



Report and Recommendation of the President to the Board of Directors

Project Number: 44253-016
November 2016

Proposed Policy-Based Loan for Subprogram 2 Republic of the Philippines: Local Government Finance and Fiscal Decentralization Reform Program

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 17 November 2016)

Currency unit – peso/s (₱)

₱1.00 = \$0.02027

\$1.00 = ₱49.21

ABBREVIATIONS

ADB	–	Asian Development Bank
AFD	–	Agence Française de Développement (French Development Agency)
ALGUP	–	Assistance to Local Government Unit Program
BLGF	–	Bureau of Local Government Finance
CCD	–	Coordinating Committee on Decentralization
DILG	–	Department of the Interior and Local Government
DOF	–	Department of Finance
eSRE	–	electronic statement of receipts and expenditures
GGACC	–	Good Governance and Anti-Corruption Cabinet Cluster
IRA	–	internal revenue allotment
LGC	–	Local Government Code
LGU	–	local government unit
PDP	–	Philippine Development Plan
PFM	–	public financial management
PCF	–	Performance Challenge Fund
SGLG	–	seal of good local governance

GLOSSARY

Assistance to Local Government Unit Program	–	The performance-based program provides a conditional grant from line agencies to LGUs that passed the “Seal of Good Housekeeping” to assist national development priorities through locally implemented projects. It encourages good local governance and participatory planning and budgeting practices.
Public financial management assessment tool	–	A self-assessment instrument designed to assist local government units (LGUs) in evaluating their public financial management (PFM) performance. The tool describes the characteristics of a good PFM system, identifies performance indicators to gauge how the LGU is actually doing in a particular area of PFM and identifies the sources of information which will help the LGUs establish their compliance with graduated levels of performance.
Performance Challenge Fund	–	The performance-based fund is open to LGUs that passed the “Seal of Good Housekeeping” and provides a “50-50” counterpart sharing scheme to be used in conjunction with big projects of LGUs, counterpart funds for foreign-assisted projects of the LGUs, co-financing for joint projects with other LGUs, and counterpart for projects of the LGUs with the private sector in the context of public private partnership in establishing more economic activities.

NOTE

In this report, “\$” refers to US dollars.

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PROGRAM AT A GLANCE

1. Basic Data		Project Number: 44253-016	
Project Name	Local Government Finance and Fiscal Decentralization Reform Program, Subprogram 2	Department /Division	SERD/SEPF
Country Borrower	Philippines Government of Philippines	Executing Agency	Department of Finance
2. Sector	Subsector(s)	ADB Financing (\$ million)	
✓ Public sector management	Decentralization		125.00
	Public expenditure and fiscal management		125.00
		Total	250.00
3. Strategic Agenda	Subcomponents	Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change	Components	Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Institutional development Institutional systems and political economy Public financial governance	Some gender elements (SGE)	✓
Knowledge solutions (KNS)	Knowledge sharing activities		
5. Poverty and SDG Targeting		Location Impact	
Geographic Targeting	No	Nation-wide	High
Household Targeting	No		
SDG Targeting	Yes		
SDG Goals	SDG10		
6. Risk Categorization:	Complex		
7. Safeguard Categorization	Environment: C Involuntary Resettlement: C Indigenous Peoples: C		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		250.00	
Sovereign Program loan: Ordinary capital resources		250.00	
Cofinancing		0.00	
None		0.00	
Counterpart		0.00	
None		0.00	
Total		250.00	
9. Effective Development Cooperation			
Use of country procurement systems		Yes	
Use of country public financial management systems		Yes	

I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on a proposed policy-based loan to the Republic of the Philippines for subprogram 2 of the Local Government Finance and Fiscal Decentralization Reform Program.¹

2. The program supports the government's commitment to improve service delivery by local government units (LGUs) and represents a long-term partnership between the Asian Development Bank (ADB) and the government.² The government's priorities to improve local service delivery include (i) enhancing LGU access to own-revenue sources, (ii) strengthening public financial management systems, (iii) improving the transparency and accountability of LGUs, and (iv) improving the regulatory framework for intergovernmental fiscal relations. The design and monitoring framework is in Appendix 1.

II. THE PROGRAM

A. Rationale

3. **The development problem.** The Philippines has achieved high economic growth rates, which averaged 6.4% of gross domestic product (GDP) during 2012–2015. However, poverty rates declined only marginally to 25.8% in 2014 from 27.9% in 2012. Reductions in poverty have not been inclusive or evenly distributed as regional disparities have continued to widen. The poor are overwhelmingly concentrated in the southern regions and in rural areas. For example, poverty rates in the National Capital Region are less than 3%, while poverty rates exceed 48% in Autonomous Region in Muslim Mindanao, and 37% in eastern Visayas and Soccsksargen. Disparities in access to services are also large. Only 25% of the rural population has access to safe water, compared with 88% in the National Capital Region. Infant mortality rates are three times higher in the regions of Caraga, Mimaropa, or eastern Visayas compared with the capital.³

4. LGUs play a central role in ensuring comparable levels of service delivery across the Philippines. LGUs accounted for some 27% of total government expenditures in 2014 (excluding debt amortization), up from 25% in 2011, and represented approximately 4% of GDP.⁴ Nevertheless, the scope and efficiency of LGU service delivery are limited. National-local government relations are weighed down by the overlapping and unclear assignments of functions across various levels of government. This has led to duplication of efforts, inefficient use of resources, and numerous mandates without funding. As a consequence, critical services are often not delivered, or are delivered in insufficient quantities. For example, the national government instructs LGUs to deliver services in support of national priorities but does not provide the LGUs with an appropriate level of financial resources. In either case, the welfare of local communities is adversely affected.

5. While a system of intergovernmental fiscal transfers—the internal revenue allotment (IRA)—provides much-needed revenues, the system is based on a rigid formulaic approach that does not consider the fiscal capacity of local governments. Compounding this issue, the ability

¹ ADB. 2014. *Report and Recommendation of the President to the Board of Directors: Proposed Programmatic Approach and Policy-Based Loan for Subprogram 1 to the Republic of Philippines for the Local Government Finance and Fiscal Decentralization Reform Program*. Manila.

² Local Government Code. 1991. The Philippines has 17 regions, 81 provinces, 38 independent cities, 107 component cities, 1,490 municipalities, and 42,029 barangays.

³ Philippine Institute for Development Studies. *Economics and Social Database*. 2012.

⁴ Bureau for Local Government Finance. 2014. *eSRE Consolidated Fiscal Data*.

of the LGUs to self-fund critical activities and service delivery is significantly constrained. Overreliance on the fiscal transfers, and administrative burdens have inhibited the development of local tax bases and, as such, tax collection is well below potential. LGUs also face limited access to the debt capital markets. This inhibits their ability to efficiently plan and execute investment programs. Finally, local public financial management (PFM) systems are outdated and do not ensure transparency or support effective monitoring by civil society.

6. **The binding constraints.** As a result, LGUs are unable to enhance local economic development and reduce the cost of doing business at the local level. Moreover, the accountability between LGUs and their constituents that is expected from an efficient local tax system has been diluted. These issues perpetuate regional disparities in poverty reduction in a number of ways. First, regional disparities limit inclusive growth and employment-generating opportunities for the country as a whole as lagging regions struggle to develop a skilled workforce and lack the conditions necessary for business development. Second, less prosperous localities are unlikely to develop good governance practices, including transparent and efficient service delivery systems, due to a lack of accountability between constituents and their local governments. This lack of basic services restrains the development prospects of the Philippines. Third, the resultant weakness in revenue collection increases pressure on the national government to provide fiscal transfers, which affects fiscal stability and sustainability.

7. During 2010–2013, ADB supported the government's efforts to address the first set of development constraints: (i) inadequate and inequitable resource mobilization, (ii) weaknesses in PFM systems at the national and local levels, and (iii) ineffective feedback and accountability systems (footnote 1). Subprogram 1 strengthened the demand side of the decentralized system of government by introducing performance-based monitoring systems and grants mechanisms, and improved the transparency and accountability of LGUs. Subprogram 1 also began the development of a medium- to long-term fiscal decentralization road map and launched an ambitious first-ever review of the Local Government Code (LGC) of 1991. The review, which was supported by ADB, covered the LGC's fiscal provisions and identified the next set of development constraints as well as a framework to further improve intergovernmental fiscal relations. Subprogram 2 will now address this remaining set of development constraints. The LGC, which interconnects and anchors the activities of LGUs, suffers from structural deficiencies that prevent an equitable distribution of fiscal transfers, limit the size of own-source tax revenue available to LGUs, and restrict their ability to access debt capital markets. This limits the capacity of LGUs to efficiently deliver services that are responsive to the needs of their constituents. In response, the government has embarked on a sequenced reform program that will address the following constraints (discussed in paras 8 to 11) by prioritizing those that do not require a change in law while simultaneously pursuing an effort to amend the LGC.

