

ANNUAL GRANTS GUIDELINES FOR LOCAL GOVERNMENTS (Dzongkhags and Gewogs)



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PREFACE

1. Introduction

The 10th FYP supports the acceleration of financial decentralisation through the introduction of the system of Annual Grants for Local Governments (LGs)¹. The Annual Grants System(AGS) is based on the principles of financial decentralisation to LGs as stated in Article 22.18 of the Constitution. It is a mechanism for inter-governmental fiscal transfers to LGs.

The Annual Grant System(AGS) supports bridging the gap between the characteristically ambitious Five Year Plan (FYP) and the actual resource envelope available at the local levels. It will allow for greater predictability of resources for LGs, which should in turn facilitate enhanced participation and ownership of the planning process. It should also enable better planning, prioritisation, development, and implementation of improved local plans and programmes leading to an overall improvement of local service delivery. LGs, who are in the best position to know diverse and specific local needs and priorities, would benefit through this system by enjoying local discretionary choice and flexibility in resource and funding allocation across a range of sectors and activities that they are mandated to deliver. The AGS thus would change the role of LGs from being spending agents of the centre into ‘principals’ in their own right, focusing on local priorities and needs. As the AGS includes a new system of annual **capital** grants, it is important to define and guide the LGs in these new processes to ensure that the grants will support public service delivery and infrastructure in an efficient and effective manner.

2. Objective

The objective of these guidelines is to regulate the use and operations of the Annual Grants, which are important parts of the overall funding system of LGs in Bhutan.

The guidelines will outline the framework and procedures for operationalising the AGS for LGs with special focus on the *capital* grant components. The guidelines will provide an overview of the various types of grants, the allocation formula for capital grants, the process of accessing the grants, the planning and budgeting calendar, the funding flows, release procedures, and the eligible expenditures – the so-called “investment menu” in accordance to the assignment of functional and financial responsibilities to LGs. The detailed eligible expenditures lists are in the assignment of functional and financial responsibility. Section 14 also define the non-eligible expenditures(negative lists) of the Annual Capital Grants.

¹ For the purpose of this document, “Local Governments” are defined as the Dzongkhag Tshogdu(DT) supported by the Dzongkhag Administration, and Gewog Tshogde(GT) supported by the Gewog Administration.

3. Definition of Annual Grants (AGs)

Annual Grants are the sum of all financial resources, allocated annually from Central Government to LGs, for implementing new development programmes/ projects and activities, and managing and maintaining existing service infrastructures and delivery of services. It includes both Current and Capital Grants and various forms of Earmarked Grants.

- a. **Annual Capital Grants** consists of Tied Grants and Untied Grants.
 - i. **Tied Grants** are resources allocated for LGs, for undertaking programmes and activities that Dzongkhag Tshogdus(DT) and Gewog Tshogdes(GT) have planned and prioritised in their 10th FYP. It consists of 80% of the total resources allocated to each Dzongkhags and Gewogs. In case of any deviation of activities from the 10th FYP, it will have to seek the approval of the GNHC.
 - ii. **Untied Grants** are resources allocated for LGs, for implementing programmes and activities *over and above their 10th FYP*. It could also include activities within the 10th FYP. It consists of 20% of the total resources allocated to each Dzongkhag and Gewog. DTs and GTs must decide the programmes/activities within the eligible expenditures provided by the “The framework of Assignment of functional and financial responsibilities to the LGs”, or any other innovative initiatives. It is important to note that the projects/programmes funded by the untied grants will be part and parcel of the annual plans and budgets of the DTs and GTs, and should not be considered as “extra-budgetary” funds. These grants provide the LGs with a higher level of flexibility and options for current targeting of the local emerging needs.
- b. **Current Grants** will be provided as part of AGS. Each LG will receive a share of the Annual Grants, based upon formula determined by DNB, MoF. The releases will be quarterly for Dzongkhags and half-yearly for Gewogs. Current Grants are resources earmarked for appropriations for personnel emoluments, special allowances, travel, utilities, rental of property, supplies and materials, maintenance of property, medical benefits, other personal emoluments, hospitality entertainment, current grants, operating expenses, retirement benefits etc.
- c. **Earmarked Grants** are resources allocated towards the achievement of national objectives and targets set by Central Government. It will translate into central activities being implemented at local level. In essence, it is similar to deposit works under the current system, whereby central agencies formulate plans and programmes while the Dzongkhags and Gewogs implement them. Plans and budgets for such programmes may remain with the central agencies or be incorporated into budgets and plans of LGs. It includes activities such as agriculture research, research and advocacy for health, environment conservation and climate change, gender mainstreaming, targeted poverty interventions, and

