



***DEBT MANAGEMENT DEPARTMENT***

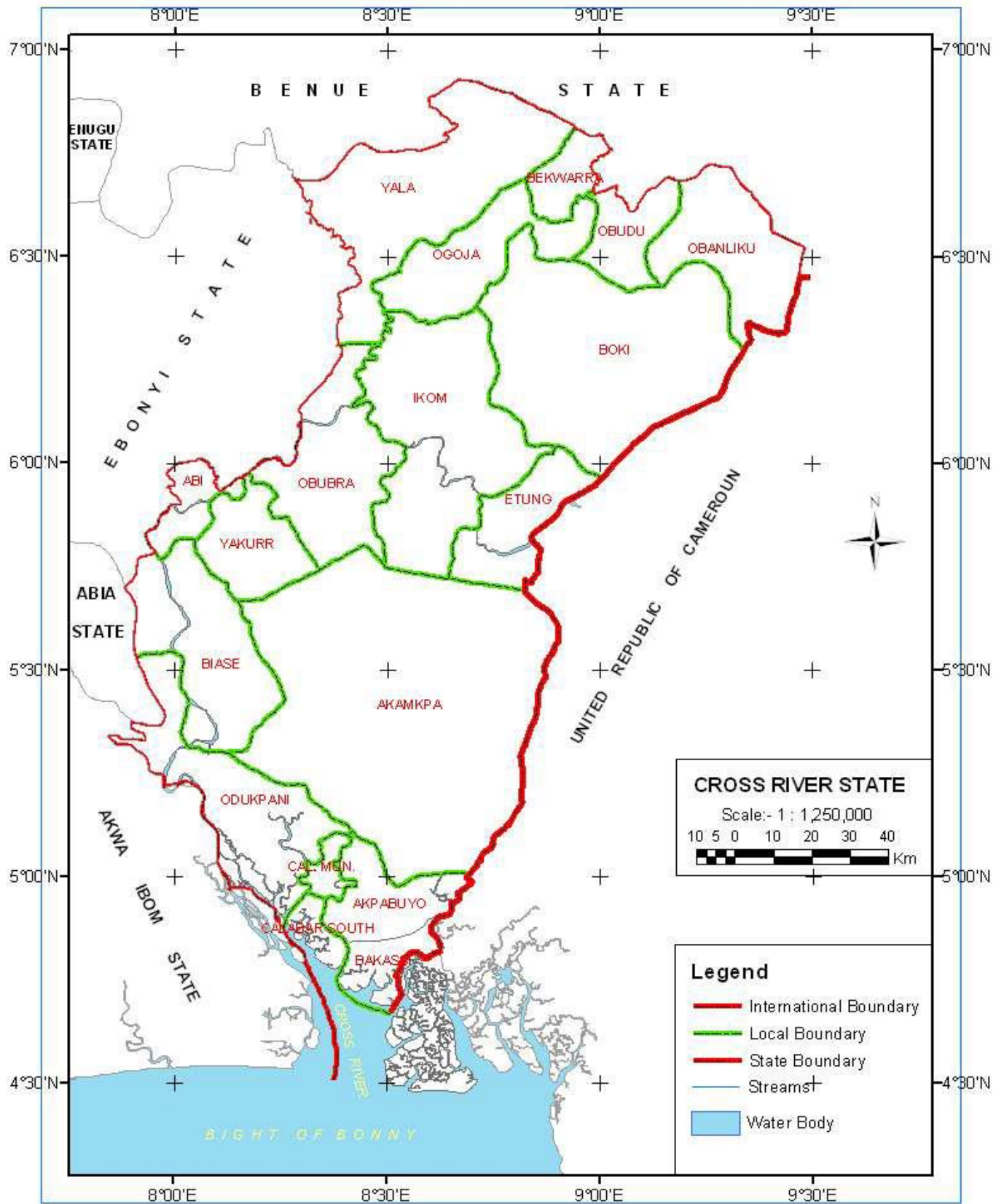
***2019 RECORDS OF DOMESTIC EXPENDITURE ARREARS AND  
CLEARANCE FRAMEWORK***

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***GOVERNOR'S OFFICE***

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## **1.0 INTRODUCTION**

The importance of Arrears Clearance Framework in handling gradual and responsive settlement of financial obligations of the State as they fall due cannot be overemphasized, considering its effect on the reduction of accumulated arrears and prevention of further arrears.

