National Economic and Fiscal Commission

2018 Budget Fiscal Report

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Foreword

It is my great pleasure to present the 2018 Budget Fiscal Report. This report will provide a better insight on the overall operations of the National Economic & Fiscal Commission (NEFC), in relation to its mandated roles and responsibilities stipulated under the Organic Law on Provincial & Local-level Governments (OLPLLG) with the purpose of further strengthening the process of undertaking fiscal decentralization in Papua New Guinea.

Pursuant to section (69) of the Intergovernmental Relations *(Functions & Funding)* Act, 2009, the NEFC is required to publish the Annual Budget Fiscal Report to be caused by the Minister – Treasury as part of the annual budget documentation to the National Government.

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

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

Provinces experience differences in the costs of providing the same service in different parts of the country. This is often due to influences outside their control. For example, a province that is linked by a good transport network will most likely have lower costs relative to those provinces that have poor transport networks and infrastructure. In this regard, the cost estimates for delivering basic services in Papua New Guinea has increased from K714 million in 2011 to K968 million in 2015. The cost of basic service delivery sets out the standard/benchmark for all provinces to utilise their full fiscal capacity in order to meet the basic service delivery needs of their people.

The 2014 PER represents the 9th year of implementation of the Reform on Intergovernmental Financing Arrangements (RIGFA). This major reform has increased the ability and the fiscal capacity of all the provinces and local-level government administrations to effectively provide basic services at the frontline of service delivery. The portion of national grants for basic service delivery has increased significantly from K134 million in 2009 to K547.3 million in 2018 and the NEFC anticipates that the level of funding is sufficient to enable provinces to adequately cater for their basic service delivery needs.

Since 2009, all provinces have benefited significantly from this system of recurrent funding to the sub-national levels government. There is evidence to show that the less resourced-rich provinces such as Simbu, Sandaun, East Sepik Provinces, etc. have demonstrated a strong support system from the recurrent funding since the inception of RIGFA in 2009. The NEFC continues to search for innovative ways to further engage resource – rich provinces to maintain the same level of consistency in providing support to service delivery. This includes modelling and forescasting exercise to ensure that the government continues to engage resource – rich provinces.

The NEFC has recently conducted a review of RIGFA and identified a number of issues, which the NEFC is currently addressing. 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 implementation once the amended Organic Law legislation is passed.

The NEFC is currently undertaking proactive initiatives to better strengthen the reforms by collaborating with the central and sector agencies to address issues affecting the delivery of basic services in the provinces and districts.

Some of the initiatives were progressed during the annual regional workshops; and adopting a Facility Based Budgeting/Funding approach to further strengthen the administrative systems, processes and procedures.

Monitoring of service delivery continues to be poor due to inadequate funding. In addition, lack of capacity together with the inconsistency of cash releases continues to hamper the provision and regularity of service delivery.

Overall, it is NEFC's intention that the various publications that NEFC produces will periodically enable the villagers and the community at large to become informed recipients 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 ring fence the cash release regime which ensures that the 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 MTDP 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 partner, the Australian Government for providing the necessary technical assistance to carry out our development work.

HOHORA SUVE
Chairman & Chief Executive Officer

Executive Summary

The National Economic & Fiscal Commission has been implementing the Reforms on Intergovernmental Financing Arrangements (RIFGA) since 2009. These reforms followed a passage of amendments to the Organic Law on Provincial & Local-level Governments to apply a more robust Intergovernmental Financing system in order to share a portion of the Net National Revenue to provinces and to local-level governments.

The NEFC mandated functions are detailed under Section 117 of the OLPLLGs and also specified in the Intergovernmental Relations *(Functions & Funding)* Act, 2009 . Essentially, the NEFC is required to provide advice to the government on how much funding for recurrent non-salary grants is to be apportioned to the provinces and local-level governments.

Since 2009, the amount of funding for provinces and local-level government has increased significantly from K134 million to K547.3 million in 2018. This amount of funding was determined on a ***"needs based"*** system. In principal, the NEFC does not only take into consideration the cost of providing services, but also takes into account the internal provincial revenues. The amount of revenue that a province is able to generate has an impact on their ability to deliver basic services *(the method in which the recurrent funding is calculated is explained in the body of this report)*.

Provinces experience cost differentials in providing the same basic services in different parts of the country. This is often due to influences outside their control. For example, a province that is linked by a good transport network is more likely have lower costs relative to those provinces that have poor transport networks and infrastructure. The cost of delivering basic services in Papua New Guinea has increased from K714 million in 2011 to K968 million in 2015. The NEFC Cost of Services Study shows that the cost of delivering basic services is high, therefore, provinces must use a part of their internal revenue *(Own-Sourced)* to meet the cost of delivering basic services to rural areas.

As required under section (69), sub-section (1) of the Intergovernmental Relations *(Functions & Funding)* Act, 2009, the NEFC is required to produce an Annual Budget Fiscal Report and under sub-section (3) required by the Minister for Treasury to table the report as part of the annual budget documentation to the National Government. The following are some of the major activities undertaken by the NEFC in 2017.

2018 Grant Calculation

The function grants have reduced by 2% between 2017 and 2018 – a decrease of K18 million (from K565 million in 2017 to K547.3 million in 2018). The RIGFA methodology provides for an inbuilt stability in the system by providing provinces and local-level governments with the ability to effectively plan for service delivery. The current declining economic activity, including GST is likely to see a fall in function grants. The NEFC is currently undertaking a modelling exercise to determine the overall impact of declining revenue on grant allocations in the near future.

From 2017 and onwards, the Morobe Provincial Government will not be eligible to function grants because it does not have any fiscal need. In other words. Morobe, according to NEFC's equalization formula, has adequate own – sourced internal revenue to fund its service delivery obligations. New Ireland Provincial Government will follow suit in 2018.

The NEFC is currently reviewing its systems so that the resource rich provinces will continue to at least receive some form of function grants in order for the provinces to continue to maintain dialogue with the national government.

While RIGFA has focused on fiscal capacity, NEFC has reservations that resource – rich provinces, based on past trends will not sufficiently prioritise spending on basic service delivery. 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).

Highlights of the 2017 Budget Implementation

Various issues surrounding the implementation and monitoring of the internal processes hampered effective and efficient delivery of basic services such as health including conducting health patrols, undertaking immunization, etc. in the health sector. Other issues also include education, such as delivery of school materials to schools, supervision and inspections, etc. which not conducted in time; infrastructure, especially, in regards to roads, jetties, and wharf maintenance, etc. are not conducted in time; and there is limited agriculture extension services undertaken.

The NEFC conducted a detailed half year review of the 2017 Budget Implementation by provinces and identified that slow release of warrants and cash has continued to hamper implementation of sectoral programs by provinces. Some provinces experience late cash releases by June or July of 2017. It was noticed that 22% of the annual appropriation was released as of June which is below 50% of the overall 2017 provincial budget appropriation. Provinces are expected to use their rollover of funds and it has become apparent that rollover funds are also released late.

From the previous year, provinces continue to rely heavily on their internal revenue to sustain their operations. However, it was also observed that the collection of the internal revenue was slow and this eventually affected provinces that have lesser internal revenue to support service delivery. The collection of internal revenues by provinces fell below 50% of the annual estimates. Provinces succeeded in collecting only 35% of their internal revenue compared to their estimates. Therefore, the NEFC suggested that there should be more emphasis placed on building the capacity of the provinces to improve revenue collection.

Progressing the Reforms of Intergovernmental Financing Arrangements (RIGFA)

The NEFC is adopting proactive approaches to further strengthen Fiscal Decentralization under RIGFA by undertaking various initiatives. Such initiatives include; Annual Regional Workshops; Provincial Budget Sessions; Provincial Expenditure Reviews; Unspent Monies/Rollover Studies; Facility Based Funding Diagnostic Expenditure Review; Personnel Emoluments Costs; Public Expenditure & Financial Accountability (PEFA); Municipal Cost Services for the City Authorities; District Development Authorities; and the 2015 Provincial Health Assessment which is an attempt to assess on how well provinces use the health function grant using the correct chart of accounts.

Regional Workshops

The NEFC Annual Regional Workshops conducted each year are an avenue which has been used since 2009 to engage with the key central agencies and the provincial administrations to discuss underlying issues affecting the delivery of basic services in the provinces and districts. In these workshops, provinces are given the opportunity to demonstrate their experiences in implementing the reforms at the provincial and district level.

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, the Game Changer attempted to examine the manner in which service delivery provision is approached currently, and to explore innovative ways to make it work better for the people of Papua New Guinea.

2017 Provincial Budget Sessions

NEFC initiated a workshop with the focus on assisting non performing provinces using the results derived from the 2017 Quality Budget Assessment. The main purpose was to assist provinces to improve their budget formulation and submissions.

The aim of this workshop was to have a one on one consultation with each province to assess how they can improve the quality of their budgets leading up to following years Budget Submission. The first Training workshop was conducted in Madang on the 24th of August, 2017 in which Madang, East Sepik, Sandaun and Western Highlands participated.

Furthermore, as part of the move towards improving the quality of provincial budgets, the NEFC conducted budget sessions on the 3rd day of its Regional Workshops. The workshop comprised of both NEFC and Department of Treasury representatives. The main purpose of the budget sessions was to ensure that the provinces used the standard Chart of Accounts as part of their Budget formulation process. The session was also used as an avenue to conduct awareness about the Budget Expenditure Instruction which was issued by DoT and for provinces to contribute ideas towards improving Provincial Budgeting.

Rollover Study

The Rollover of Grants study was an important study undertaken by NEFC in 2017 to further assess the increasing amount of rollover funding accumulated over the years. The study concluded that rollovers occurred when funding is released late or funding is not released as per the appropriation. Furthermore, when rollovers accumulate, provinces tend to use the funds for capital expenses rather than using it for operational activities as per the Budget Expenditure Instructions issued by Department of Treasury.

Personnel Emoluments Cost

Over the last few years, Department of Personnel Management and Department of Treasury have conducted reviews including a payroll validation and data cleansing 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 staff establishment which can be used as an evidence-based budget tool to review and investigate payroll variances against actual costs. The main intention behind this exercise is to assess and compare ever increasing salary cost to the total amount of goods and services funding to provinces and LLGs

Facility Based Funding Diagnostic Expenditure Review

The Facility Based Funding- Diagnosis Expenditure Review is a new initiative. It is an in-depth study undertaken to further improve the impact of Intergovernmental Financing at the sub-national levels of government. Since the implementation of RIGFA in 2009, funding to the sub-national governments has increased significantly. Therefore, it is assumed that this increased level of funding is reaching the facilities to ensure planned programs and activities are undertaken effectively and efficiently . The facilities are the fundamental points designated to ensure basic services are received by the rural population.

The study will provide an insight into how well facilities are undertaking their day to day operations and how well funding is allocated and flowing down to the facilities; how well facilities plan; how they formulate their budget; how well they execute their budgets; and finally, the study will determine on how well provinces monitor and report their annual performances.

Municipal Cost of City Authorities

During 2015 the NEFC was also tasked by Government to undertake a costing study for the City Authorities of Lae, Mt Hagen and Kokopo. These studies have since been completed with a model established to assist other City Authorities. In 2017, The NEFC also reviewed the costing and proposed improvements to further establish reasonable costing for the three (3) City Authorities.

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

Public Expenditure & Financial Accountability (PEFA)

The commission has been tasked by the Department of Finance (DoF) to be the lead agency for the development of an Evaluation Design to conduct a review to determine the allocation of staff positions in the education and health sectors for which salary support provided is based on service delivery needs. The study will assess whether performance audits or evaluations are carried out. It will also assesses the extent to which information received by service delivery units are collected and recorded.

