

11TH NOVEMBER 2005

The Secretary to the Treasury
Ministry of Finance and National Planning
P.O Box 50062
Lusaka

HEAD: 21 / 01 Loans and Investments

SUBHEADS: Various

SUBJECT: Audit of Accounts for the financial year ended December 31, 2004

Reference: (i) Minister's briefs,
(ii) Appropriation Act, 2004
(iii) Budget Office funding details,
(iv) Control 63 and 49 bank statements,
(v) General Payment Authorizations
(vi) Other relevant correspondence files

1. BACKGROUND

In 1996, the External Resource Mobilization (ERM) was created by the Loans and Guarantees (Authorisation) Act; Cap 366 of the Laws of Zambia after merging two departments namely Economic and Technical Cooperation which was under the former National Commission for Development Planning and the Department of Loans and Investment which was under the Ministry of Finance and Economic Development.

The purpose of the merger was to streamline and rationalise the functions of the two departments. As a result of the merger, three units were established namely Bilateral, Multilateral and the Debt and Aids units. The bilateral and multilateral units were responsible for designing, developing and implementation of an efficient development co-operation policy of the Government whereas the Debt and Aids Units was responsible for management of Government investments as well as accounting for Aids and Debts.

In November 2001, the External Resource Mobilization was restructured such that two new departments were created namely Investment and Debt Management (IDM) and Economic and Technical Co-operation (ETC).

The IDM is responsible for the effective monitoring and evaluation of Government investment and management of Government debt stock and its involvement in the capital markets to satisfy the cash flow requirements of Government's annual work plans. It is also responsible for maintaining an up-to-date database of foreign and domestic debt and its servicing requirements liaising with the Bank of Zambia to ensure timely servicing of external and domestic debt. In view of the country's qualification to HIPC, it is also responsible for capturing debt written off and re-scheduled and ensuring adherence to conditionalities of reaching completion point.

The main output of IDM is to report to the policymakers and general public on the benefits of Government economic reforms and the effectiveness of the IMF-World Bank reforms and ensuring that the country achieves completion point under the HIPC initiative.

The ETC is responsible for mobilizing resources from Zambia's co-operating partners and to monitor and evaluate how such resources are being utilized. Most of the resources

mobilized are in form of grants for project financing, balance of payment support, technical expertise and equipment. In order to win the fight against poverty, it has become imperative for the department to succeed in the task of resources mobilization necessary for the implementation of the Poverty Reduction Strategy Programme.

2. AUDIT OBJECTIVES

- (a) To determine whether all public debt elements are:
 - (i) Recorded correctly with respect to amounts, accounts and periods,
 - (ii) Authorised by the law or executive regulations,
 - (iii) Disclosed to policymakers and the general public in a timely, consistent and transparent manner;
- (b) To determine whether the loans obtained have been applied for the intended purpose.
- (c) Ascertain whether the Government's financing needs and its payment obligations are met at the lowest possible cost over medium to long-term, consistent with a prudent degree of risk;
- (d) To establish whether a database exist of all State Owned enterprise (SOEs) clearly indicating the level of Government investments,
- (e) To ascertain whether IDM department monitor, evaluate and report on the performance of SOEs and progress on the SOEs under liquidations, receivership and management.

3. AUDIT SCOPE AND LIMITATION

The audit covered the transactions and decisions relating to the financial year ended 31st December 2005.

There were however, problems in discharging the audit programme mainly because of lack of records in some instances, minimum cooperation from officials at the Ministry of Finance and National Planning and some files could not be obtained.

The audit did not cover physical inspections of the projects and programmes implemented by various agencies of Government to establish their status as of December 2004 due to limited time and other resources.

4. AUDIT STRATEGY AND APPROACH

The audit was discharged by a programme of test checks, inspections and examinations, in selected areas, which were intended to provide an overall assurance of the accuracy and propriety of the Government's financial and accounting transactions; and in accordance with the Generally Accepted Government Auditing Standards as stipulated by INTOSAI and Office of the Auditor General Auditing Standards.

The audit was planned to obtain all the information and explanations considered necessary to provide sufficient evidence to give reasonable assurance that the financial statements are free from material misstatements.

