

Report No. 54584-PH

Philippines Public Expenditure and Financial Accountability

May 2010

Poverty Reduction and Economic Management Sector Unit
East Asia and Pacific Region



Document of the World Bank

Currency Equivalents

Currency Unit Philippine Peso (Php)

US\$1 = Php 44.20

Fiscal Year: January 1 to December 31

TABLE OF ABBREVIATIONS AND ACRONYMS

AA	Advice of Allotment	DA	Department of Agriculture
ABM	Agency Budget Matrix	DAP	Development Academy of the Philippines
ADB	Asian Development Bank	DAR	Department of Agrarian Reform
ARP	Allotment Release Program	DBCC	Development Budget Coordination Committee
AusAID	Australian Agency for International Development	DBM	Department of Budget and Management
BAC	Bids and Awards Committee	DC	International Data Corporation
BAS	Bureau of Agricultural Statistics	DECS	Department of Education, Culture and Sports
BEATS	Budget Execution and Tracking System	DENR	Department of Environment and Natural Resources
BESF	Budget of Expenditures and Sources of Financing	DepEd	Department of Education
BESRA	Basic Education Sector Reform Agenda 2006-2010	DICT	Department of Information and Communications Technology
BFAD	Bureau of Food and Drugs	DILG	Department of Interior and Local Government
BIR	Bureau of Internal Revenue	DND	Department of National Defense
BLGF	Bureau of Local Government Finance	DOE	Department of Energy
BMB	Budget Management Bureau	DOF	Department of Finance
BPMS	Budget Preparation Management System	DOH	Department of Health
BOC	Bureau of Customs	DOJ	Department of Justice
BOS	Budget Operations Statement	DOLE	Department of Labour and Employment
BOT	Build-Operate-and-Transfer	DOTC	Department of Transportation and Communications
BSP	Bangko Sentral ng Pilipinas	DOTS	Directly Observed Treatment, Short Course
BTR	Bureau of the Treasury	DPWH	Department of Public Works and Highways
BUP	Budget Utilization Plan	DSWD	Department of Social Welfare & Development
CAF	Certificate of Availability of Funds	DTI	Department of Trade and Industry
CAR	Cordillera Administrative Region	EER	Effectiveness and Efficiency Review
CAS	Country Assistance Strategy	eNGAS	Electronic New Government Accounting System
CBIMS	Community-Based Information & Monitoring System	EO	Executive Order
CDF	Congressional Development Fund	EPS	Electronic Procurement Service
CPF	Cash Position and Forecasting	EU	European Union
CDT	Custom Duties and Tax	FAP	Foreign Assisted Project
CFAA	Country Financial Accountability Assessment	FM	Financial Management
CIAC	Construction Industry Arbitration Commission	FMIS	Financial Management Information System
CIDSS	Comprehensive & Integrated Delivery of Social Services	FMIT	Financial Management Implementing Team
CLAP	Construction Industry Authority of the Philippines	FMR	Financial Monitoring Reports
CO	Capital Outlays	FSPs	Foreign Service Posts
CO	Collection Officer	FY	Financial Year
COA	Commission on Audit	GAA	General Appropriations Act
COFOG	Classification of Functions of Government	GAAM	Government Accounting and Auditing Manual
CPAR	Country Procurement Assessment Report	GAB	General Appropriations Bill
CPBO	Congressional Planning and Budget Office	GFI	Government Financial Institution
CPD	Continuing Professional Development	GFS	Government Financial Statistics
CPPR	Country Portfolio Performance Review	GMIS	Government Manpower Information System
CRPP	Currency Risk Protection Program	GOCC	Government-Owned and/or Controlled Corporation
CSC	Civil Service Commission	GOP	Government of the Philippines
CUBES	Customized Budget Execution System	GPIS	Government Procurement Information System

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GPPB	Government Procurement Policy Board	NFT	Notice of Funds Transfer
GSIS	Government Service Insurance System	NGAS	New Government Accounting System
GSP	Generalized System of Preferences	NGO	Non-Governmental Organization
HDI	Human Development Index	NNC	Not Needing Clearance
HSRA	Health Sector Reform Agenda	NPC	National Power Corporation
HUDCC	Housing and Urban Development Coordinating Council	NSO	National Statistics Office
ICB	International Competitive Bidding	NTC	National Telecommunications Commission
ICC	Investment Coordination Committee	NTCA	Notice of Transfer of Cash Allocation
IDF	Institutional Development Facility	NTRC	National Tax Research Centre
IFAC	International Federation of Accountants	ODA	Official Development Assistance
IMCL	International Management Consultants Limited	OPIF	Organizational Performance Indicator Framework
IMF	International Monetary Fund	OS	Obligation Slip
IMR	Infant Mortality Rate	PAD	Project Appraisal Document
INFRACOM	Committee on Infrastructure	PAP	Programs, Activities and Projects
INTOSAI	International Organisation of Supreme Audit Institutions	PARC	Presidential Agrarian Reform Council
IPSAS	International Public Sector Accounting Standards	PBS	Paper on Budget Strategy
IRA	Internal Revenue Allotment	PCAB	Philippine Contractors Accreditation Board
IRR	Implementing Rules and Regulations	PCEG	Presidential Commission on Effective Governance
IT	Information Technology	PD	Presidential Decree
ITC	Industry Tripartite Council	PDIC	Philippine Deposit Insurance Company
JBIC	Japan Bank for International Cooperation	PEMIP	Public Expenditure Management Improvement Program
KFI	Key Financial Indicators	PEPFMR	Public Expenditure, Procurement and Financial Management Review
LA	Implementing Agency	PERA	Personal Equity Retirement Account
LBP	Land Bank of the Philippines	PESS	Philippines Education Sector Study
LC	Letter of Credit	PFM	Public Financial Management
LDDAP	List of Due and Demandable Accounts Payable	PHAP	Pharmaceutical and Healthcare Association of the Philippines
LCE	Local Chief Executive	PHIC	Philippine Health Insurance Corporation
LFP	Locally Funded Projects	PIM	Performance Indicators
LFS	Labour Force Survey	PIM	Project Implementation Manual
LGU	Local Government Unit	PLS	Procurement and Logistics Service
LMC	Labour Management Council	PMS	Performance Measurement System
LOC	Letter of Credit	PMU	Project Management Unit
LOI	Letter of Intent	PPB	Procurement Policy Board
LP	Loan Proceeds	PRO	Physical Report of Operations
MCP	Monthly Cash Program	PS	Personal Services
MDG	Millennium Development Goals	PSB	Procurement Service Board
MDAs	Ministries, Departments and Agencies	PSEP	Philippines Social Expenditure Priorities
MDS	Modified Disbursement Scheme	PSM	Personal Services Monitoring
MFO	Major Final Outputs	PSO	Procurement Service Office
MIS	Management Information Systems	PTCA	Parent Teacher Community Association
MOOE	Maintenance & Other Operating Expenditure	PUP	Polytechnic University of the Philippines
MOU	Memorandum of Understanding	PWI	Procurement Watch, Incorporated
MTEF	Medium Term Expenditure Framework	QPT	Quarterly Performance Targets
MTPDP	Medium-Term Philippines Development Plan	RA	Republic Act
MTPIP	Medium-Term Public Investment Program	RAOCO	Registry of Allotments and Obligations and Capital Outlay
NAMRIA	National Mapping and Resource Information Authority	RAOMO	Registry of Allotments and Obligations and Other Operating Expenses
NBC	National Budget Circular	RDC	Regional Development Council
NC	Needing Clearance	RG	Retirement Gratuity
NCA	Notices of Cash Allocation	RIV	Requisition and Issue Voucher
NCAA	Non Cash Availability Authority	RLIF	Retirement and Life Insurance Financing
NCB	National Competitive Bidding	SAA	Sub-Allotment Advice
NCIP	National Commission On Indigenous Peoples	SAGF	Special Accounts in the General Fund
NCMB	National Conciliation and Mediation Board	SAOB	Statement of Allotment, Obligations and Balances
NCR	National Capital Region	SAP	Statement of Accounts Payable
NEDA	National Economic and Development Authority	SARO	Special Allotment Release Order
NEP	National Expenditure Program	SCAP	Statement of Charges to Accounts Payable
NFPS	National Finance Procurement System	SCR	Securities Regulation Code

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SEC	Securities Exchange Commission	SWS	Social Weather Stations
SEE	Statement of Income and Expenditures	TA	Technical Assistance
SEER	Sector Effectiveness and Efficiency Review	TESDA	Technical Education and Skills Development Authority
SEI	Science Education Institute	TOR	Terms of Reference
SEMP 2	Second Social Expenditure Management Project	TRA	Tax Remittance Advice
SEMP-TA	Social Expenditure Management Project Technical Assistance	TWG	Technical Working Group
SLCIC	Summary List of Checks Issued and Cancelled	UDGS	Unified Data Gathering System
SOE	Statement of Expenditure	UP	University of the Philippines
SPAV	Special Purpose Asset Vehicle	USAID	United States Agency for International Development
SSDs	Social Sector Departments (Health (DOH), Education (DepEd) and Social Welfare (DSWD))	WB	World Bank
SSS	Social Security System	WTO	World Trade Organization

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Acknowledgements

The Public Expenditure and Financial Accountability (PEFA) PFM Performance Measurement Framework was carried out by the World Bank with major financial contribution from AusAID and in coordination with the Department of Budget and Management (DBM). The report was prepared by the team composed of Yasuhiko Matsuda (EASPR/Task Team Leader), Abby Sanglay, Richard Walsh and Carol Yorobe with inputs from Heidi Mendoza and Lawrence Tang. Professor Emilia Boncodin provided overall advice as a local expert, whereas Undersecretary Laura Pascua (DBM) served as a main government counterpart. Throughout, Emy Boncodin's passion and commitment to improving the Philippines' PFM system, in addition to her undisputed intellectual leadership on the subject, guided the completion of the report and subsequent technical dialogue among the government officials.

Forward

This Public Expenditure and Financial Accountability (PEFA) assessment report was originally prepared by the Bank team, in collaboration with the Department of Budget and Management (DBM) and other government agencies over 2006-2007. The initial assessment covered 2003-05, the prior 3-year period for which full fiscal data were already available at the time. Subsequently the team revised and updated some of the analysis, thus extending the period covered to 2006. Although the report is being published in 2010, its content has not been updated since 2007. Instead of a fully up-to-date assessment of the PFM practices in the Philippines as of 2010, the report is intended to serve as a snapshot of the situations as found in mid-2007 and as a baseline for monitoring subsequent progress in improving the quality of its PFM.

Since the completion of the report, the dialogue on the report's findings continued, especially through a series of bilateral meetings between the Bank team and DBM, the Department of Finance (DOF), the Bureau of Treasury (BTr), the Commission on Audit (COA), and the Appropriations Committee, the House of Representatives over February-May 2008.

In May 2009, the Bank sponsored a 2-day workshop for about 50 senior officials from DBM, DOF, COA and selected line departments to discuss implications of the report's findings for reform priorities. The participants in the workshop continued the inter-agency discussions through a smaller informal group composed of senior officials (Undersecretary level) from DBM, BTr and COA and two line departments (Departments of Health and Public Works and Highways). The group has since met periodically and achieved tangible progress including preparation of a memorandum of agreement for inter-agency coordination in the development of a government financial management information system. In February 2010 the group met at a follow-up workshop to begin to develop a "road map" of the PFM reforms which is near completion at the time of this publication, in time for the arrival of the new administration elected in May 2010.

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SUMMARY ASSESSMENT

1. The World Bank, with funding from AusAID and in partnership with the Department of Budget and Management (DBM) as its primary counterpart, has conducted an independent assessment of the Philippines' public financial management (PFM) system. The assessment was based on the Public Expenditure and Financial Accountability (PEFA) methodology. The overall objective of the exercise is to provide all stakeholders with an evidence-based assessment of the PFM system and a common basis for identifying priority areas for improvements. The assessment covers primarily the period 2004-06, although for some indicators more recent information is incorporated in the analysis. Some of these areas are already covered by ongoing reforms, while others may not be. The assessment is intended to serve as a baseline for reform monitoring and to facilitate coordination among those GOP agencies that carry out reforms as well as development partners that support them.

Integrated Assessment of PEM Performance

2. ***Credibility of the budget:*** Credibility of the budget refers to the extent to which the budget as approved by the legislature is executed without significant deviations. The lower the extent of deviation, the more credible the budget because what is executed reflects the original legislative intent closely.

3. Credibility of the Philippine budget, especially the expenditure out-turn, is difficult to assess fully given the particular way in which budget data are reported in the Philippines. The frequency of re-enacted budgets during the period in review as well as the inability to capture total amount of continuing appropriations ex ante make it unfeasible to determine the score for the first and second performance indicators. Revenue forecasts, in contrast, seem to have been relatively realistic during the years in review.

4. Although the available information through agency audit reports indicates that the stock of arrears appears not to be excessive, a number of agencies have failed to heed advice of the Commission on Audit (COA) to correct over-statements of their arrears that are partly due to the recent change in the accounting method. The Annual Financial Report reflects these over-statements (i.e., it does not correct for the over-statements identified through COA's own agency audits) so it may not have fully provided an accurate level of expenditure arrears.

5. ***Comprehensiveness and transparency:*** Comprehensiveness and transparency lead to better financial accountability because both these traits contribute to greater ease of public scrutiny of budget-funded government activities. If significant portions of the government operations are conducted through off-budget activities (e.g., via state-owned enterprises whose revenues and expenditures are not publicly reported) or if the budget document does not provide sufficient details on certain components of the budget, then

the public's ability to scrutinize the government operations and hold the government accountable will be diminished.

6. The performance of the Philippines' PFM system in this regard is somewhat mixed. The GOP adopts a reasonable set of budget classifications (economic, administrative and functional classifications) in presenting the budget. These are broadly in line with the international benchmarks such as the IMF's Government Finance Statistics (GFS) method. However, a particular limitation that affects the rating in this regard is the general weakness in reporting on budget execution. Some reporting is done by COA, but COA uses an entirely different classification based on an accrual accounting method of the New Government Accounting System (NGAS). The DBM includes data on budget execution ("actuals") in some of the budget documentation, but this does not follow the structure of the approved budget. The DBM also receives a variety of budget execution and accountability reports from line agencies, but these are not made public or consolidated in a meaningful report.

7. Comprehensiveness of information included in the budget documentation is reasonable, although the format of the data presentation may be improved. Availability of data related to inter-governmental fiscal relations and sub-national public finance is also quite good, if not perfect, especially given the geographic diversity of the country and the very large number of Local Government Units (LGUs). Similarly, there is adequate oversight of LGU's fiscal positions. The extent of unreported government operations is limited, but overall monitoring of fiscal risks arising especially from government-owned and controlled corporations (GOCCs) is somewhat deficient.

8. Public access to key fiscal information is hampered by some of the specific weaknesses in fiscal reporting, particularly the absence of in-year budget execution reporting and unavailability of data on resources made available to primary service delivery units. Reporting systematically on budget execution, tightening oversight and reporting of fiscal risks arising from GOCC operations, and making the already available fiscal and budgetary information more user-friendly and analytically meaningful would go a long way in improving budget comprehensiveness and transparency.

9. ***Policy-based budgeting:*** The executive operates with a fairly orderly process of budget preparation. It usually meets the constitutional deadline for submitting the budget proposal to Congress (within 30 days of the opening of the new congressional session, which usually falls in July or August). However, the final approval of the General Appropriations Act (GAA) is always delayed well into the fiscal year, and on three occasions (2001, 2004, 2006) since 2001 Congress has failed to approve the GAA at all for the whole year.

10. Incorporation of multi-year perspective in budgeting is an area the GOP has actively been addressing, although systematic debt sustainability analysis is not currently done for fiscal planning purposes. The DBM is leading the development of a medium-term expenditure framework. It has made some progress in fine-tuning the technical basis of the forward estimates of existing programs and projects and institutionalizing the MTEF process and its link to annual budgeting. However, the DBM has yet to establish

firmly its intention regarding the link between the forward estimates and annual budget ceilings.

11. The Departments of Health and Education have developed multi-year sector expenditure plans. But the other departments are not yet following their steps, and the GOP has not yet developed a clear rule regarding how the sector expenditure plans and other aspects of the MTEF such as the forward estimates will relate to each other.¹ Likewise, the MTEF has not yet matured to a point where recurrent cost implications of new investment projects are systematically estimated and taken into account.

12. ***Predictability and control in budget execution:*** Apart from the competent management of the treasury functions and procurement, budget execution is clearly an area of relative weakness in the Philippine PFM system. Effectiveness of tax administration, a necessary condition for predictable availability of funds, is limited by the technical complexity and lack of clarity of taxpayer obligations and liabilities and weak controls of the taxpayer registration system and tax audit. Tax collection seems to suffer from weak enforcement of the rules regarding transfers of collected revenues from banks to the Treasury and reconciliations between records of the BIR and the BOC on the one hand and the BTr on the other, as reflected in recent COA findings. The recorded tax arrears are not substantial, however.

13. In terms of predictability of fund availability, the GOP has in place a satisfactory mechanism for monitoring and forecasting cash flows. But the current system of managing releases of allotments through Special Allotment Release Orders (SAROs) has often created uncertainty about availability of funds for the most critical parts of agency budgets, such as capital outlays and maintenance and other operating expenses (MOOE). While the particular PEFA performance indicator is concerned only with funding predictability at the commitment level – which is regulated in the Philippines through the allotment process – anecdotes suggest that greater uncertainty arises when agencies try to access cash releases for actual payments. The Constitution accords the President with a high degree of discretion to re-allocate portions of the budget. But the weak reporting on budget execution makes it difficult to establish the extent of in-year budget re-allocation, which is a major accountability issue in the Philippines' PFM.

14. The DOF has adequate arrangements for managing its treasury and debt management functions. These cover recording and reporting on the government's debt stock and cash balances (Bureau of the Treasury) and contracting of loans and issuing of guarantees (Corporate Affairs Group) within a relatively sound regulatory arrangement. On the other hand, the GOP's ability to assure integrity of its payroll is still limited. Personnel databases of various agencies are not linked to the payroll database that the DBM manages, and data discrepancies between them are common. The Civil Service Commission (CSC) is still in the process of completing an integrated database of all government personnel. Internal control of the payroll is weak, as evidenced in numerous

¹ Since the completion of the initial assessment, the Department of Social Welfare and Development has also prepared its own multi-year spending plan.

COA audit findings of irregularity involving personnel services expenditures, and payroll audits are not carried out systematically and regularly.

15. Internal control and internal audit are two areas the GOP is beginning to strengthen. At the moment, however, the existing rules on internal control are out-dated and the degree of familiarity with these rules among GOP staff involved in financial management seems to be low. Compliance with existing internal control rules is clearly low as evidenced in the fact that the vast majority of national government agencies receive either adverse or qualified opinions in COA's annual audits. Internal audit units are functional only in a handful of agencies, and thus internal audit reports are not being produced for most government agencies. In those few cases where functioning internal audit exists, management responses are reportedly delayed, although actions are apparently taken eventually to address audit findings.

16. Based on an assessment of procurement practices in ten government entities (including one municipality), the extent of the use of non-competitive bidding methods appears to be limited. However, COA audit reports of various agencies refer to some unjustified uses of non-competitive procurement methods.

17. **Accounting, recording and reporting:** COA is a professional body that conducts competent financial and performance audits. It has introduced a new accounting framework (NGAS) based on accrual accounting concepts and is spearheading its government-wide application with the help of an electronic IT system (eNGAS).² Measured against the specific assessment criteria of the PEFA framework, however, accounting, recording and reporting comes out as an area where substantial work needs to be done for the Philippine PFM system.

18. The BTr is unable to conduct bank reconciliation in a timely manner, apparently because of staff shortage. As a result, COA audits find rather large discrepancies in the BTr national government book and bank balances (P5.65 billion in 2005). Similarly, COA audit reports repeatedly find irregularities in recording and reporting of unliquidated cash advances.

19. The GOP currently does not have an information system capable of capturing resource flows to service delivery units. Moreover, some agencies seem to suffer from other institutional constraints to better internal flows of information. For example, the fragmented arrangement for fund releases to DepEd, where the DBM's Regional Offices release SAROs and Notices of Cash Allocation (NCAs) directly to the corresponding DepEd Regional Offices constrains the DepEd Central Office's ability to track and report on fund releases for the entire department. The agencies are required to submit a set of accountability reports to the DBM to report on budget execution during a fiscal year. But delayed submissions are apparently common, and a systematic process of consolidating these reports is found to be lacking.

² Since the completion of the initial assessment, COA initiated a review of the NGAS and suspended the roll-out of the eNGAS.

20. COA prepares annual financial reports (AFRs) based on financial statements and reports submitted by government agencies. The coverage is quite complete as it reaches more than 99 percent of the government agencies. However, the AFRs are not audited and the underlying agency financial statements are only based on pre-closing trial balances. As a result, discrepancies arise between the figures reported in the AFR and those found in audit reports.

21. **External scrutiny and audit:** Unlike in most Westminster parliamentary systems where a Public Accounts Committee or an equivalent formally receives and scrutinizes audit reports, the Philippine Congress does not have a standing committee charged with the responsibility of reviewing COA audit reports. As such, even though the scope and the quality of COA audit reports is generally satisfactory, and there appear to be adequate management responses, if not systematic follow-up to COA's audit findings, the overall rating on this score suffers because of the absence of a specific institutional arrangement for Congress to play an effective external oversight role. It was determined that no regular congressional hearings to discuss findings in the COA reports occurred during the period in review, nor is there any recommendation issued by the legislature to address adverse findings.

22. Legislative scrutiny of the annual budget law is taken more seriously. The executive usually meets the constitutional deadline for submission of the budget proposal to Congress, and as such the legislature enjoys ample time to review the proposal, and follow well-established internal procedures for deliberations. Both chambers of Congress use this time to scrutinize the executive's budget proposal in detail, including its macroeconomic and fiscal framework and by calling numerous hearings on sector-specific issues. A key weakness is in the limited role Congress plays in reviewing and authorizing in-year amendments to the budget.

Assessment of the Impact of PFM Weaknesses

23. **Aggregate fiscal discipline:** The GOP has regained control over fiscal aggregates in recent years and is pursuing a balanced budget in 2008. Sound fiscal management has in turn induced reduced risk perception, and, combined with the currency appreciation and other macroeconomic developments, has translated into falling debt and declining interest payments. Nevertheless, the assessment of the PFM system points to several potential weaknesses that can threaten the hard-won fiscal stability in a more adverse external environment.

24. A main risk to aggregate fiscal discipline comes from the revenue, rather than the expenditure side. The shares of rigid expenditures (e.g., entitlements, wages and salaries) other than interest payments are not excessive in the GOP budget, although in the recent past, the size of the wage bill was thought to be unsustainable. This assessment still reveals lack of adequate control of the personnel establishment and the payroll. However, should it become necessary, the government has mechanisms to tighten discretionary spending and control deficits. As control is done mainly at the stage of cash releases rather than allotments (i.e., authorizations to obligate expenditures), these have caused uncertainty in budget execution in the recent past.

25. The vulnerabilities that can threaten fiscal discipline include the weak revenue administration, weak monitoring and management of arrears – even though these do not appear to be excessive at the moment – and weak oversight of contingent liabilities and associated fiscal risks.

26. So far, fiscal decentralization in the Philippines has not created a situation of widespread fiscal laxity by LGUs, as seen in some Latin American countries, for example.

27. ***Strategic allocation of resources:*** This is an area the DBM is actively trying to strengthen through the MTEF initiative. At least in the context of the enlarging fiscal space in 2006-07, the government has managed to prioritize key sectors of infrastructure (especially roads), education and health. The limited transparency with respect to budget realignments, the inadequate in-year and ex-post reporting on budget execution, and the technical difficulty in comparing the budget with the actual figures all heighten the risk of misallocation without public scrutiny.

28. Active involvement of the legislature in scrutinizing the executive's budget should serve as an additional incentive for the executive to execute its budget faithfully. But Congress engages in little scrutiny of in-year or ex-post budget execution data, which in any case are not made available regularly to Congress, nor to the public.

29. ***Efficient service delivery:*** The predictability of funding is key to efficient implementation of programs and delivery of services. The much-improved procurement rules following the 2003 Procurement Reform Act aid program implementation by clarifying and streamlining procurement procedures, while limiting the scope for corruption with a variety of transparency requirements. But, the complex procedures for releasing allotments and cash, combined with generally weak financial management capabilities in line agencies, remain as likely sources of delays in budget execution. A more serious deficiency is the general lack of financial accountability, as evidenced in numerous COA audit reports that find a variety of irregularities. A vast majority of agencies receive qualified or adverse opinions, which suggest that an adequate internal control arrangement is either absent or not operating properly in these agencies. Weak control of the payroll and the personnel establishment, incipient development of internal audit, and the apparent lack of reliable reporting on resource flows (and their use) by primary service delivery units are among the weaknesses identified in this assessment that are believed to affect efficient and effective service delivery.

Prospects for Reform Planning and Implementation

30. Systemic improvements in the Philippine PFM system would require concerted and coordinated efforts on multiple fronts. As noted in the section on the legal and institutional framework in the main report, however, the fragmentation of the oversight functions among several agencies, including independent constitutional bodies, may tend to complicate efforts at coordination.

31. Another challenge for the Philippines is that certain features of its PFM system are at odds with the notion of an international “standard” behind the PEFA framework because of the country’s constitutional design and other long-held practices. Thus, for example, the Constitution expressly assigned COA the dual roles of being an independent, external audit body and an agency in charge of setting the government’s accounting standards and rules. In a number of countries and in the philosophy behind the PEFA method, separation of audit and accounting functions is considered a good practice, so as to avoid possible conflict of interests. Whether the Philippine authority agrees with this principle, their ability to effectuate a change in line with the PEFA “philosophy” is limited, as that would require a constitutional amendment.

32. A third set of challenges comes from the political reality of the country. Some of the weaknesses identified (e.g., delayed or no passage of the GAA, little to no scrutiny of COA audit reports) stem from the way politicians act. PFM reformers in the government have virtually no leverage to change the political incentives with which legislators or other politicians behave in PFM areas. Enhanced transparency would be a partial deterrent, but is unlikely to be a sufficient check in the absence of more robust checks and balances and a tighter regulation of such authorities, which would also require a constitutional change.

33. These realities suggest that reform progress is likely to be slow overall, although reforms may progress at uneven paces in different areas depending on the political spaces and the presence of credible and committed reform champions. Generally, technical weaknesses in areas under sole responsibilities of a single agency, such as monitoring of fiscal risks (DOF), overall improvements in budget reporting and transparency (DBM), the technical basis of the AFRs (COA), monitoring of arrears (COA and/or DBM) and improvements in taxpayer registration (BIR) should be more easily correctible. Other reforms, even if they are predominantly technical in nature, may require additional efforts if their full implementation requires coordinated actions by numerous line agencies (e.g., establishment of effective internal control and audit, payroll control).

PERFORMANCE INDICATOR SUMMARY

PFM Performance Indicator	Scoring Method	Dimension Ratings ³				Overall Rating	
		i.	ii.	iii	iv		
A. PFM-OUT-TURNS: Credibility of the budget							
PI-1	Aggregate expenditure out-turn compared to original approved budget	M1					Not rated
PI-2	Composition of expenditure out-turn compared to original approved budget	M1					Not rated
PI-3	Aggregate revenue out-turn compared to original approved budget	M1	A				A
PI-4	Stock and monitoring of expenditure payment arrears	M1	C	D			D+
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency							
PI-5	Classification of the budget	M1	D				D
PI-6	Comprehensiveness of information included in budget documentation	M1	B				B
PI-7	Extent of unreported government operations	M1	A	A			A
PI-8	Transparency of inter-governmental fiscal relations	M2	A	B	C		B
PI-9	Oversight of aggregate fiscal risk from other public sector entities	M1	C	B			C+
PI-10	Public access to key fiscal information	M1	C				C

³ Each indicator includes one or more dimensions. A separate score is given for each dimension. Where there is more than one dimension, the overall score for the indicator is arrived at by combining the dimension ratings according to the prescribed methodology (M1 or M2) for the indicator.

Philippines Public Expenditure and Financial Accountability

PFM Performance Indicator	Scoring Method	Dimension Ratings ³				Overall Rating	
		i.	ii.	iii	iv		
C. BUDGET CYCLE							
C(i) Policy-Based Budgeting							
PI-11	Orderliness and participation in the annual budget process	M2	B	A	D		B
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	M2	C▲	D	C▲	D	D+▲
C(ii) Predictability and Control in Budget Execution							
PI-13	Transparency of taxpayer obligations and liabilities	M2	D	C	B		C
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	M2	C	C	C		C
PI-15	Effectiveness in collection of tax payments	M1	A	C	D		D+
PI-16	Predictability in the availability of funds for commitment of expenditures	M1	A	D	D		D+
PI-17	Recording and management of cash balances, debt and guarantees	M2	B	B	B		B
PI-18	Effectiveness of payroll controls	M1	C	B	C	C	C+
PI-19	Competition, value for money and controls in procurement	M2	B	B	B		B
PI-20	Effectiveness of internal controls for non-salary expenditure	M1	C	C	D		D+
PI-21	Effectiveness of internal audit	M1	D	D	C		D+
C(iii) Accounting, Recording and Reporting							
PI-22	Timeliness and regularity of accounts reconciliation	M2	D	D			D
PI-23	Availability of information on resources received by service delivery units	M1	D				D

Philippines Public Expenditure and Financial Accountability

PFM Performance Indicator		Scoring Method	Dimension Ratings ³				Overall Rating
			i.	ii.	iii	iv	
PI-24	Quality and timeliness of in-year budget reports	M1	D	D	D		D
PI-25	Quality and timeliness of annual financial statements	M1	B	D	B		D+
C(iv) External Scrutiny and Audit							
PI-26	Scope, nature and follow-up of external audit	M1	A	-na-	B		B+
PI-27	Legislative scrutiny of the annual budget law	M1	B	A	A	C	C+
PI-28	Legislative scrutiny of external audit reports	M1	D	D	D		D
D. DONOR PRACTICES							
D-1	Predictability of Direct Budget Support	M1					Not rated
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	M1	D	D			D
D-3	Proportion of aid that is managed by use of national procedures	M1	D				D

1. INTRODUCTION

Objectives, Methodology and Scope

A. Objective

1.1 The Bank, in collaboration with the ADB, published a public expenditure, procurement and financial management review in 2003.⁴ The 2003 report covered a broad range of public expenditure and related issues ranging from management of fiscal aggregates and risks to ensure aggregate fiscal discipline, efficiency in expenditure allocation in specific sectors, institutional and management issues in the areas of budget formulation and execution, and inter-governmental aspects of public expenditure and financial management. Since then, numerous consultant reports have been produced with specific purposes of diagnosing issues requiring attention in particular aspects of public financial management (PFM) and recommendations. But no comprehensive assessment of the PFM systems and capacities of the Government of the Philippines (GOP) has been conducted. This report fills this gap.

1.2 The overall objective of the report is to provide all stakeholders with an evidence-based assessment of the PFM system and a common basis for identifying priority areas for reforms, some of which are already covered by ongoing reforms, while others may not be, and facilitate coordination among those GOP agencies that carry out reforms as well as development partners that support them. It uses the methodology developed by the Public Expenditure and Financial Accountability (PEFA), a multi-donor partnership program composed of the UK's Department for International Development, the Swiss State Secretariat for Economic Affairs, the Royal Norwegian Ministry of Foreign Affairs, the French Ministry of Foreign Affairs, the European Commission, the World Bank, the International Monetary Fund (IMF), and the Strategic Partnership with Africa.

1.3 While the 2003 report was quite comprehensive in its coverage, the PEFA methodology offers an additional advantage of objectivity, thanks to its evidence-based approach. The present report is the first PEFA PFM assessment in the Philippines, and as such is intended to serve as the baseline for replications in the future. The systematic use of the tightly defined assessment criteria will allow the GOP and other stakeholders to acquire a balanced view of the areas in need of attention and monitor future progress of the ongoing or future reform efforts.

1.4 The analysis for this report was carried out in respect of fiscal years 2004 to 2006 based on a review of a wide range of documentation, reports and interviews with a large

⁴ Philippines Improving Government Performance: Discipline, Efficiency and Equity in Managing Public Resources, A Public Expenditure, Procurement and Financial Management Review (A Joint Document of the GOP, WB and ADB), 2003

number of stakeholders. A summary of the key findings is set out in the Summary Assessment above and the Summary Performance Indicator (PI) Table.