8. **LGUs have a limited capacity to raise revenue.** Highly urbanized centers are able to generate large amounts of revenues from local taxes, while rural LGUs are not. Overall, tax assessment mechanisms and the capacity of LGUs to collect tax in coordination with the national government need to be improved. Tax and nontax revenues for LGUs accounted for 34% of their total operating income in 2014. However, this metric is misleading as LGU finances are still highly dependent on fiscal transfers from the national government. For example, local tax revenue of all provinces in the aggregate represented only 0.06% of GDP in 2013. LGUs have been provided, by law, with a very limited set of potential taxes that can be used to strengthen local tax bases. Moreover, these potential revenue sources suffer from inefficient design and require frequent regulatory changes. While LGUs have been granted borrowing powers, there are implicit provisions that restrict their access to credit, including a cumbersome approval process and a narrow scope of approved borrowing purposes.

9. **Public financial management systems are inefficient.** Efficient PFM provides the framework through which public services are delivered effectively and efficiently. However, the absence of a strategic vision has resulted in a piecemeal approach which focused only on reforming individual elements of the PFM system. Budget operation systems are outdated and prevent the synchronization of planning and budgeting. Expenditure targeting needs to be improved. Regulations governing PFM at the LGU level need to be aligned with national expenditure priorities and institutionalized. New initiatives at the national level which encourage and reward enhanced PFM at the LGU level, such as the Assistance to LGU Program (ALGUP) and the Performance Challenge Fund (PCF), are not coordinated with local development plans.⁵ Key LGU policies, such as those covering local economic enterprises, the Special Education Fund, and disaster risk management, do not incorporate the recently established performance-based management systems such as the seal of good local governance (SGLG) system.

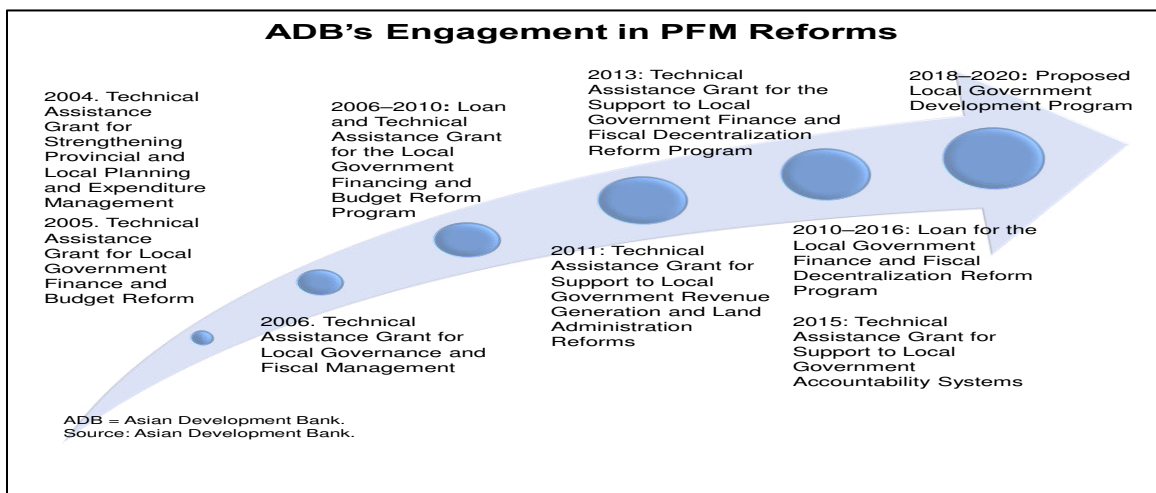
10. **Local government accountability systems are underdeveloped.** Performance measurement systems are critical to ensuring that local budgets are responsive to local needs and aligned with national development priorities. However, local constituents do not have the means to monitor and evaluate, or provide feedback on the budget performance of LGUs. The performance evaluation systems currently in use do not provide useful data to guide investment decisions, do not allow for inter-local comparisons, and are not easily accessible to the public. In addition, the number of these performance measurement instruments has multiplied which has increased LGUs compliance costs. Performance mechanisms for LGUs also need to be binding, as well as compliant with transparency policies.

11. **Fiscal transfers are not equitably distributed.** The IRA is the largest national government transfer, representing close to two-thirds of the aggregate income of LGUs in 2014 (₱341 billion). The IRA is divided among different LGUs as follows: 23% to provinces, 23% to cities, 34% to municipalities, and 20% to barangays. The IRA share of each tier of local government is then apportioned to individual LGUs within each level based on population (50%), land area (25%), and equal sharing (25%). The IRA does not consider the fiscal capacity of LGUs, which causes large disparities in expenditure per capita and limits the ability of poorer LGUs to deliver a level of basic services comparable with the more well-off LGUs.

12. **The government's sector strategy.** The PDP, 2011–2016 identifies three primary objectives: (i) promoting inclusive growth and generating employment, (ii) improving governance and human development standards, and (iii) achieving macroeconomic and fiscal sustainability. The Good Governance and Anti-Corruption Cabinet Cluster (GGACC) coordinates the implementation of the government's initiatives to strengthen public institutions, promote transparency, and increase accountability through participatory governance. Within this framework, the PFM road map provides a comprehensive reform agenda to ensure that the national government is able to maintain fiscal discipline, allocate funds efficiently, and provide efficient service delivery. For example, the road map calls for the development of an integrated financial management information system that can provide web-based access to LGU information in a common format. Emphasis is also being placed on performance-informed budgeting to strengthen alignment with national priorities, reinforce accountability, and better engage civil society. Efforts to promote decentralization and strengthen PFM are expected to continue under the draft PDP for 2017–2022 and will be supported by the LGU PFM reform road map 2016–2022, which was adopted in 2015 as part of this program. The road map addresses the gaps identified in the 2007 Public Expenditure and Financial Accountability Assessment (PEFA) through four sequenced reform clusters; linking budget planning to policy priorities,

⁵ ALGUP has superseded the Bottom-up Budgeting program.

developing reliable and predictable budgets, increasing transparency, and holding managers accountable.



13. **ADB's experience.** ADB has supported local government reforms in the Philippines since 2004. The first programmatic approach focused on decentralization and local government finance by institutionalizing the timely and transparent release of LGU shares in national government revenues.⁶ In addition, the program developed the pillars of a performance-based LGU PFM framework, provided LGUs with limited access to credit financing, and strengthened the ability of national oversight agencies to monitor LGU finances. Building on these accomplishments, the program (footnote 1) now serves as an umbrella to anchor ADB's support for broader PFM reform and its expanding engagement with LGUs. For example, the Encouraging Investment through Capital Market Reforms Program is providing complementary support to the Bureau of the Treasury to strengthen debt management, cash flow forecasting, and control over the government's cash balances.⁷ The Expanding Private Participation in Infrastructure Program⁸ provides support to the national government and LGUs to accelerate the development of infrastructure, while the proposed (2016) Enhancing Youth School-to-Work Transition Program supports measures to improve employment, including labor market activation programs in LGUs. Continuing support to LGUs is planned through the Enhancing Rural Enterprise and Rural Employment Program, planned for 2017, and the next generation Local Government Development Program, which is planned for 2018.

14. **Lessons learned from the experience.** A key lesson has been the need to sustain rich and frequent interagency coordination. The work of the Coordinating Committee on Decentralization (CCD), which was established with ADB support, and the Working Group on Decentralization of the Philippine Development Forum were instrumental in ensuring the coordination of all reform initiatives and maintaining a common focus on performance, accountability, and inclusive growth. A second lesson learned is the need to ensure bottom-up

⁶ ADB. 2007. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan and Technical Assistance Grant to the Republic of the Philippines for the Local Government Financing and Budget Reform Program Cluster (Subprogram 1)*. Manila; and ADB. 2009. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan and Technical Assistance Grant to the Republic of the Philippines for the Local Government Financing and Budget Reform Program Cluster (Subprogram 2)*. Manila.