Auditors analysed the financial statements to establish whether acceptable accounting standards for financial reporting and disclosure are complied and the various elements of financial statements are properly evaluated, measured and presented and thereafter express an opinions on the financial statements.

The audit also included discussions with management on all issues that affect the audit including an evaluation of the probity and propriety of administrative decisions taken within the Ministry. Preliminary queries on contentious issues were raised and a report was finally issued to management.

5. PRINCIPAL FINDINGS

An examination of the records and other relevant documents pertaining to 2004 Appropriation Accounts at the Ministry of Finance and National Planning in October 2005 revealed the following:

(a) External Debt Management and Reporting

A database on external debt exists in Investment and Debt Management (IDM) Department in the Ministry of Finance and National Planning although not all public debt elements such as interest rates, conditions and terms etc., were included in the records made available.

According to information contained in the database obtained from IDM, Zambia's external debt comprising multilateral, bilateral and private banks stood at K2,726,428,995,000 (US\$5,675,839,000) as at 31st December 2003 and had increased to K2,788,207,211,000 (US\$5,807,035,015) as at 31st December 2004 as tabulated below:

	Balance as at 31st December 2004	Balance as at 31st December 2003
	US\$	US\$
Bilateral	2,541,389,029	2,608,445,000
	2,541,389,029	2,608,445,000
Multilateral		
ADB/ADF	346,033,110	348,424,000
IDA	2,497,044,916	2,342,088,000
Others	320,337,495	278,654,000
	3,163,415,520	2,969,166,000
Private Banks		
Bermuda & Donegal	14,361,345	13,894,000
	14,361,345	13,894,000
Supplier of Credits		
	87,869,121	84,334,000
	87,869,121	84,334,000
GRAND TOTAL	5,807,035,015	5,675,839,000

A review of the loan repayment records at IDM revealed that the Government spent a total sum of K1,750,896,205 (US\$364,661,406) in external debt servicing in 2004. Despite the payment, the debt stock did not reduce but instead increased by K2,025,771,791 (US\$ 421,722,134) from K2,726,428,995,000 (US\$5,385,312,881) as at 1 January 2004 to K2,788,207,211,000 (US\$ 5,807,035,015) as at 31st December 2004.

A further examination of records obtained from the Ministry of Finance and National Planning revealed that the Government of the Republic of Zambia contracted total of 80,900,000 Special Drawing Rights (SDR) in form of loans from multilateral organisations. Out of the total loans contracted, two(2) were signed by the Ambassador to USA, without delegation from the Minister responsible for finance by issuance of a statutory order as provided for in part VII of the Loans and Guarantees (Authorisation) Act and one by the Minister of Finance.

It was also observed that the debt management policy and strategy, which could have guided debt managers in their day to day work, did not exist. As such officers in the IDM failed to produce comprehensive information of creditors to show when loans were contracted, purpose for which loans were obtained, how long the loans have been outstanding etc.

Risks

The financial Report of Government will not reflect a correct position of amounts outstanding to creditors and payments can be made twice for loans already settled.

Recommendation

Therefore, in order for the IDM department to monitor progress being made for external debt management, it is imperative that the IDM department in the Ministry of Finance and National implements the following

- Put in place robust debt management strategies, policies and sound risk management practices, which should be clearly defined and publicly disclosed,
- Keep records regarding loans into a central place with details showing date of contraction, purpose for the loan, payments made and balance remaining.
- Debt managers, fiscal and monetary authorities should share information on the Government's current and future liquidity needs.
- Ensure that any new loan(s) and loan guarantee(s) program are approved by the Minister responsible for finance as authorised by the National Assembly,

The above measures, if implemented by IDM, will ensure that debt obligations are managed properly and orderly without too much fiscal stress on the budgetary position of the Government, as opposed to the current position where the debt is unsustainable.

Management Response(s)

(b) Economic and Technical Cooperation

During the period under review, sixteen (16) cooperating partners pledged to support various projects and programmes in the country in amounts totalling K246,975,956,340 (US\$514,380,000) in various sectors. All the sixteen (16) partners honoured their pledges and released a total amount of K2,146,671,339 (US\$ 447,090,000) leaving a balance of K32,308,822,470 (US\$ 67,290,000).

