PUBLIC FINANCIAL MANAGEMENT ASSESSMENT IN THE PHILIPPINES

A. Macro-Fiscal Context

1. **In recent years, the Philippines has achieved rapid economic growth and currently faces favorable macroeconomic prospects.** According to the International Monetary Fund (IMF), the 6.1% economic growth rate registered by the Philippines in 2014 was one of the fastest in the region.[1] Remittances from overseas, which are around 10–12% of GDP, and accommodative monetary and financial conditions have offset the negative effects of volatile capital flows, an adverse external environment, slowing activity in the region and severe natural disasters. Momentum is expected to be sustained, with the growth rate likely to increase to 6.7% in 2015. The Philippines has advanced 28 places since 2009 (to 59th position) in the World Economic Forum's Global Competitiveness Rankings, yet challenges remain.

2. **Progress on the Millennium Development Goals (MDGs) is mixed in the Philippines.** The government has made strong progress in many areas, but is likely to fall short in meeting key MDG targets in poverty reduction, specific aspects of education and gender equality, maternal health, and malnutrition among children.[2] Poverty incidence, although declining to 25% in mid-2013 from 28% in 2012, remains high. A significantly large share of the population remains vulnerable to sliding back into poverty, threatened by natural disasters and other exogenous shocks. Government bureaucracy and red tape are recurring impediments for efficient service delivery, and rigid labor regulations constraint employment creation. Unemployment and underemployment rates remain elevated although they have improved slightly over recent years.

3. **Fiscal sustainability has always been a concern for the government over the past decade.** The low level of public expenditure on economic, social services and poverty reduction programs is partially a consequence of the government's traditionally tight fiscal position.[3] The government's fiscal consolidation program has, however, trimmed down debt service as percentage of GDP from 5.3 % registered in 2005 to 2.8 % in 2013.[4] Stepping up efforts to increase revenue collections had resulted in higher receipts during the period 2010–2013, but efforts need to be sustained and further intensified. Reduction of debt service and greater revenue will provide larger fiscal space to accommodate increased spending for basic goods and services.

4. **Fiscal outlook for the period 2015–2017 remains optimistic.** The government expects the budget deficit to be approximately 2% annually for the period 2015–2017. Spending is expected to grow 19.9% and revenue collection is expected to rise by 17.8 %. The government expects to improve revenue collection and expenditure efficiency to balance the targeted fiscal program over the next three (3) years.[5] Specific assumptions and objectives include; increased spending on priority programs, strong private sector consumption and investment, continued streamlining of business processes to promote competitiveness, and

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[1] IMF World Economic Outlook, January 2015.

[2] Government of the Philippines, National Economic Development Authority. 2014. Fifth Progress Report on the MDG.

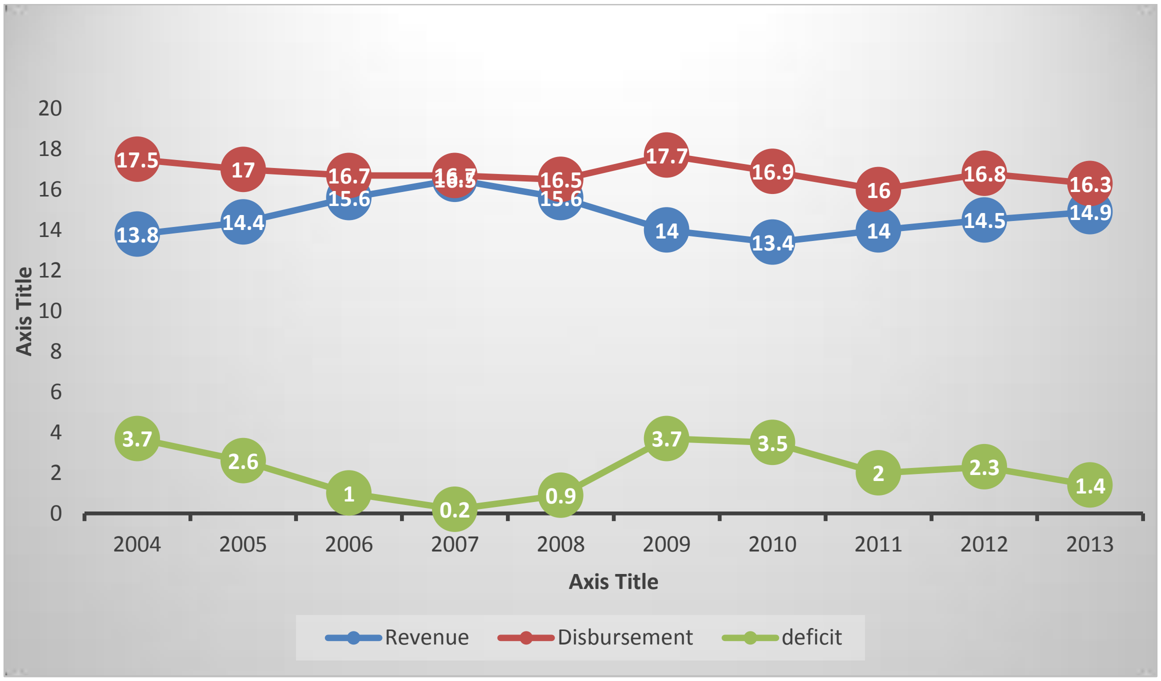
[3] Government spending on education in the Philippines averaged 2.5% of GDP during 2002–2007 compared with 4.1% for the East Asia region. In public health the Philippines spent 1.3% of GDP in 2006 compared with 2.% for the East Asia region. Source: World Bank.

