

# THE FINANCIAL GOVERNANCE COMMITTEE

Periodic Report to HLPF Session

Istanbul, Turkey  
22 February 2016

## 1 Introduction

The Financial Governance Committee (FGC) plays an important role in assisting the Federal Government of Somalia (FGS) and the international community strengthen governance within the public financial institutions in Somalia. The FGC offers a forum for frank and confidential discussions, and also provides independent non-binding advice in certain areas as required and where expertise is available. Since the latest FGC update to the HLPF meeting held in Mogadishu in July 2015, the FGC is pleased to provide the following periodic update.

The FGC is currently operating under a set of *2015 Priorities* and a resulting *2015 Work Plan*. This helps the FGC track reforms systematically, and to be held accountable for its performance and effectiveness in contributing to PFM reform.

The current FGC priorities are:

### **Core Priorities**

1. Asset Recovery and Management;
2. Procurement, Contracts and Concessions;
3. Federal Revenue and Budget Procedures; and
4. Central Bank Governance.

### **Subsidiary Priorities**

1. Country Systems Development;
2. Liaison with the Somalia and Eritrea Monitoring Group;
3. Essential Public Financial Management-related Technical Assistance; and
4. Economic Strategy and Planning.

## 2. Progress in FGC engagement areas

### 2.1 Asset Recovery and Management

The FGC approved a **3<sup>rd</sup> Somali National Asset Recovery Effort Progress Report**, which will shortly be released.

The Central Bank of Somalia (CBS) and Ministry of Finance have enhanced the membership of the National Asset Recovery Team (NART) by the appointment of a CBS staff member. The Asset Recovery and Management Strategy was completed by the CBS and adopted by the Council of Ministers in September 2015. The CBS members of the NART are working closely with the World Bank/UNODC StAR Initiative to hasten the recovery of Somalia's frozen liquid assets (such as, bank deposits), a process which is well underway.

CBS has identified the bulk of its non-liquid assets (for example, property holdings), both domestic and international, so that policy decisions can be made in respect of their recovery.

## 2.2 Procurement, Contracts and Concessions

The FGS continues to ask the World Bank delegate to review all signed concession agreements, and to review all draft concessions and contracts worth over US\$5 million. The FGC is also focused on the strengthening of the procurement institutions created under the new Procurement Act. On October 31, 2015 the FGC released ***Public Sector Contracts and Concessions: the FGC and the Confidential Assessments: Second Bi-Annual Report.***

***Concessions and Contracts:*** As per mid-February 2016, 12 signed and 3 draft Federal Government contracts and concessions have been identified; of these, 11 signed contracts and the 3 drafts have so far been given to the FGC for review. The remaining contract has not been submitted to the FGC. The FGC has delivered 12 *Confidential Assessments* and 3 *Supplementary Confidential Assessments*. In addition, 1 contract signed by a Regional Government has been passed on to the FGC for comment, which highlights a potential expansion in the role of the FGC.

The October 31 report stressed the risks posed to the country by the absence of a clear legal and fiscal framework for oil and gas exploitation. The FGC accordingly recommended both to the Federal and the Regional Governments that no exploratory drilling by international oil companies should be permitted until a new legal and fiscal framework is in place.

The October report also recommended that FGC focus on:

1. Helping the Federal Government introduce competitive procurement, in particular by supporting the work of the Interim National Procurement Board (see below);
2. Offering Regional Governments the benefit of the FGC's *Confidential Assessment* process; and
3. Exploring how the FGC might help the Federal Government and the Regions forge agreements on revenue-sharing arrangements.

It was also noted that the last few months of 2015 saw a measurable improvement in cooperation between Federal Government line ministries and the FGC, and that several *Confidential Assessments* are now being used as a basis for Federal Government action.

***Procurement:*** The Public Procurement, Concessions and Disposal Act was passed on December 12, 2015.

***Interim National Procurement Board:*** As an interim measure, on March 19, 2015, the Council of Ministers established an Interim National Procurement Board (INPB) comprising five Cabinet ministers and chaired by the Minister of Finance, in accordance with FGC advice. The INPB's mandate is to help introduce competitive procurement and to provide an oversight function in the transition towards full effectiveness of the new Act. The FGC is recruiting a Concessions Adviser to work with the INPB. The FGC recently resolved to prepare a policy paper to advise the Federal Government on how to develop a framework for managing the transition to the full application of the Act.

H.E. the President, in his September 9, 2015 speech on security sector reform, indicated that "all tenders for logistic supplies will be carried out through the Interim Procurement Board." This means that all substantial contracts for both food and logistical supplies must now be reviewed by the INPB, which will in turn share all such draft contracts and concession agreements with the FGC for a *Confidential Assessment*. As of mid-February 2016, though, this instruction has not been complied with.

