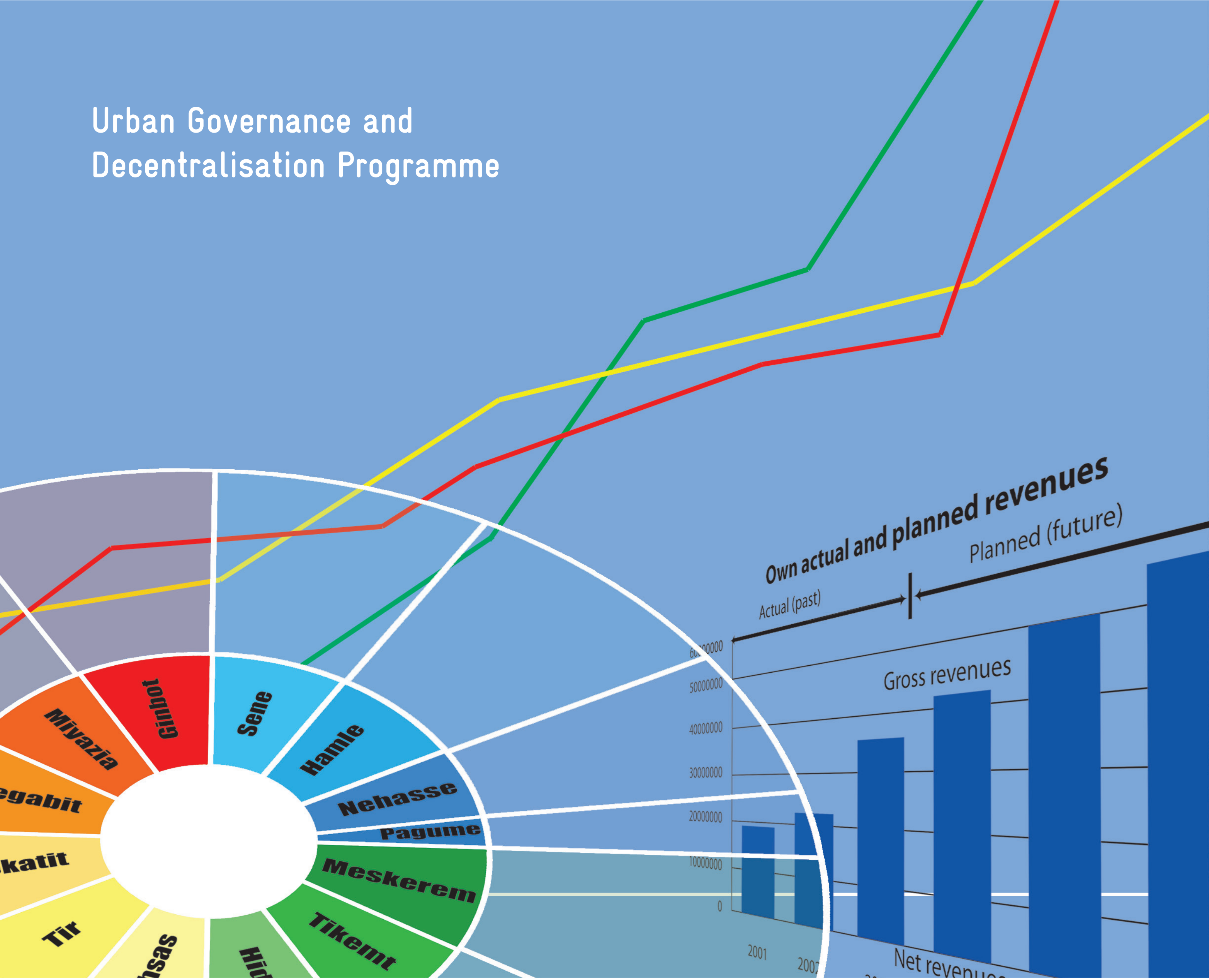
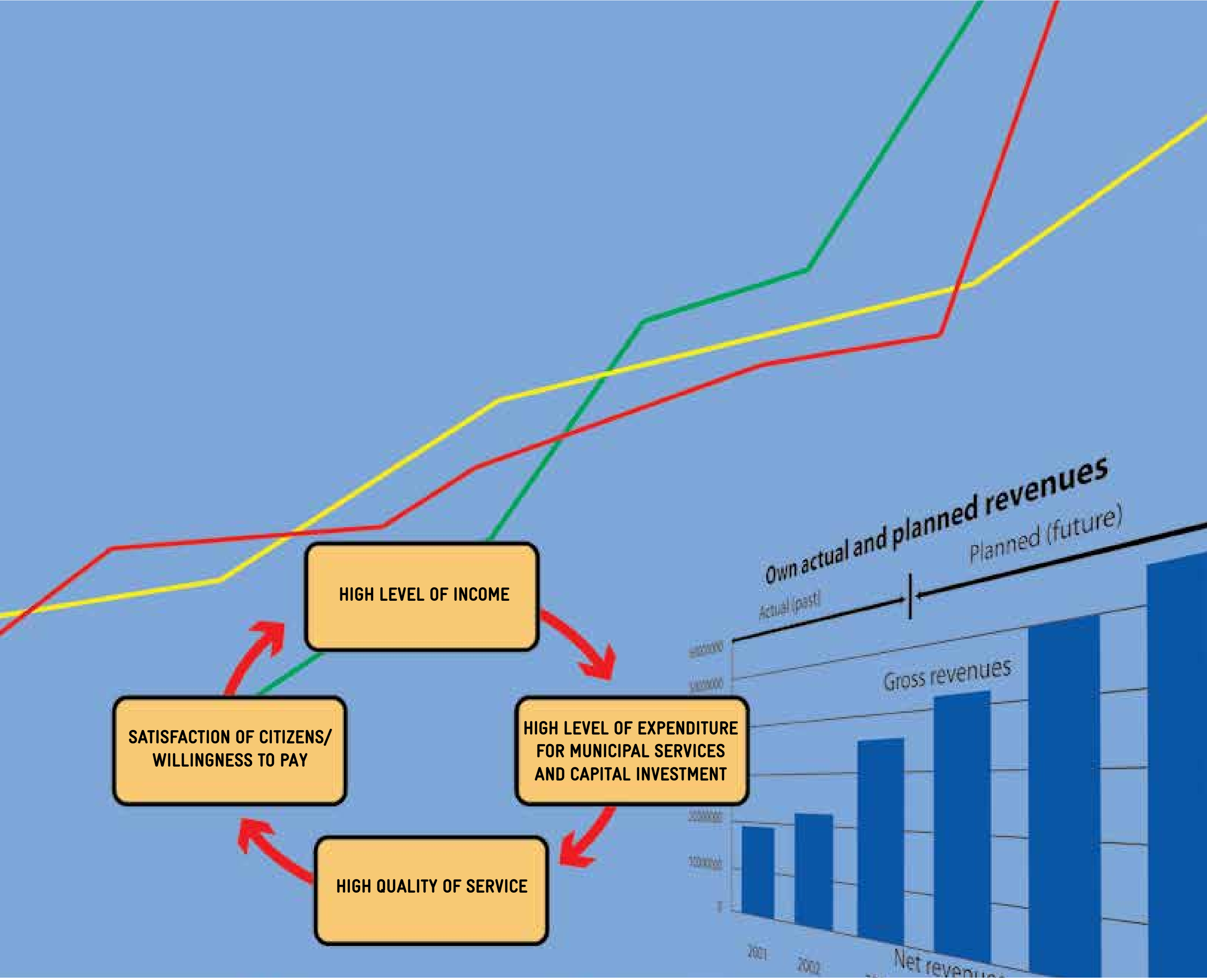
Urban Governance and
Decentralisation Programme



Capital Investment Planning Guide for Ethiopian Cities

Making cities efficient in service delivery

Ministry of Urban Development
and Construction



Revenue Enhancement Plan Guide for Ethiopian City Administrations

Working Manual

Revenue Enhancement Plan Guide for Ethiopian City Administrations

Working Manual

Revenue management nurtures healthy and functional cities

Content

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Abbreviations

AMP	*Asset Management Plan*
BoFED	*Bureau of Finance and Economic Development*
BoWUD	*Bureau of Works and Urban Development*
BPR	*Business Process Re-engineering*
CA	*City Administration*
CIP	*Capital Investment Plan*
EFY	*Ethiopian Fiscal Year*
GTP	*Growth and Transformation Plan*
IBEX	*Integrated Budget and Expenditure System*
MoFED	*Ministry of Finance and Economic Development*
MUDC	*Ministry of Urban Development and Construction*
OFED	*Office of Finance and Economic Development*
PPP	*Public-Private Partnership*
REP	*Revenue Enhancement Plan*
ToR	*Terms of Reference*
UGDP	*Urban Governance and Decentralisation Programme*
ULGDP	*Urban Local Government Development Project*

Introduction

This guide is designed to provide City Administrations (CA) with a hands-on guide to develop a municipal or city Revenue Enhancement Plan (REP). Besides the planning, it also aims to serve as a useful instrument for analysing the cause of low revenues and outlining strategies for increasing revenues. It provides practical advice on planning, maximising, carrying out and evaluating city administrations' short and long-term revenue performance. Although this guide focuses on municipal revenue items, the approaches and instruments for increasing revenue presented here are equally applicable to enhancing state revenue.

Structure of the manual

The manual is structured along the following main steps to prepare a REP:

Step One highlights the importance of considering the policy and legal framework before beginning detailed planning. Related documents can be found on the annexed CD and in the urban law book.

Step Two studies past revenue performance and emphasises past difficulties. The trend analysis gives important inputs for further planning and is the basis for the coming gap analysis.

Step Three critically examines past expenditures. The aim of revenue enhancement is to cover the cost of essential services for citizens. Therefore, revenue generation and expenditure are directly linked.

Step Four provides recommendations on areas for improvement of revenue administration. Based on the previous step, lessons learnt that need to be transformed into strategies should be developed.

Step Five presents another way to improve the revenue situation by introducing costing. Calculating costs of services will help city administrations to correctly charge for these. These costs will then be allocated to cost centres.

Step Six offers an assessment of the discretionary power of city administrations, following the calculation of the costs of actual service delivery introduced in the previous step, for increasing municipal revenue.

Step Seven critically analyses the option of borrowing financial resources to cover running and future costs.

As a result of working with this guide, city administrations should be able to plan more efficiently and address past weaknesses with the aim of increasing municipal revenue income in the future. Having higher budgets, city administrations should be able to deliver their mandated service.

- **STEP 1** Considerations before REP drafting
- **STEP 2** Analysis of past revenue performance
- **STEP 3** Examination of expenditure management
- **STEP 4** Strategies to increase revenue administration efficiency
- **STEP 5** Setting up a cost accounting system
- **STEP 6** Analysis of other means for increasing municipal revenue
- **STEP 7** Borrowing and its implications

The revenue enhancement plan

What is revenue enhancement?

Revenue enhancement means that a city administration or municipality is committed to optimising the revenue sources that are legally and administratively available. The intent is to use each source of revenue to its fullest potential in accordance with the wider goals and priorities of the country. Revenue enhancement involves exploring opportunities to diversify revenue sources when existing revenues are inadequate to meet the demands of the citizens. Finally, it means making a commitment to putting in place a wide-ranging series of improvements to its policies, procedures, staffing and organisational structure.

Why is revenue enhancement important?

The capacity for city administrations to supply urban services and undertake the necessary infrastructure development is naturally constrained by limited financial resources. Insufficient revenue generation is most commonly the result of a combination of factors, including:

1. **Tax base:** The tax base for important sources, such as the property tax and the business tax, is artificially small. This is because the city administrations and municipalities have not been updating their records and informal businesses and properties are not included in the base.
2. **Tax coverage:** Determined taxes, charges and fees are partly out of date, with no relation to current incomes and costs. However, many city administrations and municipalities still collect their revenue on the basis of rates and tariffs established in 1971. Since 2004, some municipalities have started to revise certain tax rates and tariffs but have rarely reviewed and rationalised all of them systematically. A significant amount of economic activities are currently left untaxed.
3. **Tax assessment:** In the local tax administrations, tax assessment is one of the most problematic areas. This is even worse for lower income groups as they do not maintain books of accounts to demonstrate their exact performance. Therefore, their tax assessment is only based on personal estimations.
4. **Collection efficiency:** Collection rates are poor in many city administrations and municipalities and they vary significantly from year to year. In fact, tax collection is still low relative to its tax base. As a result, the default rates and cumulative arrears are significant. The problem appears mostly in the case of land lease, trade and service taxes.
5. **Payment procedure:** Payment procedures are slow and inconvenient for taxpayers.
6. **Enforcement mechanisms:** Enforcement mechanisms are almost non-existent and the procedural legal basis to support enforcement is deficient. This further encourages defaults and adversely affects efforts to settle arrears.
7. **Weak human resources:** The above problems in the system of tax administration are worsened by the weak human resource capacity of revenue staff and poor incentives for enhancing performance.

The massive accumulation of new infrastructure requirements and the substantial need of resources to maintain, renovate and replace older, deteriorating equipment has compounded the above-mentioned problems. This calls for generating more revenue from own and external sources such as grants, intergovernmental transfers, revenue sharing and borrowing. The major objective here is to maintain a steady increase in own (municipal) revenue that is at least equal to increased inflation and population growth rates. This approach would help to offset the decline in the purchasing power of money.

What is a REP?

A REP analyses past revenue performance and demonstrates which financial resources are needed in the coming three years and how the city will generate this amount. This means that a clear strategy should be presented, detailing from which sources urban administrations can generate their own revenues to cover their expenses.

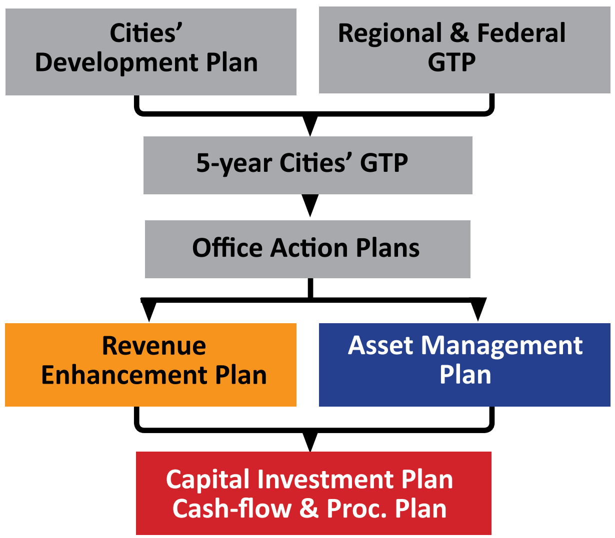
The responsibilities for its implementation should also be clearly defined. The main revenue sources include taxes, service charges and fees.

At the same time, when preparing REPs, city administrations should pay attention to expenditure requirements, financial balance at hand and revenue enhancement options. As it is mentioned in the expenditure management section of this manual, this approach will help city administrations to identify the resource gap. The definition of planned expenditure needs (what do I need to spend) sets a precise target (what do I need to receive to make it possible) for the revenue amount to be generated.

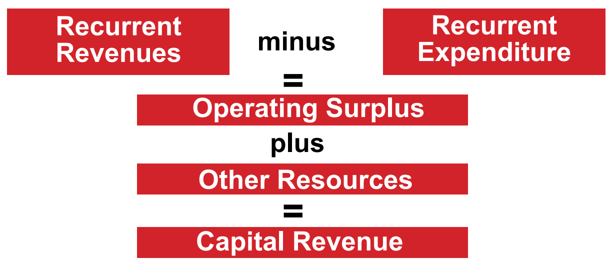
How is the REP linked to strategic objectives?

All cities in Ethiopia have development plans, consisting of strategic development objectives and structure plans. City development plans include physical and spatial objectives. This plan is then translated into the yearly action plan of city line-offices.

In these yearly plans, the line offices submit a budget proposal including a recurrent budget (e.g. salaries) and investment proposals in order to fulfil strategic objectives (e.g. building a school). These proposals and other capital projects, such as the rehabilitation of assets are listed in the Asset Management Plan (AMP). A second function of this plan is to manage existing infrastructure by determining maintenance requirements and costs, which are then consolidated in the maintenance budget. However, not all wishes from the AMP can be fulfilled. In order to match available resources with investment needs, the city with the participation of its citizens will prioritise capital investments proposals and list practical and financeable investments in its Capital Investment Plan (CIP). The CIP is linked with the city's physical and financial objectives.



Both capital investments and maintenance expenditures require financial resources, which are to be generated by the Revenue Authority as planned in the REP. Therefore, at the beginning of each calculation the amount of available revenues should be indicated. By subtracting the recurrent expenditures the city administration can calculate its operating surplus, i.e., own resources available for capital investments. In Ethiopia, many external resources by the federal government or by donors add to this and are available for the CIP.



Usage of the annex CD

This REP guide has an annex CD that provides all the necessary templates as referred to in the following chapters. Easy-to-use Excel sheets have been produced to assist with the analysis for developing a revenue enhancement plan. Furthermore, many other useful documents are included on the CD such as the stakeholder analysis, a tariff study example, a financial management manual for cost accounting and borrowing as well as many legal documents to be considered for revenue enhancement planning. The CD starts automatically when inserted into your computer. The opening screen features a menu for navigating the CD. The user is given the option to install programs on their computer, these are required to engage with the content. Please note that not all documents on the CD are translated.

Training for revenue enhancement planning

In order to effectively develop and implement the revenue enhancement plan, thorough training on REP is required in each city administration.

Together with the Ministry of Urban Development and Construction (MUDC) and with the support of the Gesellschaft für Internationale Zusammenarbeit (GIZ), the Ethiopian Civil Service University (ECSU) has developed a training programme for revenue enhancement planning.

The training is meant to be delivered directly to city administrations. It includes two face-to-face workshops, video-lectures, additional learning materials, a business game and an examination. Successful participants receive a certificate. The training It will enable city administrations to efficiently develop REPs according to Ethiopian standards. You will not only receive extended inputs, but also work practically on REPs so that you become competent in REP preparation.

Additional, this training is related and may be linked to trainings on capital investment planning and asset management planning.

For further information, please have a look at:
http://training4cities.dlc-ecsu.org

Step 1

Considerations before REP drafting

1.1 Respect legal system in place

1.2 Follow regional and local frameworks

1.3 Set up a task force

Guiding Questions

» What are the main components of the Federal Fiscal Policy, the Tax and Investment Policy and the Urban Development Policy?

» What are the main objectives of the Tax Reform and the Civil Service Reform?

» Which documents relevant for the regional and local development planning and budget work need to be gathered before drafting the REP?

» What kind of experts and professionals are required for drafting the REP?

In this step, you are required to:

✓ Identify and apply relevant policies, regional and local frameworks for the preparation of the REP.

✓ Implement an appropriate ad-hoc task force staffed with experts pooled from various disciplinary backgrounds.

Introduction

Each city administration and municipality must bear in mind that their REP should be in line with the requirements of the federal and regional constitutions and not contradict the framework of national laws when it devises its own local financial improvement policies.

The established federal and regional policy framework aims at reducing conflicts, uncertainties and misunderstandings by providing guidance and instructions on how to deal with financial matters in local governments.

City administrations need to consult the following set of policies and government reform programs:

- Fiscal Policy
- Tax and Investment Policies
- Urban Development Policy
- Civil Services Reform
- Tax Reform

Further, they need to gather and integrate regional and local frameworks.

In order to prepare the REP, a task force has to be set up, comprising of a pool of experts from different disciplines.

Several relevant documents for further reading can be found on the annex CD.

1.1 Respect legal system in place

The following policies are the most important and should be considered while preparing city administration and municipality REPs. Details on each policy can be found in the Growth and Transformation Plan (GTP) document (see annex 6 on the CD).

Figure 1: Overview of different policies relevant to REP preparation

Fiscal Policy	• Mobilisation of own revenue is a necessity but can also obstruct economic growth if citizens are over-taxed; • Management of own revenue and expenditure of a local government should contribute to a fair distribution of income and wealth between citizens; • REPs should not negatively affect the stability of the local economy, employment and inflation. These plans should not impair the allocation of local resources; • City administrations are required to follow sound financial principles that strengthen fiscal responsibility, ensure sustainability of resources and spending, apply limits to local expenditure and create meaningful relations between local policy and expenditure patterns. Value for money should be produced through transparency and accountability.

Tax and Investment Policies	• REPs should not contradict the federal and regional investment and tax policies, which provide incentives to smallholder farmers, domestic entrepreneurs and direct foreign investors, stimulating in turn economic growth and prosperity; • The private sector should be strongly supported by transparent and accountable services rendered with regard to delivery and pricing.

Urban Development Policy	• City administrations should use different methods for the full recovery of land development costs such as: - an appreciation tax for increases in land values; - full cost recovery charges for the capital costs of services provided to their estate; and - public acquisition and development of land. • City administrations should apply charges and fees (cost sharing principle) reasonably well on occupants of new areas or redeveloped areas for the provision and installation of utilities such as electricity, supply of water, drainage, sanitations, refuse collections, schools, clinics and amenities such as parks and sport grounds; • Cities should have a reliable inventory of their land; • Cities should update the value of their land.

Civil Service Reform	• One of the sub-programmes of the Civil Service Reform is the installation of the Expenditure Management and Control system which cities should consider; • City administrations should harmonise and implement the expenditure management and control mechanism, which contains the reform of accounting, budgeting, procurement, auditing, and internal control principles in the preparation of the financial improvement plans; • City administrations should formulate and introduce performance appraisals and incentive systems in relation to the objectives of the REPs; • City administrations should put systems in place to take care of the quality of local services including the establishment of complaint handling mechanisms and the participation of citizens in urban affairs; • City administrations should select and train suitable staff to manage these plans and their objectives; • City administrations should include the REP context in a chapter of their code of conduct to prevent potential corruption.

Tax Reform	• Keeping in mind the national and regional tax reforms which are currently carried out, city administrations should consider customising and updating their local revenue systems accordingly. Continued efforts are necessary to initiate essential changes to local tax tariffs, charges and fees. The local tax administration must also be modernised.

1.2 Follow regional and local frameworks

All specific documents to city administrations and the regions they are located in should be collected carefully, such as:

- Local development plans of city administrations;
- Strategic plans of city administrations;
- Medium-term fiscal planning of city administrations;
- Medium-term development plans of the region;
- Statistical abstracts such as on population growth in the region and the city (if available);
- Study documents that show the socio-economic profile of the city administrations;
- Cadastre plan especially financial cadastre for city administrations and other related.

These documents should be available in the development planning and budget work process of each OFED.

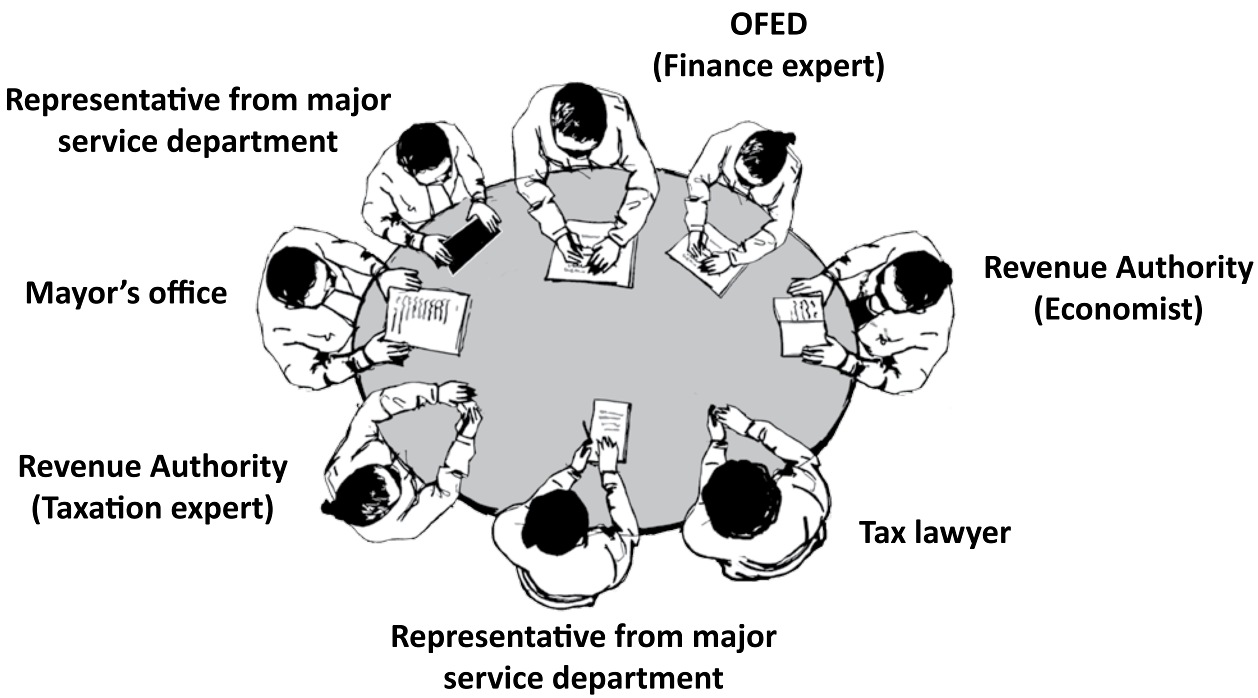
Each REP needs to follow the legal framework in the country as well as municipal and regional policies.

1.3 Set up a task force

In order to prepare a REP, city administrations should first establish an ad-hoc task force. Revenue enhancement planning needs different experts in different disciplines, such as economics, finance, taxation and law. The technical team should comprise of members from the different working units of city administrations and members from revenue administration and city finance offices.

This task force should come together one month before the REP is due and research the information needed according to this guide. So as to gather all relevant information for the REP, the members of the task force need to cooperate intensively with different sector offices and woreda officials. Relevant information on taxpayers and for widening the tax base should be collected.

Figure 2: Example of a task force composition



Checklist Step 1: Considerations before REP Drafting

Tasks	Details	References
☑ 1.1 Respect legal system in place	✓ Consult and consider key policies • Fiscal Policy • Tax and Investment Policies • Urban Development Policy • Civil Service Reform • Tax Reform	• Page 7-8 • Growth and Transformation Plan (GTP) - see annex 6 on CD
☑ 1.2 Follow regional and local frameworks	✓ Gather key documents • Local development plans of the city administration • Strategic plans of the city administration • Medium-term fiscal planning of the city administration • Medium-term development plans of the region • Statistical abstracts • Socio-economic profile of the city administration • Cadastre plan (especially financial)	• Page 9 • Documentation available at regional BOFED Planning Process Unit
☑ 1.3 Set up a task force	✓ Choose team comprising of: • Members from relevant working units and disciplines (For example: economics, law, finance, taxation) • Revenue administration • City finance office ✓ Set up team meeting one month before REP is due ✓ The task force needs to cooperate with all sector offices and woreda officials in order to gather all relevant information ✓ Particularly information on taxpayers and tax base are required	• Page 9

Exercises Step 1: Considerations before REP drafting

1.1 The revenue enhancement task force should come together:

A. One month before strategic plan is due

B. One year before REP is due

C. Five years before the strategic plan is due

D. One month before the REP is due

1.2 Among the following positions identify the one that is the least likely be the member of the municipal REP task force:

A. Finance expert

B. Federal tax advisor

C. Tax expert

D. Economist

1.3 Which of the following statements is incorrect?

A. Revenue enhancement means that a city administration or municipality is committed to optimise the revenue sources that are legally and administratively available.

B. The intent of revenue enhancement is to use each source of revenue to its fullest potential in accordance with the wider goals and priorities of the country.

C. Revenue enhancement involves exploring opportunities to diversify revenue sources when existing revenues are inadequate to meet the demands of the citizens.

D. Revenue enhancement means making a commitment to put in place a wide-ranging series of improvements to its policies, procedures, staffing and organisational structures.

E. Revenue enhancement deals with improving capital facilities planning.

1.4 Which of the following sources is not an external source of revenue?

A. Tax

B. Grants

C. Revenue sharing

D. Intergovernmental transfers

1.5 Which of the following statements is incorrect about the city administration at the time of planning their revenue enhancement?

A. There is a need to follow the valid federal and regional policies and the respective legal framework.

B. Each city administration and municipality must bear in mind that their revenue enhancement plan should be in line with the requirements of the federal and regional constitutions.

C. When city administrations and municipalities elaborate their own local financial improvement policies they should not be worried whether they contradict with the framework of national laws.

D. The established federal and regional policy framework aims at reducing conflicts, uncertainties and misunderstandings by providing guidance and instructions on financial matters in local governments.

E. The revenue enhancement plans should be participatory.

1.6 Which of the following statements is incorrect about the fiscal policy of a government?

A. Mobilisation of own revenue is a necessity but can also obstruct economic growth if citizens are over-taxed.

B. Management of own revenue and expenditure of a local government should contribute to a fair distribution of income and wealth between citizens.

C. REPs should negatively affect the stability of the local economy, employment and inflation. These plans should impair the allocation of local resources.

D. City administrations are required to follow sound financial principles that strengthen fiscal responsibility, ensure sustainability, apply limits to local expenditure and create meaningful relations between local policy and expenditure patterns.

E. The private sector should be strongly supported by transparent and accountable services rendered with regard to delivery and pricing.

Step 2

Analysis of past revenue performance

2.1 List all revenue items

2.2 Assess past performance of revenue titles

2.3 Identify main difficulties in past revenue performance

Guiding Questions

» Which revenue items are expected to be assessed?

» What methods can be used for analysing the performance of revenue titles?

» Which time frame is preferred for analysing the performance changes of the revenue items?

» Which factors determine revenue collection performance?

» What are typical risks impacting on revenue performance?

In this step, you are required to:

✓ Identify relevant revenue items.

✓ Apply tools such as the trend analysis, gap analysis, collection efficiency analysis and risk analysis.

✓ Evaluate the past revenue performance of your city administration.

✓ Understand the factors that are considered in running the performance review.

Introduction

The first exercise for developing a revenue enhancement plan is analysing past revenue performance. To do so, a list of all revenue items should be produced and their past performance assessed.

This includes: (a) Tax revenues from municipal services, (b) municipal rent revenues and investment incomes, (c) municipal service charges, (d) revenues of sales of goods and services and (e) other capital receipts.

The trend analysis provides important inputs for further planning. It is also the basis for the subsequent gap analysis.

Performance changes registered within a time span of three years are averaged out.

In assessing past performance the following factors are taken into consideration: Appropriateness of valuation and assessment, timely billing, collection efficiency and enforcement mechanisms.

The city's administration collection efficiency is reviewed using two indicators: Actual efficiency and billing efficiency respectively.

The key indicator used for measuring the performance is per capita revenue collection.

See annex 1 on the CD when studying this step.

2.1 List all revenue items

It is important to analyse the nature and structure of the city administration's revenue items before developing strategies to enhance these. Therefore all municipal revenue items should be identified and listed. The completed table will: a) allow for a detailed overview of all revenue sources, and b) help to understand the scope of the city administration's mandate and the potential revenue base available. By law, city administrations are empowered to collect and use the revenue items listed in figure 3.

Figure 3: Main types of revenues

S/N	Revenue item	Account no.
1	**Tax Revenues from Municipal Services**	**1701-1719**
1.1	*Business and professional services taxes*	*1701*
1.2	*Assurance*	*1702*
1.3	*Entertainment tax*	*1703*
1.4	*Other taxes*	*1719*
2	**Municipal Rent Revenues and Investment Income**	**1720-1731**
	*Municipal Rent Revenues excluding land lease **	*1720-1730*
2.1	*Urban land rent*	*1721*
2.2	*Residential houses rent*	*1722*
2.3	*Business building rent*	*1723*
2.4	*Market stall rent*	*1724*
2.5	*Market place rent*	*1725*
2.6	*Stable rent and livestock tax*	*1726*
2.7	*Funeral service vehicle rent*	*1727*
2.8	*Rent from machinery*	*1728*
2.9	*Other rent*	*1729*
2.10	*Municipal investment income*	*1730*
2.11	*Land lease (total)*	*1731*
2.11.1	*Land lease (10%)*	*1731 (10%)*
2.11.2	*Land lease (90%)*	*1731 (90%)*

S/N	Revenue item	Account no.
3	**Municipal Service Charges**	**1740-1749**
3.1	**Business and professional services registration and licensing fee**	*1741*
3.2	*Building and Fence Construction Permit License*	*1742*
3.3	*Soil dumping space license*	*1743*
3.4	*Permission for driving on prohibited roads*	*1744*
3.5	*Traffic fines for violation of traffic rules and regulations*	*1745*
3.6	*Fines for violation of rules and regulations*	*1746*
3.7	*Bus terminal services*	*1747*
3.8	*Environmental protection fee*	*1748*
3.9	*Other charges*	*1749*
4	**Property and Services Sales of Goods and Services**	**1750-1789**
4.1	*Sanitation services*	*1751*
4.2	*Technical services fee*	*1752*
4.3	*Supervision of building and construction works*	*1753*
4.4	*Design and tender document preparation*	*1754*
4.5	*Contract registration and confirmation*	*1755*
4.6	*Road services fee*	*1756*
4.7	*Water service*	*1757*
4.8	*Sewer service*	*1758*
4.9	*Fire brigade and emergency services*	*1759*
4.10	*Vital statistics service*	*1761*
4.11	*Driving licenses fee*	*1762*
4.12	*Garage services*	*1763*
4.13	*Annual vehicle inspection agencies fee*	*1764*
4.14	*Driving instructor and vehicle title deed*	*1765*
4.15	*Valuation of vehicle*	*1766*
4.16	*Registration of driving instructors and others registration*	*1767*
4.17	*Vehicle plate sales and rent*	1768
4.18	*Vehicle parking fees*	1769
4.19	*Permission for change of type of vehicle services*	1771
4.20	*Transfer of title deed fee*	1772
4.21	*Registration fee for land acquisition*	1773
4.22	*Renewal of land, building title deed, plan & maintenance of houses*	1774
4.23	*Debt suspension, cancellation of registration, foreclosure service*	1775
4.24	*Funeral service*	1776
4.25	*Abattoir service*	1777
4.26	*Loading and unloading charges*	1778
4.27	*Provision of cart and chariot service*	1779
4.28	*Provision of park services*	1781
4.29	*Emblems and sign board and any advertising service fee*	1782
4.30	*Other sales of property and services*	1789
5	**Other capital receipts**	**1791-1792**
5.1	*Sales of movable and immovable property*	1791
5.2	*Community contribution & other capital receipts*	1792

Each city administration might have additional revenue items. A standard list to be completed can be found in annex 1, table 1 on the CD.

2.2 Assess past performance of revenue titles

Once all revenue items are listed, a review should be made of at least the last three years (see figure 4). Different elements can contribute to the analysis of the past revenue performance such as the number of payers, the revenue performance and the percentage of total revenue generated by this item. This will show the level of change (increase, decrease, or stable revenue). Finally, the average revenue of the past three years should be calculated.

The respective tables for municipal and state revenues can be found in annex 1, tables 2 and 3 on the CD. The completed table will allow for a detailed overview and comparison of the revenue performance of the past three years.

