

## FINANCIAL ANALYSIS

### A. Introduction

1. The financial due diligence includes (i) a brief overview of the financing of education and technical and vocational education training (TVET), including a brief background on the regulatory and funding framework for TVET, and an assessment of the financial position of the Nanning Municipal Government (NMG) and the two TVET schools: Nanning Health School (NHS) and Nanning No. 4 Vocational and Technical School (NVTS); (ii) a financial sustainability analysis of NHS and NVTS; (iii) fiscal impact analysis; and (iv) financial management assessment (FMA) of the main implementing agency, the Xiangsihu Investment and Development Company (XIDC).<sup>1</sup> The financial analyses and FMA were undertaken in accordance with relevant Asian Development Bank (ADB) guidelines.<sup>2</sup>

### B. Overview of Policy Framework and Financing of Education

2. **Policy framework.** The Vocational Education Law, 1996 provides the general regulatory framework for TVET in the People's Republic of China (PRC).<sup>3</sup> The Guangxi Zhuang Autonomous Region (GZAR) Medium- and Long-term Educational Reform and Development Program (2010–2020) and the National Medium- and Long-term Educational Reform and Development Program (2009) aim to strengthen TVET within the region. The long-term policy goal is to help solve the problem of unemployment and socio-economic inequalities, and to promote economic development through urbanization and industrial transformation. Improving TVET is vital component in the plans to improving workforce skills.

3. **Financing of education in the region.** GZAR's expenditure on education as a percentage of its gross domestic product has remained stable at 3.1% during 2010–2012 (Table 1), slightly lower than the PRC average (about 3.5% in 2011) and significantly lower than average for the member states of the Organisation for Economic Co-operation and Development (OECD) (5.8%).

**Table 1: Trends in the Financing of Education, Guangxi Zhuang Autonomous Region 2010–2012**

Item	2010	2011	2012
GZAR total GDP (CNY billion)	957.0	1,172.1	1,300.0
GDP annual growth rate	23.3%	22.5%	10.9%
GZAR government total expenditure (CNY billion)	200.8	254.5	296.5
Government total expenditure as of % of GDP	21.0%	21.7%	22.8%
GZAR government education expenditure (CNY billion)	29.7	36.7	39.5
Education expenditure as of % of GDP	3.1%	3.1%	3.0%
Education expenditure as % of GZAR government total expenditure	14.8%	14.4%	13.3%
GZAR government expenditure for TVET (CNY billion)	3.3	3.5	3.6
Expenditure for TVET as % of GZAR government total expenditure	1.7%	1.4%	1.2%
Expenditure for TVET as % of GZAR government education expenditure	11.3%	9.5%	9.0%

<sup>1</sup> XIDC is a stated-owned enterprise in Nanning that is administrated by the Xiangsihu Development Zone Committee. XIDC has extensive experience in managing ADB and World Bank projects. Discussions with the project management office, XIDC, and staff of NHS and NVTS indicate that XIDC will be the main entity to undertake financial management of project funds, particularly those pertaining to project works (comprising about 94% of project funds during project implementation).

<sup>2</sup> ADB. 2005. *Financial Management and Analysis of Projects*. Manila; ADB. 2009. *Financial Due Diligence: A Methodology Note*. Manila.

<sup>3</sup> W. Wang. 2010. *Key Highlights of China's Approach to TVET/Skills Development*. <http://siteresources.worldbank.org/EDUCATION/Resources/278200-1121703274255/1439264-1242337549970/6124382-1288297991092/ChinaNote-byWenjinWang.pdf>

CNY = Chinese Yuan, GDP = gross domestic product, GZAR = Guangxi Zhuang Autonomous Region, TVET = technical and vocational education and training.

Source: Statistics Bureau. Guangxi Zhuang Autonomous Region. 2010, 2011, and 2012. *Guangxi Statistical Yearbooks*.

4. As a percentage of total government expenditures, education spending has decreased from 14.8% to 13.3% during 2010–2012. GZAR's education expenditure for TVET has been very low, about 9.9% (on average) of its total annual education expenditure or about 1.4% of the GZAR's total government expenditure (Table 1).<sup>4</sup>

5. **Financing education in Nanning municipality.** Nanning's expenditure on education increased from CNY5.9 billion in 2010 to CNY6.6 billion in 2012 (Table 2). Expenditure on education, as a percentage of Nanning's gross domestic product, was estimated at an average of 3.2% during 2010–2012, a little higher than the PRC's average of 3.5%, but significantly lower than the OECD's average of 5.8%. As a percentage of total municipal government expenditures, education spending decreased from 22.5% in 2010 to 17.0% in 2012. Nanning's expenditure for TVET has been CNY0.6 billion to CNY0.7 billion during 2010–2012. This is about 1.9% (on average) of NMG's annual total expenditure and about 10.0% of the municipality's total education expenditure on TVET.

