National Economic & Fiscal Commission

2016 Budget Fiscal Report

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Foreword

The National Economic and Fiscal Commission (NEFC) is required to provide to the Minister each year a report on the workings of the Commission and the details of the provincial grants.

This 2016 Annual Budget Fiscal Report is in compliance with Section 69 of the *Intergovernmental Relations (Functions & Funding) Act, 2009* and is required to be tabled in Parliament by the Minister-Treasury.

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

In essence, the new system is based on an equalization system which is based on provincial and local-level government funding allocations. It not only takes into consideration the cost of providing services, but also internal provincial revenues. The amount of revenue that a province is able to generate has an impact on their ability to deliver basic services.

Provinces experience differences in the costs of providing the same service in different part of the country. This is often due to influences outside their control. For example, a province that is linked by good transport networks will almost likely have lower cost relative to those provinces that have poor transport networks and infrastructure.

The NEFC continues to research ways of better costing the impact of remoteness. One such study was completed in 2014 titled', 'Go Long Ples'. The study concluded with a composite remoteness index which will assist in better determining the cost of transport.

Over the last five years 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 are unable to generate adequate internal or own-source revenue. The Provincial Expenditure Review (PER) reports, which the NEFC has released over the last 6 years, confirms this situation. Given the increase in the level of funding, it is reemphasized 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 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; 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. These include: the 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 NEFC's various publications. For instance, delays in the availability of PGAS and Warrant Release data from the departments of Finance and Treasury have hampered NEFC's efforts to have these reports published timely. The NEFC has continued vigorously advocating for timely releases of warrants and cash releases.

The Service Improvement Program (SIP) is already having a significant impact on cash flows. This was very much evident during the first half of 2014. It is anticipated that this situation will improve as the LNG sales trickle back into the country in late 2015.

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

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

In conclusion, the constitutional grants to provinces and Local-level Governments, which the NEFC closely monitors in collaboration with the Departments of Treasury, Finance and Provincial Affairs, only comprises of approximately 4% of the entire GoPNG recurrent budget. It is our desire to ensure that 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 enabling provinces to better plan and provide consistent services, and be made 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 goals and objectives of the MDTP and Vision 2050.

HOHORA SUVE
Chairman & Chief Executive Officer

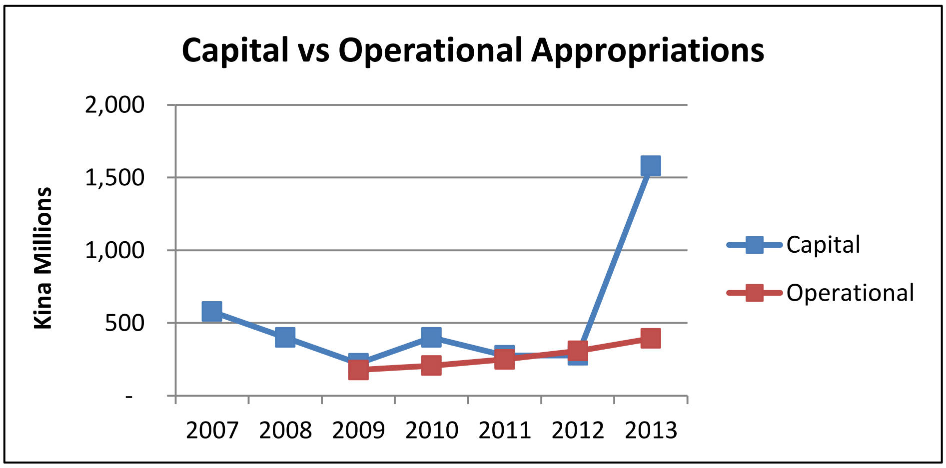
Executive Summary

Each year the National Economic and Fiscal Commission (NEFC) is required to produce to the Minister of Treasury, a report on the workings of the Commission and its annual provincial grant determination. This 2016 Annual Fiscal Report is produced in accordance with Section 69 of the *Intergovernmental Relations (Functions and Funding) Act 2009* and under Section 117 (9) of the Organic Law on Provincial & Local-level Governs; it 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 reforms have since bedded down and, the extended transitional provisions effectively come to an end in 2015. This means that only one province, Morobe, will would have been the only province not eligible to receive any function grants primarily due to its high GST receipts. The NEFC is presently considering incentive based options so Morobe Province continues to receive grant allocations to ensure that community is not disadvantaged.

Since the introduction of RIGFA grants to Provinces and LLGs, grants have increased from K140 million in 2009 to K578 million in 2016. Overall the annual provincial expenditure reviews (PER) continues to reaffirm that provinces are increasing their expenditures on the provision of basic service delivery. Some provinces such as Simbu, Madang, Milne Bay, Manus and East New Britain have consistently demonstrated prioritisation of their expenditures on the provision of basic service delivery. The provincial scorecard also reveals that the resource- rich provinces continue to lag behind in their prioritisation of function grants and is of concern to the NEFC.

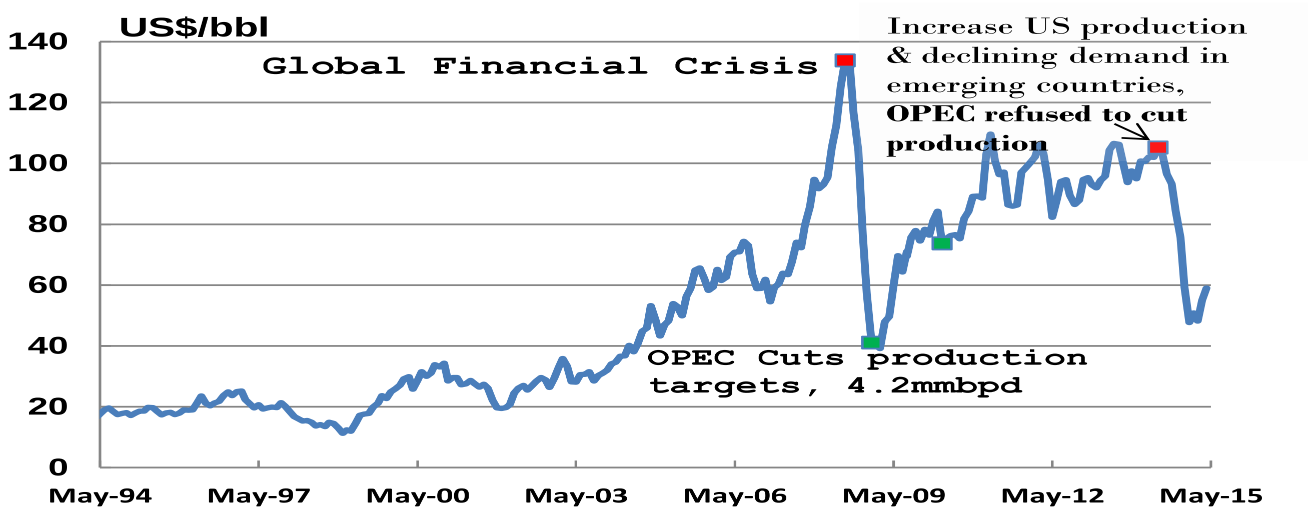
Whilst RIGFA has been successfully implemented and bedded down after nearly seven years, it faces many challenges with the growing macro reforms, such as the Tuition Fee Free (TFF) education subsidy, the free primary health care policy, and the introduction of District Development Authorities (DDAs). Additionally, the mass allocation of Service Improvement Program funds from National Government to Provinces, Districts and LLGs (i.e. K1.5 billion) compared to K578 million, is a concern. NEFC's concern is that the spending on infrastructure will increase the demand for recurrent/operational funding. This funding disparity is depicted in the chart below following the introduction of the DSIP in 2013. If the gap continues, as it has done since 2013, then this together with cash flow issues may well become critical.



Service delivery must continue to be a priority for government. It must ensure that this is delivered in an efficient and accountable manner if Government is to ensure that it's broader objectives and outcomes, such as MDGs, MDTP2 and Vision 2015 aspirations, are met.

The consistency and timely release of cash flows is critical and NEFC recommends that function grants must ensure that service delivery is provided when needed. This was cited as an issue for many provinces who attended the quarterly budget reviews, which was chaired by the Department of Treasury and supported by the NEFC in August 2015.

The graph below provides a trend analysis of oil price fluctuations between 1994 to May 2015 indicating a significant drop in commodity prices from over US$100 to close to US$60 in May 2015. The trends are likely to continue downward as the global economy shrinks. This has already had a major impact in PNG through impacting cash flows.



NEFC Accomplishments and Major Activities in 2015

The NEFC was able to advise the DoT of the 2016 provincial and local level government function grant determination within the legislated timeframe of 31 May 2015. The functional grant determination was duly signed off by the Minister.

In calculating the 2016 function grants a number of issues were inherent including the end of the transition provisions. This effectively means that funding pool previously set aside to allow for the transition guarantees would now be removed and allocated against the total available pool to be shared by all provinces. The NEFC conducted modelling exercises to determine the impact on provinces particularly the resource-rich provinces, to determine the impact on funding allocation. It was noted that Morobe and Manus province are likely to be significantly impacted. The NEFC used its influence to make the necessary adjustments to ensure that the major fluctuation in the allocation of function grants are mitigated. The Treasurer agreed with the NEFC proposal to end the transition guarantee from all provinces other than for Morobe Province for 2016, but the guarantee should cease in 2017. The NEFC will adopt the Treasurer's recommendation.

Cost of Services Study (2015)

One of NEFC's major mandated products is the Cost of Services Study. This study which is undertaken once every five years is a major undertaking by the NEFC. The 2015 Cost of Services Study (CoSS) was facilitated by a report titled, 'Thin Blue Line' which informed on how and what was included in the cost of services study. The report paved the way for a more thorough preparation prior to the field surveys to be conducted in the twenty (20) provinces and the ABG. The NEFC staff, including former public servants were contracted to assist with the field visits and supervision. In the midst of the study a funding cut was experienced. This would have prevented the study being completed. However, DFAT PLGP program provided timely financial support enabling the task to continue. The completion of the 2015 Cost of Services will provide an update of the costs of providing basic service delivery. This will also include a more accurate calculation of function grants and advising government on other areas of reforms such as the DDAs and City Authorities.

PER 2013

The NEFC launched the 2013 Provincial Expenditure Review (PER) at the 2015 regional workshops held during the months of July and August 2015. The PER provides a snap shot of the provincial performances against the minimum priority activities (MPAs), which the NEFC specifically monitors. Overall, it is positive that provinces are committing increased amounts of expenditure on the provision of service delivery. However, what also became more evident in 2013 is the overlap of funding on function grants as a result of the macro policy reforms. This included the Education function grants and health function grants. Furthermore, the dual funding, for example, to Christian Health Services allocated to provinces will need to be analysed further including clarification over the functional roles and responsibilities.

ABG Cost of Services and Grant Funding Allocation Methodology

The NEFC was approached by the ABG to assist the administration with developing a more robust grant allocation system for its recurrent functional grants allocated by the National Government. NEFC assisted by engaging a consultant to initially conduct a scoping study followed by a two phase implementation. This will include conducting the CoSS, recommending grants and developing a model for the calculation of grants. The ABG will then need assistance with the implementation including developing budgets and aligning the grants to activities.

The Bougainville costing assignment was completed ahead of the 2016 budget. This will allow the ABG to request additional funding to ensure that the function grants meet the basic cost of providing services as well including ensuring consistency with the NEFC system.

NEFC SUCCESSFULLY CONDUCTED THE 2015 REGIONAL WORKSHOPS AHEAD OF THE PACIFIC GAMES

The last of the four NEFC 2015 regional workshops was concluded on 2nd July 2015 in Lae following the Highlands Region workshop. All four regional workshops were well patronized with over 300 attendees.

Manus was the only province that didn’t send in a delegation and did not provide an explanation for the non-attendance despite being provided with two opportunities to attend due to priorities and pressing deadlines (i.e. either the MOMASE or Highlands Workshops).

Two of the four NEFC Regional workshops were supported by PLGP/DFAT and the other two were funded by GoPNG. It was NEFC’s intention that these workshops, which were previously wholly supported by DFAT, and which now have become institutionalised. It is anticipated that the NEFC workshops will be supported by the GoPNG in the future.

