GOVERNMENT OF SINDH
FINANCE DEPARTMENT

حکومت سندھ

External Debt Management Manual

Government of Sindh

Finance Department

EXTERNAL DEBT MANAGEMENT MANUAL

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List of Abbreviations

ACS	Additional Chief Secretary
ADB	Asian Development Bank
ADP	Annual Development Plan
AG	Accountant General
ATM	Average Time to Maturity
ATR	Average Time to Refixing
CDWP	Central Development Working Party
DMU	Debt Management Unit
DRMS	Debt Recording and Management System
EAD	Economic Affairs Division
ECNEC	Executive Committee of National Executive Council
FD	Finance Department
FD Federal Government	Finance Division
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IT	Information Technology
NBP	National Bank of Pakistan
NEC	National Economic Council
NFC	National Finance Commission
PDD	Planning & Development Department
PDWP	Provincial Development Working Party
SBP	State Bank of Pakistan
TO	Treasury Office
TORs	Terms of References
w.e.f.	With Effect From

1. INTRODUCTION

1.1. OBJECTIVE OF THE MANUAL

1.1.1. The objective of this manual is to describe the policies and procedures governing External Debt Management by the Government of Sindh (referred to as the "provincial government"). It should be used as a reference document that identifies controls and procedures to be used for day-to-day management of external debt activities. Where appropriate, diagrams and flow charts are used to facilitate users' understanding of the processes and work flows.

1.1.2. The purpose of this manual therefore, is to provide practical guidelines to staff directly or indirectly involved in the external debt operations in various departments of the provincial government. It will also provide a guide to staff in performing the day-to-day functions and activities. The manual attempts to instill best practices in the functions conducted by the front, middle and back offices for external debt management.

1.1.3. These procedural guidelines are not an end but a mean to achieve an end. It is also notable that such an end cannot be achieved unless the concerned persons perform their duties with due competence, efficiency and propriety. While many of the day-to-day functions and activities are performed automatically by most staff, there will be times when someone filling in due to a staff absence (i.e. sick, on-leave or travelling on business) or a new person joining the Finance Department and/or taking on new or additional functions, the manual will be the source that will provide guidance in accordance with the approved policies and procedures.

1.1.4. This document is prepared to meet all basic requirements and to attain the desired internal controls over external debt management at the provincial level.

1.2. SCOPE OF THE MANUAL

1.2.1. The manual explains activities relating to external debt management, the need for controls, the nature and content of the work processes and the importance of aspects such as debt recording, servicing and reporting.

1.2.2. It documents the policies that are to be adopted by the Finance Department (FD), Planning and Development Department (PDD), Accountant General (AG) Sindh, and Treasury Office (TO) Karachi for contracting foreign loans and recording all loan transactions including disbursements and payments. It also provides guidance on procedures that should be applied to external debt management activities for the purpose of recording and compiling the needed debt information.

1.2.3. The Manual is intended to assist stakeholders to:

- Understand institutional and legal frameworks necessary for effective external debt management;

- Understand the relationship between FD, PDD and other provincial government departments, institutions and international organizations;
- Understand the procedures and work processes in external debt management;
- Understand the roles and mandates of various participants in external debt management operations;
- Understand human and financial resource requirements for managing external debt;
- Know the reporting requirements regarding external debt management; and
- Control the quality of inputs, outputs and processes in managing external debt.

1.3. INTENDED USERS

1.3.1. This manual is particularly intended for use by the relevant staff of FD, PDD, AG Sindh, TO Karachi and will also serve as a useful reference document for line departments, accounting offices, auditors and trainers.

1.4. MAINTENANCE OF THE MANUAL

1.4.1. The Manual is a living document and will be kept in a format which facilitates easy future revisions. FD will, in consultation with PDD and other stakeholders, issue updates at least annually and when major changes in procedures occur. The changes will be approved by the Competent Authority.

1.5. LAYOUT OF THE MANUAL

1.5.1. This manual is arranged as follows:

Part one documents the introduction and general overview of the Manual.

Part two documents the different types of external debt and the external debt cycle.

Part three documents legal and institutional framework necessary for efficient and effective external debt management. It describes laws, statutes and policies that are in place, the role of different entities in debt management operations and the coordination mechanisms for efficient debt management.

Part four documents front office functions of external debt management. This includes identification of financing sources, resource mobilization processes, negotiation preparations, the art and science of debt negotiations and signing of loan agreements.

Part five documents middle office or analytical functions of external debt management. This includes debt management strategy formulation and design, instrument and portfolio analysis, sensitivity analysis of new borrowing and liability management instruments on the Province's debt portfolio, and debt sustainability analysis.

Part six documents back-office procedures of external debt operations. This includes debt recording, document handling, debt servicing, debt reports and information flows among other back office operations.

2. Overview of External Debt Management

2.1. Functions of External Debt Management

2.1.1. The functions of external debt management can be grouped into four main functions referred to as the "loan cycle", namely, planning, contracting, servicing, and reporting, which are briefly explained below:

Planning

2.1.2. This ensures that the legislation, managerial structure and policy setting, government debt strategy, and coordination mechanisms with macroeconomic policies are in place for the Province to borrow and transact. The legal framework clearly defines the laws governing borrowing authorization, borrowing purposes, debt management objectives, and accountability framework. Managerial structure clearly defines the agencies involved in dealing with external borrowings, which must be coordinated to ensure that the provincial government's policies are implemented. Hence, well-defined debt management policies consistent with the Province's development, macroeconomic policies and relevant international covenants must be formulated.

Contracting

2.1.3. This ensures that loan negotiating and contracting is undertaken within delegated authorities, limits and in accordance with the debt strategy covering multilateral, bilateral and commercial/market external borrowing, re-lending, and issuing loan guarantees, where applicable. At the operational level, there will be a strategy for seeking external funds, especially the donors to approach, the instruments to use, the currencies in which to borrow, the interest rate and maturity structure, etc. These decisions will determine the structure of the debt portfolio and will be constantly reviewed to measure the impact that changes in the borrowing choices will have on the Province's fiscal situation.

Servicing

2.1.4. This ensures that the systems and procedures to record, monitor, settle, and account for all debt and debt-related transactions are maintained in a secure and controlled environment. It also ensures that the Province meets all its debt service obligations as and when they fall due.

Reporting

2.1.5. This ensures that external, internal and audit reporting is undertaken to ensure transparency and accountability for debt management policies and operations. This involves collecting detailed information on the Province's debt on a loan-by-loan basis and putting in place the appropriate mechanisms to ensure timely reporting of debt servicing obligations as part of the accounting functions for debt management. It will also include analysis of external debt data so that the following information should be available to the policy makers and the rest of the stakeholders:

- Debt Flows [realized disbursement and debt-servicing, redemption profile];
- Debt Stock by Currency;
- Debt Stock by Creditors;

- Types of Debt;
- Debt Service Projections and Arrears, if any;
- Maturity Structure;
- Interest Rate Structure; and
- Cost and Risk Indicators, etc.

2.2. SOURCES OF EXTERNAL DEBT

2.2.1. The Government of Sindh can finance externally from multilateral and bilateral sources (i.e. development partners, other countries, and international agencies) and from commercial banks. Bilateral sources are further divided into Paris club and non-Paris club countries. These sources are listed below:

Bilateral:
Bilateral sources include:

i. Paris Club countries: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Netherlands, Norway, Russian Federation, Spain, Sweden, Switzerland, United Kingdom and United States of America.

ii. Non-Paris Club Countries: Bulgaria, China, Czech Republic, India, Iran, Iraq, Korea, Kuwait, Libya, New Zealand, Poland, Portugal, Qatar, Romania, Russia, Saudi Arabia, South Africa, Thailand, Turkey and United Arab Emirates.

Multilateral:
Multilateral sources include international institutions such as Asian Development Bank (ADB), International Bank for Reconstruction and Development (IBRD), International Development Association (IDA), International Fund for Agriculture Development (IFAD), European Union (EU), European Investment Bank (EIB), Islamic Development Bank (IDB), Nordic Development Fund (NDF), Nordic Investment Bank (NIB), and Organization of Petroleum Exporting Countries (OPEC) Fund.

2.3. TYPES OF EXTERNAL DEBT

2.3.1. External debt is defined internationally as debt owing to non-residents, i.e. the portion of the Province's debt that has been borrowed from foreign lenders including commercial banks, bilateral governments and international financial institutions/multilateral funding agencies. These loans, including interest, are usually disbursed/paid in the currency in which the loan was contracted but will be repayable in the currency designated by the donor or lending agency.

2.3.2. The currencies in which the Province can borrow are PKR, AUD, CAD, CNY, DKK, EUR, INR, JPY, KRW, MYR, NOK, GBP, SAR, SDR, SEK, CHF, THB and USD or other currencies as approved by the Competent Authority.

