FEDERAL GOVERNMENT OF SOMALIA

Financial Governance Report

September 2021

CONTENTS

ANNEXES

TABLES

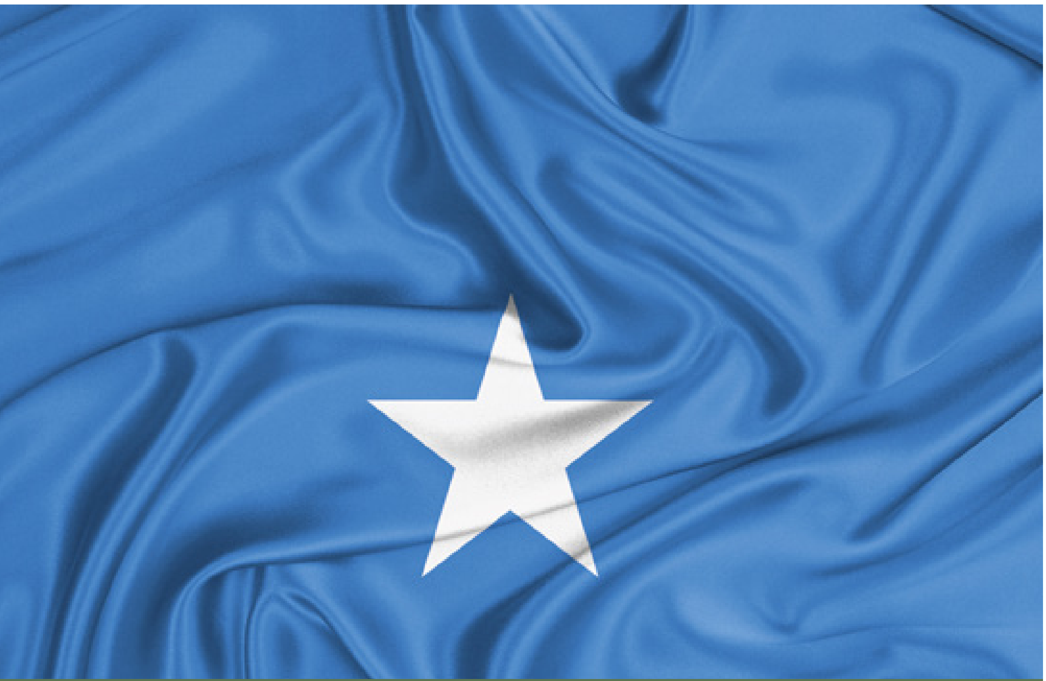
BOXES

PREFACE

The 2021 Financial Governance Report (FGR) is the fifth annual report of the Financial Governance Committee (FGC). It presents the collective view of FGC members on developments in financial governance in Somalia over the past year, and priorities for the year ahead. Previous FGRs are available on the FGC website.[1]

Work by the FGC Secretariat in producing this report is gratefully acknowledged.

[1] See website for further information: https://mof.gov.so/fgc



ABBREVIATIONS

AML/CFT	Anti-Money Laundering/Combating the Financing of Terrorism
BRA	Banadir Regional Administration
CBS	Central Bank of Somalia
COVID-19	Coronavirus Disease
EIIT	Extractives Industries Income Tax
EU	European Union
FGC	Financial Governance Committee
FGR	Financial Governance Report
FGS	Federal Government of Somalia
FMS	Federal Member State(s)
HIPC	Highly Indebted Poor Countries (debt relief initiative)
IATA	International Air Transport Association
IMCC	Inter-Ministerial Concessions Committee
IMF	International Monetary Fund
ID	Identity Document
MFMR	Ministry of Fisheries and Marine Resources
MoF	Ministry of Finance

MPMR	Ministry of Petroleum and Mineral Resources
MTB	Money Transfer Business
NCA	National Communications Authority
NGO	Nongovernment Organisation
NISA	National Intelligence Security Agency
NRA	National Risk Assessment
OAG	Office of the Auditor General
OPM	Office of the Prime Minister
PFM	Public Financial Management
PSA	Production Sharing Agreement
SDR	Special Drawing Rights
SFMIS	Somalia Financial Management Information System
SNA	Somalia National Army
SPA	Somalia Petroleum Authority
TSA	Treasury Single Account
UN	United Nations

EXECUTIVE SUMMARY

Introduction

The Financial Governance Committee (FGC) is a high-level advisory committee comprising senior members of the Federal Government of Somalia (FGS) and international representatives. It provides the FGS with a forum for dialogue and confidential advice on strategic and sensitive financial governance issues. FGC advice covers fiscal issues, contracts and concessions, natural resource management, and central bank governance. The FGC's role is purely advisory. However, it has a mandate to review and provide advice to FGS on all concession agreements and all procurement contracts above US$5 million in value.

The FGC meets on a regular basis throughout the year and provides advice to the FGS through a combination of dialogue, stakeholder engagement, formal advisory notes, contract reviews, and commissioned technical assistance. The FGC's annual Financial Governance Report (FGR) reviews progress on issues that have been discussed by the FGC during the past year. The FGR also includes a 'spotlight' chapter that takes a deeper dive into a selected topic to describe the state of play, looking beyond the general single-year time frame of the FGR to identify lessons, persistent barriers to progress, and potential reform priorities. This year's spotlight issue focuses on improving sector alignment with financial governance reforms.

Year in Review: July 2020 to June 2021

The FGS faced an extremely challenging fiscal policy context in the 12 months from July 2020 to June 2021, driven by the twin challenges of the ongoing COVID-19 pandemic and delays in the electoral process planned for 2021. As anticipated, the COVID-19 pandemic had a significant impact on domestic revenues, which were insufficient to cover the FGS wage bill in full. Increased flows of budget support helped the FGS to meet its expenditure obligations during the course of 2020. However, lack of consensus on the conduct of the 2021 elections limited the ability of international partners to provide further budget support to the FGS in the first half of 2021.

The acute fiscal situation elevated a number of financial governance risks, including potential inability to make timely salary payments, possible incentives to negotiate concession agreements that appear to offer 'quick wins' in terms of revenue gains, and loss of momentum on financial governance reforms. The Ministry of Finance (MoF) made timely salary payments its highest priority, marshalling all available resources to meet this objective, whilst reform momentum remains positive. However, unless the electoral process is successfully concluded and FGS can access additional external financing, the fiscal situation will become increasingly acute.

In this policy context, FGC advice focused on protecting fiscal reforms, providing oversight on procurement and concessions, and ensuring transparency and due process in natural resource revenue management. In line with its mandate, the FGC also focused on strengthening central bank governance and financial sector development.

Protecting fiscal reforms

Revenue mobilisation

The FGS has continued to make progress in modernising and standardising customs administration in Mogadishu and in Federal Member States (FMS) with major customs posts. The objective of these efforts is to roll out a single Customs Automated System to all major ports and airports, and to implement a common national customs tariff using value-based duty rates.

Increasing revenue from the telecommunications sector is also a priority for the FGS. The FGC has provided advice on steps to complete implementation of the licensing framework and to strengthen the collection of sales and corporate income taxes. To succeed, these actions will need to be underpinned by sustained political backing for enforcing telecom operators' compliance with licensing, reporting, and taxation requirements.

The FGC has also continued to provide advice on the collection of overflight revenues. Overflight revenues are collected from airline operators on Somalia's behalf by the International Air Transport Association (IATA). It has proven difficult for IATA to collect overflight fees from some local and regional airlines operating in Somalia that are not IATA members. The FGC has supported the FGS to develop a tender for third-party debt collection services.

Fiscal federalism

No overall agreement has yet been reached between the FGS and the FMS on how revenues will be allocated, including to the district level, in line with expenditure responsibilities and consistent with equitable development. While the constitutional review process offers an opportunity to establish a mechanism to guide overall resource sharing, consultations on the draft prepared by the Independent Constitutional Review Commission were interrupted by COVID-19 and the delays in the 2021 electoral process.

Nevertheless, the FGS has continued to make resource transfers to the FMS and the Banadir Regional Administration (BRA). Transfers in 2020 were sizeable, funded by a combination of international partner budget support and project funds, FGS own revenues, and shared FGS–FMS revenues from tuna licensing. FGS transfers to the FMS in the first half of 2021 were significantly lower as a result of overall FGS resource constraints. Technical work on fiscal federalism continued, as the MoF made progress in consolidating FGS and FMS fiscal information, providing important underpinnings for future discussions on resource allocations.

Using and strengthening country systems

The FGS continued to make progress on public financial management (PFM) reforms. The MoF prepared and issued regulations to the PFM Act and is currently developing a new PFM Reform Action Plan. The Office of the Auditor General (OAG) completed a statutory audit of the FGS's 2019 financial statements, as well as compliance audits of FGS institutions. These reports were submitted to Parliament and made available online. The MoF re-established the Use of Country Systems Working Group as a forum for discussing progress and challenges in the use of FGS systems with international partners. FGC advice focused on ensuring that international partner support to FGS institutions complies with the provisions of the PFM Act.

Sustainable cost of government

Multiple semi-autonomous or special-purpose agencies have been created or proposed as a consequence of sector legislation and donor benchmarks. The FGC is concerned that increases in FGS revenue are being absorbed by rising government administrative costs, leaving the FGS vulnerable to revenue shocks, as occurred in 2020–21. The FGC has recommended that the FGS establish a policy to set out the conditions under which the creation of a new agency is appropriate.

Natural resource management

Tuna licensing

The FGC monitored progress in tuna licensing and revenue sharing in the twelve months from July 2020 to June 2021. The Ministry of Fisheries and Marine Resources (MFMR) awarded a total of 21 annual tuna fishing licences in the second half of 2020, against FGS's Memorandum of Understanding with the Chinese Overseas Fishing Association. Revenues from the November 2019 licence round were shared with the FMS in 2020. Revenues from licences issued in 2020 have not yet been shared, and the March 2019 revenue sharing agreement has expired.

Oil and gas licensing

The FGS has made considerable progress in establishing the legal and fiscal framework for petroleum management and the award of oil and gas Production Sharing Agreements (PSAs). The award of PSAs is governed by both the 2020 Petroleum Act and the Procurement Act. The MoF has also drafted an Extractives

Industries Income Tax (EIIT) Bill to govern the fiscal terms of the PSA, including royalty rates and the applicable taxation regime. The bill was approved by the Cabinet in December 2020 and submitted to the Lower House, where it awaits its first reading. Enactment of the EIIT Bill is a Highly Indebted Poor Countries (HIPC) Completion Point benchmark.

The Somalia Petroleum Authority Board (SPA) was appointed in July 2020. It then launched a licensing round for seven offshore blocks in August 2020, with a deadline of March 2021. In November 2020, it posted a licensing round tender protocol and draft PSA on the licensing round website. In parallel to launching the licensing round, it carried out negotiations for the direct award of 10 offshore blocks to two oil exploration firms. The FGC provided advice on these developments, which took place prior to parliamentary approval of the EIIT Bill, and without the approval of the Inter-Ministerial Concessions Committee (IMCC) as required by the Procurement Act. FGC advice focused on ensuring that the award of PSAs is consistent with Somalia's legal framework so that the FGS does not expose itself unduly to the risks of future compensation claims, legal disputes, or poor value for money.

The Ministry of Petroleum and Mineral Resources

(MPMR) did not ultimately sign any direct awards, and the SPA extended the licensing round bid submission deadline to the end of June 2021, before announcing a further postponement in June.[2] The MPMR, SPA, and MoF have held discussions to resolve outstanding differences between the fiscal terms of the 2020 draft PSA and those of the EIIT Bill. Once these discussions have been concluded, the SPA has indicated that it will submit the draft PSA and tender protocol to the IMCC for approval.

Concessions and contracts

The FGC's support on concessions and contracts in 2020–21 covered advice on procurement policy and compliance, reviews of specific contracts and tender processes, and regular follow-up on contracts previously under discussion in the FGC.

Procurement policy and compliance

Although the FGS has made progress since 2017 in requiring competitive tendering for high-value goods contracts, such as security sector rations, compliance with the Procurement Act and Interim Public Procurement Requirements is still lacking across many FGS institutions. The OAG's 2019 institutional audit listed a number of contracts over US$100,000 in value that the FGC ascertained had been awarded by FGS institutions without the support of the MoF's Procurement Department. The FGC identified 14 such contracts, with a total value of US$4.7 million. It is likely that these contracts were awarded directly by the relevant FGS institutions without a competitive process. In addition, they were not registered with the OAG, as required by the Procurement Act. The FGC has recommended that the MoF and the Office of the Prime Minister (OPM) make active and sustained efforts to inform FGS institutions of their obligations, and that international partners support the FGS to deliver a sustained programme of capacity support and development on public procurement and concessions.

Emergency procurement

The COVID-19 pandemic has illustrated the way in which shortcomings in FGS institutional capacity for procurement have particularly acute implications in emergency contexts. The Procurement Act establishes the basic principle of altering procedures and processes in emergency situations, but neither the Procurement Act nor its Regulations provide guidance or direction on how procedures and processes should be altered. The FGC helped the FGS to retain technical support from the World Bank to develop more detailed guidance on emergency procurement. The guidance will define the procedures that apply to emergency procurement and establish parameters for when those emergency procedures should apply.

Mogadishu port concession

In October 2020, after two years of negotiations, the FGS signed a revised port agreement with Al Bayrak, the Turkish firm that has been managing

[2] www.somalialicensinground.com

the Port of Mogadishu since 2013. The revised agreement runs until 2034. It sets aside US$52 million of port revenue for investments in port infrastructure during the first five years. It also specifies a procedure for the FGS and Al Bayrak to agree on a long-term plan covering port investment from years six to fourteen, and enables the FGS to terminate the agreement after five years if the long-term plan is not acceptable. The FGS is required to play an active role in implementing the revised agreement. The FGC has recommended that the FGS seek further technical assistance to assist it in fulfilling its obligations.

Passport production concession

The FGS launched a tender in 2020 for a new passport production concession agreement to replace the existing contract. Although six firms were invited to bid, only one bid was received. Another bidder submitted a formal legal complaint requesting that the process be cancelled. The FGS decided not to proceed with the tender process. It has instead issued a short-term extension to the existing contract holder to give it time to prepare adequately for a new tender. The FGC has highlighted the importance of acquiring appropriate technical expertise to support the new tender process.

Security sector rations contracts

Tenders were issued in December 2020 for the supply of dry rations to the Somali National Army (SNA), Police, National Intelligence and Security Agency (NISA), and Prisons. Four contracts were awarded competitively in March 2021 for the supply of rations to the SNA (two lots), Police, and Prisons for a one-year period. NISA did not open the bids submitted for the NISA rations tender, and no contract was awarded. The FGC is reviewing the lessons learnt from the 2021 tenders and will make recommendations to the FGS on improving agency compliance and tendering competitiveness.

Education textbooks concession

In August 2020, the Ministry of Education signed an amendment to its 2016 contract with Beder Printing House. The 2016 contract granted Beder the exclusive right to develop Somalia's curriculum and associated textbooks, but it suffered from a lack of clarity over key contractual terms—including the ownership of copyright. Subsequent amendments, including one made in August 2020, have not resolved the problems in the original contract. The FGC has made recommendations on corrective actions to be taken by the Ministry of Education.

