

THE NATIONAL ASSEMBLY

DATE: 01 AUG 2023

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OFFICE OF THE AUDITOR-GENERAL
Enhancing Accountability

PERFORMANCE AUDIT REPORT OF THE
AUDITOR-GENERAL ON
DEFICIT FINANCING OPERATIONS
BY
THE NATIONAL TREASURY

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Hon Naomi Wago MP
Deputy Majority Whip
Wagah Mwale

REVENUE

EXPENDITURE

JULY 2023

VISION

Making a Difference in The Lives and Livelihoods of the Kenyan People

MISSION

Audit Services that Impact on Effective and Sustainable Service Delivery

CORE VALUES

Integrity

Credibility

Relevance

Accountability

Independence

MOTTO

Enhancing Accountability

FOREWORD BY THE AUDITOR-GENERAL

I am pleased to present this Performance Audit Report on Deficit Financing Operations by The National Treasury. My Office carried out the audit under the mandate conferred on me by Section 36 of the Public Audit Act, 2015. The Act mandates the Auditor-General to examine the economy, efficiency and effectiveness with which public money has been expended pursuant to Article 229 (6) of the Constitution of Kenya, 2010.

Performance, financial and compliance audits form the three-pillars of the 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 their use results in positive impacts on the lives and livelihoods of the citizens. The main goal of our performance audit on public debt is to ensure effective use of public resources and promote service delivery to the citizens.

Our public debt audits establish if the Country's debt is raised to the required level of funding, done at the minimum financing cost taking account of risk, and in a sustainable manner. It also establishes if other set of Public Debt Management goals, such as developing and maintaining an efficient market for government securities are met. It further examines if funded activities are managed in a prudent way. I am hopeful that corrective action will be taken in line with the recommendations in the report.

The report is submitted to Parliament in accordance with Article 229 (7) of the Constitution of Kenya, 2010 and Section 39 (1) of the Public Audit Act, 2015. I have also submitted a copy of the report to the Principal Secretary, The National Treasury and the Chief of Staff and Head of Public Service.


CPA Nancy Gathungu, CBS

AUDITOR-GENERAL

10 July, 2023

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LIST OF ACRONYMS AND ABBREVIATIONS

BPS	-	Budget Policy Statement
BROP	-	Budget Review Outlook Paper
CBK	-	Central Bank of Kenya
CI	-	Composite Indicator
CoK	-	Constitution of Kenya
CS	-	Cabinet Secretary
CS-DRMS	-	Commonwealth Secretariat-Debt Recording and Management System
DBFEA	-	Directorate of Budget, Fiscal and Economic Affairs
DeM	-	Debt Managers
DMD	-	Debt Management Department
DPDM	-	Directorate of Public Debt Management
DSA	-	Debt Sustainability Assessment
ECF	-	Extended Credit Facility
EFF	-	Extended Fund Facility
GoK	-	Government of Kenya
INTOSAI	-	International Organization of Supreme Audit Institutions
ISSAIs	-	International Standards of Supreme Audit Institutions
MDAs	-	Ministries Departments and Agencies
MEFMI	-	Macroeconomic and Financial Management Institute
MLF	-	Market Leaders Forum
MTDS	-	Medium Term Debt Management Strategy
MTEF	-	Medium Term Expenditure Framework
NGE	-	National Government Entities
OCOB	-	Office of the Controller of Budget
PDMO	-	Public Debt Management Office
PFMA	-	Public Financial Management Act
RMD	-	Resource Mobilization Department
SDR	-	Special Drawing Rights
SOEs	-	State Owned Enterprises
SWG	-	Sector Working Group
TNT	-	The National Treasury
UNCTAD	-	United Nations Conference of Trade and Development

DEFINITION OF TERMS

- i. **Concessionally:** A measure of the softness of a credit reflecting the benefit to the borrower compared to a loan at market rate. Technically, it is calculated as the difference between the nominal value and the present value of the debt service as of the date of disbursement, calculated at a discount rate applicable to the currency of the transaction and expressed as a percentage of the nominal value.
- ii. **Commitment Fees:** This is a penalty defined in an external loan agreement which is paid on funds that have not been drawn down by the borrower.
- iii. **Condition Precedent:** This is a legal term describing a condition or event that must come to pass before a specific contract is considered in effect or any obligations are expected of either party.
- iv. **Contracting:** This is the process of entering into an agreement between two or more parties, especially one that is written and enforceable by law.
- v. **Debt Service:** The amount of funds used for repayment of principal and interest of a debt.
- vi. **Debt Sustainability:** This is the level of debt which allows a debtor country to meet its current and future debt service obligations in full, without recourse to further debt relief or rescheduling, avoiding accumulation of arrears, while allowing an acceptable level of economic growth.
- vii. **Debt Sustainability Analysis:** This is conducted in the context of medium-term scenarios. These scenarios are numerical evaluations that take account of expectations of the behavior of economic variables and other factors to determine the conditions under which debt and other indicators would stabilize at reasonable levels, the major risks to the economy, and the need and scope for policy adjustment. In this analysis, macroeconomic uncertainties, such as the outlook for the current account, and policy uncertainties, such as for fiscal policy, tend to dominate the medium-term outlook.
- viii. **Disbursement:** This refers to actual transfer of financial resources or of goods or services by the lender to the borrower.
- ix. **Domestic Borrowing:** Government borrowing through issuance of local Government securities and direct borrowing from the Central Bank.

- x. **External Borrowing:** Refers to Government borrowing from both official (Government or Government agencies) and private institutions domiciled outside the country.
- xi. **Government Securities:** This refers to financial instruments used by the Government to raise funds from the primary market.
- xii. **Grant Element:** This measures the concessionality of a loan, in the form of the present value of an interest rate below the market rate over the life of a loan.
- xiii. **Monetary Policy:** The management of money supply by the Central Bank in an economy to achieve desired economic conditions such as the overall level of prices.
- xiv. **Present Value:** This is sum of all future cash flows (interest and principal) discounted at appropriate market rate. For a loan, whenever the interest rate on a loan is lower than the market rate, the resulting PV is lower than its face value.
- xv. **Primary Market:** This is a market where financial instruments are originated through initial issuance.
- xvi. **Public Debt:** This refers to outstanding financial obligations of the Government arising from past borrowing. It includes Government guaranteed debts to State Corporations and Local Authorities.
- xvii. **Public Domestic Debt:** This is part of the overall debt owed by the Government to creditors domiciled in the economy. The debt includes money owed to commercial banks, non-bank financial institutions, individuals among others.
- xviii. **Public External Debt:** This is part of the overall debt owed by the Government to creditors domiciled outside the economy. The debt includes money owed to private commercial banks, other governments, or international financial institutions such as the IMF and World Bank.
- xix. **Secondary Market:** This is a market where already issued financial instruments are traded.
- xx. **Treasury Bills:** It is a short-term borrowing instrument issued by the Government to finance the budget.
- xxi. **Treasury Bond:** This is a medium to long-term term debt instrument issued by the Government to finance the budget.

EXECUTIVE SUMMARY

Background to the Audit

1. Article 229 (6) of the Constitution of Kenya, 2010 and Section 36 of the Public Audit Act, 2015 mandates the Auditor-General to examine and report on the economy, efficiency and effectiveness with which public money has been expended.
2. Fiscal situation of a country at particular time is determined by the tax revenues collection and anticipated expenditures at that time. During budget preparation, government's fiscal balances is determined. Fiscal balance is the difference between the amount of revenue a government collects and the amount it spends on providing public goods and services (excluding net interest payments on public debt). When the government spends more than it collects as revenues, it has a fiscal deficit; when it spends less, it has a fiscal surplus and when it spends what it collects in equal measures a balanced budget is anticipated¹.
3. Many indebted developing countries face increasing fiscal deficits partly as a result of debt challenges. Rather than increasing taxes, countries opt to borrow to bridge the deficit gap, which if not managed prudently may be unsustainable in the long run. Corresponding fiscal adjustments are therefore necessary to turn current account deficits into surpluses to service debt.²
4. Over the last five years, Kenya's actual fiscal deficit has been on the rise. The fiscal deficit amount increased by 53.13%, from Kshs.607.974 billion in FY 2017/2018 to Kshs.930 billion in the FY 2021/2022. The increase in the country's fiscal deficit has been cited as one of the key contributors to the increase in public debt, from Kshs. 5.039 trillion as at end of June 2018 to Kshs. 8.206 trillion as at the end of December 2021.
5. High levels of public debt pose a threat to Government prioritized Agenda in the National Development Plan (Vision 2030) which remains a high priority and critical to economic recovery and growth as indicated below:

¹ <https://www.oecd-ilibrary.org/sites/42c624f3-en/index.html?itemId=/content/component/42c624f3-en>

² Guidotti, P. E., & Kumar, M. S. (1992). *Managing Domestic Public Debt*. 0029(003). <https://doi.org/10.5089/9781451952094.022.a003>

- a) The Big Four Agenda in the previous administration priority area focused on provision of food security, affordable housing, universal health care, manufacturing and job creation; and
 - b) The Bottom Up Economic Transformation Plan Agenda under the current administration focuses on bringing down the cost of living, eradicating hunger, creating jobs, expanding the tax base, improving the foreign exchange balance and inclusive growth.
6. Notable progress has been made towards the achievement of the prioritized development goals. However, non-adherence to project guidelines, inadequate gatekeeping function during the projects cycles and continued budget absorption challenges pose risks to the realization of government agenda. The 2021 Budget Policy Statement reported that development expenditure was below target by Kshs.6.9 billion, on account of below target disbursements to foreign financed programs by Kshs. 48.8 billion. This indicates continued challenges in implementing externally financed projects due to low absorption of funding.
7. Directorate of Budget Fiscal and Economic Affairs (DBFEA) and the Directorate of Public Debt Management (DPDM) in The National Treasury (TNT) are mandated to coordinate the preparation of budgets and sustainably manage public debt respectively. The newly established Project Investment Management Unit, under Public Investment and Portfolio Management Directorate provides the gatekeeping function to ensure that only appropriate projects are included in the budget cycle. National government institutions and counties play key roles in planning, executing and reporting on the implementation of the budget.

Objective of the Audit

8. The audit sought to assess whether the government, through The National Treasury (TNT), has effectively carried out Deficit Financing Operations (DFOs).

Scope of the Audit

9. The audit assessed the;
- i. alignment of Deficit Financing Operations to the overall debt objectives and strategies;
 - ii. effectiveness of management of loan contracting to minimize risks and cost of borrowing; and
 - iii. effectiveness of utilization of contracted loans.

10. Further, data was collected on deficit financing operations for the period 2017/2018 to 2021/2022. The audit also sampled 12 projects funded by loans for field verification.

Summary of Major Findings

11. In the recent past, The National Treasury (TNT) has put in place measures towards enhancing the management of public debt, which include the following;
 - i. There has been increased provision of information through publication of public debt information. For instance, monthly debt bulletins, annual public debt management reports and budget books can be accessed from TNT's website;
 - ii. In the interest of sustainable management of debt, TNT drafted the Public Finance Management (Amendment) Bill, 2021 which is currently in its final parliamentary stages of approval. The amendments in the Bill seek to have the debt limit approved by Parliament and ensure that it is anchored on sustainability, as advised by a competent institution, so as to provide a proper definition of public debt and county public debt. The proposals also seek to have a new function added to the Public Debt Management Office (PDMO), to advise Parliament on sustainable debt levels; and
 - iii. The formulation and preparation of the National Budget has been adhering to budget guidelines and timelines, as provided for in annual National Treasury circulars. This has contributed to timely achievement of expenditure targets and market confidence.
12. However, despite the above efforts, audit findings indicate that deficit financing operations were not effectively carried out, as detailed below: -

A. Inadequate Alignment of Deficit Financing Operations to Debt Overall Objectives and Strategies

Non-Finalization of Procedure Manuals and the Commonwealth Meridian End User Licensing Agreement

13. The Directorate of Public Debt Management (DPDM) has manuals dating from 2014 that are yet to be updated, finalized or approved. Further, the process of guiding the preparation of annual borrowing plans is not provided for in the draft manuals. Interviews revealed that finalization of the manuals was awaiting

migration of the debt management system from the current Commonwealth Secretariat-Debt Recording and Management System (CS-DRMS) to the Commonwealth Meridian. As at the time of the audit, the Commonwealth Meridian End User Licensing Agreement (EULA) had not been finalized by TNT, thus causing the delay in migration.

The External Operations Manual Lacked Key Debt Operations Processes

14. The audit revealed that the Draft External Operations Manual for the Resource Mobilization Department (RMD) dated April 2019, did not have details on processes for the formulation and implementation of annual borrowing program. No explanations were provided for failure to include the process in the manual. Inadequate procedures guiding debt operations may lead to limited transparency and accountability in debt operations and may inhibit the implementation and monitoring of debt borrowing strategies.

Inadequate Staff Capacity

15. Review of TNT Strategic Plan for 2018/2019-2022/2023 and interviews with staff revealed that both the Budget, Fiscal and Economic Affairs and the Public Debt Management Directorates had only 130 members of staff against a staff establishment of 214, resulting to a deficit of 84 members of staff. This may result to the defined roles and functions of front office, middle office and back office not being adequately segregated.

Delay in the Operationalization of the Project Implementation Management Unit

16. Interviews with staff in the Project Implementation Management Unit (PIMU) revealed that the Unit had not been operationalized since its establishment in 2018. This was attributed to the following reasons:
 - i. The Unit had proposed an establishment structure for approval by TNT. However, the approval had not been granted as at the time of the audit;
 - ii. Capacity Challenges: As at the time of the audit, the Unit had 10 technical officers, with majority of them having been seconded from other Ministries, Departments and Agencies; and
 - iii. The Project Investment Management Information System (PIMIS) had not been rolled out. PIMIS provides a database for all projects, automates project approval processes and provides a platform for accessibility of

information by stakeholders. However, the system had not been rolled out as at the time of the audit. Consequently, information on projects continues to be managed under the Electronic Project Monitoring Information System (e-Promis platform).

Conflicting Responsibilities for the Preparation of Annual Borrowing Programs in the Agency Agreement Between The National Treasury and the Central Bank of Kenya

17. Review of Section 4.2 of the Agency Agreement between TNT and the CBK, 2016 states that TNT will be responsible for the formulation of the domestic debt borrowing program for government securities while Section 5.2 of the same agreement states that on receipt of domestic borrowing requirements from TNT, the CBK would prepare the borrowing program for approval by TNT. This overlap in roles could lead to conflicts in debt management operations and inadequate segregation of fiscal operations from monetary operations.

Challenges in Retrieval of Loan Information

18. Review of the Resource Mobilization Department's (RMD's) correspondence files revealed that some projects were filed according to creditors, rather than specific projects. Therefore, retrieval of specific information on particular project funded through loans requires unnecessary review of all project files and records of the respective creditor. This exposes debt management activities to operational risks such as transaction delays; difficulties in retrieval, reconciliation of information and follow up on donors, implementing agency and TNT progress, amongst others.

Inconclusive Annual Borrowing Programs

19. Review of documents on annual borrowing program revealed that, although the Medium Term Debt Management Strategy (MTDS) had been prepared, its operationalization through an annual borrowing plan has been inadequate. This is because the Resource Mobilization Department's (RMD's) first Annual Borrowing Plan (ABP) was prepared and approved in April 2022. The implication is that the actual contracting of debt stock of up to 2021 was not undertaken based on an Annual Borrowing Plan (ABP). Although the ABP dated April 2022 was submitted for audit review, its use in bridging the budget deficit during the financial year 2021/2022 could not be established, as it was approved two months before the end of the financial year. The National Treasury management

explained that the lack of annual borrowing programs was due to inadequate policies and technical capacity.

Non-Compliance to Optimal Debt Management Strategies

20. Review of documents on planning for borrowings provided for audit revealed that Budget Policy Statements (BPS) and Budget Statements did not comply with provisions of Section 185 (1) of the Public Finance Management Regulations, 2015 which require that any borrowing should be informed by the Medium Term Debt Management Strategy (MTDS). A further review of the of BPS, Budget Statements and the actual borrowing revealed deviations of approximately 23%, 15%, and 4%, respectively from the strategies prescribed in the MTDSs.

Non-Adherence to Budget and Appropriation Committee Thresholds

21. Review of Budget and Appropriation Committee (BAC) Reports on MTDS and Budget Policy Statements indicated that in the financial years 2017/2018 and 2019/2020, the deficit financing ceilings had not been specified. Further, in the financial year 2018/2019, the approved deficit ceiling was Kshs. 635.5 billion, as set by Parliament, while the actual borrowing was surpassed by Kshs. 85.6 billion in the year. Justification for the extra borrowing of Kshs 85.6 billion was not supported as review of BAC report on 2nd supplementary estimates for the financial year 2018/2019 revealed that as a result of revenue underperformance by Kshs. 97.7 billion, the Committee resolved to approve a supplementary budget of Kshs. 50 billion, to be raised through reallocations and not borrowing.

Non-Achievement of the Deficit Ceilings Targets by the East African Monetary Union Protocol and The National Treasury

22. Article 6 Section 2b of the East African Monetary Union Protocol Deficit Ceilings sets the ceiling on fiscal deficit, including grants targets at 3% of GDP in midterm. In addition, TNT targets to reduce fiscal deficit to 3.5% of GDP in the midterm i.e. by reducing gradually from 8.2% of GDP in 2021/22 to 6% of GDP in 2022/23 to 3.9% of GDP in 2024/25. These targets are unlikely to be achieved as the actual deficit has been increasing from 7.6% of GDP in 2018/19 to 7.8% of GDP 2019/20 through 8.5% of GDP in 2020/21.

Unprecedented Borrowings from the Domestic Market

23. Review of deficit financing documents revealed that in the financial years 2017/2018 to 2020/2021, the total actual borrowing surpassed the BPS' targeted

budget deficits' of total amount of Kshs. 2,421.7 billion by KShs. 698.56 billion. Further, the audit established that Kshs. 297.76 billion, representing 42.63% of the excess amounts, was sourced externally, while Kshs. 400.80, representing 57.37% was sourced as domestic debt.

B. Ineffective Loan Contracting Leading to High Loan Costs and Increased Risk of Borrowing

Inadequate Initial Project Documents

24. Out of the 12 sampled projects, the audit established that seven (7) projects had Initial Project Documents i.e. four (4) projects namely; Konza Data Center and Smart City Project, Menengai Geothermal Project, Mwea Irrigation Development Project and LV-WATSAN had identification, justification and feasibility studies done and three (3) projects namely; Upgrading Rivatex, Kisumu Urban and Eldoret By-Pass projects had only feasibility studies done. Initial project documents for the remaining five (5) projects were not availed for audit.
25. The documentation provided for some of the projects revealed inconsistencies in the dates when the projects were initiated. For instance, proposal documents for the Menengai Geothermal Project was dated 27 June, 2012 yet the loan agreement was signed on 12 March, 2012. Further, the concept note for the Kisumu Urban Project was dated 19 October, 2012 yet the loan agreement was signed on 5 July, 2010. As a result of poor documentation, the scrutiny and approvals of these projects worth approximately Kshs. 99.83 billion before entering the budget cycle by The National Treasury, could not be established.

Non-Provision of Projects Approvals

26. Section 11(2) of the State Corporations Act, Revised Edition 2012, provides that no annual estimates and proposals for funding shall be implemented until the proposals have been approved by the Cabinet Secretary, with concurrence of The National Treasury. Document review revealed that all the sampled 12 projects had been budgeted for. However, no project approval documents were availed for audit by The National Treasury. Further interviews with the implementing agencies revealed that the project approvals were not availed to them by The National Treasury.

Inadequate Public Participation

27. The audit established that there was no involvement of the intended beneficiaries during project identification in all the 12 sampled projects. The Lake Victoria Water and Sanitation (LV-WATSAN) project stakeholder participation started at the project design stage. Further, there was no prior beneficiary engagement for the upgrading of Makindu Level 4 Hospital. Consequently, hospital officials had to negotiate for amendments during the implementation phase of the project.
28. Four (4) of the sampled projects, submitted reports on public participation. However, there was no evidence that public participation took place. This is because information on public participation, such as request for public participation, evidence of forums held, minutes and signed lists of attendees, and how the public opinions were to be considered in the implementation of the projects were not availed. Therefore, the authenticity on whether stakeholder engagement took place could not be established. These projects are Konza ICT, Menengai Geothermal, Eldoret Town By-Pass and Kisumu Urban.

