National Economic & Fiscal Commission

2017 Budget Fiscal Report

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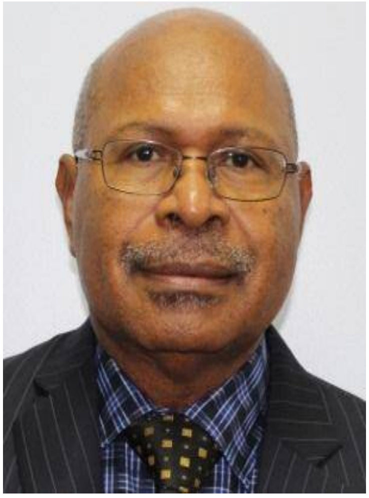
Foreword



It is my pleasure to present the National Economic and Fiscal Commission's 2017 Annual Budget Fiscal Report. This report is published 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 Budget Fiscal report is a report on the Commission's operations and the 2017 Provincial and Local-Level Government function grant calculations.

The Reforms of Intergovernmental Financing Arrangements (RIGFA) has been in operation since 2009. The new system is based on equalisation principles which takes into account provincial and local-level government funding allocations. The new system not only takes into consideration the cost of providing services but also internal revenues generated by Provinces. The amount of revenue that a province is able to generate has an impact on their ability to deliver basic services.

It is also a privilege for me to announce the establishment of the NEFC Commission. The three Commissioners were formally endorsed by the Minister and the Commission's inaugural meeting was held in July 2016. The Commission members include Dr Alphonse Gelu, Mr Uvenama Rova and myself as the CEO-Chairman bring a wealth of experience to the work of the Commission which will be a valuable asset in guiding the Commission and initiating much needed reform.

The NEFC conducted a progress review of RIGFA and identified a number of issues, which the NEFC is currently addressing in its work. RIGFA is also being challenged by a myriad of National Government reforms including larger development funding channelled directly to Districts. Other challenges include proposed changes to the Organic Law and the implementation once the amended Organic Law legislation is passed.

The implementation phase of the Districty Development Authorities including the passing of the recent City Authority Acts across the Country also merit more in-depth research and studies by the Commission to better inform government. The new approved organization structure will enable the Commission to be more responsive in addressing the fiscal related needs of Government.

The NEFC will therefore continue to research ways of accurately costing services including determining cost disabilities to account for remoteness and to progress the decentralised reforms.

I am pleased to note that two studies conducted by the Commission to improve the allocation of funding to account for remoteness cost disabilities are being used by national agencies for the allocation of funds. The 'Go Long Ples' (2014) was a study which accounted for the remoteness of service centres. The National Department of Education has indicated that it uses the index to allocate Tuituion Fee Free (TFF) grants. The NEFC also assisted the NEC working closely with the Minister Planning and Monitoring in developing a composite index for development funding (ie DSIP). This submission was not progressed ahead of the 2014 budget due to the limitation of available accurate information and the funding limitation. The NEFC has in 2016 updated the composite indiex of the Service Improvement Equalisation Regime (SIER) using more updated data.

Over the last seven years significant increases have been made in the recurrent level of funding to Provinces and Local-Level Governments. Increased funding allows provinces to improve service delivery, particularly those provinces that had previously been unable to generate adequate internal or own-source revenues. The annual Provincial Expenditure Review (PER) which is conducted each year for the last nine years, confirms the volume of function grants provided. It is re-emphasized here 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 that there is proper planning, budgeting and spending. The ordinary villager at the end of the chain must continue to receive access to basic health, education and transport services.

One of the important roles that the NEFC plays is to effectively report on the performance of the provinces through our analytical papers and publications. These include Budget Fiscal Report, the Annual Provincial Expenditure Report (PER) and the Revenue reports. To add to our annual list of publications, we have also included the District Expenditure Review (DER). The DER of a pilot of four (4) Districts was launched by the CEO/Chairman at PLLSMA in September 2016. The collaborative study between NEFC and DIRD was concluded in 2016 and highlighted a number of weaknesses including logistical issues that are likely to influence a more comprehensive review of all districts. The NEFC also concluded that the Provincial & District Cost of Services Study. This updated study conducted once every five years is part of an evidence-based methodology used as a basis of the function grant calculations.

Some of the areas of concern in providing quality analysis are delays in obtaining key financial and performance data to assist with various publications. For instance, delays in the availability of PGAS and Sub-National Warrant Releases data from the Departments of Finance and Treasury have hampered NEFC's efforts to provide more timely reports on expenditure. The NEFC has continued vigorously advocating for timely releases of warrants and cash releases.

The lack of capacity and the inconsistency of cash releases continues to hamper the provision and consistency of service delivery. Monitoring of service delivery continues to be poor including inadequate funding to monitor the provision of services.

Overall, it is NEFC's intention that the various publications that NEFC produces will enable the 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. The NEFC has rigorously advocated that if service delivery is a priority, then government must diligently find ways to structure and protect the cash release regime which ensures that four quarterly recurrent budget releases each year by Treasury occurs in a consistent and predictable manner. This also ensures that service delivery providers are held more accountable for their performance.**

The NEFC will continue to work hard with our stakeholder agencies to ensure that all Papua New Guineans, no matter where they live, have access to basic service delivery. This is also the spirit of the Constitution and the aspirational goals and objectives of the MDTP and Vision 2050.

Finally, I would like to thank my staff and advisors for assisting and contributing to our planned outcomes. The work of the Commission is complex and technical and I am personally thankful to our partners, the Australian Government for providing the necessary technical assistance to carry out our work.

HOHORA SUVE
Chairman & Chief Executive Officer

Executive Summary

Establishment of the NEFC Commission

The NEFC Commission was re-established after an absence for many years. This ensures that the Commission now complies with its legislative obligations. The Commissioners were approved by the Minister and their inaugural meeting was held in July 2016. The Commission has a wealth of experience which will be a valuable asset in guiding the Commission and progressing with the decentralised reforms.

Progressing the Reforms of Intergovernmental Financing Arrangements (RIGFA)

The Reforms on Intergovernmental Financing Arrangements (RIGFA) came into operation in 2009. The first phase of RIGFA focused on the allocative efficiency of function grants to Provinces and LLGs. The new system ensured that funding to Provinces and LLGs is based on equalisation principles taking into account the Province's fiscal capacity and its total capacity to generate internal revenues in providing basic service delivery which was costed by the NEFC through the Cost of Services Study.

The NEFC is now progressing deeper to inform government on the other areas of government expenditure including development expenditure and more specifically personnel emoluments which comprise of over one third of sub-national funding budget.

There is a dire need to control the cost and efficiency of personnel emoluments. Uncontrolled personnel emoluments impacts funds available for the provision of basic service delivery This has been highlighted by National Governments, particularly Department of Personnel Management and Department of Treasury in recent years. They have both conducted reviews including a payroll validation and data cleansing exercise to control the escalating staffing costs which lead to budget blow-outs. In assisting Provincial Adminstrations to better manage their staffing costs and for the NEFC to also progress the decentralised fiscal reforms, the NEFC has developed a personnel emoluments costing model (PECM).

Personnel Emoluments Costing Model

The NEFC has developed a tool known as the Personnel Emolument Costing Model (PECM). This tool was developed in-house by the NEFC and has since been rolled out to all the provinces. The PECM calculates the actual cost of the staff establishment and can be used by management in calculating staffing cost and to assess payroll variances against actual costs. The PECM has also since been updated to include other information including qualitative information such as gender break-up, age demographics etc.

The NEFC also completed an analysis of personnel emolument expenditure review of all provinces. This report has been compiled and is in the process of being released. The NEFC now also works closely with DPM to evaluate organizational structure reforms submitted by Provincial Administrations.

Cost of Services Study

In 2015, the NEFC commenced work on the third update of the sub-national Cost of Services (CoSS). This major task was completed in early 2016. As part of the CoSS, a qualitative district survey was conducted and also included a facility mapping exercise using GIS software. The Australian Government assisted with the purchase of software licenses and hardware including a GIS plotter. Technical expertise was also provided aimed at improving in-house capacity. The NEFC now expects to upate the GIS software with new facilities thus providing more accurate information for future costing studies and equitable funding allocations.

City Authorities

The NEFC also has been tasked by Government to undertake a cost of services study of City Authorities including Lae, Mt Hagen and Kokopo City Authorities. These studies have been progressively completed during 2016 by the NEFC providing cost estimates based on available information. Completed estimated costing infromaiton was provided for Lae City, Hagen City and Kokpo City Authority costings. The NEFC also developed a standard model which will assist with future City Authority costings.

NEFC Annual Regional Workshops 2016

The Annual NEFC Regional Workshops were conducted mid-year (2016) at four major regional venues including Mt Hagen, Port Moresby, Madang and Kokopo. All the workshops were particularly well attended by provincial administration staff and remain one of the only annual forums where National and Sub-National agencies interact and discuss major policy issues and overcoming bottlenecks.

The NEFC Regional Workshops are primarily intended to facilitate the decentralised reforms and policy dissemination by the major national agencies which include the Departments' of Finance, Treasury, Planning and Monitoring, Provisional & Local Level Government Affairs, Department of Personnel Management and major sectoral agencies including the National Department of Health, National Department of Education and Village Courts Secretariat.

At the conclusion of the Workshops, joint resolutions were collated and circulated to Provincial Administrators and Governors to improve the opportunity for addressing the pledged resolutions.

District Development Authorities

The NEFC continues to work closely with DPLGA and PLLSMA to progress the DDA implementation reforms including assisting with developing a decentralised policy framework.

The NEFC also contributed to the Organic Law Review Team undertaken by the Constitutional Law Reform Commission. The CLRC final report was tabled in Parliament in 2015, the findings of the CLRC have been subject to an independent review and the NEFC has also assisted this Parliamentary Review Team during 2016.

Provincial Expenditure Review (PER) 2014

Each year the NEFC conducts a Provincial expenditure review (PER). The 2014 expenditure review was completed in 2016 ahead of the workshops. The report continues to be a valuable source of information to government and has been consistently produced annually for the last nine years.

The title of the 2014 Provincial Expenditire Review was titled 'Game Changer', a theme which reflected the need to strengthen compliance and support towards Minimum Priority Activities on the part of provinces as well as, the need for diligent commitment on the part of the Department of Treasury to release warrants on a timely basis.

District Expenditure Review

A collaborative study of district expenditure review was completed by NEFC and DIRD. This included a pilot review of four districts. This report was launched at Provincial and Local-level Service Monitoring Authority (PLLSMA) meeting in late September 2016. The study was the first of its kind that involved two agencies working together to provide government with an indication of trends in district expenditure.

