TRANSPARENCY INTERNATIONAL ZAMBIA

ANALYSIS OF

THE SPECIAL AUDIT REPORT OF THE AUDITOR GENERAL ON EXTERNAL PUBLIC DEBT

July 2024

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This analytical brief was reviewed by Tommy Singongi, Chimuka Nachibinga, Maurice K. Nyambe and Raymond Mutale. Every effort has been made to verify the accuracy of the information contained in this brief. All information was believed to be correct as of July 2024. Nevertheless, Transparency International Zambia cannot accept responsibility for the consequences of its use for other purposes or in other contexts.

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1.0 INTRODUCTION

The Office of the Auditor General (OAG) is Zambia's Supreme Audit Institution (SAI). In accordance with the provisions of Article 250 of the Constitution of Zambia (Amendment) Act No. 2 of 2016, the OAG recently published a Special Audit Report on External Public Debt of the Republic of Zambia for the period; 1st January 2006 to 31st December 2022.[1] This special audit report is important as it provides deeper insights into the utilization of Zambia's public debt following a decade of unsustainable debt accumulation and consequent debt default.[2]

As Zambia continues to implement a 38-month International Monetary Fund supported Extended Credit Facility (ECF) Arrangement[3] which seeks to entrench macroeconomic stability, attain debt and fiscal sustainability, enhance public governance, and foster inclusive growth to improve the livelihood of the Zambian people, it is important to understand how the three Eurobonds and other public debts were contracted and utilized.

However, following the publication of the Public Debt Audit Report, some opposition political leaders labeled it as "doctored," "illegal" and "useless" because of the target period as well as the audit subject.[4] Following this, Transparency International Zambia cautioned stakeholders against labeling the report as a "witch-hunt," considering its importance to the current public debt discourse.[5]

2.0 ANALYTICAL APPROACH

This paper presents Transparency International Zambia's analysis of the Special Public Debt Audit Report[6] from two perspectives.

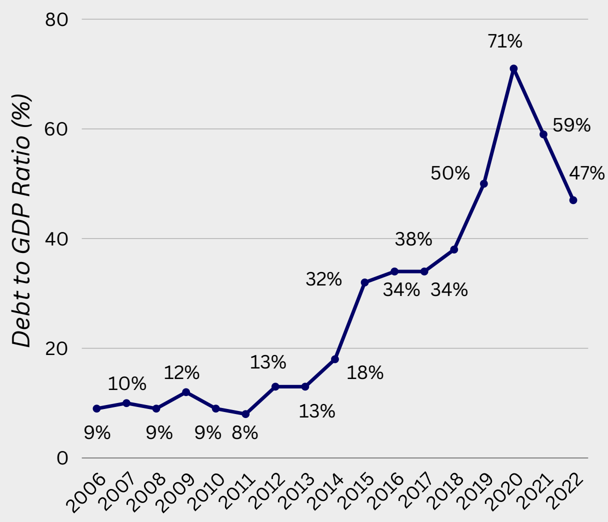
First, we conduct a Validation Analysis; to track the major revelations in the audit report as compared to civil society advocacy efforts and recommendations during the audit period. Second, we conduct a Follow the Money Analysis; to track the utilization of the three Eurobonds as indicated in the audit report. We then proceed to make appropriate recommendations based on the key findings.

3.0 KEY FINDINGS

3.1 VALIDATION ANALYSIS

1. Debt Unsustainability: According to the Report "from 2014 to 2020, there was a significant increase in external public debt stock from 30% to 70% of GDP, exceeding the thresholds of 30%, 40% and 50% for weak, medium, and strong economies respectively. This increase in external public debt during the period 2011 to 2020 was attributed to Government's contraction of expensive loans such as supply credit loans and the three (3) Eurobonds." **Figure 1** indicates that before 2015, Zambia's external debt was sustainable.

