



DEPARTMENT OF TREASURY
Budgets Division

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BUDGET CIRCULAR 5/2008

9 July 2008

CIRCULAR LETTER TO:

All Provincial Administrators

ALLOCATION OF BUDGET CEILINGS AND PREPARATION OF 2009 NATIONAL BUDGET SUBMISSIONS – PROVINCIAL ADMINISTRATIONS

1. PURPOSE

The main Purpose of this Budget Circular 5/2008 is to:

1. advise Provincial Administrations/Governments (Provinces) of their 2009 Budget Ceilings;
2. advise Provinces of the policy framework underpinning the 2009 Budget;
3. advise agencies of the revised funding arrangements for Provinces under the Review of Intergovernmental Financing Arrangements (RIGFA) and of transitional arrangements that will apply if the RIGFA legislation does not pass Parliament;
4. provide guidance to Provinces on the form and content for their 2009 Recurrent and Development Budget Submissions; and
5. seek Provinces' detailed 2009 Budget Submissions, by cob **11 August 2008**.

It is important that all Provincial Administrators ensure that their Provinces' obligations are met and that officers responsible for preparing the 2009 Budget Submission are provided with copies of this Budget Circular.

It is also important that officers responsible for preparing 2009 Budget Submissions read this Budget Circular closely and ensure that they comply with the requirements of the Circular. Please contact Budgets Division in the Department of Treasury if you need help understanding this circular.

2. STRUCTURE OF BUDGET CIRCULAR

This Budget Circular includes the following information to assist Provinces to formulate and submit their 2008 Budget Submissions.

- *Section 3* provides details on the **2009 Budget ceilings**;
- *Section 4* outlines the **key dates** for agencies to submit their 2009 Budget Submissions;
- *Section 5* provides the **policy principles** behind the formulation of the 2009 National Budget, and the priority funding areas based on the Government's development policies;
- *Section 6* explains the **revised Budget process** for Provinces under RIGFA, and advises of interim arrangements if the necessary legislation does not pass Parliament before the Budget;
- *Section 7* explains the different **recurrent grants** available to Provinces and LLGs, and, how they should be spent;
- *Section 8* provides the instructions for agencies to formulate and submit their 2009 **Recurrent Budget Submissions**;
- *Section 9* explains the instructions for agencies to formulate and submit their 2009 **Development Budget Submissions**; and
- *Section 10* lists key **Contacts** within the Department of Treasury (Treasury) and the Department of National Planning & Monitoring (DNPM).

3. 2009 BUDGET CEILINGS

The 2009 Budget Ceilings have been set to enable the Government to meet its targets under the *Medium Term Fiscal Strategy 2008-2012*, the requirements of the *Fiscal Responsibility Act 2006* that the Budget be in balance over the term of the Government, and the improved funding arrangements for Provinces arising from RIGFA. The ceilings seek to meet these objectives using the latest forecasts of Government revenue and expenditure for 2009 and the medium term.

Attachments A and B provide the ceilings for your Province. The following Ceilings have been provided:

- Table BC in Attachment A provides the aggregate and individual Goods and Services ceilings;
- Table BC in Attachment A also provides the Personal Emolument ceilings; and

- Table 1 in Attachment B provides the Preliminary Staff Ceiling for your Province. You must ensure that the total number (including unattached officers) of public servants and teachers employed in the Province is *within* this ceiling.

4. KEY DATES FOR THE 2009 NATIONAL BUDGET

For Provinces, the following dates apply:

- **July/August 2008** – Discussions with Treasury and NEFC on the distribution of the total goods and services grant ceiling between the different grants. See section 6.1 below for more details of this process.
- **11 August 2008** – the due date for agencies to submit their 2009 Budget Submissions, in accordance with the Budget Timetable provided in Budget Circular 1/2008.
- **18 November 2008** – 2009 Budget tabled in Parliament.

5. PRINCIPLES GUIDING THE FRAMING OF THE 2009 NATIONAL BUDGET

The 2009 Budget will be framed against a background of continued high commodity prices, a strongly growing economy that is running up against binding capacity constraints, and increasing inflationary pressures.

5.1 The Budget Strategy Paper

The 2009 Budget Strategy Paper is the key document establishing the broad principles that guide the 2009 Budget process. It establishes the economic and fiscal parameters within which the Budget will be framed and draws on the high level frameworks which cover the medium term - the *Medium Term Development Strategy*, the *Medium Term Debt Strategy* and the *Medium Term Fiscal Strategy 2008-2012*. Please contact Treasury officers (contact details in Section 8 below) if you require a copy of the Budget Strategy Paper.

Using the latest forecasts of revenue and expenditures, the Budget Strategy Paper provides for the following broad fiscal parameters that underpin the 2009 Budget Ceilings:

- Total Revenue and Grants are expected to be **K7,341 million**.
- Total Expenditure and Net Lending is expected to be **K6,899.1 million**.
 - Total recurrent expenditure is forecast at **K4,187.9 million**.
 - Total development expenditure is forecast to be **K2,048.3 million**.
 - Total additional priority expenditure is forecast at **K662.9 million**.
- A Budget balance of **K441.9 million** is projected for 2009.

