



# **National Economic and Fiscal Commission**

## **2011 Budget Fiscal Report**

(copies of this report can be downloaded from the NEFC website)

[www.nefc.gov.pg](http://www.nefc.gov.pg)

## FOREWORD

The annual Fiscal Report is a requirement of the National Economic and Fiscal Commission under Section 69 of the *Intergovernmental Relations (Functions and Funding) Act 2009*.

The Fiscal Report 2011 provides detailed information on how the National Economic and Fiscal Commission (NEFC) calculates the distribution and level of funding for recurrent goods and services to provincial governments and local-level governments (LLG), and then makes recommendations of these amounts to be provided by Treasury in the 2011 Budget (provincial goods and services).

The Report provides the Ministerial Determinations in relation to:

- The Kina value of the annual 'equalisation amount' to be shared among provinces and LLG;
- the individual provincial share and individual local-level government shares of that amount;
- the functions and administration grants to each province for specific service delivery;
- NEFC's reporting on provincial expenditures 2008 and 2009, revenues and other information on intergovernmental financing; and
- Monitoring the Reform to Intergovernmental Financing Arrangements.

Furthermore the Fiscal Report 2011 describes how the costs of service delivery are estimated and how revenues are assessed. The Report demonstrates how funding for provincial governments and local level governments has been distributed on a needs basis.

This report also provides a brief summary of expenditure by Provincial Governments in 2009, summarising the longer report "Green Shoots of Change" (NEFC 2010).

For three years in a row (2009 – 2011), provinces have had an increasing share of net national revenue to fulfil the service delivery obligations outlined in the eleven Minimum Priority Activities (Treasury, Budget and Expenditure Instructions 2010) and the Function Assignment Determination (see NEFC Fiscal Report 2010). It is now incumbent on provincial governments and local-level Governments to direct these funds toward their intended purposes.

In order for the reforms to take place all the relevant central agencies and government entities responsible for institutional strengthening, capacity building and monitoring performance play their part in ensuring that provincial governments are adequately equipped to manage the additional funding now made available in the new system.

The message of transparency and good governance encapsulated in the Fiscal Report 2011 and the series of Provincial Expenditure Review publications needs to be taken on board by all provincial administrations as well as line agencies to ensure that things are done differently and for the better for the people of PNG.

Finally the Reforms to Intergovernmental Financing go a long way to meeting the Millennium Development Goals - particularly important if the Papua New Guinea government wants to achieve its Vision 2050 of being in the top 50 countries in the world.

A handwritten signature in black ink, appearing to read 'Nao Badu', with a horizontal line underneath.

Nao Badu  
Chairman & Chief Executive Officer

## EXECUTIVE SUMMARY

Under the new system approved by Parliament on 16 July 2008 and the Ordinary Act passed in 2009, the amount of funding to be shared amongst provincial and local-level governments (the equalisation amount) is based on a percentage of resources available to the government. This is known as Net National Revenue (NNR), which is the total tax revenue received by the government after excluding mining and petroleum revenue.

In the Ministerial Determination for 2011, the equalisation amount is K250.0 million, an increase of K42.7 million from Budget 2010. The Determination provides for a guaranteed amount for each provincial and local-level government, the equivalent of K98.4 million for provincial governments and K39.0 million for local-level governments.

Under the transition guarantee embedded in the Reforms, for the first five years of the new system, all provincial and local-level governments will not receive less than the combined total of goods and services grants and GST than they received in the 2008 budget. It also provides for the balance of the funds of K112.6 million to be distributed amongst the provincial and local-level governments on a needs basis.

Following the Ministerial Determination, the NEFC calculates and recommends to the Treasurer individual allocations for each provincial and local-level government (called the individual province share or individual local level share), along with recommended allocations for the different service delivery function grants. These are then provided to the provincial and local-level governments by Treasury for the purpose of preparing their 2011 budgets. Provinces are then given the opportunity to vary the distribution of these funds among the different function grants, but only within the total overall amount for that province. Once this process of negotiation is completed, the Treasurer issues the Function and Administration Grants Determination that locks in the level and distribution of funding for each province for 2011.

In determining the “need” of a province, all revenues received are counted, and then compared with their estimated costs of delivery services. The main sources of revenue in a province are national government grants, GST, licences, fees, taxes, commercial activities, mining and petroleum royalties and dividends. For the purpose of calculating grants, NEFC’s assessed revenue for 2011 is K316.4 million, an increase of K6.3 million from last year. NEFC’s estimates of the cost of delivering basic services in each province are based on the work done in the 2005 costs of services study. The costing has been kept current by applying the relevant inflation and population indices for each year using 2005 as the base year. The costs estimated are only those related to recurrent goods and services and exclude personnel emoluments and development expenditures. The study involved an in-depth review of how much the provinces should be spending to ensure service delivery takes place in the vital MTDS sectors in the rural areas. Work is currently underway to update the costs of service study. The new data should be available by mid 2010.

The estimated total cost of delivering a basic level of services in the provinces, districts and local governments is K754.4 million (in 2011 prices). This includes the costs of recurrent goods and services for transport infrastructure maintenance, education, health/HIV, agriculture, village courts and administration. The per diem increase as per the recent DPM instructions is also included. This is against a projected total revenue envelope for the provinces and local-level governments in 2011 of **K546.5** million.

After estimating the costs of services and assessed revenue, the fiscal needs of provinces and a local-level governments is calculated. This is defined as the difference between estimated recurrent cost and assessed revenue.

An extensive description of the new system of intergovernmental financing arrangements now operating in Papua New Guinea is available in the *Plain English Guide to the New System of Intergovernmental Financing* (NEFC May 2009).

In addition to work on cost of services NEFC, together with the Provincial and Local-Level Service Monitoring Authority (PLLSMA) have worked to provide a clearer assignment of service delivery functions and responsibilities of provincial and local-level governments. A PLLSMA sub-committee finalised a review on function assignment that gave a clear understanding on the distribution of responsibilities among the three tiers of government to avoid confusion on who is responsible for what, and to ensure that funding follows function. The results of the review were endorsed by PLLSMA approved by Cabinet in June 2009 and published in the Government Gazette.

Under the legislation, the new system requires that monitoring and reporting of the expenditure on the different types of grants, including service delivery function grants take place. The normal process for this to happen is through Department of Treasury's quarterly budget reviews. Further details and clarification on monitoring and reporting responsibilities has been covered in the budget and expenditure instructions issued by the Secretary for Treasury (Appendix C). Among many other considerations, the instructions also spell out the possible sanctions that can be imposed in the event that grants are not used as originally intended. The second set of budget and expenditure instructions to be released by the Secretary Treasury are intended to go beyond the requirement to just budget for 11 Minimum Priority Activities. Provinces will from 2010 onwards, have to report against specific indicators in order to demonstrate actual performance. A review by the Commission on compliance shows that provinces are gradually getting used to the idea of reporting on their expenditure and outputs, based on the minimum priority activities.

The NEFC undertakes an annual Provincial Expenditure Review and provides a comprehensive overview of expenditure of each province from all revenue sources. The 2009 Review "Green shoots of change" is reported in summary later in this Report and is available on [www.nefc.gov.pg](http://www.nefc.gov.pg). The review emphasises that provincial governments and administrations need to address the priority gap by choosing to reallocate their own resources to support the MTDS priority sectors. Furthermore, provinces can use the NEFC Cost of Services Study data as a guide to how much recurrent funding is required to deliver core services in their province. The Green shoots of change showed that:

- The fiscal capacity of the six lowest funded provinces went from an average of 30% in 2008 to 45% in 2009
- The increased function grants were targeted at the government's priorities – basic education, rural health, transport infrastructure maintenance, agriculture and village courts;
- Provinces, in general, put the increased function grants to good use; and
- There was evidence of spending on the Minimum Priority Activities, however continued efforts need to be made to revitalise critical activities such as rural health patrols and delivery of school materials.

In conclusion, the Government is now starting, through the new system of intergovernmental financing, to address the funding gap faced by most of the provinces. Provinces now also need to do their part to ensure the additional funds are spent wisely and that they better prioritise the funding already available to them in order to improve service delivery.

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## 1 EQUALISATION AMOUNT

The *Intergovernmental Relations (Functions and Funding) Act* 2009 (Section 4 Schedule 1) sets a minimum level of funding for the assigned service delivery functions and responsibilities of provincial and local-level governments. It is intended to provide greater certainty for provincial and local-level governments as grants are aligned to Net National Revenue (NNR).

This amount is referred to as the equalisation amount. The equalisation amount is then divided between individual provincial and local-level governments in the later steps of grant calculation.

The equalisation amount is set by a formula based on a percentage of the NNR. The NNR amount is the total tax revenue received by the National Government excluding mining and petroleum tax revenue. In general, the new system also uses actual data (as opposed to forecasts) to determine amounts as this is considered more accurate. As such when the NNR amount for 2011 was calculated, actual 2009 revenue data was used.

If NNR revenue is high in one particular year, provincial governments and local-level governments will receive more funding. If NNR in a particular year is low, they will receive less funding. In this way the ratio of funding between the National Government and the other two levels of government (provincial and local-level governments) will ensure some parity is maintained.

Further legislative provisions related to the calculation and process for determining the equalisation amount is described below. However, first, some further background is provided on how the percentage to be applied to NNR has been determined.

### How was the percentage to be applied to NNR determined?

During the transition period, the first five years, special transitional provisions apply. These are contained in schedule 1 of the *Act*.

In the transition period, the equalisation amount is increased over the five years by increasing the percentage applied to NNR each year. To determine the funding levels for each year of the transition period, the percentage was increased in five even steps from the 2008 funding level of provincial and local-level governments as a percentage of NNR of 4.76% to the final percentage to be applied to NNR in the full system of 6.57%.

The equalisation amount in each year of the transition period is calculated as follows:

Year	Rate
2009:	net national revenue amount X 5.12%
2010:	net national revenue amount X 5.48%
2011:	net national revenue amount X 5.84%
2012:	net national revenue amount X 6.21%
2013:	net national revenue amount X 6.57%

The result of this gradual increase in the percentage in five even steps is that the overall amount of funding available for provincial governments and local-level governments gradually increases as a proportion of the NNR.

### 1.1 Calculation of the Equalisation Amount 2011

The process for the calculation of the equalisation amount in the transition period is set out in Section 4 of Schedule 1 to the *Act*.

The Act requires NEFC to prepare a written estimate of the equalisation amount each fiscal year for the coming fiscal year and provide this estimate to the Treasury Departmental Head on or before 31 March. This estimate of the equalisation amount is a minimum amount only and can be increased by the Treasury Departmental Head and provide the higher estimate to NEFC on or before the 30th April of the same year.

The equalization amount is set as a percentage of the NNR amount as specified above. Hence the NNR is calculated using the actual data from the most recent and complete fiscal year (i.e. the second preceding fiscal year) as required by the Act. The NNR data is calculated using the data published by the Treasury Department in the Final Budget Outcome on or before the 31st March as specified in the Fiscal Responsibility Act.

Consistent with Section 4 of Schedule 1 of the Act, the NNR amount for 2011 was calculated using tax revenue data from 2009 (the second preceding fiscal year) in accordance with the following formula.

<b>General tax revenue for 2009</b>	<b>-</b>	<b>Mining and petroleum tax revenue for 2009</b>	<b>=</b>	<b>Net National Revenue</b>
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Where:-

“General tax revenue” is the total amount of tax revenue received by the National Government in the second preceding fiscal year; and

“Mining and petroleum tax revenue” is the total of the following amounts received by the National Government in the second preceding fiscal year:-

- (a) gas income tax within the meaning of the *Income Tax Act 1959*;
- (b) mining income tax within the meaning of that Act;
- (c) petroleum income tax within the meaning of that Act;
- (d) any other tax imposed in relation to any gas, mining or petroleum activity.

Actual outcomes for the National Government revenues are taken from Table 1 – Fiscal out-turn tables of the 2009 Final Budget Outcome published by the Department of Treasury in March 2010.

The following table shows how the NNR amount for 2011 is calculated.

Act definition	Final Budget Outcome equivalents	Kina million
1. 2009 General tax revenue	Tax revenue	<b>K4,974.5</b>
<b>MINUS (-)</b>		
2. 2009 Mining and petroleum tax revenue	1. Mining and petroleum taxes	K693.1
	2. Mining levy	K0.0
	<b>TOTAL</b>	<b>K693.1</b>
<b>EQUALS (=)</b>		
3. 2011 Net National Revenue Amount		<b>K4,281.5</b>

For 2011 Budget, the minimum funding level for the equalisation amount is calculated according to the formula below in Kina million:



Net national revenue for 2009      X      5.84%      =      NEFC estimate of 2011 equalisation amount

K4,281.4                              x      5.84%      =                              K250.037

In accordance with the Act, the NEFC provided a written estimate of the equalisation amount to the Secretary for Treasury on 31 March 2010.

If the Government wished to decrease the funding available to provincial and local-level governments, the Parliament would need to amend *the Act* and reduce the percentage applied to the NNR amount.

## 1.2 Projections for Equalisation Amount (2011-2013)

As noted above, the percentage that is applied to the NNR amount is gradually increased over the transition period. The result of this increase in the percentage used is that the overall amount of funding available for provincial governments and local-level governments increases each year over the first five years of the new system. This also reduces the annual budgetary impact of increased funding on both the National and provincial Governments.

The following table provides preliminary projections of the estimated equalisation amount for 2011 to 2013 using data published in the 2009 Budget Outcome and the 2010 Budget.

Table: Projections of Equalisation Amount 2011 – 2013 (K'million)

	2009 act	2010 act	2011 est	2012 est	2013 est
General tax revenue (from second preceding year)	5853.9	5,756.1	4,974.5	4,705.7	4,936.6
<b>MINUS (-)</b>					
Mining and Petroleum taxes (from second preceding year)	2333.9	1,961.8	693.10	434.4	357.9
Mining Levy	56.6	11.4		0	0
<b>EQUALS (=)</b>					
NNR Amount	3463.4	3,782.9	4,281.5	4,271.3	4,578.7
<b>MULTIPLIED BY (x)</b>					
Percentage to be applied to NNR Amount	5.12%	5.48%	5.84%	6.21%	6.57%
<b>EQUALS (=)</b>					
Equalisation Amount	177.3	207.3	250.0	265.2	300.8

## 2 MINISTERIAL DETERMINATION OF THE EQUALISATION AMOUNT

### 2.1 Legislative Provisions

In the transition period (2009-2013), the *Intergovernmental Relations (Functions and Funding) Act 2009*, states that the Minister for Treasury, in consultation with the NEFC will make a written determination specifying a provincial share, a local level share, total transitional individual province guarantees and total transitional individual local-level guarantees.

The provincial guarantees are provided to ensure no Provincial Government receives less funding than they did in **total** from grants and GST for each year of the transition period than they did in 2008.

The local level guarantees are provided to ensure that no local-level government receives less than its 2008 level of funding.

The provincial and local level share will be distributed to provincial governments and local level governments on an equalisation basis.

In the full system (2014 and beyond) there will be no more guarantees and the equalization amount will be split between the amounts for provincial governments and local-level governments purely on the basis of **need**.

The Ministerial Determination specifying the splits will remain in force at least for the whole transition period until revoked by the Minister. The NEFC will publish the Determination that is in force each year in the Annual Fiscal Report (Appendix B).

### 2.2 Apportioning Equalisation Amount Between Provincial & Local-level Governments

#### *Equalisation Amount*

In the third year of implementation of the equalisation system, the Ministerial Determination that was issued by the Treasurer splits the equalisation amount of **K250.037 million** as follows;

<i>i Total amount for funding transitional individual province guarantees</i>	K'm
Amount appropriated for block grant, function grant and derivation grant for 2008	84.8
"GST" Guarantee in 2011	13.6
<b>Total</b>	<b>98.4</b>
<i>ii. Total amount for funding transitional individual local level guarantees</i>	
Receive their 2008 level of funding	<b>39.0</b>
<i>iii. Province share</i>	
Remainder – to be distributed on an equalisation basis.	<b>107.3</b>
<i>iv. Local level share</i>	
Remainder – to be distributed on an equalisation basis	<b>5.3</b>
<b>Total</b>	<b>250.0</b>

## ***Transitional Guarantees***

### **(i) Total of the transitional individual province guarantees of all Provincial Governments**

Over the transition period, no Provincial Government will be worse off compared to 2008 funding levels. Each Provincial Government will receive a guaranteed amount equal to the sum of:

- 2008 block, function and derivation grant funding (K84.8 million for all provinces)
- if the GST distribution received by a Provincial Government in 2008 is greater than the GST distribution received in the transition period, the difference between the two GST distribution amounts will be given in the form of service delivery function grants.
  - Under the new system, Provincial Governments will receive 60% of net inland GST collections from the “second preceding year.”
  - For 2011 the amount ‘converted’ from GST transfers to service delivery grants is K13.6 million for all provinces.
- In 2011 total funding for transitional individual province guarantees for all provincial governments is K98.4 million.

### **(ii) Content of Determination part (i)**

The total amount for funding transitional individual province guarantees is:

- K84.9 million: being the amount appropriated to all Provincial Governments in 2008 for block grants, function grants and derivation grants

#### **PLUS**

- For the relevant year of the transition period, the total of the following amounts for all Provincial Governments:
  - if the GST distribution received by a Provincial Government in 2008 is greater than the GST distribution received in the relevant year (2011) of the transition period.
  - The difference between the two GST distribution amounts will be allocated to Provinces as top ups to their service delivery Function Grants.

