COUNTY TREASURY

THE MEDIUM-TERM COUNTY DEBT MANAGEMENT STRATEGY PAPER, 2023

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FOREWORD

Debt remains one of the major economic policy issues facing County Governments in present Kenya. Accumulation of debt through the accrual of pending debts and other forms of public debt have acted to negatively affect the economic outlook of Meru County.

The MTDMS 2023 is Meru County's first debt management strategy paper and details Meru County's debt both from the defunct local authorities and those encountered by the County Government of Meru upon the advent of devolution.

The MTDMS aims to ensure sustainability of the County's debt, having undertaken an analysis of the existing level of debt, associated risks and strategies to address the management of the debt. There is need for fiscal prudence in management of the County's fiscal resources so as to ensure that the County Government's financing needs and payment obligations are met.

Considering the current level of debt both inherited and pending bills arising from county departments, the MTDMS 2023 will reinforce measures geared towards reduction of the County's debt and has also formulated additional strategies to deal will future debt. However, the County awaits the recommendations of the ITGRC to enable address inherited obligations.

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County Executive Committee Member,
Finance, Economic Planning and ICT.

ACKNOWLEDGEMENT

The MTDMS paper 2023 has been prepared as per the requirement of Public Finance Management Act, 2012. It covers a period of three years for Financial Years 2023/2024 to 2025/2026 and will be revised annually to provide guidance for public debt management in the medium term. The MTDMS sets out the debt management strategy of the County Government of Meru over the medium term with respect to actual and potential liabilities.

The current Debt situation in Meru County is specifically debt inherited from the defunct Local Authorities as well as the pending bills incurred by the County Government of Meru. The debt management strategy asserts the county government's debt management objectives of ensuring the County government's financing needs and payment obligations are met at the lowest possible cost with a prudent degree of risk.

Let me take this opportunity to acknowledge the CECM Finance, Economic Planning and ICT for his overall leadership, the Director Budget for overseeing the preparation of MTDS and the County Treasury's secretariat for compilation and finalization of this paper.

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ABBREVIATIONS

CALC	-	County Assets and Liabilities Committees
CFSP	-	County Fiscal Strategy Paper
IGTRC	-	Inter-Governmental Technical Relations Committee
MCRB	-	Meru County Revenue Board
MTDMS	-	Medium Term Debt Management Strategy Paper
PFMA	-	Public Finance Management Act
TA	-	Transitional Authority

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LEGAL BASIS FOR THE PREPARATION AND PUBLICATION OF THE COUNTY DEBT MANAGEMENT STRATEGY PAPER

Section 107 (2) (e) of the PFMA obligates the County Treasury to maintain the county debt at a sustainable level as approved by the County Assembly. In giving effect to this provision, Section 123 of the PFMA obligates the County Treasury to prepare a Debt Management Strategy Paper over the medium term. It provides:

> "(1) On or before the 28th February in each year, the County Treasury shall submit to the county assembly a statement setting out the debt management strategy of the county government over the medium term with regard to its actual liability and potential liability in respect of loans and its plans for dealing with those liabilities.
>
> (2) The County Treasury shall include the following information in the statement—

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

b) the sources of loans made to the county government;

c) the principal risks associated with those loans;

d) the assumptions underlying the debt management strategy; and

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

> (3) As soon as practicable after the statement has been submitted to the county assembly under this section, the County Executive Committee member for finance shall publish and publicise the statement and submit a copy to the Commission on Revenue Allocation and the Intergovernmental Budget and Economic Council."

FRAMEWORK FOR BORROWING BY COUNTY GOVERNMENTS

Section 140 of the PFMA, 2012 provides for the authority of County Governments to borrow. It provides that:

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

(a) Article 212 of the Constitution;
(b) Sections 58 and 142 of this Act;
(c) the fiscal responsibility principles and the financial objectives of the county government set out in its most recent County Fiscal Strategy Paper; and
(d) the debt management strategy of the county government over the medium term.

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

Section 141 of the PFMA, 2012, on the other hand, provides for the obligations and restrictions with respect to county government borrowing. It provides:

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

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

(3) A county government may borrow money in accordance with section 58, and only for purposes that are prescribed by regulations made under this subsection.

(4) A public debt incurred by a county government is a charge on the County Revenue Fund, unless the County Executive Committee member for finance determines that all or part of the public debt that would otherwise be a charge on that Fund shall be a charge on another public fund established by that county government or any of its entities.

