



NAMIBIA

TECHNICAL ASSISTANCE REPORT—ASSESSING AND MANAGING FISCAL RISKS FROM STATE-OWNED ENTITIES AND PUBLIC-PRIVATE PARTNERSHIPS

August 2018

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Namibia

Assessing and Managing Fiscal Risks from State-Entities and Public-Private Partnerships

Carolina Renteria, Isabel Rial, Avril Halstead, Katja Funke, and
Malcolm Pautz

Technical Assistance Report | March 2018



I N T E R N A T I O N A L M O N E T A R Y F U N D

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ACRONYMS

ACDM	Asset, Cash and Debt Management
CL	Contingent Liabilities
COM	Council of Ministers
CSP	Concentrated Solar Power
DBM	Development Bank of Namibia
FAD	Fiscal Affairs Department
FRS	Fiscal Risk Statement
GFSM	Government Finance Statistics Manual
IFRS	International Reporting Financial Standards
IMF	International Monetary Fund
IPSAS	International Public Sector Accounting Standards
NDP5	Namibia's 5 th National Development Plan
MoF	Ministry of Finance
PC	Public Corporations
PE	Public Entities
PFRAM	PPP Fiscal Risks Assessment Model
PPP	Public Private Partnerships
PSDG	Public Sector Debt Guidelines for Users
RISDP	Regional Integrated Strategic Development Plan
SADC	Southern African Development Community
SACU	Southern African Customs Union
TA	Technical Assistance
UNAM	University of Namibia

PREFACE

At the request of the Ministry of Finance (MoF) of Namibia, a mission of the IMF's Fiscal Affairs Department (FAD) visited Windhoek during January 17–31, 2018 to analyze main source of fiscal risks, notably Public-Private Partnerships (PPPs) and Public Entities (PEs), and advise on options for better monitoring, managing and reporting these risks. The mission was led by Carolina Renteria (FAD Division Chief) and included Isabel Rial, Avril Halstead (all FAD), Katja Funke, and Malcom Pautz (external experts). A workshop to present international experiences on managing fiscal risks, with special focus on PPPs and PE, was delivered to a broad range of public officials of the Ministry of Finance, Ministry of Public Enterprises and a number of large PE; training in the use of the IMF-World Bank PPP Fiscal Risk Assessment Model (PFRAM) and a two-step methodology for assessing the likelihood of fiscal risks materializing from PEs, was provided to pertinent staff members.

During its stay, the mission met with Mr. Carl HG Schlettwein Minister of Finance, Ms. Ericah B. Shafudah Permanent Secretary of Finance, Andreas Penda Ithindi, and Maru Tjihumino Deputy Permanent Secretaries of Finance, and Ms. Louise Shixwameni Deputy Permanent Secretary of the Ministry of Public Enterprises.

It held discussion with officials at the Ministry of Finance, including Mr. Saurabh Suneja Head of the PPP Unit and his team, Ms. Angelina N. Sinvula Director of the Asset, Cash, and Debt Management Department and her team, as well as other high-level officials from the Ministry of Finance, Ministry of Public Enterprises, the National Planning Commission, and the City of Windhoek. The mission also met representatives from Nampower, Transnamib, Air Namibia, UNAM, DBN, Agribank, and the Roads Fund Administration.

The team wishes to thank all the government officials met for their excellent cooperation, warm hospitality, and generosity with their time. It is especially grateful to Ms. Rauna Mukumangeni, Mr. Johannes Shipepe, and Ms. Monika Uandara for organizing the mission schedule and for the close cooperation throughout.

The mission also met representatives of donors, including the European Union and the US Treasury.

This technical assistance was provided with financial support from AFRITAC South.

EXECUTIVE SUMMARY

Following a period of strong growth, the Namibian economy is experiencing a slowdown.

Despite efforts from the authorities, there is still limited fiscal space to fund through the budget the large capital programs that underpin Namibia's long-term growth strategy. Consequently, the government is turning to public entities (PE) and public private partnerships (PPPs), which is resulting in a build-up of off-budget commitments and fiscal risks. The government is seeking to develop a framework to strengthen the management and reporting of fiscal risks.

Like many countries, Namibia is exposed to a variety of fiscal risks, which should be analyzed and reported annually in a Fiscal Risk Statement (FRS). Fiscal risks are factors that may cause fiscal outcomes to deviate from expectations or forecasts. Should such risks materialize, they could undermine ongoing fiscal consolidation, public debt would continue to deviate from a sustainable path and recovery of investment grade level would be very difficult.

Identifying, understanding and managing fiscal risks associated with PEs and PPPs is a priority. A comprehensive approach, with an increased oversight role of the Ministry of Finance (MoF), stronger coordination between different government entities, more timely and reliable data and amended legislation is required.

Fiscal risks arising from Public Entities (PEs)

Fiscal risks from PEs materialize when funding requirements are higher than expected or revenues shortfalls occur. This may include the materialization of contingent liabilities, recapitalizations or payments of additional PE subsidies as well as lower dividends, royalties and taxes being received. Delays in restructuring PEs that are not financially viable is depleting fiscal resources. Non-commercial PEs are accumulating arrears and debt, which will ultimately create unavoidable fiscal pressures on the central government. A deterioration in the financial position of certain commercial PEs is contributing to a higher likelihood of fiscal risks materializing.

The government's strategy for managing PE related fiscal risks should be informed by the likelihood of PE experiencing difficulties and, in such an event, the magnitude of the potential impact on the government. A two-step methodology was proposed for assessing the likelihood of fiscal risks materializing from PE. In the first step, key financial indicators would be used to assess the financial soundness of individual entities. In the second step, an in-depth assessment of riskier entities would be undertaken. The assessment found that PE fiscal risks are mainly concentrated in a few entities, which are macro-critical or have government guaranteed debt. To contain these fiscal risks, the authorities should develop mitigation actions. Information on the PE risk assessment should be reported as part of a Fiscal Risk Statement (FRS).

The authorities are considering legislative amendments to strengthen the institutional arrangements for supervising PE. The proposed model, where the shareholding responsibilities for nonfinancial public corporations would vest with the Ministry of Public Enterprises (MoPE), would separate the policy making and shareholding roles of government for these corporations, in line with good international practices. For the other public entities, the ownership function

would continue to be exercised by the relevant line ministry. Further amendments would be required to strengthen financial controls and the role of the MoF in overseeing PE. Within the MoF, responsibility for monitoring all PEs would need to be assigned. Institutional structures to facilitate coordination between the MoF, MoPE, National Planning Commission (NPC), line ministries and PEs should also be established.

Distinguishing between PE that are commercial public corporations and those that are non-commercial government entities, would contribute to improved budgeting, accounting, reporting, decision making and fiscal management. To prevent fiscal risks, non-commercial government entities should not be allowed to run deficits or accumulate debt and should be consolidated into the central government accounts. The MoF should report on debt levels and financial transfers between these entities and the budget. Where commercial public corporations undertake non-commercial public policy activities, these should be transparently reported and not be financed by their own resources. A review of all PEs should be done to establish their continued relevance or whether they should be closed, reabsorbed or divested.

Fiscal risks arising from Public Private Partnership (PPPs)

Namibia has not made extensive use of PPPs and consequently they are not yet a significant source of fiscal costs or risks. However, there are several PPP projects in the pipeline that could change this picture. Thus, early and timely management of fiscal costs and risks arising from PPPs is warranted.

The effective management of PPPs requires a clear process for evaluating PPP projects and a central database of information on direct and contingent fiscal commitments. Namibia will need to develop both. A database with detailed information on existing PPPs, and those in the pipeline, should be compiled and maintained to support decision making. The IMF-World Bank analytical tool, PPP Fiscal Risk Assessment Model (PFRAM), could be used to guide this effort. To evaluate new PPP projects, a six-step assessment process was recommended, which would entail verifying the project rationale, estimating government exposure, confirming the availability of fiscal space, developing risk management and mitigation measures, checking fiscal affordability, and accommodating the residual impact.

The management of PPPs should be integrated into a comprehensive public investment management (PIM) and budgeting process. The PPP unit should focus on regulating, monitoring and managing fiscal risks arising from PPPs, while the function of preparing and promoting PPPs should be housed outside the MoF. Given the ambitious investment program, limited resource envelope, co-existence of multiple actors, and variable institutional capacity, Namibia would benefit from a Public Investment Management Assessment (PIMA).

The legal and regulatory framework should be improved to support a more effective PPPs risk management function. Notably, a ceiling on overall fiscal risk exposure to PPPs should be established, consistent with a broader ceiling for government contingent liabilities. The current revision of the draft regulations of the PPP Act provide a good opportunity to strengthen the legal and regulatory framework.

