FINAL REPORT

UNITED REPUBLIC OF TANZANIA

PUBLIC EXPENDITURE REVIEW (PER) STUDY ON THE PREVENTION AND MANAGEMENT OF PAYMENT ARREARS

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November, 2014
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ABBREVIATIONS AND ACRONYMS

AFE  East AFRITAC – East Africa Regional Technical Assistance Centre
AFRITAC  African Technical Assistance Centre, IMF
AGA  Autonomous Government Agency
AGD  Accountant General’s Department
BD  Budget Department
BoT  Bank of Tanzania
CAG  Controller and Auditor-General
CFS  Consolidated Financial Statements
CPO  Central Payments Office
EFT  Electronic Fund Transfer
GoT  Government of Tanzania
HIPC  Heavily Indebted Poor Countries initiative
IFMIS  Integrated Financial Management Information System
IPSAS  International Public Sector Accounting Standards
LGA  Local Government Authorities
LPO  Local Purchase Order
MDAs  Ministries, Departments and Agencies
MoF  Ministry of Finance
MTDS  Medium Term Debt Strategy
MTEF  Medium Term Expenditure Framework
NAO  National Audit Office
NPL  Non Performing Loan
ORT  Other Recurrent Transactions
PAD  Policy Analysis Department
PEFA  Public Expenditure and Financial Assessment
PER  Public Expenditure Review
PFM  Public Financial Management
PFMA  Public Finance Management Act, 2001
PI  Performance Indicator
PMG  Paymaster-General
PMO-RALG  Prime Minister’s Office for Regional and Local Government
PS  Principal Secretary
PSPF  Public Sector Pension fund
RAS  Regional Administration Secretariat
RGoZ  Revolutionary Government of Zanzibar
SOE  State-owned Enterprise
TRA  Tanzania Revenue Authority
VAT  Value Added Tax
VCR  Vote Control Register
In response to a request by the Government of Tanzania, East AFRITAC has fielded a series of technical assistance missions to Dar es Salaam, Tanzania during the period April to September, 2014. The visits have taken place under the auspices of the Public Expenditure Review (PER)¹ and contribute to one of several studies commissioned to address emerging public finance issues. The study team comprised Guy Anderson and Amitabh Tripathi (both East AFRITAC PFM Advisors). Stephen Emasu (consultant) worked extensively on developing a comprehensive questionnaire/checklist to be used by internal audit survey teams in testing the reliability of reported payment arrears data, and also provided the teams with training on preparing for and conducting the survey.

The team benefitted from guidance and clarifications provided by the PER Payment Arrears Working Group especially on the format and expected outcomes from the study. As part of its research the study team met with senior staff from the Budget, Policy Analysis, Internal Audit and Accountant General’s departments of the Ministry of Finance, and the President’s Office - Planning Commission. The team is grateful for the candid discussions held with staff involved in planning, budgeting, procurement, human resource management and accounting functions from the ministries of Education, Health and Works. The mission also met with the finance directors of Tanzania Revenue Authority, TanRoads and the Public Sector Pension Fund (PSPF) to gain insights into specific aspects of payment arrears. The information gained during the courses of all these sessions was valuable in informing the conclusions reached and hence the recommendations proposed.

The study team worked with the internal audit survey teams and appreciates their efforts in applying the questionnaire/checklist and the clear reporting on their findings.² The data gathered through this exercise has been valuable in confirming the completeness and accuracy of reported expenditure arrears information and for identifying associated issues.

Finally, the team is indebted to the late Mr. Allice Matembele and to Mr. Sigsbert Kavishe of the Budget Department of the Ministry of Finance for their diligence in arranging the logistics for the study and survey teams.

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¹ The PER process provides a forum where working groups comprising of representatives from the Government, development partners, academia, the private sector and civil society organizations agree on an analytical agenda, guide and finance its implementation and review all outputs. Its overall objective is to improve fiscal policy formulation and management.

² The surveys covered a sample of ministry headquarters and multiple sites across seven zones.
EXECUTIVE SUMMARY

Expenditure arrears are not new phenomena to Tanzania, but one that has resurfaced and has been escalating over recent years. An expenditure arrear is an obligation that has been incurred by the government for which payment is overdue. Regular reporting by the Accountant General’s Department suggest the scale of government arrears to have increased from TZS 485 billion to TZS 1,301 billion (i.e. from 1.4% to 2.3% of GDP) over the period since December 2010. However, the volume would be even higher if all classes of arrears and all segments of the public sector were reported upon.

Arrears are detrimental to government’s delivery of public services and they adversely impact on the performance of Tanzania’s economy. Due to the re-emergence and rate of growth in the stocks of arrears and their harmful effects, the Public Expenditure Review champions commissioned this study to identify the causes of payment arrears and propose measures to both prevent the future accumulation of arrears and clear the existing stock.

A large and increasing stock of payment arrears was a symptom of a weak public financial management (PFM) environment in the 1990s. A commitment to strengthen the management of public finances led to the launch of an extensive PFM reform program. Key reforms included: a new legal and regulatory framework; a cash budgeting model; and the integrated financial management system (IFMIS). These components, supported by high-level ownership, proved capable of instilling improved fiscal discipline, including constraining the accumulation of new expenditure arrears. The three components remain central to the present day PFM environment.

Whilst the principles of these key components remain relatively sound, the ways in which they are practically applied have degraded over time. The deterioration in their effectiveness has resulted from reduced compliance coupled with the lack of effective enforcement, as well as their slowness in evolving to address new circumstances and challenges. Current practices that have either contributed to or failed to prevent the accumulation of payment arrears exist at each stage in the budget cycle. These include:

- **Budget formulation** – overly optimistic revenue estimates; and under costing of projects and policies.
- **Expenditure commitment** – ineffective commitment controls; non-compliance to laws and regulations; inadequate controls and provisions for multi-year commitments; in-year reductions in appropriations, late notifications of and limited monthly coverage of fund releases.

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3 The figures are based on the aggregate reported government arrears. Reported arrears of over 90 days grew from TZS 315billion (0.9% GDP) to TZS 1,061billion (1.9% GDP) over the same period.
• **Expenditure verification** – IFMIS constraints restricting the capture of invoice and commitment information; and the lack of regular, timely and comprehensive reporting of government liabilities.

• **Payment** – the absence of active cash management practices to counter the in-year seasonality of revenue flows, allow for more even expenditure patterns and ensure payments are made when due.

**The Ministry of Finance has embarked on activities to address several of these weaknesses.** Notably, these include: measures for introducing greater realism to budget formulation especially on assessing the affordability of new capital investments; modifying the IFMIS functionality to improve commitment registration and reporting; and updating the PFM legal framework to clarify the responsibilities for each stage of the budget cycle and define reporting requirements. Ensuring that the benefits from these initiatives are realized—and, amongst others, will be effective in preventing future payment arrears—will require commensurate efforts to both change current practices and to ensure that the changes to IFMIS functionality do not weaken expenditure controls.

**The Ministry of Finance has taken first steps to clear the current stock of arrears.** These comprise: emphasizing in the 2014/15 Planning and Budget Guidelines the priority for Accounting Officers to clear existing arrears before entering into new commitments; including in the 2014/15 budget a provision for clearing arrears and allocating part of this sum during the first quarter; and conducting a sample survey by internal auditors to test the reliability of reported arrears.

**This study recommends additional actions.** These can be broadly categorized as: modernizing the PFM framework; improving the reporting and monitoring of payment arrears; measures to prevent the future accumulation of arrears; and proposals for clearing the current stock of arrears. The recommendations are summarized in Table 1 below and assigned importance as short-term or medium-term according to their relative impact and government’s capacity to implement.

**Table 1: Summary of recommendations**

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<tr>
<td>Modernizing the PFM framework (Section II)</td>
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<td>The MoF proceeds with the concurrent drafting of the Budget and revised Public Finance Bills, including measures to strengthen expenditure control.</td>
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<td>The MoF should update and disseminate the financial regulations and other instructional materials to support the revised legal framework.</td>
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<td>The BD and AGD should jointly monitor/ review the impact of the new IFMIS commitment control functions on budget execution processes.</td>
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<td>The BD and AGD should explore future IFMIS enhancements to support expenditure control.</td>
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<td>The PAD and BD should devise and implement a model of quarterly notifications of payment fund releases.</td>
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<td>The PAD and BD should agree on mechanisms whereby early warnings of shortfalls in revenue collections will result in revised budget scenarios.</td>
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<td>Improving reporting/monitoring of payment arrears (Section III)</td>
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<td>The MoF should issue an updated guideline on the definition and reporting of payment arrears and provide associated training.</td>
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<td>The AGD in consultation with PMO-RALG should issue a similar guideline to its LGAs requiring routine reporting of payment arrears.</td>
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<td>The AGD should expand the quarterly report to analyze the arrears by the different segments of government entities.</td>
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<td>The MoF should prepare a statement of fiscal risks to accompany the budget documentation and include in it risks from payment arrears.</td>
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<td>Individual MDA and consolidated annual financial statements should include disclosures analyzing the aging of the accounts payables.</td>
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<td>The MoF should publish quarterly summary reports on payment arrears.</td>
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<td>Preventing future accumulation of arrears (Section IV)</td>
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<td>The MoF should subject the annual revenue forecasts for independent assessment prior to submitting the annual budget.</td>
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<td>The MoF should further develop its revenue forecasting capacity and expand the role of the independent assessment of revenue forecasts.</td>
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<td>The AGD should issue guidelines and conduct training to MDA finance and procurement staff to ensure that all LPOs are issued through IFMIS.</td>
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<td>The AGD should develop and implement an awareness program and enforcement regime to ensure suppliers only accept IFMIS LPOs.</td>
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<td>The PO-PC should maintain a database of development project contracts which commit government funds in future years against the MTEF.</td>
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<td>As part of the budget documentation, Parliamentary approval should set amounts which can pre-commit project funds for MTEF outer years.</td>
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<td>The Ceilings Committee should renew attempts to introduce monthly fund releases for a rolling three month period, by piloting with 5 MDAs</td>
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<tr>
<td>The Ceilings Committee should extend the pilot exercise and issue monthly fund releases for a rolling three month period to all MDAs.</td>
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<tr>
<td>The MoF should agree on the establishment and mandate for a strengthened cash management unit.</td>
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<tr>
<td>The MoF should develop cash management capacity.</td>
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<tr>
<td>Clearing the current stock of arrears (Section V)</td>
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<tr>
<td>The Government should finalize and publish its arrears clearance strategy and timeframe. The recommended strategy includes components for stocktaking, verification, classification, prioritization and liquidation.</td>
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<tr>
<td>The Government should clear the stock of arrears in accordance with its published strategy and timeframe.</td>
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I. INTRODUCTION

1. The Government of Tanzania (GoT) is concerned at the scale of payment arrears, the rate at which they have been accumulating and their negative impacts. Quarterly monitoring of arrears by the Accountant General’s Department (AGD) indicate that payment arrears have risen from TZS 485 billion to TZS 1,301 billion over the three and half years to June 2014 (equivalent to an increase from 1.4% to 2.3% of GDP).\(^4\) The GoT recognizes that persistently large and growing stocks of arrears distort the planned implementation of the budget notably due to the costs of punitive late-payment penalties and additional interest charges, and demands to divert funds from planned activities to settle the arrears.

2. The GoT has no clear policy or mechanism to tackle the escalating problem of payment arrears. Regular reporting and monitoring forms a good first step. However it acknowledges that there is no clear definition of what constitutes arrears and no regular processes to verify the reliability of the reported data.

3. Accordingly, the GoT commissioned East AFRITAC to conduct a study to identify the causes of and recommend measures to prevent future arrears. The study is one of several being carried out under the auspices of the Public Expenditure Review and dealing with emerging public finance issues. Annex 1 provides the detailed terms of reference for the study. Its objectives include:

- Establishing the level and sources of payment arrears;
- Identifying the challenges facing government in ensuring the timely settlement of its payment obligations;
- Proposing options for clearing the current stock of payment arrears; and
- Making recommendations for preventing the recurrence of payment arrears.

4. The study has concentrated on the arrears incurred by budgetary central government. This is consistent with the coverage of available reports. In particular, it has not considered the liabilities of:

- Local governments – Tanzania has 161 local government authorities that report to the Prime Minister’s Office for Regional and Local Government (PMO-RALG). Their financial management operates under the Local Government Finances Act and relies on similar IFMIS software and cash budgeting models. Financial data on payment arrears is not shared with the AGD.

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\(^4\) Figures extracted from the quarterly AGD reports based on total arrears. GDP figures for 2010 and 2014 are based on MOF calculations of TZS 34,913 billion and TZS 55,559 billion, respectively.
• **The Revolutionary Government of Zanzibar** – the RGoZ shares with the mainland a similar underpinning legal, IFMIS and cash budgeting framework. Some of the findings of this study may therefore be equally applicable to Zanzibar.

• **State owned enterprises** – the accumulation of arrears by state owned trading enterprises (such as TANESCO) poses a fiscal risk to the government. Whilst they may represent implicit contingent liabilities they have not been included as part of the GoT stock of payment arrears.

• **Government liabilities to pension funds** – amounts payable in respect of pension benefits accrued by government employees to 1999 (when the pension administration was transferred) will be substantial. However, actuarial valuations of the accrued benefits that remain subject to agreement and scheduling for payment are not included. It is expected that these would be covered in the two PER studies on contingent liabilities and pensions.

5. **Three deliverables are expected from the study.** These comprise: (i) an inception report demonstrating the study team’s understanding of the requirements and illustrating its approach; (ii) a draft report on the findings and recommendations to be presented to a broad group of stakeholders; and (iii) a final report, incorporating the stakeholder feedback. The inception report was presented to the PER Working Group in April 2014. The draft report was considered by a technical meeting on 4th November and has been updated to take account of stakeholder feedback and comments made during the technical meeting.

6. **This document represents the final report on the study’s findings and recommendations.** Following this introductory section, it is structured as follows:

• **Section II: The impact of accumulated payment arrears** – identifies the actual and potential impacts on Tanzania. It proceeds to illustrate the impact and possible solutions through international case studies.

• **Section III: The PFM environment** – considers the legal/regulatory framework, IFMIS and the cash budgeting model and the extent to which they support good commitment and expenditure control, and the level of compliance.

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5 BOT Economic Bulletin for quarter ended March 2014 reports the RGoZ to have TZS 16.2 billion as payment arrears, mostly relating to pension gratuities and suppliers for goods and services.