The main dimensions of the programs include; (i) Programs or services provided either to the general public or specifically targeted groups of citizens, either fully or partially using government resources; (ii) it includes services such as education and training, health care, social & community support, policing and road construction, maintenance, agriculture support, water and sanitation and other services; but it excludes commercial services and regulatory services, policing and administration services, defence and national security undertaken by the government; a "Service Delivery Unit" Performance Information refers to outputs and outcome indicators, planned or achieved results against those indicators, Output indicators measure the quantity of output produced or services delivered or planned; (iii) Outcome indicators measure the outcome effectiveness of the service delivered or their outputs.

Health Budget Assessment

The NEFC has continued to find innovative ways to analyse provincial public expenditure. In 2016, the NEFC conducted a review on the provincial health budgets and compared it to NEFC Cost of Services budget estimates for twenty (20) provinces. It used the provincial budget submissions presented to the Department of Treasury and compared them to the 2015 Cost of Services Study and adjusted with the CPI and population growth rates.

The analysis covered three (3) main areas: ***Budget Coding Consistency with Chart of Accounts/Budget Structure; Budget Quality; Facility Based Budgeting:***

The analysis showed that 47% of the provincial health budgets were inconsistent with Chart of Accounts, 11% as consistent and 52% were partly consistent. The second finding was 11% of the health budgets were of very good quality whereas 89% are of low and very low quality. Finally, 63% of the health budgets made reference to Health Centres, of which 37% have never made any reference to HCs. Two of the provincial health budgets have made reference to HCs by LLGs.

Low performing or ranked provinces should now consider the learning from the high ranked provinces such as Milne Bay to improve the quality of their health budgets.

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 sustained by sub national agencies.

In conclusion, the NEFC will continue to work hard to ensure that all Papua New Guineans, regardless of where they reside, receive improved access to basic service delivery as originally intended and would also assist the government achieve the objectives of the MTDP.3, Vision 2050, DSP and the Constitution.

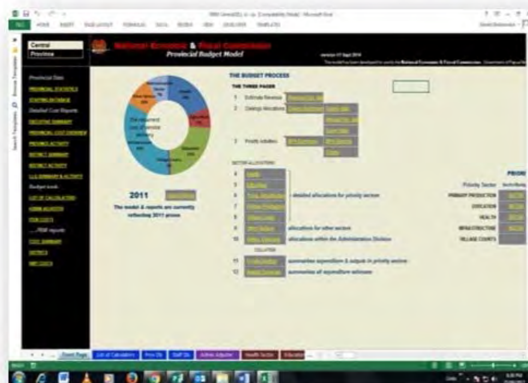
Some of NEFC's Publications & Work Initiatives

PNG Accessibility & Remoteness Index

District Expenditure Review

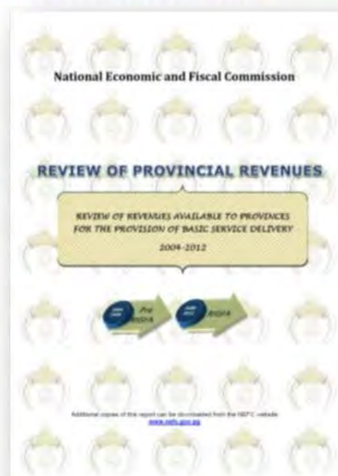
Provincial Expenditure Review "Game Changer"

NEFC Annual Report



Provincial Budget Model (PBM)

Provincial Establishment Cost Model (PECM)



Provincial Revenue Report

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CHAPTER ONE: FINANCING SERVICE DELIVERY IN PNG

All countries make decisions regarding how to structure their budget, expenditure and revenue systems to effectively deliver services to their residents. It was noted that no one government system is workable, but 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 of government 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 on 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. They are limited to the extent which certain revenue sources are being prohibited for provinces to collect revenue from. The main reason behind this ceased is to avoid duplication of revenue collection, specifically for beer and cigarette taxes as it was already been part of the Goods & Services Tax impose by the IRC.

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

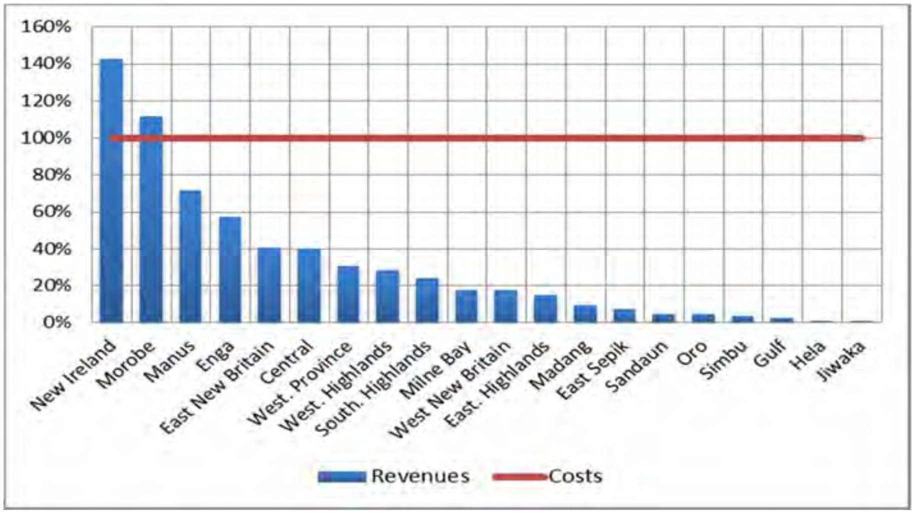
The National Government has given the Provinces and LLGs responsibility to provide a number of government services to their communities. Sustaining the operations of schools and ensuring health centres remain operational are among five of the critical activities undertaken by Provinces. The NEFC undertakes 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 such as geography, economic base, etc. 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 graph shown on next page 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 graph on the next page.

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 on the next page shows the fiscal gap for 2017.

West New Britain *is a resource – rich province, however, its ability to deliver basic services may be compromised by the high cost delivering these services to all parts of the province.*

Figure 1: 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. The previous fiscal arrangement which was based on the "Kina per Head" system has few flaws in funding distributions among National, Provincial and Local level Governments.

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 2017, 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. The management of the staffing grant is highly centralised and is managed by the DPM and DoT.

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 2017, the National Government provided billions in development 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 2018.

1.4 Role of the NEFC

The NEFC is an adviser to Government on intergovernmental financing matters in Papua New Guinea. 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 *(The process of how NEFC allocates the Function Grants is on Chapter (4)* :

- *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.*

CHAPTER TWO: 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 and Administration 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 equalization amount for the coming fiscal year and provide an estimate to the Treasury Departmental Head on or before 31 March. This estimate of the equalization amount is a minimum amount only and can be increased by the Treasury Departmental Head while notifying the higher estimate to NEFC on or before the 30th April of the same year.

The equalization amount is set as a percentage of the NNR amount, as specified above. Hence, the NNR is calculated using the actual data from the most recent and complete fiscal year (i.e. the second preceding fiscal year) as required by *Intergovernmental Relations (Functions and Funding) Act 2009*.The NNR data is calculated using the data published by the Treasury Department in the Final Budget Outcome on or before the 31st March as specified in the *Fiscal Responsibility Act*.

Consistent with Section 19 of The Act, the NNR amount for 2018 was calculated using tax revenue data from 2016 (the second preceding fiscal year) in accordance with the following formula.

General tax revenue for 2016	**-**	**Mining and petroleum tax revenue for 2016**	**=**	**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 2018 Final Budget Outcome published by the Department of Treasury in March 2017.

It was noted that the Mining and Petroleum Tax Revenue should be excluded to maintain stability in the provinces pool of funding and also stabilizes the amount of funding to provinces and local-level governments.

The following table shows how the NNR amount for 2018 is calculated

Act Definition	Final Budget Outcome equivalents	2015	2016	Difference
General tax revenue	Tax revenue	8,797.6 million	8,421.6 million	*-376.0 million*
MINUS (-)				
Mining and petroleum tax revenue	Mining and petroleum taxes	195.4 million	92 million	-103.4 million
EQUALS (=)				
		2017 Budget	2018 Budget	
Net National Revenue Amount		8,602 million	8,329.6 million	-272.4 million
Multiplied by (*) 6.57%				
Equalization Amount		**565.2 million**	**547.3 million**	**-17.9 million**

For 2018 Budget, the minimum funding level for the equalization amount is calculated according to the following formula in Kina million:

Net national revenue for 2018	X	6.57%	=	NEFC estimate of 2018 equalisation amount
K 8,329,600,000	x	6.57%	=	**K547, 254,720**

As depicted on the table above, the 2018 Equalization Amount has reduced by K17.9 million from K565 million in 2017 to K547million for 2018. The reduction is primarily due to lower total tax revenue collections in 2016 compared to 2015.

In accordance with the Act, the NEFC provided a written estimate of the equalisation amount to the Secretary for Treasury on 31 March 2017.

2.2. Apportioning Equalization Amount between Provincial & Local-level Governments

Equalization Amount

The Ministerial Determination that was issued by the Treasurer splits the equalization amount of K547.3 **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 10.5% of the 2018 Equalization Amount.

Overall, for the 2018 Budget, LLGs will receive a funding of K54.9 million.

Provincial Share

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

Available funding for Provincial Governments from Ministerial Determination		
2018 Equalization Amount	**K547.3 million**	**100.00%**
(Less) LLG Share	*K54.9 million*	*10.05%*
Provincial Share	*K492.3 million*	*89.95%*

As shown in the table above, for 2018 Budget, provinces will receive a total funding of K492.3 million. The two components are funded from the equalization amount (EA) and distributed on the basis of need.

CHAPTER THREE: 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 2018 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 2018.

Figure 2: 2018 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	Land Mediation Function Grant	Other Service Delivery Function Grant	Administration Grant	Total Provincial Government Grants
Western	10,456.7	7,689.3	11,080.9	3,142.9	387.1	106.3	1,604.0	384.6	34,851.7
Gulf	5,750.9	4,522.5	6,459.3	2,202.3	451.4	62.1	1,758.5	1,982.5	23,189.4
Central	5,407.3	5,716.5	9,524.0	1,867.9	330.8	50.6	2,347.8	1,544.2	26,789.1
Milne Bay	6,319.0	6,666.6	6,374.3	2,236.1	352.7	51.6	3,287.3	1,817.5	27,105.2
Oro	4,591.0	4,042.8	4,124.8	2,032.9	334.8	66.3	1,996.1	1,105.6	18,294.3
Southern Highlands	5,154.6	7,672.2	6,060.0	1,446.7	511.7	65.0	2,115.5	1,525.8	24,551.4
Hela	7,193.9	5,308.7	5,305.4	2,086.9	534.2	86.4	2,012.5	2,777.6	25,305.4
Enga	3,146.7	4,073.2	6,997.7	800.7	326.6	35.2	1,741.7	1,239.8	18,361.5
Western Highlands	3,047.9	2,489.3	3,509.1	977.4	346.5	46.8	704.0	799.1	11,920.0
Jiwaka	5,218.1	7,310.1	11,293.3	1,266.0	388.1	69.2	2,145.7	2,185.8	29,876.1
Simbu	6,463.4	9,607.3	10,397.7	1,720.3	647.9	71.6	3,104.2	3,394.3	35,406.6
Eastern Highlands	7,448.3	11,451.2	18,143.7	2,760.5	681.1	89.0	3,669.0	3,090.4	47,333.2
Morobe	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Madang	9,493.8	9,422.4	12,968.4	3,755.3	585.6	66.6	3,722.5	3,570.5	43,585.2
East Sepik	11,161.5	12,278.5	19,868.7	3,422.2	796.3	54.8	3,104.0	3,294.7	53,980.7
Sandaun	9,665.4	9,251.8	8,643.3	3,732.5	519.6	74.6	2,414.1	3,868.5	38,169.8
Manus	974.9	999.6	982.2	314.3	116.1	56.3	230.1	99.5	3,773.0
New Ireland	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
East New Britain	3,111.2	3,066.4	3,211.1	2,154.8	221.9	50.2	737.1	534.4	13,087.2
West New Britain	3,916.9	4,983.6	3,265.2	1,846.2	275.5	102.8	1,302.6	983.0	16,675.8
TOTAL	**108,522**	**116,552**	**148,209**	**37,766**	**7,808**	**1,205**	**37,997**	**34,198**	**492,256**

3.2. LLG Distribution

The table below shows the final amounts (in K'000) for the LLG grants by Province for 2018. The Urban and Rural LLGs are shown separately.

