THE COUNTY GOVERNMENT OF KITUI

KITUI COUNTY TREASURY

MEDIUM TERM DEBT MANAGEMENT STRATEGY PAPER

FEBRUARY 2016

Foreword

The Constitution of Kenya 2010 (CoK 2010) and the Public Finance Management Act, 2012, Section 123 requires each County to prepare and present to the County assembly on or before 28th February every year a Debt Management Strategy Paper. The 2016 Medium Term Debt Strategy paper (MTDMSP 2016) is the third Kitui County debt management strategy paper since the setting up of Kitui county government.

This paper 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. The County Government of Kitui 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. The County Government of Kitui debts and liabilities may arise from one or more of the following:

a) Loans
b) Staff emoluments/dues and related statutory deductions (PAYE, Pension, NHIF, Sacco dues)
c) Staff welfare schemes (Gratuity, pensions etc.)
d) Contract cost variations
e) Court orders and other 3rd party obligations
f) Leases and rental obligations
g) Contingent liabilities
h) Trade related disputes
i) Shortfall on budgeted revenues
j) Unforeseen professional charges (eg. legal fees).

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 in the County Government of Kitui is currently from the defunct four local authorities and the various devolved ministries that existed before the transfer of functions to counties. These are currently administered by the Transition Authority, which 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 and audited register of assets and liabilities to the Authority for advice and necessary action.

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Acknowledgements

This is the third Medium Term Debt Management Strategy (MTDMS) paper to be tabled in the Kitui County Assembly under the requirement of Public Finance Management (PFM) Act, 2012.

The MTDMS sets out the debt management strategy of County Government over the medium term with respect to actual and potential liabilities. As required under section 123 of 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 Kitui County. The County does not have any debts apart from the possible debts that might arise from the exercise being undertaken under the watch of the Transition Authority which is validating claims standing at Ksh.174 million related to the defunct Local Authorities. The correctness of these claims will be ascertained by a subcommittee established for the exercise by the Transition Authority through Gazette Notice no 45 of 2013 whose work is still in progress.

Let me take this opportunity to acknowledge the staff 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 - Enoch Nguthu – Deputy Chief Finance Officer, Fidhelis Mwaniki – Deputy Director, Festus Mulu - Assistant Director, and Nicholas Kitua - The County Transition Authority Coordinator for the part they played in developing the Strategy paper.

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List of Abbreviations

1.	MTDMS……………………..	Medium Term Debt Management Strategy
2.	CFSP………………………..	County Fiscal Strategy Paper
3.	PAYE……………………….	Pay As You Earn
4.	NHIF………………………..	National Hospital Insurance Fund
5.	PFM………………………..	Public Finance Management
6.	CRA………………………..	Commission for Revenue Allocation
7.	TA…………………………..	Transition Authority
8.	TDGA……………………….	Transition to Devolved Government Act
9.	PE………………………….	Personnel Emoluments
10	CA…………………………..	County Assembly

Definitions

i) County Government Debt

County Government debt, or borrowing, includes the contracting or guaranteeing of domestic and external (foreign) debt through loans, financial leasing, on-lending and any other type of borrowing, including concessional and non-concessional borrowing, whatever the source by the County.

Borrowing and debt of county entities would be included in the definition of total County government debt.

ii) Medium-Term Debt Management Strategy

Medium-Term Debt Management Strategy is a framework that the County government intends to use over the medium-term (five years) to ensure that debts are maintained at affordable and sustainable levels and that any new borrowing is for a good purpose whose associated borrowing costs and risks are minimized.

a) The legal basis for the publication of the Debt Management Strategy Paper

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

(1) On or before the 28thFebruary 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

- The total stock of debt as at the date of the statement;
- The sources of loans made to the county Government
- The principal risks associated with those loans;
- The assumptions underlying the debt management strategy; and
- 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) Objectivesof 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 of Kitui will strive to maintain a balanced budget to avoid incurring unnecessary debts.

c) Overview of the 2015 Debt Management Strategy Paper

The 2015 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:-

(i) Payment of salaries
(ii) Payment of County Suppliers (Merchants)
(iii) Prompt processing and submission of all related remittances i.e. PAYE, other statutory deductions and individual contributions.
(iv) Payment of utility and rental bills.

This was informed by the Debt Management Strategy Paper for 2015. During the period under review (2015) the recommendations were adhered as the County Government did not engage in any form of borrowing.

d) The 2016 Debt Management Strategy Paper

The 2016 MTDMS paper recommends that:-

(i) Fiscal discipline is installed, managed and sustained through ensuring that the entire budget of the County government is financed from:-

- Equitable share,
- Revenue raised locally,
- Donor Funds.

This will render the need to borrow at a minimum hence minimizing both cost and risk in the debt portfolio. The County Government of Kitui will continue to meet its financial obligations by ensuring:-

(i) Timely payment of salaries
(ii) Timely payment of supplies (Merchants)
(iii) Prompt processing and submission of remittances i.e. PAYE, other statutory deductions and other voluntary staff contributions
(iv) Timely payment of utility and rental bills in time
(v) Onlyclaims on professional services incurred in accordance with applicable laws are honoured
(vi) Adequate budgetary provisioning for legal and other professional fees

e)Scope

The 2016 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;

(i) The county government will continue observing fiscal discipline such that the entire budget is financed through revenues;

(ii) That in the medium term, the county government will achieve the projected revenue targets;

(iii) That both the county government and parties it enters into contract with will adhere to the specified contractual terms; and that

(iv) Debts from the defunct local authorities and devolved functions from various ministries, which are subject to verification by the Transition Authority, will not be treated as debts incurred by the County Government.

g) County Government Legal basis to borrow

The following legal provisions guide any borrowing by the counties:

Section 140 of PFM Act, 2012 provides that 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 (guarantee by the National Treasury and approval by the County Assembly)

(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.

ii) Further, Section 141 of PFM Act, 2012 states obligations and restrictions with respect to county borrowing as follows:

141 (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.

