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# Angola Public Expenditure Management and Financial Accountability

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**Currency Equivalents**  
**Currency Unit: Angolan Kwanza (Kz)**  
**USD= 87.40627 Kwanza (Exchange Rate Effective as of February 16, 2005)**

**Weights and Measures**  
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## Abbreviations and Acronyms

BAI	<i>Banco Africano de Investimentos</i>
BCI	<i>Banco de Comércio e Indústria</i>
BPC	<i>Banco de Poupança e Crédito</i>
BNA	National Bank of Angola
CABGOC	Cabinda Gulf Company
CGE	General State Accounts
CFAA	Country Financial Accountability Assessment
CPAR	Country Procurement Assessment Report
CUT	Treasury Single Account
DMFAS	Debt Management and Financial Analysis System
DNA	National Customs Directorate
DNC	National Accounting Directorate
DNI	National Tax Directorate
DNO	National Budget Directorate
DNPO	National Directorate for the State's Non-Financial Assets
DNT	National Treasury Directorate
ECP	<i>Estratégia de Combate à Pobreza</i>
EDEL	Electricity Distribution Enterprise
EMTA	Economic Management Technical Assistance
ENE	National Electricity Enterprise
FAD	Fiscal Affairs Department (IMF)
GDP	Gross Domestic Product
GEREI	Office of Studies and International Relations (MINFIN)
IMF	International Monetary Fund
INF	National Inspectorate of Finance
LNG	Liquefied Natural Gas
MAPESS	Ministry of Public Administration, Employment, and Social Security
MEO	Budget Elaboration Manual
MINARS	Ministry of Social Assistance and Reinsertion
MINFIN	Ministry of Finance
MINPLAN	Ministry of Planning
MTEF	Medium-Term Expenditure Framework
OGE	National State Budget
PCE	Chart of Accounts
PCRRP	Post-Conflict Rehabilitation and Reconstruction Program
PES	Economic and Social Program
PIP	Public Investment Program
PMFP	Public Finance Modernization Program
PSA	Production Sharing Agreement
SAI	Supreme Audit Institution
SIGFE	Integrated Financial Management System of the State
SIGIP	Integrated Public Investment Management System
UNCTAD	United Nations Conference on Trade and Development
UNDP	United Nations Development Program



## EXECUTIVE SUMMARY

i. One of the most salient features of Angola's public expenditure management and financial accountability framework is the coexistence of two parallel, but articulated, expenditure execution systems: the "conventional" system, coordinated by the National Treasury Directorate, and a "non-conventional" one centered around the national oil company Sonangol. A standard assessment of a country's fiscal framework would usually concentrate on the "conventional" system; the PEMFAR goes one step further by assessing the workings of the "non-conventional" system as well as its articulation with the conventional one. The key finding is that the justification of the use of the non-conventional system is gone, and its maintenance is imposing heavy costs on the economy. The PEMFAR proposes accordingly the adoption of a two-pronged reform strategy aiming at: (i) strengthening the formal public financial management structures and tools; and (ii) phasing-out and eventually eliminating the "non-conventional" mechanisms.

### POLICY CHOICES AND FISCAL OUTCOMES

ii. **The size of the public sector in Angola is considered high by international standards, but partly due to a 27-year long civil war government spending has had very limited impact on development outcomes.** Compared to the African continent as a whole, the expenditure-to-GDP ratio in Angola (nearly 50% throughout the 1990s) is twice as large as the region average (25.6% GDP). The composition of government expenditures, however, remains concentrated on activities with little direct contribution to development. In this context, a higher share of expenditures have been devoted to defense and public order in comparison to what has been spent on education, health, and other social sectors. This situation has started to change and social spending increased from 12.7% as a share of total public expenditures in 2003 to 20.1% in 2004, while the share for defense and public order declined from 13.8% to 12.5% of total expenditures over the same period. Despite this shift in the composition of public spending by function, health and education expenditures as a percentage of GDP in Angola (less than 2% for health and less than 5% for education) are (with the exception of Equatorial Guinea) amongst the lowest in the African continent (with averages of 6% and 10% for both categories, respectively).<sup>1</sup> Such composition of public spending is far below the country's needs in terms infrastructure reconstruction and provision of essential services to the population and seems to reflect political choices still concerned with the prevalence of a wartime budget.

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<sup>1</sup> Data from the World Bank's 2003 African Development Indicators; the African average figures are exclusive of South Africa and Nigeria.

iii. **Despite recent improvements in fiscal discipline and transparency, institutional weaknesses remain as an important threat to the country's fiscal stance.** A recent assessment of Angola's government expenditures recordings has collected evidence of remarkable progress in the elimination of the so-called "unexplained discrepancies" from the budget. Up until 2002, quasi-fiscal extrabudgetary expenditures were not initially budgeted but ended up being recorded ex post in the government accounts creating gaps in the published accounts that were translated into a discrepancy of roughly US\$1 billion between stated government funds and actual revenue. Unexplained discrepancies in the fiscal accounts were, among others, substantial funds received as signature bonuses for oil contracts and oil royalties, and non-transparent external debt transactions. The problem reached substantial proportions in 1997 and 1999 (amounting respectively to 22.47% and 18.38 % of GDP), and by 2002 unexplained discrepancies still averaged 3% of GDP, or US\$ 347 million. In 2003 and 2004, these discrepancies were completely eliminated from the published accounts, but sizable quasi-fiscal operations executed by Sonangol and BNA, which create uncertainty about the country's fiscal position, have yet to be eliminated.

iv. **Identified deficiencies in Angola's public financial management impair good macroeconomic management.** High government-to-GDP ratios and large quasi-fiscal expenditures, for example, are associated with inadequate cash and debt management practices. A weak fiscal stance, on the other hand, feeds high inflation which by its turn complicates budget formulation and impairs an efficient execution of expenditures. The perpetuation of public financial management practices that are non transparent and that are characterized by insufficiently clear channels of accountability contribute to hinder fiscal discipline and obstruct macroeconomic stabilization efforts. Ultimately, these inadequate practices reflect political choices that impose heavy costs on the economy. In this context, a notorious anomaly arising in the case of Angola is the existence of a non-conventional budget execution system that creates uncertainty as regards the country's actual fiscal stance.

#### **A DUAL PUBLIC EXPENDITURE SYSTEM**

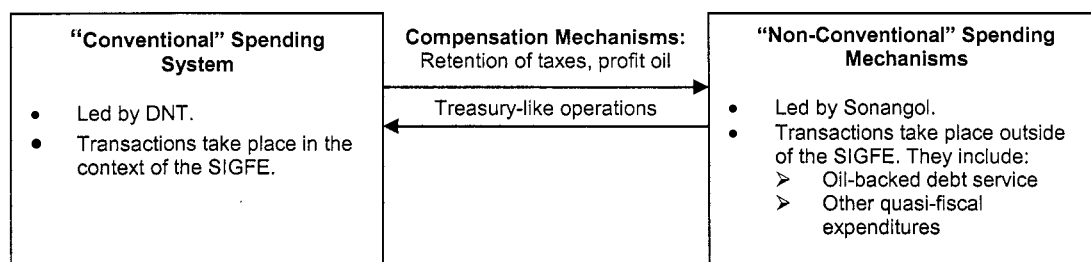
v. **A distinctive feature of Angola's public financial management system is the coexistence of two parallel spending processes.** The "conventional" system is coordinated by the National Treasury Directorate, while the "non-conventional" one, which aims to facilitate transactions such as the servicing of key external debt operations, is centered around the national oil company Sonangol. The "non-conventional" mechanisms partly emerged as a result of the war economy, where a large portion of extra-budgetary transactions were believed to be related to the procurement of military material. While expediency considerations may have played a role in a context in which national security was at stake, there is absolutely no reason for the maintenance of such mechanism in the current environment of peace.

vi. **The co-existence of parallel spending systems weakens transparency and accountability, and impairs planning.** The non-conventional system of public finances communicates with the formal system, but this happens through rather informal compensation mechanisms. In practice, Sonangol have held at the source part (or the

totality) of the profit oil and taxes due it is supposed to deliver to the Treasury, in order to compensate itself for transactions (e.g., subsidies on petroleum products, oil-backed debt service, other quasi-fiscal spending). A largely informal and unsystematic “reconciliation” process between the Ministry of Finance (MINFIN) and Sonangol ensues, and the next payment-compensation-reconciliation cycle starts.

vii. **Independently of how organized these non-conventional mechanisms can become, they violate the existing financial legislation and must be discontinued.** While during 2002 the compensation process seemed to be rather haphazard, in 2003 it became somewhat more organized and predictable. This in itself presents the additional danger of creating an artificial “functionality” that could lead to the perpetuation of a mechanism that violates basic legislation and ultimately weakens the Ministry of Finance as the chief fiscal institution in Angola. In addition, the existence of the parallel expenditure execution systems weakens the budgetary process and creates uncertainty as regards the actual fiscal stance of the Government. Chart E.1. provides a stylized picture of this complicated relationship.

**Chart E 1: The Articulation Between the Conventional and the “Non-Conventional” Spending Systems**



#### **HOW CAN NORMALITY BE RESTORED? A TWO-PRONGED REFORM STRATEGY**

viii. **There have been improvements recently in the formal public finance management system, but more needs to be done to restore normality.** Noteworthy is the progress made since 2003 on the Government’s IFMIS (Integrated Financial Management Information System or SIGFE in Portuguese – *Sistema Integrado de Gestão das Finanças do Estado*). The SIGFE is the main formal instrument to register the Government expenditures and revenues and generate monitoring reports. An updated version of it is being gradually rolled out to budget units in Luanda and the provinces for standardization and integration of all aspects of the revenue and expenditure management and reporting. Once fully implemented and control features activated, this system will be one of the strengths of public financial management in Angola.

ix. **The reforms need to be deepened in spite of some expected resistance.** In 2002, the Government took the initiative to implement a wide-ranging Public Finance Modernization Program (PMFP), with three components: (i) a *Public Finance Management* component, whose aim is to strengthen the public financial system, i.e., budgetary, financial, non-financial assets, accounting, internal control systems, public

pricing, and insurance markets; (ii) an *Information Technology* component; and (iii) a *Training and Capacity Building* component. Main areas of progress thus far include the strengthening of the commitment and verification stages of the budget cycle. The main challenges involved in meeting the PMFP goals will be political and institutional rather than merely technical. The main issue is how to engage organizations which are not part of the PMFP implementation but of whose activities lie at the core of the PMFP goals. This is particularly the case of Sonangol and, to a much lesser extent, the Tribunal of Accounts.

x. **A two-pronged reform strategy should be adopted to address the issue of the dual system of expenditure execution.** In view of the co-existence of a conventional and a “non-conventional” spending system in Angola, the PEMFAR proposes a two-pronged reform strategy:

- **To strengthen the conventional system**, by expanding and enhancing the credibility and effectiveness of the formal budget preparation, execution, accounting, reporting and control systems.
- **To “ring-fence” and phase-out the “non-conventional” budget execution mechanisms**, while establishing a carefully designed “path towards normalization” whereby Sonangol would relinquish its Treasury-like activities over a reasonable period of time.

xi. **The proposed reform strategy recognizes weaknesses in the conventional system, which must be dealt with even as broader reforms permit a gradual return to normalization.** The first prong of the strategy acknowledges that the formal budgetary mechanisms also possess weaknesses which need to be removed. The presence of such weaknesses facilitates the emergence and creates incentives for the maintenance of “non-conventional” practices. The second prong recognizes the high price of expediency – which becomes both an excuse and a conduit for corrupt practices – and proposes a transitional period in which the “non-conventional” mechanisms would be brought increasingly under the control of the Ministry of Finance and “agencies of restraint” such as the Tribunal of Accounts.

xii. **While the implementation of neither of the two prongs would be easy, reforms associated with the second prong are likely to be more politically difficult.** For one, most of the reforms under the first prong are within the sphere of influence of the Ministry of Finance, whose Public Finance Modernization Program (PMFP) may become the centerpiece of the change process. In addition, the phasing-out and eventual elimination of the “non-conventional” system is likely to face obstruction from powerful vested interests which are currently insulated from the influence of the genuine public financial management institutions.

#### **A SHORT-TERM ACTION PLAN TO STRENGTHEN THE FORMAL SYSTEM**

xiii. **Strengthening the conventional public spending system is a key element of the reform effort.** Despite recent reform efforts, the formal public financial management continues to be impaired by severe weaknesses that must be overcome. Those debilities

are pervasive, affecting all stages of the budget cycle. Their mere presence, moreover, gives rise to incentives to bypass the formal mechanisms, thereby strengthening the incentive to continue with current “non-conventional” practices. Therefore, in the short-term, the formal system should be strengthened by means of a series of implementable measures.

xiv. **To immediately improve the *budget preparation* stage it is necessary to improve coordination and forecasting skills in the Government.** Short-term actions in this realm involve: the rigorous preparation of realistic macroeconomic projections and their timely submission to the National Budget Directorate (DNO) so that the budget elaboration process initiates with a proper macroeconomic framework in place; the adoption of the Oil Diagnostic’s Financial Model to generate more accurate revenue projections; and better coordination between MINFIN and MAPESS to improve the accuracy of wage bill estimates.

xv. **The main weaknesses identified with respect to *budget execution* to a large extent refer to the non-adherence to the Organic Budget Law.** The OGE is unrealistic and therefore not easy to comply with in the first place; there is a cash rationing process and a cumbersome month-to-month cash management that makes planning impractical for the budget units. As a result, some of the latter find it legitimate to commit above and beyond the authorized commitment ceilings and quarterly plans, and sometimes even above the approved annual budget. Shortage of cash results in a selective payment of invoices and lack of transparency as well as creation of arrears. In this respect, short-term measures include: ensuring the consolidation of the Treasury’s Single Account (CUT); introducing a reasonable degree of flexibility in the cash management process; training key staff on the modus operandi of the SIGFE; and enforcing the sequencing of the budget execution process established in the Organic Budget Law (commitment, verification and payment).

xvi. **In what respects *accounting and reporting* the main weaknesses are mostly associated with the incompleteness of the process of implementing the new Accounting Law and the Chart of Accounts.** Contrary to the Organic Budget Law, which stipulates that all budgetary operations have to be recorded according to the double entry system, public accounting is still cash-based and single entry. The present accounting information system does not allow the closing of accounts and the preparation of the General State Accounts (*Conta Geral do Estado*, or CGE) as stipulated in the Organic Budget Law. To correct this situation the Government should provide training on accounting and reporting practices on a regular basis for relevant staff in the budget units; establish accounting and financial management procedures and routines for non-financial assets; and complete adoption of an accounting manual as well as the new Chart of Accounts.

xvii. **Strengthening *audit and control systems* is crucial for both prongs of the reform strategy proposed in the PEMFAR.** A major flaw in Angola’s public financial management system is that audit and control systems, although to a large extent regulated by law, do not operate in practice. The main weaknesses in this area that need to be tackled include: strengthening the National Inspectorate of Finance (INF), which is in

charge of the internal control and audit functions but is too weak to exert any real impact in terms of enforcing compliance with the Organic Budget Law; and passing and enacting the required regulations for the internal control function in Angola, which have not yet been passed, despite the fact that the Organic Budget Law was approved in 1997.

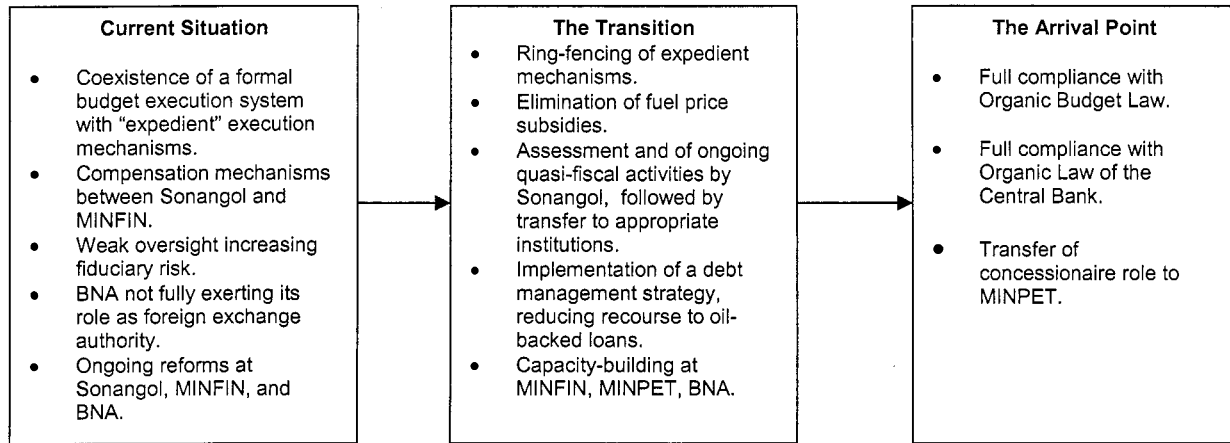
#### **RING-FENCING AND PHASING-OUT “NON-CONVENTIONAL” SPENDING MECHANISMS**

xviii. **Sonangol’s activities on behalf of the Treasury are at the core of the “non-conventional” mechanisms of budget execution.** These include quasi – fiscal activities and the servicing of oil backed loans on behalf of the Government. All those transactions are performed outside of the formal budgetary framework, the SIGFE. An ever-present risk therefore exists that their total executed amount will exceed what was allocated to them in the OGE, which further weakens aggregate fiscal discipline. The fact that they are not subject to the automatic controls of the SIGFE also implies that lines of accountability are blurred. Further, their existence gives rise to complex and largely informal compensation mechanisms between Sonangol and MINFIN.

xix. **The PEMFAR proposes a sequenced transition process, or “path towards normalization”, whereby “non-conventional” execution mechanisms would be eliminated.** This “path towards normalization” must involve the establishment of clear reporting mechanisms from Sonangol to both the Ministry of Finance and the Central Bank on all transactions it carries out on behalf of the Treasury; strengthened internal control mechanisms (both within the Ministry of Finance and Sonangol) to ensure that such transactions are conducted in accordance with legitimate fiscal policy objectives and acceptable public expenditure management practices; and improved accounting procedures, whereby the National Accounting Directorate at MINFIN obtains from Sonangol all the information it needs to prepare the yearly General State Accounts as well as Quarterly Budget Execution Reports.

xx. **“Normalization” refers in this context to a situation in which the “non-conventional” activities would have been eliminated over an agreed time period.** This would represent the arrival point of a transition process involving the key institutions - MINFIN, the BNA and the Ministry of Petroleum (MINPET). Chart E.2 summarizes the main milestones of the transition process.

**Chart E 2: A Schematic View of the Transition**



xxi. **Under these circumstances, the main challenge for the Government's PMFP lies precisely on the second prong of the proposed strategy.** Not only some of the key institutional actors currently fall outside the scope of the PMFP, but also the implementation of the needed reforms may face stiff political resistance from influential quarters in Angola. Therefore, strong political support at the highest levels of government is required for the PMFP to succeed in this task.

xxii. **Difficulties are greater with the second prong as political economy considerations are bound to play a major role.** The process of dismantling the "non-conventional" processes over a period of time will involve dealing with a powerful vested interests and traditional sources of rent-seeking. In addition, it will also require the establishment of an appropriate institutional hierarchy, one in which the Ministry of Finance would restore its undisputed role as the prime public financial management institution in Angola.



## INTRODUCTION

### THE NATURE AND SCOPE OF THE PEMFAR

The basic starting point for a sound public expenditure assessment strategy is the general proposition that the institutional framework and the management practices prevailing in a given country have a direct impact on budgetary outcomes at three levels: (i) aggregate fiscal discipline; (ii) the degree to which resource allocation and use reflect strategic priorities; and (iii) the efficient and effective use of the resources thus allocated (World Bank, 1998). The PEMFAR focuses primarily on issues related to the country's institutional framework; as a result, it emphasizes issues more directly connected with level (i), although level (ii) and (iii) issues – related to strategic prioritization and operational efficiency – are dealt with in a limited way, that is, only to the extent to which they are affected by budgetary choices<sup>2 3</sup>.

More specifically, the PEMFAR concentrates on identifying the institutional weaknesses present in Angola's public finance framework that give rise to severe fiscal problems - such as the consistent pattern of extremely large unexplained discrepancies in the fiscal accounts. Therefore, the main objective of the PEMFAR is to provide a comprehensive and integrated assessment of Angola's fiduciary framework. In this process, it also helps to fill a major knowledge gap in the critical areas of public expenditure management and financial accountability in Angola<sup>4</sup>.

The PEMFAR's policy recommendations are aimed at getting the basics right<sup>5</sup>. Although it is clear that institutional reforms need to be customized to the country's needs, some fundamental principles should guide the formulation of any proposed reform program: budgetary comprehensiveness and discipline; transparency and accountability; an adequate balance between restraint and flexibility; and a medium-term approach linking policy, planning, and budgeting.

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<sup>2</sup> For example, when operational performance is jeopardized by inadequate or untimely provision of funding.

<sup>3</sup> For a recent overview of level (ii) and (iii) issues as they affect the health and education sectors in Angola, see UNDP/IOM/UNICEF/WHO (2002).

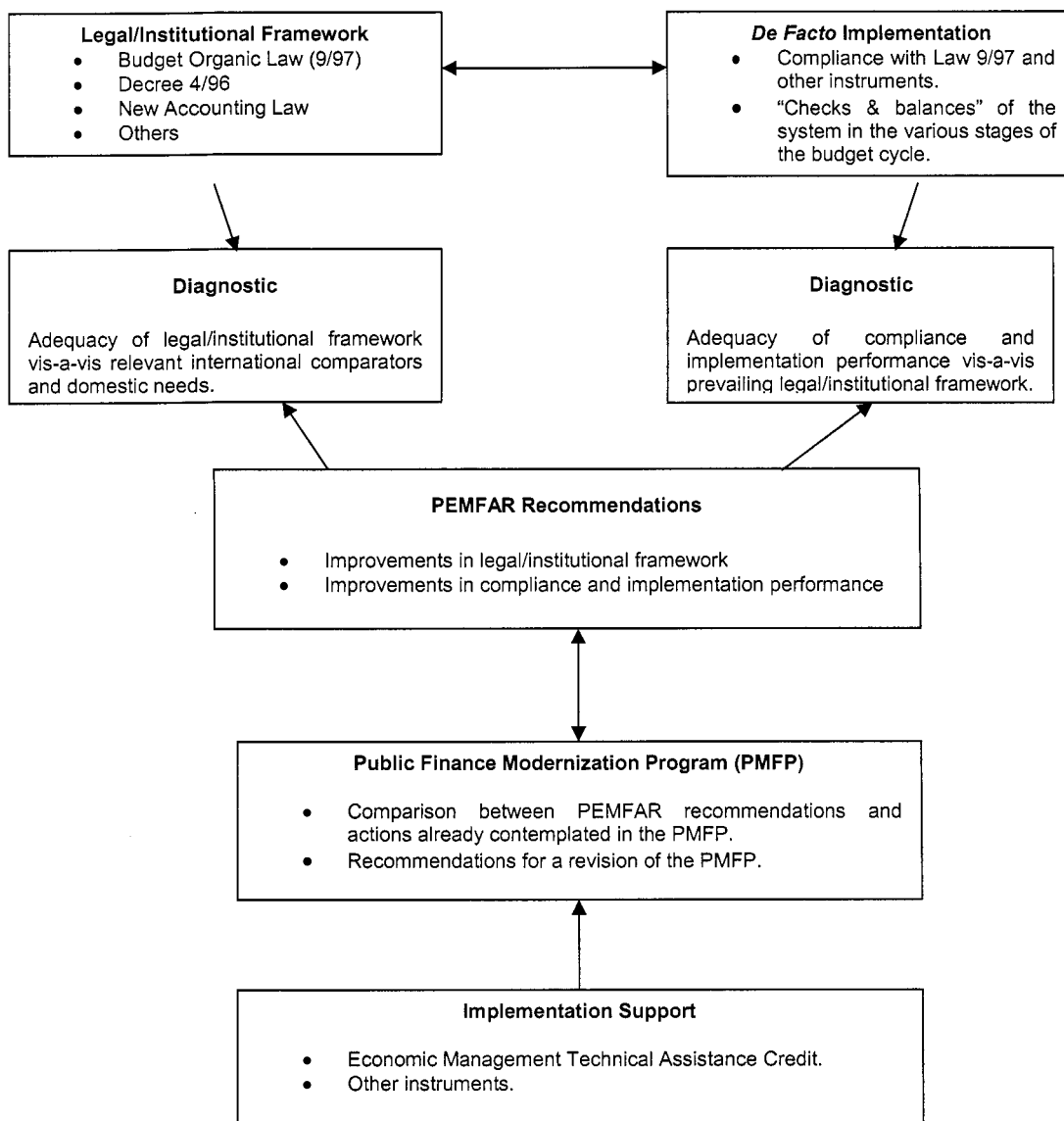
<sup>4</sup> Angola's one and only Public Expenditure Review was published in 1993. See The World Bank (1993). A Country Financial Accountability Assessment (CFAA) was never produced in Angola; a Country Profile of Financial Accountability (CFPA) was produced by the Bank in 1997. See Section IV for a fuller bibliographical discussion.

<sup>5</sup> "In other words, reformers should focus on the basics on which reform is built, not on particular techniques". World Bank (1998), p. 8.

## **THE PEMFAR APPROACH IN ANGOLA**

The overall approach of the PEMFAR has been to analyze the country's legal, institutional, and regulatory framework, comparing them with the actual, prevailing practices. Accordingly, the diagnostic work as well as possible solutions have focused both on possible gaps in the legal-institutional framework and on issues of actual implementation of legislation, regulations, and procedures. The main goals of this approach have been to maximize the country's ownership of the reform program proposed herein, while at the same time building upon existing efforts by the Angolan Government. Chart 1 below summarizes that approach.

**Chart I. 1: The PEMFAR approach in Angola**



## **ORGANIZATION OF THE PEMFAR**

The report is organized around five major themes: Overview of Angola's Fiscal Outcomes; Assessment of Angola's Public Expenditure Management Framework; Assessment of Angola's Financial Accountability Framework; Update of the Country Procurement Assessment Report (in annex 2); and, Linking Policy, Planning and Budgeting in a Credible and Transparent Resource management Framework.

The fiduciary and accountability aspects of the PEMFAR cover the following areas of the central government: Institutional and legal framework; Budget development; Budget Execution and Monitoring; Public Accounting and Financial Reporting; Internal Control System and Records; and External Fiscal Reporting and Legislative Oversight.

The PEMFAR contains nine chapters, organized in three parts: Context, Practices, and Policy Reform. Three annexes, focusing on macroeconomic and fiscal information; public procurement; and oil revenue management issues are also included.

# 1. AN OVERVIEW OF ANGOLA'S FISCAL OUTCOMES

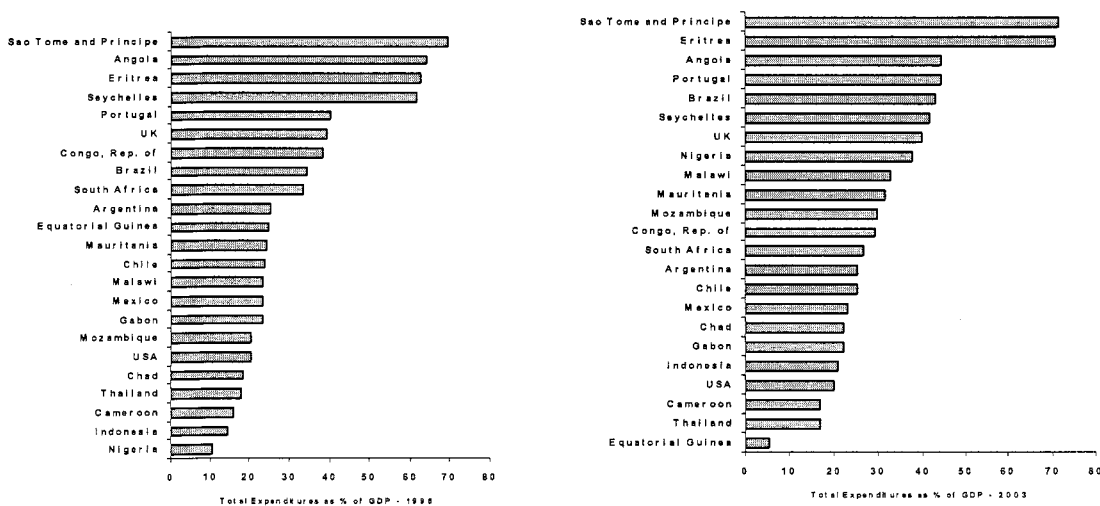
*Angola's long-term fiscal choices have been based on large public expenditures as a share of GDP. Despite the end of the conflict in 2002, the composition of public spending continues to be concentrated on activities with little contribution to development. In fact, the expenditure-to-GDP ratio remains one of the largest in Africa while the share of capital spending is one of the lowest. Identified deficiencies in the public financial management system have contributed to weaken the country's fiscal stance. As a result, the country's fiscal choices have materialized in the form of persistent fiscal deficits, the accumulation of domestic arrears, the existence of sizable quasi-fiscal expenditures, and high inflation. A concise analysis of such choices and outcomes is what this chapter sets out to do.*

## A. ANGOLA'S LONG-TERM FISCAL CHOICES

### High Expenditure-to-GDP Ratios

1.1 Partly due to a 27-year long civil war, the size of the public sector in the Angolan economy is considered high by international standards. The level of public spending as a share of GDP in Angola is one of the highest in Africa averaging as much as 55% of the GDP between 1996 and 2003 (see Chart 1.1). The highest share was registered in 1999 (82%) reflecting the scaling-up of the government's war efforts against the armed opposition movement UNITA. With the end of the conflict in 2002, this ratio has been declining steadily, reaching 37.5% of GDP in 2004, which is still high by international standards (see World Bank, 1993).

**Chart 1.1: Total Government expenditure as a percent of GDP for selected countries**



1.2 The challenge of reconstruction will demand a shift in the composition of public spending by function toward activities with a more direct contribution to development. Due to the war situation, more than half of the Government's total expenditures have been historically devoted to general administration and defense. In this context, a higher share of expenditures have been devoted to defense and public order in comparison to what has been spent on education, health, and other social sectors (see Table 1.1). This situation has started to change and social spending increased from 12.7% as a share of total public expenditures in 2003 to 20.1% in 2004, while the share for defense and public order declined from 13.8% to 12.5% of total expenditures over the same period. Despite this shift in the composition of public spending by function, health and education expenditures as a percentage of GDP in Angola (less than 2% for health and less than 5% for education) are (with the exception of Equatorial Guinea) amongst the lowest in the African continent (with averages of 6% and 10% for both categories, respectively).<sup>6</sup>

**Table 1.1: Angola Government expenditure by function, 1996 – 2004, in percent of total<sup>7</sup>**

	1996	1997	1998	1999	2000	2001	2002	2003	2004
General public services	18	15.5	17.8	3.7	7.3	27.8	33.2	47.9	30.0
Defense, Public Order and Safety	52.6	12.7	33.7	31.3	14.8	15.5	15	13.8	12.5
Social Spending (including health & education)	12.2	11	11.4	4.8	15.6	19.6	15.6	12.7	20.1
Economic Affairs and Services	2.9	3.3	3.6	1.6	3.4	7.4	5.2	8.9	5.7
Interest payments (committed)	25.9	10.7	19.9	11.1	9.3	0.2	2.1	16.8	31.7
Residual (unclassified/extra-budgetary)	-11.6	46.8	13.6	47.5	49.7	29.5	28.9	-	-

### Low Shares of Capital Expenditures

1.3 Capital expenditures in Angola are also amongst the lowest in Sub-Saharan Africa. They have dropped by more than 50% over the course of the 1990s, from as high as 35% to an average of 12% of total government expenditures, which is less than half of the average registered for SSA countries (25.3%). Excluding the Democratic Republic of Congo and Sudan, Angola has the lowest level of capital expenditures over total government expenditures in the whole of SSA.<sup>8</sup> In a country where there is an urgent need to build up infrastructure and provide essential services to the population, financing public expenditure that “crowds in” private investment should be a way to support non-oil growth and create a larger revenue base in the future.

<sup>6</sup> Source: IMF, World Economic Outlook databank.

<sup>7</sup> Source: IMF staff and Angolan Ministry of Finance estimates.

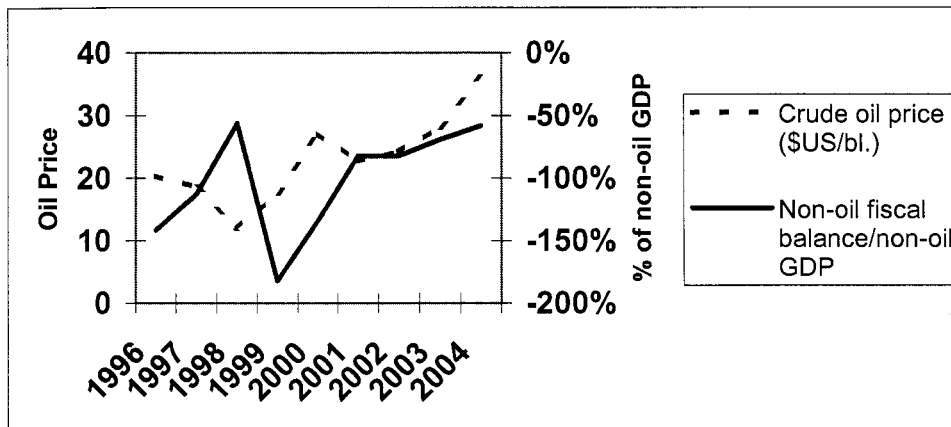
<sup>8</sup> Data from the World Bank African Development Indicators, 2003, p. 2003.

### Extreme Dependence on Oil

1.4 Angola's main source of fiscal revenue is through the taxation of the oil sector, including the state-owned oil company Sonangol. As a result, fiscal revenues have been excessively vulnerable to international crude oil price volatility and have not always been able to keep pace with expenditures. In the absence of a consistent mechanism to stabilize revenues, the Government is at the mercy of fluctuations in international oil prices – a problem made worse at times of oil market slumps.

1.5 On the other hand, during the war period the non-oil economy remained very dependent on oil price developments. As a result of the dependence on oil, pro-cyclical spending related to oil prices have led to “boom-bust” cycles with detrimental effects on the non-oil sector. The 1998 drop in oil prices to \$12 per barrel, for example, led to an immediate improvement of the non-oil fiscal balance which was followed by a major deterioration the next year when the price of oil had returned to the level observed in 1997, before the price had fallen (see Chart 1.2). The non-oil economy is apparently growing since 2002 with an estimated annual growth rate of 8.8% in 2004, which is again reflecting the impacts of higher oil production and rising international oil prices.

Chart 1.2: Non-oil fiscal balance and oil prices, 1996-2004<sup>9</sup>



1.6 Diamonds are another natural-resource source of tax revenues in Angola. The country is the world's fourth largest diamond producer, with close to 12% of the world's export value in 2003. In 2004, Angola exported 6.63 million carats of diamonds, worth US\$ 763 million. Fiscal contributions from the sector have improved dramatically in recent years, from US\$44.6 million in 2002 to US\$ 112 million in 2003. Preliminary figures for 2004, however, point to a sharp reduction in Government revenues, to US\$ 69.5 million. The potential for further growth in diamond tax revenues has yet to be fully exploited by the Government as informal production and smuggling remain significant in this sector while transparency remains very limited.

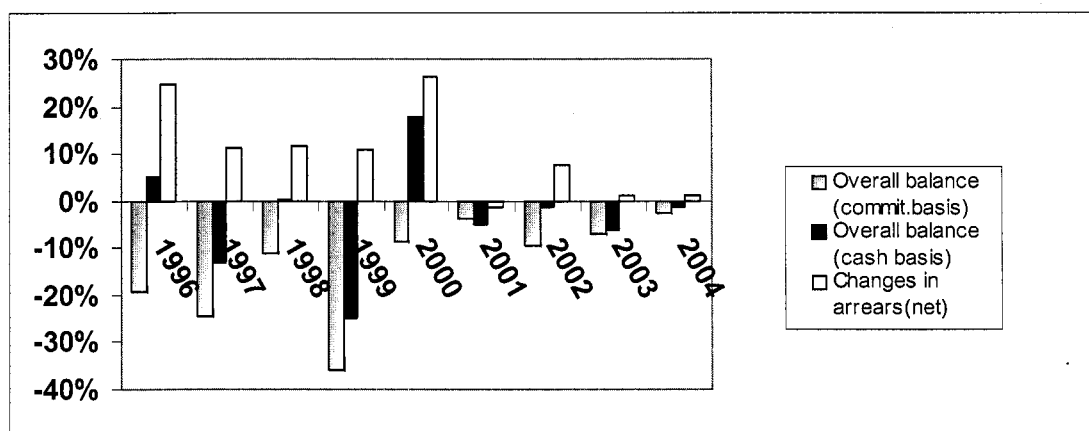
<sup>9</sup> Source: IMF staff and Angolan Ministry of Finance estimates.

