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REFORMING THE LEGAL FRAMEWORK FOR THE BUDGET PROCESS: COMMENTS ON SENATE BILL 1450 (BUDGET REFORM BILL)

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1. The literature on budget systems legislation suggests that countries introduce a new law or amend existing legislation for any one or a combination of the following reasons: (i) to correct specific problems related to budget preparation, budget authorization, budget execution, legislative review of the outcome/ output of budget implementation and independent external audit of government financial accounts, (ii) to clarify the powers of the legislative and executive branches of government in various stages of government budget process, and (iii) to ensure that budgetary institutions promote fiscal stability and sustainability, improve budget outcomes in terms of both the allocation and spending of budget resources, enhance transparency and accountability in the budget system ((Lienert and Jung 2004; Lienert and Fainboim 2010).

   Given this, Senate Bill 1450 (or the Budget Reform Bill) may be assessed from two perspectives. First, it may be assessed using a problem solving lens, i.e., to what extent the bill addresses the perceived weaknesses of the existing legal framework that governs the budgeting and public financial management (PFM) system. Second, it may be assessed from the perspective of international best practice in the design of the institutions (i.e., the rules of the game) that govern the budgeting and public financial management (PFM).

2. Assessment of SB 1450 from a problem solving perspective. First, the importance of Senate Bill 1450 (or the Budget Reform Bill) is highlighted by the weaknesses and deficiencies of the prevailing legal/ regulatory framework for budgeting and PFM as found in the first instance in provisions of the 1987 Philippine Constitution[2] and as further articulated in existing legislation governing budgeting and PFM practices. In particular, these are:

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[2] The 1987 Constitution provides the foundation for the country's PFM system by defining the roles of the Executive and Legislative branches in budgeting and public financial management. In particular, Article VI Section 29 (1) provides that "no money shall be paid out of the Treasury except in pursuance of an appropriation made by law." On the other hand, Article VIII, Section 22 provides that "the President shall submit to the Congress within thirty days from the opening of the regular session, as the basis of the general appropriations bill, a budget of expenditures and sources of financing, including receipts from existing and proposed revenue measures." Meanwhile, Article VI, Section 25 (1) provides that "Congress may not increase the appropriations recommended by the President for the operation of the Government as specified in the budget. ... (4) A special appropriations bill shall specify the purpose for which it is intended, and shall be supported by funds actually available as certified by the National Treasurer, or to be raised by a corresponding revenue proposed therein. (5) No law shall be passed authorizing any transfer of appropriations; however, the President, the President of the Senate, the Speaker of the House of Representatives, the Chief Justice of the Supreme Court, and the Constitutional Commissions may, by law, be authorized to augment any item in the general appropriations law for their respective offices from savings in other items of their respective appropriations. ... (7) If, by the end of any fiscal year, the Congress shall have failed to pass the general appropriations bill for the ensuing fiscal year, the general appropriations law for the preceding fiscal year shall be deemed reenacted and shall remain in force and effect until the general appropriations bill is passed by the Congress."

(i) Executive Order 292 (otherwise known as the Administrative Code of 1987), particularly Book VI thereof which is, in turn, largely based on Presidential Decree 1177 (or the Budget Reform Decree of 1997);

(ii) PD 1445 (or the Government Auditing Code of the Philippines), which defines the policies and guidelines on government auditing and the accounting of public funds;

(iii) Republic Act (RA) No. 9184 (or the Government Procurement Reform Act of 2003), which was envisioned to make government procurement more competitive and transparent; and

(iv) RA 7160 (or the Local Government Code of 1991) which mandates that 40 percent of the internal revenue taxes of the national government should be distributed to the local government units (LGUs) as internal revenue allotment (IRA), and which defines the policies and guidelines on fiscal administration at the LGU level.

3. The results of the Philippine Public Expenditure and Financial Accountability (PEFA)[3] assessment conducted by the World Bank in 2015 found that the country's public financial management (PFM) system exhibited strong and improved performance since the 2007 PEFA assessment in 3 out of the 7 PFM pillars (transparency, policy-based budgeting, and asset management), uneven performance in one pillar (predictability and control in budget execution, and weak performance in the other 3 pillars (budget reliability, accounting and reporting and external scrutiny) [World Bank, 2016, p xiii].