Lack of Documentation on Whether Credit Analysis Assessment was Conducted Prior to Loan Contracting

29. Interviews revealed that the Middle Office is responsible for credit analysis assessment of creditors' loan proposals. The credit analysis assessment results are then used by the front office to select appropriate creditors. However, on request for these documents, both offices did not provide the said documents, therefore, the audit could not assess whether credit analysis assessment was done prior to loan contracting.

Inadequate Involvement of Implementing Agencies during Loan Negotiation

30. The audit established that two (2) of the 12 sampled projects had documentation on loan negotiation, namely the Eldoret Town By-Pass and the Mombasa Special Economic Zone (SEZ) project.
31. Further, review of minutes of loan negotiation meetings of the Mombasa Special Economic Zone (SEZ) project revealed that the Kenya Ports Authority (KPA), who are among the key project implementers, did not attend the loan negotiation meeting despite being invited through letter Reference No: TC-19-154 (NT), dated 07 August, 2019. In addition, interviews with the project implementing

agencies revealed that five (5) out of the 12 sampled projects were not involved during loan negotiation.

Failure to Obtain Sufficient Legal Advice on Contracted Loans

32. The audit established that out of the 12 sampled projects, only eight (8) projects had documentation indicating that they obtained the Attorney General's office legal advice. Evidence of obtaining legal advice from the Attorney General was not provided for the remaining four (4) projects namely, the Upgrading of the Rift Valley Textiles (Rivatex) Factory Project, the North Eastern Transport Improvement Project, the Kisumu Urban Project and the Mwea Irrigation Development Project. Therefore, there is a risk that some legal issues not having been mitigated, that could result in the agreements' legality and validity being questionable.
33. Review of the eight (8) projects whose legal documentation were availed for audit revealed the following:
 - i. In Konza Data Center & Smart City Project, the Attorney General's office after review of the contract agreement between Huawei Technologies & Ministry of ICT, ensured that 40% of the local content was incorporated in the contract through supplementary 3; and
 - ii. In the eight (8) projects, the indebtedness of the country was assessed prior to committing to the loan to ensure that the debt ceiling was not breached. The Attorney General's office also made effort in ensuring that a neutral ground rather than creditors home country is adopted as court of arbitration, in case of breach as seen in Special Economic Zone Dongo Kundu Project.

Lack of Prior Engagement Between the Resource Mobilization Department and Implementing Agencies

34. The audit established that in all the 12 sampled projects, none of the project had an agreed and approved disbursement schedule. This could have contributed to slow uptake of loans and delay in the completion of projects, leading to payment of commitment fees.

Payment of Commitment Fees Penalty due to Non-Disbursed Loans

35. Review of CS-DRMS extract revealed that 16 projects, whose dates of loan agreements ranged between 2014 and 2021, were yet to start. Thus resulting in payment of Kshs. 1,123,976,797 as commitment fee on non-disbursed amounts. The penalty payment was mainly due to failure to fulfill the precedent conditions stated in the respective loan agreements. Further, the audit established that a project dating back to 2014 had not commenced as at the time of the audit in April 2022.

Avoidable Costs Incurred due to Delays in Project Execution

36. Review of project timelines for the 12 projects sampled for the audit revealed that there were delays in execution of projects. The delays resulted in The National Treasury incurring avoidable costs totaling to Kshs.4,629,318,570. The costs comprised of commitment fees, interest and claims.

C. Ineffective Utilization of the Contracted Loans

Untimely Update of Payments in the Commonwealth Secretariat -Debt Recording and Management System

37. The audit revealed that there was a negative variance of Kshs.5,556,139,511 and a positive variance of Kshs.11,940,309,483.07 between amounts in Payment Vouchers (PVs) and CS-DRMS disbursed amount. This could imply that debt records are inaccurately stated. Since debt is created only when a loan is partially or fully disbursed, failure to capture the disbursements accurately in the debt information management system could result in inaccurate reporting of public debt balances.

Unverified Expenditure due to Lack of Documentation

38. Expenditures on the 12 sampled projects amounting to Kshs.6,081,914,788 could not be verified due to lack of provision of Interim Payment Certificates (IPCs) and payment vouchers, among others. As a result, the audit could not: establish the amounts expended; conclusively assess the work done; assess whether inspection of the works had been done as required in the Bill of Quantities (BOQ) or contract agreements.

Under Utilization of Borrowed Funds

39. Review of the financial year 2020/2021 External Resource Handbook revealed that despite the availability of funds, the level of disbursement by The National Treasury to programs and projects recorded an average absorption rate of 86%. This translated to absorption of Kshs.812.46 billion out of the possible Kshs. 945.78 billion procured externally, thus Kshs.133.32 billion was not absorbed/utilized for the period as anticipated.

Inadequate Projects Execution

40. Audit inspections undertaken between 7 March, 2022 and 14 April, 2022 revealed the following unsatisfactory matters in the execution of the 12 sampled projects: -

- i. In **Kisumu Social Hall**; instead of Dustbin Cubicle worth Kshs.603,980 as disclosed in the Bill of Quantities (BOQ), there was only a 20 liter plastic bin. Justification for such amendment was not provided;
- ii. In **Otonglo Market**; low quality mechanically operated Rolling Doors were used i.e. door handles were already broken; no terrazzo paving to Tops & Sides as disclosed in the BOQ and the roofing was also poorly done. It is likely that in near future, this project would incur additional repair costs before it realizes its returns;
- iii. In **Lumumba Sub-County Health Facility**; idle well-equipped facilities such as Male Medical Ward, Pediatric Ward, Main Theater, General Wards and Maternity Wing were observed. The facilities were not being utilized despite being adequately equipped allegedly due to lack of staff. It follows therefore, that citizens in Kisumu are not able to adequately access affordable health care which may possibly contribute to prolonged health suffering and even possibility of increased deaths;
- iv. In **Rota Bridge Otonglo-Tiengere-Rota Access Roads**; project was stalled as the contract had been cancelled twice due to conflict in implementation design;

41. In **Sabor-Iten Tambach-Nakuru Water Project (3) Project Phase 2**; the contract involved installation of new HDPE pipelines and replacement of some 40 kilometers of asbestos cement lines. Audit verification and interviews on

replacement of the 40 kilometers asbestos cement lines in Nakuru City revealed that the old line was not replaced but left under the ground without NEMA's Environment Impact Assessment (EIA) report and clearance. Non-removal of hazardous asbestos pipes from the underground along the newly laid system poses health risk to water consumers;

42. Interview with management of Iten-Tambach Water and Sewerage Company revealed that the Lower Sabor Irrigation project has been obstructing water from River Charama which supplies water to Sabor-Iten-Tambach (main intake) water project as the intake of irrigation project is located 2.5 kilometers upstream. The significant effect is reduction of water levels downstream and diverting water meant for domestic use in Iten and Tambach to the irrigation project. If not addressed, this project of Euros 10 million will be counted a loss, to taxpayers. Also, there is a possibility that the people in Nakuru, Sabor-Iten, Tambach will not have access to water.
43. The Menengai Geothermal Development Project ID No. P-KE-FZ0-003 Phase 1 was to inject 105MW into the national grid. The audit revealed that, according to the March 2018 ADB Aide Memoir, the project was to inject 105MW into the national grid. The Aide Memoir further indicated that steam gathering of the 169MW that was harnessed from 60 wells installation was complete and awaiting power plants for commissioning. However, four years down the line, even after the KETRACO developing a sub-station and a transmission line, this energy is yet to be injected into the national grid for citizens to enjoy the benefits. This is because it is awaiting the three (3) Independent Power Producers i.e. Quantum Power East Africa (QPEA), Sosian Menengai Power Limited and Orpower 22 Limited (OTT) to put up the power plant;
44. Review of ADB Aide Memoire (18-23) May 2018 revealed that Yantai Hangtai Petroleum Technology Com who was contracted to procure Schedule B Drilling Material at contract sum of USD 206,151 had only delivered goods worth USD 42,230. It further indicated that the contractor was cashed out for non-performance. This status has remained constant from May 2018 to date (as the time of the audit verification);
45. The RIVATEX project aimed at upgrading the factory through installation of heavy machinery equipment for textile processing. Review of the 2019 BPS

indicates that the upgrading of RIVATEX was aimed at absorbing the local cotton to produce high quality textiles. To achieve this, the Government had identified 21 cotton growing counties targeting 549,000 acres to ensure self-sufficiency in cotton for the textile industries by availing the resilient genetically modified cotton seed to farmers. However, interviews with the project team revealed that the factory is no longer using locally grown cotton. This is because the ministry is no longer receiving funding for subsidizing seeds and fertilizers to boost growing of cotton locally as now the said funds are being allocated to the Ministry Agriculture. As a result, the to the factory sorted to importation thus exposing the project to additional operational costs thereby threatening its sustainability in the long term; and

46. The following observations were made in **Konza Data Center & Smart City Project**;
- i. Review of Supplementary Agreement No 3 dated 28th November 2019 between the Ministry of ICT and Huawei Technologies “Scope of the System” clause indicate that the contractor, M/s Huawei Technologies was to source 40% of the goods, works & services from citizens locally to ensure sustainable promotion of the local industry, facilitation of technological transfer and, development of professional skilled and unskilled labor. However, it was not possible for the audit to evaluate whether this objective was achieved in the absence of the sub-contract agreements that were not availed for audit review, contrary to section 9 of the Public Audit Act (2015).
 - ii. Interview and audit inspection revealed that Disaster Recovery Site was yet to be constructed even though Phase 1 Data Center was already hosting over 10 clients, among them County Government of Homabay and Dedan Kimathi University among others. The absence of Disaster Recovery Center Site, threatens business continuity for the ten (10) clients already being hosted.
47. There was diversion of Development Funds to finance Recurrent Budget Activities in **Lake Victoria Water and Sanitation Program**. Comparative analysis of the approved printed estimates in respect of various projects for the financial year 2021/2022 revealed that Kshs.170,570,000, of which portion of the amount includes Kshs.75,000,000 in respect of the Lake Victoria Water and Sanitation (LV-WATSAN) program, were budgeted under the development vote

for GOK counter-part funding. However, the funds were re-allocated to finance the agency's recurrent budget, contrary to Section 43 (1) (b) and (d) of the Public Finance Management Act, 2012.

Conclusion

48. The National Treasury has not adequately aligned its deficit financing operations to overall debt objectives and strategies. This can be attributed to:
- i. Inadequate, outdated and unfinalized manuals and delay in migration to the new debt management system which exposes deficit financing activities to debt operational risks.
 - ii. Inadequate and insufficient resource of the Public Debt Management Office which has led to understaffing and skill gap resulting to the defined roles and functions of the front office, middle office and back office not being performed as required and adequately segregated.
 - iii. Lack of clarity on who is responsible for the preparation of the domestic annual borrowing plans in the Agency Agreement between The National Treasury and the Central Bank of Kenya.
 - iv. Inadequate filing system which poses challenges in retrieval of specific information on a particular loan funded project. This may expose debt management operations to inefficiencies due to transaction delays, difficulties in retrieval and reconciliation of information.
49. The National Treasury has not put in place adequate measures and tools to operationalize and monitor the implementation of the identified Optimal Debt Strategies. This is attributed to key budget documents not being aligned to the Medium Term Debt Strategy. In addition, the Medium Term Debt Strategy has not been fully operationalized through the development of annual borrowing programs to guide on actual borrowing. Further, the set deficit ceilings, targets, and proposed measures for achieving debt sustainability have not been adequately implemented.
50. The National Treasury has not effectively carried out loan contracting activities that are geared towards minimizing borrowing costs and the associated risks. This can be attributed to inadequate project preparation, inadequate scrutiny and

project approvals before entering the budget cycle; inadequate scrutiny and negotiation of loan terms and; inadequate engagement by The National Treasury and the implementing agency on the uptake of the loans. As a result, the government's borrowing costs have increased due to payment of commitment fees, interest on delayed contractor payments and prolongation costs and; delayed project output to benefit Kenyan citizens.

51. There is inadequate utilization of contracted loans. The National Treasury has issued Circular No 16/2019 on Guidelines on Public Investment for Government and Its entities. Further TNT has established Public Investment Management (PIM) Unit under Directorate of Public Investment and Portfolio Management to ensure effective and efficient management of public investment through providing framework that guides on project identification through to post valuation. However, The National Treasury has not fully operationalized the PIM unit to enforce the guidelines, scrutinize the projects prior to funding, monitor project execution thus leading project delays, inadequate project workmanship and additional costs and wastage of funds.

Recommendations

52. To ensure that deficit financing operations are aligned to overall debt objectives and strategies The National Treasury should;
 - i. Update, finalize and approve all public debt policies and procedures manuals regularly and finalize the migration from CS-DRMS to Commonwealth Meridian. This will ensure transparency and effectiveness in performing and coordinating public debt operations.
 - ii. Ensure that the directorates have sufficient and adequately trained debt management staff, with clear defined roles for each cadre of staff and proper staff retention strategy to ensure continuity of operations during exit and entry of new staffs to address capacity challenges.
 - iii. Ensure there is clarity in roles and responsibility on the preparation of the annual borrowing plan in the 2016 Agency Agreement between TNT and CBK, by conforming to PFM Act, 2012 and Debt and Borrowing Policy 2020 to avoid contradictions in roles and responsibility.

- iv. Ensure efficiency in retrieval of debt management information, by putting in place a robust and secure filing system that provides quick access to debt information to avoid inefficiencies arising from transaction delays; difficulties in retrieval and reconciliation of information and loss of information.
 - v. Put in place adequate measures and tools to operationalize and monitor the implementation of the Medium Term Debt Strategies. This is achieved through the development of annual borrowing programs to guide on actual borrowing and further monitoring the implementation of the set deficit ceilings, targets, and proposed measures for achieving debt sustainability.
53. To ensure that loan contracting is done to minimize cost and risk of borrowing, The National Treasury should ensure proper scrutiny and negotiation of loan terms and adequate involvement of the project implementing agency during loan negotiation and preparation during uptake of the project loans.
54. To ensure effective and efficient management of public investment; i.e. adequate project appraisal prior to funding and adequate project gate keeping, The National Treasury should fully operationalize the Public Investment Management Guidelines outlined in The National Treasury Circular No 16/2019 and finalize the establishment of the Public Investment Management Unit.

1.0 BACKGROUND TO THE AUDIT

Introduction

- 1.1 The Office of the Auditor- General (OAG) is established under Article 229 of the Constitution of Kenya, 2010. The Constitution mandates the Office to oversight the management of public resources within the three arms of the government (the Executive, Legislature and the Judiciary), the Constitutional Commissions, the Independent Office of the Controller of Budget and any other entity that is funded by public funds.
- 1.2 Article 229 (6) of the Constitution of Kenya, 2010 and Section 36 of the Public Audit Act, 2015 mandates the Auditor-General to examine and report on the economy, efficiency and effectiveness with which public money has been expended.
- 1.3 Fiscal situation of a country at particular time is determined by the tax revenues collection and anticipated expenditures at that time. During budget preparation, government's fiscal balances is determined. Fiscal balance is the difference between the amount of revenue a government collects and the amount it spends on providing public goods and services (excluding net interest payments on public debt). When the government spends more than it collects as revenues, it has a fiscal deficit; when it spends less, it has a fiscal surplus and when it spends what it collects in equal measures a balanced budget is anticipated³.
- 1.4 Many indebted developing countries face increasing fiscal deficits partly as a result of debt challenges. Rather than increasing taxes, countries opt to borrow to bridge the deficit gap, which if not managed prudently may be unsustainable in the long run. Corresponding fiscal adjustments are therefore necessary to turn current account deficits into surpluses to service debt.⁴
- 1.5 When a government borrows, it creates public debt. Article 214 (2) of the Constitution of Kenya, 2010 defines public debt as all financial obligations attendant to loans raised or guaranteed and securities issued or guaranteed by the National Government.

³ <https://www.oecd-ilibrary.org/sites/42c624f3-en/index.html?itemId=/content/component/42c624f3-en>

⁴ Guidotti, P. E., & Kumar, M. S. (1992). *Managing Domestic Public Debt*. 0029(003). <https://doi.org/10.5089/9781451952094.022.a003>

- 1.6 According to the Audit of Public Debt Management Handbook for Supreme Audit Institutions, August 2020, borrowing activities constitute operations such as estimation of borrowing requirements, preparation of annual borrowing plans consistent with debt management strategies, identification of best borrowing instruments, disbursement and utilization of the borrowed funds and loan repayment. For sustainable public finance management, a strategic, well-considered, informed and transparent borrowing plan is necessary.
- 1.7 Borrowing operations require a significant amount of information and coordination among government agencies. Governments with the capacity to accurately estimate their borrowing needs will avoid over-borrowing, which is costly and could lead to a deterioration of the government's fiscal position. Governments could also avoid under-borrowing, which may force governments to alter their budgets, create a liquidity crisis, or trigger a debt default.⁵
- 1.8 Directorate of Budget Fiscal and Economic Affairs (DBFEA) and the Directorate of Public Debt Management (DPDM) in The National Treasury (TNT) are mandated to coordinate the preparation of budgets and sustainably manage public debt respectively. The newly established Project Investment Management (PIM) Unit, under the Public Investment and Portfolio Management provides the gatekeeping function to ensure that only appropriate projects are included in the budget cycle. National government institutions and counties play key roles in planning, execution and reporting of the implementation of the budget.⁶
- 1.9 In Kenya, the Medium Term Expenditure Framework (MTEF) together with the Budget Review Outlook Paper (BROP) provide the basis for annual budget planning. MTEF sets out the three - year rolling expenditure priorities and fixed budget ceilings, against which sector plans can be developed. BROP provides a review of fiscal performance from the most recent financial year and how it impacts on financial objectives and fiscal principles outlined in the current Budget Policy Statement (BPS). MTEF and the BROP therefore provide for planning of the annual budget. The Medium Term Debt Strategy (MTDS) and Annual Borrowing Plans (ABP) provide for planning for midterm budget deficit financing

⁵ Audit of Public Debt Management Handbook for Supreme Audit Institutions, August 2020 pg. 59

⁶ <https://www.treasury.go.ke/>

and liability management. This is achieved by outlining the optimal debt management strategy that seeks to minimize the cost and risk of financing the fiscal deficit, without disrupting macroeconomic stability.⁷

Kenya's Debt Level

- 1.10 As at 31 December, 2021, public debt in nominal terms stood at Kshs.8.2067 trillion, representing 68.1%, of the Gross Domestic Product (GDP). This comprised of external debt of Kshs.4.1743 trillion, and domestic debt of Kshs 4.0323 trillion. Further, Kenya's budget deficit, excluding grants, for the financial year (FY) 2022/2023 has been projected at Kshs.893 billion or 6% of GDP, at the projected revenue level of Kshs.2.4314 trillion and expenditures of Kshs.3.3244 trillion according to the 2022/2023 BPS. The FY 2022/2023 deficit was to be financed through net external and domestic financing of Kshs.275.9 billion and Kshs.570.2 billion⁸, respectively.
- 1.11 Over the last five (5) years, Kenya's actual fiscal deficit has been on the rise. The fiscal deficit amount increased by 53.13%, from Kshs.607.974 billion in FY 2017/2018 to Kshs.930 billion in the FY 2021/2022. The increase in the country's fiscal deficit has been cited as one of the key contributors to the increase in public debt, from Kshs. 5.039 trillion as at end of June 2018 to Kshs. 8.206 trillion as at the end of December 2021.
- 1.12 Increasing the fiscal deficit has been cited as one of the key contributors to the increase in public debt⁹, from Kshs. 5.039 trillion as at end of June 2018 to Kshs. 7.6966 trillion as at the end June 2021. Increase in the fiscal deficit over the years has cumulatively increased public debt through additional expenditures on interest payments. If not managed properly, high levels of public debt poses a threat to its sustainability. **Table 1** illustrates the Country's actual fiscal deficit compared to the public debt stock.

