



**GOVERNMENT OF ANAMBRA STATE  
AND  
UNITED NATIONS  
DEVELOPMENT PROGRAMME**

**THE NUTS AND BOLTS OF  
ANAMBRA STATE FISCAL  
RESPONSIBILITY LAW**

**A TOOLKIT/  
MANUAL**

**JULY 2012**

**THIS MANUAL IS FUNDED BY THE  
ANAMBRA STATE GOVERNMENT IN COLLABORATION WITH  
THE UNITED NATIONS DEVELOPMENT PROGRAMME (UNDP),  
NIGERIA**





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## **LIST OF ACRONYMS**

- DMO** – Debt Management Office
- DMD** – Debt Management Department
- FA** – Federation Account
- FAAC** – Federation Account Allocation Committee
- FG** – Federal Government
- FGN** – Federal Government of Nigeria
- FSP** – Fiscal Strategy Paper
- FRA** – Fiscal Responsibility Act
- FRL** – Fiscal Responsibility Law
- FRC** – Fiscal Responsibility Commission
- HC** – High Court
- IGR** – internally generated revenue
- IPPIS** – Integrated Personnel and Payroll Information System
- LG(s)** – local government(s)
- LGA(s)** – Local Government Area(s)
- M & E** – Monitoring and Evaluation
- MDA** – Ministries, Departments, and Agencies
- MDGs** – Millennium Development Goals
- MTEF** – Medium Term Expenditure Framework
- MTSS** – Medium Term Sector Strategies
- NA** – National Assembly
- NCS** – National Council of State
- NEC** – National Economic Council

**NEEDS** – National Economic Empowerment and Development Strategy

**NGO** – Non-Government Organization

**NPC** – National Planning Commission

**OPS** – Organized Private Sector

**PEFA** – Public Expenditure and Financial Accountability

**PEMFAR** – Public Expenditure Management and Financial Accountability Review

**PFM** – Public Financial Management

**PS** – Permanent Secretary,

**SAP** – Structural Adjustment Programme

**SC** - Supreme Court

**SEEDS** – State Economic Empowerment and Development Strategy;

**SG(s)** – State Government(s)

**SHA** – State House of Assembly

**SNG(s)** – sub national government(s)

**UNDP** – United Nations Development Programme

**VAT** – Value Added Tax

**WB** – World Bank

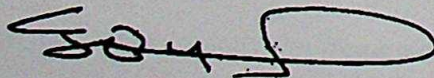
## FOREWORD

Anambra State government under the Administration of His Excellency, Mr. Peter Obi, CON, Governor of Anambra State, has embraced various Public Finance Management (PFM) Reforms in order to achieve enhanced Good Governance in the State. One such PFM initiative is the establishment of an effective and efficient Legal framework for all Fiscal Responsibility matters, resulting in the enactment of the Fiscal Responsibility Law (FRL) in 2010. The enactment of the FRL signifies a major shift from a policy-based fiscal system to rule-based regimes in line with current international best practices.

In order to facilitate the operationalization of the FRL, the State Government in collaboration with United Nations Development Programme (UNDP) embarked on the development of the "Nuts and Bolts of Anambra State Fiscal Responsibility Law" (a toolkit/manual) to enable various stakeholders understand and utilize the content of the FRL as the need arises.

The 10-chapter work extensively covers various features of the Fiscal Responsibility Law which include issues of fiscal discipline, budget management, debt and indebtedness - all discussed in simple language and style for better understanding by all stakeholders and the general public.

The Tool kit/Manual of Anambra State Fiscal Responsibility Law (FRL-2010) is strongly recommended for policy makers, political appointees, technocrats, bureaucrats, lecturers and students of Public Finance Management (PFM), as well as professionals, statutory bodies and the general public. It is hoped that researchers and, indeed, the general public will find the document a valuable working tool.



**Professor Chinyere Stella Okunna**

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*Ministry of Economic Planning & Budget*

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*July, 2012*

## **ACKNOWLEDGEMENT**

This Publication was made possible by the contributions of many people and I wish to use this opportunity to acknowledge them. Foremost in our list of appreciation and gratitude is His Excellency, Mr Peter Obi, CON, Governor of Anambra State whose abiding interest in reforms and good governance led to the signing of the Fiscal Responsibility Law (FRL) 2011. May we also thank the indefatigable Professor Chinyere Stella Okunna, Chief of Staff/Honourable Commissioner for Economic Planning and Budget whose Ministry oversees Development Partnership Programmes in the State for her useful advice.

We also wish to thank Mrs. Vivian O. Nwandu, Former Permanent Secretary, Ministry of Economic Planning and Budget, now Special Adviser to the Governor on Millennium Development Goals (MDGs) for her motherly disposition and guidance during the production of this Toolkit.

We sincerely acknowledge the invaluable contribution and assistance of the United Nations Development Programme (UNDP) particularly the Economic Governance Programme team ably led by Dr. Robert Asogwa, assisted by Maureen Chukwurah, Nike Babalola for their interest in ensuring that the Fiscal Responsibility Law was passed in Anambra State and the Toolkit produced in record time.

May we also appreciate the effort of the Economic Governance Programme (EGP) Focal Point, Mr. A.B.C. Nwosu (JP) and his team who painstakingly read through the Toolkit Policy Framework, making sure that all relevant materials were made available.

Finally, our profound appreciation also go to Professor Olaseni - Akinlola Bello and Sir Emma. Chukwudubem Okafor (CNA), the consultants that produced the Fiscal Responsibility Policy Toolkit.

**Mitchelle Onugbolu**  
Partnership Manager  
July 2012-07-18

## EXECUTIVE SUMMARY

This Manual is divided in 10 Chapters.

The first Chapter reviews the need for a Fiscal Responsibility Law. It argues that lack of Fiscal discipline, absence of focus on strategic priorities; ineffective resource allocation and the lack of correlation between government expenditure and the provision of goods and services provide strong argument for a fiscal responsibility law. Other reasons were adduced to support the case for the law. These include the existence of scissors crises – revenue falling below expenditures leading to huge borrowing and inability to service the debts, lack of checks and balances and the absence of voice and accountability frameworks. In addition, the existence of weak budget management process – (the budgets were in most cases, unrealistic, unpredictable and unreflective of policies), inefficient and corrupt procurement process further exacerbated the problem of fiscal mismanagement, reinforcing the need for public finance reform. Lessons learned from the past experiences also gave birth to the fiscal responsibility law.

**Chapter 2** discusses the major elements of the Fiscal Responsibility Law and asserts that the fiscal activities of the government are now rule-driven and legislated upon. There are four major elements which consist of:

- A permanent policy rules such as limits on government deficits, expenditures, debt and or borrowing.
- A set of procedural rules to guide public financial management in such areas as medium-term budgetary planning, annual budget planning, preparation, coverage, and the audit process.
- Prescribes requirement for open and transparent budgeting process, and
- A mechanism for monitoring and enforcement.

The chapter provides the organizational structure of the Fiscal Responsibility Commission and discusses its function and powers. It also provides a comprehensive overview – clause by clause analysis – of the thirteen parts and the fifty-four sections of the law. The manual recommends under budget planning, the adopting of organic budget procedures.

Other features of the Fiscal Responsibility Law – including issues of fiscal discipline, budget management, budget coverage, annual cash plan, disbursement schedule, savings and assets management, debt and indebtedness were discussed in **Chapter three**.

**Chapter Four** analyses the budget process as a cycle. It highlights the interaction between the various levels of government in formulating the budget. Effective public spending policies are heavily dependent on the institutional arrangements for decision making and budgeting. Sound policies derive from sound analysis. The various critical steps in the budget process are identified as including – the setting of aggregate spending limits; setting sector spending limits, preparation and analyses of line agency bids; ensuring budget compliance and providing adequate feedback on budget execution. It emphasizes the following:

- The need for accurate forecasts of growth and resources;
- The need to be conservative in allocating resources to ensure sectoral allocations do not exceed the aggregate level consistent with deficit target and overall revenue estimates;
- The provisioning for expenditure reserves – planning and contingency reserve during budget preparation;
- Identification of priority programmes (in particular pro-poor programmes) whose budget will be protected from revenue shortfall;
- Credible sector spending limits to be derived from medium-term cost estimates and revenue projection and to reflect judgments on the nature and appropriateness of existing budgetary commitments.
- The need to be flexible so as to accommodate changing circumstances, as against the need for adequate control of resources.

The shortcoming of the annual budget with regards to future resource availability was addressed in **Chapter five** where the discussion of Medium-term expenditure planning tool and the advantages of MTEF structure were summarized into four major areas which include:

- Better matching of spending with overall resource availability in the medium term.
- Aligning sectoral allocations of spending with government priorities.

- Permitting simultaneous programming of recurrent and investment expenditures thereby improving sector planning, and
- Increased effectiveness and efficiency of spending.

The chapter ends with a discussion of the seven critical steps required in preparing a Medium-term Expenditure Framework and how to increase its effectiveness as an expenditure planning tool.

**Chapters Six and Seven** discuss budget coverage and comprehensiveness. The principle is that a budget should cover all state revenues and expenditure. In particular, autonomous bodies and agencies should be required to divulge information on their financial situation for transparency and accountability purposes. Non-budget entities should be subject to budgeting on the basis of full disclosure of 'sources and uses of funds'. Combination of spending data from the state government with data from other autonomous bodies (state enterprises and parastatals), and local government on a gross bases would give a good picture of public spending in a given sector. Chapter six further gives a breakdown of how budgets can be classified, and how budget information should be structured. The need for budget transparency was exhaustively analyzed in **chapter seven**. It is essential for informed public debate, making government more accountable and for strengthening credibility and public understanding of government policies and choices. It provides a template given by the International Monetary Fund as codes of good practices which are grouped under four objectives:

- Clarity of roles and responsibilities
- Public availability of information
- Open budget preparation, execution and reporting and
- Independent assurance of integrity.

**Chapter 8** further highlights the production of reports to be prepared and specific information disclosure requirements considered international best practices for a country or state willing to increase their degree of budget transparency. These budget reports include pre-budget, monthly, mid-year and year-end reports. Specific disclosure requirements include key economic assumptions used in budget planning and preparation, tax expenditures, financial liabilities and financial assets and non-financial assets.



The last **two chapters** are pedagogic – to allow public officials gain understanding of public investment decision criteria called social cost-benefit analysis required for the evaluation of public projects. The conceptual basis of cost-benefit analysis is not different from that of private cost-benefit analysis except in the following areas: the definition of the objective function – the social welfare function, the definition of costs-private and social costs (externalities) and direct and indirect benefits, the appropriate costs of capital and many other technical issues. The information requirements and the complexity in application may make it suitable for very large public sector projects. The chapter also discusses the investment evaluation criteria – the present value, internal rate of return and benefit-cost ratio and cautions that though it has been in existence for long (old wine in a new bottle?), it is not a perfect tool, given its several measurement problems.

**Chapter 10** is meant to increase awareness of public officials to the different financial instruments available in the capital market and some of the terms and terminologies employed by the market. The implicit message is that instruments to be used should be tailored to the maturity structure of the projects, and the characteristics of the type of instruments available for financing government. The Fiscal Responsibility Law allows borrowing for capital expenditure, so long-term financing instruments would be most appropriate. Of course, the market allows innovative structuring of instruments to suit the project and repayment and or cash-flow structure.

**In conclusion**, the manual recognizes the acute technical skills shortage and capacity gaps in the state civil service particularly in the public finance and budget management processes and when this is interposed with the technical skills requirements of the FRL, particularly in the areas of preparation of the MTEF, budget planning, preparation and monitoring and in the use of cost benefit analyses to evaluate public projects; there is a need for considerable capacity building and staff training programmes in budget management processes which are presently non-existent in the service to make the implementation of the FRL and even the Procurement Law feasible, productive and effective.

## **INTRODUCTION**

This toolkit/manual on Fiscal responsibility Law is focused at providing the reader or users a deeper understanding of the major provisions of the new fiscal responsibility law in Anambra State.

The Analyses provide further explanation to what are considered the nuts and bolts (the key provisions) of the law. These key provisions are:

- i. The annual budgetary planning process
- ii. The medium term expenditure planning tool (MTEF)
- iii. Budget coverage and comprehensiveness
- iv. Best practices for fiscal transparency
- v. Reports and Information Disclosure Requirements for Budget Transparency
- vi. Replacing old-fashioned 'muddle-through' "rule of thumb" method in public expenditure decisions with a more rigorous cost-benefit analysis
- vii. The capital market requirements for government borrowing and the type of government debt instruments.

The approach adopted is descriptive and analytical. Many of the materials used in the manual could not be said to be original as they draw heavily from existing published materials on the different topics or subjects-matter. This manual is organized as follows:

- Section 1 discusses the need for a fiscal responsibility law drawing from past experiences with fiscal management in the country and the lessons learned. These lessons influenced the major provisions of the law.
- Section 2 provides an overview of the fiscal responsibility law and attempts a clause-by-clause interpretation of the major parts of the law.
- Sections 3 to 9 are devoted to the analysis of each of the key issues in the fiscal responsibility law as itemized above.
- The closing section 10 looks at the challenges before the fiscal responsibility commission in the area of enforcing and monitoring adherence to the provisions of the law, promoting public understanding of the law, building capacity and sponsoring studies to ensure efficient and effective implementation of the law.

## CHAPTER ONE

### THE NEED FOR A FISCAL RESPONSIBILITY LAW

#### 1.1. Introduction

A government fiscal policy is an instrument through which a government influences the direction of the economy. It is concerned with how the government wishes to raise revenue for the financing of its activities (fines, fees and rates), and the imposition of taxes to finance the provision of public goods and services and stabilize the economy. It also addresses the allocation of resources among the different sectors, or specific programmes for achieving socio-economic objective of the government. Fiscal policy is not only about revenue raising and expenditure decision, it also addresses the question of how much debt should a government raise to supplement its financing activities. The level and composition of debt (domestic and external) as well as their sustainability form an integral part of fiscal policy. The annual budget is one of the primary means through which the government implements its fiscal policy. The budget plays a central role in the process of government, fulfilling economic, political, legal and managerial functions. A good budget process is a tool that enables government to channel expenditure towards those areas that make the greatest contribution to objectives.

The government has responsibility for sound fiscal management and policies (tasks of allocating and managing public money) which should be geared towards:

- i. Maintaining fiscal discipline (keeping spending within limits created by the ability to raise revenue and keeping debts within levels that are not prohibitively expensive to service;
- ii. Promote strategic priorities – (that is allocating and spending resources in those areas that make the greatest contribution to the government's objectives); and
- iii. Deliver value for money – (that is efficient and effective use of resources in the implementation of strategic priorities)

These three outcomes are interdependent but the first priority is to maintain fiscal discipline even though the method adopted may undermine the achievement of strategic priorities and value for money objectives

## **1.2. Experience of Recent Past**

Nigeria's history of fiscal management has been characterised by lack of fiscal discipline, lack of focus on strategic priorities that promote growth and development (spending money on the 'wrong' goods and the 'wrong' people), huge indebtedness and debt trap; inefficient and ineffective resource allocation, widespread corruption and lack of accountability. There is gross lack of correlation between government expenditure and the availability of facilities and service delivery. There are expenditure leakages – money allocated that does not reach the ultimate destination. The incentives to provide the service are weak due to lack of accountability and monitoring, and people did not avail the services provided to them due to lack of awareness and participation. The end result has been chronic poverty, deprivation and low level of economic development. The National Bureau of Statistics Core Welfare Indicator Questionnaire Survey (CWIQ 2006) estimates that over 56 percent of the population live below the poverty line and a self-assessed (subjective assessment) poverty of over 75 percent.

### **a). Unsustainable Fiscal Management**

The need for a fiscal responsibility law can be traced to the unsustainable fiscal management of past governments. The fiscal climate was characterised by persistent scissors crises, with expenditure leading revenues and the lack of a savings culture. Debts were incurred unsustainably and without adequate recordings and documentation. Federal and state governments racked up huge debt profiles (external and domestic) without a corresponding evidence of goods and services to justify the debts. Such recklessness is debt usage.

### **b). Absence of Checks and Balances and Accountability Framework**

Systems of checks and balances built into government structures that formed the core of good governance and have helped empower citizens, normally taken for granted in many Western democracies were lacking. The incentives that motivate public servants and policy makers – the rewards and sanctions linked to results that help shape public sector performance – are rooted in a country's accountability Framework. The absence of an accountability Framework – government being accountable to the electorate, poor financial reporting rules and timelines, and lack of clarity of roles and responsibilities between the executives and legislatures on budget management and fiscal policies further exacerbated the problem. Adequate

disclosures and regulation of fiscal activities are sine qua non for controlling abuse of processes, corruption and misappropriation of resources.

### ***c). Weak budget Management Process***

The budgeting process was seriously flawed. There was no attempt to link budget to policy and planning. The absence of evidence-based policy and policy-based budgeting created a wide gap between government service delivery and level of expenditures. More often, the budgets were unrealistic, unpredictable and inconsistent with the socio-economic priorities and strategic needs of the citizens. Revenue forecasts were more of conjectures and guess mate. Allocations of funds to budget heads, or economic social and administrative sectors were haphazard and were based mostly on rule of thumb and mechanical. Recurrent expenditures dwarfed capital expenditures and deficit budgeting was the order of the day. The procurement process was too arbitrary and allowed the decision making with a wide range of discretions. The contract award lacked clear rules and procedures for the selection of winners, for pricing and costing and for performance or quality specification. The weaknesses in procurement encouraged contract manipulation, uncontrolled cost escalation and variation, variable completion time, and widespread corruption. Monitoring and evaluation culture was weak and in many cases, absent. Public access to fiscal budgetary information was virtually nonexistent and civil society participation in fiscal policy matters and budget formulation process was almost impossible.

There is a link between lack of civil society participation in governance, poor public finance management, widespread corruption, poor service delivery and poverty. What this requires is the reform of the public finance management system. A transparent budgeting and expenditure processes to promote the three objectives earlier outlined. Similarly, promoting civil society participation in governance and particularly in budget processes (budget formulation, Analysis and Review, Expenditure tracking; and budget monitoring and evaluation) to exert external pressure on government to be efficient and effective and promote voice and accountability is a prerequisite for good governance. Civil society can participate effectively in the budget process and enhance the participation of the legislative other Lawyers in strengthening budget oversight. These mechanisms, by which

increased efficiency in allocation of resources, less corruption and leakage from the system.

#### ***d) Legal and Institutional Reforms***

These challenges have led to a number of legal and institutional reforms meant to address these multi-dimensional fiscal problems. These include:

- i. The enforcement of Independent Corrupt Practices Commission Law (2004) (Federal).
- ii. The Economic and Financial Crimes Commission Law (2004) (Federal).
- iii. The Public Procurement Law 2007 (Federal) and Anambra State Procurement Law (2011).
- iv. Debt Management Office Law (2004) (Federal), and the
- v. Fiscal Responsibility ACT (2007) (Federal), and Anambra State Fiscal Responsibility Law (2010).

The Public Procurement Law regulates government commerce and the requisite due process in capital budget implementation – award of contract, monitoring and implementation. The Debt Management Law regulates local and international borrowing and debt management of the three tiers of government. It provides the conditions precedent to borrowing and the duties of the Debt Management Office. Anti-corruption legislations are expected to minimize malfeasance and corrupt behaviour and ensure efficient and effective service delivery and sets legal standards for acceptable fiscal conduct.

### ***1.3. Lessons from Past Experiences***

Public expenditure management and control in Nigeria has highlighted a number of problems with the management of resources. This section describes some of these previous problems and how the FRL has taken a cue from them.

The FRL is based from the following lessons from the last.

#### ***Lesson 1: Plan for the longer term***

Historical reliance on annual budgeting was not sufficient for sensible management of public services. Short-termism and a 'use it or lose it' mentality failed to provide

value for money. The annual spending rounds institutionalized short-term planning horizons. For investment spending in particular, an effective planning horizon of one year is clearly too short.

***Lesson 2: Be open and transparent***

Budgets and fiscal policies were shrouded in secrecy and precluded open public debates which could have increased the quality of information available to government. This prevented full and effective scrutiny of the underlying health of public finances. It was not possible to judge the affordability of public spending plans.

***Lesson 3: Take a prudent approach***

Previous fiscal policy was insufficiently prudent. Management of fiscal resources was premised on the assumption that cyclical improvements in the public finances were permanent. Such unfounded optimism led to spending plans lurching from expansion to contraction.

***Lesson 4: Avoid 'stop-go' fiscal management***

The absence of prudent management of resources and entronement of volatile public spending pattern prevented availability of resources necessary for steady growth of key priorities.

***Lesson 5: Give due attention to capital expenditure***

Previous public spending pattern gave little or no attention to spending for capital development expenditure. Short-term current expenditures dominated public spending, with undesirable long-term effects. Public infrastructures' became run down as large maintenance backlogs built up in key services such as roads, schools, hospitals and other key infrastructures.

