



REPUBLIC OF KENYA

THE NATIONAL TREASURY AND PLANNING

PPP FISCAL COMMITMENTS AND
CONTINGENT LIABILITIES MANAGEMENT
(FCCL) FRAMEWORK

APRIL 2018

ACROYNMS AND ABBREVIATIONS

CA	-	Contracting Authority
DPDM	-	Directorate of Public Debt Management
DMS	-	Debt Management Strategy
FY	-	Financial Year
GOK	-	Government of Kenya
GDP	-	Gross Domestic Product
IAS	-	International Accounting Standards
NT	-	National Treasury and Planning
PIIP	-	Project Facilitation Fund
PFM	-	Public Finance Management
PIIP	-	Privately Initiated Investment Proposal
PPP	-	Public Private Partnerships
TA	-	Transaction Advisor
VFM	-	Value for Money
VGf	-	Viability Gap Funding

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1. INTRODUCTION

The objective of the FCCL Framework is to provide a methodological tool for public officials of the National Treasury and Planning including the Directorate of Public Debt Management (DPDM); the Public Private Partnerships (PPP) Unit; the Directorate of Budget, Fiscal and Economic Affairs; and the Directorate of Accounting Services together with Contracting Authorities (CAs) at both the National and Sub-national level to assess and manage fiscal commitments and contingent liabilities arising from PPP projects.

The following tools have been developed to facilitate the implementation of this Framework:

1. “PPP FCCL Model–Kenya Portfolio” (Spreadsheet) and “FCCL Model Manual” (Document)
2. “PPP FCCL Summary–Kenya Portfolio” (Spreadsheet) which is a complementary tool to the “PPP FCCL Model–Kenya Portfolio”
3. “Stochastic Model PPP” (Spreadsheet) and “Note on Stochastic Analysis” (Document)

1.1. Regulatory Framework

The enactment of the Public Private Partnerships (PPP) Act on February 8, 2013 provided the legal and regulatory framework “for the participation of the private sector in the financing, construction, development, operation, or maintenance of infrastructure or development projects of the Government” through PPP agreements.

Procuring projects through the PPP model has the potential to reduce life cycle costs and risk to the Government and introduce private sector expertise, operational efficiency, technology, and innovation to produce an accelerated pipeline of better quality infrastructure provided that risk allocation between the government and the private party is appropriate.

However, even with appropriate risk allocation, the public sectors’ contributions to the “partnership” of PPPs inevitably give rise to liabilities for the government. In this regard, Kenya aspires to a fiscally responsible implementation of its PPP program and in so doing, has developed this Fiscal Commitments and Contingent Liabilities (FCCL) Management Framework to ensure that these liabilities are identified and managed through all stages of a PPP project i.e. from inception to operations phase. See Chart 1 on the relevant provisions in the Kenya PPP law.

Chart 1: Relevant provisions in the PPP Act, 2013

Definition of affordability (Section 2)

“2. Interpretation (...)

“affordability” means that -

(a) the financial commitments to be incurred by a contracting authority in terms of a project agreement can be met by funds - (i) designated within the existing budget of the contracting authority for its function for which the agreement relates; and (ii) assigned to the contracting authority in accordance with its relevant future budgetary allocation: Provided that the commitment shall be sustainable and shall not impose an unreasonable burden to the contracting authority; and

(b) the cost of delivering a facility or service in relation to the project by the contracting authority does not impose an unreasonable financial burden on the end users;

Functions of the PPP Committee (Section 7)

“(l) ensure approval of, and fiscal accountability in the management of, financial and any other form of support granted by the Government in the implementation of projects under the PPP Law.”

Functions of the PPP Unit (Section 14)

“(e) develop an open, transparent, efficient and equitable process for managing the identification, screening, prioritization, development, procurement, implementation and monitoring of projects, and ensure that the process is applied consistently to all projects;”

“(g) collate, analyze and disseminate information including data on the contingent liabilities of the Government in relation to a project;”

“(p) monitor contingent liabilities and accounting and budgetary issues related to public private partnerships with the relevant offices within the State department responsible for finance; and”

Use of guarantees (Section 27)

“27. Guarantee or letter of comfort by the Government

The Cabinet Secretary may, in consultation with the Debt Management Office and the Committee, where it considers it necessary to support a project and in order to reduce premiums factored for political risks, issue a guarantee, undertaking or binding letters of comfort in relation to a project.”

The costs of delivery (through PPP projects) shall be affordable to the government. (Section 28)

“28. Price setting and success fees

(...) (2) The cost of delivering a facility or service determined under subsection (1) shall be affordable to the Government and provide value for money to the contracting authority while enabling the private party to maintain its financial integrity, attract capital, operate efficiently and compensate a private party for any assumed risk.”

Responsibility of the PPP Unit to submit the feasibility reports to the DMO for assessment and approval of fiscal risks and contingent liabilities. (Section 35)

“35. Approval of feasibility report by Committee

(1) The contracting authority shall submit the feasibility report prepared under section 33 to the unit for review and evaluation.