6 IMF Staff; Arrears owed by TANESCO for supplies of natural gas and electricity estimated at TZS 456 billion at March 2014.

7 During discussions on the inception report it was agreed that an additional activity was necessary to test the reliability of the reported arrears data—this activity was to be carried out by GoT survey teams visiting a sample of institutions and assessing the accuracy of reported arrears as at 30th June, 2014—with additional study deliverables of a survey audit program, training of the survey teams and analysis of the results.
II.  CONSEQUENCES OF PAYMENT ARREARS

7.  Many countries have suffered from accumulating expenditure arrears. Examples can be drawn from within the East Africa region as well as from elsewhere in Africa, South America and Asia. The problem is less prevalent at the national level in OECD countries, though has occurred at sub-national levels of government. This section identifies the consequences of payment arrears, drawing on international examples and summarizing the impacts from country surveys.

8.  Tanzania has experienced adverse impacts from payment arrears. Specific examples were cited by the ministries that met with the study team. Others have been noted in the CAG report and the ToRs for this study. Tanzanian specific impacts include:

   •  **Late payment penalties** – contracts generally provide for punitive interest charges on invoiced amounts that are not settled within the allowed timeframe. The penalties are legally enforceable. They add to the cost of the contract.

   •  **Diversion of resources** – for instance the 2014/15 budget circular recognizes that arrears will be carried forward from the previous year and requires that these be settled as first call on the new budget – thus diverting resources from the planned 2014/15 activities.

   •  **Increased fiscal deficit and domestic borrowing** – inclusion of the increased stock of payment liabilities into the cash-basis calculation of the fiscal performance increases the deficit and the stock of domestic debt.

9.  **Box 1 provides specific regional examples of the impact of arrears on the economy.** The example draws on the case of Ghana which had amassed a sizable stock of expenditure arrears comprised of overdue payments to private contractors for road and
non-road projects, wages arrears, arrears to statutory funds, and contingent liabilities associated with SOE’s debts.

**Box 1: Impact of arrears on economic activity – Ghana example**

The Ghanaian economy was confronted with sizeable government expenditure arrears which rose to 8.4% of GDP by the end of 2009. It was assessed that they acted to stifle private sector activity and burden the banking sector, as follows:

- **Impact on private sector** – the risk of job losses and weakened tax compliance, through: businesses cutting back on employment, or going bankrupt due to arrears; loss of jobs that are not easy to rebuild; knock-on effect of pushing other sound businesses into troubles; and reduced tax collections due to businesses withholding tax payments or finding means to avoid paying tax.

- **Impact on the banking system** – as banks provided credit to companies owed by the government they bore the brunt of the problem. The rise in non-performing loans (NPL) left banks unable to extend credit to new customers. Credit growth to private sector contracted in real term in 2010, not only due to the global financial crisis but also because of tightened credit conditions arising from the rise in NPLs—of which the regulatory body estimated that the direct and indirect government related NPLs would be more than 46 percent of the total NPLs and 20% of bank loans. To offset the risks of non-recovery, banks were likely to pass the cost of arrears onto other private borrowers by adding a premium to their lending rate.

(Source: IMF staff)

10. **The country-specific examples are expanded upon by broader international experiences.** These confirm that the accumulation of expenditure arrears can have a serious negative effect on the domestic economy. A large flow of arrears may disguise the true size of the fiscal deficit and can significantly reduce the contribution that fiscal policies make to controlling aggregate demand and achieving macroeconomic stabilization goals. Moreover, arrears point to inconsistencies among expenditure commitments, revenue receipts and access to financing. Box 2 summarizes the economic impacts drawn from across a broad range of countries.

**Box 2: Economic impact of chronic arrears accumulation**

The economic consequences of persistent arrears accumulation by governments can include the following:

- **Reduced economic growth** – payment arrears imply a liquidity problem in the economy. Where businesses are dependent on government contracts, payment arrears can lead to reduced activity as a result of payment delays, or impose difficulties in businesses accessing credit from commercial banks, resulting in a reduced pace of economic activity and increased unemployment.

- **Increased cost of service provision** – government suppliers will mitigate the risks and opportunity cost of delayed payments by adjusting their prices upwards.
• **Reduced or interrupted public service delivery** – increased costs and diversion of resources to settle previous arrears will force governments to reduce the amount of supplies purchased or volume of services delivered. Some public services/projects may be halted where providers of essential services/materials suspend supplies.

• **Increased rent seeking** – the risk of rent-seeking and collusion between government and suppliers increase as the latter seek to accelerate payment or circumvent expenditure controls.

• **Increased interest rates** – illiquid suppliers may try to bridge the delay in payment by borrowing from banks, adding pressure to credit markets and driving up interest rates with adverse consequences for monetary policy.

• **Reduced confidence in fiscal policy** – payment arrears disguise the size of the government’s true fiscal deficit and debt. When these become apparent the impact on government’s financing costs can even become larger.

• **Second-round fiscal costs** – as government suppliers suffer from liquidity shortages there will be a knock-on effect from lower profits, reduced employment and falling confidence in government. Suppliers may also reduce or withhold payments of taxes and social security payments to offset the delays in receiving amounts owed to them by government.

(Source: Flynn and Pessoa; IMF Technical Guidance Note, 2014)

11. **In addition to macroeconomic consequences, suppliers may impose other restrictions on doing business with government.** Such measures might include requiring payment in advance of delivering goods or services, limiting quantities supplied, and demanding that invoices for past supplies be settled prior to more deliveries. Uncertainty on the settlement of invoices may result in only large suppliers with adequate financial capacity agreeing to work with government.

### III. The PFM Framework

12. **This section reviews key components that underpin the Tanzanian PFM operations.** It concentrates on: (i) the PFM legal and regulatory framework; (ii) the integrated financial management system (IFMIS); and (iii) the fund release mechanism. It starts by looking backwards at how the introduction of these three components was instrumental in instilling fiscal discipline. It then turns to the modern day, and examines the efficacy of these components in meeting the expenditure management challenges that Tanzania currently faces.

#### A. Background

13. **In considering the current issues around payment arrears, it is appropriate to understand the historical context.** In particular, events during the past two decades leading up to and resulting from the introduction of PFM reforms. During the years prior to 1995 public financial management was characterized by the lack of expenditure
controls, inadequate tax administration, and the suspension of financial support from multilateral and bilateral donors. Combined, these factors led to large fiscal deficits which were financed by the Bank of Tanzania (BoT) with consequent declines in international reserves and rates of inflation exceeding 30% per annum.\(^8\)

14. **From 1995 Tanzania introduced measures to improve its management of public finances.** Notable amongst these were: (i) the adoption of a cash budgeting policy in 1996 whereby expenditures only take place once the means of financing have been secured; (ii) the introduction of a new integrated financial management system (IFMIS) commenced in 1998 to better control expenditures, enable the re-centralization of payments and reduce the risk of accumulating payment arrears; and (iii) the promulgation of a new Public Finance Act and its associated regulations in 2001 as a means to codify the revised practices and reinforce the importance of fiscal discipline across government.\(^9\) These three components continue to underpin Tanzania’s present PFM environment.

15. **At March 2001 payment arrears estimated at TZS 80 billion (US$90m) was owed to suppliers.** Reportedly, these arrears partly resulted from the financial discipline and constraints imposed by the new cash budgeting system. Additionally there were arrears in repayment of domestic principal of TZS 29.5 billion (US$34 million), external principal of US$ 1.4 billion and external interest of US$1.1 billion.

16. **By 2004 it was reported that payment arrears had been virtually eliminated.**\(^10\) During the intervening years the government had benefitted from the Highly Indebted Poor Countries (HIPC) initiative and a multi-donor fund to liquidate arrears. The success was also attributed to the introduction of the IFMIS—as part of its implementation a commitment control system was introduced under which an IFMIS-generated local purchase order (LPO) was required for the purchasing of goods and services. Under the cash budgeting system quarterly fund releases were made to the priority sectors and monthly releases elsewhere. The LPOs could only be issued through the IFMIS, subject to sufficient allocated funds, and thus the accumulation of arrears was restricted to expenditures not requiring LPOs (e.g. utilities, rents, staff claims).

17. **Controls were also introduced to prevent the arrears of utility payments.** These comprised three initiatives: (i) blocking the budget allocations for utility payments, preventing their diversion to other expenditure items; (ii) requiring reallocation of budgets to utility accounts where shortfalls occurred; and (iii) quarterly monitoring of

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\(^9\) The PFM reform program contained other capacity building activities, including the establishment of the Tanzania Revenue Authority.

\(^10\) Public Expenditure Management country Assessment and Action Plan; World Bank and International Monetary Fund; July 2004.
utility payments due and cross-checking the balances to the accounts of the utility suppliers. Reportedly, these measures reduced the level of outstanding utility payments (not all of which would in any case be considered as arrears) to less than 0.8% of the domestically funded recurrent budget.

18. **The situation since 2002/03 is reflected in the findings of public expenditure and financial assessments (PEFAs).** The Tanzanian central government has undergone three PEFAs at four yearly intervals (i.e. in 2005, 2009 and 2013). The PEFA scores reflect performance evidenced during the three financial years preceding each assessment and the latest available balances. Subject to minor variations in the definitions of measures, the PEFA scores are comparable over time and provide Tanzania with useful indicators of its improvements in key PFM areas. Table 2 shows scores against the performance indicator for managing payment arrears (i.e. PI-4). It also contains the scores for performance indicators designed to measure budget reliability (PI-1, PI-2 and PI-3) and the use of commitment controls (PI-16 and PI-20).

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<thead>
<tr>
<th>PI</th>
<th>Feature</th>
<th>2005</th>
<th>2009</th>
<th>2013</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Aggregate expenditure out-turn compared to original approved budget</td>
<td>A</td>
<td>→ A</td>
<td>↓ B</td>
</tr>
<tr>
<td>2</td>
<td>Composition of expenditure out-turn compared to original approved budget</td>
<td>D</td>
<td>→ D</td>
<td>↑ D+</td>
</tr>
<tr>
<td>3</td>
<td>Aggregate revenue out-turn compared to original approved budget</td>
<td>A</td>
<td>↓ C</td>
<td>→ C</td>
</tr>
<tr>
<td>4</td>
<td>Stock and monitoring of expenditure payment arrears</td>
<td>A</td>
<td>↓ C</td>
<td>→ C</td>
</tr>
<tr>
<td>16</td>
<td>Predictability in the availability of funds for commitment of expenditures</td>
<td>A</td>
<td>↓ C+</td>
<td>↓ D+</td>
</tr>
<tr>
<td>20</td>
<td>Effectiveness of internal controls for non-salary expenditures.</td>
<td>A</td>
<td>↓ C+</td>
<td>↓ D+</td>
</tr>
</tbody>
</table>

19. **Analysis of the PI-4 score suggests deterioration in the control of payment arrears over the period since 2005.** The table also indicates strong correlations between the levels of payment arrears and with both the use of commitment controls and budget reliability (where those latter scores reflect under-performance of revenue collections and significant budget reallocations). The remainder of this section assesses how the roles and application of the PFM legal framework, IFMIS and cash budgeting model have contributed to the weakened performances as assessed by these PEFA indicators.

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11 PEFAs were developed to assess essential PFM systems by providing a common pool of information for the measurement and monitoring of PFM performance progress.

12 It should be noted that over the same periods other PEFA performance indicators have improved. Also, although PEFA scoring is designed to be evidence-based, assessments may be partially subjective.
B. The PFM legal framework

20. The PFM legal framework defines the processes and responsibilities for budget execution and expenditure management. In Tanzania, the framework is comprised of several pieces of legislation. Critical amongst these for budget execution are: the Public Finance Act of 2001 (as updated in 2004 and 2010) and its supporting regulations; and the Public Procurement and Disposal of Property Act of 2004.13

21. For budget execution, the framework is characterized by the decentralization of expenditure management to individual spending agencies. Accounting Officers (generally the Permanent Secretaries or agency heads) are appointed for each spending agency and assigned responsibility for the proper use and control of appropriations. They are: permitted to commit released funds, verify invoices and authorize payments; required to prepare budgets, procurement plans and reports on budget execution and performance; and accountable to the parliamentary Public Accounts Committee.

22. The principles governing expenditure management are codified within the legal and regulatory framework. In particular, the laws set forth the roles and responsibilities of key actors and institutions. These include:

- **National Assembly**: has the exclusive right to authorize public expenditure, through approval of annual Estimates of Expenditure and enactment of Appropriation Acts. It receives and considers the Controller and Auditor-General’s (CAG) report on the annual financial statements.

- **Controller and Auditor-General**: issues Grants of Credit to the Paymaster-General confirming amounts that may be withdrawn from the Consolidated Fund. The CAG examines, inquires into, audits and then reports to the Minister for Finance on the annual financial statements.

- **Minister for Finance**: Assigned overall responsibility for ensuring the control, management and supervision of public finances. May withdraw, limit or suspend any warrant issued by the Paymaster-General where such action is justified by financial exigencies or public interest. He receives the CAG report on the annual financial statements and must promptly submit it to the National Assembly.

- **Permanent Secretary to the Treasury and Paymaster-General**: appoints Accounting Officers and controls the issue of public moneys to ministries and departments of the Government. Subject to having received Grants of Credit he authorizes, by warrant addressed to the Accountant-General, withdrawals from the Consolidated Fund.

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13 Additional PFM legislation includes: The Loans, Grants and Guarantees Act; The Private-Public Partnership Act; The Public Audit Act; The Local Government Finance Act; The annual Finance Acts; and various Acts establishing public corporations.
**Accountant General:** is responsible for the settlement of bills, accounts and other charges on behalf of Accounting Officers, and the management of cash resources. He may not make any payment or accept a charge on the accounts unless authorized by warrant to do so. He prepares and submits to the Minister and CAG the consolidated annual financial statements.

**Accounting Officer:** controls and is accountable for the expenditure of money allocated to a vote by an Appropriation Act. He may not incur any commitment or expenditure unless and until authorized by Warrant to do so. He prepares and submits to the Accountant-General and CAG annual accounts in respect of the vote(s) for which he is responsible.

23. **These principles remain reasonably sound in setting out the delegation of authorities to spend and requirements for reporting on how resources have been used.** They seek to ensure that moneys can only be spent and commitments incurred up to amounts and for the purposes approved and authorized. In turn, they require full reporting on the receipt and application of funds and the balances held.

