

National Economic and Fiscal Commission

# 2013 Budget Fiscal Report

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## **FOREWORD**

The National Economic and Fiscal Commission (NEFC) is required each year to provide to the Minister a report on the workings of the Commission and details of its annual grant recommendations. This 2013 Annual Fiscal Report is specifically issued in accordance with Section 117 (9) of the Intergovernmental Relations (Functions and Funding) Act 2009 and is required to be tabled in the Parliament by the Minister.

The reforms to the Intergovernmental Financing Arrangements have been in operation since 2009 after passage of major Amendments to the *Organic Law on Provincial Governments and Local-level Governments* and the introduction of the *Intergovernmental Relations (Functions and Funding) Act 2009*.

In essence, the new system did away with the constitutional grants that were based on an equal kina per head arrangement and replaced them with an equalization based provincial and local government funding system that takes into consideration the internal revenue of provinces as well as the costs of delivering basic services. The amount of revenue that a province is able to generate will have an impact on their ability to deliver basic services. Similarly provinces experience differences in the cost of providing the same services due to influences outside their control. For example, a province that is linked by good transport networks will be lower cost in comparison to those provinces that have poor transport networks.

There has been a significant increase in the level of funding to provinces and local level governments over the last 4 years. This has increased the ability of provinces to improve service delivery, particularly those provinces that were unable to generate adequate internal revenue. The Provincial Expenditure Review (PER) reports which the NEFC has released over the last 6 years confirms this. Given the increase in the level of funding, the onus now lies in the hands of the public servants at both national and sub-national levels to ensure that service delivery takes place.

The National Agencies must continue to ensure that there is an adequate level of monitoring and review over the implementation of government initiatives. At the same time the various provincial administrations must ensure there is proper planning, budgeting and spending to ensure that the ordinary villager at the end of the chain receives access to basic health services, education and transport. That represents a basic function of any responsible government in society.

One of the crucial roles that the NEFC plays is to effectively report on the performance of the provinces through our various analytical papers and publications which includes this Fiscal Report.

Some of the areas of concern include delays in data being made available for use in our various publications. For instance, delays in the availability of PGAS and Warrant Release data from the departments of Finance and Treasury have hampered our efforts to have these reports published on a timely basis.

The lack of capacity in some provinces continues to hamper the capability to fully utilise the increased funding and to effectively sustain service delivery. The inclusion of two new provinces, Hela and Jiwaka will also impact the overall funding available with a reduced envelope to share between all provinces.

I am pleased to report that the 2011 Cost of Services Study which is in follow up to the first study conducted 2005 study is in the process of being finalised. The updated data will be incorporated into grant funding calculations to take effect from 2014.

Overall it is my hope that the various publications that the NEFC produces will enable even the ordinary villager to become an informed recipient of government services, so much so that he or she may now be in a position to demand from the relevant authorities, improvements in those basic rural services.

In conclusion, the constitutional grants to provinces and local level governments which the NEFC closely monitors in collaboration with the Departments of Treasury, Finance and Provincial Affairs, only comprises of just under 4% of the entire national recurrent budget. I continue to be of the view that if a similar level of rigorous scrutiny is placed on over the remaining other 96% of the budget, significant amount of funds may be saved and ploughed back into service delivery for the benefit of a majority of PNG's population.

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 intergovernmental financing system approved by Parliament on 16 July 2008 and the Ordinary Act<sup>1</sup> 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.

Under the Ministerial Determination for 2013, the equalisation amount is K394.2 million, an increase of K86.3 million from Budget 2012. The Determination provides for a guaranteed amount for each provincial and local-level government, the equivalent of K91.67 million for provincial governments and K38.9 million for local-level governments.

Under the transition guarantee embedded into 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 K263.6 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 and 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 2013 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 2013.

In determining the “need” of a province, all revenues received are counted, and then compared with the NEFC’s estimated costs to deliver basic 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 2012 as K396.9 million, an increase of K16.2million from 2012. 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 on the update to the cost of services study is presently in the process of being completed and will be used in the 2014 Budget onwards.

After estimating the costs of services and assessed revenue, the fiscal needs of provinces and 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).

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<sup>1</sup> Intergovernment Relations (Functions and Funding) Act 2009



A Provincial and Local Level government Service Monitoring Authority (PLLSMA) sub-committee finalised a review on function assignments in 2009 which gave a clear understanding on the distribution of responsibilities among the three tiers of government to avoid confusion, on who is responsible for what function, 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 Department of 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 for their originally intended purposes. The budget and expenditure instructions are intended to go beyond the requirement to just budget for eleven (11) Minimum Priority Activities. From 2010 provinces were required to report against specific indicators in order to demonstrate actual performance. A review by the Commission on compliance shows that provinces are becoming increasingly familiar using and duly 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" and 2010 Step Two 'The Ripple Effect' reemphasises that provincial governments and administrations need to address the 'priority gap' by choosing to re-allocate their own resources to support the MTDS priority sectors. Furthermore, provinces can use the NEFC Cost of Services study data as a guide as to how much recurrent funding is required to deliver core services in their province.

In conclusion, the Government, through the new system of intergovernmental financing has started to address the funding gap faced by most of the provinces. It is now important that provinces also need to do their part in ensuring that additional funds are spent wisely and that they better prioritise the funding already available to them in order to further 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.

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 equalization 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%
2014 et seq	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.

The 2013 year will be last year of the RIGFA. This means, that with effect from 2014 et seq, the percentage applied to the NNR will continue to be 6.57%. NEFC is currently reviewing the overall impact of the equalization system after the end of the transition which ends in 2013.

## 1.1 Calculation of the Equalisation Amount 2013

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 equalization amount each fiscal year for the coming fiscal year and to provide this estimate to the Treasury Departmental Head on or before 31 March. This estimate of the equalization 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 2013 was calculated using tax revenue data from 2011 (the second preceding fiscal year) in accordance with the following formula.

<b>General tax revenue for 2011</b>	<b>-</b>	<b>Mining and petroleum tax revenue for 2011</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 2011 Final Budget Outcome published by the Department of Treasury in March 2012.

The following table shows how the NNR amount for 2013 is calculated.

Act definition	Final Budget Outcome equivalents	Kina million
1. 2011 General tax revenue	Tax revenue	<b>K 7,904.2</b>
<b>MINUS (-)</b>		
2. 2011 Mining and petroleum tax revenue	1. Mining and petroleum taxes	K 1,930.2
	2. Mining levy	K0.0
	<b>TOTAL</b>	<b>K 1,930.2</b>
<b>EQUALS (=)</b>		
3. 2013 Net National Revenue Amount		<b>K 6,001.0</b>

For 2013 Budget, the minimum funding level for the equalization amount is calculated according to the following formula in Kina million:

$$\begin{array}{rclclcl}
 \text{Net national revenue for 2011} & \times & 6.57\% & = & \text{NEFC estimate of 2013 equalisation amount} \\
 \\ 
 \text{K 6,001.0} & \times & 6.57\% & = & \text{K 394,265.7}
 \end{array}$$

In accordance with the Act, the NEFC provided a written estimate of the equalization amount to the Secretary for Treasury on 31 March 2012.

If the Government wishes 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 (2014)

As noted above, the percentage that is applied to the NNR amount has gradually increased over the transition period. Combined with strong growth in national government revenue, this has resulted in an increase of funding available for provincial governments and local-level governments each year over the first five years of the new system.

NEFC is currently reviewing the impact of the equalization system after the end of the transition which ends in 2013. If it is anticipated that the transition system does not have a significant impact on financial capacity of provinces then the NNR percentage of 6.57% will continued to be applied 2014 et seq. The estimated projection for 2014 is therefore provided below based on this assumption.

The following table provides preliminary projections of the estimated equalization amount for 2014 using the annual budget outcome data for previous years

Table: Projections of Equalization Amount 2009 – 2014 (K'million)



	2009 act	2010 act	2011 act	2012 act	2013 act	2014 est*
General tax revenue (from second preceding year)	5853.9	5,756.1	4,974.5	6,434.7	7,904.2	8,519.7
<b>MINUS (-)</b>						
Mining and Petroleum taxes (from second preceding year)	2333.9	1,961.8	693.10	1,476.3	1,903.2	1872.1
Mining Levy	56.6	11.4		0	0	0
<b>EQUALS (=)</b>						
NNR Amount	3463.4	3,782.9	4,281.5	4,958.4	6,001.0	6,647.6
<b>MULTIPLIED BY (x)</b>						
Percentage to be applied to NNR Amount	5.12%	5.48%	5.84%	6.21%	6.57%	6.57%
<b>EQUALS (=)</b>						
Equalization Amount	177.3	207.3	250.0	307.9	394.3	436.7

\*Estimate based on 2012 Budget forecasts

## 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 final year of implementation of the equalization system, the Ministerial Determination that was issued by the Treasurer splits the equalization amount of **K 394.2 million** as follows;

Table: Equalisation Amount by level of government (K, millions)

Equalisation amount	394.2
Provincial governments	
Amount for funding transitional individual province guarantees	91.7
Province Share (to be distributed on an equalisation basis)	251.8
Sub-Total	343.5
Local level governments	
Amount for funding transitional individual local-level guarantees	39.0
Local-level share (to be distributed on an equalisation basis)	11.8
Sub-Total	50.8

## ***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 2013 the amount ‘converted’ from GST transfers to service delivery grants is K 6.8 million for all provinces.
- In 2013 total funding for transitional individual province guarantees for all provincial governments is K 91.7 million.