***Lesson 6: Emphasize outcome, not inputs as a measure of success***

Success in public spending was measured in terms of inputs while outputs and outcomes of expenditures were downplayed. This neglect of outcome resulted in sub-optimal decisions on allocation of resources between different areas and the poor performance of public services. Spending was not informed in any systematic way by data on the outputs of spending. Agreed measures of performance, by which success would be judged, did not exist for many programmes.

These lessons have been recognized in the design of the various provisions of the fiscal responsibility law:

- The now public spending Framework is based on clear set of principles and rules designed to embed policy credibility and economic stability. Spending plans should start with the preparation of medium-term expenditure Framework (MTEF).
- Annual budgetary planning should be derived from the MTEF.
- The prudent approach means that savings and investment culture be embedded in public spending, keeping expenditures within available resources and making debt levels to the ability to pay.
- Capital spending is protected so that necessary investment in public infrastructure is not cut for short-term reasons.
- The participation of the civil society and the publication of periodic reports to the public and submission for legislative approach promote openness, transparency and accountability.



## CHAPTER TWO

### FISCAL RESPONSIBILITY LAW TO THE RESCUE

#### 2.1. *What is a Fiscal Responsibility Law?*

The major elements of a fiscal responsibility Framework are;

1. Permanent Policy rules such as limits on government deficits, expenditures, debt or borrowing.
2. Procedural rules for public financial management such as whether to prepare a medium-term budgetary plan, budgeting and audit processes.
3. Transparency standards (timely publication and comprehensive coverage of government accounts).
4. Monitoring and enforcement mechanism usually supported by scrutiny from an independent agency.

In essence, a fiscal responsibility Framework sets government on a path of budgetary policy pre-commitment which takes a legislature form.

The benefits of the law are quite clear:

- It minimizes risk and fluctuations in government fiscal operations.
- It strengthens accountability and sound financial management by all tiers of governments.
- It ensures prudent public debt management, in this way it consolidates the gains from debt relief and place the economy on a viable platform for effective participation in the globalization process.
- It establishes high standards of financial disclosure.
- It also shields Nigeria from the volatility in commodity prices through the institutionalization of prudence and accountability.

To render the budgeting processes transparent, efficient and effective, curb the financial mismanagement of the past, reduce corruption, curb excessive borrowing, improve service delivery, and promote popular participation, the Fiscal Responsibility Law became effective on 30<sup>th</sup> July 2007 at the Federal level, and 5<sup>th</sup> August 2010 in Anambra State. This legislation embeds transparency in the public expenditure management system and also focuses on the public availability of information. A transparent budget system provides a readily understandable guide as to how

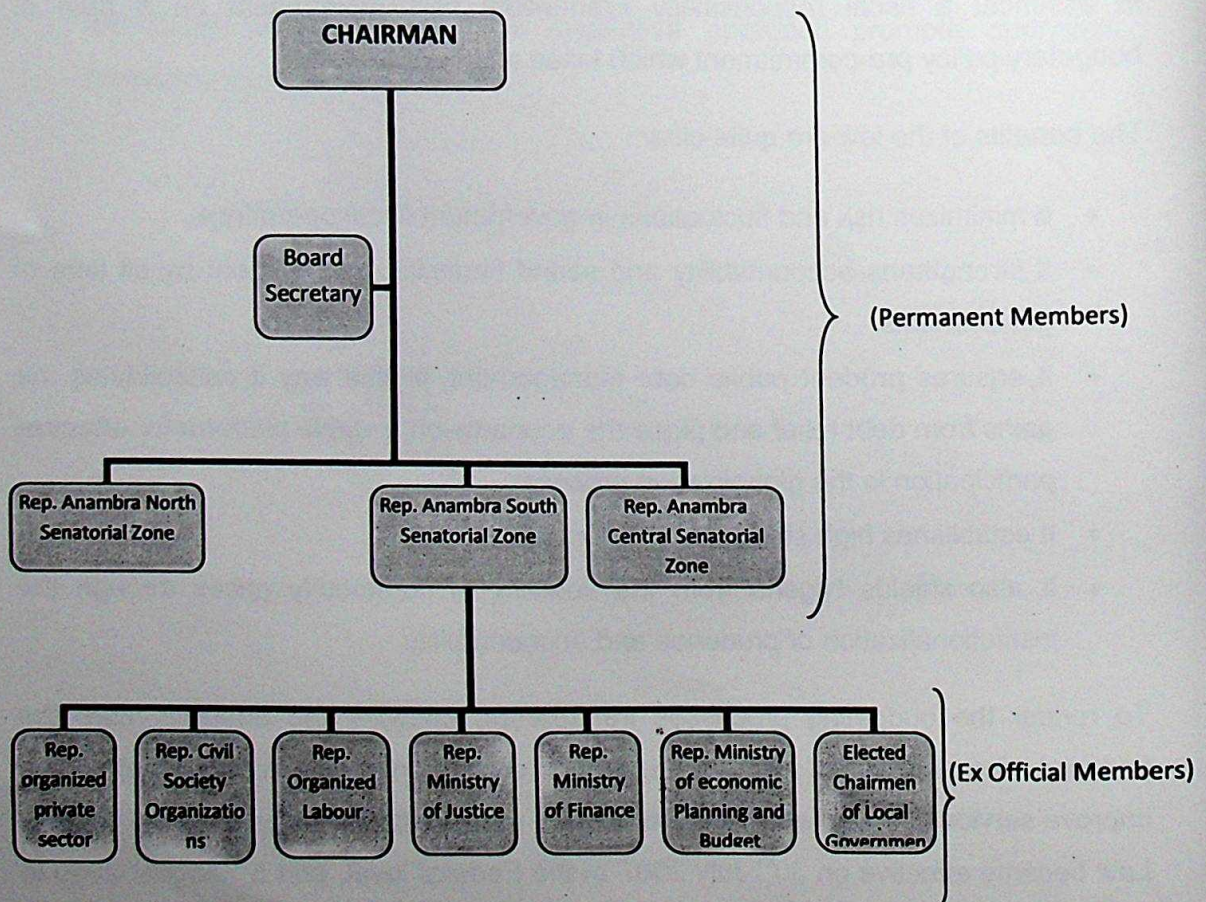
resources are planned to be used and what results are expected to be achieved. Transparency promotes certainty and confidence over budget plans and reduces the opportunity for corruption. The provision of information to the public also:

- Enables civil society to challenge the government to improve the effectiveness and efficiency of expenditure.
- Increases awareness of service users as to what services they are entitled to and provides channels for complaint and redress if they are not satisfied.

## 2.2. FISCAL RESPONSIBILITY COMMISSION

Institutional Framework: SFRL 2010

Figure 1: Fiscal Responsibility Law (2010) Organigram



State Fiscal Responsibility Law is a parliamentary creation, precisely established on 5<sup>th</sup> August 2010 with a Reg. No. ANHA/Law/2011/05

- The Commission is a body corporate with perpetual succession and a common seal and may sue, be used in its corporate name-“**Fiscal Responsibility Commission**”.
- The commission shall be independent in the Performance of its functions.
- The **powers** of the Commission are mainly centered on
  - a) compelling any person or government institutions to disclose information relating to public revenue and expenditures and
  - b) Cause an investigation into whether any person has violated any provisions of this law.

For any proven case, the commission shall forward a report of the investigation to the **Attorney-General** of the state for possible prosecution at the State High Court.

- This provision of the law makes it possible for a third party involvement in the enforcement of this law.

**Among its functions are:-**

- i. to monitor and enforce the provision of this law and by so doing, promote the economic objectives contained in section 16 of the 1999 constitution,
  - make rules of carrying out its functions under this law, exhibits good international practices in the allocation and management of public expenditure, revenue collection, debt control and transparency in fiscal matters.
  - Under take any other function consistent with the provisions and promotion of the objectives of this law.

For the Commission to discharge its statutory functions, it shall establish and maintain a fund from which shall be defrayed all expenditure incurred by the commission.

- It shall draw its fund from the budgetary allocation from State Government and grants from any other source.

**For administrative purposes, the commission shall consist of:**

- a. Chairman, who shall be the Chief Executive and Accounting officer of the Commissioner
- b. One member representing the organized private sector,
- c. One member representing civic society engaged in causes relating to probity, transparency and good governance
- d. One member representing organized labour.
- e. A representative of State Ministry of Economic Planning of a level not below the rank of a Director;
- f. A representative of State Ministry of Finance, who must be a seasoned professional accountant with not less than 10 years post qualification experience.

- g. A representative of Ministry of Justice of not below the rank of Deputy Director.
  - h. One member to represent each of the following senatorial district of the state, that is Anambra North, Anambra Central and Anambra South, and
  - i. One member of the elected chairman or in the absence, the care taker committee who should be a person not below the rank of a Deputy Director (Administration).
- The Chairman, and other members of the Commission other than ex-officio members and members representing the local government shall be appointed by the Governor subject to confirmation by the House.
  - All members according to this law must be persons of proven integrity and must possess a university degree in related field with not less than ten years cognate post qualification experience.
  - The chairman and the members representing the three senatorial districts shall be full time members and both chairman and the members of the commission shall hold office for a term of three (3) years in the first instance, subject to reappointment for another term of three years only.
  - Statutorily, the Commission is currently required by this law, to produce the State Medium-Term Expenditure Framework being the basis for the preparation of the estimate of revenue and expenditure.
  - The commission shall be compelled by this law to publish on a quarterly basis, a list of the State or local governments in the state that have exceeded respective limits of consolidated debt, indicating the amount by which the limit was exceeded.
  - As part of its statutory function, the Commission shall verify on a quarterly basis, compliance with the limits and conditions for borrowing by the state and each Local Government in the State.
  - The Commission is required by the law to publish the consolidated budget Report and shall lay it before the House and also disseminate the content to the public.

### ***2.3. An Overview of the Fiscal Responsibility Law***

The Fiscal Responsibility Law (FRL) is made as an “Law to provide for the prudent management of the fiscal resources, ensure long-term macro-economic stability and to secure greater accountability and transparency in fiscal operations within a Medium-term Fiscal Policy Framework and the establishment of Fiscal Responsibility Commission (FRC) to ensure the promotion and enforcement of the nation’s economic objectives and for related matters”. The FRL is anchored on the Fundamental Objectives and Directive Principles of the State Policy enshrined in Chapter 2 of the 1999 Constitution of the Federal Republic of Nigeria.

The operative parts of the economic objectives in S.16 of the Constitution are:

The State shall, in 16(1):

- a) Harness the resources of the nation and promote national prosperity and an efficient, dynamic and self reliant economy;
- b) Control the national economy in such a manner as to secure the maximum welfare, freedom and happiness of every citizen on the basis of social justice and equality of status and opportunity;
- c) Without prejudice to its right to operate or participate in areas of the economy, other than the major sectors of the economy, manage or operate the major sectors of the economy;
- d) Without prejudice to the right of any person to participate in areas of the economy within the major sectors of the economy, protect the right of every citizen to engage in any economic activities outside the major sectors of the economy.

The state shall (16 (2)) direct its policies toward ensuring:

- a) The promotion of a planned and balanced economic development;
- b) That the material resources of the nation are harnessed and distributed as best as possible to serve the common good;
- c) That the economic system is not operated in such a manner as to permit the concentration of wealth or the means of production and exchange in the hands of few individuals or of a group; and
- d) That sustainable and adequate shelter, suitable and adequate food, reasonable minimum living wage, old age care and pensions, unemployment and sick benefits and welfare of the disabled are provided for all citizens.

This section of the FRL imposes important obligations on the Federal Responsibility Commission (FRC) to ensure that fiscal policies do not derogate the responsibilities of all tiers of government to protect respect and fulfil the economic and social rights of all Nigerians. It recognizes the potency of fiscal policies for poverty reduction, promotion of social justice and equality of opportunities for protection of basic rights,

and for promoting socio-economic development. The FRC is thus empowered to ensure implementation of section 16 of the constitution.

The FRL has **thirteen parts, and fifty four sections**, and covers several issues which are central to public expenditure management. Fiscal responsibility reforms include: the annual budget management process; the medium-term expenditure Framework, fiscal strategy paper, strategic socio-economic priorities, limits on deficit financing; limits on the use of debt; indebtedness; the introduction of a debt management Framework; emphasizes transparent budgeting and expenditure processes; civil society participation as well as legislative oversight; full and timely disclosures and wide publications of all public financial management transactions.

The basis for annual budget is the medium term expenditure Framework (hereinafter called MTEF). A fiscal strategy paper accompanies the MTEF, and spells out the state strategic, economic, social and development priorities in the next three financial years, and how it facilitates the achievement of the economic objectives of section 16 of the nation's constitution. The MTEF incorporates a macroeconomic Framework, public expenditure and revenue Framework. The FRL specific procedures for budget preparation and execution, requiring the State Accountant General to prepare an Annual Cash Plan, and the Commissioner for Finance for a Budget Disbursement Schedule. The new law permits borrowing only for capital expenditure and human capital development purposes. The borrowing should be contracted at concessional terms with low interest rates and for reasonably long periods of amortisation. It must also be approved by the legislature.

The law seeks to improve intergovernmental fiscal coordination, promote macroeconomic stability, fiscal prudence and sound financial management as well as ensure transparency and accountability. Above all, the Fiscal Responsibility law provides a mechanism for ensuring that we meet our commitments to the Millennium Development Goals so as to drastically reduce poverty in all its ramifications through the Medium Term Expenditure Framework (MTEF). The nation's past experience with gross fiscal indiscipline informs the need for a comprehensive legislation on fiscal management system embracing the three tiers of government.

The enactment of FRL signifies a major shift from policy-based fiscal system to rule-based regimes in line with current international best practices. However, while the Federal Government has enforced FRL, only a limited number of states have

governing laws on fiscal responsibility, public debt management and even an organic budget law consisting of rules and procedures that guide the preparation and approval of the Annual Budget.

There is a need for each state to put in place these fiscal systems management laws to improve the efficiency and effectiveness of their budget preparations and execution, monitoring and evaluation and auditing and reporting system. In addition, it will also impact positively on the debt management and public procurement system thus minimizing the un-sustainability of debt, expenditure leakages, and mismanagement of public funds, corruption and other financial excesses of the past. The introduction and implementation of a fiscal responsibility law will enhance transparency, accountability and popular participation and deliver value for money in the fiscal system.

Fiscal discipline is inherently connected to notions of affordability: it has come to mean maintaining budgeted and Lawful spending, revenue and borrowing at levels that are financially sustainable and compatible with short-and-long-term economic objectives. However, the value of fiscal discipline lies as much in avoiding the negative external and internal Laws as in seeking the benefits of hard budget constraint for spending effectiveness and efficiency.

### **2.3.1. Annual Budget Planning**

- Budget planning for incoming year to commence in July based on mid-year (2<sup>nd</sup> quarter) performance review reports.
- Economic and fiscal update reports to be developed based on the midyear performance reports which should serve as vital important basis and road map for incoming year budget planning and preparation.
- Budget circulars to MDAs should among other information contain:
  - i. State economic and fiscal update based on mid-year reviews.
  - ii. Total state budget envelope
  - iii. Sectoral envelopes (estimated spending limits/ceilings)
  - iv. Guidelines on preparation of sectoral breakdowns based on advised envelopes.

- That there is urgent need to institutionalize State's Bureau of Statistics and to enhance capacity building to ensure timely and reliable data generation especially for development and preparation of economic and fiscal updates.
- Dual budgeting should be eliminated to ensure that capital and recurrent expenditure estimates are prepared by one Ministry – comprehensive budget should capture all transactions of the government including the parastatals.
- State Planning Commission should be established and or strengthened in every state as constitutionally required. State planning commission should be integrated with Local Governments budget planning process.
- Each State should set up State Committee comprising key actors in budget planning, preparation, implementation and evaluation.
- Each state should establish or activate Funds Allocation comprising key tasks of effecting monthly cash planning and disbursements to each sector/MDAs.
- Budgeting process should focus on output and outcome budgeting. This has implication for budget format.
- Principles of fiscal discipline to be incorporated into the entire budgeting process. That is matching revenue with expenditure; and debt with the ability to service the debt. This is an important budget outcome.
- Annual budget targets should be tied to the Medium Term Fiscal Framework (MTEF) targets.
- MDAs to constitute Budget Sub-Committees to be chaired by their respective Permanent Secretaries.

### ***2.3.2. Consultation and Engagement***

- Budget Consultative and participatory forums to be carried out during the planning state to ensure that opinions of key stakeholders such as CSOs, CBOs, Legislative arms, traditional institutions etc are timely incorporated. Involvement of the various Houses of Assembly will help in bridging the gap between the two arms and less frictions and delays in budget passage. It is essential that members of the legislature should be trained and retrained to ensure proper understanding of the budget preparation and implementation process.



- That there is the need for the publication of Citizens' Budget whereby the yearly budgets are published into simplified forms and versions even in local languages, mass produced and disseminated freely to the general public which will afford them an insight and understanding of the state's yearly budgets.

### **2.3.3. General Discussions**

- State Governors to attend and chair sessions of the Treasury Boards meetings to ensure budget ownership, effective and efficient budget implementation.
- State Commissioners of Budget/Economic Planning and Finance to maintain close relationship with their Governors with a view to influencing their (Governors) involvement in budgeting process.
- Every state to involve all relevant members of the State House of Assembly in the Planning Process.
- There is the need for states to adopt the use of Community Score Cards and Citizens Reports on periodical basis aimed at determining the performance of the budget.

### **2.3.4. Presentation of Draft Budget to House of Assembly**

- Recognizing the Law that our respective State Houses of Assembly are the arms that serve as watch dogs to the Executive, there is the need for the House, especially members of Appropriation and Public Accounts Committees to take the issue of budgeting as serious as business. Also, there is the need to increase the level of capacity of House members on budget management processes through peer group learning, study tours to nations or other Houses of Assembly noted for best practices. In all, training of the legislative arm on budget management processes is mandatory if the aims and objectives of the intended laws are to be achieved.
- There is need for the executive to have more engagements with the legislative arm especially at the planning and preparation stages of the budget as this will greatly facilitate their buying into the budget policy focus and proposals and reduce frictions between the two arms and ensure early passage of budgets.

### **2.3.5. Budget Execution and Control (Expenditure Recording and Accounting)**

- There is the need for robust and efficient internal control structures and systems which will help to reduce or eliminate all revenue and expenditure gaps and leakages.
- That there should be capacity building for all staff involved in budget planning, preparation and implementation.
- States should ensure that regular and periodic verification of bank accounts to ensure that charges are in line with CBN tariff structures and;
- All bank accounts to be reviewed with a view to identifying dormant accounts and closing those no longer desirable.

#### **2.3.6. Monitoring and Evaluation**

- Monitoring and Evaluation functions to be institutionalized and given a minimum of a Directorate status.
- Monitoring and evaluation functions to be streamlined to establish a linkage between input, output, outcomes and impacts and done at all levels of budgetary processes.

#### **2.3.7. Accountability and Transparency**

- As a matter of state policy, every state government should develop a budget policy statement that will highlight revenue/expenditure/debt policy (fiscal strategy paper), budget reserves, (planning and contingencies) as percentage of total budget.
- For accountability and transparency, state governments should undertake quarterly, bi-annual and pre budget annual performance review.
- State government to carry out Public Expenditure and Financial Accountability (PEFA) by external consultants should be undertaken every 3 to 5 years.

#### **2.3.8. Audit of Annual Account and Financial Reporting**

- The office of State Auditor General should be strengthened by granting the much needed autonomy/independence in terms of funding and performance of their duties as envisaged and provided for in the 1999 Constitution of the Federal Republic of Nigeria.

## **2.4. Contents of Fiscal Responsibility Law: Arrangement of Sections**

Titles of the law: Fiscal Responsibility Law, 2010 wef 5<sup>th</sup> day of August, 2010

The document is structured into 13 (thirteen) parts. Details are as follows:

### **Part I - Establishment, Functions and Powers of the Fiscal Responsibility Commission,**

Part I, Section 13, subsection 1 & 2 deals with establishment of the Commission.

Part I, Section 4 subsections (a) (b) & 2, deal with powers of the commission.

Part I, Section 5, 1(a)-e, 2, 3, 4 & 5(a) – (d) deal with functions of the commission.

Part I, Section 6, subsections 1 & 2 cover the establishment of a fund for the commission.

Part I, Section 7, subsections 1 (a – i). 2, 3, & 4 deal with composition of the commission.

Part I, Section 8, talks on tenure of office

Part I, Section 9 (a – g) talks on powers of the commission.

Part I, Section 10, 1 (a – g) & 2 deal with cessation of membership of the commission.

Part I, Section 11, 1 & 2 deal with Emoluments etc, of commission members.

Part I, Section 12, covers submission of Annual Reports of the commission.

