira da Conceição Martins Smith)

The Acting President
/s/
(Izilda Manuela Soares da Luz Pereira)