B. Methodology and Scope

1.5 The (PEFA)'s Public Financial Management (PFM) Performance Measurement Framework is intended to serve as an objective measure for benchmarking countries PFM capacities and to facilitate tracking of improvements in specific areas of PFM over time. It relies on a set of performance indicators, based on objective criteria for determining specific scores. The PEFA Performance Indicators cover the following dimensions of an open and orderly PFM system:

- *Credibility of the budget* – The budget is realistic and is implemented as intended;
- *Comprehensiveness and transparency* – The budget and the fiscal risk oversight are comprehensive, and fiscal and budget information is accessible to the public;
- *Policy-based budgeting* – The budget is prepared with due regard to government policy;
- *Predictability and control in budget execution* – The budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds;
- *Accounting, recording and reporting* – Adequate records and information are produced, maintained and disseminated to meet decision-making control, management and reporting purposes; and
- *External scrutiny and audit* – Arrangements for scrutiny of public finances and follow up by executive are operating.

To these six dimensions, the framework adds the *appropriateness of donor practices* as a final dimension, although for a middle-income country such as the Philippines, this final dimension is somewhat less salient.

1.6 The assessment covers all central government expenditure. The assessment reviews intergovernmental relationships and reporting structures with sub-national government. In the Philippines, sub-national governments are called Local Government Units (LGUs), and consist of 81 Provincial Governments, 120 City Governments, 1502 Municipal Governments and 41,890 Barangays. The performance of public financial management by individual LGUs is not assessed. The government's oversight of fiscal risk with respect to Government-Owned and/or Controlled Corporations (GOCCs) is covered, but not PFM performance of individual GOCCs. Similarly, some line agencies' PFM practices were reviewed as evidence of the performance of the national government, but the assessment is not intended to review in detail PFM of individual line agencies, and as such their coverage is partial and non-systematic.

1.7 An upward arrow was used next to the score (e.g. D▲) to indicate progress, but its use is limited to the following cases: (i) small improvements in PFM performance not captured by the indicators; and (ii) reforms implemented to date that have not yet

impacted PFM performance, or for which no evidence on their impact on PFM performance exists.

2. COUNTRY BACKGROUND INFORMATON

A. ECONOMIC AND POLITICAL CONTEXTS⁵

1. Recent Economic Performance

2.1 Situated within the dynamic East Asia region, the Philippines' economic performance has often been seen as disappointing in comparison to its neighbors, as well as with respect to its potential. The Philippines' average GDP growth rate was at 4.5% over 2001 to 2006, unfavorably compared to the average rate of 8.5% for East Asia and the Pacific as a whole in the same period. More recently, however, the Philippine economy has begun to show signs of improvements, with the GDP growth rates of at least 5% over 2004-06 (and 4.9% in 2003).

2.2 The Philippines' economic performance strengthened in 2006 aided by a recovery of agriculture and exports and continued rapid growth of remittances. Progress with the government's medium-term fiscal consolidation objectives has contributed to buoyancy in financial markets. GDP growth totaled 5.4 percent in 2006 (Table 2-1).

Table 2-1: Selected Economic Indicators

	2000	2001	2002	2003	2004	2005	2006
Growth, inflation and unemployment (percent)							
Gross national product	7.1	2.3	4.2	5.9	6.7	5.6	6.2
Gross domestic product	6.0	1.8	4.4	4.9	6.2	5.0	5.4
Inflation (period average); 2000 base year	4.0	6.8	3.0	3.5	6.0	7.6	6.2
Inflation (end period); 2000 base year	6.5	4.5	2.5	3.9	8.6	6.6	4.3
Unemployment	11.2	11.1	11.4	11.4	11.8	11.3	11.0
Public sector (percent of GDP)							
National government balance	-4.0	-4.0	-5.3	-4.6	-3.8	-2.7	-1.0
Total revenue	15.3	15.6	14.6	14.8	14.5	15.1	16.3
Tax revenue	13.7	13.6	12.8	12.8	12.5	13.0	14.3
Total spending	19.3	19.7	19.9	19.5	18.4	17.8	17.3
Consolidated public sector balance	-4.6	-4.8	-5.6	-5.1	-4.9	-1.8	0.2
Nonfinancial public sector debt	88.1	87.4	93.7	103.5	95.0	86.0	73.9
National government debt	64.6	65.7	71.0	77.7	78.5	71.8	65.0e
External debt							
Total (billions of dollars)/2	51.2	51.9	53.6	57.4	54.8	54.2	54.1
Total (percent of GDP)/2	67.5	72.9	69.8	72.1	63.3	55.1	46.2
Debt service ratio (G&S and income)/2	13.0	15.7	17.1	16.9	13.8	13.5	11.4
Exchange rate (peso/dollar, period average)	44.2	51.0	51.6	54.2	56.0	55.1	51.3
Real effective exchange rate (2000 = 100)	100.0	95.6	96.2	89.1	86.2	92.3	105.9

Source: GOP, World Bank, IMF

e/ Estimate

⁵ This section is based on recent World Bank reports including *From Short-Term Growth to Sustainable Development* (2005), *Invigorating Growth, Enhancing Its Impact* (2007).

2. Political Context and Governance Challenges

2.3 The political environment since 2000 has been challenging and plagued with allegations of political improprieties that have constrained the government's ability to undertake strong reforms. The perception of political instability lingers on, fueled by a succession of politically-charged events ranging from the ouster (and eventual conviction) of the former President Estrada for alleged involvement in corruption (for which he was later convicted on a plunder charge), an attempted coup in 2003, highly publicized resignations of several prominent cabinet secretaries in 2005, and repeated attempts to impeach the President.

2.4 Concerns about weak governance and corruption in the Philippines are long-standing. Following the end of the Marcos era in 1986, the return to democratic government and major market-oriented reforms (e.g., trade liberalization, deregulation, privatization) brought about improvements in perceived corruption. But the events leading to the impeachment of former President Estrada reversed this trend. The current government declared combating corruption one of its top priorities and announced several initiatives. These have included procurement reform, judicial reform and the passage of the Anti-Money Laundering Law, among others.

2.5 Weaknesses in governance continue to extend across government interaction with the private sector—ranging from tax evasion, collusion in procurement, inflated contracts, and leakages in service delivery programs. Good public financial management plays a key role in controlling these symptoms of poor governance. Persistent implementation of ongoing governance reforms, including public expenditure management reform and enforcement of anti-corruption laws, among others, will need to be pursued with diligence for more visible impact.

B. DESCRIPTION OF BUDGETARY OUTCOMES

1. Aggregate Fiscal Performance⁶

2.6 Restoring fiscal discipline and macroeconomic stability has been a top priority of the Macapagal-Arroyo administration. The GOP has already achieved considerable progress in this area and reversed the declining trend in revenue performance and the reduction in budget deficits since 2003. Its fiscal management is led by the publicly-stated objective of balancing the national government budget by 2008.⁷

⁶ This section is based on the assessment by the Bank staff for the First Development Policy Loan, November 2006.

⁷ The onset of the global financial crisis has since forced the government to relax its fiscal stance. Nonetheless to indicate its adherence to fiscal discipline, the government clarified that in the implementation of the 2008 budget, the status of the government's fiscal program had always been the predominating consideration in the utilization of appropriations and thus, in years when the fiscal situation is tight, the president may elect to hold some appropriations in "reserve" and the continuing appropriations can no longer be utilized or needing offsets from the new appropriations. The agencies are also asked to

2.7 *Fiscal Deterioration over 1997–2003.* Following the East Asian crisis, the Philippines witnessed a sharp deterioration of fiscal variables. Between 1997 and 2002, the National Government (NG) account moved from approximate balance to a deficit of 5.3 percent of GDP, due to a plunge in tax revenues from 17 percent of GDP to 12.8 percent, and a growing interest burden that reflected both increasing debt and higher risk premia.⁸ The deficits of Government Owned and Controlled Corporations (GOCCs) also widened significantly, rising from near balance in 1999 to 1.8 percent of GDP in 2004, driven largely by the escalating deficits of the National Power Corporation (NPC). By 2003, non-financial public sector debt exceeded GDP and global borrowing spreads had risen above 500 basis points. The fiscal deterioration was paralleled by governance concerns that in turn contributed to considerable political instability through much of the present decade.

2.8 As a result of the build-up of deficits and debt, the Philippines entered a period of fiscal instability between 2002 and 2004. During this period, the government was able to avert a full-blown fiscal crisis through expenditure restraint: primary expenditure during this period was cut by two percent of GDP reflecting cuts across the major categories of spending—civil service salaries, for example, were not increased from 2001 to 2004 despite rising prices, spending on education and health also declined in real terms, and public investment was cut further.

2.9 *Fiscal Turnaround since late 2004.* In August 2004, shortly after President Macapagal-Arroyo reassumed office for the current term, she announced that the state⁹ was on the brink of a fiscal crisis and urged Congress to pass a series of tax measures. To supplement these new revenue measures, the Department of Finance (DOF) intensified programs to identify and prosecute tax evaders and smugglers and set up a Revenue Integrity Protection Service to charge corrupt collectors in the revenue agencies. Throughout this period, and subsequently, tight controls on government spending continued to be maintained.

2.10 The GOP managed to reduce the consolidated public sector deficit (CPSD) by 3 percent of GDP in 2005, primarily the result of power tariff adjustments and expenditure restraint. Furthermore, the implementation of the VAT reform coupled with other policy and administrative measures yielded clear benefits: for the first time since 1997, the tax

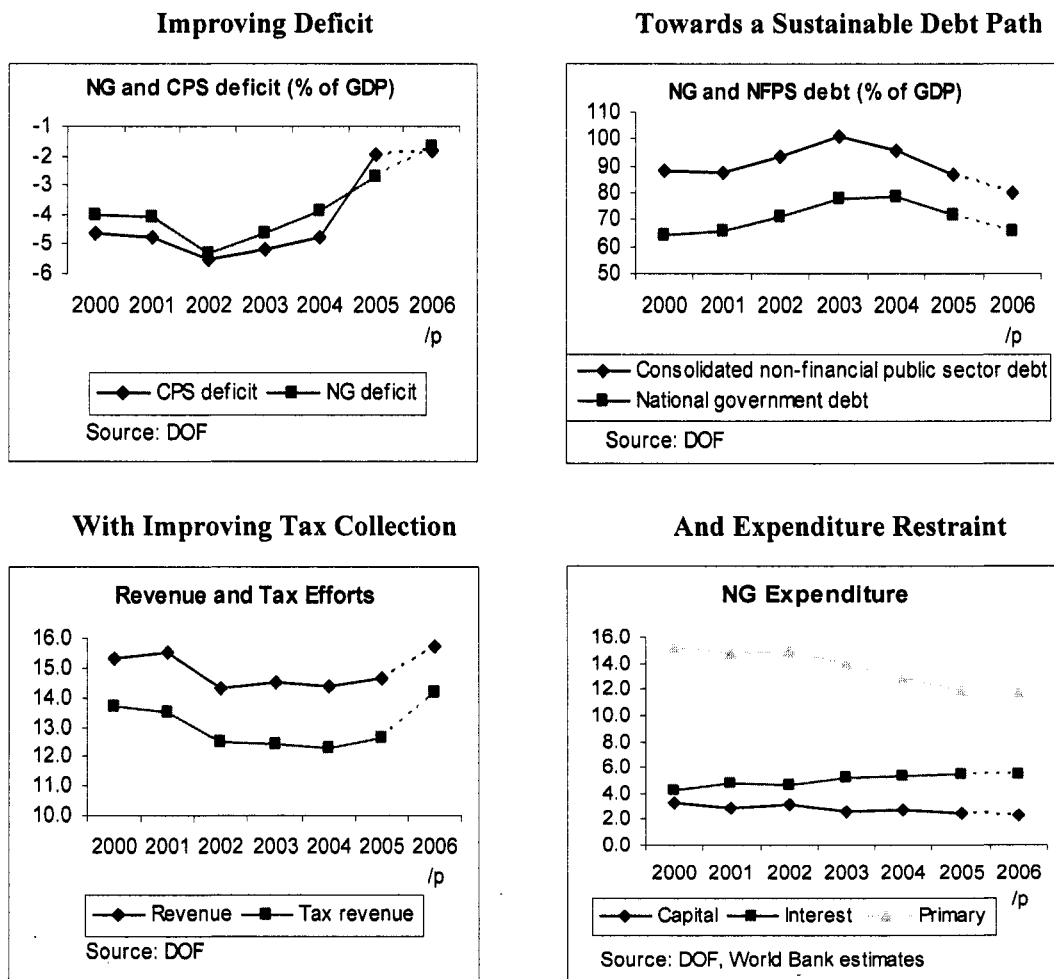
submit their proposed work and financial plans and their cash requirements at the start of the year to serve as the basis for allotment releases and to ensure consistency with the overall fiscal program.

⁸ The fall in tax revenue, which continued through 2004, was the result of weak corporate and banking profitability in the aftermath of the crisis in the late 1990s, some built-in weaknesses in tax policy, reductions in import tariffs, as well as deterioration in administrative performance of the major revenue collection agencies.

⁹ The resultant reform measures included an average 30% increase in excise taxes; broadening of VAT coverage by the removal of exemptions for petroleum products, power, and medical and legal services, increases in the VAT rate from 10 percent to 12 percent and in the corporate income tax from 32 percent to 35 percent (reverting to 30 percent in 2009); and lateral attrition for revenue agencies (to improve incentives for tax administrators). Power generation tariffs were raised by about 30 percent in late 2004/early 2005.

effort increased in 2005; and tax revenue increased by 24 percent through September 2006, setting the stage for a more significant improvement in tax effort in 2006, of about 1 percent of GDP. This has opened the way for a more sustainable fiscal adjustment path: in which an improving tax effort allows a recovery in primary expenditure *and* a declining public debt burden.¹⁰ The CPSD was reduced to 1.8 percent of GDP in 2005, implying a primary public sector surplus of 4.4 percent. Non-financial public sector debt declined from 101 percent of GDP in 2003 to 87 percent in 2005 and is projected to decline to 60 percent by 2010, even assuming a somewhat less ambitious path of declining deficits and improving tax effort than targeted by the government.

Figure 1: Fiscal Adjustment has Improved Market Indicators



¹⁰ The tax collection performance has weakened again since 2006.

2. Allocation of Resources

2.11 Over the decade since the mid-1990s, the national government's total spending contracted by about 2-3% of GDP, while mandated expenditures increasingly crowded out discretionary expenditures, especially capital outlays for public investments in infrastructure and other purposes as well as the maintenance and other operating expenses (MOOE). Together these two expense categories contracted by more than 2% of GDP between 1996 and 2006. This was mainly due to the dramatic increase in interest payments after the Asian financial crisis as well as the drop in the total expenditure as a result of the weakened revenue efforts (from 19-20% in late 1990s to 17.4% in 2006).

2.12 From a level of 3.5% in 1996, interest payments as a share of GDP ballooned to 5.2% in 2006. As a percentage of the total expenditure, interest payments rose steadily from just 18.4% in 1996 to as much as 29.7% in 2006, its level almost matching the single largest expenditure category, the wage bill. The latter, however, has declined both as a share of GDP and as a share of the total expenditure, although the number of government personnel actually increased from 1.36 million in 1996 to 1.48 million in 2004, suggesting reduced average civil service pay. Compounding the budget's inflexibility are the mandated NG transfers to local government units (LGU) by virtue of the Local Government Code of 1991 and other legislative measures.¹¹

Table 2-2 National Government Expenditure Allocation (Obligation Basis), by Expense Class, 1996-2007

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007 (Ind.)
(% of GDP)												
Total Expenditure	19.1	20.3	20.2	19.5	20.3	19.5	18.4	19.1	17.8	17.5	17.4	17.7
Mandated Expenditure	12.5	13.5	14.4	14.1	14.7	14.9	14.7	15.0	14.2	13.8	13.4	13.3
Personal Services	6.4	7.4	7.7	7.2	7.0	6.8	6.7	6.5	5.9	5.5	5.4	5.3
Allotments to Local Government Units	2.6	2.9	2.9	3.3	3.5	3.2	3.4	3.3	2.9	2.8	2.8	3.0
Interest Payments	3.5	3.2	3.7	3.6	4.2	4.8	4.6	5.3	5.4	5.5	5.2	5.0
Discretionary Expenditure	5.9	6.1	5.3	4.8	5.0	4.1	3.4	3.4	3.1	3.1	3.5	4.2
Maintenance and Other Operating Expenses	3.0	2.9	2.5	2.4	2.5	2.1	1.8	1.6	1.7	2.0	1.9	2.3
Infrastructure and Other Capital Outlays	2.9	3.2	2.8	2.4	2.5	2.0	1.7	1.8	1.5	1.1	1.7	1.9
Budgetary Support to GOCCs	0.7	0.7	0.5	0.7	0.7	0.5	0.4	0.8	0.6	0.6	0.5	0.2
(% to Total)												
Total Expenditure	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Mandated Expenditure	65.2	66.7	71.3	72.1	72.1	76.4	79.5	78.4	79.5	79.1	76.7	74.9
Personal Services	33.2	36.4	38.2	37.1	34.5	35.0	36.1	33.9	33.0	31.2	31.0	29.8
Allotments to Local Government Units	13.6	14.5	14.5	16.7	17.0	16.6	18.3	17.1	16.5	16.3	16.1	16.9
Interest Payments	18.4	15.9	18.6	18.3	20.7	24.7	25.1	27.4	30.1	31.6	29.7	28.3
Discretionary Expenditure	31.0	30.1	26.4	24.5	24.4	21.2	18.6	17.6	17.4	17.6	20.3	23.7
Maintenance and Other Operating Expenses	15.8	14.3	12.5	12.0	12.3	10.9	9.5	8.3	9.3	11.2	10.8	13.0
Infrastructure and Other Capital Outlays	15.2	15.8	13.9	12.4	12.1	10.3	9.1	9.3	8.1	6.3	9.5	10.7
Budgetary Support to GOCCs	3.8	3.2	2.3	3.4	3.5	2.4	2.0	4.0	3.1	3.4	3.0	1.4

Source: Department of Budget and Management

¹¹ Under the Local Government Code, LGUs shall have a 40% share in the national internal revenue taxes and a 40% share in the proceeds from the development and utilization of national wealth such as mining taxes, royalties, etc.

2.13 In terms of functional distribution, the same trend described above has translated into reduction in the share of budget for economic services and defense. While social services as a whole has remained at the roughly same level as a share of the total budget, the share of education and health actually diminished. In exchange, the share of the social security and labor welfare category has doubled over the past decade, likely to be driven by the steady increase in pension payments to military personnel. The only broad category that saw an increase was net lending, interest payments and others (Table 2-3).

Table 2-3: National Government Expenditure Allocation (Obligation Basis), by Function 1996-2007

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007 (Ind.)
(% of GDP)												
Total Expenditure	19.2	20.3	20.2	19.5	20.5	19.4	18.4	19.1	17.8	17.5	17.4	17.7
Economic Services	4.9	5.4	4.9	4.7	5.1	4.3	3.8	3.9	3.5	3.2	3.7	3.8
o.w. Agriculture, Agrarian Reform, and Natl. Res.	1.3	1.7	1.2	1.1	1.0	1.1	0.9	0.9	0.7	0.9	0.8	0.7
Water Resource Devt. & Flood Control	0.1	0.3	0.1	0.2	0.1	0.2	0.2	0.2	0.2	0.1	0.2	0.2
Communications, Roads & Other Transport	2.0	2.0	2.2	1.8	2.3	1.7	1.3	1.6	1.4	1.1	1.6	1.6
Social Services	5.7	6.6	6.6	6.5	6.5	5.8	5.7	5.5	5.2	4.7	4.7	5.1
o.w. Educ., Culture and Manpower Devt.	3.4	3.9	4.0	3.7	3.5	3.2	3.1	3.0	2.7	2.4	2.4	2.6
Health	0.5	0.6	0.5	0.5	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.3
Social Security and Labor Welfare	0.5	0.8	0.9	0.8	0.8	1.0	0.9	0.9	0.9	0.9	0.9	0.9
Defense	1.4	1.2	1.2	1.1	1.1	1.0	1.0	1.0	0.9	0.9	0.9	0.9
General Public Services	2.9	3.0	3.0	2.7	2.7	2.4	2.4	2.4	2.1	2.3	3.0	2.9
o.w. General Public Administration	1.5	1.5	1.5	1.2	1.2	1.1	1.0	1.0	0.9	1.2	1.0	0.9
Net Lending, Interest Payments and Others	3.5	3.2	3.7	3.6	3.9	5.0	4.6	5.2	5.4	5.5	5.2	5.2
(% to Total)												
Total Expenditure	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	95.0	95.5
Economic Services	25.3	26.8	24.1	24.0	24.5	22.1	20.4	20.6	19.4	18.4	21.1	21.5
o.w. Agriculture, Agrarian Reform, and Natl. Res.	6.9	8.3	5.8	5.7	5.1	5.5	4.7	4.8	4.0	5.0	4.5	3.9
Water Resource Devt. & Flood Control	0.7	1.3	0.7	1.0	0.7	1.0	0.8	0.9	0.9	0.7	1.1	0.9
Communications, Roads & Other Transport	10.3	9.9	10.8	9.4	11.1	8.7	7.3	8.1	7.7	6.1	8.9	8.9
Social Services	29.5	32.3	32.6	33.2	31.2	30.4	31.1	28.8	28.9	27.0	26.8	28.5
o.w. Educ., Culture and Manpower Devt.	18.0	19.3	19.9	19.1	17.1	16.6	16.9	15.6	14.9	13.9	13.7	14.6
Health	2.7	2.9	2.5	2.6	2.2	1.8	2.0	1.5	1.7	1.5	1.5	1.6
Social Security and Labor Welfare	2.4	4.1	4.2	4.3	3.9	5.0	4.9	4.7	5.2	4.9	4.8	4.9
Defense	7.4	5.9	5.9	5.7	5.3	5.1	5.2	5.4	4.9	5.0	4.9	4.8
General Public Services	15.2	14.8	14.8	13.7	13.3	12.6	12.8	12.3	11.5	13.4	12.5	11.6
o.w. General Public Administration	7.6	7.4	7.4	6.4	6.0	5.9	5.6	5.3	5.3	6.9	6.0	5.3
Net Lending, Interest Payments and Others	22.5	20.2	22.6	23.5	25.7	29.9	30.5	32.9	35.3	36.3	29.7	29.1

Source: Department of Budget and Management

2.14 Among the national government agencies, the Department of Education (DepEd) commands the lion's share of the total budget, followed by the Department of Public Works and Highways (DPWH). The government has repeated its intention to prioritize these two sectors, but because of the contraction of total spending, the allocations to these departments as a share of GDP have actually declined during the period under review.

2.15 A notable trend in the evolution of the budget composition over this period is the increase in the share of special purpose funds (SPFs), an amalgam of on-budget funds that sit outside individual agencies' annual appropriations. Some of the SPFs constitute earmarked funds for specific legislative mandates (e.g., Agriculture and Fishery Modernization Program based on the AFM Act of 1997, allocations to LGUs under the 1991 Local Government Code). Some are funds set aside for certain financial

transactions such as interest payments and the government's net lending to GOCCs with financial difficulties that cannot be foreseen accurately or are difficult to quantify at the time of finalizing the annual budget. Most of the SPFs end up being assigned to specific national government agencies during a fiscal year and show up in the final budget execution data for those agencies.

**Table 2-4: National Government Expenditure Allocation (Obligation Basis),
by Department/Special Purpose Fund, 1996-2007**

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007 (Ind)
(% of GDP)												
Total Expenditure	19.2	20.3	20.2	19.5	20.5	19.4	18.4	19.1	17.8	17.5	17.4	17.7
Departments	11.3	13.1	12.7	11.7	11.5	10.3	9.7	9.4	8.7	8.2	8.5	7.4
o.w. Department of Agriculture	0.3	0.9	0.5	0.6	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Department of Education	2.6	3.0	3.1	2.9	2.8	2.7	2.6	2.5	2.2	2.0	2.0	2.1
Department of Health	0.4	0.5	0.4	0.4	0.3	0.3	0.3	0.2	0.2	0.2	0.2	0.2
Department of National Defense	1.8	1.9	2.0	1.9	1.8	1.6	1.6	1.6	1.5	1.4	1.4	0.8
Department of Public Works and Highway	1.8	1.9	1.9	1.6	1.9	1.5	1.2	1.2	1.2	0.9	1.4	1.3
Special Purpose Funds (excluding interest)	4.4	4.0	3.7	4.2	4.8	4.3	4.2	4.4	3.7	3.8	3.7	5.3
o.w. Budgetary Support to GOCCs	0.7	0.7	0.5	0.7	0.7	0.5	0.4	0.8	0.6	0.6	0.5	0.3
Agriculture and Fisheries Modernization Prog.	0.0	0.0	0.0	0.0	0.5	0.4	0.3	0.2	0.2	0.3	0.3	0.3
Allocations to Local Government Units	2.9	3.1	3.1	3.4	3.6	3.4	3.5	3.4	3.0	3.0	2.9	3.1
Pension and Gratuity Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.8
Interest Payments	3.5	3.2	3.7	3.6	4.2	4.8	4.6	5.2	5.4	5.5	5.2	5.0
(% to Total)												
Total Expenditure	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Departments	58.8	64.5	63.0	60.0	55.6	53.3	52.3	49.3	49.0	46.6	49.2	41.7
o.w. Department of Agriculture	1.8	4.2	2.6	2.8	0.5	0.5	0.7	0.5	0.5	0.3	0.3	0.3
Department of Education	13.4	14.9	15.6	14.9	13.6	13.8	14.0	12.9	12.2	11.4	11.3	12.0
Department of Health	2.3	2.5	2.1	2.2	1.6	1.5	1.6	1.2	1.3	1.1	1.0	1.1
Department of National Defense	9.3	9.6	9.7	9.6	8.8	8.3	8.5	8.6	8.2	8.0	7.8	4.4
Department of Public Works and Highway	9.5	9.2	9.3	8.2	9.5	7.8	6.4	6.5	6.7	5.4	5.9	6.5
Special Purpose Funds (excluding interest)	22.9	19.7	18.5	21.7	23.8	22.0	22.6	23.2	20.9	21.7	21.4	30.1
o.w. Budgetary Support to GOCCs	3.8	3.2	2.3	3.4	3.5	2.4	2.0	4.0	3.1	3.4	3.0	1.4
Agriculture and Fisheries Modernization Prog.	0.0	0.0	0.0	0.0	2.5	2.2	1.8	1.2	1.2	1.4	1.6	1.9
Allocations to Local Government Units	15.0	15.2	15.4	17.6	17.8	17.4	18.9	18.0	16.6	16.9	16.6	17.5
Pension and Gratuity Fund	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	4.3
Interest Payments	18.4	15.9	18.6	18.3	20.6	24.7	25.0	27.4	30.1	31.6	29.4	28.3

Source: Department of Budget and Management

C. DESCRIPTION OF THE LEGAL AND INSTITUTIONAL FRAMEWORK FOR PFM

2.16 The Constitution establishes certain basic rules about PFM-related matters and the respective roles of different state institutions in this regard. The bulk of details of the PFM requirements are set out in the Executive Order No. 292 or the Administrative Code of 1987 as well as in annual budget circulars and other administrative norms. Specific aspects of PFM, such as accounting (NGAS), public procurement (RA 9184) and inter-governmental fiscal relations (RA 7160), are also governed by specific laws or lesser norms related to respective areas. Audit rules are codified in PD 1445 or the "Government Auditing Code of the Philippines."

2.17 The key agencies involved in public financial management are:

- (a) *Department of Budget and Management (DBM)*. The DBM is responsible for formulation and implementation of the national government budget. It coordinates preparation of the president's budget proposal based on submissions from the line departments and agencies and controls budget execution through its authority to release allotments and cash allocations to spending units. Besides, the DBM oversees the Procurement Service as its attached agency.
- (b) *Department of Finance (DOF)*. The DOF is in charge of the government's fiscal policies and management of its financial resources overall. Among the DOF's key functions related to PFM are oversight of the main revenue administration agencies, the Bureau of Internal Revenues (BIR) and the Bureau of Customs (BOC) and management of the government's cash resources and public debts through the Bureau of Treasury (BTr). The BTr coordinates with the DBM in determining the allowable cash disbursements by the agencies during budget execution (reflected in cash allocation releases of the DBM). In addition, the DOF supervises selected GOCCs (Corporate Affairs Group) and fiscal and financial affairs of LGUs (Bureau of Local Government Finance).
- (c) *National Economic Development Authority (NEDA)*. NEDA's primary responsibilities are to formulate the Medium-term Philippine Development Plan (MTPDP), the Medium-term Public Investment Programs (MTPIP) and corresponding annual plans and programs and to coordinate programming of official development assistance.
- (d) *Commission on Audit (COA)*. COA is constitutionally responsible for external audit of all government entities, for mandating an accounting and auditing framework, and for the issue of the Annual Financial Statements of Government.

2.18 Detailed provisions related to the legal and institutional arrangements for public financial management are reproduced in Annex 2.

2.19 The Philippines' prevailing legal and organizational frameworks regarding PFM include certain features that are relatively unique in the international context. While the presence of these features does not necessarily imply intrinsic strengths or weaknesses in the country's institutions governing PFM, these do need to be taken into account when a common assessment method, such as the PEFA approach, is applied.

1. Strong presidential powers

2.20 Within the presidential form of government, the Philippine Constitution grants relatively broad powers and discretions to the presidency vis-à-vis the legislature, particularly in budgetary matters. As mentioned above, the Constitution prohibits Congress from increasing the budget beyond the President's proposal, although it permits

realignments among proposed spending items. Unlike in the United States and a number of other presidential systems (e.g., in Latin America), however, the Philippine president has the authority to veto individual budget items introduced by Congress. If Congress fails to enact a GAA, the previous year's budget is "re-enacted," thus allowing the government to function.

2.21 A re-enacted budget constrains the President's ability to run the government in one way, but increases his/her discretions in another. A re-enacted budget constrains the government by fixing the total spending level to that of the previous year's budget, which, in nominal terms, would typically be lower than the amount established in the executive's new budget proposal based on new revenue estimates. In practice, this apparent reduction in the total spending level in real terms is off-set by the practice of using a pro-rated amount of the total appropriations from the previous year (as re-enacted budget) until the approval of the new GAA at which time a full one year's worth of appropriations are authorized, effectively making the total available for the year larger than the new appropriations in the GAA. Furthermore, carry-overs from the previous year as continuing appropriations add to the available appropriations, at least with respect to capital outlays and maintenance and other operating expenses. Besides the actual disposal amount, budget re-enactment increases the presidential discretions because it allows the President to reallocate resources that were appropriated to items that have already been fully executed to other unspecified purposes.

2. Multiple oversight agencies

2.22 Different phases of the PFM cycle in the Philippine government are coordinated by several oversight agencies (i.e., planning by NEDA, budgeting, procurement and other managerial matters by the DBM, fiscal, cash and debt management by the DOF, accounting and auditing by COA, non-financial aspects of personnel management by the CSC). The fact that more than one agency is responsible for overseeing different aspects of the PFM cycle is by no means unique to the Philippines. Nonetheless, the presence of multiple oversight agencies necessitates close coordination among them for the entire PFM cycle to operate smoothly.

2.23 Some of the oversight agencies, such as COA and the CSC, are constitutional bodies independent of the executive branch. That fact alone does not necessarily mean coordination with executive departments such as the DBM and the DOF is automatically precluded, and in some cases effective inter-agency coordination has been achieved. Nevertheless, the independence of these oversight bodies can sometimes complicate efforts to coordinate or harmonize government-wide policies of relevance to PFM because technical disagreements between an executive department and a constitutional body cannot be resolved by a presidential instruction.

3. Special Purpose Funds

2.24 The Philippine budget includes a number of Special Purpose Funds (SPF) outside the basic framework of appropriations to agencies' programs, activities and projects (PAP) in the GAA. Some of the SPFs are earmarked funds for specific programmatic

purposes, such as the Agriculture and Fisheries Modernization Fund, the School Building Fund, the E-government Fund, which, in principle, Congress might be able to appropriate to specific government agencies implementing them.¹² Others represent variants of contingency funds for eventualities that are impossible or difficult to estimate precisely *ex ante*, and these include the Calamity Fund, and the Contingency Fund, while others are set aside to fulfill the government's financial obligations such as the International Commitments, Miscellaneous Personnel Benefits Fund, the Pension and Gratuity Funds, the Debt Service Fund, and the Allocations to LGUs under various categories.¹³ Finally, the current set of SPFs includes the Priority Development Assistance Fund, or the so-called pork barrel fund, made up of project funds assigned to individual legislators for their constituency services.

2.25 There is no single general legal framework that defines what an SPF is, how it can be constituted, and how it should be utilized. Although these are called "funds," most of them derive their funding from the ordinary revenues of the government, and thus, in principle, are no different from other expenditures included in the GAA in terms of their financial basis. One major advantage of the Special Purpose Funds for the Executive is the flexibility in allocation of appropriations to line agencies without having to return to Congress for approval of a supplementary budget. The same flexibility can weaken accountability for the usage of SPFs, however.