## B. LINKING CHOICES TO FISCAL OUTCOMES

### Fiscal Deficits

1.7 Fiscal deficits are pervasive in Angola even in periods of rising oil prices, despite some recent improvements. The increase in oil prices observed in 1999, for example, did little to revert a long trend of fiscal deficits and accumulation of arrears. In 2000, as oil prices continued to rise, the budget deficit on a commitment basis was still as high as 8.6% of GDP, which translated into a large overall surplus on a cash basis due to the continued accumulation of domestic and external arrears. Despite a new drop in oil prices in 2001, which worsened the budget on a cash basis, the budget deficit on a commitment basis was further reduced thanks to a reduction in domestic and external arrears. Between 2001 and 2002, the fiscal deficit (on commitment basis) more than doubled reaching 9% of GDP, while the non-oil fiscal deficit remained very high, at an average of about 38 % of GDP in 2001-02. Preliminary estimates indicate a substantial decline in the fiscal deficit between 2003 and 2004, mainly reflecting exogenous factors, an apparent improvement in fiscal discipline, and policies to reduce fuel subsidies<sup>10</sup> (see Chart 1.3).

Chart 1.3: Evolution of the overall fiscal balance (% of GDP)<sup>11</sup>



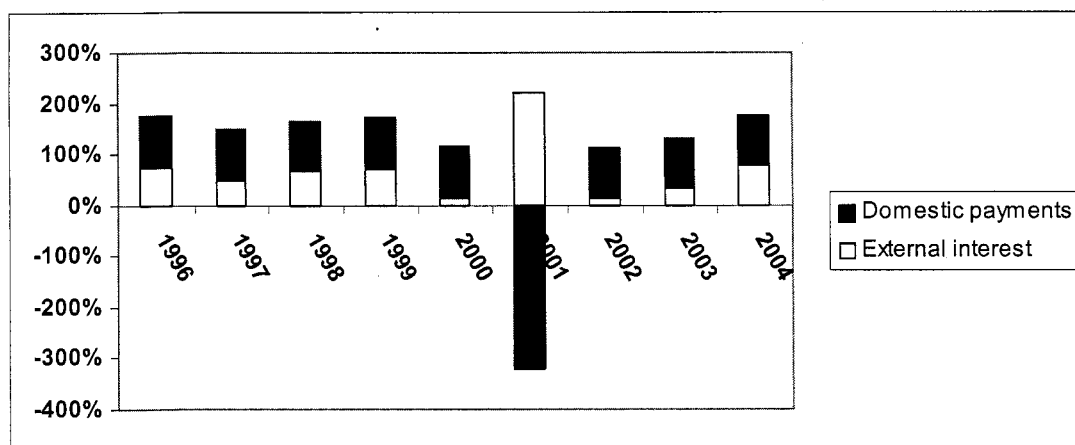
<sup>10</sup> The sustainability of this progress, however, may be limited by some associated developments: external debt levels have continued to rise following the accumulation of more, expensive oil-backed loans; international reserves remain low; the potential cost competitiveness of Angolan goods has been reduced; and, with inadequate expenditure control mechanisms, continuing payment arrears and rising debt levels, the fiscal position remains vulnerable to changes in oil prices.

<sup>11</sup> Source: IMF staff and Angolan Ministry of Finance estimates.

## Domestic Arrears

1.8 The accumulation of arrears is another marked feature of Angola's public finances management system. Since the 1990s, the composition of the government arrears has alternated between withholding domestic payments and withholding external interest payments<sup>12</sup> (see Chart 1.4). Such practice is also used by Sonangol with regard to its tax obligations to the Government. This results in a vicious circle in which Sonangol's tax arrears to the Government mirror the Government's delays in reimbursing Sonangol for the implicit subsidy to petroleum products sold domestically. This pattern of arrear accumulation is accentuated in periods of oil price declines and vice versa.

**Chart 1.4: Composition of payment arrears (% of total change in arrears)**



## Large Extra-Budgetary and Quasi-Fiscal Expenditures

1.9 Until very recently, fiscal indiscipline combined with limited comprehensiveness of the budget had resulted in large extra-budgetary and significant quasi-fiscal expenditures. In 2002, for example, the Angolan fiscal accounts revealed the existence of sizable quasi-fiscal expenditures carried out by the Central Bank (BNA), as well as large fiscal expenditures incurred outside the framework of the State budget. Quasi-fiscal expenditures<sup>13</sup> were estimated to be in the order of 6 % of GDP, while extra-budgetary fiscal expenditures reached 14.7 % of GDP. While the extra-budgetary expenditures have now been eliminated there are still concerns regarding the existence of sizable quasi-fiscal operations performed by both BNA and Sonangol.

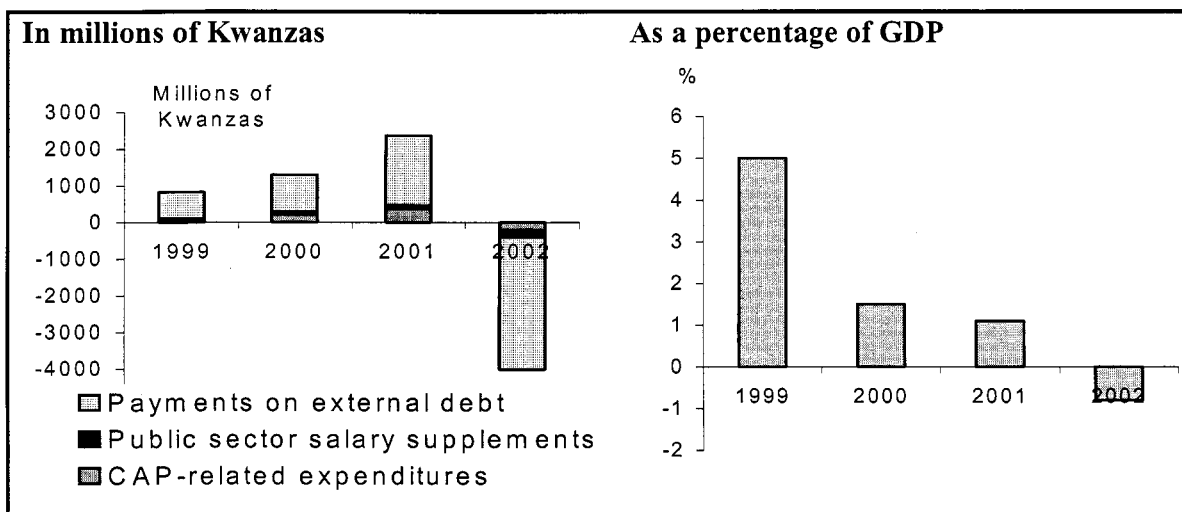
1.10 BNA's quasi-fiscal expenditures have generally fallen under two broad categories: (i) the servicing of old on-balance sheet government obligations to residents (public sector salary supplements and liquidation of the state-owned bank CAP-related expenditures), and (ii) the servicing of off-balance sheet items related to foreign debt and

12 The numbers for 1999 have been revised by IMF staff in order to account for Sonangol's tax arrears, estimated to having reached 13.2 percent of GDP in 1999.

13 Resulting mainly from a number of financial operations undertaken by BNA on behalf of the Government as well as by Sonangol.

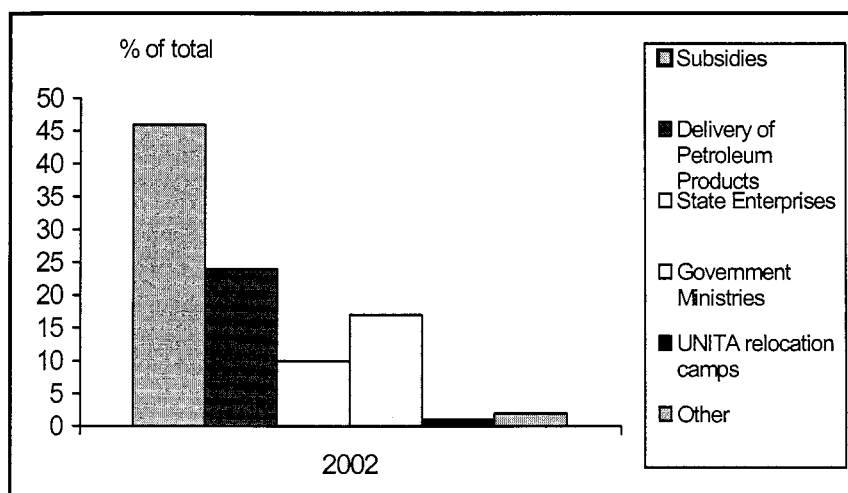
other foreign-currency denominated liabilities of the central government. The negative figure in Chart 1.5 below shows that all quasi-fiscal expenditures were transferred as credit to the government by end-2002.

**Chart 1.5: BNA quasi-fiscal expenditure (flows)**



1.11 Sonangol also performs treasury-like operations on behalf of the Government in a significant amount. In 2002, for example, the distribution of quasi-fiscal expenditures by Sonangol was concentrated on subsidies to petroleum products which amounted to 46% of total quasi-fiscal expenditures (see Chart 1.6). In addition to this, in order to compensate itself for the expenditures incurred, Sonangol unilaterally withholds tax payments to make up for the quasi-fiscal expenditures. This practice creates uncertainty over the revenue situation and the Treasury's cash position and is against the basic principles of sound financial management.

**Chart 1.6: Distribution of quasi-fiscal expenditures by Sonangol during 2002**



### **Overcoming the Plight of “Unexplained Discrepancies”**

1.12 A recent assessment of Angola’s government expenditures recordings has collected evidence of remarkable progress in the elimination of the so-called “unexplained discrepancies”<sup>14</sup> from the budget. Up until 2002, quasi-fiscal extrabudgetary expenditures were not initially budgeted but ended up being recorded ex post in the government accounts creating gaps in the published accounts that were translated into a discrepancy of roughly US\$1 billion between stated government funds and actual revenue. Unexplained discrepancies in the fiscal accounts were, among others, substantial funds received as signature bonuses for oil contracts and oil royalties, and non-transparent external debt transactions. The problem reached substantial proportions in 1997 and 1999 (amounting respectively to 22.47% and 18.38 % of GDP), and by 2002 unexplained discrepancies still averaged 3% of GDP, or US\$ 347 million. In 2003 and 2004, these discrepancies were completely eliminated from the published accounts.

#### **C. MAIN SOURCES OF DEFICIT FINANCING**

1.13 Angola’s external commitments remain a serious source of concern. Angola’s total external debt is currently estimated at US\$ 8.9 billion, or roughly 70% of GDP (including late interest). Out of this total, approximately US\$ 3.4 billion represent debt owed to Paris Club bilaterals, US\$ 2.1 billion to non-Paris Club bilaterals (including oil-backed debt to Brazil), US\$ 2.8 billion to commercial banks and US\$ 890 million as suppliers credit, which are mostly securitized, or oil-guaranteed, debt.

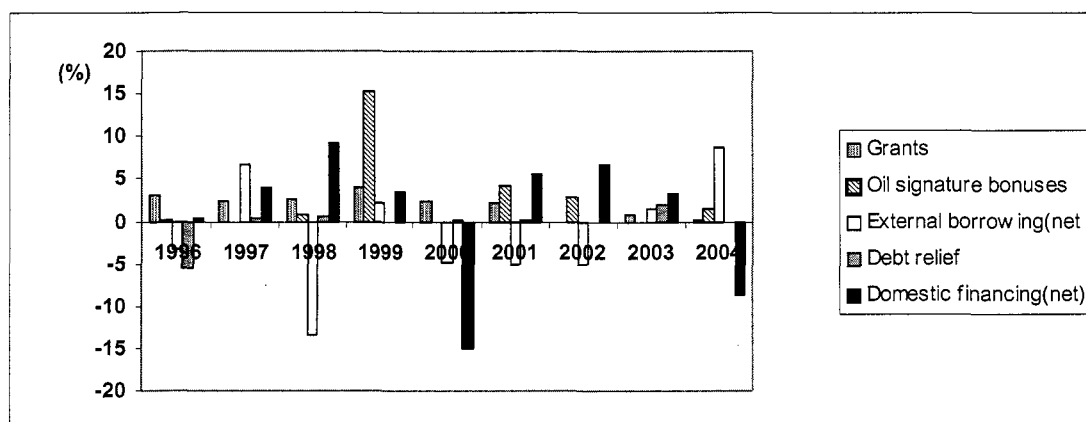
1.14 Some “stylized” facts about the deficit financing modalities practiced in Angola are worth noticing (see Chart 1.7):

- First, grants and debt relief have historically played a marginal role in financing Angola’s deficit on a cash basis.
- Second, the government has alternated between net external borrowing and domestic financing in the second half of the 1990s, probably reflecting the country’s ability to borrow in international capital markets as well as the term structure of amortization repayments of pre-existing loans.
- Third, as new oil field discoveries were made in deep and ultra-deep sea waters during the late 1990s, Angola benefited from one-time signature bonuses associated with the concession of ultra-deep water Blocks 31, 32 and 33 amounting to nearly US\$ 1 billion in 1999.
- Fourth, the accumulation of domestic and external arrears, and the receipt of oil signature bonuses allowed the government to accumulate large net claims against the banking system in 1999 and especially in 2000.

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<sup>14</sup> The discrepancy behind “unidentified” expenditures is calculated as the difference between recorded inflows (revenues plus below-the-line financing) and recorded outflows (executed expenditures as recorded by the formal budgetary system).

**Chart 1.7: Financing Angola's overall deficit (cash basis) (% of GDP)<sup>15</sup>**



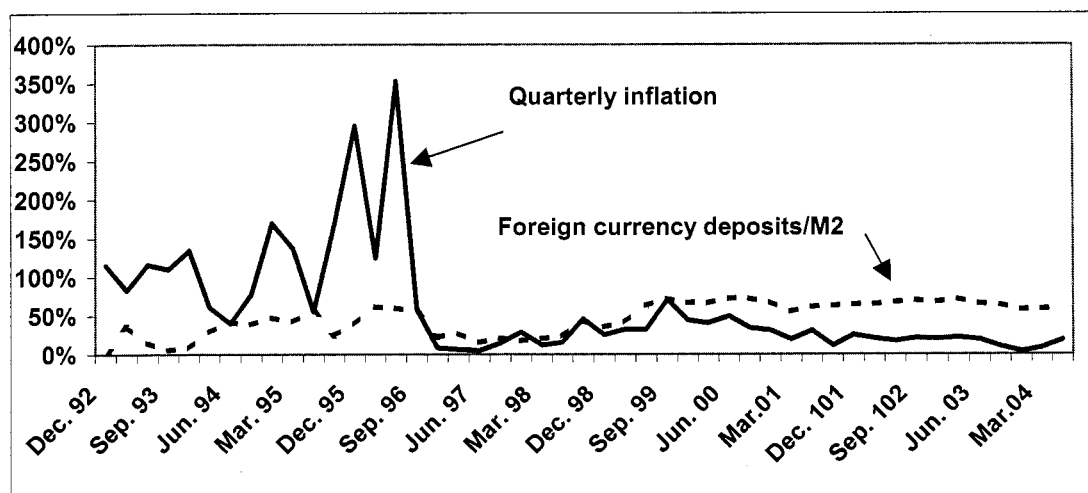
### A History of High Inflation

1.15 Angola has struggled for years with an unstable macroeconomy, but there have been recent signs of progress. A succession of failed or only partially successful stabilization plans have marked Angola's economic policy history since its first major attempts to stabilize in 1987. On the inflationary front, for example, there was a pattern of successive inflationary peaks during the period up to mid-1996 that was temporarily broken by the adoption of a stabilization plan, only to be followed by an even higher peak after some months (see Chart 1.8). There was a "structural break" in the inflation rate time series around the introduction of the "Nova Vida" Plan in 1996. Before that, inflation was not only four digits, but also very volatile, due to the continuous adoption of new (and unsuccessful) plans. With the "Nova Vida" Plan, and the introduction of a fixed exchange rate (to the dollar), inflation was halted for a while, but crept up again in 1997 as it became clear that fiscal adjustment was again being postponed.

1.16 Inflation has declined substantially more recently, but it is still considered high. The decline in the rate of inflation was made possible with a major change in macroeconomic policy implementation, popularly known as the "hard kwanza" policy. Under this new policy, the Government has promoted the liberalization of the foreign exchange market, an active absorption of domestic liquidity by central bank intervention (notably in foreign currency), development of government securities, and improvements in fiscal control. As a result, the annual rate of inflation fell from around 100% in 2003 to some 30% by end-2004. Over the same period, the exchange rate depreciated by less than 10% in relation to the US dollar, implying a real appreciation in effective terms of roughly 20%.

<sup>15</sup> Source: IMF staff and Angolan Ministry of Finance estimates.

Chart 1.8: A Snapshot of Inflation and Dollarization<sup>16</sup>



1.17 Fiscal deficits and their monetization are widely known among the main causes of inflation. The insufficient control of public spending, including notably large extra budgetary expenditures and the sizeable operational deficit of BNA, have induced large increases in base money. Additionally, in the past, favored interest groups, including Sonangol, have used arbitrage and other tactics to benefit from high inflation, for example, by delaying payments in domestic currency for oil and other sales received in hard currency. Until 2002, this combination of affairs had actually created positive incentives for high inflation. In order to guarantee the sustainability of recent progress on the inflationary front, the Government should strengthen currently ongoing efforts to improve control on public spending and monetary growth.

### A Dollarized Economy

1.18 A recent IMF study<sup>17</sup> noted that broader monetary aggregates including dollar denominated assets seem to display a closer relationship with inflation than reserve money since the issuance of kwanzas has declined over time. The high level of dollarization of the Angolan economy has been the result of high and persistent inflation and US dollars have become a main medium of exchange. Such pattern aggravates the fiscal deficit in such a way that it causes a revenue loss to the government in terms of seigniorage. The IMF estimates that 80% of demand deposits are dollar-denominated and that this phenomenon was exacerbated during 1999 and 2000 as inflation increased. Most of the monetary growth in 1999 and 2000 came from increased net foreign assets that had the cumulative effect of expanding the stock of net credit to the government.

<sup>16</sup> Source: IMF Staff, Angolan authorities.

<sup>17</sup> Angola, Selected Issues and Statistical Appendix, African Department, July 11, 2003.

## **The Road Ahead**

1.19 It is possible to relate medium-term poor fiscal outcomes with weak public expenditure<sup>18</sup> management (PEM) practices, ranging from deficient accounting to the lack of a clear, prioritized, spending program. High government-to-GDP ratios and large quasi-fiscal expenditures, for example, are associated with inadequate cash and debt management practices. A weak fiscal stance, on the other hand, feeds high inflation which by its turn complicates budget formulation and impairs an efficient execution of expenditures. The perpetuation of public financial management practices that are non transparent and that are characterized by insufficiently clear channels of accountability contribute to hinder fiscal discipline and obstruct macroeconomic stabilization efforts. Ultimately, these inadequate practices reflect political choices that have imposed heavy costs on the economy. Therefore, the conclusion seems inescapable that aggregate fiscal discipline and macroeconomic stability cannot be established without thoroughly addressing the remaining pervasive deficiencies in public financial management in Angola.

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<sup>18</sup> The analysis will focus henceforward on expenditures rather than revenues. The Bank is starting work on a Country Economic Memorandum for Angola, in which issues of oil dependency and vulnerability to oil price changes will figure prominently.

## **2. AN OVERVIEW OF ANGOLA'S PUBLIC FINANCIAL MANAGEMENT SYSTEM**

*Perhaps the most salient feature of Angola's public expenditure management and financial accountability framework is the coexistence of at least two parallel, but articulated, public spending systems: the "conventional" system, coordinated by the National Treasury Directorate, and an "non-conventional" one, which aims to facilitate transactions such as the servicing of key external debt operations, centered around the national oil company Sonangol. A standard assessment of a country's fiscal framework would usually concentrate on the "conventional" system; the PEMFAR goes one step further by attempting to understand the workings of the "non-conventional" system as well as its articulation with the conventional one. The PEMFAR proposes accordingly the adoption of a two-pronged strategy: (i) strengthening the formal public financial management structures and tools; and (ii) phasing-out and eventually eliminating the "non-conventional" mechanisms.*

### **A. ORGANIZATION AND COMPONENTS OF THE CONVENTIONAL PUBLIC FINANCIAL MANAGEMENT SYSTEM**

#### **Overview**

2.1 The basic premise for public financial management in Angola is expressed in the Constitution, which stipulates that the State guides the development of the economy and ensures the rational and efficient use of all productive capacity and national resources. It further pursues that the National Assembly is responsible for review and approval of the National Plan and of the General State budget, as well as of reports of their execution.

2.2 On the basis of the authority vested in it, the National Assembly presides over the entire budget cycle – from approval of the State budget to the examination of the final State accounts<sup>19</sup>. On the executive side, the Ministry of Finance (MINFIN) plays the main role in public finance management, from budget preparation, budget execution and accounting of all public transactions in Angola to the administration of the State non-financial and financial assets. Each spending unit has the responsibility for the execution of its budget under oversight and control of the MINFIN and to provide monthly reports on the execution.

2.3 MINFIN is organized in six operational National Directorates (Budget, Accounting, Treasury, Taxes, Customs and Non-Financial Assets), six technical support offices (International Studies and Economic Relations – GEREI; Legal; Prices and Competition; Computer Technologies; National Inspectorate of Finance – INF; and the

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<sup>19</sup> See Box 2.1 for details.

General Secretary). MINFIN has Provincial Delegations in the 18 provinces of the country. Internal control is under the responsibility of the National Inspectorate of Finance.

2.4 The other two ministries involved in public finance management are the Ministry of Planning (MINPLAN), and the Ministry of Public Administration, Employment and Social Security (MAPESS). The Central Bank of Angola (BNA) hosts the single Treasury Account, while most in-country treasury operations are carried out by the Government's fiscal agent, the Savings and Credit Bank (BPC). BPC has extensive territorial coverage (46 branches connected on line, in 14 of the 18 provinces). In the remaining four provinces, budgetary payments are still being done by another public bank, Banco Comercio e Industria (BCI). External control of state financial accounts is the responsibility of the Tribunal of Accounts, which was created in 1996 (Law 5/96).

2.5 Accounting and reporting is done by both Budget Units and the National Accounting Directorate (DNC) at MINFIN producing budgetary and management accounts. The SIGFE has become the main instrument to generate those accounts and reports and an updated version of it is being installed and gradually rolled out for standardization and integration of all aspects of the revenue and expenditure management and reporting. Once fully implemented and control features activated, this system will be one of the strengths of public financial management in Angola, not encountered in many comparable countries in the region.

2.6 The mechanical and automated internal controls over expenditures, as part of features of the SIGFE, are complemented by the internal audit function established at the MINFIN and vested in INF, which is a specialized department of the Minister of finance. As discussed in Chapter 6, INF needs strengthening to fulfill its function to its fullest, as other controls are not robust and a compliance culture is lacking.

2.7 As for the external and independent controls, the external audit of state accounts is the responsibility of the Tribunal of Accounts, which was created in 1996 (Law 5/96) and has been gearing-up to fulfill the functions of an Independent Supreme Audit Institution, yet to be fulfilled in Angola.

2.8 Finally, the cycle is completed with the scrutiny of the reports on the budget outturn by the parliament and the jurisdictional verification of the management accounts by the Tribunal (see Box 2.1).

### Box 2.1. Legislative Oversight in Angola

*The Parliament is at the very beginning and at the very end of the financial accountability cycle as far as public finances are concerned. In Angola, the National Assembly is expected to preside over the entire budget cycle – from approval of the Orçamento Geral do Estado (OGE) to the examination of the final State accounts (Conta Geral do Estado, or CGE)..*

#### a) The National Assembly at the Budget Approval Stage

The Commission for Economy and Finance (5<sup>th</sup> Commission) of the National Assembly has the power and responsibility of monitoring budget preparation on behalf of the National Assembly. In the execution of this function, it holds discussions with all the Ministries when the budget arrives at the National Assembly, and before it is presented for a vote. During these reviews and discussions the Commission compares the proposed budget with the outcome for the preceding year, to see whether the proposed budget is reasonable in the light of past experience. After the review, the Commission prepares a report, which it presents to the National Assembly for discussion in Plenary Session at the time Government is presenting the budget for parliamentary approval. The budgets for 2002 and 2003 arrived in Parliament by October 31 of the preceding year, as required by law, and were dealt with as described below.

#### b) Legislative Oversight of the Budget Execution Process

The Budget execution process is monitored by the 5<sup>th</sup> Commission itself. If deemed necessary, the Plenary can also examine specific matters, based on the opinion issued by the Commission. Again, if needed, the Commission is empowered to summon the fiscal authorities for clarification of issues. The Organic Budget Law (Law 9/97) establishes that quarterly Budget execution reports are to be submitted to the Assembly. In practice, shorter progress reports (*Balancetes Trimestrais de Execução*) are presented to the Commission 45 days after the end of each quarter.

The information is presented cumulatively; therefore, the 2<sup>nd</sup> *Balancete* contains information on the semester, and the 4<sup>th</sup> shows the yearly Budget execution. Delays are common in the presentation of such *Balancetes*. These *Balancetes* are treated as internal documents; occasionally, reference to their contents is made in the press.

Key obstacles to proper Parliamentary oversight are low capacity and lack of expertise on budgetary matters – particularly to analyze priorities at the sectoral and provincial levels - on the part of the Commission itself. In addition, the Commission's work seems to focus more in scrutinizing the budget proposal rather than on budget execution per se. The Commission currently has only two "tecnicos" to carry out all its research and advisory work. It plans to recruit four more, bringing the total to six advisers with different specializations

The Constitutional Law also establishes that the Government is authorized to contract external loans to address cash flow problems ("empréstimos de tesouraria"), as long as the loans are liquidated in the course of the year they were contracted. **For loans with longer maturity, approval by the National Assembly is required.** In practice, however, there are two modalities of approval: "explicit authorization", in which loans are individually examined by the Assembly; or "implicit authorization", in which the *total amount* of foreign loans to be contracted in a given year is recorded as part of the line item "external financing" in the State Budget. It seems that "explicit authorization" is not a common practice; however, from a legal viewpoint, the 5<sup>th</sup> Commission is empowered to request full information on the loans before they are contracted, and the authorities must attend to such requests.

#### c) Closing the Cycle: Examination of the *Conta Geral do Estado*

In addition to the quarterly balances for the last quarter of the year, the Commission is supposed to receive from the Accounts Tribunal, not later than 15 months following the end of the fiscal year, an audited financial statement, together with a summary audit report. This is expected to happen for the first time around in early 2004.

#### d) Follow-up of Audit Findings

*One of the most important traditional duties of the Parliamentary Accounts Committee (PAC) in other countries is to follow-up the recommendations of the SAI, and insists that they be implemented by the government. In Angola, where the SAI is a court of law, with powers to impose penalties for accounting failures, this traditional role of the PAC may prove to be less important.*

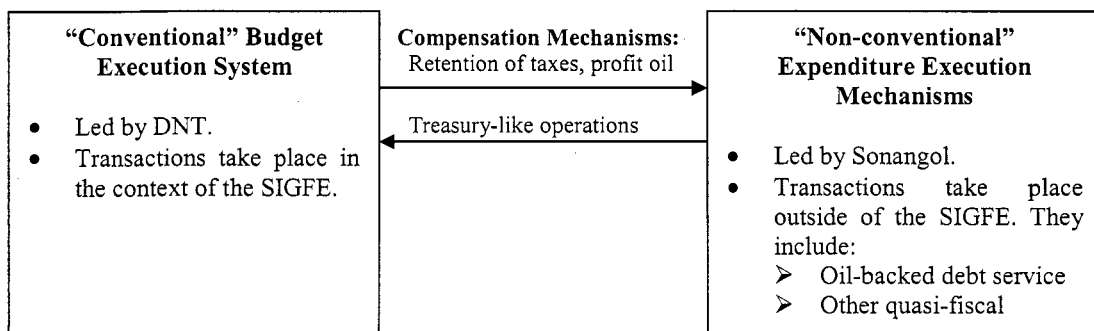
## B. A NON-CONVENTIONAL SPENDING SYSTEM DISCONNECTS BUDGETING AND POLICY

2.9 The most salient feature of Angola's public expenditure management and financial accountability framework is the coexistence of at least two parallel, but articulated, expenditure execution systems. The "conventional" system, coordinated by the National Treasury Directorate, and an "non-conventional" one, which aims to facilitate transactions such as the servicing of key external debt operations, centered around the national oil company Sonangol, among other "Treasury-like" operations carried out by the latter.

2.10 Because of such dual system, a significant share of total expenditures is executed outside the formal budgetary system. Although the numbers vary considerably in that respect, the Government's 2002 Report on Budgetary and Financial Execution of the OGE<sup>20</sup> indicates that approximately 28.4% of total expenditures (or 14.8% of GDP) were executed outside of the formal budgetary framework, the SIGFE. Given that, presumably, the entirety of the OGE is loaded in the SIGFE as the fiscal year starts, this should give a reasonable approximation of the degree of coverage of the OGE in 2002 – a little more than 70% of total Government expenditures captured in the 2002 Execution Report.

2.11 Sonangol is at the core of the "non-conventional" mechanism. What singles out Sonangol's role in Angola's public financial management processes is the degree of complexity and functionality of its articulation with the Treasury. In practice, Sonangol holds at the source part (or the totality) of the profit oil and taxes due it is supposed to deliver to the Treasury, in order to compensate itself for transactions (e.g., subsidies on petroleum products, oil-backed debt service, other quasi-fiscal spending<sup>21</sup>). A largely informal and unsystematic "reconciliation" process between MINFIN and Sonangol ensues, and the next payment-compensation-reconciliation cycle starts. Figure 2.1. provides a stylized picture of this complicated relationship.

**Figure 2.1: The Articulation Between the Conventional and the "Non-conventional" Spending Systems**



2.12 In this context, not only the links between policies and budgeting become weak, but the foundation for sound public expenditure policymaking remains fragile. As briefly

<sup>20</sup> See DNC/MINFIN (2002).

<sup>21</sup> See Chapter 7 for details.

discussed in Chapter 1, the OGE has been conceived to a large extent as a wartime budget, and the composition of Government expenditures essentially reflect that (with the share of defense and public order expenditures as high as all the social sectors combined). This is suggestive that public expenditure policies – including fuel price and utility tariff subsidies – are established in a largely ad hoc manner, and without the underpinning of a medium-term spending plan or strategy. Such situation represents a serious hinder to planning initiatives because an effective medium-term expenditure framework cannot work if a solid budgetary management process – particularly as regards budget execution – is not in place<sup>22</sup>.

2.13 The formal budgetary system must be strengthened to guide public expenditure policy. The co-existing spending mechanisms weaken the budgetary process and create uncertainty as regards the actual fiscal stance of the Government. As a result, there is not much room for effectively planning ahead and the reality is that the Government's Public Investment Program (PIP) remains merely as a list of projects to be carried out over the course of a given year when it should be the starting point for a better integration between policies and their funding. In the same fashion, the OGE, which is often referred to as a "Program Budget", has a limited scope and actually presents a listing of current Government programs that are not always consistent with the Government's intentions as stated in its annual or bi-annual Economic and Social Programs.

### **C. MAIN WEAKNESSES OF THE CONVENTIONAL BUDGETARY PROCESS**

2.14 The current budgetary legislation is complex, whereas agencies and mechanisms of control are fragmented and ineffective. There is no law below the constitution to clearly establish, in one document, the roles and responsibilities of all government agencies, relations between agencies, or establishing the authority of the MINFIN in respect of the public financial management and accountability. In fact, as an attempt to clarify, operationalize, change, or complement the laws, there is a mass of directives issued over the years. They sometimes contradict each other and need to be carefully reviewed and consolidated.

2.15 The budget legal and regulatory frameworks are not strictly followed by executing agencies. On the one hand, the financial operations undertaken by the national oil company Sonangol contradict the authority of the MINFIN and the BNA and make the revenues and debt management opaque. On the other hand, there are clear indications that the budget framework is not strictly followed by all executing agencies; sometimes reports fail to provide a sincere and truthful picture of the situation. Whatever the legislation, they should be complied with and, in particular, the annual budget law which is clear and appears annually should be followed by the executive, results and reports audited by the supreme audit institution. They should finally be scrutinized by the National Assembly.

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<sup>22</sup> As argued by Le Houreou and Taliencio (2002), "consistency between the budget and its execution is a precondition for transparency, predictability, and accountability. In a country where budget execution (i.e., actual expenditure) bears little resemblance to the voted budget (i.e., the intention to spend by sectors, functions, and programs), an MTEF is not likely to be taken seriously by sector ministries, nor by parliamentarians, nor by civil society" (p. 26).

2.16 There seems to be outright violation of the rules and bypassing of the system without consequences for the violators. The violations are evidenced by (i) arrears created by the executing agencies above and beyond the authorized ceilings and (ii) the discrepancies that exist between the administrative and financial/fiscal accounts and reports. The answerability is not clearly established and there are no known consequences for the violators of the law. No sanctions are mentioned in the legislation or known to have been taken against violators. Furthermore, rules of ethics and procedures manuals to assist civil servants in the fulfillment of their functions either do not exist or date back to the colonial time.

2.17 Finally, the internal and external controls have not been working effectively. While the internal audit bodies of the Executive lack capacity and motivation, and have not been effective, a Supreme Audit Institution (the Tribunal of Accounts) did not exist until recently. It is worth noticing that Government attempts to reform the system are in the right direction and, with assistance, the internal and external controls can become functional. By appointment of the president of the tribunal, the supreme audit institution has already started its preliminary work. This institution needs help and support of donors to fulfill its crucial function. A stronger and more effective scrutiny by the parliament will further reduce the accountability gap.

#### **D. THE NON-CONVENTIONAL SPENDING SYSTEM**

2.18 The non-conventional system is based on complex and largely informal compensation mechanisms between Sonangol and MINFIN. These include quasi – fiscal activities and the servicing of oil backed loans on behalf of the Government that are performed outside of the formal budgetary framework. Their existence blurs lines of accountability and transparency in public expenditure management in Angola.

2.19 The volume of expenditures executed through the non-conventional system is significant. According to the final 2002 Budget Execution Report, expenditures by Sonangol (excluding subsidies and debt service) outside the SIGFE represented almost 11% of total executed Government expenditures in the period. In addition, Sonangol handled in 2002 US\$ 1.2 billion to service oil-backed loans on behalf of the Treasury. In 2002, budgeted price subsidies totaled some US\$300 million dollars, of which US\$220 million (equivalent to 2 percent of GDP) were in arrears by the end of the year. Most of these price subsidy arrears (89.8 percent) were due to Sonangol Holding (through Sonangol Distribuidora) for the provision of petroleum products at below-market prices. The revised 2003 Budget incorporated some US\$ 257 million to cover for goods and services directly paid for by Sonangol.

2.20 The aimed expedience is a also source of tension. Historically, Sonangol assumed a prominent role in the execution of expenditures on the basis purely of expediency due to its having the resources and skills to perform the activities concerned. However, these activities are not the responsibility of a commercial oil and gas company but lie rather with Government. Sonangol's continued performance of these quasi-fiscal responsibilities not only blurs and complicates Sonangol's commercial operations and aspirations but also takes up the time of its own managers who would be better utilized in

furthering Sonangol's own operational objectives. It also results in tension between Sonangol, MINFIN and the BNA.

2.21 Sonangol activities on behalf of the Government are largely unbudgeted and are recovered against tax as offsets. This is a purely compensation mechanism in which no actual cash transaction occurs, preventing recording in the CUT. In practice, DNI agrees on final taxes due, but a separate MINFIN Department [GEREI] negotiates the value of the offsets. A MINFIN Committee finally agrees with Sonangol the net final balance of taxes payable. The valuation and settlement of these complex adjustments against final audited taxes due for the year is a time consuming process involving several decision stages that require political approval.