(5) The County Executive Committee member for finance shall pay the proceeds of any loan raised under this Act into the County Revenue Fund or into any other public fund established by the county government or as the County Executive Committee member for finance may determine.

(6) A County Executive Committee member for finance may establish such sinking fund or funds for the redemption of loans raised under this Act for the purposes of the county government or any of its entities as the County Executive Committee member for finance considers necessary.

(7) A County Executive Committee member for finance may in accordance with national legislation on public procurement and disposal of assets—

(a) appoint advisers, agents and underwriters for the purposes of raising loans; and
(b) enter into agreements with those advisers, agents and underwriters as to the role to be undertaken by them and the remuneration to be paid to them.

(8) Any expenses incurred in connection with borrowing by a county government shall be a charge—

(a) on the County Revenue Fund; or on such other county public fund established by the county government or any of its entities as the County Executive Committee member for finance may determine in accordance with regulations approved by the county assembly.

(b) on such other county public fund established by the county government or any of its entities as the County Executive Committee member for finance may determine in accordance with regulations approved by the county assembly.

(9) The costs, interests and principal payments made by the national government on behalf of the county concerning loans to the county government shall, together with the principal amount, be reimbursed to the national government by the county government.

Section 142 of the PFMA, 2012 provides for borrowing by county government entities. It provides:

(1) The County Assembly may authorise short term borrowing by county government entities for cash management purposes only.

(2) Any borrowing under subsection (1) may not exceed five percent of the most recent audited revenues of the entity.

(3) A county government entity that has any such borrowing shall ensure that the money borrowed is repaid within a year from the date on which it was borrowed.

CHAPTER ONE: INTRODUCTION AND BACKGROUND

1.1 INTRODUCTION

This is the first Medium Term Debt Management Strategy paper (MTDMS) prepared by the County Government of Meru. This Strategy paper sets out the County Government of Meru's objectives, strategy and plans for the management of its debt in the middle term beginning Financial Year 2022/2023; and is informed by the provisions of Section 104 of the PFMA which identifies the monitoring, evaluation and overseeing the management of public finances and economic affairs of the county government, including the management of the County Government's public debt and other obligations, as well as developing a framework of debt control for the county as being one of the functions of the County Treasury.

The MTDMS is a plan that outlines what the County government intends to implement over the medium term in order to achieve a desired composition of debt portfolio. It operationalizes the government's debt management objectives i.e. ensuring the County Government's financing needs and payment obligations are met at the lowest possible cost consistent with a prudent degree of risk. The MTDMS has a strong focus on managing the risk exposure embedded in the debt portfolio—specifically, potential variations in the cost of debt servicing and its impact on the budget. In particular, the MTDMS identifies how costs and risks vary with the composition of the debt.

1.1 Definition of Debt

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

of county government owned institutions should be included in the definition of total county government debt.

1.2 Definition of a Medium-Term Debt Management Strategy

This Medium-Term Debt Management Strategy (Debt Strategy) is a framework that the County Government intends to use over the medium-term (three years) to ensure that debt levels stay affordable and sustainable, that any new borrowing is for a good purpose and that the costs and risks of borrowing are minimized.

1.3 Objective of the Debt Management Strategy

The main objective of this Debt Management Strategy is to ensure that the County Government of Meru's financing needs and its payment obligations are met at the lowest possible cost over the medium to long term, consistent with a prudent degree of risk.

Specifically, the Strategy aims at:

a) Covering financing needs and payment obligations, while minimizing medium- and long-term costs; and
b) Limiting risk in the public debt portfolio. The limitation of risks attached to the County Government's debt portfolio is an important objective set in this Strategy, aiming at providing an optimal and sustainable composition of the public debt.

The strategy aims at providing a general policy direction that will facilitate County's access to financial markets as well as supporting future development of a well-functioning vibrant debt policy. This first formal and explicit strategy is an important step forward in enhancing transparency of the County's debt management decisions. The underlying intention is to update the strategy regularly, presenting it on an annual basis with the budget planning documents.

In summary therefore, the strategy seeks to balance cost and risk of public debt and take account of demand constraints. It also seeks to institutionalize the production of a debt strategy publication as provided for in the Public Finance Management Act, 2012 and its subsequent Regulations.

