

	The Board of Audit and Inspection of Korea	
	Fair Audit Fair Society	

Audit Report on the Status of Efficiency and Soundness of Local Education Finance

Disclosed on May 12, 2020

I. Audit Background

- The number of students from primary school to high school in South Korea decreased from 6.38 million (2014) to 5.67 million (2018). This number is expected to fall to 3.82 million by 2035 (March 2019, Statistics Korea).
- Meanwhile, the budget of the municipal and provincial education offices (hereinafter referred to as education offices) increased from KRW 40.9 trillion (USD 35.7 billion¹) in 2014 to KRW 52.5 trillion (USD 45.8 billion) in 2018. As such, the budgets of education offices continued to increase by an annual average of 6.4%. This increase stems from the fact that the Ministry of Education (MOE) subsidies,² which account for 66.6% of the education offices' revenue budgets, are linked to internal tax revenues.³
- Most notably, unspent budget⁴ and the carryover budget⁵ of education offices have increased by over 1.4 times and two-fold, respectively, over the last 5 years (2014-2018).

¹ Throughout this report, KRW was converted to USD based on the exchange rate for October 15, 2020 (USD 1 = KRW 1,147)

² As of 2020, the Ministry of Education (MOE) allocates 20.79% of its internal tax revenues as subsidies.

³ Internal tax revenues have been increasing annually in line with economic growth.

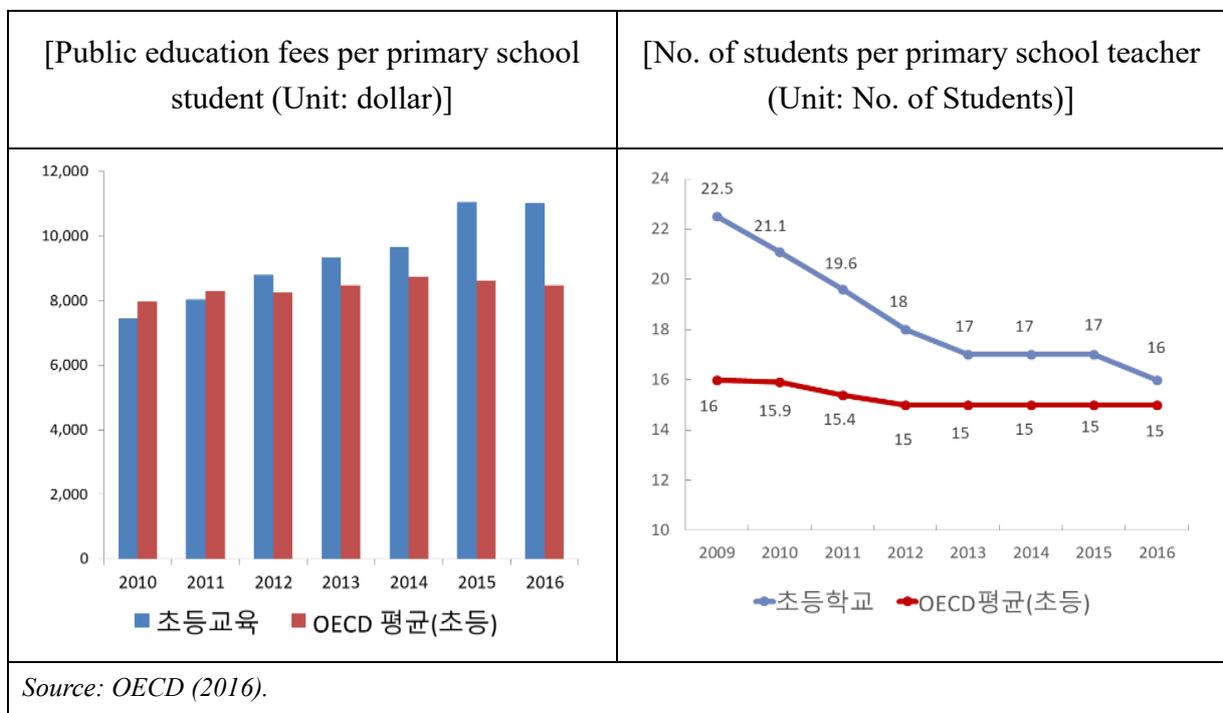
⁴ The unencumbered balance of that year.

⁵ The unobligated funds carried forward from the prior budget period to the current budget period.

