



# **GOVERNMENT OF EBONYI STATE OF NIGERIA**

## **ARREARS CLEARANCE FRAMEWORK**

**2021**

**MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT,  
ABAKALIKI**

**ABBREVIATIONS AND ACRONYMS**

APA	Annual Performance Assessment
DLI	Disbursement-linked Indicator
DLR	Disbursement-linked Result
DMD	Debt Management Department
DMO	Debt Management Office – Nigeria
FAAC	Federation Account Allocation Committee
FGN	Federal Government of Nigeria
FMIS	Financial Management Information System
FRA	Fiscal Responsibility Act
FRL	Fiscal Responsibility Laws
FSP	Fiscal Sustainability Plan
FY	Fiscal Year for the Government, running 1 Jan to 31 Dec
GDP	Gross Domestic Product
HFD	Home Finance Department (Federal Ministry of Finance)
IGR	Internally Generated Revenues
IVA	Independent Verification Agent
MDA	Ministries, Departments and Agencies
MTEF	Medium-term Expenditure Framework
OAG	Office of the Accountant General
OAuG	Office of the Auditor General
PFM	Public Financial Management
PforR	Program for Results
SFTAS	The State’s Fiscal Transparency, Accountability and Sustainability Program for Results
SMOF	State Ministry of Finance
TA	Technical Assistance
TSA	Treasury Single Account
WB	World Bank

## Contents

	<b>ABBREVIATIONS AND ACRONYMS.....</b>	<b>1</b>
<b>1</b>	<b>INTRODUCTION.....</b>	<b>4</b>
	1.1 Introduction .....	4
	1.2 Coverage and Scope of the Framework .....	5
	1.3 Purpose of the Framework Document .....	6
	1.4 Users of the Framework Document .....	6
	1.5 Presentation of Ebonyi State’s Domestic Expenditure Arrears .....	6
	1.6 Description of the State’s Policy on Arrears .....	8
<b>2</b>	<b>PLANNED ACTIONS FOR SETTLEMENT OF EBONYI STATE DOMESTIC EXPENDITURE ARREARS.....</b>	<b>10</b>
	2.1 Principles guiding the Arrears Clearance Strategy .....	10
	2.2 Principles guiding the Arrears Clearance Strategy .....	10
	2.2.1 <i>Comprehensiveness</i> .....	10
	2.2.2 <i>Transparency</i> .....	10
	2.2.3 <i>Credibility</i> .....	10
	2.2.4 <i>Realism</i> .....	10
	2.2.5 <i>Verification</i> .....	10
	2.3 Key Actions for Each Step of Arrears Clearance Strategy .....	11
	2.3.1 <i>Stocktaking</i> .....	11
	2.3.2 <i>Verification</i> .....	13
	2.3.3 <i>Classification</i> .....	15
	2.3.4 <i>Prioritisation of Arrears Clearance</i> .....	16
	2.3.5 <i>Liquidation</i> .....	16
<b>3</b>	<b>PRIORITIZATION CRITERIA FOR ARREARS CLEARANCE.....</b>	<b>22</b>
	3.1 Prioritization Criteria/Approaches between Types of Arrears.....	22
	3.2 Prioritization within Types of Arrears with Rationale .....	22
<b>4</b>	<b>ORGANIZATION/INSTITUTIONAL ARRANGEMENT.....</b>	<b>24</b>
	4.1 Description of the Organisation/Institutional Arrangement for Implementation of the Framework.....	24
	4.2 Objective and Responsibilities of the Arrangement.....	24
	4.3 Specific Activities .....	25
	4.4 Monitoring and Reporting of the Arrangement.....	25
	4.5 Membership of the Committee.....	25
	4.6 Committee Secretariat.....	25
	4.7 Power and Authorities of the Committee.....	26

**EBONYI STATE GOVERNMENT OF NIGERIA**  
**MINISTRY OF FINANCE AND ECONOMIC DEVELOPMENT**  
**DEBT MANAGEMENT COMMITTEE**



*15<sup>th</sup> March, 2021*

**DECLARATION OF COMMITMENT TO THE IMPLEMENTATION  
OF THIS FRAMEWORK**

The 2021 Arrears Clearance Framework has been carefully prepared and verified by the Committee on Debt Management in Ebonyi State. The contents of this Arrears Clearance Framework provide a guideline for the State Government to gradually and consistently clear all outstanding domestic expenditure arrears.

As a team and on behalf of the committee, we declare the commitment of Ebonyi State Government to the implementation of the 2021 Arrears Clearance Framework. The State Government will therefore ensure the clearance of the domestic expenditures arrears in line with the guidelines stipulated in this framework.

**Mr. Orlando Okechukwu Nweze**

Hon. Commissioner for Finance & Econ. Devt.

*Chairman of the Committee*

**Mr. Agwu Igwe Nweze**

Head, Debt Management Dept.

