

FISCAL AND FINANCIAL MANAGEMENT IN LOCAL GOVERNMENTS

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COMPONENTS

- As to fiscal elements
 - Revenues/Income
 - Borrowings
 - Operating costs
 - Capital investments
- As to process
 - Local budget and financial system
 - Performance monitoring and evaluation

Part 1. FISCAL ELEMENTS

Local Fiscal Policy

- Pertains to the management of the revenues and borrowed funds and the use of such resources to provide public goods and services to citizens in local units
- Governed by the constitution, existing laws and guidelines
 - Limited powers on taxation and incurrence of debt
 - Specific functions and responsibilities
- Highly dependent on country political and economic structure
 - unitary governments--- centralized
 - Federal governments--- decentralized

Revenue Administration

- **Revenues are income from**
 - non-repayable sources generated by virtue of its inherent power to tax as well as regulatory powers
 - fees/proceeds from market transactions
- **Types of revenues**
 - revenue sharing from central government
 - other subsidies
 - local revenues
 - real property tax
 - business permits/licenses
 - fees and charges
 - operations of local enterprises
- **Management of collection system**
 - assessment of taxes
 - collection of taxes and other revenues

Tax Assignment

- The act of the Legislature granting power to either the central or local government to impose taxes on persons, activities or assets within the jurisdiction of that government.
- In general, central governments are assigned broad tax powers; LGUs more limited tax powers.
- Taxes should be assigned to the lowest level of government that can effectively implement them.

Sharing of National Revenues

- a mechanism whereby central government shares its revenues to local government through direct budgetary transfer
- In the Philippines: Internal Revenue Allotment (IRA)

Purposes of Revenue Sharing

- **Local revenue expansion**
 - to augment the amount of resources available to local governments
- **Resource equalization**
 - to provide more funds to relatively resource-deficient local governments
- **Incentive tool**
 - to give incentives for priority programs and projects
 - to encourage the undertaking of desired policy initiatives

Features of Revenue Sharing

- **Amount or magnitude of annual transfer**
 - fixed percentage
 - fixed magnitude
 - mixed
- **Distribution of amount transferred to local governments**
 - fixed formula
 - variable formula based on committee/group proposal
 - variable, based on periodic evaluation
- **Use of resources transferred**
 - unconditional
 - conditional

Philippine Case: Sharing of Revenue

- **Internal Revenue Allotment**
- **Share in national wealth**
 - 40% of gross collections or preceding year from mining taxes and royalties, forestry and fishery charges and related charges
- **Share in tobacco taxes**
 - 15% of excise tax collections on locally manufactured Virginia-type cigarettes
- **Share in value added tax**
 - 50% of VAT incremental collected in the area

Internal Revenue Allotment (IRA)

- 40% of gross internal revenue tax of 3rd preceding year
- distributed by fixed formula:
 - a) LGU group share:
 - provinces - 23%
 - cities - 23%
 - municipalities - 34%
 - barangays - 20%
 - b) LGU individual share:
 - population - 50%
 - land area - 25%
 - equal sharing - 25%
- unconditional grant, provided 20% used for development projects

Sample Calculation of IRA Distribution

- Amount of IRA:

Gross internal revenue tax,
3rd preceding year (c/o BIR) - - - - P 500 B

40% ----- 200 B

=====

- Distribution by LGU Group:

Province : P 46 B
Cities : 46
Municipalities : 68
Barangays : 40

P200 B
=====

Sample Calculation of IRA Distribution ... cont'd

- Distribution by Individual LGU:

Province	Population			Land Area			Equal Sharing (billion pesos)	TOTAL (billion pesos)
	#	%	Amount (billion pesos)	sq.km.	%	Amount (billion pesos)		
Province 1	180,000	30	6.9	24,000	30	3.45	3.83	14.2
Province 2	300,000	50	11.5	8,000	10	1.15	3.83	16.5
Province 3	120,000	20	4.6	48,000	60	6.90	3.83	15.3
TOTAL	600,000	100	23.0	80,000	100	11.50	11.5	46.0

Internal Revenue Allotment

Particulars	2008	2009	2010
Amount of IRA (billion pesos)	210.7	250.0	265.8
Amount of LGU expenditures (billion pesos)	233.1	259.5	337.4
% of LGU budgets funded by IRA	90.4	96.3	78.8

Other Subsidies from National Government

- subsidies for local projects
 - Infrastructure
 - Health
 - Social services
 - Other services
- calamity assistance
- credit assistance