Overall, the NEFC regional workshops are considered to be a success. Two workshops in particular, Momase & Highlands, attracted close to 100 attendees indicating a high level of interest particularly in learning about the current government reforms, and more specifically, DDA implementation. Some logistical difficulties were experienced including the lack of accommodation in Popondetta and travel arrangements. Nevertheless, this did not impact the workshops which commenced on time, but were extended by over an hour to address the many presentations. Discussions surrounding the reforms, more specifically, issues associated with the DDA implementation, took up a lot of time.

The 2015 NEFC Regional workshops were particularly characterised by the strong support and engagement by all the major National Agencies including, DoT, DoF, DPM, DPLGA, DNPM, DIRD, NDoH and Village Court. They all significantly contributed to the success of all four (4) regional workshops. This commitment by all the major National Agencies was unprecedented in comparison to previous years. It is evident that the NEFC annual workshops have increased in stature and made a significant contribution in the dissemination and promulgation of government policy.

It was also of interest that the many were issues raised during the workshops such as bottlenecks relating to RIGFA and DDAs. These were raised with some resolutions being addressed. As a result, there was a greater appreciation of local issues by National Agencies.

National agencies also participated as part of a National Agency Panel who provided a critique of provincial 'Yu Tok' presentations. These Yu Tok presentations are a fundamental element of the regional workshops as it provides provinces an opportunity to provide evidence of their performance against the Minimum Priority Activities (MPAs), which is key feature of the increased funding following RIGFA. A National Agency Panel and other national agency representatives also participated in responding to general questions from the floor.

The DoT used the NEFC workshops to highlight the current state of the economy and promulgated the Consolidated Budget Operating Instructions. This included workshopping the use of the consolidated budget tool which will be required by all agencies in 2016. DoT also presented the monitoring template known as the 'traffic light' which will be used by DoT to monitor provincial compliance of budget instructions.

Overall a majority of the presentations were conducted by National Agencies. The NEFC was also able to showcase five of the Policy Officers who made individual presentations during the workshops. These presentations were based on their analytical areas of individual research. DPM, DPLGA and DIRD also included detailed presentations including providing an update relating to the District Development Authority implementation.

The DNPM presentations highlighted the need for better alignment of development plans including the critical need for the realignment of the District plans to the Provincial Development Plan and the PNGDSP 2030. DIRD also showcased the PNG Information tool (formerly DIMS) which identified capacity gaps at the district level based on the TNA survey.

At the conclusion of the workshops, it was clear that the contents of the workshops were too condensed for a two day workshop requiring an additional day (i.e. possibly a third day for future NEFC provincial workshops).

The long list of Resolutions is an indication of the level of sophistication and increasing levels of critical analysis. The Workshop feedback survey forms also provided further insight including acknowledgement of the value of these forums. The Workshop feedback forms from the four regional workshops will be formally analysed by the NEFC and made available to stakeholders including the Interdepartmental Committee (IDC) which meets periodically to discuss the progress of RIGFA reforms.

The NEFC workshops were covered by the media across the country including an hour long EMTV interview with the NEFC Chairman/ CEO. This was aired on EMTV on Saturday 4th July, 2015. The issues raised during the course of the interview received an instant response from many politicians including a need for consistency of cash and warrant releases and the monitoring of public expenditure.

The success of workshops also saw the attendance of distinguished Papua New Guineans including the Governor of Jiwaka: Honourable Wiliam Tongamp, who after the opening of the Highlands Workshop, decided to attend the remainder of the two day workshop. He was highly complementary of the value of workshops and its material. He also commented that as a new parliamentarian he gained a lot of knowledge during the course of the workshop.

The Popondetta workshop saw the absence of NEFC advisors. This was an attempt to increase local NEFC management and staff ownership. It was pleasing that NEFC management and staff rose to the occasion and performed exemplary. This could be described as a triumph for capacity building and the institutionalising and sustainability of the NEFC regional workshops.

Overall it can be said that the workshops remain the only annual forum which brings together national and sub-national agencies to discuss and resolve issues and bottlenecks. The quality of materials, presentations and the depth of discussions have increased markedly. The post workshop survey analysis for the first two NEFC regional workshops indicated a very positive benefit of information received and their ability to implement and the reforms based on information and knowledge gathered.

It is noteworthy that the NEFC workshops for the first time saw presentations by 9 female presenters, a chance occurrence but inadvertedly supports Government's policy on progressing gender equality.

Lae City Authority - Estimated Municipal Costs

The NEFC responded to the Chief Secretary's request to provide an estimate of the cost of providing urban services. This was not an easy task with the unavailability of key information required to conduct the study. Further ahead of the Lae City Authority Bill being passed through, there was much sensitivity in obtaining pertinent data. Nevertheless, the NEFC was able to develop a costing framework with due consideration to other proposed City Authorities.

The Chief Secretary was provided with cost estimate of the municipal costs as specifically requested. The NEFC used the NCDC as a benchmark in developing an evidenced-based framework. This benchmark will be used as part of the estimated City Authority costing framework for other provinces. The NEFC also advised that a more detailed costing will be necessary to accurately determine the costs.

In 2015, PNG successfully hosted the Pacific games it was a proud moment of not only hosting the games, but winning the most medals. We must ensure that this spirit continues to each and every public servant involved in service to 'Raising the Bar' for improving service delivery to the community.

The current implications for PNG and the need for belt tightening were raised by the Department of Treasury during the four NEFC annual regional workshops held in June and July 2015 ahead of the PNG games. The regional workshop theme, 'Raising the Bar', captured the imagination of the participants inspiring the theme to raise the bar in improving service delivery to all Papua New Guineans. The workshops also featured a session on how provinces could save money by thinking smarter.

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 2013, the Provinces have had difficulty implementing their budgets. The second quarter budget reviews highlighted low spending rates by most Provinces (i.e. by the end of June 2013) had only spent around half of the grants which they had received). This problem is exacerbated by slow cash flow to Provinces, making it difficult to plan spending.

The 2016 determination

Figure 1: Summary of the 2016 Determination

Provinces	Total Provincial Government Grants	Total LLG Grants	Grand Total
Western	13,417,885	3,782,074	17,199,959
Gulf	26,123,816	3,075,750	29,199,566
Central	30,613,306	2,063,691	32,676,998
Milne Bay	32,286,858	2,745,986	35,032,844
Oro	20,569,673	2,338,657	22,908,329
Southern Highlands	12,381,833	3,182,238	15,564,071
Hela	14,256,811	2,312,848	16,569,659
Enga	27,353,549	2,338,873	29,692,422
Western Highlands	23,979,991	2,180,432	26,160,422
Jiwaka	24,838,966	875,019	25,713,985
Simbu	36,529,791	1,724,471	38,254,261
Eastern Highlands	46,812,842	2,737,419	49,550,261
Morobe	7,782,200	6,999,418	14,781,618
Madang	43,847,118	4,478,000	48,325,118
East Sepik	58,371,493	4,810,186	63,181,679
Sandaun	40,486,931	4,443,061	44,929,991
Manus	13,360,108	746,162	14,106,270
New Ireland	4,018,024	1,394,752	5,412,776
East New Britain	22,917,436	3,475,071	26,392,506
West New Britain	20,564,101	2,074,563	22,638,664
TOTAL	**520,512,730**	**57,778,671**	**578,291,400**

The increased level of funding further emphasizes that the onus lies with 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 are proper planning, budgeting and spending to ensure that a villager at the end of the chain receives access to basic health services, education and transport. This represents a basic function of any responsible government in society.

The lack of capacity in some provinces continues to hamper the Provincial capability to fully utilise the increasing funds and effectively sustain service delivery. The inclusion of the two new provinces, 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, in so far that he or she can 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, comprises an estimate of 4% of the GoPNG recurrent budget. The NEFC strongly advocates that the function grants earmarked by government are made available in a timely manner for consistent service delivery.

The NEFC will continue working hard to ensure that all Papua New Guineans, regardless of where they reside, received, improved access to basic service delivery. This is also the intention of the Constitution and the aspirational goal and objectives of the MTDP and Vision 2050.

Contents

1 FINANCING SERVICE DELIVERY IN PNG

All countries make decisions regarding 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 a level best capable of responding to differing conditions across a country. In PNG, the multiple layers are associated with National, provincial and Local levels. Legislation and guidelines outline which particular level of government is responsible for certain services and activities, and authorises how Provinces and LLGs are able to raise revenues.

Since different Provinces experience economic imbalances, it becomes necessary for the National Government 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 amongst 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 different levels of government to raise revenue and their respective 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, raising approximately 95% of total tax revenues. However, provincial governments have the responsibilities of delivering 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 different 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.

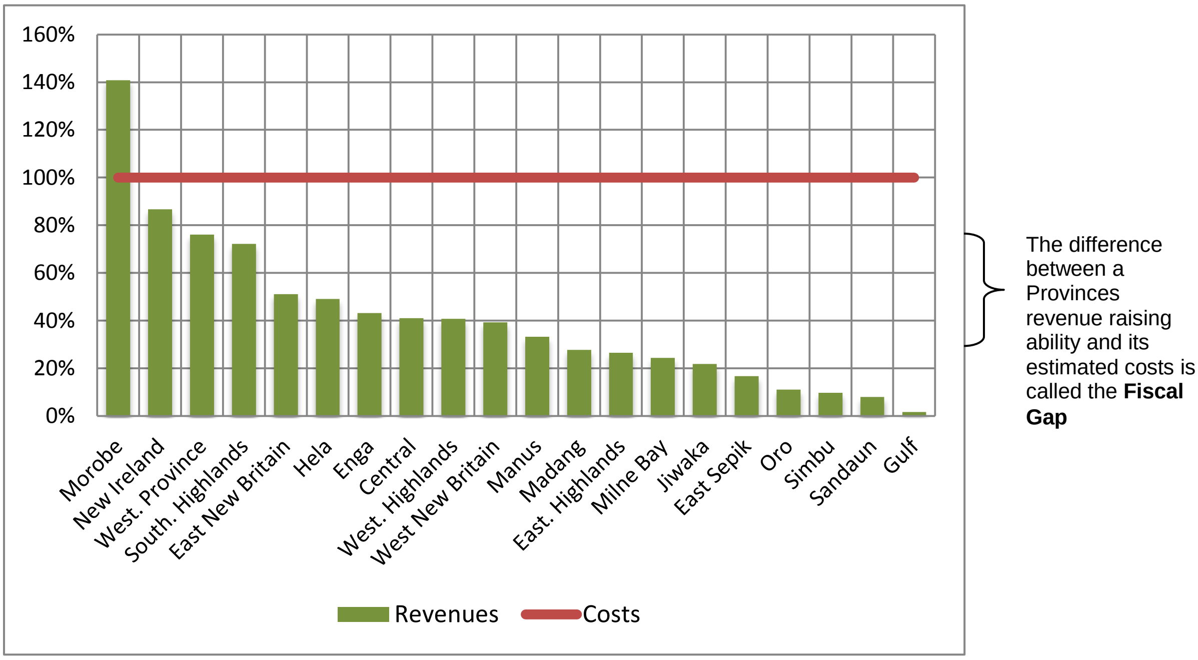
1.1 The Fiscal Gap

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 among five 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 due to having 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 costed at 100 percent.

However, from a funding perspective, the Provinces are restricted in what local 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 green 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 graph below shows the fiscal gap for 2016.

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 assist 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 where a 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, 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 results six years later is that more funding going to all Provinces, particularly, those Provinces with low fiscal capacity.

1.3 Types of Grants

In 2015, the National Government provided the Provinces with three main 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 funding. Capital and human development funding is provided through a range of grants. These are project specific while others are devolved grants provided for a range of activities. In 2013, 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) but the specific projects is left up to the discretion of decision making committees in the respective Province's, Districts 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 items such as fuel in order to undertake aid patrols or materials for maintenance. The NEFC has learned that without sufficient recurrent funding service delivery for rural communities does not occur or is ineffective. The National Government provides a set of *Function Grants* that provide extra recurrent funding to those Provinces with the lowest fiscal need. It is expected that hose Provinces with high internal revenues are to fund a larger portion of their own recurrent costs.

Recurrent funding was the focus of RIGFA, and is the main concern of the NEFC. Chapters 2 – 5 of this report outline the process for determining the Function Grants and the amounts for 2014.

