REPUBLIC OF KENYA

KITUI COUNTY TREASURY

MEDIUM TERM DEBT MANAGEMENT STRATEGY PAPER

FEBRUARY 2015

FOREWARD

The Constitution and the Public Finance Management Act, 2012 section 123 requires each County to come up with a Debt Management Strategy Paper. The 2015 Medium Term Debt Strategy paper (MTDMS), the second one since the setting up of county governments, is a versatile public debt management tool linked to the medium term fiscal framework that contains prudent revenue projections and planned expenditures consistent with County government of Kitui priorities. It recognizes the cost and risk tradeoffs in setting sustainable borrowing limits, ensuring that debt is serviced under a wide range of shocks without risk of default. County Government fiscal stance for FY2015/16 is stated in the County fiscal strategy paper (CFSP) 2015/2016. This Medium Term Debt Strategy paper has been prepared to guide financing of the budget deficit that may occur. County government debts and liabilities may arise from one or more of the following:

a) Loans
b) Unpaid salaries and unremitted statutory deductions(PAYE, Pension, NHIF, Sacco dues)
c) Gratuity plans not provided for
d) Tender contracts awarded with values above budget and variations orders
e) Debts from court decisions, 3rd party damages claims and arbitration awards.
f) Utility liabilities arising from unpaid electricity bills
g) Office and other rental debts
h) Contingent liabilities arising out of guarantees
i) Disputed or cancelled contracts owing to poor workmanship or delayed completion of works
j) Shortfall on budgeted revenues
k) Unbudgeted/unforeseen professional services

The County strategies for dealing with these debts are discussed in section G of this paper.

This paper develops the County strategies which will be used in the medium term to deal with debts. The Most probable source of debt which the County Government is from the defunct local authorities. The Transition Authority is empowered by the

Transition to devolved Governments Act 2012 section 7(2) (e) to "prepare and validate an inventory of all the existing assets and liabilities of government, other public entities and local authorities; (f) make recommendations for the effective management of assets of the national and county governments". Subsequently, the transition authority has established a Sub Committee on the Transfer of Public Assets and Liabilities as specified in legal Gazette notice No. 45 of 2013. The Subcommittee is expected to finalize its work and handover a verified list of liabilities to the Transition Authority for advice and necessary action.

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County Minister for Finance and Economic Planning

ACKNOWLEDGEMENT

This is the second Medium Term Debt Management Strategy (MTDMS) paper to be tabled under the requirement of Public Finance Management (PFM) Act, 2012 and to be tabled in the County Assembly. It is supposed to cover a period of five years 2014/2015 to 2017/2018

The MTDMS sets out the debt management strategy of County Government over the medium term with respect to actual and potential liabilities. As required by the PFM Act 2012, the MTDMS will be formally submitted to the Commission on Revenue Allocation (CRA) who will ensure sound borrowing principles are adopted in the Counties. The current Debt situation in Kitui County is specifically inherited from the defunct Local Authorities and estimated to be in the range of Kshs 110Million. This will be clearly established after a subcommittee which has been established by the Transition Authority through Gazette Notice no 45 of 2013 completes its work.

Let me take this opportunity to acknowledge the staffs of Finance and Economic Planning who were involved in the preparation of the 2014/2015 to 2017/2018 MTDMS. Specifically the core team which was composed of Chief Finance Officer June Munyao and Joseph Kairu an Economist.

Grace K. Muimi
Chief Officer, County Ministry of Finance & Economic Planning.

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List of abbreviations

MTDMS	medium term debt management strategy
CFSP	county fiscal strategy paper
PAYE	pay as you earn
NHIF	national hospital insurance fund
PFM	public finance management
CRA	commission for revenue allocation
TA	transition authority
TDGA	transition to devolved government act

A. LEGAL BASIS FOR THE PUBLICATION OF THE DEBT MANAGEMENT STRATEGY

The debt management strategy is published in accordance with section 123 of the public finance management Act, 2012. The law states that:

(1) On or before the 28th February in each year, the County Treasury shall submit to the county assembly statement setting out the debt management strategy of the county government over the medium term with regard to its actual liability and potential liability in respect of loans and its plans for dealing with those liabilities.

