Chapter 5

PROPOSED IMPROVEMENTS IN BUDGET EXECUTION PROCESSES FOR IMPLEMENTATION STARTING 2002

Section 1 presents a proposed system for controlling authorities to obligate while Sections 2 and 3 expound on suggestions to improve the system for releasing disbursement authorities in the transition (up to 2003) and subsequent periods, respectively. In view of the operational problems mentioned in Subsection 1.5.4 of Chapter 2, it is recommended in Section 2 that the NCA be released gross of withholding taxes on salaries/wages. In Section 3, a TRA mechanism can effectively operate in the future when the information technology systems in line departments will have been fully developed58. Section 4 presents the rest of recommendations. The proposals in Sections 1 and 2 are consistent with the suggestion of Diamond et. al. (1999) of the IMF for DBM to □move away from cash controls to greater emphasis on commitment controls.□

1. Proposed System for Controlling Authorities to Obligate

1.1 Considerations for the Formulation of a Proposed Decision Framework for the Release of Current Budget Allotments

The proposed allotment decision framework (a resource-shortfall-coping mechanism based on cutting approved ABPs) is discussed in Subsection 1.2.4 of this chapter and is proposed to be implemented starting 2004. A transition framework for 2002 and 2003 is also proposed in Subsection 1.2.3. In relation to this transition framework, this subsection□s reference to ABPs should be replaced by the sum of (a) agency expenditures classified as □needing clearance□ (NC) and (b) □soft cuts in both agency and SPF expenditures identified during the 2002 budget preparation stage.

1.1.1 Full Release of Allotment Program if there is No Resource Shortfall and if Provision for Accounts Payable is Adequate

With more realistic revenue targets (which may result from the adoption of the proposal in Section 1 of Chapter 4) and adequate provision for prior years□ accounts payable, it may be expected that for most years the allotment program will be fully released as appropriated to the various line entities.

1.1.2 Inevitability of Resource Shortfalls for Some Years

As a small developing economy that is vulnerable to the buffeting winds of international economic trends, the Philippines may find itself in some years to be beset by severe depreciation of the peso and other unfavorable impact of stochastically changing macroeconomic parameters. (No econometric model is 100% capable of forecasting these adverse macroeconomic events.) It is, therefore, reasonable to expect that for some years (perhaps one or two times out of five), the fiscal position tightens as a consequence of revenue shortfalls and/or enlarged disbursements brought about by the impact of peso depreciation and higher interest rates (locally and abroad).

1.1.3 Mechanism for Generating Potential Savings to Cope with Resource Shortfalls: Second-Semester Programming of NC/□Soft Cuts□ in the Transition Framework or Approved Above-the-Baseline Proposals (ABPs) in the Final Framework

As potential savings in the transition framework (Subsection 1.2.3), NC expenditures and □soft cuts□ are programmed during the second semester (Table 3) since domestic interest rates tend to be lower during that period.

In the final framework, approved □above-the-baseline proposals□ (ABPs) are proposed to be tentatively programmed for the second semester59 and will be considered potential savings. The promptly-released ABM can be used to inform agencies of their budget programs with a specification of these potential savings for possible (albeit with uncertainty) release during the second semester.60 If the resource shortfall does not materialize, then the potential savings will be released during the second semester to the expenditures originally intended for. If revenue shortfalls materialize, then the savings will not be released (in part or in full). As potential savings in the final framework, ABPs are programmed during the second semester (Table 4).[61]

1.1.4 Obligation Budget Program Cuts to the Extent Required by Any Resource Shortfall and Inadequacy in the Cash Provision for Prior Years□ APs

Since 1998, revenue shortfalls have been persistent and the foreign exchange rate has depreciated severely. The increase in foreign interest payments62 has reduced the amount available for MFO production by line entities.

To cope with this event, DBM reduced the obligation budget program but not to the full extent required to maintain the target deficit. The NCA program was significantly cut resulting to the generation of additional accounts payable. In essence, this merely postpones the agony by transferring the problem to the subsequent years. If the obligations budget program is cut to the full extent required by the revenue shortfall, then cash rationing (cutting of NCA program and setting priorities among competing claims) is not necessary.

In essence, the dual system of controlling obligations and cash is unduly complicated. Ramamurthy (1999) said that the Philippines is one of the few countries worldwide that adopts this dual control. Consistent with his suggestion is the idea that if the obligation budget program is cut to the full extent required by revenue shortfalls, then the NCA should no longer be rationed and should be given automatically as needed.