The factors that determine revenue collection performance are usually ***appropriateness of valuation and assessment, timely billing, collection efficiency and enforcement mechanisms.*** On the other hand, collection performance can be measured by examining tax assessed, levied, billed and collected compared to the per capita basis.

A collection efficiency analysis consists of two different measures:

- ***Actual collection*** efficiency that is defined as the percentage of the total amount planned (billed) against actual collection; and
- ***Billing efficiency*** which is defined as the proportion of total taxable property assessed against that actually billed;

Example: If total taxable property assessed in the city administration XY is 12,000 Birr, the amount billed is 9,000 Birr and the amount collected from 8,000 properties, collection efficiency and billing efficiency will be presented as follows:

A. Collection efficiency

Amount billed	*Amount collected*
9,000	*8,000*
Ratio: 89%	

B. Billing efficiency

Amount billed	*Total property assessed*
9,000	*12,000*
Ratio: 75%	

Per capita revenue collection is one of the key indicators that measures the revenue yield of the city (see figure 5). Determining and comparing the per capita revenue collection of the city to other, similar cities, helps to identify how much revenue city administrations could collect by utilising the unused potential.

Figure 4: Planned vs. actual collection

S/N	**Revenue item**	**Account no.**	**Total population**					
			Planned revenues	**Actual revenues**	**Actual vs. plan**	**% of total own revenues**	**Number of payers**	**Per capita revenue**
1	**Tax Revenues from Municipal Services**	**1701-1719**						
1.1	*Business and professional services taxes*	*1701*						
1.2	*Assurance*	*1702*						
1.3	*Entertainment tax*	*1703*						
1.4	*Other taxes*	*1719*						

Figure 5: Per capita revenue collection

S/N	Revenue item	Account no.	Total population					
			Planned revenues	Actual revenues	Actual vs. plan	% of total own revenues	Number of payers	Per capita revenue
1	**Tax Revenues from Municipal Services**	**1701-1719**						
1.1	*Business and professional services taxes*	*1701*						
1.2	*Assurance*	*1702*						
1.3	*Entertainment tax*	*1703*						
1.4	*Other taxes*	*1719*						

2.3 Identify main difficulties in past revenue performance

The major limitations of revenue collection performance can be explained by enforcement problems, tax payment procedures and capacity constraints. Problems such as delays in the ***legal system, absence of a tax court, absence of proper billing systems, lack of transparency and awareness of defaulters*** are the main issues that can be mentioned under enforcement problems. Besides, shortages of skilled manpower and a lack of staff training programmes, high manpower turn-over, absence of computer assisted taxpayer registration and record keeping systems are problems that fall under capacity constraints.

Based on the information gained from the previous analyses, this step should also evaluate the likelihood of the risk reappearing in the next year(s). This will indicate which problems persist and/or are new and require new solutions. This so-called risk analysis should be added to annex 1, table 4 on the CD.

Risk analysis is a technique to identify and assess factors that may jeopardise the success of the revenue target. This technique also helps to define preventive measures to reduce the probability of these factors from occurring and identify countermeasures to successfully deal with these constraints when they develop. This will avoid possible negative effects on the revenue performance.

Generally, the main difficulties encountered in revenue performance over the last three years include:

1. Small tax base
2. Poor documentation
3. Incomplete tax coverage
4. Difficulties with tax assessment:
    - The assessment procedures are not based on a standard or objective yard-stick
    - The system heavily relies on the judg-ment of tax officers
    - Taxpayers are treated inconsistently
    - Lack of categorisation of taxpayers' grades
5. Collection inefficiency
6. Problems related to the payment procedure

7. Lack of enforcement mechanisms
8. Weak human resources in tax administration (lack of institutional capacity and administrative inefficiency)
9. Wrong revenue estimation at the first stage (absence of proper tax valuation and assessment methodology)
10. Lack of awareness of taxpayers
11. Outdated tariff rates that have served for more than 40 years
12. Lack of service charge rate computation methodology

As indicated in the annex 1, table 4 on the CD, please define difficulties encountered in the last three years for the main revenue items.

After identifying all the deficiencies from the previous years and assessing whether these risks are likely to reappear in the next revenue year, the problems should be ranked according to their impact, i.e., high, medium, or low. This is the second step of the risk analysis. The purpose of this exercise is to evaluate which of the problems have the most crucial impact and need to be urgently resolved. If a problem has a major impact on the revenue performance and explains why the planned revenue could not be reached, it should be ranked as "high". If, due to the problem, revenue sources can only be partly exploited, the difficulty has a "medium" impact. Finally, if a revenue item can only be marginally increased by addressing the problem, it has a "low" impact.

Estimating the impact of each difficulty and risk will result in a ranking of the priority issues ("high" impact) to be addressed. Using the limited resources of the city administration efficiently will help with undertaking the most important problems. For example, the delay of tax audits or assessments translates into an accumulation of tax arrears. The main corrective action is to raise the awareness and willingness of taxpayers to settle tax payment obligations through regular tax education and provide adequate enforcement mechanisms for the collection of revenue and recovery of cumulated arrears.

Concrete risk mitigation strategies are presented in Step 4.

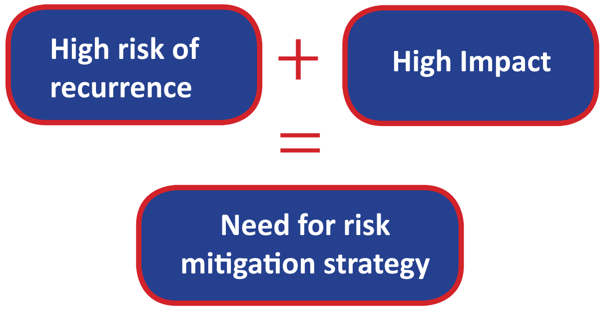
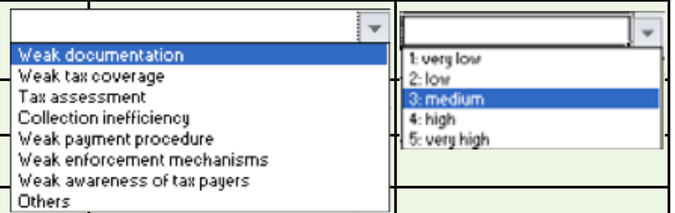


Figure 6: Identification and prioritisation of risks impacting on revenue performance

S/N	Tax Revenues from Municipal Services	Account no.	Number of arrear files	Age of arrears (from-to)	Amount of overdue tax in Birr	Amount of fine in Birr	Fine as % of total overdue tax	Possible reasons for arrears	Impact on revenue performance (very low - very high)
1	**Tax Revenues from Municipal Services**	**1701-1719**							
1.1	*Business and professional services taxes*	*1701*							
1.2	*Assurance*	*1702*							
1.3	*Entertainment tax*	*1703*							
1.4	*Other taxes*	*1719*							



Checklist Step 2: Analysis of past performance

Tasks	Details	References
☑ 2.1 List all revenue items	✓ Identify all municipal revenue items and list them • Tax revenues from municipal services • Municipal rent revenues and investment incomes • Municipal service charges • Revenues sales of goods and services • Other capital receipts	• Page 13 (Figure 3) • Annex 1, table 1 on CD
☑ 2.1 Assess past performance of revenue titles	✓ Perform collection efficiency analysis ✓ Calculate the average performance of the last 3 years of the revenue items ✓ Compare the per capita revenue collection of the city with other cities	• Page 15-16 • Annex 1, tables 2 and 3 on CD
☑ 2.3 Identify main difficulties in past revenue performance	✓ List main problems encountered ✓ Perform risk analysis ✓ Rank the problems according to their impact on the revenue performance	• Page 16-17 • Page 17, Figure 6 • Annex 1, tables 4 on CD

Exercises Step 2: Analysis of past performance

2.1 Which of the following items does not belong into the category 'Municipal Service Charges'?

A. Assurance
B. Environmental protection fee
C. Soil dumping space licence
D. Traffic fines

2.2 The percentage of the total amount of planned or billed revenue against actual collection is called:

A. Billing efficiency
B. Taxing efficiency
C. Actual collection efficiency
D. Assessment efficiency

2.3 Which of the following options do not immediately lead to a tax enforcement problem?

A. Shortages of skilled manpower
B. Absence of a regional tax enforcement policy for municipal revenues
C. High manpower turnover
D. Absence of computer assisted taxpayer registration and record keeping system

2.4 Which of the following problems is not among the main difficulties encountered in revenue performance?

A. Tax base is too large
B. Lack of awareness of taxpayers
C. Poor documentation
D. Collection inefficiency

2.5 A technique to identify and assess factors that may jeopardise the success of the revenue target is called:

A. Tax registration
B. Enforcement
C. Taxpayers education
D. Risk analysis

2.6 The Addis Ababa city administration has introduced a property tax. If total taxable property has a value of ETB 20,000,000 and the billed amount is 20% of the value of the property, then what is the billed amount?

2.7 Dire Dawa municipality has collected an annual tax amounting to ETB 42,010,000.00 in the year 2012. Collection efficiency of the municipality is 80%. Calculate the amount of tax billed by the municipality in the year 2012?

2.8 The billing efficiency of Jimma municipality was 80% in 2010 and 90% in 2011. Billed amounts were ETB 2 million in 2012 and ETB 3.6 million in 2011. Calculate the amount of assessments for both years.

2.9 If a specific problem has a major impact on the revenue performance and is the cause for not reaching planned revenue, it should be ranked as:

A. High
B. Medium
C. Moderate
D. Optimum
E. Low

2.10 The delay of tax audits or assessments translates into an accumulation of:

A. Tax revenue
B. Tax payable
C. Tax arrears
D. Depreciation
E. Tax liability

2.11 Which of the following factors is not taken into consideration when assessing past performance?

A. Appropriateness of valuation and assessment
B. Late billing
C. Collection efficiency
D. Enforcement mechanisms

Step 3

Examination of expenditure management

3.1 Align with Expenditure Management and Control Reform Programme

3.2 Budget wisely

3.3 Assess expenditures

Guiding Questions

» Why do city's need to assess their expenditure management?

» What guidance can cities receive through the government's Expenditure Management and Control Reform Program?

» How can citizens participate in the budget process?

» What are the core concepts of prudent and judicious use of budgetary resources?

» What indicators can be used to assess the cities' expenditures?

In this step, you are required to:

✓ Understand and apply the principles of the Expenditure Management and Control Reform Programme.

✓ Budget more wisely.

✓ Appreciate the advantages of participatory budget planning.

✓ Assess revenue sources that are legally assigned to finance service provision.

✓ Analyse expenditures.

Introduction

Enhancing the well-being of citizens via the provision of public services is the most important responsibility of cities.

Hence, an assessment of the potential revenue sources is made on the basis of public services identified as essential.

City administrations are also required to align their revenue enhancement plan with the existing Federal Government's Expenditure Management and Control Reform Program and its cardinal principles of efficiency, effectiveness and economy. This includes trashing out unnecessary recurrent expenditures or costs. Put differently, city administrations are told to strive towards attaining the twin goals of providing quality urban services and customer satisfaction by maximising the sustainable flow of their stream of income and bolstering up their investment into municipal services.

As an integral component of expenditure management a prudent and participatory budget planning regime geared towards indicating clearly the revenue and expenditure layouts is required.

Measurable performance indicators need to be developed and implemented accordingly. Further, an estimate of cash flow broken down on a quarterly basis is being proposed.

3.1 Align with Expenditure Management and Control Reform Programme

In the context of service delivery, city administrations should make direct reference to the government's 'Expenditure Management and Control Reform Programme'. This programme provides meaningful experience and guidance for the city administration's expenditure management:

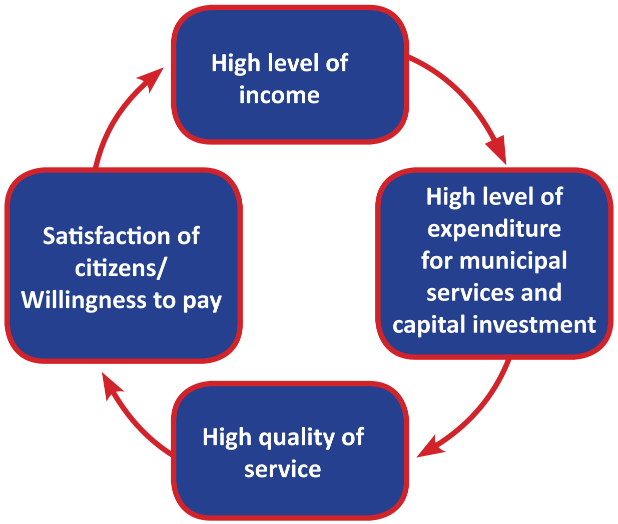
- City administrations should follow the ***principle of Efficiency, Effectiveness and Economy (EEE)*** when taking public expenditure decisions;
- Procurement of goods and services with public money should provide benefits proportional to the amount spent on the goods and services, i.e. ***value for money;***
- City administrations should strive to develop ***medium-term fiscal planning*** that has clearly defined projections for revenue and expenditure;
- City administrations should prepare a ***strategic plan*** for 3-5 years. The annual budget for both capital and recurrent expenditures should be based on the medium-term fiscal plan; This strategic plan has to serve as a guide for resource allocation, i.e., planning has to be systematically integrated in resource allocation processes;
- City administrations should ensure ***public participation*** when preparing strategic plans, approving annual budget and prioritising development projects;
- City administrations should implement ***cost centre budgeting*** so as to maximise sound financial management and allow proper information on costs which is used to determine prices for service delivery to the public (please refer to step 5 of this manual);
- City administrations should ensure propriety while using public funds and design a system to ***avoid misuse of public funds;***
- City administrations should regularly **close their accounts** and get ***annual audit reports*** six months after the end of every fiscal year.

The ultimate goal of a REP is to meet the expenditure requirements of city administrations, which enables the public administration to provide better municipal services to their clients. Therefore, whenever city administrations prepare medium-term expenditure plans they should consider the goals and objectives established in the Growth and Transformation Plan and adopt guiding principles such as EEE and accountability while utilising resources. To do so, city administrations should apply cost reduction programmes in the allocation of resources for recurrent expenditure. They should also keep in mind the huge pressure of increasing operation and maintenance costs resulting from high capital expenditure as stipulated in the asset management plan.

Revenue collected within the jurisdiction of city administrations and allocated largely for urban development activities and the expansion of municipal services increases revenue yields. This approach will help to break the vicious circle of municipal underspending caused by a low level of expenditure for municipal services and capital investment. If the spending of city administrations is low, it has only limited resources to invest and service provision will be limited and/or poor. The direct consequence of this is that citizens are not satisfied with the service and are less willing to pay. In return, the level of income is low and the vicious circle starts again.

Revenue enhancement planning has to address the gap between expenditure requirements and available revenue, taking into account the existing fiscal gaps and those projected for the future. In order to measure the fiscal gap, the financial balance of the past three consecutive fiscal years has to be analysed.

Figure 7: Effects of large spending on core urban services and capital investment



A template is provided in annex 1, table 5 on the CD for this purpose. If this balance is negative, a thorough review of all expenditures has to take place and a strict policy of revenue enhancement (as presented in the following chapters) has to begin.

Financial balance = **Revenue** – **Expenditure**

3.2 Budget wisely

Budget-planning integration is one of the most important aspects of expenditure management. An annual budget of cities should clearly indicate:

- Revenue to be collected for the budget year from each revenue source;
- Actual revenue and expenditure of the past three years;
- Annual budget divided into capital and operating budget;
- Measurable performance objectives for each revenue item;
- Particularities of annual investments;
- An estimate of cash flow for the budget year based on revenue source, broken down at least quarterly.

A good, professional budget relies on medium-term fiscal planning that is derived from the development plans of city administrations. The strategic plan of city administrations developed for three years is also an important reference for preparing annual budgets.

Public participation in budgeting

Effective management of expenditure requires active participation of the general public in the budgeting and planning processes with respect to transparency and accountability. Involving the public will develop trust between government and citizens. Whereas the city council, the city's highest organ, is ultimately responsible for approving the budget, the latter should be presented and agreed upon publicly to allow citizens to equally exercise their share of accountability and ownership. In order to realise this mutual accountability for budget decisions, city administrations should:

- Use the participation manual of the Ministry of Urban Development and Construction (MUDC) (see annex 14 on the CD) and design a participatory budget guide based on it;
- Mobilise public contributions in forms of cash, labour and skills. These efforts must be estimated and appear in the budget;
- Actively seek community participation in the preparation of the three year strategic plan, the CIP and the financial plan.

Communities should be involved in the identification of investment areas, service provision, prioritisation of projects, identification of funding sources as stipulated in the GTP ("Enhance taxpayer's awareness on tax and improve public relations"), and the regional proclamations and regulations on community participation.

The community should be informed of the capital and recurrent costs of such programmes. Citizens should be involved in the effective monitoring of the implementation of projects and programmes. Community participation improves the transparency, efficiency and effectiveness of the local authority's service provision.

When preparing the annual budget, the community should be consulted at each stage by city administrations. The ideal budget should involve a mix of 'bottom-up' and 'top-down' processes. The 'bottom-up' contribution comes from the local residents and business people and the 'top-down' contribution from federal and regional government. For example, it is important to involve the community if they are expected to make a contribution to projects or services either in cash or kind ('bottom-up'). By doing so, their trust in city administrations will be reinforced. On the other hand, tax compliance must be enforced 'top-down' by the public authority.

There are three main ways that Participatory Budgeting is regarded as offering benefits.

1. It can improve the democratic process, widening participation and re-invigorating the role of local authorities, local councillors and civil society, and increasing trust in public institutions.

2. It can improve the effectiveness of public spending by improving the way money is invested, how service provision is monitored, and by increasing the knowledge available to the local authority and public bodies when undertaking service planning.

3. Finally it strengthens the community and voluntary sector by investing in services essential to poorer communities, hence enabling their development, by increasing the number of people taking part in local democratic processes. It builds social capital by creating forums for local groups to meet, negotiate and take decisions together.

The following table shows how and when citizens shall participate in the budget process stages.

Figure 8: Citizens' participation in the budget process

What happens?	• CA sector offices prepare work plan • Revenue department estimates CA's revenue of the year • OFED prepares draft budget	• OFED presents recommended budget to city council • City council approves and appropriates budget • OFED notifies budget to CA sector offices	• Implementation of budget by CA sector offices	• Auditing of public bodies
	April-June	June	June-July	June-July
What are the budget stages?	**Budget preparation stage** • Budget planning • Budget proposal • Budget approval	**Legislative adoption stage** • Budget appropriation • Notification	**Budget execution stage** • Disbursement and accounts	**Summary of transaction stage** • Audit and inspection
How can citizens participate?	• Give inputs on annual proposed physical plan and budgeting at Kebele level • Identify community contribution for the year	• Attend Council budget approval meeting • Get information from OFED • Get information from local radio or notice board or gazette	• Participate in the evaluation • Question sector offices about budget implementation performances (public hearing) • Check accounts and disbursement reports • Look into project implementation reports	• Participate in public meetings on audit report of CA

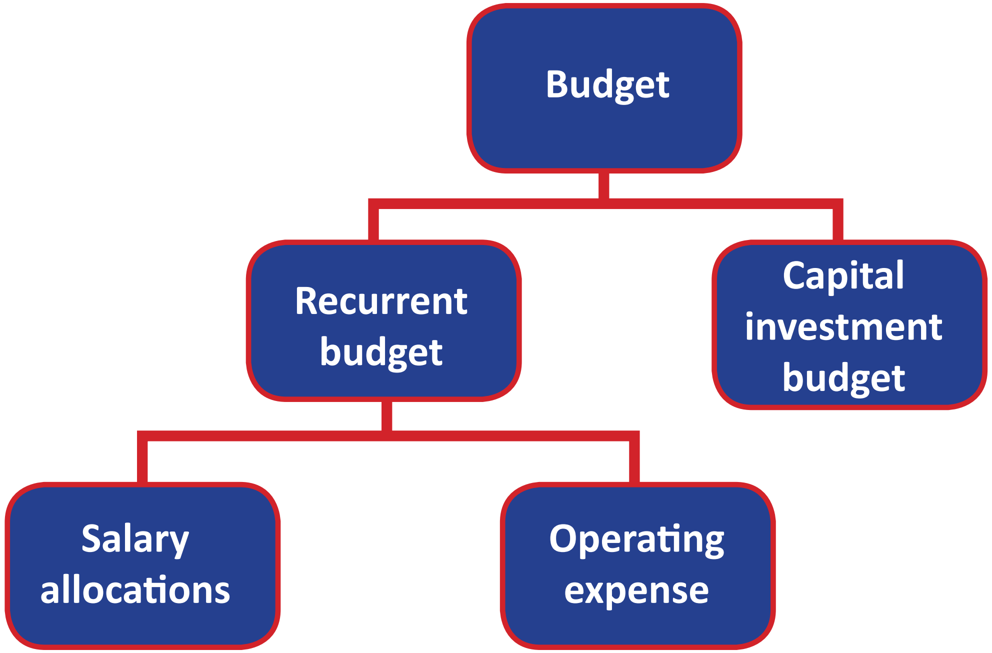
For more information on participatory budgeting, please refer to the Capital Investment Planning Guide.

3.3 Assess expenditures of cities

City administrations have two major budget lines: one used for salary payment and operating expenses, the other one for capital investment (see figure 9).

Expenditures must be analysed from different angles (see annex 1, tables 6 and 7 on the CD). City administrations should:

Figure 9: Budget expenditure of city administrations



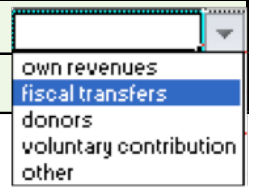
- List and analyse items of recurrent and capital expenditures over the last three years in the budget;
- Assess the ***sources of finance*** for each type of expenditure. City administrations collect charges and taxes from service delivery (as their own source), grants from regional government, loans and contributions from different sources. This allocation is not yet being practiced by most city administrations but should ideally be introduced with the cost centre approach presented in step 5. The allocation of expenditures to revenue sources helps to visualise the extent of the gap. In the medium-term, recurrent expenditure should be financed completely by own revenue sources. In the long-term, the city administration should aim at financing all regular expenses, including recurrent and capital investments through own revenue sources;
- Assess the capacity of the city to implement the whole budget during different budget years by comparing the ***planned expenditures against actual performance.*** This will help to see the capacity and performance level of city administrations in terms of expenditure;
- Calculate the ***expenditure per capita*** (for both recurrent and capital expenditure) of the past three years and compare the results with another city with a similar sized population and economic base. This is a simple self-evaluation tool. City administrations should have access to figures from other cities in their region. Other performance data can be requested from the federal government. In general, the higher the per capita expenditures are, the better the service provision as well as city development. Low per capita expenditures reflects poor service provision;
- Identify the ***controllable and uncontrollable costs*** of the city in order to help decision-makers decide which controllable costs to cut. Controllable costs are costs that can be

influenced or managed, i.e., in this case by the cost centre head. Controllable costs are for example staffing, advertisements and overtime work. Uncontrollable costs cannot be influenced by any individual. Some examples include depreciation, rent and all other fixed costs outside the cost centre's control.

The ***financial balance*** (see also page 22) tells you to what extent the revenue will cover expenditure. Based on this outcome, city administrations know how much more revenue they need to generate. Strategies on how to do that are presented in the following chapter. Yet, in a difficult situation, an increase in revenue might just cover the committed expenditure, and as a result this will require the elimination of all other uncommitted proposals. If the budget can still not be balanced, reductions in committed expenditures have to be made. The normal approach would be to first look for reductions in overhead expenditures, and if this is not enough, cuts in services might have to be considered. The balance between recurrent and capital outlays is one of the important areas cities should monitor. Greater activity devoted to the annual budget and capital should result in citizens becoming more satisfied.

Figure 10: Analysis of expenditure items

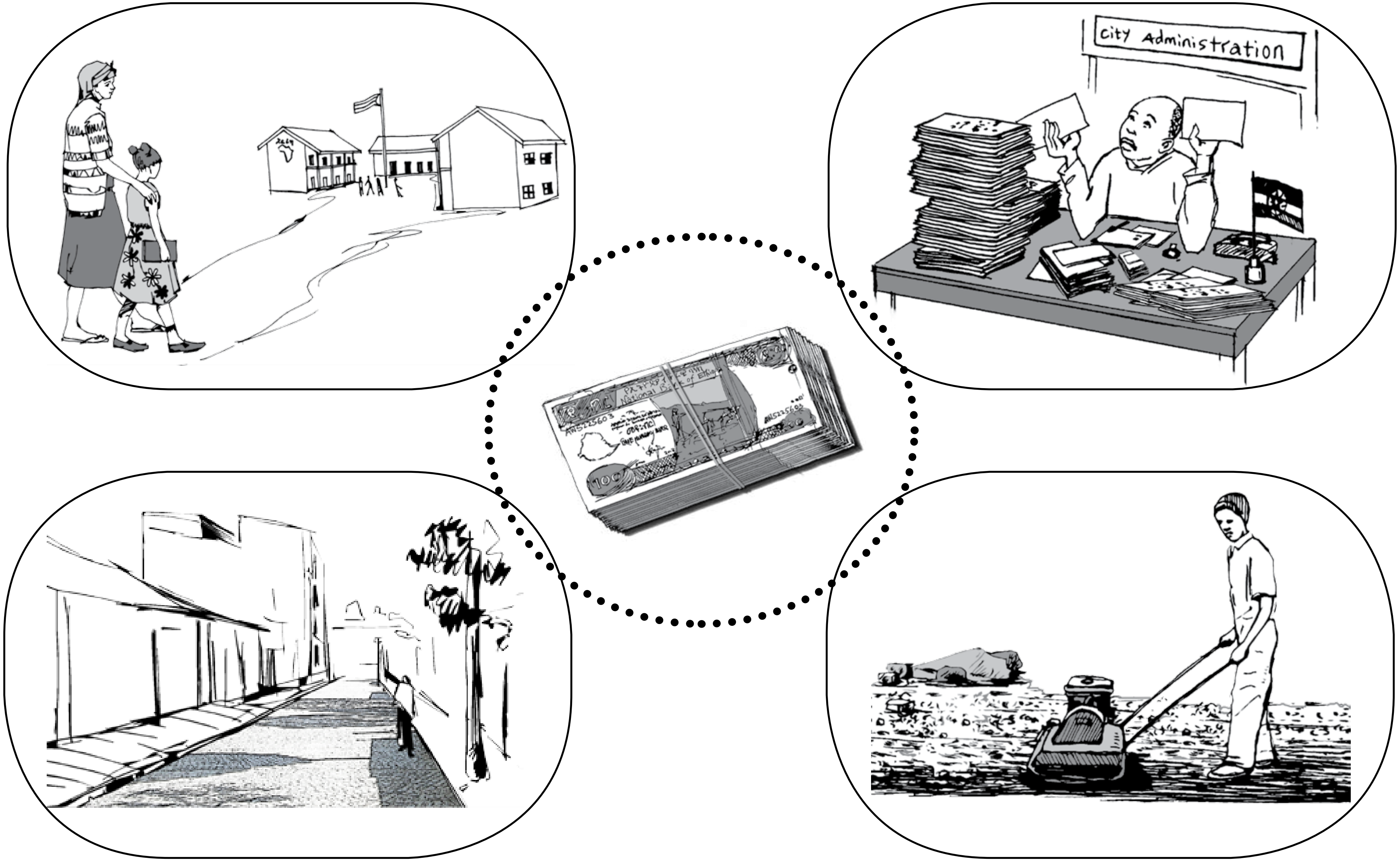
S/N	**Expenditure items**	**Account no**	**Total population:**			
			Planned expenditure	**Actual expenditure**	**Actual vs planned**	**Source of finance**
1	**Total municipal expenditures (recurrent & capital)**	**6100 - 6400**				
1.1	*Total municipal capital expenditures*	*sum 1.1*				
1.1.1	*Personnel Services*	*6100*				
1.1.2	*Goods and Supplies*	*6200*				



After having analysed the expenditure items, they should be compared to the revenue (see annex 1, table 8 on the CD).

Figure 11: Financial balance

	Last year	**2 years ago**	**3 years ago**
Actual own source of revenue			
Actual expenditure			
Financial balance/revenue vs expenditure			



Revenue management nurtures healthy functional cities

Checklist Step 3: Analysis of past performance

Tasks	Details	References
☑ 3.1 Align with Expenditure Management and Control Reform Programme	✓ Follow the principles of Efficiency, Effectiveness and Economy ✓ Analyse value for money ✓ Develop mid-term fiscal planning ✓ Prepare strategic plan for 3-5 years ✓ Involve the public when preparing strategic plans ✓ Implement cost-centre budgeting (see also Step 5) ✓ Avoid misuse of public funds ✓ Get annual audit reports within 6 months after the end of every fiscal year ✓ Consider the goals and objectives established in the GTP ✓ Review expenditures thoroughly if financial balance is negative	• Page 21 • Annex 1 Table 5 on CD • for cost-centre budgeting see step 5
☑ 3.2 Budget wisely	✓ Ensure public participation • Use the participation manual of MUDC • Mobilise public participation in forms of cash, labour and skill • Seek active community participation in the preparation of 3 years strategic plan ✓ Use 'top-down' and 'bottom-up'-processes for budgeting.	• Page 22-24 • Participation Manual of MUDC, Annex 14 on the CD
☑ 3.3 Assess expenditures of cities	✓ Clearly distinguish capital and operating expenditures ✓ List and analyse items of recurrent and capital expenditures of last three years ✓ Assess sources of finance for each type of expenditure ✓ Compare the planned expenditures against the actual performance ✓ Calculate the per capita expenditure of the past 3 years and compare data with another, similar city ✓ Identify the controllable and uncontrollable costs of the city ✓ If costs overrun, try to balance budget by reducing unnecessary expenditures	• Page 25-27 • Annex 1, tables 5, 6, 7 and 8 on the CD

Exercises Step 3: Examination of expenditure management

3.1 The strategic plan of city administrations should be prepared covering a period of:

A. 3-5 years
B. More than 5 years
C. 1 year
D. 1-3 years

3.2 City administrations should harmonise and implement the expenditure management and control mechanism. Which of the following topics is not included in the Expenditure Management and Control Reform Programme of the Civil Service Reform of the Ethiopian government?

A. Accounting
B. Top Management
C. Budgeting
D. Procurement
E. Auditing and internal control

3.3 The annual budget of cities does not include:

A. Revenue to be collected from diversified sources
B. The regional budget
C. Annual expenditure budget for both capital and recurrent expenditures
D. Measurable performance indicators for each revenue item

3.4 Which is the highest entity of a city administration?

A. City administrators
B. Police
C. City court
D. City council

3.5 City administrations should identify their controllable and uncontrollable costs in order to help decision makers decide on which controllable costs to cut. Which of the following is a controllable cost?

A. Rent expense
B. Overtime work
C. Deprecation
D. Fixed annual insurance premium

3.6 The ideal budget should involve a mix of 'bottom-up' and 'top-down' processes. Which is the correct match?

A. 'Bottom-up': citizens and business people to government
B. 'Bottom-up': federal to regional government
C. 'Bottom-up': federal government to business people
D. 'Top-down': government to citizens and business people
E. 'Top-down': local residents to regional government

3.7 Which of the following activities are conducted in the preparation stage of the budget process?

A. Budget planning
B. Budget proposal
C. Budget approval
D. Budget appropriation

Step 4

Strategies to increase revenue administration efficiency

4.1 Broaden tax base

4.2 Increase tax coverage

4.3 Consider tax rate and ratio

4.4 Valuate and assess taxes

4.5 Maximise collection ratio

4.6 Evaluate payment procedure

4.7 Implement appropriate enforcement mechanisms

4.8 Develop human resources and capacities

Guiding Questions

» What are typical efficiency problems of revenue administrations?

» How can we estimate the potential revenue yield from an improved administration?

» What are the factors directly impacting on the revenue yield?

» What strategies can be applied to enhance revenue administration efficiency?

In this step, you are required to:

✓ Calculate the potential revenue yield.

✓ Understand and analyse efficiency problems of revenue administrations.

✓ Determine the specific efficiency problems of a revenue administration.

✓ Identify and apply appropriate measures for enhancing the efficiency of the revenue administration.

Introduction

In step 4 problems related to the efficiency of revenue administration are identified (see annex 1, table 4 on the CD). Plausible strategies to increase revenue administration efficiency need to be examined:

- Initially the amount of revenue generated from each financial source (tax, charge or user fee) needs to be calculated.
- Utilising the equation made up of the five tax item components, the potential revenue yield can be estimated.
- Key areas of revenue administration such as tax base, tax rate, tax coverage, tax valuation and tax collection have to be examined regarding potential improvements.
- Further, elements impacting on the revenue yield such as payment procedures, enforcement mechanisms, human resources and tax administration capacities have to be assessed.

Please have a look at annex 1 on the CD when examining this step.

The elements of revenue enhancement can be summed up in a simple equation:

Tax Revenue = Tax Base x Tax Coverage Ratio x Valuation Ratio x Tax Ratio x Collection Ratio

Using the above model to calculate revenue makes it possible to estimate the potential revenue yield from an improved administration. Holding the tax base and tax rate constant, it should be possible to almost double the tax yield merely through administrative improvements to expand the coverage, valuation and collection ratios. This clearly shows that the revenue potential from improving administrative efficiency is significant.

For example, if all other factors remain stable, an improvement of 20% in the tax coverage, valuation and collection can result in an increased tax yield of 72.8%.

$$\frac{118{,}540{,}800 - 68{,}600{,}000}{68{,}600{,}000} \times 100 = 72.8$$

or

$$\frac{118{,}540{,}800}{68{,}600{,}000} - 1 \times 100 = 72.8$$

Leaving the base and the rate constant and working on collection, coverage and valuation brings an increase in revenue yield. A detailed discussion of each tax component follows below.

The elements that impact directly on the revenue yield include payment procedures, enforcement mechanisms, human resources and tax administration capacities.

4.1 Broaden tax base

Ethiopia, like most other developing countries, is challenged with widening its tax base largely because of the high unemployment rate and the low income levels of its citizens.

The tax base refers to the ***overall value of the economic unit*** (including individuals, enterprises, etc.) under tax consideration. This is generally represented by the region's or city's GDP. Urban local governments should consider that the tax base is more of a concern for macro-economic planners. However, the base does not necessarily refer to the overall economy but may be a particular sector or taxable group. Increasing the tax base should be directly related to economic growth measures and pro-economic development strategies.