(2) The unit shall submit the feasibility report to the Debt Management Office for assessment and approval of the fiscal risk and contingent liabilities of the project.

(3) The unit shall submit the report together with its recommendations and the approval of the Debt Management Office to the Committee for approval. “

Responsibility of DPDM to review the Project and Financial Risk Assessment Report of the Evaluation Report for any change in the associated fiscal risks to the government upon conclusion of the negotiation with the preferred bidder

Section 53(4). Preparation and submission of project and risk assessment report

the Unit shall review the Project and Financial Risk Assessment Report and submit to DPDM for confirmation of its initial approval at feasibility stage based on final contract and preferred bidder submission.

Obligation of the DPDM to assess financial implications of amendments and variations of projects, verifying the project is still affordable. (Section 64)

“64. Amendment and variation of project agreements

(2) The Committee shall not approve an amendment, variation or waiver to a project agreement under subsection (1) unless it is satisfied that the agreement, if so amended or varied, shall ensure - (...) (b) the project continues to be affordable as verified by the Debt Management Office, where such amendment, variation or waiver has a financial implication; (...)”

The obligation to consider for procurement privately initiated investment proposals only if they are affordable. (Section 61)

“(…) (3) A contracting authority shall not consider a project for procurement under this section unless it is satisfied that

(…) (b) The project shall be affordable; and (c) the appropriate risks are transferred to the private party.”

The Project Facilitation Fund shall be applied for provisions for contingent liabilities. (Section 68)

“68. Establishment of Project Facilitation Fund

(…) (3) The moneys received into the Fund shall be applied to - (…) (d) provide a source of liquidity to meet any contingent liabilities arising from a project: (…)”

Among the main regulations set by the PPP Act, 2013 (shown in Chart 1 above) the following are to be addressed through the application of the FCCL Framework:

- Projects must be affordable. Specifically, commitments from PPP projects have to be designated and assigned in existing budget of the contracting authorities. (Section 2)
- The PPP Committee has obligation to ensure fiscal accountability of the financial (or any other type) support given by government. (Section 7)
- The PPP Unit must analyze, disseminate and monitor of contingent liabilities and Debt Management Office (DMO) has an obligation to assess and approve fiscal risks and contingent liabilities. (Section 14)
- Pursuant to Section 24(3) of the PPP Act, the Cabinet Secretary shall prescribe the thresholds for approval and the carrying out of projects by the county governments under the PPP Act.
- The PPP Unit shall submit the feasibility report to the Debt Management Office for assessment and approval of the fiscal risk and contingent liabilities of the project. (Section 35)

1.2. Application of the FCCL Framework

The application of these guidelines is mandatory for all PPP projects submitted for consideration and approval under the PPP Act, 2013. Pursuant to section 54(4) of the PPP Act, 2013 the application these guidelines also extends to all PPP projects initiated by County Governments for the management of their FCCL. All PPP projects executed before the commencement of these guidelines will also be reviewed for FCCL for the purpose of collecting and consolidating FCCL information as required.

The FCCL Framework is a **dynamic document** that will be refined and revised periodically as the PPP program evolves:

- It first looks at how PPPs give rise to fiscal commitments - both Direct Liabilities and Contingent Liabilities and defines both. (Section 2)
- Section 3 of the FCCL Framework explains:
 - why liabilities need to be managed;
 - the fiscal risk of liabilities;
 - the governance framework to support the management of PPP liabilities; and
 - how to value, disclose, report, pay for, and account for government liabilities to PPPs

2. FISCAL COMMITMENTS FROM PPPs

While PPPs offer benefits to a budget, they have fiscal implications. PPPs are not “cost free” to the Government. Though they provide a source of finance, they do little, if anything, to create additional sources of funding. The Government commitment is the same only the timing is different. Under a PPP arrangement, the Government almost always bears some risk or provides some support that gives rise to an on-going fiscal commitment be it a contingent liability or an actual direct liability.

- A **Direct Liability (DL)** takes the form of a defined and quantified undertaking to pay or carry a funding obligation for a feature, phase or item in a PPP project essential to its development, operation or completion. Its salient characteristic is that the occurrence of the payment obligation is known, although uncertainty may remain as to the size. Examples of such direct liabilities include: supplying land needed for the project; upfront “viability gap” payments - in which the government makes a capital contribution to ensure a project that is economically desirable but commercially unattractive can proceed; annuity or availability payments - in which a regular unitary payment over the life of a project is conditional on the availability of the service; etc.
- A **Contingent Liability (CL)** is an obligation that arises from a particular discrete but uncertain future event (one that may or may not occur) that is outside the control of the government. For contingent liabilities, the occurrence (trigger event), value and timing of a payment may all be unknown or cannot be definitively determined. Such liabilities include guarantees on specific risk variables e.g. exchange rate, inflation, prices and traffic, force majeure, termination payments, credit guarantees, among others.

