

**Philippines: Report on the Observance of Standards and Codes—Fiscal
Transparency Module**

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PHILIPPINES

**Report on the Observance of Standards and Codes (ROSC)
Fiscal Transparency Module**

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September 12, 2002

EXECUTIVE SUMMARY

This report provides an assessment of fiscal transparency practices in the Philippines in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency* based on the authorities' response to the IMF fiscal transparency questionnaire and other documents provided by the authorities.

The Philippines meets the requirements of fiscal transparency in many important respects. Despite broad adherence to the transparency code, there are some key areas which require strengthening. While the existing responsibilities, procedures, and reporting arrangements are well defined, more efforts are required to enforce them, to clearly define accountabilities, and take firm and demonstrable corrective action when they are not met. The budget system is undermined by the need to continuously reallocate within the year, as a result, in contrast to the budget plan which is highly transparent, the budget outturn is far from clear. Providing more timely information, especially in-year, on the activities of general government should be a priority. There is also a need to improve the quality and timeliness of data on the operations of lower levels of government as well as providing a clear statement of fiscal risks, contingent liabilities, tax expenditures, and quasi fiscal operations.

The legal framework for budget procedures is somewhat dated and it may be useful to consolidate and clarify this legal framework. Independent assurances of integrity of the fiscal data also could be strengthened.

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ABBREVIATIONS AND ACRONYMS

BIR	Bureau of Internal Revenue
BOI	Bureau of Investments
BOT	Build, Operate and Transfer
BSP	<i>Bangko Sentral ng Pilipinas</i> (Central Bank of the Philippines)
BTr	Bureau of the Treasury
COA	Commission on Audit
DBCC	Development Budget Coordination Committee
DBM	Department of Budget and Management
DOF	Department of Finance
EPS	Electronic Procurement System
FIRB	Fiscal Incentives Review Board
GFI	Government Financial Institutions
GFS	Government Finance Statistics
GOCC	Government Owned and/or Controlled Corporations
LBP	Land Bank of the Philippines
LGUs	Local Government Units
NEDA	National Economic and Development Authority
NG	National Government
PEZA	Philippine Export Processing Zone Authority
QFAs	Quasi-fiscal Activities
R.A.	Republic Act
SDDS	IMF's Data Dissemination Standard
SSIs	Social Security Institutions

I. INTRODUCTION¹

1. This report provides an assessment of fiscal transparency practices in the Philippines. The assessment has two parts. The first part is a description of practices in relation to the requirements of the IMF *Code of Good Practices on Fiscal Transparency—Declaration on Principles*, prepared by the IMF staff on the basis of the authorities' response to the IMF fiscal transparency questionnaire and additional information provided by the authorities. The second part is an IMF staff commentary on fiscal transparency in the Philippines.

II. DESCRIPTION OF PRACTICE

A. Clarity of Roles and Responsibilities

2. **The boundary between general government and the rest of the economy is, for the most part, clearly specified.** Owing to pricing decisions which were not clearly reflected in budget subsidies, build, operate, and transfer (BOT) arrangements in urban transport and power supply blur responsibility between private and public sector management. The list of projects being undertaken through BOT arrangements including their total project cost and status of implementation are presented among the budget documents submitted to Congress. To strengthen the oversight of, and minimize the problems created by, contingent liabilities arising from these projects, the National Economic and Development Authority (NEDA), the Department of Finance (DOF), and the Department of Budget and Management (DBM) are taking coordinated measures to strengthen the BOT contract review; monitor Government Owned and/or Controlled Corporations (GOCCs) projects and guarantees given for these projects; and make budget provision for contingent liabilities. However, presently there is limited transparency about the extent of government guarantees associated with BOT arrangements, particularly in regard to transport projects. However, since a peak in 1993, National Government has reduced all forms of budget support to GOCCs.²

¹ Discussions with the authorities were held during September 5–18, 2001. The staff team, comprising Mr. Diamond (Head of Mission) and Messrs. Dixon and Olliffe, both Fiscal Experts, held meetings with Secretary of Budget and Management E. Boncodin, Undersecretary L. Pascua and a number of Assistant Secretaries and Directors of the various divisions of the Department of Budget and Management (DBM). Additional meetings were held with: Chairman G. Carague and staff of the Commission on Audit, Undersecretaries A. Bernardo and N. Osorio of the Department of Finance, Treasurer S. Edeza and Deputy Treasurers E. Mendiola and J. Tan of the Bureau of the Treasury, Deputy Director-General G. Llanto and staff of the National Economic and Development Authority, Undersecretary E. Pangan and staff of the Department of Education, Culture and Sports, together with senior officials of the Bangko Sentral ng Pilipinas, Bureau of Internal Revenue and senior officers of the Philippine Armed Forces. The mission also met with World Bank resident Principal Economist L. McKay.

² A large part of the remaining net lending has been a consequence of operational inefficiencies in managing own and National Government projects, including projects with private sector participation.

3. **The expenditures of the central government, making up 50–60 percent of general government expenditures (which includes LGUs and SSIs), covers that required for the current operations of national government agencies as well as budget subsidies for a number of public enterprises and some state universities.** The rest is accounted for by the expenditures of the local governments that comprises 80 provinces, 1,512 municipalities, 96 cities, and 41,882 barangays or a total of 43,570 local units. Some 62–64 percent of these expenditures correspond to the internal revenue allotment from the national government.

4. **Expenditure assignments and revenue authority are clearly specified in legislation.** However, the Philippines is in the process of undertaking a major decentralization of public sector activities. The 1991 Local Government Code reformed the governance structure in the Philippines by transferring more powers to local government units (LGUs). Along with this reform, there was an explicit transfer of former National Government expenditure responsibilities so that the LGUs became the main provider of basic public services. With the LGUs being assigned a specified and buoyant proportion of National Government revenue base,³ the National Government is undertaking measures to devolve functions to LGUs.⁴ In this transition process, the respective expenditure responsibilities of different government levels have become blurred as the NG continues to finance devolved activities, some of which resulted from congressional initiatives. It should be noted that the revenue-sharing formula on which LGU transfers are based, are calculated with a three-year lag, which has resulted, despite falling revenues, in the LGUs receiving a rising NG budget allocation. Decentralization has been progressing through cost sharing schemes (including in education) which also blur the responsibility of different levels of government.⁵ The specification in the relevant agency's budget of the use of special funds involving earmarked revenues—the Armed Forces Modernization, Agrarian Reform, and Road Funds—within the 2002 budget explicitly enhances transparency and clarity in their roles. This policy, as well as the purpose and nature of special funds, is explained in the analytical text of the budget.

