

# **Government of Malawi**



## **GUIDELINES FOR THE ISSUANCE OF PARASTATAL GUARANTEES, INDEMNITIES, AND LETTERS OF CONSENT AND COMFORT**

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## **PREFACE**

The guidelines for the issuance of parastatal guarantees, indemnities, letters of consent and letters of comfort have been produced to ensure that there is a well coordinated, streamlined and efficient governance structure for issuing approvals for private loans, borrowing on overdrafts, guarantees and indemnities.

These guidelines are further developed to guide individual statutory bodies so that their borrowing is in line with their resource envelope. Ultimately, these guidelines will go a long way in ensuring that statutory bodies borrow in a sustainable manner thereby enabling the Government to avoid financial exposure arising from the same.

The scope of guidelines covers indemnities, guarantees, letters of comfort and letters of consent. The guidelines further outline structures that have been put in place to ensure that decisions regarding approvals for the borrowing are well informed. Parastatals are expected to observe the timelines required for the Ministry of Finance to carry out its due diligence before approvals are granted.

The process of producing these guidelines was done in a consultative manner to ensure ownership and ease the implementation process from the onset. As such, it is my sincere hope that these guidelines will be adhered to whenever a parastatal plans to access the afore mentioned facilities.

**Ben Botolo**

**SECRETARY TO THE TREASURY**

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## **1.0 Background**

The Public Finance Management Act (PFMA), 2003 provides for statutory bodies to access guarantees and indemnities, borrowing on overdrafts and private loans. Guarantees and overdrafts are part of the statutory bodies' debt portfolio. The demand for overdrafts and guarantees have been increasing overtime. This increasing demand has led to an increase in contingent liabilities and financial exposure to the Government.

Considering the importance of statutory bodies in the delivery of goods and/or services that cannot be efficiently provided by the general government sector, as well as their financial constraints, it has become apparent that guidelines be put in place to ensure sustainable accumulation of liabilities by the statutory bodies.

Despite the significant demand for borrowing requirements by the statutory bodies, the shareholder has not promulgated guidelines on the issuance of private loans, borrowing on overdrafts, guarantees and indemnities. Consequently, inconsistencies have been observed in the manner in which the requests and approvals for private loans, borrowings on bank overdrafts, guarantees and indemnities are processed.

An assessment of statutory bodies over time showed that, in some instances, borrowings were being accessed without approval from the shareholder as promulgated in the Public Finance Management Act, 2003.

Furthermore, increases in the requests for borrowing requirements by statutory bodies has shown weak coordination in the governance structure within the Ministry of Finance, Economic Planning and Development. This has resulted in issuance of uncoordinated approvals. Consequently, the uncoordinated approvals have compromised the Ministry's capability to carry out thorough due diligence.

It has also been observed that some of the statutory bodies' borrowings have not achieved the intended objectives. There has been misuse and misallocation of resources and undertaking projects that are not viable.

Similarly, dividend and surplus remittance to the Government by statutory bodies have been low or nonexistent as most of the resources are channeled towards liquidating huge borrowings through principal and interest payments.

Thus, borrowing of any kind by statutory bodies needs to be addressed through a consistent application that follows clear guidelines on the issuance of private loans, borrowing on overdrafts, guarantees and indemnities.

## **2.0 Scope of the Guidelines**

These guidelines cover procedures for issuance of indemnities, guarantees, and letters of comfort and consent for accessing

private loans and borrowing on overdrafts by statutory bodies and provide step by step procedures for accessing these facilities. The guidelines define specific roles to be carried out by relevant stakeholders, namely: the statutory body, Secretary to the Treasury and the Minister of Finance, in the process of contracting private loans, borrowing on overdrafts and provision of guarantees and indemnities, as provided for by sections 63, 72, 73 and 74 of PFMA, 2003.

### **3.0 Purpose of the Guidelines**

The purpose of the guidelines is to manage fiscal exposure emanating from issuance of approvals for private loans, borrowing on overdrafts, guarantees and indemnities to statutory bodies.

All statutory bodies shall comply with the provisions of the Public Finance Management Act, 2003 and these guidelines in accessing private loans, borrowing on overdrafts, guarantees and indemnities.

### **4.0 Objectives of the Guidelines**

The objectives of the guidelines on the issuance of private loans, borrowing on overdrafts, guarantees and indemnities are as follows:

- a) To develop well-coordinated governance structure for issuance of private loans, borrowing on overdrafts, guarantees and indemnities;

- b) To ensure that statutory bodies' borrowing is consistent with the individual statutory body's resource envelope;
- c) To enhance monitoring and reporting on private loans, borrowing on overdrafts, guarantees and indemnities;
- d) To reduce fiscal risk and exposure to liabilities when a statutory body fails to pay back loans.