It is very obvious to state that one of the problems of government is handling expenditure arrears with its daily increase thereby affecting the principle of Public Financial Management (PFM). The aim of the Arrears Clearance Framework is therefore to ensure that all financial obligations of Government that are fallen due for payments are gradually and responsively paid to avoid accumulation of arrears as well as guide against possible mechanisms that will result into arrears. This idea of developing an Arrears Clearance Framework will help in curbing excesses in expending thereby maintaining macro-economic stability that will eventually lead to growth and transparency.

It is worthy of note that the accumulation of expenditure arrears if not checked may result to very serious debt overhang on the domestic economy, reduce the impact of fiscal policy on aggregate demand and potentially undermine macro-economic stability, hence the control and clearance of arrears has to be given utmost priority.

## **1.1 COVERAGE AND PURPOSE**

This document provides policy guideline and procedures for managing all verified and authenticated expenditure arrears of the Cross River State. The framework is guided by the World Bank and the Debt Management Office (DMO), Abuja's template for the establishment of the Domestic Arrears Committee (DAC) as well as establishing good practices in the settlement of the State's Domestic

Expenditure Arrears. The Coverage will be on Contractual Arrears, Pension and Gratuity Arrears, Salary Arrears, and Judgment Debts.

The domestic arrears management policy provides the framework that guides in the identification, recording, and management of the domestic expenditure arrears of the State. It will also assist in establishing processes and systems to manage and reduce validated domestic arrears over time, and also complement other existing policies and provisions in existing financial legislations, extant circulars and financial rules and regulations.

In the course of the exercise, a technical committee was setup by the Cross River State government with the mandate to collate the established database of expenditure arrears for periodic reviews and updates so that the document will become a reference one for the Public Finance Management (PFM) and other Ministries Department and Agencies (MDAs). This document will also be relevant to the State Economic Team: Ministry of Finance, Office of the Accountant General, Auditor-General, Budget Office, Debt Management Department, State Planning Commission, etc.

## **1.2 AUTHENTICATED RECORDS AND CLEARANCE FRAMEWORK**

From the available records, the established Stock of contract arrears as at year end 31<sup>st</sup> December, 2019 amounted to N39,123,760,294, Pension and Gratuity is N13,671,462,665.66, Salary Arrears N279,963,618.86, Judgment debt Arrears is N32,043,765.76 these are partly inherited from previous regime and partly under the current administration, totally **N53,107,230,344.33**.

The table below shows the breakdown of all verified and authenticated domestic arrears that are to be reviewed and updated from time to time.

STATE DOMESTIC ARREARS STOCK REPORTING											
S/N	ARREARS TYPE IN NAIRA	OUTSTANDING ARREARS AT DECEMBER 31, 2017 (stock)	NEW ARREARS INCURRED IN 2018 (FLOW)	ARREARS SETTLED (PAID) IN 2019 (FLOW)	OUTSTANDING ARREARS AT DECEMBER 31, 2018 (STOCK)	NEW ARREARS INCURRED IN 2019 (FLOW)	ARREARS SETTLED (PAID) IN 2019 (FLOW)	OUTSTANDING ARREARS AT DECEMBER 31, 2019 (STOCK)	CHANGE IN ARREARS BETWEEN DECEMBER 31, 2018 AND DECEMBER 31, 2019	% CHANGE IN ARREARS BETWEEN DECEMBER 31, 2018 AND DECEMBER 31, 2019	REMARKS
1	Contractors' Arrears	31,336,652,449.83	7,787,107,844.22		39,123,760,294.05			39,123,760,294.05	7,787,107,844.22	25%	
2	Pension and Gratuity arrears				13,671,462,665.66			13,671,462,665.66			
3	Judgment debt Arrears	32,043,765.76			32,043,765.76			32,043,765.76			
4	Salary Arrears				279,963,618.86			279,963,618.86			
	<b>TOTAL OF ALL ARREARS TYPES</b>	<b>31,368,696,215.59</b>			<b>53,107,230,344.33</b>			<b>53,107,230,344.33</b>			