Risks

As a result of the cooperating partners not releasing the total amount of funds pledged certain developmental projects were not implemented.

Recommendation

It is important to emphasise to the cooperating partners on the adverse effects/impacts of not releasing the full pledge.

Management Response(s)

(c) Highly Indebted Poor Countries (HIPC)

Due to the financial constraints experienced by Zambia during the late years of 70's and during the 80's, the Government of the Republic of Zambia started negotiating for debt write-off between 1986 and 1990. In this regard, the creditors accepted to discuss debt relief on pre-cut off debt, loans contracted before 1st January 1983 including loans under Paris club 4, 5, 6, & 7, as opposed to post cut-off debt. In addition, creditors agreed to

write off 90% of the loans and reschedule 10% (new loan) under the Paris Club 8 or HIPC / Cologne terms.

Consequently, Zambia qualified for Highly Indebted Poor Countries (HIPC) initiative in December 2000. The Highly indebted poor countries (HIPC) is an initiative developed by major creditors to Zambia such as the World Bank, International Monetary Fund (IMF), Paris Club and others to give relief of debt to countries considered to be heavily indebted.

In order to qualify for this initiative, Zambia had to make major key reforms and meet other such conditions set out. The conditions for reaching the completion point, among others, were:

- (i) The adoption of a poverty reduction strategy paper
- (ii) Maintenance of a stable macroeconomic environment
- (iii) Social sector-combating of HIV/AIDS
- (iv) Issuance of International bidding documents for sale of a majority (controlling) interest in the Zambia National Commercial Bank (ZNCB)
- (v) Implementation of Public Expenditure Management

Upon reaching the completion point, Zambia would qualify to receive the debt relief, which was targeted for the year 2005.

A review of the records and other relevant correspondence files in respect of HIPC account revealed that a total amount of K237,100,000,0000 was received from cooperating partners. However, a sum of K527,799,859,492 was transferred to Control 99 and K236,175,138,994 was disbursed directly to line ministries, provinces and other Government institutions. The money disbursed to Control 99 and line ministries was more than what was receipted in the account. No explanation on the discrepancy was given by the Director, Budget Office

A verification of records at the Government institutions confirmed that the funds were received. It was however observed that there were no mechanisms in place at the Ministry of Finance and National Planning to effectively monitor the application of funds on intended HIPC programmes / projects

Risks

Funds can be subject to abuse and re-channelled to support other programmes not beneficial to the ordinary Zambian.

Recommendation

The Ministry of Finance and National Planning should ensure that strict guidelines as to what the funds are for are followed and controlling officers in receptive ministries should ensure that Poverty Reduction Programmes (PRPs) funds are used for the intended purpose.

Management Response(s)

(d) The Presidential Jet-Challenger CL 601-9j Ron

Prior to the privatization of ZCCM Ltd in March 2000, the Government of the Republic of Zambia, among others, undertook to assume the liquidation of ZCCM Ltd trade creditors, payment of redundancies, long-term loans to IBRD and Paris club and took possession of various ZCCM assets such as schools, hospitals, lodges, recreation centres, the challenger

aircraft and CISB Dar-es-salaam in Tanzania. In this regard, the challenger aircraft No: 9J-Ron, serial No: 3057 was owned by GRZ and managed by Roan Air as of June 1999.

On 20th March 2001, the Director General, Office of the President, Special Division acting on behalf of Government sold, transferred and delivered all rights, title and interest to aircraft No: 9J-Ron, serial No: 3057 to Bombardier Aerospace Corporation of USA. However, the purchase price was not indicated on the Aircraft Bill of Sale.