4. Appropriations outside the GAA

2.26 According to the Philippines' legal framework, the annual appropriations under the GAA do not constitute the entirety of the budget. As the Philippines uses an obligations-based method of budgeting, appropriations refer to the maximum amounts the government is authorized to obligate in a given year, but appropriations for maintenance expenditures and capital outlays have a validity of two years and thus can be carried over into the following year as "continuing" appropriations. Other expenditure items (e.g., debt service, foreign grants) are considered "automatically" appropriated without specific annual legislative approval.¹⁴

2.27 From the point of view of budget transparency, continuing appropriations pose a problem as it is difficult to identify specifically which previous appropriations are

¹² The government authorities explain that some of these (e.g., the Agriculture and Fisheries Modernization Fund, the E-government Fund) represent important multi-agency programs that are presented to the Legislature as such to call the legislators' attention to them. The Agriculture and Fisheries Modernization Fund and the other funds (e.g., Budgetary Support to GOCCs and the Allocations to LGUs), however, have agency level breakdowns.

¹³ SPF allocations to LGUs include the Internal Revenue Allotment, the Special Shares of Local Government Units in the Proceeds of National Taxes, the Barangay Officials Death Benefits Fund, the Metropolitan Manila Development Authority, the Pasig River Rehabilitation Commission, the Premium Subsidy for Indigents under the National Health Insurance Program, and the Municipal Development Fund.

¹⁴ However, an examination of the budget deliberation by Congress shows that the treatment of debt service has hardly been "automatic," and in fact, has often been a contested item in the political battle over annual budgeting between the two houses of Congress and between Congress and the Executive branch.

continuing into the second budget year. The amounts and details of these continuing appropriates are not fully captured in the budget document. This problem is exacerbated by the difficulty of tracking releases of allotments by the DBM and actual incurrence of expenditures and cash disbursements by spending agencies, because of the inadequate financial management information systems.

5. Devolution of national government functions

2.28 While the Local Government Code (LGC) generally delineates clear assignment of functions across levels of government – including across the three levels of local government units, provinces, cities/municipalities, and barangays, the national government has continued to engage in some activities that have formally been devolved to LGUs. The LGC itself permits continued involvement of the national government in “devolved” functions when the LGUs’ capacity limitations call for “augmentation” of basic services and facilities. The incomplete devolution of functions is a source of ambiguous accountability in the current intergovernmental set-up. For the same reason, it obfuscates transparency of the fiscal and administrative relations between the national government and LGUs.

3. ASSESSMENT OF THE PFM SYSTEMS, PROCESSES AND INSTITUTIONS

A. INTRODUCTION

3.1 The PEFA PFM performance measurement framework is based on a consensus view among PFM experts and the participating partner agencies that a good PFM system contributes to development by supporting aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. Using a set of 28 high-level performance indicators, the PEFA method captures key dimensions of the quality of the country's PFM system in terms of: (a) PFM system out-turns; (b) cross-cutting features of the PFM system; and (c) budget cycle.

(a) *PFM system out-turns:* The Performance Indicators (PI) 1-4 capture immediate results of the PFM system in terms of (i) aggregate expenditure out-turn compared to original approved budget; (ii) composition of expenditure out-turn compared to original approved budget; (iii) aggregate revenue out-turn compared to original approved budget; and (iv) stock and monitoring of expenditure payment arrears. The conceptual emphasis is on measuring the credibility of the budget, expressed variously as variance between the original budget and actual execution.

(b) *Key cross-cutting issues:* The PI 5-10 measure comprehensiveness and transparency of the budget classification and documentation, the extent of effective oversight and/or control over selected fiscal and quasi-fiscal operations (e.g., inter-governmental fiscal relations, fiscal risks), and public access to key fiscal information.

(c) *Budget cycle:* The bulk of the PEFA assessment framework (PI 11-28) covers the budget cycle ranging from (i) policy-based budgeting (PI 11-12); (ii) predictability and control in budget execution (PI 13-21); (iii) accounting, recording and reporting (PI 22-25); and (iv) external scrutiny and audit (PI 26-28).

(d) *Donor practices:* In view of the frequent occurrence that donor practices in aid disbursement and management often undermine, rather than support and strengthen, country systems in PFM, the final module of methodology assesses the quality of donor practices in terms of the predictability and transparency of external financial assistance and the extent to which the donors utilize national procedures for channeling their aid.

Box 3-1: Two Scoring Methods

In the PEFA method, each indicator contains one or more dimensions for assessing the key elements of the PFM process. Two methods of scoring are used. Method 1 (M1) is used for all single dimensional indicators and for multi-dimensional indicators where poor performance in one dimension of the indicator is likely to undermine the impact of good performance in the other dimensions of the same indicator (in other words, by the weakest link in the connected dimensions of the indicator). A plus sign is given, where any of the other dimensions are scoring higher.

Method 2 (M2) is based on averaging the scores for individual dimensions of an indicator. It is prescribed for selected multi-dimensional indicators, where a low score in one dimension of the indicator does not necessarily undermine the impact of a high score in another dimension of the same indicator. Although the dimensions all fall within the same area of the PFM system, progress in individual dimensions can be made independent of the others and without logically having to follow any particular sequence. A conversion table is then provided for 2, 3 and 4 dimensional indicators to arrive at the overall score. In both scoring methodologies, the 'D' score is considered the residual score, to be applied if the requirements for any higher score are not met.

3.2 Although PEFA's coverage is comprehensive, it is not exhaustive nor is it intended to capture every detail of each of the dimensions. Some of the dimensions such as procurement and public debt management benefit from the existence of their own framework. These in-depth, area-specific assessments should be used to complement PEFA's more aggregate approach, whenever possible.

B. BUDGET CREDIBILITY

PI-1 Aggregate expenditure out-turn compared to original approved budget

3.3 PI-1 assesses the difference between actual primary expenditure and the originally budgeted primary expenditure.¹⁵ This measure reflects the government's ability to maintain fiscal discipline while adhering to the parameters set in the approved budget.¹⁶

3.4 During the period under review, the Philippines faced fiscal constraints but managed to maintain deficits within manageable levels and actually reduced the national government deficit from 4.6 percent of GDP in 2003 to 1.0 percent in 2006. This record demonstrates the GOP's clear commitment to, and capacity for, maintaining fiscal balance in order to ensure macroeconomic stability.

¹⁵ The budget execution data reported in DBM publications (e.g., Budget of Expenditures and Sources of Funding) do not include actual cash payments made. All the "actuals" figures are reported on the basis of obligations. For its part, COA's financial reports do report on expenditures on the basis of cash payments, but do not follow the GAA structure and therefore cannot be used for the purpose of comparing the budget and the actuals.

¹⁶ It is possible for governments to maintain fiscal discipline (i.e., control deficit) by deliberately under-executing the budget. In PI-1, such a common practice would translate into a poor score even if the deficits were under control.

3.5 However, from the point of view of budget credibility defined as the capacity to implement the budget as approved, the record is somewhat more mixed. During the height of fiscal adjustment in 2004-05, the government controlled the deficit by restricting expenditures through tight management of allotment and cash releases, thus under-executing the budget and creating unpredictability of fund flows to line agencies.¹⁷

3.6 Table 3.1 presents the total appropriations for 2004-2006 based on the ex post data. In each case the budgetary data has been drawn from the original budget proposal (National Expenditure Program, NEP) and the actual data reported in the NEP two years later. We take the total obligations as “actual expenditure” since the budget documents do not report cash disbursements. A couple of particularities in the Philippine budgeting make these otherwise straightforward fiscal statistics difficult to interpret. On the one hand, the way the re-enacted portion and the new portion of the GAA interact to constitute the total appropriations (see Box 3.1 for details) leads to over-stating the “original” budget figures (the legally authorized ceiling in a given year), thus possibly exaggerating the negative budget deviation (i.e., under-execution).¹⁸ On the other hand, at the moment the budget is passed, neither the government nor Congress has consolidated data on the continuing appropriations. These figures are omitted from the NEP and the GAA, and are only available ex post. This leads to under-reporting on the originally authorized level of spending (i.e., obligations) in the NEP and the GAA.

Table 3-1: Aggregate Expenditure Out-turn and Approved Budget

	2004	2005	2006
In million pesos	Budget (adjusted)	Budget (adjusted)	Budget (adjusted)
1. Total Appropriations	968,038	1,130,018	1,109,822
1a. New General Appropriations	608,844	717,373	597,663
1b. Continuing Appropriations	42,217	37,410	90,011
1c. Automatic Appropriations	316,977	375,235	375,221
1d. - of which debt service	260,901	299,807	310,104
1e. Less: Unused/Unobligated	101,028	182,465	64,995
2. Total obligations (1-1e)	867,010	947,554	1,044,827
3. Appropriations for primary expenditure (1-1d)	707,137	830,211	799,718
4. Total primary expenditure (2-1d)	606,109	647,747	734,723
Primary expenditure deviation (%) ((4-3)/3)	-14.29%	-21.98%	-12.30%

* 2004 Budget was as re-enacted GAA 2003.

¹⁷ With the easing of the fiscal constraint in 2006, the problem of cash rationing was reportedly reduced.

¹⁸ In 2005, however, a good portion of the additional authorization the government obtained as a result of the delayed approval of the GAA was apparently utilized as “savings,” some of which were immediately disbursed as end-of-year bonuses for government employees, while others were carried over into 2006.

3.7 The available data do not allow us to ascertain an alternative way of establishing the “original budget” figures for the purpose of this calculation. If we calculated these figures to estimate the budget out-turn, the figures for 2004-06 would indicate significant under-execution of the budget, ranging from under-execution by 14.29% in 2003 to as much as 21.98% in 2005. This performance would correspond to a “D” score by the PEFA methodology.

3.8 We chose not to assign a score for this indicator because the rules regarding re-enacted budget and the inability to capture the total amount available as continuing appropriations at the beginning of the year make the reported “original budget” figures misleading. The most desirable way of clarifying this situation would be to develop capacity to capture and report the total amount available as continuing appropriations at the beginning of the year in the GAA. So long as the recurrent pattern of delayed or non-approval of the GAA continues, however, accurate accounting of the “original’ budget will continue to be difficult.

Indicator	Score	Meaning of PEFA score	Evidence
PI-1. Aggregate expenditure out-turn compared to original approved budget	Not rated		It is not possible to calculate the expenditure out-turn ratio because of the unavailability of the ex ante figures for continuing appropriations in the budget documents.
		Scoring methodology	MI

Box 3-2: Making Sense of Philippine Budget Data

PEFA’s PI-1 and PI-2 are based on simple premises that budget documents report the total amounts the entire government as well as individual agencies are authorized to spend each year and that data is available to calculate how much of these authorized amounts were actually spent by the end of the year. In the Philippines, however, a combination of factors limits the availability of these simple budget data and complicates calculation of the scores for PI-1 and PI-2. There are at least three sources of confusion or ambiguity which make calculation of PI-1 and PI-2 difficult or misleading: (i) the financial reporting system’s inability to capture the amount of continuing appropriations ex ante at the beginning of the fiscal year; (ii) the customary delays in approving the GAA; and (iii) misleading ex post reporting on the total appropriations available in the NEP.

First, the peculiar nature of the budgetary data arises from the fact that budget appropriations in the Philippines consist of three types of authorizations, new appropriations authorized each year by Congress and not vetoed by the President, automatic appropriations for specific expenditure items (e.g., debt service) that are specified in separate laws, and continuing appropriations, or the carry-over of appropriations for specific expenditures (i.e., capital outlays, MOOE) from the previous year that were not allotted or obligated. Initially authorized amounts as new and automatic appropriations are reported in the General Appropriations Act (GAA) and other DBM

publications. But continuing appropriations are only reported as “actuals” on an ex post basis because apparently the government does not have the ability to consolidate information on the continuing appropriations from the agencies in time for the finalization of the GAA. This means that “ex ante” figures for the approved budget are always under-estimated, as they omit continuing appropriations.

Another source of the measurement problem is the frequency of delayed approval of the budget. According to the PEFA methodological guideline note “Clarifications to the PFM Performance Measurement Framework of June 2005” (October 2006 update), those cases when the legislature fails to enact a budget at the beginning of the fiscal year should be considered “outlier” years without an original budget. In such cases, the budget variance cannot be calculated. If this guidance is applied strictly to the Philippines, every single year since 1997, except 1999, would be an “outlier” year.

In the Philippines, however, when the budget is not approved by the beginning of the fiscal year, the previous year’s budget is re-enacted until the new general appropriations act is enacted. Thus there is always a legal basis for the government to incur expenditures even when Congress fails to enact a new budget. The difficulty is that in these cases, the GAA does not reflect the actual total amount the government is authorized to spend even beyond its usual omission of the continuing appropriations.

Data are problematic even on an ex post basis. NEP presents the actual “available” appropriations for the previous fiscal year on an ex post basis. In those years when the budget approval was delayed, the figures for “new” appropriations include (i) the appropriations based on the re-enacted budget (i.e., the previous year’s budget) prorated from January 1 until the date of the passage of the new GAA, and (ii) the new general appropriations for the whole year approved on the assumption that the new GAA would go into effect on January 1. For example, if the budget is approved at the end of the first quarter, the “available” appropriations would consist of the first quarter of the re-enacted budget and the full year of the new appropriations (i.e., five quarters worth of appropriations). This over-states the total amount that was available for new obligations. When this happens, estimating the budget out-turn on the basis of this “inflated” original budget becomes meaningless.

PI-2 Composition of expenditure out-turn compared to original approved budget

3.9 The budget is one of the principal tools for articulating and implementing government policies across sectors and issue areas. As such, large variations in the sectoral composition would render the budget meaningless as an expression of the government’s policy intent. Since the budget is allocated to administrative units (and to the Programs, Activities and Projects, PAP, within each), the most appropriate way of measuring the budget’s policy credibility is to assess the stability of its administrative composition.

3.10 Following this logic, PI-2 measures the extent to which reallocations between departmental and special purpose fund budget lines have contributed to variance in expenditure composition beyond the variance resulting from changes in the overall level

of expenditures.¹⁹ For the Philippines, however, the same data limitation discussed with respect to PI-1 makes it impossible to estimate the exact budget variance at the disaggregated level.

3.11 As is the case for the national budget aggregates, the “original” budget for individual departments are over-stated as a result of how the re-enacted portion and new portion of the GAA are combined to calculate the total appropriations for each department. Furthermore, no estimates of continuing appropriations are available at the departmental level when the budget is initially approved. On the other hand, a number of departments and agencies (e.g., Department of Agriculture) receive “transfers” from special purpose funds (e.g., Agriculture and Fisheries Modernization Fund) during the year. These transfers would result in higher levels of obligations than the original departmental appropriations.

3.12 Detailed obligation data is available only upon request from individual departments. An analysis of the detailed actual obligations for 2005 provided by the Department of Education revealed a variance in the total obligations for the agency between the Department of Education’s data and the figure reported in the NEP, with the agency reporting total obligations that were 2.4% less than what was reflected in the NEP. Hence, even when actual obligation data detailed at the PAP level is available from individual departments, there is no assurance that these will tie up with the official aggregate obligation data in the NEP.

3.13 No score is assigned for this indicator because there is no way to objectively determine the “original” budgets for the various departments, which prevents the calculation of variances between actual and originally budgeted expenditures at the departmental level.

Indicator	Score	Meaning of PEFA score	Evidence
PI-2. Composition of expenditure out-turn compared to original approved budget	Not rated		It is not possible to calculate the variance in expenditure composition relative to overall deviation in primary expenditure because of the unavailability of the ex ante figures for continuing appropriations in the budget documents.
		Scoring methodology	M1

PI-3 Aggregate revenue out-turn compared to original approved budget

3.14 This indicator assesses the quality of revenue forecasting by comparing revenue estimates in the original approved budget to actual domestic revenue collection based on tax and non tax recurrent revenues. The revenue data do not suffer from the types of

¹⁹ Variance is calculated as the weighted average deviation between actual and originally budgeted expenditure calculated as a percent of budgeted expenditure on the basis of administrative classification, using the absolute value of deviation.

complication encountered with the expenditure data discussed with respect to PI-1 and PI-2.

3.15 For the years under review, revenue estimates were realistic with revenue outturn numbers exceeding budgeted projections by 6 to 7% in all but one of the three years under review. In 2006, revenues just fell slightly lower than the published forecast by 0.3%.

Table 3-2: Revenue Performance over the Period 2004 – 2006

In Billion Pesos	2004		2005		2006	
	Forecast	Actual	Forecast	Actual	Forecast	Actual
Total recurrent revenue	655.2	697.4	747.7	806.3	968.6	965.3
Deviation recurrent (%)	6.4%		7.8%		-0.3%	
Tax revenue	601.4	605.0	677.7	705.6	874.3	859.9
Income and profit	275.3	278.2	319.1	323.4	401.3	377.0
Property	0.6	0.8	0.9	1.0	1.1	1.1
Use of goods	219.5	198.5	225.0	226.2	281.0	283.1
International trade	105.9	127.5	132.7	155.0	190.8	198.6
Non-tax recurrent revenue	53.8	92.4	70.0	100.7	100.6	105.4
Fees and charges	23.2	27.7	24.6	30.1	33.0	31.0
BTr income	20.8	48.7	35.3	52.5	51.9	47.6
NG income collected by BTr	9.7	16.0	10.1	18.1	15.8	26.8
Non-recurrent revenue	16.0	9.3	10.8	9.8	9.5	14.4
Sales of fixed assets	1.0	0.4	0.5	2.4	0.5	5.8
Grants from abroad	0.3	0.1	0.5	0.1	0.6	0.2
Other	14.8	8.9	9.7	7.3	8.5	8.4
Total Revenue and Grants	671.2	706.7	758.5	816.2	984.4	979.6

Source: BESF and Fiscal Statistics Handbook (DBM)

Indicator	Score	Meaning of PEFA score	Evidence
PI-3 Aggregate revenue out-turn compared to original approved budget	A	(i) Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years.	Data in table III-4 obtained from Budget of Expenditures and Sources of Financing (BESF)
Scoring methodology			M1

PI-4 Stock and monitoring of expenditure payment arrears

3.16 This indicator is concerned with measuring the extent to which there is a stock of arrears, and the extent to which the systemic problem is being brought under control and addressed.

3.17 *Stock of payment arrears:* The Balance Sheet for Government in the Annual Financial Report (AFR) prepared by COA shows accounts payable of P86.5 billion and P90.6 billion that were due to external suppliers in the 2004 and 2005 accounts,

respectively. These represent 8.1 percent and 3.7 percent of the total expenditures, respectively, in these years. These payables pertain to accounts that have been outstanding for over two years with no actual claims, administrative or judicial, being filed against them or are not covered by contracts which, under Section 98 of Presidential Decree (PD) 1445 or the Government Auditing Code of the Philippines, should be reversed. Table 3-5 lists some of the data on overstated accounts payable drawn from the COA financial audit reports to enable estimation of a more reliable level of the stock of arrears.²⁰ The 2006 Status of Prior Year's Recommendations (Part 3 of agencies' COA-AAR) reveals that such overstatements were not fully addressed.

Table 3-3: Accounts Payable to External Suppliers 31st December 2005

Pesos Millions	COA Final Accounts	Overstatement in audit report	Net
Department of Public Works and Highways	50,620	33,477	17,143
Department of Transportation & Communications	8,419	5,800	2,619
Department of National Defense	4,173	588	3,585
Department of Agriculture	3,678	1,140	2,538
Department of Education	3,210	0	3,210
Department of Budget and Management	2,412	0	2,412
State Universities and Colleges	2,222		2,222
Department of the Interior and Local Government	1,975	0	1,975
Department of Health	1,745	42	1,704
Department of Finance	1,135	0	1,135
Department of Science and Technology	1,068	0	1,068
MMDA	1,016	119	897
Autonomous Region in Muslim Mindanao	996		996
Department of Environment and Natural Resources	817	217	601
Other Agencies	7,122		7,122
Total	90,608	41,383	49,225
Total expenditures			1,326,698

Note: The blank cells refer to the cases where the PEFA assessment team was not able to review the respective audit reports, whereas the cells with 0 refer to the cases where the respective audit reports did not include any observation related to the value of accounts payable to external suppliers.

Source: COA 2005 Annual Financial Report Volume I-B COA Financial Audit Reports

3.18 These accounts payable figures may be materially overstated. Interviews with DBM officials reveal that a large portion of these accounts payable were due to the recording of obligations as accounts payable using the definition of obligations under the old government accounting system. Under the old system, an obligation referred to contracts entered into whether or not goods or services were delivered. This definition of *obligation* was tightened with the introduction of the new government accounting system

²⁰ In some of the other large agencies, no mention has been made of accounts payable owing to external suppliers (e.g. DBM, DOF and DOST) and for entities like State Universities and Colleges, reading of a very large number of audit reports would be required.

or NGAS in January 2002. NGAS defines obligations as “commitment by a government agency arising from an act of a duly authorized official *which binds the government to the immediate or eventual payment of a sum of money in view of the delivery of goods or services*” (emphasis added).

3.19 Another reason for overstatements is the way the accounts payable figures of the AFR were put together. The relevant COA audit reports on individual agencies noted the overstatement of these accounts payable and advised agencies to reverse them in their books. However, the AFR is a consolidation of pre-closing trial balances which all agencies submit to COA and do not reflect these audit findings. Once these figures are removed from calculating the total accounts payable, for example, for 2005, the net figure would amount to P49.2 billion, representing 3% of total spending of that year. These are certainly not excessive amounts, and would in fact fall within the range for a “B” score in the PEFA scoring guidelines.

3.20 *Monitoring arrears:* More reliable data on the stock of arrears was potentially available from the information submitted by line departments to the DBM in the budget process, but that data is not collated and analyzed. For example, the DBM Budget Circular 507 on Budget Execution Documents of January 2007 requires agencies to submit quarterly reports of aged data entitled “List of not yet due and demandable obligations.” The verification of the extent to which the agencies comply with this and other reporting requirements was beyond the scope of this assessment. According to the DBM, a computerized system to monitor outstanding claims and their settlement has been developed. Its full utilization should facilitate improved management of Accounts Payable.

3.21 Government also has accounts payable in the form of tax refunds which are not accounted in the annual financial report, and thus were not verified, let alone quantified, as part of this assessment.

3.22 At least for the 2003-05 period, the government lacked an effective mechanism to monitor and record payment arrears accurately, either for individual agencies or for the government as a whole. While the DBM maintains that with the easing of the fiscal constraint in 2006, payment arrears would be cleared before they built up (i.e., the DBM issued NCAs within 30 days of receiving requests for cash releases from the departments), how this improvement was reflected in actual recording of accounts payable can only be verified with the 2006 audit reports. At least for the period 2003-05, the evidence indicates that there is no systematic monitoring and recording of payment arrears, even though their level appears to be moderate.

Indicator	Score	Meaning of PEFA score	Evidence
PI-4 Stock and monitoring of expenditure payment arrears	D+		
(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.	C	The stock of arrears constitutes 2-10% of total expenditure; and there is no evidence that it has been reduced significantly in the last two years.	COA financial audit report data as presented in table III-4 indicates that arrears actually payable total around 3% of total expenditure but the stock of payables increased per COA Financial Reports 2004 and 2005
(ii) Availability of data for monitoring the stock of expenditure payment arrears.	D	There is no reliable data on the stock of arrears from the last two years.	Existing data is overstated, not corrected or managed and is consequently not reliable.
Scoring methodology			M1

C. COMPREHENSIVENESS AND TRANSPARENCY

PI-5 Classification of the budget

3.23 A robust classification system facilitates effective linking of budget allocations to underlying policies, tracking of expenditure, and management of key line items for efficient and economical management of resources. The functional and sub-functional classifications capture the policy purposes for which expenditures are allocated, while the economic classification is meant to facilitate expenditure control and analysis of economic and financial impacts of the budget. The administrative classification is the most common basis for appropriations of the budget, since it is the administrative units of the government that execute the appropriated funds and are thus held accountable for their use. Finally, the program classification is used as a tool for linking budget allocations to explicit performance objectives.

3.24 Important criteria for assessing PI-5 are whether the government makes use of a good combination of different classification schemes for different purposes, whether these are consistent with accepted international standards, and whether the structure permits not only effective interpretation of the approved budget but also monitoring of its actual execution.

3.25 In the Philippine budget, the basic structure of appropriations is the Programs, Activities and Projects (PAPs) for each administrative unit (e.g., bureaus and organizational units of lower hierarchy in each department). These are further subdivided by "object." The classification by object is broadly in line with the internationally accepted economic classification (e.g., IMF's Government Finance Statistics). But at its most aggregated form (see Table 3-4), it lumps together under the broad MOOE category various expenditures with different natures and purposes such as subsidies, current transfers, interest payments, and other operating expenses (e.g., travel). A more disaggregated presentation which distinguishes these different types of expenditures would increase transparency.

Table 3-4: Budget Reporting Framework

	Allotment Received	Obligations Incurred	Unobligated balance of allotments
Current year budget			
Personal Services			
Maintenance and other Operating Expenses			
Capital Outlays and net lending			
Special Purpose Funds			
Personal Services			
Maintenance and other Operating Expenses			
Capital Outlays and net lending			
Prior Year Budget			
Personal Services			
Maintenance and other Operating Expenses			
Capital Outlays and net lending			
Total Expenditure			

Source: DBM Budget Circular 507 on Budget Execution Documents of January 2007 Statement Allotments Obligations Balances

3.26 Largely the same structure is used in the President’s budget proposal to Congress in the form of the National Expenditure Program (NEP). The GAA then appropriates the budget based on the same PAP structure. However, there are some discrepancies in the content of the NEP and the GAA. For example, the NEP includes certain summary information, such as the breakdown among different types of appropriations (new, automatic, and continuing), budgetary adjustments, and unused obligations for the two years prior to the budget year. These entries provide useful information about the total appropriations available to each unit as well as the total obligations already incurred (for the previous year and for the ongoing budget year) and obligations to be incurred (in the new budget year). The GAA, however, does not include this information. Presumably because the items other than the new appropriations are not subject to legislative re-authorization. But, the omission of these entries diminishes the GAA’s informational value and limits the comprehensiveness of its coverage.

3.27 The DBM provides details of the budget execution from prior years in the Budget of Expenditures and Sources of Financing (BESF), which accompanies the NEP as part of the executive branch’s budget submission to Congress. The DBM also requires agencies to submit a series of budget execution documents and accountability reports (Box V), although these are not made public.²¹

3.28 For its part, COA presents Annual Reports on Allotments, Obligations and Disbursements with useful analyses of budget execution by department and by other breakdowns (e.g., region). In addition, COA prepares Annual Financial Reports for the national government as a whole. Each of these reports contains a wealth of information, and in the case of the COA reports in particular, useful financial analyses of the budget execution from budgetary and accounting points of view.

²¹ In 2007, the National Budget Circular No. 507 (Jan. 31, 2007) specified general guidelines for these submissions.

3.29 Unfortunately, from the point of view of the PEFA framework, none of these reports follows the GAA's classification structure. The BESF reports on details of budget execution on the obligation basis as well as other useful aggregates such as the sectoral distribution of public expenditures (similar to the functional classification). But it does not include data on actual cash payments/disbursements, and in any case, omits reporting budget execution by PAP.

3.30 The COA reports are more analytical, but again, they do not follow the PAP structure. The Annual Reports on Allotments, Obligations and Disbursements are organized mainly by responsibility center. The Annual Financial Reports follow the NGAS reporting requirements, which specify that the COA chart of accounts is to be used in financial statements. For example, the MOOE category in the NGAS reporting framework includes depreciation charges against capital assets, but these are not reflected in the MOOE category in the budget framework.

Table 3-5: NGAS Reporting Framework

Revenue
Operating Expense
Personal Services
Maintenance and other Operating Expenses (incl. depreciation)
Operating Result
Financial Expenses (Bank charges and interest)
Net Income before other items
Other Items
Subsidies
Gains / Losses on Assets, Guarantees Securities and Forex
Net Income (Loss)

Source: COA Manual on the New Government Accounting System for National Government Agencies Volume 3

3.31 A more complete listing of the revenue and expenditure classification components from the New Government Accounting System and the Budget framework is provided in Annex 3.

Indicator	Score	Meaning of PEFA score	Evidence
PI-5. Classification of the budget	D		
The classification system used for formulation, execution and reporting of the central government's budget.	D	The budget formulation and execution is based on a different classification (e.g. not GFS compatible or with administrative break-down only).	The execution and reporting system does not use the budget classification.
		Scoring methodology	M1

Box 3-3: Budget Execution Documents and Accountability Reports

Budget Execution Documents (BEDs): Annual documents required at the outset of the budget execution phase, which contain the agencies' targets and plans for the current year.

- Physical and Financial Plan
- Monthly Cash Program
- Estimate of Monthly Income
- List of Not Yet Due and Demandable Obligations

Budget Accountability Reports (BARs): Contain information on the agencies' actual accomplishments/performance for a given period.

Quarterly

- Quarterly Physical Report on Operation
- Quarterly Financial Report on Operation
- Quarterly Report on Income

Monthly

- Statement of Allotments, Obligations and Balances
- Monthly Report of Disbursements

PI-6 Comprehensiveness of information included in budget documentation

3.32 This indicator assesses the comprehensiveness of information included in the budget documentation. The full documentation should allow the public to appreciate the government's fiscal strategies, budget proposals and the budget out-turns of the recent years, as well as other key fiscal and financial details. According to the OECD-World Bank survey of budget practices in more than 40 countries (including 26 OECD countries), fiscal and budget reporting typically span a broad range of topics (Table 3-6).

3.33 In the Philippines, the government's budget submission to Congress includes the following documents:

- National Expenditure Program (NEP), which details the executive's budget proposal;
- Budget of Expenditures and Sources of Financing (BESF), which details the actual expenditures (on the obligation basis) of the year prior to the current year, the adjusted budget of the current year, and the proposed budget of the next year in various breakdowns;
- Staffing Summaries, which reports on detailed breakdown of the numbers of permanent positions, including the unfilled positions by agency; and
- Performance Budget, which resents selected agencies' organizational performance indicator framework (OPIF). Started with 20 departments in the FY2007 budget.

Table 3-6: Fiscal and Budget Reporting by OECD and Other Countries (2003)

Central Government Reports	Yes Annually		Yes, Regular Intervals		No		Legal Requirement	
	Total	OECD	Total	OECD	Total	OECD	Total	OECD
General Overview of revenue and expenditure	26	16	14	9	1	0	22	18
Detailed estimates of revenue and expenditure	33	21	6	3	1	1	22	16
Citizen's guide	12	10	2	1	19	11	3	2
Pre-Budget report (general budget policy, aggregates)	18	10	5	4	15	9	7	5
Long term (10 to 40 year) outlook for public finances	5	4	3	3	29	17	1	1
Mid-year report(s) on fiscal outlook	14	11	13	8	11	5	9	8
Report on Tax Expenditures	23	16	6	5	9	3	9	8
Statement of Government Assets	16	13	4	2	15	7	7	5
Special Reports for Old-age Programmes finances	11	10	4	3	22	11	6	6
Special Reports for Civil Service Pension	11	7	5	4	18	11	5	3
Special Reports on Government Debt	18	11	13	6	6	4	7	4
Special Reports on Contingent Liabilities	16	11	3	2	17	9	5	4
Pre-election Report	2	1	7	5	26	16	2	2

Source: "Results of the Survey on Budget Practices and Procedures," OECD/World Bank. <http://oecd.dyndns.org/>

3.34 The budget documents contain some economic and fiscal projections including short-run forecasts of inflation, nominal GDP growth, real GDP growth, exchange rate, 90-day note yields, current account balance and capital and financial account balance. But unlike in many of the countries surveyed by the OECD and the World Bank, the budget submission in the Philippines is not accompanied by analytical reports on key public finance issues. Nor does the GOP issue a budget policy statement and fiscal strategy report with the budget documents. An equivalent of a budget policy statement has been prepared as the Paper on Budget Strategy (PBS) since 2006, but this is currently submitted only for consideration of the Development Budget Coordination Committee (DBCC) and the cabinet and remains an internal government document. The budget submitted to Congress is accompanied by the President's Budget Message which partially fulfils the role of a fiscal or budget policy statement, but it is basically a president's speech in a written form and its content is not analytical.

3.35 The principal source of public finance information in the budget documentation is the Budget of Expenditures and Sources of Financing (BESF). The BESF contains most of the information listed as desirable in the PEFA methodological manual, as detailed below. However, the BESF is based on extremely detailed and rather cumbersome format, which limits its accessibility to ordinary persons. It is merely a compilation of economic, fiscal and financial data and provides no analysis or narratives. Mirroring the Philippines' general appropriations structure, the budgetary data in the BESF are reported in considerable details. But the absence of clear explanations of key terms as well as its complex structure limits its accessibility to the general public.

