National Economic and Fiscal Commission

2015 Budget Fiscal Report

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FOREWORD

The National Economic and Fiscal Commission (NEFC) is required each year, to provide to the Treasurer a report on the workings of the Commission and its annual provincial grant determination. This 2015 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 Treasury.

The reforms to the Intergovernmental Financing Arrangements (RIGFA) have been in operation since 2009 after a 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. The new intergovernmental financing and funding system is based on equalization principles of provincial and local level government funding allocations. It does not only take into consideration the cost of providing services but also internal provincial revenues. The amount of internal revenue that a province is able to generate has an impact on their ability to deliver basic services. Provinces experience differences in the cost of providing the same service in different parts of the country. This is often due to influences outside their control. For example, a province that is linked by good transport networks will have lower cost in comparison to those provinces that have poor transport networks. NEFC continues to research ways of better costing the impact of remoteness.

In 2014 NEFC conducted a joint study with the National Department of Education to further arrive at a more accurate basis for assessing remoteness. This study was titled “Go long Ples” and recommended a composite remoteness index which will better assist in determining the cost of transport.

The transition phase of the reforms ended in 2013, a further two year extension of the transition provisions was requested from the Treasurer to 2015. Since the reforms there has been a significant increase in the level of funding to provinces and local level governments. This has significantly increased the ability of provinces to improve service delivery, particularly those provinces that were unable to generate adequate internal or on source revenue. The provincial Expenditure Review (PER) reports which the NEFC has increased over the last six years confirms this.

The increased level of funding further emphasizes that 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 therefore 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, the annual provincial expenditure report (PER) and the revenue reports. 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 Provincial government Accounting System (PGAS) data and Warrants and Cash Releases information from the departments of Finance and Treasury have hampered our efforts to have these reports published on timely basis. Nevertheless the NEFC has continued vigorously advocating for timely release warrants and cash releases.

Development funding through the Service Improvement Program (SIP) has been increasing significantly but the Government must also take into account the flow on impact of development funding on recurrent funding needed to service development. The other impact of Service Improvement funding is the availability of cash flows to Government. The impact of this was very much evident during 2013 the first half of 2014. It is hoped that this situation will improve as the LNG sales trickle back into the country in the late 2015.

The lack of capacity in some provinces continues to hamper the Provincial capability to fully utilise the increasing funds and to effectively sustain service delivery. The inclusion of the additional two new provinces (i.e Hela & Jiwaka) into the intergovernmental financing and funding system will also impact the overall funding envelop.

Overall, it is NEFC's intention that the various publications that the NEFC produces will enable even the ordinary villager and the community at large to become an informed recipient of government services, so much that he or she may now be in a position to demand from the relevant authorities, improvement 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 under 4% of the GoPNG recurrent budget, It is our desire to ensure that the government will find a way to structure the cash releases to ensure that the 4% of the recurrent budget is released by Treasury in a consistent manner to enable provinces to better plan and provide consistent services. They should also be made more accountable for their performance in this regard.

The NEFC will continue to work hard to ensure that all Papua New Guineans, no matter where they live, will have access to basic service delivery. This is also the aim of the Constitution and the aspirational goal and objectives of the MTDP and Vision 2050.

Hohora Suve
Chairman/Chief Executive Officer

EXECUTIVE SUMMARY

This Fiscal Report outlines the recommended distribution of function and administration grants (referred to as the determination) among the Provinces and LLGs for 2015. The NEFC uses an equalization formula to allocate each Province and LLG based on its capacity to deliver Government Services. The determination is based on the same methods as in previous years year but includes updated data on population, a new estimate of provincial and LLG costs, adjustments to phase in Hela and Jiwaka, and the latest available revenue data.

The determination and the NEFC

The National Government and the Provinces have agreed to a formula for sharing revenue between the levels of government and that this shared revenue should be distributed to the Provinces and LLGs in an equitable way. The NEFC is tasked with calculating an equitable distribution for each Province and LLG and providing this as a recommendation to the Treasurer who then makes the determination. The determination is updated annually to reflect changes in the circumstances of the Provinces.

In making its recommendation the NEFC measures the level of revenue available to each Province and estimates the cost to deliver Government services to the populations in each Province. The cost and revenue estimates are then combined to calculate fiscal needs which determine each Province's share of the function and administration grants. These shares aim to provide Provinces with the fiscal capacity to provide a similar standard of government services to their populations.

An extensive description of how intergovernmental financing arrangements work is available in the Plain English Guide to the New System of Intergovernmental Financing (NEFC May 2009).

Reviewing progress in 2014

The NEFC also plays a role in monitoring the performance of the Provinces. During the quarterly reviews in mid- 2014, it is evident that some Provinces are having difficulty implementing their budgets. The second quarter budget reviews conducted by the Department of Treasury and major stakeholders has highlighted low spending rates by most Provinces. For example by the end of June 2014, it had only spent around half of the grants which they had received. This problem is exacerbated by slow cash flow to Provinces from the National Government, making it difficult for provinces to effectively plan their spending.

The success of RIGFA and a new focus for 2015

Over the last 6 years the NEFC has been focussed on implementing the 2009 amendments to the Organic Law. Now that the reforms are bedded down the NEFC intends to commence a new phase where we work on improving the understanding of the system by all stakeholders and identify where improvements can be made.

This is about fine tuning the system for greater performance and providing confidence to Government that funding provided to Provinces and LLGs is well spent. However, the NEFC has progressed to highlight the necessary blockages that in many cases hinder the flow of funding to sub-national levels or the facilities to carry out their day to day operations.

The 2015 Determination

Figure 1: Summary of the Provincial & Local Level Government 2015 Determination

Provinces	Total Provincial Government Grants	Total LLG Grants	Grand Total
Western	6,143,633	3,779,727	9,923,360
Gulf	21,774,798	2,855,457	24,630,255
Central	30,939,452	1,979,317	32,918,769
Milne Bay	31,798,224	2,749,258	34,547,482
Oro	18,940,909	2,221,642	21,162,552
Southern Highlands	15,887,605	3,128,309	19,015,913
Hela	10,873,947	1,675,278	12,549,226
Enga	27,062,629	2,252,381	29,315,009
Western Highlands	17,023,883	2,153,901	19,177,784
Jiwaka	14,444,317	837,770	15,282,087
Simbu	35,954,413	1,791,495	37,745,908
Eastern Highlands	39,939,083	2,644,361	42,583,444
Morobe	7,717,200	6,933,179	14,650,379
Madang	41,879,036	4,383,069	46,262,106
East Sepik	55,882,300	4,782,254	60,664,554
Sandaun	38,936,427	4,383,248	43,319,675
Manus	16,294,722	722,612	17,017,333
New Ireland	2,170,000	1,332,849	3,502,849
East New Britain	18,932,834	3,376,244	22,309,078
West New Britain	11,878,634	1,913,884	13,792,518
TOTAL	464,474,046	55,896,234	520,370,280

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1 FINANCING SERVICE DELIVERY IN PNG

All countries make decisions about how to structure their revenue systems and how to deliver services to their residents. A common form of government across the world is one which uses multiple layers of administration that allow powers and spending decisions to be allocated to the level which is best placed to respond to differing conditions across a country. In PNG the multiple layers are the National, Provincial and Local Levels. Legislation and guidelines outline which level of government is responsible for certain services or activities, and also set out how Provinces and LLGs are able to raise revenues.

Because the different Provinces experience economic imbalances the National Government needs to make adjustments in order to maintain equity for all Papua New Guineans. There are two main causes of these imbalances. Firstly, there are social and economic differences between different Provinces within PNG which may lead to differing tax revenues and government spending requirements. These are known as horizontal fiscal imbalances.

Secondly, there are imbalances between the ability of levels of government to raise revenue and their spending responsibilities. These are called vertical fiscal imbalances. It is often efficient for the central government to collect most of the taxes, while Provinces are often better placed to deliver services. In PNG revenue raising powers are highly centralised in the national government — they raise around 95% of total tax revenues. However, Provincial Governments have a responsibility to deliver rural health, education, roads, justice and other services to their populations. In most cases Provinces do not have sufficient revenue raising powers to fund these services on their own.

Both these imbalances can be addressed by payments between the levels of government. PNG has developed its intergovernmental financial relations framework to address both types of fiscal imbalances, as well as to serve other purposes such as the national coordination of policies.

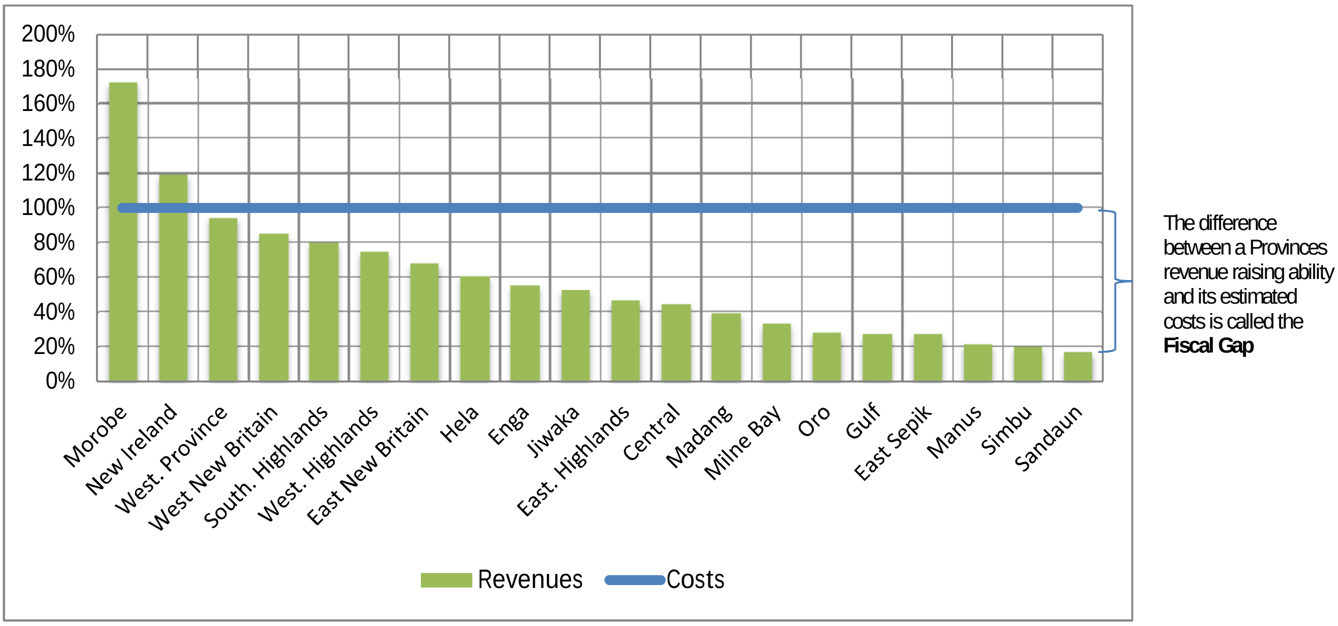
1.1 The Fiscal Gap

The National Government has given the Provinces and LLGs responsibility to provide a number of Government Services to their communities. Maintaining schools and ensuring health centres are operational, are some of the critical activities undertaken by the Provinces. The NEFC undertakes a costing exercise every 5 years of all of these responsibilities in order to calculate how much each Province and LLG requires to service their populations. Each Province has a different cost because they all have different characteristics. Some have large populations who live in easily accessible areas, whereas others have small populations that live in difficult to access remote areas. The blue line on the below graph shows the cost of delivering services as a percentage.

