

PUBLIC EXPENDITURE AND
FINANCIAL ACCOUNTABILITY (PEFA)

Public Financial Management
Performance Report

KINGDOM OF TONGA

Final Report
May 2010

Approximate currency equivalents (at 15 March 2010)

Currency unit: Tongan Pa'anga (TOP \$)

AUD \$1	=	TOP \$1.76
USD \$1	=	TOP \$1.93
EUR €1	=	TOP \$2.65

Financial year: 1 July to 30 June

ACRONYMS AND ABBREVIATIONS

ADB	Asian Development Bank
AGA	Autonomous Government Agencies
AMP	Annual Management Plan
AO	Audit Office
AusAID	Australian Agency for International Development
BAC	Bidding and Award Committee
BP	Budget Paper
COFOG	Classification of Functions of Government
CF	Contingency Fund
CSDRMS	Commonwealth Secretariat Debt Recording Management System
CSFT	Civil Society Forum of Tonga
CT	Consumption Tax
DSA	Debt Sustainability Analysis
EC	European Commission
EPSRP	Economic Public Sector Reform Program
ERC	Expenditure Review Committee
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GoT	Government of Tonga
GPC	Government Procurement Committee
HoD	Head of Department
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
JICA	Japan International Cooperation Agency
MDA	Ministries, Departments and Agencies
MLCI	Ministry of Labour, Commerce and Industry
MEWAC	Ministry of Education, Women's Affairs and Culture
MoFNP	Ministry of Finance and National Planning
MoH	Ministry of Health
MoPE	Ministry of Public Enterprises
MTEF	Medium-Term Expenditure Framework
NPV	Net Present Value
NRBT	National Reserve Bank of Tonga
NSPF	National Strategic Planning Framework

NZAID	New Zealand International Aid and Development Agency
PE	Public Enterprise
PEFA	Public Expenditure and Financial Accountability
PEFA AT	PEFA Assessment Team
PFM-PR	Public Financial Management Performance Report
PMO	Prime Minister's Office
PSC	Public Service Commission
RMS	Revenue Management System
RSD	Revenue Services Department
SDP8	Strategic Development Plan 8
TAP	Tender Assessment Panel
TBC	Tonga Broadcasting Commission
TCCI	Tonga Chamber of Commerce and Industries
TDB	Tonga Development Bank
TIN	Tax Identification Number
TWB	Tonga Water Board
VMS	Voucher Management System

Acknowledgements

This report was prepared by a core PEFA Assessment Team (PEFA AT) led by Tim Cadogan-Cowper (AusAID) and Jonathan Gouy (Consultant), with the assistance of ‘Ana Fakaola ‘I Fanga Lemani (Chief Accountant, MoFNP) and Saia Faletau (ADB & World Bank Focal Point, MoFNP).

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Summary Assessment

This Public Expenditure and Financial Accountability (PEFA) assessment has been carried out as a joint exercise by the Government of Tonga (GoT) and donors. The assessment team was comprised of two technical experts engaged by the Australian Agency for International Development (AusAID), a government official and the ADB/World Bank Focal Point in Tonga. The assessment team undertook field work during February and March 2010, consulting with a range of government and non-government stakeholders in Nuku'alofa and gathering evidence. Early in the field work stage, the GoT was provided guidance on the evidence required to support the assessment at an early workshop of three hours duration. In addition, the draft PFM Performance Report (PFM-PR) was presented to the same audience at the end of the field work stage in a three hour workshop. This final report was prepared by the two technical experts with the assistance of the GoT representative and the ADB/World Bank Focal Point. Comments were received on the draft PFM-PR from the PEFA Secretariat and the GoT.

Tonga had an initial PEFA assessment in September 2007. This new assessment is intended to track the progress of public financial management (PFM) performance to take account of the PFM reforms that the GoT has been implementing, which are part of its broader suite of policies geared at raising the long-term sustainable growth rate of the economy. The assessment is also intended to help inform decisions about future donor assistance to the GoT.

This report aims to provide an objective view of Tonga's PFM system and progress over time. It does not attempt to evaluate and score the performance of different institutions or individuals. Rather, its purpose is to assess the PFM systems themselves against a given international best practice benchmark, so as to provide a common information base for policy dialogue, discussion and debate. While reading this report it is important to note that few, if any countries might be performing at a high level on all dimensions of the indicators. Indeed it is by no means feasible or necessarily desirable to try and achieve the highest scores in every area. Like any framework, PEFA has its limitations and to some extent relies on the judgement of the PEFA AT and the depth of information that the government is able to provide.

(i) Integrated assessment of public financial management performance

Tonga's PFM system is based on a solid legal and regulatory framework which sets out the budgeting, spending and accountability structures. These include responsibility and accountability for public funds delegated to individuals and some oversight by the Legislative Assembly. There are also clear statements of the powers and respective duties of the Ministry of Finance and National Planning (MoFNP), the Revenue Services Department (RSD), the Customs Department, the Public Service Commission (PSC) and the Audit Office (AO). The legal framework for PFM is underpinned by a set of expenditure control procedures covering wages and salaries, non-salary items and procurement. For the most part, these procedures are well established, although not all aspects of the procedures are formally made public as regulations or given prominence. Nonetheless, the overall impression of the assessment team is that there are clear rules and procedures in place and these tend to be followed.

Table 1 summarises the ratings against each of the PEFA performance indicators. The ratings suggest that about two-thirds of Tonga's PFM system is performing at an average or above average level¹. The results for about one-third of the indicators are below average. Measured against the six core PFM objectives examined by the assessment, it is clear that most parts of the system work reasonably well.

¹ Taking C as the average level, around half of the indicators are above this (C+ or above).

Table 1. Summary of PFM Performance Ratings

PEFA Indicator		Scoring Method	Overall Rating (2007)	Overall Rating (2010)	Indicator Dimensions (2010)			
					(i)	(ii)	(iii)	(iv)
A. Credibility of the Budget								
PI-1	Aggregate expenditure out-turn compared to original approved budget.	M1	B	A	A			
PI-2	Composition of expenditure out-turn compared to original approved budget.	M1	C	C	C			
PI-3	Aggregate revenue out-turn compared to original approved budget.	M1	A	A	A			
PI-4	Stock and monitoring of expenditure payment arrears.	M1	B+	B+	A	B		
B. Comprehensiveness and Transparency								
PI-5	Classification of the budget.	M1	C	C	C			
PI-6	Comprehensiveness of information included in budget documentation.	M1	A	A	A			
PI-7	Extent of unreported government operations.	M1	D+	A	A	A		
PI-8	Transparency of inter-governmental fiscal relations.	M2	N/A	N/A				
PI-9	Oversight of aggregate fiscal risk from other public sector entities.	M1	C	C	C	N/A		
PI-10	Public access to key fiscal information.	M1	C	C	C			
C. Budget Cycle								
C(i). Policy-Based Budgeting								
PI-11	Orderliness and participation in the annual budget process.	M2	B	A	B	A	A	
PI-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting.	M2	D+	C	C	A	D	D
C(ii). Predictability and Control in Budget Execution								
PI-13	Transparency of taxpayer obligations and liabilities.	M2	D+	A	A	A	B	
PI-14	Effectiveness of measures for taxpayer registration and tax assessment.	M2	C+	A	B	A	A	
PI-15	Effectiveness in collection of tax payments.	M1	D+	D+	D	A	A	
PI-16	Predictability in the availability of funds for commitment of expenditures.	M1	C+	C+	A	B	C	
PI-17	Recording and management of cash balances, debt and guarantees.	M2	B	A	A	A	B	
PI-18	Effectiveness of payroll controls.	M1	D+	B+	B	B	A	B
PI-19	Competition, value for money and controls in procurement.	M2	B	C	B	C	D	
PI-20	Effectiveness of internal controls for non-salary expenditure.	M1	C+	B+	A	A	B	
PI-21	Effectiveness of internal audit.	M1	D	D+	D	C	D	
C(iii). Accounting, Recording and Reporting								
PI-22	Timeliness and regularity of accounts reconciliation.	M2	D	B	A	C		
PI-23	Availability of information on resources received by service delivery units.	M1	D	D	D			
PI-24	Quality and timeliness of in-year budget reports.	M1	C+	C+	C	A	A	
PI-25	Quality and timeliness of annual financial statements.	M1	D+	D+	C	D	C	
C(iv). External Scrutiny and Audit								
PI-26	Scope, nature and follow-up of external audit.	M1	D+	D+	C	D	C	
PI-27	Legislative scrutiny of the annual budget law .	M1	C+	D+	C	D	C	B
PI-28	Legislative scrutiny of external audit reports.	M1	D	D	D	D	D	
D. Donor Practices								
D-1	Predictability of Direct Budget Support.	M1	N/A	N/A	N/A	N/A		
D-2	Financial information provided by donors for budgeting and reporting on project and program aid.	M1	D	D	D	D		
D-3	Proportion of aid that is managed by use of national procedures.	M1	D	NS	NS			

The key issues relating to each group of PEFA indicators are as follows:

- **Credibility of the budget:** In aggregate, expenditure and revenue outturns have broadly matched budget plans over the past three years and, importantly, the system is equipped to exert aggregate fiscal discipline over total expenditure. However, the credibility of the disaggregated budget items is undermined by significant variances in the composition of outturn at the agency level, as significant resources are shifted between MDAs during the course of the budget year. These in-year budget adjustments are made using the Contingency Fund, rather than through any formal supplementary budget process.

- **Comprehensiveness and transparency:** Budget documentation and fiscal information are generally comprehensive and clear about underlying fiscal operations. Areas for possible improvement include: presentation of the budgetary impacts of policy changes and information on financial assets in the budget papers, collection and publication of more comprehensive financial information for public enterprises (including balance sheets and the assessment of fiscal risks) and public release of the individual audit reports for ministries, departments and agencies (MDAs).
- **Policy-based budgeting:** The annual budget formulation process now appears to be running smoothly and MDAs are provided with sufficient guidance and time to prepare and debate proposals with the central agencies. First steps towards a multi-year budgeting system are relatively recent (and welcome); these were made in the lead-up to the 2008-09 budget. To continue this work, the GoT could now: (i) look at building the capacity and will of MDAs to accurately cost the objectives set out in their Corporate Plans on a multi-year basis (as required by the MoFNP template); and then (ii) establish a system to ensure that these costings are properly factored into the forward estimates. This will help to ensure the forward estimates are credible. The GoT might also consider publishing its forward estimates in the budget documents and financial statements – currently they are not published anywhere.
- **Predictability and control in budget execution:** The GoT has made good progress in improving taxation administration. The collection transparency and effectiveness arrangements have improved markedly since the last assessment in terms of publicly available information on policy and tax rulings. There has been the introduction of a tax appeals mechanism and the management of arrears has improved noticeably from earlier years, reflecting substantive administrative reforms. The **procurement policy** provides a good basic framework and establishes open competition as the method for tendering above what are sensible thresholds. However, the policy is not yet firmly established in regulations or legislation and procurement decisions are not publicly available. Overall, **expenditure controls** for salaries and non-salary expenditures are operating effectively. **Internal audit** is operational and has a strengthened framework since the Public Audit Act 2007 was introduced. However, most auditing is not focused on systemic issues, audit reports are not published for public consideration and MDAs have poor response rates to management letters. There is room for improvement with regard to **accounting, reporting and recording**. In particular, the PFM-PR report draws attention to delays in clearing suspense accounts, the timely submission of financial statements (which are often a year or two overdue) and in-year budget reports not detailing information at the commitment level. Public information on service delivery units' resources is rated as below average, reflecting the lack of publication information. However, Tonga's centralised PFM system and lack of sub-national government means this result is not a first order issue of concern.
- **External scrutiny and audit:** The Audit Office effectively operates as a hybrid internal and external auditor as there is no Supreme Audit Institution. There are long lags in the tabling and approval of reports to the Legislative Assembly. Overall, there is limited scrutiny of external audit reports by the Legislative Assembly, since it only receives a summary of audit activities.
- **Donor practices:** The ratings highlight lags in donors providing financial information to the GoT, and often this information is not accurate. Predictability of donor resources remains an issue in Tonga. Although donor ratings have not changed since the last assessment, the GoT has become more active in coordinating with donors to improve the completeness of the budget papers and financial statements.

(ii) Assessment of the impact of PFM weaknesses

PFM concerns the efficiency and effectiveness of the use of public resources. The interdependence of the components of the budget cycle mean that weaknesses in one part of it can adversely affect other parts and can constrain the achievement of better budgetary outcomes. At the same time, improvements in one area which are not matched by corresponding changes in other areas can undermine the initial reforms.

The PEFA assessment results indicate that overall, the Tongan PFM system is mostly operating at average or above average levels when compared to international best practice. Scoring above average in all parts of the PFM system is not necessarily always desirable, appropriate or efficient in every country. That said, the report points to some areas that are worthy of continued attention.

Firstly, while the PFM system enforces aggregate fiscal discipline, budget credibility at the agency level is undermined by the practice of using the Contingency Fund to adjust agency budgets during the course of the year. The present approach involves bureaucratic inefficiencies in managing the iterations of budget changes and may lead to unintended short falls in the funding of priority expenditures, since unplanned reallocations might allow resources to be captured by lower priority items.

Secondly, the greater use of the multi-year perspective in budgeting is a positive step, although one caution is that if sector specific plans are not properly costed then the recurrent costs of investment decisions will not be properly identified, potentially undermining efficient service delivery. Thirdly, not presenting budgetary impacts of policy changes could impinge adversely on the strategic allocation of resources, if costs of new policy initiatives are consistently underestimated. Fourthly, revenue collection and enforcement effort has improved significantly in recent years, notably with the level of tax arrears being identified and actively pursued using a risk management approach. This has led to arrears dropping sharply. The benefits of this reform include improved efficiency of tax collection and greater faith in the fairness and rigour of the tax system by taxpayers.

Fifth, the lack of transparency around financial operations of public enterprises, procurement contracts entered into by the state, and audits performed by the Audit Office risks inefficient practices being bedded down, may waste public resources and may consequently adversely impact on service delivery provision. The limited scrutiny of the budget appropriation and audit reports might reduce pressure on government to allocate and execute the budget in line with its stated policies and intentions.

(iii) Prospects for reform planning and implementation

The GoT has shown its commitment to reform by undertaking some measures that have strengthened the PFM system, both in policy and in practice. This work has not yet necessarily or fully impacted on the PEFA assessment results, but include:

- The expected formal adoption of the draft *Treasury Instructions*;
- The gradual roll out of the SunSystem at a larger number of MDAs;
- Enhancing the presentation of information in the budget papers and financial statements, including work to introduce functional classifications and improve accounting for assets;
- The move to a multiyear budgeting perspective and implementation of the *National Strategic Planning Framework*;

- Contemplating greater devolution of financial responsibility to MDAs;
- The continuing and deepening of reforms to taxation and revenue administration;
- The work of the relatively new Ministry of Public Enterprises to try improve information flows and enhance the performance focus of the public enterprises;
- The *Public Audit Act 2007*, which creates opportunities for the audit function to occur in a more independent manner by requiring the Audit Office to report to the Speaker of the Legislative Assembly (i.e. the Legislature) rather than the Prime Minister (i.e. the Executive);
- Considering the establishment of a specialised internal audit unit at MoFNP, which GoT expects will provide the opportunity for consideration of any systemic issues that impact on the PFM system;
- Holding the *Royal Commission of Inquiry for the Sinking of the MV Princess Ashika*, which drew substantive attention to a range of matters relating to public procurement processes; and
- The constitutional changes may give rise to greater scrutiny and interest among lawmakers in scrutinising the budget and the results of government audits.

These activities should all help to further strengthen PFM performance in Tonga.

1. Introduction

This Public Financial Management Performance Report (PFM-PR) aims to provide an objective assessment of the Government of Tonga's (GoT's) PFM system. Its purpose is not to evaluate and score the performance of different institutions or individuals, but rather to assess the PFM systems themselves against international best practice standards. An earlier PEFA assessment was conducted in September 2007. Where possible, the current assessment attempts to track progress since then, taking into account recent GoT reforms which were primarily aimed at raising the country's long-term sustainable economic growth rate. In addition, several donors had expressed interest in an updated PEFA assessment, to help inform their decisions about future assistance to the GoT.

The assessment was undertaken as a joint exercise by a GoT official ('Ana Fakaola), the ADB/World Bank Focal Point (Saia Faletau) and two technical experts engaged by AusAID (Tim Cadogan-Cowper and Jonathan Gouy). In addition to the resources, time and input provided by many GoT officials, AusAID largely financed the assessment. The PEFA assessment team (PEFA AT) undertook field work during February and March 2010. Early in the field work stage, a three hour workshop was held and the GoT was provided with guidance on the evidence required to support the assessment. To prepare the assessment, extensive consultations were held with staff from: the Ministry of Finance and National Planning (MoFNP), the Revenue Services Department (RSD), the Customs Department, the Audit Office, the National Reserve Bank of Tonga (NRBT), the Ministry of Education (MoE), the Public Service Commission (PSC), the Ministry of Public Enterprises (MoPE) and the Ministry of Health (MoH). The assessment also benefited from meetings with the Minister of Finance, the Tonga Chamber of Commerce and Industries (TCCI), the Civil Society Forum of Tonga, AusAID, the European Union representative, the ADB and World Bank. Time constraints meant the team did not visit as many of the line ministries as would ideally have been consulted, especially the Ministries of Works and Transport, and Tonga Defence Services.

Information, data, policy guidelines and other material were provided to the PEFA AT from all of these sources. Ratings were assigned to each of the PEFA indicators on the basis of the available evidence and corroborating information was sought from a variety of sources during the field work. The draft PFM-PR and findings were presented to GoT officials at a three hour workshop at the end of the field work stage. This final PFM-PR was prepared by the two technical experts in consultation with the GoT representative and the ADB/World Bank Focal Point. It incorporates comments on the draft received from the GoT and the PEFA Secretariat.

The scope of this assessment is all operations of the GoT, which represent all public expenditures. The Kingdom of Tonga does not have sub-national governments with expenditure responsibilities. While there are district and town officials who represent and are elected by the local communities, the role of these officials is to act as an interface to the central government and they do not actually manage any public funds.

Institutions	Number of entities of government	% of total public expenditure
Government of Tonga*	81	100

*Includes ministries, departments, deconcentrated entities and autonomous government agencies and public enterprises

The rest of this report contains background information on Tonga (chapter 2), an explanation of the scores for each performance indicator (chapter 3), and a summary description of the government's reform program (chapter 4). Annexes include a summary of the performance indicator scores (Annex A), a document reference list (Annex B) and a list of participants in PEFA assessment meetings (Annex C).

2. Country Background Information

2.1. Description of the Country Economic Situation

1. The Kingdom of Tonga is a constitutional monarchy situated in the South Pacific. It comprises 169 islands, 36 of which are inhabited. The archipelago was united into a Polynesian kingdom in 1845. It became a constitutional monarchy in 1875 and a British protectorate in 1900. Tonga acquired formal independence in 1970 and is the only country in the region that was not colonised. About 70 per cent of the population of about 104,000 lives on the main island of Tongatapu (ADB 2010). Tonga is classified as a lower middle income country, with an income level of US\$2560 per person in 2008 (World Bank 2010) and about one quarter of the population were estimated to be living below the nationally defined poverty line in 2003-04 (CIA 2010).
2. About one-third of the Tongan economy is from agriculture and fisheries and the main exports are agricultural goods. Most Tongans engage in some form of subsistence food production. About half satisfy their basic food needs through subsistence farming, fishing, and live stocking. Like other Pacific island countries, there is a very small manufacturing sector. Tonga is highly dependent on remittances from Tongans abroad, which were equivalent to 30 per cent of GDP in 2007-08. Official development assistance from donors is also substantial, averaging around 10 per cent of GDP (ADB 2010). Recent trends in macroeconomic indicators are summarised in **Table 2**.

Table 2. Macroeconomic trends 2003/04 to 2008/09

	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09*
GDP in current prices (millions of pa'anga)	470.9	503.4	577.3	598.0	649.2	711.2
Real GDP growth (%)	1.3	-1.0	0.3	-1.7	2.6	0.4
Remittances (millions of pa'anga)	184.7	208.4	205.0	186.6	207.0	178.4
External debt (% of GDP)	34.6	30.5	35.7	32.6	28.9	30.8
Inflation (annual average CPI %)	11.7	9.7	7.0	5.1	9.8	4.7
Nominal exchange rate (Pa'anga/USD)	2.1	1.9	2.0	2.0	1.9	2.1

*Projection

Source: IMF Tonga Country Report, September 2009.

3. Civil disturbances in 2006 caused substantial damage in the capital, but the economy quickly rebounded the following year. Tonga suffered under the high global fuel and food prices prevailing during 2007-08, which saw inflation peak at over 12 per cent. From 2009, the global financial crisis led to a sharp reduction in remittances, due to job losses among Tongans in the two main source economies, New Zealand and the US. Although it is yet to play out fully, the domestic downturn resulting from this drop in remittances is the most serious economic challenge the country has faced in many decades. On the upside, tourism arrivals have not been as severely affected. This is because budget conscious international tourists from Australia and New Zealand have been substituting away from more distant, expensive destinations. In addition, the construction sector will increasingly contribute to growth, as the reconstruction work in Nuku'alofa occurs (IMF 2009).
4. The Tongan economy's main development challenge is to broaden its base away from remittances and aid and develop a bigger private sector. In particular, there is potential to expand tourism and agriculture in the economy. The constitutional reforms will present opportunities for the GoT to more closely engage civil society to achieve these aims.

Government's overall reform program

5. Under the *Strategic Development Plan 8* (SDP 8 – 2006-07 to 2007-08), and its predecessors, the GoT has prioritised social expenditures. The GoT provides free primary education for all and secondary school students face only relatively modest fees. The public health system is on a universal access basis. These policies have had an impact on development outcomes: life expectancy is 72 years, infant mortality is relatively low for Tonga's income level (World Bank 2010) and the Ministry of Education considers that gross primary school enrolments exceed 90 per cent.
6. The GoT adopted a new *National Strategic Planning Framework* (NSPF) in 2009, chiefly targeted at building the foundation for sustainable and lasting growth in part through stronger private sector development. The framework calls for "a society in which Tongans enjoy higher living standards and better quality of life through good governance, equitable and environmentally sustainable private sector-led economic growth, improved education and health standards and cultural development." NSPF takes a long term view of development, intended to be five to ten years, and puts forward a limited number of priorities. The plan calls for more effective management and monitoring of progress towards the strategic objectives, especially by using corporate plans that reflect the priorities of each Ministry, Department and Agency (MDA). The priority areas are: private sector development, community development initiatives, constitutional reform, public infrastructure, promoting health care and education standards, and environmental sustainability.
7. In the 2009-10 budget, the government reaffirmed its commitments to the revenue administration reform program, including the implementation of online filing for tax returns and customs entries, to be implemented during 2009-10. The GoT considers that this will assist in creating a more efficient taxation system. These reforms follow the legislative changes to customs and income tax laws introduced in 2008-09 that saw some rationalisation of customs rates and lower corporate income taxes introduced.
8. The budget documents highlight the GoT's other key economic reform areas of recent years. Key PFM reform programs have related to procurement (contracting out of road servicing in particular) and improving efficiencies in public service management (a greater focus on outcomes and efficiencies). The GoT also has a stated intention to consult more substantively with the private sector in considering appropriate economic policies.

Rationale for PFM reforms

9. The context of the NSPF and ongoing revenue administration provides a central rationale and context for PFM reforms. In particular, the focus on the role of corporate plans to reflect NSPF priorities will necessitate some strengthening of links between planning, budget execution and monitoring. The plan to expand the use of functional classifications in budget documents and planning frameworks will improve the government's ability to monitor MDA performance in aligning their programs with the NSPF. In addition, the ongoing reforms to streamlining revenue administration are a key part of improving the business environment, to expand private sector development.

2.2. Description of Budgetary Outcomes

Fiscal performance

10. A combination of domestic and international challenges has had a big impact on fiscal performance in recent years. The GoT overestimated revenues by over 10 per cent in 2008-09 due to the lower tax rates that applied from the reform and moderating growth, which reduced import taxes. On the expenditure side, the GoT has had to focus closely on fiscal discipline.

Donor grants allowed the budget to be in surplus during 2006-07 and 2007-08, following the deficit in 2005-06. The budget remains highly dependent on aid inflows to sustain current levels of outlays.

11. The level of debt, while sustainable at around 31 per cent of GDP (GoT Budget Papers), is high and means that there is limited room for further fiscal stimulus. The substantial draw downs of loans for the reconstruction of areas destroyed in the civil disturbance will raise debt levels further in coming years. The GoT's fiscal stimulus package is intended to maintain business confidence and preserve jobs during the downturn. Initial elements of this package include additional funding for community grants, targeted funding for vocational tertiary education and further increases in public service salaries under the Economic Public Sector Reform Program (EPSRP), that started earlier in the decade.

Table 3. Government of Tonga fiscal indicators (in per cent of GDP)

	06-07	07-08	08-09
	% GDP	% GDP	% GDP
Total revenue	28.6	26.5	28.5
Own revenue	24.8	25.2	22.2
Grants*	3.8	1.3	6.3
Total expenditure	27.5	24.9	27.3
Non-interest expenditure	27.5	24.9	27.3
Interest expenditure	0.0	0.0	0.0
Aggregate budget balance (incl grants)	1.1	1.7	1.3
Net financing	(1.1)	(1.7)	(1.3)
External	0.1	0.2	1.0
Domestic	(1.2)	(1.9)	(2.3)

* Not including in-kind grants

Source: IMF Tonga Country Report, September 2009

Allocation of resources

Table 4. Actual budgetary allocations by sectors (approximation)

	06-07 (audited)		07-08 (audited)		08-09 (unaudited)	
	TOP \$m	% total	TOP \$m	% total	TOP \$m	% total
General Public Services	82.46	46.3%	73.14	42.0%	108.90	47.4%
Education and Training	27.29	15.3%	28.66	16.5%	34.75	15.1%
Health	20.61	11.6%	20.27	11.7%	21.53	9.4%
Public Order and Safety	14.47	8.1%	15.94	9.2%	20.55	8.9%
Defence	7.46	4.2%	8.35	4.8%	10.44	4.5%
Economic Affairs	7.46	4.2%	8.81	5.1%	12.64	5.5%
Agriculture, Fisheries & Forestry	6.19	3.5%	5.33	3.1%	6.94	3.0%
Transport and Communications	5.20	2.9%	1.95	1.1%	3.61	1.6%
Tourism, Culture & Religion	3.89	2.2%	8.54	4.9%	7.07	3.1%
Natural Resources & Environment	3.18	1.8%	2.96	1.7%	3.16	1.4%
TOTAL EXPENDITURE	178.21	100.0%	173.95	100.0%	229.59	100.0%

Source: Approximation using annual financial statements for each year. 06-07 and 07-08 statements have been audited; 08-09 statements have not yet been audited. Figures have been approximated by taking administrative classification and notionally allocating each ministry to a particular sector, as there is no programme or functional classification available. Hence table should be taken as a rough guide only.