*Secretary of the Committee*

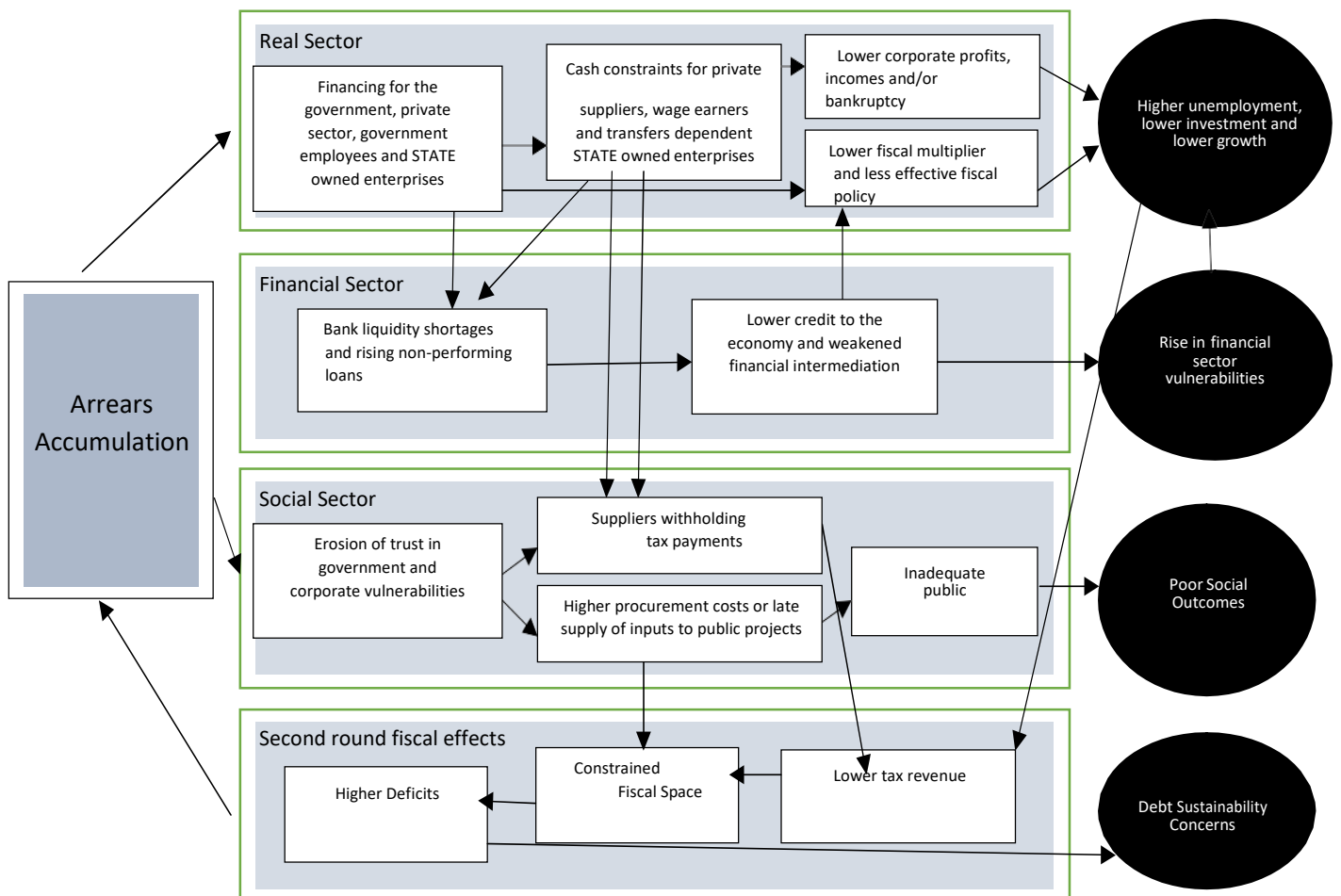
## SECTION ONE INTRODUCTION

### 1.1 Introduction

The accumulation of expenditure arrears by governments can have a serious negative effect on the domestic economy; a large flow of arrears may disguise the true size of government deficit, significantly reduce the impact of fiscal policy on aggregate demand and potentially undermine macro-economic stability, hence, the control and clearance of arrears have to be given a priority.

The Arrears Clearance Framework (ACF) is aimed at addressing the challenges involved in the gradual settlement of accumulated government arrears of Ebonyi State as well as preventing further additions. This is in recognition of the fact that government expenditure arrears are part of the most common problems in Public Financial Management (PFM). The planned actions encapsulated in the arrears clearance framework are designed to be consistent with maintaining macroeconomic stability, anchored on inclusive growth and transparent implementation.

The following schematic depicts the various impacts of arrears accumulation on the various sectors and their economic outcomes



The framework is guided by the guidelines of the World Bank, the International Monetary Fund on Domestic Debt Management as well as the Federal Government of Nigeria Debt Management Office (DMO) along established world best practices in the settlement and clearance of domestic expenditure arrears.

## 1.2 Coverage and Scope of the Framework

This document covers the policy guidelines and procedures for managing and settling the domestic expenditure arrears of EBONYI State Government.

The State's arrears are financial obligations that have been incurred by EBONYI State Government for which payments have not been made by the due dates.

These payments may have been overdue based on the following:

- Specific contractual commitment such as payment for construction of a road
- Particular legal obligation such as payment of salaries
- Continuing service arrangement such as payment for electricity supply
- Paucity of Fund

As such, the main categories of State's expenditure arrears are as follows:

- ❖ Contractual arrears,
- ❖ Salary arrears,
- ❖ Pension and Gratuity arrears.

The shorter terms: "domestic expenditure arrears", "domestic arrears", and "arrears" used interchangeably in the document refer to State Government's domestic expenditure arrears.

**Expenditure arrears** also describe **payables, liabilities and commitments** which have remained unpaid, beyond a specified due date of payment and where no due date is specified, have remained unpaid after a specified number of days after the date on the invoice or contract, in accordance with a law, regulation, government payment policy or local practice.

**Commitments** are explicit or implicit agreements to make payments to another party in exchange for supply of goods and services or of fulfilling other conditions. Commitments can also be of a continuing nature that requires a series of payments. They may or may not involve a contract, but they are often based on a legal obligation.

**Liabilities** relate to commitments and are established when one is obliged under specific circumstances to provide funds or resources to another party. Liabilities include outstanding debt, leases and provisions, as well as payables for provisions of goods and services rendered. The liability arises when a third party satisfies the terms of the contract or similar arrangement. Not all commitments however, become liabilities.

**Payables or Creditors** are a subset of liabilities for which the related goods or services have been provided by a third party but not yet paid for by the recipient. A payable is created when an invoice or bill is approved for payment and has been recorded as an outstanding liability awaiting payment

### 1.3 Purpose of the Framework Document

This framework document is aimed at providing practical guidance in the identification, recording and management of domestic expenditure arrears in the State. This will assist the State to establish processes and systems to reduce her stock of domestic arrears.

### 1.4 Users of the Framework Document

The framework is primarily meant for the government of EBONYI State. Besides, the staff of MDAs such as Ministry of Finance, Office of the Accountant-General, Ministry of Budget and Planning, Debt Management Department, Office of the State Auditor-General, State Procurement Council, Ministry of Works and Transport and other line MDAs, etc., who may be involved in debt management and settlement of arrears at one time or the other will find it useful.

The framework should be used in conjunction with other extant public finance laws and regulations, accounting system and procedures manuals in the State.

### 1.5 Presentation of Ebonyi State's Domestic Expenditure Arrears

Over the past five years, the trend of the EBONYI State Domestic Expenditure Arrears is shown below:

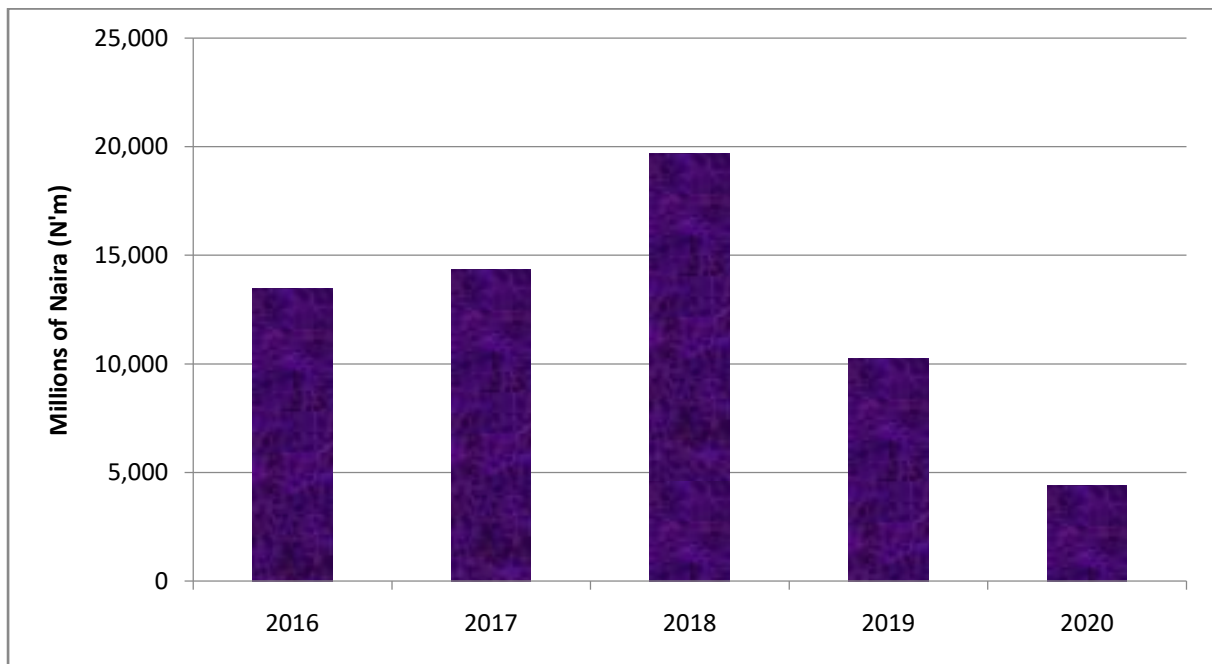
*Table 1: Breakdown of Ebonyi State Domestic Expenditure Arrears (2016 – 2020)*