Table 1. Namibia: Summary of Recommendations

Issue	Short-term (0-12 months)	Medium-term (13-24 months)	Responsibility [†]
Establish an overarching framework for assessing, managing, and reporting on fiscal risks			
<p>Assess and report on government fiscal risks. Limited awareness of contingent liabilities, threatening fiscal sustainability.</p>	<p>Identify principal sources for macroeconomic, fiscal policy, financial, and specific fiscal risks, including from sub-national entities. Undertake initial quantification, scenario and sensitivity analysis. Produce a first FRS as part of the mid-year budget review, with a high-level assessment of the most significant fiscal risks.</p>	<p>Define risk mitigation and management strategies. Produce annually a comprehensive Fiscal Risk Statement reporting in detail on government’s contingent liabilities, PEs, and PPPs. Over time, expand it to provide a more in-depth assessment of other risks. Include in the legal or regulatory framework the requirement to prepare a Fiscal Risk Statement as part of the budget documentation.</p>	MoF
Establish a framework for assessing, managing, and reporting on fiscal risks from PEs			
<p>Assessing fiscal risks from PEs. Appreciation of fiscal risks from PEs limited due to lack of information on entities and limited analytical capacity.</p>	<p>Strengthen information base, analysis, monitoring, management, and reporting of fiscal risks from the largest 10 PEs.</p>	<p>Deepen the understanding of critical entities. Expand the assessment to include more entities.</p>	MoF
<p>Transparent reporting on fiscal risks from PEs. Fiscal risk from PEs are not reported.</p>	<p>Include information on fiscal risks from PEs in the mid-year budget review.</p>	<p>Include a chapter on PEs in a FRS.</p>	MoF, MoPE
Strengthen supporting institutions for managing fiscal risks from PEs			
<p>Supporting legal framework and institutional arrangements. MoF has limited legal powers to exercise supervision over PEs to mitigate fiscal risks.</p>	<p>Enforce oversight powers provided by the existing legal framework. Expand the tripartite agreements and establish institutional structures to strengthen coordination and sharing of information between the MoF, MoPE, policy ministries, and PEs.</p>	<p>Amend the legislative framework to strengthen the MoF’s fiscal oversight role in relation to PEs.</p>	MoPE, MoF, policy ministries, PEs
<p>Supporting institutional arrangements within the MoF. Responsibilities for fiscal oversight of all PEs is not assigned within the MoF.</p>	<p>Assign responsibility for the PEs monitoring function within the MoF and build capacity.</p>	<p>Build capacity through providing training or acquiring the necessary skills.</p>	MoF

Table 1. Namibia: Summary of Recommendations (Continued)

Issue	Short-term (0-12 months)	Medium-term (13-24 months)	Responsibility*
Budgeting, accounting and reporting on PEs. PEs relationship with the government is not reflected in the budget and reporting.	For statistical purposes, classify all public entities in line with GFSM. Report key financial information on government entities in the budget documentation.	Clearly delineate commercial and quasi-fiscal activities of public corporations, and migrate toward funding quasi-fiscal activities through the budget. Ensure that non-budgetary government entities do not accumulate debt.	MoF
Establish a PPP framework for assessing, managing, and reporting fiscal costs and risks from PPPs			
Introduce a process to support informed decision making regarding PPP proposals. Approval process, as required by new PPP Act, has not been implemented yet.	Take stock of existing PPPs and PPP projects in the pipeline, collect detailed data at a project level. Agree on a process to assess PPP proposal (Six-step process could be an option).	Test, adopt and improve the process over time.	MoF, PPP unit
Estimate government exposure Fiscal costs and risks at a project level are not identified and quantified in a systematic way.	Use the PFRAM to identify and quantify cost and risks from existing PPP contracts.		MoF, PPP unit
Check fiscal space No ceilings on PPP are currently in place, which make it difficult to assess PPP proposals	Research and analyze options for ceilings on fiscal risk exposure to PPPs. The PPP ceiling should be integrated with a broader ceiling for government contingent liabilities.	PPP unit discuss PPP ceiling options with the macroeconomic and other departments within the MoF. MoF approves PPP ceiling. Cabinet endorses the PPP ceiling.	MoF, PPP unit MoF, Macroec. Dep. MoF, other Dep. Cabinet
Develop management and mitigation strategies There is no documented strategy for managing and mitigating fiscal risks.	Take stock of current practices in management and mitigation of fiscal risks in PPPs, and discuss them internally.	Recommend general policies for managing and mitigating risks for adoption by the MoF. MOF issues directives with general policies for managing and mitigating fiscal risks in PPPs.	MoF, PPP unit
Check fiscal affordability There is no systematic approach for verifying the long-term affordability of PPPs.	For on-going projects, compile a database on fiscal costs and risks from PPPs, and disclose this information within budget documents. For projects under evaluation, estimate fiscal costs and risks and use this information in the decision process, before the project goes to procurement.	Develop a PPP chapter to be included in the Fiscal Risks Statement.	MoF, PPP unit

Table 1. Namibia: Summary of Recommendations (Concluded)

Issue	Short-term (0-12 months)	Medium-term (13-24 months)	Responsibility [*]
Strengthen supporting institutions to assess and manage fiscal costs and risks from PPPs.			
PPP regulations have not been issued and draft regulations have gaps.	<p>Improve legal and regulatory framework. to support a more effective PPP risk management function. In the context of the revision of draft regulations of the PPP Act:</p> <ul style="list-style-type: none"> • Include general guidelines for contract termination and ceiling to contract amendments. • Provide guidelines for accounting and reporting PPPs in public accounts. • Provide comments regarding the consistency between the draft PFM law, the PPP Act and its upcoming regulations. 		MoF, PPP unit
PPP process is not integrated with the PIM and budget process, and roles and responsibilities are not clear.	<p>Reinforce institutional arrangements Separate monitoring and promotion function for PPPs, assigning the promotion function outside the MoF.</p>	<p>Evaluation of new PPPs should be aligned within the PIM framework and budget process Clarify roles and responsibilities of main actors assessing PPPs.</p>	MoF

I. FISCAL VULNERABILITY IN NAMIBIA

A. Background

1. Namibia has experienced a period of strong growth and economic stability, but faces policy challenges and structural issues. This growth was partly supported by a transitory expansionary fiscal policy, notably the construction of large mines and dynamic public investment. In 2016 real growth slowed down to 1.0 percent, while the fiscal deficit increased from 4.3 percent in 2014/15 to 10.3 percent of GDP in 2015/16.

2. The authorities reacted to the fiscal deterioration with a consolidation program, but the fiscal deficit and debt remain high, compromising Namibia's sovereign credit rating. Although reductions in non-wages current expenditures and public investment were implemented late in the fiscal year, high levels of budget inflexibility and persistent wage and capital spending pressures continued. The stock of public debt reached 44.2 percent of GDP, including NAD3.9 billion in domestic arrears (2.4 percent of GDP), increasing gross financing needs. The complexity of the economic and fiscal context, including expectations of a decline of SACU (Southern African Customs Union) revenues, persistent high fiscal deficits, and a public debt expected to approach 70 percent of GDP by 2022, underpinned Moody's and Fitch decision to lower Namibia's sovereign credit rating to below investment grade.

3. Considering the high debt levels and fiscal adjustment needs, there is limited scope for the public sector to finance the large capital programs that underpin Namibia's long-term growth strategy. The 5th National Development Plan (NDP5), to be implemented between 2017/18 to 2021/22, under its *Economic Progression Pillar*, includes an ambitious program for the expansion and modernization of physical infrastructure. The investment plan includes resources from the development budget, PPP, PE, and even private investments. High impact programs, that even transcend the national sphere, such as the contribution to the Southern African Development Community's (SADC), the Regional Integrated Strategic Development Plan (RISDP) and the transformation of Namibia into a Logistical Hub by investing in Trans-Kalahari, Trans-Kunene and Trans-Zambezi transport corridors, are included in the capital plan.

4. The strategy to overcome the budget's constraints through PPPs and PEs, increases Namibia's fiscal risks and adds to existing explicit and implicit contingencies. Recently, PEs have been used to clear central government arrears. The extra budgetary operations result in PEs paying for Government's arrears via debt, with the Government backing the operations with guarantees.

5. These developments are increasing the fiscal exposure of Namibia, adding to current macro-fiscal and financial risks. An initial quantification of some explicit contingent

liabilities (CL)¹ includes loan guarantees (of which loan guarantees to state-owned entities equate to 4.3 percent of GDP),² guarantees for housing loans to public employees, and PPP guarantees.³ However, the lack of timely and reliable information on contingent liabilities makes the identification, quantification, mitigation, management and reporting very difficult. Inter alia, the publishing of regular annual reports and financial statements as well as legislative compliance by state-owned entities is also poor.

6. The government recognizes the importance of better understanding fiscal exposure and developing a more comprehensive framework to manage fiscal pressures and risks.

They agree with the Article IV mission's recommendation for Namibia to start producing a fiscal risk statement (FRS) as part of the budget process; the recently created PPP Unit in the MoF is particularly interested in developing a framework to manage PPP fiscal costs and risks. The capacity building and training provided during the present mission and this report, constitute the first steps towards the production of a FRS. In addition to describing the potential components of a FRS for Namibia, it focuses on two components, fiscal risks from PEs and PPPs.

B. Fiscal Risks Analysis and Management

7. Fiscal transparency is a critical element of effective fiscal management. It helps ensure that the economic decisions of governments are informed by a shared and accurate assessment of the current fiscal position, the costs and benefits of any policy changes, and the potential risks to the fiscal outlook.

8. The Global Financial Crisis starkly revealed that weaknesses in the countries' Public Financial Management (PFM) framework made countries more fiscally vulnerable. Even among advanced economies, reporting by governments of their fiscal operations and finances was incomplete, as illustrated by the emergence of previously unrecorded deficits and debts. The crisis also demonstrated that, in many cases, countries had substantially underestimated the risks to their fiscal position and prospects, especially those emanating from the financial sector.