[4] This debt service ratio includes both domestic borrowings, which account for a substantial portion of its interest payments, and foreign debts which account for about 30–35 % of total debt service.

[5] Government of the Philippines. Department of Budget and Management. 2014 Mid-year Report.

measures to eliminate administrative bottlenecks. These measures will also boost economic growth.[6] Maintaining sound economic stewardship will continue to be important as the national election approaches in 2016. With a budget deficit program of 2% annually for 2015–2017, maintaining the expenditure focus on spending priorities while preserving fiscal prudence on a sustainable basis will be a fiscal challenge going forward.

Figure 1. Fiscal Performance as % of GDP 2004–2013



Source: Fiscal Statistics Handbook, Department of Budget and Management.

B. Public Financial Management (PFM) and constraints

5. **Improved public financial management (PFM) is central to the Philippines' achieving its development goals.** This requires, amongst other things, a transparent and credible PFM system to manage public resources for informed decision-making and effective provision of public goods and services. The 2007 PEFA Assessment and the 2011 Public Expenditure Review underlined the uneven development of various sub-systems of PFM. Among the key efforts currently underway, PFM priorities include the strengthening the evaluation of key government programs, and enhancing transparency and accountability of the budget process. Plans for the rolling out the Government Integrated Financial Management Information System (GIFMIS) are currently on hold.

6. **Institutional Framework for Public Financial Management is fragmented.** Several agencies are involved in the implementation and oversight of PFM systems and in some cases have overlapping mandates.[7] This fragmentation demands close coordination among these

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[6] Government of the Philippines. Department of Budget and Management. Statistics based on the 2015 BESF.

[7] The National Economic and Development Authority (NEDA) is responsible for planning and public investment programming, Department of Budget management (DBM is entrusted with budgeting and procurement matters, and cash and debt management is the responsibility of the Department of Finance (DOF) with DBM also being the approving agency for cash programs. Accounting and auditing is vested with the Commission of Audit (COA).

agencies, and require strong systems of checks and balances.[8] Technical coordination on macro fiscal policies is ensured through the Development Budget Coordinating Committee (DBCC) which includes the Department of Budget and Management (DBM), National Economic and Development Authority, Department of Finance (DOF), Bangko Sentral ng Pilipinas (BSP) and the Office of the President (OP). However, some constitutional and autonomous bodies like the COA and the Civil Service Commission (CSC) function independently on matters relating to policies under their jurisdiction. This requires multiple levels of accountability.

7. **Political economy behind budget formulation in Philippines.** Political engagement in the budget process occurs through a review and approval process that involves both chambers of Congress, the Executive and the President.[9] Although the "pork barrel" has been removed in the 2014–2015 budgets, additional efforts are required to eliminate the existence of lump sum amounts for discretionary spending that may provide similar opportunities for misuse of public funds. Under the Constitution, the President can also exercise a high degree of discretion to re-allocate portions of the budget across the executive branch during execution. In addition, the practice of re-enacted budgets has in the past undermined budget credibility as well as the ability of the bureaucracy to execute the budget as intended. It can also entail important management costs for agencies on top of an already complex appropriation structure.[10] These issues weaken the planning and budget process and contribute to allocative distortions in public expenditure.

8. **Fiscal consolidation program**. The Aquino administration has focused the fiscal consolidation efforts since 2010 on raising the revenue to GDP ratio and prioritizing expenditure toward key areas for inclusive growth, including education, health, safety net, and infrastructure. The tax to GDP ratio has improved from 12.1% in 2010 to some 14.7% in 2014 (although still below the level of the mid1990s at 17%). Progress on tax revenue collection are due to a number of measures, including several anti-tax evasion and anti-corruption programs, improvements in business processes, and the passing, in 2012 of the "Sin Tax Law", which increased the excise tax rates on tobacco and alcohol products.

9. **Public expenditure management** is characterized by a generally low efficiency of spending. A combination of expenditure restraints, privatization and slow budget execution has lowered the GoP's level of expenditure from 17% of GDP in 2010 to 16.3% in 2013. Together the revenue performance and expenditure management in recent years have lowered the fiscal deficit from 3.6% in 2010 to 1.4% in 2013.

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with DBM maintaining budgetary accounting, and personnel policies are dealt with by the Civil Service Commission (CSC) with DBM deciding on staffing and compensation policies.

[8] Executive branch is responsible for preparing and executing the national budget while the legislative branch is vested with the power of legislating the budget. Executive Order 292 or the Administrative Code of 1987 sets out some detailed rules, as well as the respective roles of the different agencies responsible for carrying out PFM requirements. Annual budget circulars provide guidance on carrying out budget rules. Accounting rules and procedures are provided in the Government Accounting and Auditing Manual (GAAM) and are prescribed in a Government Accounting System (NGAS) while government procurement is governed by RA 9184. Audit rules, as well as internal control systems are codified by PD 1445 or the "Government Auditing Code of the Philippines. The promulgation of rules and regulations in the organization and strengthening of internal control systems and procedures are governed by AO 119, s. 1989 with the DBM mandated to implement the order.

