National Economic and Fiscal Commission

2019 Budget Fiscal Report

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Foreword

It is my pleasure to present to you the 2019 Budget Fiscal Report. This is the twelfth (12) edition of the report. The report on the Commission's operations is produced in accordance with Section 69 (1) of the Intergovernmental Relations (Functions & Funding) Act, 2009. This annual report publication forms part of the budget documentation to the National Executive Council and is required to be tabled by the Minister for Treasury in the Parliament.

This report is a report on annual operation of the National Economic & Fiscal Commission, in relation to its Constitutional obligations the functions stipulated under section 117 of 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. This report also provides to the members of the National Executive Council (NEC) the contribution and initiatives undertaken by the National Economic & Fiscal Commission (NEFC) to support the implementation of the decentralised fiscal reforms at the sub national levels of Government.

The NEFC has used the principles of (1) affordability (2) responsibility specifications between governments (3) funding follows function and (4) accountability and transparency. The consistency of warrants and cash flows has been assumed under the 'affordability' principle. However this has been problematic and has compromised the allocation of funds to the front lines of service delivery, planning, budgeting and execution of services as was evident during the Facility Based Funding reviews that were concluded by NEFC in 2018.

With the inception of the fiscal reforms in 2009, the NEFC has provided an enabling environment for implementing the reforms through a robust system of distributing government funding to lower levels of government. This included an evidence based "Equalization System" or the allocation of function grants. A legislated funding formula does not only take into consideration the cost of providing services but also a province's resource envelope - internal provincial revenues, to be able to provide basic service delivery. The amount of revenue that a province is able to generate has an impact on its ability to deliver basic services.

The key point of contact in the context of Fiscal Decentralization in Papua New Guinea originates by appreciating the relationship between the *"vertical and horizontal balances"*. At the sub-national level each province has differing fiscal capabilities in providing similar type service delivery functions as similar to the national government, therefore, shortfall in revenues among provinces requires equal share of national government revenue to perform these functions effectively and efficiently to service their population. The estimated cost of providing services was estaimated as K714 million in 2011, this increases to K968 million following the 2015 Cost of Services. The onus lies on each province to plan and budget strategically and to ensure that they use their resource effectively to meet the estimated cost of providing basic services estimated by the NEFC. This report provides the amount of function grants allocated to each province based on their fiscal capacity.

The NEFC has been proactive in progressing the fiscal decentralised reforms by working colloborately with our stakeholders DPLGA, DoF, DoT, DPM, DIRD and provincial and district administrations to strengthen the reforms.

The NEFC annual regional workshops were conducted at the four regional centres. The workshops were themed ' Back to Basic', intended to reinforce the principles of RIGFA. The workshops provide an opportunity for national and sub national agencies to meet and assist in addressing bottlenecks in service delivery. The 2018 regional workshops were no different to the former years and concluded with meaningful resolutions which were circulated to provinces and stakeholders.

The major studies conducted during 2018 included the 2015 & 2016 Provincial expenditure reviews (PER), the three year provincial revenue study to 2015, Facility Based Funding Reviews (District Facilities in 5 provinces), review of the PEFA road map indicator 18&19 and in addition to the function grant determination 2019, the NEFC also provided advice on the estimated costs of the three newly established City Authorities.

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

Overall, it is NEFC's intention that the various publications that it produces will periodically enable the villagers and the community at large to become informed recipients of government services, so much so that they 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 & Local Level Government Affairs, only comprises of approximately 4% of the entire GoPNG recurrent budget. The NEFC will continue to rigorously advocate that if service delivery is a priority, then government must diligently find ways to structure and ring fence the cash release regime for function grants which represent basic access to service delivery under the Constitution. This also ensure that service delivery providers are held more accountable for their performance.

The NEFC will continue to work in collaboration with our stakeholder agencies and donor partners 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 Alotau Accord II, MTDP III and Vision 2050.

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 role of NEFC on equalizing funding for service delivery represent a greater deal of greater ***"Fiscal Decentralization"*** in Papua New Guinea.

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 governments has increased significantly from K134 million to K562.7 million in 2019; which K506.1 million for provinces, K11.9 million for urban LLGs and K44.7 million for rural LLGs. This amount of funding was determined on a "needs based" system through the Equalization 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).

The key point of contact in the context of Fiscal Decentralization in Papua New Guinea originates by appreciating the relationship between the ***"Horizontal and Vertical Fiscal Imbalances"***. Each province has differing fiscal capabilities in providing similar type service delivery functions as similar to the national government, therefore, shortfalls in revenues among provinces requires an equal share of national government revenue to perform these functions effectively and efficiently to service their population.

The funding allocation for recurrent goods and services which is critical for service delivery in the provinces and local level governments solely depends on the amount of the Net National Revenue (NNR). The NNR is largely influenced by the total national government revenue envelope collected annually. The more the national government collects more revenue, the more the NNR increases, the lesser collection of revenue, and the lesser the revenue decreases. The NNR is calculated based upon the Department of Treasury's Final Budget Outcome (FBO) calculated and provided every year. The amount of NNR for next year's recurrent budget was K562.7 which 89.95% is shared among provinces and 10.05% of the total envelope is distributed among the 329 local level governments.

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 modeling exercise to determine the overall impact of declining revenue on grant allocations in the near future.

While RIGFA has focused on fiscal capacity, NEFC has reservations that resource–rich provinces, based on past trends will not sufficiently prioritize spending on basic service delivery. As a result, the NEFC has embarked on a modeling 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).

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.

The recent assessment of the impact of the reforms at the sub-national levels of government, especially at the facilities, identified that there were several issues relating to the context of systems and processes of RIGFA implementation. Cash disbursements from the national level to the provinces were slow and inconsistent with the warrant release schedule. The other challenge identified was funding available for the facility operation is insufficient and often release late for implementation. There was a need for proper structural adjustments and strengthening links between different levels of government administrative bodies responsible for implementation at the province and districts to maintain a unified system of implementation in the provinces and districts.

The NEFC is currently part of government policy initiatives, especially in providing advice on fiscal arrangements between different levels of government. The NEFC function forms part of the proposed Organic Law on Decentralization relating to the proposed Reform on Gradative Decentralization lead by the Department of Provincial & Local-level Government Affairs (DPLGA).

The NEFC is also a key stakeholder in the formulation of the Policy on Integrated Community Development and National AIDS Council. It played a huge role in providing advice and assisting the Department of Community Development & Religion with the PICD implementation and NACS on the National STI & HIV Strategy by developing a fiscal and costing framework including identifying the sources of funding for the implementation of the PICD policy. This will also involve mapping of activities and costs by providing cost estimates of running a DCD Centre and activities.

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 firmly 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.

