



LETTER OF INTENT

Mogadishu, Somalia

June 15, 2018

Ms. Christine Lagarde
Managing Director
International Monetary Fund
700 19th Street, N.W.,
Washington, D.C. 20431, U.S.A.

Dear Ms. Lagarde:

The Federal Government of Somalia (FGS) continues to advance on reform and policy implementation supported by the IMF Staff-Monitored Program (SMP). Reforms implemented under the first 12-month SMP (SMP I, May 2016—April 2017) and the second SMP (SMP II, May 2017-April 2018) are bearing fruit. Our fiscal and monetary institutions, as well as our capacity, are improving. Reform efforts are strengthening budget execution, broadening the revenue base, and improving tax collection and public financial management (PFM). Progress on currency reform is encouraging and preparatory work to launch the new national currency is progressing well. We are grateful to the IMF for its continued support.

The economy in 2018 is showing signs of recovering from the severe drought in 2017. We have been able to weather this shock thanks to increased inflows of remittances from the diaspora and the appropriate responses by the FGS and the support of the international community. Strong coordination with the Federal Member States (FMS) played an important role in easing the impact at the regional level.

Despite the difficult environment, our performance under the SMP has been satisfactory. Since the last quarter of 2017, domestic revenue mobilization is exceeding the program targets and all indicative targets (ITs) for December 2017 and March 2018 were met and all but one (out of six) structural benchmarks (SBs) for December 2017 were met. The two SBs set for March 2018 were also met. We have taken appropriate actions to address two missed SBs under the SMP. The supplementary MEFP, which is attached, describes the progress made under the economic and financial program supported by the SMP (¶1-3). In view of this progress, we are requesting the completion of the second review of the current SMP.

Our challenges ahead remain significant. Growth is too low to make a significant dent in our country's widespread poverty, high youth unemployment, and large social needs. The external

public debt is high, and we do not have the capacity to service our debt obligations. Despite our recent efforts on anti-money laundering and combating the financing of terrorism we continue to suffer from pressures related to a reduction of correspondent banking relationships. This could result in lower and volatile remittances inflows, which are Somalia's lifeline. To maintain and broaden the reform agenda; and to continue to build a track record of economic performance we are requesting a third 12-month SMP (SMP III) covering the period May 2018-April 2019.

SMP III will build on achievements under the previous two SMPs and will continue to lay the foundation so that eventually we have an SMP that meets the standards of Upper Credit Tranche conditionality. The latter is a key priority for us to reach the Decision Point under the HIPC initiative. The attached MEFP describes the key objectives and features of SMP III (¶ 5-15). This SMP will focus on the following priorities: (1) enhancing PFM reform, expenditure control, and revenue mobilization; (2) completing Phase I of the currency reform, which consists of exchanging all Somali Shilling currently in circulation with a new national currency; (3) developing the financial sector; and, (4) improving macroeconomic and financial data reporting.

The FGS remains convinced that the policies and measures set forth in the MEFP are appropriate for meeting the objectives of SMP III. We remain committed to implementing these policies and reforms and stand ready to adopt any additional measures that may become necessary to keep the SMP on track. We will remain in close consultation with IMF staff on the adoption of such measures and in advance of any revisions to the policies contained in the MEFP. To that end, we seek continued and accelerated support from the IMF and our international partners. To facilitate the monitoring of the performance of the program, the FGS will regularly provide IMF staff with all necessary information within the deadlines specified in the attached Technical Memorandum of Understanding (TMU, Attachment II).

In line with our commitment to transparency, the FGS authorizes the IMF to publish this letter, the attached MEFP, and TMU, and the related staff report, including the placement of these documents on the IMF website, subject to the removal of market-sensitive information.

Sincerely yours,

/s/

Abdirahman Duale Beileh
Minister of Finance of Somalia

/s/

Bashir Issa Ali
Governor of the Central Bank of Somalia

Attachment (2)

Attachment I. Memorandum of Economic and Financial Policies

This Memorandum of Economic and Financial Policies (MEFP) reviews economic developments, assesses performance under the second 12-month Staff-Monitored Program (SMP) (SMP II), requests a third 12-month SMP (SMP III) (May 2018–April 2019), and describes policies that the Federal Government of Somalia (FGS) plans to implement in 2018–20.

A. Background and Context

- 1. Economic activity is rebounding from the effects of the drought in 2017.** The drought hurt economic activity, particularly in the north of the country and rural areas. However, swift policy responses by the government and international support mitigated the negative effects of the drought. For 2018, reflecting strong rainy season, growth is projected to increase to 3.1 percent from an estimated 2.3 percent in 2017, and inflation is expected to ease to under 3 percent from about 5.1 and 4.6 percent in 2017 and April 2018, respectively. However, recent floods in central and southern Somalia could lead to food insecurity in some areas.
- 2. The Federal Government of Somalia (FGS) remains committed to reforms.** This is evidenced by the important reforms implemented over the past two years under SMPs. We overcame strong protests to levy the sales tax on imported goods, and we are collecting revenues at the port and airport in Mogadishu. We are slowly starting to change the tax evasion culture, illustrated by the payment of sales tax by the telecommunication companies, hotels, and other businesses. We continued to improve key areas in PFM including treasury authorization and bank payments. Cooperation with the federal members states (FMS) on tax and customs harmonization and revenue sharing is well advanced. During the Spring Meetings Somalia Roundtable in Washington DC, our international partners welcomed the significant reforms implemented thus far and re-emphasized their support for Somalia.
- 3. This third SMP comes at an important juncture for Somalia.** Despite recent advances on reform and policy implementation, the development challenges ahead are daunting. Somalia's economic institutions are still weak, and poverty remains widespread. The security situation remains fragile and aggravated by high youth unemployment. Our external debt burden is heavy, and we have no capacity to service debt obligations falling due. It is in this context that the reform measures under SMP III are designed to help continue to lay the foundation to eventually have a SMP that meets the conditionality of an Upper Credit Tranche arrangement. SMP III will help us strengthen institutions and economic policies, pave the way for higher and more inclusive economic growth, continue to catalyze donor grants, and help Somalia achieve debt relief under the HIPC Initiative as soon as feasible.