2.3.3. External debt will be classified based on the utilization of loans, namely the following two categories:

i. Project loans; and
ii. Program/budget support loans

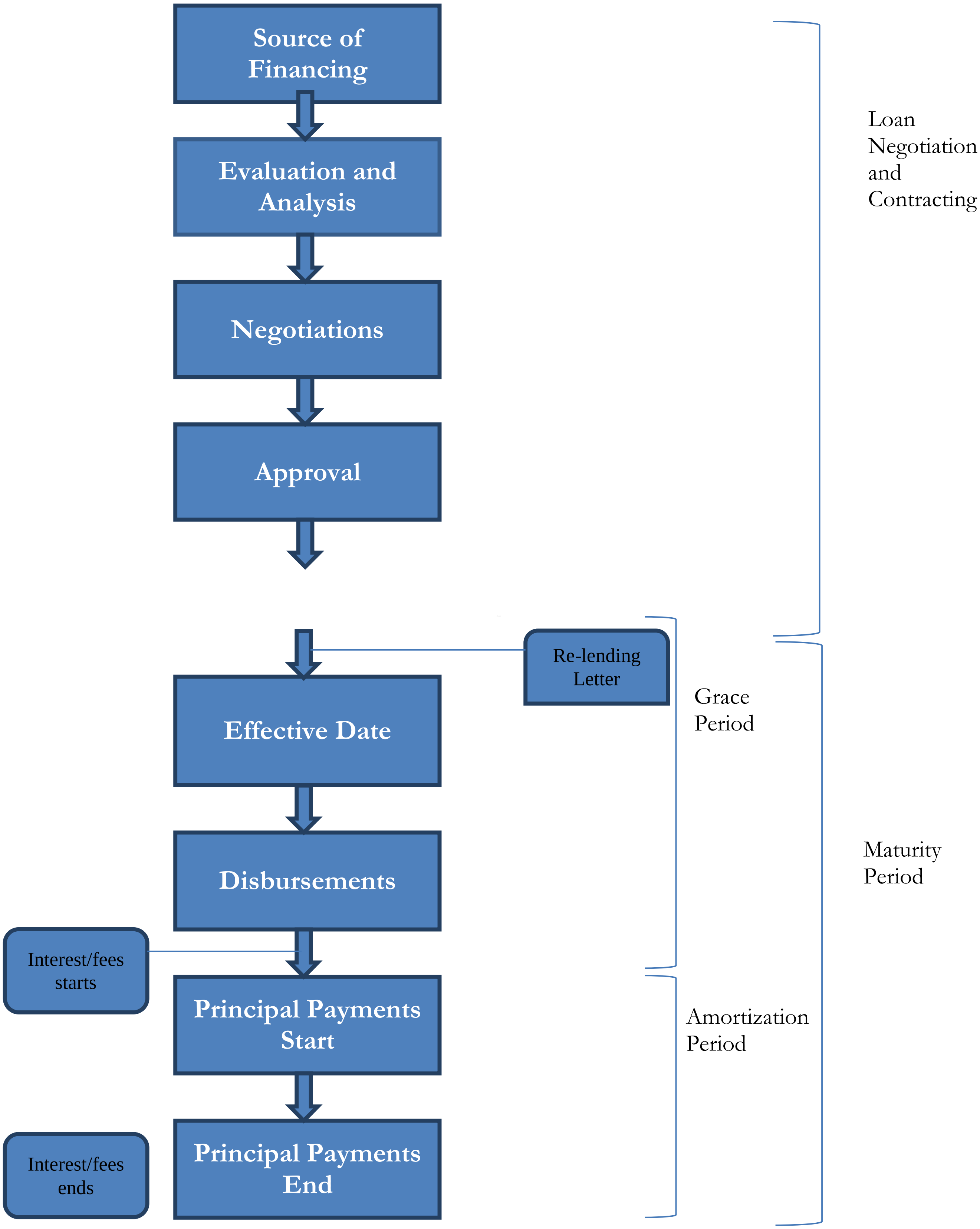
Project Loans

2.3.4. Project loans are for particular projects, such as Guddu Barrage, Indus Highways, Children Hospital, etc. Foreign loans and credits are contracted to finance the cost of the project, including machinery, equipment and technical services, and are defined in the "Project Agreement". A Project Agreement is the formal statement signed by the provincial government and the lending country/agency describing the objectives and work programme, and the obligation on both sides for its implementation with respect to an individual project. Along with the Project Agreement a "Loan Agreement" is also signed. The Loan Agreement includes financial and legal covenants, financial reporting requirements, applicable interest rate and fees, and how the loan will be repaid and over what period. Project loans are generally contracted by the Federal Government and re-lent to the project authorities/implementing agencies through the provincial government.

Program/Budget Support Loans

2.3.5. Program/budget support loans are defined as loans from multilateral or bilateral donors for budget support – either as general budget support or sector budget support. General budget support is un-earmarked contributions to the provincial government budget including funding to support the implementation of macroeconomic reforms (structural adjustment programmes, poverty reduction strategies). Sector budget support, like general budget support, is un-earmarked financial contributions to the provincial government's budget. However, in sector budget support, the dialogue between donors and partner governments focus on sector-specific areas, rather than on overall policy priorities.

2.4. THE EXTERNAL DEBT CYCLE



3. LEGAL AND INSTITUTIONAL FRAMEWORK

3.1. LEGAL FRAMEWORK

3.1.1. The Constitution of Pakistan confers on the President the executive authority of the Federation of Pakistan. This includes the authority to borrow and issue guarantees on behalf of the Federal Government, in respect of the limits fixed by Acts of Parliament. As regards provincial borrowing, the Constitution of the Islamic Republic of Pakistan stipulates:

i. The provincial government's borrowing and issuance of a loan guarantee should be subject to the limits fixed by the Act of Provincial Assembly, if any (Part VI, Article 167, Clause 1);

ii. "A Province may not, without the consent of the Federal Government, raise any loan if there is still outstanding any part of a loan made to the Province by the Federal Government; or in respect of which guarantee has been given by the Federal Government; and consent under this clause may be granted subject to such conditions, if any, as the Federal Government may think fit to impose." (Clause (3) of Article 167 of the Constitution); and

iii. "A Province may raise domestic or international loan, or give guarantees on the security of the Provincial Consolidated Fund within such limits and subject to such conditions as may be specified by the National Economic Council (NEC)" (Clause (4) of Article 167 of the Constitution).

3.1.2. Article 167, Clause (1) requires enactment of law by the Provincial Assembly to fix a limit on domestic provincial borrowing (i.e. loans and issuance of bonds) and issuance of guarantees before the Province can effectively undertake either of these functions. But the Province does not have an Act/statute to regulate external debt at this time. All foreign borrowing is, thus, re-lent by the Federal Government to the Government of Sindh according to the re-lending policy (**Annexure 1**). However, the Government of Sindh Rules of Business 1986, issued by the Cabinet, regulates the organization of the provincial government and specifies procedures to be observed. They specify the distribution of activities between administrative divisions of the provincial government. These rules legally hold FD responsible for "floatation and administration of provincial loans" and "public debt and PDD responsible for "coordination of technical assistance from abroad, evaluation of the progress of development schemes and writing their critical appraisal, and foreign aid".

3.1.3. The Rules of Business further stipulate the classes of officials who are authorized to make and execute orders, instruments, and contracts in the name of the Governor of Sindh. These are the secretary, additional secretary, joint secretary, or deputy secretary, section officers to the provincial government, or officer on special duty in the department concerned. From a legal standpoint, all of these officials have the authority to sign and their signatures will be deemed as proper authentication of such order or instrument. Moreover, drafting and execution of contracts will be made on behalf of the Governor in accordance with the instructions issued by the Law Department.

3.2. INSTITUTIONAL FRAMEWORK

3.2.1. External Debt Management involves complex, diverse and specialized functions/responsibilities like evaluating borrowing alternatives, negotiations, signing of loan/grant agreements, re-lending, disbursements, monitoring, analysis, debt service payments, and managing currency, interest, refinancing/rollover, and operational risks. The activities are distinguished by the initial process (loan negotiations and contracting), analytical examination (risk management and advisory services) and the follow up phase (debt data recording debt servicing including forecasting, debt reporting and accounting). The requisite organizational structure is correspondingly the front-, middle- and back-office functions for the initial, analytical and the follow-up phases, respectively. On Provincial Level front- office functions are led by PDD in consultation with FD whereas the middle-office and back-office roles are performed by FD.

3.2.2. The Rules of Business define one of the roles of the Government of Sindh's PDD to be management of "foreign aid and technical assistance". Consequently, PDD is involved with all aspects of project management, including foreign funded projects. The Development Section of PDD has a pivotal role in initiating and identifying new project-based lending. PDD leads the process for identification of potential donors and subsequent negotiations.

3.2.3. Given the importance of multilateral loans, the negotiation team typically includes senior provincial staff from PDD, the Development Wing of FD – for counterpart funding – and the provincial agency responsible for executing the project. The team includes also a representative from the Federal Economic Affairs Division (EAD), who will have already discussed the funding with the donor. The Chief Economist of PDD takes the lead in the pre-appraisal, appraisal, and negotiation of the loan. The Foreign Aid Section of PDD shares the analytical features of the loan (i.e. PDD shares draft finance agreement along with the project appraisal document only without any details. FD then go through the documents and provide comments on Financial terms only) with, and obtains concurrence of, FD on financial aspects of the loan (in accord with the Rules of Business). In sum, co-ordination between PDD and FD remains close during this process. The draft finance and project agreement is forwarded to the Law Department when the Donor is invited for loan negotiations at the initial stage. The Law Department deals with the vetting of agreement contents only.

3.2.4. The Rules of Business delegate the function of the management of external debt to FD. The Resources Wing of FD is responsible for examining the financial aspects of the proposed loans, and its Development Wing is responsible for determining counterpart funding for projects and program loans. Since the Resources Wing is responsible for debt servicing, it is the entity responsible also for maintaining the debt database for domestic and fully disbursed foreign loans. It carries out debt registration and validation functions and maintains also the document filing system for all debt transactions. In addition, it is responsible for initiating debt servicing which, considering that all external borrowings are from the Federal Government, takes the form of automatic deductions from the Province's first fortnightly Federal transfer from the Federal Government each month.

3.2.5. The Debt Management Unit (DMU) was established in the Resources Wing of FD on July 01, 2014 (**Annexure 2**). The Terms of References (TORs) tasks DMU with overall responsibility of Government of Sindh debt portfolio management, including debt evaluation, financial negotiation in coordination with PDD, settlement and reporting. The TORs also include conducting financial analysis of cost effectiveness of different types of funding and producing and publishing the debt statistical bulletin in line with international best practices. Reporting to the Special Finance Secretary, it is composed of a Debt Management Specialist and three Financial Analysts. DMU has, very recently, taken over the Middle Office role and also some responsibilities of the Front- and Back Offices from PDD and sub-departments of the Resources Wing of FD respectively[1].

3.3. ROLES AND RESPONSIBILITIES OF INSTITUTIONS/DEPARTMENTS

Provincial Assembly

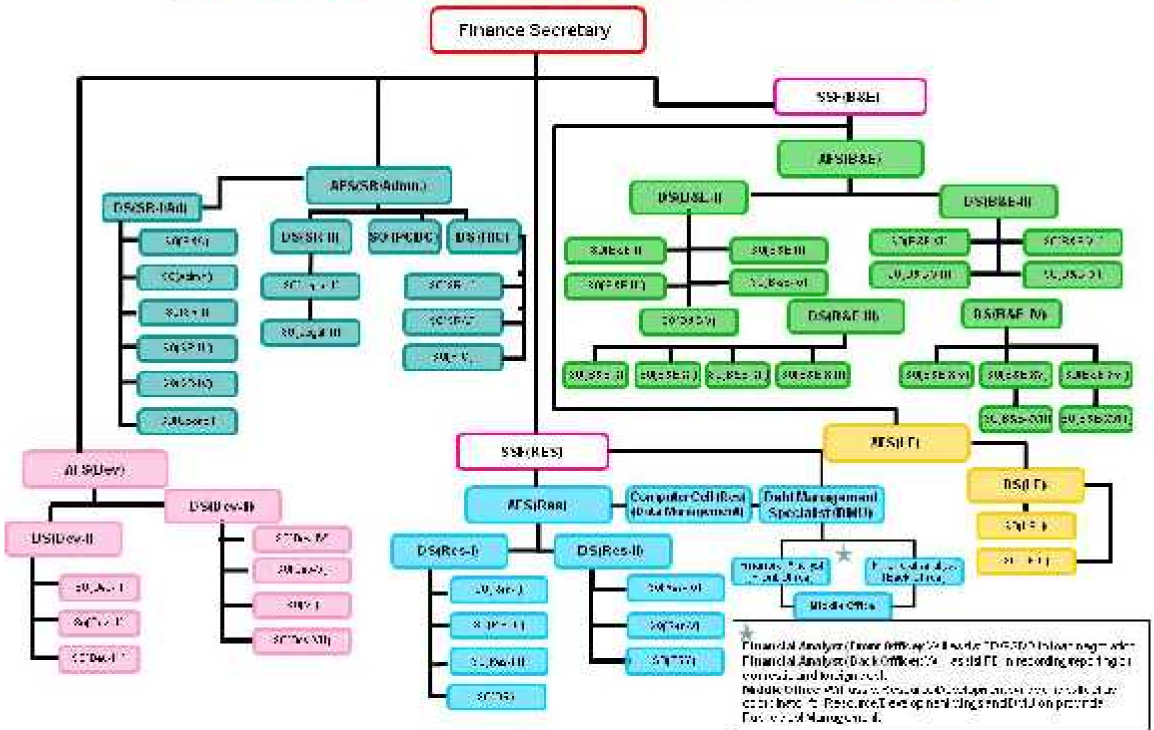
3.3.1. Provincial Assembly is the supreme legislative organ in the Province. It is charged with the responsibility of enacting legislation, which includes the legal framework for debt management.