⁷ <https://www.treasury.go.ke/budget-process>

⁸ November 2021 Budget Policy Statement FY 2022/2023

⁹ Joint World Bank-IMF Debt Sustainability Analysis May 2020 pg. 2 and 2021 Medium Term Debt Management Strategy

Table 1: Five Years Actual Fiscal Deficit Vs Public Debt Stock

Fiscal Year	Fiscal Deficit " Kshs. Millions"	Public Debt Stock Annual Public Debt Report 'Kshs. Millions ' 2020/2021	Debt Service " Kshs Millions "	Debt: GDP (Threshold 70%)
2017/2018	607,974	4,406,863	463,210	57.4
2018/2019	721,054	5,047,234	598,508	59.4
2019/2020	790,804	5,809,076	850,071	62.0
2020/2021	950,235	6,693,338	651,473	65.8
2021/2022*	930,000	7,696,600	780,628	69.3

Source: OAG Analysis of Public Debt Stock and Debt Service Annual Public Debt Reports

Kenya's Debt Sustainability

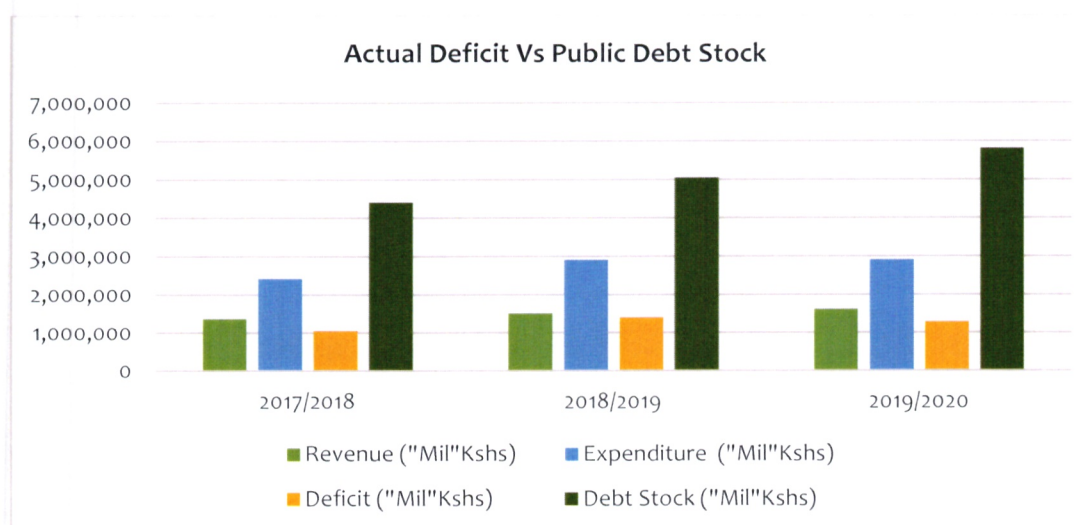
- 1.13 According to March 2021 Joint Bank Fund (IMF and IDA) Debt Sustainability Analysis Report Kenya's debt carrying capacity is assessed as medium, as its Composite Indicator (CI), is at 3.01 (through a weighted average of an institutional indicator, real GDP growth, remittances, international reserves, and world growth) indicating that Kenya's public debt remains sustainable. Further, Kenya's overall Debt Sustainability Analysis indicates that public debt remains sustainable at 63.9% of GDP. However, due to the impact of the Covid-19 pandemic, which worsened debt vulnerabilities, the Country's risk of debt distress moved from low to high.
- 1.14 In response to the increasing budget deficit, the Government spelt out expenditure rationalization and revenue recovery measures. This was by way of objectively aligning expenditures to the available fiscal space and boosting revenue performance in the financial year 2021/2022. The Budget Policy Statement needs to be implemented in order to progressively decrease the budget deficit from Kshs. 966.6 billion or 8.7% of GDP in the FY 2020/2021 to Kshs. 613.8 billion or 3.6% of GDP in the FY 2024/2025. Failure to implement these measures, amongst others aimed at effectively managing borrowing and debt activities, presents a risk of Kenya's debt growing at an unsustainable level.

Motivation for the Audit

1.15 The Auditor-General authorized the audit after consideration of the following factors:

- i. Section 62 (3) of the Public Finance Management Act, 2012 states that the objective of the Public Debt Management Office (PDMO) is to minimize the cost of public debt management and borrowing over the long-term, taking into account risk and ensuring that the benefits and costs of public debt are shared between the current and future generations.
- ii. Budget execution in Kenya has continued to be hampered by revenue shortfalls and rising expenditure pressure, leading to an increase in the budget deficit. The overall fiscal deficit increased from Kshs.1,050.18 billion in the FY 2018/2019 to Kshs.1,289.53 billion in the FY 2019/2020. The Annual Public Debt Management Report for the financial years 2018/2019 to 2020/2021 reflects the increase in fiscal deficit overtime as illustrated in **Figure 1**.

Figure 1:Kenya's Actual Fiscal Deficit Vs Debt Stock



Source: OAG analysis of Annual Public Debt Management Report for the FY 2018/19 to 2020/2021

1.16 High levels of public debt pose a threat to Government prioritized Agenda in the National Development Plan (Vision 2030) which remains a high priority and critical to economic recovery and growth as indicated below:

- i. The Big Four Agenda in the previous administration priority area focused on provision of food security, affordable housing, universal health care, manufacturing and job creation; and

ii. The Bottom Up Economic Transformation Plan Agenda under the current administration focuses on bringing down the cost of living, eradicating hunger, creating jobs, expanding the tax base, improving the foreign exchange balance and inclusive growth.

- b. Notable progress has been made towards the achievement of the prioritized development goals. However, non-adherence to project guidelines, inadequate gatekeeping function during the projects cycles and continued budget absorption challenges pose risks to the realization of government agenda. The 2021 Budget Policy Statement reported that development expenditure was below target by Kshs.6.9 billion, on account of below target disbursements to foreign financed programs by Kshs. 48.8 billion. This indicates continued challenges in implementing externally financed projects due to low absorption of funding.

1.17 As highlighted in the Hansard Report of Wednesday 9 June,2021, stalled projects have become a permanent feature in the budget. The report attributes stalled projects to non-adherence to project guidelines issued by The National Treasury, including the introduction of new projects before the completion of existing ones, despite the thin spread of resources. The issue of pending bills also continues to present a significant challenge in almost all sectoral budgets.

2.0 DESIGN OF THE AUDIT

Objective of the Audit

- 2.1 The audit sought to assess whether the Government, through The National Treasury (TNT) has effectively carried out Deficit Financing Operations. The specific audit sub-objectives were to:
- i. Assess the alignment of Deficit Financing Operations (DFOs) to the overall Debt Objectives and Strategy (DOS);
 - ii. Assess the effectiveness of management of loan contracting to minimize risks and the cost of borrowing; and
 - iii. Assess the effectiveness of utilization of contracted loans.

Scope of the Audit

- 2.2 The audit focused on deficit financing operations by The National Treasury. These operations include: preparation of annual borrowing plans that are consistent with debt management strategies; identification of best borrowing instruments; loan contracting and negotiation; disbursement and utilization of the borrowed funds. The audit covered the financial years 2017/2018 to 2021/2022.
- 2.3 The audit subjectively sampled 12 projects funded by Government loans. These sampled projects drawn from eight counties namely; Machakos, Makueni, Mombasa, Nakuru, Meru, Kisumu, Eldoret and Embu Counties. The sampled projects are as shown in **Annexure 1**:

Audit Assessment Criteria

- 2.4 The audit assessment criteria were drawn from:
- i. The Constitution of Kenya, 2010;
 - ii. Public Finance Management (PFM) Act, 2012;
 - iii. The Public Finance Management Regulations, 2015;
 - iv. National Treasury Budget Circulars;
 - v. Public Investment Management Guidelines;
 - vi. Individual Loan Agreements;
 - vii. The State Corporation Act, 2010; and;

- viii. Good debt management practices, for instance, the UNCTAD Principles, Debt Management Performance Assessment (DEMPA tool), 2007 revised in 2015, as shown in **Annexure 2**.

Methods Used to Gather Audit Evidence

2.5 The audit was conducted in accordance with the Public Debt Auditing and Performance Auditing Guidelines Issued by the International Organization of Supreme Audit Institutions (INTOSAI) GUID 5250 and ISSAI 3000, respectively. The audit also used the Public Debt Management Manual (Handbook for Supreme Audit Institutions), August 2020 and the Office of the Auditor General policies and the performance audit manual.

2.6 The audit mainly used document review, interviews and physical verification to gather audit evidence, in that order as outlined below:

a. Document Review

2.7 The audit team reviewed the following documents, in addition to documents listed on **Annexure 2**.

- i. To gain information on the legal framework and good practices on borrowing activities in Kenya, the audit team reviewed: the Constitution of Kenya, 2010; PFM Act, 2012; PFM Regulations, 2015; Debt and Borrowing Policy 2020; State Corporation Act, 2010; DeMPA Tool & Guide; and UNCTAD Principles.
- ii. To gain information on the processes and roles of key institutions and persons concerned with borrowing activities, the following documents were reviewed: Budgeting and Debt Management Procedures Manual; The National Treasury 's Strategic Plan, Organizational Structure and staff establishment, among other relevant documents.
- iii. To get insights on borrowing activities and trends in the Country, the following documents were reviewed; Medium Term Expenditure Framework (MTEF), Medium Term Debt Management Strategy (MTDMS), Budget Policy Statement (BPS), Budget Estimates (BEs) and Annual Borrowing Programs (ABPs) for the FY 2017/2018 to 2021/2022.
- iv. To gain an understanding on borrowing activities' level of performance, utilization of borrowed funds and any other emerging issues or challenges

faced; the audit team reviewed Office of the Controller of Budget (OCOB) Annual Debt Management Performance Reports, the Auditor-General's audit reports and External Resources Estimates Handbooks.

b. Interviews

To gain understanding on legal framework and structural arrangement; deficit financing operations, performance and challenges, the audit team interviewed key personnel in the Directorate of Budget, Fiscal and Economic Affairs; Directorate of Public Debt Management; Central Bank of Kenya; and the Office of the Controller of Budget. The list of persons interviewed and the data obtained from the interviews is as shown in **Annexure 3**.

c. Physical Verification

The audit team carried out physical verification of the 12 sampled projects to assess the status of their implementation.

Limitation of Scope

- 2.8 The audit encountered challenges in the timely provision of data on loan contracting, project preparation, approval and utilization of funds. Some of the were not vailed for audit though requested as shown in **Annexure 4** limited assessment on project preparation, approval, scrutiny and effective loan contracting. Further, gathering information through administering questionnaires was challenging as half of the interviewees were not responsive, as they were engaged in assignments related to the budget making process. To mitigate on the challenges, so as to ensure that they do not affect the quality of the audit report, the audit team administered questionnaires via email. In addition, data was gathered using other methods in order to collaborate audit evidence.

3.0 DESCRIPTION OF THE AUDIT AREA

Statutory Mandate for Borrowing Activities in Kenya

- 3.1 The Constitution of Kenya, 2010 and the Public Finance Management (PFM) Act, 2012 provides the legal framework for debt and borrowing. Article 212 of the Constitution of Kenya, 2010 clearly defines public debt and borrowing by the National Government.
- 3.2 Article 225 (1) of the Constitution of Kenya, 2010 provides for an Act of Parliament that shall establish, and spell out functions and responsibilities of The National Treasury (TNT). Section 12 (1) of the Public Finance Management (PFM) Act, 2012 sets out the responsibilities of The National Treasury.

The National Treasury

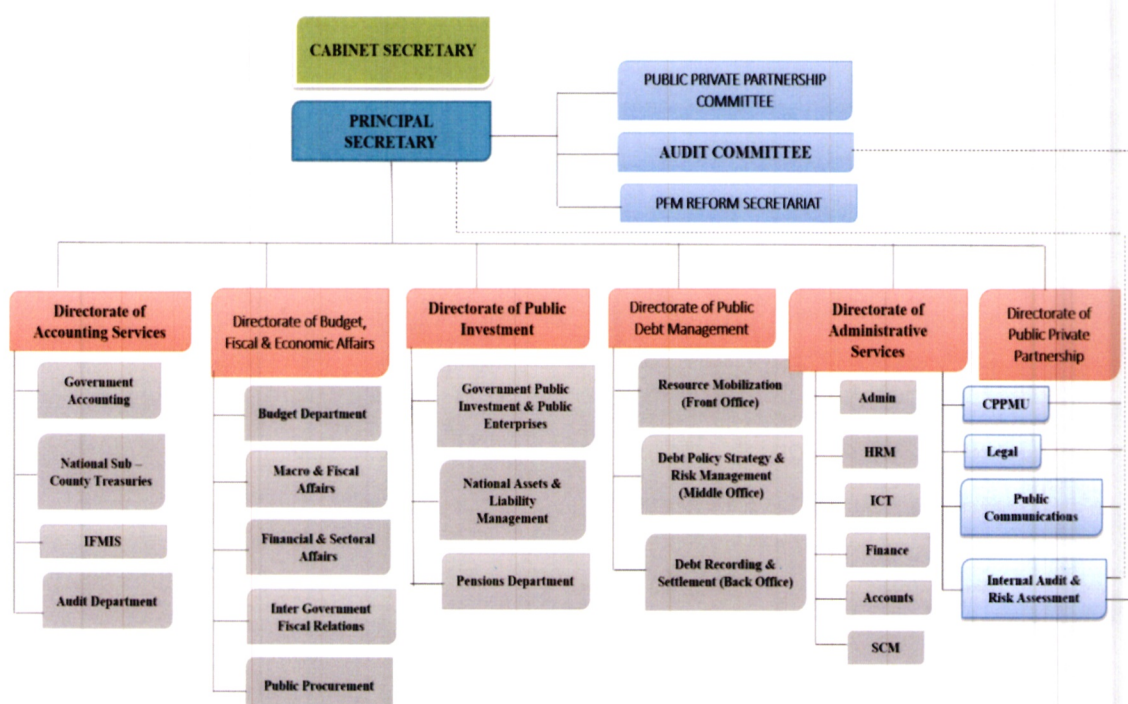
- 3.3 The responsibilities of The National Treasury as spelt out in Section 12(1) of the PFM Act, 2012 are as follows: -
- i. Formulate, implement and monitor macro-economic policies involving expenditure and revenue;
 - ii. Manage the level and composition of national public debt, national guarantees and other financial obligations of the National Government within the framework of this Act and develop a framework for sustainable debt control;
 - iii. Formulate, evaluate and promote economic and financial policies that facilitate social and economic development in conjunction with other national government entities;
 - iv. Mobilize domestic and external resources for budgetary requirements;
 - v. Design and prescribe an efficient financial management system for the national and county governments to ensure transparent financial management and standard financial reporting as contemplated by Article 226 of the Constitution: Provided that The National Treasury shall prescribe regulations that ensure that operations of a system under this paragraph respect and promote the distinctiveness of the national and county levels of government;

- vi. In consultation with the Accounting Standards Board, ensure that uniform accounting standards are applied by the National Government and its entities;
- vii. Develop a policy for the establishment, management, operation and winding up of public funds;
- viii. Within the framework of this Act and taking into consideration the recommendations of the Commission on Revenue Allocation and the Intergovernmental Budget and Economic Council, prepare the annual Division of Revenue Bill and the County Allocation of Revenue Bill;
- ix. Strengthen financial and fiscal relations between the National Government and county governments and encourage support for county governments in terms of Article 190(1) of the Constitution in performing their functions; and
- x. Assist county governments to develop their capacity for efficient, effective and transparent financial management in consultation with the Cabinet Secretary responsible for matters relating to intergovernmental relations. Further, Section 192 of PFM Regulations, 2015 provide that the National Government may borrow for the purpose of financing its budget deficit, cash management, refinancing outstanding debt, mitigation against adverse effects and meeting other development policy objectives, among other reasons. It further provides for terms and conditions for raising a loan.

The Organization Structure of The National Treasury

- 3.4 The National Treasury (TNT) is comprised of the Cabinet Secretary, the Principal Secretary and the Departments or Directorates. The Cabinet Secretary is the head of TNT, while the Principle Secretary is the Accounting Officer. TNT has six Directorates, namely; Directorate of Public Debt Management (DPDM), Directorate of Portfolio Management (DPM), Directorate of Accounting Services and Quality Assurance (DASQA), Directorate of Budget, Fiscal and Economic Affairs (DBFEA), Directorate of Administrative and Support Services (DASS), and Directorate of Public Private Partnership (DPPP). Each of the six Directorates is headed by a Director General.

Figure 2: The National Treasury 's Organogram



KEY:

AC: Accounts

CFO: Chief Finance Officer

CPU: Central Planning Unit

DA: Director of Administration

HRM: Human Resource Management

ICT: Information Communication Technology

IFMIS: Integrated Financial Management Information

PFM: Public Finance Management

PPP: Public Private Partnership

SCM: Supply Chain Management Services

The Institutional Framework for Borrowing Activities

- 3.5 Borrowing operations, including the determination of the country's borrowing need, is a function of the Directorates of Budget, Fiscal and Economic Affairs and Public Debt Management. The Directorates are each headed by a Director-General who reports to the Principal Secretary.

The Directorate of Budget, Fiscal and Economic Affairs

- 3.6 The functions of the key Departments in the Directorate are detailed below: -

I. The Budget Department

- 3.7 It is mandated with the preparation of annual estimates of revenue and expenditure that are presented to Parliament every year for approval. It also prepares supplementary estimates as need arises. The Department's functions include:

- a. coordinates the preparation and presentation of MTEF and Annual Estimates of Expenditures to Parliament;
- b. Developing broad priorities for allocation of public expenditure and implementation of the Ministerial Ceiling System;
- c. Sets up systems for the budget process, this includes; Government Finance Statistics (GFS) classification, MTEF budget and ensures that allocation of resources is consistent with government policy priorities.

II. **The Macro and Fiscal Affairs Department**

3.8 It is responsible for providing strategic support for the overall management of the economy and public finances. This is done through formulation, review, implementation, monitoring and evaluation of macro-economic and fiscal policies in the Country. Its core functions and responsibilities include:

- a. Generation of macroeconomic projections for use during planning and budgeting;
- b. Formulation, analysis and review of economic, both national and sectoral, and financial management policies, guidelines and strategies and ensure that they have been implemented;
- c. Facilitate the fulfillment of the Constitutional principles of fiscal responsibility in line with Article 201 of the Constitution of Kenya, 2010 and Section 15 of the PFM Act, 2015; and
- d. Developing, reviewing and negotiation of regional macroeconomic and fiscal policies.

The Directorate of Public Debt Management

3.9 The Directorate is organized into three Departments namely; Resource Mobilization (Front Office); Debt Policy, Strategy and Risk Management (Middle Office); and Debt Recording and Settlement (Back Office). Each Department is headed by a Director. The objectives of the Directorate include: -

- a. To minimize the cost of public debt management and borrowing over the long-term, considering risks;

- b. To promote the development of the market institutions for Government debt securities; and
- c. To ensure sharing of the benefits and costs of public debt between the current and future generations.

I. **The Resource Mobilization Department**

3.10 It performs front office functions which include: -

- a. Undertaking domestic and foreign borrowing, including raising of grants in accordance with the law;
- b. Preparation and implementation the National Government borrowing plan in consultation with the fiscal agent and prepare the annual domestic debt issuance calendar;
- c. Acting as principal in the issuance of government debt securities on behalf of TNT through implementation of the securities auction calendar;
- d. Undertaking investor relation activities, road shows, net shows, liaison and coordination with creditors and market participants;
- e. Processing government guarantees; and
- f. Coordinating missions and technical assistance from cooperative development partners.

II. **The Debt Policy, Strategy and Risk Management Department**

3.11 It performs middle office functions which include:

- a. Carrying out the government's debt management policy of minimizing its financing cost over the long-term while taking account of risk through preparation, implementation and review of the Medium Term Debt Strategy (MTDS);
- b. Monitoring and evaluating all borrowing and debt-related transactions to ensure that they are within the guidelines and risk parameters of the debt management strategy;

- c. Processing the issuance of loan guarantees, including assessment and management of risks in the National Government guarantees and Public Private Partnerships (PPP);
- d. 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;
- e. Preparing statutory debt related reports for the Cabinet Secretary;
- f. Undertaking periodic public debt sustainability analysis, portfolio risks and costs analysis;
- g. Reviewing public debt management policy and guidelines; and
- h. Advising and coordinating domestic debt market for government debt securities.

III. **Debt Recording and Settlement Department**

3.12 It performs back office functions which includes:

- a. Maintaining a reliable debt database for all loans taken by the National Government, county governments and their entities, including other loans guaranteed by the National Government;
- b. Processing and settling debt service and disbursement of loans and grants;
- c. Preparing reconciliation and maintaining financial statements on debt and grants related transactions and submitting to the Accounting Officer responsible for finance;
- d. Maintaining the public debt registry;
- e. Maintaining a comprehensive and reliable debt database for public debt and grants; and
- f. Monitoring and reporting disbursement of loans and grants.