1.4 Scope of Medium-Term Debt Management Strategy

The Medium-Term Debt Management Strategy (MTDMS) covers actual and potential liability i.e. It covers all loans and other debt that require payment of principal with or without interest by the county government to the creditor at a date or dates in future.

Potential liability includes all those debts that have been brought to the attention of the County Treasury through the issue of debt notes or other written demands but the verification of the said debts has not been completed to ascertain whether it is payable and the actual amount to be paid. However, it excludes any debt that may exist but has not been officially forwarded to the County Treasury.

The MTDMS is prepared annually on a three-year rolling basis and reviewed annually, and therefore the 2023 debt management strategy covers Financial Years 2023/24-2026.

1.2 BACKGROUND ON MERU COUNTY'S DEBT

The genesis of the Meru County's debt is two-fold. First, there are those debts that existed at the onset of devolution, belonging to the defunct local authorities. The Constitution of Kenya, 2010 gave the Transition Authority (TA) a lifetime of three years for which they were required to have completed the process of devolving all functions to county government including the verification of asset and liabilities as stipulated in Section 7 (e) of Transition to Devolved Government Act 2012. However, by the end of its tenure the TA was not able to finalize the process of liability verification and handing over to the County Government of Meru.

To bridge the gap created by delay of TA in creating an inventory of asset and liability as inherited from the defunct local authorities, the County Treasury formed a Debt Management Committee to verify all liabilities inherited from the defunct local authorities. The main goal of the committee was to establish the debt position of the County Government of Meru as inherited from the defunct Local Authorities.

The role of verification of county assets and liabilities was later on taken over from the TA by the IGTRC, who formed the County Assets and Liabilities Committees (CALC). These committees have already forwarded their findings to the IGTRC, and the body is in the process of reports validation, which will form a basis for implementation of their recommendations by counties.

During the Financial Year 2013/2014, the defunct local authorities transited pending bills amounting to Kshs. 85,920,272/-. The County Government of Meru during its first tenure (2013-2017) encountered debts in form of pending bills to the tune of Kshs.1.5 Billion against a cash balance of Kshs. 1.2 Billion. This amount grew during the term of the Second County Government of Meru to Kshs. 1.97 Billion against a cash balance of Kshs. 829 Million. Besides these amounts, there are still contingent liabilities amounting to approximately Kshs. 829 Million.

CHAPTER TWO: STOCK OF COUNTY PUBLIC DEBT

2.0 Debt Strategy Portfolio

County public debt comprises of all financial obligations, attendant to loans and securities issued by the County. A debt policy enables a county to determine, establish and uphold legal and institutional frameworks that are in place to guide its borrowing programme and addresses both external and domestic public debt management within a county. The policy is anchored in Article 212 of the Constitution of Kenya, 2010 specifically the principles of public finance. It provides for a strong accountability framework in borrowing and management of the public debt portfolio. Parliament, Auditor General, Controller of Budget, Commission on Revenue Allocation and the Central Bank of Kenya play a key role in the management of public debt and borrowing.

The County Government has accumulated pending bills amounting to Kshs. 1.15 Billion (Reported) as at June, 2022 and remains committed to clear the bills through the annual budget process as it enhances own local revenue to meet short term gaps in cash flow.

The pending bills consist of due owed to merchants and creditors and other contingent liabilities as illustrated in the table below.

No.	**Description of Pending Bills**	**Amount as at 30th June, 2022 (Kshs)**
1.	Pending Bills from Use of Goods and Services	1,147,028,386
2.	Pending Bills from the Defunct Local Authorities	53,311,393
3.	Contingent Legal Fees	728,000,000
	TOTAL	**1,928,339,779**

Source: County Treasury

The county-initiated projects whose payments have over-time been rolled over to consecutive financial years. The Departments procure late in the year and thus leading to rollovers and growth in pending bills. This is mainly due to fluctuating revenues that affect the cashflows, hence a large number of unpaid suppliers at the end of the financial year. The County Government has continually adopted various strategies to reduce and curb these debts namely:

1. Verification of outstanding claims to boost validity and hence reduce fraudulent claims;
2. Increase budgetary allocations to pending bills;
3. Formulation of robust assumptions and forecasts in the County's fiscal framework thereby enhancing credibility and realism in the County's Budget;
4. Timely remittance of statutory deductions and other obligations to avert any interest and penalties on late remittance and non-remittance; and
5. Adherence to the procurement plans and budgetary provisions to guide the County's expenditures.