Figure 1: External Public Debt to Gross Domestic Product in percentage (%), 2006 to 2022

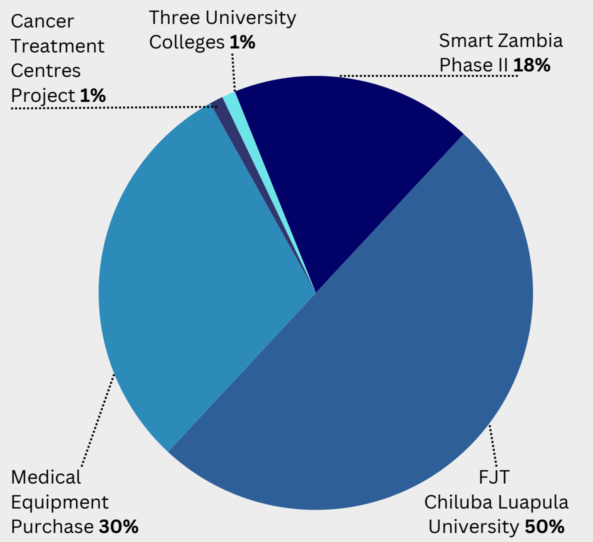


According to the benchmark classifications recommended by the World Bank and International Monetary Fund (IMF), weaker economies or least developed countries such as Zambia are expected to maintain an external debt threshold that is below 30% of GDP. **Figure 1** indicates that the government breached this recommended threshold in 2015 and continued to increase the external debt-to-GDP ratio until 2020 when it peaked at 71% of GDP.

Most recently, beyond 2020, there has been decline in the external debt to GDP ratio. It is important to note that government continued to state that Zambia's debt was sustainable[7] during the period under review amidst increased CSO call for action to address debt unsustainability.[8] The Audit therefore proves that the Zambian government was not transparent concerning debt sustainability, as it communicated to the public that Zambia's debt was sustainable even when it breached the recommended threshold.

2. Wasteful Expenditure: The audit revealed significant weaknesses in the contraction of external debt in that during the period 2014 to 2019, the Government signed seven (7) contracts in amounts totalling **US$958 million** to finance various projects. However, the loans remained undrawn as of 31st December 2022 resulting in **wasteful expenditure of US$9.51 million in the form of financing and arrangement costs**. This means that the Zambian government incurred financial costs for making financial arrangement as well as the mobilizing of money (hence generating an opportunity cost on the part of the funders) on loans that were not utilize. **Figure 2** presents a distribution of this wasteful expenditure by project name.

Figure 2: Wasteful Expenditure by Project Names



About 50% of the wasteful expenditure relates to the F.J.T. Chiluba Luapula University, a matter that landed the former Secretary to the Treasury and former Ministry of Higher Education Permanent Secretary in court for failure to comply with laid down procedures.[9] Since the World Bank flagged this risk in the 2017 Public Expenditure and Financial Accountability Evaluation[10] and Transparency International Zambia cautioned the government on the need to address corruption risk associated with rising wasteful expenditure,[11] this outturn in wasteful expenditure demonstrates sluggish follow-up action with respect to stakeholder recommendations.

3. Risks of Public Guaranteed Loans: During the period from October 2000 to November 2017, the Government disbursed thirty-six (36) on-lent loans to twelve (12) State Owned Entities (SOEs) totaling **US$2.1 billion** for various projects including working capital injection.

As of 31st December 2022, the SOEs had not been servicing these loans and thereby passing the burden to government. **Figure 3** presents the distribution of unpaid outstanding Principals and Interest by State Owned Enterprise (SOE).

Figure 3: Accrued Principal and Interest by SOEs as at 31st December 2022

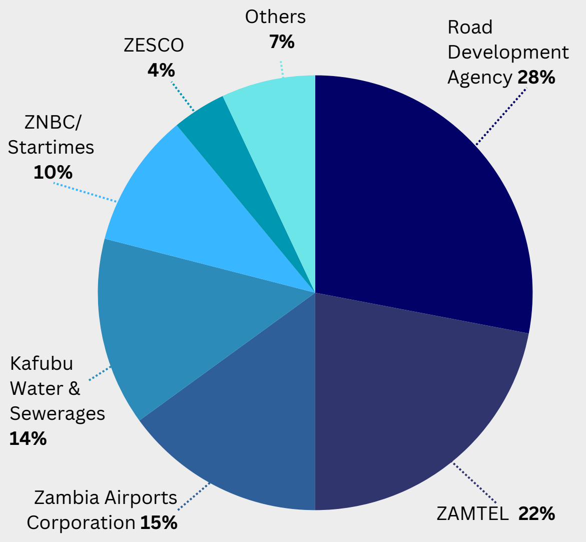


Figure 3 indicates that the SOE with the highest outstanding accrued debt obligation was the Road Development Agency, accounting for 28% of the **USD$ 206.5 million unpaid debt**, followed by ZAMTEL with 22%, Zambia Airport Corporation with 15% and Kafubu Water and Sewerage with 14%. The lack of legal provision to address the risk of Publicly Guaranteed Debt, prior to the enactment of the Public Debt Management Act No. 15 of 2022, was of great concern to several CSOs. For example, the Jesuit Centre for Theological Reflection (JCTR) in Zambia noted this risk in their 2021 Audit of the Debt Strategy[12] and the Centre for Trade Policy and Development (CTPD) cautioned government against relaunching the National Airline,[13] because of this risk as the airline would lead to an increased debt burden.