National Government Entities

3.13 The National Government Entities (NGEs) include Ministries, Department and Government Agencies. The entities prepare estimates and proposals and submit to TNT for review and consolidation. They also serve as budget implementers. The

economy, efficiency and effectiveness of public spending is critical given the tight fiscal space and the expenditure needs under Post Covid-19 Economic Recovery Strategy (ERS), Big Four Agenda, Bottom Up Economic Transformation Agenda and broad public services delivery. NGEs are supposed to utilize funds in accordance with the principles of public finance stipulated under Article 201 of the Constitution of Kenya, 2010. Further, the Public Debt Management Office (PDMO) may rely on ministries and program managers to determine the likelihood of contingencies that will be realized in the current period.

The Office of the Controller of Budget

- 3.14 Implementation of the budget is the tail end of the process; Article 228 of the Constitution of Kenya, 2010 mandates the Office of the Controller of Budget (OCoB) to oversee the implementation of the budget. This involves receipt of all moneys raised on behalf of the National Government, issue Exchequer Releases by authorizing withdrawals from public funds; and monitoring and reporting on implementation of budget by NGEs.

Other Key Stakeholders Involved in Borrowing Activities

- 3.15 Borrowing activities is a multi-government agency process whose operations involve a number of stakeholders besides The National Treasury's Directorate of Budget, Fiscal and Economic Affairs, Directorate of Public Debt Management and MDAs. The other key stakeholders include; citizens, Parliament, donors, Central Bank of Kenya and the Office of the Attorney General.

Process Description for Borrowing Activities

- 3.16 Borrowing activities, including deficit financing operations, involve: identification, prioritization, estimation of the Country's needs; estimation of borrowing requirements; preparation of annual borrowing plans that are consistent with debt management strategies; identification of best borrowing instruments; disbursements and utilization of the borrowed funds; and loan repayment. The process description may be outlined in 11 steps as outlined below: -

Step 1: Development and Issuance of the Budget Circular or Medium Term Expenditure Framework Guidelines

- 3.17 Each year and not later than 30th August, the Cabinet Secretary for The National Treasury issues the annual budget circular to all accounting officers containing the

format, recommendations and guidelines to be followed in the preparation of the following year's budget.

STEP 2: Launching OF THE SECTOR WORKING GROUP

- 3.18 The National Treasury then launches Sector Working Groups (SWGs) who are key representatives from MDAs tasked to identify, prioritize and allocate resources to areas that will have the greatest impact to the National Government priority areas. Before 31st January of each year, SWGs submit sector reports, including printed estimates for the current year and three successive years to The National Treasury.
- 3.19 Ministries, Departments and Agencies and The National Treasury review and update their strategic plans, program outputs and public expenditures. Project committees then review and approves the projects to be implemented in the coming year, prepare annual plans and set baseline policy priorities.

Step 3: Development of the Medium-Term Budget Framework and Proposals

- 3.20 Development of the Medium-Term Budget Framework (MTBF) are done by the Macro Working Group (MWG). They carry out:
- i. Estimation of the resource envelop;
 - ii. Determination of policy priorities;
 - iii. Preliminary resource allocation to sectors, Parliament, Judiciary and counties; and
 - iv. Submit draft Budget Review and Outlook Paper (BROP) to Cabinet for approval, then the approved BROP is submitted to Parliament. BROP contains proposed ceilings for the next three financial years which may be firmed up or readjusted in the Budget Policy Statement and adopted by Parliament. Sector Working Groups then retreat to draft respective sector reports, which entails the preparation of the Medium-Term Expenditure Framework (MTEF) Budget Proposal. The National Treasury then collects views from the public sector, which are later reviewed and incorporated in the draft sector budget proposals. Each sector chairperson submits his sector report to The National Treasury for a consultative meeting with the Cabinet or Principal Secretaries on Sector Budget Proposals.

Step 4: Drafting of Budget Policy Statement and Medium-Term Debt Strategy

- 3.21 The drafting of the Budget Policy Statements (BPS) and the Medium-Term Debt Strategy (MTDS) is done concurrently by the Macro Working Group. Drafting of the BPS is done by the Macro and Fiscal Department and the Budget Department in collaboration with other key stakeholders. It involves an assessment of:
- i. The current state of the economy and financial outlook over the medium term;
 - ii. Government revenues, expenditures, and borrowing for the next year and over the medium term, proposed expenditure limits for the National Government;
 - iii. Fiscal responsibility principles and financial objectives over the medium-term, including limits on total annual debt;
 - iv. Comprehensive analysis of current and three year rolling of revenue and expenditure are analyzed to determine the Budget Deficit or Financing for these periods; and
 - v. Proposing the mode of financing the budget deficit.
- 3.22 The Debt Policy, Strategy and Risk Management Department, in collaboration with various department within The National Treasury and CBK prepare the Medium-Term Debt Strategy (MTDS). Then the MTDS is formulated annually on three years rolling basis. It involves taking into consideration the borrowing needs, prevailing macro-economic conditions and financial markets, among others. to come up with strategies aimed at minimizing borrowing costs with a prudent degree of risk. Each of the four strategies undergoes cost risk analysis or stress testing scenarios to determine the best optimal strategy to be undertaken while borrowing.
- 3.23 The Medium Term Debt Strategy will guide the borrowing mix on a rolling yearly basis which sets out the borrowing ceilings for different borrowing instruments. The optimal strategy in that year would be the basis for formulating the Annual Borrowing Program which will be used to finance the fiscal balance.
- 3.24 On preparation of the Budget Policy Statement, the NT seeks and takes into consideration views of the Commission on Revenue Allocation, County Governments, Controller of Budget, Parliamentary Service Commission; Judiciary Service Commission; the Public and other interested groups or persons.

- 3.25 The Budget Policy Statement is then submitted to the Cabinet Secretary (CS) for approval. Subsequently, the approved BPS is submitted and tabled to Parliament before every 15th February each year, for a discussion of the report containing recommendations and pass resolutions to adopt it with or without amendments. The CS shall consider resolutions passed by Parliament in finalizing the budget for the coming financial year. The relevant committee of Parliament seek views of CS on recommendations then table the report containing recommendations on Budget Policy Statement for adoption by Parliament. The Budget Policy Statement will serve as the basis of expenditure ceilings specified in the fiscal framework. The ceiling for the development expenditure and personnel spending of the National Government shall be approved by Parliament and be binding for the next two budget years.

Step 5: Preparation and Approval of Final Ministries, Departments and Agencies' Budgets

- 3.26 Line ministries submit budget proposals to The National Treasury for consolidation, which results to draft budget estimates. Then TNT submits the draft budget estimate to the Cabinet for approval, which is then submitted to Parliament for discussion, who will then make a report on it. Then TNT make the final budget estimate.

Step 6: The Budget Official Speech or Statement

- 3.27 Each financial year, the Cabinet Secretary, The National Treasury, with the approval of the Cabinet, makes a public announcement of the budget policy highlights and revenue raising measures for the National Government. On the same date, the CS submits to Parliament the Finance Bill, which sets out the revenue raising measures for the National Government. The relevant committee of the National Assembly introduces the bill in the National Assembly, together with the report of the committee on the bill. The recommendations made by the committee shall also consider recommendations of the CS as provided for in Article 114 of the Constitution of Kenya, 2010 which shall be included in the report tabled in the National Assembly.
- 3.28 Sections 40 to 42 of the Public Finance Management (PFM) Act, 2012, require that not later than 90 days after passing the Appropriation Bill, the National Assembly

shall consider and approve the Finance Bill with or without recommendations. The Parliament shall then consider the Division of Revenue and County Allocation.

Step 7: Preparation of the Annual Borrowing Program that is Consistent with the Medium Term Debt Strategy

- 3.29 After receipt of the official borrowing deficit, the Resource Mobilization Department in the Public Debt Management Directorate starts preparing an Annual Borrowing Program. The formulation of the borrowing plan is informed by the Medium Term Debt Strategy (MTDS). The Annual Borrowing Plan is an explicit document or a special legal authorization for the Public Debt Management Office to borrow funds in order to cover the Country's annual financial needs.
- 3.30 Sections 185 to 186 of the Public Finance Management Regulations, 2015 and the Public Debt and Borrowing Policy, 2020 provides that;
- 3.31 The Annual Borrowing Program shall include issuance of government securities and disbursement of external loans for the fiscal year and show indicative dates of such issuance and disbursement.
- 3.32 The Government will develop and revise the Annual Borrowing Program, which will indicate the planned issuance of Government securities and disbursements of loans for each fiscal year. The Annual Borrowing Plan considers:
- i. The maturity profile of the existing debt to avoid bunching up of maturities;
 - ii. An assessment of the ability to refinance debt at lower cost and risks;
 - iii. Prevailing domestic and international conditions;
 - iv. The prevailing secondary market conditions within the year;
 - v. The need to lengthen the maturity structure of the existing public debt;
 - vi. The need to develop liquid benchmarks bonds;
 - vii. The currency composition of the existing debt;
 - viii. The interest rate composition and any recommendations on interest rate composition for entering into future debt and;
 - ix. The need to diversify sources of borrowing and diversify creditor base.

Step 8: Implementation of the Borrowing Program

- 3.33 Section 49 of the PFM Act, 2012 and Section 187 of PFM Regulations, 2015 gives the Cabinet Secretary, The National Treasury the power to raise loans for the Government of Kenya. The Regulation further states that all funds borrowed shall be expended only on the activities included in the approved estimates of expenditure of the National Government Entities.
- 3.34 According to the Section 5.4.2.1 of the Public Debt and Borrowing Policy, 2020, the PDMO's Front Office implement the Annual Borrowing Program by undertaking domestic and external borrowing, including raising grants. Other functions that they undertake include the implementation of the auction calendar, undertaking investor relations activities such roadshows, liaison and coordination with creditors; seeking legal opinions from the Attorney General on loan negotiations and liaising with the implementing agency to ensure precedent conditions are fulfilled in time to avoid commitment fees penalties, among others.

Domestic Borrowing

- 3.35 The Auction Rules and Guidelines for the Issuance of Kenya Government Securities, January 2021 dictates that: -
- 3.36 The Public Debt Management Office (PDMO), in consultation with the department responsible for cash management and CBK will prepare the Annual Borrowing Plan, upon receipt of the borrowing requirement from The National Treasury;
- 3.37 To undertake auctions of domestic Government securities, CBK issues Kenya Shillings dominated Treasury Bills and Treasury Bonds;
- 3.38 The auction process involves;
- a. Advertisement: Notify the public of the sale of the Government security and provide details of each auction, which is published on CBK's website. Such information includes; the issue numbers, value date, auction date, bid closure date and time, offer amounts, minimum and maximum bid amounts, payment date and time, bid submission requirements, coupon rate and coupon payments dates.
 - b. Bids are then submitted electronically or manually, only those bids that abide by CBK guidelines are considered successful bids.

- c. Auction: The Multiple Price Method is used to conduct auctions. Competitive bids are ranked by yield bid, from the highest to the lowest, then the weighted average interest rate of competitive bids is computed and consideration reports are presented to the Auction Management Committee for determination of the cut-off rate and amount to be accepted.
- d. Allotment is done such that: competitive bids up to the cut off rate are allotted at bid rate; Competitive bids above the cut off rate are rejected; Noncompetitive bids are allotted at the weighted average of the cut off rate determined at the auction; All noncompetitive bids are accepted in full.
- e. Result Announcement: Auction results are normally published on the CBK website. It is the responsibility of the investor to ensure that they obtain auction results from the CBK, via phone or physically, within the stipulated deadline.
- f. Settlement: Successful investors or bids make their payments. The investors may instruct their commercial banks to remit on their behalf via Real Time Gross Settlement (RTGS) and should quote the account name, account number, issue number, reference number and the amount payable. Maturing securities held in the Central Depository System (CDS) account may be rolled over into new securities offered, provided that the appropriate instructions have been received on time. Investors who do not honor payments for their successful bids will be barred from investing for a period prescribed by CBK.
- g. Rediscounting: In the event that an investor needs to redeem their securities before maturity, and is unable to find a buyer in the secondary market, CBK will buy the security as a last resort at 3% above the higher of the prevailing market yield or the coupon rate.

External Borrowing

3.39 Section 8.1.5 of the Public Debt and Borrowing Policy, 2020 dictates that;

- a. Upon project approval of some of the projects that were earlier submitted by National Government Entities for consideration, the CS will constitute in each case a negotiating committee for each external loan and grant. Mandate of each committee will be set out in relevant regulations.

- b. Upon finalization of the loan negotiation and legal clearance by the Attorney General, the CS signs the loan agreement.
- c. A checklist of the conditions precedent to signing any loan agreement by CS will be submitted to the Project Implementing Agency in a format prescribed by the CS.
- d. The loans agreements provide terms and conditions of the loan; including brief description of the Project being financed, implementing agency, loan repayment details among other details.
- e. The front office coordinates loan disbursement, while the back-office processes, monitors and reports on the disbursement of loan funds to the project account in accordance with the disbursement guidelines. The various forms of disbursement include direct and reimbursement method.

Step 9: Disbursement of Funds

- 3.40 The Office of the Controller of Budget (OCoB) is responsible for the execution of the budget. This involves receipt of funds into the consolidated fund, withdrawals, expenditures or utilization of funds and monitoring and reporting on the implementation of the budget.
- 3.41 All the loans raised are received into and issued from the consolidated fund according to Article 206 of the Constitution of Kenya, 2010. Article 228 of the CoK mandates the OCoB to oversee the implementation of the budget by authorizing withdrawal of funds from the consolidated fund.
- 3.42 According to Section 46 of PFM Regulations 2015, the release of funds to the National Government entities shall be in accordance with the authority granted by the Controller of Budget (OCoB), together with written instructions from The National Treasury withdrawal shall be approved basing on the approved cash flow plans communicated to the NT.
- 3.43 Section 2.4.9 of the MEFMI Public Debt Procedures Manual states that, for effective planning of the project, the line ministries or the implementing agency prepares expected disbursement profiles for the uptake of the proceeds of the loan meant for implementation of the project.
- 3.44 The disbursement mode adopted can either be loan Appropriation in Aid (AIA) or loan revenue. In loan AIA, the contractor is paid directly by the creditor while in the

latter, the implementing agency pays the contractor. In this case, a special project account is opened by the Implementing Agency at the CBK where the funds, after approval from the Controller of Budget (COB), and instructions from The National Treasury, will be disbursed.

- 3.45 This disbursement then, have to be recorded in IFMIS “Revenue to Cash (R2C)” which allows for recording and reporting for funds disbursed to National and County Governments.

Step 10: Utilization of Loan Funds

- 3.46 The project funds are utilized as per the objective of the loan or the scoping in the loan agreement, project implementation plan and disbursement schedule.
- 3.47 Section 188 of PFM Regulations, 2015 provides that these sums are to be expended only on the activities included in the approved estimates of expenditure of the national government entities. Further, Section 68 (1) of the PFM Act, 2012 provides that an accounting officer shall utilize these funds in a lawful, and authorized and effective, efficient, economical and transparent manner.
- 3.48 The project progress is monitored and evaluated as per the requirement in the loan agreements.
- 3.49 Monitoring and reporting of the loan disbursement is done by the back office.

Step 11: Repayments

- 3.50 Loan repayment or settlement is done according to terms and conditions stipulated in the loan agreement. DPDM’s back office prepares repayment schedules in advance, then figures are cross checked with creditors payment advice. Instructions are then sent to OCoB for approval and later to CBK for payments.
- 3.51 Process description for borrowing activities is as shown in **Figure 3**.

Figure 3: Process Description for Borrowing Activities



Source: Auditors Analysis of PFM Act ,2012 & PFM Regulations, 2015, Budget Circulars, PDMO Manual

Source of Funding for The National Treasury

- 3.52 According to the official budget statements for the financial years 2017/2018 to 2021/2022, The National Treasury has been financing the National Government Budget, including Budget Deficit, as shown in **Table 2**. The external sources include concessional loans, semi concessional loans and commercial loans, while domestic sources include Treasury Bonds, Treasury Bills and CBK overdrafts. However, a total amount of Kshs.259.2 billion variances was noted on re-computation of the true fiscal deficit indicated in the official budget statement. The reasons for the variance was not indicated in the official Budget Statement.

Table 2: The National Government Deficit Financing Sources

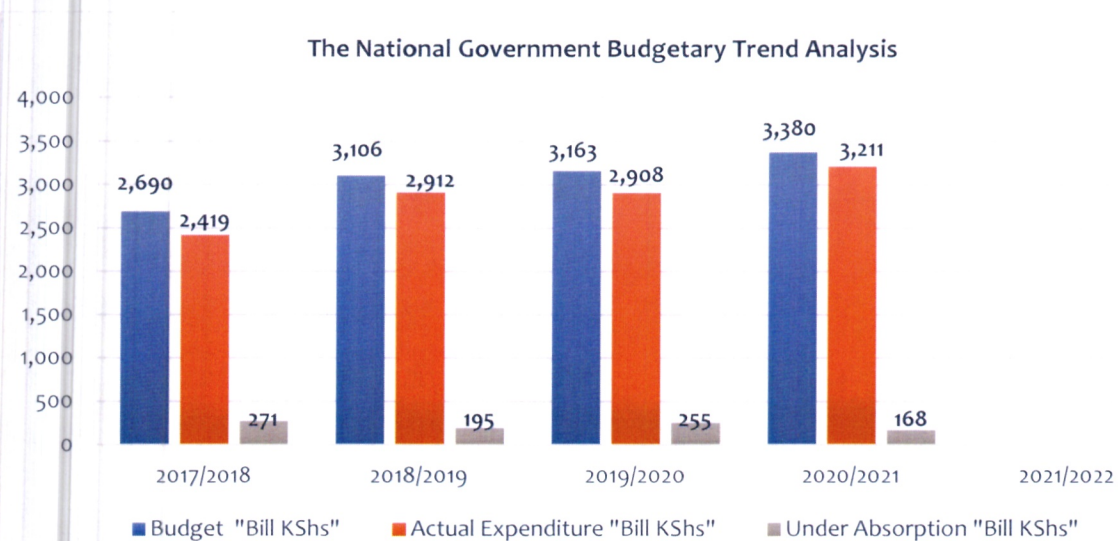
Fiscal Year	Official Budget Statement "Kshs. Millions"			Mode of Financing Deficit (Official Budget Statement)		Calculated Deficit*	Variance
	Original Approved Budget	Revenue	Fiscal Deficit	External	Domestic		
2017/2018	2,287,900	1,704,500	524,600	256,000	268,600	583,400	(58,800)
2018/2019	2,556,600	1,949,200	558,900	287,000	271,900	607,400	(48,500)
2019/2020	2,800,000	2,100,000	607,800	324,300	283,500	700,000	(92,200)
2020/2021	2,790,000	1,890,000	840,600	347,000	493,400	900,000	(59,400)
2021/2022	3,030,000	2,100,000	929,700	271,200	658,500	930,000	(300)
Total							(259,200)

Source: National Treasury's Official Budget Statement for 2017/2018 to 2021/2022

The National Government Budget Trend

- 3.53 According to the 2019/2020 National Government Financial Audit Report, the National Government budgetary allocations increased by 18%, from Kshs. 2,690 billion in the FY 2017/2018 to Kshs.3,163 billion in the FY 2019/2020. Similarly, over the period, actual expenditure increased by 20.2%, from Kshs. 2,419 billion in the FY 2017/2018 to Kshs. 2,908 billion in the FY 2019/2020. This is shown in **Figure 4**.

Figure 4: The National Government Budget Trend Analysis



Source: Office of the Auditor-General 2019/2020 Report on the National Government Financial Statements

- 3.54 The above analysis indicates that the under-absorption of the budget has been on average at 7% of the gross estimated expenditure in the last five years. The under-absorption of the budget implies that some development programs and delivery of services were not implemented as planned. It may also imply that the estimated expenditure may not be comprehensively backed by accurate data, thereby leading to over estimations.

4.0 FINDINGS OF THE AUDIT

4.1 In the recent past, The National Treasury has put in place measures towards enhancing the management of public debt, which include the following;

- i. There has been increased provision of information through publication of public debt information. For instance, monthly debt bulletins, annual public debt management reports and budget books can be accessed from TNT's website;
- ii. In the interest of sustainable management of debt, TNT drafted the Public Finance Management (Amendment) Bill, 2021 which is currently in its final parliamentary stages of approval. The amendments in the Bill seek to have the debt limit approved by Parliament and ensure that it is anchored on sustainability, as advised by a competent institution, so as to provide a proper definition of public debt and county public debt. The proposals also seek to have a new function added to the Public Debt Management Office (PDMO), to advise Parliament on sustainable debt levels; and
- iii. The formulation and preparation of the National Budget has been adhering to budget guidelines and timelines, as provided for in annual National Treasury circulars. This has contributed to timely achievement of expenditure targets and market confidence.