The findings noted a number of serious system weaknesses including a breakdown of processes, poor accountability and monitoring. Logistical issues faced include obtaining timely data from district administration. The DER of four pilot districts was not an audit but a review of trends in expenditure including logistical issues. The findings will be used as a precursor by the NEFC to undertake a more comprehensive review of all districts.

One of the major causes for concern was the inconsistency of cash releases that may be contributing to yet another weakness: the co-mingling of funds between recurrent and development funding.

NEFC considers these weaknesses as a risk that could eventually lead to a breakdown in PFM systems notwithstanding the roll-out of new financial management system. The management of cash flows and consistency of cash releases remain major obstacles and has the potential to impact future reforms. This needs to be addressed by Government as a matter of priority.

The 2017 Grant calculation

The function grants have reduced by 2 per cent between 2016 and 2017 – a decrease of K13 million (from K578 million in 2016 to K565 million in 2017). The RIGFA methodology provides for an inbuilt stability in the system providing Provinces and LLGs stability to be able to effectively plan for service delivery. The current declining economic activity including GST will likely see a fall in function grants and this could be problematic. The NEFC is currently undertaking a modelling exercise to determine the overall impact of declining revenue on grant allocations in the future.

In 2016, the Morobe Province was ineligible for any function grants (i.e. as a result of being able to meet its full fiscal needs based on the receipt of Internal Revenues). It is also likely that other resource rich provinces are likely, based on internal revenue trends to cease receiving function grants.

While RIGFA has focused on fiscal capacity, NEFC has reservations that resource rich provinces, based on past analysis will not, sufficiently prioritise spending on basic service delivery, which would be detrimental to their community. As a result the NEFC has embarked on a modelling exercise aimed at assessing options including a hybrid function grant formula (i.e. a fixed component of the function grants provided to all provinces for the provision of basic service delivery regardless of their fiscal capacity) and an equalisation component for the remainder of the function grants.

Reviewing Overall Budget Implementation in 2016

The NEFC also plays a role in monitoring the performance of the Provinces by taking part in the second quarter budget reviews with major stakeholders such as Department of Treasury, Department of National Planning, Department of Implementation & Rural Development, Department of Personnel Management and Department Provincial & Local-level Government Affairs. Our analysis identified that in 2016, provinces had difficulty implementing their budgets for a number of reasons.

The second quarter budget reviews indicated a low spending rates on the part of most provinces (i.e. by the end of June 2016) provinces had only spent seven percent (7%)of the grants which they had received). This problem was exacerbated by slow cash release and inconsistent cash flow to Provinces thus making it difficult to effectively plan spending.

The warrant releases by the Department of Treasury does not match cash releases to Provinces. Often Warrants are released on time but the cash component comes in much later and hinders the implementation of planned activities on time. As such, the second budget quarter reviews indicated that in 2016, provinces were relying on their own-sourced revenues to finance their planned activities. However their revenue projections were evidently unrealistic. Overall, revenue collections have been very low compared to the 2015 collections. There was a huge shortfall of K866 million compared to 2015 which represented a deficit of close to K47 million.

Financial Management

One of the major foundations of implementing effective policy reforms and initiatives is the robustness of the financial management information and reporting systems.

Over recent years, It has been evident that even the parallel system adopted for the direct channelling of development to districts has not necessarily ensured that funds are being spent on their intended purposes including poor outcomes or actual outcomes. Whilst the responsibility for the monitoring and auditing rests with the mandated national agencies to undertake this task, the NEFC has a responsibility within its legislation to advice government on hinderances to service delivery.

In 2016, the NEFC conducted a review of the accuracy of the classification of expenditure by sub-national agencies. The review found major weaknesses, inconsistencies and non-compliances in the classification of expenditure by sub-national agencies.

NEFC conducted a workshop with the National agencies including DoF and DoT to highlight findings of the NEFC review. This resulted in the stakeholders working together to strengthen the systems including factoring the recommemdation in progressing with the roll out of the IFMS to Provinces.

(v)

The NEFC has also been rolling out the Provincial Budget Model, This is a 3-page financial summary report which provides the Province with its total resource envelope including budget expenditure allocations. This training has been rolled out to all provinces. It is anticipated that a majority of provinces would have submitted this summary as part of their budgets to the Department of Treasury.

The NEFC aims to roll out a full version of the Provincial Budget Model, this includes a cost builder, effectively providing the provincial administrations with a basis for budget allocation. This will be rolled out by the NEFC to at least six provinces in 2017.

Legisaltive Review

The NEFC is in the process of conducting a review of all it's legilslations and since drafted Regulations in support of the Intergrovenmental (Financing and Funding) Act 2009.

The Regulations which are before the Solicitor General will further assist the Commission in determining grant allocations particularly where there are major fluctuations in economic activity between years and impacts the consistency of funding and ultimately service delivery.

Decentralisation Reforms

The myriad of government policy reforms including parallel system of funding flow has made it difficult for the NEFC to position itself appropriately and to be able to continue to influence the decentralisation reforms. There are emerging opportunities for the NEFC to address the gaps in current government policies particularly relevant to intergovernmental financing and to develop strategies going forward.

The NEFC is already embarking on informing and engaging major stakeholders including Ministers on the emerging issues and gaps in decentralisation. NEFC has also been working closely with DPLGA in developing decentralisation policy framework which is now part of the CACC Sub Steering PLSSMA Committee.

A discussion paper has been developed for internal discussion, the pnext phase of proposed decnetralised reforms has been title as RIGFA3 :Decentralisation Srategies.

Progressing Current Government Reforms and Supporting Initiatives

The NEFC has made significant progress towards reviewing the progress of the reforms by improving funding for service delivery at the lower levels of government. This has involved a great deal of work such as establishing the goods & services cost for the three proposed City Authorities; assessing district expenditures through the District Expenditure Review: A Pilot of 4 Districts; and establishment of the District Development Authorities. Other initiatives that are undertaken by the NEFC to improve transparency and accountability at the sub-national levels in 2016 is the workshop on Standardized Chart of Accounts Compliance that involved all the major stake holders such as Department Treasury and Department of Finance.

Conclusion

The NEFC is a relatively small productive agency with about 20 staff and produced quality and timely publications, which include the following:

- The Provincial Expenditure Review 2014
- District Expenditire Review of 4 Pilot Districts
- The 2017 Fiscal Budget Report

- The Warant Release 3rd Quarter Publication
- Completed the 2015 Cost of Services Study
- NEFC's Annual Reports 2011-2014 were tabled in Parliament by the Minister

Overall, the NEFC will continue to work collaboratively with all its major stakeholders such as the Department of Provincial & Local-level Government Affairs, Department of Treasury, Department of Finance, and Department of National Planning & Monitoring to ensure that the quality of basic services is sutained by sub national agencies.

In conclusion, the NEFC will continue working hard to ensure that all Papua New Guineans, regardless of where they reside, receive, 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 expenditure and revenue systems to effectively 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, multiple layers of service delivery are associated with national, provincial and local levels. Legislation and guidelines outline which particular level of government are 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.

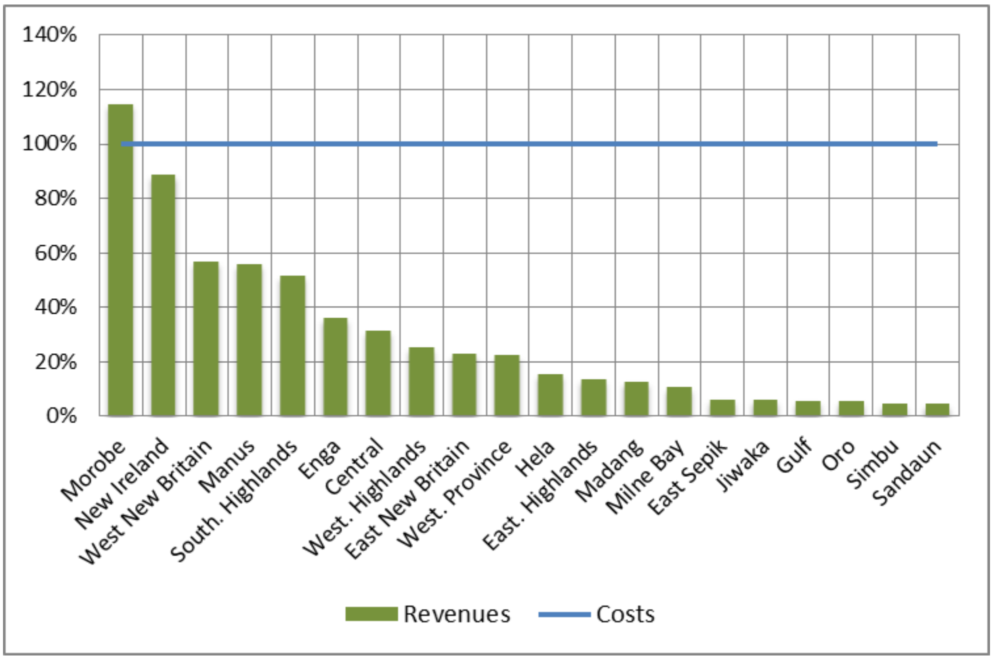
1.1 The Fiscal Gap

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 remain operational are among five of the critical activities undertaken by 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 unique 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 pose 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 results 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 2017.

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



The difference between a Provinces revenue raising ability and its estimated costs is called the **Fiscal Gap**

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 inter-governmental 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 is now based on the NEFC's cost estimates. The results, eight years later, is that more funding is going down to all Provinces, particularly, those Provinces with low fiscal capacity.

1.3 Types of Grants

In 2016, 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 K100,000 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 provinces, 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 patrols or materials for maintenance. The NEFC recognises that without sufficient recurrent funding, service delivery for rural communities 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 those 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 which outlines the process for determining the Function Grants and the amounts for 2017.

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 the advice provided by NEFC.

From a technical perspective, the NEFC works to understand the cost pressures each Province faces and their respective own-sourced 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.*

The many NEFC publications which displayed at the launch of Provincial Expenditure Review 2013 at the NRI

2 EQUALIZATION AMOUNT

The *Intergovernmental Relations (Functions and Funding) Act* 2009 Section 19 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 2017

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

The equalisation 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 19 of The Act, the NNR amount for 2017 was calculated using tax revenue data from 2015 (the second preceding fiscal year) in accordance with the following formula.

General tax revenue for 2015	**-**	**Mining and petroleum tax revenue for 2015**	**=**	**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 2015 Final Budget Outcome published by the Department of Treasury in March 2016-.

The following table shows how the NNR amount for 2017 is calculated.