(2) The County Treasury shall include the following information in the statement

(a) The total stock of debt as at the date of the statement;

(b) The sources of loans made to the county Government

(c) The principal risks associated with those loans;

(d) The assumptions underlying the debt management strategy; and

(e) An analysis of the sustainability of the amount of debt, both actual and potential.

(3) As soon as practicable after the statement has been submitted to the county assembly under this section, the County Executive Committee member for finance shall Publish and publicize the statement and submit a copy to the Commission on Revenue Allocation and Intergovernmental Budget and Economic Council. On being requested to do so by the county assembly, the County Treasury shall prepare and submit to the county assembly a report on any matter relating to its responsibilities within fourteen days of the request.

B. OBJECTIVES OF DEBT MANAGEMENT STRATEGY PAPER

The principal objective of County Debt Management strategy paper is ensuring the County government's financing needs and payment obligations are met at the lowest possible cost consistent with a prudent degree of risk. The secondary objective is to facilitate County Government access to financial markets. The county Government will strive to maintain a balanced budget to avoid incurring unnecessary debts.

C. OVERVIEW OF THE 2014 DEBT MANAGEMENT STRATEGY PAPER

The 2014 MTDMS paper recommended fiscal discipline by ensuring that the entire budget of the County government is financed from the equitable share and the revenue raised locally. The county government committed to meet its financial obligations by ensuring timely payment of salaries and merchants, prompt processing and submission of remittances i.e. PAYE and other statutory deductions and paying of utility and rental bills in time as recommended by the debt management strategy paper. The recommendations were adhered to and the County Government did not engage in any form of borrowing.

D. THE 2015 DEBT MANAGEMENT STRATEGY PAPER

The 2015 MTDMS paper recommends just like the 2014 one, fiscal discipline by ensuring that the entire budget of the County government is financed from the equitable share and the revenue raised locally. This will put the need to borrow at a minimum hence minimizing both cost and risk in the debt portfolio. The county government will continue to meet its financial obligations by ensuring timely payment of salaries and merchants, prompt processing and submission of remittances i.e. PAYE and other statutory deductions and paying of utility and rental bills in time as recommended by this debt management strategy paper.

E. SCOPE

The 2015 MTDMS paper covers both domestic and external debts of the County Government of Kitui or its agencies as may be authorized by the Kitui County Assembly.

F. ASSUMPTIONS UNDERLYING THE MEDIUM TERM DEBT MANAGEMENT STRATEGY

For the purpose of this medium term debt management strategy paper, the following assumptions are made;

- The county government will continue observing fiscal discipline such that the entire budget is financed from the equitable share and revenue raised locally;
- That in the medium term, the county government will achieve the projected revenue targets;
- That both the county government and parties it enter into contract with will adhere to the specified contractual terms; and that
- Debts from the defunct local authorities, which are subject to verification by transition authority, will not, unless ascertained otherwise, be treated as debts incurred by the county government.

G. COUNTY GOVERNMENT LEGAL BASIS TO BORROW

Section 140 of PFM Act, 2012 gives the County Government authority to borrow;

(1) A County Executive Committee member for finance may, on behalf of the county government, raise a loan for that Government's purposes, only if the loan and the terms and conditions for the loan are set out in writing and are in accordance with—

(a) Article 212 of the Constitution;

(b) Sections 58 and 142 of PFM Act; 2012.

(c) The fiscal responsibility principles and the financial objectives of the County Government set out in its most recent County Fiscal Strategy Paper; and

(d) The debt management strategy of the County Government over the medium term.

(2) A loan may be raised either within Kenya or outside Kenya.

Section 141 of PFM Act, 2012 gives obligations and restrictions with respect to county borrowing

(1) In borrowing money, a county government shall ensure that it's financing needs and payment obligations are met at the lowest possible cost in the market that is consistent with a prudent degree of risk, while ensuring that the overall level of public debt is sustainable.

(2) A county government may borrow money only in accordance with PFM Act or any other legislation and shall not exceed the limit set by the county assembly.

(3) A county government may borrow money in accordance with section 58 of PFM Act, the Cabinet Secretary may guarantee a loan of a County Government if the loan is for a capital project and County Government is capable of repaying the loan, and paying

any interest or other amount payable in respect of it.