4.2 However, despite the above efforts, audit findings indicate that deficit financing operations were not effectively carried out, as detailed below: -

A. Inadequate Alignment of Deficit Financing Operations to Debt Overall Objectives and Strategies

I. Non-Finalization of Procedure Manuals and the Commonwealth Meridian End User Licensing Agreement

4.3 Section 64(1) (a) of the Public Finance Management Act, 2012 require the Cabinet Secretary for The National Treasury to develop policies and financial frameworks in accordance with the Constitutional Principles within which the Public Debt Management Office (PDMO) operates. Further, the Debt Performance Indicator (DPI)-9 Dimension 2 DeMPA, 2015, recommends that procedures for all external borrowings be reviewed and updated annually for concurrence and alignment with

the latest regulations and technology, and to ensure consistency with organizational best practices.

- 4.4 Review of policies and procedure manuals revealed that the Directorate of Public Debt Management has Procedure Manuals in draft status dating from 2014. As at the time of the audit, the status of Policies and Procedure Manuals were as indicated in **Table 3**.

Table 3: Analysis of Delay in Updating Manuals and Policies

Procedure Manual/Policy	Department	Date of Last Update	Time of Audit	Period (Days)	Period (Years)
Kenya Resources Policy	Resource Mobilization Department	Dec-14	May-22	2,708	7
Draft External Operations Manual	Resource Mobilization Department	Apr-19	May-22	1,126	3
Draft Back Office Operational Manual	Debt Recording and Settlement	Oct-14	May-22	2,769	8
Draft Job Description Manual for Resource Mobilization Officer Cadre	Resource Mobilization Department	Dec-20	May-22	516	1
Average Period					5

Source: OAG Analysis of Draft Manuals

- 4.5 Interviews with Public Debt Management Office (PDMO) staff revealed that the finalization of the above drafts was awaiting the signing of the Commonwealth Meridian End User Licensing Agreement (EULA) by The National Treasury. Review of correspondences with the reference No. G/DMU/YDCWG1039 and The National Treasury Internal Memo referenced TNT/DMD/4/156 "A" (75) revealed that a request by the Commonwealth to The National Treasury to sign EULA was done on 06 October, 2020. As at the time of audit, the signing of the EULA was awaiting adoption of the proposed amendments by Commonwealth. This was after review and legal clearance from Ministry of Information Communication and Technology; Innovation and Youth Affairs; and the Office of the Attorney General and Department of Justice.
- 4.6 Commonwealth Meridian is the new Debt Recording and Management System (DRMS) designed by the Commonwealth Secretariat. It is superior to the Commonwealth Secretariat Debt Recording Management System (CS-DRMS). This is because it has the following features: Supports the recording, management and analysis of the entire public debt universe, including domestic debt, guaranteed debt and private sector debt; allows debt managers to model any work

flow as per institutional arrangement requirements; and allows for integration with external systems to provide end to end processing and accurate data to stakeholders. Further, it is web-based, implying that installation and granting access to users will be easier.

- 4.7 The lack of timely up-to-date and incorporation of new developments, laws and regulations into day-to-day debt management operations exposes the management of public debt to operational risks such as delays in processing debt transactions, inadequate compatibility of roles and functions across departments.

II. The External Operations Manual Lacking Key Debt Operations Process

- 4.8 The Debt Management Performance Assessment (DeMPA) tool, Debt Performance Indicator (DPI)-9 Dimension 2, 2015, require debt managers to document steps taken in all processes on external borrowing operations by way of borrowing plans and assessment of cost-effective borrowing terms and conditions, as a minimum. Further, it states that the documented procedures should identify the organizational entities and the key functions within them. This includes Front Office, Middle Office, and Back Office, that undertake the main public debt processes when mobilizing external sources of financing.
- 4.9 Content analysis of the Resource Mobilization Department's Draft External Operations Manual, dated April 2019, revealed that it did not have details on processes for the formulation and implementation of annual borrowing programs. No explanations were provided for failure to include the process in the manual. Inadequate procedures guiding debt operations may lead to limited transparency and accountability in debt operations and may inhibit the implementation and monitoring of debt borrowing strategies

III. Inadequate Staff Capacity

- 4.10 Section 64 (c) of the Public Finance Management Act, 2012 requires the Cabinet Secretary to ensure that the Public Debt Management Office has the requisite resources and skills to manage debt and borrowing, according to International Best Practices for Liability Management. Further, DPI-13 Dimension 2 DeMPA, 2015, recommends that a sufficient number of debt management staff should be employed, be adequately trained, and that individual job descriptions should be developed.

- 4.11 Further, review of The National Treasury 2018/2019 -2022/2023 Strategic Plan and interviews with staff revealed that the Budget, Fiscal and Economic Affairs and the Public Debt Management Directorates had 130 members of staff against a staff establishment of 214, resulting in a deficit of 84 members of staff, as shown in **Table 4**.

Table 4: The National Treasury 's Staff Capacity Analysis

National Treasury Department	Authorized Establishment	In-Post	Variance (Authorized - In post)
Director General, Budget, Fiscal and Economic Affairs	1	1	0
Director General Public Debt Management	1	1	0
Budget or Finance Officers	81	66	15
Macro and Fiscal Policy Officers	46	22	24
Resource Mobilization Officers	46	27	19
Debt Policy, Strategy and Risk Management Officers	19	6	13
Debt Recording and Settlement Officers	20	7	13
Total	214	130	84

Source: The National Treasury 's Strategic Plan for the FY 2018/2019 to 2022/2023

- 4.12 Interview with The National Treasury staff revealed that six (6) new staff, recently deployed to the Back Office, were yet to be trained. In addition, interviews with Public Debt Management Office staff revealed that there was understaffing in the Front and Back Offices. This led to some Front and Back Office functions being performed by Middle Office staff, without formal authorization. The inadequate capacity exposes debt management to operational and fraud risks, such as inadequate processing of debt transactions and inadequate segregation of duties. Details on inadequate segregation of duties is shown in **Table 5**.

Table 5: Inadequate Segregation of Duties

Roles and Responsibilities	Required to Be Performed by	Performed by
Entry of Public Debt Information in the System	Debt Recording and Settlement (Back Office)	Debt Policy, Strategy and Risk Management (Middle Office)
Euro Bond Road Shows	Resource Mobilization Department (Front Office)	Debt Policy, Strategy and Risk Management (Middle Office)
Credit Risk Analysis or Concessional Analysis	Resource Mobilization Department (Front Office)	Debt Policy, Strategy and Risk Management (Middle Office)
Preparation of Annual Borrowing Programs for Domestic Borrowing	Resource Mobilization Department (Front Office)	Debt Policy, Strategy and Risk Management (Middle Office)

Source: Interviews and Minutes of Meeting with the Public Debt Management Office Staff

IV. Delay in the Operationalization of the Project Implementation Management Unit

- 4.13 Review of Project Implementation Management Unit (PIMU) background, indicated diagnostic studies, together with recommendations by World Bank and IMF Africa Regional Technical Assistance Centers (AFRITAC) east 2016, 2017 and 2018 revealed that the Public Investment Management Unit (PIMU) was established in 2018. After its establishment, The National Treasury issued Public Investment Management (PIM) Guidelines to all accounting officers on 24 January, 2020 through The National Treasury Circular No. 16/2019. This was in response to challenges faced during project implementation which were largely attributed to poor project preparation, appraisal, monitoring and implementation
- 4.14 Interviews with PIMU staff revealed that the Unit had not been operationalized since its establishment in 2018. This was attributed to the factors detailed below:
- i. The unit had proposed an establishment structure for approval by TNT, however, the approval had not been granted as at the time of audit;
 - ii. Capacity Challenges: As at the time of the audit, the unit had 10 technical officers, with majority of them having been seconded from other Ministries, Departments and Agencies; and
 - iii. The Project Investment Management Information System (PIMIS) had not been rolled out. PIMIS provides a database for all projects, automates project approval processes and provides a platform for accessibility of information by stakeholders. However, the system had not been rolled out as at the time of the audit. Consequently, information on projects continues to be managed under the Electronic Project Monitoring Information System (e-Promis platform).
- 4.15 The delay in the operationalization of the Unit and the implementation of PIM Guidelines contributes to inadequate project scrutiny and inadequate gate keeping function during project cycle. The outcome of this is that it extends the vicious circle of inflated project portfolio, low budget execution, wastage of resources that are not aligned to the national development agenda, delayed translation of project outputs to benefits.

V. Conflicting Responsibilities in the Preparation of Annual Borrowing Programs in the Agency Agreement between The National Treasury and the Central Bank of Kenya

- 4.16 The overall responsibility for the preparation of Annual Borrowing Programs with indicative dates for issuance of Government securities and disbursement of external loans is the responsibility of PDMO's Resource Mobilization Department, in accordance with Section 63 (d) of the Public Finance Management Act, 2012 and Section 63 (f) of the Public Debt and Borrowing Policy, 2020. Further, section 103 of the approved Public Debt and Borrowing Policy, 2020 specifies the role of the Central Bank of Kenya as consultative. However, review of Section 5.2 of the Agency Agreement between The National Treasury and Central Bank, 2016 provides that on receipt of the domestic borrowing requirement from TNT, the Central Bank of Kenya should prepare a borrowing program for approval by the National, Treasury. This is contrary to the PFM Act, 2012 and the Public Debt and Borrowing Policy, 2020. Further, DPI-1's legal framework as stated in DeMPA, 2015 recommends for a secondary legislation to have clear authorization in undertaking debt related transactions. Review of the agreement between TNT and CBK revealed that there were conflicting roles on preparation of domestic borrowing programs as Section 4.2 of the agreement states that TNT will be responsible for the formulation of the domestic debt borrowing program for government securities. While Section 5.2 of the agreement states that on receipt of the domestic borrowing requirement from the NT, the Central Bank of Kenya would prepare a borrowing program for approval by The National Treasury. This overlap in roles could lead to conflicts in debt management operations and inadequate segregation of fiscal operations from monetary operations.

VI. Challenges in Retrieval of Loan Information

- 4.17 A good filing system is secure, robust and ensures easy and fast retrieval of information. During the audit, it was observed that the resource mobilization department's correspondence files on some of the funded projects were filed according to creditors, rather than specific projects. Therefore, retrieval of specific information on particular project funded through loans requires unnecessary review of all project files and records of the respective creditor. This exposes debt management activities to operational risks such as transaction delays; difficulties

in retrieval, reconciliation of information and follow up on donors, implementing agency and TNT progress, amongst others.

VII. Inconclusive Annual Borrowing Programs

- 4.18 Section 63 (d) of the Public Finance Management Act, 2012 and Section 63 (f) of the Public Debt and Borrowing Policy, 2020 require the Resource Mobilization Department (RMD) to prepare and implement the National Borrowing Plan.
- 4.19 Further, Section 186 (2) of PFM Regulations, 2015 and Section 92 of the Public Debt and Borrowing Policy, 2020 require the borrowing plan to include the issuance of government securities and disbursement of external loans for the fiscal year, with indicative dates for such issuance and disbursements. Review of documents on annual borrowing program provided for audit revealed that, although the MTDS had been prepared, its operationalization through an annual borrowing has been inadequate as the RMD first Annual Borrowing Plan (ABP) was only prepared and approved in April 2022. The implication is that the actual contracting of debt stock up to 2021 was not undertaken based on an Annual Borrowing Plan.
- 4.20 Although the annual borrowing plan (ABP) dated April (2022) was submitted for audit review, its use in bridging the budget deficit during the financial year 2021/2022 could not be established as it was approved two (2) months before the end of financial year. Management explained that lack of annual borrowing programme was due to inadequate Policies and technical capacity. This poses the risk of over-borrowing or under borrowing and liquidity other challenges.

VIII. Non-Compliance to Optimal Debt Management Strategies

- 4.21 Section 185 (1) of the Public Finance Management Regulations, 2015 require that any borrowing by the National Government shall be informed by the Medium Term Debt Management Strategy (MTDS), which shall be reviewed annually, prepared and executed by PDMO in accordance with the delegated authority by the Cabinet Secretary. Further, Section 88 of the Debt and Borrowing Policy, 2020 and DPI- 3 dimension 2 on development of MTDS of DeMPA, 2015 recommends that the government should have a robust decision-making process for strategy development, considering prevailing market conditions, macroeconomic environment, and borrowing needs, among others.

- 4.22 Review of documents on planning for borrowing provided for audit revealed that BPS and Budget Statement do not comply with provisions of Section 185 (1) of PFM Regulation, 2015 which requires that any borrowing should be informed by MTDS. A further review of the BPS, the Budget Statement and the actual borrowing revealed deviations of approximately 23%, 15%, and 4% levels respectively from the strategies prescribed in the MTDSs as analyzed in **Table 6**: -

Table 6: Comparative Analysis of Deficit Financing Mix Ratios Mix

Fiscal Year	Deficit Financing Mix Ratios External: Domestic							
	MTDS Strategy		Budget Policy Statement		Budget Statement		Actual Borrowing	
			Ratio	Level of Deviation from MTDS	Ratio	Level of Deviation from MTDS	Ratio	Level of Deviation from MTDS
2017/2018	Strategy 2	63:37	41:59	22	49:51	14	56:44	7
2018/2019	Strategy 1	57:43	37:63	20	51:49	6	57:43	0
2019/2020	Strategy 1	38:62	53:47	15	53:47	15	41:59	3
2020/2021	Strategy 4	28:72	60:40	32	41:59	13	34:66	6
2021/2022	Strategy 4	57:43	29:71	28	29:71	28		
	Average		23		15		4	

Source: MTDS and BPS, 2017/2018 to 2021/2022 and, the Annual Debt Management Report 2019/2020 to 2020/2021

- 4.23 The audit established that the inconsistencies between foreign and domestic borrowing was attributed to inadequate coordination between the Directorate of Public Debt Management and the Directorate of Budget, Fiscal and Macro Affairs during budget preparation.
- 4.24 The Medium Term Debt Strategy gives an assessment of the Country's debt sustainability and impact of new loans on the debt portfolio. Therefore, non-alignment of annual borrowing to the MDTs optimal strategy may lead to unsustainable levels of debt.

IX. Non-Adherence to Budget and Appropriation Committee Thresholds

- 4.25 Section 196 (2) of the Public Finance Management Regulations, 2015 require that the annual thresholds for annual borrowing by the National and County Governments and their entities shall be set by Parliament.

4.26 Review of the Budget and Appropriation Committee (BAC) Report on MTDS and Budget Policy Statements indicated that in the financial years 2017/2018 and 2019/2020, the deficit financing ceilings had not been specified. Further, in the financial year 2018/2019, the approved deficit ceiling was 635.5 billion set by Parliament while the actual borrowing was surpassed by Kshs. 85.6 billion. Justification for the extra borrowing of Kshs 85.6 billion was not supported as review of BAC report on 2nd supplementary estimates for the financial year 2018/2019 revealed that as a result of revenue underperformance by Kshs. 97.7 billion, the Committee resolved to approve a supplementary budget of Kshs. 50 billion, to be raised through reallocations and not borrowing. The non-adherence to budget and appropriation committee's thresholds is shown in **Table 7**.

Table 7: Analysis of Non-Adherence to Deficit Financing Ceilings

Fiscal Year	BPS Deficit Inclusive of Grants Kshs. "billions"	Budget & Appropriation Committee (BAC) Report Fiscal Deficit Ceilings: Kshs. billions"	Actual Financing PDMR	Deviation	Remarks
2017/2018	620.8	—	607.8		BAC report for the financial year 2017/2018 was not provided
2018/2019	635.5	635.5(6.5% of GDP)	721.1	85.6	BAC Report on 2nd Supplementary. Estimates FY 2018/19. Revenue underperformed by Kshs. 97.7 billion. Supplementary was to address the shortfall in salaries, security related and drought management. Resolved to approve the supplementary of Kshs. 50 billion to be raised through reallocations. Borrowing was not an option.
2019/2020	748.1	—	791.2		BAC report did not specify the fiscal deficit ceiling
2020/2021*	966.6	966.6	950.2	-16.3	Below ceiling
2021/2022	930.0	930.0			The Public Debt Management Report for FY 2021/2022 was not yet issued.
2022/2023	846.0	400.0			The Financial year 2022/2023 had not started yet. Approved Kshs. 400 billion to avoid breaching the Kshs. 9 trillion ceiling.

Source: OAG Analysis of Budget Policy Statements, Annual Public Debt Management Reports, and Budget and Appropriation Committee Reports

- 4.27 Further, the audit revealed that the inadequate capping of annual borrowings would result in unplanned borrowing.

X. Non-Achievement of the Deficit Ceilings and Targets by East African Monetary Union Protocol and The National Treasury

- 4.28 Article 6 Section 2b of the East African Monetary Union Protocol Deficit Ceilings sets the ceiling on fiscal deficit, including grants targets at 3% of GDP in mid-term. In addition, TNT targets to reduce fiscal deficit to 3.5% of GDP in the mid-term i.e. by reducing gradually from 8.2% of GDP in 2021/22 to 6% of GDP in 2022/23 to 3.9% of GDP in 2024/25. These targets are unlikely to be achieved as the actual deficit has been increasing from 7.6% of GDP in 2018/19 to 7.8% of GDP 2019/20 through 8.5% of GDP in 2020/21.
- 4.29 Failure to achieve the targets could be as a result of increasing deficit, due to revenue underperformance. Analysis of actual versus targeted revenue collections in the quarterly budget reviews for the financial year 2017/2018 to 2021/2022 revealed an overall under-collection of ordinary revenue of Kshs. 325 billion. This was despite the growth in actual revenue by 14.4%, as shown in **Annexure 5**.

XI. Unprecedented Borrowings from the Domestic Market

- 4.30 Section 62 (3) of the PFM Act, 2012 states that one of the objectives of the Public Debt Management Office is to minimize the cost of public debt management and borrowing over the long term, while considering risks. Review of planning and debt performance reports revealed that a total amount of Kshs. 698.56 billion was borrowed beyond the BPS budget deficit target for the period under review. Further, the audit established that Kshs. 297.76 billion, representing 42.63% of Kshs. 698.56 billion, was sourced externally while Kshs. 400.80 billion, representing 57.37% of Kshs. 698.56 billion was sourced as domestic debt, as indicated in **Table 8**.

Table 8: Unprecedented Borrowing in the Domestic Market

Year	Estimated Annual Financing Mix _ (Kshs. Billion			Actual Borrowed Funds _ (Kshs. Billion)				Excess Funding from External Kshs (Billion)	Excess Funding from the Domestic Market Kshs (Billion)
	BPS Proposed Deficit Financing			Actual Deficit Financing					
	External (Billion)	Domes-tic (Billion)	BPS Total Budget Deficit Kshs Billion	External (Billion)	Domes-tic (Billion)	Total Actual Deficit Financing	Under / Over Borro-wing		
2017/18	349.44	232.96	582.4	331.64	276.333	607.97	25.57	17.80	(43.37)
2018/19	363.77	274.43	638.2	414.52	306.54	721.06	82.86	(50.74)	(32.11)
2019/20	239.36	390.54	629.9	340.81	500.187	840.99	211.09	-(101.44)	(109.65)
2020/21	159.94	411.26	571.2	323.31	626.926	950.24	379.04	(163.37)	(215.66)
2021/22	530.10*	399.90*	930*						Report not published
Total	1,642.61	1,709.09	3,351.7	1,410.27	1,709.99	3,120.26	698.56	(297.76)	(400.80)

Source: Comparison Analysis of MTDS, BPS, 2017/2018 to 2021/202 and Annual Debt Management Reports for FY 2019/2020 to 2020/2021

- 4.31 According to the 2021 MTDS report, the outstanding debt as at 31 December 2020 was Kshs.7,041.2 billion, equivalent to 63.3% of GDP. The domestic debt comprised of Kshs. 3,438.2 billion, representing 30.9% of GDP, while the external debt accounted for Kshs. 3,603.0 billion, representing 32.4 % of GDP. The audit established that the external debt portfolio was dominated by concessional debt at 38.8%, while semi concessional and commercial debt accounted for 30.4% and 30.7% respectively. Further, the domestic debt portfolio comprised of Treasury Bills, Treasury Bonds, and Pre-1997 Debt at 24.9%, 74.5% and 0.6%, respectively. As at the end of December 2020, the domestic debt interest payment was 3.4% of GDP while the external debt interest payment was 1.0% of the GDP.
- 4.32 In view of the above analysis, the audit established that a fair share of the Country's public debt and its service costs was comprised of domestic debt whose interest rate was more than twice that of the external debt component.
- 4.33 For detailed assessment of loan contracting and utilization of the contracted loans, the audit sampled 12 loan funded projects as shown in **Annexure 6**.