Act Definition	Final Budget Outcome equivalents	2014	2015	Difference
General tax revenue	Tax revenue	K9,592.2 million	K8,797.6 million	*-K798.6 million*
MINUS (-)				
Mining and petroleum tax revenue	Mining and petroleum taxes	K794.2 million	K195.4 million	*-K598.8 million*
EQUALS (=)				
		2016 Budget	2017 Budget	
Net National Revenue Amount		K8,802 million	K8,602 million	*-K199.8 million*
Multiplied by (*) 6.57%				
Equalization Amount		**K578.3 million**	**K565.2 million**	***-K13.1 million***

For 2017 Budget, the minimum funding level for the equalisation amount is calculated according to the following formula in Kina million:

Net national revenue for 2017	X	6.57%	=	NEFC estimate of 2017 equalisation amount
K8,602.2	x	6.57%	=	K565.2

As depicted on the table above, the 2017 Equalization Amount has reduced by K13.1 million from K5788.3 million in 2016 to K565.2 million for 2017. The reduction is primarily due to lower total tax revenue collections in 2015 compared to 2014.

In accordance with the Act, the NEFC provided a written estimate of the equalisation amount to the Secretary for Treasury on 31 March 2016.

2.2 Apportioning Equalization Amount between Provincial & Local-level Governments

Equalization Amount

The Ministerial Determination that was issued by the Treasurer splits the equalisation amount of **K565.2 million** as follows;

Local Level Share

The Local Level share is the proportion of the equalization amount to be distributed amongst all rural and urban LLGs. As stated also in the Ministerial Determination, the share is about 10.05% of the 2017 Equalization Amount.

Overall, for the 2017 Budget, LLGs will receive a funding of K56.8 million.

Provincial Share

The provincial share is the amount remaining after deductions are made from the local level share on the Equalisation Amount. The share will be distributed amongst all provinces through Function and Administration Grants

Available funding for Provincial Governments from Ministerial Determination		
2017 Equalization Amount	**K565.2 million**	**100.00%**
(Less) LLG Share	*K56.8 million*	*10.05%*
Provincial Share	*K508.4 million*	*89.95%*

As shown in the table above, for 2017 Budget, provinces will receive a total funding of K508.4 million.

The two components are funded from the equalization amount (EA) and distributed on the basis of need.

3 RECOMMENDATIONS

The NEFC makes a recommendation to the Treasurer on the distribution of 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 2016 Budget Circular.

The Provinces are allowed to request minor shifts among function grants within their overall sectoral ceiling. Treasury and NEFC usually 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 2017 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 2017.

Figure 3: 2017 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	10,732.9	7,889.9	11,352.5	3,224.9	397.4	1,644.2	384.6	35,735.6
Gulf	5,297.9	4,027.4	5,783.3	1,916.3	389.8	1,632.7	1,566.3	20,675.7
Central	5,952.8	6,168.5	10,575.1	2,031.3	343.8	2,728.3	1,544.2	29,409.0
Milne Bay	7,456.6	7,652.6	7,285.7	2,265.6	379.3	4,356.6	1,817.5	31,276.0
Oro	4,524.4	3,954.5	4,064.7	1,987.2	330.6	1,987.1	1,030.2	17,945.0
Southern Highlands	4,191.1	4,844.1	4,374.1	1,164.3	419.4	1,832.2	787.6	17,677.9
Hela	5,968.5	3,718.7	4,009.8	1,700.3	276.4	1,633.3	2,090.5	19,483.8
Enga	4,611.3	4,843.1	10,183.7	800.7	369.9	2,866.2	1,674.5	25,410.0
Western Highlands	4,706.3	6,336.7	9,147.6	1,408.5	412.9	2,030.7	1,064.4	25,187.1
Jiwaka	4,562.4	5,613.7	9,301.1	1,133.8	343.8	1,887.0	1,866.4	24,777.4
Simbu	6,308.9	8,463.3	9,346.0	1,693.3	546.3	3,104.2	2,280.5	31,798.8
Eastern Highlands	7,336.0	10,552.5	17,245.1	2,693.1	636.2	3,624.0	2,933.1	45,086.6
Morobe	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Madang	9,487.3	9,403.9	12,951.2	3,751.5	585.4	3,722.2	3,566.1	43,534.3
East Sepik	11,161.5	12,227.5	19,777.8	3,405.1	795.4	3,094.8	3,268.3	53,784.7
Sandaun	9,665.4	9,046.3	7,180.0	3,164.2	344.1	2,005.3	2,961.9	34,424.4
Manus	1,883.3	1,698.0	2,169.7	602.4	159.8	535.4	151.9	7,265.4
New Ireland	865.2	721.4	751.7	267.8	45.5	83.6	75.8	2,855.9
East New Britain	5,349.1	7,626.6	8,953.6	3,168.2	306.4	3,270.5	1,210.0	29,976.9
West New Britain	3,178.5	4,337.6	2,065.4	1,154.0	183.2	887.3	198.4	12,061.0
TOTAL	**113,239**	**119,126**	**156,518**	**37,533**	**7,266**	**42,926**	**30,472**	**508,366**

3.2 LLG distribution

The table below shows the final amounts (in K'000) for the LLG grants by Province for 2017. The Urban and Rural LLGs are shown separately.

Figure 4: Local-level Government share by Province for 2017 (K'000)

Province	Urban LLG Grants	Rural LLG Grants	Total LLG Grants
Western	721.9	2,975	3,697
Gulf	139.2	2,920	3,059
Central	0.0	2,032	2,032
Milne Bay	280.5	2,410	2,690
Oro	696.7	1,598	2,294
Southern Highlands	663.5	2,469	3,132
Hela	929.2	1,344	2,273
Enga	231.3	2,072	2,304
Western Highlands	776.6	1,387	2,164
Jiwaka	0.0	872	872
Simbu	367.8	1,336	1,703
Eastern Highlands	723.0	1,975	2,698
Morobe	2,415.5	4,442	6,857
Madang	850.9	3,542	4,393
East Sepik	636.7	4,073	4,710
Sandaun	477.8	3,861	4,339
Manus	210.1	524	734
New Ireland	395.6	989	1,384
East New Britain	869.3	2,546	3,416
West New Britain	542.2	1,503	2,046
TOTAL	**11,927.8**	**44,871**	**56,799**

3.3 Transitional arrangements for Hela and Jiwaka

Hela and Jiwaka Provinces came into legal existence after the 2012 election. In determining the 2013 and subsequent grant calculations, the NEFC provided the new Provinces at the time with transitional grants which were outside the equalisation system as the revenue data had not been captured in the PNG Government Accounting System and did not distinguish between the new Provinces and their 'parent' Provinces of Southern Highlands and Western Highlands, respectively. Similarly, the NEFC could not verify an 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 the parent province and new province based on a province's 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.


Gembogl-Bundi Road


Road linking Simbu and
Madang 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 assignments 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 fulfill 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 envisaged 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 gazette 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.

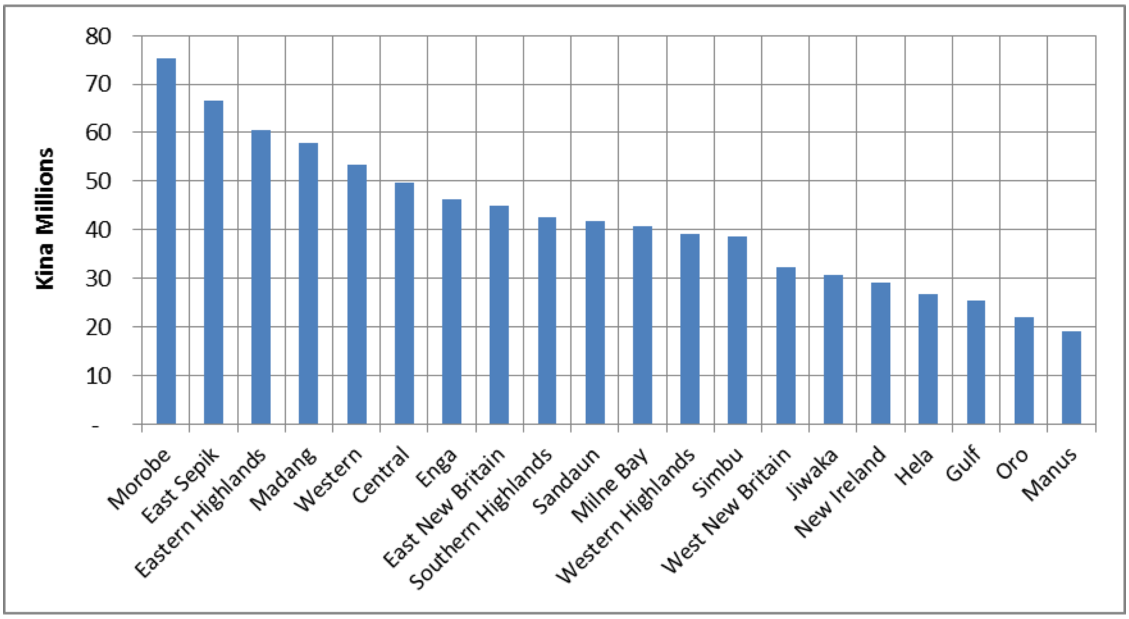
Cost of Service Estimate

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 and population growth.

The determination for any year is based on the costs from the second preceding fiscal year. Therefore, for the 2017 determination, the 2015 cost estimate is used. This maintains consistency between revenues and costs.

The graph below outlines the estimated costs for each Province in 2015.

Figure 5: 2015 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 2017 distribution year 2015 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) distributions 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 section 40 of the *Intergovernmental Relations (Functions and Funding) Act 2009*. 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 is also administered by the Internal Revenue Commission.

Bookmakers Tax received by provincial governments are 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.

Provinces that are entitled to bookmakers proceeds in 2017 are Eastern Highlands, Western Highlands, Morobe, Madang and East New Britain).

Own-source revenue

These are local taxes, charges, and receipts collected by the provincial administration, which is the primary revenue base for provinces. These comprise of:

- 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 2015 (the second preceding year), Provinces raised K57.4 million[2] from this revenue source. This data is obtained from the PNG Government Accounting System (PGAS) internal revenue electronic summary files held by the Department of Finance.

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

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[2] This excludes Bookmakers Tax

Mining and Petroleum Royalties

Provincial governments with mining and petroleum activities within their provincial boundaries may be entitled to royalties as a result of Memorandum of Agreement (MOA) between the provincial government, customary landowners, the mining company and other stakeholders. In the case of petroleum projects negotiated after 1988, provincial government 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 directly from the companies themselves.