In providing a comprehensive brief to the Secretary to the Treasury following inquiries on the status of the aircraft, the Acting Director, ERM informed the Secretary to the Treasury that Government had decided to replace the Presidential Jet, the Challenger 601 acquired by ZCCM Ltd in 1986 with a brand new version, Challenger 604 owned by Execujet Aviation Group PTY Ltd of the Republic of South Africa. The decision to replace the aircraft was necessitated by the fact that it was increasingly becoming uneconomical to service due to old age. The replacement from Execujet involved trading-in of the 601 at its current value of US\$8.5 million with the new challenger 604 valued at US\$20.85 million resulting into a net amount of US\$12.35 million payable to Execujet of South Africa. The aircraft was to be registered in South Africa and operated under Execujet licence on lease for a period of five (5) years at which time the Government will have to make payments not exceeding US\$1 million per quarter. At the end of the five years lease period, with consistence performance on payments, the ownership of the aircraft will be transferred to the GRZ.

The challenger 604 was delivered in October 2001 for use on Presidential assignments.

A scrutiny of the accounting records in respect of Control 63 and other information revealed that the government was making a quarterly payment of US\$1,074,000 exceeding the agreed quarterly payments by US\$74,000 in 2004. Out of the total purchase price of US\$28,772,873 which include interest and finance fees, a total amount of US\$22,462,000 including the trading-in of the old jet had been paid leaving a balance of US\$ 6,310,873 as of October 2004 as shown in the table:

SUMMARY OR PAYMENTS FOR CHALLENGER 604	
	US\$
Purchase Price	24,908,360
Add Interest	3,741,453
Add Finance Fees	<u>123,060</u>
TOTAL PURCHASE PRICE	28,772,873
LESS: TRADE-IN CHALLENGER 601	
13 Instalments Paid as of October 2004	<u>(8,500,000)</u>
Sub-Total	22,462,000
AMOUNT DUE TO EXECUJET OF RSA	<u>6,310,873</u>

It was also observed that no tender procedures were followed in the procurement of the challenger 604 and the decision of the Cabinet to board the challenger 601 could not be established. It was further noted that no valuation report was presented for the challenger 601 and details of how the purchase price of challenger 604 changed from US\$20,850,000, as reported by the Acting Director ERM to the Secretary to the Treasury, to US\$ 24,908,360 quoted on the schedule of purchase price could not be established.

Risks

Overpayment to Execujet Aviation Group PTY Ltd by undervaluing the challenger 601

Recommendations

Management Response(s)

(e) Management of State Owned Enterprises (SOEs)

The Investment and Debt Management (IDM) is responsible for monitoring the operations and performance of the remaining State Owned Enterprises, collect and account for all dividends from SOEs including those under liquidation, receivership and management. It has a duty to ensure that the interest of the Government and shareholders were protected in accordance with the provisions of the Minister of Finance (incorporation) Act, Cap 349 of the Laws of Zambia.

An examination of records and inquiries made with IDM officials pertaining to the management of SOEs revealed that there were forty-two (42) active companies, fifteen (15) statutory bodies and nineteen (19) entities under liquidation/receivership or/and management

Despite having details of the remaining State Owned Enterprises, the IDM did not have detailed information to show the level of Government interest and performance of the SOEs so as to determine whether entities are profit or loss making or breaking even. It was also observed that there are no policy guidelines and procedures developed and adopted to guide staff in IDM in monitoring, co-ordination and evaluating the performance of SOEs,

During the period under review, the Ministry of Finance and National Planning received a total amount of K19,249,289,620 as dividends from state owned enterprises, however they could not provide the bank statement to show where the money was banked.

Risks

Unreliable and misleading information could be presented to the end users on the performance of SOEs.

Recommendations

IDM should come up with a reliable information system to monitor and evaluate the performance of State owned enterprises.

Management Response(s)

(f) Management of the Liquidation/Receivership Process

An examination of records and inquiries made at Investments and Debt Management Department regarding monitoring of the liquidation of SOEs revealed that:

- (i) there was no database or an inventory established for all SOEs under liquidation, receivership and management.
- (ii) there were no guidelines or procedures that are followed by staff in the department in monitoring, co-ordinating and reporting on the performance status of the liquidation, receivership or management process,
- (iii) the department has no information on the liquidators, receivers or managers regarding the date appointed, amount of fees payable and other charges; and the value of the assets remaining to be disposed and liabilities to be cleared for each of the entity under liquidation, receivership or management.