4. Sinking Fund Allocation: According to the Audit Report, "only amounts totalling **US$9.5 million** had been deposited into the Sinking Fund as of 31st January 2024." This is almost equivalent to the **US$9.51 million** wasteful expenditure stated earlier (point 3.1.2). During the period under review, CSO and Parliamentarians[14] advocated for and called upon government to operationalize[15] and indicate the total allocations to the sinking fund. The Audit report therefore indicates that, against calls by relevant stakeholders, government did not take seriously the need to allocate resources to the sinking fund. The external debt default, which happened in December 2020,[16] is therefore a consequence of this lack of proactive action.

5. Increased Budget Allocation towards Public Order and Safety: During the period 2018 to 2021, there was a notable increase in budget allocation towards Public Order and Safety.[17] This audit report therefore confirms that part of these funds (about **USD$ 69.9 million**) were allocated to the purchase of police uniforms and riot kits, traffic kits and other police equipment. This validates prior CSO assessments that the government was planning to use the police and the Public Order Act to clamp down on any protest actions towards the 2021 general elections.[18] It is indeed unfortunate that during a period when social sector spending was declining, government prioritized allocations towards a pre-emptive response to control potential public expression of freedom and assembly during the 2021 general elections.

3.2 FOLLOW THE MONEY

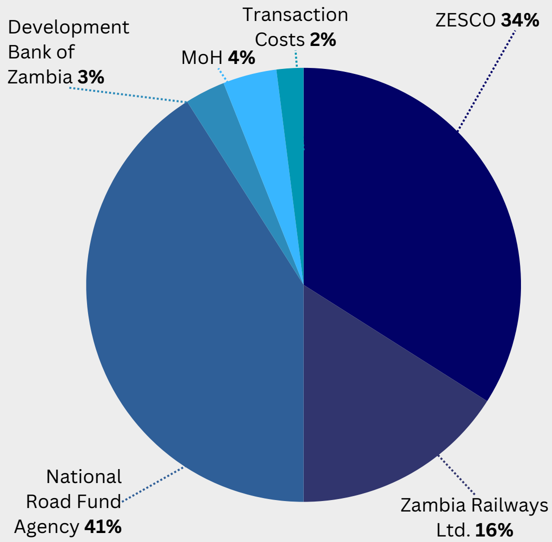
During the period under review, CSOs also called upon government to provide information on the utilization of the **US$3 billion** worth of Eurobonds proceeds. In response, the Zambian government only noted that it had invested most of the funds in infrastructure and budget support,[19] thereby providing no clear distribution of the utilization of these funds. The Special Public Debt Audit Report therefore provides insights into the disbursement, distribution and utilization of the three (3) Eurobonds.

3.2.1 FIRST EUROBOND UTILIZATION

Zambia issued its debut 10-year **US$750 million** international sovereign bond in September 2012. Investors oversubscribed to the Eurobond issuance, which had a coupon rate of **5.625%**, by more than 15 times. This led Zambia to increase the initially planned amount of US$500 million to US$750 million, with the excess funding allocated to additional investment projects.[20] **Figure 4** presents the distribution of the expenditure of the first Eurobond by public institution, as established by the audit report.

Figure 4 indicates that the majority of the first Eurobond was allocated to the National Road Fund Agency (NRFA), accounting for 41%, towards refinancing the Formula One Road Project (**USD$ 145.2 million**) Kitwe-Chingola Dual Carriageway (**USD$100 million**), and the Pave Zambia Programme (**USD$65 million**). Another 34% of the first Eurobond was allocated to ZESCO towards the Power Distribution Network Project (**USD$ 69 million**) and the Kafue George Lower Hydrobrid Power Project (**USD$186 million**)

Figure 4: Distribution of 1st Eurobond by Public Institution Implementing Investment Projects



Further, 16% was allocated to the Zambia Railways Limited, equivalent to **USD$120 million**, towards Track Rehabilitation and Purchase of rolling stock.