new and/or reconstruction of large structures such as Dzongs etc., activities required to achieve international obligations such as achieving millennium development goals (MDGs), regional development goals, national goals such as Gross National Happiness, and central agencies project tied activities.

- d. Local Resources:* In addition to the Annual Grants, received from the Central Government, LGs also have access to local resources mobilised through collection of local taxes such as land, house, and cattle taxes. *Other resources that LGs can tap are the labour contributions and in-kind contribution from the communities.*

4. Allocation Formula for the Annual Capital Grants Component.

The division of funds between the Dzongkhags and the Gewogs, the allocation formula and the compliance with the minimum access conditions will determine the actual size of the Annual Capital Grant and access to it for each LG. Of the total amount available for LGs in the 10th FYP, a certain amount will be reserved for central provision of standard infrastructure – Gewog’ offices, RNR centres and Gewog’ connectivity roads.

The first division of the overall grants for capital grants is a division between the Dzongkhags and the Gewogs. The resources will be divided between Dzongkhags and the Gewogs in a ratio of 60:40, reflecting the estimated division of functional assignments between the two tiers of LGs.

Second, the formula for resource allocation of Capital Grants, horizontally across the Dzongkhags and Gewogs, is developed to ensure objectiveness, equity and transparency in the allocation of resources amongst the LGs. The formula for resource allocation will be based on the following three factors with different weights assigned to them:

Size of the Population: Population will be solely based on actual residency and not the number of people registered in the Dzongkhags and Gewogs to ensure equitable access to services. From the overall resource envelope, 70% of the total resource allocation will be allocated for population. The populous Dzongkhags and Gewogs will receive higher share of resources and vice-versa to reflect the higher expenditures needs of these LGs

Poverty Incidence: The Dzongkhags and Gewogs with high poverty incidence will receive higher allocation and vice versa. 25 % of the total resource allocation will be based on incidence of poverty. The objective is to align the grant allocation with the poverty reduction focus of the 10th FYP and to provide extra support to the LGs with higher expenditure needs due to higher levels of poverty.