### **(iii) Total of the transitional individual local-level guarantees of all Local-level Governments**

During the transitional period, no Local-level Government will be worse off compared to 2008 funding levels.

- Each Local-level Government will receive a guaranteed amount equal to the 2008 amount for goods and services grant funding

### **(iv) Content of Ministerial Determination Part (ii)**

In 2011 the proportion of the equalisation amount available for the total of the transitional individual local level guarantees is K39 million.

**(v) Local Level Share**

In comparison to Provincial Governments, Local-level Governments fare better in that they will receive 18% of the equalisation amount despite them only accounting for 16% of the total provincial and local level government costs of service delivery. That is local-level governments receive a higher proportion of funding relative to their costs than provincial governments.

However, it would not be realistic to freeze local-level government funding at 2008 levels as recurrent costs of increased district expenditure is expected to rise with the injection of the K10 m provided under the District Service Improvement Program.

Some individual local-level governments also do not currently receive enough funding, and we therefore need to provide some of the remaining equalisation amount to those Local-level Governments that need it.

Overall, local-level governments when compared to 2008 levels will receive additional funding of K5.3 million in 2011, or a 13.5% increase.

**(iv) Provincial Share**

In the Ministerial Determination, the Province Share will be defined as all the remaining funding from the equalisation amount as shown below.

	<b><i>K'million</i></b>	<b><i>% of EA</i></b>
<b><i>Equalisation Amount (EA)</i></b>	<b><i>250.0</i></b>	<b><i>100%</i></b>
<i>(i) Total amount for funding transitional individual province guarantees</i>	<b><i>98.4</i></b>	<b><i>39.4%</i></b>
<i>(ii) Total amount for funding transitional local level guarantees</i>	<b><i>39.0</i></b>	<b><i>15.6%</i></b>
<i>(iii) Local level share – 2.11% of EA</i>	<b><i>5.3</i></b>	<b><i>2.1%</i></b>
<b><i>(iv) Province share – remaining funding from EA after paying (i), (ii) and (iii)</i></b>	<b><i>107.3</i></b>	<b><i>42.9%</i></b>

All these components are funded from the equalisation amount (EA). To ensure there is sufficient funding available to meet all these components, the guarantees must be accounted for first. The remaining component is distributed on the basis of need.

The amount distributed on the basis of needs will increase during the first five years of the new system to minimize large fiscal impacts on provinces and the National Government.

**Written Determination issued by Minister**

A copy of the Equalisation Amount Determination is contained in Appendix A.

### 3 ESTIMATING FISCAL NEED

Since provincial and local-level government grants are now being calculated on a needs basis, it is important to establish each provincial and local-level government's revenues and costs. After determining these factors, NEFC can:

- 1) determine the 'fiscal need' and
- 2) calculate the amount of grants for Provincial and Local-level Governments.

How the NEFC determines the costs and assesses the revenues in order to calculate the fiscal need and the grants for the individual provincial and local level government is outlined below.

#### 3.1 Summary of Legislative Provisions

These two legislations provide the basis for the NEFC to determine how each provincial and local level government receive as grants;

##### 1. The *Organic Law on Provincial and Local-level Governments*

Part 4, Division 2, of the Organic Law explains the division and distribution of revenue among and between the levels of government and other financial arrangements.

These provisions are further explained in greater detail in the *Intergovernmental Relations (Functions and Funding) Act 2009*.

##### 2. *Intergovernmental Relations (Functions and Funding) Act 2009*

Part 2 of the Act explains the principles and the circumstances under which service delivery functions and responsibilities assignment will be determined.

Part 3 explains the equalisation system of the new intergovernmental financing arrangements, which also clearly highlights the fiscal need basis upon which provincial and local-level Government grants will be calculated.

#### 3.2 Function Assignment Determination

The reforms to the intergovernmental financial arrangements envisage a fairer system of distribution of resources. In order to achieve this vision of a fairer system, it was necessary to establish the roles and responsibilities of local level governments and provinces. This in turn would allow for more accurately estimating the costs of the services they are supposed to provide.

During the transition period of the new intergovernmental financing system, the estimated costs of assigned service delivery functions and responsibilities will be the *"estimate by the NEFC of the cost for the fiscal year to the Provincial Government of performing its service delivery functions and responsibilities. This includes the incidental costs of administration of the Provincial Government (whether or not the service delivery functions and responsibilities are assigned under Part 2 of the Act)"*

As a result, the NEFC is allowed to make an estimate of the *costs of assigned service delivery functions and responsibilities* in the absence of a Determination that clarifies the *assigned service delivery functions and responsibilities to the different levels of government*.

Over recent years, an exhaustive review was done of legislation, sector strategies, corporate plans, policies, and other relevant publications together with broad consultation with all levels of government to determine what each level of government is responsible for. This function assignment project was undertaken to ensure improved service delivery. This was further pursued in 2009 given the introduction on the Inter-governmental Relations (Functions and Funding) Act. The ultimate aim of the exercise is to remove the already existing confusing and to provide certainty about the roles and responsibilities which contributes towards effective planning, budgeting, delivering and monitoring the activities they are accountable for delivering.

The Function Assignment Determination was passed by NEC and formally gazetted in June 2009. The NEFC examined the draft Determination prior to this to consider its potential impact on grant calculation for the 2010 and following year's Budget. No major differences between the work originally done by the NEFC under the Responsibility Specification Exercise were found and thus no changes were required to be made.

### **3.3 NEFC Cost of Services Study**

The purpose of the Cost of Services Study is to assess what provinces and local-level governments need to spend in order to deliver a minimum basic set of services, taking into account the geography and available infrastructure.

The first NEFC Cost of Services Study was undertaken in 2005. An update to this study was undertaken starting 2009 and would be completed by end 2010.

The study only covers recurrent non-salary provincial and local level government costs only. It does not include salaries, leave fares of public servants and teachers, nor any capital or development related costs.

The primary focus of the study is therefore on service delivery to the rural majority of PNG's population.

It is assumed that;

- the costing should relate to existing service delivery programs. It only applies to existing and operational facilities and infrastructure, and to current staffing numbers.
- the Costing study is based on a similar standard set of services. This was done even though some provinces undertake some services and not others.

#### **The Methodology**

A primary objective of the Cost of Services update is to accurately record any changes to the travel modes, routes and distances for each district, so that changes to these costs can be accurately calculated.

Travel routes between all service delivery points are marked on maps. The information on these maps will then be transferred to an electronic database by the University of Papua New Guinea Remote Sensing Unit for purposes of plotting and calculating actual (Euclidean) distances. Information on travel modes through walking, road, and sea transport are used calculate actual travel costs.

Other cost factors are taken into consideration in order to calculate actual travel costs, such as using actual fuel prices of each district, or PMV and boat fares.

The Cost of Services study develops cost estimates based on inputs, rather than outputs. Input-based standards are used to define activity levels for costing. The Function Assignment Determination was the basis for determining the functions of the two tiers of government within the various service delivery sectors and in so doing, guiding the study in focusing on annual activities in the study year against related costs.

In order to achieve required levels of service delivery, the study requires activities involved and the capacities of the activities, to be determined by highlighting main inputs as outlined in the following broad categories.

- Fuel, & other supplies and routine equipment servicing (provincial price survey of a basket of goods)
- Travel costs, and training costs (based on province and district-specific travel routes and local costs of accommodation and venue hire)
- Board fees, and politicians' salaries and allowances (based on determinations under the Boards Fees and Allowances Act, and the Salaries and Remuneration Commission of National Parliament, respectively), and
- Road maintenance costs and maintenance costs of buildings (based on Department of Works data)

### 3.4 Estimated Costs for 2011

#### What are we costing?

The table below shows the estimated costs for all administration and service delivery sectors at the provincial and district levels in 2009 (two years prior). These exclude staffing costs and capital or projects costs.

#### Provincial and district costs

**Table 1: Province and districts costs (excluding staffing costs) – 2009 in K'000**

Province	Health and HIV	Education	Infrastructure	Village Courts	Agriculture	Other Service Delivery Costs (b)	Administration costs (a)	Total
Central	4,302	5,704	10,640	129	2,123	3,065	2,576	28,539
East New Britain	4,315	6,007	8,149	71	2,082	3,480	3,290	27,394
East Sepik	9,591	6,169	16,524	144	2,775	3,619	4,209	43,032
Eastern Highlands	5,802	7,284	15,409	83	2,050	3,322	2,750	36,700
Enga	4,839	4,768	11,076	117	2,178	2,839	2,857	28,675
Gulf	3,350	2,793	4,332	41	1,489	1,924	1,894	15,823
Madang	6,859	4,541	9,983	52	2,750	3,788	3,161	31,134
Manus	1,863	2,239	3,816	68	846	1,814	2,326	12,972
Milne Bay	7,646	5,751	6,025	79	2,092	3,315	3,033	27,943
Morobe	8,741	10,064	14,482	91	4,039	5,042	4,469	46,928
New Ireland	4,018	3,414	4,295	42	1,214	2,717	2,623	18,323
Oro	3,427	2,728	3,247	47	1,407	2,166	2,248	15,270
Sandaun	6,712	5,373	5,586	74	2,851	2,273	3,100	25,969
Simbu	3,915	5,492	7,215	91	1,300	2,252	2,727	22,993
Southern Highlands	8,978	7,716	10,990	206	3,518	3,811	3,977	39,195
West New Britain	5,319	5,391	3,378	202	1,862	3,215	2,621	21,988
Western	7,737	6,271	12,823	139	2,702	3,240	3,497	36,409
Western Highlands	4,848	8,029	14,945	273	2,135	3,059	2,846	36,134
<b>TOTAL</b>	<b>102,258</b>	<b>99,734</b>	<b>162,915</b>	<b>1,951</b>	<b>39,413</b>	<b>54,942</b>	<b>54,204</b>	<b>515,419</b>

- (a) Assembly, Office of the Administrator, Internal Audit, Local-level Government administration, HRD Policy, Planning and Research, Finance and Administration and Legal Services
- (b) Commerce, Communication, Community Development, Correctional Services, Environment, Fisheries, HIV, Land Administration, Natural Resource Management, and Police

The three big sectors, Infrastructure, Health/HIV and Education, account for over 80 percent of the total service delivery costs at the provincial and district levels.

Individually, **Infrastructure** is the most expensive sector, making up nearly a third of total estimated service delivery costs. **Health/HIV** accounts for about 17% of total service delivery costs whilst **Education** costs is about 19% of the total service delivery costs.

The cost of **infrastructure** is dominated by the cost of maintaining roads, bridges and jetties. The length of the road network in the country determines the overall cost in this sector. **Health** and **education** are expensive because they are delivered through a large network of facilities. Schools and health facilities are the main sectors which place public servants in rural areas, outside district administration headquarters, delivering services to communities. No other sector has anywhere near the same presence.

The other major sector, **agriculture**, which makes up about 5% of total costs, mainly involves extension officers travelling into rural areas to provide extension services. As such, much of the cost in this sector is associated with public servant travel. While agriculture also involves contact with a large number of people, there are relatively fewer agricultural extension officers than there are teachers or health workers.

National responsibilities such as police, CIS and NBC were included in the 2005 cost of service study because in 1999 the National government imposed a requirement that provinces meet some of the costs associated with running these functions.

The 2009 Function Assignment Determination excludes these three national functions and are therefore not included in the updates of the Cost of Services study (see Fiscal Report 2010)

'Assembly' covers the administrative costs associated with the political structures of provincial and local-level governments. The administrative aspect of assembly services accounts for two-thirds of the administrative overhead costs of provincial and local-level governments. However, there is considerable variation among provinces.

The main reason for this is the cost of paying allowances to politicians, in particular Local-level Government politicians. The cost of politicians travelling to meetings also has a major impact on administration overheads, especially where politicians need to travel long distances to attend Assembly or Local-level Government meetings.

The main reason why assembly costs are so much higher in some provinces than in others is that they have more politicians.

The per diem increase due to the recent DPM circular is included under each sector cost.

### **Local-level Governments Costs**

Given the time and resources available at the time of undertaking the costing study, the NEFC only attempted to cost rural Local-level Governments. Table 2 shows the relevant costs associated with Local-level Governments under each sector. Note that in most sectors, there were no responsibilities which Local-level Governments were responsible to fund. The main sectors which Local-level Governments have responsibilities include Health/HIV, Education and Village Courts (refer to Function Assignment Determination booklet at [www.nefc.gov.pg](http://www.nefc.gov.pg))

The costing study found that there is far less similarity among provinces in terms of urban services than there is among rural services in different provinces. The nature of the services that need to be provided depends on the size of the urban population.



The nature of the services provided by different urban Local-level Governments around PNG varies considerably. For example, some of them are required to provide water and/or sewerage services, whereas in other towns one or both of these services are provided on a user-pays basis by the PNG Waterboard. In smaller towns, residents provide these services themselves, by collecting rainwater in tanks and using pit latrines or septic tanks. Some towns have extensive paved roads, while others have mainly dirt roads.

**Table 2: Local level government costs (excluding staffing costs) – 2009 in K'000**

Province	Health and HIV	Education	Infrastructure	Village Courts	Agriculture	Other Service Delivery Costs (b)	Administration costs (a)	Total
Central	30	247	0	23	0	0	589	889
East New Britain	37	242	0	8	0	0	961	1,248
East Sepik	42	268	0	25	0	0	1,372	1,707
Eastern Highlands	27	264	0	35	0	0	366	692
Enga	46	179	0	28	0	0	641	893
Gulf	31	63	0	8	0	0	499	600
Madang	56	150	0	17	0	0	1,251	1,475
Manus	23	66	0	10	0	0	185	283
Milne Bay	54	222	0	7	0	0	910	1,194
Morobe	79	373	0	21	0	0	1,497	1,969
New Ireland	14	130	0	9	0	0	306	460
Oro	25	83	0	4	0	0	593	705
Sandaun	57	139	0	6	0	0	1,695	1,897
Simbu	20	235	0	32	0	0	372	659
Southern Highlands	95	276	0	50	0	0	1,271	1,692
West New Britain	33	221	0	11	0	0	437	702
Western	41	142	0	12	0	0	1,196	1,392
Western Highlands	54	324	0	30	0	0	523	930
<b>TOTAL</b>	<b>764</b>	<b>3,625</b>	<b>0</b>	<b>337</b>	<b>0</b>	<b>0</b>	<b>14,662</b>	<b>19,387</b>

As Table 2 shows, apart from the administrative costs which are dominated by Assembly related costs, the only service delivery sectors which have Local-level Government funding responsibilities are Health, Education and Village Courts. Increase in the per diem cost is included under administration cost.

### **What year should costs be calculated with reference to – the distribution year or the 2<sup>nd</sup> preceding year?**

The Cost of Services Study was conducted in 2005. Therefore, 2005 will be the base year for any updating of the costing data until the 2010 update can be integrated into the costs for the 2012 budget.

Revenues, which form the other component of the fiscal needs calculation, will be based on the second preceding year's data, since those are the latest actual figures available. Hence, for 2011, the latest available actual revenue data is from 2009, which is the second preceding year from 2011.

Similarly, for costs, NEFC applies the second preceding year's cost data to calculate fiscal needs of Provincial and Local-level Governments. For that reason, applying 2008 costs and revenues in the fiscal needs calculations is more relevant and related to the same period of time.

Given the recent government cumulative allocation of K14 million DSIP funding to each district and other grants from the development budget (including DRIP, DSG), it is important to update this costing data to reflect any increase in the number of facilities and staffing levels.

## What indexation factors should be used to grow the costs?

The Cost of Services Study was undertaken in 2005. It incorporated province specific costs of inputs for that year. In between physical updates, an index is applied to these costing figures to accommodate inevitable increases in costs.

Therefore, for the 2011 budget grant calculation, NEFC took into account province-specific population growth rates as well as inflation since 2005. NEFC then used these indexed estimated costs for each province to derive the 'fiscal needs' of each provincial and local-level government.

## 3.5 Assessed Revenues

Calculation of grants for provincial and local-level governments is based on the need of each province. This need is quantified by calculating the difference between provincial revenues and their costs of assigned service delivery functions and responsibilities. In order to assess need, revenues for provincial governments will therefore have to be calculated.

Assessed revenues are the total amounts likely to be received by the provincial government for that fiscal year to be used to carry out their assigned service delivery functions.

Generally, revenues for a fiscal year are assessed with reference to the second preceding year to that fiscal year as this will be the last available year of actual complete data. That is, for the 2011 distribution year, 2009 revenues were assessed by the NEFC.

Revenue data is compiled from multiple sources.

These include:

### ***National Goods and Services grants***

The National Government provides Provincial Governments with a range of goods and services grants each year to support a variety of core service delivery activities.

This information is sourced from data on actual grants paid, as reported in National Budget Papers.

### ***Goods and Services Tax (GST)***

Provincial Governments receive a Goods and Services Tax (GST) distribution paid through the Internal Revenue Commission (IRC).

GST is collected and administered by the IRC. The IRC distributes a portion of the GST revenue to Provincial Governments and the NCD as set out in the *GST Revenue Distribution Act 2003* (the distribution Act). This Act was repealed in 2008 and the provisions relocated to the new *Intergovernmental Relations (Functions and Funding) Act*. Any remaining GST that is not distributed to Provincial Governments or the NCD under these sharing arrangements is paid into consolidated revenue (to the National Government).<sup>1</sup>

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<sup>3</sup> It is important to note that these distribution arrangements to Provincial Governments are not shown in the national budget. The amounts of GST shown in the national budget are the amounts retained by the National Government, after Provincial Governments and the NCD have received their distribution.