CHAPTER THREE: DEBT MANAGEMENT STRATEGIES & CONCLUSION

3.0 STRATEGIES OF DEALING WITH DEBT

3.1 Strategies to Deal with Pending Bills

The County Government of Meru, through the Second Supplementary Budget Estimates in the Financial Year 2022/2023, will set aside the sum of approximately Kshs. 820 Million to cater for the settlement of eligible pending bills. However, there still remains pending bills in the form of inherited debt from the defunct local governments, ineligible pending bills to the tune of approximately Kshs. 7.4 Million as reported by the National Treasury.

3.1.1 Strategy 1: Enhancing Credibility and Realism of the County's Budget

The County Treasury identifies the leading cause of the accumulation of pending bills as being the unrealistic revenue projection which encourages the procurement of goods and services beyond the County's ability to finance payments.

One of the first steps in addressing a persistent arrears problem is to strengthen the realism of the annual budget of the County. This will depend on robust assumptions and forecasts in the fiscal framework, which determines the budget. Local revenue estimations will be realistic and in tandem with the projected County's expenditure. To this end, the County Treasury will enhance local revenue collection while setting up realistic revenue targets. Going forward, the local revenue projections as stated in the County's Budget will be based on actuals derived from the previous year' collections. However, the targets for local revenue collections for the Meru County Revenue Board (MCRB) will be set to reflect the aspirations of the County's budgetary needs.

3.1.2 Strategy 2: Settlement of Recurrent Pending Bills

Recurrent pending bills arising from all Departments will have to be cleared as a first charge in the succeeding year's budget from the corresponding votes of that Department. This will not only prevent accumulation of pending bills over the years but also instil disciplined spending by all Departments.

Departments that have accumulated huge recurrent bills will face liquidity challenges in the initial phase and implementation of some of the Sector's Programmes may be compromised but is a necessary measure in ensuring that Meru County does not accumulate debt in the succeeding years. In addition, the adoption of this strategy will require all Departments to prioritize Programmes taking cognizance of the existing resource constraints.

3.1.3 Strategy 3: Establishment and Gazettement of the County Cash and Debt Management Committee

Regulation 86 (1) of the Public Finance Management (County Governments) Regulations, 2015 obligates the County Executive Committee Member for Finance to establish a cash management advisory committee which is key in improving cash flow management.

The County Treasury through the County Executive Committee Member for Finance will establish and gazette a County Cash and Debt Management Committee which will be responsible for cash flow management, monitoring the County's debt portfolio and advising the County Treasury on the management of the debt. The Committee will also be tasked with the verification of all pending bills for purposes of settlement. This will ensure credibility and minimize fraud in the verification process.

3.1.4 Strategy 4: Debt Restructuring of Inherited Debt

The County Treasury acknowledges that despite the fact that the verification of the inherited debt has since been taken over by the IGTRC, there exists need to come up with an effective strategy of addressing the inherited debt which stands at almost Kshs. 72.2 Million when it becomes due for settlement.

To this end, the County Treasury will adopt debt restructuring whose main objective is to spread repayment of debt over a number of years. Once final verification is done, the County Treasury will spread debt repayment over many years. The major area of restructuring will be on substantial debt held by the County but for small debt, prioritization will be undertaken based on the fiscal space and liquidity. This will be done in order to spread and ease the debt burden.

3.1.5 Strategy 5: Strengthening Commitment Controls

Commitment controls are part of the internal control systems which should prevent the County from initiating expenditure without available budgetary allocations and cash. The County Treasury will ensure that IFMIS as a tool of financial management is used to ensure that the expenditure incurred in a financial year is in tandem with the approved County Budget.

3.2 Strategies to deal with Statutory Debt

3.2.1 Strategy 1: Debt Rescheduling/Renegotiation

The County Treasury will seek to renegotiate with various statutory creditors on the debt owed with a view of obtaining interest waivers on older debts owed.

3.2.2 Strategy 2: Payment of Statutory Deductions as at when they Fall Due

The County Treasury intends to pay all statutory deductions as at when salary is paid every month to mitigate against the growth of the debt.