### **Part II – Sub Title – Medium – Term Expenditure Framework**

Part II, Section 13, sub sections 1 (a – b), 2, 3a – b(i) – (vi), c(i) – (iv), i – (iii), (d) & (e), deal on medium-term Expenditure.

Part II, Section 14, sub-sections 1, & 2, talks on aggregate expenditure ceiling.

Part II, Section 15, subsections 1, 2(a), b(i) – (v), (c) deal on preparation of Medium – Term Expenditure Framework.

Part II, Section 16, sub sections 1 & 2, deal on time limit for presentation of medium-term Expenditure Framework to the State Executive Council.

Part II, Section 17 applies to publication of Medium-Term Expenditure Framework in the official Gazette.

Part II, Section 18, subsections 1, & 2(a) – (b), cover provision for Governor's adjustments on MTFE after passage from the House.

**Part III,      Sub Title – The Annual Budget of the State Government**

Part III, Section 19, sub-section 1, & 2, deals on Annual Budget to be derived from MTEF.

Part III, Section 20, (a) – (f) deal with documents to be attached to the Annual Budget.

\* Part III, Section 21 deals on how the Law affects the Local Government Councils in preparing Annual Budget.

**Part IV        Sub Title – Budgetary Planning of Corporations and other related Agencies:**

Part IV, Section 22, (1) – (3) deal on preparation of Estimates revenue and expenditure of corporations, etc.

Part IV, Section 23, (1) – (2), deal on operating surplus and general reserve fund.

Part IV, Section 25, deals on cessation of application of part IV when Government owned company is privatized, using the date in which the company is privatized.

**Part V,        Sub Title – Budgetary Execution And Achievement of Targets**

Part V, Section, 26, sub-sections (1) – (3) deal on Annual Cash Plan.

Part V, Section, 27, deals on Disbursement schedule

Part V, Section, 28, sub-sections (1) – (2) deal on power of commission to approve virement.

Part V, Section 29, sub-sections, 1 – 3, deal on power to restrict further commitments.

Part V, Section 30, sub-sections, (1) – (2) deal on restrictions on grant of tax relief.

Part V, Section 31, sub-sections (1) – (2) talks on responsibility of the Budget office to monitor and report on implementation.

\* Part V, Section 32, shows how far the application of part v, apply to State and Local Government Councils.

**Part VI:        Sub Title – Public Revenue**

Part VI, Section 33, handles forecast and collection of public revenue.

Part VI, Section 34, handles revenue forecast.

Part VI, Section 35, handles how Executive gives break down of estimated revenue.

**Part VII: Sub Title – Savings And Assets Management**

Part VII, Section 36, sub-sections, (1) – (7) depict how excess proceeds are to be saved.

**Part VIII, Sub Title - Public Expenditures**

Part VIII, Section 37, sub-sections I (a) – (b), & (2) deal on conditions for increasing government expenditure.

Part VIII, Section 38, deals on conditions for increasing personnel expenditure.

Part VIII, Section 39, (a) – (b) highlights how this law (FRL) relates to (i) Procurement and Award of contract

(ii) due process and certification of contract

\* Part VIII, Section 40, handles its application to Local Government Councils.

**Part (IX) Sub Title Debt and Indebtedness**

Part (IX) Section 41, sub-sections 1(a) – (c) handle Framework for debt management.

\* Part (IX), Section 42, sub-sections (1), - (7) deal on limits on consolidated debt of Local Government Councils.

Part (IX) Section 43, sub-sections (1) – (2) deal on servicing of external debt.

**Part (X): Sub Title – Borrowing**

Part (X) Section 44, sub-section 1 – 2(a) – (b), 3 – 5 deal on conditions of borrowing and verification compliance with limits.

Part (X) Section 45, sections 1, 2(a) – (b), 3, & 4 deal on powers of Governor to grant guarantees.

**Part (XI): Sub Title- Transparency and Accountability**

Part (XI): Section 46, sub-sections 1 – 2 deal on fiscal transparency.

Part (XI): Section 47, sub-sections 1 – 3 deal on publication of audited account by all arms of Government.

Part (XI) Section 48, deals on publication of a summarized report on budget execution.

**Part (XII): Sub Title – Enforcement**

Part (XII) Section 50 (1) deals on Enforcement of this law – in the State High Court.

**Part (XIII) Sub Title – Miscellaneous Provisions**

Part (XIII): Section 51, handles Government securities as collateral guaranteed loans.

Part (XIII): Section, 52, handles restrictions on utilization of proceeds of sale of public assets, etc.

Part (XIII), Section 54, - handles Power of the Governor to make regulations.

**SCHEDULE: SECTION 25** (Provision for the list of all State Government Commissions, Agencies, or Government – Owned Companies).

## CHAPTER THREE

### OTHER FEATURES OF THE FISCAL RESPONSIBILITY LAW

#### ***3.1. Fiscal Discipline and Budget Management***

Fiscal Discipline from the layman point of view is the art of spending public funds wisely in anticipation of adding value to Government developmental projects. To ensure prudent management of resources, budgeting is necessary. In Anambra State, Budgets are prepared annually.

Cap circular provides all the guidelines and formats for the preparation of estimates. The Estimates Committee determines the revenue estimates on the basis of which expenditure ceilings are set for MDAs, Departments and agencies. Revenue estimates are usually predicated on revenue returns from relevant MDAs and agencies and projections from actual revenue start from January to May.

Ministry of Economic Planning and Budget calls for various inputs into the capital budget from the MDAs, organized private sector, NGOs and other stakeholders in the development process of the state. When submissions are received from Ministries, Departments, etc, spelling out their recurrent and capital development needs, meetings are convened and discussions obtained during these meetings are used for the policy formulation in the Budget.

At the end of the discussions, a draft budget is prepared and sends to the State Executive Council before to end of November, for vetting and other inputs. Corrections made by the Executive council are fully reflected in the draft budget. The draft Budget is usually sent to State House of Assembly by mid December for consideration and passage as Appropriation Law for the relevant financial year. It is pertinent to note that inputs from outside Government, Party manifesto and the peculiarities of the State determine the policy thrust of each year's Budget. Budget implementation and management follow as soon as the Appropriation Bill is passed by the House of Assembly.

Let us now dissect on what the Fiscal Responsibility law stressed on the following:

- Annual Budget,
- Budgetary planning of corporations and other related agencies,
- Budgetary execution and achievement of targets.

### **3.1.1. Annual Budget:**

- Part III, section 19, sub sections (1) & (2) stressed that Annual Budget of the state must be derived from medium- term Expenditure Framework (MTEF).
- It further confirmed that the sectoral and compositional distribution of the estimates of the expenditure shall be consistent with the medium term development priorities set in the Medium-term Expenditure Framework.
- Annual Budget must be presented to the State House of Assembly as and when due.
- Section (20) sub sections (a) – (f) set out the documents that must accompany to the Budget before it is presented to the House. They are:-
  - a. Revenue and Expenditure profile for the next 2 years,
  - b. Report on annual budgeted revenue and expenditure, showing performance rating for the 18 month up to June of the proceeding financial year,
  - c. Revenue Framework broken down into monthly collection targets to be matched with the predetermined projected Statutory Allocation and internally Generated Revenue as contained in the Medium-Term Expenditure Framework (MTEF),
  - d. Measures on cost, cost control, etc
  - e. Provision of Fiscal Target Appendix and Fiscal Risk Appendix respectively.These all the key features as it affects preparation of Annual Budget.

### **3.1.2. Budgetary planning of corporations and other Related Agencies:-**

- Part IV, section 22(1)-(3) has to do with preparation of estimates of revenue and expenditure of Government owned corporations etc.
- By this provision, the law requires Government owned companies listed in the schedule (section 25), to not later than six months from the commencement of this law and for every three (3) financial years thereafter, not later than the end of the second quarter of every year cause to be prepared and submitted to the Commission, their estimates of revenue and expenditure for the next three (3) financial years.
- Also each of the government-owned companies shall submit unflinching, to the Commission not later than the end of August in each financial year an annual



budget and projected operating surplus, which shall be prepared in line with acceptable accounting practices

- The Commission shall cause the estimates submitted by the government owned companies etc, to be attached as part of the Draft Appropriation Bill to be submitted to the House.
- Section 20 sub sections (1) and (2) insist of establishment of a General Reserve Fund (GRF) where at the end of each financial year, one fifth (1/5) of company's operating surplus for the year are allocated.
- The balance of the operating surplus shall be paid to the Consolidated Revenue Fund (CRF) of the State not later than one month following the statutory dead-line for publishing each government owned company's account.
- Classification of operating surplus (OP) is treated in section 24, sub-sections (1) to (3) where it is clearly indicated that Government owned company's surplus shall be classified as State Revenue payable into the State Treasury (STR).

In line with this provision, where a government company's trading result is in deficit, the deficit shall be classified as the Government-owned company's loss for the year in question.

- Also each government owned company shall not later than three months after the end of its financial year, cause to be prepared and published its Financial Reports (FR) in accordance with such rules as may be published from time to time.
- This provision of the law ceases to apply to government-owned companies from the date of its privatization, etc.

### **3.1.3. Budgetary Execution and Achievement of Targets:**

- Part V, of the State Fiscal Responsibility Law (SFRL) concentrated mostly on Budget performance and realization of set targets- hence the following are highlighted:-

**Annual Cash Plan:-** which shall be drawn up in each financial year by the office of the State Accountant-General.

- It shall span from 1<sup>st</sup> April of the financial year to 31<sup>st</sup> March of the next financial year and shall be prepared in advance of the financial year setting out projected monthly cash flows.
- It shall be revised periodically to reflect actual cash flows- vide section 26, sections (1) to (3).

**Disbursement schedule:-**

- The Commissioner for finance shall within 30 days of the enforcement of the Appropriation Law, Prepare and publish a disbursement schedule derive from the Annual cash plan for the purpose of implementing the Appropriation Law- vide section 27

**Virement from sub-Heads under Heads of Account:-**

- Section 28 sub sections (1) and (2) approve the use of virement in public sector account from sub Heads under sub Heads without exceeding the amount appropriated to such head of Account.
- This provision allows the Commissioner for Finance to vire from sub Heads under sub Heads of account in the over all public interest provided approval of the House is sought- vide sub section (2)
- Section 28, sub section (1) stressed that sums appropriated for a specific purpose shall be used solely for the purpose specified in the Appropriated Law and shall never be altered.
- Section 29 sub sections (1) and (2) allow the Commissioner for Finance to restrict further commitments and financial operations according to the criteria set in the fiscal risk appendix. Where there are fluctuations in the projected revenues, the Commissioner shall within the next 30 days take appropriate measures to mitigate the shortfalls.
- In the same vein, where the targeted revenues are later recovered within the same financial year, either in full or in part, the appropriations for which further commitment were restricted shall be restored proportionately.

- On no account according to the law, shall the statutory or constitutional expenditure be vired or re-allocated-thus virement from Heads under Heads of account are barred. Supplementary Estimates may be considered instead.

**Restriction on grant of tax relief:-** this is allowed provided it does not adversely impair the revenue estimates in the annual budget. It can only be granted by the Commissioner responsible for finance.

This provision shall not apply to:-

- (a) Changes in the rate of the taxes mentioned in section 163 of 1999 constitution.
- (b) Debt cancellation in an amount lower than the cost of collection
  - Section 31, sub-sections (1) & (2) allow the State Budget office under the Ministry of Economic Planning the responsibility to monitor and report the implementation of Annual Budget.
  - It further allows the Budget office to assess the attainment of fiscal targets and reports thereon on a quarterly basis to the Fiscal Responsibility Commission, the Ministry of Finance (MOF) and Appropriation Committee of the State House of Assembly (SHOA).
  - The commission not later than 30 days shall cause the reports to be published in the mass and electronic media and on the Ministry of Finance and/or, State Government website.

### **3.2. Financial Management in Public Sector**

For any meaningful fiscal discipline to be implemented, sound financial management strategy must be put in place. Following this trend, public financial management will entail that all revenue accruable to the government are effectively assessed and Lawually collected. It also entails that expenditure patterns of government must conform to the yearning of the masses. Wastage and revenue linkage should be properly checked and maximum value for money obtained.

Public sector financial management will involve also improvements in debt management coupled with the development of proposal for debt relief and genuine debt reduction. It has virtually become the practice that published State Estimates are not made available as timely as expected. The consequences include lack of effective budget control and monitoring at various levels of implementation hence the State Fiscal Responsibility law is meant to address the following-

- Savings and asset management
- Public Expenditure
- Public Revenues
- Framework to debt management
- Government borrowing process.

### **3.2.1. Savings and Asset Management:**

This provision accounts for the way and the manner in which excess proceeds from the projected statutory allocation and projected internally Generated revenue shall be saved (Section, 36 (1) – thus

- Savings of each local government in the state shall form part of the Government's fund and shall be maintained at the Central Bank of Nigeria by the state. (section 36(2))
- The State Ministry of Finance, in consultation with the Governor and Local Government Chairman, shall undertake investment decisions of the state and Local Government Councils. Income due to each from such investment should be clearly indentified and shared according to share holding. (Section 36(3).  
-Investment to be embarked upon in consolidated names with approval of relevant authorities.
- The State Ministry of Finance to observe prudential considerations and at the same time maintain macroeconomic stability with approval of the Governor and the Local Government chairmen or Heads of Local Government as the case may be (Section 36(4))
- Local Government Councils are not allowed to make use of the statutory savings unless where the Projected Statutory Allocations and Projected internally Generated Revenue fall below the predetermined level for a period of three (3) consecutive months. Section 36(5).
- With the sound agreement, between the state government and local government councils, a portion of the statutory savings may be appropriated in the following year for the Capital projects and program me only.

### **3.2.2. Public Expenditure:**

This provision highlights

- Conditions for increasing government expenditure vide section 37 sections (1) and (2)
- **Conditions for increasing personnel expenditure.** Any increase in personal emolument shall only be affected if there is a prior budgetary allocation sufficient to cover expenditure.
- A statement by the person requesting for the expenditure, stating that the increase is consistent with the Medium- Term Expenditure Framework, etc.
- All contracts with regards to the execution of the Budget shall be inline with the rules and guidelines on
  - a. **State Public Procurement Law (2011)**
  - b. **Due process and certification of contract-vide section 39, subsections (a) & (b)**

### **3.2.3. Debt and Indebtedness:**

Anambra State Government has set up a Debt Management (DMD) with the sole aim of consolidating and effectively managing its debts. Following this arrangement, part 4<sup>1</sup>, section (1) sub sections (a) – (c) provide the Framework for debt management during any financial year. Thus-

- The State Government and each local government shall only borrow for capital expenditure and human development, provided that such borrowing shall be on concessional terms etc.
- The Government shall ensure that the level of public debts as proportion of state income is held at a sustainable level.
- That the State Government with the approval of State House of Assembly can borrow from the capital market (CP) not withstanding the above provisions.

### **3.2.4. Limits on consolidated debt of the State and local government councils:**

With the advice from the Commissioner responsible for finance, the Governor shall within 90 days from the commencement of the law and with the approval of the House, set over all limits for the amounts of consolidated debts.

The Commission for purposes of verifying compliance with the limits specified shall at the end of each quarter determine the amount of the consolidated debt of the State Government and each Local Government.

Violators of the limits specified shall be

- Prohibited from borrowing from internal and external sources except for the refinancing of existing debts and
- Bring the debt within the established limit by restricting funding commitments accordingly.

The Governor shall submit to the House request for a review of the current limit when there is a change in the economic stability, or changes in monetary or exchange policies.

Serving of External Debt-This shall be the direct responsibility of the Government that incurred the debt, and cost of Government guaranteed loans shall be deducted at source from the share of debtor Local Government from the State Joint Local Government Account.

Conditions of borrowing and verification compliance with limits

- Shall specify the purpose for which the borrowing is intended
- Present cost benefit analysis detailing the economy and social benefits of the purpose to which the intended borrowing is to be applied.
- Each borrowing shall comply with the following conditions
  - (i) The existence of prior authorization in the appropriation law or other Law for the purpose for which the borrowing is to be utilized, and
  - (ii) The proceeds of such borrowing shall solely be applied towards long-term capital expenditure.

The Commissioner shall verify on a quarterly basis compliance with the limits and conditions for borrowing by the state and each local government in the state, while the Ministry of Economic Planning shall maintain comprehensive, reliable and current electronic database of internal and external public debts, guaranteeing public access to the information.

Power of the Governor to grant guarantees- The Governor may, with the approval of the State Executive Council, grant guarantees on behalf of the state of Local Governments in the State.

In the case of foreign currency borrowing, Government guarantee shall be a requirement and no Local Government or State Agency or Commission shall, on its own borrow externally and any guarantee provided in excess of the debts limits as provided in section 42 of this law shall be void.

### **3.2.5. Public Revenues:**

Part VI of the State Fiscal Responsibility law clearly directs on how the Public Revenues of the state should be collected and accounted for.

- The law therefore provides that any fund due to the state from any Local Government Council in the state may be set off by the state in or towards payment or remittance of any sum due to the Local Government Council in the state – (vide section 32).
- Revenue forecast. The Executive arm of the State Government shall at least 30 days before the deadline to the submission of its budget proposals, place at the disposal of House, the revenue estimates for the following year, including, the next current revenue and the respective memorandum items.
- Executive arm to breakdown estimates revenue-into monthly collection targets, etc (sub section 35).

## CHAPTER FOUR

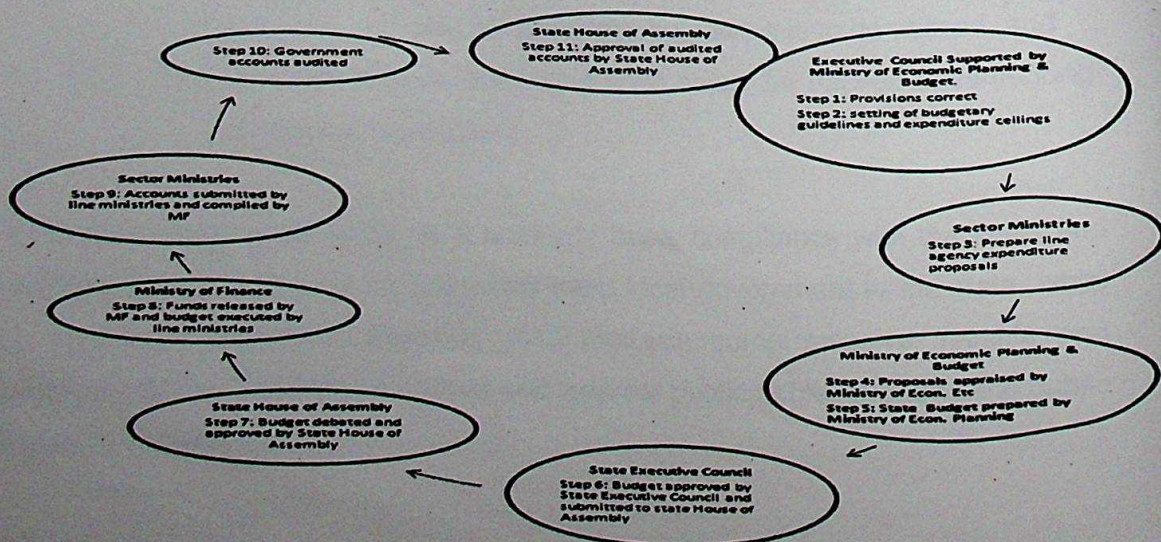
### THE ANNUAL BUDGETARY PLANNING PROCESS

Public spending operates on several levels to influence poverty, through: (1) aggregate fiscal policy; (2) policy decisions funded in the budget; and (3) the flow of budgeted resources to frontline service delivery. Improving poverty reduction outcomes and inflow in all government spending outcomes—depends on a combination of sound, analytically based policies and effective institutional arrangements, or rules of the game, at each of these three levels.

Effective public spending policies for poverty reduction are heavily dependent on the institutional arrangements for decision making and budgeting. Clearly, sound policy also requires sound analysis.

Budget formulation is crucial not only to ensuring that resources are allocated according to poverty reduction and development priorities, but also to ensuring that resources reach their intended target. Executive government, central agencies, and line agencies interact with each other to formulate the budget, as well as with the legislature and civil society. Increasingly, all are recognizing the importance of transparency and accountability for decisions and actions as a way to improve the quality of decision making and implementation. The budget process can best be understood as a cycle, as shown below:

Figure 2: Steps in the Budget Process





The critical steps in the budget cycle are worth examining in some detail, since they can present several challenges:

#### **4.1. Setting aggregate spending limits**

A feasible and credible budget can be prepared only on the basis of accurate forecasts of economic growth and resource availability (see step 1 in Figure 1). Overly optimistic projections of resource availability cause serious problems for line agencies, since they will inevitably lead to mid-year cutbacks in spending, either through a formal budget revision led by the Ministry of Economic Planning and Budget or restrictions on the flow of funds. If cutbacks become a regular feature of the budget process, the credibility of the budget is undermined, creating a web of perverse incentives. For example, managers may overestimate expenditures to provide a cushion against cuts, or bring forward expenditures in anticipation of cuts later in the budget year.