[9] In the last decade the Philippines operated under several re-enacted budgets covering the years 2001, 2004 and 2006. Also under the 1987 Constitution the previous year annual budget is automatically considered re-enacted if Congress fails to pass an appropriations law until a new annual budget is passed. Late passage (as late as March of the budget year) of annual budgets in 2002, 2007, 2008, 2009 and 2010 resulted in re-enacted budgets effective up the first quarter for these years, on the average.

[10] The Philippine Constitution provides for the re-enactment of previous year's General Appropriations Act (GAA) for the start of the fiscal year until the new appropriations law is passed.

10. **Sector composition of sectoral spending is improving.** The Public Expenditure Review of 2011[11] identified the composition and distribution of public expenditure in Philippines as a systemic constraint to inclusive growth. In a number of sectors, Philippines displayed also low efficiency of public spending, that is, comparably low performance outcomes achieved per unit of public spending per annum. The Review attributed lower efficiency in public spending largely to the disparities in the distribution of public expenditures across income groups and across regions. The Aquino administration, anchored on improved revenue performance, has since made important efforts to increase budgetary allocations to key services such as health and education. Enrolment in PhilHealth has reached approximately 90% of the population, up from 62% in 2010. In education, budget allocation for basic education continues to grow as part of an overall reform agenda that includes curriculum and management reforms. Allocations to the Department of Health more than doubled between 2010 and 2014 and a similar trend is observed in Education which received the largest budgetary increases in the national budget in 2014 and 2015. The data does not incorporate local government units' expenditure in both areas. Bringing up public expenditures on health, to regional levels, will require an additional 0.7 to 0.8% of GDP to cover additional hospital bed capacity and other health services like immunization. Agriculture, which has a high potential for growth and poverty alleviation, has struggled with a 1% GDP share of expenditures.[12] Transport spending has increased from 1.6 to 1.8 % of GDP between 2010 and 2013, but this increase needs to be sustained to attract new investments and drive growth, especially through PPP projects.[13]

11. **Capital outlays have improved** substantially since 2012, and reached 3.5% of GDP in 2014. The country is well on its way to meeting the government target of 5% of public investment to GDP by 2016. Of this, some 1.1 percentage points are expected to come from private sector contributions, aided by the comprehensive package of reforms under the PPP program. The wage bill, as a share of GDP, continues to be at comparable regional levels, or around 5% of GDP. As a share of government outlays is however large comparatively, representing some 31% of total public expenditure.

12. **Budget execution is a particular concern, together with underspending and slower disbursement.** Specific concerns include; insufficient internal capacities, delays in procurement and project implementation, weak coordination and poor information systems in spending agencies. Disbursement levels at the aggregate have deteriorated from 17.7% in 2009 to 16.3% in 2013, despite increases in budgets for basic services realized through the larger fiscal space generated from reduction of debt service and greater tax collection efforts. Comparative analysis of disbursements[14] against obligations incurred highlight recurring and serious underspending from 2008 to 2013, and this trend is reported to have continued through 2014.

13. **Strengthening PFM at the subnational level is a governance priority.**[15] Transfers of funds to local government units (LGUs) constitute 15–18 % of total public spending. The Internal

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[11] World Bank. 2011. *Philippines: Public Expenditure Review. Strengthening Public Finance for more Inclusive Growth.*

[12] Public Expenditure Review for Agriculture, World Bank Report, 2007. Poor performance of the sector is also attributed to weak policy environment. Dominance of low value commodities in production as well as bias over rice self-sufficiency policy which is characterized by high production costs and government subsidies have contributed to low productivity in the sector.

[13] The low level of investment in the sector is further exacerbated by institutional and policy distortion. Findings from the World Bank Expenditure Review showed that fragmentation and weak implementation of Public-Private Partnership initiatives contribute to underperformance in the sector.

[14] Disbursements refer to total checks encashment and debited against the National Treasury account.

[15] Internal Revenue Allotment (IRA) is a system of decentralization grants to LGUs that provides more power and resources and responsibility for the provision of basic services and facilities. Transferred basic services include

Revenue Allotment (IRA), under law (RA 7160), has been the mainstay of LGU budgets and represented 15–18% of government spending over the period 2004–2014, and an average 2.8% of GDP.[16] In addition, LGUs get a share of tobacco excise taxes, franchise, economic zones, mining taxes, royalties and forestry and fishery charges. Despite wide powers and authority to generate resources under the LGU Code, the high dependency on IRA continues to persist, and it represented 64% of local revenues on average in 2014. Out of own revenue sources (36% of the total local revenues), local governments collect some 71% from taxes (real property tax, business tax mostly) and 29% from fees and charges. Low levels of revenue collection in the LGUs is partly due flaws in the Local Government Code of 1991, which limit the potential for revenue collection, but it is also due to weak revenue administration, and lack of accurate, computerized taxpayer registration databases, including an absence of accurate cadastral information for property taxes. The Internal controls in many LGUs are weak due to frequent staff turnover and insufficient PFM capacity. Financial reporting is often for compliance. In Philippines, well formulated reform initiatives to a diverse group of independent political units are difficult but are essential for effectively managing available resources and reducing reliance on the IRA.