5.2 The Medium Term Fiscal Strategy

The key policy document that informs the Budget Strategy Paper is the new *Medium Term Fiscal Strategy 2008-2012* (MTFS). The first MTFS, for 2002-2007, established a fiscal stabilisation plan with a focus on stopping the decline in PNG's economic performance. It played a key role in turning around both Government finances and the overall economy.

The new MTFS provides a responsible, prudent and sustainable framework for the Government to manage its fiscal resources. The MTFS lays out the following three key fiscal rules to assist the Government with achieving sustainable economic growth through correct management of its resources:

- keeping ongoing expenditure in line with normal, sustainable revenues;
- using additional windfall mineral revenue to pre-fund public investment projects and repay debt and other liabilities; and
- limiting the amount of actual public investment expenditure sourced from windfall revenues to a maximum of 4 per cent of GDP in any one year, in order to promote macroeconomic stability and minimise inflationary pressures.

A key part of the strategy is a framework to manage varying, volatile and highly uncertain amounts of additional revenue from PNG's commodity exports. The 2008-2012 MTFS lays out the following four principles that should be followed when allocating the additional mineral revenues. These allocations should:

- benefit future generations;
- be flexible, in case the additional revenues do not materialise;
- be made while considering the impact on domestic and import demand; and
- be compared to and assessed against all other potential investment projects.

A copy of the 2008-2012 MTFS is available from the Treasury website at www.treasury.gov.pg or in hard copy from Treasury.

5.3 The Medium Term Development Strategy

While the MTFS provides the framework for determining how much to spend, a key policy document guiding the Government's decisions on what to spend money on is the Medium Term Development Strategy (MTDS).

The MTDS promotes fiscal sustainability as an important Government objective. It aims to strengthen public expenditure management, by providing a framework to prioritise the use of fiscal resources (including borrowing) and encourage the cost-effective implementation of programs.

The MTDS identifies the following seven key expenditure priorities areas for the period from 2005 to 2010:

- Rehabilitation and Maintenance of Transport Infrastructure;
- Law and Justice;
- Primary Health Care;

- Basic Education;
- Promotion of Income Earning Opportunities;
- Development-oriented Informal Adult Education; and
- HIV-AIDS Prevention.

Further details regarding the priority expenditure areas can be found in the MTDS document, which can be obtained from DNPM.

When preparing 2009 Budget Submissions, all agencies should ensure that they have regard to the MTDS expenditure priorities. The target for the proportion of total PNG Government expenditure allocated to MTDS priority areas for the 2008 Budget was 53.0 per cent. The 2008 Budget exceeded the target, achieving an outcome of 55.5 per cent of total PNG Government expenditure being directed to MTDS priority areas.

The target for the 2009 Budget is to maintain this result and allocate at least 55.5 per cent of total PNG expenditure to MTDS priority areas in 2009. In formulating their 2009 Budget Submissions, agencies should ensure that they give priority to funding for programs that are consistent with the MTDS.

6. REVISED FINANCING ARRANGEMENTS AND INTERIM PROCESSES

For the 2009 Budget, proposed amendments to the *Organic Law on Provincial Governments and Local-level Governments* are intended to result in the implementation of an improved system for funding Provincial and Local-Level governments. These amendments stem from RIGFA which was conducted by the National Economic and Fiscal Commission (NEFC).

The main policy objective behind the proposed amendments is to move towards the distribution of funding based on financial need, with the intention that each Province will eventually have a similar financial capacity to deliver its core service delivery functions and responsibilities.

The proposed amendments received unanimous Parliamentary support at the first vote in February 2008, but have not been considered a second time (two votes are required to amend an Organic Law). As it is likely that the amendments will pass Parliament before the Budget, it is intended that the 2009 Budget process for Provinces (other than NCD and Bougainville which are not included in the new arrangements) will be consistent with the improved system.

- This means that there will be some changes to the Budget process. There will be some changes to the grant types provided and some Provinces will receive additional funding on the basis of NEFC's analysis of the large gap between their financial needs and the amount of funding previously provided.

6.1 Changes to the Budget process

Under the revised financing arrangements, there will be a number of important changes to the Budget process for Provinces. These changes will provide the Provinces with higher levels of funding on average, more certainty over their

funding, and detailed information about funding earlier in the year to allow for more effective internal Budget processes.

6.1.1 Determining the equalisation amount

One significant change is the method for determining the amount of funding available to Provinces. Previously, the legislation provided for the payment of Goods and Services Grants on the basis of population and area, regardless of the National Government's capacity to fund the grants.

One of the key benefits of the improved system is that it will determine the amount of goods and services funding available to the Provinces and LLGs on a sustainable basis that will grow with national revenue, as the National Government's capacity to pay grows.

The legislation will set the total amount of goods and services funding available to Provinces and LLGs (this is known as the **Equalisation Amount** under the improved system), as a specified percentage of net national revenue. While this will provide more funding, on average, for Provinces, it will mean that the total amount of goods and services funding available will be set, and therefore that the Total Goods and Services Ceiling for each Province will also be set. Provinces will **not** be able to negotiate to have this ceiling increased.

6.1.2 Funding on the basis of need

In the 2009 Budget, all Provinces are guaranteed *at least* their 2008 level of funding. Above this, the Equalisation Amount is divided between Provinces on the basis of the NEFC's analysis of need.