B. Program Performance

4. Performance under SMP II has been satisfactory.

- **For June 2017, one out of the two structural benchmarks (SBs) was not met due to a small technical delay and two out of six indicative targets (ITs) were not met**—the cash fiscal balance and the revenue floor.
- **For September 2017, all but one (out of six) ITs and all but one (out of five) SBs were met.** We have advanced toward addressing the root causes of the missed SB— namely, completing the renegotiation of the port and airport fee collection contracts. The two separate memoranda of understanding (MOU) have been drafted; the one for the airport was signed, and the one for the port is under review. The two contracts are already under negotiation, and we are confident that the SB that targets the completion of these two contracts by December 2018 (SB #4) under SMP III will be completed on time.
- **For December 2017, all indicative targets were met, and all but one SBs were met.** On the missed SB, despite our efforts during the last quarter of 2017 to accelerate payments directly to vendors, we were not able to *“Meet the eligibility criteria required to achieve 100 percent of non-salary recurrent cost of the recurrent cost and reform financing (RCRF) budget.”* We have agreed to include procurement and commitment control issues as SBs in SMP III, in part because they were among the root causes of the missed SB in December 2017.
- **For March 2018, the two SBs and all ITs were met.**

C. Economic and Financial Policies for 2018-20

5. The economic recovery currently underway will gain momentum in 2019. Grants, and remittance and FDI inflows are expected to remain strong, structural reforms to accelerate, fiscal performance to continue to improve, and both fiscal and financial institutions will continue to improve. Growth is expected to reach 3.5 and inflation to stabilize at around 2.5 percent.

6. The SMP III will be aligned with our medium-term policies and strategies and will build on the achievements over the past two years. Our broad fiscal policy will continue to be anchored on: (1) maintaining a zero cash fiscal balance; (2) avoiding any new domestic arrears accumulation; and (3) continuing to improve domestic revenue mobilization as committed to under the SMP. On the monetary policy side, we will not allow the net foreign assets of the Central Bank of Somalia (CBS), as defined in the Technical Memorandum of Understanding (TMU) to fall below a continuous floor. The SMP III will particularly focus on (1) deepening progress achieved on enhancing public financial management (PFM) reform, including expenditure control; and revenue mobilization; (2) completing Phase I of the currency reform, which consists of exchanging all Somali Shilling currently in circulation with a new national currency; (3) starting broad-based financial sector reforms to foster financial development, inclusion, and stability, while strengthening compliance with the anti-money laundering and combating the financing of terrorism (AML/CFT) standards; and

(4) upgrading our data production and reporting system. Many elements of the program are also intended to reduce the vulnerabilities to governance and improve transparency that are most relevant to economic activity, particularly those related to fiscal governance, financial sector oversight, central bank governance and operations, and AML/CFT.

Fiscal Policy and Reforms

7. Our 2018 budget remains aligned with the SMP, but we plan to adopt a revised budget in June to account for new developments, particularly on the revenue side.

- **Developments through March 2018.** The strong fiscal performance recorded in the fourth quarter of 2017 has continued through March 2018, and the fiscal balance registered another surplus. This was due in part to higher than programmed domestic revenue mobilization. This revenue performance is coming mainly from (1) continued yields from tax measures implemented in late 2017, in particular, sales tax on telecommunication companies; (2) sales taxes on imported goods, which are now collected at the seaport and airport; and (3) gains from in-housing revenue collection.
- **Fiscal strategy for the remainder of 2018.** We are committed to greater fiscal discipline and to improving the fiscal framework. We will: (1) refrain from any expenditures that are not fully covered by realistic revenue and pledged grants projections; (2) remain current on our obligations, and in the event of revenue or grant shortfalls, we will cut spending in line with the rules for sequestering (prioritizing) expenditures; (3) ensure that, where possible, revenue windfalls (including additional grants for budgetary support) are used to build up fiscal buffers and pay down domestic arrears in line with the procedures established by the Domestic Arrears Management Committee (DAMC); and (4) cut non-priority spending in the event that revenue falls short of projections.
- **Revenue policy.** The new revenue measures implemented through March 2018 are expected to continue generating important yields. In addition, as outlined in the 2018 budget, we are collecting new revenues from the assessment of wages and corporate taxes, as well as sales taxes from telecommunications companies. There are possible sources of new revenues, if a number of legal and technical issues could be resolved. Following the takeover of the management of Somali Airspace from the International Civil Aviation Organization (ICAO), we can generate revenue from collecting airspace fees. Also, if technical issues could be addressed we expect to raise new revenues from annual fishing licensing fees and telecommunications licensing and spectrum fees.
- **Accountability, fiscal transparency, and expenditure measures.** We will require that all FMS report on the utilization of any FGS budgetary transfer on a semi-annual basis (SB#2). To improve expenditure control and the functionality of the SFMIS, we will require that all salaries for the Somali National Army (SNA) be paid directly to individuals' bank accounts and that all SNA payroll and non-payroll salary payments are registered into the SFMIS payroll module (SB#1). We have made encouraging progress on biometric registration of SNA personnel (over

5,000 have been registered, all in Mogadishu) followed by direct payments to individual bank accounts. Next steps would focus on the rest of the country, as we are aiming to register all SNA personnel and complete the entire process by June 2019. The FGS is of the view that our civil service needs restructuring to ensure an increase in staff productivity and to contain the public wage bill; the World Bank is assisting in the implementation of this reform. In this context, and in coordination with the National Civil Service Commission, a pilot program to identify and remove absentee staff and underperformers after due diligence and proper assessments at the Ministry of Finance will be expanded to all MDAs.

