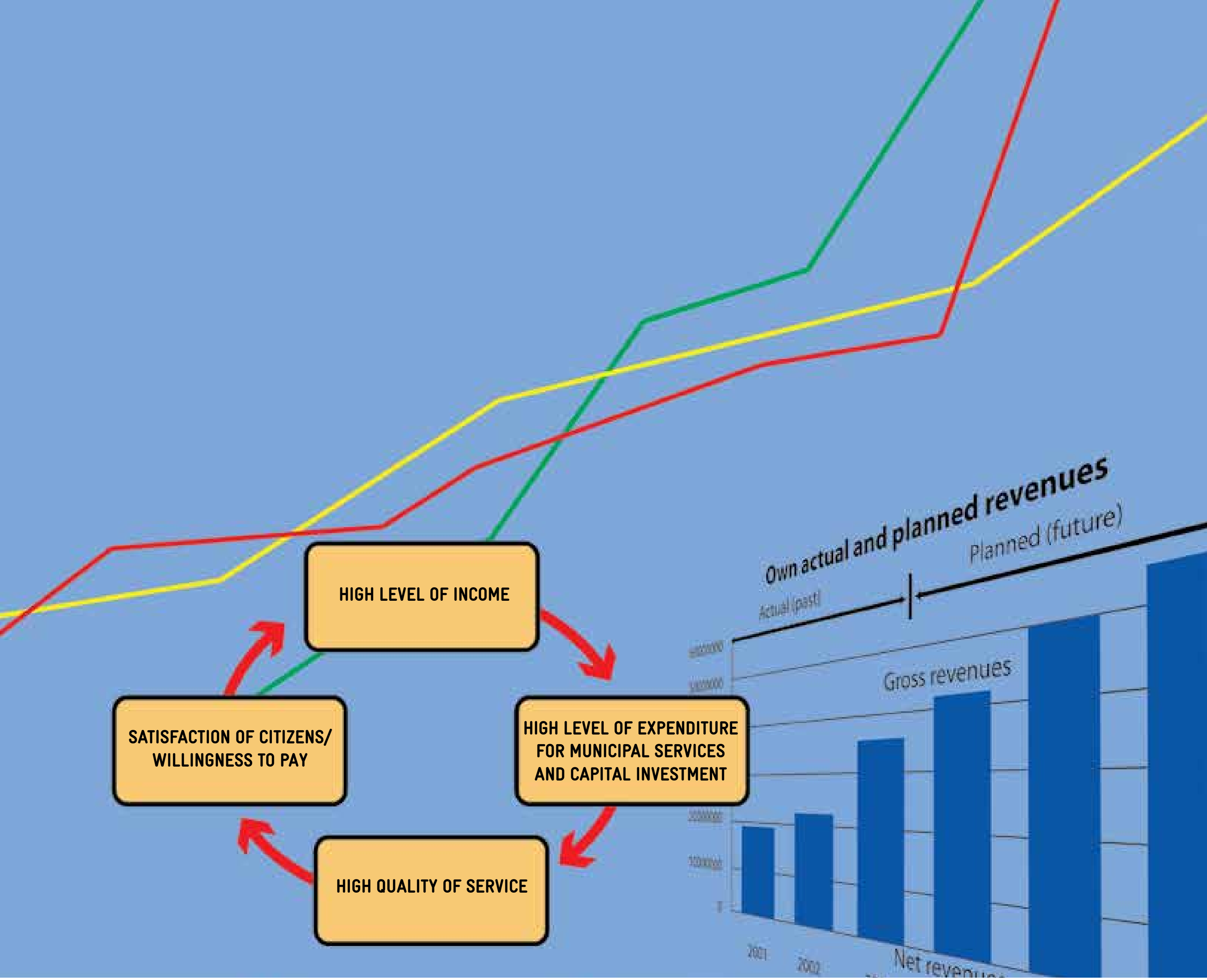


# Revenue Enhancement Plan Guide for Ethiopian City Administrations

## Working Manual

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## Working Manual

Revenue management nurtures healthy and functional cities

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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.