However, from a funding perspective, the Provinces are restricted in what revenue bases they are allowed to tax. Some of these restrictions are set out in law, such as limits on collecting income and company profits tax, whereas others are practical limitations due to the small size of taxable economic activity taking place within their jurisdictions. The revenue raised in each Province is shown as the red bars in the below graph.

The limitations in revenue raising result in a mismatch between the cost of delivering Government Services, and the financial resources available to Provinces to fund those services. This is known as the Fiscal Gap. The below graph shows the fiscal gap for 2015.

Figure 2: Fiscal capacity of Provinces compared to their estimated costs



In order to ensure that the Provinces have sufficient funding to undertake their service delivery responsibilities, the National government makes available a series of grants to each Province to pay for staffing and recurrent goods and services.

1.2 Reforms to Intergovernmental Financial Arrangements (RIGFA)

In the past, the Fiscal Gap was not fully covered for a number of Provinces. This meant that some Provinces did not have the ability to provide basic services to their people. At the same time, other Provinces who had large mining operations, or other economic activity that could be taxed, received large revenues above what they needed to provide basic services. This resulted in an unfair system where a lucky few Provinces received the bulk of funds, and those other Provinces received little.

This system was reformed under the new intergovernmental financing system approved by Parliament on 16 July 2008 and the Ordinary Act passed in 2009. The key features of the new Act were a larger revenue sharing arrangement between the national and the provincial and LLGs which is based on a percentage of the resources available to the government.

The new system also changed the way funds are distributed between Provinces. The formula used to determine each Province's share of the funds was now based on the NEFC's cost estimates. The 6 year result shows that more funding is given to all Provinces, and in particular, those poorer Provinces with low fiscal capacity.

1.3 Types of Grants

In 2015 the National Government provided the Provinces with 3 primary types of grants, namely:

The Staffing Grant. Public servant salaries and allowances are funded by the National Government regardless of whether they are provincial or National staff. The single government payroll means that administratively the payments are made directly between the National Government's payroll system and the employee. To maintain budget integrity, each Province is provided with a staffing grant that sets out the ceiling that is available for personnel emoluments and the staffing structure of each Province is approved by the Department of Personnel Management.

Development Grants. Capital and human development funding is provided through a range of grants, some of which are project specific, others are devolved grants provided for a range of activities. In 2014 the National Government provided K1.59 billion in devolved grants. The Provincial Services Improvement Program (PSIP) provided each Province with K5 million per District. The District Services Improvement Program (DSIP) provided K10 million per District, and the LLG Service Improvement Program (LLGSIP) provided K500,000 per LLG. Guidelines for the use of these funds direct that certain percentages must be allocated into particular sectors (Health, Education, Infrastructure, etc.) for the LLGSIP but the specific projects is left up to the discretion of decision making committees in the Province, District and LLGs.

Recurrent Funding (Function and Administration grants). In order to provide basic services, each level of government requires funding for goods and services. These include things like fuel in order to undertake aid patrols or materials for maintenance. The NEFC has found that without sufficient recurrent funding service delivery for rural communities either does not occur or is ineffective. The National Government provides a set of Function Grants that provide extra recurrent funding to those Provinces who need it most. Those Provinces with high internal revenues are meant to fund a larger portion of their own recurrent costs.

Recurrent funding was the focus of RIGFA, and is the key concern of the NEFC. Chapters 2 – 5 of this report outline the process for determining the Function Grants and the amounts for 2015.

1.4 Role of the NEFC

The NEFC is an adviser to Government and its role is to recommend how to distribute the function grants amongst the Provinces and LLGs. The Treasurer then makes a determination of how the Function Grants will be distributed based on that advice.

From a technical perspective, the NEFC works to understand the cost pressures each Province faces and the own-source revenues available to them. Using a legislated formula the NEFC calculates each Province and LLGs share. The NEFC have a number of principles that it follows in making its recommendations:

- Funding should follow function. That is, the level of Government that is undertaking an activity should be the level that receives the funding.
- Own source revenue should be used to fund service delivery. The NEFC calculates the needs of each Province taking into account the amount of own-source revenue available to the Province. It is assumed that the Province uses their own-source revenue on recurrent costs, and therefore those Provinces that have high revenues receive less function grants.
- Each Province should have an equitable share of funding that is sufficient to run their basic services.

2 EQUALISATION AMOUNT

The Intergovernmental Relations (Functions and Funding) Act 2009 (Section 4 Schedule 1) sets the revenue sharing formula between the National, provincial and Local-level Governments. The amount that is allocated to the sub-national levels of Government is referred to as the Equalization amount. This is the pool of funding for the Function Grants and is the minimum level of funding provincial and LLGs can expect to receive.

Once calculated the equalisation amount is then further divided between individual provincial and LLGs.

The legislation outlines that the equalisation amount is 6.57% of Net National Revenues (NNR) after deducting Mining, royalty and dividend payments (i.e. The NNR amount is the total tax revenue received by the National Government excluding mining and petroleum tax revenue).

Because it is a revenue sharing arrangement it is responsive to the revenues that are received by the National Government. If NNR revenue is high in one particular year, Provincial Governments and LLGs will receive more funding. If NNR in a particular year is low, they will receive less funding.

2.1 Calculation of the Equalisation Amount 2015

The Act requires NEFC to prepare a written estimate of the equalization amount 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 2015 was calculated using tax revenue data from 2013 (the second preceding fiscal year) in accordance with the following formula.

General tax revenue for 2013	-	Mining and petroleum tax revenue for 2013	=	Net National Revenue

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 the 2013 Final Budget Outcome published by the Department of Treasury in March, 2014-.

The following table shows how the NNR amount for 2015 is calculated.

Act definition	Final Budget Outcome equivalents	Kina million
1.2013 General tax revenue	Tax revenue	K8,587.1
MINUS (-)		
2. 2013 Mining and petroleum tax revenue	1. Mining and petroleum taxes	K666.7
	2. Mining levy	K0.0
	TOTAL	K666.7
EQUALS (=)		
3. 2013 Net National Revenue Amount		K7,920.4

For 2015 Budget, the minimum funding level for the equalization amount is calculated according to the following formula in Kina million:

Net national revenue for 2013	X	6.57%	=	NEFC estimate of 2015 equalisation amount
K7,920.4	x	6.57%	=	K520.4

In accordance with the Act, the NEFC provided a written estimate of the equalization amount to the Secretary for Treasury on 31 March 2014.

2.2 Apportioning Equalisation Amount between Provincial & Local-level Governments

Equalisation Amount

The Ministerial Determination that was issued by the Treasurer splits the equalization amount of
K 520.4 million as follows;

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 2015 the amount 'converted' from GST transfers to service delivery grants is K2.4 million for all Provinces.

The total amount for funding transitional individual Province guarantees is:

- K87.2 million: being the amount appropriated to all provincial governments in 2008 for block grants, function grants and derivation grants

<u>PLUS</u>

- 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 (2015) 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.

(ii) Local Level Share

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

Overall, LLGs when compared to 2008 levels will receive funding of K55.9 million in 2015.

(iii) Provincial Share

In the Ministerial Determination, the Province Share is all the remaining funding from the equalization amount as shown below less (i) and (ii).

	K' million	% of EA
Equalization Amount (EA)	520.4	100%
(i) Total amount for funding transitional individual Province guarantees	87.2	17%
(ii) Local level share	55.9	11%
(iii) Province share – remaining funding from EA after paying (i) and (ii)	377.3	72%

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.

3 RECOMMENDATIONS

The NEFC makes a recommendation to the Treasurer on the distribution of the Function Grants to the Provinces and LLGs. For the Provinces this recommendation is broken down amongst the different service delivery function grants (such as health or infrastructure maintenance). As part of the budget process provincial administrations were provided these amounts through the 2015 Budget Circular. The Provinces are allowed to request minor shifts among function grants within their overall sectoral ceiling. Treasury and NEFC hold negotiations with Provinces that request changes so that an agreement can be reached as to the revised split among the function grants.

The renegotiated ceilings are then recommended to the Treasurer. If this recommendation is accepted then the Treasurer makes his determination to formalize the splits amongst the provincial grants for the 2015 Budget.

The results of the NEFC's formula are detailed in this chapter. The following chapters outline the steps of how the NEFC calculates the distribution and includes the data that was used. A more detailed description on the formula is in the NEFC's Plain English guide to the New System of Intergovernmental Financing.

3.1 Provincial distribution

The table below shows the final amounts (in K'000) for each service delivery function grant for each Province for 2015.