Figure 12: Example for tax potential calculation

Tax Potential Birr 200,000,000				
2004 ratios and tax yield			**2005 Ratios and Tax yield**	
	Ratio	**Tax yield**	**Ratio improved by**	**Tax yield**
Tax base	*Constant*		*Constant*	
Tax rate	*Constant*		*Constant*	
Tax coverage	*70%*	*200,000,000 x 70% = 140,000,000*	*20%*	*200,000,000 x 84% = 168,000,000*
Tax valuation	*70%*	*140,000,000 x 70% = 98,000,000*	*20%*	*168,000,000 x 84% = 141,120,,000*
Tax collection	*70%*	*98,000,000 x 70%= 68,600,000*	*20%*	*141,120,000 x 84% = 118,540,800*
Existing tax yield in 2004				*68,600,000*
Tax yield by improving tax administration in 2005				*118,540,800*

4.2 Increase tax coverage

The coverage ratio measures the extent and number of tax rolls that exist at a relevant revenue collection office. In general, a comprehensive list and an efficiently organised database are essential for optimising tax collection. At present, only Addis Ababa and Dire Dawa have introduced the 'Standard Integrated Government Tax Administration System' (SIGTAS) at city level. Over the coming years all city administrations should use this facility. Considering this, city administrations should start to collect relevant information.

Focus should be put on the following recommendations and respective concrete measures to be taken.

Figure 13: Recommendations for improving revenue administration efficiency

Recommendations	Concrete measures to be taken
1. Set up better communication between various agencies for better tax coverage, specifically with branches of the Revenue Authority, Investment Agency, Transport Office, Chamber of Commerce and Office of Trade and Industry	• Government Bureaus and Offices are required to identify if taxpayers have met their tax obligations before providing renewal service of licenses • Provide information to Revenue Office about new taxpayers at the time of issuance of new licences • Organise regular evaluation forums to strengthen cooperation
2. Train inspection teams in each Kebele on property tax, charge and fee administration and provide them with all necessary information and guidelines when doing a house-to-house inspection	• Design guidelines for inspection • Provide training to inspection teams • Evaluate the changes • Reward best performers
3. Give rewards for those who successfully discharge their responsibility in paying their tax liabilities and encourage exemplary staff members of the revenue office	• As suggested by Ethiopian tax law, Revenue Authorities shall reward taxpayers for outstanding performance (details can be found in the Income Tax Proclamation No.286/2002, Article 85) • Give media coverage for good taxpayers (e.g. major companies that pay before the deadline could be complimented on the media) • Recognise staff's achievement in improving the efficiency of the revenue system (e.g. congratulate employee in staff meeting and provide positive feedback in staff assessment).
4. Compare and adjust the number of registered taxpayers with that of other relevant offices such as offices that provide Taxpayer Identification Numbers to all registered tax, charge and fee payers as by law	• Collect a list of names and basic information of taxpayers from government offices and NGOs (Transport, Trade, Education, Health Office, etc.) • Establish good relations with the Chamber of Commerce in order to get more information about taxpayers • Compare and update taxpayers' registration based on lists and information received from other relevant offices • Maintain the taxpayers' registration documents both in soft and hard copy • Use this updated taxpayers list as a basis for assessment, determination and collection of taxes and fees

Recommendations	Concrete measures to be taken
5. Use Tax Identification Number (TIN) to identify taxpayers	• Register all taxpayers and collect relevant information to prepare TIN for each taxpayer • Develop format and prepare TIN • Provide TIN to taxpayers
6. List the registered tax, user charge and fee payers from existing documents according to their Kebeles	• Prepare formats by which all necessary information is collected by the Kebele • Inform Kebeles about the importance of the information and their responsibility
7. Analyse the collected data of potential taxpayers and include the new taxpayers in the tax net	• Divide each Kebele into zones to check if there are unregistered taxpayers • Design and plan how these new taxpayers should come under the tax net
8. Perform continuous inspections to enlist liable taxpayers within regular intervals	• Exchange data and information with other stakeholders for follow-up (a stakeholder analysis can be found in annex 3 on the CD) • Explain the responsibilities for all stakeholders for submitting complete and clear data to the revenue office • Conduct random verifications of data received
9. Compare the status of coverage (taxpayers) of each tax item with other items	• Prepare tax coverage ratio first for lucrative revenue items (many taxpayers), such as business tax and land lease • Compare the ratio of one revenue item to another revenue item (e.g. Someone who pays a land lease, is likely to have a house and is therefore subject to property tax) • If the comparison shows a large difference, identify the possible reasons for difference in revenue item coverage • Develop a strategy to narrow the gap

4.3 Consider tax rate and ratio

The tax ratio is the weighted average of specific tax rates usually determined by legislative decree. These rates are rarely changed and are only occasionally adjusted or reduced to correspond with a change in economic realities. The tax authority has a responsibility to monitor the effects of the rates and the impact the rates have on economic activity. The authority should advise the legislature on future changes. Avoidance may exist if a tax rate is too high. However, valuable fiscal resources might decline if rates are too low.

Together with the revenue office, a city administration should closely and regularly ***monitor the appropriateness of tax rates*** taking into account the economic reality. A simple question can help to evaluate the appropriateness of the tax rates: Does the planned revenue cover the planned expenditure? Municipal tax rates are determined according to the tasks that city administrations have to fulfil. City administrations should assess the rates or tariffs for each service at least every two years and contact the regional BUDC to request a tariff revision whenever necessary. This assessment should include an economic situation analysis (taking into account the inflation rate, buying power, etc.) and a survey of taxpayers to measure the taxpayer capacity.

4.4 Valuate and assess taxes

The valuation ratio identifies the extent to which the taxable unit has assessed its market value. The valuation ratio is much more sophisticated than the coverage ratio that seeks to merely identify the taxable resource. As a result:

- City administrations must compare on an on-going basis the economic unit with its ***market value***. This implies that city administrations have a good estimation of annual expenditure and sales of taxpayers. Data has to be collected on inputs and processing costs incurred as well as revenue generated by taxpayers. To do this, city administrations should have professionals who can set mechanisms as to how to assess taxpayers;
- City administrations must create a clear procedure and encouragement for self-evaluation, for instance through self-assessment mechanisms, in order to reduce the revenue office workload and enhance compliance. Currently, only annual income declaration forms exist which are frequently completed incorrectly. Tax education programmes should be implemented to improve the completion of the income declaration forms.

4.5 Maximise collection ratio

The collection ratio is the percentage of due taxes, fees or charges actually collected. Arrears are all unpaid taxes to the government. In order to increase revenue generation, the first exercise is to summarise the recent arrears. Table 6, page 17 can serve as a template for this. Furthermore, attention should be given to the following issues:

- Large, medium and small-size businesses that are estimated to significantly contribute to the revenue and are known for having difficulties in paying their taxes (several files/entries) should be closely observed. A reminder letter should be sent to them a few weeks before the pay-day. This letter should open the doors for the managers to contact the revenue office for information on their tax liability. If this does not help, the legal procedure should be launched as early as possible;
- Identify the basic reasons for non-compliance by taxpayers with the regulations. In order to do so, randomly ask entities whom you have identified as not paying taxes why they did not comply;
- Understand that many cases of non-compliance are related to unawareness. Therefore, a strong and continuous awareness campaign with a clear and simple tax explanation (who has to pay what, when and to whom?) and usage (how is my money being used thereafter to my own and/or my community's benefit?) is fundamental to increase tax compliance;
- Abolish small, inefficient taxes with high costs of administration and collecting. To do so, check on your revenue items list to see which items generate the least revenue (see annex 1, tables 2 and 3: "actual revenues" on the CD). Then compare this revenue to its cost of collection (human resources used to identify taxpayers, to collect the taxes, to follow-up non-payers, etc.). This will help to reduce the recurrent budget. Alternatively, these 'saved' human resources can be assigned to managing more lucrative revenues;
- Evaluate both uniform and timely cases of arrears. A long period of non-payment usually also means the money is less likely to be paid in the future. Practice shows that higher levels of active enforcement through use of fines leads to an overall increased compliance;
- Compile accurate, timely and comprehensive information;
- Allocate sufficient professional resources for revenue collection.

4.6 Evaluate payment procedure

Payment procedures can be designed and implemented more efficiently by:

- ***Shortening payment procedures:*** Heavy bureaucratic payment procedures are very time consuming for most taxpayers, therefore, city administrations should devise means to shorten payment procedures;
- ***Encouraging self-assessment:*** encourage taxpayers to declare their annual income and tax liabilities on their own, perform sample checks and if correct, give a reward for being honest;
- ***Establishing different means of payment:*** payment through different private banks, post offices, credit and saving institutions, internet services, etc.;
- ***Organise payment schedule:*** city administrations could establish a payment schedule to avoid long waiting times on the due day and overburdened revenue officers. Additionally, enforcement could be practiced faster and more systematically. An option could be to group people according to their family names (e.g. Citizens whose family names start with A-E come on X date, from F-J on X date, etc) or according to Kebele (people who live in X Kebeles come on X date, in X other Kebeles on X date, etc). However, this option cannot be established yet since current tariff regulations give liberty to taxpayers to pay their taxes at any time within the defined period (e.g. category "C" taxpayers can pay between July 1 and July 30). A change in this respect would need the approval of the Regional Cabinet.

4.7 Implement appropriate enforcement mechanisms

In many city administrations serious attention to arrears management and enforcement is lacking. It is advised to:

- Clearly communicate the enforceable legal codes in place;
- Introduce and put in place a clear uniform appeal process;
- Conduct regular information forums for taxpayers;
- Design, print and distribute explanatory leaflets where taxes are explained and also the consequences of not paying them;
- Use other media channels to inform and create awareness at the taxpayer level on the consequences of tax non-compliance;
- Provide timely information and data on defaulters from the collection section to the legal service to enable persecution;
- Take appropriate legal actions on tax defaulters. In case of a shortage of human resources, prioritise how contributors (large, medium and small enterprises, etc.) should be treated;
- Carefully review fines. Fines should be designed to punish but not so large as to financially prohibit payment. Individual reviews for the largest arrear cases should be made.

4.8 Develop human resources and capacities

The first step in enhancing the capacities of the revenue office is to acknowledge the importance and responsibilities of it. This suggests a ***clearly defined institutional structure of local revenue offices with separate budget allocation.*** Many problems stem from inadequately prepared revenue staff. Better trained staff will directly improve coverage, valuation and collection ratios for many revenue sources. A well-trained office could educate the paying public to be more efficient in paying. The manpower system should be organised in such a way to enable city administrations to keep employees that are motivated, well-paid and effectively trained to do their jobs. A reasonable amount of the annual budget should be allocated to enable offices to perform their work tasks. Filling the existing vacancies is another important issue to be considered.

The second step would be to introduce in each revenue office a ***staffing plan*** based on a needs assessment detailing the tasks and responsibilities of the office. Based on this, the necessary staff number and their respective tasks and responsibilities should be determined. As a result, each employee should have clearly defined terms of reference (ToR) and be monitored by a superior. A tentative training or staff development plan for employees should be included in the ToR to improve capacities for the growing number of tasks to be performed and in order to motivate the employees to remain in their jobs. Each year, the revenue office should look into the staffing plan and revise it as necessary. The staffing plan, including the needs analysis, should be presented annually to the Regional Revenue Authority, the Mayor and OFED Head.

Well-trained and motivated employees are key to revenue enhancement
Photo: Michael Tsegaye

Checklist Step 4: Strategies to increase revenue administration efficiency

Tasks	Details	References
☑ Estimate potential revenue yields through improved administration	✓ Calculate: Tax Revenue = Tax Base x Tax Coverage Ratio x Valuation Ratio x Tax Ratio x Collection Ratio ✓ Hold tax base and tax rate constant and calculate potential increase of tax revenue through improving tax coverage, tax valuation and tax collection	• Annex 1, table 4 on CD • Page 31 (Figure 12)
☑ 4.1 Broaden tax base	✓ Examine the option of broadening the tax base • More of a concern for macro-economic planners • Increasing tax base needs to be directly related to economic growth measures and pro-economic development strategies	• Page 31
☑ 4.2 Increase tax coverage	✓ Start to collect relevant information on tax coverage ✓ Use 'Standard Integrated Government Tax Administration System' (SIGTAS) ✓ To improve revenue administration efficiency • Setup better communication between agencies • Train inspection teams • Give rewards for loyal customers • Consolidate database with other tax agencies • Use Tax Identification Number (TIN) • List the registered tax, user charge and fee payers • Analyse the collected data of potential taxpayers • Perform continuous inspections • Compare the status of coverage for each tax item	• Page 32 & 33 (Figure 13)
☑ 4.3 Consider tax rate and ratio	✓ Monitor the appropriateness of tax rates ✓ Assess tariffs and rates of all services at least once in two years and contact the regional BUDC to request revision of a tariff whenever necessary • Assessment of tariffs and rates must consider the economic situation • Conduct a survey to measure taxpayer capacity	• Page 33

☑ 4.4 Valuate and assess tax	✓ Establish mechanisms for assessing taxpayers ✓ Compare any economic unit with its market value continually ✓ Create a clear procedure and encouragement for self-assessment ✓ Implement tax education programmes	• Page 34
☑ 4.5 Maximise collection ratio	✓ Summarise recent tax arrears, evaluate arrears using annex 1, table 7 on CD ✓ Observe large, medium and small size businesses that have trouble paying taxes ✓ Identify basic reasons for non-compliance ✓ Create strong and continuous tax awareness campaign ✓ Abolish small and inefficient taxes ✓ Evaluate both uniform and timely cases of arrears ✓ Compile accurate information ✓ Allocate sufficient resources for revenue collection	• Page 34 & 35 (Figure 13) • Annex 1, table 7 on CD • Annex 1, tables 2 and 3: "actual revenues" on the CD
☑ 4.6 Evaluate payment procedure	✓ Shorten payment procedures ✓ Encourage self-assessment ✓ Establish different means of payment ✓ Organise payment schedule	• Page 35
☑ 4.7 Implement appropriate enforcement mechanism	✓ Clearly communicate the enforceable legal codes ✓ Create a clear and uniform appeal process ✓ Conduct regular information forums for tax payers ✓ Distribute explanatory materials on the benefit of tax compliance and consequences of non-compliance; Additionally use other media (e.g. Radio, TV) to create awareness ✓ Produce timely data on defaulters and take appropriate legal actions ✓ Review fines	• Page 36
☑ 4.8 Develop human resources and capacities	✓ Equip the revenue staff appropriately with knowledge and material ✓ Allocate reasonable annual budget to enable offices to perform their task ✓ Fill existing vacancies ✓ Introduce staffing plan and produce terms of reference for each employee ✓ Revise staffing plan when necessary	• Page 36

Exercises Step 4: Strategies to increase revenue administration efficiency

4.1 Match the definitions in column "A" with the appropriate terms in column "B".

Column A: Definitions

A. The overall value of the economic unit under tax consideration

B. Measures the extent and number of tax rolls that exist at a relevant revenue collection office.

C. The weighted average of specific tax rates determined by legislative decree.

D. The percentage of due taxes, fees or charges actually collected.

E. Identifies the extent to which the taxable unit has assessed its market value.

Column B: Terms

1. Collection ratio
2. Tax ratio
3. Coverage ratio
4. Valuation ratio
5. Tax base

4.2 Which of the following measurements is not advised to be implemented by city administrations as a means of giving serious attention to arrears management and enforcement?

A. Clearly communicate the enforceable legal codes in place.

B. Introduce and put in place a clear uniform appeal process.

C. Avoid conducting regular information forums for taxpayers.

D. Design, print and distribute explanatory leaflets where taxes are explained and the consequences of not paying them.

E. Use other media channels to inform and create awareness at the taxpayer level on the consequences of noncompliance.

4.3 Comparing and adjusting the number of registered taxpayers with that of other relevant offices (e.g. offices that provide Taxpayer Identification Numbers to all registered tax, charge and fee payers as by law) is a challenge to tax administration. Which of the following measures are not appropriate to address them?

A. Collect a list of names and basic information of taxpayers from government offices and NGOs.

B. Establish good relations with the Chamber of Commerce in order to get more information about taxpayers.

C. Compare and update taxpayers' registration based on lists and information received from other relevant offices.

D. Maintain the taxpayers' registration documents both in soft and hard copy.

E. Design guidelines for inspection.

4.4 In 2001 Mekele city administrations tax coverage amounted to 75% (150,000). From these 75%, 75% were valued. Of this valued 75%, 75% were collected. In 2002 Mekele has introduced strategies to increase tax coverage, valuation and collection each by 10%. What would be the tax yield by improving tax administration?

4.4 In 2003 Semara revenue office collected ETB 70,600 revenue. The tax collection rate was 50%. In 2004 Semara has planned to collect at least ETB 100,000. What is the required increase of the tax collection rate in order to meet the target.

Step 5

Setting up a cost accounting system

Guiding Questions

» Why are city administrations often not able to correctly fix their charges?
» Whose responsibility is the task of costing services and products?
» What is a cost centre?
» Which steps need to be implemented for proper cost accounting?
» What to do with cost information?

In this step, you are required to:

✓ Set up cost centres.
✓ Calculate costs of products and services in order to correctly fix the charges and fees for full or partial cost recovery.
✓ Use cost information for (advising) decision-making.

Introduction

Until today, cities have no cost accounting system that operates on its own and correctly reflects the full costs of services and products. Hence, cities are institutionally handicapped to competently price their services and products.

In due recognition of this deficit, city administrations should set up a functional cost accounting system. When putting this system in place, the first step is to set up cost centres for clearly defined municipal services. The costing department of each OFED captures all costs, calculates them and allocate these to cost centres. To that effect, cities are advised to employ a cost centre approach whenever preparing their annual budgets. After having created cost centres, the costs of the services these cost centres provide have to be calculated.

Please have a look at annex 5, chapter 3 on the CD when examining this step.

There are five basic steps in setting up a cost accounting system for city administrations.

5.1 Create cost centres for services

The first step for setting up a cost accounting system is the creation of cost centres. A cost centre is a unit to which budget is allocated for specific services.

Since city administrations and municipalities should relate their income and expenditure to the services they provide, it is essential that the budget should be prepared in accordance with the cost centre's approach. Ideally embedded in each major service centre, a cost centre is a management unit that helps to map resource allocation to the organisational structure of city administrations. By doing so, it promotes efficiency in terms of allocating the limited resources to different competing needs. Creating cost centres is also important for determining adequate prices for services and increasing revenue from services provided to users.

The generally accepted principle for creating cost centres is the identification and clear assignment of responsibility. That means the officials who are assigned certain responsibilities are entitled to get public funds, i.e., funds from city administrations, in accordance with the budgeted figures. Major aspects to consider when establishing cost centres include:

- Cost centres have to be created after a thorough study and analysis of the city administration's organisational structure and work processes in order to map the city administration's financial resources for management/responsibility units and for rationalising proper costing services;
- The cost centres should include all major service centres providing significant services such as solid and liquid waste management, street cleaning, park and beautification services;
- All other activities that cannot be categorised under major cost centre services should be put under auxiliary cost centre services.

Creating cost centres for auxiliary (support) services, like human resource management, and financial services, is necessary. They are common or shared services and should be combined in one cost centre as there is no need to analyse individual costs that incur to provide their services. The accumulated costs of these auxiliary cost centres, must of course, be entirely distributed and related to different line cost centres by allocating overheads or using indirect cost methods. For example, Solid Waste Management (SWM) is one cost centre in a municipality. The costing department under OFED is responsible to collect all cost data from the SWM unit and calculate the total cost of the service so as to determine the household solid waste collection service charge. Other examples include basic registration services or an infrastructure unit that is working in the same building. In this case, the rent of a building is a shared cost for the above-mentioned cost centres. In costing terminology, shared costs are known as overheads or indirect costs. Therefore cost centres should share the rent cost using an indirect cost allocation method, i.e., the rent is allocated to each cost centre according to the area or square meters occupied by each service unit (cost centres). Some of the methods of doing this are provided in the 'Cost Accounting Procedure Manual', which can be found in the annex 6, chapter 3 on the CD.

A line cost centre is a service providing unit such as a SWM unit, a liquid waste management unit, abattoirs, etc. It is recommended that city administrations should create line cost centres at least for the following services:

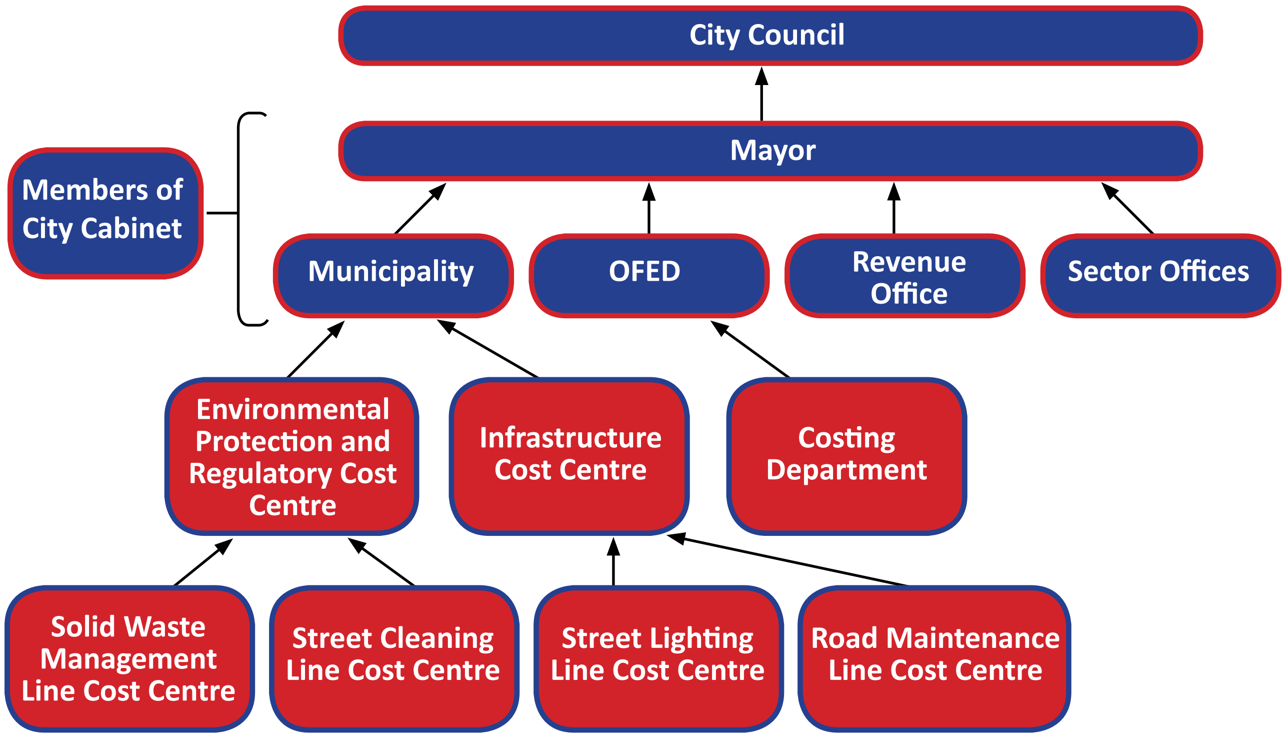
Environmental Protection and Regulatory Services

- Solid waste management
- Liquid waste management
- Street cleaning
- Car parking
- Sanitation
- Park and beautification services
- Technical services

Infrastructure services
- Street lighting
- Drainage and sewers
- Road maintenance

Auxiliary services
- Support for micro-business & local economic development
- Public education and library
- Abattoir services

Figure 14: Institutional organisation of a city



5.2 Costing municipal services

After having set up specific cost centres, the second step is to calculate the cost of the services these cost centres provide. This is done by so-called costing divisions at OFED.

City administrations and municipalities need information on the cost of goods purchased or sold and cost of services that are rendered or received for decision making on investments, pricing and other financial decisions. Ultimately, only after having calculated how much the product or service costs the local authority, full or partial cost recovery can be achieved.

Side note: Cost recovery means that all inputs into developing and offering a service or product are reimbursed. For example: A city administration spends 500.000 Birr every year on bus terminals (capital budget for terminal construction calculated over 20 years, annual maintenance and recurrent expenditures). It is calculated, that only 100 bus owners use these terminals per year paying in total 100.000 Birr per year. Hence, the investment is not cost efficient as 400.000 Birr are not covered.

Costing includes all costs of providing a service, not just those found in the budget or financial reports of the department responsible for the service. It focuses on the cost of the resources used to provide a service during a given period of time, regardless of when cash disbursements are made to purchase these resources. Hence, the purpose of costing is not only to collect cost data. Above that costing provides information that allows to make informed, and therefore better, management decisions.

Setting up a costing process involves several steps.

5.2.1 Select service(s) to be costed

The first step in costing is to choose services that should be costed. At this stage, the cost for each of the services provided by a particular department or cost centre has to be specified. It is advisable to first cost the services on which the city spends the most resources.

Further, it is required to specify the purpose of the cost study. What exactly do we want to know and how will we use this information afterwards? Is it the cost of all resources used to provide the service? The cost of performing one job? The cost of expanding the service?

After identifying the services whose cost is to be determined and the purpose of the study, it is important to determine how a service can be measured. A definition of the product or service and its quantity provided (for example kilometres of road to be paved or number of traffic police officers active). Following this, the nature of the **unit cost** can be determined (for example Birr per km of road paved or salary per day for a traffic police officer). A unit cost is the average cost of providing one unit of service.

$$\frac{\text{Cost of services}}{\text{Number products}} = \text{Unit Cost}$$

5.2.2 Collect cost information

The first information to look for is how much was spend on the service studied. Relevant evidence can be found in expenditure records such as general and subsidiary ledgers, warrants for payments, expenditure reports and others. Further information can be found in budgets and non-financial records such as equipment purchase, maintenance records, payroll and personnel records. If no evidence for a specific service exists, a short study should be conducted to identify the costs. How long this study should take, depends on the nature of the service. Building a road for example is a variable cost. The cost of cobblestones can change with the kilometres of road being constructed. Also, some services may be more expensive in the rainy season. In general, two (2) to four (4) months may be enough to survey a regular service.

For processing a business registration this study should capture labour in providing this service, supplies, equipment, facilities and purchased services. Once these resources have been identified, their costs can be collected.
The directives on municipal fees and charges adopt a modified form of full cost accounting when estimating the cost of each service for which charging already applies or for which it may apply in the future:

- The direct cost of the particular service or product, and
- The indirect cost to provide this service.

The direct costs of the services are those costs that are related directly to providing the service or product. These types of costs naturally vary with the volume of services provided. Direct costs of services would include salary cost of staff employed directly in providing the particular service. The cost of materials and other supplies in rendering that service are also considered as direct costs. For example, if a city administration builds a road, the cost of the construction materials and the cost of the road workers are direct costs—they are clearly traceable to the production department and to the item produced—so no allocation is needed.

Indirect costs refer to costs that are not directly linked to the service or product offered. They include for example buildings shared by more than one department or the salary payment of a city manager that services several sector offices. Indirect costs are incurred by city administrations as a whole and benefit the individual units and operations within the organisation. Currently there is no ‘standard’ rule for apportioning the indirect costs involved. Indirect costs are shared or pooled costs. In the example of road construction, indirect costs include the working hours spent on organising beforehand a participatory meeting with citizens to decide on this project.

These costs are usually shared costs for several services. It is essential to establish a good cost allocation base to pro-rate indirect costs.

To calculate the total cost of the production department or to calculate each product's total cost, it is necessary to allocate some of the rent (and other indirect costs) to the department and to the service/product. The following example illustrates the calculation of the cost of a service.

Example: In the city administration XY the issuance of a house construction permit involves direct and indirect costs, based on the following assumptions:

1. The city administration adopts a policy of both full cost recovery and 80% cost recovery;
2. The total annual salary of technicians, clerks and engineers in the technical department is 50,000 Birr;
3. The blueprint and stationary used directly to provide the house construction permit is 5,000 Birr;
4. The total personnel department of the city administration that handles the personnel issue of the technical department is 20,000 Birr and it uses only 20% of its time for the technical department;
5. The total salary of the finance department is 40,000 Birr and only 10% of its time is used for the technical department;
6. The floor the technical department holds amounts to 25% of the total floor area of the city administration and the annual maintenance cost of the building is 10,000 Birr;
7. Utilities used for this purpose amount to 300 Birr;
8. The total number of customers is 100.

Figure 15: Calculation of service costs

	Direct costs	**Indirect costs**	**Total**
Salary of technical department	*50,000*		*50,000*
Utilities	*300*		*300*
Supplies & stationary	*5,000*		*5,000*
Salary of personnel department		*20% x 20,000 = 4,000*	*4,000*
Salary of finance department		*10% x 40,000 = 4,000*	*4,000*
Maintenance costs		*25% x 10,000 = 2,500*	*2,500*
Total cost	*55,300*	*10,500*	*65,800*

Using the above table to calculate annual total cost, the annual service charge is calculated as follows:

- Annual service charge = Annual total cost divided by number of customers

$$\frac{65{,}800}{100} = 658 \text{ Birr}$$

- Annual service charge at 80% cost recovery = Annual cost – 20% annual costs divided by the number of customers

$$\frac{65{,}800\text{-}20\%}{100} = 52{,}640/100 = 526{,}40 \text{ Birr}$$

Table 15 gives an example on how to calculate the full cost of a service. This table can be copied for other services, e.g., engineering and technical services, market centre service, livestock market and pounding of stray animals.

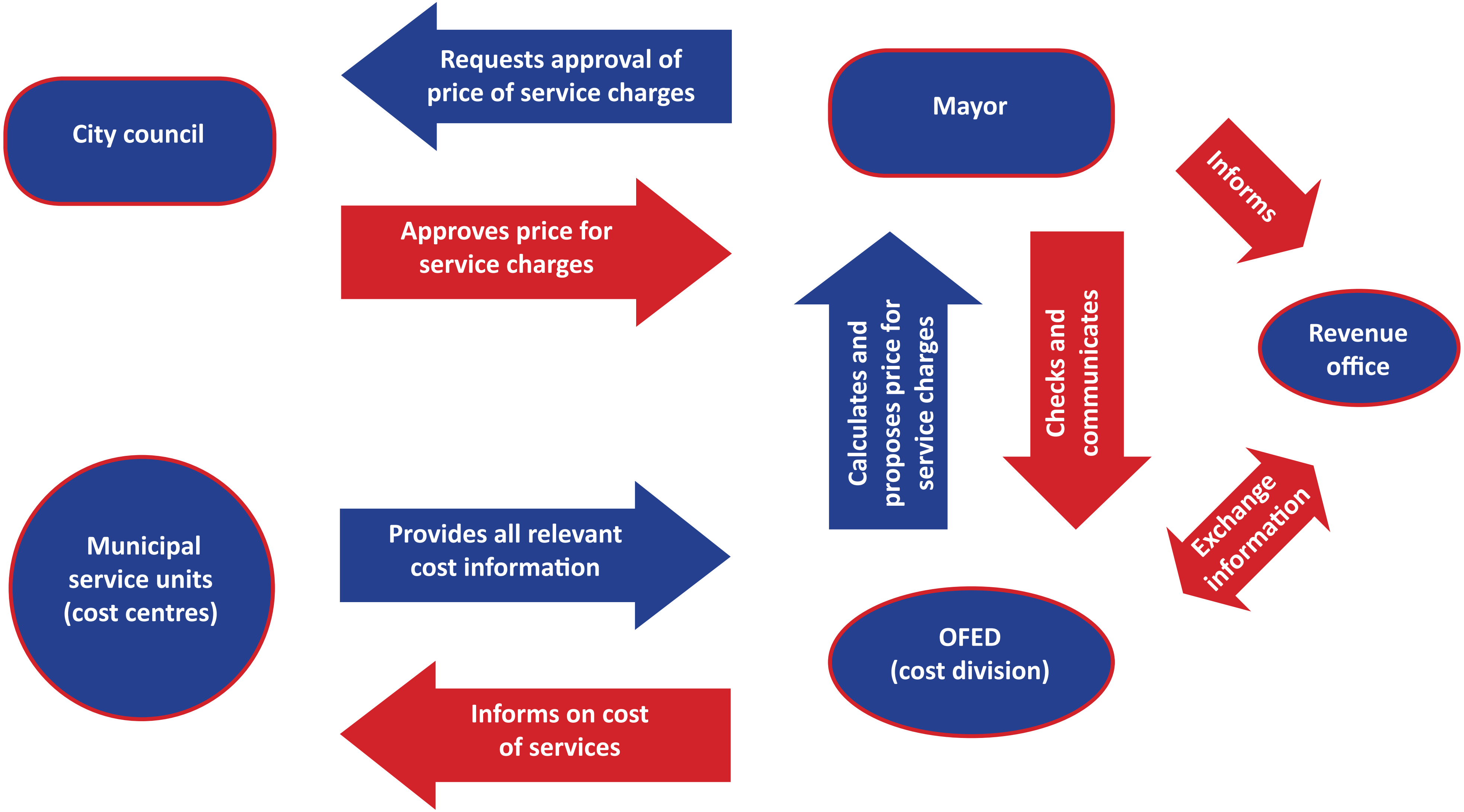
The reason for distinguishing between direct and indirect costs is to help identify all costs of providing services. Each city administration or municipality that does costing will categorise its direct and indirect costs differently, depending on how services are organized and how easily costs can be traced to them.

5.2.3 Use cost information

As presented earlier, the purpose of costing is not only to collect cost data, but also to provide information that can be used to make better management decisions in several areas:

1. Analysing the efficiency of municipal services: The efficiency of municipal services should be improved by providing relevant corrective measures and standing standards for quality and timely services. That means services should be provided at the lowest possible cost.
2. Taking budget decisions: Budgetary decisions are made through allocation of the scarce resources for the most priority are¬as and encouraging economic use of those resources without compromising on the quality of services intended to maximise the welfare of the society at large.
3. Pricing local services and determining intergovernmental charges on services rendered from one level of government to the other level of government or one department of government to the other department that can be regarded as cost centre: The urban local governments use these to decide the level of government that bears the burden for the cost of the respective service.
4. Choosing among alternative methods of providing services. All the alternatives to the city governments can be analysed here and the alternative with the least cost can be selected. This choice will allow determination of the place where a public-private partnership is required with the objective of minimising cost (see step 6).

Figure 16: Overview of the cost accounting processes



Cost centre administration staff informing citizens on costs of services
Photo: Michael Tsegaye

Checklist Step 5: Setting up a cost accounting system

Tasks	Details	References
☑ 5.1 Create cost centre for services	✓ Create cost centres • Clearly assign responsibilities to officials • Analyse the city administration's organisational structure and work processes for mapping the cities financial resources • Include all major service centres in cost centres • Put unclassified cost services as auxiliary combined into one cost centre ✓ Create line cost centres at least for the following services • Environmental protection and regulatory services • Infrastructure services • Auxiliary services	• Page 41-42 • Annex 6 chapter 3 on CD
☑ 5.2 Calculate the cost of services	✓ Select services to be costed ✓ Define service or product and quantity provided ✓ Define nature of unit for calculation of unit cost ✓ Capture all costs and calculate costs for municipal services by summarising • Direct cost of particular service • Indirect cost to provide this service ✓ Calculate annual service charge according to the following formula: • Annual service charge = Annual total cost divided by the number of customers • Annual service charge at 80% cost recovery = Annual cost – 20% annual costs divided by the number of customers	• Page 42-46

Exercises Step 5: Setting up a cost accounting system

5.1 The following is a list of basic steps in setting up a cost accounting system for city administrations. Arrange the steps in their proper sequential order.

