

Reforming the legal framework for the budget process

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The literature on public financial management (PFM) suggests that countries introduce a new law or amend existing legislation on budget systems for any one or a combination of the following reasons: (1) to correct specific problems related to budget preparation, authorization, and execution, as well as legislative review of the outcome/output of budget implementation and independent external audit of government financial accounts; (2) to clarify the powers of the legislative and executive branches of government in various stages of government budget process; and (3) to ensure that budgetary institutions promote fiscal stability and sustainability, improve budget outcomes in terms of both the allocation and spending of budget resources, and enhance transparency and accountability in the budget system (Lienert and Jung 2004; Lienert and Fainboim 2010).

In this light, this *Policy Note* examines Senate Bill (SB) 1450 or the Budget Reform Bill using two perspectives. Through the

problem-solving perspective, it assesses the extent the bill addresses the perceived weaknesses of the existing legal framework that governs the Philippine budgeting and PFM system, which include:

- (1) the provisions of the 1987 Constitution¹;
- (2) the Administrative Code of 1987,

¹The 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."

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particularly Book VI thereof which is, in turn, largely based on Presidential Decree 1177 (or the Budget Reform Decree of 1997);

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

(4) the Government Procurement Reform Act of 2003 envisioned to make public procurement more competitive and transparent; and

(5) 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, and which defines the policies and guidelines on fiscal administration at the LGU level.

This study also provides inputs from the perspective of international best practice in this area.

From the problem-solving perspective

The results of the 2016 Philippine Public Expenditure and Financial Accountability (PEFA) assessment conducted by the World Bank found that the country's PFM system has exhibited strong and improved performance 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 three pillars (budget reliability, accounting and reporting, and external scrutiny) (WB 2016).

Weak budget reliability

The budget reliability pillar requires that the government budget must be realistic and implemented as intended. It is measured by comparing actual revenues and expenditures with the original approved budget.

In its study, the World Bank attributed the country's poor performance in this area to the difficulty in comparing actual government expenditure in the aggregate as well as components thereof with the original budgeted expenditures. Such difficulty is likewise associated with the following:

- (1) frequent reenactment of the budget in 2000–2006 and the practice of including completed programs and projects funded under the General Appropriations Act (GAA) of the preceding fiscal year as part of the reenacted budget;
- (2) frequent delays in the enactment of the budget in 2000–2006 and the practice of adding all releases under the reenacted 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;
- (3) the divergence between the obligation program detailed in the National Expenditure Program (NEP) and the GAA with total available appropriations for the fiscal year because of “continuing appropriations”; and
- (4) the disparity between how the Department of Budget and Management (DBM) reports *ex ante* budgets in the NEP, Budget of Expenditures and Sources of Financing, and GAA, and how the Commission on Audit (COA)

reports actual expenditure outturns in its annual financial reports.

Although the introduction of the Unified Accounts Code Structure in 2014 was aimed at addressing the disparity identified in the last bullet, it has not been fully rolled out to date. However, Sections 21 on governing principles in budget preparation, 32 on budget with account codes, 33 on reenacted budget, and 36 on availability of cash-based appropriations of SB 1450 are envisioned to address the aforementioned concerns.

Weak accounting and reporting

According to the World Bank (2016), the accounting and reporting of financial records and information can be considered accurate and reliable when they are produced and disseminated at appropriate times to meet decisionmaking, management, and reporting needs. However, the country currently suffers from delays in the submissions by 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.

Weak external scrutiny

The issues in the area of external scrutiny relate to (1) 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” (WB 2016, p. 90) and (2) the lack of effective legislative oversight of COA audit reports. The following provisions of SB 1450 are envisioned to address the aforementioned concerns:

(1) 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 COA²;

(2) 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

(3) Section 73 – consolidated government reporting by the OCG.

Uneven predictability and control of budget execution

The pillar on predictability and control in budget execution requires that the budget is implemented based on a system of effective standards, processes, and internal controls, thereby ensuring that resources are obtained and used as intended. The country’s problem in this area relates to delays in completion of internal audit service reports and nonsubmission thereof to DBM/COA. Section 7 (b) and (c) of SB 1450 envision to address these problems by creating the OCG, which will be tasked 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

² The use of the word “consider” in Section 5 (c) is somewhat weak vis-à-vis the need for stronger legislative oversight in this regard.



This study highlights the need to clarify the definition of 'savings'. Using the problem-solving perspective, the author explains a provision of the proposed Budget Reform law addresses this concern by providing a precise definition of this budget concept and enumerating the situations that warrant its declaration, thereby hindering the heads of the Philippine Congress, for instance, from declaring savings due to the discontinuance or abandonment of projects. (Photo: Victor Villanueva/Flickr)

systems and to oversee the operation of an integrated internal control framework across government agencies,” among others.