Central Bank governance and financial sector reforms

The Central Bank of Somalia (CBS) continued to implement the Financial Sector Roadmap in 2020–21. Priorities include improving CBS capacity for core functions and organisation, developing a national payments system and facilitating international transfers, reforming the legal and regulatory framework, and developing financial infrastructure to support intermediation.

Telecommunications and mobile money licensing

The CBS started issuing licenses to mobile money providers in the first half of 2021, representing a significant milestone in its efforts to reduce financial sector risk. Licences were awarded to Hormuud Telecom in February 2021 and to Somtel in June 2021. Both providers were assessed as having met all of the licensing requirements set out in the 2019 Mobile Money Regulations, including holding a valid telecom licence issued by the National Communications Authority (NCA). A third provider, Somlink, will be licensed in August 2021.

National payments system

The CBS continued to make good progress during 2020–21 in developing the architecture for the national payments system. The system will enable automated inter-bank payments and settlements, thereby reducing cash-based transactions. It will enable better CBS oversight of payments and compliance and will provide scope for overnight borrowing. The system will be launched with nine banks in August 2021, before being rolled out to the entire banking sector.

Remittance flows

Most money transfer businesses (MTBs) operating in Somalia fly cash from remitting countries to clearance hubs, due to the absence of correspondent banking relationships. Disruptions to global travel at the start of the COVID-19 pandemic highlighted the acute vulnerabilities of this system. The CBS is in the process of implementing a number of financial sector reforms that will provide a critical foundation for restoring Somalia's correspondent banking relationships over the medium term. A country-wide National Risk Assessment (NRA) is undergoing stakeholder consultations, and a Mutual Evaluation by the Financial Action Task Force, the global money laundering and terrorist financing watchdog, is planned for 2024. However, the lack of corresponding banking relations is a major issue that Somalia cannot resolve alone. De-risking continues to be a challenge for remittance flows globally, and support from international partners is needed to address it.

Asset recovery

The CBS continued its efforts to recover legacy assets belonging to the Federal Republic of Somalia, which have been held in banks abroad since 1991. The focus has been on assets held in Italy by Banca Intesa Sanpaolo and in the United Kingdom by Crown Agents Bank, but neither process is yet complete.

SPOTLIGHT ISSUE

Improving Sector Alignment with Financial Governance Reforms

The spotlight topic in this year's FGR focuses on improving cross-government coordination within the FGS in order to strengthen financial governance. It looks at how sector entities and their international partners can align their practices and policies more closely with the financial governance reforms led by entities at the centre of government (especially the MoF, OPM, OAG, and CBS).

The FGC has observed that the policies and practices of sector institutions, and the international partners that support them, are not always consistent with the overall financial governance reform objectives of the FGS. While this lack of alignment may not be intentional, it can undermine efforts to raise revenue, improve expenditure efficiency, and strengthen financial governance. Reasons for this misalignment include differing priorities and incentives at the sector level, a lack of familiarity with FGS financial governance policies, and a tendency to view procedural requirements as an unnecessary constraint.

Areas of observed sector misalignment

Sector revenue actions that undermine fiscal coherence

The FGC has observed various attempts by sector institutions to 'secure' additional resources for sector expenditure outside of the budget process. While the motivation to obtain additional funds for sector expenditure may be understandable, the overall effect can be to compromise the integrity, comprehensiveness, and transparency of budget preparation and budget execution. These effects are additionally problematic in a context of extremely constrained FGS fiscal resources. Examples of such actions include:

- *Ring-fencing of concessions*: Poor formulation of concession agreements can limit transparency in the use of sector revenues and/or off-budget sector investment. To the extent that such agreements are not properly scrutinised, or do not follow due process as required by the Procurement Act, they can result in poor value for money for the FGS, as well as a loss of transparency in revenue or expenditure management overall.
- *Retention of revenue collections*: Unauthorised sector retention of non-tax revenues was a significant problem for the FGS up to 2016–17. MoF revenue reforms have since reduced the practice, but OAG annual audit reports identify some persistence. The OAG compliance audit report for the financial year 2019 audit identified US$1.86 million spent by three agencies at source.
- *Earmarking of revenues*: Budget earmarks proposed in sector legislation may lead to the permanent allocation of a share of government revenues to particular sectors or purposes. If sectors are able to determine their own funding through legal earmarks, the MoF will lose control over budget policy, and allocations may not reflect overall FGS priorities.

Sector institutional reforms that raise fiscal costs

The passage of sector legislation is leading to the creation of new government agencies, and the fiscal cost of such agencies is rising steadily. The 2021 FGS budget includes allocations for 18 independent agencies, amounting to US$29 million in total and accounting for 11 percent of FGS revenues. A further 16 new agencies are in the pipeline. New agency creation often stems from the requirements of international partners, including reform benchmarks or financing conditions. They may also be proposed through provisions contained in new sector legislation, which is often drafted with international partner assistance. FGS sectors are typically receptive to the idea of creating new institutions, as establishment of a new agency can bring tangible benefits to the sector.

There may be strong arguments for agency establishment in some cases. Semi-autonomous agencies can, in principle, insulate or 'protect' regulatory functions from political interference. Achievement of specific policy objectives may be accelerated through these special-purpose entities. The unintended negative effects of agency creation can also be significant, however. New agencies escalate the overall fiscal costs borne by the FGS, as well as the future liabilities implied in sustaining those costs. New agencies can create institutional fragmentation in sectors that have yet to achieve strong and cohesive capacity within the principal FGS ministry. The FGS's experience to date suggests that, while the growth in new agencies leads to rising fiscal costs, it does not always deliver the desired objective of regulatory independence or lead to a rapid improvement in public sector performance.

Sector laws that conflict with financial governance laws

A discernible body of FGS legislation (including the 2016 Procurement Act and 2019 PFM Act, 2019 Revenue Act) provides the foundations for financial governance in the FGS. These laws are intended to apply across all FGS institutions, thereby aligning the Somali framework with almost universal international practice. Sector-specific legislation is expected to serve a complementary function, by covering distinctive sector policy and institutional issues that fall within the prerogative of the relevant sector ministry. The expectation is that cross-cutting and sectoral laws should be devised and applied harmoniously.

The FGC has encountered instances in which FGS sector legislation enables the provisions of financial governance laws to be disapplied if they conflict with the relevant sector law. Challenges have also occurred at the drafting stage of sector legislation, whereby sector ministries, and the international partners providing them with technical assistance, prepare draft bills for Parliament without adequately considering their consistency and compatibility with cross-cutting legislation on financial governance. Disputes over the applicability of cross-cutting legislation on financial governance to individual sectors can weaken overall financial governance.

Procurement and concessions processes that disregard established procedures

Disregard for procurement and concession procedures has occurred repeatedly across sectors in the FGC. Often, the intention of sector institutions is to push through procurement transactions as rapidly as possible. Urgency tends to be the consequence of a lack of planning and proper preparation, such that existing contracts run close to expiry or long-anticipated requirements for goods and services are neglected until they become immediate. In the face of these pressures, sector institutions seek to fast-track 'urgent' requirements by bypassing procedures.

The overall effects on financial governance of inadequate sector compliance with due process are to reduce transparency in the award of procurement and concessions contracts; to give incumbent firms and well-connected contractors an unfair advantage; to reduce value for money; to limit the FGS's ability to manage contracts for the delivery of goods, works, and services; and to expose the FGS to potential legal challenges. Progress has been made in requiring sectors to adopt competitive tendering for large-value procurement contracts and concessions over the past two years, but full compliance has not yet been achieved.

Partner funding for FGS institutions that bypasses government systems

The PFM Act requires funds from international partners to be appropriated in the annual FGS budget and to be managed through the Treasury Single Account (TSA). Audits by the OAG have uncovered multiple instances of non-compliance prior to the law's passage. While some international partners already comply with the PFM Act or are moving towards compliance, continued efforts and attention to this issue are important to avoid donor funding inadvertently undermining efforts to strengthen PFM systems and creating opportunities for fund diversion through reduced oversight.

FGC advice and recommendations

A number of strategic financial governance risks arise from misalignment or incoherence between sectors and the centre of government. These include: unaffordable scaling of the state, weakened fiscal control, entrenchment of bureaucratic fiefdoms, and inconsistent institutional capacity development.

The FGC recommends that the FGS prioritise a number of measures to address these challenges. These include specific actions to raise sector awareness of financial governance requirements and to strengthen institutional capacity to adhere to due process; establishment and implementation of a formal FGS policy on the creation of new semi-autonomous agencies; and

systematic MoF review of all draft legislation for financial implications, as required by the PFM Act. In addition, the FGC recommends that the FGS requires international partners to comply with the PFM Act requirement that support to FGS institutions is on-budget and on-treasury and maintains a strong emphasis on the external audit of sector institutions.

The FGC recommends that international partners prioritise a set of complementary actions to change their ways of working in Somalia. These include: minimising proposals for the creation of new agencies; taking overarching financial governance legal requirements into account when designing and providing sector support; considering the implications of their support for the size and affordability of the state; bringing all financial support to FGS institutions on-budget and on-treasury; and supporting the strengthening of financial governance capacity at the sector level.

Financial Governance Priorities in 2021-22

Political and fiscal challenges are expected to continue for the 12 months from July 2021. The fiscal policy environment in Somalia is dynamic and challenging, combining elections and the ongoing effects of the pandemic. In this context, the financial governance risks that were present in the previous 12 months are likely to persist.

Against this expected backdrop of political, fiscal, and financial governance pressures, the FGC will maintain and build on its core focus during the previous year. The four priorities include fiscal reforms (including fiscal federalism), contracts and concessions, natural resource revenues, and central bank governance. While valuable progress has been made in all four areas, these agendas remain unfinished. The FGC will encourage the MoF to develop a formal debt strategy to enhance Somalia's capacity to manage current and future debt efficiently.

The FGC's agenda for 2021–22 will include a strong cross-cutting effort to encourage stronger alignment between sectors and financial governance reform, and to promote fiscal sustainability. Horizontal financial governance linkages across FGS institutions, and across international partner support to those institutions, will be emphasised more strongly. Special attention will be paid by the FGC to fiscal sustainability in the context of constrained domestic revenue growth, coupled with a rising government wage bill and overall growth in the size of government.

I. INTRODUCTION

The Financial Governance Committee (FGC) was established in early 2014 by mutual agreement between the Federal Government of Somalia (FGS), donors, and international financial institutions. Its purpose is to provide the FGS with a forum for dialogue and confidential advice on strategic and sensitive financial governance issues. The FGC's role is purely advisory; it does not have executive powers. However, it has a mandate to review and provide advice to FGS on all concession agreements and all procurement contracts above US$5 million in value.[3]

The FGC meets on a regular basis throughout the year and provides advice to the FGS through a combination of dialogue, stakeholder engagement, formal advisory notes, contract reviews, and commissioned technical assistance. The effective functioning of the FGC provides the international community with assurance that the FGS is informed of the financial governance implications of the policy decisions it makes and the contracts into which it enters. Its existence is a safeguard measure in the budget support agreement between the FGS and the European Union (EU).

The FGC is chaired by the Minister of Finance, and its membership consists of the Governor of the Central Bank of Somalia (CBS), representatives of the President and the Prime Minister, the Chair of the Budget and Finance Committee of the Lower House, the State Attorney General, and international representatives from the International Monetary Fund (IMF), African Development Bank, World Bank, and bilateral development partners (including the EU). The FGC receives expert support from a dedicated Concessions Adviser and an FGC Secretariat. Funding for FGC operations is provided by the World Bank[4] and the EU.

FGC advice covers fiscal issues, contracts and concessions, natural resource management, and central bank governance. The FGC identifies

[3] Concession agreements grant an interest in a public asset to a private entity for a specified period in return for a fee, royalty, or other consideration, whereas procurement contracts govern the purchase of public goods, works, and services.

[4] World Bank funding to the FGC is provided through the Multi Partner Fund, which is funded by the EU, Finland, Germany (KfW), Denmark, Norway, Sweden (Swedish International Development Cooperation), the United Kingdom, Italy, Switzerland (Swiss Agency for Development Cooperation), the United States (United States Agency for International Development), and the World Bank.

and monitors emerging issues in these areas, balancing its emphasis across policy, compliance, and institutional reform. FGC discussions are confidential, but meeting summaries are published on the Ministry of Finance (MoF) website following each meeting.[5] Individual FGC advisory notes may be made available to other stakeholders at the discretion of the FGC Chair.

The FGC's international delegates periodically brief the international community on the FGC's work and any emerging issues. There has been growing interest in the distinctive model of the FGC, its achievements since 2014, and potential lessons for other countries.[6] Highlighted results from FGC advice to date include improvements in the value for money of government spending through competitive tendering of rations contracts, strengthened accountability through the registration of security sector personnel, renegotiation of fiscal terms to improve concession contracts, improvements to the legal framework for public financial management (PFM) and public procurement, and the recovery of CBS assets.

Purpose of the Financial Governance Report

The FGC's annual Financial Governance Report (FGR) reviews progress on issues that have been discussed by the FGC during the past year. The FGR does not attempt to provide a comprehensive report on all economic and financial governance issues in Somalia, beyond those discussed within the FGC.

Since 2020, the FGR has also included a chapter dedicated to a 'spotlight' issue in FGS financial governance. The intention is to take a deeper dive into the selected topic, to describe the current state of play, and to look back past the single-year time frame of the FGR to identify lessons, persistent barriers to progress, and potential reform priorities.[7] The spotlight this year focuses on improving sector alignment with financial governance reforms. It draws on FGC experience since 2014 to identify inconsistencies between incentives and practices in sectors and overall FGS financial governance reforms, and it makes recommendations to strengthen consistency and coordination.

Organisation of the Report

Following this introduction, the report is organised into three chapters and associated annexes.

Chapter II provides a review of financial governance issues discussed by the FGC over the past year, from July 2020 to June 2021. The review covers progress on fiscal issues, natural resource management, concessions and contracts, and central banking. A summary of progress against the priorities identified by the FGC in the 2020 FGR is included in Annex A, and a list of all contracts formally reviewed by the FGC since 2014 is included in Annex B.

Chapter III presents the selected spotlight issue on improving sector alignment with financial governance reforms. A list of FGS autonomous and semi-autonomous agencies is set out in Annex C.

Chapter IV sets out financial governance priorities for 2021–22.

[5] See website for further information: https://mof.gov.so/fgc

[6] See https://www.worldbank.org/en/results/2019/11/11/the-subtle-art-of-reforming-financial-governance-in-somalia

[7] The 2020 FGR included a spotlight on procurement and concessions.

II. YEAR IN REVIEW: JULY 2020 TO JUNE 2021

Policy Context for Financial Governance

The FGS faced an extremely challenging fiscal policy context in the 12 months from July 2020 to June 2021, driven by the twin challenges of the ongoing COVID-19 pandemic and delays in the electoral process planned for 2021.