Contents

1. 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 has been 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 responsibility 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 to which certain revenue sources are prohibited for provinces to collect revenue from. The main reason behind this is to avoid duplication of revenue collection, specifically for beer and cigarette taxes as it is already a part of the Goods & Services Tax imposed by the Internal Revenue Commission.

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.

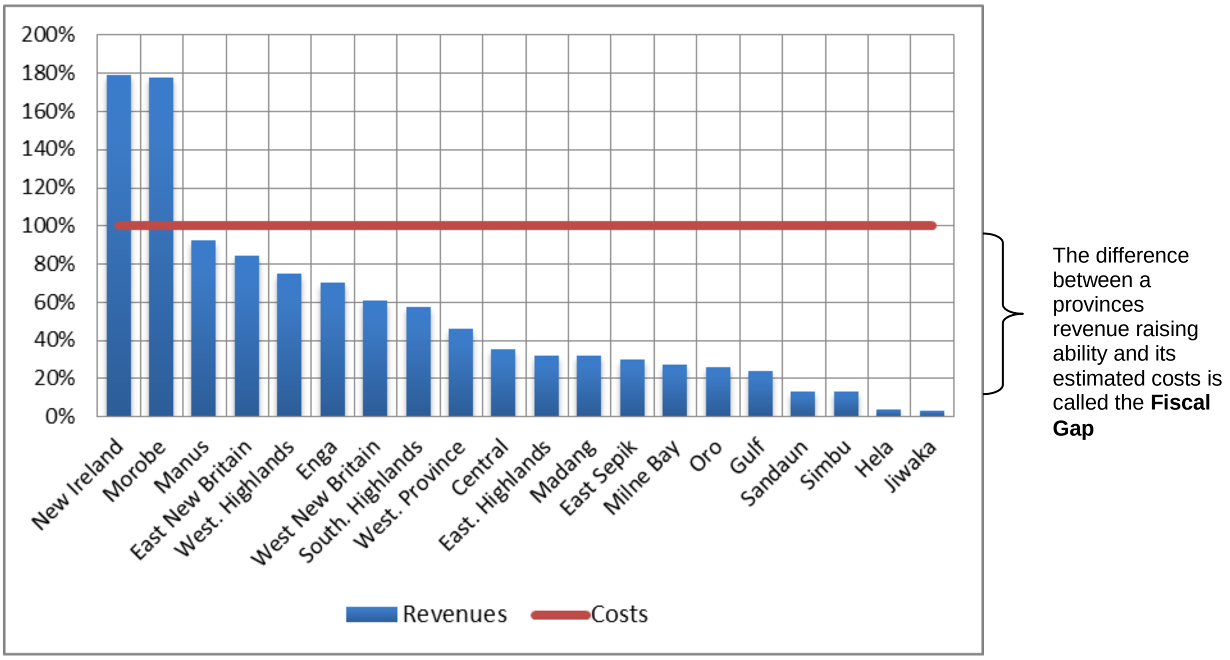
1.1. The Fiscal Gap

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 these responsibilities in order to calculate how much each Province and LLG requires to service their populations. Cost of delivering basic services differs from province to province due to each province 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 red line on the graph shown in Figure 1 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 invariably 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 2019.

Figure 1: Fiscal capacity of provinces compared to their estimated costs



In order to ensure that the provinces have sufficient funding to undertake their service delivery responsibilities, the national government makes available a series of grants to each province to assist for staffing and recurrent goods and services.

1.2 Reforms to Intergovernmental Financial Arrangements (RIGFA)

In the past, the Fiscal Gap was not fully covered for a number of provinces. This meant that some provinces did not have the ability to provide basic services to their people. At the same time, other provinces who had large mining operations, or other economic activity that could be taxed, received large revenues above what they needed to provide basic services. This resulted in instances 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 had 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 government, provincial government and LLGs, which is based on a percentage of the resources available to the government.

The new system also changed the way funds were 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 2018, 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 (DPM). The management of the staffing grant is highly centralised and is managed by the DPM and the Department of Treasurry (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. 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 outlines the process for determining the Function Grants and the amounts for 2019.

1.4 Role of the NEFC

The NEFC's primary role is to provide independent but objective advise to the 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 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.*

2. 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 2019

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 the *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 2019 was calculated using tax revenue data from 2017 (the second preceding fiscal year) in accordance with the following formula.

General tax revenue for 2017	**-**	**Mining and petroleum tax revenue for 2017**	**=**	**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	2016	2017	Difference
General tax revenue	Tax revenue	8,421.6 million	8,678.2 million	*256.6 million*
MINUS (-)				
Mining and petroleum tax revenue	Mining and petroleum taxes	92 million	113.6million	*21.6 million*
EQUALS (=)				
		2018 Budget	2019 Budget	
Net National Revenue Amount		8,329.6 million	8,564.6 million	*235 million*
Multiplied by (*) 6.57%				
Equalization Amount		**547.3 million**	**562.7 million**	***15.4 million***

For 2019 Budget, the minimum funding level for the equalization amount is calculated according to the following formula in million Kina:

Net national revenue for 2019 X 6.57% = NEFC estimate of 2019 equalisation amount

K 8,564,600,000 x 6.57% = **K 562,694,220**

As seen in the table above, the Equalization Amount for the 2019 Fiscal year has increased by K15.4 million, a slight climb from K547.3 million in 2018 to K562.7 million. The increase is essentially due to the improved higher total tax revenue collections in 2017 compared to 2016.

In accordance with the Act, the NEFC provided a written estimate of the equalisation amount to the Secretary for Treasury on 31 March 2018.

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 K562.7 **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 2019 Equalization Amount.

Overall, for the 2019 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		
2019 Equalization Amount	**K562.7 million**	**100.00%**
(Less) LLG Share	*K56.6million*	*10.05%*
Provincial Share	*K506.1 million*	*89.95%*

As shown in the table above, for 2019 Budget, provinces will receive a total funding of K506.1 million.

3. 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 2017 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 2019 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 2019.