1.4 Role of the NEFC

The NEFC is an adviser to Government. 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 their respective own source revenues available to them. Using a legislated formula, the NEFC calculates each Province and LLGs share. The NEFC follows 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 EQUALIZATION AMOUNT

The *Intergovernmental Relations (Functions and Funding) Act* 2009 (The Act) 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 equalization amount is then further divided between individual Provinces and LLGs.

The legislation indicates that the current equalisation amount is 6.57% of Net National Revenues (NNR). The NNR amount is the total tax revenue received by the National Government excluding mining and petroleum tax revenue.

Since it is a revenue sharing arrangement, the calculation 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 Equalization Amount 2016

The Act requires NEFC to prepare a written estimate of the equalization amount for the coming fiscal year and 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 while notifying of 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 *Intergovernmental Relations (Functions and Funding) Act 2009*.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 2016 was calculated using tax revenue data from 2014 (the second preceding fiscal year) in accordance with the following formula.

General tax revenue for 2014	**-**	**Mining and petroleum tax revenue for 2014**	**=**	**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 2014 Final Budget Outcome published by the Department of Treasury in March 2015-.

The following table shows how the NNR amount for 2016 is calculated.

Act definition	Final Budget Outcome equivalents	Kina million
1. 2014 General tax revenue	Tax revenue	**K9,596.2**
MINUS (-)		
2. 2014 Mining and petroleum tax revenue	1. Mining and petroleum taxes 2. Mining levy **TOTAL**	K794.2 K0.0 **K792.2**
EQUALS (=)		
3. 2016 Net National Revenue Amount		**K8,802.0**

For 2016 Budget, the minimum funding level for the equalization amount is calculated according to the following formula in Kina million:

Net national revenue for 2016	X	6.57%	=	NEFC estimate of 2016 equalisation amount
K8,802.0	x	6.57%	=	K578.3

In accordance with the Act, the NEFC provided a written estimate of the equalization amount to the Secretary for Treasury on 31 March 2015.

2.2 Apportioning Equalization Amount between Provincial & Local-level Governments

Equalization Amount

The Ministerial Determination that was issued by the Treasurer splits the equalization amount of **K578.3 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 2016 the amount ‘converted’ from GST transfers to service delivery grants is K2.0 million for all Provinces.

The total amount for funding transitional individual Province guarantees is:

- K88.4 million: being the amount appropriated to all provincial governments in 2008 for block grants, function grants and derivation grants

PLUS

- For the relevant year of the transition period, the total of the following amounts for all provincial governments:
  - if the GST distribution received by a provincial government in 2008 is greater than the GST distribution received in the relevant year (2016) 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 adequate 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 K57.8 million in 2016.

(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)	*469.4*	*100%*
(i) Total amount for funding transitional individual Province guarantees	*88.4*	*19%*
(ii) Local level share	*53.1*	*11%*
(iii) Province share – remaining funding from EA after paying (i) and (ii)	***328.0***	***70%***

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 disaggregated according to 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 allowing an agreement to 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 determination to formalize the splits amongst the provincial grants for the 2016 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 2016.

Figure 3: 2016 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	3,814.3	2,980.0	4,434.0	1,216.3	174.2	561.8	161.5	13,417.9
Gulf	6,115.1	4,844.6	7,199.8	2,461.1	403.4	2,613.4	2,410.8	26,123.8
Central	6,073.2	6,289.0	10,695.5	2,031.3	404.0	3,137.7	1,917.5	30,613.3
Milne Bay	7,608.2	7,804.2	7,437.3	2,417.2	500.6	4,538.6	1,913.5	32,286.9
Oro	5,206.8	4,426.9	4,642.2	2,321.9	356.8	2,249.6	1,292.6	20,569.7
Southern Highlands	3,926.3	3,414.1	3,050.1	634.7	313.5	720.1	258.0	12,381.8
Hela	4,387.3	2,673.3	2,912.1	1,125.4	198.0	1,319.7	1,567.8	14,256.8
Enga	5,000.0	5,231.8	10,572.4	1,189.4	389.3	3,036.3	1,868.8	27,353.5
Western Highlands	4,467.3	6,092.9	8,701.0	1,325.2	400.8	1,946.2	967.9	23,980.0
Jiwaka	4,568.5	5,622.9	9,317.8	1,135.7	353.0	1,893.2	1,872.5	24,839.0
Simbu	7,680.9	9,362.2	10,576.0	1,882.6	688.3	3,416.5	2,848.2	36,529.8
Eastern Highlands	7,594.9	10,811.4	17,590.3	2,865.8	653.5	4,055.6	3,166.2	46,812.8
Morobe	1,275.8	2,000.0	2,266.3	465.3	157.0	967.5	585.3	7,782.2
Madang	9,534.3	9,450.8	12,998.2	3,807.8	601.0	3,772.3	3,613.0	43,847.1
East Sepik	11,941.2	12,755.0	21,291.5	4,184.9	887.1	3,782.9	3,451.8	58,371.5
Sandaun	10,696.0	10,061.8	8,392.5	4,073.6	404.7	2,914.6	3,871.3	40,486.9
Manus	2,492.7	2,977.9	4,059.0	998.6	281.7	1,419.1	1,066.1	13,360.1
New Ireland	1,051.1	965.5	1,013.2	453.7	45.5	211.4	203.6	4,018.0
East New Britain	4,290.2	6,567.7	6,129.8	1,897.5	235.8	3,217.6	504.1	22,917.4
West New Britain	4,794.1	5,868.1	3,829.8	2,854.6	353.3	1,822.6	963.7	20,564.1
TOTAL	**112,518**	**120,200**	**157,109**	**39,342**	**7,802**	**47,597**	**34,504**	**520,513**

3.2 LLG distribution

The table below shows the final amounts (in K'000) for the LLG grants by Province for 2016. The Urban and Rural LLGs are shown separately.

Figure 4: Local-level Government share by Province for 2016 (K'000)

Province	Urban LLG Grants	Rural LLG Grants	Total LLG Grants
Western	734.3	3,048	3,782
Gulf	141.6	2,934	3,076
Central	0.0	2,064	2,064
Milne Bay	285.3	2,461	2,746
Oro	708.8	1,630	2,339
Southern Highlands	674.9	2,507	3,182
Hela	945.2	1,368	2,313
Enga	235.3	2,104	2,339
Western Highlands	790.0	1,390	2,180
Jiwaka	0.0	875	875
Simbu	374.1	1,350	1,724
Eastern Highlands	735.5	2,002	2,737
Morobe	2,457.1	4,542	6,999
Madang	865.6	3,612	4,478
East Sepik	647.6	4,163	4,810
Sandaun	486.1	3,957	4,443
Manus	213.7	532	746
New Ireland	402.5	992	1,395
East New Britain	884.3	2,591	3,475
West New Britain	551.6	1,523	2,075
TOTAL	**12,133.5**	**45,645**	**57,779**

3.3 Transitional arrangements for Hela and Jiwaka

Hela and Jiwaka Provinces came into legal existence after the 2012 election. In determining the 2013, the NEFC provided both Provinces with transitional grants. This was due to 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 respectively.. Similarly, the NEFC did not have a firm estimate of the cost of delivering services in Hela or Jiwaka. For 2013, 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 2014 distribution, the NEFC calculated the cost of delivering services in Hela and Jiwaka. However, the necessary revenue data from 2012 does not distinguish between parent and new Provinces. As such, a similar approach to the 2013 distribution was taken whereby 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 2015 Determination, actual revenue data will be available and the NEFC will be in a position to calculate the grants for Hela and Jiwaka similarly as all other Provinces.

4 CALCULATING THE FUNCTION GRANTS

In calculating provincial and LLG grants on a needs basis, the NEFC uses a formula that is legislated. 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 province 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 province 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 province 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 province 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 of 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.

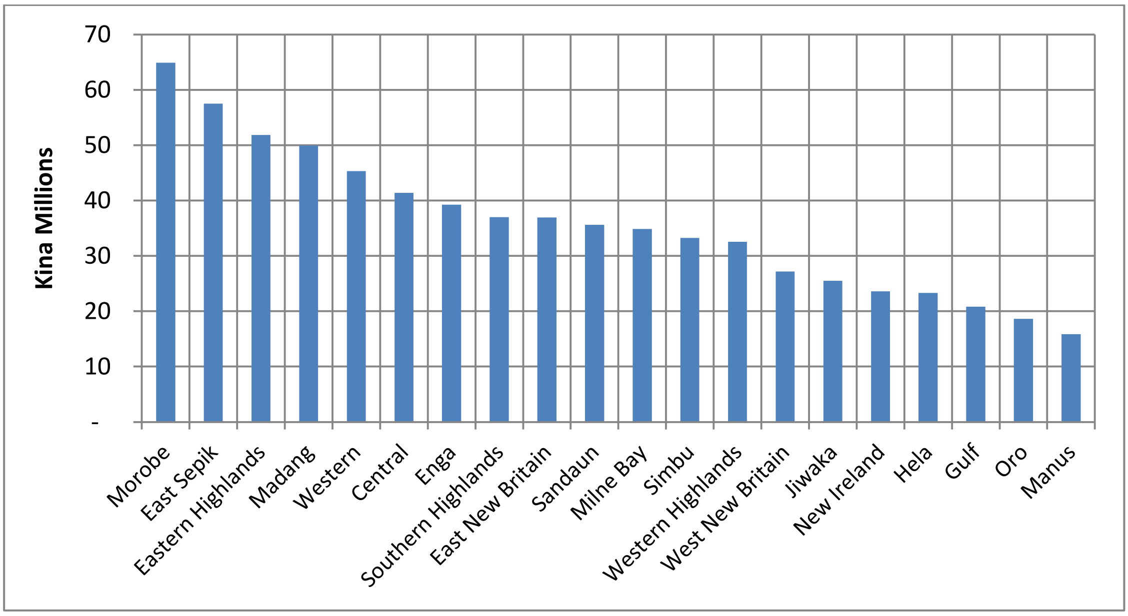
Cost of Service Estimate

The NEFC undertakes a costing exercise of all the functions of provincial governments every 5 years. This costing provides a basis for determining fiscal needs. In 2011, the NEFC updated this cost estimate, and it is indexed every year between updates to adjust for changing costs as a result of inflation.

The determination for any year is based on the costs from the second preceding fiscal year. Therefore, for the 2016 determination, the 2014 cost estimate is used. This maintains consistency between revenues and costs.

The graph below outlines the estimated costs for each Province in 2014.

Figure 5: 2014 Cost of Service Estimate by Province



4.4 Assessed Revenues

The second part of the formula to determine fiscal needs 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 2016 distribution year 2014 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 Internal Revenue Commission. 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. 2014).

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 bookmaker's 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).

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 2014 (the second preceding year), Provinces raised K57.4 million[2] from this revenue source.

[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.

[2] This excludes Bookmakers Tax

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 government's shares are provided under the provisions of the relevant mining and petroleum legislation.

For every new project since the late 1980s, the National Government has not exercised claims over mining and petroleum royalties in the MOAs. Instead, the royalties have been split amongst landowners, and, 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 2014 (the second preceding year), NEFC estimates that Provinces received K96.7 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 2014

Province	GST Distributions	Bookmakers Tax	Own Source Revenues & Others	Royalties	Dividends
Western	13,902,000	0	7,318,284	22,600,000	3,800,000
Gulf	269,000	0	250,227	0	50,000
Central	5,098,000	0	1,261,805	56,506	0
Milne Bay	8,210,000	0	1,929,754	0	0
Oro	2,088,000	0	318,170	0	0
Southern Highlands	16,814,000	0	3,913,450	24,886,076	2,330,000
Hela	420,000	0	0	0	0
Enga	1,593,000	0	3,195,985	17,351,873	2,300,000
Western Highlands	17,797,000	585,022	4,271,818	0	0
Jiwaka	82,000	0	0	0	0
Simbu	2,655,000	0	1,697,338	0	0
Eastern Highlands	13,112,000	480,599	2,475,489	0	0
Morobe	89,570,000	1,446,470	11,308,558	2,000,061	0
Madang	12,460,000	1,001,294	2,747,870	0	0
East Sepik	8,770,000	0	3,048,244	0	0
Sandaun	1,958,000	0	2,338,152	0	0
Manus	14,686,000	0	679,900	0	0
New Ireland	4,981,000	0	1,861,984	21,277,918	0
East New Britain	17,890,000	301,576	5,797,635	0	0
West New Britain	10,198,000	0	2,937,318	0	0
TOTAL	**242,553,000**	**3,814,961**	**57,351,982**	**88,172,433**	**8,480,000**

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

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

ii) Own-source Revenues

- NEFC takes into account only 50% of *own source revenues* collected in order to encourage Provinces to continue to collect and enhance their own revenue base[3].

iii) GST

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

iv) Bookmakers Turnover Tax

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

[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 2016 is outlined in the below table.