Figure 3: Local-level Government share by Province for 2018 (K'000)

Province	Urban LLG Grants	Rural LLG Grants	Total LLG Grants
Western	699.0	2,629	3,328
Gulf	134.8	2,512	2,647
Central	0.0	1,809	1,809
Milne Bay	271.6	2,161	2,433
Oro	674.7	1,537	2,211
Southern Highlands	642.5	2,211	2,854
Hela	899.7	1,347	2,246
Enga	224.0	2,336	2,560
Western Highlands	752.0	1,679	2,431
Jiwaka	0.0	1,141	1,141
Simbu	356.1	1,316	1,673
Eastern Highlands	700.1	2,427	3,127
Morobe	2,338.9	4,319	6,658
Madang	823.9	3,435	4,259
East Sepik	616.5	3,838	4,454
Sandaun	462.7	3,481	3,944
Manus	203.4	451	655
New Ireland	383.1	969	1,352
East New Britain	841.8	2,369	3,211
West New Britain	525.1	1,480	2,005
TOTAL	**11,549.8**	**43,449**	**54,999**

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.

CHAPTER FOUR: 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 fulfil service delivery functions without additional revenue from the national government.

The amount that a province and LLG needs is called the fiscal needs amount. This amount is calculated on the basis of the recurrent cost of providing the assigned service delivery functions and responsibilities, as well as the revenue already available to the province and LLGs to pay for these services.

Fiscal Needs Amounts for Provincial governments

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

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

-where

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

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

Fiscal Needs Amounts for Local-Level Governments

The fiscal needs amount of each LLG for each fiscal year is calculated using the formula –

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

Where:

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

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

4.3. Estimating the cost of service delivery

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

Roles and responsibilities - the Function Assignment

The reforms to the intergovernmental financial arrangements 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.

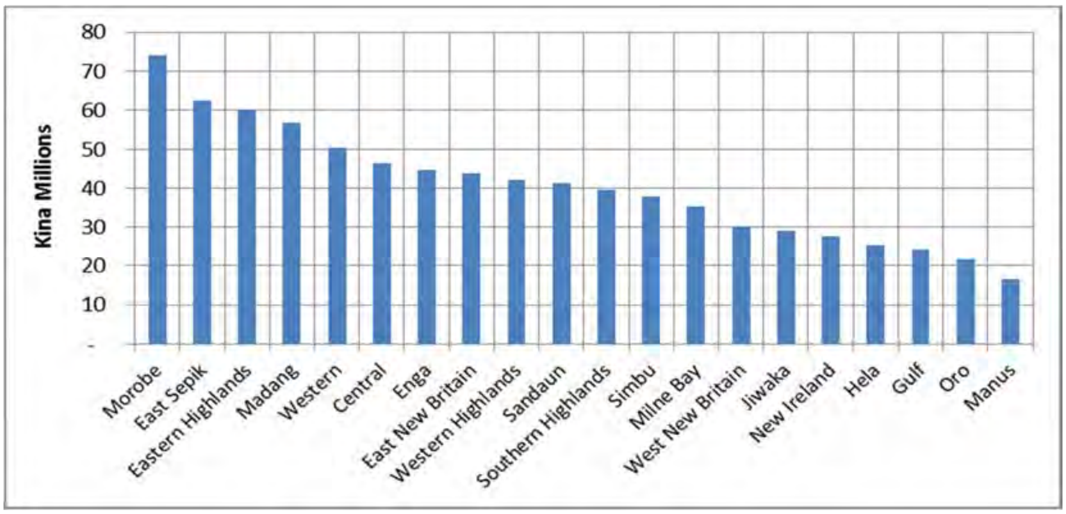
Cost of Service Estimate

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 2015, 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 2018 determination, the 2016 cost estimate is used. This maintains consistency between revenues and costs.

The graph below outlines the estimated costs for each Province in 2016.

Figure 4: 2016 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 2018 distribution year 2016 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).

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. 2016).

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 bookmaker's 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 2016 (the second preceding year), Provinces raised K 57.4 million[1] 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.

[1] 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 K 96.7 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 5: Actual revenues collected by Province in 2016

Province	GST Distributions	Bookmakers Tax	Own Source Revenues & Others	Royalties	Dividends
Western	3,777,660	0	982,589	15,800,000	0
Gulf	1,651,610	0	785,242	0	0
Central	2,148,420	0	12,521,348	0	0
Milne Bay	6,672,730	0	5,172,674	0	0
Oro	3,660,700	0	780,936	0	0
Southern Highlands	6,886,220	0	1,015,261	10,599,134	0
Hela	876,150	0	0	0	0
Enga	2,125,670	0	18,715,447	19,585,752	0
Western Highlands	28,536,510	391,735	3,671,852	0	0
Jiwaka	285,620	0	0	0	0
Simbu	3,116,650	0	1,531,782	0	0
Eastern Highlands	12,501,970	440,529	3,247,325	0	0
Morobe	95,318,850	1,130,654	15,428,853	2,621,178	0
Madang	12,635,150	825,129	2,245,228	0	0
East Sepik	8,896,540	0	2,931,627	0	0
Sandaun	3,314,190	0	2,555,396	0	0
Manus	19,236,890	0	743,544	0	0
New Ireland	6,420,760	0	1,582,788	34,938,912	18,000,000
East New Britain	23,906,980	341,283	14,244,653	0	0
West New Britain	11,420,280	0	5,283,511	0	0
TOTAL	**253,389,550**	**3,129,329**	**93,440,053**	**83,544,976**	**18,000,000**

Assessing revenues

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

i) Royalties and Dividends from Mining and Petroleum Project

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

ii) Own-source Revenues

- NEFC takes into account only 50% of *own source revenues* collected in order to encourage Provinces to continue to collect and enhance their own revenue base[2].

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 2018 is outlined in the below table.

Figure 6: Fiscal Needs of Provinces for 2018 (Kina '000)

Provinces	Estimated costs	Assessed revenues	Fiscal needs	% of total fiscal needs
Western	50,511.8	16,909.0	33,602.9	7.1%
Gulf	24,402.7	2,044.2	22,358.4	4.7%
Central	46,374.9	20,545.8	25,829.1	5.4%
Milne Bay	35,393.0	9,259.1	26,133.9	5.5%
Oro	21,690.0	4,051.2	17,638.8	3.7%
Southern Highlands	39,544.8	15,873.2	23,671.6	5.0%
Hela	25,274.8	876.2	24,398.6	5.1%
Enga	44,855.6	27,152.0	17,703.6	3.7%
Western Highlands	42,257.1	30,764.2	11,492.9	2.4%
Jiwaka	29,091.2	285.6	28,805.5	6.1%
Simbu	38,020.4	3,882.5	34,137.8	7.2%
Eastern Highlands	60,203.3	14,566.2	45,637.1	9.6%
Morobe	73,958.7	106,260.9	0.0	0.0%
Madang	56,606.3	14,582.9	42,023.4	8.9%
East Sepik	62,408.7	10,362.4	52,046.4	11.0%
Sandaun	41,393.9	4,591.9	36,802.0	7.8%
Manus	18,437.3	14,799.4	3,637.8	0.8%
New Ireland	27,702.9	44,163.3	0.0	0.0%
East New Britain	43,988.8	31,370.6	12,618.2	2.7%
West New Britain	30,140.3	14,062.0	16,078.3	3.4%
TOTAL	**812,256.2**	**386,402.3**	**474,616.4**	**100.0%**

[2] 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.

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 2018 the individual Province share is calculated using the formula:

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

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 7: 2018 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	33,602.9	7.1%	34,851.7	34,851.7
Gulf	0.0	22,358.4	4.7%	23,189.4	23,189.4
Central	0.0	25,829.1	5.4%	26,789.1	26,789.1
Milne Bay	0.0	26,133.9	5.5%	27,105.2	27,105.2
Oro	0.0	17,638.8	3.7%	18,294.3	18,294.3
Southern Highlands	0.0	23,671.6	5.0%	24,551.4	24,551.4
Hela	0.0	24,398.6	5.1%	25,305.4	25,305.4
Enga	0.0	17,703.6	3.7%	18,361.5	18,361.5
Western Highlands	0.0	11,492.9	2.4%	11,920.0	11,920.0
Jiwaka	0.0	28,805.5	6.1%	29,876.1	29,876.1
Simbu	0.0	34,137.8	7.2%	35,406.6	35,406.6
Eastern Highlands	0.0	45,637.1	9.6%	47,333.2	47,333.2
Morobe	0.0	0.0	0.0%	0.0	0.0
Madang	0.0	42,023.4	8.9%	43,585.2	43,585.2
East Sepik	0.0	52,046.4	11.0%	53,980.7	53,980.7
Sandaun	0.0	36,802.0	7.8%	38,169.8	38,169.8
Manus	0.0	3,637.8	0.8%	3,773.0	3,773.0
New Ireland	0.0	0.0	0.0%	0.0	0.0
East New Britain	0.0	12,618.2	2.7%	13,087.2	13,087.2
West New Britain	0.0	16,078.3	3.4%	16,675.8	16,675.8
Total	**0.0**	**474,616.4**	**100.0%**	**492,255.6**	**492,255.6**

4.7. Individual Local-level Government 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 and New Ireland Provinces

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 and 2018 budgets. With the cessation of the transitional guarantees, Morobe Province was the only province ineligible to receive any function grants for 2017, however, in 2018, New Ireland Province is also not eligible to receive any function and administration grants.

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 and New Ireland which both would still continue to receive these LLG Grants for 2018.

The NEFC has already engaged Morobe and New Ireland through various discussions to make necessary adjustments when framing its 2018 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 2018 budget timeline.

NEFC CEO- Chairman, Mr. Hohora Suve, ***(Middle)**t* and the Communication Officer, Mrs. Elizabeth Babate, **(*left)***, having a chat with the Member *for* Samarai/Murua, ***(right)*** Hon. Leonard Henry Isi visited the NEFC Stall during the 10th Parliament Induction for the Members of Parliament.