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

The total amount for funding transitional individual province guarantees is:

- K84.8 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 (2013) 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 2013 the proportion of the equalization amount available for the total of the transitional individual local level guarantees is K38.98 million.

### **(v) Local Level Share**

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

Overall, local-level governments when compared to 2008 levels will receive additional funding of K11.8 million in 2013.

#### **(iv) Provincial Share**

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

	<b><i>K'million</i></b>	<b><i>% of EA</i></b>
<b><i>Equalization Amount (EA)</i></b>	<b><i>394.2</i></b>	<b><i>100%</i></b>
<i>(i) Total amount for funding transitional individual province guarantees</i>	<i>91.6</i>	<i>23%</i>
<i>(ii) Total amount for funding transitional local level guarantees</i>	<i>39.0</i>	<i>10%</i>
<i>(iii) Local level share – 3% of EA</i>	<i>11.8</i>	<i>3%</i>
<b><i>(iv) Province share – remaining funding from EA after paying (i), (ii) and (iii)</i></b>	<b><i>251.8</i></b>	<b><i>64%</i></b>

All these components are funded from the equalization 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 increased 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 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 for 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 of legislation was conducted, 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 confusions 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 Department of Provincial and Local-level Government Affairs is responsible for implementation.

### 3.3 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 2013 distribution year, 2011 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>2</sup>

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<sup>2</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. 2010).

### **Bookmakers Tax**

Bookmakers Tax received by provincial governments is 100% of the revenues collected in the province in the second preceding year.

The Commissioner General of IRC and the Secretary of Department of Finance are appointed trustees under Section 46 of the *Intergovernmental Relations (Functions and Funding) Act 2009*. The distribution of the bookmakers proceeds has yet to be distributed requiring an amendment to Gaming Act. This has not progressed further despite NEFC raising this issue the IRC, DoF and DoT. As a result Bookmakers tax has not been distributed to provinces since 2009. NEFC will pursue this further with the new government. Currently the undistributed bookmakers tax to be distributed to provinces is held in a trust account by the IRC.

Table 3 below provides the estimate of revenues available to provincial governments for service delivery as collected in the second preceding year (i.e. 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 2011 (the second preceding year), provinces raised K 50.1 million<sup>3</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.

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

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<sup>3</sup> This excludes Bookmakers Tax

## 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.

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 2011 (the second preceding year), NEFC estimates that provinces received K 171.2 million from royalty and dividend payments.

This data has been sourced directly 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 2011 (K '000)**

	GST Distribution	Bookmaker s Tax	Own Source Revenues	Royalties	Dividends	Total
West. Province	9,683		410	42,900	23,600	76,593
Gulf	302		110		2,505	2,917
Central	2,162		6,433	2,469		11,064
Milne Bay	4,267		1,719			5,986
Oro	2,012		328			2,340
South. Highlands	5,014		69	30,830		35,913
HELA	-	-	-	-		-
Enga	877		3,119	19,103		23,099
West. Highlands	11,746	524	3,739			16,010
JIWAKA	-	-	-	-	-	-
Simbu	3,182		1,070			4,252
East. Highlands	14,665	436	1,642			16,743
Morobe	55,475	953	8,042	22,988		87,458
Madang	7,030	906	1,943			9,878
East Sepik	4,126		2,398			6,524
Sandaun	1,398		2,067			3,466
Manus	711		2,768			3,479
New Ireland	4,394	-	1,210	26,788		32,392
East New Britain	10,191	331	3,033			13,555
West New Britain	6,739	105	10,003			16,848
<b>Total</b>	<b>143,973</b>	<b>3,256</b>	<b>50,105</b>	<b>145,079</b>	<b>26,105</b>	<b>368,517</b>

## 2013 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<sup>4</sup>.

### 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 2013 (Kina '000)**

	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	3,074	9,683	-	205	34,320	11,800	59,082
Gulf	3,660	302	-	55	-	1,253	5,269
Central	3,578	2,162	-	7,112	1,975	-	14,828
Milne Bay	3,914	4,267	-	859	-	-	9,040
Oro	2,983	2,012	-	164	-	-	5,159
South. Highlands	7,103	5,014	-	35	24,664	-	36,816
HELA	-	-	-	-	-	-	-
Enga	6,506	877	-	1,560	15,283	-	24,225
West. Highlands	7,204	11,746	524	1,869	-	-	21,344
JIWAKA	-	-	-	-	-	-	-
Simbu	4,280	3,182	-	535	-	-	7,997
East. Highlands	6,920	14,665	436	821	-	-	22,842
Morobe	7,717	55,475	953	4,021	18,391	-	86,557
Madang	9,465	7,030	906	972	-	-	18,372
East Sepik	6,011	4,126	-	1,199	-	-	11,336
Sandaun	3,549	1,398	-	1,034	-	-	5,980
Manus	1,879	711	-	1,384	-	-	3,974
New Ireland	2,170	4,394	-	605	21,431	-	28,599
East New Britain	4,667	10,191	331	1,517	-	-	16,705
West New Britain	6,989	6,739	105	5,002	-	-	18,835
<b>Total</b>	<b>91,669</b>	<b>143,973</b>	<b>3,256</b>	<b>28,948</b>	<b>116,063</b>	<b>13,053</b>	<b>396,961</b>

<sup>4</sup> The practice by NEFC to use the above percentages of 80% of royalties and 50% of dividends is included in the Regulations of Intergovernmental Financing (Functions and Funding) Act. The application of the percentage is subject to a periodic review by the NEFC and adjustments made if necessary.

### 3.4 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:

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

where:-

“*estimated recurrent cost of assigned service delivery functions and responsibilities*” are the estimated recurrent cost for the provincial government in performing its assigned service delivery functions and responsibilities for the fiscal year, including the necessary and incidental costs of administration for 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 -

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

where:-

“*estimated recurrent cost of assigned service delivery functions and responsibilities*” are the recurrent cost to the local-level government for 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;

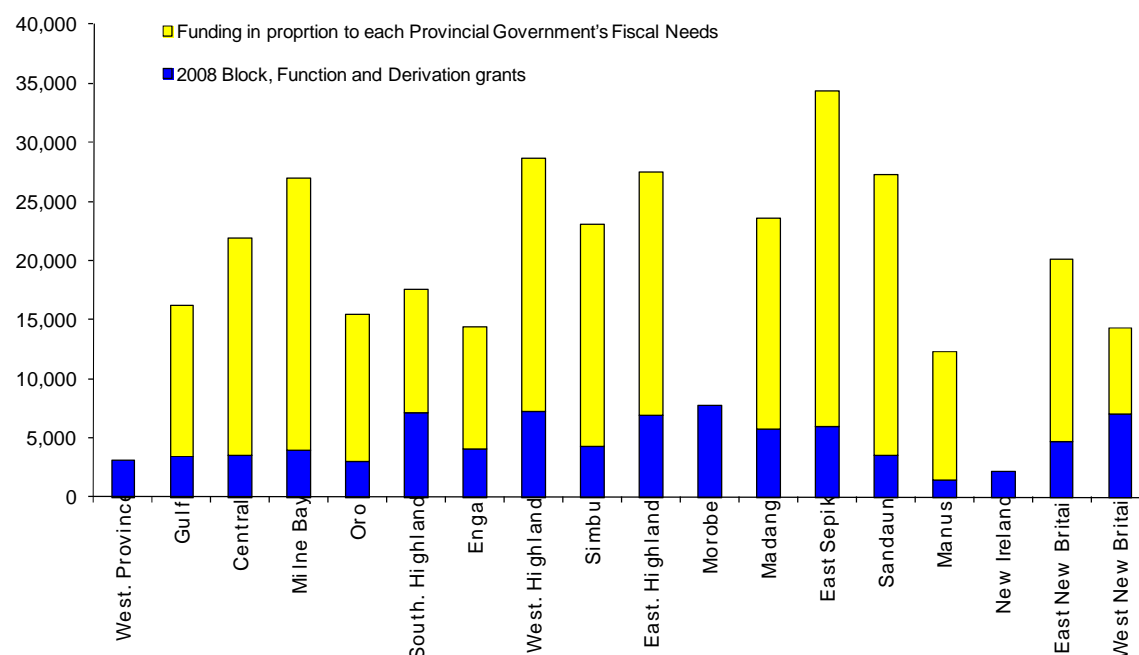
“*assessed revenue*” is the amount of revenue that the NEFC considers to be available to the local-level government for meeting the recurrent cost of its assigned service delivery functions and responsibilities for the fiscal year.



