Performance Audit on the Effectiveness of the Budget Process - 2013 Appropriations

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A report reviewing the processes and procedures of the 2013 Budget

Auditor-General's Office of Papua New Guinea

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OFFICE OF THE AUDITOR-GENERAL

5 November, 2015

The Honourable Theodore Zurenuoc, MP

Speaker of the National Parliament

Parliament House

WAIGANI

National Capital District

Dear Mr. Speaker,

In accordance with the provisions of Section 214 of the Constitution of the Independent State of Papua New Guinea, and the Audit Act 1989 (as amended), I have undertaken an audit examining and assessing the effectiveness of National Budget process and its subsequent release of warrants to the various public agencies.

I submit the report of this audit and the report is titled ***Performance Audit on the Effectiveness of Budget Process-2013 Appropriation."***

Following its tabling in Parliament, the report will be placed on the Auditor-General's Office Homepage-http://www.ago.gov.pg

Thank you

PNauga

Philip Nauga

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Acronyms and Definitions

BSC	Budget Screening Committee
BSP	Budget Strategy Paper
Budget Control	Actions and activities that are taken by the Government to ensure that actual performance of the budgetary activities conforms to the pre-determined plans to achieve the established objectives.
CACC	Central Agencies Coordinating Committee
Consolidated Revenue Fund	The account into which all the revenue of the State which the Parliament has the power to appropriate are paid and kept by Department of Finance.
CRF	Consolidated Revenue Fund.
Development Appropriation	It comprised of Government expenditure from consolidated funds appropriate at the parliament as well as the donor funds, concessional loans and infrastructure tax credit scheme.
DNPM	Department of National Planning and Monitoring
DoF	Department of Finance
DoT	Department of Treasury
FMM	Financial Management Manual
FRA	Fiscal Responsibility Act 2006
IFMS	Integrated Financial Management System
MBC	Ministerial Budget Committee
MTDP	Medium Term Development Plan
MTDS	Medium Term Debt Strategy
MTFS	Medium Term Fiscal Strategy
National Budget	A document that reflects the estimates of income and expenditure of the national government for a fiscal year which runs from January to December for the purpose of obtaining its set policies and strategies
NEC	National Executive Council
NEFC	National Economic Fiscal Commission
PBS	Program Budgeting System
PFMA	Public Finances Management Act 1995
PGAS	Papua New Guinea Accounting System
PNGDSP	Papua New Guinea Development Strategy Plan
PPEC	Parliamentary Plans and Estimates Committee
PSMA	Public Services(Management) Act 1995
Public Debt Committee	A committee set up within the treasury department to make important decisions to allocate funds to the agencies on a monthly basis. The committee is also tasked to monitor and report on cash availability at consolidated Revenue Fund to disburse in a given month.
2013 Public Investment Program	A public investment program that captures all the agencies proposed projects to be rolled out in the period of five years period under development expenditure for the year.
TMS	Treasury Management System.

Summary and Recommendations

Background

1. The Papua New Guinea Government's budget is an important political, economic and social undertaking. The outcome of the Budget process represents the end state of the decision-making process for allocating resources to the government's policy priorities in accordance with an overall government development strategy. It is through the Budget process that the government gains the Parliament's authority to expend funds from the Consolidated Revenue Fund (CRF) through the passage of the annual appropriation acts.

2. The key elements of the Government's financial management framework are set out in the *Public Finances Management Act 1995* and the *PNG Fiscal Responsibility Act 2006*. Under the *Fiscal Responsibility Act 2006*, there are two central administrative frameworks which guide the development of the National Budget:

- The Medium Term Fiscal Strategy (MTFS) which sets out the National Government's fiscal policy; and
- The Medium Term Development Plan (MTDP) which provides the Government's development priorities over the next five years.

3. The MTDS identifies the Government's key spending priority areas while the MTFS identifies how much money the Government can afford to spend, taking into account how much revenue would be received and how much would need to be borrowed.

4. In addition, the National Economic and Fiscal Commission (NEFC) provide budget estimates and policy advice to the national government on the distribution of operational grants to the provinces and to local-level governments.

Overall Audit Conclusion

5. There are a number of budget screening committees appointed by Cabinet to consider budget submissions and make recommendations to Government. In the 2013 budget process, there were no clear specific screening or assessment criteria to guide each of the budget committees in their deliberations. Instead, the committees assessed budget submissions based on the key policy objectives and expenditure priority areas of the government and did not allocate any priority to the revenue raising agencies. In the absence of clear specific screening criteria; the steps involved in the budget screening were largely ineffective, as submissions passed unchanged from one committee to another during the screening process. The lack of rigour in the screening of budget proposals increased the risk that revenues would not match planned expenditure, which in turn risks key participants and the public losing confidence in the Government's budget process.

6. One of the key committees, the Central Agencies Coordinating Committee (CACC), took no part in the budget process, and relevant records of this and other committee meetings and their terms of reference have not been maintained. In the absence of CACC input, the 2013 budget screening process and stages were incomplete, which meant that the approval and allocation of budget figures relied on data supplied by agencies and agreed by Treasury. As a result, the budget process was at risk of delivering a budget outcome that was not consistent with Government priorities. In this context, a significant number of warrants were withdrawn from several agencies in 2013 fiscal year. Warrants totalling **K280 million** were withdrawn and later reappropriated for development expenditure in the 2013 supplementary budget. The withdrawal and reallocation of warrants illustrates the weaknesses in the budget screening processes and indicates warrants/funds may have been provided to agencies on the basis of unrealistic budget submissions.

7. The 2013 Budget Strategy Paper (BSP) was the key document establishing the broad principles, strategy and fiscal parameters to guide the budget process, which was set in the context of fiscal responsibility and constraint. However, the BSP was never finalised and it was not published on the Treasury website as required under the Fiscal Responsibility Act 2006.

8. The Public Debt and Cash flow Committee (PDC) overlooks and monitors weekly cash flow and sets agencies monthly warrant ceilings based on the available cash in the Consolidated Revenue Fund (CRF). The outcome of the PDC decisions on warrant allocation often results in agencies receiving sufficient funding, but in some cases agencies can receive additional funding while others receive less funding than requested in a given month. On occasions, the system of allocating warrants based on the position of cash availability in the CRF breaks down and there is insufficient cash available, which affects the agencies capacity to deliver government services. Correspondence from the Secretary of the Department of Finance to the Treasury to overcome the systemic issues associated with cash flow management has not been answered by the Treasury. As well, there were no additional criteria in place for the PDC to use as the basis for making decisions to allocate monthly warrants/ceilings to agencies, introducing further uncertainty into the cash flow arrangements.

9. Changes to budget appropriations can occur in two ways, consistent with budget laws; administrative changes and legislative changes. The rationale behind administrative changes and transfers of funds carried out by Treasury is to manage shortfalls and unforeseen items incurred over the course of the fiscal period. There were a significant number of fund transfers in 2013 fiscal year as noted in the 2013 Final Budget Outcome (FBO) report. When funds are transferred, Sections 9 and 10 of the Appropriation Act require the Treasury to provide details of the transfer to the Auditor-General's Office and publish notices on the Treasury website. However, the required notices were not published and copies of the transfer documents not made available to the Auditor General's Office. Moreover, the records of funds transfers captured in the register of transfers were inaccurate and unreliable.

10. A draft of this report was forwarded to the Department of Treasury on 6 August 2015, to provide the department with an opportunity to formally respond to the findings and recommendations. The Department of Treasury did not respond, and a second letter was forwarded from the AGO to the Treasury on 6 October 2015 requesting its response. However, at the time of finalising this report, no response has been received. Copies of the AGO correspondence are at the appendices. Notwithstanding Treasury's non-response, the report makes six useful recommendations designed to assist the Treasury in improving the budget process.

Recommendations

Recommendation No.1

AGO recommends that in order to improve the outcome from the budget screening process, the Treasury Department in consultation with relevant government agencies, develops and documents clear specific assessment criteria for each of the budget screening committees to use in the screening process to align with key policy objectives and expenditure priority areas of the government.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

Recommendation No.2

AGO recommends that the budget administrative process and requirements are strengthened to ensure that:

(a) The Budget Strategy Paper (BSP) is completed and authorised at appropriate level; and
(b) Each of the various committees involved in the budget process complete their reviews as stated in their respective Terms of Reference.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

Recommendation No.3

AGO recommends that to better manage the Government's cash flows, the Department of Treasury works closely with the Department of Finance in the allocation and release of monthly cash ceilings/warrants to agencies to ensure that warrants issued do not exceed cash available in the CRF.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

Recommendation No.4

AGO recommends that in order to effectively manage the number of withdrawal warrants during the fiscal year and to address the problem of some agencies missing out on monthly warrants; Treasury should implement closer working relationships with implementing agencies to ensure that project submissions and cash flow requirements are realistic and based on an agency's capacity to deliver.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

Recommendation No.5

The AGO recommends that the Treasury Department should;

(a) establish and maintain accurate and reliable recordkeeping systems relating to transfers of appropriations to ensure an adequate audit trail; and

(b) report the transfers and publish to the Treasury website and copies made available to the Auditor-Generals' Office as required under sections 9 and 10 of the Appropriation Act.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

Recommendation No.6

The AGO recommends that to ensure budget funds are utilised efficiently, service delivery agencies should submit realistic budget projections and cash flow requirements based on their capacity to deliver.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

1. Introduction

Government Budget Process in Papua New Guinea

1.1 The Papua New Guinea Government's budget is an important political, economic and social undertaking. The outcome of the Budget process represents the end state of the decision-making process for allocating resources to the government's policy priorities in accordance with an overall government development strategy. It is through the Budget process that the government gains the Parliament's authority to expend funds from the Consolidated Revenue Fund (CRF) through the passage of the annual appropriation acts.

1.2 A system of warrant authorities is used to draw down and disburse appropriated public funds to agencies to carry out their functions. Warrant authorities are in two forms, the Minister's Warrant and the Warrant Authority. Minister's warrant is the warrant authority that the Minister for Treasury provides to the Treasury Department enabling the Secretary to draw down appropriated funds passed by Parliament from Consolidated Revenue Funds. The Minister's warrant authorises the release of the total appropriation of both the recurrent and the development appropriation to be drawn from the CRF. Unlike the Ministers warrant, a warrant authority is a periodic authorisation provided to agencies to expend appropriated funds within a given fiscal year. The warrant authorities are normally released on a monthly basis. However, in some cases warrant releases will be driven by the availability of funds in any given month and the funding priorities of the government.