Figure 6: Actual revenues collected by Province in 2015

Province	GST Distributions	Bookmakers Tax	Own Source Revenues & Others	Royalties	Dividends
Western	2,226,000	0	4,477,634	9,300,000	0
Gulf	394,000	0	359,159	0	1,762,000
Central	617,000	0	606,114	0	0
Milne Bay	3,169,000	0	2,222,147	0	0
Oro	880,000	0	724,693	0	0
Southern Highlands	5,525,000	0	2,590,075	17,767,783	9,320,000
Hela	357,000	0	0	0	0
Enga	852,000	0	2,421,158	17,151,787	1,833,442
Western Highlands	8,937,000	529,231	4,123,017	0	0
Jiwaka	139,000	0	90,000	0	0
Simbu	995,000	0	1,601,654	0	0
Eastern Highlands	6,240,000	487,264	2,974,631	0	0
Morobe	75,503,000	1,603,442	15,428,853	1,825,212	0
Madang	4,886,000	1,605,657	1,771,097	0	0
East Sepik	2,655,000	0	2,984,653	0	0
Sandaun	932,000	0	1,814,381	0	0
Manus	24,630,000	0	759,909	0	0
New Ireland	2,880,000	0	5,483,640	25,236,717	0
East New Britain	7,388,000	960,742	3,839,907	0	0
West New Britain	16,788,000	0	3,152,696	0	0
TOTAL	**165,993,000**	**5,186,336**	**57,425,418**	**71,281,499**	**12,915,442**

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 2009* (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.*

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 2017 is outlined in the below table.

Figure 7: Fiscal Needs of Provinces for 2017 (Kina '000)

Provinces	Estimated costs	Assessed revenues	Fiscal needs	% of total fiscal needs
Western	53,363.5	11,904.8	41,458.7	7.0%
Gulf	25,441.5	1,454.6	23,986.9	4.1%
Central	49,738.8	15,620.1	34,118.8	5.8%
Milne Bay	40,564.8	4,280.1	36,284.8	6.2%
Oro	22,061.2	1,242.3	20,818.9	3.5%
Southern Highlands	42,439.7	21,930.7	20,509.0	3.5%
Hela	26,724.7	4,120.5	22,604.1	3.8%
Enga	46,180.1	16,700.7	29,479.4	5.0%
Western Highlands	39,060.1	9,839.2	29,220.8	5.0%
Jiwaka	30,618.0	1,872.5	28,745.4	4.9%
Simbu	38,687.2	1,795.8	36,891.4	6.3%
Eastern Highlands	60,521.8	8,214.6	52,307.2	8.9%
Morobe	75,261.8	86,281.0	0.0	0.0%
Madang	57,883.4	7,377.2	50,506.2	8.6%
East Sepik	66,545.5	4,147.3	62,398.2	10.6%
Sandaun	41,776.6	1,839.2	39,937.4	6.8%
Manus	19,082.7	10,653.7	8,429.0	1.4%
New Ireland	29,124.4	25,811.2	3,313.2	0.6%
East New Britain	45,046.4	10,268.7	34,777.7	5.9%
West New Britain	32,356.9	18,364.3	13,992.5	2.4%
TOTAL	**842,479.1**	**263,718.8**	**589,779.6**	**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:

[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 Relations (Functions and Funding) Act, 2009. The application of the percentage is subject to a periodic review by the NEFC and adjustments made if necessary.

$$\text{equalization amount for provinces} \times \frac{\text{fiscal needs amount of individual province}}{\text{total fiscal needs amount of provinces}} = \text{individual province share}$$

where -

'equalization amount for Provinces' means the amount equal to the Province share specified in the determination made under Section 17 (1) *(a)* 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: 2017 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	41,458.7	7.0%	35,735.6	35,735.6
Gulf	0.0	23,986.9	4.1%	20,675.7	20,675.7
Central	0.0	34,118.8	5.8%	29,409.0	29,409.0
Milne Bay	0.0	36,284.8	6.2%	31,276.0	31,276.0
Oro	0.0	20,818.9	3.5%	17,945.0	17,945.0
Southern Highlands	0.0	20,509.0	3.5%	17,677.9	17,677.9
Hela	0.0	22,604.1	3.8%	19,483.8	19,483.8
Enga	0.0	29,479.4	5.0%	25,410.0	25,410.0
Western Highlands	0.0	29,220.8	5.0%	25,187.1	25,187.1
Jiwaka	0.0	28,745.4	4.9%	24,777.4	24,777.4
Simbu	0.0	36,891.4	6.3%	31,798.8	31,798.8
Eastern Highlands	0.0	52,307.2	8.9%	45,086.6	45,086.6
Morobe	0.0	0.0	0.0%	0.0	0.0
Madang	0.0	50,506.2	8.6%	43,534.3	43,534.3
East Sepik	0.0	62,398.2	10.6%	53,784.7	53,784.7
Sandaun	0.0	39,937.4	6.8%	34,424.4	34,424.4
Manus	0.0	8,429.0	1.4%	7,265.4	7,265.4
New Ireland	0.0	3,313.2	0.6%	2,855.9	2,855.9
East New Britain	0.0	34,777.7	5.9%	29,976.9	29,976.9
West New Britain	0.0	13,992.5	2.4%	12,061.0	12,061.0
Total	**0.0**	**589,779.6**	**100.0%**	**508,365.5**	**508,365.5**

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:

$$\text{equalization amount for urban Local-level governments} \times \frac{\text{fiscal needs amount of individual urban Local-level Government}}{\text{total fiscal needs amount of urban Local-level Governments}} = \text{individual Local-level share}$$

Where -

'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 Section 17 (1) *(b)* 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 of rural and urban LLGs have been assessed at zero. This is due to data on these revenues being 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. It may not be possible to accurately assess revenues for over 289 rural LLGs in the foreseeable future. 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 290 individual LLG amounts, based on district costs and population in each LLG.

For urban LLGs, their funding is determined as their share of 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 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 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.

End of Transitional Guarantees and its impact on the Morobe Province

The *Intergovernmental Relations (Functions and Funding) Act 2009* introduced a five year transitional arrangement. This included a five transitional guarantee whereby provinces would not be worse off than the funding they received in 2008.

The five year transitional arrangements were due to end in 2013. However the NEFC sought approval from the Treasurer and the transitional guarantee provisions were extended further to 2016. This allowed the resource-rich provinces Morobe, New Ireland and Western to continue to receive grants.

Following the end of the transitional grant provisions for 2016, the NEFC had ceased to apply the transitional guarantee funding taking effect in the 2017 budget. With the cessation of the transitional guarantees, Morobe Province is the only province ineligible to receive any function grants for 2017.

This is consistent with the principles of the Inter-governmental financing arrangements where provinces with higher fiscal capacity (higher revenues to meet cost of services) to provide for basic service delivery should be able to do so.

The end of transitional guarantees would not impact the Rural and Urban LLG Grants. Morobe would still continue to receive these LLG Grants for 2017.

The NEFC has already engaged Morobe through various discussions to make necessary adjustments when framing its 2017 provincial budget. This was vital to ensure that basic service delivery programs remain funded through the internal revenues.

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 and will not meet the 2017 budget timeline.

NEFC CEO- Chairman and Policy Officers taking the opportunity during the Regional workshops to learn about the difficulties and good news stories in service delivery.

Function Grants and other sources of funding used to effectively grow crops

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 LLG level.

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

The Minimium Priority Acitivties 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 priority activities which the NEFC monitors and encourages Provincial Administrations to adequately fund these from their their total function grant allocations..** Function grants can still be used for funding other recurrent goods and services activities within that functional area.

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

*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. In the meantime this should not deter the Province from reallocating the cost previously budgeted for the drug distribution to other areas of priority expenditure.

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:

- which 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 2014, the NEFC undertook two training sessions on the 8^{th}-9^{th} July and 8^{th}-10^{th} August in the following Provinces:

- Madang
- East Sepik
- New Ireland
- Western Highlands
- Morobe
- Manus
- Gulf
- Western

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 change 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. The NEFC also assessed and ranked provincial performances in terms of their budget formulation. The aim of this exercise is to make budgeting concurrent 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 of these reviews is to assess how well Provinces are managing and implementing their budgets. The review is undertaken on a regional basis. Key objectives of the review are to:

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

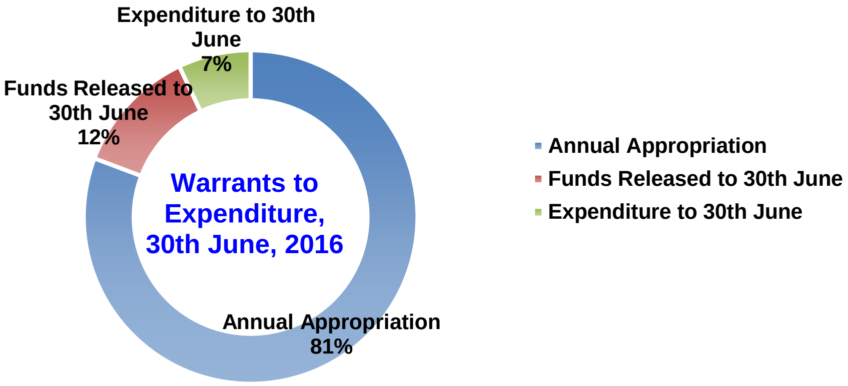
This year, representatives from national agencies, including the Department of Personnel Management, Department of National Planning and Monitoring, Department of Provincial & Local-level Government Affairs and Department of Implementation & Rural Development attended the reviews. Gulf Province did not present in the reviews. Western, Gulf, Central, Milne Bay, Western Highlands, Sandaun and East New Britain Provinces did not report their expenditures as of 30th of June, 2016.

The NEFC compiled all the available data from nineteen (19) provinces except Gulf Province as part of its review. The analysis is conducted on the findings from this year's second quarter performances and as well as a comparative analysis to assess the manner in which national government funding is treated. The findings are detailed below.

Cash flow for service delivery to Provinces remains slow

For the nineteen (19) Provinces analysed, the release of warrants from Treasury remains slow. Provinces reported that only 12% had been released of which 7% was expended by the 30th of June.