- Accordingly, the Board of Audit and Inspection (BAI) aimed to check whether the education offices made best use of their budget.
- The BAI examined whether the education offices formulated and executed their budget in due time with the required amount and checked for any practice of unnecessary or non-urgent spending by allocating excessive amounts of funds that exceeded their need.
- This allowed the BAI to suggest the operation directions necessary for the education offices to adapt to the ever-changing conditions, including the declining school-aged population.
- From September 23 to November 22, 2019, the BAI conducted the audit on the MOE and 17 education offices and enforced the audit findings of 10 cases.

II. Status of Local Education Finance

① **(International Comparison)** Higher investment toward education and significant improvement in education quality compared to OECD average



초등교육 Primary education (Korea) / OECD 평균 (초등) OECD average

② **(Total Revenue)** Majority of resources for revenue budget of education offices are internal tax-linked MOE subsidies

- Local education finance refers to financial activities of education offices, which support from primary to secondary education.
- The sources of the local education finance mainly consist of MOE subsidies (an estimated 70%), along with the money transferred from the general accounts of the local government, and earnings/borrowings of the education offices. Among them, the earnings take account for a mere 2%.
- In accordance with the Local Education Subsidy Act (Article 3-2), the MOU grants 20.79% of their internal tax revenues for the subsidies to the education offices nationwide independent of their educational needs.
- The total amount for subsidies reached KRW 40.9 trillion (USD 35.7 billion) in 2014 and KRW 52.5 trillion (USD 45.8 billion) in 2018.

Reference: Subsidy history of South Korea and Japan

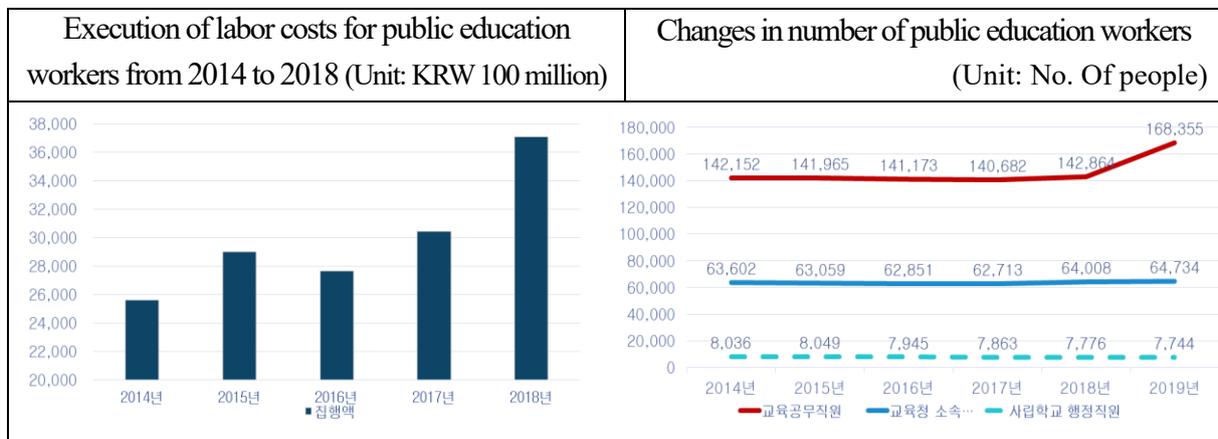
- **(South Korea)** Subsidies were introduced to secure the stability of finance when there was a drastic increase in the number of junior high and high school students before and after the “No Entrance Exam for Junior High School” policy in 1972.
- **(Japan)** Subsidies were introduced in 1952. The difference between the Japanese and the Korean subsidy is that Japan's local education finance is a part of the general finance of the local government.
- In 1998, the Board of Audit of Japan recommended reducing the subsidy by reflecting the decrease of the school-age population. Accordingly, the subsidy was lowered in 2004.



*The graph shows the rate of increase and decrease of the Korean and Japanese subsidies. The amount of the subsidies in 2012 is converted to 1 for comparison.

③ (Total Expenditure) Improper expenditure plan leads to inefficient budget execution

- Total expenditure consists of capital expenditure, current expenditure, transfer payments, repayment of loans, and transfers.
- Capital expenditures are variable expenses incurred for acquiring assets (e.g. construction costs), while current expenditures are fixed and recurring expenses that remain constant for a period of time (e.g. labor costs).
- Capital expenditures compose 11% (KRW 7.7 trillion (USD 6.7 billion) in 2018) of the total expenditure, and 95% of capital expenditures are for facilities.
- The current expenditure accounts for 75% of the total expenditure (KRW 53.3 trillion (USD 46.5 billion) in 2018), and 75% of that is for labor costs, which remain at similar levels each year.
- However, the labor costs for public education workers⁶ (e.g. fixed-term workers; and indefinite-term workers hired by principals) was up from an estimated KRW 2.6 trillion (USD 2.3 billion) in 2014 to an estimated 3.7 trillion (USD 3.2 billion) in 2018. In 2019, the number of workers in public education rose by 18% compared with the numbers in 2014.