1.3 The National Budget operates on a fiscal year basis and runs from January to December each year. In fiscal year 2013, the National Budget for PNG was **K13 billion** according to the Treasurer's Budget speech contained in the 2013 National Budget Volume 1 Economic and Development Policies and includes estimates of receipts as well as recurrent and development expenditure.

1.4 The responsibility for preparing the National Budget and presenting it to the National Executive Council (NEC) and the National Parliament for their consideration and approval as well as the overseeing of its implementation, is assigned to the Treasury Minister through *Section 3* of the Public *Finances Management Act 1995*.

Budget Policies and Strategies

1.5 The key elements of the Government's financial management framework are set out in the *Public Finances Management Act 1995* and the *PNG Fiscal Responsibility Act 2006*.Under the *Fiscal Responsibility Act 2006*, there are two central administrative frameworks which guide the development of the National Budget:

- The Medium Term Fiscal Strategy (MTFS) which sets out the National Government's fiscal policy; and
- The Medium Term Development Plan (MTDP) which provides the Government's development priorities over the next five years.

1.6 The MTDS identifies the Government's key spending priority areas while the MTFS identifies how much money the Government can afford to spend, taking into account how much revenue would be received and how much would need to be borrowed.

1.7 In addition, the National Economic and Fiscal Commission (NEFC) provide budget estimates and policy advice to the national government on the distribution of operational grants to the Provinces and to Local-Level Governments.

1.8 Based on these fiscal and development strategies and inputs from the NEFC, the Government is required through the Department of Treasury (DoT) to publish the Budget Strategy Paper (BSP) annually for the following years National Budget. The BSP sets out the broad principles, strategies, and fiscal parameters for the National Government Budget and also contains:

- A discussions of the risks to the budget parameters and the Budget Strategy;
- The medium –term outlook for government revenue and expenditure;
- A discussion of how the budget strategy relates to MTFS and MTDP; and,
- A framework for the preparation of the Departmental ceiling for budget estimates and for developing budget policies.

Key Roles and Responsibilities

1.9 People or organisations with key responsibilities in the operations or activities associated with the National Government budget process, including the initiation, formulation, coordination, screening, approval ,implementation and monitoring as outlined by DoT Budget Manual and the *Public Finances Management Act 1995* (PFMA) are briefly described in the table 1 below.

Table 1: PNG Budget Process - Roles and Responsibilities

Organisation	Key Role(s) and Functions
National Parliament	Approval of the National Budget through the Appropriation Acts and related legislation
National Executive Council (NEC)	Approval of the budget strategy paper prepared by the Treasurer. Approval of the budget estimates for tabling in the Parliament.
Treasurer	Formulation of the National Budget Presentation of the National Budget and the Appropriation bills for consideration by Parliament. Issue Minister's warrant to Secretary for Treasury.
Ministerial Budget Committee (MBC)	Setting parameters for the total of budget funding Making recommendations to the NEC in relation to the priority spending areas and the budget strategy paper.
Public Debt and Cash Flow Committee (PDC)	Provides advice and recommendations on Government financing, debt and budget matters and related issues to the Secretary for Treasury.
Central Agencies Coordination Committee (CACC).	The committee is chaired by Chief Secretary to the Government with membership including heads of Departments of Prime Minister and National Executive Council, Treasury, Finance, National Planning & Monitoring, Personnel Management, Justice & Attorney General, and Office of Rural Development. Consideration of the comments and views of the Budget Screening Committee (BSC) on the proposed budget. Making recommendations on the proposed budget to the MBC.
Budget Screening Committee (BSC)	The committee is made up of deputy heads or the secretaries of the Central Agencies. Consideration of proposed budget items from agencies, state authorities and Provincial and Local Governments. Providing advice to the CACC on National Budget Estimates. Submitting the proposed budget to the CACC.
Treasury	Provide economic advice to the National Government and overall coordination of the National Budget Process. Issue budget circulars to stakeholders to provide advice and guidance on preparation of budget submissions Prepare the Budget Strategy Paper (BSP) Formulate the Medium Term Fiscal Strategy (MTFS) Allocate and release warrant authorities Monitor recurrent appropriations
The National Economic and Fiscal Commission	Assesses revenues available in the provinces and determines the level of grants in the recurrent budget to the provinces and local-level governments. Monitors and reviews the operational grants on how provinces spend this funding. Conducts a periodic cost of services study to estimate the cost of government's service delivery obligations for grant calculation, policy development and budget purposes.
Department of National Planning and Monitoring	Develop, monitor and manage the development budget Consider and advise on new and ongoing development projects.
National Departments, Statutory Bodies, and Provincial and Local Governments	Formulate agency annual budget estimates in accordance with budget circulars Ensure expenditure is properly authorised and applied for the purposes it was appropriated Submit quarterly financial management reports to Treasury.

Source: AGO

Budget Process and Timetable

1.10 As indicated in Table 1 (above), the Minister for Treasury (Treasurer) is responsible[1] for the coordination and preparation of the National Budget and presentation of it to the NEC and the National Parliament for consideration and approval. The Treasurer is assisted by the Minister responsible for National Planning and Monitoring in preparation of the National Budget.

1.11 The Budget Process begins in January each year when Treasury seeks information from agencies, including an estimate of their cash flow needs for the upcoming budget year. In February, Treasury conducts its first round of economic forecasts to determine the overall level of funds available for the following year's budget. Treasury then develops a proposed budget strategy which takes into account the prevailing economic conditions, and considers whether the budget should run at a loss or deficit (that is, Government will need to borrow money to meet proposed level of expenditure) or a profit or surplus (surplus budget funds are used to repay some of the Government's existing debt). On completion, a total budget ceiling[2] is calculated, and indicative budget allocations for agencies are prepared for consideration by Government.

1.12 The preparation of the budget estimates or proposals, indicating requirements of the funds by spending agencies such as the various Departments, Statutory Bodies, Provincial and Local Level Governments leading to the formulation of the National Budget are made in two stages:

1. By agencies submitting their individual budget proposal to the Department of Treasury;
2. By the Treasurer submitting the consolidated National Budget to the Parliament under the direction of the NEC.

1.13 Broad timetables for a typical budget process outlined in the PNG Budget Manual are presented in Table 2 below.

[1] The Treasurer's responsibilities are set out at Section 3 of the PFMA.

[2] *Budget Manual 2008 - Budget ceiling is the Treasury issued figure representing the maximum amount acceptable[2] for a particular budget submission and it is the primary responsibility of the Treasury Department to determine and calculate the Ceiling.*

PNG MTDS – Government Expenditure Priorities

Table 2: Broad timetable for Typical Budget Process in PNG

Process	Key Dates
Treasurer seeks estimates of cash requirements from each agency for the coming budget year	January
Treasury conducts its first round of economic forecast to estimate the overall level of funds available for the following years budget	February
Treasury develops proposed Budget Strategy Papers and presents to MBC for approval	February
DoT seeks Public Submissions either in writing or participation in Regional and National Development forum	Early March
Issue of Budget Ceiling Circular by DoT and DNPM	Late May/early June
Government Agencies and Provinces to submit new Projects 2013 Budget Submissions to DNPM	Late June
Launch of Budget Strategy Paper by DoT	Late July
Government Agencies submit Budget Submissions to DoT (Recurrent Budget) and DNPM(Development Budget)	Early August
DoT presents to Ministerial Budget Committee(MBC)on fiscal estimates ,Budget Submission from Government Agencies and issues raised in Public Submission	Early August
MBC provides formal guidance to treasury for advice to BSC on broad parameters for National Budget	Late August
Government agencies make their presentation on Budget Submissions to BSC for its consideration and approval	Late September
Central Agencies Coordination Committee(CACC) Meeting to consider budget Submissions	Early October
MBC and NEC meetings on budget submissions	Mid-October
DoT briefing of Parliamentary Plans and Estimates Committee on National Budget	Early November
Presentation of Appropriation Bill and Budget Papers to National Parliament by Treasurer and Minister for DNPM for debate and approval.	Early November

Source: Budget Manual 2008 and DoT Budget Circular 4/2012 attachment A

The Audit

Audit Rationale

1.14 In 2011, the Public Accounts Committee (PAC) provided the Auditor-General's Office with a list of potential performance audit topics which to be considered and selected for audit purposes. One of these topics was an audit on the Effectiveness of the Government Budget Process and subsequent release of Warrant Authorities. The Auditor-General decided to conduct a performance audit on the 2013 Budget Appropriations and subsequent release of Warrant Authorities which is the subject of this audit.

1.15 It is expected that, among other things, the following outcomes would be achieved by a specific audit of this Budget Warrant releases:

- Providing an increased public awareness of how the appropriation and budget framework works in practice in PNG; and

- Highlighting the flow-on implications to delivering services to the people of PNG when there are unexpected timing or amount variations in the payment of funds to entities.

Audit Objective

1.16 The objective of this performance audit is to examine the effectiveness of the 2013 Budget Appropriations as approved by the National Parliament and subsequent release of warrant authorities, with a specific focus on the following key processes:

- The development and issue of Budget Ceilings and their impact on agency budget submissions;

- The approval process for the budgets and subsequent transfers; and

- The warrant release allocation process.

Audit Approach

1.17 By way of addressing the audit objective, the audit involved the following key steps and areas of coverage:

- Reviewing and assessment of publicly disclosed budget documents and records on Treasury website including the 2013 Budget Book, budget circulars and manual, 2013 Appropriation Acts and legislations, Budget Policies and Strategies, Financial Management Act, Financial Management Manuals and other related budget documents.

- Examination and comparative analysis of Warrants Authorities and related data held at Treasury against 2013 Budget Appropriations and subsequent transfers including controls surrounding the overall budget frame work.

- Confirmation of timeliness of cash movement associated with warrants releases by interviewing key government agencies including Department of Finance and Treasury.