ARREARS TYPE	2016	2017	2018	2019	2020
	(N'Million)				
CONTRACTORS' ARREARS	10,455	10,455	10,455	2,500	499
PENSION AND GRATUITY	2,004	2,855	7,407	7,470	3,807
SALARY AND OTHER STAFF	926	926	1,743	0	0
CLAIMS ARREARS					
JUDGMENT DEBTS	93	93	100	271	83
<b>TOTAL DOMESTIC ARREARS</b>	<b>13,478</b>	<b>14,329</b>	<b>19,705</b>	<b>10,241</b>	<b>4,389</b>

*Source: Ebonyi State Debt Management Department*

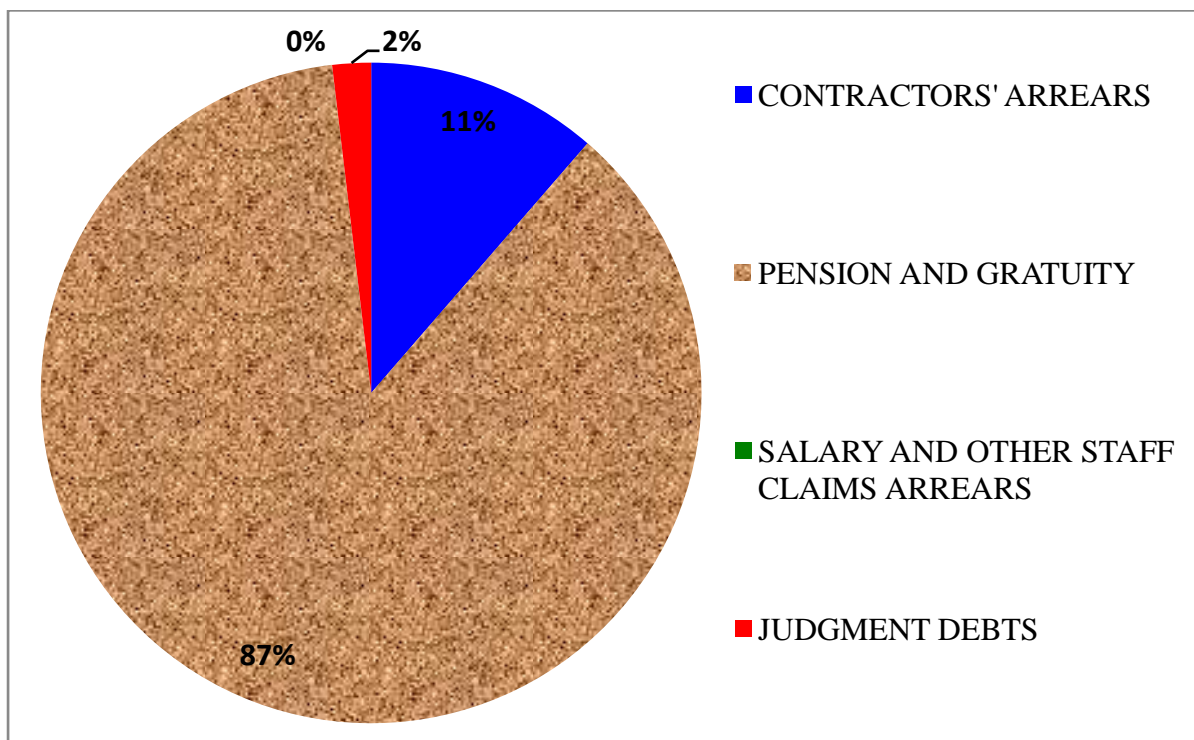
The key features of the arrears can be depicted graphically as follows:

Figure 1: Ebonyi State Total Domestic Arrears (2016-2020)



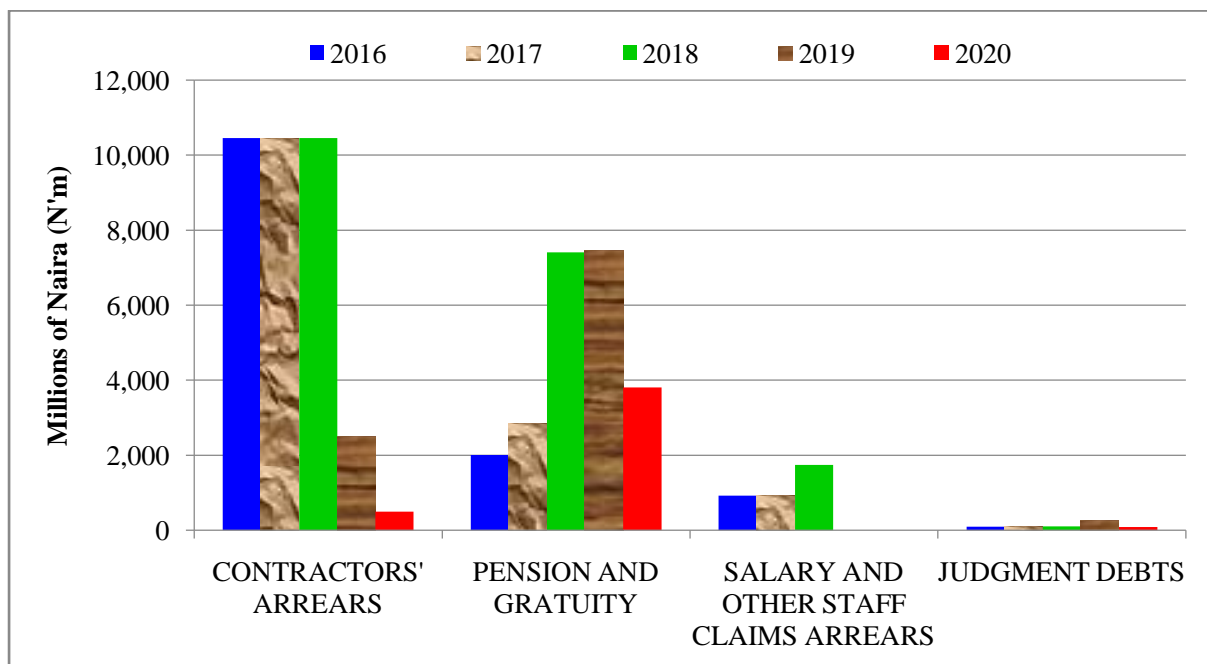
Source: Ebonyi State Debt Management Department

Figure 2: Components of Ebonyi State Domestic Arrears in 2020



Source: Ebonyi State Debt Management Department



**Figure 3: Components of Ebonyi State Domestic Arrears (2016-2020)**

*Source: Ebonyi State Debt Management Department*

## 1.6 Description of the State's Policy on Arrears

The Ebonyi State's Policy on Arrears is aimed at controlling the accumulation of arrears whilst ensuring measures that clear existing arrears.