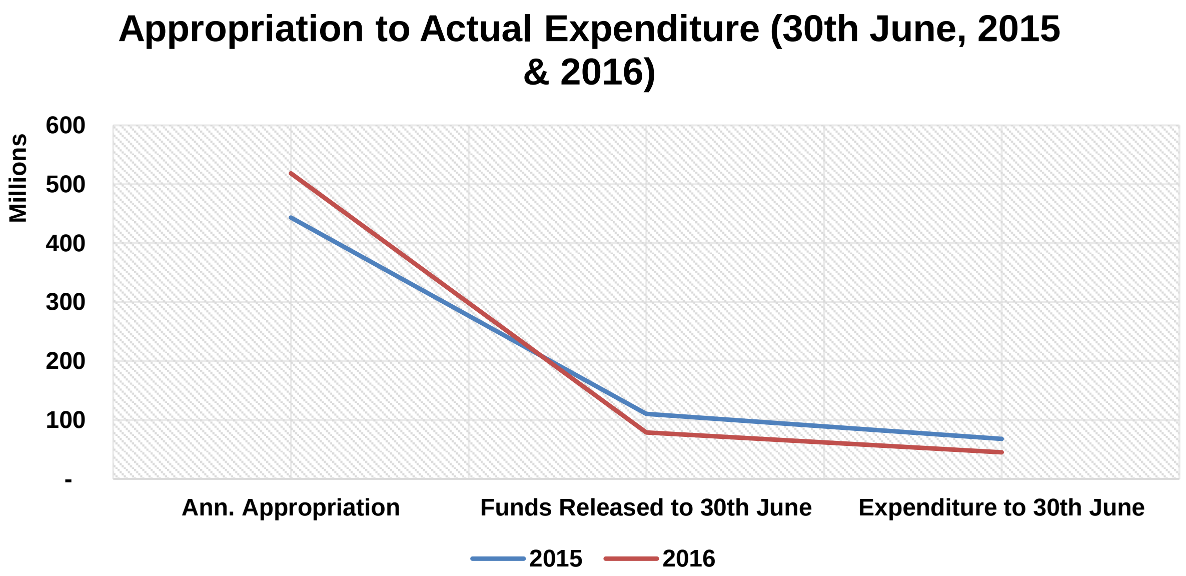
Figure 9: Cash flow to Provinces



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 the amount warranted for release. Provinces reported that a CFC worth K86 million was issued by 30th of June, 2016.

By comparing 2016 to 2015, it seemed interesting to see that the issue of warrants, issue of CFC and actual expenditure was lower than previous years due to unavailability of cash in the national government account. The expenditure trend was less although appropriations have increased significantly in 2016 compared to 2015.

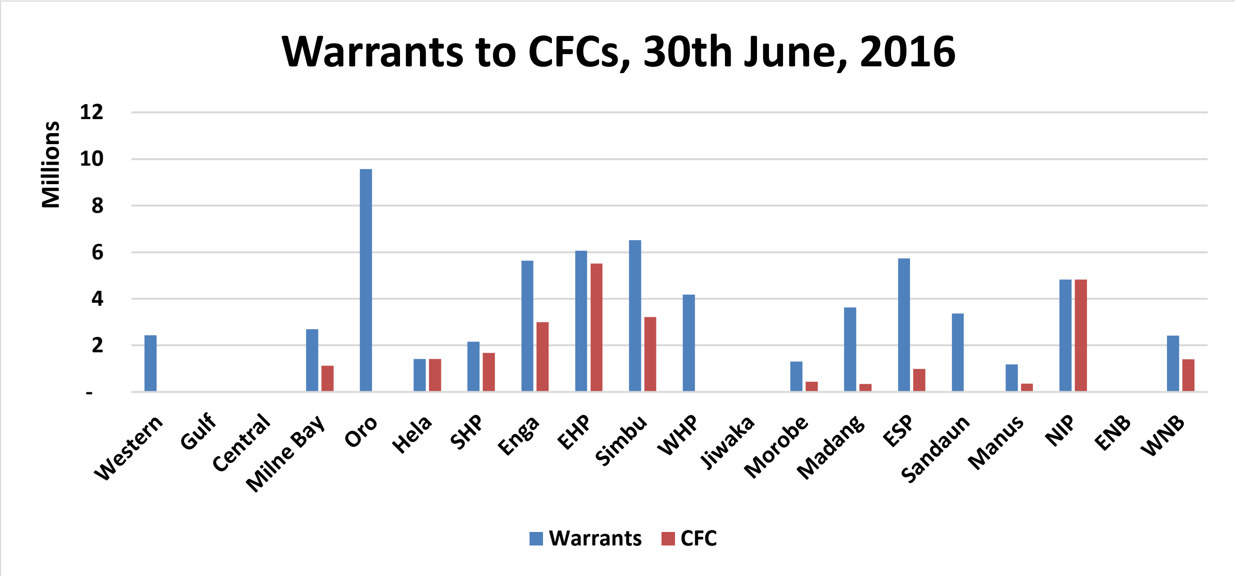
Figure.10. Warrants to Actual Expenditure-2015 to 2016



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.

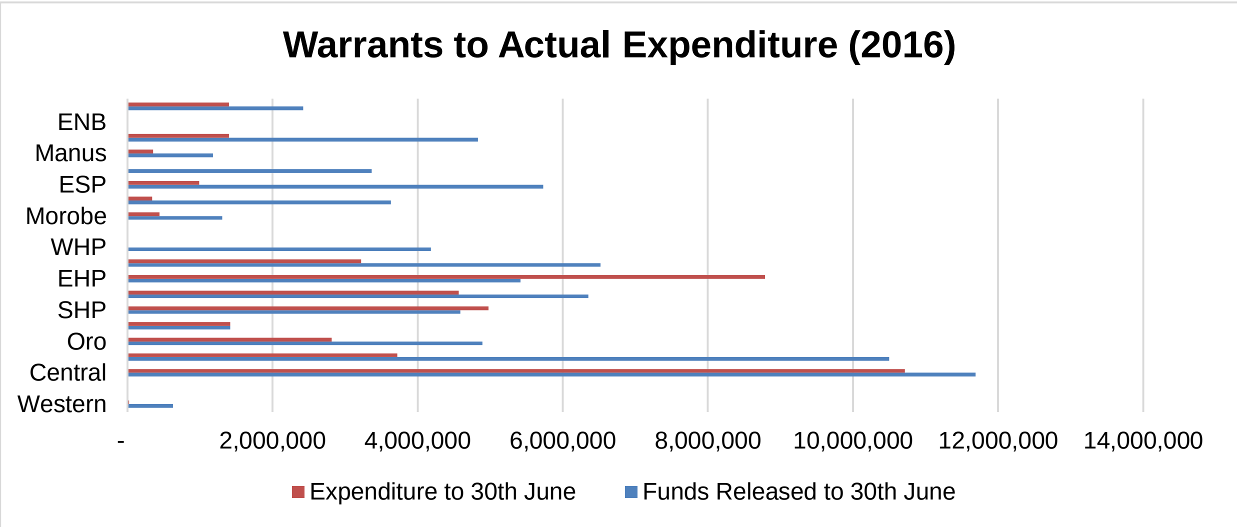
Some Provinces are struggling to implement their budgets

The release of warrants do 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 was asked about whether lack of cash was the main impediment to service delivery.



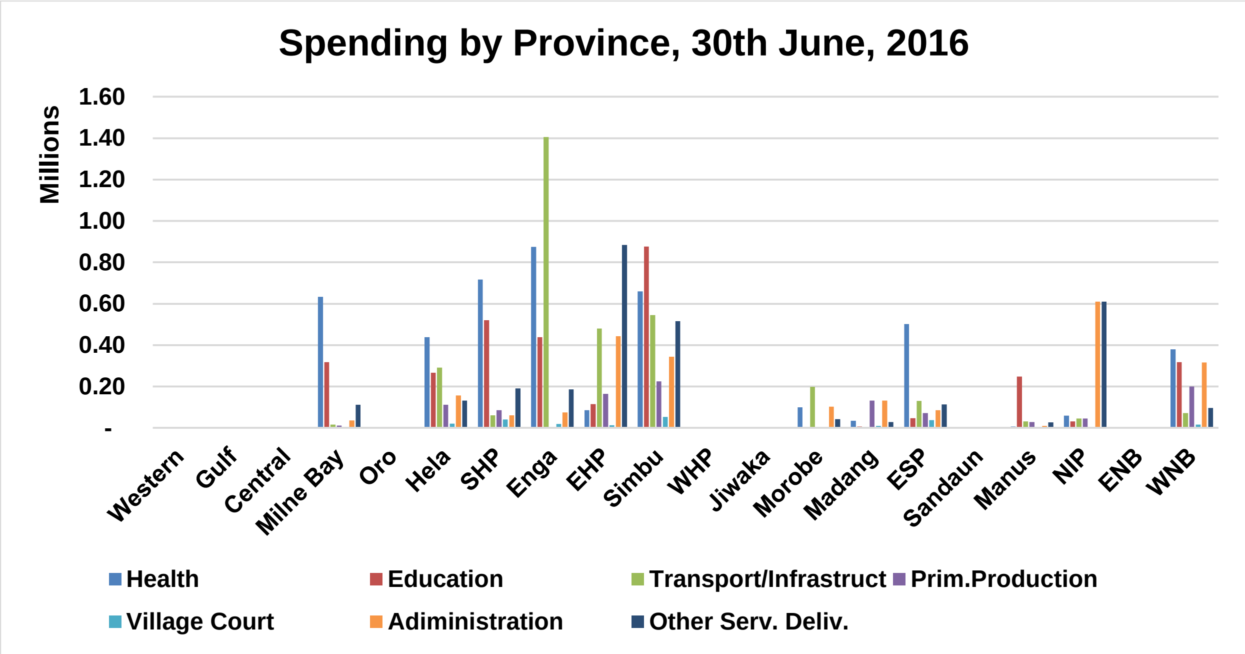
On the basis of the nineteen (19) provinces assessed, only two (Central, and to a lesser extent Southern Highlands) had spent over 80% of the funds they had received. The below graph shows the annual appropriation, the warrants released up to the end of June and the spending to the end of June.

Figure 10: Warrants and Expenditure by provinces



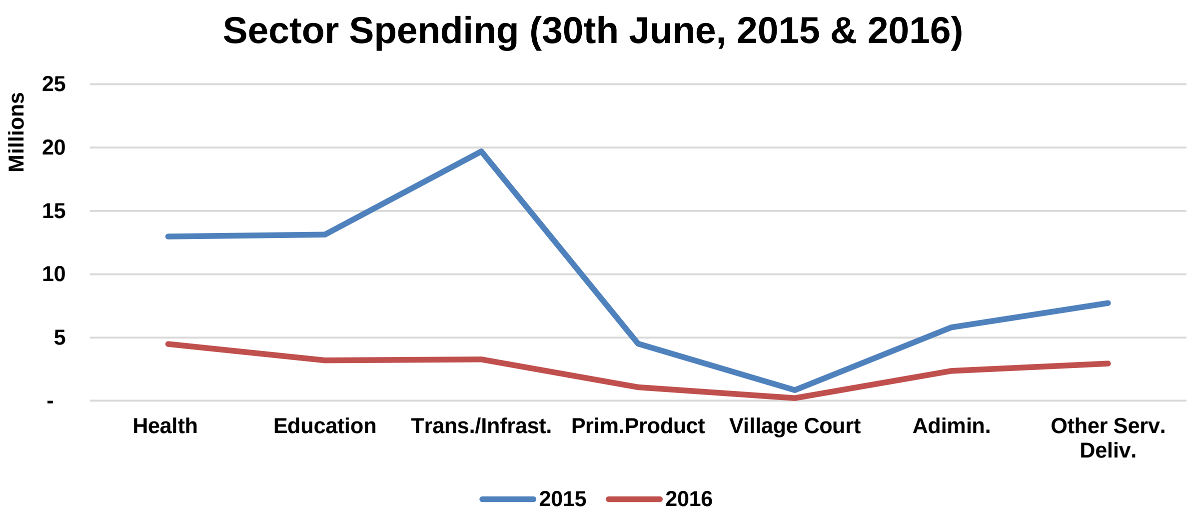
The data was then assessed on a sectoral basis which did not show a strong trend between sectors. Gulf had strong spending in all sectors whereas most other Provinces had a mix.