Ambiguity of 'savings'

The Supreme Court ruling on the Disbursement Acceleration Program highlighted the ambiguity in the definition of savings and its use under existing legislation. As a response, Section 41 of SB 1450 provides a precise definition of “savings” and enumerates the situations that warrant the declaration of savings. It also hinders the President, the Speaker of the House of Representatives, the Senate President, the Chief Justice of the Supreme Court, and 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.

Evident underspending among government agencies

The underspending of available appropriations is evident among many government agencies and has been attributed to poor planning and difficulties attendant to the procurement process. Related to this, Section 21 (e) and Section 36 of SB 1450 limit the validity of cash-based appropriation to one year, which aims to disincentivize 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 concurrent 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 six 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 imply that payments can only be made for those projects 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 three-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 multiyear contracts such as the issuance of a Multiyear Contractual Authority and ... that in all instances, the disbursements to be incurred for multiyear 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 multiyear 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 multiyear projects will be the sole prerogative of the executive branch. Such a treatment of multiyear projects will effectively weaken Congress’ role in the budget process.

From the perspective of international best practice

The following desirable characteristics 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):

Authoritativeness

Authoritativeness refers to the clear specification of the decisionmaking authority for budget preparation, approval, execution, and reporting. It is satisfied by Sections 5 to 12 of SB 1450, which define the respective roles of the Congress, the President, the OCG, the COA, the DBM, the Department of Finance,

the National Economic and Development Authority, and the heads of government agencies in the budget and PFM system.

Annuality

The principle of annuality requires that the budget authorization is limited to a one-year period with few exceptions. As indicated earlier, it is provided under Section 36 of SB 1450.

Comprehensiveness and unity

The principle of comprehensiveness requires that “all revenues and expenditures are included in the budget on a gross basis; expenditures are not offset by revenues. ... extrabudgetary funds are minimal, being established by law; contingency funds are included in the budget law; tax expenditures and quasi-fiscal activities are reported” (Lienert and Fainboim 2010, p. 8). Meanwhile, unity entails that “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” (Lienert and Fainboim 2010, p. 8). These principles are enshrined in Section 21 (b) and (c) on the governing principles in budget preparation in SB 1450.

One fund

The principle of “one fund” demands that “all resources are channeled into one common fund” (Lienert and Fainboim 2010, p. 9). It is articulated in Sections 44, 45, and 46 of SB 1450, which relate to the General Fund, including Special Accounts in the

General Fund (SAGF), Special Accounts (SAs), review of SAs, and SAGF by the Permanent Committee. 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 Executive Order 292. As such, defining the composition of this committee in SB 1450 itself would provide greater clarity.

Specificity

Specificity requires that “revenues and expenditures are approved with some detail in the budget estimates” and that “spending authorizations (appropriations) show legally binding maximum expenditures for particular purposes” (Lienert and Jung 2004, p. 133). This principle is assured under Sections 21 (f) and (h) of SB 1450, which stipulate 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. The said sections also require 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.

Accountability and performance

The principle of accountability demands that “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” (Lienert and Fainboim 2010, p. 9). Meanwhile, the principle of performance requires that “the expected and recent past results (outputs and/or outcomes) of budget programs are reported in the budget document” (Lienert and Fainboim 2010, p. 9).

These principles are expressed in SB 1450 in terms of implementation of financial management and internal control, and are supported by Integrated Financial Management Information System and reporting requirements for the various instrumentalities of government (national government agencies, government-owned and -controlled corporation, local government units) under Part VI Sections 62 to 74, and the formal institutionalization of the newly established Treasury Single Account (TSA)³ 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” (Pattanayak and Fainboim 2011, p. 4).

Transparency

This principle requires that “the roles of public bodies are clear; timely and regular financial and nonfinancial information on the budget is publicly available; terms used in the budget

law are clearly defined” (Lienert and Jung 2004, p. 133). It is articulated in SB 1450 in terms of people’s access to government financial information and their participation in the budget process under Part VII Sections 75 to 77.

Stability

The principle of fiscal stability requires that “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” (Lienert and Jung 2004, p. 133). The following provisions of SB 1450 are supportive of the *fiscal stability* principle:

- (1) Section 14 – fiscal responsibility principles that guide the proposed Budget Reform Act;
- (2) Section 15 – preparation by the DBM in coordination with the Development Budget Coordination Committee (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;
- (3) 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

³ The TSA was established in 2014. It is one of the more recent PFM innovations in the country.

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;

(4) 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 years;

(5) 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 Philippine Development Plan, estimated amount and planned allocation of the fiscal space.

However, 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, SB 1450 should further

define Sections 15 and 16 to clearly delineate the difference between these two reports.

Other recommendations

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 on the proposed national budget appears to be a misfit in that section.

This study recommends that new sections be inserted under the current Part IV of SB 1450 pertaining to budget approval, which may include provisions on the content of the GAA and the prohibition on Congress increasing the aggregate appropriation level beyond the amount proposed by the executive under the NEP. 📄

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