Figure 2: 2019 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	9,429.3	6,942.5	10,071.8	2,838.3	348.7	95.0	1,454.3	384.6	31,564.6
Gulf	4,995.7	4,069.4	5,789.3	2,035.3	422.6	49.1	1,505.3	1,982.5	20,849.1
Central	6,903.3	7,137.8	11,768.1	2,877.8	555.2	88.0	2,796.6	2,142.6	34,269.3
Milne Bay	6,679.4	7,027.0	6,824.9	2,614.6	388.8	69.6	3,305.3	1,997.7	28,907.3
Oro	4,538.1	3,989.9	4,077.2	1,993.2	332.2	63.6	1,988.1	1,047.4	18,029.7
Southern Highlands	4,661.2	7,225.8	5,449.1	1,317.5	441.2	53.3	1,645.6	1,408.3	22,201.8
Hela	7,493.5	5,683.2	5,619.3	2,186.8	594.8	93.5	2,112.3	2,948.8	26,732.3
Enga	2,960.6	3,970.8	6,597.5	782.1	308.0	25.9	1,592.7	1,193.2	17,430.8
Western Highlands	3,361.8	3,217.4	4,576.2	1,059.0	359.1	53.1	955.1	849.3	14,430.8
Jiwaka	5,408.7	7,793.9	11,850.4	1,310.0	402.7	83.8	2,219.0	2,273.8	31,342.4
Simbu	7,025.7	11,041.0	11,756.5	2,001.4	788.5	90.3	3,244.8	4,144.0	40,092.1
Eastern Highlands	7,389.9	10,971.8	17,676.0	2,713.8	657.7	77.4	3,657.3	3,020.2	46,164.0
Morobe	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Madang	9,503.9	9,449.4	12,994.6	3,761.5	585.7	66.9	3,722.9	3,577.5	43,662.5
East Sepik	9,664.8	11,264.7	18,323.8	3,180.8	651.5	54.8	2,814.3	3,198.1	49,152.8
Sandaun	10,140.7	9,686.4	8,860.6	3,854.7	526.4	81.4	2,468.4	3,909.3	39,527.8
Manus	741.8	820.2	677.4	244.8	107.2	54.0	149.4	81.6	2,876.4
New Ireland	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
East New Britain	2,526.0	2,598.2	2,824.9	1,499.4	151.7	38.5	620.0	487.6	10,746.2
West New Britain	5,295.4	7,418.3	7,400.8	3,317.3	505.3	160.3	2,221.6	1,844.5	28,163.5
TOTAL	**108,720**	**120,308**	**153,138**	**39,588**	**8,127**	**1,299**	**38,473**	**36,491**	**506,143**

3.2 LLG Distribution

The table below shows the final amounts (in K'000) for the LLG grants by province for 2019. The Urban and Rural LLGs are shown separately.

Figure 3: Local-level Government share by Province for 2019 (K'000)

Province	Urban LLG Grants	Rural LLG Grants	Total LLG Grants
Western	718.7	2,768	3,486
Gulf	138.6	1,283	1,422
Central	0.0	1,922	1,922
Milne Bay	279.3	2,284	2,563
Oro	693.7	1,626	2,320
Southern Highlands	660.6	2,346	3,007
Hela	925.1	1,428	2,354
Enga	230.3	2,487	2,717
Western Highlands	773.2	1,808	2,581
Jiwaka	0.0	1,227	1,227
Simbu	366.2	1,403	1,769
Eastern Highlands	719.8	2,578	3,298
Morobe	2,404.9	4,555	6,960
Madang	847.2	3,635	4,482
East Sepik	633.9	4,050	4,684
Sandaun	475.7	3,667	4,143
Manus	209.2	479	688
New Ireland	393.9	1,041	1,435
East New Britain	865.5	2,515	3,380
West New Britain	539.9	1,574	2,114
TOTAL	**11,875.7**	**44,675**	**56,551**

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 yet 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.

4. 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.

4.1. 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.

4.2 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 (PLLSMA) 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.

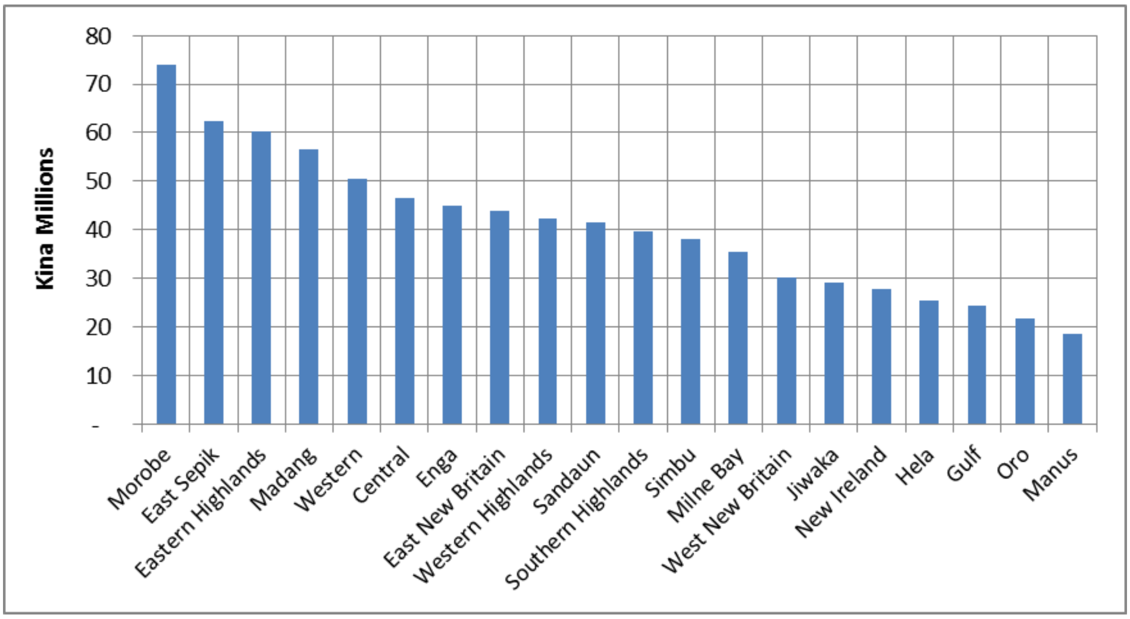
Cost of Service Estimate

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 2019 determination, the 2017 cost estimate is used. This maintains consistency between revenues and costs.

The graph below outlines the estimated costs for each Province in 2017.

Figure 4: 2017 Cost of Service Estimate by Province



4.3 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 2019 distribution year 2017 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 IRC. 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. 2017).

Bookmakers Tax

Bookmakers Tax is also administered by the Internal Revenue Commission.

Bookmakers Tax received by provincial governments are 40% 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.

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 2017 (the second preceding year), provinces raised K 61.5 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 2017 (the second preceding year), NEFC estimates that provinces received K141.4million 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 2017

Province	GST Distributions	Bookmakers Tax	Own Source Revenues & Others	Royalties	Dividends
Western	5,346,000	0	1,310,385	21,300,000	0
Gulf	930,060	0	276,728	0	9,485,000
Central	1,982,790	0	655,164	0	0
Milne Bay	9,358,880	0	326,051	0	0
Oro	5,276,740	0	706,657	0	0
Southern Highlands	4,912,050	0	2,506,262	20,471,642	0
Hela	693,420	0	304,450	0	0
Enga	2,971,430	0	16,419,568	18,990,000	10,000,000
Western Highlands	29,568,960	302,000	3,709,343	0	0
Jiwaka	799,930	0	0	0	0
Simbu	4,025,050	0	1,826,599	0	0
Eastern Highlands	16,929,910	433,000	3,591,736	0	0
Morobe	123,277,350	1,418,000	11,470,659	1,173,313	0
Madang	15,295,710	1,296,000	2,610,480	0	0
East Sepik	17,099,500	0	2,886,187	0	0
Sandaun	3,814,990	0	3,357,368	0	0
Manus	21,996,297	0	1,006,613	0	0
New Ireland	7,487,520	0	1,530,485	37,532,538	22,454,946
East New Britain	35,055,770	148,000	3,716,000	0	0
West New Britain	16,440,380	143,000	3,258,500	0	0
TOTAL	**323,262,737**	**3,740,000**	**61,469,236**	**99,467,493**	**41,939,946**

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.* (which is 40% of net inland collections).