The amount of GST distributed under the Act is based on 60% of net inland GST collections for each province from the second preceding year.

Generally, revenues for a fiscal year are to be assessed with reference to the second preceding year to that fiscal year as this will be the last available year of data. So GST distribution will be based on 60% of net inland GST collected from the second preceding year (i.e. 2009).

### ***Bookmakers Tax***

Bookmakers Tax received by Provincial Governments will be 100% of the revenues collected in the province in the second preceding year.

In 2010, Bookmakers tax was not distributed by IRC due to technical delays in the certification of the legislation. NEFC is still pursuing this matter and it is anticipated that this revenue will be fully paid to provinces as part of the 2011 Budget.

Table 3 below gives the estimate of revenues available to provincial governments for service delivery as collected in the second preceding year 2011;

### ***Own-source revenue***

These are local taxes, charges, and receipts collected by the provincial administration, which are the only revenue base that provinces have some local control and influence over. These comprise;

- sales and service tax
- licences for liquor outlets
- Licences for gambling establishments
- motor vehicle registration and license fees
- proceeds from business activities, rents, sale of assets
- provincial road users tax
- court fees & fines; and
- other fees & charges

The NEFC estimates that in 2009 (the second preceding year), provinces raised K64.3 million<sup>2</sup> from this revenue source.

This data is obtained from the PNG Government Accounting System (PGAS) “internal revenue” electronic summary files held by the Department of Finance (DoF).

The NEFC is aware that not all revenue received by provincial governments is recorded accurately in PGAS. Where this occurs, the NEFC may count these “hidden” revenues in the overall consideration of total revenues.

### ***Mining and Petroleum Royalties***

Provincial Governments with mining and petroleum activities within their provincial boundaries may be entitled to royalties as a result of Memoranda of Agreement (MOA) between the Provincial Government, customary land owners, the mining company and other stakeholders. In the case of petroleum projects negotiated after 1988, Provincial Governments shares are provided under the provisions of the relevant mining and petroleum legislation.

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<sup>2</sup> This excludes Bookmakers Tax

For every new project since the late 1980s, the National Government has not exercised claims over mining and petroleum royalties in the MOAs. Instead, the royalties have been split among landowners, Local and Provincial Governments, in various ways depending on the project. In turn, Provincial Governments have also sometimes made various long-term commitments regarding their share of royalties (for specific projects, to local governments and/or non-government agents).

In 2009 (the second preceding year), NEFC estimates that provinces received K122 million from royalty and dividend payments.

This data has been sourced direct from mining and petroleum companies and from Government agencies (Mineral Resources Authority (MRA) for mining projects, and Department of Petroleum and Energy (DPE) for petroleum projects) and also direct from the companies themselves.

**Table 3: Actual revenues collected by province in 2009 (K '000)**

Province	GST Distribution	Bookmakers Tax	Own Source Revenues	Royalties	Dividends	Total
West. Province	2,648.1		9,297.5	33,600.0	23,200.0	68,745.6
Gulf	51.1		5.9			57.0
Central	962.8		10,509.6	311.8		11,784.2
Milne Bay	3,342.2		2,203.1			5,545.3
Oro	1,441.5		217.2			1,658.6
South. Highlands	922.6		633.2	24,530.6		26,086.4
Enga	879.3		1,709.4	15,174.6	2,000.0	19,763.4
West. Highlands	11,991.1	433.8	2,671.8			15,096.6
Simbu	1,563.7		696.2			2,259.9
East. Highlands	10,822.3	274.0	1,511.7			12,608.0
Morobe	46,763.4	828.6	8,044.8	454.0		56,090.8
Madang	5,971.2	728.8	2,043.2			8,743.1
East Sepik	3,139.5	-	2,060.2			5,199.7
Sandaun	657.4		1,697.6			2,355.0
Manus	205.6		443.2			648.8
New Ireland	2,542.0	86.4	1,746.8	22,982.2		27,357.4
East New Britain	10,922.8	318.0	5,590.2			16,831.0
West New Britain	3,964.3	139.6	13,199.4			17,303.2
<b>TOTAL</b>	<b>108,790.8</b>	<b>2,809.2</b>	<b>64,281.0</b>	<b>97,053.2</b>	<b>25,200.0</b>	<b>298,134.2</b>

## 2011 Assessed revenues

For the purpose of calculating the different funding levels of the different function grants the following assessments have been made. All revenues are assessed based on the actual revenues collected for the second preceding year for each province.

### i) Royalties and Dividends from Mining and Petroleum Project

- 80% of royalties and 50% of dividends from mining and petroleum projects. This gives the recognition that some revenues are spent on development of mining infrastructure.

### ii) Own Source Revenues

- NEFC takes into account only 50% of own source revenues collected in order to encourage provinces to continue to collect and enhance their own revenue base.

### iii) GST

- 100% of GST distributed under the *Intergovernmental Relations (Functions and Funding) Act 2008* (which is 60% of net inland collections).

### iv) Bookmakers Turnover Tax

- 100% of *Bookmakers Tax* distributed under the *Intergovernmental Relations (Functions and Funding) Act 2009*.

**Table 4: Assessed Revenues by province for 2011 (Kina '000)**

Provinces	2010 Individual Transitional Province Guarantees	GST Distribution	Bookmaker s Tax	Own Source Revenues	Royalties	Dividends	Total
Assess Percentage	100%	100%	100%	50%	80%	50%	
West. Province	4,459	2,648	-	4,649	26,880	11,600	50,236
Gulf	3,910	51	-	3	-	-	3,964
Central	3,963	963	-	9,150	249	-	14,326
Milne Bay	3,914	3,342	-	1,102	-	-	8,357
Oro	2,983	1,441	-	109	-	-	4,533
South. Highlands	7,693	923	-	317	19,624	-	28,556
Enga	6,504	879	-	855	12,140	1,000	21,377
West. Highlands	7,204	11,991	434	1,336	-	-	20,965
Simbu	4,280	1,564	-	348	-	-	6,192
East. Highlands	6,920	10,822	274	756	-	-	18,772
Morobe	7,717	46,763	829	4,022	363	-	59,695
Madang	10,523	5,971	729	1,022	-	-	18,245
East Sepik	6,029	3,140	-	1,030	-	-	10,199
Sandaun	4,077	657	-	849	-	-	5,584
Manus	2,384	206	-	222	-	-	2,812
New Ireland	3,609	2,542	86	873	18,386	-	25,496
East New Britain	4,667	10,923	318	2,795	-	-	18,703
West New Britain	7,615	3,964	140	6,600	-	-	18,318
<b>Total</b>	<b>98,451</b>	<b>108,791</b>	<b>2,809</b>	<b>36,036</b>	<b>77,643</b>	<b>12,600</b>	<b>336,330</b>

## 3.6 Fiscal Needs of Provincial and Local-Level Governments

The fiscal needs of a Provincial and Local-level Government is the difference between the cost of providing the assigned service delivery functions and responsibilities and the revenue available to the Provincial and Local-level Governments to pay for these services.

Where a Provincial and Local-level Government has assessed revenues that are greater than its costs, its fiscal need is zero. That is, it has fiscal capacity to fulfil service delivery functions without additional revenue from the national government.

The amount that a Provincial and Local-level Government needs is called the fiscal needs amount. This amount is calculated on the basis of the recurrent cost of providing the assigned service delivery functions and responsibilities, as well as the revenue already available to the Provincial and Local-level Governments to pay for these services.

## ***Fiscal Needs Amounts for Provincial governments***

The fiscal needs amount for a Provincial Government is calculated using the formula:

$$\begin{array}{ccccc} \text{Estimated recurrent cost of} & & \text{Assessed} & & \text{Fiscal Needs} \\ \text{assigned service delivery} & - & \text{revenue} & = & \text{amounts} \\ \text{functions \& responsibilities} & & & & \end{array}$$

where:-

“*estimated recurrent cost of assigned service delivery functions and responsibilities*” are the estimated recurrent cost for the Provincial Government of performing its assigned service delivery functions and responsibilities for the fiscal year, including the necessary and incidental costs of administration of the Provincial Government;

“*assessed revenue*” is the amount of revenue that the NEFC considers to be available to the Provincial Government for meeting the recurrent cost of its assigned service delivery functions and responsibilities for the fiscal year.

## ***Fiscal Needs Amounts for Local-Level Governments***

The fiscal needs amount of each Local-level Government for each fiscal year is calculated using the formula -

$$\begin{array}{ccccc} \text{Estimated recurrent cost of} & & \text{Assessed} & & \text{Fiscal Needs} \\ \text{assigned service delivery} & - & \text{revenue} & = & \text{amounts} \\ \text{functions \& responsibilities} & & & & \end{array}$$

where:-

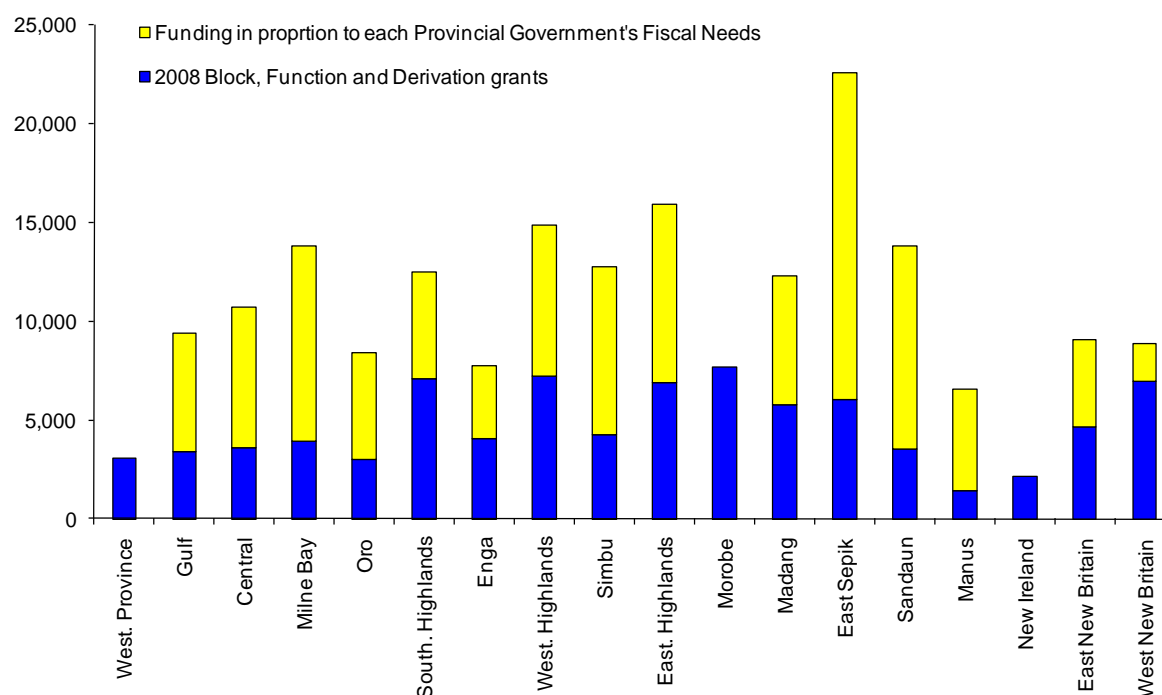
“*estimated recurrent cost of assigned service delivery functions and responsibilities*” are the recurrent cost to the Local-level Government of performing its assigned service delivery functions and responsibilities for the fiscal year, including the necessary and incidental costs of administration of the Local-level Government;

“*assessed revenue*” is the amount of revenue that the NEFC considers to be available to the Local-level Government for meeting the recurrent cost of its assigned service delivery functions and responsibilities for the fiscal year.

Table 5: Fiscal Needs of provinces for 2011 (Kina '000)

	Estimated costs	Assessed revenues	Fiscal needs	% of total fiscal needs
West. Province	36,408.9	50,236.1	0.0	0.0%
Gulf	15,822.7	3,964.1	11,858.5	5.5%
Central	28,538.7	14,325.7	14,213.0	6.7%
Milne Bay	27,942.7	8,357.5	19,585.3	9.2%
Oro	15,270.3	4,533.3	10,737.0	5.0%
South. Highlands	39,194.5	28,556.5	10,638.1	5.0%
Enga	28,674.9	20,522.6	8,152.3	3.8%
West. Highlands	36,133.7	20,964.6	15,169.2	7.1%
Simbu	22,992.9	6,192.0	16,800.9	7.9%
East. Highlands	36,700.2	18,772.0	17,928.2	8.4%
Morobe	46,928.2	59,694.8	0.0	0.0%
Madang	31,134.3	18,244.9	12,889.4	6.0%
East Sepik	43,031.5	10,198.9	32,832.6	15.4%
Sandaun	25,968.6	5,583.6	20,385.1	9.5%
Manus	12,972.2	2,811.5	10,160.7	4.8%
New Ireland	18,323.0	25,496.1	0.0	0.0%
East New Britain	27,394.0	18,702.7	8,691.2	4.1%
West New Britain	21,987.5	18,318.0	3,669.5	1.7%
	515,418.8	335,474.8	213,710.9	1.0

Kina thousands



Graph: The above chart graphs the provincial guarantees in blue with funding in proportion to each government's fiscal needs shown in yellow. Note that for 2011 there are three provinces with fiscal capacity in excess of fiscal need. Thus there is no additional funding for those three provinces.

## 4 INDIVIDUAL PROVINCE SHARE

Provincial Governments are all different; therefore they will each need a different amount to deliver their assigned service delivery functions and responsibilities.

The individual province share is the amount an individual Provincial Government receives from the equalisation system. This amount is divided into service delivery function grants and an administration grant.

During the transition period (2009 – 2013), the individual province share is calculated using the formula:

$$\text{transitional individual province guarantee} + \left( \text{equalisation amount for provinces} \times \frac{\text{fiscal needs amount of individual province}}{\text{total fiscal needs amount of provinces}} \right) = \text{individual province share}$$

where -

“transitional individual province guarantee” means the transitional individual province guarantee of that Provincial Government for the relevant fiscal year;

“equalisation amount for provinces” means the amount equal to the province share specified in the determination made under paragraph 2(1)(c) that is in force on 30 April of the immediately preceding fiscal year;

“fiscal needs amount of individual province” means the fiscal needs amount of that Provincial Government for the relevant fiscal year;

“total fiscal needs amount of provinces” means the total of the fiscal needs amounts of the Provincial Governments that have fiscal needs amounts greater than zero for the relevant fiscal year.



Table 6: 2011 Individual Province Share (K'000)

Province	Transitional Individual Province Guarantee (a)	Estimated Fiscal Needs (estimated costs minus assessed revenues)	Percentage of total fiscal needs	Funding based on percentage of total fiscal needs (b)	Individual Province Share (a) + (b)
West. Province	4,459.2	0.0	0%	-	4,459.2
Gulf	3,910.1	11,858.5	6%	5,979.3	9,889.4
Central	3,963.0	14,213.0	7%	7,166.4	11,129.4
Milne Bay	3,913.7	19,585.3	9%	9,875.3	13,789.0
Oro	2,983.2	10,737.0	5%	5,413.8	8,397.0
South. Highlands	7,692.8	10,638.1	5%	5,363.9	13,056.7
Enga	6,503.6	7,297.6	3%	3,679.6	10,183.2
West. Highlands	7,203.8	15,169.2	7%	7,648.6	14,852.4
Simbu	4,280.2	16,800.9	8%	8,471.3	12,751.5
East. Highlands	6,919.8	17,928.2	8%	9,039.7	15,959.5
Morobe	7,717.2	0.0	0%	-	7,717.2
Madang	10,523.3	12,889.4	6%	6,499.1	17,022.4
East Sepik	6,029.3	32,832.6	15%	16,554.8	22,584.1
Sandaun	4,077.4	20,385.1	10%	10,278.5	14,355.9
Manus	2,384.3	10,160.7	5%	5,123.2	7,507.5
New Ireland	3,608.6	0.0	0%	-	3,608.6
East New Britain	4,666.9	8,691.2	4%	4,382.3	9,049.2
West New Britain	7,614.5	3,669.5	2%	1,850.2	9,464.8
<b>TOTAL</b>	<b>98,450.9</b>	<b>212,856.2</b>	<b>100%</b>	<b>107,326.0</b>	<b>205,776.9</b>

## INDIVIDUAL LOCAL-LEVEL SHARE

The individual rural Local-level share is the amount an individual rural Local-level Government receives from the equalisation system.

The Local-level Government share is divided into two amounts: one for urban Local-level Governments, and an amount for rural Local-level Governments. These are called individual local-level shares.

The amounts for individual urban or rural Local-level Government for the relevant fiscal year are calculated using the formula below:

$$\text{transitional individual local-level guarantee} + \left( \text{equalisation amount for urban Local-level Governments} \times \frac{\text{fiscal needs amount of individual urban Local-level Government}}{\text{total fiscal needs amount of urban Local-level Governments}} \right) = \text{individual local-level share}$$

where—

“transitional individual local-level guarantee” means the transitional individual local-level guarantee of that urban Local-level Government for the relevant fiscal year;

“equalisation amount for urban Local-level Governments” means the amount estimated by the NEFC to be the urban Local-level Governments’ share of the local-level share specified in the determination made under paragraph 2(1)(d) that is in force on 30 April of the immediately preceding fiscal year;

“fiscal needs amount of individual urban Local-level Government” means the fiscal needs amount of that urban Local-level Government for the relevant fiscal year;

“total fiscal needs amount of urban Local-level Governments” means the total of the fiscal needs amounts of the urban Local-level Governments that have fiscal needs amounts greater than zero for the relevant fiscal year.