As anticipated, COVID-19 had a significant impact on domestic revenues. Revenue collections in 2020 amounted to US$211 million, representing a decline of 8 percent (US$18.5 million) compared to 2019 (Table 1). Non-tax revenue collections were affected by a decline in revenues linked to international travel (including overflight fees, visa and passport fees, and airport management fees), while customs revenues were affected by the FGS's decision at the outset of the pandemic to ban imports of khat from Kenya. These revenue effects commenced in the second quarter of 2020 (April to June) and continued into 2021 (Table 2). Collections in the first quarter of 2021 (January to March) were 13 percent (US$7.6 million) lower than in the first quarter of 2020. Collections in the second quarter of 2021 (April to June) were 7 percent (US$3 million) higher than in the second quarter of 2020, but remained lower than collections during the same period in 2019.

Table 1 FGS domestic revenue collections per year, 2014–20 (US$ millions)

	2014	2015	2016	2017	2018	2019	2020
Customs	64.3	71.1	76.3	92.8	100.3	107.0	91.1
Other tax revenues	9.5	11.2	12.3	19.2	38.6	47.8	48.5
Non-tax revenues	10.5	31.9	24.1	30.6	44.5	74.9	71.7
Total	**84.3**	**114.3**	**112.7**	**142.6**	**183.4**	**229.7**	**211.2**
Annual change		*36%*	*-1%*	*27%*	*29%*	*25%*	*-8%*

Source: MoF.

Table 2 FGS domestic revenue collections per quarter, 2019–21 (US$ millions)

	2019				2020				2021	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Customs	25.3	26.4	26.5	28.9	26.1	19.4	22.3	23.2	26.5	21.7
Other tax revenues	10.8	11.4	11.3	14.3	10.0	11.5	11.3	15.7	12.6	11.9
Non-tax revenues	17.8	15.9	13.0	28.2	23.4	14.3	14.3	19.7	12.8	14.6
Total	**53.9**	**53.7**	**50.8**	**71.3**	**59.5**	**45.2**	**47.9**	**58.6**	**52.0**	**48.2**
Annual change					*10%*	*-16%*	*-6%*	*-18%*	*-13%*	*7%*

Source: MoF.

FGS budgetary expenditures remain dominated by salary expenditures. Salaries for security sector personnel made up 52 percent of total FGS salary payments in 2020. Although domestic revenue collections have increased significantly over the past seven years, the increase was absorbed largely by a rising wage bill (Table 3). As a result, the FGS continued to be reliant on international partner support to help execute the non-salary components of its budget. Furthermore, its ability to cover salary payments fully from its own resources continued to be vulnerable to any shock to domestic revenue, as occurred in 2020 and 2021.

Table 3 FGS salary payments as a proportion of domestic revenues, 2014–20 (US$ millions)

	2014	2015	2016	2017	2018	2019	2020
Domestic revenues	84.3	114.3	112.7	142.6	183.4	229.7	211.2
FGS salary payments	77.2	55.4	55.1	124.6	142.4	162.4	227.0
Salaries as % of domestic revenues	92%	48%	49%	87%	78%	71%	107%

Source: MoF.

FGS salary expenditures rose significantly at the start of 2020 due to a pay increase awarded to security sector personnel following the successful completion of a biometric registration exercise in 2019. The subsequent impact of COVID-19 on FGS revenues meant that domestic revenues could not fully cover the FGS wage bill in 2020. Increased flows of budget support from the African Development Bank and World Bank helped the FGS to meet its expenditure obligations during the course of 2020. Budget support inflows in 2020 totalled US$190 million, compared to US$89 million in 2019 (Table 4). The FGS transferred US$23 million of its World Bank funding to the five Federal Member States (FMS) and the Banadir Regional Administration (BRA) in September 2020 to help them mitigate the impact of COVID-19 on their own revenue bases.

Lack of consensus among the FGS and other stakeholders, including several FMS, on the conduct of the 2021 elections contributed to an increasingly difficult domestic political environment from November 2020 on. This context limited the ability of international partners to provide further budget support to the FGS. The EU put its planned disbursements on hold, and World Bank plans to seek approval from its Board for new budget support financing were delayed. Budget support disbursements in the first half of 2021 (to end-June) amounted to just US$22.2 million, compared to the 2021 budget estimate of US$169.9 million for the year. The decline contributed to the acute fiscal pressure on the FGS in 2021 in a context of reduced domestic revenues and high salary commitments.

Table 4 Budget support disbursements to FGS, 2019–21 (US$ millions)

Provider country/agency	2019	2020	2021 (end-June)
Turkey	15.0	15.0	
Algeria	0.1		
Qatar	21.3		
European Union	29.1	7.7	
World Bank – RCRF (budget support)	23.3	30.4	22.2
World Bank – DPO		100.4	
African Development Bank		26.2	
Total	**88.8**	**179.7**	**22.2**

Source: MoF.

These fiscal developments highlighted the importance of controlling growth in the size of government and enhancing revenue mobilisation. They also elevated three financial governance risks:

1. **Risk that the FGS might not be able to make timely salary payments, including for the security forces.** Failure to pay security sector salaries on a timely basis would have substantial political and security implications. It would also jeopardise the FGS's ability to meet its target[8] of continuous zero arrears accumulation under the IMF Extended Credit Facility programme, which is a central component of its pathway to debt relief. To mitigate this risk, the MoF has made timely salary payments its highest priority in 2021 and marshalled all available resources to

[8] A payment is defined as an arrear under the Extended Credit Facility when it has remained unpaid for 90 days.

meet this objective. It has utilised the balance of unspent budget support funds from 2020, drawn down its buffer account, and arranged a temporary borrowing facility with the CBS, as permitted by the CBS Act. It will use Somalia's share of the IMF global Special Drawing Rights (SDR) allocation, amounting to approximately $222m, to repay CBS, replenish the buffer, support critical expenditures and build CBS reserves. However, unless the electoral process is successfully concluded and FGS is able to access additional external financing, the fiscal situation will become increasingly acute.

2. **Risk that the FGS might face incentives to negotiate concession agreements that offer 'quick wins' in terms of revenue gains even if those contracts may not be in the country's longer-term interest.** The Office of the Prime Minister (OPM) and MoF are continuing to counter this risk by requiring all concession agreements, including oil and gas agreements, to be tendered and awarded in line with the requirements of the Procurement Act.

3. **Risk of loss of momentum or a reversal on reforms that are vital for strengthening financial governance as political attention is absorbed by the electoral process and technical attention is focused on day-to-day cash flow management.** Stalled progress on reforms could adversely affect the FGS's completion of the Highly Indebted Poor Countries (HIPC) debt relief process, which is tied to reform benchmarks, as well as successful implementation of the IMF Extended Credit Facility programme. Noting this risk, the FGS has maintained its dialogue with the IMF and continues to focus on programme benchmarks.

Progress in Strengthening Financial Governance

FGC deliberations and advice to the FGS over the 12-month period from July 2020 to June 2021 have focused on four areas:

- Protecting fiscal reforms;
- Providing oversight on procurement and concessions;
- Ensuring transparency and due process in natural resource revenue management; and
- Strengthening central bank governance and financial sector development.

Major developments and issues are discussed below. Formal FGC outputs have included advisory notes and contract reviews (Box 1). In addition, Annex A provides an assessment of FGS progress against priority actions identified in the 2020 FGR.

Box 1 FGC advisory notes and contract reviews 2020–21

International delegates to the FGC prepared 13 advisory notes on policy issues for discussion at the seven FGC meetings held between July 2020 and June 2021.

- Passport production tender: stocktaking, lessons, and next steps (August 2020)
- Proposal for external legal advisory support for FGC (September 2020)
- Oil and gas licensing (September 2020)
- Advisory requirements for renegotiation of the Simatech dry port agreement (September 2020)
- Technical assistance requirements for Mogadishu port concession agreement implementation (September 2020)
- Guidance to development partners on how to bring aid to FGS institutions on-budget and on-treasury in accordance with the 2019 PFM Act (October 2020)
- Maintaining competitive tendering for security sector rations (November 2020)
- Review of recent developments with the 2020 oil and gas licensing round and the 2021 proposed direct award of petroleum contracts (January 2020)
- Strengthening revenue collection from the telecom sector (February 2020)
- Legal requirements for the award of oil and gas production sharing agreements (PSAs) (February 2020)
- Education textbooks contract with Beder Printing House (March 2020)
- Oil and gas PSA and tender protocol: outstanding issues for resolution (June 2020)
- Somalia Bureau of Standards tender (June 2020)

The FGC also prepared a contract review on the revised Mogadishu port concession, and it provided ad hoc support on procurement and concession policy and several individual concessions and contracts.

Protecting fiscal reforms

Revenue mobilisation

Despite the challenging political backdrop and the COVID-19 pandemic, the FGS has pressed ahead with revenue reforms. In particular, FGC engagement and advice between July 2020 and July 2021 has focused on customs administration, telecom revenues, and overflight revenues.

Progress continued in modernising and standardising **customs administration** in Mogadishu and in FMS that have major customs posts (Puntland and Jubaland). These efforts aim to roll out a single Customs Automated System to all major ports and airports, and to implement a common national customs tariff using value-based duty rates.

- A harmonised system for the classification of goods was adopted at Mogadishu Port and Airport, Garowe Airport, Bossaso Port, and Kismayo Airport, based on standards set by the World Customs Organisation. Kismayo Port is expected to adopt the new harmonised system in the second half of 2021. Adoption of a standardised harmonised system is a prerequisite for the implementation of a common national customs tariff.

- Development of the Customs Automated System is underway. Once complete, the system will standardise and automate customs management processes across all major ports and airports, increasing their efficiency.

FGC advice in the **telecom sector** has focused on options for increasing FGS revenue. Operators in Sub-Saharan Africa pay an average of 26 percent of their annual income in taxes and non-tax revenues.[9] By contrast, FGC estimates[10] suggest that Somali telecom operators have typically paid less than 4 percent annually over the past few years, largely in the form of voluntary payments rather than assessed revenues. The National Communications Act was passed in 2017. It was expected to enable the MoF to assess the revenues payable by telecom operators from general taxes such as sales tax on mobile airtime and corporate income tax. It was also expected to enable the collection of revenue from sector-specific fees, such as operator licences and spectrum allocations.

The National Communications Authority (NCA) has since been established, and the Unified Licensing Framework for telecom licensing has been developed. Four mobile operators paid licence fees in 2019 and were awarded 20-year Combined Infrastructure and Services Provider licences by the NCA in late 2020.[11] Not all existing operators have been awarded licences under the unified framework, however, and the NCA has not yet started charging annual spectrum management fees. It is due to do so within two years as a condition of the Combined Infrastructure and Services Provider licences.

The MoF continues to face challenges in collecting sales and corporate income taxes from telecom

---

9 GSMA. 2019. "Rethinking Mobile Taxation for Improved Connectivity." London: GSM Association. Available at: http://www.gsma.com/publicpolicy/resources/rethinking-mobile-taxation-to-improve-connectivity (accessed July 20, 2021).

10 Based on data provided in Peter Lange. 2015. "Telecommunications Contribution to Public Finance in Somalia." World Bank Memorandum (January).

11 The four operators are: Hormuud, Golis, Nationlink, and Telesom. See https://nca.gov.so/licensed-operators/.

operators. Revenues from sales tax on telecom services fell by 75 percent in 2020 compared to 2019. The MoF relies on self-assessments made by telecom services operators to estimate the amount of sales tax due, because the NCA does not yet have the necessary capacity and equipment in place to monitor sector activity. Corporate income tax payments by telecom operators more than doubled in 2020 compared to 2019, albeit from a low base. Six telecom companies are now registered with the Large and Medium Taxpayers' Office, which recently conducted its first-ever audit of registered firms, including the six telecom operators. The audits revealed weaknesses in companies' recordkeeping and accounting that inhibit accurate assessment of the taxes they owe.

In this context, the FGC provided advice on steps to complete implementation of the licensing framework and to strengthen the collection of sales and corporate income taxes in the telecom sector. To succeed, these actions will need to be underpinned by sustained political backing for enforcing telecom operators' compliance with licensing, reporting, and taxation requirements.

The FGS took over responsibility for the collection of Somalia's **overflight revenues** from the United Nations (UN) in 2019 after more than 25 years. These revenues are estimated at approximately US$15 million to US$18 million per year, although in 2020–21 they were adversely affected by reduced air traffic as a result of global travel restrictions in response to the COVID-19 pandemic. Overflight revenues are collected from airline operators on Somalia's behalf by the International Air Transport Association (IATA). Until August 2019, the IATA deposited the revenues into a trust fund managed by the International Civil Aviation Organisation. Since August 2019, the IATA has disbursed Somalia's overflight revenues directly to the FGS. The revenues are remitted to the Treasury Single Account (TSA) and reflected in the Somalia Financial Management Information System (SFMIS).

Some local and regional airlines operating in Somalia are not IATA members. The IATA has found it difficult to collect overflight fees from those operators. Sizeable arrears have accumulated, although they may not be fully recoverable. In December 2020, with the agreement of IATA, the FGS decided to seek third-party debt collection services. The FGC agreed to support the development of a tender, and legal support was retained using EU funding to prepare a Request for Proposals and draft a contract for use in the tender process. These documents have been shared with the Somali Civil Aviation Authority for FGS review and agreement prior to issuance of the tender.

Fiscal federalism

The principles of federalism in Somalia are set out in Article 50 of the 2012 Provisional Constitution (Box 2). Article 50(b) states that power is given to the level of government where it is likely to be most effectively exercised, while 50(d) and 50(e) state that every part of the republic has the right to enjoy similar levels of services and that resources are to be shared equitably.

These principles require an eventual agreement between the FGS and the FMS on how revenues will be allocated, including to the district level, in line with expenditure responsibilities and consistent with equitable development. No such agreement has yet been reached. Instead, individual agreements have been established on specific resource-sharing measures. For example:

- ***Petroleum:*** The 2018 Baidoa Agreement covers the ownership, management, and sharing of petroleum and mineral resources. The 2020 Petroleum Act (Article 6) further requires all petroleum resources to be shared in accordance with the Baidoa Agreement.[12]

- ***Fisheries:*** An interim agreement between the FGS Ministry of Fisheries and Marine

Box 2 Article 50 of the 2012 Provisional Constitution

Principles of federalism in the Federal Republic of Somalia
The various levels of government, in all interactions between themselves and in the exercise of their legislative functions and other powers, shall observe the principles of federalism, which are:

(a) Every level of government shall enjoy the confidence and support of the people;

(b) Power is given to the level of government where it is likely to be most effectively exercised;

(c) The existence and sustainability of a relationship of mutual cooperation and support between the governments of the Federal Member States, and between the governments of the Federal Member States and the Federal Government, in the spirit of national unity;

(d) Every part of the Federal Republic of Somalia shall enjoy similar levels of services and a similar level of support from the Federal Government;

(e) Fair distribution of resources;

(f) The responsibility for the raising of revenue shall be given to the level of government where it is likely to be most effectively exercised; and

(g) The resolution of disputes through dialogue and reconciliation.