2.22 The non-conventional spending mechanism creates a worrying burden to Sonangol. The importance of transparency to Sonangol in managing its expanding commitments has never been more important in view of its ever increasing range and size of capital commitments. Measurement of the size and timing of payments and required funding for future major commitments requires transparent and accurately recorded transactions with sophisticated planning, budgetary and cost control techniques in order to avoid major cash flow problems. At present, there appears to be a danger of over stretching of resources when the foregoing activities are added to the range of quasi-fiscal and concessionary activities which Sonangol performs on behalf of the Government. Ideally, therefore, the "non-conventional" activities should be transferred back to MINFIN and the BNA as soon as possible and the Concessionary responsibilities should be transferred to the Ministry of Petroleum thereby freeing up skills and resources within Sonangol.

#### E. A TWO-PRONGED REFORM STRATEGY

2.23 The existence of a dual system of expenditure execution calls for a two-pronged reform strategy. Having identified the co-existence of a conventional and a "non-conventional" system of expenditure execution as the most basic financial management issue in Angola, the PEMFAR proposes accordingly a two-pronged reform strategy:

- **To strengthen the conventional system**, by expanding and enhancing the credibility and effectiveness of the formal budget preparation, execution, accounting, reporting and control systems.
- **To "ring-fence" and phase-out the "non-conventional" budget execution mechanisms**, while establishing a carefully designed "path towards normalization" whereby Sonangol would relinquish its Treasury-like activities over a reasonable period of time.

2.24 The proposed reform strategy recognizes weaknesses in the conventional system and recommends a gradual return to normalization. The first prong of the strategy acknowledges that the conventional budgetary mechanisms also possess weaknesses which need to be removed. The presence of such weaknesses facilitates the emergence and creates incentives for the maintenance of "non-conventional" practices. The second prong recognizes the high price of expediency – which becomes both an excuse and a conduit for corrupt practices – and proposes a transitional period in which the "non-

conventional” mechanisms would be brought increasingly under the control of the Ministry of Finance and “agencies of restraint” such as the Tribunal of Accounts.

2.25 While the implementation of neither of the two prongs would be easy, reforms associated with the second prong are likely to be more politically difficult. For one, most of the reforms under the first prong are within the sphere of influence of the Ministry of Finance, whose Public Finance Modernization Program (PMFP) may become the centerpiece of the change process. In addition, the phasing-out and eventual elimination of the “non-conventional” system is likely to face obstruction from powerful vested interests which currently insulated from the influence of the genuine public financial management institutions.

2.26 The transition process should ultimately lead to the following arrival point:

- Full compliance with the Organic Budget Law and
- The elimination of the non-conventional mechanism of budget execution.
- Full compliance with the Organic Law of the BNA, restoring its role as Angola’s foreign exchange authority.
- Elimination of Sonangol’s dual role, and transfer of its Concessionaire functions to the Ministry of Petroleum.

2.27 The remainder of the PEMFAR develops further the storyline presented in this chapter. Part II, “Practices” (Chapters 3-6), describes the strengths and weaknesses of the formal budgetary mechanisms, and prepares the ground for policy recommendations for the first prong of the reform strategy. Chapter 7 discusses the main aspects of the MINFIN-Sonangol relationship, which lies at the core of the “non-conventional” practices, and proposes a four-phase “ring-fencing” program that forms the basis for the second prong of the strategy. All comes together in Chapters 8 and 9, in which a basic reform program is proposed on the basis of existing Government tools and initiatives, such as the PMFP.

### 3. BUDGET PREPARATION

*In Angola, the most critical budget preparation issues are the coverage and the credibility of the OGE, the State Budget. In a sound public expenditure management system, a well-functioning budget preparation stage performs two critical functions, by: (i) ensuring consistency between planned aggregate expenditures and macroeconomic targets (aggregate fiscal discipline, or “level one”); and (ii) reflecting strategic policy priorities in planned expenditure allocations (“level two”). This chapter focuses mostly on “level one” issues; expenditure policy issues will be taken up again in Chapter 8.*

#### A. OVERVIEW OF THE BUDGET PREPARATION PROCESS IN ANGOLA

##### The Budget Preparation Cycle

3.1 Typical stages of a budget preparation cycle involve<sup>23</sup> : (i) the realization of macroeconomic projections and the preparation of a macroeconomic framework for the budget year<sup>24</sup>; (ii) the allocation of total budgetary resources among line ministries/spending agencies; (iii) the circulation of instructions to line ministries/spending agencies by the agency in charge of budget preparation; (iv) the submission of bids by line ministries to the agency in charge of budget preparation; (v) the conduct of negotiations between the Ministry of Finance and the line ministries/spending agencies; and (vi) endorsement of budget proposal by the Cabinet, prior to submission to Parliament for approval.

3.2 The budget preparation cycle in Angola largely follows a similar sequence of steps, summarized in Box 3.1 below. Within the legal framework provided by the Organic Budget Law (or *Lei Quadro do Orçamento*), an annual budget law is enacted that presenting the revenue and expenditure estimates for a given fiscal year<sup>25</sup>. It starts when the Economic Consistency Team<sup>26</sup> prepares a proposal for a macroeconomic scenario containing quantitative objectives and targets, and some assumptions on key variables. With that scenario, the Tax Directorate (DNI) makes revenue projections, and based on them, the Budget Directorate (DNO) establishes expenditure ceilings for line ministries/spending agencies. The following step in this chain is the distribution of budget preparation guidelines for the following year’s OGE, with the guiding principles for budgetary policy (*Orientações de Política Orçamental*), prepared by DNO. Both the

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<sup>23</sup> See Potter, and Diamond (1999).

<sup>24</sup> In countries with multi-year budget planning, the macroeconomic framework can span three or more years.

<sup>25</sup> Angola’s fiscal year runs from January 1 to December 31, thus coinciding with the calendar year.

<sup>26</sup> Grupo de Consistência Macroeconómica (GCM) – composed by the Minister of Planning, the Minister of Finance, the Governor of the Central Bank, BNA, and the Minister of Labor and Social Security.

macroeconomic scenario and the budget guidelines require approval by the Council of Ministers. By mid-year, line ministries/spending agencies prepare budget requests, which are reviewed by and negotiated with MINFIN. Box 3.2 summarizes the budget preparation process from the standpoint of line ministries/spending agencies.

**Box 3.1. Timetable for budget preparation:**

- **January/March - Macroeconomic scenario**
- April/May – preparation and distribution of budget preparation guidelines (“budget call circular” to line ministries/spending agencies and Provincial Governments)
- June/July – Line ministries/spending agencies prepare budget requests
- August – Review and negotiation between MINFIN and line ministries/spending agencies
- By September 30 – Budget proposal presented to the Council of Ministers<sup>27</sup>.
- By October 31 – Budget proposal endorsed by the Council of Ministers and submitted to the National Assembly.
- By Mid-December – Annual Budget approved by the National Assembly<sup>28</sup>.

**Box 3.2. Budget Preparation from the Standpoint of Spending Agencies**

Typically, line ministries, spending agencies and provincial governments receive, around April or May, guidelines for budget preparation (including expenditure ceilings): recurrent expenditures guidelines from MINFIN, and capital spending instructions from MINPLAN (guidelines for PIP include ceiling expenditures for each sector and instructions for resource appropriations). At line ministries, the General Secretariats prepare proposals for recurrent expenditures; those for capital spending are the responsibility of the Planning Departments. Budget proposals are handed to MINFIN by June each year and negotiations take place around July. For capital expenditures, higher priority is given to projects already underway; remaining funds can then be allocated for new projects.

3.3 Budget ceilings provided to the line ministries/spending agencies in principle are derived from macroeconomic and revenue forecasts (the key variables used in the macroeconomic forecasts are listed in Table 3.1 ).

3.4 However, in practice, macroeconomic projections are frequently made available to DNO with a lag, which means that the budget elaboration process starts without a proper macroeconomic framework in place.

3.5 In order to establish expenditure ceilings, DNO prepares cost estimates, based on the expenditure actually executed in the previous year, the number of employees per spending agency and the number of spending agencies per line ministry.

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<sup>27</sup> The draft proposal of the Annual Budget, “*ante-projecto de Orçamento*”, with recurrent and capital expenditures as prepared by MINFIN. There are no legislative limits on expenditure, deficit and borrowing.

<sup>28</sup> The Budget approval process underwent some modifications since last year with the introduction of new methodologies and routines for approval, i.e., the whole process now takes 6 weeks (divided into 30 specific stages) for conclusion, once the Annual Budget documents are submitted to the National Assembly.

3.6 Once the “Orientações de Política Orçamental” are approved, MINFIN and MINPLAN launch the process of preparation of the annual budget and of drafting of the Public Investment Program (PIP). A budget call circular is issued, including the expenditure ceilings by line ministries/spending agencies and provincial Governments<sup>29</sup>.

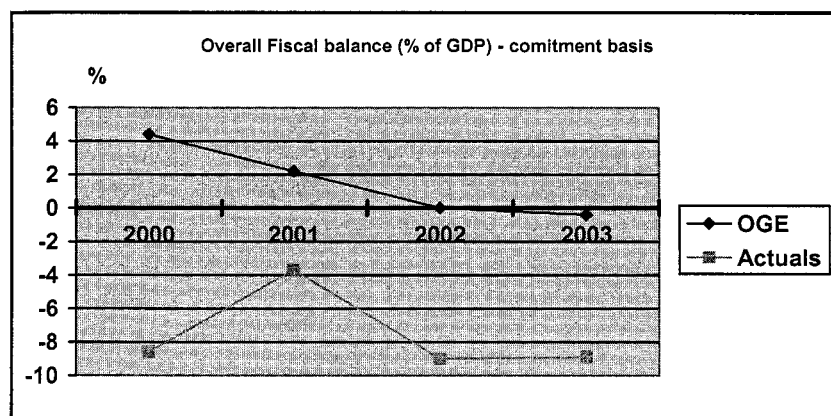
## B. THE CREDIBILITY OF THE OGE

3.7 In order to improve the credibility of the OGE, the Government needs to make progress in two crucial fronts: (i) the realism of macroeconomic assumptions and projections, including revenue and expenditure projections; and (ii) the reliability and verifiability of the cost information provided by the Budget Units, during the preparation of the OGE, particularly with respect to personnel costs in politically-sensitive areas of the public administration.

### Realism of Macroeconomic Assumptions and Projections

3.8 At the root of public management issues - such as overoptimistic budget formulation, inadequate cash and debt management or the absence of a medium-term approach to budgeting - lies inadequate macroeconomic forecasting. With the exception of overall growth and oil sector growth that have been accurately forecast, there are important discrepancies between actuals and the OGE assumptions. The fiscal deficit, for example, has been consistently underestimated over the last 4 years (see Chart 3.1) – the same happening with the case of inflation.

**Chart 3.1: Overall Fiscal Balance on a Commitment Basis  
(% of GDP): OGE vs. Actuals**



3.9 The “over-optimistic bias” in the OGE exacerbates reputational risks associated with the Government’s own disinflation program: while it might be argued that the underestimation of inflation and deficit is indeed intended as an announcement of the Government’s intention to tighten fiscal spending, the fact that those assumption have been proved incorrect in the same direction indicate a degree of inconsistency that might

<sup>29</sup> Revisions of the draft budget are still frequent; one reason is, as pointed out above, that budget preparation often starts without the fundamental economic assumptions being fully established.

have unintended effects. In particular, it might impel economic agents to require the application of more stringent fiscal restraint measures for a longer period of time before they believe on the Government's commitment to stabilization and act accordingly<sup>30</sup>.

### **Reliability and Verifiability of Cost Information**

3.10 The lack of a centralized payroll system undermines the credibility of the wage bill estimates (25.8% of the total Revised 2003 OGE). This is further complicated by the fact that the MINFIN and MAPESS registries do not include staffs from the Ministries of Defense and Interior.

3.11 Because of difficulties encountered by MAPESS in its listing of all administrative staff, MINFIN has found more efficient to work on the list of personnel prepared by each budget unit (UO) for budgetary purposes at the beginning of the year which, unfortunately, might not yet coincide with MAPESS' own lists.

3.12 In addition, control over the whole administration of staff has not been efficient so far, leading to higher real personnel costs than estimated at the time of budget preparation. Indeed, the UOs' cash need previsions sent to DNT every month might differ from the six-month cash commitments they obtain automatically from the SIGFE system on the basis of their annual budget allocation, thus creating additional discrepancies at the time of payment.

3.13 A review of budget execution for the first six months of FY03 shows that personnel costs estimates for the year increased from IRO 1,235 million at the time of budget preparation to IRO 1,749 million as of June 30, 2003, that is a total increase of 42%. Yet, for civil servants initial budget figures had been under estimated by 23%, while personnel expenses for the defense, security and public order were revised up by 162%. As the payment of salaries is first priority for the Treasury, and because of the high share of personnel costs in total current expenditures (43%), the impact of under estimating personnel costs might be one of the main factors creating scarcity of cash in the Treasury. This situation, in turn, may lead to arrears in the payment of other expenditures already budgeted and most probably already committed.

### **Recommendations for Reform**

3.14 The process of generating credible macroeconomic assumptions and projections should not be seen as a pro forma exercise. Past experience – through, for example, the use of time-series techniques to assess the behavior over time of key variables, when applicable - should be used to produce more realistic macroeconomic assumptions for budget preparation.

3.15 A review of public administration costs of personnel should be undertaken. One of its objectives would be to identify the reasons explaining the discrepancies between budget estimates and reality. This should facilitate a more accurate estimation of current expenditures during the budget preparation stage and lead to a progressive reduction in the amount of arrears.

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<sup>30</sup> Perhaps the main indicator that the Government's disinflation policies have become more credible is a sustained increase in the demand for Kwanzas and the accompanying *de-dollarization* of the economy.

3.16 It is critically important to enhance institutional coordination between MAPESS and MINFIN, on the one hand, and the Ministries of Defense and Interior, on the other. The personnel information systems at MAPESS and MINFIN should be unified, and a move towards a single cadastre of all public sector personnel should be conducted.

### C. THE COVERAGE OF THE OGE

3.17 Important aspects of Angola's Budget Law pertaining to the principles of unity and universality of the budget are critically and consistently violated. Areas in which OGE coverage is faulty or non-existent include: (i) expenditures carried out by Sonangol on behalf of the Treasury; (ii) quasi-fiscal spending by BNA; (iii) BNA's operational deficit; (iv) donor grants and counterpart funds; (v) own revenues by autonomous institutions, autonomous funds, and provinces; and (vi) payments to budget units located abroad (embassies and diplomatic missions).

3.18 Although the numbers vary considerably in that respect, the Government's 2002 Report on Budgetary and Financial Execution of the OGE<sup>31</sup> indicates that approximately 28.4% of total expenditures (or 14.8% of GDP) were executed outside of the formal budgetary system, the SIGFE. Given that, presumably, the entirety of the OGE is loaded in the SIGFE as the fiscal year starts, this should give a reasonable approximation of the degree of coverage of the OGE in 2002 – a little more than 70% of total Government expenditures captured in the 2002 Execution Report.

3.19 Defective coverage has a triple impact on Angola's fiscal and public financial management. First, it denotes insufficient transparency and unclear accountability, which creates an environment conducive to fraud and corruption. Second, it usually leads to an underestimation of the "true" fiscal deficit, thereby complicating an assessment of the country's fiscal stance. Third, it further undermines the credibility of the OGE.

3.20 *Quasi-fiscal spending by the BNA*<sup>32</sup> has mostly taken the form of: (i) costs related to the process of liquidation of the CAP (*Caixa de Agricultura e Pesca*) bank; (ii) salary supplements to certain categories of civil servants; and (iii) payments in foreign exchange for Government's liabilities contracted abroad. In total, these expenditures reached US\$ 107.1 million in 2001 (1.1% of GDP) and US\$ - 92.3 million in 2002 (- 0.8% of GDP). In addition, BNA's operational deficit, estimated at US\$ 247 million in 2002 (2.2% of GDP) has not been included in the OGE.

3.21 A recent report by the IMF's Fiscal Affairs Department<sup>33</sup> - which counted with the participation of the Bank's PEMFAR team – analyzed extensively the other expenditure categories for which coverage is insufficient. That report's main findings are highlighted as follows:

- The OGE has not been able to capture the totality of *donor grants and counterpart funds*. Data from OECD's Development Assistance Committee suggest that during 1995-1999 Angola ODA receipts were actually above the

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<sup>31</sup> See DNC/MINFIN (2002).

<sup>32</sup> See Alvesson Torrez (2003).

<sup>33</sup> See Tollini *et al* (2003).

average for Sub-Saharan Africa. The 2004 OGE estimates donor grants as US\$ 14.6 million, or 0.2 % of the total Budget, but this is very likely to underestimate the true amounts. New mechanisms for the recording of donor grants were established by Decree 80/2001. In practice, only those grants for which there are associated Government counterpart funds end up recorded, as they have immediate fiscal implications for the OGE.

- Own revenues by Angolan embassies or diplomatic missions abroad are not systematically recorded in the OGE. The usual control mechanism involves a monthly submission, by such entities, of their accounts to DNC, including their own revenues as well as their total expenses. [The total share of embassies and diplomatic missions in the 2004 OGE amounts to only \_\_%. Own revenues by autonomous institutes<sup>34</sup> are reportedly fully recorded in the OGE.] Current legislation states that autonomous institutes must surrender 60% of its own revenues to the Treasury. In both cases of own revenues, reporting to DNC is not systematically done. This is particularly relevant to the release of budget credits to embassies and diplomatic missions, as DNT would as a rule transfer them only the balance of own revenues minus total expenditures. Therefore, there is a built-in incentive for those entities to under-report their own revenues in order to increase the inflows of funds from the Treasury.
- Own revenues by provincial governments are also reported ex post – if at all – to DNC. In many instances, local revenues become, in practice, extra-budgetary funds for provincial governments. There occurs here a “compensation mechanism” analogous to that between Sonangol and MINFIN: provincial governments have an incentive to retain their own revenues as monthly financial quotas from DNT often reach them with a delay (see Chapter 4 for more details). In addition, the provincial sub-accounts (“provincial CUTs”) of the Treasury Single Account (CUT) often maintain a positive balance, contrary to the “principle of zero balance” advocated in such cases.

3.22 The main recommendations from the FAD report – endorsed by the PEMFAR - on coverage issues are:

- to enhance interaction with UNDP, which has closer contacts with the various donor agencies, to obtain updated information about the activities and plans of different donors;
- to enforce a recent agreement between MINFIN and MINARS<sup>35</sup> to improve the flow of information on humanitarian assistance;
- to create an individual code for each donor in the source-of-funds classification modality of the OGE, facilitating identification of expenditures in accordance with the sponsoring donor agency;

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<sup>34</sup> Autonomous funds are being subject to a complete evaluation by MINFIN. Those funds also have own revenues (legislation states that at least 25% of their total spending be covered by their own receipts). During this period, OGE resources to those funds will be limited to salaries and minimal operational costs.

<sup>35</sup> Ministry of Social Assistance and Reinsertion.

- to increase the capacity in DNO, DNC, and DNT to adequately oversee the process whereby own revenues are calculated, collected, and reported to MINFIN;
- to expedite the process whereby DNT releases monthly financial quotas to the provinces (refer to discussion in Chapter 4); and
- to accelerate the process of roll-out of the SIGFE to the provinces, allowing real-time connection between the Treasury Single Account (CUT) at BNA and the provincial CUTs, ensuring observance of the “zero-balance principle” for the latter.

### **The Revised 2003 OGE**

3.23 The Revised 2003 Budget – released in August 2003 - stands out as a landmark document: Not only does its justification document (Relatório de Fundamentação) provides one the most candid assessments of Angola’s public financial management woes but it also took an important step by incorporating the estimated aggregate amounts of quasi-fiscal expenditures undertaken by the BNA and Sonangol for the remainder of 2003. Added to the original 2003 OGE were US\$ 257 million for goods and services paid by Sonangol on behalf of the Treasury, and US\$ 144 million. The Revised 2003 OGE also included additional US\$ 34 million for fuel price subsidies<sup>36</sup> for the rest of 2003. Preliminary information received from Sonangol for up to October 2003 indicate, however, that those numbers were substantially underestimated, especially regarding fuel price subsidies<sup>37</sup>.

3.24 However, the Revised 2003 OGE represents the first major attempt by the Angolan Government to regularize its extra-budgetary and quasi-fiscal spending, and make them an integral part of the budget process. An important caveat is that even if the aggregate amounts for expenditures paid by Sonangol are included in the State Budget, their execution still takes place outside of the SIGFE, the formal budgetary system. As such, they are still part of the “non-conventional” mechanisms of budget execution to be discussed in more detail in Chapters 4 and 7.

### **Recommendations for Further Reform**

3.25 The Government should strive to increase the coverage of the OGE. The incorporation in the Revised 2003 Budget of estimated aggregate amounts of extra-budgetary spending by Sonangol was clearly an important first step<sup>38</sup>, but it does not solve the problem of OGE coverage. The mostly needed next step is the establishment of a regular process whereby those transactions become routinely incorporated in the OGE (even if their actual execution still, for a time, bypasses the SIGFE). First, although there exists information on the actual transactions carried out by Sonangol on behalf of the Government (see Chapter 7), it is recommended that an *independent validation*

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<sup>36</sup> Refer to Araujo *et al* (2003).

<sup>37</sup> When the Revised 2003 OGE was released, there was a general expectation – that did not materialize – that fuel price subsidies would be gradually eliminated over the course of the second half of 2003.

<sup>38</sup> As well as the first stage in the process of “ring-fencing” the Sonangol-MINFIN relations, to be discussed in Chapter 7.

*exercise* be carried out on such information, under the leadership of DNO, during the process of preparation of the OGE. This exercise could benefit from the financial audit of Sonangol's 2003 accounts, which should cover those activities as well. Second, formal mechanisms need to be developed that allow DNO to systematically assess and validate such information on a regular basis, until the phasing-out of such transactions is completed. Currently, DNO's capacity for that task is quite limited. Therefore, a tailor-made capacity-strengthening process of its staff is recommended.

#### D. BUDGETING OF CAPITAL EXPENDITURES<sup>39</sup>

3.26 The budget is de facto compiled by two different ministries - MINFIN for recurrent expenditures and MINPLAN for capital spending. Integration of current and investment spending is not complete. For all practical purposes, Angola is a typical case of "dual budgeting", defined as "a dual process of budget preparation, whereby the responsibility for preparing the investment or development budget is assigned to an entity different from the entity that prepares the current budget"<sup>40</sup>. The "dualism" is replicated at the line ministry: while recurrent expenditures are the responsibility of a sector ministry's general secretariat, capital expenditures are planned and monitored by their departments of planning and studies.

3.27 The Public Investment Program (PIP) is expected to be an annual budgeting exercise that distinguishes projects by sector and province, and which projects are on-going and new. According to the budget preparation guidelines<sup>41</sup>, UOs must present their investment budget proposal to MINPLAN not later than August 22 of any given year for the next year. In turn, MINPLAN should present a Public Investment Program (PIP) proposal to MINFIN not later than September 15 to be incorporated in the OGE for the subsequent fiscal exercise<sup>42</sup>. The PIP is still a small component of the budget and is estimated to reach IRO<sup>43</sup> 833 million in 2003 or about 17% of total budget expenditures. It does not yet provide any information on projects that have ended in a particular year, nor on investment amounts of on-going projects that will be transferred to subsequent years. In addition, there are no mechanisms to record long-term investment contracts at the moment of their signature.

3.28 A System of Public Investment Management and Programming (SIGIP, in Portuguese) was established, with the following main objectives: (i) formulation and implementation of a public investment management and programming system, (ii) articulation of the PIP with the Government's program and annual budget, (iii) articulation and coordination of public investment at sectoral and provincial level and (iv) improvements in the technical capacity for preparation and execution of public

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<sup>39</sup> The capital expenditure budget, in Angola, includes not only the Public Investment Program, but also Government's transfers to public companies (including the so-called "operational subsidies, see chapter 4) and amortization of financial liabilities, including external debt.

<sup>40</sup> Schiavo-Campo and Tommasi (1999, p. 95). The OGE presentation includes both the recurrent and investment budgets, although each is prepared by a different entity.

<sup>41</sup> *Manual de Elaboracao da Proposta Orcamental - MEPO*.

<sup>42</sup> As a matter of exception, the 2003 PIP proposal was entirely prepared by MINFIN.

<sup>43</sup> Angola's budgetary measurement unit, equivalent to US\$ 1.

investment projects. The SIGIP is also expected to contain detailed information about the projects included in the PIP (the OGE only describes the project title, its classification code, the agency in charge – either a line ministry or a provincial government – and, the amount allocated to it within the budget year). Project details such as objectives, amount, beneficiaries, and expected results can be found in project registration forms (fichas de cadastro), which are completed manually by the UOs and furnished to MINPLAN.

3.29 The SIGIP, however, is still confined to MINPLAN and not used in practice by the spending agencies. Moreover, an interface between the SIGIP and the SIGFE has not been established, which complicates further the integration between the capital and recurrent budgets.

3.30 In the absence of a multi-year planning framework<sup>44</sup>, the PIP does not show investment projects over a timeframe longer than the budgeted year. In practice, MINPLAN is responsible for PIP programming as well as monitoring of its “physical” execution, whereas MINFIN is in charge of financial programming for the PIP and of monitoring of its financial execution monitoring.

### **Ongoing Reforms and Actions Contemplated in the PMFP**

3.31 The PFMP explicitly acknowledges the need to address the dual budgeting issue. In its budgetary management chapter, and under the general goal of “increasing the comprehensiveness of budgetary control”, the PMFP includes the following policy measure: “to review and improve the budgetary process for the Public Investment Program and redefine the interface with MINPLAN”. Although not accompanied by a more specific plan of action, this measure suggests that the Government is concerned about the dual budgeting issue in Angola. The SIGIP is expected to start being a real management tool in the 2004 budget cycle. Furthermore, investments will be classified in accordance with the new public chart of accounts, including projects’ sources of financing. However, they will not include the details of the economic classification because of its complexity and the authorities’ concern that the UOs may not have the capacity to prepare the budget on time. MINPLAN is also undertaking a process of cleaning-up the PIP’s investment portfolio. As a result, new investments in 2004 will be limited to the execution of ongoing projects and to the financing of feasibility studies for new projects. The final objective of the Government is to make a complete inventory of existing commitments with a view to eliminate payments for capital expenditures that were not followed in the past and that added to the arrears problem during the course of the year. In the subsequent years, new projects will be prepared in accordance with the new Development Planning Law.

### **Recommendations for Further Reform**

3.32 The August 2003 FAD mission, supported by the Bank, concluded that the Government should converge to a situation in which a single entity be responsible for the preparation of the entire budget, including the process of negotiation with the sectoral agencies that undertake capital spending. In this context, DNO should be responsible for the preparation of the OGE as a whole, including the PIP. MINPLAN’s role would need

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<sup>44</sup> This will be discussed in detail in Chapter 8.

to be restructured accordingly, possibly with the adoption of a narrower focus, mostly restricted to medium- and long-term planning. Another possibility could be the eventual merger of MINPLAN and MINFIN. The Government should, therefore, strive to find a sustainable, long-term institutional solution for the dual budgeting issue.

3.33 It is important to stress that this is not an issue of having the capital and recurrent budgets prepared under the same roof; more importantly, the two processes need to be truly integrated. This is why simply merging the entities in charge of the State budget is not a panacea. As noted by Schiavo-Campo and Tommasi (*op. cit.*, p. 96), “(...) the real issue of dual budgeting is the lack of integration between investment and current expenditure programming, and not the formally separate processes in themselves (...) to misspecify the issue would lead (and often has) to ‘solving’ the problem by a simple merger of two ministries – even while coordination remains just as weak.”

3.34 From a sequencing point of view, before a longer-term solution for the dual-budgeting issue is chosen and adopted, attention should be paid to strengthening the investment budgeting process itself. Not only should the integration between MINPLAN and MINFIN in the budgetary process increase, but also the monitoring of the execution of the PIP (see Chapter 4) needs to be considerably improved. At a minimum, in the short term, increased collaboration between MINPLAN and MINFIN in the elaboration of the PIP should take place, and particular attention should be placed on the establishment of an interface between SIGIP and the SIGFE.

3.35 Furthermore, the design of the PIP should follow a multi-year approach, one that is solidly anchored in the PRSP (refer to discussion in Chapter 8).

## **E. THE STATUS OF BUDGET UNITS AND BUDGET CLASSIFICATION ISSUES**

### **The Multiplicity of Budget Units**

3.36 Starting with the 2001 OGE, a number of dependent agencies (órgãos dependentes), especially in the education and health sector, acquired the status of budget units, or UOs. In total, the number of UOs increased from 156 in 2000 to [487] in 2001. As a result, central and provincial hospitals, as well as secondary schools and tertiary education institutions, until then dependent on the Ministries of Health and Education, respectively, for their funding, became eligible to receive budgetary resources directly from the Ministry of Finance<sup>45</sup>. The main goal of this change was to allow greater efficiency in the transfer of resources from the Treasury to those entities, and to increase control over their financial reporting<sup>46</sup>.

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<sup>45</sup> As noted in UNDP/IOM/UNICEF/WHO (2002), “a direct consequence of this evolution of the budget management mechanisms was the decline of the role of sectoral ministries in the decisions regarding the distribution of resources within the sectors” (p. 59). The same report also ably notes that this budgetary disempowerment of the Ministries of Education and Health was preceded by a more general administrative deconcentration reform process – in which only the Ministries of Interior, Justice, and Finance were unaffected – whereby the provincial governments were given greater responsibility for the conduct of sectoral policies, at the expense of the line ministries.

<sup>46</sup> See MINFIN (2001).

3.37 However, as noted in the FAD mission report, this measure unduly diminished the coordinating role of the line ministries over the implementation of their own sectoral strategies and policies, and overburdened MINFIN with tasks for which it had no comparative advantage. This has been recently acknowledged by the Government, leading to a reversal of that change: the Guidelines for 2004 Budget Preparation (Manual de Elaboracao da Proposta Orcamental – MEO) essentially restored the pre-2001 situation and “demoted” a number of UOs to their previous status as “órgãos dependentes”.

### **Budget Classification Issues**

3.38 According to the Organic Budget Law, Government revenues should be classified by economic category (current and capital revenues) and sources of funds. Government expenditures should be classified by administrative responsibility (UOs), by economic category (use of expenditure) and by function (purpose of expenditures). However, two main budget classification issues have faced the OGE preparation: (i) differences in classification methods as between key guiding documents; and (ii) the alignment of Angola’s fiscal statistics with the methodology of the IMF’s Government Financial Statistics Manual - (GFSM 2001).

3.39 These discrepancies seem to have been solved, for the Government has now presented to the National Assembly the 2004 budget according to the MEO classification. This is a noteworthy progress, as until 2003 and despite MINFIN’s efforts to conform the State budget classification to these norms, there were different interpretations of how accounts should be classified. The main discrepancy was between the economic classification of revenues and expenditures according to the new Chart of Accounts (*Plano de Contas do Estado – PCE*) and the MEO.

## 4. BUDGET EXECUTION

*The importance of a fully-functioning budget execution system for overall public expenditure management should not be underestimated. From the point of view of aggregate fiscal discipline, budget execution information should tell policymakers and analysts alike whether fiscal deficit targets have been fulfilled, that is, outturns are within the resource envelope established in the preparation stage. From the standpoint of public expenditure policy, the budget execution process will determine whether expenditure priorities were implemented as planned. In the case of Angola, a key issue is that the process of expenditure execution is not circumscribed to the formal system; weaknesses in the latter reinforce the problem. This chapter assesses the main issues involved in the process of budget execution in Angola.*

### A THE INSTITUTIONAL FRAMEWORK FOR BUDGET EXECUTION

4.1 At the central level, budget execution is responsibility of the Treasury Directorate (Direcção Nacional do Tesouro, DNT), while at the provincial level it is responsibility of the Provincial Directorate of Finance (Delegações Provinciais de Finanças, DPF). The Treasury Directorate is responsible for the policy and financial programming of budget execution as well as for the public debt management policy.

4.2 A Treasury Single Account (Conta Única do Tesouro, or CUT) is hosted in the Central Bank; treasury operations are carried out by the Government's fiscal agent, the Banco de Poupança e Crédito (BPC), a publicly-owned commercial bank (see below). The CUT is sub-divided into two sub-accounts: CUT-MN (*moeda nacional*), for operations in local currency; and CUT-ME (*moeda estrangeira*), for operations in foreign currency<sup>47</sup>.

4.3 Although the Treasury is legally responsible for the entire budget execution process, the national oil company Sonangol carries out Treasury-like operations such as external debt payments on behalf of the Government (see Chapter 7).

4.4 Additional clarity on the institutional relationship between Treasury and the Central Bank – including the establishment of criteria for foreign exchange treasury operations with impact on the Treasury Single Account – has been provided by the signing of a Protocol between the Treasury and BNA on September 19, 2002 (see Box 4.1).

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<sup>47</sup> Oil signature bonuses have been incorporated into budget and centralized at CUT-ME; however, they are still being captured through Sonangol and will be financing the Public Investment Program. Oil exploration bonuses are up-front payments from oil companies to the Government for exploration rights. In the past bonuses were identified as income in the budget but their use was not normally registered in the fiscal accounts.

#### **Box 4.1 The Protocol Between the Central Bank and the Ministry of Finance**

The Protocol covers the main areas of interaction between BNA and MINFIN, and includes: (i) rules for movements in the Treasury Single Account (CUT), both in local currency (CUT-MN) and in foreign currency (CUT-ME); (ii) the remuneration of Central Bank for services provided and for Central Bank Bills (TBCs); (iii) rules for liquidation in local currency of external debt payments backed by oil; (iv) rules concerning the financial flows resulting from foreign exchange receipts and tax payments; (iv) the resolution of pending issues on BNA's quasi-fiscal debt; and (v) basic principles for public external debt management.

The approved version of the Protocol does not address the so-called "surrender requirement" on Sonangol for oil export earnings, established by Decree 30/95 and the basic pillar of the "petroleum account", according to which Sonangol would sell to BNA the total proceeds from oil exports.

Article I, item 1 of the Protocol addresses the issue of the consolidation of the CUT: "MINFIN will keep at BNA the Treasury Single Account (CUT), which will collect *all* State revenues, either paid directly, or paid through the banking system."

An addendum to the Protocol, accompanied by a Memorandum of Understanding between MINFIN and BNA, was issued in August 2003, offering greater operational detail as to the workings of the CUT and operationalizing a number of fiscal measures established by decree in February 2003.

### **The Stages of the Budget Execution Process**

4.5 The stages in the expenditure process are regulated by Article 26 of the Organic Budget Law and consists of three standard steps<sup>48</sup>:

- ***cabimentação*** (commitment), or the certification that a sufficient budget allocation is available to place contracts and orders, by using the Nota de Cabimentação<sup>49</sup>;
- ***liquidação*** (verification), or the confirmation that the creditor is entitled to receive payment for the services provided and goods delivered according to the contract that gave rise to the transaction; this leads to the issuing of a Nota de Saque<sup>50</sup>, and
- the actual ***payment*** by the designated bank (BPC).

#### **B. COMPLIANCE WITH THE BUDGET LAW**

4.6 Several issues, among which two are noteworthy, undermine the designed system that can otherwise be a fairly reliable system. Firstly, unavailability of funds for payment of confirmed commitments discredit the commitment system and the certificates. As a

<sup>48</sup> Angolan Ministry of Finance (2001). Seminário sobre Novo Sistema de Execução Orçamental e financeira do OGE. Luanda.

<sup>49</sup> *Nota de Cabimentação* – document that identifies the nature of the expenditure (according to the budget classification) and the amount to be paid.

<sup>50</sup> *Nota de Saque* – payment order issued by line ministry/spending agency, which the BPC will use to pay the creditor.

result of unavailability of funds for payment<sup>51</sup>, arrears are created which in turn have further negative impact such as escalation of prices for the government. Secondly, the lack of trust in the *Nota de Cabimentação* has produced an undesirable practice which consist of change in the sequence of the three steps established by the organic law; the payment order is issued prior to the delivery and the verification that should take place under the *liquidação*. This practice and the absence of complementary controls to ensure delivery of goods under such procedures is a potential financial risk that can be exploited by some and must stop immediately.

4.7 In addition, the verification stage of budget execution has been almost completely ignored, and payments have been made without physical verification and certification that goods have been delivered and services rendered. That explicitly violates the Organic Budget Law<sup>52</sup>. With the implementation of the updated version of the SIGFE from January 1, 2004, measures were introduced to strengthen enforcement of the verification stage. They include the creation of a Nota de Liquidação that has to be issued by the UO and signed by its manager before a Nota de Saque can be issued. It is still too early to evaluate the impact of those measures on the actual budget execution practices.