Figure 3: 2015 Function and Administration Grants Determination (K '000)

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	Administration Grant	Total Provincial Government Grants
Western	1,579.5	1,394.0	2,199.1	567.4	102.1	212.1	89.4	6,143.6
Gulf	5,086.9	3,966.4	6,085.9	1,681.4	360.5	2,570.6	2,023.1	21,774.8
Central	6,112.3	6,328.1	10,734.6	2,031.3	423.5	3,270.7	2,038.8	30,939.5
Milne Bay	7,489.6	7,719.5	7,348.4	2,340.9	498.5	4,530.1	1,871.1	31,798.2
Oro	4,800.2	4,145.4	4,298.1	2,009.1	341.2	2,241.8	1,105.0	18,940.9
Southern Highlands	4,104.8	4,378.3	3,942.8	991.8	384.9	1,469.9	615.1	15,887.6
Hela	3,383.7	2,009.7	2,215.4	760.4	148.2	1,120.6	1,236.0	10,873.9
Enga	4,954.8	5,186.7	10,527.2	1,144.2	387.1	3,016.5	1,846.2	27,062.6
Western Highlands	3,102.8	4,645.8	6,151.2	911.8	331.9	1,463.8	416.6	17,023.9
Jiwaka	2,502.6	3,660.3	5,480.3	825.8	260.1	1,299.2	416.1	14,444.3
Simbu	7,532.9	9,285.6	10,433.1	1,862.2	673.0	3,380.7	2,787.0	35,954.4
Eastern Highlands	6,233.2	9,579.1	15,207.3	2,133.8	585.4	3,715.1	2,485.3	39,939.1
Morobe	1,275.8	2,000.0	2,266.3	465.3	157.0	967.5	585.3	7,717.2
Madang	9,153.6	9,022.7	12,522.4	3,455.7	567.7	3,715.2	3,441.7	41,879.0
East Sepik	11,529.1	12,464.1	20,491.5	3,675.8	838.6	3,722.2	3,160.9	55,882.3
Sandaun	10,354.3	9,675.6	8,050.9	3,835.9	397.3	2,884.9	3,737.6	38,936.4
Manus	2,642.7	3,092.9	4,758.9	1,148.6	431.7	2,164.0	2,056.0	16,294.7
New Ireland	783.7	555.4	496.1	230.8	27.7	50.9	25.3	2,170.0
East New Britain	3,702.3	5,979.7	4,248.4	1,505.5	196.6	3,188.2	112.1	18,932.8
West New Britain	2,544.2	3,713.0	1,954.8	1,992.6	180.9	1,391.6	101.7	11,878.6
TOTAL	98,869.0	108,801.9	139,412.8	33,570.4	7,293.9	46,376.0	30,150.0	464,474.0

3.2 LLG distribution

The table below shows the final amounts (in K'000) for the LLG grants by Province for 2015. The Urban and Rural LLGs are shown separately.

Figure 4: Local-level Government share by Province for 2015(K'000)

Province	Urban LLG Grants	Rural LLG Grants	Total LLG Grants
Western	816.1	2,963.6	3,779.7
Gulf	144.4	2,711.0	2,855.5
Central	0.0	1,979.3	1,979.3
Milne Bay	357.0	2,392.2	2,749.3
Oro	641.2	1,580.5	2,221.6
Southern Highlands	665.8	2,462.5	3,128.3
Hela	333.1	1,342.2	1,675.3
Enga	207.0	2,045.4	2,252.4
Western Highlands	824.9	1,329.0	2,153.9
Jiwaka	0.0	837.8	837.8
Simbu	477.1	1,314.3	1,791.5
Eastern Highlands	702.5	1,941.9	2,644.4
Morobe	2,515.6	4,417.5	6,933.2
Madang	851.4	3,531.6	4,383.1
East Sepik	710.2	4,072.0	4,782.3
Sandaun	531.4	3,851.8	4,383.2
Manus	214.6	508.0	722.6
New Ireland	400.7	932.1	1,332.8
East New Britain	892.6	2,483.6	3,376.2
West New Britain	452.5	1,461.4	1,913.9
TOTAL	11,738.2	44,158.0	55,896.2

3.3 Transitional arrangements for Hela and Jiwaka

Both Provinces came into legal existence after the 2012 election and for the 2013 Determination the NEFC provided both Provinces with transitional grants. This was because the revenue data captured in the PNG Government Accounting System did not distinguish between the new Provinces and their 'parent' Provinces of Southern Highlands and Western Highlands. Similarly, the NEFC did not have a firm estimate of the cost of delivering services in Hela or Jiwaka. For 2015 the NEFC calculated what would have gone to the parent Provinces if there had been no split, and then divided this amount between the new Provinces and the parent Provinces on the basis of relative population size.

For the 2015 distribution the NEFC calculated the cost of delivering services in Hela and Jiwaka, however, the necessary revenue data from 2013 does not distinguish between parent and new

Provinces. As such, a similar approach to the 2014 distribution was taken where the total distribution was first calculated for a combined Hela/Southern Highlands and Jiwaka/Western Highlands. Then the amount was split between parent and new province based on each Provinces' relative share of estimated costs.

For the 2016 Determination actual revenue data will be available and the NEFC will be in a position to calculate the grants for Hela and Jiwaka in the same way as all other Provinces.

3.4 Funding for Land Mediation Services – NEC Decision 160/2014

The NEC Decision 160/2014 approved the establishment of Land Mediation pursuant to Section 64 of the Intergovernmental Relations (Functions and Funding) Act 2009 to;

a) Establish a "Land Mediation Function Grant"
b) Fund an additional K1.4m for Land Mediation function grant
c) Implement the decision in the 2015 fiscal year

The decision came to NEFC's attention after the 2015 Function Grants ceilings had already been sent out to provincial administrations to prepare their budgets.

NEFC consulted the Village Courts and Land Mediation Secretariat and the Department of Treasury – Budget Division in a number of discussions where various approaches were considered and a consensus arrangement was reached.

The role of Land Mediation is an important aspect of PNG culture and facilitation of issues around customary land. It is an important feature of PNG culture and as such, it is important for the intergovernmental system to recognise this area.

While accepting the fact that land mediation plays a significant role in the law and justice system in PNG, it is important that this function is technically accommodated and sustainable as a function grant annually.

There was agreement between DoT and NEFC that the DoT would fund the K1.4m Land Mediation Grants as a "transitional arrangement" for 2015 (i.e. as a one-off funding until 2016), The Intergovernmental Financing System would accommodate to take effect from 2016 et seq

The 1-year transitional-gap would enable NEFC to modify its Grants and Costing models, as well as to ensure that all necessary legislative requirements in introducing the new land mediation function grants are appropriately complied with.

4 CALCULATING THE FUNCTION GRANTS

In calculating Provincial and LLG grants on a needs basis the NEFC uses a formula that is formalised in legislation. This formula has two key steps:

Step 1: Determine the 'fiscal need' of each Province and LLG by comparing their estimated costs and assessed revenues

Step 2: Using the different levels of fiscal need, calculate the share of the equalisation pool going to each Province and LLG.

4.1 Summary of Legislative Provisions

Two key pieces of legislation provide the basis for the NEFC to determine how much each provincial and LLG 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 supported by more detailed description 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 LLG grants will be calculated.

4.2 The Framework for Determining Fiscal Needs of Provincial and Local-Level Governments

The fiscal needs of a Provincial and LLG is the difference between the cost of providing the assigned service delivery functions and responsibilities and the revenue available to the provincial and LLGs to pay for these services.

Where a Provincial and LLG 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 LLG 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 LLGs to pay for these services.

Fiscal Needs Amounts for Provincial Governments

The fiscal needs amount for a provincial government is calculated using the formula:

Estimated recurrent cost of assigned service delivery functions & responsibilities	-	Assessed revenue	=	Fiscal Needs amounts

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 LLG for each fiscal year is calculated using the formula -

Estimated recurrent cost of assigned service delivery functions & responsibilities	-	Assessed revenue	=	Fiscal Needs amounts

where:-

"estimated recurrent cost of assigned service delivery functions and responsibilities" are the recurrent cost to the LLG for performing its assigned service delivery functions and responsibilities for the fiscal year, including the necessary and incidental costs of administration of the LLG;

"assessed revenue" is the amount of revenue that the NEFC considers to be available to the LLG for meeting the recurrent cost of its assigned service delivery functions and responsibilities for the fiscal year.

4.3 Estimating the cost of service delivery

Cost is one of the two key determinants which impacts on a Provinces' share of the function and administration grants. Each Province has differing cost factors due to its unique circumstances.

Roles and responsibilities - the Function Assignment

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 LLGs and Provinces. This in turn would allow for more accurately estimating the costs of the services they are supposed to provide.

In 2009 the introduction on the Inter-governmental Relations (Functions and Funding) Act and the formal gazettal of the Function Assignment Determination in June 2009 set out the roles and responsibilities of the Provinces and LLGs. The ultimate aim was to reduce the confusion 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. More details on the Function Assignment can be found in the provincial and Local Level Services Monitoring Authority's publication: The Handbook to The Determination of service delivery functions and responsibilities.

The NEFC's cost estimates are based on how much it would cost to undertake these functions irrespective of whether the Province or LLG is actually undertaking them. This is because the intention is to give the Provinces and LLGs the fiscal ability to deliver on all their responsibilities.