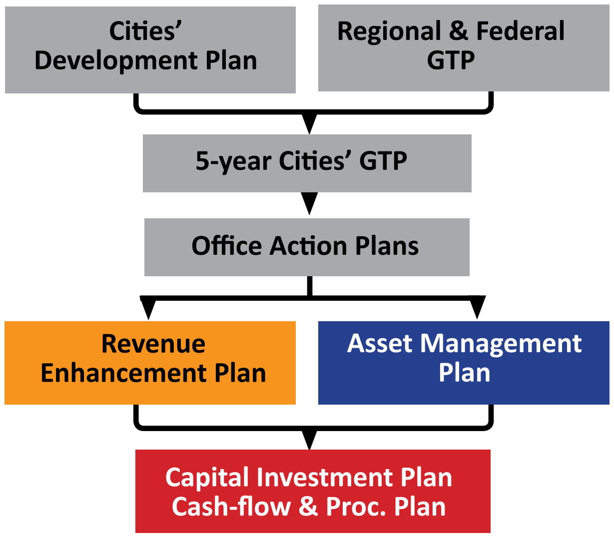
The responsibilities for its implementation should also be clearly defined. The main revenue sources include taxes, service charges and fees.

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.

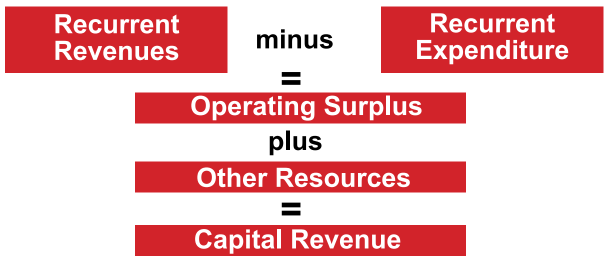
## How is the REP linked to strategic objectives?

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;<br>• Management of own revenue and expenditure of a local government should contribute to a fair distribution of income and wealth between citizens;<br>• REPs should not negatively affect the stability of the local economy, employment and inflation. These plans should not impair the allocation of local resources;<br>• 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;<br>• 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:<br>- an appreciation tax for increases in land values;<br>- full cost recovery charges for the capital costs of services provided to their estate; and<br>- public acquisition and development of land.<br>• 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;<br>• Cities should have a reliable inventory of their land;<br>• 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;<br>• 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;<br>• City administrations should formulate and introduce performance appraisals and incentive systems in relation to the objectives of the REPs;<br>• 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;<br>• City administrations should select and train suitable staff to manage these plans and their objectives;<br>• 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.

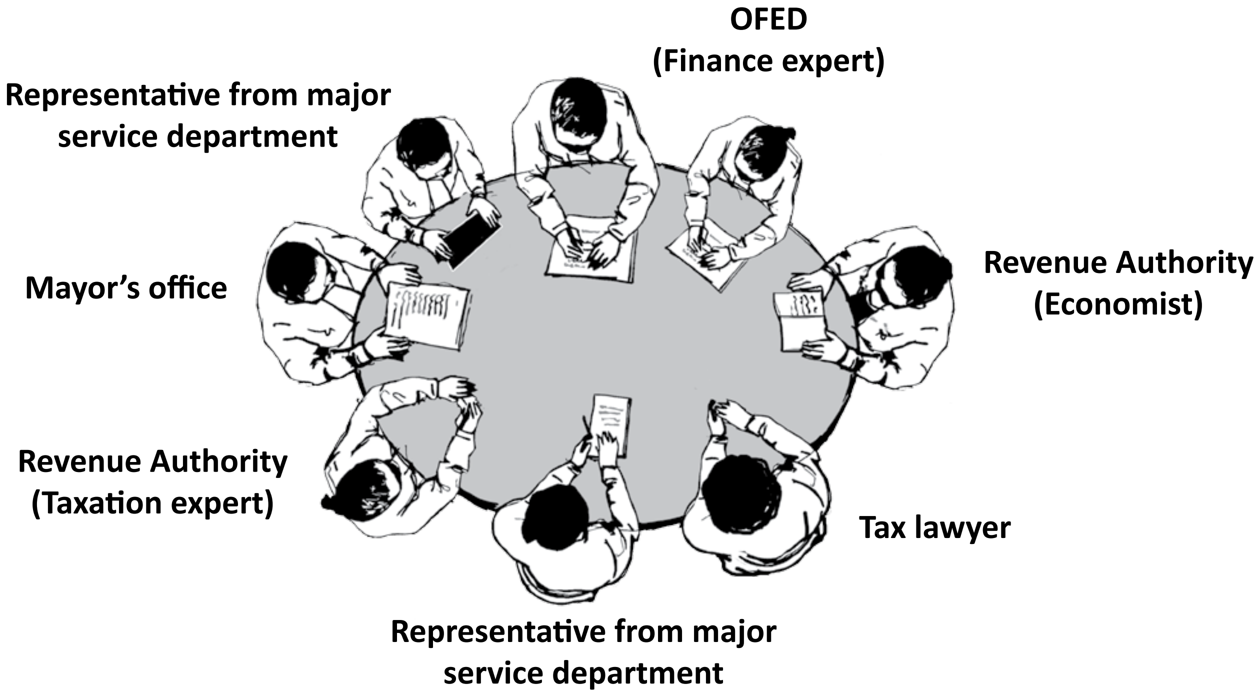
Each REP needs to follow the legal framework in the country as well as municipal and regional policies.