4. The country's poor performance in the area of budget reliability has been traced to the difficulty in comparing actual government expenditure in the aggregate as well as components thereof with the original budgeted expenditures. This difficulty is associated with (i) frequent re-enactment of the budget in 2000-2006 and the practice of including completed programs, projects, and activities funded under the GAA of the preceding fiscal year as part of the re-enacted budget; (ii) frequent delays in the enactment of the budget in 2000-2006 and the practice of adding all releases under the re-enacted budget to the approved budget levels upon the "delayed" enactment of the GAA when the GAA is not passed prior to the beginning of the fiscal year; (iii) the divergence between the obligation program detailed in the National

[3] The PEFA program is an initiative that was launched in 2001 by the European Commission (EC), the International Monetary Fund (IMF), the World Bank (WB) and the governments of by the governments of France, Norway, Switzerland, and the United Kingdom. The PEFA framework identifies seven key elements (or pillars) of an orderly PFM system, namely (i) *budget reliability* – government budget is realistic and is implemented as intended; measured by comparing actual revenues and expenditures with the original approved budget; (ii) *transparency of public finances* – information on PFM is comprehensive, consistent, and accessible to users; achieved through comprehensive budget classification, transparency of all government revenues and expenditures, published information on service delivery performance and ready access to fiscal and budget documentation; (iii) *effective management of assets and liabilities* – one that ensures public investments provide value for money, assets are recorded and managed, fiscal risks are identified and debts and guarantees are prudently planned, approved and monitored; (iv) *policy-based fiscal strategy and budgeting* with due regard to government fiscal policies, strategic plans, and adequate macroeconomic and fiscal projects are in place; (v) *predictability and control in budget execution* implemented via a system of effective standards, processes, and internal controls, ensuring that resources are obtained and used as intended; (vi) *accurate and reliable accounting and reporting* – financial records and information is produced and disseminated at appropriate times to meet decision-making, management, and reporting needs; (vii) external scrutiny and audit of public finances. On the other hand, the PEFA assessment tool "helps governments assesses achieve sustainable improvements in PFM practices by providing a means to measure and monitor performance against a set of 31 indicators" that are clustered across the seven pillars of the PFM system (PEFA Secretariat 2016).

Expenditure Program (NEP) and the GAA with total available appropriations for the fiscal year because of "continuing appropriations"; and (iv) the disparity between how the DBM reports ex ante budgets in the NEP, BESF, and GAA and how the COA reports actual expenditure outturns in its Annual Financial Reports. It should be emphasized, though, that the introduction of the Unified Accounts Code Structure (UACS) in 2014 was aimed at addressing item (iv) above, but it has not been fully rolled out to date. The following provisions of SB 1450 are envisioned to address the aforementioned concerns: Section 33 – re-enacted budget; Section 21 (e) and Section 36 – limiting the validity of cash-based appropriation to one year; and Section 32 - institutionalizing the UACS to ensure unified accounting, auditing, and reporting of all financial transactions of the government.

5. Problems in the area of accounting and reporting relate to delays in the submissions by departments/ agencies of bank accounts reconciliation, advance accounts, and in-year budget reports to COA and DBM due to continued reliance on manual recording of transactions and the use of spreadsheets.

6. Problems in the area of external scrutiny relate to (i) the "perceived conflict of interest in the function of the COA being the auditor and the accountant at the same time due to its Constitutional mandate" (IMF 2015), and (ii) the lack of effective legislative review/ oversight of COA audit reports. The following provisions of SB 1450 are envisioned to address the aforementioned concerns: Section 7 (e) (2) – creation of the Office of the Comptroller General (OCG) which will be tasked *inter alia* to "consolidate the financial reports [of government agencies] for submission to the President and COA" and Section 73 – consolidated government reporting by the OCG, and Section 5 (a) and (c) – Congress' power to monitor and review performance of government agencies and "consider" the consolidated financial statements of government prepared by the OCG and the audited financial reports of government agencies by COA.[4]

7. Problems in the area of predictability and control of budget execution relate to delays in completion of internal audit service (IAS) reports and non-submission thereof to DBM/ COA. The following provisions of SB 1450 are envisioned to address the aforementioned concerns: Section 7 (b) and (c) – creation of the Office of the Comptroller General (OCG) which will be tasked *inter alia* to "formulate measures on effective internal controls including internal audit, for the implementation by Heads of Government Agencies, to ensure the integrity, accuracy, completeness, and reliability of government financial and management systems and to oversee the operation of an integrated internal control framework across Government Agencies".

8. Over and above the inadequacies of the current budget and PFM system that were raised in the 2016 Philippine PEFA assessment report (World Bank 2016), two other vexing concerns have emerged in this area in recent years. One relates to the ambiguity in the definition of "savings" and its use under existing legislation that has been highlighted in the Supreme Court ruling on the Disbursement Acceleration Program (DAP). The other relates to the underspending of available appropriations that is evident among many government agencies, which has been attributed to poor planning and difficulties attendant to the procurement process.

[4] The use of the word "consider" in Section 5 (c) is somewhat weak vis the need for stronger legislative oversight in this regard.