A similar formula is used to calculate the rural Local-level Government share.

Most rural Local-level Governments have minimal revenues available to them. However, they each have very different costs. Reasons include higher costs due to remoteness or having different populations to service. Even though most rural Local-level Governments have little or no revenue, they have different fiscal needs amounts because they all have different costs.

Urban and rural Local-level Governments have different assigned service delivery functions and responsibilities now defined by the Function Assignment Determination approved by NEC. They also have different revenues available to them. Urban Local-level Governments can raise substantially more revenue to fund a more significant proportion of their service delivery costs. Rural Local-level Governments tend to have minimal revenues and fewer service delivery functions and responsibilities.

Revenues for rural and urban Local-level Governments have been assessed at zero. This is because data on these revenues are incomplete and of poor quality. However, eventually the NEFC expects to obtain better information on the revenues of urban Local-level Governments and would then assess these more accurately. It may never be possible to accurately assess revenues for over 308 rural Local-level Governments. In the circumstances, revenues for rural Local-level Governments may remain at zero.

Table 7: Local-level government share by province for 2011 (K'000)

Province	Individual Urban LLG	Individual Rural LLG	TOTAL per Province
WESTERN	608.2	1,484.3	2,092.5
GULF	127.9	939.4	1,067.4
CENTRAL		1,514.0	1,514.0
MILNE BAY	246.8	1,698.3	1,945.1
ORO	495.7	996.6	1,492.4
SOUTHERN HIGHLANDS	784.5	3,832.4	4,616.9
ENGA	105.0	2,141.4	2,246.4
WESTERN HIGHLANDS	695.7	2,913.5	3,609.3
SIMBU	231.2	1,799.2	2,030.4
EASTERN HIGHLANDS	656.7	2,838.0	3,494.6
MOROBE	2,353.4	3,537.9	5,891.3
MADANG	712.5	2,666.2	3,378.7
EAST SEPIK	505.6	2,693.4	3,198.9
SANDAUN	<b>243.8</b>	1,840.1	2,084.0
MANUS	146.7	338.4	485.1
NEW IRELAND	281.2	845.8	1,127.0
EAST NEW BRITAIN	595.0	1,694.3	2,289.3
WEST NEW BRITAIN	354.0	1,342.7	1,696.7
<b>TOTAL</b>	<b>9,144.0</b>	<b>35,116.0</b>	<b>44,260.0</b>

On average, Local-level Governments have experienced a 13% increase in funding each year from 2004 to 2007 and received a further 9% increase in the 2009 budget from their 2008 levels. In the 2010 budget, local level governments received a one percent increase over the 2009 amount. In 2011, they are expected to receive a three percent increase over the 2010 appropriations.

The total Local-level Government share is divided between rural and urban Local-level Governments in the same proportion as provided in the 2009 budget i.e. 79% rural, 21% urban.

The rural Local-level Government share is then further divided into 286 individual Local-level Government amounts, based on district costs and population in each Local-level Government.

For urban Local level governments, their funding is determined as what they received in 2008 PLUS their share of additional funding based on their assessed fiscal needs.

## 5 FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

As stated earlier in the report, the equalisation amount is broken down amongst the different service delivery function grants for each Provincial Government based on the fiscal need of the relevant service sector (such as health and transport infrastructure maintenance) through comparing the NEFC's estimated cost of service delivery for each sector against the funding level for each sector.

Provincial Administrations were provided these amounts through the 2011 Budget Circular. As part of the process, provinces are allowed to request minor shifts among function grants within their overall provincial ceiling.

Treasury holds negotiations with provinces that request changes and an agreement can be reached as to the revised split among the function grants.

The Determination is then prepared and signed by the Treasurer to formalize the splits amongst the provincial grants for the 2011 Budget.

This Determination is signed and issued prior to the meeting of the Budget Screening Committee with the provinces in order that they can focus their discussions on personnel emoluments and the development budget.

The table below shows the final amounts (in K'000) for each service delivery function grant for each province for 2011

Table 8: 2011 Function and Administration Grants Determination

	Primary Production Function Grant	Health Function Grant	Education Function Grant	Transport Infrastructure Maintenance Function Grant	Village Courts Function Grant	Other Service Delivery Function Grant (b)	Administration Grant (b)	Total Provincial Government Grants
Western	618.1	879.1	893.5	1,658.9	127.6	141.0	141.0	4,459.2
Gulf	790.1	2,660.8	2,583.6	2,403.6	49.0	1,055.5	347.0	9,889.4
Central	325.1	2,407.2	3,005.3	3,562.8	153.9	1,270.4	404.8	11,129.4
Milne Bay	889.4	4,138.2	2,948.1	3,124.8	76.2	1,539.3	1,073.0	13,789.0
Oro	927.8	2,142.8	1,795.4	2,065.7	42.5	827.4	595.3	8,397.0
Southern Highland	810.9	4,500.1	2,683.7	3,618.2	257.3	921.0	265.5	13,056.7
Enga	513.7	2,853.0	1,157.9	4,103.6	153.3	916.4	485.3	10,183.2
Western Highland	1,366.6	3,362.4	4,357.3	4,278.4	274.3	757.5	455.8	14,852.4
Simbu	427.0	2,721.0	3,440.2	3,971.9	150.2	1,373.6	667.7	12,751.5
Eastern Highlands	1,203.1	3,236.0	3,807.9	5,277.8	153.0	1,291.8	990.0	15,959.6
Morobe	465.3	1,275.8	2,000.0	2,266.3	157.0	1,001.3	551.6	7,717.3
Madang	976.8	4,452.7	3,307.5	5,818.7	78.3	1,683.7	704.8	17,022.4
East Sepik	1,354.7	6,074.2	4,072.1	8,818.4	167.3	1,452.3	645.0	22,584.1
Sandaun	745.5	4,540.9	3,416.6	3,560.2	67.1	1,405.5	620.0	14,355.9
Manus	340.0	1,526.7	1,619.2	2,421.2	73.3	788.6	738.5	7,507.5
New Ireland	547.3	1,160.1	771.2	930.1	51.7	110.9	37.2	3,608.6
East New Britain	1,527.3	2,082.2	2,591.2	2,242.1	70.6	454.7	81.1	9,049.2
West New Britain	3,092.9	2,005.6	2,405.6	1,673.4	165.3	61.0	61.0	9,464.8
<b>TOTAL</b>	<b>16,921.7</b>	<b>52,018.7</b>	<b>46,856.2</b>	<b>61,796.2</b>	<b>2,267.9</b>	<b>17,052.0</b>	<b>8,864.4</b>	<b>205,777.0</b>

## 5.1 Service Delivery Function Grants

Service Delivery Function Grants are provided to Provincial Governments to ensure that a minimum set of core services are adequately funded so as to benefit the majority of people across Papua New Guinea.

Service Delivery Function Grants are to be used exclusively for goods and services (operational costs) and not to fund salaries, capital or development costs unless specified in the budget.

The following service delivery function grants will be in operation in 2011.

- Education Service Delivery Function Grant
- Health Service Delivery Function Grant
- Transport Infrastructure Maintenance Grant
- Village Courts Function Grant (Operations)
- Village Courts Allowances Grant
- Agriculture Service Delivery Function Grant
- Other service delivery Function Grant

## 5.2 Administration Grant

This grant is to fund general overhead costs or meeting the day to day operation costs of the Provincial Administration.

No salaries or other personal emoluments, casual wages, and debt payment are to be paid using the administration grant.

## 5.3 Minimum Priority Activities and Performance Indicators

Commencing from the 2009 Budget, the Secretary for Treasury issued Budget and Expenditure Instructions calling for provinces to adequately fund eleven specific service delivery activities. These eleven activities have been identified as basic provincial responsibility across the five key function grant categories of Agriculture, Education, Health, Transport Infrastructure and Village Courts (all MTDS priority areas) and are known as **Minimum Priority Activities**.

These Minimum Priority Activities (MPAs) were arrived at after extensive consultation with national agencies, provinces and PLLSMA. MPAs should assist Provincial Governments to prioritise effective and targeted service delivery outcomes at the district and rural level.

Provincial Governments must create identifiable activity codes for each MPA in their respective budgets and request performance reporting from sector managers.

The following eleven MPAs across five key sectors were endorsed by the Inter-Departmental Committee (IDC) and issued by the Secretary of Treasury in the Budget and Expenditure Instructions for use by all Provincial Governments in the 2009 budget onwards;

### **Agriculture**

- Extension activities for agriculture, fisheries and forestry

**Education**

- Distribution of school materials
- Supervision of schools by district and provincial officers
- Operation of district education offices

**Health**

- Operation of rural health facilities
- Integrated health outreach patrols
- Drug distribution

**Transport Infrastructure Maintenance**

- Road and bridges maintenance
- Airstrip maintenance
- For maritime provinces- wharves and jetties maintenance

**Village Courts Operations**

- Operational materials

In addition, there is a set of very specific indicators against which each of these MPAs could be measured.

The full set of MPA and performance indicators are provided on the following pages.

**Minimum Priority Activities and Performance Indicators.**

Minimum Priority Activity	Performance Indicator
<u>Health</u>	
1. Operation of rural health facilities	i. Total Number and Names of health facilities ii. No of Health Facilities open and staffed iii. Health facilities with access to running water in labour ward
2. Drug distribution	i. Number of months health facilities stocked with essential supplies in the last quarter
3. Integrated health outreach patrols	i. Total number of health patrols conducted and then, a. Number of administrative supervision patrols to health facilities b. Number of patrols with specialist medical officers to health facilities c. Number of maternity child health patrols to health facilities.
<u>Education</u>	
4. Provision of school materials	i. Total no of schools by type ii. Percentage of schools that received basic school supplies before 30th April.
5. Supervision by provincial/district officers	i. Number of schools visited by district / provincial education officers
6. Operation of district education offices	i. Number of District Education Offices that provided quarterly performance reports.
<u>Transport Maintenance</u>	
7. Road and bridge maintenance	i. Names and approximate lengths of provincial roads maintained ii. Names of bridges maintained
8. Airstrip maintenance	i. Names of rural airstrips maintained
9. Wharves and jetties maintenance	i. Names of wharves, jetties and landing ramps maintained
<u>Agriculture</u>	
10. Extension activities for agriculture, fisheries and forestry	i. Number of extension patrols conducted by provincial government staff and ii. Number of people who attended extension sessions
<u>Village Courts</u>	
11. Operational materials	i. Number of village courts in active operation ii. Number of village courts supplied with operational materials

- These are minimum activities that **must** be funded from service delivery function grants within each financial year
- These form part of the conditions of the service delivery function grants
- These minimum activities are a **minimum**. Function grants can still be used for funding other recurrent goods and services activities within that functional area.

## 5.4 Conditions of Funding of Function Grants

Conditions for function grants (including the minimum priority activities) and management of expenditure are provided for in the Function Grant and Administration Grant Determination and the “Budget and Expenditure Instructions” issued by the Secretary for Treasury in May 2010.

The Budget and Expenditure Instructions specify:

- i. What grants, receipts or other revenues are to be used for and the expected outputs from spending
- ii. The management of grants, receipts or other revenues
- iii. How the expenditure of grants, receipts or other revenue is reported; and
- iv. The budget preparation process, including consultation with stakeholders.

The Department of Treasury, in conjunction with the Department of Provincial and Local Government and the National Economic and Fiscal Commission will seek to ensure compliance of these Budget and Expenditure Instructions.



## 6 BUDGETING, MONITORING AND REPORTING

Section 65 of the *Intergovernmental Relations (Functions and Funding) Act 2009* serves as the basis on which the Secretary for the Department of Treasury may, in consultation with the National Economic and Fiscal Commission, determine the conditions to which all or any of the following grants are subject;

- a) service delivery function grants
- b) administration grants
- c) rural local-level government grants
- d) urban local-level government grants
- e) staffing grants, and
- f) payments to address development needs

### 6.1 Treasury Budget and Expenditure Instructions

The Secretary for the Department of Treasury may issue Budget and Expenditure Instructions outlining conditions surrounding management and reporting on the expenditure of the above-mentioned grants.

Budget and Expenditure Instructions contain specific instructions as stipulated in s.65 of the *Intergovernmental Relations (Functions and Funding) Act 2009*.

The Department of Treasury ensures compliance with the conditions of implementation of the grants through quarterly budget expenditure reviews.

The analysis of the 2010 Provincial Government Budget Documents conducted at NEFC revealed that, when compared to 2009, there is an improved level of compliance with the requirements of the Budget and Expenditure Instructions (BEI) issued by the Department of Treasury in May 2010. ([www.treasury.gov.pg](http://www.treasury.gov.pg)).

#### **Unspent Grants**

Many provincial administrations rolled over significant amounts of national grants into the Provincial Government Operating Account for use in future years. This practice, which is in accord with both Budget and Expenditure Instructions and a Finance Instruction leaves no or very little assurance for Treasury that funds have been or will be used for their intended purpose.

In addition, the value of these rolled over amounts is treated as actual expenditure in Provincial Government financial statements for the current year and own source revenue for the following year which is not consistent with any generally accepted accounting principles.

After consultation with Provincial Treasurers, the Office of the Auditor General, Treasury and NEFC, the Department of Finance proposes to address this problem by directing Provinces to retain unspent grant funds in the Provincial Government Grant Account, so that the funds are available for their intended purpose early in the new financial year.

## ***Budget assignment of Function Grants***

Most Provinces do budget for the use of national function grants in accordance with the BEI.

The major exception to this is in infrastructure maintenance spending, where funds are often directed to rehabilitation or even the construction of new roads. There is a potentially valid argument that perhaps this is unavoidable because maintenance expenditure has been at such a low level for so many years that the infrastructure has deteriorated to the stage where no benefit will be accrued from routine maintenance expenditure. In some cases grant funds have been directed to government owned corporations where little assurance is available that services have actually been performed and in other cases to the purchase of capital equipment.

## ***Revenue Estimation***

Realistic revenue estimates, where budgeted revenue is only slightly ahead of prior year actual collections, were included in more budgets in 2010 than was the case in 2009.

## **6.2 Provincial Government Budget Scorecard**

During 2010, NEFC performed a budget quality assessment process to examine the quality of 2010 Provincial Government budget documentation against the requirements outlined in the Budget and Expenditure Instructions and what is considered best practice in public sector budgeting.

Budgets were rated on timeliness of submission, the quality of presentation of data on overall sectoral expenditure splits shown by financing source - recurrent grant, own source revenue or development grant and whether they included a complete expenditure split showing goods and services, personnel emoluments and capital expense by sector.

Positive scores were allocated to budgets if they included details of estimated actual Revenue and Expenditure for the prior year and actual data for the second prior year.

Sectoral allocations for the Minimum Priority Activities were compared to the NEFC estimate of the cost of delivering a basic level of services and then corrected for fiscal capacity for all of those Provinces where fiscal capacity was less than 100%.

Positive scores were also applied where the proportion of own source revenue appropriation allocated to Health, Education, Transport Infrastructure Maintenance, Primary Production and Village Courts was significant.

Negative scores were applied if Provincial Governments allocated funding for Universities, tertiary scholarships or Provincial Hospitals from national government function grants.

A summary of the assessment scores appears in the table on the next page and a complete listing of the performance indicators and a guide as to how scores were applied appear as Appendix one and two of this chapter.

### Provincial Government 2010 Budget Quality Assessment

	Overall	BEI compliance	Admin	Other Services	Health	Education	Transport maintenance	Primary Production	Village Courts	Own Source Appropriation	Total
<b>Oro</b>	11	10	1	2	12	15	14	7	4	5	81
<b>ENB</b>	13	10	1	2	14	15	7	7	3	4	76
<b>Central</b>	6	7	1	2	16	15	11	3	4	7	72
<b>Milne Bay</b>	9	10	0	0	16	14	12	1	3	6	71
<b>Gulf</b>	4	7	0	2	15	15	11	4.5	3	7	68.5
<b>Sandaun</b>	9	10	1	1	11	14	11	2	4	5	68
<b>Morobe</b>	1	10	1	2	14	15	10	2	3	8	66
<b>Manus</b>	7	8	1	2	8	14	8	6	4	7	65
<b>NIP</b>	3	8	0	2	6	14	14	5	3	8	63
<b>EHP</b>	9	2	0.5	2	14	7	9	7	4	3	57.5
<b>WNB</b>	13	7	0	0	6	8	8	5	2	8	57
<b>WHP</b>	10	7	0.5	2	11	7	7	4.5	3	5	57
<b>ESepik</b>	3	5	0	2	12	13	5	5	3	6	54
<b>Simbu</b>	7	7	1	2	8	10	11	2	4	0	52
<b>Madang</b>	8	5	1	2	11	9	7	2	3	1	49
<b>SHP</b>	0	10	1	2	11	7	3	2	4	0	40
<b>Western</b>	3	7	0	1	10	3	7	0	3	4	38
<b>Enga</b>	1	10	0	0	11	4	2	0	2	7	37

### 6.3 Chart of Accounts Standardisation for Provincial Governments

During both 2009 and 2010, NEFC in partnership with Finance, Treasury Provincial Budgets Branch (PBB) and DPLGA conducted regional workshops for Provincial Governments which were focussed on budgeting, reporting, service delivery and the Minimum Priority Areas for spending.

At each workshop, Provincial Governments expressed a real interest in standardisation of program and activity expenditure codes in the PGAS chart of accounts to enable improvements in financial reporting.