One approach is to be conservative in allocating resources to sectors so that the sum of the sectoral allocations (including all statutory expenditures such as public debt interest payments) is slightly less than the aggregate level consistent with the deficit target and overall revenue estimates. The unallocated funds would be treated by the Ministry of Economic Planning and Budget as a contingency reserve, and could be allocated according to clear rules if realized (see Box below).

#### **Expenditure Reserves during Budget Preparation**

A *planning reserve* is a sum (usually 1 or 2 percent of total expenditure) that is not allocated in the budget guidelines. The ministry of Planning can later allocate this sum to new programs, or existing programs, above the amount allocated during budget negotiations.

A *contingency reserve* is a reserve for in-year expenditures above appropriations for handling genuine contingencies. It should be modest in size so as to encourage ministries to stay within their budget constraints, and rarely exceeds 2 or 3 percent of total spending. It should be under the control of the ministry of finance and access should be granted only under specific conditions.

Source: Potter and Diamond (1999) 24.

However this has the disadvantage of constraining government's decision making processes. Another approach is to identify priority programs whose budgets will be protected from revenue shortfalls. Such arrangements are particularly important for programs with directly linkages to the well-being of the poor. However, these approaches are second best solutions. The priority must be to make the initial estimates of revenue intake more reliable, to fund only core programs in the first place, and to minimize ad hoc reallocations during budget expenditures. It is important to ensure parliamentary oversight of decisions on the allocation of any contingency reserves.

#### **4.2. Setting sector spending limits**

Beginning the budget formulation process with centrally determined sector or agency spending limits is not useful if these ceilings lack credibility, and will not be sustained. As discussed below, sector spending ceilings are more likely to be credible when they are derived from medium term cost estimates and revenue projections, and when they reflect of the costs of currently policies, and sectoral priorities. Given that poverty reduction is the overarching priority, indicative ceilings could be accompanied by a clear signal that these ceilings will be modified based on consideration of new policies for poverty reduction and savings options.

These spending limits will reflect judgments on the nature and appropriateness of existing budgetary commitments. Examples of commitments include:

- *Statutory commitments* covering transfers to local government, earmarked revenues for special funds, and welfare and pension entitlements;
- *Contractual commitments* for the payment of personnel (until retirement and pension entitlements after that);
- *Debt servicing and amortization* and, in some cases, contract for the delivery of goods and services that extend between budget periods;
- *Agreements and accords* with bilateral and multilateral agencies for the counterpart financing for projects and programs; and
- *Changes to sector policy* debated and approved by State Executive Council and parliament outside the context of a budget process, particularly where these

result in statutory commitments to service delivery levels and standards or welfare entitlements.

The scope for spending reallocation can be improved by moving away from budgets with annual time Frames to those with a medium-term focus. Budgets with an annual planning horizon tend to subordinate longer-term development priorities to immediate needs and thus reinforce the status quo. They often fail to provide an adequate basis for appraising the implications of policy decisions. These concerns can best be addressed by developing a longer-term perspective on policy analysis by introducing a medium term expenditure Framework (MTEF).

#### ***4.3. Preparing and analyzing line agency bids***

The detailed composition of sector expenditures is determined while line agency bids are being prepared and analyzed (steps 3 and 4). In principle, this is when resource requests are linked to the activities that government will undertake and the services it will provide.

Typically, line agencies will have only limited time from the distribution of the budget guidelines and limits to prepare their bids. But this may be insufficient time for line agencies to consult with operational and regional departments. Line agency budget departments, then, will often take the previous year's budget as the base and request more increments, often on the basis of a crude percentage, rather than budgeting on the basis of planned service levels and activities.

Negotiations with the Ministry of Finance will also tend to focus on the increment, giving little consideration to the relevance, efficiency, and effectiveness of ongoing programs or administrative overheads that make up the bulk of expenditures. To overcome this timetable, it is crucial that ministries and line agencies have some form of strategic plan, which means that resource decisions are not driven simply by the central budget timetable but by a well-thought-out sector, ministry, and agency plan. Where this is the case, budget preparation does not wait for the Budget Circular.

Stronger connections between operational plans and budgets can be developed when line agencies are provided with credible forward forecasts of spending limits. This allows departments to cost out the implications of policy decisions, adjusting

targets so that they are consistent with resource availability, and prepare operational plans to guide implementation.

This requires a medium-term perspective: an expansion in the number of service delivery units, for instance, may take several years to implement, as infrastructure is built and staff are recruited and trained. The introduction of an MTEF also helps line agencies initiate spending planning and consultation with operational departments well before budget limits are distributed, using that window to concentrate on adjustments to the line agency's program and budget in light of the spending limits set for the budget year. However, introducing a MTEF does not end the need for an annual budget formulation. The annual budget remains an important focus for making adjustments to policies and programs that reflect changing macroeconomic conditions and priorities and information on their annual performance.

#### ***4.4. Ensuring budget compliance***

Budget systems have to balance the need for flexibility, to accommodate changing circumstances, against the need for adequate control, to ensure that resources are used as intended by government and approved by parliament (step 8).

While a hard budget constraint is an essential discipline on managers, some flexibility is usually built into the budget system through contingency reserves and authorizations for the virement of spending from one budget line to another.

Contingency reserves may be included within the spending agency appropriations or, more often, held centrally at the discretion of the Ministry of Finance. Permitting the virement of budget funds—or shifting budgetary funds between different control categories may facilitate expenditure switching toward priority activities at the sector level. However the scope for virement is usually fixed by law. In most countries it is not possible to vire between the salary and non-salary recurrent budget; nor between the recurrent budget and the investment or development budget, to which different approval rules usually apply.

Compliance measures have two potential weaknesses:

- *Overspending* on agreed-upon limits at the organizational level, diversion of resources from one department to support another, over commitment of funds and the buildup of arrears with suppliers; and
- *Restrictions on the flow of funds* to the spending agencies rather than formal budget alterations should aggregate resources fall below projections.

Growth in expenditure arrears is another common sign of weakness in compliance mechanisms (and control systems more generally). Combating these weaknesses will require that government accounting and monitoring systems provide information on the financial status of all budget holders during budget execution (step 9) and independent auditing of the government's final accounts (step 10). To be effective, ex-post controls should be supported by sanctions for unauthorized spending.

Adequate control of budget execution and improved cash management are essential to ensuring the budget is executed as originally intended. Where controls have traditionally been weak, it is advisable to balance any increased flexibility with strong accountability mechanisms in an effort to ensure that resources are used as intended. Where controls have been overly tight, managers may be given greater discretion in using funds by providing broader appropriations and relying on ex-post controls to ensure that they have used resources efficiently and effectively, and in ways that are consistent with the government's strategic poverty reduction goals.

#### **4.5. *Providing adequate feedback on budget execution***

Ideally, the budget cycle is a feedback loop in which monitoring and evaluation inform budget development (linking steps 9 and 1). This should allow decision makers to identify areas where existing limits are too tight (or too loose and make the needed adjustments. Data on financial execution can be compared with performance targets for service delivery to appraise spending efficiency and effectiveness.

The scope for analyzing the prior years' results may be severely constrained by the lack of time and data. If accounting information is prepared only to verify compliance, it will lack the analytical content needed to support budget formulation.

If the Ministry of Economic Planning budget limits and line agency proposals are prepared based on the previous years' budget allocations without reference to actual

spending, this will compound errors where the actual spending deviated significantly from the previous budget allocations.

Clearly, these problems can best be addressed by improving the timeliness and quality of information prepared by accounting and operational departments, and improving coordination between these departments and those responsible for budget formulation. Strengthening these systems is likely to be a long-term task. In the meantime, the information constraints facing decision-makers can be alleviated by complementing routine monitoring information with tracking studies and periodic detailed studies of public expenditures.

## CHAPTER FIVE

### THE MEDIUM TERM EXPENDITURE PLANNING TOOL

#### 5.1. *Ensuring Better Resource Planning*

The annual budget is, in itself, a poor tool for resource planning.. It fails to capture the long-term implications of spending decisions and does not provide an adequate basis for planning program implementation and spending in relation to future resource availability. Also, its short-term focus is likely to subordinate longer-term poverty reduction and development priorities to immediate financial needs. Effective and efficient resource management requires a medium- to longer-term perspective for budgeting. To address these concerns, many countries have introduced medium-term expenditure Frameworks (MTEF).

The MTEF provides a structure that seeks to:

- Discipline policy choices within a realistic aggregate resource constraint over the medium term, with policies requiring funding having to compete with each other, as concepts and for funding;
- Translate longer-term strategic priorities into sustainably funded programs and activities over the medium term;
- Ensure that policy and spending decisions are based on full disclosure of their expected inflows and costs over the medium term, applying to increases and decreases in funding; and
- Improve the predictability of policy and funding.

In turn, the above will be reflected in:

- **Better matching of spending with overall resource availability over the medium term**, thereby increasing the likelihood that policies will have their intended inflows and will be consistent with short-term stabilization needs;
- **Sectoral allocations of spending** more in line with government priorities, on the basis of a comprehensive review of resources, policy options and their cost;
- **Improved sector planning** and management, including by requiring the simultaneous programming of recurrent and investment expenditures; and
- **Increased effectiveness and efficiency of spending**, by requiring line agencies to define their mission, goals, and activities and, where possible, link spending amounts to measures of performance in outputs and outcomes.

In essence, the MTEF consists of a “top-down” resource envelope consistent with macroeconomic stability and explicit strategic priorities, a “bottom-up” estimate of the current and medium-term cost of existing national priorities and future programs, and an iterative decision-making process that matches these costs with available resources. The Box below illustrates one approach to this process.

Preparing the MTEF and PRSP should be an iterative process. Various aggregate spending scenarios can be prepared to reveal the tradeoffs between different macroeconomic and fiscal policy options (steps 1 and 2), allowing decision makers to set aggregate expenditure and sectoral allocations that best fit their broad development and poverty reduction goals.

Since economic growth and revenue forecasts are unreliable in the outer years of the MTEF, and the costs of new or expanded poverty reduction programs are unknown when the indicative limits are set, it is generally advisable to set aside a contingency reserve before informing sectors of their medium-term spending limits. Part of this reserve can be reallocated to accommodate revised spending limits once the sector programs have been prepared (steps 3–5).

Box 1: Steps in Preparing a MTEF

**Steps in preparing a MTEF**

**Step 1. (Re) estimate the resource envelope.** This is based on forecasts of economic performance during a three- to five-year period, from which revenue estimates may be derived, and forecasts of development assistance flows.

**Step 2. Define medium-term sectoral resource limits.** The resources available for allocation are determined by deducting funds that are already committed by contract or agreement --such as counterpart financing of aid, debt service obligations and, in some cases, salaries--and statutory expenditures--such as pensions and intergovernmental transfers--from the overall resource envelope. Indicative sectoral spending limits are then defined based on government priorities and after preliminary discussions with sector Ministries. The indicative limits, along with proposed policy changes from line Commissioners and the Commissioner of Finance, are submitted to the State Executive Council (or a designated subcommittee of the State Executive Council) for consideration and decision, usually several months before the beginning of the annual budget cycle.



**Step 3. Prepare sector programs.** The sector ministries prepare medium-term strategic plans that set out their key objectives, outputs and activities, together with expenditure forecasts within the spending limits agreed upon by the State Executive Council. These plans should consider the cost of ongoing and new programs, relating the expenditures to the performance targets to be met. Ideally, spending should be presented by program and discriminated by spending categories--distinguishing, at the very least, salaries, operations and maintenance, and investment.

**Step 4. Review the sector programs (Ministry of Economic and Planning).** The Ministry of Economic And Planning analyzes the sector programs to verify their consistency with the government priorities and the spending limits, focusing on broad strategic issues rather than the detailed structure of proposed spending. Where the sector forecasts exceed the limits, the Ministry of Economic Planning may assist the sector agency in trimming spending or request more information to revise the limits.

**Step 5. Submit revised limits to the State Executive Council.** Based on this review, the Ministry of Economic Planning will propose revised multiyear limits on sector spending for State Executive Council approval. These limits provide the basis for preparing more detailed budget proposal in the first year of the MTEF.

**Step 6. Finalize the budget and present it to parliament.** The annual budget is then prepared by the line agencies, based on the MTEF proposal, and submitted to the Ministry of Economic Planning for aggregation and presentation to State House of Assembly. In some countries, the proposal submitted to House includes the indicative limits for outer years of the MTEF.

**Step 7. Review and rollover.** The following year, the spending estimates are reviewed in relation to performance and preliminary budget out-turn data, where available. These provide an input to sectoral resource limits in step 2 of the next MTEF process, together with an analysis of policy changes and their budgetary implications.

Source: Based on Elizabeth Muggeridge, 1999.

The MTEF provides a means of assessing the scope for spending reallocations in the short and medium term, by identifying the scale of statutory and contractual commitments (steps 1 and 2), and allows sectors to plan the release of resources from ongoing or terminating programs over an extended period, thereby minimizing disruption (step 3).

## 5.2. *Ensuring the Effectiveness of MTEF*

While the MTEF is still at an early stage of development, a number of areas merit attention to increase its effectiveness as an expenditure planning tool for reducing poverty.

- **Improving the reliability of resource and spending forecasts.** Unanticipated reductions in revenue or increases in the cost of major programs can make forward estimates redundant, as spending limits are revised at the beginning of each budget year. This risk can be reduced by adopting measures to help ensure macro stability, the development of more accurate macroeconomic forecasting tools, and understanding the incentives operating on those responsible for revenue estimation (see the **Governance and Poverty** chapter) and improved cost analysis of ongoing and new programs.
- **Identifying key poverty reduction programs.** It may be helpful to identify high-priority spending items within the poverty reduction strategy. These can in turn be protected from any cuts that prove necessary. Care should also be taken to identify the synergies between different programs. This requires analysts to focus on the intended outcomes of public policy, such as reducing mortality rates, rather than individual program outputs, such as the number of vaccinations, which may require government agencies to collaborate at the operational level.
- **Ensuring an adequate time-frame for analysis.** An extension of the temporal perspective of major programs beyond the time frame of the MTEF may be needed to evaluate their full cost.
- **Broadening the scope of policy analysis.** Initially, MTEF forward estimates will tend to present aggregate forecasts of sector and program spending broken down by broad economic classifications. As capacity develops, more detailed forecasts can be prepared, focusing particularly on administrative overheads where these are a significant part of costs—and a potential area for savings—and the regional allocation of resources. In the longer term, more sophisticated analysis of intra sectoral allocations can be introduced to ensure that the composition of intrasectoral spending is pro-poor.
- **Opening the policy debate.** The forward estimates provided by the MTEF are much more useful as a basis for policy debate than the budget, since expanding poverty reduction programs will entail long-term commitments that are not evident in annual appropriations.

- **Using the MTEF to set budget limits.** Clear procedures are needed to ensure that the MTEF, which presents indicative resource allocations, is used in preparing the budget—a legal instrument for appropriating resources. Where MTEF forecasts are not used as the basis for budget appropriations, the exercise will quickly lose validity.
- **Linking spending forecasts to performance targets.** A link between resources and performance targets should be built into the MTEF exercise at an early stage. The presentation of performance targets for programs and sectors, along with the corresponding MTEF spending allocations, allows decision makers to appraise the expected benefits of alternative spending options.

The MTEF represents a significant innovation in its emphasis on the sectoral allocation of spending and the link between spending and performance. It is essential that MTEF development be accompanied by broader public financial management reforms and improvements in budget execution procedures.

## CHAPTER SIX

### BUDGET COVERAGE AND COMPREHENSIVENESS

The budget should provide information on all the resources available; this will help decision-makers to adequately address poverty reduction concerns through the budget process. This information should be presented in a structure that permits meaningful analysis and ensures consistency between spending management instruments. As described below, however, many budget systems do not fulfill these criteria.

#### **6.1. *Covering public financial operations***

In principle, all state revenues and spending should be registered in the budget. Comprehensive coverage of state revenues and spending allows the government to consider all the resources at its disposal and overall spending priorities when determining appropriate aggregate spending levels and allocations.

To gauge the completeness of budget coverage, it is helpful to draw a clear distinction between the budget of the state and the budgets of autonomous public organizations, including public enterprises, special development or social security funds, and local government. Autonomous bodies will generally have their own supervisory structures and finance sources, so may not be directly controlled through the budget; indeed, their autonomy may be guaranteed by specific legislation. Usually, only the transfers between the state budget and the autonomous public bodies are registered in the budget. However, autonomous bodies should be required to divulge information on their financial situation to satisfy transparency and accountability concerns. Non-budget entities should be subject to budgeting on the basis of full disclosure of 'sources' and uses of funds'.

If we want to quantify the level of public spending in a given sector, it is advisable to combine spending data from the central government with data from these autonomous public bodies and local government on a gross basis, since these entities may be responsible for a large part of overall public spending and particularly, for the delivery of services such as education, health, urban sanitation, water supply, and rural roads. If autonomous organizations have their own budget and supervisory structure, all that should appear on the state budget and accounts is the transfers between the two—outflows for subsidies and transfers on the spending

side, and inflows from royalties or shared receipts on the revenue side. Hybrid organizations that are set up using earmarked receipts, or revolving funds, which are autonomous with their own receipts and supervisory structures, should be treated the same as other autonomous organizations. If the fund is not legally an autonomous body, however, and lacks earmarked receipts or a clearly defined supervisory structure and reporting requirements, then these expenditures and receipts should be combined into the state budget.

One example of how earmarked receipts can be included in the state budget is how receipts from school user fees are treated. User fees may be retained by the school, but, if the school does not enjoy financial autonomy, it should present a forecast of receipts. These receipts would be included on the revenue side of the state budget--usually in a specific category of receipts that identifies them as retained--along with gross expenditures--those financed by user fees and other funds from the education budget. Revenue retention decisions have to balance deficit control concerns, the use of the state's power to tax and charge for services, and incentives on front-line service deliverers. These incentives can be particularly essential in improving the quality of service delivery.

Coverage of public spending and revenues may be weak for several reasons:

- Extra budgetary funds, financed from earmarked revenues, such as petrol taxes, may not be captured by the budget process or may use different reporting schedules and formats;
- Transparent reporting and oversight arrangements may be lacking;
- Line agencies may fail to report resources derived from sales of goods, user charges, and other levies, particularly where these are used within the Framework of self-contained revolving funds;
- Information on local government budgets and accounts may also be of poor quality and apply different procedures and classifications; and
- External assistance may be accounted for outside the budget (as described in the Box below).

## Box 2: Reasons why external assistance may be missing from the budget

These include the following:

- Donors may deal directly with line agencies. The donor and the beneficiary institution may then fail to provide the Ministry of Finance with information on disbursements and forward commitments.
- Line agencies may be unable to provide information on external financing where projects use different accounting classifications and foreign currency payments, such as those for technical assistance and major contracts, are made out of country.
- Line agencies may be unwilling to divulge complete information on the aid financing received, since this may be used as grounds for reducing the domestic contribution to sectoral spending.
- Line agencies may be reluctant to present the full cost of some high-cost items, such as technical assistance, since this may be considered as distorting the overall picture of resource allocation to the sector.

Clearly, these problems can be overcome only through the concerted action of external partners and government.

Where the government is committed to a transparent budget process, these shortcomings can be overcome. Measures to improve budget coverage include: developing a systematic inventory of public entities, their sources of finance, and areas of spending; integrating all spending and revenues in the budget, unless there is a legitimate reason for extra-budgetary financial management; and designing transparent oversight mechanisms and standardized reporting systems for those areas of spending that remain off-budget. Improving the information base about spending financed by external assistance is key, and may be overcome only through the concerted action of donors and government. Fragmentation, including earmarking, undermines the need for policies and programs to compete for resources and tends to reduce the pressure on organizations to perform efficiently and effectively.

### Box 3: Budget Classifications

**Line Item Classification:** Structures spending by object according to the categories used for administrative control, for instance: salaries travel allowances, telephone, and office materials.

**Administrative Classification:** Structures spending by the organization responsible for the management of funds. The structure of administrative classification will vary from country to country, as will the number and administrative level of the budget holder.

**Functional Classification:** Structures government activities and spending according to their purpose, for instance: policing, defense, education, health, transportation and communication. The United Nations standard functional classification used in the preparation of national accounts and government financial statistics distinguishes 14 major groups, 61 groups, and 127 subgroups of government Lawivities.

**Economic Classification:** Structures government financial operations according to their economic categories, distinguishing: capital and current spending and revenues; subsidies; transfers from the state to families and other public institutions; interest payments: and financing operations. This classification is used in Government Financial Statistics prepared by the IMF.