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Section 41 of SB 1450 provides a precise definition of "savings" and enumerates the situations that warrant the declaration of savings. It is notable that Section 41 dis-incentivizes the President (or the Speaker of the House of Representatives, the Senate President, the Chief Justice of the Supreme Court or the heads of the various Constitutional bodies) from declaring savings due to the discontinuance or abandonment of projects and using said savings elsewhere within the bounds of their jurisdiction by providing that the "abandoned" project cannot be proposed for funding in the next two fiscal years.

On the other hand, it is laudable that Section 21 (e) and Section 36, which limit the validity of cash-based appropriation to one year, would tend to dis-incentivize poor project planning and slow budget execution as well as speed up spending of government agencies. However, while having appropriations that have a one-year validity is important, the concomitant shift to a cash-based appropriation system might be too radical and disruptive a step to take in one leap. In particular, if the GAA is considered as providing the government agencies "the authority to contract out and disburse funds" (as provided in the Constitution and Section 35 of SB 1450), then government agencies can initiate the procurement process short of award 6 months prior to any given budget year at the earliest (Section 38 of SB 1450). In turn, this means that the contract is awarded on January 2 of the given budget year at the earliest. Also, the shift to cash-based appropriations would also necessarily imply that payments can only be made for those projects which are completed within the 12-month period of the given budget year. Note that the Extended Payment Period would allow agencies to settle payments for goods and services delivered during the previous fiscal year within the 3-month period immediately following the given budget year. This is a very tight budget schedule given the difficulties currently faced by many government agencies in obligating the current year's appropriations fully within the given budget year. Given this perspective, the author of SB 1450 might wish to introduce a transitory period, say one or two years upon the enactment of the bill into law, during which obligations-based appropriations would be valid for a period of one year prior to shifting to a cash-based appropriations regime with one-year validity.

Still related to Section 36, Section 37 of SB 1450 provides that "the DBM shall identify the requirements and / or prescribe guidelines before agencies may enter into multi-year contracts such as the issuance of a Multi-year Contractual Authority (MYCA) and ... that in all instances, the disbursements to be incurred for multi-year contracts shall in no case exceed the cash appropriations for the purpose during the year." From the above, it appears that legislative approval of appropriations for multi-year projects will be limited to the approval of cash appropriations for single-year payment requirements of said projects, and that the approval of the commitment authority for multi-year projects will be the sole prerogative of the Executive branch. Such a treatment of multi-year projects will effectively weaken Congress' role in the budget process.

9. <u>Assessment of SB 1450 from the perspective of international best practice</u>. The following desirable characteristics (or sound principles) of budget system laws have been distilled from international experience in the formulation and implementation of said type of legislation (Lienert and Jung 2004; Lienert and Fainboim 2010):

(i) *Authoritativeness* – clear specification of the decision making authority for budget preparation, approval, execution and reporting;

(ii) *"Annuality" principle* – budget authorization is limited to a one-year period with few exceptions,

(iii) *Comprehensiveness* - "all revenues and expenditures are included in the budget on a gross basis; expenditures are not offset by revenues. ...extra-budgetary funds are minimal, being established by law; contingency funds are included in the budget law; tax expenditures and quasi-fiscal activities are reported";

(iv) *Unity* - "the budget presents, and the legislature approves, all receipts and payments in the same annual budget law; for expenditures, there is no "dual" budget system that splits current and development (or capital) transactions";

(v) *"One fund"* - "all resources are channeled into one common fund";

(vi) *Specificity* - "revenues and expenditures are approved with some detail in the budget estimates;" "spending authorizations (appropriations) show legally binding maximum expenditures for particular purposes";

(vii) *Balance* – "budget expenditures are balanced by budget revenues and financing;

(viii) *Accountability* - "the executive must account to the legislature for how it has met its responsibilities at least twice a year; an independent external audit body reports at least annually to the legislature on budget execution and annual government accounts; within the executive, the accountability of budget managers is clearly defined";

(ix) *Transparency* - "the roles of public bodies are clear; timely and regular financial and nonfinancial information on the budget is publicly available; terms used in the BSL are clearly defined";

(x) *Stability* - "revenues, total expenditures, fiscal balance or public debt, specified in the context of a regularly updated medium-term budget framework; medium-term fiscal sustainability is also another important aspect of stability"; and

(xi) *Performance* - "the expected and recent past results (outputs and/or outcomes) of budget programs are reported in the budget document"; "principles of efficiency, economy and effectiveness are associated with "performance".