### C. CASH PLANNING AND MANAGEMENT

4.8 From a legal standpoint, budget execution (expenditures) should be made through “budget credits” (appropriations divided between initial credits and additional credits) effected on the basis of one-twelfth (duodécimos) of the respective budgetary appropriations. Additional budgetary credits are allowed on the basis of changes that may have occurred after the approval of the Annual Budget Law. The current system is as follows. At the beginning of the year, the Ministry of Finance holds back 20% of the total of the budget, as a “financial reserve” (cativação), for adjustments during the annual execution. The remaining 80% are distributed to spending agencies according to the one-twelfth rule. Spending agencies might request access to the remaining 20% as long as well justified and on a punctual basis. Expenditure provisions can be transferred from one line item to another (virement) - except salaries and investments - and are allowed on condition that such adjustments do not exceed the authorized budget ceiling (upon request by line ministries/spending agencies and after approval by DNO). During the execution, it is the Budget Directorate’s task to monitor and control the public investments in collaboration with provincial and sectoral levels.

4.9 In practice, the Treasury Directorate prepares a Monthly Cash Plan (MCP) with a view to match financing capacity and financial resource needs. The MCP has to be approved by the Financial Programming Commission (CPF)<sup>53,54</sup>, in charge of the

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<sup>51</sup> The causes for unavailability of funds are most likely a combination of unrealistic budget estimates for both expenditures and revenues, inadequate planning, and lack of firm control over extra-budgetary as well as payments for transactions outside the formal system

<sup>52</sup> Refer to Tollini *et al.* (2003) for a more detailed discussion.

<sup>53</sup> *Comissão de Programação Financeira* - composed by the Minister of Finance, the Minister of Planning, the Governor of the Central Bank and the Minister of Labor and Social Security. The Protocol between BNA and MINFIN sets up a joint team to oversee the Monthly Cash Plan execution.

<sup>54</sup> Actually, the Comissão also approves a quarterly financial programming plan (which has to take into account the “request for financial funds”, *Necessidades de recursos financeiros*, prepared by line ministries

financial programming, and by the Standing Commission of the Council of Ministers. In practical terms, although entitled to one-twelfth (*duodecimos*), spending agencies receive what is approved in the Monthly Cash Plan on the basis of its level of execution in the previous month. In short, they receive a monthly *Quota Financeira* (lump sum), which may or not correspond to a one-twelfth (Box 4.2 discusses the practical workings of the system). The only exceptions are the Ministries of Health and Education, which are entitled to receive the entire one-twelfth. Line ministries/spending agencies are not allowed to carry over any remaining balance of *Quota Financeira* to the following month, i.e., it should be entirely spent within the month. Otherwise, remaining funds revert back to the Treasury.

**Box 4.2. The Duodécimo System in Practice**

The one-twelfth, or *duodécimo*, principle, is used mostly as a reference point rather than as an effective financial programming tool. If concretely applied, the monthly *Quota Financeira* (QF) for a budget unit *i* would be exactly one-twelfth of the annual OGE allocation (*a*) for that unit, as follows:

$$QF_{it} = \sum_{t=1}^{12} \frac{a_{it}}{12} \times 0.8$$

The number 0.8 indicates that MINFIN is entitled to retain 20% of the total allocation. DNT still uses the above formula to prevent UOs from spending its yearly OGE allocation before the end of the fiscal year. If revenues were perfectly predictable and entered the Treasury in a smooth fashion, financial programming should mirror the monthly *duodecimos*. That not being the case, the *duodécimo* works as an upper limit for budget execution.

According to the Treasury Operations Department of DNT, the actual formula takes into account the amounts already executed in previous months (*e*) and the number of months already passed (*m*):

$$QF_{it} = \sum_{t=1}^{12-m} \frac{(a_{it} - e_{it})}{12 - m} \times 0.8$$

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in a quarterly basis). Line ministries are then informed by MINFIN of the amount they are entitled to receive for the period followed by the reception of the monthly *quota financeira*.

**Box 4.3. Budget Execution from the Standpoint of Spending Agencies**

Typically, line ministries/spending agencies receive *quotas financeiras* in response to their quarterly “requests for funds”. Although these *quotas* are expected to be allocated to the spending agencies on a monthly basis, as the Monthly Cash Plan is implemented, the process quite often does not follow a regular periodicity. The *quotas* normally do not correspond to the one-twelfth appropriation. When expenditure is committed (*Nota de Cabimentação, NC*), a payment order (*Ordem de Saque, OS*) is immediately issued and sent to BPC for payment (reportedly, payments may take some days to be processed at the bank, causing losses due to exchange-rate fluctuations; capital expenditures are particularly affected by such fluctuations). In an attempt to avoid accumulation of arrears, line ministries make an effort to commit expenditures only after receiving the monthly quota financeira (reportedly, there is no carryover of *quota financeira* balances from month to month). Changes in line budget appropriations (virement) are permitted upon request to DNO, as long as the total resource envelope is respected. For public companies, *quotas* are processed through the Treasury’s Department in charge of overseeing State-Owned Enterprises Dept (CPED); CPED remits the payment order to BPC, which then credits the company’s account in a commercial bank. Once a year, public companies are expected to send a report on their accounts to both DNC and CPED.

i.

**Expenditure Processing Arrangements**

4.10 Due to its extensive territorial coverage (46 branches connected online, in 14 out of the 18 provinces)<sup>55,56</sup>, BPC has been the State’s fiscal agent (banco operador) since October 2001. The way fiscal expenditure processing takes place in Angola can be succinctly described as follows. After the Monthly Cash Plan is approved, funds are transferred from the CUT to a mirror account, or “sub-CUT” at BPC through a transfer order (*Ordem de Transferência*) issued by the Treasury. Since the Treasury monitors the sub-CUT daily operations in real time - a computer software was commissioned by MINFIN and installed at BPC to allow for real-time link between the Treasury and the BPC – transfer of funds from CUT to sub-CUT occurs only when cash management liquidity needs occur. BPC reports daily on the balance of sub-CUT to BNA and MINFIN; since March 2003 BPC transfers to the CUT the entire revenue collected the previous day.

4.11 Line ministries/spending agencies send payment orders (*Ordens de Saque*) directly to BPC for execution; withdrawals from their accounts at BPC, which are related to the sub-CUT as transit accounts, are made only upon presentation of such payment orders. The fact that line ministries/spending agencies are not yet linked online with the

<sup>55</sup> In the remaining 4 Provinces (Lunda Norte, Lunda Sul, Moxico and Kwanza Norte) budgetary payments are still being done by another public bank, *Banco Comércio e Indústria* (BCI) (which has been performing this role after many years).

<sup>56</sup> Arrangements of this nature are not uncommon. See The World Bank (1998): “A common variation is that the retail banking operations are delegated to a fiscal agent (normally an authorized commercial bank) by the Central Bank. This model is put in place in those cases where the Central Bank does not have an adequate network of provincial/regional branches or does not have the capacity to handle the large volume of transactions that are associated with government payments and receipts. In these cases, the fiscal agent makes payment on behalf of the Treasury, the Central Bank recoups all payments made by the agent for government operations and the fiscal agent makes daily deposits of all government revenues to the TSA [Treasury Single Account] in the Central Bank” (pp. 169-171).

Treasury, DNC and BPC constitutes a bottleneck in the system (requiring that information flows take place via diskettes and print outs).

### **Consolidation of the Treasury Single Account (CUT)**

4.12 The mechanism of the CUT, however, is far from being consolidated. The main issues impairing its consolidation are related to some of the operations carried out by Sonangol, and to the service of debt based on oil-backed loans.

4.13 In principle, profit oil, Sonangol's taxes, the Kwanza-equivalent the dollar-value of taxes paid by the foreign oil companies, and all other taxes transit through the CUT-MN. However, since the CUT records only actual cash transactions, taxes and profit oil from Sonangol are often not recorded, due to the compensation mechanisms described in Chapter 7. This clearly contradicts Article I, item 1 of the Protocol (see Box 4.1).

4.14 As for the debt service operations, oil signature bonuses and proceeds from external loans, they should all transit through the CUT-ME with payments being made through the CUT-ME by the Central Bank. However, *for contractual reasons, external debt service of oil-backed loans is still made through dedicated escrow accounts*, thus bypassing the CUT-ME. Oil-backed debt service does not go through the CUT as it does not involve an actual cash transaction undertaken by the Treasury.

4.15 In summary, in addition to its complexity, this cash management system is not achieving its intended purpose and does not allow adequate planning by OUs nor prevents over commitments. Most probably due to the complexity and difficulties in information flow, the estimates do not reach the destination before the beginning of the period. The complying OUs wait for the plans before commitment and therefore can't plan ahead of time and therefore are penalized. Those who are not compliant undermine the system and create arrears. In all circumstances the existing system does not allow the recording of long term commitments and contracts beyond the expenditure cycle are only recorded for the payable amounts and that only when the payment order is to be issued. The unexecuted amount of the contract is not recorded anywhere and the amounts are not known.

## **D. REVENUES MANAGEMENT**

4.16 Although the revenue side of the budget was not included in the scope of the exercise, a brief analysis of the overall revenue management is presented in this Section. The fiduciary framework for oil revenue management are discussed in Chapter 7.

4.17 The principle of consolidated fund, single revenue account, collection and management of government assets and management and payment of liabilities through the formal budget system has been formally accepted and imbedded in the legislation. The MINFIN is making efforts and has made strides in achieving some noticeable results in cash management and rationalization of the government banking operations.

4.18 As regards the management of the state revenue, several observations are worth mentioning:

- Firstly, assessment of the government revenue, the first step in generation, collection, and, more generally, the preparation of a meaningful budget, is

inadequate and the practice seems somewhat ad-hoc. Due to lack of capacity, DNI relies heavily on self-assessments and others' data banks and systems and tries to cope by checking the big numbers and big tax payers.

- Secondly, it is acknowledged that the collection of revenue by the banks and transfer of collected revenue to the single account is not efficient nor transparent. Once the funds reach the single account, DNT seems to have good control (on line access) over them.
- Finally, the PEMFAR team did not obtain any evidence, or was not told about control mechanisms and reconciliation of revenue data with deposits made. However, the practice of reconciliation of the deposits data provided by the banks and the credits to the government revenue account seems satisfactory. The upstream accounts of the revenue (the banks) are not audited and no reconciliation is done to confirm that all collected revenues end up in the government revenue account. Not all financing is recorded and loans are contracted/guaranteed by the Government without being recorded.

4.19 In summary, fragmentation of the banking operations (on the collection side) and financial operators has increased the complexity of the system. Controls need to be rationalized and streamlined, in line with the implementation of the updated version of the SIGFE (see Chapter 6).

## **E. PUBLIC EXPENDITURE MANAGEMENT**

4.20 In addition to the difficulties that the execution of an unrealistic budget represents, at that stage, the PEM process is also confronted with three problems related to weak internal controls within the expenditure cycle. At present the budget execution is decentralized and each spending entity (UO) has the authority to execute its budget, commit, and issue payment orders. As much as a very positive and welcome development for expediting the budget execution and making the UOs responsible vis-a-vis their budget, this arrangement, poses challenges for internal controls.

4.21 Angolan PFM system is, at the origin, based on a reference model which relies heavily on independent ex-ante controls, thus by design ex-post controls are weak. The Angolan departure from that reference model<sup>57</sup> has taken place without the necessary accompanying measures. The elimination of ex-ante control should be accompanied by the strengthening of the ex-post controls (by INF, for instance). The commitment is therefore not verified independently from the UOs before hand, thus posing a risk that the UOs might not respect the quarterly Financial Plans and over commit the government (sometimes done outside the system<sup>58</sup>).

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<sup>57</sup> The so-called Continental European model (Belgian, French, Portuguese, etc. ) based on which the Angolan model was established. Under the reference model a financial controller, representing the MINFIN, verifies and approves all commitments, without which the government is not committed.

<sup>58</sup> in particular contracts with more than 12 month execution time cannot be fully entered in the system. Only the portion executable within the FY is committed and the remainder is not tracked in the SIGFE.

4.22 In addition, the DNC is dependent on financial information received from UOs which would be prone to delays, errors, and omission of information such as the commitments created outside the system. Any control exercised by the DNC can't be considered effective and independent and accounts and reports produced by it are reflection of information received from UOs.

4.23 The flaws observed in the budget execution lie in the way the budget is executed in practice and not in the Organic Law. These deviations in execution are probably the rational reaction to two issues (i) lack of ownership of the budget by the UOs, and (ii) the cash rationing and very short term and unpredictable management through this rationing.

4.24 The budget is unrealistic and therefore not easy to comply with in the first place; the cash rationing and management from month to month (sometimes information becomes available well into the month) makes planning impractical for the UOs. Because of this, until recently, some UOs found it legitimate to commit above and beyond the authorized commitment ceilings and quarterly plans, and sometimes even above the approved annual budget. The first results of the Government's PMFP, however, have made such practices more difficult.

4.25 Shortage of cash results in a selective payment of invoices and lack of transparency as well as creation of arrears. Worse yet, this undermines the normal sequence of actions crucial to ensure that the government has received goods and services for payments made. In fact it has been widely acknowledged that the NCB does not reassure the suppliers of quick payment. Due to this lack of trust, with consent of officials, the suppliers wait for payment before delivering the goods and service. This change of sequence undermines the adequate control of delivery which under this new arrangement is to take place after payment (documents are filed after payment and no follow-up action takes place). Anecdotal examples indicate that in some instances the goods are never delivered<sup>59</sup>. This is further aggravated by loose public procurement processes, as discussed in detail in the *Country Procurement Assessment Report* and reported in Annex 2.

4.26 An important part of the payroll is that of the Army, Police and Interior. These are not included in the MINFIN system and their payment is made only through lump-sum amounts. As for the others, payment of salaries are made by provinces and there are indications (i.e. unpaid teachers) that the funds are sometimes used for other purposes.

4.27 As payroll expenditures are not well controlled, a census and audit needs to be done followed by the creation of a unique/single database for the government payroll. It is possible to devise mechanisms (communicating /interfacing databases) to protect the confidential information without jeopardizing accountability while at the same time it is also necessary to develop controls to deal with the reliability of the non-Defense payrolls.

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<sup>59</sup> A variation of this practice is what the UOs introduce commitment and immediately after the payment order in order to speed the payment to the suppliers.

## F. PAYMENT ARREARS AND PRICE SUBSIDY ARREARS

4.28 Expenditure control has been based on cash rationing rather than on refraining from placing orders for which funds may not be available. Line ministries/spending agencies, which are the originators of *Nota de Cabimentação*, are in theory not supposed to issue them for values above the duodecimo, however several possible practices explain the arrears. First, the Quota Financeira is usually below the amount of the duodecimo. Information from line ministries indicate that this is particularly the case with capital spending, as contracts (often associated with civil works) span several months and sometimes beyond the financial year. Second, the limit is ignored, the commitment step is delayed or ignored, or, some commitments are not included in the SIGFE.

4.29 All three steps of expenditure (Commitment, Liquidation and issuance of Payment Order, and Payment) are supposed to take place at the right time and with the right sequence and commitments made within the framework of the budget are expected to be recorded in the SIGFE. However, large unexplained or unrecorded expenditures imply that many transactions occur outside the realms of the formal rules. Legislation on sanctions against managers of public entities who have incurred non-authorized expenditures is not available, i.e. there are no practical sanctions that MINFIN can apply to discipline line ministries. Therefore, expenditure controls are not binding at the commitment stage and expenditure approvals are not always backed by cash availability, leading to payment arrears.

4.30 This has also discredited the *Nota de Cabimentação* and has created a sense of mistrust by suppliers who would rather deliver the goods and services after payment. Therefore, in order to move to commitment controls, the Government will need to overcome the currently low credibility of its *Nota de Cabimentação*, which is likely to have been generated by a history of arrears. This can be done by automation of the issuance of this note by the system and requires careful financial planning and payment of all of them.

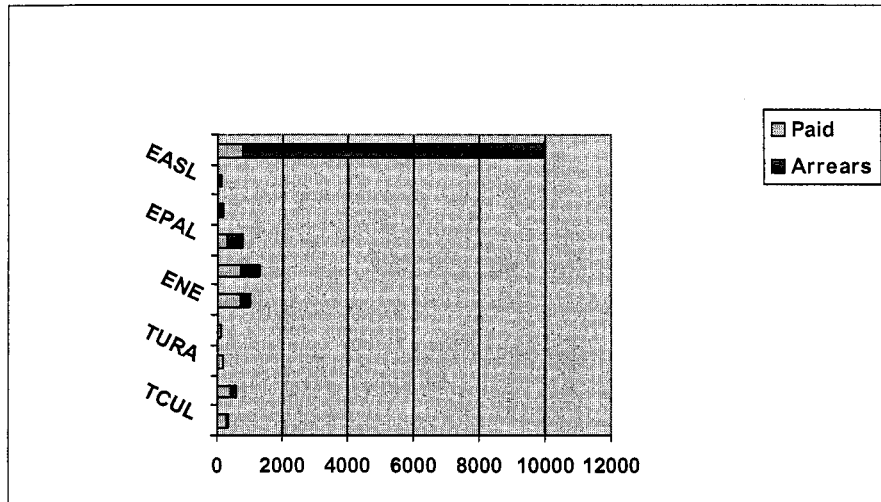
4.31 On the other hand, budget execution numbers for 2002 show that subsidy arrears are still very high in Angola<sup>60</sup>. In that year, budgeted price subsidies totaled some US\$300 million dollars, of which US\$220 million (equivalent to 2 percent of GDP) were in arrears by the end of the year. Most of these price subsidy arrears (89.8 percent) were due to Sonangol Holding (through *Sonangol Distribuidora*) for the provision of petroleum products at below-market prices. Substantial arrears have also been accumulated in respect of the electricity companies (EDEL<sup>61</sup> and ENE) and the municipal water supply company in Luanda (EPAL). Chart 1 below shows the composition of price subsidy arrears in 2002.

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<sup>60</sup> See Araujo *et al* (2003) for a detailed discussion. [Final budget execution numbers for 2003 were not available at the time of the writing].

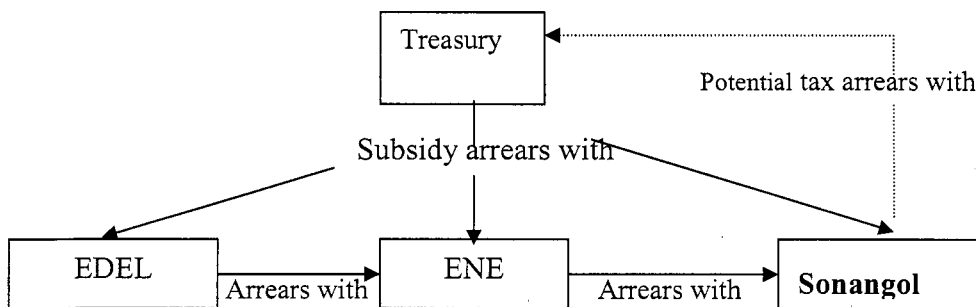
<sup>61</sup> EDEL stands for *Empresa de Distribuição de Electricidade* and ENE for *Empresa Nacional de Electricidade*.

**Chart 4.1: Price Subsidy Arrears, Company by Company (kz). Fiscal Year 2002**



4.32 The fact that the State incurs arrears to the service-providing companies helps weaken their financial position and triggers the accumulation of inter-enterprise arrears in the energy sector (see Figure 4.1 for an illustration). Indeed, it is quite often that EDEL cannot honor its debt to ENE for the electricity it receives, and ENE cannot pay Sonangol for the fuels required for electricity generation. As of June 2002, cross-arrears between EDEL/ENE and ENE/Sonangol were more than Kz 1 bn, or US\$ 24 million dollars.

**Figure 4.1: Cross Arrears: A Chain Reaction**



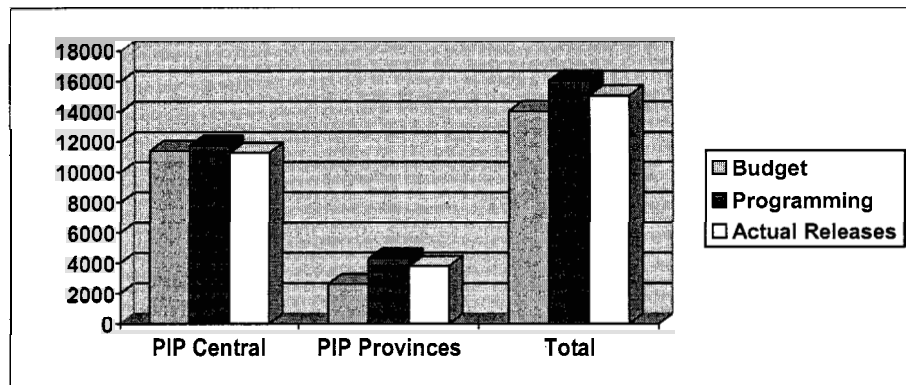
4.33 In addition, as will be noted in Chapter 7 and in Annex 4, the fact that the Treasury has a history of subsidy arrears towards Sonangol is part of the reason why the mechanism of the “Petroleum Account” broke down in late 2000, leading to the existing system of tax and profit oil offsets.

## G. EXECUTION OF THE PUBLIC INVESTMENT PROGRAM

4.34 As noted in Chapter 3, there are two dimensions to the execution of the Public Investment Program in Angola: the “financial” dimension, carried out by the Ministry of Finance, and the “physical” one, carried out by line ministries such as the Ministry of Public Works, but monitored by the Ministry of Planning. While the financial dimensional refers to *actual payments made*, the physical dimension relates to *the actual rate of implementation* of the programmed investment projects within the PIP.

4.35 Data on PIP execution are not usually timely or particularly reliable, especially given the fact that there is no interface established as yet between the SIGIP and the SIGFE (see Chapter 3). The main source of information for this section is MINPLAN’s “2002 Public Investment Program Execution Report”<sup>62</sup>. Financial execution information is disaggregated as follows: (i) budgeted amounts; (ii) amounts contemplated in the financial programming; and (iii) amounts actually released to investment projects. The total amount budgeted for the PIP in the Revised 2002 OGE was approximately Kz 14 billion (US\$ 170 million). Financial programming exceeded the budgeted PIP by about 14%, while actual releases fell short of programming by around 6%. Chart 4.2 below shows PIP execution numbers for 2002, further disaggregated between centrally-executed and province-executed projects. The bulk of the difference between budgeting and programming stems from the portion of the PIP executed by the provincial governments. According to MINPLAN’s report, this difference is mostly accounted for by unexpected rehabilitation-related expenditures triggered by the peace process, which started in earnest after April 2002.

**Chart 4.2: Execution of the 2002 PIP: The “Financial” Dimension (Kz million)**



Source: MINPLAN

4.36 While by law the execution of capital expenditures should follow the same three-stage process (commitment, verification, and payment) of recurrent spending, in practice the phenomenon of advance payments is particularly pronounced with respect to the PIP. MINPLAN’s report alludes to two possible explanations: (i) the lack of confidence on the

<sup>62</sup> MINPLAN (2003). “Relatório de Execução do Programa de Investimento Público 2002”. Luanda: March. Final execution data for 2003 were not available at the time of writing.

*Nota de Cabimentação* on the part of private suppliers, as discussed in section A, favoring the practice of large, upfront payments before the commencement of works; and (ii) the large concentration of the PIP in infrastructure projects, in which it is common practice to mobilize the material means only after the payment of the first tranche of a works contract is effected.

4.37 Although it is difficult to disentangle the dominant reason for this phenomenon, it is clear that there is a very large disconnect between financial execution and the estimated value of what was indeed physically implemented<sup>63</sup>. MINPLAN estimates that the value of physical execution represented only 19% of total actual releases.

4.38 The results of the 2002 PIP execution process suggest that the non-observance of the appropriate sequence of the budget execution process – as established in the Organic Budget Law – leads to sub-optimal outcomes in terms of achieving the objectives of the PIP. The fact that the PIP does not follow a multi-year exercise exacerbates the problem, as it is unclear whether there is any “catching-up” over time between physical and financial execution. It also indicates that there are serious fiduciary risks associated with the execution of the capital budget, and that they should be addressed in the process of designing multi-year investment programs (see Chapter 8 for further discussion).

## H. DEBT MANAGEMENT ISSUES

4.39 Angola’s debt management process, in practice, is scattered among three agencies<sup>64</sup>:

- The recently-established Debt Unit (*Gabinete da Dívida*) at BNA, which is in charge of compiling and managing external debt statistics. This function is contemplated in Article 17 of the Organic Law of the Central Bank.
- The Treasury’s External Debt Department, which is more directly involved in the borrowing process itself, as it is involved in loan commitments, repayments and renegotiations.
- The national oil company Sonangol, which acts as an underwriter and provider of collateral for *oil-guaranteed loans*<sup>65</sup>. Sonangol is also a main source of information on the amortization of such loans.

4.40 To facilitate coordination among these entities, the Council of Ministers passed on March 2, 2001 a decree (Decree 7/01) establishing a Public Debt Management Committee (*Comité de Gestão da Dívida Pública*, or CGDP). The CDGP reports to the Council of Ministers and is composed by the Minister of Finance (Head), the Minister of Planning, and the Governor of BNA. The operational work of the Committee is carried out by an Executive Commission, headed by the National Treasury Director, and encompassing representatives from MINPLAN, BNA, and the Ministry of Foreign Affairs. At a technical level, the work of the Commission is supported by BNA’s Debt

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<sup>63</sup> The valuation methodology employed by MINPLAN for such estimates is not discussed in MINPLAN’s report.

<sup>64</sup> Aide Memoire of joint IMF-World Bank mission to Angola on external debt management issues, December 2003.

<sup>65</sup> See Chapter 7 for more details on the role of Sonangol.

Unit and MINFIN's External Debt Department (EDD). It is interesting to note that Sonangol, which carries much of the burden of loan negotiations and contracting, is not formally represented at any level.

4.41 The Executive Commission is viewed as a transitional arrangement, until a new Public Debt Framework Law is approved by the National Assembly. This law would provide for a new institutional set-up for debt management in Angola<sup>66</sup>. A joint IMF-World Bank external debt mission visited Angola in December 2003, and proposed the creation of a Public Debt Management Operations Unit (PDMOU), assisted by an international specialist. The PDMOU would accumulate information collection and forecasting functions, and would also monitor debt-service payments. The PDMOU would not necessarily become a formal "unit" as such, but would rather operate as a working group, comprised of representatives from BNA, DNT, Sonangol, and BPC (as the latter is involved at the tail end of non-oil backed loan repayments). A technical expert from the Bolivian Central Bank, identified by the IMF, is providing technical assistance to the Angolan Government in the implementation of the recommendations of the December 2003 mission. The proposal for the new institutional setup is still under study by MINFIN.

4.42 With support from an IDA credit, an UNCTAD-designed debt management information system, the DMFAS, was installed at BNA. However, in practice, BNA's Debt Unit compiles external debt information in two databases, DMFAS itself and an in-house debt database (the "old system"). Different sets of numbers are produced by each of those systems. The Fund-Bank mission recommended the phasing-out of the "old system" by June 2004 and the utilization of DMFAS as the sole debt management information system. The DMFAS interface with MINFIN still needs to be established as well.

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<sup>66</sup> The Bank-supported EMTA credit has also earmarked funds to assist in this process.

## 5. BUDGET ACCOUNTING AND REPORTING

*“At the heart of any fiscal and financial information system is the accounting system, which maintains the basic records of government transactions and, thus, outturn expenditures”<sup>67</sup>. In Angola, this function is performed by the National Directorate of Accounting (DNC), a key component of the Sistema Integrado de Gestão Financeira do Estado (SIGFE), which is, in turn, the backbone of Angola’s reporting system. A major process of reform is underway in this area, as part of the Public Finance Modernization Program (PFMP). This chapter describes Angola’s public accounting system, assesses progresses achieved under the PFMP, and identifies main areas for further reform.*

### A. ANGOLA’S PUBLIC ACCOUNTING SYSTEM

5.1 The public accounting system in Angola is still cash-based and single-entry, but a transition towards a "double entry" accounting system (*método das partidas dobradas*) has begun with the roll-out of the new version of the SIGFE (see below) that ties up the whole accounting stage of the budget cycle. All accounting is centralized at the National Accounting Directorate (*Direcção Nacional da Contabilidade, DNC*), but as mentioned before, UOs are obligated to maintain their own budgetary accounts and submit monthly budget execution reports to the DNC.

5.2 Two new documents, a public accountability manual and a new chart of accounts, were prepared in 2001 and were implemented early in 2004 and have facilitated the introduction of an accounting system based on double entries. In addition, there is a plan to produce an Accounts Glossary (*Função das Contas*, i.e., the explanation of the accounts). Every other week spending agencies send to the Accounting Directorate data on the expenditure commitment stage (*cabimentação* or the so called “floating” debt) that occurred in the two previous weeks. In principle, this recording practice should facilitate the implementation of an accrual accounting system and improve the quality and reliability of the reports.

5.3 The full implementation of the SIGFE and activation of all of its automatic controls should be completed as soon as possible. With a robust system in place the functions of staff need to be changed. The work flow and organization will require a thorough review and reorganization after the full implementation of the new SIGFE. Such review and redefinition should include independent controls over data entry, classification, and adjustments to the accounts entries.

#### ***The Government’s Financial and Fiscal Reports***

5.4 The system of information collection and report generation by the DNC is totally dependent on the information provided by the UOs, mostly through statistical reports and

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<sup>67</sup> Potter and Diamond (1999).

vulnerable to error or manipulation at the source. Given the number of UOs (487 for the 2003 fiscal year), regular and relatively timely production of consolidated reports is understandably a cumbersome and difficult task (never achieved so far). The full installation and use of the maximum capacity of the SIGFE will certainly improve the controls and automate the production of reports. It is crucial though that the internal controls are strengthened on data manipulation and reporting. The SIGFE is a powerful tool in terms of report production and, provided the quality and timeliness of data improves, it would be able to provide reliable outputs. However, currently there are discrepancies between the budget classification and the chart of accounts used in the SIGFE. Furthermore, payment orders are being issued without commitments already produced for those expenses. There are also partial commitments produced leaving portions of legally created commitments outside the system and without any monitoring and tracking. These issues, and others need to be addressed in parallel.

5.5 The reconciliation between the Treasury information (banking) and information from the UOs does not regularly take place; thus some financial reports may be based on unreliable information. In addition, the reconciliation between the administrative and fiscal accounts does not take place routinely and end-year adjustments lack transparency, un-reconciled items remain in the books or arbitrarily allocated. In general, there is an excessive reliance on the banking system information rather than on the government's own accounts. Considering these and the shortcomings in reconciliation of revenues and expenditures, described earlier, the financial reports are unreliable. However, on the positive side, the linkage of the treasury to the bank accounts allows a real time monitoring of balances.

5.6 The Accounting Directorate produces budget execution reports. It is also supposed to submit quarterly accounts to the National Assembly and the final annual Government accounts, *Conta Geral do Estado* are due to the National Assembly by March 31 - only 3 months following the end of the fiscal year. In addition, it analyses the accounts of the Autonomous Funds (the accounts of State-owned enterprises are responsibility of the Public Enterprises Department at the Treasury). However, non of the above takes place with the regularity needed to generate a steady flow of budget execution data to the Ministry of Finance and other stakeholders.

5.7 For all of the above reasons, the financial reports are not complete and do not reflect all major government financial transactions. There is a relatively high risk that the financial reports are not reliable and do not sincerely reflect the financial transactions. These risks will be reduced by the full implementation of SIGFE but also with strengthening of internal and independent controls over classification and production of reports.

### **Non-Financial Assets and Liabilities**

5.8 Non-financial assets and liabilities management is under the responsibility of the National Directorate for the Management of Non-Financial Assets of the State (*Direcção Nacional do Património do Estado, DNPE*). A key concern in this area is to ensure that quality information on the non-financial assets of the State is generated in order to increase coverage and accuracy of the General State Accounts (*Conta Geral do Estado, CGE*). Indeed, lack of timely and accurate data on public debt and on State physical

assets inventory prevents the production of reliable assets and liabilities accounting” (*contabilidade patrimonial*). The key inputs from DNPE to the CGE are information on the stock of State non-financial assets (*balanço patrimonial*) as well as on yearly changes in that stock (*balanço das variações patrimoniais*).

5.9 Although the DNPE is supposed to maintain an inventory of all government non-financial assets at both central and provincial levels, its records, maintained mostly by hand (especially in the provinces), are incomplete and out of date. A proposal to computerize the records and introduce a more sophisticated accounting system (including asset depreciation), which will ultimately be integrated with SIGFE, is being implemented<sup>68</sup>.

## **B. MAIN ISSUES IDENTIFIED IN ANGOLA’S PUBLIC ACCOUNTING SYSTEM**

5.10 As in the case of budget preparation and execution, important flaws encountered in the public accounting system do not lie in the Organic Budget Law itself, but rather in the compliance with it:

- Contrary to Article 41, which stipulates that all budgetary operations have to be recorded according to the double entry system, public accounting is still cash-based, single entry. The single-entry system only records services, supplies and works paid. Consequently, as the state commitments are not being recorded it is difficult for the DNO to exactly determine whether forthcoming revenues would cover total expenditures needs.
- Likewise, Article 49 stipulates that fixed assets should be recorded. Although the DNPE is supposed to maintain an inventory of all government non-financial assets at both central and provincial levels, its records, are for the time being incomplete and out of date.
- According to Articles 53 to 57, closed accounts (*Conta Geral do Estado*) must include all government bodies, services, autonomous funds and the Social security. They should be presented in statements showing budgeted and realized revenues and expenditures, the balance of financial assets, the balance of non-financial assets and the changes occurred in non-financial assets. In addition a balance sheet of the State should be prepared, clearly showing government short-term and long-term assets and liabilities. The present accounting information system does not allow the closing of accounts as stipulated in the Organic Law. However, one should recognize that the production of such statements are out of reach of countries at the development level as Angola.
- Compensatory and inter-agencies transactions are not recorded when they are not realized in cash. This creates a serious gap in the presentation of the country fiscal accounts. It is particularly serious when the non-cash compensatory transactions are important, as in the case of state subsidies to Sonangol being compensated, in principle, by Sonangol debt payment on behalf of the State.

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<sup>68</sup> Support from the EMTA credit will be provided to this activity.

- The system does not permit to record simultaneously the debit and credit operations when the proceeds of an existing loan are used to pay directly a supplier. This complicates tremendously the analysis of the status of foreign debt and double counting often creates confusion in the accounts.
- The new accounting manual and chart of accounts, originally scheduled for introduction in 2002, have not been adopted or implemented, even though the two documents are available. One of the structural problems stems from two different charts of accounts proposed by MINFIN: the structure of *Plano de contas do Estado (PCE)* consists in 6 algorisms, while the instructions for 2004 budget preparation (*Manual de Elaboração de Proposta Orçamental – MEO*) request 8 algorisms<sup>69</sup>.

5.11 The Government is well-aware of the severe weaknesses affecting its accounting system. Box 5.1 enumerates the main problems as identified by the National Accounting Directorate (DNC) itself:

**Box 5.1. Main Weaknesses in Angola's Public Accounting System, as seen by DNC**

- *Non-centralization of key information in DNC*
- *Excessive use of DNC's staff time for typing and incorporating in the accounting system information "manually" provided by the UOs, especially in the provinces.*
- *Inexistence of non-financial asset accounting (contabilidade patrimonial). Inexistence of a formal recording process for the verification stage (liquidação) of budget execution.*
- *Delays in the generation of information by the UOs.*
- *Insufficient knowledge of key legal and policy-related information.*
- *Insufficient institutional and human-resource capacity.*

**C. ANGOLA'S INTEGRATED FINANCIAL MANAGEMENT INFORMATION SYSTEM**

5.12 The Angolan IFMIS (*Sistema Integrado de Gestão Financeira, SIGFE, in Portuguese*) has been officially in place since 1999 (Decree 13/99) and has undergone an upgrade during the second half of 2001, using bilateral assistance (Decree 73/01). The model was adopted in 1992 and developed under a technical assistance project jointly executed by the Government, IMF and UNDP. The system was originally based on three modules: budgeting, treasury, and accounting, and the 2001 review focused on the integration of the three modules. A new process of upgrading is underway, with significant technical and coverage improvements which has already resulted in the incorporation of a new module covering non-financial asset accounting (see Chart 5.1).

<sup>69</sup> This issue is in the process of being solved as part of the SIGFE reforms underway.