- The NEFC has conducted a detailed *Costs of Services Study* which enables it to accurately estimate the minimum recurrent, non-staffing cost of basic service delivery at the Provincial, District and Local levels of Government.
- The NEFC has also assessed the revenues available to each Province including National Government Grants, their GST distribution, royalties and dividends from mining and petroleum projects, and other internal revenues.

Where the analysis indicates that the cost of providing basic services is *more than* the revenue available, the Province is considered to have a funding gap. The larger the funding gap, the greater the need and the more funding will be provided from the equalisation amount.

6.1.3 Discussion with Treasury on individual goods and services grants

While Provinces **cannot change** the Total Goods and Services Ceiling, they can propose a different split of the ceiling between the various grants **within** the total ceiling.

- Where Provinces propose an alternative split of grants, they should advise Treasury as soon as possible. If you do not raise this with Treasury, the Treasury ceilings will be provided in the Budget.

Where a Province proposes a different split of Grants, Treasury will assess the proposal and may enter into further discussions with the Provinces with the aim of negotiating the best possible outcome.

However, because the ceilings provided by Treasury are based on a detailed analysis by NEFC of costs, expenditure and resources within each Province, Provinces will have to provide detailed and complete data to support their request for a different split of Grants.

In most cases, Treasury will not agree to a variation of more than 10 per cent from the ceiling in any individual Grant.

If Provinces would like any assistance in the allocation of the **Total Goods and Services Ceiling** between the Administration Grant and Function Grants, they should contact Treasury or the NEFC. The NEFC's *Costs of Services Study* may assist Provinces to make decisions about how best to allocate this funding.

6.1.4 Ministerial Grant Determination to set Goods and Services Grants

Once discussions on the individual grants are finalised with all Provinces, Treasury and NEFC will make a recommendation to the Treasurer on what the individual Goods and Services Grants should be for each Province and LLG.

The Treasurer will then issue a Ministerial Determination which will set the Goods and Services Grants for the 2009 Budget. As this determination will be issued before the commencement of the normal Budget Committees, the Goods and Services Grants for Provinces will not be considered further by the Committees.

6.2 Additional grant types

In response to feedback from Provinces in the 2008 Budget Process, the 2009 Budget Ceilings do not include a Block Grant. Instead two new grants have been provided.

A ceiling has been provided for an **Administration Grant** to fund the general administration of the Province. The NEFC *Costs of Services Study* has demonstrated that, in most cases, Provinces have sufficient funding for administration. For this reason, where additional funding is available it has been directed towards the MTDS priority areas. If Provinces feel that they need a higher level of funding for Administration, they should find this funding from their own internal revenue.

In order to provide funding for all the non-MTDS functions that Provinces are responsible for, an **Other Services Function Grant** ceiling has been provided for the first time. The purpose of this grant is to provide funding toward the Provincial functions which are not covered by the other sector specific Function Grants.

It is also intended that the Derivation Grant will be replaced with an **Agriculture Function Grant**. However, this will only occur if the legislation to implement the improved system passes the second parliamentary vote before the 2009 Budget. See section 7.2.8 below for further details on this Grant.

6.3 Conditions on the use of Function Grants

Function Grants are provided to the Provinces by the National Government on a **conditional basis**. That is, they are provided on the condition that they be used for the purpose provided, in the year that the funding is provided.

The main intention of the Function Grants is to improve service delivery in the MTDS core priority areas by ensuring that these sectors have a minimum level of funding provided by the National Government. As with the Administration Grant, it is expected that Provinces will supplement these National Government Function Grants with funding from their own internal revenues where available.

Function Grants are to be used to pay only for operational goods and services and maintenance costs incurred in the relevant sector. They must not be spent on salaries or capital development.

6.3.1 Budget and Expenditure Instructions

Under the improved system, the Secretary for Treasury will be empowered to issue Budget and Expenditure Instructions to specify conditions on the use of Provincial Grants. The legislation will allow for a broad range of conditions to be set, including conditions that deal with:

- the nature, format and timing of reporting on the use of Grants;
- the timing and nature of expenditure of Grants;
- the outputs expected to be achieved from the spending of Grants; and
- the management of Grants.

Furthermore, the legislation will allow for a range of sanctions to be applied to Provinces that fail to comply with the conditions and reporting requirements for their Function Grants, including:

- a Non-compliance notice issued by the Secretary for Treasury;
- a Direction from the Treasurer to comply with certain conditions;
- a requirement to repay some or all of the Grant to the National Government; and
- withholding of future Grants, until the conditions are complied with.

It is anticipated the Budget and Expenditure Instructions will be issued after the legislation to introduce the improved system passes Parliament, and that they will be updated from time to time.

6.3.2 Reviews and Reporting of Expenditure

The NEFC has completed a review of the expenditure of Function Grants for the 2005 Budget year, and is close to completing its review for 2006. These reviews concluded that in order for the Provinces to effectively use the function grant funds, they must:

- Spend **all** the money they receive;
- Spend it in a **timely** manner and avoid holding the money until the end of the year;
- Spend the money on the **purposes** for which it was granted and avoid spending the Function Grants on wages, capital work and non-essential items;
- **Share** financial information with Program Managers to ensure effective implementation; and

- Include the Provincial Treasurer as part of the management team. The Provincial Treasury **must** make financial data available to the Provincial Administration on a regular basis.

