National Economic and Fiscal Commission

2023 Budget Fiscal Report

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Foreword

I am delighted to have the opportunity to present the 2023 Annual Budget Fiscal Report. The National Economic and Fiscal Commission (NEFC) publishes this Report annually; this being the sixteenth edition.

The Annual Budget Fiscal Report seeks to provide a more reliable basis for informed public policy by focusing on the core fundamental objectives of fiscal decentralization with the precept of improving access to service delivery consistent with the development objectives of the government as well as the aspirational objectives of Vision 2050.

To support these objectives, both national and sub-national have to establish the balance between driving economic growth and funding service delivery needs. This report facilitates comparisons and ways in which Provincial Governments raise, collect and report on their revenues whilst at the same time sourcing funding from the national government as provided in the intergovernmental relations (functions & funding) Act of 2009.

A major event this year has been the national general election of which we have yet again experienced changes in the political arena whilst at the same time maintaining our service delivery responsibilities in serving our general population.

About maintaining an effective service delivery system, the Commission has embarked on an important exercise in reviewing the current intergovernmental financing arrangement (IGFAR). Being the Chair of the PLLSMA Sub-Committee on IGFAR with my Co-Chair from the Department of Treasury (DoT), have been tasked with the establishment of a working Committee that comprises eleven (11) important stakeholder agencies. I am happy to report that we have progressed seemingly well in 2022 with important consultative workshops undertaken that are intended to set the basis for implementation to come 2023.

There are prevailing issues in the current system and most of which have been mentioned in previous editions of this report. These issues will be addressed systematically through the Review as we envisage a gradual improvement to the system in the coming years.

Overall, the NEFC has been constantly maintaining its function as an independent advisor to the government on fiscal and economic matters and more importantly on agendas relating to the reforms on intergovernmental financing.

Finally, on behalf of the Commission, I hope that this publication will be of benefit to readers and decision-makers, and I welcome any observations or suggestions which may assist the Commission in improving the usefulness of this publication.

Patrick Kennedy Painap
Chairman & Chief Executive Officer

Executive Summary

Each year the National Economic & Fiscal Commission (NEFC) is required by law to produce to the Government and Parliament through the Minister for Treasury, a report on the workings of the NEFC and its function grant determination for the Provincial and Local Level Governments (LLGs). The Annual Budget Fiscal Reports are produced per Section 69 of the Intergovernmental Relations (Functions and & Funding) Act 2009 and under Section 117 (9) of the Organic Law on Provincial & Local Level Governments. These reports are required to be tabled in Parliament by the Minister for Treasury.

The following is a summary of the 2023 Fiscal Report giving the function grant determinations for 2023 and other key operational achievements of the NEFC in 2022. More detailed information on these milestones is given in the subsequent sections of this report.

Since the inception of the Reforms in Intergovernmental Financing Arrangements (RIGFA) in 2009, funding for provinces through the function grants has recorded substantial increases. Over the decade (2009 – 2023), more than K4 billion kina in functions grants has been given to the Provincial and Local Level Governments (LLGS) for service delivery activities. Funding for key sectors has increased in this decade for key service delivery sectors. Funding for provinces has also increased especially for provinces with low internal revenue capacities having benefited greatly from the equalization system of funding.

The total Function Grant Determination for 2023 is K642.1 million, an increase of K37.1 million from the previous year. The following summary table shows the function grant allocation for 2023 compared to 2022.

(Kina in millions)	2023	2022	Variance
Provincial Government Function Grants *	K571.4m	K534.3m	K37.1m
Local-Level Government Function Grants	K70.6m	K59.7m	K10.9m
Total	K642.1m	K594.0m	K48.1m
Major Sectors			
Health	K116.7m	K109.6m	K7.1m
Education	K134.9m	K125.9m	K9.0m
Transport Infrastructure	K170.3m	K160.6m	K9.7m

* This includes the health function grants which now go directly to the Provincial Health Authorities (PHAs) and not through the provincial governments.

Institutional and Sectoral Reforms

The IGFA system has spanned over fifteen (15) years with various agencies implementing structures of the reform and being guided by important pieces of legislation. By hierarchy of law, the system is established in the Organic Law on Provincial and Local Level Governments (OLPLLG) and its provisions are specified in the Intergovernmental Relations (Functions & Funding) Act of 2009. Within this period, several government interventions have been introduced that have directly impacted the functions and funding of the sub-national levels of government. These interventions are also subjected to key pieces of legislation

Government interventions are the direct introduction of the extension of functions imposed by the national government. These interventions can be seen as either institutional or sectoral. With the introduction of these extended functions, the IGFA system has to be reviewed to address an effective fiscal transfer system that encompasses government policies.

The current intergovernmental financing system has stood the test of time though, the evolution of additional functions has exerted pressure on the system thus drawing the need for a review. Hence, a review is now inevitable.

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List of Abbreviations

BEI	Budget Expenditure Instructions
CoSS	Cost of Services Study
DFAT	Department of Foreign Affairs & Trade
DoT	Department of Treasury
DPM	Department of Personal Management
DPLGA	Department of Provincial & Local Level Government
DSIP	District Services Improvement Program
EA	Equalization Amount
GST	Goods & Services Tax
IFMS	Integrated Financial Management System
IGFAR	Intergovernmental Financing Arrangement Review
IRC	Internal Revenue Commission
LLG	Local Level Government
MPA	Minimum Priority Activities
MRA	Mineral Resources Authority
MTDS	Medium-Term Development Strategy
NEC	National Executive Council
NEFC	National Economic & Fiscal Commission
NNR	Net National Revenue
PEFA	Public Expenditure & Financial Accountability
PGAS	Papua New Guinea Government Accounting System
PHA	Public Health Authority
PLLSMA	Provincial & Local Level Services Monitoring Authority
PSIP	Provincial Service Improvement Program
RIGFA	Reform of Intergovernmental Financing Arrangement
TFF	Tuition Fee Free

CHAPTER ONE: FINANCING SERVICE DELIVERY IN PNG

Papua New Guineas' intergovernmental financing framework was purposely established to address differences among provinces. Service delivery is and has always been a major concern of the national government. In its venture to address service delivery, necessary adjustments have to be made to maintain the principle of equity for all Papua New Guineans taking into account the perception of social and economic differences amongst provinces.

Having a highly centralized system, the national government raises approximately 95% of total tax revenues. Provincial governments in their capacity raise their own-source revenues, though certain revenue sources have been prohibited for provinces to collect mainly to avoid duplications. This can be seen from prohibitions imposed by the Internal Revenue Commission (IRC) on beer and cigarette taxes as this is already part of the Goods & Services Tax

The different levels of payments between PNG's three-tier government are subjected to legislation and guidelines which outlines what level of government is responsible for certain services and activities. These legislations also outline how provinces and LLGs can raise revenues.

The system recognizes the differences amongst the sub-national levels of government thereby, fixates the different imbalances that inhibit the implementation of service delivery within provinces. The two underlying imbalances that the system aims to address are:

1. The differing tax revenues and government spending requirements which can be referred to as **horizontal fiscal imbalances** &
2. the inability of provinces to raise revenues and spend according to their responsibilities- **vertical fiscal imbalance.**

As opposed to the horizontal fiscal imbalances, the inability of provinces to raise greater revenue calls for centralized tax collections by the national government. Provinces in this context are better placed to only deliver services.

The intergovernmental financial relations framework addresses both types of fiscal imbalances whilst serving other purposes, such as the national coordination of policies.