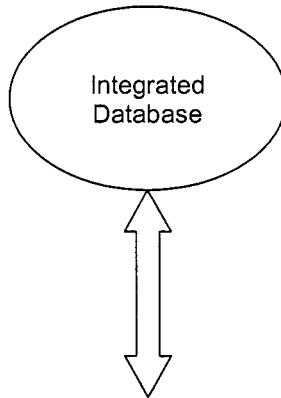
**Chart 5.1: The SIGFE at a Glance**

**Modules of the SIGFE:**



**Entities Involved:**

1. Treasury Directorate
2. Provincial Directorates of Finance
3. The Central Bank
4. Savings and Credit Bank (BPC)
5. Planning and Studies Departments
6. Administration and Budget Departments



**Sub-Systems of the SIGFE:**

- Tax Collection
- Public Debt
- Tax Administration
- Procurement
- Non-Financial Asset Accounting
- Human Resources
- Social Security
- Strategic Information

**SIGFE Outcomes:**

- Better control of budgetary, financial, and "patrimonial" execution;
- Establish the recording of the verification stage of budget execution;
- Accelerate financial programming;
- Adoption of double-entry accounting;
- Use of public accounting as a reliable and timely source of information;
- Standardize working methods and routines;
- Link all national territory and budget units abroad;
- Operation of the system in real time;
- Improve control over external and internal debt;
- Consolidate the process of preparation of the quarterly budget execution reports

5.13 As previously pointed out, BPC became the banco pagador for the State in 2001. The reporting mechanism underwent several adjustments. In addition, the Government accelerated the implementation of a full on-line system between the Ministry of Finance (Treasury, Tax and Accounting Directorates), the BPC and the line ministries/spending agencies. A real-time link between the Treasury and BPC is almost fully operational, which allows the Treasury to regularly check its available balance in the “sub-CUT” (Portuguese acronym for the Treasury account in BPC) that mirrors the Treasury Single Account (CUT) in BNA. The next step is to move as soon as feasible to a full online system linking the CUT and the sub-CUT, and therefore, the Treasury, BNA, and BPC. With the introduction of a commercial bank, the Treasury Directorate expects to increase efficiency by avoiding delays in the payments operations.

5.14 SIGFE’s legislation clearly defines the entities involved in the system, the rules, procedures and the instruments of financial and budgetary execution, and the norms of accounting, control and reporting of state accounts. In addition, it establishes that financial programming is the main instrument for public resource management, under the supervision of the Financial Programming Commission. Quarterly financial programming should be approved by the Standing Commission of the Council of Ministers. Currently, the following entities are part of the SIGFE.

5.15 The Treasury Directorate (*DNT*) is the backbone of the SIGFE in charge of supervising, ruling and coordinating the system and is also responsible for the management and control of the *Conta Única do Tesouro, CUT*, hosted at the Central Bank, as well as of the sub-CUT at BPC (the CUT’s mirror account). Other entities with responsibilities in the SIGFE are:

- the Provincial Directorates of Finance (*Delegação Provincial de Finanças, DPF*) of each province, responsible for provincial-level entries into the system;
- the Central Bank (*Banco Nacional de Angola, BNA*), the banker of the State and host of the *Conta Única do Tesouro, CUT*;
- the *Banco de Poupança e Crédito, BPC*, the State-owned commercial bank in charge of the Government budgetary expenditure and collection of revenues, the fiscal agent, through the sub-CUT nourished by the *Conta Única do Tesouro*;
- the Planning and Studies Departments (*GEP*) at the line ministries/spending agencies, either at the central or local level, in charge of identifying the budgetary needs and responsible for its distribution among its subordinate agencies;
- the Administration and Budget Departments (*DNAGO*) of line ministries/spending agencies, in charge of budgetary and financial execution.

#### **D. THE RECENT PUSH FOR REFORMS**

5.16 The ongoing process of reforms on the SIGFE and the accounting system – carried out in the context of the Public Finance Modernization Program (PMFP), see Chapter 9 – benefited from the advice of the August 2003 FAD mission, supported by the PEMFAR team<sup>70</sup>. However, the main motivation came from MINFIN itself, and DNC has played a key role in spearheading those reforms.

5.17 The ongoing reform process – which has a major bearing on DNC - includes the following objectives: (i) to control budgetary, financial, and “patrimonial” execution; (ii) to formally establish the recording of the verification stage of budget execution; (iii) to accelerate financial programming; (iv) to adopt double-entry accounting; (v) to allow the use of public accounting as a reliable and timely source of information; (vi) to standardize working methods and routines; (vii) to link all national territory and budget units abroad as part of the SIGFE; (viii) to allow the system to operate in real time; (ix) to improve control over external and internal debt; and (x) to consolidate the process of preparation (and submission to the Tribunal of Accounts and the National Assembly) the quarterly budget execution reports as well as the CGE.

5.18 During 2004, the SIGFE reform process will focus mostly on the introduction of non-financial asset accounting (*contabilidad patrimonial*); the integration of budget execution with financial and “patrimonial” execution; strengthening of financial programming; training of staff on the use of the new version of the SIGFE software; and the establishment of a centralized database.

5.19 In order to be fully responsive to this new environment, during 2004 DNC will undergo a process of restructuring of its organic functions as well as of its human resources profile. A key component of this process will be a capacity building effort, which will include training on operational public accounting; accounting for decision-making; and adapting and streamlining the administrative flows and processes in the Government.

5.20 Part of the reform process includes the establishment of an interface between the SIGFE and the various “subsystems”, which include: (i) tax subsystem; (ii) salary bill subsystem; (iii) non-financial asset subsystem; (iv) debt management subsystem; and (v) procurement subsystem. World Bank support through the EMTA credit has been sought in the process of establishing most of these subsystems.

#### **E. MAIN AREAS FOR FURTHER REFORM**

5.21 A series of additional measures should give the authorities the necessary tools to manage the State accounts in a more efficient and transparent way. These measures include:

- At present, DNT financial programming does not take into account information available from the SIGFE and rather makes its financial projections from its own information sources. Under these circumstances no control of budget execution can really be made. This situation should be corrected.

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<sup>70</sup> See Tollini *et al.* (2003).

- Revise the SIGFE so that it does record all UOs' verification (liquidação) of services rendered or equipment or materials received.
- Introduction of the accounting manual and the new chart of accounts before fiscal year 2004 (January 2004). The conflict between the two charts of accounts (DNO and PCE) should be solved and the 2004 budget should be presented to the National Assembly based on one chart of account only.
- All State transactions would be made according to accrual accounting, including those concerning the State budget, all financial transactions and all fixed assets records.
- All PCE transactions should be recorded with specific assignment to the accounts to be credited or debited.
- Non-financial assets should be recorded.
- Public enterprises accounting and reporting should be made part of a regular assessment process.

## 6. AUDIT AND CONTROL SYSTEMS

*Despite the fact that Angola is one of the only countries in the Southern African Development Community that has a Supreme Audit Institution, neither the internal nor the external functions are performed satisfactorily in the country. Recent literature on public expenditure management has emphasized the importance of adequate institutional arrangements for the quality of fiscal outcomes. In particular, cross-country analysis suggests that less transparency is associated with higher fiscal disequilibria<sup>71</sup>. Ministry-level control and audit agencies are a key element in ensuring transparency and enforcing accountability in fiscal management. And so are Supreme Audit Institutions (SAIs) with respect to external controls and audits. This chapter identifies Angola's main weaknesses in this area and proposes a reform approach to strengthen the country's public resource management processes.*

### A. INTERNAL CONTROL, FINANCIAL ACCOUNTABILITY, AND FIDUCIARY RISK

6.1 In Angola, the internal audit function is mostly carried out by the National Inspectorate of Finance (INF). In turn, the external audit function is the responsibility of the recently established Tribunal of Accounts. The Tribunal is the Supreme Audit Institution (SAI) whose sole function is to audit State accounts, pronounce on them, and impose fines.

6.2 Both the internal and external audit functions in Angola have a potentially very important role in the implementation of the reform strategy recommended in the PEMFAR. Currently, however, it can be said that neither function is performing satisfactorily in Angola. Despite its long history, INF is too weak to exert any real impact in terms of enforcing compliance with the Organic Budget Law<sup>72</sup>. At the same time, the Tribunal of Accounts is still very incipient and its strength and independence have yet to be put to test.

6.3 It is important to note that, both in the Organic Budget Law and in the PMFP, the terms "internal control" and "internal audit" are used interchangeably or, in many instances, the expression "internal control" is used when it is actually meant "internal audit". As pointed out in Havens (1999), internal (or management) controls refer to policies and procedures to ensure the proper functioning of entities to which they apply, while internal audit refers to the mandate to report to the top leadership of an organization on findings related to the functioning of the management control systems in place. Within that definition, "internal audit is part of an organization's management control structure" (Havens, op. cit., p. 219). INF is more concerned with internal audit

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<sup>71</sup> See The World Bank (1998).

<sup>72</sup> Cf. the mission report for the IMF's Fiscal Affairs Department mission to Angola in August 2003 (Tollini et al, 2003).

proper, although it is mandated to perform some non-audit internal control activities as well<sup>73</sup>.

6.4 Therefore, it can be said that *internal control* is a collective term describing the whole system of internal checks and balances – including authorization limits, reviews, counterchecks, procurement regulations, and internal audit – put in place by an organization or government in an effort to protect its assets and income from loss, and protect the integrity and accuracy of its records<sup>74</sup>.

6.5 For all these reasons, the internal control system constitutes a major link in the financial accountability chain, and its quality an important indicator of the level of fiduciary risk in a country. Furthermore, the executive, not only should execute the budget as desired, it has the responsibility to provide timely and accurate reports to the parliament on the execution of the budget. Therefore, internal controls should expand to cover accounting and reporting.

6.6 Institutionally, internal controls are at two levels. First, within various budget units (UOs) and maintained by the accounting officer responsible for the execution of and reporting on the budget for each UO. Second, at the country level, maintained by the Minister of Finance as the responsible for the overall PFM (budget execution and reporting). It is also the responsibility of all parties mentioned above to maintain adequate controls to ensure the safeguard and maintenance of state's assets and patrimony. Finally, it is the responsibility of the MINFIN (DNT) to ensure safeguard and adequate management of government funds and their use for purposes intended and in the public interest.

6.7 This requires that (i) the rules and regulations are clear and written directives are issued and procedures manuals are available to staff, (ii) training is provided so that the staff is knowledgeable and well informed of those rules, and (iii) control are in place to deter and detect irregular practices.

### **Expenditure Controls**

6.8 The system of expenditure control in Angola consists of three main components: (i) a priori controls on expenditures by UOs at “Commitment”, “liquidation” and “Ordonancement”, (ii) mechanical controls exercised (or to be in place in near future) by SIGFE computerized system, (iii) a-posteriori control available to the MINFIN through INF.

6.9 Regarding (i) - these a-priori controls are in theory at commitment as well as prior to the issuance of payment orders (Liquidations step). Different services apparently follow the quarterly financial plans sent to the DNT and the system of one twelfth to

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<sup>73</sup> Other elements of the overall internal control system at the level of the Ministry of Finance include the accounting controls exerted by the National Accounting Directorate and SIGFE's automated controls over the commitment and payment stages of the expenditure cycle.

<sup>74</sup> Such a system reduces opportunities for fraud, and reduces the possibility of error. The emphasis is on risk elimination or minimization in all significant areas. A common characteristic of a good internal control system is that nobody is able to initiate, authorize, execute, and record a transaction without the intervention of another person. Such a system makes frauds and mistakes difficult, because they require collusion by at least two persons.

contain commitments at the level of budget credit. There are also separation of duties and approval processes in place to ensure that the expenditures are for the goods and services required. However, unfortunately, procedures manuals are not available to staff nor is there a functioning internal audit within UOs to provide assurance to the accounting officer that the formal rules are being followed. There seems to be relatively high risk that informal rules and exceptional measures are frequently used. In particular the following areas require attention and action for strengthening of the internal controls:

- Payroll – it seems that the decentralized treatment of the payroll and lack of robust linkage (unique database) among the UOs, MINFIN, and MAPESS has made the system vulnerable to manipulation and error, resulting in undue payments.
- Classification of expenditures - there is anecdotal examples which indicate a relatively high risk that the expenditures can be classified inaccurately not reflecting the real nature of the expenditure.
- Payments for undelivered goods – it is widely acknowledged that payment orders are being issued before the delivery of related goods (refer to discussion in Chapter 4 on the non-observance of the verification stage of the budget execution process). This breakdown of the internal control sheds doubt about the delivery of goods even after payment and is a high risk area for consideration and strengthening. The reason given for such practice is the distrust of suppliers and the reputation of the government as bad payer (this is inconsistent with the existence of arrears, as suppliers arrears exist).
- Commitment control (also see Chapter 4 , on payment arrears) – given the fact that the commitment is done by a large number of UOs it is crucial that a centralized system controls and manages the commitments as to ensure the commitments within the approved budget (provided the budget is realistic). It is unclear at this stage whether the SIGFE can reject unplanned commitments. But, as mentioned before, indications are that this automatic control is not taking place.

6.10 Regarding (ii), the mechanical controls by computerization under the SIGFE are a positive step towards commitment and payment control which, once fully operational, will help the UOs and MINFIN to manage the resources better and dispose information very timely. These mechanical controls include verification of budget availability and issuance of unique commitment numbers and commitment certificates, and issuance of payment orders only for issued commitment certificates. This system, if well managed, can provide the assurance to all parties that the government commitments will be paid and to change the practice of premature issuance of payment orders, thus improving controls on delivery of goods.

6.11 An unresolved issue is the data against which the commitments are approved. The question of what data is downloaded into the SIGFE for budgetary control needs to be carefully reviewed and answered. Such data needs to be reliable and have direct relevance to the reality and availability of cash for payment of government commitments, once they become due. At present there are different explanations for commitment

approval i.e. (i) the approved budget and the system of 1/12, (ii) quarterly Financial Programs prepared and submitted by the UOs, (iii) quarterly Financial Programs as prepared by the DNT and approved by the two committees, or (iv) the monthly cash projections.

6.12 Related to this issue are the contracts for large works and goods going beyond the duodecimo or the fiscal year. As the system may not allow commitment within the system, those commitments take place outside the SIGFE and it maybe that payment for those contracts drain the treasury and result is arrears on the commitments duly executed. This issue needs careful study and resolution. A change in budget (to a multi-year budget) and modification of the system is necessary to stop commitments outside the system and to control commitments within the cash availability rather than financial plans made by the UOs.

## **B. INTERNAL AUDIT: OVERVIEW**

### **Legal and Institutional Framework**

6.13 The primary function of a governmental internal audit department is to verify whether government transactions and activities are complying with the law, as well as with the internal control checks and balances, and the procurement regulations. Internal audit in the Angolan Government is the responsibility of the National Inspectorate of Finance (Inspecção Nacional de Finanças, INF). INF is the technical support agency within MINFIN in charge of carrying out financial control activities of all budget units across the public administration as well as of the State-owned enterprises. In collaboration with the National Tax Directorate (DNI), INF can also conduct financial control activities (mostly restricted to tax issues) of private companies.

6.14 INF was created in 1958, twenty-seven years before Independence, and to a great extent its work program still reflects legislation passed during colonial times. According to the Organic Budget Law (Law 9/97 - *Lei Quadro do OGE*), the internal control and audit functions are to be “institutionalized” within MINFIN, requiring complementary regulation through a Council of Ministers Decree, which was never passed<sup>75</sup>. The key legal document defining the responsibilities of INF is MINFIN’s own Charter (*Estatuto Organico*, Council of Ministers’ Decree 4/98). On the basis of Decree 4/98, INF has initiated work on the preparation of draft regulations for itself, which represents the first major effort in conducting a legal and institutional reform of MINFIN’s internal audit agency since its creation in 1958.

### **Auditing Standards**

6.15 INF does not have an audit manual, does not publish an annual report on its activities, and practices audit standards adapted from those prevailing in Portugal. A

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<sup>75</sup> The internal control and audit functions in Angola are not clearly defined. In principle, the main internal control and audit agency in Angola should be the General Inspectorate of State Administration (IGAE, in Portuguese). IGAE was established by Law 9/92, but the accompanying regulations have never being prepared. IGAE should, in principle, coordinate all previously established internal control agencies, notably INF and the inspectorates established in the level of the sectoral ministries. Law 2/92, however, allows some flexibility for the autonomous functioning of INF.

review of its audit questionnaire shows that, out of 41 questions, 25 (61%) deal with timeliness of accounting and reporting; one deals with timeliness and correctness of deposits; 3 deal with ensuring that expenditures are within budgetary limits; only 2 deal with checking that expenditures are properly authorized; one deals with legality of salaries and benefits; one with the legality of budget management commission; one with ensuring that reconciliations are prepared in a timely manner; one with ensuring confirmation of balances; one with the legality of the reporting format; one with prevention of waste; one with proper inventory; one with orderly filing; and two with correct bookkeeping and accounting. Although the audit program covers most of the traditional areas of internal control and accounting, there is clearly heavy emphasis on timeliness of reporting, and legality of various activities, rather than on ensuring that built-in automatic internal checks and balances are operating, as they should.

6.16 In practice, only few controls are carried out annually by INF. This is mostly due to its limited human and material resources<sup>76</sup>. In addition, the Internal Regulations and Terms of Reference for INF, that were prepared in 1958 are not adapted to the modern internal control role INF should play.

### **Reporting and Follow-up Mechanisms**

6.17 The usual reporting procedure is as follows: Audit reports, once prepared, are submitted to the National Inspector, who then transmits them to the Minister of Finance. The Minister, in turn, sends a copy of the report to: (i) the line Minister for the area being audited; (ii) to the National Directorate of Accounting (DNC); and (iii) to the Tribunal of Accounts, when there are clear problems of public financial management.

6.18 According to INF, the follow-up role lies with DNC; in practice, however, there are no concrete follow-up mechanisms on the cases brought to light by the audits, once the audit reports are issued. The absence of regular follow-up procedures further undermines the credibility of the internal control and audit functions in Angola, as it facilitates the creation of an environment of impunity for wrongdoers.

## **C. REFORMING THE INTERNAL CONTROL AND AUDIT FUNCTIONS**

6.19 The severe weaknesses identified in the performance of the internal control and auditing functions in Angola essentially imply that the quality of public expenditure is subject to a permanent risk. In fact, INF is insufficiently capacitated and in need of a business plan and a risk management strategy. In addition, INF's findings and recommendations are not acted upon. Finally, even the automated controls through SIGFE do not offer much respite, since they : (i) are not utilized at their full potential; and (ii) are constrained by the system's limited coverage.

6.20 As noted, the required regulations for the internal control function in Angola have not been passed, despite the fact that the Organic Budget Law was approved in 1997.

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<sup>76</sup> At its Luanda headquarters, INF is organized in three departments, dealing respectively with: the public administration (i.e. the ministries); public enterprises; and private enterprises. INF also has branch offices in the provinces. It has a total of 60 staff members, of who about half are in headquarters, and the other half are in the provinces. Of the 60 auditors, only six have university degrees at the time of the PEMFAR writing.

Therefore, there is still a great deal of uncertainty as to the institutional framework within which INF is supposed to operate. This uncertainty needs to be removed as soon as possible, if INF is to properly perform the tasks mandated to it by the existing legislation.

### **Ongoing Reforms and Actions Contemplated in the PMFP**

6.21 The PMFP objective with respect to internal control<sup>77</sup> is to “restructure the Control System with a view to improving the process of evaluation of public resource management”. To meet this objective, the PMFP aims to:

- Develop a concept of a systemic model for the internal control function.
- Adjust the functioning of INF to the new model.

6.22 Concretely, the PMFP proposes a sequence of reform actions, starting with an assessment of alternative internal control models. Once a model is chosen, internal control guidelines – covering administrative and financial aspects – would be established. The PMFP also refers to possible changes in legislation, although it does not offer details as to what such changes should be.

### **Recommendations for Further Reform**

6.23 The actions identified in the PMFP should be translated into a clear implementation action plan. They are conceptually correct; however, they are presented in fairly general terms which do not lend themselves easily to operationalization. Ultimately, internal control and audit reform will hinge upon the choice of the systemic model referred to above.

6.24 The Bank-supported EMTA credit has earmarked resources to assist the internal control/audit component of the PMFP. More specifically, EMTA will support: (i) the design of an appropriate institutional framework for INF, thus assisting in the development of the “systemic model” envisaged by the PMFP; (ii) the technical work underpinning the revision of the relevant legislation; (iii) the preparation of manuals of guidelines; (iv) the design of curriculum of the career of INF inspector as well as of a training program for INF’s technical staff.

6.25 Other major areas in need of deeper reform – beyond what is currently contemplated in the PMFP – include:

- Internal audit work should be enhanced and be treated as a high-priority matter, both at the level of INF and the UOs, to improve the quality of expenditures and the reliability of the reports generated by the system.
- Awareness should be raised within the civil service as a whole of the importance of the INF, and its credibility should be enhanced through concrete examples of successful follow-up actions.
- Rules of ethics for public sector staff should be established and training geared towards changing individual behavior should be implemented.

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<sup>77</sup> “Internal control” is often used instead of “internal audit” in the Government’s documents.

6.26 The ultimate test of INF's strength and relevance would be its participation in exerting preventive controls and conducting regularity audits – in coordination with the Tribunal of Accounts – on the compensation mechanisms between MINFIN and Sonangol, and investigating other potential sources of leakages from the formal system of expenditure execution. To perform at that level, however, INF's capacity should be enhanced and the Inspectorate's terms of reference should be clarified, as proposed above, particularly vis-à-vis other agencies such as the IGAE.

#### **D. THE EXTERNAL AUDIT FUNCTION: OVERVIEW**

##### **Legal and Institutional Framework**

6.27 The Tribunal of Accounts (Tribunal de Contas) was institutionalized by the Constitution of the Republic of Angola<sup>78</sup>. It is regulated by its Organic Law 5/96 of April 12, 1996 and is organized by Decree 23/01 of April 12, 2001. Decree 24/01 of April 12, 2001 establishes fees for the services rendered by the Tribunal. The Tribunal of Accounts is also a member of the International Organization of Supreme Audit Institutions (INTOSAI), the African Organization of Supreme Audit Institutions (AFROSAI), and the Southern African Development Community Organization of Supreme Audit Institutions (SADCOSAI). The membership to these three organizations guarantees the Tribunal access to INTOSAI auditing standards, which are acceptable to the World Bank for audits of government accounts.

6.28 The Tribunal of Accounts is an external body, with its de jure independence assured by law, performing the following main functions: (i) controlling and auditing the Government accounts and financial statements, particularly the General State Accounts (Conta Geral do Estado, CGE); (ii) undertaking ex ante control (fiscalização preventiva) of contracts above \$350,000 and (iii) controlling a posteriori (fiscalização sucessiva), i.e. regularity auditing, of spending agencies. According to its Organic Law (Articles 58 and 60), the Tribunal's report and final position on the General State Account must be presented to the National Assembly and published in the official gazette (Diário da República).

6.29 The President and the other six judges of the Tribunal of Accounts are appointed by the President of the Republic. They are selected through a competitive process, based on their qualifications and experience, by a jury consisting of the [President of the Supreme Court], a member of the Superior Council of Judicial Magistrates, and a Professor from the Law Faculty of the Agostinho Neto University.

6.30 As part of the judicial system, the Tribunal essentially follows the model of the Supreme Audit Institutions in Italy, France, Portugal, Spain, and most South American countries, in contrast with the Anglosaxon system, where the Auditor General model prevails. The closest SAI to Angola's in Southern Africa (in terms of objective and structure) is the Tribunal Administrativo in Mozambique. However, the latter deals with a broad range of administrative and tax issues, in addition to the State accounts.

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<sup>78</sup> Law 23/92 of September 16, 1992, No. 3, Article 125.

6.31 The Tribunal of Accounts has only become effective recently, as its first President was appointed on April 4, 2001. Its de facto independence from the executive has yet to be tested. If confirmed by actual practice, such independence would allow the Tribunal to play a major role in the implementation of the two-pronged strategy for public financial reform proposed by the PEMFAR (see Chapter 2 as well as Section D below).

6.32 According to its Organic Law, the Tribunal is empowered to control and conduct any analysis, review and supervision of all personnel, services and entities that are part of the central and local administration, all institutes and associations, public enterprises, other enterprises where the State has majority of capital, as well as other entities, private or public, that execute financial transactions involving State resources. In principle, the Tribunal is, therefore, entitled to control the various existing UOs.

### **Auditing Standards and Coverage**

6.33 The Tribunal is required by law to express opinions on the following:

- State financial activities in the areas of assets and liabilities, receipts and expenditures, cash flow, and public debt;
- Compliance with the Organic Budget Law and its supporting legislation;
- Direct and indirect State responsibilities, including guarantees;
- Inventory of State assets;
- Subventions, subsidies, loans, and other forms of State aid; and
- Implementation of action programs, investments, and financing of State-owned enterprises, including employment and application of subsidies to autonomous funds.

6.34 In addition, the Tribunal's program of ex ante controls is designed to: (i) confirm the legality and regularity of receipts and payments; and (ii) ensure that contracts offer the most advantageous terms when they are signed.

### **Organization and Staffing**

6.35 In addition to the Office of the President and his staff, the Tribunal is jurisdictionally divided into two chambers, dealing respectively with ex ante controls and ex post audits. In terms of detailed operations, it is divided into two Directorates, namely: Directorate of Technical Services (DTS), which carries out all the audits, and the Directorate of Administrative Services (DAS) responsible for finance, human resource management, transport, public relations, documentation, and information technology. The DTS, headed by an Auditor-General ("Contadoria Geral") is further sub-divided into five departments, the first two of which are responsible for ex ante controls in various jurisdictions and institutions, while the remaining departments are responsible for ex post audit in various jurisdictions.

6.36 Capacity is an issue for the Tribunal. The [enabling Act] provides for the Tribunal to have 170 employees: 7 judges and one deputy chief prosecutor; 31 directors, division chiefs and other managerial staff; 54 professionally qualified auditors and senior staff; 15 middle level technicians, and the rest administrative and support staff. Only 70 employees have been hired by the Tribunal, primarily due to inadequate office space. Of

the 70, only six are qualified to carry out audits, and only one of them can audit a computerized accounting system. Five more auditing staff are currently being trained in Portugal. Salaries are said to be totally inadequate to attract the right kind of staff; no provincial office has yet been established, even though the Tribunal is supposed to have them.

### **Quality and Timeliness of Reporting**

6.37 The Tribunal has yet to issue its first audit report on the General State Accounts (CGE). The CGE for the fiscal year ended December 31, 2002 will be the first to be audited by the Tribunal. Preparations have started for this task. Indeed, since January 2003, all UOs have been requested to submit to the Tribunal a detailed list of all their transactions, being revenues or expenditures. These lists will be compared to the financial statements submitted by MINFIN. A special working group has been set up to carry out this work. Technical assistance has been provided by Portugal and INTOSAI, which will furnish a software program to the Tribunal that will facilitate the task. Although it is too early to evaluate the Tribunal's quality and efficiency in conducting this work, at least all necessary measures seem to have been taken to minimize the risks of arriving at an unsatisfactory end-product.

### **Government Follow-up to the Tribunal's Recommendations**

6.38 In Angola, legislation grants the Tribunal of Accounts the power to impose penalties and fines on institutions and individuals for a variety of infractions, including, for example, failure to submit financial statements in time, or to provide information required by the auditor. This is potentially one of the strongest advantages of the Angola model. However, this follow-up power still needs to be tested in practice as most SAIs suffer from the weakness that their recommendations are often ignored by the government for years.

6.39 The relationship and collaboration between the Tribunal and the National Assembly's Commission on Economy and Finance has yet to start in earnest. The first test will come in March 2004, when the Tribunal is due to submit its first report to the National Assembly.

## **E. MAIN AREAS FOR REFORM**

6.40 The Tribunal of Accounts' financial autonomy falls somewhat short of the degree of independence provided by the law. Although the Ministry of Finance (MINFIN) normally accepts the budget proposals submitted by the Tribunal, subsequent cash rationing by the MINFIN affects the Tribunal as much as it affects line ministries. According to the Tribunal, while its annual budget is part of the public sector budget, it is a sovereign entity, as are the National Assembly and the Government. Greater predictability in budgetary receipts would clearly enhance the operational efficiency of the Tribunal.

6.41 It is important to phase out the current practice of ex-ante controls carried out by the Tribunal while internal control mechanisms are strengthened. The assignment of ex-ante control activities to the Tribunal of Accounts is compatible with the Declaration of

Lima on the main principles of control of public finances (IX INTOSAI Congress, October 1977). Section 2 of the Declaration stresses that “ex-ante controls by a superior Tribunal presents the benefit of avoiding prejudicial acts but that, at the same time, might create an excessive amount of administrative burden to the supreme Tribunal, as well as creating a certain confusion in the distribution of responsibilities according to public rights”. However, in many countries *ex-ante* controls by the Tribunal of Accounts have been eliminated, as they might create a potential conflict of interest. Such controls may also dilute the Tribunal’s independence, by putting it in a position of having to audit its own work. Preventive audits are usually a function of internal audit and control system, not of external audit. It is recommended that these *ex-ante* controls by the Tribunal of Accounts be phased out and eventually eliminated, *to the extent that internal controls are strengthened*.

6.42 Adequate staffing and appropriate compensation levels are critical to ensure the de facto independence of the Tribunal. It is unclear how well the Tribunal can apply auditing standards, given the limited numbers and experience of its staff. The Tribunal has submitted to the National Assembly a proposal to increase the number of its staff as well as the levels of its salaries. The request is now with the President of the Republic.

6.43 The time allowed for submission of the CGE to the Tribunal should be reduced to six months. According to Article 58 of the Organic Budget Law, the Government must submit the CGE for any given year to the Tribunal of Accounts up to December 31 of the following year. This lengthy interval raises questions about the relevance and usefulness of the CGE. In particular, this timetable prevents the National Assembly from fully appreciating the budget execution performance for a given year and using it as an input into the approval process for the OGE for the next year. This hampers the learning process and makes it difficult to incorporate lessons from the previous fiscal exercise into the design of the immediately subsequent one.

6.44 The costs of including the largest public companies in the Tribunal’s work program should be carefully assessed and incorporated into the Tribunal’s financial needs assessment, and borne by the OGE. Although the Tribunal’s responsibilities include the control of public enterprises’ financial statements, they are not part of the ongoing and 2004 work program of the institution. Given the economic and financial importance of some key public enterprises in Angola, they should not be left out of the Tribunal’s work program from 2005 onwards. Capacity issues can be temporarily addressed through outsourcing, that is, by hiring internationally-reputable audit firms that could perform regularity audits in selected public enterprises on behalf of the Tribunal<sup>79</sup>.

6.45 In consonance with the two-pronged reform strategy proposed in the PEMFAR, the Tribunal should be empowered to conduct strategic regularity audits on the compensation mechanisms between MINFIN and Sonangol (see Chapters 2, 4, and 7). This would be an important element of the “ring-fencing” of the so-called non-conventional mechanisms of budget execution discussed elsewhere in this report. By

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<sup>79</sup> This would not exempt the Tribunal from overseeing the work of the contractor and ensuring quality control. Outsourcing could also generate capacity constraints of a different nature: “In any event, the SAI must equip itself with staff who are sufficiently skilled in this type of auditing [especially financial auditing] to assess the quality of the work, even if the work is to be outsourced.” (Havens, *op. cit.*, p. 209).

doing so, the Tribunal of Accounts would be truly engaged in the process of strengthening the formal mechanisms of budget execution and phasing out the informal ones. This involvement could become the most important test of the Tribunal's relevance and independence.

6.46 The ultimate focus of the Tribunal of Accounts should lie on a strategy – in close coordination with INF and MINFIN more generally<sup>80</sup> – to strengthen management controls at the level of the UOs and key public enterprises, rather than trying to detect and eliminate each and every managerial and financial irregularity in Angola's public resource management processes.

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<sup>80</sup> Part of this coordination could be done by incorporating reform actions related to the Tribunal into the work program of MINFIN's PMFP, to help ensure that sufficient budgetary resources would be allocated in the future to the Tribunal's reform efforts.

## **7. THE FIDUCIARY FRAMEWORK FOR OIL REVENUE MANAGEMENT IN ANGOLA**

*At the center of Angola's fiduciary framework for oil revenue management the special relationship between the Ministry of Finance, the Central Bank, and the national oil company, Sonangol. A transition towards a fully functional relationship between these three key institutions is proposed. This "path towards normalization" is the basis for the second prong of the reform strategy proposed in the PEMFAR and should involve: (i) the establishment of clear reporting mechanisms from Sonangol to both the Ministry of Finance and the Central Bank on all transactions it carries out on behalf of the Treasury; (ii) strengthened internal control mechanisms (both within the Ministry of Finance and Sonangol) to ensure that such transactions are conducted in accordance with legitimate fiscal policy objectives and acceptable public expenditure management practices; and (iii) improved accounting procedures, whereby the National Accounting Directorate at MINFIN obtains from Sonangol all the information it needs to prepare the yearly General State Accounts as well as Quarterly Budget Execution Reports.*

### **A. BACKGROUND**

7.1 Oil and gas revenues are central to Angola's economic, social and indeed political performance. Oil revenues already account for 40 % of GDP, 80 % of government revenues and 95 % of foreign exchange earnings. These revenues are expected to grow rapidly as exploitation of major deepwater offshore oil and natural gas reserves gets underway.

7.2 While the record to date has not been encouraging, these revenues, if properly managed, have the potential to drive Angola's economic and social recovery. Over the past few months, the Government has shown increasing signs of commitment to establishing a fiduciary framework for the management of petroleum revenues designed to correct past misuse or abuse and deliver the positive developmental impacts expected of the sector.

7.3 The key agencies involved in petroleum revenue management are MINFIN; BNA; MINPET; and Sonangol. In theory, the roles and responsibilities of these agencies are as follows:

- *MINFIN*: overall economic and financial policy, budgetary management, tax collection, audit and reconciliation, and oversight of Sonangol as the Government's representative.
- *BNA*: depository for taxes and other petroleum payments, clearing house for financial flows, debt and foreign exchange management.
- *MINPET*: sector policy and oversight.

- *Sonangol*: Government's representative in the sector as concessionaire, cost audits, collection of selected payments due Government and commercial participant in the sector.

7.4 In practice, expediency considerations have eroded many of the individual agency responsibilities and transferred them to Sonangol. Better staffed, better funded and with critical control over oil production, Sonangol has either assumed these responsibilities at the Governments' request, or has taken them over on its own initiative to address agency failings which might otherwise adversely impact Sonangol's commercial performance.

7.5 This Chapter examines three key dimensions of the fiduciary framework for the management of Angola's oil revenues, namely: a) taxation; b) Treasury-like operations (including debt and foreign exchange management); and c) sector governance (regulatory roles and oversight of Sonangol). Performance in each area is critiqued, with particular emphasis on the influence of expediency considerations, and a series of reform steps, or a path towards normalization of the roles of the several agencies involved is recommended<sup>81</sup>.

## B. PETROLEUM TAXATION

7.6 Petroleum revenue flows start with petroleum taxation. For purposes of this Chapter, taxation is taken to include all forms of tax and other payment required under law or contractual provisions. The principal components of petroleum taxation thus defined in Angola are as follows:

- *Bonuses*. These are lump sum cash payments, the most important of which is paid on award of a contract to explore and produce. Bonus payments may also be required on declaration of a commercial discovery and on commencement of production. Other bonuses, recently introduced, go to social funds. Bonuses are bid by would-be foreign investors and are paid to the national oil company, Sonangol.
- *Royalties*. Royalties are levied as a percentage of gross production from each concession or contract area. Existing royalties fall in the range of 16.67 percent to 20 percent. Royalties and the taxes listed below are paid to the Ministry of Finance.
- *Petroleum Income Tax*. The Petroleum Income Tax (PIT) is levied at a 65.75 per cent rate on normal profits from older concession areas, and at a 50 percent rate on profit oil from newer Production Sharing Agreement (PSA) areas.

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<sup>81</sup> This chapter draws on the recently completed Diagnostic Study of the Oil Sector which was funded jointly by the Angolan Government and the World Bank. The aim of the Diagnostic Study was to review the upstream petroleum sector (i.e., crude oil production activity) as it affected the public finances of the country. Specific objectives were to assist the Government in enhancing the transparency of revenue flows from oil production, and to build capacity for managing those flows.

- *Petroleum Transactions Tax.* The Petroleum Transactions Tax (PTT) applies only to the Cabinda Concession Area and is designed to ensure that the Government receives an increased share of Concession Area profits when oil prices are very high.
- *Profit Oil.* Investors operating under PSAs, including Sonangol, are obliged to pay the Government, through Sonangol, a share of their production after recovery of cost. This Profit Oil share is negotiated contract by contract, and increases as function of either daily or cumulative production.
- *Payments to Provincial Government.* These are payments made to the governments of Cabinda and Zaire out of PIT. Payments are made directly by the oil companies, and the Ministry of Finance adjusts its reported PIT revenue accordingly.

