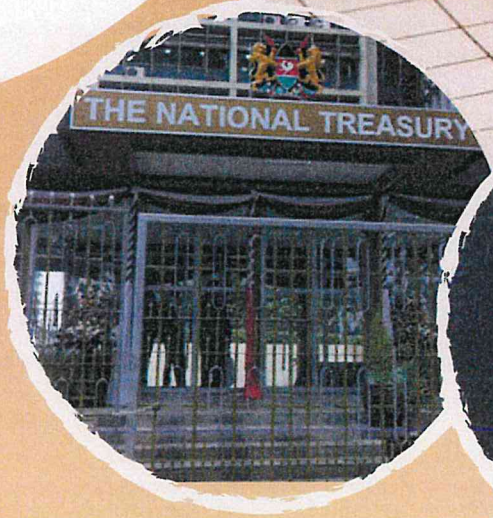
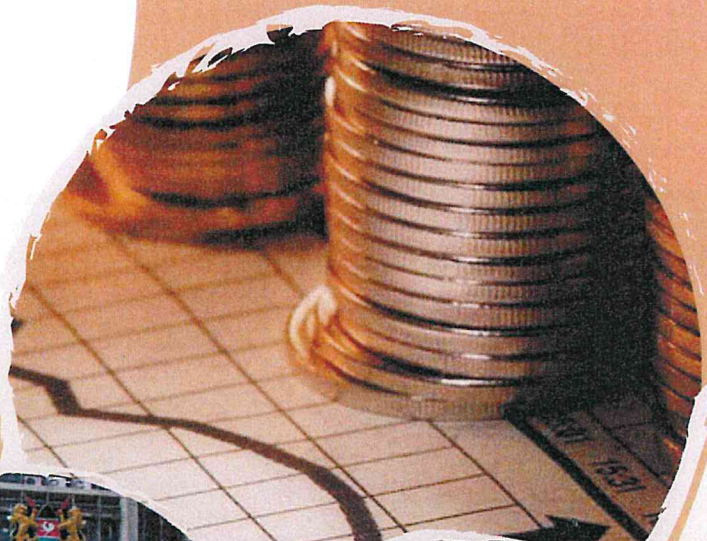




OFFICE OF THE AUDITOR-GENERAL
Enhancing Accountability

THE NATIONAL TREASURY
FEBRUARY 2017



**PERFORMANCE AUDIT REPORT ON
THE EFFECTIVENESS IN MANAGEMENT
OF PUBLIC DEBT IN KENYA**

Foreword by the Auditor –General

I am pleased to publish and publicize this performance audit report which assessed the effectiveness in Management of Public Debt by Directorate of Public Debt Management, National Treasury. My office carried out the audit under the mandate conferred to me by the Public Audit Act, 2015 Sec 36. The Act mandates the Office of the Auditor- General to examine the Economy, Efficiency and Effectiveness with which public money has been expended pursuant to the Article 229 of the Constitution.

Performance audits together with financial and continuous audits form the three pillar audit assurance framework that I have established to give focus to the varied and wide scope of the audit work done by my Office. The framework is intended to provide a high level of assurance to stakeholders that public resources are not only correctly disbursed, recorded and accounted for, but that the use of the resources results in positive impact on the lives of all Kenyans. The main goal of performance audits is to ensure effective use of public resources and promote services delivery to Kenyans.

The audit has a public finance management perspective on the importance of Effective Public Debt Management given the recent developments in the debt management in Kenya such as rising debt levels (from Kshs.1.89 trillion in June 2013 to Kshs 2.84 trillion in June 2015), issues of sovereign bonds, county borrowing and increase in debt ceiling. All these developments pose risk of debt sustainability which may result to debt crisis. The Constitution and the Public Finance Management Act (PFMA), provides the requisite framework to ensure that the Country continues with prudent debt management. The PFMA Section 62 has a provision for the National Treasury to establish a Public Debt Management Office (PDMO). The audit therefore assessed; establishment of PDMO, its performance, functionality and institutional arrangement as well as capacity to assess risks, and also the procedures, accountability and reporting requirements in place on public debt management for both National and County Governments since the adoption of these new legislative documents in achieving the Public Debt Management objectives. I am hopeful that corrective action will be taken in line with our recommendations in the report. The recommendations will contribute towards realization of Public Debt Management objectives as enshrined in PFMA Section 62 (3).

The report shall be tabled in Parliament in accordance with Article 229 (7) of the Constitution. I have as required in Section 36 (2) of the Public Audit Act, submitted the original copy of the report to Parliament. In addition, I have remitted copies of the report to the Cabinet Secretary and the Principal Secretary, National Treasury.



FCPA Edward R.O Ouko, CBS

AUDITOR-GENERAL

20th February, 2017

Table of Content

List of Tables	iii
List of Figures	iii
List of Acronyms and Abbreviations	iv
Executive Summary	v
Chapter 1	1
Background of the Audit.....	1
Introduction.....	1
Background on the Management of public Debt in Kenya	1
Motivation for the audit	2
Chapter 2	2
Design of the Audit	2
Objectives of the Audit.....	2
Scope of the Audit.....	2
Audit Assessment Criteria.....	2
Methods of Data collection	3
Chapter 3	4
Description of the Audit area.....	4
Legal Framework of Public Debt Management.....	4
Statutory mandate and role of the DPDM	4
Public Debt Management Office Objectives	4
Public Debt Management’s Institutional Framework.....	5
Organizational Arrangement of the PDMO.....	5
Process Description	5
Process for Procuring External Debt.....	5
Process for Sovereign Foreign Bond issue	5
Process of Borrowing from Commercial Banks.....	5
Process for Cash Management	6
Implementing Medium Term Management Debt Strategy (MTDS).....	6
Process for Domestic borrowing through Treasury Bills and Treasury Bonds	6
Debt Servicing Process	7
Chapter 4	9
Findings of the Audit.....	9
A. Organizational structures put in place to manage public debt are not adequately operationalized	9
Lack of quality system procedures for on-lending of the Public Debt	9

B. Directorate of Public Debt Management has not been adequately and sufficiently resourced to effectively manage Public Debt:.....	9
i) Understaffing and Skill Gap in Directorate of Public Debt Management.....	9
ii) Non establishment of the Office of the Registrar of National Government Securities	10
iii) Lack of task force on Contingent Liabilities	10
iv) Non Establishment of Sinking fund for loan redemption by the National Treasury	10
Chapter 5	11
Conclusions.....	11
Chapter 6	12
Recommendations.....	12
Annexures	13
Annexure 1: List of Documents Reviewed	13
Annexure 2: List of Officers Interviewed.....	13
Annexure 3: National Treasury Organisational Structure.....	14
Annexure 4: Front Office Workflow	15
Annexure 5: Back Office Workflow	16
Annexure 6: Duties not Performed by the appropriate offices	17
Annexure 7: Public Debt Management Office Staff Establishment.....	20
Annexure 8: National Treasury Response to audit findings and Recommendations	21

List of Tables

Table 1: Kenya's Growing Debt Portfolio	1
Table 2: Audit Policies and Procedures.....	5
Table 3: Provisions of the PFMA on Management of Public Debt in Kenya	7
Table 4: Non – performing on – lent loan portfolio.....	15

List of Figures

Figure 1: Graphical representation of Kenya's Growing Debt Portfolio	2
Figure 2: External Debt Servicing Process	12
Figure 3: Process of Domestic Debt Servicing.....	13

List of Acronyms and Abbreviations

CS	-	Cabinet Secretary
CS-DRMS	-	Commonwealth Secretariat-Debt Recording and Management System
DGIPE	-	Department of Government Investment and Public Enterprises
DMD	-	Debt Management Department
DPDM	-	Directorate of Public Debt Management
DPM	-	Directorate of Portfolio Management
DSA	-	Debt Sustainability Assessment
ERD	-	External Resources Department
INTOSAI	-	International Organization of Supreme Audit Institutions
ISSAIs	-	International Standards of Supreme Audit Institution
MEFMI	-	Macroeconomic and Financial Management Institute
MLF	-	Market Leaders Forum
NT	-	National Treasury
PA	-	Payment Advice
PADES	-	Payment Advice Data Entry System
PDMO	-	Public Debt Management Office
PFMA	-	Public Financial Management Act

EXECUTIVE SUMMARY

Background to the Audit

1. Kenya's public debt comprises of all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the National Government. Kenya's debt portfolio as at 30 June 2015 stood at Kshs. 2,843.69 billion (49.75% of the GDP). Therefore, the efficiency and effectiveness with which the management of public debt is done is a matter of national importance given its level. Furthermore, the debt portfolio has increased from Kshs. 1,229.41 billion in 2010 to Ksh. 2,843.69 billion in 2015 representing approximately 131% increase. Public debt is managed by Directorate of Public Debt Management (DPDM) under the National Treasury. The Directorate is organized into three (3) Technical Departments; Resource Mobilization (Front Office), Debt Policy, Strategy and Risk Management (Middle Office), and Debt Recording and Settlement (Back Office).

Why the effective public debt management in Kenya is important

2. The Constitution of Kenya provides that public debt is a charge on the Consolidated Fund while the regulation to the PFM Act recognizes the importance of prudent management of public debt through the guiding principles for National government borrowing. The prudent management of public debt through guiding principles is to avoid; instability of domestic financial markets, inter-generational inequity in the sharing of burdens and benefits of public borrowing, unsustainable debt levels for both levels of government coupled with high contingent liabilities through lack of objective criteria for evaluating National government entities or County government eligibility for National government debt guarantee and lack of prudence and equity in setting limits for debt stock levels for each County government. This can be attained through a well-established, specified and robust Public Debt Management Office (PDMO) and ensuring its operational efficiency.