4.4 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 2019 is outlined in the below table.

[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.

Figure 6: Fiscal Needs of Provinces for 2019 (Kina '000)

Provinces	Estimated costs	Assessed revenues	Fiscal needs	% of total fiscal needs
Western	54,101.0	23,041.2	31,059.8	6.2%
Gulf	26,326.6	5,810.9	20,515.7	4.1%
Central	50,137.1	16,415.1	33,722.0	6.8%
Milne Bay	37,966.8	9,521.0	28,445.8	5.7%
Oro	23,371.4	5,629.3	17,742.1	3.6%
Southern Highlands	44,389.2	22,542.4	21,846.7	4.4%
Hela	27,150.3	845.2	26,305.1	5.3%
Enga	48,525.2	31,372.8	17,152.4	3.4%
Western Highlands	45,925.6	31,724.7	14,201.0	2.9%
Jiwaka	31,641.0	799.0	30,842.0	6.2%
Simbu	44,389.2	4,938.3	39,450.9	7.9%
Eastern Highlands	64,584.4	19,157.9	45,426.5	9.1%
Morobe	78,970.3	131,369.0	0.0	0.0%
Madang	60,861.0	17,896.2	42,964.8	8.6%
East Sepik	66,909.2	18,542.1	48,367.1	9.7%
Sandaun	44,389.2	5,492.7	38,896.5	7.8%
Manus	19,830.9	17,000.5	2,830.4	0.6%
New Ireland	30,250.0	49,505.7	0.0	0.0%
East New Britain	47,636.1	37,061.0	10,575.1	2.1%
West New Britain	45,925.6	18,212.3	27,713.4	5.6%
TOTAL	**893,280.2**	**466,877.4**	**498,057.3**	**100.0%**

4.5 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 2019 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: 2019 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	31,059.8	6.2%	31,564.0	31,564.0
Gulf	0.0	20,515.7	4.1%	20,848.8	20,848.8
Central	0.0	33,722.0	6.8%	34,269.5	34,269.5
Milne Bay	0.0	28,445.8	5.7%	28,907.7	28,907.7
Oro	0.0	17,742.1	3.6%	18,030.1	18,030.1
Southern Highlands	0.0	21,846.7	4.4%	22,201.4	22,201.4
Hela	0.0	26,305.1	5.3%	26,732.2	26,732.2
Enga	0.0	17,152.4	3.4%	17,430.9	17,430.9
Western Highlands	0.0	14,201.0	2.9%	14,431.5	14,431.5
Jiwaka	0.0	30,842.0	6.2%	31,342.7	31,342.7
Simbu	0.0	39,450.9	7.9%	40,091.4	40,091.4
Eastern Highlands	0.0	45,426.5	9.1%	46,164.0	46,164.0
Morobe	0.0	0.0	0.0%	0.0	0.0
Madang	0.0	42,964.8	8.6%	43,662.3	43,662.3
East Sepik	0.0	48,367.1	9.7%	49,152.3	49,152.3
Sandaun	0.0	38,896.5	7.8%	39,528.0	39,528.0
Manus	0.0	2,830.4	0.6%	2,876.4	2,876.4
New Ireland	0.0	0.0	0.0%	0.0	0.0
East New Britain	0.0	10,575.1	2.1%	10,746.8	10,746.8
West New Britain	0.0	27,713.4	5.6%	28,163.3	28,163.3
Total	**0.0**	**498,057.3**	**100.0%**	**506,143.5**	**506,143.5**

4.6 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 300 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 300 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.

4.7 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 Morobe and New Ireland Province.

The *Intergovernmental Relations (Functions and Funding) Act 2009* introduced a five year transitional arrangement. This included a five year 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 of 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 2017,2018 and 2019 budgets. With the cessation of the transitional guarantees, Morobe Province was the only province ineligible to receive any function grants for 2017. In 2018, New Ireland Province also became ineligible 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 2019.

The NEFC has already engaged Morobe and New Ireland through various discussions to make necessary adjustments when framing its subsequent years provincial budgets. 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 2019 budget timeline.

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

5.1 Service Delivery Function Grants

Service Delivery Function Grants are provided to provincial governments to ensure that a minimum set of core services are adequately funded so as to benefit the majority of people across Papua New Guinea.

Section 65 of the *Intergovernmental Relations (Functions and Funding) Act 2009* serves as the basis on which the Secretary for the Department of Treasury may, in consultation with the National Economic and Fiscal Commission, determine the conditions over the administration of the following grants; As follows:

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

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

Service Delivery Function Grants are to be used exclusively for goods and services (operational costs) and not to fund salaries, capital or development costs unless specified in the Budget Expenditure Instructions.

The following service delivery function grants will be in operation in 2019;

- 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.).*

5.2 Administration Grant

This grant is to fund general overhead costs or meeting the day to day operational costs of the provincial administration.

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

5.3 Minimum Priority Activities and Performance Indicators

In 2009, the Secretary for Treasury issued Budget and Expenditure Instructions calling for provinces to adequately fund eleven specific service delivery activities. These eleven activities were identified as a basic provincial responsibility across the nominated five key function grant categories of Agriculture, Education, Health, Transport Infrastructure and Village Courts (all MTDS priority areas) and are known as the Minimum Priority Activities (MPAs).

These Minimum Priority Activities 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 MPAs and performance indicators are provided on the following pages.

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

*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 newly 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.

5.4 Improving Compliance of Conditions for Funding

Conditions for function grants (including the Minimum Priority Activities) and management of expenditure are provided for in the Function Grant and Administration Grant Determination and the 'Budget and Expenditure Instructions' issued by the Secretary for Treasury in August 2012. The Budget and Expenditure Instructions specify:

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

The Department of Treasury, in conjunction with the Department of Provincial and Local Government Affairs and the NEFC continue to work with provinces to improve the compliance of these Budget and Expenditure Instructions. The NEFC 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.The NEFC undertook a rollover study in 2017 to assess the main causes of the rollovers and the manner in which rollovers in the provinces are treated.