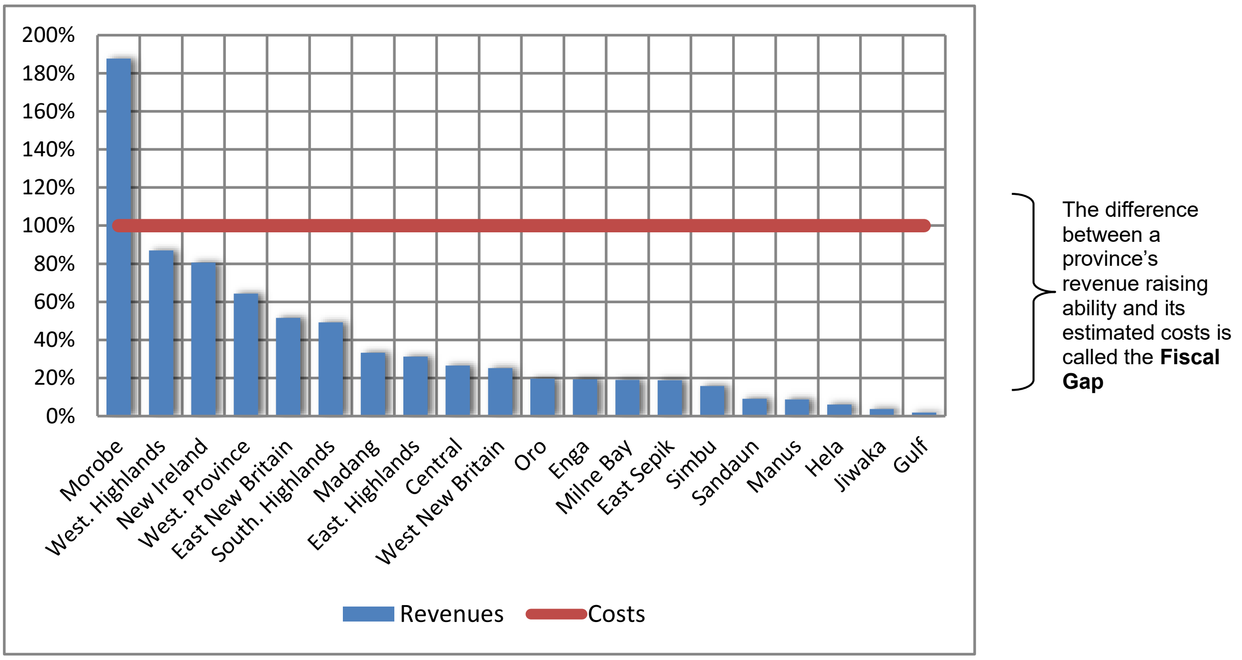
In addressing the coordination of national policies, the intergovernmental arena has since witnessed changes to the structures of the reform on intergovernmental financing with the inclusion of various government interventions in recent years. Within the last decade, several government interventions have been introduced that have directly impacted the functions and funding of the sub-national levels of government. These interventions are also subjected to key pieces of legislation such as the Provincial and Local Level Government Acts, the City Authority Act, the PHA Act, the DDA Act, the Fiscal Responsibility Act, and also other Acts that are not directly specified.

1.1 The Fiscal Gap

Function Grants are determined annually by the NEFC using a legislated formula. The formula takes into consideration the levels of responsibility of both the national and sub-national governments to provide services to communities. The cost levels within different provinces also differ mainly because of the unique characteristics that provinces bear. Some have large populations who live in easily accessible areas whereas others have small populations that live in difficult-to-access remote areas. The NEFC conducts a costing exercise once every five years of the critical activities undertaken by the provinces; this goes in line with their levels of responsibilities, hence, considering their characteristics.

Once provincial costs have been established, the national government looks into funding arrangements. Though from a funding perspective, provinces are restricted in what local revenue bases they are allowed to tax. There are limitations on certain taxes mainly because of the issue of duplication and hence, the centralized role of the national government in tax-imposed activities. The limitations imposed by the IRC on provinces in revenue raising result in a mismatch between the cost of delivering government services and the financial resources available to provinces to fund those services. This is known as the Fiscal Gap. The graph on the next page shows the fiscal gap for 2023.

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



1.2 Reforms on Intergovernmental Financial Arrangements (RIGFA)

The funding flow to the provinces has always been of paramount interest to the national government. Before 2009, provinces were receiving funds based on a "Kina per Head" system. In essence, this fiscal arrangement saw few provinces receiving the bulk of funds and others receiving less. The "Fiscal Gap" was not fully covered for several provinces. Hence, there were minor flaws that paved way for a non-equitable distribution of funds amongst provinces. Provinces that have larger revenue sources such as mines and other economic activities that could have been taxed were receiving larger revenues that were above what they needed to provide basic services.

Based on the principle of equal distribution, an Act had to be passed in which the key features would involve a larger revenue-sharing arrangement between the different levels of government. Eventually, the old system was reformed under the new inter-governmental financing arrangement approved by Parliament on 16 July 2008, and the *Ordinary Act* passed in 2009. The Reform brought astounding changes; one that focused on revenue sharing based on a percentage of the resources available to the government.

The new system also changed the way funds are being 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 result, ten years later, is that more funding is going down to all provinces, particularly, those provinces with low fiscal capacity.

1.3 Types of Grants

Over the last decade, the national government has been providing 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 centralized and is managed by the DPM and the Department of Treasury (DoT).

Development funding. Capital and human development funding is provided through a range of grants. These are projects specific while others are devolved grants provided for a range of activities. The Provincial Services Improvement Program (PSIP) provides each province with K5 million per District. The District Services Improvement Program (DSIP) provided K10 million per District, and most recently the Ward Services Improvement Program (WSIP) will be provided K10,000. Guidelines for the use of these funds direct that certain percentages must be allocated into sectors (health, education, infrastructure, etc.) but the specific projects are left to the discretion of decision-making committees in the respective Provinces, Districts, LLGs, and Wards.

Recurrent funding (function and administration grants). To provide basic services, each level of government requires funding for goods and services. These include items such as fuel to undertake patrols or materials for maintenance. The NEFC recognizes 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 capacities. It is expected that those provinces with high internal revenues can fund a larger portion of their recurrent costs.

Recurrent funding was the focus of RIGFA and is the main concern of the NEFC. Chapters 2 to 5 of this report outline the process for determining the Function Grants and the amounts for 2022.

1.4 Role of the NEFC

The NEFC provides advice 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 decides how the function grants will be distributed based on the advice provided by the 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 LLG's share. The NEFC follows several principles in making its recommendations *(The process of how NEFC allocates the Function Grants is in Chapter (4)*.

CHAPTER TWO: EQUALIZATION AMOUNT

Provinces are expected to receive a minimum level of funding annually. The amount that is allocated to provinces is known as the "Equalization" amount. This forms the pool of funding for the Function & Administration Grants. The revenue-sharing formula is embedded in Section 19 of the *Intergovernmental Relations (Functions and Funding) Act 2009.* Further, the equalization amount is then divided between individual provinces and LLGs. For the 2023 Fiscal Budget, the Equalization amount is calculated to be **K642.1 million** (*Detailed calculations provided on page.11*).

Since the transitional period, the prescribed percentage has been fixed at 6.57% of the Net National Revenues (NNR). Accordingly, the funding available for provincial & Local Level Governments increases or decreases as a proportion of the NNR concerning the prescribed percentage. The NNR amount is the total tax revenue received by the national government excluding mining and petroleum tax revenue. RIGFA emphasizes the revenue-sharing arrangements between the national government and provincial & local level governments. Coherently, if NNR 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- 2023

The *Intergovernmental Relations (Functions and Funding) Act 2009* sets out the formula for calculating the Equalization Amount. As specified above, this forms the funding pool to be distributed on an equitable basis between provincial and local level governments. The NNR is calculated using actual data from the second preceding fiscal year. Accordingly, the 2023 NNR was calculated using data published by the Treasury Department in the 2021 Final Budget Outcome which is usually on or before the 31st of March.

A written estimate of the equalization amount for the subsequent fiscal year is provided to the Secretary for Treasury on or before the 31st of March. The Secretary of the Treasury has the power to increase the amount. The Act states the Secretary of Treasury will then notify the NEFC of the increased estimate on or before the 30th of April of the same year. This estimate of the 'equalization amount' is a minimum amount and so can only be increased rather than decreased.

The following formula illustrates section 19 of the Act.

General tax revenue for 2021	**-**	**Mining and petroleum tax revenue for 2021**	**=**	**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 concerning any gas, mining, or petroleum activity.

Being highly volatile in nature, the Mining and Petroleum Tax Revenue is usually excluded to maintain stability in the province's pool of funding and stabilize the amount of funding to Provinces and Local-Level-Governments.

The following table shows how the NNR amount for 2023 was calculated:

Act Definition	Final Budget Outcome equivalents	2020	2021	Difference
Total Tax Revenue	Tax revenue	9, 223.7 million	10, 408.2 million	1, 184.5 million
MINUS (-)				
Mining and petroleum tax revenue	Mining and petroleum taxes	183. 4 million	635. 4 million	452.0 million
EQUALS (=)				
		2022 Budget	2023 Budget	
Net National Revenue Amount		9, 040.3 million	9, 772.8 million	732.5 million
MULTIPLIED BY (*) 6.57%				
Equalization Amount		593.9 million	642.1 million	48.2 million

For the 2022 Budget, the minimum funding level for the equalization amount is calculated according to the following formula in Kina million:

Net national revenue for 2021	X	6.57%	=	NEFC estimate of 2023 equalization amount
K 9,772,800,000	x	6.57%	=	**K642, 072, 960**

The total amount for 2023 (K642.1 million) has increased by K48.2 million higher than the 2022 total funding amount (K593.9.0 million). The increase is primarily due to high total tax revenue collections in 2021 compared to 2020. Given the increase in the 2023 total funding, most provinces' funding is expected to have some slight increases.