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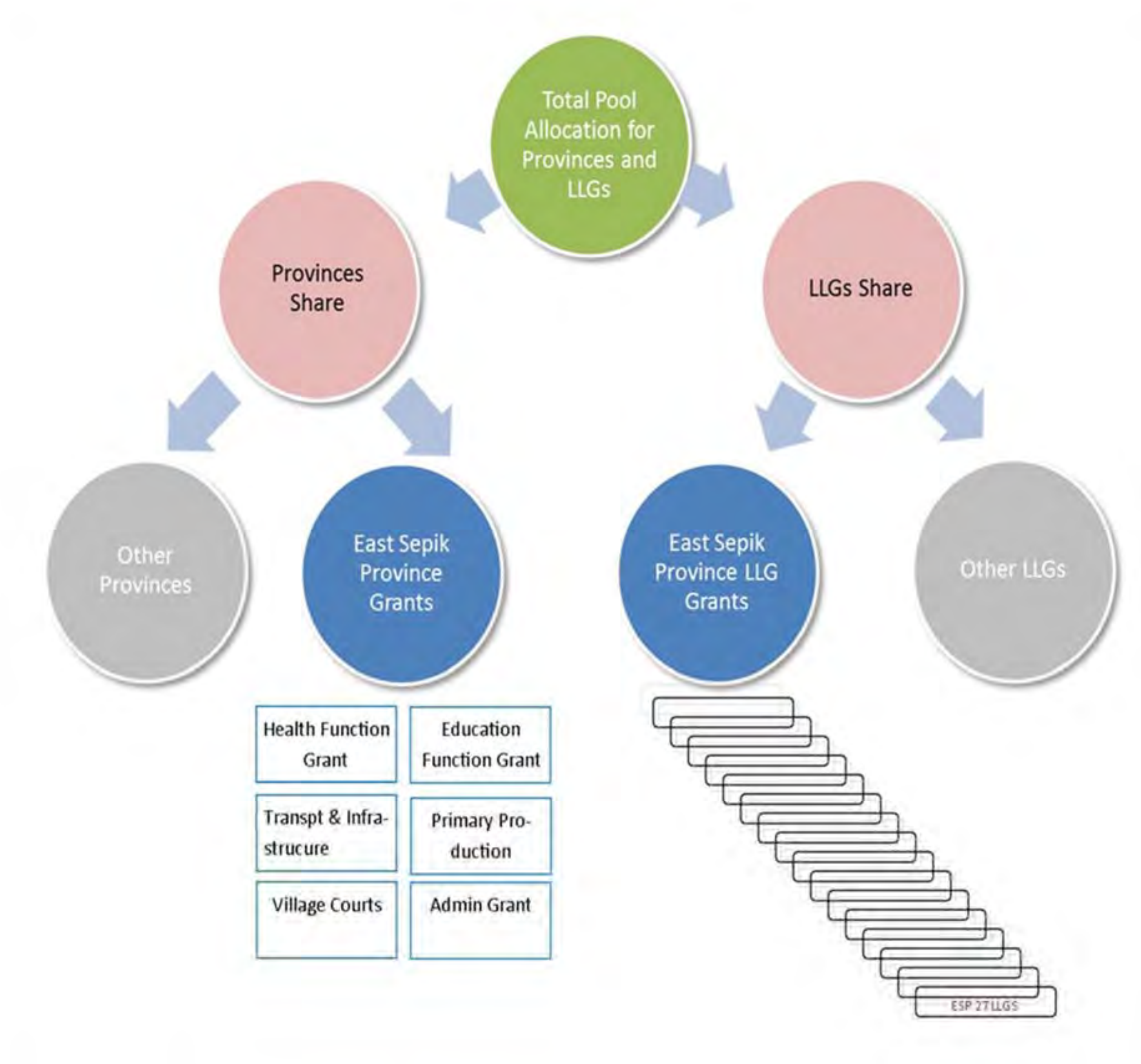
The Process how NEFC apportions Goods & Services Funding to Provinces and LLGs



Note:

1. East Sepik Province is used in this example to resemble the case for each province.
2. Each rectangle under the province represents each LLG within each province.

CHAPTER FIVE: CONDITIONS ATTACHED TO THE USE OF THE FUNCTION AND ADMINISTRATION GRANTS

4.9. 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 Expenditure Instructions.

The following service delivery function grants will be in operation in 2018;

- Education Service Delivery Function Grant;
- Health Service Delivery Function Grant;
- Transport Infrastructure Maintenance Grant;
- Village Courts Function Grant (Operations);
- Land Mediation Function Grant *(newly established)*
- Village Courts Allowances Grant;
- Agriculture Service Delivery Function Grant;
- Other service delivery Function Grant *(Grant composed of funding for other services sectors such as Community Development, Lands, Commerce, Environment, etc.).*

4.10. 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. This grant is intend to fund the operation of the administration sectors such as the Legal Services; Human Resource Development; Policy, Planning & Research; Internal Audit; Assembly/Parliamentary Services; Office of the Administrator; and LLG Administration.

4.11. 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 the 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. Launching of the District Expenditure Review 2013 during the PLSSMA Meeting in 2015

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 Minimum Priority 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 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
Health	
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.
Education	
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.
Transport Maintenance	
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
Agriculture	
10. Extension activities for agriculture, fisheries and forestry	i. Number of extension patrols conducted by provincial government staff and ii. Number of people who attended extension sessions
Village Courts	
11. Operations of Village Courts	i. Number of village courts in active operation ii. Number of village courts supplied with operational materials iii. Number of inspection to village courts

*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.

*It is aslo understood that the establishment of the TTF has induced provinces to use the Education Function Grants on other activities. The NEFC still maintains its objectivity by encouraging provinces to fund distribution of school supplies as TTF is only a policy and NEC decision and can be abolished anytime.

The new established Land Mediation Function Grant is yet to establish its minimum priority activities and its performance indicators through another consultation process with the key stakeholders such DoT, Finance, Department of Justice & Attorney General and Provincial Administrations.

4.12. 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. The National Economic & Fiscal Commission has undertook a series of budget workshops with all provinces to further improve budget compliance to the use chart of accounts coding and other budget scorecard criteria. Furthermore, the NEFC also undertook a rollover study to assess the main causes of the rollovers and the manner in which rollovers in the provinces are treated the budget workshop venues include;

(a) Lorengau- Manus Province;
(b) Kundiawa- Simbu Province;
(c) Alotau- Milne Bay Province; and
(d) Vanimo- Sandaun.

CHAPTER SIX: IMPLEMENTATION OF PROVINCIAL BUDGETS: ASSESSMENT 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 is at a pivotal point in ensuring that the available funding for goods & services is spent wisely on intended purposes. It 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 advisors and the deputy provincial administrators. The focus of these workshops had gradually changed each year based on pertinent issues that have arisen. The workshops place a large emphasis on 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. More to an extent, the NEFC often attempted exclusively to pursue this issues to gain more political support and direction by advocating for solutions during the Governor's Conference or by one – on – one approach.

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.

In 2017, the NEFC initiated a one – on – one approach workshop with each provincial administration through its Provincial Finance Division to further address issues identified from the provincial budget assessment. The main aim/objective of these workshops was to assist provinces compile well-structured and readable budgets and easy to implement and monitor annually.

6.1. Implementation of Budgets and Analysis

Generally, it was noticed, that implementation of the provincial budgets remained slow as noticed in the half-year (second quarter) review information. 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 provincial 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. . Most of the provinces have attended the reviews, however, few did not attend due to National Elections.

There were number of observations made during the review. The major observation was that provinces are still confronted with the dilemma relating to issue of warrant and cash releases. It seemed obvious that the current year monthly warrants and cash releases are slow to reach provinces in a timely manner.

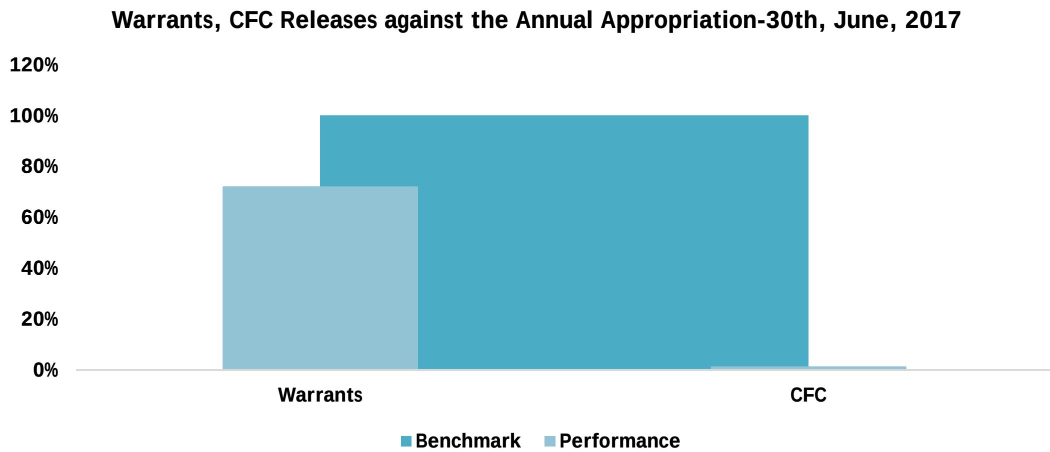
Most of the provinces still operates on the rollovers made available from the first preceding year. Some provinces have indicated that they were maintaining their operations through their internal revenue.

The NEFC compiled all the available data from three (3) selected provinces as part of its review. The analysis is conducted on the findings from this year's (2017) 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 few Provinces analysed, the release of warrants from Treasury remains slow. Provinces reported that only had been released of which was expended by the 30th of June. From the recent findings, it was noticed that warrants were release in February, however, the actual cash reaches provinces in mid-May.

Figure 8: Cash flow to Provinces (Selected Provinces - 2017).



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. From the Provinces selected , it was reported that a CFC worth K7.42 million from the initial appropriation of K473.8 was issued by 30th of June, 2017, however, warrants released was noted at K171 million. It is quite interesting to see the trend in which funds are being disbursed to provinces and has already indicated that slow release of funding is likely to impact basic service delivery.

Slow Release and use of Rollovers

It was initially intended that while awaiting funding from the 2017 budget, provinces are required to use the rollovers from the preceding year to begin implementation. However, it was noticed that there was also an issue relating to the release of the rollover funds budget for under the current fiscal year.

It was noted that some provinces started receiving their operational funds and commence implementation in April. Some provinces such as New Ireland Province had gone to an extent of having experienced the late release in late July, 2017. In summary, it was noted that the continuing trend in the late releases of actual cash slows the implementation of service delivery activities.

On the other hand, it was understood that the rollovers from the preceding year would significantly supplement funding for the first half of the year if the current funding is released in a timely manner.

However, there was an indication that rollover funds are also released late as of July. There was consistence release for some provinces such as East New Britain. Provinces such as East Sepik, release of rollovers was done a month apart commencing in June.

It was also obvious that there was continuous and one off releases of rollovers has experienced by some provinces such as New Ireland Province in 2016. The NEFC continued to look at alternatives and consult the Department of Treasury to try and address the issue on the cash releases. The table below shows how cash was disbursed and expanded in 2016.

Figure 9: Monthly Cash Releases (including rollovers) in 2016

Cash/Rollover Releases & Expenditure - Selected Three (3) Provinces

Province	Type of Release & Expediture	JAN	FEB	MAR	APR	MAY	JUN	JUL	AUG	SEP	OCT	NOV	DEC
East New Britain	Cash Release & Expenditure				3,242	156,373	294,679	757,998	255,292	433,741	540,279	423,756	2,001,262
	Rollover Release & Expenditure		622,596	515,887	897,567	226,352	396,085	165,127	73,007	149,854	133,392	73,038	607,423
East Sepik	Cash Release & Expenditure						1,007,250	1,462,018	1,672,029	2,017,135	2,922,108	2,992,918	10,457,245
	Rollover Release & Expenditure						337,100	-	43	-	3,591	-	5,489
New Ireland	Cash Release & Expenditure							126,636	1,647,427	4,691,744	2,157,203	4,613,760	3,007,029
	Rollover Release & Expenditure				1,330,000								
		-	622,596	515,887	2,230,809	382,725	2,035,114	2,511,779	3,647,798	7,292,474	5,756,573	8,103,472	16,078,448

Data Source: PGAS - 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. The table below shows the percentage disbursement of the cash releases from the first quarter to the last quarter in 2016.