집행액 Execution cost, 교육공무직원 Public education workers, 교육청 소속 Staff at education offices, 사립학교 행정직원 Administrative staff at private schools

- Between 2014 and 2018, the unspent budget increased by 44%. In the meantime, carryover budgets and specified carryovers increased by 110% and 180%, respectively, with 93% of the carryover budgets (as of 2018) being for facilities.

⁶ Public officials are not included.

[Overview of carryover budgets in 2014 and 2018]

	Specified carryovers ⁷	Unusual carryovers ⁸	Carryover of continuing expenditures ⁹	Total
2014	KRW 914.4 billion (USD 0.8 billion)	KRW 560.7 billion (USD 0.49 billion)	KRW 854.9 billion (USD 0.75 billion)	KRW 2.33 trillion (USD 2.03 billion)
2018	KRW 2.56 trillion (USD 2.23 billion)	KRW 1.15 trillion (USD 1 billion)	KRW 1.2 trillion (USD 1.02 billion)	KRW 4.89 trillion (USD 4.26 billion)
Increase rate	180%	105%	38%	110%

- The education offices can only use the funds that remain after executing the carryover budgets on the purpose for which they were initially intended. In order to use these funds for other purposes, the education offices are required to lapse the unspent balances and to reappropriate them in the budget for the following year. Therefore, when the carryover budgets increase, it becomes more difficult to use the carryovers for other projects, making the budget allocation inefficient.

④ **(Financial Management)** MOE predicts the demands of the offices of education. Subsidies and borrowings are used to supplement the shortage.

- The MOE provides subsidies to education offices by estimating and calculating their required expenditure (standard amount of financial demand) and revenue (standard amount of financial revenue). However, this figure is not based on the actual demands of the education offices. If any shortage is expected, the ministry recommends that those education offices issue local education bonds to raise borrowings.
- The education offices autonomously formulate their special account for educational expenses¹⁰ by using the money transferred from the local government, MOE subsidies, and borrowings as the sources of their revenues. As of 2019, the education offices executed 69.1% of their expenditure budgets, while transferring the remaining 30.9% to the schools in their districts.

⁷ If the education offices expect that they will not be able to execute a certain amount of budget within the fiscal year, they can request a budget carryover. The education office must gain resolution from the local council after clearly stating its purpose in the revenue and expenditure budgets.

⁸ Once the education offices enter into a contract (e.g. facilities construction contracts), the offices can request a budget carryover if they cannot spend the funds within the fiscal year for unavoidable reasons (e.g. disaster or construction delay).

⁹ The education offices can disburse funds over several fiscal years for construction, manufacturing, research, or development projects that require years for completion after they gain prior approval from the National Assembly.

¹⁰ Special accounts for educational expenses manage the revenue and expenditure of the education offices. According to Article 38 of the “Local Education Autonomy Act,” the local governments can create a special account for educational expenses for separate accounting of expenses incurred in relation to education and academic sciences.

III. Audit Findings

Overview of Audit Findings

- The revenue of the local education finance consists of MOE subsidies, transferred funds from the general accounts of local governments, borrowings (by issuing local education bonds), and the earnings of education offices. Of the revenues, the MOE subsidies¹¹ make up the largest percentage (70% each year).
- The subsidies, therefore, determine the size of the local education finance of the year. In other words, the determining factor of local education finance are internal revenues instead of the actual demands of education offices.
- With the low fertility trend becoming the norm in Korea, the school-age population drastically decreased but due to economic growth and the resultant increase in tax revenue, the size of local education finance has steadily expanded. This induced more investment in primary and secondary education, leading to a significant improvement in educational conditions.
- Reduced number of students (final beneficiaries of education) and increased local education finance are contributing to a burgeoning increase in a budget surplus among the 17 education offices nationwide. The budget surplus of education offices in 2018 increased by 93.8% compared to 2014. Accordingly, the problem of imbalance in government resource allocation gradually gained nationwide notice.
- The BAI analyzed the revenue and expenditure of local education finance between 2014 and 2018, and compared the total revenue and expenditure in 2014 with the figures in 2018. The rate of total revenue increase (30.3%) outnumbered that of the total expenditure increase (26.1%), which shows that the budget surplus locked in the offices of education is growing exponentially.
- There are a number of reasons for the increasing budget surplus:
 - **(Total revenue)** The subsidies and borrowings compose the revenue of education offices. The education offices receive subsidies every year from the MOE. Even though the scale of the MOE subsidies shows continuous growth, this does not necessarily reflect the demands of the education offices. The education offices' practice of issuing local education bonds in excess of need also aggravates the revenue and expenditure imbalance.
 - **(Total expenditure)** In general, uncontrollable expenditures (e.g. labor costs) account for the majority of local education finance (around 80% each year). As there was not enough demand to adequately spend the excessively allocated budget in time, the amount remaining after executing the budget (hereafter referred to as "unexpended funds") were carried over to the following year, resulting in inefficient budget execution.
 - Further to this, the education offices cannot consume carryovers from the previous year for different projects in the next year, creating obstacles that hamper them from managing their budget efficiently.