C. PFM achievements

14. **Policy framework**. Over the past decade, the government has adopted a "whole of system" approach to PFM reforms. A medium-term expenditure framework and procurement reforms have been completed.[17] In 2011, to further strengthen reforms, the government formulated the Philippine Public Financial Management Reform Roadmap (PPFMRR) 2011 to 2016 to address PFM dysfunctions and issues identified in the 2010 PEFA.[18] The PFM Reform Roadmap (consisting of an ambitious 5-year action plan) seeks to establish a more credible PFM system supported by an integrated financial management information system to enhance greater accountability and transparency in public expenditure management. Reforms aim to provide reliable and accurate information to support operational budgeting, cash programming, management of liabilities, timely financial reporting, and effective enforcement and financial controls. The reforms hold the potential to improve oversight by Congress and Civil Society Organizations (CSOs).

15. **PEFA Assessment**. On the basis of the 2014 update of the 2010 PEFA assessment, the average scores for three of the six dimensions (comprehensiveness and transparency; policy-based budgeting; and accounting, recording and reporting) of the PEFA assessment

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agricultural extension and on-site research, community-based forestry, field health, hospital and tertiary services, public works funded out of local funds, school building, social welfare, tourism, telecommunication and housing for provinces and cities. There are eighty one (81) Provinces, one thousand four hundred ninety (1,490) municipalities, one hundred forty-four (144) cities and forty two thousand twenty-eight (42,028) barangays that, each, receives checks from the national government for their respective IRA allocation computed based on a prescribed formula .

16 The Local Government Code of 1991. Philippines.

17 Many initial reforms- (i) relatively comprehensive budget documentation; (ii) a framework for strategic prioritization of the budget through the introduction of a Paper on Budget Strategy and a performance budgeting framework; (iii) tight controls of cash releases which has allowed the government in times of crises to effectively control expenditure and thus the budget aggregates; (iv) high quality procurement law that approximates international best practice; (v) reasonably transparent and predictable allocation of transfers to Local Government Units (LGUs); (vi) systems improvement in various departments that has led to strengthening some aspects of financial management; and (vii) comprehensive coverage of external audits by the supreme audit institution, the Commission on Audit (COA) - have worked well and achieved their objectives.

18 Government of the Philippines. Government Integrated Financial Management Information System (GIFMIS) Committee. 2011. Philippine Public Financial Management Reform Roadmap: Towards Improved Accountability and Transparency 2011 to 2015. Manila.

have improved from 2010 to 2014. Areas where no progress was observed since 2010 included budget credibility, predictability and control in budget execution, and external scrutiny and audit (in particular legislative scrutiny of external audit reports).

16. The PFM Reform Roadmap is a comprehensive reform agenda, overseen by a PFM Committee consisting of a four-level governance set-up and membership of four oversight agencies [DBM, DOF, Bureau of Treasury (BTr) and Commission of Audit (COA)] with implementation support provided by DFAT/Australian Aid. The roadmap focuses at six specific projects:

17. **Budget reporting and performance management**. A harmonized budget classification and unified account code structure (UACS) has been formulated by DBM and CoA. It was rolled out for the 2014 budget preparation process, and is being adopted for accounting and reporting during 2015. When fully implemented UACS will integrate budgeting and accounting classifications, and enable more timely financial reporting and monitoring. DBM has also introduced performance-informed budgeting to improve the link between resources and results, and various revised budget presentation formats have been prepared. Additional reforms in this area include:

i. Medium-Term Expenditure Framework**.** This framework was launched in 2007 and provides a results-based approach to expenditure planning that provides a longer term perspective to budget formulation and strengthens linkage of planning and budgeting processes for attainment of organizational and national development goals. Every year during the annual budget preparation period, DBM requires all agencies of the national government to submit a 3-year Forward Estimates (Fes) that incorporate key program and expenditure priorities starting with the budget year and two years forward. The Fes is updated every year to consider past performance and new expenditure requirements.[19] However, the utility of MTEF as an effective planning and results-based management tool has not gone beyond compliance. The capacity to plan and develop investment projects is weak.

ii. Organizational Performance Indicator Framework (OPIF)**.** An attendant requirement is the submission of the Operations Performance Indicator Framework (OPIF) – a results-based budgeting approach that links the budget with organizational goals and objectives and measures agency performance through an output-outcome indicator system over the same 3 years. OPIF identifies major final outputs (MFOs) based on mandated agency functions and links them with organizational and higher societal and national development goals. The process of integrating OPIF with the budget has taken a number of years. Since 2007, DBM has produced a consolidated Book of Outputs for all the government departments. However, OPIF has remains an isolated performance reporting tool and its potential for enhancing budget decisions has not been fully explored. The framework still offers scope for technical refinements but OPIF has yet to be cascaded and entrenched in internal business processes.

iii. Performance-Informed Budgeting (PIB). In 2014, DBM adopted a performance-informed budgeting (PIB) approach to provide more responsive, transparent and accountable public expenditure management (national budget memorandum no. 117). The budget for the year 2014 was further enhanced by important performance

[19] AusAid's PEGR introduced a system of forward estimates as part of the introduction of MTEF and the production of OPIF Book. To date, the reform can be considered to be still in their early stages.

