



Kano State Government

Arrears Clearance Framework (ACF)

August, 2020

TABLE OF CONTENTS

S/No	Description	Page
	Table of Contents	ii
	List of Acronyms	iii
1.0	Kano State Arrears Clearance Framework	1
	1.1 Introduction	1
	1.2 Meaning and Definition of Arrears	2
	1.3 Purpose of the Framework	2
	1.4 The Scope and Coverage of the Framework	2
	1.5 State's Current Total Stock of Domestic Expenditure Arrears	4
	1.6 State's Historical Data of Stock Arrears at year end for the past 5 years	5
	1.7 State's Policy on Prevention of New Arrears Accumulation	7
	1.8 Clearance of Existing Arrears	9
	1.9 Procedural Arrears Clearance Strategy	9
2.0	Planned Actions on Arrears Clearance	12
	2.1 Earmarked Sources of Revenue	12
	2.2 Coverage of Expenditure Arrears	13
3.0	Prioritization Criteria for Arrears to be Settled	14
	3.1 Prioritization Between and Within the Classes of Arrears	16

4.0	Establishment of a Supportive Institutional Mechanism to Clear Arrears	18
	4.1 Specific Activities of the Committee	19
	4.2 Supervision and Reporting Arrangements	20
	4.3 Tenure and membership of the Committee	20
	4.4 Committee compensation	21
	4.5 Committee Secretariat	21
	4.6 Powers and authorities of the Committee	21
5.0	Monitoring and Reporting for SFTAS on the Domestic Arrears DLI	21
	Appendix: Multi-Year Funding Plan	

ABBREVIATIONS AND ACRONYMS

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

1.0 Kano State Arrears Clearance Framework

1.1 Introduction

Kano State is located in northern Nigeria. Kano was created on May 27, 1967 from part of the Northern Region, and borders Katsina State to the northwest, Jigawa State to the northeast, Bauchi State to the southeast and Kaduna State to the southwest. The state's capital is the city of Kano.

Kano State is the second-largest industrial center after Lagos State in Nigeria and the largest in Northern Nigeria with textile, tanning, footwear, cosmetics, plastics, enamelware, pharmaceuticals, ceramics, furniture and other industries. Others include agricultural implements, soft drinks, food and beverages, dairy products, vegetable oil, animal feeds etc.

The State is a participant in the Federal Government of Nigeria (FGN) and World Bank multi-year (2018-2022) program to support Nigerian states to strengthen fiscal performance and sustainability: *The State Fiscal Transparency, Accountability and Sustainability (SFTAS) Program for Results* (“The Program”).

One of the disbursement-linked indicators under the Program (DLI #8) requires the state to establish a database of verified domestic arrears, establish an arrears clearance framework (ACF) setting out the procedures to clear the stock of arrears, and implement the ACF. Any state that reduces its stock of arrears at the end of the year by at least five percent, compared to the previous year, will be eligible for an annual performance-based grant. Performance will be assessed for each of the four years in the Program.

To this end, The State’s Ministry of Finance in a bid to achieve the requirements of the DLI and more importantly to improve the recording, verification and

clearance of arrears in the State has designed this guideline called the Kano State Arrears Clearance Framework.

The framework provides guidance to the State on the handling of State's Arrears within acceptable limits and the eventual clearance of State's Arrears and total Debt Stock in the foreseeable future.

1.2 Meaning and Definition of Arrears

The Kano State Government has defined and interpreted the word "Arrears" to mean all financial obligations that have been incurred by any part of the public sector for which the State has responsibility to pay and payments were not made as and when due. Payment may be overdue based on a legal obligation, specific contractual commitment, continuing service arrangement or paucity of funds. The value of expenditure arrears constitutes the amount of the original overdue payment, as well as any interest or financial penalties that the Government might not have paid.

1.3 Purpose of the Framework

The purpose of this framework is to provide a basic structure aimed at guiding the Kano State Government in the identification, recording, verification and clearance of the State' arrears. The framework will also help to institute process and procedure for the control and reduction of the debts total indebtedness.