¹¹ Allocate 20.79 percent of internal revenues on a statutory basis.

1. Revenue

① The volume of borrowings is decided and executed based on a simple forecast and regardless of the actual demands, which results in over-borrowing

- According to the Local Education Subsidy Act, the MOE calculates in detail the revenue and expenditure of individual education offices. Based on these calculations, the ministry gauges the fiscal shortage and provides subsidies to make up for the shortages.
- For any shortages found, each education office can issue¹² local education bonds¹³ based on the Local Finance Act to secure borrowings.
- The MOE estimates and determines the local education finance for the current fiscal year by multiplying a certain percentage to the amount of the local education finance of the previous year. Upon this estimation, the MOE subsidizes and borrows to each education office.
- Under these circumstances, the education offices issued local education bonds without examining the necessity for extra bonds.
- Even in the cases where there was extra capital, the offices of education issued the bonds equivalent to the amount of the borrowings.
- To prevent lax financial management in education offices, the issuance of local education bonds must be preceded by the approval of the local council. However, in practice, the local councils deliberated on and voted for the bill to issue local education bonds without reviewing any details of the individual projects.
- As a result, in the last 3 years, an excess of KRW 2.55 trillion (USD 2.2 billion) worth of local education bonds were issued even though the education offices have had an expenditure budget surplus of KRW 4.96 trillion (USD 4.3 billion) for 3 years (2016-2018).

¹² General purpose local governments submit detailed project plans (e.g. total project budget) to the Ministry of the Interior and Safety, and the council under, which the local governments belong, to issue local government funds as needed.

¹³ In the Local Finance Act, the term “local government bonds” embraces local education bonds as well. However, in this audit report, the BAI distinguished local education bonds (managed by the MOE) from local government bonds (issued by the local government).

② Incorrect borrowing conditions and incentive schemes result in lost opportunities to reduce interest rate costs

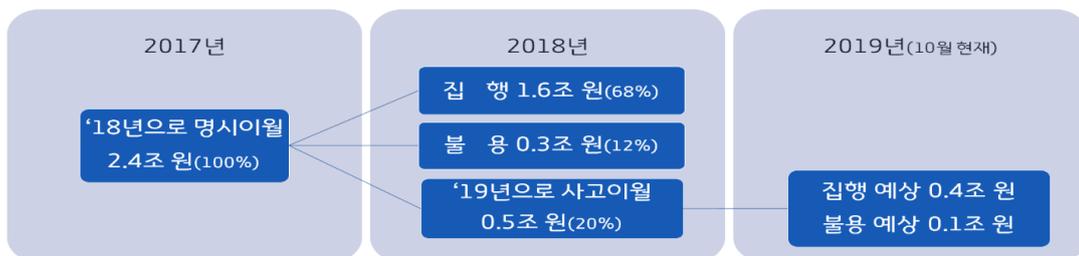
- When issuing local education bonds, short-term bonds (2-year grace period, 3-year repayment period) are better to secure fiscal soundness, as shorter repayment periods contributed to lower interest rates and the burden of interest is less.
- However, the MOE failed to check whether the loss of revenues for education offices would be exacerbated or not between 2016 and 2018, and instead asked all the education offices to issue long-term bonds (5-year grace period, 10-year repayment period). This led to a loss of opportunities for the education offices to reduce the interest costs of KRW 13.7 trillion (USD 11 billion) (2017-2019).
- Also, the average carryover and unspent budget of education offices for 3 years (2016-2018) was an estimated KRW 6.3 trillion (USD 5.5 billion).
- However, the MOE allowed the education offices to use only KRW 6.4 trillion out of the KRW 9.7 trillion (USD 8.5 billion) of additional revenue (the settlement of subsidies from the previous year) to repay borrowings. The ministry provided the remaining amount (KRW 3.3 trillion (USD 2.9 billion)) to the education offices, allowing them to execute the provided funds according to their needs.
- If this amount (KRW 3.3 trillion (USD 2.9 billion)) had been used toward early repayment, there would be a reduction cost of KRW 638.7 billion (USD 556 million) in interest rates.
- To improve the soundness of local education finance, the MOE introduced and has been operating the “Incentive Schemes for Early Repayment.” The MOE provides additional unrestricted subsidies (2.5% of the repayment amount) in the next year to the education offices to repay their local education bonds ahead of schedule with their budget surplus.
- However, the major objective of the education offices did not coincide with that of the MOE: fiscal soundness. Since the education offices place greater emphasis on securing more subsidies, 11 out of 17 education offices issued an estimated KRW 932 billion (USD 812 million) in local education bonds after repaying their existing bonds of near KRW 1.99 trillion (USD 0.9 billion). As the interest rate on newly issued bonds was higher than that of previous bonds, this will incur more interest costs (an estimated KRW 2.5 billion (USD 2.1 billion)) annually.
- Even under these circumstances, the ministry still provided additional subsidies (an estimated KRW 27.5 billion (USD 23.9 billion)) to the 11 education offices.