9. Fiscal risks are factors that may cause fiscal outcomes to deviate from expectations or forecasts. They can arise from macroeconomic shocks or the realization of contingent liabilities, i.e., obligations triggered by an uncertain event. These can be either explicit liabilities that are legally grounded (e.g., government loan guarantees) or implicit liabilities, where there is

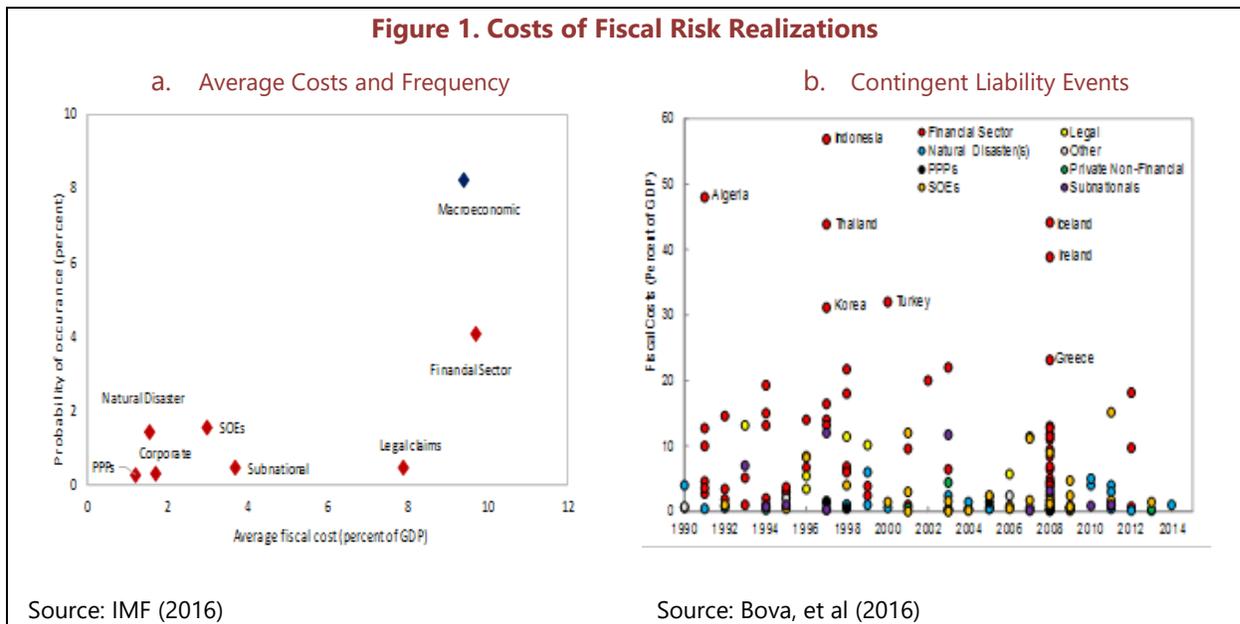
¹ IMF, Staff Report for the Article IV Staff Report Consultation, February 2018.

² Large public entities with government guarantees are public corporations (e.g., Air Namibia and Nampower) and, to a lesser extent, municipalities.

³ Existing PPPs are small both in number and volume (except in the energy sector) and are concentrated in a few sectors (mainly housing).

a public expectation of government responsibility not established in law (e.g., bail out of public corporations).⁴

10. There are, potentially, different sources of fiscal risks, varying significantly in size and frequency. Of the various fiscal risks that materialized over the period 1990 and 2014 (Figure 1), macroeconomic shocks have been relatively frequent, with public finances typically hit by their occurrence every 12 years and an average fiscal cost equivalent to around 9 percent of GDP. Fiscal risks deriving from the financial sector, natural disasters and public corporations were also significant. Specific fiscal risks have showed different patterns of occurrence and costs.



11. To minimize their negative impact on fiscal outcomes, fiscal risks need to be managed. The management of fiscal risks can be divided into five stages (i) identifying the sources of fiscal risks and assessing their magnitude and likelihood of realization; (ii) deciding which mitigating steps should be taken to reduce fiscal exposure; (iii) determining whether to budget or provision for residual risks; (iv) determining whether additional fiscal space is needed to accommodate remaining fiscal risks; and (v) reporting fiscal risks (Box 1).

12. Governments should regularly publish a Fiscal Risk Statement disclosing risks to their fiscal prospects. Comprehensive FRS allows for an assessment of aggregate risk exposures across government, and for the identification of systematic relationships and interactions between risks and possible gaps. It will lead to an integrated approach to manage fiscal risks and strengthened accountability for risk management. It can also promote a better understanding of the true state of the public finances, facilitating better policy responses and stronger support for

⁴ IMF, Analyzing and Managing Fiscal Risks – Best Practices, June 2016.

fiscal policies, ultimately enhancing the credibility of the Government's management of public finances. The FRS should be published at least annually.

Box 1. Outline of a Comprehensive Fiscal Risk Statement

Macroeconomic Risks: Comparison of recent macroeconomic assumptions included in the budget against outcomes; sensitivity of aggregate revenues, expenditures, budget balance, and debt to variations in key economic assumptions; alternative macro-fiscal scenarios, or probabilistic fan charts.

Public Debt: Sensitivity of the stock of debt and debt-servicing costs to variations in key parameters (e.g., interest rates and exchange rates); discussion of debt management strategies; and summary results of debt-sustainability analysis.

Government Lending Programs: A policy framework for lending programs; the stock of outstanding loans in aggregate and by borrower, or borrower category; the purpose of loans; and details of loan performance (including disclosure of non-performing loans, outstanding amounts, or any history of loan restructuring).

Guarantees: The policy purpose of guarantees; intended beneficiaries; total guaranteed amounts (gross exposure); the likelihood that guarantees will be called (where appropriate and feasible) and the associated costs; the history of guarantee calls (i.e., amount of government payments on servicing guaranteed loans); information on any recoveries; guarantee fees; and budget provisions.

Public-Private Partnerships: Details of government obligations under PPPs, both direct commitments and any obligations related to contingent liabilities arising from the risks assumed by the government.

Public Corporations: Any explicit obligations to public corporations not disclosed elsewhere in the fiscal risk statement; the aggregate financial position of the sector; recent financial performance (including information on loss-making entities, and key financial risk indicators); transactions with the government, and quasi-fiscal activities.

State and Local Governments: A summary of recent state and local government financial performance and position, and financial exposures; any explicit obligations of the central government to local governments not disclosed elsewhere in the statement.

Financial System: Any explicit liabilities to the financial sector, not disclosed under guarantees; the size of the financial sector; an assessment of the soundness of the financial system and its regulation, drawing on a comprehensive, accurate and systematic analysis of financial stability.

Natural Disasters: Discussion of the country's exposure to natural disasters; the direct fiscal impact of natural disasters in recent years; allowance for natural disaster-related costs in the budget; a summary of the government's disaster risk management strategy, including catastrophe risk insurance.

Legal Claims: Discussion of any legal claims pending against the state and, where feasible, estimates of gross exposure (such as plaintiff claims).

Other Material Fiscal Risks such as geopolitical or security risks where relevant; the gross exposure of indemnities, warranties, uncalled capital, or a summary of obligations where they cannot be quantified; other fiscal commitments not included in the fiscal forecasts because their timing or magnitude is uncertain.

Source: IMF, Fiscal Transparency Manual (forthcoming), 2018.

13. Fiscal risk reporting should cover both, general macroeconomic risks and specific fiscal risks. An increasing number of countries produce summary reports in the form of a FRS as part of their budget documentation.⁵ The statement usually includes a discussion of past

⁵ Australia, Brazil, Cyprus, Georgia New Zealand, Sierra Leone, South Africa, the Central African Economic and Monetary Community (CEMAC), United Kingdom.

experiences with the materialization of risks, forward-looking estimates for various types of risks, and a discussion of policies to mitigate and manage risks. Box 1 includes an outline of a comprehensive FRS. Evidence shows that not all risks will be relevant for all countries and their relative importance also varies.

C. Namibia: Early Stages of Fiscal Risk Management

14. Namibia has implemented some good initiatives to better manage their fiscal risks.

It recently issued a legal framework for governing public entities and PPPs,⁶ there is an initiative to reform the State Finance Act and to develop a PFM Act; limits on contingent liabilities from loan guarantees have been issued; initiatives to continue strengthening institutional arrangements to manage PE and PPP's such as the creation of the Ministry of Public Enterprises and the PPP unit in the MoF in 2015.

15. However, Namibia is exposed to several macro-fiscal and financial risks that the MoF needs to understand, quantify, and act upon. One of the first steps that should be done to start production of a FRS, is to produce a list of all potential risks. The recent Article IV report identifies a list of FR which can be used as initial input for the FRS (Box 2).

16. If these risks materialize, fiscal forecasts will deviate from the budget, undermining the ongoing adjustment process and delaying the transition of public debt to a sustainable path, reinforcing a vicious cycle. The MoF subsequently needs to perform simulations of different assumptions and economic scenarios, calculate the sensitivities of revenues, expenditures, budget balance and debt to variations in macroeconomic conditions and variables such as exchange rate, interest rate, prices, exports. Scenarios should cover both, negative and improved conditions, simulations and analysis of sensitivities. All these should be presented and explained in the macroeconomic and public debt sections of the FRS.

17. A meaningful assessment of risks related to macroeconomic uncertainties has to be based on realistic and reliable macroeconomic forecasts. A 2017 AFRITAC South TA mission recognized the challenges the MoF is facing in generating such forecasts and provided recommendations for improving the quality forecasting. Developing capacities for macro-forecasting and macro-fiscal risk analysis will take some time and require close cooperation between different units of the MoF and the Bank of Namibia.

18. Other sources of specific fiscal risks are relevant for Namibia, but time will be required to identify and quantify them. The MoF needs to do a stocktaking of alternative sources of contingencies liabilities. Initial analysis in the Article IV has identified the main explicit contingent liabilities as loan guarantees, guarantees for housing loans to public employees, and

⁶ The PPP Act, approved on July 14, 2017, provides a legal framework for PPP projects. It prescribes the creation of the institutional units managing and monitoring PPPs (notable a Public Private Partnership Committee, and the PPP unit in the MoF) and it regulates PPP-relate operations from project initiation, preparation, procurement, conclusion, management through implementation.

PPP guarantees (mainly for local governments). Better understanding, quantification and reporting of these CL, coupled with analysis of historical data, including unexpected deviations from budget estimates, and of current and future conditions with potential fiscal implications to identify additional sources of contingent liabilities of the central government should be the next step. Given that PEs and PPPs have been identified as potential major sources of fiscal contingencies by the Government, the following sections of the report develop methodologies for managing and mitigating fiscal risks that may emanate from them.