Figure 10: Quarterly Cash Releases (including rollovers) in 2016

Period	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
% of Cash Released	2%	9%	28%	62%

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.

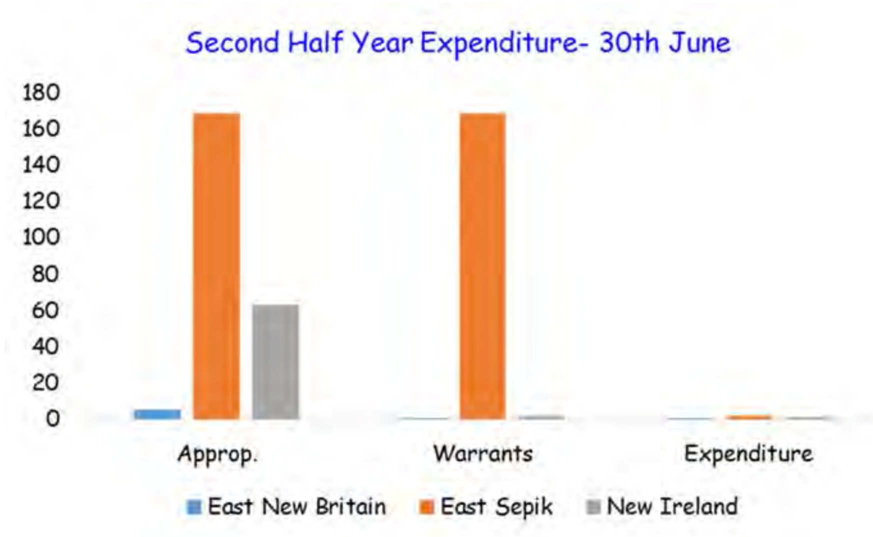
It was noticed during the second quarter budget review that some provinces have indicated in overall, a low spending as of 30th of June. From the three (3) provinces selected, spending was noted to be lower than the 10%, which depicted clear picture that spending was not even 50% or higher than 50% of the annual appropriation and warrants released as of 30th of June.

Provinces raised concerns during the review that slow spending affects most of the implementation of the sectoral plans during the first half of the year. Provinces hoped to start implementing as soon as rollover funds are released early, however, as indicated by the provinces that, all funds are released late and eventually impede consistency in implementing their sectoral programs.

Provinces such as East Sepik started implementation in June, as shown in the timing of the current year cash and rollover releases. Furthermore, cash release are quite low to expand on a vast set of planned activities that proposed to be implemented in a month.

As indicated in the chart below, expenditure was quite low which complimented the amounts release in each quarter. Less and medium resource – rich provinces such as East Sepik have shown a high level of appropriation, but is slow expanding up to 50% of its appropriation.

Figure 11: Second Half year Expenditures against Warrants and Appropriations in 2016 in millions.



Overall Spending Performance by Sectors

The data was then assessed on a sectoral basis which did not show a strong spending trend between sectors. It has become obvious that much of the funding is being delayed through various reasons. Therefore, the expenditure by sector shows an unremarkable performance below the 50% of the expected appropriation as of 30th June.

The use of former years (rollovers) was seen as a significant funding source in the first half of the year's (2017). With the unavailability of the current year's (2017) funding in the first two (2) quarters, former years were used to fund sector plans as indicated in the second quarter reviews.

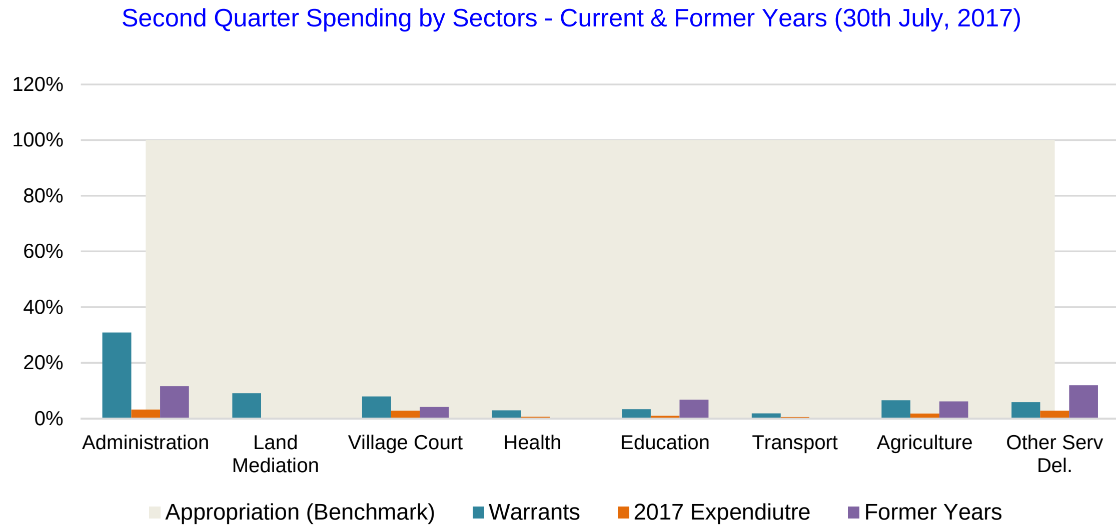
Some service delivery sectors had shown heavy reliance on the former years. The example of such sectors are Education, Agriculture, Administration and Other Service Delivery sectors. The picture looks quite promising but the amounts of Kina expanded were never amounted to the half of the annual budget appropriation and more.

The overall equity and equal disbursements of funding is still a concern. This is because releases indicated by the Department of Finance show a huge disparity in the distributions of current year funds and the rollovers as shown in the Figure.11.

By undertaking this assessment on annual budget appropriations, warrant and cash releases, and expenditure, it is quite seemingly the distribution trend may have a detrimental impact on the issue of funds intended for basic service delivery.

High level forum was held in July. *This involved all key central agencies including National Economic & Fiscal Commission, Departments of Finance, Treasury, Provincial Affairs, Implementation & Rural Development and sector agencies such as Departments of Health, Education, Transport, and Agriculture & Livestock. This forum was held to discuss issues affecting cash releases and come up with possible solutions to address the issue.*

Figure 12: Chart showing the Second Quarter Spending by Sectors including the Current & Former Years as of 30th of June against annual appropriation.



2017 Revenue collections were lower than budgeted

The provinces' internal revenues is considered as a paramount sources of income which provinces should prioritise in supporting the key service delivery sectors to fund basic service delivery activities. This was supported through the intention behind the reforms that the use of both Function Grants and Own-Sourced Revenues will holistically show the fiscal ability/strength of each individual provinces to meet all basic service needs of their rural population.

Therefore, to compliment the whole concept on the use of own-sourced revenues, revenue projections and consistency collecting revenue to support service delivery, revenue collection bodies in the provinces should be strengthened by improving their capacity.

As indicated by the three (3) selected provinces during the reviews, provincial revenues collections were below the budget; which is expected to result in a shortfall of around K89.2 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. From the three (3) selected provinces, revenue collection performance was at 35% which is below 50% of what it should be collected as of June 30th. The table below shows the performance of each province relating to the revenue collection as of 30th June in 2017.

Figure 13: Revenue Collection Performance of the three (3) selected provinces (30th, Jun) in millions.

Selected Province	Projections	Collection	Outstanding	Half Projection	% Collection(30th June)
East New Britain	29.0	5.8	23.2	16.9	34%
East Sepik	13.2	2.9	10.3	6.6	44%
New Ireland	66.7	10.9	55.8	33.3	33%
	108.9	19.6	89.2	56.9	35%

Data Source: Second Quarter Review Report, 2017

This has a negative impact on service delivery. However, 2017 was a challenge to all provinces. Most of the provinces depended heavily on their own-sourced revenues to implement service delivery.

Individual provincial ability to collect the projected annual revenues is a challenge. Few provinces have the capacity to collect revenue.

The trend shows that revenue projections for provinces have increased steadily, however, actual collections have dropped dramatically in 2017.

6.2. NEFC Regional Workshops

The 2017 NEFC workshops were conducted between May and July 2017. The four (4) workshops were held at the following regional centres: Southern Region in Alotau; Highlands Region in Kundiawa; New Guinea Islands in Lorengau; and Momase region in Vanimo.

Overall, all workshops were successfully conducted with a total of more 200 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 Education, Department of Implementation & Rural Development and was also included as part of the regional workshop team. This year was a bonus in having the Department of Transport, Department of Agriculture & Livestock and Small Medium Enterprises (SME). 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).*

The picture shows the Four (4) 2017 Regional Workshops conducted in Highlands, Southern, Momase and New Guinea Islands.

2017 Regional Workshop Resolutions ….

Theme: "Between the Lines"

Objective: Focusing on Frontline Service Delivery

Year	Res. No.	Resolution	Responsible Agency	What needs to be done	What's the progress	Action Officer	Remarks
2017		OVERALL RESOLUTIONS	National Economic & Fiscal Commission	'Between the Lines' - Working collaboratively across government to further highlight underlying issues to improve and 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			
			All Provinces and stakeholders	That all provinces continue to use the workshop to learn from each other and to improve on the issues and challenges with assistances from National Agencies			
2017	STRUCTURED SCHEDULE FOR WARRANT AND CASH RELEASES		Department of Treasury	*DoT – Budget Division*, to continue to advocate proactively on behalf of provinces, to secure a consistent and matching warrants and cash releases to Provinces; Such as adopting the Governors' Conference - '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			

2017		**DEPARTMENT OF TREASURY - Budget Reforms**	**All Provincial Administrations**	• To adhere with the key changes in the budget reforms and the new budget cycle.			
	Resolution 1	**DEPARTMENT OF TREASURY – Budgeting Issues**	**All Provincial Administrations**	• Both Provincial & LLGs budgets should be submitted at the same time before 31st January. • To provide updated manpower data to Department of Treasury quarterly for the provision of manpower budget formulation. • To comply with the Budget Circular by furnishing Quarterly Budget reports to Department of Treasury and Department of National Planning & Monitoring for both national grants and internal revenue regardless of funding not provided for the Quarter.			
2017	**Resolution 2**	**Chart of Accounts Issues**	**DoT/DoF/NEFC/DIRD/DNPM**	• To work together with Provinces/Districts in formulating Chart of Accounts for the SIP funds – clearly specify the COA for SIP from the capital investment program.			
			All Provincial Administrations	• Must use the standard chart of accounts in their 2018 Provincial Budgets.			

2017	**Resolution 3**	**Rollover Issues**	**All Provincial Administrations**	• To follow up with DoT and DoF on previous years Rollovers to ensure that it is included in Provinces appropriation in order for them to expend on.			
2017	**Resolution 3**	**Sustainable Development Goals, MTDP 3 and M&E Framework**	**DNPM/DIRD/DPLGA**	• To work together with Provinces for the SDG localization and MTDP3 formulation. • To work together with Provinces to assist them in drafting their five year development. • To pilot MTDP, M&E Framework in few provinces and assist provinces to strengthen their M&E Systems.			
			All Provincial Administrations	• To ensure that Districts 5-Year Development Plans must be aligned or linked to the Provincial 5-year Development Plans. • To take ownership of the PNG Planning & Monitoring Responsibility Act, 2015.			
2017	**Resolution 4**	**GST Issues**	**IRC/DoT**	• To liaise with Provinces on issues relating to GST rebates. • To provide projections for GST distributions to Provinces for better planning and budgeting process.			