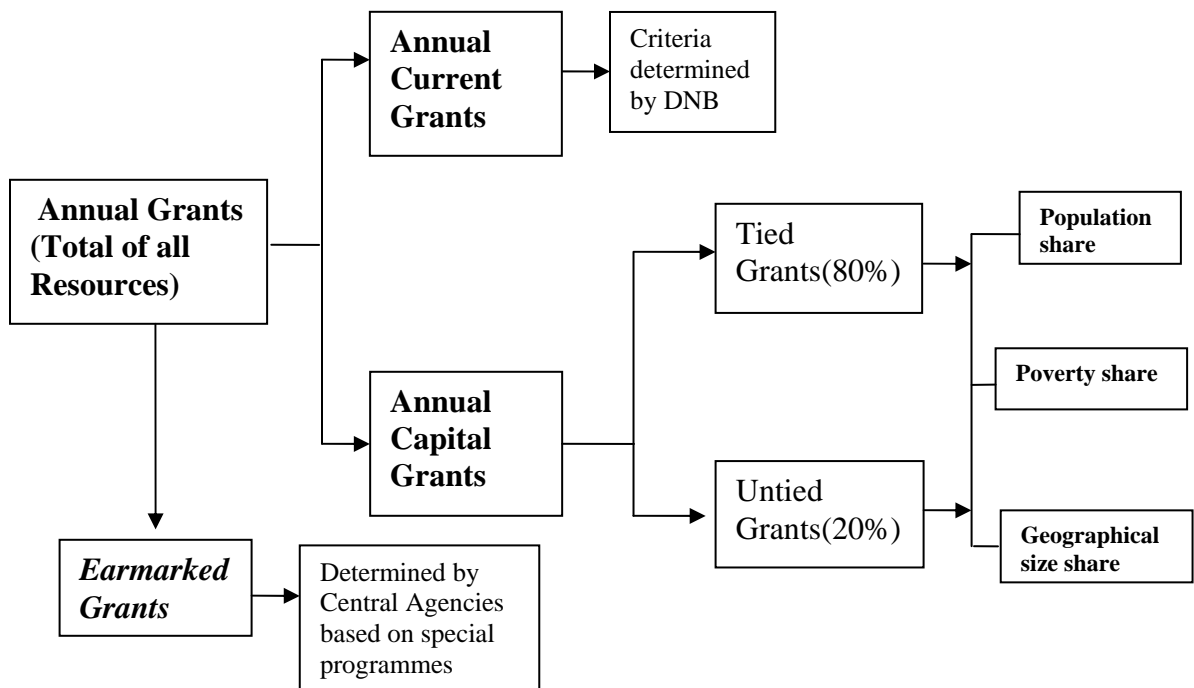
Size of the territory: Geographic size or land area of the Dzongkhags and Gewogs will determine 5 % of the total resource allocation. LGs which have larger areas typically have higher unit costs, longer distance to services, etc. and this is therefore factored into the allocation formula.

The criteria and weighting of the criteria is subject to review and refinement from time to time.

In addition to these three criteria, it is ensured that all Gewogs, even the smaller ones, will receive a certain minimum capital grant allocation by way of ‘equal share’ (same amount). This is to provide sufficient funding to guarantee that every LG can do some meaningful investments, provide minimum standard of public service, and have a basic minimum amount available for local planning, prioritisation and development.

5. Schematic Illustration of Annual Grant Allocation Formula

The figure below illustrates the various types of grants, and the criteria applied for allocation. As mentioned, there is a minimum level of allocation to each Gewog, in case the results of the three criteria applied is below a minimum defined level.



6. Minimum Conditions (MCs) and the Process for accessing Annual Capital Tied Grants (80%) and Untied Grants (20 %) for Dzongkhags and Gewogs

The Grants will be accessed through current practice of annual planning, budgeting and accounting process (*also refer to Section 9*). The Dzongkhags and Gewogs have to comply with a few core **minimum access conditions** (MCs) (*as explained under Section 7, below*) in order to be eligible to receive their Annual Capital Grants.

In addition, a number of **triggers** for the in-year releases will have to be complied with, (See Section 8). ***All MCs have to be submitted by May end of every financial year for accessing the funds.*** Failure to comply with these MCs will automatically lead to delay of funds releases for the specific fiscal year. The MCs are assessed prior to transfer of the funds and non fulfilment of it all will eventually lead to disqualification of the Dzongkhags and Gewogs from receiving the funds.

7. Minimum Conditions (MCs)

All **MCs** for accessing the Annual Capital Grants (Tied & Untied) for both Dzongkhags and Gewogs, will have to be complied with prior to the first funds release. The MCs for the coming Financial Year(FY) are detailed as follows:

- i. Annual Dzongkhag/Gewog plans and budgets in accordance with the assignment of functional and financial responsibilities of the Dzongkhags and Gewogs, endorsed by DTs and GTs. The format for annual plan will be provided by Planning and Monitoring System (PlaMS) of GNHC and budget format by DNB,MOF. Plans and budgets will have to be submitted no later than by the 15th of February.
- ii. Monthly accounts have to be submitted as per the Fund Release Guidelines of Ministry of Finance.
- iii. Minutes of GTs and DTs related to Annual Plans-to GNHC by May end.

