

COMMITTEE ON ECONOMIC AFFAIRS AND LABOUR

MEMORANDUM BY THE AUDITOR GENERAL, OFFICE OF THE AUDITOR GENERAL.

Study on the National Debt Contraction Process and Debt Management in Zambia.

Reference is made to your correspondence, NAS/11/15/6 Conf dated 12th April 2005 in which you require my office to submit a memorandum to the Committee on Economic Affairs and labour on the above captioned matter. In particular, you requested detailed information on the following subjects:

(a) **Legal and Regulatory Framework**

The national debt procurement and management is generally governed by the provisions of Part X of the Constitution of Zambia and Volume 20 of the Laws of Zambia covering Chapter 347 to 379. In particular, the following are of great interest:

- (i) **CAP 348; Treasury Bills.** An Act to enable money to be borrowed on Government of the Republic of Zambia treasury bills and provides for matters incidental to or connected therewith.
- (ii) **CAP 350; General Loan and Stock Act.** An act to declare the terms and conditions applicable to loans authorized to be raised by the Government of the Republic of Zambia, provide for the creation of stock and matters incidental or connected with the foregoing. Raising of loans by debentures and stock.
- (iii) **CAP 353; Local Loans (Registered Stock and Securities) Act.** An Act to make provision for the creation and issue of registered stock and debentures for the purpose of raising loans in Zambia and to provide for matters incidental thereto and connected therewith.
- (iv) **CAP 355; Loan (Authorization) Act.** An Act to make provision for the raising of loans and provide for matters incidental thereto and connected herewith.
Under the Act, authority is given for the raising on behalf of the Republic of a loan or loans by the President and Secretary to the Treasury in the Ministry responsible for finance.
- (v) **CAP 358; General Loans (Guarantee) Act.** An Act to empower the GRZ to guarantee the discharge by certain corporations of their obligations under agreements between such corporations and governments, IBRD (World Bank), CDC or

other bodies or organizations outside Zambia and to provide for matters incidental to or connected with the foregoing.

Under the Act, the Minister responsible for finance may on such terms and conditions as he thinks fit:

- Guarantee in whole or in part the discharge by the corporation of its obligations under any agreement,
- Undertake such other obligations as he may deem necessary or expedient; and
- May give written authority to any person to sign and execute any such guarantee or undertaking as his representative.

(vi) **CAP 366; Loans and Guarantees (Authorization) Act.** An Act to provide for the raising of loans, establishment of sinking funds, giving of guarantees and indemnities and granting of loans by or on behalf of the GRZ and provide for matter incidental thereto and connected therewith.

Under the Act, the Minister responsible for finance may raise from time to time, in the Republic and elsewhere on behalf of the Government such loans as he may deem desirable, not exceeding in the amount outstanding at any one time, for periods of not more than a year or in excess of one year, such amounts as he shall from time to time be authorized by a resolution of the National Assembly to prescribe by statutory instrument. It is important to note that any loans raised are raised in accordance with such conditions and upon such terms as the Minister responsible for finance shall in respect of such loans direct.

(b) **The Role of the Auditor General**

The Auditor General has no direct role to play in deciding the level or purpose of public debt management, data disclosure policies and regulatory regimes for the financial sector.

The primary responsibility for the Auditor General is to audit the publicly disclosed debt information in the Government financial statements or other documents in which the amounts of the public debt are disclosed and ensures that the amounts are measured on appropriate bases. The Auditor General undertake independent analysis of the data disclosed to foster improve management of the debt and improved understanding of the current and future financial implications of the commitment.

The scope of audits generally cover:

- (i) Control environment,
- (ii) Risk assessment'
- (iii) Control activities
- (iv) Information disclosure and communication,
- (v) Monitoring and evaluation.

The Auditor General work aims at helping to ensure full disclosure to all interested parties of complete and reliable information on Government liabilities, hence, increasing awareness through annual reports among policy makers, markets and the general public. In this regard, encourage policy makers to adopt debt and risk management practices that are sound and robust focusing more on vulnerability, monitoring and giving high priority to risk management.

The report of the Auditor General usually focuses on:

- (i) Promoting good debt control and management principles and practices,
- (ii) Promoting sound public debt and risk management practices
- (iii) Encouraging Government to improve data disclosure and best practices approaches in dealing with risk assessment and mitigation approaches,
- (iv) Encouraging the Government to put in place proper regulatory and supervisory framework for the banking industry since the industry can be a significant source of fiscal vulnerability; and
- (v) Ensuring that the quality of the information on fiscal exposures provided in the financial statements can be useful in assessing the sustainability of the country's long-term fiscal condition

(c) Procedures followed in the National Debt Procurement in the past 15 years.

Depending on the financial needs of the Republic, the Government through the Minister responsible for finance would negotiate with governments, bilateral and multilateral lending institutions for the financing of capital grants and projects. Based on the agreements reached and pledges made by the financing institutes, the level of the debt is presented to Parliament during the presentation of the National Budget. In addition, the Government through the Bank of Zambia borrows internally by issuing treasury bills and bonds; and sometimes borrows directly from parastatals and other institutions.