Finance Department

- Supports PDD in preparing the Annual External Borrowing Plan;
- Support PDD in foreign loan negotiations;
- Prepare budgetary forecasts for debt servicing;
- Maintains external debt database;
- Monitors disbursements and debt servicing;
- Performs analytical functions typical of a middle-office;
- Conduct periodical reconciliation of debt stock and transactions with EAD, AG and Finance Division at the Federal level; and
- Correspond with State Bank of Pakistan (SBP) for disbursements and debt service payments.

[1] There are sub-departments of the Resources Wing working on different assignments. For example, Resources Wing Section (II) is responsible for debt recording and correspondence. Another sub-department, I.T. Section is responsible for verification of budgeted figures and amortization schedule provided by EAD. DMU being one of the sub-departments of Resources Wing has taken over the responsibilities as mentioned.

ORGANIZATION CHART OF FINANCE DEPARTMENT

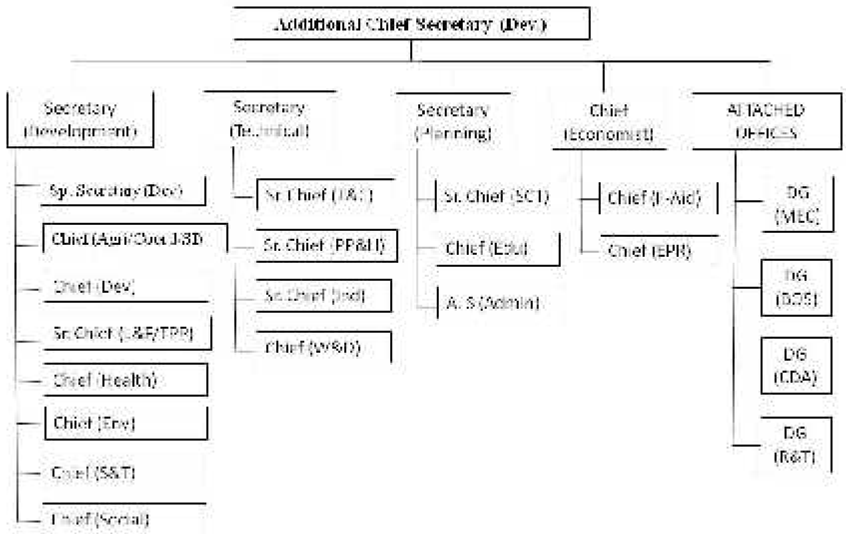


Planning and Development Department

- Prepares the Annual External Borrowing Plan;
- Formulates provincial development plans, prioritizes projects in line with provincial government's socio-economic objectives and works with FD to identify ways and means of closing the budget deficit by borrowing;
- Spearheads the negotiation and re-negotiations of terms and conditions of foreign loans; and
- Acts as the interface of Government of Sindh with EAD.

ORGANIZATIONAL CHART PLANNING & DEVELOPMENT DEPTARTMENT

MINISTER (P&D)



Accountant General Sindh

- Records debt service payments into the provincial government Financial Management System; and
- Maintains government accounts including external debt records.

Treasury Office Karachi

- Records disbursements into the provincial government Financial Management System.

State Bank of Pakistan

- Acts as the agent to the provincial government in settling external debt receipts and payments.

3.4. EXTERNAL DEBT MANAGEMENT COMMITTEE

3.4.1. The role of External Debt Management Committee (EDMC) is to advise the provincial government on all issues relating to external debt management policy, and to ensure an efficient, effective and professional management of external debt. It coordinates executive functions of debt management, which includes regulatory and policy functions. The EDMC is constituted as follows:

- Chairman Planning and Development Board – as Chair
- Finance Secretary – Member
- Special Secretary Finance (Resource Wing- FD) – Member
- Chief Economist (PDD) – Member

- Additional Finance Secretary (Development) – Member
- Chief Foreign Aid (PDD) – Member/Secretary
- Debt Management Specialist (DMU)/Representative from DMU –Member
- Deputy Accountant General (AG Sindh) – Member
- Area Expert (if required) – Member

3.4.2 The EDMC shall meet every quarter as well as on need basis.

4. FRONT OFFICE PROCEDURES

4.1. INTRODUCTION

4.1.1. The Front Office regarding external debt for Government of Sindh is PDD, which is supported by FD and relevant line departments. The Front Office has the prime responsibility of mobilizing foreign funding for the development of the economy, within the legal and policy framework, in an efficient and effective manner and at the minimum cost subject to an acceptable level of risk.

4.1.2. The primary functions of the Front Office include:

- Preparing the Annual External Borrowing Plan/assessing borrowing needs;
- Consultations with the stakeholders;
- Negotiation and signing of the loan/grant agreement;
- Ensuring the fulfillment of the loan conditionalities in consultation with all stakeholders;
- Dealing with modifications to agreements [deferring disbursement closing date, cancellation/ enhancement of commitments, etc.];
- Monitoring the Project Loan Disbursements; and
- Coordinating with donors.

4.2. ANNUAL EXTERNAL BORROWING PLAN

4.2.1. PDD will, in consultation with FD and other stakeholders, prepare the Annual External Borrowing Plan which will be in line with the Annual Development Plan (ADP). The Annual External Borrowing Plan will include aggregate borrowing requirement, and cost/risk assessment of borrowing options.

4.2.2. All foreign loans whether project or program/budget support are conceived by the executing agency/line department concerned. The executing agency/line department will ensure that potential external loan requirements are in line with the Annual External Borrowing Plan. PDD ensures that potential external loan requirements are in line with the Annual External Borrowing Plan. PDD is also an administrative department that is responsible to ensure compliance with support of FD.

Procedure: Formulation of Annual External Borrowing Plan	
PDD FD EAD	1. Consult with stakeholders in order to obtain and prepare the following information: • medium-term primary balance and cash flow projections • medium-term economic and financial projections and/or scenarios • project utilisation and expected schedule of loan disbursements, and pipeline for new project loans 2. Determine the aggregate borrowing requirement.
PDD	Prepare Annual External Borrowing Plan.

PDD	Review and sign-off Annual External Borrowing Plan.
PDD	Submit Annual External Borrowing Plan to the External Debt Management Committee for approval.
EDMC	Recommends CM for the approval of Annual External Borrowing Plan.
PDD	Circulate/publish Annual External Borrowing Plan.

4.3. DONOR IDENTIFICATION

4.3.1. PDD is responsible for assessment of requirements, programming and negotiations of foreign loans from foreign governments and organizations at the Provincial level. However, as all foreign loans are contracted by the Federal Government and then re-lent to the provincial government, these negotiations are led [held] by EAD.

4.3.2. In PDD, the foreign loans negotiations and contracting is the responsibility of the Foreign Aid Section. The executing agencies/line departments, however, play an important role as they have better knowledge of projects and programmes to be aided and are responsible for loan utilization. These departments are generally the primary point for putting up proposals to initiate foreign loan mobilisation and negotiation efforts.

4.3.3. PDD acts as the coordinating agency and keeps close liaison with both the line departments and the donors. For effective coordination, communication between PDD and line departments on the one hand and between PDD and the donors on the other hand, a systematic procedure is to be followed.

Procedure: Donor Identification	
Line Departments	Submit proposals regarding foreign loan requirements in accordance with the Annual External Borrowing Plan to PDD.
Technical Committee on External Debt	Evaluate/review each proposal and recommend possible donor(s) for the proposed foreign loan requirement based on the following criteria: • The type of support traditionally provided by a donor; • The traditional sectors and projects supported by a particular donor; • Concessionality and amounts of the loan instrument and other financial terms at which the loan instrument is offered; • The channels through which the resources will be delivered to the Province; • The flexibility of the creditor in accommodating the provincial government's funding requirements; • Predictability of the creditor in the delivery of the committed loanable funds;

	• Conditionality associated with the disbursements of the committed loans and how strictly they are enforced; • Assessment of the degree to which a creditor plays an independent role in the policy dialogue relating to disbursements of loans. That is, how strict is the donor's disbursement tied to the performance of Provincial government.
Provincial Development Working Party (PDWP)[2]	Once potential donor(s) are identified, the proposal is submitted to the Provincial Development Working Party (PDWP) for recommendation.
PDD	Share the proposal with EAD for initiating negotiations with the potential donors
PDD	Potential donors will normally undertake their own appraisal in order to justify their involvement in the project. If the potential donors get interested in funding the project, prepare to initiate negotiations, which involve: • selection of the negotiating team; • Identifying creditor information/culture/precedents and other details.
PDD	Before negotiations begin, prepare the necessary pre-negotiation authorizations and approvals to be obtained from the appropriate competent authority and submit for approval.
CDWP[3]/Executive Committee of National Executive Council (ECNEC)[4]	Approve the proposed project/program from (as the case may be depending upon size of the project) prior to going into the negotiations.

[2] PDWP is a committee headed by the Chairman P&D Board. Its members are: (1) Secretaries of the Provincial Departments concerned with Development; and (2) Representative of Federal Ministry of Planning & Development. Its functions are to: (1) approve Development Projects according to its financial limits; (2) scrutinize projects for inclusion in the provincial ADP; and (3) recommend projects to Central Development Working Party (CDWP) above certain financial limits.

[3] The secretariat of CDWP is at planning division. It is chaired by Deputy Chairman Planning Commission. Its members are the secretaries of the Federal Ministries Concerned with Development and heads of the Planning Departments of the provincial Governments. Its functions are to approve/scrutinize Projects exceeding a certain financial limit of the Federal Ministries, Provincial Governments, and Autonomous Bodies, and to submit/ recommend such projects to the ECNEC for final approval.

[4] It is chaired by the Minister for Finance. Its members are Federal Ministers of Economic Ministries, Provincial Governors/Chief Ministers or their nominees, and Provincial Planning and Finance Ministers. Its functions are (1) sanction development projects in the public and private sector; (2) approve moderate changes in the plan and plan allocations; and (3) supervise the implementation of Economic Policies laid down by the NEC/Government.

4.3.4. The Technical Committee on External Debt is composed of the following members:

- Chief Economist (PDD) – as Chair
- Additional Finance Secretary (Development) – Member
- Chief Foreign Aid (PDD) – Member
- Debt Management Specialist (DMU)/Representative from DMU – Member
- Representative of the executing agency/line department – Member
- Area Expert (if required) – Member

4.4. SELECTION OF NEGOTIATION TEAM

4.4.1. Loan negotiation is a lengthy, intricate and tedious process. An appropriate negotiating team composed of well-trained and experienced professionals should be selected to counteract the experienced negotiating teams of the donors. Once the expressions of interest and draft project documents have been received from the potential donor, the negotiation team is constituted by the Chief Minister upon request from PDD. Mostly in case of foreign loans, the donors use a standard agreement for which there is not almost no margin for modification.

Procedure: Selection of Negotiation Team	
PDD	Prepare documentation for the requested negotiation team and submit to the Chief Minister. The team is led by the Chief Economist (PDD) and represented by the Additional Finance Secretary (Development Wing – FD), Chief Foreign Aid (PDD), Debt Specialist (DMU)/Representative from DMU, representative from executing agency/line departments and any other area experts (if required). There is no representative from the Law Department in the negotiation team. It is a separate unit referred only for legal vetting.
Chief Minister	Approve the negotiation team.
PDD	Set up the negotiations to be held at EAD and representatives from EAD and other concerned Federal authorities that will also join the negotiations.