A. Create cost centres for services

B. Collect cost information

C. Select service(s) to be costed

D. Use cost information

5.2 Which of the following is not an advantage of implementing cost centre budgeting:

A. Better financial management

B. Maintaining proper information about costs which are used to determine prices for service delivery

C. Maximised public spending

D. Improved efficiency

5.2 In the city administration of Bahir Dar the issuance of a house construction permit involves direct and indirect costs, based on the following assumptions:

- The city administration adopts a policy of both full cost recovery and 90% cost recovery;
- The total annual salary of technicians, clerks and engineers in the technical department is ETB 780,000;
- The blueprint and stationary used directly to provide the house construction permit is ETB 35,000;
- The total personnel department of the city administration that handles the personnel issue of the technical department is ETB 600,000 and it uses 20% of its time for the technical department;
- The total salary of the finance department is ETB 240,000 and 10% of its time is used for the technical department;
- The floor the technical department holds amounts to 25% of the total floor area of the city administration and the annual maintenance cost of the building is ETB 80,000;
- Utilities used for this purpose amount to ETB 6,000;
- The total number of customers is ETB 1,000;

a) What is the total amount of direct costs?

A. ETB 985,000

B. ETB 874,600

C. ETB 821,000

D. ETB 164,000

E. ETB 780,000

b) Calculate the annual service charge at full cost recovery?

A. ETB 985.00

B. ETB 874.60

C. ETB 821.00

D. ETB 780.00

E. ETB 896.50

c) Calculate the annual service charge at 90% cost recovery?

A. ETB 780.00

B. ETB 896.50

C. ETB 985.00

D. ETB 874.60

E. ETB 821.00

d) What is the sum total of indirect costs?

A. ETB 780,000

B. ETB 896,500

C. ETB 164,000

D. ETB 240,000

E. ETB 66,000

Step 6

Analysis of other means for increasing municipal revenue

6.1 Increase tax rate and adjust user charges and fees

6.2 Introduce new taxes, user charges and fees

6.3 Consider Public-Private Partnerships

6.4 Choose the right option

Guiding Questions

» What needs to be considered when adjusting or introducing tax rates, user charges and fees?

» What are the advantages and disadvantages of Public-Private Partnerships (PPP)?

» What other measures have to be taken prior to entering a PPP?

» What measures are suggested to motivate the private sector to invest in municipal programmes, projects and services?

In this step, you are required to:

✓ Consider all elements to design appropriate tax rates, user charges and fees.

✓ Evaluate pros and cons for introducing new taxes, user charges and fees.

✓ Understand the core concept of PPP.

✓ Analyse benefits and risks associated with the utilisation of PPP.

✓ Develop measures that city administrations have to undertake before engaging in a PPP.

Introduction

After having improved revenue administration (Step 4) and calculated the costs of services (Step 5), tax rates, user charges and fees may be adjusted under careful consideration of their impact on citizens. Additionally, new revenue sources should be identified.

Public-Private Partnerships (PPPs) may help to reduce costs by outsourcing public services to competitive and cheaper private actors. Private actors can cross-subsidise some municipal projects that in return generate revenue through taxes, charges and user fees.

To continue raising revenue from taxpayers, resources mobilised must be transparent and be seen to contribute towards the delivery of services required by taxpayers.

A participatory prioritisation of capital investment projects is already being practiced based on the Capital Investment Plan. Revenue collection and investment in demand-driven projects have to be interlinked directly.

6.1 Increase tax rate and adjust user charges and fees

It is important for urban local governments to review their own efforts to increase their level of financial self-sufficiency by accelerating the growth of their own source revenue. One way to effectively achieve this is by increasing the tax rate and adjusting user charges and fees.

The following elements should be taken into account when evaluating tax, user charges and fee rate adjustments:

- A study of the socio-economic dynamic of the city, i.e., population growth, price increases, average income, etc., should be undertaken prior to increasing taxes and adjusting user charges and fees;
- Institutional capacity of the finance and revenue departments should be raised before tax and tariffs are increased;
- The tariff adjustments for user charges and fees should take into consideration the full cost of services and how frequently the cost has been adjusted to market prices;
- The increase in tax rate should correspond with the annual inflation rate. In the absence of RGDP, city administrations can make use of National Gross Domestic Product;
- Any tax increase or decrease in tariffs needs to be carefully planned, discussed with and communicated to the local community to avoid unwillingness to pay;
- Similarly, any increase in tax or tariffs should be justified with the local development strategy. An increase in taxes should translate into additional and improved services for citizens.

The ability to pay and to effectively raise revenue should be considered and special attention should be given to the following issues:

- Identify the reasons for the increment of a tax base of a certain tax item;
- Clearly describe which tax or tariff is planned to be increased (which, when, how);
- Give reasons why this tax or tariff must be increased by:
  - referring to planned service improvements;
  - referring to the strategic plan;
  - referring to capital investments;
- Describe the actual situation of revenues and expenditure (if a specific tariff is to be increased, give more detailed information according to the cost centre approach);
- Describe what would happen if the tax or tariff was not increased.

6.2 Introduce new taxes, user charges and fees

The introduction of new taxes, user charges and fees substantially increases the revenue of the city at a relatively low administrative cost. In consideration of this opportunity, attention should be given to introduce easy and high yielding items. Examples of new taxes, user charges and fees are presented in the following table.

Figure 17: Example for new taxes, imposition and areas of use

No	Type of tax /charge	Imposed on	Method of collection	Area of use
1	*Municipal spa tax*	*Direct users*	*A certain % on ticket*	*Development of recreational centres*
2	*Utility tax*	*Direct users*	*Per kilowatt consumed/ specify % on bill*	*Street lighting*
3	*Bus terminal service charge*	*Vehicle owners*	*Per passenger served add the specific % on ticket*	*Maintenance of roads and bus terminals*
4	*Charges for drainage service*	*Building owners*	*Per m^2 of the floor area*	*Drainage maintenance*
5	*Automotive tax*	*Vehicle owners*	*Per vehicle served*	*Maintenance of road*
6	*Livestock sales tax*	*Butchery owners*	*Per cattle slaughtered*	*Sanitation service*

6.3 Consider Public-Private Partnerships

Public-Private Partnerships (PPP) (i) is commonly defined as a mechanism to engage private management and resources in the area of public service provision by means of a contractual bond between an operator and a public authority. Fundamentally, it grants all or part of the public services to be operated and/or financed by the private sector. As the name implies, PPPs are collaborations mainly, but not exclusively, between two important actors. These are i) the public sector, which is the traditional provider of public goods and services, represented by the government or governmental institutions with their own legal personality and, ii) the private sector with physical and/or legal personality oriented to maximising profit through efficient, innovative, price sensitive and effective utilisation of resources.

In the past, city administrations believed that their service provision mandates could only be fulfilled by direct service provision. Gradually, this approach has been modified, starting more than 35 years ago with the concept of "site and service", where local administrations combined efforts with private individuals and companies to provide services housing plots. However, the concept of PPP (ii) which may take the form of a number of partnership arrangements, e.g., management contracts, service contracts, lease arrangements, concessioning, etc., has not been fully exploited by city administrations. Yet, PPPs are valuable instruments that can be used to increase the administrations' limited financial and technical expertise through the involvement of the private sector.

As more than one service provider is assigned to an area, the private sector service providers have to compete among themselves to obtain service contracts from the service recipients. Thus, the PPP modalities provide an alternative solution for cities, which often have problems in financing their development programmes and providing basic services for their urban communities. Therefore, they:

- Generate new sources of income, infrastructures and services through mobilising the financial and manpower resources, sector efficiency, expertise and skills of the private sector;
- Assist in redirecting public resources to the most important development priorities of local governments;
- Reduce the state's direct role in public service delivery through the involvement of private companies;
- Reduce subsidies through cost recovery, efficiency gains and cost saving mechanisms; and
- Help in redirecting gains from efficiency to increase the cities' wealth and generate additional financial resources and thereby guarantee a dynamic management of public finance and public infrastructure.

City administrations may benefit from adopting a policy to enforce and regulate private participation and PPPs in providing some of the urban services, such as:

- Waste disposal;
- Public parks and recreational centres;
- Abattoir services;
- Road maintenance; and
- Cemeteries.

City administrations have to categorise services that should be provided by the government alone and that should be left for private sector involvement. The classification of services that are provided on the basis of full cost coverage, cost-sharing or cross subsidy have to be undertaken and approved by the city administration's mayoral committee or council. Figure 26 shows the proposed/recommended categorisation of services according to their characteristics and financing sources.

However, it should be noted at this stage that ***PPPs may create significant benefits and advantages, but also risks.*** Each potential PPP requires a comprehensive feasibility study to ensure that the PPP is affordable, mutually beneficial to both partners and ensures value for money for taxpayers with social and economic benefits.

Lessons learnt from international experience with PPPs

Possible facts in favour of deciding for a PPP arrangement:

- Relieves the financial and administrative burden on city administrations;
- Satisfies needs not currently addressed by city administrations;
- Promotes innovation and adoption of new technology;
- Encourages economic growth and entrepreneurship;
- Has the potential to de-politicise decisions regarding the service provided;
- May result in a more stable level of service provision;
- Results in better cost control for the service.

Possible critical factors in deciding for or against a PPP arrangement:

- Impact on unemployment, wage levels, working conditions and the price of public services;
- Servicing of remote, unprofitable areas or groups of society;
- Opportunities for corruption;
- Limited control of the service quality;
- Concentration of economic power and the creation of private monopolies replacing public monopolies;
- Need to guarantee the supply of essential goods/services, e.g., water, in times of crisis, etc.

6.4 Choose the right option

For effective participation of the private sector and the adoption of PPP options, city administrations have to explore all options in order to decide for which services, for what purposes and on which basis charges should be set. PPP options could provide some of the services on a profit basis, so that city administrations could provide other services on a subsidy basis in order to utilise cross-subsidies from the private sector. The following table gives an overview of identified constraints (as listed in Step 2), possible financing sources and proposed intervention measures.

Figure 18: Classification of services according to their characteristics and financing sources

S/N	Type of Services	Identified constraints	Possible financing sources	Proposed intervention
1	• Public services • Need services • Basic Education • Basic Health • Environmental protection • Infrastructure • Fire Brigade • Traffic light	• Lack of proper assessment • Absence of proper categorisation valuation and assessment	• General state taxes • Personal income tax • Business profit tax • Sales and excise taxes	• Review the existing taxpayers categorisation • Update valuation and assessment
	• Amenity services • Street Lighting • Waste disposal • Environmental • Health	• Low tax rate and absence of regular updating • Inefficient tax administration	• Municipal taxes • Property taxes • Road taxes • Advertisement taxes • Land rent • Cattle market taxation • Trade license renewals	• Update taxpayers' rolls • Undertake property revaluation • Adjust tax rate and base • Review collection and billing procedures • Review enforcement mechanisms
	• Facility services • License renewal • Activity permit • Registration, verification, etc. of utility services	• Absence of policy based service charge pricing methodology • Lack of categorisation of services according to their source of financing	• User charges at cost recovery • Service charges fees • Public prices • Specific benefit charges • Admission charges	• Propose appropriate service charge pricing methodology • Propose cost recovery mechanisms options • Propose implementation strategy
2	• Public-Private partnership (PPP)	Absence of specific policy	• User charges with marginal profit • Service Contracting	• Issuance and enforcement of appropriate policy regulation
	• Cemetery • Public parks recreation and cultural centres • Road maintenance • Bill collection of water supply	• Low quality due to lack of expertise for evaluating contract offers • Limited financial resources for services • Lack of competition between bidders	• Management Contracting • Concession based contracting • Joint venture • Build-Operate-Transfer (BOT) • Rehabilitate-Operate & Transfer (ROT) • Build-Operate-Own (BOO)	• Identification and indication of services that could be provided through PPP options
3	• Purely/partially private services • Solid waste collection • Liquid refuse disposal • Health service • Education service • Car parking service	• Lack of detail Policy regulation	• User charges with profit privatisation	• Identification of services that could be provided by the private sector and issuance and enforcement of appropriate policy regulation

A cobblestone road as a result of a public-private partnership in Adama
Photo: Toni Kaatz-Dubberke

Checklist Step 6: Analysis of other means for increasing municipal revenue

Tasks	Details	References
☑ 6.1 Increase tax rate and adjust user charges and fees	✓ Evaluate tax rates, user charges and fee rate adjustments • Consider socio-economic dynamics of the city • Raise institutional capacity of finance and revenue departments • Balance tariffs with their cost of service delivery • Consider inflation • Involve the public in the tax adjustment process • Make sure that the increase in tax or tariff is in support of the local development strategy and translates into additional and improved services ✓ Review own ability to effectively raise revenue level • Identify the reason for the increment of the tax base of a certain item • Clearly show which tax or tariff is planned to be increased (which, when, how) • Give reasons for the changes • Describe the actual situation of revenue and expenditure (cost centre approach) • Describe the outcome of inaction	• Page 51
☑ 6.2 Introduce new taxes, user charges and fees	✓ Identify potential new taxes, user charges and fees • Give attention to items that have high yields	• Page 51
☑ 6.3 Consider Public-Private Partnerships	✓ Evaluate the pros and cons of PPP ✓ Carefully analyse which services can be effectively delivered to the public in this mode (e.g. waste disposal, cemeteries, …) ✓ Differentiate services to be provided by the government alone and services to be left for private sector involvement ✓ Relentlessly analyse risk factor and conduct feasibility study	• Page 52-53
☑ 6.4 Choose the right option	✓ Explore all options available to properly justify charges for services	• Page 53-55 (figure 18)

Exercises Step 6: Analysis of other means for increasing municipal revenue

6.1 Which statements are true?

A. The introduction of new taxes, user charges and fees substantially increases the revenue of the city at a relatively high administrative cost.

B. The increase of tax or tariffs must be justified against planned service improvements as well as the strategic plan and capital investments.

C. Utility taxes shall be imposed on all residents of the city in order to collect sufficient revenue from the services.

D. It is advisable to engage private management and resources in the area of public service provision by means of a contractual bond between an operator and public authority.

E. Urban services such as waste disposal, road maintenance, public parks and recreational centres, abattoirs and cemeteries should only be provided by government while others can be privatised.

6.2 The city of Gambella has identified new taxes with their respective tax bases, methods of collection and area of use. The table elaborated by the city however shows a mismatch between either of the elements across the row. Can you help the revenue office to find the mistake?

No	Type of tax/charge	Imposed on	Method of collection	Area of use
A	Municipal spa tax	Direct users	A certain % on ticket	Development of recreational centres
B	Utility tax	Direct users	Per kilowatt consumed/ specify % on bill	Street lighting
C	Bus terminal service charge	Vehicle owners	Per passenger served add the specific % on ticket	Maintenance of roads & bus terminals
D	Charges for drainage service	Building owners	Per m2 of the floor area	Drainage maintenance
E	Automotive tax	All residents	Per household	Maintenance of road
F	Livestock sales tax	Butchery owners	Per cattle slaughtered	Sanitation service

6.3 Which of the following statements is incorrect?

A. A PPP can relieve the financial and administrative burden off city administrations.

B. A PPP can satisfy needs not currently addressed by city administrations.

C. A PPP discourages innovation and adoption of new technology.

D. A PPP can encourage economic growth and entrepreneurship.

E. A PPP has the potential to de-politicize decisions regarding the service provided.

6.4 City administrations have to differentiate between services that should be provided by the government alone and services that should be left for private sector involvement. Which of the following is correct in this regard?

A. All the costs of services must be provided on full cost coverage basis.

B. All the costs of services must be provided on cost-sharing basis.

C. All the costs of services must be provided on cross subsidy basis.

D. All services must be rendered for free.

E. Services may be provided on the basis of either full cost coverage, cost-sharing or cross subsidy basis.

Step 7

Borrowing and its implications

Questions

» Under which circumstances and for what purposes should cities consider borrowing as an option to overcome financial deficits?

» What criteria have to be met by cities in order to borrow?

» What are the sources and methods of borrowing?

» What criteria limit the borrowing capacity of cities?

» How can debts be managed efficiently?

In this step, you are required to:

✓ Understand under which circumstances cities should think about borrowing.

✓ Identify external funding sources.

✓ Recognise the preconditions that city governments have to fulfil prior to exploring external resources.

✓ Implement the harnessing of external resources.

Introduction

Only after having analysed all 'internal' possibilities of revenue enhancement as well as potential cooperations with the private sector, city administrations should turn to external funds for delivering services and products to the citizens.

Loans or credit finance are regarded as a natural sources of capital financing. To utilise those sources credit-worthiness is vital. Further, good governance principles such as accountability and transparency have to rein.

A thorough assessment must take place prior to the decision to borrow. Debt management must be taken into account before an arrangement with a financial institution is made.

Hence, city administrations are advised to:

- Limit their borrowing to capital expenses, large and costly projects as well as income earning investments,
- explore sources and methods of borrowing,
- assess their borrowing capacity, and
- consider the debt management afterwards.

Further information on borrowing can be found in annex 5, chapter 4 on the CD.

7.1 Understand the purpose and extent of borrowing

Urban authorities should strictly limit their borrowing to the provision of their main purposes, such as:

- to cover certain types of capital expenses that may be financed safely and reasonably by long-term loans. The capital costs of self-supporting enterprises, such as water and power systems, justifiably may be met by borrowing, and on the basis that the amortisation of the debt is sufficiently rapid to keep ahead of depreciation and obsolescence;
- projects, which are large and costly in relation to the city administration's current financial resources, which have long-term utility, and are not of a frequently recurrent type, are legitimate purposes for borrowing;
- to finance investment which is expected to earn income.

However, urban authorities are not recommended to borrow at any rate:

- to finance short-term cash-flow deficit; and
- to finance deficit in the annual operating budget.

Borrowing for annual operating expenses and to cover short-term deficit would increase the city administration's debt. These operating costs are recurring costs which will therefore most likely not be able to be repaid. It is therefore better to cover such costs directly through taxation.

Always consider the long-term implications of borrowing
Photo: Michael Tsegaye

7.2 Sources and methods of borrowing

In Ethiopia, city administrations have the following financing options:

Figure 19: Borrowing options for city administrations

City administration credit enhancement facility	This is a mechanism to ensure that any borrowings from lenders are secured by claim against funds, which could be administered on an outsourced short-term insurance basis or through the banking sector. The fund is established with a contribution made towards the start up capital by a donor or the state.
Sinking fund investment bond	A sinking fund is a method by which an organisation sets aside money over time to retire its indebtedness. It implies that the city administration sells its bonds to receive funds. These bonds issued under a sinking fund agreement require the debtor organisation (obligor) to periodically set aside a sum which will be sufficient to cover parts of the whole debts. The purpose of sinking fund bonds is to give assurance to investors that systematic provision is to be made for the repayment of the loan; sinking fund payments become an obligatory part of the contract. Sinking fund payments are usually made to a trust company or a sinking fund trustee and are just as binding on the issuer as interest payments.
Intermediary lending institutions	Financial institutions (intermediaries) perform the vital role of bringing together those economic agents with surplus funds who want to lend, with those witnessing a shortage of funds wanting to borrow. Financial intermediaries include: • Banks • Building societies • Credit unions • Financial advisers or brokers • Insurance companies • Collective investment schemes • Pension funds
City administration bond market	Issuance of bonds shall be in compliance with constitutions, general statutes, special acts, and local charters regulating the authorisation and issuance of bonds. This is true both in securing the authorisation of bonds and in all the steps essential to their marketing. At present, there is no clear law governing the issuance of bonds for city administrations in Ethiopia; in the meantime, city administrations shall consult the appropriate government body.
City administration borrowing subsidisation grant	The city administration will fund a predetermined percentage of the infrastructure project to be financed from its own operating revenues. In accordance with an approved project-spending plan, donors will contribute the balance of the funding through direct transfers to MoFED, which MoFED will have to pay back at a later stage. MoFED thus takes a loan from a development assistance organisation, such as the World Bank, and disburses this money in the form of grants to city administrations that successfully apply.

The process to borrow loans is very long and needs approval from the following institutions:

- At city level, city cabinet and city council have to approve;
- At regional level, board, BoFED, Regional Government Council and Regional Council have to approve if the loan affects the regional economy; and
- At federal level, MoFED has to approve in order to measure to what extent the loan affects the national/macro economy.

More information can be found in the 'Cash management and borrowing' in annex 6, chapter 4 on the CD.

7.3 Assess borrowing capacity

The decision of how much a city administration can safely borrow has to be based upon assessment of its capacity to service debt. In general, debt-paying capacity must be assessed by the amount and quality of the city administration's resources and by its legal and practical ability to draw upon these resources for payment. Furthermore, the following questions should be critically answered based on real arguments:

- Does the particular investment financed by a loan actually lead to economic growth?
- How long does it take to materialise?
- Does such economic growth increase the specific revenue, which the borrowing authority does or can exploit?

7.4 Consider debt management

For better management of debt:

- City administrations should not use long-term debt for current expenses;
- Urban local governments should retire short-term debt within twelve months;
- City administrations should limit themselves to the maximum per capita loan, indicating how much each citizen is liable for;
- Cities are supposed to limit long-term borrowing to capital investment that cannot be financed from current revenues;
- City administrations should fix their annual debt service so that it does not exceed the limited percentage of the total operating revenues.

Checklist Step 7: Borrowing and its implications

Tasks	Details	References
☑ 7.1 Understand the purpose and extent of borrowing	✓ Borrowing should be restricted to: • Long-term loans for capital expenses • Large and costly projects which have long term utility • Investment which is expected to earn income ✓ Urban authorities should not borrow at any rate, especially not to cover: • Short-term cash-flow deficit • Deficit in the annual operating budget	• Page 59
☑ 7.2 Sources and methods of borrowing	✓ Potential sources: (a) city administrations credit enhancement facility, (b) sinking fund investment bond, (c) intermediary lending institutions, (d) city administration bond market, (e) city administration borrowing subsidisation grant ✓ Since the borrowing process is long, get approval • At city level: city cabinet and city council • At regional level: Board, BoFED, regional government council and regional council • At federal level: MoFED	• Page 60-61 • Annex 6 chapter 4 in CD
☑ 7.3 Assess borrowing capacity	✓ Only borrow to the limit you can service your debt ✓ Answer the following questions critically • Does the investment financed by a loan actually lead to economic growth? • How long does the expected economic growth take to materialise? • Does such economic growth increase the specific revenue, which the borrowing authority does or can exploit?	• Page 61
☑ 7.4 Consider debt management	✓ No long-term debt for current expenses ✓ Retire short-term debt within 12 months ✓ Limit yourself to the maximum per capita loan ✓ Limit long-time borrowing to capital investment ✓ Fix your annual debt service so it will not exceed the limited percentage of the total operating revenues	• Page 61

Exercises Step 7: Borrowing and its implications

7.1 Which of the following statements is a bad practice?

A. City administrations should use long-term debt for current expenses.

B. Short-term loans should be retired within 12 months maximum per capital loan.

C. Cities are supposed to limit long-term borrowing to capital investment.

7.2 The decision of how much to borrow has to be mainly based upon?

A. Capacity to service debt

B. Method of repayment

C. Political stability

D. Existing collateral

7.3 Which of the following institutions is not involved in loan approval at regional level?

A. Bureau of Finance and Economic Development

B. City Cabinet

C. Regional Government Council

D. Regional Revenue Authority

7.4 Which of the following is not a financial intermediary?

A. Banks B. Insurance companies

C. Credit unions D. Sinking funds

7.5 Which of the following statements about a loan is correct?

A. Loan or credit finance is often considered to be a natural source of capital financing.

B. Loans do not cause costs for the society.

C. City administrations have to demonstrate a record of good credit to be eligible for credit finance or borrowing.

D. Borrowing should be tied to the accountability of city administration officials.

E. Public participation must be ensured before a final approval of a loan by the city council is made.

7.6 Urban authorities may borrow for all of the following purposes except:

A. To finance deficit in the annual operating budget.

B. To cover certain types of capital expenses that may be financed safely and reasonably by long-term loans.

C. To finance the capital costs of self-supporting enterprises, such as water and power systems.

D. To finance projects that are large and costly and which have long-term utility, and are not of a frequently recurrent type.

E. To finance investment that is expected to earn income.

7.7 A city administration credit enhancement facility is a mechanism to ensure that any borrowings from lenders are secured by claims against funds, which could be administered on an out-sourced short-term insurance basis or through the banking sector. The fund is established with a contribution towards the startup capital by

A. Lenders B. Donors

C. The state D. Lender or the state

E. Donor or the state

7.8 Which of the following statements about a sinking fund is correct?

A. The purpose of sinking fund bonds is to give assurance to investors that systematic provision is made for the repayment of the loan.

B. Sinking funds can be used to finance recurrent expenditure of municipalities.

C. Sinking fund payments become an obligatory part of the contract.

D. Sinking fund payments are usually made to a trust company or a sinking fund trustee and are just as binding on the issuer as interest payments.

E. A sinking fund is a method by which an organisation sets aside money over time to retire its indebtedness.

Solutions to exercises

Step 1 exercises

1.1 The revenue enhancement task force should come together:

D. One month before the REP is due

The revenue enhancement task force should come together one month before the REP is due.

1.2 Among the following positions identify the one that is the least likely be the member of the municipal REP task force:

B. Federal tax advisor

Federal tax advisors are least likely to be member of the municipal REP task force. However the municipal experts with tax, finance and economical background are the most potential members of the task force.

1.3 Which of the following statements is incorrect?

E. Revenue enhancement deals with improving capital facilities planning.

All of the choices A through D are correct statements. However E refers to the capital investment program of local authorities.

1.4 Which of the following sources is not an external source of revenue?

A.Tax

All of the choices B through E are external sources of revenue. However A refers to the internal source of revenue for local the authorities.

1.5 Which of the following statements is incorrect about the city administration at the time of planning their revenue enhancement?

C. When city administrations and municipalities elaborate their own local financial improvement policies they should not be worried whether they contradict with the framework of national laws.

A, B, D and E are true statements about considerations of city administrations and municipalities at the time of planning their revenue enhancement. However choice C is incorrect. When devising their own local financial improvement policies city administrations should make sure that they comply with the framework of national laws.

1.6 Which of the following statements is incorrect about the fiscal policy of a government?

C. REPs should negatively affect the stability of the local economy, employment and inflation. These plans should impair the allocation of local resources.

All of the above mentioned are correct about the fiscal policy of the government except choice C. Fiscal policy of a government should be designed in a way that ensures the stability of local economy, employment and inflation. These plans should not impair the allocation of local resources

Step 2 exercises

2.1 Which of the following items does not belong into the category 'Municipal Service Charges'

D. Traffic fines

All the choices from A through C are payments made for the services rendered by the municipal governments to the users of the services. Traffic fines are however payments made for a breach of traffic laws in using road transport.

2.2 The percentage of the total amount of planned or billed revenue against actual collection is called:

C. Actual collection efficiency

There are two types of collection efficiencies. One is the actual collection efficiency and the other one is billing efficiency. Billing efficiency compares assessment of the taxable item against the actual bill. Total amount billed against actual collection is actual collection efficiency.

2.3 Which of the following options does not immediately lead to a tax enforcement problem?

B. Absence of a regional tax enforcement policy for municipal revenues

The major limitations of revenue collection performance can be explained by enforcement problems; tax payment procedures and capacity constraints choice A, C and D are problems that fall under a capacity problem whereas choice B is incorrect, as regions are not supposed to issue a tax enforcement policy for municipal revenues.

2.4 Which of the following problems is not among the main difficulties encountered in revenue performance?

A. Tax base is too large

Choices B, C and D are typical problems encountered in revenue performance. Having a large tax base is an opportunity to better revenue performance on the other side; a small tax base is the main difficulty in this respect.

2.5 A technique to identify and assess factors that may jeopardise the success of the revenue target is called:

D. Risk analysis

Choices A, B, and C are tax administration issues. They are not dealing with identification of constraints of success. However identification and assessment of constraints to success is risk analysis. It helps to define preventive measures in order to minimize of occurrence of risks or their severity.

2.6 The Addis Ababa city administration has introduced a property tax. If total taxable property has a value of ETB 20,000,000 and the billed amount is 20% of the value of the property, then what is the billed amount?

Answer: 4,000,000.

*20,000,000*0.2= 4,000,000*

2.7 Dire Dawa municipality has collected an annual tax amounting to ETB 42,010,000 in the year 2012. Collection efficiency of the municipality is 80%. Calculate the amount of tax billed by the municipality in the year 2012?

Answer: 52,512,500

42,010,000/0.8=52,512,500

2.8 The billing efficiency of Jimma municipality was 80% in 2010 and 90% in 2011. Billed amounts were ETB 2 million in 2012 and ETB 3.6 million in 2011. Calculate the amount of assessments for both years.

Answer: 2011: 2.0 million/0.8 = 2.5 million

2012: 3.6 million/0.9 = 4.0 million

2.9 If a specific problem has a major impact on the revenue performance and is the cause for not reaching planned revenue, it should be ranked as:

A. High

If a problem has a major impact on the revenue performance and explains why the planned revenue could not be reached, it should be ranked as high.

2.10 The delay of tax audits or assessments translates into an accumulation of:

C. Tax arrears

The delay of tax audits or assessments translates into an accumulation of tax arrears. Tax payables and liability are amounts owed to the government. Tax revenue is government earning from tax measures. Depreciation is the decline in the usefulness of an asset.

2.11 Which of the following factors is not taken into consideration when assessing past performance?

B. Late billing

Revenue authorities in assessing past performance, all of the above-mentioned factors should be taken into consideration except the late billing. The factor to be considered is timely billing not late billing.

Step 3 exercises:

3.1 The strategic plan of city administrations should be prepared covering a period of:

A. 3-5 years

Strategic plans are prepared for 3 to 5 years to serve as a guide for resource allocation.

3.2 City administrations should harmonise and implement the expenditure manage- ment and control mechanism. Which of the following topics is not included in the Expenditure Management and Control Reform Programme of the Civil Service Reform of the Ethiopian government?

B. Top management

Choices A, C, D and E are the elements of the Public Expenditure Management and Control Program. Whereas the top management reform program is an element of the Civil Service Reform Program introduced at national level.

3.3 The annual budget of cities does not include:

B. The regional budget

The regional budget is not an element of the annual budget of city administrations. The other choices; A, C and D are elements of annual budgets of city administrations.

3.4 Which is the highest entity of a city administration?

D. City council

According to the existing law the highest organ city administration is the city council. All the other mentioned institutions are under the city administration.

3.5 City administrations should identify their controllable and uncontrollable costs in order to help decision makers decide on which controllable costs to cut. Which of the following options is a controllable cost?

B. Overtime work

Controllable costs are costs that are influenced by cost centers where as the uncontrollable once are those costs that cannot be influenced by any individual in the cost center. Over time work can be controlled by the cost center's manager. Choice A,C, and D are not managed internally within the cost centers.

3.6 The ideal budget should involve a mix of 'bottom-up' and 'top-down' processes. Which is the correct match?

A. 'Bottom-up': citizens and business people to government

D. 'Top-down': government to citizens and business people

The ideal budget should involve a mix of 'bottom-up' and 'top- down' processes. The 'bottom-up' contribution comes from the local residents and business people and the 'top-down' contribution from federal and regional government. For example, it is important to involve the community if they are expected to make a contribution to projects or services either in cash or kind ('bottom-up'). By doing so, their trust in city administrations will be reinforced. On the other hand, tax compliance must be enforced 'top-down' by the public authority.

3.7 Which of the following activities are conducted in the preparation stage of the budget process?

A. Budget planning

B. Budget proposal

C. Budget approval

The budget preparation stage of the executive body of a government involves planning, proposal of the budget and approval of the budget. The appropriation of the budget is made at the legislative adoption stage of the budget.

Step 4 exercises:

4.1 Match the definitions in column "A" with the appropriate terms in column "B".

Column A: Definitions

A. The overall value of the economic unit un- der tax consideration

B. Measures the extent and number of tax rolls that exist at a relevant revenue col- lection office.

C. The weighted average of specific tax rates determined by legislative decree.

D. The percentage of due taxes, fees or charges actually collected.

E. Identifies the extent to which the taxable unit has assessed its market value.

Column B: Terms

1. Collection ratio
2. Tax ratio
3. Coverage ratio
4. Valuation ratio
5. Tax base

Answer 1.E, 2.C, 3.B, 4.A, 5.D

4.2 Which of the following measurements is not advised to be implemented by city administrations as a means of giving serious attention to arrears management and enforcement?

C. Avoid conducting regular information forums for taxpayers.

Serious attention to arrears management and enforcement can be given through all of the choices given including conducting of regular information forums for taxpayers. Avoiding such a forum to taxpayers cannot contribute to achieve the desired goals.

4.3 Comparing and adjusting the number of registered taxpayers with that of other relevant offices (e.g. offices that provide Taxpayer Identification Numbers to all registered tax, charge and fee payers as by law) is a challenge to tax administration. Which of the following measures are not appropriate to address them?

E. Design guidelines for inspection.

All of the alternatives given A through D are appropriate measures during the case under consideration. However, designing guidelines for inspection is important during training inspection teams in each Kebele on property tax, charge and fee administration and provide them with all necessary information and guidelines when doing a house-to-house inspection.

4.4 In 2001 Mekele city administrations tax coverage amounted to 75% (150,000). From these 75%, 75% were valued. Of this valued 75%, 75% were collected. In 2002 Mekele has introduced strategies to increase tax coverage, valuation and collection each by 10%. What would be the tax yield by improving tax administration?

Answer: 122,825

	Ratio	Tax yield	Ratio Improved by	Tax Yield
Tax Coverage	75%	150,000	10%	200,000*0.85=170,000
Tax Valuation	75%	112,500	10%	170,000*0.85=144,500
Tax Collection	75%	84,375	10%	144,500*0.85=122,825
Tax Yield				**122,825**

4.4 In 2003 Semara revenue office collected ETB 70,600 revenue. The tax collection rate was 50%. In 2004 Semara has planned to collect at least ETB 100,000. What is the required increase of the tax collection rate in order to meet the target?

Answer: 20.82%

(100,000/(70,600/50))-50=20.82

Step 5 exercises:

5.1 The following is a list of basic steps in set- ting up a cost accounting system for city administrations. Arrange the steps in their proper sequential order.

1. Create cost centres for services
2. Select service(s) to be costed
3. Collect cost information
4. Use cost information

5.2 Which one of the following is not an advantage of implementing cost centre budgeting?

C. Maximised public spending

Implementing cost centre budgeting allows better financial management, improved efficiency in public sector, reduced public spending and maintenance of proper information about costs which are used to determine prices for service delivery.