## 2.3 Federal Revenue and Budget Procedures

A note entitled ***The 2015 Budget: Short-changing Security*** was prepared and circulated by the FGC World Bank delegate. The note observed that late payments of stipends were contributing to a dangerous situation in which Somali security services were being inadequately remunerated, and proposed a number of steps to address the issue, collectively embedded within a “Security Compact” between the Federal Government and donors.

***Fiscal Federalism:*** FGS consultation with the Regions has started, and an initial FGC meeting with Regional Finance Ministers was held on January 25, 2016, in Nairobi. It was suggested to the Regional delegates that the FGC can extend the *Confidential Assessment* process to them should they wish. The FGC also foresees a potential advisory role in relation to revenue sharing and the harmonization of taxes and taxation procedures.

## 2.4 Central Bank Governance

***CBS Governance Report:*** An updated ***CBS Governance Report*** was adopted by the FGC and was circulated on November 30, 2015. In summary, its key points were:

### 2.4.1 Modernization & Organizational Development:

- The CBS has embarked on a general reorganization reform initiative to assess the state of its organization, governance, management, human resource, workforce dynamics, and skills.
- During 2015, the CBS hired several qualified experts: (i) 7 in bank licensing and supervision; (ii) 1 in economic research; and (iii) 2 senior accountants for finance and accounting.
- The CBS is receiving ongoing training in governance, institutional strengthening, and human-capacity development from specialized financial institutions. Examples: (i) the IMF on CBS internal governance; (ii) the World Bank on money transfer operations; (iii) since June 2015, the World Bank on implementing a Core Banking System as part of the wider PFM reform initiative; and (vi) the US Department of the Treasury and the IMF on banking supervision.

### 2.4.2 Improved Transparency & Accountability:

- The Board of Directors of the CBS has approved a first set of by-laws and prudential regulations supported by technical assistance from the IMF. These include: (i) rules for conduct and ethics; (ii) procedures for the meetings of the Board; and (iii) Memorandum of Understanding between the CBS and the Ministry of Finance on the role of the central bank as fiscal and financial agent for the Federal Government.
- The Governor of the CBS appeared before the Parliamentary Committee on Budget, Finance, Planning, International Cooperation and Financial Oversight of Public Institutions and made a formal presentation on “Currency Reform Considerations for Somalia.”
- In June 2015, the Board appointed a Director of an Internal Audit Department in an effort to provide an independent and effective audit function.
- In October 2015, the CBS appointed an independent external audit firm to audit the financial accounts for 2014 in line with international standards for central banks.

### 2.4.3 Adoption of International Standards & Codes:

- The CBS has improved its accounting and internal controls system by modernizing the information technology that allows production of timely financial reports and, over time, reaching compliance with International Financial Reporting Standards.

- Monthly financial statements have been provided by the CBS to the IMF, and the central bank is successively supplying additional data required by its membership in the IMF.
- The balance sheet and other CBS's financial statements are successively being published on its website.
- In August 2015, the Board of Directors approved a regulation on financial integrity; subsequently, a law on anti-money laundering and combating the financing of terrorism has been passed.

#### 2.4.4 Enhancing a Formal Financial System:

- The CBS is in the process of developing and implementing a comprehensive roadmap for the prudent growth of financial intermediation in Somalia, supported by advice by international donors and technical assistance providers.
- With support from the IMF and US Treasury Department, the CBS has started the process of prudential regulation, supervision and examinations of commercial banks.
- Through enhanced licensing procedures, the formal banking sector has strengthened. During 2015, 6 banks were licensed and 13 applications for bank licenses were pending.
- With support from the World Bank, the CBS has been preparing regulations pertaining to money transfer operators.
- In April 2015, the CBS hired a highly qualified Compliance and Remittance Advisor.

#### 2.4.5 International Remittances to Somalia:

- Based on a Memorandum of Understanding, the CBS has been working with the World Bank on a "Third Party Agent" to jointly co-examine money transfer operators with the CBS, the goal being to ensure the continued flow of remittances.

#### 2.4.6 Strategy to Develop Statistical and Accounting Systems

- During 2015, the CBS gradually modernized its accounting system in a bid to strengthen its banking operations and financial reporting.
- The CBS is working with the Ministry of Planning and International Cooperation and Ministry of Finance on future statistical systems and reports, especially statistical institutional arrangements.
- The CBS is undertaking a back-to-back examination of all payment systems and accountability procedures and processes to strengthen its fiduciary responsibility as the financial agent of the Federal Government of Somalia. This activity is funded by DFID.

#### 2.4.7 Technical Assistance Missions to Nairobi

- The CBS continuously engages with international financial institutions, development partners, and their counterparts in discussions on how best to undertake the reform work. There is considerable international support to enhance the central bank's governance.