What the Audit Examined

3. The objective of the audit was to assess whether the Parliament and National Treasury has put in place organizational structures to effectively manage the National government debt to ensure that;

i. There are organizational structures put in place that define clear roles and responsibilities in the management of National Government

Debt;

- ii. Medium Term Debt Management Strategy (MTDS) are developed and updated by Directorate of Public Debt Management (DPDM) to address the objectives set;
- iii. Directorate of Public Debt Management is resourced to effectively fulfil its obligations.

Scope of the Audit

4. The audit covered operations, activities and performance of DPDM for the period August 2010 to June, 2015. The audit focused on the effectiveness of the DPDM: clarity of roles and responsibility of the organizational structures of DPDM; development and update of MTDS and how it addresses the DPDM overall debt objectives and the extent at which DPDM has been resourced to effectively fulfil its obligations. The audit only focused on the National Government debt

Summary of Audit Findings

Lack of quality system procedures for on-lending

5. The National Treasury DPDM did not put in place quality system procedures, for on-lending. Document review and interview revealed that the Directorate of Portfolio Management (DPM)- Department of Investment and DPDM- Resource Mobilization Departments that are currently involved in on-lending do not coordinate their affairs with the other DPDM departments as mandated in achieving effective and efficient exchange of on-lending information.
6. The lack of quality systems for on-lent loans has resulted in a gap in the regular oversight by the DPDM on the performance of the on-lent loans. This has resulted to over 80% of the total on - lent loan portfolio of Kshs.196.8 billion as at 30 June, 2015 non - performing leading to outstanding arrears.

Understaffing and Skill Gap in Directorate of Public Debt Management

7. The National Treasury has not filled key positions including but not limited to; directors for middle and back office. Competitive opportunities have attracted exiting officers hence their departure and equally transfers of staff is allowed and openly done as a delegated responsibility by the NT. Since the key positions in DPDM are yet to be filled, the available limited number of staff perform front, middle and back office functions interchangeably leading to lack of segregation of duties within DPDM. The absence of proper segregation of

duties within these key divisions is likely to expose the Country to financial losses and damage to the reputation of the public debt managers through erroneous or fraudulent activities. The situation where the ICT section is being handled by one person may expose the public debt operations and management to greater operational risk of errors, delays in settlement of debt and fraud risks. This may grossly impacts on a country's credit worthiness.

Non establishment of the Office of the Registrar of National Government Securities

8. The National Treasury's DPDM did not establish the office of the Registrar of National Government Securities (RNGS) and the function of recording and publishing of all securities issued by or on behalf of the National Government. This is currently undertaken by the Central Bank of Kenya (CBK) which is not in tandem with the PFM Act. Further, it was not evident that the function of publicizing was being undertaken. The lack of a functioning RNGS could be attributed to the fact that the National Treasury has not fully operationalised the DPDM. This may result in lack of transparency and accountability of debt securities traded within the domestic debt market.

Lack of task force on Contingent Liabilities

9. Interview held at the Directorate of Public Debt Management – Department of Debt Policy, Strategy and Risk Management revealed that as at the time of the audit, the task force to establish the extent of contingent liabilities under the devolved Government system had not been established. However, the strategy did not specify the person or department to accomplish this task hence this may have led to the failure. Lack of determination of the extent of contingent liabilities within the counties' borrowing may lead to these devolved systems incurring substantial amounts of debt in addition to the liabilities that they inherited from defunct local authorities. This may in turn result into the risk of non – servicing of the borrowed funds hence their transfer to the National government. The ultimate effect would be increase in the National government's public debt portfolio requiring the citizens to forego other critical services which would otherwise be financed by the National government.

Non Establishment of Sinking fund for loan redemption by the National Treasury

10. Document review and interviews revealed that;
 - i. There is no sinking fund established for the redemption of Government securities issued by the National Government.

- ii. The National Treasury did not publish in the Kenya Gazette, the guidelines for the management of the fund as per the regulation to the PFMA, which was gazetted on 20 March 2015.

11. Lack of establishment of the sinking fund and publishing in Kenya gazette the guidelines for the management of the fund may result in poor cash management. This may lead to the government borrowing financial resources from other sources to service the already incurred public debt instead of using the acquired debt for development purposes. This was evidenced when the Government issued a debut USD 2 billion International Bond in June, 2014 and used USD 604.56 million (30%) to service a syndicated loan which was earlier procured.

Conclusions

12. The National Treasury has the mandate and resources to put in place systems and structures to effectively manage public debt, for economic development of a country. The Government of Kenya through Parliament has enacted the PFM Act 2012 and developed its regulations, which requires the National Treasury to put in place an organizational structure to be known as PDMO to manage the National government debt. The National Treasury's DPDM has defined clear roles and responsibilities in their quality systems procedures document. However, there is inadequate and insufficient resourcing of the DPDM which has led to understaffing and skill gap in the management of public debt in Kenya. This has led to defined activities and roles within the Front, Middle and Back Offices not performed as required leading to interchange of roles among the three offices. The Office also updates the MTDS but does not put in place measures and tools to monitor debt levels at State Corporations and Counties.

Recommendations

13. In view of the findings of the audit, the Auditor General has proposed the following recommendations for consideration by the Accounting Officer in the National Treasury; adequate resourcing of the DPDM, development of regulations on on-lending, establishment of the Office of RNGS and competitive appointment of the Registrar to the Office of the RNGS, establishment of sinking fund, and a task force to determine the level of contingent liabilities. The recommendations are detailed in chapter six of this report for consideration.

CHAPTER 1

Background of the Audit

Introduction

1.1 This audit assessed management of National government debt. The audit was conducted as mandated under Section 36(1) of the Public Audit Act, 2015¹ and a report prepared for tabling in Parliament as per Article 229 – Section 4(g) of the Constitution.² Public Debt in Kenya is managed by the DPDM in the National Treasury. The Central Bank of Kenya through an agency agreement assists in the raising of domestic debt.

Background on the Management of Public Debt in Kenya

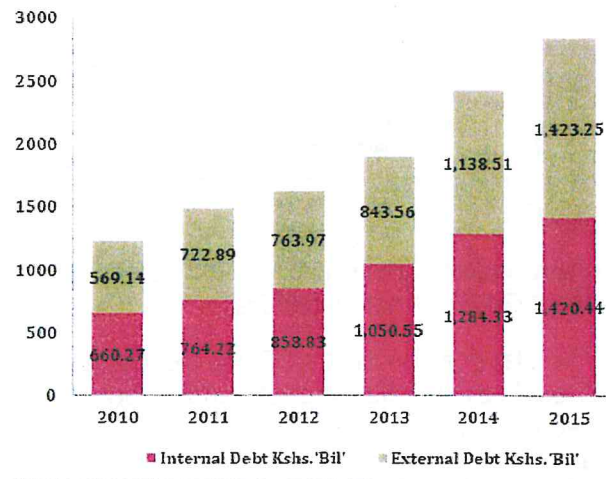
1.2 Kenya's public debt comprises of all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the National Government³. Kenya's debt portfolio as at 30 June, 2015 stood at Kshs. 2,843.69 billion⁴ and the debt portfolio has been on an increasing trend as can be shown in the table below.

Table 1: Kenya's Growing Debt Portfolio

Year	Internal Debt Kshs.'Bil- lion'	External Debt Kshs.'Bil- lion'	Total Debt Kshs.'Bil- lion'
2010	660.27	569.14	1,229.41
2011	764.22	722.89	1,487.11
2012	858.83	763.97	1,622.80
2013	1,050.55	843.56	1,894.11
2014	1,284.33	1,138.51	2,422.83
2015	1,420.44	1,423.25	2,843.69

Source: OAG Analysis of Annual Public Debt Management Reports

Figure 1: Graphical representation of Kenya's Growing Debt Portfolio



Source: OAG Analysis of Annual Public Debt Management Reports

1.3 PDMO's objectives are: to minimise the cost of public debt management and borrowing over the long-term taking account of risk; promote the development of the market institutions for Government debt securities; and to ensure the sharing of the benefits and costs of public debt between the current and future generations⁵.

1.4 The Constitution of Kenya Article 214(1) provides that public debt is a charge on the Consolidated Fund⁶. On the other hand, regulation to the PFM Act Section 183(1) recognizes the importance of prudent management of public debt through the guiding principles for National government borrowing. These include; stability of domestic financial markets, inter-generational equity in the sharing of burdens and benefits of public borrowing, determination of thresholds of borrowing rights for both levels of government, use of objective criteria for evaluating National government entities or County government eligibility for National government debt guarantee and prudence and equity in setting limits for debt stock levels for each County government. This can be attained through a well-established, specified and robust PDMO and ensuring its operational efficiency.

Information Technology Applications used for Debt Operations

1.5 The DPDM operates Commonwealth Secretariat Debt Recording and Management System (CSDRMS) and Payment Advise Data Entry System (PADES) for day to day processing of settling and recording public debt. CS-DRMS is the

1 The Public Audit Act, 2015, Section 36(1)
 2 Constitution of Kenya, Article 229 Section 4 (g)
 3 Constitution of Kenya Article 214(2)
 4 National Treasury Monthly Debt Bulletin – June, 2015

5 Public Finance Management Act 2012 section 62
 6 Constitution of Kenya, Article 214 (1)

information system where all debt information is recorded. It has CS-DRMS 2000+ software made up of a number of inter - related modules. PADES is an in house payment processing system which computerized the printing of the Payment Advise and generates electronic memos with listing of Payment Advises for exchequer issue requisition⁷.