24. **However, shortcomings in the legal and regulatory framework hinder the effectiveness of Tanzania’s expenditure management.** For instance, the framework: does not adequately cover the entire budget cycle; contains cases of conflicting requirements and ambiguities; refers to outdated practices and tools; and lacks appropriate sanctions for non-compliance. Examples include:

- **Incomplete coverage:** the law does not include processes that will ensure credible budget formulation, the setting of fiscal rules or the consideration of fiscal risks; it does not define clear rules for changes to the appropriation or budget virements; fiscal reporting is essentially annual reporting with no requirements for in-year reports, disclosures on payment arrears or the publication of reports; makes no provisions for medium term expenditure frameworks or ceilings for multi-year commitments; and does not require a cash management and fund release framework that supports the smooth execution of the budget.

- **Potentially conflicting or ambiguous requirements:**
  - **Article 8** requires an Accounting Officer to control and be accountable for the expenditure of money applied to that vote by an Appropriation Act, whereas **Article 17(3)** restricts an Accounting Officer to incur a commitment or expenditure unless authorized by a Warrant and **Article 19** includes provisions for the retrospective approval of excess expenditures.

  - **Regulation 85(3)** requires expenditure chargeable to the account of a given year to be met within that year and not deferred, whereas **Regulation 91(2)** allows liabilities from one year to be charged in the Vote Control Register (VCR) for the next.
The unit of appropriation is unclear. Regulation 41(6) states that the National Assembly approves expenditure by Head but controls it by item.

- **Outdated references:**
  - Regulation 53(1) requires that the Government account shall be kept on a cash basis enabling comparisons with the amounts authorized by the National Assembly. Regulation 56(1) further requires the cash basis of accounting to be used for the control of payments for the normal activities of MDAs.
  - Regulation 91 requires an Accounting Officer to maintain a VCR whereas the regulations make no reference to the IFMIS as the primary ledger or performing the role of VCR, or require reconciliation between the VCR and IFMIS.
  - Various requirements exist for paper-based warrants – these fail to exploit the efficiencies of electronic workflows.

- **Sanctions for non-compliance:** Article 10 allows for penalties and surcharges and Article 44 defines offences against the Act, but neither is specific on institutional or personal sanctions where funds have been over-committed or overspent.

25. **These shortcomings combine to undermine the legally binding expenditure control principles intended by the framework.** The strengthening of these and other elements of the PFM legal framework are currently being considered by government teams drafting two complementary bills: (i) a revised Public Finance Bill; and (ii) a Budget Bill. A recent IMF/FAD mission assisted in proposing the scopes, outlines and action plan for finalizing the bills during this financial year. The proposals from that mission are far broader than expenditure control but include measures to prevent and manage expenditure arrears. Box 3 summarizes its recommendations.

**Box 3: Strengthening the legal framework – IMF/FAD recommendations**

**Macro-economic and fiscal policy:** The Budget Bill should require the government to: (i) set out fiscal policy objectives; (ii) publish its medium-term macroeconomic and fiscal framework twice per year; and (iii) publish analysis of fiscal risks.

**Budget formulation:** The Budget Bill should establish: (i) the budget calendar and process in law; (ii) institutions and procedures for Parliamentary scrutiny; (iii) institutional coverage of budget information; (iv) the unit of budget appropriation; and (v) robust rules for in-year changes to appropriations.

**Budget execution:** The Budget Bill and Public Finance Bill should together establish: (i) a cash management framework that enables a smooth execution of the budget and provides a legal backing to the Treasury Single Account; (ii) the legal basis for an improved budget release system.

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14 Tom Josephs; Towards a Comprehensive Legal Framework for Public Financial Management; IMF/FAD; September 2014.
and tighter commitment controls avoiding accumulation of payment arrears; and (iii) rules to govern the retention of revenues.

**Accounting and audit:** The Public Finance Bill should establish: (i) the basis of accounts and audit and their compliance with international standards; (ii) the publication of in-year financial reports and the comprehensiveness of their coverage; and (iii) clarify the role of internal audit.

**Oversight of the general government and state-owned enterprises:** The two laws should establish: (i) submission of financial and budget reporting from these sectors; (ii) the MoF’s oversight powers, including approval of borrowing and enforcement of sanctions; and (iii) coordination in this area between the MoF, line ministries and the Treasury Registrar.

### C. IFMIS functionality

26. **The IFMIS is based on a commercial-off-the-shelf software package customized to meet the government’s requirements.** A standard IFMIS configuration is implemented at all central budgetary MDAs. Its primary uses include budget execution, payments and reporting. Since its introduction the IFMIS has undergone several version updates and other enhancements to add functionality. The same software platform, albeit with a slightly different configuration, has been progressively rolled-out to local government authorities (LGA). Amongst others, the IFMIS has benefitted the completeness and timeliness of fiscal reports, the efficiency of payment processes and the tracking of transactions. However, challenges remain.

27. **IFMIS challenges to managing expenditure arrears can be classified under two groupings.** These concern (i) the ability of the IFMIS to generate comprehensive reports on expenditure arrears, and (ii) its ability to limit future arrears. The limitations that existed to end-June 2014 are described below:

**Reporting Limitations:**

- **Predominantly cash-based government reporting.** Information on accounts payable (i.e. invoices received and verified) are not systematically registered in IFMIS. Registration has tended to take place only when funds have been allocated to effect payment.

- **Captured invoice information is incomplete.** The IFMIS did not capture the invoice and payment due by dates. Reporting of the aged analysis of the accounts payables has not been possible through the IFMIS.

- **IFMIS coverage.** The IFMIS is used by the central government budget agencies whilst a different configuration of the same software platform is used by local governments. The two versions do not share information. Additionally, there are a large number of autonomous agencies, funded through the central budget and with the potential to incur arrears, who are not IFMIS users.

- **Consolidation.** The consolidated financial statements are limited to budgetary central government MDAs. They do not consolidate the flows and stocks of
controlled “general government” autonomous agencies or include information on local government flows and balances.

Prevention limitations:

- **Commitment controls.** The purchasing module restricts the issuance of local purchase orders (and commitments) to the availability of released funding. IFMIS validation of funds availability prior to the issuance of orders has been routinely circumvented.

- **Lack of functionality for multi-year commitments.** There had been no functions for committing contracts with long lead-in times except against the released annual funds, and are no functions for recording contracts where disbursements span several years.

- **Does not provide a central repository on outstanding contracts.** Information on contracts is dispersed over multiple executing agencies. It is not possible for the central finance agencies to validate budget requests via the IFMIS.

28. **An ongoing priority PFM reform is the introduction of accrual international public sector accounting standards (IPSAS).** As evidenced by the National Audit Office (NAO) reports, whilst issues remain steady progress has been achieved in incrementally recognizing or disclosing accrual information—at both individual MDA and consolidated levels of reporting.

29. **Functional enhancements have been introduced to the central government IFMIS since June 2014.** These address several of the limitations discussed above and advance the IFMIS capacity to disclose information on accrued liabilities. In particular, the enhancements allow LPOs to be issued and invoices registered against uncommitted approved budget, whilst only allowing payments against the allocated released funds. The capture of the invoice details now includes the invoice and payment due by dates.

30. **These changes should enable improved reporting on commitments and payables.** They also remove many of the obstacles that discouraged MDAs from issuing LPOs through IFMIS. However, the enhancements change the nature of the fund releases—and tends to support the current practices—in that they will no longer restrict the level of commitments but only the payments.

31. **The IFMIS enhancements introduce a risk that commitments allowed in IFMIS may exceed the availability of funds, creating new arrears.** The implementation of the enhancements will need to be carefully managed to ensure that: (i) all LPOs and commitments are initiated and registered in the IFMIS; (ii) allowing commitments against the full appropriated budget does not compromise the achievement

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15 The annual general report of the CAG on the financial statements of the central government (MDAs) for the year ended 30th June, 2013.
of fiscal targets; and (iii) in-year monitoring and annual financial statements can be produced on the same (cash/modified cash) basis as the approved budgets. Success will be dependent on less technical factors and in particular: the credibility of the budget and its ability to absorb in-year shocks; reliable cash forecasting and the use of active cash management techniques; and a cultural change whereby MDAs respect the IFMIS controls.

D. Cash budgeting

32. Tanzania’s cash budgeting form of budget execution is a top-down process focused on ensuring that the fiscal deficit is not exceeded and priority expenditures are met. A number of institutions and the following steps are involved:

- **Determination of cash envelope**, the Policy Analysis Department (PAD) calculates the aggregate cash availability for the period based on inputs from Tanzania Revenue Authority (cash collections), AGD (releases and payments to date, commitments, balances), and BoT (borrowing and bank balances). The PAD maintains the overall cash plan and acts as secretariat to the Ceilings Committee.

- **Identification of priority expenditures**, the PAD and Budget Department identify the first calls on the aggregate cash envelope. These include: debt servicing; payroll and pensions; social net and special expenditure items (e.g. examination fees, drugs and medicines, prisoner food and grant transfers). The residual is available for other recurrent transactions (ORT, goods, services, travel, claims, utilities, capital investments, transfers etc) and domestic funding of development projects.

- **Approval of cash budget for period**, based on recommendations from BD/PAD, the high-level Ceilings Committee approves amounts to be released for the specific priority items and on the balance to be distributed for ORT and development projects.

- **Division of cash budget for period**, the Budget Department agrees on the lump sum (i.e. per vote and per major expenditure class) distribution of the ORT and project amounts. The distributions are based on MDA procurement and cash plans and an assessment of prioritization, subject to the aggregate distributions being constrained by the approved budget and cash budget for the period.

- **Funds released in IFMIS**, the AGD formally notifies each Accounting Officer of the funds that have been released for the period and enters the lump sum releases to the IFMIS. Simultaneously cash funds are transferred from the Exchequer Account to the respective operational bank account.

- **Detailed allocation of released funds**, the MDA finance staff allocates, in the IFMIS, the released funds to individual cost centers, projects and economic items. Generally, allocation is in accordance with decisions reached by internal
management meetings. The allocation enables commitments and payments to be registered in the IFMIS.

33. **These steps can be effective in both managing the fiscal deficit and preventing arrears.** However achieving these objectives would require: reliable annual estimates of revenues and expenditures; realistic in-year forecasts of revenue inflows, procurements and payments; active cash management that uses available tools to level cash flows; predictable and timely releases of funds for procurements and payments; and fiscal discipline that ensures all procurements are promptly registered in IFMIS and constrained by the budget.

34. **Whilst it may be argued that the cash budgeting process has helped to limit the fiscal deficit, it has failed in recent years to prevent the accumulation of payment arrears.** As previously indicated, the introduction of cash budgeting succeeded in containing spending within available funds and without the accumulation of new arrears. These benefits have not been sustained. Recent trends include escalating payments arrears which, in turn, imply additional domestic borrowing and breaches in the fiscal deficit targets. Contributing factors have included:

- **Over optimistic revenue estimates** – revenue collections have persistently underperformed against the approved estimates. Rather than developing a fresh budget scenario based on revised revenue assumptions, cash budgeting has been relied upon to restrict fund releases to the available cash.

- **Unrealistic expenditure forecasts** – MDAs are required to submit annual procurement and cash plans. These are based on the approved budget; are not frequently updated; and do not clearly differentiate between the timings of funding to enable procurements and the settlement of invoices arising from those procurements.

- **Unpredictability of fund releases** – uncertainty in the amounts, the timing of the releases and their limited monthly coverage discourages effective planning for service delivery.

- **Commitments allowed outside of IFMIS** – the general practice has been for contracts and local purchase orders to be issued outside of the IFMIS. Data entry tasks to allocate released funds to cost centers and items, to register commitments in IFMIS and to authorize payment vouchers are performed simultaneously. The fund release mechanism restricts payments but not manually issued commitments.

- **Passive cash management** – there is little coordination between cash and debt management, and little use of cash management tools (e.g. treasury bills) to level out the in-year and seasonal fluctuations in revenue streams.
35. **Previous technical assistance reports have suggested amending the cash budgeting and cash management practices.** Their recommendations have included the introduction of: rolling quarterly fund releases; more frequent updates to the government cash plan; rigorous commitment controls in IFMIS; greater cash management capacity; the progressive use of active cash management tools; and an extended treasury single account and modern payment methods. Whilst improvements in the banking arrangements have occurred, the other recommendations have not yet been implemented but remain relevant.

36. **The suitability of the current cash budgeting model needs to be critically appraised.** In the narrowest sense it should be re-assessed for its appropriateness in protecting the fiscal deficit, ensuring the financing of priority expenditures and preventing the accumulation of future payment arrears. In the broader context the model needs to be examined for its ability to support emerging PFM reforms and their underlying objectives of improving service delivery. In particular, the model should clearly support:

- The trend towards performance budgeting and increased accountability for delivering results - outputs and outcomes.
- Government’s planned transition from the cash to accrual basis of reporting.

### E. Conclusions and recommendations

37. **The nature and magnitude of payment arrears suggests systemic weaknesses in the current PFM framework.** Its underpinning legal, IFMIS and cash budgeting components need to be updated and their proper applications enforced. Until there is a track record of credible budgets there may be a need to retain a cash budgeting approach, but one with greater predictability on future releases. The recently announced changes to the IFMIS will advance fiscal reporting and the adoption of IPSAS accrual but may weaken commitment controls—the IFMIS needs to be capable of limiting commitments and supporting the execution of a cash basis budget. Specific recommendations are:

**PFM legal framework**

**In the short term:**

- The MoF proceeds with the concurrent drafting of the Budget Bill and revised Public Finance Bill to expand the coverage of the PFM legal framework, remove conflicting and ambiguous requirements, codify existing and intended PFM practices, and strengthen the provisions for enforcement.

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16 Guy Anderson; Cash management and Banking arrangements; IMF/East AFRITAC; March 2012. Abdul Khan; Improving Preparation, Execution and Reporting of the Budget; IMF/FAD; April, 2011. Stephen Mayes; Cash Management and Government Banking Arrangements – Next Steps; IMF/East AFRITAC; June, 2009.
In the medium term

- The MoF should update and disseminate the financial regulations and other instructional materials to support the revised legal framework.

IFMIS functionality

In the short term:

- The AGD and BD should jointly monitor and review the impact of the new IFMIS commitment control functions on budget execution processes.