2. Expenditure

① The carryover system to enhance the expenditure elasticity results instead in inefficiency of budget allocation

- In principle, expenditures of the year should be covered by the revenues of the same year. However, under certain conditions, some unexpended budgets from the prior budget period can be carried over to the following year.
- According to the Local Finance Act (Article 50) and the principle of annuality, the education offices are not allowed to use the unexpended budgets for a new project scheduled in the following year. As such, the more the carryover budget increases, the more barriers to efficient budget allocation.
- Meanwhile, the total amount of carryover budgets by the education offices more than doubled, up from KRW 2.3 trillion (USD 2 billion) in 2014 to KRW 4.8 trillion (USD 4.2 billion) in 2018.
- Thus, the BAI identified and analyzed the specified carryover budgets that were carried over from 2017 to the next budget year. This audit was designed to examine how long the carryover budgets from the previous fiscal year remained unexecuted.
- The education offices executed a mere 68% of the budget in 2018, and the remaining budget (32%) was unencumbered and carried over to the next budget period (2019). The BAI noticed that a certain amount of budgets had been unexpended or disbursed over 2 to 3 years.

[Execution process of specified carryovers]



'18년으로 명시이월 Specified carryovers to 2018 / 2.4조원 KRW 2.4 trillion (USD 2.1 billion) / 집행 1.6조원 Execution KRW 1.6 trillion (USD 1.4 billion) / 불용 0.3 조원 Unspent budgets KRW 0.3 trillion (USD 0.26 billion) / '19년으로 사고이월 Unusual carryovers to 2019 / 10월 현재 as of October / 집행 예상 0.4조원 Estimated execution KRW 0.4 trillion (USD 0.34 billion) / 불용 예상 0.1조원 Estimated unspent budgets KRW 0.1 trillion (USD 87 million)

- For Jeju Self-governing Provincial Education Office, for example, there was an unexecuted budget of near KRW 7.2 billion (USD 6.2 million) as of March 2020 after creating the budget plan in 2016 (e.g. new auditorium establishment project for primary schools, approx. KRW 7.2 billion (USD 6.2 million)). Such a budget was transformed from being categorized as “total amount as specified carryovers” to “unspent budgets” then to “repeated carryover after budget formulation.”

② No adjustment to the unexecuted budget in the fiscal year in advanced budget formulation for the following year leads to carryovers

- The “preliminary settlement” system refers to when the education offices review the budget that will remain unexecuted (e.g. estimated carryover budget and unspent budget) before the settlement and deduct that amount when formulating a revised supplementary budget to use toward the budget of other projects.
- By utilizing the preliminary settlement, it is possible to effectively control the excessive and unnecessary carryover budgets and unspent budgets.
- However, only 16.5% (approx. KRW 0.3 trillion (USD 0.26 billion)) from projects that expected carryover budgets and unspent budgets (approx. KRW 1.9 trillion (USD 1.7 billion)) adjusted their budgets with the deduction during the preliminary settlement in 2016, demonstrating that the preliminary settlement system was not being utilized properly.
- In addition, an additional budget for new projects was added, instead of using the preliminary settlement when formulating a revised supplementary budget.
- For three years (2016-2018), 18.8% (approx. KRW 1.5 trillion (USD 1.3 billion)) of the facility costs included in the supplementary budget was not executed to the designated projects (about 4,000). Instead, the whole amount was authorized to become specified carryover budgets for the following year.
- In regards to seismic retrofitting construction costs, for example, five education offices expressed negative opinions stating that the existing budget (KRW 489.7 billion (USD 426 million) in 2018) cannot be spent within the fiscal year. The MOE, however, provided an additional budget of KRW 149.5 billion (USD 130 million), resulting in carryover budgets of near KRW 105.2 billion (USD 91 million).