[12] The FGC has previously noted that, under the terms of the Baidoa Agreement, there could be significant disparities among FMS revenue shares depending on whether or not they produce oil. It has advised that the terms of the agreement be reviewed periodically.

Resources (MFMR) and the FMS fisheries ministries in March 2019 determined how fisheries revenues would be distributed for a period of 18 months.

- ***Budget support:*** The MoF agreed with the FMS finance ministries in September 2019 that funds from international partners would be shared 60/40 between the FGS and the FMS.

All of these agreements signal a willingness to find pragmatic solutions to specific resource-sharing questions. There is, however, no mechanism to assess whether the overall allocation of resources is equitable (including inter-FMS allocations) and whether it matches agreed expenditure responsibilities as required by Article 50 of the 2012 Provisional Constitution.

The constitutional review process offers an opportunity to establish a mechanism to guide overall resource sharing. Doing so would ensure that the distribution of resources is not driven by individual sector agreements or ad hoc arrangements. The FGC provided advice on these issues in 2019. In January 2020, the Parliamentary Oversight Committee endorsed a draft version of the revised federal constitution prepared by the Independent Constitutional Review Commission. It proposes establishing a Revenue Sharing Commission responsible for making recommendations on the fair and equitable distribution of resources between the FGS and the FMS, including revenues from natural resources. Consultations on the draft commenced in several FMS in March 2020, before being interrupted by COVID and by delays in the 2021 electoral process.

Although progress in agreeing on a constitutional mechanism to ensure the equitable allocation of resources has stalled, the FGS has continued to make sizeable resource transfers to the FMS and BRA. Transfers in 2020 totalled US$76.1 million (Table 5) and were provided by the MoF; the Ministry of Interior, Federal Affairs, and Reconciliation; and the Ministry of Education. They were funded by a combination of international partner budget support and project funds, FGS own revenues, and shared FGS–FMS revenues from tuna licensing. FGS transfers to the FMS in the first half of 2021 were affected significantly by overall resource constraints, totalling only US$17.1 million by the end of June.

Technical work on fiscal federalism continued between July 2020 and June 2021. The MoF made progress in consolidating FGS and FMS fiscal information. For the first time, the FGS budget for 2021 included an annex setting out consolidated budgetary information for the FGS, FMS, and BRA.[13] The FMS also started providing the FGS MoF with timely data on budget execution

Table 5 FGS transfers to FMS and BRA, 2020 (US$ millions)

Subnational jurisdiction	Amount
Puntland	16.5
Jubaland	8.0
Hirshabelle	9.6
South West	10.0
Galmudug	11.9
Banadir Regional Administration	20.1
Total	**76.1**

Source: MoF.

[13] See QOONDAHA MIISAANIYADDA 2021-KA | Wasaaradda Maaliyadda (mof.gov.so)

(revenues and expenditures) in a standardised format, enabling publication of consolidated monthly budget execution statements.[14] This progress at the technical level provides important underpinnings for future discussions on resource allocations. It will be important in the future that FGS transfers to FMS and BRA be identified by funding source as well (for example, FGS own resources, donor budget support, donor project funds, shared revenues, and so on).

Using and strengthening country systems

The FGS continued to make progress on PFM reforms between July 2020 and June 2021. Most notably, the MoF prepared and issued regulations to the PFM Act.[15] Drawing on the findings of a Quality Assurance Review of the SFMIS and a World Bank Expenditure Management Review, and supported by EU technical assistance, the MoF is currently developing a new PFM Reform Action Plan. The Office of the Auditor General (OAG) completed a statutory audit of the FGS's 2019 financial statements, as well as compliance audits of FGS institutions. These reports were submitted to Parliament and made available online in December 2020.[16]

FGC advice focused on ensuring that international partner support to FGS institutions complies with the provisions of the PFM Act, which requires that all external grants to FGS institutions be appropriated in the FGS budget ('on-budget') and paid into an account held in the TSA ('on-treasury'). Although some international partners already provide their support to FGS through government systems, some still follow the legacy practice of providing funding to individual institutions without reflecting it in the budget or passing it through the treasury. When international partners provide off-budget, off-treasury funding to FGS institutions, they undermine efforts by the MoF to strengthen PFM systems. They also increase their own fiduciary risk because the Accountant General's Office in the MoF does not oversee the management and expenditure of their funds and the OAG does not oversee their audit.

In 2020, at the request of the Prime Minister, the OAG conducted a special forensic audit of US$6 million in donor funding provided by three international agencies[17] to the Federal Ministry of Health between 2017 and 2019. It found that the funding was not appropriated in the FGS budget, did not disburse through the FGS treasury, and was held in bank accounts operated privately outside the CBS. The audit identified multiple instances of fraudulent payments using these funds. A number of senior FGS officials were convicted in August 2020 on charges of misuse of public funds.[18]

Following these findings, the FGC's international delegates consulted extensively with international partners, including the UN country team, to explain the significance of the PFM Act provisions on funding to FGS institutions and the benefits of complying with those provisions. The FGC developed an advisory note explaining how partners could take steps to bring their support to FGS institutions into compliance with the PFM Act. The UN subsequently made an undertaking in its Sustainable Development Cooperation Framework for Somalia for 2021–2025[19] to channel all of the financial support it provides to FGS institutions on budget and on treasury, in accordance with the PFM Act. The UN subsequently shared data

[14] For example, April 2021 Consolidation Report | Ministry of Finance (mof.gov.so)
[15] See https://mof.gov.so/sites/default/files/2020-12/Xeerarka%20Maaliyadda%202020.pdf
[16] See http://oag.gov.so/audit-reports/
[17] The three agencies include the United Nations Children's Fund, United Nations Population Fund, and World Vision.
[18] See https://www.garoweonline.com/en/news/somalia/somalia-court-jails-senior-health-ministry-officials-for-corruption
[19] See UNSDG | UN Sustainable Development Cooperation Framework for Somalia 2021-2025

with the MoF on its support to FGS institutions in 2021, amounting to US$7.5 million, for inclusion in the 2021 supplementary budget.

The MoF re-established the Use of Country Systems Working Group as a forum for discussing progress and challenges in the use of FGS systems with international partners. The experience of the Global Partnership for Education has highlighted that processing payments through the TSA can take a considerable amount of time. The World Bank's Expenditure Management Review found that manual, duplicate, and cumbersome payment processes create delays in payment execution. Streamlining commitment control and budget execution processes, together with making maximum use of the capacity provided by the SFMIS, must be priorities for the MoF if it is to encourage further use of country systems by international partners. Further discussion of this issue can be found in Chapter III on this year's spotlight topic.

Sustainable cost of government

For the past two years, the FGC has continually flagged concerns over the fiscal and institutional consequences to the FGS of the unchecked establishment of new government agencies. Multiple semi-autonomous or special-purpose agencies have been created or proposed as a consequence of sector legislation and donor benchmarks (Annex C). The FGC is concerned that increases in FGS revenue are being absorbed by rising government administrative costs, leaving the FGS vulnerable to revenue shocks, as occurred in 2020–21. The FGC has recommended that the FGS establish a policy to set out the conditions under which the creation of a new agency is appropriate. A draft policy has been prepared for Cabinet consideration, but it has not yet been tabled. Further discussion of this issue can be found in Chapter III on this year's spotlight topic.

Natural resource management

The FGC continues to monitor the FGS's progress in awarding licenses and concessions for the exploitation of natural resources and in distributing any resulting revenues to the FMS. Article 25 of the 2012 Provisional Constitution states that every person has the right to have a share of the natural resources of the country, while Article 44 states that allocation of the natural resources of the Federal Republic of Somalia shall be negotiated and agreed upon by FGS and the FMS. Securing agreement between the FGS and the FMS on the management of natural resources and the distribution of related revenues is therefore an important element of federalism in Somalia.

From a financial governance perspective, it is important that licences and concessions for the exploitation of natural resources be awarded transparently and according to due process, and that their commercial terms protect Somalia's financial interests. It is similarly important that revenues be distributed in accordance with prevailing agreements between the FGS and the FMS. FGC engagement between July 2020 and June 2021 focused on tuna licensing and on oil and gas licensing.

Tuna licensing

In February 2018, the FGS and the FMS agreed that the FGS would take responsibility for issuing fishing licences to vessels fishing beyond 24 nautical miles from the Somali coast. The MFMR duly signed a Memorandum of Understanding on tuna fishing with the Chinese Overseas Fishing Association in July 2018. It then signed an 18-month agreement on fisheries revenue sharing with the FMS in March 2019. That agreement expired in September 2020, and a new agreement has not yet been put in place.

The MFMR has awarded a number of licences against the Memorandum of Understanding on tuna fishing, yielding US$3.86 million in revenue (Table 6). It issued one-year licences to 31 vessels in September 2018 and renewed these for a further year in November 2019. The MFMR awarded an additional 10 one-year licences in August 2020, and another 11 in December 2020. Details of the licences issued in 2020 are published on the MFMR website.[20]

Revenues from the September 2018 licence round were distributed to the FMS in 2019, in accordance with the March 2019 revenue sharing agreement. Revenues from the November 2019 licence round were shared with the FMS in September 2020. Revenues from the September 2020 and December 2020 licence rounds had not been shared by end June 2020, and the March 2019 revenue sharing agreement has expired. The funds are being held at CBS until a new agreement is reached.

The FGC monitored progress in licensing and revenue sharing. It also engaged with the technical experts supporting the MFMR on developing a new Fisheries Bill.

Table 6 Tuna licence revenues, 2018–20 (US$ millions)

Licensing round	Vessels	Revenue
September 2018	31	1.04
November 2019 (renewal)	31	1.69
September 2020	10	0.51
December 2020	11	0.62
Total		**3.86**

Sources: MFMR, MoF, CBS.

Oil and gas licensing

FGC engagement on petroleum sector issues in Somalia dates back to 2014, when it reviewed six petroleum-related contracts. At that time, the FGC voiced concern at the absence of a clear legal and fiscal framework for petroleum management. The FGC noted the risks associated with destabilising competition for the exploitation of petroleum resources among different levels of government. It recommended that no exploratory drilling by international oil companies be permitted until a new legal and fiscal framework for petroleum was in place.

The FGS has since made considerable progress in establishing the legal and fiscal framework for petroleum management and the award of oil and gas Production Sharing Agreements (PSAs). The award of PSAs is governed by both the 2020 Petroleum Act and the Procurement Act.

[20] See: Microsoft Word - FN MFMR List of Licensed Vessels of 2020-2021.docx

- The *Petroleum Act* provides a framework for the management of the petroleum sector in Somalia. It assigns the exclusive right to enter into PSAs with oil companies to the FGS and establishes the Somalia Petroleum Authority as the entity responsible for regulating petroleum operations and negotiating PSAs on behalf of the FGS. The Petroleum Act includes some basic provisions applicable to PSA award and signature.

- The *Procurement Act* sets out more detailed procedural requirements for the negotiation and award of PSAs, whether through open international competitive tendering or direct negotiation. It requires that all PSA award processes be subject to oversight by the Inter-Ministerial Concessions Committee (IMCC).

The Petroleum Act requires that PSA tax provisions be governed by a 'special law,' in conformity with Somalia's financial system. The MoF has drafted an Extractives Industries Income Tax (EIIT) Bill to govern the fiscal terms of the PSA, including royalty rates and the applicable taxation regime. The bill was approved by the Cabinet in December 2020 and submitted to the Lower House, where it awaits its first reading.

Enactment of the EIIT Bill is a HIPC Completion Point benchmark. In addition, the FGS has made an undertaking to its international partners[21] that it will not issue any oil exploration licences until the following conditions are satisfied: the Petroleum Act is made operational, the EIIT Bill is enacted, the Model PSA is finalised, and PFM Act regulations on natural resource management are issued.

In line with the requirements of the Petroleum Act, the Somalia Petroleum Authority (SPA) Board was appointed in July 2020. The SPA then launched a licensing round for seven offshore blocks in August 2020, with a deadline of March 2021. In November 2020, it posted a licensing round tender protocol and draft PSA on the licensing round website.[22] In parallel to launching the licensing round, it carried out negotiations for the direct award of 10 offshore blocks to two oil exploration firms.

The FGC provided advice to the FGS on these developments, which took place without the approval of the IMCC and while the EIIT Bill remains unapproved by Parliament. The FGC noted that:

- The 2020 Draft PSA and Tender Protocol had not been reviewed and approved by the IMCC, as required by the Procurement Act.

- The fiscal terms of 2020 Draft PSA were not consistent with the provisions of the EIIT Bill.

- The 2020 Draft PSA and Tender Protocol contained inconsistencies with the Petroleum Act and Procurement Act.

FGC advice focused on ensuring that the award of PSAs is consistent with Somalia's legal framework so that the FGS does not expose itself unduly to the risks of future compensation claims, legal disputes, or poor value for money.

The Ministry of Petroleum and Mineral Resources (MPMR) did not ultimately sign any direct awards, and the SPA extended the licensing round bid submission deadline to the end of June 2021. A further postponement was announced in June 2021.[23] The MPMR, SPA, and MoF have held discussions to resolve outstanding differences between the fiscal terms of the 2020 draft PSA and those of the EIIT Bill. Once these discussions have been concluded, the SPA has indicated that it will submit the draft PSA and Tender Protocol to the IMCC for approval.

---

[21] IMF. 2020. *Second Review of the Staff Monitored Programme.* IMF Country Report 20/85 (March). Washington, DC: IMF.

[22] www.somalialicensinground.com

[23] www.somalialicensinground.com

Concessions and contracts

The FGC's support on concessions and contracts in 2020–21 covered adice on procurement policy and compliance (including emergency procurement), reviews of specific contracts and tender processes, and regular follow-up on contracts previously under discussion in the FGC.

Procurement policy and compliance

The Procurement Act establishes a highly decentralised approach to procurement. Each FGS institution is expected to be certified as a procuring entity, responsible for carrying out its own procurement in accordance with the Procurement Act, using its own procurement unit and procurement committee. In 2017, recognising that the FGS lacked the institutional capacity for near-term implementation of the Procurement Act, the Cabinet approved a set of Interim Public Procurement Requirements. These interim requirements reaffirmed the principles of the Procurement Act, including competitive bidding. They stipulated that FGS institutions must carry out all public procurement for contracts valued in excess of US$100,000 in conjunction with the MoF's Procurement Department.

As noted in the 2020 FGR, which contained a spotlight chapter on procurement and concessions, the FGS has made progress since 2017 in requiring competitive tendering for high-value goods contracts, such as security sector rations. These tenders have been issued with the support of the MoF's Procurement Department, as required by the Interim Public Procurement Requirements. However, the OAG's 2019 institutional audit listed a number of contracts over US$100,000 in value that the FGC ascertained had been awarded by FGS institutions without the support of the MoF's Procurement Department. The FGC identified 14 such contracts, with a total value of US$4.7 million. It is likely that these contracts were awarded directly by the relevant FGS institutions without a competitive process. In addition, they were not registered with the OAG, as required by the Procurement Act.