In the medium and longer terms

- The BD and AGD should explore future IFMIS enhancements which would enable:
  
  o Elements of the approved budget to be “reserved” and not available for commitment until financing is secured, and then “de-reserved”;

  o Outer year commitments to be approved against MTEF provisions; and

  o Fund availability controls being exercised at an economic group level (rather than by line items) as a means to support the program budget approach, reduce the volume of reallocations, and encourage earlier allocation of released funds.

Cash budgeting

In the short term:

- The PAD and BD should devise and implement a model of quarterly notifications of payment fund releases; and

- The PAD and BD should agree on mechanisms whereby early warnings of significant shortfalls in revenue collections will result in the communication of revised budget scenarios.

IV. REPORTING ON PAYMENT ARREARS

38. **Government payables and payment arrears are reported in several publications.** Notably: (i) arrears data are collated and reported as part of a regular function of the AGD; (ii) central government payables are included in the annual consolidated financial statements; (iii) figures on the consolidated central government and local government arrears are noted in the National Audit Office’s (NAO) reports on the respective financial statements; and (iv) a special internal audit exercise to verify the end-June 2012 payment arrears was undertaken.

39. **The figures for arrears contained in the various reports lack consistency.** Consequently, they raise doubts as to the reliability of the reported levels of arrears and
distract attention from addressing the root causes of accumulating arrears. Brief commentary and analysis of the four reports follows.

A. AGD quarterly/monthly reporting

40. The AGD has been collating quarterly information on payment arrears since December 2010. This provides the most frequent assessment and indicates the trend in the size and composition of the overall stock of arrears. Circulars requesting the information are sent to all Accounting Officers. They provide a standard template for summarizing liabilities by period (e.g. 30 days or less; between 30 and 60 days; between 60 and 90 days; and more than 90 days) and by broad expenditure category (e.g. supplies; utilities; office rent; construction works; and staff claims). Data are now collected on a monthly basis with consolidated quarterly reports being shared with other MoF departments, the BoT and the IMF.

41. Figure 1 illustrates the trend in total reported arrears since September 2012 categorized by age. The chart shows:

- The high proportion of arrears of longer than 90 days - Excepting the quarters ending in June and September 2013, more than 70% of the reported arrears are in the 90+ days category. More recently, for the quarters ending March and June 2014, this age group accounts for more than 80% of reported arrears.

- Unexplained growth in the longer aged arrears – In four of the eight quarters the volume of 90+ day arrears has increased by far more than the reported 60-90 day arrears from the previous quarter. Accrued penalties and interest in the quarter on the stock of 90+ day arrears will not explain the difference. The levels of reported less than 90 day arrears provides no early warning of accumulating systemic arrears.

These factors also question the consistency and reliability of the reported arrears and particularly the completeness of the reporting on the expenditure arrears of less than 90 days.

Figure 1: Reported expenditure arrears, analyzed by age
42. **Figure 2 illustrates the level of reported 90+ day arrears.** Over the three and half year period it shows an upward trend in arrears (albeit with dips in the fourth quarters of the past three years), and a growth more than doubling each category during 2013/14. The chart is limited to the longest aging period as being indicative of the systemic arrears (as opposed to delays caused by invoice and payment processing times). At the end of June 2014 the stock of 90+ day payment arrears amounted to TZS 1,061 billion (1.9% GDP).

**Figure 2: Payment arrears of 90+ days – trend since December 2010**

43. **Payment arrears are evident in each expenditure category.** Figure 3 analyzes the 90+ day stock of payment arrears as at June 2014. It shows that arrears arising from construction works and goods and services account for 57% and 29% of the total, respectively. Staff arrears relate mainly to travel and other claims, which together with rents, utilities and goods and services fall into the “other charges” economic grouping.

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17 The ToRs specified analysis of arrears over a five year period using the data compiled by the AGD (2.3(i)). However, AGD data only available from December 2010.
Expenditure arrears exist in multiple agencies, but the majority pertains to only a few Votes. Table 3 identifies from the reported June 2014 figures that the top three votes account for 73% of the total arrears and the top ten Votes account for 93% of the 90+ day arrears. Further analysis indicates that six Votes account for 99% of the arrears on construction works with VT98 accounting for 88% of the total for that category.

Table 3: June 2014 payment arrears of 90+ days – by Vote

<table>
<thead>
<tr>
<th>Vote</th>
<th>Agency</th>
<th>Total Reported Arrears</th>
<th>90 + day arrears</th>
</tr>
</thead>
<tbody>
<tr>
<td>VT98</td>
<td>Ministry of Works</td>
<td>664.4</td>
<td>535.4</td>
</tr>
<tr>
<td>VT28</td>
<td>Min of Home Affairs - Police Force</td>
<td>146.1</td>
<td>123.7</td>
</tr>
<tr>
<td>VT52</td>
<td>Ministry of Health</td>
<td>143.4</td>
<td>103.0</td>
</tr>
<tr>
<td>VT29</td>
<td>Min of Home Affairs - Prisons Services</td>
<td>66.6</td>
<td>60.0</td>
</tr>
<tr>
<td>VT38</td>
<td>Defense</td>
<td>66.0</td>
<td>64.0</td>
</tr>
<tr>
<td>VT39</td>
<td>National Service</td>
<td>28.5</td>
<td>24.2</td>
</tr>
<tr>
<td>VT57</td>
<td>Min of Defence &amp; National Service</td>
<td>27.2</td>
<td>27.2</td>
</tr>
<tr>
<td>VT43</td>
<td>Ministry of Agriculture</td>
<td>20.4</td>
<td>20.4</td>
</tr>
<tr>
<td>VT46</td>
<td>Min of Education &amp; Vocational Training</td>
<td>16.7</td>
<td>15.0</td>
</tr>
<tr>
<td>VT34</td>
<td>Ministry of Foreign Affairs</td>
<td>15.7</td>
<td>12.4</td>
</tr>
<tr>
<td>VT34</td>
<td>Others - MDAs X 50</td>
<td>82.6</td>
<td>59.8</td>
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<td>VT34</td>
<td>Others - RAS X 25</td>
<td>23.6</td>
<td>15.9</td>
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<tr>
<td></td>
<td>Totals</td>
<td>1,301.2</td>
<td>1,061.0</td>
</tr>
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</table>

Data limitations

The reported figures are useful in identifying indicative levels of payment arrears. They are sufficient for illustrating the trend in accumulating arrears over time and as the basis for researching the factors that have led to or failed to prevent the accumulation for the reported categories of payment arrears, and for suggesting corrective actions.
46. **However, the reliability of the arrears data is uncertain.** A number of factors influence the completeness and accuracy of the reported figures. These include:

- **No common definitions of arrears** – payment arrears are not defined in the legal/regulatory framework.

- **Omission of expenditure categories** – some categories are not included in the analysis. Box 4 identifies two notable omissions: tax refunds (estimated at TZS251bn) and the government’s liability to pension funds in respect of the pension benefits accrued by public servants up to 1999.

**Box 4: Expenditure arrears omitted from AGD reports**

**Tax Refunds**

These are administered by the TRA and relate to tax exemptions for specified classes of taxpayers, refunds of VAT where allowable tax credits exceed taxes paid and duty drawback on imported goods. The VAT Act prescribes that claims for tax refunds will be settled within 30 days of the claims being lodged—claims outstanding for more than 30 days should therefore be considered as payment arrears. At 31st December 2013 the stock of tax refund claims stood at TZS 249 billion, of which TZS 216 billion (87%) were older than 30 days. At 30th June 2014 there were 265 outstanding claims amounting to TZS 251 billion. Recommendations for managing tax refunds were included in a January 2014 East AFRITAC report.18 (Source TRA).

**Liabilities to pension funds**

The government makes direct payments from its budget for about 59,000 pensioners who retired before 2004 (and had not joined the new pension fund) and some military pensioners. Payments for these are current and no significant arrears are reported.

It also has liabilities for the pre-1999 portion of pensions of government employees retired after July 2004. The bulk of this liability is due to the Public Sector Pension Fund (PSPF). The net present value of the pre-1999 liabilities is estimated as TZS 4.8 trillion of which TZS 1.4 trillion could be considered as payment arrears—this is the net sum due to the PSPF to recompense it for the pre-1999 liabilities that it has paid out on behalf of the government up to 2014. (Source: PER Contingent Pension Policy Note, World Bank, September 2014)

- **Incomplete institutional coverage** – data collection concentrates on budgetary central government entities. Some of these collate information from the semi-autonomous bodies that they oversee (e.g. the Ministry of Works includes TanRoads) but others do not (e.g. the Ministry of Education excludes universities and its other controlled entities).

- **Non-submission of returns** – only data from those agencies that submit payment arrear reports are included in the consolidated report. The AGD is proactive in sending reminders and follow-ups, and MDA responses have improved over time.

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18 G.Holland; Improving the management and payment of VAT refunds; East AFRITAC; January 2014.
• **No routine data verification** – the data submitted by MDAs is copied to summary tables without independent validations. A previous verification by internal audit indicated discrepancies between its findings and the reported payment arrears.

### B. Consolidated government financial statements

47. **Uncertainty also arises from the different reporting of year-end payables.** Separate from the AGD quarterly report on payment arrears for end-June, accounts payable information is reported in the consolidated financial statements (CFS).\(^\text{19}\) Table 4 provides a comparison of the AGD quarterly arrears report for June 2013 and the CFS for the same date.

<table>
<thead>
<tr>
<th>Expenditure Type</th>
<th>Quarterly AGD Arrears Report</th>
<th>CFS Accounts Payable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction Work</td>
<td>431</td>
<td>15</td>
</tr>
<tr>
<td>Interest on Deficit</td>
<td>-</td>
<td>53</td>
</tr>
<tr>
<td>International Contributions</td>
<td>-</td>
<td>6</td>
</tr>
<tr>
<td>Liquidity Management Cost – Domestic</td>
<td>-</td>
<td>31</td>
</tr>
<tr>
<td>NSSF Short term loan</td>
<td>-</td>
<td>32</td>
</tr>
<tr>
<td>Office Rent</td>
<td>21</td>
<td>41</td>
</tr>
<tr>
<td>Staff Claims</td>
<td>56</td>
<td>62</td>
</tr>
<tr>
<td>Supplies of Goods and Services</td>
<td>170</td>
<td>345</td>
</tr>
<tr>
<td>Utilities</td>
<td>14</td>
<td>11</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td><strong>692</strong></td>
<td><strong>595</strong></td>
</tr>
</tbody>
</table>

48. **Significant differences are apparent.** Payment arrears would normally be considered a sub-set of accounts payable. However, the reported arrears are greater than the total CFS accounts payable. The variances might be explained by the different institutional coverage of the two reports (e.g. the treatment of arrears pertaining to semi autonomous bodies such as TanRoads) and expenditure types (e.g. the CFS includes payables on public debt and contributions to international organizations whilst the quarterly statements do not). There is no reconciliation between the two reports. The CFS does not provide any aging of the accounts payable to assist further analysis.

### C. National Audit Office (NAO) annual reports

49. **In his report on the 2012/13 CFS,\(^\text{20}\) the CAG comments on the trend of government expenditure arrears.** Table 5 reproduces the information from the NAO report. It illustrates that over the three financial years since 2010/11 expenditure arrears have decreased in values and relative to the approved budget.

\(^\text{19}\) Consolidated Financial Statements for the Year Ended 30\(^{\text{th}}\) June 2013 (as submitted to the Auditor General); Ministry of Finance; 31\(^{\text{st}}\) December 2013.

\(^\text{20}\) The annual general report of the CAG on the financial statements of the central government (MDAs) for the year ended 30th June 2013; National Audit Office; March 2014.
Table 5: CAG analysis of expenditure arrears

<table>
<thead>
<tr>
<th>FY</th>
<th>Arrears</th>
<th>Budget</th>
<th>Arrears/Budget (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2012/13</td>
<td>595,568,566,057</td>
<td>15,191,944,300,000</td>
<td>3.9%</td>
</tr>
<tr>
<td>2011/12</td>
<td>899,000,000,000</td>
<td>13,525,895,350,000</td>
<td>6.7%</td>
</tr>
<tr>
<td>2010/11</td>
<td>1,058,000,000,000</td>
<td>11,609,557,584,000</td>
<td>9.1%</td>
</tr>
</tbody>
</table>

50. **The trend is contrary to that indicated in the AGD quarterly reports.** These indicate a decrease of arrears between 2010/11 and 2011/12, then increasing to June 2013. Variations in the figures may also arise due to differences in definitions of arrears, institutional coverage and the expenditure categories included. The NAO report does not provide an aging profile to assist further analysis.

51. **Commentary in the CAG report highlights how expenditure arrears have impacted budget execution.** In particular, it notes that funds have been reallocated from planned activities to settle overdue payments. It further suggests that the cash budgeting system should be reviewed to allow for more flexible budget release durations.

**Report on Internal Audit verification**

52. **Questions as to data reliability resulted from an internal audit exercise to verify arrears.** The verification exercise was based on the MDA schedules of payment arrears as at 30\textsuperscript{th} June 2012. The audit report suggested the aggregate of arrears at that date amounted to TZS 1,567 billion plus USD 107,605 plus EUR 175,000 (compared to TZS 197 billion reported through the AGD quarterly monitoring report). The report provides no reconciliation to the AGD figures.

53. **Annex 2 summarizes the findings of a fresh internal audit exercise based on the June 2014 stocks of arrears.** This was undertaken as part of this study on payment arrears and was intended to test the reliability of the arrears data submitted by a representative sample of institutions. Compared to the 2012 exercise, this latest audit shows a closer match between the AGD reported arrears and surveyed figures.

**D. Expenditure arrears – nature and definitions**

54. **Inconsistency in the reported levels of arrears partly results from the lack of an appropriate Tanzanian definition of expenditure arrears.** A general interpretation is that “a payment arrear is an expenditure obligation that has been incurred by the government for which payment is overdue”. Payments may be overdue according to a particular legal obligation (e.g. salaries, pension fund contributions), a specific contractual arrangement (e.g. for rents, supplies or construction works) or continuing service arrangements (e.g. utilities). Expenditure arrears comprise the original overdue payment together with any accrued interest or penalties. Payments can fall into arrears at any time during the year—the existence of arrears is not confined to the year-end and not dependent on the invoices being registered in IFMIS. Figure 4 illustrates the payment process showing that expenditure arrears are a sub-set of liabilities.
Agreeing on a single definition is not straight-forward, as the precise point at which a government liability falls into arrears may differ according the nature of expenditure. Determination of due dates may be established by: contract; an Act of parliament, regulation or charter; or as a norm of acceptable practice. Invoices that remain unpaid after the “payment due date” may result in penalties. The numbers, amounts and periods of overdue accounts provide indicators of financial management performance and fiscal discipline. The possibilities of accumulating payment arrears are also fiscal risks that need to be tackled to avoid disruption to budget implementation and service delivery. For each major category of expenditure Table 6 describes the payment norms and proposes definitions for arrears monitoring and management purposes.