## **5.0 Governance Structure**

Sections 72-74 of the PFMA, 2003 provides that statutory bodies shall contract private loans or borrow on overdraft upon written approval by the Minister of Finance. Prior to giving these approvals, the Minister shall ascertain, from the Secretary to the Treasury, the financial implications on the Government of these borrowings and ensure that they are in the public interest.

In this regard, the Guarantees Review Committee established under the guidelines on external debt management in Malawi, 2007, shall be responsible for reviewing the recommendations, made by the Public Enterprise Reform and Monitoring Unit (PERMU) under the Public Finance Management Systems Division (PFMSD), to the Secretary to the Treasury. The committee shall comprise of the following:

- i. Public Enterprise Reform and Monitoring Unit
- ii. Debt and Aid Management Division

- iii. Economic Planning Department (PSIP)
- iv. Line Ministry shall be co-opted to the Committee
- v. Legal Practitioner from Ministry of Justice
- vi. Accountant General's Department (Accounting Services)

The terms of reference for the Guarantees Review Committee are in the annex to these guidelines.

## **6.0 General guidelines on the process for obtaining approvals**

The following processes shall be followed when a statutory body is requesting private loans, borrowing on overdrafts and provision of guarantees and indemnities from the Government:

1. The application shall be made in writing to the Secretary to the Treasury;
2. The application shall be accompanied by the following:
  - i. Board Resolution;
  - ii. A project justification including the economic and financial impact, and cash flow forecast;
  - iii. Term sheet specifying the terms of the facility, i.e. agreed repayment schedule and liquidation model;
  - iv. Audited financial statements for the previous year;
  - v. A copy of the approved Performance Management Plans and Budgets for the current financial year;

3. The Public Finance Management Systems Division shall analyze the application and submit a report on the analysis with recommendations to the committee;
4. The Committee shall scrutinize the report and make final recommendations to the Minister through the Secretary to the Treasury;
5. Where necessary, the applicant shall make a formal presentation to the committee;
6. The Secretary to the Treasury shall communicate in writing the outcome of the application to the statutory body concerned;
7. The statutory body shall submit quarterly progress reports to the Secretary to the Treasury on the performance of the project financed by the facility within 30 days after end of the quarter;
8. PERMU shall monitor the execution of the project for which a guarantee is provided for and subsequent recovery of funds from the statutory body in case the Government has to bail out on their financial obligation; and
9. No contract shall be awarded prior to obtaining an approval from the Secretary to the Treasury on the guarantee under consideration.

## **7.0 Issuance of Guarantees for Statutory bodies**

Section 74 of the PFMA, 2003 states that a statutory body shall not give a guarantee without the prior written approval of the Minister of Finance.

Further, a statutory body shall be given an approval, after the Secretary to the Treasury has ascertained the financial implications on the Government of the statutory body giving the guarantee, and has ensured that the giving of the guarantee is in the public interest. The issuance of the guarantee, by virtue only of the approval of the Minister shall not attach liability to the Government except where the guarantee has been issued under section 63 of the PFMA, 2003.

The processes to be followed are as per the general guidelines in section 6.

### **8.0 Issuance of Letter of Consent on Borrowing on Overdraft**

Section 73 of the PFMA, 2003 states that a statutory body may, with prior written approval of the Minister, borrow for its purposes, by overdraft, within such limits as the Minister approves, and there shall be no liability attached to the Government by virtue only of the approval of the Minister.

In this regard, the processes outlined in section 6 shall be followed when a statutory body is requesting for a letter of consent from the Government.

In addition, the Secretary to the Treasury shall provide the overdraft limits for respective statutory bodies as determined by:

- i. The entity's recent financial performance; and
- ii. Capital intensiveness of the statutory body.

## **9.0 Issuance of Private Loans to Statutory bodies**

Section 72 of the PFMA, 2003 states that a statutory body may, with the prior written approval of the Minister, borrow money for its purposes, on such terms, as agreed between the statutory body and the lender.

Where a statutory body raises a private loan there shall be no liability attached to the Government by virtue only of the approval of the Minister.

In this regard, the processes outlined in section 6 shall be followed when a statutory body is requesting for a letter of consent from the Government to raise a private loan.

## **10.0 Issuance of Guarantees and Indemnity for Statutory bodies under section 63 of PFMA, 2003.**

Section 63 of the PFMA, 2003 states that the Minister, on behalf of the state, may, if it appears to the Minister to be in the public interest and necessary, to do so, in writing a guarantee or indemnity upon such terms and conditions as the Minister thinks fit, in respect of the performance of any person, company, or body corporate, organization or statutory body may do so- with prior approval of cabinet and where such guarantee or indemnity is consistent with section 12 of the PFMA, 2003.

In this regard, the processes outlined in section 6 shall be followed when a statutory body is requesting a guarantee or indemnity from the Government.