The NEFC will continue to monitor the transfer and expenditure of the **Function Grants**. In order to assist the NEFC in future reviews, Treasury has emphasised the importance of Provinces providing expenditure reports for health, education, transport infrastructure maintenance and village court spending from their '200 series' grants and '700 series' revenues, as part of the Quarterly Budget Review process.

As in previous years, Provinces will be asked to provide full and complete expenditure information for the 2008 fiscal year in the 2009 First Quarter Budget Review.

6.3.3 'Rolling over' of Function Grants

Function Grants are appropriated by the Government for the purpose provided. While it is expected that Provinces will expend the full amount of the Function Grant within the Budget year, there may be occasions when it is not possible to expend all the available funds. However, this should only occur in *exceptional* circumstances. In the normal course of business, Provinces should actively work towards spending funding provided as Function Grants in line with this Circular.

Where it is not possible to expend all the available funds at the end of the Budget year, Provinces should 'roll over' the unspent National Government funds into the following year's internal ('700 series') revenue Budget.

To ensure these rolled over funds remain in the core priority sectors, Provinces should carry over the unused **Function Grant** funds into four specific revenue votes in their following year's internal revenue Budget, as follows:

- Health Function Grant Former Year's Appropriation;
- Education Function Grant Former Year's Appropriation;
- Transport Function Grant Former Year's Appropriation; and
- Village Court Function Grant Former Year's Appropriation.

The NEFC will be requesting that Provinces provide evidence that, where applicable, this has been done.

Other revenue and grants can be rolled over into a general 'former years' vote.

6.4 Interim transitional arrangements

6.4.1 GST distribution

As part of the guarantee that Provinces are not worse off under the new system, it will include funding to offset the effect of proposed changes to GST distribution arrangements.

Under current GST distribution arrangements, Provincial Governments are entitled to the higher of their 2006 GST distribution or 60% of net inland collections from the second preceding year (2006 for 2008 distribution). In 2008, many Provinces are

receiving their 2006 GST distribution, as this is higher than 60% of 2006 net inland collections.

Under the proposed new GST arrangements, Provinces will receive 60% of net inland collections from the second preceding year (2007 net collections for the 2009 GST distribution). In order to ensure that Provinces are not worse off as a result of the new GST arrangements, if a Province's 2008 GST distribution is more than 60% of net inland GST collections, it will receive the difference between the two amounts in the form of service delivery function grants under the new arrangements.

However, if the new system does not pass Parliament in time for the 2009 Budget, the current GST arrangements will continue during 2009 (until the new system is passed by Parliament), and most Provinces will continue to receive their guaranteed 2006 GST funding levels. Consequently, the ceilings provided to Provinces for the 2009 Budget have been reduced by the amount of additional GST distribution they receive.

If the new system passes Parliament in time for the 2009 Budget, those Provinces that currently receive more than 60% of GST will be informed that funding has been shifted from GST distributions to goods and services grants.

6.4.2 Derivation Grant

If the new system is passed by Parliament in time for the 2009 Budget, the Derivation Grant will be replaced by an Agricultural Function Grant. However, Provinces will be guaranteed the 2008 level of funding for the Derivation Grant for the first five years of the new system.

In order to account for the risk that the new system may not be passed by Parliament in time for the 2009 Budget, Provinces have been provided with an identified ceiling for the Derivation Grant. If the new system passes, this will become an Agricultural Function Grant.

- If the new system does not pass Parliament in time for the 2009 Budget, the NEFC will provide Treasury with revised estimates for the 2009 Derivation Grant based on 2007 export data.

7. RECURRENT GRANTS

The following guidance has been provided to assist Provinces to understand the grants that are appropriated by National Government and, in particular, how the goods and services grants should be spent.

7.1 Personal Emoluments

7.1.1 Public Servants and Teachers Salaries and Allowances Grants

Separate grants are provided for the salaries and allowances of both Public Servants and Teachers. The ceilings are based on achieving a reasonable balance between the actual costs of teachers and public servants over the past few years and requests from Provincial Administrations for funding under these items.

Leading up to the 2008 Budget, Treasury worked with the Department of Personnel Management and agencies to review manpower numbers. The staff ceilings provided in Table 1 at Attachment B are the result of this review.

Public Servants and Teachers paid under these grants should be processed through the Alesco 'Concept' payroll system.

7.1.2 Public Servants and Teachers Leave Fares

Outstanding leave fare arrears from earlier years for the Provinces should have been met. Therefore, it is expected that funding for leave fares will be similar to what was provided in 2008, with appropriate indexation to reflect inflation.

Treasury requests that Provinces implement a more robust system of leave records to ensure that more accurate estimates of leave fare costs can be provided to Treasury. This will allow for more accurate provisions for leave fares in the future.

7.1.3 Village Courts Allowances Grant

It is expected that the Village Courts Allowances Grant for 2009 will be similar to what was provided in 2008. This grant may *only* be used to fund the costs of salaries for village court officials.