Table 1

It is believed that the huge outstanding arrears will be validated by the committee for approval and subsequent payments. The technical committee will also be responsible for vouching, verifying and authenticating claims not previously captured before their inclusion in the database and review/update of the online published data. All the verified and authenticated arrears are housed with the Debt Management Department (DMD) of the Governor's office.

The gradual liquidation plan will serve as the financial plan for clearance of validated stock of arrears based on the total fund available in the state's current budget year and the budget year to come. Consequently, the State Government plan to liquidate the arrears in four (4) years using fund from Statutory Federal allocation/transfers, internally generated revenues and /or borrowings from Commercial/ Deposits Banks.

### **1.3 DESCRIPTION OF THE STATE'S POLICY ON ARREARS**

The following measures are adopted by the state to clear existing arrears and prevent accumulation of new arrears:

1. Strengthen legal and regulatory framework. The State Government shall empower its legal and regulatory framework on financial issues.
2. Enhancing the credibility and realism of the State's budget. The state's budget shall be a realistic plan for expenditure based on conservatively estimated revenues based on robust assumptions and forecasts in the fiscal frameworks.
3. Improved Accounting and Reporting. The State shall ensure proper accounting and reporting system is in place.
4. Strengthen commitment controls to effectively limit commitments to approved budget allocations and to availability of actual cash with improved integrated cash and debt management.
5. Effective oversight of State-owned enterprises or Government Business Enterprise (GBE) to prevent accumulation of arrears.
6. Enforcement of Treasury Single Account (TSA) to reduce state's reliance on commercial bank loans and the prevention of accumulated arrears.
7. Implementation of the State Cash Management Strategy to ensure liquidity is readily available to meet to cash obligations as they arise through accurate and timely short term estimates of cash inflows and outflows

## **2.0 PLANNED ACTIONS FOR SETTLEMENT OF CROSS RIVER STATE DOMESTIC EXPENDITURE ARREARS**

The essence of the Arrears Clearance Framework is to address the root causes of accumulated arrears as well as clear any outstanding arrears there-from. The framework is to be made known to all stakeholders and how Government intends to settle their arrears highlighting the time and possible criteria will be outright expressed. This will help to avoid any form of nepotism and preferential treatment in the cause of selecting creditors to be paid.

### **2.1 PRINCIPLES GUIDING THE ARREARS CLEARANCE STRATEGY**

The following factors should guide the arrears clearance strategy

➤ **Comprehensiveness**

The strategy should be used for all outstanding payments incurred by Government, and/or state-owned enterprises

➤ **Transparency**

To ensure that the exercise is devoid of ambiguity, the timetable and the method used in prioritizing the clearance should be transparent and adhered to.

➤ **Credibility**

There should adequate measures in place to stem against the accumulation of arrears and those responsible sanctioned

➤ **Realism**

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

➤ **Verification**



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

To effectively attain the needed structure, the arrears clearance strategy should follow the steps below:

- a. Stocktaking
- b. Verification
- c. Classification
- d. Prioritization, and
- e. Liquidation

## **2.2 ACTIONS FOR EACH STEP OF ARREARS CLEARANCE STRATEGY**

### **2.2.1 Stocktaking**

Stocktaking of Arrears should be carefully handled to enable the state government understand the extent, composition and the age of all unpaid arrears and prioritize for clearance.

The stocktaking exercise requires a timetable and a cut-off date for the inclusion of new arrears to encourage timely reporting and avoid the generation of fraudulent claims.