Compliance with the Procurement Act and Interim Public Procurement Requirements is still lacking across many FGS institutions, as the OAG's 2019 report findings demonstrate. The FGC has recommended that the MoF and the OPM make active and sustained efforts to inform FGS institutions of their obligations. The Procurement Act provides the tools required to ensure compliance. It enables central oversight of high-value procurement contracts and non-standard bidding methods. It also requires all concessions contracts to be overseen by the IMCC.

Non-compliance issues are in part related to capacity challenges. As noted in the 2020 FGR, the capacity limitations among spending agencies have multiple dimensions. FGS institutions lack the capacity to develop clear contract specifications, often underestimate the complexity and time requirements involved in the contracting process, and have a limited understanding of the tendering and approval processes that apply to concessions in particular. In addition to increasing the likelihood of non-compliance with the law, these limitations raise the risk that the FGS will enter into contracts that offer poor value for money or do not adequately protect its interests.

The FGC recommends that international partners support the FGS to deliver a sustained programme of public procurement and concessions capacity building and development. Partners have shown a disappointing lack of interest in supporting the FGS in developing its capacity for public procurement and concessions to date. It is hoped that this will change as donors start to channel more of their funding through country systems.

Emergency procurement

The COVID-19 pandemic has illustrated the way in which shortcomings in FGS institutional capacity for procurement have particularly acute implications in emergency contexts. Clear specifications for goods to be purchased on an emergency basis are almost entirely lacking, thereby increasing the risk of wasted expenditure. There is sustained pressure to set aside due process in awarding contracts.

The Procurement Act establishes the basic principle of altering procedures and processes in emergency situations, but neither the Procurement Act nor its Regulations provide guidance or direction on how procedures and processes should be altered. The FGC helped the FGS to retain technical support from the World Bank to develop more detailed guidance on emergency procurements. The guidance will define the procedures that apply to emergency procurement transactions and will establish parameters for when those emergency procedures should apply.

Mogadishu port concession

In October 2020, after two years of negotiations, the FGS signed a revised port agreement with Al Bayrak, the Turkish firm that has been managing the Port of Mogadishu since 2013. The revised agreement runs until 2034. The main improvements, compared to the original 2013 contract, are that:

- The 2020 contract captures a clearer specification of contractor operating and investment obligations.
- The FGS is now better able to hold the contractor to its obligations to undertake essential investments in the Mogadishu port.
- The distribution of revenue shares between the parties has been updated based on estimated costs for port operations and investments.
- Monitoring and reporting requirements are much clearer.
- Termination provisions have been clarified.

The revised agreement sets aside US$52 million of port revenue for investments in port infrastructure during the first five years. It specifies a procedure for the FGS and Al Bayrak to agree on a long-term plan covering port investment from years six to fourteen, and it enables the FGS to terminate the agreement after five years if the long-term plan is not acceptable.

Legal and technical support funded by the African Legal Support Facility, the World Bank, and the EU played an important role in assisting the FGS to develop the revised agreement. The FGS is now required to play an active role in its implementation. The FGC has recommended that the FGS seek further technical assistance to assist it in fulfilling its obligations under the agreement. These obligations include reviewing detailed designs and works to be completed, monitoring performance standards, and conducting financial reporting. Failure to review or approve/reject submissions from the contractor in a timely manner may affect the FGS's ability to hold the contractor responsible for meeting its obligations.

More generally, the FGC is concerned that ensuring that the FGS enters into good-quality contracts is a necessary, but not sufficient, condition for strengthening financial governance of FGS concession agreements. Support from international partners to improve FGS capacity for contract implementation and management will be essential.

Passport production concession

The FGS launched a tender in 2020 for a new passport production concession agreement to replace the existing contract, which was signed in 2013. Although six firms were invited to bid, only one bid was received. Another bidder submitted a formal legal complaint requesting that the process be cancelled.

The FGS decided not to proceed with the tender process. It has instead issued a short-term extension to the existing contract holder to allow sufficient time to prepare adequately for a new tender. The FGC has highlighted the importance of acquiring appropriate technical expertise to support the new tender process, and discussions are underway with international partners. There is some urgency to decide a way forward if the new tender is to be launched and concluded in good time so that a new service provider can be appointed before the contract extension expires.

Security sector rations contracts

FGS security rations supply contracts have historically been awarded on a sole source basis. That approach fuelled suspicions of corruption and poor value for money in the security sector. In 2019, as a part of its security sector reform programme and in line with the requirements of the Procurement Act, the FGS issued competitive tenders for rations supply. The tenders covered the supply of dry rations to the Somali National Army (SNA) (two lots), the Somali Police Force, and the National Intelligence and Security Agency (NISA) for a one-year period. In total, 21 firms participated in the tenders. Four contracts were awarded competitively in September 2019. The tender process enabled the FGS to achieve lower unit costs for most items compared to the previous contracts.

Although the 2019 rations contracts expired in September 2020, there was a delay in launching a new tender process due to a lack of clarity in required specifications. Tenders were eventually issued in December 2020 for the supply of dry rations to the SNA, Police, NISA, and Prisons. Twenty-two firms participated in the tender process, and four contracts were awarded competitively in March 2021 for the supply of rations to the SNA (two lots), police, and prisons for a one-year period.

NISA did not open the bids submitted for the NISA rations tender process in early 2021, and therefore no new contract has been awarded for the supply of rations to NISA. The FGC has highlighted the importance of ensuring that NISA rations are delivered against a valid contract.

Although the 2021 rations tender process resulted in the successful award of four contracts, it revealed ongoing challenges to the effective conduct of FGS procurement processes. High bid rejection rates appear to prevent the FGS from benefitting fully from price competition between bidders. More than half of the bids received were assessed to be non-compliant and were not considered for full evaluation. The FGC is reviewing the lessons learnt from the 2021 tenders and will make recommendations to the FGS on improving agency compliance and tendering competitiveness.

Education textbooks concession

In August 2020, the Ministry of Education signed an amendment to its 2016 contract with Beder Printing House. The 2016 contract granted Beder the exclusive right to develop Somalia's curriculum and associated textbooks, but it suffered from a lack of clarity over key contractual terms—including the ownership of copyright. Subsequent amendments, including the August 2020 amendment, have not resolved the problems in the original contract.

The August 2020 amendment awards new services to Beder on a sole source basis and is not consistent with specific commitments on non-exclusivity and ownership of copyright made by the Ministry of Education and Beder to international partners in the education sector in 2019. Neither the original contract nor the subsequent amendments followed due process as required by the Procurement Act.

The FGC has reviewed the original 2016 contract and the amendment of August 2020, and it has made recommendations on corrective actions to be taken by the Ministry of Education.

Central Bank governance and financial sector reforms

The CBS continued to implement the Financial Sector Roadmap in 2020–21. Developing a stable financial sector that provides intermediation and inclusive access to financial services is critical to economic growth and poverty reduction, while sound financial sector governance is essential to Somalia's reintegration into the global financial system. Roadmap priorities include improving CBS capacity for core functions and organisation, developing a national payments system and facilitating international transfers, reforming the legal and regulatory framework, and developing financial infrastructure to support intermediation.

Telecommunications and mobile money licensing

The CBS started issuing licenses to mobile money providers in the first half of 2021, representing a significant milestone in its efforts to reduce financial sector risk. Licences were awarded to Hormuud Telecom in February 2021 and to Somtel in June 2021. A third company, Somlink, was approved to be granted a licence in August 2021. All three service providers were assessed as having met all of the licensing requirements set out in the 2019 Mobile Money Regulations, including holding a valid telecom licence issued by the NCA.

National payments system

The CBS continued to make good progress during 2020–21 in developing the architecture for the national payments system. The World Bank provided support. The system will establish a National Switch and Automated Transfer System that integrates real-time gross settlement system and automated clearing house functionality onto a single platform, with links between the CBS and commercial banks and mobile money. The system will enable automated inter-bank payments and settlements, thereby reducing cash-based transactions. It will enable better CBS oversight of payments and compliance and will, in time, provide scope for overnight borrowing. The system will launch with nine banks in August 2021, and later will be rolled out to the entire banking sector.

Remittance flows

Most money transfer businesses (MTBs) operating in Somalia fly cash from remitting countries to clearance hubs, due to the absence of correspondent banking relationships. Disruptions to global travel at the start of the COVID-19 pandemic highlighted the acute vulnerabilities of this system. Ongoing financial sector reforms are a critical foundation for restoring Somalia's correspondent banking relationships over the medium term. The FGS is undertaking a number of reforms to re-engage Somalia in the global financial system.

Beyond bringing mobile money under the regulation of CBS and establishing the national payments system, FGS is also addressing gaps in anti-money laundering and combating the financing of terrorism (AML/CFT). Lack of unique ID has been one of the main challenges for the financial sector to establish Know Your Customer procedures to an international standard. The World Bank is supporting an ongoing initiative to develop a national ID system. In addition, the Targeted Financial Sanctions Bill is with the Parliament for approval, and the Financial Institutions Act is under review. Revised AML/CFT regulations are in the process of being issued for the financial sector. A country-wide National Risk Assessment (NRA) is in progress under the coordination of the Financial Reporting Centre, and a first draft of the NRA report is undergoing stakeholder consultations. This NRA will support the expected Mutual Evaluation to be conducted by the Financial Action Task Force, the global money laundering and terrorist financing watchdog, in 2024.

Despite progress, the lack of corresponding banking relations is a major issue that Somalia cannot resolve alone. The perception that Somalia is a high-risk country persists. De-risking continues to be a challenge for remittance flows globally, and disproportionately affects Somali MTBs. Support from international partners is needed.

As a result of the COVID-19 crisis, the CBS increased the frequency of its monitoring of financial institutions and MTBs from a quarterly to monthly basis. Monitoring reports show that remittances to Somalia have been remarkably resilient in the face of the COVID-19 pandemic. Total remittance inflows in 2020 amounted to US$2.8 billion, compared to US$2.38 billion in 2019. Remittance inflows have continued to show growth in 2021, at US$1.4 billion in the first five months of the year. This represents a 40 percent increase over the same period in 2020. The observed trend can be explained by various factors, including new channels and instruments being used by Somali MTBs, such as special couriers for cash transport and digital platforms, as well as adjustments in cost policies.

Asset recovery

The CBS continued its efforts to recover legacy assets belonging to the Federal Republic of Somalia, which have been held in banks abroad since 1991. The focus has been on assets held in Italy by Banca Intesa Sanpaolo and in the United Kingdom by Crown Agents Bank, but the processes are not yet complete.

III. SPOTLIGHT ISSUE: IMPROVING SECTOR ALIGNMENT WITH FINANCIAL GOVERNANCE REFORMS

The FGR spotlight chapter takes a deeper dive into a topic that is relevant to FGC discussions, to describe the current state of play and to look back past the single-year time frame of the FGR to identify progress, lessons, and potential reform priorities.

The spotlight topic in this year's FGR focuses on improving cross-government coordination within the FGS to strengthen financial governance. It looks at how sector entities (including ministries, departments, and agencies) and their international partners can align their practices and policies more closely with the financial governance reforms led by entities at the centre of government (especially the MoF, including the Accountant General's Office, as well as OPM, OAG, and CBS). The topic has been selected because, in the FGC's experience, it is a major determinant of whether or not financial governance reforms succeed, yet receives relatively less attention than the separate issue of intergovernmental fiscal coordination between FGS and the FMS, which is a high priority for the FGS and development partners.

The quality of financial governance in the FGS is influenced by the behaviour of actors across the entire government. Reforming financial governance is principally the domain of the MoF, which holds overall responsibility for revenue collection, budget preparation and execution, procurement policy, debt management, and the preparation of FGS accounts. It is charged with the efficient and effective stewardship of public resources and with maintaining the legal framework that supports good financial governance. It is supported in these objectives by the OPM, OAG, the CBS, and other central institutions. The objectives cannot be achieved in isolation from the rest of government, however. Sector ministries, departments, and agencies have critical roles to play in supporting good financial governance by following due process and safeguarding value for money. International partners are also influential through their policy advice, programme design, and financial support in multiple sectors. Their engagement can serve to reinforce good financial governance, or to undermine it.

Reform Context and Challenges in the FGS

The MoF has made extensive efforts since 2013 to raise domestic revenue and improve expenditure efficiency against a backdrop of severe fiscal constraints. Notable measures have included the verification and biometric registration of all security sector personnel as the basis for making payments directly to their bank accounts; the introduction of regular competitive tendering for personnel rations in the justice and security sectors; the reintroduction of a sales tax, including on imports; and a significant expansion of non-tax revenues into areas such as port and airport management, telecom licensing, overflight fees, and fisheries licensing.

These efforts have been accompanied by the development of legislation and procedures to strengthen financial governance. New laws have been introduced to support revenue administration, public procurement and concessions, and PFM, with the aim of strengthening transparency, value for money, and due process. Establishment of the TSA and development of the SFMIS have improved system efficiency and coherence, and the SFMIS is now integrated with the core banking system of the CBS. The Accountant General's Office prepares annual financial statements on a cash basis and in accordance with International Public Sector Accounting Standards. Annual financial and compliance audits by the OAG, together with occasional special audits or forensic audits, have improved accountability, public awareness, and parliamentary oversight. The Accountant General's Office is making efforts to institutionalise the implementation of prior year audit recommendations across all FGS entities.

The FGC has observed, however, that the policies and practices of sector institutions, and those of the international partners that support them, are not always consistent with the overall financial governance reform objectives of the FGS. While this lack of alignment may not necessarily be intentional, it can undermine efforts to raise revenue, improve expenditure efficiency, and strengthen financial governance. Reasons for this misalignment include differing priorities and incentives at the sector level, a lack of familiarity with FGS financial governance policies, and a tendency to view procedural requirements as an unnecessary constraint.

Within the financial governance domain, the FGC has observed that international partners in Somalia tend to concentrate on the intergovernmental fiscal relations between FGS and the FMS. This focus on *vertical fiscal linkages* is critical in the context of fiscal federalism and the revision of the constitutional settlement. However, comparatively less attention is paid by international partners to *horizontal financial governance linkages* and alignment across FGS institutions. The specialised sector mandates of some international agencies may cause them to pursue a narrow engagement that does not take into consideration wider financial governance objectives or reforms. Larger agencies operating across multiple sectors—especially multilaterals—may in principle cover the broad spectrum of issues 'under one roof,' but nonetheless this institutional coherence may not always come to fruition in practice. As a result, the support provided by international partners to individual sectors may unintentionally reinforce existing challenges in strengthening good financial governance across the FGS.

Areas of Observed Sector Misalignment

Over the past seven years, the FGC has observed five main areas of misalignment between sector practices and cross-cutting financial governance reforms:

- Sector revenue actions that undermine fiscal coherence;
- Sector institutional reforms that raise fiscal costs;
- Sector laws that conflict with financial governance laws;
- Procurement and concessions processes that disregard established procedures; and
- Partner funding for FGS institutions that bypasses government systems.

Instances of misalignment may only be occasional, and some efforts are underway to address them. The issues are sufficiently important, however, to merit special consideration by the FGS. The remainder of this section considers each of the above areas in turn, looking at the issues specifically observed by the FGC, the apparent intentions of sector ministries or international partners, and the unintended negative consequences.