4.5. NEGOTIATION PROCESS

4.5.1. The responsibility for negotiation of foreign loans and contracting agreements with the donors rests with PDD. In some cases, however, other authorities also negotiate and contract agreements. The agreements for Food Aid, for example, are generally processed by the Ministry of Food and Agriculture. The agreements may take the shape of detailed documents containing basic and supplemental provision or they may take the shape of a letter or memorandum. Loan negotiations may be grouped in four main stages: Pre-negotiations; Negotiations; Post-negotiations and Renegotiations.

Procedure: Negotiation Process	
Pre-negotiations	
Negotiating Team	Obtain and analyze all loan information based on the debt strategy, explained above in Section 2.1.2. This involves reviewing the project documents [i.e. appraisal documents, draft agreements, disbursement letter, financial characteristics, and procurement procedures, etc.] including the legal obligations. Importantly, this review helps to ensure that the proposed obligation clauses are not in conflict with the objectives and laws of the province.
DMU	Provide the negotiations team with a basic financial analysis of the potential loan along with alternative funding sources of agreed Donor so as to enable the team to be better prepared for the negotiations.
Law Department	Provide the legal opinion on draft project documents especially with respect to legal covenants.
Negotiations	
Negotiating Team	The type of negotiations will vary from one donor to another. The negotiation team will prepare before going into negotiations and all relevant data and analysis will be obtained before meeting the donors. Enter into negotiations with the donor.
Executing agency/line department, DMU and Law Department	Assist the negotiation team in their areas of expertise.
Post-negotiations	
EAD	Once the negotiations are complete, share the minutes of the negotiations with all parties concerned. These minutes are signed by both the donor and the negotiating team.
EAD	Before putting together the final loan documents, ensure that both parties confirm the minutes to avoid any later confusion or disputes.
Renegotiations	
PDD	There are instances where there is need to re-negotiate terms of existing debts by either rescheduling or debt restructuring. The renegotiations can arise when the Government of Sindh needs to: • Restructure its debt, where the structure of a loan or a portfolio of loans is changed (i.e. currency, interest rate basis, maturity, repayment profile etc.); • Currency and Interest Rate Swaps; or • Reschedule its debt service obligations, where there is renegotiation with the donor to change the repayment profile of a loan or portfolio of loans. Approach EAD and go through the whole process as if dealing

	with a new loan.
DMU	Undertake a thorough financial analysis to be able to ascertain the benefits of any intended debt restructuring/rescheduling. Renegotiations should attempt to explain the nature and the structure of transactions in simple and clear terms and provide basis for understanding the restructured/rescheduled debt. Attempt to eliminate future disputes and dispose of existing claims [known and unknown] against both parties.

4.6. SIGNING OF THE AGREEMENTS

4.6.1. After all stages of negotiations are completed and where the process is successful, final draft of project documents is shared by the donor with EAD and PDD. The Project Agreement is signed between the donor and the representative of the Provincial Government and the Loan Agreement by representatives of the Federal Government and the donor.

Procedure: Signing of the Agreements	
PDD	Prepare and send a summary note to the Governor along with the recommendation that "Department Head/Secretary" will be authorized to sign/approve the project agreement along with the representative of EAD.
Governor	Approve PDD to sign the project/loan agreement.
PDD	Inform EAD of the approval from the Governor.
PDD	Prepare and facilitate signing event including timing and venue.
Department Head/Secretary	Sign project/loan agreement along with the donor.
EAD	Send letter to PDD stating that the loan has been re-lent to the provincial government according to the prevailing re-lending policy (**Annexure 1).**

4.7. EFFECTIVENESS OF THE AGREEMENTS

4.7.1. The loan/grant agreements become effective only after the lender [government] has obtained the legal opinion from the Law Department. In term of time, normally an agreement becomes effective within a period of 90 days from the signing date.

Procedure: Effectiveness of the Agreements	
PDD	Submit signed loan agreements to the Law Department.
Law Department	Prepare legal opinion confirming that the laws, relevant statutes and due process have been followed in entering this commitment.

PDD	Obtain legal opinion from the Law Department and ensure that all the associated conditionalities like establishment of Project Management Unit, appointment of Project Director, etc. are completed for the smooth, successful and timely completion of the respective project.
PDD	Send copies of signed loan/grant agreements to DMU.

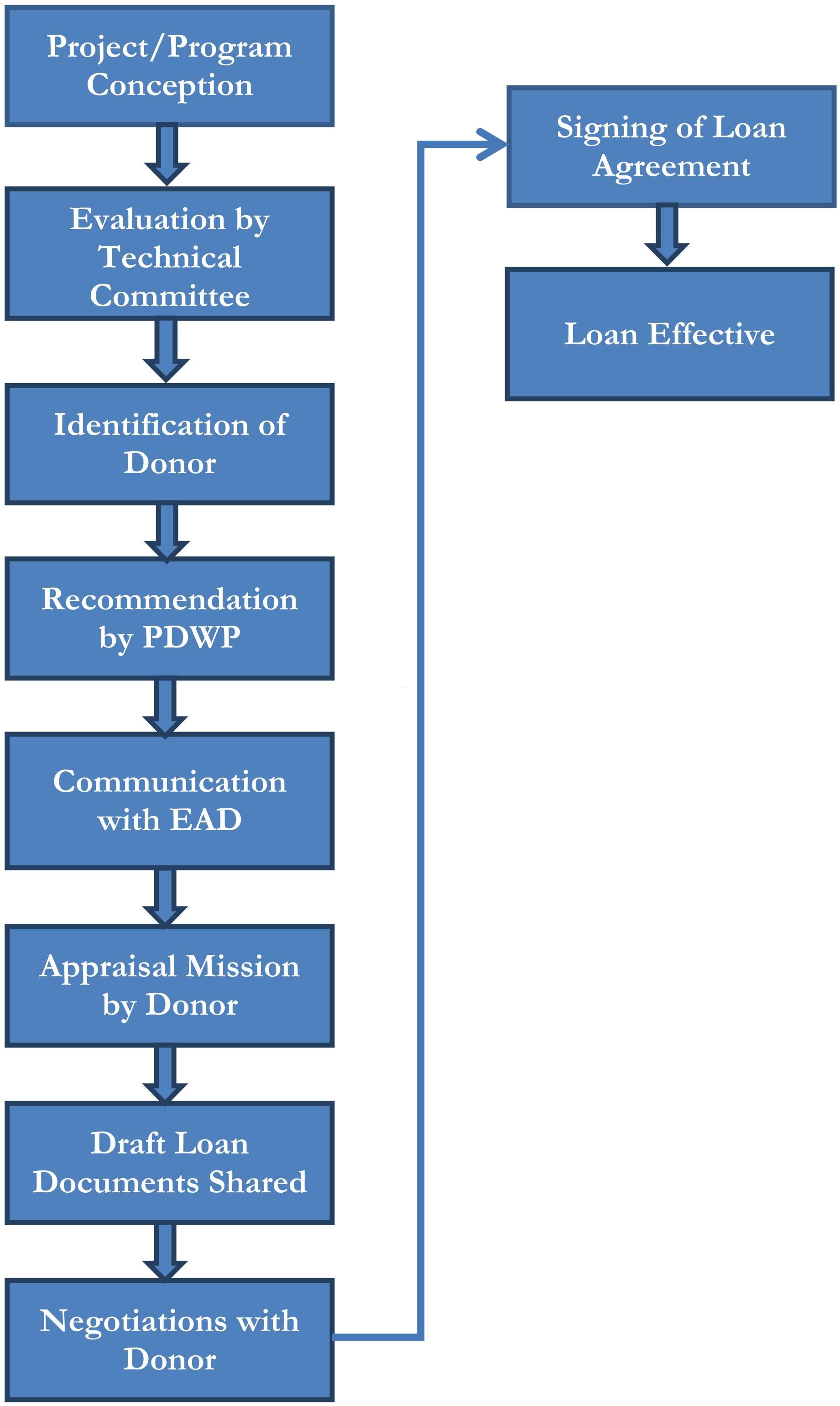
4.8. FRONT OFFICE REPORTS

4.8.1. The key reports that are required from the Front Office are as follows:

- Annual External Borrowing Plan
- Quarterly report on pipeline loans specifying the amount, the donor, the currency and status
- Quarterly report on new loan agreements, negotiated, signed or committed
- Analysis report on funding alternatives by DMU before entering into loan negotiations

Procedure: Front Office Reports	
DMU Front Office	Collect data and prepare report in the format set out in Annexure 3.
DMU Front Office	Review and sign-off report.
PDD	Approve report.
DMU Front Office	Circulate report to relevant stakeholders.

4.9. EXTERNAL DEBT NEGOTIATIONS AND CONTRACTING – PROCESS FLOW



5. MIDDLE OFFICE PROCEDURES

5.1. INTRODUCTION

5.1.1. The functions of Middle Office are highly analytical in nature that enables the provincial government to meet its financing needs and its debt service obligations at the lowest possible cost with a prudent degree of risk exposure. It has to provide policy advice on keeping external debt at sustainable levels. The Middle Office is responsible for debt and risk management and undertakes portfolio analyses, prepares risk management strategy and borrowing scenarios, and compares the emerging debt indicators with agreed benchmarks.

5.1.2. The Middle Office role for external debt management at Government of Sindh is with the DMU. The Middle Office responsibilities include:

- Supporting PDD in preparing the Annual External Borrowing Plan;
- Providing analytical support to PDD during loan negotiations;
- Providing reliable medium and long-term forecasts of debt servicing that feed into fiscal forecasts;
- Performing the cost-risk analysis of external debt;
- Performing adjustments to borrowing plans in the course of fiscal year based on budget monitoring outcomes and fiscal policy adjustments;
- Estimating the effects of changes in interest rates and exchange rates on debt service;
- Undertaking frequent portfolio analysis to assess future debt service obligations and problems and propose action that should be taken to overcome them;
- Preparing debt sustainability analysis to assess the long-term sustainability of projected borrowing levels;
- Providing inputs on public debt to periodic economic and financial reports and data for presentation to Cabinet as well as Provincial Assembly;
- Making recommendations for debt rescheduling or restructuring as and when necessary;
- Monitoring and supervising performance against set benchmarks;
- Monitor the implementation of loan agreements, including disbursements and other obligations of the provincial government;
- Monitor disbursements of re-lending agreements; and
- Monitor all explicit contingent liabilities and ensure that adequate loan loss provisions are made in the budget to meet likely defaults.
- Monitor forecasts of the provincial government cash requirements to provide guidance on the volume and timing of issuance of debt by the provincial government (The responsibility for cash flow forecasting is the responsibility of FD Resource wing).

5.2. DEBT ANALYSIS

5.2.1. There are two main categories of analysis undertaken by the Middle Office namely instrument and portfolio analysis.

Instrument Analysis

5.2.2. Instrument analysis is necessary for the purpose of assisting the Front Office to arrive at the best options of instrument mix to be used for borrowing in conformity with the debt management strategy, see Section 5.2.3. Through sensitivity analysis, DMU will evaluate the impact of the instrument mix on the overall external debt portfolio. Instruments analysis also includes determining concessionality for external debt.