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

Equalization Amount

The Ministerial Determination that was issued by the Treasurer splits the equalization amount of **K642.1 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 11% of the 2023 Equalization Amount.

Overall, for the 2023 Budget, LLGs will receive funding of **K70.6 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		
2023 Equalization Amount	**K642.1 million**	**100.00%**
(Less) LLG Share	*K70.6 million*	*11%*
Provincial Share	*K571.4 million*	*89%*

As shown in the table above, for the 2023 Budget, provinces will receive total funding of **K642.1 million**.
The two components are funded from the equalization amount (EA) and distributed based on need.

CHAPTER THREE: RECOMMENDATIONS

Recommendations on the distribution of Function & Administration Grants to Provinces and LLGs are made to the Treasurer through Ministerial Determination. For the provinces, this recommendation is disaggregated according to the different service delivery function grants such as health or infrastructure maintenance. Within the province's overall sectoral ceiling, provinces are allowed to request minor shifts among function grants. The NEFC sets a maximum shift of no more than 10%. Treasury and NEFC usually negotiate with provinces that request changes allowing an agreement to be reached as to the revised split among the function grants.

The Treasurer is then advised of this shift through a negotiated recommendation from both the NEFC and Treasury. If accepted, the Treasurer then determines to formalize the splits amongst the provincial grants for the coming year's fiscal 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.

3.1. Provincial distribution

The table below shows the final amounts (in K'000) for each service delivery function grant for each province for 2023.

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	5,687.8	4,215.8	6,413.8	1,755.4	187.3	131.9	791.0	394.0	19,577.0
Gulf	6,128.0	5,264.5	7,550.6	2,790.2	611.3	112.0	1,882.7	2,800.2	27,139.4
Central	7,801.3	7,990.8	13,115.0	3,483.9	689.9	110.4	3,066.0	2,501.8	38,759.1
Milne Bay	7,138.3	7,495.1	7,409.9	3,106.0	435.6	93.0	3,328.7	2,240.8	31,247.5
Oro	4,797.4	4,249.2	4,310.6	2,187.7	345.1	76.6	2,027.0	1,332.7	19,326.4
Southern Highlands	4,665.3	7,229.4	5,455.1	1,320.8	441.9	53.5	1,650.4	1,409.5	22,225.8
Hela	7,400.7	5,567.2	5,522.1	2,155.8	576.0	91.3	2,081.4	2,895.8	26,290.3
Enga	6,288.7	10,627.0	12,540.5	5,298.8	1,258.9	263.6	2,068.2	2,857.3	41,202.9
Western Highlands	2,361.9	897.7	1,176.5	799.0	319.1	33.1	155.2	689.3	6,431.7
Jiwaka	5,628.3	8,298.2	12,506.8	1,372.7	418.3	100.0	2,295.8	2,351.9	32,972.1
Simbu	5,672.1	10,256.0	11,192.1	1,437.4	738.8	97.8	3,113.5	3,688.4	36,196.0
Eastern Highlands	7,300.2	10,662.9	17,430.3	2,700.7	638.3	94.8	3,671.4	2,912.8	45,411.4
Morobe	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Madang	9,309.4	8,779.6	12,344.0	3,608.4	534.9	26.7	3,686.2	3,459.6	41,748.7
East Sepik	9,857.8	12,854.5	21,104.6	3,732.0	712.4	107.2	3,015.6	3,895.5	55,279.7
Sandaun	10,650.1	10,152.2	9,093.5	3,985.7	533.6	88.6	2,526.7	3,953.0	40,983.4
Manus	2,332.6	3,627.1	5,976.2	1,876.6	526.6	90.8	1,885.7	2,423.0	18,738.6
New Ireland	1,310.0	1,278.0	1,469.7	543.2	447.3	319.5	383.4	639.0	6,390.1
East New Britain	5,964.8	5,349.2	5,094.4	5,350.8	564.4	107.3	1,307.8	762.7	24,501.2
West New Britain	6,358.6	10,076.3	10,590.3	3,671.7	682.5	204.6	2,930.4	2,509.0	37,023.3
TOTAL	**116,653**	**134,871**	**170,296**	**51,177**	**10,662**	**2,203**	**41,867**	**43,716**	**571,445**

Figure 2: 2023 Function and Administration Grants Determination (K '000).

3.2. LLG Distribution

The table below shows the final amounts (in K'000) for the LLG grants by Province for 2023. The Urban and Rural LLGs are shown separately.

Figure 3: Local-level Government share by Province for 2023 (K'000)

Province	Urban LLG Grants	Rural LLG Grants	Total LLG Grants
Western	901.8	4,578	5,480
Gulf	351.4	1,401	1,752
Central	0.0	2,838	2,838
Milne Bay	350.4	2,455	2,806
Oro	870.4	2,830	3,700
Southern Highlands	828.9	2,570	3,399
Hela	1,257.3	2,183	3,441
Enga	288.9	3,756	4,045
Western Highlands	970.1	2,113	3,084
Jiwaka	0.0	1,422	1,422
Simbu	459.4	1,571	2,030
Eastern Highlands	903.2	2,853	3,756
Morobe	2,704.3	5,811	8,515
Madang	1,033.4	3,937	4,970
East Sepik	795.3	4,337	5,132
Sandaun	596.9	3,880	4,477
Manus	262.5	524	786
New Ireland	494.2	1,203	1,697
East New Britain	1,086.0	2,757	3,843
West New Britain	677.4	2,778	3,455
TOTAL	**14,831.9**	**55,796**	**70,628**

CHAPTER FOUR: CALCULATING THE FUNCTION GRANTS

In calculating provincial and LLG grants on a need 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 financial need, calculate the share of the equalization 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 a more detailed description of 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 equalization system of the new intergovernmental financing arrangements, which also clearly highlights the fiscal need basis upon which provincial and LLG grants will be calculated.

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

Over the cause of the reforms, much clarification had to be put into understanding the financial needs of Provinces and LLGs. The underpinning definition of fiscal needs is essentially 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. Though, in a case where a province or LLG has a strong revenue base, this reflects a favorable fiscal capacity. For all intent, this shows strong assessed revenues against costs. The NEFC assesses this as having a fiscal need equal to zero. That is, it has the fiscal capacity to fulfill service delivery functions without additional revenue from the national government.

The amount that a province and LLG need is called the fiscal needs amount. This amount is calculated based on 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.

4.2.1 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*" is 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.

4.2.2 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" is 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.

Since the inception of the new system, the NEFC has predominantly been assessing LLG fiscal needs against the costs carried out at the district level in proportion to the district population. This has been a proxy for the assessment of fiscal needs at the LLG level mainly because of the unavailability of revenue data. Coherently, the NEFC assesses LLG revenues annually as equal to zero.

Urban and Rural Local-Level Governments have different assigned service delivery functions and responsibilities. Though having different revenues available to them, the question lies with how best the NEFC can gather these revenue data and assess them using the legislated formula. Eventually, the NEFC expects to obtain better information on the revenues of urban and Rural Local-level Governments and would then assess these more accurately.

4.3. Estimating the cost-of-service delivery

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

4.3.1 Roles and responsibilities - The Function Assignment

The reforms to the intergovernmental financial arrangements envisaged a fairer system of distribution of resources. 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 accurate estimating of the costs of the services they are supposed to provide.

In 2009, the introduction of the *Inter-governmental Relations (Functions and Funding) Act 2009* and the formal gazette of the Function Assignment Determination in June 2009 set out the roles and responsibilities of the Provinces and LLGs. The aim was to reduce the confusion and to provide certainty about the roles and responsibilities which contribute toward 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 Department of Provincial & Local Level Government Affairs 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 undertaking them. This is because the intention is to give the Provinces and LLGs the fiscal ability to deliver on all their responsibilities.

4.3.2 Cost of Service Estimate

The NEFC undertakes a costing exercise of all the functions of provincial governments every five 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 2023 determination, the 2021 cost estimate is used. This maintains consistency between revenues and costs.

The graph below outlines the estimated costs for each province in 2021.