5. **Although it is unsure how they are valued, the government's equity holdings are widely reported in the Budget documents submitted to Congress, and the information is publicly available in the Bangko Sentral ng Pilipinas (BSP) Annual Report.** There is a sizable, but declining, state ownership of the financial sector, including two banks whose operations are a vehicle for government policy—Land Bank of the Philippines (LBP), and the Development Bank of the Philippines. The LBP and Development Bank of the

³ Although the LGUs have the right to borrow, they have no direct foreign loans. They obtain foreign funding through the DOF's Municipal Development Fund Office for projects implemented by National Government agencies.

⁴ LGUs have been running small surpluses between 0.1 percent and 0.4 percent of GNP in the last few years.

⁵ These schemes are regarded as transitional arrangements to facilitate some LGU's assumption of new devolved functions, such as rural roads and agricultural extension.

Philippines offer among others, financial support for the development of rural areas and loans for development activities, respectively. The amount and type of government support are explicitly identified in the budget and are relatively minor.⁶ As of June 8, 2001, there remain 98 fully operational GOCCs, including their subsidiaries. It should be noted that in June 2001, the Electric Power Reform Act paved the way for the privatization of the National Power Corporation, and the deregulation of the power sector. Privatization is an open process, handled by the Privatization Council (a Cabinet level body) which conducts public bidding and hearings.

6. **Government regulation of industry is complex but is being streamlined.** Due to accretion of regulations on industry, the regulating framework can be nontransparent and ineffectively managed. To address this, the government has a deregulation policy and significant gains have been realized in deregulating the communications and water sectors. The passage of an E-Commerce law in 2000 is encouraging the use of IT for frontline services which is leading to greater transparency and streamlining of regulatory processes.⁷

7. **There is a clear separation of fiscal and monetary management.** The BSP is an independent organization, and the *New Central Bank Act—Republic Act (R.A.) No. 7653*—of 1993 not only gives it the exclusive right to issue currency and formulate and implement monetary policy, but clearly specifies that it should “operate as an independent and accountable body corporate in the discharge of its mandated responsibilities” (Article 1, Section 1). The role of the BSP as a lender of the last resort is clearly defined in its Charter and there are clear rules about solvency status of banks seeking such lending. The BSP Charter defines supervision requirements for banks and regulatory requirements for quasi-banking financial institutions. Policy is formulated by a seven person appointed Monetary Board, with the Governor as its chairman, which reports directly to the President and Congress. The government is unable to influence the policy of the BSP for fiscal purposes, although Article II, Section 89 gives the government the right to ask for provisional advances which in aggregate should not exceed 20 percent of the average annual income for the last three preceding fiscal years. The maximum duration of these advances is six months, with the interest charge being discretionary. It should be noted that the BSP’s role as fiscal agent of the government is now being undertaken by the Bureau of the Treasury (BTr) and the Bank pays interest on government deposits. In both the New Central Bank Act and Memorandum of Agreement between the Department of Finance and the BSP, it is clearly stated that the BSP will pay 75 percent of its net income as dividend to the government to offset the cost of central bank restructuring. In addition to this dividend, interest rebates will be given by BSP to National Government equivalent to the portion of BSP profits before dividends, in excess

⁶ Equity contributions, subsidies, and net lending from the NG to the GFIs were less than 0.1 percent of GNP in the last three years.

⁷ The E-Commerce law (RA 8792) mandates the substantial computerization of government frontline services in 2 years. Notable examples are the government electronic procurements system launched in November 2001, the BIR e-filing for large taxpayers, and electronic filing of passports.

of one percent of its assets. This arrangement is to assist in the financing of liabilities of the previous central bank which were transferred to the Board of Liquidators, due mainly to their quasi-fiscal nature. Although the BSP has become liable for taxation since July 1998, it continues to pay for the account of the government subscriptions to international agencies arising from previous laws—a minor breach of the separation of roles.⁸

8. **Asset management practices of the social security institutions (SSIs) have in the past lacked transparency although internal operations have been strengthened by predominantly private sector Board of Trustees.** Consistent with international practice, the two social insurance agencies invest in private enterprises, and these two SSIs are required by law to report or submit financial statements for audit by COA and Congress. In the past, the SSIs have been used to support government policy (e.g., investing in companies, offering lower than market loans for housing etc.) giving rise to important accountability and transparency issues within the SSIs.

9. **There is a clear separation of fiscal and public enterprise management.** The government's holdings in nonfinancial public enterprises are run on commercial grounds or with clear state subsidies, the latter being detailed in the budget.⁹ However, tax incentives and discretionary exemptions result in incomplete transparency of public sector enterprises' financial position. Since August 2001, their financial management is subject to monitoring by the DOF. Government regulation of public sector enterprises has clearly been used as a quasi-fiscal instrument, (for example, the holding down of power tariffs and the reduction of tariffs to enable the passing of the Power Sector Reform Law). Subsidies can also reflect inefficient operation and, although they are clearly identified in the budget, and tax subsidies of GOCCs must be approved by the Fiscal Incentives Review Board (FIRB), the nature of any government policies generating the need for subsidies is not transparent.¹⁰ In 1998, in an effort to increase the generation of cash revenues in the wake of the financial crisis, the granting of tax subsidies for NG agencies and GOCCs was stopped. It was resumed in 1999 on a very limited basis: i) to NG agencies for taxes and duties resulting from foreign-assisted projects (hence all tax obligations, including those for locally funded importations, must be incorporated in their budgets); and ii) to selected GOCCs (usually hospitals and cash-strapped GOCCs) approved by the FIRB.

10. **The law provides automatic government guarantees for some of the GOCCs' debt.** Although the provision of such guarantees is now more limited and subject to a

⁸ Under the New Central Bank law, these advances are supported by 5-years Promissory Notes from the NG which can only be renewed once.

⁹ Actual subsidies and equity investments to GOCC are detailed in the COA Annual Financial Report of the National Government, and also in the budget documents submitted to Congress.

¹⁰ Subsidies under the Tax Expenditure Fund which are endorsed by the Fiscal Incentives Review Board are reported by agency in the Department of Finance Statistical Bulletin.

payment of a guarantee fee to the NG equivalent of 1 percent of the loan, this also blurs the distinction between government and commercial activities. RA 7656 requires that all government corporations remit at least 50 percent of their prior year's net income to government. The GOCCs are established by specific charter, and depending on this charter are allowed to invest in private enterprises, usually through joint ventures. Some are also able to establish subsidiaries, usually after scrutiny.