2. Budget Submission and Approval Process

The Budget Process

2.1 The budget process is governed by requirements administered by the Department of Treasury (DoT) and with parameters set out in a Budget Strategy Paper, prepared by DoT. The 2013 budget was framed against a background of fiscal responsibility and constraint due to increased expenditure pressure and as a result, the draft Budget Strategy Paper (BSP) was the key document used to establish the broad principles and fiscal parameters to guide the 2013 budget process. The Medium Term Fiscal Strategy 2008--2012 (MTFS) and Medium Term Development Plan 2011-2015 (MTDP) were the key policy documents informing the 2013 Budget Strategy Paper (BSP). A summary of the processes that are followed by the various committees and stakeholders involved in the budget process is shown in Appendix 1.

2.2 The primary responsibility for the submission of initial budget proposals rests with individual agencies (as shown in Appendix 1). Although there are a number of committees and other stakeholders involved in the preparation of the budget, the Central Agencies,[3] are expected to maintain an awareness and oversight of agencies' submissions and the overall budget position. This is discussed in more detail in paragraph 2.5 below.

2.3 Budget circular 4/2012 was prepared by Treasury and it clearly specified that when preparing budget submissions for the 2013 budget, agencies should ensure that their submissions aligned with the expenditure and sector deliverables outlined in the MTDP, and must be done within existing resources available. Specific instructions are also outlined in the circular as administrative requirements for agencies to comply with in preparing their budget submissions.

Budget Ceilings

2.4 Budget ceilings are an administrative mechanism used to guide or set the bench mark for financial resource allocation in relation to recurrent budgets.[4] Budget ceilings enable government agencies to prepare and compile budget submissions designed to be contained within the financial resource envelope that will be available in the Consolidated Revenue Fund (CRF). Budget ceilings are also used as budgetary control measures for agencies to plan, execute and control their operational activities and programs contained within the given budget.

Determination, Calculation and Approval of Budget Ceilings

2.5 Budget ceilings are determined and set by Treasury based on the best estimates of the level of revenues the Government expects to have available for the following year, and reflecting the key MTDP and MTFS expenditure priority areas. In 2013, the Provincial Government budget ceilings were completed separately by the National Economic Fiscal Commission (NEFC), and forwarded to Treasury, taking into account the internal revenue raised by each of the Provinces and local-level governments.

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[3] The of Departments of Prime Minister and National Executive Council, Treasury, Finance, National Planning & Monitoring, Personnel Management, Justice & Attorney General, and Office of Rural Development.

[4] Funds appropriated under the development budget are for pre-determined amounts are not subject to adjustment through the budget ceiling process.

2.6 Treasury advised the AGO that the overall 2013 budget ceiling was predominantly determined by the Vision 2050 document,[5] the PNG Development Strategic Plan (2010-2030),[6] and the related Medium Term Development Plan (2011-2015), the Medium Term Debt Strategy (MTDS), the Medium Term Fiscal Strategy 2013-2017 (MTFS) and the *Fiscal Responsibility Act 2006*. Through this process there was also a focus on increased funding on the Government key expenditure priority areas including;

- Education;
- Health;
- Infrastructure; and
- Law & Order.

2.7 In addition, in developing and calculating agency budget ceilings, Treasury takes into account certain factors, such as the level of funding appropriated in the previous year's budget; subsequent NEC Decisions; the impacts of other processes such as an election; one-off funding required in the current year; budget funded retrenchment; changes in Public Service Personnel Emoluments and the Public Employee Association Agreement (PEA). In doing so, the new funding level may then be indexed to take account of cost increases and in some cases population increases from year to year.

2.8 The calculation and application of 2013 budget ceilings for the recurrent budget was completed using a formula as follows**:**

OBUD[7] x (1 + %△ Revenue) = Budget Ceiling

The OBUD used in the formula is the Original Budget or current year appropriation and the percentage change in the revenue is the difference between the original budget and the projected revenue figure of the following fiscal year Treasury calculates taking into account the movement in the CPI. This formula used for calculating budget ceilings is consistently applied every year, unless the Government decides to change the formula.

2.9 For the approval process, once the agency ceilings have been calculated and finalised, Treasury presents the Budget Strategy Paper which contains high level expenditure ceilings to the MBC for its approval. When approved, the Budget Strategy Paper (BSP) is presented to the CACC prior to being submitted to the NEC for final approval. The approved BSP is then circulated publicly and a budget circular is released to agencies advising them of their ceiling and seeking their detailed budget submissions. However, as noted above, the setting and calculation of budget ceilings only applies for the Recurrent Budget and not the Development Budget component. The development budget component is mostly tied to project funding and the Government has decided that it is not necessary to set ceilings on this component of the budget due to unforeseen cost variations often involved, and the time period generally required for project implementation.

[5] In December 2007, the National Executive Council (NEC) of PNG, developed a framework for a long-term strategy — "The Papua New Guinea Vision 2050". Vision 2050 has seven Strategic Focus Areas: Human Capital Development, Wealth Creation; Institutional Development and Service Delivery; Security and International Relations; Environmental Sustainability and Climate Change; Spiritual, Cultural and Community Development; and Strategic Planning, Integration and Control. Available at http://www.treasury.gov.pg/html/publications/files/pub_files/2011/2011.png.vision.2050.pdf

[6] The PNG Development Strategic Plan (2010-2030) is intended to be implemented through four 5-year medium term development plans (MTDPs) – the first of which is the MTDP 2011-2015. Key to the MTDP is the planning of resource allocation for achieving targets by 2015 that set a pace of progress consistent with the 2030 targets in the PNGDSP. The MTDP 2011-2015 was set in motion in the 2011 Budget. Available at:http://devpolicy.org/a-new-path-for-development-policy-in-papua-new-guinea20110417/

[7] OBUD in this context stands for Original Budget.

2.10 The BSP is normally published to assist public understanding of the fiscal situation and the Government budget strategy as required under the *Fiscal Responsibility Act 2006*. The AGO found that the 2013 budget ceilings were calculated and approved without an approved Budget Strategy Paper (BSP) in place. The BSP provided by Treasury for audit verification was in a draft form specifically designed for internal use and had not been published on the Treasury website. Although the department may have met the formal requirements of the budget process in this regard, there was a lack of adequate documentation in relation to the development of the BSP, which, of course, means an inadequate audit trail. Let alone any other interest, this is not helpful to departmental management.

2.11 Ceilings on budget submissions can in some circumstances operate as a restriction on agencies being able to fully carry out their operational plans and programs in delivering goods and services to the population. Apart from the government key policy objectives and expenditure priority areas used as most influential factors in determining the calculation and setting of agencies ceilings; the AGO found that there were no other additional specific criteria considered when calculating and allocating ceilings to agencies.

2.12 Since budget ceilings are set based on the best estimates of the level of revenues the Government expects to have available for the following year, there would be merit in consideration being given to allocating a priority to key revenue making agencies of the government in setting their annual budget ceilings. This would provide a higher level of assurance that these agencies are sufficiently resourced to carry out their duties and responsibilities, which would assist the government in funding the whole budget expenditure priority areas of the government. For instance, the Internal Revenue Commission (IRC) as one of the important key revenue making agency of the government in its 2013 budget submission requested a total recurrent budget of K50.3 million to fund its operations, however, Treasury and MBC recommended and appropriated in the budget K45.9 million.

Communication of Budget Ceilings

2.13 AGO noted in the audit documentary review that after budget ceilings are calculated, a Budget Circular is sent out to agencies advising them of their budget ceilings and other relevant information required to be adhered to in compiling budget submissions. A Budget Circular is the formal communication method which Treasury as the budget coordinating agency, uses to communicate information on budget ceilings and other related information to implementing agencies.

2.14 The 2013 budget ceilings were communicated to government agencies in two separate Budget Circulars **4/2012** and **5/2012** for National Departments and Statutory Authorities, and Provincial Governments respectively. Although there were two different circulars issued to government agencies regarding the 2013 budget, both circulars served the same purposes which are to:

- Inform government agencies of the 2013 Recurrent Budget Ceilings;[8]
- Advise agencies on the policy framework underpinning the 2013 Budget;
- Provide guidance to agencies on the form and content of their 2013 Recurrent and Development Budget submissions; and
- Seek 2013 Recurrent Budget Estimate submissions by giving relevant closing deadline dates for agencies submissions.

[8] Budget Circular 4/2012

Agency Submissions

2.15 Treasury advised that, in practice, most agencies' budget submissions are higher than their ceilings, and request additional funds. The reasons and arguments for agencies requesting extra funding mainly centred on agency Corporate Plan and work programs required to be implemented including cost associated with the work plan and programs. Given the limited financial resources and opportunity costs involved, however, Treasury rarely considers requests for extra funding above the ceilings. The government allocates funding on the basis of the whole of government expenditure priority areas and policy objectives and, hence, any request for extra funding above the ceilings has to be genuine and justified, and also aligned with the expenditure priority areas of the government, in order for the Treasury to consider and entertain the request for extra funding.

2.16 Budget circular 4/2012 states that agencies have to comply with the requirements of the circular and submit their budgets in accordance with the timetable specified in the circular. Those agencies that do not submit budgets on time are not included in the Budget Screening Committee (BSC) process (See Table1 above) where their spending programs would be evaluated with respect to their ceilings set by the Treasury/Government. In these cases, if there is a need for additional funding, there is not opportunity for these agencies to argue for the extra funding. It was further noted that where agencies needed to find savings to stay within the ceilings, they were urged by Treasury to identify funding from:

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

2.17 Treasury advised that in relation to the 2013 budget process, some agencies lodged submissions that did not comply with elements specified in the budget circulars. However, these agencies were still given time to participate in the Budget Screening Committee (BSC) meetings to justify their request for extra funding and eventually received additional funding higher than their ceilings. However, records of the agencies that made late submissions in 2013 have not been maintained by Treasury for audit verification. Treasury advised that there is some flexibility in dealing with late submissions and these are considered on a case by case basis to ensure that the investment plan and other priorities of the Government are achieved.

2.18 The AGO noted in this context that there was no clear specific screening criteria for each of the various committees to use in the budget screening process and as a result, the relevant committees assessed budget submissions against the key policy objectives and expenditure priority areas of the government. Some responsibilities for the budget process have been recognised and formalised through the establishment of the Central Agencies Coordination Committee (CACC). The CACC is required to consider the outcome from the Budget Screening Committee and make recommendations prior to submission of the overall budget to the Ministerial Budget Committee (MBC). However, the AGO found that in the 2013 budget screening, the CACC took no part in the budget screening process. Instead, the budget went from the BSC directly to the MBC and subsequently to the NEC for approval. Treasury advised the AGO that the CACC was bypassed in the process due to the fact that in practice, the members of the BSC are also the members of the CACC. While the formal constitution of those committees calls for officials of the CACC to be at a higher level than the BSC, this is not always achieved. In this instance, common membership of the BSC and CACC meant that officials were already aware of the issues involved in the budget through the initial meeting of the Budget Screening Committee (BSC).