Table 3-7: Summary of Publicly Available Budget Information

Elements of budget documentation	Availability	Notes
Macro-economic assumptions, incl. at least estimates of aggregate growth, inflation and exchange rate	Yes	See Budget of Expenditures and Sources of Financing (BESF) Table A1
Fiscal deficit, defined according to GFS or other internationally recognised standard	Yes	See BESF Table A2
Deficit financing, describing anticipated composition	Yes	Recorded with the schedule mentioned for debt stock below. BESF Table D1
Debt stock, incl. details at least for the beginning of the current year	Yes	Done in prior years BESF Table D3-D4. Dropped in 2007 budget documentation. Data was separately submitted to Congress during budget deliberations.
Financial assets, incl. details at least for the beginning of the current year	No	
Prior year's budget out-turn, presented in the same format as the budget proposal	Partially yes	See BESF 2007. Budget proposals and the GAA follow the PAP structure. Reporting on budget out-turn does not, although BESF includes additional details (e.g., expenditure by sub-category of MOOE).
Current year's budget (revised budget or estimated out-turn), presented in the same format as the budget proposal	Partially yes	Idem.
Summarised budget data for both revenue and expenditure according to the main heads of the classification used, incl. data for current and previous year	No	See BESF 2007 and National Expenditure Program 2007
Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs	Yes	Table C2 of the BESF for FY2005 describes the new revenue measures and their estimated yields. This practice was not repeated in the BESF for FY2006 because there was no major revenue measure. No explanation of major change to expenditure programs is included.

Indicator	Score	Meaning of PEFA score	Evidence
PI-6. Comprehensiveness of information included in budget documentation			
Share of the above listed information in the budget documentation most recently issued by the central government	B	Recent budget documentation fulfils 5-6 of Table the 9 information benchmarks (counting "Partially yes" as ½ each)	111-8
		Scoring methodology	M1

PI-7 Extent of unreported government operations

3.36 One element of government operations which affects the efficient allocation of resources or fiscal sustainability is reflected in unreported government operations. The PEFA methodology assesses the extent of unreported government operations against two dimensions: (i) unreported extra-budgetary expenditure; and (ii) income/expenditure information on donor-funded projects which is included in fiscal reports.

3.37 *Level of extra-budgetary expenditures:* The Administrative Code (E.O. 292) provides that all income and revenues of government must accrue to the General Fund deposited in the National Treasury under the “one-fund” concept (Book VI, Section 44). Amounts received in trust and from business-type activities of government may be separately recorded and disbursed through a separate special, fiduciary or trust fund duly authorized by law and created in accordance with such rules and regulations determined by the Permanent Committee.²²

3.38 Because of the imposition of this one-fund concept, the amount of unreported revenues and expenditures that sit outside the budget framework appears to be relatively modest and is unlikely to surpass 1% of total expenditure. In 2004 and 2005, for example, COA accounted for P8.2 billion and P5.7 billion, respectively, of other business receipts, which were paid into revolving funds and were not recognized in the budget. These represent roughly 1.4% and 0.9%, respectively, of the budget of these years.

3.39 Unreported revenue is accrued in the health sector where, under Special Provision No. 6 of the appropriations of the DOH under the 2003 GAA (R.A. 9206), all income of the special hospitals, medical centers, Institute for Disease Prevention and Control, and other national government hospitals of the DOH are allowed to be retained and constituted as a trust fund for its use. Other material activities conducted outside the budget and the general fund include: investment activities of the Municipal Development Fund Office estimated at P1 billion and the activities of the Board of Liquidation which manages previously foreign-owned assets secured after the World War II; income from students and consequent expenditures of the State Universities and Colleges; and the President’s Social Fund, which received P1.09 billion from the Philippine Amusement & Gaming Corporation (PAGCOR) as per the COA 2005 Annual Financial Report.

3.40 Overall, however, reporting on the activities of these revolving funds is poor. There is an apparent lack of systematic reporting and monitoring of revenues and expenditures accruing to these accounts despite specific legislative requirements under the GAA to do so.

3.41 *Donor-funded projects in fiscal reports:* As for reporting of donor-funded projects, the executive is required to account for foreign loans and grants and seek

²² The Permanent Committee consists of the Secretary of Finance as Chairman, and the Secretary of Budget and the Chairman, Commission on Audit, as members.

appropriation for related expenditure under Section 12(2) of Book VI of E.O. No. 292. Table B.14 of each year's BESF contains a complete listing of foreign-assisted projects per Department or SPF including peso counterpart, loan proceeds and grant proceeds.

Indicator	Score	Meaning of PEFA score	Evidence
PI-7 Extent of unreported government operations	A		
(i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports.	A	The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of total expenditure).	Level of revolving funds and other funds operated outside budget according to COA 2005 Annual Financial report and other documents appears to total over P10bn compared to P1,300bn total expenditure (i.e., below 1%).
(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports.	A	Complete income/expenditure information for 90% (value) of donor-funded projects is included in fiscal reports, except inputs provided in-kind.	Table B14 2007 Budget Expenditure and Source of Finance(BESF)
Scoring methodology			M1

PI-8 Transparency of inter-governmental fiscal relations

3.42 This indicator assesses the transparency of inter-governmental fiscal relations against:

- transparency and objectivity in the horizontal allocation among SN governments;
- timeliness of reliable information to SN governments on their allocation; and
- the extent of consolidation of fiscal data for general government according to sectoral strategies.

3.43 *Transparency and objectivity in horizontal allocation:* The principal source of intergovernmental fiscal transfers in the Philippines is the Internal Revenue Allotment (IRA). According to the Local Government Code of 1991 (RA 7160), IRA is to be distributed to all LGUs based on the following formula: population (50%), land area (25%) and equal sharing (25%) of the 40% of BIR revenue collections of the third quarter of the fiscal year preceding the current year. In the aggregate, IRA is by far the dominant source of inter-governmental transfers. In 2003, for example, non-IRA portion of the national government transfers to LGUs amounted to P4.1 billion, or less than 3% of the P141 billion IRA transfers.²³

²³ "An Assessment of Non-IRA Transfers and Other Funds for Devolved Services in the Philippines: Final Main Report." Ma. Cecilia G. Soriano et al. (2005). *Mimeo*.

3.44 *Timeliness and reliability of information:* Each year the DBM issues at least two Local Budget Memoranda to communicate the amount of the IRA transfer available to each LGU, along with other instructions related to budget preparation. One memorandum, issued in June-July of the year before the fiscal year in question, establishes the “initial” IRA allocation by LGU, and the second one, typically issued between March and May of the fiscal year in question, fixes the “final” allocation. The Local Government Code (Section 318) mandates local chief executives to submit their budgets to the Sanggunian (local legislature) by not later than October 16. By June-July, the LGUs will have initiated preparation of the budget proposals, but the communication of the IRA allocation by June-July should give LGUs enough time to use this information as a basis for finalizing their budgets (Table 3-8).

3.45 There is room for improving the reliability of information. The initial allocations communicated to the LGUs in 2003-06 are all equal to or somewhat less than the final allocations established the following year. Therefore, an average LGU would not have suffered from an unexpected revenue shortfall during the budget year. However, some LGUs would have received amounts different from those originally informed because inclusion of new municipalities or conversion of municipalities into cities changes allocation among of LGUs of the same type (i.e., among cities). While such changes in LGU status are frequent, they do not involve more than a handful of LGUs in a given year. An impact of the change in allocations may be important for small LGUs that are highly dependent on IRA, but the aggregate effects seem limited. On the other hand, the final allocations in FY05 and FY06 exceeded the initial allocations by 8% and 10%, respectively. In particular, the final allocations in FY06 were communicated rather late in the year (October 17), and it is unlikely that the LGUs would have been able to plan efficient use of these additional resources.

Table 3-8: Timing of the Notification of the IRA Amounts to the LGUs, 2003-06

	FY03 Initial (7/16/02)	FY03 Final (5/26/03)	FY04 Initial (7/15/03)	FY04 Final (3/15/04)
Provinces	*	33,797,000,000	33,789,000,000	33,780,000,000
Cities	*	31,845,000,000	31,847,000,000	31,850,000,000
Municipalities	*	48,455,000,000	48,459,000,000	48,463,000,000
Barangays	*	26,903,000,000	26,905,000,000	26,907,000,000
Total	134,422,000,000	141,000,000,000	141,000,000,000	141,000,000,000
	FY05 Initial (6/15/04)	FY05 Final (3/31/05)	FY06 Initial (6/18/05)	FY06 Final (10/17/06)
Provinces	33,780,730,000	36,234,249,476	36,234,250,000	39,648,212,846
Cities	31,849,970,000	34,304,131,919	34,304,130,000	37,718,095,289
Municipalities	48,461,930,000	52,055,341,631	52,055,340,000	57,102,070,091
Barangays	26,907,370,000	29,029,330,974	29,029,330,000	31,997,994,774
Total	141,000,000,000	151,623,054,000	151,623,050,000	166,466,373,000

* Details unavailable (The Local Budget Memorandum issued on July 16, 2002 was not available on the DBM web site).

Sources: DBM Local Budget Memorandum, 2002-2006

3.46 *Extent of consolidation of fiscal data:* The agency in charge of collecting LGU fiscal data is the Bureau of Local Government Finance (BLGF) of the DOF. The BLGF publishes *LGU Fiscal and Financial Profile* with consolidated data on revenues and expenditures by all provinces, cities and municipalities. Consolidated fiscal data are reported for the three levels of LGUs combined, all provinces, all cities, and all municipalities as well as by region. The report also includes statements of income and expenditures for each of the individual provinces, cities and municipalities.

3.47 Against the assessment standard of the PI-8, the following are the specific shortcomings of the BLGF reports in terms of the extent of consolidation of LGU fiscal data. First of all, data coverage is less than 90% of the total LGU spending because the reports do not cover barangays, which receive 20% of the IRA transfers. In 2003, the estimated total spending by the LGUs was about P161 billion, whereas the IRA transfer to barangays was P26.9 billion, assuming (safely) that barangays' own revenues were negligible. Under these assumptions, the BLGF's fiscal reporting covers around 85% of the total value of the LGU spending. Second, the reports are published with a delay greater than 18 months of the close of the fiscal year; as of August 2007, the report published in January 2007 covered the FY2004. Third, the fiscal information reported

does not include ex-ante data (i.e., budgeted as opposed to actual expenditure). Fourth, although the expenditures are reported on a sectoral basis, the classification used differs from the classification used by the DBM for reporting on the sectoral distribution of national government expenditures in the BESF.

3.48 As an alternative source of LGU fiscal data, the BESF includes a section on LGU statements of receipts and expenditures for the previous, current and next fiscal years. Given the time lag in fiscal data collection by the BLGF, it seems unlikely that the previous year's data reported in the BESF are final figures. The expenditures are reported by sector, but only at a high level of aggregation. Like the BLGF reports, the BESF omits fiscal data for barangays.

Table 3-9: Inconsistent Sectoral Classifications

Sectoral classification in the BESF	Sectoral classification in the BLGF reports
Economic Services	
Agriculture, Agrarian Reform and Natural Resources Agriculture Agrarian Reform Natural Resources Trade and Industry Tourism Power and Energy Water Resources Development & Flood Control Communication, Roads and Other Transport Other Economic Services Subsidy to Local Government Units	Economic Services
Social Services	
Education, Culture and Manpower Development Health Social Security, Welfare and Employment Housing and Community Development Land Distribution Other Social Services Subsidy to Local Government Units	Education, Culture & Sports/Manpower Development Health, Nutrition, & Population Control Labor and Employment Housing & Community Development Social Security/Social Services & Welfare
Defense	
Domestic Security	
General Public Services	
General Administration Public Order and Safety Other General Public Services Subsidy to Local Government Units	General Public Services
Interest payments	Debt Service
Financial Services	
	Other Purposes

Source: BESF, LGU Fiscal and Financial Profile

Indicator	Score	Meaning of PEFA score	Evidence
PI-8. Transparency of Inter-Governmental Fiscal Relations	B		
(i) Transparency and objectivity in the horizontal allocation amongst sub-national governments	A	The horizontal allocation of almost all transfers (at least 90% by value) from central government is determined by transparent and rules based systems.	The formula-determined IRA comprises roughly 97% of the intergovernmental transfers.
(ii) Timeliness and reliable information to SN governments on their allocations	B	SN governments are provided reliable information on the allocations to be transferred to them ahead of completing their budget proposals, so that significant changes to the proposals are still possible.	DBM circulars to LG issued in July 2005, June 2004 and July 2003 which was after the commencement of the LGU budget preparation process but still well before the deadline for budget submission to Sanggunian, as defined in the Local Government Code.
(iii) Extent of consolidation of fiscal data for general government according to sectoral categories	C	Fiscal information (at least ex-post) that is consistent with central government fiscal reporting is collected for at least 60% (by value) of SN government expenditure and consolidated into annual reports within 24 months of the end of the fiscal year.	The coverage of the fiscal data is estimated to be around 85% of the LGU, which would qualify for a “B” score. But given the lag in the availability of the annual LGU fiscal reports (<i>LGU Fiscal and Financial Profile</i>), the inconsistency in the sectoral classifications used between the BLGF reports and the BESF, and the exclusion of ex-ante budgetary data, we have judged that “C” would be a more appropriate score.
		Scoring methodology	M2

PI-9 Oversight of aggregate fiscal risk from other public sector entities

3.49 This indicator reflects the extent to which central government monitors fiscal position of autonomous government agencies, public enterprises and sub-national governments. These “arms-length” public entities are potential sources of fiscal risks. Some governments neglect to monitor their fiscal behavior closely when they are often not covered in the national budget. Such fiscal risks can take a variety of forms such as debt service defaulting (with or without guarantees issued by central government), performance undertakings on Build Operate Transfer projects, operational losses caused by unfunded quasi-fiscal operations and unfunded pension obligations.

3.50 *Monitoring fiscal position of government corporations:* The DOF, DBM and COA monitor the financial performance of the government corporate sector.²⁴ The DOF’s Corporate Affairs Group (DOF-CAG) is the government’s principal fiscal

²⁴ The most recent AFR identifies 597 GOCCs which include 452 local water districts which were recognized as GOCCs by virtue of a 1992 Supreme Court Ruling. For monitoring purposes, however, water districts are not included since local governments have oversight over them and their fiscal weight is negligible.

oversight agency over GOCCs. However, because of its manpower constraint DOF-CAG largely focuses its efforts on monitoring 14 major corporations and six financial institutions. Financial statements of all GOCCs are submitted regularly to DOF-CAG but beyond that, monitoring is reportedly largely reactive and limited to reviewing investment proposals, requests for guarantees for new loans and/or requests for additional budgetary support as they come in. DBM also monitors financial performance of GOCCs and consolidates their financial reports in the annual BESF. Such monitoring is relevant in determining the level of budgetary support provided to GOCCs in the budget in the form of subsidy, equity and net lending. COA, on the other hand, audits the financial statements of GOCCs and consolidates results of their financial operations in the AFR Volume II for GOCCs.

3.51 Although the oversight agencies monitor results of financial operations of GOCCs, monitoring of fiscal risks of the government corporate sector is inadequate overall, especially in terms of analytical quality. The Bureau of Treasury (BTr) monitors contingent liabilities arising from guaranteed GOCC debt but again the BTr reports do not contain an assessment of the probability of these contingent liabilities materializing into direct liabilities.

3.52 The government has already recognized weaknesses in the current set-up for monitoring fiscal risks. For example, a COA audit on public debt management (October 2005) concluded that “existing laws, rules and regulations were inadequate to ensure proper management and monitoring of public debt.”²⁵ The report raised concerns such as that there was no mandated ceiling on public debt, that foreign borrowings exceeded 50% of GDP, that there was inconsistent treatment of liabilities, and that DOF data on outstanding public debt did not include GOCC contingent liabilities from projects.

3.53 Unlike unreported government operations covered in the PI-7 above, the amount of contingent liabilities is not negligible, and as such the current weaknesses in the monitoring of these risks are of greater concern. For the years 2003, 2004 and 2005, the National Government’s outstanding contingent debt amounted to 16%, 17% and 11% of GDP, respectively.²⁶ The government is already forced to finance some of these liabilities through its budget, as evidenced in rising annual appropriations for net lending.²⁷ From the P5.5 billion automatic appropriation for net lending under the BESF for 2003, this figure jumped to P7.6 billion in 2005.

3.54 *Monitoring sub-national governments’ fiscal position:* The Bureau of Local Government Finance (BLGF) monitors the financial performance of LGUs and COA reports on consolidated figures in the AFR Volume III for Local Governments. Similar

²⁵ Commission on Audit Management Services Report No. 2004-004, “Public Debt Management Overall Report”

²⁶ Source: Bureau of Treasury website

²⁷ Net lending is defined as advances by the national government for the servicing of government guaranteed corporate debt during the year, net of repayments on such advances. This includes loan outlays or proceeds from program loans relent to government corporations.

to other weaknesses in fiscal reporting discussed earlier, the reporting on sub-national fiscal and financial situations does not include analysis of fiscal risks these present to the national economy. Section 296 of the Local Government Code of 1991 (RA No 7160) authorizes LGUs to borrow funds from the domestic market. Although the national government is not formally obliged to guarantee these transactions, these borrowings can still be a source of future risk. The Philippines has not developed an unfortunate record of national government bail-outs of fiscally reckless sub-national governments, but such a problem has been widely noted in developing countries that have implemented far-reaching fiscal decentralization, such as in Latin America.

Indicator	Score	Meaning of PEFA score	Evidence
PI-9 Oversight of aggregate fiscal risk from other public sector entities	C+		
(i) Extent of central government monitoring of AGAs and PEs.	C	Most major AGAs/PEs submit fiscal reports including audited accounts to central governments at least annually, but a consolidated overview is missing or significantly incomplete.	Although COA (in its Annual Financial Report) and the DOF-CAG monitor most of the GOCCs, the failure to conduct valuation of contingent liabilities and consolidated analysis of performance and risks leaves reporting incomplete.
(ii) Extent of central government monitoring of SN governments' fiscal position.	B	The net fiscal position is monitored at least annually for the most important level of SN government, and central government consolidates overall fiscal risk into a report.	The overall fiscal position is reported on in the COA Annual Financial Report Vol. III for 98.8% of all LGUs less than 7 months after year end. Fiscal risk is not documented, however.
		Scoring methodology	M1

PI-10 Public access to key fiscal information

3.55 Transparency will depend on whether information on fiscal plans, position and performance of the government is easily accessible to the general public or at least interested groups. The quality of the information (e.g., ease of reading and understanding the documents) and the means by which this is made available to the public is as important as the extent of information coverage. However, for the sake of simplicity and objectivity, the PEFA methodology assesses the adequacy of public access simply by counting the types of fiscal/budgetary information made available to the public, as listed below:

- Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the legislature;
- In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion;

- Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit;
- External audit reports: All reports on central government consolidated operations are made available to the public through appropriate means within six months of completed audit;
- Contract awards: Award of all contracts with value above approx. USD 100,000 equiv. are published at least quarterly through appropriate means; and;
- Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics).

3.56 The GOP discloses fiscal information through various agencies' websites. The DBM website (www.dbm.gov.ph) contains all of the budget documents from 2003 onwards, including the BESF, NEP and the GAA. It also contains all of the budget circulars and memoranda issued from 2000 onwards. The DOF website (www.dof.gov.ph) and the Bureau of Treasury (BTr) website (www.treasury.gov.ph) both contain statistical data on the national government's fiscal position with a breakdown of revenues and expenditure on a cash flow basis. The level of public sector debt is also disclosed on these sites.

3.57 Currently no in-year budget report is published. DBM collects such reports from line departments, but does not collate or consolidate them for public disclosure or for reporting to Congress.

3.58 As for the year-end Annual Financial Report (AFR), Section 41 (1) of PD 1445 specifically states that the deadline for its submission to the President and Congress should be not later than the last day of September of each year. For the 2005 AFR, the date for submission to the President and Congress was July 31, 2006.

3.59 Audit reports of all government agencies and its instrumentalities, including selected GOCCs and LGUs, are posted on the COA website (www.coa.gov.ph). According to COA, audit reports are posted on the website immediately after completion of the audit. Based on Section 43 of PD 1445 or the Government Auditing Code of the Philippines, the report of audit for each calendar year shall be submitted on the last working day of February following the close of the year. But for 2006, some of the audit reports were still unavailable on the COA website as of August 31, 2007.

3.60 The government, through the Government Procurement Policy Board (GPPB) and its electronic procurement monitoring system, PhilGEPs, has begun to report on procurement transactions on-line. Thousands of bid notices, purchase selections, and Bids and Awards Committee decisions are posted. But not all agencies fully utilize PhilGEPs as of October 2007.

3.61 Information flow to and from primary service delivery units (e.g., schools, hospitals) seems to be quite limited. In the education sector, for example, the schools, school district offices, regional offices and the central office are not linked with information systems. Allocations of resources are communicated via internal memos, but many school heads claim they do not receive timely information of resource allocations to them, if at all.²⁸

Table 3-9: Percentage of Awards and Publicly-bid-out Contracts Posted in PhilGEPS

YEAR	Bid Notices (a)	Awards (b)	Percentage (%) (b/a)
2005	86,592	13,094	15.12
2006	128,259	12,310	9.60
(Jan-Oct.) 2007	137,355	11,787	8.58
TOTAL	352,206	37,191	10.56

Source: Government Electronic Procurement Service (GEPS)

*Data as at November 14, 2006

Table 3-10: Public Access to Budget Documentation

Elements of information for public access	Availability and means
Annual budget documentation	<i>Yes.</i> Available through the DBM internet site (www.dbm.gov.ph).
In-year budget execution reports within one month of their completion	<i>No.</i> Execution reports are not prepared for Government in a budgetary format. However, aggregate outturn from a cash management perspective including revenue and expenditure performance is publicly disclosed in the DOF and BTr websites. Other budget execution reports are not prepared or made public.
Year-end financial statements within 6 months of completed audit	<i>Yes.</i> The Annual Financial Report for 2005 was received by the Office of the President and Congress on August 8, 2006, less than six months from the deadline of mid February for the agencies to submit pre-closing trial balances to COA.
External audit reports within 6 months of completed audit	<i>No.</i> Audit reports of all line departments and their attached bureaus for 2005 were available in 2007 from COA and its internet site (www.coa.gov.ph), but as of August 2007, not all audit reports for 2006 were available. Without data on the date on which each audit is completed, it is not possible to determine whether the audit reports are made public within 6 months of their completion. It appears, however, that the reports are indeed posted on the COA website as the audits are completed (e.g., a report file dated July 20, 2007 was found on the COA website on August 6, 2007).

²⁸ BESRA KRT 5: New Budget Framework and Financial Management Reform Strategy (Final Report) by Eleanora E. Tan (2006)

Elements of information for public access	Availability and means
Contract awards (app. USD 100,000 equiv.) published at least quarterly	No. Some data are available from the Government Procurement Service and its internet site (PhilGEPS) as outlined in discussion of PI-19, but the coverage is still not complete.
Resources available to primary service unit at least annually	No. Not available in a timely manner and not released to public

Indicator	Score	Meaning of PEFA score	Evidence
PI-10. Public Access to key fiscal information	C		
(i) Number of the above listed elements of public access to information that is fulfilled (in order to count in the assessment, the full specification of the information benchmark must be met).	C	The government makes available to the public 1-2 of the 6 listed types of information	Some documentation is available from the internet.
Scoring methodology			M1

D. POLICY-BASED BUDGETING

PI-11 Orderliness and participation in the annual budget process

3.62 This indicator reflects the organization, clarity and comprehensiveness of the annual budget process as well as participation of departments and agencies in it. It is assessed against existence of and adherence to a fixed budget calendar, political involvement in the guidance on the preparation of budget submissions and timely budget approval by the legislature.

3.63 *Budget calendar and the political involvement in the budget process:* The annual budget process officially starts with the issuance of the National Budget Call by the DBM through a National Budget Memorandum issued to all government agencies. The purpose of this issuance is to: communicate the overall macroeconomic and fiscal policy framework and priority thrusts for the coming budget year, including the budgetary ceilings of all departments; prescribe the guidelines and procedures in the preparation of the agency budget; and set the schedule of budget preparation activities. From 2004 to 2006, the Budget Call Memorandum was issued during the last week of April or the first week of May. The departments then prepared and submitted their budget estimates to the DBM after four to six weeks (depending on the deadline prescribed in the budget call memorandum) and then entered into discussions/negotiations over them. The Executive Technical Board of the DBCC (Undersecretary level) would present recommendations to the DBCC (Cabinet secretary level) and to the entire cabinet. Once endorsed, the budget proposal would be presented to the President as the DBCC's recommendations.

3.64 The President's budget proposal is submitted to the House of Representatives within 30 days of the opening of the new congressional session.²⁹ This generally falls around the third week of July. Once Congress receives the President's proposal, the House Appropriations Committee reviews it by organizing hearings on a sector-by-sector basis. The approved House version goes to the Senate Finance Committee for similar procedures. The two houses then form a bicameral conference to resolve any discrepancy that may exist between the House and the Senate versions of the General Appropriations Bill. Once a consensus bill is agreed upon, the final bill is sent back to the executive for the President to endorse it or veto it in whole or in parts. When Congress fails to reach a consensus bill the previous year's budget is "re-enacted" until such time that a new appropriations law is finally enacted, if ever.³⁰

3.65 Since the FY2006 budget preparation, the government has introduced certain new procedures to strengthen the budget preparation process. Two related initiatives in this regard are the re-introduction of a medium-term expenditure framework (MTEF) and the elaboration of agency-by-agency organizational performance indicators framework (OPIF). The activities related to the MTEF in particular have introduced additional steps in budget preparation. Prior to the issuance of the Budget Call, the DBM now prepares forward estimates (FEs) of the budgetary costs of existing programs and projects for each agency. With the FEs as a basis, the DBM calculates the amount of fiscal resources that are expected to be available for funding new initiatives ("allocable"). As an analytical base for determining the government's budgetary priorities for the upcoming budget year, the DBM prepares a Paper on Budget Strategy (PBS) and engages the DBCC and the cabinet for strategic guidance. This new process is still in its early stage of development and is yet to be fully institutionalized.³¹

3.66 *Timeliness of the legislative approval:* Delayed approvals of the GAA have become a customary pattern. The GAAs of 2003 and 2005 were enacted into law in April 2003 and March 2005, respectively, while the 2004 and 2006 Acts were never passed, leading to the legally prescribed automatic "re-enactment" of the 2003 and 2005 versions.³²

²⁹ This is in accordance to Section 22 (1), Article VII of the 1987 Constitution. This is also reiterated in Section 11, Book VI of EO292 or the Administrative Code.

³⁰ Pursuant to Section 25 (7), Article VI of the 1987 Constitution.

³¹ Due to lack of institutionalization of the new procedure, levels of uncertainty remained in the internal decision-making process. For example, after considering the estimated "allocable" amounts for the FY2007 budget, the government decided to give some agencies additional resources which the agencies had not planned for in their own budget submissions. Another agency, in contrast, received a presidential instruction to re-prioritize their budget after the agency itself had gone through an elaborate process of internal prioritization.

³² Some observers allege that in some cases, the non-adoption of an Appropriations Act may have been by informal design in partnership with the Executive to facilitate expenditure reduction.

3.67 The D Score in the table below is attributable to failures in the legislative scrutiny process. The executive always submits budget documentation on time in accordance with the budgetary timetable and requirements of EO292 in July of each year.³³

Indicator	Score	Meaning of PEFA score	Evidence
PI-11. Orderliness and participation in the annual budget process	B		
(i) Existence of and adherence to a fixed budget calendar	B	A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows line agencies reasonable time (at least four weeks from receipt of the budget circular) so that most of them are able to meaningfully complete their detailed estimates on time	The Budget Calendar is clearly outlined in the National Budget Call memorandum and is posted on the DBM website. For the 2004 budget preparation (issued in 2003), the date of the Budget Call was May 5, 2003 and the deadline was May 31, 2003. This gives the agency less than four weeks to prepare the budget. The succeeding budget calls and their respective deadlines are: 2005 – issued April 30, 2004, deadline June 7, 2005 (less than six weeks to prepare); 2006 – issued April 25, 2005, deadline May 31, 2005 (more than six weeks to prepare).
(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent);	A	A comprehensive and clear budget circular is issued to line agencies, which reflects ceilings approved by Cabinet (or equivalent) prior to the circular's distribution.	A National Budget Call Memorandum is issued annually by the DBM.
(iii) Timely budget approval by the legislature or similarly mandated body (within the last three years);	D	The budget was approved with more than two months delay in two of the three years during 2004-06.	The budget was not passed for 2004 and 2006. The 2005 GAA (RA9336) was signed into law in March 2005.
		Scoring methodology	M2

PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting

3.68 This indicator looks at the link between budgeting and policy priorities from the medium-term perspective and the extent to which costing of the implications of policy initiatives are integrated into the budget formulation process. In particular, it assesses multi-year fiscal forecast and functional allocations, scope and frequency of debt sustainability analysis, existence of costed sector strategies and linkages between investment budgets and forward expenditure estimates.

³³ In 2007, however, the Executive submitted its budget proposal to Congress during the third week of August, missing the deadline of July 23, 2007 as set in the 2008 budget calendar.

3.69 *Multi-year fiscal planning and budgeting:* As discussed briefly in the previous section, an MTEF is a fairly recent initiative in the Philippines. At the time of this writing (mid 2007), the government has gone through two rounds of MTEF-based budget preparation (for the FY2007 and the FY2008 budgets). The basis of the MTEF is the two-year (i.e., the budget year plus two outer years) rolling forward estimates (FEs) of the budgetary costs of existing programs and projects.

3.70 Prior to 2006, the budget ceilings set by DBM were based on the prior year's budget plus a certain percentage without considering medium-term costs of the agencies' ongoing policy commitments. In 2006, for the preparation of the 2007 budget proposal, the DBM considered using the agency forward estimates as the basis of setting the ceilings, but the government decided to guarantee the agencies at least the amount allocated in the previous budget, thus in effect continuing with the traditional practice of incremental budgeting.

3.71 Efforts have been made to address these deficiencies. For the FY2008 budget preparation process, the DBM set the ceilings as equal to each agency's forward estimate. The government plans to deepen the MTEF process by further improving the technical basis of the FEs, and engaging line departments more effectively in the process.

3.72 *Debt sustainability analysis:* Key to credible medium-term fiscal planning is sound debt sustainability analysis, especially for a highly indebted country like the Philippines. The GOP's fiscal and financial reports include relevant information on the country's debt levels and profiles as well as their financing costs on an annual basis. The annual reports of DOF and BTr disclose debt to GDP ratios and the BTr Annual Report shows total debt servicing costs as a proportion of export earnings and national government expenditures. Monthly debt management reports are also prepared by BTr.

3.73 While this data is useful for analysis, sensitivity analysis projecting debt data against various economic possibilities or outcomes such as movements in exchange rates, interest rates and global economic activity is not undertaken.

3.74 *Sectoral strategies with multi-year costing:* For the third dimension, only two departments (DepEd and DOH) had developed costed sectoral strategies that could serve as a basis for medium-term expenditure planning.³⁴ Other key departments such as DPWH are expected to follow this path of crafting sector plans consistent with likely available budget resource envelopes to guide budget preparation and investment project development and appraisal. At the moment, however, the combined budgets of the two departments with costed medium-term strategies, DepEd and DOH, represent just less than 25 % of primary expenditures.

3.75 *Investment budget and forward estimates:* On dimension (iv), budgeting for investment and recurrent expenditure are currently separate processes. The government does not estimate recurrent cost implications of new capital investments in a systematic

³⁴ The Department of Social Welfare and Development (DSWD) has since developed one.

manner, nor does it therefore budget for recurrent expenditures arising from new capital expenditures. However, NEDA and the DBM have agreed on harmonizing infrastructure planning and budgeting and prepared a draft Executive Order (EO) for submission to the Office of the President. The EO details the processes and systems for linking the Comprehensive Integrated Infrastructure Program (CIIP) through a planning stage to be consistent with the DBM's indicative ceiling, and a second cycle concerned with the evaluation of agency budget proposals together with infrastructure projects included in the final CIIP. According to the government's current plan, details of major investment projects appraised by NEDA during the 2nd half of 2007 will be submitted to the DBM for consideration in projecting available budget resources.