1.4 The Scope and Coverage of the Framework

This framework shall be the policy guideline and procedure that is aimed at settling the State's arrears in the following categories:

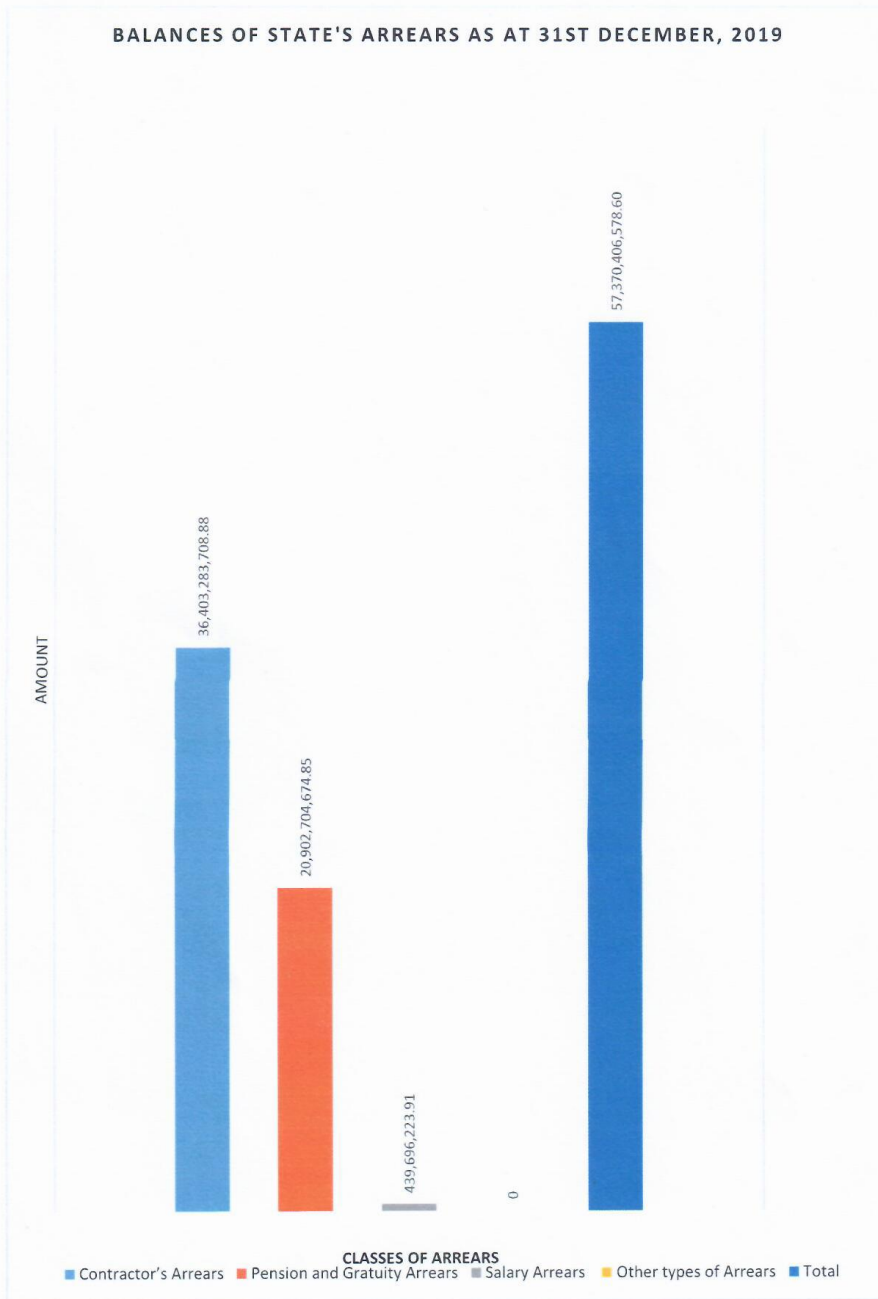
- Contractor's Arrears
- Pension and Gratuity Arrears
- Salary Arrears
- Other types of Arrears

1.5 State's Current Total Stock of Domestic Expenditure Arrears

This information is presented to represent the State's total domestic expenditure arrears as at 31st December, 2019.