Figure 7: Fiscal Needs of Provinces for 2016 (Kina '000)

Provinces	Estimated costs	Assessed revenues	Fiscal needs	% of total fiscal needs
Western	49,297.0	37,541.1	11,755.8	2.6%
Gulf	23,307.0	419.1	22,887.9	5.1%
Central	45,548.4	18,727.2	26,821.2	6.0%
Milne Bay	37,462.4	9,174.9	28,287.5	6.3%
Oro	20,268.8	2,247.1	18,021.7	4.0%
Southern Highlands	39,016.0	28,168.0	10,848.1	2.4%
Hela	24,587.5	12,096.6	12,490.8	2.8%
Enga	42,187.8	18,222.5	23,965.3	5.3%
Western Highlands	35,514.6	14,505.1	21,009.6	4.7%
Jiwaka	27,857.0	6,094.9	21,762.2	4.8%
Simbu	35,508.5	3,503.7	32,004.8	7.1%
Eastern Highlands	55,844.5	14,830.3	41,014.1	9.1%
Morobe	69,734.4	98,270.8	0.0	0.0%
Madang	53,251.0	14,835.2	38,415.8	8.6%
East Sepik	61,435.1	10,294.1	51,141.0	11.4%
Sandaun	38,598.9	3,127.1	35,471.8	7.9%
Manus	17,533.5	5,828.3	11,705.2	2.6%
New Ireland	26,454.6	22,934.3	3,520.3	0.8%
East New Britain	41,169.0	21,090.4	20,078.7	4.5%
West New Britain	29,683.5	11,666.7	18,016.8	4.0%
TOTAL	**774,259.6**	**353,577.4**	**449,218.6**	**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 determine the final amounts going 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 2016 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: 2016 Individual Province Share (K'000)

Province	Transitional Individual Province Guarantee (a)	Estimated Fiscal Needs (Estimated costs minus assessed revenues)	Percentage of total fiscal needs	Funding based on percentage of total fiscal needs (b)	Individual Province Share (a) + (b)
Western	0.0	11,755.8	2.6%	13,417.9	13,417.9
Gulf	0.0	22,887.9	5.1%	26,123.8	26,123.8
Central	0.0	26,821.2	6.0%	30,613.3	30,613.3
Milne Bay	0.0	28,287.5	6.3%	32,286.9	32,286.9
Oro	0.0	18,021.7	4.0%	20,569.7	20,569.7
Southern Highlands	0.0	10,848.1	2.4%	12,381.8	12,381.8
Hela	0.0	12,490.8	2.8%	14,256.8	14,256.8
Enga	0.0	23,965.3	5.3%	27,353.5	27,353.5
Western Highlands	0.0	21,009.6	4.7%	23,980.0	23,980.0
Jiwaka	0.0	21,762.2	4.8%	24,839.0	24,839.0
Simbu	0.0	32,004.8	7.1%	36,529.8	36,529.8
Eastern Highlands	0.0	41,014.1	9.1%	46,812.8	46,812.8
Morobe	7,782.2	0.0	0.0%	0.0	7,782.2
Madang	0.0	38,415.8	8.6%	43,847.1	43,847.1
East Sepik	0.0	51,141.0	11.4%	58,371.5	58,371.5
Sandaun	0.0	35,471.8	7.9%	40,486.9	40,486.9
Manus	0.0	11,705.2	2.6%	13,360.1	13,360.1
New Ireland	0.0	3,520.3	0.8%	4,018.0	4,018.0
East New Britain	0.0	20,078.7	4.5%	22,917.4	22,917.4
West New Britain	0.0	18,016.8	4.0%	20,564.1	20,564.1
Total	**7,782.2**	**449,218.6**	**100.0%**	**512,730.5**	**520,512.7**

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 another 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 as 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 are rural and urban LLGs have been assessed at zero. This is due to data on these revenues are incomplete and of poor quality. However, eventually the NEFC expects to obtain better information on the revenues of urban LLGs and will then assess these more accurately. However, it may not be possible to accurately assess revenues for over 289 rural LLGs. Consequently, revenues for rural LLGs may continue to be estimated 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 289 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 the calculated estimates may sometimes differ 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.

4.9 2016 Calculation Outliers

During the process of calculating the 2016 Provincial Function and Administration Grants, two specific issues were encountered.

Issue 1: End of Transitional Guarantees

The five year transitional arrangement was due to end in 2013. However, the NEFC sought approval from Treasury Department and the transitional guarantee provisions were extended for a further two years to 2015. This allowed the three resource-rich provinces (Morobe, New Ireland and Western Provinces) to continue to receive grants in the past two years.

Following the end of the Transitional Guarantee in 2015, the NEFC will effectively cease applying the transitional guarantees funding in 2016.

While calculating the fiscal needs for each province, it appeared that for 2016, Morobe would be the only province ineligible to receive any function grants, primarily due to its high GST revenues. This is consistent with the principles of Intergovernmental Financing Arrangements. Basically, provinces with higher fiscal capacity are expected to fund basic service delivery using their own internal revenues. Previously, Morobe has been allocated the transitional guarantees of K7.8 million annually.

NEFC continues to have the view that, if the transitional funding guarantees were eliminated, the result may have a detrimental impact on service delivery in Morobe Province. The NEFC has reservations about how provinces commit their internal revenue towards service delivery, based on PER analysis, that generally all resource rich provinces including Morobe Province, have not been committing their internal revenues to prioritize basic service delivery expenditure (i.e. based on NEFC's Cost of Services Benchmarks).

NEFC has been looking at other options including incentive based funding to encourage resource-rich provinces to commit their own internal revenues to fund basic service delivery. However, the legislation required is likely to take time might be impossible to meet the 2016 budget timeline.
As an interim measure, the NEFC sought approval, subsequently was endorsed by the Treasurer, enabling Morobe to be the only province to be allocated in transitional guarantee of its historic amount of K7.8 million.

Issue 2: Impact of GST increase for Manus Province

It was noted during the 2016 Grant Calculation process that, Manus Province would receive an unprecedented increase in GST revenues (i.e. the 2016 60% share of distribution) from K1.2 million in 2015 to K14.7 million in 2016. This was attributed to the economic activity associated with the Australian Government's Detention Facility.

By factoring these figures, the Manus Province entitlements to function grants would have fell from K16.4 million in 2015, to K2.5 million in the 2016 Budget year. This represents a significant drop in function grants and NEFC would likely impact basic service delivery within the province. Hence, it is possible that the province would not be in a position to make the timely necessary budget adjustments.

The NEFC was granted approval from the Treasurer to take into account only a portion of GST as assessed revenue (37%) instead of a 100% amount which would normally constitute the revenue component for GST.

This interim measure would enable NEFC to determine more appropriately the continuity of the level of the province's GST entitlements and collections.

In applying this measure, the provinces function grants have therefore decreased only from K16 million in 2015 to K13 million for 2016 Budget year. Whilst it may appear that the province has less grant allocation than 2015, taking into account the overall resource envelop (i.e. including GST receipts), this would still be sufficiently adequate to meet the cost of providing basic service delivery.


Turubu Oil Palm Project - East Sepik Province

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; As follows:

- 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 2014

- 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

Additionally, 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.

Picture.1. A part of Kundiawa/Gembogl District in Simbu Province

Adequately funding all the Minimum Priority Activities (MPAs), we will actually see services reaching the most remote parts of Papua New Guinea.

"Going Rural", "Go Long Peles"

Minimum Priority Activities and Performance Indicators

Minimum Priority Activity	Performance Indicator
<u>Health</u> 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.
<u>Education</u> 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.
<u>Transport Maintenance</u> 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
<u>Agriculture</u> *10.* Extension activities for agriculture, fisheries and forestry	***i.*** Number of extension patrols conducted by provincial government staff and ***ii.*** Number of people who attended extension sessions
<u>Village Courts</u> *11.* 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 two training sessions on the 8^{th}-9^{th} July and 8^{th}-10^{th} August in the following Provinces:

- Western Highlands
- East Sepik

Picture.2. Cost Services Study Exercise conducted by two NEFC officers assisted by a Simbu Provincial Administration Staff.

The Cost of Service Study (CoSS) is the fundamental exercise under the new Intergovernmental Financing Arrangement (RIGFA); and is conducted after every five (5) years. It provides the basis of determining the level of funding to individual provinces and local level governments.

6 IMPLEMENTATION OF PROVINCIAL BUDGETS: ANALYSIS AND ISSUES

The NEFC sees its role as being a bridge between the National 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 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 undertakes 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. This year the NEFC undertook two PER’s, the 2011 and the 2012 PER. 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 2015 Budgets Analysis

Provincial government Half Year Budget Reviews were conducted by the Department of Treasury and assisted by NEFC staff. This process is one of the major monitoring exercises undertaken throughout the year the aim 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.

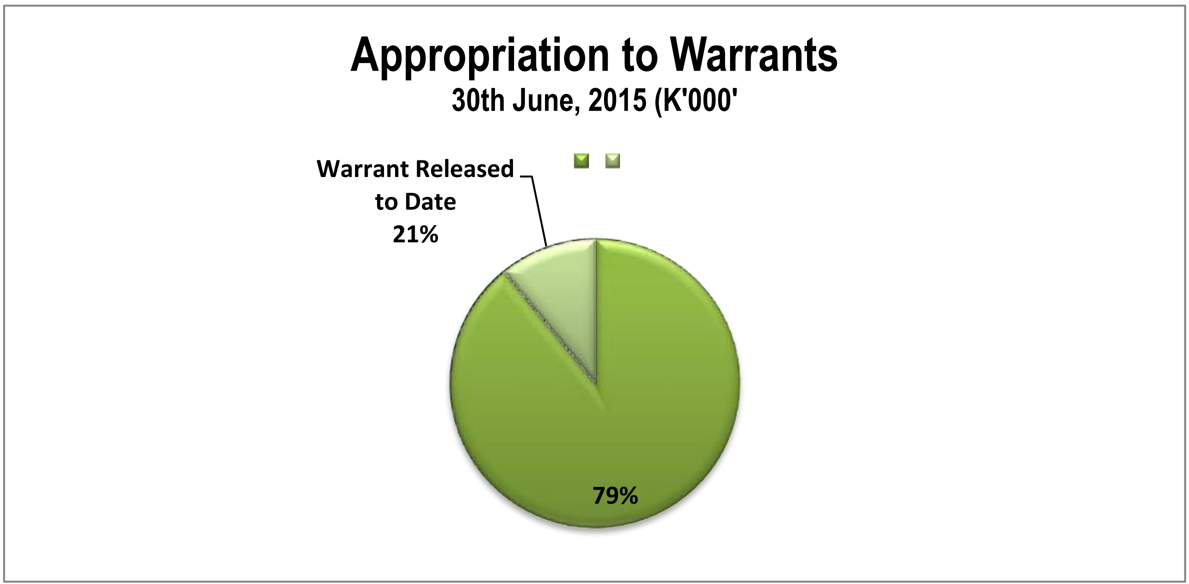
This year, representatives from national agencies, including the Department of Personnel Management and the Department of National Planning and Monitoring, attended the reviews. Oro, Western Highlands, Hela, and Jiwaka Provinces did not present in the reviews. Enga only presented the development budget, whilst Western Province was asked to redo the, review as they were using out-dated budget review templates.

