

ARREARS CLEARANCE FRAMEWOK

POLICY FORMULATION

Section 1

BACKGROUND

An expenditure is classified as an arrears when the financial obligations that were incurred by any level of government sector for which payments have not been made by the due date. The accumulation of expenditure arrears by governments reduce their credibility and ratings which may have negative effect on the domestic economy by reducing growth, increasing cost of service and reducing service delivery.

Expenditure arrears can be the result of failures at any or all stages of public financial management cycle, which include inadequate legal frameworks, unrealistic budgeting, weak or cumbersome expenditure controls, inefficient cash management, lack of (or problems associated with) a financial management information system (FMIS), or gaps in fiscal reporting.

An online comprehensive domestic expenditure arrears register must be maintained by the MDAs with the database residing in the DMO.

The database shall be a robust record containing the contractors' names, amount due at year end, the nature of the goods and services procured that generated the claim and the billing data or payment history.

The database shall be updated on monthly basis. This will enable debts managers ascertain percentage movement in the domestic expenditure arrears of the state.

The stock of arrears amounting to **N20million and above** legally due to contractors, consultants and suppliers from all MDAs in Lagos State at the end of every month for at least **3 years** down the line shall be pulled from the database for publication. However, payments of domestic debts below N20million emanating from any of the MDAs shall be paid as and when due.

SECTION 2

PLANNED ACTION TO SETTLE ARREARS

DEVELOPMENT OF A MULTI-YEAR FUNDING FOR CLEARING ARREARS

The Ministry of Economic, Planning and Budget (MEPB) with inputs from the Ministry of Finance develops a realistic 3year Medium Term Expenditure Profile (MTEF) every year where budget provisions are made for MDAs to execute projects and to pay debts that may emanate from such projects.

Due to the full adoption of TSA by the Lagos State government, government bank accounts have been streamlined, all multiple revenue accounts with different codes have been closed down and all revenue generating agencies pay directly into a common accounts with agency codes to differentiate which agency of government generate what in order to measure performance.

Because MDAs don't maintain separate expenditures accounts, all payment requests shall be directed to the State Treasury Office (STO) for payments. STO make use of Account Payable module with a preset suppliers' numbers for processing. All payment requests that were cleared for payments shall be collated and forwarded to DMO to be included in the database.

MAJOR SOURCES OF FUNDS

There are two major sources of funds that may be available for settling the arrears. A state's estimate of total funds available to clear arrears may include any or all these sources:

(i)The Internally Generated Revenue (IGR), Federal Transfers, Grants and a one-off revenues such as the Paris Club refund. The proportion of the fund available to clear the arrears will depend on how much comes into the state purse from the above and the ability to control other competing state's expenditures e.g. personnel costs, pensions and gratuities.

(ii) Borrowings.

- Such as Federal government financial assistance in form of loans to states for the purpose of settling accumulated and backlogs of domestic arrears.
- Commercial bank loans. The Ministry of Finance through the DMO advises the government on budget financing strategies. DMO enters into negotiation with commercial banks to obtain loans at competitive market

rates to fund infrastructural developmental projects. This will reduce pressure on the IGR and allows for payment of domestic arrears.

- Bond Issue. Another funding alternative that is available to the government is issuance of state bond to finance capital projects and to fund budget gap. However, proceeds from such bond issue can only be used for specified projects and arrears that might accrued from such projects as approved by Security and Exchange Commission (SEC)

SECTION 3

PRIORITIZATION CRITERIA FOR ARREARS TO BE SETTLED

- Due to general paucity of funds for budget financing and that the volume of arrears will be too large to be cleared within a year and also fund allocations to each type of domestic arrears is unlikely to be sufficient to pay all the arrears owed, Ministry of Finance with the approval of Mr Governor designed a template of recording all domestic arrears as they were incurred for age analysis/prioritization.
- A combination of approach of prioritization which include the followings have been adopted. For example, prioritization could be based on size or vintage i.e. the largest or oldest first. Other approaches include prioritization of arrears that accrue interest and penalty charges or may result in legal action. However, a combination of criteria may be adopted depending on the situation but whichever criteria is chosen, we must ensure that the mechanism is open, transparent and fair to all beneficiaries.
- Clearance/Settlement of domestic arrears shall be prioritized and sequenced. That is, which arrears were cleared in the past 12 months and reason. Domestic arrears should be separated into types of arrears and available fund is allocated among the types. Under each of the category, how much were cleared/settled within each type of arrears shall be reported.
- One of the financial policies of Lagos State is to set aside at minimum **10%** of the monthly Internally Generated Revenue (IGR) for settlement of domestic arrears. The Ministry of Finance through the Accountant General and with the approval of **Mr Governor** has been consistent in doing this every month.
- In order not to allow contractors with strong political connections to be considered first at the detriment of others, schedules of arrears are

updated on weekly basis on first come first serve basis and submitted to **Mr Governor** for approval based on the available fund for payment of domestic arrears.

Since the responsibility of settling the state's new and old creditors rest with the Ministry of Finance, a percentage of the IGR must be set aside on monthly basis as target towards the settlement of expenditure arrears.