NEFC responded to this by developing and piloting a framework for standardisation of program and activity codes, amongst all the Provincial Governments and between the 200 series (national grant financed appropriation) and 700 series expenditures (own source revenue financed appropriation).

This document was the subject of consultation with Treasury PBB and detailed collaboration with several provinces. Maps of the proposed movement from old budget codes to new codes were prepared for a number of Governments.

A paper was tabled as an advisory brief on financial management matters providing a potential coding framework for the standardisation of revenue and expenditure program and activity expenditure codes across all provinces in the PGAS chart of accounts.

This document was also recently referred to the Department of Finance Public Financial Management Review and account may be taken of the proposed framework in the upgrade of the PGAS system currently under way which includes introduction of a controlled and centralised process to add new accounts and deactivate invalid, incorrect and redundant accounts in the current Provincial Government and District charts of accounts.

### 6.4 Provincial Budget Reviews and MPA Performance Indicator Reporting

Provincial Government Half Year Budget Reviews were conducted by the Department of Treasury assisted by NEFC staff. This process is one of the major monitoring exercises on expenditure levels and performance against the MPAs. Following the Reviews, the Provincial Budgets Branch of Treasury prepares a report to CACC.

This year, representatives from national agencies including Health, Education, Finance, DPM and DNPM were also invited and some were able to attend. In addition increased time was allocated to the reviews.

Some Provincial Governments have commenced service delivery reporting on the Minimum Priority Area (MPA) activities actually performed and quantifying –

- No of village courts supplied with operational materials
- Health Facilities open and staffed
- Health Facilities with running water in labour ward
- Health clinics and patrols conducted
- Supervision patrols to Health Facilities
- Patrols by specialist doctors
- Maternity child health patrols

- Distribution of drugs – deliveries to Health Centres
- Schools receiving basic materials prior to 30th April
- Schools visited by Provincial / District Officers
- District Education Office Reports received
- Number of Primary Production Extension Activities and total attendance
- Routine maintenance activity by number of km of trunk roads, km feeder roads, km access roads and the number of bridges and air strips attended to.

Some Provincial Governments, such as Simbu, did table details of the number of MPA activities actually performed (services delivered) for the first half compared to Annual Action Plans. Other provinces, like Madang, Morobe and Sanduan, simply stated for various sectors whether plans were achieved, part achieved or not progressed at all. Central provided percentage figures showing what proportion of the activity included in the Annual Action Plan had been completed.

Of the amount released for expenditure by midyear, on average only 60% was spent. When combined with the late release of warrants and cash by Waigani, this means that large amounts of funds will be spent in the last few weeks before accounts are closed for the 2010 year. The reasons for low rates of expenditure in the first half were the late release of funds resulting from late submission and approval of budgets and the late opening of many of the new Provincial Government Grant Accounts with BSP.

Whilst budget review documentation contained evidence of funding of MPA activities, the allocation in the budget for each of the 11 MPAs was usually not clear.

The current budget review templates require a lot of information and needed reviewing to ensure they fill information needs for Treasury monitoring of service delivery. NEFC did work with Provincial Budgets Branch of Treasury on revising the templates to be used for the 2010 Second Quarter Budget Review and onward. Three provinces did use the revised versions in 2010 even with late notice of the change.

The Department of Treasury has not released “warrant authorities” for item 111 budget appropriations for Public Servants and Teachers salaries which form part of Provincial Government Annual Budget Appropriation. Whilst salary is processed centrally in Waigani, warrant authority must be issued in respect of all funds included in the Appropriation Act of the Provincial Government.

In addition, in some provinces appropriations for Provincial and or District Support Grants are included in the Provincial Appropriation Act, but no equivalent warrant authority amounts are released to Provincial Governments.

There is a greater need to further improve the linkage between the Provincial Administration and the Provincial Treasury. Both organization need to work closely together to ensure the spending that support service delivery happens in a timely manner.

It was strongly stressed during the 2011 Budget Screening Committee process that provinces must clearly show a distinct budget line item for each MPA specified under each of those core service delivery sectors Education, Health, Transport Infrastructure Maintenance, Primary Production and Village Courts Function Grants.

## 6.5 Provincial Government Financial Report Template

The following one page Provincial Government reporting template was developed in response to concerns raised by Provincial Administrators and Sector Managers in response to very detailed expenditure listings received from Provincial Treasuries. It has been designed to convey in one page the proportion of budgeted revenue actually received, the proportion of budgeted expenditure actually spent and some comparative prior year data.

It has not been adopted as yet and is the subject of ongoing consultation with Provincial Governmental and National Departmental officials.

Year Ended 31st December 2009	Prior Year Actual 2009	2010 Budget	2010 Actual	2010 Variance from Budget	2010 Variance from 2009
<b>Revenue</b>					
Own Source Revenue				0	0
Recurrent Grants	0	0	0	0	0
Development Grants				0	0
<b>TOTAL RECEIPTS</b>	0	0	0	0	0
<b>Expenditure</b>					
Administration				0	0
Other Service Delivery				0	0
Agriculture				0	0
Health				0	0
Education				0	0
Infrastructure Maintenance				0	0
Village Courts				0	0
Local Level Government Grants				0	0
Development Expenditure				0	0
<b>TOTAL EXPENDITURE</b>	0	0	0	0	0
Surplus / Deficit	0	0	0	0	0
<b>Notes</b>					

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**Appendix 1 Provincial Budget Quality Assessment Performance Indicators**

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**Budget Summary quality assessment**

1. Timeliness of provincial budget submission that was approved
2. High level budget summary showing overall sectoral expenditure splits by financing source - recurrent grant, own source revenue or development grant and whether they included a complete expenditure split showing goods and services, personnel emoluments and capital expense by sector. Realistic Own Source Revenue Estimates
3. Actual Revenues and Expenditures for second year prior disclosed (e.g. 2008 data in 2010 budget)
4. Estimated Actual Revenues and Expenditures for prior year included (e.g. 2009 data in 2010 budget)
5. Used unique Expenditure program and activity codes for every MPA activity

**National Grant Financed Expenditure Appropriation**

6. Correctly budgeted for the receipt of goods and services grants
7. Correctly budgeted for expenditure of these grants against identified programs in the correct sector
8. Unused funds from 2009 were rolled over into correct Function Grant Appropriation revenue vote
9. Unused funds from 2009 were rolled over into correct Expenditure Appropriation
10. Administration Degree of rolled over unspent grants from prior year
11. Other Services - Degree of rolled over unspent grants from prior year

**Health**

12. Excluded Provincial Hospitals ( 200 series )
13. Excluded wages / personnel emoluments ( 200 series )
14. MPA - Operation of rural health facilities
15. MPA - Included drug distribution
16. MPA - Outreach health patrols
17. Degree of rolled over unspent grants from prior year

**Education**

18. Excluded funding of Universities and tertiary scholarships ( 200 series )
19. Funding proportion for basic education exceeds 60% education appropriation

- 
- 20. MPA Included - Distribution of school materials / school subsidies
  - 21. MPA Included - Supervision by provincial/ district officers
  - 22. MPA Included - Operation of district education offices
  - 23. Degree of rolled over unspent grants from prior year

#### **Transport Infrastructure maintenance**

- 24. MPA Road and bridge maintenance
- 25. MPA Airstrip maintenance and Wharves and jetties maintenance
- 26. Excludes new infrastructure / capital
- 27. Excludes maintenance of buildings
- 28. Degree of rolled over unspent grants from prior year

#### **Primary Production**

- 29. MPA Extension activities for agriculture, fisheries and forestry
- 30. Degree of rolled over unspent grants from prior year

#### **Village Courts**

- 31. MPA Operational materials
- 32. Degree of rolled over unspent grants from prior year - VC function grant
- 33. Degree of rolled over unspent grants from prior year - VCA

#### **Own Source Revenue (700 series) Appropriation**

- 34. Proportion allocated to MTDS sectors (Health, Education, Infrastructure maintenance, Primary Production and Village Courts) [ Excludes capex and housing and office maintenance ]
- 35. LLG allowances budgeted from provincial internal revenue appropriation



## ***Appendix 2 Provincial Budget Quality Assessment score guide***

### **Provincial budget quality assessment scoring guide**

#### **Overall**

<b>Timeliness of provincial budget submission that was approved</b>	<b>0-5</b>
Submitted after 12 December	0
Submitted before 12 December	3
Submitted within two weeks of national budget being handed down	5
 <b>High level budget summary (incorp. all sectors, G&amp;S/PE/Capex/Dev, all revenue sources - grant/IR/development)</b>	<b>0-7</b>
No high level budget summary at front of the budget document	0
Overall sector expenditure split shown by financing source (recurrent grant, own source revenue or development grant)	3
Complete expenditure split showing goods and services, personnel emoluments and capital expense by sector	5
Complete high level reconciled revenue and expenditure budget summary including allocation to MPAs	7
 <b>Realistic Own Source Revenue Estimates</b> [ Requires obtaining some Prior Year(PY) actuals; not appropriations *]	<b>0-5</b>
Budgeted revenue includes material amounts that will definitely not be received and / or budgeted revenue exceeds Prior Year actual collections by >15%	0
Budget year revenue estimates somewhat realistic: 8 to 15% increase over PY actual	3
Budget year revenue estimates realistic: < 8 % increase over prior year actuals	5
 <b>Actual Revenues and Expenditures for second year prior disclosed (e.g. 2008 data not 2008 estimates in 2010 budget)</b>	<b>0-2</b>
No second prior year actuals included in the budget	0
Partial inclusion of actual second prior year data	1
Both actual revenues and expenditures from second year prior included	2
 <b>Estimated Actual Revenues and Expenditures for prior year included (e.g. 2009 data in 2010 budget)</b>	<b>0-2</b>
No estimated actual prior year expenditure or revenue outturns included in the budget (only original prior year budget estimates)	0
Partial inclusion of estimated actual prior year expenditure or revenue outturns	1
Both estimated actual revenues and expenditures from prior year included ( which are not equal to prior year appropriations )	2
 <b>Used unique Expenditure program and activity codes for every MPA activity</b>	<b>0-1</b>
Some duplication of codes i.e.same code used for at least two quite different activities	0
All Expenditure program and activity codes are unique for every activity	1

## National Grant Financed Expenditure Appropriation

<b>Correctly budgeted for the receipt of goods and services grants</b>	<b>0-2</b>
Incorrectly budgeted for the receipt of goods and services grants i.e. incorrect amounts recorded	0
Correctly budgeted for the receipt of all goods and services grants	1
Correctly budgeted for the receipt of all grants	2
<b>Correctly budgeted for expenditure of these grants against identified programs</b>	<b>0-3</b>
Incorrectly budgeted for the expenditure of goods and services grants i.e. incorrect amounts applied in any sector	0
Correctly budgeted for the spending of most goods and services grants but some applied to activities contrary to BEI	1
Correctly budgeted for the spending of all goods and services grants	2
Correctly budgeted for the spending of all grants	3
<b>Unused funds from 2009 were rolled over into correct Function Grant Appropriation revenue vote</b>	<b>0-3</b>
Revenues not documented in budget document	0
Placed one amount into a revenue entitled Former Years Appropriation (FYA)	1
Some of the funds rolled over into the correct FYA function grant codes	2
Placed all rolled over amounts into individual FYA function grants or rollovers insignificant	3
<b>Unused funds from 2009 were rolled over into correct Expenditure Appropriation</b>	<b>0-2</b>
Unused grant funds not rolled over to correct expenditure sector appropriation	0
Some of the funds rolled over into sector appropriation in accord with original grant purpose	1
Placed all rolled over amounts into sector appropriation in accord with original grant purpose	2
<b>Administration</b>	
Degree of rolled over unspent grants from prior year^	<b>0-1</b>
above 10%	0
above 5%	<b>0.5</b>
below 5%	1
<b>Other Services</b>	
Degree of rolled over unspent grants from prior year^	<b>0-2</b>
above 10%	0
above 5%	1
below 5%	2

**Health**

<b>Excluded Provincial Hospitals</b>	<b>0-1</b>
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<b>Excluded wages / personnel emoluments</b>	<b>0-1</b>
----------------------------------------------	------------

<b>MPA - Operation of rural health facilities #</b>	<b>0-4</b>
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MPA Activity budgeted at <51 % MPA cost of services estimate	0
--------------------------------------------------------------	---

MPA Activity budgeted at >50 % MPA cost of services estimate	2
--------------------------------------------------------------	---

MPA Activity budgeted at >70 % MPA cost of services estimate	4
--------------------------------------------------------------	---

<b>MPA - Included drug distribution #</b>	<b>0-4</b>
-------------------------------------------	------------

MPA Activity budgeted at <51 % MPA cost of services estimate	0
--------------------------------------------------------------	---

MPA Activity budgeted at >50 % MPA cost of services estimate	2
--------------------------------------------------------------	---

MPA Activity budgeted at >70 % MPA cost of services estimate	4
--------------------------------------------------------------	---

<b>MPA - Outreach health patrols #</b>	<b>0-4</b>
----------------------------------------	------------

MPA Activity budgeted at <51 % MPA cost of services estimate	0
--------------------------------------------------------------	---

MPA Activity budgeted at >50 % MPA cost of services estimate	2
--------------------------------------------------------------	---

MPA Activity budgeted at >70 % MPA cost of services estimate	4
--------------------------------------------------------------	---

<b>Degree of rolled over unspent grants from prior year^</b>	<b>0-2</b>
--------------------------------------------------------------	------------

above 10%	0
-----------	---

above 5%	1
----------	---

below 5%	2
----------	---

**Education**

<b>Excluded University funding and tertiary scholarships</b>	<b>0-1</b>
--------------------------------------------------------------	------------

<b>Funding proportion for basic education exceeds 60% education appropriation</b>	<b>0-1</b>
-----------------------------------------------------------------------------------	------------

<b>MPA Included - Distribution of school materials / school subsidies #</b>	<b>0-4</b>
-----------------------------------------------------------------------------	------------

No MPA Activity budgeted for	0
------------------------------	---

MPA Activity budgeted at >50 % MPA cost of services estimate	2
--------------------------------------------------------------	---

MPA Activity budgeted at >70 % MPA cost of services estimate	4
--------------------------------------------------------------	---

<b>MPA Included - Supervision by provincial/ district officers #</b>	<b>0-4</b>
No MPA Activity budgeted for	0
MPA Activity budgeted at >50 % MPA cost of services estimate	2
MPA Activity budgeted at >70 % MPA cost of services estimate	4
<b>MPA Included - Operation of district education offices #</b>	<b>0-4</b>
No MPA Activity budgeted for	0
MPA Activity budgeted at >50 % MPA cost of services estimate	2
MPA Activity budgeted at >70 % MPA cost of services estimate	4
<b>Degree of rolled over unspent grants from prior year^</b>	<b>0-2</b>
above 10%	0
above 5%	1
below 5%	2
<b>Transport maintenance</b>	
<b>MPA Road and bridge maintenance</b>	<b>0-6</b>
No MPA Activity budgeted for	0
MPA Activity budgeted at >20 % MPA cost of services estimate	3
MPA Activity budgeted at >50 % MPA cost of services estimate	4
MPA Activity budgeted at >60 % MPA cost of services estimate	5
MPA Activity budgeted at >80 % MPA cost of services estimate	6
<b>MPA Airstrip maintenance and Wharves and jetties maintenance #</b>	<b>0-3</b>
No MPA Activity budgeted for	0
MPA Activity budgeted at >20 % MPA cost of services estimate	1
MPA Activity budgeted at >60 % MPA cost of services estimate	2
MPA Activity budgeted at >80 % MPA cost of services estimate	3
<b>Excludes new infrastructure / capital</b>	<b>0-2</b>
Includes new infrastructure / capital allocations from the function grant	0
No new infrastructure / capital allocations from the function grant	2
<b>Excludes maintenance of buildings</b>	<b>0-1</b>
<b>Degree of rolled over unspent grants from prior year^</b>	<b>0-2</b>

above 10%	0
above 5%	1
below 5%	2
<b>Primary Production</b>	
<b>MPA Extension activities for agriculture, fisheries and forestry #</b>	<b>0-5</b>
Little or no MPA Activity budgeted for	0
MPA Activity budgeted at >10 % MPA cost of services estimate	1
MPA Activity budgeted at >50 % MPA cost of services estimate	2.5
MPA Activity budgeted at >70 % MPA cost of services estimate	5
<b>Degree of rolled over unspent grants from prior year^</b>	<b>0-2</b>
above 10%	0
above 5%	1
below 5%	2
<b>Village Courts</b>	
<b>MPA Operational materials #</b>	<b>0-2</b>
No MPA Activity budgeted for	0
MPA Activity budgeted at >50 % MPA cost of services estimate	1
MPA Activity budgeted at >70 % MPA cost of services estimate	2
<b>Degree of rolled over unspent grants from prior year - VC function grant^</b>	<b>0-1</b>
above 10%	0
above 5%	0.5
below 5%	1
<b>Degree of rolled over unspent grants from prior year - VCA^</b>	<b>0-1</b>
above 10%	0
above 5%	0.5
below 5%	1
<b>Own Source Revenue (700 series) spending</b>	
<b>Proportion allocated to MTDS sectors (Health, Education, Infrastructure maintenance, Primary Production and Village Courts) [ Excludes capex and housing and office maintenance ]</b>	<b>0-7</b>

*Formula: MTDS priority sectors 700 series G&S allocation / 700 series total allocation (all - G&S, PE, dev)*

No MTDS allocations from 700 series 0

Below 10% of 700 series allocated for MTDS sectors 3

Between 10% and 20% of 700 series allocated for MTDS sectors 5

Above 20% of 700 series allocated for MTDS sectors 7

**LLG allowances budgeted for under provincial internal revenue**

**0-1**

*these should be budgeted for under internal revenue and not under LLG grants which are for goods and services*

Not budgeted for under provincial internal revenue financed appropriation 0

Budgeted for under provincial internal revenue financed appropriation 1

**Total Provincial Budget Quality Score**

**100**

\* 2008 Actual Revenues are tabled at page 112 of the 2008 NEFC Provincial Expenditure Review

**#Formula for MPAs**

MPA budget (note no PE, capex or dev) / MPA CoS estimate

**^For all rollovers, formula is as follows:**

Rollover amount / appropriation

## 7. 2009 PROVINCIAL EXPENDITURE REVIEW “GREEN SHOOTS OF CHANGE”

This report provides vital information to government agencies and partner organisations that are committed to improving the delivery of critical basic services throughout our country. The fiscal year 2009 was the first year of implementation of the new intergovernmental financing arrangements that saw more funding reaching the provinces that need it most and targeted at priority sectors and priority activities. It is enormously satisfying to see government allocate more funds to the front-line to fund the activities that make an impact to the rural majority spread across Papua New Guinea. Few would argue that seeing health facilities open and operating, supervising teachers and schools, maintaining roads and watching as extension patrols with health and agriculture professionals cross the districts bringing care and skills are what it is all about.