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

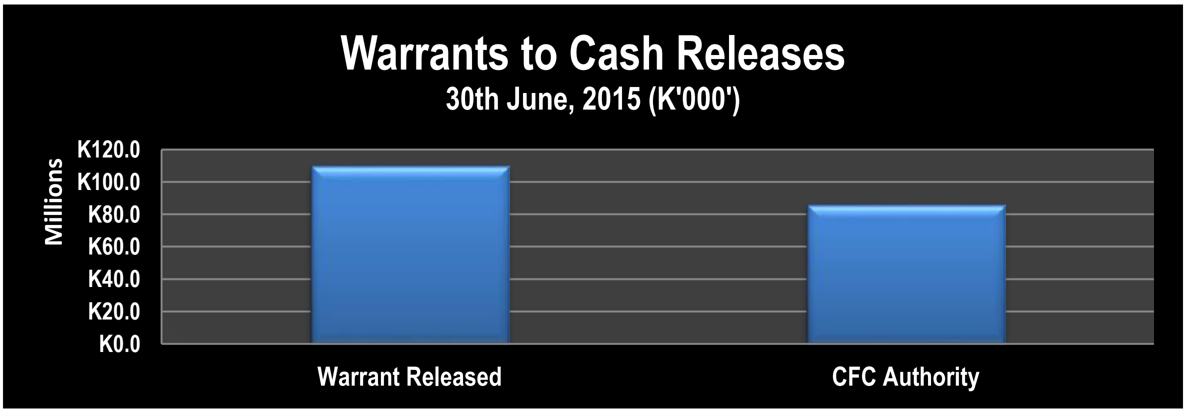
Cash flow for service delivery to Provinces remains slow

For the twelve Provinces analysed, the release of warrants from Treasury remains stubbornly slow. Provinces reported that only 37% 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. On many occasions the CFC Authority issued is less than amount warranted for release. Provinces reported that CFC worth of K86 million was issued by 30th of June.



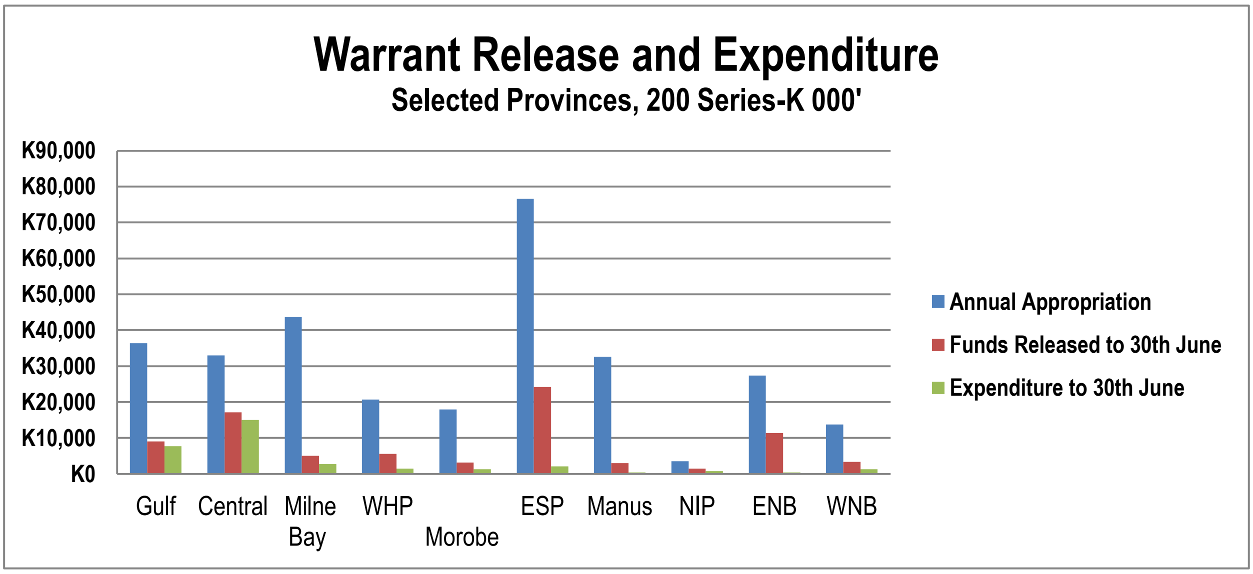
The NEFC raised this issue at a number of forums and the 2012 Governor's conference made a resolution that Treasury should release the warrants using a standard schedule of 40% in the first quarter, then 30%, 20%, 10% in the following quarters. Frontloading the release of cash is important because it 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 problems. 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.

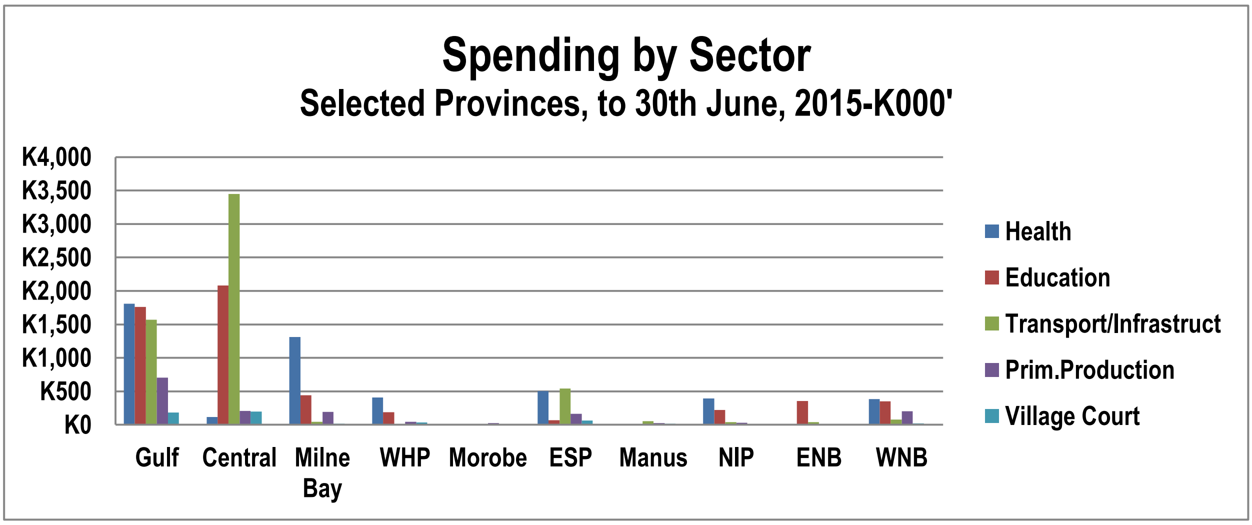
On the basis of the twelve Provinces assessed, only two (Central and to a lesser extent Southern Highlands) had spent over 80% of the funds they had received. The below graph shows the annual appropriation, the warrants released up to the end of June and the spending to the end of June.

Figure 10: Spending by Provinces



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

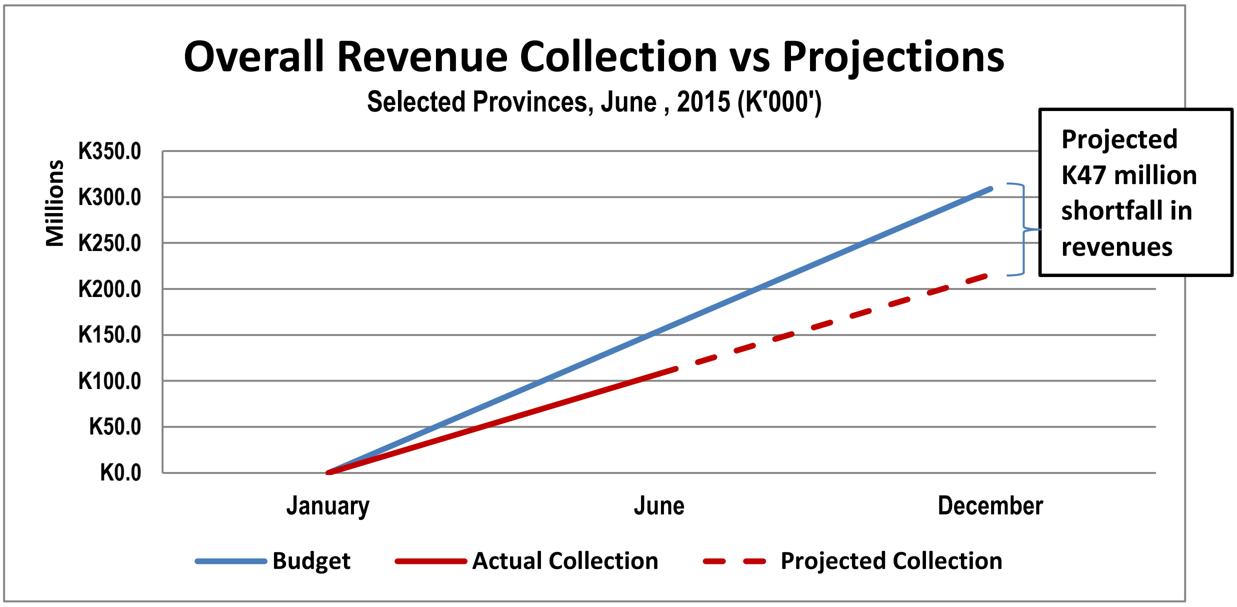
Figure 11: Spending by Provinces (by sector)



Revenue collections are lower than budgeted

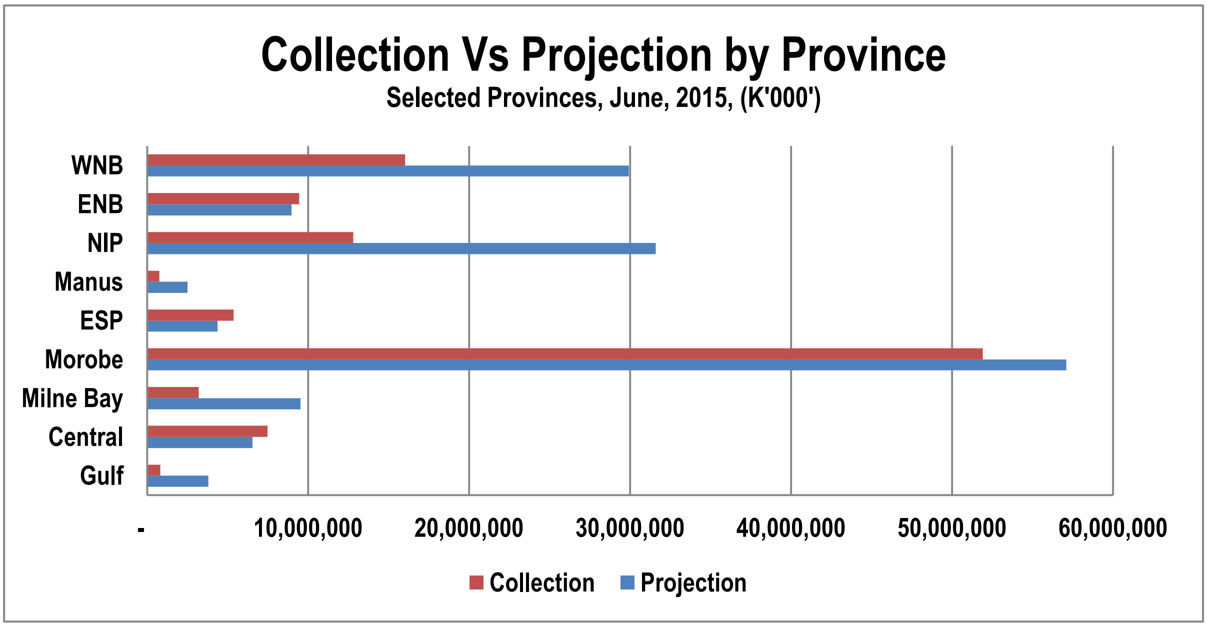
Provincial revenues were below budget which is expected to result in a shortfall of around K47 million over the financial year. Because Provinces are unable to borrow money, any shortfalls in revenues impact directly on their spending for recurrent goods and services. This has a negative impact on service delivery.

Figure 12: Forecast revenues



Individual provinces' ability to collect the projected annual revenues is a challenge. Few provinces have the capacity to collect revenue, for example, Morobe Province which collected almost 91% of the projected revenue. Whereas some provinces were able to collect over their revenue projections such as East New Britain, East Sepik and Central. Milne Bay, Manus and Gulf struggles with their revenue collection.