Motivation for the audit

1.6 The Constitution, PFM Act and its regulations, provides the requisite framework to ensure that the Country continues with prudent debt management. The PFM Act Section 62 has a provision for the National Treasury to establish a PDMO⁸. There has been need therefore for an audit to determine its establishment, performance, functionality and institutional arrangement as well as capacity to assess risks. An audit is also required to find out whether strict procedures, accountability and reporting requirements on public debt management have been laid down for both National and County Governments since the adoption of these new legislative documents.

1.7 There have been recent developments in the debt management in Kenya including the first successful issuance of debut USD 2 billion International sovereign bond on 24th June, 2014⁹. The issue comprised of USD 500 million at a coupon rate of 5.875 percent with a five year maturity and USD 1,500 million at a coupon rate of 6.857 per cent with a ten year maturity. There is also an anticipated increase in demand for explicit guarantees as the Country implements a devolved system of governance under the Constitution of Kenya, 2010, which requires that in order to borrow, County governments must be issued with a National Government guarantee¹⁰. Further, the National public debt shall not exceed 50 percent of Gross Domestic Product in net present value terms¹¹. All these developments pose risk of debt sustainability, there is need therefore to assess the institutional strength in management of debt.

1.8 It is against this background that the Office of the Auditor General decided to undertake an independent assessment of the effectiveness and performance of the Public Debt Management in Kenya to ascertain whether the public debt management objectives were being achieved.

CHAPTER 2

Design of the Audit

Objectives of the Audit

2

2.1 The audit sought to assess whether Government has put in place organizational structures to effectively manage the National government debt. The specific audit objectives were to;

- i. Assess whether there are organizational structures put in place that define clear roles and responsibilities in the management of National Government Debt;
- ii. Establish whether the Medium Term Debt Management Strategies are developed and updated by Directorate of Public Debt Management to address the objectives set;
- iii. Find out the extent at which the Directorate of Public Debt Management is resourced to effectively fulfill its obligations.

Scope of the Audit

2.2 The audit examined the operations, activities and performance of DPDM for the period August 2010 to May 2015. The audit focused on the effectiveness of the DPDM: clarity of roles and responsibility of the organizational structures of DPDM; development and update of MTDS and how it addresses the DPDM overall debt objectives and the extent at which DPDM has been resourced to effectively fulfill its obligations. The audit only focused on the National Government debt.

Audit Assessment Criteria

2.3 The audit criteria were drawn from the Constitution of Kenya, PFMA 2012 and its regulations, Central Bank of Kenya Act, Cap. 491 2009, DPDM debt Operational Manual, National Treasury circulars, and good practices (MEFMI Public Debt Management Procedures Manual and Debt Management Performance Assessment Tool). Therefore, the public debt management was assessed in relation to:

- i. DPDM organizational structural arrangement, roles and responsibilities in accordance with its organizational structure, DPDM operational manual.
- ii. DPDM provision of resources and skills to manage debt in accordance with PFMA 2012.
- iii. The systems that should be in place to coordinate debt management activities are

7 Ministry of Finance Back Office Operational Manual page 1-11

8 Public Finance Management Act 2012 section 62

9 Annual Public debt report

10 Constitution of Kenya, Article 212 (a)

11 Regulation to the PFMA part III (Fiscal Strategy and Macro Economic Framework) Section 26 (1) (c)

stipulated in Debt Management Department's Operations Manual Section 3.4 and 3.5 and CBK Act Cap 491 Section 32.

- iv. Head of the PDMD to administer the fund and utilise its proceeds for the payment of expenses of, or incidental to, redemption of an issue of Government securities. As indicated in the PFM Act regulation part Section 206(1) and (2)

Methods of Data collection

2.4 The audit was conducted in accordance with Performance Audit Guidelines set by INTOSAI standards: 3000, 3100, 5410 and 5440, INTOSAI Development Institute course guidelines on Audit Process for Public Debt Audit and the Office of the Auditor General audit policies and procedures.

Table 2: Audit Policies and Procedures

No	Guidelines	Reference
1	IDI course guidelines, ISSAI 5410, Public Audit Act, 2015	Audit Process for Public Debt Audit.
2	ISSAI's 3000, 3100	Guidelines for performance auditing standards based on INTOSAI Auditing standards and practical's
3	ISSAI'S 5400	Guidelines in auditing Public Debt, use Substantive Audit Test in Public Debt Audits, Auditing Public Debt Institutional Arrangements and capacity, Information System Risks
4	ISSAI 5410, ISSAI 5440, ISSAI 5411	Public Debt Audit Procedures, Planning and conducting, Debt Indicators
5	The Office of the Auditor General-Kenya	Audit policies and procedure especially Report writing format as provided for the Performance Audit Manual

OAG Analysis of the ISSAIs and Audit Manual

2.5 Document review, interviews and observation were used to gather audit evidence.

- i. To gain information on the DPDM's mandate, objectives and functions, we reviewed the PFM Act, Sec 62-65; and regulation to the PFM Act.
- ii. To understand the DPDM's institutional

arrangement, stakeholders, day to day roles and operations, we reviewed the DPDM Manual, CBK operations manual, Executive order number 2/2013 on debt management organization and administrative structure circular.

- iii. To gain insight on the public debt composition and borrowing trends from the period August, 2010 to 2015 in Kenya, we reviewed annual Public Debt Management Reports for the Financial years 2010/11 to 2014/2015, MTDS, 2012, Budget Statements and OAG Audit Reports covering the same period.
- iv. To understand the legal framework applied in the management of public debt in Kenya, we reviewed the documents listed in **Annexure 1**
- v. To gain insight on the DPDM's status, performance, emerging issues or challenges faced; we conducted interviews and administered questionnaires to key departmental personnel at the DPDM. A list of the officers interviewed is in **Annexure 2**.

CHAPTER 3

Description of the Audit area

Legal Framework of Public Debt Management

3

3.1 PFM Act 2012 and its regulations are the key legislations with regard to public debt management in Kenya. They clarify the authority to borrow and to issue new debt instruments. The provisions on the legal framework related to public debt management are listed in **Table 3** below.

Table 3: Provisions of the PFMA on Management of Public Debt in Kenya

Section	Provisions
49	Authority for borrowing by national government
50	Obligations and restrictions on government guaranteeing and borrowing
51	Borrowing by national government entities
52	Persons authorized to execute loan documents at national government
53	Issuance of securities by national government
55	Establishment of the office of Registrar of national government securities
56	Power of national government to enter into derivative transactions
58	Power of Cabinet Secretary to guarantee loans
59	Reporting on loan guarantees to the Parliament by the Cabinet Secretary
62	Establishment and objectives of the Public Debt Management Office
63	Functions of the Public Debt Management Office
64	Role of Cabinet Secretary in Public Debt Management Office
140 – 146	Relates to borrowing by County governments

Source: OAG Analysis of the PFMA

3.2 The PFM Act and its regulations also define the relationship with the Legislature and the Executive in terms of reporting and authorization process, the rules and regulations coordinating all the actors involved with public debt management, the PDMO's responsibilities and the procedures manuals, and job descriptions for each one of the participating bodies and its officers.

Statutory mandate and role of the DPDM

3.3 The management of public debt is a national Government function. DPDM derives its mandate from the PFM Act, Section 62(1), which provides for the establishment of PDMO under the National Treasury. Further PFM Act, Section 63 mandates PDMO to perform the following functions:

- i. Carry out the government's debt management policy of minimizing its financing cost over the long-term taking account of risk;
- ii. Maintain a reliable debt data base for all loans taken by the National government, County governments and their entities including other loans guaranteed by the national government;
- iii. Prepare and update the annual MTDS including debt sustainability analysis;
- iv. Prepare and implement the national government borrowing plan including servicing of outstanding debts;
- v. Act as the principal in the issuance of Government debt securities on behalf of the National Treasury;
- vi. Monitor and evaluate all borrowing and debt-related transactions to ensure that they are within the guidelines and risk parameters of the debt management strategy; Process the issuing of loan guarantees including assessment and management of risks in national government guarantees; and
- vii. Transacting in derivative financial instruments in accordance with best international practices benchmarked to the debt management offices of other governments that are internationally respected for their practices ¹².

Public Debt Management Office Objectives

3.4 The PFM Act section 62(3) created a PDMO under the National Treasury to manage public debt with the following objectives;

- i. Minimizing cost of public debt management and borrowing over the long-term taking account of risk;

¹² Public Finance Management Act 2012 section 62 & 63

- ii. Promoting the development of the market institutions for Government debt securities; and
- iii. Ensuring the sharing of the benefits and costs of public debt between the current and future generations.¹³

Public Debt Management's Institutional Framework

3.5 The PSC through a letter reference Number PSC/2/1 dated 19th August, 2014 approved the National Treasury organisation structure with the following substantive directorates: Public Debt Management; Portfolio Management; Budget, Fiscal and Economic Affairs; Administrative Services ; and Accounting Services. Further, the National Treasury through internal memo dated 3rd October, 2014 implemented the Public Service Commission structure by appointing the heads of the five directorates as per **Annexure 3**.

Organizational Arrangement of the PDMO

3.6 The PFMA provides for the establishment of a fully-fledged PDMO under the National Treasury. The Office is to have 3 technical departments namely; Front, Middle and Back Offices.

- i. The Front Office has the responsibility of mobilizing funding for Government including contracting loans and issuing guarantees as detailed in **Annexure 4**.
- ii. The Middle Office undertakes analytical functions that enable government to meet its financing needs and its debt service obligations at the lowest possible cost with a prudent degree of risk exposure.
- iii. The Back Office performs the following; maintains the database of the debt portfolio, confirms debt settlements and payments and report on debt as detailed in **Annexure 5**. Further, the Issuance of government debt securities is done by the Central Bank of Kenya on behalf of the National Treasury.