3.2.2 OUTSTANDING AUDIT ISSUES FROM FIRST EUROBOND

Table 1 presents the outstanding audit issues from the audit of the utilization of the first Eurobond.

Table 1: Outstanding Audit Issues- 1st Eurobond

Development Bank of Zambia

Outstanding Audit Issues:

- The Bank disbursed the **USD$20 million** to 37 SMEs but only 13 SME fully liquidated their loan obligations while 24 were still owing amounts totalling **USD$ 13.4 million** and **K303.8 million**, with the loans being classified as non-preforming as of 28th February 2024.

Table 1: Outstanding Audit Issues- 1st Eurobond

Zambia Railways Limited (ZRL)

Outstanding Audit Issues:

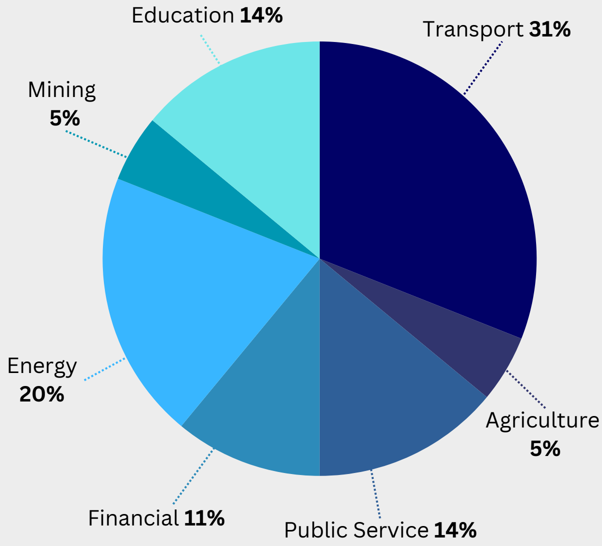
- The ZRL made an advance payment of **USD$3.6 million** to Bombardier for signaling and equipment but as of 31st January 2024, ZRL had not received any equipment or recovered the advance payment made.
- The ZRL made a 25% advance payment to Diamond Motors Limited, amounting to **USD$1.29 million**, for the purchase of two new mobile flush butt-welding machines. However, as of 31st January 2024, the supplier had delivered only one machine, and the delivered machine had specifications that were not consistent with the contract.

3.2.3 SECOND EUROBOND UTILIZATION

The Zambian Government successfully issued a second Eurobond amounting to **US$1 billion** in 2014 at a coupon rate of 8.5%, and oversubscribed by US$ 4.5 billion.[21] According to the audit report, Zambia issued the second Eurobond to investment in transport and energy sectors and for general budget purposes. **Figure 5** presents the allocation of the second Eurobond across sectors.

Figure 5 indicates that the government allocated 31% of the Eurobond to the transport sector, specifically to the Link Zambia 8000 (**USD$200 million**) and TAZARA (**USD$ 40 million**), among others. Further, the government allocated 20% of the Eurobond to the energy sector (i.e. **USD$ 200 million** to ZESCO), 14% to the education sector (i.e. **USD$140 million** for university infrastructure) and another 14% to public service, specifically towards infrastructure in the new districts.

Figure 5: Distribution of 2nd Eurobond by Public Institution Implementing Investment Projects



3.2.4 OUTSTANDING AUDIT ISSUES FROM SECOND EUROBOND

According to the audit report, about $USD 807 million was utilized in 2014, leaving a balance of **USD$193 million**. **Table 2** presents the outstanding audit issues from the audit of the utilization of the second Eurobond.

Table 2: Outstanding Audit Issues- 2nd Eurobond

Ministry of Finance

Outstanding Audit Issues:

- About **USD$ 85 million** was disbursed from the second Eurobond to four entities; namely Development Bank of Zambia, Lusaka Water and Sewerage Company, PTA Bank, and the Ministry of Transport, Works, Supply and Communication, without approval from Parliament.