2.19 In the absence of clear specific budget screening criteria and the input of the CACC, the 2013 budget screening process was incomplete, thus posing a greater risk of error in the budget decision making process in the approval and allocating of budget figures to agencies. Treasury advised that the various budget screening committees were appointed by Cabinet with Terms of Reference that were intended to guide their deliberations. However, AGO was unable to obtain from Treasury the Terms of Reference of these various committees including copies of any minutes of meetings that may have been held, setting out the reasoning underpinning recommendations made in relation to the 2013 budget. With the lack of such records maintained by Treasury, there is no audit trail and it would be difficult for Treasury to demonstrate that due process has been followed in the screening process.

Criteria for consideration of Budget Submission

2.20 As noted above, the AGO found that the screening and consideration of budget submissions is based on the development investment plan and expenditure key priority areas of the government as provided in the MTDP. In the 2013 budget, the government announced[9] funding increases of 50.9% in the key priority areas of Education, Health, Infrastructure and Law & Order, compared to the 2012 budget year. AGO analysis of the budget figures shows that overall, increases of recurrent appropriations in these key areas were in the order of 25% and there were some reductions in the development appropriations, which meant that the overall increase in appropriations in the key priority areas was approximately 8%.

Table 3: Comparative Table – 2012-2013 Budget Appropriations

Functional Area	2012 Recurrent Appropriation (K million)	2013 Recurrent Appropriation (K million)	% +/- Increase
Law and Justice Sector	594.959	639.949	7.56%
Education (Social Sector)	639.364	1,032.959	61.56%
Health (Social Sector)	648.094	719.191	10.97%
Infrastructure Sector	234.173	243.585	4.02%
Sub-Total Recurrent Appropriation (Law, Education, Health and Infrastructure)	2,116.591	2,635,684	24.52%
	2012 Development Appropriation (K million)	**2013 Development Appropriation (K million)**	
Law and Justice Sector	232.574	110.712	-52.40%
Education (Social Sector)	600.988	355.575	-40.83%
Health (Social Sector)	410.419	301.132	-26.63%
Infrastructure Sector	1,116.437	1,442.564	29.21%
Sub-Total Development Appropriation (Law, Education, Health and Infrastructure	2,360.418	2,209.983	-6.37%
Total Appropriation (Law, Education, Health and Infrastructure	**4,447.809**	**4,845.677**	**8.23%**

Source: AGO from Appropriation Acts.

2.21 Budget circular 4/2012 states that agencies wishing to request more funding in their budget submissions will be considered on the basis of genuine justification and the request for extra funding should be within the priority areas and align with development investment plan of the government

[9] 2013 National Budget Paper Volume 1 Economic and Development Policies for the year ending 31st December, 2013, p.3.

as a whole. Treasury advised that based on prior years' experience, budget is sometimes put under pressure trying to accommodate all the expenditure priorities of the government as there was insufficient actual revenue cash inflow to fund them.[10] This was reflected in the 2013 Final Budget Outcome (FBO) reporting a Final Budget Deficit of K2.67 billion compared to original Budget Deficit Estimates of K2.55 billion, due in part to lower total revenue which was K649.2 million less than projected as a result of lower tax revenue, non-tax revenue, grants, and infrastructure credits.

2.22 The budget circular refers to the 2013 Budget Strategy Paper (BSP). However, AGO found that the 2013 Budget was formulated before the BSP was finalised. As discussed in paragraph 2.10 above, the Budget Strategy Paper (BSP) provided for audit verification was in a draft form specifically designed for internal use and was not published on the Treasury website as required under the *Fiscal Responsibility Act 2006*. In the absence of finalised BSP, data on economic updates and forecasts were obtained from the Treasury Economic Policy Division (EPD) instead to formulate the 2013 Budget.

Outcome of Budget Screening Process

2.23 According to the Treasurer's Budget speech,[11] a total of **K13 billion** consolidated national budget for 2013 fiscal year was approved by Parliament after undergoing various stages in the screening process. A comparative audit analysis completed on the 2013 budget records for the 128 government agencies provided by Treasury in relation to budget screening process noted the following outcomes as tabulated below.

Table 4: Outcome of Budget Screening Process

No. of Government Agencies (Total 128)	Result of Screening Process
28 out of 128 agencies	Received approved appropriation recommended by MBC **above** the Treasury recommended figure.
69 out of 128 agencies	Received approved appropriation recommended by MBC **less** than the Treasury recommended figure.
31 out of 128 agencies	Received approved appropriation recommended by MBC **equivalen**t to Treasury recommended figure.

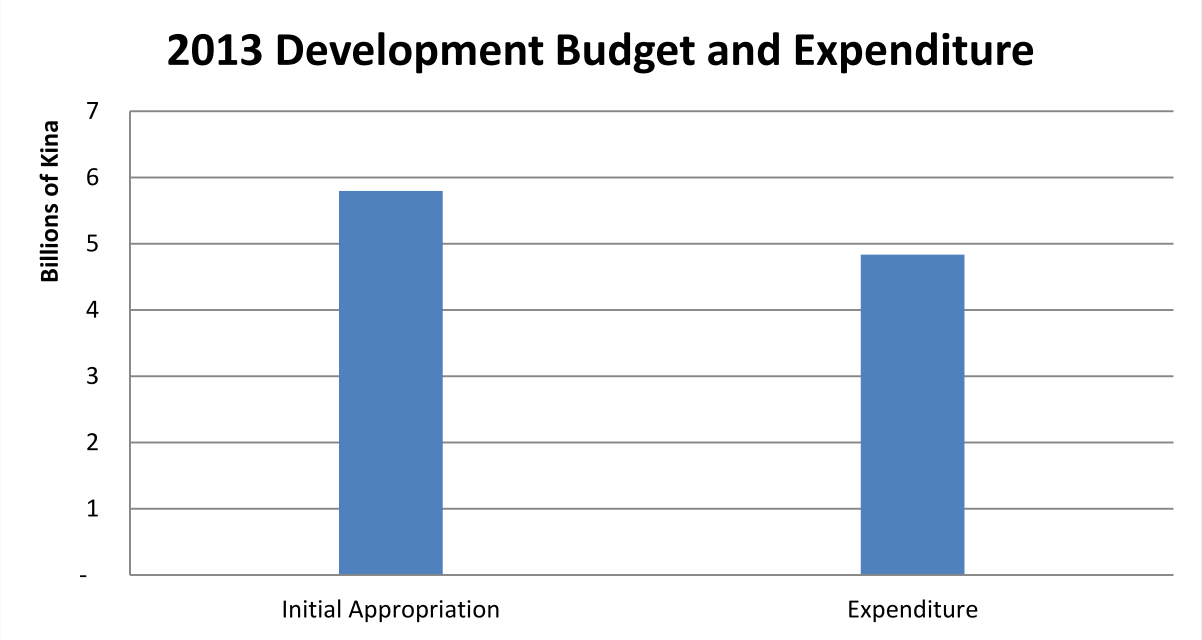
2.24 In recent years, various screening processes have been introduced aimed at providing improvements to the budget process and to facilitate greater scrutiny of budget projects, and consequently expenditure. These processes did not have a significant effect on the planning and delivery of the 2013 budget. Although submissions were passed from one committee to another for screening purposes, the audit found that at the end, most of the final approval figures are based on the figures recommended by Treasury. This reflects the relatively short period of time the new processes have been in place, as well as the need for clear specific screening criteria to be developed for each of the various budget screening committees to use at each stages of the screening process.

Actual Outcome against Appropriation

2.25 In overall terms the development budget was underspent by K95.3 million. In 2013 the overall development budget against agency total is shown in Figure 1.

[10] 2013 Final Budget Outcome report
Budget circular 4/12
[11] 2013 National Budget Volume 1 Economic and Development Policies

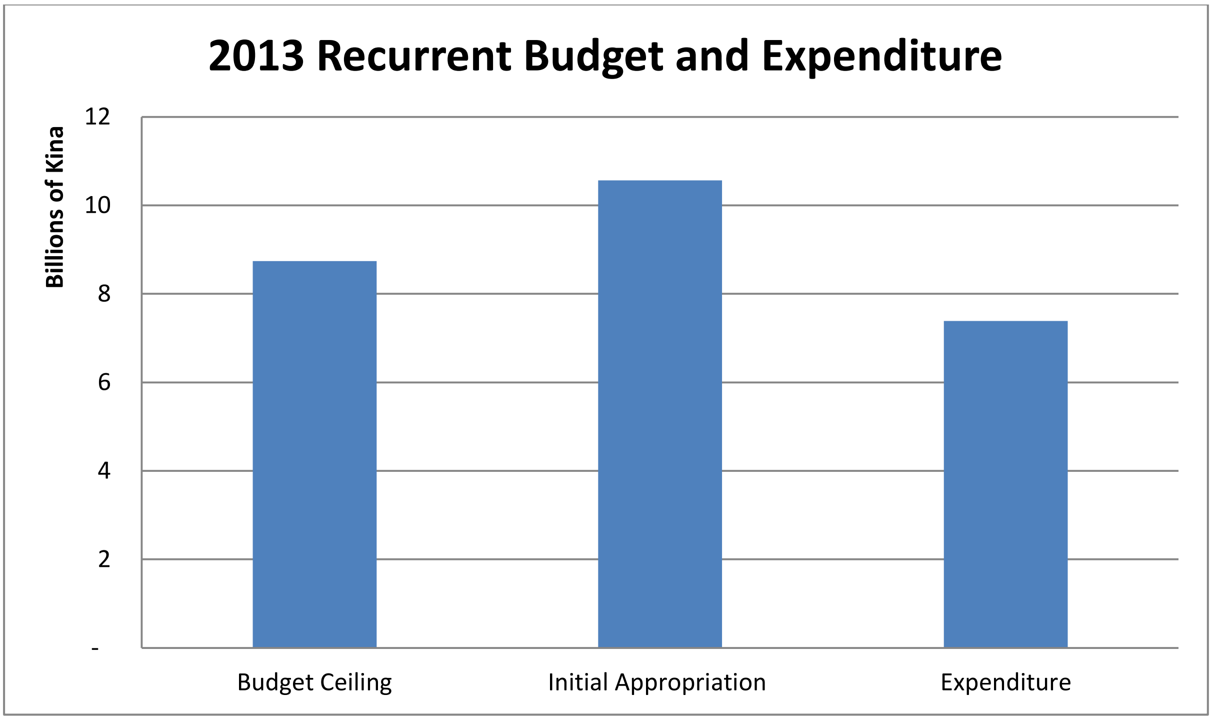
Figure 1: Comparison between the 2013 Initial Approved Appropriation budget and actual Development Expenditure.