**Program Classification:** Structures spending according to program, considered as a set of activities undertaken to meet the same goals. The program classification may correspond to a disaggregation of the administrative classification or may cross administrative units.

**Territorial classification:** Structures revenues and spending by the geographical area of impLaw of the financial operation.

Source: Based on Schiavo-Campo, S. and Tommasi , D. (1998), Chapter 2.

## **6.2. Structuring budget information**

There is often thought to be a trade-off between the details of the classification used for control—the more detailed the classification, the better the administrative control—and the degree of flexibility given to budget holders in managing resources. Detailed line item classifications, for instance, give managers little flexibility to swap

(vire) funds from, for example, transport costs to the contracting of services. There is evidence that detailed line item appropriations do not guarantee effective control while interfering with the ability to deliver services efficiently and effectively. Broad administrative classifications do not, on their own, guarantee good performance. However, the evidence that autonomy is a key incentive for improving operational performance argues for building matching accountability arrangements—ones that not only improve probity and stewardship of budget resources but also focus on the quality of associated outputs and outcomes.

Ultimately, the type of budget appropriation and classification systems will be determined by the capacity of the government to match authority and accountability and to manage information. It is, perhaps, advisable to aim for consistency rather than seek to provide an ambitious range of accountabilities and information that cannot be sustained by the capacity available. Where it is not possible to provide a multidimensional analysis of all spending, attention should focus on the key programs of the government's PRS. More detailed, multidimensional analysis of these programs can be used for internal management rather than submitted to parliament as the basis for appropriations. Coverage can always be extended in the future, as information bases and analytical skills are further developed.

### **6.3. Coordinating budget instruments**

Many countries operate dual budget systems. These systems distinguish between 1) a *recurrent* budget, which presents continuous spending such as payroll, operating, and maintenance expenses, broken down by organization and line item, and 2) an *investment* or *development* budget, which presents one-off capital expenditures, usually by project or program. The Ministry of Finance typically prepares the recurrent budget, while the Planning Ministry or Commission usually prepares the investment budget. This ensures a close link between the government's investment program and its development plans.

It has proved difficult to manage dual budgets to achieve an allocation of resources consistent with a government's development priorities and high-quality services at reasonable cost. An overarching medium-term budgeting Framework can help to reduce the adverse effects.

More generally, the institutional division of responsibility between the recurrent budget, prepared by administrative departments, and the investment program,



prepared by planning departments, may cause serious problems or underfunding of operations and maintenance, which will in turn affect the quality of public service delivery.

One approach to overcoming these divisions between the planning department, responsible for preparing the development budget, and the finance department, responsible for preparing the recurrent budget, is to merge the separate agencies that manage these divisions. For example, the Planning Commissions and Ministries of Finance could be merged, as could the investment program and finance departments in Ministries. This does not guarantee integration. Unifying the development and recurrent budgets will not cause classification problems, since standard economic classification in a unified budget can distinguish between current and capital expenditures. However, budget unification can have managerial implications, since the projects, which provide the basic managerial unit of the development budget, are not really an appropriate unit for managing the budget. Projects should not disappear in the budget, as they provide governments with a way to clearly identify non continuing spending and a structure for undertaking one-off tasks, whether these are institutional or infrastructural. Many governments keep the investment and recurrent budgets separate for appropriation, but ensure they are considered together during budget formulation and managed by the same functional agencies at all levels so that the trade-offs and connections between the two become explicit.

## CHAPTER SEVEN

### BEST PRACTICES FOR FISCAL TRANSPARENCY

#### ***7.1. Fiscal Responsibility Law and Transparency in Planning and Reporting***

The relationship between good governance and better economic and social outcomes is increasingly acknowledged. Transparency - openness about policy intentions, formulations and implementation – is a key element of good governance. The budget is the single most important policy document of governments, where policy objectives are reconciled and implemented in concrete terms. Budget transparency is defined as the full disclosure of all relevant fiscal information in a timely and systematic manner. It should lead to better informed public debate about the design and results of fiscal policy,, make governments more accountable for the implementation of fiscal policy, and thereby strengthen credibility and public understanding of macro-economic policies and choices.

A transparent budget system provides a readily understandable guide as to how resources are planned to be used and what results are expected to be achieved. Reporting should also enable easy monitoring of actual expenditures against the government's stated intentions.

Transparency is important because it promotes certainty and confidence over budget plans and reduces the opportunity for corruption. Clear communication of the government's strategy also helps public sector managers to ensure that their budget plans are consistent with the strategy. Managers can only be held accountable, if expectations are clearly specified ex ante. The provision of information to the public also enables civil society to challenge the government to improve the effectiveness and efficiency of expenditure. It increases awareness of service users as to what services they are entitled to and provides channels for complaints and redress if they are not satisfied.

Transparency can be measured using the Framework developed in the International Monetary Fund's code of Good Practices on Fiscal Transparency. The Code defines good practices around the following objectives:

- Clarity of roles and responsibilities
- Public availability of information
- Open budget preparation, execution and reporting
- Independent assurance of integrity

The Code sets out what governments should do to meet these objectives in terms of principles and practices which are reproduced below (Source: <http://www.imf.org/external/np/fad/trans/code.htm>)

## **7.2. INTERNATIONAL MONETARY FUND – CODE OF GOOD PRACTICES ON FISCAL TRANSPARENCY (2007)**

### **I. CLARITY OF ROLES AND RESPONSIBILITIES**

**1.1 The government sector should be distinguished from the rest of the public sector and from the rest of the economy, and policy and management roles within the public sector should be clear and publicly disclosed.**

1.1.1 The structure and functions of government should be clear.

1.1.2 The fiscal powers of the executive, legislative, and judicial branches of government should be well defined.

1.1.3 The responsibilities of different levels of government, and the relationships between them, should be clearly specified.

1.1.4 Relationships between the government and public corporations should be based on clear arrangements.

1.1.5 Government relationships with the private sector should be conducted in an open manner, following clear rules and procedures.

**1.2 There should be a clear and open legal, regulatory, and administrative Framework for fiscal management.**

1.2.1 The collection, commitment, and use of public funds should be governed by comprehensive budget, tax, and other public finance laws, regulations, and administrative procedures.

1.2.2 Laws and regulations related to the collection of tax and non-tax revenues, and the criteria guiding administrative discretion in their application, should be

accessible, clear, and understandable. Appeals of tax or non-tax obligations should be considered in a timely manner.

1.2.3 There should be sufficient time for consultation about proposed laws and regulatory changes and, where feasible, broader policy changes.

1.2.4 Contractual arrangements between the government and public or private entities, including resource companies and operators of government concessions, should be clear and publicly accessible.

1.2.5 Government liability and asset management, including the granting of rights to use or exploit public assets, should have an explicit legal basis.

## **II. OPEN BUDGET PROCESSES**

**2.1 Budget preparation should follow an established timetable and be guided by well-defined macroeconomic and fiscal policy objectives.**

2.1.1 A budget calendar should be specified and adhered to. Adequate time should be allowed for the draft budget to be considered by the legislature.

2.1.2 The annual budget should be realistic, and should be prepared and presented within a comprehensive medium-term macroeconomic and fiscal policy Framework. Fiscal targets and any fiscal rules should be clearly stated and explained.

2.1.3 A description of major expenditure and revenue measures, and their contribution to policy objectives, should be provided. Estimates should also be provided of their current and future budgetary Law and their broader economic implications.

2.1.4 The budget documentation should include an assessment of fiscal sustainability. The main assumptions about economic developments and policies should be realistic and clearly specified, and sensitivity analysis should be presented.

2.1.5 There should be clear mechanisms for the coordination and management of budgetary and extra budgetary activities within the overall fiscal policy Framework.

## **2.2 There should be clear procedures for budget execution, monitoring, and reporting.**

2.2.1 The accounting system should provide a reliable basis for tracking revenues, commitments, payments, arrears, liabilities, and assets.

2.2.2 A timely mid-year report on budget developments should be presented to the legislature. More frequent updates, which should be at least quarterly, should be published.

2.2.3 Supplemental revenue and expenditure proposals during the fiscal year should be presented to the legislature in a manner consistent with the original budget presentation.

2.2.4 Audited final accounts and audit reports, including reconciliation with the approved budget, should be presented to the legislature and published within a year.

### **III. PUBLIC AVAILABILITY OF INFORMATION**

#### **3.1 The public should be provided with comprehensive information on past, current, and projected fiscal activity and on major fiscal risks.**

3.1.1 The budget documentation, including the final accounts, and other published fiscal reports should cover all budgetary and extra budgetary activities of the central government.

3.1.2 Information comparable to that in the annual budget should be provided for the outturns of at least the two preceding fiscal years, together with forecasts and sensitivity analysis for the main budget aggregates for at least two years following the budget.

3.1.3 Statements describing the nature and fiscal significance of central government tax expenditures, contingent liabilities, and quasi-fiscal activities should be part of the budget documentation, together with an assessment of all other major fiscal risks.

3.1.4 Receipts from all major revenue sources, including resource-related activities and foreign assistance, should be separately identified in the annual budget presentation.

3.1.5 The central government should publish information on the level and composition of its debt and financial assets, significant no debt liabilities (including pension rights, guarantee exposure, and other contractual obligations), and natural resource assets.

3.1.6 The budget documentation should report the fiscal position of sub national governments and the finances of public corporations.

3.1.7 The government should publish a periodic report on long-term public finances.

### **3.2 Fiscal information should be presented in a way that facilitates policy analysis and promotes accountability.**

3.2.1 A clear and simple summary guide to the budget should be widely distributed at the time of the annual budget.

3.2.2 Fiscal data should be reported on a gross basis, distinguishing revenue, expenditure, and financing, with expenditure classified by economic, functional, and administrative category.

3.2.3 The overall balance and gross debt of the general government, or their accrual equivalents, should be standard summary indicators of the government fiscal position. They should be supplemented, where appropriate, by other fiscal indicators, such as the primary balance, the public sector balance, and net debt.

3.2.4 Results achieved relative to the objectives of major budget programs should be presented to the legislature annually.

### **3.3. A commitment should be made to the timely publication of fiscal information.**

3.3.1 The timely publication of fiscal information should be a legal obligation of the government.

3.3.2 Advance release calendars for fiscal information should be announced and adhered to.

## **IV. ASSURANCES OF INTEGRITY**

### **4.1 Fiscal data should meet accepted data quality standards.**

4.1.1 Budget forecasts and updates should reflect recent revenue and expenditure trends, underlying macroeconomic developments, and well-defined policy commitments.

4.1.2 The annual budget and final accounts should indicate the accounting basis used in the compilation and presentation of fiscal data. Generally accepted accounting standards should be followed.

4.1.3 Data in fiscal reports should be internally consistent and reconciled with relevant data from other sources. Major revisions to historical fiscal data and any changes to data classification should be explained.

## **4.2 Fiscal activities should be subject to effective internal oversight and safeguards.**

4.2.1 Ethical standards of behaviour for public servants should be clear and well publicized.

4.2.2 Public sector employment procedures and conditions should be documented and accessible to interested parties.

4.2.3 Procurement regulations, meeting international standards, should be accessible and observed in practice.

4.2.4 Purchases and sales of public assets should be undertaken in an open manner, and major transactions should be separately identified.

4.2.5 Government activities and finances should be internally audited, and audit procedures should be open to review.

4.2.6 The national revenue administration should be legally protected from political direction, ensure taxpayers' rights, and report regularly to the public on its activities.

## **4.3 Fiscal information should be externally scrutinized.**

4.3.1 Public finances and policies should be subject to scrutiny by a national audit body or an equivalent organization that is independent of the executive.

4.3.2 The national audit body or equivalent organization should submit all reports, including its annual report, to the legislature and publish them. Mechanisms should be in place to monitor follow-up actions.

4.3.4 Independent experts should be invited to assess fiscal forecasts, the macroeconomic forecasts on which they are based, and their underlying assumptions.

4.3.4 A national statistical body should be provided with the institutional independence to verify the quality of fiscal data.

## CHAPTER EIGHT

### INFORMATION DISCLOSURE REQUIREMENTS FOR BUDGET TRANSPARENCY

The OECD (organisation for economic Cooperation and Development) also provided some best practices as reference tool for countries willing to increase their degree of budget transparency. These Best Practices, organised around the production of periodic budget reports, the information contents or disclosure requirements and the quality and integrity of these reports, do not constitute a formal "standard" for budget transparency. The extent of compliance depends on the preferences of individual countries for the areas of transparency they wish to emphasise. These Best Practices are reproduced below for the benefit of the readers of this manual.

#### **8.1. Budget reports**

##### **8.1.1. The budget**

- The budget is the government's\* key policy document. It should be comprehensive, encompassing all government revenue and expenditure, so that the necessary trade-offs between different policy options can be assessed.
- The government's draft budget should be submitted to Parliament far enough in advance to allow Parliament to review it properly. In no case should this be less than three months prior to the start of the fiscal year. The budget should be approved by Parliament prior to the start of the fiscal year.
- The budget, or related documents, should include a detailed commentary on each revenue and expenditure programme.
- Non-financial performance data, including performance targets, should be presented for expenditure programmes where practices.
- The budget should include a medium-term perspective illustrating how revenue and expenditure will develop during, at least, the two years beyond the next fiscal year. Similarly, the current budget proposal should be reconciled with forecasts contained in earlier fiscal reports for the same period; all significant deviations should be explained.
- Comparative information on actual revenue and expenditure during the past year and an updated forecast for the current year should be provided for each programme. Similar comparative information should be shown for any non-financial performance data.



- If revenue and expenditures are authorised in permanent legislation, the amounts of such revenue and expenditures should nonetheless be shown in the budget for information purposes along with other revenue and expenditure.
- Expenditures should be presented in gross terms. Ear-marked revenue and user charges should be clearly accounted for separately. This should be done regardless of whether particular incentive and control systems provide for the retention of some or all of the receipts by the collecting agency.
- Expenditures should be classified by administrative unit (e.g. ministry, agency). Supplementary information classifying expenditure by economic and functional categories should also be presented.
- The economic assumptions underlying the report should be made in accordance with Best Practices.
- The budget should include a discussion of tax expenditures in accordance with Best Practices 2.2 (below).
- The budget should contain a comprehensive discussion of the government's financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices 2.3-2.6 (below).

### **8.1.2. Pre-budget report**

- A pre-budget report serves to encourage debate on the budget aggregates and how they interlay with the economy. As such, it also serves to create appropriate expectations for the budget itself. It should be released no later than one month prior to the introduction of the budget proposal.
- The report should state explicitly the government's long-term economic and fiscal policy objectives and the government's economic and fiscal policy intentions for the forthcoming budget and, at least, the following two fiscal years. It should highlight the total level of revenue, expenditure, deficit or surplus, and debt.
- The economic assumptions underlying the report should be made in accordance with Best Practice.

### **8.1.3. Monthly reports**

- Monthly reports show progress in implementing the budget. They should be released within four weeks of the end of each month.
- They should contain the amount of revenue and expenditure in each month and year-to-date. A comparison should be made with the forecast amounts of monthly

revenue and expenditure for the same period. Any in-year adjustments to the original forecast should be shown separately.

- A brief commentary should accompany the numerical data. If a significant divergence between actual and forecast amounts occurs, an explanation should be made.
- Expenditures should be classified by major administrative units (e.g., ministry, agency). Supplementary information classifying expenditure by economic and functional categories should also be presented.
- The reports, or related documents, should also contain information on the borrowing activity.

#### **8.1.4. Mid-year report**

- The mid-year report provides a comprehensive update on the implementation of the budget, including an updated forecast of the budget outcome for the current fiscal year and, at least, the following two fiscal years. The report should be released within six weeks of the end of the mid-year period.
- The economic assumptions underlying the budget should be reviewed and the impact of any changes on the budget disclosed (see Best Practices below).
- The mid-year should contain a comprehensive discussion of the government's financial assets and liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices.
- The Law of any other government decisions, or other circumstances, that may have a material effect on the budget should be disclosed.

#### **8.1.5. Year-end report**

- The year-end report is the government's key accountability document. It should be audited by the Supreme Audit Institution, in accordance with Best Practice 3.3 (below) and be released within six months of the end of the fiscal year.
- The year-end report shows compliance with the level of revenue and expenditures authorised by Parliament in the budget. Any in-year adjustments to the original budget should be shown separately. The presentation format of the year-end report should mirror the presentation format of the budget.
- The year-end report, or related documents, should include non-financial performance information, including a comparison of performance targets and actual results achieved where practicable.

- Comparative information on the level of revenue and expenditure during the preceding year should also be provided. Similar comparative information should be shown for any non-financial performance data.
- Expenditure should be presented in gross terms. Ear-marked revenue and user charges should be clearly accounted for separately.
- Expenditure should be classified by administrative unit (e.g. ministry, agency). Supplementary information classifying expenditure by economic and functional categories should also be presented.
- The year-end report should contain a comprehensive discussion of the government's financial assets and financial liabilities, non-financial assets, employee pension obligations and contingent liabilities in accordance with Best Practices (below).

#### **8.1.6. Pre-election report**

- A pre-election report serves to illuminate the general state of government finances immediately before an election. This fosters a more informed electorate and serves to stimulate public debate.
- The feasibility of producing this report may depend on constitutional provisions and electoral practices. Optimally, it should be released no later than two weeks prior to elections.
- The report should contain the same information as the mid-year report.
- Special care needs to be taken to assure the integrity of such reports, in accordance with Best Practice 3.2 (below).

#### **8.1.7. Long-term report**

- The long-term report assesses the long-term sustainability of current government policies. It should be released at least every five years, or when major changes are made in substantive revenue or expenditure programmes.
- The report should assess the budgetary implications of demographic change, such as population ageing and other potential developments over the long-term (10-40 years).
- All key assumptions underlying the projections contained in the report should be made explicit and a range of plausible scenarios presented.

## **8.2. Specific disclosures**

### **8.2.1. Economic assumptions**

- Deviations from the forecast of the key economic assumptions underlying the budget are the government's key fiscal risk.
- All key economic assumptions should be disclosed explicitly. This includes the forecast for GDP growth, the composition of GDP growth, the rate of employment and unemployment, the current account, inflation and interest rates (monetary policy).
- A sensitivity analysis should be made of what implications changes in the key economic assumptions would have on the budget.

### **8.2.2. Tax expenditures**

- Tax expenditures are the estimated costs to the tax revenue of preferential treatment for specific activities.
- The estimated cost of key tax expenditures should be disclosed as supplementary information in the budget. To the extent practicable, a discussion of tax expenditures for specific functional areas should be incorporated into the discussion of general expenditures for those areas in order to inform budgetary choices.

### **8.2.3. Financial liabilities and financial assets**

- All financial liabilities and financial assets should be disclosed in the budget, the mid-year report, and the year-end report. Monthly borrowing activity should be disclosed in the monthly reports, or related documents.
- Borrowings should be classified by the currency denomination of the debt, the maturity profile of the debt, whether the debt carries a fixed or variable rate of interest, and whether it is callable.
- Financial assets should be classified by major type, including cash, marketable securities, investments in enterprises and loans advanced to other entities. Investments in enterprises should be listed individually. Loans advanced to other entities should be listed by major category reflecting their nature; historical information on defaults for each category should be disclosed where available. Financial assets should be valued at market value.

- Debt management instruments, such as forward contracts and swaps, should be disclosed.
- In the budget, a sensitivity analysis should be made showing what impact changes in interest rates and foreign exchange rates would have on financing costs.

#### **8.2.4. Non-financial assets**

- Non-financial assets, including real property and equipment, should be disclosed.
- Non-financial assets will be recognised under full accrual-based accounting and budgeting. This will require the valuation of such assets and the selection of appropriate depreciation schedules. The valuation and depreciation methods should be fully disclosed.
- Where full accrual basis is not adopted, a register of assets should be maintained and summary information from this register provided in the budget, the mid-year report and the year-end report.

#### **8.2.5. Employee pension obligations**

- Employee pension obligations should be disclosed in the budget, the midyear report and the year-end report. Employee pension obligations are the difference between accrued benefits arising from past service and the contributions that the government has made towards those benefits.
- Key material assumptions underlying the calculation of employee pension obligations should be disclosed. Any assets belonging to employee pension plans should be valued at market value.

#### **8.2.6. Contingent liabilities**

- Contingent liabilities are liabilities whose budgetary impact is dependent on future events which may or may not occur. Common examples include government loan guarantees, government insurance programmes, and legal claims against the government.
- All significant contingent liabilities should be disclosed in the budget, the mid-year report and the annual financial statements.
- Where feasible, the total amount of contingent liabilities should be disclosed and classified by major category reflecting their nature; historical information on defaults for each category should be disclosed where available. In cases where contingent liabilities cannot be quantified, they should be listed and described.