Box 2. Macroeconomic, Fiscal Policy and Financial Risks Identified in Article IV and FSAP

Domestic macroeconomic risks: Slower recovery in the mining and construction sectors, sudden corrections in the overvalued housing market, and financial sector vulnerabilities that will amplify the negative effect via macro-financial linkages.

External macroeconomic risks: Declines in SACU revenue if growth in South Africa deteriorates; lower demand for key exports and subdued commodity prices, as China addresses domestic imbalances, protectionist pressures rise, and if growth in trading partners and Angola slows down. Additional risks arise from tighter global financial conditions prompted by rising US policy rates.

Slippages in fiscal policies: A consolidation of about 2 percent of GDP per year is expected. Over the medium term, SACU revenues are expected to decline, in the absence of revenue measures and significant expenditure reduction, the fiscal deficit is projected to continue growing to around 9–10 percent of GDP.

Expenditure measures: Significant reduction in the wage bill, transfers to extra budgetary entities such as PEs, an active prioritization of public investment and increased efficiency of social expenditure. Reduced transfers to PEs, without restructuring the expenditures, including mega projects, that have been shifted to them will result in a financial and fiscal crisis in the PE sector.

Revenue measures: reducing tax incentives and exemptions and eliminating tax loopholes (e.g., under the corporate income tax and the VAT), boosting consumption taxation^{1/}and improving the progressivity of the personal income tax. Improvements in revenue administration could contribute to the fiscal effort.

Public debt dynamics: If fiscal consolidation is not achieved, public debt would continue rising and approach 70 percent of GDP by 2022, and government's gross financing needs would average about 21 percent of GDP per year, creating financing pressures and possible funding risks.

Financial Risks: With weak demand, private sector credit would decelerate, prompting a decline in house prices. With elevated household indebtedness, these developments would negatively affect banks' asset quality and financial intermediation, with strong feedback effects on growth, particularly if negative expectations take hold.^{2/}

Source: IMF, 2018, Namibia Staff Report for the 2017 Article IV Consultation, 2018 Financial Sector Assessment Program (FSAP).

1/ This may require strengthening social transfers to offset possible negative redistributive effects.

2/ The 2018 Financial Sector Assessment Program (FSAP) recommends that risks from banks' concentrated balance sheets, financial institutions' interconnections, and private sector indebtedness be monitored and managed.

Recommendations

Recommendation 1. Develop systematic identification, quantification, analysis, monitoring, management and reporting of central government fiscal risks.

- Identify principal sources for macroeconomic, fiscal policy, financial and specific fiscal risks.
- Undertake initial quantification, scenario and sensitivity analysis.
- Define risk mitigation and management strategies.

- In the short term, produce a FRS as part of the mid-year budget review providing a high-level assessment of the most significant fiscal risks.
- Produce annually a more comprehensive FRS reporting in more detail on contingent liabilities in the central government, PE's and PPPs; over time, expand it to cover other risks.
- Include in the legal or regulatory framework the requirement to prepare a FRS, so that it can be used to inform fiscal policy and budget allocation decisions.

II. PUBLIC ENTITIES AND FISCAL RISKS

A. Background

19. The PE sector in Namibia currently comprises 71 entities⁷ which operate in a range of sectors across the economy. The PEs operating in the energy, transport, communications, water, education, and financial sectors account for more than 90 percent of the entities' assets. PEs provide over 5 percent of total employment in the country. Of the 71 entities, 38 are classified as non-commercial, 22 as commercial, and 11 as financial institutions. The PEs are owned and supervised by several line ministers (termed "portfolio ministers"), with the largest entities falling under the Ministers of Mines and Energy, Works and Transport, Information and Communication Technology, and Finance.

Box 3. Terminology

In Namibia, the term **public enterprises** refers to companies that are wholly or majority owned by the state and other entities established under law or listed in Schedule 1 of the Public Enterprises Governance Act (PEGA). Draft amendments to the PEGA propose distinguishing between commercial and non-commercial public enterprises. **Commercial public enterprises** provide a product or render a service and have the potential to generate a sustainable profit. The remaining public enterprises are classified as **non-commercial**.

The Government Financial Statistics Manual (GFSM) defines **public corporations** as legal entities controlled by the government that are engaged in market production, i.e., that provide all or most of their output at economically significant prices, and which are capable of generating a profit. The basis for determining whether a company is capable of generating a profit is whether the company is able to cover at least half of its operating costs with revenues (excluding subsidies). If a company has been unable to do so for three or more years, it would not be classified as a public corporation for statistical reporting purposes.

According to GFSM, **financial public corporations** are those that are principally engaged in financial sector activities. All other public corporations are classified as **nonfinancial public corporations**.

In this report, **government entities** is used to refer to all entities that are controlled by the government but which do not meet the criteria to be classified as public corporations. The term **public entities** is used to refer collectively to government entities and public corporations.

Source: PEGA Namibia, GFSM

⁷ The number 71 public entities, is based on the current definition, but may change, based on the classification process that is currently underway.

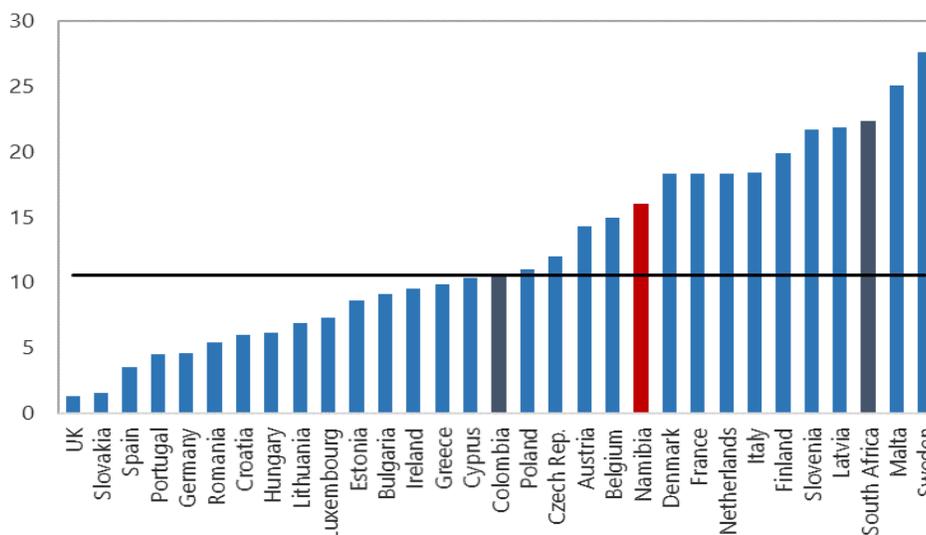
20. The PE sector is sizable and represents an important potential source of fiscal risk (Table 2). According to the latest available financial information,⁸ the total assets of PEs amount to 52 percent of GDP. The total liabilities of PEs amount to 25 percent of GDP, which is significant, but in line with international norms (Figure 2 below). Non-commercial PEs, which are required to be reported as part of the general government (see Section 2.B), account for liabilities amounting to 5 percent of GDP. PEs receive subsidies amounting to about 7 percent of current budget expenditure per year. Loan guarantees provided by government amount to 6 percent of GDP.

Table 2. Namibia: Key Indicators of the PE Sector

	Non-commercial PE	Commercial PEs	Financial institutions
Number of entities	38	22	11
Employees	5,583	11,475	483
Subsidies in percent of current expenditure	4.9	1.7	0.1
Liabilities in percent of GDP	5	16	4
Guarantees in percent of GDP	0.2	3.1	1.7

Source: Authorities and staff calculation.

Figure 2. Liabilities of Non-Financial Public Corporations
(percent of GDP)*



Source: Eurostat, World Bank, and Namibian authorities.

*Latest available data; Namibia data corresponds to non-financial commercial public enterprises.

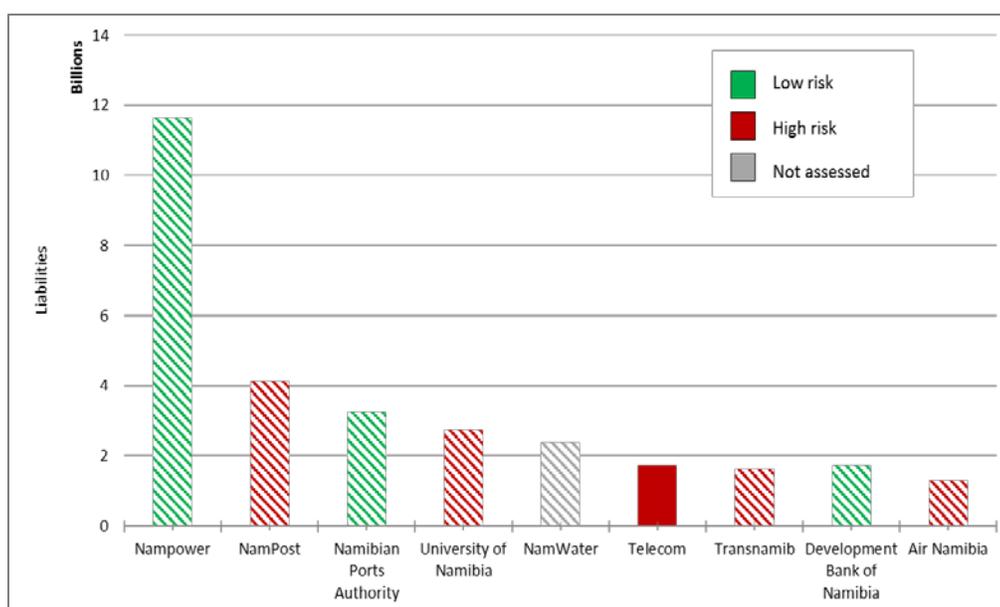
⁸ Data on the PEs, including on their main financial indicators has been provided by the MoPE from the Public Enterprises Management and Evaluation System (PEMES). According to the information provided, the data is based on the latest available annual financial statements of the entities, as follows 2012 (1), 2013 (1), 2014 (6), 2015 (11), and 2016 (31). For 19 entities, financial data was not available.

