EXAMINATION OF THE COMPONENTS OF THE FISCAL POLICY PAPER

WHICH WAS LAID BEFORE THE HOUSES OF PARLIAMENT

ON MAY 24, 2012

REPORT BY

THE AUDITOR GENERAL OF JAMAICA

FINANCIAL YEAR 2012/13

Auditor General of Jamaica
Auditor General's Department
8 Waterloo Road, Kingston 10
Jamaica, W.I.

July 2012

Table of Contents

Auditor General's Comments on the Fiscal Policy Paper – 2012/13

1. I have examined the components of the Fiscal Policy Paper (FPP) of the Minister of Finance, which was laid before both Houses of Parliament on May 24, 2012.

Responsibilities of the Minister of Finance

2. The Minister of Finance is responsible for the FPP, including the underlying conventions and assumptions on which the principles of prudent fiscal management are based. As stated in section 48B(2) of the Financial Administration and Audit (FAA) Act:

   "Upon presentation of the annual Estimates of Revenue and Expenditure, the Minister shall lay before both Houses of Parliament, a Fiscal Policy Paper containing the information indicated in the Third Schedule and setting out, in accordance with this section–

   a) Macroeconomic Framework;
   b) A Fiscal Responsibility Statement; and
   c) A Fiscal Management Strategy"

3. Section 48B (3-5) provides that the Macroeconomic Framework is to present an overview of the state of the economy, and an assessment of the prospects for economic growth including medium-term projections for the main macroeconomic variables. The Fiscal Responsibility Statement should specify the levels of fiscal balance and debt that are prudent in the opinion of the Minister, proposed fiscal-policy measures and a declaration that the Minister will adhere to the principles of prudent fiscal management. The Fiscal Management Strategy must provide an assessment of the current and projected finances of the Government, outline plans and policies for economic development and explain how such plans and policies conform to the Fiscal Responsibility Statement.

4. As outlined in section 48D of the FAA Act (further amended in 2011), the Minister shall act in conformity with the following fiscal management principles –

   a. the total debt is to be reduced to, and thereafter maintained at, a prudent and sustainable level;
   b. fiscal risks are to be managed prudently with particular reference to their quality and level;
   c. borrowings are to be geared toward investment activities that support productivity and economic growth; and
   d. expenditure is to be managed in a manner that is consistent with the level of revenue generated, so as to achieve the desired fiscal outcomes.

5. Section 48C of the FAA Act explicitly outlines fiscal targets for which the Minister of Finance should take appropriate measures to achieve by the fiscal year ending March 31, 2016. These include:

a) Reducing the fiscal balance to nil;
b) Reducing the total debt to 100 per cent or less of the gross domestic product;
c) Reducing the ratio of wages paid by the Government as a proportion of the gross domestic product to 9 per cent or less;
d) Maintaining or improving the above targets beyond March 31, 2016.

Responsibilities of the Auditor General

6. My responsibility, as set out in section 48B(6) of the FAA Act, is to examine the components of the Fiscal Policy Paper and provide a report to the Houses indicating whether –

   a) the conventions and assumptions underlying the preparation of the Fiscal Policy Paper comply with the principles of prudent fiscal management specified in section 48D; and

   b) the reasons given pursuant to subsection (5)(d)(ii) are reasonable having regard to the circumstances.

7. I conducted my examination in accordance with International Standard on Assurance Engagement (ISAE) 3000 – *Assurance Engagements Other Than Audits or Reviews of Historical Financial Information*. This standard requires that I obtain sufficient appropriate evidence to base my comments in line with the criteria, which are established in section 48D of the FAA Act.

Methodology

8. The examination included:
   - review of the provisions of the FAA Act and FAA (Fiscal Responsibility Framework) Regulation, 2012;
   - review of the Fiscal Policy Paper for financial years (FYs) 2012/13 and 2011/2012;
   - review of evidence and clarifications on the FPP from the Ministry of Finance
   - meetings with external experts;
   - reviews of publications from external experts;
   - obtaining representations[1] from the Ministry of Finance;
   - consulting with technical experts in keeping with International Standards on Assurance Engagements (ISAE) 3000; and
   - performing such other procedures considered necessary in the circumstances.