The county executive member in charge of finance may enter into an overdraft arrangement with the central bank of Kenya purely for cash flow management if there are enough funds in the county revenue funds account to guarantee it. Such an arrangement must be in line with section 142 of the public finance management Act, 2012 which states as follows

(1) The County Assembly may authorize short term borrowing by county government entities for cash management purposes only.
(2) Any borrowing under subsection (1) may not exceed five percent of the most recent audited revenues of the entity.
(3) A county government entity that has any such borrowing shall ensure that the money borrowed is repaid within a year from the date on which it was borrowed.

The County government intends to request for such a short term borrowing arrangement with the central bank of Kenya for cash flow management during transition between financial years

The 2015 budget policy statement released by the national treasury recommends that Public debt obligations be maintained at a sustainable level as approved by Parliament (NA) and County Assembly (CA). It goes further to state that External financing will be largely on concessional terms. The county Government should ensure that the level of domestic borrowing does not crowd out the private sector given the need to increase private investment to accelerate economic expansion.

H. DEBT MANAGEMENT STRATEGY

The objectives of public debt management include:

a. To ensure that the county government's financing needs and its payment obligations are met at the lowest possible cost over the medium to long run, consistent with a prudent degree of risk.

b. Support the public finance strategy by assuring that the execution of the public debt policy in the medium and long term will take place in an environment of public debt sustainability.

c. Foster a healthy development of the county financial system and improve the efficiency of the local debt market.

d. Promote transparency and the modernization of the statistical information related to public debt.

Article 201 of the Constitution sets out the principles of public finance management which are to be observed by both the national government and county governments one of which is to ensure the burdens and benefits of the use of resources and public borrowing are shared equitably between present and future generations.

The strategies to be adopted by the county government to manage debts and liabilities arising from various sources are:

i. Loans. The county government may borrow from the domestic market or foreign sources

   The county government will endeavor to finance its operations both recurrent and development within the revenue raised locally and the share from revenue raised nationally. However, the County Government shall arrange short term borrowing with the central bank for cash flow management during transition between financial years secured by the county revenues and payable immediately funds become available.

   If deemed fit to borrow, borrowing as a source of revenue shall be used for development expenditure and only:

   a) if the national government guarantees the loan; and with the approval of the county government's assembly (Article 212 of the Constitution)
   b) after confirming cash flow projections adequately cover repayments
   c) After establishing value addition of the project.

ii. Unpaid salaries and unremitted statutory deductions(PAYE, Pension, NHIF, Sacco dues)

   Strategies for managing this kind of liability are:

   a) Full provision of personnel emoluments (PE) in the annual budgets and ring fence the same
   b) Immediate payment of salaries and the deductions
   c) No employment of staff not provided for in the PE
   d) Outsource the payroll processing function

iii. Gratuity plans not provided for

   Payments will be provided for in the budget and a separate account shall be opened where such amount shall be credited at the end of each financial year or a pension plan shall be established where such monies shall be paid into.

iv. Tender contracts awarded with values above budget and variations orders

Local Purchase and Local Service Orders shall only be issued and released after entering into the system to commit the funds. Vote heads without sufficient funds will automatically be rejected.

The county has automated its procurement processes to ensure all Local Purchase and Local Service Orders are electronically issued to eliminate any manual errors

Budgeted amounts ceilings shall be enforced by the County Treasury

v. Debts from court decisions, 3rd party damages claims and arbitration awards.

The County shall carry out its operations within the law to avoid any instances of court cases or arbitration processes that may bring about unbudgeted liabilities

The County shall procure insurance covers for vehicles and buildings that indemnify it of any liabilities which may arise.

vi. Utility and rental debts

Full provision of the expense in the annual budgets and

Immediate payment upon receipt of invoice.

vii. Contingent liabilities arising out of guarantees

Contingent liabilities become due on the happening of a future event for example if the county government issues a guarantee but the party guaranteed fails to honour obligations as they fall due. The County will not issue any guarantees in the medium term. However, letters of undertaking may be issued on behalf of contractors to facilitate them to raise funds for performing contracts

viii. Disputed or cancelled contracts owing to poor workmanship or delayed completion of works.