Purposes of Local Tax Assignment

- to provide local governments with revenue they can control
- to increase the accountability of the local government
- to increase fiscal discipline of the local government
- to ensure real autonomy of local government operation

Features of Local Taxes

- use benefit principle
- administrative feasibility
- limit tax export
- minimize excess burden and distortion
- provide revenue stability
- prefer revenue elasticity
- prevent destructive tax competition

Common Local Revenues and Taxes

- **User Charges**
 - excellent source of local revenue
 - ✓ economically efficient
 - ✓ fair and equitable
- **Property Tax**
 - most commonly used local tax
 - easy to administer
- **Excise Tax**
 - must be collected at the retail sales level
 - collected ex-factory is distortionary and unfair
- **Retail Sales Tax**

Borrowing and Debt

- Borrowing – funding from repayable resources; a substitute for taxing immediately where people with relatively low preference for present consumption lend to those with relatively high preference for present consumption
- In public sector, initially considered as “extraordinary finance”, resorted to only during wars and economic depression. Later, considered an efficient source of funding for many public projects with foreseeable future benefits

Purposes of Borrowing

- To finance a budget deficit
 - working capital requirements in the short-term
- To finance capital investment projects
 - undertake long term investments anticipated to improve productive or revenue generating capacity of LGU
- To monetize future revenue
 - revenue anticipation bonds
- Refinancing of existing debt

Sources of Borrowings

- **sources**
 - project loans
 - bond market
 - loans from central government
 - short term bond accommodations
- **limitations on debt**
 - imposed by central governments to ensure local fiscal prudence
 - general limitation on foreign denominated debt

Factors Affecting Credit Worthiness

- **Local fiscal balance**
 - deficit may show low revenue capacity or aggressive spending
 - surplus may show absence of viable projects or inability to push projects through the political process
 - strong financial position of local unit, i.e., good financial indicators, comfortable cash position, etc.
- **Fiscal relations with national government**
- **Debt burden and contingent liabilities**
- **Strength of financial management**
 - revenue management and institutions
 - fiscal and financial transparency
- **Use of credit enhancement**
 - insurance
 - guarantee by the government or by independent public or private guarantee firms
- **Political stability**

Improving Financial Transparency

- standardizing local management financing report
- public disclosure of LG budgets
- independent audit of financial report of LG
- monitoring the local debt service and other financial ratios by the NG

Credit Quality

- **Credit quality affects market acceptance and debt pricing**
 - ↑ credit quality,
 - ↑ degree of acceptance,
 - ↓ cost of debt
- **Credit rating as a way to determine credit quality**
 - provides independent and neutral opinion
 - evaluated by Rating Agency based on likelihood of default
 - reflects both the capacity and willingness of local government to make timely payment of principal and interest obligations
 - reflects risks involved