12. The GoT's expenditure priorities are broadly reflective of its overall development goals. Education and health spending are a substantial proportion, over 40 per cent of discretionary budgetary outlays and are thus consistent with the tenets of its development goals. Expenditure

on the infrastructure sector rose markedly in 2008-09 and will assumedly rise further as draw downs of the reconstruction loan are expended. Going forward, constraining discretionary expenditure on non-core items will be a challenge.

13. Government outlays by economic item are dominated by spending on wages and salaries, which account for over half of domestic discretionary expenditure (excluding donors). Interest payments will rise as the government draws down the reconstruction loan. Capital expenditures rose sharply in 2008-09.

Table 5. Actual budgetary allocations by economic classification

	06-07 (audited)		07-08 (audited)		08-09 (unaudited)	
	TOP \$m	% total	TOP \$m	% total	TOP \$m	% total
Current expenditures	148.26	83.2%	145.96	83.9%	166.62	72.6%
Wages and salaries	84.03	47.1%	74.43	42.8%	79.17	34.5%
Goods and services	30.03	16.9%	39.31	22.6%	52.52	22.9%
Interest payments	3.12	1.8%	8.39	4.8%	5.19	2.3%
Transfers	17.57	9.9%	15.32	8.8%	15.46	6.7%
Others	13.51	7.6%	8.52	4.9%	14.28	6.2%
Capital expenditures	5.09	2.9%	2.95	1.7%	41.42	18.0%
Donor-funded project expenditures	24.86	14.0%	25.04	14.4%	21.56	9.4%
TOTAL EXPENDITURE	178.21	100.0%	173.95	100.0%	229.59	100.0%

Source: Annual financial statements for each year. 06-07 and 07-08 statements have been audited; 08-09 statements have not yet been audited.

2.3. Description of the Legal and Institutional Framework for PFM

Legal framework for public financial management

14. Clause 19 of Tonga's *Constitution* establishes two or three basic PFM requirements: (i) all monies paid from the Treasury must have received a prior vote of approval by the Legislative Assembly (i.e. must be appropriated under law); and (ii) the Treasurer, with approval from the Privy Council, may increase or decrease existing, or establish new, taxes and customs duties. Clause 78 elaborates upon clause 19 and states that the Legislative Assembly shall determine overall estimates (ceilings) for public service expenditure in each coming year, based upon revenue and expenditure reports received from the Minister of Finance for the preceding year.
15. A more detailed description of Tonga's overall PFM framework is set out in the *Public Finance Management Act 2002*. This outlines the overall rules for budget and accountability structures, managing PFM and public finances, the manner by which budgets and appropriations are drawn up and approved, management and approval of public monies, borrowing, loans and guarantees, financial reporting, and the chain of accountability for all public expenditure. The Act does not explicitly contain procurement arrangements. The Act is underpinned by seven sets of regulations, including a draft set of *Treasury Instructions*, which lays out the administrative rules for implementing the Act and also procurement arrangements.
16. The public audit function is provided for in the *Public Audit Act 2007*, which introduced a greater level of independence for the Audit Office, notably, clearer lines of reporting to the Executive and the Legislative Assembly. Management and corporate governance arrangements for public enterprises are contained in the *Public Enterprises Act 2002*.
17. Tax administration is covered by various Acts, including the *Consumption Tax Act 2003*, *Customs And Excise Management Act 2007*, *Income Tax Act 2007* and *Revenue Services Administration Act 2002*. Arrangements, functions and role of the central bank are covered by the *National Reserve Bank of Tonga Act 1988*. These are all underpinned by regulations.

18. The *Public Service Act 2002* lays out arrangements for the engagement and management of the public service and is supported by a *Public Service Policy Manual* that outlines the administrative arrangements applying to all employees of the Public Service, as well as the 2004 *Public Service Code of Conduct*.

Institutional framework for public financial management

19. The Head of State sits as a constitutional hereditary Monarch. The Legislative Assembly has 32 seats: 14 of which are reserved for cabinet ministers sitting *ex officio*, 9 for nobles selected by and from the 33 nobles, and 9 determined by popular vote. Members serve 3 year terms.
20. Cabinet has 14 members and 10 are appointed by the Monarch for life, 4 are appointed from the elected members of the Legislative Assembly, including 2 each from the nobles' and peoples' representatives serving three-year terms. There is also a Privy Council made up of the Monarch, the Cabinet, and 2 governors that administer the outer islands. The Prime Minister and Deputy Prime Minister are appointed by the Monarch (PMO 2010).
21. The judicial branch consists of the Supreme Court, for which judges are appointed by the Monarch. There is also a Court of Appeal which has a Chief Justice and high court justices are chosen by the Privy Council.
22. The responsibility for managing and implementing PFM is primarily a function of the Ministry of Finance and National Planning (MoFNP), with its treasury unit undertaking the payment and cash management functions and its planning area overseeing PFM and economic policy settings. An administrative Expenditure Review Committee (ERC) composed of key ministers and senior public servants meets at least monthly to consider progress with implementing the budget, revenue collection and other fiscal and economic policy developments. MDAs manage their own procurement up to the thresholds for open competition, above which the Government Procurement Committee (GPC) must approve proposed engagements of suppliers.
23. Taxation and customs collection is split between the Customs and the Revenue Services Department (RSD). The Ministry of Public Enterprise (MoPE) oversees the public enterprises. The Audit Office effectively fulfils the function of an internal and external auditor and the Public Service Commission (PSC) implements and manages human resource policies, public service conditions and assists MDAs with the engagement of staff.
24. Ministries have sector-wide responsibilities for policy, co-ordination and management. Departments and agencies are responsible for execution of ministries' policy decisions. Tonga does not have sub-national governments, but deconcentrated administrative offices that coordinate ministries' and agencies' provision of services outside the main island of Tongatapu.

Key features of the public financial management system

25. A key feature of the PFM system is that it is highly centralised. In particular, the MoFNP manages the payroll and pays public servants. It also must approve and execute all payments to suppliers on behalf of ministries, with the exception of the Prime Minister's Office (PMO). MoFNP also manages and executes the GoT's debts, loans and guarantees.

3. Assessment of the PFM systems, processes and institutions

3.1. Budget Credibility

PI-1. Aggregate expenditure out-turn compared to original approved budget.

26. A credible budget is essential to achieving aggregate fiscal discipline and allocative efficiency. Although it may be necessary to make significant in-year budget adjustments from time-to-time, such adjustments should be kept to the minimum and should be adequately justified (for example, urgent and unforeseen additional expenditure to respond to a natural disaster). In-year budget adjustments may involve a combination of: (i) expansion or contraction of the overall budgetary expenditure envelope for the year (changes that PI-1 is designed to detect) or (ii) reallocation between budget line items, which may not necessarily result in any net impact on the budget bottom line (changes that PI-2 is designed to detect).
27. At the aggregate level, the GoT has succeeded in maintaining credible expenditure budgets over the three financial years 2006-07, 2007-08 and 2008-09. As per **Table 6**, aggregate budget out-turns were less than the approved budgets in each financial year, but in no instances was there an absolute variance in primary expenditure of greater than 5 per cent.

Table 6. Aggregate budget out-turns for 2006-07, 2007-08 and 2008-09

	PFY3 - 06/07			PFY2 - 07/08			PFY1 - 08/09		
	Orig Est (TOP m)	Act (TOP m)	Var (%)	Orig Est (TOP m)	Act (TOP m)	Var (%)	Orig Est (TOP m)	Act (TOP m)	Var (%)
Total Operating Expenditure	210.37	178.21	(15.3%)	186.10	173.95	(6.5%)	257.45	229.59	(10.8%)
Less Debt Servicing Payments	18.89	16.20	(14.2%)	18.92	15.59	(17.6%)	21.10	17.49	(17.1%)
Less Donor-Funded Project Expenditures	52.09	24.86	(52.3%)	33.48	25.04	(25.2%)	41.81	21.56	(48.4%)
equals Primary Expenditure	139.40	137.15	(1.6%)	133.70	133.32	(0.3%)	194.54	190.55	(2.1%)

Source: Note 3 to the corresponding annual financial statements for each year. The 06-07 and 07-08 statements have been audited; the 08-09 statements have not yet been audited.

28. In September 2007 the previous PEFA AT found that primary expenditure variances were -2.4 per cent, -3.3 per cent and 13.8 per cent in 2003-04, 2004-05 and 2005-06 respectively. This finding, in conjunction with the above, demonstrates that the GoT has managed to sustain aggregate primary expenditure credibility over the medium term, with only one absolute variance greater than 5 per cent during this six year period.
29. As can be seen above, there are much larger variances in relation to donor-funded projects. Predictability of donor fund flows is a significant problem in Tonga (as will be seen in later indicators) and the GoT has recently established a Project and Aid Management Division within the MoFNP to address the problem and improve donor reporting.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-1)	B	A	M1
PI-1(i) Difference between actual primary expenditure and the original budgeted primary expenditure (i.e. excl. debt service charges, but also excl. financed project expenditure).	B	A	In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure.

PI-2. Composition of expenditure out-turns compared to original approved budgets.

30. Although at the aggregate level primary expenditure budgets are credible, at the disaggregated level they are not, as can be seen in **Table 7**.

Table 7. Disaggregated budget out-turns for 2006-07, 2007-08 and 2008-09

	PFY3 - 06/07				PFY2 - 07/08				PFY1 - 08/09			
	Orig Est (TOP m)	Act (TOP m)	Var (abs)	Var (%)	Orig Est (TOP m)	Act (TOP m)	Var (abs)	Var (%)	Orig Est (TOP m)	Act (TOP m)	Var (abs)	Var (%)
Palace Office	4.94	2.54	2.41	(48.7%)	3.33	5.78	2.45	73.8%	3.80	5.05	1.25	33.0%
Legislative Assembly	2.94	2.88	0.06	(1.9%)	4.03	3.94	0.09	(2.3%)	4.09	4.72	0.63	15.5%
Prime Minister's Office	4.98	4.90	0.08	(1.6%)	5.70	8.33	2.63	46.1%	8.44	9.01	0.56	6.7%
Commissioner of Public Relations	0.24	0.11	0.13	(53.3%)	0.18	0.11	0.07	(39.4%)	0.38	0.14	0.24	(63.8%)
Audit Department	0.70	0.63	0.07	(10.0%)	0.72	0.70	0.02	(2.3%)	0.82	0.89	0.07	8.1%
Ministry of Finance and National Planning ⁽¹⁾	39.08	37.86	1.22	(3.1%)	32.07	23.64	8.43	(26.3%)	59.25	54.89	4.36	(7.4%)
Ministry of Foreign Affairs	6.31	6.67	0.36	5.8%	6.51	6.77	0.25	3.9%	9.62	14.19	4.57	47.5%
Tonga Defence Services	6.96	7.10	0.14	2.0%	7.15	8.08	0.93	13.0%	8.35	9.89	1.54	18.5%
Ministry of Lands, Survey, Natural Resources and Environment	2.21	2.01	0.21	(9.4%)	2.15	2.29	0.14	6.3%	2.96	2.65	0.31	(10.4%)
Ministry of Justice and Attorney-General	2.04	1.90	0.13	(6.5%)	1.76	1.76	0.00	(0.2%)	1.76	1.87	0.11	6.4%
Ministry of Police, Prisons and Fire Services	7.94	8.11	0.18	2.2%	9.16	8.38	0.78	(8.5%)	12.53	10.88	1.65	(13.1%)
Ministry of Education, Women Affairs and Culture	22.74	22.66	0.08	(0.4%)	21.80	22.45	0.65	3.0%	25.57	24.20	1.37	(5.4%)
Ministry of Health	20.23	20.00	0.23	(1.1%)	17.76	19.21	1.45	8.2%	21.58	20.90	0.68	(3.1%)
Ministry of Agriculture, Food, Forests and Fisheries	5.76	5.32	0.44	(7.7%)	5.27	5.05	0.22	(4.1%)	6.59	5.72	0.87	(13.2%)
Ministry of Labour, Commerce and Industries	1.93	1.89	0.04	(2.0%)	1.97	2.14	0.17	8.6%	3.03	2.60	0.43	(14.2%)
Tonga Visitors Bureau (later Ministry of Tourism)	1.21	1.13	0.08	(7.0%)	1.52	1.65	0.13	8.2%	2.08	2.01	0.07	(3.5%)
Ministry of Works	3.45	3.25	0.20	(5.8%)	4.14	4.25	0.11	2.6%	9.90	8.48	1.42	(14.3%)
Ministry of Transport	2.91	4.92	2.01	69.1%	1.70	1.94	0.23	13.7%	3.37	3.08	0.29	(8.5%)
Ministry of Training, Employment, Youth and Sports	1.67	1.86	0.19	11.3%	2.12	2.19	0.07	3.3%	2.76	2.67	0.08	(3.0%)
Crown Law Department	1.15	1.02	0.13	(11.5%)	1.21	1.19	0.02	(1.3%)	1.28	1.91	0.64	49.8%
Public Enterprises	-	0.38	0.38	0.0%	0.35	0.41	0.05	14.2%	0.81	0.60	0.20	(25.4%)
Revenue Services Department	-	-	-	0.0%	3.08	3.07	0.02	(0.5%)	5.58	4.18	1.40	(25.1%)
Variance in Primary Expenditure Composition	139.40	137.15	8.76	6.3%	133.70	133.32	18.89	14.1%	194.54	190.55	22.74	11.7%

Source: Annual Financial Statements for each year (08-09 unaudited), particularly Note 29/30.

(1) Figures for MoFNP has been adjusted to exclude appropriation for debt servicing payments that is provided to this ministry. Figures include appropriations for the CF.

Key to colour coding:

Var > 10% in all years

Var > 10% in 2 years

Var > 10% in 1 year

31. Budget credibility at the disaggregated level is undermined by the large number of significant in-year budget adjustments that are made using the Contingency Fund (CF).² Use of the CF is commented on further in indicator PI-16(iii). Almost all MDAs made significant (greater than 10 per cent) budget adjustments during at least one of the three financial years under review. Two MDAs made significant adjustments in all three of the financial years under review. These were: (i) the Palace Office; and (ii) the Commissioner of Public Relations. The largest variance (Palace Office, 74 per cent in 2008-09) was attributed to unforeseen expenditures associated with the King of Tonga's Coronation in July 2008.
32. Variance of expenditure composition is calculated in **Table 8** by taking the weighted average deviation between actual and originally budgeted expenditure. This is calculated by taking the total of the absolute budget-actual variations for each line item, then dividing this by the total original (not revised) budget estimate. The score for this indicator is then determined by looking at the extent to which the primary expenditure composition variance in each year exceeds the primary expenditure variance calculated for the previous indicator.

Table 8: Extent to which composition variance exceeds total variance

	PI-1: Total primary exp. dev. (%)	Comp. of exp. dev. (%)	PI-2
	1	2	3 = 2 - ABS(1)
06-07	-1.6%	6.3%	4.7%
07-08	-0.3%	14.1%	13.8%
08-09	-2.1%	11.7%	9.6%

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-2)	C	C	M1
PI-2(i) Extent to which variance in primary expenditure composition exceeded overall deviation in primary expenditure (as defined in PI-1) during the last three years.	C	C	Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than one of the last three years.

PI-3. Aggregate revenue outturn compared to original approved budget.

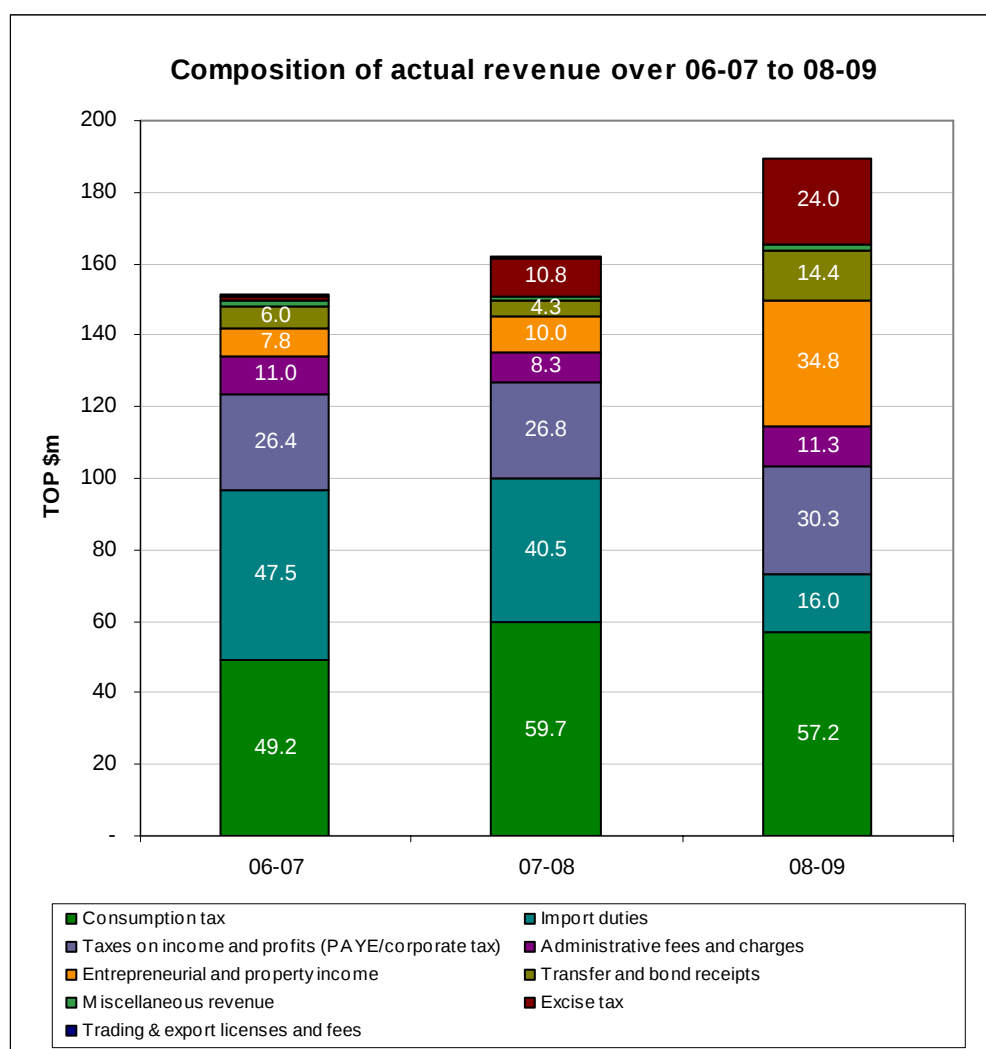
33. Accurate forecasting of revenue is crucial to maintaining aggregate fiscal discipline. Irrespective of how credible the expenditure budgets are, ultimately they must be based upon and constrained by credible revenue forecasts. If there is insufficient revenue to finance these budgets, the government will be forced to run budget deficits and increase public debt.
34. MoFNP's Treasury Division is responsible for collecting revenues data and making revenue forecasts. This data is published using a classification disaggregated by major revenue heads (income tax, trade tax, domestic fees on goods and services, etc.) in the financial statements. A slightly different revenue classification is used in Budget Paper No. 2 compared to the financial statements. In the last three financial years, GoT experienced revenue shortfalls in both 2006-07 (collected 97.8 per cent of estimate) and 2008-09 (collected 87.9 per cent). In 2007-08, GoT collected more (105.1 per cent) than the forecast amount. See **Table 9**.

² In Tonga there is no formal supplementary budget process – in-year adjustments are made via the CF, capped at 5 per cent of forecast domestic revenue. For adjustments requiring expansion of the overall budgetary envelope by more than 5 per cent, in-year ad-hoc Appropriation Acts would need to be passed.

Table 9: Aggregate revenue out-turn compared to original forecasts

	PFY3 - 06/07			PFY2 - 07/08			PFY1 - 08/09		
	Orig Est (TOP m)	Act (TOP m)	Collect Rate (%)	Orig Est (TOP m)	Act (TOP m)	Collect Rate (%)	Orig Est (TOP m)	Act (TOP m)	Collect Rate (%)
TAX REVENUE	135.75	124.81	91.9%	125.61	138.18	110.0%	155.33	127.76	82.2%
<i>Taxes on income and profits (PAYE/corporate tax)</i>	26.90	26.43	98.3%	20.50	26.85	131.0%	20.63	30.28	146.8%
<i>Taxes on international trade and transactions:</i>	25.96	47.97	184.8%	25.47	40.82	160.3%	30.22	16.34	54.1%
Import duties	25.46	47.54	186.7%	25.00	40.53	162.1%	30.00	16.04	53.5%
Trading & export licenses and fees	0.51	0.43	85.1%	0.47	0.29	61.7%	0.22	0.30	135.9%
<i>Taxes on goods and services:</i>	82.89	50.42	60.8%	79.64	70.51	88.5%	104.48	81.14	77.7%
Consumption tax	59.08	49.23	83.3%	55.00	59.68	108.5%	74.28	57.18	77.0%
Excise tax	23.82	1.18	5.0%	24.64	10.84	44.0%	30.20	23.97	79.4%
NON-TAX REVENUE	19.11	26.70	139.7%	28.25	23.59	83.5%	60.34	61.80	102.4%
Entrepreneurial and property income	4.11	7.76	188.7%	11.49	10.00	87.0%	36.48	34.79	95.4%
Administrative fees and charges	8.24	11.02	133.7%	8.62	8.26	95.8%	12.77	11.26	88.2%
Miscellaneous revenue	0.57	1.92	337.1%	0.57	1.02	179.1%	0.59	1.40	238.7%
Transfer and bond receipts	6.18	6.00	97.0%	7.57	4.32	57.0%	10.50	14.35	136.6%
Total recurrent revenue (tax + non-tax)	154.86	151.51	97.8%	153.86	161.77	105.1%	215.67	189.56	87.9%

Source: Note 2 to the corresponding annual financial statements for each year. The 06-07 and 07-08 statements have been audited; the 08-09 statements have not yet been audited.



35. From the disaggregated revenue figures, it can be seen that the major shortfall in 2008-09 revenues were primarily caused by a major contraction in import duties (only 53.5 per cent of the forecasted amount for that year was actually collected), followed by consumption tax (77 per cent collected), excise tax (79.4 per cent) and income tax (82.2 per cent). Many of these shortfalls can be attributed to flow on effects from the Global Financial Crisis, which amongst

other things, saw remittances, comprising around 30 per cent GDP, decline substantially. The chart beneath **Table 9** shows how the composition of actual revenue streams changed over the period 2006-07 to 2008-09.

36. The level of tax arrears in Tonga is also very high. For example, the amount of gross income and consumption tax arrears owing to the GoT (including both amounts in dispute and amounts not in dispute) was TOP \$25.2m at the end of 2008-09, which is almost 30 per cent of the total amount of income and consumption tax collected in that year. One reason for this has been taxpayers without a Taxpayer Identification Number (TIN), who receive a default assessment based on the maximum tax rate and then dispute this when they lodge a return. However, according to RSD officials, TIN registration has improved markedly over the last few years, and as at the date of writing, more than 90 per cent of potential Tongan taxpayers now have a TIN. The issue is discussed further under indicator PI-15.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-3)	A	A	M1
PI-3(i) Actual domestic revenue collection compared to domestic revenue estimates in the original, approved budget.	A	A	Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years.

PI-4. Stock and monitoring of expenditure payment arrears.

37. There does not appear to be any formal established legislation or guidelines referring to how the GoT handles expenditure payment arrears. However the draft *Treasury Instructions* do set out a number of relevant requirements. Firstly, all MDAs must submit a complete list of their commitments to Treasury within 5 working days of the end of each month (clause 26(2)). Secondly, subsection “Payments” under Section 3 “Accounting for Expenditure” (pp. 19-20) requires that - to the extent possible - all ministries process and pay accounts by the due date to avoid interest charges, supplier premiums and obtain any discounts that apply for prompt payments. Finally, clause 27(6) requires that all payments must be settled within 30 days of receipt of a correctly rendered invoice if no specific due date is specified.
38. Unfortunately these draft *Treasury Instructions* have not yet been approved by the Finance Minister and hence have no legal force as yet. If and when approved, they will become legally binding under section 45 of the *Public Financial Management (PFM) Act 2002*.
39. MoFNP currently tries to collect data on commitment arrears (including age profiles) from Ministries every month. However, according to advice received from MoFNP staff and an “Asset Register, Commitment and Revenue Arrears as at 31 Jan 2010” checklist provided to the PEFA AT, most MDAs do not usually provide this information on time. In fact, in the checklist provided to the PEFA AT, only 2 MDAs – Ministry of Justice and Ministry of Agriculture – had submitted up-to-date information. Once the draft *Treasury Instructions* are approved and distributed this situation may improve by virtue of its clause 26(2).
40. A Summary Report on Government Commitment Arrears (as at 30 June 2009) was also provided to the PEFA team by MoFNP. This shows arrears carried over from 2004-05, 2005-2006, 2006-07 and 2007-08, along with age profiles for 2008-09 arrears of less than 1 month, 1-2 months, 2-3 months and greater than 3 months. A sizeable amount of the arrears (approximately 20 per cent of the total) is also undated, confirming that there are issues with the accuracy of the age profiles. The list is itemised by arrears to each supplier/contractor and individuals, some of whom appear to be government employees, as well as arrears owed by each government agency.

Table 10: Stock of expenditure payment arrears as at end 2008-09

	Cumul. arrears at end 08-09	% of total cumul. arrears	Age Profile - expense was incurred in...					
			2008-09	2007-08	2006-07	2005-06	2004-05	Age unknown
	TOP \$m	%	TOP \$m	TOP \$m	TOP \$m	TOP \$m	TOP \$m	TOP \$m
Revenue Service Department	0.77	41.31%	0.01	0.34	0.19	0.17	0.07	-
Ministry of Agriculture, Food, Forests, & Fisheries	0.29	15.70%	0.01	0.06	0.03	0.03	0.03	0.13
Ministry of Health	0.23	12.35%	0.18	0.01	0.00	-	-	0.04
Ministry of Police, Prisons & Fire Services	0.11	5.68%	0.01	0.01	-	-	-	0.09
Ministry of Finance & National Planning	0.10	5.40%	0.04	0.02	0.00	-	-	0.04
Ministry of Transport	0.08	4.06%	0.02	0.03	0.01	0.01	0.01	0.00
Ministry of Education, Women's Affairs & Culture	0.07	3.99%	0.03	0.00	0.00	-	-	0.04
Ministry of Works	0.04	2.30%	0.01	0.02	0.00	-	-	0.01
Prime Minister's Office	0.04	2.25%	0.03	0.01	-	-	-	-
Tonga Defence Services	0.03	1.48%	0.01	0.00	-	-	-	0.02
Ministry of Lands, Survey, Natural Resources & Environment	0.02	1.26%	0.02	0.00	-	-	-	0.00
Palace Office	0.02	1.23%	0.02	0.00	0.00	-	-	0.00
Ministry of Training, Employment, Youth & Sports	0.01	0.73%	0.00	-	0.01	-	-	0.00
Ministry of Justice	0.01	0.54%	0.01	0.00	-	-	-	0.00
Ministry of Tourism	0.01	0.42%	0.01	-	-	-	-	0.00
Commissioner of Public Relation	0.01	0.27%	0.00	-	-	-	-	0.00
Ministry of Labour, Commerce & Industries	0.00	0.25%	0.00	0.00	-	-	-	0.00
Ministry of Foreign Affairs	0.00	0.19%	0.00	-	-	-	-	0.00
Audit Office	0.00	0.18%	0.00	-	-	-	-	-
Crown Law Department	0.00	0.15%	0.00	-	0.00	-	-	-
Legislative Assembly	0.00	0.11%	0.00	-	-	-	-	0.00
Ministry of Public Enterprise & Information	0.00	0.11%	0.00	-	-	-	-	-
Statistics Department	0.00	0.03%	0.00	-	-	-	-	0.00
TOTAL	1.87	100.00%	0.43	0.51	0.24	0.21	0.10	0.37

As % of total 08-09 primary expenditure:

0.98%

Source: Commitment Arrears spreadsheet provided by MoFNP.