The following measures will be adopted in this regard:

- i. **Strengthen legal and regulatory framework.** A framework should define payment terms, when in arrears, reporting requirements as well as the necessary controls at the budget stages of authorization, commitment and payments with appropriate provisions for breaching sanctions;
- ii. **Enhance the credibility and realism of the State's budget.** The State's budget shall be a realistic plan for expenditures based on conservatively estimated revenues based on robust assumptions and forecasts in the fiscal frameworks;
- iii. **Improve accounting and reporting.** Arrears clearance require adequate, timely and reliable information about their size, composition and impact through government accounting systems that recognize expenditure commitments, liabilities and payments;
- iv. **Strengthen commitment controls** to effectively limit commitments to approved budget allocations and to availability of funds;
- v. **Facilitate improved and integrated cash and debt management** that ensure liquidity to meet cash obligations as they arise through accurate and timely short term estimates of cash inflows and outflows;

- vi. **Enhance oversight of the State owned enterprises** through governance frameworks that require timely payment of bills, regular monitoring and reporting of liabilities to reduce implicit contingent liabilities;
- vii. **Establish Treasury Single Account (TSA)** for effective management of cash flows and ensure that payments are centralized to the State's Treasury to prevent arrears as a result of administrative hurdles;
- viii. **Upgrade the government's financial management information systems** to one that is capable of controlling the main stages of budget execution that handles the entire expenditure chain, including the release of budget funds, commitments against the budget funds, production of purchase orders, receipt of goods and services claimed in the invoices, and payment or non-payment of invoices;
- ix. **Hold regular Liquidity Management Committee (LMC)** meeting to guide government decisions on budget and fund releases;
- x. **Implement technological solutions to control expenditures** that historically contribute to the accumulation of arrears.

## SECTION TWO

### PLANNED ACTIONS FOR SETTLEMENT OF EBONYI STATE DOMESTIC EXPENDITURE ARREARS

#### 2.1 Introduction

The Arrears Clearance Framework is designed to address the causes for the accumulation of arrears and eliminate the outstanding stock. This framework will communicate to stakeholders the government's plan, timetable and criteria for the liquidation of arrears, thereby minimizing any possibility for any perception of favouritism and corruption in the selection of creditors to be paid.

#### 2.2 Principles guiding the Arrears Clearance Strategy

The following key factors will guide the arrears clearance strategy – (a) Comprehensiveness; (b) Transparency; (c) Credibility; (d) Realism; and (e) Verification.

##### 2.2.1 *Comprehensiveness*

The arrears clearance strategy should apply to all outstanding payments incurred by all parts of the public sector, whether in the State government, or State-owned enterprises.

##### 2.2.2 *Transparency*

The clearance of arrears should proceed according to a public timetable, and criteria for prioritizing clearance should be transparently stated and adhered to.

##### 2.2.3 *Credibility*

To demonstrate commitment to addressing the root causes of the problem, the strategy should include measures to avoid the accumulation of new arrears, and ministries or agencies that fail to implement these measures should be penalized appropriately.

##### 2.2.4 *Realism*

The government's annual budget and medium-term fiscal projections should make adequate provision for the cash cost of arrears clearance.

##### 2.2.5 *Verification*

Arrears should be verified to ensure that only valid claims are cleared.

## 2.3 Key Actions for Each Step of Arrears Clearance Strategy

A comprehensive, transparent, and credible arrears clearance strategy should typically follow these five steps:

- Stocktaking,
- Verification,
- Classification,
- Prioritization, and
- Liquidation.

### 2.3.1 Stocktaking

A Stocktaking of **Arrears** will enable the State Government to understand the extent, composition and the age of the State Government's unpaid bills and prioritize their clearance. The State government should come up with a time table which should be communicated for the stocktaking exercise, and a clear definition of the information requirements should be provided to all relevant stakeholders/institutions. There should be a cut-off date for inclusion of new arrears which should be established to encourage timely reporting and avoid the generation of fraudulent claims. The Government will prepare a database of all apparent claims and a regular reporting framework should be instituted. The database should have enough information as to allow for proper definition and classification of arrears into categories for proper evaluation

A sample arrears datasheet for the recording of arrears is as shown in the next page below:

The explanations of the relevant columns are as follows:

1. Debtor details: The government entity incurring the liability, agency, extra-budgetary fund, or state-owned enterprise.
2. Creditor details: The database should capture the creditor name classified by type: *employees, private individuals, private businesses, financial institutions etc.*
3. Contact Information: The appropriate address for each creditor
4. Arrears owed (Cumulative): The total amount owed as at the date of reporting
5. Effective/Billing date: This should be the original due date on each invoice, or the date when the amount owed fell into arrears. It will enable classification of the arrears into those overdue by 1-3 months, 3-6 month, 6-12 months and more than 12 months
6. Amounts settled / part paid: This will indicate how much was previously owed and has been settled.
7. Nature of the debt: This will enable differentiation between various types of arrears, for example, *goods supplied, services supplied, salaries, pensions, gratuities, judgment debt etc.*
8. Contract terms and penalties: This is to record any interest or penalties that are due or may become due on the arrears
9. File reference: This is to provide a unique file/record identifier that can enable the location of primary documents (relevant for the verification)
10. Economic category should be compliant with the National Chart of Accounts (NCoA)

*Table 2: Sample of Arrears Datasheet for Recording of Arrears*

<b>Primary Record Holder:</b> For example: Ministry of Works and Transport <b>Type of Arrears:</b> For example: Contractor payment arrears / Salary Arrears / Pension and Gratuity Arrears												
S/N	Debtor details (MDA)	Creditor details	Contact information	Arrears owed (cumulative) NGN	Effective /Billing Date	Amounts settled/Part paid to date (NGN)	Nature of the debt	Contract terms (interest & penalties)	File Reference No.	Economic Category	Comments, including notes on risk of non-payment (litigation etc.)	Verified/Contested/Rejected
1												
2												
3												
4												
5												
6												
7												
8												
9												
10												
11												
etc.												

*Source: Ebonyi State Debt Management Department (DMD) – Debt Database*

Sanctions for non-reporting, fraudulent, and incomplete reporting of arrears should be announced and enforced. Using the information produced from the database, a review of the types of arrears, the age of the debts, and the spending agencies generating the arrears should be undertaken. This will help to identify the underlying causes and the specific corrective actions required to address them.