**Table 5: Fiscal Needs of provinces for 2013 (Kina '000)**

Province	Estimated costs	Assessed revenues	Fiscal needs	% of total fiscal needs
West. Province	43,734.4	59,082.5	0.0	0.0%
Gulf	18,806.0	5,268.8	13,537.2	5.1%
Central	34,191.8	14,827.8	19,364.1	7.3%
Milne Bay	33,467.7	9,039.8	24,428.0	9.2%
Oro	18,366.5	5,159.2	13,207.2	5.0%
South. Highlands	47,934.5	36,815.5	11,118.9	4.2%
HELA	0.0	0.0	0.0	0.0%
Enga	35,183.6	24,225.4	10,958.2	4.1%
West. Highlands	44,036.6	21,343.9	22,692.7	8.5%
JIWAKA	0.0	0.0	0.0	0.0%
Simbu	27,920.7	7,997.3	19,923.4	7.5%
East. Highlands	44,657.2	22,842.3	21,815.0	8.2%
Morobe	56,691.9	86,557.1	0.0	0.0%
Madang	37,245.6	18,371.7	18,873.9	7.1%
East Sepik	41,336.8	11,336.0	30,000.8	11.2%
Sandaun	31,111.4	5,980.4	25,131.0	9.4%
Manus	15,520.3	3,973.9	11,546.4	4.3%
New Ireland	21,895.6	28,599.4	0.0	0.0%
East New Britain	33,050.7	16,705.0	16,345.6	6.1%
West New Britain	26,592.1	18,835.3	7,756.8	2.9%
<b>TOTAL</b>	<b>611,743.5</b>	<b>396,961.1</b>	<b>266,699.3</b>	<b>100%</b>

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 2013 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;

“equalization 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: 2013 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	3,074.2	0.0	0%	0.0	3,074.2
Gulf	3,659.7	13,537.2	5%	12,780.1	16,439.8
Central	3,578.3	19,364.1	7%	18,281.2	21,859.5
Milne Bay	3,913.7	24,428.0	9%	23,061.9	26,975.6
Oro	2,983.2	13,207.2	5%	12,468.6	15,451.8
South. Highlands	7,103.2	11,118.9	4%	10,497.1	17,600.3
HELA	0.0	0.0	0%	0.0	0.0
Enga	6,506.4	10,958.2	4%	10,345.4	16,851.8
West. Highlands	7,203.8	22,692.7	9%	21,423.7	28,627.5
JIWAKA	0.0	0.0	0%	0.0	0.0
Simbu	4,280.2	19,923.4	7%	18,809.2	23,089.4
East. Highlands	6,919.8	21,815.0	8%	20,595.0	27,514.8
Morobe	7,717.2	0.0	0%	0.0	7,717.2
Madang	9,464.9	18,873.9	7%	17,818.4	27,283.4
East Sepik	6,010.6	30,000.8	11%	28,323.0	34,333.6
Sandaun	3,548.5	25,131.0	9%	23,725.5	27,274.0
Manus	1,879.1	11,546.4	4%	10,900.7	12,779.8
New Ireland	2,170.0	0.0	0%	0.0	2,170.0
East New Britain	4,666.9	16,345.6	6%	15,431.5	20,098.4
West New Britain	6,989.4	7,756.8	3%	7,323.0	14,312.4
<b>TOTAL</b>	<b>91,669.2</b>	<b>266,699.3</b>	<b>100%</b>	<b>251,784.3</b>	<b>343,453.5</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 is 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;

“equalization 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 the 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 is 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 2013(K'000)**

<b>Province</b>	<b>Individual Urban LLG</b>	<b>Individual Rural LLG</b>	<b>TOTAL</b>
WESTERN	698.3	1,929.8	2,628.0
GULF	146.9	1,104.4	1,251.3
CENTRAL	0.0	1,753.8	1,753.8
MILNE BAY	283.3	2,044.7	2,328.0
ORO	569.1	1,204.6	1,773.7
SOUTHERN HIGHLANDS	647.8	2,759.3	3,407.0
HELA	252.8	1,495.7	1,748.6
ENGA	120.6	2,355.5	2,476.1
WESTERN HIGHLANDS	798.7	1,707.8	2,506.5
JIWAKA	0.0	1,360.2	1,360.2
SIMBU	265.5	1,934.1	2,199.5
EASTERN HIGHLANDS	753.9	2,922.7	3,676.6
MOROBE	2,701.7	4,076.0	6,777.7
MADANG	818.0	3,053.7	3,871.7
EAST SEPIK	580.4	3,171.5	3,751.9
SANDAUN	280.0	2,452.4	2,732.3
MANUS	168.4	424.9	593.3
NEW IRELAND	322.9	965.3	1,288.2
EAST NEW BRITAIN	683.1	2,069.1	2,752.2
WEST NEW BRITAIN	406.4	1,528.9	1,935.3
<b>TOTAL</b>	<b>10,497.6</b>	<b>40,314.6</b>	<b>50,812.2</b>

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 287 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 2013 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 2013 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 2013.

**Table 8: 2012 Function and Administration Grants Determination**

Province	Health Function Grant	Education Function Grant	Transport Infrastructure Maintenance Function Grant	Primary Production Function Grant	Village Courts Function Grant	Other Service Delivery Function Grant (b)	Administration Grant (b)	Total Provincial Government Grants
Western	781.4	657.3	1,048.1	414.0	86.8	43.3	43.3	3,074.2
Gulf	3,723.7	2,998.9	4,969.1	1,152.2	195.2	2,568.9	831.8	16,439.8
Central	4,277.9	3,570.7	8,590.7	1,345.8	423.5	2,596.1	1,054.7	21,859.5
Mlne Bay	5,535.8	6,977.7	6,657.8	1,870.7	339.9	4,520.6	1,073.0	26,975.6
Oro	3,757.4	3,529.3	4,154.4	1,310.4	83.2	2,021.7	595.4	15,451.8
Southern Highland	3,234.1	2,567.5	3,280.3	771.0	296.6	1,148.2	173.4	11,471.0
Hela	1,848.0	1,478.4	1,540.0	431.2	123.2	616.0	92.4	6,129.3
Enga	3,779.1	1,470.4	7,697.2	1,002.8	368.2	2,000.3	533.8	16,851.8
Western Highland	3,067.9	4,549.7	5,759.0	817.6	265.5	1,292.2	266.9	16,018.8
Jiwaka	2,141.3	3,526.9	4,786.5	755.8	201.5	1,007.7	188.9	12,608.7
Simbu	4,134.0	6,069.3	7,579.8	1,209.4	346.6	2,893.1	857.2	23,089.4
Eastern Highlands	4,788.8	5,648.4	10,397.0	1,528.1	1,032.1	2,921.3	1,199.0	27,514.8
Mbrobe	1,275.8	2,000.0	2,266.3	465.3	157.0	1,026.0	526.8	7,717.2
Madang	5,954.8	5,161.7	8,363.4	2,497.8	343.9	4,069.6	892.2	27,283.4
East Sepik	8,197.7	6,646.0	12,303.0	2,167.4	528.3	3,485.2	1,006.0	34,333.6
Sandaun	5,935.4	7,498.4	6,757.5	2,611.9	302.6	3,230.7	937.6	27,274.0
Manus	2,544.6	2,669.7	3,560.6	726.0	229.8	2,154.9	894.1	12,779.8
New Ireland	783.7	555.4	496.1	230.8	27.7	50.9	25.3	2,170.0
East New Britain	3,883.4	6,343.4	4,501.5	1,610.3	208.6	3,404.7	146.6	20,098.4
West New Britain	3,050.6	4,521.7	2,299.6	2,483.6	220.7	1,675.1	61.0	14,312.4
<b>TOTAL</b>	<b>72,695.6</b>	<b>78,440.8</b>	<b>107,008.1</b>	<b>25,402.0</b>	<b>5,781.0</b>	<b>42,726.5</b>	<b>11,399.5</b>	<b>343,453.5</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 2013.

- 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 operational costs of the provincial Administration.

The Administration Grant **cannot** be used to pay salaries or other personal emoluments, casual wages, or debt payment.

## 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 were identified as a basic provincial responsibility across the nominated 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**

- Operation of village courts
- Supply of uniforms / inspection of village courts

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* <small>see below</small>	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>i.</i> Names and approximate lengths of provincial roads maintained <i>ii.</i> Names of bridges maintained
8. Airstrip maintenance	<i>i.</i> Names of rural airstrips maintained
9. Wharves and jetties maintenance	<i>i.</i> Names of wharves, jetties and landing ramps maintained
<u>Agriculture</u>	
10. Extension activities for agriculture, fisheries and forestry	<i>i.</i> Number of extension patrols conducted by provincial government staff and <i>ii.</i> Number of people who attended extension sessions
<u>Village Courts</u>	
11. Operations of Village Courts	<i>i.</i> Number of village courts in active operation <i>ii.</i> Number of village courts supplied with operational materials <i>iii.</i> Number of inspection to village courts

- 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.

\*It is understood that the distribution of drug supplies is being managed through donor support. Whilst this activity was identified as minimum priority activity, a proper assessment and monitoring of this activity is being considered by the NEFC.

## 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 August 2012. 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.

## 5.5 Transitional arrangements for Hela and Jiwaka

As both provinces came into legal existence after the 2012 election the NEFC will is now obligated to include them in the grant calculation process in the same way as all other provinces. However, because both these provinces are new there was limited information for the NEFC to base its determination. As a transitional arrangement the NEFC calculated the 2013 Function Grants and sector breakdowns for each new province (Hela and Jiwaka). This was done by adjusting our assessment of the grant to each ‘parent’ province (Southern Highlands Province and Western Highlands Province) to recognise that these provinces will now be providing services to smaller populations. The below table outlines the breakdown between the two provinces.

**Comparison of 2013 Function Grants for new provinces  
(K million)**

	<b>Before Split</b>	<b>After Split</b>
Southern Highlands Province	K17.6	K11.5
Hela Province	-	K6.1
<b>Total</b>	<b>K17.6</b>	<b>K17.6</b>
	<b>Before Split</b>	<b>After Split</b>
Western Highlands Province	K28.6	K16.0
Jiwaka Province	-	K12.6
<b>Total</b>	<b>K28.6</b>	<b>K28.6</b>

Each grant was calculated by taking the total grant of the parent province before the split, then sharing that grant on the basis of the population size of the new province relative to the parent<sup>5</sup>. As such, the creation of the new provinces has not affected any other provinces’ grant shares (except the parent province) and total grants remain within the equalisation amount.