41. **Table 10** provides a summary of the aggregate arrears data, by MDA. As can be seen from the table, the cumulative stock of commitment arrears as at 30 June 2009 was around TOP \$1.89m. This constitutes around 1.0 per cent of total primary expenditure for that same financial year. Although the arrears information is likely incomplete for a number of expenditure categories, and there are some concerns about the accuracy of the age profile, in the view of the PEFA AT it is unlikely that the missing data would be enough to cause total stock to double to over 2% of total primary expenditure.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-4)	B+	B+	M1
PI-4(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.	A	A	The stock of arrears is low (i.e. is below 2% of total expenditure)
PI-4(ii) Availability of data for monitoring the stock of expenditure payment arrears.	B	B	Data on the stock of arrears is generated annually, but may not be complete for a few identified expenditure categories or specified budget institutions.

3.2. Comprehensiveness and transparency

PI-5. Classification of the budget.

42. The recurrent budget, both in terms of its formulation (e.g. Budget Paper No. 2) and its execution (e.g. in-year reports, audited annual financial statements) is presented and recorded using economic and administrative classifications, but not functional classifications. Furthermore, no data is provided at the program level so it is not possible to construct any meaningful sub-functional or functional data through aggregation. The development budget (that is, the budget for all monies flowing through the General Development Fund) is presented

and recorded at the budget formulation and execution points on an administrative basis only, by MDA.

43. MoFNP advises that the upcoming 2010-11 budget will present figures using the IMF Government Finance Statistics / UN Classification of Functions of Government (GFS/COFOG)³ functional classifications for the first time. Further work however still needs to be done to revise the GoT's Chart of Accounts to support this.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-5)	C	C	M1
PI-5(i) The classification system used for formulation, execution and reporting of the central government's budget.	C	C	The budget formulation and execution is based on administrative and economic classification using GFS standards or a standard that can produce consistent documentation according to those standards.

PI-6. Comprehensiveness of information included in budget documentation.

44. Three Budget Papers (BP), plus Appendices, are provided to the Legislative Assembly for scrutiny prior to each new financial year. These are: (i) BP No. 1: Review of the Tongan Economy and Outlook; (ii) BP No. 2: Fiscal Outlook; and (iii) BP No. 3: Regional and Rural Development. After scrutinising copies of the budget papers relating to 2006-07, 2007-08 and 2008-09, provided by MoFNP, the PEFA AT is of the view that 7 of the 9 elements required by this indicator are satisfactorily met.
45. Currently the Budget Papers do not provide a Balance Sheet or details of financial assets. In addition, although 2008-09 BP No. 2 briefly discusses some government revenue reform initiatives (e.g. changes to import duties) there are no estimates of the budgetary impacts these reforms are likely to cause. On the expenditure side, no mention is made of any of the changes to expenditure programs nor any attempts made to estimate the impacts of these changes.
46. Although the overall rating for this indicator remains unchanged from 2007, it should be noted that the previous PEFA AT was satisfied that requirement (ix) had been met, whilst the current PEFA AT is not.

Element	Req. Met?
(i) Macro-economic assumptions , including at least estimates of aggregate growth, inflation and exchange rate.	Yes
(ii) Fiscal deficit , defined according to GFS or other internationally recognized standard.	Yes
(iii) Deficit financing , describing anticipated composition.	Yes
(iv) Debt stock , including details at least for the beginning of the current year.	Yes
(v) Financial Assets , including details at least for the beginning of the current year.	No
(vi) Prior year's budget outturn , presented in the same format as the budget proposal.	Yes
(vii) Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal.	Yes
(viii) Summarized budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-5), including data for the current and previous year.	Yes
(ix) Explanation of budget implications of new policy initiatives , with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.	No

³ GFS and COFOG standards are available at <http://www.imf.org/external/pubs/ft/gfs/manual/index.htm> and <http://unstats.un.org/unsd/cr/registry/regcst.asp?Cl=4> respectively.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-6)	A	A	M1
PI-6(i) Share of the listed information in the budget documentation most recently issued by the central government (in order to count in the assessment, the full specification of the information benchmark must be met).	A	A	Recent budget documentation fulfils 7-9 of the 9 information benchmarks.

PI-7. Extent of unreported government operations.

47. Advice from the MoFNP, donors, private sector representatives and the Audit Office is that the year-end financial statements appear to comprehensively cover the activities of government and there is no significant non-donor extra-budgetary revenue/expenditure. This is perhaps in large part due to the centralised and small-scale nature of the PFM system in Tonga, which allows the MoFNP to closely monitor all revenue and expenditure.
48. On the expenditure side, apart from a few small exceptions (e.g. the Prime Minister's Office - PMO), MDAs are not permitted to hold their own bank accounts. When MDAs wish to make a payment, they submit a payment voucher to the MoFNP which, after processing, pays directly from the General Services or General Development fund to the third party. On the revenue side, MDAs are required to bank all non-tax revenue they receive as soon as possible, directly into the central General Revenue account. The current PFM Act regulations formally require this to be done within one week (clause 6(1)). However, MoFNP advise that in practice they ask that all receipts be banked within 24 hours. This informal 24 hour limit will be formally introduced when the draft *Treasury Instructions* come into force (via clause 46(9)).
49. The head of Aid Management Division in MoFNP estimates that around 40 per cent of donor assistance is provided through funding transferred to the GoT Development Fund, while the other 60 per cent comprises inputs provided in-kind (and not generally reported to the government, as disclosed by Note 1(iii) to the annual financial statements). Although the majority of assistance is provided in-kind, for the purposes of this indicator, as per subsequent PEFA framework clarifications (PEFA 2009), in-kind contributions should not be taken into consideration.
50. In 2008-09 donor financing to GoT was TOP \$45.6m, around 19 per cent of total government revenue for that year. Donor-funded project expenditure was TOP \$21.6m, around 9 per cent of total government expenditure. Income and expenditure data on donor-funded projects (loans and grants, excluding in-kind assistance) is readily available. MoFNP maintains a General Development Fund account in the National Reserve Bank of Tonga (NRBT), held in TOP. This Development Fund is used to pay for all donor-funded projects. When payments are made from the Development Fund, they are recorded in the cash book of the individual MDA associated with the project. Advice from MoFNP staff is that donors either: (i) transfer funds directly to the Development Fund; or (ii) transfer funds to one of a number of project-specific USD or EURO foreign currency trust accounts in NRBT, then periodically convert currency to TOP and advance funds to the Development Fund from these. In theory donors might also transfer funding directly to MDA bank accounts; however advice from donors and MoFNP is that this currently does not occur.
51. Hence, irrespective of the method used, according to MoFNP staff, all donor financing provided to the government (and not in-kind) will flow through the Development Fund account at some stage, and these flows are all reported and audited. Cash receipts to the Development Fund are reported in Note 4 to the Annual Financial Statements (itemised by donor country or organisation) while cash payments from the Development Fund are reported in Note 5 (itemised by the MDA associated with the donor financed project). However the quarterly in-year budget execution reports do not report the Development Fund cash flows.

52. Considering the above, the PEFA AT is of the opinion that 90% or higher of donor funded projects (excluding in-kind inputs) are captured in the Government's annual financial statements. Consequently, while the 2007 rating for PI-7(i) remains unchanged, the rating for PI(ii) has changed from a D to an A. This does not reflect any major improvements; rather the previous rating was taking into account in-kind inputs, while the current rating does not.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-7)	D+	A	M1
PI-7(i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports.	A	A	The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of total expenditure).
PI-7(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports.	D	A	Complete income/expenditure information for 90% (value) of donor-funded projects is included in fiscal reports, except inputs provided in-kind OR donor funded project expenditure is insignificant (below 1% of total expenditure).

PI-8. Transparency of inter-governmental fiscal relations.

53. There are no sub-national governments in Tonga. Advice from MoFNP and donors is that, while there are district and town officials which represent and are elected by the local communities, the roles of these officials is to act as an interface to the central government and they do not actually manage any money. There has been some talk about this arrangement changing in the future, particularly in relation to some community grants schemes.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-8)	N/A	N/A	M2
PI-8(i) Transparent and rules based systems in the horizontal allocation among SN governments of unconditional and conditional transfers from central government (both budgeted and actual allocations).	N/A	N/A	Not applicable.
PI-8(ii) Timeliness of reliable information to SN governments on their allocations from central government for the coming year.	N/A	N/A	Not applicable.
PI-8(iii) Extent to which consolidated fiscal data (at least on revenue and expenditure) is collected and reported for general government according to sectoral categories.	N/A	N/A	Not applicable.

PI-9. Oversight of aggregate fiscal risk from other public sector entities.

54. In Tonga, Public Enterprises (PEs) are defined as those entities listed in the first or second Schedule of the *Public Enterprises Act 2002*. Some of these are companies registered under the *Companies Act 1995* and some are statutory bodies (also known as autonomous government agencies or AGAs) established under their own statutory legislation. For a company to qualify as a PE, the government must hold a controlling interest. As at 30 June 2009, there were 17 PEs in Tonga, of which 11 were companies, 3 were statutory bodies and 3 were both companies and statutory bodies. See **Figure 11**.
55. Current legislation and regulations oblige all PEs to forward in-year financial statements and year-end financial statements to the central government. Under the *Public Enterprises Act 2002*, the Chairman of the Board of each PE is required to deliver to the Minister for Finance: (i) a draft *Statement of Corporate Intent* not later than one month before the commencement of each financial year; (ii) a report of the operations of the PE within two months after the end of the first half of each financial year – this must include the same items as those provided in the *Statement of Corporate Intent*; (iii) a report of the operations of the PE

and the consolidated financial statements for that financial year within 3 months of the end of each financial year; and (iv) an audit report on the annual financial statements, within 6 months of the end of the financial year.

56. Under their own establishing legislation, some of the statutory bodies are required to report annually, but not any more frequently:
- Under the *Ports Authority Act 1998*, the Ports Authority is required to submit annual audited financial statements and an annual report to the Minister of Marine and Ports within 90 days of the end of the financial year (clause 39(1)). The Minister also has the power to request further financial or management reports whenever they wish, however there is no requirement for in-year financial statements.
 - Under the *Tonga Broadcasting Commission Act 1988* (as amended), the Commission must submit annual audited financial statements and an annual report to the Minister of Communications (clauses 17-18). In this case, there is no upper time limit set on how long this must be after the end of the financial year. There is also no requirement for in-year financial statements.
 - Under the *Tonga Water Board Act 2000*, the Water Board must submit an annual report, containing a report of operations and audited financial statements, to the Prime Minister, by no later than 31 December after the end of the FY. There is no requirement for in-year financial statements.
57. However, Section 6(2) of the PE Act states that where the requirements of the PE Act differ from the requirements of a statutory body's establishing legislation, the PE Act will prevail, and presumably this applies for the above three bodies. Therefore all PEs – irrespective of whether they are government companies or statutory bodies – must meet the reporting requirements in the PE Act.

Figure 11: Public Enterprises in Tonga as at 30 June 2009

Public Enterprises		
Government Companies	Statutory Bodies (AGAs)	
	Name	Establishing Statute
1 International Dateline Hotel	1 Ports Authority Tonga	Ports Authority Act 1998
2 Sea Star Fishing Co.Ltd	2 Tonga Broadcasting Commission	Tonga Broadcasting Commission Act 1988 (amended 1993, 2000, 2003)
3 Shipping Corporation of Polynesia	3 Tonga Water Board	Tonga Water Board Act 2000
4 Tonga Development Bank*	4 Tonga Development Bank*	Tonga Development Bank Act 1988 (amended 1991, 2002)
5 Tonga Investment Ltd	5 Waste Authority Ltd*	Waste Management Act 2005
6 Tonga Communications Corporation*	6 Tonga Communications Corporation*	Tonga Communications Corporation Act 2000
7 Tonga Timber Ltd		
8 Tongatapu Market Ltd		
9 Tonga Airports Ltd		
10 Waste Authority Ltd*		
11 Tonga Power Ltd		
12 Tonga Print Ltd		
13 Tongatapu Machinery Pool Ltd.		
14 Tonga Post Ltd		

* Technically both a company and a statutory body.

58. As far as the PEFA AT is aware, there is no legislative or regulative requirement for the GoT to monitor fiscal risk of PEs on a regular basis. However the Ministry of Public Enterprises (MoPE) advises that it does conduct ongoing monitoring of fiscal risk issues, as well as monitoring of profitability, in order to achieve its core objectives which are: (i) improving the profitability of PEs; (ii) improving returns on government equity; and (iii) improving dividend payouts from PEs.
59. The GoT discloses the following basic information on PEs in the GoT's annual financial statements:
- the shares the GoT holds in each PE, along with the estimated value of the GoT's investment and the value of any guarantees the GoT has provided to the PE – both for the financial year just gone and the previous financial year (Note 24(a));
 - the GoT's share of each PE's net profit/loss, both for the FY just gone and the previous FY (Note 24(b));
 - the shares held by GoT in all organisations, including PEs, and value per share (Note 25); and
 - any loans provided by the GoT to PEs and other organisations (Note 26 – this also appears as Table 19 in the Appendix to each set of Budget Papers).
60. Clearly the information disclosed in the financial statements is insufficient to monitor the fiscal risks posed by PEs or their financial health. For example, there is no information on PE balance sheet items (assets and liabilities) and even the net profit/loss figures are bottom-line only and do not include any separate information on the PE's revenue or expenses.
61. MoPE advises that it prepared its first consolidated overview of PEs last year (2009) – in a spreadsheet. It has taken some time to do this as they are only a relatively new MDA, established in 2006. However, apart from being a small MDA, they are experiencing difficulties in that many PEs are only reporting net profit/loss to them (if reporting at all) and not reporting their assets and liabilities, or even their revenue and expenses. Some PEs are also very late in providing their annual audited financial statements or interim in-year reports – in worst cases, over a year past the due date.
62. MoPE is of the view that, at present, the best-quality and most timely reports are produced by the Tonga Development Bank, Tonga Airports Ltd, and Tonga Power Ltd. MoPE ascribes the difficulties in obtaining the reports from other PEs to a combination of factors, including: (i) that the PEs are generally lacking the resources and capacity needed for this type of reporting; (ii) that other shareholders are refusing to sign reports in a timely fashion; (iii) that the auditors are asking to see information that the PE does not have on file and is therefore unable to provide; and (iv) that the auditors often take a long time to finalise their audit report.
63. The PEFA AT received late anecdotal advice from a GoT consultant that the MoPE has “generally good and up to date financial information on the majority and largest of the PEs”. However the MoPE was unable to provide any evidence to the PEFA AT during the field trip to support this view. Considering the evidence that was provided and the limited information disclosed in the GoT's financial statements, the PEFA AT is of the opinion that the MoPE does not generally have sufficient information at this point in time to undertake a proper analysis of the fiscal risks posed by PEs, nor is it in a position to prepare high-quality fiscal risk overviews.
64. The PEFA AT has also been advised that one of the conditions for the disbursement of the second tranche of an ADB grant to the GoT is that MoPE must publish in local newspapers the financial performance up to 2009-10 for all PEs. This is a welcome initiative.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-9)	C	C	M1
PI-9(i) Extent of central government monitoring of AGAs and PEs.	C	C	Most major AGAs/PEs submit fiscal reports to central governments at least annually, but a consolidated overview is missing or significantly incomplete.
PI-9(ii) Extent of central government monitoring of SN governments' fiscal position.	N/A	N/A	Not applicable.

PI-10. Public access to key fiscal information.

65. Only one of the elements is satisfied: the audited financial statements along with the auditor's opinion are made available to the public through publication in the Tonga Government Gazette, as required under section 35(5) of the PFM Act 2002. Even in this instance, although the statements are made available within six months of completed audit, they are usually published so late (see indicator PI-25) that it is questionable how useful they would be.
66. Annual budget documentation is made available to the public. According to MoFNP hardcopies are available for purchase at their office (the PEFA AT was unable to ascertain the price), and MoFNP is also willing to email electronic copies to anyone who requests them. However, the element remains unsatisfied, because the documentation is only made available to the public *after* it has been approved by the legislature. The documents are not made publicly available at the time they are submitted to the legislature.

Element	Req. Met?
(i) Annual budget documentation: A complete set of documents can be obtained by the public through appropriate means when it is submitted to the legislature.	No
(ii) In-year budget execution reports: The reports are routinely made available to the public through appropriate means within one month of their completion.	No
(iii) Year-end financial statements: The statements are made available to the public through appropriate means within six months of completed audit.	Yes
(iv) External audit reports: All reports on central government consolidated operations are made available to the public through appropriate means within six months of completed audit.	No
(v) Contract awards: Award of all contracts with value above approx. USD 100,000 equiv. are published at least quarterly through appropriate means.	No
(vi) Resources available to primary service units: Information is publicized through appropriate means at least annually, or available upon request, for primary service units with national coverage in at least two sectors (such as elementary schools or primary health clinics).	No

67. In-year budget execution reports are not available to the public. MoFNP informs the PEFA AT that the GoT does publish a quarterly update, entitled "At a Glance", but upon reviewing some of these statements, the PEFA AT confirmed that they provide an overview of broad economic developments only and do not contain any information on actual expenditure.
68. The previous PEFA AT considered that element (iv) was satisfied. The current PEFA AT disagrees with this. Individual detailed audit reports are not available to the public. Only brief summaries are publicly available, in a consolidated form in the Audit Office's (AO's) *Annual Reports*. These reports may be purchased by the public, although they are likely to be prohibitively expensive for most (the PEFA AT was charged TOP \$100 for the 2006-07 annual report). It is not clear whether it is generally possible to obtain electronic copies. Although the AO has a website (www.audit.gov.to), when the PEFA team attempted to access it (3 March 2010 and 4 March 2010) to verify if electronic copies of the annual reports were available, it was offline. A subsequent visit, in May 2010, found a placeholder page and contact details for the AO, but no links to publications.

69. Finally, discussions with MoFNP, MoE, MoH and the GPC secretariat confirm that neither contract award information nor information on resources available to service delivery units are made public. The GPC secretariat mentioned that it is exploring options for making contract information available on a webpage under the MoFNP website sometime in the next year or so.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-10)	C	C	M1
PI-10(i) Number of the listed elements of public access to information that is fulfilled (in order to count in the assessment, the full specification of the information benchmark must be met).	C	C	The government makes available to the public 1-2 of the 6 listed types of information.

3.3. Policy-based budgeting

PI-11. Orderliness and participation in the annual budget process.

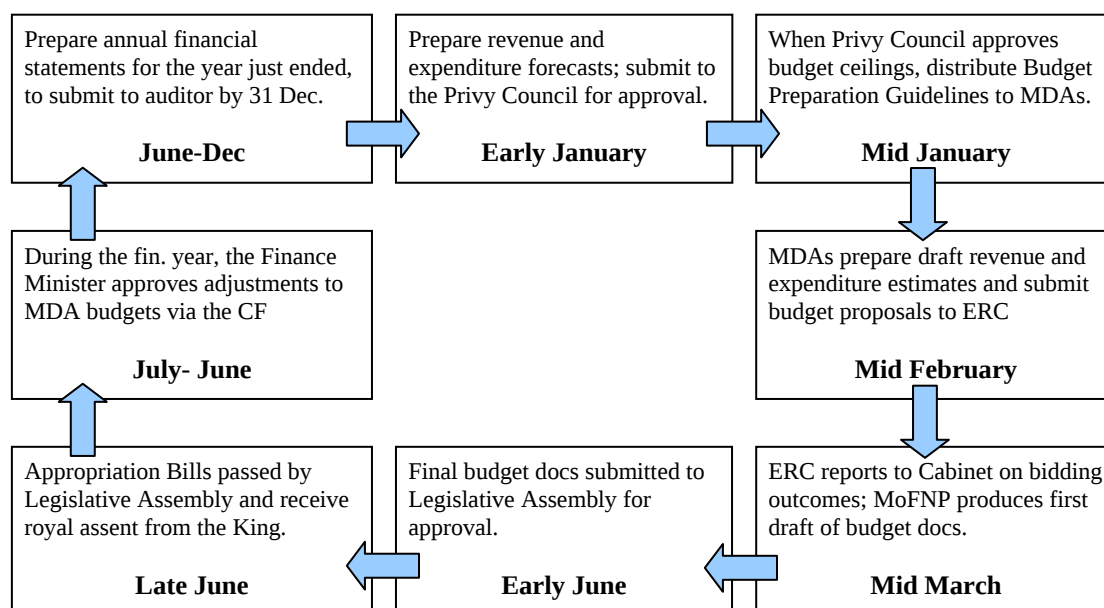
70. The only legislation referring to the budget process at the current point in time is the PFM Act 2002. The act does not set formal deadlines or processes, but it does require the Finance Minister to:
- first prepare and submit to Privy Council, via Cabinet, statements of anticipated revenue and anticipated budgetary appropriations for the coming FY (clause 7(1)); and then
 - prepare detailed estimates for the coming FY, in accordance with the budget ceilings approved by the Privy Council, and including anticipated statutory expenditure, for introduction to the Legislative Assembly (clause 7(2)).
71. The PFM Act also requires Appropriation Bills to be introduced to the Assembly prior to the end of the financial year (clause 14) and establishes basic powers for the Finance Minister to fund essential services of Government for short-term periods if these Bills are not approved before the financial year commences.
72. In practice, the budget cycle in Tonga works as follows. At the beginning of each budget cycle, after the Privy Council has approved the overall budget ceilings, the MoFNP circulates *Budget Preparation Guidelines* to MDAs, which set out the key deadlines in the upcoming budget cycle, set expenditure ceilings for each MDA (in an Appendix), and provide standard guidance on how MDAs should go about preparing and completing their draft Program Budget Estimates. **Table 13** (next page) shows the deadlines set by the Budget Preparation Guidelines relating to the 05-06, 07-08 (draft)⁴ and 08-09 financial years, as provided by MoFNP to the PEFA AT.
73. After the *Budget Preparation Guidelines* and ceilings are issued, MDAs have around one month to update their Corporate Plans and prepare budget proposals (revenue and expenditure estimates) for submission to ERC⁵. ERC then scrutinises these over mid February to early March, while MoFNP takes notes. Once ERC completes its scrutiny, MoFNP prepares several drafts of the budget estimates and budget documents, culminating in the final package which is submitted to the Legislative Assembly for scrutiny and approval by early June. The Legislature has around one month to scrutinise, and if consensus is reached, the Appropriation Bills are passed and receive royal assent from the King before the new financial year.

⁴ The PEFA AT was unable to obtain a copy of the 06-07 budget preparation guidelines or a final copy of the 07-08 guidelines. The previous PEFA AT mentioned in its report in 2007 that “Due to the financial difficulty facing the GoT in accommodating the public service salary increase and the impact of the November 2006 riots budgets were prepared with less than usual consultation with line ministries.”

⁵ The Expenditure Review Committee, or ERC, was first introduced into the Tongan budget process in the lead-up to the 2008-09 budget.

74. The different steps in the budget cycle are summarised in **Figure 12**.

Figure 12: The Tongan Budget Cycle (based on 08-09 timetable)



75. The PEFA AT is of the opinion that the budget calendars and guidance set out in each of the 05-06, 07-08 and 08-09 *Budget Preparation Guidelines* were clear. MoFNP officials advise that the 08-09 and 09-10 budget preparation deadlines were generally followed, but minor delays and slippages in deadlines were common. As can be seen from **Table 13**, in 05-06 and 07-08 MDAs had about eight weeks to prepare their detailed estimates, after receiving the budget circular. In 08-09, they were only given four weeks.

Table 13: Deadlines set for budget preparation processes in 2005-06, 2007-08 and 2008-09

Budget Activity	Responsibility	05-06 Deadline	07-08 Deadline	08-09 Deadline
Submission to Cabinet of Budget Guidelines	MoFNP	10-Dec-2004	5-Dec-2006	Jan-2008
Distribute approved Budget Guidelines	MoFNP	13-Dec-2004	8-Dec-2006	16-Jan-2008
Briefing on approved Budget Guidelines	MoFNP	3 – 7 Jan 2005	11 –15 Dec 2006	4-Feb-2008
Corporate Plans Updated	All Ministries	10-Jan-2005	8-Jan-2007	8-Feb-2008
(a) Staff List for Established and Unestablished Staff	All Ministries	31 Jan – 11 Feb 2005	9-Feb-2007	9-Feb-2008
(b) Staff Proposal for Returning Scholars				
(c) Revised Ministerial Programme Performance Statement				
(c) Draft Revenue and Expenditure Estimates submitted	All Ministries	14 – 18 Feb 2005	16-Feb-2007	16-Feb-2008
Ministries prepare submissions (bidding for additional Budget) for ERC, consulting MoFNP officers.	All Ministries	21 – 25 Feb 2005	19 Feb – 2 Mar 2007	16-Feb-2008
MoFNP & PSC begin preparing briefs to ERC giving central agency perspectives on submission and analysing them against ERC mandate.	MoFNP & PSC			19-Feb-2008
ERC special meetings to enable Ministers to present bidding submissions	All Ministries			21-Feb-2008
ERC to report to Cabinet on the bidding outcome	ERC			25-Feb-2008
First (Draft) Budget Estimates	MoFNP	28 Feb – 31 Mar 2005	28-Mar-2007	28-Feb-2008
Second (Draft) Budget Estimates	MoFNP			20-Mar-2008
Final Budget Estimates	MoFNP	Late May/Early June	20-Apr-2007	20-Apr-2008
Final Budget Estimates & Statement	MoFNP		Late May/Early June	Late May/Early June
Approved Budget Estimates	MoFNP	1-Jul-2005	1-Jul-2007	30-Jun-2008

76. The PEFA AT has received copies of the signed *Appropriation Acts* for 2006-07, 2007-08 and 2008-09. In each case the Appropriation Bill received royal assent by the King of Tonga, and

passed into law, just before the commencement of the new financial year – the 06-07 Bill received assent on 30 June 2006; the 07-08 Bill received assent on 29 June 2007; and the 08-09 Bill received assent on 30 June 2008.