The Stocktaking will enhance the creation of a database for all claims, their classifications and categories for proper evaluations. Ultimately, this will propel efficiency in timely and regular reporting.

### **2.2.2 Verification**

This is to ensure that only authenticated data collated are verified to avoid payments of fraudulent claims. The activity should be handled either by the

Auditor-General's office or the inspectorate unit of the Accountant- General's office and the report made available to the Auditor-General.

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 Accountant of that entity, while the responsibility for proof of validity of claims without proper documentation should rest with the claimant. In this case, only original copies should be accepted to avoid fraudulent claims.

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

The following guidelines are to be used:

- The Legal Validity of the Claims should be carried out to authenticate if the transaction followed laid down procedures.
- Evidence that the goods were delivered and services were duly received and accepted by a responsible officer. The proof should be evidence of certificate of valuation, completion certificate produced by experts should be made available.
- Invoices and supporting documentation should be checked to verify the value of the amount payable. The invoices should contain the following
  - a) The Amount
  - b) The Supplier
  - c) The reference to the contract

- d) The purchase order or agreement signed by the responsible officer,  
and
- The documents confirming receipt of goods or services, such as inventory records of the purchasing entity.

### **The Arrears Database**

The following data should be captured for each outstanding claim:

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

In the event that the due date is not recorded in the invoice, the invoice date can be used as proxy for the due date.

- **Debtor:** The database should capture the government entity incurring the liability, classified by institutional group.
- **Creditor:** The database should capture the creditor's name classified by type:
  - a) Employees;
  - b) Private individuals
  - c) Private businesses
  - d) Financial institutions
  - e) The State government
  - f) Local government
  - g) Extra-budgetary fund, or
  - h) State-owned enterprises

There should be a clear demarcation between extra- Government and inter-Government obligations to facilitate rapid administrative clearance.

- **Economic category:** The database should classify the arrears in economic categories such as acquisition of non-financial assets and financial assets etc.
- **Currency:** The original currency which the transaction was denominated should be captured.
- **The age of the payable should be checked** by reference to the documents and other supporting documentation.
- **The ministry of finance:** The ministry should care of the legal framework with respect to the disclosure of tax records.

**Step 3 Categorization of claims:** The claims should be classified as valid, contestable and rejected depending on the level of verification carried out.

**Step 4 Appeals from claimants:** This occurs when contestable claimants are invited to provide evidence to support their claim or have their matter referred for adjudication.

**Step 5 Rejection of invalid claims:** The government should formally notify rejected claimants and state the reason the basis for the rejection.

**2.2.3 Classification:** A database of valid outstanding arrears should be established and centrally maintained by the Debt Management Department. The practical approach to this would be to focus on the large claims and gradually expanding the coverage of the database.

The database should capture the contractual information taking cognizance interest rate and penalties charges for non-payments. The payment status on the

invoice should be noted specifying the amount paid, amount outstanding and any rescheduling, discounting or factoring of the unpaid obligations. The risk factor of non-payments should be considered.

#### **2.2.4 Prioritization of Arrears for Clearance**

Once a database of valid claims has been established, a set of criteria for prioritizing their liquidation should be determined based on the nature of the arrears. The prioritization should be considered based on the socio economic impact, age of the debts, the cost, the risk, the currency, the creditor, and the value.

#### **2.2.5 Liquidation**

The liquidation of arrears begins after the establishment and publication of the criteria for prioritizing it for clearance. The mandate of clearance should be on the “Arrears Clearance Committee” applying the principles of the framework. There should also be adequate provision in the Medium Term Expenditure Framework (MTEF) for the clearance of the arrears and the payments should be centralized. Any transaction that would undermine transparency and accountability and engender moral hazard should be avoided. In most cases, the funding needed for the payment of arrears is source from

1. Statutory Allocation
2. Internally Generated Revenue
3. Grants from the Federal Government, and
4. Loans

Furthermore, the securitization of arrears directly into government debts should be considered only as a last resort. The range of securitization options include

promissory note, marketable treasury bills or bonds directly to creditors. The advantage here enables government to select the debt maturity structure and repayment profile that best matches its financing needs. These approach will help creditors to raise liquidity by trading their title in the secondary market, possibly at a discount.