Five years ago NEFC commenced a process of painting a picture of what was happening in provincial Papua New Guinea. We wanted to know whether service delivery activities were being funded or not and we wanted to find ways to communicate this meaningfully and simply to the many people who play a role in the service delivery supply chain. By establishing and refining this process over the last five years we now have a platform to monitor results and to compare financial performance. Central agencies such as the Department of Treasury and the Department of Provincial and Local Government Affairs are playing a critical role by monitoring performance indicators – an ultimate test that the money is being put to good and proper use.

This Review examines year one of increased funds and we are looking for green shoots of change, positive indications that more money is reaching the places where it makes a difference. In any garden, green shoots are about promising signs and new hope; it is not about miracles or silver bullets. Revitalising services that have stopped or become haphazard takes the efforts of many and includes money, planning and management.

### ***The Provincial Expenditure Review series***

In 2005 we first painted the picture of what was happening across Papua New Guinea by looking through a fiscal lens. *Cost Capacity Performance (2005)* established a methodology for reviewing our progress in a systematic way by using an evidence-based approach that sought to answer the following three key questions:

<b><i>COST</i></b>	How much does it cost to deliver priority services in each province?
<b><i>CAPACITY</i></b>	What can we afford?
<b><i>PERFORMANCE</i></b>	Does provincial spending support service delivery?

The *Provincial Expenditure Review* has since become an annual publication that continues to inform and challenge us on our journey toward improving the delivery of basic services across the country. *Green Shoots of Change* is the fifth and latest edition in the series. This report seeks to stimulate discussion around these issues – by considering cost (what we need to spend), fiscal capacity (what can we afford) and provincial expenditure patterns (where are we spending) – we are painting a picture of how we are doing and where we need to change.



## RIGFA, is it working?

In 2009, the first year of implementation, we believe there are green shoots of change.

- ***Did the increased funding reach the provinces that need it most?***

Yes it did, the fiscal capacity of the six lowest funded provinces went from an average of 30% in 2008 to 45% in 2009.

- ***Did the increased function grants reach the sectors?***

Yes they did, the increased grants were targeted at the Government's priorities – basic education, rural health, transport infrastructure maintenance and primary production.

- ***Did provinces use the additional function grant funding they received under RIGFA in 2009? Or did they struggle to spend the additional money?***

Overall, we can see that in 2009 the amounts of un-used function grant funding remained similar to previous years. The under-spending rate in health decreased whilst in education it increased. So we can be pleased that provinces have been able to put the additional funding to good use.

- ***Were the grants spent on the purposes intended?***

Overall, the spending of the function grants in health, education and infrastructure maintenance generally appeared in keeping with intention of grants with some areas that were questionable or uncertain.

- ***Was there evidence of spending on MPAs?***

Yes there was evidence of spending on MPA's however we need to continue to be proactive in our efforts to support provinces as they seek to revitalise these critical activities.<sup>3</sup> Clearly identifying budget line items will help ring-fence these funds and ensure sectors have the resources necessary to carry out the activities.

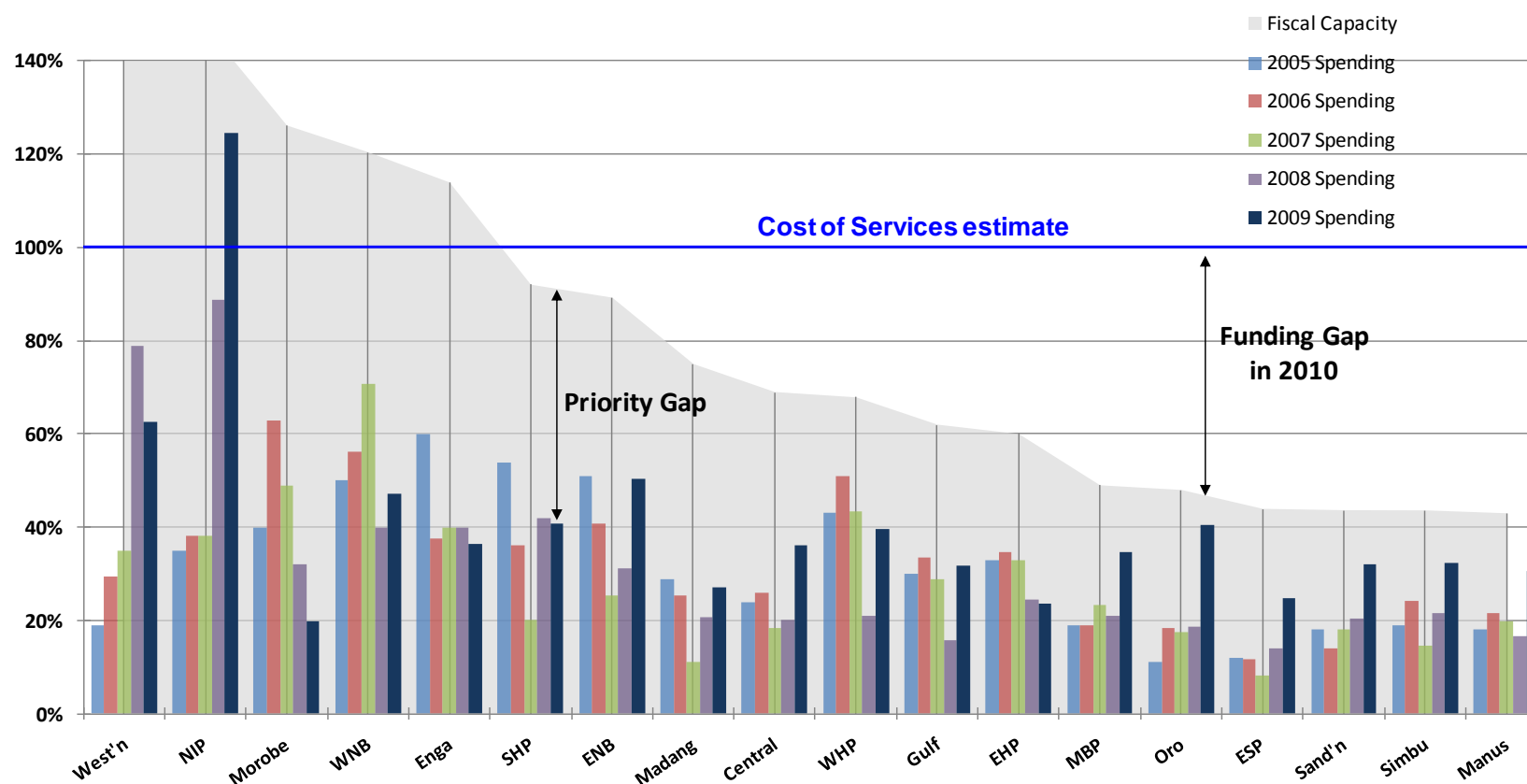
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<sup>3</sup> Supporting provinces to revitalise the minimum priority activities is a shared responsibility. Many provinces have been starved of recurrent funding for a significant period of time. Activities need to be planned, resources and budgets allocated and then monitoring needs to take place at a variety of levels. Central agencies and national line agencies have a critical role to play in supporting this process.

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This graph draws together all provincial spending on MTDS priorities and compares this with the cost of fully funding the MTDS priorities. It demonstrates the twin hurdles we face in improving the delivery of services throughout the provinces. The first is a matter of provincial choice, that is, something provinces individually have the power to change by allocating more money within their province to basic services – we call this the priority gap<sup>4</sup>. The second is a matter of funding, many provinces simply do not have sufficient funding – we call this the funding gap.

**Graph 17: Supporting MTDS priorities: 2005 to 2009**



<sup>4</sup> In practice, provinces may allocate some of the funds they have discretion over to staffing, capital and development costs. This is not reflected in the calculation of fiscal capacity nor the priority gap. The assumption is that all untapped funds can be applied to funding recurrent operational activities.

## Cross-cutting Issues

- **Funding Gap:** Whilst the funding gap remains it continues to be reduced. More money is reaching the provinces that need it most and is being targeted at priority sectors and activities. The funding gap is the difference between the revenue a province receives and the amount it costs to deliver all the basic services it has responsibility to provide.
- **Priority Gap:** There continues to be a priority gap that can only be addressed by provinces choosing to spend their available funding on priority sectors. The priority gap happens when a province has the revenue, but chooses to spend its money on other things – not core services. To address this, provinces have to choose to spend their funds on basic services and this may mean reducing spending in one area (such as administration) and redirecting it to another (such as health).
- **Minimum Priority Activities:** Some activities are absolutely critical and must be carried out. When these activities stop, or happen infrequently or haphazardly service delivery within the sector declines. Under RIGFA we are funding and monitoring a set of 11 priority activities across five sectors (3 in each of education, health and transport infrastructure; and 1 in both primary production and village courts).

The aim is to fund and revitalise these activities to ensure they happen.

- **Per diems, pushing up the Thin Blue Line:**<sup>5</sup> In 2010 the Department of Personnel Management reviewed and increased the rates of per diem paid to all levels of government. Per diems (also known as TA) are a necessary cost to enable government officers to carry out their work duties. However, this benign-looking policy change will continue to have a highly significant impact on the provinces recurrent budgets. The increase in the per diem rates equates to a K55 million cost increase for provinces. The extra K55 million represents a 12% increase in the cost of services estimate.

What does this mean? In reality the increase in per diems may reduce the amount of duty travel that can take place in each province. Sadly, the costs of undertaking a health patrol, or an agriculture extension visit, or a school supervisory visit will increase markedly which means less of these vital activities may take place. Provincial administrations will themselves need to ensure that core activities are still prioritised despite the increased cost in carrying out these activities.

- **Parallel Systems:** There is a natural desire to see and report tangible outputs from donor funds. This desire combined with a historical lack of confidence in government systems has led to the practise of establishing systems that run parallel to the government financial system. By systems we mean establishing and operating trust accounts at the provincial level. Whilst this may serve the purpose of the donor, it fragments and dilutes the ability of the province to effectively budget and manage the funds allocated to the province for the delivery of services. We already have an internal fragmentation with the split between grant and internal revenue – additional external sources of fragmentation are unhelpful and against the thrust of policy in this area both within Papua New Guinea and internationally.<sup>6</sup>

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<sup>5</sup> The Thin Blue Line describes the costs of service estimate, being the cost the NEFC conservatively calculates is necessary to be incurred to deliver a particular service.

<sup>6</sup> PNG has given considerable emphasis to the *implementation of the international Paris and Accra agreements on aid effectiveness*, which amongst other things commits to the principles of harmonization and alignment. Other agreements signed between PNG and donor partners are written in the same spirit.

- **District Data:** In recent years more funding is finding its way to the district treasuries and thereby under the management of the district administration. We need to design and implement a robust and pragmatic form of data transfer between districts, provinces and the national level that enables this expenditure to be reported more easily, more regularly and more reliably.
- **More Infrastructure?** We need to consider the impact of new infrastructure development. Every new infrastructure development creates ongoing costs. Effectively, new infrastructure development that is not matched with an increased recurrent budget will reduce service delivery.

How does this happen? When we build a new school we need to increase the recurrent budget to support this school year after year to pay for costs like materials and maintenance. If we don't provide increased recurrent funding we are taking funding away from existing schools to cover the new school. The more we do this the worse it gets.

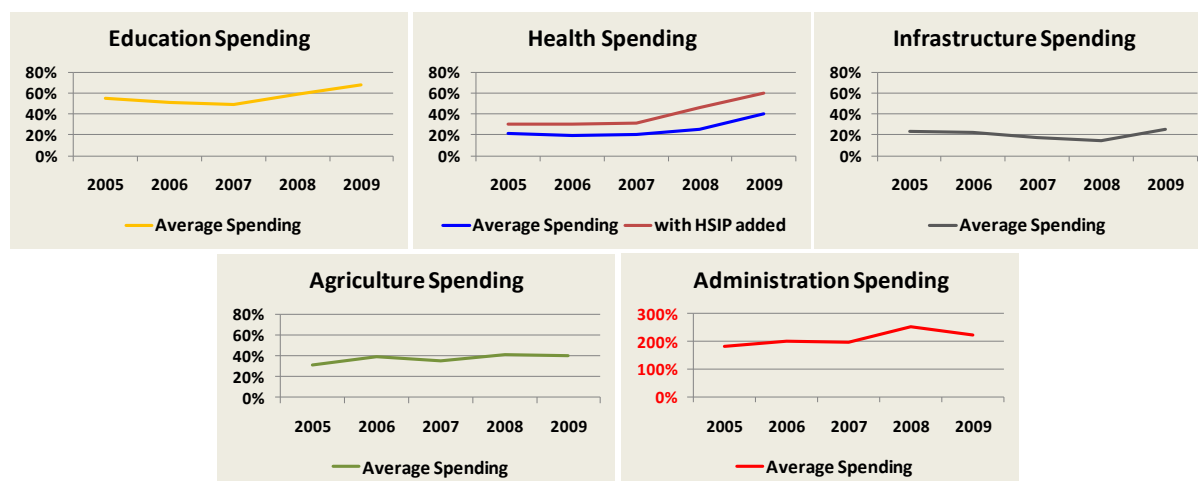
- **More Staff?** We also need to consider the impact of employing more staff or restructuring that creates unattached personnel. Increasing staff numbers places more demand on the recurrent goods and services budget. Effectively increasing staff numbers that are not matched with an increased recurrent budget will reduce service delivery.

How does this happen? When we employ additional staff they need to be resourced. They need office space, use electricity, need a computer, need to travel for work (which means travel allowance, fuel costs, car hire, air travel etc) and recreation leave fares. When we don't increase our recurrent budget to provide for these costs we reduce the amount available to support all our staff – and we thereby reduce their effectiveness.

## Sector by Sector

The *Provincial Expenditure Review* has stories at every level, let's summarise each major sector:

- **Education:** Recurrent spending in education has increased by K9 million with most provinces spending more in 2009 and some spending significant amounts.
- **Health:** 2009 saw a positive change in health spending with overall spending increasing by K12.6 million. Many lower and medium funded provinces showed significant increases in their spending on the sector. Spending from HSIP remained strong.
- **Transport Infrastructure Maintenance:** Maintaining infrastructural assets is expensive particularly when they have left to degrade. Spending identified as routine maintenance increased by K12.8 million in 2009. There is still an enormous amount of work to be done.
- **Agriculture:** Overall spending on agriculture remains relatively static. Whilst agriculture is identified as being the economic bedrock of rural Papua New Guinea a major effort appears necessary to revitalise this sector.
- **Village Courts:** The village courts sector receives two grants, one for operations the other for allowances. The grants are in line with the modest cost estimates for the sector.
- **Administration:** Recurrent spending on administration reduced slightly in 2009 but remains high relative to the estimated costs required and very high relative to what is spent on sectors delivering services.

**Graph 1: Average Spending by Sector from 2005 to 2009**

- **Upward trends:** In education and health.
- **Donor impact on recurrent service delivery activities:** in education and health.
- **Concern:**
  - Infrastructure spending remains low and is expensive – and will become even more expensive the longer we wait.
  - Administration is high (relatively speaking) and needs to be reduced and managed.

## What now?

- **Prioritisation of internal revenue:** More internal revenue needs to go to funding goods and services in the priority sectors of education, health, transport infrastructure and primary production. This applies particularly to higher-funded provinces.
- **Late Spending:** We can demonstrate better planning and expenditure management by spending more evenly during the year and not a large proportion in the fourth quarter.
- **Transparency of MPA's:** Clearly label MPA's in the 2011 budget – showing that funding is reaching these most critical of service delivery activities.
- **Transport Infrastructure maintenance:** We need to consider how to better define and report the work we are doing on maintaining the roads (and other transport infrastructure assets) that provinces are responsible for. The sooner and more frequently we 'maintain' a road the cheaper it is. Leaving roads to degrade is a terrible legacy for our children to repair.
- **Per diems:** Can central agencies go some way in assisting provinces to meet the 12% increase in their costs that has arisen due to the increase in per diems rates? And can provinces develop good controls and planning to ensure that travel directly related to service delivery is seen as a budget priority.