B. Assessing and Reporting on Fiscal Risks from Public Entities

21. Fiscal risks from PEs materialize when funding requirements are higher than expected or revenues shortfalls occur. Lower dividends and taxes from PEs; an increased need for subsidies or recapitalization, or an unanticipated call on PE related government guarantees, would all result in deviations from fiscal forecasts. PEs may also have an indirect impact on public finances through their influence on the economy. In addition, changes in the valuation of the PE balance sheet will result in changes to the government's net worth.

22. A preliminary, high-level assessment of the fiscal risks of PEs suggests that the risks are mainly concentrated in a few entities, which are macro-critical or have government guaranteed debt. The initial assessment focused on estimates of few key financial indicators of profitability, solvency and liquidity that were based on the most recent financial information available (see below). It shows that at least 5 of the 10 entities with the largest liabilities are likely to pose high fiscal risk (shown in red in Figure 3). These 10 entities account for close to 80 percent of PE liabilities and more than 90 percent of government guaranteed debt (bars with diagonal shading in Figure 3). An in-depth analysis of the high risk and macro-critical entities should be undertaken, examining a wider set of financial ratios, historical trends, forward looking projections and other qualitative factors, identify the risk drivers and potential mitigations. This deeper analysis may result in changes to the risk ratings from the preliminary risk assessment.

Figure 3. Initial High-level Risk Assessment of PEs with Largest Liabilities
(NAD billion)*



Source: Authorities and staff calculations.

* Solid bars indicate PEs with no government guarantees. Diagonal shading indicates that all or a portion of the PE's debt is government guaranteed.

23. Further analysis and additional information, including from meetings with management, provided more insight into the drivers of their financial condition, mainly significant quasi-fiscal operations:

- In 2016, Nampower's financial performance was negatively impacted by higher than anticipated costs of power imported from Mozambique to ensure energy security. The costs are being recovered through adjusted electricity tariffs. The company's performance recovered in 2017.
- Nampost's deposit-taking activities, which provide a cost-effective but short-term source of funding, create a potential liquidity risk. Its ability to weather potential difficulties is limited as the company's level of capitalization is low compared to other deposit taking institutions.
- University of Namibia (UNAM) has substantial debt and is dependent on the government for close to 75 percent of its revenue. Its liquidity deteriorated and arrears accumulated during 2014/15 despite an increase in the government subsidy. Subsequently, this situation seems to have worsened when subsidies were reduced.
- At Telecom, liquidity appears to be a risk with high levels of trade payables relative to cash and receivables and warrants further investigation.
- Transnamib is technically insolvent. It recorded operational losses, because its revenues (including government subsidies) were insufficient to cover its high fixed cost base. The company has accumulated arrears, which are now long overdue.
- Air Namibia has not produced financial reports since 2012. Indications are that the airline is technically insolvent, recording operational losses and having low levels of liquidity. The government is servicing the company's aircraft leases.

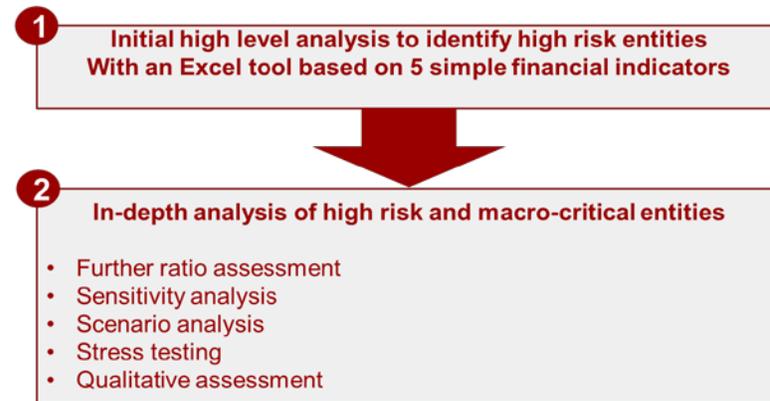
24. Non-commercial PEs are accumulating arrears and debt. This is mainly due to (i) budget cuts that have not been accompanied by a commensurate scaling back of the entities activities, e.g., UNAM; or (ii) the allocation of new policy responsibilities to the entity, without providing adequate funding from the budget, e.g., Namwater.

25. In aggregate, the financial position of commercial PEs is deteriorating, increasing the likelihood of fiscal risks materializing. Contributing factors include, (i) PEs not being able to operate profitably in highly competitive sectors, e.g., Air Namibia; and (ii) PEs being tasked with undertaking large projects, exposing them to significant risk, e.g., Development Bank of Namibia (DBN). While PEs should be driven to improve efficiency by agreeing ambitious, but realistic performance targets, and being held accountable for delivery, non-commercial public policy activities undertaken by commercial PEs on behalf of the government, should be funded directly from the government budget (see Section 2.B).

26. Delays in restructuring PEs that are not financially viable, are likely to cause a continued depletion of fiscal resources. Realistic restructuring plans for Transnamib and Air Namibia need to be concluded swiftly. The credibility of these plans will depend on alignment of policy and fiscal considerations. Similarly, in the energy sector, strategic decisions on the sector's evolution and the role to be played by Nampower are required.

27. The risk assessments shown above were determined using a two-step approach. In a first step, vulnerable entities are identified based on a high-level analysis. In a second step, an in-depth assessment was undertaken for individual high-risk and macro-critical entities (Figure 4). This simple and pragmatic approach, based on the analytical methodology used by rating agencies and financial institutions for assessing the credit worthiness of companies, is a good starting point for Namibia. Over time more sophisticated analyses can be added (see paragraph 31).

Figure 4. Two-Step Process for Assessing Fiscal Risks from PEs



Source: Fund staff.

28. The high-level analysis, based on key financial indicators, provides an initial indication of the likelihood of fiscal risks materializing from individual entities. The five indicators examine the need for fiscal support, and assess the profitability, solvency, and liquidity of the individual PE (Box 4). Financial independence is evaluated on a “yes” or “no” basis. The remaining indicators are assessed as being either (i) sound; (ii) low risk; (iii) moderate risk; (iv) high risk; or (v) very high risk. The assessment of the five indicators is consolidated into an overall risk-rating of the PE as high, medium, or low. The financial information needed for the assessment is taken from the PEs’ annual financial statements. An Excel based tool for a high-level assessment of fiscal risks of individual PEs and the PE portfolio has been provided and ministry staff has been trained on the tool.

29. In the second step, entities that have a high-risk rating and are macro-critical, are assessed in more detail to improve the accuracy of the risk assessment. This in-depth assessment aims to identify the drivers of poor performance and thereby the factors that need to be addressed to achieve a turnaround and reduce risk. Additional quantitative analysis can be undertaken, including the assessment of additional ratios, sensitivity analysis, scenario analysis, and stress testing. Qualitative factors that could be examined include, industry risk, competitive position, and the quality of management and governance.

Box 4. Key Indicators for Conducting an Initial, High-Level Assessment of Financial Soundness of PEs ^{1/}

The high-level assessment is based on the following five key financial indicators:

- **Financial dependence:** Indicates whether the company depends on fiscal support from the Government through subsidies, equity, loans, guarantees to continue operating.

No	Yes
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Profitability

- **Return on equity:**

>15%	8% - 15%	0% - 8%	-10% - 0%	<-10%
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Determines the relationship between profit and equity and indicates whether the company is generating profits and whether these are in line with commercial rates of return. For loss making companies, it indicates how quickly the equity is being eroded.

Solvency

- **Debt ratio:**

<30%	30% - 50%	50% - 80%	80% - 100%	>100%
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Determines the relationship of liabilities to assets and indicates whether the company is solvent (assets are larger than the liabilities) and the degree to which the company is leveraged. Highly leveraged companies have less financial flexibility.
- **Debt to EBITDA:**

<1.5	1.5 - 2	2 - 3	3 - 5	<5
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Determines the relationship between debt to profit and indicates the company's ability to service its debt from operating cash flows.

Liquidity

- **Current ratio:**

>2	1.5 - 2	1.2 - 1.5	1 - 1.2	<1
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Determines the relationship of current assets to current liabilities and indicates the company's ability to meet its short term liabilities using its short-term assets.

Source: Standard & Poor's Rating Services Corporate Methodology and staff analysis.

1/ A broader set of financial ratios should be used for an in-depth assessment during the second step of the analysis.

30. To undertake a more detailed assessment of entities, further information needs to be collected. Line ministries, regulators, local and international industry bodies, and research associations can be useful sources for information on the sector and the competitive environment in which a PE is operating. Discussions with the PEs can assist in gaining a deeper understanding of the current financial situation, as well as their strengths and weaknesses, and the opportunities and threats they face.

31. The likelihood, as well as the magnitude of the potential impact on the government, inform the appropriate mitigating actions. The size of the potential impact is estimated based on the quantum of the PE's outstanding liabilities. PEs with a high-risk rating and a large potential impact, should receive intensive supervision, whereas smaller, lower risk entities require a lower level of monitoring (Figure 5, refer to Annex 1 for additional detail).

Figure 5. Framework to Guide Risk-Based Monitoring and Management of PEs

Impact	Likelihood		
	Low	Medium	High
Small	Limited	Low	Moderate
Medium	Low	Moderate	Close
Large	Moderate	Close	Intensive

Source: Fund staff.