[1] Written confirmation of information provided

Compliance with the Principles as Stated in the FAA Act

General Comments

Breach of the Financial Administration and Audit Act

9. Section 48E (3) of the FAA Act requires that, "The Minister shall lay before each House of Parliament, at least twice in each financial year, a report on the performance of the economy, the public finances of Jamaica, and the actions taken under the Fiscal Management Strategy." However, a second report was not laid before the Houses in FY 2011/12.

Ministry's Response

10. *A second report in the format specified under Section 48E (3) of the FAA Act was not tabled in Parliament due to some unforeseen circumstances. Nevertheless, the Minister presented reports to Parliament, on February 6, 2012 and February 29, 2012 outlining the performance of the economy, public finances & status of the fiscal reform undertakings.*

Part A: Principles of Prudent Fiscal Management

Criterion A: Total debt is to be reduced to, and thereafter maintained at, a prudent and sustainable level.

Related Target: To reduce the total debt to 100 per cent or less of GDP by the end of the financial year ending on March 31, 2016.
Long term objective: Reducing debt/GDP ratio and maintaining it at no more than 60 per cent of GDP.

11. 'Sustainable level' is defined as "that level of a fiscal indicator that does not compromise the required fiscal space necessary to meet socio-economic objectives"[2]. As it relates to 'prudent', the Ministry has indicated that a prudent debt level is 60 per cent of GDP[3]. However, it was further stated by the Ministry that even if the debt does not reach this level, where the Government indicates a clear commitment and takes decisive and responsible action to move the debt on a path and in the direction toward that level, such actions of the Government can be considered prudent[4].

Fiscal Risk

12. Critical to managing the growth of the public debt will be the management of fiscal risks such as: contingent liabilities; rollover risk; interest rate as well as the

[2] Section 48A, FAA (Amendment) Act, 2011
[3] Pg. 2, Par. 5 - Fiscal Responsibility Statement, FY 2011/12
[4] MoFPS response to AGD requisition, dated May 30, 2011

risk to elements of expenditure and revenue over the medium term. However, because of the uncertainties in the timing and amount for fiscal risks, the GOJ may under-provide, or not provide, for them in the budget. If the risks do materialise, they could significantly increase expenditure and possibly the debt level.

13. The FPP clearly indicated contingency plans for four of the 18 sources of fiscal risks identified. These are national disasters, adverse movement in key macroeconomic variables (inflation), tax expenditure (discretionary), and arrears over 90 days. However, detailed contingency plans or provisions were not stated for 14 of the sources of fiscal risks. The FPP did not indicate, for example, the quantitative impact the materialization of the stated risks may have on revenue, expenditure or the debt level. Thus, it is probable that there may be material differences between FPP's projections and the outturn. [See Ministry's Response at paragraph 18]

Total Public Debt Stock

14. The stock of Public Debt is budgeted to increase to J$1,816,902.6mn in FY 2012/13, which represent an increase of 9.3 per cent ($155,339.8mn), when compared to the outturn for the previous fiscal year. The projected total debt comprises; domestic debt of $939,767.70mn and external debt of $877,134.90mn.

15. The FPP projects that the debt/GDP ratio will increase to 130.5 per cent in FY 2012/13, compared to the 128 per cent outturn in FY 2011/12. The debt/GDP ratio is projected to trend towards 104.2 per cent by FY 2015/16, which is outside the legislated target of 100 per cent.

Comment

16. **As stated in paragraph 15 above, the debt/GDP ratio is projected to trend towards 104.2 per cent by FY 2015/16, which is outside the legislated target of 100 per cent. On that basis, in my opinion, the FPP does not comply with the principle stated in Section 48D (a) of the FAA Act, which requires that "Total debt is to be reduced to, and thereafter maintained at, a prudent and sustainable level."**

Ministry's Response

17. *The MOFP disagrees with this comment by the AG. The FPP clearly shows an improving fiscal position (lower deficits), which supports a debt trajectory that declines to prudent levels over the medium term. The FPP embodies astute fiscal management, as reflected in the quantified expenditure and revenue measures, that will facilitate a fall in the Debt/GDP ratio from 128% in March 2012 to*