The review will also help to assess whether the problem is restricted to past events, or whether the problem persists.

### **2.3.2 Verification**

After the collection of the data on outstanding stock of arrears, the data should be verified to ensure that they are genuine claims to avoid payment of fraudulent claims.

This activity can be undertaken by the State Auditor General's Office, an inspectorate or internal audit function in the Ministry of Finance, or private audit firms, depending on the legal, institutional arrangements and capacity available. All reports and relevant information should be provided to the external auditor.

This process should include the following steps:

**Step 1 (Collection of unpaid invoices):** The initial responsibility for producing the necessary documentation should rest with the chief financial officer of the entity.

The responsibility for the proof of validity of claims without proper documentation should rest with the claimant. Only original documents should be accepted, not photocopies, to avoid fraudulent claims.

**Step 2 (Verification of claims):** Arrears should be subject to tests to verify their existence, value, and age of the debt.

**Step 3 (Categorization of claims):** Based on this review of validity, each claim should be categorized as **valid, contestable, or rejected**.

- Valid claims are those for which adequate documentation exists to recognize a government liability.
- Contestable claims are those for which incomplete documentation has been provided.
- Rejected claims are those for which legitimate documentation has not been presented.

**Step 4 (Appeals from claimants):** Holders of contestable claims may be invited to provide further documentation to support their claims or have their claims referred for adjudication. Such claims may arise through collusion with government officials or poor record keeping. The burden of proof on the validity of such claims should rest with the claimants, and the government may decide to settle them in the future on a case-by-case basis, based on the recommendations of the external auditor or independent adjudicator. Claim holders should have the right to appeal the external auditor or independent adjudicator's decisions through the judicial system.

**Step 5 (Rejection of invalid claims):** The government should formally notify rejected claimants and state the basis for the rejection. It is essential that government retain full records of decisions made to defend future legal actions by claimants.

Arrears should be verified using the following guidelines:

- ❖ **The legal validity of the payable** should be verified by checking that the transaction was duly authorized by a responsible officer in accordance with authorized public finance and procurement laws, rules, regulations and consistency with budgetary authorizations. Where this is not the case, appropriate sanctions should be applied to officials, and a legal assessment should be made as to whether the claim is valid.
- ❖ **Evidence that the goods were delivered and services were duly received** and accepted by a responsible officer should be verified.
  - ✓ In case of doubt or for material transactions, delivery should be reconfirmed by requesting information from the supplier.
  - ✓ For goods and services, the financial records of the supplier can be asked to show that amount was registered as a receivable in their accounts.
  - ✓ In cases of salary arrears, payroll records should be checked to ensure beneficiaries were employed at that time.
  - ✓ In more complex transactions, particularly those related to major construction or other investment projects, evidence of certificate of valuation or a completion certificate produced by relevant experts should be required.
- ❖ **Invoices and supporting documentation should be checked** to verify the value of the amount payable. Invoices should contain the following information at a minimum:
  - ✓ The amount,
  - ✓ The supplier,
  - ✓ The reference to the contract or
  - ✓ Purchase order or agreement signed by the responsible officials, and
  - ✓ The documents confirming receipt of goods or services, such as the inventory records of the purchasing entity.
  - ✓ In case of doubt, a cross-check with suppliers' financial statements should be made.

Entitlement arrears should be computed by the line ministry or agency and provided to the Ministry of Finance. The Local Government ministry should be responsible for the collation of arrears of data for all the local governments.

### **The Arrears Database**

To allow for appropriate categorization, the following data should be captured for each outstanding claim:

- **Age of Debts:** The database should capture the original due date on each invoice, and arrears should be classified according to how long they have been overdue:
  - One to three months,
  - Three to six months,
  - Six to 12 months, and
  - More than 12 months.
  - Older arrears should be classified by the financial year in which they were incurred.

If the due date is not recorded in the invoice, the invoice date can be used as a proxy for the due date.

- **Debtor:** The database should capture the government entity incurring the liability, classified by institutional group (The State government, Local government, MDAs, extra-budgetary fund, or State-Owned enterprise).
- **Creditor:** The database should capture the creditor's name classified by type:
  - Employees,
  - Private individuals,
  - Private businesses,
  - Financial institutions,
  - The State government,
  - Local government,
  - Extra-budgetary funds, or
  - State-Owned enterprise.

Clearly distinguishing extra-government and intra-government obligations will facilitate rapid administrative clearance of the latter.

- **Economic category:** The database should classify arrears into economic categories, such as compensation of employees, acquisition of goods and services, transfers, acquisition of nonfinancial assets, and acquisition of financial assets.
- **Currency:** The database should capture the currency in which the obligation was originally denominated so that cash managers can ensure that sufficient foreign exchange is available to meet external arrears.
- **The age of the payable should be checked** by reference to the invoice and other supporting documentation. A confirmation from the supplier should be obtained in contentious cases.
- **The Ministry of Finance**, taking full account of the legal framework with respect to disclosure of taxpayer records, should undertake checks with the revenue authority to ensure that suppliers are registered taxpayers and determine whether they are delinquent in tax payments.

### *2.3.3 Classification*

Once collected and verified, the data of the arrears should be analyzed and classified for the purposes of arrears clearance. A **database of valid outstanding payments** should be established and maintained centrally by the Ministry of Finance. This can be a resource-intensive and time-consuming exercise, requiring dedicated staff resources. A practical approach would be to focus in the first instance on large claims, gradually expanding the coverage of the database.

- ❖ **Contractual terms:** The database should capture any relevant contractual information including, for example, whether the outstanding balance results in interest and/or penalties for non-payment.



- ❖ **Payment status:** The database should capture the total amount due on the invoice, amounts already paid, amount outstanding, and any rescheduling, discounting, or factoring of the unpaid obligation.
- ❖ **Risk of non-payment:** The database should include a risk assessment of further payment delays. For example, if civil servants are not paid, this could be a potential for industrial action; if a contractor for a major infrastructure project is not paid, the project may not be completed, or completion may be delayed for many years. Other risk factors would include litigation and potential socio-economic impacts.

When the database has been established, the Ministry of Finance or its agency should keep it up-to-date showing the discharge of arrears and any subsequent additions to the stock. All stocks of accounts payable should be classified as liabilities, further classified as either domestic or foreign, and included in the government's measurement of gross debts. Payments in arrears should be included as a memorandum item to the Government's Balance Sheet.

### *2.3.4 Prioritisation of Arrears for Clearance*

Once a database of valid claims on government has been established, a set of criteria for prioritizing their liquidation should be determined.

The prioritization of arrears clearance should be based on transparent criteria; depending on the nature of the arrears, these might include the following:

- ❖ **Socioeconomic impact:** Arrears to economically sensitive or vulnerable sectors, such as salaries of low-income workers, pensions, and social benefits, should be prioritized.
- ❖ **Age of Debts:** Older obligations should have priority over newer obligations.
- ❖ **Cost:** Arrears that accrue interest and penalty charges should have priority.
- ❖ **Risk:** Arrears that may result in legal action, disruption of essential services, or cost escalation of future supplies to government should be prioritized.
- ❖ **Currency:** Payment of foreign currency denominated debt should be prioritized if domestic currency devaluation is outpacing domestic inflation.
- ❖ **Creditor:** The government should prioritize the clearance of intra- government debts, as this can be done administratively through the annual budget at minimal net cost.
- ❖ **Value:** The government should grade the debts according to their amount. Whereas large amounts are placed in the lower rung of the ladder, smaller amounts may be accommodated as early as possible.