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<sup>5</sup> NEFC’s own population estimates

However, under normal circumstances the NEFC would calculate each province's Function Grant by taking into account both the cost of delivering services and the amount of own source revenues and resource royalties available to fund these services. We have not been able to do this in this instance as both Hela and Jiwaka are in negotiations with their parent provinces to agree on revenue sharing arrangements. The outcome of these negotiations may impact on their future grant shares, and as such, the NEFC considers the 2013 Function Grants to be a transitional arrangement.

The intention is to fully incorporate the new provinces into the 2014 calculation.

Also please note that the LLG grant shares remain unchanged (although they are classified under their respective provinces).

## 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 over the administration of the following grants;

- a) service delivery function grants
- b) administration grants
- c) rural local-level government grants
- d) urban local-level government grants
- e) staffing grants, and allowances for village court officials
- f) other development needs

The conditions are subject to the provisions outlined under section 66.

The Department of Treasury, through the regular quarterly budget expenditure reviews is to ensure compliance with conditions of the implementation of the grants.

The Secretary of the Department of Treasury is also responsible for issuing Budget and Expenditure Instructions highlighting conditions surrounding management and reporting aspects on the expenditure of the above mentioned grants.

The NEFC may provide to the Minister responsible for Finance and Treasury such information based on their findings.

### 6.1 Treasury Budget and Expenditure Instructions

The Secretary for the Department of Treasury issues Budget and Expenditure Instructions (BEI) 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 preliminary analysis of the 2012 Provincial Government Budget processes conducted by the NEFC identified that, when compared to 2011 and earlier years there continues to be an improvement in the level of compliance with the requirements of the Budget and Expenditure Instructions (BEI) issued by the Department of Treasury each year. ([www.treasury.gov.pg](http://www.treasury.gov.pg)). However some provinces still continue to require capacity in order to effectively manage their budget and to have a greater impact on service delivery.

### 6.2 2012 Mid Year Budget Reviews

The major issues identified during the 2012 midyear provincial budget review included the following observations:

- The late release of warrant / cash releases from National Government to provinces and local level government is a significant factor in the lower than expected utilization of funds and delivery of service. There were a number of reasons for the late release of funds. This included:

- provinces not submitting their budgets on time
- delays in Treasury processes
- the 2012 General Elections (as a large number of public servants undertook electoral duties which ultimately had an impact – A similar pattern was observed during the 2007 elections.)
- There was some confusion in applying the new policy relating to the ‘rollover’ of function grants. The use of administrative accounting codes needed to make the transition, thus enabling the formal rollover processes, were not timely executed by some provinces and provincial treasuries. As a result the available roll over funds could not be used.
- There is inconsistency in the percentage and amounts of warrants and cash released by Treasury between provinces. This varied, with some provinces only receiving 44% of their total budget allocation whereas other provinces received as much as 72% of their total budget allocation. Treasury will review their internal processes to ensure consistency over future releases.
- Some provinces continue to overstate the amount of anticipated internal revenue. This estimate even appeared to be unrealistic to previous year actual revenues.
- The expenditure on personal emoluments continues to escalate requiring more effective internal controls including data cleansing and checking of periodic reports. Further there is a need for consistency of in payroll and staffing records maintained by DPM and DoT, primarily to ensure that funding is there to support all approved funded positions.
- There continues to be poor reporting of Minimum Priority Activities and its Performance indicators. Whilst there was improvement in some provinces, this needs to significantly improve.
- The use of templates to assist with the mid-year budget reviews needs to be both consistent in format to ensure that all provinces accurately report on provincial performance.
- Manpower data recordings are not reconciled to records held by the national line agencies-DPM,DoE,DoF and DoT. It was evident that there is a need for this to be pursued more rigorously.
- Monthly Bank Reconciliation are not performed by provinces in a consistent manner.
- Concern over the accountability particularly the reporting to provinces, over the use of public funds at district and LLG levels is poor. Controls need to be strengthened to prevent mismanagement of funds.
- The capacity of some provinces to manage funds and to provide effective and consistent service delivery continues to be an issue in some provinces.

### 6.3 Budget assignment of Function Grants

Most provinces are budgeting effectively in compliance with the Budget Expenditure Instructions (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 may potentially be a 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 can 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.



## 6.4 Budget and Expenditure Instructions (BEI) Application

There is an inconsistency of application in the use of the BEI. For example the BEI states that function grants are strictly to be used for goods and services (i.e. not personnel emoluments or maintenance of institutional housing). However it is evident that there were many instances where emoluments are erroneously included. This is also the case with the maintenance cost of institutional housing. The inconsistency with the BEI increases the risk of underfunding of MPAs including failing to achieve GoPNG priority areas.

## 6.5 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, Education, Finance, DPM DPLGA and DNPM for the first time made up the review team together with Treasury and NEFC. There was increased time allocated to the reviews.

Some provincial governments have commenced service delivery reporting on the Minimum Priority Area (MPA) activities actually performed and quantified;

- 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.

It's encouraging to note that a good number of provinces had reported on MPAs and supporting performance indicators. There is still room for improvement for greater amounts of spending to occur at the mid year point. An average of only 48% was recorded by provinces as being 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 2012 budget 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 officers participated in the running of National Government Election.

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

The current budget review templates were revised to reduce the number of columns. An additional template designed to report on MPAs and its performance indicators which was introduced in 2011 so that provincial governments could commence using this during the second quarter of 2011 and onwards. It is imperative that these templates are duly completed with the data to assist the Department of Treasury with the analysis.

The Department of Treasury has not been releasing “warrant authorisations on public servant and teachers’ salaries which forms part of provincial government Annual Budget appropriation”. There is a perception that as payroll expenditure is appropriated in Waigani at a National level there is no need for accountability of payroll expenditure incurred at the provincial level. It is vital that controls are maintained over payroll expenditure at all levels. Payments must only be made to bona fide employees and that payments are accurate for the purposes of Section 114 reporting.

In addition, the non-discretionary component of DSG included in provincial government budget appropriation without warrant authority being issued also raises the issue of proper accountability on the part of the provinces. Compliance needs to be further monitored by the Auditor General’s Office and PLSMA.

There is a greater need to further improve the linkages between the provincial Administration and the provincial Treasury Offices. Both organizations need to work more closely together to ensure the spending in support service delivery occurs consistently and in a timely manner.

It is also strongly recommended in the 2013 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.

## **6.6 Chart of Accounts Classification System of Revenue and Expenditure**

The revised Chart of Accounts was endorsed by the Department of Treasury for adoption by all provinces to take effect from 2011. An overview of the chart of accounts is provided below. The PGAS software upgrade team incorporated the DoT-NEFC chart of accounts into the software upgrade. This is expected to be rolled out during 2013.

## **6.7 CHART OF ACCOUNTS – PGAS Software Upgrade**

The Chart of Accounts endorsed by the Department of Treasury is reproduced below for the benefit of the readers of this fiscal report. Introductory guidelines are included in the Chart of Accounts briefly reproduced below. The primary intention of the comprehensive guidelines is intended to inform and engage provincial staff users promoting use and accuracy.

This Chart of Accounts was also used by Multibase - the PGAS software upgrade team as the basis for the development of the generic chart of account for GoPNG. The upgrade is intended to serve the government during the transition period pending the full rollout of IFMS across GoPNG. This will also ensure that government reforms are not compromised during the transition between the two systems. It is anticipated that the PGAS upgrade roll out will take place during 2013. In the meantime provinces will continue to use the existing PGAS CoA structure.

The Chart of Accounts comprises of 14 digits, some of which have been categorized in a manner to distinguish the Division, indicator, district no, LLG grant no., sector, program, activity and item code. A breakup of each category code is demonstrated below:

Division	Indicator	Dist	LLG	Grant	Sec.tor	Program	Activity	Item
<b>1 2 3</b>	<b>4</b>	<b>5</b>	<b>6 7</b>	<b>8</b>	<b>9</b>	<b>10</b>	<b>11</b>	<b>12 13 14</b>

**The first three digits of the above table** are for Division Identification. In the case of provinces, for example; **271** – Western Province or **279** – Western Highlands Province are the province identifier codes.

**The 4<sup>th</sup> Digit** is to indicate expenditure type i.e.: 1 is utilized for Recurrent Expenditure and 2 is used for Development Expenditure.

**Digits 5, 6, 7** are used to describe the location where expenditure takes place, i.e. the Cost Centre. These codes are specific to each province based on their PHQ, District, and local level government structure.

For example **010** Provincial Headquarters : **011** District 1

**The 8<sup>th</sup> Digit** is used for Grant Code :Administration and Other Service Delivery Grants; Personnel Emolument Grant (Staffing Grant, Teaching Services Commission Salaries, Public Servants Leave Fares, Teachers Leave Fares, Village Courts Allowances) Functional Grants (Health, Education, Infrastructure Maintenance, Primary Production and Village Court Operations) local level government Grants  
Urban local level government Grants Special Support Grants (SSG) and Mining Agreements  
Other Economic Support Grants; Provincial and District Support Grants, including Rural Action Program

**Others:** Loans, Aid, etc. through the National Government

**The 9<sup>th</sup> Digit** is the Function Code used to describe the expenditure sector

- 1 Administration
- 2 Health
- 3 Economic
- 4 Education
- 5 Law and Order
- 6 Infrastructure
- 7 Community Services
- 8 Reserved
- 9 Others

**Digits 10 and 11** are used for Programs, Activities and Projects and the options available for these codes are what is being outlined in this guide. The examples that have been placed in bold type and underlined are the Minimum Priority Activities as announced in the 2009 Budget.