**Table 2: Trends in the Financing of Education, Nanning Municipality, 2010–2012**

<b>Nanning</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Nanning total GDP (CNY billion)	180.0	209.0	234.7
GDP annual growth rate	18.1%	16.1%	12.3%
Nanning government total expenditure (CNY billion)	26.1	36.2	38.8
Government total expenditure as of % of GDP	14.5%	17.3%	16.5%
Nanning government education expenditure (CNY billion)	5.9	6.9	6.6
Education expenditure as of % of GDP	3.3%	3.3%	2.8%
Education expenditure as of Nanning government total expenditure	22.5%	19.1%	17.0%
Nanning government expenditure for TVET (CNY billion)	0.6	0.7	0.7
Expenditure for TVET as % of Nanning government total expenditure	2.1%	1.9%	1.8%
Expenditure for TVET as % of Nanning government education expenditure	9.4%	10.1%	10.6%

CNY = Chinese Yuan, GDP = gross domestic product, TVET = technical and vocational education training.

Source: Nanning Statistics Bureau. 2010, 2011, and 2012. *Nanning Statistical Yearbooks*, Nanning Municipality.

6. During 2010–2012, the total expenditure of NMG on education increased 37% (from CNY5,866 million to CNY8,059 million), mainly because of significant increases in capital (124.6%) and recurrent (15.9%) expenditures during the period. A breakdown of 2012 recurrent costs, by level of education, indicated that recurrent expenditures on (i) preschools accounted for about 6.7%; ii) on primary and secondary education for 84.5%; and (iii) on TVET for about 6.2%.

**Table 3: Public Education Expenditure, Nanning Municipality, 2010–2012**

<b>Item</b>	<b>2010</b>	<b>2011</b>	<b>2012</b>
Total education expenditure <sup>a</sup> (CNY million)	5,866	6,927	8,059
Total education expenditure annual growth rate	34.4%	18.1%	16.3%
Capital expenditure <sup>b</sup> (CNY million)	1,061	1,624	2,383
Capital expenditure annual growth rate	26.8%	53.1%	46.7%
Recurrent expenditure <sup>c</sup> (CNY million)	4,805	5,303	5,568
Recurrent expenditure annual growth rate	36.3%	10.4%	5.0%
Breakdown of recurrent expenditure:			
Preschool education (CNY million)	178	227	372
Preschool education as % of total recurrent costs	3.7%	4.3%	6.7%

<sup>4</sup> In 2009, the GZAR government initiated a tuition fee waiver policy for students from poor rural families and for secondary school TVET students. <http://www.chinanews.com/edu/2011/06-15/3113924.shtml>

Item	2010	2011	2012
Primary and secondary education (CNY million)	4,085	4,542	4,704
Primary and secondary education as % of total recurrent costs	85.0%	85.6%	84.5%
TVET(CNY million)	361	347	345
TVET as % of total recurrent costs	7.5%	6.6%	6.2%
Higher education (CNY million)	112	139	147
Higher education as % of total recurrent costs	2.3%	2.6%	2.6%
Other recurrent costs (CNY million)	69	47	
Other recurrent costs as % of total recurrent costs	1.4%	0.9%	0.0%

CNY = Chinese Yuan, TVET = technical and vocational education training

<sup>a</sup> University-level higher education not included.

<sup>b</sup> Capital expenditure includes new goods and civil works and rehabilitation.

<sup>c</sup> Recurrent expenditure includes wages and benefits, subsidies, and services payment.

Source: Ministry of Education. 2010, 2011, and 2012. *China Education Expenditure Books*. Beijing.

7. **Financing of technical and vocational education and training in Nanning.** The total funding of TVET in Nanning increased from CNY6,002 million in 2010 to CNY8,725 million in 2012. As of 2012, Nanning's TVET schools have been financed largely by municipal subsidies and budgetary allocations (about 80.4%),<sup>5</sup> while the balance is derived from tuition fees (7.6%), proceeds from the education surtax (7.9%),<sup>6</sup> and social grants and other sources (4.2%) (Table 4).