Figure 13: Revenue Projection Vs Collection by Province



6.2 NEFC Regional Workshops

The 2015 NEFC workshops were conducted from May to July 2015. The four workshops were held in following regional centres: Southern Region in Popondetta; Highlands in Lae; New Guinea Islands in Kavieng; and Momase region in Wewak.

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

The workshop presenters included NEFC's primary stakeholders: Department of Finance, Department of Treasury, DPLGA, Department of Personnel Management, Department of National Planning, Department of Health and the 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. Additionally, 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.

2015 NEFC Collective Workshop Resolutions

Overall Resolutions

- **'Raising the Bar' by working collaboratively across government, both vertically and horizontally, to implement government reforms.**
- **NEFC to use workshop resolutions and issues to advocate with relevant Ministers, Department Heads of Treasury, Finance, National Planning to address long standing issues.**
- **NEFC consider broadening the scope of the NEFC workshops to include SIP funding**
- **Increase focus on internal revenues on spending and budget priorities other than administration costs.**

STRUCTURED SCHEDULE FOR WARRANT AND CASH RELEASES

- That DoT-PBB advocate proactively on behalf of provinces, **to secure a consistent and matching warrant and cash release** to Provinces; Such as adopting the Governors - **'Cash Release' resolution in 2013:**
  - **40%** of cash releases in the 1st Quarter;
  - **30%** in the 2nd Quarter;
  - **20%** in the 3rd Quarter; and
  - **10%** in in the last (4th) quarter.

Resolution (1)

NEFC 'Yu Tok' Presentation

NEFC 'Yu Tok' provincial presentations on performance against Minimum Priority Activity performance

- All provinces must use NEFC's 'Yu Tok' template for their presentations.
- Adopt the 'Yu Tok' Panel Critiques to further improve 2016 workshop presentations
- Provinces to work with DPM/DPLGA/DoT/DoF and other relevant agencies on the implementation of DDAs.

Resolution (2)

Department of Treasury Issues

- Provinces must adhere to the DoT Non-Financial Instructions - Consolidated Budget Operational Rules including prompt submission of priorities and savings.
- Provinces ensure that function grant roll-overs are approved by the PEC and re-appropriated as part of the following year's budget.
- All Provinces pledge to include Staffing data as part of the DoT's quarterly reviews.
- Provinces seek ways to reduce budget expenditure to overcome the anticipated fall in commodity prices and ultimate impact on National Budget.
- Provinces to provide their updated 2015 reductions approved by their Provincial Administrator; to Treasury

Resolution (3)

Payroll Administration

- Consider the use of the NEFC - Provincial Establishment Costing Model (PECM) developed by NEFC to control personnel emolument costs;
- Provinces seek assistance from DoF and DoT to obtain required payroll reports to assist with the payroll verification / checking;

Resolution (4)

DIRD/DPLGA/DoF/DNPM

- DSIP - Provinces assist districts ensure that their 5 year integrated development plans are integrated with the Province's Master Development Plan. The province's Master plan must be linked to the MDTP.
- Provinces consult DPM for engagement of Staff / structure relating to DDA;
- Provinces and Districts in collaborations with relevant National Agencies and Civil Society consider Periodic Monitoring and Evaluation of SIP funds; and
- Provinces to use most updated Financial Instruction & Administrative Guidelines for SIP funding.

1. **'Whole of Government Approach by DNPM, DIRD, Finance & DPLGA to undertake monitoring on the:**
    - Capital Investment Program
    - Services Improvement Programs
    - Check on Chart of Accounts, compliance to Financial Instructions
    - Performance and Reporting

Resolution (5)

- All Provinces to work closely with DPLGA and other Central Agencies to implement the District Development Authority;
- DPLGA to confirm final DDA's district determinations with the respective provinces.
- That provinces start budgeting for DDA operations in the 2016 Budget
- That the monitoring and reporting for DDA will be properly integrated into the current reporting framework with clear indicators

Resolution (6)

Improving the Quality of Budgeting- Adherence to Budget & Expenditure Instructions (BEIs) for 2015.

- Provinces to provide a single three year integrated budget as per DoT Instructions
- 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 Governors 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 2016 Annual budget submissions.
- That Provinces provide **indicative cash flow requirement** as part of their budget submission to DoT.

Resolution (7)

Miscellaneous Issues

Provinces consider supporting the growth of SMEs as an avenue to encourage revenue generation within the province.

- **That Provinces consider direct facility funding** in their planning and budgeting
- In relation to confusion with planning in the provinces – there should be partnership, co-ordination and consultation between sub-national levels.
- Provinces to confirm with DPM to minimize/correct the overrun in Personnel Emoluments and manpower
- That Provinces continue to work in partnership with relevant NGOs and other Donor partners to improve service delivery processes.
- CIP acquittals submitted to Finance on quarterly and mid-year reports to DNPM national projects.

Resolutions Specifically for Central Agencies to Jointly Address

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

- Village Court Secretariat to liaise with Provinces providing feedback on village court officials currently listed; and
- Village Court Secretariat to ensure that all Provincial administrations commit to validating and submitting the names for village court officials duly nominated at the 30th June.

Department of National Planning & Monitoring

- DNPM provide CIP feedback to Provinces on status of CIP submissions
- DNPM to assist provinces to better align their 5-year integrated development plans.

- DPLGA, DNPM, DoF & DIRD to work together to provide standardized planning templates for the district and LLGs for their integrated provincial plans

- DPLGA, DNPM, DoF & DIRD to consider Awareness workshops at District Level:

    - To assist districts with district & LLG plans

    - Use Standardized planning templates for districts and LLGs

    - On reforms with CIP as per the new MTDP ii and SIP guidelines

DPM

- DPM to assist Provinces to sort out payroll manpower issues with DoT / DPM prior to providing Budget staffing submission, and budget technical meetings.
- DPM tor reinforce with Provinces/ Districts to consider training needs associated with the DDA implementation- DIRD has information on hand to assist with this.
- Agreed that DDA manpower staffing will be reviewed and determined by DPM

6.3 Assessing the quality of Provincial Budget Submissions

Annually, 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 2015 Quality Budget Assessment was conducted in April 2015 and presented to Provinces during the NEFC Regional workshops held in June and July 2015.

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 data for both prior year and 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 MTDP sectors which are Health, Education, Transport Infrastructure Maintenance, Primary Production and Village Courts was significant. Furthermore, negative scores were applied if provincial governments allocated funding for Universities, tertiary scholarships or Provincial Hospitals from national government function grants.

Figure….. Quality of Provincial Budget Performance (Ranking on a 3-year Average)

Province	2013	2014	2015	3 - Year Average	Rank
ENB	75	74	64.5	71	1
Central	71.5	76	61	70	2
EHP	73	67.5	68	70	3
Simbu	72	67.5	69	70	4
Manus	74.5	69	62	69	5
Sandaun	77	58	69	68	6
Milne Bay	56.5	80.5	65	67	7
Gulf	62	73	65	67	8
Western	67	62	60.5	63	9
WNB	68	63	58	63	10
SHP	68	62	58	63	11
NIP	76.5	56.5	47	60	12
Madnag	67.5	61.5	48	59	13
Hela	62	67	45	58	14
Enga	60	59	52	57	15
Morobe	66	55	50	57	16
Oro	60.5	56.5	52	56	17
East Sepik	50	63	53	55	18
Jiwaka	65	38	55	53	19
WHP	43.5	51	50	48	20

Top 5

Top 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 Kavieng for New Guinea Islands, Popondetta for the Southern Region, Wewak for the Momase Region and Lae for the Highlands Region. Apart from the regional workshops, minor trainings were also conducted as per individual provinces request. Therefore, this year, East Sepik, New Ireland and Highlands provinces made formal requests to the NEFC for assistance. 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 that NEFC developed. . Some provinces have already commenced using these tools and are increasingly finding this to be a useful.

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 these two bodies with a view to mainstreaming the training as part of standard training programs.

PLLSMA 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. PLLSMA and other monitoring agencies have a critical role to play in this area.

6.5 2013 Provincial Expenditure Review "Raising the Bar"

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 2013 was the fifth year of implementation of the new intergovernmental financing arrangements that continues to see more funding reaching the Provinces that need it most and targeted at priority sectors and priority activities. It is enormously satisfying to see the government allocate more funds to the front-line to fund the activities that make an impact to the rural majority spread across Papua New Guinea. Few would argue that seeing health facilities open and operating, supervising teachers and schools, maintaining roads, and watching as extension patrols with health and agriculture professionals cross the districts bringing care and skills; that is what it is all about.

Seven years ago commenced a process of providing a picture of what was happening at the provincial level throughout provincial Papua New Guinea. We wanted to know whether service delivery activities were being funded or not, as well as 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 NEFC has 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 five of increased funds and looking for what is termed as *"Raising the Bar",* where the reforms should be embraced by all levels of government with a view to improving service delivery. There are positive indications that more money is reaching the places where it makes a difference. What is therefore needed is for all stakeholders to look retrospectively and see what has worked well or did not work within the system, and collectively bring about changes to better facilitate service delivery. This takes the effort of many to where it is needed most, including overcoming bottlenecks Including revitalising services that have stopped or become haphazard, and resources money, planning and management.

The *Provincial Expenditure Review* series

In 2005, NEFC 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 NEFC on our journey toward improving the delivery of basic services across the country. The 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. NEFC is 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.

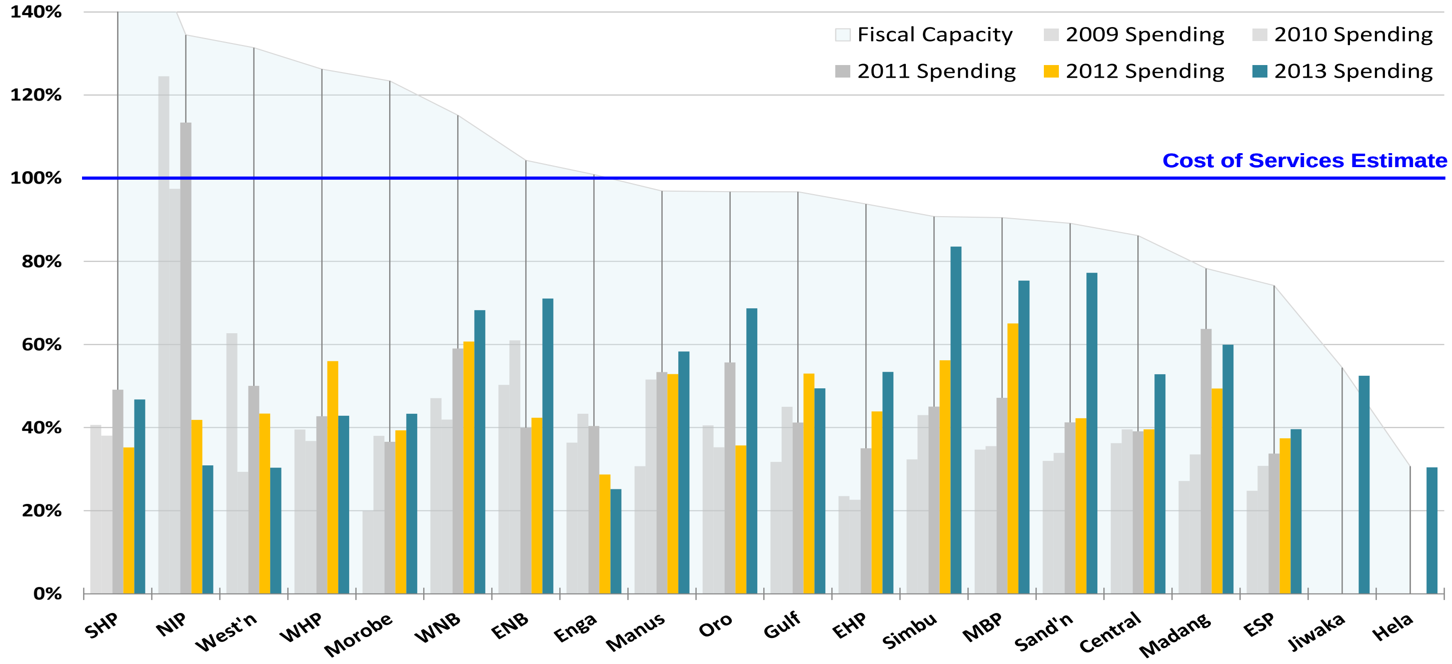
- ***Was there evidence of spending on MPAs?***

  Yes there was evidence of spending on MPA's. However NEFC needs 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 14: Supporting MTDS priorities: 2008 to 2013



[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. PNG needs 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?*** **The national government** needs 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 the government builds a new school it needs to increase the recurrent budget to support this school year after year to pay for costs like materials and maintenance. If the national government doesn't provide increased recurrent funding it is taking funding away from existing schools to cover the new school. The more the government does this the worse it gets.
- ***More Staff?*** Government organisations 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 organisations 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 the government doesn't increase our recurrent budget to provide for these costs we reduce the amount available to support all our staff – and thereby reduce their effectiveness.