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

| S/N | Revenue item | Account no. |
|---|---|---|
| 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 turnover, 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 judgment 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.

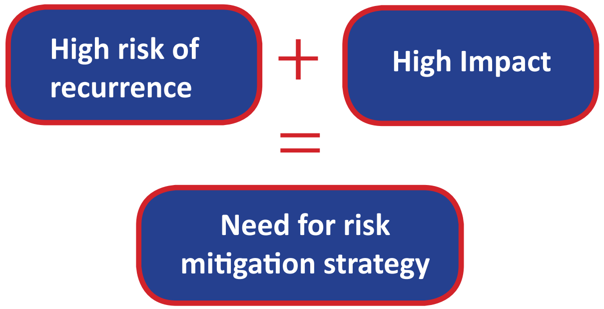
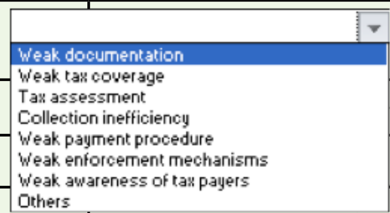
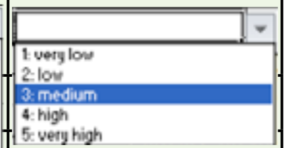



*Figure 6: Identification and prioritisation of risks impacting on revenue performance*

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

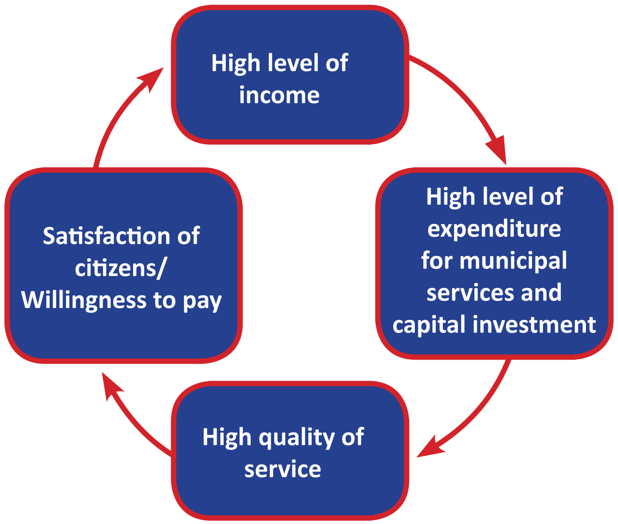
- City administrations should follow the ***principle of Efficiency, Effectiveness and Economy (EEE)*** when taking public expenditure decisions;
- Procurement of goods and services with public money should provide benefits proportional to the amount spent on the goods and services, i.e. ***value for 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.