2017	**Resolution 5**	**Revenue Collection and Improvements**	**All Provincial Administrations**	• To support the growth of SMEs and the Primary Production Sector as an avenue to encourage revenue generation within the province. • To plan and work towards improving Revenue base for Provinces for Sustainability purposes through introduction of innovative programs and Public Private Partnership (PPP). • To support SME in the Provinces through providing training and better resourcing SME officers.			
2017	**Resolution 6**	**Provincial Audit Committees & Performance Reporting**	**AGO/DoF**	• To assist provinces in establishing Provincial Audit Committees.			
			All Provincial Administration	• To cooperate and work together with AGO during performance auditing exercise.			
2017	**Resolution 7**	**S119 Reporting**	**All Provincial Administration**	• To continue to adhere to the Organic Law requirements under S119 reporting timeframes and submit on time.			
			Hela and Jiwaka Provinces	• To start reporting under S119 starting 2018 for the 2017 performance, with assistance from DPLGA.			

			DPLGA/NEFC	• Link S119 reporting with Provincial Expenditure Review particularly on the Minimum Priority Activities (MPAs).			
2017	**Resolution 8**	**Regulations in respective to DDA's**	**DPLGA/DPM**	• To provide clarity in the demarcation of roles and responsibilities between the CEOs for DDAs and the District Administrator.			
2017	**Resolution 9**	**DDA Financial Arrangement FI Operationalization of DSTB**	**DoF**	• To assist Provinces and DDAs in establishing respective DSTB in the Districts.			
			All Provincial Administrations and DDAs	• To comply with DDA Financial Arrangement FI process on establishment of DSTB as provided for in Ministerial Instrument.			
2017	**Resolution 10**	**Administrative Guidelines & Monitoring of SIP funds**	**DIRD/DoF/DNPM**	• To review the administrative guidelines including process and procedures for the use of SIP funds.			
			All Provincial Administrations and Districts	• To report/submit the acquittals for the Service Improvement Programs (PSIP and DSIP) as per the timeframe in order for DIRD to complete the appraisal process.			

2017	Resolution 11	NDoH – Technical Support	NDoH/NEFC/DoT/DoF	• To continue assisting provinces through technical support (ABB Tool - Activity Based Budget Template) facility based budgeting. • To continue assisting provinces in establishing Direct Facility Funding for Health Centres.			
			NDoH	• To work together with Provinces to review distribution process for medical supplies.			
			All Provincial Administrations	• To implement facility based budgeting and direct facility funding so that funds can be broken up into the respective MPAs for Health.			
2017	Resolution 12	Village Courts and Land Mediation Issues	All Provincial Administrations/VCLMS	• To continue to ensure supervision of village courts are undertaken regularly to make sure village courts are operational and officials continue to perform their respective roles.			
2017	Resolution 13	Tuition Fee Free Policy- Department of Education (DoE)	All Provincial Administrations and Districts	• To coordinate and work together with Education Department in supporting and providing required school data and ensuring that the TFF Policy is complied with. • To support School Inspectors operations in the districts for effective monitoring evaluation and compliance reporting.			

				• To coordinate and work together with NDoE to support school infrastructures by providing financial assistance through SIPs to complement TFF funding.			
			NDoE	• To review the procurement process and to work together with the provinces to ensure that TFF grants are released as per the schedule to support school materials distribution and infrastructure development.			
2017	**Resolution 14**	**Department of Transport (Rural Airstrip)**	**All Provincial Administrations and Districts**	• To provide financial assistance to maintain and rehabilitate airstrips. • To collaborate with CASA/Department of Transport in providing capacity building and training for Airstrip Reporting Officers so that reliable information and data for Rural Airstrips are relayed to Department of Transport, NAC, PNGASL and CASA. • To abide by the Minimum Safety and Regulatory Compliance provided by CASA to ensure sustainability for Airstrips.			

2017	**Resolution 15**	**Small Medium Enterprise**	**All Provincial Administrations and Districts/LLGS**	• To develop Provincial, District and LLG SME policies and SME development plans. • To translate and integrate the SME policy 2016 and SME master plan 2016-2030 through Provincial, District and LLG development plans.			
			SMEC	• To conduct regional SME integration awareness workshops.			
2017	**Resolution 16**	**Department of Agriculture and Livestock**	**All Provincial Administrations and Districts**	• To provide reports/information on the available land (Agriculture State Lease) as well as existing facilities available for purpose of carrying out extension activities.			
2017	**Resolution 17**	**MISCELLANEOUS ISSUES**	**All Provincial Administrations**	• To work together with districts and LLGs to improve regular and quality monitoring and reporting systems. Also seek assistance from relevant agencies where necessary. • To address issues relating to rural population living along border provinces. Provinces should develop MOA to deliver services to people living along the border.			

6.3. Assessing the quality of Provincial Budget Submission

Figure 14. *Ranking of Provinces' Performances based on a 3-year average.*

No	Province	2015	2016	2017	2017 Ranking	Scores 3year Average	Ranking 3year Average
1	Manus	62	68	59.5	3	63.2	1
2	Simbu	69	65	55.5	6	63.2	1
3	ENB	64.5	61	63	1	62.8	3
4	EHP	68	74	45	16	62.3	4
5	Central	61	70.5	55	7	62.2	5
6	WNB	58	65.5	58	4	60.5	6
7	Milne Bay	65	53	61	2	59.7	7
8	Oro	52	67	54	8	57.7	8
9	Sandaun	69	51.5	47	12	55.8	9
10	Gulf	65	40	56.5	5	53.8	10
11	SHP	58	53	45.5	15	52.2	11
12	East Sepik	53	51	47	12	50.3	12
13	Western	60.5	34	54	8	49.5	13
14	Enga	52	47.5	47	12	48.8	14
15	WHP	50	32	54	10	45.3	15
16	Morobe	50	39	43	16	44.0	16
17	Madang	48	32	50	11	43.3	17
18	NIP	47	46	37	19	43.3	17
19	Jiwaka	55	33	36	20	41.3	19
20	Hela	45	35.5	40.5	18	40.3	20

Annually, NEFC performs a budget quality assessment process to examine the quality of provincial governments' budget documentation against the requirements outlined in the Budget and Expenditure Instructions, and what is considered as best practice in public sector budgeting. The 2017 Quality Budget Assessment was conducted in May 2017 and presented to Provinces during the NEFC Regional workshops held in May and July 2017.

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 where fiscal capacity was less than 100%.

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

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 and then classified by regions.

The tables on the next page show the points scored by each province by each region – New Guinea Islands, Highlands, Momase and Southern. When there is a "0" score, it indicates that there is no expenditure shown against the service delivery category.

Some provinces did well like East New Britain and Milne Bay, however, there needs to more improvement formulating annual provincial budgets so it make expenditure more accurate and efficient. This will make it easier to monitor annual budget implementation.

Highlands Region

rovincial budget quality assessment	SHP	Enga	WHP	Simbu	EHP	Hela	Jiwaka
verall	4	15	17	15	10	12	9
ational Grant Financed Expenditure Appropriation	5	5	5	3	5	5	4
dministration	0	0	1	0	0	0	0
ther Services	0	0	2	0	0	0	0
ealth	11	9	2	9	13	7	2
ducation	16	6	8	11	11	1	11
ransport maintenance	5	7	6	11	2	7	8
rimary Production	2	0	7	6	2	3	0
illage Courts (Operations)	3	2	3	1	2	0	2
wn Source Revenue (700 series) Appropriation	3	3	0	0	4	6	0
LG allowances budgeted from provincial internal revenue ppropriation	0	1	1	0	0	1	0
017 Total Provincial Budget Quality Score	**48.5**	**48.0**	**52.0**	**55.5**	**49.0**	**41.5**	**36.0**
016 SCORES	53	47.5	32	65	74	33	35.5

Momase Region

rovincial budget quality assessment	Morobe	Madang	ESP	Sandaun
verall	12	14	12	18
ational Grant Financed Expenditure Appropriation	5	4	5	5
dministration	0	0.5	0	0
ther Services	0	1	0	0
ealth	12	12	11	6
ducation	2	11	10	12
ransport maintenance	5	6	6	5
rimary Production	1	1	1	1
illage Courts (Operations)	2	0.5	2	0
wn Source Revenue (700 series) Appropriation	3	0	0	0
LG allowances budgeted from provincial internal revenue ppropriation	1	0	0	0
017 Total Provincial Budget Quality Score	**43.0**	**50.0**	**47.0**	**47.0**
016 SCORES	39.0	32.0	51.0	51.5

New Guinea Islands Region

rovincial budget quality assessment	Manus	NIP	ENB	WNB
verall	12	17	10	16
ational Grant Financed Expenditure Appropriation	5	5	5	4
dministration	0	0	0	1
ther Services	0	0	0	2
ealth	16	2	17	5
ducation	11	1	16	15
ransport maintenance	8	6	9	9
rimary Production	3	1	1	0
illage Courts (Operations)	2	2	2	3
wn Source Revenue (700 series) Appropriation	3	3	3	3
LG allowances budgeted from provincial internal revenue ppropriation	0	0	0	0
017 Total Provincial Budget Quality Score	**59.5**	**37.0**	**63.0**	**58.0**
016 SCORES	68.0	46.0	61.0	65.5

outhern Region

rovincial budget quality assessment	Western	Gulf	Central	Milne Bay	Oro
verall	16	9	18	13	15
lational Grant Financed Expenditure Appropriation	5	5	4	5	5
dministration	0.5	0	0	0	0
ther Services	0	0	0	0	1
lealth	7	16	7	12	8
ducation	11	11	11	15	8
ransport maintenance	10	11	9	8	8
rimary Production	1	3	1	1	2
illage Courts (Operations)	0.5	2	2	2	4
wn Source Revenue (700 series) Appropriation	3	0	3	5	3
LG allowances budgeted from provincial internal revenue ppropriation	0	0	0	0	0
017 Total Provincial Budget Quality Score	**54.0**	**56.5**	**55.0**	**61.0**	**54.0**
016 SCORES	34.0	40.0	70.5	61.0	67.0

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

Positive scores were allocated to budgets if provinces included details of estimated actual Revenue and Expenditure data for both prior year and the second prior year. Sectoral allocations for the Minimum Priority Activities were compared to the NEFC estimate of the cost of delivering a basic level of services and then corrected for fiscal capacity for all of those Provinces where fiscal capacity was less than 100%.

Positive scores were also applied where the proportion of own- source revenue appropriation allocated to MTDP sectors which are Health, Education, Transport Infrastructure Maintenance, Primary Production and Village Courts were significant. Furthermore, penalties were applied if provincial governments allocated funding for Universities, tertiary scholarships or Provincial Hospitals from national government function grants.

Left: A NEFC Officer conducting a Provincial Budget Model (PBM) Training for the Highlands and Momase Provinces in 2015. ***Right:*** A Budget Session conducted by the NEFC Staff with the New Guinea Islands Provinces.

6.4. Assisting the Reform Processes

NEFC has been proactively involved in assisting provinces through various interventions such as the annual regional workshops conducted for each region; Budget Workshops; Unspent/Rollover Study; Facility Based Funding-Diagnostic Expenditure Review; Personal Emoluments Costs; and Public Expenditure & Financial Accountability (PEFA).

Annual Regional Workshop

This year the regional workshops were held in Lorengau for New Guinea Islands, Alotau for the Southern Region, Vanimo for the Momase Region and Kundiawa for the Highlands Region. These workshops are used as avenues to further engage all stakeholders including provinces to discuss issues and contribute ideas to further improve the flow of service delivery. During the workshops, pertinent issues relating to service delivery were raised. There was a major concern with the cash flow situation in the country. This almost affected 80% of the service delivery funding to provinces and districts.