### **3.0 PRIORITIZATION CRITERIA FOR ARREARS CLEARANCE**

The prioritization of arrears clearance should be based on transparency criteria, depending on the nature of the arrears. These would be coordinated by looking at the socio-economic impact, the age of debts, the cost, the risk and the value. The State government is at liberty to use any of these options for the payment of the expenditure arrears.

#### **3.1 Prioritization Criteria**

There would be two criteria for prioritizing the arrears clearance:

The first approach will allocate available fund among the type of arrears in proportion to their share of the total outstanding stock of the arrears, while the second will allocate available fund on a particular type of arrears.

### 3.2 Prioritization within types of arrears

S/N	CRITERIA/APPROACHES	RATIONALE	REQUIRED DATA
1	CONTRACTORS		
	Ongoing works first	Ensure ongoing works are completed	Status of Project Construction
	Largest Value First	Largest value of arrears is addressed first	Value of outstanding Arrears
	Smallest Value First	Immediate payment of individual and small firms arrears	Value of outstanding Arrears
	Oldest First	Creditors are paid on first come basis	Date missed payment was due
	Subject to Penalties First	Paying arrears that bear penalties for late payment reduce cost to the State	Contract terms whether provided for late penalties
2	Salaries		
	Oldest First	Largest value of arrears is addressed first	Date missed payment was due
	Smallest First	immediate payment of individual and 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
3	Pension and Gratuity		
	Oldest First	Largest value of arrears 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
4	Judgment Debt		
	Oldest First	Largest value of arrears 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



## **4. INSTITUTIONAL ARRANGEMENT**

### **4.1 Description for the implementation of the framework**

Cross River State will put in place Arrears Clearance Committee as an institutional arrangement charged with the overall arrears clearance processes, including recording, verification, classification, reporting, prioritization, and clearance of domestic expenditure arrears in the State.

The committee is expected to operate within the principles of the framework by ensuring payments in accordance with the prioritization criteria. Besides, the committee is to receive reports and equally prepare periodic reports to the Governor's office and ministry of finance on the performance of the arrears payments. The report should highlight any non-reporting spending units and recommend remedial actions.

### **4.2 Objectives and Responsibilities**

The committee will support the debt Management Department 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:

- a. Review of the Arrears Clearance Framework for implementation
- b. Regular update of the established database and publicly accessible online version of the database
- c. Ensure adequate classification of the arrears based on the prioritization criteria

- d. Oversight of the overall recording, verification and reporting processes for the expenditure arrears.
- e. Provide accurate monthly, quarterly and annually reports showing the true and fair position of the verified arrears and the progress made.

### **4.3 Specific Activities**

These activities include, but not limited to the following:

- a. Periodic review of the Arrears Clearance Framework
- b. Adoption and implementation of records management guidelines for domestic arrears.
- c. Adoption and implementation of verified guidelines for all types of domestic arrears.
- d. Establishment of a publicly accessible online version of the database.
- e. Reporting of valid and verified domestic arrears to end users

### **4.4 Monitoring and Reporting**

The committee shall report directly to the State Governor through the Commissioner for Finance.

### **4.5 Membership of the committee**

The membership of the committee will be as follows:

- a. Attorney-General
- b. Commissioner of Finance
- c. Special Adviser, Debt Management Department as the Secretariat as well

- d. Special Adviser, Budget and Monitoring Department
- e. Special Adviser, Economic Planning
- f. Auditor- General
- g. Accountant- General

#### **4.6 Committee's Secretariat**

The committee shall establish a secretariat to support its work using existing staff within the office of the Accountant-General and the State's Debt Management Department.

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

The committee shall have delegated authority to request any and every information relevant to their assignment from the MDAs.

The committee will be able to incur expenditures including the engagement of professional assistance in the course of the assignment. All expenditures must be incurred through the procurement systems of the selected institutions.