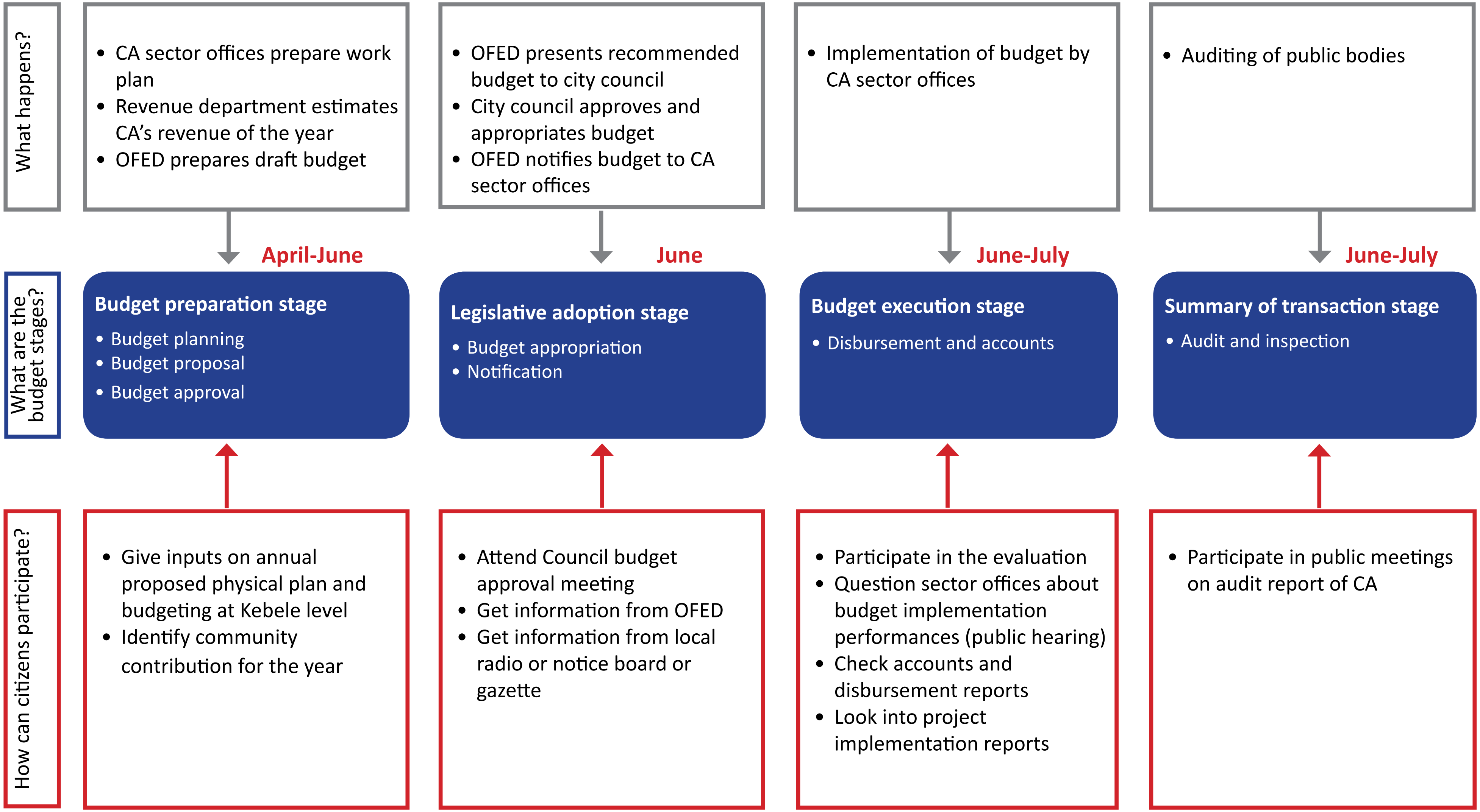
1. It can improve the democratic process, widening participation and re-invigorating the role of local authorities, local councillors and civil society, and increasing trust in public institutions.

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*



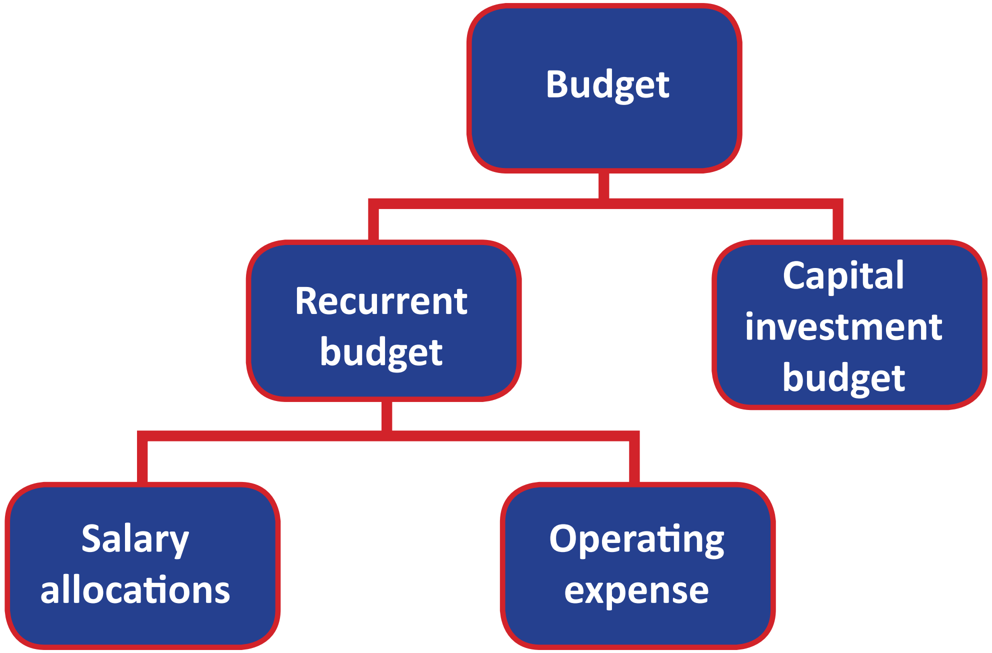

For more information on participatory budgeting, please refer to the Capital Investment Planning Guide.