Table 6: Proposed definitions for expenditure arrears

<table>
<thead>
<tr>
<th>Expenditure category</th>
<th>Description</th>
<th>Proposed Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tax Refunds</td>
<td>VAT Act (article 17) specifies that refunds will be honored within 30 days of claim submission.</td>
<td>Amounts unpaid for longer than 30 days since claim for refund was lodged with TRA.</td>
</tr>
</tbody>
</table>
| Employee expenses    | Salaries and wages:  
  - Existing employments – once records are created on the payroll staff should be paid on a regular basis, usually at the end of each month.  
  - New starters, promotions – processes for creating a new payroll record are estimated to take up to two months.  
  - Staff claims; travel, transfer and other non-salary allowances – can reasonably take 30 days to verify entitlement and process payment. | Payments to employees should be classified as in arrears where:  
  - Payments to existing employees are not remitted within the month for which those salaries are due.  
  - Payments to new starters are not paid within 60 days of the employee commencing duties.  
  - Staff claims etc are not settled within 30 days of claim being lodged. |
<table>
<thead>
<tr>
<th>Expenditure category</th>
<th>Description</th>
<th>Proposed Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Utilities</td>
<td>Category includes: electricity; water; sewerage; telephone/fax; and internet facilities. Increasingly, pre-payment options are used. Otherwise, invoice verification of units consumed and payment processes should be completed within 30 days of invoice being lodged.</td>
<td>Payment should be considered to be in arrears if invoice has not been settled within 30 days of it being received.</td>
</tr>
<tr>
<td>Rents</td>
<td>Rentals are generally payable in advance and may be due as monthly, quarterly or longer installments. The payment terms will be agreed in the respective contract or lease agreements.</td>
<td>Rental payments should be considered to be in arrears where they have not been paid by the due dates, as specified in the contract/lease.</td>
</tr>
<tr>
<td>Court judgments and other claims</td>
<td>Comprises compensation claims awarded against the government. The court ruling will generally prescribe the date(s) by which payment must be made. The category includes other claims such as agreed contributions to settle government’s liability for public servant accrued pension benefits.</td>
<td>Payments are considered in arrears where they have not been settled by the due date.</td>
</tr>
<tr>
<td>Public debt</td>
<td>Consists of domestic and external borrowings and the interests, discounts and commissions due in respect of those borrowings. Loan agreements determine the payment schedule – due dates, currencies and amounts.</td>
<td>Payments are considered in arrears where they have not been settled by the due date. The schedule of payment arrears should distinguish between domestic and external arrears and between principal and interest.</td>
</tr>
<tr>
<td>Membership and other subscriptions to international organizations.</td>
<td>Membership of regional and international institutions may oblige the government to make periodic contributions towards operational costs. Terms of membership and payments will be set out in protocol agreements. Amounts due determined by the governing bodies and the contributions requested by letter or invoice.</td>
<td>Payments are considered in arrears where they have not been settled by the due date.</td>
</tr>
<tr>
<td>Recurrent goods and services</td>
<td>Includes payments for materials, supplies, repairs and other services. These should normally be ordered from suppliers through a local purchase order or contract. Unless otherwise specified, processes of verification, certification and payment should be completed following the goods being delivered or services rendered and within 30 days of a valid invoice being received.</td>
<td>Payments are considered in arrears where they have not been settled by the due date specified in the supply contract, or (in the absence of a specific term) within 30 days of receiving the invoice.</td>
</tr>
</tbody>
</table>
### Expenditure category

<table>
<thead>
<tr>
<th>Description</th>
<th>Proposed Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Construction works</td>
<td>Payment schedules to contracts will specify amounts for mobilization, interim certificate and retention payments as well milestones and payment terms. Payment against certificates will require sufficient time for measurement, verification and payment authorization processes. This can require authorization by several agencies. In the absence of specific contract terms payments should be settled within 60 days of receiving the certificate. Payments are considered in arrears where they have not been settled by the due date specified in the construction contract or (in the absence of a specific term) within 60 days of receiving the certificate.</td>
</tr>
</tbody>
</table>

---

#### E. Conclusions and recommendations

56. **Regular, comprehensive and consistent reporting is vital for identifying any underlying trends and for managing the associated fiscal risks.** The AGD reports provide a sound basis but can be improved. Specific recommendations are:

*In the short term:*

- The MoF should issue an updated guideline on the reporting of payment arrears and provide associated training to MDA finance and internal audit staff. These would include:
  - A consistent and clear definition of payment arrears
  - Requirements for reporting on additional expenditure categories of tax refunds and public debt servicing.
  - An additional aging category to identify arrears of more than one year.
  - Identification of payment arrears where invoices have been captured in and reported through IFMIS, and invoices which are outside IFMIS.

- The AGD in consultation with PMO-RALG should issue a similar guideline to LGAs requiring routine reporting of payment arrears. The information should be aggregated and shared with the AGD.

*In the medium term:*

- The AGD should expand the quarterly report to analyze the arrears by the different segments of government institutions, e.g.: MDAs; general government agencies; other extra-budgetary funds; and local governments.
A statement of fiscal risks should accompany the budget documentation and in it include information on the government’s exposure to risk from payment arrears.\textsuperscript{21}

Individual MDA and consolidated annual financial statements should include disclosures analyzing the aging of the accounts payables.

Quarterly summary reports on payment arrears should be published on the MoF website.

V. PREVENTING FUTURE ACCUMULATION OF PAYMENT ARREARS

A. Business processes

57. The design and implementation of preventative measures requires some understanding on the underlying causes of arrears. Expenditure arrears can arise because of weaknesses at any stage in the budget cycle. Table 7 provides examples of good international practices at four stages in the budget cycle and assesses Tanzania’s practices against those measures. The section proceeds to discuss specific current practices in more detail.

Table 7: Comparison against international good practices\textsuperscript{22}

<table>
<thead>
<tr>
<th>Stage</th>
<th>Good Practices</th>
<th>GoT Practices</th>
</tr>
</thead>
</table>
| 1. Budget Formulation| • Government prepares and submits the budget for legislative approval based on a realistic medium-term fiscal framework or annual budget projections.  
• Government has comprehensive assessment of fiscal risks.  
• Contingency provisions are used to accommodate unplanned, unavoidable, and unforeseen expenditures.  
• Budget reflects expenditure commitments carried forward from prior years. | • In recent years, revenues have underperformed.  
• Budget documents do not contain statement on fiscal risks or make reference to the extent of payment arrears  
• Contingency budget included under MoF Vote – part for emergencies, part for known but non-quantified activities.  
• Budget guidelines require accounting officers to accommodate arrears and ongoing commitments as first calls on budget ceilings. Not explicitly shown in budget documents. |
| 2. Expenditure Commitment | • Legal right to acquire goods or services is made with the issuance of a purchase order or contract, and commitments are recorded at this stage for all types of expenditures.  
• Cash planning reflects commitment profiles.  
• Monitoring and control mechanisms cover all budgetary and extra-budgetary funds for the public sector. | • Orders for recurrent goods frequently bypass LPO process. Commitments not entered to IFMIS until after goods delivered and invoices verified  
• Cash plans derived from annual procurement plans but no regular in-year updates.  
• Arrears data concentrate on budgetary agencies. |

\textsuperscript{21} Inclusion of a statement of fiscal risks is consistent with EAMU convergence criteria. Kenya publishes one as part of its budget documentation. Countries also include contingency budgets which can act as buffers against revenue shortfalls and crystallization of other risks.

\textsuperscript{22} Flynn and Pessoa; Technical Guidance Note on Prevention and Management of Government Expenditure Arrears; IMF; March 2014.
<table>
<thead>
<tr>
<th>Stage</th>
<th>Good Practices</th>
<th>GoT Practices</th>
</tr>
</thead>
</table>
| 3. Expenditure Verification | • Work is completed, goods and services are delivered, and the invoice is received.  
• Liability is registered in an accrual accounting environment. The liability arises when the third party satisfies contractual obligations. The invoice becomes an obligation, and the payment due date is registered in the accounting system.  
• In cash accounting systems, controls are in place to track commitments and liabilities. | • Mostly payments after goods/services received but sometimes in advance.  
• Liability not registered in IFMIS until invoice entered for payment. Registration does not include due date.  
• IFMIS commitment controls limited to short term in-year procurements, but even these are not used. |
| 4. Payment | • Request for payment is made by the accounting or financial officer, and a payment is recorded in the accounting system, removing the liability.  
• Finance department/treasury processes orders and issues checks or electronic transfers.  
• Payment due date is known, and available funds are in government bank accounts on the due date.  
• There is a chronological sequence for payment.  
• Checks are cashed/electronic transfers made expeditiously in favor of the creditor. | • Budget agencies record and certify payment within IFMIS.  
• The Central Payments Office (CPO) instructs BOT to make EFT payments.  
• The CPO determines payment priorities; selection criteria not always transparent.  
• Most payments by EFT. |

58. The above analysis suggests that major weaknesses occur at the budget formulation and expenditure commitment stages. Once payments are approved in the IFMIS some processing delays may arise but generally these do not contribute to the stock of payment arrears. Following expenditure verification invoices can only be entered to IFMIS against an existing commitment or if sufficient uncommitted funds exist – invoices that cannot be entered because of insufficient funds make up the stock of payment arrears.

Budget formulation

59. Budget formulation has suffered from over optimistic revenue forecasts and inaccurate costing of projects and services. Figure 5 illustrates domestic revenue outturns against the approved budget over the past 8 years. For five of the years revenue collections have under-performed; on average revenue have under-performed by 4% over the period. Under the cash budgeting system the consequence of lower actual revenue is the corresponding reduction in expenditure budget releases.
60. **The annual budgets for some individual development projects have been unrealistically low.** This can be the case if contractors allocate more resources to a project and payment milestones are achieved at a faster pace than planned. It also occurs where ministries compress the budget allocation for individual projects so as to accommodate a wider spread of projects within the allotted ministerial budget ceiling. With both scenarios, during budget implementation the budget envelope is exhausted which may either be offset from projects where implementation is under-performing or result in the accumulation of arrears. This has been the experience with multi-year infrastructure (roads) projects where outer year expenditure commitments have exceeded the funding constraints. 23

61. **The 2014/15 budget process looks to address these issues.** A strengthening of the role of the PO-PC and its improved coordination with the Budget Department has led to project applications being subjected to greater scrutiny as to their affordability. Box 5 provides an extract from the most recent budget guidelines stressing the need for prudent budget practices.

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**Box 5: Extract from budget guidelines 2014/15**

2.2 **Responsibilities of budget committees**

a) Ensuring that budget estimates adhere to the ceilings and are prepared in line with defined government priorities.
b) Ensuring all outstanding activities for 2013/14 are reviewed and reprioritized for inclusion in the plans and budgets for 2014/15
c) Assessing all signed contracts and memoranda of understanding for which commencement activities have been issued and hence costing them into the budget.

18. **Locally funded projects**

a) Projected resources for the forthcoming year will sustain on-going projects before contracting new ones.
b) Outstanding claims raised by contractors, suppliers and service providers should be settled first.
c) Strategic projects including those under the Big Results Now initiative should be given top priority in the allocation of development budget resources

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23 The Ministry of Works also quotes examples of arrears arising from: where contracts on donor-funded projects have been terminated and donors have declined to finance the substitute contractor; and accrued interest/ penalties.
d) On-going projects forming part of the annual development plan should be aligned to the resource envelope ceilings provided

e) New projects shall be submitted to PO-PC for scrutiny and endorsement….Inclusion of new projects in the budget estimates can only be considered if there are sufficient resources available from indicative ceilings… after deducting the cost of all ongoing projects.

Expenditure commitment

62. Controlling commitments is essential for controlling expenditures and preventing payment arrears. Commitment controls manage the initial incurrence of obligations, rather than the resulting cash payments. Commitment controls based on cash limits or fund releases reconcile the availability of cash resources with commitments, thereby allowing MDAs to enter into new contracts or other obligations only if sufficient uncommitted balances are available, or likely to be available when payment is due.

63. Several factors have led to commitment controls becoming ineffective in Tanzania. These result from inadequacies in the fund release and allocation processes and the circumvention of IFMIS controls. They are discussed below and include:

- Unpredictable fund releases – timing, period of cover and amounts.
- Reliance on manual commitment registers.
- Lack of multi-year registration of commitments.

Fund releases

64. Tanzania has a Ceilings Committee which decides on the aggregate level of budget releases for the month. The committee is headed by the MoF Permanent Secretary. Its decisions cover budget releases of recurrent and domestically funded development expenditures and are constrained by the estimated availability of cash (i.e. cash balances plus estimated inflows plus estimated credits available from the BoT). Where actual revenues are less than budgeted, the difference will be reflected in budget releases less than the appropriated budget.

65. Priority budget release allocation is granted to certain categories of expenditure. Priority categories include personal emoluments, debt servicing costs, specific non-discretionary items (e.g. medical supplies, examination fees, prisoner foodstuffs) and counterpart funding for donor-financed projects. After allocating amounts to the priority items, the balance of the estimated available cash is allocated for other charges (including rents, staff claims, utilities and non-protected goods and services) and development expenditures, and between the central government MDAs and local governments. Where actual revenues have under-performed, the aggregate budget releases for the non-protected other charges and development projects suffer a

24 Radev and Khemani, 2009
disproportionate reduction. The impact is demonstrated by releases made to the Ministry of Education.

66. **The proportion of the budget released to the Ministry of Education has varied significantly between purposes.** Figure 6 illustrates the proportion of the revised domestically funded budget released during the past two financial years. It reveals that whilst the total releases for FY13 and FY14 were respectively 96% and 90%, the releases against the main components varied considerably. In both years the transfers to the Higher Education Student Loans Board achieved 100% of the revised budget whilst releases for personal emoluments (MOE and its institutions) were close to 100%. However, releases for Other Charges and Development costs were significantly lower, especially during FY14 where only 55% and 51% were realized. Similar scenarios were cited to the study team by other ministries. The reduction in releases for other charges in 2013/14 has almost certainly contributed to the doubling of arrears for that category.