Risks

Lack of knowledge, could result in loss of government assets.

Recommendations

The IDM department in the Ministry responsible for finance should immediately establish a database of all SOEs under liquidation, receivership or management and develop proactive policy guidelines and procedures to be followed by staff in the monitoring, co-ordinating, evaluating and reporting on the performance status of the liquidation process.

(g) Privatization Revenue Account

An audit carried out at the Ministry of finance and National Planning on the privatisation of State Owned Enterprises revealed that Zambia Privatisation Agency (ZPA) had a total working portfolio of 284 companies out of which a total of 261 companies/unit were privatised, three (3) companies were ready/under negotiations and twenty (20) companies under preparation to be privatised as at December 2004. In this regard, a total amount of K122,118,398,720.60 was realised from the sale of SOEs between 1993 and December 2004; and was deposited in the privatization revenue account held at Bank of Zambia as shown in the table below:

ZPA SUMMARY STATUS REPORT FOR NUMBER OF SOEs SOLD, AMOUNT REALISED AND PAYMENTS INCURRED.			
PERIOD	NO: SOEs SOLD	RECEIPTS (K)	PAYMENTS (K)
2004	-	4,750,000,000.00	
2003	-	26,498,667,283.30	23,770,170,725.75
2002	10	194,000,000.00	23,047,795,666.00
2001	3	252,000,000.00	2,788,977,375.00
2000	13	3,609,514.89	6,784,582,972.00
1999	30	7,096,345,246.95	500,340,000.00
1998	16	8,386,467,546.45	7,629,617,249.35
1997	58	10,830,496,840.81	9,055,765,995.65
1996	82	32,638,517,113.66	9,359,270,223.33
1995	34	25,609,351,785.08	27,188,884,961.84
1994	9	5,168,607,489.46	2,282,593,920.10
1993	6	690,335,900.00	200,000.00
GRAND TOTAL	261	122,118,398,720.60	112,408,199,089.02

An examination of the payments made from the privatization fund account during 2002 up to December 2004 revealed that the Ministry of Finance and National Planning used this account to pay for items which were not approved by Parliament such as ex-employees terminal benefits and legal fees, salaries of RAMCoZ Plc (in Receivership) and operational costs of ZPA, contrary the provisions of the Privatization Act, 1992.

Risks

Money realised from the sale of companies would not serve the intended goals and not meet the privatisation objectives.

Recommendation

All moneys withdrawn from the privatisation revenue account should have approval from Parliament and all moneys withdrawn from the account should be refunded back in the privatisation revenue account.

Management Response(s)

(h) Zambia Privatization Trust Fund (ZPTF)

The Privatisation Act; Cap 386 of the Laws of Zambia was enacted in 1992 to provide a legal and regulatory framework within which the privatization programme must be implemented. The Act provided for and resulted in the formation of the Zambia Privatisation

Agency as Government's executing agents of the programme. Thus, to date 261 companies and units have been privatised. The remaining shares were transferred to the Zambia privatisation Trust Fund (ZPTF).

The ZPTF was established in 1993 through a Trust Deed. Generally, the ZPTF is a warehousing vehicle through which Government shares are held in trust for citizens of Zambia for the divestiture after a State Owned Enterprise has been privatised. The divestiture of such shares from the ZPTF is done through the Lusaka Stock Exchange and offered to the Zambia citizens by way of an initial public offer.

A review of details in the IDM regarding ZPTF revealed that as at 31st December 2004, the Trust held 82,556,980 shares with different companies as shown in the table below:

Company	Opening balance	SALE OF SHARES K'000	RESIDUE SHARES BEFORE DEBT SWAPS	DEBT SWAPS PSPF (K8BILLION)	DEBT SWAP LASF (K7BILLION)	CURRENT RESIDUE BALANCE
Zambia Sugar Plc	379,736,000	- 224,630,227	155,105,773	-70,000,000	-61,835,285	23,270,488
British American Tobacco Company	30,239,000	-14,057,152	16,181,848	-8,000,000	-5,000,000	3,181,848
Bp Zambia Plc	124,999,999	-70,707,000	54,292,999	-24,451,522	-28,339,126	1,502,351
National Breweries Plc	18,900,000	-16,448,500	2,451,500	-1,130,000	-700,000	621,500
Pamodzi Hotels Plc	30,000,000	-6,862,527	23,137,473	-12,000,000	-10,000,000	1,137,473
African Explosives Zambia Limited	4,081,320	0	4,081,320			4,081,320
Metal Fabricators of Zambia Plc	48,762,000	0	48,762,000			48,762,000
Grand Total						82,556,980