These types of commitments are explicitly set in the PPP agreements. However, fiscal commitments can come from implicit sources as well. For instance, a Letter of Support (LOS) for a specific project may be considered a type of guarantee for some stakeholders; Political or social sensitive projects might expect to be rescued by Government if financial distress occurs.

Additionally, increase of existing obligations or creation of new obligations may arise from contract adjustments and renegotiations. They may, for example, significantly modify the costs of the projects and the payments to be made by Government. Section 64 of the PPP Act, 2013 obligates the DPDM to assess the financial implications of any amendment and variation of the project agreement to ensure that the project continues to be affordable.

Although direct liabilities are often considered to be more predictable than contingent liabilities, this is not always the case. Direct Liabilities can also include uncertain components within their structure. For example, the project agreement of a toll road project may include a service payment defined as an annual payment to be made by the government to the concessionaire in function of availability characteristics. This service payment can change in function of inflation, exchange rate, local interest rate, change in function of quantity and weight of vehicles, change of scope, increase of road size, and other components. This goes to show that direct liabilities can have a significant amount of uncertainty.

Fiscal Risks are factors that cause fiscal outcomes to deviate from expectations or forecasts (IMF, 2016). They arise from the realization of Contingent Liabilities - obligations triggered by an uncertain event and from the realization of macroeconomic shocks, or other unpredictable variables.

Hence, CLs are by definition fiscal risks. Direct Liabilities may be subject to fiscal risks when they may change because of uncertain parameters. Within the context of PPP agreements, we need to pay attention to other sources of fiscal risks than those embedded in direct or contingent liabilities.

Other sources of fiscal risks are those channeled through different provisions – controlled by the Government – of the PPP contract. For instance, an extension of the project scope, allowed in the PPP contract and subject to consent of the Government, that modifies the costs of the project to the Government. Other sources are outside the scope of liabilities to be paid by the Government to the private partners. An example of this is a reduction of user-based revenues used by the Government to fund a project. This reduction does not affect Government liabilities owed to the concessionaire (that may be fixed and independent of user-revenues performance) but it does have a fiscal impact.

Uncertainty, or more precisely, unpredictable outcomes is what makes the estimation and management of fiscal commitments more challenging.

Chart 2: Examples of fiscal commitments in a PPP portfolio of projects

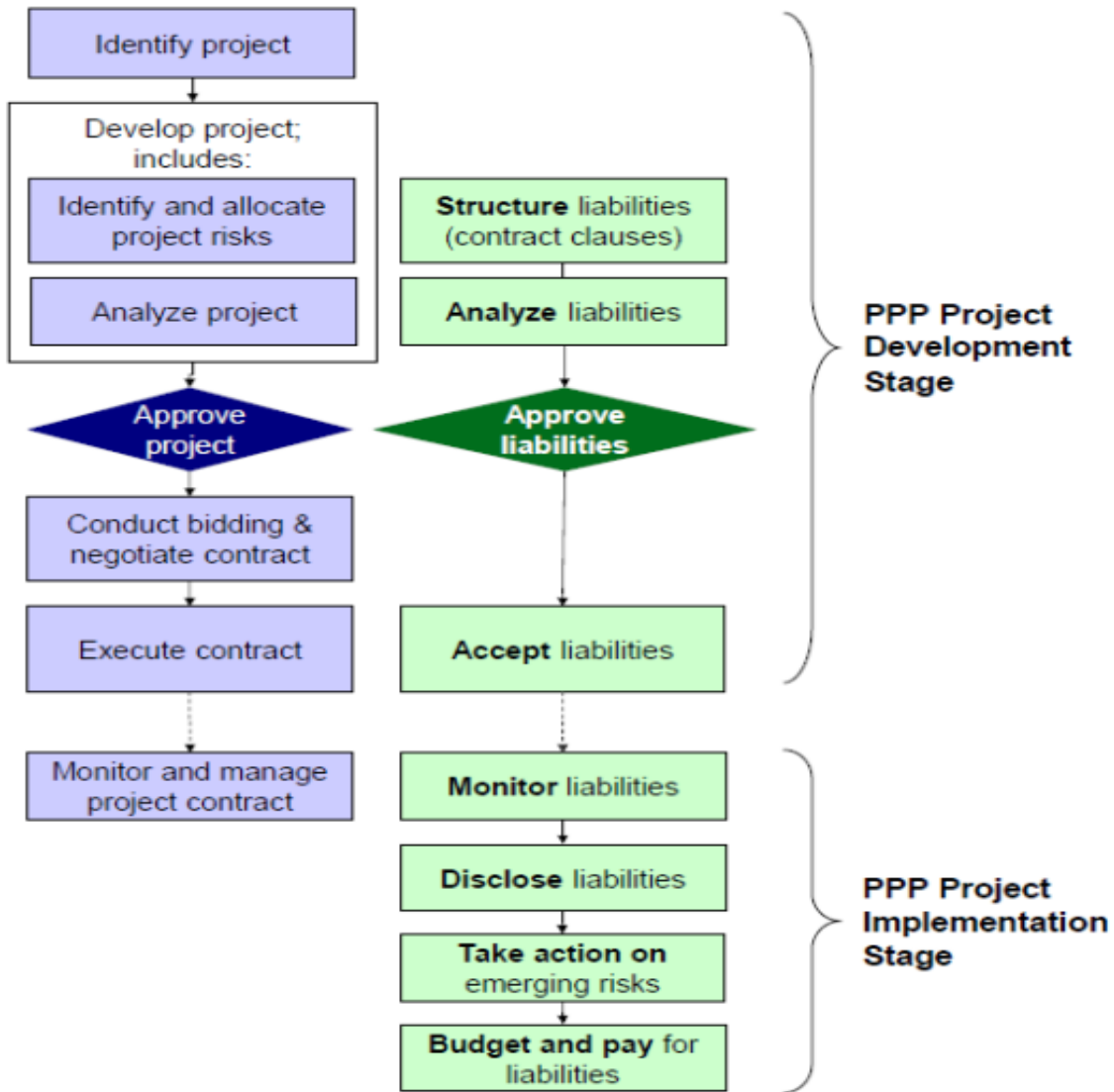
Project	Fiscal Commitment (Central Government)		Other fiscal risks
	Direct Liability	Contingent Liability	
Toll Road	- (One-time) Upfront capital subsidy - (Quarterly) Service payments - adjusted permanently by macroeconomic parameters and contingent events.	-Termination payments in case of default of the concessionaire, or contracting authority, or force majeure.	- Change of scope that modifies the service payment. - Toll-revenue risk.
Roads Annuity Program	- (Quarterly) Annuity payments - adjusted permanently by macroeconomic parameters, and contingent events.	-Termination payments in case of default of the concessionaire, or contracting authority, or force majeure.	- Change of scope that modifies the service payment (capped on a fixed percentage of annuity value)
Students Accommodation	None	- Guarantee on 100% occupancy of the hostels - Termination payment in case of default of concessionaire, or contracting authority, or force majeure	