![Figure 6: Ministry of Education budget releases 2012/13 and 2013/14](image)

67. **The distribution and notification of the budget releases occurs late in the month; the coverage of the budget release is limited to one month.** Although the MoF Client Server Charter requires Exchequer releases to be made on the fifth days of the months, this does not generally occur until after 20th. At the start of 2011/12 the GoT had an ambition of introducing quarterly budget releases, but after piloting with a release covering July and August and experiencing difficulties due to cash shortages, soon reverted to the previous monthly release model – which remains the current practice.

68. **The amounts of monthly releases vary significantly according to economic categories.** Using the same Ministry of Education example, the monthly releases for personal emoluments and transfer to the Higher Education Loans Board are regular and predictable. Conversely, monthly releases for other charges are more volatile. Development releases are subject to PO-PC verifying the MDA authorized certificates and confirming the availability of budget and, subject to the availability of cash, MoF then releases the cash.

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25 [www.mof.go.tz](http://www.mof.go.tz), client service charter.
69. **The cash management function does not support the smoother and more predictable releases of funds.** The cash management function is fragmented over the PAD, BD and AGD. The PAD acts as secretariat to the Ceilings Committee and maintains the high-level cash plan. The BD collates MDA requests for fund releases, assists with advising on the prioritization of releases within the available envelope and prepares for the block releases. The AGD has made progress in rationalizing the number of bank accounts, establishing a core treasury single account and has delivered cash flow forecasting training to MDAs. However, cash forecasting remains poor and there is no active cash management.

70. **The budget releases are intended to constrain commitments and the resulting cash payments.** The Exchequer releases are made as block amounts per Vote. The agency management then allocates the block amount to individual cost centers and line items. The allocations are made within IFMIS. The IFMIS functionality was designed to prevent commitments or expenditures from exceeding the amount of allocated released budget. However, the lateness of the release, the less than anticipated amounts of the release, the difficulty in offsetting savings on one item to finance increased needs on another, and a failure to appreciate time lags between when funds are required for commitment and payment (see Figure 7), rendered the IFMIS controls ineffective.

![Figure 7: Commitment to payment – time lag](image)

71. **The time lags between registering a commitment and effecting payment could be lengthy.** The time lag will depend on a number of variables such as: the lead-in time to manufacture or deliver a product or service; the processes for verifying, authorizing and effecting payment; and the payment terms agreed with the supplier. To circumvent the IFMIS commitment controls, MDAs introduced workarounds solutions.

**Commitment registers**

72. **MDAs by-pass the IFMIS commitment controls and use the released funds to simultaneously record and settle existing obligations.** Seemingly, much of the block fund releases were allocated to cost centers and line items not as the means for planning for future service delivery, but as the means for settling known invoices. Allocations were entered to the IFMIS based on the actual invoices due for payment.
73. **Local orders for goods and services were issued outside IFMIS.** MDAs advised that commitments have been manually recorded in Vote Control Registers (VCRs) against the approved appropriation and in anticipation that those funds would eventually be released. An inevitable consequence of the lower than appropriated levels of fund releases was that not all invoices could be paid.

**Commitment controls**

74. **Effective expenditure management requires controls at the commitment stage of the payment cycle.** Whilst the issuing of all LPOs through IFMIS provides some safeguards, LPOs will not cover all categories of expenditure. Table 8 describes how effective commitment control requires realistic expenditure budgets, rules governing budget reallocations and fiscal discipline ensuring the use of IFMIS and LPOs.

### Table 8: Realistic budgeting and commitment controls

<table>
<thead>
<tr>
<th>Expenditure Category</th>
<th>Budget Formulation</th>
<th>Commitment Controls</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employee expenses</td>
<td>● Budget computed based on numbers and grades of positions in approved establishment register. ● Budget requests validated for accuracy.</td>
<td>● Recruitment against vacant positions in establishment register. ● Commitment equivalent to approved budget. ● No budget reallocations from personal emoluments.</td>
</tr>
<tr>
<td>Utilities</td>
<td>● Baseline budget calculated on existing units, past consumption patterns and known tariffs.. ● Baseline incremented for planned increases/decreases in units, consumption and tariffs. ● Budget requests tested.</td>
<td>● No budget reallocations from utilities. If insufficient funds, budget to be reallocated from other lines in Other Charges. ● Payments to be made on regular monthly basis.</td>
</tr>
<tr>
<td>Rents</td>
<td>● Baseline budget calculated on existing leases and rentals. ● Baseline incremented for any planned and approved changes in the properties rented and anticipated changes in rentals.</td>
<td>● No budget reallocations from utilities. If insufficient funds, budget to be reallocated from other lines in Other Charges.</td>
</tr>
<tr>
<td>Transfers and subscriptions.</td>
<td>● Budgets prepared on agreed levels of contribution for existing organizations and institutions.</td>
<td>● No budget reallocations from membership and other subscriptions ● No new pledges should be permitted during the year.</td>
</tr>
<tr>
<td>Recurrent goods and services</td>
<td>● Protected and other items – budget on assessed needs based on previous experience and expected level of activities. The aggregate to be contained within budget ceiling.</td>
<td>● No reallocations from protected items. ● All purchases to be supported by LPOs issued through IFMIS.</td>
</tr>
</tbody>
</table>
### Expenditure Category

<table>
<thead>
<tr>
<th>Expenditure Category</th>
<th>Budget Formulation</th>
<th>Commitment Controls</th>
</tr>
</thead>
</table>
| Construction works   | • Continuing projects – annual budget based on milestones and payment schedules from awarded and anticipated contracts, and other costs. Outer year costs also updated against MTEF. Budget includes fund source.  
• New projects – inclusion in annual and outer year budgets subject to priority and sufficient space after deducting costs of continuing projects. Take account of procurement times, estimated costs and realistic timeframe. | • Current year – commit estimates for individual certificates, milestone payments in IFMIS.  
• Outer years – maintain latest estimates against MTEF.  
• Update IFMIS and MTEF for contract variations and project slippage etc.  
• Restrict tender adverts or contract signing unless agreement on financing. |

### B. Conclusions and recommendations

75. **Preventing the accumulation of future payment arrears is not a simple fix.** It requires complementary changes in practices and attitudes across a range of PFM business processes. Recommendations include:

#### Budget formulation

**In the short term:**
- The MoF should subject the annual revenue forecasts for independent assessment prior to submitting the annual budget, and take on board any comments.\(^{26}\)

**In the longer term:**
- The MoF should: further develop its revenue forecasting capacity; subject the annual revenue forecasts for independent assessment prior to setting the annual budget framework and ceilings, and then prior to finalizing the annual budget; and include as part of the budget documentation details of the differences between the independent assessment and estimated revenues.

#### Expenditure commitment

**In the short term**
- The AGD should issue guidelines and conduct training to MDA finance and procurement staff to ensure that all new LPOs are issued through the IFMIS.

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\(^{26}\) Initially, external agencies such as IMF or World Bank could fill this role.
In the medium term:

- The AGD should develop and implement an awareness program to ensure suppliers only accept IFMIS-generated LPOs. An enforcement regime should be introduced.

Multi-year commitment

In the short term:

- The PO-PC should maintain a database of development project contracts which commit government funds in future years. These should be monitored and controlled against the MTEF and used to inform the annual budgets for subsequent years.

In the medium term:

- As part of the budget documentation, Parliamentary approval should be sought on the amounts which can pre-commit development project funds for the outer years of the MTEF. Reports on actual commitments made would form part of subsequent year budget documentation.

Fund releases

In the short term:

- The Ceilings Committee should renew attempts to introduce monthly fund releases for a rolling three month period, by piloting an exercise with five MDAs. The monthly releases would constrain payments for the respective month.

In the medium term

- The Ceilings Committee should extend the pilot exercise and issue monthly fund releases for a rolling three month period to all MDAs.

Cash management

In the short term:

- The MoF should confirm in which department a strengthened cash management unit should be located (e.g. AGD, PAD or DMO), and agree on its establishment.\(^{27}\)

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\(^{27}\) For instance as part of recent restructuring exercises strengthened cash management functions have been included as part of Directorate of Debt and Cash Management in Uganda, and under the Accountant General’s Department in Kenya.
In the medium and longer term:

- The MoF should commit to strengthening its cash management function enabling it to: maintain a comprehensive cash plan targeting an appropriate balance/buffer on its treasury single account to cover unplanned variances; analyze forecasting errors and apply the knowledge to improve the quality of future forecasts; and use in-year cash management instruments to ensure payments can be made when due.

VI. CLEARING THE STOCK OF ARREARS

A. Current measures

76. The Minister for Finance acknowledges the challenge posed by accumulating arrears and confirms that measures for clearing them are being considered. She advised that the Government was finalizing the strategy for clearing the arrears and the intention that Treasury will pay verified arrears centrally. This study’s conclusions should help with determining the strategy.

77. Tanzania has taken some interim steps to reduce its current stock of payment arrears. These include directives for the treatment of arrears in the 2014/15 budget guidelines and including within the budget a provision for clearing arrears. The appropriated budget includes under Vote 21 (Budget Department) line item 290700 (Contingencies, non-emergency) a sum of TZS 227 billion, an unspecified part of which is intended for—and part of this has been released during the first quarter of 2014/15—settling payment arrears. However, the clearance of arrears will not be resolved until a comprehensive strategy is in place. This section proceeds to outline the features of such a strategy.

B. Principles for clearing arrears

78. Good practices suggest that Tanzania’s strategy to retire arrears should be guided by the following principles:

- **Comprehensiveness** - the strategy should apply to all parts of general government: budgetary central government; extra-budgetary agencies; and local governments.

- **Transparency** – the modalities for clearing arrears should be simple, clear and according to a public timetable. The criteria for prioritizing payments should be stated and adhered to.

- **Credibility** - to demonstrate commitment to tackling the root causes, the clearance strategy should be accompanied by measures to avoid the accumulation of new

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28 Speech by the Minister for Finance, Honorable Saada Mkuya Salum (MP) introducing to the National Assembly the estimates of government revenue and expenditure for fiscal year 2014/2015.
29 A high level technical committee has been formed, chaired by the Deputy Budget Commissioner.
arrears and application of sanctions against institutions and individuals who fail to comply.

- **Realism** – the government’s budget and medium term fiscal projections should make adequate provisions for arrears clearance.

- **Verification** – arrears should be verified to ensure that only valid claims are paid.

### C. Steps in clearing the arrears

79. **A comprehensive, transparent and credible arrears clearance strategy typically includes five steps:** stocktaking; verification; classification; prioritization; and liquidation. The design of these steps appropriate for Tanzania is discussed below.

#### Stocktaking

80. **The importance of a comprehensive survey of the arrears is threefold:** (i) Accurate arrears data are needed to illustrate the scale of the problem, and for designing the clearance strategy to the nature of the arrears; (ii) A definitive survey limits the risk of undisclosed arrears emerging later in the process; and (iii) Incomplete assessments may result in creditors pursuing recognition of their claims through the courts— with the potential for delaying the clearance process and increasing the cost.

81. **The AGD reporting and internal audit surveys form a good starting point.** They provide the basis for identifying the types of arrears, the agencies generating the arrears and the underlying causes. Through this analysis they provide the basis for developing the corrective liquidation and arrears prevention strategies.

82. **However, existing reports are not comprehensive and lack consistency in the interpretation of arrears.** The recent internal audit survey was conducted on a sample basis to test the reliability of the reported data rather than to establish the actual stock. Based on the survey results, a fuller stock taking may be required. This would involve:

- **Issuing a treasury circular** – containing a clear definition of payment arrears (as described in Section III); a timetable for the stocktaking exercise, including a cut-off date for the inclusion of new arrears; a clear definition of the information requirements to be gathered; and penalties for non-reporting.

- **Preparing centralized arrears databases** – these would build on the current AGD MS-Excel workbook and be used to record, classify and track all apparent claims.

83. **In establishing the databases of arrears, information from government institutions and creditors should be sought.** Creditor claims should be cross-checked against the information returned by the government institutions. The database of national government arrears should be managed by the AGD and regularly updated to reflect changes in exchange rates, accrued penalties, settlements and dismissed claims etc. A similar database of local government arrears should be administered by PMO-RALG.
However, maintaining such databases can be resource intensive—it would be appropriate to focus on the larger claims.

**Verification**

84. **After taking stock of arrears, an audit should validate the accuracy and credibility of the claims.** The validation process is intended to verify the documentation and transactions supporting the claims, and ensure that costs are legitimate and have not been inflated, fraudulently claimed or previously settled. The validation process could also help verify whether the transaction was conducted within or outside the normal procurement chain.

85. **This validation process in Tanzania has not been conducted on a comprehensive basis.** The sample survey carried out by internal audit teams on the June 2014 reported arrears has identified the challenges to be addressed as part of the audit (including incomplete documentation). Further analysis of the results will confirm whether internal audit units are competent in carrying out the audit or whether engaging an external audit firm is warranted.

**Classification**

86. **To allow for appropriate categorization a variety of data should be captured for each claim.** These include: *Vintage* – the payment due date, enabling analysis of how long payments have been overdue; *Government institution* – the agency responsible for incurring the payment arrear; *Creditor* – the contractor, institution or employee who is owed money; *Economic category* – each claim should be classified as to whether it relates to personal emoluments, goods and services, debt servicing, transfers, construction works etc; *Currency* – the currency in which the obligation is denominated; *Contractual terms* – for instance late payment penalties/interest charges; *Payment status* – capturing the total due, amounts paid to date, agreed rescheduling etc.; and *Risk of non-payment* – assessment of the consequences of further payment delays, e.g. incomplete project or legal action.

87. **The reports prepared by MDAs and consolidated by the AGD provide for some categorization.** They contain summary analysis on vintage, government institution, and economic category. The detail of creditor, currency and contractual terms is retained by the MDA.

**Prioritization**

88. **A set of criteria for prioritizing the liquidation of arrears should be determined.** The prioritization should be based on transparent criteria, which might include: *Socioeconomic impact* – arrears of payments to vulnerable sectors having priority; *Vintage* – older obligations should get preference; *Cost* – arrears that accrue penalties and interest should be settled early; *Risk* – arrears that threaten legal action, disruption of services or supplies should be prioritized; and *Currency* – foreign
denominated debt should be cleared where the exchange rate may deteriorate. For Tanzania the prioritization criteria has yet to be set.