(i) Government Subsidies – RAMCOZ Plc

According to the records obtained at the Zambia National Commercial Bank plc and receiver/manager, the Government of the Republic of Zambia released a total amount of K67,600,000,000 to RAMCOZ Plc (in receivership), a privately owned company between April 2001 and October 2002 towards meeting the cost of workers' salaries, capital expenditure and terminal benefits.

It also was observed from the progress report of the Receiver/Manager that between October 2003 and January 2004, the Government of the Republic of Zambia released a total amount of K167,803,000,000 to RAMCOZ Plc (in receivership) for the payment of terminal benefits to 4,883 ex-employees, statutory contributions and other payments. In this regard, 4,481 ex-employees were paid a total amount of K146,929,830,692 leaving 402 ex-employees unpaid.

Out of the total amount received, payments in respect of terminal benefits, statutory contribution and others were made in amounts totalling K167,038,452,229 leaving a balance of K764,547,771 as at 31st December 2004 as shown below:

	<u>Amount (k)</u>
Terminal Benefits	146,929,830,692
Statutory and Other Payments	18,083,753,426
Luanshya Municipal Council	2,000,000,000
Bank Charges	<u>24,868,111</u>
	<u>167,038,452,229</u>

It was further observed that in addition to the funding for terminal benefits payments, a total amount of K3 billion was released by the Ministry of Finance and National Planning to facilitate Trust Fund payments to the widows of the deceased ex-miners. In this regard, out of 133 widows, 100 were paid a total amount of K2,480,743,837 leaving a balance of K519,256,163 unutilised and 33 widows unpaid as of December 2004.

It was further observed that RAMCOZ plc (in receivership) was sold in 2003 to Luanshya Copper Mines Plc at a purchase consideration price of the assets of K38,810,367,500 (US\$ 7,250,000). The amount of K29.6 billion realised from the sale of the assets was invested in treasury bills by the receiver / manager through the Zambia National Commercial bank Plc. As of September 2005, the investment stood at K33.71 billion from the original investment of K29.6 billion representing an increase of K4.11 billion.

It was however noted that officials from the Ministry of Finance and National Planning could not indicate how the money remitted to RAMCOZ plc (in receivership), a privately owned entity will be reimbursed to the Government.

Risks

The Government risk losing the total amount of K170,870,600,000 as RAMCOZ Plc (in Receivership) is not capable of paying back the money.

Recommendations

Government should state conditions attached to the money that is being remitted to RAMCOZ, as opposed to remaining silent.

Management Response(s)

(j) **GRZ Guaranteed borrowings for ZCCM Holdings Plc**

According to the records obtained from the IDM, ZCCM-IH indebtedness to Government stood at K2,176,723,461,786 as of June 2004. Details are as shown in the table below:

Description	Amount
	K
IDA Public Sector Reform & Export Programme ZA2406	341,208,894,703.28
Government Loans	869,995,464,031.88
ERIPTA Loan	12,321,540,000.00
Subordinate Loans	865,445,000,000.00
ZESCO/ZCCM/CEC I	23,965,240,699.00
ZESCO/ZCCM/CEC Debt	63,787,322,351.87
	<u>2,176,723,461,786.03</u>

Risks

The indebtedness of ZCCM-IH to government is high and as such it may be difficult not to be repaid at all

Recommendation

A deliberate strategy to recover the debt should be implemented.

5. Inquiry

Your response to the above observations is required soon.

Mafuta J

**Ag Director; Public Debt and Investment Audits
For/Auditor General
Office of the Auditor General**

CC: The Permanent Secretary (BEA)

CC: The Permanent Secretary (FMA)