11. There is a well-defined, though rather complex, clear legal and administrative framework for budgetary and extrabudgetary operations but, in the past, the framework has not always been adhered to. The legal framework for these operations includes the Constitution and the Administrative Code of 1987—*Executive Order No. 292*, supplemented by a large number of Executive Orders, Presidential Decrees, Budget Circulars and other implementing instructions. In particular, National Government budgetary management is governed by Book VI of the Administrative Code of 1987, and the local governments by the Local Government Code of 1991—*R.A. No. 7160*.¹¹ The complexity of this framework detracts from its capacity to set out comprehensive transparency and accountability requirements for the executive branch of government. The Administrative Code gives extensive powers to the DBM to reallocate, delay and suspend spending authorizations, which in the past has resulted in substantial deviations of actual from planned government expenditure programs.¹² These powers undermine the transparency of the budget as a statement of the government's policy intentions. However, since 1997, in an effort to improve the predictability and transparency of budget releases, 80–85 percent of agency appropriations for specified on-going programs and projects are released at the start of the year for obligation, based on the General Appropriations Act. The rest are withheld pending the submission of the details on the proposed utilization of the appropriation, or else is withheld as a cushion for projected revenue shortfalls. The strategy for the areas and procedure for withholding of fund releases and the release of other funds are issued and clearly laid out in Administrative Orders and National Budget Circulars which are available to agencies, local government units, GOCCs, Congress and all interested entities.

12. Taxes, duties, and fees are levied under the authority of law. Tax powers are well documented in the National Internal Revenue Code of 1997, which gave effect to a Comprehensive Tax Reform Program. Some confusion has been generated by the Bureau of Internal Revenue (BIR) regulations not being in place to support the Tax Code (e.g., the

¹¹ This is supplemented by comprehensive Rules and Regulations Implementing the Local Government Code of 1991.

¹² Under Book 6, Chapter 5 of the Code “The Secretary of Budget shall recommend to the President the year's program of expenditure for each agency of the government on the basis of authorized appropriations. The approved expenditure program shall constitute the basis for fund release during the fiscal period, subject to such policies, rules and regulations as may be approved by the President.” (Section 34) Requests for allotment are also approved by the Secretary on the basis of appropriation cover and “the probable needs of the department or agency for the remainder of the fiscal year or the period for which the appropriation was made.” (Section 33).

Code provides for loss carry forward but, without implementing regulations in place, companies are unable to use this provision). Moreover, the laws and regulations have been complicated by a wide variety of reliefs, preferences, exemptions and privileges, which are sometimes vague and conflicting. This coupled with burdensome documentary requirements, makes the system susceptible to avoidance and evasion and prone to undue exercise of discretion, both on the part of the taxpayer and the tax administration, when administering these laws. The authorities are also in the process of rationalizing tax incentives and intend to submit a draft law to Congress in the near future. There is now an ombudsman resident in the tax office and taxpayer assistance is available, although the need to strengthen this is recognized. Other problems are presently being addressed by reforms introduced in the BIR. The tax authorities have no explicit code of conduct for their employees but the rights and obligations of employees are specified in the general code of ethics for civil servants.

13. **Public employees are governed by a code of ethical standards developed by the Civil Service Commission.** This code provides terms of conduct, employment, rights and obligations of civil service employees.¹³ The Civil Service Commission, a fiscally autonomous agency, is responsible for the enforcement of the Code. Under Section 12 of the Act, the Commission can take disciplinary measures but has been reactive to complaints rather than auditing compliance under the Code. Apart from this Act, other significant legislation is RA No. 3019 or the Anti-Graft and Corrupt Practices Act, which defines those acts constituting graft and corrupt practices, and concomitantly, imposes criminal sanctions to deter their commissions. Available evidence of corruption supports the view that enforcement of this ethical code is not effective. The Office of the Ombudsman investigates behavior by officials or agencies which is illegal, unjust, improper or inefficient, either on its own initiative or when a complaint is lodged. It can direct action to be taken by responsible agencies and is a fiscal autonomous agency (its annual appropriation is automatically released). Procedures concerning public sector employment are clearly stated and require merit-based competition for vacancies. The Civil Service Commission has been working extensively to prepare an updated draft of a new code. This has been submitted to Congress and is currently under review by the Legislature.

B. Public Availability of Information

14. **This provision is substantially observed.** The Constitution requires full public disclosure by the state of all its transactions involving the public interest (Sec 28, Article II). The annual budget covers all general government in detail, including transfers to LGUs, while the activities of the government financial institutions (GFIs) and GOCCs are appended as annexes to the state budget.¹⁴ Overseas development assistance is included in the budget

¹³ The code is promulgated in Republic Act No. 6713 "An Act Establishing a Code of Conduct and Ethical Standards for Public Officials..."

¹⁴ Statements of the financial operations of major GOCCs are included in the annual Department of Finance Statistical Bulletin.

framework for expenditures and financing. A consolidated resource budget is also presented with the annual budget, including the revenue and expenditures of major GOCCs and nonfinancial corporations and LGUs, to determine the public sector borrowing requirement.

15. **Consolidated data are summarized by administrative and functional classifications during budget preparation, but not during budget execution.** This prevents identification of the impact of under/overshoots during budget execution on the intended balance of spending across social, economic and other sectors.

16. **The financial performance and direct support for GOCCs and GFIs are reported in the budget.** The performance of fourteen nonfinancial GOCCs for which the government provides subsidies or guarantees is monitored and reported, together with their impact on the PSBR. GFIs (pension funds, Development Bank of the Philippines, the LBP) are subject to the same rules as commercial banks, and their lending (including nonperforming loans) is reported. The cash surplus and deficit information of financial corporations is also monitored. The central bank is bound by its Act and Charter to report its profits to Congress annually according to accounting standards determined by the Commission on Audit (COA). The COA submits a separate report to Congress and the Office of the President. Information on the two previous year's outturn, and current fiscal year estimates is presented in the budget document. The budget is available in book form and is widely accessible through the DBM website (www.dbm.gov.ph). In-year information on fiscal developments, however, exhibits some weaknesses. The reporting system is cumbersome and imposes heavy demands on agencies, often resulting in reporting requirements not being met comprehensively or in a timely manner. The budget outturn is reported both in the budget documents submitted to Congress in July or August, and in the COA report. The budget documents contain actual expenditures on an obligation basis as submitted by the different departments based on financial statements. The audited actual expenditures (obligation basis, not cash nor estimates) is reported in the COA annual financial report.¹⁵ The cash disbursements of the government are also featured in the budget documents but on an aggregative basis and only by economic classification based on the report submitted by the Treasury.