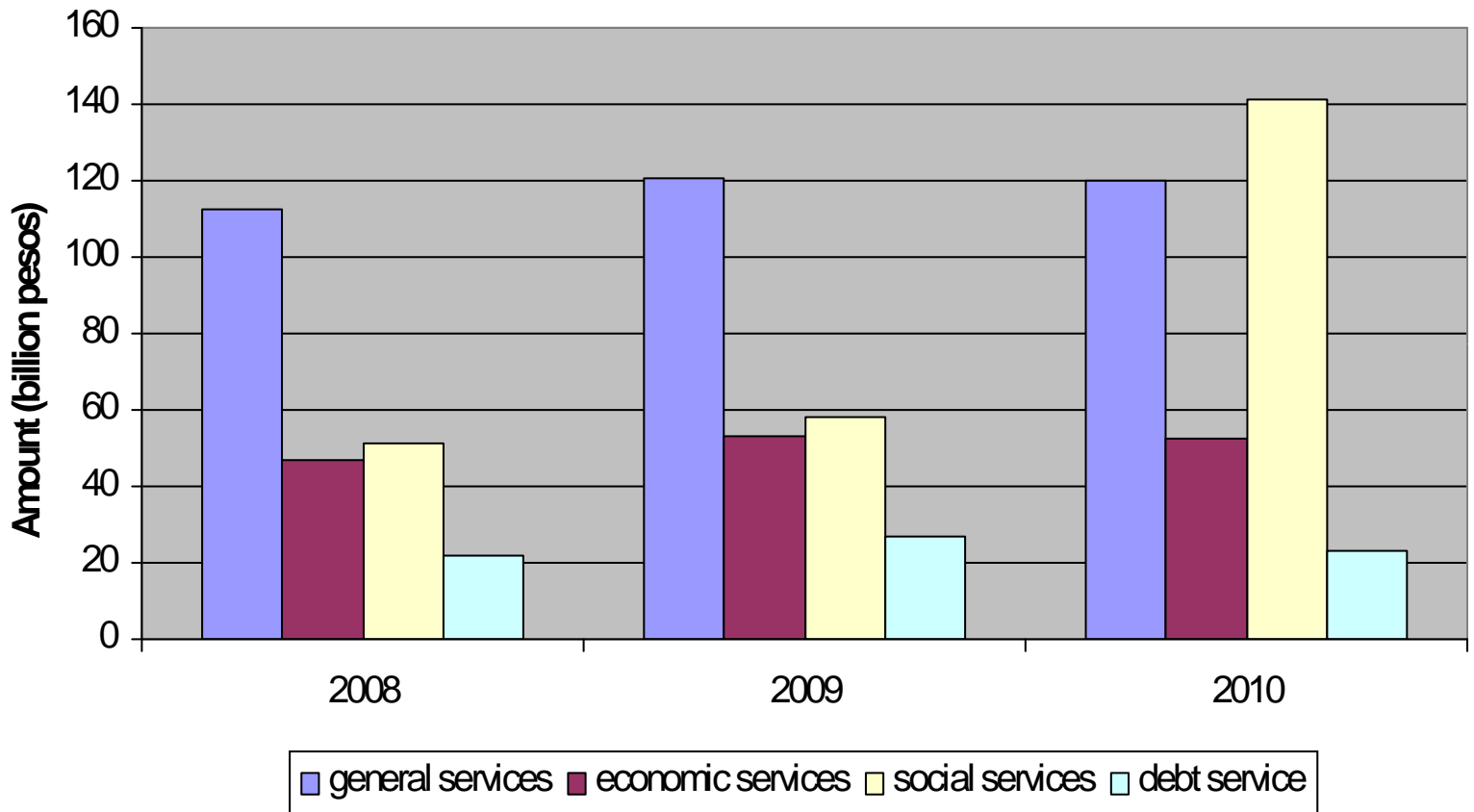
Expenditures

- Purposes: prescribed by law and local ordinance
 - social services (health, social assistance, education, etc)
 - infrastructures
 - agriculture and related services
 - calamity assistance
 - general services
- Limitations of expenditures
 - restrictions on share of salaries
 - limits on position/staffing

Distribution of Local Expenditures, by Major Sector (billion pesos)

Particulars	2008	2009	2010
General Services	112.6	120.7	119.9
Economic Services	47.1	53.4	52.7
Social Services	51.2	58.3	141.4
Debt Service	22.1	27.1	23.4

Distribution of Expenditures, by Major Sector



Fiscal Position of Local Governments, 2008 - 2010

Particulars	2008	2009	2010
Revenues (1)	259.5	294.5	314.8
IRA	170.0	201.3	213.9
Local taxes	48.6	51.5	54.3
Other revenues	40.9	41.7	46.6
Expenditures (2)	233.1	259.5	337.4
Surplus/(Deficit) (3)	26.4	35.0	(22.6)
Borrowings (4)	9.2	9.6	6.8
Change in Cash (5 = 3+4)	35.6	44.6	(15.8)
Beginning cash balance (6)	21.6	57.2	101.8
Ending cash balance (7 =6+5)	57.2	101.8	86.0

Part 2. FINANCIAL MANAGEMENT PROCESS

THE BUDGET SYSTEM

- prescribed by country statutes, laws
- consistent with political, economic structures
- determined by constituency requirements/demands
- influenced by practices in other countries and political subdivisions
- in subnational governments, generally patterned after the budget system of the central or national government

“The public sector budget is the document resulting from a process where, in a free society, the individual and government enter into a social contract whereby private resources are exchanged for public resources for the common good.”