5.2.3. The responsibility for the development of the external debt management strategy will be with the middle office. The debt management strategy will include the following:

- objectives and guidelines for external debt management
- financing requirement of the government for the fiscal year including external borrowing requirements
- description of the market risks being managed (currency, interest-rate, and refinancing/rollover risks) and the historical context for the external debt portfolio
- description of the future environment for external debt management, including fiscal and debt projections, assumptions about interest and exchange rates, and constraints on portfolio choice
- description of the analysis undertaken to support the debt management strategy clarifying the assumptions used and limitations of the analysis
- recommended strategy and its rationale, including either:
  - specified targets and ranges for key risk indicators of the portfolio and the financing program over the projected horizon or
  - guidelines to indicate the direction in which certain key indicators are expressed to evolve

Procedure: External Debt Analysis and Debt Management Strategy	
PDD FD EAD	1. Obtain medium-term primary balance and cash flow projections. 2. Obtain medium-term economic and financial projections and/or scenarios. 3. Obtain project utilization and expected schedule of loan disbursements, and pipeline for new project loans. 4. Consult with stakeholders to ensure that the debt analysis is consistent with the ADP.
PDD	Prepare details of proposed new external financing for the medium term (i.e. next 3 fiscal years): • multilateral • bilateral • commercial
DMU Middle Office	Undertake external debt analysis including new/future financing.
DMU Middle Office	Prepare draft debt management strategy including external debt/instrument analysis report.
FD	Check and sign-off draft debt management strategy.

PDD	Authorize draft debt management strategy and send to EDMC.
EDMC	Review draft debt management strategy and recommend acceptance. Submit recommended debt management strategy to Cabinet for approval.
Cabinet	Review recommended debt management strategy and approve.
FD	Publish debt management strategy and post to FD website (in pdf format).

Portfolio Analysis

5.2.4. Portfolio analysis is the critical analysis of the status of the loan portfolio. This includes financial analysis as well as sector analysis focusing on source and use of funds. The analysis can be broken down into the following broad categories:

i. **Creditor category:** Analysing debt by major source of finance to the Province, i.e. multilateral sources, bilateral sources, and commercial sources;

ii. **Maturity structure of debt:** An analysis of the maturity structure of debt stock is important in identifying bunching of payments well in advance, so that corrective action can be taken. This helps to minimize roll over risks;

iii. **Interest rate structure:** Determining the interest rate structure of the debt portfolio is important in order to assess the risk and the performance against the determined strategy set benchmarks;

iv. **Currency composition:** The currency composition of any debt portfolio is crucial to mitigate against the impact of exchange rate movements in the debt portfolio;

v. **Disbursements profile:** An analysis of loan disbursements profile is important because it shows an important part of expected inflows of external funds, and affects the debt service forecast; and

vi. **Debt service projections:** This analysis provides an indication of the liquidity and solvency status of the Province.

Procedure: External Debt Portfolio Analysis	
PDD FD EAD	1. Obtain medium-term primary balance and cash flow projections. 2. Obtain medium-term economic and financial projections and/or scenarios. 3. Obtain project utilization and expected schedule of loan disbursements, and pipeline for new project loans. 4. Consult with stakeholders to ensure that the debt analysis is consistent with the ADP.
DMU Middle Office	Undertake external debt portfolio analysis including new/future financing: • calculate basic risk measures (currency mix, duration, fixed/floating interest rate ratio, average time to refixing, redemption profile, average time to maturity, residual maturity, 1-year residual maturity) and debt

	sustainability indicators.
DMU Middle Office	Prepare debt portfolio analysis report including the risk indicators as shown in Section 5.2.4.
FD	Check and sign-off debt portfolio analysis report.
FD	Authorize debt portfolio analysis report and send to EDMC.
EDMC	Review and sign off debt portfolio analysis report.
FD	Circulate debt portfolio analysis report to relevant stakeholders.

5.2.5. The output from the external debt portfolio analysis will be the following cost-risk table:

Risk Indicators		YYYY DD MMM
Nominal external debt as % of GDP		
Present value of external debt as % of GDP		
Implied interest rate for external debt (%)		
Refinancing Risk	ATM external debt portfolio (years)	
Interest Rate Risk	ATR external debt portfolio (years)	
	External debt refixing in 1 year (% of total)	
	External fixed rate debt (% of total)	
Foreign Currency Risk	Foreign currency debt as % of total debt	

<u>Notes:</u>

Average time to maturity $= \sum_{t=0}^{T} \left(\frac{t \times P_t}{DOD_0} \right)$

where:

P_t = payment of principal at time t

DOD_0 = total debt outstanding at time 0

Average time to re-fixing = $\sum_{t=0}^{T} \left(\frac{t \times RF_t}{Nom} + \frac{t_0 \times RV}{Nom} \right)$

where:

RF_t = redemptions of fixed rate debt at time t

RV = total outstanding variable rate debt at time t_0

Nom = total nominal amount of debt outstanding at time t_0

Debt Sustainability Analysis

5.2.6. Debt Sustainability Analysis (DSA) is important because it gives the Province a medium to long-term perspective of its debt burden. DSA is conducted annually to analyze the external debt portfolio by multiple indicators and ratios and to construct different scenarios to project the government's future debt ratios. The stakeholders that take part in the DSA are PDD, FD, EAD, and other relevant government entities. The DSA feeds in to the debt management strategy. The responsibility for conducting the DSA rests with the middle office. For an effective debt sustainability analysis, the following requirements are necessary:

Procedure: Debt Sustainability Analysis	
PDD FD EAD	1. Obtain medium-term primary balance and cash flow projections. 2. Obtain medium-term economic and financial projections and/or scenarios. 3. Obtain project utilization and expected schedule of loan disbursements, and pipeline for new project loans. 4. Consult with stakeholders to ensure that the debt analysis is consistent with the ADP.
DMU Middle Office FD Federal Government	For an effective DSA, the following requirements are necessary: • Reconciliation and validation of debt data in the debt recording and management system. • Baseline macroeconomic projections (with different scenarios of economic performance, i.e. GDP growth, fiscal performance and new borrowing). • Borrowing structure of the Province in the medium-to-long term.
DMU Middle Office FD	Complete DSA using the model(s) chosen by FD. DSA will involve three scenarios: • Baseline scenario • Historical scenario • Extreme stress test scenario The DSA will calculate the following ratios: • Present value of external debt to GDP • Present value of external debt to government revenue • Debt service to revenue
DMU Middle Office	Prepare DSA report.
FD	Check and sign-off DSA report.
PDD/FD	Authorize DSA report and send to EDMC.
EDMC	Review and sign off DSA report.
FD	Circulate DSA report to relevant stakeholders.

5.3. MIDDLE OFFICE REPORTS

5.3.1. The Middle Office will prepare reports on periodic basis as well as on need basis. Some of the common types of Middle Office reports are:

- Annual Debt Sustainability Analysis report
- Annual, half-yearly and quarterly debt service payment projections report
- Quarterly Debt Portfolio Analysis report

Procedure: Middle Office Reports	
DMU Middle Office	Collect data and prepare report in the format set out in Annexure 4.
FD	Review and sign-off report.
FD	Authorize report and send to EDMC.
EDMC	Review and sign off report.
FD	Circulate report to relevant stakeholders.

6. BACK OFFICE PROCEDURES

6.1. INTRODUCTION

6.1.1. The tasks of the Back Office cover debt recording and validation, debt accounting, quality control and debt reporting. It also includes managing debt service payments. Accounting transactions should be accurate and should be reflected in provincial government accounts. Good debt management requires accurate, up-to-date information and efficient storage and retrieval systems.

6.1.2. The Back Office functions within the Government of Sindh are split across different entities. Maintaining[5] debt records and managing debt servicing is with DMU (FD). Disbursements are also accounted at TO Karachi by entering them into the Government Financial Management System. Similarly, AG Sindh enters the debt service payments into the Government Financial Management System.

6.1.3. The Back Office undertakes the following activities:

- Manage debt information systems and maintain an accurate and up-to-date loan database;
- In coordination with the Middle Office, prepares debt service forecasts for external debt as an input to the expenditure estimates of the fiscal budget;
- Reconcile all debt transactions with stakeholders;
- Ensure timely and accurate debt service for external debt;
- Validate debt data regularly;
- Prepare statistical and management reports; and
- Coordinate with the Front Office so that the recording and monitoring of new financing is done in a timely manner.

6.2. RECORDING

6.2.1. Once the loan agreement is signed, the signed loan agreement along with project agreement and disbursement schedule will be sent to DMU. The Computer Center of Resources Wing (FD) maintains the debt database (i.e. the Debt Recording and Management System (DRMS). Data entry is the sole responsibility of Computer Center along with the entry of loan disbursement amounts in the DRMS. Computer Center is an IT Section of Resources Wing which supports all the sub-departments of Resource Wing including DMU. The Financial Analyst (Front Office) in DMU is responsible for reviewing the information to validate that no errors have been made while recording.

[5] DMU (Back Office) and I.T Section (Resource Wing) will be responsible maintaining records on debt system. Physical files and correspondence with Finance Division, EAD and SBP and other stakeholders would remain the responsibility of Section II (Resource Wing). In addition to this, as per recommendation of World Bank mission loan data shall be maintained at all three locations. i.e DMU, IT Section Resource Wing and Section II Resource Wing.

Procedure: Recording	
DMU/SO(Res II)	Receive signed loan agreement along with the project agreement and disbursement schedule and send copy to Computer Center of Resources Wing (FD).
Computer Center of Resources Wing (FD)	Input debt data into the Debt Recording and Management System (DRMS). Debt recording entails capturing vital information on: i. Basic instrument/loan details as set out in Section 6.2.2 ii. Terms and conditions of loan instruments iii. Disbursement schedules and data on actual disbursements iv. Exchange rates and interest rates that are applicable to various instruments v. Codes to designate creditors, borrowers and disbursement agencies, implementing agencies, economic sectors and use of funds vi. Ledger transactions including principal, interest, commitment fees and other charges (penalty, management, legal etc.)
Computer Center of Resources Wing (FD)	Check debt data input in DRMS.
DMU Front Office/SO(Res II)	Review debt data input in DRMS to validate that no errors have been made while recording.

Basic Loan Details

6.2.2. The following are basic details of a loan, which will be recorded once a loan agreement has been signed:

- Unique identification number
- Status of the loan
- Donor name
- Donor reference
- Date of Signature
- Executing agency
- Line department
- Last date of disbursement
- Effective date of loan
- Date authorized
- Maturity profile (including grace period)
- Amount borrowed

- Currency of borrowing
- Participants and their roles (i.e. officer who filled out the term sheet along with the officer who checked/verified the debt data)
- Amendments to agreements
- Type of creditor
  - Loans from financial institutions
  - Provincial government securities
  - Loans from governments (bilateral sources)
  - Loans from multilateral agencies
- Economic sector
- Use of funds
- Interest terms including interest rates, applicable day convention, and interest period
- Commitment and other fees
- Penalty rates
- Payment dates
- Payment amounts and currency of payment

6.3. DISBURSEMENTS

6.3.1. Disbursements refer to the release of funds by the donor. Expenditure occurs when funds are utilized for purchase of goods and/or services. Disbursements may or may not precede expenditure (it all depends on the method of disbursement as discussed below).