Process Description

Process for Procuring External Debt

3.7 Resource Mobilization Department (Front Office) of the DPDM sends draft loan proposal with request for determination of loan concession to Debt Management Department (Debt Policy, Strategy and Risk Management). The proposed loan amount in Kenya shilling is added to the current disbursed outstanding debt stock in the CS-DRMS to determine whether the new

stock would exceed the ceiling approved by Parliament. If loan is concessional and is within the stock ceiling, then the Resource Mobilization Department is advised to finalize negotiations and signing.¹⁴

Process for Sovereign Foreign Bond issue

3.8 The Principal Secretary of the National Treasury or Director General- Directorate of Budget, Fiscal and Economic Affairs officially communicates the decision to borrow through bond issuance to Director General - DPDM. The Principal Secretary then sets a bond transaction task force comprising of appropriate technical officers and Evaluation Committee to select winning bidders for both the Lead Counsel and Lead Managers.

3.9 Pre-launch phase involves; confirmation of international and domestic Legal Counsel and joint Lead Managers. Mandate letter is signed, discussions made on documentation process, structure and terms and due diligence. Offering Circular is drafted giving details on Kenya description and risk factors, terms and conditions, local taxation and selling restrictions. The final Offering Circular incorporating views of due diligence meetings and Lead Managers is circulated before launch.

3.10 Final Transaction Documents are then prepared after review comments and legal opinions from all counsels. The bond is then marketed through investor presentations and road shows and then the transaction structure discussed with Rating Agencies to get confirmation of the rating from them.

3.11 The last stages involve the sale launch and closing of sale. The sale launch involves the launch and book building including announcement of the transaction, pricing, allocation, confirmation of final terms and sign the subscription agreement while closing of sale includes signing of documentation and final Offering Circular and Settlement/Closing: fulfillment of conditions precedent and official listing.¹⁵

Process of Borrowing from Commercial Banks

3.12 The Principal Secretary in National Treasury officially communicates the decision to borrow from local and/or international commercial banks to the Director General, DPDM. A loan transaction task force is then constituted and an Expression of Interest is sent out to eligible banks. Due diligence is then carried out to

¹³ Public Finance Management Act 2012 section 62(3)

¹⁴ Debt Management Directorate Quality Systems Procedures Manual for National Treasury – Page 8

¹⁵ Debt Management Directorate Quality Systems Procedures Manual for National Treasury – Page 10 & 11

establish whether applicants are liquid and shortlisted banks to form syndicate. After this, authority to negotiate is sought from Ministerial Tender Committee as lending terms are negotiated and authority to sign obtained from Ministerial Tendering Committee. The agreement is signed and DPDM then seeks request for disbursements.¹⁶

Process for Cash Management

3.13 Resource Mobilization Department under the DPDM and the Directorate of Accounting Services within the National Treasury provide monthly or weekly projected external and domestic debt service figures for the Consolidated Funds Services annual budget. The Resource Mobilization Department, Directorate of Accounting Services and CBK participate in the weekly cash management technical committee meetings to decide on domestic borrowing plan to adopt for the financial year. The Resource Mobilization Department (Front Office) then tables a report on cumulative performance of government securities.¹⁷

Implementing Medium Term Management Debt Strategy (MTDS)

3.14 The Front Office implements the debt strategy drawn by the Middle Office by providing input in the design and annual review of the Debt Sustainability Analysis and the Debt Strategy, recommending the terms of contracting of external loans to Resource Mobilization Department. On Domestic borrowing, the Front Office ensures the implementation of the recommended policies and the borrowing mix¹⁸.

Process for Domestic borrowing through Treasury Bills and Treasury Bonds

3.15 The Resource Mobilization Department (front office) participates in the Market Leaders Forum once a month during the first week of the month to provide the National Treasury and CBK with market sentiments and appetite for Government securities. A representative from Resource Mobilization Department (front office) of the DPDM attends the Bills Auction Committee meetings at the CBK meeting to determine the amounts and interest rate cut-off points and ratify and acknowledge the borrowing by the government. After the cut – off price is decided

and the results agreed upon, a summary sheet is signed by the Governor, Deputy Governor, representative of the DPDM at the CBK and the DPDM representative.

3.16 The officer who attends the auction committee meeting scans the signed copy and forwards to all other DPDM Staff for information. The officer then updates the tables on Government's domestic borrowing through Treasury Bills and Bonds. The updated tables' track domestic borrowing showing their performance at a specific target and the cumulative borrowing position verses the target. Weekly bulletin brief are then prepared for the Principal Secretary and a copy for the Accountant General and the Economic Secretary.

16 Debt Management Directorate Quality Systems Procedures Manual for National Treasury – Page 14 & 15

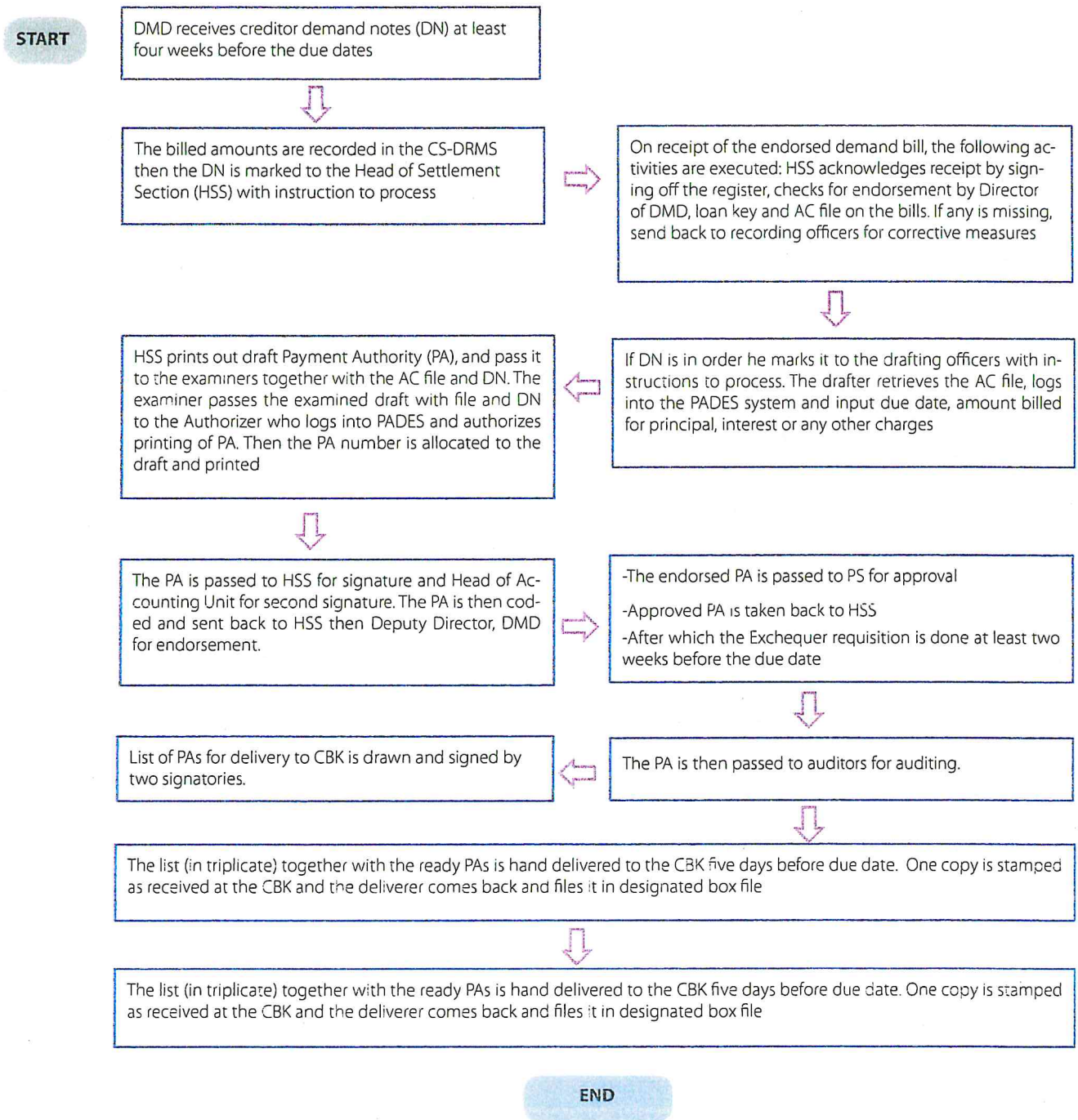
17 Debt Management Directorate Quality Systems Procedures page 19