information for every government program, including the purpose of the funds, outputs to be delivered, outcomes to be achieved and cost of the programs, activities and projects. For the first time, government departments and agencies have specified their vision and mission, as well as the target outputs that they will produce from the resources sought, and the expected performance standards in service delivery.[20]

iv. Paper on Budget Strategy. A yearly budget document is prepared by the DBM covering macro-economic policies, priorities and strategies as laid down by the DBCC in the context of budget formulation. So far, this document has remained an internal document and has not been made part of the set of budget documents officially submitted to Congress.

v. Online submission of budget proposals**.** Online submission of budget proposals was adopted in 2013 during the preparation of the 2014 national budget. The system allows agency central offices to encode their budget data directly into the system and submit their consolidated budget proposals to DBM in real time, replacing the paper and worksheet files that were used for manual submission. Technical glitches delayed the full use of the system for the 2015 budget.

vi. Professionalization of PFM workforce. The above PFM measures have enhanced the policy dynamics of budget making, and are moving the government towards a results-based budget. The challenge that the government now faces is how to fully institutionalize these reforms. A PFM competency model has been developed to provide a common language on PFM capacity building across government.[21]

18. **Accounting and auditing reforms**. In Philippines, both audit and accounting functions are vested upon a supreme audit institution; the COA. There is a general recognition to move away from this practice, but the constitutional provision requiring COA to “keep the general accounts of the government” is seen as a major impediment. With this mandate, COA has continued to set accounting standards and rules and in 2002 rolled out a new government accounting system (NGAS) that aimed to simplify government accounting, in conformity with international standards, and to generate periodic and relevant financial statements. With the implementation of the NGAS, a modified accrual basis of accounting was introduced. All government agencies are required to prepare a Balance Sheet, Income and Expenditure Statement and a Cash Flow Statement. Central Offices of government departments consolidate the financial statements. COA is developing a Philippine Public Sector Standards of Auditing (PPSSA) and Public Sector Accounting Standards (IPSAS). Twenty–five PPSAS have been harmonized with IPSAS, and the International Financial Reporting Standards (IFRS) have been adopted for implementation in 2014 through COA Resolution 2014-003. The chart of accounts of the National Government has been revised to provide new accounts for the adoption of PPSSA through COA circular no. 2013-002. The new chart of accounts is being incorporated in the new government accounting manual. In auditing, 24 Philippine Public Sector Standards in

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[20] For instance, one of the Bureau of Fire Protection’s targets was to respond within five to seven minutes to 87% of the more than 5,000 distress calls the Bureau expected to receive in the year. The National Police promised a minimum of 629,258 crime investigations and a 25% increase in the number of foot and mobile patrols. The Department of Education aimed to deliver a pass rate of 84% in the National Achievement Test that was to be taken by 12.56 million secondary school students; and the Department of Social Welfare committed to serve meals to more than 2.5 million schoolchildren. This approach enhances the use of OPIF information and key indicators to evaluate selected and key programs of the government and integrate results to budget formulation process.

[21] The competency model can guide agencies on recruiting and training competent PFM personnel. The Model has a competency-based training program in budgeting, procurement, cash management, accounting and auditing. The competency model design was completed in November 2013 with the active participation of CSC, COA, DBM, DOF, BTR, BIR, DEPED, DENR, DPWH, AFP and the Procurement Board.

Auditing (PPSSA) have been adopted through the issuance of COA resolution 2013-007. Training tools have been produced and the new accounting and auditing reforms are being rolled out in national government agencies.

19. In the Philippines, poor budget execution results from (i) inadequate capacity of the spending agencies (e.g. weak capacities in policy coordination, project management and procurement delays); (ii) cumbersome budget execution procedures and internal reporting requirements; and (iii) introduction of adhoc changes in policies or rules at the oversight level.[22] In addition, the long process and tight management of cash releases has been consistently cited as a key constraint.[23] Alternatively, agencies that have weak disbursement management and reporting systems fail to comply with cash status reporting needed to determine how much cash DBM should replenish. In recent years, however, budget execution policies and procedures have been changing. Agencies have been given more flexibility in managing their resources. Comprehensive release of allotment at the beginning of the year, made quicker with the use of the GAA as release instrument and removal of the ABM and Release of Special Allotment Release Order (SARO in 2014),[24] provides ample time for the agencies to plan and execute their activities during the year. However, oversight agencies such as the DBM continue to exercise greater fiscal controls by withholding the remaining 25% of allotment and by adopting a quarterly lapsing of NCAs.

20. Financial Reporting. The consolidated financial statements of the national government are reflected in the Annual Financial Report prepared by COA usually within six months after the end of the year. These statements are based on numerous reports submitted by the agencies to both DBM and COA.[25] At this stage, the audit of the books of agencies may not have been completed; hence the accuracy of data may be compromised. Further, multiple reporting requirements coupled with the absence of an automated and integrated information system in most agencies makes the preparation of monthly financial statements a difficult task. Agencies with regional offices and staff bureaus produce consolidated financial statements on a manual basis. The suspension of the electronic-New Government Accounting System (E-NGAS) in 2009, which was intended to generate more accurate and timely financial statements, has not yet been lifted. Meanwhile, numerous special reports produced on a regular basis for different oversight agencies create duplicity and additional administrative cost for government agencies.