### *2.3.5 Liquidation*

The payment or liquidation of obligations can begin after establishing and publishing the criteria for prioritizing arrears for clearance.

**The Arrears Clearance Committee:** The Arrears Clearance Committee should oversee arrears liquidation to ensure the consistent application of the principles of the framework. The committee should ensure that payments are made in accordance with the agreed prioritization criteria. This committee should comprise representatives from relevant departments, receive reports from spending units, and prepare periodic (for example, quarterly) reports to the Ministry of Finance on the performance of entities on payment of arrears. The reports should

highlight any non-reporting spending units and recommend remedial actions.

**Provision in the Medium Term Expenditure Framework (MTEF):** The annual budget and medium-term budget framework should make explicit provision for the clearance of arrears. The Multi-Year Plan is the financial plan of the State for clearance of her stock of arrears based on the total fund available to the State in the fiscal year. Measures including the centralized management and control of the budget line for arrears repayment should be put in place to avoid the recycling of arrears (paying old arrears while accumulating new ones). Any payment from this centralized budget should be backed by a list of verified eligible creditors, in line with the priorities of the repayment strategy. Entities should be required to provide this information to the Ministry of Finance for budget preparation, medium-term expenditure framework, performance monitoring, and budget release purposes, as well as verification against the database at the time of payment. A separate control on the remaining stock of arrears should be kept by the Ministry of Finance to ensure that sufficient provision is made in each subsequent annual budget until all arrears are paid.

**Centralization of Payments:** Responsibility for payments of arrears should be centralized. This is to ensure that payments are made according to the agreed framework and schedule. Reports of payments made against the budget line for arrears in addition to regular fiscal reports will help to demonstrate the government's commitment to the arrears clearance strategy and build confidence among suppliers in their subsequent dealings with government.

**Netting arrangements:** Offsetting the settlement of arrears to the private sector against tax obligations are not advisable; as they undermine transparency and accountability and engender moral hazard. All payments must be accounted for on a gross basis. Any netting off of tax liabilities could undermine tax compliance and encourage the future accumulation of tax arrears. To avoid liquidity problems in its cash flow, the government may want to coordinate the payment to suppliers, with payment of their tax obligations to be concomitant, especially in the case of large amounts outstanding. If fiscal space is available and the stock of arrears is small, the best option is to pay arrears in cash either from current receipts or government borrowing. This ensures that governments do not incur further financial penalties or interest and that enables suppliers to rebuild working capital.

**Funding payment of arrears:** The State Government shall clear her arrears using funds from any of the following sources:

- a) Statutory Allocation
- b) Internally Generated Revenue
- c) Grants from the Federal Government, and
- d) Loans

The stock of arrears could be paid off from FAAC allocation, from the State's internally generated revenue, or from grants from the Federal Government. They can also be paid immediately by borrowing in the domestic commercial or capital markets (bonds). The proceeds of the borrowing operations would be earmarked for the reduction of the stock of arrears. This option would increase the stock of government debt but would not decrease net worth, as government is explicitly recognizing a liability that existed as an implicit obligation to pay. If sufficient liquidity is not immediately available, governments may negotiate a schedule of payments with creditors according to a pre-defined calendar and an agreed interest rate. This option may be more viable if the stock of arrears is large and the current market conditions are not ripe for the placement of sizeable amounts of new debt, or if doing so would imperil other government short-term macroeconomic objectives. It may, however,

impose a liquidity problem for some creditors that may be unable to wait for payment in tranches. As part of these negotiations, governments may agree to a discount, often termed a haircut; however, this approach should be treated with caution, since it can have the effect of increasing costs to the government, if suppliers inflate prices for further supplies in anticipation of an expected future discounting.

**Arrears or Debt Securitization:** The securitization of the arrears, directly transforming them into government debt, should be considered only as a last resort. The range of securitization options includes issuing promissory notes (discountable by commercial banks that cannot be repurchased by the central bank, as that would lead to monetization of the deficit), marketable treasury bills, or bonds directly to creditors. This approach has the advantage of allowing the government to select the debt maturity structure and repayment profile that best matches its financing needs. It also gives creditors the opportunity to raise liquidity by trading the titles in the secondary market, possibly at a discount. However, the direct securitization of arrears also has a number of disadvantages.

- Experience suggests that securitization of unpaid bills creates strong moral hazard incentives for government financial managers to continue to commit resources in excess of available appropriations in the expectation that these will eventually also be securitized and paid centrally.
- The securitized instruments almost always trade at a considerable discount which reduces the working capital available to the original supplier compared with cash payment.
- Securitization of the outstanding stock of arrears prevents the government from prioritizing payment of the most urgent arrears as securities are issued to all creditors on equal terms.
- Identifying and settling the stock of arrears between government and State-owned enterprises is necessary to avoid problems of solvency and profitability of enterprises.
- For government, a book entry can be made reflecting all outstanding bills, leaving a single remaining debt that can be resolved through an injection of funds in the State-owned enterprise from the budget and included in the MTEF. If reciprocal payments are owed to government, in the form of dividends for example, these can be netted off against the required cash injection.

Based on the above processes, the **Multi Year Funding Plan** for clearing the domestic arrears for Ebonyi State for the years 2012 – 2025 is as shown in the table below:

Table 3: Multi-Year Funding Plan for Clearing Domestic Expenditure Arrears

DOMESTIC ARREARS CLEARANCE FINANCING TARGETS	Value	Notes				
Finance (some) clearance of arrears from budget surplus?	Yes					
Finance (some) clearance of arrears through formal debt	Yes					
Target domestic expenditure arrears percentage decline (minimum)	5.00%	State Target - shown here is the basic target of the SFTAS DLI#8				
<b>FISCAL PROJECTION ASSUMPTIONS [IF NO STATE MTEF FIGURES ARE AVAILABLE]</b>						
Annual percentage growth in revenue - FAAC and VAT (nominal)	7.50%	State MTEF estimates = national nominal GDP growth				
Annual percentage growth in revenue - IGR (nominal)	20.00%	State is committed to achieving the basic target for SFTAS DLI #4				
Annual percentage growth in recurrent expenditure - non interest (nominal)	2.00%	State is committed to managing its recurrent non-interest expenditure				
Annual percentage growth in capital expenditure (nominal)	5.00%	State is committed to increasing CAPEX - growing by at least national nom				
Balanced Budget i.e. no budget deficit in the future (budget surplus allowed)	Yes	State targets to run a surplus of around 5 billion naira through the medium term				
<b>SUMMARY OF BUDGET FRAMEWORK</b>						
	<b>Fiscal Year</b>					
	<b>2020 (Revised Budget)</b>	<b>2021 (Proj)</b>	<b>2022 (Proj)</b>	<b>2023 (Proj)</b>	<b>2024 (Proj)</b>	<b>2025 (Proj)</b>
<b>Total Budget Revenue and Grants (Billion Naira)</b>	<b>105.56</b>	<b>106.25</b>	<b>113.49</b>	<b>121.56</b>	<b>130.56</b>	<b>140.66</b>
<i>Total Net FAAC allocation exc VAT</i>	30.93	37.00	39.78	42.76	45.96	49.41
<i>VAT</i>	11.86	14.00	15.05	16.18	17.39	18.70
<i>IGR</i>	8.54	12.86	15.43	18.52	22.22	26.67
<i>Grants and Other Revenue (inc. one-off items such as Paris Club refund)</i>	54.23	42.39	43.24	44.10	44.98	45.88