S/N	Class of Arrears	Amount
		₦
1	Contractor's Arrears	36,403,283,708.88
2	Pension and Gratuity Arrears	20,902,704,674.85
3	Salary Arrears	439,696,223.91
4	Other types of Arrears	-
	Total	57,370,406,578.60

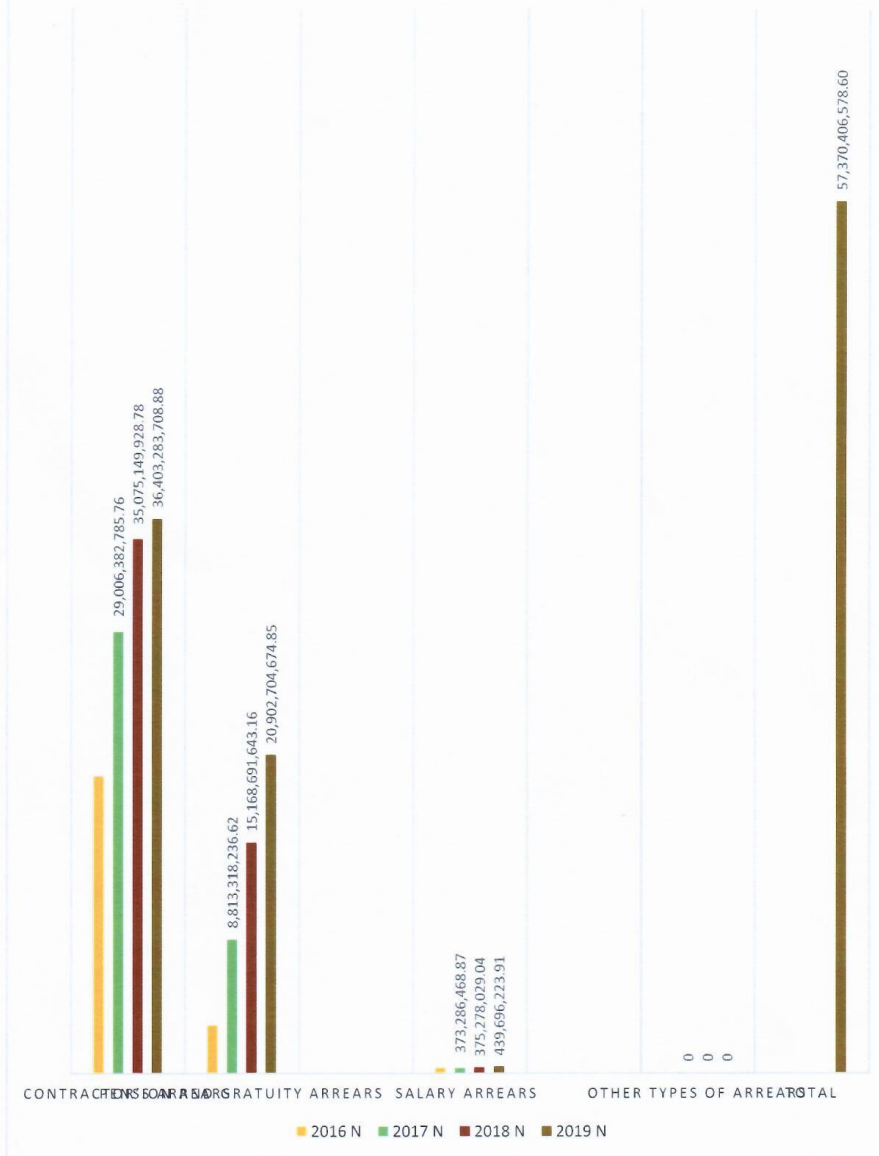
BALANCES OF STATE'S ARREARS AS AT 31ST DECEMBER, 2019