LGs have to fulfil the above requirements to prove the compliance with the conditions (MCs).

The MCs will be reviewed yearly, and new MCs may be added, in order to provide progressive incentives for the LGs for improved performance/results such as a requirement to have addressed all major audit queries from the previous audit report(s) may be introduced, as well as other MCs.

It may also be decided to introduce performance measures in the future financial years(FY), which measure the performance of LGs within core functional areas, and which will impact on the *size* of the actual allocation to each Dzongkhag and Gewog.

8. Release and Reporting Procedures, and Triggers for Releases of Capital Annual Grants(Tied & Un-Tied)

In addition to the MCs, to get access to the grants, *funds* will only be released subject to the fulfilment of following reporting requirements (triggers). These **triggers** apply for every release/instalment throughout the FY.

Reporting Requirements: Dzongkhags and Gewogs will follow the guidelines prescribed in the National Monitoring and Evaluation Manual of GNHC to monitor and evaluate the implementation of activities through Annual Grants. Both the financial and physical progress reporting have to be complied with and submitted in accordance with reporting formats defined in Planning and Monitoring System (PLaMS) and Financial Rules and Regulations (FRR 2001) as triggers for the actual release of funds.

The Dzongkhag Administration will play a lead role in consolidating and submitting the physical progress reports, the financial statements and monthly accounts in areas where the Gewogs are not able to submit directly to GNHC through PLaMS and to DPA through BAS/PEMS due to various reasons. The Dzongkhag Administration should also receive a copy of each physical and financial statement from the Gewogs for monitoring purposes.

For monitoring and auditing purposes etc, the required documents in accordance to the rules and regulations have to be maintained by the Dzongkhags and Gewogs to document the use of the Grants.

An overview of the triggers for releases is made below:

The LG will have to be in line with the budgeting and reporting procedures for the fund requisition, i.e. there has to be:

- a) Sufficient budget provision: As per the Fund Release Guidelines (2009) there should be sufficient budget provision against the activity for which fund release is requested. If the activity is new, budget incorporation process has to be completed before requesting for funds release.
- b) Monthly Accounts: As per the Fund Release Guidelines(2009), monthly accounts has to be submitted by the agencies within 15 days after completion of the month , see above (the last month but one is checked and used for compliance control and trigger)
- c) Donor fund balance: Will be checked by Ministry of Finance to ensure that funding is available;

In addition to this, the Dzongkhags and Gewogs need to fulfil:

- d) Submission of physical progress report through PLaMS to GNHC for the previous quarters (the last quarter but one is checked and used for compliance control and as a trigger).
- e) Use of funds within the eligible expenditure areas of the functional and financial responsibilities of the LGs especially capital investments: Use of funds outside of the functional and financial responsibilities and not in accordance to *Section 14* of AGG, may lead to reductions in the future grant allocations. Some of the functional assignments are voluntary in nature and not development oriented, thus

the use of grants should be as far as possible spent on new investments and developmental activities. The audit report shall also be a basis for reviewing the compliance with the eligible expenditure as defined in these guidelines.

9. Local Government Planning and Budgeting

To have a clear understanding of the process and timeline such as planning, budgeting, fund releases and reporting etc, a Local Government Planning and Budgeting Calendar is elaborated as follows.