Overall, it is important to note that Government commitments to PPPs are materially different to Government debt and require a different management approach. When a Government borrows, it uses the borrowed funds and the Government is obliged to repay the debt regardless of how well the borrowed funds are used. Government liabilities to PPPs are in the nature of payments for services delivered and are linked to the performance of the service provider and are non/limited recourse in nature.

3. MANAGEMENT OF FISCAL COMMITMENTS

The two-stage structure of managing fiscal commitments (development and implementation) used in this FCCL Framework is based on the framework proposed at Shendy (2014). Managing and controlling liabilities takes place in all phases of PPP development, approval, and implementation processes. The functions to be undertaken are shown in the context of the broader PPP project development and implementation process.

Figure 1: Functional Components of Managing Liabilities



While the primary FCCL oversight role is assigned to the DPDM, the general governance and institutional framework including the specific functions that need to be undertaken to manage and mitigate contingent liabilities during the PPP project lifecycle is shared as follows:

Function	Objectives	Role/Responsibility
Preparing	To develop a project design that will be bankable and ensure that the risks the government will bear are consistent with good risk allocation principles, borne at the lowest cost and with minimal fiscal impact.	Contracting Authorities: Project feasibility studies and implementation plans
Analyzing	To inform decision making when the project is structured and approved, and provide a basis for monitoring and budgeting for liabilities.	DPDM, PPP Unit: Fiscal risk assessments and other tools for analyzing liabilities
Approving	To ensure the use of government resources in the form of liabilities is focused on policy priorities; represents value for money; and is consistent with good fiscal management.	PPP Committee: Central approval to ensure that PPPs are focused on the government's policy priorities, represents value for money, and are consistent with good fiscal management DPDM: Allocated the overall responsibility of approving the fiscal commitments and contingent liabilities before submission to the PPP Committee for approval.
Accepting	To clarify the government's commitment to its liability obligations, and to ensure the executed contract is consistent with earlier analysis and approval.	Contracting Authorities (sometimes including National Treasury): Involves the government executing formal instruments such as project agreements, issuing letters of support or performance undertakings with the purpose of guaranteeing that they will honor its obligations and commitments
Monitoring	To provide information needed to disclose, act on emerging issues and, if necessary, budget for liabilities.	Contracting Authorities, DPDM, PPP Unit: To help government track its exposure to fiscal risk from year to year, and improve its ability to take action to reduce the cost or likelihood of an event triggering a payment occurring should risks emerge.
Budgeting and Paying	To ensure resources are available to make payments promptly when required, improving credibility and clarity as to how costs of liabilities will be borne, and mitigating the fiscal impact.	Directorate of Budget, Fiscal & Economic Affairs, CAs: Establish a well-defined system for budgeting and paying for liabilities will ensure the government has the resources available to meet its obligations and mitigate the fiscal or budgetary impact of contingent liabilities.