Indicator	Score	Meaning of PEFA score	Evidence
PI-12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+		
(i) Preparation of multi-year fiscal forecasts and functional allocations;	C	Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis.	National Budget Memorandum provides forward macroeconomic assumptions only. Development of Forward Estimates covering two forward years started in 2006, but the link to annual budget ceilings has yet to be firmly established.
(ii) Scope and frequency of debt sustainability analysis	D	No DSA has been undertaken in the last three years	While debt data compared to GDP is reported, sensitivity analysis which is integral to DSA is not performed.
(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure;	C	Statements of sector strategies exist for several major sectors but are only substantially costed for sectors representing up to 25% of primary expenditure.	Education and Health sector plans have been costed and represented 22.4% of primary expenditures.
(iv) Linkages between investment budgets and forward expenditure estimates	D	Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared.	Budget documents and advice from NEDA and DBM indicate that these are separate activities. However, the full implementation of the above-mentioned EO on harmonization of planning and budgeting would change this arrangement.
Scoring methodology			M2

E. PREDICTABILITY AND CONTROL IN BUDGET EXECUTION

3.76 Predictability in fund flows for budget execution depends in the first instance on effective and timely tax collection and subsequently on the efficiency in the systems and processes for releasing available cash resources for expenditure commitments and payments. As the funds are made available and expended, it becomes important to assure integrity of budget execution through a series of control mechanisms. Some of the most important control mechanisms include recording and management of cash, debt and guarantees, payroll control, procurement, internal control and internal audit. This module assesses the quality of the PFM system along the above-mentioned dimensions.

PI-13 Transparency of taxpayer obligations and liabilities

3.77 Transparency of taxpayer obligations and liabilities aids not only the tax administrators who collect taxes but also the taxpayers who are willing to comply with their tax obligations. Thus PI-13 assesses the transparency of tax administration by reviewing clarity and comprehensiveness, taxpayer access to information and functioning of a tax appeals mechanism.

3.78 *Clarity and comprehensiveness of tax liabilities:* Lack of clarity of the laws, regulations and rulings related to tax liabilities contributes to weak enforcement of tax obligations in the Philippines. According to a joint IMF-World Bank assessment of tax administration issues, the complexity of the Philippine tax laws means that “only highly experienced tax practitioners can negotiate the maze of regulations, orders, memoranda, and rulings that BIR has issued over an extended period” especially with respect to income tax (Ludlow et al. 2006, p. 49).³⁵ Furthermore, the DOF’s own review of the BIR’s rulings reportedly called into question possibly as many as 400 out of the 2000 rulings examined for their technical accuracy and clarity.

3.79 *Taxpayers’ access to information on tax liabilities and administrative procedures:* Actual and potential taxpayers can easily access information briefs on the taxation laws, regulations and procedures on the internet. The BIR internet site provides a very basic clear eight-page guide on business taxpayer obligations and liabilities. BIR also provides hard copy pamphlets and forms.

3.80 Customs information was not accessible from the internet. Documentation was available from BOC port staff, but this was not particularly user-friendly. According to interviews with representatives of the business community, the BOC does not make timely decisions and tends not to be open to communication even at accountability forums.

3.81 *Existence and functioning of a tax appeals mechanism:* On tax matters, taxpayers can protest a decision or assessment to the BIR. The protests are referred to Regional office legal staff rather than the revenue officer who made the original decision. Once

³⁵ The BIR started to consolidate and index the VAT law and regulations.

the Bureau has disallowed a protest against an assessment or amended the assessment, the taxpayer can resort to the independent Court of Tax Appeals.

3.82 In the case of Customs, a valuation classification review committee will first consider objections, and then the concern should be directed to the Commissioner. If that is not sufficient, the client can appeal to the Secretary of Finance and finally the Court of Tax Appeals.

Indicator	Score	Meaning of PEFA score	Evidence
PI-13. Transparency of Taxpayer Obligations and Liabilities	C		
(i) Clarity and comprehensiveness of tax liabilities	D	Legislation and procedures are not comprehensive and clear for large areas of taxation and/or involve important elements of administrative discretion in assessing tax liabilities.	Tax codes and the BIR-issued regulations and rulings especially for income tax are highly complex, unclear, and sometimes technically inaccurate.
(ii) Taxpayer access to information on tax liabilities and administrative procedures.	C	Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due to coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date.	The basic guide available from BIR and the internet site is very clear. Customs information was not accessible from the internet but the user-friendliness of the documentation available from BOC is limited.
(iii) Existence and functioning of a tax appeals mechanism.	B	A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow up on its decisions need to be addressed.	Taxpayers can protest a decision or assessment which is referred to Regional office legal staff. If protest is disallowed taxpayer can appeal to the Court of Tax Appeals (created by RA 1125) and or the courts. BOC provides more appeals options but decision making is not timely.
		Scoring methodology	M2

PI-14 Effectiveness of measures for taxpayer registration and tax assessment

3.83 Effectiveness is determined by reviewing controls in the taxpayer registration system, penalties and conduct of tax audits. Effectiveness in tax assessment is ascertained by an interaction between registration of liable taxpayers and correct assessment of their tax liability.

3.84 *Controls in taxpayer registration:* Incompleteness and the low reliability of the taxpayer registration is recognized as a major challenge for the BIR. As of 2005, only 5.6 million taxpayers were registered vis-à-vis the estimated 32.5 million employed persons in the country. Similarly, the number of firms registered for VAT stood at 270,000. While a precise figure on the total number of potential tax-liable firms is not available, this figure falls awfully short of the numbers of VAT registration in other countries (e.g., 1.3 million registered firms for the similar population of 106 million in Mexico). Furthermore, the existing taxpayer register suffers from a number of data integrity problems. The register includes a number of persons and firms who are no

longer subject to taxation (e.g., no longer residing in the Philippines, no longer operating as business, etc.) as well as multiple entries of the same taxpayers. The central database is not always systematically linked to databases at the revenue district offices.³⁶

Box 3-4: Tax and Customs Registration Processes

Prior to commencement of business activity, potential taxpayers are required to secure registration in the form of a business registration. This requires the completion of an application form, provision of photographs, an identity check, explanation of details of the proposed business activity, and projections of financial information. The Tax Identification Number (TIN) is used for the Business, Cash Register Registration for the BIR and authority to issue receipts. On issuing the business registration, the BIR will advise the client of their TIN and VAT and Income Tax obligations. Customer Service staff will provide orientation sessions. The registration database is compromised to some degree by holding much inaccurate data which is currently being cleaned out.

The BOC Legal Service requires importers to seek accreditation, which must be renewed every year. As part of the accreditation process, applicants must disclose their TIN, VAT registration number and their Mayor's business permit. Companies must also submit their CDA Certificate of Registration, Articles of Incorporation and By-laws. Customs Brokers are required to meet additional requirements such as the provision copies of financial statements and income tax returns.

3.85 The BIR annual report notes that it exchanges information with the BOC and the Securities and Exchange Commission to facilitate audits. Results so far have been positive, and the government is planning to extend this practice to a number of other agencies. EO 98 prescribes the use of Tax Identification Numbers (TIN) as a secondary index to government transactions.

3.86 *Effectiveness of penalties for non-compliance with registration and tax declaration:* Related to the weaknesses found in the taxpayer registration is the management of the return filing and payments. The IMF-World Bank assessment noted that "the number of stop filers ha(d) reached dramatic proportions" and attributed this to the absence of an adequate mechanism to keep reliable records of tax filers. As a result, the BIR is "unable to identify and pursue in any systematic way those taxpayers that have not filed returns or have not paid taxes" (Ludlow et al. 2006, p. 35). There is a large backlog of tax returns to be filed, while the BIR does not keep a record of tax arrears, and as a result, is not in a position to have an accurate picture of the total tax debts. Although the BIR applies penalties (surcharge of 25% and interest of 12%) for non-compliance, the magnitude of the non-compliance as reported in the IMF-World Bank report suggests that in practice these penalties are not being particularly effective.

3.87 *Planning and monitoring of tax audit and fraud investigation:* The BIR conducts its audits in a decentralized manner whereby regional directors have been given complete authority over the conduct of audits in their jurisdictions. At the national level, audit

³⁶ Ludlow et al. (2006), *Critical Priorities in Tax and Customs Administration Reform*. IMF and the World Bank

coverage of the taxpayer population is low, and the central office has limited abilities to ensure that taxpayers who may pose the greatest compliance risks are adequately pursued nationwide.³⁷ Audit procedures are not risk-based, although the BIR is now moving in that direction. For example, the current procedures require that all refund claims are subject to mandatory audits, irrespective of their risk profiles.

3.88 The IMF-World Bank report concludes that the inadequacy of the current audit arrangement makes it impossible to “draw any aggregate conclusions about the effectiveness of the audit program and whether or not audits are addressing key compliance risks” (Ludlow et al. 2006, p. 48).

Indicator	Score	Meaning of PEFA score	Evidence
PI-14. Effectiveness of measures for taxpayer registration and tax assessment	C		
(i) Controls in the taxpayer registration system.	C	Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/ licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers.	Income Tax TIN used for VAT Business Licence, Cash Register Licence and authority to issue receipts. EO 98 requires TIN to be used for other government permits. Database currently being cleaned up.
(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations	C	Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance.	Surcharges of 25% and interest of 12% are standard penalty measures at BIR. Their credibility is reduced by the write-offs as part of tax abatement programs which are conducted at least annually. BOC does not impose penalties. More importantly, the inadequacy of the return filing practices means that the BIR has no overview of the extent of the stop-filer problem.
(iii) Planning and monitoring of tax audit and fraud investigation programs.	C	There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria.	Compliance program was based on simply visiting known businesses, per BIR Interviews and Annual Report. The program is now shifting to a risk based approach.
Scoring methodology			M2

³⁷ For example, the central office does not have adequate knowledge of the exact number of tax examiners assigned to tax audits in the regional offices.

PI-15 Effectiveness in collection of tax payments

3.89 Collection efficiency is determined by reviewing collection ratio for gross tax arrears, transfer mechanism of funds to the Treasury and frequency of complete accounts reconciliation.

3.90 *Collection of tax arrears:* The BIR monitors income tax and VAT arrears actively and follow up with collection letters, imposition of surcharges of 25% and interest charges at 12% per year. The BIR conducted an abatement program in November and December to write off additional charges in exchange for prompt settlement of liability.

3.91 The BIR's performance in collecting the recorded arrears is not stellar. In each of 2003 to 2005, it collected only 3 to 6% of the total arrears. But the recorded BIR arrears are insignificant at around P6 billion in 2005, which represented 1% of gross BIR collections of P622 billion in the same year.³⁸

3.92 The BIR is currently carrying out analysis of these arrears, known as delinquent accounts, to state the age of all accounts and ascertain the probability of collection. The abatement program which closed on December 22, 2006 increased the collections from delinquent accounts. The stock of delinquent accounts also markedly increased in 2006. The BIR's 2005 Annual Report (p. 32) reported that P222 million of the arrears in tax were collected during 2005 compared to 152 million in 2004.

Table 3-11: Income Tax Arrears and Collections

Income Tax (Billions of Pesos)	2003	2004	2005
Total Arrears	4.8	5.9	7.9
Arrears collected	0.290	0.152	0.222
Arrears collected/total arrears	.06	.03	.03
Total BIR Collections	427	470	542
Arrears / Total Collections	.01	.01	.01

3.93 *Transfer of tax collections to the Treasury:* The commercial banks are required to transfer collected taxes and customs duties to the Treasury within five and ten days of collection, respectively. Those concessions are currently being reviewed for cost effectiveness. A performance audit on the collections system in 2002 revealed that the banks do not comply with these requirements and do not pay the penalties imposed by the BOC and the BIR for non compliance. We have no information on whether this situation continued into the 2003-05 period.

3.94 *Reconciliation between tax assessments, collections, arrears records and receipts by the Treasury:* Reconciliations of collections are supposed to occur by the 15th of every

³⁸ The weaknesses in file return management and audits noted in the previous sections cast doubt on the reliability of the arrear figures reported by the BIR, but this assessment is based on the official information that is available.

month, but the available information indicates deficiency in accounts reconciliations for both the BOC and the BIR. According to the COA 2005 financial audit report on the BOC, discrepancies between BOC and BTr records totaled P427 million. In the prior years, discrepancies amounted to P321 million and P545 million. The COA 2005 financial audit report on the BIR also showed discrepancies in the cash at bank account of P20,204 million.

3.95 Treasury has advised that a reconciliation is being performed every month for the major collecting agencies before the official reports are issued. The difference between the BTr and BOC collections of P427 million in 2005 refers to the collections remitted by the BOC's collecting officers compared to the BTr collections based on the daily credit advices which are actual credits to the Treasurer of the Philippines' account received from the Authorized Government Depository Bank. The BOC, on the other hand, records collections based on the reports submitted by their District Officers. The discrepancies are said to be due to the time lag in recording of transactions.

Indicator	Score	Meaning of PEFA score	Evidence
PI-15. Effectiveness in collection of tax payments	D+		
(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years).	A	The total amount of tax arrears is insignificant (i.e. less than 2% of total annual collections).	Recorded total tax arrears are insignificant (i.e. less than 2% of total annual collections). BIR Annual Report and information from BIR
(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration.	C	Revenue collections are transferred to the Treasury at least monthly.	By rule BOC banks can hold collections for only 10 days and BIR banks for only 5 days. COA collection systems performance audit indicated some non compliance
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.	D	Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place annually or is done with more than 3 months' delay.	Completed reconciliations are not achieved as evidenced by discrepancies between BOC and BTr of 427m per COA financial audit report 2005. BIR accounts also required reconciliation.
Scoring methodology			M1

PI-16 Predictability in the availability of funds for commitment of expenditures

3.96 Budget execution is more effective when there is a reasonable degree of predictability in the availability of funds. PI-16 assesses cash flow forecasts, in-year information to departments and agencies on funds availability, and frequency and transparency of adjustments to budget allocations.

3.97 *Forecasting and monitoring of cash flows:* The DBM and the BTr are both involved in the government's cash management function. The DBM manages allotments and cash releases to spending agencies via issuance of Notices of Cash Allocations

(NCAs). The BTr manages the government bank accounts. The DBCC's Cash Programming and Monitoring Committee (CPMCO), chaired by the Treasurer of the Philippines, regularly meet to assess the fiscal performance of the national government and recommend to the DBCC the annual and quarterly cash budget programs of the government. These cash budget programs are monitored closely and updated from time to time to take into account significant fiscal developments and status of resources and expenditures. Cash flows are also monitored by a Cash Flow Committee chaired by the Treasurer. This Committee reports the forecast on the level and direction of the yield rates for government securities to guide the Auction Committee composed of the BTr, DOF and BSP. The Committee updates cash forecasts based on daily estimates of cash inflow, outflow and debt service.³⁹

3.98 *Reliability and horizon of periodic in-year information to departments on ceilings for expenditure commitment:* Allotment orders are released by DBM to ensure that expenditures are covered by appropriations both as to amount and purpose. These allotments are issued through obligational authorities such as the Agency Budget Matrix (ABM), which is the basis for comprehensive release of allotment chargeable against the GAA, or through a Special Allotment Release Order (SARO), which is released for a lump-sum expenditure that requires prior approval or clearance from the DBM. The release of ABM and SAROs does not follow any pre-established schedule, and as such could be a source of uncertainty for spending departments especially in years when the government's revenue performance lags its targets. In 2005, for example, the ABM for DepEd was signed by the Secretary of DBM in July, almost three months from the promulgation of the GAA. The DBM releases SAROs on a per request basis, subject to the submission of pertinent documents satisfactory to the DBM. Releases are sometimes made in batches based on the absorptive capacity of the agency or the expected timing of execution.

3.99 Disbursement authorities, such as a Notice of Cash Allocations (NCA) are released by DBM on a monthly or quarterly basis based on the Monthly Cash Program (MCP) prepared and submitted by the agency to DBM. The NCA acts as a second level of control as recipients of allotments can incur obligations but cannot make payments until they receive NCAs, which are treated as authorizations to issue checks.

3.100 The Bureau of Treasury (BTr) replenishes daily the Modified Disbursement Scheme (MDS) account with government servicing banks with funds equivalent to the amount of negotiated checks presented to the government servicing banks by implementing agencies. Under the "common fund" system, agencies are given a maximum flexibility in the use of their cash allocations provided that the authorized allotment for a specific purpose is not exceeded. In the earlier years under review, agencies faced some difficulties getting NCAs early in the year and the delays in the releases of SAROs and NCAs have been frequent objects of complaints by line

³⁹ Philippines: Improving Government Performance: Discipline, Efficiency and Equity in Managing Public Resources (April 2003).

departments.⁴⁰ But that problem has reportedly eased with the improvement in the government's fiscal situation.

3.101 *Frequency and transparency of adjustments to budget allocations:* The President enjoys considerable authorities to realign the budget during execution. For example, Section 39 of Book 5 of EO292 allows for the use of savings in any appropriation to be used to cover a deficit in any other item of regular appropriation, subject to the approval of the President. The government also resorts to shifting special purpose fund appropriations to individual line departments. Because of the limited monitoring of and reporting on budget execution, the extent to which the government adjusts budget allocation during the year is difficult to establish firmly. Some adjustments are effectuated through supplemental budget authorizations by Congress, but these tend to be rare. Most changes are apparently done with executive discretion, which limits transparency.

Indicator	Score	Meaning of PEFA score	Evidence
PI-16. Predictability in the availability of funds for commitment of expenditures	D+		
(i) Extent to which cash flows are forecast and monitored.	A	A cash flow forecast is prepared for the fiscal year, and are updated monthly on the basis of actual cash inflows and outflows.	Cash flows are monitored daily through bank account data consolidated in NGAS, based on interview with Treasurer and sample report
(ii) Reliability and horizon of periodic in-year information to departments on ceilings for expenditure commitment	D	MDAs are provided commitment ceilings for less than a month OR no reliable indication at all of actual resource availability for commitment.	Under the current system, the DBM does not issue commitment ceilings for the entire agency, but instead controls commitments (obligations) by issuing an ABM and individual SAROs in response to specific agency requests.
(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of departments.	D	Significant in-year budget adjustments are frequent and not done in a transparent manner.	Poor reporting on budget execution makes it difficult to establish the actual extent of budget re-alignment (re-allocation). The President enjoys broad discretion for in-year budget adjustment, and this discretion is used with limited transparency.
		Scoring methodology	M1

PI-17 Recording and management of cash balances, debt and guarantees

3.102 This indicator assesses overall fiscal management by reviewing the recording and management of cash, debt and guarantees. In particular it assesses the quality of debt

⁴⁰ The Bank's review of budget execution in a line department has revealed, however, that a larger blame may be placed on the department itself as in this particular case at least, the line department's central office was found to be often slower in releasing commitment authorities (Sub-AROs) to regional offices than the DBM in issuing SAROs.

recording and reporting, the extent of consolidation of cash balances and systems for contracting loans and issuing guarantees.

3.103 *Quality of debt data recording and reporting:* The DOF is responsible for the overall “review, approval and management of all public sector debt...[to ensure] that all borrowed funds are effectively utilized and all such obligations are promptly serviced by the government.” It is also mandated to “undertake and supervise activities related to the negotiation, servicing and restructuring of domestic and foreign debt incurred or guaranteed by the government and its instrumentalities, including taking part in activities which affect the country’s capacity to service foreign debt.”⁴¹ To undertake all these functions, several offices within the DOF are involved in distinct aspects of debt monitoring and reporting. Data on availments, repayments, and status of the public debt are lodged with the Bureau of Treasury. The Corporate Affairs Group monitors debt obligations of GOCCs and GFIs while the International Finance Group processes all foreign borrowings of the National Government. The Bureau of Local Government Finance, on the other hand, is mandated to monitor all local government units’ borrowing.

3.104 The BTr prepares a monthly report of the national government debt stock within 12 days of month’s end.⁴² However, its debt monitoring activities do not extend to GOCC and LGU borrowings. The BTr only keeps records of GOCC or LGU borrowing which are explicitly backed by a national government guarantee.

3.105 *Extent of consolidation of government cash balances:* Payments of government obligations are facilitated under a single Treasury Account. This system of payment is called the Modified Disbursement Scheme (MDS) and it was introduced in 1990 through the DOF and DBM Joint Circular No. 1-90 dated February 27, 1990. Under the MDS, the BTr deposits seed funds (estimated to equal two days of cash disbursements) with the head offices of the government service banks. The authorized government service banks maintain separate sub-MDS accounts for each agency by fund and for the central and regional offices. The spending agencies receive NCAs, which are treated as deposits, or authorizations to issue checks. Agencies issue checks against the NCA and these are honored by the respective service bank branch.

3.106 A daily cash flow statement is prepared in eNGAS using consolidated data from BTr cash collection officers, the Bangko Sentral (Central Bank), and the government service banks (GSB) such as Land Bank of the Philippines, Development Bank of the Philippines, Philippines Veterans Bank, Philippine National Bank and other GSBs through e-mail, fax messages or viewing facilities provided by the banks.

3.107 Although the MDS accounts are regularly reconciled by the BTr, there are several reconciliation issues identified with regards to extra-budgetary accounts (see PI-7). Contrary to directives to remit interest earnings of special, fiduciary and trust funds to the

⁴¹ Per EO292 or the Administrative Code of the Philippines.

⁴² The BTr uses the UNCTAD Debt Management Financial and Analysis System.

BTr, some departments continue to hold interest earnings of these funds. For example, COA financial audit reports cite the BIR for withholding P786.9 million in interest and the DOTC for P97.8 million. The COA 2005 financial audit report on the DOH recommended remission of idle funds of P30.8 million to the BTr. Excess trust collections, unutilized funding including interest and unexpended NCAs, and cash advances totaling P16.9 million were not remitted to the BTr by various DPWH offices according to their 2005 financial audit report, and the DOTC was cited for non-transference of P50.5 million to the BTr. The same problem also emerges with unutilized or idle funds which departments are required to return to the BTr. Holding of funds in this manner represents a breach of Section 44 of Book VI of Executive Order. 292 of 1987.

3.108 This matter is the subject of many observations in financial audit reports, but according to the reviews of compliance with prior year audit recommendations, non-compliance seems to be the normal behavior.

3.109 *Systems for contracting loans and issuance of guarantees:* Republic Act No. 4860 or the Foreign Borrowings Act authorizes the President, on behalf of the Republic, to contract foreign borrowings and to guarantee foreign loans by government-owned and controlled corporations. It prescribes a ceiling on foreign borrowings (US\$10 billion) and guarantees (US\$7.5 billion). The Secretary of Finance is provided full powers by the President to sign, on behalf of the Republic, the loan and guarantee documents.

3.110 An annual borrowing program is prepared by the BTr and is approved by the DBCC. This program is broken down into foreign (program and project loans plus bond issuances) and domestic borrowings (T-bills, Treasury bonds), and is disclosed in the budget proposal documents.

3.111 Proposals for the National Government's program and project loans as well as guaranteed GOCC borrowings go through the NEDA-Investment Coordination Committee (ICC) for feasibility review and NEDA Board approval. Loan processing is undertaken by the DOF-International Finance Group (DOF-IFG) and the required documentations are cleared by the oversight agencies such as the BSP, DOF, DBM, NEDA and DOJ.

3.112 Section 3 of RA 4860 authorizes the President, upon recommendation of the DOF, Monetary Board and NEDA, to guarantee foreign loans of GOCCs and GFIs. After securing the NEDA Board approval for the loan, the GOCC requests DOF-CAG to issue a willingness to guarantee the loan. DOF Department Order No. 35-89 provides the guidelines on the extension of sovereign guarantees to GOCC borrowings. Extension of the guarantee is favorably considered for GOCCs which are permitted to avail of NG guarantee under their charters, if the project is financially viable and if the guarantee ceilings set under RA 4860 are observed. Other than these criteria, DOF-CAG also looks into the absorptive capacity of the GOCC as well as the borrowing's impact to the consolidated public sector financial position.

Indicator	Score	Meaning of PEFA score	Evidence
PI-17. Recording and management of cash balances, debt and guarantees	B+		
(i) Quality of debt data recording and reporting	B	Domestic and foreign debt records are complete, updated and reconciled quarterly. Data considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least annually.	BTr produces a monthly debt management report. Some concerns exist about quality of GOCC data and data is not reconciled with DOF and BSP
(ii) Extent of consolidation of the government's cash balances	B	Most cash balances calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement.	Use of MDS accounts for payment of government obligations.
(iii) Systems for contracting loans and issuance of guarantees.	B	Central government's contracting of loans and issuance of guarantees are made within limits for total debt and total guarantees, and always approved by a single responsible government entity.	RA 4860 sets the ceilings for foreign borrowings and guarantees. The DOF is responsible for processing the loans and guarantees and is given full powers by the President to sign the loan and guarantee agreements.
Scoring methodology			M2

PI-18 Effectiveness of payroll controls

3.113 As a major component of expenditure, effective control of the payroll is an important indicator of sound financial management. The assessment looks in particular at the degree of integration and reconciliation between personnel and payroll databases, timeliness of changes to the personnel records, adequacy of internal controls, and the existence of payroll audits which identify control weaknesses and/or ghost workers.

3.114 *Personnel records:* The GOP's personnel records systems are a mix of manual and automated systems. Although the Civil Service Commission (CSC) has recently developed a software pilot, it has not been fully rolled out to the entire bureaucracy. Some departments' payroll systems are linked to personnel records systems, but not all departments have human resource records. Audit reports indicate overpayments are common. The Department of Education (DepEd), the agency with the largest staffing, has its own Basic Education Information System (BEIS), which includes data on teacher deployment. However, the BEIS is not linked to the DBM payroll database (Government Management Information System, GMIS), and as a result, DepEd is not in a position to have timely information on whether specific authorized positions are filled or unfilled.

3.115 The most comprehensive and up-to-date data on personal services is kept by the Organization, Position Classification and Compensation Bureau of the DBM. They maintain the Personnel Services Itemization-Plantilla of Personnel (PSI-POP) or the list

of filled and unfilled positions in the bureaucracy. It comprises the list of authorized positions and the names of incumbents occupying these positions.

3.116 *Timeliness of changes to the personnel records and the payroll:* The line department's payroll clerks register changes in the payroll only after receiving required documentation from the DBM. Some of the DepEd's regional offices acknowledged problems with staff movements and departures from the service not being recorded in the payroll documentation. To alleviate the problem of delay in adjusting the personnel records and the payroll, the DBM and the DepEd issued the Joint Circular No. 2004-1 to devolve responsibility for the payrolls of elementary and secondary schools to the DepEd. This has facilitated some reduction of payroll lag times.

3.117 *Internal control of changes to personnel and the payroll:* The ex ante control system for payroll tends to be quite demanding in most departments. Most agencies use the output from Bundy time clocks as the input for the payroll process. Some use the thumb scan identifying equipment. This information is used to prepare the base document for payroll processing; Form 7–Monthly Reports of Service. But COA's audit reports often identify payroll-related problems and the inadequacy of the control mechanisms that give rise to these problems.

3.118 For example, the COA 2005 financial audit of the operations of DepEd CY 2005 reported that "(d) effective and complicated payroll system resulted in the net overstatement of P44.21 million in Salaries and Wages-Regular account in 14 regions." Similarly, COA reported overpayments of P81 million in salaries in the Department of Agriculture, payment of unjustified employee benefits in the DOH, and both of these problems at the DPWH in their 2005 year financial audits. In the 2004 DOTC financial audit, COA noted that "...various unauthorized allowances were paid, such as Collective Negotiation Agreement (CNA) signing bonus, honoraria of DPWH personnel and other personnel benefits which amounted to P190 million pesos in violation of law and other existing issuances..." Overall, these audit reports offer little evidence that payroll checks are conducted systematically to identify control weaknesses and the possibility of ghost workers.

3.119 *Payroll audits:* Payroll audit is not among the internal audit components stipulated in the guidelines on internal audit services by the DBM.⁴³ Some payroll checks are conducted by COA during audit. Observations, if any, are reflected in the agency's annual audit report. Payroll audits are conducted by COA only for DepEd since its personal services expense accounts for 35% of the total government's. However, this audit covers only the identification of payroll control weaknesses and not ghost workers. DepEd itself carried out an audit in 2004, but this was limited to the National Capital Region and was done on a sample basis only.⁴⁴

⁴³ Per DBM Budget Circular 2004-4 issued by DBM on March 22, 2004, internal audits of government entities shall consist of operations audit and financial audit.

⁴⁴ Interview with DepEd officials.

3.120 According to staff from the CSC Central Office, the CSC does not conduct payroll audits. They rely on the manual audits conducted by their regional offices. They expect that the issue of ghost employees can be addressed by their on-going project called the CSC Personnel Information Database System (CSC-PIDS) that has been rolled out to selected regions for implementation. However, the CSC has yet to develop a reliable procedure for regular updating of personnel data to be inputted by front-line offices.

Indicator	Score	Meaning of PEFA score	Evidence
PI-18. Effectiveness of payroll controls	C+		
(i) Degree of integration and reconciliation between personnel records and payroll data.	C	A personnel database may not be fully maintained but reconciliation of the payroll with personnel records takes place at least every six months.	Human resource data recording systems are not in place in all departments. Some agencies check payroll against personnel data. Most agencies do perform a quarterly validation check.
(ii) Timeliness of changes to personnel records and the payroll	B	Up to three months' delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally.	Problem is being reduced through decentralization process in Education but they still have problems with non recording of length of service, staff movements and departures from service.
(iii) Internal controls of changes to personnel records and the payroll.	C	Controls exist, but are not adequate to ensure full integrity of data.	Overpayments and unjustified payments documented in COA Financial audits DepED DA DPWH DoH DOTC 2004 &2005
(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.	C	Partial payroll audits or staff surveys have been undertaken within the last 3 years.	COA Financial audits identify payroll discrepancies but there is little evidence of checks being conducted on the attendance or existence of employees.
Scoring methodology			M1

PI-19 Competition, value for money and controls in procurement

3.121 Open competition in the award of contracts has been shown to provide the best basis for achieving efficiency in acquiring inputs and value for money in delivery of programs and services by government. This indicator assesses the degree of use of open competition, justification for use of less competitive methods, and operation of a procurement complaints mechanism.

3.122 The Government Procurement Reform Act (RA9184), which was enacted on January 10, 2003, provides for open and competitive bidding in all areas of procurement. The law requires posting of procurement opportunities in the government electronic procurement system so that a single source of public procurement opportunities are

created.⁴⁵ Thresholds have been established specifying the values of contracts for procurement methods in Section 48 of the Implementing Rules and Regulations (IRR).

3.123 The Government Procurement Policy Board's (GPPB) Agency Procurement Performance Indicators (APPI) is used to assess the degree to which open competition is used as well as the justification for use of less competitive procurement methods by ten government agencies.⁴⁶

3.124 *Use of open competition for award of contracts:* APPI Indicator No. 11 on *Limited Source Competition/ Shopping* indicates the level of competition by measuring the percent of processes using limited source competition or shopping instead of public bidding or open competition. A full rating of 2.0 is given to agencies in which the use of limited source procurement or shopping does not exceed 10% of the value of the contracts under the Annual Procurement Plan (APP). Of the ten agencies surveyed, five received a rating of 2.0. The compliant agencies are DPWH, DOH, NPC, City of Marikina and BIR.

3.125 Specific evidence of non-compliance is found in COA audit reports. For example, the Region IV-A of DepEd was cited in 2005 for payments amounting to some P49.8 million on items without resorting to public bidding. Similarly, WESCOM of the Armed Forces Central Command used the shopping method instead of the required public bidding to procure construction materials and motor vehicle spare parts totaling P6.4million. According to the audit report on the Army, some 50.2 % of Third Infantry Division's annual procurement, or P28.2million, was purchased in ways that contravened RA 9184. Evaluation of procurement transactions undertaken by the Navy revealed the purchase of supplies and materials for use in operations done through shopping using cash advances instead of public bidding. COA did not quantify the degree of the transgressions. The DPWH and the DOTC were also cited without detailed reference to the degree of the problem or the value of the transactions involved.

3.126 *Justifications for use of less competitive methods:* The procurement law clearly defines specific conditions for allowing alternate methods of procurement. The threshold levels defined for non-competitive bidding are low. For example, shopping is allowed "(w)hen there is an unforeseen contingency requiring immediate purchase" ... "involving an amount not exceeding P250,000." Evidence from the audit reports suggests that these emergency procedures may be utilized more frequently than warranted.

3.127 APPI Indicator No. 10 or *Method of Procurement Used* measures the number of alternative procurement methods conducted without valid justification (excluding

⁴⁵ The EPS advertises bids electronically. Bids are received in hard copy and evaluated by hand. The evaluation and award results are then posted electronically. (Source: Philippines - Improving Government Performance: Improving Government Performance: Discipline, Efficiency and Equity in Managing Public Resources (April 2003))

⁴⁶ Philippines: Agency Procurement Performance Indicators (APPI), Government Procurement Policy Board, August 21, 2005. The ten agencies are DPWH, DepEd, DOH, Armed Forces of the Philippines (AFP), DND, National Power Corporation (NPC), City of Marikina, DILG, DENR and BIR.

procurements from other government agencies). A full score of 3.0 is given to agencies where no more than 10% of total value of contracts under the APP is conducted using alternative procurement methods without valid justification. Based on the survey, six out of ten agencies – DPWH, DOH, DND, NPC, DENR and BIR – reported full ratings.