**Digits 12 – 14** are for Item codes.

**Adoption of Chart of Accounts 2012 and beyond**

The detailed code classification is included in the Chart of Accounts which was endorsed by the Department of Treasury for application in 2012. Whilst it is anticipated that provinces have been progressively moving towards adopting the revised Chart of Accounts during 2012, the NEFC anticipates that by 2013 all provinces will be adopting a uniform standard Chart of Accounts.

## **6.8 Assisting the Reform Processes**

NEFC has been proactively involved in assisting with training to provinces who have requested assistance. To date three other provinces Manus, New Ireland and Madang made formal requests to the NEFC for assistance and NEFC assisted by travelling to these provinces providing assistance in a form of a rescue package/ technical assistance targeting budget preparation, monthly reporting including promoting the use of the Chart of Accounts. NEFC has also developed a 3 page budget report template to further assist provinces. Some provinces have already commenced using these and are increasingly finding this to be a useful tool.

NEFC hopes to engage the Finance Training Branch and Provincial Capacity Building initiative to sustain these training activities. Planned training sessions on the NEFC tools will be held with the two bodies with a view to mainstreaming these as part of standard training programs.

PLSMA have since developed a Monitoring Tool to assist with specifically monitoring MPAs. NEFC jointly assisted in developing the monitoring tool. This tool will be progressively introduced to provinces during 2013 and will assist provinces to effectively report against MPAs and Section 119 reporting.

This phase of intergovernmental financing reforms should place reliance on compliance in particular ensuring that these grants are used for their intended purposes. PLSMA and other monitoring agencies have a critical role to play in this area.

## **6.9 NEFC Regional WorkShops**

The 2012 NEFC workshops were conducted in June 2012. These workshops were conducted ahead of the PNG General Elections. The primary intention of conducting the annual workshops just prior to the general elections was to send a message that service delivery to the community should not be compromised as a result of electoral activities. NEFC expenditure analysis during the 2007 elections noted that there was a significant drop of in service delivery during this period.

Also being mindful of the potential security issues in carrying out the regional workshops, it was decided that the highlands region workshop would be held in Kokopo. This was made possible through the generous support of AusAID. The four workshops were held in following regional centres; Southern Region Alotau, Highlands and New Guinea Islands Kokopo and MoMase region in Madang.

Overall all four workshops were successfully conducted with an average of 60 participants attending each of the four workshops. The target participants were provincial administration and budgeting staff and provincial treasury staff.

The workshop presenters included our primary stakeholders: Department of Finance, Department of Treasury, DPLGA, PLSMA and the Auditor General's Office. It was evident that stakeholder commitment and participation promoted a more cohesive approach and engaging province in the reforms.

Another positive outcome was that each workshop concluded with a firm set of resolutions. This has been increasingly an increasing expectation of NEFC workshops. As in past workshops, these joint resolutions have resulted in addressing common issues including addressing operational road blocks.

Examples of resolutions in the past included the development of a standard provincial Chart of Accounts, the ability of provinces to roll over function grants between years, ensuring that these grants are used for their intended purposes. PLSMA and other monitoring agencies have also secured greater commitment from provinces in improving service delivery.

A summary of the collective workshop resolutions were circulated and distributed to the participants at the end of the workshop. In addition a final version was sent to each Provincial Administrator. A final version of the collective workshop resolutions are reproduced below.

## 6.10 Collective 2012 Workshop Resolutions

### **Chart of Accounts**

- Implement standardized Chart of Accounts program and activity codes (in accordance with BEI 1/2011)
  - Consistency between 200 & 700 series
- MPAs must be clearly identified with budget appropriations.
- More general awareness on MPAs across stakeholders (incl politicians)

### **Quality budgeting in accordance with Budget & Expenditure Instructions (BEIs)**

- Provinces to improve budget processes by adopting Quality Budget Criteria including:
  - a. Improving format of head budget summary report.
  - b. Consistent coding between Own-source (local) Revenue and standard Chart of Accounts
  - c. Realistic forecasting of Own-source Revenues and Internal Revenue (use actual revenue from two year's prior)
  - d. Chart of Accounts classifications to accurately track MPA expenditure.
  - e. Appropriate funding allocations to MPA, including from Internal Revenue (engage politicians on legal requirements to fund MPAs)
  - f. Provinces consider 3 page summary in 2013 Budget (Provincial Budget Module)

### **IFMS**

- New grants will be issued under IFMS. Use 'bridging tables' distributed by Treasury to assist using old grant codes.

### **Unspent funds/rollovers**

- Provinces to familiarize themselves with Finance Instruction on rollovers
- At close of accounts, Sector Managers to be advised by PT/PBO of their rollovers that will be available next year

- Must remain in provincial Govt Grant Account (PGGA)
- Rollover grants must be reflected in the following year's budget and used for original purpose
  - Dept Finance to assist provinces with Coding

### ***Treatment of interest accrued on grants***

- Provinces inform themselves and follow new Finance Instruction on budgeting and accounting for bank interest accrued on grants
  - Interest remains in PGGA; offset bank fees; distributed to sectors proportionately

### ***Late Provincial budgeting & submission***

- Each province to start the budget process as soon as ceilings received (e.g. July), so detailed budget can be finalized by early December
  - Follow Treasury's deadlines & develop 'a provincial budget schedule'

### ***A proposal on warrant and cash releases***

- Treasury & provinces to consider proposal: A schedule and fixed percentage of warrant and cash releases to provinces
  1. First small warrant release very early, such as January
  2. Predictable (scheduled) release of remainder of funds
  3. Bulk of funds released mid-year so have time to spend
  4. All funds by end of August
- Provinces to indicate cash flow requirements as part of budget submission (e.g. if a Province needs significant Education Function Grant early to undertake centralized bulk purchase of basic materials).

### ***Reporting expenditure from district level***

- Each District and LLG to remit expenditure reports to PT for uploading into PGAS. A simple transfer to districts cannot be coded as expenditure
- Provinces to follow Finance Instruction to properly account for unspent funds/rollovers transferred to district level.

### ***Improve Accountability and Reporting at LLG level***

- Both PA and DA will be informed of funds going down to LLGs.
- Provinces to study and provide feedback to Dept of Finance on Finance Instruction 03/2012 (included in materials)

### ***Political interference in budget implementation***

- Funds budgeted for MPAs are sometimes diverted by political 'directives'.
  - Provincial officers to clarify to their politicians the legal obligations regarding BEIs & MPAs.

### ***MPA Indicators & DPLGA's Performance Management database tool***

- DPLGA to assist interested provinces to adopt DPLGA's performance management database to track MPA spending and indicators
  - Reporting system on MPAs indicators, not just expenditure.

**Controls over Payroll Costs - Establishment**

- Conduct a comprehensive audit of payroll costing, including regular audits to validate staff costs to the payroll system.
- Provincial budget submissions to include provincial staff structure/establishment and staff costing
  - Include evidence of audit undertaken (use as BSC submission question)

***Internal audit functions***

- Provinces without audit committees to take steps to establish them (legal requirement)
- Provincial Management to build skills and effectiveness of audit units (oversee audit annual plans, reports, and performance)

***Other potential consideration*** for DoT to improve predictability over warrant and cash releases to provinces:

- DoT consider monthly warrant /cash releases or smaller fixed disbursements of grants to provinces
- Release total MPA function grants during first quarter
- Change of accounting period (i.e. from December to June)

## 7 QUALITY BUDGET ASSESSMENT SCORECARD

Each year, NEFC performs a budget quality assessment process to examine the quality of provincial government budget documentation against the requirements outlined in the Budget and Expenditure Instructions and what is considered as best practice in public sector budgeting. The 2012 Quality Budget Assessment was conducted in May 2012 and presented to provinces during the NEFC Regional workshops held in June 2012.

The province's administrative budgeting processes were assessed and rated for 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 below.