In addition, the following processes shall apply:

- i. The committee shall make recommendations to the Secretary to the Treasury and the Minister, who shall seek Cabinet approval; and
- ii. Where the guarantee or indemnity is approved, the Minister shall report to the National Assembly.

### **11.0 Recording and Reporting**

PERMU shall be responsible for recording and reporting quarterly and annually on guarantees and indemnities, borrowing on overdrafts and private loans.

PERMU shall develop and update on a quarterly basis a database of the private loans, overdrafts, guarantees and indemnities.

### **12.0 Review of the Guidelines**

These guidelines shall be reviewed every 3 years.

## ANNEXES

### Annex 1: Process Flow

Process	Responsible	Timelines from Date of receipt
Submission of the Application	Statutory Body	Not applicable
Review and Technical Analysis of the Application	PERMU	Within 4 working days
Guarantees Review Committee (GRC) assessment	Chairperson GRC (PERMU)	Within 9 working days
Communicating the Outcomes	Secretary to the Treasury and Minister of Finance	Within 15 working days

## **Annex 2: Definition of Terms**

**Bank Overdraft:** Debt or total current/non-current liabilities consists of all liabilities that are debt instruments. A debt instrument is defined as a financial claim that requires payment(s) of interest and/or principal by the accounts receivable to the accounts payable at a date, or dates, in the future.

**Contingent Liability:** a possible obligation that arises from past events and whose existence will be confirmed on by occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity of a present obligation that arises from past events but is not recognized because it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability (IPSAS 19).

**Current Liabilities:** Current liabilities a company's debts or obligations that are due within one year appearing on the company's balance sheet, and include short term debt, accounts payable, accrued liabilities and other debts. Essentially these are bills that are due to creditors and suppliers within a short period of time.

**General Government:** includes central Government, Local Government and extra budgetary units.

**Guarantees:** A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs before the specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument (IPSAS). In this context, a formal assurance by the shareholder to the statutory bodies that certain conditions will be fulfilled or a pledge to pay statutory bodies' debt or to perform a statutory bodies obligation in the case of default.

**Indemnity:** A legally binding promise whereby a party accepts to undertake a risk of loss or damage that the statutory body may suffer.

**Letter of Comfort:** a communication from a party to a contract to the other party that indicates an initial willingness to enter into a contractual obligation absent the elements of a legally enforceable contract. The objective is to create a morally binding but not legally binding assurance.

**Letter of Consent:** A letter of consent is a written authority to a person to do something on your behalf or to use something you own.

**Minister:** In these guidelines the "Minister" refers to the Minister of Finance

**Non-current liability:** these are long term financial obligations listed on a company's balance sheet that are not due within the present

accounting year, such as long-term borrowing, bonds payable and long-term lease obligations.

**Private Loan:** any loan, which is not a public debt as defined in these guidelines, accessed from any commercial entity.

**Public Debt:** means all liabilities of the Executive Government and other branches of Government, but does not include liability where the Government is trustee for another person, or liabilities of any statutory body.

**Public Interest:** means something that is to the advantage, direct or indirect, to the people of Malawi.

**Service Potential:** is a supplementary asset recognition criteria in public service to account for items that do not result in the inflow or outflow of economic benefits, where an item either contributes or detract from the entity's ability to deliver its services.

**Statutory body: defined in Section 2 of the PFMA (2003) as:**

“a body of persons, whether corporate unincorporated, other than the Reserve Bank of Malawi, established by any written law, and includes an Assembly established under the Local Government Act, 1998 and any corporation or a subsidiary of a corporation where the Government, directly or indirectly:

a) Controls the composition of any board of directors of the body;

or

- b) Controls more than fifty per cent of the voting power of the body; or
- c) Holds more than fifty percent of any of the issued share capital of the body either directly or through another agency or statutory body (excluding any part of it that carries no right to participate beyond a specific amount in a distribution of either profits or capital)

### ***Annex 3: Terms of Reference for the Committee***

The Guarantees Review Committee established under the guidelines on external debt management in Malawi, 2007, shall be responsible for reviewing the recommendations, made by the Public Enterprise Reform and Monitoring Unit under the Public Finance Management Systems Division, to the Secretary to the Treasury.

The Terms of Reference for the Guarantees Review Committee:

1. Review and analyze the submission on recommendations from the Public Enterprise Reform and Unit on issuance or non-issuance of approvals for private loans, borrowing on overdrafts, guarantees and indemnities to statutory bodies.
2. Provide the rationale or reasons for issuance or non-issuance of approvals based on due diligence analysis or the project appraisal documentation.
3. Provide resolutions to the Secretary to the Treasury based on the review and analysis done.
4. Receive reports on the monitoring and evaluation activities for the issuance of approvals for private loans, borrowing on overdrafts, guarantees and indemnities to statutory bodies.