Function	Objectives	Role/Responsibility
Disclosing	To improve accountability for decision-makers, and increase transparency of the government's commitments to third parties (such as credit agencies and lenders).	DPDM: Reporting on exposure to liabilities through the budget and government accounts to increase transparency and improve the accuracy and completeness of information available to external parties.
Mitigating	To help reduce the cost to government of bearing contingent liabilities by reducing the likelihood or cost of those liabilities realizing.	All - CAs and National Treasury directorates: Continuous monitoring of exposure to contingent liabilities from PPP projects, and actively managing that exposure where possible, by identifying and taking action on emerging issues.

An adequate identification and assessment of fiscal commitments and risks during the development stage will allow the Government to take good decisions regarding the financial structure, risk allocation and approval of the project.

3.1. Development Stage

The development stage includes the identification and assessment of fiscal commitments and risks, and the assessment of affordability. Chart 5: Methodologies for Assessment and Analysis of Fiscal Commitments and Fiscal Risks, and Chart 6: Affordability Indicators, (below) are based on the framework proposed at Shendy (2014).

3.1.1. Identification and Assessment

The first step to assessing fiscal commitments and other potential fiscal risks is to identify them within the project structure. Identifying and assessing fiscal implications of a PPP agreement involves: identification and allocation of risks of the project; definition of the payment mechanism; obligations and rights of all parties; etc. In practice, the base information needed shall be found in the risk analysis and risk matrix within feasibility studies. For active projects, these would be found in the project agreements, letters of support, guarantee instruments, etc. Advice from experts also will be required regarding all aspects of the project sector (i.e. water and sanitation, transport, energy, etc.) and the project's specific financial structure.

PPP agreements, letters of support and other explicit Government support provide the fiscal commitments (direct and contingent). These documents contain provisions for the payment mechanism and allowed adjustments to availability payments, tariff-based payments etc.; guarantees and trigger conditions; and, termination payments. Additionally, the risk register will allow us to identify mitigation and monitoring measures (explained in Section 3.2.1) for risky liabilities. For instance, if Government pays termination in the event of default of the concessionaire, the risk matrix shall content mitigation actions to mitigate this risk of default including monitoring actions to anticipate potential default.

Moreover, the contract agreement may not explicitly content all risks and their consequences of risks taken by the Government in a project. For example, Government may take revenue risk and pay to

the concessionaire an availability payment. In this case, the contract will content the characteristics of such availability payment and not about the effects of real demand falling below expectations, for instance. The risk matrix, therefore, complements the contract agreement in identifying fiscal commitments and fiscal risks.

The process of identification and assessment of fiscal commitments and fiscal risks is undertaken in the following three steps:

- (1) Analysis of the project risk matrix using a Risk Register;
- (2) Identification of fiscal commitments using a Fiscal Commitments Register; and
- (3) Assessment of fiscal commitments and fiscal risks

The first step involves the analysis of the project’s risk matrix. It must be noted that a typical project risk matrix focuses on the consequences and mitigation measures of risks over the private partner. A fiscal risk matrix shall be developed by an expert and must be focused on the effects and mitigation measures over the Government entity. Inputs to develop this matrix are the project risk allocation matrix elaborated for the feasibility study, the finance structure documents, the PPP agreement, etc.

Chart 3 shows an example of the Risk Register that consolidates step 1. It shall contain only risks that are allocated partially or totally to the government. The Register contains description of the risk, allocation, cost, likelihood and fiscal impact, and government mitigation actions. As the objective we are pursuing is to assess fiscal impact, columns “Cost”, “Likelihood/Fiscal impact”, and “Government mitigation actions” of the Chart Risk Register must be populated only when the risk is allocated totally or partially to the government. All these aspects shall be done with help of a project’s expert adviser.

Chart 3: Risk Register

Risk	Description	Allocation	Cost	Likelihood / Fiscal Impact (*)	Government Mitigation Measures
Project X					
Risk A	-	Private / Central Government / State-owned enterprise / Local authority	Estimated cost	Qualitative estimate of likelihood of occurrence	Measures to be done by government to mitigate the risk
Risk B	-	-	-	-	-

() According to analysis of risk, historic information and expert judgment, the likelihood and impact of risk may be Low, Medium or High.*

The last column “Government Mitigation Measures” is directly related to the column “Monitoring Information: Fiscal Commitments and Fiscal Risks” of Chart 7 of the Monitoring Section. Hence, consistency between both columns shall be checked. These measures are important to formulate management responses and actions to reduce and control the identified risks.