Workshop on Improvement of Budget Submission

NEFC initiated a workshop particularly to assist the non performing provinces by using the results derived from the 2017 Quality Budget Assessment. The main purpose is to assist provinces to improve their budget submission and budget formulation. The aim/objective of this workshop is to have a one on one approach with each province to assess how they improve the quality of their budget leading up to 2018 Budget Submission. The first Training workshop was conducted in Madang on the 24th of August, 2017 which Madang, East Sepik, Sandaun and Western Highlands participated.

Roll-over study

Rollover study was an important study undertaken by NEFC in 2017 to further assess the increasing amount of rollover funding accumulated over the years. The study highlighted three (3) main areas; the first area covered in this study is the causes of the rollovers; the second area is the main types of the rollovers; and third area is how rollover funds are treated and used.

There are two (2) types of rollovers. The first type of a rollover appears as an appropriation from the preceding year which funding hasn't been released. The second type of rollover appears as an available funding which never been used in that particular fiscal year, and was intentionally moved forward to the upcoming year.

It is quite paramount that the study highlighted how rollover funds are treated and used by provinces. Under the previous system, unused recurrent funds held at the end of the financial year were rolled over to the Provincial Internal Revenue. However in 2011, the Department of Treasury instructed through the Budget and Expenditure Circular that the roll-overs remain in the Provincial Grant account and not to be rolled over into to Internal Revenue *(See appendix)*.

One of the reasons this became necessary was due to the late release of funds, in many instances, large amounts even up to 60% of a province's total function grants were released in the last quarter of financial year.

A number of years since the routine application of the rollover of unspent funds, it seems other weaknesses have crept into the system, besides the late releases of Warrant Authority and a mismatch of the non-release of the equivalent cash in a fiscal year.

To gain a better understanding of the issues surrounding the rollover of funds, the mismatch of warrant and cash releases, NEFC is undertaking a study using the source PGAS and provide Government a snap shot analysis over the application and availability of funding which facilitate timely and consistent service delivery. There were four (4) provinces selected for this study to establish how operational (recurrent) funds are being implemented:

1. East New Britain – Service delivery function grant transferred to LLG
2. East Sepik – Highest recipient of service delivery grant
3. Central – Service delivery function grant transferred to District
4. Milne Bay – Service delivery function grant transferred to Provincial Health Authority

3rd Day Budget Session

NGI 3rd Day Budget Workshop

Furthermore, as part of the move towards improving the quality provincial budgets, the NEFC conducted budget sessions on the 3rd day of its Regional Workshops. The workshop comprised of both NEFC and Department of Treasury representatives. The main purpose of the budget sessions was to ensure that the provinces used the standard chart of Accounts as part of their Budget formulation process. The session was also used as an avenue to conduct awareness about the Budget Expenditure Instructions and provinces to contribute ideas towards improving Provincial Budgeting.

During the session, the NEFC uses a set of measures to assess the provincial budgets. Positive scores were allocated to budgets if they included details of estimated actual Revenue and Expenditure data for both prior year and the second prior year. Sectoral allocations for the Minimum Priority Activities were compared to the NEFC estimate of the cost of delivering a basic level of services and then corrected for fiscal capacity for all of those Provinces where fiscal capacity was less than 100%.

Positive scores were also applied where the proportion of own- source revenue appropriation allocated to MTDP sectors; 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.

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 main intention behind this exercise is to assess and compared ever increasing salary cost to the total amount of goods and services funding to provinces and LLGs

The PECM has also since been further updated to include other information including qualitative information such as demographic information. This eventually set the basis DPM and DoT in determining an appropriate level of staffing grants for provinces and LLGs.

Facility Based Funding Diagnostic Expenditure Review

The Facility Based Funding- Diagnosis Expenditure Review is a National Economic & Fiscal Commission (NEFC) initiative. It is an in-depth study undertaken to further improve the impact of Intergovernmental Financing at the sub-national levels of government. Since the implementation of RIGFA in 2009. Funding to the sub-national governments has increased significantly, therefore, it was assumed that this increased funding is reaching the facilities to ensure planned programs and activities for the operations are undertaken effectively and efficiently at the facility level. The facilities are the fundamental points designated to ensure basic services are received by the rural population.

The study will provide government with an insight, on how well facilities are undertaking their day to day operations and how well funding is allocated and is flowing to the facilities? How well they plan? How well they budget? How well they execute their budgets? And finally, how well they monitor and report their annual performances.

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. In 2017, The NEFC has reviewed the cost and proposed for improvement to further establish a reasonable cost for the three (3) city authorities.

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.

Public Expenditure & Financial Accountability (PEFA)

The National Economic & Fiscal Commission (NEFC) has been tasked by the Department of Finance (DoF) to be the lead agency for the development of an Evaluation Design for conducting a review to determine the allocation of staff positions for education and health sector for which salary support is provided is based on transparent and horizontally equitable rules.

PEFA Performance Indicator.18 of the PEFA Framework examines the performance of service delivery it assesses whether performance audits or evaluations are carried out. It also assesses the extent to which information received by service delivery units are collected and recorded. There are four (4) main dimensions relating to this:

- Programs or services provided either to the general public or specifically targeted groups of citizens, either fully or partially using government resources.

- It includes services such as education and training, health care, social & community support, policing and road construction, maintenance, agriculture support, water and sanitation and other services.

- It excludes commercial services and regulatory services, policing and administration services, defence and national security undertaken by the government.

- A *"Service Delivery Unit"* Performance Information refers to outputs and outcome indicators, planned or achieved results against those indicators, Output indicators measure the quantity of output produced or services delivered or planned. Outcome indicators measure the outcome effectiveness of the service delivered or their outputs against the approved budget.

As part of the IMF Review Recommendations in the Road Map, the PEFA Indicators were dissected and allocated to each technical agency of government who is responsible for implementing the primary element of the Public Financial Management System.

Health Budget Assessment

The NEFC has continued to find innovative ways to analyse provincial public expenditure. In 2016, the NEFC conducted a review on the provincial health budgets and compared it to NEFC Cost of Services budget estimates for twenty (20) provinces. It used the provincial budget submissions presented to the Department of Treasury and compared them to the 2015 Cost of Services Study estimates and factoring in the CPI costs (refer to Appendix D).

The analysis covered three (3) main areas;

(a) **Budget Coding Consistency with Chart of Accounts/Budget Structure:** Provincial Government and District Chart of Accounts Expenditure and Revenue Code Structure

(b) **Budget Quality:** Assess on the basis of coherent health centre operational budgets in line with the Cost of Services Study that will provide operational resources to enable the health centre.

(c) **Facility Based Budgeting:** Assessment of the extent to which explicit references are made to individual Health Centres; how these are built into the budgets; and how complete related to NHIS Health Centres (Goods and Maintenance) as a measure of assessing the readiness of provincial health management to (eventually) embark on Health Facilities based budgeting and funding, whether in cash or kind.

The analysis showed that 47% of the provincial health budgets were inconsistent with Chart of Accounts, 11% were consistent and 52% were mostly or partly consistent. The second finding was 11% of the health budgets are of very good quality whereas 89% are of low and very low quality; and final finding was, 63% of the health budgets have made reference to Health Centres, 37% have never made any reference to HCs. Two of the provincial health budgets have made reference to HCs by LLGs.

Low or ranked provinces below the benchmark should now consider learning from the high ranked provinces such as Milne Bay, especially, to improve the quality of their health budgets.

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).

For a full report of the PER 2014, it can be downloaded from the NEFC website: www.nefc.gov.pg.

APPENDIX A: DETERMINATION APPORTIONING THE EQUALIZATION AMOUNT

DETERMINATION APPORTIONING THE EQUALISATION AMOUNT

PAPUA NEW GUINEA

Inter-Governmental Relations (Functions & Funding) Act 2009

DETERMINATION APPORTIONING THE EQUALISATION AMOUNT

I, **Hon. Peter O'Neill, CMG, MP, Prime Minister and 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 day of 20th June , 2017

MINISTER FOR TREASURY

APPENDIX B: FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

Function Grant Determination 2018

	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	10,456,673	7,689,275	11,080,898	3,142,902	387,059	106,270	1,604,007	384,638	**34,851,722**	699,011	2,629,027	**3,328,038**	**38,179,760**
Gulf	5,750,882	4,522,475	6,459,337	2,202,264	451,364	62,090	1,758,502	1,982,471	**23,189,383**	134,800	2,512,399	**2,647,199**	**25,836,582**
Central	5,407,269	5,716,507	9,523,971	1,867,927	330,790	50,583	2,347,827	1,544,200	**26,789,075**	0	1,808,885	**1,808,885**	**28,597,960**
Milne Bay	6,319,010	6,666,587	6,374,319	2,236,139	352,732	51,611	3,287,306	1,817,469	**27,105,174**	271,592	2,161,393	**2,432,984**	**29,538,158**
Oro	4,591,007	4,042,831	4,124,796	2,032,906	334,809	66,257	1,996,076	1,105,650	**18,294,331**	674,662	1,536,781	**2,211,442**	**20,505,774**
Southern Highlands	5,154,629	7,672,186	6,059,961	1,446,686	511,684	65,000	2,115,461	1,525,750	**24,551,357**	642,479	2,211,182	**2,853,661**	**27,405,019**
Hela	7,193,879	5,308,676	5,305,377	2,086,900	534,152	86,362	2,012,453	2,777,589	**25,305,387**	899,710	1,346,767	**2,246,477**	**27,551,864**
Enga	3,146,719	4,073,201	6,997,677	800,664	326,611	35,219	1,741,659	1,239,767	**18,361,518**	223,971	2,336,221	**2,560,192**	**20,921,710**
Western Highlands	3,047,906	2,489,263	3,509,071	977,353	346,516	46,822	703,999	799,088	**11,920,017**	751,991	1,678,893	**2,430,885**	**14,350,902**
Jiwaka	5,218,097	7,310,060	11,293,252	1,265,984	388,060	69,171	2,145,683	2,185,803	**29,876,110**	0	1,141,441	**1,141,441**	**31,017,551**
Simbu	6,463,418	9,607,263	10,397,657	1,720,263	647,906	71,566	3,104,222	3,394,292	**35,406,587**	356,114	1,316,397	**1,672,510**	**37,079,097**
Eastern Highlands	7,448,313	11,451,158	18,143,720	2,760,537	681,123	89,048	3,668,964	3,090,378	**47,333,242**	700,087	2,426,586	**3,126,673**	**50,459,916**
Morobe	0	0	0	0	0	0	0	0	**0**	2,338,915	4,319,496	**6,658,410**	**6,658,410**
Madang	9,493,848	9,422,364	12,968,372	3,755,326	585,598	66,629	3,722,534	3,570,526	**43,585,198**	823,938	3,435,062	**4,259,000**	**47,844,198**
East Sepik	11,161,471	12,278,523	19,868,729	3,422,185	796,316	54,781	3,104,008	3,294,673	**53,980,685**	616,482	3,837,653	**4,454,134**	**58,434,820**
Sandaun	9,665,360	9,251,806	8,643,347	3,732,470	519,567	74,568	2,414,115	3,868,549	**38,169,783**	462,670	3,481,183	**3,943,854**	**42,113,637**
Manus	974,892	999,550	982,233	314,308	116,142	56,269	230,120	99,523	**3,773,036**	203,448	451,256	**654,703**	**4,427,740**
New Ireland	0	0	0	0	0	0	0	0	**0**	383,096	969,230	**1,352,326**	**1,352,326**
East New Britain	3,111,242	3,066,358	3,211,117	2,154,836	221,930	50,223	737,056	534,434	**13,087,196**	841,781	2,369,048	**3,210,829**	**16,298,025**
West New Britain	3,916,889	4,983,630	3,265,210	1,846,205	275,524	102,821	1,302,586	982,952	**16,675,817**	525,065	1,480,389	**2,005,455**	**18,681,271**
TOTAL	108,521,506	116,551,712	148,209,043	37,765,856	7,807,882	1,205,290	37,996,578	34,197,753	**492,255,621**	11,549,811	43,449,288	**54,999,099**	**547,254,720**

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;

Should you require any further clarification, do not hesitate to contact the followin 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 an 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

APPENDIX D: PROVINCIAL HEALTH BUDGET ASSESSMENT

Budget assessment – Provincial Summary:

Central

Budget consistency: CoA consistent
MPA: 19%
Budget quality: fragmented budget, possible overlaps between HF operations and health programs with certain HF operations elements possibly hidden behind health program budgets.
Explicit HC reference: no explicit HC reference

EHP

Budget consistency: inconsistent CoA codes with hardly any relation with the CoA. Activity text/descriptions for same activity often cover several activities. HF Operations budget re-built by picking individual budget lines.
MPA: 148%
Budget quality: fragmented HF budget, large parts of the budget unclear and not well specified and therefore often difficult to determine whether these belong to the HF Operations budget.
Explicit HC reference: Only Kainantu and Daulo DH explicitly referred, no other HCs.