- ***PFM measures.*** Building on recent progress, we will:
 - Record all cash advances in the SFMIS and process them in accordance with the Appropriations Act (SB#3) to reduce cash advances to the absolute minimum and increase compliance with purchasing policy. This SB implies that cash advances are recorded as advances in SFMIS (using Asset code) and that they are acquitted with expenditures recorded to appropriate expense codes.
 - Complete the stocktaking and recording of all payroll and goods and services vouchers that are in arrears into the SFMIS (SB#4) to create an accurate and verified compilation of domestic arrears, to allow a transparent process of repayment to begin.
 - Design and implement a cash-forecasting framework to inform allotments which will be issued prior to approval of commitments (SB#5) in order to improve cash management and avoid new arrears. This SB implies that the “allow to exceed” overriding function will be used only exceptionally.
 - Accelerate progress toward a treasury single account. In this regard, we will issue an order to: (1) identify MDAs’ accounts at commercial banks and the CBS excluding off-budget accounts, close unnecessary accounts, and move active accounts to CBS; and (2) require that all active MDAs accounts be mapped to the SFMIS (SB#7) with the objective of improving our cash management capabilities. Meanwhile, we will step up efforts to update the legal framework under the PFM Law to ensure that the Minister of Finance will continue to be the sole legal authority for opening and closing government bank accounts.
- ***Inland revenue measures.*** A significant increase in domestic revenue remains an important target under the program. We are pressing ahead with full implementation of agreed-upon tax measures as well as improving compliance with tax laws. We will ensure that the large-and-medium-taxpayer office (LMTO) is fully operational (SB#8) and that its organizational structure and staffing are aligned; we have so far deployed 16 staff, and appointed an experienced manager to start work on June 1. We will also step up efforts to expand the coverage of large and medium taxpayers from 25 to at least 50, evaluate all potential tax arrears for 2017 in Mogadishu, and collect the corresponding tax obligations due (SB #10). To further increase domestic revenues, we will work to ensure that at least five of the remaining MDAs still collecting non-tax revenues will hand over collection of these revenues to the Ministry of

Finance (SB #13). In addition, the Minister of Finance will issue and order to make the renewal of all licenses by MDAs conditional on presenting a tax clearance certificate (TCC) from the Ministry of Finance. (SB #9). Finally, the Ministry of Post and Telecommunication and the Ministry of Finance will determine regulatory requirements and develop a plan to enforce regulations associated with fees to be levied, including licensing and spectrum fees (SB#12).

- **Customs measures.** We are committed to start implementing our Customs Roadmap with assistance from the World Bank and DFID. The roadmap is initially geared toward basic reforms to support discussions with the FMS and then to move rapidly toward achieving a modern, nationwide customs system with harmonized rates based on value, a declarative customs process, and modern business processes and audits. The reform will include the submission of an amended National Customs Act to Parliament, and the Ministry of Finance’s implementation of a common classification of goods based on HS codes and a front-end customs declaration process (SB#15). We will also reactivate Somalia’s membership in the World Customs Organization to further support a broad range of customs functions.
- **Fiscal federalism.** Progressing toward fiscal federalism is a critical political and economic objective for the FGS which will help foster higher and more inclusive growth. We have held several fiscal federalism meetings with the FMS and agreed to take steps to harmonize tax rates and on licensing for off-shore fishing, starting with tuna (season 2018). We will finalize a revenue-sharing agreement on petroleum and fisheries by March 2019 (SB#14). We have also made good progress on a text for the Revenue Bill and will submit it to Parliament by December 2018 (SB#11) to update our tax laws.
- **Budgetary and off-budget grants.** To improve the FGS oversight of budgetary and off-budget grants to Somalia, we will write to donors and recommend that all grants to Somalia be reported to the CBS and MoF.
- **Procurement and concessions.**
 - **Port and airport contracts.** We will have these new contracts signed by December 2018 (SB#6). Significant progress is being made on the Al Bayrak port and Favori airport contract concession renegotiations. The two MOUs have been drafted; the one for Favori was signed, and the MOU with Al Bayrak is under review.
 - **General procurement and concession issues.** We are aware that the lack of a proper procurement authority, guidelines, and framework hampers the effectiveness of procurement and contract concessions processes. This is critical as we currently have in the pipeline over 30 FGS contracts (each exceeding \$5 million in value) that require review and renegotiation, where necessary. In the meantime, we will empower the Interim National Procurement Board in line with the Procurement Act to review the contracts, and enforce current regulations and complete the procurement framework.

Financial Sector Reforms

8. We plan to launch Phase I of currency reform this year. Following the endorsement letter received from the IMF in early March, we have started reaching out to donors for their financial support for the currency reform. We have received positive feedback from some donors. The accountability framework associated with Phase I was endorsed by the CBS Board of Directors, and it is expected to be staffed by end of June 2018 to support the preparatory work for the launch of the new currency. We will develop and test a comprehensive plan to operationalize Phase I. We will also proceed soon with a transparent bidding selection of a printing company and consult with the IMF prior to the launch of the new currency.