B. Inadequate Loan Contracting Leading to High Loan Costs and Increased Risk of Borrowing

- 4.34 The audit sampled 12 projects funded by loans and assessed them based on; initial project documents, The National Treasury project approvals, public participation, credit analysis, involvement of implementing agencies during loan negotiation, legal advice and prior engagement between the Resource Mobilization Department (Front Office) and the implementing agency, through an agreed disbursement schedule. The findings of the assessment are detailed below: -

I. Inadequate Project Initial Documents

- 4.35 Section 205 of PFM Regulations, 2015 Section 22 (3) of the Public Investment Management Guidelines issued by The National Treasury through Circular No. 16 of 2019 and the Draft External Resource Manual 2019 require the implementing agency to prepare a concept note and project proposals and feasibility study designs. Out of the 12 sampled projects, the audit established that seven (7) projects had Initial Project Documents i.e. four (4) projects namely; Konza Data Center and Smart City Project, Menengai Geothermal Project, Mwea Irrigation Development Project and LV-WATSAN had identification, justification and feasibility studies done and three (3) projects namely; Upgrading Rivatex, Kisumu Urban and Eldoret Town By-Pass projects had only feasibility studies done. Initial project documents for the remaining five (5) projects were not availed for audit. Inadequate initial project documents may result in insufficient scrutiny of projects details before commencement of the budget cycle.
- 4.36 Review of documents provided for some of the projects revealed inconsistencies in the dates when the projects were initiated. For instance, proposal documents for the Menengai Geothermal Project was dated 27 June, 2012 yet the loan agreement was signed on 12 March, 2012. Further, the concept notes for the Kisumu Urban Project was dated 19 October, 2012 yet the loan agreement was signed on 5 July, 2010.
- 4.37 As a result of poor documentation, the scrutiny and approvals of these projects amounting to approximately Kshs. 99.83 billion before entering the budget cycle by National Treasury, could not established. This could imply that more undesirable projects are being approved for funding leading to bloated project portfolio as a

result of non-disbursing & non-performing projects resulting to a narrow fiscal space.

II. Non-Provision of Projects Approvals

- 4.38 Section 11 (2) of the State Corporations Act, Revised Edition 2012, provides that no annual estimates and proposals for funding projects shall be implemented until the proposals have been approved by the Cabinet Secretary, with concurrence of The National Treasury. Document review revealed that the sampled 12 projects had been budgeted for. However, no project approval documents were availed for audit by The National Treasury. Further interviews with the implementing agencies revealed that the project approvals were not availed to them by The National Treasury. Lack the approvals could imply that inappropriate projects are being funded, consequently leading to wastage of funds.

III. Inadequate Public Participation

- 4.39 Section 205 of PFM Regulations, 2015 and Section 22 (3) of PIM Guidelines Circular No. 16 of 2019, and the Draft External Resource Manual 2019, require the implementing agency to ensure that during the project identification and design, the intended beneficiaries are involved through public participation. Public participation through various forums enhances project leadership, ownership, social accountability and sustainability. In addition, public participation is used to gather information during the initial screening of the project idea, with a view of assessing its suitability for funding or recommendation for further studies in the form of feasibility studies.
- 4.40 The audit established that there was no involvement of the intended beneficiaries during project identification in all the 12 sampled projects. The Lake Victoria Water and Sanitation (LV-WATSAN) project stakeholder participation was adequate, however, the stakeholder engagement started at the project design stage. Further, there was no prior beneficiary engagement for the upgrading of Makindu Level 4 Hospital. Consequently, hospital officials had to negotiate for amendments during the implementation phase of the project.
- 4.41 Four of the sampled projects, submitted reports on public participation, however, there was no evidence that public participation took place as information on public participation, such as request for public participation, evidence of forums held, minutes and signed lists of attendees, and how the public opinions were to be

considered in the implementation of the projects were not availed. Therefore, the authenticity on whether stakeholder engagement took place could not be established. These projects are Konza ICT, Menengai Geothermal Eldoret Town By-Pass and Kisumu Urban.

- 4.42 The inadequate involvement of the intended beneficiaries in all project cycle, contributes to limited project support and limited project sustainability beyond completion.

IV. Lack of Documentation on Whether Credit Analysis Assessment was Conducted Prior to Loan Contracting

- 4.43 Section 5.2 of MEFMI Procedures Manual provides that front office services should be able to evaluate funding prospects and their impact on the debt portfolio, in terms of compliance with the approved strategy. Further, evaluation should be made of the technical, financial and legal terms and conditionalities of the external loan proposals, including the loan purpose, conditions for disbursing loans and the degree of concessionality. This should be in line with the Middle Office Debt Management Strategy. Interviews revealed that middle office is responsible for credit analysis assessment of creditors' loan proposals. The credit analysis assessment results are then used by the front office to select appropriate creditors. However, on request for these documents, both offices did not provide the said documents, therefore, the audit could not assess whether credit analysis assessment was done prior to loan contracting.

Inadequate Involvement of Implementing Agencies during Loan Negotiation

- 4.44 Section 5.2.2 of the MEFMI Manual recommends that for effective loan negotiation, the negotiating team should comprise of well-trained professionals who can meaningfully engage the experienced negotiating teams of creditor institutions or countries. Further, the manual states that there must be representation from the sectors involved, the parent ministry, the Ministry of Finance, the debt office, and the government legal office (Attorney General).
- 4.45 The audit established that two (2) of the 12 sampled projects had documentation on loan negotiation, namely the Eldoret Town By-Pass and the Mombasa Special Economic Zone (SEZ) project.

4.46 Further, review of minutes of loan negotiation meetings of the Mombasa Special Economic Zone (SEZ) project revealed that the Kenya Ports Authority (KPA), who are among the key project implementers, did not attend the loan negotiation meeting despite being invited through letter Reference No: TC-19-154 (NT), dated 07 August, 2019. In addition, interviews with the project implementing agencies revealed that five (5) out of the 12 sampled projects were not involved during loan negotiation.

4.47 Therefore, there is a likelihood of project construction risks and repayment risks due to inadequate project ownership and lack of a clear understanding of each party's obligations prior to the commencement of projects.

V. Failure to Obtain Sufficient Legal Advice on Contracted Loans

4.48 The Debt Management Performance Assessment (DeMPA) tool, 2009, DPI-9 recommends that it is important for debt managers to receive appropriate legal advice and to ensure that the debt transactions they undertake are backed by sound legal documentation. The audit established that out of the 12 sampled projects, only eight (8) projects had documentation on legal advice indicating that they obtained the Attorney General's Office legal advice. This is as analyzed in **Annexure 7.**

4.49 Evidence of obtaining legal advice from the Attorney General (AG) was not availed for the remaining four (4) projects. The projects include the upgrading of the Rift Valley Textiles (Rivatex) Factory Project, the North Eastern Transport Improvement Project, the Kisumu Urban Project and the Mwea Irrigation Development Project. Therefore, there is a risk that some legal issues were not mitigated, which could result in the agreements legality and validity being questionable. In the circumstance audit could not establish whether all legal issues were mitigated. For the eight (8) projects with documentation; there was evidence of effective reviews as follows: -

4.50 In Konza Data Center & Smart City Project the AG Office after review of the contract agreement between Huawei Technologies and Ministry of ICT, ensured that 40% of the local content was incorporated in the contract through Supplementary 3.

- 4.51 In the eight (8) projects, the indebtedness of the Country was assessed prior to committing to the loan to ensure that the debt ceiling is not breached. The AG office also made effort in ensuring that a neutral ground rather than creditors home country is adopted as court of arbitration, in case of breach as seen in Special Economic Zone Dongo Kundu Project.

VI. Lack of Prior Engagement Between the Resource Mobilization Department and Implementing Agencies

- 4.52 The Debt Management Performance Assessment (DeMPA) tool, 2009 DPI-9 and Section 2.4.9 of MEFMI Debt Procedures Manual require that Debt Managers (DeM) to liaise with line ministries to ensure that they coordinate with the creditor in ensuring that disbursements are completed according to the loan agreement terms. Further, the implementing agency is required to prepare the expected disbursement profiles for the uptake of loan proceeds for implementation of the project. The disbursement schedule needed to have been agreed upon by The National Treasury and the respective creditor. The disbursement schedule was to be used to guide project implementation and act as a monitoring tool in adherence to disbursement timelines.
- 4.53 The audit established that in all the 12 sampled projects, none of the project had an agreed and approved disbursement schedule. This could have contributed to slow uptake of loans and delay in the completion of projects, leading to payment of commitment fees. **Annexure 7** contains more details on the engagement between The National Treasury and implementing agencies.

Payment of Commitment Fees Penalty due to Non-Disbursed Loans

- 4.54 Interviews with The National Treasury staff and reviews of CS-DRMS extract revealed that 16 projects whose date of loan agreements ranged between 2014 and 2021 but were yet to start, resulting to payment of Kshs.1,123,976,797 as commitment fee on non-disbursement amounts as shown as in **Annexure 8**.
- 4.55 The penalty payment was mainly due to failure to fulfill the precedent conditions stated in the respective loan agreements. It was further noted that a project dating from 2014 had not commenced at the time of audit April 2022.
- 4.56 The delayed completion of projects may deny Kenyan citizens timely realization of project benefits. In addition, extra debt servicing costs cumulatively narrow a

Country's fiscal space, leading to an increase in fiscal deficit and consequently resulting in the increase of public debt.

VII. The National Treasury Incurred Avoidable Costs due to Delays in Project Execution

- 4.57 Review of project timelines for the 12 projects sampled for the audit revealed that there were delays in execution of projects. The delays resulted in The National Treasury incurring avoidable costs totaling to Kshs.4,629,318,570. The costs comprised of commitment fees, interest and claims. **Annexure 9** details an analysis of avoidable costs due to delays in project execution. As analyzed in the above table, project delays caused by the various reasons such as delays in the implementation of the Resettlement Action Plans (RAP), delays in the release of the GoK counterpart funding, delay in the fulfillment of the of condition precedent from multiple donors led to payment of avoidable costs amounting to Kshs.4,629,318,570, thereby increasing the cost of borrowing.

C. Ineffective Utilization of the Contracted Loans

I. Untimely Update of Payments in the Commonwealth Secretariat Debt Recording and Management System

- 4.58 The audit revealed that there was a negative variance of Kshs.5,556,139,511 and a positive variance of Kshs.11,940,309,483.07 between amounts in Payment Vouchers (PVs) and CS-DRMS disbursed amount. **Table 9** details payments not updated in CS-DRMS.

Table 9: Payments not Updated in CS-DRMS

N o.	Project Name	Amount	Payment Voucher Amount	CSDRMS Disbursements Loan Currency	Variance PVs Vs Drawdowns	Approx. Kshs. "Bill" Equivalent Deficit	Appro Kshs. "Bill" Equivalent Surplus	Remarks
1	Kenya Konza Data Centre and Smart City Facilities Project	159 Million USD	73,792,555.59 USD	68,549,443 USD	-5,243,112	610.33		USD 5,243,112.13 not recorded in CSDRM S. Direct AIA
2	Mombasa Port Area Roads Development Project (MPARD)-2	12.466 Bill JPY	USD 85,372,311.46 JPY 2,196,325,178	0	USD 85,372,311.46 JPY 2,196,325,178		11.940	Amounts not Captured in CSDRM S. Direct AIA
3	Mwea Irrigation Development Project*	13.178 Billion JPY	3,039,623,120.22 (Kshs)	8,151,627 JPY	-5,120,408,499	4,668.46		Direct AIA
4	Eldoret Town Bypass*	82 Million USD	4,076,322,323.45 (Kshs)	32,635,268 JPY	-2,382,607	277.35		Direct AIA
					Total Kshs.	5,556.14	11.940	

Source: OAG Analysis of Project Payments Vs CSDRMS Disbursements

- 4.59 This could imply that debt records are inaccurately stated. Since debt is created only when a loan is partially or fully disbursed, failure to capture the disbursements accurately in the debt information management system could result in inaccurate reporting of public debt balances. It was further revealed the affected projects used direct loan Appropriation in Aid (AIA) as the mode of disbursement; delays could therefore be attributed to lack of timely acknowledgment of contractor payments by the creditor.

II. Unverified Expenditure due to Lack of Documentation

- 4.60 Expenditures amounting to Kshs.6,081,914,788 could not be verified due to lack of provision of Interim Payment Certificates (IPCs) and payment vouchers, among others. As a result, the audit could not establish the amounts expended; conclusively assess the work done; assess whether inspection of the works had been done as required in the Bill of Quantities or contract agreements. Details on the unverified expenditure is shown in **Table 10**.

Table 10: Unverified Expenditure due to Non-Provision of PVs

No	Project Name	Currency	Amount	CSDRMS Disbursement	Approx. Kshs. Equivalent	Remarks
				Disbursing Currency		
1	Mombasa Special Economic Zone Development Project	JPY	37.09Billion	74,014	67,481	Expenditure Schedule for consultancy and designs were not availed
2	North Eastern Transport Improvement Project (NETIP)	USD	6,000,000	5,950,573	692,681,806	Designs complete, PVs not availed. The loan balance 49,427USD
3	Sabor-Iten Tambach-Nakuru Water Project (3) Project Phase 2	EUR	10,000,000	9,364,753	1,147,579,308	The audit could not confirm the eligibility of project expenses due to non-availability of IPC's paid
4	Kisumu Urban Project	EUR	40,000,000	34,613,213	4,241,586,192.73	PVs and IPCs were not availed
				Total	6,081,914,788	

III. Under Utilization of Borrowed Funds

- 4.61 The conditions precedent, amongst other conditions, to disbursement set out in project loan agreements have to be fulfilled before the loan is declared effective or before any drawdowns can be made. Review of the financial year 2020/2021 External Resource Handbook revealed that despite the availability of funds, the level of disbursement by The National Treasury to programs and projects recorded an average absorption rate of approximately 86%. This translated to Kshs. 812.46 billion, out of the possible Kshs. 945.78 billion procured externally. The underutilization of borrowed funds is summarized in **Table 11**.

Table 11: Under-Utilization of the Borrowed Funds

FY	Externally Borrowed/Procured Loans "Kshs. Bill"			Actual Disbursed/Drawdowns Loans "Kshs. Bill"			Loan Performance	
	Loan Revenue	Loans AIA	Totals	Loans Revenue	Loans AIA	Totals	Un-Utilized Loan Amounts "Kshs. Bill"	Absorption Rates %
2017/2018	33.57	186.39	219.97	24.21	162.51	186.72	33.25	85
2018/2019	54.22	205.29	259.50	41.69	191.67	233.36	26.15	90
2019/2020	56.34	171.22	227.56	48.02	155.21	203.23	24.33	89
2020/2021	88.32	150.43	238.75	75.56	113.59	189.15	49.60	79
Totals	232.45	713.33	945.78	189.48	622.98	812.46	133.32	86

Source: 2020/2021 External Resource Handbook

- 4.62 The underutilization of the borrowed funds was attributed to challenges such as, a lengthy procurement process, weak project implementation procedures, delays in getting no objections; conditions precedent to credit effectiveness, poor project designs, inadequate provision of GoK counterpart funds and cashflow challenges.¹⁰

IV. Inadequate Project Execution

- 4.63 Field inspections undertaken between 7 March, 2022 and 14 April, 2022 revealed the following unsatisfactory matters on the execution of the 12 sampled projects.

a) Kisumu Urban Project

- 4.64 As at the time of the audit, physical works completion was recorded at 93.3%, against the planned work program of 100%, a clear indication of slow progress of works.

The following observations were made: -

- i. A dustbin cubicle valued at Kshs.603,980 in the Bills of Quantities was supposed to be constructed at **Kisumu Social Hall**. However, the audit confirmed that such works were never implemented. Instead, there was a

20 liter plastic bin whose impact is environment pollution as shown in **Annexure 10A.**

- ii. As at the time of the audit, the construction works at Otonglo Market was ongoing, however, the quality of steel used in molding rolling doors are of inferior gauge whose door handles were broken and damaged; There were no Terrazzo Paving's to Tops & Sides specified in BOQs. Iron sheets used in the roof appear to be of lower gauge.
- iii. Although renovation works at Lumumba Sub-County Health Facility was complete and opened on 2 March 2022, Male Medical Ward, Pediatric Ward, Main Theater, Maternity Wing wards were well equipped but not operational due to lack of staff. This under under-utilization would therefore, impact negatively on citizens who are not obtaining medical services from the facility despite huge investment in renovation as shown in **Annexure 10B.**
- iv. Rota Bridge Otonglo-Tiengere-Rota Access Roads were incomplete & the project was stalled. Interview with the Project Manager revealed that the contract had been canceled twice due to conflict in implementation design. As at the time of the audit the remaining works were being tendered afresh. Five (5) years later, the citizens are yet to enjoy ease of mobility across the river as the carrying capacity of existing structure cannot allow for cars & motorcycles as shown in **Annexure 10C.**

b) Hazardous Asbestos Pipes & Irrigation Project Cutting Main Supply of Sabor-Iten Tambach-Nakuru Water Project (3) Project Phase 2.

- 4.65 The scope of works involved installation of new HDPE pipelines and replacement of some 40 kilometers of Asbestos Cement Lines.

The following observations were made;

- i. It was explained that delay by one (1) year was occasioned by delays in Land acquisition, permits, licenses, authorizations, litigation, and conflicts from the beneficiary communities among others.
- ii. Although the scope involved replacement of 40 kilometers of asbestos cement lines, the contractor did not replace the hazardous underground asbestos cement lines.

- iii. An interview with management of Iten-Tambach Water and Sewerage Company revealed that the Lower Sabor Irrigation project has been obstructing water from River Charama which supplies water to Sabor-Iten-Tambach (main intake) water project as the intake of irrigation project is located 2.5kilometers upstream. The significant effect is reduction of water levels downstream and diverting water meant for domestic use in Iten and Tambach to the irrigation project.
- iv. Although we requested severally for production of Environment Impact Assessment report, the management has not produced the same as required in Section 9 of Public Audit Act (2015). In this circumstance, we were unable to assess the impact of the irrigation project with regard to risk of losing taxpayers loan valued at Euro 10,000,000 as there could be no adequate water to serve Nakuru residents.

c) Menengai's 169 MW Steam Energy Yet to be Injected to the National Grid

4.66 The purpose of this loan was to enable the achievement of the Menengai 105MW by financing the procurement and commissioning of drilling rigs, wellheads generation units, acquisition of offshore drilling materials and purchasing drilling simulator for training.

The following observations were made;

- i. A review of ADB Aide Memoir of March 2018, the Menengai Geothermal Development Project ID No. P-KE-FZ0-003 Phase 1 was to inject 105MW into the national grid. It also indicated that 169MW of steam energy was harnessed from 60wells drilled, Steam gathering installation was complete and its awaiting power plants for commissioning.
- ii. However, four years down the line, even after the KETRACO developed a substation and a transmission line, just awaiting final commissioning in 2018, this energy is yet to be injected into the National Grid for Citizen to enjoy its benefits as it is awaiting the IPPs to put up the power plants. In the year 2013 GDC had invited 3 IPPs; Quantum Power East Africa (QPEA), Sosian Menengai Power Limited and Orpower 22 Limited (OTT) to put up the power plants. The IPPs entered into project steam supply agreement (PISSA) with GDC and Power Purchase Agreement PPA with KPLC. As at the time of audit only one (1) IPP; Sosian Menengai Power Limited was

observed implementing the Power Plant. Copies of the IPPs Power Supply Agreements & Timelines were not availed for audit.

- iii. A further review of the ADB Aide Memoire (18-23) May 2018 revealed that Yantai Hangtai Petroleum Technology Com who was contracted to procure Schedule B Drilling Material at contract sum of USD 206,151 had only delivered goods worth USD 42,230 resulting in terminating the contract due to non-performance of the contract in May 2018. The status has remained the same since 2018.
- iv. Although, the loan agreement indicate that the final Disbursement was 3rd December 2017, examination of records during the month of March 2022, revealed that GDC had utilized USD 5.379 Million disbursed from the loan amount of USD 7.5 Million leaving a balance of USD 2.121 Million whose where about has not been explained.
- v. Further, drilling of simulator for training as a component of the loan has not been justified with the possibility of underutilization of the equipment.
- vi. Although we requested for production of Procurement documents for audit review, they were not provided contrary to Section 9 of Public Audit Act, 2015. In the circumstance, it is not possible to confirm that the procurement of this project complied with Article 227 (1) of the Constitution, 2010.

d) Inadequate Locally Grown Cotton Hindering Sustainability of Rift Valley Textile (RIVATEX) Factory

- 4.67 According to the Loan Agreement, the project aimed at upgrading Rivatex Factory through installation of heavy machinery equipment for textile processing.