- **Costing policy changes:** Can we build upon current practises and cost the impact of proposed policy changes? We need to anticipate the cost that new policy may have and identify where the increased recurrent budgets are to come from. This is particularly pertinent as we consider that today's development cost is tomorrow's recurrent cost. As we envision the future and record our aspirations we need to be mindful of the recurrent cost implications of our policies.
- **Parallel systems:** Donors can assist provinces and all those that play a role in the delivery of services by working through the provincial financial management systems and not creating alternate systems (such as trust accounts).
- **District Data:** We need to design and implement a robust and pragmatic form of data transfer between districts, provinces and the national level that enables district expenditure to be reported more easily, more regularly and more reliably.

NEFC will continue to monitor provincial expenditure on an annual basis and report back to Treasury and the Provinces. It is our intention that such expenditure monitoring leads to increased focus on service delivery and good use of the function grants from the national government.

The full report can be seen at [www.nefc.gov.pg](http://www.nefc.gov.pg)



## APPENDIX A DETERMINATION APPORTIONING THE EQUALISATION AMOUNT

SI 101/2010



*Inter-Governmental Relations (Functions and Funding)(2010 Budget Amendment) Act 2009.*

### DETERMINATION APPORTIONING THE EQUALISATION AMOUNT.

I, **PATRICK PRUAITCH**, Minister for Treasury and Finance, by virtue of the powers conferred by Item 2 of the Schedule of the *Inter-Governmental Relations (Functions and Funding)(2010 Budget Amendment) Act 2009* and all other powers me enabling hereby make the following determination:-

**1. TRANSITIONAL INDIVIDUAL PROVINCE GUARANTEES.**

For a fiscal year of the transition period, the proportion of the equalization amount for that fiscal year available for the total of the transitional individual province guarantees of all Provincial Governments is the sum of the following 2 amounts:-

- (a) K84,849,100 being the amount appropriated to all Provincial Governments in the fiscal year commencing on 1 January 2008 under the *Organic Law on Provincial Government and Local-level Government* for block grants, function grants and derivation grants; and
- (b) if the amount of GST distribution received by a Provincial Government for the fiscal year commencing 1 January 2008 under the *Goods and Services Tax Revenue Distribution Act 2003* is greater than the amount of GST distribution received by that Provincial Government for the relevant fiscal year of the transition period, the total of the differences between the 2 GST distribution amounts for each of those Provincial Governments.

**2. TRANSITIONAL INDIVIDUAL LOCAL LEVEL GUARANTEES.**

For a fiscal year of the transition period, the proportion of the equalization amount for that fiscal year available for the total of the transitional individual local level guarantees of all Local-level Governments is an amount of K38,984,200.

**3. LOCAL-LEVEL SHARE.**

For a fiscal year of the transition period, the local-level share, being the proportion of the equalization amount for that fiscal year available for distribution amongst Local-level Governments, is an amount equal to 2 per cent of that equalization amount.

1.2



4. **PROVINCIAL LEVEL SHARE.**

For a fiscal year of the transition period, the province share, being the proportion of the equalization amount for that fiscal year available for distribution amongst Provincial Governments, is the amount remaining after deducting from that equalization amount the total of the amounts calculated under Clauses 1, 2 and 3 for that fiscal year.

5. **MEANING OF TERMS.**

In accordance with Section 77 of the *Interpretation Act 1975*, the terms used in the determination have the same meaning as in the *Inter-Governmental Relations (Functions and Funding) (2010 Budget Amendment) Act 2009*.

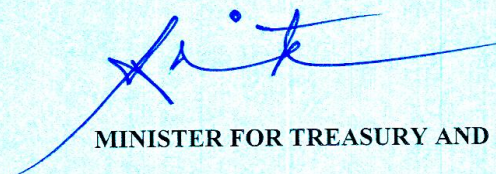
MADE this

18<sup>th</sup>

day of

May

, 2010.



MINISTER FOR TREASURY AND FINANCE.



## APPENDIX B: FUNCTION AND ADMINISTRATION GRANTS DETERMINATION



### *Intergovernmental Relations (Functions and Funding) Act 2009.*

#### FUNCTION AND ADMINISTRATION GRANTS DETERMINATION.

I, **Peter O'Neill**, Minister for Treasury and Finance, by virtue of the powers conferred by Section 64 and Clause 17 of the Schedule of the *Intergovernmental Relations (Functions and Funding) Act 2009* and all other powers me enabling, in consultation with the National Economic and Fiscal Commission, hereby make the following determination:-

#### 1. AMOUNT OF SERVICE DELIVERY FUNCTION GRANT AND ADMINISTRATION GRANT.

Subject to the approval of the Parliament, the amount of each service delivery function grant and administration grant to be made to a Provincial Government is the relevant amount set out in the attached table.

#### 2. SERVICE DELIVERY FUNCTION GRANTS.

(1) Service delivery function grants are provided to Provincial Governments to ensure that adequate funding is directed towards a minimum set of core services for all people across Papua New Guinea and consistent with the Government's Medium Term Development Strategy priorities.

(2) Service delivery function grants must not be used to fund salaries or capital development unless the budget allocated specifies that purpose.

#### 3. HEALTH FUNCTION GRANT.

(1) A health function grant must be used to fund operational and maintenance costs (i.e. goods and services) incurred in the primary health sector.

(2) Without limiting Subclause (1), a health function grant must be used to fund goods and services for the following main programs and activities:-

- (a) the distribution of medical supplies;
- (b) outreach services;

- (c) malaria supervision;
- (d) safe motherhood;
- (e) immunization;
- (f) water supply and sanitation;
- (g) health service monitoring, review and performance agreements.

#### **4. EDUCATION FUNCTION GRANT.**

(1) An education function grant must be used to fund operational and maintenance costs (i.e. goods and services) incurred in the basic education sector.

(2) Without limiting Subclause (1), an education function grant must be used to fund the operational costs for elementary and primary education that are within the responsibilities of a Provincial Government, such as:-

- (a) the maintenance of primary schools; and
- (b) the procurement and distribution of school materials; and
- (c) the operation of district education offices in the province.

#### **5. TRANSPORT INFRASTRUCTURE MAINTENANCE FUNCTION GRANT.**

(1) A transport infrastructure maintenance function grant must be used to fund operational and maintenance costs (i.e. goods and services) incurred in the transport infrastructure maintenance sector.

(2) Without limiting Subclause (1), a transport infrastructure maintenance grant must be used to fund the maintenance costs of provincial roads, bridges, jetties, wharves, airstrips and airfields that are within the responsibilities of a Provincial Government.

(3) A transport infrastructure maintenance grant must not be used to fund all or any of the following:-

- (a) the construction of new roads;
- (b) the maintenance of buildings;
- (c) the major reconstruction or rehabilitation of unusable existing roads, bridges, wharves, jetties, airstrips or airfields.

#### **6. VILLAGE COURT FUNCTION GRANT.**

(1) A village court function grant must be used to fund operational and maintenance costs (i.e. goods and services) incurred in the village court sector.

(2) Without limiting Subclause (1), a village court function grant must be used to fund the operational and supervision costs incurred in the village court sector for the purchase of goods and services, such as uniforms, flags and badges.

(3) A village court function grant must not be used to fund the costs of salaries or allowances for village court officials.

**7. PRIMARY PRODUCTION FUNCTION GRANT.**

(1) A primary production function grant must be used to fund operational and maintenance costs (i.e. goods and services) incurred in the agriculture sector.

(2) Without limiting Subclause (1), a primary production function grant must be used to fund primary production through support for supervision, training and extension activities to the agricultural, forestry and fisheries sectors, as well as for the export promotion of these products.

**8. OTHER SERVICE DELIVERY FUNCTION GRANT.**

An other service delivery function grant must be used to fund the recurrent goods and services costs for other sectors not covered by the service delivery function grants mentioned in Clauses 3 to 7, such as business development, community development and environment and conservation.

**9. ADMINISTRATION GRANT.**

An administration grant must be used to fund the costs of administrative overheads of a Provincial Government, excluding salaries.

MADE this 7th day of October, 2010.

  
Minister for Treasury and Finance



## Attachment A: 2011 Budget Function and Administration Grants Determination

## 2011 BUDGET FUNCTION AND ADMINISTRATION GRANTS DETERMINATION - KINA THOUSANDS

	Health Function Grant	Education Function Grant	Transport Infrastructure Maintenance Function Grant	Primary Production Function Grant	Village Courts Function Grant	Other Service Delivery Function Grant	Administration Grant	Total Provincial Government Grants	Urban LLG grants	Rural LLG grants	Total LLG Grants	GRAND TOTAL	2008 GST Guarantees transferred to 2011 function grants (a)
Western	879.1	893.5	1,658.9	618.1	127.6	141.0	141.0	4,459.2	608.2	1,484.3	2,092.5	6,551.7	1,385.0
Gulf	2,560.8	2,433.6	2,403.6	790.1	100.0	1,055.5	546.0	9,889.4	127.9	939.4	1,067.4	10,956.8	485.7
Central	2,407.2	3,005.3	3,562.8	325.1	153.9	1,270.4	404.8	11,129.4	0.0	1,514.0	1,514.0	12,643.4	384.7
Milne Bay	4,138.2	2,948.1	3,124.8	889.4	76.2	1,539.3	1,073.0	13,789.0	246.8	1,698.3	1,945.1	15,734.1	0.0
Oro	2,142.8	1,795.4	2,065.7	927.8	42.5	827.4	595.3	8,397.0	495.7	996.6	1,492.4	9,889.3	0.0
Southern Highlands	4,500.1	2,683.7	3,618.2	810.9	257.3	921.0	265.5	13,056.7	784.5	3,832.4	4,616.9	17,673.6	589.6
Enga	2,853.0	1,157.9	4,103.6	513.7	153.3	916.4	485.3	10,183.2	105.0	2,141.4	2,246.4	12,429.6	2,460.3
Western Highlands	3,362.4	4,357.3	4,278.4	1,366.6	274.3	757.5	455.8	14,852.4	695.7	2,913.5	3,609.3	18,461.6	0.0
Simbu	2,721.0	3,440.2	3,971.9	427.0	150.2	1,373.6	667.7	12,751.5	231.2	1,799.2	2,030.4	14,781.9	0.0
Eastern Highlands	3,236.0	3,707.9	5,177.8	1,203.1	153.0	1,391.8	1,090.0	15,959.6	656.7	2,838.0	3,494.6	19,454.2	0.0
Morobe	1,275.8	2,000.0	2,266.3	465.3	157.0	1,001.3	551.6	7,717.3	2,353.4	3,537.9	5,891.3	13,608.6	0.0
Madang	4,452.7	3,307.5	5,818.7	976.8	78.3	1,683.7	704.8	17,022.4	712.5	2,666.2	3,378.7	20,401.2	4,734.2
East Sepik	6,074.2	4,072.1	8,818.4	1,354.7	167.3	1,452.3	645.0	22,584.1	505.6	2,693.4	3,198.9	25,783.0	18.7
Sandaun	4,540.9	3,416.6	3,560.2	745.5	67.1	1,405.5	620.0	14,355.9	243.8	1,840.1	2,084.0	16,439.8	528.9
Manus	1,526.7	1,619.2	2,421.2	340.0	73.3	788.6	738.5	7,507.5	146.7	338.4	485.1	7,992.6	951.0
New Ireland	1,160.1	771.2	930.1	547.3	51.7	110.9	37.2	3,608.6	281.2	845.8	1,127.0	4,735.6	1,438.6
East New Britain	2,082.2	2,591.2	2,242.1	1,527.3	70.6	454.7	81.1	9,049.2	595.0	1,694.3	2,289.3	11,338.5	0.0
West New Britain	2,005.6	2,405.6	1,673.4	3,092.9	165.3	61.0	61.0	9,464.8	354.0	1,342.7	1,696.7	11,161.5	625.1
<b>TOTAL</b>	<b>51,918.7</b>	<b>46,606.2</b>	<b>61,696.2</b>	<b>16,921.7</b>	<b>2,318.9</b>	<b>17,152.0</b>	<b>9,163.4</b>	<b>205,777.0</b>	<b>9,144.0</b>	<b>35,116.0</b>	<b>44,260.0</b>	<b>250,037.0</b>	<b>13,601.8</b>

(a) This is the funding resulting from the changes to GST distribution arrangements under the new system. Under the new intergovernmental funding arrangement, Provincial Governments will receive 60% of net inland collections in their province. If Provincial Government's 2008 GST distribution is more than their GST distribution they will receive under the new arrangements in 2011, they will receive the difference between the two amounts as part of their goods and services National grant funding. This has no impact on the Budget as it is simply a shift in GST distributions from the IRC to grants.

Note: This does not factor in the additional funding required to cover the increase in per diem costs

## APPENDIX C: REVISED BUDGET AND EXPENDITURE INSTRUCTIONS



### DEPARTMENT OF TREASURY Office of the Secretary

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Vulupindi Haus  
PO Box 542, WAIGANI, NCD

## REVISED BUDGET AND EXPENDITURE INSTRUCTIONS

7 May 2010

To: The following officers in all Provinces, *except* the National Capital District and the Autonomous Region of Bougainville:

- Provincial Administrators
- Provincial Budget Officers
- Provincial Planning Officers
- Provincial Treasurers

*These instructions replace all previously issued Budget and Expenditure Instructions and come into effect on the date of issue.*

## CONDITIONS OF FUNDING, EXPENDITURE, ESTIMATION AND PROGRESS REPORTING FOR PROVINCIAL GOODS AND SERVICES GRANTS

### 1 Background

- 1.1 On Wednesday 16<sup>th</sup> July 2008, the National Parliament passed amendments to the *Organic Law on Provincial Governments and Local-level Governments* establishing a new system for funding goods and services in Provinces and Local Level Governments.
- 1.2 The new system covers goods and services grants for all Provinces, *except the National Capital District and the Autonomous Region of Bougainville* which are both subject to separate legislation.
- 1.3 Grants for personal emoluments continue to be determined through the normal Budget process.

### ***National Government Funding***

- 1.4 Under the new system, the amount of funding provided to Provincial and Local-Level Governments for goods and services is set at a specified percentage of actual revenue from two years preceding the Budget year. The legislation specifies the proportion of this net national revenue that should be provided.
- 1.5 This “share of net national revenue” approach ensures that, as “normal” revenues rise, funding to Provincial and Local-Level Governments will increase. On current forecasts, these new arrangements will lead to substantial and ongoing increases in funding. However, medium to long term funding levels largely depend on the overall performance of the economy.

### **Focus on functions**

- 1.6 The National Government has always provided funding to Provinces to perform particular functions. However, with the introduction of the revised system and substantially increased funding, the Government has more clearly defined the functions that Provinces are responsible for, and will establish reasonable conditions to link grant funding directly to those functions.
- 1.7 The intention is to ensure that funding is used as efficiently and effectively as possible to perform the vital basic services for which it is provided. To ensure that funds are used as intended, with a focus on improving service delivery to the people of Papua New Guinea, the new system allows the Treasury Secretary to issue Budget and Expenditure Instructions specifying what the funding has been provided for and how it is to be managed and used.

## **2 Purpose**

- 2.1 The primary objective of these Budget and Expenditure Instructions is to advise Provincial Administrations/Governments (Provinces) of:
  - the legal framework establishing these Budget and Expenditure Instructions;
  - the functions for which the service delivery function grants, administration grants and local level government grants are provided;
  - the minimum priority activities that Provinces are required to establish and report against;
  - how Provinces are to budget for the receipt and expenditure of goods and services grants;
  - how Provinces are to monitor and report on the expenditure of their goods and services grants;
  - the strict conditions under which unspent service delivery function grant funding may be rolled over from one year to the next; and
  - the penalties and sanctions that may be imposed if Provinces do not comply with the requirements set out in these Budget and Expenditure Instructions.
- 2.2 Provincial Administrators are responsible for ensuring that these Budget and Expenditure Instructions are complied with and must ensure that officers involved with preparing and executing Provincial Budgets are provided with copies of these Budget and Expenditure Instructions.

## **3 Legal Framework**

- 3.1 These Budget and Expenditure Instructions are issued under Section 65 of the *Intergovernmental Relations (Functions and Funding) Act 2009*, which was passed by Parliament in March 2009. Section 65 allows the Treasury Secretary to issue Budget and Expenditure Instructions that specify:
  - What grants, payments or other revenue are to be used for, and what Provinces are expected to achieve from spending these funds;
  - The timing and nature of expenditure of grants, payments or other revenue;
  - How grants, payments or other revenue are to be managed by Provinces;

- How the expenditure of grants, payments or other revenue is to be monitored and reported; and
  - The budget preparation process, including consultation with stakeholders.
- 3.2 Section 67 of the *Intergovernmental Relations (Functions and Funding) Act 2009* empowers the National Government to take serious actions if these conditions are not complied with.
- 3.3 These Budget and Expenditure Instructions will stay in force until they are withdrawn, replaced or superseded.

#### 4 Funding for Functions

- 4.1 Section 5 of the *Intergovernmental Relations (Functions and Funding) Act 2009* allows for service delivery functions and responsibilities to be formally assigned to Provinces and Local-Level Governments.
- 4.2 Furthermore, if a Province is determined to have a 'fiscal need', Section 28 of the *Intergovernmental Relations (Functions and Funding) Act 2009* requires the National Government to provide service delivery function grants and an administration grant to assist with meeting the recurrent costs of the *assigned* service delivery functions and responsibilities.
- 4.3 In June 2009, NEC approved a Function Assignment Determination which sets out the responsibilities of provincial and local-level governments. This clarifies the service delivery activities each tier of government is responsible for (assigned functions).
- 4.4 This means that National Government goods and services grants are **only** provided to contribute towards the costs of providing functions which are assigned to Provinces under the law. Provinces may choose to perform other functions, but will have to ensure that they have other sources of funding available.