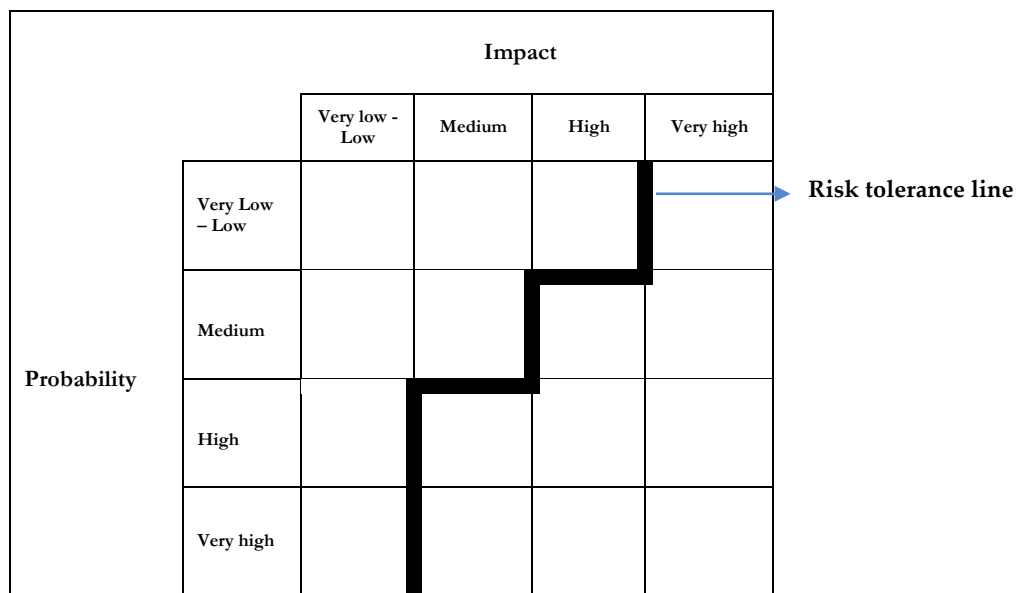
The benefits of managing risk appropriately include facilitating informed and systematic decision making, minimizing consequences of risks, and giving an improved understanding of the project’s risks.

The following are some of the suggested types of mitigation measures:

- **Preventive Measures.** To limit the possibility of an undesirable outcome. Some examples include: insurances, partial guarantees (such as those provided by financial institutions to mitigate the risk of public entity failing to perform its financial obligations), financial instruments (to mitigate financial risks, such as interest rate, exchange rate, commodity prices) and cap-provisions.
- **Corrective Measures.** To correct undesirable outcomes. For example, putting in place a contingency plan in case of natural disasters or termination of contract.
- **Detective Measures.** To identify occasions of undesirable outcomes. This includes all monitoring activities and reports. For example, if government provides termination payments in case of default of contracting authority default, it shall monitor financial performance and compliance of obligations of the contracting authority.

In addition to the risk register, it is recommendable to create a summary of the risk profile for each project, as shown below. This summary will allow for the comparison of the various risks within the project in terms of impact and probability.

Figure 2: Summary of risk profile



Source: Modified version from Irwin (2006).

The second step is to identify and register direct and contingent commitments. They shall be consolidated in the “Fiscal Commitments Register” shown in Chart 4 below. It contains types of the liabilities, description of adjustment factors and trigger events, and the location (which will depend on the stage of the project).

Chart 4: Fiscal Commitments Register

Fiscal Commitment	Type of fiscal commitment/Definition	Adjustment factors /Trigger events	Location
Project X			
Payment 1	Direct/Contingent Explain payment concept, periodicity, and form of calculation	Detail adjustment factors and trigger events if apply	Specific location where this information was taken (Feasibility Study, PPP Contract, Letter of Support, etc.)
Payment 2	-	-	-

The last step is the assessment. Chart 5 provides guidelines on what measure and methodologies to use for the assessment fiscal commitments and fiscal risks.

Chart 5: Methodologies for assessment and analysis of fiscal commitments and fiscal risks

Fiscal commitment	Estimate	In function of available information
Direct Liabilities		
Upfront payment	- Annual cost over life of project - Present value of payment stream for the period of agreement	-
Availability payment		-
Availability payment adjusted permanently by macroeconomic parameters		- Scenario analysis - Stochastic analysis
Availability payment adjusted by contingent events		- Scenario analysis - Qualitative analysis of likelihood of reaching trigger values - Stochastic analysis
Contingent liabilities		
Revenue guarantee	- Estimated annual cost over life of project - Estimated present value of payment stream for the period of agreement	- Scenario analysis - Qualitative analysis of likelihood of reaching trigger values - Stochastic analysis
Debt guarantee		
Guarantee over annual payment by state-owned enterprise, local or subnational government	- Estimated annual cost over life of project - Estimated present value of payment stream for the period of agreement	
Termination payment	- Maximum value	- Qualitative analysis of likelihood of reaching trigger values
Other fiscal risks		
-	- Maximum value	- Qualitative analysis of likelihood - Stochastic analysis

The assessment/analysis/quantification can be done using the following spreadsheet models. These three tools allow the users to calculate direct and contingent liabilities and provide cash flow and Government accounting statements:

- PPP FCCL Model - Kenya Portfolio:
 - The “PPP FCCL Financial Model Manual” provides a step-by-step guidance on how the spreadsheet model “PPP FCCL Model – Kenya Portfolio.xlsm” operates
- Stochastic Analysis:
 - The “Stochastic Analysis” spreadsheet allows for estimations with stochastic analysis (Monte Carlo simulation). This is explained in the “Note on Stochastic Analysis”.
- Termination Payment:
 - The spreadsheet Termination Payment allows calculating termination payments.