The following observations were made;

- i. A review of 2019 BPS further indicated that the upgrading was aimed at absorbing the local cotton to produce high quality textiles. To achieve this, the Government had identified 21 cotton growing counties targeting 549,000 acres to ensure self-sufficiency in cotton production for the textile industries by availing the resilient genetically modified cotton seed to farmers.
- ii. However, interviews with the project team revealed that the factory is no longer receiving funding for subsidizing seeds and fertilizers to boost growing of cotton locally, as now the said funds are being allocated to the Ministry Agriculture and

there was no evidence to confirm that the same was being channeled to benefit initially intended producers. As a result, locally grown cotton has reduced leading to the factory sorting to import thus exposing them to additional operational costs and thereby threatening its sustainability in the long term.

- iii. Further, as at the time of audit, all necessary machinery was installed, tested, commissioned and operational. However, the audit was not able to assess the accuracy of training component worth USD 173,621 and if relevant staff were trained on how to operate the textile machines.
- iv. Although, we requested procurement documents for training services for audit review, they were not provided contrary to Section 9 of Public Audit Act, 2015. In the circumstance, it is not possible to confirm that the procurement of this project complied with Article 227 (1) of the Constitution, 2010.

e) Inadequate Local Content Assessment and Data Recovery for the new Clients, in Konza Data Center & Smart City

- 4.68 The purpose of the project is to provide Government cloud Infrastructures for Government applications such as IFMIS, e-Citizen and iTax, which would improve Government decision-making and efficiency; provide enterprise cloud infrastructure and digital platforms for investment as well as improving innovation. The project components included Internet of Things, Data Center, ICT Network, Project Management, Design Service and Data Center Building.

The following observations were made;

- iii. A review of Supplementary Agreement No 3 dated 28th November 2019 between Ministry of ICT and Huawei Technologies "Scope of the System" clause indicate that the contractor, M/s Huawei Technologies was to source 40% of the goods, works & services from citizens locally to ensure sustainable promotion of the local industry, facilitation of technological transfer, development of professional skilled and unskilled labor.
- iv. However, it was not possible to evaluate whether this objective was achieved in the absence of the sub-contract agreements that were not availed for audit review, contrary to section 9 of the Public Audit Act (2015).

- v. An audit inspection revealed that the project was 90% complete while the remaining 10% is for training component, Disaster Recovery Site; testing and commissioning of Phase II Data Centre.
- vi. Although it was explained through interviews with the Project Manager revealed that Phase 1 Data Center was already hosting over 10 clients among them County Government of Homabay and Dedan Kimathi University among others. However, in the absence of Disaster Recovery Center Site, the management explanation on the controls in-place in mitigating risks of data loss was not given, for the ten (10) clients being hosted thus threatening business continuity in case of disasters.

f) Diversion of Development Funds to Finance Recurrent Budget Activities in Lake Victoria-Water and Sanitation Project

- 4.69 Comparative analysis of the approved printed estimates in respect of various projects for the financial year 2021/2022 revealed that Kshs.170,570,000 which includes Kshs.75,000,000 in respect of Lake Victoria-Water and Sanitation (LV-WATSAN) Project were budgeted under development vote for GOK counter-part funding was re-allocated to finance the agency's recurrent budget contrary to Section 43 (1) (b) and (d) of the Public Finance Management Act, 2012.
- 4.70 Therefore, activities that were planned to be financed from counter-part funding may not be funded, resulting in additional payments for claims and interest.

The National Treasury Response to Audit Findings and Recommendations

- 4.71 At the conclusion of the audit, an exit meeting was conducted. Subsequently, the draft audit report was sent to The National Treasury, requesting for their comments on the audit findings and recommendations. The comments from The National Treasury are as shown in **Annexure 11**.

5.0 CONCLUSION

- 5.1 From the findings of the audit, it is evident that the Government, through The National Treasury has not effectively carried out deficit financing operations.
- 5.2 The National Treasury has not adequately aligned its deficit financing operations to overall debt objectives and strategies. This can be attributed to:
- i. Inadequate, outdated and unfinalized manuals and delay in migration to the new debt management system which exposes deficit financing activities to debt operational risks.
 - ii. Inadequate and insufficient resource of the Public Debt Management Office which has led to understaffing and skill gap resulting to the defined roles and functions of the front office, middle office and back office not being performed as required and adequately segregated.
 - iii. Lack of clarity on who is responsible for the preparation of the domestic annual borrowing plans in the Agency Agreement between The National Treasury and the Central Bank of Kenya.
 - iv. Inadequate filing system which poses challenges in retrieval of specific information on a particular loan funded project. This may expose debt management operations to inefficiencies due to transaction delays, difficulties in retrieval and reconciliation of information.
- 5.3 The National Treasury has not put in place adequate measures and tools to operationalize and monitor the implementation of the identified Optimal Debt Strategies. This is attributed to key budget documents not being aligned to the Medium Term Debt Strategy. In addition, the Medium-Term Debt Strategy has not been fully operationalized through the development of annual borrowing programs to guide on actual borrowing. Further, the set deficit ceilings, targets, and proposed measures for achieving debt sustainability have not been adequately implemented.
- 5.4 The National Treasury has not effectively carried out loan contracting activities that are geared towards minimizing borrowing costs and the associated risks. This can be attributed to inadequate project preparation, inadequate scrutiny and project approvals before entering the budget cycle; inadequate scrutiny and

negotiation of loan terms and; inadequate engagement by The National Treasury and the implementing agency on the uptake of the loans. As a result, the government borrowing costs have increase due to payment of commitment fees, interest on delayed contractor payments and prolongation costs and; delayed project output to benefit Kenyan citizens.

- 5.5 There is inadequate utilization of contracted loans. The National Treasury has issued Circular No 16/2019 on Guidelines on Public Investment for Government and Its entities. Further in 2018, TNT established Public Investment Management (PIM)Unit under Directorate of Public Investment and Portfolio Management to ensure effective and efficient management of public investment through providing framework that guides on project identification through to post valuation. However, The National Treasury has not fully operationalized the PIM unit to enforce the guidelines, scrutinize the projects prior to funding, monitor project execution thus leading project delays, inadequate project workmanship and additional costs' and wastage of funds.

6.0 RECOMMENDATIONS

6.1. To ensure that deficit financing operations are aligned to overall debt objectives and strategies, The National Treasury should;

- i. Update finalize and approve and all public debt policies & procedures manuals regularly and finalize the migration of the debt management system from CS-RDMS to Commonwealth Meridian. This will ensure that public debt management are up to date with the latest regulations and technology and consistent with organizational best practices thus ensuring transparency and effectiveness in coordinating public debt operations
- ii. Ensure that the directorate has sufficient and adequately trained debt management staff, clear defined roles for each cadre of staff and proper staff retention strategy to ensure continuity of operations during exit and entry of new staffs to address capacity challenges.
- iii. Ensure there is clarity in roles and responsibility on the preparation of the annual borrowing plan in the Agency Agreement between TNT and CBK 2016, by conforming to PFM act 2012 and Debt and Borrowing Policy 2020 to avoid contradictions in roles and responsibility.
- iv. Ensure efficiency in retrieval debt management information, The National Treasury should put in place a robust and secure filing system that provides quick access to debt information to avoid inefficiencies arising from transaction delays; difficulties in retrieve and reconciliation of information and loss of information.
- v. Put in place adequate measures and tools to operationalize and monitor the implementation of the Medium Term Debt Strategies. This is achieved through the development of annual borrowing programs to guide on actual borrowing and further monitoring the implementation of the set deficit ceilings, targets, and proposed measures for achieving debt sustainability.

6.2. To ensure that loan contracting is done to minimize cost and risk for borrowing The National Treasury should ensure proper scrutiny and negotiation of loan terms and adequately involvement of the project

implementing agency during loan negotiation and preparation during uptake of the project loans.

- 6.3. To ensure effective and efficient management of public investment; i.e. adequate project appraisal prior to funding and adequate project gate keeping, The National Treasury should fully operationalize the Public Investment Management Guidelines outlined in The National Treasury Circular No 16/2019 and finalize the establishment of the Public Investment Management Unit.

7.0 ANNEXURES

Annexure 1: List of Project Sampled

No	Name of Project
1	Kisumu Urban Project
2	Upgrade the maternal and new born care units in Kapenguria district hospital (West Pokot County), Chepkorio Health Centre (Elgeyo-Marakwet county) and Makindu sub-county Hospital (Makueni County)
3	On Kenya Konza Data Centre and Smart City Facilities Project
4	Mombasa Port Area Road Development Project (11)
5	LV-WATSAN-KISUMU
6	Sabor-Iten Tambach-Nakuru Water Project (3) Project Phase 2
7	Mombasa special Economic Zone Development Project (1)
8	Menengai Geothermal Development Project
9	Mwea Irrigation Development Project
10	Meru By Pass (North Eastern Transport Improvement Project (NETIP)
11	Upgrading of Rift Valley Textiles (Rivatex) Factory Project
12	Eldoret Town By-Pass

Annexure 2: List of Documents Reviewed

No	Document Reviewed	Information Obtained
1	The Constitution of Kenya, 2010	The legal framework on public debt
2	PFM Act, 2012	The legal framework governing borrowing operations
3	PFM Regulations, 2015	
4	Public Debt and Borrowing Policy, 2020	DPDM roles and processes
5	Back Office Manual	Back office roles and debt reporting
6	Front Office Manual	Deficit financing planning, resource mobilization, and disbursement
7	Agency Agreement CBK & NT	Roles of NT and CBK in domestic borrowing
8	National Treasury Budget Circular	Budget preparation calendar of events and other stakeholders' roles and expectations
9	Annual Public Debt Management Report	The debt and fiscal deficit trends
10	Financial Statement	Budget trends, or financial position of the entity
11	Budget Books	The budget trends, revisions among others
12	OAG Audited Reports	Information on material issues on public debt borrowing activities
13	Controller of Budget Implementation Reports	Material issues on public debt, borrowing activities, budget execution trends or performance
14	Budget Policy Statement	Information on fiscal framework, budget estimates, budget deficit, fiscal risks and national government priorities
15	Medium Term Debt Management Strategy	Information on debt sustainability, optimal mix to be applied in deficit financing
16	National Treasury Strategic Plan/ Staff Establishment	The National Treasury current establishment, objectives and strategies
17	External Resource Handbook	The disbursement trends, and absorption performance of the project loans
18	Budget Review Outlook Paper	Actual revenue and expenditures current year, forecasts on revenue and expenditure trends and policies set
19	Budget & Appropriation Committee Report on BPS & MTDS	The roles of the committee, approvals of the BPS, MTDA, and resolutions passed

No	Document Reviewed	Information Obtained
20	IDI Public Debt Manual & GUID 5250	The public debt audit process of borrowing activities
21	Loan Agreements	The scope of the project, disbursement and payment terms and conditions
22	Concept Note	The need for the project
23	Project Feasibility Studies and Proposals	The viability of the project, detailed scoping
24	Loan Negotiation Minutes	Representation of the negotiation team, roles of each representative and their contribution
25	Legal Opinion	The importance of legal opinion, the amendment suggested and incorporation in the final loan agreement
26	Contract Agreement and Bill of Quantities	Information on the scope of implementation of the project, contract sum, terms and condition,
27	Expenditure Documents. Payment Vouchers, Interim Payment Certificates	Understanding and assessing utilization of the loan funds
28	Aide Memoirs and Project reports	The project progress and challenges
29	Kenya Revenue Authority Revenue Performance Reports	The revenue trends and gaps in deficit financing operations
30	Quarterly Budget Review	Budget performance and challenges
32	CSDRM data	Disbursement and other loan costs

Annexure 3: List of Persons Interviewed

No	Person Interviewed	Data/Information Obtained
1	Director Debt Policy Strategy & Risk Management Department	Roles of the department, formulation of MTDS, policies in place and challenges faced
2	Ag. Director Resource Mobilization Department	Roles of the department, policies & guidelines used, information on planning for deficit financing and implementation
3	Ag. Assistant Director Debt Recording & Settlement	Roles of the department, policies guidelines and system used for debt recording, level of in-debttness and challenges face
4	Chief Economist Macro & Fiscal Affair Department	Roles of the department, policies used, information on resource estimation, fiscal framework during preparation of budget and challenges
5	Assistant Director Budget Directorate	Roles of the departments, budget estimation activities, policies, guidelines used and challenges faced
6	Director Central Bank of Kenya Financial Market	Roles of the agents, handling of domestic debt, procedures and guidelines used
	Head of Policies Coordinating Unit (RMD)	Roles played in deficit financing operations, preparation of Annual Borrowing Programs and challenges faced
7	Controller of Budget	Roles of the office with regard to deficit financing operation, budget execution and challenges faced
8	Public Investment Management Unit	Roles played in deficit financing operations, its establishment and challenges faced
9	Project Implementing Ministries for the 12 Sampled Projects	Roles played in deficit financing operations, activities carried out in selection, preparation, approval, budgeting of the projects and challenges faced. Also, engagement during loan contracting.
10	Project Agencies for the 12 sampled projects	Roles played in deficit financing operations, project preparation, implementation, arrangement of project team, disbursement process, utilization of the project funds and challenges faced.

Annexure 4: Information Request but not provided for Main-Study Audit

No	Information Requested	Remarks
1	Current Status of National Treasury Staff Establishment	Received Only for Back Office
2	Approved Annual Borrowing Program from FY 2017/2018 to Date	Only provided for 2021/2022
3	Exchequer Issue Summary Report in the Following Format FY 2017/2018 to Date: To capture Development, Recurrent & Total Exchequer Release Format provided in Table 2	Not Provided
4	Total Outstanding Debt to Date: Showing Disbursed amounts & Committed Undisbursed. CSDRM Data on Current Public Debt: Grouped into Commercial Debt; Semi & Concessional Debt; Domestic T-Bond & T-Bills FY 2017/2018 to Date	Remaining Treasury bonds & T-bills
5	CSDRM Data on Current Public Debt: Grouped into Commercial Debt; Semi & Concessional Debt; Domestic T-Bond & T-Bills FY 2017/2018 to Date	
6	MTDS & BPS Certificate of Approval 2017/2018 to Date	only received for yr. 2018/2019
7	Sectors actual expenditures FY 2017/2018 to Date	Not Provided
8	A published report to parliament regarding the MTDS strategy deviation indicating reasons, proposals to address deviation, the period the deviation is supposed to last.	Not Provided
9	All Projects Listings: for Each MDAs. Showing Ongoing, Stalled, Pipeline & Completed Projects status to date.	Not Provided
10	Due diligence report & Credit Analysis Assessment	Not availed
11	Composition of the approved loan negotiating team, negotiating process and minutes	Not provided for 11 projects. Only provided for SEZ Dongo Kundu Project
12	Draft loan agreements recommendations on changes to clauses submitted at various stages of the negotiation process and Legal opinion report from Attorney General	Not provided for 11 apart from Only provided for Konza Data Center Projects

Annexure 5: Under-performance in Revenue Collection

Estimated Ordinary Revenue Versus Actual Revenue Collected

Fiscal Year	BPS Ordinary Revenue ("Bill"Kshs)	Ordinary Revenue Target ("Bill"Kshs.)	Actual Revenue ("Bill"Kshs.)	Deviation (Kshs.)	%Deviation
2017/2018	1,643.1	1,489.633	1,365.063	(124.570)	8.36
2018/2019	1,651.517	1,641.522	1,499.757	(141.765)	8.64
2019/2020	1,843.813	1,615.378	1,573.418	(41.960)	2.60
2020/2021	1,594.009	1,578.787	1,562.015	(16.772)	1.06
2021/2022	1,578.8				

Source: Budget Review Outlook Paper and KRA Revenue Performance Reports for FY 2017/18 to Fys2021/2022

Annexure 6: List of Sampled Projects

No	Project Name	Loan Details/Key	Creditor	Date of Loan Signature	Implementing Agency	Loan Amount	Status
1	Kisumu Urban Project	AC/37/208/038/, Loan Agreement No: CKE1035.01.G	Agence Francaise De Development	05/07/2010	Municipal Council of Kisumu	EUR 40,000,000	Incomplete
2	Upgrade the maternal and new born care units in Kapenguria district hospital (West Pokot County), Chepkorio Health Centre (Elgeyo-Marakwet county) and Makindu sub-county Hospital (Makueni County)		Erste Group Bank Ag	12/07/17	Ministry of Health	EUR 5,000,000	Complete and in use
3	On Kenya Konza Data Centre and Smart City Facilities Project		The Export-Import Bank of China	26/4/2019	Ministry of Information, Communications and Technology	\$175,000,000	95% Complete
4	Mombasa Port Area Road Development Project (11)	LK 2017038	Japan International Cooperation Agency	04/07/2017	Kenya National Highway Authority	¥12,466,000,000	Yet to mobilize
5	LV-WATSAN-KISUMU	AC37/205/041	European Investment Bank	10/02/20	Lake Victoria South Water Works Development Agency	EUR 70,000,000	Yet to mobilize
6	Sabor-Iten Tambach-Nakuru Water Project (3) Project Phase 2	AC37/207/40	Belfius Bank SA/NV	08/12/15	Rift valley water service board- Ministry of water and irrigation	EUR 10,000,000	

No	Project Name	Loan Details/Key	Creditor	Date of Loan Signature	Implementing Agency	Loan Amount	Status
7	Mombasa special Economic Zone Development Project (1)	AC 37/174/52/ 2000004 Loan NO.KE-P35	Japan International cooperation Agency	27/2/2020	Kenya Ports Authority Kenya National Highways Authority Kenya Electricity Transmission Company Ltd.	¥37,090,000,000	
8	Menengai Geothermal Development Project	P-KE-FZ0-003, LOAN NO.5560130000051	African Development Bank	03/12/12	Geothermal Development Company Agency	USD 7,500,000	
9	Mwea Irrigation Development Project	AC37/174/042	Japan International cooperation Agency	16/8/2010	National Irrigation Board	¥ 13,178,000,000	Complete and in use
10	Meru By Pass (North Eastern Transport Improvement Project (NETIP)	LK2017006	International Development Association (World Bank)	February 16/02/2017	KeNHA	\$6000,000	Civil works yet to start
11	Upgrading of Rift Valley Textiles (Rivatex) Factory Project	lk-2016051	export -import bank of India	11/07/2016	1172 - State Department for Investment and Industry	\$29,950,000	90% Complete
12	Eldoret Town Bypass	LK 2017022	The African Development Bank	Not indicated	State Department of Infrastructure	\$82,000,000	Complete

Annexure 7: Summary of Loan Contracting Assessment

Project Name	Initial Project Documents		National Treasury Approvals	Public Participation	Evidence of Creditor Loan Concessionality	Effective Loan Negotiation, Composition	Evidence of Legal Advisory	Prior Engagement by RMD with the Implementing Agencies	Was there an agreed & approved disbursement schedule prepared before project implementation?
	Concept Note/ Project Need	Feasibility Study/ Proposal							
Upgrading of Rift Valley Textile (Rivatex) Factory Project	Not Provided	Business Plan for Textile Mill Modernization Project June 2013	Not provided	Not Provided	Not Provided	Not provided	Not Provided	Not Provided	None
Kisumu Urban Project	Concept Note came after Loan Agreement	Pre-Feasibility Study of KUP, Sep 2009.	Not provided	KUP Sensitization, 15/10/2012, No raw evidence of participation	Not Provided	Not provided	Not provided	There was evidence of prior engagement provided on 8th /11/2016	None
Mwea Irrigation Development Project	Not Provided	Feasibility Study Report March 1988	Not provided	Not Provided	Not Provided	Not provided	Not Provided	Not Provided	None
Eldoret Town Bypass	Not Provided	ADB RDGE/PICU Departments March 2017 pg. 9	Not provided	The report: Environment & Social Safeguards Orientation Workshop	Not Provided	Parties concerned in attendance. Video Conference	Dated 3 Aug 2017	Not Provided	None