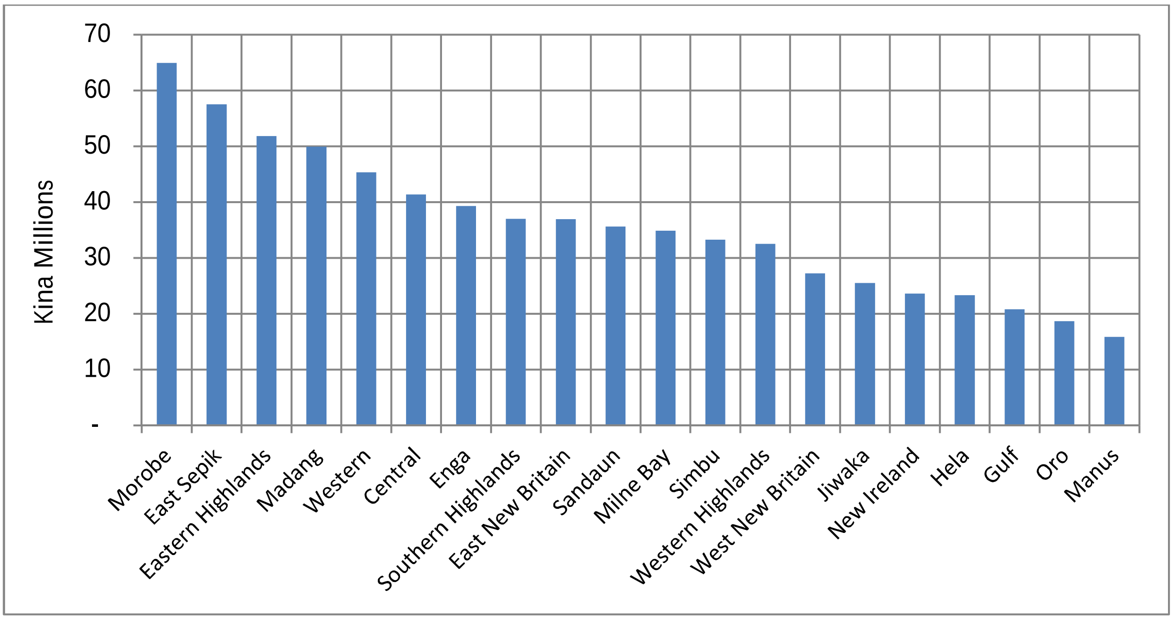
Cost of Service Estimate

The NEFC undertakes a costing exercise of all the functions of Provincial Governments every 5 years. This costing provides a basis for determining fiscal need. In 2011 the NEFC updated this cost estimate, and it is indexed every year between updates to remain accurate.

The determination for any year is based on the costs from the second preceding fiscal year, so for the 2015 determination the 2013 cost estimates were used. This maintains consistency between revenues and costs.

The graph below outlines the estimated costs for each Province in 2013.

Figure 5: 2013 Cost of Service Estimate by Province



4.4 Assessed Revenues

The second part of the formula to determine a fiscal need is a calculation of the available own-source financial resources for 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 data for provincial governments are calculated by the NEFC.

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 2015 distribution year 2013 revenues were assessed by the NEFC.

The sources of revenue are outlined below.

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 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).[1]

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. 2013).

[2] 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.

Bookmakers Tax

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

The distribution of the bookmakers proceeds since 2009 had not been distributed up until 2012 due to an anomaly between the Intergovernmental Relations (Functions and Funding) Act 2009 and the Gaming Control Act 2007. A Budget Amendment in 2013 resolved this situation and the Bookmakers turnover tax was paid to those recipient Provinces (Eastern Highlands, Western Highlands, Morobe, Madang, East New Britain and West New Britain).

For the 2015 Fiscal year, the receipient provinces will receive 100% of Bookmakers Turnover Tax collected in 2013

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 2013 (the second preceding year), Provinces raised K57.2 million[2] 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.

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.

[2] This excludes Bookmakers Tax

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

In 2013 (the second preceding year), NEFC estimates that Provinces received KK133.6 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.

Figure 6: Actual revenues collected by Province in 2013

Province	GST Distributions	Bookmakers Tax	Own Source Revenues & Others	Royalties	Dividends
Western	7,000,712	0	1,811,788	25,100,000	23,344,512
Gulf	231,758	0	1,785,834	0	1,670,000
Central	1,982,650	0	7,839,354	2,046,679	0
Milne Bay	7,126,909	0	894,435	0	0
Oro	2,268,375	0	56,740	0	0
Southern Highlands	10,364,024	0	947,487	23,625,314	13,980,000
Hela	0	0	0	0	0
Enga	1,280,870	0	390,921	15,457,233	3,500,000
Western Highlands	26,818,248	1,423,693	4,538,041	0	0
Jiwaka	0	0	0	0	0
Simbu	1,583,630	0	1,697,338	0	0
Eastern Highlands	14,988,544	393,344	3,681,170	0	0
Morobe	95,697,484	1,015,626	10,777,936	2,398,025	0
Madang	11,610,768	1,024,757	2,470,685	0	0
East Sepik	8,529,203	0	2,280,952	0	0
Sandaun	1,358,545	0	2,127,076	0	0
Manus	1,192,935	0	1,546,234	0	0
New Ireland	7,624,881	0	626,626	22,523,934	0
East New Britain	17,414,427	206,994	5,385,013	0	0
West New Britain	11,909,316	0	8,398,537	0	0
TOTAL	228,983,279	4,064,414	57,256,168	91,151,184	42,494,512

Assessing 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

- o 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

- o 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[3].

iii) GST

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

iv) Bookmakers Turnover Tax

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

[3] 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.

4.5 Calculating Fiscal Needs of the Provinces

Bringing together the estimated costs and assessed revenues of each Province gives a calculation of fiscal needs. The calculation for 2015 is outlined in the below table.

Figure 7: Fiscal Needs of Provinces for 2015 (Kina '000)

Provinces	Estimated costs	Assessed revenues	Fiscal needs	% of total fiscal needs
Western	45,305.7	42,733.1	2,572.6	0.8%
Gulf	20,813.9	5,689.1	15,124.7	4.8%
Central	41,366.9	18,434.1	22,932.8	7.3%
Milne Bay	34,859.3	11,487.8	23,371.5	7.4%
Oro	18,654.9	5,279.9	13,375.0	4.2%
Southern Highlands	36,997.9	29,635.2	7,362.7	2.3%
Hela	23,310.0	14,196.0	9,114.0	2.9%
Enga	39,262.3	21,694.1	17,568.2	5.6%
Western Highlands	32,533.4	24,302.7	8,230.7	2.6%
Jiwaka	25,518.6	13,412.0	12,106.5	3.8%
Simbu	33,260.3	6,712.5	26,547.8	8.4%
Eastern Highlands	51,817.4	24,142.3	27,675.2	8.8%
Morobe	64,913.2	111,737.7	0.0	0.0%
Madang	49,908.8	19,660.0	30,248.8	9.6%
East Sepik	57,480.3	15,680.3	41,800.0	13.2%
Sandaun	35,631.0	5,970.6	29,660.4	9.4%
Manus	15,855.5	3,399.4	12,456.1	3.9%
New Ireland	23,577.2	28,127.3	0.0	0.0%
East New Britain	36,937.8	24,980.8	11,957.0	3.8%
West New Britain	27,195.9	23,098.0	4,097.9	1.3%
TOTAL	715,200.4	450,373.0	316,202.1	100.0%

4.6 Calculating Individual Province Shares

Once fiscal needs have been calculated the next step is to apportion the shares of the equalisation pool to come up with the final amounts to go to each provincial government. The calculation of fiscal needs recognises that each Province is different and as such each Province will receive a different share of the equalisation amount.

Once the individual Province share is calculated the next step is to divide up the total share into service delivery function grants and an administration grant.

For 2015 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.

Figure 8: 2015 Individual Province Share (K'000)

Province	Transitional Individual Province Guarantee (a)	Estimated Fiscal Needs (Estimated costs minus assessed	Percentage of total fiscal needs	Funding based on percentage of total fiscal needs (b)	Individual Province Share (a) + (b)
Western	3,074.2	2,572.6	0.8%	3,069.4	6,143.6
Gulf	3,729.4	15,124.7	4.8%	18,045.4	21,774.8
Central	3,578.3	22,932.8	7.3%	27,361.2	30,939.5
Milne Bay	3,913.7	23,371.5	7.4%	27,884.5	31,798.2
Oro	2,983.2	13,375.0	4.2%	15,957.7	18,940.9
Southern Highlands	7,103.2	7,362.7	2.3%	8,784.4	15,887.6
Hela	0.0	9,114.0	2.9%	10,873.9	10,873.9
Enga	6,102.0	17,568.2	5.6%	20,960.6	27,062.6
Western Highlands	7,203.8	8,230.7	2.6%	9,820.1	17,023.9
Jiwaka	0.0	12,106.5	3.8%	14,444.3	14,444.3
Simbu	4,280.2	26,547.8	8.4%	31,674.2	35,954.4
Eastern Highlands	6,919.8	27,675.2	8.8%	33,019.3	39,939.1
Morobe	7,717.2	0.0	0.0%	0.0	7,717.2
Madang	5,789.1	30,248.8	9.6%	36,089.9	41,879.0
East Sepik	6,010.6	41,800.0	13.2%	49,871.7	55,882.3
Sandaun	3,548.5	29,660.4	9.4%	35,387.9	38,936.4
Manus	1,433.3	12,456.1	3.9%	14,861.4	16,294.7
New Ireland	2,170.0	0.0	0.0%	0.0	2,170.0
East New Britain	4,666.9	11,957.0	3.8%	14,265.9	18,932.8
West New Britain	6,989.4	4,097.9	1.3%	4,889.2	11,878.6
Total	87,212.9	316,202.1	100.0%	377,261.2	464,474.0

4.7 Individual Local-Level Share

The individual rural local-level share is the amount an individual rural LLG receives from the equalisation system.

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

The amounts for individual urban or rural LLG for the relevant fiscal year are calculated using the formula below:

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

where—

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

“equalization amount for urban LLGs” means the amount estimated by the NEFC to be the urban LLGs’ 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 LLG” means the fiscal needs amount of that urban LLG for the relevant fiscal year;

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

A similar formula is used to calculate the rural LLG share.

Most rural LLGs 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 LLGs have little or no revenue, they have different fiscal needs amounts because they all have different costs.

Urban and rural LLGs 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 LLGs can raise substantially more revenue to fund a more significant proportion of their service delivery costs. Rural LLGs tend to have minimal revenues and fewer service delivery functions and responsibilities.

Revenues for rural and urban LLGs 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 LLGs and would then assess these more accurately. It may never be possible to accurately assess revenues for over290 rural LLGs. In the circumstances, revenues for rural LLGs may remain at zero.

The total LLG share is divided between rural and urban LLGs in the same proportion as provided in the 2009 budget i.e. 79% rural, 21% urban.

The rural LLG share is then further divided into 290 individual LLG amounts, based on district costs and population in each LLG.

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

4.8 A note on calculating the determination

Occasionally revenue data is not available to the NEFC at the time it undertakes its calculations early in the financial year (May). When data is not available the NEFC makes a forecast of the revenues using historical data (normally based on the 3 year average).

Due to the uncertain nature of forecasting these are sometimes different to the actual revenues eventually recorded later in the year. Similarly, on occasions data collected by other government agencies is later revised after the NEFC makes its calculations. The NEFC has a long-standing practice of not changing its recommendations in these circumstances. The NEFC makes its calculations using its best efforts and the data available to it at the time. This ensures that the calculations are made early in the financial year which then means that Provinces receive their funding ceilings in a timely manner.