③ Concerns over increased burden on local education finance due to poor management of public education workforce and budget

- Public education workers (non-civil servants) work for school principals under contract to carry out educational administration tasks and other general administrative tasks, as well as educational welfare and support work, such as school lunches.
 - Among these workers, fixed-term workers become eligible for an indefinite-term contract after working two years, according to relevant laws and regulations.
 - In January 2014, the MOE introduced the system to transfer fixed-term workers to work under indefinite-term contracts to improve their working conditions.
- Public education workers consist of fixed-term and indefinite-term contract workers. However, in managing the total payroll budget¹⁴, the MOE only included indefinite-term workers, leaving out the fixed-term workers.
 - There were a number of cases where the status of fixed-term workers (hired by school principals) were automatically transferred to that of indefinite-term contract workers.
 - It is necessary to implement proper management measures for hiring fixed-term workers. Otherwise, an increase in the number of public education workers or personnel payroll costs can create a burden for the local education finance.
- In addition, according to regulations for education and administrative offices, there should be a quota set for the number of indefinite-term contract workers by type of work in their ordinances that are managed by each of the education offices.
 - However, the 12 education offices hired 9,469 indefinite-term contract workers¹⁵ who do not belong to any of the regulation-related categories.
- The 4 education offices, including Gyeongbuk Province, hired 122 educational administrators who were supposed to provide support to schools. Instead, they were assigned to work at the 4 education offices, which was not the set purpose of their employment.

¹⁴ The 6 education offices (including Seoul) set 87% of the cost for fixed-term workers as subsidies from the central government in 2018 and executed the budget.

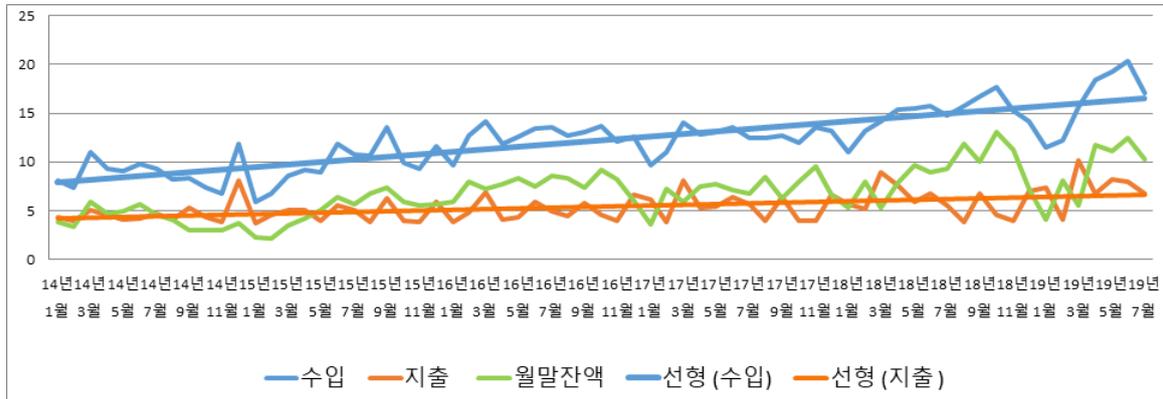
¹⁵ Between 2015 and 2019, there was only a 15% increase in categorized jobs, while uncategorized jobs increased by 249.8%.

3. Surplus

① A higher revenue compared to expenditure with an increase in improper spending of accumulated budget