1.6 State's Historical Data of Stock Arrears at year end for the past 5 years

S/N	Class of Arrears	2015	2016	2017	2018	2019
		₦	₦	₦	₦	₦
1	Contractor's Arrears	7821787562.67	19486818313.39	29006382785.76	35075149928.78	36,403,283,708.88
2	Pension and Gratuity Arrears	-	3,165,340,440.01	8,813,318,236.62	15,168,691,643.16	20,902,704,674.85
3	Salary Arrears	-	372,444,968.87	373,286,468.87	375,278,029.04	439,696,223.91
4	Other types of Arrears	-	-	-	-	-
Total						57,370,406,578.60

HISTORICAL DATA OF ARREARS FOR THE PAST FOUR YEARS



1.7 State's Policy on Prevention of New Arrears Accumulation

The State, while focused on the clearance of new arrears is determined to prevent the accumulation of new arrears. This is intended to be achieved by enshrining the following fiscal measures:

- **Review of Existing Approval Limits for Accounting Officers:** The State is focused on reviewing the existing approval thresholds for accounting officers in the State MDAs, this will help centralize the approval of expenditure and will therefore enhance the ease of payment. Upon approval electronic payment option will be deployed, where all designated signatories could authorize payment seamlessly. We are certain that this measure will prevent or at the very least bring to a minimal the accumulation of new arrears in the State.
- **Improved and Reliable Periodic Cash Forecasting:** The State will periodically review its cash flow forecast and will use the forecast to advise the political class and top government officials on the nature and extent of expenditure that the State has enough cash viability to meet.
- **Cash Backing of Award of Contracts:** The State has considered the need to emphasize on adequate resources and availability of funds as condition precedent to the award of contracts. This effort is geared towards improving the procurement function to be driven by needs assessment, such procurement activity adequately budgeted for and funds made available before award to prevent accumulation of new arrears.
- **Budget Review:** The State has also mapped out strategy to cut down on non-essential capital projects in future budget periods. This will enable the State government to make available enough funds to execute the few

essential and budgeted capital expenditure without accumulating new arrears.

- **Promoting and Encouraging Budget Realism:** The State will set realistic plan for expenditures based on conservatively estimated revenues and the borrowing limit should include a margin to handle the situation of revenue shortfalls. Only realizable goals in terms of revenue generation will be pursued. All revenue generating MDAs will be enjoined to take budgeting very seriously and sanctions will be introduced for unexplainable budget deviations.
- **Improved Accounting and Reporting:** The State which already accounts and reports on IPSAS Accrual Basis have established a comprehensive arrears accounting and reporting, by such all arrears during the year are recorded and reported appropriately;
- **Improved Integrated Cash and Debt Management:** The State shall calibrate the use of short-term Treasury Bills or any other short-term instrument, according to the underlying cash flows and increase the issuance of Treasury Bills when the revenues are lower than average (and *vice versa*);
- **Putting the Government State Integrated Financial Management Information System (SIFMIS)** into effective use to handle the entire expenditure chain, including the release of budget funds, commitments against the budget funds, production of purchase orders based on commitments, receipt of invoices within the purchase orders, receipt of goods and services claimed in the invoices, and payment or non-payment of invoices.

1.8 Clearance of Existing Arrears

The State Government will key into the prescribed cogent characteristics of an effective arrears clearance strategy, which can be summarized as the following:

- **Comprehensiveness.** The arrears clearance strategy would apply to all outstanding payments incurred by a state government, including budgetary institutions and state-owned enterprises.
- **Transparency.** The clearance of arrears would proceed according to a public timetable and criteria for prioritizing clearance should be transparently stated and adhered to.
- **Realism.** The government's annual budget and medium-term fiscal projections would make adequate provision for the cash cost of arrears clearance.
- **Credibility.** To demonstrate commitment to addressing the root causes of the problem, the strategy would include measures to avoid the accumulation of new arrears, and ministries or agencies that fail to implement these measures should be penalized appropriately.