Sector by Sector

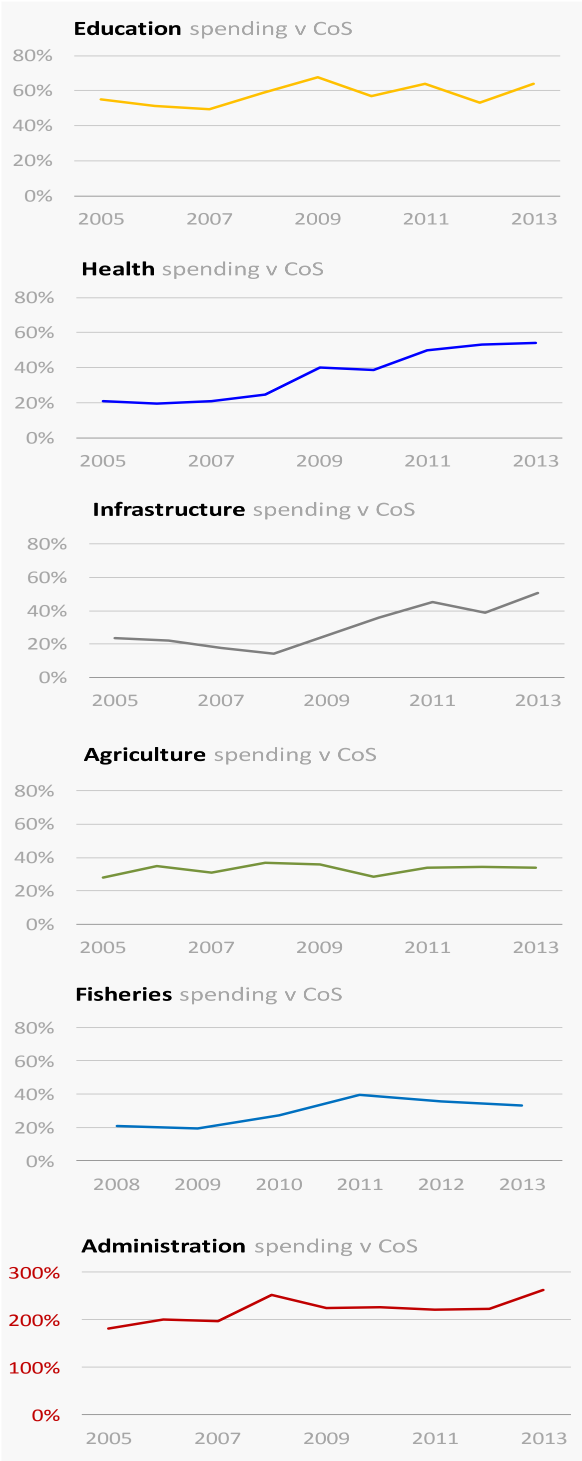
The *Provincial Expenditure Review* has stories at every level, let's summarise each major sector:

- ***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 and 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 2013



Spending on education continues to increase, but relative to cost it hovers above and below the 60% mark.

This means provinces, overall, spend about 60% of what is necessary to fund a rural education service.

Spending on health continues to increase in Kina terms, but relative to cost it has plateaued at about the 55% mark.

This means provinces, overall, spend about half of what is necessary to fund a rural health service.

Infrastructure is much cheaper to maintain than to rehabilitate! Provinces have a large stock of government assets to maintain – roads, bridges, jetties – spending money on routine maintenance saves the country a fortune.

Provinces spend about half of what they need to on routine maintenance.

With 87% of the people in rural areas, subsistence farming remains a vital activity. Cash crops provide both food and entry in to the cash economy.

Presently, provinces spend about one-third of what is required. Some spend nothing. Much more needs to be committed to support training and extension activities.

For coastal and river communities, fishing is a vital source of food security and income.

Presently, provinces spend about one-third of what is required. Some spend nothing. Much more needs to be committed to support training

What now?

- ***Prioritisation of internal revenue:*** More internal revenue needs to go to funding goods and services in the priority sectors of education, health, transport infrastructure and primary production. This applies particularly to higher-funded Provinces.
- ***Late Spending:*** Provinces 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:*** Responsible and relevant agencies need to consider how to better define and report the work we are doing on maintaining the roads (and other transport infrastructure assets) that Provinces are responsible for. The sooner and more frequently we 'maintain' a road the cheaper it is. Leaving roads to degrade is a terrible legacy for our children to repair.
- ***Per diems:*** Can central agencies go some way in assisting Provinces to meet the 12% increase in their costs that has arisen due to the increase in per diems rates? And can Provinces develop good controls and planning to ensure that travel directly related to service delivery is seen as a budget priority.
- ***Costing policy changes:*** Can relevant national agencies 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:*** Key national agencies 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

Papua New Guinea

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 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, capital or development unless the budget allocation specifies that purpose.

3 HEALTH FUNCTION GRANT

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

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

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

4 EDUCATION FUNCTION GRANT

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

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

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

5 TRANSPORT AND INFRASTUCTURE MAINTENANCE FUNCTION GRANT

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

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

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

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

6 VILLAGE COURT FUNCTION GRANT

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

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

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

7 LAND MEDIATION FUNCTION GRANT

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

(2) Without limiting subclause (1), a land mediation function grant must be used to fund the operational, training and supervision costs incurred in the land mediation sector.

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

8 PRIMARY PRODUCT FUNCTION GRANT

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

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

9 OTHER SERVICE FUNCTION GRANTS

An other service delivery function grant must be used to fund the recurrent goods and services costs for other sectors not covered by the service delivery function grants mentioned in clauses 3 to 8, such as business development, community development and environment and conservation.

10 ADMINISTRATION GRANT

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

MADE this 22nd **day of** June **, 2015**

Minister for Treasury

	Health Function Grant	Education Function Grant	Transport Infrastructure Maintenance Function Grant	Primary Production Function Grant	Village Courts Function Grant	Land Mediation Function Grant	Other Service Delivery Function Grant	Administration Grant	Total Provincial Government Grants	Urban LLG Grants	Rural LLG Grants	Total LLG Grants	Grand Total	2008 GST Guarantees transferred to 2016 function grants (a)
Western	3,814,348	2,980,026	4,433,959	1,216,270	174,213	75,814	561,794	161,461	**13,417,885**	734,337	3,047,736	**3,782,074**	**17,199,959**	0
Gulf	6,115,070	4,844,586	7,199,787	2,461,120	403,379	75,710	2,613,406	2,410,757	**26,123,816**	141,612	2,934,138	**3,075,750**	**29,199,566**	267,800
Central	6,073,234	6,288,973	10,695,504	2,031,311	403,989	65,000	3,137,748	1,917,548	**30,613,306**	0	2,063,691	**2,063,691**	**32,676,998**	0
Milne Bay	7,608,244	7,804,215	7,437,344	2,417,191	500,630	67,118	4,538,610	1,913,505	**32,286,858**	285,318	2,460,668	**2,745,986**	**35,032,844**	0
Oro	5,206,827	4,426,899	4,642,159	2,321,885	356,836	72,819	2,249,613	1,292,636	**20,569,673**	708,758	1,629,899	**2,338,657**	**22,908,329**	0
Southern Highlands	3,926,266	3,414,145	3,050,108	634,745	313,510	65,000	720,079	257,980	**12,381,833**	674,949	2,507,289	**3,182,238**	**15,564,071**	0
Hela	4,387,311	2,673,257	2,912,143	1,125,359	197,953	73,295	1,319,722	1,567,772	**14,256,811**	945,179	1,367,669	**2,312,848**	**16,569,659**	0
Enga	4,999,961	5,231,842	10,572,402	1,189,368	389,342	65,565	3,036,263	1,868,806	**27,353,549**	235,290	2,103,583	**2,338,873**	**29,692,422**	1,746,600
Western Highlands	4,467,281	6,092,884	8,700,952	1,325,242	400,780	78,782	1,946,211	967,858	**23,979,991**	789,996	1,390,436	**2,180,432**	**26,160,422**	0
Jiwaka	4,568,531	5,622,906	9,317,776	1,135,693	353,030	75,330	1,893,152	1,872,548	**24,838,966**	0	875,019	**875,019**	**25,713,985**	0
Simbu	7,680,875	9,362,152	10,576,015	1,882,582	688,276	75,208	3,416,467	2,848,217	**36,529,791**	374,111	1,350,360	**1,724,471**	**38,254,261**	0
Eastern Highlands	7,594,913	10,811,447	17,590,319	2,865,759	653,453	75,213	4,055,583	3,166,154	**46,812,842**	735,468	2,001,951	**2,737,419**	**49,550,261**	0
Morobe	1,275,800	2,000,000	2,266,300	465,300	157,000	65,000	967,500	585,300	**7,782,200**	2,457,120	4,542,298	**6,999,418**	**14,781,618**	0
Madang	9,534,265	9,450,845	12,998,160	3,807,810	600,999	69,758	3,772,301	3,612,979	**43,847,118**	865,578	3,612,422	**4,478,000**	**48,325,118**	0
East Sepik	11,941,234	12,755,007	21,291,476	4,184,855	887,130	77,121	3,782,854	3,451,817	**58,371,493**	647,638	4,162,548	**4,810,186**	**63,181,679**	0
Sandaun	10,695,998	10,061,789	8,392,525	4,073,555	404,735	72,428	2,914,649	3,871,251	**40,486,931**	486,053	3,957,007	**4,443,061**	**44,929,991**	0
Manus	2,492,734	2,977,911	4,058,997	998,585	281,690	65,000	1,419,082	1,066,108	**13,360,108**	213,730	532,433	**746,162**	**14,106,270**	0
New Ireland	1,051,123	965,488	1,013,202	453,721	45,548	73,915	211,416	203,611	**4,018,024**	402,457	992,295	**1,394,752**	**5,412,776**	0
East New Britain	4,290,208	6,567,664	6,129,828	1,897,509	235,784	74,799	3,217,572	504,073	**22,917,436**	884,324	2,590,747	**3,475,071**	**26,392,506**	0
West New Britain	4,794,107	5,868,114	3,829,750	2,854,603	353,290	77,931	1,822,594	963,711	**20,564,101**	551,601	1,522,962	**2,074,563**	**22,638,664**	0
TOTAL	112,518,329	120,200,151	157,108,708	39,342,463	7,801,567	1,440,804	47,596,616	34,504,092	**520,512,730**	12,133,521	45,645,150	**57,778,671**	**578,291,400**	2,014,400

APPENDIX B: REVISED BUDGET AND EXPENDITURE INSTRUCTIONS

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

7 May 2010

To: **The following officers in all Provinces, *except* the National Capital District and the Autonomous Region of Bougainville:**
- **Provincial Administrators**
- **Provincial Budget Officers**
- **Provincial Planning Officers**
- **Provincial Treasurers**

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

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

1 Background

1.1 On Wednesday 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 preceding the Budget year. The legislation specifies the proportion of this net national revenue that should be provided.

1.5 This "share of net national revenue" approach ensures that, as "normal" revenues rise, funding to Provincial and Local-Level Governments will increase. On current forecasts, these new arrangements will lead to substantial and ongoing increases in funding. However, medium to long term funding levels largely depend on the overall performance of the economy.

Focus on functions

1.6 The National Government has always provided funding to Provinces to perform particular functions. However, with the introduction of the revised system and substantially increased funding, the Government has more clearly defined the functions that Provinces are responsible for, and will establish reasonable conditions to link grant funding directly to these functions.