104.2% by March 2016. The other measures mentioned in the FPP, though not yet quantified, will serve to further reduce the debt to the legislated target of 100% of GDP by March 2016. [Please see further comments from the Ministry at Paragraph 40]

18. *The Ministry of Finance & Planning maintains a matrix that quantifies some of the stated fiscal risks but is of the view that for market sensitivity reasons it would not be useful to include them in the FPP at this time. Additionally it is difficult to quantify some of the risks, example, Changes in Government Policies – this can be wide in scope and impact and hence challenging to pin-point and quantify all the possible associated risks. Notwithstanding, the MOFP feels it important to identify and notify this as a fiscal risk. Importantly too, where negotiations and agreements are required with stakeholders, for example labour unions and bargaining groups, explicitly specifying, quantifying and publishing the risks could be a risk in and of itself in that these negotiations could be compromised and prejudiced. The MOFP will nevertheless continue to monitor and assess these risks and quantify them as far as practically possible.* **[See recommendation: Paragraph 53]**

Criterion B: Fiscal risks are to be managed prudently with particular reference to their quality and level.

Related Target: The Act did not specify a related target for this criterion.

19. Definitions for 'quality' and 'level' as provided by the Ministry of Finance it relates to fiscal risks are: (i) Quality is the probability or likelihood of occurrence of a fiscal risk, (ii) Level is the quantum or magnitude of a fiscal risk.
20. However, there is no specific target in section 48C of the FAA Act for this criterion. Consequently, I was unable to measure the extent to which fiscal risks, as provided by the FPP, will be managed prudently with reference to their quality and level.

Comment

21. **In light of the aforementioned, I will not form an opinion as to whether the FPP complies with this principle. [See recommendation: Paragraph 49]**

Ministry's Response

22. *This is a principle and as such no quantitative target is attached. However with respect to guarantees, which constitute a major risk element, the externally sourced components of contingent liabilities or guarantees are counted in the external debt stock and the Debt/GDP ratio. As a measure of control, annually the quantum of additional guarantees to be issued for the year is determined and*

this is included in projections for the debt stock. No further guarantees are granted over and above the pre-determined amount. A provision for payments on guaranteed loans and other contingencies by the Central Government are included in the Estimates of Expenditure.

23. *In order to reduce the fiscal risks and minimize the Government's exposure and ensuring the optimal quality of the guarantee, prior to the issuance of a guarantee, the Ministry conducts a financial assessment of the requesting entity, paying particular attention to solvency and liquidity ratios. Financial ratios are calculated to ensure that the entities' ratios are within acceptable levels to support the additional debt servicing that will result from the new debt.*

Criterion C: Borrowings are to be geared toward investment activities that support productivity and economic growth

Related Target: The Act did not specify a related target for this criterion.

24. The Ministry has not established specific targets for this principle. However, the Ministry provided a definition for **'**investment activities that support productivity and economic growth': **"***this means expenditure which seeks to enhance the country's economic capacity. Examples of this would relate to investments in physical infrastructure, transportation rehabilitation, and education-and-health."* **[See recommendation: Paragraph 49]**

25. Our analysis of the use of central government borrowing revealed that, with the exception of 2012/13, recurrent expenditures are increasingly covered by recurrent revenue and not borrowings. See Table 1 below.

Table 1: Use of Central Government Borrowing

Fiscal Year	2009/10 (J$ million)	2010/11 (J$ million)	2011/12 (J$ million)	2012/13 (J$ million)	2013/14 (J$ million)	2014/15 (J$ million)	2015/16 (J$ million)
Loan Receipts	299,599.60	212,968.90	163,520.50	251,145.70	203,346.90	174,893.40	167,549.80
Less Amortization	169,514.00	102,157.50	128,373.20	198,170.20	161,472.90	142,815.90	154,309.20
Capital	34,414.30	55,594.10	53,230.90	39,493.00	44,757.50	47,890.50	51,242.90
Balance to fund Recurrent Expenditure	95,671.30	55,217.30	-18,083.60	13,482.50	-2,883.50	-15,813.00	-38,002.30

Source: Ministry of Finance

Criterion D: Expenditure is to be managed in a manner that is consistent with the level of revenue generated, so as to achieve the desired fiscal outcomes.