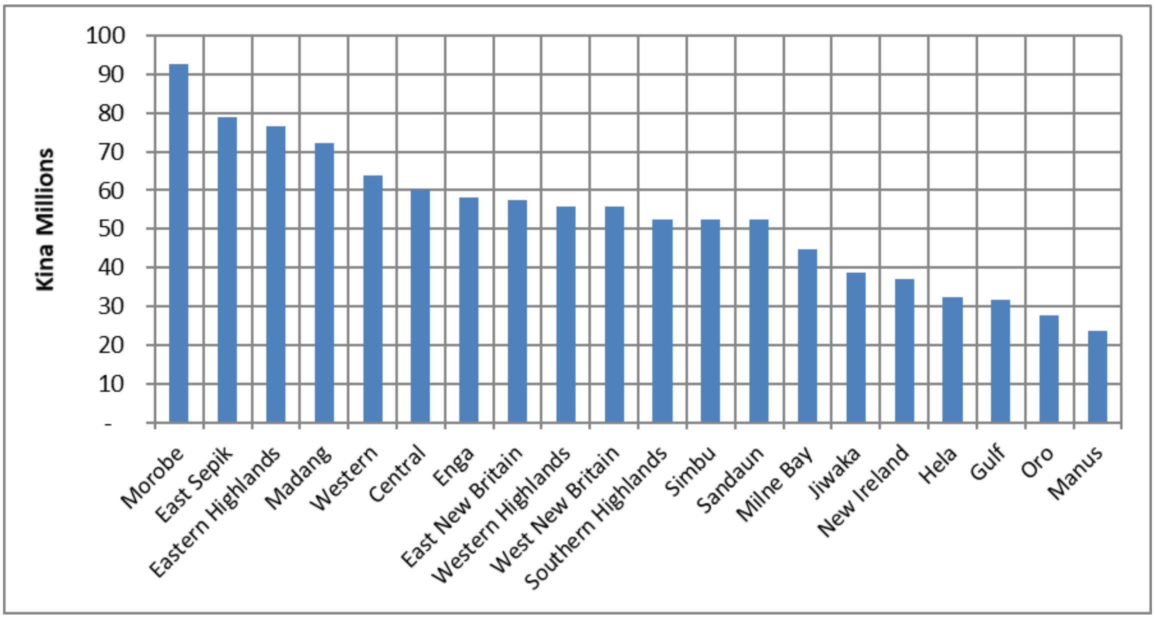


Figure 4: 2021 Cost of Service Estimate by Province

4.4. Assessed Revenues

The calculation of the available own-source revenues forms the second part of the formula to determine the financial needs of provinces. This need is quantified by calculating the difference between provincial revenues and the costs of assigned service delivery functions and responsibilities. By conforming to the formula, the NEFC is required to collect and assess revenue data for provinces. This process involves provinces extracting revenue data from their PGAS. However, with the introduction of the Integrated Financial Management System (IFMS), several provinces have transitioned into using this system. Like all other systems, flaws are inevitable. With this being the case, the collection of revenue data in 2021 from provinces was to some extent slow, as capacity issues were of concern.

The NEFC recognizes the use of this revenue source when carrying out assessments. 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 concerning the second preceding year to that fiscal year as this will be the last available year of actual complete data. That is, for the 2023 distribution year, 2021 revenues were assessed by the NEFC.

The sources of revenue are outlined below:

4.4.1 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 the National Budget Papers.

4.4.2 Goods and Services Tax

Provincial governments receive Goods and Services Tax (GST) distributions paid through the 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 concerning the second preceding year to that fiscal year as this will be the last available year of data. So, GST distribution for 2023 will be based on 60% of net inland GST collected from the second preceding year (i.e., 2021).

4.4.3 Bookmakers Tax

Bookmakers Tax is also administered by the IRC.

Bookmakers' Tax received by provincial governments is 40% of the revenues collected in the province in the second preceding year.

4.4.4 Own-source revenue

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

- licenses for liquor outlets.
- licenses for gambling establishments.
- motor vehicle registration and license fees.
- proceeds from business activities, rents, and sale of assets.
- provincial road users' tax.
- court fees & fines; and
- Other fees & charges.

The NEFC estimates that in 2021 (the second preceding year), provinces raised **K88.9** 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. It is well understood that several provinces have also transitioned into the Integrated Financial Management System (IFMS). The NEFC is aware that not all revenues received by the provincial governments are recorded accurately in PGAS & IFMS.

4.4.5 Mining and Petroleum Royalties

Provincial governments with mining and petroleum activities within their provincial boundaries may be entitled to royalties as a result of a 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 2021 (the second preceding year), the NEFC estimates that provinces received **K69.7 million** from royalty and dividend payments.

This data has been sourced directly from mining and petroleum companies and government agencies (Mineral Resources Authority (MRA) for mining projects, and Department of Petroleum and Energy (DPE) for petroleum projects) and directly from the companies themselves.

[1] This excludes Bookmakers Tax

Figure 5: Actual revenues collected by the province in 2021

Province	GST Distributions	Bookmakers Tax	Own Source Revenues & Others	Royalties	Dividends
Western	18,317,503	11,483	1,437,539	30,500,000	0
Gulf	503,261	0	400,255	0	0
Central	3,141,058	0	14,703,591	0	0
Milne Bay	8,830,928	0	1,907,567	0	0
Oro	5,698,490	0	1,319,606	0	0
Southern Highlands	9,251,407	0	8,465,596	19,352,526	0
Hela	2,308,946	0	0	0	0
Enga	3,963,260	0	18,677,948	0	0
Western Highlands	52,482,231	93,478	10,590,037	0	0
Jiwaka	1,683,660	0	0	0	0
Simbu	8,618,133	29,259	999,040	0	0
Eastern Highlands	25,067,294	152,032	2,249,093	1,677,311	0
Morobe	191,204,360	525,388	9,019,727	3,769,927	0
Madang	23,933,388	663,629	2,210,134	2,803,531	0
East Sepik	15,649,692	0	3,013,237	0	0
Sandaun	3,958,553	0	3,030,511	0	0
Manus	2,842,554	0	533,036	0	0
New Ireland	25,924,306	0	1,021,968	11,644,566	0
East New Britain	32,444,756	10,653	5,006,871	0	0
West New Britain	14,555,693	84,528	4,306,377	0	0
TOTAL	**450,379,472**	**1,570,450**	**88,892,134**	**69,747,861**	**0**

4.4.6 Assessing revenues

To calculate 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 Projects

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

ii) Own-source Revenues

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

iii) GST

- 100% of *GST* is distributed under the *Intergovernmental Relations (Functions and Funding) Act 2009* (which is 60% of net inland collections).

[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.

iv) Bookmakers' Turnover Tax

- 100% of *Bookmakers Tax* is distributed under the *Intergovernmental Relations (Functions and Funding) Act 2009.* (Which is 40% of net inland collections)

4.5. Calculating Fiscal Needs of the Provinces

Bringing together the estimated costs and assessed revenues of each province gives a calculation of fiscal needs. The calculation for 2023 is outlined in the below table.

Figure 6: Fiscal Needs of Provinces for 2023 (Kina '000)

Provinces	Estimated costs	Assessed revenues	Fiscal needs	% of total fiscal needs
Western	73,716.4	47,429.1	26,287.3	3.4%
Gulf	37,145.3	703.4	36,441.9	4.7%
Central	70,895.6	18,851.2	52,044.4	6.8%
Milne Bay	51,742.8	9,784.7	41,958.1	5.5%
Oro	32,309.1	6,358.3	25,950.8	3.4%
Southern Highlands	58,810.3	28,966.2	29,844.1	3.9%
Hela	37,610.6	2,308.9	35,301.7	4.6%
Enga	68,628.1	13,302.2	55,325.9	7.2%
Western Highlands	66,507.0	57,870.7	8,636.3	1.1%
Jiwaka	45,957.4	1,683.7	44,273.8	5.8%
Simbu	57,749.7	9,146.9	48,602.8	6.3%
Eastern Highlands	88,662.6	27,685.7	60,976.9	7.9%
Morobe	106,124.3	199,255.6	0.0	0.0%
Madang	84,003.7	27,944.9	56,058.8	7.3%
East Sepik	91,384.0	17,156.3	74,227.7	9.7%
Sandaun	60,505.0	5,473.8	55,031.2	7.2%
Manus	27,560.0	2,398.4	25,161.5	3.3%
New Ireland	44,331.4	35,750.9	8,580.5	1.1%
East New Britain	67,858.3	34,958.8	32,899.4	4.3%
West New Britain	66,507.0	16,793.4	49,713.6	6.5%
TOTAL	**1,238,008.7**	**563,823.3**	**767,316.6**	**100.0%**

4.6. Calculating Individual Province Shares

Once fiscal needs have been calculated, the next step is to apportion the shares of the equalization pool to determine the final amounts going to each provincial government. The calculation of fiscal needs recognizes that each province is different, and as such, each province will receive a different share of the equalization 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 2023, 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 fiscal needs amounts of the provincial governments that have fiscal needs amounts greater than zero for the relevant fiscal year.