Source: AGO analysis of development from the FBO, and 2013 development Appropriation Act.

2.26 The AGO noted that there were a number of entities that received through the development warrants significantly more, or less than the original appropriation. This process is managed through a system of transfers within the DoT. However, there are few controls over this process.

Figure 2: Recurrent Budget and Expenditure 2013.



Source: AGO analysis of 2013 Recurrent Appropriation Act & FBO.

Conclusion

2.27 The process in which budget submissions were screened and approved involves several stages and key players performing different roles in the overall screening and approval process. The committees include the Ministerial Budget Committee (MBC), the Budget Screening Committee (BSC), and the Central Agencies Coordinating Committee (CACC), with the Treasury and National Planning & Monitoring Departments acting as the coordinating agencies in charge of the recurrent and development budgets respectively.

2.28 The 2013 Budget Strategy Paper (BSP) was the key document establishing the broad principles, strategy and fiscal parameters guiding the budget process which was framed against a background of fiscal responsibility and constraint. However, the BSP was never finalised and in its absence, data on economic updates and forecasts were obtained from the Treasury Economic Policy Division (EPD). Moreover, the (draft) BSP was not published on the Treasury website as required under the *Fiscal Responsibility Act 2006*.

2.29 Although several committees were involved in the budget screening process; AGO found that the Central Agencies Coordinating Committee (CACC) took no part in the screening process. The various budget screening committees were appointed by Cabinet; however, relevant records of committee meetings and their terms of reference established by Cabinet have not been maintained. In the absence of CACC input, the 2013 budget screening process and stages were incomplete, which meant that the approval and allocation of budget figures relied on data supplied by agencies and agreed by Treasury. As a result, the budget process was at risk of delivering a budget outcome that was not consistent with Government priorities.

2.30 It is apparent that there were no clear specific screening or assessment criteria for each of the various budget committees to use in the budget screening process. Instead, the committees assessed budget submissions based on the key policy objectives and expenditure priority areas of the government and did not allocate any priority to the revenue raising agencies. In the absence of clear specific screening criteria; the various stages of the budget screening processes were largely ineffective, as submissions passed unchanged from one committee to another during the screening process. The lack of rigour in the budget screening process increased the risk that revenues would not match planned expenditure and of key participants and the public losing confidence in the Government's budget process.

2.31 In order to address the issues identified in the budget screening process, AGO makes the following recommendations.

Recommendation No.1

AGO recommends that in order to improve the outcome from the budget screening process, the Treasury Department in consultation with relevant government agencies, develops and documents clear specific assessment criteria for each of the budget screening committees to use in the screening process to align with key policy objectives and expenditure priority areas of the government.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

Recommendation No.2

AGO recommends that the budget administrative process and requirements are strengthened to ensure that:

(a) The Budget Strategy Paper (BSP) is completed and authorised at appropriate level; and

(b) Each of the various committees involved in the budget process complete their reviews as stated in their respective Terms of Reference.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

3. Allocation and Release of Warrants

Background

3.1 Warrant authorities are an administrative method used to draw down and disburse appropriated public funds to agencies to carry out their functions. Warrants provide authorisation for the appropriated amounts to be drawn from the Consolidated Revenue Fund (CRF) and transfer to agencies operating accounts. A warrant authority is valid for the twelve months of a fiscal year cycle and may lapse if not used.

3.2 Warrant authorities come in two forms, the Minister's warrant and the warrant authority. The Minister's warrant is the authority that the Minister for Treasury provides to the Department of Treasury enabling the Secretary of the department to draw down appropriated funds passed by Parliament from the CRF. The Minister's warrant is issued immediately after Parliament passes the appropriation bills. The Public Financial Management Act[12] provides the legislative authority to the Minister for Treasury to issue this warrant. The Minister's warrant authorises the release of the total appropriation of both the recurrent and the development appropriation to be drawn from the CRF. Specifically, the Minister's warrant authorises the secretary for the Treasury to issue warrant authorities against the appropriations passed by the parliament within the fiscal calendar of the government. No appropriation can be disbursed to agencies without a warrant authority except for personnel emolument.

3.3 Unlike the Ministers warrant, a warrant authority is a periodic authorisation provided to agencies to expend appropriated funds within a given fiscal year. The warrant authorities are normally released on a monthly basis,[13] however, in some cases warrant releases will be driven by the availability of funds in any given month and the funding priorities of the government. The Secretary of the Department of Treasury is authorised to release warrants periodically under the Public Financial Management Act[14]according to financial guidelines that are designed to ensure that the amount authorised in a given period of time falls within the boundaries of sound fiscal management principles.[15]

Public Debt and Cash flow Committee (PDC)

3.4 As indicated in Table 1, the Public Debt and Cash flow Committee (PDC) has been established with the objective of providing advice and recommendations to the Secretary for Treasury on Government financing, debt and budget matters. The PDC is served by two committees; a policy committee[16] which meets quarterly, and a technical committee[17] which meets weekly.

3.5 The PDC technical committee provides advice on the budget financing requirements of the Government. It is required to consider government cash flow on a weekly basis as well as public debt information, detailed debt servicing projections, the outstanding volume of Treasury Bills, expected movements in interest rates and anticipated market demand for government securities. It also

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[12] Public Financial Management Act, Section 29, subsection 1
[13] Finance Management Manual, division 6.3
[14] Public Financial Management Act, Section 31.
[15] Fiscal Responsibility Act Section, 4 & Section 5
[16] The PDC Policy Committee members are the Departments of Treasury, Finance, National Planning and Monitoring and the Bank of Papua New Guinea.
[17] The PDC Technical Committee members are the Departments of Treasury, Finance, National Planning and Monitoring, the Internal Revenue Committee and the Bank of Papua New Guinea.

provides projections of taxation revenue and reports on any extraordinary variances or unplanned additions to the expenditure budget and the level of used and unused warrants.

3.6 The PDC policy committee considers and recommends to the Secretary for his approval any other Government financing requirement. The PDC policy committee also considers warrant releases on a quarterly basis and any extraordinary variances or additions to the expenditure budget, which will have a definite impact on the financing programme of the Government. In this process, the PDC also considers the level of unused warrants each quarter.

3.7 Through the two committees, the PDC plays a key role in allocating warrant authorities on a monthly basis to the agencies to expend. The PDC monitors cash coming in and going out of the Consolidated Revenue Account (CRA) at the Bank of Papua New Guinea and makes decisions on the disbursement of appropriated funds/warrants to the agencies. Due to the variability of cash flow in and out of the CRA, on occasions where there are insufficient funds to meet agencies monthly cash flow requirements, changes to the warrant figures can be recommended by the PDC during the month. In practice, the PDC advises when the Treasury Budget Division is to release the monthly ceiling/warrants to the agencies.

Warrant Allocation Process

3.8 The Public Finance Management Manual[18]states that a cash flow statement should be prepared setting out how funds will be spent and submitted to Treasury for consideration and for allocation of warrant authorities. However, as discussed at paragraph 3.7 above, at times Treasury is faced with situations where there is a shortfall in the actual cash available in the Consolidated Revenue Fund (CRF). When such situations arise; the Public Debt Committee (PDC) will decide on an alternate source of income it can obtain to meet the funds shortfall for the month or decide on how the available funds can be best allocated to the agencies.

3.9 As discussed at paragraphs 3.4 and 3.5, one of the options available to the PDC is to make recommendations to raise revenue if there are limited funds in the CRF. The PDC can advise Treasury to issue Treasury Bills and other Government securities in order to raise the required funds needed to allocate to agencies. Another option is to delay and/or provide abridged funding to agencies in a given month. Fund cuts and delayed funding have been some of the issues that agencies claimed as factors constraining their capacity to deliver required services effectively.

3.10 As discussed above, the PDC makes decisions to allocate monthly cash/warrants to meet agencies competing demands based on the position of cash availability in the CRF. AGO was advised that these decisions are mostly influenced by the need to fund the government's priority areas and essential services. That means if there is insufficient cash in the CRF; those agencies that are in the position of implementing key priorities of the government or essential services will be considered priority when allocating limited monthly cash/warrants. Agencies cash flow requirement is also an important area of consideration for PDC to make decisions on the allocation of monthly warrants and those agencies that do not submit cash flow requirements are usually allocated monthly warrants on a pro-rata basis. The outcome of the PDC decisions on warrant allocation often results in some agencies receiving more and sufficient funding while others gets less funding in a given month.

3.11 The PDC guidelines indicate that both the technical committee and the policy committee are required to consider warrant releases and the level of used and unused warrants as well as variances or unplanned additions to the expenditure program which will have a definite impact on the financing programme of the Government. The importance of this is reaffirmed in several parts of the PDC guidelines that require the cash management and expenditure control division of Finance Department to provide information in relation to the public account balances with the Bank of

[18] Division 4

Papua New Guinea, including any abnormal expenditure items in the coming month or quarters. The AGO noted that although the PDC guidelines are comprehensive, there is no requirement to comply with any standards set out in the guidelines and as a result, the PDC is required to make recommendations to allocate monthly cash/warrants to agencies based on the cash availability position in the CRF and the key priorities of the government. In attempting to balance these competing considerations, on occasions the monthly cash ceiling approved by the PDC does not correspond with the actual cash availability as per the weekly and monthly statement of balance supplied by BPNG. This causes significant disruption in the distribution of government funds as there is insufficient cash available to match the warrants that have been issued. In correspondence[19] to the (then) acting, now confirmed Secretary of the Department of Treasury on this matter, the Department of Finance noted:

> This concern has now prompted me to propose a way forward to address this critical situation. I now propose that any future cash ceilings for consideration by PDC must emanate from the Finance Department which will ensure that the monthly cash ceiling is based in the actual cash available and so warrants release by Treasury will have equivalent cash component.