Disbursement Methods

6.3.2. There are three methods of disbursement namely: direct, reimbursement and replenishment:

i. **Direct disbursements**: refer to the release of funds by the donor directly to the beneficiary. It is important to note that direct disbursements may be made in kind. In such cases the lending agency should be required to report to PDD and to FD as well as to the line department/implementing agency on the type and value of all direct disbursements to the project. Direct disbursements are normally used for program loans.

ii. **Reimbursement method**: In this case, the provincial government undertakes expenditure from its own resources and then submits evidence of such expenditures to the creditor for reimbursement. The funds have to be warranted from FD to the implementing agency before expenditure can take place. The line department or the project involved should ensure that all reimbursement claims are made and paid in order to clear any advances.

iii. **Replenishment method (or advance/special account disbursements method)**: Under this method, on receipt of a signed copy of a loan agreement and a disbursement letter, FD writes to AG Sindh to open special accounts in accordance with the loan agreement. Special accounts are required to be opened normally with the National Bank of Pakistan (NBP), although in certain circumstances the account may be with SBP. The institution holding the Special Account must be able to:

- execute foreign exchange and local currency transactions
- open letters of credit
- handle a large number of transactions promptly

The donor advances funds, usually on installment basis, to the project account. The implementing agency undertakes the expenditure by drawing down the project account. When funds in the project account are reaching a minimum level, the implementing agency, through the provincial government, initiates the reimbursement process by applying to the donor as per the terms of the loan.

Withdrawal of Funds

6.3.3. The fact that a loan is effective does not mean that the funds will be released. The implementing agency/project authorities have to make a formal application for the requisite funds. Some donors provide standard application forms. For accountability and control purposes it is necessary for PDD and FD to be involved in the process.

6.3.4. Timely data on loan disbursements is needed for several reasons; firstly, the Back Office will keep track of available loan balances (commitments less disbursements made to date). Secondly, amounts of disbursed debt are also needed to estimate interest due to donors. Lastly, all records of external financing must be consistent with records maintained elsewhere on provincial government borrowing.

Confirmation of Disbursements

6.3.5. For the disbursement transactions to be recorded in a timely manner, it is the responsibility of the Executing Agency/Project Director to inform Resources Wing (FD) and PDD. One unique issue with recording of disbursements is the recording of payments directly to vendors by the donors which are more commonly known as the third party payments. The executing agency/Project Director will inform all third party payments to Resources Wing (FD) and PDD in the same manner as routine disbursements so as to enable the Back Office to update the debt profile.

Procedure: Disbursement	
Withdrawal of Funds	
Project/ implementing agencies	Prepare Withdrawal Applications and submit to the donor, and send a copy to PDD and DMU/SO(Res II).
DMU Back Office	Keep record of each Withdrawal Application and tally this with actual disbursement by the donor.
FD SBP	The disbursements from donors are received into the Federal Government's account with SBP. SBP upon advice from FD will transfer the disbursements into provincial government's accounts with intimation to TO Karachi, and FD.
TO Karachi	Record the disbursements into the provincial government Financial Management System. TO Karachi will ensure that it enters the disbursements correctly along with the unique loan

	ID number.
Confirmation of Disbursements	
Donors	Notify EAD and the project authorities of the disbursements through official correspondence.
DMU Back Office Resources Wing (FD)	Receive information on disbursements from any of the following stakeholders: • SBP (which manages provincial accounts) • The donor – disbursement advices (creditor notes) • Implementing agency/project authorities • Electronic disbursement details from creditors' websites
Executing Agency/Project Director	For the disbursement transactions to be recorded in a timely manner, inform Resources Wing (FD) and PDD within seven working days of receiving the disbursement with all disbursement details such as amount, tranche number and loan ID.
Computer Center of Resources Wing (FD)	Record the disbursements in the debt database promptly, update the debt stock and inform DMU/SO(Res II) of each disbursement recorded in the database along with all details mentioned above within two working days.
DMU Back Office	Conduct quarterly reconciliation of disbursements with AG Sindh, FD and EAD separately to ensure that the debt database is correct and up to date. Any differences will be promptly resolved and corrected (if required).
Executing Agency/Project Director	Once all disbursements have been made by the donor, notify PDD and FD.
Computer Center of Resources Wing (FD)	Mark the loan as fully disbursed in the debt database.

6.4. DEBT SERVICING

6.4.1. The Back Office must ensure that the database is up-to-date especially with disbursements and all ledger transactions. An invalid database will generate incorrect payment amounts, which may differ from donor billing statements. The DMU Back Office will maintain separate/dedicated records of external debt transactions. The debt servicing will be funded from the consolidated fund (revenue account) as and when debt payments fall due.

Procedure: Debt Servicing	
Resources Wing (FD)	Prepare debt payments falling due in a financial year for inclusion in a provincial government budget for external debt.
EAD	As all external loans are re-lent to Government of Sindh from Federal Government, the debt payments are made to donors by the Federal Government in the first place. These records are maintained at EAD.
FD Federal	Upon advice from EAD, deduct the debt service payments

Government	from revenue share of Government of Sindh on a monthly basis and advise AG Sindh and FD through the Federal Transfers statement.
AG Sindh	Record the debt service payment into the Government Financial Management System
DMU Back Office Computer Center of Resources Wing (FD)	For the purposes of accountability and ease of reconciliation, maintain separate/dedicated records of external debt transactions by entering all transactions into the DRMS. Ensure that accurate and loan wise debt service payment information is received from the EAD[6] within 3-4 business days of the Federal Transfers statement. Record the payments in the DRMS and update the debt stock.
DMU Back Office	Check all transactions entered into the DRMS.
DMU Back Office	Reconcile debt records quarterly with AG Sindh, FD(IT Section and SO(Res II) and EAD.

6.5. BACK OFFICE REPORTS

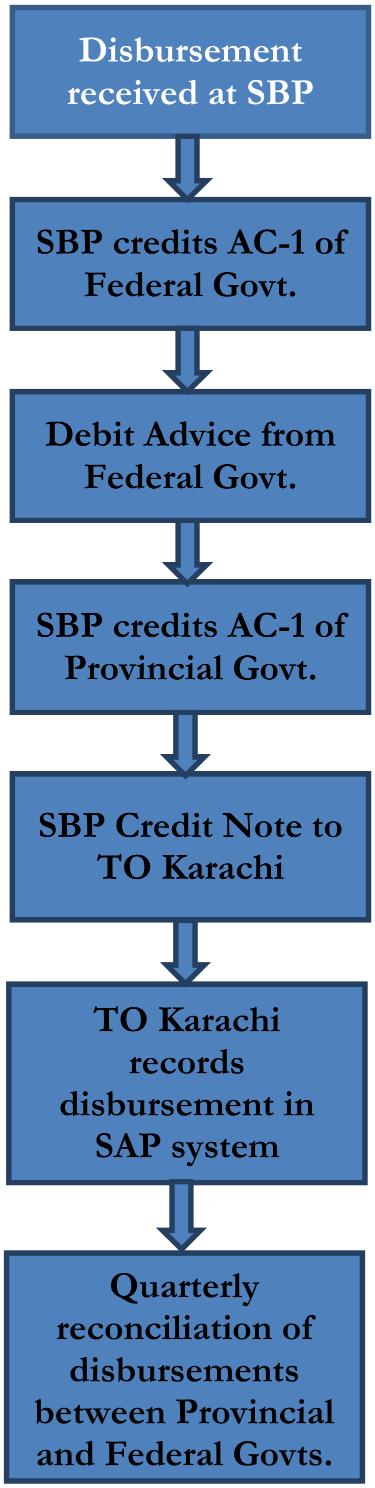
6.5.1. Different Back Office reports are required by different users. These reports include:

- Quarterly Debt Statistical Bulletin
- Quarterly Disbursements Report (Total and Loan wise)
- Quarterly Debt Service Payments Report (Principal and Interest wise, Total and Loan wise)
- Monthly Debt Portfolio Report (Total and Loan wise Disbursed Outstanding Debt (DOD), disbursement projections, payment projections etc.)

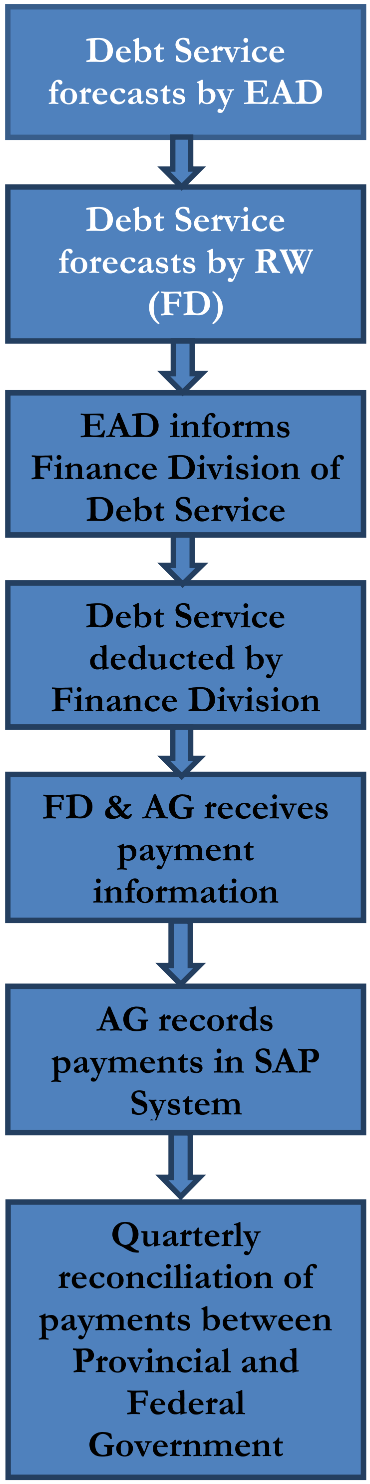
[6] As per current scenario, It would be difficult to get loan wise debt servicing payment report from EAD. DMU will rely on their debt record and may verify the payment in future if data from EAD/Donor provided.

Procedure: Back Office Reports	
DMU Back Office	Collect data and prepare report in the format set out in **Annexure 5**.
DMU Back Office	Review and sign-off report.
FD	Approve report.
FD	Circulate report to relevant stakeholders.

6.6. Disbursements – Process Flow



6.7. DEBT SERVICING – PROCESS FLOW



Annexures

Annexure – 1

Government of Pakistan
Ministry of Economic Affairs & Statistics
(Economic Affairs Division)
****

No.1(1)SO(DM)/09 Islamabad, the 23rd January, 2010

OFFICE MEMORANDUM

Subject: RE-LENDING OF FOREIGN LOANS / CREDITS

The undersigned is directed to refer to this Division's O.M. of even number dated 17/03/2009 (Annex-I) on the subject noted above and to say that revision of relending policy of foreign loans/credits to provincial governments/departments was under consideration of the Federal Government. Accordingly, the Economic Coordination Committee of the Cabinet [ECC] has approved the relending policy of foreign loans/credits in its meeting held on 12/01/2010. The revised relending policy will, therefore, be applicable to provincial governments/departments w.e.f. 12/01/2010 as per table given below:

AGENCY	INTEREST RATE / EXCANGE RISK COVER [ERC]	REPAYMENT PERIOD
Provincial Governments	Foreign loans/credits will be relent to provincial governments / departments on the same terms and conditions at which they have been borrowed by the Federal Government and ERC will be borne by the provinces.	The actual redemption period available to the Government of Pakistan.