1.1.4.1 Past Cash Rationing Due to Inadequate Obligation Program Cuts

In case of revenue shortfalls/adverse macroeconomic parameter changes during the past, DBM would tend to ration the NCA (with inadequate cuts in the obligation program). This would have the effect of unduly building up accounts payables and transferring the problem to the next year.

1.1.4.2 Approved ABPs as the First to be Cut and Hierarchy of ABP Cuts: Minor Outputs, Low Priority SPFs (If Any), GASS in Excess of Benchmark, Medium-priority MFOs/SPFs,

and High-priority MFOs/SPFs

If there is resource shortfall/inadequacy in prior years’ AP provision, then the first to be cut would be ABPs63 of SPFs and line entities. The ABM can be used to inform agencies of their budget program including potential savings in the form of approved ABPs that may be necessary during the exceptional years of fiscal tightness (when there are significant resource shortfalls and adverse expenditure impact of macroeconomic parameter changes.) When used during these exceptional years, ABMs should be released no later than one month after the approval of the GAA for the year involved.

If the totality of ABPs is higher than the expenditure cut required by the resource shortfalls/macroeconomic parameter changes/AP cash provision inadequacy, then the proposed hierarchy of expenditure cuts to preserve64 outcome-orientation would be on ABPs for (a) minor final outputs, (b) low priority SPFs (if any), (c) GASS, (d) medium-priority MFOs of agencies with “excess budgets”, (e) medium-priority MFOs of agencies with “inadequate budgets”, (e) high-priority MFOs of agencies with “excess budgets”, and (f) high-priority MFOs of agencies with “inadequate budgets”. (The budget “excess or inadequacy” is in the context of Figure 1 for the transition system and Subsection 1.2.4 for the proposed final system.)

Secretary Boncodin emphasized that the ABPs for SPFs and those within agency budgets will be treated in the same manner if the contribution to the attainment of desired outcomes is more or less the same. In other words, the first priority to be cut are those approved ABPs that have less contribution to outcome attainment. (In cutting ABPs of agencies, DBM should ensure that the remaining level is self-contained65.) If the procedures in this subsection and earlier subsections of this chapter are done, it would not conceptually be necessary to ration NCAs.

In cutting line entities’ ABPs for medium-priority MFOs, sectors/ subsectors where expenditures would have lower contribution to the attainment of desired ultimate societal outcomes should be identified. For instance, 100% of the ABPs in the sectors/subsectors66 on general public services (GPS) and defense operations in Luzon/Visayas could be cut. The same procedure may be followed for high-priority MFOs.

1.1.4.3 Baseline Expenditures as the Last to be Cut if Resource Shortfall/AP Provision Inadequacy is Greater than Approved ABPs

This paper proposes that baseline[67] expenditures should be the last to be cut68. (With OPIF prescribing MFO-related PIs and a mechanism enabling department secretaries to reallocate baselines, they are expected to focus the allocation of their baselines to MFOs. This will contribute to the cleaning of “baseline expenditures” as the proportion of amounts devoted to minor outputs/GASS is reduced. It is important to note that at this stage, precision in the calculation of baseline is less important than its predictability.)

1.2 Proposed Transition and Final Decision Frameworks for Releasing Current Budget Allotments for National Government Agencies

Transition and final frameworks are presented in this subsection. The latter is proposed to be implemented starting 2004.

1.2.1 Differences

1.2.1.1 Final Framework's Reference to ABPs is Replaced by the Sum of NC Expenditures and "Soft Cuts" in the Transition Framework

The final framework refers to ABPs while in lieu of this, the transition framework refers to the sum of (a) agency expenditures classified as "needing clearance" (NC)69 and (b) "soft cuts in both agency and SPF expenditures" identified during the 2002 budget preparation stage. It appears that most (if not all) NC expenditures and "soft cuts", like new positions in DECS are in the approved ABPs.

1.2.1.2 To Estimate "Excess Budget", Transition System Compares Actual Quarterly MFO Quantity with Projection During Budget Preparation While Final System Compares Actual Quarterly MFO Unit Cost with Corresponding Figure (as Adjusted for Inflation and TEIR) in the Immediately Preceding Year

To estimate "excess budget" (holding quality of MFO constant) the transition system compares actual quarterly MFO quantity with projection made during budget preparation while final system compares actual quarterly MFO unit cost (using accrual concept) with corresponding figure in the immediately preceding year.

1.2.2 Commonality of Basic Framework

Except for the aforesaid differences, the basic frameworks of both systems are common. For instance, if the indicative total cash budget provision for prior years' accounts payables (APs) is inadequate, then the ABPs or "soft cuts" (as the case may be) will be cut or applied to enable AP full payment and maintain the deficit. If the total AP cash provision is sufficient, the current budget program is released fully if the resource targets are likely to be met. If not, the resource shortfall is offset from the current budget program in accordance with earlier mentioned hierarchy of cuts.

