

FINANCIAL ANALYSIS

A. Introduction

1. The financial analysis includes (i) an analysis of trends in education and technical and vocational education and training (TVET) financing, (ii) an assessment of the fiscal impact of the proposed program, (iii) an analysis of the government's ability provide sustained financial support for the program, and (iv) a summary of the financial management assessment of the executing agency.

B. Financing of Education and Training in the Kyrgyz Republic

2. **Country context.** The Kyrgyz Republic is a landlocked, mountainous country with a population of almost 6 million. It is a democracy and adopted a parliamentary system in 2011; it has achieved lower-middle income country status, with gross national income per capita in 2015 of \$1,133.¹ The Kyrgyz Republic has progressively increased economic output over the past two decades, and has an average gross domestic product (GDP) growth rate of 4.9%. However, economic growth has been volatile and the poverty rate remains high (32.1% in 2015).² The economy is characterized by significant informality, and relies heavily on a few sectors, and remittances from migrant workers.

3. **Policy and legal framework for education and training.** The constitution of the Kyrgyz Republic established the right to free education at all levels, including compulsory secondary education, provision of state scholarships (stipends) and benefits to pupils and students, and free textbooks. According to the sovereign constitution of 5 May 1993, amended in 2007, free, compulsory education is now limited to 9 grades (instead of 10), to be provided through state and municipal educational institutions. Following 4 years of primary and 5 years of lower secondary education, 2 years of general upper secondary education, specialized secondary education, or vocational education are offered. Entry to higher education is allowed from general secondary and secondary vocational education. The Ministry of Education and Science (MOES) oversees education in the Kyrgyz Republic.

4. The secondary TVET system is not regulated by any specific law, except the National Education Act, while the primary TVET system has its own act. The scope of primary TVET is legally restricted to the delivery of initial vocational education. The Primary Vocational Education Act determines that the primary vocational education is free in the Kyrgyz Republic. Therefore, primary TVET schools cannot charge tuition fees for full occupational courses, but instead rely on the state budget for about 90% of their financial support.

5. **Government expenditure for the education and training sector.** The education and training sector remains a priority for the country. This is demonstrated by government expenditure on education, which totaled 5.6% of GDP in 2015 and is projected to reach 5.7% in 2017; the Organisation for Economic Co-operation and Development (OECD) average was 4.5% in 2015.³ However, expenditure for education as a percentage of GDP has decreased from 7.4% in 2012, to 6.8% in 2013, and 5.7% in 2017. The education sector accounted for 18.0% of government annual expenditures in 2015, and is projected to be 18.6% in 2017. While the percentage of GDP

¹ 2016. World Bank. *Country Snapshot Kyrgyz Republic*. Washington, D.C.

² World Bank. GDP Growth (annual %). <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=KG> (accessed 4 September 2017)

³ OECD Family database. Public Spending on Education. https://www.oecd.org/els/soc/PF1_2_Public_expenditure_education.pdf. (first accessed on 5 January 2017).

allocated for education is high by international standards, the efficiency and quality of education, as well as the budgetary allocation for TVET, remain low. Trends in education expenditure in the Kyrgyz Republic are in Table 1.

Table 1: Trends in the Financing of Education in the Kyrgyz Republic, 2013–2017

Item	2013	2014	2015	2016	2017
Kyrgyz Republic GDP (Som million, current price) ^a	355.295	400.694	443.471	471.832	509.325
Real GDP annual growth rate	10.90%	4.00%	3.90%	3.00%	3.00%
Govt. annual expenditure (Som million)	104.269	121.304	138.576	151.623	154.714
Govt. expenditure as share of GDP	29.35%	30.27%	31.30%	32.10%	30.40%
Govt. expenditure on education (Som million)	24.090	25.999	24.927	22.661	28.841
Govt. education expenditure as share of GDP	6.78%	6.49%	5.60%	4.80%	5.70%
Govt. expenditure on education as share of total Govt. expenditure	23.10%	21.43%	18.00%	14.90%	18.60%
Govt. expenditure for TVET (Som million) ^b	1.379	1.430	1.470	1.559	1.621
Govt. expenditure for TVET as share of Govt. total expenditure	1.32%	1.18%	1.06%	1.03%	1.05%
Govt. expenditure for TVET as share of Govt. total expenditure for education	5.72%	5.50%	5.90%	6.90%	5.60%

GDP = gross domestic product, Govt. = Government of the Kyrgyz Republic, Som = Kyrgyz Republic Som, TVET = technical and vocational education and training.

^a Government estimates.

Sources: National Statistics Committee and Ministry of Finance of the Kyrgyz Republic.

6. **Financing of technical and vocational education and training.** The annual budget for TVET in the Kyrgyz Republic was Som1,470 million in 2015, and Som1,621 million in 2017, an increase of 10% over 3 years. Major public expenditures for TVET are in Table 2. In 2016 spending on primary TVET equaled Som1,161 million, with Som398 million in spending on secondary TVET. Education expenditure in 2017 is expected to total Som28,841 million, a 16% increase from 2015. Growth in TVET spending over the same period is projected at 10%, but secondary TVET is growing in importance. Trends in TVET expenditure for 2015–2017 are in Table 2.