5.2 In the city administration of Bahir Dar the issuance of a house construction permit involves direct and indirect costs, based on the following assumptions:

- The city administration adopts a policy of both full cost recovery and 90% cost recovery;
- The total annual salary of technicians, clerks and engineers in the technical department
- is ETB 780,000;
- The blueprint and stationary used directly to provide the house construction permit is ETB 35,000;
- The total personnel department of the city administration that handles the personnel issue of the technical department is ETB 600,000 and it uses 20% of its time for the technical department;
- The total salary of the finance department is ETB 240,000 and 10% of its time is used for the technical department;
- The floor the technical department holds amounts to 25% of the total floor area of the city administration and the annual maintenance cost of the building is ETB 80,000;
- Utilities used for this purpose amount to ETB 6,000;
- The total number of customers is ETB 1,000;

a) What is the total amount of direct costs?

b) Calculate the annual service charge at full cost recovery?

c) Calculate the annual service charge at 90% cost recovery?

d) What is the sum total of indirect costs?

Answer. Look at the following table for the details

	Direct costs	**Indirect costs**	**Total**
Salary of technical department	780,000		780,000
Utilities	6000		6000
Supplies and stationary	35,000		35,000
Salary of personnel department		20% x 600,000 =120,000	120,000
Salary of finance department		10% x 240,000 = 24,000	24,000
Maintenance costs		25% x 80,000 = 20,000	20,000
Total cost	821,000	164,000	985,000

Step 6 exercises:

6.1 Which statements are true?

A. The introduction of new taxes, user charges and fees substantially increases the revenue of the city at a relatively high administrative cost.

Answer false: Administrative costs of new taxes are relatively low.

B. The increase of tax or tariffs must be justified against planned service improvements as well as the strategic plan and capital investments.

Answer true: Justification for increased taxes should be given by referring to all the three issues; planned service improvements, strategic plan and capital improvements.

C. Utility taxes shall be imposed on all residents of the city in order to collect sufficient revenue from the services.

Answer false: It will be more appropriate if such taxes are levied on direct users of the service. It is not justifiable if non-users are charged.

D. It is advisable to engage private management and resources in the area of public service provision by means of a contractual bond between an operator and public authority.

Answer true: By doing so, city administrations can increase their limited financial and technical expertise through the involvement of the private sector.

E. Urban services such as waste disposal, road maintenance, public parks and government should only provide recreational centres, and abattoirs and cemeteries while others can be privatised.

Answer false: City administrations may benefit from adopting a policy to enforce and regulate private proving all the above-mentioned services.

6.2 The city of Gambella has identified new taxes with their respective tax bases, methods of collection and area of use. The table elaborated by the city however shows a mismatch between either of the elements across the row. Can you help the revenue office to find the mistake?

No	Type of tax/ charge	Imposed on	Method of collection	Area of use
A	Municipal spa tax	Direct users	A certain % on ticket	Development of recreational centers
B	Utility tax	Direct users	Per kilowatt consumed/ specify % on bill	Street lighting
C	Bus terminal service charge	Vehicle owners	Per passenger served add the specific % on ticket	Maintenance of roads & bus terminals
D	Charges for drainage service	Building owners	Per m2 of the floor area	Drainage maintenance
E	Automotive tax	All residents	Per house hold	Maintenance of road
F	Livestock sales tax	Butchery owners	Per cattle slaughtered	Sanitation service

Answer E: All of the matching above is feasible and matches among tax bases, method of collection and the area of use except for E. Taxing all residents including non-owners of vehicles is not feasible. It will be preferable if vehicles owners are taxed per vehicles served.

6.3 Which of the following statements is incorrect?

C. A PPP discourages innovation and adoption of new technology

All of the factors are in favor of deciding for a public private partnership arrangement except choice C. PPPs will encourage innovation and adoption of new technology

6.4 City administrations have to differentiate between services that should be provided by the government alone and services that should be left for private sector involvement. Which of the following is correct in this regard?

E. Services may be provided on the basis of either full cost coverage, cost-sharing or cross subsidy basis

None of the methods works independently. A mix of the methods should be used depending on the nature of the service.

Step 7 exercises

7.1 Which of the following statements is a bad practice?

A. City administrations should use long-term debt for current expenses.

Current expenses should be financed from current revenues not from long-term loans. Choice B and C are correct statements about better debt management.

7.2 The decision of how much to borrow has to be mainly based upon?

A. Capacity to service debt

Amount to borrow mainly depends on capacity to repay the loan when it is due. However other factors have an effect, but they are less important than capacity.

7.3 Which of the following institutions is not involved in loan approval at regional level?

B. City Cabinet

All except the city cabinet will be involved in loan approval at regional level.

7.4 Which of the following is not a financial intermediary?

D. Sinking funds

All the choices A, B and C are financial intermediaries except the sinking fund. A sinking fund is a method of setting aside money overtime to retire indebtedness. Therefore it is not a financial institution.

7.5 Which of the following statements about a loan is correct?

A. Loan or credit finance is often considered to be a natural source of capital financing.

C. City administrations have to demonstrate a record of good credit to be eligible for credit finance or borrowing.

D. Borrowing should be tied to the account- ability of city administration officials.

E. Public participation must be ensured before a final approval of a loan by the city council is made.

All but B are correct statements about a loan. The loan has a cost on the society to be paid in the form of interest. The burden falls on the society through government tax.

7.6 Urban authorities may borrow for all of the following purposes except:

A. To finance deficit in the annual operating budget.

A loan fund may be used to finance capital projects of a government. But current expenditures should be covered only from the government domestic sources of revenue.

7.7 A city administration credit enhancement facility is a mechanism to ensure that any borrowings from lenders are secured by claims against funds, which could be ad- ministered on an out-sourced short-term insurance basis or through the banking sector. The fund is established with a contribution towards the start-up capital by

E. Donor or the state

A startup capital for establishment of the fund may be financed by either donors or the state.

7.8 Which of the following statements about a sinking fund is correct?

A. The purpose of sinking fund bonds is to give assurance to investors that systematic provision is made for the repayment of the loan.

C. Sinking fund payments become an obligatory part of the contract.

D. Sinking fund payments are usually made to a trust company or a sinking fund trustee and are just as binding on the issuer as interest payments.

E. A sinking fund is a method by which an organization sets aside money over time to retire its indebtedness.

All of the alternatives but B are correct about a sinking fund. However the fund cannot be used to finance recurrent expenditure of municipalities.

This publication is supported by the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH on behalf of the German Government.

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Capital Investment Planning Guide for Ethiopian Cities

Making cities efficient in service delivery

Infrastructure is the backbone of prospering cities

Foreword

Ethiopia will be a middle income country by 2025. The Growth and Transformation Plan outlines how we intend to achieve this goal.

Cities play a decisive role in accomplishing the GTP, since urban areas are the growth engines and the educational hot spots of Ethiopia. However, only well-managed cities that provide infrastructure and services will unfold the full potential of citizens. Hence, infrastructure is a prerequisite for human and economic development: without schools there is no education, without roads there is no mobility, and without health facilities, clean water, proper solid and liquid waste management there are no healthy citizens. Healthy, educated and mobile citizens are the base for a complex society and economic growth. Therefore, capital investment planning is the core function of public administration — it plans the investments which will provide services to citizens.

Capital investment planning is also at the heart of democracy. The capital budget expresses the people's priorities about how their money should be spent—money they have entrusted to the administration in order to provide services. Therefore, the centrepiece of capital investment planning is the participatory decision making process.

By addressing the voice of the citizens, not only is the nature of the participatory and consultative approach of CIP inclusive, it also empowers citizens to make important decisions regarding their needs. It provides an opportunity to devolve power for planning, implementation, operation and maintenance; it increases public participation, in particular that of women and youth in the urban development and governance process. As CIP is a means to preserve existing assets and strategically expand new ones, it serves as a management tool for urban leaders.

As mentioned, citizens have the right to be served, and also have the responsibility to pay for services. The administration in turn has the right to collect money from citizens and the duty to deliver services. Hence, the capital budget, its efficient implementation and joint control by the citizens and the council are the most important functions to guarantee this mutual responsibility.

This guideline is a legally-binding document that helps city administrations to fulfil this responsibility. It provides a straight forward approach to developing capital investment plans for cities in Ethiopia. It supports urban administrations in providing a healthy environment for our children and in including all urban stakeholders in the decision-making process.

Finally, I would like to commend the good spirit of cooperation during the preparation of this manual, and to thank all of our partners, especially the Gesellschaft für Internationale Zusammenarbeit (GIZ) for their contributions and support in the process.

Mekuria Haile

Minister,
Ministry of Urban Development and Construction
Federal Democratic Republic of Ethiopia

Capital Investment Planning Guide for Ethiopian Cities

This publication is supported by the Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ) GmbH on behalf of the German government.

July 2011
Addis Ababa, Ethiopia

Ministry of Urban Development
and Construction

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Content

How to use this manual

The purpose of this manual is to enable city administrations to develop a Capital Investment Plan (CIP).

CIP preparation is a participatory process requiring close collaboration between the technical and financial units of a city's administration, and consultation with citizens and other urban stakeholders.

The CIP is also part of a city's planning system; preparation therefore necessitates drawing on information from various other plans.

Manual overview

Chapter 1 provides essential background information on capital investment planning. It describes the purpose and components of a CIP, locates it within a city's overall planning system and identifies responsible experts. Also described are the necessary sequence of actions and how to execute them.

Chapter 2 This chapter presents a simplified approach to capital budget development that makes clear how much money is available for investments.

Chapter 3 discusses project proposal development, which is done to link the CIP with the city's strategic objectives. Before pursuing a given project, cities should understand their development objectives and be aware of the long-term cost implications of capital investments.

Chapter 4 looks at the feasibility of capital investments. Project proposals should undergo a technical and financial feasibility check. Each project must also be evaluated for its potential social and environmental impacts and contribution to the objectives of the city.

Chapter 5 describes the participatory process, wherein stakeholders express their priorities regarding the city's capital investments. The objective is to ensure compliance of investments with the interests of beneficiaries.

Chapter 6 illustrates how to consolidate prioritized projects into one budget plan. This chapter also describes how to develop the CIP narrative and accompanying annexes. The annexes described in this chapter - along with the two that are the subject of Chapter 7 - are to be submitted along with the main CIP document. These are not to be confused with the "annex" documents on the resource CD.

Chapter 7 develops two documents to prepare for CIP implementation: the procurement plan (CIP Annex 8) and the cash-flow plan (CIP Annex 9). These plans lay the foundation for how and when procurement is done and, consequently, when cash-flow requirements occur.

Chapter 8 describes the CIP approval process. The dissemination of budget decision is described. The chapter also includes brief information on monitoring and evaluation.

Throughout the manual, sidebars in grey are used to clarify specific topics and to highlight examples and case studies. Terms in blue are explained in sidebars, along with other supplementary items.

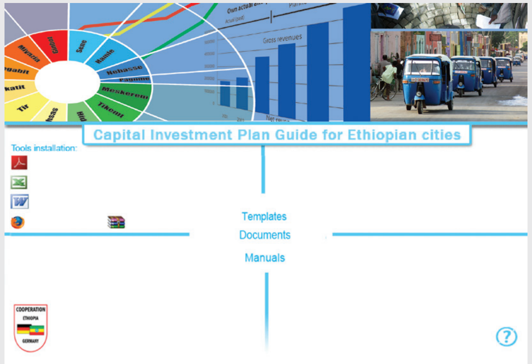


Figure 1: CD opening screen

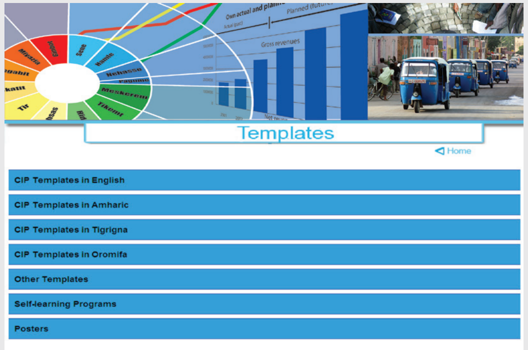


Figure 2: CD template screen

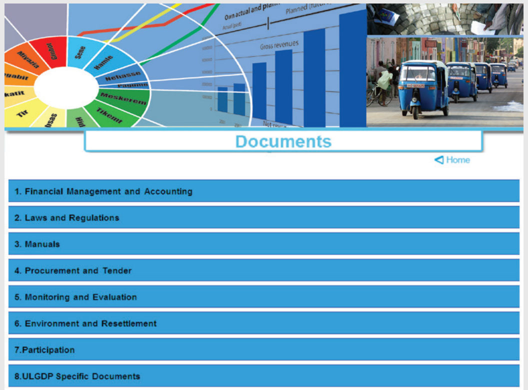


Figure 3: CD document screen

1. The resource CD

This manual comes with a CD which includes the English and Amharic versions of the manual along with automatic CIP templates and many other useful documents. The CD starts automatically when inserted into your computer. The opening screen features a menu with which to navigate the CD. The user is given the option to install programs required to engage with the content. Please note that not all documents on the CD are translated.

CD opening screen: Select between templates, manuals and annex documents.

CD template and manual screens: Select from different languages for templates and manuals.

CD document screen: Choose background and annex documents.

Within the text, references to documents on the CD are generally cited as “CD Annex,” followed by the annex number.

Overview of CD annex documents

1. Financial Management and Accounting
   - 1.1. Municipal finance induction manual
   - 1.2. Financial management guidelines
   - 1.3. Chart of Account
   - 1.4 Capital budget formats
2. Laws and Regulations
   - 2.1. Land and tenure laws
   - 2.2. Environmental laws
   - 2.3. Financial administration laws
   - 2.4. Urban planning laws
   - 2.5. Census 2007
   - 2.6. Growth and Transformation Plan
3. Manuals
   - 3.1. Revenue Enhancement Plan
   - 3.2. Asset Management Plan
   - 3.3. Municipal infrastructure investment plan guideline
4. Procurement and Tender
   - 4.1. Procurement regulations
   - 4.2. Standard bidding documents
   - 4.3. Cobblestone road construction
   - 4.4. Technical specifications
5. Monitoring and Evaluation
   - 5.1. Monitoring manuals and templates
   - 5.2. Report templates
   - 5.3. Information dissemination
6. Environment and Resettlement
   - 6.1. Environmental Impact Assessment
   - 6.2. Resettlement Policy Framework
   - 6.3. Environmental laws
7. Participation
   - 7.1. Public consultation
   - 7.2. Participatory budgeting
   - 7.3. Public hearing
   - 7.4. Baseline surveys
8. ULGDP Specific Documents
   - 8.1. Participation and performance agreement template
   - 8.2. ULGDP operational manual
   - 8.3. ToR for ULGDP focal persons
   - 8.4. Monitoring manuals

2. Using the Capital Investment Plan template

The CIP template is a central element of this manual. It consists of one Microsoft Word file containing the final CIP document and one Microsoft Excel file to calculate tables (see the template screen on the resource CD). These documents are pre-programmed and linked to each other. The MS Excel file will automatically calculate figures entered by the user; MS Excel tables are then automatically transferred to the MS Word file. Any change in the Excel file is automatically reflected in the Word document. The templates are available in all of Ethiopia's major languages.

These files are also available in a non-automatic version; however, using the pre-programmed version will greatly speed up and simplify the work. The use of the template is obligatory for all city administrations.

Note: Both MS Excel and MS Word templates must be stored in the same folder. Please, therefore, **copy the two files from the CD into the same folder on your computer. Do not rename the files!**

2.1 CIP template overview

The first section of the MS Word template comprises a narrative outlining essential information. It lists basic information about the city in question – name, population, growth rate, climate, etc. – and a summary of the city's goals and objectives. The narrative also provides a short overview on the outcome of the participatory process and the response to goals, objectives and community needs.

The second section consists of a set of seven tables capturing key details on financial administration. This section derives entirely from the MS Excel file. It should thus not be edited in the MS Word file. The first three tables provide an overview on the past recurrent and capital expenditures and revenues. Table 4 develops the maintenance budget. Tables 5 and 6 are the centerpiece of the CIP – here, the Capital Investment Budget is developed. Table 7 provides an overview on staffing requirements, and Tables 8 and 9 are instruments for developing the procurement and cash-flow plans. All tables will be explained in detail in this manual.

The third section of the template consists of nine CIP annexes. The first seven annexes are explained in detail in Chapter 6 of this manual. The final two - the procurement and cash-flow plans, are discussed in Chapter 7.

Key skills: Handling Microsoft Excel and Microsoft Word

Developing a CIP requires computer skills, especially in MS Excel. Excel is a so-called spreadsheet application: it calculates information in tables. Information entered into the spreadsheet can consist of numbers or text -- both can be calculated. Excel calculations range from simple addition to complex formulas, such those as verifying statements. Information, such as figures, is entered into the cells at the command line. The toolbar provides quick access to navigation instruments.

Although not essential, MS Excel can be very helpful. The Excel template on the CD calculates automatically the CIP's most important figures. Plus, it is partially protected, that is, to avoid errors, pre-programmed formulas located in the 'closed cells' cannot be changed; the only figures that can be inserted go in the "open cells" where they are calculated. See the CD for MS Excel tutorials.

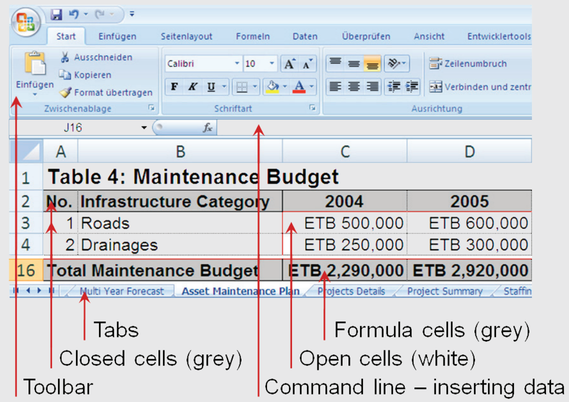


Figure 4: Using the automatic template in MS Excel

Chapter 1

The Capital Investment Plan

The Capital Investment Plan is the city administration's most important instrument for steering and realizing the city's strategic objectives. Its development and implementation is therefore the responsibility of the mayor.

The CIP is also a flexible tool that municipalities can use to plan long-term infrastructure projects. Capital investments do not include recurrent expenditures, such as salaries, but can encompass physical and socioeconomic infrastructure (e.g., roads and schools) equipment (e.g., vehicles) and consultancy work (e.g., project design).

The development of the CIP is a process that links investment needs with available resources and with the priorities of stakeholders. A comprehensive decision-making process is used to select the most appropriate capital projects by assessing and responding to the needs of citizens. The CIP is a legally binding plan that should be adopted by the city council.

1. Why Capital Investment Plan?

Urban services include, among others, access to electricity, communications, drinking water, drainage, solid and liquid waste management, and roads and bridges. These services help improve the health, mobility and overall wellbeing of thousands of urban dwellers. Services also create jobs, especially for the urban poor, and provide opportunities for the private sector.

Capital investment planning is a systematic approach to enhancing a city's capacity to deliver services to citizens through expanded infrastructure.

As a mechanism for enhancing good governance, the CIP is part of a holistic approach for service delivery and infrastructure management, including life-cycle asset management and efficient procurement procedures. It is guided by the overarching principle of participatory decision making.

In parallel, a new financial management system has been introduced to promote transparent, efficient and effective utilization of scarce resources and to ultimately enhance revenue due to improved service delivery. If reform is to take place, both systems — CIP and Financial Management — must work effectively together.

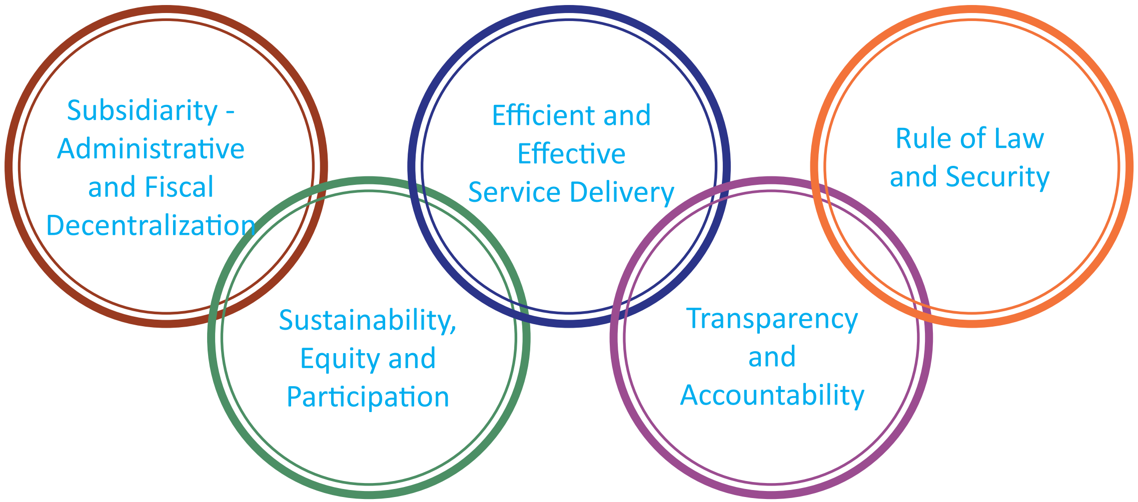


Figure 5: Principles of good governance addressed by the CIP

Life-cycle asset management is a tool for developing a maintenance plan for an asset over the course of that asset's "life."

Subsidiarity says that the lowest level possible be responsible for a task – e.g., building roads at local level, national defense at federal level.

Efficiency is the extent to which time or effort is well used – e.g., it is more efficient to pave roads with cobblestone than asphalt, since cobblestone paving is cheaper and lasts longer.

Effectiveness is the degree to which an asset is capable of producing a desired effect – for example, mobility, for a road.

Rule-of-law is a legal maxim that states that no one is above the law and no one can be punished except for a breach of the law.

Sustainability is the potential for long-term preservation of wellbeing; it has environmental, economic, and social dimensions.

Equity is the idea of fairness in economics, especially taxation or welfare economics.

Participation encompasses various ways people can influence political, economic, management or other social decisions.

Transparency allows citizens access to information on what the city administration is doing.

Accountability has to do with account-giving, especially of administrations, e.g., answerability and liability.

Where does the CIP fit into a city's planning system?

All cities in Ethiopia have development plans, consisting of strategic development objectives and structure plans. City development plans encompass both physical and spatial objectives.

There also exists the federal government's Growth and Transformation Plan, which outlines guiding objectives for cities, such as development of the construction sector, for example.

Each city is required to prepare a local, five-year GTP integrating both federal and local objectives. This plan is thereafter translated into the yearly Action Plan of city line-offices.

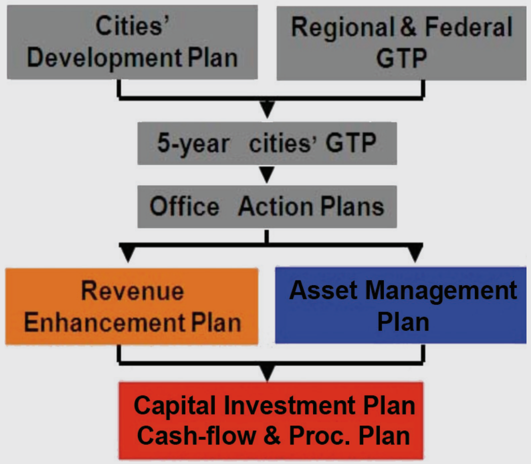


Figure 6: From strategy to implementation: The urban planning system

2. Revenue Enhancement Plan and Asset Management Plan

The Revenue Enhancement Plan (REP) shows how much revenue the city administration can generate from its own resources in three to five years' time. A key output is the Capital Investment Budget for the upcoming three years, as well as the Revenue Collection Plan, which articulates how the city will collect revenues (see Chapter 2). However, other sources also contribute to the capital budget, namely grants, public contributions or loans. The mayor, the Revenue Authority and the OFED have the best overview on sources of revenue for the city and should therefore be involved in developing the capital budget.

The Asset Management Plan translates strategic objectives into concrete project proposals, such as infrastructure extension, or one-time investments, such as vehicles (see Chapter 3). A second function of the AMP is to manage existing infrastructure by determining maintenance requirements and costs, which are then consolidated in the maintenance budget (Chapter 4).

The CIP derives from both these plans. Their key functions are to link the CIP with the city's physical and financial objectives. (Both plans have not yet been introduced in all cities.)

3. Participatory process

The outputs from the REP and the AMP feed into the process by which the priorities of citizens are determined. That is to say, participatory decision making with citizen involvement (Chapter 5) must take place before the final document can be developed, because, for the most part, demand for infrastructure does not correspond to available resources.

In addition to the project proposal put forward in the Asset Management Plan, there are likely to be other ideas – from local politicians, line departments and other stakeholders, especially citizens – about where to spend the capital budget. Hence, the three plans – REP, AMP and CIP – must be interlinked, and thus state the same figures.

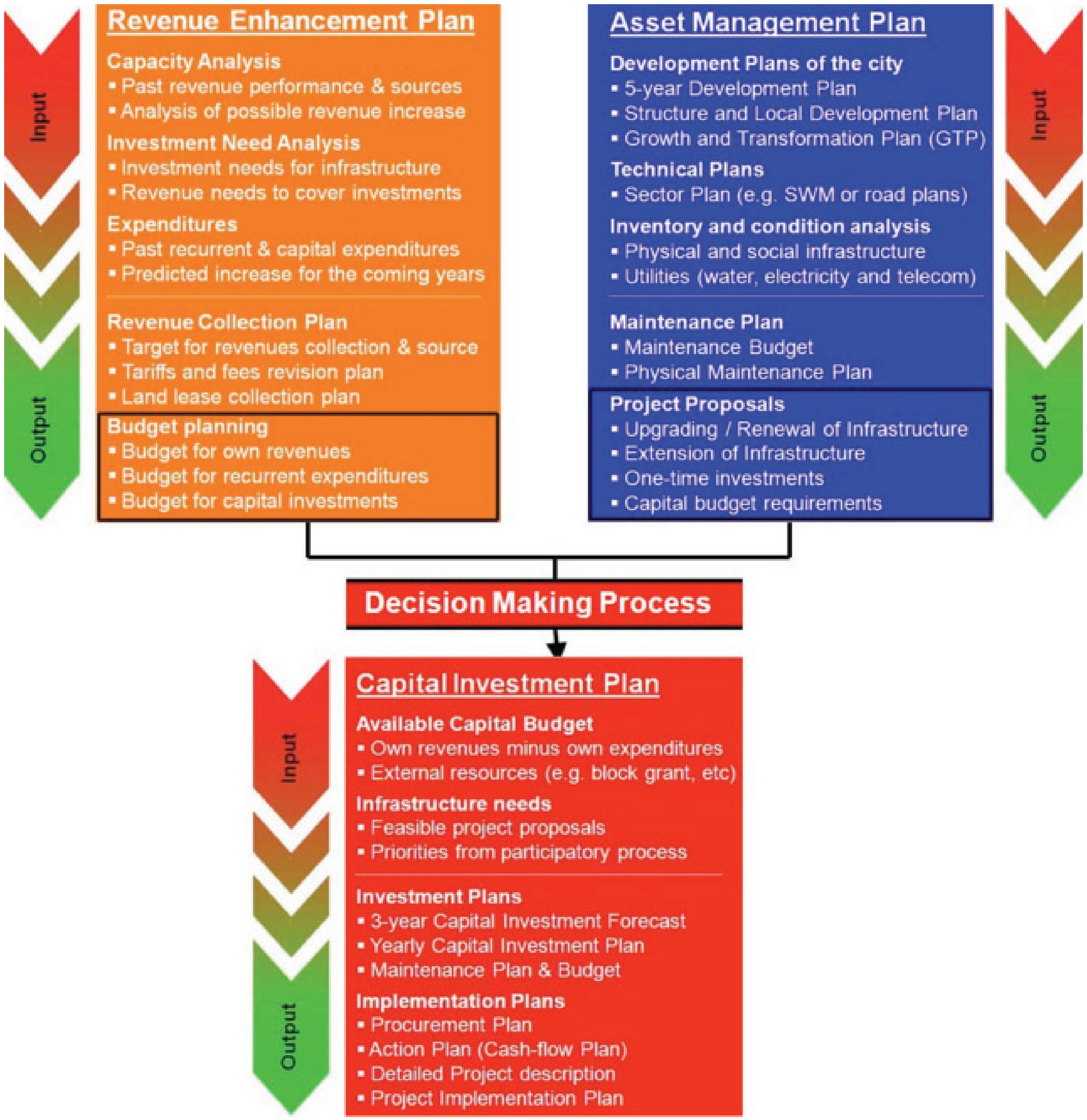


Figure 7: How to link the REP and AMP with the decision-making process and the CIP

CIP: A multilayered process

Capital investment decision making is a multilayered process. With each additional process the project becomes more realistic. At the beginning of the process, the city develops a "project wish-list;" at the end are approved and feasible projects. Throughout the whole decision-making process there should be constant stakeholder involvement.

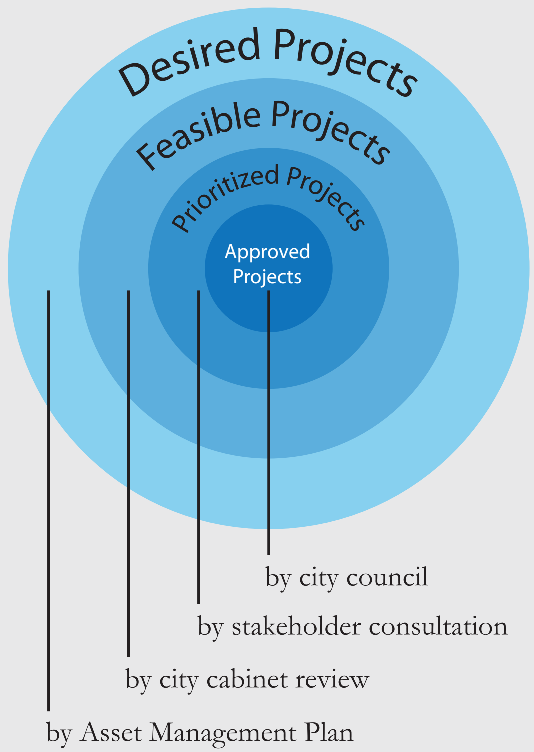


Figure 8: CIP, a multilayered process

The steering committee is mandated to do the following:

- Gather information on available resources and future projections from the Office of Finance/Revenue Authority.
- Gather information from the cabinet on the investment needs of line-offices.
- Review and prioritize potential projects in light of the strategic objectives of the city and available resources.
- Consult external stakeholders and guide the citizen participatory process.
- Supervise CIP preparation, implementation and reporting to bureaus.
- Coordinate plans, ensuring the consistency of the CIP with the AMP and the REP.
- Prepare approval of the Capital Investment Plan by the city council.

The responsibilities of the technical committee are as follows:

- Draft the CIP and other documents necessary for project implementation.
- Prepare detailed designs and technical specifications as well as other tender documents for each project.
- Prepare and effect the procurement of items following the cash-flow and procurement plans.
- Supervise the progress, quality, compliance with design and cash-flow of construction.
- Maintain an archive of all relevant documents.
- Install and follow up the monitoring and evaluation system, prepare reports.
- Identify capacity gaps and training needs and prepare measures to address shortages.
- Install active horizontal and vertical communication to ensure smooth information flow.

4. CIP supervision: Steering Committee

The development and implementation of the CIP is the direct responsibility of the mayor, who merges the needs of citizens with the objectives of the city administration.

The cabinet prepares yearly action plans and budgets for their respective offices, including investment needs. The city manager, a cabinet member, is responsible for more than 90 percent of the city's investments and thus should be heavily involved in the CIP process. The head of the Office of Finance and Economic Development (OFED) provides the estimated investment budget for the CIP and thus also has a major stake in its preparation.

The mayor, city manager and the head of finance form the core CIP steering committee. The steering committee should meet on a regular basis during the preparation period to supervise the technical development of the CIP. The steering committee must be in place at the beginning of the process and should be advised by the infrastructure coordinator.

5. CIP preparation: Technical Committee

The infrastructure coordinator should support the steering committee with technical advice. The coordinator heads the technical committee, made up of various experts from the city administration, such as the asset management expert, the monitoring and evaluation expert, environmental and procurement specialists, the financial manager, the internal auditor and the project engineer. For respective Terms of References, see CD Annex 8.3.

6. CIP process cycle

Major steps in developing a Capital Investment Plan are:

First: Develop a list of project proposals.
Second: Hold an initial participatory consultation to determine citizens' priorities.
Third: Consolidate and evaluate projects with respect to their intended impacts.
Fourth: Conduct a second participatory consultation with citizen stakeholders.
Fifth: Consolidate the CIP and prepare all annexes.
Sixth: Forward the consolidated documents to the city council for approval and dissemination to the public.

The CIP must be adopted by the council before the Ethiopian fiscal year ends (Sena 30th). Thus the call for budget – the initiation of the CIP process – should be announced early in the fiscal year. Thereafter, the city administration must follow a strict action plan to submit the final product to the council on time. Figure 9 illustrates the process.

CIP process cycle

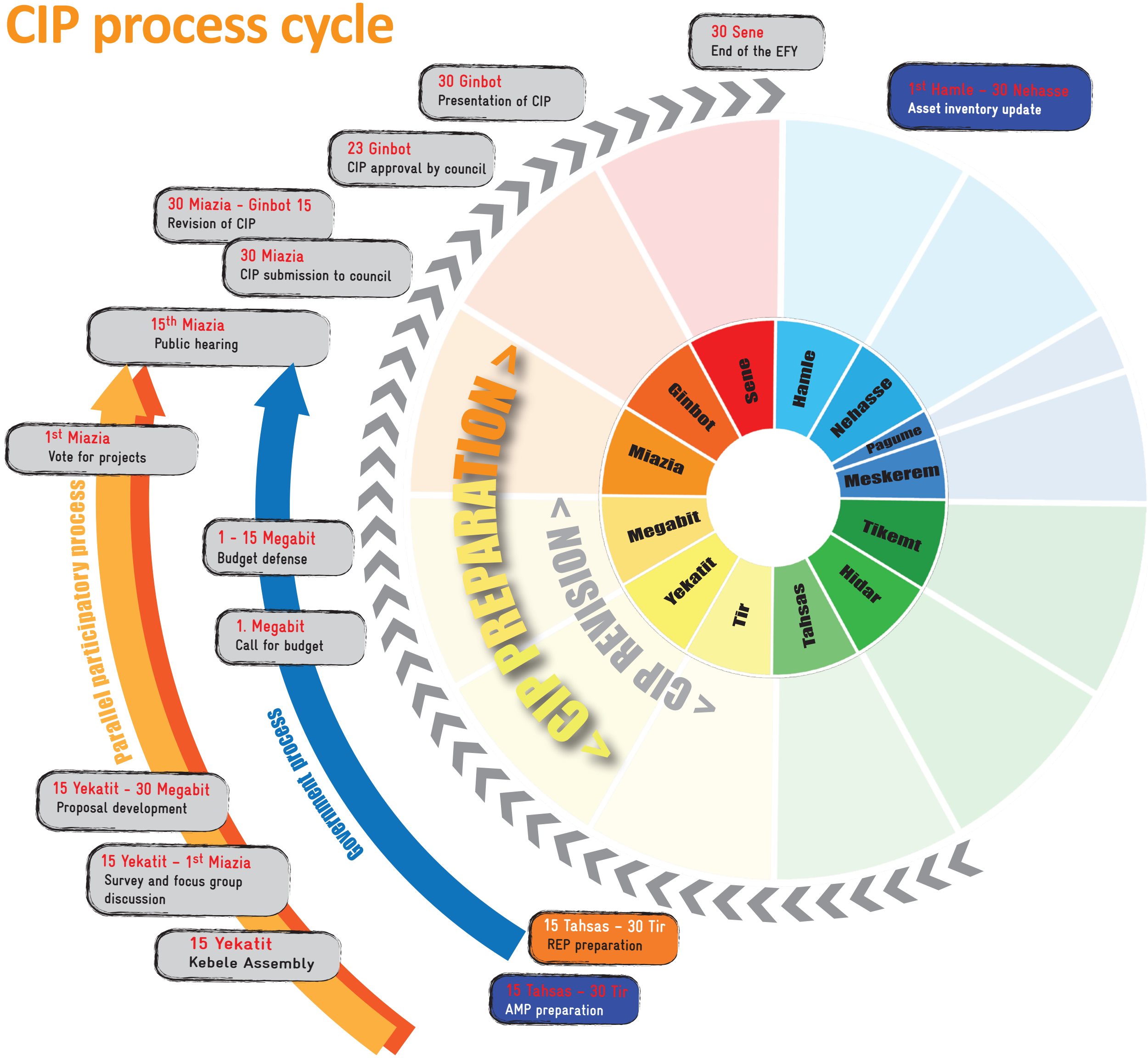


Figure 9: The CIP process cycle

Urban Local Government Development Project

The Urban Local Government Development Project (ULGDP) is a joint project of the Ministry of Urban Development and Construction and the World Bank and is supported by the Deutsche Gesellschaft für Internationale Zusammenarbeit – GIZ (formerly GTZ).