### 2012 BUDGET SCORECARD BY REGION

#### Momase Region

Provincial budget quality assessment	Morobe	Madang	ESP	Sandaun
Overall	6	10	17	11
National Grant Financed Expenditure Appropriation	5	3	5	5
Administration	0	0	0	0
Other Services	0	1	0	0
Health	10	12	15	15
Education	14	16	16	17
Transport maintenance	9	11	6	8
Primary Production	1	3	5	1
Village Courts (Operations)	2	3	3	2
Own Source Revenue (700 series) Appropriation	4	4	5	3
<b>Total Provincial Budget Quality Score</b>	<b>51.0</b>	<b>63.0</b>	<b>72.0</b>	<b>62.0</b>
2011 SCORES	52.0	53.0	73.0	61.0



## New Guinea Islands Region

Provincial budget quality assessment	Manus	NIP	ENB	WNB
Overall	14	14	14	9
National Grant Financed Expenditure Appropriation	3	5	5	5
Administration	1	0	0	0
Other Services	2	2	2	0
Health	16	11.5	14	16
Education	17	8	16	13
Transport maintenance	9	5	13	10
Primary Production	6	1	6	5
Village Courts (Operations)	2.5	3	2	2
Own Source Revenue (700 series) Appropriation	0	5	3	3
<b>Total Provincial Budget Quality Score</b>	<b>70.5</b>	<b>54.5</b>	<b>75.0</b>	<b>63.0</b>
<i>2011 SCORES</i>	74.0	54.0	75.0	68.0

## Southern Region

Provincial budget quality assessment	Western	Gulf	Central	Milne Bay	Oro
Overall	5	11	16	9	9
National Grant Financed Expenditure Appropriation	4	5	5	5	5
Administration	0	0	1	0	0
Other Services	0	2	1	0	0
Health	13	18	16	2	14
Education	13	16	14	14	12
Transport maintenance	5	8	11.5	11	12
Primary Production	4	4	4	2.5	3
Village Courts (Operations)	3	2	2	3	3
Own Source Revenue (700 series) Appropriation	7	3	7	6	4
<b>Total Provincial Budget Quality Score</b>	<b>53.5</b>	<b>69.0</b>	<b>77.5</b>	<b>52.5</b>	<b>62.0</b>
<i>2011 SCORES</i>	55.0	69.0	76.0	53.0	66.0

## Highlands Region

Provincial budget quality assessment	SHP	Enga	WHP	Simbu	EHP
Overall	10	14	8	10	9
National Grant Financed Expenditure Appropriation	5	4	3	5	4
Administration	1	0	1	0	0
Other Services	1	1	2	0	2
Health	15.5	17	16	16	16
Education	11.5	11	12	14	15
Transport maintenance	6.5	5	11	11	12
Primary Production	3	3	7	5	6
Village Courts (Operations)	2.5	3	3	2	3
Own Source Revenue (700 series) Appropriation	6	3	4	5	7
<b>Total Provincial Budget Quality Score</b>	<b>62.0</b>	<b>61.0</b>	<b>67.0</b>	<b>68.0</b>	<b>74.0</b>
<i>2011 SCORES</i>	60.0	46.0	55.0	71.0	72.0

### Provincial Government 2012 Budget Quality Assessment

Provinces	Overall	BEI compliance	Admin	Other Services	Health	Education	Transport maintenance	Primary Production	Village Courts	Own Source Appropriation	Total
Central	16	5	1	1	16	14	11.5	4	2	7	77.5
ENB	14	5	0	2	14	16	13	6	2	3	75
EHP	9	4	0	2	16	15	12	6	3	7	74
ESepik	17	5	0	0	15	16	6	5	3	5	72
Manus	14	3	1	2	16	17	9	6	2.5	0	70.5
Gulf	11	5	0	2	18	16	8	4	2	3	69
Simbu	10	5	0	0	16	14	11	5	2	5	68
WHP	8	3	1	2	16	12	11	7	3	4	67
WNB	9	5	0	0	16	13	10	5	2	3	63
Madang	10	3	0	1	12	16	11	3	3	4	63
Oro	9	5	0	0	14	12	12	3	3	4	62
Sandaun	11	5	0	0	15	17	8	1	2	3	62
SHP	10	5	1	1	15.5	11.5	6.5	3	2.5	6	62
Enga	14	4	0	1	17	11	5	3	3	3	61
NIP	14	5	0	2	11.5	8	5	1	3	5	54.5
Western	5	4	0	0	13	13	5	3.5	3	7	53.5
Milne Bay	9	5	0	0	2	14	11	2.5	3	6	52.5
Morobe	6	5	0	0	10	14	9	1	2	4	51

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

### **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 2011 were rolled over into correct Function Grant Appropriation revenue vote
9. Unused funds from 2011 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 Operation of village courts

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

### Provincial Budget Quality Assessment score guide

<b>Provincial budget quality assessment scoring guide</b>	
<b>Overall</b>	
<b>Timeliness of provincial budget submission that was approved</b>	<b>0-5</b>
Submitted after 31 December 2012	0
Submitted before 31 December 2012	3
Submitted within two weeks of national budget being handed down	5
<b>High level budget summary (incorporate. 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 actual	5
<b>Actual Revenues and Expenditures for second year prior disclosed</b>	<b>0-2</b>
No second prior year actual 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. 2010 data in 2012 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
<b>National Grant Financed Expenditure Appropriation</b>	
<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 2011 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 2012 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^	0-1
above 10%	0
above 5%	0.5
below 5%	1
<b>Other Services</b>	
Degree of rolled over unspent grants from prior year^	0-2
above 10%	0
above 5%	1
below 5%	2
<b>Health</b>	
<b>Excluded Provincial Hospitals</b>	<b>0-1</b>
<b>Excluded wages / personnel emoluments</b>	<b>0-1</b>
<b>MPA - Operation of rural health facilities #</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 - 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
<b>Education</b>	
<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

**Village Courts**

<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

**Own Source Revenue (700 series) spending**

<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>
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*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

<b>LLG allowances budgeted for under provincial internal revenue</b>	<b>0-1</b>
<i>these should be budgeted for under internal revenue and not under LLG grants which are for goods and services</i>	
Not budgeted for under provincial internal revenue financed appropriation	0
Budgeted for under provincial internal revenue financed appropriation	1

<b>Total Provincial Budget Quality Score</b>	<b>100</b>
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\* 2010 Actual Revenues are included in the 2010 NEFC Provincial Expenditure Review

## 7.1 2010 PROVINCIAL EXPENDITURE REVIEW “STEP TWO: The Ripple Effect”

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 2010 was the second year of implementation of the new intergovernmental financing arrangements that continues to see more funding reaching the provinces that need it most and targeted at priority sectors and priority activities. It is enormously satisfying to see the 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.

Six years ago NEFC commenced a process of providing 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 better 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 two of increased funds and we are looking for “STEP TWO: The Ripple Effect” where the reforms should be embraced by all levels of government with a view to improving service delivery. There are positive indications that more money is reaching the places where it makes a difference. What is therefore needed is for all stakeholders to bring about changes to better facilitate service delivery to where it is needed most, including overcoming bottlenecks. Including 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?

**PERFORMANCE**

## 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. STEP TWO The RIPPLE EFFECT is the sixth 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?

### Year Two – a recap

In 2009, the first year of implementation, we saw clear signs of change, what can we see in Year Two?

- ***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 48% in 2010.

- ***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 2010? Or did they struggle to spend the additional money?***

Overall spending levels remained fairly high and this was despite the poor timing of cash release from central agencies. So we can be pleased that provinces sought 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?***

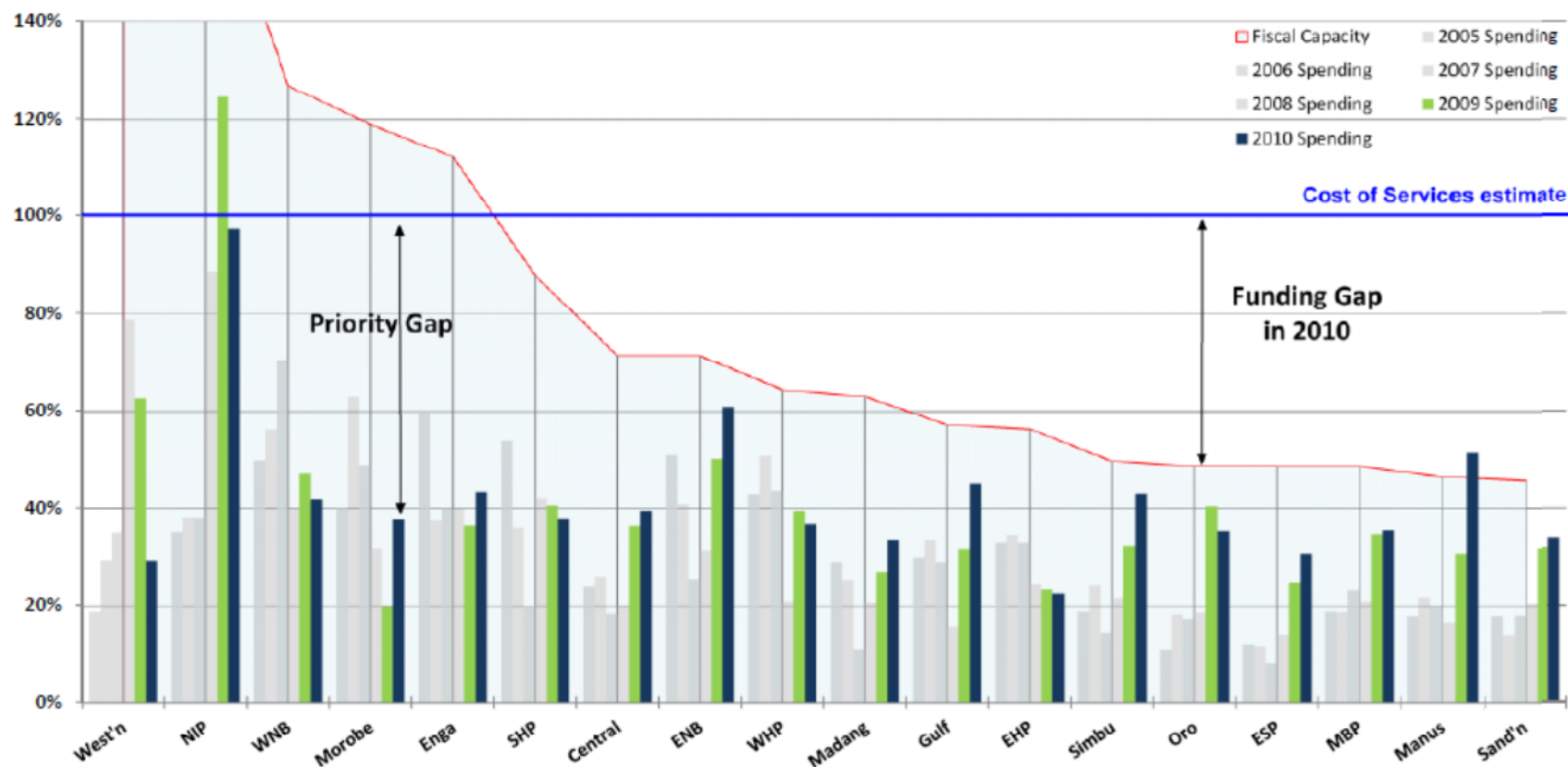
Yes there was evidence of spending on MPA's however we need to continue to be proactive in our efforts to support provinces as they seek to revitalise these critical activities<sup>6</sup>. Clearly identifying budget line items will help ring-fence these funds and ensure sectors have the resources necessary to carry out the activities.