## 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.

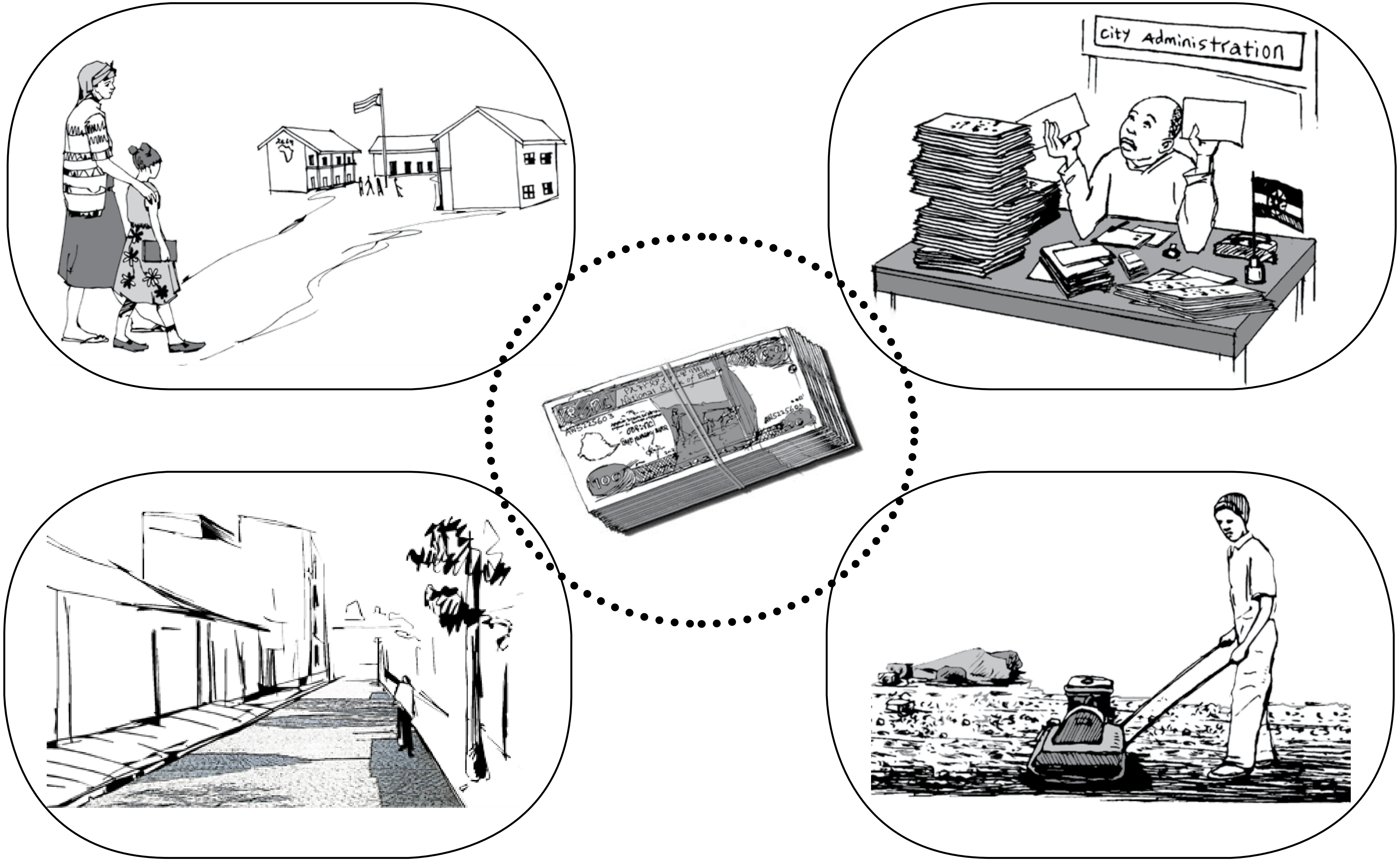
*Figure 10: Analysis of expenditure items*