5 CONDITIONS ATTACHED TO THE USE OF THE FUNCTION AND ADMINISTRATION GRANTS

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.

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;

- service delivery function grants
- administration grants
- rural LLG grants
- urban LLG grants
- staffing grants, and allowances for village court officials
- other development needs

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

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 2015

- 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

In 2009, 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 MPA's are:

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
Health 1. Operation of rural health facilities 2. Drug distribution*see below 3. Integrated health outreach patrols	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 i. Number of months health facilities stocked with essential supplies in the last quarter 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.
Education 4. Provision of school materials 5. Supervision by provincial/district officers 6. Operation of district education offices	i. Total no of schools by type ii. Percentage of schools that received basic school supplies before 30th April. i. Number of schools visited by district / provincial education officers i. Number of District Education Offices that provided quarterly performance reports.
Transport Maintenance 7. Road and bridge maintenance 8. Airstrip maintenance 9. Wharves and jetties maintenance	i. Names and approximate lengths of provincial roads maintained ii. Names of bridges maintained i. Names of rural airstrips maintained i. Names of wharves, jetties and landing ramps maintained
Agriculture 10. Extension activities for agriculture, fisheries and forestry	i. Number of extension patrols conducted by provincial government staff and ii. Number of people who attended extension sessions
Village Courts 11. Operations of Village Courts	i. Number of village courts in active operation ii. Number of village courts supplied with operational materials iii. 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 Improving Compliance of Conditions for Funding

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:

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

The Department of Treasury, in conjunction with the Department of Provincial and Local Government Affairs and the National Economic and Fiscal Commission continue to work with Provinces to improve the compliance of these Budget and Expenditure Instructions. In 2013 the NEFC undertook 2 training sessions on the 8^{th}-9^{th} July and 8^{th}-10^{th} August in the following Provinces:

- Western Highlands
- East Sepik

6 IMPLEMENTATION OF PROVINCIAL BUDGETS: ANALYSIS AND ISSUES

The NEFC sees its role as being a bridge between the national level of government and the Provinces. On occasions policy and administrative practices at the national level can have detrimental impacts on the Provinces and vice versa. The NEFC uses a number of opportunities throughout the year to bring attention to any issues at either level and try to bring the parties together to find a solution.

Every year the NEFC holds a series of regional workshops which brings in all the provincial sector managers and the deputy provincial administrators. The focus of these workshops changes each year based on pertinent issues that have arisen. The workshops place a large emphasis on the Provinces to provide an assessment of their own performance, and to detail any barriers they see to successful implementation. The NEFC then engages through a variety of national level forums (such as PLLSMA, and the Inter-Departmental Committee) in an attempt to solve these issues.

Another annual activity undertaken by the NEFC is to support the Department of Treasury, through the second quarterly budget expenditure review. The second quarter is a useful time to assess how effectively Provinces are implementing their budget.

The NEFC also undertakes an assessment of the budgets submitted by each Province. It plays a support role in the Budget Screening Committee, and also scores the quality of provincial budget documents in a scorecard.

Most importantly the NEFC undertake the Provincial Expenditure Review (PER). This review assesses whether spending by Provinces in the previous year has been in high priority areas, such as on front-line service delivery and on the MPAs. The aim was to make the PER as contemporaneous as possible in order to provide the Provinces with a fair reflection of their current performance.

6.1 Implementation of 2014 Budgets, Analysis

Provincial government Half Year Budget Reviews were conducted by the Department of Treasury assisted by NEFC staff and Department of Personnel Management. This process is one of the major monitoring exercises undertaken throughout the year and the aim is to assess how well Provinces are managing and implementing their budgets. The review is undertaken on a regional basis. Key objectives of the review are to:

- Determine whether cash release and spending trends are supporting service delivery. This is seen through an even expenditure profile throughout the year.
- Satisfy the various reporting requirements. NEFC emphasis is on the reporting of MPAs. Treasury's focus is on compliance with the PFMA and Budget Expenditure Instruction and in reporting in a consistent manner using the reporting templates.

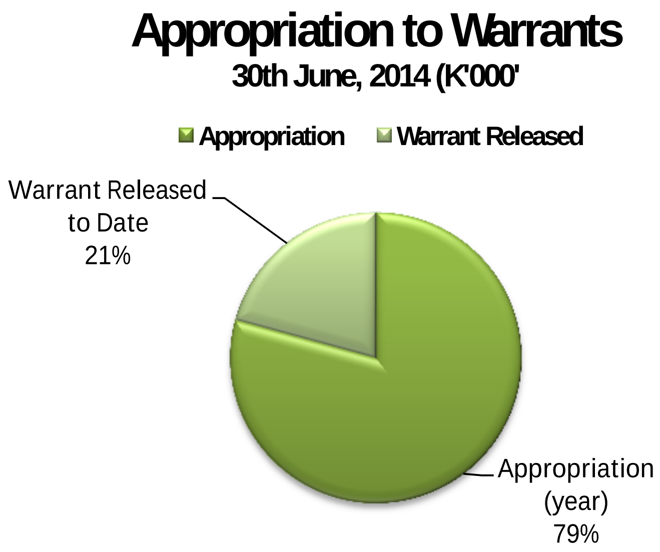
This year, representatives from national agencies including the Department of Personnel Management and the Department of National Planning and Monitoring attended the reviews. West New Britain, Western Highlands, Hela, Jiwaka and Simbu Province did not present in the reviews.

The NEFC compiled all the available data from twelve Provinces as part of its review analysis. The findings are detailed below.

Cash flow for service delivery to Provinces remains slow

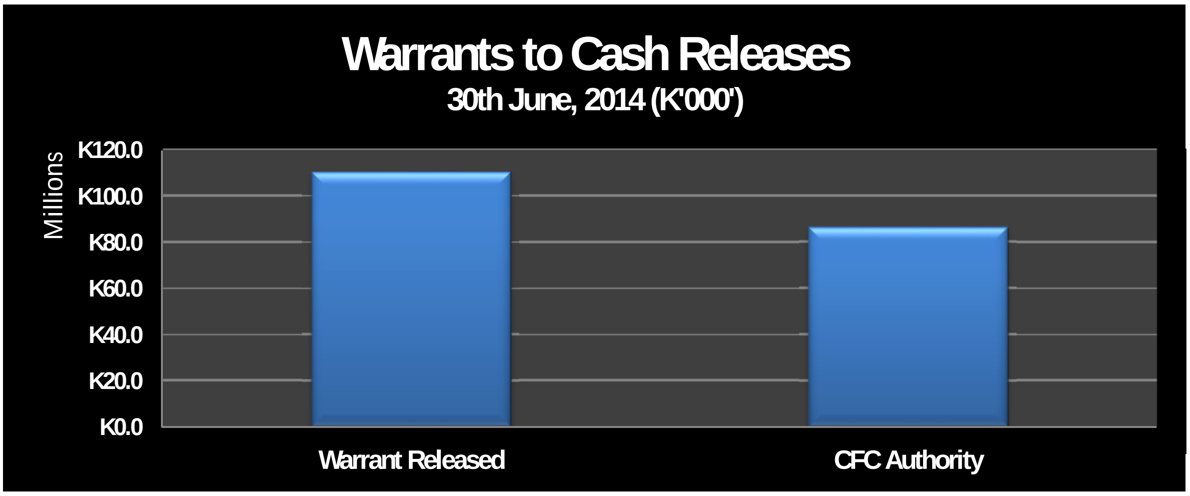
For the twelve Provinces analysed, the release of warrants from Treasury remains stubbornly slow. Provinces reported that only 21% had been released by 30 June.

Figure 9: Cash flow to Provinces



Although there is no guarantee that front loading the release of warrants will improve the implementation of provincial budgets, it is quite clear that slow cash release impedes service delivery. In many occasions CFC Authority issued is less than amount warranted for release. Provinces reported that CFC worth of K86 million was issued by 30th of June.

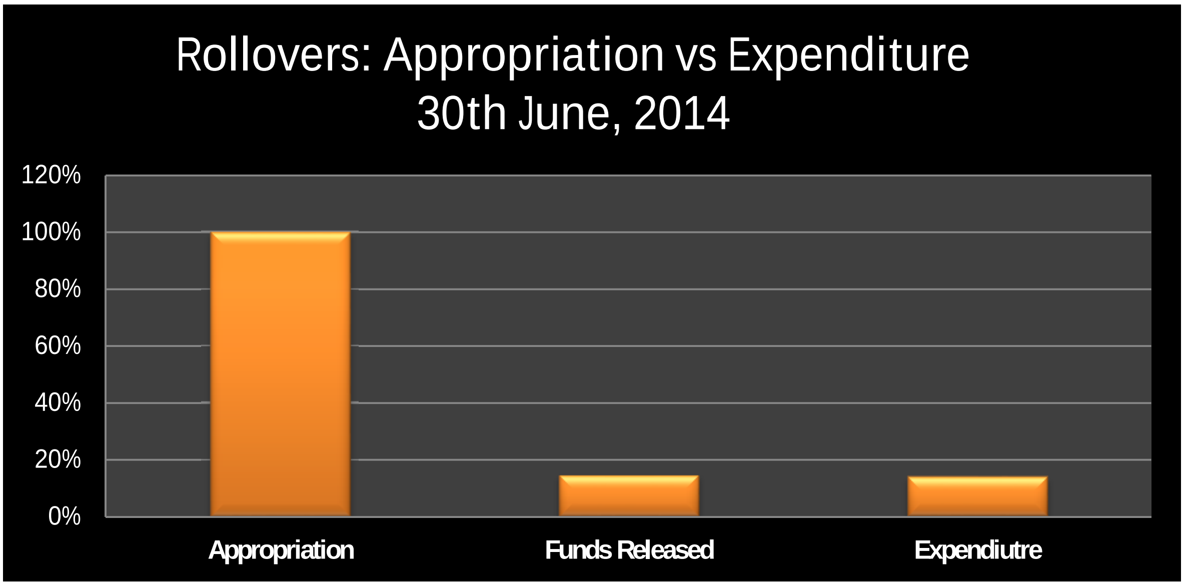
Figure 10: Warrants and CFC to Provinces



The use of Rollovers by provinces

In the case of slow release of cash, provinces were encouraged to fully utilise their rollovers, to supplement the current year appropriations. East Sepik provinces was reported to have a rollover of K15 million unused as of 30th June. Provinces reported that rollover of 14% of the rollovers were released to 30th June.