6. 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.

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. As compared to previous years, most of the provinces have attended the reviews.

It seemed apparent during the review that provinces are still being faced with the dilemma relating to issue of warrant and cash releases. Coincidentally, most provinces still operate on the rollovers made available from the first preceding year. Provinces have also indicated the use of internal revenue to maintain their operations.

Cash flow for service delivery to provinces remains slow

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. 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 and the Impediments

It was initially intended that while awaiting funding from the 2018 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.

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.

It was also obvious that there was continuous and one off releases of rollovers has previously experienced by some provinces 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 8. Monthly Cash Releases (including rollovers) in 2016

2016 Current Cash and Rollover Releases Expenditure -Selected Three (3) Provinces

Province	Type of release & expenditure	Jan	Feb	Mar	April	May	June	July	Aug	Sep	Oct	Nov	Dec	Total per province
East New Britain	Function Grants release and Expenditure	16,122	98,412	59,631	13,495	30,752	104,896	31,637	62,301	13,938	6,475	44,076	26,145	507,880
	Roll over Release and Expenditure	59,434	42,206	60,782	388,738	142,388	135,507	138,568	149,092	83,592	114,468	121,449	192,845	1,629,069
East Sepik	Function Grants release and Expenditure			564,805	1,272,499	1,571,522	3,821,936	4,544,416	3,544,416	3,870,259	4,463,382	3,982,854	5,895,000	33,531,089
	Roll over Release and Expenditure					50,400	26,990	14,520			20,600		2,151,825	2,264,335
New Ireland	Function Grants release and Expenditure								82,179	199,731	133,262	137,583	585,016	1,137,771
	Roll over Release and Expenditure					3,000	643,674	1,463,803	99,827	1,000,587	1,491,381	393,587	2,976,523	8,072,382
	Total exp per month	**75,556**	**140,618**	**685,218**	**1,674,732**	**1,798,062**	**4,733,003**	**6,192,944**	**3,937,815**	**5,168,107**	**6,229,568**	**4,679,549**	**11,827,354**	**47,142,526**

Data Source: PGAS - 2016

The 2012 Governor's conference was an avenue by which NEFC raised the issue on Cash Releases. Subsequently a resolution was passed 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 9. Quarterly Cash Releases (including rollovers) in 2016

Period	1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
% of Cash Released (2016)	**2%**	**9%**	**28%**	**62%**
% of Cash Released (2016)	**2%**	**17%**	**32%**	**48%**

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.

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.

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

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.

Because provinces are unable to borrow money, any shortfalls in revenues impact directly on their spending for recurrent goods and services. This has a negative impact on service delivery. However, 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 2018.

6.2. NEFC Regional Workshops

The 2018 NEFC workshops were conducted between May and June 2018. The four (4) workshops were held at the following regional centres: Southern Region in Central; Highlands Region in Morobe; New Guinea Islands in West New Britain and Momase region in East Sepik Province .

Overall, all workshops were successfully conducted with a total of more than 200 participants attending the four workshops. The target participants were from provincial administrations, budgeting staff, sector managers/advisors, and provincial treasury staff. However, most of the provinces had 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. The Department of Implementation & Rural Development was also included as part of the regional workshop team. The workshop was further enlightened with the participation of the Department of Transport and Department of Agriculture & Livestock. It was evident that stakeholders 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 the 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 needed to be addressed by the central agencies. *(Regional Workshop Resolutions are shown on the next page).*

The picture shows the 2018 Highlands Regional Workshops conducted in Lae, Morobe Province.

2018 Regional Workshop Resolutions ....

Theme: *"Back to Basics"*

Objective: **Engaging greater collaboration for Effective & Efficient Service Delivery**

2018 COLLECTIVE WORKSHOP RESOLUTIONS

Year	Res. No.	Resolution	Responsible Agency	What needs to be done
2018	OVERALL		All Provincial Administrations & National Agencies	That both provinces & National agencies continue to use the workshop to learn from each other and work collaboratively to improve on issues and challenges on service delivery at the sub-national level.
2018	STRUCTURED SCHEDULE FOR WARRANT AND CASH RELEASES		Department of Treasury / NEFC	DoT – Budget Division & NEFC 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

2018	Resolution 1	DEPARTMENT OF TREASURY - Budget Reforms	All Provincial Administrations	• Provincial sectors to begin dialogue with relevant National Departments for budget formulation • To adhere to the key changes in the budget reforms (e.g.: Multi-year budgeting) and the budget cycle
		DEPARTMENT OF TREASURY – Budgeting Issues	All Provincial Administrations	• Both Provincial & LLGs budgets must be submitted at the same time before the 31st January. • To comply with the Budget Circular by furnishing Quarterly Budget reports to Department of Treasury & Department of National Planning for both national grants, internal revenue & staffing manpower regardless of funding not provided for the Quarter • To adhere to the PFMA by attending Quarterly Budget Reviews despite delays in Cash Transfers • Review aging workforce and provide phased exits of aging workforce with costing's
2018	Resolution 2	IFMS Rollout/Chart of Accounts	DoT/DoF	• To work together with Provinces/Districts & PHA's in the implementation and roll out of IFMS and to also take into account issues relating to Chart of Accounts at both national and sub-national levels • To review IFMS issues of connectivity and compatibility with provincial financial arrangements structure
			All Provincial / District/ LLG Administrations	• To use current standard chart of accounts in their 2019 Provincial Budget submissions. Those provinces on IFMS to use unified IFMS chart of accounts which is slightly different from the PGAS chart of accounts

2018	**Resolution 3**	**Sustainable Development Goals, MTDP 3 and M&E Framework**	**DNPM/DPLGA**	• To carry out MTDP3 Regional consultation & Roll out • To work together with provinces to integrate SDG and MTDP3 into their provincial plans
			All Provincial/District Administrations	• To ensure that Provincial & District plans must be integrated with the SDG & MTDP3 (capturing the key sectorial activities)
2018	**Resolution 4**	**Revenue Generation**	**DNPM**	• To ensure provinces conform to the SDG and take on the initiative of strengthening provincial economies through Wealth Creation
			All Provincial Administrations	• To invest more in revenue raising measures such as supporting the Primary Production Sector and SME's as an avenue to encourage revenue generation within the province.
2018	**Resolution 5**	**Service Delivery Partnership Agreement**	**DPLGA**	• To assist provinces and concerned parties to implement the approved NEC Service Delivery Partnership Framework
			All Provincial Administrations	• To mobilize the processes at the political and administration levels to prepare for the facilitation of Service Delivery Partnership Agreements