1.9 Procedural Arrears Clearance Strategy

In order to ensure transparent and credible arrears clearance, the State will adhere to this strategy methodologically as follows:

- (i) **Compilation of Arrears:** A comprehensive compilation and recording of arrears debt stock would be carried out, this will enable the government to clearly see and understand the true position of things with respect to the extent, composition, magnitude and vintage of the State Government's Arrears. A circular would be sent to all State Government MDAs to submit their arrears claims to Debt Management Office to consolidation and proper reconciliation.

- (ii) **Verification:** Once data on the outstanding stock of arrears has been collected, the data would be verified to ensure that they are genuine and valid claims to avoid payment of fraudulent claims. This activity will be undertaken by the Debt Management Office of the state and supervised by the Arrears Clearance Committee.

STEP 1: Collection of Unpaid Invoices

The initial responsibility for producing the necessary documentation should rest with the Chief Financial Officers of the MDAs. The responsibility for the proof of the validity of claims without proper documentation should rest with the claimant. Only original documentation should be accepted for signing and not photocopies, to avoid fraudulent claims.

STEP 2: Verification of Claims

- a) Invoices and supporting documents should be checked to verify the value of amount payable.
- b) The age of the payable should be checked by reference to the invoice and other documents
- c) The State Ministry of Finance taking full account of the legal framework with respect to disclosure of taxpayer records should undertake checks with revenue whether they are delinquent in tax payment
- d) The claims should have been properly approved for payment

STEP 3: Categorization of Claims

Based on the review of the validity and verification exercise, each claim should be categorized verified, contested, rejected. Verified claims are those claims that have been certified to be complete, accurate and valid both to the arrears holder

and the State Government, while Contested claims are those with varying degree of disparity as to some material particulars in the arrears either by the arrears holder or the State or both. Rejected claims are those for which legitimate and other evidential documents have been presented.

STEP 4: Appeal from Claimants

Holders of contestable claims may be invited to provide further documentation to support their claims or have their claims referred for adjudication.

STEP 5: Rejections of Invalid Claims:

The State Government would formally notify rejected claimants and State the basis of the rejection. It is essential that Government retain full records of decisions made to defend future legal actions by claimants.

(iii) Classification: When the arrears data is collected and verified. It should be analyzed and classified for the purpose of arrears clearance. A database of valid outstanding payment would be established and maintained centrally by the State Ministry of Finance. In classifying the arrears, the following information would be considered:

1. Debtor details: the government entity incurring the liability, agency, extra-budgetary fund, or state-owned enterprise.
2. Creditor details: the database should capture the creditor name classified by type: *employees, private individuals, private businesses, financial institutions etc.*
3. Contact Information: the appropriate address for each creditor
4. Arrears owed (Cumulative): the total amount owed as at the date of reporting
5. Effective / Billing date (i.e. Vintage): this should be the original due date on each invoice, or the date when the amount owed fell into arrears.

It will enable classification of the arrears into those overdue by 1-3 months, 3-6 months, 6-12 months and more than 12 months.

6. Amounts settled / part paid: this will indicate how much was previously owed and has been settled.
7. Nature of the debt: this will enable differentiation between various types of arrears, for example, *goods supplied, services rendered, salaries, pensions, gratuities, judgement debt* etc.
8. Contract terms and penalties: this is to record any interest or penalties that are due or may become due on the arrears
9. File reference: this is to provide a unique file/record identifier that can enable the location of primary documents (relevant for the verification)
10. Economic category should be in accordance with the National Chart of Account (NCOA)

2.0 Planned Actions on Arrears Clearance

For the year 2020 and future years of assessment, the State developed a realistic multi-year funding plan for clearing the stock of Arrears, based on realistic estimates of funds available and competing expenditures.

2.1 Earmarked Sources of Revenue: The following are the sources of funding that have been identified for the clearing of domestic debts.

- 1) Internally Generated Revenue (IGR)
- 2) Revenue from Federal Government (i.e made of FAAC allocation including VAT net of deductions.
- 3) Grants (from the Federal Government and other non-governmental organizations i.e World Bank, IMF etc)

4) Loans (State borrowings like Federal Government Loans, CBN development financing programmes, State Bonds, Commercial Bank Loans and Contract Financing)

2.2 Coverage of Expenditure Arrears

The Kano State Government took into consideration a combination of various prioritization criteria which would lead to reduction of domestic arrears stock in the years of assessment.