⁷ ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of the Philippines for Encouraging Investment through Capital Market Reforms Program*. Manila.

⁸ ADB. 2015. *Report and Recommendation of the President to the Board of Directors: Proposed Loan to the Republic of the Philippines for Expanding Private Participation in Infrastructure Program*. Manila.

engagement of stakeholders to incorporate the views of the business sector, academe, and civil society for successful reform implementation. This has been particularly true in the review of the LGC, among other initiatives. A third lesson was gained from the continuing dissemination of the link between LGU reform and the achievement of the country's long-term development goals which enhanced stakeholder participation. In addition, good local governance is instrumental in ensuring program implementation and, in particular, infrastructure development.

15. **ADB's value added to the design and implementation of the program.** Through the provision of technical assistance and policy advice, ADB established a framework that improved the administration of real estate and property taxes,⁹ and supported the completion of a number of policy reforms under the program.¹⁰ Notably, ADB provided the technical and logistical resources to complete the government-led review of the fiscal provisions of the LGC. ADB also provided capacity development to improve comprehensive development planning and, in particular, the harmonization of the different planning processes linked to national and local programs (e.g., the ALGUP and the PCF). ADB strengthened the analytical value of reporting through the implementation of financial management information systems for LGUs (e.g., the electronic statement of receipts and expenditures [eSRE]). Technical assistance was provided to assess the impact of national tax incentives on local government revenues and economic growth, identify new sources of local revenue for LGUs, and develop a financing framework for LGU alliances that assists joint service delivery. Finally, ADB encouraged the civil society to play an enhanced role in LGUs by reengineering the local government performance measurement system to align it with the SGLG.

16. **Development partner coordination.** The program has benefited from close coordination with the Agence Française de Développement (AFD) through joint missions and onsite reviews. AFD provided parallel financing in the amount of \$150 million equivalent for subprogram 1 and plans an equivalent amount of support for subprogram 2. In addition, close coordination has been sustained with the European Union-led LGU Public Finance Reform Program through the CCD. Coordination with other development partners (such as the World Bank, Australia, and Canada) has been assisted by the work of the Philippine Development Forum working group on decentralization.

17. **Policy-based loan and budget support.** The programmatic approach was selected as it leverages government and stakeholder engagement and supports the implementation of a complex set of policy initiatives, including eventual amendments to the law, into a comprehensive and cohesive medium-term reform plan. The approach is optimized by the ability to deliver technical assistance from several development partners to national and local government agencies. The post-program partnership framework will support a continuing policy dialogue between the government and ADB.

18. **Economic impact of the program.** Research indicates that decentralization of government expenditure can reduce income inequality, given a sufficiently large government expenditure program, comprehensive decentralization, and most importantly, decentralization on the revenue side to reduce LGU reliance on the IRA.¹¹ Therefore the program will increase the efficiency of service provision by LGUs through a better allocation of budgetary resources. The economic benefits will be achieved by aligning expenditure assignments across tiers of

⁹ ADB. 2011. *Technical Assistance to the Republic of the Philippines for Support to Local Government Revenue Generation and Land Administration Reforms*. Manila.

¹⁰ ADB. 2013. *Technical Assistance to the Republic of the Philippines for Support to Local Government Finance and Fiscal Decentralization Reform*. Manila.

¹¹ IMF. 2014. *Income Inequality, Fiscal Decentralization and Transfer Dependency*. Washington DC.

government, increasing LGU own-source revenues, strengthening PFM systems and local governance, and establishing accountability in and improving the capabilities of local officials. Moreover, the reforms complement each other, giving LGUs the ability and incentive to improve.

B. Impact and Outcome

19. The impact, which is aligned with the PDP, 2011–2016, will be improved governance and human development standards through more efficient service delivery. The outcome will be efficient and transparent local government financial management systems developed. There are four major outputs which are aligned with the government's reform priorities. Subprogram 2 includes 26 policy actions (14 triggers and 12 milestones), which were completed from July 2013 to May 2016.¹²

C. Outputs

20. **Output 1: Resource framework for fiscal sustainability developed.** LGUs need to increase their own source revenue. As LGUs currently generate tax revenues primarily from business and real estate taxes, the government improved the assessment of real estate market values and strengthened the capacity of the personnel that conduct tax assessments. In addition, the government developed proposals to reform property and business taxes, and to create new tax instruments for LGUs.¹³ Access to the Bureau for Internal Revenue's taxpayer database was increased and the related reporting requirements are now an assessment criterion in the performance standards of local treasurers and assessors. As a result, aggregate property taxes collected by LGUs increased by 48% between 2010 and 2015.

21. The government also increased LGU access to credit financing through the deployment of new eSRE modules on LGU creditworthiness to the regional offices of the Bureau of Local Government Finance (BLGF) of the Department of Finance (DOF). The modules allow LGUs to estimate their debt borrowing limits and provide a solid technical instrument for the DOF to validate the borrowing capacity of LGUs. In addition, a dedicated Debt Monitoring Unit has been created in the BLGF, which is designing and maintaining LGU monitoring procedures, collecting consolidated LGU borrowing data, and issuing regular publications.

22. Concurrently, the government strengthened its oversight of LGU expenditures. A new module under the eSRE provides a publicly available means of monitoring LGU capital expenditures from the development fund.¹⁴ In addition, reporting mechanisms have been incorporated into the ALGUP to capture and monitor the capital expenditure of LGUs, and to facilitate ex post monitoring through the Commission of Audit's annual audits. Eligibility to access development funds, including the PCF and ALGUP, has been tied to the SGLG to incentivize performance-based management in local governments. Expanding on the initial Seal of Good Financial Housekeeping, the SGLG validates that LGUs comply with national legal and policy requirements in additional performance areas, including disaster preparedness, competitiveness, and environment protection.

23. **Output 2: Public financial management system to assist efficient local government unit service delivery strengthened.** To provide much-needed strategic guidance and continuity, the government approved and implemented its LGU PFM road map and strategy. In

¹² Subprogram 2 originally proposed 59 policy actions and sub-actions. All were completed as originally proposed. Subsequently, the policy matrix was modified and streamlined to improve its presentation and readability.

¹³ These proposals emanated from output 1 and the review of the LGC.

¹⁴ The development fund is defined as 20% of the IRA allocation and is earmarked for capital investment projects.

addition, the government updated its budget and planning systems and synchronized project development, planning, investment programming, and budgeting across all levels of government. The Department of Budget and Management revised the Budget Operations Manual to institutionalize performance-informed and participatory budgeting processes at the LGU level. The revised manual covers the preparation of medium-term expenditure frameworks for LGUs, and incorporates policy changes to dedicated funds (e.g., the Special Education Fund and the Local Disaster Risk Reduction and Management Fund). The manual also incorporates the provisions of the new manual on local economic enterprises along with enhanced procedures for internal audit. In addition, the government has upgraded financial management information systems and completed a common database of financial information for LGUs.

24. The ALGUP initiative has been expanded and now encompasses over 1,514 LGUs with an aggregate expenditure of ₱25 billion (\$517 million) in 2015 compared with 595 LGUs and ₱8 billion (\$165 million) in 2013. Concurrently, the government has integrated the ALGUP into local planning process through synchronized calendars, formats, terminologies, and the composition of consultative bodies. Civil society provides inputs in the identification of projects and ensures funds are allocated in an increasingly equitable manner.

25. **Output 3: Local governance, transparency, and accountability systems established.** A performance-based, responsive PFM requires transparency and the participation of civil society. In recognition, the government has improved accountability mechanisms between LGUs and their constituents. The Citizen's Satisfaction Index, which covered 35 cities in 2013, has been expanded and now covers 140 cities (2015). The index allows constituents to evaluate the performance of LGUs in the areas of health, governance and response, environment management, public works and infrastructure, support to education, social welfare, tourism promotion, and agricultural support. Full disclosure of the results of the index is required as a binding prerequisite to access national government funds. To further expand and strengthen the participation of civil society, the Department of the Interior and Local Government (DILG) has redesigned the Local Government Performance Management System and, over time, will align it with the SGLG. This will enhance the analytical capacity of the system to assist planning and budget formulation by LGUs, and improve access of local constituents to the data and information contained in the system.