18 Debt Management Directorate Quality Systems Procedures page 10-19

Debt Servicing Process

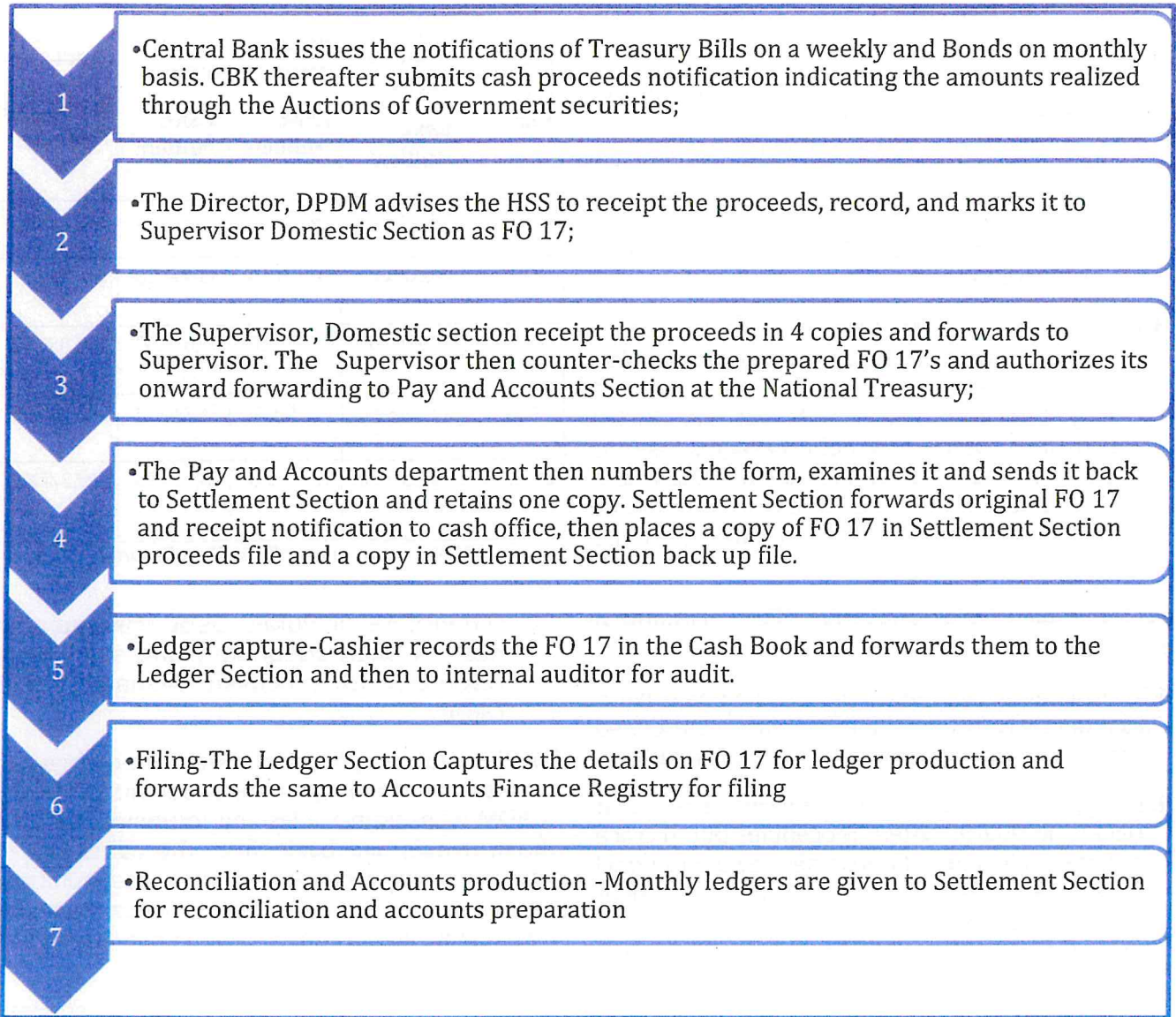
3.17 The process for servicing debt external and domestic debts is as shown in the following figures ;

Figure 2: External Debt Servicing Process



Source: OAG Analysis of the DPDM Procedures Manual

Figure 3: Process of Domestic Debt Servicing



Source: OAG Analysis of the DPDM Procedures Manual

Findings of the Audit

4

4.1 Audit of effectiveness in the management of Public debt in Kenya was done for the period August 2010 to 2015. The observations made include:

A. Organizational structures put in place to manage public debt are not adequately operationalized

4.2 The audit revealed that some of the policy documents which are supposed to operationalise the public debt management objectives and strategies as enshrined in PFM Act Sec (61-64) and in clarity define how debt managers need to operate with their counterparts such as Department of Investment in the Directorate of Portfolio Management, Central Bank of Kenya were yet to be operational.

Lack of quality system procedures for on-lending of the Public Debt

4.3 National Government should lend money only in accordance with terms and conditions prescribed by the regulations approved by the Parliament¹⁹.

4.4 Document review and interviews reveal that there is no quality system procedures put in place to guide on-lending of public debt by the National Government. This has resulted in the Department of Investments (in the Directorate of Portfolio Management) and the Resource Mobilization Department (in the DPDM), currently involved in on-lending not coordinating their affairs with other departments within the DPDM (Debt Policy Strategy and Risk Management department and Debt Recording and Settlement Department) as mandated in achieving effective and efficient exchange of on-lending information.

4.5 The lack of quality system procedures especially for on-lent loans has resulted in a gap in the regular oversight by the DPDM on the performance of the on-lent loans. This has resulted to continuous growth of outstanding on – lent loans as shown in **Table 4**. The balance of the outstanding loan amount was standing at Kshs 217,577.80 million as at 30th June 2014.

Financial Year	Out Standing Loans KShs. 'Million'	Principal Arears KShs. 'Million'	Accrued Interest KShs. 'Million'	Total KShs. 'Million'
2009/10	42,876.10	14,522.20	33,415.40	90,813.70
2010/11	46,666.00	14,781.10	33,491.20	94,938.30
2011/12	87,976.90	16,257.60	39,616.60	143,851.10
2012/13	166,939.60	12,300.00	24,221.20	203,460.80
2013/14	181,287.30	12,136.60	24,153.90	217,577.80

Source: OAG Analysis of Annual Public Debt Reports

B. Directorate of Public Debt Management has not been adequately and sufficiently resourced to effectively manage Public Debt:

4.6 The audit revealed that there were policies put in place that underpins the establishment of the DPDM with distinct roles and responsibilities of a front, middle and back office. The adherence to these policies requires adequate and sufficient resources to effectively manage public debt. This was highlighted by the following observations;

i) Understaffing and Skill Gap in Directorate of Public Debt Management

4.7 The PFM Act 2012 Section 64(1)(c) provides that the Cabinet Secretary to the National Treasury is to ensure that the PDMO has the resources and skills to manage the debt and borrowing according to the international best practices²⁰. In addition, the National Treasury under its Strategic Plan (2012-2017), planned to strengthen national debt management, by establishing and making operational the PDMO's front, middle and back offices.

4.8 Document review and interviews revealed existing vacant positions within DPDM as per internal memo reference number MOF/CONF/HRM/2/02 of 3 October, 2014 and Public Service commission circular reference number PSC/2/1 of 19/8/2014 respectively. It was noted that key senior positions are yet to be filled as per the authorized establishment and as shown in **Annexure 7**. Further, the ICT section within the back office

19 PFM Act, Section 57

20 PFM Act Section 64 (c)

runs the CS-DRMS that allows for external debt recording, analysis and generating debt forecast and reports. They also run the Payment Advice Data Entry System which provides for day to day settling and recording of debt. This section is being handled by one person.²¹

4.9 The National Treasury has not filled key positions including but not limited to; directors for middle and back office. Competitive opportunities have attracted exiting officers hence their departure and equally transfers of staff is allowed and openly done as a delegated responsibility by the National Treasury. Since the key positions in DPDM are yet to be filled, the available limited number of staff perform front, middle and back office functions interchangeably leading to lack of segregation of duties within DPDM. The absence of proper segregation of duties within these key divisions is likely to expose the country to financial losses and damage to the reputation of the public debt managers through erroneous or fraudulent activities. The situation where the ICT section is being handled by one person may expose the public debt operations and management to greater operational risk of errors, delays in settlement of debt and fraud risks. This may grossly impact on a country's credit worthiness.

ii) **Non establishment of the Office of the Registrar of National Government Securities**

4.10 The PFM Act, 2012 Section 55 provides for the establishment of an Office of the Registrar National Government Securities under the PDMO, headed by a Registrar competitively recruited and appointed by the Cabinet Secretary of National Treasury. The Registrar of the National Government Securities is to establish and maintain a register of the National Government Securities where the details of all securities issued by or on behalf of the National Government are to be recorded; and publish and publicize securities issued by or on behalf of the National Government.

4.11 The audit noted the aforementioned Office does not exist within the DPDM, and the function of recording and publishing is currently undertaken by the Central Bank of Kenya which is not in tandem with the PFM Act. Further, it was not evident that the function of publicizing was being undertaken²². The lack of a functioning office of the Registrar of National Government Securities could be attributed to the fact that the National Treasury has not fully operationalised the PDMO. This may result in lack of transparency

and accountability of debt securities within the domestic debt market.

iii) **Lack of task force on Contingent Liabilities**

4.12 Article 212 of the constitution and Section 140 of the PFM Act provide for the authority for County governments to borrow. These documents further indicate that County governments may borrow only if the National government guarantees the loan; this therefore makes borrowing by these governments contingent liabilities to the National government. According to the MTDS of 2014, a task force was to be set up to establish the extent of contingent liabilities under the devolved government system.

4.13 Interviews conducted with the officers at the DPDM- Debt Policy Strategy and Risk Management Department revealed that as at the time of the audit, the task force had not been established. However, MTDS of 2014 did not specify the person or department to accomplish this task hence this may have led to the failure.

4.14 Lack of determination of the extent of contingent liabilities within the Counties' borrowing may lead to these devolved systems incurring substantial amounts of debt in addition to the liabilities that they inherited from defunct local authorities. This may in turn result into the risk of non – servicing of the borrowed funds hence their transfer to the National government. The ultimate effect would be increase in the National government's public debt portfolio requiring the citizens to forego other critical services which would otherwise be financed by the National government.

iv) **Non Establishment of Sinking fund for loan redemption by the National Treasury**

4.15 The PFM Act, 2012 Section 50 (8) and regulations to the Act Section 206(1) provides for the establishment of a National Government Sinking fund. Further the regulations to the Act Section 206(1) and (2) provides the Head of the PDMO to administer the fund and utilise its proceeds for the payment of expenses of, or incidental to, redemption of an issue of Government securities. In addition the regulations to Act Section (3) provide that the Cabinet Secretary shall upon approval of the regulations publish in the Kenya Gazette the guidelines for the management of fund as per section 206(3) of regulations to PFM Act.