Local Government Planning and Budgeting Calendar

Timeline	Activity/Event	Responsible/ Lead Agencies
December	<p><i>Based on the Medium Term Fiscal Framework(MTFF) generated Indicative Planning Figure, the GNHC Secretariat releases Formula Based Annual Capital Grants(Tied and Untied) figures of Dzongkhags and Gewogs to DNB, MoF².</i></p> <p>DNB, MoF issues Budget call notification to Dzongkhags & Gewogs informing them of Annual Capital and Current Grants figures for coming financial year.</p> <p>Dzongkhag administration notifies the Gewogs and Dzongkhag Sector Offices of the Budget call and guidelines therein.</p> <p>Gewog administration conducts meeting with Tshogpas and notifies them regarding the Budget call and guidelines therein.</p> <p>Tshogpas conduct village ‘Zomdue’ and submit prioritized planned activities to GT.</p> <p>Minutes of Zomdue to be submitted to GT.</p>	<p>MTFF Committee</p> <p>GNHC</p> <p>DNB,MoF</p> <p>Dzongkhag administration</p> <p>Gewog administration</p> <p>Tshogpas</p>
Jan-Feb	<p>Dzongkhags & Gewogs, in line with the participatory planning process, execute their needs assessment, prioritisation, prepare proposals, workplans and cost estimates with support from Dzongkhag administrations(see Local Development Planning Manual).</p> <p>Gewog Administration submits proposals to GT.</p> <p>GT deliberates on the same and allocates budget within the ceilings of the Annual Capital Grants provided</p>	<p>GT/DT.</p> <p>Dzongkhag/Gewog Administrations</p> <p>Gewog Administration.</p> <p>GAOs and Gewog staff provide technical advice and support</p>

² All activities in italics are new elements in the planning and budgeting cycle.

	<p>GT submits the endorsed proposal to DT. Dzongkhag administration & sectors submit proposals to DT for deliberations.³</p> <p>Respective Dzongkhag Sectoral Offices review the Gewog proposals in line with their sectoral policies, programmes, priorities and prepare ground work for further deliberation in the DT.</p> <p>DT deliberates, reviews and prioritises the proposals from the Gewogs and Dzongkhags respectively. The DT approves the Dzongkhag/Gewog plans and budget & forwards to DNB (see the Local Development Planning Manual, Step 3)</p>	<p>DT/Dzongkhag Administrations</p> <p>Dzongkhag Administrations</p> <p>DT, Dzongkhag Administration provide technical advice, support and coordination</p>
15 th Feb	DT forwards the approved plans and budget to Dzongkhag administration. Dzongkhag administration forward the consolidated Dzongkhag/Gewog plans and budget to DNB & GNHC	Dzongkhag Administration
March	<p><i>DNB engages in budget discussions with the Dzongkhags and Gewogs to ensure compliance with the budget guidelines and financial parameters and finalizes the national budget.</i></p> <p><i>The GNHC will participate during the budget discussions especially relating to compliance with grants system and guidelines, FYP, annual plans and delivery issues, adjustments etc.</i></p>	<p>DNB, MoF</p> <p>GNHC</p>
May-June	National Assembly deliberates and approves the National Budget	Parliament
June-July	DNB, MoF notifies all Dzongkhags and Gewogs of approved budget.	DNB, MoF
July	<p><i>Upon fulfilment of MCs, Dzongkhag/Gewog Administrations will apply for releases as per the Fund Release Guidelines,2009 (MoF).</i></p> <p><i>Dzongkhag/Gewog Administration will submit their financial and quarterly physical progress report(of previous financial year) in line with the PLaMs and PEMS/MYRB</i></p>	<p>Dzongkhag/Gewog Administrations</p> <p>Dzongkhag/Gewog Administrations</p>

³ Due to the predictability of the budget under the Annual Grants system the Dzongkhags and Gewogs can go ahead with preparatory work such as technical drawings, getting clearances, tender documents etc in advance so as to prepare and launch the plan from the day the budget is received.

October	<i>Dzongkhag/Gewog Administrations will submit their financial and quarterly physical progress reports in line with PLaMS and PEMS/MYRB</i>	Dzongkhag/Gewog Administrations
Jan	Mid-Year Budget Review for compliance, re-appropriations, budget and plan delivery etc. <i>Dzongkhag/Gewog Administrations will submit their financial and physical progress reports in line with PLaMS and PEMS/MYRB</i>	DNB,DPA in coordination with GNHC Dzongkhag/Gewog Administrations
April	<i>Dzongkhag/Gewog Administration will submit their financial and physical progress reports in line with PLaMS and PEMS/MYRB.</i>	Dzongkhag/Gewog Administrations
Year round	Dzongkhags and Gewogs implement approved planned activities. Dzongkhags/Gewogs will submit their requests for budget releases through FRF, as and when needed over the course of the year. <i>Funds will be released if the minimum conditions and the in-year triggers for releases are fulfilled.</i> <i>Monitoring and evaluation of Dzongkhag and Gewog Annual Plans in line with PEMS/MYRB,PLaMS/National Monitoring and Evaluation Manual.</i>	DT, GT, Dzongkhag/Gewog Administrations DPA GNHC, DPA,DNB