Figure 7: 2023 Individual Province Share (K'000)

Province	**Estimated Fiscal Needs** (Estimated costs minus assessed revenues)	**Percentage of total fiscal needs**	**Funding based on percentage of total fiscal needs** ***(b)***
Western	26,287.3	3.4%	19,577.0
Gulf	36,441.9	4.7%	27,139.4
Central	52,044.4	6.8%	38,759.1
Milne Bay	41,958.1	5.5%	31,247.5
Oro	25,950.8	3.4%	19,326.4
Southern Highlands	29,844.1	3.9%	22,225.8
Hela	35,301.7	4.6%	26,290.3
Enga	55,325.9	7.2%	41,202.9
Western Highlands	8,636.3	1.1%	6,431.7
Jiwaka	44,273.8	5.8%	32,972.1
Simbu	48,602.8	6.3%	36,196.0
Eastern Highlands	60,976.9	7.9%	45,411.4
Morobe	0.0	0.0%	0.0
Madang	56,058.8	7.3%	41,748.7
East Sepik	74,227.7	9.7%	55,279.7
Sandaun	55,031.2	7.2%	40,983.4
Manus	25,161.5	3.3%	18,738.6
New Ireland	8,580.5	1.1%	6,390.1
East New Britain	32,899.4	4.3%	24,501.2
West New Britain	49,713.6	6.5%	37,023.3
Total	**767,316.6**	**100.0%**	**571,444.9**

4.7. Individual Local-level Government Share

The individual rural local-level share is the amount an individual rural LLG receives from the equalization 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 immediate 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 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 need 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. As stated in ***sub-section 4.2.2***, given the unavailability of revenue data, the NEFC has sought to use District costs and population as proxies for determining LLG costs. This method of assessing LLG fiscal needs narrows NEFC's assessment to be permissive with deriving a base cost for both Rural and Urban LLGs. 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, and 21% urban.

The rural LLG share is then further divided into the 300 plus individual LLG amounts, based on district costs and population in each LLG. Considerably, the NEFC understands the nature of the establishment of rural LLGs. Should new LLGs be gazette in the foreseeable future, LLG shares will have to be shared accordingly.

For urban LLGs, their funding is determined as their share of funding based on their assessed fiscal needs[3].

4.8. A note on calculating the determination

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

Due to the uncertain nature of forecasting, the calculated estimates may sometimes differ from 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 promptly.

4.9. Resource-Rich Provinces & the Funding Arrangements.

Since the inception of RIGFA, the reform has witnessed astounding shifts in funding arrangements. However, the NEFC has not shifted its attention to advocating for service delivery. The use of provinces' own-source revenues has always been of paramount concern. With lessons learned from the previous "Kina per Head" System, the reform plays a pivotal role in allocating funds for provinces in an "equitable" manner, more so, funding arrangements will have to be made on a needs basis. The NEFC takes into account provincial fiscal capacities when allocating funds. This process involves assessing provincial revenues to weigh out fiscal needs. Where a province's fiscal need is equal to zero, subsequently this means the province has the fiscal capacity to accolade service delivery.

This is consistent with the principles of the Inter-governmental financing arrangements where provinces with higher fiscal capacity (*higher revenues to meet the cost of services*) to provide for basic service delivery must utilize their internally generated resources to complement government funding.

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. This allowed resource-rich provinces like Morobe, New Ireland, and Western to continue receiving grants. The Arrangement ceased in 2016 and the transitional guarantee funding was last effected in the 2017 Budget. Accordingly, following the 2017 and 2018 Budget, Morobe & New Ireland province became ineligible to receive any function and administration grants.

New Ireland however, has since transitioned back into the system with a low assessed fiscal capacity resulting from an arrangement that facilitates the diversion of royalties directly to Districts which disadvantages the provinces' ability to effectively plan and budget for its service delivery obligations. Though ceasing the provincial portion of the grants to resource-rich provinces, the Rural & Urban Local-level Governments continue to receive LLG grants.

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[3] Fiscal needs in the context of assessing District costs in proportion with District population.

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

In 2020, the NEFC issued a letter to the Secretary for Treasury to remind provinces of the "Conditions of Funding", purposely on the use of function grants and roll-overs. The subsequent approach would involve the Secretary issuing a directive to provinces highlighting the conditions outlined in the Budget Expenditure Instructions (BEI). This was a necessary approach as assessments on the Service Delivery Function Grants showed misapplication on the use of these 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 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 NEFC, 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 2020.

- 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 Grants

This grant is to fund general overhead costs or meet 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 payments. This grant is intended 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 of Treasury issued Budget and Expenditure Instructions calling for Provinces to adequately fund eleven (11) 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 MPAs were arrived at after extensive consultation with national agencies, Provinces, and PLLSMA. MPAs should assist provincial governments to prioritise effective and targeted service delivery outcomes at the district and LLG levels.

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 **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 **minimum priority activities that 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 the labor ward i. Several months health facilities stocked with essential supplies in the last quarter i. A total number of health patrols conducted and then, a. Number of administrative supervision patrols to health facilities b. A number of patrols with specialist medical officers to health facilities c. A 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 number 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. A number of District Education Offices 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 inspections of village courts

*It is understood that the distribution of drug supplies is being managed through donor support. Whilst this activity was identified as a minimum priority activity, proper assessment and monitoring of this activity are 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 also understood that the establishment of the TTF has induced provinces to use the Education Function Grants for other activities. The NEFC still maintains its objectivity by encouraging provinces to fund the distribution of school supplies as TTF is only a policy and NEC decision and can be changed anytime.

The Land Mediation Function Grant as it was created in 2016 is yet to establish its minimum priority activities and its performance indicators through another consultation process with key stakeholders such Department of Treasury, Department of Finance, Department of Justice & Attorney General, and Provincial Administrations.

5.4 Improving Compliance with 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, continues to work with provinces to improve compliance with these Budget and Expenditure Instructions. The NEFC has undertaken a series of budget workshops with all provinces to further improve budget compliance with the use chart of accounts coding and other budget scorecard criteria.

CHAPTER SIX: ISSUANCE OF WARRANTS AND CASH RELEASES

6.1 Provincial Warrant Release Review

The Provincial Warrant Release Review is a target activity undertaken by the NEFC to review and assess the release of funds from the national government to the sub-national governments and to make recommendations and advise the subnational governments respectively on fiscal transfer matters.

The NEFC has been undertaking this important activity as a study since its establishment and the first subnational warrant release review was conducted and report published in 2004. Since the first review and publication of the warrant released report, it has received positive feedback as it addresses issues surrounding; the schedule and timely release of funds to the provinces, funds released accordingly as per budget/funds allocated over-commitment, and high rollovers.

However, the activity was left long outstanding since the last Warrant Release Review was conducted and the report published back in 2017 due to provinces transitioning from PGAS to IFMS.

6.2 Importance of the Review

The review focuses on functional grants – warrants released to the provinces as they are the main recipients of the funding. The review is conducted annually every quarter in line with the subnational quarterly budget review schedule.

It assesses the schedule, timeliness, and percentage (%) released from the total function grant funds allocated by provinces by sectors, and by local level governments (LLG).

The activity involves the collection of the provincial warrants release schedule and data, analysis, and publication of the provincial and LLG warrant released reports.

The review is conducted per the PFM Act and Inter-governmental Relations (Functions & Funding) Act on functional grants and fiscal transfers and complying with requirements of the Open Government Partnership (OGP) and Public Expenditure and Financial Accountability (PEFA) on fiscal transparency and accountability.

The following will outline an overview of the review conducted for the fiscal years of 2018, 2019, 2020, and 2021 mainly on trends and analysis of warrants released for both the provincial and LLG administrations respectively.

Total Warrants Released by Year by Region

Total Functional Grants - Warrants Released by Years			
2018	**2019**	**2020**	**2021**
K489,420,503	K523,815,408	K547,471,852	K601,370,519

Outlined above is the trend analysis of function grant warrants released to the provinces.