3.12 At the time of the audit, there had been no response from the Department of Treasury to the Department of Finance letter and proposal.

3.13 Making sure that the monthly cash ceilings and the approved warrants allocated to agencies are consistent with the actual cash available at the time, is essential for ensuring that Government programs operate smoothly and that planned improvements in Government services can be achieved. However, at the time of the audit, the administrative mechanism for the PDC, Treasury and the Finance Department to share information regarding the overall cash position compared to the value of the warrants that were to be issued was less than effective. The AGO noted that the Terms of Reference (TOR) for the PDC allow for amendments to the TOR following a review of the operation of the PDC or as and when required to take account of the policy or operational changes that could hinder or affect the operations or functions of PDC for effectively performing its functions. There would be benefit in PDC members considering the audit findings outlined above and considering revised guidelines to avoid situations where the demand for cash significantly exceeds the cash available and differs significantly from that which has previously been considered by the PDC. This would serve a number of important purposes, including:

- Helping to promote compliance with the requirements of the Public Finance Manual because fundamental changes in the overall cash position may mean that a further referral to the PDC is required;
- Encouraging more consistently, rigour in agency development of the cash requirement and revenue estimates that are advised to the PDC; and
- Drawing Finance, Treasury and the PDC's attention to areas that might warrant closer scrutiny in the development of future cash requirements.

Timing of Warrant Release

3.14 Section 29 (1) of the *Public Finance Management Act 1995*, states that the Minister may, by warrant, authorise the Departmental Head of the Department responsible for financial management to issue warrant authorities authorising the expenditure of moneys from the Consolidated Revenue Fund (CRF) for the purpose for which those moneys were appropriated or charged or deemed to have been appropriated or charged. This section of this enabling Act was specifically stated in Division 2, part 6.1 of the Public Financial Management Manual as part of delegation of responsibility which gives the Secretary for Treasury responsibility to authorise the agencies to commit and spend their appropriated funds by way of warrant authorities released.

[19] Letter dated 16 October 2014.

3.15 Division 2, Part 6.3 of the Public Financial Management Manual further states that Warrant Authorities are to be issued periodically on a monthly basis and the amount of warrant should be based upon cash availability. Part 7.1 states that all recurrent appropriations/ warrants out of the Consolidated Revenue Fund (CRF) lapse at the end of the fiscal year with the exception of Government contribution to donor funded projects.

3.16 AGO found in the audit review process that when the warrants are issued from Treasury for Statutory Authorities and Provincial Governments, the original is forwarded to the financial control and expenditure division within the Department of Finance and copies go to the respective agencies. Once receipt of the warrants is confirmed by the Department of Finance, it (Finance) then liaises with the Bank of Papua New Guinea to remit the cash components of the warrants to the agencies operating accounts to allow agencies to draw down funds. However, warrants are issued directly to the National Government Departments (such as Education and Works Departments) and these are entered into the PGAS/IFMS system enabling these agencies to draw down funds. Since those National Government Departments can operate a drawing account with a negative balance, warrant funds can be drawn from the bank even in circumstances where there are no funds in their accounts.

3.17 An analysis of the 2013 warrants release process and control register records from Treasury noted that almost every agency received their recurrent warrants on a monthly basis from January to December as required by legislation, although there were some monthly budget reductions as described at paragraph 2.20 above. However, AGO found that the department of finance records of cash remitted to agencies could not be reconciled with warrants records from Treasury. Finance department working papers indicate that there was no significant delay in the timing of warrants released and the actual cash remittance to agencies operating accounts. Only minor delays were experienced by agencies in cash movement to their operating accounts which is attributed by compliance to banking and administrative procedural requirements.

3.18 However, for the development budget, warrants were not released and cash remitted on a monthly basis but on certain months based on the agencies cash flow requirements. It was noted from the warrants register control records that those departments in charge of implementing the key priority of the government were frequently given warrants to fund their programs and projects. For instance, Department of Works was issued warrants on a monthly basis to fund infrastructure projects as one of the key priority areas of the government. Further, non-submission of cash flow requirements and budget quarterly review reports to Treasury are major contributing factors causing delay in the manner warrants are released to agencies to implement development projects.

Impacts of Late Release of Warrants

3.19 As discussed above, much of the recurrent budget warrants released to agencies in 2013 fiscal year were on a monthly basis as required by Financial Laws. However, warrants totalling **K3.8 billion** specifically allocated for development funding, were not released on a monthly basis. For non-priority areas, warrants were released on average after 2 – 3 months, while the priority areas such as the Department of Works, received their development warrants on an average of every after 1 -2 months period.

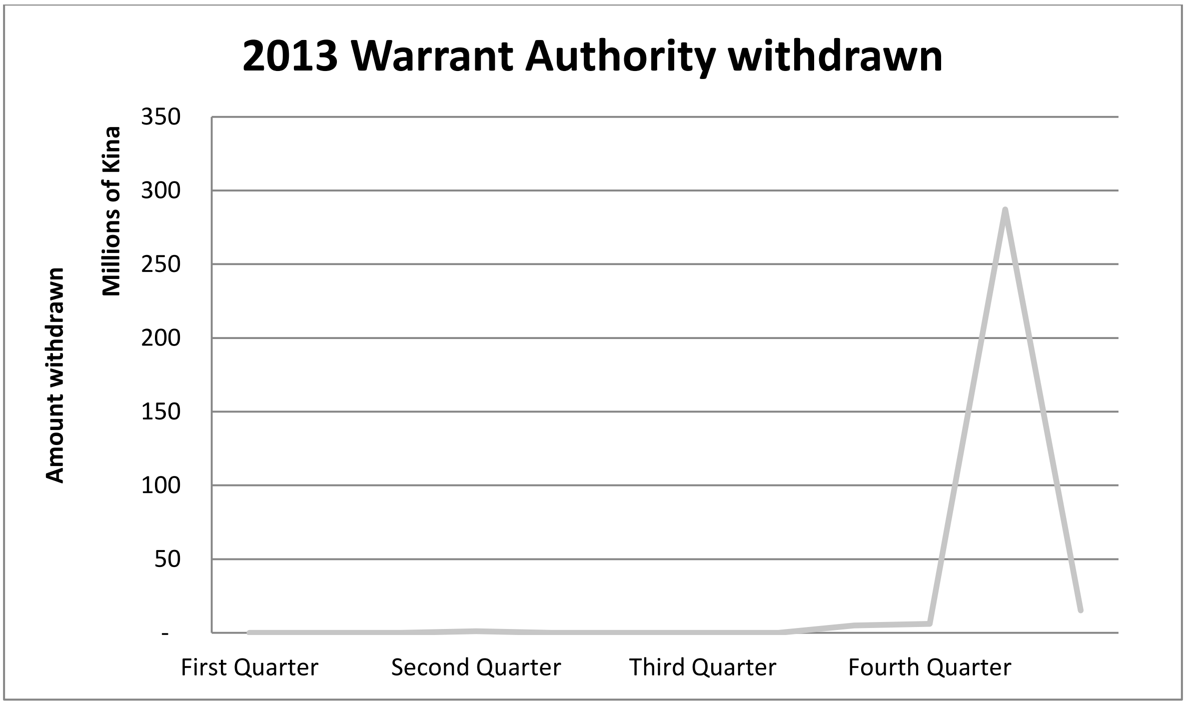
3.20 Factors such as different agency operating and service delivery environments, together with diversity in project deliverables and locations, means it is reasonable for warrant funding practices to vary. However, the AGO found that funds that were earmarked for development purposes were released to agencies based on submission of cash flow requirements and the availability of cash in the CRF. There is a risk that variation in the timing of the warrants could have flow on impacts on agencies receiving the funding by slowing down their capacity to deliver and complete scheduled projects on time and subsequently affecting timing of service delivery to the population.

Withdrawal of Warrants

3.21 The Treasury Department as part of managing the overall budget can withdraw certain warrants from agencies during the fiscal year by issuing withdrawal warrants. This allows the funds that have been withdrawn from an agency to be reallocated to other priority expenditure areas. The practice of warrant withdrawal is usually done for those agencies that were initially given warrants to commit and spend funds for recurrent programs and development projects but have not yet been expended. Withdrawal warrants are normally issued towards the end of the fiscal year as part of budget wrap up process and close of government public accounts.

3.22 From the audit analysis AGO found that a significant number of warrants were withdrawn from several agencies in 2013 fiscal year. In particular, warrants totalling **K280 million** appropriated for development expenditure were withdrawn in the month of November which was then reappropriated in the 2013 supplementary budget. It was noted that among the ten agencies with the highest warrants withdrawal in 2013, six of them were the key agencies responsible for implementing service delivery in the key priority areas identified by the government. These higher key priority agencies includes; Department of Works & Implementation, Hospital Management Services, Department of Education, Department of Health, Office of Higher Education, and Department of Information & communication. Other agencies are; Department of Foreign Affairs, PNG defence Force, Judiciary Services, and PNG Customs.

Figure 3: Amount of warrants withdrawal in 2013.



Source: AGO analysis on Warrant Control Register Data

3.23 Treasury advised that most of the warrants withdrawn in 2013 fiscal year resulted from agencies not fully utilizing appropriated funds/warrants given to them to implement development projects. Some implementing agencies submit to Treasury budget submissions, including cash flow projections, which are unrealistic and do not take into account the capacity of the agency to deliver in the time available. Treasury's view is that there has been a lack of initial feasibility studies and scoping of projects carried out, and as a result, when funds/warrants are released to implement the projects, there are delays as the agencies cannot deliver those projects on time. Treasury then withdraws those unspent warrants/funds and reallocates the funds to other most needed areas.

3.24 Such significant amount of warrants withdrawal and subsequent reallocations to other areas reflected to various degrees, weaknesses in the budget screening processes where warrants/funds were initially given to those agencies without realistic budget submissions.

3.25 In order to effectively manage the growing number of withdrawal warrants and addressing the problem of some agencies missing out on warrants during the fiscal year; a collaborative effort should be undertaken by implementing agencies with Treasury to ensure that project submissions and cash flow projections given to Treasury for funding request should be realistic, and based on agency's capacity to deliver so it minimizes inefficiency and withdrawal of warrants/funds during the fiscal year.