9. We will start implementing the financial sector development roadmap. The roadmap highlights key bottlenecks for financial development and inclusion, and outlines the reforms to improve financial intermediation and stability. Our priorities over the next twelve months are outlined below:

- **CBS organization.** To support the core functions of the CBS, we will take steps to reassess the current organizational structure of the CBS with the objective to focus on operational functions and efficiency. We have already initiated consultations with the World Bank and the IMF in this regard.
- **Prudential supervision.** We will continue to improve capacity of the Licensing and Supervision Department (LSD):
 - For **commercial banks**, we will expand financial reporting requirements, develop on-site inspection and supervisory manuals, and will issue regulations on credit classification (SB#18). One small bank license was revoked in 2018 and we are working towards an orderly resolution of that bank.
 - On **money transfer businesses (MTBs)**, we will improve the MTBs licensing process and enhance compliance with existing regulations. We will also develop standards for disclosing Inspection Reports to MTBs and improve communication. With World Bank support, we are developing an automated transfer system and national switch, which are tentatively planned to be operational in early 2019.
 - **Mobile money** has grown rapidly in the past years and is also an important element in Somalia's payment system. We will prioritize the proper regulation and supervision of the mobile money services as soon as possible. Hence, we will pursue two parallel tracks. In the near term, with support from the IMF and World Bank, the CBS will issue necessary regulations to license and supervise mobile money providers under the current legal framework. In the context of CBS reorganization and ongoing capacity building, we will build these operational requirements into the LSD structure. At the same time, the National Communications Authority (NCA) will build licensing and reporting requirements necessary for proper regulation of the telecommunications sector and mobile network operators

(MNOs). Importantly, these future regulations will require MNOs, that provide mobile money services, to fulfill reporting requirements – and cooperate with – the CBS in order to receive and maintain a license to operate telecommunications and mobile money services in Somalia. In coordination with international partners, we will look to update the Financial Institutions Act to address legal gaps.

- **CBS accounting and audit.** We will appoint a Director of Internal Audit, develop an Audit Manual, and detail an IFRS transition plan to start accrual accounting for the 2018 financial statement and aim to begin implementing IFRS in 2019.
- **Financial infrastructure.** With assistance from the World Bank, we are developing a plan to issue a digital identification to Somalis to support collateral based lending and KYC objectives. In addition, we are starting to explore options for developing a collateral registry.

10. Improving the AML/CFT framework and increasing compliance with regulations is a priority. To comply with Financial Task Force (FATF) standards and UNSC Resolutions 1267 and 1373, we will submit the Targeted Financial Sanctions Regulation Law to the Parliament for approval by September 2018 (SB#17). Upon its passage, we will move quickly to issue regulations to implement these targeted sanctions. We will also improve the MTBs' compliance with the AML/CFT regulations and the reporting of suspicious transactions to the Financial Reporting Center (FRC) by implementing the MTB plan to improve compliance and licensing. We will expand the capacity of the FRC, in cooperation with international partners, by addressing personnel and IT gaps. Finally, we will resolve any overlaps and inconsistencies between the Article 14 of the AML/CFT Law and Article 9 of Regulation CBS/NBS/REG/05 which obligate MTBs to report suspicious transactions.

Policies for Accelerating Economic Recovery and Social Inclusion

11. We are advancing a broad-based reform agenda to strengthen economic resilience and bolster the foundations for sustained inclusive growth. The development challenges for Somalia, after decades of civil war, are significant. The risk of humanitarian crisis due to droughts and flooding are elevated. In this context, progress on reform implementation under the mutual accountability framework (MAF) has been broad-based and covers all critical areas for Somalia, including (1) political settlement; (2) security; (3) rule of law; (4) human rights and gender; (5) youth empowerment; (6) financial and economic management; (7) growth, economic recovery, and resilience; and (8) social inclusion.

12. We have identified several priority areas for accelerating economic recovery and social inclusion.

- **Combating corruption and improving governance will remain essential for the FGS.** We are taking steps to combat corruption and improve governance. These include (1) the passage of the Anti-Corruption Bill which is in line with international best practices; (2) the establishment of a Reform Implementation Unit ("Delivery Unit") to monitor the performance of all government reform priorities; (3) issuing of orders by all ministers to fight against civil servant workers'

absenteeism; (4) continued efforts to improve transparency on monetary and fiscal reporting, including, where possible, on the off-budget support; and (5) strengthening the MoF website including Budget information. The anti-corruption law has been approved by the House of the People and is awaiting the approval of the Senate. Once the Bill is approved by the Parliament and signed by the President, we will quickly move to the formation of the Anti-Corruption Commission. To improve governance and combat mismanagement and malpractice.