3.0 Prioritization Criteria for Arrears to be Settled

The Kano State Government has given priority to its Stock of domestic arrears in the following manner:

S/N	Class of Arrears	Criteria	Rationale	Data Required	Amount ₦
1	Contractor's Arrears	<ul style="list-style-type: none"> a) Ongoing Projects 70% b) Completed Projects awaiting payment 30% 	<ul style="list-style-type: none"> a) Ensures ongoing works are completed b) Creditors who have been waiting are paid from the smallest to the largest 	Status of project construction	4,812,705,000.00
2	Pension and Gratuity Arrears	Oldest 10 years and above receives 70% and recent 10 years and below 30% of allocated funds.	Largest injury (in terms of delay) is addressed first	Date missed payment was due	3,629,410,000.00

3	Salary Arrears	Equal percent to all	All staff receive something, regardless of when salary payment was first missed or level of salary.	Amount owed to each staff	108,000,000.00
4	Other types of Arrears	-	-	-	-

3.1 Prioritization Between and Within the Classes of Arrears

A. Prioritization Across Types

Type of Arrears	Total Stock at End of 2019	Criteria for Allocating Among Types	Planned amount to be Cleared in 2020	Actual amount Cleared in 2020	Prioritization Criteria to be applied to arrears within each type of arrears
Contractor's Arrears	36,412,283,708.88	Estimate	4,812,705,000.00	-	Smallest First
Pension and Gratuity Arrears	20,902,704,674.85	Estimate	3,629,410,000.00	-	Oldest First
Salary Arrears	439,696,223.91	Estimate	108,000,000.00	-	Equal Amount

Other types of Arrears	Estimate	1,500,000.00	-	Largest First
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B. Prioritization Within Types

Type of Arrears	Total Stock at End of 2019	Prioritization Criteria to be applied to arrears within each type of arrears	Planned amount to be Cleared in 2020	Actual amount Cleared in 2020
Contractor's Arrears	36,412,283,708.88	Smallest First	4,812,705,000.00	-
Pension and Gratuity Arrears	20,902,704,674.85	Oldest First	3,629,410,000.00	-
Salary Arrears	439,696,223.91	Equal Amount	108,000,000.00	-
Other types of Arrears (FIRS)	-	Largest First	1,500,000.00	-

4.0 Establishment of a Supportive Institutional Mechanism to Clear Arrears

Objectives of the Committee

The Committee would support the AG in its responsibility for accurate recording, verification and reporting of domestic arrears balances across all types. The Committee would ensure that the arrears are adequately classified for prioritization purposes, develop the ACF and produce the State Arrears Recording, Verification and Clearance Report. Its duties will include, but are not limited to, the following:

- Introduction of specific guidelines setting out the roles and responsibilities of individuals and institutions for the recording of domestic arrears. i.e. the roles and responsibilities of each Primary Record Holder (the entity primarily responsible for keeping the records for each type of arrears).
- This will include specific reporting requirements (i.e. the use of agreed recording templates and any supporting schedules) and timelines for submission to the committee (monthly).
- Introduction of specific guidelines setting out the roles and responsibilities of individuals and institutions for the verification of domestic arrears balances. i.e. the role of Internal Audit, Inspectorates, and contracted consultants. This will include reporting requirements (a validated copy of the agreed recording templates and any supporting schedules) and timelines for submission to the Domestic Arrears Committee (monthly).
- The creation, maintenance and regular (monthly) update of an accurate internal domestic expenditure arrears database and the publicly-accessible online version of the database.

- Oversight of the overall recording, verification and reporting processes for domestic expenditure arrears to ensure that they meet the requirements of SFTAS DLI #8 as described in the SFTAS verification protocols.
- Ensure adequate classification of the arrears for prioritization purposes.
- Develop the State's Arrears Clearance Framework (ACF), including policies on prioritization and clearance of arrears.
- Provide accurate monthly, quarterly, and annual reports that present the position for verified domestic arrears and the progress made in implementing the State's ACF.
- Provide data/documentation to support the verification of SFTAS DLI #8, including the State Arrears Recording, Verification and Clearance Report.