21. Internal control and audit. Efforts to strengthen internal control and internal audit started in 2012. About 80% or 66 out of 77 government departments have internal audit and internal control units and have been trained on the Philippine Government Internal Audit Manual (PGIAM). In 2013 DBM enhanced the capacities of internal audit units of 29 departments, agencies and GOCCs by providing training on the Philippine Government Internal Audit Manual (PGIAM) and the National Guidelines on Internal Control System (NGICS) covering a total of

[22] The DBM Mid-Year Report in 2014 attributed underspending to bottlenecks in agency internal processes such as unrealistic cash programs, poor coordination between planning and budget and operations groups, procurement issues and processing of claims for payment and other administrative issues.

[23] International Monetary Fund. 2008. Improving Budget Execution and Cash Management.

[24] In 2014 another innovation implemented by DBM is the use of the General Appropriations Act (GAA) as release document (GAARD) effectively removing the Special Allotment Release Order (SARO) and Agency Budget Matrix (ABM). The GAARD replaces the SARO, which is an authority for agencies to commit funds.

[25] Numerous reports are required to be submitted to both DBM and COA. COA requires: Monthly trial balances, Consolidated Balance Sheet Year end Consolidated Statement of Income and Expenditure Year End and Consolidated Statement of Cash Flows Year End. DBM requires a least nine sets of reports - Full Year Physical and Financial Plan, Full Year Monthly Cash Program, Full Year Estimate of Monthly Income, List of Not Yet Due and Demandable Obligations, Quarterly Physical Report of Operations, Quarterly Financial Report of Operation, Quarterly Report of Income, Monthly Statement of Allotments, Obligations and Balances and Monthly Report of Disbursements.

490 participants.[26] Establishment of Internal Audit Services (IAS) in all government agencies and its performance is constrained by lack of adequate resources and relevant technical skills. Institutionalization of the role of internal control as a management tool is yet to be achieved.

22. **Government Integrated Financial Management Information System (GIFMIS) –**

i. Track I: A National Payroll System (NPS) and Comprehensive Human Resource Information System (CHRIS) is being developed and will cover all 1.3 million government, government-owned and/or -controlled corporations (GOCC) and LGU staff. The system developments are so far well behind schedule.
ii. Track II: A comprehensive conceptual design and specification was developed in 2012–2013 for an integrated IT system for fiscal planning, budget preparation, budget execution and financial reporting. However, instead of a government-wide system, the Government of the Philippines now plans to implement a new system only for DBM and BTr, but allowing line departments to interface with this system.

23. **Capacity building.** The participation of civil society organizations in the national budget process has been developed and formalized based on Budget Partnership Agreements (BPAs) with a large number of departments, agencies and GOCCs. Also, CoA has piloted citizen participatory audit activities through CSOs in four spending departments.

24. **Management of contingent liabilities.** A list of contingent liabilities has been prepared to facilitate central monitoring and management of guaranteed loans.

25. In general, the PFM reform initiatives that have been implemented so far, especially UACS and TSA, provide a positive trajectory of change. Some activities (e.g. PPSAS and PPSSA) are intermediate rather than material, and so the results will thus be seen only after successful implementation. Furthermore, the delays and reduced scope of GIFMIS Track II – which had the potential of fundamentally changing and improving the framework for and processes of financial management in the government – have for the time being reduced the potential benefits of the PFM reform plans. Several areas of the government's PFM (in particular accounting, recording and reporting) are thus likely to continue to have shortcomings due to the lack of automation. An updated PFM Reform Roadmap is currently being prepared by the PFM Committee.

26. As noted earlier, the GoP has pursued broad governance reform initiatives through the GGAC Cluster Plan 2012–2016, but it also covers some PFM-specific items, including initiatives from the PFM Reform Roadmap. The GoP is furthermore pursuing a number of stand-alone initiatives such as, for example, rolling out internal audit, developing performance-informed budgeting, grassroots participatory budgeting (previously termed bottom-up budgeting), parliamentary expenditure oversight through the Joint Congressional Oversight Committee on Public Expenditures, GAA-as-release-document, and open data (http://data.gov.ph/) so as to improve openness and transparency.

27. The GoP is currently in the process of developing a PFM framework law. It aims at institutionalizing the various budget cycle reforms introduced in recent years, harmonizing and standardizing the current mix of laws and regulations, and addressing the budget weaknesses identified by the Supreme Court in its 2014 ruling on the DAP. The law will also institutionalize the position of Chief Financial Officers in government entities. The aim is for the law to be passed by the Congress in 2015.

[26] The National Guidelines on Internal Control Systems (NGICS) was issued on October 23, 2008.

28. **LGU PFM Reform Roadmap**. A PFM Reform roadmap for the local government units (LGU PFM Reform Roadmap) has been developed under an EU-funded project, and provides the platform for instituting PFM reforms at the LGU level. The road map is complemented by an implementation strategy that details the activities and timeframe to carry out the roadmap with a focus on strengthening support to the LGUs for revenue generation and expenditure management. A PFM Assessment Tool (PFMAT) was launched in February 2015 which established sets of indicators to determine the state of PFM that will provide the baseline for a customized reform strategy in each LGU. The PFMAT is self- administered and has been piloted in several provinces, cities and municipalities. Further, the implementation of the Bottom-Up-Budgeting initiative (BUB) of the Department of Budget and Management continues to progress. In 2015, 1590 LGUs participated in the initiative, with a total budget of P20.9 billion. In addition, the roll-out of the eSRE modules on revenue forecasting to regional offices and related trainings continue to improve the availability and quality of information for financial management.