1.2.3 Proposed Transition Framework for Implementation in 2002 and 2003

Figure 1 proposes the aforesaid decision framework. Without waiting for agency requests and immediately after approval of GAA, DBM will formulate ABMs considering timing of allotment effectivity in Table 3. Hopefully, this process would be completed during the first quarter. After the first quarter of the year, the attainability of full year revenue targets and projected macroeconomic parameters will be assessed during the second and subsequent quarters.

If there is a resource shortfall, the hierarchy of cuts would be as shown in Figure 1.

1.2.4 Proposed Final Framework for Implementation Starting 2004

This framework differs from the transition system in the procedure for determining whether an agency's budget is in excess or not at a given level of MFO quality. The following procedures (applied on a cumulative70 quarterly basis) are used:

- Step 1 – from the agency's accountability reports (say for the first quarter of the current budget execution year) as proposed to be revised in Chapter 6, calculate these parameters

 accrued expenses per MFO or
 accrued expenses per full time equivalent personnel (actual or normative) if MFOs are non-measurable or do not exist;
 Step 2 calculate similar parameter for the first quarter of the year immediately preceding the current budget execution year;
 Step 3 multiply the parameter in Step 2 with (1+ actual annualized domestic inflation rate)(1-TEIR as defined in Table 4a) 71 and compare with that of Step 1.

In Step 1, weights will be used to reflect degree of organizational effort to produce drastically non-homogenous MFOs72. (It should be noted that perhaps less than 10% of line entities will have fairly homogenous MFOs which would not require any weight.) If MFOs are non-measurable or do not exist, the actual number of full-time equivalent personnel will be used if the entity is not overstaffed. Otherwise, a normative level based on benchmarking (or observation-based heuristic estimates) will be used assuming reengineered processes.

1.2.4.1 Assuming Revenue Targets/Projected Macroeconomic Parameters are on Track and AP Provision is Adequate

With the aforesaid assumptions, the resources to support line government entities budgets are likely to be on target. The following will be done:

 Step 4 a Step-3 parameter that is less than that in Step 1 means that current budget provision (gross of the approved ABPs) is in excess if the indicator for the quality[73] of service/good is held at historical level. (This can happen if the actual MFO quantity for the current year is less than originally expected.) Thus, the quality of service/good will have to be adjusted (using judgment or relevant historical data) proportionally upwards.

A Step-3 parameter that is more than that in Step 1 means that current budget provision (gross of the approved ABPs) is lacking if the indicator for the quality of service/good is held at historical level. (This can happen if the actual MFO quantity is greater than originally expected.) Thus, the quality of service/good will have to be adjusted accordingly after assuming that the approved ABPs will be fully released. (If the parameter for the latter becomes higher after assuming full-release of approved ABPs, then an upward proportional adjustment will be made.)

1.2.4.2 Assuming Revenue Targets/Projected Macroeconomic Parameters are Not on Track and/or AP Provision is not Adequate

With the aforesaid assumptions, the resources to support line government entities budgets are likely to be lower than target.

 Step 4 the following is the proposed hierarchy of expenditure cuts to preserve the outcome-orientation on ABPs for (a) minor final outputs, (b) low priority SPFs (if any), (c) GASS, (d) medium-priority MFOs of agencies with excess budgets, (d) medium-priority MFOs of agencies with inadequate budgets, (e) high-priority MFOs of agencies with excess budgets, and (f) high-priority MFOs of agencies with inadequate budgets.

 Step 5 Cut baselines following the order in Step 4[74] (items a to e).

1.3 Make it a Policy Not to Release[75] Continuing Appropriations SAROs that Have not been Released Prior to the Budget Execution Year

The implementation of this policy will enhance aggregate fiscal discipline. An exception to this could be if the PAP in the aforesaid SARO is high priority and the agency involved is willing to offset the amount from its current budget program (approved ABPs).

2 Proposed Alternative Transition NCA Release Systems over the Medium Term from 2002 to 2003

The first alternative is the version (presented in the first draft of this paper) as modified in the meeting with senior officials (DBM Secretary down to Directors) last September 1. The second alternative is in response to Secretary Boncodins guideline to explore non-NCA based system and has been formulated during the meeting of the author with Assistant Secretary Guerrero last September 3. (It may be noted that Australia recently abandoned the second alternative in favor of a decentralized system apparently because the latter is more consistent a the performance management strategy.)

