KISII COUNTY GOVERNMENT

FINANCE AND ECONOMIC PLANNING DEPARTMENT

COUNTY DEBT MANAGEMENT STRATEGY PAPER

FOR FINANCIAL YEAR 2022/2023

OCTOBER, 2021

FOREW0RD

The preparation of this Debt Management Strategy Paper (DMSP) marks an important step in the budget making cycle. The strategy framework outlines the County Government intentions to achieve the optimal debt portfolio. The 2022 DMSP has been prepared against the background of the global Covid-19 health pandemic which has strained the County's resources.

The 2022 DMSP has been prepared in line with the provisions of Section 123 of the Public Finance Management Act (PFM Act) 2012 which outlines refinancing measures necessary to reduce the costs and risks involved in the management of debts. The strategy considers existing stock of debt and potential financing strategies.

The DMSP is aimed at ensuring that County debt is managed to sustainable levels through an in-depth analysis of the existing debt level, associated risks and strategies to address its management and sustainability. This will only be realized if fiscal prudence is ensured in the management of county's resources and more emphasis laid on operational efficiency. This will go a long way in ensuring that the financing needs and payment obligations of the County are met at the lowest possible cost and guaranteed debt sustainability.

The practice of reviewing on regular basis the County debt is a clear demonstration of the County Government commitment to promoting transparency and accountability in the County debt management. The DMSP 2022 is aimed at outlining strategies to address the payment challenges of the unpaid sums to contractors and suppliers.

Moses Onderi

County Ececutive Committee Member, Finance and Economic Planning

ACKNOWLEDGEMENT

As a requirement of Public Finance Management Act 2012, this Debt Management Strategy Paper provides guidelines and strategies on how the County Government intends to prudently manage its actual and potential debt over the medium term.

It is worth noting that the preparation of DMSP is a relatively technical process because of inadequate and quality input data and thus determining an appropriate tool from which we can reliably determine an optimal debt management strategy. To ensure wide circulation of the DMSP we shall upload the same into our official website.

I would like to acknowledge the immense contributions of staff from Finance and Economic Planning department led by the Director Budget who were involved in the preparation of the 2022 DMSP.

Zablon Ongori
Chief Officer, Economic Planning

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 a 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 assumption 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 the Intergovernmental Budget and Economic Council.

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LIST OF ABBREVIATION

CFSP	County Fiscal Strategy Paper
CIDP	County Integrated Development Plan
DMSP	Debt Management Strategy Paper
FY	Financial Year
IFMIS	Integrated Financial Management Information System
KCG	Kisii County Government
KHS	Kenya Shillings
PFMA	Public Finance Management Act

EXECUTIVE SUMMARY

The County government's accumulation of expenditures arrears is one of the major challenges in Public Financial Management (PFM). By government debts it refers to the financial obligations incurred by any level of the public entity for which remain unpaid when due. The overdue payments may be caused by particular legal obligation (such as payment of social security benefits, or salaries), specific contractual commitment (such as payment for the construction of a workshop in a vocational centre), or a continuing arrangement (such as payment for water bills).

In the current era, debt still remains one of the major economic policy issues facing County Governments. The Kisii County Government debt has been rising steadily since the inception of devolution. The County Government's debt portfolio comprises of mainly money owed to various contractors and suppliers of goods and services.

Given that these debts date as early as 2014/15 financial year and have been accumulating with time, they have impacted negatively on the ability of the County Government to undertake development projects and also deliver services effectively. At the same time, this scenario not only creates a bad image of the county government but also put the county government into conflict with the service providers who have rendered service to the county but have not been paid. This Debt Management Strategy Paper (DMSP) provides strategies and financing options to address the debt issues in the County.

The strategy is structured into four sections where each section highlights a specific segment of the paper.Section one gives the background information, the objectives of Debt Management Strategy Paper, scope and status of the county debt.

Section Two discusses key assumptions and potential financing sources. Section Three provides the proposed strategies in 2022 DMSP while Section Four provides conclusions and recommendations.

SECTION ONE

1.0 BACKGROUND INFORMATION

The legal framework as provided for in the Constitution and the Public Finance Management Act requires the County Governments to disclose specific fiscal risks with potentially significant impact on the county economic environment, and to prudently manage such risks. In particular, Article 225 of the Constitution read together with Section 96 of the PFM Act gives the Cabinet Secretary responsible for Finance powers to stop any transfer of funds to a County Government whenever such County Government is in persistent material breach of its obligations or failure by County Governments to make payments as and when due, or default on financial obligations may indicate material breach of legally established measures.

The County Government has been facing the challenge of the growth of debt portfolio which affects service delivery to the County residents and hence there is need for a robust debt management strategy in conformity with the Public Finance Management Act (PFMA). DMSP provides the direction in which the County Government intends to meet its financial obligations during the period.