RELATED TARGETS: **To reduce the fiscal balance to nil by the end of the financial year ending on March 31, 2016 [FAA Act, Section 48C (a)]**

To reduce the ratio of wages paid by the government as a proportion of the Gross Domestic Product to 9 per cent or less by the end of the Financial Year ending on March 31, 2016 [FAA Act, Section 48C (c)]

26. The main factors that impact on this principle, vis-à-vis the identified targets, include Tax Revenue, Wages & Salaries, Interest Costs, Programme Expenditure, and Capital Expenditure.

Tax Revenue

27. For FY 2012/13, tax revenue of $335,625.1mn, which accounts for approximately 92.9% of total revenue, is budgeted to grow by 15.8% ($45,742.90mn) over collections in FY 2011/12. Please see Table 2 below. The Government of Jamaica (GOJ) expects to generate $19,360.00mn from tax reform measures, and $6,800.00mn from legislative and administrative measures. However, the GOJ has not indicated the source of the balance of $19,582.90mn in the FPP. This unspecified amount represents 42.8 per cent of the expected increase in tax revenue (5.8 per cent of the tax revenue target), or 1.4 per cent of the projected GDP.

Table 2: Sources of Changes in Tax Revenue

	2011/12 Prov.($mn)	2012/13 Proj. ($mn)	Change Actual.($mn)		Change %
Identification of tax revenue sources in FPP					
Tax reform measures				19,360.00	6.7
Growth (excluding revenue measures)				26,382.90	9.1
Legislative/ administrative measures			6,800.00		
Not specified*			19,582.90		
Tax Revenue	**289,882.20**	**335,625.10**		**45,742.90**	**15.8**

Data Source: FPP 2012/2013

Ministry's Response

28. *The referenced "unspecified" amount of $19,582.90mn is the baseline/passive forecast based on the assumptions about the macro-economy, (see pages 6-7 of Macroeconomic Framework) such as growth, inflation, exchange rate, interest rates, import value, wage adjustments. These are the usual assumptions that*

underpin the revenue forecasts in all the budgets. Thus strictly speaking it is not an "unspecified" amount as this emanates from the assumption about the economic variables that influence revenue generation. The MOFP however agrees that for greater clarity this should have been explicitly stated in the FPP as is done in the case of the legislative/administrative measures and tax reform measures.

Wages & Salaries

29. It was noted in the FPP that, *"With respect to wages and salaries, this is budgeted at $146,860.1mn or 10.5% of GDP, compared to 10.7% of GDP in FY 2011/12. The provision in the FY 2012/13 Budget represents a nominal increase of 5.2%, reflective of:*

- *$9,510.6mn, comprised of $7,611.3mn for the scheduled instalments of the 7% one-off payment and $1,899.3mn for teachers reclassification, arising from the Industrial Disputes Tribunal award; and*
- *$577.60mn for security forces recruitment."*

30. The FPP projects that there will be an improvement in the wage/GDP ratio from 10.5 per cent of GDP in FY 2012/2013 to 9 per cent of GDP by financial year ending on March 31, 2016.

Interest Cost

31. The FPP projected interest cost of $136,533.9mn for FY 2012/13, which represents an increase of 13.1 per cent over the previous year. Interest cost as a percentage of GDP, is estimated to be 9.8 per cent in FY 2012/13 compared to 9.3 per cent in FY 2011/12, largely due to the higher debt stock.
32. The FPP projects the Central Government borrowing requirement for FY 2012/13 to be $251,145.7mn, which represents an expected increase of 53.6 per cent ($163,520.6mn), in gross receipts over the previous fiscal year. This amount is required to finance amortization of $198,170.4mn, and expected fiscal deficit of $52,975.5mn. However, the GOJ indicated in the FPP that total debt stock is projected to increase to $1,816,902.6mn, which represents a 9.3 per cent ($155,339.8mn) increase over the previous fiscal year.

Recurrent Programme Expenditure

33. As noted in the FPP, recurrent programmes are budgeted at $91,370.8mn, a slight 1.9 per cent increase over the previous fiscal year, reflecting the GOJ's cost containment stance. However, there was a reduction in programme expenditure in real terms of 10.7 per cent based on the inflation of 12.6 per cent. Recurrent programme is projected to be 6.6 per cent of GDP in FY 2012/13, compared to 6.9 per cent outturn in FY 2011/12.