Sector revenue actions that undermine fiscal coherence

The FGC has observed various attempts by sector institutions to 'secure' additional resources for sector expenditure outside of the budget process. These include revenue earmarking, ring-fencing of the cash flow arising from concession agreements, and retention of non-tax revenues. While the motivation to obtain additional funds for sector expenditure may be understandable, the overall effect can be to compromise the integrity, comprehensiveness, and transparency of budget preparation and budget execution. These effects are additionally problematic in a context of extremely constrained FGS fiscal resources.

Ring-fencing of concessions

Concession agreements involve contracting a third party to manage or develop a government asset in return for a consideration. Such arrangements can help to leverage private sector expertise and financing for the delivery of a public good or service, while generating a return for the government. They can be developed in a manner that is compatible with good financial governance. The FGS's two largest concession agreements, for management of the port and airport, were revised based on detailed studies to determine appropriate revenue sharing and to ensure payment of the government's agreed revenue share directly into the TSA.

However, poor formulation of concession agreements can sometimes limit transparency in the use of sector revenues and/or off-budget sector investment. One example is the FGS's 2016 textbook contract with Beder Publishing House, which combined an eight-year monopoly on textbook production with support for curriculum development. The FGC has provided advice to the Ministry of Education on the resolution of key issues arising from the contract. In other sectors, the FGC has provided advice on draft tenders that have aimed to enable a third party to collect sector revenues and reinvest them in sector infrastructure outside of the budget. To the extent that such agreements are not properly scrutinised, or do not follow due process as required by the Procurement Act, they can result in poor value for money for the FGS, as well as a loss of transparency in revenue or expenditure management.

Retention of revenue collections

Unauthorised sector retention of non-tax revenues was a significant problem for the FGS up to 2016–17. MoF revenue reforms have since reduced the practice, but OAG annual audit reports identify some persistence. The OAG compliance audit report for financial year 2018 identified US$1.35 million collected and spent by four agencies at source,[24] while the 2019 audit identified US$1.86 million collected and spent by three agencies at source.[25]

Budget earmarking

Sector legislation may sometimes be used to allocate a percentage of the national budget to a specific sector on a permanent basis, thereby reducing the resources available to fund the rest of the government budget. Although no earmarks have yet been passed into law, the 2020 draft Internally Displaced People Bill proposes that between one percent and three percent of the national budget be deposited in the Integrated Humanitarian Fund. In 2021, this earmark would have amounted to an automatic allocation of between US$7 million and US$20 million. Such earmarks need to be fully justified and should only be introduced if there are sound budgetary reasons for doing so. If sectors are able to determine their own funding through legal earmarks, the MoF will lose control over budget policy, and allocations may not reflect overall FGS priorities.

The MoF and OPM must ensure that laws proposed by sector institutions are examined properly and considered for their affordability and their relative priority against other demands prior to their approval by Cabinet and submission to Parliament. The PFM Act already includes such a provision (Box 3), so the FGS's effort needs to focus on strengthening compliance and improving awareness. The MoF is in the process of preparing guidelines for sector institutions on how to assess and declare the budgetary implications of draft legislation, and has prepared an opinion on the budgetary implications of the Armed Forces Pension Bill.

[24] The four agencies were the Ministry of Transport and Civil Aviation, Civil Aviation Authority, Police Criminal Investigations Department, and Somali National University.

[25] The three agencies were the Ministry of Transport and Civil Aviation, Civil Aviation Authority, and Ministry of Endowments and Religious Affairs.

Box 3 PFM Act provisions on the budgetary implications of a draft law

Article 25 of the PFM Act on “Declaration of Budget Implications of a Draft Law” contains the following provisions:

- Any FGS institution that is drafting a law must prepare a declaration of budgetary implications and submit it to the Minister of Finance prior to submission of the draft law to Cabinet (Article 25:2).
- The Minister of Finance must provide an opinion to the Cabinet on the affordability of the draft law based on the declaration of budgetary implications (Article 25:3).
- All draft laws submitted to Parliament must be accompanied by a statement on their budgetary implications, in terms of their impact on revenue and expenditure for the first and subsequent fiscal years (Article 25:1).
- The Minister of Finance should prepare detailed instructions for use by FGS institutions in the preparation of a declaration of budgetary implications (Article 25:4).

These legal requirements mean that no draft law should be tabled in Cabinet by an FGS minister or institution unless it has first been reviewed by the MoF for its budgetary implications. Furthermore, the Cabinet should routinely consider the opinion of the Minister of Finance on the implied fiscal costs of any proposed legislation, and the affordability and sustainability of those costs, before deciding whether to proceed.

Source: FGC Advisory Note. 2020. “The 2019 PFM Act and the budgetary implications of creating new FGS Agencies.'
Ref: 2020/004 (March 5).

Sector institutional reforms that raise fiscal costs

The passage of sector legislation is leading to the creation of new government agencies (formally referred to as independent commissions, authorities, and agencies). The fiscal cost of such agencies is rising steadily. The 2021 FGS budget includes allocations for 18 independent agencies, amounting to US$29 million in total. This represents a 34 percent increase in allocations to independent agencies compared to the 2020 budget, and accounts for 11 percent of FGS revenues. A further 16 new agencies are in the pipeline; they are either required by the Constitution, proposed in draft legislation, proposed as a part of development partner dialogue or benchmarks, or already established despite having no provision in the FGS budget. (See Annex C for a full list of agencies currently mandated or under consideration.)

New agency creation often stems from the recommendations or requirements of international partners. These may be explicit requirements, such as reform benchmarks or financing conditions, or they may be proposed through the provisions of new sector legislation, which is often drafted with international partner assistance. Proposals for the creation of new agencies may also originate among FGS actors themselves.

There may be strong arguments for agency establishment in some cases. Semi-autonomous agencies can, in principle, insulate or ‘protect’ regulatory functions from political interference. Separate agencies may provide space for increased policy autonomy on mandated issues within in a particular sector. Achievement of specific policy objectives may be accelerated through these special-purpose entities. It is often thought that systemic weaknesses in institutional capacity at the sector level can be avoided and overcome by creating dedicated institutions and staff cadres. Sector actors may wish to emulate institutional arrangements and practices observed in other countries, which have made successful progress on a particular policy agenda.

Agency creation may support the interests of particular individuals or sectors. It may lead to additional sector resources from international partners and increased FGS budget allocations. It may offer opportunities for new job appointments. The result is often an alignment of interests for the creation of new agencies between international partners and sector institutions.

The costs of agency creation may be significant, however. New agencies escalate the overall fiscal costs borne by the FGS, as well as the future liabilities implied in sustaining those costs. FGS revenues are thus absorbed by rising government administrative costs, rather than funding service delivery or infrastructure. New agencies may create institutional fragmentation in sectors that have yet to achieve strong and cohesive capacity within the principal FGS ministry. They can dilute what is already a constrained level of specialised professional capacity by spreading it across sector institutions.

It could be argued that these various ‘costs’ are an acceptable price for strengthened FGS capacity for sector regulation and service delivery. Establishment of the Somalia National Bureau of Statistics is driving improvements in statistical management, for example. However, the FGS’s experience to date suggests that the growth in new agencies does not always deliver the desired objective of regulatory independence or lead to a rapid improvement in public sector performance. During the past two years, for example, differences in opinion over the management of sector resources between the MPMR and the SPA, between the Ministry of Communications and Technology and the NCA, and between the Ministry of Commerce and Industry and the Somali Bureau of Standards have each illustrated the challenges posed by more complex institutional and functional arrangements.

Against the backdrop of acute fiscal pressures, closer cross-government attention to fiscal costs is needed to help the FGS and its international partners weigh the costs and benefits of creating new agencies. Factors to consider include the effectiveness of FGS institutions and the sustainability of the overall size of the FGS within a context of constrained revenues and uncertain levels of direct budgetary support.

Sector laws that conflict with financial governance laws

A discernible body of FGS legislation—including the 2016 Public Procurement, Concessions, and Disposals Act, as amended in 2020 (the ‘Procurement Act’), the 2019 PFM Act, and the 2019 Revenue Act—provides the foundations for financial governance in the FGS. These laws are intended to apply across all FGS institutions, thereby aligning the Somali framework with almost universal international practice. Sector-specific legislation is expected to serve a complementary function, by covering distinctive sector policy and institutional issues that fall within the prerogative of the relevant sector ministry. The expectation is that cross-cutting and sectoral laws should be devised and applied harmoniously.

The FGC has encountered instances in which FGS sector legislation—for example, the 2020 Petroleum Act—enables the provisions of financial governance laws to be disapplied if they conflict with the relevant sector law. In the petroleum sector, this has led to a detailed debate between the MPMR and MoF as to whether or not the provisions of the Petroleum Act and the Procurement Act are in conflict. An independent legal opinion commissioned by the FGC in 2021 found that they can and should be interpreted harmoniously.

In other cases, bills that are currently still in draft contain provisions that are not consistent with cross-cutting legislation on financial governance. Examples encountered by the FGC include the draft Internally Displaced People Bill, which earmarks a percentage of the national budget to the Integrated Humanitarian Fund, and the draft NGO Bill, which provides tax exemptions to nongovernment organisations engaging in profit-making ventures.

Conflicts between different pieces of legislation may arise for various reasons. Sector institutions and the international partners providing them with technical assistance may be inattentive to or disregard existing legislation, the legal drafting of sector legislation may be weak or ambiguous, or the interpretation of laws may be incorrect. The effects are often similar. Unnecessary and counterproductive tensions or disputes can arise between different FGS institutions that are the 'owners' of particular laws applicable to a sector. This tension most typically arises between the MoF and a sector ministry. Such disputes over applicability can undermine the application of cross-cutting legislation on financial governance and could potentially weaken financial governance overall. These disputes would be eased if sectors were required to carry out a regulatory impact assessment for each bill they prepared, and if the MoF were to routinely assess all draft bills for their fiscal implications.

Procurement and concession processes that disregard established procedures

The Procurement Act is the bedrock of strengthened contracting practices in Somalia. It requires transparent and competitive tendering as a standard procedure, and it defines the respective roles and responsibilities of different institutions in that process. The Procurement Act applies to the award of government contracts, including public procurement contracts (for the purchase of goods, works, and services) and concession contracts. Different tendering and oversight procedures apply to both processes. The FGS has made progress in implementation of the Procurement Act over the past five years. However, many sector institutions continue to lack strong awareness of the procedures required, particularly for concessions. In other cases, sector institutions may simply resist the applicability of those provisions in their approaches to tendering and contracting at the sector level.

Disregard for procurement and concession procedures has emerged repeatedly across sectors. Often, the intention of sector institutions is to push through procurement contracts as rapidly as possible. Urgency tends to be the consequence of a lack of planning and proper preparation, such that existing contracts run close to expiry (or indeed beyond expiry and into extensions by default) or long-anticipated requirements for goods and services are neglected until the need is immediate. In the face of these pressures, sector institutions seek to fast-track 'urgent' requirements by bypassing procedures. One way in which sector institutions seek to speed up the process is to avoid competitive tendering, thus attempting to circumvent engagement with the MoF for procurement transactions above US$100,000 or with the IMCC for all concessions.

The MoF and OPM have worked hard over the past two years to insist that all concessions tenders must be submitted to the IMCC for approval. Progress is similarly being made in requiring competitive tendering for large-value procurements, but full compliance has not yet been achieved.

Lack of adequate capacity for oversight of concession processes is a broader, but closely related, problem. The IMCC does not yet perform the comprehensive and systematic role foreseen for it in the Procurement Act. Nor does it have access to specialised technical expertise through a dedicated Concessions Technical Unit, also envisaged in the Procurement Act. These institutional gaps and weaknesses hamper effective oversight, making it more difficult to ensure that concession tenders proposed by the sectors comply with the Procurement Act.

The overall effects on financial governance of inadequate sector compliance with due process in the award of procurement and concession contracts are to reduce transparency; to give incumbent firms and well-connected contractors an unfair advantage; to reduce value for money (through a lack of project preparation and market testing); to limit the FGS's ability to manage contracts for the delivery of goods, works, and services; and to expose the FGS to potential legal challenges.

Partner funding for FGS institutions that bypasses government systems

The FGC has been following closely the compliance of international partners with the 2019 PFM Act provisions on using government systems when providing direct financial support to FGS institutions. The PFM Act requires funds from international partners to be appropriated in the annual FGS budget and to be managed through the TSA. Audits by the OAG have uncovered multiple instances of non-compliance prior to the law's passage. For example, the 2018 audit identified five international partner agreements with FGS institutions, amounting to US$12 million, that were not reflected in the budget. A 2020 special audit examined US$7 million in external funding that had been provided off-budget to the Ministry of Health over a three-year period.

FGS institutions and international partners may face intersecting incentives for external support to bypass government systems. FGS institutions may prefer to capture resources more reliably and to use them more flexibly than they expect will be possible through the budget and the TSA. International partners may want to establish and strengthen their relationships with sector institutions, while also attempting to 'protect' their funds through separate procedures and project management units.

While these motivations are understandable, the consequences are the undermining of MoF efforts to strengthen PFM systems, an increase in opportunities for fund diversion through reduced oversight, the disregarding of considerations of medium-term affordability and sustainability, and the creation of incentives for legal non-compliance. Through their instinct for greater direct control, international partners may in fact increase their own fiduciary risk, because the Accountant General's Office in the MoF does not oversee the management and expenditure of their funds and the OAG does not provide external audit. While some international partners do already comply with the PFM Act or are moving towards compliance, continued efforts and attention to this issue are important.

Financial Governance Risks from Weak Sector-Centre Alignment

Drawing together the areas of misalignment or incoherence between sectors and the centre of government observed by the FGC over the past seven years, it is possible to identify a compound set of strategic financial governance risks to the FGS. These extend well beyond a purely technocratic sphere. They include:

- **Unaffordable scaling of the state:** adoption of policies, enactment of legislation, and establishment of institutional arrangements, often recommended and enabled by international partners, that increase the cost of government, while absorbing or diverting scarce human resource capacity.

- **Weakened fiscal control:** leeway for inefficient allocation, earmarking, or capture of resources, outside the proper annual process of fiscal analysis by the MoF and collective decision making by the Cabinet.

- **Entrenchment of bureaucratic fiefdoms:** reinforcement of political and bureaucratic fiefdoms that militate against common FGS objectives and interests, potentially exacerbating conflicts over the allocation of fiscal resources, appointment of public officials, and award of public contracts.

- **Inconsistent institutional capacity development:** perpetuation of practices, often driven by international partners, that privilege the short-term delivery of direct results over the medium-term strengthening of government institutions, systems, and capacity.

This would be a challenging set of issues for the FGS to tackle even in a favourable political and economic context. Given the severely constrained fiscal environment prevailing since 2020, the risks are even more pronounced.

International partners have tended to consider and engage with these issues only from the perspective of centre-of-government institutions, such as the MoF and OPM. What has been missing is more multifaceted reflection across economic, governance, and sector teams in international agencies so that coherent approaches to financial governance reform can be recommended to the FGS and so that international assistance avoids creating perverse or contradictory incentives.