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<sup>6</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.

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>7</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 2010**



<sup>7</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 untagged 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>8</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>9</sup>

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<sup>8</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>9</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.

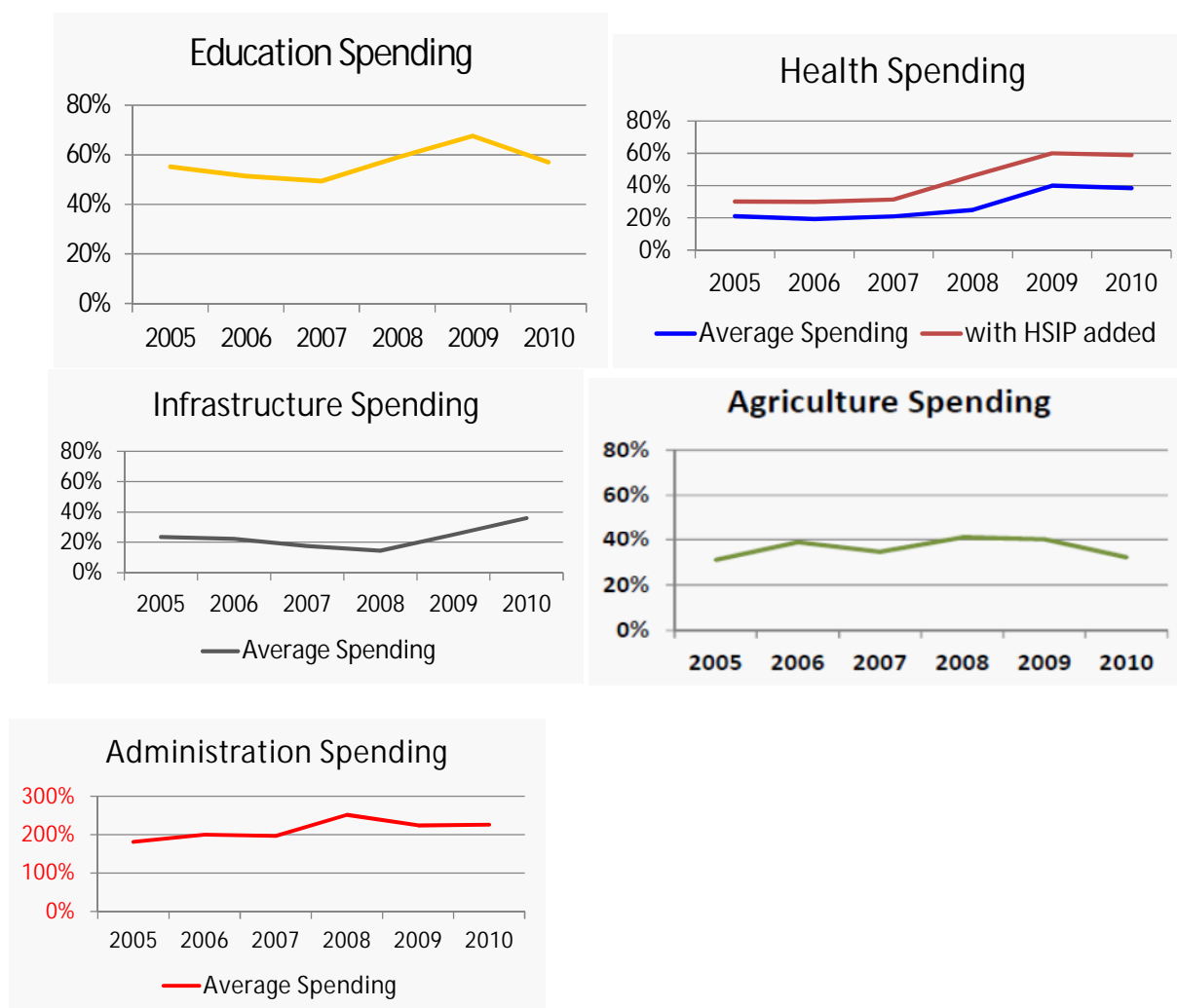
How does this happen? When we employ additional staff they need to be resourced. They need office space, use electricity, need a computer, need to travel for work (which means travel allowance, fuel costs, car hire, air travel etc) and recreation leave fares. When we don't increase our recurrent budget 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 K5 million with most provinces (12) spending more in 2010 and some spending significant amounts.
- **Health:** 2010 saw a positive change in health spending with overall spending increasing by a further K9 million. Many lower and medium funded provinces showed significant increases in their spending on the sector for the second consecutive year. 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 K24 million in 2010 – a 66% increase. For the first time in many years provinces are being funded with significant amounts of maintenance funding. This enables them to implement meaningful maintenance programs.
- **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 increased in 2010 and remains high in many provinces (but not all) 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 2010**

- **Upward trends:** In health and infrastructure
  - The dip in the education graph indicates that whilst spending increased in kina in 2010 – the costs increased even more.
- **Donor impact on recurrent service delivery activities:** in education and health.
- **Concern:**
  - 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.

- **Improved partnerships between national line agencies and provinces:** National line agencies working more closely with provinces and provincially based sector staff will help ensure that the new increased funding is better targeted in their budgets and their expenditures.
- **Transparency of MPA's:** Clearly label MPA's in the 2013 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 324/2012



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

### DETERMINATION APPORTIONING THE EQUALISATION AMOUNT.

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

**1. TRANSITIONAL INDIVIDUAL PROVINCE GUARANTEES.**

For a fiscal year of Transitional 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 distributed received by a Provincial Government for the fiscal year commencing 1 January 2008 under the Goods and Services Tax Revenue Distribution Act 2002 is greater than the amount of GST distribution received by the Provincial Government of 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 a transition period, the proportion of the equalization amount for that fiscal year available for the total of 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 for a transitional period, the local level shares, being the proportion of the equalization amount for the fiscal year available for distribution amongst Local-Level Governments, is an amount equal to 3 per cent of that equalization amount.



4. **PROVINCIAL SHARE.**

For a fiscal year of transitional period, the province share, being the proportion of the equalization amount of that fiscal year available for distribution amounts Provincial Governments, is the amount remaining after deduction from that equalization amount the total of the amounts calculated under Clauses 1.2 and 3 for that fiscal year.

5. **MEANING OF TERMS.**

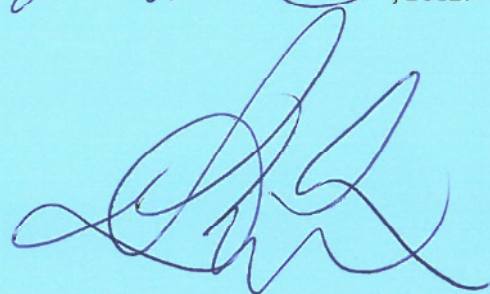
In accordance with Section 77 of the *Interpretation Act* (Chapter 2), the terms used in the determination have the same meaning as in the *Inter-Governmental Relations (Functions and Funding) (2010 Budget Amendment) Act 2009*.

MADE this

6<sup>th</sup>

day of

November, 2012.



**MINISTER FOR TREASURY.**

## APPENDIX B: FUNCTION AND ADMINISTRATION GRANTS DETERMINATION



*Intergovernmental Relations (Functions and Funding) Act 2009*

### FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

I, **Don Pomb Polye, CMG, BE (Civil) MBA, MIE PNG (Reg.), MP**, Minister for Treasury, 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 GRANT

(1) Service delivery function grants are provided to Provincial Governments to ensure that adequate funding is directed towards to 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 allocation 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) immunisation;
- (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 PRODUCT 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 Sub clause (1), a primary production function grant must be used to fund primary production through support for supervision, training and extension activities to the agricultural and fisheries sectors, as well as for the export promotion of these products.

## **8 OTHER SERVICE FUNCTION GRANTS**

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

21<sup>st</sup>

day of

September, 2012

  
Minister for Treasury



**2013 BUDGET NEFC ADVICE - KINA THOUSANDS****Attachment A**

INCLUDES TRANSFERRED FUNDING FROM GST DISTRIBUTION CHANGES RESULTING FROM NEW SYSTEM OF INTERGOVERNMENTAL FINANCING (ADDITIONAL K6.8 MILLION FOR GRANTS and ALSO INCLUDES THE TRANSFER OF FUNDS FROM THE TWO(2) MOTHER PROVINCES (WESTERN HIGHLANDS and SOUTHERN HIGHLANDS) TO THE TWO (2) NEW PROVINCES OF JIWALA and HELA. This however does not change the overall resource envelop recommended for the provinces in 2013).