26. To promote an accelerated adoption of the revised performance-based PFM systems, the government has implemented a program to test and evaluate the technical capacity of LGU treasurers. The first assessments have been released. In addition, the DILG upgraded the Newly Elected Officials' training program, and provided training to 560 newly elected officials as part of the recent election cycle. Capacity development has also been provided to local planning officers in select regions to improve the preparation of local comprehensive development plans. Moreover, the government has improved the implementation of gender and development plans for LGUs by issuing guidelines to incorporate the Magna Carta for Women in LGU budgets and investment plans, and has deployed a system to monitor implementation.¹⁵ This effort has been supported by training programs, delivered at the local level, to help LGUs identify and evaluate activities in local gender and development plans.

27. **Output 4: Fiscal framework for inclusive growth created.** Changes to the legal framework are required to provide a more equitable system for intergovernmental fiscal relations. To support an eventual revision of the LGC, the government completed the first comprehensive

¹⁵ The Magna Carta for Women (Republic Act 9710 dated 28 July 2008) is a comprehensive women's human rights law that seeks to eliminate discrimination and promote the rights of Filipino women.

review of the LGC in 25 years. The review, which was completed in 2015, was led by national and local government agencies, and included the participation of academe, the private sector, civil society, and development partners. The DILG submitted the results of the review to all members of the GGACC, and to the head of the Oversight Committee on Devolution (i.e., the executive secretary to the government). Two of the proposals (i.e., the Valuation Act and the LGU Income Classification Bill) were filed in the 16th Philippine Congress, and have reached different stages of progress. Moreover, the recommendations for amendment of the LGC obtained from the review have provided a comprehensive medium-term road map for fiscal decentralization that will be available for the next administration.

D. Development Financing Needs

28. The government has requested a single-tranche loan of \$250 million from ADB's ordinary capital resources to help finance subprogram 2, which is the second and last subprogram of a programmatic approach (footnote 1). The loan will have a 15-year term, including a grace period of 3 years, an annual interest rate determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility, a commitment charge of 0.15% per year, and such other terms and conditions set forth in the draft loan agreement. Based on this, the average loan maturity is 12.1 years. The loan size is based on the financing needs of the Philippines, the strength of the policy reform package, and its development impact. The Philippines' gross financing needs are high. In 2016, with a budget deficit target of 2.7% of GDP, the government will need to borrow \$6.9 billion, of which an estimated \$1.5 billion will be sourced through official development assistance. AFD will provide parallel financing in the amount of \$150 million equivalent.

29. The government has provided ADB with (i) the reasons for its decision to borrow under ADB's LIBOR-based lending facility based on these terms and conditions, and (ii) an undertaking that these choices were its own independent decision and not made in reliance on any communication or advice from ADB. The loan proceeds will be used to finance foreign exchange of economy-wide imports, excluding ineligible items and imports financed by other bilateral and multilateral sources in accordance with ADB's *Loan Disbursement Handbook* (2015, as amended from time to time). The loan proceeds will be disbursed to the Philippines as the borrower.

E. Implementation Arrangements

30. The DOF is the executing agency for the program and is responsible for the overall implementation of both subprograms and the medium-term results framework. CCD served as the steering committee for the program, as it includes all the implementing agencies and relevant stakeholders. CCD led the review of the LGC and submitted the recommendations to Oversight Committee on Devolution for consideration. The program's implementing agencies include the BLGF, the DILG, the DBM, and the National Economic and Development Authority. Subprogram 2 was implemented from July 2013 to May 2016.

III. DUE DILIGENCE

A. Economic and Financial

31. The net present value of the potential gains from full implementation of the program is estimated to be \$2 billion. This estimate assumes a 10% discount rate, that the program accelerated the reforms by 10 years, and that the costs and expenditures grow at a real rate of

3% a year. The program's benefits are derived from three primary sources: increased efficiency of LGU expenditure, redistributive gains arising out of a realignment of the IRA towards relatively poorer LGUs, and gains arising from more targeted and efficient spending programs. However, the primary benefit arising out of the reforms is clearly due to the increased efficiency of LGU service provision. In the aggregate, the direct costs of the program are estimated to total \$1.4 billion. This includes the cost of financing the ALGUP initiative, estimated at around \$1.1 billion, the PCF and associated funds to the Seal of Good Governance (with an estimated budget of \$170 million), and costs related to policy development and administration.¹⁶

B. Governance

32. Under the PDP, 2011–2016, the government has instituted an aggressive reform agenda to create an enabling environment for citizens and the private sector (para. 11). Under this agenda, the implementation of the 2011 PFM reform road map has achieved measurable results. The 2014 update of the 2010 PEFA noted that the average scores for three of the six dimensions (comprehensiveness and transparency; policy-based budgeting; and accounting, recording, and reporting) have improved. The remaining areas of weakness (e.g., budget credibility, predictability and control in budget execution, and external scrutiny and audit) are being addressed. Budget credibility has been enhanced through the adoption of performance-based budgeting and efforts to ensure accelerated budget execution. In addition, the government has strengthened the budget review process and has reduced the number and magnitude of special purpose funds. The recent adoption of a treasury single account will also increase budget credibility by centralizing the collection of government revenues. Transparency has been strengthened through the adoption of the transparency seal. This program requires all government agencies to disclose key information, including open-source data sets, through their respective websites. To improve scrutiny and audit, Congress now reviews and approves the annual budget and the standards governing public audit have been strengthened.¹⁷

33. ADB's Anticorruption Policy (1998, as amended to date) was explained to and discussed with the government and the DOF. GGACC is implementing a comprehensive and results-based anticorruption action plan, drawing on a review of the National Anti-Corruption Plan of Action. Various initiatives by various development partners to strengthen the capacity of the Office of the Ombudsman and the justice sector have achieved positive results. The Philippines rose to 95th place out of 175 countries in Transparency International's 2015 Corruption Perception Index, from 134th place out of 178 countries in 2010 when the program commenced.

C. Poverty and Social

34. The potential beneficiaries of the program will include local constituents, the private sector, civil society organizations, and the poor. The program will introduce participatory and accountable planning, budgeting, and monitoring systems that allow improved matching of local budgets and local development priorities and preferences. The reforms implemented under the program will also have a direct impact on poverty reduction by helping prioritize and improve the coordination of pro-poor expenditures. The reforms will also improve service delivery through the ALGUP and PCF and, indirectly, through savings obtained from more efficient PFM practices. Finally, the program will support the creation of predictable and adequate local revenue bases that assist private entrepreneurship and business development, as well as employment generation. Subprogram 2 is classified as *some gender elements* and includes improvements to the preparation and monitoring of gender and development plans by LGUs, the

¹⁶ Program Impact Assessment (accessible from the list of linked documents in Appendix 2).

¹⁷ Public Financial Management Assessment (accessible from the list of linked documents in Appendix 2).

prioritization of gender-sensitive expenditures under the ALGUP, and the inclusion of gender dimensions in performance-based monitoring systems.

D. Safeguards

35. In accordance with ADB's Safeguard Policy Statement (2009), subprogram 2 is classified *category C* for the environment, involuntary resettlement, and indigenous peoples. The assessment of policy actions concludes that no safeguard policies are triggered.

E. Risks and Mitigating Measures

36. The program is exposed to broad macroeconomic risks, as well as risks associated with PFM and corruption. Overall, risks are medium and well-controlled, and the integrated benefits and impacts are expected to outweigh the costs. Macroeconomic risks are low, and ADB is actively coordinating with other development partners to mitigate the remaining broad risks by supporting a whole of government approach, which includes this program, to reduce corruption and strengthen the entire PFM cycle, including procurement. Contextual or project-specific risks arise primarily out of the need to assure the continuity of reforms through the government transition. ADB has addressed these risks by building a wide stakeholder engagement, including representatives from the Senate and the House of Representatives, and by providing explicit incentives in the reform program for local government officials. ADB will also provide the new administration with a briefing note to describe the rationale and benefits of the program, as well as the extent of existing stakeholder support. The CCD, which was established with ADB support, also plays a lead role in ensuring continuing progress. Major risks and mitigating measures are described in detail in the risk assessment and risk management plan.¹⁸

IV. ASSURANCES

37. The government and DOF have assured ADB that implementation of the program shall conform to all applicable ADB policies, including those concerning anticorruption measures, safeguards, gender, procurement, consulting services, and disbursement as described in detail in the loan document.