2. Further, Provinces are allowed to borrow/get loans directly through sale of bonds after having devised a mechanism in consultation with Finance Division and State Bank of Pakistan.

3. Relending policy for the Federal Government Departments, Autonomous Bodies and Development Financial Institutions has already been approved by the ECC and circulated by EAD vide its O.M. of even number dated 17/03/2009.

4. Other guidelines / conditions as contained in this Division's O.M.No.1(15)SO(DM)/97 dated 30/10/1997 and O.M. of 20/06/1990 and amended from time to time shall continue to remain in force [Annex-II].

(M. Shamim Wazir)
Chief
Debt Management Wing
Ph: 9209476

All concerned:

Government of Pakistan
Ministry of Economic Affairs & Statistics
(Economic Affairs Division)
****

No.1(1)SO(DM)/09 Islamabad, the 17th March, 2009

OFFICE MEMORANDUM

Subject: RE-LENDING OF FOREIGN LOANS / CREDITS

The undersigned is directed to refer to this Division's O.M.No.1(15)SO(DM)/97 dated 30/10/1997 (Annex) on the subject noted above and to say that revision of relending policy of foreign loans/credits was under consideration of the Government. Accordingly, the existing policy has been revised and approved by the ECC of the Cabinet in its meeting dated 03/03/2009 which will be applicable to Federal Government Departments, Autonomous Bodies and Development Financial Institutions [DFIs] on foreign loans/credits contracted and relent w.e.f. 03/03/2009. The revised terms pertaining to interest rate and exchange risk coverage fee [ERC] shall be fixed as per table given below:

AGENCY	INTEREST RATE / ERC	REPAYMENT PERIOD
i) Federal Government departments like NLC, CAA etc. for which commercial accounts are maintained.	12% p.a. inclusive of interest rate of 5.2%+ ERC of 6.8% which shall be charged both on the principal amount and interest amount separately.	The actual redemption period available to the Government of Pakistan.
ii) Autonomous Bodies / Corporations	15% p.a. inclusive of interest rate of 8.2% + ERC of 6.8% which shall be charged both on principal amount and interest amount separately.	The actual redemption period available to the Government of Pakistan.
iii) Development Financial Institutions	12% p.a. inclusive of interest rate of 5.2% + ERC of 6.8% which shall be charged both on principal amount and interest amount separately. The DFIs may, however, charge maximum spread of 3% p.a. from the final borrowers as their administrative charges over the rate of 12% p.a.	The actual redemption period available to the Government of Pakistan.

2. For the default cases of recovery of relent loans, late fee charges will be levied on the due installment [principal + interest] at the rate of 1% during the first year of default, 2% during 2nd year of default, 3% during the 3rd year of default and - - - - -.

3. Relending policy for provinces is still under consideration and will be circulated on its approval by the ECC. As such, the existing relending policy for the provinces will remain the same as circulated vide EAD's O.M.No.1(15)SO(DM)/97 dated 30/10/1997.

4. Other guidelines / conditions as contained in this Division's O.M.No.1(15)SO(DM)/97 dated 30/10/1997 and O.M. of 20/06/1990 and amended from time to time shall continue to remain in force.

(M. Shamim Wazir)
Deputy Chief
Debt Management Wing
Ph:9209476

<u>All concerned</u>

Government of Pakistan
Ministry of Finance & Economic Affairs
[Economic Affairs Division
****

No.1[15]SO[DM]/97 Islamabad, the 30th October,1997

OFFICE MEMORANDUM

Subject:- RE-LENDING OF FOREIGN LOANS/CREDITS -ABSORPTION OF EXCHANGE RISK.

The undersigned is directed to refer to this Division's O.M. No.1[1] SO[DM]/90 dated 20th June 1990 [Annex] on the subject noted above and to say that the matter of fixation of adequate exchange risk cover fee had been under consideration of the Government. It has now been decided that for foreign loans contracted and relent w.e.f. 19.8.1997 the fee for exchange risk cover will be 6% of total outstanding amount and charged both on principal and interest separately. Accordingly, the liability of Provincial Governments, Federal Departments, Autonomous Bodies and Development Financial Institutions on account of interest and exchange risk fee shall be fixed as per table given below:

RELENT LOANS

AGENCY	INTEREST/EXCHANGE RISK FEE ETC.	REPAYMENT PERIOD
i] Foreign loans for provincial governments	The loans/credits will be passed on to the provincial governments/departments on the same terms and conditions at which these have been borrowed. There will be no exchange risk coverage in such cases.	The actual redemption period available to the Government of Pakistan.
ii] Federal Government departments like NLC, CAA etc. for which commercial accounts are maintained.	The re-lending will be made at 14% p.a. inclusive of interest rate of 8%+ ERC fee of 6%, which shall be charged both on the principal amount and interest amount separately.	Maximum period of 25 years including a grace period of 5 years or the actual redemption period available to the Government of Pakistan whichever is less.
iii] Autonomous bodies/Corporations	Re-lending will be made at 17% inclusive of re-lending interest of 11% + ERC fee of 6% which shall be charged both on principal amount and interest amount separately.	Generally, the repayment period as specified under category-iv] below will be applicable. However, this period can be extended up to the limit prescribed under [ii] above with the approval of Finance Minister.
iv] Development Financial Institutions	Interest rate of 8% p.a. In addition, 6% p.a. will be charged on accounts of exchange risk fee both on	Maximum period of 15 years including a grace period of 2 years or the actual redemption period

	principal as well as interest separately. The maximum re-lending rate for the final borrowers will be 17% p.a. inclusive of exchange risk fee.	available to the Government of Pakistan whichever is less. Grace period can be extended up to 5 years with the approval of Finance Minister. The grace period will start from the date of disbursement of first installment.

2**.** For direct loans and supplier's credit contracted by DFIs/public sector agencies including corporations/autonomous bodies, the fee for exchange risk cover, if these organizations opt to avail this facility from the government, will be recovered at the rate notified by the National Bank of Pakistan for the purpose from time to time for both principal and interest separately. Repayment period will be actual redemption period available in the loan agreement signed with the foreign lenders.

3. Other guidelines/conditions as contained in the above quoted O.M. of 20.6.1990 and amended from time to time shall continue to remain in force.

Sd/-
[AHMED MAHMOOD ZAHID]
Deputy Secretary
[Debt Management Wing]

<u>All concerned</u>

Government of Pakistan
Ministry of Finance & Economic Affairs
[Economic Affairs Division]
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No.1[1]SO[DM]/90 Islamabad, the 20th June, 1990

OFFICE MEMORANDUM

Subject: **RE-LENDING OF FOREIGN LOANS-ABSORPTION OF EXCHANGE RISK.**

The undersigned is directed to refer to this Division's O.M. of even number dated April 15, 1990 on the subject noted above and to say that consequent upon the upward revision of the exchanger risk fee rate from 3% p.a. to 5% by the Government of Pakistan w.e.f. April 30, 1990 the terms and conditions in the aforementioned O.M. have been modified as under:

CATEGORY OF LOAN/CREDIT

A. RELENT LOANS

AGENCY	INTEREST/EXCHANGE RISK FEE ETC.	PAYMENT PERIOD
[i] The Departments of Provincial Governments for which no commercial accounts are maintained.	The loans/credits will be passed on to the Provincial Governments/ Departments on the same terms and conditions at which these have been borrowed. There will be no exchange risk coverage in such cases.	The actual redemption period available to the Government of Pakistan.
[ii] The Departments of Federal/Provincial Governments for which commercial accounts are maintained.	11% p.a. inclusive of exchange risk coverage fee.	Maximum period of 25 years including 5 years grace period or the actual redemption period available to the Government of Pakistan whichever is less.
[iii] Autonomous Bodies/ Corporations of the Federal/Provincial Governments. [a] Projects of public utilities.	-do-	-do-

[b] Projects other than public utilities [Industry, Fuel, Minerals, Air/Sea/Road Transport etc.]	14% p.a. inclusive of exchange risk coverage fee.	Generally, the repayment period as specified under Category-iv below will be applicable. However, this period can be extended up to the limit prescribed under [a] above with the approval of Finance Minister.
[iv] Development Financial Institutions [PICIC/IDBP/NDFC, Bankers Equity Ltd. etc.]	11% p.a. inclusive of exchange risk coverage fee. The re-lending rate to the final borrowers will be 14% p.a.	Maximum period of 15 years including a grace period of 2 years or the actual redemption period available to the Government of Pakistan whichever is less. Grace period can be extended up to 5 years with the approval of Finance Minister. The grace period will start from the date of disbursement of first installment.

B. <u>DIRECTS LOANS/SUPPLIERS CREDITS.</u>

Development Financial Institutions and Public Sector agencies including Corporations/Autonomous Bodies of Federal and Provincial Governments.	The rate for exchange risk fee will be the difference between the re-lending interest rates specified in [iii] & [iv] of 'A' above and the interest rates payable to the foreign lenders subject to minimum of 5% p.a. The rate of exchange risk fee in respect of public sector agencies will not exceed the rates notified by the State Bank of Pakistan from time to time.	Actual redemption period available in the loan agreement signed with the foreign lenders.

2. Further guidelines/conditions which the borrowers will have to observe in addition to the terms specified above are as follows:

[i] The exchanger risk coverage is available from the date of opening of L/C or the date of disbursement on the option of the borrowers.

(ii) The exchange risk coverage option will be registered by the Economic Affairs Division [Debt Management Wing]. The exchange risks option in respect of category [A] Relent Loans of para-I will be reflected in the subsidiary loan agreement/re-lending sanction letter. The requests for registration of option in respect of category-B Direct Loans/Suppliers Credits of para-1 should however, be received in the Economic Affairs Division within 30 days from the date of signing of the agreement/contract or within such extended time limit as may be allowed by the Ministry of Finance.

(iii) The exchange risk coverage fee at the rates mentioned against each category of loans in para-1 above will be charged with effect from the date[s] of option/arrangements/ date[s] of opening of L/Cs or dates of withdrawals as the case may be.

[iv] The exchange risk coverage fee subject to a minimum of 5% p.a. will separately be charged for the period commencing from the L/Cs opening date and ending on the day preceding the date of disbursement if the coverage is opted w.e.f. the L/Cs opening date.

(v) In cases where loans are guaranteed by the Federal Government, guarantee fee @ 0.5% p.a. will be charged from the borrowers on the amount of loan disbursed and outstanding from time to time.

(vi) All charges and fees including commitment charges etc. if any, payable by the Government of Pakistan to the foreign lenders will also be borne by the borrowers' pro-rate of the allocation made to each borrower in addition to the amounts of principal and interest.

(vii) The option in respect of exchange risk coverage, once exercised will be final and will remain valid till the liquidation of the entire loan.

*[vii] For the purpose of determining the debt liability in cases where the borrowers opts for exchange risk cover from the L/C opening date, the foreign currency of the L/C will be converted into Pak rupee instead of the currency of disbursement/re-imbursement at the exchange rates prevailing on the date of opening of L/C.

*[viii] The exchange risk fee will be charged at the rate notified by the State Bank of Pakistan for the respective currency of L/C for the period commencing from the L/C opening date and ending on the day preceding the date of disbursement. After the disbursement, the prescribed interest, which invariably includes the exchange risk fee, will be charged from the borrowers as usual.