10. The principle of *authoritativeness* is satisfied by Sections 5 – 12 of SB 1450, which define the respective roles of (i) Congress, (ii) the President, (iii) the OCG, (iv) COA, (v) DBM, (vi) DOF, (vii) NEDA, and (viii) heads of government agencies in the budget and PFM system. As indicated earlier, the principle of "*annuality*" is provided under Section 36. On the other hand, the principles of *comprehensiveness* and *unity* of the budget are enshrined in Section 21 (b) and (c) [i.e., the governing principles in budget preparation], which provide that "the overall expenditure program of government for a given fiscal year shall be included, identifying those requiring approval by Congress and those authorized under existing laws; and that all sources of funds and authorized uses available to the agency shall be considered in the evaluation of agency proposals and determination of agency budget levels, and shall likewise be disclosed in the proposed national budget and reports. On the other hand, the principle of *specificity* is provided under Section 21 (f) and (h), which provide that items of appropriation shall be presented in such a way that identify both the entity responsible for the expenditure and the intended results from the use of the appropriation in order to evaluate the performance of the agency; and that items of appropriations shall be reflected by the department, agency, bureau, and offices, and shall be presented for information purposes by region and province, and eventually, by city and municipality. Meanwhile, the *"one fund"* concept is articulated in Sections 44, 45, and 46, which relate to the General Fund, including Special Accounts in the General Fund (SAGF), Special Accounts, review of Special Accounts, and SAGF by the Permanent Committee.

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Note that Section 44 and Section 46 talk about a Permanent Committee which is tasked to review SAGFs and SAs without clearly articulating the members of this committee, but instead refers to its creation under EO 292. It is noted that defining the composition of this committee in SB 1450 itself would provide greater clarity.

The *accountability* and *performance* principles find expression in SB 1450 in terms of implementation of financial management and internal control, and are supported by IFMIS and reporting requirements for the various instrumentalities of government (NGAs, GOCCs, LGUs) under Part VI Sections 62 to 74 of SB 1450, and the formal institutionalization of the newly established Treasury Single Account (TSA)[5] under Section 50. In principle, the TSA promotes better cash and debt management, facilitates the reconciliation of fiscal and banking data, "which in turn improves the quality of fiscal information"and tends to "significantly reduce government debt servicing costs, lowers liquidity reserve needs, and helps maximize the return on investments of surplus cash" (IMF 2010).

11. On the other hand, the principle of *transparency* is articulated in terms of people's access to government financial information and people's participation in the budget process under Part VII Sections 75 – 77 of SB 1450.

12. Finally, the following provisions of SB 1450 are supportive of the *fiscal stability* principle:

(i) Section 14 – fiscal responsibility principles that guide the proposed Budget Reform Act;
(ii) Section 15 – preparation by the DBM in coordination with the DBCC, subject to the approval of the President, of the Statement of Fiscal Policy which shall contain measurable medium-term macroeconomic and fiscal objectives and forecasts consistent with the Fiscal Responsibility Principles and the Long-Term Vision Report;
(iii) Section 16 – preparation by the DBM in coordination with the DBCC, subject to approval of the President, of the Medium-term Fiscal Strategy and its annual updates; the medium-term strategy and its updates shall be consistent with the approved Statement of Fiscal Policy and Long-Term Vision Report; it shall include a summary of the fiscal policies for revenue, debt, deficit, expenditure, and fiscal risk management, supported by a medium-term fiscal sustainability analysis, consistent with the measurable fiscal objectives established in the approved Statement of Fiscal Policy;
(iv) Section 20 – shared fiscal discipline whereby all proposed revenue eroding and expenditure bills shall include a Financial and Budgetary Information Sheet upon filing of the bill containing an estimate of the financial and budgetary implications of said proposal for the initial year of implementation and the next five (5) years;
(v) Section 23 – budget priorities framework including the Medium-term Fiscal Strategy and targets underlying the budget, the priority areas for government spending reflected in the PDP, estimated amount and planned allocation of the fiscal space.

It should be noted, however, that the fiscal responsibility principles under Section 14 and Section 20 of SB 1450 are somewhat weaker than earlier proposals which require any new expenditure bill to identify sources of revenues that will finance said expenditure bill. Also,

[5] The TSA was established in 2014. It is one of the more recent PFM innovations in the country.

SB 1450 should define the Statement of Fiscal Policy and the Medium-Term Fiscal Strategy to clearly delineate the difference between these two reports.

13. Other suggested improvements to SB 1450. SB 1450 does not have a section that pertains to budget approval or authorization. As such, the sentence which reads "Congress may not increase the appropriations recommended by the President for the operations of government as specified in the Proposed National Budget" under Section 25 (the Proposed National Budget) appears to be a misfit in that section. It is recommended that new Sections be inserted under the current Part IV of SB 1450 pertaining to budget approval or authorization which may include provisions on the content of the GAA, the prohibition on Congress increasing the aggregate appropriation level beyond the amount proposed by the Executive under the National Expenditure Program (although this is not necessary strictly speaking because this is already provided for under the 1987 Constitution).