Figure 10: Release of Rollover Funds to Provinces



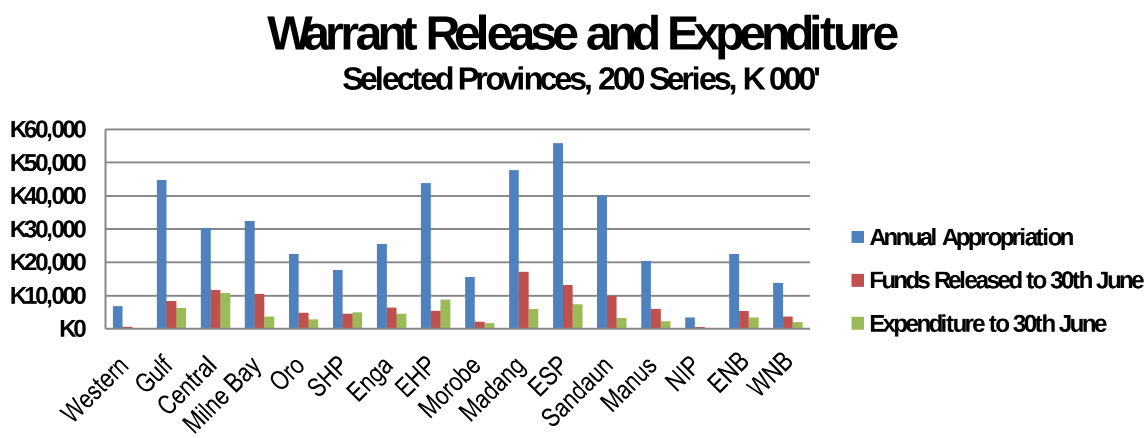
The NEFC has raised this issue at a number of forums and the 2012 Governor's conference made a resolution that Treasury should release the warrants using a standard schedule of 40% in the first quarter, then 30%, 20%, 10% in the following quarters. Frontloading the release of cash is important because it takes time for Provincial Treasuries to process those warrants and move funds to the intended recipients (the Districts or service delivery facilities). Receiving large amounts of funding late in the year is difficult for Provinces to spend effectively.

Some Provinces are struggling to implement their budgets

The release of warrants does not provide the entire story about budget implementation. Analysis was also undertaken to determine the level of spending undertaken by Provinces compared to the amount of funds that were released to them. The question asked was about whether lack of cash was the main impediment to service delivery.

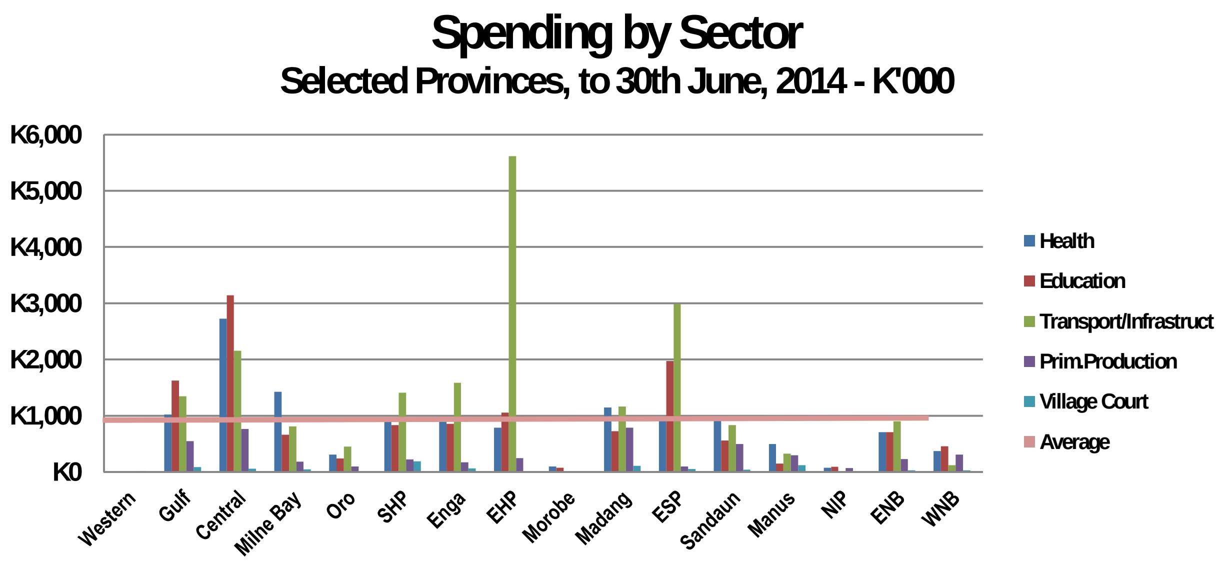
On the basis of the twelve Provinces assessed, only two (Central and to a lesser extent Southern Highlands) had spent over 80% of the funds they had received. The below graph shows the annual appropriation, the warrants released up to the end of June and the spending to the end of June.

Figure 11: Spending by Provinces



The data was then assessed on a sectoral basis which did not show a strong trend between sectors. Central had strong spending in all sectors whereas most other Provinces had a mix.

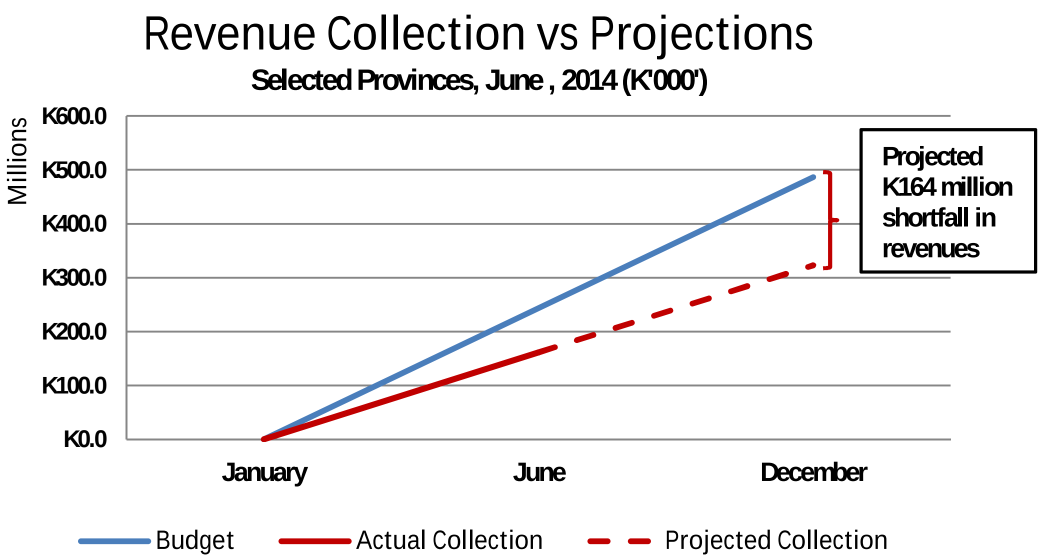
Figure 12: Spending by Provinces (by sector)



Revenue collections are lower than budgeted

Provincial revenues were below budget which is expected to result in a shortfall of around K164 million over the financial year compared to K53 million shortfalls last year. Because Provinces are unable to borrow money, any shortfalls in revenues impact directly on their spending for recurrent goods and services. This has a negative impact on service delivery.

Figure 13: Forecast revenues



6.2 NEFC Regional Workshops

The NEFC workshops were conducted from May to June 2014. The four workshops were held in following regional centres; Southern Region NCD, Highlands Goroka, New Guinea Islands Kimbe and Momase region in Madang.

Overall all workshops were successfully conducted with a total of 287 participants attending the four workshops. The target participants were provincial administration and budgeting staff, sector managers/advisors and provincial treasury staff.

The workshop presenters included our primary stakeholders: Department of Finance, Department of Treasury, DPLGA, Church Health and Village Courts Secretariat. 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. As in past workshops, these joint resolutions have resulted in addressing common issues including addressing operational road blocks.

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 split into two separate sections: the issues which can resolve by Provinces; and the issues which can be resolved by the central agencies.

Collective 2014 Workshop Resolutions

ISSUES FOR THE PROVINCIAL GOVERNMENTS TO ADDRESS

Resolution (1)

NEFC 'Yu Tok' Presentation

- That all provinces pledge to ensure that 'Yu Tok' presentations' are completed prior to the workshops in preparation for presentation on the first morning of workshop.
- That provinces use the NEFC template included with the Workshop invitation letter and continue to make high level presentation supported by quality data and concise on MPAs

Panel's Critique

- o Data information on roll-overs/internal revenue must be included in the province's presentation.
- o Provide comparative presentation data analysis between years to better inform workshop participants.

Resolution (2)

Department of Implementation and Rural Development (SIP)

- That provinces use 5 year Development Plan as a Prerequisite to draw down SIP fund.

Including adherence to the new proposed Financial Instructions

- Consult DPM for engagement of staff/structure – Not permitted to use DSIP funds for engagement of staff
- Provinces consider Periodic Monitoring and Evaluation of SIP funds and ensure correct chart classifications for SIPs

Resolution (3)

Cross Cutting

- That provinces make a commitment to the allocating of funds to HIV & AIDS programs and education.
- Continue to encourage and promote gender equity issues in provincial decision making, planning and recruitment.

Resolution (4)

Department of Provincial and Local Level Government Affairs

- That provinces make a commitment to submit 2013 Section 119 reports within DPLGA's timeframe
- Provinces to improve in the quality of reporting in the DPLGA S119 and also in the DoT quarterly budget reports

Resolution (5)

Department of Treasury (Provincial budgeting – Submissions & Reporting)

- That provinces prepares its budget within DoT budget timeframes.
- That provinces ensure Quarterly Reports to be submitted promptly each quarter to assist DoT

Resolution (6)
Chart of Accounts

- That provinces ensure that proper accounting entries are recorded to track and report on District /LLG expenditure.
- Provinces to contact DoT-PBB or NEFC for assistance.