V. RECOMMENDATION

38. I am satisfied that the proposed policy-based loan would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve the loan of \$250,000,000 to the Republic of the Philippines for subprogram 2 of the Local Government Finance and Fiscal Decentralization Reform Program, from ADB's ordinary capital resources, with interest to be determined in accordance with ADB's London interbank offered rate (LIBOR)-based lending facility; for a term of 15 years, including a grace period of 3 years; and such other terms and conditions as are substantially in accordance with those set forth in the draft loan agreement presented to the Board.

Takehiko Nakao
President

21 November 2016

¹⁸ Risk Assessment and Risk Management Plan (accessible from the list of linked documents in Appendix 2).

DESIGN AND MONITORING FRAMEWORK

Impact the Program is Aligned With			
The program is aligned with the Philippine Development Plan, 2011–2016 ^a and will improve governance and human development standards through more efficient service delivery.			
Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
Outcome Efficient and transparent local government financial management systems developed	By 2017: a. Real property tax collection increased by 20% (2010 baseline: ₱33.1 billion) b. Local government recurrent expenditures increased by 20% (2011 baseline: ₱266.2 billion) c. LGU PFM assessment tool average score improved by 20% (2013 baseline: 2.34) d. Overall average national score for “satisfaction” in the Citizen Satisfaction Index improves. (2013 baseline: 58.85)	a–b. Department of Finance BLGF eSRE c. DBM reports d. National Consolidated Report of the Citizen Satisfaction Index	LGU programs, like ALGUP and PCF, do not constitute a priority of successor administrations. The revision and approval of the LGC is delayed, or pursued in an ad hoc manner. A lack of coordination in policy formulation among central government agencies undermines the pace of reform.
Outputs 1. Resource framework for fiscal sustainability developed 2. PFM system to assist efficient LGU service delivery strengthened	By 2016: 1a. Seal of good local governance completed and implemented (2012 baseline: none) 1b. eSRE expenditure module completed and implemented (2012 baseline: not implemented) 1c. Performance standards for local treasurers introduced (2012 baseline: No performance standards) 2a. Medium-term strategy and road map for LGU PFM reform approved (2012 baseline: none) 2b. Guidelines for harmonization of LGU planning and budgeting processes completed (2012 baseline: not	1a. DILG reports and website 1b. BLGF reports and consultant reports 1c. BLGF reports and circulars 2a. DBM circulars and program progress reports 2b. DILG Joint Memorandum Circular	The short political terms of local chief executives limit incentives for reform implementation. Budget allocations are distorted due to weak PFM and procurement systems, or a lack of oversight. There are insufficient resources to support capacity development for LGUs.

Results Chain	Performance Indicators with Targets and Baselines	Data Sources and Reporting Mechanisms	Risks
	completed)		
	2c. ALGUP fully implemented with ₱21 billion released through the program by 2014 (2012 baseline: 0)	2c. DBM budget circulars	
	2d. Budget Operations Manual review completed (2012 baseline: not completed)	2d. DBM official submission and program progress reports	
	2e. Local economic enterprise guidelines completed and released (2012 baseline: none)	2e. DBM reports	
3. Local governance, transparency, and accountability systems established	3a. Citizen satisfaction index reports completed (2012 baseline: none)	3a. DILG	
	3b. Redesign of the local government productivity and performance measurement system completed (2012 baseline: not completed)	3b. DILG and consultant reports	
4. Fiscal framework for inclusive growth created	4a. Recommendations for amendment of the LGC submitted to the Good Governance and Anti-Corruption Cabinet Cluster and executive secretary (2012 baseline: none)	4a. DILG official submission	
Key Activities with Milestones			
Not applicable.			
Inputs			
Asian Development Bank			
Subprogram 2: \$250,000,000 (ordinary capital resources)			
Assumptions for Partner Parallel Cofinancing			
Agence Française de Développement			
Subprogram 2: \$150,000,000			

ALGUP = Assistance for Local Government Units Program, BLGF = Bureau of Local Government Finance, DBM = Department of Budget and Management, DILG = Department of the Interior and Local Government, eSRE = electronic statement of receipts and expenditures, LGC = Local Government Code, LGU = local government unit, PCF = Performance Challenge Fund, PFM = public financial management.

^a Government of the Philippines. 2011. *Philippine Development Plan, 2011–2016*. Manila.

Source: Asian Development Bank.

LIST OF LINKED DOCUMENTS

<http://www.adb.org/Documents/RRPs/?id=44253-016-3>

1. Loan Agreement
2. Sector Assessment (Summary): Public Sector Management
3. Contribution to the ADB Results Framework
4. Development Coordination
5. Country Economic Indicators
6. International Monetary Fund Assessment Letter
7. Summary Poverty Reduction and Social Strategy
8. Risk Assessment and Risk Management Plan
9. List of Ineligible Items

Supplementary Documents

10. Program Impact Assessment
11. Public Financial Management Assessment
12. Comparative Design and Monitoring Framework

DEVELOPMENT POLICY LETTER



Republic of the Philippines
DEPARTMENT OF FINANCE
Roxas Boulevard Corner Pablo Ocampo, Sr. Street
Manila 1004

DEVELOPMENT POLICY LETTER

15 November 2016

Mr. TAKEHIKO NAKAO
President
Asian Development Bank
Manila, Philippines

SUBJECT: Local Government Finance and Fiscal Decentralization Reform (LGFFDR) Program

Dear **Mr. Nakao**:

On behalf of the Government of the Philippines (Government), we would like to express our appreciation for the continuing support of the Asian Development Bank (ADB), and your own keen interest in strengthening public financial management systems in the Philippines, as well as improving the efficiency of expenditure at the local government level. Local governments play a critical role in ensuring comparable levels of service delivery across the Philippines and are key to our efforts to reduce poverty and make our economic gains more inclusive. In this regard, eliminating the constraints that prevent our local government units (LGUs) from providing high quality and efficient service delivery remains our priority.

This development policy letter outlines our reform program, and our request for financial assistance from the ADB. It highlights the Government's efforts to achieve inclusive growth and poverty reduction through improved service delivery by Local Government Units (LGUs) by introducing reforms that would create a conducive fiscal framework for inclusive growth, develop an adequate and equitable resource frameworks for fiscal sustainability, strengthen local government public financial management, and foster good local governance, transparency and accountability.

In the attached policy matrix, we have identified key reform initiatives which we sought support for by the ADB through the Local Government Finance and Fiscal Decentralization Reform (LGFFDR) Program. The first Subprogram (Subprogram 1) approved by ADB in 2013 achieved significant milestones and laid the foundation of the second Subprogram (Subprogram 2). Subprogram 2 is consistent with the Government's 0-10 Point Socioeconomic Agenda, which will be the main basis of the new Philippine Development Plan 2017–2022.

Through the LGFFDR, the Government tried to address the shortcomings of the existing regulatory framework for inter-governmental fiscal relations through the first

comprehensive review of the Local Government Code since its enactment in 1991, with a focus on the provisions related to expenditure and revenue assignments, and fiscal transfers to LGUs. The Department of Interior and Local Government (DILG) through the Coordinating Committee on Decentralization led the review under Subprogram 1 that was implemented from 2010 to 2013. Under Subprogram 2 (implemented from 2013 to 2015), the proposals for amendments of the LGC were submitted to the Oversight Committee on Decentralization and the Cabinet Cluster on Good Governance and Anti-Corruption. Recommendations covered a variety of issues, including: clearly assigning responsibility for delegated and devolved functions which cover simplifying business taxes, strengthening the framework for property taxes, and allowing for taxes and fees to be indexed to inflation. These revenue measures provided LGUs with additional resources in excess of P100 billion per year. Strong support allowed the filing of two proposals – the Valuation Act and the LGU Income Classification Bill – to the Philippines 16th Congress, reaching different stages of progress. These, and a variety of proposals to amend the Internal Revenue Allotment, will form a pillar of our reform agenda through the next five years.