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



## 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<br>• Provide information to Revenue Office about new taxpayers at the time of issuance of new licences<br>• 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 guide-lines when doing a house-to-house inspection* | • Design guidelines for inspection<br>• Provide training to inspection teams<br>• Evaluate the changes<br>• 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)<br>• Give media coverage for good taxpayers (e.g. major companies that pay before the deadline could be complimented on the media)<br>• 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.)<br>• Establish good relations with the Chamber of Commerce in order to get more information about taxpayers<br>• Compare and update taxpayers' registration based on lists and information received from other relevant offices<br>• Maintain the taxpayers' registration documents both in soft and hard copy<br>• 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<br>• Develop format and prepare TIN<br>• 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<br>• 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<br>• 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)<br>• Explain the responsibilities for all stakeholders for submitting complete and clear data to the revenue office<br>• 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<br>• 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)<br>• If the comparison shows a large difference, identify the possible reasons for difference in revenue item coverage<br>• 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<br>✓ 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<br>• Page 31 (Figure 12) |
| ☑ 4.1 Broaden tax base | ✓ Examine the option of broadening the tax base<br>• More of a concern for macro-economic planners<br>• 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<br>✓ Use 'Standard Integrated Government Tax Administration System' (SIGTAS)<br>✓ To improve revenue administration efficiency<br>• Setup better communication between agencies<br>• Train inspection teams<br>• Give rewards for loyal customers<br>• Consolidate database with other tax agencies<br>• Use Tax Identification Number (TIN)<br>• List the registered tax, user charge and fee payers<br>• Analyse the collected data of potential taxpayers<br>• Perform continuous inspections<br>• 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<br>✓ 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<br>• Assessment of tariffs and rates must consider the economic situation<br>• Conduct a survey to measure taxpayer capacity | • Page 33 |

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

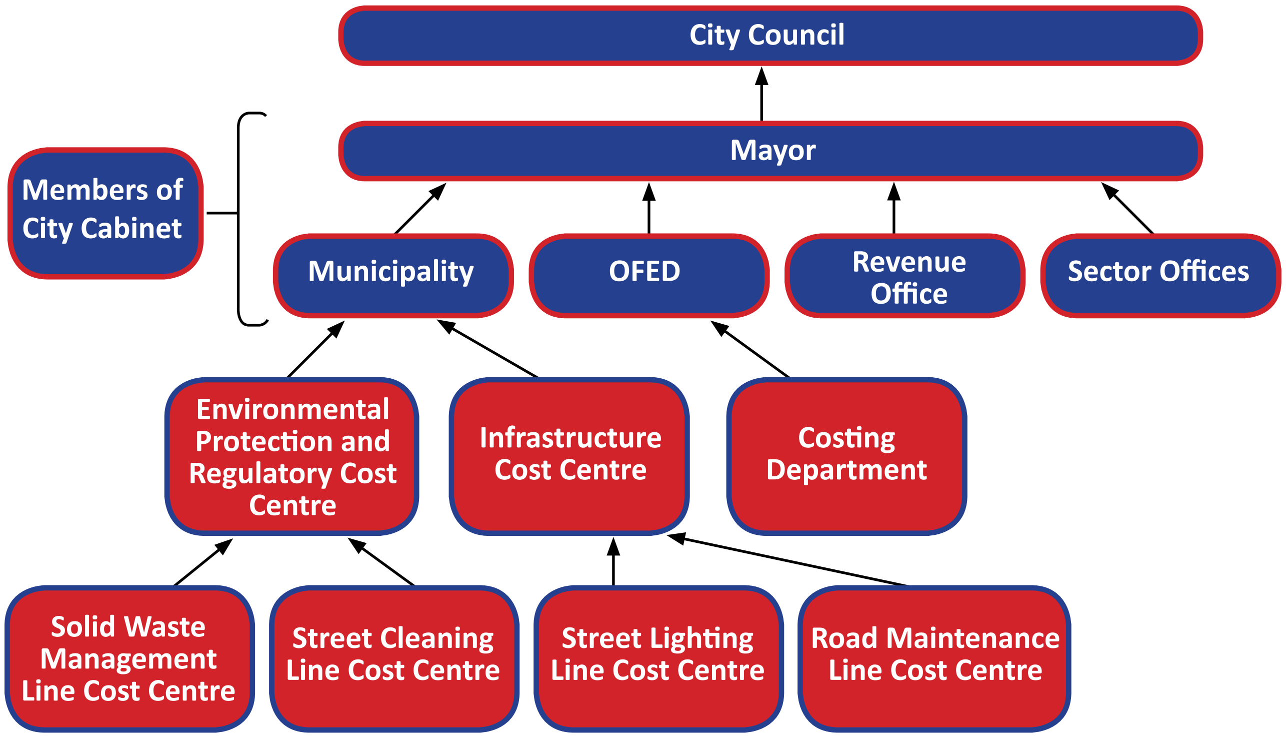
A line cost centre is a service providing unit such as a SWM unit, a liquid waste management unit, abattoirs, etc. It is recommended that city administrations should create line cost centres at least for the following services:

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, live-stock market and pounding of stray animals.