- ***The FGS is committed to fighting corruption, establishing the foundation for good governance, and protecting public property and assets.*** Since the collapse of the state, many of the public assets and properties have been expropriated illegally and leases awarded without due process. In this regard, the FGS will set up a Public Property Protection Committee (PPPC) under the Office of the Prime Minister. The PPPC will be tasked to compile statistics of all public assets, develop appropriate policies and regulations required to protect and safeguard public assets. In addition, this committee will be empowered to investigate and evaluate all leases and contracts implicating public assets awarded since 2012, and make recommendations to the leadership on their validity, fairness, and actions to resolve problematic contracts and leases.
- ***We will continue to improve the business environment.*** We have already stepped up efforts to increase the private sector's role in the economy. We passed a foreign direct investment (FDI) law and adopted a procurement bill. We will continue to enhance the business environment through public-private sector dialogue, improved financial governance and intermediation, and new business regulations, as well as improve access to finance. Access to financial services will be achieved by following through with the Financial Sector Development Roadmap, including better AML/CFT compliance. We are pleased that Somalia entered the Global Doing Business Survey for the first time in 2017. We will work on areas identified in the report to raise the position of Somalia in subsequent surveys.
- ***We will update our NDP (SB#16).*** We are developing a long-term Vision 2040 plan that will be broken down into 5-year blocks with the support of a group of multilateral institutions. The 2020 to 2024 portion of the plan will be used to meet SB#16. The plan will be developed through a consultative process with participation from all stakeholders across the country, including the National Development Council. We aim to use it as a basis for the Poverty Reduction Strategy Paper (PRSP) that is a requirement for the HIPC initiative. We will start preparing a medium-term fiscal framework and link it to the NDP. We will also improve the realism of the social program targets, including poverty incidence, job creation, and capacity and resilience program in response to drought, flooding, and other social safety net programs. Finally, we will identify and ensure adequate financing of the revised NDP.
- ***Developing social safety net programs in the budget and improving social spending will remain critical for developing resilience and supporting poverty reduction.*** We have made progress on managing and facilitating the return of refugees to Somalia. Also, under the United Nations Refugee Return and Reintegration project, an increasing number of refugees are being placed in training institutions (mainly in Kenya), where they are trained in peace-building and conflict-resolution. We will develop and include social safety net programs in our future budgets

and increase budgetary allocations on social spending, including education, health, and humanitarian support.

D. Institutions and Statistics

13. Our efforts to empower the government and institutions will be essential for sustained growth and social cohesion.

- **Natural resource management and transparency.** We remain committed to transparent and equitable management of natural resources. The draft PFM Bill includes a clause that sets out the principles of governing natural resource revenue management as it relates to fiscal policy. Also, discussions with the FMS in the Intergovernmental Finance Ministers meetings on natural resource management and revenue sharing are well advanced. Many of these issues are addressed in the National Revenue Bill which is being finalized.
- **Economic and financial data.** Despite important progress to reconstitute our economic data in the past three years, the challenges ahead are significant. We will press on the Parliament to adopt the long-awaited Statistical Law which was submitted in September 2017. The Ministry of Finance, MOPIED, and CBS will jointly develop a roadmap for statistical data production and dissemination by end of September 2018. In this regard, we have identified the following critical tasks: (1) estimate the national account aggregates on the demand side (consumption, gross capital formation, and exports and imports of goods and non-factor services) and the GDP (for 2013–17) at both current and constant prices; (2) complete the reconstitution of the public debt database; (3) update, on a regular basis, the statistical business register across FGS and FMS; (4) launch a capital expenditure survey based on the existing one and strengthen Somalia's export and import data by collecting trade in goods data by value and volume; (5) implement IFRS-based accounting at the CBS; (6) improve remittance data mainly with the MTB survey; (7) start conducting surveys on travel, primary current transfers related to embassies and NGOs; (8) finalize the survey form for foreign direct investment and coordinate with the Ministry of Trade and Commerce to begin surveying the 20 largest companies; and (9) complete a civil service database. Meanwhile, we are taking steps to compile and review GFSM2014-based annual data for the budget for the period of 2015–18 and the draft 2019 budget. Separately, the CBS will implement the action plan for improving source data for the CBS and for collecting financial and non-financial data.

E. Relations with International Creditors and Debt Relief

14. We will continue to make efforts to normalize relations with international creditors.

This should, in due course, help address the burden of external debt and arrears, and facilitate access to concessional financing. Given the urgency of meeting Somalia's social and reconstruction needs, a substantial reduction in the debt burden is an essential element of our economic strategy. We understand that qualifying for the HIPC Initiative requires (1) establishing a satisfactory track record of cooperation with the Fund on policies; (2) normalizing relations with creditors, including to mobilize donor agreement and resources to finance debt relief; and, (3) preparing a poverty

reduction strategy. We seek to reach a decision point as soon as feasible under established HIPC policies.

15. Meanwhile, we will step up efforts to complete our debt database and improve capacity at the Debt Management Unit (DMU). Reconciling external debt and confirming that debt sustainability indicators are above the relevant HIPC initiative thresholds is a technical prerequisite for HIPC. Hence, we have reached out to 21 bilateral creditors, representing nearly 80 percent of Somalia's external debt, to confirm the loan-by-loan terms, principals, interest and outstanding penalties (the remaining 20 percent of external debt are primarily with multilateral creditors). As of today, 12 bilateral creditors have responded to the validation exercise; once the remaining 9 bilateral creditors respond, we would have nearly all of Somalia's external debt confirmed. The DMU is coordinating with the IMF in following up with 9 creditors who have not responded to the debt validation exercise. We are also supporting the IMF and World Bank in developing Somalia's first debt sustainability analysis (DSA).

Technical Assistance

16. During the program period, we are requesting IMF TA in: (1) tax policy, revenue, and customs administration; (2) budget preparation and execution; (3) reforms in cash management and forecasting, and the TSA; (4) planning and implementing Treasury management and reforms, including a GFS-compliant Chart of Accounts; (5) internal controls; (6) natural resources sharing; (7) licensing, supervision, and regulation of banks; (8) currency reform; (9) central banking operations and governance structure; (10) CBS accounting and internal audit; (11) macroeconomic statistics; and, (12) Debt Sustainability Analysis.

F. Program Monitoring

17. Our standing SMP Monitoring Committee will continue to monitor the implementation of our program by preparing and assessing the quarterly indicative targets (Table 1) and SBs (Table 2). The program will have two reviews to assess its performance based on the test dates of September 30, 2018, and March 31, 2019. The indicative targets are defined in the TMU (Attachment II).