17. **The government provides information on the level and composition of gross debt at issue value both with the annual budget and on a monthly basis.** Detailed information on government debt is also contained in annual reports by the Department of Finance and Commission on Audit. In addition, a monthly Cash Operations Report of the BTr outlines broad developments in the National Government Budget and its borrowing requirements

¹⁵ The financial position of the national government is reported by the COA in the Annual Financial Report based on a comparison of income collection on a cash basis and the expenditure obligations made during the year on an obligation/commitment basis. However, unlike the concept of the budget deficit, borrowing availments/proceeds generated during the year are also treated and reported as income. Hence, this picture of the financial position of the government approaches more the concept of an overall cash position which compares the total cash receipts and expenditures of government.

during the course of the year. This also reports over-the-counter sales of government securities. However, the use of separate windows for the sale of over-the-counter debt to SSIs and GFIs outside the weekly auction subtracts from the transparency in government financing.¹⁶ Information on financial assets held by the government is provided in government agency reports but there is no aggregate report on government financial assets. Since government-owned enterprises can invest in private enterprises, public sector enterprises' relations to the private sector also need to be identified. In 1999 to 2000, all public sector contracts costing P50 million require approval by the Office of the President. However, in 2001, this contract review task was delegated to the NEDA. This function was subsequently abolished (except for contracts required by law to be approved by the President) recently to enhance the accountability of agency heads given the more transparent and competitive procurement procedures set in place by government. In October, 2001, the modernization and standardization of government procurement procedures, which began the year before, culminated in the issuance by the President of Executive Order 40 to consolidate and standardize all procurement guidelines for works, goods and consultancy services, including the adoption of an electronic procurement system (EPS). The BTr is proposing to report the outstanding government securities by holder and issuances via the tap window. The BTr pre-announces its borrowing programs to its securities dealers for transparency.

18. The budget documents do not include statements on the stock of contingent liabilities, the size of aggregate tax expenditure, or the extent of quasi fiscal operations. Government guarantees are not catalogued in the budget and are not reported in-year, although the government is undertaking a review of these liabilities and does intend to report the data. More generally, the Foreign Borrowing Act (RA4860) puts a ceiling of US\$7.5 billion on guarantees that can be issued. Charters of some GOCCs also limit NG guarantees to the corporation. The tax subsidies on budget institutions are automatically appropriated, and estimates are contained in the budget and the monthly "State of Cash Operations" of the BTr. Private companies that are registered with either the Bureau of Investments (BOI) or the Philippine Export Processing Zone Authority (PEZA) are vetted by the BOI or PEZA to determine their eligibility for tax exemptions. All tax exempt companies are certified by the BIR which maintains a register of these companies, which is not publicly available and the associated tax expenditures are not reported. The Foreign Borrowing Act (RA 4860) prescribes a set limit on total National Government guaranteed debt. The right of GOCCs to borrow abroad is explicitly detailed by their charter.

19. The Philippines subscribes to the IMF's Data Dissemination Standard (SDDS). As part of the commitment to the SDDS, the government publishes advance release date calendars for fiscal reporting, and the date calendar for SDDS is posted on the website of the National Statistical Coordination Board; release-dates are usually adhered to.

¹⁶ The price is 90 percent of the average price in the last three auctions for tax exempt agencies and 100 percent for the remainder. This could be viewed as a QFA, if, for example, an auction is cancelled and the price that agencies receive is based on past lower rates, not reflecting the rise in interest rates that caused the auction to be cancelled.

20. **The deficit is reported and measured on a cash basis, although recent changes in the accounting system will allow the estimation of arrears in the future.**¹⁷ The budget and its outturn is largely presented on an obligations basis. While the outturn is also reported in cash making, this is highly aggregated comprising only one table.¹⁸ At the same time, the obligations-based presentation is not easy to interpret in economic terms and may lead to a distorted view of budgetary policy.¹⁹ Treasury financing flows are difficult to reconcile with monetary data, due to nonbank financing excluded from the monetary survey, timing and definitional differences.

21. **National government accounts based only on the Treasury's cash accounts are published on a monthly basis with a twelve working days lag.** Annual reports are prepared and submitted to the legislature within the deadline of September 30 legislated in the Administrative Code. Reports on local governments are available only on an annual basis with a lag of several months. The annual audited reports of GOCCs and GFIs are available with similar lag.

C. Open Budget Preparation, Execution, and Reporting

22. **Economic fiscal targets are set out for the budget year and two subsequent years with the critical economic parameters on which they are based.** The government's budget cycle begins early in the year and agencies get involved around February with the issuance of the National Budget Call document to all heads of budget institutions, which offers the policy guidelines and specifies the procedures for preparing the next year budget. The overall expenditure program of the government is set out in great detail in the budget documents for each individual budget institution broken down by detailed line items of expenditure. However, the clarity of this expenditure program is somewhat blurred by the fact that some expenditure authorizations do not expire at the end of the fiscal year, and some spending is executed on the basis of the previous year's budget (although this spending is included in NEP/GAA).²⁰ LGUs normally pass their budgets before the end of the year, but this depends

¹⁷ The budget papers report the current balance (revenue minus current operating expenditure), primary balance (current balance plus interest payments) and total surplus/deficit (current balance less capital outlays and net lending). They do not publish operational balance (incorporating inflation adjustment), underlying balance (removing financial transactions including asset sales) and structural balance (expenditure and revenue adjusted for cyclical effects).

¹⁸ The difference between the obligation figures would be the proportion of cash payments to be made for the current year's obligations which are expected to be liquidated and the amount of accounts payable to be paid as a result of prior years obligations. Hence, the relative proportions of these two kinds of cash payments then will determine the difference between obligation and cash amounts.

¹⁹ For example, the 2002 budget on a obligations basis shows an increase in capital outlays of 46 percent over the previous year, however, on a cash basis this is likely to represent only a 1 percent increase.

²⁰ Appropriations for capital outlays remain valid for obligation for a period up to one additional year; appropriations for maintenance and operations lapse at the end of the fiscal year.

on the speed of local legislative processes. The budget documentation is on the same basis as that of the National Government, viz. actual obligation, adjusted program and proposed appropriation. It is unclear whether local budgets are always publicly available. While the Local Government Code does not require LGUs to make their approved budgets publicly available, the Code mandates them to post their financial statements and other accountability reports in conspicuous places.²¹ The previous year's budget outturn is available in the COA Annual Financial Report, which is published within nine months of the end of the budget year.

23. **The budget documents contain only a general statement of the National Government's medium-term fiscal policy objectives, and priorities and the objectives are not identified in a way that facilitates comparison with budget outcomes.** The budget is set within the context of a description of economic prospects. In the course of budget preparation fiscal aggregates are forecast two years beyond the coming budget year. Since 1998 the DBM, in cooperation with the NEDA, has refined the fiscal projections and developed a medium-term budgetary framework, which will soon be published. While the medium-term projections are shared with academia and the private sector, detailed disaggregated fiscal projections are not published in the budget, and information on the medium-term prospects for GOCCs, GFIs, and LGUs are unavailable.²² From 2001, the Budget of Expenditures and Sources of Financing has included discussion of the medium-term prospects for GOCCs and GFIs.