In pursuing fiscal sustainability, the Government initiated setting-up of mechanisms to merit good financial management performance of LGUs through the institutionalization of the Performance Challenge Fund (PCF) and the Seal of Good Housekeeping (SGH). These performance-based financing and monitoring systems were scaled up in Subprogram 2 to become the Seal of Good Local Governance (SGLG), incorporating components on business friendliness and competitiveness, disaster preparedness, and environmental management, while retaining as major component the good financial housekeeping. Moreover, with the aim of assisting higher revenue collection by LGUs, instruments were developed to estimate local government revenues under Subprogram 1. Building from this, the Subprogram 2 developed instruments to assist LGUs improve their property tax collection performance such as mandating them to regularly update their schedule of market values (SMVs). Further, LGU's access to credit financing was supported through the establishment of LGU creditworthiness, debt certification and fiscal capacity systems and incorporating the data on LGU creditworthiness and borrowing capacity into the new Electronic Statement of Receipts and Expenditures (eSRE) modules. eSRE now allows monitoring of expenditures under the 20% of the Internal Revenue Allotment that is devoted to development projects.

Following public financial management (PFM) reforms at the national level that contributed to the improvement of the country's fiscal profile, key improvements to the financial management systems of LGUs were undertaken under the LGFFDR Program. The Department of Budget and Management led the drafting of a medium-term LGU public financial management reform roadmap and strategy during the program's first Subprogram, and sought its approval and started implementation of the plan during the second Subprogram. A review and revision of the Budget Operations Manual for LGUs was likewise undertaken under Subprogram 2. Efforts on the implementation of the Assistance to Local Government Units program (formerly Bottom-Up Budgeting Initiative) piloted in 2010 provided PhP8 billion amount of funds in 2012, with 595 LGUs benefiting from the allocations. This was also sustained and expanded during the program's second Subprogram with an increased budget allocation of PhP21 billion covering 1,200 LGUs. A strengthened LGU PFM was moreover assisted by developing a common database of all financial information of LGUs.

Finally, towards fostering good local governance, transparency and accountability, the DILG led the institutionalization of the Full Disclosure Policy (FDP), mandating full disclosure of particular financial transactions of LGUs and uploading them into the FDP portal. Compliance to the FDP was also made a requirement for access to performance-based sources of financing by LGUs from the national government. Likewise, the Citizen's Satisfaction Index piloted in Subprogram 1 was sustained in the Subprogram 2, providing a mechanism to assess the "satisfaction" with basic services delivered by LGUs. This index allows constituents to evaluate the performance of their LGUs in the areas of health, governance and response, environmental management, public works and infrastructure, support to education, social welfare, tourism promotion, and agricultural support.

In fostering good local governance, trainings such as the Newly-Elected Officials (NEO) Program by the DILG was piloted in 2010 and was redesigned in its 2013 implementation. The redesigned training program has been continued and expanded to include all councilors, and specifically all new female councilors. A performance evaluation system for local budget officers has also been implemented along with a similar system specifically designed for local treasurers.

In order to assist the implementation of local government reforms, the Government is requesting financing from ADB totaling USD250 million for Subprogram 2. In addition, we are expecting USD150 million equivalent parallel co-financing from the Agence Française de Développement (AFD). The proceeds will be used primarily to support local government reform spending as defined in this policy letter.

In closing, the Government reiterates its commitment to the development of efficient and accountable local governments. We will continue to work in coordination with ADB, the AFD, and other development partners to pursue these reforms. We deeply appreciate ADB's leading role in support to local government finance and fiscal decentralization reforms over the long term. To assist continuation of recent, successful efforts, we look forward to sustained policy dialogue with the ADB through the post-program partnership framework.

Very truly yours,


CARLOS G. DOMINGUEZ
Secretary of Finance



POLICY MATRIX

Development Partner Coordination	Subprogram 1 (Phase 1) Actions Accomplished Under Subprogram 1 (2010–2013)	Subprogram 2 (Phase 2) Actions Accomplished Under Subprogram 2 ^a (2013–2016)	Post Program Partnership Framework
Output 1: Developing an adequate and equitable resource framework for fiscal sustainability			
<p><i>1 Performance-based financing and monitoring systems deployed.</i></p> <p>Design of the Performance Challenge Fund was assisted by the DIALOG Fund and ADB TA 7451 <i>Support to Local Government Financing</i></p> <p>Subprogram 2 policy actions will be supported with ADB, AFD (Seal of Disaster Preparedness) and CIDA (Seal of Competitiveness)</p>	<p>To incentivize efficient financial management, the government develops performance-based financing mechanisms for LGUs. Accomplishments included:</p> <ol style="list-style-type: none"> 1. Establishing the Performance Challenge Fund. 2. Jointly with DBM, formulating and approving Guidelines on the appropriation and utilization of the IRA's development fund. 	<p>To strengthen the oversight of, and transparency over the use of public funds, the Government deploys disclosure and accountability mechanisms for LGUs. Accomplishments include:</p> <ol style="list-style-type: none"> 1. The government approved and launched a system to monitor the utilization of LGU expenditures, including the Development Fund (DBM/BLGF). 2. The government completed and piloted the Seal of Good Local Governance for LGUs in 2015, incorporating the upgraded Seal of Good Financial Housekeeping and new core components covering competitiveness and business-friendly, disaster preparedness, environmental compliance (DILG). 	<p>eSRE reports, including the expenditure module, are made available to the public.</p> <p>LGUs are increasingly compliant with performance requirements under the SGLG.</p>
<p><i>2 Capacity of LGUs to generate own revenue enhanced.</i></p> <p>Assistance to the completion of SP 1 was provided under ADB's TA 7451 <i>Support to Local Government Financing and REGALA initiative. (Support to Local Government Revenue Generation and Land Administration Reforms).</i></p>	<p>The DOF has taken steps to improve the revenue collection capacity of LGUs. Accomplishments include:</p> <ol style="list-style-type: none"> 3. Developing a computer module including a local tax payer database and a system for the estimation of presumptive income level. 4. Incorporating uniform valuation standards in the 2010 addendum to the real property assessors' manual, and training assessors on the new standards. 	<p>To enhance revenue generation, and to improve the efficiency of tax collection, the government implemented measures to expand and rationalize taxes which LGUs can access. Accomplishments include:</p> <ol style="list-style-type: none"> 3. To provide for a more rigorous collection of property taxes, the government issued guidelines for the assessment of the revised LGU Schedules of Market Values (SMVs), and conducted training for BLGF regional offices to ensure they have the capacity to use the revised LGU SMVs (BLGF). 4. To improve transparency and discipline, the government began issuing Tax Watch weekly reports which provide up to date information to the public at large on LGU tax collection performance (BLGF). 	<p>LGUs continue to improve share of locally sourced revenues over total revenues with review of LGC tax measures and the consideration of new and additional tax and non-tax revenue instruments outside of the LGC review scope.</p>

Development Partner Coordination	Subprogram 1 (Phase 1) Actions Accomplished Under Subprogram 1 (2010–2013)	Subprogram 2 (Phase 2) Actions Accomplished Under Subprogram 2 ^a (2013–2016)	Post Program Partnership Framework
<p>Support to SP 2 implementation is expected to be financed under <i>REGALA 2 Strengthening Local Government Revenue Generation and Land Management</i> from 2014 onwards and the WB's LAMP2 extension.</p>	<p>5. Civil service commission memorandum circular passed requesting the licensing of all local assessors as a condition for appointment.</p> <p>6. Issuing a memorandum circular as a reiteration of tax information sharing between the BIR and the LGUs.</p> <p>7. Issuing draft guidelines for the preparation of Local Revenue codes and Local Investment and Incentive codes (DILG and DTI).</p>	<p>5. To improve the efficiency of tax collections, the tax information sharing agreement between the BIR and the LGUs is now being enforced through the system of performance standards for local treasurers (BLGF).</p> <p>6. To minimize tax erosion, a draft bill on the rationalization of fiscal incentives to investment has been filed and is under consideration by the legislature to ensure incentives have a neutral or positive impact on local economic development and fiscal revenues (DOF).</p> <p>7. To expand the range of taxes available to LGUs, the government completed a detailed study on expanding revenue assignments to LGUs, including the identification of potential new green taxes (BLGF).</p> <p>8. To ensure a timely and equitable distribution of tax revenues, the government completed a policy review of how mining revenue is shared with LGUs (DOF).</p>	
<p><i>3 LGU access to credit financing increased.</i></p> <p>SP1 policy actions were assisted by ADB TA 7451 <i>Support to Local Government Financing</i></p> <p>SP2 policy actions will be supported by the EU's PFM reform program.</p>	<p>To provide increased flexibility and to provide additional funding sources to LGUs, the government established a framework to support LGU access to debt capital markets. Accomplishments included:</p> <p>8. The BLGF has developed LGU creditworthiness systems that assist the accurate evaluation of prospective LGU borrowers by creditors.</p> <p>9. The BLGF has developed an LGU debt certification system that allows for facilitating the issuance of certificates on maximum borrowing and debt service capacities.</p>	<p>The Government has operationalized systems to enhance the ability of LGUs to access the debt capital markets. Accomplishments include:</p> <p>9. The government completed the roll out of new eSRE modules on: a) credit worthiness, b) LGU debt certification, and c) fiscal capacity system to BLGF regional offices (BLGF).</p> <p>10. The government enhanced the implementation of the eSRE modules by establishing a dedicated single LGU loan monitoring unit to improve debt monitoring (BLGF) and by providing training to all relevant personnel at regional offices. (BLGF).</p>	<p>eSRE system capabilities continue to be expanded, improving the quality of LGU financial management information systems.</p> <p>Integrated systems for LGU loan monitoring are implemented and the first consolidated report is published.</p> <p>Dialogue continues to simplify</p>