Resolution (7)
Improving the Quality of Budgeting- Adherence to Budget & Expenditure Instructions (BEIs) for 2014.

- That provinces improve their budget processes by adhering to the Budget Expenditure Instructions

- That provinces continue to engage with NEFC, DoT and Sectoral Agencies, prior to budget submission.
- Observe local communication protocols prior to lodging budget with DoT (i. e consult their Provincial Assemblies and arrive at a consensus before submitting their budgets).
- That all provinces adopt the 3 pager (Provincial Budget Model) Summary Report developed by NEFC and be included as part of their 2015 Annual budget submissions.
- That province provide indicative cash flow requirement as part of their budget submission to DoT.

Resolution (8)

Payroll Administration

- Provinces pledge to improve controls over payroll validation processes.
- Seek assistance from DoF and DoT to obtain required payroll reports to assist with the payroll verification / checking
- Periodic audits be conducted to ensure that non bona fide employees are identified and promptly removed from the system
- Termination of cessation payments must be paid made timely and removed from the payroll system.
- The completed verified payroll summary reports must then be returned back to DoF after all anomalies identified are addressed.

Resolution (9)

Audit functions

- That provinces effectively use their internal audit units and committees effectively as a tool to assist provincial management efforts in achieving planned goals and objectives.
- That province take steps to improve internal monitoring and compliance and evaluation processes. This should be over sighted by provincial administrators.

Resolution (10)

Department of Finance -

- That provinces familiarize themselves with the Finance Instructions specifically the proposed revised New Financial Instructions relating to DSIP.

- That provinces/provincial administrations agree to participate in awareness raising programs of improving financial management arrangements for statutory bodies under part 8 of the PFMA.

ISSUES FOR THE CENTRAL AGENCIES TO ADDRESS

Structured Schedule for Warrants and Cash Releases

- That DoT-PBB advocate proactively on behalf of provinces, to secure a consistent and matching warrant and cash releases to Provinces.
- That DPLGA continue to roll out of the 'Monitoring Tool' to ensure that provinces effectively implement the tool to meet Section 119 reporting.

Improve Accountability and Reporting at LLG level

- That DoF/DoT inform both PAs and DAs on the status of funds allocated to LLGs.

Village Courts & Department of Justice and Attorney General (DJAG)

- That Village Court Secretariat continues to advocate with NEFC/DoT to create a Function Grant for Land Mediation activities.

Department of Treasury

- That DoT-PBB to review and to ratify the most current chart of accounts to be used by provinces to overcome the confusion expressed by provinces.

Special Workshop Resolution

- NEFC Chairman/CEO on behalf of provinces take up at a higher level for a firm commitment on fixed percentage of matching warrants and cash releases.

Other Issues

- That DPLGA finalize the minimum standards for services and infrastructures
- Provinces to support the growth of SME as an avenue to encourage revenue generation within the province.
- That Provinces consider direct facility funding in their planning and budgeting
- Consider repealing section 47 of the Organic Law relating to Village Courts

6.3 Assessing the quality of Provincial Budget submissions

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 2014 Quality Budget Assessment was conducted in April 2014 and presented to Provinces during the NEFC Regional workshops held in May and June 2014.

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.

Overall most provincial budgets have improved in quality over the past 3 years.

Figure 14: Quality of Provincial Budget Performance (Ranking on a 3-year Average)

Province	2012	2013	2014	3-year Average	Rank
ENB	75	75	74.0	75	1
Central	77.5	71.5	76.0	75	2
EHP	74	73	67.5	74	3
Manus	70.5	74.5	69	73	4
Simbu	68	72	67.5	70	5
Sandaun	62	77	58	70	6
Gulf	69	62	73.0	66	7
NIP	54.5	76.5	56.5	66	7
WNB	63	68	63.0	66	7
Madang	63	67.5	61.5	65	10
SHP	61.5	68	62.0	65	11
Oro	62	60.5	56.5	61	12
ESepik	72	50	63	61	13
Enga	61	60	59.0	61	14
Western	53	67	62.0	60	15
Morobe	51	66	55.0	59	16
WHP	70.5	43.5	51.0	57	17
Milne Bay	52.5	56.5	80.5	55	18
Jiwaka	0	65	38.0	33	19
Hela	0	62	67.0	31	20

Top Five (5)

Top Ten (10)

6.4 Assisting the Reform Processes

NEFC has been proactively involved in assisting provinces through regional workshops conducted for each region. This year the workshops were held in Kokopo for New Guinea Islands, Alotau for the Southern Region, Lae for the Momase Region and Mount Hagen for the Highlands Region. Apart from the regional workshops, minor trainings were as well conducted as per individual provinces request. Therefore, this year, East Sepik , Central and Western Highlands provinces 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 Provincial Budget Model and the Provincial Establishment Costing Model which were developed . 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 was introduced to Provinces in 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.

6.5 2011 Provincial Expenditure Review "Government, Money Arteries & Services"

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 2012 was the fourth 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 across the districts bringing care and skills are what it is all about.

Seven years ago 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.

The PER examines year four of increased funds and we are looking for what is termed as "Government, Money Arteries & Services": The "Government, Money Arteries & Services" where the reforms should be embraced by all levels of government with a view to improving service delivery. It highlights the role of the hidden system of money flows plays in ensuring the delivery of services takes place. The government can, and is, committing increased funding through the intergovernmental system and yet blockages within its funding arteries will strangle and eventually kill off the service delivery outlets and activities; the schools and the clinics, and the supervisory and extension staff located at the district service centres.

Schools and health clinics will become; uninviting to students and patients, under-stocked and without critical supplies and materials. Activities vital in a rural setting such as supervisory visits in health and education and extensions patrols in health, agriculture and fisheries will simply fail to happen. We know this to be true, because this is the very reality we are seeking to reverse.

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:

COST	How much does it cost to deliver priority services in each Province?
CAPACITY	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. The latest review entitled Taking Stock is the seventh edition in the series and reviews the situation in 2011. The 2011 fiscal year is the third year of implementation of the reform on the intergovernmental financing arrangements (RIGFA). Many readers will now be aware that more funding is being allocated to Provinces and it is being targeted firstly at those who need it most and at the priority sectors of health, education,

RIGFA, is it working?

Year Three – 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 2009? 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.

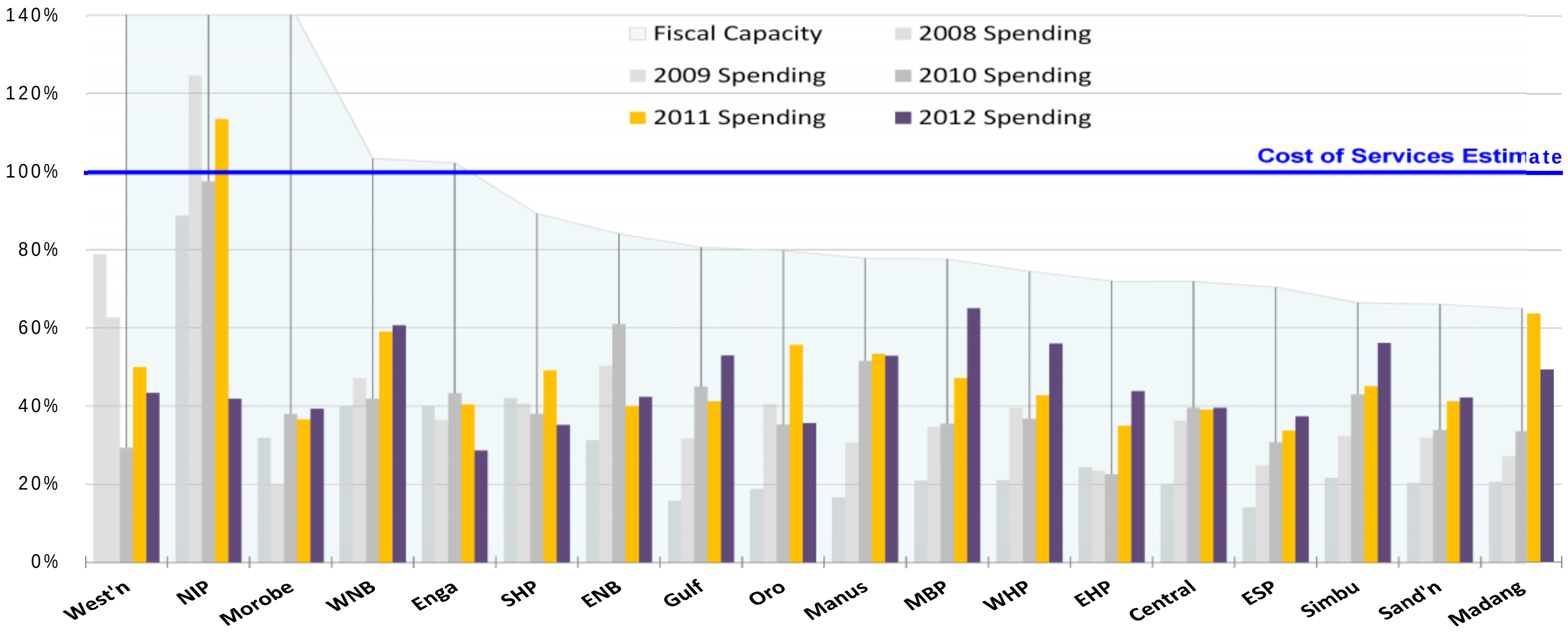
- Was there evidence of spending on MPAs?

  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[4]. Clearly identifying budget line items will help ring-fence these funds and ensure sectors have the resources necessary to carry out the activities.

[4] 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[5]. The second is a matter of funding, many Provinces simply do not have sufficient funding – we call this the funding gap.

Figure 15: Supporting MTDS priorities: 2008 to 2012



[5] 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:[6] In 2011 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 increases 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.

[6] 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.