**Liquidation**

89. **Agreeing upon a liquidation policy is a key element of an arrears strategy.** The liquidation policy will: (i) consider whether legitimate claims would be honored in full or if a haircut should be applied to the claims; (ii) determine the form of financing and timeframe for settlement; and (iii) the responsibility for administering payments.

90. **Based on the availability of fiscal resources for full repayment and the credibility of claims, Tanzania might consider a possible haircut.** In this scenario the government would agree to settle part of the claim. This would represent a partial default on the part of government, may cause reputational damage and is hence not necessarily desirable. However, such a course may be appropriate where there is ambiguity over the size of the claim or where suppliers have willingly delivered goods or services without proper documentation or process. It could also be considered as a means to compensate for excessive punitive late payment charges. Examples of where haircuts have been applied include Togo (20% of face value of claim) and Benin and Niger (10%).

91. **The form of settlement and timeframe are dependent on several factors, notably the size and nature of the claims.** The standard practice would be to settle claims with cash payments financed through either revenue receipts or new borrowings. Consideration may be given to settling larger amounts through securitization. For the claimant a cash payment is preferable but securitization provides some clarity on the timing of repayment and interest income, and may serve as collateral for new credits. The options are described:

- **Cash expenditure budget** – consistent with the current directives whereby MDAs are expected to clear most arrears from their future budget releases as well as centralized settlement from a budget contingency provision. The timeframe would depend on the fiscal space, may need to be spread over several years and scheduling of payments should be advised to creditors. The method will divert resources from planned activities. To enhance transparency, it would be best to include a specific line item in the annual budget and medium term expenditure framework (MTEF) and for this to be managed in a central Vote.

- **Borrowing** – the proceeds of new loans would be applied to make cash settlements of the arrears. The borrowing would need to be compatible with the medium term debt strategy (MTDS). The method may be suitable for settling the arrears on construction projects. As with the cash expenditure process, settlement of arrears claims would be through a specific centrally managed budget.

- **Securitization** - delays the need for government to obtain financing until a later date, at which time the fiscal situation may have improved. It allows the government to phase the impact of large payments of arrears. The instruments
should specify the timing of a future cash settlement (with debt maturity dates consistent with the MTDS):

- **Promissory notes** – these should indicate the nature of any accruing interest and whether they are tradable. Generally these: should bear a market interest rate; allow interest to be capitalized and paid on maturity; and should be marketable. These may be suitable for the settling infrastructure and other large debts.

- **Converting debts to Treasury bonds** – similar to promissory notes but may be for longer terms and capable of being rolled-over. May be suitable as a means to settle the pre-1999 pension liabilities. They would enable the government liability to be cleared and provide the pension fund with an asset and regular income.

**Applying revenue windfalls** – in cases where governments anticipate significant one-off revenues there may be merit in using those funds to clear expenditure arrears. This would not disrupt other expenditure plans and would be analogous to using the proceeds to retire debt. In Tanzania there are potential windfall revenues from the capital gains tax revenues arising from the sale of participation rights in offshore production sharing agreements between two companies).

92. **The liquidation strategy should specify the responsibility for processing the claims for arrears in accordance with the agreed prioritization and timeframe.** It should determine the responsibilities for administering payments, reporting on the clearance, and monitoring progress against the approved clearance program. Options would be a decentralized approach through individual MDAs or a centralized process where the MoF makes the payments centrally. The current proposals are unclear – documents simultaneously refer to a central finance clearance process and MDA responsibilities for settling debts; the contingency budget was provided centrally but amounts reallocated to individual MDAs for them to settle arrears directly.

D. **Recommendations**

93. **In the short term, the Government should finalize and publish its arrears clearance strategy and timeframe.** In the medium term, it should clear the stock of arrears in accordance with its strategy and timeframe. It is recommended that the strategy includes the following five components:

**Stocktaking**

- The treasury circulars for 2014/15 arrears reporting should require updated status on the arrears that existed at 30th June 2014 – according to the agreed definitions and revised templates and to reflect whether they have since been liquidated. The reports should call for the details of individual invoices and the availability of documentation.
The AGD should update its database to record and report on the revised information. PMO-RALG should construct a similar database for LGAs and commence data collection.

**Verification**

To ensure that the strategy is implemented, its scope should focus on the large systemic arrears that existed at 30th June 2014. Efforts could concentrate on verifying arrears that at that date were overdue by more than 90 days; were incurred by the top ten agencies; and are included in the construction works and Goods and Services expenditure categories. An external audit firm could be used to verify these claims. Original documentation should be provided and retained centrally.

The strategy should require internal audit units to verify other invoices and claims.

**Classification**

The current classification required by the AGD should be expanded to include the invoice currency and details of penalties.

**Prioritization**

The criteria for settlement should be based on vintage and take account of the additional costs and risks of further delays.

**Liquidation**

The systemic payment arrears as defined above and verified by an external auditor should be settled centrally by the MoF—this should be against a specific line item and budget for arrears clearance. The settlement of other invoices and claims, as verified by the internal audit units, should be settled by the respective agency from their 2014/15 budget allocations.

Where the verification exercises prove that the claims are properly documented and correct in all regards, settlement should be made in full (although the case might be made to pay reduced penalties/interest). Claims that are ambiguous should not be entertained until the verifiers are satisfied on the legitimacy of the claim.

The GoT should consider financing the settlement of the systemic arrears through new domestic borrowing. The option should be assessed against the likely additional direct costs of late payment penalties/interest, and the lack of sufficient fiscal space in the recurrent budget. Any subsequent windfall revenues could be applied to redeem other debt.
• Budget contingency provisions could be applied to assist in the settlement of the other outstanding arrears from 30th June 2014, where agencies are unable to meet the costs from their budgets.

• Government should evaluate the option of settling its liability to the pension funds through securitization—converting the debt to medium term treasury bonds.
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ANNEX 1: PAYMENT ARREARS STUDY - TERMS OF REFERENCE

The Solution to Curtailing Payment Arrears in Tanzania
Dar es Salaam, November 2013
PER Working Group

1. BACKGROUND

In recent years the Government of Tanzania (GOT) has incurred huge payment arrears comprising of staff claims, contracted works, suppliers and other services. Available data (PEFA report 2013) reveals that by September 2013 the GOT budget ministries and agencies had outstanding payment liabilities amounting to TShs 876.8 billion (equal to 1.6 percent of GDP).

The persistent accumulation of payment arrears are impacting negatively on the government finances such as accumulation of interest and reducing the resources available for financing the delivery of goods and services to the public in future years. In the context of Tanzania, payments arrears arise out of unpredictable financial resource inflow (domestic and foreign), including problems associated with budgeting and budget execution systems.

In light of the above, the Government intends to carry out a study which will come up with findings and recommendations that will address the problem.

The government monitors the accumulation of expenditure arrears through quarterly reports compiled by the Accountant General on outstanding payment liabilities submitted by Ministries, Department, and Agencies (MDAs) and regions (RAS). The data is classified by category, expenditure vote, and aging profile. There is no regular process for verifying the data submitted, and questions have been raised about the veracity and consistency of the data reporting. More recently, the Internal Auditor General has been tasked by verifying the stock of expenditure arrears on an ad hoc basis. The verification has been completed for the stock of end-June 2012: the verified data have neither been reconciled with the quarterly data reported by the Accountant General’s Department nor with any subsequent clearance of arrears. While the Ministry of Finance expects MDAs and RAS to settle outstanding payment obligations within the fiscal year in which they are accumulated, this is not consistently achieved. Hence, there are accumulating balances of outstanding payment obligations at the end of the fiscal year. There is no clear policy or mechanism to tackle the growing arrears problem.

2. PURPOSE, OBJECTIVES AND SCOPE OF THE STUDY

2.1 Purpose

The purpose of this study is to find solutions to payment arrears that affect credibility of the budget execution. The following key elements would be needed:

1. A clear definition of expenditure arrears following GOT accounting principles and international practice (e.g., aligned with the PEFA assessment).

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30 Payment arrears are defined as overdue expenditure obligations on goods and services, salaries and pensions, rents and debt service. As a rule of thumb, if payment for goods and service has not been made within 30 days after the receipt of an invoice, it will be treated as in arrears; salary and pension obligations that are outstanding after the date for the payment of the payroll will be in arrears.
2. Establishment of a credible mechanism for monitoring expenditure arrears ensuring that the data are both comprehensive across MDAs and RAS and compiled in a timely manner.

3. Institute a transparent mechanism for verifying expenditure arrears that have not been cleared by MDAs or RAS that remain outstanding at the end of the fiscal on a timely basis (within three months after the end of the fiscal year). This is important for any expenditure arrears that cannot be settled by the MDAs or RAS within the fiscal year, and for which a separate budget allocation is required to settle the arrears.

4. A medium term plan to reduce the stock of expenditure arrears including by adequately budgeting for arrears clearance.

5. Improvements to the public financial management system and practice to prevent the recurrence of expenditure arrears by: (i) formulating a credible budget with achievable revenue targets and adequate budget provisions for commitments carried forward from previous fiscal years; (ii) improvements to the budget execution including strengthened cash forecasting; and (iii) measures to tighten the commitment controls in IFMIS (incl. by enforcement of obligations to enter commitments and finding ways to register commitments for multi-year contracts, allowances and utility payments.)

2.2 Study Objectives

The main objectives of the study are:

a) To establish the level and sources of payment arrears;

b) To identify challenges facing the Government in ensuring timely payment of obligations;

c) To propose best options on how the current payment arrears can be paid so as to reduce arrears accumulation; and

d) To make recommendations on prevention of re-occurrence of payment arrears;

2.3 Scope of work

The scope of the study will involve, among others, the consultant doing the following:

i. Using the quarterly data compiled by the Accountant General outstanding payment liabilities for MDAs, track the evolution and distinctive features of payment arrears by category, institution and duration (aging);

ii. Establish factors underlying and contributing to payment arrears; and

iii. Recommend modalities of paying current arrears and prevent re-occurrence of arrears.

In undertaking the above general assignment, the consultant will be guided by the following specific tasks:

i. Establish the magnitude of arrears over the last five years by category (claim by staff, construction works, suppliers etc), institution (MDAs, RSs and LGAs) and by duration (aging);

ii. Assess the adequacy of existing legal and regulatory frameworks in abating accumulation of arrears;

iii. Analyze the state of compliance to existing legal and regulatory frameworks and enforcement mechanisms in limiting accumulation of arrears;

iv. Identify causes of arrears of each category and by institution;
v. Assess budget credibility (in terms of preparation, ceiling setting, allocation, disbursement and spending);

vi. Analyze consequences of the accumulated arrears on socio-economic development. This should include country cases identifying success stories within the region on modalities of reducing payment arrears;

vii. Identify challenges posed by re-occurrence of payment arrears (socio-economic, extra budgetary);

viii. Make recommendations on how to pay/reduce the existing arrears and a system to avoid re-occurrence of accumulation of arrears. Recommendations should be specific to each category of arrears, and spell out possible needed changes to the legal and regulatory frameworks and/or administrative practices to avoid future payment arrears.

3. KEY DELIVERABLES

The consultant should deliver the following:

a) An inception report showing understanding of the TORs;

b) A draft report. This report will be discussed by stakeholders (including MOF, POPC, POPSM, PMO, PMORALG, NSAs, DPs, Academia), at a technical meeting and comments will be incorporated as appropriate;

c) A final report incorporating stakeholders’ comments and policy brief version of the study findings.

4. QUALIFICATIONS

The consultant should have the following qualifications:

a) Senior-level expertise in Public Financial Management;

b) Detailed knowledge of auditing, accounting and public financial management systems, ideally from Tanzania and other African countries; and

c) Experienced in policy, planning and budgeting processes for socio-economic development in Tanzania.

5. TIMELINE

The consultant shall commence the study not later than the end of January, 2014. The submission of reports should meet the following time frame:

Inception Report – Mid-February, 2014;
Draft Report - End of March, 2014; and
**ANNEX 2: SUMMARY OF PAYMENT ARREARS SURVEY**

<table>
<thead>
<tr>
<th>Main findings</th>
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<tbody>
<tr>
<td>• The data available at the survey sites were incomplete. However, the survey program has confirmed indicative levels of payment arrears.</td>
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<tr>
<td>• The sample coverage of the survey tends to confirm as “reasonable” the magnitude of arrears reported by the AGD as at 30th June 2014.</td>
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<tr>
<td>• Reporting practices at MDAs are inconsistent – some are still adapting to the new framework issued by the AGD. No all entities (notably the LGAs) regularly report on arrears to the AGD.</td>
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<tr>
<td>• Primary reasons for the accumulation of arrears, as reported by surveyed entities, are related to weaknesses in the budget formulation and fund release processes.</td>
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<tr>
<td>• Settlement of arrears would require a more thorough verification of the arrear claims than has been carried out by the survey teams.</td>
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The Payment Arrears Study included an audit survey program that was carried out by the internal audit staff. As part of the audit program representative government institutions were surveyed to test the completeness and reliability of payment arrears being reported to the AGD\(^{31}\) and to identify factors that have contributed to the current stock of arrears. The survey also gathered information on controls that should assist in preventing arrears and the extent to which these are being applied in practice.

The approach and methodology for the survey was decided upon in consultation with the payment arrear working group. The adopted approach involved:

a) using the returns submitted by various institutions as the starting point for the survey. The audit program tested the completeness and reliability of the returns with respect to the latest submissions on payment arrears i.e. quarterly returns for 30th June 2014;

b) the survey was intended to be carried out in August 2014 to coincide with the availability of the end of the year financial data;

c) establishing a common set of payment arrear definitions for application by the survey teams;

d) ensuring consistency in data collection to enable meaningful aggregation and analysis. The audit program thus relied on standard questionnaires / checklists and uniform recording of responses.

\(^{31}\) The data on payment arrears is reported by MDAs to AGD who collates it on a quarterly basis.
The questionnaire and checklist used for the survey consisted of two parts designed to test:

1. **Completeness and reliability** – organized by expenditure types, the questions tested the payment arrears information provided in the quarterly report as at 30th June 2014 and where appropriate, updated that information.

2. **Expenditure controls** – sought to assess the expenditure controls that exist at various stages in the budget cycle, the extent to which they are applied by the individual institutions surveyed, and their effectiveness in preventing, limiting or managing payment arrears.