4.1 Specific Activities of the Committee

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

- a. Adoption and implementation of records management guidelines for domestic arrears.
- b. Adoption and implementation of verification guidelines for all types of domestic arrears.
- c. Establishment of a consolidated internal domestic arrears database.
- d. Establishment of a publicly-accessible online version of the database.
- e. Reporting of valid and verified domestic arrears to end-users.
- f. Development of the ACF.
- g. Produce the State Arrears Recording, Verification and Clearance Report.

4.2 Supervision and Reporting Arrangements

The Committee will report directly to the State Governor, keeping the State Commissioner of Finance and appointed SFTAS focal persons informed.

4.3 Tenure and membership of the Committee

The Committee will operate in perpetuity and may be disbanded or reconstituted on the directive of the State Governor.

Membership of the Committee will be as follows;

- Commissioner of Finance (Chairman of the Committee)
- State Accountant-General (*Alternate Chair*)
- Permanent Secretary – Ministry of Finance
- Permanent Secretary – Ministry of Budget and Economic Planning
- Chief Executive/Accounting Officer – Pensions Board/Commission
- Chief Executive/Accounting Officer – Debt Management Department (Secretary to the Committee)
- Chief Executive/Accounting Officer – Bureau of Public Procurement / Public Procurement Agency
- State Internal Auditor (Secretary)
- Auditor-General for the State (as observer)
- Others

The Chair of the Committee will be appointed from the members by the State Governor. The Committee will also include the SFTAS focal persons and any other individuals so appointed by the State Governor.

4.4 Committee compensation

[To be determined by the State]

4.5 Committee Secretariat

The Committee shall establish a Secretariat to support its work using existing Staff or Units at the Office of the State Accountant-General.

The work of the secretariat will be funded through the selected institution.

4.6 Powers and authorities of the Committee

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

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

The Committee is to present annual expenditure estimates for its operations within one week of its composition, and thereafter as part of the annual budget process for the selected secretariat institution. The staff complement determined by the Committee for its secretariat should be presented at the same time.

5.0 Monitoring and Reporting for SFTAS on the Domestic Arrears DLI

Given the number of elements and steps to be implemented, the state has decided to regularly (on a monthly basis) monitor and report on the progress of each of the key requirements of DLI #8. The progress would be shared with the *Domestic Arrears Committee*, the SFTAS focal points and the *SFTAS Steering Committee*.

This monitoring and reporting will be done using the template below:

#	SFTAS Domestic Arrears DLI #8 CHECKLIST of Key Steps	Status (Not Started, In Progress, Complete)	Actions to be taken (to complete the key element)	Responsibility (MDA, Dept)	Timeline (Month, Year)
1	Optional: A domestic arrears committee established with clear ToRs and authority				
2	All domestic arrears should be recorded in an internal domestic arrears database that has updated data on the total stock (recommended on a monthly basis)				
3	An arrears verification process is in place and arrears categorized into valid, contested and rejected				
4	A publicly-accessible arrears database online, including the following information:				

<p>(1) total contractors' arrears, total pension and gratuity arrears, total salary arrears; and (2) a list of names of contractors with recognized arrears exceeding 20 million naira</p>				
<p>5 The website supporting the online publicly-accessible arrears database shall contain an electronic link that permits contractors to query/verify their claim</p>				
<p>6 The State Arrears Clearance Framework is established and published online containing: 1) The planned actions to settle arrears; 2) An explicit prioritization of expenditure arrears to be settled</p>				

7	Clearance of arrears is implemented in accordance with the ACF				
8	At least 5% decline in the stock of total domestic expenditure arrears* at end of FY2019 compared to FY2018 (*arrears which have been verified and valid across all categories)				

Signed by:

Ashelmar
28/10/2020

Director Planning, Research and Statistics
(Director in charge of Debt Management)

Mufaz
Accountant - General

Approved by:

[Signature]
Honorable Commissioner of Finance