BUDGET CONCEPTS

- unified or public sector budget vs. administrative or general budget
- recurrent or operating budget vs. capital or development budget
- cash budget vs. accrual budget
- line-item budgets vs. performance-based budgets
- baseline vs. zero-based budget

BUDGET CYCLE

Preparation / formulation

Legislation and approval

Execution and control

Accountability, review and audit

Preparation/Formulation

➤ **Pre-budget activities**

- review of local programs, objectives, issues
- review of overall budget policy, management issues, budget impact of previous decisions
- analysis of economic developments; tentative targets
- issuance of initial budget guidelines

➤ **Budget preparation**

- intra-agency budget review
- costing of agency program initiatives
- preparation of funding proposals
- transmittal of proposal to local budget unit

Preparation/Formulation . . . cont'd

- **Preparation of overall budget**
 - review of competing claims and proposals
 - negotiations on budget proposals
 - consolidation of approved agency proposals
 - approval by local chief executive
- **Transmittal of consolidated budget to local council or legislative body**

Budget Formulation : Issues

- Size of the budget: local fiscal policy, deficit policy, extent of service provision
- Size of intergovernment transfer from central government
- Level of discretionary vs. mandatory expenditures
- Compliance to legally mandated expenditure restrictions
 - limits to borrowings
 - limits to revenue or tax power
 - other restrictions

Budget Formulation : Issues

. . . cont'd

- Recognition of “non-expenditures”
 - contingent liabilities
 - loan and credit guarantees
 - performance guarantees
 - repayment of debt
- Level of transfers to subnational governments, local enterprises and special purpose entities
- ODA or foreign-funded projects
 - priority claims? commitments?

Legislation and Approval

- Conduct of budget hearings
 - Evaluation of current budget programs
 - Review of issues carried over from previous budgets
 - Review of actions taken from audit reports
 - Analysis of new program initiatives
- Vote on individual agency budgets
- Vote on consolidated budget proposal
- Signing of budget appropriation/authority

Budget Legislation: Issues

- Failure to enact budget
 - “automatic repeat” or reenacted budget
 - continuing resolution by legislative authority

- “Off-budget” entities or activities

- Supplemental budgets
 - emergency requirements
 - expansion programs from windfall revenues

Budget Legislation: Issues . . . cont'd

- Earmarked or special purpose revenues
 - sunset provisions
 - period limits

- Automatic expenditures
 - debt service
 - personnel insurance contributions

Execution and Control

- Apportionment of budget authority
- Allotment of budgets to spending agencies
- Commitment of funds
- Incurrence of obligations
- Payment/liquidation of obligations
- Reporting of transactions and results

Execution: Issues

- implementation of “directed” funds
- budget authorizations as “orders to spend” vs. “limits to spending”
- budget impoundment and sequestration
- budget realignment
- use of program/project savings
- use of unutilized budget authority
- contingency budget authority
- expenditure and revenue tracking

Review and Audit

- Examination of reports and records of transactions
 - comprehensive or system audit
 - audit of internal control system
 - general or compliance audit
 - examination of books of disbursing and certifying officers to determine compliance with laws, rules and regulation
 - special audit
 - examination of selected transactions or programs

Review and Audit . . . cont'd

- Reporting of overall fiscal and status of local government
 - external audit: expression of opinion on whether or not financial statements present fairly the results of operation of the local governments for the period indicated

- Recommendation of remedial or punitive measures, when necessary

Review And Audit: Issues

- monitoring of budget performance
 - progress reports
 - periodic assessments and implementation of remedial measures
- value-for-money vs. financial audit
- external audit vs. internal audit
- pre-audit vs. post-audit
- simplification of reportorial requirements
 - harmonization of reporting formats
 - streamlining of reports
 - emphasis on report timeliness
- disposition of adverse audit findings

BUDGET REFORM

- medium-term expenditure framework
- budgeting for results
 - organizational performance indicators
 - budget performance indicators
- budgeting for performance
- budget transparency provisions
- the role of civil society

Fiscal management issues usually emerge as the leading issues in local elections.

Decisions pertaining to tax increases, expenditure cuts or allocation and local debts oftentimes spell the difference between winning or losing an election.

Where budget decisions are rational and clearly understood by citizens, sound local fiscal management remains the best avenue towards good local service delivery and election victory.

LOCAL FINANCIAL MONITORING AND PERFORMANCE EVALUATION

IMPETUS FOR MONITORING AND PERFORMANCE EVALUATION

- Heightened client/beneficiary awareness and demand for effective service from government
- Introduction of financial and management information systems that make information more accessible
- Accelerated decentralization and devolution of powers
- Organizational reengineering trends that exact performance from agencies
- Increased acceptability of performance-based tenure of government personnel

REQUISITES

Effective financial monitoring and performance evaluation requires understanding of the following:

- What are the objectives?
- What provisions (or resources) were made available to accomplish objectives?
- How was the task/function undertaken?
- What controls were in place to safeguard integrity of work?
- What were the results?
- What do the results mean to the stakeholders
 - ✓ those who undertook the task
 - ✓ those who benefited