The Village Courts Allowances Grant is based on data which was agreed between Treasury, the NEFC and the Village Courts Secretariat in 2006. Since then, this data has been indexed, as appropriate, to increase for inflation.

The 2009 Budget also includes a separate provision for a *Village Court Function Grant*, which was introduced in 2007. The Village Court Function Grant should *only* be used for the purchase of goods and services to assist in meeting the operational and supervision costs of village courts.

7.2 Goods and Services Grants

As in previous years, Provinces have been provided with a **Total Goods and Services Ceiling** that they are only allowed to use for the recurrent, non-staffing costs of delivering goods and services. This Total Goods and Services Ceiling is a hard ceiling. This means that it provides the total level of goods and services funding that will be available to the Province and is **not negotiable**. The ceiling is determined in consultation with the NEFC on the basis of:

- the total amount of funding available to Provinces and LLGs under the revised financing arrangements (known as the Equalisation Amount under RIGFA);
- the amount of internal revenue available to the Province; and
- the fiscal need of the Province as assessed by the NEFC.

The Total Goods and Services Ceiling has been split into three broadly grouped ceilings as follows:

- **Function and Administration Grant Ceiling** for funding the Administration Grant and the five Function Grants (health, education, transport infrastructure maintenance, village courts and other services). While this total ceiling may not be varied, Provinces are able to negotiate with Treasury regarding a revised distribution of the Ceiling *between* the individual grants.

- **Derivation Grant/Agriculture Function Grant Ceiling** for funding the Derivation Grant, which will be replaced by the Agriculture Function Grant if the legislation to enact the revised financing system passes before the Budget. This ceiling is not negotiable as it is based on actual revenue.
- **Local-Level Government Ceiling** for funding the Urban LLG Grants for urban LLGs and the Rural LLG Grants for rural LLGs. The Local-Level Government Ceiling and the individual LLG grants under it are not open to negotiation. They have been determined on the basis of NEFC analysis of the amount of funding available and the population of each LLG.

Under these three ceilings are a number of individual Grant Ceilings. Further details of these ceilings, and the purpose for which they are provided is provided below.

7.2.1 Administration Grant

In the 2004 Budget, the Administration and Infrastructure Grants were replaced by an unconditional Block Grant and three conditional Function Grants tied to service delivery in the MTDS core priority areas: basic education, primary health care and transport infrastructure maintenance.

For the 2009 Budget, the Block Grant has now been split into an Administration Grant and an Other Services Function Grant.

The Administration Grant is provided to cover the goods and services component of the Province's administrative overheads. In order to fund local priorities, Provinces may need to supplement this Grant from their own resources by using internal revenues or other benefits.

7.2.2 Other Services Function Grant

In response to comments from Provinces in the 2008 Budget process, they will now be provided with an Other Services Function Grant to cover all the other services they provide, other than those funded by individual Function Grants.

7.2.3 Health Function Grant

The Health Function Grant is provided to fund goods and services targeted towards the following main programs and activities:

- Immunisation;
- Malaria;
- Safe Motherhood;
- Water Supply and Sanitation;
- Outreach services;
- Supervision;
- Health service monitoring, review and performance agreements, and
- Distribution of medical supplies.

To assist in quarterly reporting and monitoring, Provinces should report the outcome of expenditure from the Health Function Grant against these programs and activities.

Under certain conditions, Provinces may also be able to access funding through the Hospital Services Improvement Program (HSIP), which is administered by the National Department of Health. To access these funds, Provinces will be required to appropriate **at least 6%** of their discretionary goods and services resources to rural health services. Discretionary goods and services resources are defined as all internal revenues (GST, petroleum and mining project royalties and dividends, and other own source revenues) and non-salary National Government recurrent grants.

It is imperative that the Health Function Grant is utilised to its fullest so as to realise its value and deliver improved services. Provinces should not solely rely on HSIP funding.

7.2.4 Education Function Grant

The Education Function Grant should be used to fund operational costs for:

- Elementary Schools;
- Community/Primary Schools;
- Technical & Vocational Schools; and
- Provincial High/Secondary Schools.

More emphasis should be placed on expenditure on Elementary Schools and Community/Primary Schools than Technical & Vocational Schools and Provincial High/Secondary Schools.

There are also several other key activities that need to be managed and funded effectively to ensure continuous service delivery to staff and students, including:

- Processing and release of operational funds for school inspectors;
- Paying freight charges and distribution costs for curriculum materials;
- Processing and distribution of teachers' pay to the right location; and
- Funding support for training and staff development programs.

To aid reporting to and monitoring of outcomes by National Government agencies, Provinces should report expenditure outcomes by the category and location of school.

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.

7.2.5 Transport Infrastructure Maintenance Function Grant

The Transport Infrastructure Maintenance Function Grant can only be applied to the maintenance costs of provincial roads, jetties/wharves, airstrips/airfields etc.

This grant must not be used for the construction of new roads or maintenance of buildings, or for major reconstructions of unusable existing roads.

7.2.6 Village Court Function Grant

The *Village Court Function Grant* was introduced in 2007 to ensure that Village Courts are provided with an identified and secure amount of funding for the purchase of goods and services for operational and supervisory functions. The *Village Court Function Grant* can only be used for this purpose.