3.2.5 THIRD EUROBOND UTILIZATION

On the 28th of July 2015, the Government issued a third sovereign Eurobond on the international capital market amounting to **USD$1.25 billion** at 8.5% per annum. The purpose of the bond was for investment in transportation, energy and water infrastructure projects, public housing projects and the education, health and maritime sectors. Further, the Government of Zambia also contracted the third Eurobond to recapitalize certain State-Owned Entities (SOEs) and to refinance domestic debt as well as finance the Government's fiscal deficit. The audit report provided no allocation or distribution on the utilization of the third Eurobond.

3.2.6 OUTSTANDING AUDIT ISSUES FROM THIRD EUROBOND

Table 3 presents the outstanding audit issues from the audit of the utilization of the third Eurobond.

Table 2: Outstanding Audit Issues- 2nd Eurobond

Ministry of Finance

Outstanding Audit Issues:

- ·On 28th December 2015, K100 million (about **USD$ 13 million**) was drawn from the third Eurobond Account and deposited into the Ministry of Finance's consolidated account (Control 99) for Budget Support. However, as of 31st January 2024, management had not provided details on the utilization of these funds.
- On 29th August 2015, the Ministry disbursed amounts totaling **USD$30.6 million** from the Eurobond Account to a named commercial bank for loan repayment. However, as at 31st December 2023, management did not provide the loan agreement on which Government contracted the debt.

4.0 CONCLUSION AND RECOMMENDATIONS

The Special Audit Report of the Auditor General on External Public Debt is an important report that sought to provide crucial information on the utilization of Zambia's public debt. The validation analysis indicates that the Zambian government was not transparent concerning that state of public debt, despite calls from stakeholders challenging the escalating debt accumulation.

Further, the lack of proactive action in allocating funds to the sinking fund amidst increased external debt unsustainability contributed to the external debt default in 2020. There are also indications that the government adopted a sluggish approach in dealing with public finance management recommendations from cooperating partners and CSOs. Consequently, the Zambian people suffered losses in the form of wasteful expenditure, including interest and penalties on unutilized public debt.

The audit report suggests that there were no outstanding issues in the utilization of over 75% of the first Eurobond; an outcome which is at variance with the trends observed in recent audit reports on parastatal bodies.[22] For examples, the 2016 Audit Report on parastatal bodies[23] revealed issues such as failure to have accounts audited, internal control weaknesses which include the failure to remit statutory contributions, unsupported payments and unaccounted for stores.

Further, it is unfortunate that the Audit report provides very limited insights into the utilization of the second Eurobond. The Audit presentes the allocation of the second Eurobond by sector, instead of public institution, thereby concealing the names of some of the public institutions that received the Eurobond proceeds. It is also surprising that there are no outstanding issues related to the **USD$ 807 million** utilized in 2014 from the second Eurobond, thereby suggesting that about 80% of the Second Eurobond was utilized without outstanding audit issues.

Finally, our follow the money analysis revealed limited insights into the utilization of the third Eurobond. This is because the audit report presented no allocations or disbursement figures on the utilization of the third Eurobond. Only two audit issues are cited related to the Ministry of finance, accounting for only **USD$34.6 million**, a mere 2.8% of the **USD$1.25 billion**. Consequently, the audit suggests that there were no outstanding audit issues with over 97% of the third Eurobond.

Therefore, the Special Audit Report of the Auditor General on External Public Debt from 2006 to 2022 failed to deliver the necessary information expected of such a comprehensive audit. It is suspicious that the audit cited no outstanding audit issues from the utilization of 75% of the first Eurobond, 80% of the second Eurobond and 97% of the third Eurobond. Further, the audit report excessively focused on auditing Supplier Credit Agreements and the cited outstanding audit issues were linked on one named supplier.

Considering these findings, TI-Z makes the following recommendations:

1. The Ministry of Finance and National Planning should enhance transparency in the management of public debt and **ensure adherence to the provisions of the Public Debt Management Act No. 15 of 2022**. Debt management has not been transparent in the past as evidenced by the validation analysis of in audit report.

2. Government should endeavour to **act on the recommendations made by CSOs** and other stakeholders in strengthening debt management and procurement processes. The validation analysis has revealed that ignoring stakeholder recommendation comes at a great cost to the Zambian people.

3. The Office of the Auditor General should conduct a **more comprehensive audit on the utilization of the three Eurobonds**. The audit report provides very limited insights and presents a picture that is inconsistent with other recent audit reports.

4. Government should take action to **protect the Office of the Auditor General from political influence** to ensure that the undertaking of audits is in national interest and not for any political expediency.

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