3.128 *Complaints mechanisms:* RA 9184 provides for the establishment of a complaints mechanism. The IRR requires that a request for reconsideration should be referred to the Bids and Awards Committee (BAC) within 3 days of the communication of the award decision. The BAC must determine its position within 7 days of receiving the complaint. Upon receipt of a resolution from the BAC denying the motion for reconsideration, the bidder may file a protest to the head of the procuring entity and must pay a non-refundable protest fee of 1% of approved budget for the contract. The head of the procuring entity must resolve the protest decision within 7 days.

3.129 In the case of the request for reconsideration, the decision is to be made by those that made the recommendation in the first place and in the case of a protest, the decision on the protest is to be made by the person who approves the recommendation of the BAC. There is no access to an external higher authority until these two processes are complete, the protest fee has been lost, and the bidder commences action in the courts. Complaints regarding the conduct of a BAC can also be referred to the Ombudsman.

3.130 The Philippine authorities defend this framework on the ground that immediate resort to courts hampers the bidding process since losing bidders can cause unnecessary delay by seeking restraining orders from the courts. The protest procedure combined with the protest fee discourages filing of unmeritorious and frivolous complaints.

Indicator	Score	Meaning of PEFA score	Evidence
PI-19. Competition, value for money and controls in procurement	B		
(i) Evidence on the use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases (percentage of the number of contract awards that are above the threshold);	B	Available data on public contract awards shows that more than 50% but less than 75% of contracts above the threshold are awarded on the basis of open competition, but the data may not be accurate.	Use of Limited Source Competition/ shopping.
(ii) Extent of justification for use of less competitive procurement methods.	B	Other less competitive methods when used are justified in accordance with regulatory requirements.	Results for APPI No. 10. Regulatory requirements in RA 9184 and IRR Rule 16 are clear and appropriate. However, audit reports suggest some non-compliance.
(iii) Existence and operation of a procurement complaints mechanism	B	A process (defined by legislation) for submitting and addressing procurement process complaints is operative, but lacks ability to refer resolution of the complaint to an external higher authority.	RA 9184 and IRR Rule 17
Scoring methodology			M2

PI-20 Effectiveness of internal controls for non-salary expenditure

3.131 This indicator assesses the internal control mechanisms in place by reviewing the effectiveness of expenditure commitment controls, comprehensiveness, relevance and understanding of procedures and degree of compliance.

3.132 *Effectiveness of expenditure commitment controls:* Mechanisms for expenditure commitments (obligations) consist of a series of prior approvals/clearances by DBM. The box below provides an overview of the budget execution process. DBM administers the allotment and fund release system to agencies, although sub-allotments are frequently done by the central offices of line departments to regional and district offices. The allotments and cash releases are not linked at the level of individual transactions.

3.133 DBM allots funds to agencies through either the Agency Budget Matrix (ABM), which is a comprehensive release of allotment chargeable against the General Appropriations Act, or through the issuance of a Special Allotments Release Order (SARO), which is a specific release for a lump-sum expenditure that requires certain documentation to ensure that the proposed expenditure conforms to the appropriations and to verify additional program-specific details. For example, for the DepEd School Building Program, the DBM requires a list of school construction sites before it releases SAROs, presumably to ascertain that the department is ready to implement the budget once the SARO is issued. The DBM issues individual SAROs in response to specific agency requests that come in at irregular intervals and these are not issued based on cash availability. Similarly, sub-allotments by the central offices of line departments to regional offices are not based on cash availability.

3.134 When a payment, or a group of payments is due, the line department submits a request to the DBM for cash releases (NCA). The basis for NCAs is the monthly Cash Release Program (CRP) prepared by the Budget and Management Bureaus and Regional Offices of DBM. Cash release memoranda are prepared by DBM's Undersecretary for Operations based on the percentage of the CRP to be released for that month and on the cash program of the Bureau of Treasury. This ensures that funds are not released beyond the available cash balances of the national government

3.135 *Comprehensiveness, relevance and understanding of other internal control rules/procedures.* The general guidelines for internal control systems are specified in the 1992 Government Accounting and Auditing Manual Vol. III. The manual defines the basic concepts and objectives as well as the role of COA as an overseer of agencies' internal control systems. The manual discusses standards that each agency should follow in setting up and operating its internal control system and points out the importance of cost-effectiveness as a criterion for determining the extent of control to be introduced in specific cases. These standards refer to documentation, recording of transactions and events, authorization and execution of transactions, segregation of duties and functions, supervision schemes, physical control of assets, etc. The manual mandates each agency to set up its own internal control system based on the guidelines and thus does not enter into specific details of how specific transactions should be processed and recorded.

3.136 The date of the manual's issuance (1992) suggests that some of the content may possibly require updating, although the general principles espoused in the manual seem to be appropriate for modern financial management. The manual, however, is not available on COA's website and printed copies are no longer available for public consultation. This suggests that GOP officials charged with setting up or administering an internal control system are unlikely to have access to these guidelines, unless copies are already available in their respective units. It follows logically that it is unlikely these guidelines are understood well within the public sector, although we have not been able to ascertain this assertion with empirical evidence (e.g., survey of GOP officials across agencies). We have verified that at least DepEd does not have internal control rules of its own, according to the Department's accounting unit. We have not been able to verify whether other individual agencies have their own detailed internal control rules that follow these guidelines.

3.137 In 2002, COA issued the New Government Accounting System (NGAS), which partially updates aspects of guidelines on internal control as they relate to recording of financial transactions. A World Bank-commissioned review of the NGAS Manual finds that it provides detailed guidance on procedures and the sequence of processing of budget execution and accounting, including appropriate segregation of duties in most cases. But it also finds some weaknesses such as the lack of clear definitions of commitment and verification stages of budget execution and an inadequate procedure for recording transactions by accountable officers, among others.⁴⁷

3.138 Noting the existing weaknesses, the government is beginning to review the adequacy of its internal control systems.

Box 3-5: Overview of the Budget Execution Process in the Philippines

The basis for the budget execution process in the Philippines is Chapter 4, Book VI of the Administrative Code (E.O. 292). This chapter sets forth procedures for allotments and funds release, rules on the use of savings, treatment of special purpose funds and administration of lump-sum funds.

The basic rule in budget execution is that all funds appropriated for functions, projects, activities and programs (PAP), as presented in the General Appropriations Act (GAA), are to be made available solely for the specific purpose for which these were appropriated. This means that diverting funds from a specific purpose authorized in the GAA is prohibited. However, unutilized funds can be reverted to overall savings and then transferred out to another PAP by virtue of a Presidential directive. The President has authority to augment the appropriation of the Executive Branch in the GAA from its savings⁴⁸ except for the creation of new positions or the increase of salaries.

⁴⁷ Florence Brillaud and Ana Lemani (2007), "Review of the Manual on the New Government Accounting System for National Government Agencies Philippines."

⁴⁸ The Constitution provides that the President, the President of the Senate, the Speaker of the House of Representatives, the Chief Justice of the Supreme Court and the heads of Constitutional Commissions may,

DBM administers the allotment and funds release system. DBM is tasked to ensure that expenditures are covered by appropriations both as to amount and purpose as well as the agency's capacity to disburse such funds. On the basis of its appropriations from the GAA, government agencies request DBM to issue allotments for their expenditure requirements. These allotments are issued through obligational authorities such as the Agency Budget Matrix (ABM), which is the basis for comprehensive release of allotment chargeable against the GAA, or through a Special Allotment Release Order (SARO), which is released for a lump-sum expenditure that requires prior approval or clearance from DBM.

The pertinent budgetary policies relative to the release of funds are issued annually by DBM through a *National Budget Circular* pertaining to the *Guidelines on the Release of Funds* for a particular fiscal year. This circular also specifies the appropriate procedural guidelines on the releases of funds as well as the necessary rules and regulations for the implementation of specific items under the GAA.

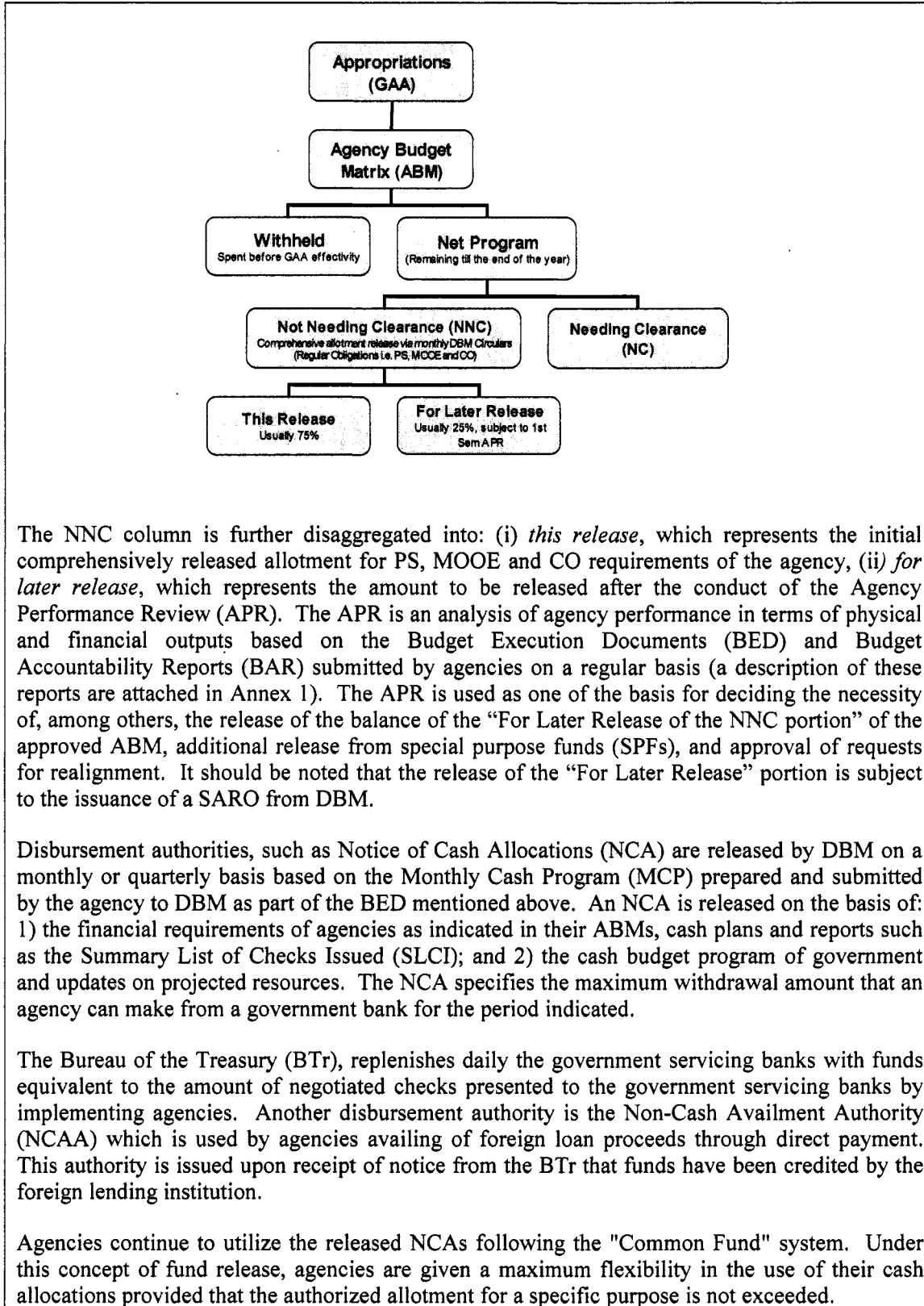
DBM, in coordination and consultation with the agencies, prepares and issues the ABM, which is the basis for authorizing the agency to incur obligations within the indicated amount comprehensively released. ABMs are broken down by PAP and allotment class (i.e., PS, MOOE and CO) and by operating unit. The DBM Secretary or his authorized representative signs and approves the central office ABMs while that of the regionalized portion of DPWH, DepEd and DOH, among others, are signed and approved by the concerned DBM Regional Director.

The ABM is disaggregated into two portions: (i) withheld portion, which corresponds to the amount programmed by agencies for their regular operating requirement until the year's GAA goes into effect; and (ii) net program, which pertains to the amount intended for regular operating requirements from the effective date of the GAA to the end of the year.

The net program is then segregated into two portions: (i) Needing Clearance (NC); and Not Needing Clearance (NNC). Those needing clearance are those to be released to the implementing unit through a Special Allotment Release Order (SARO) and these are usually built-in lump-sum appropriations that require submission of additional documents prior to release of funds. The allotments not needing clearance refers to budgetary items of agency budgets under the GAA considered as regular operating requirements such as personal services, MOOE for office maintenance, and some capital outlay.

by law, be authorized to augment any item in the GAA for their respective offices from savings in other items of their respective appropriations.

Figure 2: Budget Release System



The NNC column is further disaggregated into: (i) *this release*, which represents the initial comprehensively released allotment for PS, MOOE and CO requirements of the agency, (ii) *for later release*, which represents the amount to be released after the conduct of the Agency Performance Review (APR). The APR is an analysis of agency performance in terms of physical and financial outputs based on the Budget Execution Documents (BED) and Budget Accountability Reports (BAR) submitted by agencies on a regular basis (a description of these reports are attached in Annex 1). The APR is used as one of the basis for deciding the necessity of, among others, the release of the balance of the “For Later Release of the NNC portion” of the approved ABM, additional release from special purpose funds (SPFs), and approval of requests for realignment. It should be noted that the release of the “For Later Release” portion is subject to the issuance of a SARO from DBM.

Disbursement authorities, such as Notice of Cash Allocations (NCA) are released by DBM on a monthly or quarterly basis based on the Monthly Cash Program (MCP) prepared and submitted by the agency to DBM as part of the BED mentioned above. An NCA is released on the basis of: 1) the financial requirements of agencies as indicated in their ABMs, cash plans and reports such as the Summary List of Checks Issued (SLCI); and 2) the cash budget program of government and updates on projected resources. The NCA specifies the maximum withdrawal amount that an agency can make from a government bank for the period indicated.

The Bureau of the Treasury (BTr), replenishes daily the government servicing banks with funds equivalent to the amount of negotiated checks presented to the government servicing banks by implementing agencies. Another disbursement authority is the Non-Cash Availment Authority (NCAA) which is used by agencies availing of foreign loan proceeds through direct payment. This authority is issued upon receipt of notice from the BTr that funds have been credited by the foreign lending institution.

Agencies continue to utilize the released NCAs following the "Common Fund" system. Under this concept of fund release, agencies are given a maximum flexibility in the use of their cash allocations provided that the authorized allotment for a specific purpose is not exceeded.

3.139 *Degree of compliance:* The existence of a comprehensive, relevant, and cost-effective set of internal controls will be rendered useless if such rules are effectively ignored by the government on a routine and widespread basis. Evidence of the effectiveness of the system should come from government financial controllers, regular internal and external audits, or other surveys carried out by management.

3.140 In the Philippines, COA's Annual Audit Reports (AARs) for national government agencies provide a strong basis for assessing the government's degree of compliance with internal control rules and procedures. These audits are prepared for each agency and cover their accounts and transactions for the fiscal year, including the propriety of an agency's financial transactions and compliance with prescribed rules and regulations. The auditor ultimately renders an opinion on the fairness of the presentation of the financial statements of each agency.

3.141 These opinions are classified as one of the following: 1) Unqualified – the financial statements were prepared in accordance with applicable laws, rules and regulations and in conformity with generally accepted accounting principles; 2) Qualified – there were exceptions in certain accounts and transactions that affected the fairness of the presentation of financial statements; and 3) Adverse – there were material deficiencies in the accounts and transactions of the agency that significantly affected the accuracy and reliability of the financial statements.

3.142 The following table lists the COA AAR opinions in 2005 for the major national government agencies, including offices of nationally-elected officials and major bureaus and authorities. Out of the 28 entities on the list, there were 16 qualified opinions, ten adverse opinions, one unqualified opinion, and one case where the auditor's opinion was not clearly stated. This survey indicates that in the vast majority of government agencies (26 out of 28 agencies), the auditor found evidence of discrepancies in the accounts and transactions of agencies, including non-compliance with internal control rules and processes, that compromised the fairness of the presentation of financial statements. Furthermore, in more than one-third of the cases (10 out of 28 agencies), adverse opinions were rendered, which indicated the presence of material infractions of accounting and internal control rules and regulations. Overall, this indicates that internal control systems are commonly circumvented by national government agencies and suggests a generally weak level of compliance with these rules and procedures.

Table 3-12: Summary of COA Annual Audit Report Opinions – 2005

Agency	COA AAR Opinion
Office of the President	Qualified
Office of the Vice-President	Qualified
House of Representatives	Unqualified
Senate of the Philippines	Qualified
Bureau of Customs	Qualified
Bureau of Internal Revenue	Adverse
Department of Agrarian Reform	Adverse
Department of Agriculture	Adverse

Philippines Public Expenditure and Financial Accountability

Agency	COA AAR Opinion
Department of Budget and Management	Qualified
Department of Education	Adverse
Department of Energy	Not stated
Department of Environment and Natural Resources	Adverse
Department of Finance	Qualified
Department of Foreign Affairs	Adverse
Department of Health	Qualified
Department of the Interior and Local Government	Adverse
Department of Justice	Qualified
Department of Labor and Employment	Qualified
Department of National Defence	Qualified
Department of Public Works and Highways	Adverse
Department of Science and Technology	Qualified
Department of Social Welfare and Development	Qualified
Department of Tourism	Qualified
Department of Trade and Industry	Qualified
Department of Transportation and Communication	Adverse
Metropolitan Manila Development Authority	Adverse
National Economic Development Authority	Qualified
Philippine National Police	Qualified

Indicator	Score	Meaning of PEFA score	Evidence
PI-20. Effectiveness of internal controls for non-salary expenditure	D+		
(i) Effectiveness of expenditure commitment controls.	C	Expenditure commitment control procedures exist and are partially effective, but they may not comprehensively cover all expenditures or they may occasionally be violated.	DBM's ABM and SARO mechanisms are used to control agency expenditures but these do not limit commitments to actual cash availability. DBM's NCA constrains the release of funds and is based on cash availability but is unlinked to commitment control
(ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures.	C	Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. Some rules and procedures may be excessive, while controls may be deficient in areas of minor importance.	Reporting and post purchase order controls are lacking as evidenced in COA audit reports
(iii) Degree of compliance with rules for processing and recording transactions.	D	The core set of rules are not complied with on a routine and widespread basis due to direct breach of rules or unjustified routine use of simplified/emergency procedures.	The vast majority of COA AAR opinions for national government agencies are either qualified or adverse.
Scoring methodology			M1

PI-21 Effectiveness of internal audit

3.143 Internal control mechanisms can be improved through the effective use by management of internal audit. Internal audit capability is assessed by reviewing its coverage and quality, frequency and distribution of reports and the extent of management response.

3.144 *Coverage and quality of the internal audit function and frequency and distribution of reports:* The establishment of the internal audit function was authorized under the Internal Audit Code and under Administrative Order No. 70 of April 2003 requiring all government offices, local government units, and government corporations to organize an internal audit service in their respective organizations. Other Laws and issuances pertaining to Internal Auditing include:

- Memorandum Circular 89 Reiterating Compliance with Administrative Order 70, s.2003 and its Implementing Guidelines under DBM Budget Circular No. 2004-4;
- DBM Budget Circular No. 2004-4 – Guidelines on the Organization and Staffing of Internal Audit Units; and
- Joint Circular of CSC and DBM (Resolution No. 1) – Rationalization Program’s Organization and Staffing Standards and Guidelines (Annex D – On the Creation of an Internal Audit Service).

3.145 The Presidential Anti-Graft Commission (PAGC), the DBM and COA are the overseeing agencies. The DBM and PAGC expect that internal audit units will be set up in the entire bureaucracy after the rationalization currently being conducted is completed. At present, however, the effective coverage of internal audit throughout the national government is minimal.

3.146 Internal audit is not yet functional in the majority of departments, including major departments such as the DOH, the DepEd, the DA, and the DOTC. As such, it is not possible to assess the quality of the functions throughout the government and to determine whether these meet international standards.

3.147 Only a few departments can confirm the presence of functioning internal audit units.⁴⁹ The DPWH maintains an internal audit division that reports directly to the Secretary and is staffed with approximately 40 full-time technical staff. DPWH conducts both regular audits, based on an audit program prepared at the beginning of the year, and special audits, which are initiated by the Secretary or Undersecretary to investigate specific issues. The DSWD has an internal audit function that reports directly to the Secretary and is staffed with 6 full-time technical staff at the central office along with one staff person in each of the 16 regional offices. The audit function at the BIR is part of the Inspection Service unit under the Legal and Inspection Group. This group is staffed with

⁴⁹ Although it is possible that other agencies have functioning internal audit units, we have not been able to verify such a possibility.

12 full-time technical staff. In each of these agencies, the focus of internal audit is on compliance with internal control systems and procedures.

3.148 Finally, the DoST has an internal audit unit that reports directly to the Secretary although it does not maintain full-time staff. The DoST audit teams are assembled on an ad hoc basis and are composed of officials and managers from across the different agencies and bureaus of the department who are commissioned by the Secretary to participate in audit engagements in addition to their regular workload. Unlike the other departments, the DoST primarily focuses on program audits rather than compliance audits.

3.149 *Frequency and distribution of reports:* Given the absence of internal audit functions in most departments, our review of the issuance of reports is narrowly limited to the four departments that maintain functioning internal audit units. In each of these agencies, reports are regularly prepared after each audit engagement. In most cases, the audited organization is given an opportunity to respond to the audit findings before the final report is prepared.

3.150 The final internal audit reports and recommendations are distributed to the Secretary of the department and to the managers of the audited unit. The three nominal oversight agencies for the internal audit function (PAGC, DBM, and COA) are not furnished copies of the internal audit reports.

3.151 *Extent of management response to internal audit findings:* In each of the agencies with functioning internal audit units, the final reports and recommendations that are prepared after every audit engagement are submitted to the Secretary of the department. In fact, in the case of the DoST, a presentation of the findings to the Secretary is organized and is conducted in the presence of the managers of the audited organization. The Secretary then specifies the next steps to be taken by the audited organization to comply with the recommendations of the audit report.

3.152 For the DPWH, the DSWD, and the DoST, the internal audit unit tracks the compliance of the audited organizations after the final report and recommendations are submitted. Reports updating the progress of implementation are either prepared for the Secretaries of the department or included in larger, department-wide reports that are submitted to the Secretaries. In the case of the BIR, the internal audit unit is not mandated to follow through on the implementation of audit recommendations. The Internal Security Division, which is another group under the Inspection Service unit, is ultimately responsible for overseeing the enforcement of the recommendations.

3.153 In each of these cases, it appears that there is top management support for the implementation of internal audit recommendations. However, there are no summary reports available that provide information on the status of implementation. Hence, it is not possible to fully assess the promptness and comprehensiveness of the actions taken by the managers of the audited organizations.

Indicator	Score	Meaning of PEFA score	Evidence
PI-21. Effectiveness of internal audit	D+		
(i) Coverage and quality of the internal audit function.	D	There is little or no internal audit focused on systems monitoring.	Internal audit units are functional only in four departments: DPWH, DSWD, BIR, and DoST.
(ii) Frequency and distribution of reports.	D	Reports are either non-existent or very irregular.	As above.
(iii) Extent of management response to internal audit findings.	C	A fair degree of action taken by many managers on major issues but often with delay	PAGC advised that reports remain pending for some time but are usually implemented.
Scoring methodology			M1

F. ACCOUNTING, RECORDING AND REPORTING

PI-22 Timeliness and regularity of accounts reconciliation

3.154 This indicator is assessed on the basis of regularity of bank account reconciliations and regularity and clearance of suspense and imprest accounts.

3.155 *Regularity of bank reconciliations:* Reliable reporting of financial information requires constant checking and verification of the recording practices of accountants – this is an important part of internal control and a foundation for good quality information for management and for external reports. Timely and frequent reconciliation of data from different sources is fundamental for data reliability.

3.156 Monthly bank account reconciliation is required by Section 74 of Presidential Decree 1445 and COA Circular No. 92-125A dated March 4, 1992. However, COA's 2006 annual audit of the Bureau of Treasury's National Government accounts reveal: (1) un-reconciled discrepancy of book and bank balances amounting to Php5.6 billion; and (2) un-updated bank reconciliation statements (BRS). This has been a perennial problem for the BTr as the same audit findings were found in prior years' audit (2004 and 2005). Such findings cast doubts on the validity and correctness of Cash-in-Bank accounts/sub-accounts with authorized government depository banks/authorized agent banks (AGDBs/AABs) since such discrepancy accounts to 4.1% of the Php137.6 billion cash-in-bank sub-accounts.

3.157 There is an absence of completed/updated BRS for about 90% of the total net book balance of active sub-accounts as of end-2006.⁵⁰ According to the BTr's National Cash Accounting Division, the reason for this is the lack of personnel and/or inability of personnel to cope with the volume of assigned sub-accounts and the non-/late submission of bank statements by some banks. Although additional manpower was requested, no hiring has been done to date.

⁵⁰ Per COA 2006 Audit Report for BTR's NG books.

3.158 *Regularity of reconciliation and clearance of suspense accounts and advances:* In most audit reports COA also comments on another reconciliation problem in the form of the depth of unliquidated cash advances to employees. COA points out in every report sighted that cash advances are to be reported on and liquidated as soon as the purpose for which it was given has been served in accord with Section 89 of PD1445. In every audit sighted, the amounts outstanding run to many millions of pesos.⁵¹

Indicator	Score	Meaning of PEFA score	Evidence
PI-22. Timeliness and regularity of accounts reconciliation	D		
(i) Regularity of bank reconciliations	D	Bank reconciliation for all Treasury managed bank accounts take place less frequently than quarterly OR with backlogs of several months.	Un-reconciled discrepancy in BTr's NG book and bank balances amounting to Php5.65 billion and absence of complete/updated BRS.
(ii) Regularity of reconciliation and clearance of suspense accounts and advances.	D	Reconciliation and clearance of suspense accounts and advances take place either annually with more than two months' delay, OR less frequently.	Overdue un-liquidated cash advances outstanding in every agency per COA Annual Audit reports.
Scoring methodology			M2

PI-23 Availability of information on resources received by service delivery units

3.159 Problems frequently arise in front-line service delivery units providing services at the community level (such as schools and health clinics) in obtaining resources that were intended for their use, when overall resources fall short of budget estimates or when higher level organizational units decide to re-direct resources to other purposes. In most cases, information about the receipt of resources and expenditures in the field offices is incomplete and unreliable.

3.160 Reports on fund utilization by implementing units are required per COA Circular No. 94-013 dated December 13, 1994. Both the 2005 and 2006 COA Audit Reports of DOH reveal that, among others, immediate submission of Fund Utilization Reports of fund transfers from DOH-Central Office and regional Centers for Health Development (CHD) was not observed by some NGAs, LGUs and NGOs/POs after completion of the projects. Unsettled balances amounting to Php83.87 million (2005) and Php2.0 billion (2006) of transferred funds were due to the seeming laxity of DOH and CHDs in compelling implementing units to submit reports.⁵² The lack of computerized applications and the current structure of financial information flows means that it is very unlikely appropriate information is available and or disclosed.

⁵¹Commission on Audit 2005 financial audit, of the operations of BoC(182m), DA(116m), DepED(330m),BIR(56m) & AFPGHQ(310m)

⁵²2006 COA Audit Report for DOH, *Observations and Recommendations*.

3.161 In the case of DepEd, the implementation of the direct release system lessened the accountability of service delivery units (i.e., school division offices (SDO) and secondary schools with financial staff) to the DepEd Central Office (CO). Since funding is released directly by the DBM-Regional Offices instead of going through the DepEd CO, there is less incentive for the SDOs and the schools to report their fund utilization to the CO. According to DepEd officials, this arrangement makes it very difficult for them to gather fund utilization data from the field offices.

3.162 On the receipt of resources by service delivery units, there are no available data that could show how much each service delivery unit would receive for a given year. In the case of DepEd, school heads were not aware of their school budget allocation since these are subject to SDO discretion. Based on the BESRA Key Reform Thrust No. 5 Report, one-fifth of all school head respondents were unaware of their school budget allocation. An additional 5% of elementary school principals (ESP) had only partial knowledge.⁵³

3.163 On the basis of the above findings, it is found that regardless of whether responsibilities have been devolved or whether the national government remains responsible; appropriate reporting on funds budgeted and actual utilization for front-line service delivery units generally does not happen.

Indicator	Score	Meaning of PEFA score	Evidence
PI-23. Availability of information on resources received by service delivery units	D		
Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (focus on primary schools and primary health clinics) in relation to the overall resources made available to the sector(s), irrespective of which level of government is responsible for the operation and funding of those units.	D	No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last 3 years.	Reporting on resource usage by service delivery units is not done.
		Scoring methodology	M1

PI-24 Quality and timeliness of in-year budget reports

3.164 The indicator focuses on the ability to produce comprehensive reports from the accounting system on all aspects of the budget.⁵⁴ Coverage of expenditure at both the commitment and the payment stage is important for monitoring of budget implementation and utilization of funds released. The dimensions covered are (i) the scope of reports, (ii) their timeliness, and (iii) the quality of information on actual budget implementation.

⁵³ “BESRA KRT 5: New Budget Framework and Financial Management Reform Strategy,” by Eleanora E. Tan (2006).

⁵⁴ Flash reports on release of funds to departments are not sufficient

3.165 *Scope of Reports:* Numerous reports are required to be submitted by the line departments to both COA and the DBM. The COA manual on NGAS requires monthly preparation of trial balances (within 10 days of month end) as well as complete annual financial statements. The DBM requires departments to submit four budget execution documents or BEDs (plans and programs) and five budget accountability reports or BARs (actual). Scope and timing of submission of these reports are set out in the National Budget Circular No. 507 or the Omnibus Circular on the Submission of Budget Execution Documents/Accountability Reports (issued in January 2007) (See Table 3.14). In-year budget execution reports submitted monthly by the line departments are the Statement of Allotments Obligations and Balances (SAOB) and Monthly Report of Disbursements. The former provide data which enables comparison of allotments received from the DBM and the corresponding obligations incurred during the month while the latter reflects all disbursements arising from the NCAs issued such as MDS checks issued and direct payments to suppliers.⁵⁵ Although these reports are regularly submitted by the line departments, DBM does not consolidate the figures within the year thus there is no in-year comparison of budget appropriations vs. obligations/disbursements.

Table 3-134: Budget Execution Documents (BED) and Budget Accountability Reports (BAR)

Reports/Submissions Due	Frequency/Deadline
1. Full-Year Physical and Financial Plan (BED No. 1) 2. Monthly Cash Program (BED No. 2) 3. Estimate of Monthly Income (BED No. 3)	On or before February 15 of every year
4. List of Not Yet Due and Demandable Obligations (BED No. 4) -	On or before January 31 of each year
5. Quarterly Physical Report of Operation (BAR No. 1) 6. Quarterly Financial Report of Operation (BAR No. 2) 7. Quarterly Report of Income (BAR No. 3)	On or before the 10 th day following the quarter
8. Statement of Allotments, Obligations and Balances (BAR No. 4) 9. Monthly Report of Disbursements (BAR No. 5)	On or before the 10 th day following the month

3.166 *Timeliness of the reports:* End-of-year submissions of obligations by line departments serve as the basis for the “actuals” specified in the succeeding two year’s National Expenditure Program (e.g., 2005 actuals are reflected in the 2007 NEP which the Executive submitted to Congress in mid 2006). Although line agencies submit their obligations figures by PAPs, only the aggregate figures are presented in the NEP.

3.167 *Quality of information:* The in-year budget documents that line departments regularly submit (although most of the time delayed) are the Monthly Report of Disbursements and the SAOBs. DBM operations bureaus admit that they do not really

⁵⁵ This also includes disbursements arising from Non-Cash Availment Authority, Cash Disbursement Ceilings and Tax Remittance advice.

have much use for these documents. The presence of the Land Bank terminal in the DBM premises is a more up-to-date and accurate way to check line department's disbursements through the MDS balances. The SAOBs, which are too tedious to monitor on a monthly basis, are sometimes set aside for "reference purposes" until the end-of-year SAOBs are submitted.

Indicator	Score	Meaning of PEFA score	Evidence
PI-24. Quality and timeliness of in-year budget reports	D		
(i) Scope of reports in terms of coverage and compatibility with budget estimates	D	Comparison to the budget may not be possible across all main administrative headings.	Although there are a lot of reports required to be submitted by the line departments, these data are not consolidated by the DBM.
(ii) Timeliness of the issue of reports	D	Quarterly reports are either not prepared or often issued with more than 8 weeks delay.	Departments are required to prepare SAOBs for the DBM but the data is not aggregated or used outside the DBM.
(iii) Quality of information	D	Data is too inaccurate to be of any real use.	Because of the timing and the question about accuracy of reports submitted by the line departments, these are usually set aside and not used.
Scoring methodology			M1

PI-25 Quality and timeliness of annual financial statements

3.168 Dimensions used for this indicator include completeness and timeliness of annual financial statements and the accounting standards used.