3.3 Strategies to Deal with Debts Arising from the Use of Goods and Services

3.3.1 Strategy 1: Enhancing Local Revenue Collections

The County Treasury, in collaboration with the Meru County Revenue Board, will work towards formulating effective strategies to enhance local revenue collections in order to improve liquidity and enhance realism in revenue collection for purposes of supporting the County's Budget.

3.3.2 Strategy 2: Verification of Arrears

Data to repay outstanding claims is usually readily available but the same needs verification to boost validity and reduce fraudulent claims. Each Department of the County Government of Meru will verify the provision of listed goods and services and this verification will inform the settlement of such pending bills.

3.3.3 Strategy 3: Increase Budgetary Allocations on Pending Bills Vote and Decentralize them to the Departmental Level

Budget proposals will factor in pending bills per Department noting to give the nature of the pending bill. There is a working proposal to increase budgetary allocations to cater for the growing debt portfolio arising from pending bills. As a matter of policy, pending bills and roll over project allocations will be given priority for settlement on any new financial year or budget allocations.

3.3.4 Strategy 4: Enhancing Compliance to the Legal and Regulatory Framework

The legal framework or related regulations should define payment terms; reporting requirements; controls at the budget authorization, commitment and payment stages; and the sanctions associated with any breach of those provisions.

In this regard, the County Treasury will work to enhance compliance with the framework law relating to public procurement and public finance management. Similarly, in accordance with the provisions of Regulation 50 (1) of the Public Finance Management (County Governments) Regulations, 2015, no new commitments for the supply of goods and services shall be done after 31st March of each financial year except with the express authority of the accounting officer. This will reduce or eliminate the roll-over of projects and growth of pending bills at the end of the financial year.

CHAPTER FOUR: IMPLEMENTATION OF THE 2023 MTDS AND CONCLUSION

4.0 IMPLEMENTING THE 2023 MTDMS

The County Government recognizes the importance of managing debt prudently to avoid unwarranted debt burden to the future generation and reduce the risk of macro-economic instability. Thus, upon approval of the Financial Year 2023/2024 Budget, a program will be developed for debt repayment based on priorities and cash flow forecast and forwarded to the County Treasury for implementation.

After verification of the pending bills, a report detailing on the approved pending bills will be availed for payment. This will ensure that all pending bills approved are settled as a first charge in the Budget.

A proposal for the debt ceilings for the County Government of Meru for the Financial Year 2023/2024 will be submitted to the County Assembly for approval in line with the provisions of Section 107 (2) of the Public Finance Management Act, 2012 and the Public Finance Management (County Governments) Regulations, 2015. This will not only guide the sustainability of debt but will also lay the ground for future borrowing to finance the budget if need be.

Negotiation with various parties owed substantial amount will be fast tracked to ensure that those negotiations are concluded by the end of June 2023 so that implementation of the agreement can start at the beginning of Financial Year 2023/2024. Timely conclusion of this agreement will facilitate their inclusion in the debt repayment program.

The County Treasury will continue to strengthen the debt management section in terms of staffing, training and provision of working tools and equipment to ensure that the office is in position to give comprehensive, accurate and timely information on debt.

The County Treasury will continue to maintain effective linkages with the National Treasury to facilitate future borrowing when the need arises to bridge the budget deficit through borrowing or for management of cash flow as stipulated by PFMA and capacity building on debt management.

5.0 CONCLUSION

This is the first debt management strategy paper for the County Government of Meru covering the period, 2023/2024 –2025/2026. The institutional framework envisaged will ensure that both the Executive Arm and the County Assembly play their roles within the provisions of the Constitution of Kenya, 2010, The Public Finance Management Act, 2012 and the County Governments Act, 2012 for the benefit of the public.

The 2023 medium term debt management strategy is a forward-looking framework that describes the sustainability of the county debt in the medium term. Given the current debt level estimate in pending bills, it is important that the County Government of Meru embarks on sustained prudent debt management practices and policies to avoid unnecessary accumulation of debt.

The medium-term debt management strategy paper has emphasized more on management of existing debt and formulating additional measures to avoid future accumulation of debts. The successful implementation of 2023 MTDMS will not only improve the sustainability of debt but will also lay ground for the prudent management of public resources. Going forward all Departments are expected to be more conscious while spending and ensure that programmes implementation is in line with the approved budget and the availability of funds.