77. Ratings for two of the dimensions under this indicator have improved since 2007. The rating for PI-11(i) has improved, primarily because at the time of the last PEFA there had recently been some political instability (November 2006 riots) and MDAs were not properly consulted in the budget preparation processes during those years. The rating for PI-11(ii) has improved for much the same reason – budget preparation circulars were generally not being issued at the time of the last mission whereas now this is a routine process again.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-11)	B	A	M2
PI-11(i) Existence of and adherence to a fixed budget calendar.	C	B	A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows MDAs reasonable time (at least four weeks from receipt of the budget circular) so that most of them are able to meaningfully complete their detailed estimates on time.
PI-11(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions (budget circular or equivalent).	C	A	A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent) prior to the circular's distribution to MDAs.
PI-11(iii) Timely budget approval by the legislature or similarly mandated body (within the last three years).	A	A	The legislature has, during the last three years, approved the budget before the start of the fiscal year.

PI-12: Multi-year perspective in fiscal planning, expenditure policy and budgeting.

Multi-year budgeting and forward estimates

78. The PEFA AT has been unable to find any legislation or regulations explicitly calling for multi-year budgeting. The 2008-09 Budget Guidelines did request – as far as the PEFA AT is aware, for the first time – that MDAs prepare estimates for the coming year (2008-09) and two forward years (2009-10 and 2010-11), on a per-MDA administrative basis only, to assist with the production of a Medium-Term Expenditure Framework (MTEF).
79. According to the 2008-09 Guidelines, the purpose of the MTEF was to: (i) ensure that the MDAs were planning their annual budget allocation efficiently; and (ii) rationalise expenditures, through streamlining administrative procedures to ensure proper management of physical and financial resources. The PEFA AT has seen a copy of the forward estimates that MDAs provided back to inform the MTEF (in a consolidated spreadsheet held by MoFNP); however these forward estimates have never been published in any budget documentation, financial statements or other reports.
80. To be effective, it is of course also important that forward estimates are fed back into the preparation processes for each successive budget cycle, on a rolling annual basis. MoFNP officials advised the PEFA AT that this does take place. According to those officials, although forward estimates are not published anywhere yet, during preparation processes the last year's FE1 is used as the basis for setting budget ceilings for MDAs in upcoming budget, while FE2 is used as the basis for forecasting the new FE1.

Debt Sustainability

81. In May 2009, the Government of Tonga approved a Debt Sustainability Policy, which has been reviewed by the PEFA AT. The policy explicitly establishes a new macroeconomic policy objective for Tonga as follows: “The Government maintains sovereign debt within levels that are sustainable over time”. The Policy also uses the IMF's Debt Sustainability Framework to

set initial indicative debt targets for Tonga. The targets are not supposed to be binding upper limits, rather guides to good practice, and are reproduced in **Table 14**.

Table 14: Tonga Debt Sustainability targets

Indicator of debt sustainability	Target for Tonga	As at end 08-09 (baseline)
NPV of external debt as:		
% of GDP	40	34.8
% of exports and remittances	100	100.9
% of government revenues	200	113.4
NPV of debt service as:		
% of exports and remittances	15	2.8
% of revenues	25	2.7

82. The Debt Management Section in MoFNP produces monthly and quarterly Debt Status Reports for the Finance Minister and Cabinet. Since approval of the Debt Sustainability Policy, these reports have tracked the DSA indicators against the targets and analysed movements. The PEFA AT has reviewed samples of both report types, the Monthly Debt Status Report for end 31 January 2010 and the Quarterly Debt Status Report for end 30 June 2009, and is of the opinion that they are clear and comprehensive.
83. In addition to the Government's in-house tracking and analysis referred to above, the IMF and World Bank regularly conduct joint Debt Sustainability Analyses (DSA), covering external and domestic (public sector) debt, as a supplement to the annual IMF Article IV Consultations. Three of these DSA reports have been published in the past three FYs, on the following dates: (i) 22 June 2007; (ii) 17 June 2008; and (iii) 14 August 2009. They are available for download from the IMF's website at <http://www.imf.org/external/np/sec/aiv/indexc.htm>.

Sector Strategies

84. Commencing with the 2009-10 financial year and running for 5 years, Tonga's current high level development strategy is known as the *National Strategic Planning Framework* (NSPF). The NSPF was approved by Cabinet in April 2009, and continues on from where the *Strategic Development Plan* (SDP8), which covered the period 2006-07 to 2008-09, left off. The NSPF attempts to present a more streamlined and simplified set of high-level policy objectives than its predecessor.
85. Every MDA is routinely asked to prepare:
- a three-year **Corporate Plan** that: (i) links to the overall priorities set out in the NSPF; (ii) sets out strategies for the sector(s) that the MDA is responsible for; and (iii) describes activities that will be conducted by the MDA, with associated performance indicators. Corporate Plans are not all aligned to the same time periods, so some developed under SDP8 will not be revised to link to NSPF until next year.
 - an Annual Management Plan (AMP).
86. At the moment there does not appear to be any legislative or regulatory requirement that MDAs produce these documents, but this will change once the draft *Treasury Instructions 2010* are approved and come into force. In particular, clauses 9 and 10 of those Instructions will require:
- that all MDAs submit a copy of their Corporate Plan and AMP, developed with regard to the NSPF, to MoFNP as part of the preparation process for each budget; and

- that Corporate Plans cover: (i) the role and responsibilities of the MDA; (ii) the policy objectives of Government that the MDA will contribute to; (iii) the specific outcomes that the MDA is aiming to achieve; (iv) the outputs contributing to those outcomes; (v) outcome indicators and targets; (vi) output measures and targets; and (vii) any other information prescribed by any Act or Regulation.

87. The Economics, Social Policy and Planning (ESSP) section within MoFNP is responsible for coordinating and providing guidance on the drafting of the Corporate Plans and AMPs. To this end, ESSP has produced templates for both of the documents. The PEFA AT has reviewed these templates and notes that they explicitly include a column entitled “Required Resources”, asking MDAs to cost each listed objective and indicate the amount of staff needed to achieve it.
88. However, ESSP advises that, in practice, most MDAs: (i) are late producing the above documents; (ii) do not see Corporate Plans as a priority, so do not invest sufficient time and resources to ensure they are of adequate quality; and (iii) tend to dwell on resourcing issues and try to retain a ‘wish-list’ of programs rather than aligning with the overarching strategic objectives set out in the NSPF. Furthermore none of the Corporate Plans reviewed by the PEFA AT⁶ included detailed estimates of inputs and associated costings, as required by the MoFNP template. Typically Ministries would simply describe the current levels of staff and current budgets in the resourcing sections, rather than attempting to undertake any costing of outputs.
89. Based on this sample, the PEFA AT is of the opinion that, although Corporate Plans have been prepared with strategies covering most if not all sectors, it likely that very few (if any) have been costed, with respect to either investment or recurrent expenditure. Because the Corporate Plans for the major sectors (health, education, agriculture) as well as most, if not all, other sectors are not costed, either in terms of investment or recurrent costs, there is no clear link between investment decisions, Corporate Plans and forward estimate recurrent cost implications.
90. These issues aside, the move by MoFNP towards using these plans and attempting to move MDAs to thinking about the multi-year perspective and costing issues, is a welcome reform, which is obviously at an early stage. Further progress and improvement in this area can be expected in coming years.
91. All of the ratings for the dimensions under this indicator have stayed the same since 2007, except for one – PI-12(ii). The rating for this indicator has improved from C to A. This is primarily due to the Debt Unit within MoFNP issuing the Debt Sustainability Policy and commencing regular DSAs each month and quarter. However it is also not clear why the previous PEFA AT decided to rate this indicator C, given the IMF was already conducting annual DSAs as a supplement to their Article IV consultations, at the time that the last assessment took place.

⁶ These were the Corporate Plans for the: (i) Ministry of Tourism (covering 2009-2011); (ii) Ministry of Agriculture, Food, Forests and Fisheries (2009/10 – 2014/15); (iii) Ministry of Health (2008/09 – 2011/12); and (iv) Ministry of Education, Women’s Affairs and Culture (covering 2009-2012)

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-12)	D+	C	M2
PI-12(i) Preparation of multi-year fiscal forecasts and functional allocations.	C	C	Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis.
PI-12(ii) Scope and frequency of debt sustainability analysis (DSA).	C	A	DSA for external and domestic debt is undertaken annually.
PI-12(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure.	D	D	Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure.
PI-12(iv) Linkages between investment budgets and forward expenditure estimates.	D	D	Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared.

3.4. Predictability and control in budget execution

PI-13. Transparency of taxpayer obligations and liabilities.

Table 15: Details of major taxes and associated legislation

Name of tax	Legislation & Procedures		Administering agency		Significance
	Description	Compr.& Clear?	Name	Discretionary Powers	% of 08/09 tax revenue
Consumption Tax	Consumption Tax Act 2003, as amended. Consumption Tax Regulations 2005	Yes	IRD, RSD	Strictly limited	44.75%
Income Tax	Income Tax Act 2007 Income Tax Regulations 2008	Yes	IRD, RSD	Strictly limited	23.70%
Excise Taxes	Customs And Excise Management Act 2007 Customs And Excise Regulations 2008	Yes	Customs	Strictly limited	18.76%
Customs Duties	Customs And Excise Management Act 2007 Customs And Excise Regulations 2008	Yes	Customs	Strictly limited	12.56%

The major taxes and how they are administered

92. As shown in **Table 15** there are four major taxes in Tonga, which are governed by various Acts and regulations, as well as the high-level PFM Act of 2002. Rules for government administration of tax law are also set out in: (i) the *Revenue Administration Act 2000* (as amended); (ii) the *Revenue Services Administration (RSA) Act 2002* (as amended); and (iii) the *Revenue Services Administration (RSA) Regulations 2003* (as amended).
93. The Minister for Finance is the Chief Commissioner of Revenue and Chief Commissioner (or Comptroller General) of Customs. In this capacity the Minister is responsible for the Revenue Services Department (RSD) and the Customs Department. Within RSD, Inland Revenue Division (IRD) is responsible for collection of Consumption Tax (CT) and Income Tax (IT). The Customs Department is responsible for collection of Customs Duties and Excise Taxes.
94. CT is levied on goods and services at a rate of 15%. Companies selling goods and services with an annual turnover of greater than TOP \$100,000 are required to: (i) register for a CT TIN and collect CT on the behalf of GoT; and (ii) regularly lodge CT returns to RSD within 15 days of every two month calendar period. CT tax works on a self-assessment basis.
95. IT tax, which is also based on self-assessment, can be categorised into Corporate Tax and Individual PAYE Tax. Individuals whose only income is from employment or interest income can elect to have their employer withhold income tax and do not have to lodge a tax return at the end of the financial year. Other individuals and companies are required to conduct a self-assessment of the taxes they owe and lodge a return by no later than 31 August following the end of the corresponding financial year.

96. Sections 15-24 of the IT Act 2007 list entities eligible for standing exemption from paying income tax. These are: (i) the King; (ii) diplomats, international organisations and the NRB; (iii) entities exempt under international agreements; (iv) non-profit organisations; (v) pensions to members of the Tongan Defence Force who suffer disabilities received in war, and their dependents; (vi) any compensation for death or injuries; (vii) dividends paid by a resident company to a resident person; (viii) approved retirement funds; (ix) scholarships; and (x) maintenance payments.

Level of discretion in the administration of tax law

97. Under sections 50 & 51 of the RSA Act 2002, the Chief Commissioner may:
- publish orders and rulings in relation to application of revenue law which are binding until revoked (public rulings)
 - upon application in writing by a taxpayer, issue to the taxpayer a written ruling which is also binding (private rulings)
98. CT Public Ruling 2005/1 sets out the following five additional binding principles in relation to the public and private CT rulings programs. IT PR 2008/1 establishes similar principles for the public and private IT rulings programs.
1. **RSD will abide by public rulings** – Chief Commissioner cannot adopt a position for assessment of one person's tax liabilities that conflicts with a previously issued public ruling.
 2. **Public rulings not binding on taxpayers** – if someone believes a public ruling presents an incorrect interpretation of the law they may appeal it.
 3. **Replacement of public rulings** – Chief Commissioner may at any time replace one public ruling with another; where this occurs the new ruling must provide transition arrangements for taxpayers who were relying on the old ruling.
 4. **Private rulings** – Chief Commissioner can issue private rulings that are only binding for a particular transaction or period for which a person requests a ruling, unless this is explicitly indicated otherwise; private rulings cannot be relied upon by persons other than the person to whom they are issued because they are only binding if the person seeking the ruling has provided a full and true disclosure of all aspects of the transaction or planned arrangement relevant to the ruling.
 5. **Publication of rulings** – all public rulings will be published by the RSD and made available to taxpayers and tax officers; a notice will also be placed in the Official Gazette of Tonga advising their promulgation. Private rulings will not be published.

99. Public IT and CT rulings, as well as legislation, forms and guidelines are available for download from the RSD website at <http://www.revenue.gov.to>.
100. Based on the above, particularly the requirement for transparency around public tax rulings, and advice from the Revenue Commissioner, Audit Office and private sector, the PEFA AT is of the opinion that IT and CT discretionary powers are strictly limited.

Public access to tax information and associated education campaigns

101. The RSD and Customs website at <http://www.revenue.gov.to>, allows tax payers to access comprehensive information on tax liabilities and administrative procedures associated with all four of the major taxes mentioned above, as well as forms, tax rulings, contact details, and other material. Information on this website is generally provided in English and Tongan and,

although internet connections are slow in Tonga, most people are able to connect by visiting internet cafes. Finally, the PEFA AT notes that when it accessed the website on 4 March 2010, the counter at the bottom said that it had been last updated on 1 Sept 2009, so the information there may not be totally up-to-date at the moment.

102. A bi-monthly tax newsletter is also emailed or posted to tax clients, containing updated information on tax obligations, liabilities and procedures. The PEFA AT has seen copies of this newsletter dated May 2008, August 2008, November 2008 and March 2009, and is of the opinion that the information contained therein is generally clear and user-friendly.
103. Aside from making information available online and through newsletters, RSD has advised the PEFA AT that it routinely conducts a wide range of educational initiatives for different types of taxpayers. For example, over the month of October 2009, according to a schedule and other materials provided to the PEFA AT, RSD officials undertook the following activities to educate and remind taxpayers about their tax obligations under the self assessment approach and the relevant Tax Forms that were due by the end of October 2009:
 - emailing information and articles to a taxpayer distribution list, and using this distribution list to inform taxpayers of updates to legislation, guidelines, etc.;
 - posting information and articles on the website;
 - delivering information and articles to taxpayers via drivers in Vava'u and Tongatapu;
 - advertising self assessment and new tax form requirements on radio and television; and
 - running several information sessions and presentations on the requirements, both in English and in Tongan, and including specially targeted workshops for key groups such as the Chinese community.
104. The PEFA AT has also seen a copy of a back-to-office report describing how RSD ran a booth at the Pasifiki Trade Fair, from 18 – 20 October 2007, to answer tax questions, distribute flyers and brochures, etc.
105. When asked for a second opinion on RSD's taxpayer education campaigns,
 - the opinion of the Audit Office was that large businesses generally understand the tax system, but small businesses sometimes struggle and are not always complying with the rules. Sole traders in particular fall into this latter category.
 - the Tongan Chamber of Commerce (TCC) commented that: (i) the Deputy Tax Commissioner would often invite businesses to forums to explain tax requirements, which was a good initiative; (ii) the new CT introduced in 2005 had placed a big burden on small businesses, but feedback was that the requirements were still manageable; and (iii) big businesses had a good understanding of their tax obligations and liabilities (in any case there are many tax consultants in Tonga to draw upon) so it would be better if the RSD tax education campaigns were aimed more at the small business level.

Tax appeals mechanism

106. The Revenue Commissioner has advised the PEFA AT that there is a functioning tax appeal mechanism, which works on a hierarchy of appeals basis as follows:
 - appeal to the Revenue Commissioner;

- appeal to the Chief Commissioner of Revenue (i.e. Minister of Finance) – this person is then required to issue a decision or tax ruling within 30 days of receipt of the appeal;
 - appeal to the Tax Tribunal; and, finally,
 - appeal to Chief Justice of the Supreme Court.
107. According to advice from RSD, since the time of the last PEFA mission the Tax Tribunal has been established (late 2008) and two formal appeals have been lodged. One of these appeals has been decided and another is in process, with the possibility of a third to come. The PEFA AT is of the opinion that the fact that only a few formal appeals have been lodged to date may be an indication that the system is not accessible or there is a general lack of awareness of how it works, or that people lack confidence in the system. It may also be an indication that RSD is very good at resolving issues at the operational level. It is difficult to say at this stage when the system has only been operational for a year or so.
108. Second opinions:
- Officials in the Audit Office verified that the tax appeals mechanism was not used much, and their understanding was that the Tax Tribunal was *not* yet fully established and operational. The PEFA AT has been unable to ascertain for certain whether the Tax Tribunal has or has not been established; however given that some appeals have been lodged and decided, it has been decided to give RSD the benefit of the doubt in this instance.
 - The Tongan Chamber of Commerce (TCC) confirmed that most tax concerns were resolved at the lower levels and that legal appeals were rare. According to the TCC, companies who were known to comply with the rules in the past and were polite to tax officials were unlikely to encounter any major issues in having their case heard.
109. The appeals process described by the Commissioner is consistent with that required by the *Revenue Services Administration Act 2002*, sections 8-11 and sections 58-61. The RSA Act adds that, after being notified of a decision by either the Tax Tribunal or the Supreme Court, the Chief Commissioner is required to take action within 45 days to give effect to the decision. Sections 28-45 of the *RSA Regulations 2003* (as amended) also discuss the appeals process in more detail, setting the quorum for the Tribunal at 3 members and establishing a fee of TOP \$50 for each review conducted by the Tribunal.
110. Given the advice from RSD that the Tribunal has only recently been established and that only 2 appeals have been received by it to date, the PEFA AT is of the opinion that, although the system is fully operational, it is still too early to tell whether it is efficient, effective and accessible.
111. Each of the ratings associated with this indicator have improved since 2007. The rating for PI-13(i) has changed from D to A: the reason appears to be that the last PEFA AT rated the dimension on the basis of non-compliance in relation to tariff rates, when in fact the dimension is more about the clarity and comprehensiveness of tax legislation. The rating for PI-13(ii) has changed from C to A: this appears to be primarily because RSD has increased its education campaigns and the channels it uses (e.g. radio and television) to communicate with potential taxpayers. The rating for PI-13(iii) has increased from D to B: this is because no functioning appeals system was in place when the last PEFA AT visited, whereas the system does now appear to be operational (although still in its infancy) – the two appeals lodged are evidence of this.

Indicator	Score		Meaning of 2010 Score
	(2007)	(2010)	
OVERALL RATING (PI-13)	D+	A	M2
PI-13(i) Clarity and comprehensiveness of tax liabilities.	D	A	Legislation and procedures for all major taxes are comprehensive and clear, with strictly limited discretionary powers of the government entities involved.
PI-13(ii) Taxpayers' access to information on tax liabilities and administrative procedures.	C	A	Taxpayers have easy access to comprehensive, user friendly and up-to-date information tax liabilities and administrative procedures for all major taxes, and the RA supplements this with active taxpayer education campaigns.
PI-13(iii) Existence and functioning of a tax appeals mechanism.	D	B	A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow up on its decisions need to be addressed.

PI-14. Effectiveness of measures for taxpayer registration and tax assessment.

Systems used to register taxpayers

112. Section 24(1) of the RSA Act 2002 grants the Chief Commissioner of Revenue the power to "...require every person liable for income tax or sales tax to apply in the prescribed form for a Taxpayer Identification Number."; and "... require a taxpayer to state the taxpayer's Taxpayer Identification Number in any tax return, notice, or other document used for the purposes of any revenue law."
113. RSD has advised the PEFA AT that:
- As at 24 Feb 2010, more than 90% of Tongan tax payers had registered and been assigned a unique TIN, although RSD considers that there were still taxpayers without one;
 - All TINs are assigned and linked to all taxes in one complete tax database managed by RSD and Customs, known as the Revenue Management System (RMS);
 - RMS is not, however, currently linked to the registration systems of other government MDAs – this is more due to technical reasons than privacy reasons;
 - Cross-checking between RMS and the other external government registration systems, primarily the business licence register, is currently done rigorously, but manually. This can cause significant delays in processing - for example, companies that wish to register for a CT TIN need to first ensure they have registered with the Ministry of Labour and Commerce (MLC) for a valid business licence. Once they have done that they are eligible to register with RSD for a CT TIN. Before registering the TIN, in order to check that the business licence was in fact issued, RSD has to manually cross check with a hard copy list provided by MLC. While this process is not automatic nor uses electronic linkages to expedite it, the PEFA AT is of the view that RSD does this regularly and rigorously.
 - RSD conducts occasional surveys of potential tax payers to determine what proportion has registered for TINs, along with other details.
114. Discussions with the local business community, as represented by the Tongan Chamber of Commerce, suggest that, although the TIN registration process is not seen as particularly quick, most of the concerns in the private sector are more around the time it takes to register for the annual business licences. Amongst other things this is seen as a common cause of delays in GoT paying companies early in each new calendar year, as MoFNP is unable to pay a supplier who does not have a valid business licence for that year. The TCC reps suggested that MLC

should put the whole licence system on-line so companies could register for licences over the internet, or even remove the requirement for business licences altogether.

Effectiveness of penalties for non-compliance

115. Penalties for non-compliance with various tax requirements and obligations are described in sections 36-49 of the RSA Act 2002. The two penalties that specifically relate to tax registration and declaration are:

“43. (1) Any person who knowingly and fraudulently uses a false Taxpayer Identification Number on any return or document prescribed or used for the purposes of any revenue law commits an offence and shall be liable upon conviction to a fine not exceeding \$10,000 or to imprisonment for a term not exceeding 3 years, or both.”

“44. (1) Any person who knowingly makes a false or misleading statement or omits from such statement any material particular commits an offence and shall be liable upon conviction to a fine not exceeding \$10,000 or imprisonment for a term not exceeding 3 years, or both..”

116. No penalty appears to be established in the existing legislation for taxpayers who fail to register for a TIN. Strictly speaking TINs are not mandatory for tax-payers, unless the Chief Commissioner of Revenue requires such people to register under section 24(1) of the RSA Act 2002. However written advice from RSD is that taxpayers who do not register a TIN are taxed at a higher rate and do not have the benefit of a tax-free threshold (similar to the practice in many countries).
117. Advice from RSD, the Audit Office and private sector representatives suggest that the above penalties are generally set sufficiently high to deter non-compliance, and are administered consistently.

Tax audits

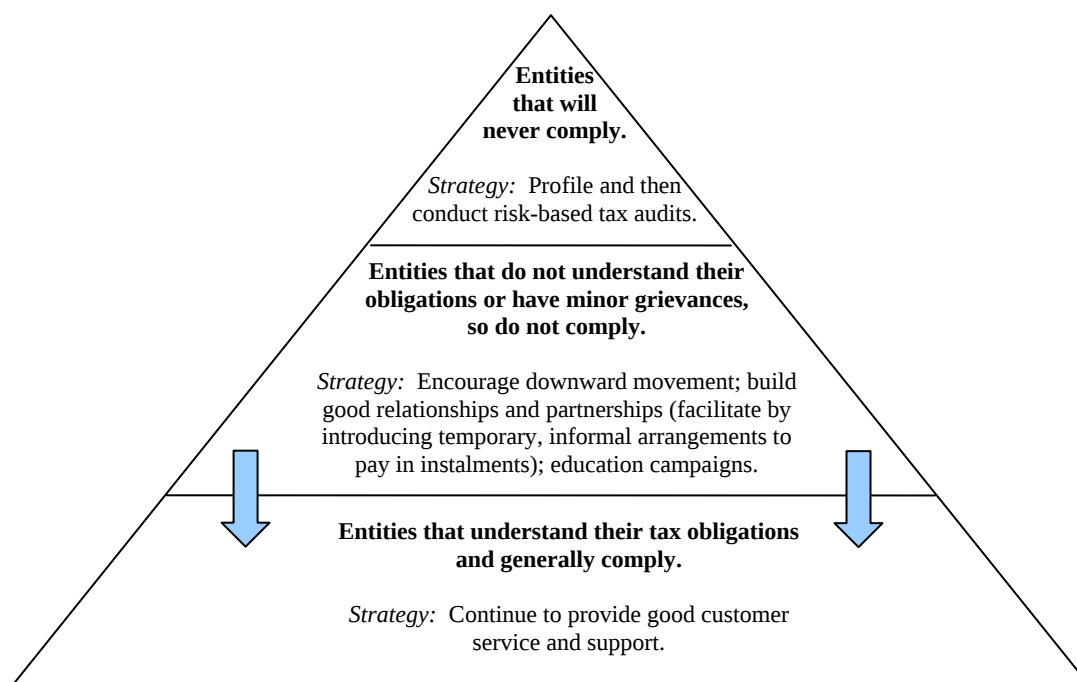
118. According to RSD, since the introduction of the CT in 2003, it has been:
- **Undertaking regular routine tax compliance audits.** There is a dedicated audit team of six officers within RSD which usually splits into three teams of two. They focus on auditing medium to small companies, also looking at CT refund applications, conducting random spot audits and checks before refunds are paid. The PEFA AT has reviewed copies of all the monthly audit reports issued by RSD over the period July 2009 to February 2010 and notes that, on average, the audit team has been completing around 47 cases - or profiling of cases - a month over this eight month period (the total number of cases completed is 373).
 - **Conducting risk profiling of the largest potential tax payers to focus future audit activities.** This work has been led for the past two years by a tax expert seconded from the Australian Taxation Office; he will be returning to Australia soon and the recruitment of a replacement has almost been finalised. To date almost 75% of large business taxpayers have been risk profiled and targeted audits are complete or underway.
119. RSD’s current tax collection strategy is represented schematically, in the form of a pyramid dividing potential taxpayers into three groups, as per **Figure 16**. Consistent with the different tiers of this pyramid, RSD has three key objectives for each group of taxpayers. The first group are those entities (companies and individuals) that understand their tax obligations but deliberately choose to ignore them. The strategy for this group is to first conduct risk profiling and then assign resources to audit those entities of greatest risk. The second group are those entities which either do not understand their obligations, or avoid paying what they owe because

of minor grievances they have due to past interactions with the tax office. The strategy in this case is to attempt to move as many of these entities as possible down to the third group, by conducting education campaigns and building good partnerships with those who have past grievances. The third group are those entities that understand their obligations and generally comply with them. RSD's objective for this group is to maintain a good relationship, by continuing to provide high-quality customer service and support.

120. RSD has three work plans that are linked to its umbrella Corporate Plan. Copies of these work plans have been reviewed by the PEFA AT. They are:

- a **Tax Compliance Plan (Jan 2008 – Jan 2010)**, aiming to “encourage voluntary compliance through various methods and ensure the correct amount of tax is collected for the 2008-2010 financial years.”
- a **Debt Collection Plan (Jan 2008 – Dec 2011)**, aiming to “encourage payment of tax debt outstanding through various methods and ensure the correct amount of tax owed is collected for the 2008-2011 financial years.”
- a **Communication and Training Plan (Jan 2008 – Dec 2011)**, aiming to “have an effective communication, training and education program for staff taxpayers alike for the compliance/audit taxes division.”