#### 2.4.8 Comprehensive Currency Reform Initiative

- The CBS faces the daunting challenge of discharging its mandate in a largely dollarized economy, in which it does not have monetary tools to control the money supply in the country.
- The CBS, with advice and assistance from the IMF and a development partner, is in the process of establishing a roadmap for a comprehensive national currency reform taking into account the underlying situation, security issues, and socio-political factors.
- In September/October and October/November 2015, with technical support by a development partner, detailed frameworks for the planning and preparations of an entire currency reform were discussed with the CBS officials in Mogadishu and Nairobi.

- In October 2015, the Steering Committee of the IMF-managed Trust Fund for Somalia agreed to finance future technical assistance on a currency reform.
- Agreed prerequisites and modalities for successful national currency reform include: (i) building technical capacity; (ii) mobilizing financial resources; (iii) planning and conducting currency conversion; and (iv) ensuring policy consensus and broad-based political support.

## 2.5 Country Systems Development

No substantive engagement from the FGC in 2015.

## 2.6 Liaison with the Somalia and Eritrea Monitoring Group (SEMG)

The FGC has established formal contacts with SEMG. SEMG representatives attended the FGC meeting on August 4, 2015, and the parties conferred around the production of the SEMG's reports on the Soma Capacity Building contract and the SEMG's main 2015 Report.

## 2.7 Essential PFM-related Technical Assistance

The provision of essential PFM-related technical assistance is constrained by two factors. The first is that the National Parliament has yet to pass the Public Financial Management Act. The second comprises the security constraints in Somalia, which have made it difficult to embed technical advisors within key institutions. The FGC is developing a matrix that will identify the current constraints in design and delivery of technical assistance, as well as track ongoing delivery of this assistance. This matrix will be shared with donors in March 2016.

The Ministry of Finance will be holding a Financial Management strategy session in March 2016, supported by the IMF and World Bank, to engage with key stakeholders and develop a 5-year plan for implementing PFM reforms. One of the key inputs to this process will be the FGC matrix. Considerable progress has been made in PFM reforms, including a credible 2016 budget based on sound fiscal principles and strengthening of budget execution using the Somali Financial Management Information System. Enhanced expenditure controls, including commitment control, have been developed and training has been rolled out to all government entities. Payroll systems have been reformed, with strengthened controls and semi-automated payments using biometric data. Key pieces of legislation have been passed, including the Procurement, Audit and AML/CFT laws. However, there continue to be challenges in the operationalization of reform activities, and further capacity building is required to strengthen implementation.

## 2.8 Economic Strategy and Planning

No substantive engagement from the FGC in 2015.

# 3. Composition and Functioning of the FGC

In addition to the new members of the expanded membership announced during the last FGC presentation to the HLPF, a new donor member recruited by the EU joined as of January 15, 2016, somewhat later than planned due to recruitment delays. The African Development Bank delegate is in the course of being replaced.

The Development Partnership Forum created to enhance dialogue with international partners met with the FGC on four occasions: on January 31, August 4, and November 23, 2015, and on January 25, 2016.

Since the completion of the first review, the FGC has met on eight occasions: on January 29–30, April 12, June 1, August 3–4, September 30, November 22–23, December 17, 2015, and on January 24–25, 2016. The next FGC meeting is scheduled for March 7, 2016.

#### 4. The second review of the FGP/FGC

An initial review of the FGP/FGC was carried out in November 2014. Recommendations were made to revisit the FGC's terms of reference to specify and define the FGC's role, purpose, and functions; develop clear criteria for FGC engagement in specific financial governance issues; expand the FGC's membership and quorum; provide the FGC with technical support to enable the implementation of key reforms; hold open quarterly FGC meetings; strengthen FGC resourcing; enhance FGC operating procedures; and adjust the concept of the IAP. Most of these recommendations were addressed.

The second FGC review was carried out between November 2015 and January 2016. A draft of the report was discussed at the December 17, 2015, meeting of the FGC, and the FGC transmitted its assessment of the report to donors through the donor review reference group on January 6, 2016. The final report was received from reviewer on January 10, 2016. The review was positive about the FGC's impact on aspects of confidence between donors and the Federal Government, but also argued that many of the tasks that the FGC had set itself were reaching their conclusion, and that the committee needed the authority to take on a new set of challenges, as well as additional personnel resources to enable this. The FGC's own assessment was positive, but differed from the review in arguing that the FGC's agenda embodies the necessary flexibility to take on new issues as the need arises and when the FGC possesses the requisite skills, and also that there is less an issue of inadequate resources than a need to use existing capacity properly.

The FGC's mandate expires on April 30, 2016, and the FGS and donors are currently examining the review and FGC's response. They will meet in March to discuss whether the FGC's term should be extended, and if so, for how long.