Table 2: Technical and Vocational Education and Training Financing Trends in the Kyrgyz Republic, 2015–2017

Item	2013	2014	2015	2016	2017 ^a
Kyrgyz Republic GDP (Som million, current price)	355.295	400.694	443.471	471.832	509.325
Govt. annual expenditure (Som million)	104.269	121.304	138.576	151.623	154.714
Govt. expenditure on education (Som million)	24.090	25.999	24.927	22.661	28.841
Govt. education expenditure annual growth rate	5%	8%	(7%)	(9%)	27%
Govt. expenditure for TVET (Som million)	1.379	1.430	1.470	1.559	1.621
Govt. expenditure for primary TVET ^a (Som million)	880	971	1.064	1.161	1.161
Govt. expenditure for secondary TVET ^a (Som million)	441	428	412	398	460
Annual growth rate primary TVET expenditure	N/A	10.27%	1.50%	9.10%	0.00%
Annual growth rate secondary TVET expenditure	N/A	(2.95%)	6.00%	(3.40%)	15.60%
Annual growth rate TVET expenditure	N/A	3.70%	2.70%	6.10%	4.00%

() = negative, GDP = gross domestic product, Govt. = Government of the Kyrgyz Republic, Som = Kyrgyz Republic Som, TVET = technical and vocational education and training.

^a Government estimates.

Sources: National Statistics Committee and Ministry of Finance of the Kyrgyz Republic.

7. **Extra-budgetary income.** Secondary TVET institutions derive income from charging tuition fees and renting facilities of the institution. Their income from tuition fees can exceed funds allocated from the state budget by more than 300%. Primary TVET lyceums generate income by renting out lyceum facilities, as they can only charge tuition fees for short courses. Commercial income from productive activities is limited due to the lack of equipment, the absence of an entrepreneurial outlook, and uncertain treasury regulations.

C. Fiscal Impact and Financial Sustainability

8. **Fiscal impact.** Projections of annual total government expenditures, including those for education overall and for TVET, and the funding needed to finance program expenditures during implementation, are in Table 3. The total annual program cost (i.e., counterpart funding, and the ADB project and policy-based grants) as a proportion of annual government expenditures is small: 0.23% in 2018, increasing to 0.42% in 2021, and decreasing to 0.07% in 2022. The impact of the program cost on the government's total annual budget is not significant, and the financial analysis confirmed that the government has adequate financial resources and will be able to fulfill its financial obligations under the program.

Table 3: Fiscal Impact of the Skills for Inclusive Growth Sector Development Program

Item	2018	2019	2020	2021	2022
Government expenditure:					
Total expenditure (Som million)	164,465	172,499	180,602	188,636	196,740
Total expenditure on education (Som million)	29,391	31,314	33,236	35,228	37,150
Total expenditure on TVET (Som million)	1,696	1,772	1,840	1,916	1,985
Program cost ^a	404.0	383.0	639.4	837.3	178.1
Counterpart funding (Som million)	21.8	57.2	125.7	30.3	27.1
ADB investment grant (Som million)	100.7	325.8	513.7	215.8	151.1
ADB policy-based grant (Som million)	281.6	0.0	0.0	591.2	0.0
Total ADB grant (Som million)	382.3	325.8	513.7	807.0	151.1
Ratios:					
Proportion of ADB grant to total expenditure	0.23%	0.18%	0.28%	0.42%	0.07%
Proportion of ADB grant to total expenditure on education	1.30%	1.04%	1.54%	2.29%	0.40%
Proportion of ADB grant to total expenditure on TVET	22.54%	18.39%	27.92%	42.12%	7.61%

ADB = Asian Development Bank, Som = Kyrgyz Republic Som, TVET = technical and vocational education and training.

^a Annual disbursements of project and program grants were converted from their dollar values to Som using adjusted exchange rates for 2018–2022.

Sources: Estimates of National Statistics Committee and Ministry of Finance of the Kyrgyz Republic.

D. Financial sustainability analysis

9. **Financial sustainability.** Analysis indicates the government, as the end-borrower, can meet annual operation and maintenance (O&M) costs beyond the program implementation period. As a proportion of total government annual expenditures, annual O&M costs account for about 0.028% over 2018–2021. This is expected to increase to about 0.316% in 2022, when the government has to make additional investments for the replacement of equipment provided to TVET institutions. With respect to total annual expenditure on education, the proportion is very small at less than 1% (Table 4). The financial sustainability analysis indicates that the government easily has the capacity to cover annual O&M costs.