### **8.3 Integrity, control and accountability**

#### **8.3.1. Accounting policies**

- A summary of relevant accounting policies should accompany all reports.
- These should describe the basis of accounting applied (e.g. cash, accrual) in preparing the reports and disclose any deviations from generally accepted accounting practices.
- The same accounting policies should be used for all fiscal reports.
- If a change in accounting policies is required, then the nature of the change and the reasons for the change should be fully disclosed. Information for previous reporting periods should be adjusted, as applicable, to allow comparisons to be made between reporting periods.

#### **8.3.2. Systems and responsibility**

- A dynamic system of internal financial controls, including internal audit, should be in place to assure the integrity of information provided in the reports.
- Each report should contain a statement of responsibility by the finance Commissioner and the senior official responsible for producing the report. The Commissioner certifies that all government decisions with a fiscal year have been included in the report. The senior official certifies that the Finance of Ministry has used its best professional judgement in producing the report.

#### **8.3.3. Audit**

- The year-end report should be audited by the Supreme Audit Institution in accordance with generally accepted auditing practices.
- Audit reports prepared by the Supreme Audit Institution should be scrutinised by Parliament.

#### **8.3.4. Public and parliamentary scrutiny**

- Parliament should have the opportunity and the resources to effectively examine any fiscal report that it deems necessary.
- All fiscal reports referred to in these Best Practices should be made publicly available. This includes the availability of all reports free of charge on the Internet.
- The Finance Ministry should actively promote an understanding of the budget process by individual citizens and non-governmental organisations.

## CHAPTER NINE

### COST BENEFIT ANALYSIS AND PUBLIC EXPENDITURE

#### 9.1. Introduction

Widespread use of cost-benefit analysis (C.B.A) as a tool of public sector investment appraisal began in the 1950s. This growth was partly the result of the increased size and complexity of the investment decisions in a modern industrial state. Cost-benefit techniques were specifically designed to bring into account the social, rather than financial criteria of government policy, and to consider and evaluate large investment projects.

Much has been written upon the theory and practice of C.B.A; emphasizing its capacity to consider the wider and longer-term social implications of various investment proposals, instead of just concentrating on the pecuniary implications as traditional private sector appraisal techniques do. By its very nature, C.B.A is a flexible and adaptable method of considering the merits of investment schemes and its applications have been widespread.

Economic appraisal in the public sector differs from that of the private sector. The criterion of rate of return on capital is employed as a basis for resource allocation among competing uses. The rate of return must also exceed the cost of obtaining capital as expressed through the rate of interest.

In a competitive market economy, the value of benefits yielded by an activity is determined by the price mechanism and the amount the consumers are willing to pay. Similarly, the costs of an activity are determined by the cost of the factors of production – Labour, Land, Capital, Entrepreneurial talents – in the market. These reflect the opportunity costs in other alternative uses.

It is assumed that if the return on capital in one use is higher than those in other uses, the competitive mechanism will result in the transfer of resources to areas of higher returns, all things being equal.

For government sector, the invincible law of the price mechanism in moving resources from areas of low return to areas of higher return is too simplistic given the existence of monopoly and other restrictive practices. Moreover, a whole range of public services are supplied by the public sector without direct prices being charged

for them. In many cases, the scale of supply is decided without reference to a market-determined indicator of benefits.

For some goods that are public goods such as education and health services, these are paid by taxation and partly by direct charges. However, for collectively consumed goods, such as defence, police services, and street lighting, the supply is not influenced by the price mechanism. In short, when public goods are involved, ordinary market forces may be incapable of detecting a demand for them, and of organizing goods. The existence of 'collective goods' which caters for a 'group want' is one major rationale for public services though there are now a wide range of 'public goods' which are now being supplied through the private sector though with appropriate regulations in place to safeguard standards and prevent abuse.

The supply of public goods and services outside the market mechanism rests on political decisions which may not reflect social needs and preferences. In practice these decisions have very largely come to rest with Commissioners and public officials. Hence the need for tools of economic appraisal such as cost-benefit analysis, to assess the wisdom of alternative courses of action for application in areas where a market is not, or cannot be used.

The divergence between private and social costs and benefits and the existence of external effects further reduce the application of private market valuation technique to government sector investments. Market forces may fail to encompass all costs and all benefits in the case of collective goods and where there are alternatives.

Social costs represent the sum total of the costs of an economic action. It included private costs and other costs reflected in the market and not impinging on the entrepreneur. For example, the private costs of a pure water producer include the market cost of labour for materials, land and capital, as well as his own rewards. These are the 'opportunity costs' to society at large. Over and above them may be additional 'external' costs not impinging on the entrepreneur, for instance, the environment nuisance of pure water sachets and bottles. Just as there are external costs, external benefits also exist which might also accrue to society. A dam, in addition to generating electricity for sale in the market, brings flood protection benefits, for which no payment is made. The existence of external social costs and external benefits over-states and under-estimates the private rate of return relative to the social returns respectively.



## **9.2. Applying Cost-Benefit Analysis**

Cost-benefit analyses normally comprise several stages. The first stage is to define the project and list the associated current benefits and costs. The benefits will include goods and services produced for sale in the market or accruing as collective good. 'Current operating costs associated with the project must be subtracted'.

Secondly, express the list of benefits and costs, direct or indirect in monetary values to accrue at an estimate of the current net benefit of the project (if any). There may be difficulties in placing a monetary value on collective or other goods or services and also when the scale of the project is so large as to have marked effects on the prevailing market prices. This is the problem of 'indivisibility'.

Thirdly, final step is to compare the stream of annual net benefits with the capital cost of the project. This can be expressed as a percentage rate of return on the investment, after an allowance has been made for depreciation of capital assets. The question is then to consider whether this rate of return is high or attractive enough to justify undertaking the project. This requires comparing the rate of return with the price of capital represented by the rate of interest.

At this stage, two issues become relevant. The first is the method of investment appraisal while the second concerns choosing the appropriate rate of interest (or discount rate) to be used as a 'cut-off' rate within the investment appraisal calculations

## **9.3. Methods of appraisal**

In appraising mutually exclusive projects, a method of ranking projects in order of preference and in choosing between them, some evaluation procedures need to be considered. Three methods of appraisal can be used. These are (a) the net present value; (b) the internal rate of return on capital employed yielded by each project to be derived mathematically or through trial and error, and (c) the project values of the benefit stream expressed as benefit-cost ratios.

### **9.3.1 The Net Present Value Method (NPV)**

The method converts the time stream of benefits using the discount rate to derive the present value of benefits. The present value of costs is subtracted from the present value of benefits to derive the net present value of the project. A project is acceptable if its net present is positive, and projects can be ranked in order of their

net present value with a project with the highest Net Present Value selected. A project with zero NPV indicates a break-even project. The Internal Rate of Return (IRR) is the rate of discount which equates the present value of benefits to the present value of costs. For a project to be acceptable, the internal rate of return must be greater than the rate of interest which reflects the 'opportunity costs' of capital to the government. A break-even project will have an internal rate of return equal to the rate of interests.

### **9.3.2. The Benefit-Costs Ratio (B/C ratio)**

This divides the present value of the benefit stream by the present value of the cost outlay project selection using this method will depend on the size of the resulting ratios, but the benefit-cost ratio of a project must be greater than 1. A benefit-cost ratio of 1 will indicate a break-even project.

#### ***Similarity in ranking***

When projects are simple and or independent, the accept-reject decision or ranking produced by these methods will be the same. In other words, when:

$$\text{NPV} = 0; \text{IRR} = C; \text{ and } \text{B/C} = 1$$

$$\text{NPV} > 0; \text{IRR} > C; \text{ and } \text{B/C} > 1$$

#### ***Problems in ranking***

Basically, the major difficulty (in what can be a rather complex problem) is associated with the varying scale of possible projects. In the net present-value method, the 'cut-off' rate of discount is applied to the benefit stream, and for any project to be judged viable, the resulting present values must be higher than investment costs. If this is so, the internal rate of return would exceed the cut-off rate. For mutually exclusive investments, however, other projects (typically those of smaller scale) could yield higher internal rates of return. A small project with a higher internal rate of return should not be regarded as superior to a larger project if its net present value is lower. Quite simply, the investment in scale is economically justified since the 'cut-off' criterion is satisfied. In a similar way, the project with the highest ratio of the benefit to cost need not be the one which maximizes net present value. For this reason, benefit-cost ratios are often calculated in incremental terms.

### **9.3.3. Choice of 'cut-off' rate**

The rate of interest allocates capital funds between alternative uses in the market. Based on the 'equi-marginal principle', rates of return on capital in one use should be equated with that in competing uses. In short, the 'cut-off' rate for the appraisal of a project needs to reflect the 'opportunity costs' of capital. What the opportunity cost of capital to a public-sector project is may be difficult to determine for at least three reasons:

- i. A government or its agency may raise funds on favourable terms issuing government securities which may be considered as risk free and guaranteed by government. This puts a private sector issuer at a disadvantage.
- ii. The private sector projects are characterized by differing degrees of risks aside from the existence of corporate taxation. These two factors tend to affect the required yield on private sector securities. Hence, the underlying rates of return on capital employed tend to be higher than any set of returns reflected in the market.
- iii. The third reason is that taxation is a major source of finance for many government projects. This raises the question: how does one calculate the "opportunity cost" of a capital not raised in the market in competition with other uses?

### **9.4. Social time preference**

Market-determined interest rates reflect private individuals' time preference between present and future consumption, and to some extent, the society's preferences between present consumption and delayed future consumption. The former may be too high while a lower social rate of time preference may be considered as appropriate.

Generally, an appropriate rate is purely a value-judgment, and no clear-cut rules or procedures exist for determining a 'cut-off' rate for public sector investment appraisal.

### **9.5. Summary and Conclusion**

Investment appraisal through some form of cost-benefit analysis as recommended in the fiscal responsibility law is a recognition of the need to bring public spending under closer scrutiny.

The failure of market forces to reflect all costs and benefits, and the presence of externalities with possible beneficial or injurious consequences point to the need for cost benefit appraisals. Measurement difficulties, however, exists:

- i. There are clearly stubborn practical difficulties in identifying and valuing external effects, and it must not too easily be assumed that external consequences are un-reflected in market transactions. Many can be dealt with by regulations and other market-modifying measures.
- ii. There are quantification uncertainties associated with the elusive and entangled web of the direct and indirect effects to be measured. The usefulness of cost-benefit analysis is critically dependent on the realism of the valuation assumptions. How firmly based are they on the preferences of individuals as expressed through organized markets? To what extent are they arbitrarily determined by the analysts' value-judgments? And what about the dangers of overstating the non-market benefits.
- iii. The use of rates of return or discounted present values is not without its problems. Fundamental controversies still exist over the relative merits of the opportunity cost of capital and the social rate of time preference as the basis for 'cut-off' criterion. There is yet no agreement as to whether the derived cost-benefit rate of return can be compared with other rates.
- iv. There is also income distribution problem arising from differences on values placed on a unit of benefit (a naira of benefit) by differing income groups within the population. Considerations other than efficiency, such as income redistribution may be the government maxim and. A project with a high rate of return may have 'adverse income distributional effects' when compared with another project with a low yield but favourable income distribution effects. The conventional wisdom is that other considerations can be handled through other policy instruments, while government projects should be concerned with efficiency. An alternative view is that cost benefit studies should whenever possible list benefits by class of recipients to provide for detailed information about the need for such projects that or schemes. It has also been suggested that a weighting system should be introduced to reduce the range of distributional benefits to a single common measure.

Cost benefit methodology is an imperfect tool but the task of analysing costs and benefits focuses attention on basic issues and is in itself a valuable discipline. Because of its many measurement problems, it is not a technique that can simply be "switched in" to provide solution to the problem of efficient and effective public spending. Cost-benefit analysis has a wide range of applications in the public sector and the challenge is for the Fiscal responsibility Commission to encourage public agencies to undertake cost-benefit studies to sharpen decision making.

## CHAPTER TEN

### REQUIREMENTS FOR GOVERNMENT BORROWING

#### *10.1. Bond Characteristics*

A bond is a security that is issued in connection with a borrowing arrangement. The borrower issues (ie sells) a bond to the lender for some amount of cash: the bond is the “IOU” of the borrower. A bond is a financial contract between the issuer and the buyer. Bonds are interest – bearing obligations of governments or companies. It carries no ownership privileges. Most bonds are fixed income securities because the stated payments are constant overtime. However, some bonds pay variable income and are referred to as floating – rate bonds. The issuer is obligate to pay the bondholder specified amounts of money at specified dates. As long as the maturity of the bond is not for long, the risk is generally low, with corresponding and low returns. Bonds are usually less liquid than stocks and generate high cash flow.

The arrangement obligates the issuer to make specified payments to the bondholder on specified dates. A typical coupon bond obligates the issues to make semi annual payments of interest to the bondholder for the life of the bond. These are called coupon payments because in pre computer days, most bonds had coupons that investors would clip off and mail to the issuers of the bond to claim the interest payment. When the bond matures, the issuer repays the debt by paying the bondholder the bond's par value (equivalently, face value or principal).

The coupon rate of the bond serves to determine the interest payment. The annual payment is the coupon rate times the bond's par value. The coupon rate, maturity date, and par value of the bond are part of the bond Indenture which is the contract between the issuer and the bondholders.

To illustrate, a bond with par value of N1000 and coupon rate of 8% might be sold to a buyer for N1000. the bondholder is then entitled to a payment of 8% of N1000, or N80 per year, for the stated life of the bond, say 25 years. The N80 payment typically comes in two semi-annual installments of N40 each. At the end of the 25-year life of the bond, the issuer also pays the N1000 par value to the bondholder.

Bonds usually are issued with coupon rates set high enough to induce investors to pay par value to buy the bond. Sometimes, however, zero-coupon bonds are issued that make no coupon payments. In this case investors receive par value at the maturity date but receive no interest payments until then: the bond has a coupon rate of zero. These bonds are issued at prices considerably below par value, and the investor's return comes solely from the difference between issue price and the payment of par value at maturity.

There are three major identifying characteristics of bonds. First, they are typically securities issued by a company or governmental unit. Second, they usually pay fixed periodic interest installments called coupon payments. Also available are variable coupon payment bonds, where the coupon payment changes as market interest rates change. Third, bonds pay a lump sum at maturity that is called the par value, face value or principal.

#### **Cash flow characteristics of a bond in general form**

Most bonds are annuities plus an ultimate payment of principal. An annuity promises a fixed amount on a regular periodic schedule for a finite length of time.

#### **Diagram of cash flow of an 80% Semi-annual four-year Bond**

Example: A 9 1/2 percent coupon bond with semi-annual interest payments currently selling for N900 and due eight years from today. At maturity, the bond returns N1000 to the bond holder. The bond's present value is N900, its term (eight years) and the future cash flow N47.50 every six months for eight years and a single N1000 payment.

Table 1: Cash Flows from A 9.5 Percent, 8-Year Bond

TIME	CASH FLOW	PRESENT VALUE	
		AT 11.44%	AT 11.77%
0.5	47.50	45	44.93
1.0	47.50	42.62	42.50
1.5	47.50	40.38	40.20
2.0	47.50	38.25	38.02
2.5	47.50	36.23	35.97
3.0	47.50	34.32	34.02
3.5	47.50	32.51	32.18
4.0	47.50	30.80	30.44
4.5	47.50	29.17	28.79
5.0	47.50	27.64	27.23
5.5	47.50	26.18	25.76
6.0	47.50	24.80	24.36
6.5	47.50	23.49	23.05
7.0	47.50	22.25	21.80
7.5	47.50	21.08	20.62
8.0	1,047.50	440.38	430.08



## **10.2 Basic Principles of Bonds**

### **Identification of Bonds**

Bonds are identified by the issuer, the coupon, and the maturity

### **Classification of Bonds**

The details of a bond issue are contained in a legal document called the indenture. The pamphlet describes the terms of the loan and includes the issuer, security, and terms of payment.

### **Issuer**

One method of classifying bonds is by the nature of the organization initially selling the bond. Bonds are sold by companies; Federal, State and local government, by government agencies, foreign corporations and governments. Bonds sold by companies in Nigeria are known as debentures.

### **Security**

The security of a bond refers to what backs the bond, or what collateral is provided to reduce the risk of the loan.

### **Unsecured Debt.**

All debt of the government is secure by the ability of the Federal, or State government to make principal and interest payments from general tax revenues. No specific assets are ever listed as collateral for Federal, State government debt. These bonds are usually called full faith and credit issues, or general obligation issues like obligations of the government, these are backed by the taxing power of the issuer.

### **Secured Debt**

Specific security can be provided for a risky debt issue in a great many ways. Municipal (SLG) issues may be revenue bonds or assessment bonds. A revenue bond is a bond in which the interest and principal are repaid from revenue generated by the project financed by the bond. Assessment bonds are those which benefit a specific group of people, with those people paying an assessment to help pay principal and interest. Revenue bonds might be used to finance a bridge across a

river or a turnpike, with user fees being the primary source of debt repayment. Assessment bonds might be used to pay for projects that benefit a specific group of people. The installation of street lights in a residential area is an example. Revenue bonds are not secured because the revenue stream from the project are tied to the loan and will be used to repay the loan. The failure of a toll bridge (for instance) is comparable to the failure of a city to provide sufficient tax revenue to support its general obligation bonds. The bridge is not pledged as a or collateral on a revenue bond.

People who directly benefit from this improvement would be assessed a higher property tax.

### **Term**

This means the original life of the debt security. Short-term securities are those an initial life of less than one year. (Treasury bills are a good example). Intermediate – term securities, such as Notes, have lives ranging from one year to perhaps ten years; there is no precise demarcation between intermediate term and long term. Long term securities have maturities greater than ten years.

### **Terms of Repayment**

All bonds have specific provision for the payment of interest and repayments of principal. Some common provisions are discussed here.

#### **Interest only.**

Most marketable debt is structured such that the periodic payments are entirely interest. The principal amount of the loan is repaid in it's entirely at maturity.

#### **Sinking fund**

A sinking fund ( which may be required by a bond indenture) requires the establishment of a cash reserve for the ultimate repayment of the bond principal . In some circumstances lenders may require that the borrower provide for the eventual settlement of the debt by setting aside a portion of the principal amount of the debt each year. For instance, a N 100 million 20-year debt issue might provide that after five years the borrower must deposit N10 million every third year into special escrow account to partially offset the eventual burden of debt repayment.

Alternatively, the debt might provide that after a period of time the borrower must call a certain number of the bonds each year. This means that a portion of debt must be paid off early each year accordingly to the call schedule contained in the bond indenture.

### ***10.3. How to Raise the Fund***

The primary market is where new issues of bonds are sold by government units, state and local governments or companies to acquire new capital.

#### **SLG Bond Issue**

- New issues are sold by one of three methods: Competitive bond, negotiation or private placement. Competitive bids are sealed bids. The bond issue is sold to the bidding syndicate of underwriters that submits the bid with the lowest interest rate in accordance with the stipulations set forth by the issues.
- Negotiated sales involve contractual arrangements between underwriters and issuers wherein the underwriters help the issuers prepare the bond issue and set the price and has the exclusive right to sell the issue.
- Private placements involve the sale of a bond issue by the issuer directly to an investor or small group of investors (usually institution).

#### **The Underwriting Function**

- The underwriting function is performed by an investment bank. This means the bank purchases the entire issue at a specified price, relieving the issuer from the risk and responsibility of selling and distributing the bonds. Subsequently, the underwriter sells the issue to the investing public. For municipal bonds, the underwriting function is performed by both investment banking firms and commercial banks.
- The underwriting function can involve three services: organization, risk-bearing and distribution. Organization involves the design of the bond issue and initial planning. To fulfill the risk-bearing function, the underwriter acquires the total issue at a price dictated by the competitive bid or through negotiation and accepts the responsibility and risk of reselling it for more than the purchase price. Distribution means selling it to investors typically with the help

of a selling syndicate that includes other investment banking firms or commercial banks.

In a negotiated bid, the underwriter will carry out all these services. In a competitive bid, the issuer specifies the amount, maturities, coupons and call features of the issue and the competing syndicates submit a bid for the entire issue that reflects the yields they estimate for the bonds. The issuer may have received advice from an investment firm on the desirable characteristics for a forthcoming issue but this advice would have been on a fee basis and would not necessarily involve the ultimate underwriter who is responsible for risk-bearing and distribution. Finally, a private placement buyer involves no risk-bearing, but an investment banker could assist in locating potential buyers and negotiating the characteristics of the issue.

#### ***10.4. Types and Features of State and Local Government Debt Obligation***

There are two different types of State and Local Government (hereinafter SLG) debt obligations. The first type is the general obligation bonds that are backed by the full taxing power of the SLG and the second are the revenue bonds that are dependent on the revenues from a specific project that was funded by an issue such as toll road, or hospital or sewage system.