3.169 *Completeness*: The consolidated financial statements of the National Government are found in COA's Annual Financial Report (AFR) for National Government (Volume I). It comprises the national government books plus the regular agency books. The national government books, as reflected in the AFR, are maintained by the Bureau of Treasury, which is the principal custodian of the financial assets of government.⁵⁶ The regular agency books are the consolidated financial statements and reports submitted by 36 departments and its 434 attached agencies totaling 470, representing 99.4% of the total of 473 national government agencies.⁵⁷ The BTr's-National Government (BTr-NG) books cover government's tax and non-tax collections, overall expenditures (mostly from the MDS account) as well as foreign and domestic borrowings, and are audited by COA. The regular agency books, on the other hand, are based on the consolidated pre-closing trial balances of individual departments involved.⁵⁸

⁵⁶ Executive Order No. 449

⁵⁷ Source: COA's AFR 2005. The figure does not include all of the GOCCs.

⁵⁸ COA Annual Financial Report CY2005 Notes to Consolidated Financial Statements Item 1(b).

3.170 *Timeliness*: The audit certificate for the BTr-NG books for FY2005 was dated March 28, 2006 while the COA AFR for NG was submitted to the President, the Senate President and the Speaker of the House of Representatives together with that of the GOCCs and the LGUs on July 31, 2006.

3.171 However, the underlying financial figures submitted by the agencies are not audited, and thus the consolidated data are not corrected for all of the errors identified in subsequent agency audits. Many of these errors in the individual financial statements are material (see the discussion on PI-21(iii)). Use of these data without correction in compiling the annual financial reports leads to questionable veracity of the reported financial figures,

3.172 The problem of not basing the AFR on properly audited financial statements is illustrated in the material weaknesses found in COA's own audit of the BTr-NG books for 2005. The audit report concluded that "(t)he Auditor was unable to render an opinion on the fairness of the presentation of the financial statements of the BTr-NG due to the limitations in the scope of the examination caused by the inability of management to provide the required documents and reconcile the discrepancies which prevented us from determining the correctness and validity of the accounts presented."⁵⁹ The report goes on to mention a number of other material issues such as discrepancy between market value and transferred amount of forfeited assets of US\$64.8 million, absence of an updated promissory note to support balance of Notes Receivable totaling P137 billion, non-receipt of GOCCs dividends of P3.3 billion, overstatement of Land (201) by P6.7 billion, understatement of P3.7 billion due from GOCCs because of unreconciled balances and incomplete documentation, and non-receipt of yearly 50% dividend due to the national government from the Philippine Amusement & Gaming Corporation under RA 7656 since 1993 (Table 3.15).

3.173 *Accounting standard*: The AFRs are prepared based on the accounting standards of the New Government Accounting System (NGAS), which is largely consistent with international standards.

Table 3-145: COA financial audit of BTr National Government books

Observations	Billion Pesos
Un-reconciled book and Bank balances	4.3
Due from GOCCs due to un-reconciled balances, and incomplete documentation	282.1
Other Property, Plant and Equipment un-reconciled balances	9.4
Other Property, Plant and Equipment un-reconciled balances	6.0
Loans Payable due to un-reconciled discrepancies	56.2

Source: Commission on Audit 2005 Financial audit of the operations of BTr CY 2005

⁵⁹ COA 2005 Audit Report for the Bureau of Treasury's National Government Books

Indicator	Score	Meaning of PEFA score	Evidence
PI-25. Quality and timeliness of annual financial statements	D+		
(i) Completeness of the financial statements	B	A consolidated government statement is prepared annually. They include, with few exceptions, full information on revenue, expenditure and financial assets/liabilities	COA AFR provides relatively complete information for national and local governments and GOCCs. The financial audit report for BTr-National Government books and line departments highlights problems with underlying data, however.
(ii) Timeliness of submission of the financial statements	D	If annual statements are prepared, they are generally not submitted for external audit within 15 months of the end of the fiscal year.	The AFR is not audited, nor are the pre-trial balance data submitted by the agencies as the basis for the AFR. The financial statements of the BTr-NG books are audited annually, but the BTr-NG books represent only 65% of the consolidated financial statements.
(iii) Accounting standards used	B	IPSAS or corresponding national standards are applied	The COA AFRs are consistent and rely on generally accepted accounting principles as presented in NGAS.
Scoring methodology			M1

G. EXTERNAL SCRUTINY AND AUDIT

PI-26 Scope, nature and follow-up of external audit

3.174 Greater transparency in the use of public funds is achieved through an effective external audit. This is assessed on the basis of scope and the nature of audit performed, timeliness of the report submissions, and follow up on recommendations.

3.175 *Scope and nature of audit:* COA's external audit activities are quite comprehensive. They include financial compliance audits of individual national government agencies, local government units, and GOCCs as well as value-for-money (performance) audits on systemic government functions (e.g., procurement system, regulatory functions), government programs (e.g., housing program, the Comprehensive Agrarian Reform Program), and individual government agencies and some special studies. Financial audits are conducted in accordance with generally accepted state auditing standards which require that auditors plan and perform the audit to obtain reasonable assurance that financial statements are free of material misstatements.

3.176 *Timeliness of submission to the legislature:* Audit reports are not formally submitted to the legislature as they are addressed to the head of the agency being audited.⁶⁰ But a copy of each report is submitted to the Office of the Speaker of the

⁶⁰ Section 43(2) of PD 1445 or the "Government Auditing Code of the Philippines" provides that, "A report of audit for each calendar year shall be submitted on the last working day of February following the close of the year, by the head of each auditing unit through the Commission to the head or the governing body of the agency concerned, and copies thereof shall be furnished the government officials concerned or authorized to receive them."

House. Relevant sub-committees of the House Appropriations and the Senate Finance Committees may question line departments under their jurisdiction about implementation of audit recommendations at budget hearings. There is no equivalent of a public accounts committee charged with receiving and reviewing audit reports.

3.177 *Follow-up on recommendations:* COA audit reports are submitted to the heads of the departments being audited. The audit certificate is addressed to the head of the entity being audited in every case. Section 90 of the general provisions of the GAA requires all departments and GOCCs to submit within 60 days of their receiving an audit report a status report and an official response to COA, the DBM, the House Committee on Appropriations and the Senate Committee on Finance. COA tries to ensure proper follow-up by the audited agencies by returning to its prior year recommendations in its financial audits. According to COA's own tally in 2004, around three fourths of the recommendations made in the previous year's audit reports had been implemented, at least partially (Table 3-16).

Table 3-15: Response to 2004 COA Audit recommendations at time of 2005 audit

Agency	Total	Implemented	Partial	Not
<i>Agricultural Reform</i>	20	4	15	1
AFPGHQ	33	12	8	13
Agriculture	178	60	85	33
Air Force	13	1	12	
Education	45	2	33	10
DENR	20	5	10	5
Army	21	7	12	2
DBM	9	6	2	1
DOF	19	5	9	5
DOST	12	1	8	3
NEDA	25	6	12	7
DILG	23	15	8	
BIR	62	15	27	20
BoC	94	7	73	14
DND	4	1	2	1
DOTC	121	30	31	60
Court of Appeals	12	5	4	3
CBAA	3	1		2
Justice	11	2	5	4
Office of the President	7	3	2	2
Procurement Service	5	1		4
Total	737	189	351	190
		26%	48%	26%

Source: FY2005 COA Audit Reports of various government agencies (Source: COA website)

Indicator	Score	Meaning of PEFA score	Evidence
PI-26. Scope, nature and follow-up of external audit	B+		
(i) Scope/nature of audit performed (incl. adherence to auditing standards).	A	All entities of central government are audited annually covering revenue, expenditure and assets/liabilities. A full range of financial audits and some aspects of performance audit are performed and generally adhere to auditing standards, focusing on significant and systemic issues.	Examination of a sample of 2005 COA financial audit reports
(ii) Timeliness of submission of audit reports to legislature	-	Not Applicable	PD 1445 of the "Government Auditing Code of the Philippines" provides that annual audit reports are to be submitted to the head of the agency concerned and not to Congress.
(iii) Evidence of follow up on audit recommendations.	B	A formal response is made in a timely manner, but there is little evidence of systematic follow up.	Table 3.16 above as well as various COA Audit reports for FY2005 reviewed, particularly for DA, DoH, DBM, GPS, DepED
		Scoring methodology	M1

PI-27 Legislative scrutiny of the annual budget law

3.178 In order to assess the role of the legislature in the annual budget process, this indicator reviews :(i) the scope of the legislature's scrutiny; (ii) the procedures followed; (iii) the time allowed; and (iv) the rules for in-year budget amendments.

3.179 *Scope of the legislative scrutiny:* Both chambers of Congress have specialized committees (House Appropriations Committee and Senate Finance Committee), each of which is divided into sectoral sub-committees. Through this committee structure, Congress reviews both the overall macroeconomic framework and specific details of agency budget proposals. Because the executive proposal does not contain any explicit medium-term fiscal strategy and priorities, these are not reviewed. Instead, members of the legislature, especially in the House, tend to focus on details of line items from the point of view of their geographic constituencies. It is generally reported that the Senate, in contrast, tends to focus more on national-level issues because the senators are all elected on a national ballot.

3.180 *Extent to which legislature's procedures are well-established and respected:* The organizational arrangement for legislative scrutiny of the executive's budget proposal is well-established. For example, the House Appropriations Committee includes most of the members of Congress as members of the Committee and divides them into as many as 50 sub-committees for consideration of various aspects of the budget proposal before submitting a collective Committee report put together by the vice chairs (who lead sub-committees) to a plenary sitting of the House.

3.181 Procedures for congressional reviews of the executive's budget proposal are clearly established and generally respected. Once the executive submits its budget proposal to Congress in July-August (within 30 days after the opening of a regular congressional session), Congress typically has more than four months to review it and prepare its general appropriations bill. In general terms, congressional scrutiny of the budget proposal takes place in three stages. First, the House of Representatives, through its Committee on Appropriations, reviews it and adopts a bill in a plenary session. The Senate then reviews the House bill through its Finance Committee and adopts its own bill in plenary. Both chambers conduct hearings at the committee stage to scrutinize individual agencies' budget proposals as well as the macroeconomic framework. Finally, if the Senate bill differs from the House bill, which is typically the case, a bicameral conference committee is convened to reconcile the differences and hammer out a final bill.

3.182 *Adequacy of time for the legislature to provide a response to budget proposals:* As shown in Table 3-17, the executive has consistently submitted its budget proposal on time to allow Congress sufficient time to review and deliberate on the proposal. However, the approval of the GAA before the beginning of the fiscal year has been exceptions rather than the norm. In recent years, Congress failed to arrive at a consensus bill, and thus to enact a GAA for the entire year on several occasions.

Table 3-16: Approval Dates of Budget Bills

Fiscal Year	Budget Proposal	House's Approval	Senate's Approval	Bicameral Approval	President's Approval
1995	July 25, 1994	Oct. 25, 1994	Dec. 17, 1994	Dec. 20, 1994	Dec.30, 1994
1996	July 24, 1995	Nov. 6, 1995	Dec. 15, 1995	Dec. 21, 1995	Dec. 29, 1995
1997	July 22, 1996	Nov. 4, 1996	Dec. 17, 1996	Jan. 29, 1996	Feb. 12, 1997
1998	July 28, 1997	Nov. 20, 1997	Dec. 17, 1997	Jan. 12, 1998	Feb. 14, 1998
1999	Aug. 22, 1998	Nov. 19, 1998	Dec. 11, 1998	Dec. 21, 1998	Dec. 30, 1998
2000	July 27, 1999	Nov. 15, 1999	Dec. 13, 1999	Feb. 2, 2000	Feb. 16, 2000
2001	July 24, 2000	Dec. 19, 2000	Failed to Pass	***	***
2002	Aug. 8, 2001	Nov. 20, 2001	Dec. 18, 2001	Dec. 22, 2001	Jan. 21, 2002
2003	Aug. 21, 2002	Dec. 18, 2002	March 6, 2003	March 12, 2003	April 23, 2003
2004	Aug. 6, 2003	Dec. 17, 2003	Jan. 23, 2004	Failed to Pass	***
2005*	Aug. 25, 2004	Dec. 9, 2004	Feb. 10, 2005	March 1, 2005	March 15, 2005
2006	Aug. 24, 2005	April 5, 2006	June 1, 2006	Failed to pass	***

Source: DBM

3.183 *Rules for in-year amendments of the budget without legislative authorization:* Section 1 of Book VI of EO292 provides authority for the President to augment any item in the GAA from savings to other items within the Executive appropriation.⁶¹ This is further supported by Section 39, which provides that any savings from the GAA for PAPs of any department, office or agency may, with the approval of the President, be used to cover a deficit in any other item of the regular appropriation. These provisions give the President flexibility to reallocate budgets within the executive branch as long as total appropriations do not exceed the levels prescribed in the GAA. In addition, a good portion of the appropriations for special purpose funds are effectively re-appropriated to line departments.

⁶¹ The Constitution also accords the President of the Senate, the Speaker of the House of Representatives, the Chief Justice of the Supreme Court, and the heads of the Constitutional Commissions the authority to “augment any item in their in the general appropriations law for their respective offices from savings in other items of their respective appropriations” (Article VI, Section 25).

3.184 The ability of the President to augment any item in the GAA from savings for a particular year diminishes the importance of supplemental budgets. The executive has no need to return to the Congress to secure supplemental appropriations unless large amounts of additional appropriation are required. This further limits the possibility of public scrutiny of budget execution and re-allocation.

Indicator	Score	Meaning of PEFA score	Evidence
PI-27. Legislative scrutiny of the annual budget law	C+		
(i) Scope of the legislature's scrutiny.	B	The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue.	As above.
(ii) Extent to which the legislature's procedures are well-established and respected.	A	The legislature's procedures for budget review are firmly established and respected. They include internal organizational arrangements, such as specialized review committees, and negotiation procedures.	Internal procedures within Congress are firmly established and generally respected.
(iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined).	A	The legislature has at least two months to review the budget proposals.	Table 3.17. The legislature has had at least 3 to 4 months to deliberate on the executive's budget proposal before its deadline on December 31 in the last 12 years.
(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.	C	Clear rules exist, but they may not always be respected OR they may allow extensive administrative reallocation as well as expansion of total expenditure.	Significant resource allocation shifting is achieved from shifting special purpose funds to overspending agencies and from reallocating appropriated funds from "saving" (i.e., unused obligation authority for an activity or a project that has completed).
Scoring methodology			M1

PI-28 Legislative scrutiny of external audit reports

3.185 The legislature has a key role in exercising scrutiny over the execution of the budget that it approved. Internationally a common way in which this is done is through a legislative committee which examines external audit reports and questions responsible parties about the findings of the reports. The effectiveness of legislative scrutiny is assessed by timeliness of audit reports, extent of hearings and issuance and response to recommendations.

3.186 *Timeliness of examination of audit reports by the legislature:* As discussed in reference to the PI-26, the COA audit reports are not formally submitted to the legislature. A copy of each report is submitted to the Office of the Speaker of the House. The audit reports on individual departments are formally submitted to departmental secretaries.

3.187 *Extent of congressional hearings on key findings:* Congressional committees do not question departments on implementation of audit recommendations as a routine. There is no regular process in place for the legislature to systematically receive, scrutinize, and review audit reports and monitor the implementation of findings.

3.188 *Issuance of recommended actions by the legislature and implementation by the executive:* While reports are potentially available to Congress, and copies may be delivered to the Office of the Speaker, the receipt, scrutiny and review of audit reports and ensuring recommendations are implemented does not form part of the operations of any committee in Congress.⁶²

Indicator	Score	Meaning of PEFA score	Evidence
PI-28. Legislative scrutiny of external audit reports	D		
(i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years).	D	Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete.	As described above based on interviews with staff of Congressional Planning and Budget Department
(ii) Extent of hearings on key findings undertaken by the legislature.	D	No in-depth hearings are conducted by the legislature.	As above
(iii) Issuance of recommended actions by the legislature and implementation by the executive.	D	No recommendations are being issued by the legislature.	As above
Scoring methodology			M1

H. DONOR PRACTICES

D-1 Predictability of Direct Budget Support

3.189 This indicator assesses the extent to which inflows of budget support affect the government's ability to formulate its budget and consequently implement it as planned. This indicator was not relevant to the GOP during the 2003-2006 years as direct budgetary support flows were not in place.

⁶² The Congressional Planning and Budget Department of the House of Representatives has noted that "(b)oth Houses of Congress, while having the constitutional mandate to do oversight have no current or focused effort in oversight and monitoring Congressional Planning and Budget Department, *Governing the Philippine Bureaucracy Issues and Challenges in Legislative Oversight*, March 2006.

D-2 Financial information provided by donors for budgeting and reporting on project and program aid

3.190 This indicator reflects the quality and timeliness of the information provided by the donors on their budget estimates for disbursement of project aid as well as actual disbursements made. It is assessed against the following dimensions: i) completeness and timeliness of budget estimates by donors; ii) frequency and coverage of reporting by donors on actual donor flows.

3.191 According to NEDA’s project management staff, all projections of disbursements on overseas development assistance are drawn from loan agreements and disbursement information is drawn from line departments. In general, development partner agencies provide little or no information on projected disbursements or actual disbursements but share some information on the potential possible pipeline for funded projects. No schedules of likely fund flows are provided to Government.⁶³

3.192 The data was not collated from any consolidated information on projections or actual disbursements available from multi-lateral or bilateral agencies.

Indicator	Score	Meaning of PEFA score	Evidence
PI 30. Financial information provided by donors for budgeting and reporting on project and program aid	D		
i) completeness and timeliness of budget estimates by donors	D	Not all major donors provide budget estimates for disbursement of project aid at least for the government’s coming fiscal year and at least three months prior its start.	Interview with Foreign Assisted Project Management NEDA and WB staff
ii) frequency and coverage of reporting by donors on actual donor flows	D	Donors do not provide quarterly reports within two month of end-of-quarter on the disbursements made for at least 50% of the externally financed project estimates in the budget.	Interview with Foreign Assisted Project Management NEDA and WB staff
Scoring methodology			M1

D-3 Proportion of aid that is managed by use of national procedures

3.193 This indicator relates to the proportion of donor aid funds that are managed through national procedures (i.e., banking, authorization, procurement, accounting, audit, disbursement and reporting).

3.194 While donors are now much more comfortable with the GOP procurement framework, it is generally relied upon only for local procurement. Loan agreements

⁶³ This score may appear to conflict with the scoring of the second dimension of Performance Indicator 7 where the oversight agencies had been able to gather appropriation information on foreign project and loans for the purpose of projecting required appropriations. In that case the agencies collected the data from consolidating information collected from donors on a case by case basis. Disbursement data is also collected on a case by case basis from departments.

generally involve extra procurement procedures such as World Bank prior review of many transaction types. All internationally competitive bidding processes are managed through the bilateral or multilateral agency's procurement and other procedural frameworks, although this is still consistent with the Procurement Law.

3.195 In financial management, GOP procedures are generally used for banking, but slowness in release of funds encourages some overseas development agencies to use other approaches in getting funds to line departments.

3.196 GOP procedures are used for audit and COA generally performs this work. The exceptions are grant-financed activities for which work is often contracted out to the private sector.

Indicator	Score	Meaning of PEFA score	Evidence
PI 31. Proportion of aid that is managed by use of national procedures	D		
(i) Overall proportion of aid funds to central government that are managed through national procedures.	D	(i) Less than 50% of aid funds to central government are managed through national procedures.	Interview with Foreign Assisted Project Management NEDA and World Bank staff
		Scoring methodology	M1

4. GOVERNMENT REFORM PROCESS

A. DESCRIPTION OF RECENT AND ON-GOING REFORMS

4.1 *PEM reforms prior to 2003:* In recent years the government has pursued a variety of reforms related to various aspects of public financial management. In the late 1990s, the government launched a Public Expenditure Management Improvement Program (PEMIP) with emphasis on the introduction of a medium-term expenditure framework (MTEF). The GOP attempted to introduce an MTEF along with the Organizational Performance Indicator Framework (OPIF) in the National Budget Calls for FY2000-02. The FY2001 Budget Call introduced Sector Effectiveness and Efficiency Reviews (SEERs) as a tool to align each sector's budget to its policy priorities and their major final outputs (MFOs).⁶⁴ Perhaps because of the political turmoil that engulfed the country in the 2001-04 period, these reform efforts were suspended.

1. Public expenditure and financial management reforms

4.2 In 2005, in the context of the preparation of the FY2006 budget, the government re-initiated some of these reform initiatives, including the adoption of an MTEF and continued development of OPIF. Other related measures include efforts to better harmonization of investment planning and budgeting and establishment of internal audit functions at the agency level.

4.3 *MTEF:* For the preparation of the FY2006 and FY2007 budgets, the DBM based the budget proposal on a combination of agency-by-agency forward estimates (FEs) and the Paper on Budget Strategy (PBS), which have formed the backbone of the revived MTEF reform. With FEs, the DBM calculates budgetary costs of the ongoing programs and projects for each agency and estimates the amount of fiscal resources available for funding new priorities by subtracting the total FEs from the total revenue estimates. Once the "allocable" fiscal space is estimated, the DBM uses the PBS to articulate relevant policy issues and their budgetary consequences, and through the DBCC, recommends key budgetary choices to be made by the President. This process was repeated in 2007, with refinement in the technical basis for calculating FEs and the quality of analysis in the PBS.

4.4 *OPIF:* The government also attached to the FY2006 budget proposal compilation of OPIF for 20 departments. To develop an OPIF, each department went through a logical framework exercise to clarify its core mandates and Major Final Outputs (MFOs).

⁶⁴ For additional details of the PEM reforms in the early 2000s, see Chapter 5 of *Philippines Improving Government Performance: Discipline, Efficiency and Equity in Management Public Resources, A Public Expenditure, Procurement and Financial Management Review*, World Bank (2003). Similar reform efforts had preceded the PEMIP, including MTEF. See "Public Expenditure Management Improvement in the Philippines: Efforts Initiated and the Envisioned Reforms," OECD 1998 (<http://www.oecd.org/dataoecd/59/16/1910593.pdf>)

OPIF aligns each agency's programs, activities and projects (PAPs) with its MFOs. The MFO structure is not used for the purpose of budget appropriations, but the publication of OPIF (as "Performance Budget") enhances transparency of the national government budget. The government is currently working to extend the coverage of OPIF to all the agencies attached to the 20 departments.

4.5 *Internal audit:* The GOP recognizes the weaknesses in the current internal control environment, and has decided to institutionalize internal audit units in each agency. The Presidential Anti-Graft Commission (PAGC) and the DBM spearhead this effort with support from external development partner agencies such as the Bank and AusAID. PAGC is currently managing a project involving survey mapping of internal audit in 15 pilot departments, training and preparation of internal audit manuals.

4.6 *Accounting:* The ongoing activity to strengthen government accounting involves full implementation of the New Government Accounting System (NGAS), issued by COA in 2002. NGAS adopts a modified accrual accounting method and accounting and reporting by responsibility centers. A main thrust of the reform is to fully install e-NGAS, the electronic software that supports NGAS, across the entire public sector. However, the pace of the implementation has been slow.

2. Procurement reform

4.7 Since the passage of the 2003 Government Procurement Reform Act (RA9184), the government has made steady progress in strengthening its procurement system. RA9184 harmonized a number of existing, and often mutually contradictory, rules and regulations under a single legal framework and associated rules and regulations. While the issuance of implementing rules and regulations governing procurement for foreign-assisted projects is still pending, the formal legal infrastructure is now quite advanced. Major challenges relate to implementation and full enforcement of the various provisions of the law.

4.8 The government is pursuing reform implementation on multiple fronts. Some of the current priorities include professionalizing the procurement professions in the public sector, restraining unjustified uses of non-competitive bidding methods by procuring entities, increasing participation of a larger number of bidders to increase competitiveness of public procurement, and expanding the use of PhilGEPS, the e-procurement system, among others.

3. Agency rationalization and civil service reform

4.9 *Rationalization:* Since 2003 the GOP has pursued a government-wide rationalization program following the Executive Order 366 that mandated "a strategic review of the operations and organizations of the executive branch." The rationalization program entails each agency preparing a rationalization plan for review and approval by the DBM and identifying personnel who will be separated from their positions with pecuniary incentives.

4.10 The original motivations for launching the rationalization program included the concern about the government wage bill that was seen to threaten fiscal sustainability. Thus the government, through the Civil Service Commission (CSC) and the DBM, developed a personnel information database system (PIDS). The PIDS will be linked to the Government Human Resource Management Information System (HRMIS). Once it is fully operational, the HRMIS will be an instrument to control the levels and the costs of the civil service employment.

4.11 *Pay reform:* Based on the technical work by the CSC and the DBM, the government proposed to Congress a new government classification and compensation bill, aimed at rationalizing the civil service job classification system and adjusting the civil service pay scale to the relevant private-sector comparator. The bill, which is still pending congressional approval, is meant to replace the 1987 Salary Standardization Law and contribute to professionalization of the civil service.

4.12 *Tax administration:* The BIR has created a Tax Reform Administration Group (TRAG) headed by a Deputy Commissioner to manage the reform program of the bureau. Task forces were created for each of the seven critical reform areas that were identified, including registration cleanup, legislative improvements, enforcement of collections, enhanced audit, improved taxpayer service particularly on rulings and performance-based management. The BIR has secured external assistance in developing Computer Assisted Audit Tool Systems (CAATS), training auditors in International Financial Reporting Standard (IFRS) and the development of Audit Manuals by Industry, Industry Profiling & Benchmarking.

B. INSTITUTIONAL FACTORS SUPPORTING REFORM PLANNING AND IMPLEMENTATION

1. Government leadership and ownership

4.13 Most of the ongoing reforms count on strong champions at the technical level. The DBM is particularly active in pushing the budget management reforms such as MTEF and OPIF, and other related initiatives. For example, in September 2006, the DBM convened a PEM reform workshop involving leadership from all of the oversight agencies and selected line departments to reflect on the progress thus far and steps ahead in harmonizing infrastructure planning and budgeting, revenue forecasting, OPIF and MTEF. The DBM Secretary participated fully in the workshop, and each agency sent senior officials (e.g., undersecretaries or assistant secretaries) as their representatives.

4.14 Similarly, the procurement reform has proceeded in a highly participatory manner. The GPPB has led the process and convened senior officials from various agencies and development partners to an action planning workshop in June, 2007, as part of the World Bank-led Country Procurement Assessment Review process.

4.15 The accounting reform led by COA is a genuinely home-grown effort. In contrast, some other reform attempts, such as the CSC-led civil service reform, have benefited from external assistance while leaving the respective government agencies firmly in the positions of leadership.

2. Coordination across government agencies

4.16 The different facets of the ongoing reforms are led by different oversight agencies such as the DBM (e.g., MTEF, OPIF), COA (e.g., NGAS, e-NGAS), the CSC (e.g., pay reform), PAGC (e.g., internal control). Most of these measures require coordination among some of the oversight agencies, but the effectiveness of inter-agency coordination seems to vary.

4.17 An area that seems to suffer from this fragmented leadership is the integration of the various information systems. The development of separate information systems for planning, budget preparation, budget execution, cash management, budget monitoring and reporting, foreign-assisted project management and financial reporting could work effectively against meaningful coordination and meaningful reporting of actual outcomes (physical and financial) against budget.

3. Sustainability of the reform process

4.18 A key contributor to sustaining reform is permanence of reform champions. The current administration still has three more years before the next election, and this should be sufficient time to consolidate some of the ongoing reforms. But, the frequent changes in agency leadership that characterize the Philippine bureaucracy pose a particular threat in this sense. While the technical leadership in the central oversight agencies has been relatively stable, a number of line departments have seen rather frequent changes in their leadership. This has reportedly affected reform implementation in some cases.

4.19 Another risk is the apparent lack of strong reform impetus from the political level, either within the Executive or from the Legislature. There is no omnibus PFM reform bill or other government-wide policy that mandates PFM reforms. Many of the promising reforms have been initiated by technocrats as technical measures to improve the quality of specific aspects of the PFM cycle. Other reforms which started with a high-level commitment have not always progressed as originally envisioned.

4.20 Civil society has been an important source of reform impetus. But its emphasis has been on those reforms related to anti-corruption, such as procurement reform. Other reform areas, such as the effort to make budget decision-making more rational and policy-based (e.g., MTEF) have so far escaped attention of the civil society organizations. These are, however, precisely the areas where those who benefit from the lack of reform have strong vested interests to resist or obstruct reform efforts.

4.21 Therefore the situation is characterized by a combination of technocratic reform champions trying to maneuver within limited spaces and generally weak political impetus for pursuing comprehensive governance reforms. Many civil society groups are vigilant and active in pushing governance reforms but their attention is directed to certain areas at the neglect of others. Reform sustainability therefore depends on the ability of the technocratic reform champions to continue to push the agenda within the public sector and is more likely in those areas where civil society is already actively engaged, such as procurement reform. To the extent reform sustainability depends on active support of

well-meaning civil society groups, strong emphasis on transparency seems to be critical as a way of countering the manifested resistance from vested interests.

Annex 1: Performance Indicators Summary

Indicators		Rating	Brief Explanation
A. PFM-OUT-TURNS: Credibility of the Budget			
PI-1	Aggregate expenditure out-turn compared to original approved budget	Not Rated	It is not possible to calculate the expenditure out-turn ratio because of the impossibility of establishing a total approved budget ex ante, which in turn is due to, inter alia, unavailability of the ex ante figures for continuing appropriations in the budget documents.
PI-2	Composition of expenditure out-turn compared to original approved budget	Not Rated	It is not possible to calculate the variance in expenditure composition relative to overall deviation in primary expenditure because of the impossibility of establishing a total approved budget ex ante, which in turn is due to, inter alia, the unavailability of the ex ante figures for continuing appropriations in the budget documents.
PI-3	Aggregate revenue out-turn compared to original budget	A	Revenue out-turn was higher than projections in 2004 and 2005, and slightly lower (less than 1%) in 2006.
PI-4	Stock and monitoring of expenditure payment arrears	D+	Arrears are overstated, not being reduced and not well monitored/managed
B. KEY CROSSCUTTING ISSUES: Comprehensiveness and Transparency			
PI-5	Classification of the budget	D	The execution and reporting system does not use the budget classification.
PI-6	Comprehensiveness of information included in budget documentation	B	Budget documentation includes economic forecasts, prior year data, policy initiatives and debt level.
PI-7	Extent of unreported government operations	A	E.O. 292 imposes use of "one-fund" concept. Revolving fund and trust fund transactions remain off budget but are not material.
PI-8	Transparency of inter-governmental fiscal relations	B	Internal Revenue Allotments are determined by reference to revenues collected and distributed according to a formula based on land area, population and equal sharing. However, there is a lag in the availability of the annual LGU fiscal reports, sectoral classifications used between the BLGF reports and the BESF are inconsistent and ex-ante budgetary data are excluded.
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	C+	Although COA and DOF-CAG monitor most of the GOCCs, the failure to conduct valuation of contingent liabilities and consolidated analysis of performance and risks leaves reporting incomplete. Fiscal risk of LGUs is not documented.
PI-10	Public access to key fiscal information	C	The GOP discloses fiscal and budget information through various agencies' websites. However, posting of budget execution, contract awards, COA audit reports and availability of resources to service delivery units is not timely and are most of the time incomplete or entirely absent.