141(2) A County government may borrow money only in accordance with PFM Act, 2012, or any other legislation and shall not exceed the limit set by the county assembly.

141(3) A County government may borrow money in accordance with section 58 of the 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.

i) Section 142 empowers the County Assembly to authorize for short-term borrowing for cash flow management purposes only with any entity under the following conditions:
   (a) Any such borrowing may not exceed five percent of the most recent audited revenues of the entity.
   (b) 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.

Further, the 2016 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 Assemblies (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,

e) To ensure a seamless flow of payments between two financial periods.

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 of Kitui to manage her debts and liabilities are:-

i) Prudential Financial Management

The County will continue to employ prudent financial management in its operations to ensure that its lives within its revenue base as under:

a) The County will endeavor to finance its operations from its revenues
b) All foreseen expenditures will be budgeted for at expected market prices
c) Procurement of both goods and services will be at competitive prices through the employment of tenets and procedures as stipulated under the Public Procurement and Disposals Act.
d) All payments will be within legal deadlines to avoid both litigation costs and/or trade fines and penalties
e) Revenue enhancement strategies to be implemented to ensure that all budgeted revenues are collected.
f) Any contract/s requiring extra funding will be scrutinized by a technical committee and unnecessary costs removed from bill.

g) All bills and/or invoices submitted against the County Government of Kitui shall be validated for correctness and existence.

ii) Establishment and use of the Kitui County Emergency Fund

In the event that the County cash low does not allow for payments from revenues or circumstances exist that will result in debts that were otherwise unforeseen, the County will employ the following strategies:

a) Establish an Emergency Fund under the terms of Sections 110, 111 and 112 of the PFM Act, 2012. This Fund will be held with a local commercial bank.
b) Understand the nature of the debt and if an emergency, explore the utilization of the Emergency Fund as provided for under section (a) above.

ii) Short-term borrowing

Having exhausted the other strategies as contained under i) and ii) above, the County will, as stipulated under Section 143(1) of the PFM Act, The County Executive Committee member for finance or any person designated by the County Executive Committee member for finance in writing will enter into short-term borrowing with the Central bank of Kenya or any other lender within Kenya.

Such borrowing shall not exceed 5% of the latest audited revenues permitted under section 142 (2) of the PFM Act and shall be at terms and conditions conducive to the County.

Once obtained and utilized, the loan shall be paid in full immediately funds (read revenues) become available.

The security for such borrowing, if necessary, shall be as may be determined by the County Executive Committee member for finance as it is allowed under Section 144 of the PFM Act.

j) Total stock of Debts and sources of loans made to the County Government of Kitui

As at the date of the preparation of this Debt Management Strategy Paper, the County did not have debts or outstanding loans. However, there are probable debts emanating from the defunct local authorities was follows;

Category	Amount (Kshs)	Verification	Audited
The 4 Defunct local Authorities	174 Million	On going	No
Devolved functions of various Ministries	Not yet established	No	No

The County Sub-committee on verification and transfer of public assets and liabilities established by Transition Authority is still working on the same to ascertain the correctness of the amounts.

K) Analysis of Probable Debts

Section 123 (1) (e) of the PFM Act, 2012 requires a County Treasury to provide "An analysis of the sustainability of the amount of debt, both actual and potential". In the light of this, it is important to note that there are probable debts from the defunct local authorities currently amounting to Kshs 174 million. This is according to an unverified report to the Transition Authority which is the subject of a sub-committee on the transfer of assets and liabilities commissioned by the Transition Authority pursuant to Section 7(2) of the Transition to Devolved Governments Act 2012 which mandates the 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, through Legal Gazette notice No. 45 of 2013, set up a sub-committee to verify Public Assets and Liabilities. 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 for service delivery and not for settling pending bills. Any attempt to settle existing bills from current county budgets will result in delays or completely hindering the provision of services by the counties. The county governments expects the Transition Authority to advise accordingly once these liabilities are fully ascertained.

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

i. Evidence that the creditor was pre-qualified (prequalification of tenders)
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 applicant purporting to have done any works or provided any services is proved otherwise, the County Government will make an official report to the applicant stating the extent of the debt verified against the application.

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 rejected.

d) Legal fees emanating from the defense of any cases filed by complainant creditors.

Given the fact that the defunct local authorities were agents of the National government through the defunct Ministry of Local Government and County Governments established under the Constitution of Kenya 2010 are not the successors of the defunct local authorities, it is expected that once the liabilities verification exercise being undertaken by the Transition Authority is complete, the National Government will make provisions in its budgets to either pay the creditors directly or provide conditional grants to the County Government to settle the debts.

l) Debt Sustainability

The County Government recognizes the importance of managing debt prudently to avoid unwarranted debt burden to future generations 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.

m) Principle risks associated with short-term loans

This debt strategy paper focuses more on prudential financial management which includes the setting up of an Emergency Fund as the first option for the County when faced with unforeseen debts. Even the source of borrowing proposed is short-term in nature which should fully be paid for once funds become available.

This Medium Term Debt Management Strategy paper proposes that any short term borrowing be sourced from Central Bank of Kenya and the maximum borrowing is set at 5% of latest audited revenues of the county by the borrowing framework and at an interest rate to be agreed with the lender. The associated risks are;

- The short term borrowing is likely to attract high interest rates
- The risk of being unable to repay if the expected resources from the equitable share are not received as anticipated.

n) Conclusion

The 2016 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 use of public funds and probable debts emanating from the defunct local authorities or any new debts that the County could encounter, taking into account both cost and risk.