Figure 16. Conceptual representation of RSD's tax collection strategy



121. The first of these plans – the Tax Compliance Plan – describes RSD's overall audit plan and strategy for the period 2008-2010. It outlines basic principles for the audit program, including movement away from responsive ad-hoc audits towards risk profiling and a more focussed risk-based approach to audit. RSD determines the level of risk that IT or CT requirements will not be complied with by comparing the behaviour of large business clients against a set of clear risk assessment criteria.⁷ This results in a risk score for each client, which is used to prioritise and identify audit activities.

⁷ Criteria include, for example: (i) history of non-lodgement and/or outstanding tax debt; (ii) difficulty contacting; (iii) no visible means of maintaining lifestyle; etc.

122. Each of the ratings associated with this indicator have changed since 2007. The revised rating for PI-14(i) is related to improvements that have been made to the RMS, which now covers all of the major taxes. (income, consumption, excise and customs) RSD is developing linkages between this system and the business licence system held by MLCI. The revised rating for PI-14(ii) arises from the current PEFA AT taking a stricter view of what that dimension covers – tax payer registration and assessment only – and, based on consultations, penalties for these specific areas are sufficiently high to deter non-compliance. Finally, the revised rating for PI-14(iii) relates to significant improvements in the tax audit function since 2007.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-14)	C+	A	M2
PI-14(i) Controls in the taxpayer registration system.	C	B	Taxpayers are registered in a complete database system with some linkages to other relevant government registration systems and financial sector regulations.
PI-14(ii) Effectiveness of penalties for non-compliance with registration and tax declaration.	B	A	Penalties for all areas of non-compliance are set sufficiently high to act as deterrence and are consistently administered.
PI-14(iii) Planning and monitoring of tax audit programs.	C	A	Tax audits and fraud investigations are managed and reported on according to a comprehensive and documented audit plan, with clear risk assessment criteria for all major taxes that apply self-assessment.

PI-15. Effectiveness in collection of tax payments.

123. As can be seen in **Table 17**, the level of gross CT and IT arrears at end 08-09 is significant. At TOP \$25.2m, or almost 30% of total 08-09 CT and IT collections, this is much greater than the 2% threshold set by the PEFA Secretariat. In addition, the 2008-09 collection ratio was low, at only around 40%.
124. If we then consider collection ratios at a disaggregated level - by tax type - it becomes apparent that the greatest shortfalls were in relation to collection of domestic CT, followed by collection of corporate income tax for small businesses. In both cases, no disputed arrears were collected and, in the case of corporate small business arrears, no undisputed arrears were collected either. One implication is that there may be benefit in conducting more intensive tax education campaigns for small businesses (as recommend by the TCC), particularly in relation to their obligations to collect and pay CT.
125. Although the collection ratio in 2008-09 was low, according to RSD there are two important points that need to be noted:
- Collection ratios have improved significantly since previous years, and are expected to continue improving over the coming years. 2008-09 is the first year for which RSD has accurate data on tax arrears and collection. Hence it is not possible to determine the exact extent to which collection ratios have improved, but RSD estimates that the 08-09 amount is probably at least double what was collected in 2007-08. They expect that this trend will continue over the coming years, as the capacity and skills of their tax collection team grow.
 - A few very large assessments – RSD estimates these totalled around TOP \$5m – were issued in June 2008.** This has substantially increased the overall debt stock at the start of the 08-09 financial year. If these assessments had been issued a few weeks later, e.g. in July, then the 08-09 stock snapshot shown in **Table 17** would be substantially lower, perhaps only TOP \$20m, increasing the 08-09 collection ratio to 50%. RSD are therefore of the view that, because their efficiency and effectiveness in issuing tax assessments has improved markedly over the past years, the collection ratios

look worse than they otherwise would have. In their view, this indicator should take into account movements over the course of the year and not be based solely on snapshots.

Table 17: Collection Ratio for Gross Tax Arrears

	Stock at start 08-09 TOP \$m	Collected 08-09 TOP \$m	Collect Ratio 08-09 %	Stock at start 09-10 TOP \$m
Tax debts in dispute				
Corporate Tax (LBD)	2.98	0.98	32.8%	8.55
Corporate Tax (SBD)	2.25	-	0.0%	2.25
PAYE Non-Govt	0.02	0.00	11.8%	0.02
PAYE Govt	0.01	0.00	7.2%	0.01
Domestic CT	2.10	-	0.0%	4.31
<i>Subtotal - disputed:</i>	<i>7.36</i>	<i>0.98</i>	<i>13.3%</i>	<i>15.15</i>
Tax debts not in dispute				
Corporate Tax (LBD)	8.11	6.72	82.9%	3.52
Corporate Tax (SBD)	1.34	-	0.0%	1.64
PAYE Non-Govt	0.11	0.67	610.0%	0.10
PAYE Govt	0.02	-	0.0%	0.00
Domestic CT	8.47	1.88	22.1%	4.78
<i>Subtotal - not disputed:</i>	<i>18.05</i>	<i>9.27</i>	<i>51.4%</i>	<i>10.05</i>
GROSS ARREARS	25.41	10.25	40.3%	25.20
<i>Total IT & CT collection in 08-09:</i>				<i>87.45</i>
<i>09-10 stock as % of total IT & CT collection in 08-09:</i>				<i>28.8%</i>

Source: Hardcopy table provided to PEFA AT by RSD on 5 March 2010.

126. When taxes are actually paid, according to RSD (and corroborated by MoFNP) taxpayers are required to pay them directly into the GoT's General Revenue account. According to MoFNP, reconciliations of tax assessments, collections, arrears, and transfers to Treasury are carried out monthly within one month.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-15)	D+	D+	M1
PI-15(i) Collection ratio for gross tax arrears, being the percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year (average of the last two fiscal years).	D	D	The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collections).
PI-15(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration.	B	A	All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily.
PI-15(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury.	A	A	Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least monthly within one month of end of month.

PI-16. Predictability in the availability of funds for commitment of expenditures.

Cash forecasts and reconciliations

127. MoFNP advises that:
- cash flow forecasts are prepared by the Policy & Planning Division at the start of each FY for the year ahead, and are updated during the year.
 - cash flows are monitored and MDA cash books reconciled with the SunSystem and bank statements, on a daily basis.

- cash flow forecasts are revised on a monthly basis.
128. In 2008 MoFNP established the **Government Financial Managers (GFM) Forum**. This Forum meets on a quarterly basis, or sooner if necessary. It provides an opportunity for MDAs to discuss any PFM issues they may have with MoFNP, and is also used as the vehicle for MoFNP to advise MDAs of the expected cash flow situation over the coming quarter.
129. The most recent meeting of the GFM Forum was on 11 Feb 2010. The PEFA AT was provided with a copy of the agenda for this meeting, as well as the corresponding invitation emails, and can confirm that a MoFNP presentation on MDA commitment ceilings for the period Jan – June 2010 was on the agenda.
130. Consequently, in the opinion of the PEFA AT, MDAs are generally able to plan and commit expenditures in accordance with their budget appropriations. However:
- During periods of cash flow problems, MoFNP does use non-transparent cash control mechanisms – in particular, the delaying of voucher processing and printing of supplier cheques is reasonably common (as verified by donors, the Audit Dept and the TCC). MoFNP adds that, although this is a source of delays, outstanding government cheques that have been printed but not cashed do not bounce as MoFNP takes care to ensure sufficient funds are available to cover these.
 - These non-transparent cash control mechanisms have, according to the Tongan Chamber of Commerce, led to some businesses who work with the Government insisting that they be paid in cash or provided credit, as they do not trust the voucher system will issue their cheque in a timely fashion.

Inter-MDA reallocations and additional appropriations (use of the Contingency Fund)

131. The Budget Division of MoFNP advises that, in Tonga, there is no regular mid-year supplementary budget (additional estimates) process. Instead when essential unforeseen expenditure is anticipated, MDAs can lodge a request to the Finance Minister to draw down additional appropriation from the Contingency Fund (CF).
132. The rules governing CF use are established in law by section 12 of the *PFM Act 2002* and mentioned in the draft *Treasury Instructions 2010* (section 15). In summary:
- When annual budget appropriations are presented to the Legislative Assembly for approval prior to each FY, they may also request CF appropriation, not exceeding 5% of the forecast domestic revenue for the coming year.
 - Throughout the year, if the Minister for Finance considers that expenditure for a given program should be raised above its core appropriation the Minister may, with approval of the Privy Council, transfer funding to the program from the CF to cover the shortfall.
 - Also if, after a review of economic and fiscal performance, the Privy Council decides that savings should be offered up from MDAs (or spending redirected) they may authorise the Minister for Finance to sequester portions of MDA appropriations and transfer them to the CF.
 - Every instance of an appropriation revised in this manner, together with an explanation of the reasons for such revision, must be disclosed in the annual financial statements.
133. In other words the Minister for Finance and the Privy Council together have the power to use the CF as a tool to change the budgetary allocations (although not the overall budget envelope) approved by the Legislative Assembly to whatever extent they see fit, without seeking

re-approval from the Legislative Assembly. Since any such reallocations are not scrutinised by the Legislature, the main safeguard against abuse of this power appears to be the requirement that all such adjustments, along with justifications, are published in the annual financial statements.

Table 18: Transfers to/from the Contingency Fund during 2008-09

Name of MDA	2008-09				
	Original Approp	To CF	From CF	Revised Approp	% Var.
	1	2	3	4	5 = (4-1)/1
Palace Office	3.80	-	1.40	5.20	36.9%
Legislative Assembly	4.09	-	0.66	4.75	16.2%
Prime Minister's Office	8.44	-	0.92	9.36	10.9%
Commissioner of Public Relations	0.38	0.15	-	0.23	(39.7%)
Audit Department	0.82	0.02	0.20	1.00	22.0%
Ministry of Finance & National Planning	80.35	13.59	6.10	72.86	(9.3%)
Ministry of Foreign Affairs	9.62	-	5.06	14.68	52.6%
Tonga Defence Services	8.35	-	1.89	10.24	22.6%
Ministry of Lands, Survey, Natural Resources and Environment	2.96	0.08	-	2.88	(2.5%)
Ministry of Justice	1.76	-	0.12	1.88	6.7%
Ministry of Police, Prisons & Fire Services	12.53	0.50	-	12.03	(4.0%)
Ministry of Education, Women Affairs & Culture	25.57	0.50	0.22	25.29	(1.1%)
Ministry of Health	21.58	0.41	-	21.17	(1.9%)
Ministry of Agriculture, Food, Forests & Fisheries	6.59	0.10	-	6.49	(1.5%)
Ministry of Labour, Commerce and Industries	3.03	-	-	3.03	0.0%
Ministry of Tourism	2.08	-	-	2.08	0.0%
Ministry of Works	9.90	1.30	0.19	8.79	(11.2%)
Ministry of Transport	3.37	-	-	3.37	0.0%
Ministry of Training, Employment, Youth & Sports	2.76	-	-	2.76	0.0%
Crown Law Department	1.28	-	0.91	2.19	71.2%
Public Enterprises	0.81	0.07	-	0.74	(8.7%)
Revenue Services Department	5.58	0.91	-	4.67	(16.3%)
TOTAL	215.64	17.62	17.67	215.69	0.0%

Source: Draft unaudited financial statements for 2008-09 (Statement of Contingency Fund and Note 30)

134. The Statement of Contingency Fund and its accompanying Note 30, in the draft unaudited 08-09 financial statements show in-year budgetary adjustments made using the CF during that year. See **Table 18**. The standard CFS format requires explanations for each variance; however as the 08-09 statements are still being drafted at present (7 March 2010) explanations are not yet provided.
135. As can be seen the top three MDAs receiving the greatest in-year budget increases in 08-09 were: (i) Crown Law Department (71.2% increase); (ii) Ministry of Foreign Affairs (52.6% increase); (iii) Palace Office (36.9% increase). These were largely funded by savings of TOP \$13.59m offered up by MoFNP (a 9.3% budget cut, although this is not as significant as it appears because the 5% CF appropriation is allocated to MoFNP at the start of each financial year).
136. By way of comparison, CF flows (and justifications) in 07-08, as per the CF Statement and Note 30 of the audited financial statements for that financial year, are shown in **Table 19**. In this case, the top three MDAs receiving the greatest in-year budget increases in 07-08 were: (i) Palace Office (73.5%); (ii) Prime Minister's Office (48.6%); and (iii) Ministry of Transport (17.5%). These were largely funded by savings of TOP \$11.45m offered up by MoFNP (a footnote states that TOP \$4.8m of this figure was an existing CF provision including in MoFNP's budget).

Table 19: Transfers to/from the Contingency Fund in 2007-08

Name of MDA	2007-08					Justification for transfers from CF
	Original Approp	To CF	From CF	Revised Approp	% Var.	
	1	2	3	4	5 = (4-1)/1	
Palace Office	3.33		2.45	5.77	73.5%	To fund preparation for His Majesty's coronation in July 2008 and other operational expenses incurred during the year.
Legislative Assembly	4.03			4.03	0.0%	
Prime Minister's Office	5.70		2.77	8.47	48.6%	To fund expenses associated with the Pacific Leaders Forum Meeting, Electoral expenses and other operational expenses during the year.
Commissioner of Public Relations	0.18	0.07		0.11	(36.9%)	
Audit Department	0.72			0.72	0.0%	
Ministry of Finance & National Planning	32.07	11.45	1.09	21.71	(32.3%)	To fund equity payments to some public enterprises, settlement recovery order to EU and to increase allocations to pensions.
Ministry of Foreign Affairs	6.51		0.62	7.13	9.5%	To fund additional operational expenses incurred during the year.
Tonga Defence Services	7.15		1.08	8.23	15.1%	To fund Tonga Defence Services deployment to Iraq.
Ministry of Lands, Survey, Natural Resources and Environment	2.15		0.21	2.36	9.8%	To fund hosting of the 36th SOPAC annual Meeting.
Ministry of Justice	1.76			1.76	0.0%	
Ministry of Police, Prisons & Fire Services	9.16	0.60		8.56	(6.6%)	
Ministry of Education, Women Affairs & Culture	21.80		0.79	22.60	3.6%	To fund the payments of scholarships arrears and other operational expenses needed to be paid.
Ministry of Health	17.76		1.77	19.53	10.0%	To fund government contributions to Health projects, overseas medical treatment, laboratory supplies and other operational expenses.
Ministry of Agriculture, Food, Forests & Fisheries	5.27		-	5.27	0.0%	
Ministry of Labour, Commerce and Industries	1.97		0.30	2.27	15.2%	To fund operations of the Regional Seasonal Employer Scheme in both Tonga and New Zealand.
Ministry of Tourism	1.52		0.15	1.67	9.8%	To fund Tourism Week in Tonga and the outer islands.
Ministry of Works	4.14		0.19	4.33	4.6%	To fund road constructions in 'Eua and the Niua.
Ministry of Transport	1.70		0.30	2.00	17.5%	To fund hosting of the 36th SOPAC annual Meeting.
Ministry of Training, Employment, Youth & Sports	2.12		0.10	2.22	4.7%	To fund insurance payment for the MV Takuo.
Crown Law Department	1.21		0.07	1.28	5.8%	To fund additional operational expenses incurred during the year.
Public Enterprises	0.35	0.03	0.09	0.42	17.0%	To fund new website for its Information Unit.
Revenue Services Department	3.08	0.34	0.50	3.24	5.2%	To fund operation of the Post Office and other operational expenses.
TOTAL	133.70	12.48	12.48	133.70	(0.0%)	

Source: Audited financial statements for 2007-08 (Statement of Contingency Fund and Note 30)

137. Some general observations from the above:

- Whilst aggregate fiscal discipline is maintained in the sense that transfers to/from the CF are more or less balanced, variances in the composition of budget expenditures are significant. This explains why in the earlier PEFA indicators, PI-1 has received a rating of A while PI-2 receives a rating of C.
- Although the justifications provided for CF transfers in Note 20 to the 07-08 (and 06-07) audited CFS are fairly transparent, they are not always entirely clear (e.g. some comments are simply "to fund additional operational expenses incurred during the year"). To improve discipline in use of the CF, it would perhaps be useful to clarify what constitutes a satisfactory justification. For example, in some countries onus is put on the MDAs to demonstrate that they need CF funds because either: (i) additional expenditures are urgent and unforeseen; or (ii) additional expenditures are urgent and were erroneously omitted from the budget appropriations.

Intra-MDA program reallocations (virements)

138. Rules governing the application of virements are established in law by section 10 of the PFM Act 2002. In summary:
- The Finance Minister, at the request of the Minister responsible for an MDA, may direct that funding for one program managed by that MDA be transferred to any other program managed by that MDA, provided that:
 - (i) the amount transferred does not increase the budget for the receiving program by more than 10 percent for that FY;
 - (ii) the transfer will not compromise the performance of the program from which the budget is transferred; and
 - (iii) the overall appropriation for the MDA in the FY is unaltered.
 - Any virements directed in this way by the Finance Minister must be noted in a clause to corresponding annual financial statements for that FY (in practice this is done in a clause under Note 3 to the CFS entitled “Transfer of funds within and between programmes”).
139. Hence, and somewhat oddly, it would seem that the controls relating to intra-MDA (program) budgetary reallocations are stricter (because of the 10% rule) than those relating to inter-MDA budgetary reallocations. The draft *Treasury Instructions 2010* also describe the process for applying for virements (section 8); however they vary slightly from the PFM Act 2002 in that they state that Prime Ministerial approval, not Finance Minister approval, is required for all virements.
140. Advice from MoFNP is that the Heads of MDAs can transfer funds between line items within a given program at their discretion without seeking approval from the Minister.

Conclusion

141. Based on the preceding information, the PEFA AT concludes that: (i) significant budget adjustments using the CF are usually made more than twice during a FY; and (ii) the basis for these adjustments is reported in a fairly transparent manner via the annual financial statements.
142. The first rating associated with this indicator, PI-16(i) remains unchanged since 2007. The second rating, PI-16(ii) has improved, from a C to a B. This is in no small part due to the establishment of the quarterly GFM Forum by the MoFNP. The third rating, PI-16(iii) has been downgraded from a B to a C. This probably does not represent any real change in that area, as much as a difference in interpretation between the current PEFA AT and the previous AT about the frequency of in-year budget adjustments and how transparently these are performed.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-16)	C+	C+	M1
PI-16(i) Extent to which cash flows are forecast and monitored.	A	A	A cash flow forecast is prepared for the fiscal year, and are updated monthly on the basis of actual cash inflows and outflows.
PI-16(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure commitment.	C	B	MDAs are provided reliable information on commitment ceilings at least quarterly in advance.
PI-16(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs.	B	C	Significant in-year budget adjustments are frequent, but undertaken with some transparency.

PI-17. Recording and management of cash balances, debt and guarantees.

Recording of debts and guarantees

143. Debt data is recorded by the Debt Management Section of MoFNP in a specialised software package, the *Commonwealth Secretariat Debt Recording Management System* (CSDRMS). All debt and guarantees, both external and domestic, are included in the CSDRMS. Both foreign and domestic debt is included in the database. Details of loans entered and guarantees for all parts of the public sector are also included, including public enterprises. The Debt Management Section, however, notes that the software is not well set up for handling guarantees.
144. According to the Debt Management Section, the quality of debt data is ultimately a function of how it is recorded. The PEFA AT considers that the completeness of the debt data is good, since under the *Public Finances Management Act 2002*, all proposals for loans or guarantees by MDAs must be brought to the Minister of Finance. The Minister has discretion to accept or reject proposals, which must then further approved by Cabinet, the Privy Council and the Legislative Assembly if they exceed \$15 million
145. Only a small proportion of PE loans are guaranteed and the PFM Act implies that all PE loans and guarantees are their own. The PEFA AT was unable to identify whether PE borrowing contracts explicitly include this provision, to ensure that lenders are cognisant before entering into contracts of the fact that loans to PEs do not receive an explicit or implicit state guarantee. The Minister, through Cabinet and the Privy Council, can provide explicit guarantees for the financial liabilities of PEs. The GoT financial statements list these explicitly. The monthly or quarterly debt reports also contain details of guarantees for PEs.
146. According to the Debt Management Section, domestic and foreign debt data are complete and reconciled monthly. The Debt Management Section prepares regular reports on external and domestic debt, including service, stock and operations. These reports are issued monthly and quarterly. The reports are not available on the MoFNP website, but the appendices of the budget papers list outstanding loans.
147. The Audit Office considers the debt and guarantees reports and data compiled by MoFNP are generally complete records of all loans and guarantees issued or entered into by the state.

Calculation and consolidation of GoT bank accounts

148. The GoT has a number of accounts to manage its day to day operations. These are held at the Westpac Bank of Tonga (WBOT was previously Bank of Tonga, which was the country's national bank until it was later sold to Westpac) and the National Reserve Bank of Tonga (NRBT). See **Tables 20 and 21**. In addition to the standard operating accounts in WBOT and NRBT, the GoT holds a number of term deposit accounts with WBOT and ANZ Bank. The MoFNP considers that they are aware of all government accounts currently open.
149. All government revenue (both tax and non-tax) is supposed to be deposited directly in the General Revenue account at WBOT. Non-salary government expenditure is paid from the General Services account, while government employee salaries are paid from the General Salary account. These three accounts, and the General Revenue account, are the main official bank accounts of the GoT. Almost all public financial management functions are centralised in the MoFNP, but there is one exception to this rule. In what could be seen as a pilot for potential PFM decentralisation to other MDAs, the Finance Minister has approved the PMO holding its own cheque account and managing its own non-salary expenditure.
150. There are also a number of cheque accounts in WBOT that relate to the ad-hoc independent councils and commissions that are formed from time-to-time. At the moment there are accounts for the: (i) National Economic Development Council; (ii) Nuku'alofa Development Council;

(iii) Royal Land Commission; and (iv) Royal Commission of Inquiry into the Sinking of the Princess Ashika. The funding for all of these councils and commissions is appropriated to the MoFNP at the start of each financial year and transferred across into their bank accounts.

Table 20. GoT bank accounts with WBOT

Name of WBOT account		Description	Balance as at 19 Feb 2010 (TOP \$)
1	General Revenue	Main operating account into which govt. revenue is paid.	263,511.13
2	General Services	Main operating account for govt. non-salary expenditure.	235,370.57
3	General Salary	Main operating account for govt salary expenditure,	1,869,543.56
4	General Reserve		32,939.43
5	PMO cheque account	PMO's account, which it uses to undertake its operations. PMO is the only agency that has devolved financial management responsibilities.	24,458.10
6	NEDC Cheque Account	National Economic Development Council	925,595.03
7	NDC Cheque Account	Nuku'alofa Development Council	66,578.03
8	RLC Cheque Account	Royal Land Commission	80,721.56
9	CEC Cheque Account	Constitutional and Electoral Commission	17,459.19
10	RCISA Cheque Account	Royal Commission Inquiry into the Sinking of the Princess Ashika	201,471.86
11	Communication and IT Cheque Account		3,016.06
TOTAL			3,720,664.52

Source: Spreadsheet from MoFNP.

151. The main NRBT accounts held by GoT relate to donors and development expenditure. There is the General Development Fund, through which all donor funding provided to the GoT is supposed to flow. In this sense it is essentially a tracking account that can be used to monitor the GoT's development budget each year. Some donors currently provide funding to the NEDC and the CEC. In such cases the donors are first supposed to pay their funding to the General Development Fund, and then MoFNP transfers it across to the appropriate cheque account in WBOT. Other donors prefer to make payments in foreign currency (usually USD or Euros). In these cases, the money is first transferred to the NRBT foreign currency account, then NRBT undertakes the currency conversion and deposits the equivalent amount of Tongan Pa'anga into the General Development Fund.

Table 21. GoT bank accounts with NRBT

Name of NRBT account		Description	Balance as at 19 Feb 2010 (TOP \$)
1	General Development Fund	Cash from donors for donor-funded project expenditure	2,800,072.64
2	Operating Account		912,422.06
3	Reserve Account		1,886.91
4	Donor Funds Account (USD)	Foreign currency account for donor cash receipts denominated in USD	1,891,806.22
5	Donor Funds Account (Euros)	Foreign currency account for donor cash receipts denominated in Euros	88,576.36
TOTAL			5,694,764.19

Source: Spreadsheet from MoFNP.

152. The balances of the most important government accounts held at WBOT and NRBT are identified and calculated daily (and in addition staff monitor WBOT account transactions via internet banking). All of the accounts are centralised and managed by the MoFNP, and staff conduct daily reconciliations between their FMIS, the SunSystem, and the bank statements.
153. The bank accounts are not set up in a way that permits automatic, electronic consolidation. For example, many governments in other countries set up one single treasury account in their central bank and then sub-accounts sit underneath that. The balances of those sub-accounts are then “swept” back into the parent account every night by the central bank, to be productively invested on money markets. In the case of Tonga, although such a system has not been established, the MoFNP advises that it is able to, and does, perform manual consolidation to ensure that none of the WBOT accounts are overdrawn, by transferring funds between the accounts using internet banking. While this is certainly a labour-intensive process for MoFNP, it is manageable in a country such as Tonga where the PFM system is small-scale and not devolved. The PEFA AT is of the opinion that this satisfactorily meets this indicator’s requirements for consolidation, as per the PEFA Secretariat’s clarifications of September 2008.
154. The Audit Office during 2006-07 had a positive impression of the quality of cash reconciliation and cash management by MoFNP. Its 2006-07 Annual Report ‘commended Treasury for its effort to update the bank reconciliation procedures of government bank accounts. This is a vital control to ensure the government cash position is determined accurately on a regular basis and that decision making is based on a more accurate data (sic).’

Contracting of loans and issuance of guarantees

155. All proposals for loans or guarantees by MDAs must be brought to the Minister of Finance. The Minister has the power to approve loan proposals under TOP \$15m. For proposals over TOP \$15m, if the Minister decides to endorse the proposal it must then be forwarded to Cabinet, the Privy Council and the Legislative Assembly for final approval. The PFM Act permits guarantees where the total level of all guarantees or indemnities given in any one financial year and still outstanding does not exceed five percent of the revenue raised domestically by the government as appropriated in that financial year. The guarantees must be approved by the Privy Council and constitute an ‘approved investment’. The Minister of Finance is also responsible for approving GoT’s overall level of public debt.
156. As far as the quantum of debt is concerned, the PEFA AT notes that the GoT has adopted debt targets that seek to cap NPV of public external debt at a maximum of 40% of GDP and cap servicing of that debt to a maximum of 15% of exports (including remittances). See the commentary for indicator PI-12 for more information.
157. There is no formal link between level of debt and the rest of the macroeconomic framework. That is, if the debt targets are exceeded, unlike many other countries there is no legislative or regulatory requirement that this trigger an automatic review process within GoT to consider expenditure or other fiscal adjustments. The GoT’s stated policy intent of the target is that it is simply a non-binding guide to help keep debt at sustainable levels.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-17)	B	A	M2
PI-17(i) Quality of debt data recording and reporting.	A	A	Domestic and foreign debt records are complete, updated and reconciled on a monthly basis with data considered of high integrity. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least quarterly.
PI-17(ii) Extent of consolidation of the government's cash balances.	C	A	All cash balances are calculated daily and consolidated.
PI-17(iii) Systems for contracting loans and issuance of guarantees.	C	B	Central government's contracting of loans and issuance of guarantees are made within limits for total debt and total guarantees, and always approved by a single responsible government entity.