32. The government should regularly publish a FRS, providing an assessment of their PE portfolio. The PE FRS should be published as a chapter of a more comprehensive FRS, at least annually. Such statements typically include (i) details on all direct and indirect support between the government and public corporations; (ii) a report on the overall financial performance of the PE sector; (iii) a fiscal risk assessment; and (iv) a financial analysis of individual macro-critical and high-risk entities. Box 5 summarizes the content of the FRS produced by Georgia. The PE section of the FRS is usually prepared by the MoF, working in collaboration with key ministries or agencies responsible for PE oversight, e.g., the MoPE. The FRS is often complemented by a detailed report on public corporations.⁹ A draft of an illustrative FRS for Namibia is provided in Annex 2.

Box 5. Structure of Georgia’s PEs Section of a Fiscal Risk Statement

Analysis of PEs

- Overview of sector
 - Type of PEs and sectors in which PEs operate
 - Responsibility for oversight of PEs
- Financial relations between Government and PEs
 - Financial transfers
- Quasi-fiscal activities
- Financial analysis
 - Aggregated Income statement and balance sheet of PE sector
 - Key financial indicators
- Fiscal risk assessment
- Analysis of large PEs
 - Summary of financial performance

Source: Georgia Fiscal Risk Statement

⁹ Refer to paragraph 44 for more information on public corporations.

Recommendations

Recommendation 2. Strengthen information base, analysis, monitoring, management, and reporting of fiscal risks from PE.

- MoF to agree information requirements with MoPE for inclusion in the Public Enterprises Management and Evaluation System being developed by the MoPE.
- In the meanwhile, MoF to collect up-to-date annual financial reports and strategic plans, at least for the ten entities with the highest liabilities and any entities receiving government guarantees.
- Undertake a high-level assessment of fiscal risks and a detailed assessment of high-risk and macro-critical entities.
- Deepen the understanding of critical entities and take action to manage and mitigate risks, including implementing restructuring plans.
- Produce risk assessments and mitigation measures for PE, include them in the Fiscal Risk Statement report.
- Strengthen accounting and auditing to ensure the availability of timely and reliable PE information.

Recommendation 3. Include information on fiscal risks from PEs in the FRS, or, initially, in the mid-year budget review. Include an overview of the portfolio performance and a review of each high-risk and macro-critical entity, with details on budget support and transactions with government, quasi-fiscal activities, contingent liabilities, a risk assessment and mitigation measures.

C. Supporting Legal Framework and Institutional Arrangements within Government

33. There are several different institutional models for organizing the three main functions (policymaker, shareholder and fiscal authority)¹⁰ that the government is required to perform in relation to PEs. Under a centralized model, both the shareholder and fiscal oversight functions are located within a central ministry (usually the MoF, or the Prime Minister or President’s office), whilst policy making remains with the line ministry. In a decentralized model, the shareholder and fiscal oversight responsibilities are separated, with the fiscal responsibilities remaining with the MoF. The shareholder responsibilities may be centralized within a single ministry, agency or holding company or vested in different ministries, usually the policy ministry thereby merging the ownership and policy making responsibilities. The OECD¹¹

¹⁰ **Policymaker:** determine policies that apply to the sector in which the public entity operates. **Shareholder:** Ensure the public entity operates efficiently and financially sustainably, whilst maximizing their contribution to the economy. **Fiscal authority:** ensure fiscal sustainability of public entity’s activities. These roles are frequently overlapping.

¹¹OECD Guidelines on Corporate Governance of State-Owned Enterprises, 2015.

recommends that a clear separation be made between the policy making and shareholding responsibilities of government.

34. Currently, Namibia has a decentralized model for overseeing the public entities. The shareholder responsibilities are exercised by line Ministers, with the Minister of Public Enterprises advising the line Ministers. Previously, this role of the Minister of Public Enterprises, was fulfilled by a special Council of Ministers, but this found to be ineffective. Since the Council was done away with, the MoF's role has become very circumscribed, largely being limited to the issuance of contingent liabilities.

35. Amendments are being considered which would establish a hybrid model that separates the policy making and shareholding roles of government. The Minister of Public Enterprises would act as the shareholding minister for all commercial entities. The shareholding responsibilities for non-commercial entities would remain with the relevant line Ministers, with the Minister of Public Enterprises continuing to act in an advisory capacity. This approach provides for the necessary separation of the shareholder and policy making functions in relation to commercial entities and is in line with good international practice.

36. Namibia has a well-developed legal framework incorporating many elements key to sound governance of PEs.¹² The *State Finance Law* governs PFM, including budgeting and the issuance of contingent liabilities. An overarching *Public Enterprises Governance Act* (PEGA) clarifies the roles and responsibilities of the shareholding ministry and establishes a standard framework within which the PEs are overseen and managed. It augments the founding legislation of individual PEs. The PEGA includes provisions relating to the submission of audited financial statements, and business and financial plans (strategic plans), as well as other information to the shareholding Minister and Minister of Public Enterprises. The *Companies Act* specifies the fiduciary duties of company directors and audit requirements which apply to all incorporated public entities.

37. However, the current legal framework does not provide adequate financial controls to enable the monitoring and mitigation of fiscal risks by the MoF. As fiscal risks may arise from any of the PEs, the MoF needs to exercise fiscal oversight over the entire portfolio of PEs. Currently, unlike the MoPE, the MoF does not have statutory powers to obtain the necessary information from PEs to assess and monitor fiscal risks that may be arising.

38. In addition, the MoF lacks many of the key instruments that are helpful for managing identified fiscal risks. Including being jointly involved in approving the strategic plans, setting the performance targets, being a party to the governance and performance agreements, regulating mergers and acquisitions and other major transactions, determining dividends, and appointing and removing board members (see for example Box 6). Rather than

¹² Refer to IMF FAD note entitled "How to improve the Financial Oversight of Public Corporations" for guidelines on the key elements of the SOE law and the financial controls that are typically provided for in legislation.

replicating the ownership function of the shareholder Minister, the MoF's prime focus is on ensuring fiscal sustainability. By jointly exercising these functions (rather than one Minister acting only as an advisor to the other), the two Ministers would act as an important check and balance on one another.

Box 6. Role of the MoF in New Zealand

New Zealand has adopted an institutional model for managing its public entities, where the MoF and the relevant policy ministry jointly agree the performance targets to be achieved with the PE. Public entities are required to submit half-yearly and annual reports to both ministers and may be required to submit other supplementary information. The ministers determine the dividends payable by the PE based on a proposal from the board.

39. Appropriate provisions to strengthen the MoF's role could be included in the PEGA or in the PFM bill. It is important that these powers be embedded in legislation, rather than in regulations or policy statements, to ensure that the MoF has sufficient weight to effectively mitigate fiscal risks, even under adverse circumstances.

40. However, there is weak implementation and enforcement of the existing legal provisions. For example, up-to-date audited annual financial statements are not available for many PEs. This is problematic because comprehensive, clear, reliable, timely, and relevant information on PEs is critical for effective decision making and accountability.¹³

41. Close coordination must be maintained between the MoF and the MoPE, as well as with the policy ministries and PEs. In exercising their respective fiscal oversight, shareholder oversight and policy-making functions, there will be areas of overlap and suitable institutional structures should be put in place. To ensure that each department can effectively exercise its distinct function, whilst eliminating unnecessary duplication (e.g., the collection and analysis of PE information), promoting efficient coordination and agile decision-making, the tripartite agreements that the MoPE is concluding with the policy ministries and PEs¹⁴ could be expanded to include the MoF. Especially important is that all four stakeholders (the MoF, MoPE, policy ministry and PE) work together when developing restructuring plans. In the absence of legal provisions requiring that public entities submit their strategic plans and financial statements to the MoF, it is important that the MoPE collect and share the information with the MoF. The two ministries could pool resources in capturing and analyzing this information, for use in fulfilling their distinct responsibilities; and they should collaborate in producing the report on PE.

¹³ IMF, Fiscal Transparency Handbook (forthcoming), 2018.

¹⁴ These tripartite agreements are intended to govern the relationship between the MoPE, SOE and relevant policy ministry, particularly with respect to assigning SOEs to undertaken quasi-fiscal activities and the compensation thereof.

Recommendations

Recommendation 4: Enforce oversight powers provided by the existing legal framework.

- Enforce existing requirements for PEs to submit audited financial statements.
- Build public sector accounting and auditing capacity to improve the timeliness and reliability of information relating to PEs provided by PEs, shareholder and policy ministries.

Recommendation 5: Amend the legislative framework to strengthen the MoF's fiscal oversight role in relation to PEs.

- Align definitions and procedures prescribed in the PEGA and the PFM bill.
- Expand the tripartite agreements and establish institutional structures to enable collaboration and avoid duplication between the MoF, MoPE, policy ministries and PEs.
- Public entities should be required to submit to the MoF their strategic plans, audited annual financial statements, in-year monitoring reports and any other relevant information required by the MoF to enable the monitoring of fiscal risks from public entities.
- The MoF should be empowered to regulate borrowing, the issuance of contingent liabilities and the sale and pledging of assets by public entities, to limit the implicit contingent liability exposure that this can pose to the fiscus.
- The legal framework should provide the MoF with the powers necessary to manage fiscal risks arising from public entities.
- Eventually, a statutory requirement that public entities must be compensated for any losses associated with quasi-fiscal activities they are required to undertake (see Section E below for more details).
- A legislative requirement for the government to report on public entities in the form of a fiscal risk statement should be provided for in the legal framework. Ideally, the key elements to be reported upon should be specified in law.

D. Supporting Institutional Arrangements within the Ministry of Finance

42. The Asset, Cash and Debt Management (ACDM) department of the MoF currently oversees only seven public entities (financial institutions) reporting to the Ministry. For each of these entities, the department reviews the PEs' reports and prepare an assessment, but this does not include a financial analysis. Regular quarterly meetings take place between these PEs and the MoF. ACDM is also responsible for assessing and maintaining a record of the contingent liabilities that have been issued to public entities.