- For 5 years (2014-2018), the total revenue increased by 30.3% due to the increase in subsidies from the expansion of internal tax revenue and excessive borrowings. The total expenditure, however, only increased by 26.1%.
- In the end, the budget surplus (total revenue after deducting the total expenditure) doubled over the last 5 years (KRW 3.7 trillion (USD 3.2 billion) → 7.2 trillion (USD 6.3 billion)).
- Among the surplus, there was also an increase in carryover budgets (KRW 2.3 trillion (USD 2 billion) → 4.9 trillion (USD 4.3 billion), 109.7%), of which 93.4% of it was carryover budgets for facilities (as of 2018).
- The analysis result of the cash flow (e.g. monthly revenue and expenditure) of 17 education offices for the last 5 years showed that the increase rate (27.6%) of monthly expenditures did not reach the level of the increase rate (68.5%) of the monthly revenues (revenue of the month + balance from the previous month).
- The monthly balance (revenue of the month + balance from the previous month - expenditure for the month) is the amount that is always kept at an education office each month. The annual average of the monthly balance increased more than twofold (KRW 4.2 trillion (USD 3.7 billion) → 9 trillion (USD 7.8 billion)), with the Seoul and Gyeonggi metropolitan areas accounting for a large portion of the increased amount (33%).
- The average term deposit (at the end of each month) for education offices in 2018 was KRW 6.7 trillion (USD 5.8 billion); within this amount, the term deposit with a one-year term was confirmed to be KRW 1.6 trillion (USD 1.4 billion) (at the end of December 2018). This deposit is usually regarded to be automatically carried over to the next year upon deposit (no plan to be executed at least in the year of deposit).

[Cash flow of 17 education offices (Monthly revenue and expenditure, monthly balance)
(Unit: KRW trillion)]



14년 2014 15년 2015 16년 2016 17년 2017 18년 2018 19년 2019
1월 January 3월 March 5월 May 7월 July 9월 September 11월 November
수입 Revenue 지출 Expenditure 월말잔액 Monthly balance
선형 (수입) Linear regression (Revenue) 선형 (지출) Linear regression (Expenditure)

② Inputting new capital without reducing the budget for unexecuted projects

- The budget execution rate for facility costs amounted to only two-thirds of the total budget for facility costs, leaving one-third unused (including carryover budgets from the previous year). When the education offices receive a new budget and it is included into the main budget for facility costs, there is a high probability that the remaining one-third will not be executed.
- Therefore, it is ideal for the MOE and the education offices to conduct a preliminary settlement to reduce the budget for the projects expected to remain unexecuted for that year and to use the unexecuted amount as a supplementary budget.
- The analysis result of the preliminary settlement of 17 education offices in 2018 showed that an estimated KRW 2.5 trillion (USD 2.2 billion) of the formulated main budget was expected to remain unexecuted (e.g. carryover budgets, unspent budgets) that year.
- An additional budget of KRW 2.97 trillion (USD 1.8 billion) was formulated, even though the unexecuted amount could have been used if it had been deducted as the revised supplementary budget was being formulated.
- As such, the facility cost of KRW 2.97 trillion (USD 1.8 billion) that was newly introduced to the supplementary budget in 2018 had nowhere to be executed, and was kept idle in the accounts of the education offices.

③ Gyeonggi Provincial Education Office transfers budget to district schools to execute projects

- According to the Local Finance Act, the expenses that an education office executes should be from the education office budget (special accounts budget), and as such, the same applies for schools, in that the expenses executed by the school should be from the school budget (school accounting), after being transferred from the education office.
- The Gyeonggi Provincial Office of Education (Gyeonggi POE), however, transferred the budget to each school in its district even though it is the provincial office that carries out the projects for school facilities. The budget would then be returned from the schools to the provincial office as cash accounting instead of as revenue and expenditure, which does not comply with standard procedure, and be expediently executed.
- As a result, the project budget that was regarded to be fully executed according to the settlement of the Gyeonggi POE¹⁶ actually resulted in being carried over to the accounting of Gyeonggi district schools.
- Eventually, near KRW 807.4 billion (USD 703 million) transferred from the Gyeonggi POE to the schools of its district in 2018 remained unused and carried over as a part of school accounting due to the lack of a detailed budget execution plan.

④ Budget of KRW 5.3 trillion (USD 4.6 billion) was not implemented in time and the remaining budget was not used for repayment of bonds

- According to the settlement of the 2018 fiscal year, approximately KRW 5.3 trillion (USD 4.6 billion)* (Gyeonggi POE¹⁷: approx. KRW 4.2 trillion (USD 3.7 billion), schools¹⁸: approx. KRW 1.1 trillion (USD 0.9 billion)) was kept as a part of the local education finance throughout the year on the grounds that there was nowhere to spend the budget.

¹⁶ Average carryover budgets for the schools within the district of the Gyeonggi POE amounted to over 14 times that of the schools under the other 16 education offices.

¹⁷ Gyeonggi POE (special accounts budget for education): Formulating a supplementary budget in –advance for facility costs: approx. KRW 2.1 trillion (USD 1.8 billion); budget surplus: approx. KRW 2.1 trillion (USD 1.8 billion).

¹⁸ Schools (school accounting): Facility costs that Gyeonggi POE transferred to schools was approx. KRW 0.8 trillion (USD 0.6 billion); budget surplus: approx. KRW 0.3 trillion (USD 0.26 billion).