2018	**Resolution 6**	**Drafting of five year development plans & Monitoring of SIP funds**	**DIRD/DNPM/DPLGA**	• To assist Sub national levels in reviewing and drafting their five year development plan
			DIRD	• To provide SIP performance report (***2013-2017, including project monitoring & expenditure***) to the National Government
			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.
2018	**Resolution 7**	**Health Sector**	**NDoH/NEFC**	• To continue to collaborate with NEFC to improve Facility Based budgeting and Direct Facility funding in all PHA provinces, in order to improve service delivery in rural areas in PNG.
			NDoH	• To collaborate with provincial administration to review the procurement process and distribution 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. • To conduct joint patrols between district & provincial staff, where possible engaging NGOs. • To commit to meeting the difference between health function allocated and the actual cost of services by entering into MOU with PHAs.
2018	**Resolution 8**	**Village Courts and Land Mediation**	**VCLMS**	• To review Village Court Act to accommodate for the Village Court Officials Ex gratia payments and the standard age limit for officials
			VCLMS/DJAG	• To liaise with provinces to ensure the information on revocations and appointments of village courts officials are updated in order for these officials to execute their responsibilities at their court areas
			VCLMS/DJAG/NEFC	• To establish MPA indicators for the Land Mediation

2018	**Resolution 8**	**Village Courts and Land Mediation**	**All Provincial Administrations & VCLMS**	• To ensure that village court areas are fully supplied with court materials, training manuals & other required necessities. • To conduct review on the performance of Village Court officials and submit recommendation for re-appointment or termination of appointments for VCO's appointed in 2014 & 2015. • To organize proper training for Village Court & Land Mediation Officers • To develop a Village Court & Land Mediation Administration Act to take ownership of the sectors implementation functions
			All Provincial Administrations, VCLMS & DPM	• To clearly align the provincial structure to include respective Village court & Land Mediation positions within the provincial administrations

2018	**Resolution 9**	**Education Sector**	**All Provincial/District Administrations**	• To submit enrolment forms to NDoE on a timely manner in order for the schools to receive TFF funds • To develop Sectorial & Divisional AAPs with budget appropriations on a timely basis • To assist by complementing the infrastructure component of TFF funds with internal revenue for school infrastructure maintenance. • To conduct joint patrols between District & Provincial Staff, where possible engage NGOs. • To review sector AAPs and AIS through a thorough planning process • To properly monitor activities implemented by the sector in compliant to the AAPS & AIS

2018	Resolution 10	Transport Infrastructure Sector	Department of Transport	• To develop a more robust statistical data management system • To develop a sea transport connectivity pilot project
			All Provincial Administrations and Districts	• To provide updated statistical data on roads, jetties wharves, small crafts and bridges to the Department of Transport • To coordinate & cooperate with the Department of Transport including PPP stakeholders to develop a shipping & rural air freight subsidy for your respective provinces
	Resolution 11	Primary Production Sector	DAL	• To strengthen partnership through MOU/MOA's with the National, Sub-National levels of government and commodity boards regarding service delivery in the primary production sector
			All Provincial Administrations and Districts	• To work in partnership with other sectors through conducting integrated patrols. • To provide copies of Section 119 Report to the Department of Agriculture & Livestock

2018	**Resolution 12**	**Administrative Sector**	**All Provincial Administrations**	• To consider and use the NEFC Cost of Services Estimate as a benchmark when planning and budgeting for Minimum Priority Activities (MPAs). • To collaborate & coordinate with Districts & LLGs in implementing their MPA responsibilities through joint patrols with respective service delivery sectors. • To align MPAs to Provincial/District/LLG Plans • To set up internal reporting arrangements based on planning & budgeting arrangements • To strengthen coordination with development partners
2018	**Resolution 13**	**Cross-Cutting-GESI**	**All Provincial Administrations & DPM**	• All provincial administrations through the support of DPM must implement the GESI Policy.

2018	**Resolution 14**	**MISCELLANEOUS**	**All Provincial Administrations**	• To continually work closely with districts and LLGs to improve regular and quality monitoring, reporting &evaluation systems. • To establish audit committees within the province. • To look into cost sharing activities by carrying out integrated patrols with other sectors • To develop your provincial "Yu Tok" presentations as per the Yu Tok template guideline and submit to the NEFC before the start of each Regional Workshops
			All Provincial Administrations / DPM/ DoT	• To seek DPM & DoT's assistance on processes and submissions for Retirement & Retrenchment
			NEFC	• To ensure that key relevant national agencies fully participate in future regional workshops to disseminate important government policies and reforms as well as address some of the lagging issues raised by the provinces

6.3. Assessing the quality of Provincial Budget Submission

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 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.

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 in 2016 which showed consistent performances by certain provinces.

Some provinces have done fairly well, however, there needs to be more improvement formulating annual provincial budgets so it makes expenditure more accurate and efficient. This will make it easier to monitor annual budget implementation.

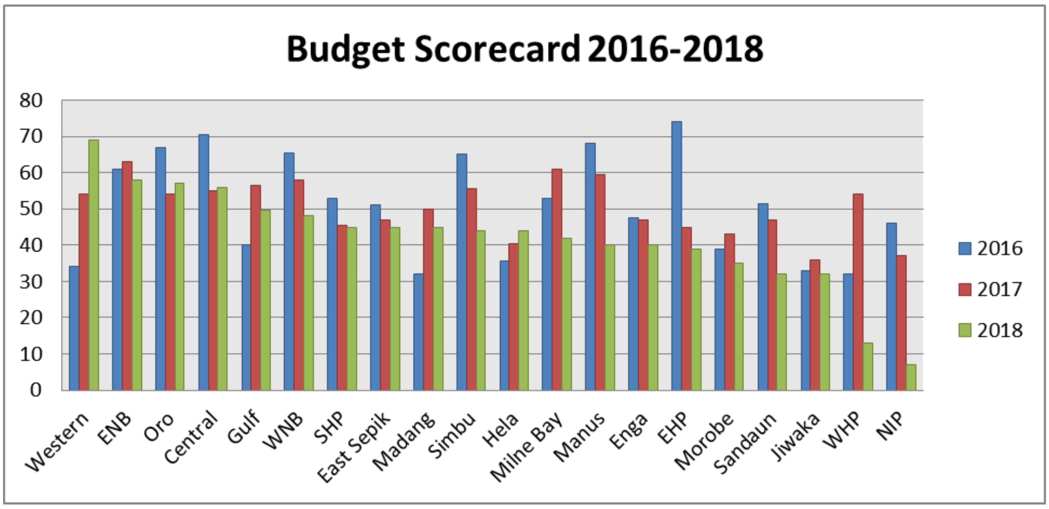


Figure 10: Ranking of Provinces' Performances based on a 3-year year trending

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 Kimbe for New Guinea Islands, Central for the Southern Region, East Sepik for the Momase Region and Lae 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.

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 undertook a study using the PGAS source basically to provide the 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 were 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

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 - Diagnositic 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. The cost was reviewed by NEFC in 2017. Subsequent proposals have been made 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) was 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.