21 Interviews question number 22

22 PSC/2/1 Organizational Structure National Treasury

4.16 Document review and interviews revealed that;

- i. There is no sinking fund established for the redemption of Government securities issued by the National Government.
- ii. The National Treasury did not publish in the Kenya Gazette, the guidelines for the management of the fund as per section 206 (3) of the regulation to the PFMA, which was gazetted on 20 March 2015.

4.17 Lack of establishment of the sinking fund and publishing in Kenya gazette the guidelines for the management of the fund may result in poor cash management . This may lead to the government borrowing financial resources from other sources to service the already incurred public debt instead of using the acquired debt for development purposes. This was evidenced when the Government issued a debut USD 2 billion International Bond in June, 2014 and used USD 604.56 million (30%) to service a syndicated loan which was earlier procured.

CHAPTER 5

Conclusions

5

5.1 The National Treasury has the mandate and resources to put in place systems and structures to effectively manage public debt, for economic development of a Country. The Government of Kenya through Parliament has enacted the PFM Act 2012 and developed its regulations, which requires the National Treasury to put in place an organizational structure (PDMO) to manage the national government debt.

5.2 As revealed by audit findings through an internal memo MOF/CONF/HRM/2/02/G/78, the National Treasury has established a directorate known as the Directorate of Public Debt Management (with the Front, Middle and Back Offices) and not known as the Public Debt Management Office as required by the PFM Act . Further, the National Treasury has not operationalized the PFM Act regulations relating to management of public debt.

5.3 The DPDM has defined clear roles and responsibilities in their quality systems procedures document. However, the defined activities and roles within the Front, Middle and Back Offices are not performed as required leading to interchange of roles among the three offices and therefore weak internal controls.

5.4 The DPDM develops and updates the MTDS. However, it was established that the directorate has not put in place measures and tools to monitor debt levels at state corporations and Counties.

5.5 There is inadequate and insufficient resources to DPDM which has led to understaffing and skill gap in the management of public debt in Kenya.

CHAPTER 6

Recommendations

6

6.1 In view of the findings of the audit, the Auditor- General has proposed the following recommendations for consideration by the Accounting Officer in the National Treasury;

To ensure regular oversight of performance of the on – lent loans by the DPDM through documented systems and procedures

6.2 The National Treasury to develop regulations on on-lending so as to ensure regular oversight of performance of the on – lent loans by the Directorate of Portfolio Management.

To strengthen the internal controls of Directorate of Public Debt Management;

- i. The National Treasury should competitively recruit and fill the key vacant positions within the Directorate of Public Debt Management as per the staff establishment.
- ii. The Cabinet Secretary of National Treasury to ensure;
 - That the head of Registrar of National Government Securities is competitively recruited as required by the PFMA, and
 - The deployment of ICT staff to Debt Recording and Settlement (Back Office) to enhance segregation of duties especially in the ICT section of the Directorate of Public Debt Management.

To ensure adequacy, transparency, accountability and monitoring of domestic debt and trading of domestic market the Cabinet Secretary of National treasury should;

6.3 Fast – track the establishment of the Office of Registrar, National Government securities and competitively appoint the Registrar to maintain the details of all securities issued by or on behalf of the National Government.

To ensure that contingent liabilities does not rise to levels that result in unsustainable public debt the National Treasury should;

6.4 Establish a task force to determine the level of contingent liabilities and put in place measures to ensure that the contingent liabilities do not result in unsustainable public debt.

To encourage borrowing for development project the Cabinet Secretary National Treasury should;

6.5 Set up a sinking fund for the payment of expenses of, or incidental to redemption of government securities, and redemption of Government Securities issued by the national government

ANNEXURES

Annexure 1: List of Documents Reviewed

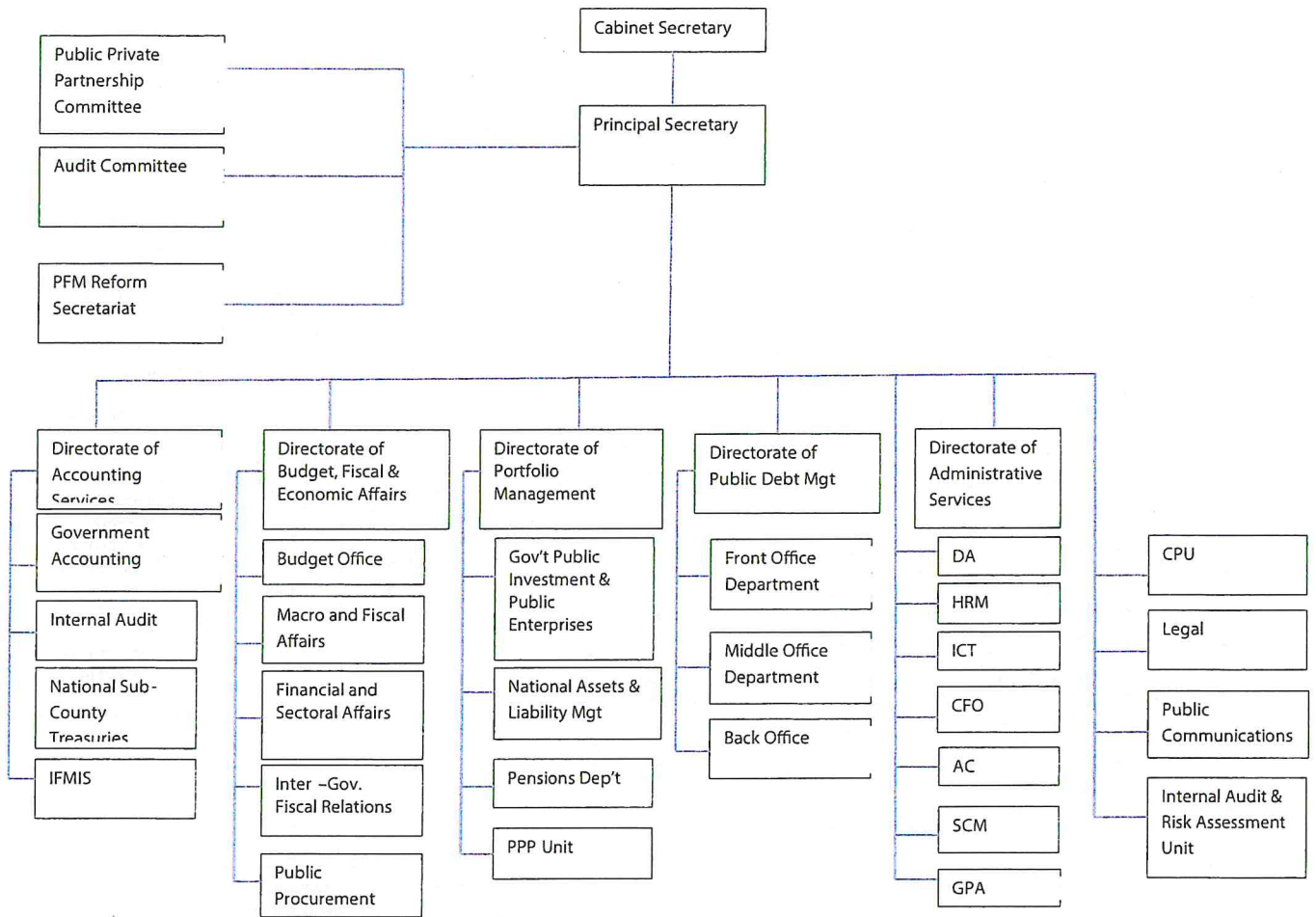
To understand the legal framework applied in the management of public debt in Kenya, the following documents were reviewed;

No.	Document Reviewed
1	Constitution of Kenya Articles 186(4), 262(7,15(1));
2	Service Delivery Charter for the National Treasury;
3	The National Treasury's Strategic Plan; 2012 - 2017
4	Annual Public debt reports for financial years 2010/11 – 2013/14
5	Annual Public debt audit reports for financial years 2010/11 – 2012/13
6	Standard Operating Procedures manuals for Front, Middle and Back Offices in Public Debt Departments;
7	Medium Term Debt Management Strategies for Financial Years 2010/11 to 2014/15;
8	Market institutions for government debt securities development policy document;
9	Budgetary provisions, staff capacity rationalization reports,;
10	Policy documents and monitoring reports by DPDM (DMD, ERD and DGPE) covering the period under scope