This funding is not for the staffing costs of Village Courts, which is provided through the *Village Courts Allowance Grant* under the Personnel Emoluments Budget.

It is expected that each Province should at least maintain the level of funding provided under the *Village Court Function Grant* in the 2008 Budget.

7.2.7 Local-level Government Grants

Separate ceilings have been provided for each of the urban and rural local level governments (LLGs).

The Rural and Urban LLG Grants **cannot** be spent on salaries, fees and allowances, unless specifically provided for in the Budget.

In the 2007 Budget, funding that was previously provided under the *LLG Secretariat Grant*, to meet the staffing costs of local level government secretariats, was incorporated into the Rural Local-level Government Grants. As a result, there is no longer a separate LLG Secretariat Grant.

7.2.7.1 Urban Local-level Government Grant

Urban Local-level Government Grants are provided to fund the functions for which an urban LLG is responsible.

The total funding for urban LLGs is determined on the basis of the population of each urban LLGs in each Province. Each urban LLG will receive funding on the basis of population on the same Kina per head basis.

Since the 2007 Budget, Provinces have not received funding under the Town and Urban Services Grants. In order to make it clear that this funding was specifically for urban LLGs, this funding is now paid through separate Urban LLG Grants for each urban LLG.

7.2.7.2 Rural Local-level Government Grant

Rural Local-level Government Grants are provided to fund the functions for which rural LLGs are responsible.

The total funding for each Rural LLG is determined on the basis of population and land area. Rural LLG Funding to each Province is determined on an equal Kina per head basis, after abstracting from funding based on the land area per Province. Funding for each Province is then divided between rural LLGs in that Province on the basis of population.

7.2.8 Derivation/Agriculture Function Grant

The **Derivation Grant** is a conditional economic grant that the National Government is legally bound to transfer to Provinces under the current *Organic Law on Provincial Governments and Local-level Governments*. It will be replaced by an Agriculture Function Grant when the new system comes into effect.

Under the Organic Law, Provinces are required to use the **Derivation Grant** to promote exports of their primary and secondary processed products, or to rehabilitate the infrastructure necessary to enable producers to take their produce to market.

The *Derivation Grant* is calculated at a fixed rate of 0.75% of the value of eligible exports in the year two years prior to the Budget year (2006 for the 2008 Budget).

For more information on transitional arrangements regarding the Derivation Grant, see section 6.4.2 above.

8. INSTRUCTIONS FOR COMPLETING 2009 RECURRENT BUDGET SUBMISSIONS

8.1 Format of a Province's 2008 Recurrent Budget Estimates

Provinces are required to prepare a 2009 Budget submission and submit it to the Department of Treasury by **Monday, 11 August 2008**. In most cases, where a Province does not lodge a submission, it will be provided with the same level of funding as was provided in 2008.

8.1.1 Electronic (Flat file) Budget Submissions

Provinces are required to lodge a diskette containing an electronic flat file of their 2009 Recurrent Budget Bids for uploading into the Planning and Budgetary System (PBS). They are also required to provide a signed hard copy version and four (4) photocopies.

8.1.2 Written Budget Submissions

In addition to the electronic submission outlined under 8.1.1 above, Provinces will also be required to provide a written Budget submission outlining their planned expenditure for the coming year. The submission should be consistent with the Budget structure in Volume 2 Part 2 of the 2008 Budget papers. Provinces will need to supply an electronic copy (diskette), a signed hard copy and four (4) photocopies of their 2009 Recurrent Budget Submissions and all attachments.

Use Table 2 (included at Attachment C to this circular) to present a Provincial Budget Summary Table. Information should be provided, to the nearest thousand Kina for:

- 2007 (actual expenditure as shown in the final public accounts);
- 2008 (current appropriation); and
- 2009 (the funding sought in your agency's Budget Submission).

Although the Goods and Services grants will be set by the Ministerial determination **before** the submission is due, you must include these grants in your submission. Provinces will not be able to seek to change the goods and services grants through their submission.

Where a Province is proposing Personal Emolument funding that is different from the ceilings (refer to Section 3), a clear justification should be provided. In particular, you must explain why any additional staff are needed, what they will achieve, and why you could not achieve your objectives with current staff.

The fact that the Department of Personnel Management has approved a new establishment does not automatically mean that funding will be provided for additional position in the establishment.

8.2 Preparation of 2009 Budget Submissions within the Ceilings Allocated

Provinces should endeavor to ensure that their 2009 Budget Submissions are within the Budget Ceilings allocated to them.

- The Budget Ceilings allocated to your agency are detailed in **Table BC** in Attachment A to this Circular.

8.2.1 Guidance to Agencies on Meeting Budget Ceilings

8.2.1.1 General Guidance

The Budget Ceilings provided are the **maximum** levels of funding that will be available to Provinces. Where Provinces need to find savings to stay within the ceiling, they should look to find them from:

- reductions in operating costs (particularly in head/regional office administration);
- non-core or low priority areas; and
- reductions in non-service delivery activities (e.g. advertising, vehicles, travel, security, non-outsourced cleaning, non-essential telecommunications, etc).

Provinces should be aware that the Budget Ceilings allocated may be revised (i.e. adjusted up or down) should there be changes to revenue estimates arising from movements in economic parameters.