PI-18. Effectiveness of payroll controls.

158. In February 2010, there were 5,046 permanent public servants in the GoT (excluding Police and the Tonga Defence Services staff). These officials are all employed under the *Public Service Act 2002*, and are subject to the *Public Service Code of Conduct 2004* which was approved under Section 19 of that Act. There were also a number of “daily paid workers” (i.e. casual or temporary staff) who were paid directly in cash at the end of each day by the MDAs. This of course means that MDAs, while not having their own bank accounts, must maintain petty cash floats advanced from MoFNP. The PEFA AT has been unable to establish the magnitude of these floats due to time constraints, but it is understood that they are not significant.
159. Pay ranges for the different levels of permanent government employees are shown in **Table 22**.

Table 22. Tonga Public Service Salary Structure

Level	Pay points (all figures in TOP \$)											
	1	2	3	4	5	6	7	8	9	10	11	12
1	48,400	(contract)										
2	38,420	(fixed)										
3	34,808	36,909	39,009	41,570								
4	32,355	33,738	35,121	36,504	39,009							
5	28,482	30,311	32,140	33,968	35,797							
6	28,186	29,612	31,038	32,464	33,890							
7	25,070	26,028	26,986	27,943	28,901	29,859	30,817					
8	20,922	21,959	22,996	24,033	25,070	26,106	27,143	28,180	29,217			
9	14,353	15,327	17,276	18,250	19,224	20,198	21,173	22,147	23,121	24,095	25,070	26,044
9A	14,353	15,256	16,160	17,063	17,967	18,870						
10	15,735	16,715	17,695	18,674	19,654	20,634	21,613					
11	12,451	12,981	13,511	14,042	14,572	15,102	15,632	16,162	16,692			
12	10,529	11,076	11,624	12,171	12,719	13,266	13,814	14,361				
13A	7,296	7,601	7,907	8,212	8,518	8,823	9,129	9,434	9,739	10,045	10,350	
13	7,146	7,452	7,757	8,062	8,368	8,673	8,979	9,284	9,590			
14A	5,763	5,947	6,132	6,316	6,501	6,685	6,869	7,054	7,238			
14	5,187	5,371	5,556	5,740	5,924	6,109	6,293	6,478	6,662	6,846		

Source: Public Service Commission data emailed to PEFA AT on 4 March 2010.

160. The entities involved in managing GoT personnel and payroll information are:

- The **MoFNP**, which administers the government payroll using MicrOpay⁸ software. Since 2005 MoFNP has been processing salary payments to GoT permanent staff via electronic funds transfer from the General Salary Account⁹ direct to staff personal bank accounts, and staff are not allowed to receive their salary payments by any other method, such as cash or cheque. Salaries are paid every fortnight and alternating weeks are used for non salary payments. As already mentioned, casual ‘daily paid’ workers are paid by the MDAs in cash at the end of each day, using petty cash floats.
- The **Public Service Commission (PSC)**, which keeps personnel files for all public servants, and maintains the personnel database (in a Microsoft Access database). PSC assists MDAs with recruitment by sitting on all recruitment panels and considering MDA proposals for promotions, new appointments, demotions and dismissals.
- The **HR section of each MDA**, which maintains personnel files for the staff in their agency, and keeps track of staff leave and absences that would give rise to pay adjustments. The IT section of MoFNP has informed the PEFA AT that the HR section of most MDAs also has read-only access to MicrOpay and can view the payroll information for their specific agency.

161. Aside from MDA read-only access to MicrOpay, there are no electronic links between the personnel records held by MoFNP, PSC and MDAs.
162. Police and staff in the Tonga Defence Services are not classified as public servants. These MDAs have their own classification structure and manage their own promotions, appointments, demotions and dismissals. These MDAs also pay their staff using their own system. The PEFA AT was unable to interview these MDAs about their internal systems and processes. In 08-09, police expenditure represented 5.7% of total primary expenditure, while defence expenditure represented 5.2%.
163. According to MoFNP (and corroborated by PSC) the processes to make changes to the personnel database and payroll are as follows (consistent with the draft *Treasury Instructions*):
- Leave and most other routine issues resulting in temporary salary adjustments can be approved by HoDs of MDAs without seeking approval from an external party. In such cases, once the HoD has signed the approval letter, the HR section forwards it to the PSC, copying in MoFNP. If the letter is in the correct format and signed by the appropriate authority, PSC will make changes to the personnel database it maintains and notify MoFNP to make the necessary (temporary) adjustments in MicrOpay.
 - Non-routine issues, such as promotions, demotions and severances, which result in permanent salary adjustments, must be approved by the PSC. In such cases, the HoD of the MDA sends a recommendation letter to the PSC, which then makes a decision and updates its personnel database as appropriate. The PSC then sends a response letter to the HoD, copying in MoFNP. If PSC approval is granted in that letter, MoFNP makes the corresponding (permanent) adjustments in MicrOpay.

⁸ See <http://www.sagemicropay.com.au>. The IT section of MoFNP advised the PEFA AT that there would be considerable benefits in upgrading, as their version (from 1999) has some major limitations: (i) there are around 25 MDAs in the GoT but MicrOpay only allows 14 entities to be defined – so they have to combine MDAs into groups for the system; (ii) MicrOpay assumes bank account codes will only have nine digits (the Australian standard), but some account codes in Tonga have ten; (iii) reporting is not very friendly – it generates text files only, when spreadsheets would be more useful; and (iv) the system locks the database when someone is logged into it (doesn’t allow concurrent commits) and it doesn’t say who is holding the lock, so IT has to call around to find out and ask that person to log out. Consequently the IT team has had to develop a number of workarounds, including spreadsheets with VBA macros.

⁹ For more information on the GoT’s bank accounts, see commentary under PI-17.

164. MoFNP considers that the payroll data it maintains, and the personnel records and database maintained by PSC are generally complete and accurate. The most common problem that arises is when a HoD approves leave without pay or something similar, but fails to provide timely notification to MoFNP and PSC, so that the official continues to be paid after their leave has commenced. As one would expect, this is said to occur more frequently with the larger MDAs. In such cases, retroactive adjustments are made to reclaim the money by either deducting from future salary payments (most common approach) or, in a few cases, by requiring the official to pay the money back directly or in installments. This problem rarely occurs for non-routine issues as communication between PSC and MoFNP is generally very good.
165. Complete reconciliations between the payroll held by MoFNP and the personnel records held by PSC and the MDAs are supposed to occur monthly. However according to MoFNP staff, as at 23 February 2010 only two complete payroll-personnel reconciliations had taken place during the 09-10 financial year, i.e. in practice reconciliations were only being undertaken quarterly. Furthermore, the more recent reconciliations have usually uncovered discrepancies, most relating to the issue mentioned above – that is, officials being paid during temporary periods when they should not have been paid. MoFNP also attempts to address these issues by printing a copy of the MicrOpay payroll report every day and sending it to MDAs to check; they ask the HoD of each MDA to sign the report to certify it is correct and then send it back to them. Response rates to this initiative also appear to be low.
166. Although complete MoFNP-PSC-MDA reconciliations appear to be occurring only quarterly in practice, the PEFA AT was advised, by both MoFNP and PSC, that MoFNP-PSC reconciliations between the MicrOpay payroll and the personnel database generally do occur each month and all changes are supported by approval letters and documentation that result in a clear audit trail. Therefore the PEFA AT is of the opinion that although there may be some discrepancies in the payroll relating to temporary salary adjustments (approved by HoDs), discrepancies relating to permanent salary adjustments (must be approved by PSC) should be uncommon.
167. The above arrangement, where the payroll and personnel databases are maintained by two separate ministries, can result in problems with the timeliness of approvals and salary payments. The PEFA AT has heard that the government has very recently decided to try and address this by moving the payroll function out of MoFNP into PSC, with a planned start in the 2010-2011 financial year.
168. Finally, it should be noted that the Ministry of Education has some unique arrangements regarding their teachers. As in many other countries, teachers are “resumed” annually – that is, at the start of each new school year there is a short period during which the Ministry of Education must verify that each teacher is at their post before their salary payments can be processed. Until this process has completed – the PEFA AT is advised that it usually takes up to a month or so – teachers do not get paid.

Effectiveness of payroll controls

169. Key controls in the payroll system, as described above are:
- HoDs are accountable for, and must approve, all temporary pay adjustments for leave, overtime and other routine HR issues within their MDA. It is their responsibility to check that staff have accrued sufficient leave to take, etc., before they sign off.
 - PSC are accountable for, and must approve, all permanent pay adjustments for promotions, demotions, severances, etc. It is their responsibility to check that the recruitment, promotion, etc. was conducted in accordance with the PSC Policy Manual

and the Public Service Act, and calculate appropriate pay points, etc., before they sign off.

- MoFNP's payroll section acts as a final check before salaries are released, as only that section has the access privileges needed to make changes and authorise payments in MicrOpay. It is their responsibility to ensure that correct authorisation and supporting documents have been provided by the other two parties before they release funds.

170. In addition to the above, since MDAs do not have any financial delegations, and all personnel payments are made from the General Salary account, if any MDA happens to start generating abnormally high salary payments, this should become obvious to MoFNP, who can then ask for an explanation or demand that a complete payroll reconciliation is undertaken before further payments are released.
171. Another control, according to the Audit Report of Payroll Section, 2008, is that overtime needs to be approved by the Deputy Secretary of Finance. The process is that the work-plan and timesheets of MDAs must be submitted to MoFNP for approval. If overtime is not approved, it is returned the salary clerk of the respective MDA.
172. There are two caveats to make about controls. The first one is that the PEFA AT has not been able to review the systems and approaches for payroll controls in the Tonga Defence Services, which does not use MicrOpay but processes payments for its staff manually. The PEFA AT has been advised that the Tonga Defence Services sends its records through to MoFNP intermittently, but it is not clear exactly how often this takes place. The second caveat is that daily paid workers and contractual workers are not managed through MicrOpay but through systems kept by the particular MDA employing them. However the PEFA AT understands that the amounts involved for this second case are not significant as they are financed out of petty cash floats.
173. In answering the question about whether the above controls are effective, it is useful to consider payroll audit reports. Advice from Audit and MoFNP is that only one payroll audit was undertaken during the period 06-07 to 08-09, in July 2008. The PEFA AT has obtained a copy of this audit report. Its general conclusion was that, overall, there were 'satisfactory controls in all areas documented'. In the opinion of the PEFA AT, the other issues mentioned in the report do not raise any substantive or systemic concerns. For example,
- Previously (perhaps prior to mid 2008), the salaries, overtime and allowances for Legislative Assembly staff were all processed within MoFNP, but outside the Payroll Section.
 - "Sometimes" MDAs are late to notify MoFNP about study leave and leave without pay.
 - The report also noted weaknesses and gaps in the links between the SunSystem and MicrOpay, since deductions for benefits provided by the government to individuals (such as government housing) should also be reflected in the SunSystem but were not. These cases appear to be minor and isolated, more a result of missing paper work rather than systemic issues.
174. Both MoFNP and the PSC commented that Tonga has had no (or extremely limited) experiences with 'ghost workers'. In addition, a survey of IMF reports for the last three years found no mention of problems with ghost workers. However, the PEFA AT was unable to find any evidence that staff surveys or staff censuses were being conducted on a single day, which is the preferred method for identifying ghost workers.

175. Two of the dimensional ratings for this indicator have changed since 2007 (PI-18(iii) and PI-18(iv)), the other two have stayed the same. The movement in PI-18(iii) relates to improvements in payroll controls and audit trails since 2007; the movement in PI-18(iv) relates to the fact that no payroll audit had been undertaken at the time of the last PEFA whereas at the time of this PEFA one payroll audit had been undertaken in 2008.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-18)	D+	B+	M1
PI-18(i) Degree of integration and reconciliation between personnel records and payroll data.	B	B	Personnel data and payroll data are not directly linked but the payroll is supported by full documentation for all changes made to personnel records each month and checked against the previous month's payroll data.
PI-18(ii) Timeliness of changes to personnel records and the payroll.	B	B	Up to three months' delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally.
PI-18(iii) Internal controls of changes to personnel records and the payroll.	C	A	Authority to change records and payroll is restricted and results in an audit trail.
PI-18(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.	D	B	A payroll audit covering all central government entities has been conducted at least once in the last three years (whether in stages or as one single exercise).

PI-19. Competition, value for money and controls in procurement.

Procurement framework and approach

176. The processes for public procurement are not laid out in legislation or tabled regulations. The *Public Finance Management Act 2002* provides information about other upstream and downstream budget processes, but does not lay out processes or standards for public procurement.
177. There is, however, other internal guidance. The PEFA AT was provided with a seven page approved *Government Procurement Instructions*, approved 16 August 2005, which are replicated in the more recent (albeit draft) *Treasury Instructions 2010*. The Procurement Unit in MOFNP has prepared a more substantive procurement directive but this is yet to be approved as regulations. This draft contains substantial details about the key aspects of a public procurement process. This includes: planning procurements, assessing bidder eligibility, procedures for evaluating bids, announcing outcomes, dealing with complaints and appeals, and contracting.
178. The approach of the Procurement Unit is to scrutinise relevant bids using the *Government Procurement Instructions* guidelines, which lay out the threshold and method that particular procurements must follow. A summary of the thresholds and procurement methods required by these guidelines is provided in **Table 23**. The table also refers to the Bidding and Award Committee (BAC) and the Government Procurement Committee (GPC). The BAC is essentially a whole-of-government Tender Assessment Panel (TAP) responsible for evaluating high-value tenders. When the BAC is involved in a procurement process it is required to submit a written report on the process and outcome to the GPC for final review and endorsement.
179. The GPC is a high-level committee comprising a mix of ministers and heads of MDAs: (i) Minister of Works; (ii) Director of Works; (iii) Auditor-General¹⁰; (iv) Solicitor-General;

¹⁰ The PEFA AT notes that having the Audit Office represented on the GPC risks compromising the perceived independence of it, if it subsequently decides to undertake audits of any high-value procurement processes. As noted elsewhere in this report, the Audit Office is, in effect, a hybrid internal-external auditor and Tonga does not have a dedicated Supreme Audit Institution which could otherwise conduct audits on procurement.

(v) Commissioner of Revenue; (vi) Secretary of Finance (Accountant General); and (v) Relevant representatives of line ministries. Aside from approving the award of high-level contracts, the GPC has the power to permit tenders or quotes to not be sought when it is satisfied that either: (i) there is only one supplier (sole provider) capable of supplying goods, services or works; (ii) there is a standing annual contract established with the MDA; or (iii) a supplier has been nominated by an aid agency which is fully funding the procurement. Where the GPC has given approval not to seek tenders or written quotes, they must do so in writing. It is supported by the GPC Secretariat, which is comprised of staff from the Procurement Unit.

Table 23: GoT Procurement: Thresholds and default methods from the Government Procurement Instructions

Amount	Default procurement method	Who undertakes the procurement?	Reviewed by GPC?
THRESHOLDS ON PROCURMENT OF GOODS			
less than TOP \$500	Discretionary shopping receipt		
TOP \$500 - TOP \$2,000	At least two written quotes	MDAs; no review by GPC	No
TOP \$2,000 - TOP \$100,000	At least three written quotes		
More than TOP \$100,000	International Competitive Bidding	BAC, reviewed by GPC	Yes
THRESHOLDS ON PROCUREMENT OF SERVICES (EXCLUDING CONSULTANTS)			
less than TOP \$500	At least one written quote	MDAs	No
TOP \$500 - TOP \$50,000	At least three written quotes	Docs prepared by Ministry of Works, they then assist MDAs	No
TOP \$50,000 - TOP \$500,000	National Competitive Bidding		
Over TOP \$500,000	International Competitive Bidding	BAC	Yes
THRESHOLDS ON PROCUREMENT OF CONSULTANTS			
Up to TOP \$100,000	At least three written quotes	Docs prepared by Ministry of Works, they then assist MDAs	No
More than TOP \$100,000	International Competitive Bidding	BAC	Yes

180. Aside from thresholds and procurement methods, the *Government Procurement Instructions* also set out some basic minimum standards regarding the scope of advertisements (must be international, in newspapers and online) and remind MDAs that advertisements should be framed so as to encourage, not discourage, tenders. If MDAs would like to make a case for non-competitive bidding, the procurement guidelines ask MDAs to state and justify the procurement procedure followed and explain any issues or problems encountered. The guidelines only provide one example of where this is easily permissible, in the case of donor funds being used (either part or full), where the donors' own guidelines can be followed. However, in situations where the donor and GoT are providing funds for a particular project, in the event of inconsistencies it unclear whether the donor or government guidelines take precedence. Also, it is unclear what MDAs should do if the donors' procurement approach is weaker than the government's own approach.
181. For high-value procurement, there are two specific controls. Firstly the GPC can reject award of a contract if it believes the appropriate process was not followed. Secondly, MoFNP (as per the *Treasury Instructions*) will not pay invoices relating to high-value contracts, unless it has received a copy of the GPC approval relating to that contract.
182. According to the GPC Secretariat, the MDAs that conduct the most large-scale procurement are: (i) Ministry of Works; (ii) Ministry of Transport; (iii) Ministry of Health; and (iv) Ministry of Education. The GPC Secretariat also provided a summary of the types of large-scale contracts awarded during the 2008-09 and some summary information is provided in **Table 24**.

Table 24: Basic statistics about the large-scale contracts awarded during 2008-09

TYPE OF CONTRACT	No. awarded during 08-09
Tenancy agreement	1
Donor-funded consultants	2
Construction and renovation works	9
<i>of which</i> : funded by donors	4
<i>of which</i> : funded by government	5
Construction and upgrade of community water supplies, funded under the Japanese Government's Grassroot Project Scheme .	6
Miscellaneous services	3
Total contracts awarded over TOP \$100k threshold in 08-09	21
Total contracts awarded in 08-09	188
<i>total contracts over TOP \$100k as % of total contracts</i>	<i>11.2%</i>

Source: Note emailed to PEFA AT by GPC Secretariat on 5 March 2010

183. The number of large-scale contracts awarded during 2008-09 above the open tender threshold was relatively small - 21 or 11 per cent of total contracts awarded. These 21 contracts were worth a total of TOP\$5.3 million, which is equivalent to about two per cent of total annual GoT spending. The overwhelming majority of contracts by number at least (data on size not available) are therefore outside the purview of the GPC.
184. From the information provided on the 21 large scale contracts awarded during 2008-09, 19 were implemented according to the *Government Procurement Instructions*, one contract was actually a subsidy to a public enterprise (not a contract) and only one contract was not awarded in accordance with the instructions. Of these 21 contracts, however, only eight were wholly or partially funded by the GoT. The others were donor funded, in some cases using their own procurement methods (which were all open tender). Of these eight contracts, six procurements complied and two procurements did not comply with the GPC rules. The PEFA AT notes that the procurement for the *MV Princess Ashika*, a substantial GoT procurement during 2008-09, was not covered in this information.
185. The PEFA AT was not able to gather information on how MDAs comply with the rules governing contracts *below* the open tender thresholds, where different rules apply. The PEFA AT has attempted to check other sources that may discuss the general functioning of the procurement system:
- the Audit Office's 2006-07 Annual Report (most recent available) makes little comment on the procurement issues encountered by MDAs, or the extent of compliance. It identifies only one instance of procurement non-compliance – in the Civil Aviation unit of the Ministry of Transport, the process for “hiring of private vehicle (sic) for official use did not comply with *Treasury Instruction...*”
 - the private sector and civil society representatives did not make any substantive comments other than to suggest the team look at testimonies and proceedings coming out of the *Royal Commission into the Sinking of the MV Princess Ashika*, a high-profile enquiry underway in Tonga while the PEFA AT was conducting its mission (see **Box 25**).

Box 25. Inquiry into the sinking of the MV Princess Ashika

Shortly before midnight on 5 August 2009, Tongan maritime authorities received a mayday call from the *MV Princess Ashika*. The *Princess Ashika* was on-route from Nuku'alofa to Ha'afeva when it began to spring a number of leaks. Within five minutes of the mayday call a distress beacon was activated and the ship sunk soon thereafter. Official figures released by the Tongan Government two weeks later confirmed that, of the 128 passengers and crew, only 54 people had been rescued. Tragically, the rest were lost at sea.

Soon after the sinking, pursuant to the *Royal Commission Act (as amended)*, a Royal Commission was established to inquire into the matter. Hearings commenced in October 2009. The inquiry learned that the *MV Princess Ashika* was built in Japan in 1972. From 1985 to mid 2009, it was owned by the Patterson Brothers Shipping Company Ltd. and operated as an inter-island ferry in Fiji. In mid 2009 it was purchased by the GoT and was intended as a temporary service to replace the ageing inter-island ferry, the *MV Olovaha*, until a new ferry was completed in 2011.

As the inquiry progressed, testimonies added to an increasing body of evidence suggesting systemic failures within the GoT in general and within the Shipping Corporation of Polynesia Ltd. – the public enterprise recommending the purchase – in particular. Amongst other things, the inquiry heard Mr. John Jonesse, Managing Director of the Shipping Corporation of Polynesia Ltd had inspected the *Ashika* prior to its purchase, concluded that it was “in good condition” and had been “well maintained”, and had advised the members of the board to this effect (*day 5 of the hearings*). This was in contrast to the opinion of an independent marine engineer (Mr. Mosese Fakatou), who conducted an insurance survey of the ship for British Marine on 4-5 August 2009 and concluded that the ship was unseaworthy (*day 1*). Other employees of the Shipping Corporation (Mr. Manase Katoa and Mr. Sateki Tupou) also inspected the ship in early July and were “surprised about the amount of corrosion visible on the boat” and the holes in the cargo deck. They noted that “there were certain places on both sides of the boat that one could poke a pen through... [in some places the corrosion was so advanced that] it had fallen off and it was only the paint that was covering the hole”. Furthermore, “... about 95 per cent of the floor was corroded.” (*days 3 & 4*).



The Princess Ashika

On 18 November 2009 (*day 16*), the GPC Secretariat told the Commission that it first heard about the purchase on 11 May 2009, after: (i) a Cabinet decision had been made to purchase the vessel (on 23 April 2009); (ii) the contract for purchase had been signed; and (iii) the deposit for the vessel paid. Despite this, the GPC was asked to retrospectively approve the procurement process followed. It refused to do so. The GPC Secretariat agreed with the Commission's suggestion that “in this particular case... the process was completely... back-to-front”.

The final report of the Commission was handed down on 31 March 2010, making a range of observations and recommendations regarding procurement, government policy processes and maritime safety. At this stage, the government has not formally responded.

Procurement complaints and appeals mechanism

186. The GoT does not publicly release information on the details of contract awards. However, under the *Government Procurement Instructions*, bidders must at least be formally informed of the outcomes of any contracts that they have bid for.
187. Complaints can be made to the GPC and these are received, but there is no publicised formal appeals process in legislation or approved guidelines (the draft guidelines contain proposed details of these processes). The GPC Secretariat advised the PEFA AT that, since the *Procurement Guidelines* have been in place, only one complaint had been received which (in their view) had been dealt with in a timely manner. Notwithstanding that there has only been one complaint, no statistics are published on the timeliness of complaints process - for example, the average number of days from complaint lodgement to closure, the number of complaints received, etc. It is therefore difficult to evaluate how efficient and effective the process is.
188. According to the GPC Secretariat, unsuccessful applicants usually go back to the GPC to seek reasons why they were not successful. If still unsatisfied with the explanation, their other options are to take it up with the Minister or elsewhere in the Government. Government and civil society representatives indicate that since Tonga is a small country, domestic tenderers would likely judge that they are better off 'not complaining' to avoid missing out on other contracts for reputational reasons. It seems less probable that unsuccessful international tenderers would adopt this same approach.
189. Presumably unsuccessful tenderers could also take the Government to court if they felt that the process has not been followed, but this is probably a prohibitively expensive exercise for most companies, with highly uncertain outcomes. In some clarifications issued in September 2008, the PEFA Secretariat advised that it considers that general law courts do not constitute an accessible administrative appeals process.
190. PI-19(i) is rated as B, since available information on the award of contracts is not complete. PI-19(ii) remains C, as justification for less competitive methods were missing from some contracts in the information provided. PI-19(iii) has been downgraded to D, as the procurement complaints process is not formally and publicly defined in approved guidelines.

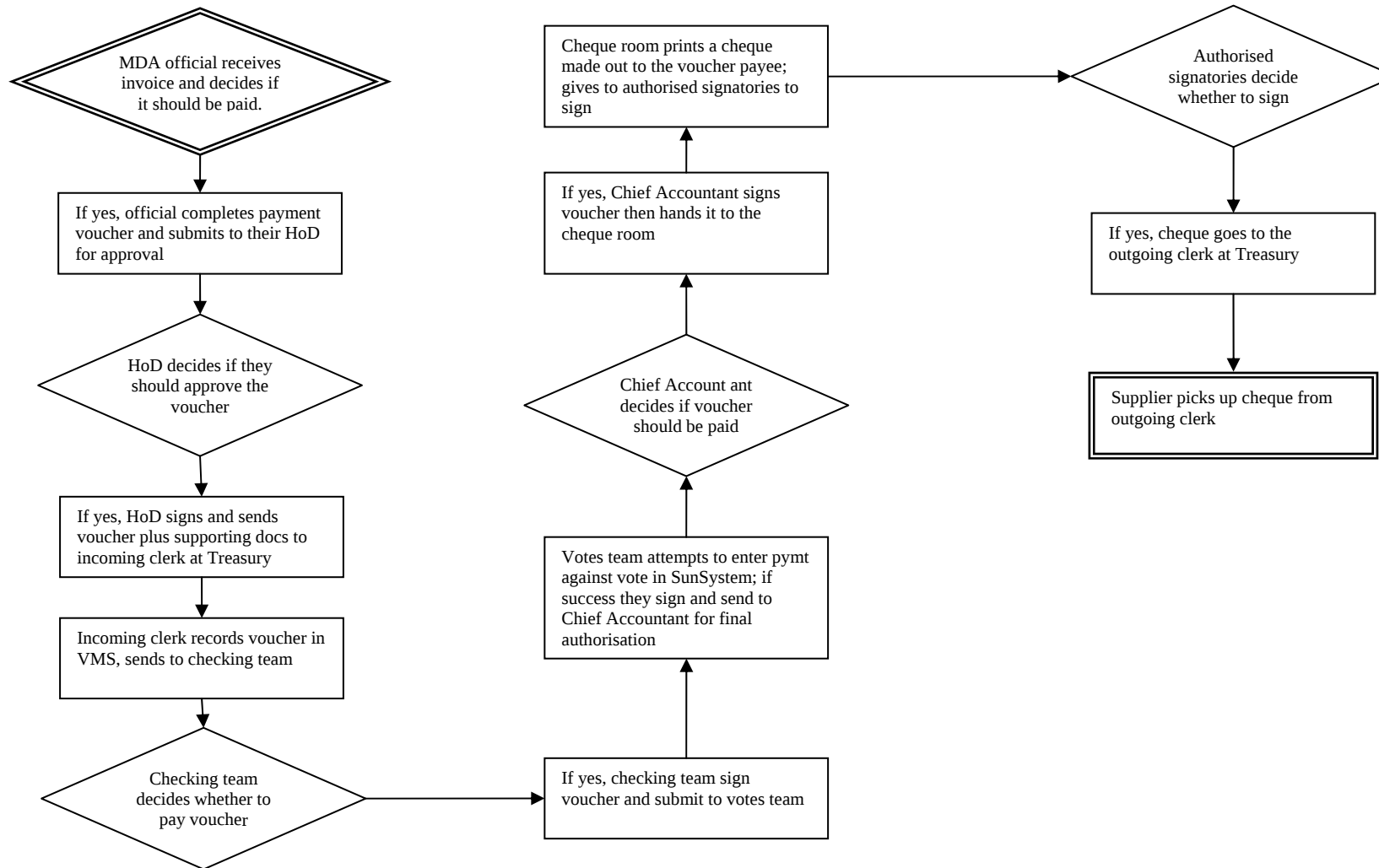
Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-19)	B	C	M2
PI-19(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases.	A	B	Available data on public contract awards shows that more than 50% but less than 75% of contracts above the threshold are awarded on basis of open competition, but the data may not be accurate.
PI-19(ii) Justification for use of less competitive methods.	C	C	Justification for use of less competitive methods is weak or missing.
PI-19(iii) Existence and operation of a procurement complaints mechanism.	C	D	No process is defined to enable submitting and addressing complaints regarding the implementation of the procurement process.