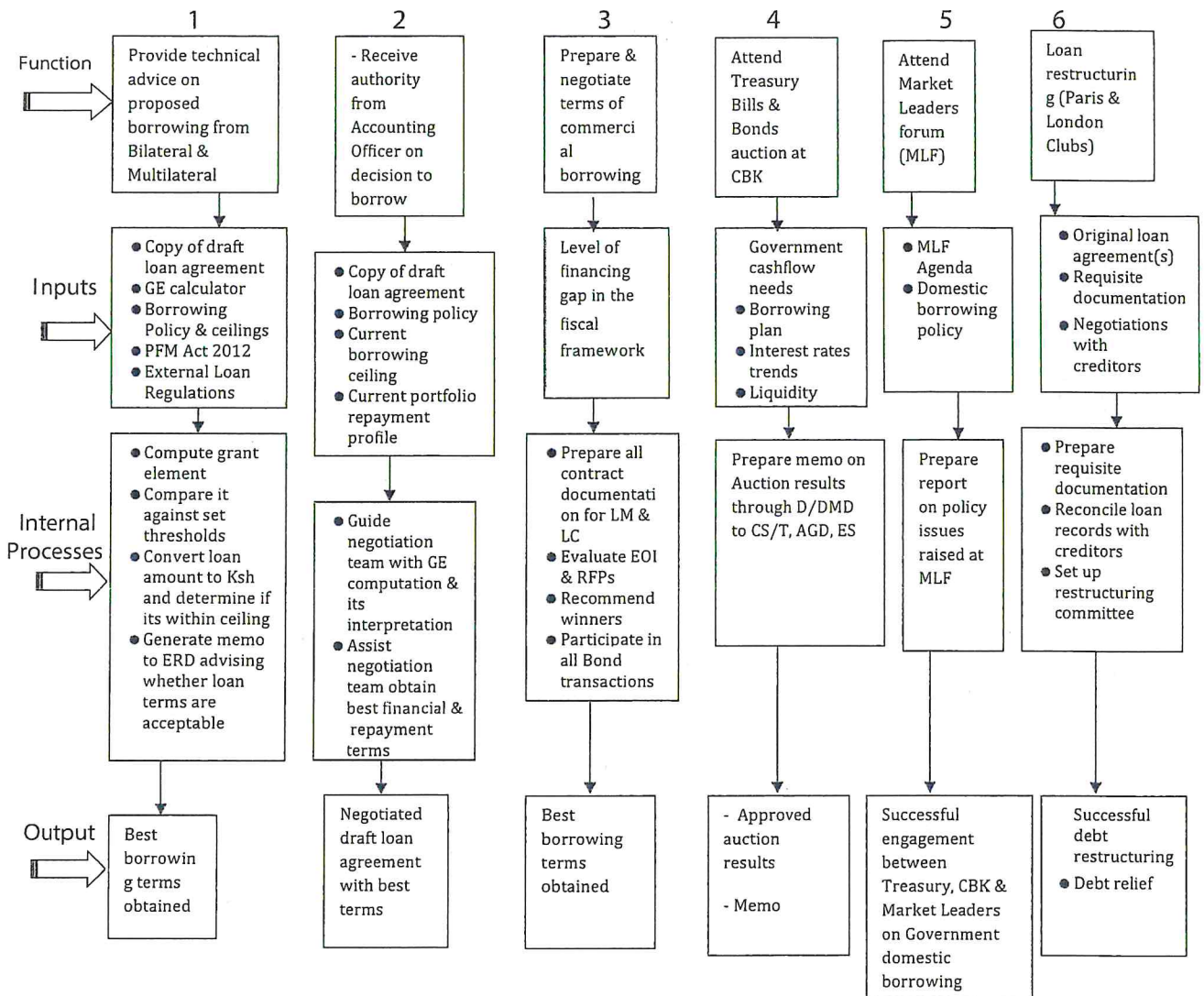
Annexure 2: List of Officers Interviewed

Date	Office and Staff interviewed	Purpose of the interview
11.8.14	Assistant Director DMD&DMD Economists	To obtain an understanding and clarification of the functions and operations of the DMD
12.8.14	Head of Department of Debt CBK	To obtain an understanding and clarification of the functions and operations of the CBK on Debt management
19.5.15	Senior Assistant Director Debt Management	To obtain information on DPDM implementation status and performance
04.6.15	Acting Assistant Director Debt Management	To obtain information on DPDM implementation status and performance
22.5.15	Assistant Director ICT	To obtain information on DPDM implementation status and performance
18.5.15	Senior Economist II	To obtain information on DPDM implementation status and performance
26.5.15	Economists	To obtain information on DPDM implementation status and performance
26.5.15	Economists I	To obtain information on DPDM implementation status and performance
5.6.15	Chief Accountant	To obtain information on DPDM implementation status and performance
18.5.15	Chief Accountant	To obtain information on DPDM implementation status and performance
18.5.15	Senior Accountant	To obtain information on DPDM implementation status and performance

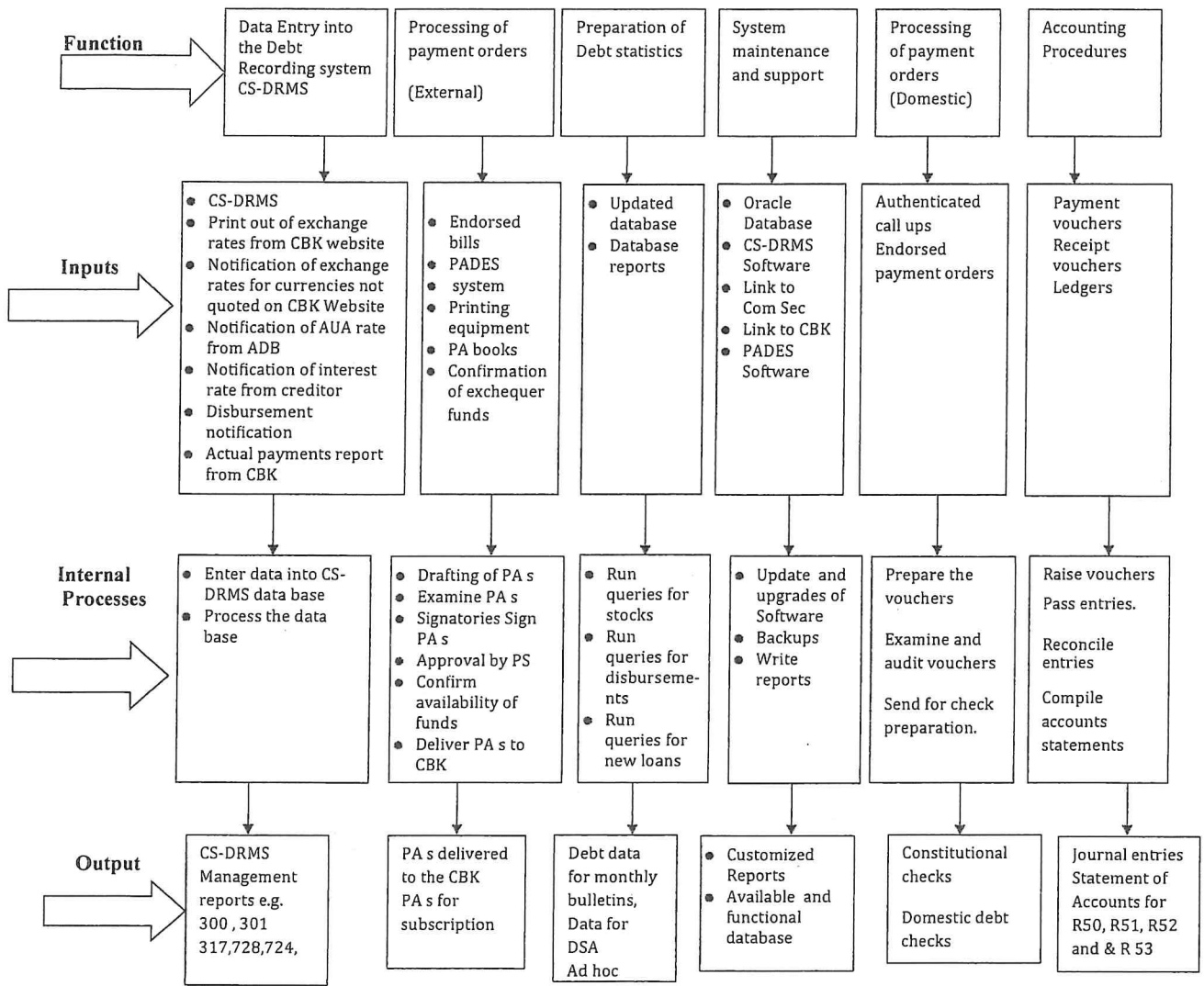
Annexure 3: National Treasury Organisational Structure



Annexure 4: Front Office Workflow



Annexure 5: Back Office Workflow



Annexure 6:Duties not Performed by the appropriate offices

ACTIVITIES OF PUBLIC DEBT MANAGEMENT AND OFFICES CURRENTLY PERFORMING		
DPDM Office	Roles and Responsibilities as per MEFMI/ DPDM Procedures Manuals	Office Currently performing it
Front Office	Implement the borrowing plan based on the strategy approved by the government.	DMD-ERD implements domestic and commercial debt borrowing while ERD implements External Debt borrowing plan
	Mobilize resources from external and domestic sources based on the country's borrowing strategy;	ERD/DMD-External resource mobilization CBK with DMD on behalf of Treasury-Domestic debt mobilization
	Process applications for government guarantees, issue guarantees and conclude agreements with borrowers and creditors;	DMD
	Clearing house for requests for information from/to donors/creditors, International financial institutions, commercial banks e.t.c	ERD/DMD
	Implement strategies that minimize costs and risks of debt management including hedging and derivative	DMD- it implements the external and domestic debt
	Ensure conformity with the legal and regulatory framework during borrowing	ERD/DMD(Domestic Debt and External Debt
	Interact with funding sources; markets, investors, credit rating agencies and International creditors	DMD- for both domestic debt and Commercial External Debt ERD- for external Non/Concessional sources
	Periodic reports of the country's debt and risk management strategies, funding needs and development priorities.	DMD-Periodic reports of the country's debt and risk management strategies ERD- funding needs and development priorities.
	Evaluation of funding alternatives	ERD/DMD
	Identification of potential creditors	ERD/ DMD
	Selection of negotiating Team	ERD- Concessional Borrowing and DMD- Commercial
	Collect and update information on creditor practices and policies	