ULGDP has introduced CIP, AMP, and REP plans in 19 pilot cities in Ethiopia. The project addresses short-term objectives, such as the introduction of digitalized accounting, and system objectives, such as capital investment planning. The ULGDP has also introduced a monitoring system to assess the progress of reforms.

In parallel, GIZ has also introduced a reformed Financial Management System. Its five key elements are:

1. Developing a legal framework for city administrations, such as city finance administration regulations, tariff regulations, revenue enhancement guidelines, and procurement guidelines.
2. Introducing the new city administration modified cash-basis accounting system, including the reparation of one budget for city administrations, based on cost centers (costing of municipal services).
3. Closing of accounts (cleaning of backlogs), updated financial statements, and institutionalizing/ conducting internal and external audits.
4. Putting in place systems for managing cash, departments, investments and property, including procurement.
5. Developing a yearly updated Revenue Enhancement Plan.

Chapter **2**

Capital Investment Budget

A city's Capital Investment Budget helps clarify how much money is available for investments.

To calculate the budget, cities need to forecast their own revenues, recurrent expenditures and additional external resources. This is largely done by reviewing past performance. The development of the capital budget is coordinated by the Office of Finance and Economic Development in collaboration with the Revenue Authority, responsible for the development of the Revenue Enhancement Plan. However, in some cities, the REP has not yet been introduced. This chapter thus provides an overview on how to develop the capital budget without an REP.

Step 1: Review the past to predict the future

To forecast revenue collection or expenditure, a city must review past performance. The first step in predicting the future is to obtain actual data from the past three years, so that this data can be extrapolated. Three types of financial data from past years are most important to evaluating a city's performance:

1. Amount of collected own revenues, also called municipal revenues.
2. Amount of recurrent expenditures, also called operating expenditures.
3. Capital investments (expenditures) split into different investments.

To delineate past revenues and expenditures for obtaining accurate data over time and for monitoring performance, use the new Chart of Account (CD Annex 1.3).

First: Calculate past own revenues, referencing Chart of Account series numbers. Only municipal taxes and fees are relevant, including:

- Tax revenues from services (no. 1701-1719)
- Rents and investments (no. 1720-1730)
- Service charges (no. 1740-1749)
- Sales (no. 1750-1789)
- Urban land lease income (no. 1731)

Second: State past recurrent expenditures. Again, only for municipal expenditures (500 series), including:

- Personnel salaries (6100 series)
- Goods and services (6200 series)
- Maintenance budget deriving from the Asset Management Plan, called "Fixed Assets and Constructions," excluding capital investments (6245 series)
- Subsidies, grants and payments (6400 series)

Figure 10: Review the past to predict the future

Extrapolate. To estimate the value of a variable (x) outside a known range from values within a known range by assuming that x follows logically from the known values.

Own revenues comprise tax, rent, and income from municipal services, urban land lease and property or service sales. These revenues remain in the city treasury, unlike "state revenues," which are forwarded to the regional Bureau of Finance.

Recurrent expenditures are operating costs. These should be entirely covered by "own revenues." State functions costs, such as salaries of teachers, are paid for by block fund from the region and are not part of recurrent expenditures.

The new Chart of Account is a set of coded accounting lines that standardizes and identifies booking activities. It identifies the planned and actual status of revenues and expenditures from all public entities. For cities, only the following lines are of importance: Own (municipal) revenues are booked under the 1700 series, whereas recurrent expenditures are booked under the 6100 to 6400 budget lines of the 500 series. The 6300 series are the so-called investments. These may be expenditures on fixed assets, infrastructure constructions, goods and consultancies.

Land lease income (no. 1731). The Ethiopian Urban Proclamation states that 90 percent of land lease revenues must be used for capital investments and that only 10 percent may be used for recurrent expenditures.

Maintenance budget. Expenditures for **"maintenance and repair of infrastructure,"** including minor repairs and cleaning of assets, should be booked under account line 6245 as recurrent expenditures. This is in contrast to the "rehabilitation, renewal and upgrading" of infrastructure, which represent capital investments and should be stated in the CIP.

Gross and net data

Revenue data obtained from OFED and inserted into the Excel table are "real figures" – also referred to as "gross" figures. However, these figures should be reexamined in light of the recent inflation rate of the Ethiopian Birr and the annual urban population growth rate, as net figures provide a better impression of a city's actual performance.

An example: A given city increases its gross revenues by 15 percent per year. When considering the inflation rate of the Birr (in this case, 5 percent per year) and the population growth of the city (5 percent per year) the net increase in revenues is only 5 percent.

This is why the city is asked to state the annual inflation rate and the population growth in the automatic template. The graphs in the monitoring template will illustrate both gross and net change in revenues (see Chapter 8).

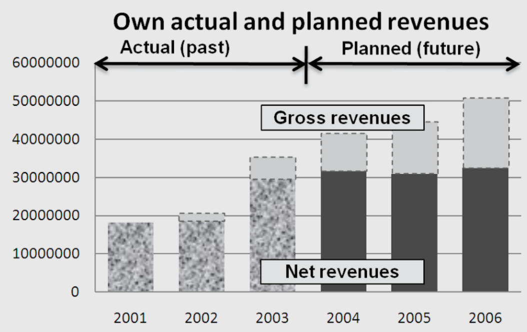


Figure 11: Example of a monitoring template comparing gross and net data

Third: Indicate past investments in the 6300 series under "Fixed Assets and Constructions," excluding the maintenance expenditure. List all past capital investments, including infrastructure works, goods and consultancies in Table 1 of the MS Excel template (see CD Annex, template screen).

Some figures will be difficult to calculate or obtain, especially when cities are just beginning to introduce the CIP. However, it is the responsibility of the Office of Finance and Economic Development to regularly provide financial reports to the regions. Cities that already use the new computerized accounting system (IBEX) will have all data available. Sometimes this information might derive from reviewing previous annual financial reports submitted to the Bureau of Finance and Economic Development (BoFED).

Step 2: Forecast revenues, recurrent expenditures and the operating surplus

There are three ways to forecast budgets: analyzing capacity, analyzing need and analyzing performance. The combination of these three perspectives will constitute the forecast for revenues and expenditures.

Capacity analysis: "Actual" performance is based on an analysis of the past; the future shows "planned" revenues and expenditures. Forecast budgets by extrapolating from past performance to predict future results. However, budgets do fluctuate; therefore, analyze each position in the Chart of Account individually.

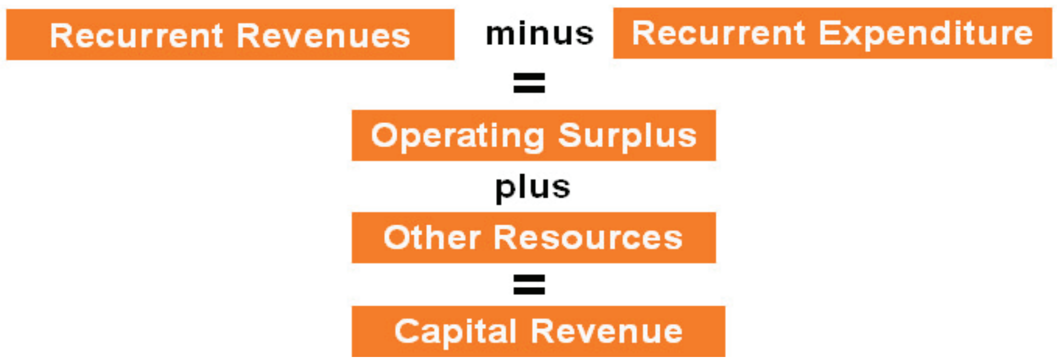


Figure 12: Logic of the capital investment budget development

Need analysis: Growing cities need infrastructure and other investments that can be calculated in monetary terms. A city's financial needs derive from its Asset Management Plan (CD Annex 3.2). Use the AMP to calculate the revenue requirements in the Revenue Enhancement Plan.

Performance analysis: The government aims to increase revenues from cities by at least 30 percent per year to cover future costs in recurrent and capital expenditures. Review past performance and existing capacities in revenue collection to fulfill this directive.

The difference between own revenues and expenditures is called the operating surplus or net income of a city. This is the "own contribution" of the city to capital revenues. The Capital Investment Budget depends greatly on the city's ability to collect its own revenues and to adapt recurrent expenditures to reach maximum efficiency.

More details about the budget items listed in the multiyear budget forecast table (Table 3, MS Excel template) can be found in the Chart of Account (CD Annex 1.3). However, the maintenance budget (Fixed Assets and Construction, number 6245 of the 500 series) derives from the Asset Management Plan and must be prepared separately (Chapter 4).

Step 3: Capital Revenues

The capital budget consists of other capital revenues in addition to the operating surplus. These are:

- 90 percent of urban land lease income (Chart of Account line no. 1731)
- Non-governmental and private contributions (Chart of Account lines 1732 and 1733)
- One-time sales of property (line 1791)
- Community contributions and other capital receipts (lines 1792-1799)
- Regional block grant for capital investments (line 1622)
- Donor grants, excluding matching funds (lines 2000-2999)
- The road fund (line 1604)
- Other capital revenues and unutilized resources from previous years (no Chart of Account line numbers)

In the near future cities will require bigger investments that cannot be financed by their capital budget. In this case cities should borrow resources in the form of bank loans. To qualify, cities will have to become "credit worthy," that is, they will have to demonstrate their annual revenue performance, as well as the value of their "collateral," for example, infrastructure and movable assets.

The Revenue Enhancement Plan

A city's own revenues should constitute the major share for capital investments. Therefore, cities are asked to increase their capacity for revenue collection by preparing and implementing the Revenue Enhancement Plan (CD Annex 3.1). This is done by:

- Assessing the city's existing recurrent expenditures for delivering services to the public, as well as clarifying existing own revenues.
- Analyzing the city's need for capital expenditures (this is where the REP connects with the AMP).
- Elaborating how the city's revenue collection will cover the costs of required infrastructure and service expenditures.
- Planning revenue and expenditures for the coming three years, while focusing on how to increase revenue collection. (Ways of increasing the revenue base include new tariff regulations, improving the efficiency of collection, and decreasing costs for services and personnel.)

One of the REP's key functions is to produce the multiyear budget forecast. This information is fed into the Capital Investment Plan. The objective is to create a positive cycle of public investments that will boost private investments and land value, and in turn increase the revenue base of cities. The increased revenue is then channelled toward more capital investments.

Chapter 3

Developing Project Proposals

This chapter describes how to develop a project proposal list for the Capital Investment Plan. The purpose of this list is to link infrastructure projects or other capital investments in the CIP with the strategic objectives of the city — for example, road construction for the development of an extension area or school construction to increase educational enrolment.

Step 1: Review the city's objectives

All cities in Ethiopia have a development plan of some sort. This might be a Structure Plan, Local Development Plans (LDP) or, in some cases, an Integrated Development Plan. These plans define spatial objectives, such as extension areas, and strategic objectives, such as poverty reduction.

Spatial plans. Spatial plans, such as structure plans, local development plans and, for smaller cities, basic plans, define areas for upgrading, extension, and renewal. Other spatial plans are road network or drainage plans. Spatial plans define the work of three main administrative bodies: Land Administration, Building Control, and Design and Construction. These offices must supervise and coordinate the execution of structure plans and LDPs, as they are legally binding. Other departments, as well as the mayor and city manager, are equally responsible.

Strategic plans. Development plans articulate a city's socioeconomic strategic objectives – for example, revenue enhancement, land-market development or youth employment creation. Cities must link these objectives to the government's Growth and Transformation Plan at regional and federal levels. Offices of the city administration must use spatial or strategic plans to disclose capital investment needs. Once offices have determined their capital needs, they must then share them with the city cabinet for vetting.

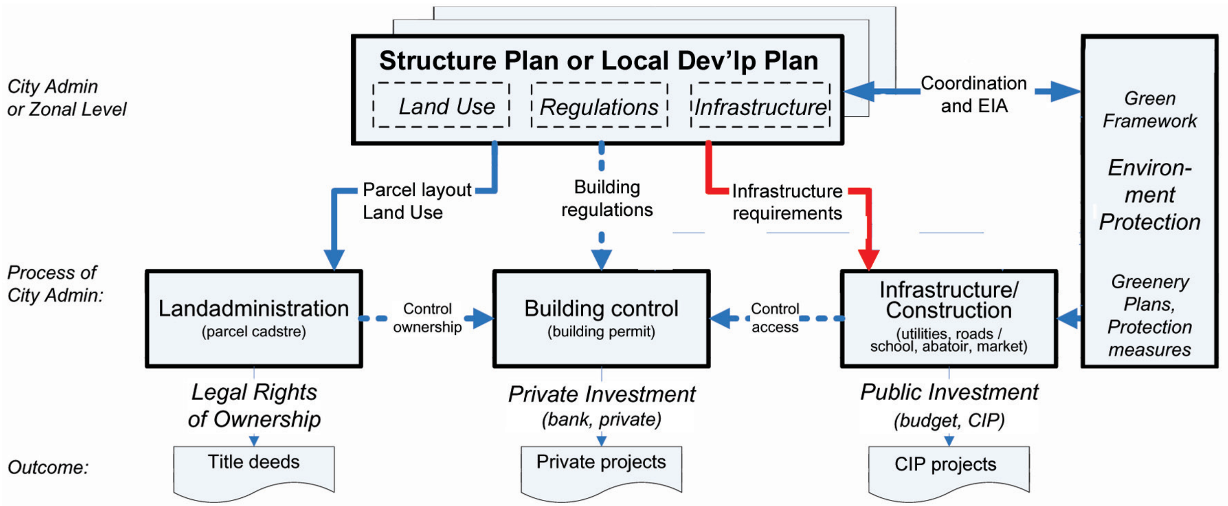


Figure 13: Linking spatial and strategic plans to the CIP (by Thomas Gross, modified)

Structure Plans are legally binding plans as stated in the Urban Planning Proclamation No. 574/2008, indicating:

1. Magnitude and direction of growth
2. Principal land-use classes
3. Housing development
4. Layout and organization of major physical and social infrastructure
5. Redevelopment intervention areas of the urban center
6. Environmental aspects
7. Industrial zones

Local Development Plans focus on strategic areas and describe functions, development objectives, implementation strategies, local economic dynamism, urban design principles, standards, budgets and timelines in order to facilitate the implementation of a structure plan.

Upgrade, renewal and extension

In the case of a gravel road, for example, upgrading can mean changing from a gravel road to a cobblestone road; extension means adding a drainage line to a road or lengthening the road; renewal means that severely deteriorated parts of a road are fully rebuilt. All three are types of capital investments.

The Asset Management Plan

The objective of the Asset Management Plan (AMP) is to link the CIP with the city's strategic objectives and long-term operation and maintenance. Hence, the AMP supports the city to manage existing infrastructure by allocating a maintenance budget to each asset. The AMP also advances priorities regarding upgrading, rehabilitation, and new capital investment projects.

For the time being the AMP is limited to main infrastructures and service networks, that is, the city's asset (infrastructure) base: road and drainage networks, drinking water supply, liquid and solid waste management systems, and street lights.

The AMP document includes:

- An asset inventory, featuring a tabular and spatial database of all infrastructure, with specifications and characteristics.
- An asset condition, which describes the current status of deterioration of the asset base.
- An asset value and deficit, which calculates the remaining asset value, maintenance and rehabilitation deficit based on annual depreciation rates.
- The related budget for asset maintenance, rehabilitation and new assets, which lists all necessary infrastructure development for the city.
- The AMP implementation strategy, which details individual activities and their respective budgets over the course of a year.

Step 2: Disclose project proposals

There are various ways of linking spatial and development plans with the CIP. To generate a list of project proposals, the city may use the following means:

A. Call for Budget

The mandate to "call for budget" lies with the Office of Finance and Economic Development (OFED), to be declared at the start of April (1st of Megabit). The OFED prepares worksheets to assist the heads of office (cabinet members) in preparing department budget estimates. This should be done by using the capital budget formats – (CD Annex 1.4). Only after budget requests have been prepared and approved and a notification issued using these standard formats can the request be integrated into the computerized accounting system of the OFED (IBEX).

In principle, sector offices should present to the OFED their recurrent and capital budget requirements, based on yearly action plans or spatial plans. In other words, they should submit project proposals for investments. However, in practice, both the OFED and sector offices often lack the capacity to undertake this procedure thoroughly.

B. Asset Management Plan

The city's Infrastructure Construction Administration is charged with building all physical infrastructure, such as roads, drainage, slaughterhouses and landfill sites. This department is thus responsible for more than 90 percent of the city's capital investments. These investments or "development needs" are defined in the Asset Management Plan. Therefore, include in the AMP a list of desired projects, including rehabilitation, upgrading and extension projects.

C. Sector plans

Not all cities have AMPs, however. An alternative way to develop project proposals from spatial plans is via so-called sector plans. Theoretically, these plans should be included in the spatial plans described above. Develop sector plans for specific objectives. In some cities, the following plans might be available:

- Transport plans for roads, pedestrian and bicycle paths, minibus lines and, eventually, dry-ports or other national transport infra-structure, such as airports.
- Flood-control plans for drainage networks and erosion control infrastructure, as well as plans for areas being protected for reforestation.
- Solid/liquid waste management plans for identifying collection areas, container areas, transport needs, and landfill and recycling sites.

These plans represent only a fraction of possible plans. However, each includes capital investments that might be added to the CIP project proposal list.

D. Public participation

In theory, spatial plans should reflect the interests of citizens. Citizen participation begins with spatial planning and may extend to the point where citizens participate in the monitoring of city administrations. Participation fosters trust and lends ultimately to a more stable society.

Conduct a participatory hearing at this point in the CIP development process (date: Yekatit 15th). The administration may choose the means for participation, such as kebele meetings, questionnaires or stakeholder interviews (see also Chapter 5).

Step 3: The project list

Whichever method the city administration adopts, it is of vital importance to compile a project proposal list at this stage. In compiling the project list, use the format shown below in Table 1 (see also CD Annex 7.1).

Proposed Project	Detailed Description	Contributes to	Derives from	Estimation
Cobblestone road	Upgrading and extension of existing gravel road to connect the city centre with extension area	Citizen access from extension area to city centre by minibus and private vehicle	AMP and city structure plan	2.3 mil ETB
Public toilet	Construction of a public pit latrine in the old town of the city	Reduction of health threats to citizens from the area	Public participation	200,000 ETB
Local Development Plan	The consultancy will prepare an LDP for the old town of the city, including a land use plan and a road network plan.	Enhanced tenure security and planning, and consequently enhanced private investments and economic development	City structure plan	3.3 mil ETB
Container truck	The city administration requires a container truck to transport waste to a landfill site	A healthier environment	Integrated waste management plan	3 mil ETB

Table 1: Example of a project proposal list

Chapter 4

Feasibility Check and Infrastructure Management

This chapter describes how to prioritize proposed projects. Project lists are mostly "wish lists" – just because a project is desirable does not mean it is possible to implement it in the time and manner desired. In other words, desirable does not equal feasible.

All proposed projects must undergo a technical and financial feasibility check. This review includes an estimation of initial investment, operation and maintenance costs, and a calculation of the return on investments.

It also includes an evaluation. Each project must be evaluated in terms of its intended impact, contribution to the city's overall objectives, and its social and environmental impact. Some projects, especially those pertaining to liquid and solid waste management, require an environmental and social feasibility study.

Step 1: Calculate the life-cycle cost

Currently, most cities in Ethiopia perceive infrastructure development as "one-time" investment, taking into account only construction costs. However, infrastructure assets have a lifespan of a defined number of years. When that lifespan comes to an end, the assets have to be renewed. Moreover, investments in infrastructure incur maintenance expenditures of diverse magnitude. Finally, cities often accumulate backlogs in maintenance. To bring an asset back to a normal depreciation rate, cities must invest more in maintenance. See sidebar for an example of a life-cycle cost calculation.

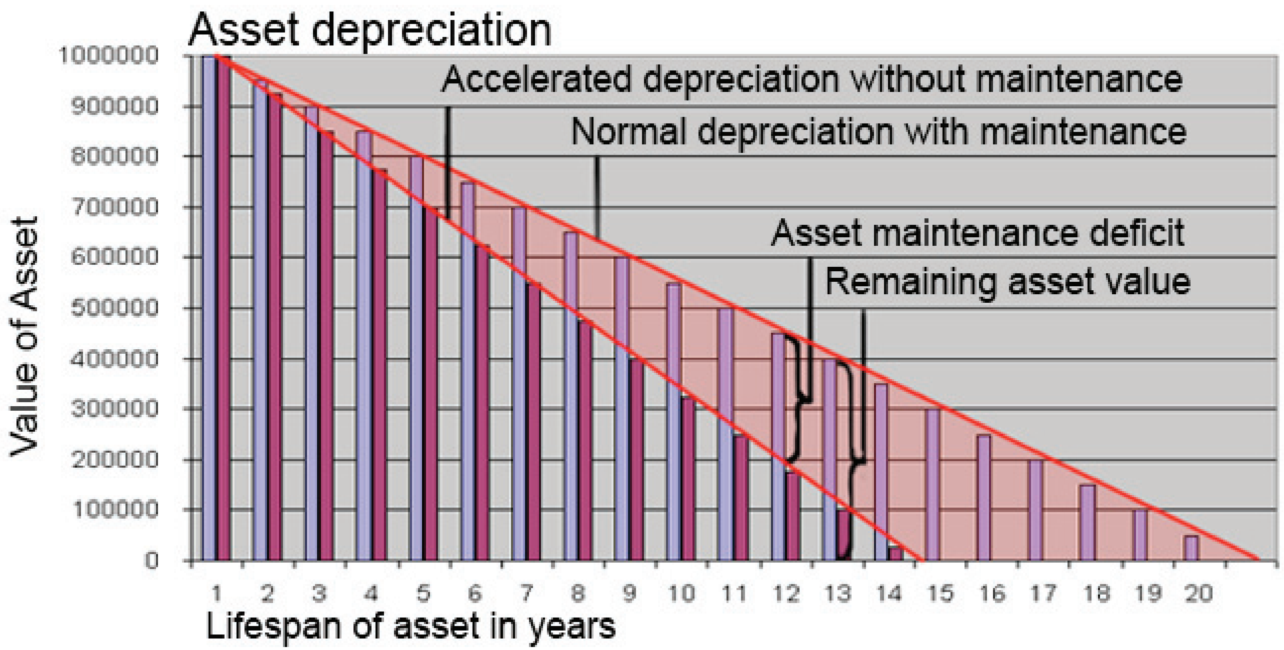


Figure 14: Example of an asphalt road: Asset depreciation, maintenance deficit and residual value

Example: Calculating infrastructure costs: Life-cycle asset management

The city of Adi Grundun wants to connect its city centre with an extension area. A new asphalt road with a lifespan of approximately 20 years would cost one million Ethiopian Birr (ETB). Thereafter, the road will have to be renewed. During its life the road loses value, at 5 percent or 50,000 ETB per year. This is called asset depreciation.

Let's assume that during the rainy season the shoulder of the asphalt road is damaged. The city is responsible for repairing the defect using its maintenance budget of 20,000 ETB/year. If maintenance is not undertaken, the asphalt layer of the road will be damaged as well. The difference between the depreciation that would occur without maintenance (accelerated depreciation) and that which would occur with maintenance (normal depreciation) is called the maintenance deficit. It is crucial to recognize that regular maintenance is much less expensive than accelerated value depreciation.

As mentioned, our asphalt road has an assumed lifespan of 20 years. Cobblestone roads, on the other hand, have a lifespan of more than 40 years and require less in maintenance expenditure. In other words, not only does a cobblestone road cost less to construct, its depreciation rate is also slower.

The high cost of constructing and maintaining infrastructure makes it important to ensure that the solutions provided and budgeted for in the Capital Investment Plan meet the needs of the population in a cost-effective, sustainable manner.

Example: How to develop a maintenance budget

A city has recently built a new 1km asphalt road to connect the inner city with the Ring Road, including 1km of concrete pipe drainage. Furthermore, the city has begun a cobblestone project, and has so far laid just above 500m. The city also has more than 4km of gravel roads and almost 10km of earth roads that need to be maintained yearly after the rainy season. Finally, there is 1km of masonry drainage to channel rainwater around the city.

To develop the maintenance budget, each item in the asset inventory is listed with its unit maintenance cost, which is a percentage of its unit cost. Finally, the maintenance costs are totalled. In this example the total annual maintenance cost exceeds 1 million ETB. Half of that budget will be needed for repairing damages to dirt roads after the rainy season.

Item, unit and amount	Asset value	% of value applied	Maintenance cost per item (ETB)
Asphalt road (1 km)	4, 500, 000	5%	225, 000
Cobblestone road (0.5 km)	1, 400, 000	3%	42, 000
Gravel road (4 km)	10, 000, 000	3%	300, 000
Earth road (10 km)	5, 000, 000	10%	500, 000
Concrete pipe (1000 m)	400, 000	3%	12, 000
Masonry drain (1000 m)	300, 000	3%	9, 000
Total maintenance			**1, 088, 000**

Table 2: Maintenance budget development by asset inventory

Step 2: Develop the maintenance budget

To compare investment alternatives, it is important to know their lifespan, depreciation and maintenance costs. The example below shows that comparing the construction costs of alternatives does not provide a good picture of the financial viability of an investment; one should rather compare the lifecycle costs of assets.

Maintenance costs are part of a city's recurrent expenditures. Maintenance activities fall into the category of capital investment only when maintenance significantly extends the life of an asset, as in the case of renewing the asphalt layer on a dilapidated road, for example.

In reform cities, the maintenance budget derives from the Asset Management Plan, which calculates the maintenance needs and deficits for each asset. Cities without an asset inventory should use between five and ten percent of their capital budget for maintenance. However, if the city does have an asset inventory listing existing infrastructure, that list should be used to allocate a maintenance budget for each item. The amount of the allocation should be a percentage of the construction value of the item. The example in the sidebar and in Table 3 illustrates how to develop a maintenance budget for a city.

Length 1km, width 10m	Asphalt	Cobblestone	Gravel
1. Construction cost (ETB)	4,500,000	2,800,000	2,500,000
2. Estimated lifespan	15 years	40 years	5 years
3. Annual depreciation (ETB)	300,000	70,000	500,000
4. Annual maintenance (ETB)	225,000	84,000	75,000
Annual life-cycle cost (3 + 4, ETB)	**525,000**	**154,000**	**575,000**

Table 3: Example of life-cycle costs of different road types

Step 3: General feasibility check

Perform a feasibility check on each project. In checking, review each proposed project from several perspectives, including technical and financial feasibility, and impact. Add the resulting documents to Annex 6 of the final CIP document.

The technical and financial feasibility check is to determine whether technical constraints – such as required land compensation and clearance – can be overcome. The feasibility check also helps assess a project's economic viability using tools such as simplified cost-benefit analysis, revision of alternative modes of delivery and return-on-investments calculation.

The impact assessment reviews a project's projected economic, social and environmental impacts and its contribution to the overall objectives of the city.

For both types of assessment, the first step is to compile the project's base data. Include the following information:

- Project description. Include information on location (e.g., kebele); dimensions and material (e.g., width, length, pavement type); and other items (e.g., sidewalks). In the case of rehabilitation or renewal, state the condition of the asset. Also, address the availability of sector plans, detailed project designs, technical specifications and procurement or cash-flow/action plans.
- Project economics and finance. Include estimated investment costs and recurring operation and maintenance costs, lifespan, annual depreciation costs, chosen mode of delivery (e.g., procurement by National Competitive Bidding), and the pros and cons of possible alternatives. Also include the source of finance for a given project, or alternative sources and respective cost-reduction or cost-recovery mechanisms (e.g., introducing infrastructure development charges).
- Project rationale and impact. Include a discussion of the project's contribution to the city's strategic objectives, its linkage with previous/other actions, and its history and origin. Also include information on beneficiaries at the time of implementation and throughout the project's lifespan, the project's responsiveness to the priorities of citizens, and socioeconomic and environmental impacts.

A standardized analysis sheet has been developed and annexed to the MS Word template to facilitate this work, along with an example of a cobblestone road project (CD Annex 4.3). The results of this quick analysis should be made available to all stakeholders during public hearings.

Cost-benefit analysis is a way to determine whether a project is desirable from the point of view of social welfare. It involves technical-engineering analysis, financial analysis, and an economic analysis that serves to identify all income and expenditures and their relative market prices, and applies a series of corrections that allow information to be seen from the point of view of the public operator.

Return on Investments is a calculation of the financial impact of a project, including development, operations and maintenance costs. Generally, cities develop products and services to provide value to citizens - without specifically intending to make a profit. Therefore, the public sector seldom receives a financial return for a product or service. Moreover, funding from federal, donor, or local government sources may be contingent on providing that product or service.

Infrastructure development charges (IDC) are fees on the enhanced land value resulting from new development. IDCs help to pay for infrastructure and other municipal services. Unlike property taxes, IDCs help ensure that the capital costs of providing services are paid by those who will benefit from them.

Step 4: Screening, Environmental Assessment & Resettlement Framework

All CIP projects must undergo a social and environmental screening. Screening is the processes of determining whether or not a project requires a full Resettlement Action Plan (RAP) and/or an Environmental Impact Assessment (EIA) and the level of assessment necessary.

Screened projects fall into three categories: Schedule 1 (RAP and/or EIA required), Schedule 2 (abbreviated RAP and/or partial EIA required) or Schedule 3 (no further assessments required). The process is initiated by the city administration's Design and Construction/Infrastructure Office, which outsources the work or submits the screening report and respective assessments to both the regional Bureau of Urban Development and the Environmental Protection Agency, with a request for approval.

The screening report describes proposed activities and their potential impact, characteristics of the location in question (sensitivity of the area), dimension or size, degree of public interest, institutional requirements and monitoring considerations (for more details see CD Annex 6).

Resettlement impacts

Some projects, notably urban upgrading and renewal projects, might imply citizen resettlement. If more than 200 residents are affected, the city must submit a Resettlement Action Plan following the Resettlement Policy Framework (RPF; CD Annex 6.2). An abbreviated Resettlement Action Plan is required if between 25 and 199 residents are affected. A plan is not required if the numbers are fewer.

This framework is used when a proposed investment project leads to population disturbance or temporary displacement. The implications of appropriating land on which stand residences and commercial properties, or land used for farming and grazing, must be considered seriously: The disruption of communities causes serious stress. The most vulnerable groups – women, children, the disabled and the elderly – are especially dependent on the informal social networks in their communities. These groups, in particular, should be consulted during preparation of the RAP. Finally, large-scale resettlement processes are frequently associated with unwanted pregnancies, spreading of sexually transmitted diseases and an increase in prostitution. Thus, the main objectives of the RPF are to:

1. Ensure that involuntary resettlement and land acquisition is avoided, or, when necessary, minimized, by exploring all viable alternatives.

2. Support any person, in particular members of vulnerable groups adversely affected by infrastructure investments, by enabling them to get jobs and other assistance.

3. Ensure that where involuntary resettlement and land acquisition is unavoidable, resettlement and compensation activities are prepared and implemented by providing sufficient investment resources according to Ethiopian law (CD Annex 2.1):

- Proclamation No. 455/2005 on Expropriation of Landholdings for Public Purposes and Payment of Compensation.
- Council of Ministers Regulation No. 135/2007, on the Payment of Compensation for Property Situated on Landholdings Expropriated for Public Purposes.

Environmental impacts

A few kinds of projects may have significant, adverse environmental and social impacts on the lives of citizens. Such projects require project scoping and a full Environmental Impact Assessment (EIA), prepared by an external consultant. Schedule 1 projects include major dams, reservoirs (>100 hectares), ground water development (> 4,000m^3/day), large-scale canalization and flood-relief works, and drainage plans close to water bodies. Other projects are landfills for waste disposal in urban centres, waste disposal installations for industrial-waste incineration, chemical treatment plants, landfills for hazardous wastes, large-scale hospitals and educational facilities, housing development (>50 hectares), designation of new towns and residential areas, new industrial estates, shopping centres, urban open-air market areas, bus and rail terminals, major urban roads, rail infrastructure and railways, high-power transmission lines, large biomass energy-using plants, thermal power stations and other combustion installations (heat output >100 megawatts), and combined cycle power stations.

Most projects may require only a partial EIA but might still produce negative environmental and social impacts. They must therefore be evaluated for *any* potential inverse impact. This is done through field visits to project areas, brief consultations with affected residents, and through the Environmental and Social Management Framework's environmental contract clauses (CD Annex 6). Schedule 2 projects include urban water supply and sanitation, small-scale land drainage, sewage systems and recycling plants, housing and commercial projects, cemetery sites and religious institutions, upgrading or rehabilitation of major urban roads and airports (runway length < 2,100m), thermal power stations and other combustion installations (heat output < 300 megawatts), and electricity transmission lines.

Scoping is used to identify the assessment requirements for a project. It also includes preparing a Terms of Reference to secure and guide an experienced consultant to carry out the Environmental Impact Assessment.

Chapter 5

The Decision-making Process

Negotiation among stakeholders is crucial to the success of capital investment planning.