1.1 OBJECTIVES OF THE DEBT MANAGEMENT IN KISII COUNTY

The present County Debt Management Strategy Paper for 2022/2023 sets out the Kisii County Government's objectives, strategies and plans for the management of its debts. The paper aims at ensuring the County debt is managed to sustainable levels as the County Government implements the outlined strategies in this paper. The paper further aims at servicing the existing debt portfolio in the County so as to inject resources to the County economy for service delivery.

1.2 SCOPE

The scope for coverage of the County debt portfolio includes the debt contracted by the Kisii County government between the Financial Year 2014/15 and 2020/21.Time horizon of DMSP is 2022/2023.The starting point of the analysis is the debt portfolio as at 31st October 2021.

1.3. STATUS OF THE COUNTY DEBT

The Kisii County Overall debt as at 31st December 2021 stood at KShs **488,163,421** majorly comprising of unpaid suppliers and contractors across the County Government departments. Table 1 indicates a summary of outstanding debts as at 31st October 2021 for both development and recurrent department wise.

Table **1: Pending Bills by Department (KShs Millions) as at 31st October 2021.**

KISII COUNTY GOVERNMENT			
SUMMARY OF PENDING BILLS AS AT 31ST OCTOBER 2021			
DEPARTMENT	DEVELOPMENT	RECURRENT	TOTAL
ADMINISTRATION AND STAKEHOLDER MANAGEMNT	15,696,054	54,030,705	69,726,759
TRADE , TOURISM AND INDUSTRY	40,590,289	14,709,320	55,299,609
ENERGY, WATER, ENVIRONMENT AND NATURAL RESOURCES	26,570,930	18,980,128	45,551,058
AGRICULTURE, LIVESTOCK, FISHERIES AND COOPERATIE DEVELOPMENT	31,841,529	777,980	32,619,509
LANDS, PHYSICAL PLANNING AND URBAN DEVELOPMENT	30,622,292	1,182,544	31,804,836
COUNTY EXECUTIVE	0	21,284,874	21,284,874
HEALTH SERVICES	627,396	618,688	1,246,084
CULTURE, YOUTH, SPORTS AND SOCIAL SERVICES	37,093,632	7,861,934	44,955,566
FINANCE AND ECONOMIC PLANNING	1,768,726	69,072,846	70,841,572
ROADS , PUBLIC WORKS AND HOUSING	48,739,163	3,041,609	51,780,772
KISII MUNICIPALITY	41,872,551	1,832,970	43,705,521
EDUCATION, LABOUR AND MANPOWER DEVELOPMENT	19,347,261	0	19,347,261
TOTAL	**294,769,823**	**193,393,598**	**488,163,421**

The County Debt as at 31st October, 2021 was KShs 488,163,421 comprising of both development and recurrent expenditures across the County departments compared to the County

Debt of KShs 765,729,392 in the same period last year. This is a clear indication that the County government is determined to bring its debt to manageable levels. Departments with the highest debt as at 31st October 2021 are, Finance and Economic Planning KShs 70,841,572, Administration and Stakeholder Management KShs 69,726,760 and Trade, Tourism and Industry KShs 55,299,609 respectively.

The departments with the lowest debts are Health Services, KShs 1, 246,084, Education, Labour and Manpower Development KShs 19,347,261 and County Executive KShs 21,284,874 respectively.

SECTION TWO

2.0 KEY ASSUMPTIONS, RISKS AND POTENTIAL FINANCING SOURCES

2.1 Key Assumptions

Kisii County's economic growth prospects for the FY 2022/23 and over the medium term will largely be influenced by the national growth prospects, the emerging global and national challenges posed by COVID-19, 2022 general election and the County internal risks. In this respect, Kenya's economic growth in 2021 is estimated at **6.0** percent reflecting recovery due to reopening after the closure associated with the COVID-19 pandemic. The easing of the containment measures in 2021 has led to increased economic activities which has resulted to increase of Own Source Revenue in the first quarter of FY 2021/2022 when compared to the first quarter of FY 2020/21. OSR is, therefore, estimated to grow to KShs 450 million in FY 2022/23 and register positive growth over the medium term.

Looking ahead, economic growth is projected to slow down to 5.5 percent in 2022 (due to in part the uncertainty associated with the 2022 general elections) and recover to 6.1 percent by 2024. The anticipated August, 2022 election activities are likely to have an effect on domestic revenue since most markets are likely to be used for political rallies, therefore affecting business and in turn revenue collection. In addition, most people, especially boda boda operators are likely to default on stickers as many of them will be engaged in political campaigns.

2.2 Risks

Risks from the global economies relate to persistence of the COVID-19 pandemic and required lockdowns, voluntary social distancing and its effect on consumption, the ability of laid off workers securing employment in other sectors, rising operating cost to make workplaces more hygienic and safer, reconfiguration of disrupted global supply chains, extent of cross-border spillovers occasioned by weaker external demand and funding shortfalls.