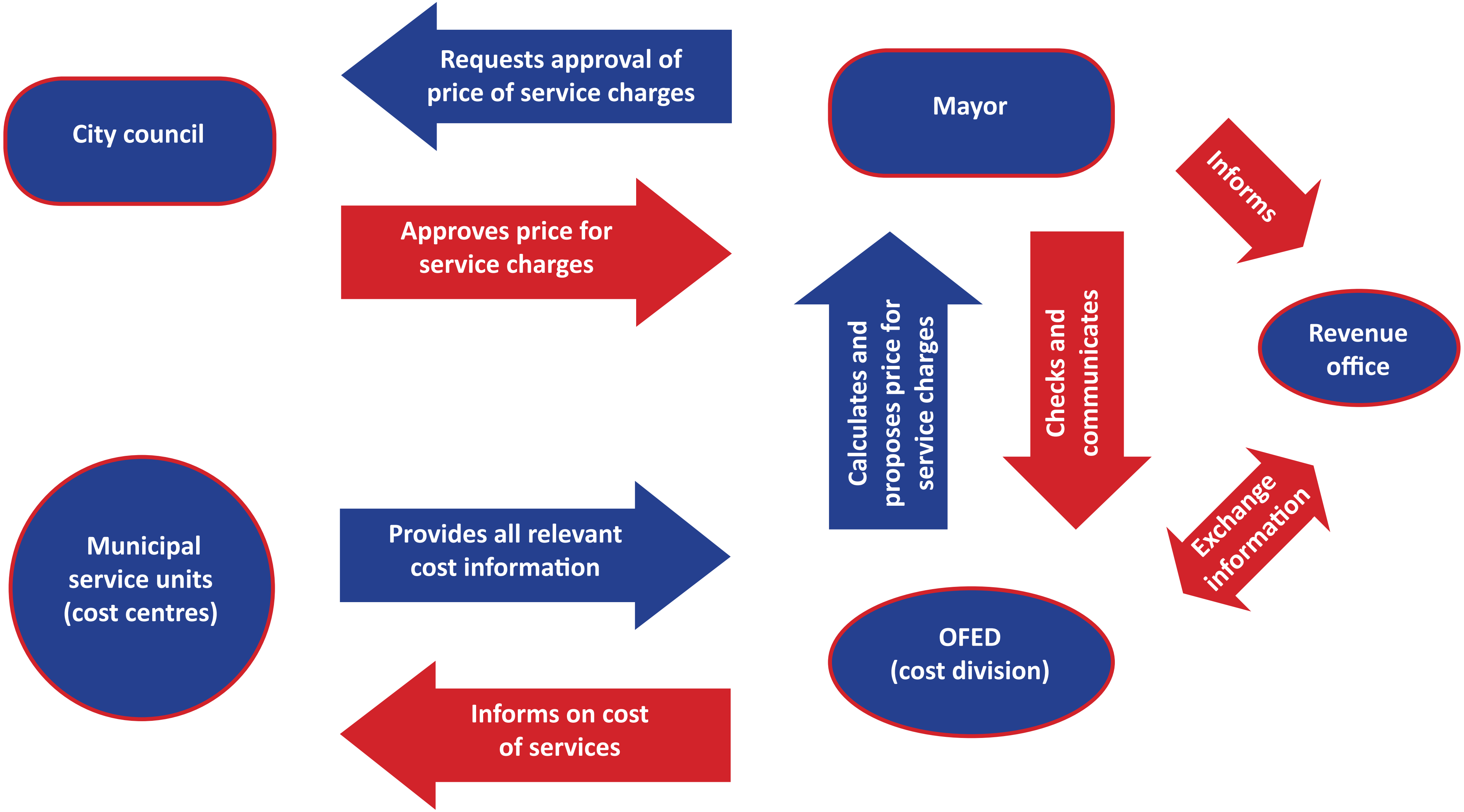
The reason for distinguishing between direct and indirect costs is to help identify all costs of providing services. Each city administration or municipality that does costing will categorise its direct and indirect costs differently, depending on how services are organized and how easily costs can be 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<br>• Clearly assign responsibilities to officials<br>• Analyse the city administration's organisational structure and work processes for mapping the cities financial resources<br>• Include all major service centres in cost centres<br>• Put unclassified cost services as auxiliary combined into one cost centre<br>✓ Create line cost centres at least for the following services<br>• Environmental protection and regulatory services<br>• Infrastructure services<br>• Auxiliary services | • Page 41-42<br>• Annex 6 chapter 3 on CD |
| ☑ 5.2 Calculate the cost of services | ✓ Select services to be costed<br>✓ Define service or product and quantity provided<br>✓ Define nature of unit for calculation of unit cost<br>✓ Capture all costs and calculate costs for municipal services by summarising<br>• Direct cost of particular service<br>• Indirect cost to provide this service<br>✓ Calculate annual service charge according to the following formula:<br>• Annual service charge = Annual total cost divided by the number of customers<br>• 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<br>• Need services<br>• Basic Education<br>• Basic Health<br>• Environmental protection<br>• Infrastructure<br>• Fire Brigade<br>• Traffic light | • Lack of proper assessment<br>• Absence of proper categorisation valuation and assessment | • General state taxes<br>• Personal income tax<br>• Business profit tax<br>• Sales and excise taxes | • Review the existing taxpayers categorisation<br>• Update valuation and assessment |
| | • Amenity services<br>• Street Lighting<br>• Waste disposal<br>• Environmental<br>• Health | • Low tax rate and absence of regular updating<br>• Inefficient tax administration | • Municipal taxes<br>• Property taxes<br>• Road taxes<br>• Advertisement taxes<br>• Land rent<br>• Cattle market taxation<br>• Trade license renewals | • Update taxpayers' rolls<br>• Undertake property revaluation<br>• Adjust tax rate and base<br>• Review collection and billing procedures<br>• Review enforcement mechanisms |
| | • Facility services<br>• License renewal<br>• Activity permit<br>• Registration, verification, etc. of utility services | • Absence of policy based service charge pricing methodology<br>• Lack of categorisation of services according to their source of financing | • User charges at cost recovery<br>• Service charges fees<br>• Public prices<br>• Specific benefit charges<br>• Admission charges | • Propose appropriate service charge pricing methodology<br>• Propose cost recovery mechanisms options<br>• Propose implementation strategy |
| 2 | • Public-Private partnership (PPP) | Absence of specific policy | • User charges with marginal profit<br>• Service Contracting | • Issuance and enforcement of appropriate policy regulation |