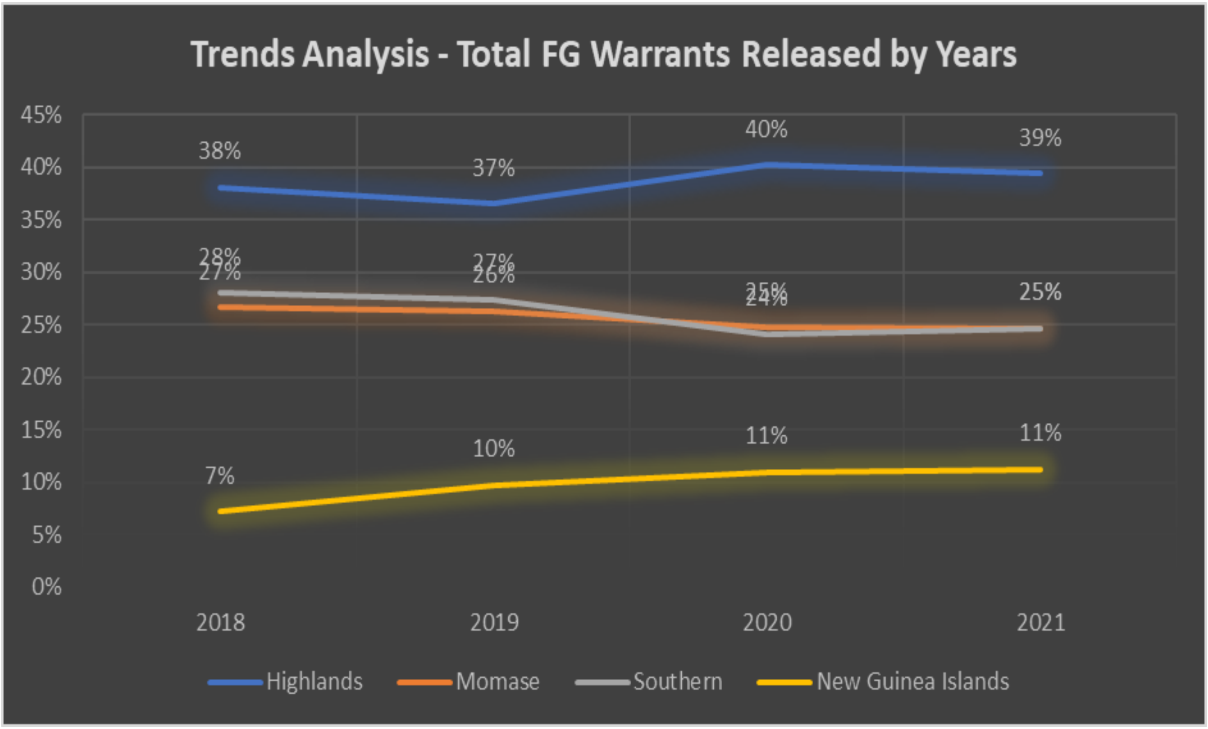

Figure 8. Total warrants released for years respectively across the regions measured in %.

Analysis: The difference in the % received by regions, is the number of provinces in the regions. The Highlands Region has consistently been receiving over 40% of their function grants whilst other regions shared the remainder. The NGI region is the least with warrants released below the 15% quartile over the years 2018-2021.

6.3 Warrants Released by LLGs

Outlined below is the trend analysis for warrants released by LLGs measured in % out of the total allocated for each year.

LLG warrant release for the years 2018 – 2021 only captures the LLG grants released to the LLGs. The following table shows the total for each year, while the graph depicts the total % received by LLGs in each region for each year respectively from 2018 – 2021.

Total LLG Grants - Warrants Released by Years			
2018	**2019**	**2020**	**2021**
K55,000,679.00	K57,085,190.50	K60,544,227.00	K67,594,478.00

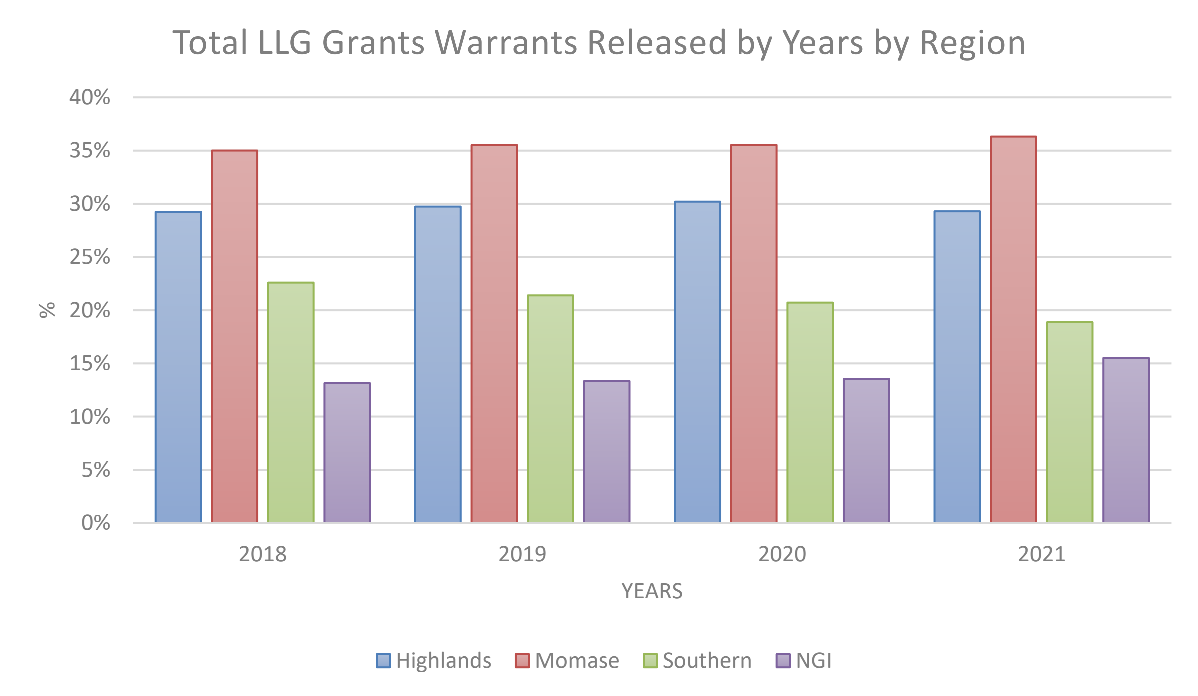

Figure 9. The Highland region can see consistency, whilst the Momase region can see a consistent increase as well. The Southern region saw a decrease in grants to the LLGs, whilst in comparison, the NGI region saw a considerable increase in grants to the LLGs as well over the years.

CHAPTER SEVEN: INTERGOVERNMENTAL FINANCING ARRANGEMENT REVIEW (IGFAR)

7.1 IGFAR- The Strategy & Framework

Due to issues relating to intergovernmental financing and ineffective service delivery, the national government has given directions for relevant agencies to review the current intergovernmental financing system. The Alotau Accord 2 explicitly called for the review of the current intergovernmental financing system. In September 2020, the Provincial and Local Level Service Monitoring Authority (PLLSMA) established the Intergovernmental Financing Arrangement Review Sub Committee to undertake a comprehensive review of the current intergovernmental financing system and make appropriate recommendations to the national government. The National Economic & Fiscal Commission (NEFC) and the Department of Treasury (DoT) have been tasked as chair and deputy chair respectively of the PLLSMA Sub Committee.

The IGFA Review is a whole government approach and will be undertaken more holistically and cohesively. The issues of the current intergovernmental financing system are cut into all major sectors, sub-national governments, and other stakeholders engaged in service delivery. Therefore, a wider consultation with relevant stakeholders will be a critical part of the review. To help achieve this, the PPLSMA Sub Committee established to drive the review, comprises senior officers from the key national departments and agencies. This list is not inclusive as relevant stakeholders can become part of the review committee as and when necessary.

Key Issues

- Fragmented and multiple sub-national funding systems: There are numerous fiscal transfers uncoordinated within the sub-national financing system (e.g., PSIP, DSIPs, Function Grants, District Support Grants, PIPs, Special Support Grants, national agency spending, Tax Credit Schemes, Development Partner funding, etc.). Capital and Recurrent funding are not integrated.
- Inconsistencies – Functions & Responsibilities: There is an overlap in the functions and responsibilities for each level of government or institutions at the sub-national levels resulting

- in duplication, overlapping, inconsistencies, and confusion as to "who" should do "what" and be accountable for funding to perform the assigned functions.
- Ad-hoc and Concurrent Reforms: Ad-hoc & concurrent institutional and legislative reforms such as DDAs, PHAs, City Authorities, and greater autonomy arrangements, have also posed a challenge in terms of the financial arrangements for these institutions.
- Affordability Issues: The government has been struggling to adequately fund sub-national budgets. Late releases of funds and issues relating to rolled-over budgets continue to affect budget performance and execution.
- Equity Issues: Not all provinces and districts and the same in demographic, economic development, and fiscal capacity. The cost of delivering a similar set of services varies in all the provinces/districts.
- Limited Sub-national Revenue Mobilization: Currently the generation or collection of revenue at sub-national revenue is very weak. Sub-national levels tend to be entirely dependent on national grant transfers. There is less incentive within the current system for provinces to improve internal revenue generation.
- Governance, accountability, monitoring, and reporting issues: Weaknesses in the monitoring and reporting systems have led to poor accountability. What is missing is performance reporting that brings together financial, performance, outcome, and impact information.