Figure 11: Sector Spending by Provinces



Spending trend by all sectors showed low spending 2016 compared to 2015 sector spending.

Figure.12. Sector Spending Trend



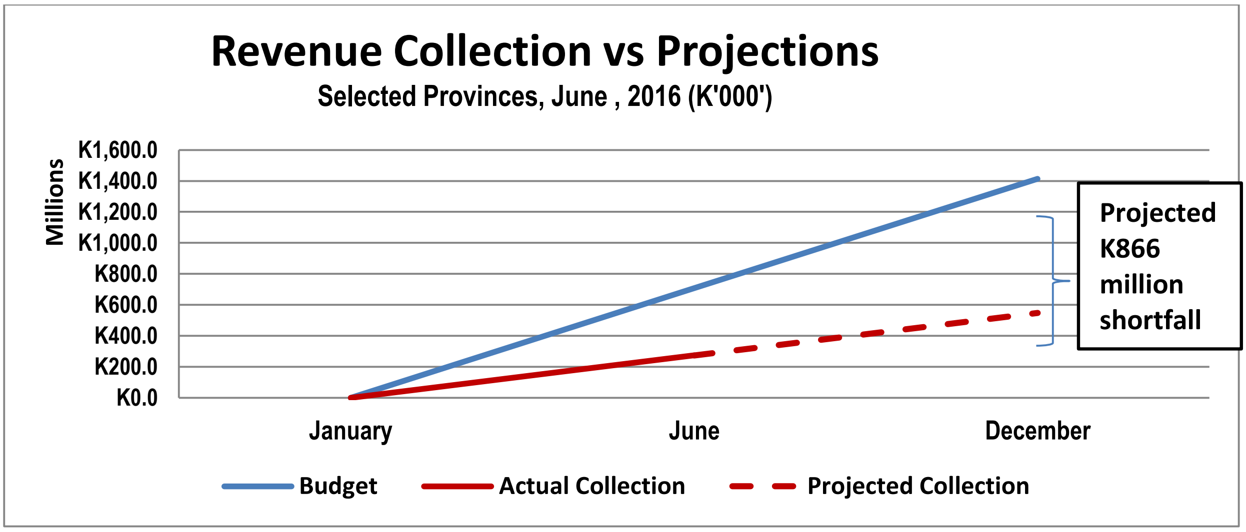
This shows that expenditure in all sectors dropped dramatically in 2016. Provinces such as Western, Gulf, Central, Western Highlands, Jiwaka, Sandaun and East New Britain did not show any spending in all sectors even though warrants had been released.

Revenue collections are lower than budgeted

Provincial revenues were below budget which is expected to result in a shortfall of around K866 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.

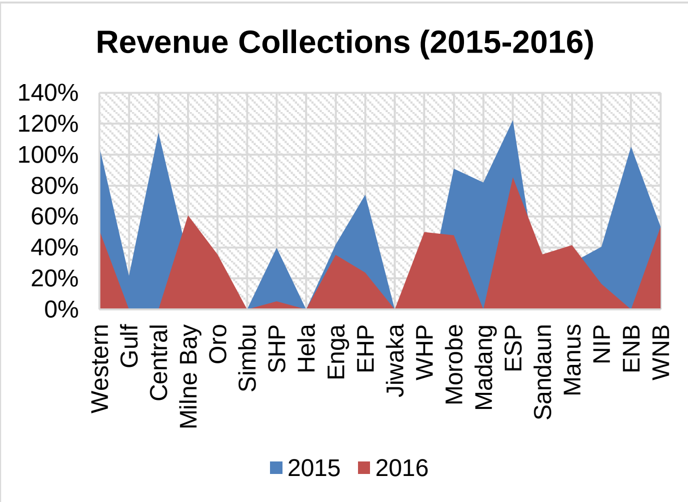
This has a negative impact on service delivery. However, 2016 was a challenge to all provinces. Most of the provinces depended heavily on their own-sourced revenues to implement service delivery.

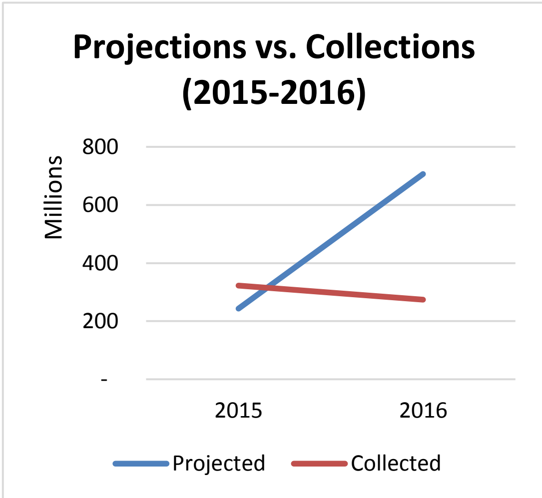
Figure 12: Forecast revenues



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

Figure 13: Revenue Projection Vs Collection by Province





The trend shows that revenue projections for provinces have increased steadily, however, actual collections have dropped dramatically in 2015 and 2016.

6.2 NEFC Regional Workshops

The 2016 NEFC workshops were conducted between May and July 2016. The four workshops were held at the following regional centres: Southern Region: in Port Moresby; Highlands Region in Mt. Hagen; New Guinea Islands in Kokopo; and Momase region in Madang.

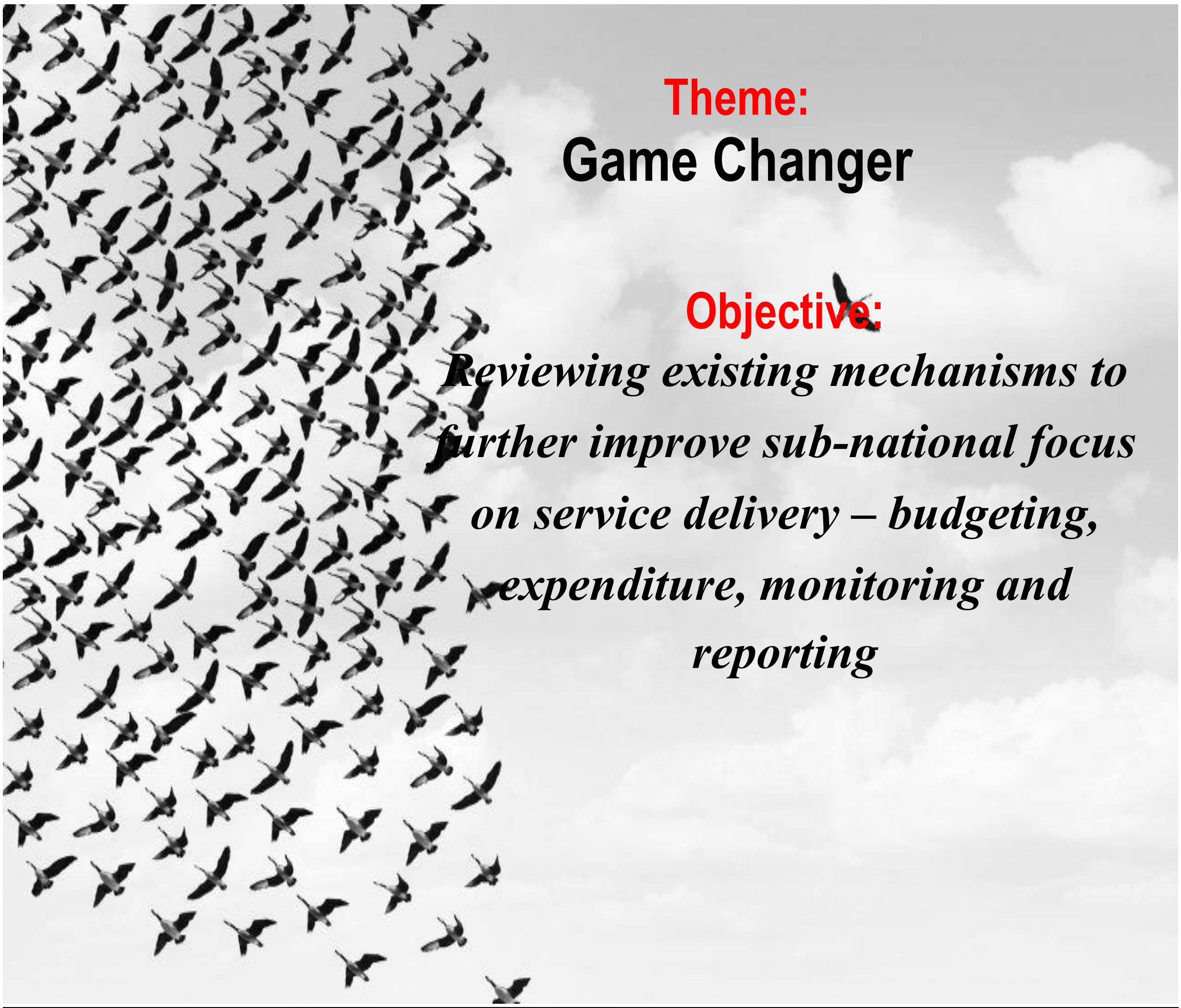
Overall, all workshops were successfully conducted with a total of 287 participants attending the four workshops. The target participants were provincial administration, budgeting staff, sector managers/advisors, and provincial treasury staff. However, most of the provinces have taken the initiative to invite their district and Local-level Government Administration staff to the regional workshops.

The workshop presenters included NEFC's primary stakeholders: Department of Finance, Department of Treasury, DPLGA, Department of Personnel Management, Department of National Planning & Monitoring, Department of Health, Department of Implementation & Rural Development and Law & Justice was also included as part of the regional workshop team. It was evident that stakeholder commitment and participation promoted a more cohesive approach and engaged provinces 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 operational issues.

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 be resolved by provinces and the issues which need to be addressed by the central agencies. *(Regional Workshop Resolutions are shown on the next page.)*

2016 Regional Workshop Resolutions



Year	Res. No.	Resolution	Responsible Agency	What needs to be done	What's the Progress	Action Officer	Remarks
2016	OVERALL RESOLUTIONS		National Economic & Fiscal Commission	• 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	Department of Treasury	• 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.			