43. Many advanced and middle-income countries have established a dedicated monitoring unit within the MoF with responsibility for overseeing PEs. Advanced and middle-income countries tend to have a dedicated unit focused exclusively on overseeing PEs. In contrast, in less developed countries, responsibility for PE monitoring, to the extent it exists,

may be assigned to an existing department or be combined with other functions. Typical functions of such units include analyzing PEs' financial plans, setting appropriate performance targets, monitoring performance against quarterly and annual financial reports, and advising on dividend policies and requests for funding.¹⁵

Recommendations

Recommendation 6: Assign responsibility for the PE monitoring function within the MoF and build capacity through the provision of training or acquisition of the necessary skills.

- Acquire or develop experts in financial analysis, corporate governance, corporate finance and law as well as knowledge of the sectors in which the public entities operate.

E. Supporting Budgeting, Accounting for and Reporting on Public Entities

44. Distinguishing between public corporations and government entities when budgeting, accounting and reporting, contributes to better decision making and fiscal management. In Namibia, PEs are currently categorized into (i) non-commercial entities; (ii) commercial entities; and (iii) financial institutions.¹⁶ With some exceptions, the allocation of entities to these categories is largely in line with the GFSM categorization of (i) government entities; (ii) public corporations; and (iii) financial public corporations.¹⁷ The GFSM classification used for reporting of government statistics may differ from how the entities are classified in terms of Namibia's legal framework. Based on the GFSM definition, it may be required that PEs like Air Namibia and Transnamib be classified as government entities for statistical reporting purposes.¹⁸

¹⁵ IMF, FAD, How to Improve the Financial Oversight of Public Corporations, 2016.

¹⁶ The draft Public Financial Management Act includes provisions for the classification of public entities. According to comments provided through AFRITAC South TA, the suggested classification is not sufficiently clear and not in line with international practice.

¹⁷ According to GFSM, corporations are legal entities that are engaged in market production, i.e., it provides all or most of its output at economically significant prices, and capable of generating a profit. The remaining PEs, even if they are legally constituted as corporations, should be reported as part of central government.

¹⁸ Transnamib and Air Namibia have been loss making for several years. Using the financial information over the last 3–5 years, their classification under the GFSM definitions should be reviewed to test whether they have been able to consistently generate revenues (excluding subsidies) to cover more than 50 percent of their operating expenditure (excluding financing costs). If not, they should be classified as government entities for reporting purposes. In the future, if they were to generate revenues that sustainably covered the majority of their operating costs, they could be reclassified as public corporations, as they are market producers.

Government entities

45. To mitigate fiscal risks, government entities should not be allowed to run deficits, accumulate debt or arrears.¹⁹ Since their activities are largely funded from budgetary resources, their debt would have to be covered from transfers and thus represents a commitment of future budgetary resources. Consequently, the government entities need to be integrated into the budget process and be under the same scrutiny as central government budgetary entities. Each entity should be reviewed to determine whether they are undertaking an important public function that the government wishes to preserve and whether there is still a sound rationale for this to be done by a separate legal entity. This would inform whether certain entities could be closed, absorbed back into government or divested. In addition, they need to be consolidated as part of central government in government reports and accounts (see Table 3). This strengthens the control over fiscal outcomes and limits fiscal risks.

Table 3. Namibia: The Attribution of PEs in the Sectors of the Economy^{1/}

General Government Sector	Nonfinancial Corporations Sector	Financial Corporations Sector	Household Sector	Nonprofit Institutions Serving Households Sector
Central government • Budgetary entities • Non-budgetary government entities	Public Corporations	Public Corporations	Private	Private
State governments	Private Corporations	Private Corporations		
Local governments				

Source: IMF, 2014, GFSM.

1/ These are public entities controlled by the government, that are not market producers.

46. Existing debt from government entities should be reported. In the absence of integrated government accounting and consolidated reporting, debt should be disclosed in debt or fiscal policy reports or included in a FRS (see Section 2.B).

Public corporations

47. Public corporations may be involved in policy activities, which are not provided on a commercial basis. These activities are termed quasi-fiscal activities (see Box 7). Some example in the Namibian context include, concessional lending by Agribank, and Nampower providing services at prices that are below cost recovery. In many cases, but not all, the public corporations have received budget funding for such activities. Also, quasi-fiscal activities undertaken by public corporations are not explicitly delineated from their commercial activities.

¹⁹ Like UNAM (See paragraph 23 and Annex 2).

Box 7. Quasi-Fiscal Activities

- **Definition**

- Quasi-fiscal activities are activities undertaken by state-owned enterprises at the direction of the government that are non-commercial or that are not being provided at market prices.

- **Challenges caused by Quasi-Fiscal Activities**

- Quasi-fiscal activities can generate implicit contingent liabilities. For example, if a public financial corporation grants a loan that is not in line with credit limits or that does not have a commercial justification, and a default on the loan could materially impair its profitability and future viability, it might ultimately require a capital injection from the government. Also, quasi-fiscal activities, because they are often not subject to the budget process, impede the process of effective and flexible prioritization of government activities. In addition, absence of a clear distinction between commercial activities and quasi-fiscal activities within a public corporation, makes it harder to measure whether the corporation is running its commercial activities effectively.

- **Typical quasi-fiscal activities**

Common examples for quasi-fiscal activities include utility companies that provide services at prices under cost-recovery levels, and financial institutions that give housing loans at below those prevailing in the market.

- **Legal framework**

Legislated provisions requiring that the cost of undertaking quasi-fiscal activities be fully funded through the budget strengthen fiscal controls are good practice.

Source: Fund staff.

48. To safeguard financial sustainability of public corporations, non-commercial government activities should be clearly separated from commercial activities and funded from the budget.²⁰ International good practice suggests that:²¹

- Commercial activities of public corporations should be required to be financially viable and to provide the government with a return on investment that is in line with private sector conditions; and
- Costs of quasi-fiscal activities undertaken by public corporations that are not covered by revenues related to the activity, should ultimately be transparently included in and funded from the budget.

This enables public corporations to be held accountable for business decisions and their outcomes.

49. The relationships between the government and public corporations should be based on clear processes and rules. This includes a budget process that strictly links the

²⁰ See IMF, 2007, Manual on Fiscal Transparency.

²¹ For more detail on good practice, see IMF, Manual on Fiscal Transparency, 2007; IMF, FAD, How to Improve the Financial Oversight of Public Corporations 2016; and OECD, 2015, Guidelines on Corporate Governance of State-Owned Enterprises.

assignment of non-commercial activities to public corporations to the allocation of budget resources.

50. Governments should regularly publish comprehensive information on any quasi-fiscal activity undertaken by public corporations. This could be included in a report on PEs or in the FRS (see Section 2.B). These reports should transparently reflect any transactions between the government and the public corporation.²²

Recommendations

Recommendation 7. For statistical reporting purposes, classify all public entities in line with GFSM.

- The categorization of PEs for statistical reporting purposes, should be in line with GFSM.

Recommendation 8. Clearly delineate commercial and quasi-fiscal activities of public corporations and migrate toward funding quasi-fiscal activities through the budget.

- The MoF in cooperation with the MoPE should prepare guidelines and issue instructions for separating commercial and quasi-fiscal activities in the public corporations' business and finance plans, and annual financial statements.²³
- In the medium term, the MoF and the MoPE agree financial performance targets with reasonable returns on commercial activities. They monitor the implementation and agree on actions with public corporations in case of underperformance.
- Quantify all quasi-fiscal activities, migrate toward having the costs of these activities funded through the budget and disclose all transfers between government and public corporations.

Recommendation 9. Report key financial information on government entities in the budget documentation.

- The MoF should provide in the budget information on government entities, including on main financial indicators and on their relation to the budget. (Budget 2019/20)
- The MoF should report liabilities from government entities together with debt from budgetary government.
- Consolidate government entities as part of the general government.

²² The government would record financial transactions public in line with IPSAS and the public corporation would according to applicable accounting standards, e.g., IFRS.

²³ The approach used by Lithuania, which could also be applied in the Namibian context where most of the public corporations are already reporting on the basis of IFRS, has been to require that public corporations report on quasi-fiscal activities as a separate operating segment in line with IFRS 8.

Recommendation 10. Ensure that the activities of non-budgetary government entities do not accumulate debt.

- The MoF instructs line ministries and government entities to align government entities' business and financing plans as to ensure that the costs of the entities are covered from own revenues and budget allocations.
- The budget directorate ensure that the business and financial plans of government entities are consistent and that they do not entail a financing gap after transfers included in the line ministry's budget. This includes the resources needed to repay any outstanding loans of the government entity.
- The MoF issues instructions that government entities are not allowed to borrow and monitors their implementation.

III. PUBLIC-PRIVATE PARTNERSHIPS AND FISCAL RISKS

A. Background

51. Namibia has not made extensive use of PPPs to procure public infrastructure.

So far, experience in PPPs is limited to a few projects in the energy, water and sewerage sectors, and to a lesser extent in housing (Table 4). Currently, total investment in PPPs account for only about 0.2 percent of GDP.²⁴ No PPP project has been procured at the central level, with the largest ones been implemented by the energy sector.

52. As of today, the PPP portfolio is not a large source of fiscal costs or risks for government.

Table 5 describes main sources of fiscal costs and risks arising from PPP contracts, and other sources. Until now, most of the PPP projects in Namibia have not required explicit funding from the government budget, and there are no government explicit guarantees provided to private partners. Most existing PPPs have taken the form of user-funded contracts (concessions), except in the water and sewerage sector, where contracts are mostly government-funded (i.e., with annuity payments). However, all PPP contracts, by nature, are exposed to fiscal risks arising from contract termination clauses and force majeure, but it is not clear whether these risks are significant in current contracts.²⁵ In some sectors, such as housing, the Namibian

²⁴ There are other long-term projects related to contract management and land servicing, among others, although they are not necessarily PPPs. Although there is no universally accepted definition of PPPs, FAD typically refer to PPPs as long-term arrangements where the private sector supplies infrastructure assets and services that traditionally have been provided or financed by the government, where the public and private sectors share significant risks, and remuneration to the private is linked to performance. PPPs exclude simple joint ventures, the sale of public assets or of public company shares—which are part of a privatization process—and arrangements in which the private partner is not required to finance investment.