Project Name	Initial Project Documents		National Treasury Approvals	Public Participation	Evidence of Creditor Loan Concessionality	Effective Loan Negotiation, Composition	Evidence of Legal Advisory	Prior Engagement by RMD with the Implementing Agencies	Was there an agreed & approved disbursement schedule prepared before project implementation?
	Concept Note/ Project Need	Feasibility Study/ Proposal							
				Report held on 28 -30 January 2019.		March 13 2017.			
Upgrade the maternal and new born care units in Makindu sub-county Hospital (Makueni County)	Not Provided	Not Provided	Not provided	Not Provided; beneficiaries need captured during implementation by VAMED Engineering	Not Provided	Not provided	Legal Clearance Letter Ref: AG/CONF /21/53 VOL II (78), dated 3rd August, 2017.	Letter Ref. No. MOH/ADM/1/1/51 dated 10th August 2016 and Ref. No. MOH/DP/16/1/1/V OL.II dated 8th March, 2017, the funds to be utilized for 3 prioritized health facilities	None
Mombasa Port Area Road Development Project (11)	Not Provided	Not Provided	Not provided	Not Provided	Not Provided	Not provided	Availed	Not Provided.	None
North Eastern Transport Improvement Project (NETIP)	Not Provided	Not Provided	Not provided	Not Provided	Not Provided	Not provided	Not provided	Not Provided	None

Project Name	Initial Project Documents		National Treasury Approvals	Public Participation	Evidence of Creditor Loan Concessionality	Effective Loan Negotiation, Composition	Evidence of Legal Advisory	Prior Engagement by RMD with the Implementing Agencies	Was there an agreed & approved disbursement schedule prepared before project implementation?
	Concept Note/ Project Need	Feasibility Study/ Proposal							
Kenya Konza Data Centre and Smart City Facilities Project	letter ref. KOTDA/1/15 dated March 26 2019 from Konza Technopolis Development Authority (KoTDA) to the Principal Secretary ICT	Revised (03)Feasibility Study for National Data Center & Smart City Facilities at Konza Technopolis issued 04 April 2019.	Not Provided	letter ref. KOTDA/1/15 dated March 26 2019 from Konza . survey of 46 out of 100 MDAs	Not Provided	Not provided	Availed	Not Provided	None
LV-WATSAN-KISUMU	Availed	Availed	Not provided	Availed	Not Provided	Not provided	Availed	Not Provided	None
Sabor-Iten Tambach-Nakuru Water	Not Provided	Not Provided	Not provided	Not Provided	Not Provided	Not provided	Availed	Not Provided	None

Project Name	Initial Project Documents		National Treasury Approvals	Public Participation	Evidence of Creditor Loan Concessionality	Effective Loan Negotiation, Composition	Evidence of Legal Advisory	Prior Engagement by RMD with the Implementing Agencies	Was there an agreed & approved disbursement schedule prepared before project implementation?
	Concept Note/ Project Need	Feasibility Study/ Proposal							
Project(3) Project Phase 2									
Mombasa special Economic Zone Development Project (1)	Not Provided	Not Provided	Not provided	Not Provided	Not Provided	KPA was absent in the negotiation meeting	Availed	Not Provided	None
Menengai Geothermal Development Project	Concept Note came after Loan Agreement	Availed	Not provided	Report was availed but no actual evidence of participation	Not Provided	Not provided	Availed	Not Provided	None

Annexure 8: Commitment Fees Charged on Non-disbursed Loans

Loan ID	Creditor Name	Project Name/Loan Details	Financing Agreement Date	Financed Amount (Foreign)	Currency	Commitment Fee Paid (Kshs.)
2014007	Exim Bank of China	Kenya Nairobi 132 KV &66KV Net Work Upgrade and Reinforcement Project Phase 11	10-05-2014	660,000,000	CNY	68,503,044.73
2017031	Deutsche Bank	Ruiru Phase II -BPIAE Facility	14-05-2017	27,633,375	EUR	64,614,533.71
2017041	Exim Bank of China	Kenya National Wide Remote Sensing Airborne Geophysical Survey Project	31-08-2017	438,000,000	CNY	108,123,523.95
2017042	Exim Bank of China	Kenya Nairobi Underground Electric Power Distribution Network in Kilimani, Hurlingham, Ngong Road, State House and Lavington	15-05-2017	1,200,000,000	CNY	295,820,000.26
2017043	Exim Bank of China	Kenya Nairobi Underground Electric Power Distribution Network in Kileleshwa, Westlands, Parklands, Ngara and Riverside Area Project	15-05-2017	685,000,000	CNY	169,156,659.27
2018001	African Development Bank	Jomo Kenyatta International Airport, Airfield Expansion Project-2nd Runway Development	01-01-2018	-	USD	21,447,599.65

2020005	Agence Francaise De Development	Nairobi Water & Sanitation Project	02-03-2020	100,000,000	EUR	5,753,332.76
2017026	Govt of Fed. Republic of Germany – GTZ	EAC Kenya South Sudan Regional Corridor	24-04-2017	90,000,000	EUR	153,367,665.76
2017027	Govt of Fed. Republic of Germany – GTZ	Regional Mombasa Port Road Access Project	31-03-2017	50,000,000	EUR	88,216,112.50
2017037	Exim Bank of China	Kamburu- Embu - Kibirigwi - Thika - 220KV Transmission Line and Associated 220-132KV Substation Works and 132/66KV Substations	01-08-2017	90,286,383.39	USD	-
2017038	Government of Japan	Mombasa Port Area Development Project- Phase II	04-07-2017	12,466,000	JPK	-
2017060	European Investment Bank	Regional Mombasa Port Access Road (Mombasa)	28-08-2017	50,000,000	EUR	49,716,733.80
2018002	Government of Japan	Olkaria 1 Units 1, 2 and 3 Geothermal Power Plant Rehabilitation Project (Nakuru)	16-03-2018	10,077,000	JPK	-
2018010	Agence Francaise De Development	Mwache Dam Project (Kinango Kwale)	21-06-2018	120,000,000	EUR	76,208,600.04

2020018	African Development Bank	Bagamoyo-Horohoro-Lunga Lunga-Malindi Road Project - Phase1	10-06-2020	108,000,000	EUR	21,716,775.00
2021002	KBC BANK	Ithanga Water Supply Project-Phase III (Muranga)	01-01-2021	8,300,579.15	EUR	1,332,215.53
Total		1,123,976,796.96				

Source: Project Loan Agreements, CSDRMS data OAG field observations

Annexure 9: Analysis of Avoidable Costs due to Delays in Project Execution

Project Name	Delay in Starting the Project (Months)	Delay In Completion (In Months)	Commitment Fees Penalties Approx. Kshs. CSDRM Data	Prolongation Cost (Claims) Ksh.	Interest on Delayed Payments Ksh.	Total	Remarks/ Reasons for delay
Upgrading of Rift Valley Textile (Rivatex) Factory Project	-	-	1,114,025	-	-	1,114,025	Documentation not provided
Kisumu Urban Project	-	19.2	-	-	-	0	Double cancellation of Rota-Tiengre Bridge and access road contracts and project KCB account frozen for 6 months by DCI for investigation
Mwea Irrigation Development Project	-	-	45,960	-	-	45,960	Documentation not provided
Eldoret Town Bypass	-	6.5	69,579,652	4,286,315,856	-	4,355,895,508	Delay in Implementation of RAP and contractor's prolongation costs due to delays. Annexure 8B
Upgrade the maternal and new born care units in Makindu sub-county Hospital	-	-	2,951,642	-	-	2,951,642	Documentation not provided

Project Name	Delay in Starting the Project (Months)	Delay In Completion (In Months)	Commitment Fees Penalties Approx. Kshs. CSDRM Data	Prolongation Cost (Claims) Ksh.	Interest on Delayed Payments Ksh.	Total	Remarks/ Reasons for delay
Mombasa Port Area Road Development Project (11)	-	-	-	-	181,482,340	181,482,340	The project is ongoing, however, documentation on delay not been provided. (Amounts shoAnnexure 8A)
North Eastern Transport Improvement Project (NETIP)	-	-	4,827,806	-	-		The project preparatory activities are ongoing; however, no documents were provided
Kenya Konza Data Centre and Smart City Facilities Project	-	-	82,243,270	-	-	82,243,270	The project is ongoing
LV-WATSAN-KISUMU	12	12.7	5,585,825	-	-	5,585,825	Yet to be declared Effective. Delay was attributed to numerous CPs to be fulfilled for all the 3 creditors for this project, Slow & Reduced GoK Disbursement of Counterpart Funds
Sabor-Iten Tambach-Nakuru Water Project (3) Project Phase 2	2.5	-	-	-	-	-	

Project Name	Delay in Starting the Project (Months)	Delay In Completion (In Months)	Commitment Fees Penalties Approx. Kshs. CSDRM Data	Prolongation Cost (Claims) Ksh.	Interest on Delayed Payments Ksh.	Total	Remarks/ Reasons for delay
Mombasa special Economic Zone Development Project (1)	-	-	-	-	-	-	Yet to fulfil CPS due to delay in implementation on Resettlement Action Plan.
Menengai Geothermal Development Project	-	-	-	-	-	-	loan agreement has not indicated the payment of commitment fees nor has it given the timeframe as to when the loan is supposed to be effective.
TOTALS			161,520,374	4,286,315,856	181,482,340	4,629,318,570	

Source: OAG analysis of CSDRMS data and project documents

Annexure 9A: Interest on Late Contractor Payment

  Mitsubishi Corporation Fujita Corporation / Mitsubishi Corporation Consortium MOMBASA PORT AREA ROAD DEVELOPMENT CONSTRUCTION OF MWACHE JUNCTION-TS KeNH										
Amount Paid by currency	Amount Balance by currency	Date of Payment			Delays Months	GoK KSHS	USD	JPY	Interest Amount (KES)	Remarks
USD 23,560,415.62	-	1-Feb-20	34.00	1.13	1.13	-	-	-	-	ADVANCE PAYMENT
USD 17,497,812.72	-	15-Sep-20	124.00	4.13	4.13	-	USD 371,196.54	-	KES 38,184,988.07	ADVANCE PAYMENT
USD 6,062,602.85	-	4-Dec-20	204.00	6.80	6.80	-	-	-	-	
USD 5,551,884.82	-	23-Mar-21	242.00	8.07	8.07	-	USD 124,698.16	-	KES 12,827,699.72	
JPY 592,741,683.00	-	23-Mar-21	242.00	8.07	8.07	-	-	JPY 26,818,857.13	KES 25,024,593.76	
JPY 375,084,307.00	-	6-Aug-21	378.00	12.60	12.60	-	-	-	-	
USD 3,537,847.18	-	6-Aug-21	191.00	6.37	6.37	-	USD 57,487.56	-	KES 5,913,745.30	
JPY 123,495,123.00	-	6-Aug-21	191.00	6.37	6.37	-	-	JPY 1,982,462.67	KES 1,849,829.87	
-	KES 99,159,057.17	PENDING	-	-	-	KES 14,671,507.22	-	-	KES 14,671,507.22	
USD 6,968,494.65	-	6-Aug-21	95.00	3.17	3.17	-	USD 56,096.91	-	KES 5,770,689.13	
JPY 192,061,780.00	-	6-Aug-21	95.00	3.17	3.17	-	-	JPY 1,529,211.47	KES 1,426,902.56	
-	KES 79,086,208.67	PENDING	-	-	-	KES 8,636,772.50	-	-	KES 8,636,772.50	
USD 4,920,304.61	-	6-Aug-21	17.00	0.57	0.57	-	USD 7,106.45	-	KES 731,040.51	
JPY 135,610,703.00	-	6-Aug-21	17.00	0.57	0.57	-	-	JPY 192,754.07	KES 179,585.23	
-	KES 54,283,682.98	PENDING	-	-	-	KES 4,858,844.52	-	-	KES 4,858,844.52	
USD 3,377,229.23	-	7-Dec-21	98.00	3.27	3.27	-	USD 453,150.44	-	KES 466,155,585.76	
JPY 93,081,316.00	-	7-Dec-21	98.00	3.27	3.27	-	-	JPY 765,336.94	KES 714,133.56	
-	KES 107,142,119.01	PENDING	-	-	-	KES 6,481,053.82	-	-	KES 6,481,053.82	
USD 6,663,787.51	-	7-Dec-21	36.00	1.20	1.20	-	USD 20,380.87	-	KES 2,096,580.10	
JPY 183,718,734.00	-	7-Dec-21	36.00	1.20	1.20	-	-	JPY 553,561.44	KES 516,526.49	
-	KES 80,422,132.14	PENDING	-	-	-	KES 3,065,733.80	-	-	KES 3,065,733.80	
USD 3,347,022.75	-	28-Jan-22	39.00	1.30	1.30	-	USD 11,093.88	-	KES 1,141,227.44	
JPY 92,248,783.00	-	22-Dec-21	2.00	0.07	0.07	-	-	JPY 15,434.61	KES 14,401.99	
-	KES 103,560,150.29	PENDING	-	-	-	KES 226,981.15	-	-	KES 226,981.15	
USD 1,794,502.39	-	16-Mar-22	5.00	0.17	0.17	-	USD 762.05	-	KES 78,392.08	
JPY 223,229,315.00	-	15-Mar-22	4.00	0.13	0.13	-	-	JPY 74,699.26	KES 69,701.65	
-	KES 107,920,496.79	PENDING	-	-	-	KES 236,538.08	-	-	KES 236,538.08	
USD 2,088,407.07	-	16-Mar-22	5.00	0.17	0.17	-	USD 886.86	-	KES 91,231.29	
JPY 185,053,434.00	-	15-Mar-22	4.00	0.13	0.13	-	-	JPY 61,924.46	KES 57,781.52	
-	KES 114,085,507.05	PENDING	-	-	-	-	-	-	-	
-	USD 1,852,592.35	PENDING	-	-	-	-	-	-	-	
-	JPY 195,624,700.00	PENDING	-	-	-	-	-	-	-	
-	-	-	-	-	-	KES 38,177,431.09	USD 1,102,859.72	JPY 31,994,242.05	KES 181,482,340.12	
-	-	-	-	-	-	-	-	-	-	
-	-	-	-	-	-	KES 38,177,431.09	USD 1,102,859.72	JPY 31,994,242.05	KES 181,482,340.12	

Ksh 38,177,431.09 Ksh 113,451,179.40 Ksh 29,853,729.64 Ksh 181,482,340.12
 Total Interest on Delayed Paid **Ksh 181,482,340.12**

Annexure 9B: Prolongation Costs

No	Claim Description	Time Extension (EOT) Sought Months	Prolongation Cost (Kshs)	Recommendation made by the Engineer to the Employer
1	Delayed possession of site covering the period from 13/02/2018 to 12/2/2019 (Delay on Land Acquisition)	11	-	4 months
2	Cost related to Claim No. 1	0	733,430,573.40	Contractor advised that the claim would be considered after deciding on Claim No. 1 because most of the costs were time based
3	Delayed issuance of drawings for bridges	8	-	This was consolidated with Claim No. 1
4	Delayed possession of site covering the period from 13/2/2019 to 12/2/2020 (Delay on Land Acquisition). This was submitted as a continuing event	9.5	-	Contractor asked to consolidate all EOT Claims and come up with a POW to address critical activities up to completion
5	Delayed possession of site covering the period from 13/2/2018 to 30/6/2020 (based on the premise that all the outstanding possession of site would be granted by 1st July 2020.)	20	-	16 months EOT recommended by the Engineer; 20 months being a consolidation of the 3 EOT claims) pushing the contract completion date to 13th April 2022)
6	Costs related to Consolidated Claim No. 4	0	1,622,520,498.00	Kshs 80,349,587.80 recommended by the Engineer
7	EOT and Cost Claim for the period between 1st July 2020 and 8th October 2021	9.7	1,930,364,784.37	Draft Determination made by the Engineer on 31st March 2022 and circulated to the Employer and the Contractor for comments. (revising the contract completion date from 13th December 2021 to 30th September 2022)
TOTAL			4,286,315,856.00	

Annexure 10A: Improper Waste Management Kisumu Social Hall



IDLE FACILITIES LUMUMBA HEALTH FACILITIES



Annexure 10C: Stalled Tiengre-Rota Bridget

STALLED TIENGRE-ROTA BRIDGE



Annexure 11: The National Treasury Response to Audit Findings and Recommendations

No	Audit Findings	The National Treasury's Response	Auditor's Comments
1	The Directorate of Public Debt Management had Procedure Manuals in draft status dating from 2014 as shown in Table 3. The draft manuals included Job Description Manual for Resource Mobilization Cadre (Par 4.4)	The Draft Job Description (JD) Manual for Resource Mobilization Cadre is not a draft as reported rather it was discussed and approved by The National Treasury organs including the Ministerial Human Resource Advisory Committee (MHARAC)	As at that of the time of audit, the Job Description Manual for Resource Mobilization Cadre was a Draft. Auditee has not provided the approved the document. The finding remains as reported.
2	Inadequate Staff Capacity of the middle office (Para 4.11)	The response shows a proposed establishment of 32 staff, authorized establishment of 28, in post 10 and a variance of 18.	Auditee yet to avail the documentation showing this update. The finding remains as reported
3	Inadequate segregation of duties (Table 5). (Para 4.12)	The functions in PDMO are being aligned to specific departments in the Directorate to conform with the Public Debt and Borrowing Policy. For instance: i. The Front Office is now handling both Domestic and External Borrowing function as well as Commercial Borrowing ii. Entry of public debt information in the system is performed by Back office and not middle Office iii. Credit risk analysis /Concessionally analysis is a Middle Office and not Front Office function and it aimed at cost-risk minimization objective.	As at the time of the audit, the function of Domestic Borrowing was being coordinated by Middle office. The finding remains as reported.

No	Audit Findings	The National Treasury's Response	Auditor's Comments
4	Conflicting responsibilities in the preparation of the annual borrowing plan (Para 4.16)	We note that there is no contradiction on whose role vests in the preparation of the Annual Borrowing Plan. The Debt and Borrowing Policy places the role on the Front Office of PDMO (Resource Mobilization Department). The National Treasury however delegates the implementation of the Domestic Borrowing Program to its Fiscal Agent as stipulated in the Agency Agreement.	1. Review of Section 63 (d) of PFM Act, section 63 (f) and Section 103 of the Public Debt & Borrowing Policy 2020 provides that resource mobilization department is responsible for the formulation of annual borrowing program having indicative dates of issuance of government securities and <u>CBK only meant to play consultative roles.</u> 2. Further review of Section 4.2 and Section 5.2 of the of Agency Agreement between NT and CBK (2016) revealed, clashing roles between NT & CBK on preparation of Domestic Borrowing. The agency agreement accords both The National Treasury and CBK the responsibility of formulating the domestic annual borrowing programme at the same time. • After formulation of the Annual Borrowing Program as per sec 63 (f) of debt policy, the Central bank is only required to implement the plan. However, the agreement provides

No	Audit Findings	The National Treasury's Response	Auditor's Comments
			that the CBK is to be given borrowing targets and then formulate domestic annual borrowing plan.
5	Non-Achievement of the Deficit Ceilings and Targets by East African Monetary Union Protocol and The National Treasury (Par 4.28-4.29)	The debt target is consistent with debt sustainability level for Kenya. In addition, the Cabinet Secretary National Treasury was required to report to Parliament on time-bound measures to restore public debt level whenever it rises beyond the set limit. The reporting requirement seeks to enhance debt transparency and accountability in line with the Constitution of Kenya. The National Treasury carried out public participation and received comments from the general public on the proposed amendments of the Regulations. Upon further consultations, and after reviewing comments received, The National Treasury proposed amendment of the PFM Regulations to raise public debt limit from Kshs 9 trillion to Kshs 10 trillion to facilitate financing of the FY 2022/3 Budget. The amendments were passed by Parliament	The finding remains as reported as the response is not addressing the non-achievement of the said targets I. Targets by East African Monetary Union Protocol and The National Treasury

No	Audit Findings	The National Treasury's Response	Auditor's Comments
6	Unprecedented borrowing from Domestic Debt (Par 4.30).	The statement is incorrect. The borrowing is guided by the approved budget by Parliament. No borrowing is done outside the approved limits. One of the reasons for borrowing besides meeting the financing needs is to develop the domestic market as illustrated in Section 62 (3) of the PFM, Act 2012. One of the objectives of PDMO is to: a. promote the development of the market institutions for Government debt securities. Table 8 should be amended to take into account the revised budgets (supplementary budget) which are approved by the National Assembly.	The response is not adequate. The finding remains as reported. The supplementary budgets for the period under review were reviewed as per table 7 of the report , and so far none provided approval for the extra borrowing. The finding remains as reported.

No.	Recommendations	The National Treasury 's Response	Auditor's Comments
1	Recommendation 6.1 (ii and iii)	This recommendation should separate the issue of staffing from the Agency Agreement between CBK and The National Treasury	Considered
2	Recommendation 6.3	The last sentence (and; <i>inadequately the implementing agency...</i>) appears not well linked with the first part of the statement	Considered.



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