2016		**NEFC "YU TOK"**	**All Provincial**	Presentations on performance against Minimum Priority Activity performance.			
2016	**Resolution. No.1**	**PRESENTATION**	**Administrations**	• All provinces must use NEFC's 'Yu Tok' template for their presentations.			
				• Adopt the 'Yu Tok' Panel Critiques to further improve 2016 workshop presentations			

2016	**Resolution. No.2**	**DEPARTMENT OF TREASURY ISSUES-BUDGETING ISSUES**	**All Provincial Administrations**	• 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.			
2016				• 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.			

2016	**Resolution. No.3**	**PAYROLL ADMINISTRATION**	**All Provincial Administrations**	• 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.			
2016	**Resolution.No.4**	**5-year Integrated Development Plan-DNPM**	**All Provincial Administrations**	• 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.			
2016	**Resolution. No.5**	**SERVICES IMPROVEMENT PROGRAM FUNDS & DISTRICT ADMINISTRATIVE STRUCTURES**	**All Provincial Administrations**	• Provinces and Districts in collaborations with relevant National Agencies and Civil Society consider Periodic Monitoring and Evaluation of SIP funds.			
				• Provinces to use most updated Financial Instruction & Administrative Guidelines for SIP funding.			

2016	**Resolution. No.6**	**DISTRICT DEVELOPMENT AUTHORITY**	**All Provincial Administrations**	• All provinces to work closely with DPLGA and other Central Agencies to implement the District Development Authority.			
				• That provinces start budgeting for DDA operations in the 2016 Budget.			
				• That the monitoring and reporting for DDAs will be properly integrated into the current reporting framework with clear indicators.			
				* Provinces consult DPM for engagement of Staff / structure relating to DDA.			
			DPLGA	• DPLGA to confirm final DDA's district determinations with the respective provinces.			

2016	Resolution. No.7	**IMPROVING THE QUALITY OF BUDGETING - ADHERENCE TO BUDGET EXPENDITURE INSTRUCTIONS (BEIs) for 2015**	**All Provincial Administrations**	• 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 consider direct facility funding in their planning and budgeting.			
				• That Provinces provide ***indicative cash flow requirement*** as part of their budget submission to DoT.			

2016		**Resolution Specifically for Central Agencies to Address-Village Court Official Listing & Data Validation**	**Village Court Secretariat**	• Village Court Secretariat to liaise with Provinces providing feedback on village court officials currently listed			
				• 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.			

2016	**Resolution. No.8**	**MISCELLANEOUS ISSUES**	**All Provincial Administrations**	Provinces consider supporting the growth of SMEs as an avenue to encourage revenue generation within the province.			
				• 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.			
			1. 'Whole of Government Approach by DNPM, DIRD, Finance & DPLGA to undertake monitoring on the:				

			Doff	• Check on Chart of Accounts, compliance to Financial Instructions			
			DIRD	• Services Improvement Programs			
			DPLGA	• Performance and Reporting			
			DNPM	• Capital Investment Program • DNPM provide CIP feedback to Provinces on status of CIP submissions			

6.3 Assessing the quality of Provincial Budget Submissions

Province	2013	2014	2015	3 - Year Average	2015 Rank	2016 Ranking
ENB	75	74	64.5	71	1	4
Central	71.5	76	61	70	2	2
EHP	73	67.5	68	70	3	1
Simbu	72	67.5	69	70	4	3
Manus	74.5	69	62	69	5	5
Sandaun	77	58	69	68	6	8
Milne Bay	56.5	80.5	65	67	7	6
Gulf	62	73	65	67	8	9
Western	67	62	60.5	63	9	14
WNB	68	63	58	63	10	7
SHP	68	62	58	63	11	11
NIP	76.5	56.5	47	60	12	15
Madang	67.5	61.5	48	59	13	18
Hela	62	67	45	58	14	16
Enga	60	59	52	57	15	13
Morobe	66	55	50	57	16	17
Oro	60.5	56.5	52	56	17	10
East Sepik	50	63	53	55	18	12
Jiwaka	65	38	55	53	19	20
WHP	43.5	51	50	48	20	19

Figure.9. *Ranking of Provinces' Performances based on a 3-year average.*

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 2016 Quality Budget Assessment was conducted in April 2016 and presented to Provinces during the NEFC Regional workshops held in May and July 2016.

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 the previous year and the year before. 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 fwhere 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, penalties were applied if provincial governments allocated funding for Universities, tertiary scholarships or Provincial Hospitals from national government function grants.

Budget formulation over a 3-year period was measured against a 3-year average and followed by a ranking method to measure the performances by provincial administrations. The 3-year average was introduced last year which showed consistent performances by certain provinces namely, East New Britain, Central, Simbu, Eastern Highlands and Manus which ranked at the top five (5) (Refer to Table above).

Southern Region

Provincial budget quality assessment	Western	Gulf	Central	Milne Bay	Oro
Overall	18	11	19	15	19
National Grant Financed Expenditure Appropriation	5	4	4	4	4
Administration	0	0	1	0	0
Other Services	0	0	1	0	0
Health	1	4	7	2	17
Education	1	5	16	15	6
Transport maintenance	3	8	13	10	11
Primary Production	0	3	1	1	5
Village Courts (Operations)	2	2	2	0	2
Own Source Revenue (700 series) Appropriation	3	4	6	5	3
LLG allowances budgeted from provincial internal revenue appropriation	1	0	1	1	0
Total Provincial Budget Quality Score	**34.0**	**40.5**	**70.5**	**53.0**	**67.0**

- Z

Highlands Region

Provincial budget quality assessment	SHP	Enga	WHP	Simbu	EHP	Hela	Jiwaka
Overall	13	10	14	21	18	12	8
National Grant Financed Expenditure Appropriation	5	5	5	5	4	5	2
Administration	0	1	0	0	0	0	0
Other Services	0	0	0	0	0	0	0
Health	11	11	2	12	17	7	7
Education	11	8	5	10	12	1	11
Transport maintenance	6	2	2	11	12	7	3
Primary Production	1	2	1	1	5	3	0
Village Courts (Operations)	2	2	2	2	2	0	2
Own Source Revenue (700 series) Appropriation	4	6	0	3	4	0	0
LLG allowances budgeted from provincial internal revenue appropriation	0	1	1	0	0	1	0
Total Provincial Budget Quality Score	**53.0**	**47.5**	**32.0**	**65.0**	**74.0**	**35.5**	**33.0**

Momase Region

Provincial budget quality assessment	Morobe	Madang	ESP	Sandaun
Overall	12	12	11	17
National Grant Financed Expenditure Appropriation	5	4	5	5
Administration	0	0	0	0
Other Services	0	0	0	0
Health	7	2	17	2
Education	1	5	6	11
Transport maintenance	4	7	8	10
Primary Production	1	0	1	1
Village Courts (Operations)	2	0	2	3
Own Source Revenue (700 series) Appropriation	6	1	0	3
LLG allowances budgeted from provincial internal revenue appropriation	1	1	1	0
Total Provincial Budget Quality Score	**39.0**	**32.0**	**51.0**	**51.5**

* *The zero scores in the table indicate no expenditure shown against the service delivery category*

6.4 Assisting the Reform Processes

NEFC has been proactively involved in assisting provinces through regional workshops conducted for each region. This year the workshops were held in Kokopo for New Guinea Islands, Port Moresby for the Southern Region, Madang for the Momase Region and Mt. Hagen for the Highlands Region.

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. Some provinces have already commenced using these tools and are increasingly found this to be 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 mainstream 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 reporting on Section 119 Which a type of performance report card for provinces.

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.

Furthermore, the NEFC has gone ahead to strengthen the reforms by looking at other expenditure areas such as Development and Personnel Emoluments.

Personnel Emoluments Costing

Over the last few years, Department of Personnel Management and Department of Treasury have conducted reviews including a payroll validation and cleaning exercise to control the escalating staffing cost blowouts.

In assisting government to control the cost, the NEFC developed a staff establishment costing model called the Provincial Establishment Cost Monitoring (PECM). It was developed in-house by the NEFC and has been rolled out to all the provinces. The PECM calculates the actual cost of the staff establishment and can be used as an evidence-based budget tool to review and investigate payroll variances against actual costs.

The PECM has also since been further updated to include other information including qualitative information such as demographic information.

District Expenditure Review

A collaborative study between the NEFC and DIRD on four pilot districts was completed and launched at PLLSMA in late September 2016. The study was a first of its kind that involved two agencies working together to provide government with an indication of trends in spending at the District level. A number of serious system weaknesses including poor practices were identified in the District Expenditure Review. The pilot study was not an audit but a review of trends in expenditure. The findings will used as a precursor by the NEFC to undertake a more comprehensive review of all districts. One of the major causes for concern was the inconsistency of cash releases that may be contributing to the co-mingling of funds between the recurrent and development budgets.

NEFC considers this a worrying trend that may eventually lead to breakdown in systems notwithstanding the roll-out of new financial management systems. The management of cash flows and consistency of cash releases remains a major obstacle which could also impact future reforms if not addressed urgently.

City Authorities

During 2015 the NEFC was also tasked by Government to undertake a Cost of Service study for the City Authorities of Lae, Mt Hagen and Kokopo. These studies have since been completed and NEFC has established a model to assist with other proposed City Authorities.

The Annual NEFC Regional Workshops were conduct mid-year (2016) at four major regional venues including Mt Hagen, Port Moresby, Madang and Kokopo. All the workshops were particularly well attended and remains one of the few forums for National and sub-national agencies to interact and discuss major issues including helping overcome bottlenecks. The NEFC regional workshops are primarily intended to facilitate the decentralised reforms and policy decimation by the major national agencies which included the Departments' of Finance, Treasury, Planning and Monitoring, Provisional & Local Level Government, Personnel Management, Sector Agencies including the National Department of Health and Village Courts Secretariat.

At the conclusion of the Workshops, joint resolutions were drawn and circulated to Provincial Administrators and Governors to improve the opportunity for addressing the resolutions.

District Development Authorities

The NEFC continues to work closely with DPLGA and PLLSMA to progress the DDA reforms including developing the decentralised policy framework.

The NEFC also contributed to Organic Law Review undertaken by the Constitutional Law Reform Commission. The final report was presented to Parliament in 2015.

6.5 2014 Provincial Expenditure Review "Game Changer"

Based on the principles of affordability and increased accountability, the inter-governmental financing arrangements were introduced in 2009. The fiscal year 2014 was the sixth year of its implementation. The *Game Changer* focused on identifying provinces that have effectively strengthened service delivery by spending according to need, as reflected by provincial priority activities such as the Minimum Priority Activities. As part of reflecting on the realities of financing service delivery, *Game Changer* examines spending from the Development budget, which are pre-approved funds towards specific projects. Due to the late release of function grants in the financial year, provinces are sometimes forced to use pre-approved funding from the development budget to finance service delivery.