Detailed information on the purpose of the loans raised is usually made available in the Minister's briefs, which accompany the draft estimate of revenue and expenditure submitted to Parliament for consideration and approval by the Minister responsible for finance annually.

However, it has been noticed during the period from 1992 to 2001, some loans contracted were not appearing in the Estimate of Revenue and Expenditure.

Change with regard to legislation governing public debt management is actually inevitable.

(d) Whether in my opinion, the procedures were in accordance with laid down legislation and regulations.

A review of the audit findings on the audit of Investment & Debt Management (formerly Loans and Investments) Department in the Ministry responsible for finance indicate that most loans were raised without following what was laid down in the various laws that governs them.

While the provisions of the law require the Minister responsible for finance to be authorized by a resolution of the National Assembly before raising any loan(s), all loans procured during the last 15 years were contracted without the approve and authorization by a resolution of Parliament.

According to the provisions of CAP 365: the General Loans (International Bank) Act, CAP 361: International Development Association and CAP 368: International Finance Corporation, the Minister responsible for finance is required as soon as practicable after any agreement has been concluded with the international institution to lay a copy of the agreement before the National Assembly. No copies of the agreements with international lending institutions had ever been laid before the National Assembly

The provisions of Article 54 (2) (b) of the Constitution of Zambia stipulates that the Attorney General shall, among others, draw and peruse agreements, contracts, treaties, conventions and documents, by whatever name called, to which the Government is a party or in respect of which the Government has interest. The majority of loan agreements entered into by GRZ and lending institutions are never referred to the Attorney General's chambers

for scrutiny and advise before execution. In most case, the Attorney General is only aware of the loan agreement whenever there is a dispute and Government has sued or is being sued.

(e) Whether the process of national debt management has been satisfactory and efficacious; and

Public Debt management is the process of establishing and executing a strategy for managing the government's debt in order to raise the required amount of funding at the desired risk and cost level. It is important for a number of reasons, such as:

- (i) to ensure that the level and rate of growth of public debt is sustainable in a wide range of circumstance,
- (ii) to lower government borrowing costs over the long-term thus reducing the impact of deficit financing and contributing to debt sustainability,
- (iii) to avoid economic crisis because of a poorly structured debt, and
- (iv) the government debt portfolio is often the largest financial portfolio in the country and can have a far-reaching impact on financial stability, therefore, an effective and efficient management system is very essential.

In an effort to control and manage the national debt and investment, the Government of the Republic of Zambia created the External Resource Mobilization (ERM) through the Loans and Guarantees (Authorization) Act; Cap 366 of the Laws of Zambia in 1996 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.

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.

An overview of the main observations as the result of the previous audits indicate that the provisions of the Loans and Guarantees (Authorization) Act, Cap 366 of the Laws of Zambia were contravened with regard to power to raise loans, application of loans and determination of terms of the loans; and that the provisions of the Minister of Finance (Incorporation) Act have not been strictly adhered to in the management of government assets.

It was also observed that there were no standard guidelines and procedures and a sound and robust debt management strategy, which should have guided officers in Investment and Debt Management Department in their daily operations of managing, monitoring, evaluating and reporting the performance of Government investment and the public debt portfolio.

It was further observed that contrary to the provisions of the Minister of Finance (incorporation) Act, Cap 349 of the Laws of Zambia, IDM has failed to monitor the operations and performance of the remaining State Owned Enterprises (SOEs), collect and account for all dividends from SOEs including those under liquidation, receivership and management; and ensure that the interest of the Government and shareholders were protected.

In conclusion, I would say that the management of the national debt has not been satisfactory.

(f) **Proposed appropriate legislative reform measures.**

While I appreciate that the current legislation on public debt is necessary, I believe it is inadequate and has on several occasions not been complied with. Therefore, I would propose that the current legislation is strengthened by:

- Enforcing compliance practices,
- Setting limits (values or ranges) to the costs and risks associated to public debt; and provide for guidelines to measure them,
- Setting limits (values or ranges) to the following ratios: Public debt/Gross Domestic Product (PD/GDP), Interest Paid / Gross Domestic Product (IP/GDP), Interest Paid/Tax Revenue (IP/TR) and other indicators,
- Ensuring the use of derivatives such as swaps, options, etc as public debt management instruments,
- Ensuring that when reporting public debt, the costs and risks associated are fully disclosed including indicators used in management or evaluation of the debt,
- Setting limits to the loans and securities provided by the Bank of Zambia to the Government Republic of Zambia,
- Requiring periodical external auditing of public debt and that the recommendations of the Public Accounts Committee are strictly followed to the logical conclusion.

April 15, 2005

Anna O. Chifungula (FCCA, FZICA)
AUDITOR GENERAL