8.2.1.2 Aligning Corporate Plans with the Budget

Treasury is aware, from Budget committee meetings and quarterly review meetings, that some Provinces consider that they are *under-funded* because they are not allocated sufficient funds to carry out the work areas identified in their corporate planning documents. Provinces should be aware that there is limited funding available, and that the Government allocates funding on the basis of *whole of government* expenditure priorities and its policy objectives.

The Budget is the Government's money plan for the year and the Government expects Provinces to work within what is affordable for PNG. All Provinces should ensure that the tasks identified in their Corporate Plans and Annual Management Plans are achievable **within** the funding allocated to them through the National Budget. Provinces should adjust their work plans (including their Corporate Plans and Annual Management Plans) to ensure that they are able to operate **within** the Budget Ceilings allocated.

8.2.2 Public Employees Association (PEA) Agreement 2007 to 2010

Provinces **should not** include in their 2009 Budget Submissions any allowance for the 3 per cent increase to individual base salaries payable to Public Servants covered under the *Public Employees Association (PEA) Agreement 2007 to 2010*. This 3 per cent increase has already been included in your agency's allocated Budget Ceiling in Table BC, at Attachment A to this Circular. This increase only applies to Public Servants.

Provinces **should include** in their 2009 Budget Submissions any financial implications of annual automatic increment progression expected in 2009 for Public Servants. When calculating increment increases, agencies should refer to

Schedule 1 of the Memorandum of Agreement – Salaries & Other Terms and Conditions of Employment in the Public Service 2007 to 2010.

8.2.3 Annual Return on Trust

The *Public Finances (Management) Act 1995* (Section 19(3)) requires each Provincial Administrator responsible for managing trust accounts to provide a return for each trust account before the commencement of the following financial year. Therefore, Provinces that have trusts should use *Table 4 (at Attachment D* to this Circular) to provide a return for each trust account they operate or have responsibility for. All returns must be included with the 2009 Budget Submission.

The return should detail an *estimate* of the balance of the trust account and the expected receipts and payments to be made into or from each trust account over the 2009 financial year.

8.3 Province Staffing Resources

Preliminary Staff Ceiling levels for 2009 for each Province are provided in Table 1 at Attachment B to this Circular. The ceilings include **both Public Servant and Teachers**. As the 2007 Retrenchment and Retirement process is not yet finalised, and Ministers may take decisions in the formulation of the 2009 Budget which affect agency staffing levels, these ceilings may change. *The Preliminary Staff Ceiling* levels should be used as the basis for costing staffing resources in your Province's 2009 Recurrent Budget Submissions.

Provinces that participated in the 2007 Retrenchment and Retirement Program will be provided with an adjusted *Staff* ceiling for 2009, once that process is concluded and your Province's original *Staff* ceiling has been reduced by the number of officers retrenched.

Staff ceiling levels include:

- *2009 Preliminary Funded Staff Ceiling* – this is the funded staff ceiling. The ceiling includes all staff, including Staff on Strength, Unattached officers and Vacancies. It is important to remember that Department of Personnel Management approval of an increase in your agency's establishment does **not** mean you have additional funded positions;
- *Staff on Strength* – these are the staff on your payroll who are attached to positions;
- *Unattached Officers*; and
- *Vacancies* sought in your Province in the 2009 Budget. These vacancies should only be sought within the *Preliminary Staff Ceiling*. The total of Staff on Strength, Unattached Officers and Vacancies should not be more than the 2009 Preliminary Funded Staff Ceiling.

Each Province should ensure that its staff register is updated to reflect the *Preliminary Staff Ceiling* level and that the correct vote codes have been used. In addition, to assist government cash flow estimation, Provinces should provide information to Treasury in relation to the level and timing of contract gratuities and expected leave fares for the following year.

Each Province must also advise Treasury of the number of *Casuals* it currently employs, and explain how these *Casuals* assist in the delivery of key services.

Approval to advertise funded vacancies and to fill the advertised positions following recruitment processes must, unless the agency has had responsibility for HR devolved to it by the Department of Personnel Management, be sought from the Joint Department of Personnel Management – Treasury Inter-Departmental Committee on Recruitment.

- Provinces with devolved powers are responsible for their own recruitment of funded vacancies. Devolved agencies are not required to seek approval from the Joint Department of Personnel Management – Treasury Inter-Departmental Committee on Recruitment for the advertisement of funded vacancies and filling of advertised positions.

Provinces should be aware that they will be required to manage their staff numbers **within** the adjusted budget allocation for personnel emoluments in 2009.

9. INSTRUCTIONS FOR COMPLETING 2009 DEVELOPMENT BUDGET SUBMISSIONS

9.1 Format of a Province's 2009 Development Budget Submissions

It is anticipated that new projects in the 2009 Public Investment Program (*PIP*) will be limited to those fully appraised and processed by the DNPM. All Provinces are therefore requested not to submit any new projects that have not already been fully appraised by 1 July 2008.

With respect to donor-funded projects, only those projects for which the Government has already negotiated loans/grants or signed MOUs/MOAs with donors by 1 July 2008 will be considered for funding and start-up in 2008.