FGC Advice and Recommendations

The financial governance risks discussed in this spotlight chapter are not new terrain for the FGC. An increasingly clear and comprehensive legal framework is emerging, backed up by a growing body of regulations and operational guidance. This helps to remove some of the ambiguities and gaps that have been used in the past as loopholes by sector institutions. It also reduces the opportunity to claim lack of awareness or misunderstanding as a reason for non-compliance. However, financial governance capacity remains weak among sector institutions and oversight bodies in the FGS, and international partners sometimes fail to lead by example on this agenda.

Recommendations for the FGS and for international partners are presented separately here for ease of consideration by the relevant parties. In practice, they are closely connected and should be considered as complementary sets of actions.

Recommendations for FGS institutions

FGC advice centres on actions to strengthen compliance, improve awareness, and build capacity as three mutually reinforcing approaches to improve coherence in financial governance practices across the FGS.[26] Specific recommendations are intended to address the areas of misalignment identified above. In many cases, the recommendations are expected to contribute to improvements in more than one area. The FGC recommends that FGS prioritise the following specific actions:

Strengthen compliance

i. **Enforce the provision of the PFM Act that requires the MoF to review all draft legislation to analyse its fiscal implications** (Box 1). In line with the PFM Act, all draft laws should first be submitted to the MoF for review and a written opinion signed by the Minister of Finance before they are submitted to the Cabinet. The scope of this review could be broadened to cover a regulatory impact assessment for each draft law.

ii. **Establish and implement a formal FGS policy on the creation of new semi-autonomous agencies** (Box 4). This policy will establish the conditions under which a new agency may be created, subject to affordability.

iii. **Require international partners to bring direct financial support to FGS institutions on-budget and on-treasury.** Building on the example of the Global Partnership for Education and the commitments made by the UN, the MoF—in partnership with the Ministry of Planning, Investment, and Economic Development—should communicate to sector institutions and to international partners the requirements of the PFM Act regarding the provision and management of direct financial support to FGS institutions. This is a subset of the wider FGS agenda, led by the Ministry of Planning, Investment, and Economic Development and OPM, to encourage international partners to increase the proportion of direct budgetary funding to the FGS.

iv. **Maintain a strong emphasis on external audit of sector institutions.** It will be important for the OAG to continue raising issues of non-compliance or concern as part of annual institutional audits.

Raise awareness

v. **Update and reissue the Prime Minister's Decree on Procurement to remind FGS institutions of their obligations under the Procurement Act.** The decree needs to be updated in line with the 2020 Procurement Act Amendments and Regulations. Wide dissemination is vital to ensure that sector institutions are informed of due process and their obligations under the Act.

vi. **Communicate the applicability of the concessions section of the Procurement Act across sectors to all FGS institutions.** Somalia's Procurement Act explicitly covers concession contracts as well as government purchasing of goods and services. This is not widely understood across FGS sector institutions, however. While issues of consistency and compliance may not be fully resolved by improving awareness, it is a vital first step.

[26] This trio of conditions suggested by the FGC for improving sector alignment with financial governance reforms echoes the factors of authority, acceptance, and ability, identified in research by Andrews (2004) as influential on the success of public administration reforms across countries. See Matthew Andrews. 2004. "Authority, acceptance, ability and performance-based budgeting reforms." *International Journal of Public Sector Management* 17(4): 332–44.

Box 4 Draft FGS policy on the creation of new agencies, authorities, and commissions

The proposed policy for consideration and approval by the Cabinet is as follows:

1. Commissions may only be established by the Constitution. The constitutional review process provides an opportunity to revisit whether the 11 independent commissions established in the 2012 Constitution are still required, or whether the number can be reduced. The Minister of Constitutional Affairs is requested to make a proposal to the Cabinet on this issue.

2. New agencies and/or authorities may only be established following approval by the Cabinet and the passage of enabling legislation. The Cabinet will only approve the creation of new public bodies when:
    i. There is a clear need for the state to provide the function or service;
    ii. The function or service cannot be delivered by any existing public institution; and
    iii. The MoF has confirmed the affordability of the creation of the agency/authority.

3. When a line ministry is presenting sector legislation to the Cabinet for approval, it must indicate whether the legislation proposes the creation of a new agency or authority. If it does, the line ministry must justify to the Cabinet why the functions cannot be delivered by any existing FGS institution and must present a confirmation from the MoF that the cost of the new agency or authority is affordable, or that it has self-financing capacity. Availability of donor financing will not be considered sufficient justification of institutional affordability, given the short-term nature of donor funding.

4. In the event that the Cabinet endorses, in principle, the creation of a new agency or authority, it may require the enabling legislation to specify the minimum conditions that need to be in place before the authority/agency can be established, including the availability of necessary financing and a clear staff proposal.

5. The Cabinet will undertake a review of all existing agencies and authorities that currently receive an allocation in the FGS budget, and their continuation will be justified on a case-by-case basis. The OPM will make a proposal to the Cabinet on this issue.

6. The National Civil Service Commission will establish guidelines on the remuneration structure of commissions, authorities, and agencies for consideration by the Cabinet. These guidelines will establish the maximum permissible differentials in remuneration between commissions, authorities, and agencies and the civil service pay scale.

Source: FGC Advisory Note. 2020. "The 2019 PFM Act and the budgetary implications of creating new FGS Agencies." Ref: 2020/004 (March 5).

vii. **Increase regular publication of procurement information covering contract awards and procurement plans.** There is a need to expand the amount of information that is published with respect to procurement processes, in line with the requirements of the Procurement Act. This information should include notification of contract awards for all concessions and public procurement contracts over US$100,000, publication of annual procurement plans, and notification of all direct contracting (sole sourcing) processes.

Build capacity

viii. **Establish and/or strengthen the MoF Contracts Oversight Committee, the IMCC (including the Concessions Technical Unit), and, eventually, the Public Procurement Authority.** These bodies will each need to play a critical role in overseeing procurement and concession processes. Making them operational is the priority. The FGS then needs to support and strengthen them to understand their roles and adopt basic operating procedures, to guarantee that they have the necessary expertise to perform those roles effectively, and to ensure that they have the political support and enforcement tools necessary to drive compliance.

ix. **Arrange in-depth training for procuring entity staff engaged in sector procurement activities.** This training should include a mix of formal training programmes with certification, and practical or on-the-job sessions related to the specific requirements of the Somali legal framework and to common challenges faced by Somali procurement officials. Issues to cover include basic procurement rules and procedures required by law; use of standard bidding documents; development of specifications for goods, services, or works contracts; and procurement planning.

x. **Strengthen the legal and institutional capacity of 'centre-of-government' institutions to enable and support alignment and coherence across the FGS.** Those institutions notably include MoF, OPM, the Ministry of Planning, Investment and Economic Development, and the Office of the State Attorney General. This function requires dedicated capacity for active coordination across FGS institutions, for supporting analysis and recommendations, and for upgraded communication of requirements and issues. It should also provide a stronger interface with international partners.

A mapping of FGC recommendations relevant to each of the key challenges is provided in Table 7.

Table 7 Mapping of FGC recommendations to strengthen sector financial governance practices

FGC recommendations to FGS	Challenges to be addressed				
	Sector revenue actions that undermine fiscal coherence	Sector institutional reforms that raise fiscal costs	Sector laws that conflict with financial governance laws	Procurement and concessions processes that disregard established procedures	Partner funding for FGS institutions that bypasses government systems
i. Enforce PFM Act provision for MoF to review all draft legislation to analyse its fiscal implications	✓	✓	✓		
ii. Establish and implement formal FGS policy on creation of new semi-autonomous agencies	✓	✓			
iii. Require international partners to bring direct financial support on-budget and on-treasury	✓				✓
iv. Maintain strong emphasis on external audit of sector institutions	✓			✓	✓
v. Update and reissue Prime Minister's Decree on Procurement				✓	
vi. Communicate applicability of concessions section of Procurement Act across sectors			✓	✓	
vii. Increase regular publication of procurement information on awards and planning				✓	
viii. Establish and/or strengthen Contracts Oversight Committee, IMCC/ Concessions Technical Unit, and Public Procurement Authority			✓	✓	
ix. Arrange in-depth training for procuring entity staff engaged in sector procurement				✓	
x. Strengthen capacity of 'centre-of-government' institutions to support alignment across FGS	✓	✓	✓		✓

Recommendations for international partners

International partners should prioritise a set of complementary actions and changes to their ways of working.

i. **Minimise proposals for the creation of new agencies and be aware of financial governance legal requirements when designing and providing sector support.** International partners should make it a standard practice to consider explicitly the fiscal implications of recommendations made in sector dialogue, programming, and conditions/benchmarks in order to test affordability and coherence. It should become a standard requirement for international partners to confirm that recommendations relating to sector legislation and to the roles and responsibilities of sector institutions do not conflict with cross-cutting financial governance legislation.

ii. **Support the strengthening of *sector* financial governance capacity.** Financial governance reforms are often viewed by sector specialists as the domain of economic and governance dialogue and programmes. International partner support is often viewed either in siloed terms or as a matter applicable to the MoF and other institutions at the centre of government. That mindset and approach should be changed so that sector financial governance capacity becomes a routine focus of sector assistance.

iii. **Commit to bringing all financial support to FGS institutions on-budget and on-treasury by a fixed date.** While progress has been made, this objective is largely still a work in progress. All international partners currently providing direct financial support to FGS institutions should engage through the Use of Country Systems Working Group to make firm commitments to compliance with the requirements of the 2019 PFM Act. Those commitments should be declared transparently so that progress can be monitored.

Consider implicit assumptions about the size and affordability of the state when designing financing instruments. Major shifts from in-kind assistance to direct financial support (such as budget support) should be accompanied by specific dialogue on the desirable scale of government and the pathways to ensuring that it is affordable and sustainable. This dialogue may be connected to sector discussions on institutional arrangements and revenue/expenditure, as well as to the overall FGS medium-term revenue strategy.

IV. FINANCIAL GOVERNANCE PRIORITIES IN 2021-22

Context and Risks in 2021-22

Political and fiscal challenges are expected to continue for the 12 months from July 2021. The fiscal policy environment in Somalia is dynamic and challenging, combining electoral politics and the ongoing effects of the pandemic.

Until high COVID-19 vaccination rates are achieved worldwide, there will continue to be risks of further waves of transmission and the emergence of new variants. Efforts to stimulate economic recovery, while also managing continued public health risks and contending with suppressed international travel, will impose strong fiscal pressures through constrained revenues and high expenditure demands.

Political tensions are likely to remain high in the run-up to the elections, scheduled for the second half of 2021. Any further delay in the electoral process is likely to undermine the confidence of international partners. A full resumption of budget support to the FGS, and therefore indirectly to the FMS, is not expected until after the elections. The absence of those funds will compound the extremely tight fiscal position in the short term. Some temporary relief will be provided through access to Somalia's new quota of IMF SDR.

In this adverse context, the financial governance risks that were present in the previous 12 months are likely to persist. The FGS will have to marshal all available resources to make timely salary payments, limiting other government expenditures in the process. Fiscal pressures may encourage the FGS to negotiate sub-optimal concession agreements that appear to offer 'quick wins' in revenue but do not protect the FGS's long-term interests. There may be a loss of momentum, or even a reversal, on reforms that are vital for strengthening financial governance and achieving HIPC debt relief completion. An additional risk is that individuals in the FGS may try to award or influence contracts from which they stand to benefit personally in advance of the change in administration, as was observed in the months prior to the 2017 elections. The legal and institutional framework for financial governance will be a vital bulwark against these pressures.

FGC Areas of Focus in 2021-22

Against this expected backdrop of political, fiscal, and financial governance pressures, the FGC will maintain and build on its core focus on the four areas covered during the previous year. Those priorities include fiscal reforms (including fiscal federalism), contracts and concessions, natural resource revenues, and central bank governance (Chapter II). While valuable progress has been made in all four areas, these agendas remain unfinished.

Accordingly, the five FGC priorities for 2021–22 will be:

- Sustainability of the fiscal position and consolidation of fiscal reforms;
- Transparency and due process in natural resource revenue management;
- Central bank governance and financial sector development;
- Debt management capacity; and
- Compliance and value for money in public procurement and concessions.

The FGC's agenda for 2021–22 will include a strong cross-cutting effort to encourage stronger alignment between sectors and financial governance reform, and to promote fiscal sustainability. The spotlight issue discussion in the FGR (Chapter III) sets out the issues and priorities. To recap, those cross-cutting issues of concern are:

- Sector revenue actions that undermine fiscal coherence;
- Sector institutional reforms that raise fiscal costs;
- Sector laws that conflict with financial governance laws;
- Procurement and concession processes that disregard established procedures; and
- Partner funding for FGS institutions that bypasses government systems.

While many aspects have already been the subject of routine focus for the FGC, they have not previously been brought together as a focused and coherent agenda. These *horizontal financial governance linkages* across FGS institutions, and across international partner support to those institutions, will be emphasised more strongly. Special attention will be paid by the FGC to fiscal sustainability in the context of constrained domestic revenue growth, coupled with a rising government wage bill and overall growth in the size of government in Somalia.

Sustainability of the fiscal position and consolidation of fiscal reforms

Priority areas for the FGC in 2021–22 will include the following:

- Encourage FGS efforts to **strengthen revenue collection from key sectors** where receipts are falling substantially below policy expectations and/or regional benchmarks. Those sectors or items include telecom operators, airline overflight fees, and *khat* imports.
- Encourage FGS adoption of a **policy on the establishment of new semi-autonomous government agencies** and systematic **MoF review of the fiscal implications and affordability of new draft laws.**
- Monitor progress in bringing **external financial support to FGS institutions on-budget and on-treasury,** in line with the PFM Act. Preliminary outreach to the FMS should consider how to encourage consistent practices at both tiers of government.
- Emphasise the **implementation of existing legal, regulatory, and procedural reforms.** The FGS has achieved notable success in updating or amending core financial governance legislation; these efforts now need to shift to implementation and to translating reforms 'on paper' into routine practice.
- Encourage a strengthening of the MoF policy function to improve its **effectiveness in engaging on cross-cutting and strategic priorities.** The MoF has taken some steps toward reorganisation and institutional strengthening with support from international partners. Building capacity to engage effectively across government, and strategically with international partners, will be important in making tangible progress on priorities such as sector fiscal issues, use of country systems, rational agency creation, and HIPC completion.
- Encourage the **development of a constitutional mechanism and transparent formula-based transfer system** to ensure equitable allocation of resources, consistent with delivering a minimum standard of public services.
- Encourage **further acceptance and strengthening of the OAG's independent oversight function** to improve accountability and transparency in public resource management. This includes championing enhancements in the quality, efficiency, and impact of OAG technical capacity to carry out compliance audits, scrutinise the use of public resources, and fight corruption.

Transparency and due process in natural resource revenue management

Priority areas for the FGC in 2021–22 will include the following:

- Ensure that **oil and gas contracting complies with the Somali legal framework and with commitments to international partners.** Those include aligning the Model PSA with the EIIT Bill and ensuring enactment of the bill. Any contract awards, whether through direct negotiations or the licensing round, must be fully compliant with all legal requirements under the Procurement Act.
- Monitor **tuna licensing revenue distribution to the FMS** in line with prevailing agreements.