It is prudent to try one or both systems on pilot bases prior to full-scale implementation of the alternative that the DBM Secretary wants to implement.

2.1 First Alternative

With earlier suggestions (on how to deal with revenues that are not likely to be realized and to cope with resource shortfalls), it is expected that cash rationing will not likely be done in the future. If this is the case, then DBM can fully release the cash requirements for current budget and accounts payables. This state of affairs could pave the way to revert to the past practice of using only one MDS account for current budget (excluding FAPs where creditors require separate bank accounts for the projects they fund) and accounts payable. This merger is consistent with a suggestion of IMF.

2.1.1 DBM Unilaterally Sets the January and February Cash Programs for Each Agency
Without waiting for requests, DBM will set the January and February cash programs for each agency in the following manner:[76]

- for each month, the initial cash release program (CRP) is equal to obligation program (after deducting FAPs direct payment transactions, FAPs foreign-currency proceeds where loan documents specify separate working funds, bonuses/ incentives, clothing allowance, and productivity incentive benefits) divided by 12;
- amount for year-end bonus/cash gift is divided by 2 with the first and second halves added to initial CRP for May and November, respectively;
- amount for clothing allowance and productivity incentive benefits[77] is added to initial CRP for March;
- for January, an accounts payable provision will be added equal to two thirds of unpaid accounts as of end-November of the immediately preceding year (due and demandable obligations for that year and prior years as indicated in the November trial balance).

FAPs direct payment transactions are deducted since they do not require NCAs. The amount for year-end bonus/cash gift[78] is programmed for May and November to ensure cash availability for these purposes.

On the basis of accounts in the monthly trial balance submitted by agencies, unpaid accounts are the sum of the credit balance of payable-due and demandable (8-81-440) and the credit total of obligations incurred-due and demandable (0-82-040) less the debit total of obligations liquidated-due and demandable (0-83-040). The document that triggers the booking of due and demandable accounts are completed vouchers. (This means that in case of supplies, the same have been delivered and found by the supply officer as correct in terms of number and specifications, and billings have been received by the agency involved. In case of infrastructure, this means that work has been accomplished, an agency engineer has certified as to the compliance of the work with contract specifications, and billings have been received.)

These procedures assume that the General Appropriations Act (GAA) for the budget execution year is passed into a law in December immediately prior to the said year. If not, then the obligation program in step 1 refers to that of the immediately preceding year excluding completed projects and FAPs direct payment transactions.

2.1.2 DBM's Release for January and February Without any Agency Request or Submission of Full-Year Proposed CRP

NCAs will be released (if possible before the beginning of the year) for January and February with monthly specifications of effectivity based on Subsection 2.1.

It may be noted that in this proposed system, agencies will not request for the release of NCA, nor is it necessary to submit a proposed full-year CRP.[79]

2.1.3 Monitoring of Unused NCAs Through the Servicing Banks of the Modified Disbursement System (MDS) and Cross Checking of Used NCAs with Corresponding Accounts in the Monthly Trial Balance

End-month balances of unused and used NCAs are expected to be given by the banks (LBP, DBP, and PVB) to the BMBs through BTS with a lag of not more than 2 weeks. Olayon (2001) stated that the reporting lag now is only about one week.

Used NCAs for accounts payable and current budget should respectively be cross checked with the debit totals of payable-due and demandable (8-81-440) and obligations liquidated-due and demandable (0-83-040). If the former is higher than the latter, then one possibility is that the agency involved has issued an MDS check without a voucher and other supporting documents.[80]

2.1.4 Unused NCAs in a Given Month will be Deducted from the Program NCA in Month + 2 to Allow for Reporting Lags

Unused NCAs in January will be deducted from the March NCA which should be released during the last week of February. Unused NCAs in February will be deducted from the April NCA which should be released during the last week of March. This pattern will be repeated until the year is over. (It may be noted that the unused NCAs in November and December of the immediately preceding year will not be deducted from original NCA programs for January and February of the current year. This is the reason for placing not applicable□ in row A2 for the columns January/February in Table 5.)

2.1.5 Possible Monthly NCA Augmentation (Starting March) Based on (a) □Unpaid Accounts-Prior Years□ in the Monthly Trial Balance and (b) □Unpaid Accounts (Current Year)□ in the Same Report and Unfunded Allotment, Whichever is Lower

The proposed NCA-release system allows for possible monthly NCA augmentation (starting march) based on (a) □unpaid accounts-prior years□ in the monthly trial balance and (b) □unpaid accounts-current year□ in the same report and unfunded allotment, whichever is lower. (The term □unpaid account□ is defined in Subsection 2.1 and is further clarified in the footnotes of Table 5.) It may be noted that the second item has the effect of limiting NCA[81] augmentations associated with □unpaid accounts-current year□ to the level of unfunded allotments.