<b>Total Budget Expenditure</b>	<b>132.00</b>	<b>122.85</b>	<b>127.40</b>	<b>132.15</b>	<b>137.10</b>	<b>142.27</b>
<i>Personnel Cost and Pensions</i>	15.58	16.45	16.78	17.11	17.46	17.81
<i>Other Recurrent (Overheads, Transfers) exc. interest payments</i>	28.29	31.69	32.32	32.97	33.63	34.30
<i>Interest Payments &amp; other recurrent debt charges</i>	0.00	0.00	0.00	0.00	0.00	0.00
<i>Capital expenditures</i>	85.13	71.71	75.30	79.06	83.01	87.16
<i>Expenditure adjustments (to achieve budget target)</i>	3.00	3.00	3.00	3.00	3.00	3.00
<b>Overall Balance</b>	<b>-26.44</b>	<b>-16.60</b>	<b>-13.90</b>	<b>-10.59</b>	<b>-6.54</b>	<b>-1.61</b>
<b>SUMMARY OF BORROWING, FINANCING AND DEBT STOCK</b>	<b>Fiscal Year</b>					
	<b>2020 (Revised Budget)</b>	<b>2021 (Proj)</b>	<b>2022 (Proj)</b>	<b>2023 (Proj)</b>	<b>2024 (Proj)</b>	<b>2025 (Proj)</b>
<b>Gross and Net Borrowing Needs (Billion Naira)</b>						
<b>(1) Overall Balance</b>	<b>26.44</b>	<b>16.60</b>	<b>13.90</b>	<b>10.59</b>	<b>6.54</b>	<b>1.61</b>
<b>(2) Investments - Accumulation of financial assets</b>	0.00	0.00	0.00	0.00	0.00	0.00
<b>(3) Debt Amortization (exc Arrears Clearance)</b>	0.00	0.00	0.00	0.00	0.00	0.00
<b>(4) Arrears Clearance</b>	5.87	0.22	0.21	0.20	0.19	0.18
<b>(5) Gross Borrowing Needs (5) = (2)+(3)+(4)-(1)</b>	<b>32.31</b>	<b>16.82</b>	<b>14.11</b>	<b>10.78</b>	<b>6.72</b>	<b>1.79</b>
<b>(6) Net Borrowing Needs (6) = (5)-(4)</b>	<b>26.44</b>	<b>16.60</b>	<b>13.90</b>	<b>10.59</b>	<b>6.54</b>	<b>1.61</b>
<b>Sources of Financing</b>	<b>2020 (Revised Budget)</b>	<b>2021 (Proj)</b>	<b>2022 (Proj)</b>	<b>2023 (Proj)</b>	<b>2024 (Proj)</b>	<b>2025 (Proj)</b>
<b>Domestic Debt_Total</b>						
<b>1. Commercial Bank Loans</b>	0.00	0.00	0.00	0.00	0.00	0.00
<b>Sale of Government Assets</b>	0.00	2.00	2.10	2.21	2.32	2.43
<b>2. State Bonds</b>	0.00	0.00	0.00	0.00	0.00	0.00
<b>3. CBN Devt. Financing (Agric, Infrastructure, MSMEDF)</b>	5.00	2.00	2.10	2.21	2.32	2.43

<b>4. FGN Borrowing</b>	0.00	0.00	0.00	0.00	0.00	0.00
<b>5. Domestic Expenditure Arrears</b>	0.00	0.00	0.00	0.00	0.00	0.00
<b>External Debt_Total</b>	0.00	0.00	0.00	0.00	0.00	0.00
<b>Asset privatisation proceeds/other funds</b>	0.00	0.00	0.00	0.00	0.00	0.00
<b>Total Financing</b>	<b>5.00</b>	<b>4.00</b>	<b>4.20</b>	<b>4.41</b>	<b>4.63</b>	<b>4.86</b>
<b>Financing Gap (Total Financing minus Gross Borrowing)</b>	<b>-27.31</b>	<b>-12.82</b>	<b>-9.91</b>	<b>-6.37</b>	<b>-2.09</b>	<b>3.07</b>
<b>Debt Stock (End of Year)</b>	<b>2020 (Actual)</b>	<b>2021 (Proj)</b>	<b>2022 (Proj)</b>	<b>2023 (Proj)</b>	<b>2024 (Proj)</b>	<b>2025 (Proj)</b>
<b>Domestic Debt_Total</b>	<b>46.19</b>	<b>44.26</b>	<b>43.19</b>	<b>42.29</b>	<b>41.56</b>	<b>41.00</b>
<b>1. Commercial Bank Loans</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
<b>2. State Bonds</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>
<b>3. CBN Devt. Financing (Agric, Infrastructure, MSMEDF)</b>	<b>7.62</b>	<b>7.62</b>	<b>8.38</b>	<b>9.22</b>	<b>10.14</b>	<b>11.16</b>
<b>4. FGN Borrowing</b>	<b>34.20</b>	<b>32.49</b>	<b>30.87</b>	<b>29.32</b>	<b>27.86</b>	<b>26.46</b>
<b>5. Domestic Expenditure Arrears</b>	<b>4.37</b>	<b>4.15</b>	<b>3.94</b>	<b>3.75</b>	<b>3.56</b>	<b>3.38</b>
<i>Contractor Arrears</i>	0.49	0.47	0.44	0.42	0.40	0.38
<i>Pension and Gratuities</i>	3.80	3.61	3.43	3.26	3.10	2.94
<i>Judgement Debts</i>	0.08	0.08	0.07	0.07	0.07	0.06
<b>External Debt_Total</b>	<b>19.30</b>	<b>18.93</b>	<b>19.36</b>	<b>17.67</b>	<b>16.97</b>	<b>16.28</b>
<b>Total Debt Stock</b>	<b>65.49</b>	<b>63.19</b>	<b>62.55</b>	<b>59.96</b>	<b>58.53</b>	<b>57.28</b>
<b>Total Debt Stock annual change</b>		-3.51%	-1.01%	-4.14%	-2.39%	-2.13%
<b>Domestic Arrears Dynamics</b>	<b>2020 (Actual)</b>	<b>2021 (Proj)</b>	<b>2022 (Proj)</b>	<b>2023 (Proj)</b>	<b>2024 (Proj)</b>	<b>2025 (Proj)</b>
<b>Annual Change in Domestic Arrears Stock (N'Billion)</b>	<b>-5.87</b>	<b>-0.22</b>	<b>-0.21</b>	<b>-0.20</b>	<b>-0.19</b>	<b>-0.18</b>
<b>Annual Percentage Change in Domestic Arrears Stock (%)</b>	<b>-57.33%</b>	<b>-5.00%</b>	<b>-5.00%</b>	<b>-5.00%</b>	<b>-5.00%</b>	<b>-5.00%</b>