Participatory budgeting and public consultations are a compulsory part of the process, the goal being to ensure that investments comply with the wishes and needs of beneficiaries. This chapter offers guidance on how to make decisions about capital investments with participation from the public. Coordination of the decision-making process is chiefly the responsibility of the mayor.

Stakeholders in decision making

Clearly, there are many perspectives on the development needs of a city – legal, technical and beneficiary perspectives, among others. Information on these various points of view are housed and disclosed by the city administration. The steering committee is responsible for collecting data of interest to:

- The city council. The council is the highest elected organ of the city. It controls the city cabinet and takes the final decision on budgets. It is to the council that the mayor must present the final CIP proposal for approval.
- Citizens. As both beneficiaries and agents of development, citizens are a highly interested body. Citizens voice their priorities either through interest groups, such as religious institutions, iddirs, or youth and professional associations, or directly through participatory budgeting. NGOs, universities and the private sector are other important stakeholders to consider.
- The mayor. The mayor is responsible for coordinating the participatory process, but he or she also has a political agenda – e.g., creating jobs – and thus often prioritizes labor-intensive, visible projects. But the mayor should not be too involved in the decision-making process; rather, his or her role is to bring about a consensus on capital investment decisions.
- Municipal infrastructure experts. The role of these experts is to develop the Asset Management Plan. They have the best overview on what infrastructure is required. However, most cities lack a well developed AMP and depend on spatial plans or development plans (see Chapter 2).
- The cabinet. Cabinet members often have their own agenda and sometimes even have access to "conditional resources." These are resources that can be applied only toward sector-specific projects – schools, for example, are specific to the education sector.

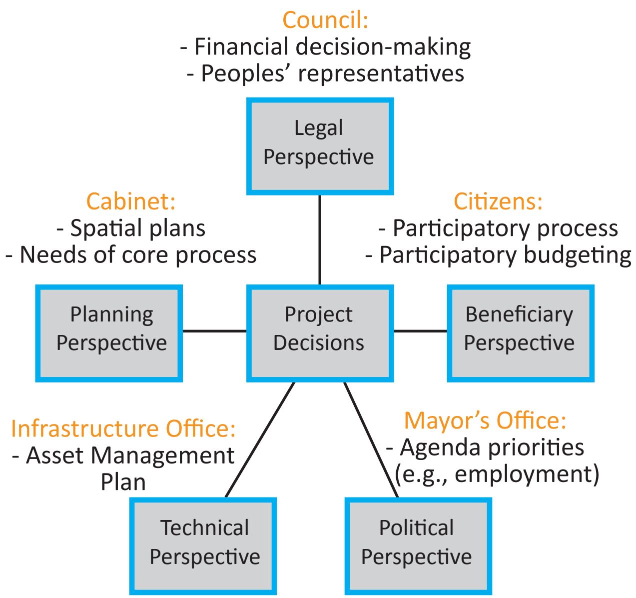


Figure 15: Perspectives on project decision making

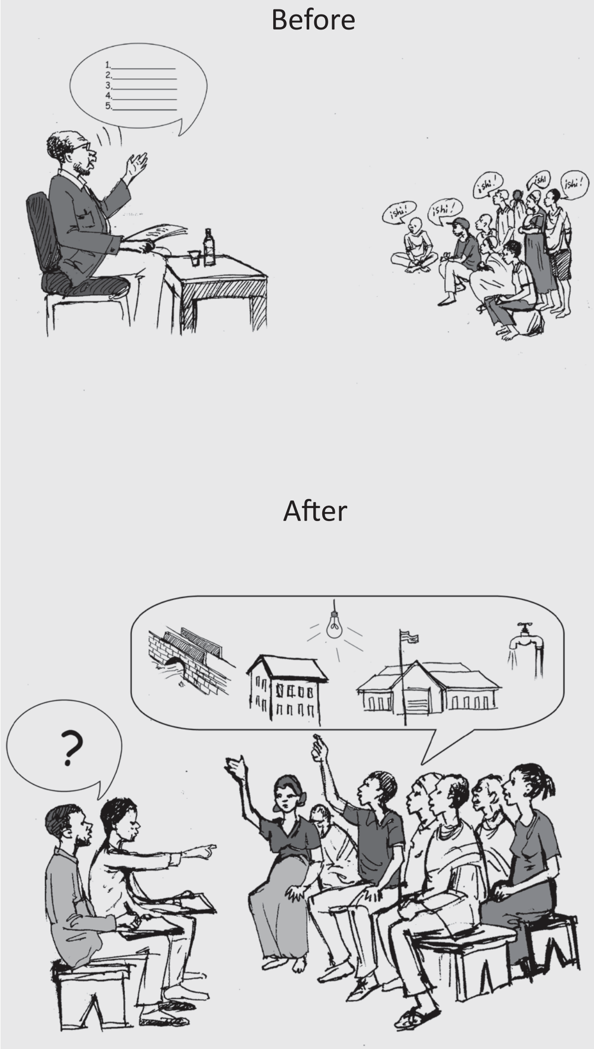


Figure 16: Empowering citizens to voice their interests is the key responsibility of the city administration

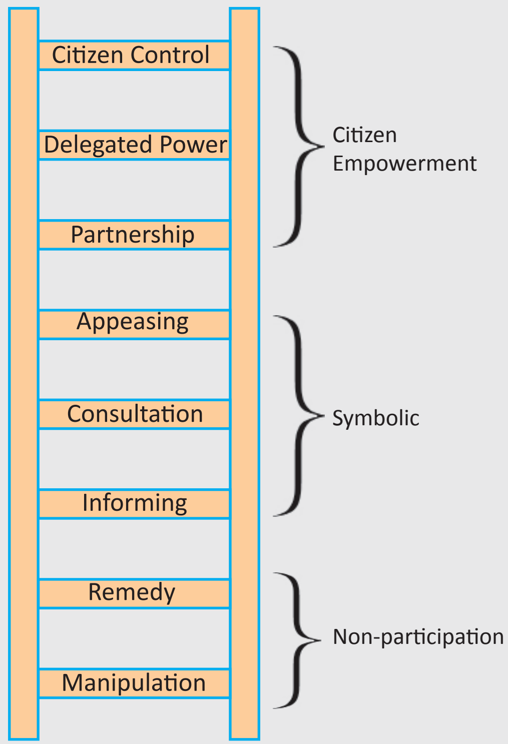


Figure 17: Ladder of participation: From non-participation to empowerment

The direct democratic approach contrasts with representative democracy. In the latter, people vote for representatives, delegating their power to make decisions to leaders (in the case of cities, these are the councillors). In a direct democracy the decision-making power lies with the people; their interests are negotiated during participatory processes.

The conventional approach

There are a number of ways to engage stakeholders in the process of deciding where to allocate public funds. Public participation around the world can be seen as a graded process, a kind of ladder (Figure 17). The lower end characterizes countries run by autocratic leaders who decide where and how much money will be allocated; on the upper end, citizens have total control over budgets.

Effective public participation requires social inclusion, a sense of personal security, and freedom of speech and assembly. Currently in Ethiopia, there is in place a conventional approach to consulting citizens, however, the capacity of vulnerable groups to participate in public consultations needs greatly to be strengthened. The format and content of these consultations should be improved to facilitate greater active public engagement in debates and decisions about urban development.

The new approach

Ethiopian cities currently function somewhere around the middle of the participation ladder, but a strong political directive to climb upward and to conduct decision making through community mobilization is now in play. These objectives are articulated in various legal frameworks (see sidebar, page 33).

To pursue these goals, the Urban Development and Construction Ministry has decided on two important targets in its sectoral Growth and Transformation Plan (GTP; CD Annex 2.6) to increase citizen ownership in development: (1) Up to 50 percent of the total development project cost shall be covered by the public in terms of knowledge, labor, finance and material contribution; (2) 35 to 50 percent of the contributors in all development programs shall be women.

Through the GTP the federal government recognizes the importance of leveraging the untapped potential of women in enhancing development. City administrations should pay special attention to the percentage of women attending public hearings and stakeholder consultations and to the priorities they raise. City administrations should also prioritize creating jobs for women through capital investments. However, while the will and legal framework exist, limited knowledge and experience about how to conduct the participatory process hampers both public participation and the engagement of women at the required level.

In response to this shortcoming the GTP is adopting an additional, “new” approach, a direct democratic approach to decision making through community mobilization and participatory budgeting. The approach is based on a model currently in use in Brazil.

Step 1: Planning participation

When talking of participation, most people think of “citizens” as a collective. However, urban stakeholders can be as varied as the poor on one hand and international investors on the other. What is essential is that all groups have a voice. Of course, the highest consideration should be given to the voices of the most vulnerable members of the population – mostly women and children. Thorough planning of the participatory process entails the following:

First: Decide which share of the capital budget should be provided for which participatory process. As said earlier in this chapter, there are two main approaches to engaging citizen participation: conventional consultation and participatory budgeting. Figure 18 (page 35) illustrates the timeline for both. The upper part of the figure shows the timeline for the conventional consultative process. This approach decides on the spending of less than 80 percent of the budget. The lower part of the figure shows the timeline for participatory budgeting. At least 20 percent of the CIP should be decided by citizens through participatory budgeting. (This share may increase over the years.)

Second: Simultaneously plan the conventional and “new” participatory approaches, including the share of the budget that will be spent through each approach. The CIP process cycle described in Chapter 1 suggests initiating both participatory approaches on Yekatit 15th.

The conventional process starts with surveys and semi-structured focus-group discussions. Participatory budgeting, conducted in parallel, begins with kebele assemblies and ends with the Council of the Participatory Budget vote for project prioritization. Both processes merge at the most important public hearing, around Miazia 15th, to assess citizen investment priorities and to consolidate the CIP before submission to the city council.

Third: Define and prepare the documents required to conduct the two approaches to participation; keep a record of the documents.

For the conventional process, prepare stakeholder lists, letters inviting stakeholders for consultations, interview questionnaires, citizen surveys and letters of invitation to potential attendees of public hearings.

For the participatory budgeting process, additional documents, such as invitation letters inviting stakeholders to kebele assemblies and voting sessions, must be developed (see CD Annex 7.1 and 7.2).

The Constitution of Ethiopia states:

“Peoples of Ethiopia have the right to improve living standards and to sustainable development and thus have the right to participate in national development and in particular to be consulted with respect to policies and projects affecting their community” (Article 43.1 - 43.4).

and:

“Women have the right to full consultation in the formulation of national development policies, and in the design and execution of projects, especially when this affects the interest of women” (Article 35).

The Urban Development Policy states:

“The public should participate in issues of development and good governance not only through its delegates (councillors), but also should directly be consulted on basic issues of concern”; similarly, the procedural manual for councillors states: “[…] councillors are responsible to ensure direct participation in decision making and budgeting.”

Finally the Growth and Transformation Plan states:

“Ensure public participation in the planning period, including local good governance, to support activities of the Millennium Development Goals. Take affirmative actions to enhance women’s participation at woreda and kebele level, engaging and mobilizing the public in the construction of local infrastructure, creating conducive legal and institutional participatory mechanisms and making them operational at all levels of the government structure to enable the public to participate in the formulation and evaluation of government policies, strategies and development plans.”

Participatory budgeting in Porto Alegre

For more than 20 years in Porto Alegre, Brazil, citizens have directly determined how the city spends its money. Known as participatory budgeting, the process is one in which ordinary citizens decide how to allocate part of a city administration's annual budget. Today more than 20,000 citizens actively participate in open regional assemblies with elected representatives, affecting the distribution of around 160 million US$ in investments.

Participatory budgeting generally involves three basic steps:

First: In popular assemblies community members identify spending priorities and select budget delegates.

Second: Budget delegates develop specific spending proposals with the help of experts.

Third: Community members vote for neighborhood priorities, investments in infrastructure, and social projects.

In Porto Alegre, citizens are elected to the Regional Budget Forum and to the Council of the Participatory Budget (COP) by 16 popular assemblies representing different areas of the city. The number of delegates elected to the budget forum is related to the number of votes cast (i.e., the higher the turnout from a neighborhood, the greater representation the neighborhood will get). Only two councillors from each assembly are elected to the COP

continued on page 31

Participation lists and voting on project priorities should be done beforehand. The Ministry of Urban Development and Construction is currently developing a manual on participatory budgeting which will serve in the future to guide the participatory budgeting process.

Step 2: The conventional consultation process

Less than 80 percent of the capital budget should be decided through conventional consultation. Before the general public is consulted, the development needs of all relevant stakeholders must be known. Therefore, organize stakeholders into groups, represented by individuals. The most important stakeholders are:

- Community-based organizations (CBOs) such as women and youth groups, slum-dweller associations and iddirs.
- Professional organizations, such as labor, business, and shop-owner associations, and the Chamber of Commerce.
- Non-governmental organizations (NGOs), including national groups working on advocacy, and international aid organizations such as the Gesellschaft für Internationale Zusammenarbeit (GIZ; formerly GTZ).
- Religious institutions, such as the Orthodox, Muslim and Protestant churches.
- Urban and kebele councillors: Kebele representatives serve when there is no formal kebele council.
- Representatives of the higher education sector and the hospital sector.

Stakeholder needs and priorities are determined in the following manner:

First: Conduct the first community meeting to reveal community interests (see pages 15 and 23). There, develop and distribute questionnaires to households or stakeholder organizations. Questionnaires are not mandatory and do not have to be reported to regional authorities.

Advantages, however, include getting a relatively large amount of opinions, and anonymity. Potential disadvantages are bias in the distribution of questionnaires (who is asked) and little transparency in evaluating results. Questionnaires should be prepared using the template on the CD (CD Annex 7.1).

Second: Conduct focus-group discussions with stakeholders. Here, representatives of various stakeholder groups are asked to discuss investment priorities. This type of consultation promotes consensus building among interviewed groups regarding investment needs and has the great advantage of revealing the interests of marginalized groups, such as women, youth, and the poor. Careful selection of focus groups is therefore crucial to the success of this process.

A disadvantage of focus groups is that “natural leaders” often take the lead, while shy persons go unheard. The resource CD (CD Annex 7.1) has a template for guiding the interview process. Having focus-group discussions, documenting and reporting them are obligatory.

Third: Conduct public hearings with representatives from all stakeholder groups.

An obligatory public hearing takes place around Miazia 15th to prioritize project proposals. (It is also at this meeting that the two types of budgets are consolidated. This is further discussed below.)

During the meeting, first present a list of pre-assessed priorities from various stakeholder groups, including the city administration. Next, explain potential projects in detail, including physical and financial parameters and financial resources, as well as anticipated social, economic and environmental impacts. Then discuss priorities and potential projects. Participants should raise questions and provide opinions on proposed projects. Finally, prioritize potential projects by either secret or public vote. Publicly announce results and document them for dissemination.

Figure 18: Parallel public participation processes

continued from page 30

(i.e., equal representation for each region of the city). These councillors also represent their regions at the regional forum. Forum meetings are open to all citizens, but only delegates can vote.

At the Regional Budget Forums:

Delegates prioritize the list of demands developed in popular assemblies. Choices have to be made, as resources are limited (only around 30 percent of demands can be financed). Delegates engage in ongoing negotiations and monitoring of project implementation.

More than 20 percent of citizens in Porto Alegre are involved in the budgetary process, partly due to incentives that engage the poorest citizens. Porto Alegre’s Human Development Index has grown significantly, due to efficient investment. The Porto Alegre example has helped fuel the practice of participatory budgeting around the world.

The learning process in Porto Alegre was far from easy. Citizens had to learn how to organize and spend money and generally exercise their collective power. Their hard-won efforts have led to noticeable improvement in the behaviour of politicians, community leaders and councillors, and to working systems of accountability and transparency in the formation, allocation and implementation of municipal budgets (See CD Annex 7.2 for further information).

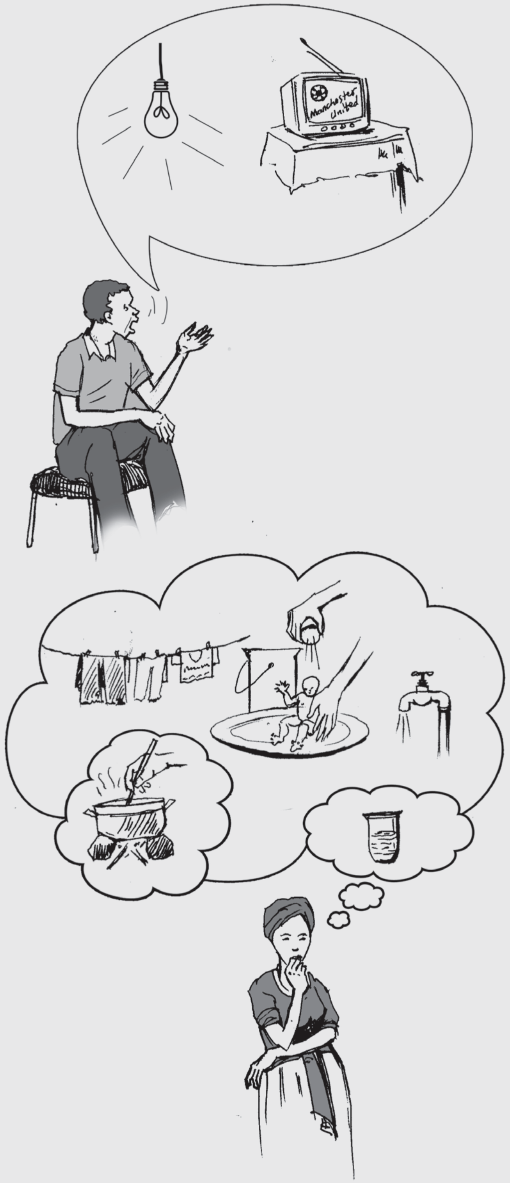


Figure 19: Key challenge: Voicing the interests of women

Step 3: The participatory budgeting process

A model in use in Brazil (see sidebar, pages 34 and 35) is being adapted for Ethiopia. The Ethiopian model has five steps:

First: Conduct popular assemblies at kebele level. This should be done around mid Yekatit with the support of a facilitator. Kebele representatives should call for a popular assembly with the maximum number of representatives from the neighborhood. During the assembly, a kebele official and a facilitator explain the concept and process of participatory budgeting and clarify the available capital budget. Afterwards, the assembly discusses neighborhood priorities. These may encompass concrete projects or political objectives such as employment creation. Suggestions from the assembly should be voted on. The assembly should then elect two budget delegates from the kebele to join the Council of the Participatory Budget (COP), where final investments are voted on and budgets allocated.

Second: City administration and kebele budget-delegates (supported by technical and financial experts from the city administration) meet weekly to further develop project proposals based on the neighborhood's revealed priorities and budget constraints. The delegates then refine and submit more tailored project proposals following the process outlined in Chapter 4 of this manual.

Third: The Council of the Participatory Budget votes on the proposals. The COP includes, among others, the two budget delegates from each kebele, the standing committee of the city council, and speakers of the kebele council. The budget delegates will present the COP with a set of concrete proposals. Each representative then has one vote on which project(s) to invest in. Following the vote, a final participatory budget based on investment and available resources is consolidated. The COP is open to the public, but only representatives may vote.

Fourth: Consolidate the participatory and conventional consultative budgets. Merge the budgets derived from the conventional consultative process and the participatory budgeting process into one final CIP budget. This should be done during the public hearing around Miazia 15th. At this meeting, representatives of the COP may vote on other investment priorities. However, the budget which came out of the participatory budgeting process (see above) may not be negotiated further.

Fifth: Consolidate the CIP and submit it to the city council.

Participatory Budgeting in Ethiopia

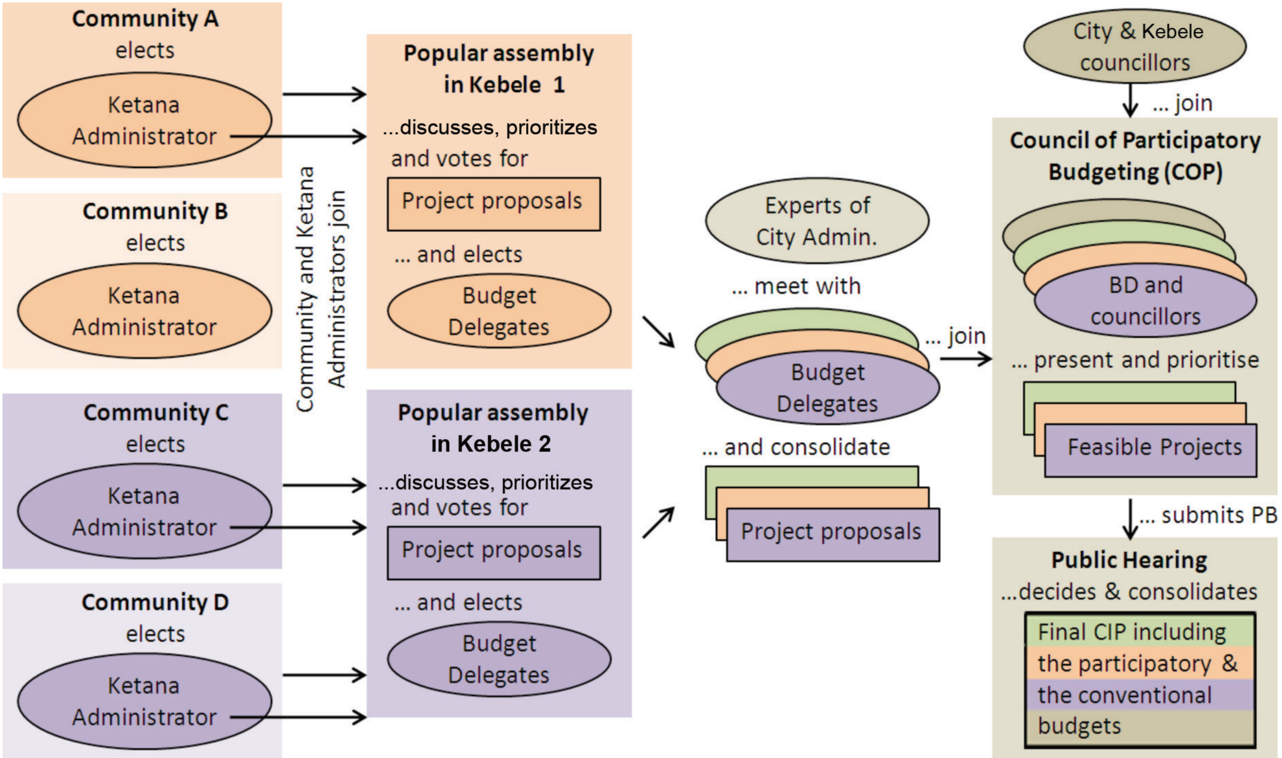


Figure 20: Participatory budgeting process in Ethiopia

Step 4: Documenting the process

The city administration, especially the technical committee is responsible for documenting and reporting both kinds of participatory processes to the regional Bureaus of Urban Development and, in a consolidated form, to the federal level bureau. Prepare the reports in a standard format (CD Annex 7.1 and 7.2) and include the following documents:

Conventional consultative process:

- Questionnaires for citizen surveys, sample size, gender ratio of surveyed persons, and survey results
- Questionnaires and reports from each stake-holder focus-group interview/discussion

Participatory budgeting process:

- Invitation letter, attendance list, gender ratio, photos or film of each kebele assembly, list of priorities and voting results
- Project proposals developed by budget delegates, evidence that proposals conform with kebele priorities, evidence of quality and amount of expert support
- Invitation letter, attendance list, gender ratio, photos or film of the general meeting of the Council of the Participatory Budget, and voting results

Public hearing and submission to council:

- Invitation letter, attendance list, gender ratio, photos or film of the public hearing, and results of voting
- Copy of the final draft of the CIP with all annexes (in the case of ULGDP cities, the participation and performance agreement also; see CD Annex 8.1)

"Public participation to prioritise capital investment projects in Adama"

Chapter 6

Consolidate the Capital Investment Plan

The preceding chapters explained how to ascertain available financial resources and how to develop a prioritized and feasible project list. This chapter will show how to match planned investments with future revenues in the three-year rolling CIP and how to consolidate the plan.

The CIP is called a "rolling" plan because each year the plan for the next three years is prepared. This approach takes into account the fact that some projects might last longer than one year, and that cities may not have sufficient resources to implement a prioritized project in the first year.

Who consolidates the CIP?

Consolidation of the capital budget requires a well informed expert in the city administration. As discussed in earlier chapters, it is the mayor's office that prepares the CIP, with support from the Office of Finance and the municipality. Within the mayor's office, the ULGDP/infrastructure coordinator is charged with consolidating the plan. He or she must therefore have a basic handle on MS Excel and MS Word.

The coordinator requires the support of experienced engineers, because the majority of a city's investments are spent on physical infrastructure. In addition to possessing detailed technical knowledge about the project, a project engineer is also responsible for defining the measurement unit, such as m^2 or km, and respective unit costs.

The year of implementation and the financial resources for each project must also be defined. The latter often has implications that are not always visible at first glance (see the sidebar on matching fund conditions). Thus, an expert from the finance office should also assist during CIP preparation and consolidation.

Step 1: Descriptive overview of the city

The goal of the city overview is to help locate the CIP in a broader context. The first section of the CIP MS Word template (see Step 3) presents important basic information about the city, such as name, population, growth rate, climate, and so on. This information can usually be gotten from the city information office; much of it can be found in the Census as well (CD Annex 2.5).

Also described in this section are the goals and objectives of the city. This information should be presented only in the form of indicators (for example: "youth unemployment shall be bisected by 2015"). Goals and objectives derive primarily from the city's development or structure plan.

Next, the outcome of the participatory process and the responsiveness of the CIP to goals, objectives and community needs should be described. Again, this should be a brief overview, including a discussion of citizens' priorities and how the city administration is responding to these concerns. Details and proof of the execution of the participatory process should be presented in CIP Annex 5. (The resource CD provides CIP examples from numerous cities that may serve as models for CIP preparation.)

New matching fund conditions under ULGDP

The World Bank provides co-funding for reform cities. Assume the World Bank is providing 100 million ETB overall. The matching fund for the loan would be an additional 25 percent, donated by each region and respective city. Both region and city would each contribute 25 million, for a total of 150 million ETB.

Expressed in percentages, the World Bank (IDA) would provide 66.67 percent, while the region and the city would each provide 16.67 percent. Thus, projects will have to be calculated accordingly. Table 5, "Project Details," in the MS Excel template should reflect this. The table automatically calculates the respective percentage.

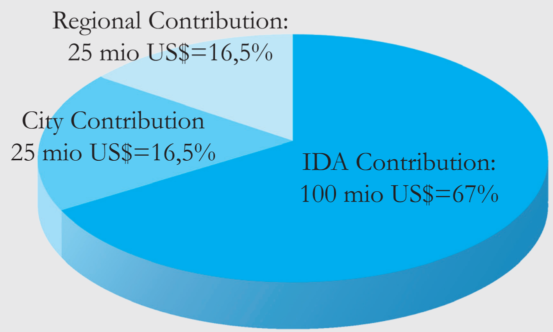


Figure 21: New matching fund conditions under the ULGDP

Estimations on investment costs of frequent CIP projects (EFY 2004)

Asphalt road, pavement only, width 10m	1 km	4.0 to 5.8 mil ETB
Cobblestone road, pavement only, width 10m	1 km	2.2 to 3.1 mil ETB
Gravel road, surface only, width 10m	1 km	2.5 to 3.0 mil ETB
Earth road, width 10m	1 km	0.5 to 1 mil ETB
Sub-base for all roads, width 10m, depth ~1m	1 km	1 to 1.7 mil ETB
Concrete pipe, non-reinforced, Ø 60 to 100	1 lm	150 to 300 ETB
Concrete pipe, reinforced, Ø 100 to 150	1 lm	300 to 500 ETB
Concrete pipe, reinforced, > Ø 150	1 lm	500 to 700 ETB
Masonry drainage, retention stone walls	1 m3	700 to 1,000 ETB
Slaps, non reinforced concrete walls	1 m3	2,500 to 3,000 ETB
Construction steel	1 kg	20 to 30 ETB
Market sheds, simple housing	1 m2	2,500 to 4,500 ETB
Solid waste collection cart for 1m3	piece	3,000 to 3,500 ETB

Step 2: Financial and organizational data

The second part of the CIP document consists of a set of tables presenting core information. Included are the summaries of past capital investments, revenues, and capital and recurrent expenditures, as well as the multiyear budget forecast and the asset maintenance budget, among others. These tables derive entirely from the MS Excel template provided on the accompanying CD.

At this point the city should have detailed information on each project, in particular the estimated investment cost. This data must be inserted into “Project Details,” Table 5 of the MS Excel template. Information required in the template includes the project item, unit and respective unit costs, and quantity. The table will automatically calculate the inserted data to arrive at the total cost.

Next, the city must indicate in which year the project should be implemented and which financial sources will be used. The Excel table will automatically compare capital revenues (MS Excel template, Table 3) with intended investments. It is the city’s task to match revenues with expenditures. Extensive surpluses or deficits must be avoided. MS Excel worksheet Table 5 is linked to Table 6 – the summary of the Capital Investment Plan.

Please note that the MS Excel sheet automatically develops diagrams for graphical representation; these will become part of the monitoring template discussed in Chapter 8.

Units, prices and calculation

Experience has shown that cities often have trouble filling in Table 5. The list in the sidebar provides some information that might ease the difficulty.

1. Normally, all roads are calculated in kilometres, with a width indicated in the remarks or directly with the project item. In the case of cobblestone roads, the square metre (m^2) is often used. Drainage and utility lines (water, electricity and telecom) are measured in linear metres (lm); remaining items are measured in straight numerical units.

2. Unit costs vary strongly, due to differences in the location of cities and the design of infrastructure. Thus, for a realistic cost calculation, cities should refer to similar projects from their own city or from a neighboring city.

3. Projects vary in preparation and implementation time. The procurement of heavy machinery through International Competitive Bidding (ICB) and projects

requiring an Environmental Impact Assessment will delay implementation at least one year. Thus, it is important to ascertain how long implementation will take, especially if projects are to be undertaken within the first or second year of the plan.

4. Donors typically have a sector or project approach, meaning that their financial contribution can be spent only on specific projects (also known as "eligible" items). For example, since the World Bank fosters labor-intensive infrastructure, vehicles cannot be procured with World Bank funds.

The use of external resources often implies that the city will provide matching funds. "Own resources" from the city are obliged to satisfy the requirement to "match" donor funds.

In addition, most donor funding carries conditions and calls for donor-specific procurement procedures. Thus, all external resources listed in Table 3 of the MS Excel template must be revised in light of such constraints, and projects procured by external resources should be listed separately.

The staffing table

A lack of sufficient and qualified staff has been the main obstacle to smooth implementation of the CIP. Table 7 of the MS Excel template lists all projects and their total estimated costs, as well as the respective implementation process and implementation focal person (in most cases the process will be the infrastructure core process and the focal person will be a municipal engineer). Staff for design, procurement, and contract management should be carefully selected based on the scope of the project. (As a rule-of-thumb, one engineer can implement about 10 million ETB per year.)

If the numbers of required and actual staff differ dramatically, the human resource department should rapidly hire staff and provide initiation training.

Step 3: The CIP annexes

The third section of the CIP consists of annexes. If the process outlined in this manual is being followed, most of the annexes should already have been developed. Following is a listing of the information contained in each annex:

Annex 1: Detailed information on the city, including a brief narrative on:

- Facts and Figures: Population and growth rate, land size and extension, unemployment and poverty, ethnic and religious distribution
- History: Date of the city's founding, historical development-impacts and reasons for development
- Location: Geographical, political and climate zones, and respective impacts
- Economic bases: Agriculture, services, industry, manufacturing, trade, mining, military
- Environment: Soil and erosion, surface and ground water, fauna and flora

Annex 2: Details on development goals and objectives

- Available plans: For example, Structure Plan, Local Development Plan, inner-city upgrading, drainage network plan; including approval and expiration date
- Vision and goals: Overall and specific objectives, particularly spatial needs, such as extension areas
- Sector plans: Brief summary of offices' one-year action plans with focus on capital investments
- Achievements: Summary of past progress toward stated objectives

Annex 3: Status and condition of infrastructure (from the Asset Management Plan, if available):

- Road and drainage network: Amount, surface and condition of existing physical infrastructure
- Solid and liquid waste: Facts and figures on waste production and collection, existing infrastructure, vehicles, collection scheme, and operation expenditure and cost-recovery
- Socioeconomic infrastructure and greenery: Health and education; parks and greenery, markets, industrial zones and abattoirs
- Utilities: Facts and figures on water, electricity, streetlight and telecommunication supply
- Public buildings: Facts and figures and conditions

Annex 4: Detailed review of income and expenditure (from the Revenue Enhancement Plan):

- Past performance: Revenues, recurrent and capital expenditures and respective trends
- Own revenues: Planned amounts and sources as well as enhancements and trends
- Recurrent expenditures: Planned amounts and purpose, and respective trends
- Capital revenues: Planned amounts, sources, conditions, matching-fund and procurement requirements, their trends

- Investment recovery: General existing mechanisms for cost recovery or cost sharing

Annex 5: Details of the participatory process:

- Stakeholder: Existing stakeholder groups and their interests
- Focus-group discussion: description, documentation and outcomes
- First public hearing: description, documentation (invitations, photos, film, etc.) and list of expressed priorities
- Second public hearing: description, documentation and list of prioritized projects
- Photos, film, invitations, documentation of voting, etc.

Annex 6: Breakdown of each project including:

- Project description
- Project economics and finance
- Project rationale and impact

Annex 7: Maintenance plan with respective staffing plan:

- Budget: Detailed breakdown of the budget allocated for maintenance
- Organization: Sector-specific arrangements for maintenance (e.g., outsourcing of street sweeping, greenery, etc.)
- Rehabilitation: Major repairs and renewal

Annexes 8 and 9 are described in the next chapter.

Chapter 7

Procurement and Cash-flow Plan

The objective of this chapter is to develop the procurement and annual cash-flow plans of the CIP. These plans lay the foundation for how and when an investment is procured and consequently when the cash-flow requirement occurs. Procurement management involves six basic steps: (1) procurement planning, (2) advertising and receiving the offer, (3) opening, (4) evaluation, (5) negotiation and contract award, and (6) contract administration. Procurement planning is the act of scheduling each step involved. Cash-flow planning is the timely scheduling of liquidity to the right party.

Developing these plans requires basic knowledge of procurement and market mechanisms. In collaboration with the relevant technical departments, the Office of Finance and Economic Development is responsible for preparing procurement and cash-flow plans. The procurement plan and cash-flow plan are submitted along with the main CIP document as Annexes 8 and 9, respectively.

Step 1: Defining procurement conditions

The goal of the procurement process is to identify the best supplier for a client's needs through a transparent, accountable, open and fair bidding process. Thus, all eligible bidders are provided with the same information and have equal opportunity to compete.