Conclusion

3.26 Agencies are required to prepare cash flow statements setting out how funds will be spent and to forward these to Treasury for consideration and subsequent allocation of warrant authorities. The Public Debt and Cash flow Committee (PDC) overlooks and monitors weekly cash flow and sets agencies monthly warrant ceilings based on the available cash in the Consolidated Revenue Fund (CRF). Agencies cash flow requirements are also an important area of consideration for the PDC to make decisions on the allocation of monthly warrants and those agencies that do not submit cash flow requirements are usually allocated monthly warrants on a pro- rata basis. The outcome of the PDC decisions on warrant allocation often results in some agencies receiving sufficient funding and in some cases additional funding while others receive less funding than requested in a given month.

3.27 On occasions, the system of allocating warrants based on the position of cash availability in the CRF breaks down and there is insufficient cash available, which places pressure on relevant agencies to address, so that the key priorities of the government can be funded. Correspondence from the Secretary of the Department of Finance to the Treasury to overcome the systemic issues has not been answered. As well, there were no additional criteria in place for the PDC to use as basis for making decisions to allocate monthly warrants/ceilings to agencies.

3.28 While almost every agency received its warrants for recurrent spending on a monthly basis in the 2013 fiscal year as required by legislation, the development budget warrants were not released and cash remitted on a monthly basis. Instead development budget warrants were released in certain months based on submission of cash flow requirements and the availability of the cash in the CRF. Non submission of cash flow requirements and budget quarterly review reports to Treasury as well as limited cash availability in the CRF were major contributing factors causing delay in the manner warrants are released to agencies to implement development projects. Late release of warrants can have a flow on impacts on agencies receiving the funding by slowing down their capacity to deliver and complete scheduled projects on time and subsequently affecting timeliness of effective service delivery to the population.

3.29 A significant number of warrants were withdrawn from several agencies in 2013 fiscal year. In particular, warrants totalling **K280 million** appropriated for development expenditure were pulled back in the month of November which was then reappropriated in the 2013 supplementary budget. Such significant amount of development warrants withdrawal in 2013 fiscal year demonstrated weaknesses in the budget screening processes where warrants/funds were initially given to agencies without realistic budget submissions and lack of capacity to deliver development projects on a timely manner to enable effective service delivery to the population.

3.30 In order to address the issues identified in the process of allocation and release of warrants, AGO makes the following recommendations.

Recommendation No.3

AGO recommends that to better manage the Government's cash flows, the Department of Treasury works closely with the Department of Finance in the allocation and release of monthly cash ceilings/warrants to agencies to ensure that warrants issued do not exceed cash available in the CRF.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

Recommendation No.4

AGO recommends that in order to effectively manage the number of withdrawal warrants during the fiscal year and to address the problem of some agencies missing out on monthly warrants; Treasury should implement closer working relationships with implementing agencies to ensure that project submissions and cash flow requirements are realistic and based on an agency's capacity to deliver.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

4. Changes of Appropriations

Types of Changes

Administrative Changes

4.1 The Treasury Department as the Government Central Agency in charge of coordinating and administering the Budget is also responsible for making changes in the Budget Appropriations. The change in the Budget Appropriation is done by way of transfers of funds from one agency to another agency or movement of funds within agency's activity line vote items and such changes are known as **Section 3** and **Section 4** Transfers as these are permitted by Laws under Section 3 and Section 4 of the Appropriation Acts.

4.2 The rationale behind changes and transfers of funds done by Treasury is to cover shortfalls and unforeseen items incurred during the budget implementation fiscal period. Emergencies involving natural disasters and State contractual legal obligation may also force the Government to request Treasury to locate funding within the budget and transfer funds to cover the costs involved. Such changes made to transfer funds within the budget are sometimes based on Government Decisions and Ministerial Directives, or are in other ways properly authorised.

4.3 According to Treasury, Transfers of funds are determined based on proper and genuine justification requests from agencies and also by considering that what was requested by agencies is important and within the priority areas of the government. A number of agencies request for additional funding and transfers in the 2013 budget were rejected due to no proper justification and genuineness of the request. The availability of funds within the Consolidated Revenue Fund (CRF) or Public Purse also determines whether or not the request made by agencies for additional funding can be considered by Treasury.

4.4 It was noted in the audit review that a significant number of transfers were done in 2013 fiscal year as reported in the 2013 Final Budget Outcome (FBO) report. The AGO found that there were no any monthly reports of the 2013 transfers published on the Treasury Website and copies made not provided to the Auditor General's Office as required under Sections 9 and 10 of the Appropriation Act respectively. Treasury advised that pressure from Government and Ministerial Directives to transfer funds sometimes meant that proper administrative and financial procedures were bypassed.

Legislative Changes

4.5 Legislative changes to Budget Appropriations are carried out through Parliament passing a new Appropriation Bill over the existing Budget Appropriation Act to reappropriate funds according to the Parliament's priorities. Such legislative changes to budget appropriations are effected through the creation and passing of a Supplementary Budget.

4.6 In 2013 fiscal year a Supplementary (Appropriation) Bill 2013 was passed to provide a sum of **K379.8 million** for expenditure in the Supplementary Budget. The total amount reappropriated in the 2013 Supplementary Budget were mostly unspent funds retained from agencies made up of recurrent expenditure (K24.44 million) and development expenditure (K355.4 million) originally appropriated in the 2013 Budget.

4.7 AGO found that the legislative changes to the initial Budget Appropriation through the enactment and passing of the Supplementary Appropriation Bill 2013 enabling the reappropriation and expending of funds in the 2013 Supplementary Budget is required by law under Section 209 (2) (c) of the Constitution as amended and also operates as a way of avoiding warrant lapses at the end of the fiscal year.[20] The Supplementary Budget was passed following the withdrawal of a significant amount of warrants from agencies. This suggests a key area of variability in agency practices has been related to the development and approval of budget estimates. In addition to determining which development projects require funding, agency budget estimates are an important input to the Government's overall budget, as well as highlighting the current and future public value of the resources expended. However, financial information being provided by the agencies has been of variable standard. There has been insufficient clarity about the level of confidence attaching to budget estimates; and/or insufficient allowance has been made for risks and price and cost increases over time (through a provision for cost escalation).

4.8 In order to minimize significant amount of warrants/funds withdrawal during the fiscal year, agencies budget submissions and cash flow projections submitted to Treasury should be realistic and based on their capacity to deliver on a specified budget time frame so that warrants/funds given to implement government programs and projects are fully utilized as per budget. This will also address the problem of some agencies missing out on warrants/funds during budget screening process and allocation of monthly ceilings as there will be sufficient funds available to allocate and meet competing demands of agencies for limited funds.

Authority of Changes

4.9 Pursuant to sections 3 and 4 of the Appropriation Act, the Secretary for Treasury is authorised to make changes and transfer funds in the Budget Appropriation.[21] The Minister for Treasury also by virtue of power conferred to him under sections 5(1)(2)(3) of the Appropriation Act in exceptional circumstances may direct the reallocation of funding held in Division 207 (Treasury and Finance Miscellaneous) for other purposes and/or reallocation of Appropriations for activities identified in the budget. Further, the Minister (Treasurer) is required to publish in the Department of Treasury Website a notice identifying the amount of the proposed transfer, the relevant divisions and the purpose of the transfer. Section 8 of the Appropriation Act also allows the Transfers of Activities between agencies which extends the authority conferred by Section 3 & 4 transfers.

4.10 It is apparent that the authority to make changes and transfer funds in the budget appropriation is vested in the Secretary for Treasury and Minister responsible as stipulated in the Appropriation Act. However, AGO found that the Secretary for Treasury has also informally delegated the power to approve transfer of funds to the Deputy Secretary for Budget & Financial Management within the Treasury Department as part of routine administration within the organisation. AGO sought to obtain a copy of the signed delegation instrument to approve transfers but none was made available. While it may be appropriate for the deputy secretary of the Treasury department to exercise these powers, with no clear approved delegation of power, there is a risk that changes and transfers in the budget appropriation may not be properly authorised. The Appropriation Act exists to provide an authority of roles, responsibilities, and set boundaries of operations to promote efficient and effective use of resources. Where the authority, and roles and responsibilities have been delegated for operational reasons, these should be recorded through a formal instrument.

Control of Changes

4.11 The Treasury Department maintained a Register of Transfers which captured records of funds transferred in 2013 budget appropriation. Audit examination and analysis of budget records noted that around 60 agencies have been given actual warrants above their appropriation passed in

[20] Public Financial Management Manual Part 7.1 states that all recurrent appropriation/warrants out of the Consolidated Revenue Fund lapse at the end of the fiscal year with the exception of Government contribution to donor funded projects.

[21] Appropriation Act 2013

Parliament and yet there was no section 3 or 4 transfer records captured in the register to identify the additional funding given to those agencies. In the similar analysis, Division # 202 the Office of Governor General has been given actual warrants of around K6 million which is more than the K5 million approved appropriation, however, from the register of transfers records a total of K57 million was noted to be transferred out under section 4 transfers which is well above the amount of actual warrants issued and the appropriation passed at Parliament. There is also no record of funds transferred in for that particular vote #202 captured in the register records as noted.

4.12 The AGO found that the records of funds transfer in the 2013 budget appropriation captured in the register of transfers were inaccurate and unreliable with greater weaknesses in the controls surrounding the management records of the funds transfers. Due to poor standard of records however, essential information required for subsequent fiscal year budget planning and preparation can be inaccurate and also poses greater risk of misleading budget figures reported in the Final Budget Outcome (FBO) report and other relevant budget report documents.

Impacts of Changes

4.13 Although the changes and transfers of funds in the budget appropriation are authorised by Appropriation Laws, there are impacts that such changes and transfers can have on the budget if not closely managed within the confinement of the approved appropriations laws.

4.14 Treasury advised based on its experience that over the years that transfers of funds affect the budget by causing shortfalls in agencies budgeted programs and activities and also at times placed Treasury under pressure to locate funding within the budget's limited financial resources to cover shortfalls created by transfers. Agencies are sometimes not being informed of their budgeted funds being transferred out to other agencies to use or meet other government commitments. As a result of funds being transferred out, this practice affects and delays agencies in implementation of their budgeted programs and activities required in order to deliver goods and services to the people within the given budget time frame.