Contracts management processes shall be strictly adhered to avoid unnecessary delays.

ix. Shortfall on budgeted revenues

Strict revenues collection shall be enforced. Spending units charged with collection of revenue and which collect less than the budgeted amounts shall have their recurrent budget reduced by the same amount.

x. Unbudgeted/unforeseen professional service fees.

These fees include attorney’s fees among others.

The county government will endeavor to follow due legal process in all transactions and make adequate provision in the annual budgetary allocations to cater for such fees adequately.

I. TOTAL STOCK OF DEBTS AND SOURCES OF LOANS MADE TO THE COUNTY GOVERNMENT

As at the date of the preparation of this debt management strategy paper, the county hadn't accumulated any debts nor borrowed any loan. However, there are probable debts of Kshs 109,557,299.25 from the defunct local authorities whose verification by Transition Authority is currently going on.

J. ANALYSIS OF PROBABLE DEBTS

Section 123 (1) (e) of the public finance management Act, 2012 requires that a County treasury provide "An analysis of the sustainability of the amount of debt, both actual and potential". In the light of this, it's important to note that there are probable debts from the defunct local authorities currently amounting to Kshs 109,557,299.25 according to the draft report by the subcommittee on transfer of assets and liabilities.

Transition to Devolved Government Act, 2012 , Section 7 (2) (e and f) requires Transitional Authority to prepare and validate an inventory of all the existing assets and liabilities of government, other public entities and local authorities and make recommendations for the effective management of assets and liabilities of the national and County Governments.

The transition authority has set up a subcommittee to verify Public Assets and Liabilities as specified in legal Gazette notice No. 45 of 2013. The Subcommittee is expected to finalize its work and handover a verified list of liabilities to the Transition Authority for advice and necessary action. Once the liabilities are verified, the Transition Authority is expected to share the report with stakeholders before making recommendations on how, when debts will be settled and who settles the debts.

It should be noted from the onset that the County government budgeted funds are for service delivery and not for settling pending bills. Any attempt to settle existing bills will result in delaying or completely hindering provision of services. The County government expects the transition authority to advise accordingly once these liabilities are fully ascertained.

In verification of Assets and Liabilities, the following documents/information is normally required;

i. Evidence that the creditor was pre qualified(prequalification of tenderers)
ii. Evidence showing when the tenders were advertised.
iii. Minutes of tender opening.

iv. Minutes of tender evaluation.
v. Minutes of tender award.
vi. Letter of notification of tender award by the respective local authorities.
vii. Tender acceptance letter by the respective contractors.
viii. Signed contract documents by contractor and procurement or user department.
ix. Dully signed Local Service Orders or local purchase order.
x. Minutes of site handing over to contractors.
xi. Site minutes showing work progress.
xii. Copies of any certificate of payments.
xiii. Valuation of works and materials by technical personnel and dully signed.
xiv. And any other document the committee may decide.
xv. Physical verification of the work allegedly done.

If any individual or firms purporting to have done any work or provided any services is proved otherwise, the matter will be reported to Kenya Ethics and Anticorruption Commission and legal proceedings will be instituted against them.

The probable liabilities pose various risks including but not limited to:-

a) Scaling down of development projects in the event Transition Authority recommends County Governments to settle them.
b) Necessitating budget revision once such liabilities are declared a responsibility of the County government. This may lead to a reduction in funding for some priority projects to provide for settling of the liabilities.
c) Creditors taking legal action in the event the debts they are claiming are not verified to their favour.

The county government recognizes that former local authorities were agents of the national government and once the liabilities are verified, it expects the national government to make provisions in its subsequent budgets to either pay the creditors directly or provide conditional grants to the County Government to settle the debts.

K. DEBT SUSTAINABILITY

The County Government recognizes the importance of managing debt prudently to avoid unwarranted debt burden to the future generation and reduce the risk of macroeconomic instability. The County Government will endeavor to have comprehensive, accurate and timely information on public debt. The County Government will enact legislation governing borrowing which is in line with PFM Act, 2012.

L. CONCLUSION

The 2015 MTDMS paper is a robust framework for prudent debt management. It provides a systematic approach to decision making on the appropriate action especially on the probable debts from the defunct local authorities, taking into account both cost and risk