Table 1. Somalia: Indicative Targets under the Staff-Monitored Program, 2017–18 ^{1/}
(Millions of U.S. dollars)

	2018			2019
	June Prog.	Sept. 2/ Prog.	Dec. Prog.	March 3/ Prog.
Fiscal				
Fiscal balance (cash basis; floor)	0.0	0.0	0.0	0.0
Revenue (floor)	75.7	116.1	165.0	47.0
Accumulation of new domestic expenditure arrears (ceiling) 4/	0.0	0.0	0.0	0.0
Contracting of new domestic debt (ceiling) 4/	0.0	0.0	0.0	0.0
Contracting or guaranteeing of new nominal external non-concessional borrowing (ceiling) 4/	0.0	0.0	0.0	0.0
Central Bank of Somalia (CBS)				
Net foreign assets of the CBS (floor) 4/ 5/	24.0	24.0	24.0	24.0
Memorandum item				
Debt contracting or guaranteeing of nominal external concessional borrowing (ceiling).	0.0	0.0	0.0	0.0

Sources: Somali authorities; and Fund staff estimates and projections.

1/ Based on preliminary data. Cumulative from the beginning of the year.

2/ Test date for the first review of the SMP.

3/ Test date for the second review of the SMP.

4/ Continuous indicative target.

5/ Calculated using program exchange rates. See Technical Memorandum of Understanding (Attachment II) for definitions of the program targets.

Table 2. Somalia: Structural Benchmarks under the Staff-Monitored Program, May 2018–April 2019

Benchmarks	Target dates	Rationale and Monitoring 1/
Public Financial Management		
1 A Minister of Finance order to require that all salaries provided in cash be paid directly to individuals' bank accounts and record/register all Somali National Army payroll and non-payroll into the SFMIS payroll module.	Jun-18	Improve PFM and fiscal reporting.
2 A Minister of Finance order to require all Federal Member States (FMS) and the Banadir region to report at end-Q1 and end-Q3 on the utilization of any FGS budgetary transfer.	Sep-18	Improve fiscal transparency, accountability, FGS leadership and oversight over the FMS.
3 Record cash advances in SFMIS and process them in accordance with the Appropriations Act.	Sep-18	Improve cash management and payment processes.
4 Complete the stocktaking and recording of all payroll and goods & services vouchers to December 31, 2017 which are in arrears into SFMIS.	Sep-18	Create an accurate and verified compilation of domestic arrears, to improve governance, and to allow a transparent process of repayment to begin.
5 Design and implement a cash-forecasting system to inform allotments which are issued prior to commitment, in accordance with the Appropriations Act.	Dec-18	Provide effective use of the purchasing module in SFMIS, improve cash management, and limits/avoid new arrears.
6 Conclude the renegotiation of the Mogadishu port and airport fee-collection contracts.	Dec-18	Strengthen PFM and broaden FGS revenue base. Provide concluded and signed Mogadishu port and airport fee-collection contracts
7 The Minister of Finance to issue an order: (1) to identify Ministries, Departments, and Agencies (MDAs) accounts at commercial banks and the CBS, close unnecessary accounts, and move active accounts to CBS; and, (2) to require that all active MDA accounts be mapped to the SFMIS.	Mar-19	Make progress towards developing the Treasury Single Account. Will require that: (1) the ministry will establish a list of all MDA bank accounts respective signatories and operating mandates; (2) all MDA bank accounts be opened upon express issuance of formal authorization by the Accountant General; and, (3) CBS will report monthly bank balances of Treasury accounts.
Tax Administration and Tax Policy		
8 Ensure that the large-and-medium-taxpayer office (LMTO) is fully operational and share its organizational structure and staffing status.	Jun-18	Enhance the Inland Revenue Department, expand the revenue base and increase domestic tax collection.
9 Minister of Finance to issue order to make the renewal of all licenses by Ministries, Departments, and Agencies (MDAs) conditional on presenting a tax clearance certificate (TCC) from the Ministry of Finance.	Jun-18	Expand the revenue base and increase domestic tax collection.
10 The LMTO to increase the number of registered large and medium taxpayers from 25 to at least 50, evaluate all potential tax arrears for 2017 in Mogadishu, and collect the corresponding tax obligations due.	Sep-18	Expand the revenue base and increase domestic tax collection. This follows the establishment of the LMTO. LMTO staff will determine which of these arrears are considered potentially recoverable and record needed information. Provide new registration list of large- and medium taxpayers.
1/ To be provided within four weeks of the respective structural benchmark's due date.		

Table 2. Somalia: Structural Benchmarks under the Staff-Monitored Program, May 2018–April 2019 (cont.)