PHA Advocacy Workshop: The use of the Health Function Grant

The PHA Advocacy Workshop is an initiative of NDoH and the NEFC, supported by the World Bank. The workshop coincided with the NEFC Annual Regional Workshops and was conducted in the third day of workshops in the four (4) regions including Highlands, New Guinea Islands, Southern and Momase.

The workshops were conducted to ensure that three (3) main objectives are achieved; firstly, raise awareness on NDOH's strategic policies and legislative reforms; secondly, consult with provincial health advisors to learn about challenges and opportunities related to the roll-out of the PHA reform; and finally, harmonize the implementation of health programs and activities in the provinces through the correct use of the Health Function Grants.

This has evolved as a result of the fragmentation of health service delivery that followed the introduction of the Public Hospitals Act in 1994 and the Organic Law on Provincial and Local Level Governments in 1995, led to a decline of health outcomes. In response to this concern, the Parliament of PNG passed the Provincial Health Authorities (PHA) Act in May 2007. PHAs were set up as voluntary arrangements between Provincial Governors and the Minister of Health with the main goal of reducing fragmentation in health service delivery by unifying all provincial health functions, including hospital management. The PHA Act was proclaimed in February 2008.

The participants were key stakeholders including National Department of Health (NDOH), provincial health advisors, provincial deputy administrators, provincial administrator financial advisors, National Economic and Fiscal Commission, Department of Finance, Department of Treasury, Department of National Planning and Monitoring, Department of Provincial and Local Government, Department of Personnel Management, civil society organizations (including Church Health Services), private sector agencies, and development partners.

Southern Region PHA Advocacy Workshop held at Dixies Bungalows, 17 Mile, Central Province

6.5. 2015 Provincial Expenditure Review *"Between the Lines"*

Based on the principles of affordability and increased accountability, the inter-governmental financing arrangements were introduced in 2009. The fiscal year 2015 was the seventh year of its implementation. The theme "Between the Lines" focused on the provision of Public Goods and Services on the part of provincial administrations by examining spending of the recurrent budget. Between the Lines examines expenditure from the viewpoint of the provincial administrations none the less, exploring new ways to capture expenditure at the front lines of service delivery. The bearing question that PER 2015 aims to answer is whether money is being spent in the right areas.

When reflecting on trends, in 2005, when the first Provincial Ependiture Review was carried out,a number of lower-funded provinces had just over one-fifth (20%) of capacity needed to deliver a set of basic services. In 2015, 17 provinces were able to meet their full fiscal need and, in theory, meet service delivery obligations. High resourced provinces like Southern Highlands, Morobe and New Ireland's' functional grant assignment accounts for less than 50 per cent of their estimated fiscal needs, while Manus, Sandaun and Simbu province have more than 90 per cent of their estimated fiscal need addressed by functional grants from the national government.

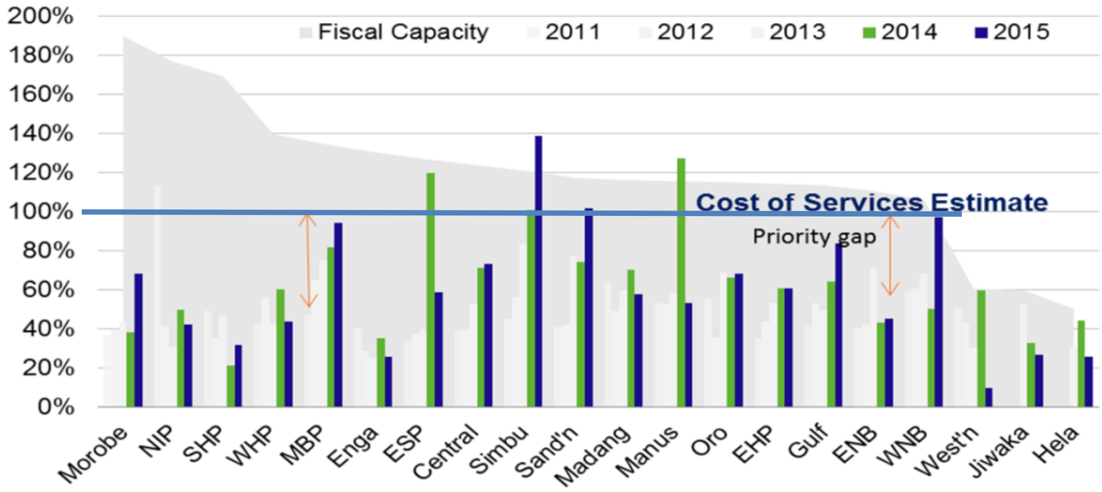


Figure 11: Graph showing ***cost of services as a benchmark (blue line at 100%), overall provincial spending (both function grants and internal revenue spending on operational (recurrent) expenses and fiscal capacity (grey area).***

The mother graph above depicts the position of 17 provinces having the fiscal capacity to meet their cost of services. The release of national funds in a timely manner and the reality of having all revenue sources available is very important to deliver service on time per budget given an apparent situation where there was a late release of national grant warrants and internal revenue, service delivery will eventually be afftected. A subsequent effect as shown from the graph is the priority gap. This occurs when a province has the revenue, but chooses to spend its money on other things which do not support core services. In observing the graph, one might have in mind the theoretical and practical nature of how the relations of Cost, Capacity and Performance might affect each other:

The 2015 PER results show that; there an increasing average spending trend in education and health sectors whilst transport infrastructure maintenance, agriculture and fisheries sectors show a decreasing trend. In carrying out a comparative analysis between administrative divisions and MTDP sectors, the results show that provinces are still spending more on administration. It is of high importance that all provinces properly manage their national operational funds and the internal revenue in terms of planning and budgeting so that service delivery activities can be effectively implemented in the priority sectors.

In 2015 it was assessed that provincial spending from internal revenue slightly decreased in comparison to 2014.

Subsequent to the decrease in the spending level, spending on MTDS sectors also fell. Administration spending which increased steadily to 2013 declined in 2014 and 2015, whilst spending on other sectors slightly increased in 2015.

The implementation of RIGFA has made an immense difference, with additional grant funding flowing towards Health, Education, Agriculture and Infrastructure Maintenance.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.

The PER 2015, also focuses on the expenditure on Minimum Priority Activities (MPA's). The contemporary analysis carried out identified existing issues with the compliance of coding against the chart of accounts, hence, having to actually identify expenditure on Minimum Priority Activities is still difficult on the PGAS. 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 2015. It should be re-emphasized 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,***Between the Lines,*** is the eleventh edition in the series and reviews the situation in 2015. The 2015 fiscal year is the fifth 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.