10. Fund Flow

Funds will be transferred to the Letter of Credit account of the Dzongkhags and the Gewogs.

11. Supplementary Budget and Unspent Annual Capital Grants (Tied & Untied)

The Annual Capital Grants are expected to provide predictability in the planning and budgeting cycle by providing upfront Indicative Planning Figures(Grants). Hence, it must be stated that for any programmes/activities undertaken with Annual Grants funding, no supplementary budget will be provided over and above the Annual Capital Grants during a FY, except as may be permitted by the *Public Finance Act,2007*.

Activities initiated (e.g. contracted) but not completed within the current FY will be taken up during the Dzongkhags' and Gewog's annual budget review process for inclusion in the next financial year as spillover within the ceiling for the coming FY.

12. Mid-year Review

Every year, there shall be a mid-year budget and plan review meetings spearheaded by the MoF. The GNH Commission shall participate where major plan activities are involved. The purpose of this meeting is to review and discuss the delivery of the budget, progress of plan activities, need for budget re-appropriation to other activities or agencies and compliance issues by the agencies and to make the necessary adjustments mentioned above.

13. Eligible Expenditures

The use of Tied and Untied Capital Grants is based on and guided by the “Assignment of Financial and Functional Responsibilities Framework for LGs”. The Assignment of Functional and Financial Responsibilities i.e the roles and responsibilities for Dzongkhags and Gewogs is as per the recommendations from the Good Governance + (2005), the Local Governments’ Act (2009) and Local Government Rules and Regulations.

The overall *first* principle for the eligible funding is that the activity is contributing towards “public” service delivery and improved infrastructure, development oriented activities and not “private” goods. Activities should be of benefit for a minimum of 5 Gungs.

The *second* principle is that the grants are to be used for capital investments and not recurrent costs, but there are few limited exemptions from this general rule, defined below.

The *third* principle, is that the Dzongkhags and the Gewogs should pursue a strong prioritisation of cross-cutting issues/themes such as good governance, gender equality, poverty alleviation, food security and nutrition, socially disadvantaged and vulnerable groups, community happiness/vitality, natural resource management, disaster management and risk reduction, climate change adaptation and mitigation, and environmental management and sustainability in all activities included under the capital grant schemes.

Fourth, priority must be given in the plans, budgets and implementation to completion of ongoing projects. Equal emphasis to be given to provision of small maintenance⁴ and investment servicing cost⁵(refer as eligible expenditure list in functional and financial responsibilities).

⁴ Small maintenance of infrastructure, facilities and buildings e.g painting of buildings, filling of smaller pot holes etc(not cleaning and current operations). Minor current maintenance worth less than Nu. 0.1 Million must be met from the recurrent budget. *Rehabilitation* is defined here as major up-grading of infrastructure, facilities and buildings where the structure/facility/infrastructure is improved significantly, contrary to regular current maintenance. Rehabilitation is classified as capital expenditures and is done on existing infrastructure, buildings and facilities.

⁵ Investment servicing cost(need for support to outsourcing, feasibility studies, planning, engineering cost, design and survey, appraisal, advertisement, follow-up of the proposals and activities)

Finally (*and Fifth*), for the purpose of the 10 FYP for LGs, the Annual Capital Grants for LGs(Dzongkhags & Gewogs) do not apply to the education sector related works. The assignment of functional and financial responsibilities of the LGs do not have expenditure functions assigned for education sector. Therefore, the LGs' plan and budget for education sector shall be determined through joint consultation by LGs(Dzongkhags &Gewogs) and the Ministry of Education(MOE) assessing the implementation capacity of the Dzongkhags and Gewogs.