Main Objective

- Recalibrate the current intergovernmental fiscal arrangements for an integrated, efficient, and effective system that supports the National Government's decentralization reforms.

Key Broad Outcomes

The following are the key expected outcomes of the review. While these outcomes are very broad, it reflects the very key issues of the current intergovernmental financing system. The intent of the review is not to stop at the policy recommendation level but to work on modifying and implementing an improved system.

- A Clear Demarcation of Decentralized Administrative and Financial functions and responsibilities of different levels of government and institutions
- Affordable and equitable intergovernmental fiscal transfer system based on equalization principles and promoting development priorities through proper costing that reflects remoteness and accessibility
- National Governmental fiscal transfers are done based on funds following the function principle.
- Improved sub-national fiscal capacities and empowered revenue mobilization opportunities through tax-sharing arrangements and non-taxing options.
- Affordable and equitable intergovernmental fiscal transfer system based on equalization principles and promoting development priorities through proper costing methodology that reflects remoteness and accessibility
- Integrated planning and budgeting coordinated through a more cohesive approach with good governance and accountability mechanisms of financing systems such as public finance management (PFM) systems.
- Effective Policy, Institutional, and Legislative frameworks of the fiscal decentralization systems
- Effective and more integrated monitoring, evaluating, reporting & learning system.

Key Strategic Focus Areas

The review will primarily look at the following key focus areas. It is intended that research and analysis in these areas will provide insights into the issues, and views and explore practical solutions to issues in the current intergovernmental financing arrangement system.

#	Strategic Focus Area	Action
1	Fiscal Decentralization & Revenue Mobilization	Review the current fiscal decentralization pillars – namely 1. **Expenditure assignment** (who is to do what at all levels of governments and government sponsored institutions (functions and responsibilities), 2. **Revenue Assignment** (who is supposed to collect what tax?) Taxing options available for sub nationals to raise their own internal revenue base. 3. **National government transfers** to correct vertical and horizontal imbalances (equalization) and also funding for targeted government priority areas. 4. **Sub national borrowing** to balance their budgets is an option to look at in the review.
2	Integrated Development Planning and Budgeting	Review the current planning and budgeting systems and practices at various levels of governments. The strategy is to have planning and budgeting practices coordinated in a more cohesive and holistic manner.
3	Public Financial Management (PFM)	The review will look at the current PFM platforms at different levels of governments. This is critical in managing sub national funding in an integrated manner in terms of governance, monitoring and reporting.
4	Policy, Institutional and Legislative Framework	The review will look at the policy, institutional and legislative arrangements and frameworks adopted under the current sub national funding systems. In the integrated system these policy, institution and legislative arrangements needed to be framed in a more cohesive and coordinated manner.
5	Monitoring & Evaluation	The IGFAR will look at the current Monitoring & Evaluation systems used under different systems of sub national funding and an M & E framework under the integrated system.

Figure 10. Key Strategic Focus Areas of the Review.

Major Deliverables

In the process of the review period, the following are some expected key deliverables or outputs. expected to deliver some key output

1. Wide consultation & Desk Reviews undertaken
2. Reports - progress reports, information papers, and consultation reports
3. Major Report of the review with s and recommendations
4. Major policy paper to the NEC with selective recommendations
5. A modified and improved integrated intergovernmental financing system
6. Successful Implementation of the Improved and Integrated System
7. An effective Monitoring, Evaluating & Reporting system for the integrated system

Review Framework

The scope of the work will compromise five (5) phases. It is estimated that the 5 phases will take four (4) to five (5) years but this is subject to the progress of the review.

Phase One	**Consultation & Target Studies:** A complete review of the current IGFA systems is undertaken through key studies and wider consultation with key stakeholders. Major Report with findings and recommendations	2022/2023
Phase Two	**Policy Development:** Based on the findings in phase one, develop and make a major policy recommendation to the National Executive Council (NEC).	2023/2024
Phase Three	**Adjust/Modify:** Based on the outcome of the NEC on the policy submission and parliament decision, design, develop and/or modify the current system.	2024/2025
Phase Four	**Implementation:** Implement the modified and integrated fiscal decentralization system.	2025/2026
Phase Five	**Monitor, Evaluation, Reporting, and Learning** Develop and implement an integrated fiscal decentralization monitoring, evaluation, reporting, and learning system.	2026 onwards

7.2 IGFAR- A Progressive Update

The following are the key activities that were undertaken in progressing the review. Given the magnitude and complexity of the review, it has progressed well.

2020 – September

The IGFAR commenced in September 2020, when the Provincial, Local Level Service Monitoring Authority (PLLSMA) decided to establish the PLLSMA Sub Committee to undertake the intergovernmental financing review. The National Economic & Fiscal Commission (NEFC) and the Department of Treasury (DoT) were appointed as Chair and Deputy Chair of the Sub Committee. This paved way for the review of the current intergovernmental, financing system.

2021

The following are key milestones achieved in 2021 and 2022 as part of the PLLSMA Sub-Committee on IGFARs commitment;

- The PLLSMA Sub Committee (SC). The PLLSMA Sub Committee membership on IGFAR was successfully established. This Sub Committee to head the review comprises senior officers from 11 key national departments and agencies. This list is not inclusive as relevant stakeholders will become part of the review committee as and when necessary. This team will play a critical role in providing the leadership and overall coordination of the review project to ensure that the expected deliverables and outcomes are achieved.
- PLLSMA SC Meetings. Three (3) SC meetings were successfully held in 2021. These meetings were crucial in providing leadership and setting the direction of this important review.
- Terms of Reference (TOR). The TOR for the IGFAR was developed setting the scope and parameters of the review.
- IGFAR Strategy. The IGFAR Strategy was developed setting out the main objective, broadly expected outcomes, key focus areas, key deliverables, resource requirements needed for the review, potential risks, and timeframe of the review.
- IGFAR Technical Working Groups (TWG). A technical working group comprising senior technical officers from key national departments and agencies was successfully established in 2021. These officers are from the national departments and agencies that make up the PLLSMA Sub Committee. The TWG will be responsible for all technical work of the review including research, stakeholder engagements/consultations, and compiling all required reports and outputs.
- IGFAR Funding: The national government has supported the review with an appropriated budget in the national budget.

2022

- IGFAR progressed in 2022 and the following are key milestones achieved in that year. It must be noted that the progress of the review slowed in the early part of the year because funding for the review was not released until the 2nd half of the year when half of the appropriated funding was released. This has helped to implement the plans and progress the work in 2022.
- PLLSMA SC Meetings. Due to a delay in funding, only two PLLSMA SC meetings were held in 2022 to continue the progress of the review.
- Technical Working Groups (TWG) Meetings. The TWG progressed in the year with initial meetings and deliberated on strategies and actions to take on the key focus areas of the review.
- Presentation to National Members of Parliament. The Chairman of the PLLSMA Sub Committee who is also the Chairman and CEO of the NEFC made a presentation on IGFAR to the Members of Parliament during the induction period of the 11th Parliament Sitting.
- Technical Working Groups (TWG) Workshops. The TWG workshops are very crucial for the technical team to prepare properly before embarking on the next steps in undertaking

- desk reviews and stakeholder engagement and consultations. In the workshops, the TWG critically looks at the key focus areas of the review, established methodologies, and plans for undertaking the desk reviews and stakeholder consultations. Three TWG workshops were successfully conducted in 2022.

APPE NDICES:

- ***APPENDIX A: DETERMINATION APPORTIONING THE EQUALIZATION AMOUNT***
- ***APPENDIX B: FUNCTION AND ADMINISTRATION GRANTS DETERMINATION***
- ***APPENDIX C: REVISED BUDGET AND EXPENDITURE INSTRUCTIONS***

APPENDIX A: DETERMINATION APPORTIONING THE EQUALIZATION AMOUNT

DETERMINATION APPORTIONING THE EQUALIZATION AMOUNT

Inter-Governmental Relations (Functions & Funding) Act 2009

DETERMINATION APPORTIONING THE EQUALIZATION AMOUNT

I, **Hon. Ian Ling-Stuckey, MP, Minister for Treasury,** by the 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 11 percent 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 the deduction from that equalization amount from the total of the amounts calculated under Clauses 1 for that fiscal year.