Capital Expenditure

34. Budgeted spending on capital programmes of $39,493.4mn is 25.8 per cent less than the provisional expenditure in FY 2011/12. This is a continuation of a declining trend in capital expenditure in recent years. The GOJ has indicated that it is keen on containing capital spending in the event of lower revenue outturn.

Primary Balance

35. The 2012/13 FPP projects a primary surplus of 6 percent of GDP for FY 2012/13. This represents an upward revision over the 4.4 per cent which was projected in the 2011/12 FPP. The 2012/13 FPP indicates that primary surplus outturn for FY 2011/12 was 3.1 per cent of GDP, which was 2.1 percent less than the projection of 5.2 per cent of GDP. See Table 3 below. The MOFP indicated that the upward adjustment was primarily attributed to the revenue measures noted for FY 2012/13.

Table 3: Medium Term Trend for Primary Surplus

Primary Balance as per:	2011/2012 Provision	2012/2013 Budget	2013/2014 Projection	2014/2015 Projection	2015/2016 Projection
2011/12 FPP (% of GDP)	5.2[#]	4.4	5.1	5.4	5.7
2012/13 FPP (% of GDP)	3.1	6.0	6.2	6.6	6.9
Variance	-2.1	1.6	1.1	1.2	1.2

Source: FPP

[#] budgeted percentage.

Fiscal Balance

36. For 2012/13, the FPP projects a fiscal deficit of 3.8 per cent of GDP ($52,975.5mn), relative to the deficit outturn of 6.2 per cent of GDP ($80,972.4mn) for FY 2011/12. However, the fiscal deficit outturn widened by 1.6 per cent in FY 2011/12, when compared to the related projection of 4.6 per cent.

37. Contrary to the legislative target of zero per cent, the FPP projects that there will be a fiscal deficit of 1.1% of GDP ($20,797.6mn) for the financial year ending on March 31, 2016. The FFP provided a menu of additional measures, which the Minister intends to pursue to close the fiscal gap of 1.1 per cent of GDP in order to achieve the targeted fiscal balance of nil by March 31, 2016. Please see Table 4: Measures to Close Fiscal Gap. However, the FPP did not quantify the purported measures.

Comment

38. **In my opinion, the FPP is not in full compliance with the principle stated in Section 48D (d) of the FAA Act on the basis that the FPP projects a fiscal gap of 1.1 per cent at FY 2015/16, which is inconsistent with the legislated target of nil. Further, despite the mention of mitigating measures to adjust the fiscal deficit, the FPP did not provide a timeline for implementation of these measures and the savings/revenue they are expected to generate. [See recommendation: Paragraph 50]**

Additional Comments

39. **My examination determined that the components of the FPP, that is, the Macroeconomic Framework, the Fiscal Responsibility Statement, and the Fiscal Management Strategy, complied with the requirements as outlined in Section 48B(3-5) of the FAA Act. The Fiscal Management Strategy outlined the risk exposures to the Government for the achievement of the targets specified in Section 48C (a-c) of the Act. However, risk response measures were not included and noted for all the risks identified. [See recommendation: Paragraph 51]**

Ministry's Response

40. *The ministry is not in a position at this time to give details as to implementation timelines for measures to close the fiscal gap of 1.1% of GDP in FY 2015/16. With respect to some of the stated measures, such as tax reform, pension reform, wage settlements, these are subject to negotiations and agreements with various stakeholders. It is important to note that (i) the White Paper on Tax Reform is yet to be finalized (ii) the Parliamentary Committee on Pension Reform is still deliberating. Within this context, the MOFP is not in a position at this time to be conclusive on the timeline and quantitative impact of these measures. Notwithstanding, the GOJ remains fully committed to achieving the fiscal targets and to manage expenditure in a manner that is consistent with the levels of revenue generated.* [Please see previous comments from the Ministry at Paragraph 17]

Table 4: Measures to Close Fiscal Gap

• Tax reform (both policy and administration) designed to promote stable and predictable levels of revenue and maintain the integrity of the tax system by minimizing special incentives, concessions and exemptions, as well as improving compliance; • Financial distribution/dividends from public enterprises; • Pension reform – implementation of a contributory pension scheme in order to partly transfer the cost of financing retirement benefits from the taxpayer to the ultimate beneficiary; • Public Sector transformation – to generate efficiencies and contain wages; • Better management of expenditure through effective use of the Project Prioritization Tool, implementation of the FRF and enforcement of sanctions; and • Continuous assessment and management of fiscal risks, including contingent liabilities.