(ix) The amount of principal, interest, commitment charges, exchange risk fee, guarantee fee etc. are to be deposited in separate Heads of Accounts as under:

PRINCIPAL	2200000- Recovery of Loans and Advances
INTEREST, COMMITMENT CHARGES/ OTHER CHARGES	1130000-Interest and Commitments charges/Other Charges
EXCHANGE RISK FEE	3312018-Reserve Fund for Exchange risk on Foreign Loans
GUARANTEE FEE	1139000-Commission on Foreign Loans and Credits

(x) Exchange risk fee, guarantee fee, or commitment charges etc. are to be deposited on the due dates along with the interest/principal payments.

*:-As modified w.e.f. 8th September 1992 under EAD's O.M. No.1[1]SO[DM]/90 -A dt. 29th October, 1992.

(xi) Exchange risk fee, guarantee fee, or commitment charges etc. are to be deposited on the due dates along with the interest/principal payments.

(xii) Exchange risk coverage will be provided for both principal as well as interest while exchange risk coverage fee will be charged only on the amount of loan disbursed and outstanding from time to time.

3. The exchange risk fee will be recovered in the following manner if the Exchange risk coverage is availed from the date of opening of letter of credit:

   (a) The fee will be recovered in advance on the amount of letter of credit, at the time of its opening for a period of one year or for the period of validity of the letter of credit whichever is less, subject to adjustment on the basis of actual disbursement.

   (b) In case the letter of credit is initially valid for less than one year and is extended subsequently, exchange risk coverage fee for the extended period will be recovered in advance at the time of extending the letter of credit. After disbursement, the exchange risk fee will be recovered at the time of repayment of principal/interest in the case of direct borrowings, while in the case of “relent” loans; exchange risk fee will not be recovered after disbursement separately because the composite interest rate already includes the element of exchange risk coverage fee.

   (c) Conversion of foreign currency amounts into Pak. rupee will be made at the Authorized Dealer’s Spot Selling rate obtaining on the date of opening of letter of credit. In case several letters of credit are opened under a single loan, the foreign currency amount of each letter of credit will be converted into Pak. rupee at the Authorized Dealer’s Sport Selling rate obtaining on the date of opening of the respective letter of credit and the total Pak. Rupee amount of all the L/Cs will give the average rate at which exchange risk coverage has been provided under that loan.

   (d) In case disbursement is made in currencies other than currencies in which L/Cs are opened, the conversion of the currencies of disbursement will be made at the rate prevailing on the date of opening of Letters of Credit.

4. The cases where exchange risk coverage has been provided before issue of this Office Memorandum shall governed by the terms and conditions under which the facility was originally made available unless otherwise mutually agreed.

5. After completion of disbursement, borrowing agencies will prepare repayment schedule showing the amounts of principal/interest in foreign currency as well as in Pak. rupee and will submit three copies thereof to the Economic Affairs Division [Debt Management Wing] along with photo copies of the relative letters of credit/Bills of Lading and Exchange Rate Bulletins showing the rates obtaining on the date of opening of letters of credit/disbursement. Economic Affairs Division [Debt Management Wing] will return one copy of the repayment schedule duly registered to the borrowing agency.

6. The borrowers in respect of loans falling under category-B of para-I above including loans guaranteed by the Government of Pakistan will effect remittances of payment installments after obtaining necessary authority from the Economic Affairs Division[Debt Management Wing] and thereafter submit claims for re-imbursement against the exchange rate differential if any, to the Economic Affairs

Division [Debt Management Wing] or make deposits into Government accounts, supported by the following documents:-

i. Photo copies of receipted challans showing deposits of exchange risk coverage fee/ guarantee fee [where required] with State Bank of Pakistan/National Bank of Pakistan duly certified by the concerned bank with particular reference to the item in the monthly statement of deposit submitted to Economic Affairs Division.

ii. Photo copies of Exchange Rates Bulletins for the dates of remittances of the repayment installments.

iii. Photo copy of the challan for deposit of amount, in case the rate prevailing on the date of remittance of repayment installment happens to be lower than that on the date of disbursements.

7. Requests for exemption from the above terms shall be put up to the ECC of the Cabinet through the Administrative Ministry after obtaining the views of the Finance Division and Economic Affairs Division.

8. Clarification, if any, as to the interpretation of the instructions contained in this Office Memorandum may be sought from the Economic Affairs Division.

Sd/-
[ZAFAR IQBAL]
Deputy Secretary

All concerned

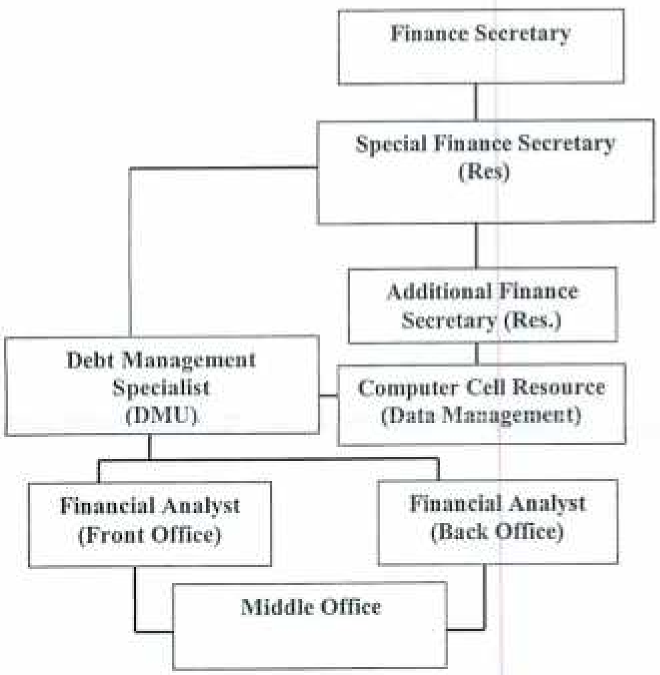
Annexure – 2

GOVERNMENT OF SINDH
FINANCE DEPARTMENT

Karachi, dated the 1st July, 2014

NOTIFICATION

No: FD(E&A)9(58)/2014:With the approval of the competent authority, it is notified that a Debt Management Unit is being established in Resources Wing of Finance Department, Government of Sindh which will become operational with effect from the FY 2014-15. In this context necessary budgetary allocation has been made for the FY 2014-15. The organogram for DMU in Finance Department will be as follows:



The terms of references (ToRs) of DMU are as under:

OVERALL RESPONSIBILITIES OF DMU

- All task of Provincial Public Debt Management (domestic & foreign debt) pertaining to Front, Middle and Back Offices.
- The DMU will have a clear mandate for overall responsibility for GoS debt portfolio management, including debt evaluation, financial negotiation in coordination with P&DD, settlement and reporting.
- Preparation of draft Manual for Provincial Public Debt Management.
- Framing of Policies for domestic and foreign debt.
- Conduct financial analysis of cost effectiveness of different types of funding.
- Operate a debt management information system such as DMFAS or any other system with the appropriate functionality.
- Produce and publish the debt statistics bulletin in compliance with international standard.
- Organize workshops, seminars, and conferences.

W.Post-2

TASK OF FRONT OFFICE

- The Front Office (Financial Analyst) will undertake/prepare transactions in coordination with Planning & Development Department. In this regard, the office will assist Line Department (Loan-taking Department), Planning & Development Department and Law Department in preparation of draft Loan Document for domestic and foreign debt/ Subsidiary Loan Agreement (SLA) between the Federal Government and Government of Sindh in case of on-lending.
- Loan Negotiation with Domestic and Foreign Lenders (Donors) on behalf of Finance Department, Government of Sindh in coordination with Planning and Development Department, Government of Sindh.
- Identify external creditors according to their respective focus on activities and expected financial terms and conditions
- Review international and domestic markets for changing patterns of Debt.

TASK OF BACK OFFICE

- The Back Office will validate transactions, make payments and prepare reports.
- Disbursement and Debt service Recording/Accounting/Reconciliation of domestic and foreign debt (all categories: active, closed, umbrella, third-party).
- Liaison with Finance Division/Economic Affairs Division, Government of Pakistan, Planning & Development Department, Loan-taking Administrative Department of Government of Sindh, State Bank of Pakistan, National Bank of Pakistan and other Banks, Office of Accountant General, Sindh, Treasury Office/District Accounts Offices in Sindh, and Project Directors of Foreign Funded Projects.
- Maintain the debt database.
- Prepare key quarterly statistics for aggregate debt portfolio.

TASK OF MIDDLE OFFICE

- Examine all draft loan documents pertaining to domestic and foreign debt and provide technical inputs.
- Prepare the analytical component of debt management reports, based on statistical information provided by back office.

SECRETARY TO GOVERNMENT OF SINDH
FINANCE DEPARTMENT

No. FD(E&A)9(58)/2014 Karachi dated the 1st July, 2014

A copy is forwarded to:

i. The Additional Chief Secretary to Government of Sindh, Planning & Development Department, Karachi.
ii. The Senior Member, Board of Revenue, Sindh, Karachi.
iii. Principle Secretary to Chief Minister Sindh, Karachi.
iv. The Administrative Secretary to Government of Sindh (All).
v. Deputy Secretary (Staff) to Chief Secretary Sindh, Karachi.
vi. Private Secretary to Advisor to Chief Minister Sindh on Finance, Karachi.
vii. R.O to Secretary to Government of Sindh, Finance Department, Karachi.
viii. The PS to Special Secretary, Government of Sindh, Finance Department, Karachi.
ix. The PS to Chief Economist, Finance Department, Government of Sindh, Karachi.
x. The PS to Additional Secretary, Government of Sindh, Finance Department, (All)
xi. Office File.

(NIZAMUDDIN SOLANGI)
Section Officer (Admin)

Comments and suggestion for External Debt Manual

- Brief Capacity building requirement with refer to notification of Debt Manual.
- There shall be formal work plan along with the specific time lines.
- DMU may report to FS to avoid involved in routine matters and concentrate on Debt reform program contents only.
- Functions of DMU shall be the part of Debt Manual. As per TORs(notification), DMU is not obligated to train the other department staff but improve coordination with them along with the relevant job responsibilities of front, middle and back office operations.
- Training and Development of DMU shall be the part of Debt Manual.
- Future work plan should be circulated along with the Debt Manual.
- DMU shall be the part of preparation of Annual Development Plan.
- There shall be standard format to check the feasibility of any proposed project loan supplemented with funded alternatives available along with the reasoning. DLI's and KPI's should be defined so one can track the progress accordingly. It shall also embedded with risk management controls i.e contingency plan, costing etc.
- Following Controlled instruments should be the integral part of Debt manual.
    - ✓ Procedure for monitoring of Assignment account
    - ✓ Progress report along with the expense report duly reconciled with FD and AG Office.
    - ✓ Procedure for Project Budget approval.
    - ✓ Monitoring of Variance on monthly and quarterly basis.
- Project valuation should be done by the third party as per approved panel.
- Regular Inspection of SITE by DMU (FD) and PDD staff.
- Surprise inspection of SITE by DMU (FD) and PDD staff.
- Project Audit report by an external auditor selected from approved list of ICAP.
- SITE visit reports from internal and external agencies should include in debt manual.
- Operationalize manual by presentation and checklist.