On the domestic front, risks will emanate from low economic activities due to COVID-19 containment measures. In addition, the economy will continue to be exposed to risks arising from public expenditure pressures, particularly wage related recurrent expenditures and the erratic weather-related shocks that could have a negative impact on agricultural output leading to low production that could reduce income.

The County Government is continually monitoring these risks and taking appropriate measures to strengthen resilience in the economy. To cushion the county against the downsides of the risks, the County Government has prepared the Post COVID-19 Recovery Strategy to protect the lives and livelihoods of the residents. Implementation of the County priorities will unlock better growth, and positively impact on the lives of people through jobs creation and poverty reduction.

2.3 Potential Financial Sources

In line with the Constitution and the Public Finance Management (PFM) Act of 2012, the principle of sharing the burdens and benefits of the use of resources and public borrowing between the present and future generation implies that we have to make prudent policy decisions today so that we do not impose an unwarranted debt burden on future generations. Adherence to the ratio of development to recurrent expenditures of at least 30:70 over the medium term, as set out in the PFM Act is crucial and statutory leaving little resources to debt servicing. The preferred source of financing in the County remains our own revenues in view of the cost and risk of other sources of financing.

The other potential financing sources include:

i) Engineering Procurement and Construction

This is where the contractor finances the projects and the county contributes in kind for things like land.

ii) Borrowing from, the money and capital markets

The county will pursue to engage in public private partnerships to finance projects. The process is very rigorous and requires approval from the National Treasury.

SECTION THREE

3.0 PROPOSED STRATEGIES in the 2022 DMSP

During the implementation period of this DMSP, the County government will resort to the following debt reduction strategies in its endeavor to bring debts to manageable levels.

Strategy 1: Verification of arrears: To boost validity and reduction of fraudulent claims, the available data will be verified by the internal audit department of the County or an appointed pending bills committee to undertake verification.

Strategy 2: Prioritise allocation for pending bills: Budgetary allocation on the pending vote will be prioritised and the same decentralised to all departments. This will enable all departments to pay their pending bills promptly.

Strategy 3: Repayment Plan: The County government will during the period come up with a detailed, realistic repayment plan, which will be adopted / approved in clearing the pending bills.

Strategy 4: Enhancing credibility and realism of the budget: On of the first steps in addressing a persistent arrears problem in the County is to strengthen the realism of the annual budget. This will depend on robust assumptions and forecasts in the fiscal framework, which determines the budget. Local revenues will be realistic and in tandem with the expenditure. The County will enhance revenue collection while setting up realistic targets. This will help address the pending bills issues given that in the past, one of the causes of increased pending bills have been unrealistic revenue projections that encourage procurement of goods and services beyond the County's ability to finance payments.

Strategy 5: Strengthening commitment controls: Commitment controls are part of the internal control system, which should prevent the County from initiating expenditure without available budget and cash. IFMIS as an efficient tool of financial management shall enforce commitment control to ensure that expenditure incurred in a financial year is in tandem with the budget. In this way, the rising pending bills will be contained.

Strategy 6: Strengthening legal and regulatory framework: The legal or related regulations should clearly define payment terms (and when a payment is in arrears); reporting requirements; controls at the budget authorization, commitment, and payment stages; and the sanctions associated with any breach of those provisions. In this regard, the County Treasury will draft a payment guideline that will prioritize payment based on urgency, availability of funds and the age of the payment.

SECTION FOUR

4.0 CONCLUSIONS AND RECOMMENDATIONS

The following conclusions and recommendations have been outlined in this Debt Management Strategy Paper;

4.1 CONCLUSION

The 2022 DMSP is a robust framework for prudent debt management. It provides a systematic approach to decision making on the appropriate composition of debt finance taking into account both cost and risk.

The Kisii County Government (KCG) current debt level is sustainable and therefore, it is imperative that the County Government continues to implement prudent debt management practices.

4.2 RECOMMENDATIONS

The following recommendations have been proposed in this Debt Management Strategy;

1. **Availability of information on the reporting of debt management strategies and operations:** Materially important aspects of debt management operations should be publicly disclosed. The County Assembly and the members of public should be informed through an annual report on the context in which debt management operates and in the outcomes of the debt management strategy.
2. Accountability and assurances of integrity by the department responsible for debt management: Debt management activities should be audited annually by external auditors. In addition, there should be regular internal audits of debt management activities, and of systems and control procedures.
3. Staff involved in debt management should be subjected to a code-of-conduct and conflict of interest rules regarding the management of their personal financial affairs: This will help to allay concerns that staff's personal financial interests may undermine sound debt management practices.
4. Debt management activities should be supported by an accurate and comprehensive management information system with proper standards:

   There is need to give priority to developing accurate debts, recording and reporting systems. This will not only be useful for proper debt updates and ensuring timely payment of debt service, but/and also for improving the quality of budgetary reporting and the transparency of County government financial reports.