1.7 The intention is to ensure that funding is used as efficiently and effectively as possible to perform the vital basic services for which it is provided. To ensure that funds are used as intended, with a focus on improving service delivery to the people of Papua New Guinea, the new system allows the Treasury Secretary to issue Budget and Expenditure Instructions specifying what the funding has been provided for and how it is to be managed and used.

2 Purpose

2.1 The primary objective of these Budget and Expenditure Instructions is to advise Provincial Administrations/Governments (Provinces) of:

- the legal framework establishing these Budget and Expenditure Instructions;
- the functions for which the service delivery function grants, administration grants and local level government grants are provided;
- the minimum priority activities that Provinces are required to establish and report against;
- how Provinces are to budget for the receipt and expenditure of goods and services grants;
- how Provinces are to monitor and report on the expenditure of their goods and services grants;
- the strict conditions under which unspent service delivery function grant funding may be rolled over from one year to the next; and
- the penalties and sanctions that may be imposed if Provinces do not comply with the requirements set out in these Budget and Expenditure Instructions.

2.2 Provincial Administrators are responsible for ensuring that these Budget and Expenditure Instructions are complied with and must ensure that officers involved with preparing and executing Provincial Budgets are provided with copies of these Budget and Expenditure Instructions.

3 Legal Framework

3.1 These Budget and Expenditure Instructions are issued under Section 65 of the *Intergovernmental Relations (Functions and Funding) Act 2009*, which was passed by Parliament in March 2009. Section 65 allows the Treasury Secretary to issue Budget and Expenditure Instructions that specify:

- What grants, payments or other revenue are to be used for, and what Provinces are expected to achieve from spending these funds;
- The timing and nature of expenditure of grants, payments or other revenue;
- How grants, payments or other revenue are to be managed by Provinces;

- How the expenditure of grants, payments or other revenue is to be monitored and reported; and
- The budget preparation process, including consultation with stakeholders.

3.2 Section 67 of the *Intergovernmental Relations (Functions and Funding) Act 2009* empowers the National Government to take serious actions if these conditions are not complied with.

3.3 These Budget and Expenditure Instructions will stay in force until they are withdrawn, replaced or superseded.

4 Funding for Functions

4.1 Section 5 of the *Intergovernmental Relations (Functions and Funding) Act 2009* allows for service delivery functions and responsibilities to be formally assigned to Provinces and Local-Level Governments.

4.2 Furthermore, if a Province is determined to have a 'fiscal need', Section 28 of the *Intergovernmental Relations (Functions and Funding) Act 2009* requires the National Government to provide service delivery function grants and an administration grant to assist with meeting the recurrent costs of the *assigned* service delivery functions and responsibilities.

4.3 In June 2009, NEC approved a Function Assignment Determination which sets out the responsibilities of provincial and local-level governments. This clarifies the service delivery activities each tier of government is responsible for (assigned functions).

4.4 This means that National Government goods and services grants are only provided to contribute towards the costs of providing functions which are assigned to Provinces under the law. Provinces may choose to perform other functions, but will have to ensure that they have other sources of funding available.

Function Grant Funding only available for the stated purposes

4.5 Service delivery function grants are only to be used for the recurrent costs of goods and services related to the specific function grant.

4.6 Under no circumstances are service delivery function grants to be used for salaries and other personal emoluments, casual wages, debt payments, legal settlements or capital projects.

4.7 Provinces may spend a service delivery function grant on the administrative costs that are *directly* related to performing the relevant service delivery function. For example, the health function grant can be used to support health administration, but not other types of administration.

4.8 Service delivery function grants cannot be transferred between different grant and expenditure types without the express approval of the Treasury Secretary.

Service Delivery Function Grants and Administration Grant

Health Function Grant

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

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

Education Function Grant

4.10 Provinces are responsible for the administration and routine maintenance of elementary, primary and secondary schools (including provincial high schools), and vocational centres, including the delivery of basic recurrent education goods and services such as the purchase and distribution of school materials to schools and vocational centres, distribution of curriculum materials and supporting supervision activities of teachers and schools.

4.11 More emphasis should be placed on expenditure on elementary schools and primary schools than vocational schools and provincial high/secondary schools. The Education Function Grant should not be used to subsidise university fees. While this is a worthwhile objective, it *is not* a Provincial Government function. If a Province wishes to subsidise, or otherwise fund university education, it must use provincial government own source revenues.

4.12 The Education Function Grant is not to be used for the construction of new teachers' houses or classrooms; however, it may be used for routine maintenance of these facilities.

Transport Infrastructure Maintenance Function Grant

4.13 The Transport Infrastructure Maintenance Function Grant can only be applied to the maintenance costs of existing transport infrastructure in the Province, such as provincial roads, jetties/wharves, airstrips/airfields etc.

4.14 This grant must not be used for the construction of new roads or maintenance of buildings, or for major reconstructions of unusable existing roads. Routine maintenance of buildings, including schools, health facilities and administrative buildings must be funded out of the relevant function or administration grant.

Village Court Function Grant

4.15 The Village Court Function Grant is provided to assist with the goods and services costs associated with the administration, supervision and support for the village court system in the Province. This includes operational materials needed for day to day operations of the courts.

4.16 The grant is not to be used for the staffing costs of Village Courts, which are funded separately through the Village Courts Allowance Grant under the Province's Personnel Emoluments Budget.

Primary Production Function Grant

4.17 The Primary Production Function Grant is provided to further the development of subsistence, domestic trade and export commodities in the Province. This was previously known as the Derivation Grant or Agriculture Function Grant.

4.18 The Primary Production Function Grant provides funding for the recurrent cost of goods and services associated with agriculture and other primary production, including fisheries, livestock and forestry.

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

Other Service Delivery Function Grant

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

Administration Grant

4.20 In addition to the service delivery function grants, Provinces will receive an Administration Grant to assist them to meet the day-to-day operational costs of the Provincial and District Administrations.

4.21 This grant is provided for the core costs of the administration such as utilities, stationary and anti-virus programs. The administrative costs of specific sectors, such as health and education, are provided for under the respective service delivery function grants.

4.22 Under no circumstances is the administration grant to be used for salaries and other personal emoluments, casual wages, debt payments, legal settlements or capital projects, without the express approval of the Treasury Secretary.

Local-level Government Grants

4.23 Local-level Government Grants are provided for *goods and services* directly related to the functions for which rural and urban LLGs are responsible.

4.24 Since 2007, there is no longer a separate LLG Secretariat Grant. Secretariat wages, salaries and allowances are to be met out of the Staffing Grant.

4.25 Provincial governments are required to specifically budget from their internal revenue for the allowance costs of LLG councillors.

Urban Local-level Government Grant

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

5 Minimum Priority Activities

5.1 In addition to the general requirement that the service delivery function grants be used for goods and services for the assigned functions outlined above, from 2009 Provinces have been *required* to specifically fund a set of Minimum Priority Activities (MPAs).

5.2 The MPAs, which were determined in 2008 following consultation between Provinces, the National Economic and Fiscal Commission (NEFC) and the Department of Provincial and Local-level Government Affairs, are a minimum set of activities that *must* be funded out of each of the function grants.

5.3 The MPAs are not the only activities that can be funded, and in general Provinces would be expected to fund a broader range of activities out of each of their service delivery function grants. However, they are a core set of basic activities that most Provinces would be already expected to have in place.

5.4 In order to demonstrate that they are adequately funding these activities, Provinces will be required to establish programs/activities for each MPA within their Budget, and report regularly on performance against these activities throughout the year.

5.5 The minimum priority activities are:

Primary Production
Agriculture Extension
Fisheries Extension
Forestry Extension

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

Health
Rural Health Facilities
Outreach Health Patrols & clinics
Drug distribution

Transport Infrastructure Maintenance
Road and bridges maintenance
Airstrip maintenance
For Mmaritime provinces – wharves and jetties maintenance

Village Courts Operations
Provision of operational materials

5.6 The inter-departmental committee overseeing implementation of the reforms to intergovernmental financing arrangements has agreed and endorsed Indicators for MPAs which will serve as the standard performance assessment guide for Provincial Administrations. These indicators are included with this Instruction as "*Attachment A*". Explanatory notes including definitions from NEFC are also attached for information and reference.

5.7 Provinces will be required to report on their performance against these indicators through the regular quarterly reporting process. This requirement will start with the second quarter review in 2010.

6 Provincial Budgets

6.1 Provinces are required to correctly budget for the receipt of National Government Grants for goods and services from the Recurrent Appropriation as well as the Development Budgets. The expenditures of these grants must be aligned to purposes/functions intended and identified programs.

6.2 The Provincial Budgets should be endorsed and enacted through an "Appropriation Act" by the Provincial Assembly and submitted in two parts; Part One reflecting expenditure estimates for the approved National Grants for both Recurrent & Developments Grants and; Part Two showing the expenditure estimates under Internal.

6.3 This means that Provinces will have to use the correct PGAS codes for both revenue and expenditure, clearly identify each grant in the Budget documents they submit to Treasury, and identify all of the programs/activities, including the MPAs, that the grants will be spent on.

6.4 Provinces should submit their draft budget for vetting to ensure that they comply with this Instruction soon after the circulation of the preliminary ceiling, given the level of certainty over the final figures that would be approved in the National Budget. Treasury officers within the Provincial Budget Branch will assist in the vetting process of the Provincial Budgets.

Revenue - Correct PGAS Grant Codes

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

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

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

Expenditure - Correct PGAS Activity Codes

6.6 Provinces must also ensure that programs/activities are established to expend the goods and services grants. As a minimum, this will mean that all Provinces will have to establish, and account for expenditure against, each of the MPAs.

6.7 Provinces must ensure that each activity, including each MPA, has its own activity code in their future Budgets submitted to the Department of Treasury, and that these activity codes are consistent with the standard chart of accounts guide, *"Attachment B"* of this instruction.

6.8 Before submitting the Budgets for ministerial approval, Provinces should consult with Budget Division in the Department of Treasury to ensure consistency with the correct chart of accounts for the programs and activities they will fund, including the MPAs.

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

7 Monitoring and Reporting on Performance

7.1 At this stage, all additional reporting requirements, such as reporting on performance in the MPAs and reporting on expenditure of rolled over funds, will be met by the regular quarterly reporting process.

7.2 Section 5 of the *Public Finances (Management) Act* 1995 requires Provinces to report each quarter on their financial performance. However, despite this, Treasury is concerned that Provinces regularly fail to submit their reports on time.

7.3 Provincial governments must report on service delivery, so that the Government is satisfied that the funding provided is being spent for the benefit of the people. Under the revised funding system, Provinces that fail to report as required may be subject to a range of sanctions, as outlined in Section 9, below.

7.4 In 2009, the Department of Treasury, with NEFC and the Department of Provincial and Local-level Government Affairs, consulted with Provinces about introducing a range of relevant performance indicators for the MPAs and has introduced the MPA Indicators endorsed by the Inter Departmental Committee as highlighted in section 5.5 above and outlined in Attachment A.

7.5 Provinces will be required to report against these indicators from second quarter of 2010.

8 Restrictions on Rollovers

General restrictive approach to Function Grants Rollovers

8.1 As outlined in section 4 above, service delivery function grants are provided by the National Government for specific purposes, with the intention that they be spent on the function for which they are provided within the year they are provided.

8.2 In the normal course of business, Provinces should actively work towards spending their service delivery function grants throughout the Budget year. In the event that Provinces do not fully spend their Function Grants, they should 'roll-over' the unspent National Government funds into specific Revenue Heads in the Internal Revenue ('700 Series') estimates.

8.3 It is a *strict* condition that these funds remain in the core priority sectors for which these were provided. For example, rolled over Health Function Grants must *only* be used on recurrent goods and services relevant to primary health care.

8.4 To ensure they are used as intended, unused funds from previous year must be rolled over into one of the following four specific revenue votes for current/(budget) year:

- 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, it Treasury will consider re-allocating the funds to a Province with a better track record.

9 Penalties for Non-Compliance with Budget and Expenditure Instructions

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

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

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

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

10. Contact Officers

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

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

11. Conclusion

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

ALOYSIUS HAMOU
Acting Secretary

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

Improving Service Delivery in remote areas of Papua New Guinea