##### ***10.4.1. GENERAL OBLIGATION (GO) BONDS***

GO municipal bonds tend to be issued on a serial basis so that the issuer's cash flow requirements will be steady over the life of the obligation. Therefore the principal portion of the total debt service requirement generally begins at fairly low level and builds up over the life of the obligation.

These are debt instruments issued by States and Local Governments to finance the general working capital requirements. They are secured by the issuer's general or unlimited taxing power. The sources of tax revenues available to a government are varied and diverse and are the primary source on which the repayments of the issue are based. Hence, the security pledge is referred to as being full-faith and credit obligations.

General obligation bonds can also be secured by certain identified fees or user charges, grants and special charges, in addition to the issuer's general taxing powers, in order to provide additional revenues from outside the general funds. Bonds whose repayments come from these two sources are referred to as being **double barreled** in security because of the dual nature of the revenue sources.

A general obligation bond that is not secured by the unlimited taxing power of the issuer but is limited to some particular revenue source is known as **limited-tax general obligations bonds**.

#### **10.4.2. REVENUE BONDS**

This is the second major type of debt obligation a government can raise. Revenue bonds are issued for either projects or enterprise financing. The revenues generated by the completed project are pledged as the main source of repayments to the bondholders. The bond issuer (the state or local government) promises to pay the debt service to the bondholders immediately after revenues are paid to the basic operating and maintenance funds, but before paying all other expenses. Though most revenue bonds are structured and appear to be supported by identifiable revenue streams, it is important to remember that those revenues sometimes can be negatively affected directly by the other levels of government.

In contrast, most municipal revenue bonds are term issues, so the principal value is not due until the final maturity date of the last few payment dates. Specifically, should a municipality fail to generate sufficient income from a project designated to service a revenue bond; it has absolutely no legal debt service obligation until the income becomes sufficient. The issuer purchases an insurance for the benefit of the investor and the municipality benefits from lower interest cost due to lower default risks which in turn causes an increase in the rating on the bond and increased marketability.

#### **Adequacy of user-charges**

To protect the bondholders, the issuer must ensure that the rates or user-charges would be sufficient to meet expenses, including debt services as well as provide for some debt reserves. The issuer's legal power to increase rates or user charges without having to obtain prior approval from other governmental units is critical to the success of the issue. In addition, the project (if it is a project financing revenue bond)

must be insured and an annual audit of the financial and accounting transactions must be conducted. An annual engineering check of plant and equipment must be provided for, while it is essential that the facility must keep operating for the life of the bond.

#### **Annual debt service coverage**

Usually, it is required that the maximum annual debt service on the new bonds as well as on the old bonds must be covered by the projected net revenue by a specified minimum amount. This coverage can be as low as 1 times coverage or twofold. However, to be on the safe side, a rule of the thumb is that the projected revenues must provide at least 1.50 times the estimated maximum annual debt service on the outstanding and to-be-issued bonds.

#### ***10.5. COOPERATION BETWEEN EXECUTIVE AND LEGISLATURE***

For both general obligations and revenue bonds, the existence of a stable political relationship between the executive and the legislature is critical to a successful bond issue. A highly charged and partisan environment with competition so bitter and personal that precludes real cooperation among the warring parties or personalities in addressing future budgetary problems is not conducive to raising SLG bonds. For example, if prior approval must be obtained from another governmental jurisdiction before the user-fees or other changes can be levied, then the stability of the political relationships between the units of government becomes a critical success factor for the issue.

#### **The Government as a Multi-Service Firm**

The government is the central element of a formal political structure. A perspective we share is to consider states as simply firms, although admittedly ones that produce primarily public goods. It is more useful to view states as simply multi-service firms. They make decisions regarding certain services used by society: police protection, health care, education services, sanitation and so forth. A major decision is financing the provision of these services. There is hardly any of these services that cannot be financed through the issuance of special type of revenue bonds.

## Varieties of Revenue Bonds

Different kinds of revenue bonds specifically tailored to the purpose, project or service are possible. Such bonds are issued for either project or enterprise financings in which the bond issuer pledge to the bond holders the revenue generated by the operating projects financed.

Below are the possible specific types of revenue bonds that could be issued.

Table 2: Types of Revenue Bonds

s/ no	Revenue Bond	Purpose	Primary Repayment Source or Revenue Pledged
1	Airport revenue bond	To finance the development of a complete new facility or improve the infrastructure in the existing airport.	Landing fees paid by the airlines for their flights, concession fees paid by restaurants, shops, newsstands and parking facilities and from airline apron and fueling fees.
2	College or university revenue bond	To finance the development of infrastructure facilities such as classrooms/lecture theatres, library, science blocks, road networks, halls of residence and audio visual and learning aids	Revenues securing this bond usually include: hall of residence or dormitory room rental fees, tuition payments, general development levy and other facility fees.
3	Housing Mortgage Development	For the construction of low and medium income houses	<ul style="list-style-type: none"> <li>▪ Mortgage loan repayment</li> <li>▪ Monthly rental payments from the tenants</li> <li>▪ Government subsidies in form of interest-cost reduction and property tax abatement</li> </ul>

			<ul style="list-style-type: none"> <li>▪ A state moral obligation pledge when issued by a state housing agency or corporation.</li> </ul>
4	Hospital revenue bond	For the development of hospital infrastructures and medical facilities	State budgetary allocation for individual parents payments – fees from card, beds, treatment, etc
5	Highway revenue bonds	To build specific revenue-producing facilities as toll roads, bridges and tunnels	Tolls



## RECOMMENDATIONS AND FOLLOW-UP

- Generally, there is need to build the capacity of the operators; state actors and non-state actors and sponsoring studies to ensure efficient and effective implementation of the law.
- Strengthening further training on:
  - Medium Term Sector Strategy (MTSS)
  - Medium Term Expenditure Framework (MTEF)
  - Medium Term Budget Framework (MTEBF),
  - Budget Preparation Process.
  - Public Sector Project appraisal techniques
  - Debt sustainability analysis.
- Streamline all existing financial laws in the state in one document. The streamlined laws (Procurement law, Fiscal Responsibility Law, Debt Management Law, IGR Law, Organic Budget Law, Financial Instructions ) and should be named and called “Anambra State Financial Management Laws”. The essence is to make cross-referencing very easy, and to reduce overhead costs.
- To make the law fully operational, there is every need for state government to empanel the FRL members, and also organiser sensitization workshops for the members.
- Strengthening the oversight functions of the state legislature.
- Strengthen capacity of legislators and legislative staff to scrutinize audit reports through training/workshops.
- Strengthen independence of office of the Auditor General by guaranteeing funding. This could be a charge in the consolidated Revenue Fund (CRF) of the State.

## APPENDIX

### APPENDIX ONE – INCEPTION WORKSHOP REPORT

#### PRODUCTION OF FISCAL RESPONSIBILITY POLICY MANAGEMENT TOOL KIT

##### (Inception Report)

The context of this Fiscal Responsibility Law (RL) in Anambra State is informed by the fiscal and economic Reforms initiated by the Federal level in 2005 financial year. The reforms include fiscal and budget management, procurement, fiscal responsibility, accounting, and payroll management etc.

The nature of Nigeria's Federalism, which grants State Governments limited autonomy, over their fiscal decision did not allow the Federal Government to immediately extend the reforms to State Government. The autonomy of the States also mean't that they would set their respective reform agenda. This Fiscal Responsibility law is one of the several studies intended to raise critical issues that will inform the design of the reform program.

The Anambra State Ministry of Economic Planning which houses the State Government's economic reforms took the lead. It received assistance from the UNDP to produce a State Government Fiscal Policy Management tool kit to help policy makers and public officers understand key features of the Fiscal Responsibility Law with a view to proper implement the law. The law has been duly passed by the House and consequently accented by the Governor on the 5<sup>th</sup> day of August, 2010 with a registration No –ANHA/LAW/2011/03.

**Methodology:** A participatory method will be used to facilitate the one-day mini workshop. Principally this approach involved the presentation of a situational analysis of data collected from the MDAs including the Fiscal Responsibility Law of the State. It is expected to have group work sessions, questions and answers, interactive session, and at the end an assessment of the workshop and the participants.

A half-day inception and advocacy visits to political and administrative heads of relevant MDAs and their top advisers. The essence is to buy-in government, and secure basic understanding of the principles and objective of FRL. Arrangements will

be made to raise and train technical Team to work with the consultants. The technical team will be drawn from, the offices of Auditor General, Accountant General, Ministry of Justice and other core ministries the ultimate aim is to raise necessary documents that will help the consultants to do a good job. A joint review of official documentation such as financial instructions, procurement law, financial and Establishment Circulars) will be made. Hold mini seminar or workshop to review the draft fiscal policy management tool kit by the stock holders. Finally, the Technical Team and the consultants will brief the Hon. Commissioner or the Permanent Secretary at the close and share with her key observations and findings.

### **Fiscal Responsibility Policy Management Manual / Tool Kits**

#### **1.1 Objective of State Fiscal Responsibility Law (FLR)**

- Improve fiscal management of both state and Local Government Councils
- Reduction of risk and fluctuations in government fiscal operations
- Standardize the planning and control of public operation
- Ensure transparency in budget planning and implementations.

#### **1.2 Assigned specific tasks**

- Review state SFRL to identify all key issues
- Interact with various stake holders on the approach to fiscal management
- Design draft fiscal policy management tool kit reflecting the following
  - ❖ Budget planning frame work
  - ❖ Economic and fiscal update
  - ❖ Periodic budget performance review
  - ❖ Hold mini seminar for the draft fiscal policy management kit by stake holders.
  - ❖ Printing of drafts and fiscal copy policy management tool kit

### **1.3 Deliverables**

- Report on the findings and recommendations on each of the four objectives of the exercise (see TOR)
- An annex containing all training materials.

### **1.4 Reporting format:**

- Do an Inception Report within one week after commencement involving
- Understanding of the TOR
- Overview of the methodology, visits, collection and analysis of data.
- Work plan for the job
- ❖ Validation workshop if needed
- ❖ Acknowledgement
- ❖ 5 hardcopies of the report and soft copy to be submitted to UNDP office.

### **Suggested Paper to be Presented**

1. An overview of State Fiscal Responsibility Law (SFRL) – (Prof Bello)
2. Highlighting Relationship between Fiscal Policy, Public debt and budgetary flexibility – (Prof Bello)
3. Public Procurement Reforms in Anambra State Status and progress
4. Key features of State Fiscal Responsibility – (Okafor)
5. Template on Fiscal Responsibility Policy Management tool kit OR Manual. – (Prof Bello)
6. General Financial Responsibilities of public servants with reference to Anambra State Financial Instructions (FIS). Okafor
7. Why we need the Fiscal Responsibility Law in the State – (Okafor)

## **APPENDIX TWO - VALIDATION WORKSHOP REPORT**

### **VALIDATION MEETING FOR FISCAL RESPONSIBILITY TOOLKIT/MANUAL**

**HELD FROM 29<sup>TH</sup> TO FROM 29<sup>TH</sup> TO 30<sup>TH</sup> MARCH, 2012**

**AT CRISPAN HOTELS LTD, ABAGANA**

#### **10.20am Opening:**

Opening prayer was said by Mr. A.B.C. Nwosu.

#### **10.30 Opening Remarks by the Partnership Manager, UNDP, Anambra State**

In her opening remarks, the Partnership Manager UNDP Anambra State, Mrs. Michelle Onugbolu, on behalf of the UNDP, welcomed all the members of the meeting, and thanked them for answering the call inspite of their busy schedules. The meeting, according to her, is a crucial one being necessitated by the need to make the Fiscal Responsibility Law in the State operational. She emphasized that the law having been passed by the State House of Assembly since 5<sup>th</sup> August, 2010 and subsequently assented to by the Governor of Anambra State on 16<sup>th</sup> September, 2010, there is need to implement the provisions thereof to the letter. Furthermore, Mrs. Onugbolu informed the meeting that the UNDP in partnership with the Anambra State Government, has hired a consultant to prepare a manual to guide its implementation. The zero draft of the manual, which is titled, 'The Nuts and Bolts of Fiscal Responsibility Law in Anambra State', as prepared by the UNDP Consultant will be reviewed and validated in the meeting, she added. She concluded by urging the members of the meeting to participate effectively in the interest of moving Anambra State to greater height.

#### **11.15am Introducing the Fiscal Responsibility Law (2010) and the Fiscal Responsibility Manual/Toolkit by the Lead Consultant, Prof. Olaseni Akintola-Bello**

Welcoming the participants, Prof. Bello pointed out that a law is useless if it is not implemented. He explained that the Anambra State Fiscal Responsibility Law (2010) has been passed for 2 years now, and therefore its implementation should attract serious and urgent consideration.

According to the Consultant, in line with the provisions of this law, a Medium Term Expenditure Framework (MTEF) should be prepared by the Fiscal Responsibility Commission, from which the annual budget will be drawn. Anambra State has a challenge to make the law operational, he added.

Prof. Bello eulogised the former Director of Planning, Mr. Dan Ezeanwu for his efforts in preparing a more robust call circular, the Budget Management Bill and Budget Calendar, to guide the budget cycle timelines, which he referred to as being in line with best practices. He then urged his successor, Mr. K.O. Oji to maintain the pace of the ongoing reforms.

### **Introduction of the FRL Toolkit/Manual**

According to the Lead Consultant, the toolkit/manual on Fiscal responsibility Law is focused at providing users a deeper understanding of the major provisions of the new fiscal responsibility law in Anambra State.

He outlined seven (7) Critical Success Factors (CSF) for the FRL to be effectively implemented:

- i. The annual budgetary planning process
- ii. The medium term expenditure planning tool (MTEF)
- iii. Budget coverage and comprehensiveness
- iv. Best practices for fiscal transparency
- v. Reports and Information Disclosure Requirements for Budget Transparency
- vi. Replacing old-fashioned 'muddle-through' "rule of thumb" method in public expenditure decisions with a more rigorous cost-benefit analysis
- vii. The capital market requirements for government borrowing and the type of government debt instruments.

Concluding, Prof. Bello explained that the meeting shall be interactive, and urged all the members of the meeting to comment freely about their individual findings, clarifications or any area of concern as generated from their review of the fiscal responsibility manual/toolkit, which according to him, would guide further editing of the manual.

## Interactions/Questions/Responses/Comments

- The Director (Planning), Mr. K.O. Orji complained that inadequate personnel is a key factor that would militate against his effective discharge of his duties. He lamented that upon assumption of office as the new Director of Planning in March, 2012; only one staff at grade level 08, was bequeathed to him. He explained that there should be four divisions/units in the planning department viz Economic, Social, Environment, and General Administration, which should each be managed by at least grade levels 12 to 14 officer. Contrarily however, the department has at present, only two(2) staff – the Director and a grade level 08 officer.
- Responding to the complaints by the Director (Planning), the former Director of Planning, presently the Focal Person MDGs-CGS, Mr. Dan Ezeanwu, advised that we should not dwell more on challenges/constraints. He stressed that there are reforms that can come on board without involving too many hands, adding that the Ministry can out-source personnel if need be. In the words of Mr. Ezeanwu, “Consultants can be engaged to do the job while the Ministry take the glory for attaining such height.” The problem of lack of personnel can only be felt so much during the time of primary data collection, he added.
- Still on the issue of lack of personnel in the planning department, the Permanent Secretary, Ministry of Agriculture and also one-time Director of Planning, Mr. A.U. Umeobi, advised that the effects of inadequate personnel could be curbed if the Director (Planning) is a team player. He stressed that the benefits of being a team player is far-reaching and rewarding, given that planners (DPRS) in other ministries, supplies the data from their various MDAs e.g. quarterly returns on capital, etc. According to him, the Ministry of Economic Planning can drive the law for a while till the Commission is established. Despite the constraint, he continued, if the Ministry prepares the MTEF, MTSS, it will guide annual budgeting, adding that we have been speculating all these years since there is no consistency in revenue forecasts and plans, without which we cannot move forward.

## **Lecture 2 Consultant Mr. Emma Okafor**

While introducing the FRL toolkit/manual, the Consultant, Mr. Okafor thanked each and everyone for being present to validate the document, explaining that the document is a zero draft as it does not contain the executive summary and recommendations yet. The Consultant apologised that the document contains too many typographical errors and assured that the errors would have been checked, pending the readiness of the finalized document.

Emphasizing the importance of the Fiscal Responsibility Law (2010), he said that the law should be in the hands of every civil servant. In his words, 'it should be regarded as the bible.'

### ***Composition of the Commission***

Mr. Okafor while explaining the Composition of the Commission (Organigram) as provided in the law (Section 7 subsection 1), pointed out that the law did not provide for the position of a 'Secretary', however, in the manual/toolkit, provision was made for the position of a Secretary of the Commission. In the manual, the organigram was organized as follows:

At the topmost is the Chairman of the Commission, the next in the organigram is the Secretary of the Commission. The Representatives of the 3 Senatorial Zones in the State are permanent members of the Commission

The following are ex-officio members

- Representative of Organized private sector,
- Representative of Civil society organization engaged in causes relating to probity, transparency and good governance
- Representative of Organized Labour
- Representative of State Ministry of Economic Planning of a level not below the rank of a Director



- Representative of the State Ministry of Finance, who must be a season professional Accountant with not less than 10 years post qualification experience.

Mr. Okafor went on to explain that the Commission has been empowered by the FRL (2010) to prepare the MTEF, from which annual budget will be drawn. Inarguably, the meeting is not here to question the provisions of this law. The question according to him is, does the Commission have the manpower to prepare the MTEF. He also informed the members of the meeting of the provision of the Anambra State FRL (2010) about 3<sup>rd</sup> party involvement in enforcement of this law as provided in Part XII Section 50. The Consultant summarized the document as given below.

### **Summary of the FRL (2010)**

Summarizing the FRL (2010), Mr. Okafor informed the members of the meeting that the law has 13 parts and 54 sections. He did a brief review of the different sections as hereunder listed.

### **Contents of Fiscal Responsibility Law: Arrangement of Sections**

#### **Part I - Establishment, Functions and Powers of the Fiscal Responsibility Commission,**

Part I, Section 13, subsection 1 & 2 deals with establishment of the Commission.

Part I, Section 4 subsections (a) (b) & 2, deal with powers of the commission.

Part I, Section 5, 1(a)-e, 2, 3, 4 & 5(a) – (d) deal with functions of the commission.

Part I, Section 6, subsections 1 & 2 cover the establishment of a fund for the commission.

Part I, Section 7, subsections 1 (a – i). 2, 3, & 4 deal with composition of the commission.

Part I, Section 8, talks on tenure of office

Part I, Section 9 (a – g) talks on powers of the commission.

Part I, Section 10, 1 (a – g) & 2 deal with cessation of membership of the commission.

Part I, Section II, 1 & 2 deal with Emoluments etc, of commission members.

Part I, Section 12, covers submission of Annual Reports of the commission.

**Part II – Sub Title – Medium – Term Expenditure Framework**

Part II, Section 13, sub sections 1 (a – b), 2, 3a – b(i) – (vi), c(i) – (iv), i – (iii), (d) & (e), deal on medium-term Expenditure.

Part II, Section 14, sub-sections 1, & 2, talks on aggregate expenditure ceiling.

Part II, Section 15, subsections 1, 2(a), b(i) – (v), (c) deal on preparation of Medium – Term Expenditure Framework.

Part II, Section 16, sub sections 1 & 2, deal on time limit for presentation of medium-term Expenditure Frame work to the State Executive Council.

Part II, Section 17 applies to publication of Medium-Term Expenditure Framework in the official Gazette.

Part II, Section 18, subsections 1, & 2(a) – (b), cover provision for Governor's adjustments on MTFE after passage from the House.

**Part III, Sub Title – The Annual Budget of the State Government**

Part III, Section 19, sub-section 1, & 2, deals on Annual Budget to be derived from MTEF.

Part III, Section 20, (a) – (f) deal with documents to be attached to the Annual Budget.

\* Part III, Section 21 deals on how the Law affects the Local Government Councils in preparing Annual Budget.

**Part IV Sub Title – Budgetary Planning of Corporations and other related Agencies:**

Part IV, Section 22, (1) – (3) deal on preparation of Estimates revenue and expenditure of corporations, etc.

Part IV, Section 23, (1) – (2), deal on operating surplus and general reserve fund.

Part IV, Section 25, deals on cessation of application of part IV when Government owned company is privatized, using the date in which the company is privatized.

**Part V, Sub Title – Budgetary Execution And Achievement of Targets**

Part V, Section, 26, sub-sections (1) – (3) deal on Annual Cash Plan.

Part V, Section, 27, deals on Disbursement schedule

Part V, Section, 28, sub-sections (1) – (2) deal on power of commission to approve virement.

Part V, Section 29, sub-sections, 1 – 3, deal on power to restrict further commitments.

Part V, Section 30, sub-sections, (1) – (2) deal on restrictions on grant of tax relief.