- However, Ministry of Economic Planning and Budget (MEPB) must ensure realistic budget and Ministry of Finance must ascertain adequate funds to accommodate such requests.
- Effective expenditure controls through commitments limits shall be put in place. MDAs must limit commitments to budget provision. Effective commitment control should limit the commitments to both the approved budget and the actual cash availability. Extra budgetary/discretionary spending which will eventually lead to arrears must be discouraged.
- An efficient and accurate cash flow forecasting and cash management system must be put in place.

The payments from arrears data base is however limited to a minimum of 10% of the State monthly Internally Generated Revenue (IGR).

SECTION 4

POLICIES AND ACTIONS TAKEN TO STRENGTHEN THE RECORDING, VERIFICATION AND REPORTING OF ARREARS.

In order to settle government domestic expenditure arrears, Ministry of Finance has put in place certain measures to ensure reduction in the stock of expenditure arrears on yearly basis. Some of these measures are:

- Setting aside 10% of the State Internally Generated Revenue (IGR). This amount is dedicated for payment of domestic expenditure arrears.
- Prepare and operate a realistic budget. This is done by comparing budget performance of previous year with the current year. The preceding year's budget is deemed unrealistic whenever the actual revenues (expenditures) are significantly lower (higher) than the budgeted figures.
- Prepare a comprehensive cash flow forecast. The development of a cash flow forecast will guide and limit commitments. MDAs are requested to forecast for all revenues and expenditures within the budget year at

monthly frequency in order to determine seasonal pattern of revenue generation.

- Prepare Debt Service Forecast. DMO prepares a comprehensive domestic debt report made up of all domestic debt, include the domestic expenditure arrears, and suggest available funding sources such as IGR, Federal Transfers, borrowing and presents to the HCF/AG for onward submission to Mr Governor for clearance/approval.
- Prepare State Domestic Arrears Stock Reporting which shows the category of arrears, outstanding at end of year, new arrears incurred in the year under consideration, arrears settled in the year and outstanding balance at year end. **Percentage change (Reduction) must be stated which must be at least 5% compared to the previous year.**
- Regular assessment to establish the consistency with the state arrears clearance framework and where there were inconsistencies, we must provide explanation for the deviation.

AUDIT ASSURANCE & COMPLIANCE.

- Adequate audit control shall be put in place to ascertain the appropriateness of payment requests, adequacy of documents submitted by contractors and establish the correct value of the amount payable.
- All necessary documents must be attached for payment request to be cleared, such as original contract papers duly signed, contractor/consultant/suppliers registration certificate with Corporate Affairs Commission and Lagos State Public Procurement Agency, Tax certificates, Performance bond from a Commercial bank or a reputable Insurance company.
- The Auditors must vouch all the documents attached to the Payment Voucher of each of the Contractor and ensure that the transaction reflects a valid charge on the public fund for which commensurate goods and/or services have been received by the Government, stamped and signed before payment can be made or uploaded into the expenditure arrears data base.
- **Categorization of claims. Each claim should be categorized as follows:**
 - i. Valid – Those for which adequate documentation exists to recognize a government liability. Such will be stamped and passed for inclusion in the payment schedule at STO.
 - ii. Contestable – Those for which incomplete documentation has been provided and/or items under litigation. Such PVs are queried and

- labelled with those issues to work on. The PV is however sent back to the Auditors after necessary corrections are done.
- iii. Rejected – Those for which legitimate documentation has not been presented. Such PVs are also queried and labelled with all the findings.
- The arrears database as well as the verification process shall be published online with references to all attached documents and details about the website and how to access it shall be made public.
 - Contractors' reactions to the categorization shall be looked into and necessary adjustment and re-categorization shall be done.

VARIATION IN VALUE OF CONTRACT.

- All variations must be in agreement with the Terms and Conditions of the value of a contract to be altered, there must be a genuine reason and this must be approved by the appropriate authority e.g. Mr Governor, Deputy Governor and Honorable Commissioner.
- The Project Monitoring Department of the Ministry of Economic Planning and Budget must sign off.
- Contract variations must be included in the domestic arrears data base and taken into consideration when payment are made. Proper budgetary provision must be available for the payment.

STAGE PAYMENT

- Stage payment must be evaluated and reviewed to ascertain that funds are not released to jobs/contracts that were not executed.
- There must be sign-off from the Projects Monitoring department of the Ministry of Economic Planning and Budget at every stage completed and to which payment is to be made.

(6) PUBLICATION OF STATE'S ARREARS CLERANCE FRAMEWORK

Outstanding contractors, consultants and suppliers of N20million and above from all the MDAs that are on the Creditors' database are to be published by DMO on the MOF official website. Full details of all creditors that fall within this class shall be provided such as the contract sum, the job/contract executed the sector that the contract belongs and the executing MDA.

(7) FINAL PAYMENT

The State Domestic Arrears Stock shall be updated on regular basis (monthly). This will show flow in the arrears reporting. As the newly incurred arrears increased the stock balance likewise arrears settled reduces the stock of the

domestic arrears. This will ensure the integrity of the data base and avoid duplication of payments.

(8) DISCLOSURES

The Creditors Arrears Balances shall be disclosed on the Financial Statements of Lagos State in accordance with the provisions of International Public Sector Accounting Standards (IPSAS). This is usually stated as Payables under Liabilities in the statement of financial position.