Conclusion

4.15 Changes to budget appropriations can occur in two ways, consistent with budget laws; administrative changes and legislative changes. Administrative change is pursuant to sections 3 and 4 of the Appropriation Act which authorises the Secretary for Treasury to make changes by way of transferring funds in the Budget Appropriation. The Minister for Treasury also by virtue of power conferred under sections 5(1)(2)(3) of the Appropriation Act in exceptional circumstances may direct the reallocation of funding held in Division 207 (Treasury and Finance Miscellaneous) for other purposes and/or reallocation of Appropriations for activities identified in the budget. Further, the Minister (Treasurer) and Secretary for Treasury are required under sections 5 and 9 of the Appropriation Act respectively to publish on the Department of Treasury Website, a monthly notice of all Transfers identifying the amount of the proposed transfer, the relevant divisions and the purpose of the transfer. Section 8 of the Appropriation Act also allows the Transfers of Activities between agencies which extends the authority conferred by Section 3 & 4 transfers.

4.16 The rationale behind changes and transfers of funds done by Treasury is to manage shortfalls and unforeseen items incurred during budget implementation fiscal period. Emergency cases involving natural disasters and State contractual legal obligation may also force the Government to exert pressure on Treasury to try locating funding within the budget by making changes and transferring funds to cover the costs involved and such changes made to transfer funds within the budget are sometimes based on the Government Decisions and Ministerial Directives.

4.17 There were a significant number of Section 3 and 4 transfers in 2013 fiscal as reported in the 2013 Final Budget Outcome (FBO) report. Given these significant amount of transfers completed in

2013 budget appropriation; the AGO expected to find monthly reports and notice of all the transfers published on the Treasury Website. However, the required notices were not published and copies were not made available to the Auditor General's Office as required under Sections 9 and 10 of the Appropriation Act respectively. Further, it was also found that the records of funds transfers captured in the register of transfers were inaccurate and unreliable with greater weaknesses in the controls surrounding the management records of the funds transfers. Due to inaccurate and unreliable records maintained, however, essential information required for subsequent fiscal year budget planning and preparation can be distorted and also poses greater risk of inaccuracy in budget figures reported in the Final Budget Outcome (FBO) report and other relevant budget report documents.

4.18 Legislative changes to budget appropriations resulted in the creation and passing of the 2013 Supplementary Budget totalling **K379.8 million**. Several agencies were issued with warrants to implement their recurrent programs and development projects in 2013 fiscal year, but in some cases did not fully utilise their budgeted funds. As a result, Treasury withdrew the unused warrants towards end of the year close of accounts and reappropriated the funds through the Supplementary Appropriation Bill 2013. The significant amount of withdrawal warrants from agencies and unspent funds demonstrated some agencies' inefficiency in managing and utilising their budgeted funds given to them by Treasury to spend for development projects during the fiscal year. It also demonstrates agencies lack of budget planning and projections in the initial stage of budget process by not considering their capacity to deliver and yet submitted projects submissions to Treasury which were unrealistic and not achievable within the budget given time frame.

4.19 In order to address the issues identified in the changes of budget appropriation; AGO makes the following recommendations.

Recommendation No.5

The AGO recommends that the Treasury Department should;

(a) establish and maintain accurate and reliable recordkeeping systems relating to transfers of appropriations to ensure an adequate audit trail; and

(b) report the transfers and publish to the Treasury website and copies made available to the Auditor-Generals' Office as required under sections 9 and 10 of the Appropriation Act.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

Recommendation No.6

4.20 The AGO recommends that to ensure budget funds are utilised efficiently, service delivery agencies should submit realistic budget projections and cash flow requirements based on their capacity to deliver.

Department of Treasury Response:

No response to this recommendation was provided. Refer to Summary and Recommendation paragraph 10.

Appendix 1: The National Budget Formulation Process and Stages

Stage	Activities
Agency submission to Department of Treasury	• The budget is submitted to Treasury and it s uploaded into Treasury, PBS, now IFMS. Department of Treasury ensures that recurrent Budget is within the ceiling and/or budget complies with Budget Strategy Paper.
Ministerial Budget Committee (MBC)	• Consider the overall briefing from DoT and set the parameters on any funding available above announced budget ceiling and policy priorities for used by bureacratic committees(BSC&CACC) to screen the budget proposals from agencies.
Budget Screening Committee (BSC)	• Consider each budget submission working on the priorities and parameters set by MBC as well as budget submission evaluation from DoT • Offer each agency the opportunity to make apresentation based on their submissions • Delibarate on the funding requesr and briefs CACC to seeek its review and endorsement for budget decision
Central Agency Co-ordinating Committee (CACC)	• Consider the BSC briefing and endorses the budget decision and forward to MBC for its briefing
Ministerial Budget Committee (MBC)	• Consider the CACC briefing and endorses the budget proposals to seek NEC consideraion and approval
National Executive Council (NEC)	• Consider MBC briefing and endorses the budget estimates for briefing to Parliamentary Plans & Estimates Committee(PPEC)
National Parliament	• The opposition members respond to the budgte and parliament vote for the budget. • Appropriation Act is passed.

Appendix 2: Correspondence

AUDITOR GENERAL'S OFFICE
PAPUA NEW GUINEA

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6 August 2015

Mr. Dairi Vele
Secretary
Department of Treasury
P. O. Box 542
WAIGANI
National Capital District

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Lisa
MARGARET

Dear Mr. Vele

DRAFT PERFORMANCE AUDIT REPORT ON THE EFFECTIVENESS OF BUDGET PROESS – 2013 APPROPRIATIONS

I am writing to inform you of the status of the Auditor's General's Office (AGO) performance audit on the effectiveness of the budget process – 2013 appropriations. Our audit work is nearing completion and the audit team has prepared the attached draft report for your consideration, and to seek your comments and responses at an Exit interview to be organized in August 2015.

The Government's budget is an important political, economic and social undertaking. The outcome of the budget process represents the end of state of the decision – making process for allocating resources to the government's policy priorities in accordance with an overall government development strategy. Accordingly we sought to examine and assess the effectiveness of the budget process – 2013 appropriations as approved by the National Parliament and subsequent release of warrant authorities, with a specific focus on the key processes:

- The development and issue of budget ceilings and their impact on agency submissions,
- The approval process of the budgets and subsequently transfers; and
- The warrant released allocation process.

The draft report is based on the evidence from field work conducted by the audit team, and results from our analyses, interviews and our understanding of the audit. The draft report is detailed to ensure the audit findings are fully

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explored. The audit was supported and with technical assistance from the SGP Performance Audit Advisor to the AGO.

The AGO would welcome the opportunity to discuss these audit findings and conclusions at an Exit Interview to be arranged through our Head of Performance Audit, Assistant Auditor General, Mr. Puva Heako. The purpose of the Exit Interview is to get feedback on the draft report, and discuss audit conclusions and findings. Following the Exit Interview, the AGO will finalize the report for tabling in Parliament as per Part II, Section 7(4)of the Audit Act *1989*.

Specific attention is drawn to areas of the report that seeks Treasury's advice and comments or confirmation. These areas are identified by square brackets and the text is in bold as highlight by the following example – **[Treasury to please comment].** Formal written responses to the audit recommendations are also sought.

It would be appreciated if the requested comments could be forwarded separately or at the Exit Interview for inclusion in the final report. In order to ensure the timely production of this report for Parliament, it would be appreciated if these comments could be provided to the AGO by Friday 21st August 2015. Please advise me at your earliest convenience if this timing cannot be met. As our aim is to produce an informative and readable document, we therefore request that your responses be directly relevant to the audit queries, findings and recommendations, and be reasonably concise. This will aid readers, in particular, the Parliament. Following consideration of the any comments received, we may make amendments to the report.

If you have any questions on the report, please contact me on 301 2254 or Mr. Titus Simo at TSimo@ago.gov.pg or on 301 2252. We look forward to meeting with you at the Exit Interview to discuss the report.

Thank you.

Yours sincerely

Mr Puva Heako

Assistant Auditor General

PERFORMANCE AUDIT DIVISION

AUDITOR-GENERAL'S OFFICE
PAPUA NEW GUINEA

Jeanelle V Dai: 3133507/506

6/10/15

Phone: (+675) 3012200 Fax: (+675) 325 2872 Email: agopng@ago.gov.pg Website: www.ago.gov.pg

6 October 2015

Mr. Dairi Vele
Secretary
Department of Treasury
P. O. Box 542
WAIGANI
National Capital District

Dear Mr. Vele

SUBJECT: RESPONSES TO THE DRAFT PERFORMANE AUDIT REPORT ON THE EFFECTIVENESS OF BUDGET PROCESS – 2013 APPROPRIATIONS

Reference is made to my letter dated 6th August 2015 which was delivered to your office, together with the Draft Performance Audit Report on the Effectiveness of Budget Process – 2013 Appropriations on the 7th August2015.

The draft audit report was provided to you for your written responses and comments to the issues/matters raised in the report so that these responses would be incorporated in the final version of the report to the Parliament.

My officer-Mr. Titus Simo has spoken to several of your staff members- Ms Magaret, Ms Rebecca, and Ms Lisa on the 18th, 21st and 22nd September by telephone respectively and he was advised by your staff that they will check and get back to him by Friday 25th September 2015.

The deadline for your responses has lapsed on 21st August 2015. However, as required in audit reports. Hence my staff has been in contact with your staff to obtain the responses, comments and explanations required to finalize the audit report.

Considering, the follow up actions taken as above, I kindly request you to provide your responses to the audit issues raised in the draft Audit Report to the Office of Auditor General; by Wednesday 14th October 2015.

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On the other hand, if the responses from your agency are not received by 14/10/2015 and no other communication has reached this office, I will assume that you have no comments and have agreed to the audit findings mentioned in the draft audit report.

Consequently, I will go ahead to make final preparation to produce the Performance Audit Report on the Effectiveness of Budget Process – 2013 Appropriations without your responses for tabling in Parliament.

My email address is pheako@ago.gov.pg should you wish to contact me about the matter mentioned above.

Thank you

Yours sincerely,

Mr. Puva Heako
Assistant Auditor-General
Performance Audit Division

For: Auditor General