24. **There is no reporting of quasi-fiscal activities (QFAs).**²³ There is limited indication or analysis in the budget documentation on the sustainability of fiscal policy or of potential fiscal risks, although the budget documents do contain some analysis on how the government's financial position would change with changes in important economic parameters. The authorities plan to implement a sustainability analysis in the medium-term framework. In preparation for this the DOF is undertaking an inventory of contingent

²¹ Section 352 of the Code entitled "Posting of the Summary of Income and Expenditures" requires local treasurers, accountants budget officers and other accountable officers to post within 30 days from the end of each fiscal year, in at least 3 publicly accessible and conspicuous places in the local government unit a summary of all the revenues collected and funds received, including the appropriations and disbursements of such funds during the preceding fiscal year.

²² This medium-term fiscal plan is the basis on which annual budget ceilings are set. Budget documentation also provides detail on receipts and expenditures of LGUs (broken down by regions, municipalities, provinces, and cities) as well as their consolidated deficit. While this does not include their current balances or debt, this information is submitted to the Bureau of Local Government Finance.

²³ There is limited evidence on the extent to which GOCCs undertake QFAs, although prevailing opinion is that this is not a major issue. However, there is anecdotal evidence of QFAs associated with government guarantees for projects operating under BOT arrangements, and lending by the Development Bank

liabilities, including those of the LGUs, and will also undertake a contract review to assess risks.²⁴

25. **The National Government is not bound by formal fiscal rules, but targets the overall balance.** In meeting this fiscal target the legislative branch cannot increase total spending of the executive proposed budget.²⁵ However, this has been circumvented in the past by the legislature lowering interest payment estimates to accommodate expenditure on preferred programs. Since interest payments are automatically appropriated, this increases total expenditure.²⁶ More generally, the Law on Foreign Borrowing sets a specific foreign exchange denominated limit on foreign borrowing. Borrowing from the BSP by the National Government cannot exceed 20 percent of the average annual income of the government over the previous three years. An LGU can incur debt without the DOF approval, subject to the constraint that the debt servicing does not exceed 20 percent of its regular income.²⁷ There is also a legislative ceiling on guarantees to GOCCs. Besides targeting the NG budget balance, the DBM also targets two larger concepts of “government”—the “public sector” and “consolidated public sector” balances. The former includes the impact of central bank restructuring and adjustments in the net lending and equity changes in GOCCs, to derive the public sector borrowing requirement. The latter adds to this the balances of social security institutions,²⁸ the GFIs—including the BSP—as well as the LGUs, so deriving the concept of the consolidated public sector surplus/deficit.

26. **In the budget presentation, there is often a lack of clear distinction between existing commitments and new programs.** However, when preparing their budgets, the budget agencies are requested to prepare projections for the “baseline” budget and “above the baseline” (the latter with justification). Policy changes are included in agency briefing materials for Congressional budget hearings, although there does not appear to be a summary table of new policy measures in the core budget documents. Each agency prepares detailed projections for salaries, other current outlays and capital expenditures, disaggregated by program or project. The costing of each program/project over a three-year time horizon is currently well developed. The BTr’s capacity for forecasting the debt service requirements is sufficiently accurate. However, shortfalls in programmed revenue, and inaccurate cash plans

²⁴ The oversight agencies (the DOF, the NEDA, and the DBM) are focusing currently on the fiscal risks arising from GOCCs operations, BOT projects, and pension funds.

²⁵ Reflecting Article VI, Section 25 of the Constitution.

²⁶ In 2002 there was some move away from this practice.

²⁷ In 2002, the Department of Interior and Local Governments, and the NEDA, the latter specifically for foreign loans, has strengthened its monitoring of LGUs. The DOF through its Bureau of Local Government Finance has also made substantial progress in monitoring the financial performance of LGUs.

²⁸ It should be noted, however, that GFS classify the operations of the Social Security System as part of the national government.

submitted by spending agencies, can result in arrears rather than corresponding reductions in spending. This reflects a disconnect between the obligations covered and cash allocations provided to agencies in the course of budget execution.²⁹ However, the refinements made by COA in the accounting system in 1999 will facilitate the identification of arrears and their presentation in the monthly trial balances of agencies.

27. **Agency statements to Congress outline program objectives.** It is recognized that there is a need to strengthen this area. The DBM has plans to develop standard costs as well as to introduce with the NEDA, a system of performance reviews. Reflecting this thrust the Sector Effectiveness and Efficiency Review is introducing prioritization of program and project funding according to contribution to sector outcomes. An Organizational Performance Indicators Framework (OPIF) requires agencies to submit performance targets/major final outputs as part of their budget submission.³⁰ While these budget reforms are overseen by the DBCC, these are also initiatives in institutional strengthening by the Presidential Committee on Effective Governance. The President has annual performance contracts with Cabinet Secretaries which focus on results against objectives. However, there is little attempt to provide information on budget outcomes and outputs of various programs, which make it difficult to assess whether budget activities have met objectives except in the limited sense of financial compliance.

28. **Regarding revenue projections, there is a clear distinction between projections on the basis of current laws and projections reflecting changes in the tax laws.** However, there has been admitted weakness in the quality of revenue projections, in part caused by the unstable macroeconomic environment, and lack of an adequate data base, but also due to weaknesses in tax administration. While a baseline budget system is used, in the past there was no summary table of new policy measures in the core budget documents. However, in the 2002 Budget, a start has been made by introducing a table summarizing new policy measures. Also, new tax measures are discussed in the primary budget overview document (*Budget of Expenditures and Sources of Finance*) while agency briefing materials for Congress provide a general overview of new policy initiatives.

29. **With some qualifications, data for National Government budget, LGUs and social security systems are generally reliable, comprehensive, and broadly compatible with Government Finance Statistics (GFS) 1986 standards.**³¹ The periodicity and timeliness of BTr and the DOF data are in accordance with the SDDS (refer IMF Report on

²⁹ Agencies provide only crude cash program estimates to the DBM (obligation level divided by 12), without reference to the seasonality of cash requirements and the time at which obligations become due and demandable.

³⁰ It can be noted that national agencies have monitoring systems to measure their outputs.

³¹ Government financial statistics conform to the definition of General Government in the 1993 SNA. The same concept is being adopted for the Philippine System of National Accounts. The budget is not compatible with the new GFS 2001 standards.

Country's observance). However, there appear to be some inconsistencies which give rise to problems in reconciling budget financing with monetary data.³² While classifications are comprehensive in covering all NG transactions, a GFS/SNA consistent function classification of expenditures is lacking. LGUs do not report on GFS basis. There is no consolidated annual report to Congress on outputs/outcomes of government programs against objectives in the budget documentation, although agency briefing materials to Congressional budget hearings include accomplishments in the past year. Moreover, in-year reporting of revenues and expenditures is by broad category and institution but lacks a detailed classification by economic type.³³ There is a clear analytical table showing the relationship between budget estimates and the overall balance. Moreover, a summary table in the budget document provides data on the consolidated public sector deficit (i.e., including data on the financial position of the GOCCs, special funds, the BSP, GFIs and LGUs). While monthly data on the aggregate fiscal position of the NG is available, there is no in-year summary of the aggregate fiscal position of lower levels of government.