Development Partner Coordination	Subprogram 1 (Phase 1) Actions Accomplished Under Subprogram 1 (2010–2013)	Subprogram 2 (Phase 2) Actions Accomplished Under Subprogram 2 ^a (2013–2016)	Post Program Partnership Framework
	<ul style="list-style-type: none"> • BLMG financing modalities and debt management manuals developed. 		procedures for LGUs to access to credit
Output 2: Strengthening public financial management to assist efficient LGU service delivery			
<p><i>1 Local PFM strategic planning improved.</i></p> <p>TA support to the preparation of the Medium-Term Plan under EC's Support to Local Government Units for More Effective and Accountable Public Financial Management</p>	<p>The Government has launched an initiative to provide greater strategic direction to efforts to improve public financial management systems for LGUs. Accomplishments included:</p> <p>10. The Government has initiated drafting of the Medium-Term LGU PFM road map incorporating all relevant stakeholders (DBM).</p>	<p>The Government has provided greater strategic direction to efforts to improve public financial management systems for LGUs. Accomplishments include:</p> <p>11. The government approved and implemented the Medium-Term LGU PFM reform strategy and road map, with progress reports to be web-posted (DBM).</p>	
<p><i>2. National and local development priorities aligned and incorporated into national and local planning and participatory budget processes.</i></p> <p>TA for the design and review of the ALGUP initiative has been provided by AusAID and the DIALOG Fund.</p> <p>TA for ALGUP implementation provided under EC's Support to Local Government Units for More Effective and Accountable Public Financial Management</p> <p>Proposed review of the budgetary allocation formula under SP2 will be provided by ADB TA</p>	<p>The Government has improved the alignment of national and local development priorities. Accomplishments included:</p> <p>11. Approving and piloting the ALGUP, encouraging participatory planning and gender-sensitive project selection (DBM).</p> <p>12. Budgeting P8 billion under the ALGUP in 2013, with 595 LGUs participating in the process (DBM).</p> <ul style="list-style-type: none"> • Improving disaster risk reduction management by approving new guidelines on the allocation and utilization of the DRMF (DILG). <p>13. Finalized Compendium of Planning Documents and of the nationwide regional training of trainers for the comprehensive development plan (DILG).</p>	<p>To improve the efficiency of expenditures, the government updated planning and budgetary systems for LGUs. Accomplishments include:</p> <p>12. The government finalized the updated guidelines to harmonize and synchronize local planning (including participatory processes, investment programming, revenue administration, budgeting and expenditure management) and submitted them for approval. (DILG).</p> <p>13. The government concluded the implementation of the ALGUP initiative and budgeting processes, processed improvements to participatory planning including changes to the budgetary allocation formula, and enhanced the engagement of civil society leading to an increase in the scope of the program to cover P21 billion and over 1200 LGUs by 2014 (DBM).</p> <p>14. The DBM amended the Budget Operations Manual to incorporate participatory budget processes at the LGU level, performance-based mechanisms and accountability measures, and Policy changes to the SEF</p>	<p>JMC-2016 on harmonized LGU planning and budgeting guidelines is fully implemented.</p> <p>The government continues to encourage and support the use of performance-based development grants.</p> <p>The revised BOM and all associated policy changes are implemented in 2017 and beyond.</p>

Development Partner Coordination	Subprogram 1 (Phase 1) Actions Accomplished Under Subprogram 1 (2010–2013)	Subprogram 2 (Phase 2) Actions Accomplished Under Subprogram 2 ^a (2013–2016)	Post Program Partnership Framework
		and to the Disaster Risk Management plan formulation (NEDA, DBM, DILG, BLGF).	
<p><i>3 The availability and quality of information to support financial management expanded.</i></p> <p>SP1 policy actions supported under ADB TA 7451</p> <p>SP2 policy actions will receive support under the EC's <i>Support to Local Government Units for More Effective and Accountable Public Financial Management</i> and ADB TA</p>	<p>The DOF has instituted reforms to improve the accuracy of revenue targets between BLGF regional offices and local treasurers, and enhanced budget formulation and execution. Accomplishments included:</p> <p>14. Developing an eSRE module on LGU fiscal capacity (BLGF) 3.1.1. The BLGF has developed a new cash flow forecasting model that will assist improving budget formulation and execution.</p> <p>15. Migrating year-end financial status report of LGUs to eSRE format.</p>	<p>The government has continued to improve the accuracy of revenue targets by upgrading financial management information systems for LGUs. Accomplishments include:</p> <p>15. The government completed and implemented the expenditure management module for LGUs (DBM, BLGF).</p> <p>16. The government improved data availability by integrating the LGFPMS and the LGPMS information systems, allowing for the creation of a common database of financial information for LGUs (DILG and BLGF).</p> <p>17. The government has adopted a consolidated eSRE reporting format for LGU financial data.</p>	<p>Financial management information systems for LGUs are continually integrated and which: a) reduces compliance costs for LGUs; b) improves planning and budget formulation processes; c) provides for efficient national government monitoring; and d) improves public access to comprehensive financial data on LGUs.</p>
<p><i>4 LGU expenditure patterns (personal matters and Local Economic Enterprises) rationalized.</i></p> <p>SP2 policy actions will receive support under the EC's <i>Support to Local Government Units for More Effective and Accountable Public Financial Management</i></p>	<p>The government continues to rationalize LGU personal expenditure to ensure efficient use of resources. Accomplishments included:</p> <p>16. Implementing limitations to the LGU use of transfers and advances to LEEs, particularly for payment of public service requirements and providing options to enable LEEs to fund public service requirements.</p>	<p>The Government implemented measures to reduce tax erosion and to limit the increase in contingent liabilities derived from LGU operations. Accomplishments include:</p> <p>18. To strengthen the tax system, the government approved new guidelines for the establishment and financial management of LEEs to be incorporated as part of the BOM (DBM).</p>	<p>Dialogue on the review of local government staffing levels, is sustained in coordination with the Civil Service Commission and the new LEE policy is fully implemented supported by external audits covering the performance of local economic enterprises.</p>
Output 3: Fostering good local governance, transparency and accountability			
<p><i>1 Development of inter-local cooperation for improved service delivery and local economic development encouraged.</i></p>	<p>The government launched efforts to improve the efficiency of service delivery systems. Accomplishments included:</p>	<p>Government has sustained efforts to improve the efficiency of service delivery systems. Accomplishments include:</p>	