When reflecting on trends, in 2005, a number of lower-funded provinces had just over one-fifth (20%) of capacity needed to deliver a set of basic services. In 2014, 13 provinces – including Gulf and Manus – were able to meet their full fiscal need and, in theory, meet service delivery obligations. The Southern Highlands, Morobe and New Ireland provinces' functional grant assignment accounts for less than 50 per cent of their estimated fiscal need while Manus, Sandaun and Simbu provinces have more than 90 per cent of their estimated fiscal need addressed by functional grants from the national government.

Spending from internal revenue increased markedly in 2014 in comparison to 2005, when the first Provincial Expenditure Review was initially carried out. In 2005, spending from internal revenue was K160 million. In 2014, this amount almost tripled to Kina 462.9 million. It should be noted here that although spending from internal revenue increased in nominal terms, spending on MTDS sectors fell in 2014 by 4 per cent from the previous year. While Administration spending decreased by 10 per cent, expenditure rose by 28 per cent for Education as well as for Infrastructure where expenditure increased by 26 per cent. Except for HIV and AIDS and Village Court Allowances, all other sectors saw increased spending. The implementation of RIGFA has made a substantial difference, with additional grant funding flowing towards Health, Education, Agriculture and Infrastructure Maintenance, as also noted in *Raising the Bar*, 2013.

That being the case, it is important to reflect further pre and post RIGFA to identify differences not just in volume but in spending flows to districts and LLGs.

Game Changer increased the focus on spending against Minimum Priority Activities. MPA spending was calculated as an estimate in previous years but has now been updated to include spending amounts (as recognised by PGAS) – what this means is that transfers to districts and LLGs are not recognised as expenditure.

Identifying expenditure on Minimum Priority Activities is difficult on the PGAS, partly due to low compliance of coding against the Chart of Accounts. With this ongoing caveat, road maintenance was identified as the highest supported MPA while extension activities for forestry and fisheries were the least supported by provinces in 2014. A key learning is that provinces need to strengthen their reporting on MPAs by clearly and consistently identifying budget line items on their PGAS records.

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, ***Game Changer,*** is the tenth edition in the series and reviews the situation in 2014. The 2014 fiscal year is the fourth 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,

Overall trends indicate that allocating funds through RIGFA ensure that provinces are being funded and are mostly being held accountable. However, while allocated funding efficiency has improved, the integrity and validity of actual expenditure by provinces including whether expenditure has been used for its intended purposes remains the responsibility of the agencies mandated to conduct actual audits and performance reviews (i.e. Auditor General's Office and PLLSMA).

The full report can be seen at *www.nefc.gov.pg*

APPENDIX A: DETERMINATION APPORTIONING THE EQUALIZATION AMOUNT

DETERMINATION APPORTIONING THE EQUALISATION AMOUNT

Inter-Governmental Relations (Functions & Funding) Act 2009

DETERMINATION APPORTIONING THE EQUALISATION AMOUNT

I, **Hon. Patrick Pruaitch, CMG, MP, Minister for Treasury,** by virtual of powers conferred by Section 17 of the ***Inter-Governmental Relations (Functions & Funding) Act 2009*** and all other powers enabling me, in consultation with the National Economic and Fiscal Commission, hereby make the following determination:-

1. **LOCAL-LEVEL SHARE.**
   For a fiscal year, the local-level share, being the proportion of the equalization amount for that fiscal year available for distribution amongst Local-Level Governments, is an amount equal to 10.05 per cent of that equalization amount.

2. **PROVINCIAL SHARE.**
   For a fiscal year, the provincial share, being the proportion of the equalization amount of that fiscal year available for distribution amongst Provincial Governments, is the amount remaining after deduction from that equalization amount from the total of the amounts calculated under Clauses 1 for that fiscal year.

3. **MEANING OF TERMS**
   In accordance with Section 77 of the *Interpretation Act* 1975, the terms used in the determination have the same meaning as in the *Inter-Governmental Relations (Functions & Funding) Act* 2009.

MADE this 06th day of June, 2016

MINISTER FOR TREASURY

Advice on Province and LLG Share Split

2017 Grant Calculation

Available funding for Provincial Governments from Ministerial Determination		
2017 Equalisation amount	**K565,164,540**	**100%**
(Less) LLG share	56,799,036.3	10.05%
Province Share (funding available to be distributed on basis of fiscal needs)	508,365,503.7	89.95%

*LLG Share is the total amount to be distributed amongst all rural and urban LLGs. The Share is about 10.05% of the Equalization Amount

* The Province Share is the total amount to be distributed amongst all provinces. The share is the amount remaining after deduction from the LLG share on the Equalization Amount.

APPENDIX B: FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

PAPUA NEW GUINEA

Intergovernmental Relations (Functions and Funding) Act 2009

FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

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

3 HEALTH FUNCTION GRANT

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

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

(a) the distribution of medical supplies;
(b) outreach patrols;
(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 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 and maintenance 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 SERVICES DELIVERY FUNCTION GRANTS

Another 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 06th **day of** June **, 2016**

Minister for Treasury

Function Grant Determination 2017

	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
Western	10,732,852	7,889,932	11,352,463	3,224,868	397,390	109,291	1,644,206	384,638	**35,735,641**	721,887	2,974,927	**3,696,814**	**39,432,455**
Gulf	5,297,857	4,027,373	5,783,284	1,916,311	389,759	62,090	1,632,750	1,566,303	**20,675,726**	139,211	2,920,188	**3,059,399**	**23,735,124**
Central	5,952,799	6,168,538	10,575,069	2,031,311	343,771	65,000	2,728,269	1,544,200	**29,408,957**	0	2,032,374	**2,032,374**	**31,441,332**
Milne Bay	7,456,609	7,652,580	7,285,709	2,265,556	379,322	62,064	4,356,648	1,817,469	**31,275,957**	280,480	2,409,909	**2,690,389**	**33,966,346**
Oro	4,524,412	3,954,458	4,064,731	1,987,240	330,589	66,257	1,987,146	1,030,169	**17,945,003**	696,741	1,597,587	**2,294,328**	**20,239,331**
Southern Highlands	4,191,067	4,844,076	4,374,118	1,164,349	419,431	65,000	1,832,247	787,584	**17,677,871**	663,506	2,468,752	**3,132,258**	**20,810,128**
Hela	5,968,483	3,718,660	4,009,816	1,700,331	276,358	86,362	1,633,343	2,090,473	**19,483,825**	929,154	1,343,970	**2,273,124**	**21,756,949**
Enga	4,611,257	4,843,139	10,183,699	800,664	369,907	60,706	2,866,205	1,674,454	**25,410,032**	231,301	2,072,413	**2,303,714**	**27,713,745**
Western Highlands	4,706,296	6,336,728	9,147,597	1,408,535	412,852	79,989	2,030,711	1,064,430	**25,187,138**	776,601	1,387,386	**2,163,988**	**27,351,126**
Jiwaka	4,562,373	5,613,668	9,301,149	1,133,846	343,793	69,171	1,886,993	1,866,390	**24,777,384**	0	871,819	**871,819**	**25,649,202**
Simbu	6,308,891	8,463,267	9,345,961	1,693,342	546,347	56,284	3,104,222	2,280,499	**31,798,814**	367,768	1,335,696	**1,703,464**	**33,502,278**
Eastern Highlands	7,335,983	10,552,516	17,245,079	2,693,139	636,191	66,582	3,624,032	2,933,116	**45,086,638**	722,999	1,975,245	**2,698,243**	**47,784,882**
Morobe	0	0	0	0	0	0	0	0	**0**	2,415,460	4,441,706	**6,857,165**	**6,857,165**
Madang	9,487,339	9,403,919	12,951,234	3,751,499	585,357	66,629	3,722,247	3,566,053	**43,534,278**	850,902	3,542,046	**4,392,948**	**47,927,226**
East Sepik	11,161,471	12,227,521	19,777,819	3,405,092	795,393	54,187	3,094,828	3,268,343	**53,784,655**	636,657	4,073,456	**4,710,113**	**58,494,768**
Sandaun	9,665,360	9,046,307	7,180,009	3,164,169	344,110	57,271	2,005,263	2,961,865	**34,424,354**	477,812	3,861,297	**4,339,109**	**38,763,463**
Manus	1,883,268	1,698,032	2,169,653	602,432	159,797	65,000	535,356	151,909	**7,265,448**	210,106	524,015	**734,121**	**7,999,569**
New Ireland	865,176	721,432	751,714	267,773	45,548	44,861	83,577	75,772	**2,855,853**	395,634	988,792	**1,384,425**	**4,240,279**
East New Britain	5,349,134	7,626,590	8,953,631	3,168,221	306,379	92,448	3,270,518	1,210,024	**29,976,945**	869,330	2,546,368	**3,415,698**	**33,392,643**
West New Britain	3,178,515	4,337,553	2,065,354	1,153,980	183,228	56,673	887,251	198,431	**12,060,985**	542,249	1,503,294	**2,045,543**	**14,106,528**
TOTAL	113,239,143	119,126,290	156,518,090	37,532,658	7,265,521	1,285,865	42,925,814	30,472,124	**508,365,504**	11,927,798	44,871,239	**56,799,036**	**565,164,540**

APPENDIX C: 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 those functions.

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

2 Purpose

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

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

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

3 Legal Framework

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

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

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

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

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

4 Funding for Functions

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

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

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

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

Function Grant Funding only available for the stated purposes

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

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

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

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

Service Delivery Function Grants and Administration Grant

Health Function Grant

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

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

Education Function Grant

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

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

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

Transport Infrastructure Maintenance Function Grant

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

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

Village Court Function Grant

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

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

Primary Production Function Grant

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

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

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

Other Service Delivery Function Grant

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

Administration Grant

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

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

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

Local-level Government Grants

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

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

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

Urban Local-level Government Grant

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

5 Minimum Priority Activities

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

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

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

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

5.5 The minimum priority activities are:

Primary Production
Agriculture Extension
Fisheries Extension
Forestry Extension

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

Health
Rural Health Facilities
Outreach Health Patrols & clinics
Drug distribution

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

Village Courts Operations
Provision of operational materials

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

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

6 Provincial Budgets

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

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

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

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

Revenue - Correct PGAS Grant Codes

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

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

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

Expenditure - Correct PGAS Activity Codes

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

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

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

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

7 Monitoring and Reporting on Performance

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

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

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

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

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

8 Restrictions on Rollovers

General restrictive approach to Function Grants Rollovers

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

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

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

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

- 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

Costing of all Service Delivery Activities

Annual Regional Workshops

The National Economic & Fiscal Commission's Contribution to Service Delivery in Papua New Guinea appears in many ways.

Training Workshops

Project Site Visits