PI-20. Effectiveness of internal controls for non-salary expenditure.

Process for non-salary payments

191. Basic expenditure commitment controls are outlined in the *Public Finance Management Act 2002* and its supporting regulations, the *Public Finance Administration (Public Funds) Regulations 1984*. More detailed descriptions of controls and processes are provided in MoFNP's draft *Treasury Instructions 2010* which will have legal force once approved.

Figure 26. Summary of the process followed for payment of non-salary expenditure



192. According to MoFNP staff, non-salary expenditure is managed through a manual voucher system. A summary of the process is presented in **Figure 26**. A more detailed description follows:

- **Completion of payment voucher by MDA official and submission to HoD.** When a supplier has satisfactorily delivered a good or service or met a contractual milestone, an official in the relevant MDA completes a payment voucher and submits it to the MDA HoD for approval. The voucher template (as reviewed by the PEFA AT) has fields for: (i) the MDA's number and division; (ii) the SunSystem accounting code to which the payment should be charged; (iii) a brief description of the goods or services provided; (iv) the name of the payee; and (v) the amount to be paid. In addition, the voucher should attach supporting documentation, which varies depending on the nature of the payment, but would usually include: (i) the original invoice; (ii) sufficient evidence to demonstrate that the payee has a valid business licence (where the payee is a company); (iii) a procurement certificate to demonstrate that the GPC approved the procurement method used to award the payee's contract (for large-scale contracts); and (iv) a copy of the contract, so MoFNP can confirm the particulars of the contract match the services described in the invoice. If original invoices are not available or applicable, vouchers for payment need to contain full particulars of each service provided, the name of the supplier, the invoice number to which they relate, payment terms, the dates they were provided and so on. MoFNP staff advised the PEFA AT that in practice, MoFNP staff were unwilling to process claims without the original invoice and that, if there is no invoice, the Finance Secretary would need to personally approve the payment before it could proceed.
- Once the HoD has signed the voucher, it is entered into the MDA's vote ledger then delivered to the clerk at the incoming voucher booth of the Treasury Office, together with all supporting documentation. The incoming clerk registers all vouchers received in the Voucher Management System (VMS) and then gives it to the checking team. After the checking team is satisfied that the voucher and its supporting documentation are all in order, they stamp the voucher and sign it, then submit it to the voting section.
- **The voting section attempts to enter the payment into the SunSystem against the account code specified on the voucher.** If payment of the amount would cause a breach of the total appropriation recorded against that account code, SunSystem rejects the entry, the voucher is voided (both on the hardcopy and in the VMS) and the MDA is asked to resubmit a new voucher with a valid account code¹¹. If SunSystem does not reject the payment, the vote section also signs the voucher then submits it to the Chief Accountant for final authorisation.
- **If the Chief Accountant is satisfied, they also sign the voucher.** After the Chief Accountant has signed the voucher, final approval is recorded against the voucher's ID in VMS and it is sent to the cheque room. The voucher and supporting documentation, including the three signatures from treasury staff, are filed in the cheque room¹² and a non-negotiable cheque made out to the payee shown on the voucher is printed.

¹¹ It is the responsibility of MDA officers to check their vote register and ensure that there is a sufficient appropriation available to make payments. In order to meet this responsibility, it is essential that they keep their vote ledger up-to-date. Accounting officers at MDAs are also required to undertake monthly reconciliations of their vote ledgers with the records held at MoFNP to minimise discrepancies. Over the coming year the IT section of MoFNP has plans to connect four agencies to the SunSystem, PMO, Defence, Statistics Department and Public Enterprises: this may also help the reconciliation process.

¹² There is an exception to this rule. If payments are to an individual and are less than TOP \$1,000, the individual can choose to collect the money in cash from the Treasury cashier rather than a cheque.

- **Once the cheque is printed it needs to be signed by two authorised signatories.** Any two of the following five people can sign cheques on behalf of the GoT: (i) the Secretary of Finance; (ii) the Deputy Secretary of Finance; and (iii) the three Chief Accountants.
- **After the cheque is signed it is handed back to the clerk at the outgoing cheque booth of the Treasury Office.** The outgoing clerk keeps the cheque there until it is collected by the supplier. When the cheque is collected, the outgoing clerk records the date and time it was picked up in their register, which shows which of the printed cheques have been collected and which have not. This register allows MoFNP to ensure the actual daily balance is identified and underpins an accurate (cash) reconciliation of the accounts. It also assists MoFNP in ensuring that sufficient cash is available in the accounts to honour outstanding cheques.

193. According to MoFNP, on average they take around 2 days to process a correctly rendered voucher with all supporting documentation and print the corresponding cheque. Other entities consulted by the PEFA AT (private sector and donors) were of the view that it usually took longer than this.
194. The PEFA AT is of the opinion that the processes and controls described above are widely understood, in no small part because Tonga is a small country and payment functions are highly centralised.

Comprehensiveness and effectiveness of non-salary expenditure controls

195. The key controls in the non-salary expenditure system are therefore:
- the MDA official's assessment as to whether the invoice should be paid;
 - the MDA HoD's decision to approve the payment voucher;
 - the Treasury checking team's assessment as to whether the voucher and supporting documentation are complete and in order;
 - the Treasury vote team's attempt to enter the proposed payment against the nominated vote in the SunSystem (this is an automated expenditure commitment control, because the system will not allow any payments that would cause a breach of appropriation);
 - the Chief Accountant's decision to authorise the payment; and, finally,
 - the willingness of two of the possible five authorised signatories to sign the printed cheque.
196. It can be seen that the controls in the above system are comprehensive and satisfy the criteria for effective internal controls set out in the *INTOSAI Guidelines for Internal Control Standards for the Public Sector*, which include: (i) *authorisation and approval procedures*: only valid transactions and events are initiated as intended by management; (ii) *segregation of responsibilities*: no single individual or team controls all stages of the voucher process; (iii) *pre and post-verification*: vouchers must be in the correct form and accompanied by supporting documentation and, when cheques are printed, a register is kept to ensure the supplier receives their cheque; and (iv) *controls over use of IT*: only the vote team can enter proposed payments into the SunSystem. In terms of coverage, the PEFA AT was advised by MoFNP that this system covers all expenditure of government MDAs.
197. Although the controls may seem excessive, the PEFA AT is of the opinion that they are not. The fact that Tonga is a small place is relevant, since staff inevitably all know each other and

are in some cases related, having a greater number of, or more senior staff sign off on various elements of the controls is probably an astute approach.

198. In terms of effectiveness, MoFNP advised the PEFA AT that, although the expenditure controls are generally followed, there are occasionally some issues and about 10 percent of all vouchers received are rejected. The most common reason for rejection these days is because there are insufficient funds available in the vote account nominated on the voucher. This is usually a case of the MDA making an error rather than MoFNP trying to ration payments for cash management reasons. Previously rejections were largely due to vouchers missing procurement approval certificates from GPC, but this does not occur as often anymore. Other rejections are due to the supplier not having a business licence (this is more of a problem in January and February, since licences are renewed annually at the end of a calendar year), or other problems with the paperwork. None of these reasons are indications of problems in the voucher system; rather they indicate that the system is functioning effectively.
199. Aside from voucher rejections, sometimes valid payments are also deliberately delayed by MoFNP as a non-transparent mechanism to manage cash flows. The Tongan Chamber of Commerce has advised the PEFA AT that some small businesses refused to accept government cheques because of this and insisted in being paid in cash or being provided credit.
200. The PEFA AT has not seen any evidence suggesting the controls are not generally respected. The Audit Office's Annual Report 2006-07 did not point to any substantive problems and the MoFNP considers that compliance with the rules is fairly high. They note, however, that payments associated with contracts over the procurement 'open competition' threshold tend to have lower compliance than other, smaller payments.
201. However, there is some evidence that the controls are occasionally overridden at a high-level. For example, in relation to the *Princess Ashika* enquiry, the GPC Secretariat testified to the Royal Commission that the relevant documents for purchase of that ship were only submitted to the Secretariat after the contract had already been signed and the deposit paid (see **Box 25**). In theory the MoFNP should not have paid the deposit until it had received, as part of the supporting documents, evidence that GPC had approved the procurement process followed, which in this case was not possible. Hence, in this case, MoFNP overrode one of its own key controls and authorised payment when full supporting documents had not been provided. It appears the reason why this occurred was because there had already been a high-level Cabinet decision (evidenced by Cabinet Memorandum No. 300, dated 23 April 2009) that the purchase should take place.

Use of emergency procedures

202. Under the *Public Finances Management Act 2002*, where a state of emergency has been declared, the Minister of Finance may issue Interim Emergency Instructions, which may add to or replace some instructions in any current Treasury Instructions. However the PEFA AT is unaware of any time when this clause has been invoked.
203. The use of unjustified simplified or emergency procedures, on the basis of discussions with the MoFNP, occurs infrequently. When asked what they would do in an emergency where the standard voucher process could not be followed, MoFNP staff said that they would either prepare a Note for File recording that payment had been made on request of the Minister (if the Minister initiated it) or, where they felt that a request to expedite a payment and cut corners was unjustified, they would seek advice from their superior officer about what to do.
204. All of the dimensional ratings associated with this indicator have improved since 2007.

Indicator	Score		Meaning of 2010 Score
	(2007)	(2010)	
OVERALL RATING (PI-20)	C+	B+	M1
PI-20(i) Effectiveness of expenditure commitment controls.	B	A	Comprehensive expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations (as revised).
PI-20(ii) Comprehensiveness, relevance and understanding of other internal control rules/procedures.	C	A	Other internal control rules and procedures are relevant, and incorporate a comprehensive and generally cost effective set of controls, which are widely understood.
PI-20(iii) Degree of compliance with rules for processing and recording transactions.	C	B	Compliance with rules is fairly high, but simplified/emergency procedures are used occasionally without adequate justification.

PI-21. Effectiveness of internal audit.

205. The Audit Office (AO) is responsible for all internal audit activities in the GoT¹³. It is in a unique position in that it also acts as the GoT's (external) Supreme Audit Institution since the *Public Audit Act 2007* was introduced. Until then, it was not clear how it could undertake the latter function given that it was reporting to the Prime Minister and hence not independent of the Executive. The AO is now required to report to the Speaker of the Legislative Assembly instead.
206. The AO carries out financial audits, compliance audits and special investigations audits on a routine basis. It has recently completed its first performance audit and is currently building up its capacity to allow it to conduct more of these types of audits in the future. The AO is very much transactions-oriented and does not generally take a systems approach to audits. However, some recommendations on systemic issues that have come to the attention of the auditors are made, including in the management letters. Based on a review of the AO's *2006-07 Annual Report*, the PEFA AT estimates that systemic issues account for less than 20 per cent of audit activities. That said, the AO has conducted some Special Investigation audits, where the effectiveness of procedures and controls applied were investigated and systems strengthening recommendations made.
207. Internal audit reports are issued to MDAs along with management letters, but none of these documents are ever published in full. Reports are usually provided to MoFNP. The *Annual Report* is the only publicly available information on audits. This report summarises the key audit findings for the year in about half a page for each agency. Of the MDAs visited during that year, 95 of the government's 326 audit units were sent management letters, 13 audit opinions were issued, 2 special investigation reports were issued and there was one further report. The *Annual Report* does not contain much detail about the transgressions, systemic problems or the responses of managers.
208. AO audits cover about 90 per cent of the GoT's total expenditure. The AO *Annual Report* notes that most of the MDAs in Tongatapu were covered during that year. Other entities were audited as their financial statements were received. The AO considers that they visit all MDAs at least once every two years and reports are issued regularly on each MDA.
209. Because neither audit reports nor management responses are published, it is difficult to determine whether managers are actually addressing audit recommendations. The *Annual Report* does not state what actions MDAs have taken against prior recommendations, however it does provide a summary of management responses – in relation to the 95 management letters issued by the AO in 2006-07, one MDA agreed to take action verbally, 21 agreed to take action in writing and 11 did not make any response at all. The AO considers that the MDA responses

¹³ However, this is expected to change over the coming months as a new internal audit office has just been established in the MoFNP. It appears that the MoFNP internal audit office will eventually become the GOT's internal auditor, while the Audit Office will become the external SAI.

to management letters were generally not detailed or substantively address concerns. As far as the improvement in rating for PI-21 (ii) is concerned, the PEFA AT notes that audit reports are provided to MDAs, the SAI and sometimes to MoFNP. The 2007 PFM-PR does not present any evidence for the lower rating.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-21)	D	D+	M1
PI-21(i) Coverage and quality of the internal audit function.	D	D	There is little or no internal audit focused on systems monitoring.
PI-21(ii) Frequency and distribution of reports.	D	C	Reports are issued regularly for most government entities, but may not be submitted to the ministry of finance and the SAI.
PI-21(iii) Extent of management response to internal audit findings.	D	D	Internal audit recommendations are usually ignored (with few exceptions).

3.5. Accounting, recording and reporting

PI-22. Timeliness and regularity of accounts reconciliation.

210. See PI-17 for a detailed description of the different GoT accounts.
211. The Audit Office during 2006-07 had a positive impression of the quality of MoFNP's cash reconciliation and cash management activities. Its *Annual Report* "... commended Treasury for its effort to update the bank reconciliation procedures of government bank accounts. This is a vital control to ensure the government cash position is determined accurately on a regular basis and that decision making is based on a more accurate data (sic)."
212. Within MoFNP, bank reconciliation takes place at aggregate and detailed levels and MoFNP considers that there should be no discrepancies between Treasury records and bank account balances, because of the daily reconciliation of the accounts, and the monthly reconciliation of the vote book for MDAs.
213. Currently there is no process documented for clearing and reconciling of suspense accounts, however the MoFNP advises and the Audit Office considers that suspense accounts are usually cleared by the end of the financial year although sometimes this occurs within two months of the end of the financial year.
214. Advances are permitted for the purpose of travel, but these must first be approved by the Finance Minister. Other advances (and loans) to public servants are not permitted according to the draft Treasury Instructions, although MoFNP officials informed the PEFA AT that they could be approved at the Cabinet level through the Finance Minister.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-22)	D	B	M2
PI-22(i) Regularity of bank reconciliations.	D	A	Bank reconciliation for all central government bank accounts take place at least monthly at aggregate and detailed levels, usually within 4 weeks of end of period.
PI-22(ii) Regularity of reconciliation and clearance of suspense accounts and advances.	D	C	Reconciliation and clearance of suspense accounts and advances take place annually in general, within two months of end of year, but a significant number of accounts have uncleared balances brought forward.

PI-23. Availability of resources received by service delivery units.

215. Tonga does not have sub-national governments, and the Ministries of Education and Health do keep, for their own internal purposes records of the cash transfers received through their budget allocations by schools and health centres. They use this for internal reporting purposes, but the information is not published anywhere in the budgets or other documents.
216. Their reports do not necessarily include all in-kind resources received. For example, the education data does include the grants provided by NZAID (since these go through government systems) but probably does not include other donor assistance. It is not clear how (or if) the data is aggregated for internal use by management, or the extent to which the data informs strategic decision making and corporate planning.
217. The PEFA AT is not aware of any Public Expenditure Tracking Surveys that have been conducted in Tonga.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-23)	D	D	M1
PI-23(i) Collection and processing of information to demonstrate the resources that were actually received (in cash and kind) by the most common front-line service delivery units (focus on primary schools and primary health clinics) in relation to the overall resources made available to the sector(s), irrespective of which level of government is responsible for the operation and funding of those units.	D	D	No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last 3 years.

PI-24. Quality and timeliness of in-year budget reports.

218. In-year budget reports are prepared by MoFNP (and audited by the AO), but they are simple operating statements only, presenting actual cash revenue and expenditure for the quarter on the same economic basis as the annual financial statements. They do not compare the actual expenditures with approved budgets or discuss variances, and there is no information or accrual-based data on expenditure commitments.
219. The MoFNP informed the PEFA AT that these reports are all prepared within four weeks of the end of the corresponding quarter. There is no reason to doubt the quality of the data, especially since the reports are audited.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-24)	C+	C+	M1
PI-24(i) Scope of reports in terms of coverage and compatibility with budget estimates	A	C	Comparison to budget is possible only for main administrative headings. Expenditure is captured either at commitment or at payment stage (not both).
PI-24(ii) Timeliness of the issue of reports	A	A	Reports are prepared quarterly or more frequently, and issued within 4 weeks of end of period.
PI-24(iii) Quality of information	C	A	There are no material concerns regarding data accuracy.

PI-25. Quality and timeliness of annual financial statements.

220. A financial statement covering all of government is prepared annually. In each of the years 2006-07, 2007-08 and 2008-09, a qualified audit opinion has been provided. This is primarily because in the balance sheet, receivables and payables are not disclosed and the amount disclosed for physical assets is an estimated value only. Discussions with MoFNP indicate that it has experienced ongoing difficulties in collecting accurate physical asset valuations from

MDAs. Furthermore, GoT Financial Statements exclude loan fund disbursements (note viii) where they are paid directly to third parties. The PEFA AT considers that these amounts are not significant.

221. Under section 35 of the *Public Finance Management Act 2002*, the annual financial statements are required to be submitted for audit within no more than six months after the end of the corresponding financial year. In practice this requirement has not been complied with. The 2006-07 and 2007-08 financial statements were authorised by the Minister for Finance and submitted to the external auditor as shown in the table below (as per Note 19/20 to each). At 5 March 2010 the 2008-09 statements have still not been submitted to the Auditor-General.

FY	End of FY	Date audit report submitted to auditor	Months after end of FY
06-07	30-Jun-2007	11-Sep-2009	27
07-08	30-Jun-2008	14-Oct-2009	16
08-09	30-Jun-2009		9

222. As can be seen in the table, these dates equate to 27 months after the end of the corresponding FY, 16 months and at least 9 months respectively.
223. The *Public Finance Management Act 2002* does not set a requirement as to the specific accounting standards that the financial statements should be prepared in accordance with. Section 38 simply states that “Financial reports, financial statements, associated information and accounting procedures required by this Act shall be in accordance with generally accepted accounting practice.” In practice, as mentioned in Note 1(i) to the statements, GoT attempts to prepare them in accordance with the cash basis form of the International Public Sector Accounting Standards (IPSAS).
224. The AT, however, notes that the statements do not fully comply with these standards – in particular, Section 1.3.24 of the IPSAS standard requires disclosure of third party direct purchases of goods and services for the benefit of the GoT. To satisfy 1.3.24, these should be disclosed in separate columns on the face of the statement of cash receipts and payments. This requirement is not complied with when the proceeds of loans are used by the lender to purchase goods and services.
225. The 2006-07, 2007-08 and 2008-09 financial statements maintained a consistent format.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-25)	D+	D+	M1
PI-25(i) Completeness of the financial statements	C	C	A consolidated government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete, but the omissions are not significant.
PI-25(ii) Timeliness of submission of the financial statements	D	D	If annual statements are prepared, they are generally not submitted for external audit within 15 months of the end of the fiscal year.
PI-25(iii) Accounting standards used	C	C	Statements are presented in consistent format over time with some disclosure of accounting standards.

3.6. External scrutiny and audit

PI-26. Scope, nature and follow-up of external audit.

226. External audit is regulated by the *Public Audit Act 2007*, which became effective in February 2008. Before this time, there was effectively no external auditor in Tonga. This discussion

reflects activities occurring after that period. The Auditor-General currently reports to the Speaker of the Legislative Assembly. Previously, this position reported to the Prime Minister and hence the Audit Office was effectively part of the Executive. The Auditor-General has powers to access information and records in MDAs and in Statutory Bodies.

227. Public enterprises are required to seek approval from the Auditor-General before contracting a private firm to undertake their audits or may request the Auditor-General to audit them on a fee for service basis. According to the Audit Office, about seven public enterprises and statutory bodies were using them as their auditor. The other nine were using private firms: Tonga Broadcasting Corporation, the Tonga Water Board; Tonga Print Ltd, Tonga Post Ltd, Tonga Markets Ltd, Tonga Waste Authority and Tongatapu Machinery Pool Ltd.
228. Most audits the Audit Office conducted of public enterprises and statutory bodies resulted in an unqualified opinion. Currently the Audit Office is undertaking one performance audit (on solid waste management). This type of audit is new for the department but it is building its capacity in this regard and hopes to commence undertaking more performance audits soon. At the moment, it only has three to four staff with the requisite skills to undertake performance audits.
229. The Audit Office typically manages to cover all MDAs within the space of two years. Although the Audit Office advised the PEFA AT that its focus was on systems rather than transactions, a review of their latest available *Annual Report*, for 2006-07 suggests the opposite. This report presents a consolidated overview of the findings of all the audit activities it conducted during the year. However, it may be that the detailed audits that are not made public in any way provide deeper insights into systemic issues of concern. In absence of publicly available evidence, the AT has to rely on the published *Annual Report*.
230. Section 35(4) of the *Public Finance Management Act 2002* requires that the Auditor-General return its report on the annual financial statements to the Minister for Finance no later than eight months after the end of the corresponding financial year. In practice, it has been impossible for the Audit Office to meet this requirement given how late after the financial year it has received the financial statements (refer indicator 25(ii)). However in 2006-07 and 2007-08, the Audit Office did succeed in submitting its report within four months of receipt of the statements.
231. There is also a long lag in the Audit Office submitting and having its *Annual Reports* tabled. For example, as at 5 March 2010 the Audit Office had not yet completed its 2007-08 annual report. Based on advice from the Audit Office, the audit recommendations it presents to auditees are rarely addressed by management. Although auditees generally do send a formal and timely response to the audit findings, this response is usually not thorough and there is little evidence of any effective follow-up.
232. See also PI-21 for further information on audit activities.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-26)	D+	D+	M1
PI-26(i) Scope/nature of audit performed (incl. adherence to auditing standards).	C	C	Central government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only.
PI-26(ii) Timeliness of submission of audit reports to legislature.	D	D	Audit reports are submitted to the legislature more than 12 months from the end of the period covered (for audit of financial statements from their receipt by the auditors).
PI-26(iii) Evidence of follow up on audit recommendations.	D	C	A formal response is made, though delayed or not very thorough, but there is little evidence of any follow up.

PI-27. Legislative scrutiny of the annual budget law.

233. Indicator PI-11 should also be referred to for this indicator. The budget documents described in PI-6 and detailed budget estimates are typically presented to the Legislative Assembly by early June for scrutiny. This allows for less than one month of scrutiny and debate. As the detailed budget proposals are finalised by that time, the Legislative Assembly would have little time in practice to make substantive changes to the proposed budget. In turn, Cabinet would not have sufficient time to meaningfully revise the detailed proposals for legislative approval before the start of the financial year. The AT could not find any documented procedures for legislative review of the budgetary documentation.
234. As mentioned in PI-27(i), the Legislative Assembly is involved for the first time in each budget preparation when it receives the budget estimates in late May or early June, and is therefore permitted around one month to scrutinise these. The PFM Act requires the Finance Minister to present the budget to the Legislative Assembly, however given the timeframe, and an absence of any process for review, the PEFA AT is of the view that this does not constitute an active process for legislative review.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-27)	C+	D+	M1
PI-27(i) Scope of the legislature's scrutiny.	C	C	The legislature's review covers details of expenditure and revenue, but only at a stage where detailed proposals have been finalized.
PI-27(ii) Extent to which the legislature's procedures are well-established and respected.	B	D	Procedures for the legislature's review are non-existent or not respected.
PI-27(iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined).	B	C	The legislature has at least one month to review the budget proposals.
PI-27(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.	B	B	Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations.

PI-28. Legislative scrutiny of external audit reports.

235. Advice from the Audit Office is that the Legislative Assembly usually takes more than 12 months to complete its scrutiny of external audit reports, which are submitted in a consolidated Annual Report. For example, the Audit Office submitted its 2007-08 *Annual Report* to the Speaker of the Legislative Assembly around March 2009. As at 5 March 2010, it has still not been tabled. Delays are attributed to the perception that the Legislative Assembly has different priorities for its sitting period. The Assembly also only sits for about six months, generally June to mid-November.
236. The Audit Office further advised that *Annual Reports* usually provoke no action or debate within the Legislative Assembly about the audit findings. Generally, there is no requirement that Ministers respond to audit reports and in practice they do not respond to the findings, leaving this to their CEOs. No in-depth hearings are conducted by the Legislative Assembly regarding audit findings and audit findings do not appear to generate discussion or debate in the local media or among civil society.
237. Advice from the Audit Office is that the *Audit Act 2007* does not require actions to be taken in relation to any specific recommendations issued by a legislative review of the audit reports. It further advised that such recommendations have not been issued by the Legislative Assembly.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (PI-28)	D	D	M1
PI-28(i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years).	D	D	Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete.
PI-28(ii) Extent of hearings on key findings undertaken by the legislature.	D	D	No in-depth hearings are conducted by the legislature.
PI-28(iii) Issuance of recommended actions by the legislature and implementation by the executive.	D	D	No recommendations are being issued by the legislature.

3.7. Donor practices

D-1. Predictability of Direct Budget Support.