30. The accounting system for National Government and the other components of the public sector while comprehensive due to the obligation basis of accounting did not generate adequate and timely cash information.³⁴ Moreover, there are three sets of books (managed by the agencies, the BTr, and the COA) which are not fully reconcilable. The authorities advise that these issues will be addressed by the new accounting system that was introduced by the COA in January 2002. The COA has prepared detailed manuals for chart of accounts on a modified accrual accounting basis. Expenditures are recorded upon incurrence of obligations (i.e., upon the delivery of goods and services and not upon the signing of contracts and issuances of purchase orders as before), and by responsibility centers (e.g., by department and its agency/bureau subdivisions and by program/project) consistent with the classification of the budget. This will assist in the measurement of expenditures arrears and

³² The financial position of the national government is reported by COA in the Annual Financial Report based on a comparison of income collection on a cash basis and the expenditure obligations made during the year on an obligation/commitment basis. However, unlike the concept of the budget deficit, borrowing availments/proceeds generated during the year are also treated and reported as income. Hence, this picture of the financial position of the government approaches more the concept of an overall cash position which compares the total cash receipts and expenditures of government.

³³ A report on the obligations undertaken by agencies, reported by the DBM are actual expenditure obligations reported by the agencies based on the unaudited financial statements the agencies submit to the COA for audit. The authorities have plans for a DBM Web site which would contain data on cash releases by agency and type, and would also cover the LGUs.

³⁴ Under the old accounting standards expenditures were recorded upon incurrence of obligations (e.g., upon signing of the contract and issuance of purchase order for construction of buildings and other capital projects, and inventories, respectively). Data on unpaid bills or unliquidated obligations were reported in the annual financial statements for the current year (those obligations unincurred in the current year and remained unpaid at year-end) and prior year (those incurred in prior years and unpaid as of the end of current year). Moreover, obligations incurred or expenditures for the period were reported in the current year (funded by allotted continuing appropriations released in prior year but still valid until the following year).

accounts payable, and make available better cost information on the different government programs and projects. To simplify government accounting, and make it better understood by the public, budgetary accounts (appropriations, allotments, and obligations) have been removed from the financial statements for the current year and are being monitored under a separate registry.

31. **COA regulations are aimed at giving a better measure of government's outstanding liabilities.** The regulations, effective FY 1999, require agencies to expand the account pertaining to obligations and payables as to nature of accounts, and not only those that are due and demandable. Unliquidated obligations already backed up by cash advances in the hands of disbursing officers and other offices do not need any cash programming by the Government. The new government accounting system will record the Notices of Cash allocation to agencies to make them accountable for funds at the agency level instead of tracking it through the national clearing account.

32. **Internal financial controls are weak, and the rules for public procurement lack clarity.** It is recognized that there are problems with internal controls and monitoring which have been exacerbated by decentralization. The authorities, recognizing this, have commenced a pilot project in the Department of Education, Culture and Sports and Department of Social Welfare to develop agency financial management skills. While the COA, responsible for external audit, is extremely large by international standards, internal audit within agencies is weak. An Internal Audit Code has been prepared and an Internal Control Bill is being prepared, but no budget funding is being provided for an internal audit function within individual agencies. An Inter-Agency Committee on Graft and Corruption composed of representatives from the COA, the CSC, the Department of Justice, the National Bureau of Investigation, the Presidential Commission Against Graft and Corruption, as well as the Ombudsman, was created in 1997 to formulate and develop concerted strategies in the prevention, detection, investigation, and prosecution of graft cases. The latter Office monitors, and performs appropriate actions on the behavior of government officials and employees; and, investigates and prosecutes any public officer or employee, office or agency, performing any act that appears to be illegal, unjust, improper, or inefficient.

33. **These procedures are governed by over 100 different laws, which will be rationalized and consolidated by a Government Procurement Reform Act drafted in 2000 but yet to be passed by the Senate.** Administrative issuances, however, were signed starting 2000 establishing new standardized procedures for the procurement of civil works, goods, and consulting services. The issuances also mandated the use of an EPS for the procurement of common office supplies after it was launched in December 2000. The EPS consisted of a public tender board, a suppliers' registry, and a price catalogue. In October 2001, with the issuance of *Executive Order 40*, as a further step towards transparency and efficiency, the EPS was declared as the government's single portal for e-procurement. The proposed law presently pending in Congress is intended to institutionalize these reforms, cover LGUs, and set penal sanctions for violators both in the public and private sectors. In principle, all agencies must resort to public bidding and post in newspapers, in the agency website, and in the EPS-Tender Board, contracts over P1 million. In the past, there have been

political pressures to avoid these procedures.³⁵ For foreign-assisted projects, procurement procedures have now largely been aligned with donor requirements.

34. **Government employment and pay regulations are not well defined and allow considerable discretion.**³⁶ The laws underlying public workers' remuneration are clear, but in the case of GOCCs there are numerous exemptions, and in the case of government agencies numerous allowances obscure pay scales. The Presidential Commission on Effective Governance has recently issued a moratorium on the raising of allowances by GOCCs.³⁷ The DBM will also soon undertake a government compensation study to shift to a more performance-based and market-oriented pay system, and a more flexible position classification system.

D. Independent Assurances of Integrity

35. **The Philippines has not attained complete separation between accounting and audit functions within the government, although there is a national audit body (Commission of Audit) that is given significant independence under the constitution independent of the executive.**³⁸ The COA has a mandate to keep the general accounts of the government and prepare the Annual Financial Report of the national government; to promulgate accounting and auditing regulations, and prescribe the chart of accounts; to undertake independent audits of government entities; and to promote accountability, transparency, and effectiveness of government operations. In supervising and consolidating the government accounts and then auditing those accounts, it might be considered that the COA is infringing good international practices. Moreover, with the COA chairman appointed by the President and in reporting both to the President and Congress, it might be considered that the COA is not fully independent of the executive branch.³⁹ However, while the COA Chairman is appointed by the President, he can only be removed by impeachment, and is independent of the Senate and the Congress.⁴⁰ While there are institutional mechanisms in

³⁵ These refer to the revised *Implementing Rules and Regulations of Presidential Decree 1594*, Series of 2000 for civil works; *Executive Order (EO) 262*, Series of 2000 for goods; *EO 322*, Series of 2000 on the FPS; *EO 40*, Series of 2001, for the consolidation and standardization of the procurement procedures for works, goods, and consulting services.

³⁶ For example, with devolution of authority to agency heads to pay allowances and with a monitoring system which is not fully operative, there has been a tendency for agencies to grant unauthorized year-end benefits.