	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 2013 function grants (a)
Western	781.4	657.3	1,048.1	414.0	86.8	43.3	43.3	3,074.2	698.3	1,929.8	2,628.0	5,702.2	0.0
Gulf	3,723.7	2,998.9	4,969.1	1,152.2	195.2	2,568.9	831.8	16,439.8	146.9	1,104.4	1,251.3	17,691.1	235.3
Central	4,277.9	3,570.7	8,590.7	1,345.8	423.5	2,596.1	1,054.7	21,859.5	0.0	1,753.8	1,753.8	23,613.3	0.0
Milne Bay	5,535.8	6,977.7	6,657.8	1,870.7	339.9	4,520.6	1,073.0	26,975.6	283.3	2,044.7	2,328.0	29,303.6	0.0
Oro	3,757.4	3,529.3	4,154.4	1,310.4	83.2	2,021.7	595.4	15,451.8	569.1	1,204.6	1,773.7	17,225.5	0.0
Southern Highlands	3,234.1	2,567.5	3,280.3	771.0	296.6	1,148.2	173.4	11,471.0	647.8	2,759.3	3,407.0	14,878.1	0.0
HELA	1,848.0	1,478.4	1,540.0	431.2	123.2	616.0	92.4	6,129.3	252.8	1,495.7	1,748.6	7,877.9	0.0
Enga	3,779.1	1,470.4	7,697.2	1,002.8	368.2	2,000.3	533.8	16,851.8	120.6	2,355.5	2,476.1	19,327.9	2,463.1
Western Highlands	3,067.9	4,549.7	5,759.0	817.6	265.5	1,292.2	266.9	16,018.8	798.7	1,707.8	2,506.5	18,525.3	0.0
JIWAKA	2,141.3	3,526.9	4,786.5	755.8	201.5	1,007.7	188.9	12,608.7	0.0	1,360.2	1,360.2	13,968.9	0.0
Simbu	4,134.0	6,069.3	7,579.8	1,209.4	346.6	2,893.1	857.2	23,089.4	265.5	1,934.1	2,199.5	25,289.0	0.0
Eastern Highlands	4,788.8	5,648.4	10,397.0	1,528.1	1,032.1	2,921.3	1,199.0	27,514.8	753.9	2,922.7	3,676.6	31,191.4	0.0
Morobe	1,275.8	2,000.0	2,266.3	465.3	157.0	1,026.0	526.8	7,717.2	2,701.7	4,076.0	6,777.7	14,494.9	0.0
Madang	5,954.8	5,161.7	8,363.4	2,497.8	343.9	4,069.6	892.2	27,283.4	818.0	3,053.7	3,871.7	31,155.0	3,675.8
East Sepik	8,197.7	6,646.0	12,303.0	2,167.4	528.3	3,485.2	1,006.0	34,333.6	580.4	3,171.5	3,751.9	38,085.5	0.0
Sandaun	5,935.4	7,498.4	6,757.5	2,611.9	302.6	3,230.7	937.6	27,274.0	280.0	2,452.4	2,732.3	30,006.4	0.0
Manus	2,544.6	2,669.7	3,560.6	726.0	229.8	2,154.9	894.1	12,779.8	168.4	424.9	593.3	13,373.1	445.8
New Ireland	783.7	555.4	496.1	230.8	27.7	50.9	25.3	2,170.0	322.9	965.3	1,288.2	3,458.2	0.0
East New Britain	3,883.4	6,343.4	4,501.5	1,610.3	208.6	3,404.7	146.6	20,098.4	683.1	2,069.1	2,752.2	22,850.7	0.0
West New Britain	3,050.6	4,521.7	2,299.6	2,483.6	220.7	1,675.1	61.0	14,312.4	406.4	1,528.9	1,935.3	16,247.7	0.0
<b>TOTAL</b>	<b>72,695.6</b>	<b>78,440.8</b>	<b>107,008.1</b>	<b>25,402.0</b>	<b>5,781.0</b>	<b>42,726.5</b>	<b>11,399.5</b>	<b>343,453.5</b>	<b>10,497.6</b>	<b>40,314.6</b>	<b>50,812.2</b>	<b>394,265.7</b>	<b>6,820.1</b>



**APPENDIX C: REVISED BUDGET AND EXPENDITURE INSTRUCTIONS****REVISED BUDGET AND EXPENDITURE  
INSTRUCTION 1/2012**25<sup>th</sup> May 2012

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

- Provincial Administrators
- Provincial Budget Officers
- Provincial Planning Officers
- Provincial Treasures

This Instruction is issued to advise amendments to Item 6.12 of the Revised Budget Expenditure Instruction 2011 relating to the expenditure code structure to treat Former Year's Grants as follows:

<u>GRANT TYPE</u>	<u>INDICATOR</u>	<u>VOTE CODE</u>
Recurrent	1	271-1-100-3101
Development	2	271-2-100-9101

Former Years indicators 4 and 5 under the current coding will now be replaced by Grant Type Code 9 for Former Year's Function Grants (Recurrent) and Former Year's Development.

This is to ensure the grants including rollovers funds are applied as specified by the Treasurer- refer to item 8.4 of Revised BEI 2011, the following codes should be applied to expenditure.

- Administration Function Grant Former Year's Appropriation
- Health Function Grant Former Year's Appropriation
- Primary Production Function Grant Former Year's Appropriation
- Education Function Grant Former Year's Appropriation
- Village Court Operations Function Grant Former Year's Appropriation
- Transport Infrastructure Maintenance Function Grant Former Year's Appropriation
- Other Services Delivery Grant Former Year's Appropriation: and
- Interest from PGGA – Bank Fees Former Year's Appropriation

<u>GRANT TYPE</u>	<u>INDICATOR</u>	<u>NEW VOTE CODE</u>
Former Year Recurrent	1	271-1-100-9101
“	1	271-1-100-9201
”	1	271-1-100-9301
“	1	271-1-100-9401
“	1	271-1-100-9501
“	1	271-1-100-9601
“	1	271-1-100-9901
“	1	271-1-100-9100
Current Development	2	271-2-100-3101
Former Year Development	2	271-2-101-9101

And in respect to revenue:

**Provincial Government Former Year's Revenue Codes**

071-1	Administration Function Grant Former Year's Appropriation
071-2	Health Function Grant Former Year's Appropriation
071-3	Primary Production Function Grant Former Year's Appropriation
071-4	Education Function Grant Former Year's Appropriation
071-5	Village Court Operations Function Grant Former Year's Appropriation
071-6	Transport Infrastructure Maintenance Function Grant Former Year's Appropriation
071-9	Other Services Delivery Grant Former Year's Appropriation: and
071-10	Interest from PGGA – Bank Fees Former Year's Appropriation

**INTEREST (PGGA)**

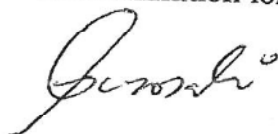
The interest earned from the Provincial Government Grant Account (PGGA) is to be used in the former years function grants to supplement the function grants in succeeding years. Interest may be used to offset Bank fees and any remaining balance to be distributed to sectors in the basis of the sector amounts.

**REMITTANCE OF LOCAL LEVEL GOVERNMENT GRANTS**

Following a Ministerial directive, new arrangements will apply to remit monthly grants from Waigani Public Account. These will now be remitted through the District Treasuries Operating Account to Local Level Government Accounts. The current practice of transfer through the Provincial Government Grant Accounts will cease.

**2013 Budget Negotiation**

The Budget negotiation process provides Provinces with the opportunity to critically review budget ceilings for each function grant type, and to request where necessary, changes in allocation between functions grants. A request for changes (ie either increase or decrease) of up to 10% must be presented at the 2012 half year budget review for discussion. The results may then reflect in the Ministerial Determination (Administration & Function Grants Determination for Ministerial approval).



**SIMON TOSALI**  
Secretary



**DEPARTMENT OF TREASURY**  
Office of the Secretary

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Vulupindi Haus  
PO Box 542, WAIGANI, NCD

## **REVISED BUDGET AND EXPENDITURE INSTRUCTIONS**

9 August 2011

**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 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.
- 6.10 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.
- 6.11 It is now compulsory that a standardized chart of accounts must be used from 2012 budget onwards both under the 200 and 700 series,
- 6.12 The expenditure Code structure to treat the former years grants will be as follows:

Grant Type	Indicator Code	Vote Code
Recurrent Grant	1	27111013101
Development Grant	2	27121013101
Local Level Government	3	27131013101
Former Years	4	27141013101
Former Years	5	27151013101

- 6.13 The details Revenue Code structure are shown as “Attachment C”.

## 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 or fail to report at all.
- 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 2011.

## 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 to remain in the Provincial Government Grants Account (PGGA) and create specific Revenue Heads in the following year ('200 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 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, 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.

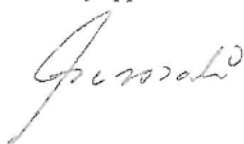
## 10. Contact Officers

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

Lazarus Enker	312 8739
Dessie Kuburam	312 8786
Graham Ararua	312 8784
Robyne Joshua	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.



**SIMON TOSALI**  
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. Operation of Village Courts	i. Number of village courts in active operation ii. Number of village courts supplied with operational materials