Benchmarks	Target dates	Rationale and Monitoring 1/
Tax Administration and Tax Policy (continued)		
11 Submit the Revenue Bill to Parliament.	Dec-18	Update the tax law by also correcting deficiencies of the old tax laws
12 The Minister of Post and Telecommunication (MPT) and the Minister of Finance to develop a plan to enforce regulations-associated with the fees to be levied (licensing, spectrum, etc.).	Dec-18	Improve revenue collection. Communications Act, which would provide considerably broader powers to MPT to regulate the sector, including the ability to set appropriate fees and regulatory requirements. Provide the agreed fee structure and the plan for collection.
13 The Ministry of Finance to take over all non-tax revenue collections from at least 5 of the remaining MDAs which are currently collecting these revenues.	Dec-18	Improve revenue collection. FGS to provide SFMIS report showing non-tax revenue collections from the regulatory and operational activities of all MDAs.
14 Finalize petroleum and fisheries operational revenue-sharing mechanisms between the FGS and FMS.	Mar-19	Operational step toward fiscal federalism. Adopting a petroleum and fisheries revenue sharing mechanisms will advance the tax harmonization process, contribute to national unity, and promote equity and accountability.
15 Submit an amended National Customs Act to Parliament, and the Ministry of Finance to implement a common classification of goods based on HS codes and a front-end customs declaration process.	Mar-19	It will provide the foundation for a new tariff while improving coordination and efficiency. It will focus on HS classifications of goods. Provide common nomenclature of goods by HS code and a report detailing the progress of implementing the customs declaration process.
MOPIED–National Development Plan		
16 Prepare an update of National Development Plan 2020-24.	Mar-19	Prepare for the interim PRSP document. The draft NDP will include (1) links to the fiscal and macroeconomic framework; (2) costing and critical financing identified; and, (3) a social program and protection framework.
CBS–Financial Sector Development		
17 Submit to Parliament the draft Targeted Financial Sanctions Act.	Sep-18	Strengthen the AML/CFT framework to address terrorist financing risks and reduce correspondent banking relationship (CBR) pressures.
18 CBS to issue regulation on credit classification and provision, and review reporting requirement for banks.	Mar-19	Improve financial intermediation, banking supervision, legislation, and supervision. This action will include update on reporting requirements for banks to include data relevant to the classification of credit and extent of provisioning. It will also include identification of gaps that would be filed by reporting requirement.
1/ To be provided within four weeks of the respective structural benchmark's due date.		

Attachment II. Technical Memorandum of Understanding

This technical memorandum of understanding (TMU) sets out the understanding between the Somali authorities and the International Monetary Fund (IMF) regarding the definitions of the indicative targets for the 12-month Staff-Monitored Program (SMP) spanning May 2018–April 2019. It specifies the indicative targets on which the implementation of the SMP will be monitored. In addition, the TMU establishes the terms and timeframe for transmitting the data that will enable IMF staff to assess program implementation and performance. The definitions are valid at the start of the program but may need to be revisited during the program reviews to ensure that the memorandum continues to reflect the best understanding of the Somali authorities and IMF staff in monitoring the program.

A. Indicative Targets

1. The indicative targets have been set for the end of June 2018, end of September 2018, end of December 2018, and end of March 2019. Unless otherwise specified, all indicative targets will be evaluated in terms of cumulative flows from the beginning of each calendar year. Indicative targets are specified in Table 1 of the Memorandum of Economic Financial and Policies and they are:

- Floor on the fiscal balance (on a cash basis).
- Ceiling on accumulation of new domestic expenditure arrears of the Federal Government of Somalia (FGS).
- Floor on FGS revenue.
- Ceiling on new domestic debt contracted by the FGS.
- Ceiling on new external debt contracted or guaranteed by the FGS or the Central Bank of Somalia (CBS).
- Floor on CBS's net foreign assets.

Definitions and Computation

2. For the purposes of the SMP, the government is defined as the FGS. This definition excludes public entities with autonomous legal personalities whose budgets are not included in the federal government budget. The general government includes the FGS and the federal member states (Galmudug, Hirsabelle, Jubaland, Puntland, and South West State).

3. Government revenue includes all tax and nontax receipts transferred into the FGS general accounts at the CBS and excludes grants. It is measured on a cash basis, and cumulative from the beginning of the fiscal year (which coincides with the calendar year). Revenues of the government, which are defined in line with the Government Financial Statistics Manual (GFSM 2001) on a cash accounting basis, excluding grants.

- Revenues of the central government include taxes and other compulsory transfers imposed by the government, property income derived from the ownership of assets, sales of goods and services, penalties and forfeits and voluntary transfers received from nongovernment other than grants. The definition for program monitoring excludes grants and other noncompulsory contributions received from foreign governments and international organizations; such transfers between the government units would be eliminated in the consolidation of the fiscal reports and not recorded as revenue. Receipts from the sale of nonfinancial assets (for example, the sale of physical assets) and future signing bonuses from natural resource contracts, transactions in financial assets and liabilities, such as borrowing but excepting interest payments, are also excluded from the definition of revenue.
- Revenues should be recognized on a cash basis and flows should be recorded when cash is received. The Government SFMIS reports will be used as the basis for program monitoring of revenues and expenditures; supplemented by the monthly financial statements prepared by the Minister of Finance.

4. The fiscal balance, on a cash basis, is defined as the difference between (a) the sum of government revenue (as defined in paragraph 3) and budget grants; and (b) total current expenditure plus capital expenditure (excluding foreign-financed off budget investment).

5. New domestic expenditure arrears of the government are defined as budgeted federal government payments to residents determined by contractual obligations that remain unpaid 90 days after the due date. Under this definition, the due date refers to the date in which payments are due according to the relevant contractual agreement, considering any contractual grace periods. Government payment include all expenditure for which vouchers have been approved by the Budget Department/Accountant General Office, expenditures that are automatically approved by legislation, debt payments to CBS and commercial banks, and transfers to regional governments.

6. Debt is defined for program purposes in accordance with Executive Board Decision No. 15688-(14/107), Point 8(a) and 8(b), adopted on December 5, 2014.

- For program monitoring purpose, the term “debt” will be understood to mean a current (that is, not contingent) liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, at some future point(s) in time; these payments will discharge the principal and/or interest liabilities incurred under the contract. Debts can take several forms; the primary ones being as follows:
 - Loans, that is, advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers’ credits) and temporary exchanges of assets that are equivalent to fully collateralized loans under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral

from the buyer in the future (such as repurchase agreements and official swap arrangements);

- Suppliers' credits, that is, contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and
 - Leases, that is, arrangements under which property is provided which the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments that cover the operation, repair, or maintenance of the property.
- Under the definition of debt set out in this paragraph, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (for example, payment on delivery) will not give rise to debt.