**Table 4: Financing of Technical and Vocational Education and Training, Nanning Municipality, 2010–2012**

Item	2010		2011		2012	
	(CNY million)	(%)	(CNY million)	(%)	(CNY million)	(%)
Public fund-mainly from municipal government	4,972	82.8	6,134	84.6	7,108	80.4
Tuition	483	8.0	516	7.1	659	7.6
Grants from international donor						
Proceeds from educational surtax	236	3.9	288	4.0	685	7.9
Grants and investments from private sector						
Social grants	21	0.3	14	0.2	6	0.1
Other sources (e.g., loans and other income sources)	290	4.8	302	4.2	357	4.1
Total funding for TVET	6,002	100	7,254	100	8,725	100

TVET = technical and vocational education training.

Source: Ministry of Education. 2010, 2011, and 2012. *China Education Expenditure Books*. Beijing.

### C. Financial Sustainability Analysis<sup>7</sup>

8. A review of the revenue and expenditure flows and funding sources during 2010–2012 indicated that NHS and NVTS are heavily dependent on annual budgetary allocations from NMG. Given the government's policy of providing subsidies for TVET, it is reasonable to assume that the two project TVET schools will continue to receive at least their current levels of financial support from the government for the foreseeable future.

<sup>5</sup> Government budgetary allocations, on a per student basis, are estimated at about CNY2,080/student/year.

<sup>6</sup> Financing for education is augmented by education surtax (1.0%), as specified in the Education Law. The State Council issued a guideline for TVET development during the 11th Five-Year Plan (2006–2010) indicating that 30% of the education surtax should be used for TVET development. The education surtax is an additional fee imposed on enterprises that pay value-added tax, consumption tax, and business tax. It is also imposed on those who pay individual income tax.

<sup>7</sup> Details are presented in the consultant's Detailed Financial Analysis Report.

## D. Fiscal Impact Analysis

9. Analysis indicates the total annual project cost in 2013 will be just 0.03% of Nanning government's annual expenditures;<sup>8</sup> this will increase to 0.34% in 2014, and decrease to 0.07% in 2017 (Table 5). The government's annual commitment to the project as a percentage of the total education budget is projected to increase from 0.19% in 2013 to 1.81% in 2014, and then decrease to 0.33% in 2017. As a percentage of the government's TVET budget, the commitment is expected to increase from 1.88% in 2013 to 18.00% in 2014, and then decrease to 3.30% in 2017. Financial analysis confirms that NMG has adequate financial resources and will be able to provide the necessary counterpart funds for the project. NMG has the capacity to cover both annual operations and maintenance costs and debt service requirements; these account for at most 0.02% of the total NMG annual expenditure, or 0.106% of the education budget.

**Table 5: Fiscal Impact of the Project**

Item	2014	2015	2016	2017	2018	2019	2020
<b>Fiscal Impact Analysis:</b>							
Nanning Government expenditure (CNY billion)	46.904	56.701	68.544	82.860	100.167	121.089	146.380
Nanning Government education expenditure (CNY billion)	8.374	10.490	13.140	16.461	20.620	25.830	32.357
Nanning Government TVET budget (CNY billion)	0.846	1.056	1.317	1.643	2.049	2.556	3.189
ADB Project (CNY billion)	0.016	0.190	0.256	0.097	0.068		
- Counterpart funding (CNY billion)	0.008	0.099	0.133	0.050	0.035		
- ADB loan (CNY billion)	0.008	0.091	0.123	0.047	0.032		
ADB Project as a proportion of Nanning Government expenditure	0.03%	0.34%	0.37%	0.12%	0.07%		
Counterpart fund as a proportion of Nanning Government expenditure	0.02%	0.17%	0.19%	0.06%	0.04%		
ADB loan as a proportion of Nanning Government expenditure	0.02%	0.16%	0.18%	0.06%	0.03%		
ADB Project as a proportion of Nanning Government education expenditure	0.19%	1.81%	1.95%	0.59%	0.33%		
Counterpart fund as a proportion of Nanning Government education expenditure	0.10%	0.94%	1.01%	0.31%	0.17%		
ADB loan as a proportion of Nanning Government education expenditure	0.09%	0.87%	0.94%	0.28%	0.16%		
ADB Project as a proportion of Nanning Government TVET expenditure	1.88%	18.00%	19.43%	5.91%	3.30%		
Counterpart fund as a proportion of Nanning Government TVET expenditure	0.98%	9.35%	10.09%	3.07%	1.71%		
ADB loan as a proportion of Nanning Government TVET expenditure	0.90%	8.65%	9.34%	2.84%	1.59%		
<b>Ability to Cover Annual O&amp;M and Debt Service:</b>							
Annual O&M cost (CNY billion)				0.009	0.009	0.009	0.009
Annual loan repayment (CNY billion)		0.000	0.001	0.002	0.003	0.004	0.026
Total annual O&M cost and annual loan repayment		0.000	0.001	0.011	0.012	0.012	0.034
Annual O&M cost and loan repayment as a proportion of Nanning Government expenditure		0.000%	0.002%	0.014%	0.012%	0.010%	0.023%
Annual O&M cost and loan repayment as a proportion of Nanning Government education expenditure		0.001%	0.009%	0.068%	0.058%	0.048%	0.106%
Annual O&M cost and loan repayment as a proportion of Nanning Government TVET expenditure		0.009%	0.089%	0.683%	0.585%	0.485%	1.077%