Table 4: Skills for Inclusive Growth Sector Development Program Financial Sustainability

Item	2018	2019	2020	2021	2022
Government expenditure:					
Total expenditure (Som million)	164,465	172,499	180,602	188,636	196,740
Total expenditure on education (Som million)	29,391	31,314	33,236	35,228	37,150
Total expenditure on TVET (Som million)	1,696	1,772	1,840	1,916	1,985
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ADB investment grant (Som million)	100.7	325.8	513.7	215.8	151.1
ADB policy-based grant (Som million)	281.6	0.0	0.0	591.2	0.0
Total ADB grant (Som million)	382.3	325.8	513.7	807.0	151.1
Ratios:					
Proportion of ADB grant to total expenditure	0.23%	0.19%	0.28%	0.43%	0.08%
Proportion of ADB grant to total education expenditure	1.30%	1.04%	1.55%	2.29%	0.41%
Proportion of ADB grant to total TVET expenditure	22.54%	18.39%	27.92%	42.12%	7.61%

ADB = Asian Development Bank, Som = Kyrgyz Republic Som, TVET = technical and vocational education and training.

^a Annual project and program grant disbursements were converted from dollar values to Som using adjusted exchange rates for 2018–2022.

Sources: Estimates of National Statistics Committee and Ministry of Finance of the Kyrgyz Republic.

E. Financial Management Assessment

10. **Country financial management system and capacity.** To assess financial management capacity and fiduciary risks at the country level, Kyrgyz Republic development partners have conducted several studies. A comprehensive analysis conducted by the World Bank-funded technical assistant program shows considerable improvement in the financial management system from 2009 to 2015.⁴ The assessment judged the country governance risk as relatively substantial. Specific assessment ratings for financial management include: (i) effectiveness of the control of non-salaries (C+), (ii) effectiveness of internal audits (C), (iii) quality and timeliness of annual financial reports (C+), (iv) effectiveness of internal audits (C+), (v) effectiveness of external audits (C), (vi) legislative scrutiny of the audit reports (C+), and (vii) the controls of payroll (D+).

11. According to the report, financial management areas where improvements are lagging, with a high or substantial risk indication, are: (i) control of payrolls, effectiveness of non-salary controls, effectiveness of internal audits, quality and timeliness of annual financial statements, effectiveness of external audit, and legislative scrutiny of audit reports; (ii) internal financial controls, which require substantial further strengthening; (iii) the lack of assurance for program administration units regarding the availability of cash for non-protected expenditures beyond the horizon of monthly allocations from the Ministry of Finance (“protected” expenditures include salaries, debt interest, transfers to the Social Fund and social benefits); (iv) the treatment of revenues and expenditures on a cash basis in financial reports (expenditures are covered only at the payment stage, with no information about commitments); and (v) the lack of adherence to International Public Sector Accounting Standards in preparing financial reports (a form determined by the Ministry of Finance is used, which is consistent from year to year).

12. The program-specific financial management assessment was conducted in accordance with ADB guidelines for MOES, the program executing agency.⁵ Program implementing unit staff

⁴ World Bank-managed Capacity Building for Public Finance Management Project. *Kyrgyz Republic Public Expenditure and Financial Accountability Assessment Report*. <https://pefa.org/sites/default/files/assessments/comments/KG-Mar15-PFMPR-Public.pdf>

⁵ ADB. 2005. *Financial Management and Analysis of Projects*. Manila; ADB. 2009. *Financial Due Diligence: A Methodology Note*. Manila.

will be recruited, but it has been agreed that MOES will use an organizational arrangement for implementation that is very similar to that in the ongoing ADB-funded Second Vocational Education and Skills Development Project.⁶ In this regard, the financial management assessment was conducted for MOES, including aspects of the project implementing unit of the Second Vocational Education and Skills Development Project, as a sample assessment. Capacity was assessed in the areas of funds flow arrangements, staffing, accounting and financial reporting systems, financial information systems, and internal and external auditing arrangements.

13. MOES has acquired significant experience over the last ten years with ADB procedures for managing funds flows and related operational procedures for procurement of goods and services. Two ADB project implementing units are currently hosted at MOES. Capacity was assessed in the areas of funds flow arrangements, staffing, accounting and financial reporting systems, financial information systems, and internal and external auditing arrangements.

14. The overall risk rating for MOES with respect to handling finances is assessed as moderate, with the following specific risk ratings: (i) TVET financial management (low), (ii) fund flow arrangements (moderate), (iii) staffing (moderate), (iv) accounting policies and procedures (low), (v) budgeting primary TVET and secondary TVET (moderate), (vi) internal audits (moderate), (vii) external audits (low), (viii) reporting and monitoring (moderate), and (ix) information systems (low).

15. MOES capacity will be reinforced by compliance with the accounting system and standards issued by the Ministry of Finance of the Kyrgyz Republic. The accounting policies and procedures will ensure that cost allocations are readily identified and will allow for proper recording of project financial transactions. This includes the allocation of expenditures to the respective cost components, disbursement categories, and funding sources. Controls are also in place concerning the preparation and approval of transactions.

⁶ ADB. Kyrgyz Republic. [Second Vocational Education and Skills Development Project](#).