It is important to note that the best supplier is not necessarily the one that has submitted the cheapest offer, even though in public procurement only the least evaluated offer can be awarded. Identifying the best supplier means providing clear, unambiguous criteria for bidder qualification and clearly conveying the scope and complexity of the work in the bidding document. Cities should assign or recruit procurement staff that have the necessary skills not only to handle procurement per se, but to study the market and define the rules of the game. Table 5 of the MS Excel template, "Project Details," lists planned projects, estimated costs and sources of finance. The following elements have a decisive influence on procurement.

- Project scope: The more complex a project, the more detailed the procurement that is required, and thus more time has to be built into the planning process. For example, a disposal site requires consultancy work for its design, for supervision of the contractor, and for the procurement of construction. Other projects, such as small-scale drainage lines, require more simplified procurement procedures. Low complexity increases access to contracts for less experienced small contractors and micro and small enterprises (MSEs). Small contractors may require additional support from the city administration — the administration may, for instance, be called on to supply machinery.
- Cost: The higher the estimated cost of a project, the more complex the procurement. For example the Ethiopian Procurement Regulation (CD Annex 4) permits procurement by local shopping of works only if the project is below 250,000 ETB (in the case of ULGDP, below 500,000 ETB), thus providing opportunities for small enterprises. Above this threshold the city has to use national competitive bidding (NCB) and in some cases even international competitive bidding (ICB).
- Source: An external resource, especially from donors, often obligates cities to use specific procurement procedures. The Kreditanstalt für Wiederaufbau (KfW), for example, did not allow procurement by local shopping; also, KfW permits direct contracting and force account (see Step 2 below) methods only under very strict restrictions.

Several other factors influence the outcome of the tender process:

- Procurement categories: Procurement categories are works, consultancies, goods or other items. Please note that this chapter covers only the procurement of works, since the large majority of city administrations' CIPs consist only of infrastructure projects. Procurement categories and thresholds determine which procurement methods are used. The choice of category, therefore, has a bearing on the amount of time required for the bidding process. Normally, contracts will be awarded within a single category (in the case of the CIP, mostly "works"), although there are exceptions. Certain types of plant equipment, for instance, in the construction of abattoirs, are always procured on a "supply and install" basis, where goods delivery and related installation services are combined into a single contract.
- Contract package: Defines how to organize the lots and "packages" for the bidding process to ensure economy and efficiency. For instance, the construction of a market with sheds, public toilets, waste management and drainage lines can be procured either in one "package" or by many single contracts. By determining the packaging, the city administration influences the manageability of and coherency in the planning of such complex contracts.
- Procurement time: In certain cases, time might factor significantly in deciding what procurement methods to use. Consider the example of tractors, necessary to many types of construction work. If such vehicles are procured by International Competitive Bidding or National Competitive Bidding, the procedure will take almost one year. Thus, the city might decide to use direct procurement (single source) to save time, provided that other conditions, such as the reception of approvals, are granted.

Step 2: Procurement method (works)

The Ethiopian Procurement Regulation (CD Annex 4) recognizes an array of procurement methods as "eligible": national and international procurement, local shopping (LS), and direct procurement. Donors might introduce additional procurement methods, such as local competitive bidding (LCB) and community participation in procurement, in the case of ULGDP. The method of procurement has strong implications for the outcome of a given bid and on the potential for fraud. Furthermore, procurement methods determine whether donors demand prior or post review of bid documents and bid evaluation reports (BER). The set of recognized procurement methods are briefly outlined below.

International Competitive Bidding (ICB): ICB should be used to acquire highly complex and machinery-intensive public investments (i.e., dams) as well as complex machinery (i.e., vacuum trucks). Where donor funding is involved, ICB is required for bid contracts exceeding 5,000,000 US$ for works and 500,000 US$ for goods in the case of ULGDP.

National Competitive Bidding (NCB): NCB may be an efficient and economical way of procuring goods or works that are unlikely to attract foreign competition, where the advantages of ICB are clearly outweighed by the administrative or financial burden involved and when competition is available locally. Advertising for NCB may be limited to the national press and official newspaper. NCB applies to goods estimated below 500,000 US$ and for works estimated below 5,000,000 US$.

Local Shopping (LS): When a contract is valued at less than 250,000 ETB for works (for ULGDP, less than the equivalent of 50,000 US$), less than 100,000 ETB for goods, and less than 60,000 ETB for consultancy, at least three qualified local contractors or micro and small enterprises may bid. The contract must be awarded to the contractor or MSE offering the lowest evaluated price on the basis of criteria mentioned in the Request for Quotations, which is sent to as many registered MSEs and contractors as necessary to ensure that at least three offers are received and compared.

If all offers are substantially higher than the reference prices in the city's unit price database, the city may negotiate with the bidder who offered the lowest quotation (and met qualification criteria). If negotiations do not result in a lower price, the city government may need to reassess the scope of the work and revise its reference unit prices, or find other alternatives.

Own force or force account: In Ethiopia, no specific process is identified to apply "own force," therefore, abstention from this method is highly recommended. To use the force account method under ULGDP, cities should gather the following information and seek approval from the city council:

- Estimated cost and reason for carrying out a specific work on a force account basis
- Detailed capacity of the force account unit and its relationship with the city administration
- Methods and procedures applied to fixing unit rates
- Proposed arrangement for the supervision of works
- Other information relevant to the specific works in question

However, please note that the force account method implies many loopholes; donors permit the use of this procurement method only under very particular conditions.

Local Competitive Bidding (LCB):

The World Bank has introduced the LCB procurement method, which can be applied by city administrations for up to an equivalent of 100,000 US$ for IDA-financed projects. In this process both local small contractors and MSEs are invited to compete. An advertisement should be run for at least 15 days through local newspapers, radio stations and city administration billboards. If the least submitted offer is in the range of the price estimate of the city administration, no negotiation is allowed. Please note that even if only one bidder submits a reasonable offer the contract shall be commissioned.

Community Participation in Procurement:

Under ULGDP procurement, a project may involve small-scale, labor-intensive subprojects (works) implemented at kebele or community level, under the direct supervision of the city. Subprojects would be contracted using simplified bid documents. Works done through community participation must follow special procedures to manage and supervise contracts; sample bid documents for contracting subprojects and contracts (CD Annex 4.2) should be referred to.

Direct procurement/contracting: the Ethiopian Procurement Proclamation states that direct procurement is "eligible" only if:

- Goods or works can be supplied or provided by only one candidate.
- Additional deliveries of goods by the original supplier are required, either for replacement or extension of existing supplies.
- The head of the respective public body has determined that there is urgent need.
- Shopping becomes necessary to meet the special procurement needs of public bodies.
- There is a question of goods available under exceptionally advantageous conditions which arise only in the very short term.
- Additional works not included in the initial contract have, through unforeseeable circumstances, become necessary.
- There are new works consisting of the repetition of similar works – but only if the initial contract was awarded on the basis of open or restricted bidding.
- There is a need for continued consultant services, where the original contract has been satisfactorily performed and continuation will likely lead to gains in economy and efficiency.

For detailed conditions under which direct procurement can be used, see CD Annex 4.

Step 3: Develop the procurement plan

Each item in the CIP must be reflected in the procurement plan, regardless of whether it is financed through donor or own resources. The procurement template demands a wealth of technical information. The template can only be completed if the project proposal has been thoroughly prepared. Thus, before filling in the templates the procurement officer should do a comprehensive review of the tender documents for each project, including design, technical specifications, bill of quantity, and special or normal procurement notice. In the case of missing items, the procurement officer shall calculate the time required to provide the outstanding documents and follow up the process. The following background information is required to complete the procurement template **(It would be helpful to keep open and refer to the template file while reading this section):**

- Serial number and description of project: Serial numbers should be unique and should always accompany a short but precise project name.
- Complexity: The preparation of bid documents differs according to the complexity of a project. Complexity is also linked to tender dates. Here the user may choose between a designation of "complex" or "simple." For projects procured

under ULGDP, this differentiation does not have any influence on procurement procedures.

- Package and lot number: Package numbers should correspond to the following scheme: Name of City/Source of Finance/Procurement Category–number/year of procurement. For example: The City of Hosanna wants to build a cobblestone road with own resources in the year 2003. The respective code would be: Hos/Gov/W-001/2003, where "Gov" stands for Government and "W" for Works. In any correspondence concerning this project, the package number should be used as the reference. Lot numbers are of significance only when the contract packaging is more complex.
- Lump sum or bill of quantity (BoQ): Most projects have a detailed BoQ which describes each step of the work and requires a financial bid for each of these steps. Normally, the BoQ states the unit of measurement and the respective quantity, and is accompanied by technical specifications. However, some projects require a lump-sum amount — procurement of goods is one example.
- Procurement regulation and method: Bid opening times vary according to the method of procurement. Furthermore, different entities have different procurement regulations, especially concerning times and thresholds. Thus, it is best that the decision on procurement method be left to an expert. The procurement template automatically calculates the time

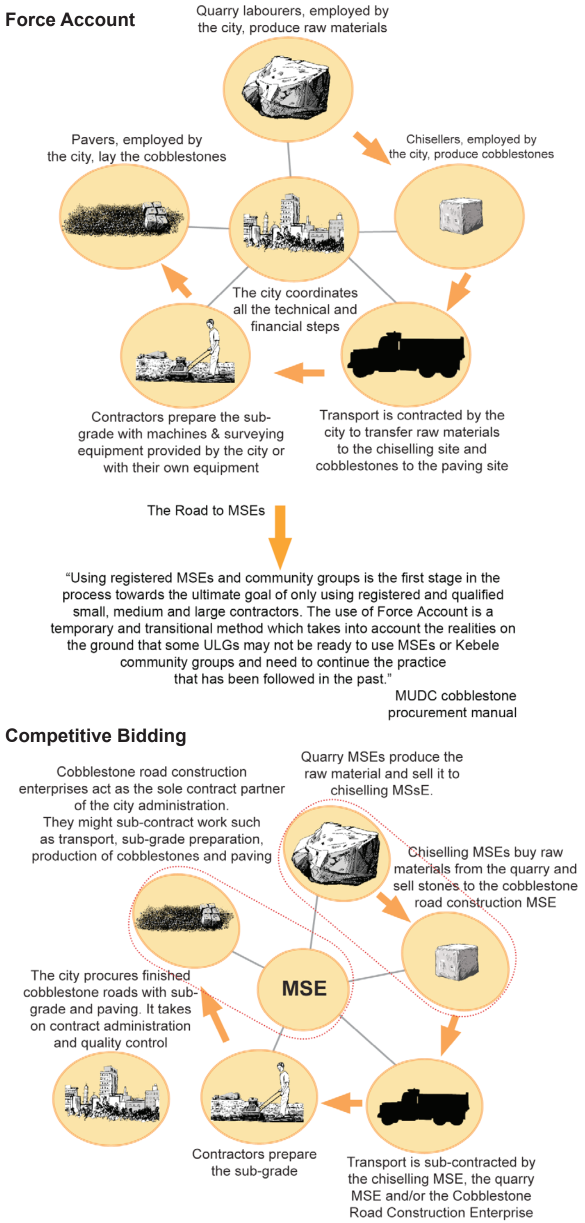


Figure 22: From force account to competitive bidding

Cobblestone procurement

When cities first launch their cobblestone sector, they usually use the force account method to procure the required works. However, this method is not recommended, because cities cannot afford to constrain their administrative and logistical capacities by being so deeply involved in the overall construction process.

The first scenario (above left) shows how the force account method puts the city in the middle of the cobblestone organizational process where it has to coordinate complex activities, such as providing sufficient raw material to meet the demands of pavers, paying workers, and reviewing the quality of work and worker productivity. The implication is that once the city ends construction of these roads, the entire sector is likely to collapse.

The second scenario shows a strong enterprise at the heart of the construction process, managing the entire construction cycle. This is a role for a construction contractor or MSE capable of undertaking office, construction and contract management. In this scenario, cities act as clients and can procure works by various methods, including competitive bidding. A free market operating context, with its supply-demand mechanisms, would significantly reduce costs. Finally, a clear separation between client and contractor would lend to improved quality, since the client will tend to demand better performance from a contractor.

The Ministry of Urban Development and Construction has provided a manual for cobblestone procurement to help cities to outsource the work and has also provided standard tender documents, such as contracts, bills of quantity and technical specifications to facilitate the procurement of cobblestone works (CD Annex 4.3).

Automatic templates

The Ministry of Urban Development and Construction has developed a standardized, automatic template for calculating the procurement of works. The MS Excel template (see resource CD) features one tab containing a pre-programmed procurement plan for civil works, one for goods. The tab contains two tables. The table on the left in the template (Figure 23) is for inserting data; the other (Figure 24) returns a fully developed procurement plan with respective dates.

The table in Figure 23 is designed to hold basic data and information needed to determine the procurement procedure. The user may choose the procurement procedure and indicate whether pre or post reviews are needed. This information will allow MS Excel to automatically fill in the procurement plan.

Table two of the procurement template (Figure 24) is the procurement plan itself. Based on the data inserted in the first section, the plan presents various time targets that should be met during the project management cycle.

The information in the "procurement plan" tab is automatically transferred to a tab called "cash-flow plan." This in turn will be automatically filled. The MS Excel table is automatically linked to CIP Annexes 8 and 9 in the MS Word template (i.e., the actual CIP document) thus rendering copy and pasting of data unnecessary.

	A	B
8	**Basic Data / Information Item 1**	
9	Serial number (S/N):	1
10	Description of project:	1.1.1 Asphalt Road no. 1
11	Complexity of project:	Complex
12	Package number:	1
13	Lot number:	1
14	Lump sum or Bill of Quantity:	Bill of Quantity
15	Applied procurement regulation:	Ethiopian
16	Procurement method:	National Competitive Bidding
17	Estimated amount in ETB:	
18	Estimated amount in US$:	
19	Prior or post review of bid doc	
20	Prior or post review of bid report:	Prior review of bid report
21	Plan:	Plan
22	Revised:	
23	Planned date of SPN, BI or CA*:	10/10/2012
24	Revised date of SPN, BI or CA*:	
25	Contract implementation (weeks):	20

International Competitive Bidding
National Competitive Bidding
Local Shopping
Direct Procurement
Force Account

Figure 23: Table 1 of the procurement plan template: Data input table

Bid period, considering procurement regulations (in days):				0	Preparation & submission time, considering complexity (in days):				0				
	Draft Bid Documents, including specifications and BOQ, draft SPN		SPN Advertisement	Bidding Period		Submission of bid eval. report	Contract Finalisation			Submission of performance security	Contract Implementation		
Plan	Prep. & Subm.	No-objection		Bid Invitation	Closing/opening		No-objection	Contract Awards	Signature		Mobilisation	Commencement	Completion
Revised													
Actual													

Figure 24: Table 2 of the procurement plan template: Automatically developed procurement plan

implications based on the expert's choice of method.

- Estimated amounts: Each project must undergo a cost estimation (discussed in previous chapters) based on readily available designs and technical specifications. The procurement table automatically calculates the ETB amount in US dollars, based on the current exchange rate, and this amount must be inserted into the respective field.
- Prior or post review of documents and bid reports: Prior review of the procurement plan is only relevant if external (donor) funds are used. This is mostly the case when cities want to use local shopping or direct procurement, or when the contract amount surpasses a certain threshold (in the case of ULGDP, 5 million US$). In other words, most procurement of works does not demand prior review of bid documents or bid reports. However, prequalification is required in the case of complex consultancy procurements, where only a few candidates in the market are capable of doing the job.
- Planned and revised: These rows are to indicate the procurement implementation status – that is, whether the procurement expert wishes to develop a "planned" or "revised" version of the procurement plan. Where the procurement expert wishes to indicate the actual status of implementation, he or she must manually enter that information into the table.
- Planned and revised dates: This date is the key date used to calculate all other dates automatically. The date varies depending on procurement procedure. In the case of ICB, it is the date of submission of the special procurement notice (SPN), or the procurement notice (PN) to the press. With procurement by local shopping, the date indicates the bid invitation date. In the case of direct procurement, the contract award date is used. In the case of force account, the date used is the mobilization date.
- Contract implementation period: Finally, the duration of contract implementation must be indicated in weeks. Doing so influences the end of the procurement plan and the cash-flow plan.

Automatic calculation

From this point on, the Excel procurement table calculates automatically. Below is information on how the template calculates the different stages in procurement planning for works:

- Tender floating and preparation period: This key information varies greatly depending on the procurement method and regulation chosen. The table on the next page indicates the range of time given for the various options.
- No-objection dates: In the case of prior review of bid documents and bid reports, the procurement table provides two weeks

(14 days) for the donor agency to return the documents and provide its "no-objection." If the donor voices an "objection," the procurement plan has to be revised accordingly.

- Bid invitation date: The date when the bid is officially opened. At this time all procurement notes (PN or SPN) should be published and distributed through newspapers and through the Internet – within a week (7 days) after the procurement note has been submitted to the respective agency (e.g., in ULGDP cases, the United Nations Development Business website).
- Submission of the bid evaluation report: The bid evaluation report is done by the bid evaluation committee, which consists of technical and financial experts. The report is submitted to the Office of Finance's procurement office or to the donor (in case of prior review of bid report) that is responsible for awarding the contract. Here, a 14-day period is provided for the bid evaluation.
- Contract finalization: Contract finalization is the announcement of the bid winner and the awarding of the contract. The winner and unsuccessful bidders are announced at the latest 14 days after submission of the bid report or the "no objection," respectively. The announcement should be published in local newspapers and announced on the city administration's billboard. The contract signature follows one week later.
- Submission of performance security: This is done by the contractor to the city administration and requires an application to the bank. The contractor has two weeks to submit after signing the contract.

	Tender floating period in days		**Preparation period in days**	
Procurement regulation and method applied	Complex	Simple	Complex	Simple
Ethiopian, ICB	45	35	140	70
Ethiopian, NCB	30	21	112	56
Ethiopian, LS	15	15	42	21
Ethiopian, DP		NA	112	56
World Bank, ICB		45	168	84
World Bank, NCB		30	112	56
World Bank, LS		15	42	21
Other donors, ICB		45	168	84
Other donors, NCB		30	112	56

Table 4: Sample of the amount of time required for various procurement options

- Contract implementation: The mobilization date represents the official beginning of contract implementation. It is an important date for the Office of Finance and donors to define cash-flow requirements. Mobilization of machinery and personnel is done in the 14 days after the submission of the performance security; commencement takes place one week later. The duration of contract implementation depends solely on the scope and complexity of the project. Estimating how long implementation will take is often done during contract negotiation, between the client (the city) and the contractor. An experienced engineer is indispensable to this negotiation. The procurement plan and the cash-flow plan, discussed below, are presented as the eighth and ninth annexes to the CIP.

Step 4: Cash-flow plan

The cash-flow plan (formerly named the action plan) derives directly from the procurement plan; both plans are correlated with each other and are automatically linked. The cash-flow plan states the amount of cash needed and when. This plan is mostly required for external fund providers (donors), but also is important for the city's Revenue Authority, which is charged with assuring that money is available once the contract has been awarded and advance payment needs to be made. Among the automatic MS Excel templates is a template for a cash-flow plan. It is automatically completed in light of the dates given in the procurement plan. Distribution of the total cash-flow requirements for a given project over the four quarters of a year needs to be revised by an experienced expert.

Chapter 8

Approval, Dissemination and Monitoring

The approval of a budget such as the CIP represents a consensus decision made by a city. The budget for capital investments should therefore be approved by all stakeholders involved in developing the Capital Investment Plan.

That said, it is the city council – the city's highest organ – that is ultimately responsible for approving the plan. Budget approval means more than just official authorization; once approved, the budget/plan becomes "owned" by the city council. The council can thus be held responsible for its content. This chapter describes how the CIP is approved and made legally binding.

Step 1: Endorse the Capital Investment Plan

Once approved, the CIP document becomes legally binding. Ownership of the plan is transferred from the city administration to the city councillors, who must control its implementation.

Because approval symbolizes a consensus decision by both city administration and citizens (represented by their councillors), the CIP should also be presented and agreed upon publicly to allow citizens to exercise their share of accountability and ownership. The formal approval also demonstrates the starting point for the city administration to implement the CIP – once approved it becomes their official, guiding document.

The Urban Proclamation states that all city budgets must be approved by the city council. However, the council is only one entity, although the most important, that must approve the CIP. In ideal cases the document should be approved following a ladder approach:

- The cabinet is the most important "executive organ" of the city; it has prepared the CIP and thus has to approve the final draft.
- The citizens, who have been involved in the decision-making process, must approve the final draft in order to verify that their demands have been taken into consideration.
- The kebele councils of a city, especially in bigger cities, approve those positions in the budget related to investments in their respective kebele.
- The city council, the highest legislative organ of the city, approves the CIP and thus turns the draft into a legally binding document.

(In the ULGDP, some financial resources derive from external donors. In these cases the financing entity, mostly banks, will also in a sense have to "approve" the CIP by affirming its conformity with donor regulations – a lengthy process that can take four to six weeks.)

Following the Ethiopian fiscal year, the CIP should be approved by the council by Sena 30th of each year at the latest. In the case of ULGDP, the deadline for review and approval is held between January and March each year as per the Operational Manual (CD Annex 8.2), since the CIP must be forwarded to the regional and federal authorities and from there to the World Bank for approval. However, experience has shown that the Capital Investment Plan has to be revised semi-annually, in which case the council is called on to provide its approval more often (see CIP process cycle, page 15).

Figure 25: Ladder of approval

Step 2: Documentation and reporting

Reporting is more than just an administrative task; it is the most important mechanism to hold the city administration accountable to higher authorities, to the council, and most importantly to citizens. In the case of CIP development, reporting serves to provide evidence on the execution of CIP planning. For this, vigorous documentation of the process is essential.

A report on the CIP development process must be shared with regional authorities and with the city council. The report must include what is known as a Participation and Performance Agreement (for ULGDP cities only; CD Annex 8.1). By signing this agreement the mayor, the highest representative of the city, commits his administration to adhere to the regulations issued by the respective performance grant, and thereby reconfirms his or her accountability for the success of CIP implementation.

Documentation is as crucial as reporting. It means filing all documents in a comprehensive manner in a central space. Each office is responsible for filing its own documents. Distribution is done by the City Information Office, in collaboration with the mayor's office, the municipality, the Office of Finance and the Revenue Authority. Documentation encompasses all documents produced during the CIP process, including the evidence of participation from Chapter 5 and the actual CIP, along with its annexes. During the plan's implementation, many more documents will be generated, such as tender documents and respective bidding reports, as well as financial and physical progress reports.

Step 3: Information dissemination

Dissemination of information, especially when it comes to budget decisions and the announcement of tender results, is crucial for enhancing the accountability and transparency of local governments. As with reporting and documentation, it is the City Information Office, in collaboration with the departments implementing the CIP, that is in charge of dissemination.

The objective of informing citizens is to enable them to participate in the development of their city. Thus, information dissemination is an obligation for the administration — not a "one-time-task," but a continuous process to inform citizens.

The following pieces of information are the most important to disclose to the public (for each type of information, standardized templates have been developed, introduced in previous chapters and annexed on the documentation CD):

- Outcome of public hearings, including priorities of different citizens' groups
- Budgets, such as the capital investment plan, maintenance budget and recurrent expenditures
- Results of bid evaluations and awarding of contracts, including amount and justifications
- Results of social and environmental safeguard screenings and assessments, following the Environmental Safeguard Management Framework, the Resettlement Policy Framework and the Ethiopian Environmental Guideline

The means of disclosing information to the public depends on the local context and overall administration capacity. In most cases, municipalities have pin-boards, which are useful for information dissemination. Local newspapers, radio stations and information flyers have been used by various cities in Ethiopia with great success for various purposes, including the broadcasting of council meetings. Kebele-level public hearings can also be a useful instrument for informing the public. Finally, it is important to make information comprehensible. Often this means using the local language, avoiding technical terms and working with visual information as much as possible.

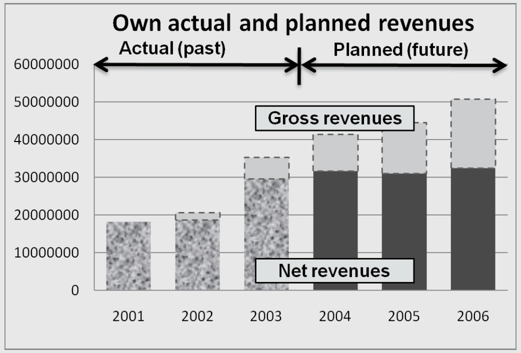


Figure 27: Example of an automatically developed graphic for monitoring revenues

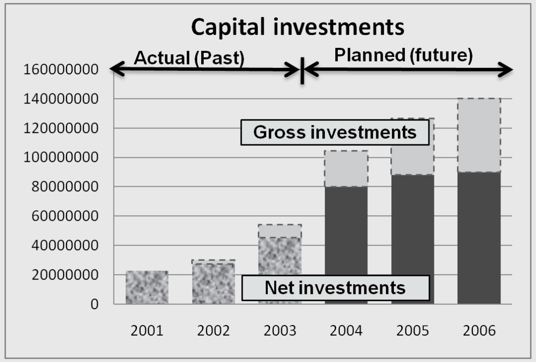


Figure 28: Example of a graphic for monitoring capital investments

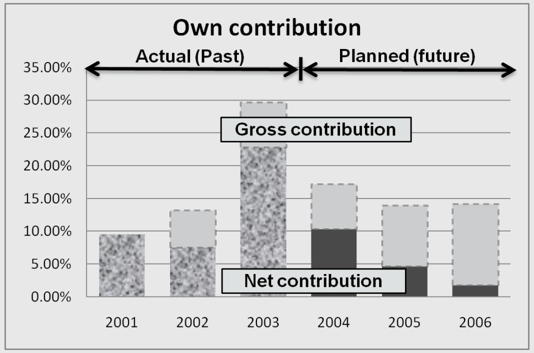


Figure 29: Example of a graphic for monitoring city's own contribution to the CIP

Step 4: Monitoring

CIP development requires many items of base data, which are used to determine key performance indicators (KPI). This important information helps decision makers to set a city's development "direction." Standardized reporting of KPI allows these indicators (see example, Figure 26) to be tracked over time and allows for comparisons between cities.

The MS Excel template automatically calculates input data and illustrates them in diagrams. These are then automatically transferred to the Word template (see resource CD for templates).

The diagrams combine actual (past) data with planned (future) data and at the same time take into account inflation rate and population growth. (Figures 27, 28, and 29 are examples).

For the ULGDP system, there is a monitoring and evaluation matrix (CD Annex 8.4). Reports are submitted based on a standardized report template (Annex 5). The monitoring cycle (Figure 30) defines what information should be reported, in which format, when reports should be submitted, how frequently, and to whom. Key reports are quarterly progress reports and the annual report, due after the beginning of the new Ethiopian fiscal year.

A monitoring report shows planned performance against actual achievements for each project in a city's CIP. The main sources of information are the procurement plans and the cash-flow plans. The accumulated progress of all projects shows a city's overall performance in CIP implementation.

The monitoring report also requires information on the progress of revenue collection and recurrent expenditures, focusing on the implementation of the maintenance budget.

General Information about the city						
Year	2001	2002	2003	2004	2005	2006
1 Estimated population growth in %	4.00%	5.00%	4.00%	5.00%	4.00%	4.00%
2 Inflation rate in %	5.00%	6.00%	5.00%	6.00%	7.00%	5.00%
Population growth and inflation	**9.00%**	**11.00%**	**9.00%**	**11.00%**	**11.00%**	**9.00%**
Summary - actual numbers (gross)						
Year	2001	2002	2003	2004	2005	2006
1 Own Revenues	ETB 130,000.00	ETB 175,000.00	ETB 195,000.00	ETB 215,000.00	ETB 270,000.00	ETB 318,000.00
2 Recurrent Expenditures	ETB 110,000.00	ETB 125,000.00	ETB 140,000.00	ETB 10,000.00	ETB 15,000.00	ETB 20,000.00
3 Surplus (1 minus 2)	ETB 20,000.00	ETB 50,000.00	ETB 55,000.00	ETB 205,000.00	ETB 255,000.00	ETB 298,000.00
4 Investments	ETB 125,000.00	ETB 100,000.00	ETB 75,000.00	ETB 340,000.00	ETB 435,000.00	ETB 460,000.00
5 Surplus / Investments (3 devided 4)	0.16	0.50	0.73	0.60	0.59	0.65

Figure 26: Example of a summary table of the most important CIP figures

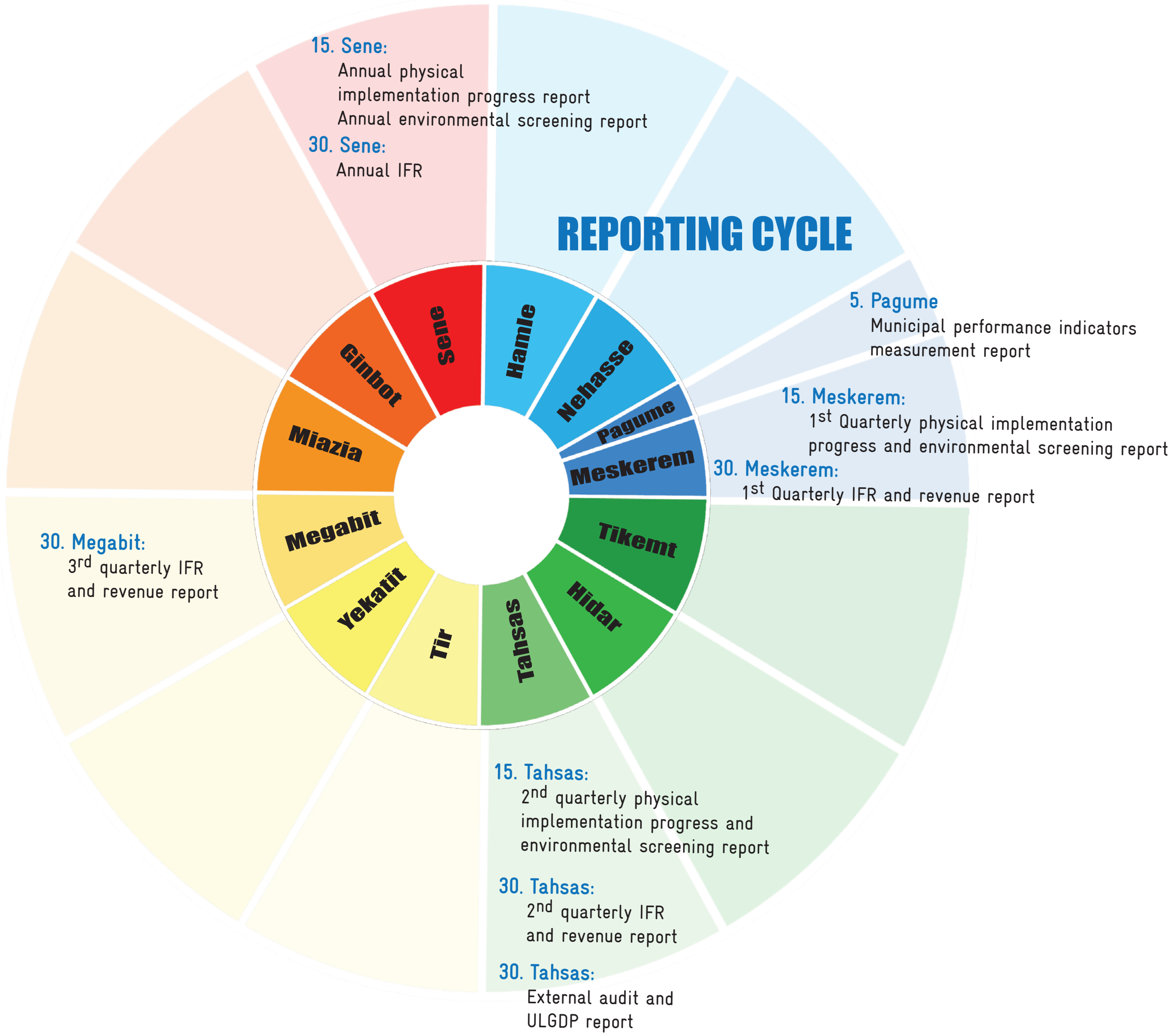


Figure 30: Annual reporting and monitoring cycle

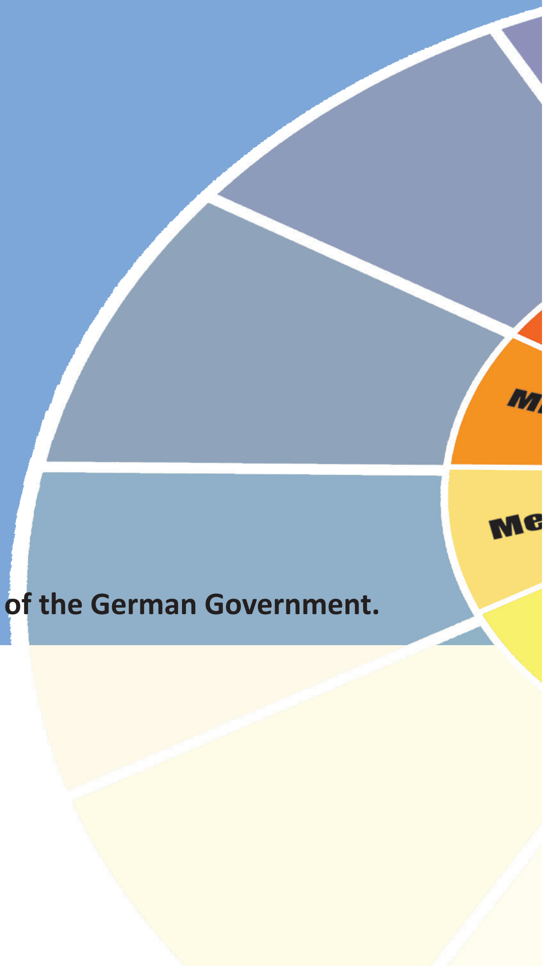
ULGDP Monitoring and Evaluation System

The ULGDP has been piloted in the 19 largest cities of Ethiopia. There were four prerequisites for participation, including submission of a three-year capital investment plan based on a consultative participatory process, with an annual action plan approved by the city council.

The amount of external funding allocated to cities for infrastructure projects is based on city performance. Thus, all cities are evaluated based on performance criteria, of which the first and most important measures implementation capacity, which means comparing planned investments with actual investments after the close of each year. (More specifically, cities shall prove that they have implemented at least 80 percent of what was planned in their CIP in order to continue to get external funding.)

With the new phase of ULGDP (2011 to 2014), new supplementary outcome indicators have been introduced:

- Urban local governments (ULG) that achieve targets specified in ULG revenue enhancement plans (number that achieve 85 percent of targets by end fiscal year 2014)
- ULGs producing timely external audit reports, which are either unqualified, or qualified with minor comments (number)
- ULGs using 75 percent of annual operations and maintenance budgets as specified in their CIPs (number)
- Direct project beneficiaries (number); percentage of beneficiaries who are female (%)
- People in participating urban local governments provided with access to all-season roads within a 500-metre range under the ULGDP (number)



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