9.2 On-going Development Projects

All Provinces are asked to prepare Budget Submissions based on ongoing projects being implemented your Province. The 2009 Development Budget will focus on Government development priorities as identified in the MTDS.

For projects that will continue to be funded in 2009, Provinces must submit accurate expenditure estimates for the period beyond 2009, especially in regard to the counterpart funding requirements of donor-related programs and projects. Forward estimates of expenditure over the life of the project are also required for inclusion in the 2009–2013 PIP and for the development of the Medium Term Resource Framework 2006-2009.

It is important that appropriate details and break-up of funding components of the projects and appropriate percentages for reimbursements are correctly reflected in estimates for the 2009 Development Budget. Please ensure that the cash and non-cash component of each project is clearly flagged in the submission.

Provinces implementing donor-funded projects are required to complete the Budget forms in detail and are required to submit a break-up at the item level by donor code for each of the projects. In addition, Provinces are urged to provide a full

description of the project's objectives for 2009, especially for new donor-funded projects, for inclusion in the Budget documents.

9.3 Donor-Funded Projects (Recurrent and Development Budget)

Donor-funded projects are subject to the normal government planning and budgeting processes. Items of expenditure covered by loan agreements and memoranda of understanding must be clearly identified on the Budget submission forms, including the percentage of each item that is reimbursable. For a given fiscal year, the receipts on the financing side must match the total donor-funded expenditure that is appropriated in the budget.

Total costs, whether Government or donor, within Papua New Guinea or offshore, must be included in the Budget. Loan agreements and memoranda of understanding often provide for direct payments to suppliers.

Amounts intended to be paid in this manner (offshore payments) must also be included in the budget estimates, under the appropriate votes, identified by donor, with the amount or percentage of estimated offshore payment. It is not permissible to allow offshore payments when there is no Budget appropriation to cover such payments under the relevant vote during the year.

Donor codes are entered after each line item. When entering the donor code, care must be taken to include the correct number to indicate the source of funds:

0. Government
1. Asian Development Bank
2. World Bank
3. European Union – Grant only
4. IFAD
5. OECF
6. JICA
7. New Zealand Aid
8. AusAID
9. Other donors including UNDP, EU (loans only), France, KFW, Kexim, etc.

It is very important that the correct vote number and donor codes are used because errors at this stage will produce incorrect reports in the General Ledger and the PBS.

9.4 Domestic Component of the Development Budget Provided by the Department of National Planning and Monitoring

The Development Budget Ceiling for 2009 is set at K2,048.3 million, an increase of K161.2 million from last year.

Details of individual Province ceilings will be provided at a later date by DNPM. Provinces should prepare their 2009 Development Budget Submissions within their individual Province ceilings.

Submissions for amounts in excess of the total individual Province ceiling levels provided will only be considered in exceptional circumstances and in cases that are deemed to substantially contribute to the Government's development priorities.

For Provinces, the ceilings are for wholly domestically funded projects and/or projects requiring Government counterpart monies only (i.e. the Government funded component of the Development Budget).

9.5 Major National Government Initiatives – Development Budget

Major Government initiatives regarding the District Road Improvement Program, Special District Support Grants and Provincial Performance Improvement Initiative will be clearly but briefly laid out for the benefit of the Provinces and District Administrations, particularly, in terms of the different Guidelines being used.

10. CONTACTS FOR THE 2009 NATIONAL BUDGET

If clarification is required in relation to any section of this Circular, or if your Province requires any further information or assistance in preparing their 2008 Budget Submissions, please contact the following officers:

10.1 Recurrent Budget (Treasury)

Provincial Sector	Mr. Lazarus Enker	312 8739
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10.2 Development Budget (DNPM)

Ongoing Projects

Economic Sector	Mr Kone Samuel	328 8333
Infrastructure Sector	Mr Gregory Ume	328 8333
Social Sector	Ms Rose Koyama	328 8333
Law/Justice & Admin Sectors	Ms Rose Koyama	328 8333

New Projects

Economic Sector	Mr Kevin Kautu	328 8319
Infrastructure Sector	Mr Paul Ilia	328 8332
Law/Justice & Admin Sectors	Mr Hakaua Harry	328 8559
Social Sector	Mr Paul Mange	328 8260

10.3 Trusts (Department of Finance)

Trust Accounting, Public Accounts	Ms. Cathy Ali	328 8602
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Important Note

We seek your co-operation in ensuring your Province provides Treasury, DNPM and the Department of Finance with accurate information in the format provided in this Budget Circular by the due date so that the 2009 Budget process can be conducted successfully.

In addition, we request that this Circular and attachments be provided to the relevant officers in your Province as soon as possible after receipt. This will ensure that your Province has more time to formulate its 2009 Budget Submissions and to clarify any issues with Treasury, DNPM or Finance.

.....
Simon Tosali
Secretary
Department of Treasury

.....
Joseph Lelang
Secretary
Department of National Planning
& Monitoring

Attachments:

- A.** 2009 Budget Ceilings Allocated to Your Province (**Table BC**)
- B.** *Preliminary Staff Ceilings* for 2009 (**Table 1**)
- C.** 2009 Provincial Budget Summary Table Format (**Table 2**)
- D.** Format of Trust Information Required (**Table 3**)