238. According to the Project & Aid Management Division within MoFNP, and as verified in discussions with donors (AusAID, NZAID, EC and JICA), the resident bilateral donors in Tonga are AusAID, NZAID, Japan (JICA) and China. Until recently, donors were not providing direct budget support to the GoT. In December 2009, ADB approved a project that will provide budget support to the GoT. The grant is comprised of two US \$5m tranches that depend upon the GoT satisfactorily meeting a number of triggers. The first tranche is scheduled for disbursement in late 2009-10 and the second in 2010-11. The GoT announced that China will be providing grant aid in-kind during the 2010 calendar year.
239. The World Bank and EC are also considering providing direct budget support and a World Bank mission was visiting Tonga during the time of this PEFA assessment to assess its feasibility. NZAID advised that it runs an education sector support program (around NZD \$2.2m a year) which is on-budget with funds going through the GoT treasury. The program disburses funds to the GoT, which then pays contractors and schools. This program does not constitute budget support as the funds are tied to the particular project.
240. Given that no direct budget support was being provided to the GoT during the three financial years under review by this PEFA (2006-07, 2007-08 and 2008-09), this indicator receives a rating of N/A.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (D-1)	N/A	N/A	M1
D-1(i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature (or equivalent approving body).	N/A	N/A	Not applicable.
D-1(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates)	N/A	N/A	Not applicable.

D-2. Financial information provided by donors for budgeting and reporting on project and program aid.

241. According to the Project & Aid Management Division within MoFNP, data is available on estimated and actual receipts from donors in-cash (all of which must go via the Development Fund and is reported in Note 4 to the annual financial statements). However there is generally not data on in-kind assistance from donors, or if there is information it is incomplete. This situation is disclosed in Note 1(iii) to the financial statements ("Payments by external third parties"). MoFNP estimates that overall, around 40% of donor assistance is provided as cash and 60% provided in-kind.

242. MoFNP further advised that in the lead-up to each budget, MoFNP attempts to collect information on anticipated in-kind and in-cash donor assistance by sending two forms to donors. One asks for estimates of the magnitude of accountable cash grants that will be disbursed through the Treasury system. The second form seeks information on in-kind assistance. The estimates provided in Notes 4 & 5 to the financial statements are based on feedback received via the first form. MoFNP observed that most donors do not respond to this request and many do not provide estimates in time to be incorporated into the budget. In the view of MoFNP, ADB provides the best quality and most detailed estimates. In addition, none of the donors provide estimates using the GoT's expenditure classification system, though MoFNP does not ask them to do this.
243. Some donors provide assistance to regional programs but do not advise GoT of the proportion that will benefit Tonga. For example, ADB has about 20 many Pacific regional programs with funding of \$US48 million, but none are disaggregated by country. MoFNP would like to receive more information on regional programs in particular.
244. AusAID, NZAID, EC and JICA confirmed that they generally do not send MoFNP estimates of the assistance they intend to provide prior to each financial year. Some donors mentioned that differences in timing of financial years and the nature of accounting systems (GoT uses a cash system, but some donors use accrual accounting) made this difficult. All donors, however, were unanimous in their view that the Project & Aid Management Division, which was only established a few years ago, has greatly improved donor coordination and they welcomed its proactive approach to seeking donor information.
245. **Table 27** provides some data regarding predictability of donor support. It is based on Note 4 to the draft *2008-09 Financial Statements*. It shows the benefits GoT was estimating it would receive from each donor during 2008-09 and what was actually received:

Table 27: Predictability of Donor Receipts

Donor Country/Organisation	08-09 Cash Receipts		
	Est. (TOP \$m)	Act. (TOP \$m)	Var (%)
People's Republic of China	6.54	23.84	264.6%
Australian Bilateral	5.49	6.67	21.5%
New Zealand Bilateral	4.02	6.21	54.4%
European Union	14.37	2.21	(84.6%)
NZ AID/World Bank Trust Fund	-	1.53	
Asian Development Bank	5.08	0.76	(85.1%)
Other Donors	6.30	4.41	(30.0%)
TOTAL	41.81	45.62	9.1%

246. According to the Project & Aid Management Division within MoFNP, most of the major donors provide information on actual disbursements to MoFNP at the end of each financial year. However MoFNP also would like to receive quarterly expenditure reports and most donors do not provide these. Donor reports on actual expenditure are classified in accordance with the donor systems and not in accordance with GoT's chart of accounts.
247. AusAID, NZAID, EC and JICA confirmed that they do not submit quarterly expenditure reports to MoFNP, although they do receive the MoFNP requests for this information. Some donors mentioned that they are actively addressing this issue so hopefully they will be in a position to provide regular quarterly reports soon. Other donors said that it is not possible to report their in-kind expenditure to GoT because of their organisation's confidentiality policies around amounts being paid to individual technical assistance consultants.

248. **Table 28** is based on Note 5 to the draft 2008-09 Financial Statements. It compares the cash amounts GoT was estimating would be paid for donor projects that are on-budget and what was actually paid. The amounts shown are not handled by the MDA shown, but are reported against the MDA responsible for managing the donor project.

Table 28: Predictability of Donor-Funded Project Expenditures

Ministry administering donor project (NOT recipient)	08-09 Cash Payments		
	Est. (TOP \$m)	Act. (TOP \$m)	Var (%)
Ministry of Education, Women's Affairs & Culture	5.45	7.78	42.6%
Ministry of Finance & National Planning	14.64	4.16	(71.6%)
Prime Minister's Office	0.70	2.32	233.4%
Ministry of Agriculture, Food, Forests & Fisheries	2.92	1.22	(58.2%)
Revenue Services Department	2.67	1.18	(55.9%)
Ministry of Police, Fire Services & Prisons	0.50	1.02	103.9%
Ministry of Works	8.90	0.80	(91.0%)
Ministry of Health	1.36	0.63	(53.7%)
Ministry of Land, Survey, Natural Res & Environ	2.25	0.51	(77.4%)
Other Ministries	2.41	1.83	(23.8%)
TOTAL	41.81	21.45	(48.7%)

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (D-2)	D	D	M1
D-2(i) Completeness and timeliness of budget estimates by donors for project support.	D	D	Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior its start.
D-2(ii) Frequency and coverage of reporting by donors on actual donor flows for project support.	D	D	Donors do not provide quarterly reports within two month of end-of-quarter on the disbursements made for at least 50% of the externally financed project estimates in the budget.

D-3. Proportion of aid that is managed by use of national procedures.

249. The PEFA AT has determined that this indicator will be rated "no score". The reason is that information is not sufficient to make an accurate judgement about the proportion of funds that use government systems. Excluding in-kind assistance, all donor funds to government go through the Development Fund and are thus subject to national accounting, reporting and audit procedures. However AusAID, the largest donor, have established parallel procurement procedures for their projects and NZAID has at times used this alternative process as well. Contracts exceeding TOP \$30,000 are managed by a separate AusAID procurement process. Ordinarily, the government open tender procurement arrangements would kick in at TOP \$50,000 to TOP \$100,000 depending on the type of contract. The data available to the PEFA AT did not provide details on the magnitude of the procurements where the AusAID process was used instead.

Indicator	Score (2007)	Score (2010)	Meaning of 2010 Score
OVERALL RATING (D-3)	D	NS	M1
D-3(i) Overall proportion of aid funds to central government that are managed through national procedures.	D	NS	

Section 4: Government reform process

4.1. Description of recent and on-going reforms

250. The GoT has demonstrated a greater commitment to improving several PFM systems in recent years. Since the beginning of the decade, the GoT has put in place a range of legislative and policy frameworks to guide and assist government. In many cases, previously these frameworks did not exist, or were not publicly available. These frameworks have been intended to strengthen the legislative framework and improve oversight of the use of public sector resources.
251. At the overall planning level, the GoT has enhanced the focus of its planning efforts with the *National Strategic Planning Framework*, targeted at building the foundation for sustainable and lasting growth in part through stronger private sector development. The intention is for more effective management and monitoring of progress on the strategic objectives, especially by using government Ministries' corporate plans to reflect priorities. NSPF is intended to build on the gains achieved under the earlier Strategic Development Plans, where notably social expenditures have long been given priority.
252. The GoT has made some steps towards strengthening planning arrangements, particular the relationship and relevance of agency level corporate plans to overarching development goals. Key ministries, including education, health and agriculture have put forward plans that, although not costed, contain strengthened planning and monitoring frameworks and key indicators to operationalise the plans. The gradual moves to embedding and strengthening a multi-year budgeting approach, expanding functional classifications in budget frameworks and adopting GFS consistent classifications is providing a better framework for government to execute, monitor and report on how well MDAs are performing in meeting the aspirations of the NSPF. The PEFA AT expects further progress and some payoffs from this work in future years.
253. The GoT continues its focus on rolling out IT systems to facilitate more efficient administrative operation of government. In particular, there has been the gradual rollout of the SunSystem and MicrOpay systems to a greater number of line ministries, which has coordination and information sharing benefits, to aid efficiency. There has also been trialling some decentralisation of the payment function to the Prime Minister's Office.
254. In the area of procurement, the adoption and publication of an, albeit short, policy provides MDAs clearer guidance on improving purchase practices to aid greater efficiencies, than the situation that existed previously. The adoption of the more substantive draft procurement guidelines would improve this situation markedly by providing a substantive framework to guide MDAs and the political branch on procurement processes. The findings of the MV Royal Ashika enquiry add considerable weight to this view.
255. There has also been the stated intention and work done by MoPE to improve management, corporate governance arrangements, transparency and reporting of public enterprises.
256. The *Public Audit Act 2007* introduced a greater level of independence for the Audit Office and clearer lines of reporting to the Executive and the Legislative Assembly. The act also provides for broader powers for the Audit Office.
257. There have been substantial changes to taxation policy and revenue administration, including the move reducing the number of customs rates and thus administrative discretion associated with applying them, and a reduction in corporate income taxes. RSD has made very good progress in dealing with arrears, bringing more and more businesses into the tax system and markedly improving relations with business taxpayers. Solid progress has been made regarding

the plan to online filing for tax returns and customs entries. These ongoing reforms to streamlining revenue administration are a key part of improving the business environment, to expand private sector development as envisaged in the NSPF.

4.2. Institutional factors supporting reform planning and implementation

258. The implementation of recent improvements in the PFM system provides evidence of government commitment to the reforms. Sufficient leadership capacities and political will are necessary to sustain, benefit and build on the reforms that have commenced. Support for and leadership of reforms is probably strongest in the MoFNP, and it will need to continue to encourage and lead MDAs through budget processes and the ERC.
259. Going forward, MoFNP will need to occupy a central position in assisting MDAs to improve their corporate planning framework to better reflect costing issues and focus on getting better value for money in public expenditure and by gearing planning mechanisms on outputs and outcomes of budgets. In particular, MDAs will need close assistance in understanding and reaping the potential benefits of effective multi-year planning and budgeting. Inevitably, MoFNP will need to be the ‘champion’ and ‘focal point’ to move PFM reforms forward within government. MoFNP has made several moves in this direction, by codifying its own standard practices in the *Treasury Instructions* and moving towards creating its own internal audit unit.
260. In addition, the enhanced role, independence and scope permitted to the Audit Office by the new act, provides an opportunity for it to more deeply consider performance and systemic issues, as well as financial accountability, in conducting its work. Given that it can report to the Legislative Assembly, the constitutional reform offers greater opportunities for it to directly engage with lawmakers.
261. Tonga, as a small country with substantial opportunities for emigration, inevitably faces challenges in training, recruiting and retaining the technocrats that are essential to run government and implement the priority reforms of government. The donor agencies consulted during the preparation of this PFM-PR indicated that they are ready to further assist the government with technical assistance, to help with reforms.
262. The constitutional reforms offer the opportunity for government to have greater engagement with the private sector and non-government organisations, to enhance the appropriateness and relevance of future reforms. This change provides a chance for government to follow through with its already stated intention, to consult more substantively with the private sector in considering appropriate economic and PFM policies.

Annex A. Summary of 2010 performance ratings

PEFA Indicator		Scoring Method	Overall Rating (2010)	Brief Explanation and Cardinal Data used
A. Credibility of the Budget				
Pt-1	Aggregate expenditure out-turn compared to original approved budget.	M1	A	Actual primary expenditure (excluding donor funded projects and debt servicing) was 1.6 per cent below budget in 06-07, 0.3% below in 07-08 and 2.1% below in 08-09.
Pt-2	Composition of expenditure out-turn compared to original approved budget.	M1	C	Variance in composition of expenditure exceeded the overall primary expenditure deviation by 4.7% in 06-07, 13.8% in 07-08 and 9.6% in 08-09.
Pt-3	Aggregate revenue out-turn compared to original approved budget.	M1	A	Recurrent revenue collection rates (as compared to the original budget estimate) were 97.8% in 06-07, 105.1% in 07-08 and 87.9% in 08-09.
Pt-4	Stock and monitoring of expenditure payment arrears.	M1	B+	Cumulative stock of expenditure payment arrears at end 08-09 was less than 1% of total primary expenditure during that year. Arrears data generated at least annually, but probably incomplete for some institutions.
B. Comprehensiveness and Transparency				
Pt-5	Classification of the budget.	M1	C	Budget formulation and execution is based on economic and administrative standards consistent with GFS, but no functional or program level classifications as yet (expected to change in 2010-11).
Pt-6	Comprehensiveness of information included in budget documentation.	M1	A	Budget documentation satisfies 7 of the 9 PEFA requirements - two items not satisfied: (i) no information on financial assets; and (ii) insufficient detail on the budgetary impacts of new expenditure and revenue policies.
Pt-7	Extent of unreported government operations.	M1	A	Level of unreported extra-budgetary expenditure (excluding donor-funded projects) is deemed to be below 1% of total expenditure, primarily because system is centralised within MoFNP. The majority of donor financing to the GoT should also be captured as it is required to go through the General Development Fund bank account. As per PEFA clarification in-kind contributions are not taken into account for the purposes of this indicator.
Pt-8	Transparency of inter-governmental fiscal relations.	M2	NA	There are no levels of sub-national government in Tonga.
Pt-9	Oversight of aggregate fiscal risk from other public sector entities.	M1	C	Although most AGAs/PES submit fiscal information to the MPE, this information is insufficient to conduct any meaningful analysis of fiscal risk. No consolidated fiscal risk overview is published.
Pt-10	Public access to key fiscal information.	M1	C	Public access to key fiscal information is very limited. Of the six PEFA requirements, only one is satisfied - public access to the financial statements, which are published in the Tonga Government Gazette.
C. Budget Cycle				
C(i). Policy-Based Budgeting				
Pt-11	Orderliness and participation in the annual budget process.	M2	A	The GoT has recently begun issuing budget preparation circulars again. These circulars include ceilings pre-approved by Cabinet as well as a budget calendar and clear guidance. MDAs are generally given enough time to complete detailed budget proposals and Appropriation Bills were, in all years reviewed, passed before commencement of the FY.
Pt-12	Multi-year perspective in fiscal planning, expenditure policy and budgeting.	M2	C	The GoT has made first steps towards a multi-year budgeting framework. Estimates are prepared for two forward years in each budget preparation process (since 08-09); however these are not published anywhere and are not based on costed sector strategies/corporate plans. DSAs, for both external and domestic debt, are undertaken monthly by MoFNP and annually by the IMF.
C(ii). Predictability and Control in Budget Execution				
Pt-13	Transparency of taxpayer obligations and liabilities.	M2	A	There are four major taxes in Tonga: Consumption Tax, Income Tax, Excise Taxes and Customs Duties. Information on all these taxes is available at www.revenue.gov.to . In addition RSD conducts taxpayer education campaigns through workshops, radio and television, as well as delivery of hard-copies. Tax rulings are published on the website and administrative discretion appears to be limited. The tax appeals mechanism has recently become operational, with the establishment of the Tax Tribunal in late 2008.
Pt-14	Effectiveness of measures for taxpayer registration and tax assessment.	M2	A	Over 90% of Tongan taxpayers are now registered with a unique TIN, in a database covering all taxes (Revenue Management System). This database has weak linkages to other government databases (e.g. for business licences). Penalties appear to be sufficiently high to encourage general compliance. RSD supplements this with profiling and risk-based audits.
Pt-15	Effectiveness in collection of tax payments.	M1	D+	Although there have been significant improvements since previous years, collection of arrears remains an issue. The arrears collection ratio in 2008-09 was 40.3%, and the total stock of arrears at the end of that year was significant - almost 30% of the total annual IT/CT collection. Tax revenue is paid directly into the General Revenue account controlled by MoFNP and reconciliations take place monthly.
Pt-16	Predictability in the availability of funds for commitment of expenditures.	M1	C+	Cash flow forecasts are prepared prior to each FY and updated monthly. MDAs are also advised regularly, via the quarterly GFM Forum, of the cash flow situation and upcoming commitment ceilings. Significant in-year budget adjustments using the CF were frequent over 06-07 to 08-09. Although basic explanations are required for each of these adjustments, these were generally vague and did not provide sufficient detail to determine if the adjustment was warranted (e.g. "to fund additional operating expenses").

PEFA Indicator	Scoring Method	Overall Rating (2010)	Brief Explanation and Cardinal Data used
PI-17 Recording and management of cash balances, debt and guarantees.	M2	A	Domestic and external debt data is recorded by MoFNP in the CSDRMS. It is deemed complete and debt status reports are produced monthly and quarterly. MoFNP holds a number of bank accounts in WBOT and NRBT. These are calculated and consolidated on a daily basis. MDAs are not permitted to hold bank accounts (with the exception of PMO). All proposals for loans and guarantees must go through the Minister for Finance, and there are notional limits established for total debt and total guarantees.
PI-18 Effectiveness of payroll controls.	M1	B+	MoFNP manages the GoT's payroll (with the exception of Defence and Police personnel), using MicroPay software. PSC maintains a separate personnel database (which is not directly linked to the payroll) and each MDA maintains individual files for their staff within their HR section. MoFNP and PSC reconcile payroll/personnel changes at least monthly. Retroactive adjustments are occasionally necessary if MDAs do not promptly advise MoFNP of temporary payroll changes (e.g. leave without pay). Authority to change records in the personnel database and MicroPay is restricted and results in an audit trail. One payroll audit was conducted by the Audit Office in 2008, and did not raise any significant issues.
PI-19 Competition, value for money and controls in procurement.	M2	C	There is no legislation regulating public procurement, however there are draft guidelines. Data from the GPC secretariat shows that, of 188 contracts awarded in 08-09, 21 were high-value (above TOP \$100k). Of these, records show that between 50%-75% were awarded using open competition, however the data may not be accurate. Where open competition was not used, justifications were (in the opinion of the PEFA AT) weak. There is no formal process for handling procurement complaints.
PI-20 Effectiveness of internal controls for non-salary expenditure.	M1	B+	The PEFA AT is of the opinion that non-salary expenditure controls are generally comprehensive and effective, although occasionally overridden at a high level (e.g. it appears that payment of the <i>Ashika</i> deposit was made despite the fact that a key piece of supporting documentation - GPC's endorsement of the procurement process - was missing).
PI-21 Effectiveness of internal audit.	M1	D+	The PEFA AT was only able to review the Audit Office's 06-07 Annual Report (which cost TOP \$100) as the other reports had not yet been tabled. Based on this, the PEFA AT is of the opinion that internal audit is focussed more on transactions rather than systems. Discussions with the AO indicate that audit recommendations are usually ignored by management.
C(iii). Accounting, Recording and Reporting			
PI-22 Timeliness and regularity of accounts reconciliation.	M2	B	MoFNP reconciles its records with WBOT bank statements on a daily basis. There is no process documented for clearing/reconciling suspense accounts; MoFNP advise that this is usually done on an annual basis.
PI-23 Availability of information on resources received by service delivery units.	M1	D	Although both the Ministry of Education and the Ministry of Health collect data on resources received by service delivery units, this is used only for internal reporting purposes and is not published anywhere.
PI-24 Quality and timeliness of in-year budget reports.	M1	C+	MoFNP prepares quarterly in-year budget reports, which are audited by the Audit Office. These reports only include a simple cash operating statement (using an economic classification) and nothing else - no information on commitments and no balance sheet. It is also not possible to compare actual expenditure on a disaggregated level with MDA budgets.
PI-25 Quality and timeliness of annual financial statements.	M1	D+	Although the GoT prepares annual financial statements, these are not totally complete (omit information on receivables and payables in the balance sheet, for example) and are not submitted to the auditor in a timely fashion (27 months after end 06-07 and 16 months after end 07-08). GoT attempts to prepare the statements in accordance with IPSAS although there is not full compliance.
C(iv). External Scrutiny and Audit			
PI-26 Scope, nature and follow-up of external audit.	M1	D+	The Audit Office attempts to cover all government entities within two years' and, based on review of the 06-07 Annual Report, the audits are more focussed on transactions than systems. A consolidated overview of audits is submitted to the legislature in the Annual Reports (detailed individual reports are not submitted).
PI-27 Legislative scrutiny of the annual budget law.	M1	D+	The Legislative Assembly commences its review of expenditure and revenue in late May/early June, after detailed budget proposals have already been finalised. They therefore have about one month. There are clear rules around use of the CF by the Executive for in-year budget adjustments; these allow extensive administrative reallocations (although not increase of the overall budget envelope) without any additional scrutiny by the Legislature.
PI-28 Legislative scrutiny of external audit reports.	M1	D	Advice from the Audit Office is that the Legislature usually takes more than 12 months to examine its Annual Reports and no in-depth hearings are held or recommendations issued. MoFNP advises that there is no Public Accounts Committee.
D. Donor Practices			
D-1 Predictability of Direct Budget Support.	M1	N/A	No donors were providing direct budget support in 06-07, 07-08 or 08-09. ADB expects to disburse a first budget support payment in late 2009-10.
D-2 Financial information provided by donors for budgeting and reporting on project and program aid.	M1	D	The Project & Aid Management Division in MoFNP attempts to collect annual estimates and in-year actual data from donors, however many donors do not currently fully comply and information provided is not very accurate.
D-3 Proportion of aid that is managed by use of national procedures.	M1	NS	Excluding in-kind contributions, all donor funds to the GoT should go through the Development Fund and hence be subject to national accounting, reporting and audit procedures. However some donors (AusAID and NZAID) are using parallel procurement procedures. The PEFA AT was unable to quantify the extent to which this occurs.

Annex B. Key Reference Documents

1. ADB, *Tonga country and people*, downloaded from www.adb.org/Tonga/country-info.asp in March 2010.
2. CIA, *World Factbook*, downloaded from www.cia.gov in March 2010.
3. GoT, *National Strategic Planning Framework*, 2009.
4. GoT, *Budget Preparation Guidelines*, various years.
5. GoT, *Draft Treasury Instructions 2010*.
6. GoT, *Debt Sustainability Policy*, 2009.
7. GoT, *Appropriation Acts*, various years.
8. GoT, *Public Audit Act 2007*.
9. GoT, *Consumption Tax Act 2003*.
10. GoT, *Customs And Excise Management Act 2007*.
11. GoT, *Income Tax Act 2007*.
12. GoT, *Revenue Services Administration Act 2002*.
13. GoT, *Public Finance Management Act 2002*.
14. GoT, *Public Enterprises Act 2002*.
15. GoT, *Strategic Development Plan 8 (SDP 8)*, 2006.
16. GoT, *Budget Papers (Nos. 1, 2 and 3)*, various years.
17. GoT, *Public Service Code of Conduct*, 2004.
18. GoT, *Public Service Policy Manual*, 2007.
19. GoT, *National Reserve Bank of Tonga Act 1988 (as amended)*.
20. GoT, *Audited Financial Statements*, various years.
21. GoT, *Ports Authority Act 1998*
22. GoT, *Tonga Broadcasting Commission Act 1988*
23. GoT, *Tonga Water Board Act 2000*
24. GoT, *Corporate Plans* for the: (i) Ministry of Tourism (covering 2009-2011); (ii) Ministry of Agriculture, Food, Forests and Fisheries (2009/10 – 2014/15); (iii) Ministry of Health (2008/09 – 2011/12); and (iv) Ministry of Education, Women’s Affairs and Culture (covering 2009-2012).
25. IMF, *Debt Sustainability Analysis (supplement to Article IV consultations)*, various years.
26. IMF, *IMF Tonga Country Report 2009*, downloaded from www.imf.org in March 2010.
27. PEFA, *Public Expenditure Framework and Accountability: clarifications*, downloaded from www.pefa.org in late 2009.
28. PMO, *Our Constitution 2010*, downloaded from www.pmo.gov.to in March 2010.
29. Royal Commission Inquiry into the Sinking of the MV Princess Ashika. Transcripts and final report downloaded from <http://www.rcimvprincessashika.to> in March and May 2010.
30. World Bank, *World Development Indicators Electronic Database*, downloaded from www.worldbank.org in March 2010.

Annex C. List of people consulted

Government of Tonga

Hon. ‘Otenifi Afu’alo Matoto	Minister of Finance and National Planning
‘Aisake Eke	Secretary, MoFNP
Balwyn Fa’otusia	Deputy Secretary, Aid Mgmt & Projects, MoFNP
Tiofilusi Tiueti	Deputy Secretary, Treasury Division, MoFNP
Makeleta Siliva	Chief Accountant, Treasury Division, MoFNP
Fiona Foliaki	Chief Accountant, Debt Management, MoFNP
Lesieli Tufui	Economic, Social Policy and Planning, MoFNP
Pauli Kautoke	Senior System Analyst, Treasury Division, MoFNP
Tupou Halatanu	Supervisor Payroll, Treasury Division, MoFNP
Vika Fe’iloakitau	Senior Economist, Budget & Procurement, MoFNP
Lusitania Latu	Acting Deputy Secretary, Budget Division, MoFNP
Mosese S. Fatukala	Senior Economist, Budget Division, MoFNP
Mary-Jane F. Moala	Revenue Manager, Treasury Division, MoFNP
Sefita Tangi	Commissioner of Revenue, RSD
Praveen Reddy	Deputy Commissioner of Revenue, RSD
Peter Nash	Deputy Commissioner of Customs, RSD
Talanaivini Vea	Secretariat for the Government Procurement Committee
Pohiva Tu’I’onetoa	Auditor-General, Audit Office
Kolopeaua Tonga	Audit Office
Maamaloa Fotofili	Audit Office
Lotomo’ua Tu’ungafasi	Audit Office
‘Inoke Finau Vala	Director for Public Enterprises, MoPE
Dr. Siale ‘Akau’ola	Director, MoH
Viliani Fukofuka	Director, MEWAC
Tevita Ma’u	Deputy Director, MEWAC
Salalina Prescott	Deputy Commissioner, PSC

National Reserve Bank of Tonga

Joyce Mafi	Governor, NRBT
‘Anapuli Matoto	Head, Fiscal Policy Monitoring, NRBT
Lata Tangimana	Head, Cash Operations, NRBT

Private Sector

Paula Taumoepeau	President, Tongan Chamber of Commerce and Industries
<i>(Also other representatives from TCCI)</i>	
Timothy Solo	Civil Society Forum of Tonga
Vanessa	Civil Society Forum of Tonga
Maka	Civil Society Forum of Tonga

Development Community

Debbie Reschke	First Secretary, AusAID
Nobuaki Matsui	Resident Representative, JICA
Maria Melei	Country Specialist, ADB
Dominic Walton-France	Manager, NZAID
Malakai Kaufusi	Development Programme Coordinator, NZAID
‘Isileli ‘Aholelei	Technical Advisor, EU