D. Public procurement

29. **Background**. Procurement reforms were adopted in 2003 through the enactment of RA 9184, otherwise known as the procurement reform act (Act), that seek to modernize, standardize and regulate all procurement activities of the government. The Act will serve to ensure efficiency, transparency, competitiveness and accountability of the government procurement processes. The Act created the Government Procurement Policy Board, a policy and monitoring body with the mandate of dealing with all procurement related matters and provides for standard bidding documents, together with procurement manuals. A new harmonized procurement regulation to implement the Act took effect in July 2009, and requires all government procurement to be published in the Philippine Government Electronic Procurement System (PhilGEPs). This system is a web based bulletin of all solicitations for expression of interest, quotations and bids. The PhilGEPs is currently being improved to ensure that it is linked with the GIFMIS for tracking of budget and expenditures. In 2013 the government piloted the cashless purchase card system at the DBM and Department of Defense. The system allows the use of cashless purchase cards, similar to credit cards, for commonly used items funded by petty cash. The system ensures automatic recording of the transaction thereby ensuring transparency and integrity of the transactions.

30. **Assessment**. Despite these reforms, reform of the public procurement process is a work in progress.[27] While the Government Procurement Reform Act appears to have fully met the baselines for a good procurement legal and regulatory framework, and a number of improvements have already been instituted, important challenges remain:

i. <u>Legislative and regulatory framework for procurement</u>: The framework overall meets international standards, but there are significant shortcomings in some areas (e.g. procedures for international competitive bidding (ICB), nationality requirements restricting participation of wholly-owned foreign entities, the approved budget for the

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[27] The Philippines has been selected as a candidate for the World Bank pilot program for use of country systems in procurement. To move to pilot country status, mitigation measures must be implemented to address the outstanding issues. The remaining issues relate to (i) lack of an independent complaint review body; (ii) lack of transparency of the bid evaluation process; (iii) use of the approved budget for the contract as a bid ceiling which may distort the application of free market rules; (iv) conflict of interest in COA's function as observer; (v) restrictions on the ownership of Filipino firms in joint ventures; (vi) existence of eligibility requirements that do not reflect the technical and financial capacity of bidders; and (vii) lack of systematic matching of skills against requirements of competitive recruitment for procurement practitioners.

contract (ABC) approach, and the lack of an independent complaint review body). Implementing rules and documentation are generally good, except that the GoP has replaced pre-qualification with an eligibility check and post-qualification process, which restricts competition and contributes to few bidders.

ii. Institutional framework and management capacity: The procurement system is well-integrated into the public sector governance system, but there is no link to the PFM system. The Government Procurement Policy Board (GPPB) regulates procurement, but also contracts, which is a possible conflict of interest. There are shortcomings regarding institutional development capacity, including collecting and monitoring procurement statistics and using quality control standards to evaluate staff performance and address capacity development issues.

iii. Procurement operations and market practices: Operations and practices are relatively efficient, but the competency of officials is low, training of and information to officials and private sector participants not fully consistent with demand, and norms for safekeeping records and documents not fully in place. The functionality of the public procurement market is reasonably good, but some PPP-related issues are yet to be clarified, and shortcomings in the ability of private firms to access the market, including systemic constraints (e.g., regarding registration and securing licenses and permits). Provisions for contract administration and dispute resolution are good, but monitoring of dispute resolution lacks procedures.

iv. Integrity and transparency of the public procurement system: Control and audit systems are somewhat weak, and there is a lack of timely provision of compliance information to enable management action. There is no independent complaints review body. Procurement information is fully available, but a communication plan is needed to increase awareness of legislation. Ethics and anti-corruption measures are generally in place, but there are shortcomings as regards evidence on enforcement of rulings and penalties, support to create a procurement market characterized by integrity and ethical behavior, and the existence of a mechanism for reporting fraudulent, corrupt, or unethical behavior.

31. **Procurement reforms**. The 2012 CPAR Action Plan includes 64 actions/measures to be implemented between 2012 and 2016. Follow-up on the implementation of actions/measures is undertaken regularly by the GPPB-TSO, but on an ad hoc basis, i.e. there is no formal progress reporting and the current implementation status is therefore not quite clear. Specific proposals to develop and enhance the functioning of the PhilGEPS are furthermore included under the GGAC Cabinet Cluster Action Plan 2013–2016 (e.g., software modernization initiative to provide a full e-government procurement solution and ensure linkage with a GIFMIS for tracking budget and expenditure) as well as the OGP (e.g., additional functionalities to upload bid documents, undertake electronic payment, and upload annual procurement plans). The GoP considers applying for observer status to the WTO Plurilateral Agreement on Government Procurement (GPA), which would require amending legislation and regulations that currently favor Philippine-controlled companies and locally produced materials and supplies. The same applies to the Trans-Pacific Partnership (TPP) Agreement, which incorporates procurement commitments and favors ‘open market-oriented approaches’.