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Indicators		Rating	Brief Explanation
C. BUDGET CYCLE			
C(i) Policy Based Budgeting			
PI-11	Orderliness and participation in the annual budget process	B	Although the executive always submits budget documentation on time in accordance with a budgetary timetable, the budget law is passed with a 3-4 month delay or is sometimes not passed at all.
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting	D+	Development of Forward Estimates covering two forward years started in 2006, but the link to annual budget ceilings has yet to be firmly established.
C(ii) Predictability and Control in Budget Execution			
PI-13	Transparency of taxpayer obligations and liabilities	C	The basic guide available from BIR and the internet site is very clear. However, tax codes and the BIR-issued regulations and rulings especially for income tax are highly complex, unclear, and sometimes technically inaccurate.
PI-14	Effectiveness of measures for taxpayer registration and tax assessment	C	BIR registration process is sound and is associated with some data sharing. But the extent of registration is limited. Penalties tend to be written off to secure collections. Customs is less advanced.
PI-15	Effectiveness in collection of tax payments	D+	Collections are not reconciled with receipts and cash at bank
PI-16	Predictability in the availability of funds for commitment of expenditures	D+	DBM controls commitments (obligations) by issuing Agency Budget Matrix (ABM) or special allotment release orders (SAROs). SAROs in particular can be a source of unpredictability since agencies need to submit specific sets of additional documentations for SARO release on a case-by-case basis (no commitment ceiling or calendar). Poor reporting on budget execution makes it difficult to establish the actual extent of budget re-alignment (re-allocation).
PI-17	Recording and management of cash balances, debt and guarantees	B	BTr actively manages debt and consolidates cash balances but does not sweep interest, idle funds and other account balances from MDAs. RA 4860 sets the ceilings for foreign borrowings and guarantees.
PI-18	Effectiveness of payroll controls	C+	Human Resource records are not in place in all MDAs. Audit reports indicate overpayments are common and systematic payroll audits are not carried out.
PI-19	Competition, value for money and controls in procurement	B	Use of limited source procurement or shopping does not exceed 10% of the value of the contracts under the Annual Procurement Plan (APP) in 5 out of 10 agencies surveyed. However, audit reports still indicate that compliance with RA 9184 needs improvement.
PI-20	Effectiveness of internal controls for non-salary expenditure	D+	Vast majority of COA AAR opinions for national government agencies are either qualified or adverse.
PI-21	Effectiveness of internal audit	D+	Internal audit has not commenced in most MDAs

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Indicators		Rating	Brief Explanation
C(iii) Accounting, Recording and Reporting			
PI-22	Timeliness and regularity of accounts reconciliation	D	Un-reconciled discrepancy in BTr's NG book and bank balances amounting to Php5.65 billion and absence of complete/updated BRS. Overdue un-liquidated cash advances outstanding in every MDA per COA Annual Audit reports.
PI-23	Availability of information on resources received by service delivery units	D	No systematic reporting on resource usage by service delivery units exists.
PI-24	Quality and timeliness of in-year budget reports	D	Although there are a lot of reports required to be submitted by the line departments, these data are not consolidated by the DBM.
PI-25	Quality and timeliness of annual financial statements	D+	COA Annual Financial Report provides relatively complete information for national and local governments and GOCCs. But the financial audit report for BTr-National Government books and line departments highlights problems with underlying data.
C(iv) External Scrutiny and Audit			
PI-26	Scope, nature and follow up of external audit	B+	Quality financial audits are performed across Government. Most of COA's recommendations are acted upon, at least partially.
PI-27	Legislative scrutiny of the annual budget law	C+	Procedures for congressional reviews of the executive's budget proposal are clearly established and generally respected. Although executive has consistently submitted its budget proposal, approval of the GAA was delayed or in some years was not passed.
PI-28	Legislative scrutiny of external audit reports	D	There is no process in place for the legislature to systematically receive, scrutinize, and review audit reports and monitor the implementation of findings.
D. Donor Practices			
D-1	Predictability of Direct Budget Support	Not rated	Not applicable as direct budgetary support was not in place during the years under review.
D-2	Financial information provided by donors for budgeting and reporting on project and program aid	D	Information tends to be provided on a project-by-project basis and forward estimates tend not be provided by donors.
D-3	Proportion of aid that is managed by use of national procedures	D	National procedures are used for local procurement but all ICBs are managed through bilateral or multilateral agency's procurement and procedures framework.

Annex 2: Details of the Legal and Institutional Framework for PFM

Key constitutional provisions related to PFM

The Constitution sets forth a number of general and specific provisions related to matters of budgeting and fiscal and financial management. For example, it includes a number of provisions intended to guard against fiscal indiscipline, such as the prohibition for Congress to increase appropriations beyond the level proposed by the executive, or financial impropriety, such as the Section 29 of Article VI that proscribes inappropriate uses of appropriated and/or Treasury funds.

The Constitution grants the President a broad range of discretionary authorities over budgetary matters including line item veto and the rule that the Congress' failure to enact an appropriations bill automatically leads to "re-enactment" of the previous year's budget, while allowing the President to reallocate "savings."

It defines a set of constitutional or independent bodies and grants fiscal autonomy to some of them. It defines the jurisdiction and the mandates of one of these constitutional bodies, the Commission on Audit (COA), a key institutional player in PFM, as the body in charge of both matters related to audit and accounting of the entire public sector and public money.

The Constitution establishes a broad range of policy concerns as matters of general principles (e.g., "The State shall pursue an independent foreign policy") without any budgetary implication. An exception is the Section 5 of Article XIV, which specifically requires that the State "assign the highest budgetary priority to education."⁶⁵

On matters related to fiscal transparency, the Section 7 of Article III guarantees "the right of the people to information on matters of public concern" and declares that "access to official records, and to documents and papers pertaining to official acts, transactions, or decisions, as well as to government research data used as basis for policy development, shall be afforded the citizen, subject to such limitations as may be provided by law." Thus, although the Constitution guarantees the general right to information, enactment of a specific law referred to in the Section 7 is still pending to make this provision operational.

The roles of the legislature and the executive

- The Congress may not increase the appropriations recommended by the President for the operation of the Government as specified in the budget (Art. VI, Section 25-1).

⁶⁵ The Section continues to demand that the State "ensure that teaching will attract and retain its rightful share of the best available talents through adequate remuneration and other means of job satisfaction and fulfilment."

- No law shall be passed authorizing any transfer of appropriations; however, the President, the President of the Senate, the Speaker of the House of Representatives, the Chief Justice of the Supreme Court, and the heads of Constitutional Commissions may, by law, be authorized to augment any item in the general appropriations law for their respective offices from savings in other items of their respective appropriations (Art. VI, Section 25-5).
- If, by the end of any fiscal year, the Congress shall have failed to pass the general appropriations bill for the ensuing fiscal year, the general appropriations law for the preceding fiscal year shall be deemed re-enacted and shall remain in force and effect until the general appropriations bill is passed by the Congress (Art. VI, Section 25-7).
- The President shall have the power to veto any particular item or items in an appropriation, revenue, or tariff bill, but the veto shall not affect the item or items to which he does not object (Art. VI, Section 27-2).
- All money collected on any tax levied for a special purpose shall be treated as a special fund and paid out for such purpose only. If the purpose for which a special fund was created has been fulfilled or abandoned, the balance, if any, shall be transferred to the general funds of the Government (Art. VI, Section 29-3).
- The President shall submit to the Congress, within thirty days from the opening of every regular session as the basis of the general appropriations bill, a budget of expenditures and sources of financing, including receipts from existing and proposed revenue measures (Art. VII, Section 22).

Fiscal autonomy

- The judiciary and the three constitutional commissions (Commission on Elections, Commission on Audit, Civil Service Commission) as well as the Office of the Ombudsman “enjoy fiscal autonomy” and their appropriations shall be automatically released (Art. VIII, Section 3; Art. IX-A, Section 5; Art. XI, Section 14)). The judiciary’s appropriations shall not be reduced below the level appropriated for the previous year (Art. VIII, Section 3).

Jurisdiction and mandates of the Commission on Audit (COA)

- COA is a constitutional body charged with “the power, authority, and duty to examine, audit, and settle all accounts pertaining to the revenue and receipts of, and expenditures or uses of funds and property, owned or held in trust by, or pertaining to, the Government,” including GOCCs and other agencies” (Art. IX-D, Section 2-1) and no government entity should be exempted from COA’s jurisdiction (Art. IX, Section 3).
- The Commission shall have exclusive authority “to define the scope of its audit and examination, establish the techniques and methods required therefore, and promulgate accounting and auditing rules and regulations, including those for the prevention and

disallowance of irregular, unnecessary, excessive, extravagant, or unconscionable expenditures or uses of government funds and properties.” (Art. IX-D, Section 2-2).

National economic planning

- The Congress establishes an independent national economic and planning agency, National and Economic Development Authority (NEDA), to be headed by the President (Art. XII, Section 9).

Laws and other norms governing PFM

The principal law governing the structure and the functions of the public administration, including PFM-related matters, is the Executive Order (EO) 292, the Administrative Code of 1987. The EO292 specifies organizational and procedural details governing matters related to budgeting, accounting and auditing. In addition, the Code specifies the mandates, functions and the basic organizations of the key government agencies, including the DBM, the DOF, NEDA and COA.

The EO292 details specific provisions governing national government budgeting (Book VI), covering budget preparation, authorization, execution, and accountability as well as rules regarding expenditure of appropriated funds as well as government accounting and auditing. The Code’s coverage is comprehensive, and when additional details are to be provided, it specifies whose responsibility (e.g., DBM Secretary) it is to issue such details.

Some of the details that are relevant for the PEFA assessment include the following.

Planning-budgeting linkage

Section 4 expresses the ideal of annual budgets as an instrument for the attainment of national development goals and as part of the planning-programming-budgeting continuum. It calls for close coordination among the national planning, budgetary, fiscal authorities in determining the aggregate magnitudes of the budget, and requires that budgetary priorities be consistent with those specified in the approved national plans. By the same token, agency budget proposals are intended to be linked explicitly to approved agency plans.

Budget preparation

The preparation phase covers both the processes for individual agencies to prepare their budget estimates and for the executive branch, through the DBM, to submit its budget proposal to Congress. Section 12 itemizes the required content of the President’s budget submission to Congress, and this includes:

- A budget message that sets forth the government’s budgetary thrusts for the budget year;
- A specific set of summary financial statements on estimated and actual expenditures and receipts for the previous, the current, and the budget years, as well as on other financial and fiscal conditions (e.g., long-term indebtedness, treasury balance, etc.).

The Code demands a rational, policy and performance-based approach to agency budgeting. Section 14 specifies details to be included in agencies' budget estimates, while Section 16 calls for a zero-based assessment of each agency proposal, rather than an incremental adjustments or allocation based on other "rules of thumb." As basis for determining allocations to specific agencies, the Section singles out: (i) the agency proposal's relationship with the approved development plan; (ii) agency capability as demonstrated by past performance; and (iii) complementary (sic) role with related activities of other agencies.⁶⁶

Budget authorization

The chapter 4 on budget authorization defines the content of the General Appropriations Act (GAA) and defines key basic rules about appropriations. Of particular relevance is the relatively uncommon rule regarding automatic and continuing appropriations, which are generally not specified in the GAA.

Some of the salient details regarding budget authorization are:

- The GAA should be presented in the form of budgetary programs and projects for each agency (Section 23);
- Congress is not allowed to increase the appropriation of any project or program above the level proposed by the President (Section 24);
- Congress is not allowed to add special provisions to earmark the use of appropriations for specific programs (Section 25);
- All expenditures for (i) personnel retirement premiums, government service insurance, and other similar fixed expenditures; (ii) principal and interest on public debt; and (iii) national government guarantees of obligations which are drawn upon, are automatically appropriated (Section 26);
- Appropriations for capital outlays remain valid until fully spent or reverted (i.e., continuing appropriations), and continuing appropriations for current operating expenditures may be approved in support of projects whose effective implementation calls for multi-year expenditure commitments (Section 28).
- The President may approve reversion of funds no longer needed for activities funded by continuing appropriations (Section 28).

⁶⁶ Section 16 specifically notes that non-utilization of appropriated or released funds because of agency "savings" should not constitute a ground for reducing allocation to this agency in the subsequent budget.

Budget execution

The chapter 5 on budget execution details the steps and procedures for executing an appropriated budget, and clearly states that appropriated funds will be made available to departments with quarterly releases of allotments to be determined by the DBM secretary. The DBM secretary is also given the authority to modify or amend allotments previously issued in case of revenue shortages, and at the same time is required to maintain a control record of the budget execution details on a quarterly basis, including amounts allotted and available for expenditures, the unliquidated obligations, actual balance on hand, and the unencumbered balance of the allotments for each department or agency (Section 33). On the other hand, agency heads are prohibited from incurring expenditures or obligations beyond the allotments released by the DBM secretary (Section 41).

Section 39 stipulates that the President can authorize use of “savings” from the regular appropriations authorized in the GAA to cover a deficit in any other item of the regular appropriations, except funding of the creation of new positions or increase of salaries. The Code does not define what constitutes “savings,” nor does it set quantitative limits to the amount that can be transferred from “savings” to other expenditure items. This clause seems to amount to a fairly liberal rule regarding virement (transfer of appropriated funds from one category to another without legislative re-authorization).

Similarly, Section 49 permits use of “savings” for a variety of pre-specified purposes related to staff benefits and remunerations (e.g., salary adjustments of officials and employees as a result of classification action, payment of retirement gratuities or separation pay of employees separated from the service due to government reorganization, cash awards for deserving officials, etc.) and other ad hoc purposes (e.g., “priority activities that will promote the economic well being of the nation,” repair, improvement and renovation of government buildings and infrastructure, etc.).

Budget accountability

The Code gives proper emphasis on the importance of timely monitoring, evaluation, and reporting of agency performance in executing the budget. The DBM Secretary is charged with the responsibility of:

- evaluating the quantitative and qualitative measures of agency performance on a continuing basis (Section 51);
- determining accounting and other information requirements for the purpose of monitoring budget performance and to assess agencies’ operational effectiveness (accounting rules and regulations are to be issued by COA) (Section 52);
- developing categories for recording agency expenditures (Section 53);
- developing standard costs for “duly approved units of work measurement for each agency’s budgetary projects or activities” (Section 54); and

- reviewing each agency’s budgetary program and project structure, as a basis for modifying or amending such structure (Section 55).

For their part, agency heads are required to file semi-annual reports on accomplishments, following the content and format to be prescribed by the DBM secretary (Section 56). Failure to submit these reports would “automatically cause the suspension of payment” of the salaries of the officials responsible for reporting (i.e., agency heads, chief accountants, budget officers, etc.) (Section 57).

A summary of the budgetary framework arising from the legislation, prior year GAAs and EO292 has been placed in the table below.

Table A2-1: Budget Framework

New General Appropriation - General Appropriation Act
Automatic Appropriation
Continuing Appropriation
Unreleased appropriation
Unobligated Release
Budgetary Adjustments
Transfer to savings
Transfers from Special Purpose Funds
Supplemental Appropriation
Available appropriation

Source: GOP Budget of Expenditure and Source of Financing

Government accounting and auditing

The EO charges COA with the responsibility of promulgating auditing and accounting rules and regulations (Section 10, Chapter 4, Subtitle B, Title 1). While the Code specifies the mode of COA’s audit as post-audit, it also allows the Commission to adopt temporary or special pre-audits in cases where the internal control system of the audited agencies is inadequate (Section 11-(1)).

The Commission is granted the exclusive authority to define the scope of its audit and examination, establish the techniques and methods required, and promulgate accounting and auditing rules and regulations (Section 11-(2)).⁶⁷ The other sections of the Chapter 4 define specific jurisdiction, powers and functions of COA.

In implementing these requirements COA issued a manual on the New Government Accounting System (NGAS) for National Government Agencies, based on the principle of accrual accounting. Section 73 of the Manual on NGAS states that: “Responsibility for the fair presentation and reliability of financial statements rests with the management of the reporting agency. This responsibility is discharged by applying generally accepted

⁶⁷ The Constitution includes an identical clause as is also the case with a number of other provisions of the EO292.

state accounting principles that are appropriate to the entity's circumstances, by maintaining effective system of internal control and by adhering to the Chart of Accounts prescribed by the Commission on Audit."

COA's audit functions are codified in Presidential Decree 1445 or the "Government Auditing Code of the Philippines.

Procurement

The overall framework for public procurement is defined in the 2003 Government Procurement Reform Act (RA 9184). The RA9184 replaced a myriad of previous laws and regulations, many of which were mutually inconsistent and together provided for a procurement governance framework that presented a number of problems such as prevalence of limited competition, susceptibility to corruption, and constraints to participation of foreign bidders, among others. The RA9184 has served not only as a basis for less cumbersome and more transparent government procurement but also for effective harmonization of procurement rules and regulations for both the government and major international financial institutions.

Specifically the Act mandated: (a) creation of a single oversight body, the Government Procurement Policy Board, with comprehensive powers and authority to protect national interest in all matters concerning public procurement; (b) the use of E-Government Procurement through the Philippine Government Electronic Procurement System (PhilGEPS); (c) linking procurement plans to budget system through the Annual Procurement Plans; (d) the issuance of standard bidding documents, contracts and forms; (e) defined protest and complaint mechanisms; (f) training and professionalization of procurement practitioners; (g) criminalizing procurement irregularities and imposing criminal, civil and administrative sanctions thereof; and (h) presence of civil society organization as observers in the bidding process.

Inter-governmental fiscal relations

The principal features of the Philippines' intergovernmental fiscal relations are established in the 1991 Local Government Code (LGC). Prior to the passage of the LGC, the LGUs' functions were limited to: (i) levying and collecting local taxes, (ii) regulating business activities, and administration of garbage collection, public cemeteries, public markets and slaughterhouses. The Code significantly broadened the LGUs' roles into service delivery in multiple sectors including: (i) agricultural extension and research; (ii) social forestry; (iii) environmental management and pollution control; (iv) primary health and hospital care; (v) social welfare services; (vi) repair and maintenance of infrastructure; (vi) water supply and communal irrigation; and (vii) land use planning.

On the revenue side, the LGC assigns a set of local taxes including property tax (only to provinces and cities) and taxes, fees, and levies on other miscellaneous local-level economic assets and activities. The LGC explicitly reserves income taxes, value-added taxes, customs duties, and excise taxes on specific products (so-called sin taxes) to the national government.

The most important source of LGU revenue is the Internal Revenue Allotment (IRA), an intergovernmental fiscal transfer from the national government to LGUs based on a legally-fixed formula. Currently, the IRA formula is based on the LGU's population and land area as well as on the principle of equal sharing among them. The total amount available for the IRA is determined as 40 percent of the actual internal revenue tax collections by the national government three years prior to the current year. In addition to the expanded taxing authorities and the IRA, the LGC also allowed the LGUs to finance their expenditures with private credits such as by floating their own bonds or entering into build-operate-transfer contracts.⁶⁸

The organization of the public sector related to PFM functions

The Philippine state is organized under a presidential system with separation of powers among three co-equal branches, the executive, the legislature, and the judiciary. The President and members of the bicameral legislature are elected separately. In the Judiciary, the Supreme Court has administrative supervision over all courts and the personnel.

Legislature

The Philippine national legislature consists of the Senate of 24 seats one-half of which are elected every three years for six-year terms and the House of Representatives of 212 members elected to serve three-year terms. Each chamber has standing committees which handle public finance issues. In the House, these include the Committee on Appropriations which handle budgetary matters and the Committee on Ways and Means which handles taxation and other forms of government revenues and financing. In the Senate, the Committee on Finance oversees government budgeting, including auditing of accounts and expenditures of the national government, while the Committee on Ways and Means covers matters related to government revenues in general. In addition, the Senate has the Committee on Accountability of Public Officers and Investigations with jurisdiction over matters relating to investigation of malfeasance by government officers and employees and other matters of public interest. This committee, however, is not like public accounts committee in some parliamentary systems with the explicit responsibility of receiving and review audit reports.

In the annual budget process, Congress' principal role is to approve the annual General Appropriations Acts (GAAs). The deliberations start in the Committee on Appropriations of the House of Representatives, which receives the president's budget proposal. The House version is then passed on to the Senate's Committee on Finance. Any discrepancy between the two versions will then be discussed and compromises reached in the bicameral conference committee composed of members nominated by the respective chambers.

⁶⁸ Details of the fiscal aspects of the LGC are found in Rosario G. Manasan (2004), "Local Public Finance in the Philippines: In Search of Autonomy with Accountability," Philippine Institute of Development Studies Discussion Paper Series No. 2004-42.

The House is supported by the Congressional Planning and Budgeting Department, which conducts independent analysis of budgetary and economic policy matters.

Executive

The executive branch is led by the President, who is elected to a single term of six years with no reelection. Between the broad discretionary authorities on budgetary matters granted by the Constitution and other legal norms such as the EO292 and the power to make thousands of appointments to senior government posts,⁶⁹ the President influences formulation of policies (and the corresponding resource allocations) and their execution by the bureaucratic machinery of the state. Table 4-2 below presents key budgetary powers of the Philippine president.

Table A2-2: Budgetary Powers of the President in the Philippines

Veto	1. Package Veto 2. Item Veto
Gate Keeping/Agenda Setting	1. Exclusive Introduction 2. Ceiling of Total Amount
Decree*	No
Reversion	Carryover of Previous Budget
Implementation	1. Imposing Savings and Augmenting Items under the Executive Branch 2. Control over Fund Release

* Although the President has the power to issue executive orders for budget implementation, she has no power to enact a budget itself without congressional authorization, unlike her counterparts in Argentina and Chile.

Source: The 1987 Constitution, adopted from Kawanaka (2007).

Three oversight agencies, the National Economic and Development Authority (NEDA), the Department of Budget and Management (DBM), and the Department of Finance (DOF), coordinate the planning and budgeting cycle for the national government.

National Economic and Development Authority

NEDA is mandated by the Constitution and the EO292 as the country’s economic development and planning agency. It is headed by the President as chairman of the NEDA board, with the Secretary of Socio-Economic Planning, concurrently NEDA Director-General, as vice-chairman. A majority of Cabinet members and the Central Bank Governor are members of the NEDA Board. The NEDA Secretariat, composed of technical staff, supports the Board in its decision-making.

NEDA’s primary responsibilities are to formulate the Medium-Term Philippine Development Plan (MTPDP), the Medium-Term Public Investment Programs (MTPIP)

⁶⁹ Some of the senior appointments, such as those of cabinet secretaries, require confirmation by the Congressional Commission on Appointments.

and corresponding annual plans and programs and to coordinate programming of official development assistance. Along with the heads of other oversight agencies, the NEDA Director-General chairs or participates in several inter-agency committees (BoxA2-1).

Box A2-1: Relevant Inter-Agency Committees

- *Development Budget Coordination Committee (DBCC)*: Composed of the NEDA Director-General, the Executive Secretary, and the Secretaries of Finance and Budget and Management. The DBCC recommends to the President the level of the annual government expenditure program and its allocation government spending.
- *Investment Coordination Committee (ICC)*: Composed of the NEDA Director-General, the Executive Secretary, the Secretaries of Finance, Agriculture, Trade and Industry, and Budget and Management. The ICC's responsibilities are to evaluate fiscal, monetary and balance of payments implications of major national projects and recommend to the President an annual borrowing program.
- *Committee on Infrastructure (INFRACOM)*: Composed of the NEDA Director-General, the Executive Secretary, and the Secretaries of Public Works and Highways, Transportation and Communications, Finance, and Budget and Management. INFRACOM coordinates activities of government agencies, including government-owned or controlled corporations in infrastructure development.

Department of Budget and Management

The DBM is responsible for formulation and implementation of the national government budget. It coordinates preparation of the President's budget proposal based on submissions from the line departments and agencies. Besides, the DBM oversees the Procurement Service as its attached agency. The Procurement Service carries out centralized procurement of common-use goods and supplies for the entire government and acts as a procuring agent for government agencies that request its support for a fee. The DBM Secretary chairs the 15-member Government Procurement Policy Board (GPPB), an oversight body for matters related to government procurement that was created on the basis of the RA9184. The GPPB is supported by its own Technical Support Office.

The DBM's primary function is to lead the national government budget process. During the preparation phase, the DBM leads the process by issuing a national budget call. The budget call establishes the principles of budget preparation, defines the macroeconomic framework, assigns budget ceilings to departments and other national government agencies, and determines the calendar for budget preparation. For the 2007 and 2008 budgets, the DBM has revived a medium-term expenditure framework (MTEF) and the operational performance indicators framework (OPIF) as tools for guiding budget formulation.

Box A2-2: MTEF and OPIF

The MTEF consists of calculation of forward estimates of the budgetary costs of ongoing policies, programs and projects, estimation of “allocable” fiscal space as the difference between the estimated total revenue and the sum of the forward estimates, and identification of policy priorities (as recommendations to the DBCC, the cabinet, and the President) in a Paper on Budget Strategy (PBS).

OPIF is a structured framework for clarifying major final outputs (MFOs) of agency budget programs. Through the budget call, the DBM instructs line agencies to align their programs, projects and activities to their respective MFOs, and thus aims to ensure that their budget structure is aligned with their formal performance objectives and targets.

The DBM remains a central player in the execution phase. After the passage of the GAA, agencies are not allowed to incur expenditures until the DBM authorizes them to do so. The DBM’s authorizations for budget execution take several forms at different stages of the budget execution cycle. First the agencies obtain authorizations to commit (or obligate) expenditures when they receive allotment release orders from the DBM. The DBM releases allotment release orders either “in block” (as part of the Agency Budget Matrix) early in the budget year for a certain group of expenditure items, or individually via Special Allotment Release Orders (SAROs) which are released in exchange for specific documentation by the agencies concerned. Subsequently, the DBM authorizes agencies to make cash payments by issuing Notices of Cash Allocation (NCA) or Non-Cash Availability Authority (NCAA). Throughout the execution phase, the DBM requires agencies to submit a series of reports on budget execution and accountability for monitoring and control purposes.

Department of Finance

The DOF is in charge of the government’s fiscal policies and management of its financial resources overall. Among the DOF’s key functions related to PFM are oversight of the main revenue administration agencies, the Bureau of Internal Revenues (BIR) and the Bureau of Customs (BOC) and management of the government’s cash resources and public debts through the Bureau of Treasury (BTr). The BTr coordinates with the DBM in determining the amounts the agencies are allowed to pay during budget execution (through joint circulars with the DBM). In addition, the DOF supervises selected GOCCs through its Corporate Affairs Group and fiscal and financial affairs of LGUs through its Bureau of Local Government Finance.

Line departments

Departmental secretaries are appointed as the administrative head of departments and assigned specific responsibilities for financial management, including the requesting of allotment of appropriation under Executive Order 292. Section 2 of the Presidential Decree 1445 states that fiscal responsibility rests directly with the chief or head of the agency.

Government Owned or Controlled Corporations. According to the DOF’s Corporate Affairs Group, the total population of GOCCs is in the order of 700, some 500 of which

are local water districts classified as GOCCs by a Supreme Court decision. Some of them operate on a purely commercial basis, but many of them execute public policy functions with or without financial subsidies from the government.

Judiciary

The judiciary is headed by the Supreme Court and its Chief Justice. The Supreme Court is composed of 15 justices appointed by the President from among three candidates recommended by the Judicial and Bar Council. Once appointed, the justices serve until 70 years of age. Special courts include a Sandiganbayan for hearing corruption cases against government officials, and Court of Tax Appeals, among others.

Constitutional Offices

Commission on Audit

COA is constitutionally responsible for external audit of all government entities, mandating an accounting and auditing framework and is responsible for the issue of the Annual Financial Statements of Government. Unlike in other systems where the supreme audit institutions remain independent of the executive branch and report to the legislative branch, COA in the Philippines is independent from both branches, given its status as a constitutional commission. The constitution grants fiscal autonomy to COA and the other constitutional commissions.

COA comprises the chairman and two commissioners, who should have no less than ten years of auditing experience as certified public accountants or practicing law for at least ten years as members of the Philippine Bar and may not have held any elected position immediately before their appointment. The chairman and the commissioners are appointed for a 7-year term without reappointment. The appointments are by the President with the consent of the Congressional Commission on Appointments.

The Constitution defines that COA “shall have the power, authority, and duty to examine, audit, and settle all accounts pertaining to the revenue and receipts of, and expenditures or uses of funds and property, owned or held in trust by, or pertaining to, the Government, or any of its subdivisions, agencies, or instrumentalities, including government owned- or controlled corporations with original charters, and on post-audit basis” (Art. IX, D, Section 2-1). COA is responsible for submitting to the President and the Congress an annual report covering the financial condition and operation of the government, including recommendations to improve their effectiveness and efficiency.

Other constitutional offices

In addition to COA, the Constitution established two other constitutional commissions, the Civil Service Commission (CSC) and the Commission on Elections (COMELEC) as well as other constitutional bodies, which are the Commission on Human Rights, the Office of the Ombudsman (OMB), NEDA, and the Central Bank (BSP).

Annex 3: NGAS and Budget Account Classification

NGAS	BUDGET
<p>REVENUE/INCOME</p> <p>Subsidy Income from National Government</p> <p>Subsidy from Central Office</p> <p>Subsidy from Regional Office/Staff Bureau</p> <p>Subsidy from Other LGUs</p> <p>Subsidy from Other Funds</p> <p>Subsidy from Special Accounts</p> <p>Income from Government Services</p> <p>Income from Government Business Operations</p> <p>Sales Revenue</p> <p>Rent Income</p> <p>Insurance Income</p> <p>Dividend Income</p> <p>Interest Income</p> <p>Gain on Sale of Securities</p> <p>Gain on Sale of Assets</p> <p>Sale of Confiscated Goods and Properties</p> <p>Foreign Exchange (FOREX) Gain</p> <p>Miscellaneous Operating and Service Income</p> <p>Fines and Penalties – Government Services and Business Operations</p> <p>Income from Grants and Donations</p>	
<p>EXPENSES</p> <p>Personal Services</p> <p>Salaries and Wages</p> <p>Life and Retirement Insurance Contributions</p> <p>PAG-IBIG Contributions</p> <p>PHILHEALTH Contributions</p> <p>ECC Contributions</p> <p>Pension and Retirement Benefits</p> <p>Other Personnel Benefits</p>	<p>CURRENT OPERATING EXPENDITURES</p> <p>Personal Services</p> <p>Civilian Personnel</p> <p>Permanent Positions</p> <p>Salaries and Wages</p> <p>Other Bonuses and Allowances</p> <p>Life and Retirement Insurance Contributions</p> <p>PAG-IBIG Contributions</p> <p>PHILHEALTH Contributions</p> <p>ECC Contributions</p> <p>Pension and Retirement Benefits</p> <p>Other Personnel Benefits</p> <p>Total Compensation</p> <p>Non Permanent Positions</p> <p>Total Compensation</p> <p>Military Uniformed Personnel</p> <p>Salaries and Wages</p> <p>Other Bonuses and Allowances</p> <p>Life and Retirement Insurance Contributions</p> <p>PAG-IBIG Contributions</p> <p>PHILHEALTH Contributions</p>

Philippines Public Expenditure and Financial Accountability

NGAS	BUDGET
	ECC Contributions Pension and Retirement Benefits Other Personnel Benefits Total Compensation
Maintenance and Other Operating Expenses Travelling Expenses Training and Seminar Expenses Water Electricity	Maintenance and Other Operating Expenses Travelling Expenses Communication Repair and Maintenance Transportation and Delivery Expenses
NGAS	BUDGET
Cooking Gas Telephone/Telegraph and Internet Postage and Deliveries Subscription Expenses Advertising Expenses Rent Expenses Insurance Expenses Printing and Binding Expenses Accountable Forms Expenses Office Supplies Expenses Medical, Dental and Laboratory Supplies Expenses Food/Non-food Expenses Gasoline, Oil and Lubricants Expenses Agricultural Supplies Expenses Legal Services Auditing Services Consultancy Services General Services Security and Janitorial Services Taxes, Duties and Licenses Tax Credit Subsidy Repairs and Maintenance Awards and Indemnities Extraordinary and Miscellaneous Expenses Confidential and Intelligence Expenses Anti-Insurgency/Contingency Expenses Subsidy to National Government Agencies Subsidy to Local Government Units Subsidy to Government Corporations Membership Dues to International Institutions Depreciation Bad Debts Expense Loss on Sale of Assets Other Expenses Financial Expenses	Supplies and Materials Rents Interest Subsidies and Donations Utility Expenses Training and Scholarship Expenses Extraordinary and Miscellaneous Expenses Confidential and Intelligence Expenses Taxes Insurance Premiums and Other fees Professional services Printing and Binding Expenses Advertising expense Representation Expenses Storage Expenses Subscription expense Survey Expenses Membership Dues and contributions to organisations Awards and Indemnities Rewards and other claims

Philippines Public Expenditure and Financial Accountability

NGAS	BUDGET
Bank Charges Interest Expenses Other Financial Charges Foreign Exchange (FOREX) Loss	
	Capital Outlays Investment outlay Loan outlay Livestock and crops outlay Land and improvements outlay Building and Structures outlay Office Equipment furniture and fixtures Machineries and equipment Public Infrastructure Reforestation projects Net Lending
	TOTAL OBLIGATIONS OF THE NATIONAL GOVERNMENT

Annex 4: Officials Consulted

The Government of the Philippines

Laura B. Pascua, Undersecretary, Department of Budget and Management
Omar T. Cruz, Treasurer of the Philippines
Ma. Teresa S. Habitan, Director, Fiscal Policy and Planning Office, Department of Finance
Marietta U. Lorenzo, Assistant Commissioner, Policy and Planning Service, Bureau of Internal Revenue Department of Finance
Cynthia Santos, Bureau of Internal Revenue Department of Finance
Angelito Ursabia, Acting Director, Collections Bureau of Customs
Evie Villarin, Collections Bureau of Customs
Mario Mantaring, Office of Legal Services Bureau of Customs
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