Central bank governance and financial sector development

Priority areas for the FGC in 2021–22 will include the following:

- Continued CBS rollout of the **National Payment and Settlement System.** This includes encouraging passage of the new law through Parliament and finalising the remaining parts of the system, including the Somali National Switch and Cheque Truncation, while rolling out the system to all commercial banks.

- Continued CBS rollout of the **National Payment and Settlement System (NPS).** This includes encouraging passage of the new law through Parliament and finalising the remaining parts of the system, including the Somali National Switch and Cheque Truncation, while rolling out the system to all commercial banks.

- Continued CBS **progress in licensing and regulating mobile money service providers** (in accordance with the 2019 Mobile Money Regulations) and improving coordination with the NCA on licensing.

- Continued CBS progress in addressing the **structural obstacles to inward money transfers**, including correspondent banking relationships, and the operational and legal framework for AML/CFT.

- CBS progress towards the **first phase of currency reform centred on a 'currency exchange project'** to remove counterfeit banknotes from circulation. Commercial banks and mobile money providers do not currently accept Somali shillings due to a lack of trust in the currency in circulation, but this is expected to change once a legal and secure Somali shilling is issued by the CBS.

Debt management strategy development

Priority areas for the FGC in 2021–22 will include the following:

- Encourage the MoF to develop a formal debt strategy to manage the risk exposure embedded in the debt portfolio and to minimise the cost of debt servicing. This is critical for two FGS objectives. The first is to build economic management capacity through policy and structural reforms to secure full debt relief. The second is to enhance Somalia's capacity to manage current and future debt efficiently, and to access debt financing for growth and poverty reduction only, while avoiding a relapse into debt distress.

Compliance and value for money in public procurement and concessions

Priority areas for the FGC in 2021–22 will include FGS action on the following:

- Maintaining a **firm commitment to compliance** through application and enforcement of the provisions of the Procurement Act and associated procurement regulations across the FGS.

- Deepening **awareness and understanding across FGS institutions** of due process in public procurement and concessions. This will involve active outreach by the MoF, as well as regular communications and circulars on procedural changes.

- Maintaining **annual competitive tendering of personnel rations contracts** in the justice and security sectors, including SNA, the Somali Police Force, the Prisons Service, and NISA.

- Establishing (where needed) and strengthening the **capacity of FGS oversight bodies** and their accompanying technical units. These include the MoF Contracts Oversight Committee, the IMCC, the Concessions Technical Unit, and, eventually, the Public Procurement Authority.

- **Monitoring the implementation of renegotiated concessions** to ensure that concessionaires fulfil their obligations, that the FGS achieves the expected fiscal gains/returns, and that the FGS is not in breach of its own obligations. These efforts should give particular focus to Mogadishu Port and Mogadishu Airport.

- Encouraging **improvements in the technical knowledge and capacity of the print, radio, and television media** to promote greater transparency and public awareness of value for money in public procurement and concessions.

The FGC will continue to:

- Engage with, and provide advice on, the **process for updating the legal framework for concessions.** This work is being led by the MoF, with support from the International Finance Corporation.

- Consider **needs and opportunities for concessions support at the FMS level.** This agenda reflects the growing interest stated by some individual FMS, the financial governance risks associated with concessions (both to the individual FMS and more systemically), and the limited technical and legal capacity on concessions and contracts.

ANNEXES

Annex A: Progress against FGR 2020 Priorities

FGR 2020 priorities	Progress July 2020 – June 2021
Protect fiscal reforms	
i. Conclude enactment of legislation relating to financial governance and commence implementation.	i. PFM Regulations issued. EIIT Bill submitted to Lower House. Audit Bill passed by Lower and Upper Houses and pending presidential approval.
ii. Clarify and deepen the arrangements for fiscal federalism through finalisation of the revised constitution.	ii. No further progress on constitutional revisions.
iii. Work with the international community to bring all aid to FGS institutions on budget/on treasury.	iii. UN agencies have submitted information on support to FGS institutions to MoF for the 2021 supplementary budget.
iv. Review all proposed laws for their fiscal implications prior to submission to Cabinet.	iv. Not systematically implemented so far.
Maintain focus on procurement and concessions	
i. Deepen understanding across FGS institutions of due process in public procurement and concessions.	i. Limited progress to date.
ii. Maintain a firm commitment to compliance.	ii. Rations tenders for SNA, police, and prisons followed due process. IMCC approval is understood as prerequisite for concessions contracts (including oil and gas PSA).
iii. Strengthen capacity of oversight bodies and technical units.	iii. Limited progress to date.
iv. Seek development partner support for capacity development.	iv. EU providing support for procurement portal development.
Ensure transparency and due process in natural resource management	
i. Align the Model PSA with the EIIT Bill.	i. Differences remain between the Model PSA and EIIT Bill.
ii. Ensure that oil and gas contracting is fully compliant with all legal requirements, including approval requirements in the Procurement Act.	ii. MPMR has accepted, in principle, that the Procurement Act is applicable to oil and gas contracting.
Strengthen central bank governance and financial sector development	
i. Continue to implement CBS transition plan.	i. Implementation continuing despite limited resources.
ii. Implement the 2019 Mobile Money Regulations.	ii. Two money licences awarded in February and June 2021.
iii. Progress plans for first phase of currency reform.	iii. Necessary preparations are completed, but funding is required.
iv. Maintain and develop the interface between CBS core banking system and SFMIS.	iv. Integration between the systems is maintained without any issues.
v. Implement National Payment and Settlement System.	v. Due to be launched in the third quarter of 2021.
vi. Seek resolution of obstacles to inward money transfers.	vi. Progress has been made to address gaps in the AML/CFT, but the issue of international corresponding banking relations cannot be resolved by Somalia alone.

Annex B: Contracts and Concessions Reviewed by the FGC since 2014

#	FGS institution	Contract	Contractor	Contract type	FGC formal review	Status
1	Central Bank of Somalia	Land lease and redevelopment	Riverside Holding	Concession	2016, 2018	Contract signed but not yet under implementation.
2	Central Bank of Somalia	Asset recovery	Shulman, Rogers, Gandal, Pordy & Ecker PA	Concession	Not reviewed	Cancelled
3	Commerce and Industry	Import/export quality assurance	Proje Gözetim Mühendislik (PGM Project)	Concession	2015, 2016	Incorporated FGC recommendations; contract was signed but not implemented.
4	Defence	SNA Rations	AGETCO	Procurement		Sole source supply arrangements that were discontinued following recommendation that security sector rations contracts should be competitively awarded.
5	Defence	SNA Rations	AGETCO	Procurement	2017	Competitively awarded; subsequently cancelled
6	Defence	SNA Rations	Kasram	Procurement	2017	Contract irregularly awarded; annulled shortly prior to conclusion.
7	Defence	SNA Rations – Lot 1	Scandinavian Trading	Procurement	2019	Competitively awarded; concluded
8	Defence	SNA Rations – Lot 2	East Africa Trading	Procurement	2019	Competitively awarded; concluded
9	Defence	SNA Rations – Lot 1	United Group of Companies	Procurement	2021	Competitively awarded; operational
10	Defence	SNA Rations – Lot 2	Scandinavian Trading	Procurement	2021	Competitively awarded; operational
11	Defence	Supply of 6 marine patrol boats	AMO Shipping Company Ltd.	Procurement	2014	Contract was signed; subject to an arbitration claim
12	Defence	Equipping and training Coast Guard	Atlantic Marine and Offshore Group	Procurement	Not reviewed	Contract was signed; subject to an arbitration claim
13	Defence	Logistics	SKA	Unclear	2018	Status unclear; letter to Prime Minister from MoF conveyed FGC recommendation to annul via notification to contractor

#	FGS institution	Contract	Contractor	Contract type	FGC formal review	Status
14	Education	Textbooks	Beder Printing House	Concession	2018	Operational (new amendment signed in August 2020), recommended to be renegotiated and/or cancelled
15	Education	Certificates	Security Printing Press	Concession	2019	Contract signed; status unknown
16	Finance	Collection of property transfer registration tax	M&T Solutions Ltd	Concession	2016	Cancelled
17	Finance	Collection of road tax	Smart General Service Ltd.	Concession	2016	Cancelled
18	Finance	Khat tax collection on behalf of FGS	The ADCO Group of Companies	Concession	2015	Cancelled; contract replaced by direct tax
19	Fisheries and Marine Resources	Protecting, licensing, and promoting policy and institutional development of fisheries sector	Somalia-FishGuard Ltd.	Concession	2014	Did not proceed
20	Galmudug Regional Government	Oil production sharing agreement	Petro Quest Africa (CN)	Concession	2014	Did not proceed
21	Somali Police Force	Police rations	Perkins Logistics	Procurement	2016	Partially incorporated FGC recommendations; contract now concluded
22	Somali Police Force	Police rations	Muna Transport	Procurement	2019	Competitively awarded; concluded
23	Somali Police Force	Police rations	Hanad Construction & General Trading	Procurement	2021	Competitively awarded; operational
24	Immigration Directorate	Visas	Empire Tech Solutions Ltd.	Concession	2018	Operational; recommended to be cancelled or revised
25	Immigration Directorate	Passport Production	Ebtkaraat Smart System	Concession	2018	Operational (extension signed in 2020)
26	Immigration Directorate	Passport Production Tender Documents		Concession	2020	Tender was cancelled, new tender process recommended

#	FGS institution	Contract	Contractor	Contract type	FGC formal review	Status
27	NISA	NISA rations	Horn Logistics	Procurement	2016	Partially incorporated FGC recommendations; contract has now concluded
28	NISA	NISA rations	Express logistics	Concession	2019	Competitively awarded; should have concluded, but still operational
29	Ministry of Internal Security	Scanning services for Mogadishu port	M&T Solutions Ltd	Procurement	2016	Contract was signed but not implemented
30	Justice	Prisons rations	Bakhaari Logistics	Procurement	2018	FGC comments were not addressed; contract now concluded
31	Justice	Prisons rations	Bakhaari Logistics	Concession	2021	Competitively awarded; operational
32	Petroleum and Mineral Resources	Model terms for petroleum exploration, development, and production	Model Oil and Gas Production Sharing Agreement	Concession	2016, 2019, 2021	FGC 2021 recommendations not yet incorporated
33	Petroleum and Mineral Resources	Seismic data analysis	Mubadala Oil and Gas Holding Company LLC (CN)	Concession	2014	Agreement expired
34	Petroleum and Mineral Resources	Seismic exploration	Soma Oil and Gas Exploration Limited	Concession	2014	Operational; did not incorporate FGC recommendations
35	Petroleum and Mineral Resources	Geospatial analysis	CGG Data Services AG/Robertson GeoSpec International Ltd.	Concession	2014, 2015, 2016	Operational; incorporated FGC recommendations
36	Petroleum and Mineral Resources	Collation, analysis, and marketing of petroleum data	Spectrum ASA	Concession	2015	Operational; incorporated FGC recommendations
37	Petroleum and Mineral Resources	Acquisition, processing, and marketing of geophysical data	TGS-NOPEC Geophysical Company ASA	Procurement	2014	Did not proceed
38	Presidency	Rations	Regional Suppliers Company Ltd.	Concession	2018	Recommended to be retendered after expiry
39	Ports and Shipping	Management of port operations	Albayrak Turizm Inşaat Ticaret A.Ş.	Concession	2014; 2020	Operational; renegotiated agreement signed 2020

#	FGS institution	Contract	Contractor	Contract type	FGC formal review	Status
40	Ports and Shipping	Harbour, fishing port, and related infrastructure developments	Great Horn Development Company	Concession	2014	Did not proceed
41	Ports and Shipping	Lease and concession for operating Mogadishu port container terminal	Mogadishu Port Container Terminal and Simatech International	Concession	2014	Did not proceed
42	Ports and Shipping	Management and operation of a container yard and freight station at Mogadishu dry port	Mogadishu International Port and Simatech International	Concession	2016	Requires resolution following the renegotiation of the port management contract with Al Bayrak
43	Posts and Telecoms	Telecoms gateway	VBH Holdings SPA	Concession	2016	Did not proceed
44	Power and Water	Electricity generation	Polaris Energy SDN BHD	Concession	2015	Did not proceed
45	Transport and Aviation	Airport operations	Favori LLC	Concession	2014, 2019	Operational; renegotiated agreement signed May 2019
46	Transport and Aviation	Vehicle licensing	Modern Technology Ltd.	Concession	2016	Cancelled
47	Transport and Aviation	Airport taxi shuttle service	Sahel	Concession	2017	Operational; recommended to be renegotiated
48	Transport and Aviation	Airport hotel	Sat Service LLC	Concession	2018	Interim agreement Signed with FGS in early 2020; full contract needs to be developed
49-54	Information, Culture, and Tourism	6 leases for development of property in Mogadishu	Various	Concession	2019	Status unclear; recommended to be cancelled or revised
55	Transport and Aviation	Overflight equipment and services		Procurement	NA	Tender did not proceed
56	Transport and Aviation	Overflight arrears debt collection services	TBD	Procurement	NA	Tender being prepared
57	Somali Bureau of Standards	Consignment Based Conformity Assessment Program	TBD	Procurement	NA	Tender being prepared

Annex C: FGS Autonomous and Semi-autonomous Agencies as of June 2021

Agencies in the FGS 2021 budget	Agencies established in the 2012 Constitution but not yet budgeted for	Agencies proposed in draft legislation	Agencies proposed in 2020 Mutual Accountability Framework	Agencies with unclear status
1. Judicial Service Commission 2. Human Rights Commission 3. Anti-Corruption Commission 4. Boundaries and Federation Commission 5. National Independent Electoral Commission 6. National Reconciliation Commission 7. Constitutional Review Commission 8. Civil Service Commission 9. Somali National Telecommunications Authority 10. Somalia National Commission for Refugees and Internally Displaced People 11. Somali Marine Research 12. Somali Civil Aviation and Meteorology Authority 13. National Disability Agency 14. Somali National Statistics Bureau 15. National ID Authority DADSOM 16. Somali Quality Assurance Agency 17. Public Procurement Authority 18. Somalia Petroleum Authority	1. Parliamentary Service Commission 2. Inter-State Commission 3. National Security Commission 4. Office of the Ombudsman	1. National Professional Health Council 2. Somali Film Agency 3. Agricultural Research Agencies 4. Investment Promotion Agency 5. Somalia National Highways Authority 6. Electricity Regulatory Authority	1. Drug Regulatory Authority 2. National Institute for Health	1. National Higher Education Commission[27] 2. Somalia Explosives Management Authority[28] 3. National Public Infrastructure Agency[29] 4. Somalia Maritime Agency[30]

27 Reportedly inaugurated by the Minister of Education in September 2019.
28 Received funding from the UN in 2020.
29 Referenced in the 2020 Mutual Accountability Framework as having been established.
30 Reportedly established in 2019 with EU support.