APPROACHES

- **Value-for-money audit**
- **Responsibility budgeting and accounting**
(also budgeting for results)
- **Performance budgeting**

Comparison of Approaches

Particulars	Value for Money	Responsibility Budgeting and Accounting	Performance Budgeting
Concept	Exacting best value for resources provided	Exacting best results from organizational units to which task is assigned	Exacting desired performance from government programs executed by responsible units
Origins	Audit organization	Private Sector Military	Military
Unique features	Enhancement of unit costs and cost attributions Shift from compliance to value gains for resource contributions	Highly decentralized organizations Wide flexibility in budget execution for responsible units	Emphasis on controllable factors; uncontrollable factors not a de-merit
Broad Measures/ Indicators	Economy Efficiency Effectiveness	Efficiency Effectiveness Output	Input Work Load Efficiency Effectiveness Impact/Outcome

PERFORMANCE INDICATORS

Categories

- **Quantity** - number produced/served
- **Quality** - improvement in desirability of product/service
- **Time** - time saved
- **Client Satisfaction:**
 - ✓ **rating** - % satisfied
 - ✓ **willingness to pay** - % willing

PERFORMANCE INDICATORS

Illustration

Measure	Focus	Sample Indicator
Input/Economy	Personnel, time, resources spent	No. of personnel employed; total budget spent
Output/Workload	What agency does	No. of audits done; Kilometers of highway constructed
Efficiency	Cost per unit of output	Dollar subsidy per school; dollar cost per irrigation hectare
Effectiveness	Rate of accomp- lishment	% of clients satisfied; % time savings
Impact/Outcome	End result	Clean city; crime-free zone

MONITORING OF PROGRESS

Key Elements

- Assessing progress of work in the course of the budget year to implement rapid corrective measures, where necessary
- **Key elements:**
 - periodic reporting of progress (even if nothing to report)
 - periodic assessment and feedback on reported progress
 - spot audit of reported progress
 - spot check by third parties
 - rapid execution of corrective measures
 - e.g., realignment of resources; transfer of project location
 - taking difficult decisions early
 - e.g., abandon project to cut costs

MONITORING PROCUREMENT

- **Objectives of procurement reform**
 - transparency
 - predictability of procedure
 - timeliness
 - accountability of responsible individuals
- **BOTTOM LINE:** best product/service at desired quantity for least cost at right price

MONITORING PROCUREMENT : SUCCESS ELEMENTS

GENERAL:

- Active participation of third parties, e.g., NGOs
- Strict enforcement of laws, rules and regulations
- Consolidation of procurement laws, rules and regulations
- Clear grievance mechanism available to suppliers/contractors from bid, award, implementation and completion of good/service procured
- Fast feedback mechanism from procurement to full delivery

MONITORING PROCUREMENT :

SUCCESS ELEMENTS . . . cont'd

BID AND AWARD

- Minimum discretionary element in bidding and award process, through:
 - specified timetables and criteria for award
 - free access to draft contract prior to time of bid
 - Open, competitive bidding
 - Trained procurement personnel

DELIVERY OF GOODS/SERVICE

- Reasonably expeditious payment
- Accessibility to unscheduled checks and validation

EVALUATING ORGANIZATIONAL PERFORMANCE: SUCCESS ELEMENTS

- Alignment of organizational goals to national development goals
- Linkage to performance budgeting
- Availability of resources
- Flexibility in use of resources within reasonable limits
- Delegation of adequate authority to match responsibility
- Working management information system

COMMON TECHNIQUES FOR ASSESSING PERFORMANCE

- Comparison with set targets (**achievement**)
- Comparison with previous performance
(**improvement**)
- Comparison with other government agencies with generally similar tasks
(**honor roll**)
- Comparison with non-government entities performing similar functions
(**competitiveness**)
- Client awareness and satisfaction
(**customer value**)

RESULTS OF PERFORMANCE BUDGETING

Positive

- improved planning
- more effective administrative control
- decentralized decision making
- improved public relations from clearer program information
- more precise measures for assessing performance

Negative

- unequal applicability among agencies performing basically dissimilar functions
- no guarantee for efficiency in using unit costs
- difficulties in identifying indicators
- some agencies have no quantifiable end product fully attributable to it
- impracticality in cases of small agencies

WORD OF CAUTION

Financial monitoring and performance evaluation can be easily manipulated for politically-motivated ends. One must, therefore, take caution over those out to subvert organizations and programs critical to the development agenda from falling victims to unscrupulous elements.

THANK YOU!