Part V, Section 31, sub-sections (1) – (2) talks on responsibility of the Budget office to monitor and report on implementation.

\* Part V, Section 32, shows how far the application of part v, apply to State and Local Government Councils.

**Part VI, Sub Title – Public Revenue**

Part VI, Section 33, handles forecast and collection of public revenue.

Part VI, Section 34, handles revenue forecast.

Part VI, Section 35, handles how Executive gives break down of estimated revenue.

**Part VII: Sub Title – Savings And Assets Management**

Part VII, Section 36, sub-sections, (1) – (7) depict how excess proceeds are to be saved.

**Part VIII, Sub Title - Public Expenditures**

Part VIII, Section 37, sub-sections I (a) – (b), & (2) deal on conditions for increasing government expenditure.

Part VIII, Section 38, deals on conditions for increasing personnel expenditure.

Part VIII, Section 39, (a) – (b) highlights how this law (FRL) relates to (i)  
Procurement and Award of contracts

(ii) due process and certification of contracts

\* Part VIII, Section 40, handles its application to Local Government Councils.

**Part (IX)      Sub Title Debt and Indebtedness**

Part (IX) Section 41, sub-sections 1(a) – (c) handle Framework for debt management.

\* Part (IX), Section 42, sub-sections (1), - (7) deal on limits on consolidated debt of Local Government Councils.

Part (IX) Section 43, sub-sections (1) – (2) deal on servicing of external debt.

**Part (X):      Sub Title – Borrowing**

Part (X) Section 44, sub-section 1 – 2(a) – (b), 3 – 5 deal on conditions of borrowing and verification compliance with limits.

Part (X) Section 45, sections 1, 2(a) – (b), 3, & 4 deal on powers of Governor to grant guarantees.

**Part (XI):      Sub Title- Transparency and Accountability**

Part (XI): Section 46, sub-sections 1 – 2 deal on fiscal transparency.

Part (XI): Section 47, sub-sections 1 – 3 deal on publication of audited account by all arms of Government.

Part (XI) Section 48, deals on publication of a summarized report on budget execution.

**Part (XII):      Sub Title – Enforcement**

Part (XII) Section 50 (1) deals on Enforcement of this law – in the State High Court.

**Part (XIII)      Sub Title – Miscellaneous Provisions**

Part (XIII): Section 51, handles Government securities as collateral guarantee loans.

Part (XII): Section, 52, handles restrictions on utilization of proceeds of sale of public assets, etc.

Part (XIII), Section 54, - handles Power of the Governor to make regulations.

Following the presentation of the toolkit/manual, observations, questions/comments were entertained from members of the meeting.

### Interactions/Questions/Comments

- In his comments, Mr. Umeobi explained that annual plans will be hanging if it is not based on the MTEF. He requested the consultants to develop templates for MTEF, MTSS, Cash Plan, etc to guide the FRL implementation. In his words, "if plans should derive from the MTEF, every planner must be able to prepare the MTEF for their various Ministries."
- The Lead Consultant, Prof. Bello, while explaining the MTEF, said that Medium Term Expenditure Framework (MTEF) is the end-process. The Medium Term Sector Strategy (MTSS) is the starting point, followed by the MTEF before arriving at the MTEF. He cited example with the Ministry of Education. According to him, since for instance in Anambra State, the pupil-teacher ratio is 52:1, working with the ratio of 30:1, as best practice requires, we can determine the cost of building more classrooms required to meet the target ratio of 30 : 1. By costing this capital good, the MTEF is realized.
- Citing example with the activity based costing as applied by the UNICEF, Mr. Umeobi explained that for the MTEF to stand, the revenue forecast for 3 – 4 years should be in place, adding that expenditure cannot be determined in the medium-term.
- Responding to the comments above, the lead consultant, Prof. Bello explained that activity based costing is insufficient as it does not take into account the administrative cost, for instance, time taken accountant to write a check is not included in the overall cost.
- In his submission, the Focal Person MDGs-CGS, Mr. Ezeanwu outlined three(3) key factors for effective budget management and enhancing good budget performance. In his words, the budget must be as realistic as possible,

secondly, there must be annual cash plan, i.e, the way it should be disbursed and lastly, and thirdly, there must be in-year budget reviews.

- To enhance budget performance in Anambra State, Prof. Bello advocated for removal of those sub-heads that has been occurring in the budget for many years without attracting any fund.

### **Conclusion**

The members of the meeting were grouped into four. Each group were assigned to review specific chapters of the Fiscal Responsibility Toolkit/Manual as follows:

Group 1: Chapters 1, 2 and 3

Group 2: Chapters 4 and 5

Group 3: Chapters 6, 7 and 8

Group 4: Chapters 9 and 10

The group leaders were to present the report of the review on the second day of the meeting.

### **Day Two**

Opening Prayer was said by Ifeoma Ezedebego at 10.00am.

### **Group Presentations/Comments**

The different group leaders were invited to present the report of their reviews as assigned the previous day. After each presentation, there were comments, clarifications and recommendations. As hereunder stated, the following recommendations should be included in the manual.

### **Recommendations**

- Chapters 2 and 3 should be narrowed down to the Anambra State situation.
- The manual should include as an addendum, the templates for the preparation of the MTEF.

- There is need to include other memorandum items in addition to other documents to go with the annual budget to the Anambra State House of Assembly.
- There is need for the Fiscal Responsibility Commission when set up, to coopt people with sound knowledge and background in investment and borrowing
- The Public Procurement Law, Budget Management Law, and Fiscal Responsibility Law have overlapping functions. The Ministry of Justice should harmonize all these laws and bring up a single document. The government is advised to employ a consultant or set up a committee to avoid duplicity of agencies/commission

### **Adoption of Fiscal Responsibility Manual/Toolkit**

Subject to the following amendments, the motion for the adoption of the Fiscal Responsibility Toolkit/Manual was moved by Mr. S.T. Ikedinma and seconded by Ifeoma Ezedebego

### **GROUP REPORTS**

#### ***GROUP 1 Presentation***

#### **TASK: REVIEW OF CHAPTERS 1, 2 & 3**

#### **GROUP MEMBERS:**

**Mr. Azuka Okeke, Mr. S.T. Ikedinma, Mrs. E.C. Dike & Ifeoma Ezedebego.**

#### **COMMENTS:**

**Chapter 1 – This chapter is introductory and stated the obvious facts about Anambra State fiscal responsibility situation.**

#### **Chapter 2:**

**Page 12, Paragraph 2.1, Bullet point 4, *'Monitoring and enforcement mechanism usually supported by scrutiny from an independent agency'***

There is need to define the independent agency in question and specify their limit of enforcement.

### **Page 20, Paragraph 2.3.3 General Discussion**

Why the general statements referring to other states. There is need to be more specific and make reference to Anambra State.

Page 21, paragraph 2.3.6

*'Monitoring and evaluation functions to be institutionalized and given a minimum of a directorate status.'*

There is need to specify that the M&E will be institutionalized in the proposed Fiscal Responsibility Commission. The Commission being an independent body, should undertake their own M&E.

Page 21 -22, under Paragraph 2.3.7 Accountability and Transparency

The entire subsection is too general, referring to every state. It needs to be specifically Anambra State.

## **GROUP 2 PRESENTATIONS**

### **CHAPTERS 4 AND 5 OF THE TOOLKIT/OPERATIONAL MANUAL FOR THE OPERATIONALIZATION OF THE FISCAL RESPONSIBILITY LAW**

#### **CHAPTER 4 – ANNUAL BUDGETING PROCESS:**

- i. At page 35, line 4, in-flaw should “inflow” and of should be added close to it.
- ii. In same page, paragraph 3, line 4, interact should replace interlaw
- iii. In same page, and paragraph, line 6, the sentence should be re-casted to make it clearer and meaningful
- iv. On page 36, and in figure 1: steps in the Budget process, the following amendments should be made:
  - a. Step 4 should be re-casted to read Ministry of Economic Planning and Budget (MEPB) holds Bilateral discussions with MDAs



- b. Step 5 should read state budget prepared by MEPB and not Ministry of Finance
- c. After step 7, step 8 should be Accent of Budget into law by the Executive Governor
- v. At page 36, section 4.1 lines 5, Ministry of Finance should be replaced with Ministry of Economic Planning and Budget
- vi. In line 15, same page and paragraph, Ministry of Finance should read Ministry of Economic Planning and Budget
- vii. At page 37, line 2 Ministry of Finance should be changed to Ministry of Economic Planning and Budget
- viii. On page 38, under bullet 3, the opening word in the sentence should be "Contractual"
- ix. On same page, paragraph 2 line 2, FRLmes should be corrected to frames
- x. In line 7, same page and paragraph the word framework was wrongly spelt and should be corrected
- xi. On same page, section 4.3 line 3 the sentence should read requests are linked to activities not Lawivities
- xii. On page 39, line 3, the last word in that sentence should be corrected to activities
- xiii. On same page, in paragraph 4, line 2, the word infrastructure was wrongly spelt and should be corrected
- xiv. On page 40, paragraph 2, line 4, the appropriate word should be activities not Lawivities
- xv. On page 41, section 4.5, Ministry of Finance in the opening sentence should be corrected to Ministry of Economic Planning and Budget. The word Lawual in lines 2 and 3 of that sentence does not fit. The correct word should be actual

	beginning of the current year.	ACCOUNTANT-GENERAL
5.	Financial Assets, including details at least for the beginning of the current year.	HC (FINANCE)/ACCOUNTANT-GENERAL
6.	Prior year's budget outturn, presented in the same format as the budget proposal.	HC MEPB/ HC (FINANCE)
7.	Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal.	HC MEPB/ HC (FINANCE)
8.	Summarized budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-5), including data for the current and previous years.	HC MEPB/ HC (FINANCE)
9.	Explanation of budget implications of new policy initiatives, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs.	HC MEPB/ HC (FINANCE)

**Chapter 6 of the Draft Tool Kit, page 50 highlights "Budget Classifications". The provision here appears suggestive, instead of actually pin-pointing what should be done.**

**Recommendation:**

In line with International Good Practice (IGP), the Government Financial Statistics and Classification of Functions of Government (COFOG) should be included.

The Classification of the Functions of Government (COFOG) was developed by the Organization for Economic Co-operation and Development and published by the United Nations Statistical Division. It can be applied to government expense and the net acquisition of nonfinancial assets. COFOG has three levels of detail: Divisions, Groups, and Classes. The Divisions could be seen as the broad objectives of government, while the Groups and Classes detail the means by which these broad objectives are achieved.

Code	Description
<b>01</b>	<b>General public services</b>
01.1	Executive and legislative organs, financial and fiscal affairs, external affairs
01.1.1	Executive and legislative organs (CS)
01.1.2	Financial and fiscal affairs (CS)
01.1.3	External affairs (CS)
01.2	Foreign economic aid
01.2.1	Economic aid to developing countries and countries in transition (CS)
01.2.2	Economic aid routed through international organizations (CS)
01.3	General services
01.3.1	General personnel services (CS)
01.3.2	Overall planning and statistical services (CS)
01.3.3	Other general services (CS)
01.4	Basic research
01.4.0	Basic research (CS)
01.5	R&D General public services
01.5.0	R&D General public services (CS)
01.6	General public services n.e.c.
01.6.0	General public services n.e.c. (CS)
01.7	Public debt transactions
01.7.0	Public debt transactions (CS)
01.8	Transfers of a general character between different levels of government

01.8.0 Transfers of a general character between different levels of government  
(CS)

**02 Defence**

02.1 Military defence

02.1.0 Military defence (CS)

02.2 Civil defence

02.2.0 Civil defence (CS)

02.3 Foreign military aid

02.3.0 Foreign military aid (CS)

02.4 R&D Defense

02.4.0 R&D Defense (CS)

02.5 Defense n.e.c.

02.5.0 Defense n.e.c. (CS)

**03 Public order and safety**

03.1 Police services

03.1.0 Police services (CS)

03.2 Fire-protection services

03.2.0 Fire-protection services (CS)

03.3 Law courts

03.3.0 Law courts (CS)

03.4 Prisons

03.4.0 Prisons (CS)

03.5 R&D Public order and safety

03.5.0 R&D Public order and safety (CS)

- 03.6 Public order and safety n.e.c.
- 03.6.0 Public order and safety n.e.c. (CS)
- 04 Economic affairs**
- 04.1 General economic, commercial and labour affairs
- 04.1.1 General economic and commercial affairs (CS)
- 04.1.2 General labour affairs (CS)
- 04.2 Agriculture, forestry, fishing and hunting
- 04.2.1 Agriculture (CS)
- 04.2.2 Forestry (CS)
- 04.2.3 Fishing and hunting (CS)
- 04.3 Fuel and energy
- 04.3.1 Coal and other solid mineral fuels (CS)
- 04.3.2 Petroleum and natural gas (CS)
- 04.3.3 Nuclear fuel (CS)
- 04.3.4 Other fuels (CS)
- 04.3.5 Electricity (CS)
- 04.3.6 Non-electric energy (CS)
- 04.4 Mining, manufacturing and construction
- 04.4.1 Mining of mineral resources other than mineral fuels (CS)
- 04.4.2 Manufacturing (CS)
- 04.4.3 Construction (CS)
- 04.5 Transport
- 04.5.1 Road transport (CS)
- 04.5.2 Water transport (CS)

- 04.5.3 Railway transport (CS)
- 04.5.4 Air transport (CS)
- 04.5.5 Pipeline and other transport (CS)
- 04.6 Communication
  - 04.6.0 Communication (CS)
- 04.7 Other industries
  - 04.7.1 Distributive trades, storage and warehousing (CS)
  - 04.7.2 Hotels and restaurants (CS)
  - 04.7.3 Tourism (CS)
  - 04.7.4 Multi-purpose development projects (CS)
- 04.8 R&D Economic affairs
  - 04.8.1 R&D General economic, commercial and labour affairs (CS)
  - 04.8.2 R&D Agriculture, forestry, fishing and hunting (CS)
  - 04.8.3 R&D Fuel and energy (CS)
  - 04.8.4 R&D Mining, manufacturing and construction (CS)
  - 04.8.5 R&D Transport (CS)
  - 04.8.6 R&D Communication (CS)
  - 04.8.7 R&D Other industries (CS)
- 04.9 Economic affairs n.e.c.
  - 04.9.0 Economic affairs n.e.c. (CS)
- 05 Environmental protection**
  - 05.1 Waste management
    - 05.1.0 Waste management (CS)
  - 05.2 Waste water management

- 05.2.0 Waste water management (CS)
- 05.3 Pollution abatement
  - 05.3.0 Pollution abatement (CS)
- 05.4 Protection of biodiversity and landscape
  - 05.4.0 Protection of biodiversity and landscape (CS)
- 05.5 R&D Environmental protection
  - 05.5.0 R&D Environmental protection (CS)
- 05.6 Environmental protection n.e.c.
  - 05.6.0 Environmental protection n.e.c. (CS)
- 06 Housing and community amenities**
  - 06.1 Housing development
    - 06.1.0 Housing development (CS)
  - 06.2 Community development
    - 06.2.0 Community development (CS)
  - 06.3 Water supply
    - 06.3.0 Water supply (CS)
  - 06.4 Street lighting
    - 06.4.0 Street lighting (CS)
  - 06.5 R&D Housing and community amenities
    - 06.5.0 R&D Housing and community amenities (CS)
  - 06.6 Housing and community amenities n.e.c.
    - 06.6.0 Housing and community amenities n.e.c. (CS)
- 07 Health**
  - 07.1 Medical products, appliances and equipment

- 07.1.1 Pharmaceutical products (IS)
- 07.1.2 Other medical products (IS)
- 07.1.3 Therapeutic appliances and equipment (IS)
- 07.2 Outpatient services
  - 07.2.1 General medical services (IS)
  - 07.2.2 Specialized medical services (IS)
  - 07.2.3 Dental services (IS)
  - 07.2.4 Paramedical services (IS)
- 07.3 Hospital services
  - 07.3.1 General hospital services (IS)
  - 07.3.2 Specialized hospital services (IS)
  - 07.3.3 Medical and maternity centre services (IS)
  - 07.3.4 Nursing and convalescent home services (IS)
- 07.4 Public health services
  - 07.4.0 Public health services (IS)
- 07.5 R&D Health
  - 07.5.0 R&D Health (CS)
- 07.6 Health n.e.c.
  - 07.6.0 Health n.e.c. (CS)
- 08 Recreation, culture and religion**
  - 08.1 Recreational and sporting services
    - 08.1.0 Recreational and sporting services (IS)
  - 08.2 Cultural services
    - 08.2.0 Cultural services (IS)



- 08.3 Broadcasting and publishing services
- 08.3.0 Broadcasting and publishing services (CS)
- 08.4 Religious and other community services
- 08.4.0 Religious and other community services (CS)
- 08.5 R&D Recreation, culture and religion
- 08.5.0 R&D Recreation, culture and religion (CS)
- 08.6 Recreation, culture and religion n.e.c.
- 08.6.0 Recreation, culture and religion n.e.c. (CS)

**09 Education**

- 09.1 Pre-primary and primary education
- 09.1.1 Pre-primary education (IS)
- 09.1.2 Primary education (IS)
- 09.2 Secondary education
- 09.2.1 Lower-secondary education (IS)
- 09.2.2 Upper-secondary education (IS)
- 09.3 Post-secondary non-tertiary education
- 09.3.0 Post-secondary non-tertiary education (IS)
- 09.4 Tertiary education
- 09.4.1 First stage of tertiary education (IS)
- 09.4.2 Second stage of tertiary education (IS)
- 09.5 Education not definable by level
- 09.5.0 Education not definable by level (IS)
- 09.6 Subsidiary services to education
- 09.6.0 Subsidiary services to education (IS)

- 09.7 R&D Education
- 09.7.0 R&D Education (CS)
- 09.8 Education n.e.c.
- 09.8.0 Education n.e.c. (CS)
- 10 Social protection**
- 10.1 Sickness and disability
- 10.1.1 Sickness (IS)
- 10.1.2 Disability (IS)
- 10.2 Old age
- 10.2.0 Old age (IS)
- 10.3 Survivors
- 10.3.0 Survivors (IS)
- 10.4 Family and children
- 10.4.0 Family and children (IS)
- 10.5 Unemployment
- 10.5.0 Unemployment (IS)
- 10.6 Housing
- 10.6.0 Housing (IS)
- 10.7 Social exclusion n.e.c.
- 10.7.0 Social exclusion n.e.c. (IS)
- 10.8 R&D Social protection
- 10.8.0 R&D Social protection (CS)
- 10.9 Social protection n.e.c.
- 10.9.0 Social protection n.e.c. (CS)

## **COFOG - notes**

Abbreviations used:

(CS) - Collective services

(IS) - Individual services

## **GROUP FOUR PRESENTATION**

### **CHAPTERS 9 AND 10**

#### **MEMEBERS:**

- A. A. O. UMEOBI – PERMANENT SECRETARY (MOA)- TEAM LEADER**
- B. CHARLIE OKEKE – DPRS (MOE)**
- C. REV P. C. AMANZECHUKWU – DPRS (MLG&CM)**
- D. KAROL IKEANYIONWU – HEAD (TECH AIDE)**

#### **CHAPTER NINE: COST BENEFIT ANALYSIS AND PUBLIC EXPENDITURE**

The focus in this chapter is on Cost-Benefit Analysis as a tool for appraising both Private and Public investments. For the private investor, calculating cost and benefit is simple because the investor is guided by market signals/forces since investments will usually go to where profit will be maximized. The public investor will first give consideration to public goods. These public goods include roads, defense (including police services), Health and Education services, etc. Investments in these areas are guided by streams of social costs and social benefits. The calculation is therefore not very simple and requires expertise. The question therefore is can the Commission as constituted in the Act have the expertise to calculate the costs and benefits with a view to taking investment decisions on behalf of Government.

Our view is that the capacity is not there. If the Commission must advise the Government on how to invest, the technocrats must be engaged and capacity of the members of the Commission enhanced.

## **CHAPTER TEN: REQUIREMENTS FOR GOVERNMENT BORROWING**

This is similar to the issues involved in the Cost and Benefit Analysis. This is because, if we must invest, we must be able to spend wisely.

In our capital receipts for instance, we have provisions for Bonds which have never been explored because Government is not sure whether investing in the area is worth it. Government thinks it will be risky and has rather been going for grants and soft credits.

There must be enabling political climate and environment (with the backing of the State legislature) for a Government to float a bond for meaningful investment.

In conclusion, we need a Commission that will be able to advise Government on borrowing otherwise, the Commission as it is presently constituted in the Act cannot do it without technocrats.

It is our view that when the present Law was being crafted, adequate consideration was not given to the capacity and human resources to implement the Law. These are necessary ingredients for the operationalization of the Fiscal Responsibility Law in the State.

The manual should take into cognizance the requirements for the appraisal of public sector programmes and the criteria for borrowing especially bond floatation.