Source: Fiscal Responsibility Statement/MOFP

Ministry's Response

41. *Over the course of FY 2012/13, the MOFP will have a more definitive position on the referenced measures to close the medium term, fiscal gap.*

42. *With regards to mitigation measures for the risks specified in the FPP, for some of the risks, it would be difficult to specify exactly how they would be dealt with, if materialized. At best, the MOFP can state that the appropriate revenue and/or expenditure measures would be applied to deal with such an eventuality.*

Part B: Reasonableness of Deviation of Fiscal Indicators

43. Subsection (5)(d)(ii) of the FAA Act requires the Minister to compare the outcome of the fiscal indicators with the targets for the previous financial year and give reason for any deviations.

44. Section 48B (6) of the FAA Act requires that the Auditor General indicates whether the reasons given pursuant to subsection (5)(d)(ii) are reasonable having regard to the circumstances.

45. In making a determination regarding the reasonableness of the justification provided by the Minister, I applied the following criteria:

 - whether initial projections considered fiscal risks; and
 - ability to confirm the Minister's explanation with observed data.

46. I have reviewed the explanations provided in the FPP, as shown in Table 5. In applying the above criteria, I made reference to the Budget Memoranda for FYs 2008/09 to 2012/13 and other published data from the Planning Institute of Jamaica (PIOJ), Statistical Institute of Jamaica (STATIN) and Bank of Jamaica (BOJ) and found that the reasons provided in the FPP for the variances could be substantiated with observed data.

47. My review of the 2011/12 FPP revealed that, though some fiscal risks were mentioned therein, they were not quantified or reflected in the projections. Consequently, it was not clear to what extent deviations, such as underperformance of revenue, were due to forecast errors, deviations from assumptions, or unforeseen events/ shocks. In my report on the 2011/12 FPP, I recommended that fiscal risks should be identified and reflected accordingly in the FPP.

48. With regards to my comments in Table 5 below, I accept that some of the explanations provided by the Ministry are reasonable. However, I did not comment on some variances for the following reasons:

 - the 2011/12 FPP failed to factor the fiscal risks in the projections, consequently, the reasonableness of some variances were harder to assess; and
 - the lack of information in the FPP and from the MOFP.

 [See recommendation: Paragraph 52]

Table 5: Audit Comments on the Explanations for Deviations

Item	Provision Apr-Mar	Budget Apr-Mar	Difference	Difference %	GOJ's Explanation	Audit Comments	Ministry's Response
Operating Revenue	**322,149.8**	**350,641.9**	**-28,492.1**	**-8.1%**			
Tax Revenue	289,882.2	308,215.3	-18,333.1	-5.9%	Lower collections from most items (exception: PAYE and Bauxite alumina taxes). Other Companies, Tax on Interest and Other Individuals being the significant contributors to the unfavourable performance of this category.	The budget memorandum stated that increases in the incidence of non-compliance contributed to the unfavourable out-turn, and inflows were less than targeted from administrative efforts. The FPP did not specify the inflows anticipated from renewed administrative methods nor did it quantify the anticipated base revenue growth. On that basis I cannot comment on the reasonableness of this explanation.	*Conventionally, the MOFP does not specify anticipated inflows from administrative and base revenue growth. Going forward the MOFP will be more specific on these items.*
					Corporate taxes performed well below expectations as receipts of $29,035.2mn deviated from target by $6,477.2mn (18.2%) partly as a result of lower than targeted flows from administrative efforts and weaker than anticipated base revenue growth. Indications are that there was an increase in the incidence of non-compliance.	The FPP did not specify the inflows anticipated from renewed administrative methods nor did it quantify the anticipated base revenue growth. On that basis, I cannot comment on the reasonableness of this explanation.	*Conventionally, the MOFP does not specify anticipated inflows from administrative and base revenue growth. Going forward the MOFP will be more specific on these items.*
					With respect to Tax on Interest, there was a $2,284.1mn (15.3%) shortfall when compared to budget, due mainly to lower than anticipated interest incomes occasioned largely by a faster than anticipated decline in interest rates within the economy.	The FPP did not indicate why there was a faster than anticipated decline in interest rate.	*The interest rate forecast comes from the BOJ as a component of a comprehensive macroeconomic programme. The interest rates are however determined by the market.*