### SECTION THREE PRIORITISATION CRITERIA FOR ARREARS CLEARANCE

The prioritization of arrears clearance should be based on transparent criteria; depending on the nature of the arrears, these might include the following:

- **Socioeconomic impact:** Arrears to economically sensitive or vulnerable sectors, such as salaries of low-income workers, pensions, and social benefits, should be prioritized.
- **Age of Debts:** Older obligations should have priority over newer obligations.
- **Cost:** Arrears that accrue interest and penalty charges should have priority.
- **Risk:** Arrears that may result in legal action, disruption of essential services, or cost escalation of future supplies to government should be prioritized.
- **Value:** The government should grade the debts according to their amount. Whereas large amounts are placed in the lower rung of the ladder, smaller amounts may be accommodated as early as possible.

EBONYI State Government shall specifically adopt any of the following criteria/approaches in deciding which of her domestic expenditure arrears are to be paid.

#### 3.1 Prioritization Criteria/Approaches between Types of Arrears

##### **Approach 1:**

Allocation of available fund among the types of the arrears in proportion to their share of the total outstanding stock of arrears

##### **Approach 2:**

Allocation of available fund within a particular type of arrears will be based on their level of importance.

#### 3.2 Prioritization within Types of Arrears with Rationale

The table below shows how the funds will be allocated on the basis of prioritisation within a particular type of arrears. The table also shows the rationale for such prioritisations.

**Table 4: Prioritization of Arrears with Rationale**

<b>S/N</b>	<b>Criteria/Approaches</b>	<b>Rationale</b>	<b>Required Data</b>
<b>1</b>	<b>Contractors</b>		
	Ongoing Works First	Ensure ongoing works are completed	Status of project construction
	Largest Value First	Largest injury in terms of arrears value is addressed first	Value of outstanding arrears
	Smallest Value First	Allows many individual arrears to be paid immediately and focus funds on small firms that may be vulnerable to cash flow problems (assuming most small arrears are owed to small contractors)	Value of outstanding arrears
	Oldest First	Creditor who has been waiting longest is paid first	Date missed payment was due
	Subject to penalties first	Paying arrears that bear penalties for late payment reduces cost to State	Contract terms whether provided for late penalties
<b>2</b>	<b>Salaries</b>		
	Oldest first	Largest injury (in terms of delay) is addressed first	Date missed payment was due
	Smallest first	Allows many individual arrears to be paid immediately and focuses funds on lowest paid workers that may be vulnerable to cash flow problems	Value of outstanding arrears
	Equal Percent to all	All Staff receive something regardless of when salary payment was first missed or level of salary	Amount owed to staff
<b>3</b>	<b>Pension and Gratuities</b>		
	Oldest First	Largest injury (in terms of delay) is addressed first	Date missed payment was due
	Equal Percent to all	All pensioners receive something, regardless of when they retired	Amount owed to each pensioner
<b>4</b>	<b>Judgment Debt</b>		
	Oldest First	Largest injury (in terms of delay) is addressed first	Date missed payment was due
	Equal Percent to all	All claimants receive something regardless of when contracts fall due.	Amount owed to each contractor



## SECTION FOUR ORGANISATIONAL AND INSTITUTIONAL ARRANGEMENT

### 4.1 Description of the organization/Institutional Arrangement for Implementation of the Framework

EBONYI State Government has put in place a Domestic Arrear Clearance Committee as an institutional arrangement charged with the overall arrears clearance process, including recording, verification, classification, reporting, prioritization and clearance of government domestic expenditure arrears in the State.

The Arrears Clearance Committee should oversee arrears liquidation to ensure the consistent application of the principles of the framework. The committee should ensure that payments are made in accordance with the agreed prioritization criteria. This committee should receive reports from spending units, and prepare periodic (for example, quarterly) reports to the Ministry of Finance and the Governor's office on the performance of entities on payment of arrears.

The reports should highlight any non-reporting spending units and recommend remedial actions.

### 4.2 Objectives and Responsibilities of the Arrangement

The Committee will support the Ministry of Finance in its responsibility for accurate recording, verification and reporting of domestic arrears balances across all types.

The Duties of the Committee shall include, but not limited to the following:

- i. Implement and from time to time review the State's Arrears Clearance Framework (ACF), including policies on prioritization and clearance of arrears
- ii. Introduction of specific guidelines setting out the roles and responsibility of individuals and institutions for the recording, verification of domestic arrears on agreed recording templates,
- iii. The creation, maintenance and regular (monthly) update of an accurate internal domestic expenditure arrears database and the publicly accessible online version of the database,
- iv. Oversight of the overall recording, verification and reporting process for domestic expenditure arrears.
- v. Ensure adequate classification of the arrears for prioritization purposes,
- vi. Provide accurate monthly, quarterly and annually reports that present the true position for verified domestic arrears and the progress made in implementing the State's ACF

### 4.3 Specific Activities

Specific activities for the committee will include but are not limited to the following:

- i. Implement and do a periodic review of the ACF
- ii. Adoption and implementation of records management guidelines for domestic arrears.
- iii. Adoption and implementation of verification guidelines for all types of domestic arrears.
- iv. Establishment of a consolidated internal domestic arrears database.
- v. Establishment of a publicly-accessible online version of the database.
- vi. Reporting of valid and verified domestic arrears to end-users.
- vii. Produce the State Arrears Recording, Verification and Clearance Report.

### 4.4 Monitoring and Reporting of the Arrangement

The Committee will report directly to the STATE Governor through the Honourable Commissioner for Finance.

### 4.5 Membership of the Committee

The membership of the Committee will be as follows:

1. COMMISSIONER FOR FINANCE	CHAIRMAN
2. ACCOUNTANT GENERAL OF THE STATE	VICE-CHAIRMAN
3. HEAD/DIRECTOR, DEBT MANAGEMENT DEPT	SECRETARY
4. PERMANENT SECRETARY – BUDGET	MEMBER
5. PERMANENT SECRETARY – FINANCE	MEMBER
6. EXECUTIVE SECRETARY – STATE PROCUREMENT COUNCIL	MEMBER
7. ATTORNEY GENERAL	MEMBER
8. AUDITOR GENERAL – STATE	MEMBER

### 4.6 Committee Secretariat

The Committee shall establish a Secretariat to support its work using existing Staff or Units within the Office of the Accountant General and the State's Debt Management Department.

#### **4.7 Power and Authorities of the Committee**

The Committee shall have delegated authority to request any and every information it requires in order to carry out its functions from the MDAs.

The Committee will be able to incur expenditures, including the engagement of professional assistance in the course of executing its role. All expenditures must be incurred through the procurement systems of the Ministry of Finance.