ENB

Budget consistency: Mostly CoA consistent
MPA: 75%
Budget quality: HF budget not clearly demarcated, pieced together from different sections of the budget.
HF budgets primarily under LLGs as 143 transfers. Not clear whether funds paid/spent by HC, or paid by LLG administration on behalf of HCs. Transfers to LLGs for HF operations, CAP-Intergrated Patrol - Primary Health Care, medivac for 4 Pomio LLGs, but also for healthy island activities. Not clear how the transfers (143) are accounted.
Explicit HC reference: explicit reference to 3 HC/DHs- Kerevat, Palmalamal, Warangoi. All other HCs through LLGs assuming there is 1 HC in each LLG - not more than 1 or no HC in an LLG.

Enga

Budget consistency: CoA consistent in principle, however all HF operations budgets in 3211 Administration
MPA: 44%.
Budget quality: HF budget not clearly demarcated, pieced together from different sections of the budget. Specific references to HCs found in expenditure sub-item text.
Explicit HC reference: explicit references HCs, which more or less reconcile with the NHIS, includes 3 mission (M) HCs.

ESP

Budget consistency: CoA codes partly consistent. HF operations correctly budgeted in 322x and 323x. HC budget is broken down by LLG with HC names listed as activity text/description within same activity codes.
MPA: 84%
Budget quality: HF budget re-built by piecing together budget line by budget line.
Large (128) building maintenance more likely rehabilitation/construction.
Possibly up to 23 mission (M) HCs included in the budget.
Explicit HC reference: explicit reference to HCs. Budget for 39 explicitly named HCs. The NHIS includes 16 government (G) HCs and 29 mission (M) HCs.

Jiwaka

Budget consistency: CoA codes consistent in principle. 3211 Administration bundles HF operations together with administration, office construction etc. with a total budget of K3,446,000.
MPA: 28%
Budget quality: Fragmented and in-transparent budget, in particular as HF operations are bundled together with administration and other activities in 3211.
Explicit HC reference: no explicit reference to HCs.

Gulf

Budget consistency: CoA codes are used incorrectly and inconsistently with no relation to CoA at all. Activity codes seem to be established and used more or less arbitrarily.
MPA: NA
Budget quality: Fragmented budget. The budget is more than twice as large as the total health CoSS estimates. Budget assessment compared with the CoSS is meaning-less as the budget does not distinguish between the HFG allocation and the rollovers. In any case about two third of the entire budget is allocated for capital purposes with little left for HF operations..
Explicit HC reference: explicit reference to HCs.

Madang

Budget consistency: CoA codes inconsistent with hardly any relation to the CoA. HF operations found in activity codes outside 322x and 323x.
MPA: 53%
Budget quality: 53% of the HFG budget is allocated to district health administration. 52% of the district health administration budgets are allocated and budgeted for HF operations.
Explicit HC reference: no explicit reference to HCs.

Manus

Budget consistency: CoA codes are inconsistent.
Activity codes have been re-arranged to accommodate 8 government (G) HCs and 3 mission (M) HCs.
MPA: 84%
Budget quality: Each HC budget broken down into 4 operational sub-activities: HC operation, outreach/patrols; AP supervision; drug distribution supervision. Not clear why drug distribution (to the Aps) need separate budgets, neither how Patient transfers is covered.
Explicit HC reference: explicit reference to HCs reconciled with NHIS.

Milne Bay

Budget consistency: CoA codes consistent. 4 activity codes are not found in the CoA.
MPA: 95%
Budget quality: HC budget seem to be by and large in line with CoSS estimates catering for 18 government HCs, including 4 new CHPs. 11 of the HC budgets refer to LLG codes with the remaining 7 HCs referring to 4 DHAs. A large proportion of the HFG budget is budgeted as 143 grant transfers. It is not clear to which organizational entity – district administration, LLG administration or HC - these grants are transferred.
Explicit HC reference: explicit reference to HCs.

Morobe

6

Budget consistency: CoA codes mostly consistent – for the internal revenue (782) budget. No HFG appropriation in 2017.
MPA: 61%
Budget quality: The HF operations budget include integrated health patrols, but no provision for other operational costs. Medivac – patient transfers from the HC – are adequately budgeted assuming mission (M) HCs are incorporated.
There is no provision for HC indirect operations costs – vehicles, equipment etc.
Explicit HC reference: no explicit reference to HCs.

New Ireland

Budget consistency: CoA codes partly consistent. 5 activity codes are not found in the CoA. Most of the budget lines that reflect individual HCs appear in the activity texts of the budget line for the same activity code.
MPA: 11%
Budget quality: HF budget not clearly demarcated, pieced together from different sections of the budget. The HF budget seems to reflect Integrated health patrols interchangeably with Operations of rural health facilities. The internal revenue (715) development budget does not provide any further funds for HF operations in line with the CoSS.
Explicit HC reference: There are explicit references to individual HCs in the budget.

Hela

Budget consistency: CoA codes by and large consistent. Some activity codes contain texts depicting sometimes several different activities.
MPA: 49%
Budget quality: Fragmented HF budget spread across activities, including 3212 etc. The HFG budget does not cater for HC indirect operations costs – vehicles, equipment etc. whereas the 700-Health (recurrent) budget - total of K11,350,000 - indicates a budget of K500,000 for purchase of vehicles, but to where.
Explicit HC reference: 31 different HCs are referenced in the 700-Health budget. The number corresponds with the total number of HCs in Hela – 8 G-HCs and 23 M-HCs. 6 HCs are explicitly referenced in the HFG budget.

Sandaun

Budget consistency: CoA codes correct apart from 6 non-existing codes. Individual HC names are reflected in the activity text/description for activity codes within program 323x Rural Health Facilities and Outreach Health Patrols.
MPA: 44%
Budget quality: HF operations budgets contained with 323x Rural Health Facilities and Outreach Health Patrols. The budget does not seem to cater sufficiently for in particular patient transfers (by air) in line with the CoSS. No indication of budget for indirect HF operations – vehicles, equipment etc. – except for cold chain equipment with a budget of K336,000.
Explicit HC reference: The budget contains explicit references to HCs. Those HCs that are referenced all reconcile with the NHIS.

Oro

Budget consistency: CoA codes correct apart from 2 activity codes not found in the CoA. Individual HC names are reflected in the activity text/description for activity codes within program 323x Rural Health Facilities and Outreach Health Patrols.
MPA: 65%

Budget quality: HF operations budgets are budgeted correctly on the activity codes 3222, 3231 and 3232 with each referring to the LLG code in which they are situated. The HF operations budget – direct costs – compares reasonably well with the CoSS estimates. No indication of budget for indirect HF operations – vehicles, equipment etc., but relatively large construction budget of K1,008,200.
Explicit HC reference: The budget contains explicit references to 10 HCs, 8 of these can be reconciled with the 13 government (G) HCs registered in the NHIS.

SHP

Budget consistency: CoA codes are used incorrectly and inconsistently, and with almost no relation to CoA at all. Activity codes more or less sequentially numbered from 3201.
MPA: 58%
Budget quality: The budget more or less had to be re-built in order to make it comparable with the CoSS estimates. Activities were picked from across the entire budget based on activity descriptions from the district budgets. A total direct operations budget of K1,933,900 compares reasonably well with CoSS estimates of K1,795,648 for direct HF operations.
No indication of budget from the HFG for indirect HF operations – vehicles, equipment etc. whereas the internal revenue development budget contains a budget of 5 ambulances of K1,000,000.
Explicit HC reference: No explicit references to HCs.

Western

Budget consistency: CoA codes are used incorrectly and inconsistently, and with almost no relation to CoA at all.
MPA: 40%
Budget quality: MPA indicator of 19% would have been the result based on only the HFG. As the internal revenue budget contained most of the direct HF operations with specific HC references the MPA indicator was worked out on the combined HFG and internal revenue budget.
The budget was re-built to make it comparable with the CoSS estimates. The internal revenue budget contained most of the specific HF operations budgets Activities were picked out from across the entire budget based on activity descriptions from the district budgets. A total direct operations budget of K1,933,900 compares reasonably well with CoSS estimates of K1,795,648 for direct HF operations. 3444.7
Because of un-specified provision for "Medical Supplies & Equipment" of K3,444,700 in the HFG it was not possible to get indication of any budget from the HFG for indirect HF operations – vehicles, equipment etc. whereas the internal revenue development budget contains a budget for 5 ambulances of K1,000,000.
Explicit HC reference: The internal revenue budget contains explicit references to HCs.

WHP

Budget for health only provided as one budget line representing transfer to the WHP PHA. Not possible to get budget from the PHA

Simbu

Budget consistency: CoA codes are used incorrectly and inconsistently, and with almost no relation to CoA at all. Activity code 3232 – CoA: Rural Health Facilities and Outreach Health Patrols – contains all the HF operations budgets. The Simbu budget labels the activity District Health Administration. That the budget concerns HF operations, is indicated in the expenditure sub-item text
MPA: 47%

Budget quality: Total budget for HF operations amounts to K3,080,000. As most of this budget relates to K2,260,000 for 128 building maintenance, the budget is adjusted by the assumed capital element (construction, rehabilitation) of that budget to make it comparable with the CoSS estimates.
Budget of 2 ambulances for specific HCs (3232)and solar panels for HCs (3251) indicates that the budget does consider replacement of HC vehicles, although only for government HCs
Explicit HC reference: No explicit references to HCs.

WNB

Budget consistency: CoA codes are used incorrectly and inconsistently, and with almost no relation to CoA at all. HF operations budgets are identified from the activity texts of 322x and 323x. HF operations for these activities appear with budgets for individual HCs. This has been accommodated by renumbering activity codes so that they fit the HCs within each district
MPA: 51%
Budget quality: The main difference between the HF operations budget and the CoSS estimates is the indirect HF operations costs, i.e. the capital formation costs of replacement of HC vehicles and boats, medical equipment etc. CoSS estimate for indirect costs K 1,119,119 is only partly catered for through the internal revenue development budget that has set aside K150,000 for "Eseli/Sagsag Ambulance/Bialla N/v".
Explicit HC reference: The budget contains explicit references to HCs.

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