The fiscal commitments and risks that cannot be assessed quantitatively shall be assessed qualitatively using information from the Risk Register (Chart 3), and the Risk profile (Figure 2).

3.1.2. Assessment of Affordability

With the estimations of fiscal costs, the government must now check if the project is affordable. The three common instruments used to check affordability are:

- (1) Comparing annual cost estimates against the projected budget;
- (2) Assessing the impact on debt sustainability; and
- (3) Introducing limits on PPP commitments.

The first instrument entails the Budget Department checking whether the project is aligned with budget constraints and priorities. Verifying that the fiscal commitments are affordable within the budget is the primary step. This is achieved by just assessing if the commitments allow the contracting authority to achieve the target fiscal or surplus. It must be noted that this step needs to be done in line with the overall PPP framework, i.e. verification that the fiscal commitment estimations allow for positive social benefits (pass the cost-benefit analysis). Also, affordability analysis must be consistent to the overall liability and fiscal risk management of the budget department.

Fiscal commitments from PPPs are considered debt-like obligations. Hence, DPDM may consider the consistency of treatment of such obligations within the overall Government liabilities and fiscal management framework. PPP commitments could be included in debt measures to determine a project’s impact on overall debt sustainability.

Finally, some governments adopt specific limits or thresholds on direct fiscal commitments of PPPs. The objective is to avoid tying up too much of the budget (within a specific sector or at aggregated level) in long-term payments. However, such limits are usually not needed in the early stages of the PPP programs such as Kenya’s PPP program. This could be later developed as the magnitude and potential of the program increases.

In addition, the Kenyan Government, under section 68 of the PPP Act, 2013 established a specific fund from which realized PPP CLs will be paid i.e. the PPP Project Facilitation Fund (PFF).

Window 4 of the PFF is purposed to provide short-term liquidity for contingent liabilities that arise from implementation of PPP projects.

The institutional governance and operational framework of the Fund is described in the current PPP Project Facilitation Fund Regulations 2017 and the PFF governance and operations manual. That provides necessary guidance to CAs on the procedures to be followed for assessment and decision on potential CL payments.

This next chart shows affordability indicators proposed in this Framework:

Chart 6: Affordability indicators

Fiscal commitment	Cost	Indicator of fiscal affordability (Including projections over PPP contract length-beyond medium-term horizon)
Direct liabilities	- Estimated Annual payments - NPV	- Cost as percentage of ministry or sector agency, and national annual revenue / deficit-surplus budget - Cost as percentage of national public debt - Cost as percentage of GDP
Guarantees	- Estimated annual payment, or expected average payment - NPV (Base/Downside cases)	- Cost as percentage of ministry or sector agency, and national annual revenue / deficit-surplus budget - Cost as percentage of contingency line - Cost as percentage of public debt - Cost as percentage of GDP
Termination payment	- Estimated worst-case payment or expected average payment - NPV	- Cost as percentage of national budget - Cost as percentage of contingency line - Cost as percentage of GDP
Other fiscal risk	- Estimated worst-case payment or expected average payment - NPV (Base/Downside cases)	- Cost as percentage of ministry or sector agency, and national annual revenue / deficit-surplus budget - Cost as percentage of contingency line - Cost as percentage of GDP

3.1 Implementation Stage

3.2.1. Monitoring

Managing fiscal commitments entail monitoring, reporting and budgeting of PPP projects both at individual project level and at portfolio program level. An adequate monitoring and disclosure of fiscal commitments and risks will allow preventing undesirable events, mitigating its impact, and making informed decisions during the operation phase.

This stage will require gathering project financial parameters, risks and performance, and country macroeconomic information, and any other input that might affect fiscal commitments and fiscal risks. The objective will be to ensure that updated information is reported at the right time to the relevant gatekeeping entities, in line with section 65(1)(f) of the PPP Act that obligates each CA to submit reports on the project agreement implementation to the PPP Committee every half-yearly.

Each commitment or fiscal risk must have specific information such as financial and accounting ratios and indicators to monitor the evolution along the entire length of contract. This next chart highlights what minimum information shall be collected and registered by the CAs in each project.