- While a large portion of the budget was left unused and locked in, the Gyeonggi POE did not repay its local education bonds that amount to KRW 2.43 trillion (USD 1.8 billion) (as of December 2019). The office also did not establish and operate the Fiscal Stability Fund¹⁹.
- Rather, the Gyeonggi POE newly established legal grounds by amending the Local Education Subsidy Act; this amendment allows the education office to provide additional subsidies, aside from subsidies with legal rates, if there are any inevitable demands.
- This creates an unnecessary burden of interest (approx. KRW 267.5 billion (USD 233 million)) until the maturity date of the local education bonds and by injecting extra financial resources, the efficiency in allocating the national budget becomes deteriorated.

⑤ **(Best practice)** Gangwon Provincial Office of Education enhances financial soundness by minimizing carryover budgets and repaying local bonds

- **(Self-repayment of debt)** The Gangwon Provincial Office of Education (Gangwon POE) was able to achieve repayment early with around KRW 70 billion (USD 61 million) from the reduction of facility costs in 2017 and 2018, resulting in “zero debt.”
- **(Designating subsidies as excessive revenue)** The education office found that the special subsidy amounting to KRW 8 billion (USD 6 million) given by the MOE in November 2019 would carry over to the following year if the office included the budget into the facility cost as a part of the supplementary budget plan. Therefore, in an effort to reduce the 2020 budget, the office designated the subsidy as excessive revenue.
- **(Reserve fund)** The Gwangwon office reduced the budget of facility costs (KRW 97 billion (USD 84 million)), deciding that it would be difficult to execute the budget if it was included as a part of the 2019 supplementary budget. The reduced amount was deposited into the Fiscal Stability Fund for education (a total of KRW 210 billion (USD 183 million)) as a response to the revenue imbalance among different fiscal years.
- As a result, the carryover rate for the facility costs of the Gangwon POE decreased over 10% in 2018 compared to the 2016 nationwide average (37.8%), and the overall efficiency of budget execution showed great improvement.

¹⁹ According to Article 14 of the Local Finance Act, it is possible to establish the Fiscal Stability Fund with the budget, including surplus cash accounting, in order to adjust the imbalance of the fiscal revenue for that fiscal year.

IV. Major Recommendations

① **(Revenue)** Inappropriate process of deciding the size and borrowing conditions of local education bonds

- The BAI recommended the Minister of Education to:
 - Prevent the issuance of excessive local education bonds to the education offices, regardless of their financial conditions and demands.
 - Submit a report on the projects managed through local education bonds (e.g. project name, total cost) to the Ministry of Education and the local councils.
 - Create measures to strengthen the management and supervision of approving and issuing local education bonds based on the submitted reports.
 - Establish conditions (e.g. repayment period) to minimize the burden of interest rates for education offices issuing local education bonds due to the lack of subsidies.
 - Provide an early repayment incentive system of local education bonds but only after the education offices enhance the soundness of their local education finance.

② **(Expenditure)** Improper carryover budget formulation and inadequate operation of public education workforce and budget

- The BAI notified the Minister of Education to:
 - Organize the project budget for facilities appropriately so that they can be executed within the fiscal year
 - Introduce measures to minimize carryover budgets and unspent budgets by utilizing the preliminary settlement system.
- Establish and execute standards for spending labor costs by extending the work period of fixed-term workers within the range of the total labor costs, as needed.
 - Establish measures to adjust the total labor cost by checking the appropriateness of labor operations, the management of public education workers and on whether the workers are being properly allocated according to the purposes of their employment.

③ (Surplus) Improper implementation of surplus in local education finances

- The BAI recommends the Minister of Education to:
 - Use the local education budget that is locked in (KRW 5.35 trillion (USD 4.6 billion)) (as of December 31, 2018) to repay the local education bond balance first when the MOE provides subsidies in 2021. The BAI also recommends the minister to encourage the education offices to use the remaining surplus toward Fiscal Stability Funds.
 - Work in partnership with related organizations, such as the Ministry of Economy and Finance, to discuss ways to adjust the subsidy rate [which is fixed with the ratio of internal tax (20.79% as of January 1, 2020)] based on any changes to educational and financial conditions, such as a decrease in school-age population and increase in tax revenue. The BAI also recommends the minister to establish improvement measures to inject and allocate subsidies in a rational manner.
- **(Best practice)** The Gangwon POE was selected for an award for best practice by the Board of Audit and Inspection. The Gangwon office won the award for enhancing the soundness and stability of its local education finance (e.g. reducing excessive carryover budgets in order to repay local bonds).