Prevention and Management of Government Expenditure Arrears

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Content

• Definition and typology of expenditure arrears

• Economic impact of chronic expenditure arrears accumulation

• Underlying causes of expenditure arrears

• Mechanisms for preventing and controlling expenditure arrears

• Strategies for managing and clearing expenditure arrears
Government expenditure arrears are financial obligations that have been incurred by any level of the public sector for which payments have not been made by the due date.
Stock of Arrears in selected countries

Arrears as % of GDP

- Côte d’Ivoire (2008)
- Niger (1999)
- Albania (1999)
- Bosnia and Herzegovina (2001)
- Angola (2011)
- Gabon (2003)
- Malawi (2012)
- Georgia (2003)
- Greece (2012)
- Romania (2011)
- Portugal (2011)
- Seychelles (2008)
- Nigeria (2005)
- Central African Republic (2011)
- Gambia (2002)
Economic Impact of Arrears

- **Increased cost of service provision** - Government suppliers mitigate risks and opportunity cost of delayed payments by adjusting their initial prices upward.

- **Reduced or interrupted public service delivery** - As the cost of supplies rise, governments with limited resources may be forced to reduce the amount of supplies purchased and/or the volume of service provided. Suppliers themselves may require that government pay for goods and services in advance, that quantities supplied be limited, or that delivery of further supplies or services be made dependent on the payment of outstanding amounts.

- **Increased rent-seeking** - Chronic payment delays also increase the incentives for rent-seeking and collusion between government and suppliers, as the latter seek to accelerate payment or circumvent expenditure control procedures.
Availability of Information on Arrears

PEFA scores for 121 countries...

- A - Reliable and complete data. 12%
- B - Data generated annually, but incomplete 26%
- C - Data based on ad hoc exercise 17%
- D - No reliable data 38%
- Not scored 7%
PEFA-Stock of Arrears as % total expenditure

A- Stock <2% 31%
B- Stock between 2 and 10% and reducing 12%
C- Stock between 2 and 10% and not reducing 10%
D- Stock >10% 19%
Not scored 28%
## Typical due date for payment

<table>
<thead>
<tr>
<th>Days</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td>Afghanistan, Australia, Botswana, Brazil, Dominican Republic, Ethiopia, EU member countries, Grenada, Jamaica, Kosovo, Malawi, Moldova, Seychelles, South Africa, Trinidad and Tobago, Tunisia, Vanuatu</td>
</tr>
<tr>
<td>45</td>
<td>Costa Rica, Haiti, Lesotho</td>
</tr>
<tr>
<td>60</td>
<td>Cape Verde, Central African Republic, Guatemala, São Tomé and Principe</td>
</tr>
<tr>
<td>90</td>
<td>Angola, Benin, Burkina Faso, Cambodia, Ghana, Mali, Mauritania, Morocco, Portugal, Senegal</td>
</tr>
<tr>
<td>120</td>
<td>Niger</td>
</tr>
<tr>
<td>Not defined</td>
<td>Albania, Armenia, Bangladesh, Bolivia, Burundi, Cook Islands, Côte d’Ivoire, El Salvador, Gabon, Georgia, Ghana, Guinea Bissau, Haiti, Honduras, India, Lao People’s Democratic Republic, Macedonia, former Yugoslav Republic of Macedonia, Madagascar, Mauritius, Mozambique, Myanmar, Nepal, Peru, Philippines, Republic of Congo, Samoa, Republic of Serbia, Sierra Leone, South Sudan, Sudan, Swaziland, Tajikistan, Timor Leste, Tonga, Uganda, Ukraine, and Yemen</td>
</tr>
</tbody>
</table>
### Main Causes of Arrears

<table>
<thead>
<tr>
<th>Stage</th>
<th>Causes</th>
</tr>
</thead>
</table>
| Budget Formulation | • Unrealistic Budgets  
                  | • In year variations  
                  | • Inadequate provision for multi year commitments                     |
| Commitment      | • Incomplete coverage  
                  | • Weak cash management – monthly cash limits                           |
| Verification    | • Failure to register invoices  
                  | • Collusion with suppliers                                            |
| Payment         | • Selective payments  
                  | • Administrative delays                                               |
Government Expenditure Chain

Order for goods/services placed.

Commitment created, amount reserved against budget.

Goods and services delivered, invoice received.

Invoice approved for payment.

Expense and Payables created. Commitment is replaced by an actual expense.

Payment made by due date.

Payable is reversed, and cash is reduced by the corresponding amount.

Payment not made by due date.

Payable remains as a Liability in the books. Payment is in Arrears.
## Relationship between Stocks of Arrears and Commitment Controls

### Effective commitment controls lead to lower arrears!

<table>
<thead>
<tr>
<th>Indicator</th>
<th>PI 4 - (i) Stock of expenditure payment arrears (as a % of actual total expenditure for the corresponding fiscal year) and any recent change in the stock.</th>
<th>PI 20 - (i) Effectiveness of expenditure commitment controls.</th>
</tr>
</thead>
</table>

- **Effective commitment controls lead to lower arrears!**

**Indicators:**
- **A** includes countries from Antigua & Barbuda to Zambia.
- **B** includes countries from Armenia to Zimbabwe.
- **C** includes countries from Afghanistan to Philippines.
- **D** includes countries from Kuwait to Tunisia.

**Notes:**
- **PI 4 - (i)** Stocks of expenditure payment arrears are provided as a percentage of actual total expenditure for the corresponding fiscal year, along with any recent change in the stock.
- **PI 20 - (i)** Effectiveness of expenditure commitment controls is assessed through specific countries listed in the table.
Prevention and Control of Arrears

Strategies to deal with arrears should be tailored to specific circumstances

• **Strengthening legal and regulatory framework**
  - Definitions, sanctions
  - Expenditure controls
  - Reporting

• **Enhancing credibility and realism of the budget**
  - Check that costs are estimated adequately
  - Ensure that risks to the budget are adequately estimated and provided for, using contingency reserves
  - Ensure that outstanding commitments of multi-year investment projects are included in the budget and outer-year forecasts
  - Provide ministries and agencies with greater medium-term certainty

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Prevention and Control of Arrears

• Improving accounting and reporting
  • Coverage
  • Scope

• Strengthen commitment controls
  • FMIS controls, procurement order controls, manual ledgers

• Improve cash and debt management
  • Forecasting, short-term borrowing

• Enhance oversight of subnational governments and state-owned enterprises

• Upgrade government financial management information systems

• Implement other technological solutions
  • Prepaid utilities, meters, central purchasing etc
Clearance of Expenditure Arrears

- Take stock
- Verify/audit claims
  - Identify unpaid invoices
  - Verify and validate claims
  - Classify arrears (vintage, debtor, creditor, economic category, risk, etc.)
  - Assess appeals
  - Reject/accept claims
- Prioritize payments transparently
- Liquidate (payment, debt, securitization)
Where you can find the TNM on Arrears