Development Partner Coordination	Subprogram 1 (Phase 1) Actions Accomplished Under Subprogram 1 (2010–2013)	Subprogram 2 (Phase 2) Actions Accomplished Under Subprogram 2 ^a (2013–2016)	Post Program Partnership Framework
<p>WB, and CIDA have provided assistance in this area to the Government for SP1.</p> <p>Support will be provided under ADB and AFD TA for SP2.</p>	<p>17. Policy review on potential for and benefits of a financing framework for LGU alliances' projects including loan financing and shared revenue options (DILG).</p>	<p>19. The government has submitted recommendations to the Good Governance and Anti-Corruption Cabinet Cluster to establish a policy framework for LGU alliances which promotes inter-local cooperation for service delivery, including: a) the development of corporate powers of LGU alliances; b) clarification of financing modalities for joint service delivery; and c) a definition of the legal personality of LGU alliances (DILG).</p>	<p>Recommendations are disseminated to the new legislature and relevant agencies regarding LGU alliances for eventual consideration in the formulation of relevant bills.</p>
<p><i>2 Transparency and accountability of local administrations and civil society involvement strengthened.</i></p> <p>SP1 policy actions have been assisted by the DIALOG Fund, which will continue to provide TA for SP2 implementation.</p> <p>Assisted by RETA 6445: <i>Support for Implementation of the Second Governance and Anticorruption Action Plan</i></p>	<p>The government has continued to improve the transparency and accountability of local government operations. Accomplishments included:</p> <p>18. Issuing the Full Disclosure Policy of Local Budgets and Finances, Bids and Public Offerings.</p> <p>19. Implementing capacity building activities for CSOs to assist their analytical capacity on understanding the LGU disclosed documents.</p> <p>20. Development of "Civil Society Participation Fund" Guidelines.</p> <p>21. Piloting the "Citizen Satisfaction Index System" to generate feedback on the service performance and programs of the government.</p>	<p>Government has enforced compliance with transparency requirements for LGUs. Accomplishments include:</p> <p>20. The government requires compliance with full disclosure policies for LGUs to access grants and funding mechanisms for LGUs (e.g. Performance Challenge Fund and BuB Initiative) and establishes a policy view portal system to provide the public access to the disclosures. (DILG).</p> <p>21. The government expands the coverage of the Citizen's satisfaction index and distributes the first reports covering cities. (DILG).</p>	<p>The citizen's satisfaction index is fully rolled out to cities and piloted for other LGUs. In addition, a review is undertaken with the objective of informing future LGU policy reform.</p>
<p><i>3 Capacities of local government officials, budget officers, planning officers and treasurers improved.</i></p>	<p>The Government established a program to increase the technical capacity of elected officials and executive officers. Accomplishments included:</p>	<p>The Government has continued to improve the capacities of elected officials and executive officers. Accomplishments include:</p>	

Development Partner Coordination	Subprogram 1 (Phase 1) Actions Accomplished Under Subprogram 1 (2010–2013)	Subprogram 2 (Phase 2) Actions Accomplished Under Subprogram 2 ^a (2013–2016)	Post Program Partnership Framework
<p>SP2 policy actions will be assisted by the EC's <i>Support to Local Government Units for More Effective and Accountable Public Financial Management</i>.</p>	<p>22. Newly Elected Officials (NEO) Program implemented after the 2010 election with 100% new officials trained on general administration issues (DILG).</p> <ul style="list-style-type: none"> • Assessment of the NEO completed and recommendations for NEO review endorsed by PDF. • Redesign the NEO program and development of a monitoring framework to assess its impact. 	<p>22. The government upgrades the NEO program, first completed in 2013, and provides training to all first-time elected officials, including female councilors (DILG).</p> <p>23. The government implemented a performance evaluation rating system for local treasurers, completed the first performance assessments, and provided capacity development to local planning officers in selected Regions (BLGF and DILG).</p>	<p>Within the reform broader framework of the CSC's Strategic Performance Management systems, stakeholder engagement is sustained to improve the performance criteria for local budget officers.</p> <p>The government continues to assess local treasurers while continually improving the assessment system.</p>
<p><i>4 Representation by women in LGU committees increased and gender sensitive planning and budgeting systems implemented.</i></p>	<p>The government facilitated women representation at LGU consultative committees. Accomplishments included:</p> <p>23. Ensuring the inclusion of Women NGO representatives in the Local Development Council.</p> <p>24. Enjoining LGU adoption of a referral system on violence against women.</p>	<p>The Government improved systems for the implementation of gender and development (GAD) plans for LGUs. Accomplishments include:</p> <p>24. The government issued guidelines for the localization of the Magna Carta for Women at the LGUs, improved the formulation and submission of GAD Plans and implemented a system for DILG to monitor LGU compliance with their GAD (DBM and DILG).</p>	<p>The government sustains its efforts to sustain enforcement of GAD provisions by local governments.</p>
<p><i>5 Performance monitoring systems and local accountability relationships strengthened.</i></p> <p>Earlier ADB TAs assisted work on the implementation of the LGPMS.</p> <p>SP2 actions will be assisted by additional ADB TA resources.</p>	<p>The government has improved the coverage and effective use of local performance monitoring systems. Accomplishments included:</p> <p>25. Ensuring that 90% of provinces, cities, and municipalities provide data to the LGPMS and use it in the formulation of LGU's development plans.</p>	<p>The Government is strengthening the capacity of LGU performance monitoring systems. Accomplishments include:</p> <p>25. The government revised the LGPMS, aligned it with the System of Seals of Good Governance and instituted improvements to the analytical capacity of the LGPMS using benchmarking tools developed for LGUs to assist and guide investment decisions. (DILG)</p>	<p>The government continues to integrate performance measurement systems for LGUs, with a view to:</p> <p>a) improve efficiency and reduce compliance costs; b) increase their analytical capacity and ability to inform budget and plan formulation; and c) improve the public's access to data.</p>

Development Partner Coordination	Subprogram 1 (Phase 1) Actions Accomplished Under Subprogram 1 (2010–2013)	Subprogram 2 (Phase 2) Actions Accomplished Under Subprogram 2 ^a (2013–2016)	Post Program Partnership Framework
	<p>26. Uploading to the web the revised state-of-local-governance and state-of-local-development reports.</p> <p>27. At least 10 LGUs make public their full state-of-local-governance report based on the LGPMS and local government financial monitoring system.</p>		
Output 4: Creating a conducive fiscal framework for inclusive growth			
<p>ADB TA <i>Local Government Finance and Fiscal Decentralization reforms</i> will provide technical and logistical support to the review of the LGC.</p>	<p>To provide the appropriate framework and incentives to improve local governance and financial management, the government prepares to amend the legal framework for intergovernmental fiscal relations. Accomplishments include:</p> <p>28. The 2013–2015 work plan of the Cabinet Cluster on Good Governance and Anti-corruption includes a review of the Local Government Code 1991.</p> <ul style="list-style-type: none"> The scope of the proposed review of the local government code includes expenditure and revenue assignments, and fiscal transfers of the LGUs (DILG). The work plan identifies the DILG as the leading agency for the LGC review (DILG). 	<p>To provide an appropriate framework and incentives for efficient, effective and responsive local governance and financial management, the government begins to process amendments to the legal framework for intergovernmental fiscal relations. Accomplishments include:</p> <p>26. The proposals for amendment of the Local Government Code, including expenditure and revenue assignments, and fiscal transfers of the LGUs were submitted to the Cabinet Cluster on Good Governance and Anti-corruption, and to the head of the Oversight Committee on Devolution (DILG).</p> <p>Two of the proposals (i.e. the Valuation Act and the LGU Income Classification Bill) were filed in the Philippine 16th Congress, reaching different stages of progress.</p>	<p>To improve local governance and financial management, amendments to the LGC continue with the drafting and processing of several bills under the leadership of national government agencies. In addition, the government will continue processing implementing regulations which do not require legislative review.</p>

ADB = Asian Development Bank, AFD = Agence Française de Développement, ALGUP = Assistance to Local Government Unit Program, BLGF = Bureau of Local Government Finance, BOM = Budget Operations Manual, BIR = Bureau of Revenue, CIDA = Canada International Development Agency, CSO = civil society organizations, DBM = Department of Budget and Management, DILG = Department of the Interior and Local Government, DOF = Department of Finance, DRMF = Disaster Risk Reduction and Management Fund, DTI = Department of Trade and Industry, EC = European Commission, eSRE = Electronic Statement of Receipts and Expenditures, EU = European Union, GAD = gender and development, JMC = Joint Memorandum Circular, LEE = Local Economic Enterprises, LGC = Local Government Code, LGU = local government unit, LGPMS = Local Productivity and Performance Measurement System, LGFPMS = Local Government Financial Performance Monitoring System, NEO = newly elected official, PDF = Philippine Development Forum, PFM = public financial management, PFMAT = Public Financial Management Assessment Tool, SGLC = Seal of Local Governance, SMV = Schedule of Market Values, TA = technical assistance, WB = World Bank.

^a Policy triggers are **in bold**. Policy triggers are expected prior actions of the next subprogram in a programmatic series. Lending is committed based on prior actions completed by the client country before Board approval. Expected prior actions for subsequent subprograms will be indicative and such actions will not be conditionality for disbursement, and the actions may be amended as subsequent subprograms are developed.