³⁷ *Administrative Order 5* issued in February 2002 called a stop to salary increases by GOCCs because of the general 5 percent government salary increase.

³⁸ The COA is a fiscal autonomy agency for which the approved annual appropriation is automatically released.

³⁹ However, the Chairman of the COA cannot be removed by the President once appointed, but can only be removed by impeachment by Congress.

⁴⁰ The COA is a constitutional body and is therefore independent from the three branches of government. It has three commissioners with a fixed tenure of seven years who can only be removed by impeachment. These

(continued)

place to follow up the COA reports, there are a number of factors that appear to limit their effectiveness. The government is required by the Audit Code (*Presidential Decree 1445*) to make an official response to the COA on measures to address problems the latter has identified, but there is no formal body set up to ensure implementation of the measures, similar to the Public Accounts Committee in other countries. The Congress Appropriation Committee and the Senate Finance Committee use the COA's Annual Financial Report of the NG at the time of budget discussions to pressure departments and spending agencies to implement the COA recommendations. However, evidence of the same findings in the same institutions year after year questions whether this mechanism is effective. It has also been felt that the COA has overly concentrated its efforts on agency scrutiny and failed to identify systemic government-wide problems, and has been conservative in its approach to value for money auditing, preferring to stress financial regularity.

36. **Macroeconomic forecasts are not generally available to the public.** The macroeconomic models maintained by the NEDA are discussed with other agencies, and academia and the private sector are often requested to contribute to its work. Although the models themselves are not publicly disseminated, these can be obtained from the NEDA through official request. There is, however, an ongoing effort to reconfigure the NEDA website to accommodate models used for forecasting and policy simulation. Internal assessments and emerging scenarios vis-à-vis the macroeconomic targets or projections are discussed internally within the agencies of the DBCC, but are not shared with the public on the grounds of avoiding confusion and opportunities for speculation. However, once the new macroeconomic assumptions are officially adopted by the DBCC, they are immediately released to the public through press briefings and interviews. The underlying macroeconomic models and methods maintained by the NEDA are discussed with other government agencies who are generally involved in the preparation of the macroeconomic assumptions underlying the annual budget of the national government and the medium-term development plan. The Technical Working Group on the Macroeconomy of the DBCC serves as the venue for discussing the improvements in the various models and methods maintained by the members of the TWG-Macro such as the NEDA, the DBM, the DOF, the BSP, the BIR, the Bureau of Customs, and the BTr. The documentation of such models are shared with members of Congress and the Senate who request for such models. In the past, there has been evidence of the tendency for economic forecasts to be over optimistic.

37. **The National Statistics Office is statutorily independent under Executive Order 121 of 1987 and fiscal statistics (with some important exceptions) comply with the standards for integrity and quality set out in the SDDS.**⁴¹ Procedures for collection, processing and presentation of fiscal data are decentralized among five major statistical

commissioners while being nominated by the President must be accepted by the Congress, by passing scrutiny and approval of its Committee on Appointments.

⁴¹ One notable example is the failure to provide timely in-year data on the economic composition of expenditures, another is the failure to provide a break-down between bank and non-bank financing.

agencies and are determined by the producing agency rather than solely by the statistical agency head. However, the National Statistical Coordination Board has final authority on standards in the collection, processing and dissemination of data and can comment on erroneous use of statistics.⁴²

III. IMF STAFF COMMENTARY

38. **While the Philippines has made significant progress in improving fiscal transparency, two key challenges remain.** First, the Philippines presents the paradox of well defined budget responsibilities, procedures and reporting requirements but with the international perception of relatively high corruption levels. There is a pressing need, therefore, to direct more effort at enforcing present financial rules and regulations, more clearly defining individual accountabilities, and taking firm and demonstrable corrective actions when these are breached.

39. **A second priority is to establish realistic revenue estimates, an essential key to fiscal transparency and implementation of the budget.** In this way the over-reliance on intrusive controls at the budget execution stage would be obviated and parliament's role in shaping budget policy would be restored. Implementing annual performance contracts for Cabinet Secretaries will be very difficult unless a realistic budget environment is established.

40. **Third, the Philippines budget execution system in which agencies are able to incur obligations without assurance that cash will be available at the appropriate time creates many problems for fiscal transparency.** This reflects, in part, fundamental gaps in the internal information systems required for prudent financial management. Without an obligation control system that is firmly linked to available cash, budget execution is inherently prone to arrears, and violates a fundamental principle of responsible fiscal management—effective control of overall public indebtedness. Under difficult economic circumstances, this has also meant that budget management has relied on a system of centralized cash releases to control the speed of budget execution and to attain overall fiscal targets. Over reliance on this mechanism has caused the approved budget to lose its relevance, and the DBM to assume widespread discretion in reallocating resources within the fiscal year, adding to the lack of transparency in budget operations. The thrust of reform efforts should be based on addressing the following issues aimed at greater fiscal transparency. The authorities advise that the disconnect between incurrence of obligation and the release of cash has been addressed with the partial release and implementation of only a portion (in FY2002, 75 percent) of authorized appropriations at the start of the year. This portion is dependent upon the extent of the risk in realizing revenue projections, and with the remaining balance to be released upon review of the physical and financial performance of agencies.

⁴² The Board reviews survey proposals and ensures standard classification systems.

41. **Perhaps the greatest problem in the Philippines is the persistence of the perception of graft and corruption due to lack of transparency in many areas of budget execution.** An important need in this area is being addressed by the new procurement legislation which is awaiting debate in Congress. However, effective internal audit is also a front line defense against corruption in spending agencies. In the Philippines internal audit capacity within agencies is generally poorly developed, and under-resourced. As a consequence internal control procedures are seldom challenged or improved. In the past there have been proposals to use the COA audit skills and experience in order to promote the development of internal audit skills in program agencies, but these have not progressed. There is an urgent need for virtually non-existent internal audit functions in individual agencies to be speedily activated, including possibly through the use of the services of outside auditing companies. The authorities are urged to direct renewed efforts in developing internal audit within agencies and strengthening their internal controls. There is also an urgent need to strengthen management audit at the sub-national levels of government, as spending responsibilities increase at these lower levels.

42. **A fundamental defect in budget execution is the absence of an information and control system based on realistic information on future cash available.** As a result of poor information, unsustainable obligations are incurred on ongoing programs/projects. The introduction by the COA of a new accounting system based on commercial practice is an important step in remedying this defect. However, a full solution requires effective agency financial management information systems at both national and sub-national levels. These systems should both allow and require agencies themselves to manage new and existing obligations with respect to realistic and approved cash plans. There is a parallel need on the part of central agencies to ensure that top-down budget execution procedures maximize information for each spending unit on cash available to them in coming months. This requires urgent action to improve existing revenue forecasting standards. There is also a need for resumption of progress on developing a Government Financial Management Information System which enables the assignment of available cash to agencies during the course of the budget year in a manner consistent with the approved budget plan. This would also form the basis of reliable in-year reporting of budget outturn in relation to the budget plan.