7.7 Revenues from all these sources are currently on the order of USD 4.7 billion annually, and, as suggested above, can be expected to grow sharply over the next few years.<sup>82</sup>

7.8 The Government has for some time had in place audit procedures designed to ensure that taxes assessed and paid are accurate. The first of these is a “value for money” audit conducted on behalf of Sonangol. This audit verifies or challenges, as appropriate, the costs claimed by industry as recoverable against required tax or profit oil payments. The second audit, prepared for the National Tax Directorate (DNI) in the MINFIN, is a tax audit, verifying or challenging the taxpayer’s calculation of payments due and payments made. These audits are conducted by internationally qualified and recognized firms, selected by transparent, international competitive tender. Sonangol is covered by both audits and treated the same as its international partners. As a result of these two audits, and the original US dollar accounts and invoices on which they are based, the Government is regularly provided with a very reliable set of US dollar numbers for tax payments due, payments made, and revenues received, except in relation to Sonangol.

7.9 Reliable numbers on tax collection and payments are indispensable to oil revenue management and in this respect Angola is well positioned. Several issues have yet to be addressed, however. The first of these relates to Sonangol’s payment, or apparent non-payment of taxes.

7.10 Reports on payments made versus payments due show Sonangol’s payments to be irregular, delayed and frequently well below what is calculated by the auditors as due. This is often interpreted as deliberate on the part of Sonangol, the charge being made that payments are withheld to cover inefficiencies or misuse of funds – which is not necessarily the case. As suggested in section A, Sonangol, at the Government’s request, undertakes a wide range of activities or tasks on behalf of the Government (see discussion of quasi-fiscal expenditures under the next heading). In the past, the Government has sometimes failed to reimburse Sonangol, or has been delayed in doing

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<sup>82</sup> Volume will certainly increase dramatically. The pace of revenue growth will depend additionally on the future path of oil prices.

so, making it very difficult for Sonangol to meet its own obligations or otherwise behave in a proper commercial manner. Sonangol's reaction has been to reduce the tax and profit oil payments it owes Government by the amount of the costs it has incurred on Government's behalf.

7.11 The consequences of this practice for effective revenue management are adverse. Total payments to Angola from the petroleum sector are underreported and final net payments are made uncertain and delayed as a result of contentious and often protracted negotiations between Sonangol and the MINFIN, over the allowable tax offsets. Disputes arise because in the past there has not been clarity on which activities qualify for offset treatment, and because expenditures under qualifying categories have not been audited.

7.12 The second outstanding issue relates to the conversion of US dollar numbers and accounts into Kwanzas. The Oil Revenue Diagnostic Study revealed a number of discrepancies in the Kwanza reporting of oil revenues among the several agencies involved (MINFIN, BNA and Sonangol). While a number of outside observers have interpreted these findings as evidence of abuse, the Study itself attributes them primarily to institutional failings. Translations of US dollar revenue figures into Kwanzas have been made at different times and different exchange rates by the different agencies, resulting in confusion and inevitably in some discrepancies between payments reported as made and revenues reported as received which do not exist in the dollar figures. In response, the Government will continue the reporting in US dollar figures it has recently begun, and has assigned a high priority to the improved reconciliation of Kwanza reporting among Government agencies.

7.13 The final issue is transparency – the public reporting of petroleum revenues. Transparency is important for a number of reasons: a) it fosters public and democratic debate on revenue use; b) it acts to increase accountability in the executive and legislative branches of government at all levels, reducing the opportunities for corruption and the potential for waste of public funds; and c) increasingly demanded by not only citizens within the country, but also by international financial institutions (public and private), donor organizations and international civil society, transparency can be expected to attract increased finance and investment. While in the past, the Government was not prepared to go public with its oil revenues, it now is, and implementation difficulties appear to have more to do with institutional capacity than lack of will. Revenue numbers have appeared on the MINFIN's website, and the Government has also authorized their release in the latest IMF Article IV Staff Report. Ease of access to both sources is a problem, however, and audiences for both are limited.

### **C. TREASURY-LIKE OPERATIONS BY SONANGOL**

#### **Overview**

7.14 Sonangol's activities on behalf of the Treasury are at the core of the non-conventional mechanisms of budget execution as previously referred to. These include quasi – fiscal activities (including fuel price subsidies) and the servicing of oil backed loans on behalf of the Government.

7.15 All those transactions are performed outside of the formal budgetary framework, the SIGFE. An ever-present risk therefore exists that their total executed amount will exceed the fiscal targets of the OGE. This is clearly inimical to aggregate fiscal discipline and macroeconomic stability. In addition, the fact that such expenditures are not subject to the automatic controls of the SIGFE also implies that lines of accountability are blurred. Further, their existence gives rise to complex and largely informal compensation mechanisms between Sonangol and MINFIN.

7.16 Because Sonangol controls the oil volumes required to back loans to Angola, and because Sonangol is familiar with oil and financial markets and has the requisite commercial expertise, Sonangol is the principal agency charged with arranging loans on behalf of the Government, largely bypassing MINFIN and the BNA, notwithstanding the existence of a Debt Management Commission (refer to Chapter 4) in which all three agencies nominally have a role to play. In addition to the debt it arranges on the Government's behalf, Sonangol raises debt on its own account. Since Sonangol is wholly state owned, this is essentially part of the national debt along with Government debt<sup>83</sup>.

7.17 The "expediency" proved financially costly to the Government, as it led to the accumulation of tax arrears by Sonangol. During the late Nineties, a formal compensation mechanism existed through the so-called "petroleum account" at BNA, whereby the latter would act as a "clearing house" for the financial flows – in Kwanzas and in U.S. dollars – between MINFIN, BNA and Sonangol. This mechanism broke-off as the three partners did not fully comply with the terms of the legislation. Sonangol stopped paying its "cash call" obligations through the "petroleum account" before the end of 2000, and started accumulating tax arrears vis-à-vis the Treasury that amounted to 4.6% of GDP in 2001.

7.18 Additionally, the Central Bank has been excluded from the compensation mechanisms and has become partially unable to monitor the country's foreign exchange. A key legal and fiduciary concern emerged as a result of the demise of the "petroleum account" in 2001: since then, the BNA is excluded from the compensation mechanisms, thereby preventing it from fulfilling its role as the Government's official Manager of all foreign exchange. This violates the spirit of the Organic Law of the Central Bank.

7.19 From a fiscal point of view, Sonangol's Treasury-like operations are not negligible and have reached a sizable magnitude. According to the final 2002 Budget Execution Report, expenditures by Sonangol (excluding subsidies and debt service) outside the SIGFE represented almost 11% of total executed Government expenditures in the period. In addition, Sonangol handled in 2002 US\$ 1.2 billion to service oil-backed loans on behalf of the Treasury. In 2002, budgeted price subsidies totaled some US\$300 million dollars, of which US\$220 million (equivalent to 2 percent of GDP) were in arrears by the end of the year. Most of these price subsidy arrears (89.8 percent) were due to Sonangol Holding (through Sonangol Distribuidora) for the provision of petroleum products at below-market prices.

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<sup>83</sup> These practices, together with an evident lack of coordination among the several agencies involved, have made it very difficult to access accurate or complete data on Angola's debt, a state of affairs confirmed by the Oil Diagnostic exercise and by World Bank and IMF missions over the past several years. Lack of transparency in turn has locked the country into oil-backed loans as the only source of loan finance, resulting in high prices and short tenures, again underscoring the need to move to greater transparency.

7.20 The “petroleum account” was discontinued in 2002 and replaced by largely informal compensation mechanisms involving Sonangol and MINFIN, but again excluding BNA. Such mechanisms take the form of tax and profit oil offsets, whereby Sonangol “pays itself out” for the expenses it incurs on behalf of the Treasury. One of the main implications – as discussed in Chapter 4 – is that the Treasury Single Account (CUT) can no longer capture the totality of fiscal transactions – which violates the Protocol between BNA and MINFIN.

7.21 Independently of how organized these non-conventional mechanisms can become, they violate the rule of the law. While during 2002 the compensation process seemed to be conducted in a rather haphazard way, since 2003 it became somewhat more organized and predictable. This in itself presents the additional danger of creating an artificial “functionality” that could lead to the perpetuation of a mechanism that violates basic legislation and ultimately weakens the Ministry of Finance as the chief fiscal institution in Angola.

7.22 In the remainder of this section, we will discuss in more detail the workings and the eventual collapse of the “petroleum account”, followed by an analysis of the currently prevailing compensation mechanisms between MINFIN and Sonangol.

### **The Petroleum Account Mechanism**

7.23 Under the previously existing petroleum account mechanism, a transit account was established at the BNA in which all credit and debit transactions between Sonangol and the Treasury and between Sonangol and its foreign partners were recorded. BNA acted as a clearing house for the financial flows involved, which were essentially foreign exchange flows. This ensured that the BNA would be the focal point for foreign exchange management.

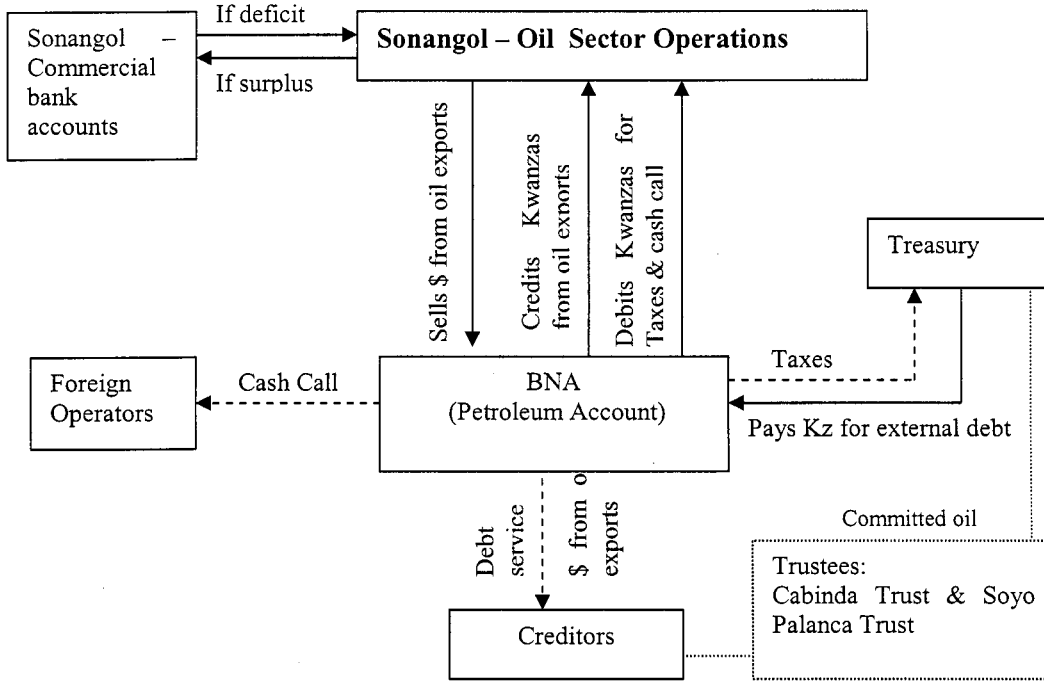
7.24 Under Decrees 15/89<sup>84</sup> and 30/95<sup>85</sup>, the mechanics of financial flows seemed to be clearly defined, albeit complex: Sonangol would sell to BNA the total proceeds from oil exports. In turn, BNA credits the company with the corresponding Kwanzas. From those, the company would pay its main obligations, i.e., taxes to the Treasury and cash call to operators. If any surplus remained, it would be transferred to a Sonangol’s account in a commercial bank or, if there was a deficit, funds would be transferred from Sonangol’s commercial bank accounts to BNA. Figure 7.1 illustrates the workings of this mechanism.

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<sup>84</sup> Sonangol should give to the OGE the revenues received in its role as a concessionaire, being authorized to retain up to 10% of these proceeds to pay contractors supervision

<sup>85</sup> Companies under general foreign exchange regime should sell to BNA the total foreign currency revenue resulting from exports of crude oil and should be credited by the corresponding amount in Kwanzas - Article 1, nr. 2 and Article 3, nr. 1 and 3.

**Figure 7.1: Financial Flows under Decree 30/95**



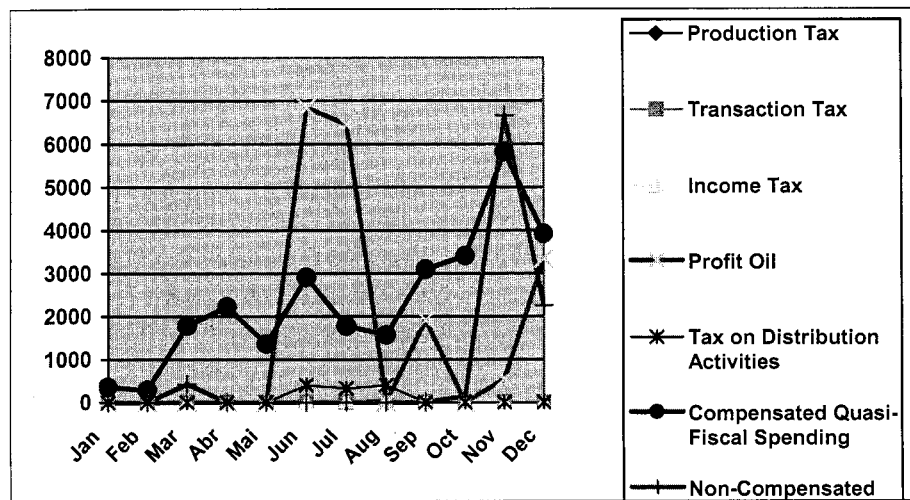
7.25 In practice, the mechanism broke down because the monies owed to Sonangol from the transit account were either not transferred in full or not quickly enough to allow Sonangol to meet either its tax obligations or the cash calls of its foreign joint venture partners (Sonangol's payment obligations as an equity participant in joint venture operations). Sonangol's response to this state of affairs was to retain its foreign exchange earnings in its own accounts and, bypassing the BNA, pay its tax and cash call obligations directly, undermining the BNA's foreign exchange management responsibilities

**An Informal Compensation Mechanism**

7.26 The accumulation of arrears against each other (tax arrears on the side of Sonangol, and fuel-price subsidy arrears on the side of the Treasury) seems to have been a major motivation for the introduction of some sort of compensation mechanism (albeit informal) to replace the "petroleum account" – but without the participation of BNA.

7.27 The new mechanism works largely through tax and profit oil offsets: Sonangol's expenditures on behalf of the Treasury are deducted from their obligations towards the latter. During 2002, this mechanism appears to have compensated only partially for Sonangol's treasury-like spending – still allowing for the accumulation of fuel-price subsidies on the part of the Treasury (as seen in Chapter 4, Chart 4.1). Chart 7.1 below shows the mechanism operated during 2002.

**Chart 7.1: The Informal Compensation Mechanism at Work in 2002  
(Kz million)**



Source: Sonangol.

7.28 Quasi-fiscal spending (excluding external debt service) was compensated during 2002, mostly, but not exclusively, against profit oil (see Chapter 7.1)<sup>86</sup>. Total non-debt quasi-fiscal spending by Sonangol during this year is estimated to have reached US\$ 597 million. The timing for both spending and offsetting in the course of the year gives rise to a number of observations:

- Not all quasi-fiscal spending by Sonangol was compensated in 2002 through offsets. Quasi-fiscal spending not compensated in 2002 was offset against Sonangol's obligations to the Treasury during 2003.
- Quasi-fiscal spending by Sonangol started low in 2002, and increased substantially from March onwards, peaking in November. This pattern reflects both an increased demand for peace-process-related spending (e.g., quartering of former UNITA rebels) and rising fuel-price subsidies, in the absence of price adjustments for petroleum products, in the context of a highly inflationary economy.
- However, the compensation process really kicked-off from May onwards, and mostly relied on profit-oil offsets (some minor recourse to tax offsets took place throughout 2002 as well). It is interesting to note that profit-oil-based compensation was substantially "frontloaded" in June and July, which is likely to have been a factor in the cash-flow difficulties affecting the Treasury in the fourth quarter of 2002.

<sup>86</sup> It appears that most of the debt service conducted through Sonangol was compensated by tax offsets during 2002.

7.29 It could be argued that, to a large extent, 2002 was an exceptional year, and that the fiscal phenomena observed over the course of that year reflected the new demands (e.g. demobilization-related spending) arising from the peace process. During 2003, however, an informal compensation mechanism continued to operate, arguably on a more predictable and systematic basis.

7.30 The “informal rules of the game” with respect to the compensation mechanisms adopted in the course of 2003 are as follows. Quasi-fiscal spending is now fully compensated against profit oil, while external debt service conducted by Sonangol is compensated against tax offsets. Although the total value of offsets for 2003 were not made available to the PEMFAR team, it is estimated that profit-oil offsets have been more than sufficient to cover Sonangol’s non-debt treasury-like operations. In turn, external debt service costs handled by Sonangol are deducted monthly from its taxes due. At any given month, the following theoretical sequence of events has been applied:

- If debt service due (handled by Sonangol) = X
- And taxes due by Sonangol =  $Y < X$
- Then the Treasury issues a payment order in favor of Sonangol equivalent to X.
- Finally, the difference ( $Y-X$ ) is rolled over to the following month.

7.31 The estimated total external service handled by Sonangol on behalf of the Treasury in the way described above is approximately [US\$ 1.2 billion].

7.32 In addition, as noted in Chapter 3, the revised 2003 Budget incorporated some US\$ 257 million to cover for goods and services directly paid for by Sonangol, introducing a further degree of predictability (for MINFIN) with respect to the behavior of the profit oil offsets<sup>87</sup>. However, preliminary Sonangol numbers for up to October 2003 already indicate a total of approximately US\$ 815 million (of which US\$ 421 million as fuel price subsidies) total Treasury obligations against Sonangol. Therefore, the budgeted amount for Sonangol’s spending was far below the accrued actuals up to October 2003. Although an important step, the budgeting of Sonangol’s quasi-fiscal spending is not sufficient in itself to ensure that the non-conventional execution system would not undermine aggregate fiscal discipline.

#### **D. PETROLEUM SECTOR GOVERNANCE**

7.33 Sector governance has a bearing on petroleum revenue management in two respects: a) through certain aspects of sector regulation undertaken by Sonangol in its Concessionaire capacity; and b) through oversight of Sonangol’s investment operations.

7.34 *Sonangol as Concessionaire.* As title-holder of each oil exploration and production license, or Concessionaire, one of Sonangol’s critical roles is to approve all major procurement contracts. Given Sonangol’s equity participation in a wide range of oil field service and supply companies, there exists clear potential for conflict of interest in its exercise of the Concessionaire role. Awards of procurement contracts to non-

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<sup>87</sup> It is important to note that the mere introduction of such amount in the OGE does not mean that the actual spending would take place within the formal budgetary system (that is, through the SIGFE and the CUT).

competitive suppliers could significantly raise costs, especially where contract provisions may allow for cost recovery with an “uplift”, i.e, greater than 100% recovery. The main adverse impact of such cost inflation will not be on the foreign investor (who will recover the cost against taxes) nor on Sonangol, whose subsidiaries will benefit from the contract awards, but on the Treasury, whose tax revenues will be reduced, possibly significantly. This potential problem was identified in the Oil Diagnostic, and while disputed by Sonangol, its existence was confirmed in informal meetings with Sonangol’s international oil company partners.<sup>88</sup>

7.35 *Oversight of Sonangol.* As a wholly owned state enterprise, Sonangol both generates and consumes public funds on a massive scale. Sonangol’s investment requirements will escalate rapidly in the near term to fund its 20% share of ultra deep water oil field developments, expected to cost in excess of US\$ 1 billion each. Other major investments are also under consideration – participation in a LNG export project, and in a grass roots 300,000 barrels/day refinery at Lobito. Clearly, these investments have a macroeconomic significance, and should only be made in the context of a careful budget debate which takes into account not only the merits of the investments themselves and the use of public funds in particular, but also competing budgetary demands, e.g., for social and other infrastructure. Unfortunately, the state is not well equipped to exercise the necessary oversight. MINFIN, the state’s representative on Sonangol’s Board, does not have the skills or resources to critically examine or oversee Sonangol’s performance and plans, their macroeconomic relevance notwithstanding.

## E. SUMMARY AND RECOMMENDATIONS

7.36 Implementing an appropriate fiduciary framework for petroleum revenue management is enormously important for Angola. Some progress has been made in this regard, but a significant agenda remains. The paragraphs below summarize the observations made in this Chapter and make a number of recommendations for the transition from present circumstances to full reform.

7.37 *Taxation.* Reasonably robust audit procedures are already in place that provide the Government with credible US dollar numbers on tax payments made and received, at least as far as foreign taxpayers are concerned. Total tax payments and receipts are clouded by tax offset procedures followed by Sonangol to compensate for a range of quasi-fiscal activities performed on behalf of the Government. Clarity further deteriorates when US dollar figures are translated into Kwanzas by different agencies at different rates without coordination. Finally, while the Government has taken steps towards increased transparency of tax revenues, public access is still relatively restricted.

7.38 Recommendations for the transition include: a) negotiated and public clarity on which quasi-fiscal activities will be undertaken by Sonangol and qualify for tax offsets; b) explicit audit of these activities. This is expected under the ongoing independent audit of Sonangol; c) adoption of US dollar accounting for oil revenues; d) capacity building at

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<sup>88</sup> Sonangol retains 10% of the value of the Government’s oil entitlement from production sharing contracts which it sells on behalf of the GOA. This fee is intended to cover not only the cost of the oil marketing activity, but also the cost of other regulatory obligations assigned to Sonangol as Concessionaire, as well as part of the quasi-fiscal operations discussed earlier in this Chapter.

each of the key agencies (MINFIN, BNA, Sonangol), with an emphasis on improved inter-agency coordination. This might be achieved by setting up a Petroleum Revenue management Unit in MINFIN with representation from the other agencies involved.

7.39 *Budgetary Management.* Quasi-fiscal expenditures, principally by Sonangol, occurring outside the normal budget process, have undermined fiscal discipline and also led to misconceptions on the use of funds. A second concern is the absence in the budgetary process of any mechanism designed to deal with oil revenue volatility.

7.40 The Government (MINFIN) has moved to incorporate at least some of Sonangol's quasi-fiscal operations into the budget, but needs to go much farther. Agreement on allowable offsets and planned audits will help. Ultimately the quasi-fiscal activities should be moved out of Sonangol. Although this cannot happen immediately, in the meantime all-quasi fiscal activities could be "ring-fenced" within Sonangol for better monitoring and control and ease of eventual transfer. The phases of the ring-fencing process is described in Box 7.1.

### Box 7.1. Phases of the “Ring-Fencing” Process

#### *First phase*

- First step - ensure that the value of these activities is estimated in advance and included in the annual budget. (This has started with the 2003 Revised Budget).
- Second step – agree what quasi activities are to be identified and measured within Sonangol for recovery (that is subject to the profit oil and tax offsets).
- The improved measurement of the associated costs would include the introduction of time writing techniques and cost allocation systems.
- Third step – the foregoing transactions would be included as a separate task within the proposed independent audit of Sonangol.

#### *Second phase*

Submission by Sonangol of an independently audited analysis of unbudgeted expedient type costs, in accordance with a Cabinet Minute would simplify and accelerate the approval process within MINFIN.

- The present independent audit of taxes paid should be extended to include an audit of the calculation of net taxes due to GOA after netting off offsets and the value of quasi-fiscal activities.
- This would result in the whole cycle of tax flows being audited from the taxes paid by Sonangol to the final receipt of these taxes by MINFIN after the deduction of the offsets and quasi-fiscal activities.
- Thus an independently audited full reconciliation between taxes originally due and net taxes finally received by MINFIN would be available.

#### *Third phase*

- Another important aspect would be that approval of Sonangol’s tax returns should be strengthened by centralizing both the approval of gross taxes due and the value of offsets to arrive at the net taxes due and paid within MINFIN’s Tax Directorate.
- The foregoing should be formalized in a new procedure approved by Cabinet.

#### *Fourth phase*

Formal reporting mechanisms from Sonangol to MINFIN, and from Sonangol to BNA, need to be established, particularly regarding:  
External debt service. tax and profit oil offsets and oil exports undertaken by Sonangol.

7.41 Some consideration should be given to the application of fiscal rules to the budget process that would set aside a portion of excess funds resulting from unexpected oil price increases.

7.42 Budgetary management, and indeed all aspects of petroleum revenue management, would be greatly helped by use of a petroleum sector financial model such as that developed in the context of the Oil Diagnostic Study (see Annex 3).

7.43 *Financial Management.* There is an urgent need for greater transparency with respect to both debt and foreign exchange transactions. The ongoing independent audit of Sonangol should provide some of this, but it will take a concerted comprehensive approach to get the required results. A capacity building program in the BNA should be

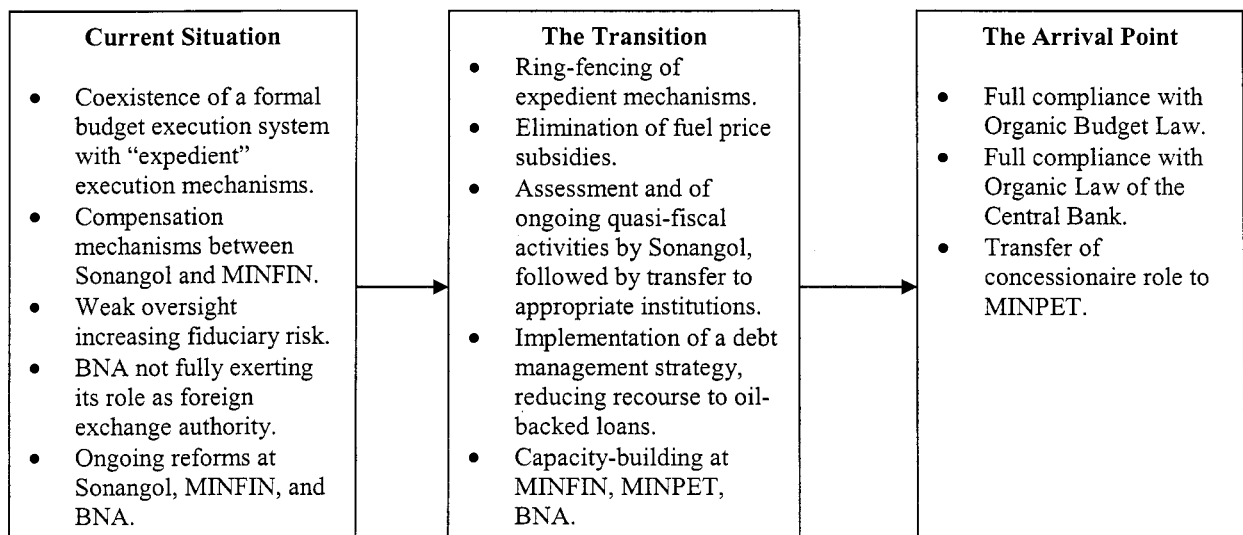
pursued in order to guarantee a safe return of all debt and foreign exchange operations currently carried out by Sonangol can be safely restored to that institution.

7.44 *Sector Governance.* Certain aspects of Sonangol's role as Concessionaire, notably its approval of all major procurement contracts create a significant potential for conflict of interest and loss of revenues to the Treasury. Further, the GOA lacks the capacity to oversee effectively Sonangol's revenues and investment programs although their scale is enormous and has clear macroeconomic relevance.

7.45 Tempered by expedience and by the need to build capacity in oversight agencies, consideration should be given to transferring Sonangol's Concessionaire roles to the Ministry of Petroleum, where they are traditionally found in international practice. Ring-fencing these activities first within Sonangol would help prepare the transfer (see Box 1 above). The urgency of proper oversight of Sonangol is such that the GOA/MINFIN might be well-advised to engage qualified consultants sooner rather than later to assist in performing this function.

7.46 *A "Path to Normalization".* "Normalization" refers in this context to a situation in which the "non-conventional" or "expedient" activities would have been eliminated over an agreed time period. This would represent the arrival point of a transition process involving the key institutions - MINFIN, BNA, and MINPET. However attention must be paid as part of the transition process to upgrade the resources, skills, training, internal procedures and reporting and communication within and among these institutions in order for them to be ready to take back ownership of the Treasury-like activities. These changes would involve improvements to salary structure, employee career planning and benefits, all of which would require commitment to institutional reform. The main milestones of the transition process are summarized in Chart 7.2.

**Chart 7.2: Schematic View of the Transition**



7.47 The transition process should ultimately lead to the following:

- Full compliance with the Organic Budget Law and
- The elimination of the non-conventional mechanisms of budget execution.
- Full compliance with the Organic Law of the BNA, restoring its role as Angola's foreign exchange authority.
- Elimination of Sonangol's dual role, and transfer of its Concessionaire functions to the Ministry of Petroleum.

7.48 It is important to stress that different time scales will be involved in the process of reaching each different component of the "arrival point". In particular, The Government should adopt a phasing-out strategy specific to each category of treasury-like operation.

- The gradual elimination of fuel price subsidies through periodic price adjustments would lead to substantial savings for the State. In parallel, appropriate social safety nets should be designed and implemented.
- The Government should carefully examine the rationale for the various other categories of quasi-fiscal activities carried out by Sonangol on behalf of the Treasury. Those for which justifications are weak should be simply eliminated. A plan should be put in place in which justified quasi-fiscal activities would be transferred to the appropriate organizations within the State.
- Only *sustained fiscal adjustment over the medium-term* will eliminate the deficit-financing motivation for the contracting of external loans. Fiscal adjustment should also give multilateral and bilateral creditors the confidence required to increase Angola's access to concessional external financing. A clear debt management strategy should also be designed in which the recourse to oil-backed financing would be made less necessary over a realistic timeframe.

7.49 A proposed three-year reform program – indeed the second prong of the reform strategy proposed in the PEMFAR – is presented in Chapter 9, Table 9.2.

## **8. LINKING BUDGETING AND POLICY**

*Currently, Angola's Public Investment Program (PIP) is not prepared on the basis of a multi-year methodology, nor is the State Budget (the OGE) solidly grounded on a medium-term policy framework. However, both on the revenue and on the expenditure side there have been progress in the development of policy tools that may prove to be the seeds for a successful medium-term approach to budgeting and policy. This chapter notes that the expected increase in oil revenues as well as Angola's reconstruction needs make it all the more necessary for the country to implement a medium-term approach to budgeting, as well as to strengthen the links between budgeting and policy.*

### **A. THE NEED FOR A MEDIUM-TERM APPROACH TO BUDGETING**

8.1 The start of production in the giant oilfield Girassol in 2002 – which added approximately 200,000 barrels to the country's daily oil production – inaugurated a new era for Angola's oil sector, one in which production will be dominated by newer, deeper-water oilfields. Not only the composition of oil production is changing, but its volume as well. As noted before, total daily oil production is expected to rise from the current 1 million barrels to more than 2 million in 2008.

8.2 The particular nature of the contracts (production sharing agreements, or PSAs) established between the Government, through Sonangol, in its concessionaire role, and the oil companies<sup>89</sup> may further complicate the already intricate task of forecasting revenues from oil<sup>90</sup>. The PSAs – the dominant arrangement in deep- and ultra-deep-water concession blocks - essentially imply that the behavior of cost oil and profit oil do not follow a linear pattern over time, which means that simple spreadsheet-based linear models – such as the one currently used by the National Tax Directorate – will not properly capture the ensuing revenue fluctuations.

8.3 Over the next few years, Angola's revenues from oil will be subject to three additional sources of variation, in addition to crude price volatility: (i) the changing composition of production; (ii) the increasing volume of extraction; and (iii) the increased importance of PSAs and its implications for the behavior of the State's profit oil. Thus,

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<sup>89</sup> Refer to Chapter 7 for a fuller discussion on the nature of PSAs as well as of Sonangol's role in Angola's public financial management.

<sup>90</sup> Witness the discussion on the effective rate of oil taxation in the IMF's Staff Report for the 2003 Article IV consultation (International Monetary Fund (2003)). The share of oil receipts in GDP declined in 2002, despite rising oil prices and production, presumably because cost oil deductions increased as well. The lack of a systematic analysis of the behavior of oil tax and profit oil receipts meant that to some extent the authorities were taken by surprise and could not make timely adjustments in its expenditure patterns to reflect the behavior of revenues.

more than desirable, it is very necessary that Angola adopts an approach to budgeting that goes beyond the one-year framework of the OGE, to avoid unnecessary disruptions in cash management and to correctly forecast the Government's fiscal stance. In particular, the Government should take advantage of tailor-made instruments, such as the Oil Sector Financial Model (to be discussed in Section B below), to improve the quality and reliability of oil revenue forecasts, over a multi-year period.

8.4 The need for a multi-year approach to budgeting is even greater when it comes to establish sound public expenditure policies. The link between the latter – especially at the sectoral level – and the budget process is weak in many developing countries, and Angola is no exception. As briefly discussed in Chapter 1, the OGE has been conceived to a large extent as a wartime budget, and the composition of Government expenditures essentially reflect that. Public expenditure policies – including fuel price and utility tariff subsidies – are established in a largely ad hoc manner, and without the underpinning of a medium-term spending plan or strategy. Therefore, not only the links between policies and budgeting are weak, but the foundation for sound public expenditure policymaking is very shaky as well. *The adoption of a medium-term approach to budgeting, therefore, has to be accompanied by a medium-term approach to public expenditure policy as well.*

8.5 The adoption of such medium-term approaches should not imply the outright implementation of a Medium-Term Expenditure Framework (MTEF). As pointed out by recent literature (see Le Houerou and Taliércio (2002)), MTEFs cannot work if a solid budgetary management process – particularly as regards budget execution – is not in place<sup>91</sup>. Insofar as Angola's public financial management remains characterized by a dichotomy between formal and “non-conventional” mechanisms of budget execution, an MTEF is clearly not an option. But this does not prevent the Government from moving towards the conditions required for a successful MTEF<sup>92</sup>. Indeed, some of the seeds for a successful medium-term approach to budgeting and policy have already been planted and will be discussed in Section C.

## **B. EXISTING OBSTACLES TO LINKING BUDGETING AND POLICY**

### **The Absence of a Multi-Year Public Investment Program**

8.6 The Public Investment Program, by its own nature, should be the starting point for a better integration between policies and their funding in a medium-term context. Indeed, the PIP is composed of projects with maturities longer than one year. However, the PIP has been prepared as an annual tool, which in practice subverts its multi-year nature. Although its presentation in the OGE has considerably improved over time, the PIP continues to be little more than a list of projects to be carried out over the course of a

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<sup>91</sup> “The MTEF should also rest upon a solid budget foundation, which would encompass many elements, though chief among them is budget execution that complies with the adopted budget. Consistency between the budget and its execution is a precondition for transparency, predictability, and accountability. In a country where budget execution (i.e., actual expenditure) bears little resemblance to the voted budget (i.e., the intention to spend by sectors, functions, and programs), an MTEF is not likely to be taken seriously by sector ministries, nor by parliamentarians, nor by civil society” (*op. cit.*, p. 26).

<sup>92</sup> One of the activities foreseen as part of the Bank-supported EMTA credit is the conduct of a study on the preconditions for a successful MTEF in Angola.

given fiscal year. The PIP does not provide any information on projects that have ended in a particular year, nor investment amounts of on-going projects that will be transferred to subsequent years. It also does not provide an overview of public investments over a timeframe longer than the budgeted year.

8.7 The World Bank and the IMF have recommended that the PIP preparation and execution processes need to be thoroughly reviewed, including the individual analysis of each projects, including their merits. Projects should be analyzed not only on financial and physical terms, but also in terms of benefits accrued to the economy if those expenditures are continued or terminated. Currently, there is very little evidence that projects are selected for inclusion in the PIP on the basis of a strategic approach.

8.8 A process of “cleansing” (saneamento) of the PIP started in 2004. Further improvements have been made in terms of its presentation in the OGE, which is now made within the organic, functional, and territorial standpoints. The PIP classification system is now closer to the one proposed in the Manual de Elaboração do Orçamento (MEO) 2004 (see Chapter 4). The 2004 PIP contains only either ongoing projects or the costs of feasibility studies for newly-proposed ones. MINPLAN has been taking stock of all projects approved between 2001 and 2003 with a view to phase them out or terminate them. The ultimate stated objective of the “cleansing” is the adoption of a multi-year budgeting perspective for the PIP.