Chart 7: Monitoring Information: Fiscal Commitments and Fiscal Risks

Fiscal Commitment	Required information / Periodicity	Entity who must send information	Obligation to submit information set at: (PPP Agreement, Letter of Support, etc.)	Follow-up of mitigation activities of Risk Register
Project X				
Direct Liabilities				
Payment 1	-	-	-	-
Payment 2	-	-	-	-
Contingent Liabilities				
Payment 1	-	-	-	-
Payment 2	-	-	-	-
Other fiscal risks				
Risk A	-	-	-	-

Chart 7 above and Chart 8 below are based on the framework proposed at Shendy (2014).

3.2.2. Reporting and Disclosing

GOK needs to account for and report on their fiscal commitments of PPP contracts. The National Treasury and Planning shall keep a centralized register of fiscal commitments for PPP transactions at National or Sub-national level. Proper reporting incentivizes the government to scrutinize its own financial position. Additionally, making reports available to other parties such as lenders, rating agencies, PPP stakeholders, and the public enable them to make informed opinion on the Government's PPP fiscal management and performance.

For internal and external transparency of the financial effects of PPPs on Government's position, fiscal commitments shall be reported. It is also recommended that given that fiscal commitments may have debt-like effects on public finances, they should be subject to similar checks and limits.

Chart 8 below shows the suggested information to be reported on direct and contingent liabilities. Description shall include: description of the liability, estimate of the value of the liability, annual cost and present value (for direct liabilities) and maximum exposure (for contingent liabilities). This reporting shall be included medium-term budget reports and debt strategy reports. Specifically, the DPDM shall publish information on all fiscal commitments as a section in the Debt Management Strategy (DMS) published annually by GOK under the PFM Act, 2012. The DPDM shall also publish the consolidated information on all FCCLs in the Annual Debt Report.

For public disclosure purposes, it is recommended to disclose the stream of annual payments and net present value of all payments with respect to direct liabilities per project. It is also recommended to publish maximum exposure for those contingent liabilities which probability or occurrence is considered low (such as for instance termination payments). In the case of guarantees, it is recommended either (1) to disclose the stream of annual payments and net present value of all

payments per project if the information used for its estimation is reliable, or (2) the maximum exposure of aggregated payments.

The reporting format sample for presenting direct and contingent liabilities by project is as shown below.

Chart 8: Reporting Sample of Fiscal Commitments by project

PPP project	Direct liabilities	Annual payments value for 3-year budget			Present value of all payments
		2018	2019	2020	2018
Project 1	- Annuity payment. Indexed quarterly by inflation.				
Project 2	- Annuity payment. Indexed quarterly by inflation.				
PPP project	Contingent liabilities	Estimated annual payments value for 3-year budget			Present Value of Maximum exposure
		2018	2019	2020	
Project 1	- Revenue Guarantee				
	- Termination payment in case of contracting authority default				
Project 2	- Termination payment in case of contracting authority default				

It must be noted that estimations of liabilities (Chart 5) and follow-up activities (last column Chart 7) must be updated in an ongoing basis. Estimates should be updated at least during the following milestones:

- a. Approval by Budgetary department
- b. After Feasibility Study
- c. Before signing
- d. After signing
- e. After financial closure
- f. During construction years (they are the riskiest years)
- g. During operation (checking on financial performance of firm)

3.2.3. Accounting

GOK needs to decide whether and/or when fiscal commitments should be recognized in financial statements through creation of public assets, liabilities or expenses. This is important because fiscal responsibility is usually examined in relation to thresholds over Government's liabilities and expenditures. It must be taken into account that adequate accounting and reporting tackle the perception bias that PPPs attract immediate private financing without increasing Government spending and debt. Determining how PPP commitments are to be recognized is important as it

defines whether such liabilities count toward debt management limits. International public-sector accounting standards, such as IPSAS 32 and international government financial reporting and statistics guidelines, such as IMF's GFSM (2014) and IMF's Guide on Public Sector Debt Statistics (2013) provide a framework for accounting and statistics of PPP transactions.

IPSAS 32 defines when PPP assets and liabilities should be recognized; assuming the Government follows the accrual accounting standards. Assets and liabilities appear in government's balance sheet, if: (1) the government controls or regulates the services the operators must provide through a PPP agreement, and (2) the government controls any residual interest in the asset at the end of the contract. Under the FCCL Framework, the assets provided by the concessionaire are recognized together with the correspondent liabilities whether the assets are funded through users-tariffs or by government. Regarding contingent liabilities, IPSAS 19 states that the expected cost of a contingent obligation should be recognized on the government's books only if: (1) it is more likely than not (50%) that the event will occur; and (2) the amount of the obligation can be measured with sufficient reliability. The model "PPP Fiscal Commitments Model - Kenya Portfolio.xlsm" contains Government's financial statements considering IPSAS 32 approach and accrual accounting. Given that GOK uses cash-based budgetary system, accrual estimations over the income statement or the balance sheet may be used for supplementary disclosure. However, reporting in line with the accrual standards is recommended.

The model "PPP FCCL Model - Kenya Portfolio.xlsm" also generates cash flow estimations and contains stream of payment of direct liabilities (e.g. availability payments) and revenue and debt guarantees.

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