3. **MEANING OF TERMS**
   Under 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** **, 2022**

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Minister for Treasury

APPENDIX B: FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

Intergovernmental Relations (Functions and Funding) Act 2009

FUNCTION AND ADMINISTRATION GRANTS DETERMINATION

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

1 AMOUNT OF SERVICE DELIVERY FUNCTION GRANT AND ADMINISTRATION GRANT

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

2 SERVICE DELIVERY FUNCTION GRANT

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

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

3 HEALTH FUNCTION GRANT

(1) A health function grant must be used to fund operations 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 EDUCATION FUNCTION GRANT

(1) An education function grant must be used to fund operations 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 TRANSPORT INFRASTRUCTURE MAINTENANCE FUNCTION GRANT

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

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

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

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

6 VILLAGE COURT FUNCTION GRANT

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

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

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

7 LAND MEDIATION FUNCTION GRANT

(1) A land mediation function grant must be used to fund operations 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 PRIMARY PRODUCT FUNCTION GRANT

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

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

9 OTHER SERVICES DELIVERY FUNCTION GRANTS

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

10 ADMINISTRATION GRANT

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

MADE this day of , 2022

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Minister for Treasury

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

9 August 2011

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

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

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

1 Background

1.1 On Wednesday 16th July 2008, the National Parliament passed amendments to the *Organic Law on Provincial Governments and Local-level Governments* establishing a new system for funding goods and services in Provinces and Local Level Governments.

1.2 The new system covers goods and services grants for all Provinces, *except the National Capital District and the Autonomous Region of Bougainville* which are both subject to separate legislation.

1.3 Grants for personal emoluments continue to be determined through the normal Budget process.

National Government Funding

1.4 Under the new system, the amount of funding provided to Provincial and Local-Level Governments for goods and services is set at a specified percentage of actual revenue from two years proceeding the Budget year. The legislation specifies the proportion of this net national revenue that should be provided.

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

Focus on functions

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

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

2 Purpose

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

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

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

3 Legal Framework

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

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

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

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

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

4 Funding for Functions

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

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

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

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

Function Grant Funding only available for the stated purposes

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

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

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

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

Service Delivery Function Grants and Administration Grant

Health Function Grant

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

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

Education Function Grant

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

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

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

Transport Infrastructure Maintenance Function Grant

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

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

Village Court Function Grant

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

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

Primary Production Function Grant

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

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

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

Other Service Delivery Function Grant

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

Administration Grant

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

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

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

Local-level Government Grants

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

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

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

Urban Local-level Government Grant

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

5 Minimum Priority Activities

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

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

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

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

5.5 The minimum priority activities are:

Primary Production
Agriculture Extension
Fisheries Extension
Forestry Extension

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

Health
Rural Health Facilities
Outreach Health Patrols & clinics
Drug distribution

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

Village Courts Operations
Provision of operational materials

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

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

6 Provincial Budgets

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

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

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

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

Revenue - Correct PGAS Grant Codes

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

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

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

Expenditure - Correct PGAS Activity Codes

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

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

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

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

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

6.11 It is now compulsory that a standardized chart of accounts must be used from 2012 budget onwards both under the 200 and 700 series,

6.12 The expenditure Code structure to treat the former years grants will be as follows:

Grant Type	Indicator Code	Vote Code
Recurrent Grant	1	27111013101
Development Grant	2	27121013101
Local Level Government	3	27131013101
Former Years	4	27141013101
Former Years	5	27151013101

6.13 The details Revenue Code structure are shown as "Attachment C".

7 Monitoring and Reporting on Performance

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

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

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

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

7.5 Provinces will be required to report against these indicators from second quarter of 2011.

8 Restrictions on Rollovers

General restrictive approach to Function Grants Rollovers

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

8.2 In the normal course of business, Provinces should actively work towards spending their service delivery function grants throughout the Budget year. In the event that Provinces do not fully spend their Function Grants, they should 'roll-over' the unspent National Government funds to remain in the Provincial Government Grants Account (PGGA) and create specific Revenue Heads in the following year ('200 Series') estimates.

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

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

- AdministrationHealth Function Grant Former Year's Appropriation;
- Other Service Delivery Grant Former Year's Appropriation;
- Health Function Grant Former Year's Appropriation;
- Education Function Grant Former Year's Appropriation;
- Transport Infrastructure Maintenance Function Grant Former Year's Appropriation;
- Primary Production Function Grant Former Year's Appropriation; and
- Village Court Operations Function Grant Former Year's Appropriation.

8.5 Where a Province intends to roll over one or more service delivery function grants, it must include accurate estimates of the rollover in its Provincial Budget, with the rolled over funds shown against the relevant revenue vote from paragraph.

The Department of Treasury will not approve Budgets that fail to clearly roll over unspent function grants into the correct revenue votes.

8.6 If a Province continually fails to fully spend its service delivery function grants, Treasury will consider re-allocating the funds to a Province with a better track record.

9 Penalties for Non-Compliance with Budget and Expenditure Instructions

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

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

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

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

10. Contact Officers

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

Lazarus Enker	312 8739
Dessie Kuburam	312 8786
Graham Ararua	312 8784
Robyne Joshua	312 8785
Richard Lucas	312 8787

11. Conclusion

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

SIMON TOSALI
Secretary

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

"Attachment A"

Quarterly Minimum Priority Activity Indicators

Minimum Priority Activities (MPAs)	Agreed Indicators
Health	
1. Operation of Rural Health Facilities	i. Total Number and Names of all Health Facilities (HFs) ii. No. of Health Facilities (HFs) open & staffed iii. Number of HFs with access to running water in labour ward
2. Outreach Health Clinics and Patrols	i. Total number of health clinics and patrols conducted ii Number of administrative supervision patrols to HFs iii Number of patrols with specialist medical officers to HFs iv Number of maternity child health patrols to HFs
3. Drug Distribution	i Number of months HFs stocked with essential supplies in last quarter
Education	
1. Provision of School Materials	i. Total number of schools by type ii % of schools that received basic school supplies before 30 April
2. Supervision by Provincial/ District Officers	i. Number of schools visited by district/provincial education officers
3. Operation of District Education Offices	i. Number of District Education Offices that provided quarterly performance reports to Provincial Education Officers
Transport Maintenance	
1. Road and Bridge Maintenance	i. Names and length of provincial roads maintained ii. Names of bridges maintained
2. Airstrip Maintenance	i. Names of rural airstrips maintained
3. Wharves and Jetties Maintenance	i. Names of wharves, jetties and landing ramps maintained
Primary Production	
1. Extension Activities for Agriculture, Fisheries and Forestry	i. Number of extension patrols and training sessions conducted ii. Number of people who attended extension and training sessions
Village Courts	
1. Operation of Village Courts	i. Number of village courts in active operation ii. Number of village courts supplied with operational materials

"Attachment B"

Chart of Accounts Guide for MPAs

The Provincial Chart of Accounts has 14 digit Coding, i.e.

Sample Chart of Accounts

	A			B	C				D	E	F			G		
1	**2**	**3**	**-**	**4**	**5**	**6**	**7**	**-**	**8**	**9**	**10**	**11**	**-**	**12**	**13**	**14**

Part A – Digits – 1,2,3 = Division Identification
e.g: 271 – Western Province

Part B – Digit – 4 = Activity or Project Code
i.e: '1' = Activity (Recurrent Expenditure)
'2' = Project (Development/Capital Expenditure)

Part C – Digits – 5,6,7 = Cost Centre (Location of Expenditure)
i.e: PHQ, District & Local Level Government

Part D – Digit – 8 = Grant Code (refer to Section 6.5 of Revised BEI 09, pg 7)
e.g: '1' for Administration Grant
'3' for Function Grants
'4' for Rural LLG Grant

Part E – Digit – 9 = Function Code (refer to Section 6.5 of Revised BEI 09/10, pg 7)
e.g: '1' for Administration
'2' for Health Function
'3' for Primary Production Function
'4' for Education Function

Part F – Digits – 10, 11 = Activity/Project/Programme
Numbers – 01 to 99

Part G – Digits – 12,13,14 = Expenditure Item Code

Eg:

Activity Description: **Operations of Kerowagi District Education Office**
Correct Vote: 280 – 1050 – 3210 – 123
i.e. 280 for Simbu Province
'1' for Recurrent Activity
'050' for Kerowagi District
'3' for Function Grant
'2' for Education Function
'10' District Education Office Operations &
'123' Office Materials & Supplies