| | • Cemetery<br>• Public parks recreation and cultural centres<br>• Road maintenance<br>• Bill collection of water supply | • Low quality due to lack of expertise for evaluating contract offers<br>• Limited financial resources for services<br>• Lack of competition between bidders | • Management Contracting<br>• Concession based contracting<br>• Joint venture<br>• Build-Operate-Transfer (BOT)<br>• Rehabilitate-Operate & Transfer (ROT)<br>• Build-Operate-Own (BOO) | • Identification and indication of services that could be provided through PPP options |
| 3 | • Purely/partially private services<br>• Solid waste collection<br>• Liquid refuse disposal<br>• Health service<br>• Education service<br>• 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<br>• Consider socio-economic dynamics of the city<br>• Raise institutional capacity of finance and revenue departments<br>• Balance tariffs with their cost of service delivery<br>• Consider inflation<br>• Involve the public in the tax adjustment process<br>• Make sure that the increase in tax or tariff is in support of the local development strategy and translates into additional and improved services<br>✓ Review own ability to effectively raise revenue level<br>• Identify the reason for the increment of the tax base of a certain item<br>• Clearly show which tax or tariff is planned to be increased (which, when, how)<br>• Give reasons for the changes<br>• Describe the actual situation of revenue and expenditure (cost centre approach)<br>• Describe the outcome of inaction | • Page 51 |
| ☑ 6.2 Introduce new taxes, user charges and fees | ✓ Identify potential new taxes, user charges and fees<br>• Give attention to items that have high yields | • Page 51 |
| ☑ 6.3 Consider Public-Private Partnerships | ✓ Evaluate the pros and cons of PPP<br>✓ Carefully analyse which services can be effectively delivered to the public in this mode (e.g. waste disposal, cemeteries, …)<br>✓ Differentiate services to be provided by the government alone and services to be left for private sector involvement<br>✓ 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.<br><br>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.<br>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.<br>Financial intermediaries include:<br>• Banks<br>• Building societies<br>• Credit unions<br>• Financial advisers or brokers<br>• Insurance companies<br>• Collective investment schemes<br>• 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:<br>• Long-term loans for capital expenses<br>• Large and costly projects which have long term utility<br>• Investment which is expected to earn income<br>✓ Urban authorities should not borrow at any rate, especially not to cover:<br>• Short-term cash-flow deficit<br>• 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<br>✓ Since the borrowing process is long, get approval<br>• At city level: city cabinet and city council<br>• At regional level: Board, BoFED, regional government council and regional council<br>• At federal level: MoFED | • Page 60-61<br>• Annex 6 chapter 4 in CD |
| ☑ 7.3 Assess borrowing capacity | ✓ Only borrow to the limit you can service your debt<br>✓ Answer the following questions critically<br>• Does the investment financed by a loan actually lead to economic growth?<br>• How long does the expected economic growth take to materialise?<br>• 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<br>✓ Retire short-term debt within 12 months<br>✓ Limit yourself to the maximum per capita loan<br>✓ Limit long-time borrowing to capital investment<br>✓ 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.*

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