The first sets of trial balances (for January and February) may be expected on or about the third week of March of the budget execution year. The reason of the delay is the finalization (on or before February 15 of the budget execution year) of the financial statements for the immediately-preceding year.

The amount of augmentation in March would be equal the unpaid accounts as end-February (row Ea of the memorandum item in Table 5). The augmentation in April would be equal to the unpaid accounts as of end-March. The pattern is repeated for the subsequent months up to the end of the year.

Agencies with unpaid accounts and which do not submit monthly trial balance will not receive NCA augmentations and are therefore penalized. (Late submissions by agencies with unpaid accounts will also be automatically be penalized through late augmentations.)

2.1.6 If the Provisions for Current Budget and Prior-Years□ AP Disbursements in the Aggregate Cash Budget Program is Exceeded, then Corresponding Obligation-Budget Cuts Should be Applied to NCs/□Soft Cuts□ in the Transitional Framework or ABPs of SPFs/Agencies in the Final Framework

If as a consequence of the augmentations in Subsection 2.1.5, the provisions for current budget and APs in the aggregate cash budget program is exceeded, then the obligation budget should be cut as earlier explained.

2.1.7 Self-Correcting Mechanisms of the Proposed NCA Release System

Tables 5 and 6 hypothetically illustrate the aforesaid self-correcting mechanisms of the proposed system. Both tables assume that: (a) the full-year obligation budget program net of the expenditures specified in the first item of Subsection 2.1.1 is P120 million or P10 million per month; (b) year-end bonus/cash gift are P2 million each in May and November; (c) total amount for clothing allowance and productivity incentive benefits is P 1 million in March; and (d) the initial AP provision in January is P6 million, derived on the basis of the formula in Subsection 2.1.1.

2.1.7.1 Inherent Systemic Tendency to Augment NCAs in Case the Releases in January and February are not Sufficient

Table 5 presents a case where DBM□s NCA releases for January and February are not sufficient. In this case, an augmentation is made in March and the system is able to self-correct for the earlier understatement. Instead of the original full-year program of P131 million, the actual release is P143 million.

2.1.7.2 Inherent Systemic Tendency to Reduce NCAs in Case the Releases in January and February are Excessive

In case the January AP provision is excessive or the agency is not able to implement its programs on time, **Table 6** indicates that the system also self-corrects for the excess through the mechanism in Subsection 2.4. Instead of the original full-year program of P131 million, the actual release is P100 million.

2.1.8 Augmentation of NCA Program for Government-wide Salary Adjustments and Calamity Fund Releases to Departments/Agencies

Because of the self-correcting mechanism of the proposed system, in concept it is not necessary to adjust the original NCA program even if there are allotment augmentations from SPFs. This would mean a month delay in the associated payments which in generally is apparently all right[82] except for government-wide salary adjustments.

On this basis, the NCA program is proposed to be adjusted upwards for government-wide salary adjustments charged to a SPF to ensure that employees will be paid on the time of salary adjustment effectivity. If the said adjustment requires a monthly amount of say, one million pesos effective January, then in row A4 of Table 5, the aforesaid amount will be placed in each of the columns corresponding to July up to December.

Similarly, the NCA program is proposed to be adjusted upwards for Calamity Fund releases to ensure timely disbursements.

2.1.9 NCAs for Local Government Units (LGUs) and GOCCs

The release of SAROs for LGUs and GOCCs will generally be accompanied by NCAs except in cases when a GOCC has liquid assets in excess of say, one month disbursement.

2.2 Second Alternative

This alternative is based on direct-payment from DBM to line agency creditors for payments (both prior years□ and current budget) either (a) above a cut-off level or (b) a certain type of transaction like infrastructure billings. Agencies will submit a list of creditors/amounts payable to each creditor and a certified true copy of the first two pages of the disbursement voucher for each payment. (Creditors may be required to have a deposit account with the MDS servicing bank.)

In the longer-run[83], it may be expected that cash rationing will not be resorted except in hopefully unusual cases of the borrowing program is not likely to be realized. In most cases, it is expected that the total amount of unpaid accounts (based on the trial balance and in the aforesaid list) will be paid by DBM. In the unusual case specified above, the existing pro-rata system will be applied.

Agency disbursements that are not covered by direct payment by DBM will be paid by the agency involved from a "petty cash or cash advance" that is subject to liquidation prior to replenishment by DBM.