					Production and Consumption tax receipts of $84,628.9mn were $3,973.5mn (4.5%) below budget, as the under-performance in some items (primarily GCT) outweighed the better than targeted performances on other items.	Further explanation was needed for this variance. The Budget Memorandum suggests that the outturn was primarily affected by the slower than anticipated growth in the base revenue and lower than targeted receipts from administrative efforts. However, the FPP did not specify the inflows anticipated from renewed administrative methods nor did it quantify the anticipated base revenue growth. Further, it did not specifically indicate what contributed to the under-performance of "some items"; such as GCT. On that basis I cannot comment on the reasonableness of this explanation.	*Conventionally, the MOFP does not specify anticipated inflows from administrative and base revenue growth. Going forward the MOFP will be more specific on these items.*
					Receipts from the International Trade category totalled $96,511.6mn, which were $8,626.5mn (8.2%) below budget. All sub-categories of taxes with the exception of Travel Tax registered shortfalls relative to the budget.	The FPP did not provide details on the factors that resulted in lower inflows.	
Non-Tax Revenue	16,709.2	18,079.8	-1,370.6	-7.6%	Receipts from the Customs User Fee (CUF) were primarily responsible for the under-performance compared to budget. CUF receipts of $7,770.3mn were $755.6mn (8.9%) below target partly as a result of the slower than expected depreciation of the Jamaica Dollar. Receipts from departmental and miscellaneous revenues were also below projections.	The reason provided in relation to the "slower than anticipated depreciation of the Jamaican dollar" accords with the average foreign exchange outturn of J$86.35:US$1 versus the estimation of J$86.95:US$1	

Capital Revenue	10,585.1	9,182.4	1,402.7	15.3%	Capital revenue receipts totalled $10,585.1mn, an excess of $1,402.7mn (15.3%) relative to budget, due to collections from loan repayments being $1,229.3mn higher than budgeted. The higher than projected increase in capital revenue was attributable mainly to a payment from the Development Bank of Jamaica (DBJ).	I could not determine from the FPP, why the payment from DBJ was not factored in the 2011/12 projection for Capital revenue.	*The referenced payment from the DBJ was not factored into the budget.*
Grants	3,448.8	13,378.3	-9,929.5	-74.2%	Grant receipts amounted to $3,448.8mn, a shortfall of $9,929.5mn (74.2%) against budget. This shortfall was due mainly to the delay in programmed proceeds from the European Union (EU) as these flows were linked to successful reviews of the GOJ/IMF SBA programme. In addition, the lower than planned GOJ capital spending led to delays in the disbursement of planned inflows.	The FPP does not provide a detailed analysis of the Grants. However, for the FY ended 2010/11, there was a shortfall of $5,490mn (35.2 per cent) as against the budget amount of $15,615.7mn. The FPP for FY 2011/12 has revealed a shortfall of $9,929.5mn (74.2 per cent) against budget. Both FPPs provide the same explanation for the variance in the Grants, which suggest that the FPP did not factor the uncertainties, attached to Grant inflows or overstated the projections.	*The FPP for 2011/12 could not anticipate that the SBA reviews would not have taken place.*
Operating Expenditure	**403,122.2**	**412,461.8**	**-9,339.6**	**-2.3%**			
Recurrent Expenditure	349,891.3	352,046.4	-2,155.1	-0.6%	The main contributor to the reduction was lower than programmed interest payments, as spending on recurrent programmes and wages and salaries exceeded budget.	We can confirm that the outturn for the interest payment was below the projection. However, the FPP for FY 2011/12 identified as a fiscal risk, the 7 per cent wage increase (arrears) for the period FY 2008/09 to 2009/10; but no provision was made accordingly. This fiscal risk materialized during the FY 2011/12 with the payment of these wage arrears, which resulted in a higher outturn of 4.3 per cent ($5.809.5mn) than was projected.	