7. Domestic debt is defined as short-term and medium-to-long-term borrowing from residents of Somalia, including the CBS. The definition of domestic debt excludes temporary advances for liquidity management from the CBS, and domestic expenditure arrears as defined in paragraph 6. Temporary advances will be fully repaid within 90 days.

8. Benchmarks for external debt are cumulative ceilings on contracting or guaranteeing of new nominal external non-concessional borrowing by the government from the beginning of the calendar year. External debt is defined by the residency of the creditor.

9. The CBS's net foreign assets are defined as the difference between the CBS's gross foreign assets and gross foreign liabilities. Gross foreign assets are defined as (1) gold valued, over the program period, at the market price of December 31, 2017 (\$1,302.80 per ounce); plus (2) foreign exchange (including recovered CBS assets, non-earmarked budget, and earmarked donor grants); minus (3) government budget grant deposits at the CBS in foreign currency; minus (4) other earmarked foreign currency deposits by residents of Somalia. Somalia's net position to the IMF is excluded from the definition of net foreign assets. Relevant exchange rates against the U.S. dollar at December 31, 2017 will be used to convert foreign assets and liabilities denominated in currencies other than U.S. dollars.

B. Program Monitoring

Program-Monitoring Committee

10. The Somali authorities shall maintain a program-monitoring committee composed of senior officials from the Ministry of Finance, the Central Bank of Somalia, and the Ministry of Planning, Investment and Economic Development. The IMF Resident Representative will have observer status on this committee. The committee shall be responsible for monitoring the performance of the program, recommending policy responses, informing the Fund regularly on program performance, and transmitting the supporting materials necessary for the evaluation of benchmarks. The committee shall provide the Fund with a monthly progress report on the program within four weeks of the end of each month, using the latest available data.

Data Reporting to the Fund

11. To allow monitoring of developments under the program, the Ministry of Finance, the CBS and the Ministry of Planning, Investment, and Economic Development will provide to the Resident Representative's office of the IMF the following information contained in the data reporting table below.

Somalia: SMP Data Reporting, May 2018–April 2019

Reporting Agency	Type of Data	Description of Data	Frequency	Timing (within period specified)
Central Bank of Somalia	Monetary survey	Detailed balance sheet data of the CBS submitted in the reporting template.	Monthly	3 weeks after the end of each month
		Consolidated commercial banks' balance sheet data by residency submitted in the reporting template.	Quarterly	4 weeks after the end of each quarter
	Other financial indicators	Prudential data as per associated CBS regulations (total capital, core capital, total net assets, high quality liquid assets, and 30-day funding requirement), and average interest and maturity information for private sector loans.	Quarterly	4 weeks after the end of each quarter
	Balance of payments	Trade in goods data by value for the port of Mogadishu; petroleum imports to Mogadishu; travel data from the Immigration Department; and MTB survey on cross-border transfers.	Quarterly	4 weeks after the end of each quarter
	CBS temporary advances to the FGS	Provide monthly amounts and terms of the temporary advances to the Ministry of Finance.	Monthly	1 week after the end of each month
	Budget grants	Provide data on the amounts of on-budget grants, including transfers to the government's accounts from the government's external accounts at the CBS.	Monthly	3 weeks after the end of each month
Ministry of Finance	FGS budget operations	The detailed revenue and expenditure by budget line and a comprehensive table summarizing Government operations including TSA balances.	Monthly	4 weeks after the end of each month
		The outstanding appropriation, allotment, commitment, vendor purchasing/payments, cash advances, and bank balances (including for all MDA accounts) since the beginning of the calendar year.	Monthly	4 weeks after the end of the month
		A report on all the fees collected by the MOF from MDAs, disaggregated by MDA.	Monthly	4 weeks after the end of the month
		Monitoring Agent reports for Recurrent Cost and Reform Financing non-salary reimbursement eligibility.	Monthly	4 weeks after the end of the month
		SFMIS audit report recording use of the allotment "allow to exceed" control override function.	Monthly	4 weeks after the end of the month
		The monthly cash plan.	Monthly	4 weeks after the

				end of each month
		A report of all payment requests by MDAs awaiting payment since the beginning of the calendar year where the commitments exceed the agreed payment terms (in SFMIS/Excel).	Monthly	4 weeks after the end of the month
		Payroll and non-payroll salary and allowance payments made by MDAs and individual embassies (in Excel).	Monthly	4 weeks after the end of the month

	Regional Member States' budget operations	Reports from all Federal Member States (FMS) and the Banadir region on the utilization of any FGS budgetary transfers.	Semi-annually	4 weeks after the end of Q1 (March) and Q3 (September)
	Domestic arrears	A table providing the end-of-period stock of domestic arrears accumulated during the year by MDA and 4-digit Object Code.	Annually	4 weeks after the end of the year
	Domestic debt	The amount of new domestic debt contracted by Government.	Monthly	4 weeks after the end of the month
	External debt	End of year external debt in US dollars, by creditor, and origination currency. The amount of new external debt contracted or guaranteed by Government.	Monthly	4 weeks after the end of the month
		Disbursements and repayments: (1) scheduled; and (2) actual interest and principal on debt of the Government and the CBS, by creditor.	Monthly	30 days after the end of each month
	Structural benchmarks	A table with a description of the status of implementation of the structural benchmarks in Table 2 of the MEFP.	Monthly	4 weeks after the end of the month
National Statistics Bureau	CPI and other economic indicators	Indicators to assess overall economic trends, such as the consumer price index.	Monthly	6 weeks after the end of each month
		Production data	Annually	6 months after the end of each year