14. Non-Eligible Expenditures(negative list) for LGs(Dzongkhags & Gewogs)

The following types of activities are **NOT** eligible under the Annual Capital Grants(Tied and Untied) :

- Construction/maintenance/renovation of *privately owned* religious and cultural institutions (lhakhangs, choetens, goendeys, shedras, drubdras, anim dratshangs, lobdras, mani-dungkhor, chokhor-mani, lukhang, sangthab etc);
- Meeting recurrent expenditure;
- Credit schemes;
- Services of private nature (which benefit only few people) as well as investments such as buying shares, private business, such a shops, industries, etc;
- Investments which are not complying with the system for environmental assessments and clearances as laid down in the Environmental Assessment Act of 2000 and the 2002 Regulations for Environmental Clearance of Projects(RECOP);
- Investments in areas where there is acquisition of land with land disputes;
- Support to individuals, social benefits (e.g. pensions, payment of social assistance to unemployed people, etc.), or other types of funding;
- Celebrations ;
- Political campaigns;
- Programmes/Activities outside of the Dzongkhag's and Gewog's mandated responsibilities in the Functional and Financial Assignment Framework.

15. Role of Dzongkhag Administration(DA)

The Dzongkhag Administration(DA) has important roles in supporting and monitoring the Gewogs' performance within the Annual Grants System. Some of the core roles are:

- The DA will be responsible for overall planning and Public Expenditure Management, and shall provide technical support to the Gewogs in planning, budgeting, costing, estimation, implementation process etc, and consolidate the quarterly physical and financial reports in areas where direct reporting flow from the Gewogs to the MoF through BAS/MYRB/PEMS, and to the GNHC through PLaMS are not operating;
- DA will be fully accountable for the use of Annual Capital Grants including compliance with the reporting requirements, minimum access conditions and standard financial management procedures of the MoF including submission of monthly and quarterly financial reports and quarterly physical progress reports (the triggers for releases);

- DA shall use the funds efficiently in accordance with the objectives of the AGS and also comply with the assignment of functional and financial responsibilities for LGs;
- DA should monitor and submit progress reports as per the prescribed procedures in the National Monitoring and Evaluation Manual of GNHC through PLaMS;
- DA will also monitor the general implementation of the AGS and inform the GNHC and MoF on any problems, challenges and issues which may hamper the successful implementation of the AGS;

16. Role of Gewog Administration(GA)

The roles of the Gewog Administration(GA) are the following:

- The GA in coordination with GT shall be responsible for their planning and Public Expenditure Management;
- GA will be fully accountable for the use of Annual Capital Grants including compliance with the reporting requirements, minimum access conditions and standard financial management procedures of the MoF including submission of monthly and quarterly financial reports and quarterly physical progress reports (the triggers for releases);
- GA shall use the funds efficiently in accordance with the objectives of the AGS and also comply with the assignment of functional and financial responsibility for LGs;
- GA shall monitor and submit progress reports as per the prescribed procedures and format in the National Monitoring and Evaluation Manual of GNHC through PLaMS whenever possible;
- GA shall provide required information on progress regarding various activities concerning the operations of the AGS through DA;
- The Gewog Administrative Officer will be fully responsible in coordinating, updating, compiling, and submitting the physical progress reports through Gewog/Dzongkhag Administrations;
- The Gewog Accountant will be fully responsible in coordinating, updating, compiling, and submitting the financial reports through Gewog/Dzongkhag Administrations;

17. Role of Royal Audit Authority (RAA)

The RAA will conduct as a minimum, an audit of the accounts of the Dzongkhags and Gewogs, at least once in two years. *In addition to the financial audits, the RAA will also conduct performance audits to ensure that Dzongkhags and Gewogs have complied with the functional and financial assignment of the LGs and procedures related to this guideline.*

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