Middle Office	Determining borrowing ceilings for government consistent with fiscal and monetary policy requirements.	DMD- External
	Formulating of debt strategy	DMD
	Providing reliable medium and long-term forecasts of debt servicing and interest income that feed into fiscal forecasts;	DMD
	Monitoring unplanned debt requirements;	
	Performing adjustments to borrowing plans in the course of fiscal year based on budget monitoring outcomes and fiscal policy adjustments;	DMD
	Estimating of effects of changes in interest rates and exchange rate on debt service;	
	Undertaking frequent portfolio analysis to assess future debt service obligations and problems and propose action that should be taken to overcome them;	DMD
	Preparing debt sustainability analysis to assess the long-term sustainability of projected borrowing levels;	World Bank in conjunction with DMD
	Assessing external vulnerability using debt and reserves adequacy indicators;	DMD
	Recommending policy changes in debt management.	DMD
	Providing inputs on public debt to periodic economic and financial reports and data for presentation to Cabinet as well as Parliament.	DMD
	Coordinating with Ministry of Finance and Central Bank for effective debt management.	DMD
	Designing benchmarks or reference debt portfolios that reflect the countries debt strategy in order to guide the Front Office in its funding and hedging operations. Such benchmarks include the currency composition of debt, interest rate structure, duration etc	DMD/CBK
	Identifying and quantifying exposures related to contingent liabilities including designing strategies that will allow effective management of these exposures or risks.	DMD
	Implementing the risk control, compliance and performance monitoring of the Front Office	
	Making recommendations for debt restructuring as and when necessary.	DMD
	DEBT ANALYSIS;	
	a). Instrument analysis	DMD
	b). Portfolio Analysis	DMD

Back Office	EXTERNAL DEBT section of on external debt back office operations will include the following aspects: recording, disbursements and repayment procedures, reporting and performance standards and indicators	Resource mobilization department does part of disbursement functions while the Back office of Debt Management Department does settlement and database base maintenance of commonwealth secretariat Debt Recording and management System. DMD-records disbursements based on Disbursement statements from Creditors.
	Manage debt information systems and maintain an accurate and up-to-date loan database.	Back Office Debt Management Department (DMD)
	Prepare debt service forecasts for external and domestic borrowing of the public sector as an input to the balance of payments forecasts and for total government borrowing as an input to the expenditure estimates of the fiscal budget.	DMD-Middle Office
	Reconcile all debt transactions with stakeholders. Ensure timely and accurate debt service for public and publicly guaranteed debt.	DMD
	Monitor the implementation of loan agreements, including disbursements, utilization of loan funds and other obligations of government.	ERD
	Monitor disbursements and repayments of loan guarantees.	DMD/DGIPE
	Monitor disbursements of on-lending agreements.	DGIPE
	Monitor all contingent liabilities and ensure that adequate loan loss provisions are made in the budget to meet likely defaults;	DMD
	Prepare forecasts of government cash requirements to provide guidance on the volume and timing of issuance of debt by government.	
	Validate debt data regularly	DMD-Back Office
	Prepare statistical and management reports	DMD
	Coordinate with the Front Office so that the recording and monitoring of new financing is done in a timely manner.	DMD/ERD

Source: Interviews

Annexure 7: Public Debt Management Office Staff Establishment

Position	Proposed Establish- ment	In-post	Understaffed as per pro- posed structure
Front Office(ERD)-Resource Mobilization			
Director	1	1	0
Senior Deputy Director	1	1	0
Deputy Director	3	4	1
Senior Assistant Director/Deputy Chief Economist	4	2	2
Assistant Director/Principal Economist	5	3	2
Principal DPDM/Senior Economists	4	6	(2)
Senior DPDM	4	4	0
DPDM II/I	7	7	0
Sub-Total Technical Staff	28	28	0
Secretarial Staff	5	16	(11)
Total Front Office	33	44	(12)
Middle Office(Formerly ERD/DMD Payment Unit-Debt Recording and Settlement Department			
Director	1	0	1
Senior Deputy Director	1	1	0
Deputy Director	2	0	2
Principal DPDM	2	1	1
Senior DPDM/Principal Economist	6	2	4
DPDM II/I/Economist	8	6	2
Sub Total Technical officers	20	10	10
Secretarial Staff	3	3	0
Driver	1	1	0
Clerical officer	2	3	(1)
Support Staff	1	4	(3)
Sub-Total Other Staff	7	11	(4)
Total Middle Office	27	21	6
Back Office(Formerly ERD Disbursement Unit and DMD Payment Unit)-Debt Recording and Settlement Department			
Director	1	0	1
Senior Deputy Director	1	0	1
Deputy Director	2	0	2
Senior Assistant Director	2	0	2
Assistant Director	2	1	1
Principal/Chief/Senior DPDM/DPDM II	13	15	(2)
Sub-Total Technical Officers	21	16	5
Secretarial Services	2	0	2
Clerical Staff	2	2	0
Support	1	1	0
Sub Total Other Officers	5	3	2
Total	26	19	7

Source: The National Treasury Strategic Plan

Annexure 8: National Treasury Response to audit findings

No	Audit Finding	Response to the Audit Findings
5-7	It was established that there is no appointed agent, though there is a draft agency contract meant to provide details on rules of engagement. Further, Central Bank of Kenya is still informally engaged as an agent.	The Central Bank of Kenya has been acting informally as the fiscal agent of the National Treasury, providing technical advice and undertaking administrative functions for the management of domestic debt. On 19th February, 2016 appointment of DPDM Fiscal Agent was formalized through a signed Service Level (Agency) Agreement between the Central Bank of Kenya and the National Treasury (copy of agreement given). The formal appointment of CBK is expected to improve coordination, transparency, accountability and monitoring of domestic debt issuance and in secondary trading.
8	It was noted that there is no quality system procedures put in place to guide on-lending of public debt management by the National Treasury	<p>DPDM has noted the audit findings and is putting in place a process to improve the on-lending procedures in tandem with the Directorate of Government Investment & Public Enterprise to ensure adequate oversight and the efficient and effective exchange of on-lending information. The measures include;</p> <ul style="list-style-type: none"> i. Working closely with the Directorate of Accounting Services to collect on-lending information on public entities for monitoring purposes; ii. Using the same information from the Directorate of Accounting Services to gain the requisite visibility of contingent liabilities arising from Public Entities. This improvement of its oversight function will be further enhanced by the deployment of staff to its newly created Risk Management Unit.
9-10	Public Service Commission has not filled key positions including but not limited to; directors for middle and back office. Competitive opportunities have attracted exiting officers hence their departure and equally transfers of staff is allowed and openly done as a delegated responsibility by the National Treasury.	<p>DPDM does have staffing gaps. The restructuring of the National Treasury to conform to the requirements of the PFM Act is currently underway. The Public Debt Management Office is now a full Directorate within the National Treasury and is headed by the Director General and structured into Front, Middle and Back Office.</p> <p>The Director General is already in place and competitive recruitment of the Directors and other staff is also underway in consultation with the Public Service Commission. It is noteworthy that although the current staff establishment is lean, debt management processes and procedure put in place have been improved over the years to ensure no fraudulent activities can occur through detailed operational manuals</p>

11-12	The audit noted the Registrar of the National Government Securities does not exist within the DPDM, and the function of recording and publishing is currently undertaken by the Central Bank of Kenya which is not in tandem with the PFM Act. Further, it was not evident that the function of publicizing was being undertaken.	It is acknowledged that Section 55 of the PFM Act provides for the establishment of the Office of Registrar of Government Securities under the DPDM. The National Government Securities register is currently managed by the CBK as part of the fiscal agency function under the recently signed Agency Agreement (see section 8.1). It is expected that the DPDM will take over this function once it has adequate capacity after the completion of the ongoing operationalization of the DPDM structure and strategy in 18 months. The Cabinet Secretary will thereafter competitively recruit the Registrar.
13	It was established that the task force on contingent liabilities had not been established.	<p>In deed, the Medium Term Debt Management Strategy, 2014 envisaged the formation of a taskforce by the National Treasury to conduct a study on the total contingent liabilities arising from devolved Government and State Corporations. Under the new DPDM structure, a Risk Management Unit has been formed to assess and review the matter of contingent liabilities across government.</p> <p>A constituent Sub-Unit within it – the Fiscal Commitment and Contingent Liabilities (FCCL) Unit has already been operating with a focus primarily directed at Public Private Partnership Projects, and is therefore already developing the requisite skill set to carry out this function.</p>
14	The audit noted that there is no sinking fund established for the redemption of Government securities issued by the National Government.	<p>It is acknowledged that section 50(8) of the PFM Act and Regulations to the Act Section 206 provide for the establishment of a sinking fund. The Regulations also provide for the gazettelement of the guidelines for the management of the same as noted. The National Treasury has every intention of complying with all legislation. The current operationalization of the DPDM is the first and main step has taken towards this goal.</p> <p>The National Treasury envisages establishing a sinking fund within the wider context of managing risks associated with the maturities of external and domestic debt and contingent liabilities in line with the international best practice. The assertions that the non-establishment of a sinking fund led to the borrowing of US\$2 billion sovereign bond in June 2014 to service a syndicated loan of US\$604.56 million is materially inaccurate. The Sovereign Bond was issued with one of its stated principal objectives being to pay off the maturing syndicated loan. This is entirely in order and in line with its fiduciary duty to manage government finances prudently, efficiently and effectively to minimize borrowing cost and with a view to inter-generational equity in all borrowings. This was clearly stated in the Expression of Interest (EOI) and the Bond proceeds was therefore planned and not incidental. It is worth noting that, at the time of issuing the sovereign bond, PFM regulations had not yet been approved by Parliament. They were gazetted on 20th March, 2015.</p>

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