E. Vulnerability to Corruption

32. There is currently no overall anti-corruption strategy and related action plan for addressing corruption challenges and implementing prioritized measures to counter these, including to coordinate efforts in different sectors and institutions as well as to involve external stakeholders. It is understood that DBM for some time has been in the process of preparing an

anti-corruption strategy. The PDP 2011–2016 included a six-point plan to curb corruption, but a "comprehensive and integrated anti-corruption framework and program", mentioned as an essential part of the GoP's commitment to fight corruption, has not yet been prepared. The 2014 PDP Midterm Update mentions a two-pronged approach focusing on strengthening internal control systems related to generation and allocation of government funds, and strict enforcement of penalties in corruption cases. The updated GGAC Cluster Plan Action Plan 2013–2016 includes improved anti-corruption measures as one of four priority outcomes. The focus is on exacting greater accountability of public servants, while another outcome covers support for the passage of priority legislations, including on anti-corruption.

F. ADB and other development partners

33. **Development partners (DPs) have provided strong support to government's PFM agenda.** In particular, DPs have supported the government's core programs such as the roll-out of OPIF and internal audit and controls, procurement reforms, as well as analytical products. The Philippine Development Forum (PDF) and the sub-committees under it provide a strong platform for sustaining strong links between the Government and the development Partners through policy and technical dialogues.

34. **PFM is highly relevant to ADB operations in the Philippines**. Sound PFM is of crucial importance to improving service delivery and achieving allocative efficiency. ADB recognizes that part of the solution to rendering pro-poor growth, and to increase public spending on education, health, transport and other services, while at the same time improving the efficiency and accountability of public funds, is to improve governance. In addition, ADB continues to oversee progress in reforming the country's system for PFM, procurement, and corruption and in designing and implementing risk mitigation plans. ADB has promoted policy dialogue and reforms through its leadership of the Philippine Development Forum working group on governance and anticorruption. In addition, a series of technical assistance projects have been provided either as stand-alone projects or linked to program loans such as the Development Policy Support Program, the Governance in Justice Sector Reform Program, and the Local Government Finance and Budget Reform Program.[28] ADB has supported the mitigation of corruption risks in a road project,[29] has mainstreamed OPIF in the rural development and natural resources sectors,[30] and has supported improvements in local governance in the areas of procurement reform, debt management, reform of GOCCs.[31]

G. Lessons Learned

35. There are a range of lessons from the past regarding how to best support progress on PFM reforms in the Philippines. First, an over-arching agenda or strategy on strengthening PFM such as the Philippines PFM Reform Roadmap will ensure political buy-in, and improve interagency coordination and address risks from institutional silos. Political economy for strengthening PFM requires a shared understanding and commitment of key problems around a

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[28] ADB. 2009. *Technical Assistance to the Republic of the Philippines for Strengthening the Philippine Government Electronic Procurement System*. Manila. Footnote 9. ADB 2008. *Technical Assistance to the Republic of the Philippines for Improving Public Expenditure Management.* Manila. ADB 2008. *Technical Assistance to the Republic of the Philippines for Governance in Justice Sector Reform Program.* Manila. ADB 2009. *Technical Assistance to the Republic of the Philippines for Support to Local Government Financing.* Manila.

[29] ADB. 2009. *Technical Assistance to the Republic of the Philippines for Strengthening Transparency and Accountability in the Road Subsector.* Manila.

[30] ADB. 2008. *Technical Assistance to the Republic of the Philippines for Harmonization and Development Effectiveness.* Manila.

[31] Philippines' Government Owned and Controlled Corporations which receive budgetary support in the form of equity or subsidy from the national government

comprehensive reform agenda. Second, budget must be underpinned by resource adequacy to ensure effective budget implementation. It must not be underfinanced. Third, procedures and systems for obligation and cash management should be well understood, transparent, and decentralized with a rigorous system of internal control, reporting and monitoring to accelerate budget implementation. Fourth, proper sequencing of reforms is vital, with emphasis on improvement and implementation of existing systems is a prerequisite, given that PFM reform is a long and slow process. This will avoid "reform fatigue", as often the benefits from implementation take a long time to be fully realized. Fifth, a shared understanding and commitment of key problems and mitigation measures is required to sustain an effective political economy for improving PFM, as well as a shared understanding and commitment of key problems around a comprehensive reform agenda. Finally, flexibility and prioritization of activities are essential prerequisites to manage the implementation process so that reforms will not overburden the bureaucracy's absorptive capacity or alienate key actors within the system. As reform 'champions' alter over time, flexibility allows a program to adapt as the government's reform agenda, and sustain reforms.

H. Conclusion

36. It is a fair assessment to conclude that the trajectory in PFM reforms is a work-in-progress, with different stages of implementation. Progress continues but the benefits from implementation have yet to be fully realized. From a development perspective, it would mean longer term commitments and sensitivity to the pace of change to support the government in sustaining the reform agenda. The scope and costs of PFM reforms and issues the government is required to deal with are far beyond its technical capacity, and that of any one single development partner. Hence, the strong cooperation between the government and development partners should continue. The results-based approach to budgetary assistance is a unifying strategy for the government to attain reform objectives within and towards the attainment of its long term development goals.