8.9 The elaboration of all pieces of the OGE should be under the responsibility of a single entity, in this case the National Budget Directorate at MINFIN. MINPLAN’s current responsibility for the PIP would then be transferred to DNO, but this would not necessarily imply that MINPLAN and MINFIN would merge: MINPLAN could still retain its role in medium-term planning, including the preparation and monitoring of the poverty reduction strategy. In the short term, attention should be paid to the establishment of an adequate interface between the SIGIP and the SIGFE, as well as to the integration of the teams in charge of the PIP and the recurrent budget.

### **The Lack of a Medium-Term Policy Foundation for the OGE**

8.10 The OGE is often referred to as a “Program Budget”, when it actually presents a listing of current Government programs. The activities under such listing are not always consistent with the Government’s intentions as stated in its annual or bi-annual Economic and Social Programs (Programa Econômico e Social, PES). For example, MINPLAN launched the PES 2003-2004 in October 2002, aiming to cover two fiscal years. While the original 2003 OGE was prepared with the PES in view, the revised 2003 OGE as well as the 2004 OGE considerably depart from it. The OGE’s justification chapter (Relatório de Fundamentação) thus becomes the ultimate policy basis for the expenditure allocations for the corresponding year. However, the justification chapter is prepared exclusively in the confines of MINFIN, with little consultation with line ministries, although the latter have an opportunity to react to it when it is submitted to the Council of Ministers for approval.

**C. THE SEEDS FOR A SUCCESSFUL MEDIUM-TERM APPROACH TO BUDGETING AND POLICY**

**The Revenue Side: The Oil Sector Financial Model**

8.11 As part of the work on the Oil Sector Diagnostic Study<sup>93</sup>, a “Financial Model” was developed with the following purposes<sup>94</sup>: (i) to forecast tax and other petroleum revenues accruing to the Angolan State; (ii) to provide the Government with a tool to monitor and manage oil revenues; (iii) to provide five-year financial forecasts on oil operations on a monthly and quarterly basis; and (iv) to assist the Government in the reconciliation of financial flows between MINFIN, BNA, and Sonangol.

8.12 Table 8.1. below summarizes the main exogenous (input) and endogenous (output) variables of the model:

**Table 8.1: Financial Model: Main Exogenous and Endogenous Variables**

Main Exogenous Variables (Inputs)	Main Endogenous Variables (Results)
Crude oil prices	Total Government’s oil revenues (taxes, bonuses, profit oil, <i>plus</i> Sonangol’s revenues as exploration partner)
Exploration cost profiles	Total Government’s oil revenues (taxes, bonuses, profit oil, <i>minus</i> Sonangol’s revenues as exploration partner)
Alternative production profiles	Sonangol’s after tax net financial flows (revenues minus costs and taxes)
Fiscal instruments (taxes, bonuses, profit-oil sharing, royalties)	IOCs’ after tax net financial flows (revenues minus costs and taxes)
Cost-recovery ceilings	Royalties due
Behavior of the depreciation of the Petroleum Income Tax	Petroleum income taxes due
Sonangol’s equity share	Petroleum transaction taxes due
Carrying of Sonangol during exploration phase	Profit oil due

8.13 The Financial Model, if well-implemented and properly utilized, is expected to generate benefits in a number of areas, all of which facilitating the establishment of a medium-term approach to oil revenue management and substantially increasing the accuracy and reliability of oil revenue forecasts. These benefits include: (i) improved financial planning and reporting; (ii) enhanced revenue and cash management; (iii) improved monitoring of strategic developments in the oil sector, including future explorations and investments; and (iv) strengthened Government’s ability to negotiate future contracts, including the forecasting of future revenues.

8.14 The National Tax Directorate should become the model’s “institutional home”. Establishing such “home” will require the implementation of a capacity building effort and the design of an appropriate incentive system to ensure that the model is manned by

<sup>93</sup> KPMG (2003).

<sup>94</sup> This subsection draws extensively on a presentation made by KPMG to the Angolan Government and Bank and Fund staff in January 2003. See Annex 3 for a detailed exposition of the model.

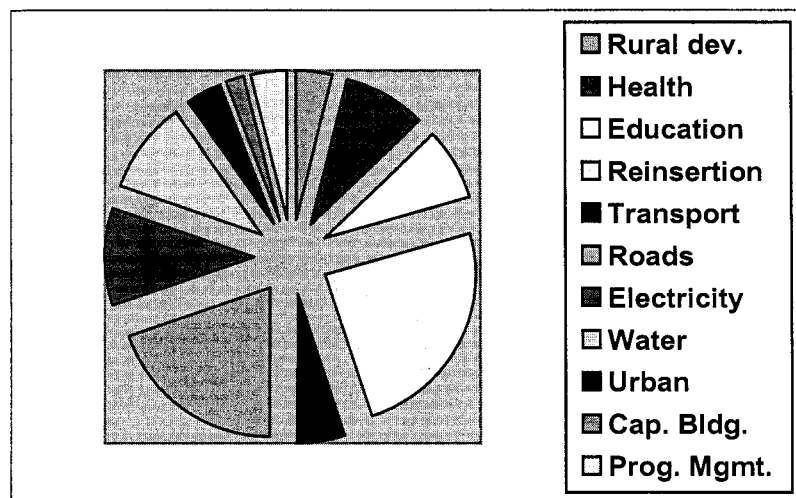
skilled and motivated staff. This can be developed with support from the Bank through earmarked EMTA credit resources for the institutionalization of the model.

### **The Expenditure Side: The Post-Conflict Rehabilitation and Reconstruction Program**

8.15 The Post-Conflict Rehabilitation and Reconstruction Program (PCRRP), prepared by the Ministry of Planning with assistance from the World Bank, is an important step towards devising a multi-year PIP. The PCRRP was conceived in the context of the peace process, which allowed for a more systematic approach to rehabilitating and rebuilding social and economic infrastructure damaged or destroyed during the conflict. Naturally, the PCRRP, which covers the period [2003-2005] focus on the most immediate post-conflict investment needs, and as such should be understood as a subset of a potential multi-year PIP.

8.16 The PCRRP comprises capital expenditure outlays on rural development, health services, education, reinsertion & community development, transport, roads & bridges, electricity, water supply, and urban infrastructure & services, totaling US\$ \_\_\_ billion over its duration. Part of those resources are also to be used for capacity building activities as well as for the management of the program. The expected distribution of expenditures is described in Chart 8.1 below.

**Chart 8.1: Composition of the PCRRP, 2003-2005**



Source: World Bank and MINPLAN staff calculations.

8.17 The PCRRP was originally developed to be submitted to the donor community for support, in the context of a post-war donor conference or roundtable. Since the conference did not take place in the intended period, the Government decided to fully cover the PCRRP costs for 2003, as part of the Public Investment Program. Table 8.1. shows the expected weight of the PCRRP as a component of the PIP.

**Table 8.2: The Share of the PCRRP in the total Public Investment Program**

	2003	2004	2005	2006	2007
Estimated capital spending (US\$ million)	1,066	1,076	1,164	1,399	1,744
Of which: PCRRP (US\$ million)	600	600	600	700	370

Source: Government of Angola (2003), *Estratégia de Combate à Pobreza*. Draft for Discussion.

8.18 From an operational point of view, a major risk will be implementation capacity. Nevertheless, a detailed analysis of this issue is beyond the scope of the PEMFAR. It suffices here to recall the large hiatus between “physical” and financial execution of the PIP discussed in Chapter 4. With the substantial increase in capital expenditures to be brought about by the PCRRP, such concerns will be magnified. Nevertheless, this program can be viewed as a first effort at adopting a multi-year approach to a relevant subset of the PIP. Thus, it is fair to say that the PCRRP subset of the PIP has already assumed a more medium-term character. The PCRRP will also be a key component of the Government’s Poverty Reduction Strategy.

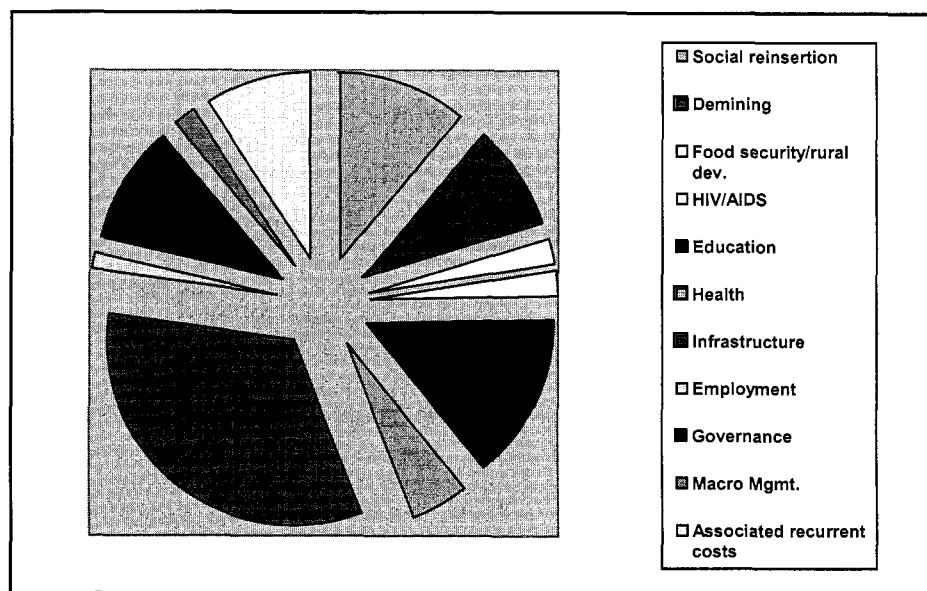
### **The Poverty Reduction Strategy**

8.19 The Government circulated in January 2004 to the donor community a near-final version of its Poverty Reduction Strategy (*Estratégia de Combate à Pobreza*, or ECP). The ECP, if successfully finalized and implemented, has the potential to become the first medium-term tool for public expenditure policymaking by the Government since Angola opted to become a market economy.

8.20 The ECP proposes to implement a three-year public expenditure program focusing on ten priority areas, namely: (i) social reinsertion; (ii) demining; (iii) food security and rural development; (iv) HIV/AIDS; (v) education; (vi) health; (vii) basic infrastructure; (viii) employment and vocational training; (ix) governance; and (x) macroeconomic management. The estimated costs of the ECP for the 2003-2006 period total US\$ 3.17 billion. The ECP costs are presented as part of a multi-year fiscal framework, which should be the basis for any future effort at establishing an MTEF.

8.21 Chart 8.2 below describes the composition of expenditures proposed by the ECP, which is broadly consistent with the one for the PCRRP.

**Chart 8.2: Poverty Reduction Strategy (ECP): Priority Areas in Terms of Multi-Year Allocations, 2003 - 2006**



Source: Estratégia de Combate à Pobreza (MINPLAN)

### Recommendations for Further Reform

8.22 In the final analysis, a successful adoption of a medium-term approach to budgeting and policy needs to rest on three main pillars<sup>95</sup>:

- Expenditure control mechanisms, particularly with respect to budget execution, need to be strengthened;
- The budget process needs to be guided by public expenditure policy, not the reverse; and
- Revenue forecasting capacity needs to be enhanced.

8.23 The first pillar is at the core of the proposed two-pronged PEMFAR strategy for Angola – particularly in what concerns the strengthening of the formal budgetary execution system. And much progress can be made on the third if the Financial Model is adequately implemented. The second one – public expenditure policy driving the budget process – requires a sound articulation between short- and medium-term policy and planning instruments, as well as improved coordination between MINFIN and MINPLAN.

8.24 Chart 8.3 suggests a possible model of articulation. The model advocates the establishment of clear links between four basic medium-term programming instruments – the PIP, sectoral/provincial plans, the PRSP, and the MTEF – with the two basic yearly

<sup>95</sup> Cf. Schiavo-Campo and Tommasi (1999), p. 88.

operational plans – the Economic and Social Programs (PES) (often bi-annual) and the State Budget (OGE). The model proposed here follows closely that of Mozambique. The main difference is that in Mozambique all six instruments are under the responsibility of a single entity, the Ministry of Finance and Planning. In Angola, MINPLAN is in charge of the PIP, the sectoral/provincial plans, and the PES, while MINFIN is responsible for the OGE. The PRSP process has also been assigned to MINPLAN, while an eventual MTEF would likely be part of MINFIN's work program.

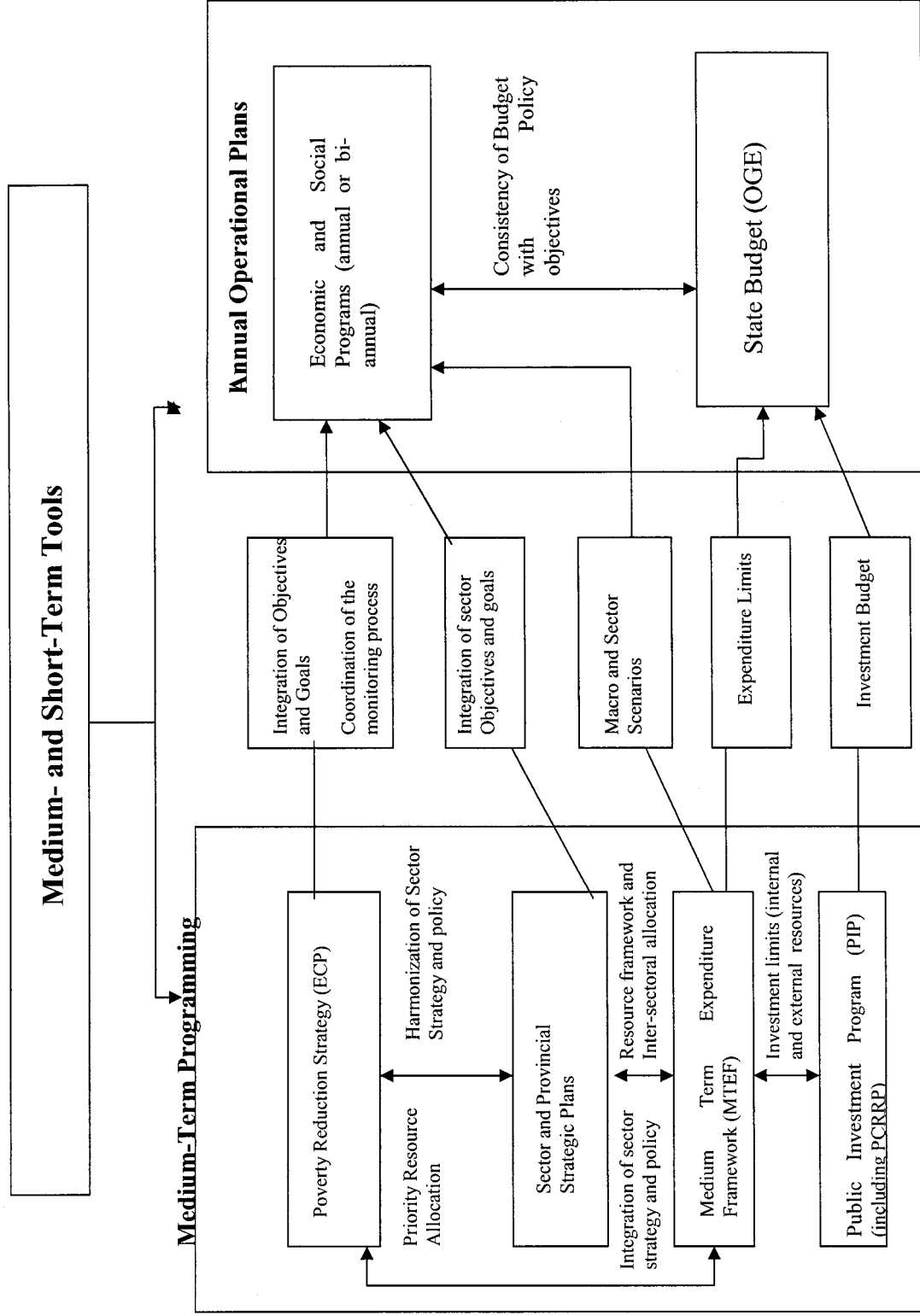
8.25 While merging MINFIN and MINPLAN might facilitate such articulation<sup>96</sup>, this would be neither a necessary nor a sufficient condition for a successful integration of the medium- and short-term processes. As noted by Schiavo-Campo and Tommasi (op. cit., p. 96) for the particular case of “dual budgeting”, “the real issue (...) is the lack of integration between investment and current expenditure programming, and not the formally separated processes in themselves. This is important, because to misspecify the issue would lead (and often has) to ‘solving’ the problem by a simple merger of two ministries – even while coordination remains just as weak. A former minister becomes a deputy minister, organizational ‘boxes’ are reshuffled, a few people are promoted and others demoted. But the dual budgeting problem remains alive and well within the bosom of the umbrella ministry”.

8.26 The importance of the PRSP process in strengthening the links between policy and budgeting should not be underestimated. A sufficiently consultative process would increase the odds that the line ministries would take ownership of the policies envisaged in the poverty reduction strategy, and would reduce the degree of MINFIN discretion in devising public expenditure allocation across sectors and provinces. Therefore, the ultimate instrument for articulating policies and financing will be Angola's ECP. As the public financial management process gets strengthened, and the “seeds” for a medium-term approach to budgeting continue to be cultivated, the Government should consider a careful move towards a Medium-Term Expenditure Framework – as one of the ECP pillars.

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<sup>96</sup> See discussion on FAD's recommendations - supported by the Bank's PEMFAR team – in Section B, in the particular case of the PIP-OGE connection.

**Chart 8.3: Policy, Planning, and Budgeting System: Proposed Articulation of Instruments**



## **9. THE PUBLIC FINANCE MODERNIZATION PROGRAM**

*The Government's Public Finance Modernization Program (PMFP), initiated in 2002, has the potential to be the main vehicle for the implementation of the two-pronged reform strategy proposed in the PEMFAR. The PMFP – which counts on World Bank support through the Economic Management Technical Assistance (EMTA) credit – is already fairly well-placed to push ahead with reforms associated with the first prong of the reform strategy, namely, “Strengthening the Formal Expenditure Execution System”. The main challenge for the PMFP lies precisely on the second prong – “Ring-Fencing and Phasing-Out the Non-conventional Execution System”. Not only some of the key institutional actors currently fall outside the scope of the PMFP, but also the implementation of the needed reforms may face stiff political resistance from influential quarters in Angola. Therefore, strong political support at the highest levels of government is required for the PMFP to succeed in this task. The reform action plan proposed by the PEMFAR aims to strengthen, not to replace, the PMFP. Accordingly, this chapter argues that a solidly implemented PMFP may prove to be the main tool for the Ministry of Finance to establish fuller control over public financial management in Angola.*

### **A. THE PUBLIC FINANCE MODERNIZATION PROGRAM**

9.1 In 2002, the Government took the initiative to put together a wide-ranging Public Finance Modernization Program, PMFP, with three components:

- A Public Finance Management component, which aim is to strengthen the public financial system, i.e., budgetary, financial, non-financial assets, accounting, internal control systems, public pricing, and insurance markets.
- An Information Technology component; and
- A Training and Capacity Building component.

9.2 The overall objective of this program is to improve institutional capacity within the Ministry of Finance. The PMFP contains its own diagnostic of the weaknesses of Angola's public finance management system (see Box 9.1)The PMFP originally covered the period 2002/2004 – but it is very likely to require an extension - and includes activities that are also part of other ongoing reforms packages, such as the Customs Reform process.

**Box 9.1. Weaknesses in the Angola financial management system as seen by the Government in the PMFP**

*The PMFP contains its own diagnostic of the existing weaknesses of Angola's public finance management system, many of which reflect previous discussions with Bank and Fund staff. Most weaknesses were found in the following areas:*

- In the mechanisms and procedures for budgeting, managing, use and registration of State financial resources;
- In the lack of appropriate integration of the PIP in the regular budget preparation and execution processes
- In the mechanisms and procedures for the recording and monitoring of public debt, donor grants and compensation funds;
- In the mechanisms and procedures for recording and monitoring of non-financial State assets;
- In the mechanisms and instruments for monitoring and evaluating public enterprises;
- In the mechanisms and procedures regarding internal control;
- In the existing Customs Administration procedures;
- In the insufficient automation of all management processes involved in the SIGFE

9.3 In order to monitor the development and the evolution of these actions, a coordinating body, “Coordenação de Programa”, was set up within the Ministry of Finance in July 2002 (Despacho Interno 37/GMF/02). The coordinating body is also in charge of needs assessment, coordination of technical assistance, identification and hiring of consultants, and periodic progress evaluation. The PMGFP contains a breakdown of the program by components and sub-components; the objectives and targets envisaged; the specific actions to be implemented; an implementation calendar and cost estimates for 2003/2004.

**B. PROGRESS IN PROGRAM IMPLEMENTATION**

9.4 Implementation of the PMFP received a substantial impetus in the last few months of 2003, when the reforms related to the new version of the SIGFE – including those recommended by the FAD-WB mission of August 2003 – started being implemented. Main areas of progress include:

- A strengthened commitment stage of the budget cycle. Now budget units are limited in their ability to commit funds by both the annual amount budgeted in the OGE and by the quarterly amount authorized by financial programming.
- A strengthened verification stage of the budget cycle. Previously unobserved to a large extent, the verification stage is now solidly incorporated into the SIGFE. Payments to suppliers can only be made after a “nota de liquidação” is issued in the system, attesting that the corresponding good was delivered or service rendered.
- All central government budget units in Luanda are linked online to the SIGFE.
- An improved integration among the following subsystems of the SIGFE: (i) budget; (ii) treasury; (iii) accounting; and (iv) non-financial asset management (“património”).

9.5 As noted, many of the PMFP activities – including public procurement reform – will be supported by EMTA. MINFIN has been diligently working to put together the terms of reference for these activities.

### C. MAIN CHALLENGES AHEAD

9.6 The main challenges involved in meeting the PMFP goals will be political and institutional rather than merely technical. The main issue is how to engage organizations which are not part of the PMFP implementation but of which activities lie at the core of the PMFP goals. This is particularly the case of Sonangol and, to a much lesser extent, the Tribunal of Accounts.

9.7 As will become clear in the next section, the PMFP is already quite advanced in terms of the main priority areas for reform within the first prong of the proposed strategy, namely, *strengthening the formal system of expenditure execution*. However, the PMFP is clearly silent with respect to the second one: ring-fencing and phasing-out the “non-conventional” spending mechanisms.

9.8 Difficulties are greater with the second prong as *political economy considerations are bound to play a major role*. The process of dismantling the “non-conventional” processes over a period of time will involve dealing with powerful vested interests and traditional sources of rent-seeking. In addition, it will also require the establishment of an appropriate institutional hierarchy, *one in which the Ministry of Finance would restore its undisputed role as the prime public financial management institution in Angola*.

9.9 From a technical standpoint, the PMFP could become the instrument whereby MINFIN would increasingly extend its control over all public financial management activities in the country, including those currently undertaken by Sonangol. Therefore, the PEMFAR recommends that the necessary politico-institutional conditions be created that the PMFP can also incorporate the priority actions under the second prong of the proposed strategy.

9.10 External audit activities undertaken by the Tribunal of Accounts should also become part of the PMFP. This should not be seen as a way of weakening the Tribunal vis-à-vis MINFIN. On the contrary: the ability of the Tribunal to meet its goals would only be strengthened if they are mainstreamed onto the PMFP. *The institutional implication is that the PMFP becomes the Government of Angola’s – rather than only MINFIN’s – chief device for public financial management reform in Angola*<sup>97</sup>.

### D. PRIORITY AREAS FOR REFORM

9.11 The three-year action plan presented in Tables 9.1a and 9.1b highlights the key areas of reform already being proposed in the PMFP and proposes an additional set of measures required to meet the goals of the two-pronged reform strategy proposed in the PEMFAR. *It must be stressed that the proposed action plan aims to strengthen and complement, by no means replace, the PMFP.*

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<sup>97</sup> It should be stressed that an additional challenge is that for the most part the Bank-supported EMTA project does not finance activities related to the second prong of the proposed strategy.

9.12 Finally, the adoption of specific legislation should form the basis for undertaking the reforms under the second pillar of the strategy. Currently, the legislative pieces (laws and decrees) are fairly scattered, and in many cases outdated. This new legislation should include a timetable for the measures required in the ring-fencing and phasing-out of the non-conventional expenditure execution mechanisms.

**Table 9.1: Priority Actions: Strengthening the Formal System**

Priority Action	Year 1	Year 2	Year 3	Agency Charge	in	Already in the PMFP?	EMTA Funding?
<b>Budget Preparation</b>							
Increase realism of macroeconomic assumptions, especially targeted inflation and overall balance	X			MINFIN (GEREI) and Economic Consistency Group		No	No
Adopt Oil Diagnostic's Financial Model to generate more accurate revenue projections	X			MINFIN (DNI, DNO, GEREI)		No	Yes
Improve coordination between MINFIN and MAPESS on payroll information	X			MINFIN (DNO) and MAPESS		No	No
Establish a single cadastre for all public sector personnel			X	MINFIN (Human Resources, DNO), MAPESS, Ministries of Defense and Interior		No	No
Establish interface between SIGIP and SIGFE		X		MINFIN (DNC) and MINPLAN		No	Yes
Turn the Public Investment Program into a multi-year exercise		X		MINPLAN		No	Yes
<b>Budget Execution</b>							
Ensure consolidation of the Treasury Single Account (CUT)	X			MINFIN, BNA		No	No
Use financial programming projections as the ceilings for commitments	X			MINFIN (DNT)		Yes (Initiated)	No

Priority Action	Year 1	Year 2	Year 3	Agency Charge	in	Already in the PMFP?	EMTA Funding?
Introduce a reasonable degree of flexibility in the cash management process	X			MINFIN (DNT)		Yes (Initiated)	No
Train key UO (budget units) staff on the modus operandi of the new version of the SIGFE	X	X	X	MINFIN (especially DNC)		Yes (Initiated)	Yes
Enforce the correct sequencing of the budget execution process (cabimentação -> liquidação -> pagamento) , by making full use of SIGFE's automated controls	X			MINFIN (DNC, DNT, INF)		Yes (Initiated)	No
Rationalize cash rationing mechanism and improve communication with UOs	X			MINFIN (DNT)		Yes (Initiated)	No
[Implement recommendations on debt management made by December 2003 IMF-WB mission]	X	X		MINFIN (DNT) and BNA		Partially	Yes
Implement recommendations on public procurement reform made in the context of the CPAR	X	X	X	MINFIN (Procurement Reform Committee)		Partially	Yes
<b>Accounting and Reporting</b>							
Reduce time allowed for submission of the CGE to Tribunal of Accounts to six months after the end of the fiscal year		X		MINFIN (DNC) and Tribunal of Accounts		No	No
Establish mechanisms for the production of timely and complete accounts, including regular follow-ups with UOs, especially those with a history of non-compliance		X		MINFIN (DNC)		Partially	No
Provide training on accounting and reporting practices on a regular basis for relevant staff in the UOs	X	X	X	MINFIN (DNC)		Yes (Initiated)	Yes

Priority Action	Year 1	Year 2	Year 3	Agency Charge	in	Already in the PMFP?	EMTA Funding?
Establish accounting and financial management procedures and routines for non-financial assets	X			MINFIN (DNPE)		Yes (Planned)	Yes
Complete adoption of accounting manual as well as the new Chart of Accounts.	X			MINFIN (DNC)		Yes (Initiated)	No
<b>Internal Audit</b>							
Design an appropriate institutional framework for INF, as part of the development of a concept of a systemic model for the internal control function	X			MINFIN (INF)		Yes (Planned)	Yes
Review relevant legislation for the internal control and audit functions		X	X	MINFIN (INF)		Yes (Planned)	Yes
Operationalize the internal control and audit functions, through: <ul style="list-style-type: none"> <li>the preparation of manuals of guidelines</li> <li>the design of curriculum of the career of INF inspector as well as of a training program for INF's technical staff</li> </ul>		X		MINFIN (INF)		Yes (Planned)	Yes
Establish rules of ethics for staff and provide the associated training		X		MINFIN (INF)		No	Possible (training)
<b>External Audit</b>							
Move towards strategic regularity audits on the compensation mechanisms between MINFIN and Sonangol		X		Tribunal of Accounts		No	No
Phase out and eventually eliminate ex-ante controls by the Tribunal of Accounts	X	X	X	Tribunal of Accounts		No	No

Priority Action	Year 1	Year 2	Year 3	Agency Charge	in	Already in the PMFP?	EMTA Funding?
Hire internationally-reputable audit firms that could perform regularity audits in selected public enterprises on behalf of the Tribunal as required	X	X	X	Tribunal of Accounts	of	No	No

**Table 9.2: Priority Actions: Ring-Fencing and Phasing-Out the “Non-conventional” System**

Priority Action	Year 1	Year 2	Year 3	Agency Charge	in	Already in the PMFP?	EMTA Funding?
<b>“Ring-Fencing”: Phase 1</b>							
Ensure that the value of these activities is estimated in advance and included in the annual budget	X	X	X	MINFIN (DNO), in cooperation with Sonangol		No	No
Agree what quasi –fiscal activities are to be identified and measured within Sonangol for recovery (that is subject to the profit oil and tax offsets)	X	X		MINFIN (DNO, DNI, DNT), in cooperation with Sonangol		No	No
Include such activities as a separate task within the independent audits of Sonangol	X	X		Sonangol		No	No
<b>“Ring-Fencing”: Phase 2</b>							
Submit an independently audited analysis of unbudgeted “non-conventional”- type costs, in accordance with a Cabinet Minute to simplify and accelerate the approval process within MINFIN		X	X	Sonangol		No	No
Extend the scope of the tax audits to include an examination of the calculation of net taxes due to the Treasury after netting off offsets and the value of quasi-fiscal activities		X	X	MINFIN (DNI)		No	No

Priority Action	Year 1	Year 2	Year 3	Agency in Charge	Already in the PMFP?	EMTA Funding?
<b>"Ring-Fencing": Phase 3</b>						
<i>Strengthen the approval process for Sonangol's tax returns by centralizing both the approval of gross taxes due and the value of offsets to arrive at the net taxes due and paid within MINFIN's Tax Directorate</i>		X	X	MINFIN (DNI)	No	Possible
Formalize the foregoing in a new procedure approved by Cabinet		X	X	Council of Ministers	No	No
<b>"Ring-Fencing": Phase 4</b>						
<i>Establish formal reporting mechanisms from Sonangol to MINFIN and to BNA, particularly regarding:</i> <ul style="list-style-type: none"> <li>• External debt service</li> <li>• Tax and profit oil offsets</li> <li>• Oil exports undertaken by Sonangol.</li> </ul>		X	X	Decision: Council of Ministers  Implementation : BNA, MINFIN (DNI, DNC, DNT, INF), and Sonangol		Limited
<b>Other Required Actions</b>						
Eliminate fuel price subsidies through periodic price adjustments	X	X	X	MINFIN	No	No
<i>Transfer justified quasi-fiscal activities undertaken by Sonangol to the appropriate organizations within the State</i>	X	X		MINFIN, in collaboration with Sonangol	No	No
Establish a clear debt management strategy should also be designed in which the recourse to oil-backed financing would be made less necessary over a realistic timeframe		X		MINFIN (DNT) and BNA, in collaboration with Sonangol	No	Possible

### E. PERFORMANCE INDICATORS

9.13 Success in the implementation of a revised and expanded PMFP depends critically on a close monitoring of selected performance indicators. To the extent possible, these indicators should be quantifiable. Table 9.2 suggests a number of possible indicators, together with their respective sources of information.

**Table 9.3: Recommended Performance Indicators**

Indicator	Agencies in Charge	Data Collection Strategy
Percent of total Government expenditures executed through the SIGFE.	MINFIN	Information to be collected through quarterly and yearly budget execution reports, plus <i>ad hoc</i> reports generated by DNC.
Volume of resources transiting through the Treasury Single Account (CUT), as a percent of total Government spending.	MINFIN/BNA	Information to be collected through: DNT's Department for Treasury Operations; BNA's Accounting Department.
Payment arrears to suppliers	MINFIN	Information to be collected through DNT and DNC.
Intra-public sector arrears.	MINFIN	Information to be collected through DNT's Public Enterprises Department.
Difference between practiced and cost-recovery prices for petroleum products.	MINFIN	Information to be collected through MINFIN's <i>Gabinete de Preços</i> (GAPREC), in coordination with Sonangol.
Oil-backed debt <i>stock</i> as a percentage of total external debt.	MINFIN, BNA, Sonangol	Information to be collected primarily through DMFAS system at BNA; reconciliation with DNT's and Sonangol's own databases to be made regularly.
Oil-backed debt <i>service</i> as a percentage of total exports.	MINFIN, BNA, Sonangol	Information to be collected primarily through DMFAS system at BNA; reconciliation with DNT's and Sonangol's own databases to be made regularly.
Volume of quasi-fiscal transactions incurred by Sonangol on behalf of the Treasury.	MINFIN, Sonangol	Information to be collected through

## **ANNEXES**

ANNEX I

Angola - Selected Economic and Financial Indicators, 1999-2003

<i>Indicators</i>	<i>1999</i>	<i>2000</i>	<i>2001</i>	<i>2002</i>	<i>2003</i>
<b>Output, income, and prices</b> ( Annual percentage change, unless otherwise indicated)					
Real GDP	3.3	3.0	3.2	15.3	4.5
Real GDP per capita	0.7	0.2	0.2	12.0	1.4
GNI per capita (Atlas method) in US dollars	440	470	530	680	740
Consumer price index (annual average)	248	325	153	109	98
<b>External sector</b>					
Exports (f.o.b.)(based on current US dollars)	45.6	53.6	-17.5	27.7	18.3
Oil	45.3	58.5	-18.5	32.0	18.8
Non-oil	47.4	20.2	-8.7	-6.8	13.0
Imports (f.o.b.) (based on current US dollars)	49.5	-2.2	4.6	16.7	25.7
Export volume	1.4	1.6	-2.6	23.1	8.7
Import volume	55.2	1.4	6.5	14.3	10.7
Terms of trade (decline - )	49.0	56.8	-13.8	1.7	-3.4
Real effective exchange rate (depreciation -)	-18.7	20.1	13.0	1.8	12.3
<b>Money and credit end period (As percent of beginning period M3)</b>					
Net domestic assets	-362	-327	54	48	13
Money and quasi-money (M2)	533	304	163	158	57
Interest rate (3 month time deposit-in percent)	36	46	56	41	27
<b>Public finances</b> (In percent of GDP, unless otherwise indicated)					
Total revenues	46.8	51.7	42.5	39.0	36.2
of which:oil	41.1	46.2	33.9	29.9	29.1
Grants	4.0	2.3	2.3	0.0	1.3
Total Expenditures	82.4	60.4	46.3	47.9	43.8
Overall balance (accrual basis)	-35.6	-8.7	-3.8	-8.9	-7.5
Overall balance (cash basis)	-24.7	17.6	-4.9	-1.4	-6.4
<b>External sector</b>					
Current account balance incl. Transfers	-28.1	9.0	-15.1	-5.8	-6.2
Debt-service in percent of exports of goods and services	44.4	36.3	41.2	26.4	24.0
( In million of US dollars, unless otherwise indicated)					
Gross domestic product in current prices	6088	8864	9472	11204	13183
Gross official reserves					
In millions of US\$	496	1198	732	375	620
In months of imports of goods and services	0.8	1.9	1.1	0.5	0.7
Exchange rate- period average (local currency per US\$)	2.8	10.0	22.1	43.5	74.6
Oil production (thousands of barrels per day)	746	748	740	903	970
Price of Angola's oil	17.6	27.2	24.2	24.3	26.6

Source: IMF.

## ANNEX II

### COUNTRY PROCUREMENT ASSESSMENT REPORT SUMMARY OF FINDINGS AND PROGRESS REPORT<sup>98</sup>

#### A. FINDINGS OF THE CPAR

In 2001, the Government of Angola spent some 53 percent of total public expenditure or about 12 percent of GDP on public procurement. However, the public procurement and management system is not providing optimal benefit to the country's development needs. A country procurement system<sup>99</sup> analysis, in the context of the *Country Procurement Assessment Report*, reviews usually several factors, such as: (i) the degree to which the government promotes a culture of accountability; (ii) the status of procurement staff, including salary structure and capabilities; (iii) the degree to which procurement is free from political interference; (iv) the existence of clearly written standards; and, (v) the degree of efficiency, transparency and value for money. In each of these areas, the Angolan procurement system needs major improvements, and, consequently, is considered high-risk.