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 2015, 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. Charles Abel, MP, Deputy 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 , 2018

Deputy Prime Minister & Treasurer

Advice on Province and LLG Share Split

2019 Grant Calculation

Available funding for Provincial Governments from Ministeral Determination

Equalisation amount	K562,694,220	100%
(Less) LLG share	56,550,769.1	10.05%
Province Share (funding available to be distributed on basis of fiscal needs)	506,143,450.9	89.95%

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

* The Province Share is the total amount to be distributed amongst all provinces and comprises of 89.95% of the amount remaining after deduction from the LLG share of the Equalization Amount.

APPENDIX B: 2019 FUNCTION AND ADMINISTRATION GRANTS

Intergovernmental Relations (Functions and Funding) Act 2009

FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

I, **Hon. Charles Abel, MP, Deputy Prime Minister and Minister for Treasury,** by virtue of the powers conferred by Section 64 of the ***Intergovernmental Relations (Functions and Funding) Act 2009*** and all other powers enabling me, in consultation with the National Economic and Fiscal Commission, hereby make the following determination:-

1.0 AMOUNT OF SERVICE DELIVERY FUNCTION GRANT AND ADMINISTRATION GRANT

Subject to the approval of the Parliament, the amount of each service delivery function grant and administration grant to be made to a Provincial Government is the relevant amount set out in the attached table.

2.0 SERVICE DELIVERY FUNCTION GRANT

(1) Service delivery function grants are provided to Provincial Governments to ensure that adequate funding is directed towards to a minimum set of core services for all people across Papua New Guinea and consistent with the Government's Medium Term Development Strategy priorities.

(2) Service delivery function grants must not be used to fund salaries or capital development unless the budget allocation specifies that purpose.

3.0 HEALTH FUNCTION GRANT

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

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

(a) The distribution of medical supplies;
(b) Outreach patrols;
(c) Malaria supervision;
(d) Safe motherhood;
(e) Immunization;
(f) Water supply and sanitation;
(g) Health service monitoring, review and performance agreements.

4.0 EDUCATION FUNCTION GRANT

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

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

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

5.0 TRANSPORT INFRASTUCTURE MAINTENANCE FUNCTION GRANT

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

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

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

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

6.0 VILLAGE COURT FUNCTION GRANT

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

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

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

7.0 LAND MEDIATION FUNCTION GRANT

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

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

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

8.0 PRIMARY PRODUCT FUNCTION GRANT

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

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

9.0 OTHER SERVICES DELIVERY FUNCTION GRANTS

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

10.0 ADMINISTRATION GRANT

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

MADE this day of , 2018

Deputy Prime Minister & Treasurer

Function Grant Determination 2019

	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	9,429,340	6,942,508	10,071,795	2,838,338	348,678	95,037	1,454,301	384,638	**31,564,634**	718,731	2,767,756	**3,486,487**	**35,051,122**
Gulf	4,995,699	4,069,368	5,789,269	2,035,341	422,593	49,125	1,505,257	1,982,471	**20,849,123**	138,603	1,283,225	**1,421,827**	**22,270,951**
Central	6,903,322	7,137,757	11,768,050	2,877,762	555,198	87,984	2,796,642	2,142,621	**34,269,338**	0	1,921,744	**1,921,744**	**36,191,082**
Milne Bay	6,679,438	7,027,015	6,824,854	2,614,588	388,775	69,632	3,305,328	1,997,683	**28,907,312**	279,254	2,284,121	**2,563,376**	**31,470,688**
Oro	4,538,084	3,989,907	4,077,165	1,993,214	332,162	63,611	1,988,137	1,047,434	**18,029,714**	693,696	1,625,845	**2,319,541**	**20,349,255**
Southern Highlands	4,661,225	7,225,773	5,449,080	1,317,461	441,197	53,252	1,645,553	1,408,273	**22,201,813**	660,606	2,345,900	**3,006,506**	**25,208,319**
Hela	7,493,523	5,683,231	5,619,289	2,186,781	594,794	93,497	2,112,334	2,948,814	**26,732,263**	925,093	1,428,450	**2,353,543**	**29,085,806**
Enga	2,960,577	3,970,824	6,597,473	782,050	307,997	25,912	1,592,746	1,193,232	**17,430,811**	230,290	2,486,855	**2,717,145**	**20,147,956**
Western Highlands	3,361,757	3,217,397	4,576,163	1,058,955	359,070	53,099	955,080	849,304	**14,430,824**	773,207	1,807,664	**2,580,871**	**17,011,695**
Jiwaka	5,408,713	7,793,931	11,850,437	1,309,973	402,723	83,834	2,218,997	2,273,780	**31,342,387**	0	1,226,532	**1,226,532**	**32,568,919**
Simbu	7,025,681	11,041,034	11,756,459	2,001,395	788,472	90,308	3,244,788	4,143,976	**40,092,112**	366,160	1,403,245	**1,769,406**	**41,861,517**
Eastern Highlands	7,389,851	10,971,768	17,676,023	2,713,767	657,738	77,356	3,657,272	3,020,224	**46,164,000**	719,838	2,577,687	**3,297,525**	**49,461,525**
Morobe	0	0	0	0	0	0	0	0	**0**	2,404,902	4,554,710	**6,959,612**	**6,959,612**
Madang	9,503,892	9,449,405	12,994,640	3,761,507	585,675	66,938	3,722,921	3,577,480	**43,662,457**	847,183	3,635,095	**4,482,279**	**48,144,736**
East Sepik	9,664,817	11,264,660	18,323,795	3,180,789	651,478	54,781	2,814,333	3,198,114	**49,152,768**	633,874	4,050,464	**4,684,338**	**53,837,107**
Sandaun	10,140,652	9,686,359	8,860,623	3,854,688	526,357	81,358	2,468,434	3,909,288	**39,527,761**	475,724	3,666,883	**4,142,607**	**43,670,367**
Manus	741,771	820,226	677,382	244,820	107,176	54,027	149,424	81,590	**2,876,416**	209,187	478,804	**687,992**	**3,564,408**
New Ireland	0	0	0	0	0	0	0	0	**0**	393,905	1,041,018	**1,434,923**	**1,434,923**
East New Britain	2,526,003	2,598,167	2,824,859	1,499,368	151,701	38,519	620,008	487,614	**10,746,239**	865,530	2,514,817	**3,380,347**	**14,126,586**
West New Britain	5,295,408	7,418,342	7,400,768	3,317,297	505,278	160,260	2,221,599	1,844,527	**28,163,478**	539,879	1,574,290	**2,114,169**	**30,277,647**
TOTAL	108,719,752.27	120,307,670.76	153,138,125.15	39,588,094.22	8,127,062.67	1,298,529.06	38,473,152.52	36,491,064.25	**506,143,450.89**	11,875,661.51	44,675,107.60	**56,550,769.11**	**562,694,220.00**

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