- 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.[7]
- 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 Infrastructures? We need to consider the impact of new infrastructure development. Every new infrastructure development creates on-going 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

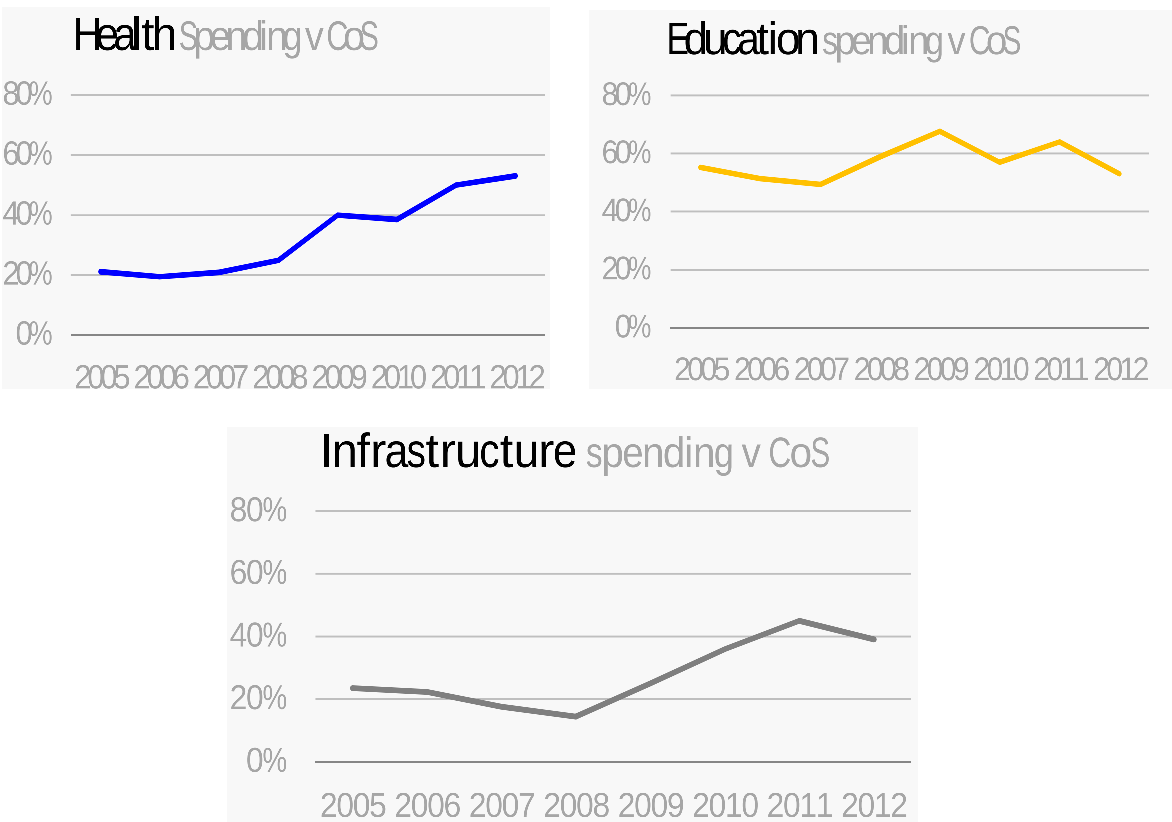
The Provincial Expenditure Review has stories at every level, let's summarise each major sector:

- Education: Recurrent spending in education has increased by K5 million with most Provinces (12) spending more in 2011 and some spending significant amounts.

[7] 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.

- Health: 2011 saw a positive change in health spending with overall spending increasing by a further K10 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 K25 million in 2011 – 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 2011 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.

Figure 16: Average Spending by Sector from 2005 to 2011



- Upward trends: In health and infrastructure
    - The dip in the education graph indicates that whilst spending increased in kina in 2011 – 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 <u>internal revenue</u> 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 2014 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 <u>central agencies</u> 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 tomorrows 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

APPENDIX A: FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

Intergovernmental Relations (Functions and Funding) Act 2009

FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

I, **Patrick Pruaitch, CMG, 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 enabling me, 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 sub clause (1), a health function grant must be used to fund goods and services for the following main programs and activities:

(a) the distribution of medical supplies;
(b) outreach services;
(c) malaria supervision;
(d) safe motherhood;
(e) immunization;
(f) water supply and sanitation;
(g) health service monitoring, review and performance agreements.

4 EDUCATION FUNCTION GRANT

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

(2) Without limiting sub clause (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 and infrastructure sector.

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

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

7 PRIMARY PRODUCTION FUNCTION GRANT

(1) A primary production function grant must be used to fund operational and maintenance costs (i.e. goods and services) incurred in the agricultural and fisheries 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 SERVICES DELIVERY FUNCTION GRANT

An other services 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 01st **day of** October **, 2014**

Minister for Treasury

2015 BUDGET ADVICE – (KINA)

Attachment B

1) EXCLUDES THE K1.4 MILLION APPROVED FOR 2015 LAND MEDIATION GRANTS – that funding is calculated outside of the intergovernmental financing system thus not included in the this determination.
2) INCLUDES NEGOTIATION SHIFTS - but no change to the overall resource levels for recommended provinces for 2015
3) INCLUDES TRANSFERRED FUNDING FROM GST DISTRIBUTION CHANGES RESULTING FROM NEW SYSTEM OF INTERGOVERMENTAL FINANCING (ADDITIONAL K2.4 MILLION) FOR GRANTS – but no change to the overall resource levels for recommended provinces for 2015

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	Administration Grant	Total Provincial Government Grants	Total Provincial Government Grants	Urban LLG Grants	Rural LLG Grants	Total LLG Grants	Grand Total
Western	1,579,479	1,393,991	2,199,091	567,437	102,120	212,146	89,368	6,143,633	6,143,633	818,099	2,963,628	3,779,727	9,923,360
Gulf	5,086,906	3,966,363	6,085,942	1,681,428	360,539	2,570,566	2,023,053	21,774,798	21,774,798	144,441	2,711,015	2,855,457	24,630,255
Central	6,112,348	6,328,087	10,734,619	2,031,311	423,546	3,270,737	2,038,804	30,939,452	30,939,452	0	1,979,317	1,979,317	32,918,769
Milne Bay	7,489,627	7,719,488	7,348,381	2,340,937	498,512	4,530,138	1,871,141	31,798,224	31,798,224	357,018	2,392,239	2,749,258	34,547,482
Oro	4,800,248	4,145,421	4,298,131	2,009,132	341,199	2,241,794	1,104,984	18,940,909	18,940,909	641,180	1,580,462	2,221,642	21,162,552
Southern Highlands	4,104,804	4,378,254	3,942,801	991,822	384,925	1,469,941	615,057	15,887,605	15,887,605	665,777	2,462,532	3,128,309	19,015,913
Hela	3,383,657	2,009,684	2,215,391	760,394	148,185	1,120,650	1,235,986	10,873,947	10,873,947	333,072	1,342,206	1,675,278	12,549,226
Enga	4,954,777	5,186,658	10,527,218	1,144,184	387,083	3,016,495	1,846,214	27,062,629	27,062,629	206,951	2,045,430	2,252,381	29,315,009
Western Highlands	3,102,841	4,645,751	6,151,243	911,775	331,869	1,463,834	416,570	17,023,883	17,023,883	824,863	1,329,038	2,153,901	19,177,784
Jiwaka	2,502,601	3,660,272	5,480,312	825,804	260,063	1,299,197	416,068	14,444,317	14,444,317	0	837,770	837,770	15,282,087
Simbu	7,532,865	9,285,596	10,433,109	1,862,166	672,965	3,380,740	2,786,971	35,954,413	35,954,413	477,146	1,314,349	1,791,495	37,745,908
Eastern Highlands	6,233,162	9,579,061	15,207,254	2,133,817	585,366	3,715,145	2,485,278	39,939,083	39,939,083	702,502	1,941,859	2,644,361	42,583,444
Morobe	1,275,800	2,000,000	2,266,300	465,300	157,000	967,500	585,300	7,717,200	7,717,200	2,515,640	4,417,540	6,933,179	14,650,379
Madang	9,153,648	9,022,652	12,522,390	3,455,740	567,695	3,715,209	3,441,702	41,879,036	41,879,036	851,439	3,531,631	4,383,069	46,262,106
East Sepik	11,529,121	12,464,104	20,491,492	3,675,774	838,646	3,722,249	3,160,914	55,882,300	55,882,300	710,248	4,072,006	4,782,254	60,664,554
Sandaun	10,354,332	9,675,558	8,050,859	3,835,875	397,308	2,884,939	3,737,556	38,936,427	38,936,427	531,400	3,851,848	4,383,248	43,319,675
Manus	2,642,715	3,092,892	4,758,901	1,148,566	431,671	2,163,997	2,055,980	16,294,722	16,294,722	214,641	507,971	722,612	17,017,333
New Ireland	783,669	555,393	496,125	230,843	27,718	50,944	25,309	2,170,000	2,170,000	400,727	932,122	1,332,849	3,502,849
East New Britain	3,702,267	5,979,724	4,248,419	1,505,549	196,588	3,188,175	112,112	18,932,834	18,932,834	892,603	2,483,642	3,376,244	22,309,078
West New Britain	2,544,165	3,712,997	1,954,799	1,992,556	180,881	1,391,571	101,665	11,878,634	11,878,634	452,465	1,461,420	1,913,884	13,792,518
TOTAL	**98,869,035**	**108,801,946**	**139,412,777**	**33,570,413**	**7,293,877**	**46,375,966**	**30,150,032**	**464,474,046**	**464,474,046**	**11,738,209**	**44,158,025**	**55,896,234**	**520,370,280**

APPENDIX B: REVISED BUDGET AND EXPENDITURE INSTRUCTIONS

REVISED BUDGET AND EXPENDITURE INSTRUCTION 1/2012

25th 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:

GRANT TYPE	INDICATOR	VOTE CODE
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

GRANT TYPE	INDICATOR	NEW VOTE CODE
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.

REMITTANE 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

Telephone: (675) 312 8736
Facsimile: (675) 312 8806

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 16th 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 proceeding 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.

7

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:

- AdministrationHealth 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

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"Attachment A"

Quarterly Minimum Priority Activity Indicators

Minimum Priority Activities (MPAs)	Agreed Indicators
Health	
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
Education	
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
Transport Maintenance	
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
Primary Production	
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
Village Courts	
1. Operation of Village Courts	i. Number of village courts in active operation ii. Number of village courts supplied with operational materials

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