**Three major problems:** transparency, enforcement, and lack of capacity, are considered the main shortcomings of the system, as discussed below:

- **Weaknesses of the legal framework and lack of enforcement** While there are laws pertaining to public procurement matters that are written but not adequately publicized or enforced (Decrees n° 7/96 and 22-A/92 regulate the main procurement aspects), some procurement practices have no legal basis but are vigorously enforced<sup>100</sup>. Even when they are familiar with its rules, civil servants seem to ignore procurement law without being penalized; and enforcing of the Law is erratic. A national study conducted by a national consultant found that 54.2% of the members of personnel in charge of procurement in the various ministries and at the provincial authorities level were not aware of the existence of Decree n° 7/96<sup>101</sup>. Procurement regulations are not enforced because control mechanisms, either internal (within procurement entities) or external are missing at all levels. In addition, none of the state-owned enterprises visited had written

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<sup>98</sup> Prepared by Slahhedine Ben-Halima and Christine De Mariz.

<sup>99</sup> A public procurement system may be considered well functioning if it achieves the objectives of transparency, competition, economy and efficiency, fairness and accountability. The absence of adequate public advertising, public bid opening, announcement of award, record keeping, oversight authority, audit or recourse, prevents a clear quantitative insight in the Angolan procurement system. Procurement within the central government is for the most part carried out without consideration to cost-saving measures.

<sup>100</sup> The conviction that the Government should buy only from Angolan suppliers and importers; the legislation or the belief that Government should buy only from Angolans-at any price-, contributes to excluding foreign bidders from the Angolan market, and consequently increases the cost for the Government.

<sup>101</sup> The government Gazette is published and printed, but it is inadequately distributed in the various Ministries.

internal procurement rules, describing methods and levels of authorization for spending public funds. The government Gazette does not seem to contribute to transparency as well as to the dissemination of regulations, as it is relatively expensive and apparently not widely distributed within the government itself.

- **Inefficient and costly procedures and practices** Sound public procurement policies and practices are among the essential components of good governance. Good procurement practices reduce costs and allow for timely results; poor practices lead to waste and delays, and are often the basis for allegations of corruption and government inefficiency. The Angolan government acquires goods, works and services, but not in a consistent manner or according to rules generally recognized as binding. A number of procurement procedures and practices are neither economic nor efficient, and are not in compliance with recommended procurement best practices. Although nearly all goods are imported, most of them are procured through local suppliers. However, if the government awarded contracts to international suppliers, it would contribute to substantial savings for the Treasury (especially for bulk commodities). The two areas where practices need to change in order to enhance fairness and transparency in the procurement process are: (i) adoption of open competitive bidding as the primary method of procurement; and (ii) establishment of a transparent procurement system<sup>102</sup>. There is currently no effective mechanism to lodge complaints in relation to the bidding process. The lack of oversight, transparency, and audit, has created many opportunities for corruption.
- **Weak procurement organization and capacity** There is a lack of procurement capacity at all levels, both in Luanda and in the provinces, including poor record keeping within Ministries. This deficit in capacity is due to the following reasons: (i) very little importance is given to public procurement in general; and (ii) lack of adequately trained personnel in the full range of activities linked to procurement functions. It is stimulating to note however, that as part of the imports management process (mainly relating to efficient collection of customs duties and other import taxes), efforts have recently been made to improve Customs Service staff skills through technical assistance provided by Crown Agents. However, this is only one side of phase of the trade cycle (revenue collection), the other one --public expenditure on acquisition of goods, works and services-- needs appropriate Government attention to ensure that benefits from improved revenue collection are not eaten away by poor public procurement practices.

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<sup>102</sup> Upfront setting up of evaluation criteria, bid publication, publication of contract award, complaint mechanism.

- **Weak audit and anti-corruption mechanisms** There is no oversight mechanism to ensure regular application of procurement regulations, and there are no procurement audits. Procurement regulations are not enforced because procuring entities internal control mechanisms are missing at all levels, as is the case for external mechanisms. The Tribunal of Account staff would be able to exercise audit oversight over government procurement, but lacks proper training to assume its responsibilities and perform its duties. Corruption in government procurement is usually suspected. The two entities whose role is to determine cases of corruption and apply sanctions, the Tribunal of Accounts<sup>103</sup> and the High Authority Against Corruption<sup>104</sup>, are just being set up, not fully operational, and inadequate.
- **Payment Delays breed higher award prices** It is a common practice for Government Ministries and other departments to delay payments<sup>105</sup> by more than 90 days (internationally accepted practices in that matter are 30 to 45 days) to suppliers and contractors. Most payment delays are due to poor planning, especially in relation to the budgeting process and the actual funding available to pay against committed. Interest penalties are included in some larger contracts but are neither asked for nor paid. Although allowed by Decree 7/96, price adjustment clauses are not used, and the risk of inflation and the effects of devaluation of the local currency are passed on to suppliers and contractors. The expectation of slow payment has two equally damaging consequences: (i) it imposes on the government's contract partners the burden to pre-finance contract payments for several months and therefore discourages participation of qualified businesses with limited liquid funds- particularly newly established Angolan businesses; and (ii) it encourages bidders to factor the cost of late payments to their bid prices, resulting in higher than necessary award prices. This in turn increases the burden on the Treasury and negates the positive effects of the revenue enhancement mechanism. Moreover, high construction prices in Angola may be explained in part by very slow payments.

## B. WHAT CAN BE DONE ?

**Nothing can be done without ownership** Without the Government's full support of the initial changes proposed in the CPAR, the combination of weak capacity with lack of control will not allow any newly introduced system to function, no matter how well

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<sup>103</sup> The Tribunal hopes to start its operations in 2003 with the audit of the General State Accounts for fiscal year 2002.

<sup>104</sup> The High Authority Against Corruption has never become operational, as its president has never been elected.

<sup>105</sup> Delayed payment, lack of national industrial production, high cost of imports, unfair competition on the part of the informal sector, complexity of the tax system, lack of appeal systems, and crumbling infrastructure (roads and ports), have a negative impact on the final cost of goods and services.

designed. Until now, the team working on procurement reform has only been a small group of consultants reporting to the Ministry of Finance, and there is no formally established working group with the appropriate authority to move procurement reform forward. It is not clear who will eventually be responsible for making the findings and recommendations of this report the basis of a national consensus and commitment to change the existing procurement system.

**Five recommendations for the short term** In the short term (between 2002-2004), improved transparency and integrity, the application of basic discipline as well as managing the process with due diligence, will result in savings for the country. These savings obtained thanks to a more efficient procurement system could in turn be used by the Government to alleviate the condition of some vulnerable groups of the population. The action plan below aims at helping the Government to improve efficiency and value for money of public procurement. A certain number of activities could be initiated in parallel, over the next few months. However, the first action to be taken should be the revision of the legal framework for public procurement, given the well-known challenges in matters of enforcement due to too many exceptions included in the current Law. This critical initial action to revise the legal framework should be followed immediately by others to improve record keeping; establish a policy directorate for procurement in the Ministry of Finance; and insure that institutions set up to provide sound controls and accountability, begin to function effectively in order to effectively counter fraud and corruption.

- i. **Identify a champion to spearhead the Procurement reform process and organize a high-level workshop** for the Council of Ministers to raise ministers and their procurement staff awareness about the benefits for the Government of a more open bidding environment. In addition, the Ministry of Finance should issue circulars or publish newsletters on a regular basis intended for the private sector, to ensure that it is kept informed of the practices followed by the government. Information meetings with both the public and the private sectors should be regularly held to complement these circulars.
- ii. **Create a comprehensive procurement framework.** Set up a national working group composed of national consultants<sup>106</sup>, lawyers, representatives of the public sector (especially the Ministries of Planning, Finance and Public Works), national experts and private sector representatives, to assist an international legal consultant in drafting of the new procurement legislation<sup>107</sup>. This legislation could

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<sup>106</sup> The Bank has already established a dialogue and close partnership with the consultants financed by the Norwegian Agency for Development (NORAD). The mission held working sessions with the consultant team and benefited from the wealth of information of its work. Some of the mission current findings and recommendations are based on this information. As to the aspects related to the legal framework and regulatory setting, the mission agreed with the consultant that the work accomplished so far should be completed with the assistance of an international specialist in procurement law.

<sup>107</sup> Adopt the open competitive bidding as the primary method of procurement. Open competitive bidding is rarely used as a procurement method (most often, bidding is limited to obtaining three bids from local

be based on the Brazilian procurement law, considered a good model in Portuguese-speaking countries. Following the enactment of the Law, the Government should: (i) issue a complete set of regulations, standard bidding documents for goods, works, and services applicable; (ii) launch a sustainable, overall procurement training program at various levels, and a n awareness campaign for the public sector, the private sector and the civil society. None of the proposed changes can succeed without: (iii) extensive training and advertisement; and (iv) an updated anti-corruption law (taking into account the new modern legal framework for procurement).

- iii. **Introduce record keeping** to establish a transparent procurement system<sup>108</sup>. During the first year pilot program, at least five Ministries should start keeping records on all procurement activities above a certain threshold of contract value, and transmit them to the Ministry of Finance. This Ministry should gather and analyze data, which will help improving its oversight mandate over public sector procurement. While in the short term this can be with proper filing of hard copy documentation, in the medium term, the design of a computerized record keeping and reporting system would facilitate this operation.
- Design record keeping procedures for ministries and provincial authorities, including a determination of who prepares procurement documentation and where the documents are filed.
- iv. **Establish a directorate at the Ministry of Finance** to undertake procurement policy formulation and procurement analysis, because a well functioning procurement system requires that an authority must be in charge with both procurement policy formulation and “maintenance” of the procurement framework.
- Provide for adequate funding, staffing, technical assistance and training to undertake the directorate’s regulatory and administrative functions.
- v. Establish sound controls (audits) and accountability. It is expected that in the long-term: (i) internal controls by the National Inspectorate of Finance will be fully operational; and (ii) external controls by the Tribunal of Accounts will also be operational. The key next steps are to :
- Nominate the President and members of the High Authority Against Corruption and provide it with an adequate budget to fulfill its mandate;

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companies), although this is the procurement method that guarantees economy, efficiency and transparency, in most circumstances. In addition, this method is mandated by Decree 7/96 for larger tenders. Based on experience in other countries, Government could save as much as 20 percent through competitive public procurement.

<sup>108</sup> The Mauritius procurement filing system could be used as an example.

- Remind the target group of the approaching deadline for production of audited accounts under resolution 6/01, with copy of the resolution attached;
- Prepare a work program for the Tribunal of Accounts and include the audit of some pilot ministries in first year; and
- Provide for legislation prohibiting reappointment of civil servants guilty of corruption.

### C. THE WAY FORWARD

Three possible models could be adopted for the reorganization of procurement in Angola. After the government has presented its views on these options, or decided upon another model, the legislation should be drafted taking into account the selected reorganization model. The stated intent to decentralize procurement should be preceded by a study of local procurement capacity in the provinces, and by an effort to organize such capacity. The table below explains in more detail the three options for the reorganization of the procurement system.

	<b>Option 1</b>	<b>Option 2</b>	<b>Option 3</b>
<b>Responsibilities:</b> planning of procurement, recruitment of independent consultants to prepare bid documents and supervise execution, launching of bids, opening, evaluation and signature of contracts, monitoring of execution, certification of payments, keeping records.	Strengthen procurement capacity within each ministry and province, starting with a group of three – four (3-4) on a pilot basis. Staff is paid normal civil service salaries. Supported by technical assistance paid by the government, and work only for the ministry or province where they are usually employed.	Successive creation over a period of three years of ten free-standing procurement management units, six in the provinces (two each in north, center and south) and four in Luanda. Staff– civil servants within the Ministry of Finance – recruited through competition by that Ministry and paid market-oriented salaries from the government budget, Supported by technical assistance paid by government.	Creation of independent contract management agencies, probably ten (10). Staff – not civil servants - recruited through competition. Operations of these agencies and some technical assistance initially subsidized by government, later financed by fees generated by the agencies for their services to client institutions in the public and private sector on a contract basis.
<b>Oversight</b> of the system, data analysis and statistics	Ministry of Finance	Ministry of Finance	Ministry of Finance
<b>Complaints by and appeal to</b>	Procuring entity – Courts	Procuring entity – Courts	Procuring entity – Courts
<b>Audit</b> (a posteriori)	<i>Tribunal of Accounts</i>	<i>Tribunal of Accounts</i>	<i>Tribunal of Accounts</i>

Option 1, is the option that would be preferred in terms of sustainability. The expected outcome is that after a period of technical assistance support and the expansion of the system to all the Government departments and provinces, Angola would become self-sufficient and would have the means to carry out its procurement processing effectively. Examples of countries where Option 1 is practiced are Mozambique, Guinea and Ethiopia. However, this approach can work only if the pilot is expanded to all Government entities, the legal framework, including setting of oversight and appeal mechanisms and the institutional capacity are established, and the staff in charge of procurement is organized as a cadre of specialists with adequate resources to perform their tasks. In other words, this approach requires a Government that is fully committed to procurement reform, and a civil service that fulfills its duties appropriately and has the means to do so.

Option 2, is the one to use in case progress regarding the setting of the legal and institutional framework lags behind schedule or proves to be difficult to achieve in a timely fashion. This option will, in the meantime, enable Angola to develop a procurement system that would somehow guarantee that public resources are used as efficiently as possible. Although more expensive than Option 1, because it includes a technical assistance component, this option can be implemented rather quickly.

There could be, however, a problem of sustainability with Option 2, in that it may not be possible to pay selected civil service staff above the usual scale of salaries on a continuing basis.

Option 3, could be considered as the continuation of or a solution to Option 2, in the sense that members of the civil service hired on a contractual basis could leave and create self-standing procurement agencies. With this option the Government is assured of a high standard quality service provided by independent and accountable companies with clear standards of ethics; and oversight (through ex-post) performed by independent contract management agencies. Although results are still being assessed, recent examples of countries where Option 3 is practiced are Senegal and Mali.

Given the scarcity of qualified personnel in that area, the problem with this Option is whether there will be sufficient human resources available in the country to staff these companies. The other issue is that members of the civil service could feel ostracized and become reluctant to collaborate with them.

#### **D. PROGRESS AS OF MARCH 2004**

As of March 16, 2004, the recommendations (i); (ii); and (iv) mentioned above were successfully implemented or are well advanced.

- i. Identify a champion to spearhead the Procurement reform process and organize a high-level workshop for the Council of Ministers to raise ministers and their procurement staff awareness about the benefits for the Government of a more open bidding environment.**

√ The taskforce or “Grupo de trabalhos” was created by *despacho* No. 35/03 on April 22, 2003. This taskforce is composed of the Director of Patrimônio do Estado (coordinator of the taskforce); two representatives of the Ministry of Finance of whom one is the deputy coordinator of the taskforce; one representative from the Ministry of Planning (Ministério do Planejamento); one representative of the Ministry of Public Works (Ministério das Obras Públicas); and two national consultants. The taskforce is responsible for: (i) coordinating and spearheading the procurement reform process; (ii) make technical recommendations on the existing reports (namely, the Country Procurement Assessment Report- CPAR and the report financed by the Norwegian Agency for Development); (iii) preparing adequate materials (decree and legal documents) for implementing the procurement reform; (iv) preparing meetings with other partners to discuss the ongoing process; (v) disseminate information to general public about the objectives and results expected of the reform; (vi) prepare a capacity building program necessary to successfully implement the reform; and (vii) presenting twice per month a progress report to Ministry of Finance or relevant entities.

√ The taskforce held its first meeting on October 8, 2003 and since then, held working sessions on a regular basis (at least twice per week). The taskforce mainly (i) discussed the option to be selected for reforming procurement; (ii) prepared various encounters with other Ministries and representatives of the private sector, and in particular one which took place on November, 16 2003; (iii) prepared the workshop to be held in 2004 which represents the keystone of the reform process and it is meant to validate the procurement reform process and action plan.

√ On November 24, 2003 and parallel to the procurement reform, the Bank’s Procurement team held a procurement seminar on WB procurement main principles and a clinic on World Bank procurement procedures. Representatives from the private sector and from Ministries (about 20 persons) attended the WB’s presentation which was composed of two back-to-back presentations: (i) the first presentation was a procurement seminar that meant to present procurement main principles to the private community; and (ii) the second presentation was intended for managers working on World Bank projects mainly, the Economic Management Technical Assistance (EMTA), FAS (Fundo de Apoio Social, and Demobilization Program. It took the form of a procurement clinic, which was meant to address procurement issues that projects managers may encounter on a daily basis.

√ Also in parallel and in December, the CPAR team kept informed the Norwegian Agency for Development (NORAD) on the status of the procurement reform (NORAD financed a report on procurement delivered in 2002).

**ii. Create a comprehensive procurement framework. Set up a national working group composed of national consultants<sup>109</sup>, lawyers, representatives of the public**

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<sup>109</sup> The Bank has already established a dialogue and close partnership with the consultants financed by the Norwegian Agency for Development (NORAD). The mission held working sessions with the consultant team and benefited from the wealth of information of its work. Some of the mission current findings and

**sector (especially the Ministries of Planning, Finance and Public Works), national experts and private sector representatives, to assist an international legal consultant in drafting of the new procurement legislation<sup>110</sup>.**

✓ From October to December 2003, the taskforce appointed to coordinate the procurement process discuss the different institutional arrangements for procurement. The outcome of these discussions is critical, as it will enable the taskforce to draft a new procurement law based on the option selected.

✓ The institutional model selected by the taskforce is closer to option 1 proposed and described above, i.e., strengthen procurement capacity within procuring entity (mainly, Ministries and provinces). The “sectorial” (for instance, Ministries of Health, Transportation, public Works) and “local” entities will be responsible for: (i) preparing the bids, with technical assistance of consulting firms, if necessary, and in particular for the preparation of the bidding documents and terms of reference; (ii) creating evaluation commission when needed; (iii) signing contracts in line with the prevailing rules; and (iv) providing all relevant information about bids to the regulatory body.

iv. Establish a directorate at the Ministry of Finance to undertake procurement policy formulation and procurement analysis.

✓ The new procurement Law will provide for the creation of a Regulatory body called “Orgão de Regulação e Apoio”. So far, there is no independent institution in charge of formulating procurement policy. A well functioning procurement system needs an authority in charge with both procurement policy formulation and “maintenance” of the procurement framework, and to enforce proper application of the existing and forthcoming procurement legislation. This *Orgão de Regulação e Apoio* will have several duties and mainly, (i) to approve rules, methods for procurement; (ii) to meet regularly with the procuring entities at the central and decentralized levels; (iii) to gather, centralize and disseminate information and data on procurement and procurement procedures; (iv) to support and advise procuring entities and foster training programs; (v) to work in close partnership with the SIPIP (Sistema de Informação do Programa de Investimentos Públicos); (vi) disseminate relevant information about bidders and more generally private companies (mainly, capacity and price); and (vii) to solve procurement conflict as the *Orgão de Regulação e Apoio* will also play the role of a dispute resolution entity.

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recommendations are based on this information. As to the aspects related to the legal framework and regulatory setting, the mission agreed with the consultant that the work accomplished so far should be completed with the assistance of an international specialist in procurement law.

<sup>110</sup> Adopt the open competitive bidding as the primary method of procurement. Open competitive bidding is rarely used as a procurement method (most often, bidding is limited to obtaining three bids from local companies), although this is the procurement method that guarantees economy, efficiency and transparency, in most circumstances. In addition, this method is mandated by Decree 7/96 for larger tenders. Based on experience in other countries, Government could save as much as 20 percent through competitive public procurement.

## **E. LATEST DEVELOPMENTS AND EXPECTED IMMEDIATE NEXT STEPS**

► *Document for the Minister of Finance was prepared* The taskforce produced a short document for the Minister of Finance. This document is based on the CPAR and NORAD financed report and present the weaknesses of the prevailing system and the actions to be taken to improve the current procurement system [see Annex 1]. The document focus on the five pillars determined by the CPAR, i.e., (i) the legal and regulatory framework; (ii) the institutional framework; (iii) the procedures and practices; (iv) the capacity; (v) the audit, control and appeals measures, and the anti-corruption measures.

► *Approval by the GoA and transmittal to the World Bank* The document produced by the taskforce was delivered to HE. Minister of Finance in order to be approved [see Annex 2]. The document along with a letter from the taskforce was then transmitted to the World Bank on February 25, 2004.

► *Terms of reference for consultants to be drafted* Terms of reference for international lawyer, national lawyer, procurement specialist and procurement institutional reform specialist should be prepared.

► *Drafting of the new procurement Law, regulations bidding documents and user's manual*

*Starting beginning 2004* The plan of work is organized in two phases, in accordance with the terms of reference, with Phases I and II overlapping to a considerable degree.

- In phase I, Dra. Theresinha Lopes, the national procurement lawyer, and the international lawyer to be selected, in consultation with the procurement reform taskforce, will prepare a new public procurement law and comprehensive set of new procurement regulations to implement the Angola public procurement law.
- In phase II, the technical procurement specialist, to be selected, will develop the standard bidding documents, which will be used by procuring entities pursuant to these regulations and user's manual.
- Also in phase II, the procurement institutional reform specialist will prepare the internal regulations; financing needed for the creation of this regulatory body; and terms of reference for the newly created *Orgão de Regulação e Apoio*.

► *Workshop to be held in 2004 to validate GOA procurement reform program* This full day workshop to be chaired by H.E. the Minister of Finance will endeavor to discuss the documents prepared. To raise awareness and build consensus among people involved in procurement, several groups will be formed to discuss the procurement action

plan more thoroughly. A final document and action plan will be prepared upon completion of the workshop.

Action	Objective	Proposed Action	Technical and Financial Support Needs	Schedule Planned	Schedule Actual
1. a	<p>Establish a working group to move procurement reform forward</p>	<p>- Identify a champion to spearhead the Procurement reform process - Held meeting on a regular basis</p>		<p>Before December 2002</p>	<p>Creation of a taskforce or "grupo de trabalhos" through "Despacho" No. 35/03 issued on April 22, 2003                      ✓ October 2003: Internal rules for the grupo de trabalhos ("regulamento interno") finalized                      ✓ First meeting of the taskforce held on October, 8 2003. The taskforce holds meetings at least once a week</p>
b.	<p>Discuss and select a model to improve procurement system</p>	<p>- The taskforce should discuss the pro and cons of the models proposed in the NORAD financed report and CPAR to improve system of procurement (procuring entities) and establish entity to oversee procurement ( directorate) - Organize a high-level workshop with donors, private sector and NGOs</p>		<p>January to June 2003</p>	<p>From October to December 15, 2003: discussions on the different options for reforming procurement</p>
2. a	<p>Raise awareness among Ministers, procurement staff and other partners regarding the need for reform and the model to be adopted</p>			<p>From January 2002 to December 2003</p>	<p>November 20, 2003: meeting with other Ministries and representatives from private sector ( about 20 persons) to receive comments and advice from them                      ✓ November 25, 2003: meeting with Vice Minister of Finance to discuss the way forward. The date of the workshop was scheduled on December 2003 and materials should be prepared</p>
b.	<p>Get GoA approval</p>	<p>- Prepare and share the analysis with Government and prepare a note to be approved by the GoA</p>		<p>First week of December</p>	<p>Preparation of note for HE Vice Minister of Finance                      ✓ The document was sent to the World Bank on February 25, 2004</p>
	<p>Preparation of TORs</p>	<p>- for international lawyer - national lawyer - institutional reform specialist - technical procurement specialist</p>			
c.	<p>Create comprehensive</p>	<p>- Set up a national working group to assist an international legal consultant</p>	<p>Legal assistance <b>Financial</b></p>	<p>From January to</p>	

Action	Objective	Proposed Action	Technical and Financial Support Needs	Schedule
	procurement framework *	in the drafting of the new procurement legislation and regulatory framework.. Then, enact the new legislation	support through EMTA	March 2004
d.	Improve the regulatory framework *	<ul style="list-style-type: none"> <li>- Prepare standard bidding documents and manuals</li> <li>- Issue the complete set of regulations, standard bidding documents for goods, works and services applicable, prepared during the short-term phase.</li> </ul>	Financial support through EMTA, WB	From January to March 2004
e.	Review laws	<ul style="list-style-type: none"> <li>- Review laws that could interact with the new procurement law Update anti-corruption laws</li> </ul>		From January to March 2004
3.	Establish a directorate to oversee public procurement (shall be determined in 1.b) *	<ul style="list-style-type: none"> <li>- Create the directorate in the legislation (provide for its creation in 2.c) This body will conduct policy formulation; control procurement process; perform analysis; participate in the appeal process</li> <li>- Make it operational</li> </ul>	Financial support through EMTA, WB	April-June 2004
4. a.	Establish a more transparent procurement system *	<ul style="list-style-type: none"> <li>- Introduce record keeping in at least five pilot ministries. These ministries should report contracts above a certain threshold of contract value, to the Ministry of Finance</li> </ul>	Fin.support through EMTA, WB	From September 2003
b.	Improve procurement system at "Patrimonio"	<ul style="list-style-type: none"> <li>- Put in place a computerized system</li> </ul>	Fin.support through UNDP Project	
5.	Train staff *	<ul style="list-style-type: none"> <li>- Prepare a training program</li> <li>- Launch a sustainable, overall procurement training program at various level in coordination with INFORSEF</li> </ul>	Financial support through EMTA, WB	From March-August 2004
6.	Foster dissemination	<ul style="list-style-type: none"> <li>- Launch an awareness campaign for the public sector, the private sector, and</li> </ul>	Financial support through	March-August

Action	Objective of procurement reforms *	Proposed Action	Technical and Financial Support Needs	Schedule	Schedule
7.	Implement the model chosen *	the civil society - Put in place the procuring entities - Provide the entity with adequate staff and resources	EMTA, WB Financial support through EMTA	2004 July-Dec 2004	
5.	Establish sound controls and accountability	-Nominate the President and members of the High authority Against Corruption - Prepare a work program for the Tribunal of Accounts and include audits of some pilot ministries - Remind the target group of the approaching deadline for production of audited accounts - Provide legislation prohibiting reappointment of civil servants convicted of corruption - Train customs personnel		Before January 2002 Before June 2002 Before December 2002 Before December 2003	
6.	Ensure sustainability at Customs			Throughout Crown Agents' contract	

**THE OIL SECTOR FINANCIAL MODEL<sup>111</sup>**

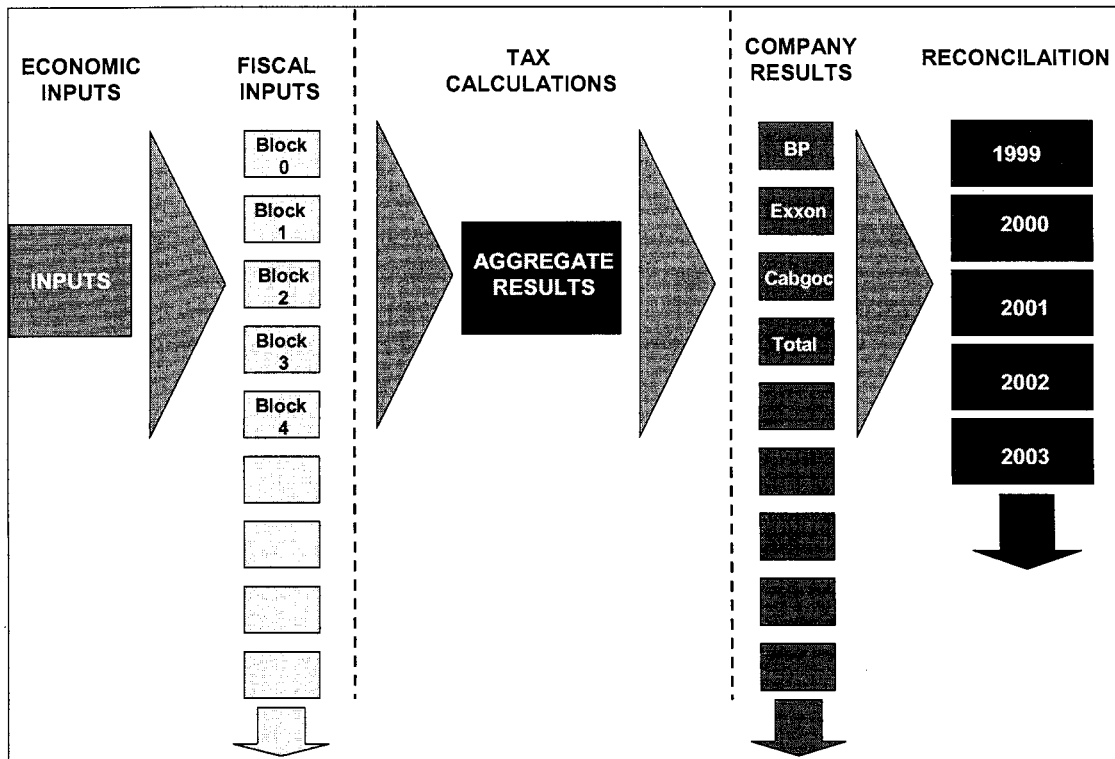
The Angolan oil sector, or “aggregate” financial model is a bespoke policy tool devised specifically for the government of Angola to assist in managing petroleum revenue flows, and, in an economy so dependent on oil, to assist in the preparation and control of national budgets. The financial model is intended as the focal point of a revenue management system that is able to monitor, control and reconcile the flow of revenues into the treasury in a transparent and accountable manner. The revenue management system will be the responsibility of a dedicated agency resourced by professionals who will employ secure and efficient procedures to generate data and reports, and who will communicate with industry and government at a senior level.

i. The aggregate financial model is structured around a database populated with technical oil field data and fiscal information provided by foreign oil companies and Sonangol. The database forms the key input to a series of pre-tax and post-tax cashflow models that derive the final projections of government tax take, contractor and operator net cashflows and Sonangols share of net cashflows. The post-tax calculations include all of the royalties, taxes and profit oil payable by investors according to the concession agreements and operating production sharing agreements signed with the government to 2000 (see schematic below).

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<sup>111</sup> Prepared by David Reading and Peter Macnab (AUPEC).

### Aggregate Financial Model



The financial model has been constructed in a spreadsheet format, using Microsoft Excel, so that all calculations remain visible and easily accessible to potential users. Given the capacity constraints identified within government ministries, and the additional training required by users to understand, execute and manage the financial model, it was not considered appropriate to create an alternative 'black box' version of the model at this stage.

The main input parameters to the model are highlighted below.

- Oil prices
- Production and Cost profiles
- Fiscal instruments (tax rates, bonuses, profit sharing tiers, royalties)
- Cost recovery limits
- Depreciation schedules
- Equity (Sonangol and IOC's)
- Sonangols carry through the exploration phase

Outputs generated by the financial model are too extensive to review in detail here. The quarterly projection reports provide a wealth of financial output disaggregated by operator, partner, and block, including Sonangol. Aggregate results are also extensive and are summarised in each quarterly projection report. The main summary outputs shown at an aggregate level in the quarterly projection reports are defined below.

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**Total Government Take**

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Total Government Take. This comprises all taxes, royalties and bonuses payable, plus 100% of all profit oil, plus Sonangol's post-tax net cashflow (that is Sonangol Holding or Sonangol P&P's equity share in any field). Total Government Take is shown to highlight the total government take that accrues to the nation as a result of Angolan oil activity.

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**Total Government Tax Take**

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Total Government Tax Take is essentially the Total Government Take less Sonangol's post-tax net cashflow. Total Government Tax Take is equal to the total revenue that we believe the government should expect to receive from oil operations. This figure comprises all field taxes and royalties due from all of the field partners (including Sonangol Holding and Sonangol P&P's share of royalties and taxes due to the government if they have an equity share). The figure also includes all field profit oil due to the government under the PSA regime (governments share of profit oil is administered by Sonangol Holding who lift and sell the oil on the governments behalf through its trading arm, and remit the sales value to the government less the administration fee equal to 10% of the fields profit oil, which is retained by Sonangol Holding). The figure also includes signature and production bonuses and any non-fiscal payments that companies are contractually obliged to pay to the government.

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**Sonangol's Net Cashflow**

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Sonangol's net cash flow is equal to the share of post-tax project net cashflow that Sonangol receives as an equity partner in several blocks. Sonangol Holding is an equity partner in onshore blocks FS/FST and Block 0. Sonangol P&P is an equity partner in blocks 2, 3, and 14 and operator of Block 4 (Kiabo) and block 34.

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**Contractors Net Cashflow**

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The Contractors net cashflow shows how much wealth the operating groups (comprising all of the partners but excluding Sonangol) generate from Angolan oil activity.

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**Royalties**

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Royalties comprise all field royalties due to the government (from all partners including Sonangol).

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**Petroleum Income Tax (PIT)**

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Petroleum Income Tax comprises all field PIT due to the government (from all partners including Sonangol).

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### **Petroleum Transactions Tax (PTT)**

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Petroleum Transaction Tax comprises all field PTT due to the government (from all partners including Sonangol). PTT is only levied on fields in Block 0.

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### **Profit Oil**

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Profit Oil comprises all field Profit Oil due to the government from its share of production.

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### ***Using the Aggregate Financial model***

The financial model was developed to achieve the following four main objectives

- To project petroleum revenues and related taxes to the state from oil activity in Angola
- To provide a tool to assist the government in monitoring and managing petroleum revenues
- To provide 5 year financial projections of petroleum operations on a quarterly and annual basis
- To assist the government in reconciling the financial flows between Sonangol, the Bank of Angola and the Ministry of Finance.

There are a number of areas in which the government can immediately employ the financial model.

One important area is in monitoring loan repayments backed by oil. The financial model can be used to execute alternative price scenarios, that at an aggregate level will provide estimates of break-even prices, below which it would be difficult for Angola to service all of its oil backed loan commitments. Knowing this would be important in ensuring that future repayments could be met, and that the country did not over-extend itself in securing loans backed by oil.

Initial use of the model has already focused on a number of key areas described below. It is our recommendation that further work should be progressed by the government in each of these.

The financial model can be used as an effective planning and reporting tool. The model is a dynamic instrument that should be regularly updated with both current and future production, price, cost and tax information. By employing scenario analysis users will be able to forecast alternative price scenarios, production and cost forecasts and measure their impact on future government revenues. This will be critical in preparing, annually

the National Budget, and developing future policy in key areas of government spending. As an input to the policy decision making process the financial model will become an indispensable government tool.

In addition to modeling price scenarios the government may wish to measure the financial impact of cost over-runs on specific projects, declining production trends or the phasing of future investments by the industry. The financial model will be important in enabling the preparation of an effective, and transparent reporting mechanism that shows oil tax revenues, and supports inter-ministerial financial reconciliations. The financial model will be a central platform in the reconciliation process.

The Tax Directorate of the Ministry of Finance has, over the years, constructed tax spreadsheets that are used to monitor the collection of tax revenues and to reconcile taxes paid with the independent review of taxes by third parties such as Ernst and Young. However the process is flawed in that the Tax Directorate is unable to independently verify tax calculations using its own models, and cannot rely on the independent review, as this is not a standardized audit. It is critical that the Tax Directorate develops its own expertise, with the model, to confidently project future tax revenues. With the introduction of a transparent and co-ordinated reporting mechanism these outputs should then be compared with the actual tax flows due by, and received from the oil companies on an ongoing basis. The financial model will initially complement the spreadsheets being used by the Tax Directorate. Ultimately it should be a government objective to replace the current flawed system with the financial model and new reporting mechanisms.

The financial model will provide valuable guidance in enabling the government to effectively manage the revenues being generated by the petroleum sector, and in particular to verify oil company's tax declarations. Overall the model will contribute to improved cash management.

The government will be closely involved in monitoring and guiding the future strategic direction of the petroleum industry in Angola. The financial model will provide important information to assist the government in formulating policies relating to investment levels, the pace of future exploration and development, the extent of Sonangol equity involvement, the growth in the support and service industries, and oil related employment.

The financial model maybe employed as an important tool to influence macro-economic policy. The model can be modified to provide meaningful estimates of the share of the petroleum industry in the National Budget, and to measure the impact of the growth of the oil sector on the non-oil economy.

#### *I. PC Specification*

The size of the financial model is currently over 25 megabytes. This can be compressed to approximately one third of the original size.

The most effective storage for the model is on a compact disc in a zipped directory. The model can be downloaded onto a hard drive or executed from the CD (provided the CD drive on the PC matches the CD drive stored on the compact disc).

To store and run the financial model the following PC specification is recommended:

- At least 30MG hard disk space for the models
- Personal or multimedia computer with a pentium 2 processor
- Office 2000
- Microsoft Windows® 2000 operating system
- 64 MB memory
- CD-ROM drive
- Microsoft Mouse

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