ADB = Asian Development Bank, CNY = Chinese Yuan, O&M = operation and maintenance, TVET = technical and vocational education training,

Source: ADB estimates

## E. Financial Management Assessment

10. NMG is the executive agency of the project. A project management office (PMO) has been established within the Nanning Development and Reform Commission, which is tasked with daily coordination and management of project preparation and implementation. NMG, which has

<sup>8</sup> Based on average annual growth during 2010–2012, NMG expenditures grew annually at about 21% while expenditures on education and TVET both grew annually at about 25%. These rates were applied in the projections for the period 2013–2019.

previous experience in the management and implementation of projects funded by ADB and the World Bank, has designated a government-owned company—XIDC—to manage the project’s ADB loan proceeds and government counterpart funds.<sup>9</sup> Under the supervision of the PMO and Nanning Finance Bureau, XIDC will implement, on behalf of NHS and NVTs, the physical components of the project, which account for 94% of the loan. The focus of the FMA was mainly on the capacity of XIDC to manage effectively, including its accounting of project funds (i.e., ADB loan proceeds and government counterpart funds).

11. The FMA indicated that XIDC has already established a financial management system and structure, with adequate and experienced staff dedicated to the project.<sup>10</sup> XIDC is subject to independent external audit in accordance with national arrangements. XIDC’s accounting system is computerized, follows national accounting standards, and has an established system of safeguards to protect assets from fraud, waste, and abuse. However, XIDC and the PMO staff managing the project will require further training and support on ADB policies and procedures, including procurement, disbursement, and project management. The FMA also confirmed that XIDC strictly follows PRC financial management policies and regulations. It has high-level financial management capability and experience managing capital projects. For the project, XIDC will follow No. 13 Regulation on Accounting Method of Projects Financed by the World Bank for executing agencies and/or implementing agencies as issued by the Ministry of Finance. Although XIDC has experience in implementing foreign-funded projects, a short training course should be conducted for XIDC’s project financial management staff on ADB financial management guidelines, and reporting requirements. XIDC staff with experience in the financial management of ADB- and World Bank-funded projects will be assigned and dedicated to the project.

12. During 2010–2012 XIDC’s total assets and net worth increased: total assets rose from CNY3.0 billion to CNY4.91 billion, an increase of about 64%; and net worth increased from CNY1.8 billion to CNY3.51 billion, an increase of about 95%. XIDC mainly serves as a funding channel for NMG projects and is mandated to implement, manage, and supervise the construction of publicly funded urban infrastructure, such as buildings and roads. As such, it relies mainly on government funds for its operations. The audit reports indicated that the financial statements are in accordance with national corporate accounting standards and enterprise accounting system. The financial statements accurately reflected each year’s financial situation, operation results, and cash flow situation covering all aspects of the company’s operations.

13. An assessment of the financial management system of NHS and NVTs indicated that both schools have a financial management and accounting system that can allow for the proper recording of project financial transactions, including the allocation of expenditures in accordance with the respective components, disbursement categories, and sources of funds. The schools’ financial management and accounting follows national accounting laws and principles and is supervised by the Nanning Financial Bureau in accordance with the relevant financial management and accounting policies of the Ministry of Education. Each school has sufficient and suitably qualified accounting staff, and NHS and NVTs are considered to have accounting systems and financial management capacity sufficient to undertake their limited role in project accounting.

---

<sup>9</sup> (i) Kelijiang River Environmental Upgrading Subproject of the ADB. 2006. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People’s Republic of China for the Nanning Urban Environment Upgrading Project*. Manila; and (ii) Fenghungjiang River Environmental Upgrading Subproject of the World Bank-funded Nanning Urban Environment Project. XIDC served as implementing agency for the infrastructure components of these projects.

<sup>10</sup> The full FMA is presented in the Detailed Financial Analysis Report, includes recommendations on capacity building to overcome the specific weaknesses identified while conducting the assessment.