Programmes	89,699.4	87,215.1	2,484.3	2.8%	The higher spending on recurrent programmes in FY 2011/12 stemmed in part from the costs associated with the holding of General and Local Government elections.		
Wages & Salaries	139,556.9	133,747.5	5,809.5	4.3%	The programmed payment of the 7.0% increase to public sector workers resulted in Wages and Salaries of $139,556.9mn being $5,809.5mn (4.3%) above Budget.	Refer to comments under recurrent expenditure	
Interest	120,635.0	131,083.9	-10,448.9	-8.0%	Interest Payments of $120,635.0mn was $10,448.9mn (8.0%) below budget, with both domestic and external interest payments being less than budgeted.		
Domestic	81,547.9	88,610.0	-7,062.1	-8.0%	Lower domestic Interest Payments resulted from, inter alia, lower than anticipated interest rates, the slower than anticipated depreciation in the value of the Jamaica dollar, later than anticipated assumption of debt and lower than budgeted contingency payments.	Reasonable	
External	39,087.1	42,473.9	-3,386.8	-8.0%	Savings from lower external interest payments emanated from the slower than anticipated depreciation in the value of the Jamaica dollar and lower than anticipated loan raising expenses.	Reasonable: However, I cannot comment on the loan raising expenses due to insufficient information.	
Capital Expenditure	53,230.9	60,415.4	-7,184.5	-11.9%	Expenditure on Capital Programmes of $53,230.9mn was $7,184.5mn (11.9%) below budget. The lower capital expenditure was mainly as a result of the GOJ's attempt to contain spending in the face of lower than budgeted revenue.	Reasonable	
Loan Receipts	**163,520.5**	**140,778.2**	**22,742.4**	**16.2%**	The lower than anticipated external loan receipts resulted from the non-receipt of programmed Policy Based	Reasonable	
Domestic	142,752.5	97,002.8	45,749.7	47.2%			

External	20,768.1	43,775.4	-23,007.3	-52.6%	Loans (PBLs) that have been delayed as a result of the issues relating to macro-economy and the SBA with the IMF. This resulted in the borrowing of a higher than programmed loan amount from domestic sources.		
Primary Balance (Surplus + / Deficit -)	**39,662.6**	**69,264.0**	**-29,601.4**	**-42.7%**			

This page is left intentionally blank.

Recommendations

49. The Ministry should clarify the following principles, and identify their related targets, to allow for an assessment of whether the FPP is in compliance therewith:

    a) Fiscal risks are to be managed prudently with particular reference to their quality and level.

    b) Borrowings are to be geared toward investment activities that support productivity and economic growth.

50. The Ministry should disclose, in subsequent FPPs, the timeline for the implementation of the measures to close the fiscal gap and the savings/revenue they are expected to generate/contribute.

51. The Ministry should take the necessary steps to ensure that future FPPs quantify the effect of the fiscal risks and introduce a robust system of risk management public sector wide. This will likely require a dedicated team in the MOFP to monitor the risk management activities in Ministries, Departments and Agencies (MDAs).

52. The FPP should indicate the source of the macro-economic assumptions and provide greater details on the factors contributing to the deviations. For example, the explanation provided for the variance for Production and Consumption would have provided useful information had it indicated whether the reduced inflows for GCT was attributable primarily to low growth or low compliance.

53. MOFP has stated its concern regarding public disclosure of market sensitive assumptions. In that regard, I propose that the Ministry either incorporates the fiscal risks in the projections or provide the Auditor General's Department with an addendum to the FPP, which provides the following information: (i) scenario analysis based on the perceived fiscal risks, and (ii) quantification of the growth and cost savings measures. This will aid in the assessment of the variances between the fiscal targets and the outturns, as well as the explanations provided by the Ministry.

Pamela Monroe Ellis, FCCA, FCA, CISA
Auditor General