43. **There is a need for more timely information, especially in-year, on the activities of the general government.** There are four priorities in this area. First, monthly in-year fiscal reports lack adequate detail on the economic type of expenditure or revenues. Second, there is no functional classification of expenditures which meets international standards. Both these deficiencies should be more easily remedied when the new COA accounting system for spending agencies is in place. Third, there is no breakdown between bank and non-bank financing of government. This will require improved information collection on holders of government debt. Fourth, the transparency in BOT operations should be improved. The reports on guarantees associated with BOTs should be prepared and made public. The budget or a related document should comment on the pricing policies underlying the profitability of the BOTs. The tax incentives associated with BOTs should be enumerated.

44. **The quality of published data could be improved.**

- Although the Philippine budget plan is highly transparent, presentation of the budget outturn is much less clear (except on the basis of object of expenditure). It is therefore not possible to identify how far the composition of the budget approved by Congress is modified at an administrative level in the course of budget execution. This weakness is of particular concern given the extensive budget execution powers of the DBM, making it difficult to enforce accountability for budget managers. The authorities are of the view that the introduction of the new government accounting system, the computerization of Budget Execution and Accountability Tracking System, both of which are ongoing, and the linking of these systems to the agencies' financial management, will facilitate the timely accounting and reporting of the budget outturn to improve the accountability of budget managers.
- Given the devolution of government activities to the LGUs, there is a need to improve the quality and timeliness of their reporting and to give a more timely consolidated view on general government fiscal developments. The government should take steps to address the information systems and reporting standards of the LGUs, and perhaps provide central assistance through a task force to up-grade their systems. Quarterly consolidated data on general government should be publicly available with no more than a one-quarter delay after the end of the reporting period. Consideration should also be given to publishing disaggregated general government statistics to enhance the democratic process behind decentralization by giving local electorates information on the performance of their localities.
- In the past, the quality of fiscal data has been compromised by the failure to reconcile above-the-line and financing data, as well as by substantial but poorly defined budgetary arrears. There is a need to clarify the sources of discrepancy between government financing flows and the data reported in the monetary survey, reconciling the evolution of government debt stocks with associated budget flows. While the arrears problem may have been aggravated by the "obligations" system of accounting which is now to be replaced from 2002 by modified accrual basis accounting, it will (as indicated above) still be important to ensure that arrears are aggregated and reported.
- The budget document should contain a clear statement of the fiscal risks the government perceives will be faced during the year and, insofar as is possible, attempt to quantify those risks for the legislature and the public.
- The budget should include a more specific statement on objectives and should be cast in a form that facilitates ex post evaluation against measurable budget outcomes. In order to better assess the degree to which the budget has achieved its stated objectives, the government should provide more information on budget outputs and extend its recent initiatives in promoting performance budgeting.

- Although the budget is based on a medium-term perspective, this is not fully disclosed with the budget documents. This data should include both a full specification of the macroeconomic environment and a clear presentation of revenue and expenditure components within the existing medium-term fiscal framework. The government could also consider publishing the working methods and assumptions used in producing its macroeconomic forecasts, highlighting key assumptions that are implicit in the fiscal projections, including the cost assumptions of budget programs.
- The government should begin reporting contingent liabilities, tax expenditures, and quasi-fiscal activities with the budget documents. The government should also provide an analysis of fiscal sustainability and information on its holdings in the private sector enterprises as part of the budget. Consideration should be given to including information on the maturity structure of the debt stock.
- The government should regularly publish consolidated information on its financial assets so that the public can assess the net indebtedness of the public sector. Such publication would include comprehensive information on valuation methods.

45. In order to comply more fully with the code of fiscal transparency, a number of further steps to reform the budget process would be needed.

- The legal basis of the budget process, the 1987 Budget Code, is somewhat dated and has been buttressed by numerous executive orders, financial regulations and presidential decrees. It is perhaps time to consolidate and clarify this legal framework—perhaps along the lines of a Fiscal Responsibility Act, which also obliges the government to present its fiscal strategies in the context of a medium-term expenditure and resource framework, and report its budget outturn against financial and performance plans.
- The Philippines for many years has operated an incremental bottom-up baseline budgeting system, in which budget decisions have been limited to an increasingly small budget increment. In terms of “fixed commitments,” this baseline now absorbs around 85 percent of National Government expenditures. There is a basic need to increase flexibility in fiscal choices and to make the programs underlying the baseline more transparent. In this regard, the authorities’ efforts at moving to a more performance focused budgeting approach is welcome. It is suggested that this process be accelerated in the future, and instruments be put in place to put pressure on agencies to re-examine their baseline budgets, enhancing transparency and increasing fiscal flexibility.
- Over reliance on a centralized cash release system has caused the approved budget to lose relevance, and deflected attention from improved budget preparation techniques. It has also implied that the DBM has assumed some of the financial management functions of the program agencies. There is a need to redress this imbalance by devoting more attention to budget preparation, and most particularly in improving

revenue forecasts to arrive at more realistic and conservative expenditure programs. In this process there should be a move to give more latitude to agencies to develop their financial management skills and restore accountability for the execution of their budgets.

46. A number of other improvements are also recommended that would significantly enhance transparency.

- Significant simplification of the tax administration system through the rationalizing of tax reliefs, preferences, exemptions and privileges is a high priority. This will not only make the tax system easier to understand, but also improve compliance with tax laws and diminish the degree of discretion that can be exercised by taxpayers and tax administrators, a major source of corruption and a reason for the decline in the revenue-GDP ratio.
- The government should continue to expand recent initiatives to improve taxpayer services which include providing information on the tax services' website and simplifying tax documentation.

47. Independent assurances of the integrity of the fiscal data could be strengthened.

The ultimate assurance of the integrity of fiscal numbers rests with an external audit institution reporting to the legislature, and independent of the executive. In this the Philippines differs significantly from good international practice. The COA is a constitutional institution, whose chairman is appointed by the president and reports both to the President and Congress. While the chairman is protected from removal by the executive, this arrangement means that he/she cannot be regarded as genuinely independent of the executive. Moreover, the COA has responsibility not only for external audit but also for setting accounting standards in government and for supervising and consolidating the annual accounts to be presented to Congress. The independence implied by this arrangement may be questioned since the COA is in effect asked to judge the soundness of its own accounting rules. While recognizing the difficulty implied, since present arrangements are based on a constitutional provision, it is recommended that the Philippines initiate steps to move closer to international practice with a view to reassigning government accounting to the executive branch.