##### ***Function Grant Funding only available for the stated purposes***

- 4.5 Service delivery function grants are only to be used for the recurrent costs of goods and services related to the specific function grant.
- 4.6 Under no circumstances are service delivery function grants to be used for salaries and other personal emoluments, casual wages, debt payments, legal settlements or capital projects.
- 4.7 Provinces may spend a service delivery function grant on the administrative costs that are *directly* related to performing the relevant service delivery function. For example, the health function grant can be used to support health administration, but not other types of administration.
- 4.8 Service delivery function grants cannot be transferred between different grant and expenditure types without the express approval of the Treasury Secretary.

##### ***Service Delivery Function Grants and Administration Grant***

###### ***Health Function Grant***

- 4.9 Provinces are responsible for the administration and routine maintenance of all rural health facilities in the Province, other than provincial hospitals, including health centres, rural aid posts and urban day clinics.

Their responsibility includes the delivery of basic recurrent health services such as drug distribution, health patrols, immunisation, supporting women during childbirth, and HIV/AIDS awareness activities.

#### *Education Function Grant*

- 4.10 Provinces are responsible for the administration and routine maintenance of elementary, primary and secondary schools (including provincial high schools), and vocational centres, including the delivery of basic recurrent education goods and services such as the purchase and distribution of school materials to schools and vocational centres, distribution of curriculum materials and supporting supervision activities of teachers and schools.
- 4.11 More emphasis should be placed on expenditure on elementary schools and primary schools than vocational schools and provincial high/secondary schools. The Education Function Grant should not be used to subsidise university fees. While this is a worthwhile objective, it *is not* a Provincial Government function. If a Province wishes to subsidise, or otherwise fund university education, it must use provincial government own source revenues.
- 4.12 The Education Function Grant is not to be used for the construction of new teachers' houses or classrooms; however, it may be used for routine maintenance of these facilities.

#### *Transport Infrastructure Maintenance Function Grant*

- 4.13 The Transport Infrastructure Maintenance Function Grant can only be applied to the maintenance costs of existing transport infrastructure in the Province, such as provincial roads, jetties/wharves, airstrips/airfields etc.
- 4.14 This grant must not be used for the construction of new roads or maintenance of buildings, or for major reconstructions of unusable existing roads. Routine maintenance of buildings, including schools, health facilities and administrative buildings must be funded out of the relevant function or administration grant.

#### *Village Court Function Grant*

- 4.15 The Village Court Function Grant is provided to assist with the goods and services costs associated with the administration, supervision and support for the village court system in the Province. This includes operational materials needed for day to day operations of the courts.
- 4.16 The grant is not to be used for the staffing costs of Village Courts, which are funded separately through the Village Courts Allowance Grant under the Province's Personnel Emoluments Budget.

#### *Primary Production Function Grant*

- 4.17 The Primary Production Function Grant is provided to further the development of subsistence, domestic trade and export commodities in the Province. This was previously known as the Derivation Grant or Agriculture Function Grant.
- 4.18 The Primary Production Function Grant provides funding for the recurrent cost of goods and services associated with agriculture and other primary production, including fisheries, livestock and forestry.



The grant covers activities such as extension services to farmers, farmer training, and the distribution of seeds and other technologies to farmers and fishermen.

#### *Other Service Delivery Function Grant*

- 4.19 The Other Service Delivery Function Grant is to provide goods and services funding for functions other than those which have a specific service delivery function grant. This includes business development, community development, natural resource management, sports, environment, disaster management and lands administration.

#### *Administration Grant*

- 4.20 In addition to the service delivery function grants, Provinces will receive an Administration Grant to assist them to meet the day-to-day operational costs of the Provincial and District Administrations.
- 4.21 This grant is provided for the core costs of the administration such as utilities, stationary and anti-virus programs. The administrative costs of specific sectors, such as health and education, are provided for under the respective service delivery function grants.
- 4.22 Under no circumstances is the administration grant to be used for salaries and other personal emoluments, casual wages, debt payments, legal settlements or capital projects, without the express approval of the Treasury Secretary.

#### *Local-level Government Grants*

- 4.23 Local-level Government Grants are provided for *goods and services* directly related to the functions for which rural and urban LLGs are responsible.
- 4.24 Since 2007, there is no longer a separate LLG Secretariat Grant. Secretariat wages, salaries and allowances are to be met out of the Staffing Grant.
- 4.25 Provincial governments are required to specifically budget from their internal revenue for the allowance costs of LLG councillors.

#### *Urban Local-level Government Grant*

- 4.26 Urban Local-level Government Grants are provided to fund the functions for which an urban LLG is responsible, such as town maintenance, cleaning, upkeep and urban beautification.

## **5 Minimum Priority Activities**

- 5.1 In addition to the general requirement that the service delivery function grants be used for goods and services for the assigned functions outlined above, from 2009 Provinces have been *required* to specifically fund a set of Minimum Priority Activities (MPAs).
- 5.2 The MPAs, which were determined in 2008 following consultation between Provinces, the National Economic and Fiscal Commission (NEFC) and the Department of Provincial and Local-level Government Affairs, are a minimum set of activities that *must* be funded out of each of the function grants.
- 5.3 The MPAs are not the only activities that can be funded, and in general Provinces would be expected to fund a broader range of activities out of each of their service delivery function grants. However, they are a core set of basic activities that most Provinces would be already expected to have in place.

- 5.4 In order to demonstrate that they are adequately funding these activities, Provinces will be required to establish programs/activities for each MPA within their Budget, and report regularly on performance against these activities throughout the year.
- 5.5 The minimum priority activities are:
- Primary Production**  
Agriculture Extension  
Fisheries Extension  
Forestry Extension
- Education**  
Distribution of school materials  
Supervision of schools by district and provincial officers  
Operation of district education offices
- Health**  
Rural Health Facilities  
Outreach Health Patrols & clinics  
Drug distribution
- Transport Infrastructure Maintenance**  
Road and bridges maintenance  
Airstrip maintenance  
For Mmaritime provinces – wharves and jetties maintenance
- Village Courts Operations**  
Provision of operational materials
- 5.6 The inter-departmental committee overseeing implementation of the reforms to intergovernmental financing arrangements has agreed and endorsed Indicators for MPAs which will serve as the standard performance assessment guide for Provincial Administrations. These indicators are included with this Instruction as “Attachment A”. Explanatory notes including definitions from NEFC are also attached for information and reference.
- 5.7 Provinces will be required to report on their performance against these indicators through the regular quarterly reporting process. This requirement will start with the second quarter review in 2010.

## 6 Provincial Budgets

- 6.1 Provinces are required to correctly budget for the receipt of National Government Grants for goods and services from the Recurrent Appropriation as well as the Development Budgets. The expenditures of these grants must be aligned to purposes/functions intended and identified programs.
- 6.2 The Provincial Budgets should be endorsed and enacted through an “Appropriation Act” by the Provincial Assembly and submitted in two parts; Part One reflecting expenditure estimates for the approved National Grants for both Recurrent & Developments Grants and; Part Two showing the expenditure estimates under Internal.

- 6.3 This means that Provinces will have to use the correct PGAS codes for both revenue and expenditure, clearly identify each grant in the Budget documents they submit to Treasury, and identify all of the programs/activities, including the MPAs, that the grants will be spent on.
- 6.4 Provinces should submit their draft budget for vetting to ensure that they comply with this Instruction soon after the circulation of the preliminary ceiling, given the level of certainty over the final figures that would be approved in the National Budget. Treasury officers within the Provincial Budget Branch will assist in the vetting process of the Provincial Budgets.

#### **Revenue - Correct PGAS Grant Codes**

- 6.5 With regard to revenue, the following Grant Types (codes) and function codes (FC) are to be used to identify each of the goods and services grants:

Grant Type (Code)	Function Code	Grant Description (Name)
1	1	Administration Grant
1	9	Other Service Delivery Grant
2	1	Staffing Grant
2	4	TSC Teachers' Salaries Grant
2	1	Public Servants Leave Fares Grant
2	4	Teachers' Leave Fares Grant
2	5	Village Court Allowances Grant
3	2	Primary Health Services Function Grant
3	3	Primary Production Function Grant
3	4	Basic Education Function Grant
3	5	Village Court Function Grant
3	6	Transport Infrastructure Maintenance Function Grant
4	7	Rural Local Level Government Grant
5	7	Urban Local Level Government Grant

Projections for Internal Revenue should be realistic and there should be a high degree of certainty for the realisation of those projections. It is advisable to exclude political commitments as well as sector programs that involve financing from uncertain Internal Revenue projections.

#### **Expenditure - Correct PGAS Activity Codes**

- 6.6 Provinces must also ensure that programs/activities are established to expend the goods and services grants. As a minimum, this will mean that all Provinces will have to establish, and account for expenditure against, each of the MPAs.
- 6.7 Provinces must ensure that each activity, including each MPA, has its own activity code in their future Budgets submitted to the Department of Treasury, and that these activity codes are consistent with the standard chart of accounts guide, "Attachment B" of this instruction.
- 6.8 Before submitting the Budgets for ministerial approval, Provinces should consult with Budget Division in the Department of Treasury to ensure consistency with the correct chart of accounts for the programs and activities they will fund, including the MPAs.

- 6.9 If a Province submits a Budget that does not comply with the requirements regarding activity codes, it will be returned to the Province for correction before it will be considered for approval by the Treasurer.

## 7 Monitoring and Reporting on Performance

- 7.1 At this stage, all additional reporting requirements, such as reporting on performance in the MPAs and reporting on expenditure of rolled over funds, will be met by the regular quarterly reporting process.
- 7.2 Section 5 of the *Public Finances (Management) Act* 1995 requires Provinces to report each quarter on their financial performance. However, despite this, Treasury is concerned that Provinces regularly fail to submit their reports on time.
- 7.3 Provincial governments must report on service delivery, so that the Government is satisfied that the funding provided is being spent for the benefit of the people. Under the revised funding system, Provinces that fail to report as required may be subject to a range of sanctions, as outlined in Section 9, below.
- 7.4 In 2009, the Department of Treasury, with NEFC and the Department of Provincial and Local-level Government Affairs, consulted with Provinces about introducing a range of relevant performance indicators for the MPAs and has introduced the MPA Indicators endorsed by the Inter Departmental Committee as highlighted in section 5.5 above and outlined in Attachment A.
- 7.5 Provinces will be required to report against these indicators from second quarter of 2010.

## 8 Restrictions on Rollovers

### ***General restrictive approach to Function Grants Rollovers***

- 8.1 As outlined in section 4 above, service delivery function grants are provided by the National Government for specific purposes, with the intention that they be spent on the function for which they are provided within the year they are provided.
- 8.2 In the normal course of business, Provinces should actively work towards spending their service delivery function grants throughout the Budget year. In the event that Provinces do not fully spend their Function Grants, they should 'roll-over' the unspent National Government funds into specific Revenue Heads in the Internal Revenue ('700 Series') estimates.
- 8.3 It is a *strict* condition that these funds remain in the core priority sectors for which these were provided. For example, rolled over Health Function Grants must *only* be used on recurrent goods and services relevant to primary health care.
- 8.4 To ensure they are used as intended, unused funds from previous year must be rolled over into one of the following four specific revenue votes for current/(budget) year:
- Administration Health Function Grant Former Year's Appropriation;
  - Other Service Delivery Grant Former Year's Appropriation;
  - Health Function Grant Former Year's Appropriation;
  - Education Function Grant Former Year's Appropriation;
  - Transport Infrastructure Maintenance Function Grant Former Year's Appropriation;

- Primary Production Function Grant Former Year's Appropriation; and
- Village Court Operations Function Grant Former Year's Appropriation.

8.5 Where a Province intends to roll over one or more service delivery function grants, it must include accurate estimates of the rollover in its Provincial Budget, with the rolled over funds shown against the relevant revenue vote from paragraph.

The Department of Treasury will not approve Budgets that fail to clearly roll over unspent function grants into the correct revenue votes.

8.6 If a Province continually fails to fully spend its service delivery function grants, it Treasury will consider re-allocating the funds to a Province with a better track record.

## **9 Penalties for Non-Compliance with Budget and Expenditure Instructions**

9.1 Provinces must ensure that they comply with these Budget and Expenditure Instructions when developing, presenting and executing their Budgets.

9.2 Where a Province submits, for approval, a Budget that does not comply with the conditions in these Budget and Expenditure Instructions, it will be returned to the Province for correction before it is considered for approval by the Treasurer.

9.3 Furthermore, there are a range of possible sanctions set out in Section 67 of the *Intergovernmental Relations (Functions and Funding) Act 2009*. These include:

- The Treasury Secretary may issue a non-compliance notice under the legislation outlining:
  - the circumstances of the non-compliance;
  - the action required to be taken to rectify the non-compliance;
  - the date by which the action must be undertaken; and
  - any additional reporting requirements;
- The Treasurer may make a written determination to the Province for all or any of the following purposes:
  - specifying how the expenditure of the grant is to be managed;
  - requiring expenditure to be supervised or authorised by a person or body specified in the determination;
  - delaying the making of any further grants or payments to the Provincial Government, until such time as is specified in the determination; or
  - requiring the Provincial Government to repay an amount specified in the determination.
  - redirecting funding to Functions with the capacity to effectively spend the funds for service delivery.

## 10. Contact Officers

Should you require any further clarification, do not hesitate to contact the following officers;

Lazarus Enker	312 8739
Gima Rupa	312 8784
Dessie Kuburam	312 8786
Michael Awi	312 8788
Linus Wafi	312 8785
Richard Lucas	312 8787

## 11. Conclusion

I urge all Provinces to comply with this Budget & Expenditure Instructions for effective and timely approval and implementation of all future Budgets.



**ALOYSIUS HAMOU**  
Acting Secretary

*Attachment A: Quarterly Performance Reporting - Minimum Priority Activity Indicators*  
*Attachment B: Chart of Accounts Guide for Minimum Priority Areas*

*“Attachment A”***Quarterly Minimum Priority Activity Indicators**

<b>Minimum priority activities (MPAs)</b>	<b>Agreed indicators</b>
<b>Health</b>	
1. Operation of rural health facilities	i. Total Number and Names of all health facilities (HFs) ii. No. of health facilities (HFs) open & staffed iii. Number of HFs with access to running water in labour ward
2. Outreach Health clinics and Patrols	i. Total number of health clinics and patrols conducted ii. Number of administrative supervision patrols to HFs iii. Number of patrols with specialist medical officers to HFs iv. Number of maternity child health patrols to HFs
3. Drug Distribution	i. Number of months HFs stocked with essential supplies in last quarter
<b>Education</b>	
1. Provision of school materials	i. Total number of schools by type ii. % of schools that received basic school supplies before 30 April
2. Supervision by provincial/district officers	i. Number of schools visited by district/provincial education officers
3. Operation of district education offices	i. Number of District Education Offices that provided quarterly performance reports to Provincial Education Officers
<b>Transport Maintenance</b>	
1. Road and bridge maintenance	i. Names and length of provincial roads maintained ii. Names of bridges maintained
2. Airstrip maintenance	i. Names of rural airstrips maintained
3. Wharves and jetties maintenance	i. Names of wharves, jetties and landing ramps maintained
<b>Primary Production</b>	
1. Extension activities for agriculture, fisheries and forestry	i. Number of extension patrols and training sessions conducted ii. Number of people who attended extension and training sessions
<b>Village Courts</b>	
1. Provision of operational materials	i. Number of village courts in active operation ii. Number of village courts supplied with operational materials

*“Attachment B”***Chart of Accounts Guide for MPAs**

The Provincial Chart of Accounts has 14 digit Coding, i.e.

**Sample Chart of Accounts**

Sample Chart of Accounts																	
A				B			C			D		E	F	G			
1	2	3	-	4	5	6	7	-	8	9	10	11	-	12	13	14	

Part A – Digits – 1,2,3

= Division Identification  
e.g: 271 – Western Province

Part B – Digit – 4

= Activity or Project Code  
i.e: ‘1’ = Activity (Recurrent Expenditure)  
‘2’ = Project (Development/Capital Expenditure)

Part C – Digits – 5,6,7

= Cost Centre (Location of Expenditure)  
i.e: PHQ, District & Local Level Government

Part D – Digit – 8

= Grant Code (refer to Section 6.5 of Revised BEI 09, pg 7)  
e.g: ‘1’ for Administration Grant  
‘3’ for Function Grants  
‘4’ for Rural LLG Grant

Part E – Digit – 9

= Function Code (refer to Section 6.5 of Revised BEI 09/10, pg 7)  
e.g: ‘1’ for Administration  
‘2’ for Health Function  
‘3’ for Primary Production Function  
‘4’ for Education Function

Part F – Digits – 10, 11

= Activity/Project/Programme  
Numbers – 01 to 99

Part G – Digits – 12,13,14

= Expenditure Item Code

**Eg:**

Activity Description:  
Correct Vote:

**Operations of Kerowagi District Education Office**  
280 – 1050 – 3210 – 123  
i.e. 280 for Simbu Province  
‘1’ for Recurrent Activity  
‘050’ for Kerowagi District  
‘3’ for Function Grant  
‘2’ for Education Function  
‘10’ District Education Office Operations &  
‘123’ Office Materials & Supplies