The questionnaire included extensive guidance notes explaining and defining the terms and processes and helped develop a common understanding of issues amongst the survey teams. The survey program also provided summary schedules for reporting by the teams under three classes: (i) arrears verified by the survey teams from amongst those reported as at 30th June 2014 along with amount and date and/or if already paid; (ii) payment arrears that have been omitted from the quarterly report; and (iii) possible payment arrears that require further analysis. The survey team members were taken through a familiarization process on the purpose and requirements of the audit program. Training was also provided to the team members on the use of questionnaire, reporting of findings and compilation of the results. The training for the zonal teams was provided by East AFRITAC whereas training for the Dar es Salaam team members was provided by MoF.

The survey covered the following categories of payment arrears:
- Wages, Salaries and Allowances
- Pension Liabilities
- Goods and Services
- Utilities
- Construction and Similar Works
- Loan Creditors
- Refunds of Tax Payers
- Transfers to Regional and International Organizations
- Court Awards
- Local Transfers, Grants and Subsidies

The survey program covered a representative cross-section of institutions to confirm the credibility of currently reported figures for arrears. The sample was selected in consultation with the payment arrear working group with the objective of testing commonality of issues and ascertaining the trends both in terms of categories of arrears and their incidence amongst institutions. Accordingly, the survey included (i) MDAs where high levels of payment arrears are reported and those where no arrears are recorded; (ii) central government and local government institutions from the five regional

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32 This included budget formulation, procurement planning, in-year budget management including revised budget scenarios, in-year revision to cash forecasting, procurement plans, budget and cash releases, commitment controls for LPOs, payment, reporting and managing arrears.
zones; and (iii) institutions from Dar es Salaam, other major commercial centers and rural locations. The standard questionnaire was administered by the survey teams at all the selected sites and covered all expenditure types. This annexure summarizes the findings from the internal audit survey.

**Data completeness**
The survey program was intended to test the completeness and accuracy of different categories of reported payment arrears and identify areas where inconsistencies where apparent. The survey program results have been useful in verifying indicative levels of payment arrears. However, the verification results cannot be taken as comprehensive as survey teams have reported that the arrears data is incomplete on the following counts:

- **inadequate information** with reference to invoice number /date and insufficient supporting documentation in case of goods and services; employee number and date of claim in case of personnel claims; ageing profile and categories of arrears. In the absence of this information, attributed largely to poor record keeping and lack of preparedness on part of the entities, survey teams have not been able to collate/verify all the information.

- **inconsistent practices across survey teams** that compromise the comparability of survey results especially in relation to arrear claims requiring further investigation and those that have already been paid. At times the difference between reported arrears and those confirmed by the survey team has been shown as disputed but not consistently by all teams. Survey teams have pointed out that some of these arrears reported as at 30th June 2014 have already been paid; some before cut-off date and some even after that date but continue to be reported as part of the existing stock by surveyed entities.

- **coverage of claims** by survey teams. In case of some entities, survey teams have not been able to verify the entire stock of arrears because of difficulties in getting information from subordinate offices, paucity of time and absence of a centralized system for record keeping relating to arrears. In some other cases only a sample verification of the reported arrears has been done by survey teams (Njombe and Geita).

- **lack of common understanding and reporting format** has affected the integrity of arrear reporting. Survey teams have noted a failure on part of the entities to draw a distinction between accounts payable and arrears. They have also reported that a standard reporting format was communicated to MDAs only in June 2014 and most of the MDAs are still adapting to the new format resulting in inconsistent reporting practices.

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33 Selected institutions included Ministries of Health, Education, Home Affairs, Agriculture, Water, Foreign Affairs and Infrastructure including Tanroads. The Regional Administrative Secretariat(RAS) covered included Arusha, Tabora, Njombe, Singida, Mtwara and Geita; local government authorities (LGA) included district councils of Korogwe, Kibondo, Kasulu, Singida, Mpwapwa, Tandahimba, Kilwa and Sengerema; city councils of Arusha, Tanga, Mbeya and Mwanza; town councils of Njombe, Mbozi and Geita; municipal councils of Dodoma, and Lindi.
The settlement of arrears would require a more thorough verification of the arrear claims than has been done by the survey teams. The survey results point towards general trends of the nature and magnitude of payment arrears. However, all the teams agreed that given the absence of adequate documentation, the paucity of time, incomplete coverage of the survey, these results could not form the basis for clearance / payment of arrear claims.

Central Government

Timing of the surveys has been reported as an issue by the teams in getting the required cooperation from central government entities. Although the surveys were intended to be carried out in July-August 2014, delays in arranging for the logistics meant that the actual surveys for the central government could only take place in September-October 2014. This was the period when the finance and accounts units of MDAs were busy with annual closure of the accounts and preparation of annual financial statements and could not engage well with the survey teams. In addition, the survey timing also coincided with the schedule of stock verifiers and the statutory auditors who were examining the same records as the survey teams.

As a result the survey for the central government entities has not been carried out as expected. Of the entities selected for the survey, verification could not be carried out in the Prison Services Department and Police Defense Force. Survey teams have reported difficulties in receiving documents in a timely manner and also lack of cooperation from the officials of these entities. They have also indicated that in addition to the usual reasons of insufficient budget and delays in release of funding by the Treasury, the nature of activity carried out by Prison Services and Police Force accounted for a substantial share of the arrears. In case of other ministries, a significantly large proportion (68.74%) of the arrears as per the Accountant General’s report has been verified as correct by the survey teams. In case of Ministries of Foreign Affairs and Works, the survey teams could only verify the arrears with respect to the required documentation available at the headquarters. Thus the arrears relating to embassies abroad (Foreign Affairs) and regional manager’s offices up-country (Works) have not been verified. The results of the verification exercise are summarized in the Table 1 below.

| Table 1: Arrear figures for selected surveyed ministries(TSH billion) |
|---------------------|-----------------|-----------------|-----------------|-----------------|
| **Ministry**        | **AGD report**  | **Verified during Survey** | **Omitted from AGD report** | **Requires investigation** |
| Works               | 664.37          | 454.09          | 0.42            | 24.73           |
| Health              | 143.41          | 113.58          | 0               | 0               |
| Agriculture         | 20.36           | 8.25            | 0.46            | 63.66           |
| Education           | 16.65           | 11.83           | 1.42            | 4.01            |
| Foreign Affairs     | 15.71           | 0.38            | 2.72            | 8.71            |
| Water               | 10.85           | 10.85           | 25.59           | 0               |
Regional Administrations and Local Governments

Given the small number of the RAS and LGAs covered by the survey, only general conclusions can be drawn on the nature and magnitude of payment arrears. Tanzania has 25 RAS and 161 LGA that are administratively part of the Prime Minister’s Office for Regional and Local Government (PMO-RALG). The survey program on payment arrears only covered six RAS and seventeen LGAs. The AGD quarterly report on payment arrears includes the arrears reported by RAS but does not include arrears existing at the level of local government. The teams reported difficulties in accessing data from the entities surveyed. Some entities did not even have a list of payment arrears but prepared them after the survey teams had commenced the audit. The aging profile is a weak link in the reporting process as the ‘overdue period’ is not being recorded by the entities on a consistent basis. In cases where these have been recorded, most are more than 90 days old. The reported figures do not appear to be reliable in terms of coverage and classification as only in case of 50% of entities, the summary totals for arrears reported agree with the survey results. Of the different categories of payment arrears, those relating to salary, wages and allowances are more reliable than the other categories.

The survey results point to weaknesses in the reporting of arrears by RAS. The arrears reported by the survey teams for the RAS do not match with those appearing in the AGD reports (Box 1).

As against the total of TSH 5.24 billion appearing in the AGD report, the survey teams have only reported TSH 3.87 billion. In addition survey results indicate unreported claims

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34 http://www.pmoralg.go.tz
amounting to TSH 117 million (3%) and claims requiring further investigation amounting to TSH 811 million (21%).

**The LGAs do not record the arrears in a consistent manner and do not report on a regular basis to the AGD.** The total arrears presented to the survey teams from the seventeen local government authorities are to the tune of TSH 29.61 billion. In addition survey results indicate unreported claims amounting to TSH 1.36 billion (12%) and claims requiring further investigation amounting to TSH 5 billion (45%). The total arrears for GoT are likely to substantially higher if all the LGAs are included in the reporting framework.

**The verification carried out by the survey teams could not cover the entire stock of arrears reported by RAS and LGAs.** This has been attributed to the lack of preparedness by the selected entities, paucity of time, non-availability of documents etc. Survey teams in these cases have only been able to verify a sample of the reported arrears. In other entities where all the reported arrears have been verified, survey teams have confirmed 78% and 88% of the total stock of reported arrears in case of LGAs and RAS respectively.

**The distribution of arrears across categories is slightly different from what has been reported at the central government level.** Construction retains the majority share in case of central government and LGAs but not at the level of RAS. The share of personnel payments, including salary, wages and other allowances at 27% (LGAs) and 43% (RAS) is much higher than 8% reported at the central government level. The share for goods and services at 29% and 39% for central government and RAS respectively is much higher than 11% reported for the LGAs.

**Figure 2: Category-wise distribution of arrears: LGAs and RAS**

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35 In RAS Njombe and Geita, LGAs: Njombe TC, Mbozi TC, Mbeya CC, Geita TC and Sengerema DC.
The findings as emerging from the internal audit surveys have been summarized in the section below:

General findings

- The average arrears reported by entities are in the range of 2.5% to 5% of the budget of the entity surveyed.

- In case of arrear claims that require further investigation survey teams have not provided adequate explanation/justification.

- There is lack of consistency in treatment of the arrears that have already been paid and their inclusion in the verified stock of arrears. Survey teams have pointed out that some of these arrears reported as at 30th June 2014 have already been paid, some before cut-off date and some even after that date. Entities have not reconciled the paid arrears while reporting the arrears to the AG.

- The survey points to weaknesses in the budgetary process. Annual budgets are formulated on the basis of incrementing previous year provisions and not with reference to agreed priorities and work plans.

- The preparation of cash plans and procurement plans remains an annual exercise and these are not updated during the course of the year. The provisions for Goods and Services and Utilities, central government entities have reported are not reflected in the annual procurement plans.

- The common causes for the payment arrears emerging from the survey include inadequate budget provision, especially for Other Charges; untimely and delayed release of funds and low revenue collection by the LGAs.

- Substantial claims presented as arrears have not been verified by the survey teams as they were meant to be financed by own sources. In Mwanza City Council out of the reported arrears of 2.6 billion TSH, 1.7 billion (65%) was on account of activities financed by own source (LGAs) funds.

Personnel payments

- The check (employee) number has not been consistently reported in case of arrears relating to salary, wages and other personnel payments and in some cases duplicate employee numbers have also been reported in RAS and LGAs. Survey teams have however confirmed the arrears even in the absence of the check number. In some cases these payments are being reported in the name of offices viz. Commissioner of Income Tax, RAS etc.

- The budget is being released in a timely manner to enable payments of monthly payroll costs and in most cases the provision and releases are adequate to cover the payroll costs. However, this does not hold true for other personnel claims related to transfer, medical etc.
• The **deductions from salaries** (taxes, pension deductions) through the payroll seem to be paid to correct institutions on a regular and timely basis for most entities. In case of central government entities these are paid within two weeks of the monthly payroll. However, data on deductions and their time of payments has not been provided by the surveyed entities.

• **Acting allowance and delays in effecting pay increase associated with promotion** is a common source of arrear for personnel emoluments. Acting allowance is payable to acting HoD and is regulated by the Public Service Standing Orders 2009 wherein officials in case of acting appointment are entitled either to the salary of the post or to an acting allowance paid from the provision of PE of the agencies. There are instances of accumulated payment arrears reported and verified at most of the surveyed entities.

• The arrears on count of **new recruits** are not significant. Most entities have reported that new recruits start getting salary within a month especially after the implementation of Lawson in 2010 except in the case of Police where it takes more than five months.

• Some entities have reported **payroll audit** being carried out recently in June-September 2014. In case of the surveyed entities from the central government payroll audit was done in September 2014. However, this does not seem to have been done consistently across RAS and LGAs and not all at the same time. The last inspection for example was done in 2012 for Kilwa, Dodoma, Singida DC and Lindi.

• **Other weaknesses** reported include number of current positions being more than the approved positions; recruitment against vacant positions not provided in the budget.

**Goods and Services**

• The **approved budget is not released in time** and in most cases not in its entirety. As a result entities enter into commitments even when they have not received the funds. In addition there are frequent in-year re-allocations being made to the provision for goods and services.

• The **payment due dates** are not shown on invoices. Invoices are also not issued in time and one invoice can be used for multiple supplies and payments.

• In case of entities using EPICOR, **LPOs** are issued through the system. However ‘call of order’ (LPO) are issued outside of the system on a regular basis without reference to the release funds from the Treasury.

• Some of the surveyed entities have **no centralized procurement** making keeping track of the process difficult.
Utilities
- The **budget provision** for utilities is adequate in most cases though it is not released in a timely manner. The provision is based on current usage level and projected tariff. These also do not form part of cash flow plans. The utilities budget however, is protected and cannot be reallocated to other priority items.
- The **payment due dates** are not stated on the invoices. However, utilities are better monitored with some entities having established a central registry for monitoring payments.
- The practice of **pre-payment of utilities** is common though not uniformly instituted. These include payment for electricity and internet.
- There is **no central point for monitoring** of utilities payment in the surveyed entities and individual cost centers are responsible for the same.

Construction
- The most common reason is **inadequate budget provision** which could arise because of weaknesses in the medium term budget framework (MTBF) process, contract variations not being considered in the current financial year, provisions not taking into account multi-year contracts and contracts that get extended. Other reasons include delay in release of budget, release being mostly inadequate and in most cases even the approved budget is not released in its entirety. However, this may not always be the case, for example in Tabora RAS the actual expenditure was only 16% of the released budget.
- **Political consideration** has been cited as a frequent reason for taking up construction projects outside of the approved annual budget.
- Issues with **multi-year contracts** which cannot be processed through IFMIS and are not recorded and monitored separately.
- The **budget release process in case of RAS and LGAs** turns out to be a long drawn out process - treasury to road fund board and then to implementing agency- and further compromises the timing of the release.
- There is **no central focal point for monitoring** of all construction contracts for the votes. Each department / cost center has separate arrangements for monitoring construction contracts.