²⁵ At the time of the mission, there is no enough information to estimate these risks.

authorities²⁶ have begun developing standardized PPP contract, as a way to manage fiscal risks arising from legal contract design (e.g., termination clauses). Other fiscal risks, for example, when government's payments are indexed to exchange rate, seem to be marginal in Namibia.²⁷

Table 4. Namibia: PPP Portfolio (as of December 2017)

Projects	Year ¹	Sector	Investment ²	Sources of risks ³	Level of government
Rosh Pinah PV Plant	2017	Electricity	134 M NAD	Termination clauses, force majeure	Public entity
Karibib Solar Power Plant	2017	Electricity	126 M NAD	Termination clauses, force majeure	Public entity
Northern Electricity	1996	Electricity	24 M NAD	Not assessed by the mission	Public entity
Reho-Electricity	2000	Electricity	6.0 M NAD	Not assessed by the mission	Public entity
Goreangab Water Plant	2001	Water& sewerage	0.5 M NAD	Demand, nominal exchange rate, termination clauses, force majeure	Municipality
UNAM, student hostel accommodations	2012	Housing	80 M NAD	Occupancy, termination clauses, force majeure	Public entity
Total			267 M NAD		

Sources: WBG-PPIAF database as of January 15, 2018. This worldwide database is the most comprehensive one currently available on public sector commitments on PPPs. Yet, in some cases it might not be complete and/or projects could be uploaded to the database with some delay.

1/ Year reaching financial closure.
2/ In million national currency.
3/ Risks for the public sector.

Table 5. Namibia: Fiscal Costs and Risks Arising from PPPs

Type	Examples	Impact in main fiscal variables (fiscal deficit & gross debt)
Direct liabilities (fiscal costs) <i>Need for payment is known; yet, there might be some uncertainty about the exact value of the payment</i>	Upfront viability gap payments (e.g., capital transfers)	Expenditures, increase in deficit Increase gross debt (or reduce cash)
	Availability payments (regular payment conditional to availability of services or assets)	Expenditures, increase in deficit Increase gross debt and gov. non-financial assets same amount (construction value of the non-financial asset)
	Output based payments (payments made per unit services)	
Contingent liabilities (fiscal risks) <i>Payments depend on uncertain future events outside the control of the government (occurrence, value and timing is unknown)</i>	Guarantees (e.g. on exchange rate, debt, minimum revenue guarantees)	Expenditure only if guarantee is called.
	Force majeure	No change in gross debt.
	Termination payments	
Other fiscal risks (not identified in the contract)	Governance risks (for example risks that the public investment management framework is not strong enough to guarantee that the project is a good project)	No explicit

Sources: Fund staff and World Bank, "Implementing a Framework for Managing Fiscal Commitments from PPPs," 2016.

²⁶ UNAM projects and city of Windhoek water projects.

²⁷ Yet, these risks are present in very small projects, such as water recycling project at the city and municipal level.

53. There are several PPP projects in the pipeline that could, potentially, increase the size of the PPP portfolio considerably and the risks associated with it. PPPs are envisaged in the energy, housing, water, and to a lesser extent transport sectors. In particular, one large project in the energy sector (135 MW Concentrated Solar Power project) is currently being evaluated, with an estimated investment of 10 billion NAD (about 7.0 percent of GDP).

54. There is no central database that records total fiscal commitments (direct and contingent) under PPPs. The PPP Law, approved in 2017, allows the PPP unit at the MoF to compile data on PPPs; but work on preparing this database is still at an early stage of development. In Namibia, financial information on existing PPP projects is limited, and current budgeting and accounting practices do not support the compilation of data on PPP transactions (see discussion below). In this context, efforts to improve information on PPPs to better manage future fiscal costs and risks are warranted, before increasing the number and magnitude of PPPs.

55. Good practices suggest that countries with a large PPP portfolio (current or planned) should disclose relevant information, for example in their FRS. For example, Portugal has one of the largest PPP portfolios relative to GDP, which was heavily impacted during the 2008 global financial crisis resulting in large fiscal costs for government.²⁸ Similarly, Colombia also revised its reporting practices of all contingent liabilities, including those related to PPPs in the late 1990s (Annex 3).

56. There is no framework to manage fiscal costs and risks from PPPs. Namibia does not have an overarching framework for managing the fiscal risks arising from PPP's or other sources. A strong PPP management function is crucial to delivering a successful "partnership" with the private sector. Government contributions to this "partnership" create different types of fiscal costs and risks, normally referred to as PPP fiscal commitments (Table 5). Inadequate assessment of fiscal cost and risk from PPPs, can bias project selection and prioritization, and can result in a fiscally unsustainable PPP portfolio.

57. Institutions that would support the PPP management function, are still being developed. Effective and efficient PPP management requires institutions, such as sound legal and regulatory framework; clear and effective governance structures; rules and procedures for disclosing information, and capacity for negotiating, assessing and procuring and managing them for the duration of the contract. Namibia has made significant progress in many of these institutions. A new PPP Act was approved in 2017, with corresponding regulation currently being drafted. A PPP unit in the MoF, created in 2015, has the responsibility to support other departments in the MoF by verifying cost-benefit analysis, value-for-money and providing an

²⁸ After the crisis, Portugal significantly improved its reporting of PPP commitments. The budget documents include a clear description of the current stocks on PPPs (liabilities in nominal value, percent of GDP and percentage of government expenditures), current and future payments (both annual nominal amounts and discounted NPV). "Parcerias Público-Privadas e Concessões – Relatório de 2011," MoF, several publications. www.dgtf.pt

opinion about fiscal affordability of new PPPs proposed by line ministries. Yet, several challenges remain, as discussed below.²⁹

B. Establishing a Framework to Manage PPPs Fiscal Costs and Risks

58. In response to a request of the MoF's PPP unit, the mission developed a process for the unit to evaluate new PPP projects and be able to provide an opinion, from the perspective of the MoF, about the viability of these projects. The PPP Law assigns to the PPP unit, the duty of providing an opinion to the PPP Committee, entity responsible for approving PPPs at various stages of the project cycle. The opinion of the PPP unit, despite not being binding, should be mainly focused on fiscal affordability considerations, assessing if PPPs threaten long-term fiscal sustainability and expose the government to excessive risks. The process to inform decision making on individual PPPs, should feed into an integrated public investment and budget framework, as discussed later in the analysis of the supporting institutional arrangements (Section 3.C).

59. A six-step process to evaluate new PPP projects, tailored to Namibia's specific needs, was proposed to support informed decision making.³⁰ To better manage PPPs, Governments need to understand their PPP portfolio and associated fiscal costs and risks; develop tools and techniques for evaluating new PPP proposals; consider appropriate risks mitigation measures, and adopt suitable budgeting, accounting and disclosure practices. The mission proposed a six-step process to evaluate new PPP projects:

- Verify project rationale.
- Estimate government exposure.
- Check fiscal space.
- Develop risk management and mitigation measures.
- Ascertain fiscal affordability.
- Accommodate residual risks.

60. The process can be applied at any government level. At the central government, local governments, PE, and should involve the relevant responsible agencies (e.g., if applied to PEs, the MoPE would be involved). In the following subsections, the report discusses key challenges in implementing the proposed process by a PPP unit based on international experiences, as well as key concerns expressed by the authorities during the mission.

²⁹ At the request of the authorities, the report focused in assessing fiscal implications of PPP contracts (costs and risks). Other topics, such as risks sharing agreements, budgeting, accounting and reporting PPPs in government accounts, and others were discussed with the authorities in the context of a one-day workshop organized during the mission, and follow-up meetings. In particular, accounting for PPPs is discussed in Annex 4.

³⁰ The proposed framework is in line with the principles prescribed by the IMF's Fiscal Transparency Code (2014).

Step 1. Verifying project's rationale

61. The PPP Unit at the MoF is already responsible for the first step of the process, verifying the project's rationale. The PPP unit verifies whether a new PPP proposed by a line ministry or other public entity is in line with national investment priorities, is a good use of public resources (cost-benefit-analysis), and if is the most cost-effective way to procure an infrastructure asset or service (value-for-money). The current mandate of the PPP Unit in the MoF, if well applied, is in line with good international practices. For example, in the case of the 135 MW Concentrated Solar Power (135CSP) project referred earlier, the PPP unit with Nampower are currently analyzing the potential fiscal implications of alternative options for project design and financing.

Step 2. Estimating government exposure

62. The second step is identifying and estimating fiscal costs and risks implied in a project structure and the likelihood of these risks materializing. Which costs and risks are borne by the government, and which are transferred to the private partner? Which are the triggers for fiscal costs and risks to materialize in the short-term? What is the probability of them materializing (likelihood)? The PPP unit has assessed in recent years PPP projects, but on an ad-hoc basis, which generates significant challenges in understanding the overall government exposure to PPPs.

- All PPP projects, whether financed by the government or users, generate fiscal costs and risks.³¹ The main fiscal costs and risks are summarized in Table 5. In the case of government-funded³² PPPs, the main sources of risks occur in flows and stocks;
- Projects comprise payments, e.g., viability gap, availabilities, output-based payments that are typically recorded as government expenditures (flow effect); and
- Increase government gross debt by an amount equal to the construction cost of the related asset, e.g., road, hospital (stock effect).

Government-funded PPPs can also create contingent liabilities for government:

- They can generate fiscal risks arising from contract clauses, like those related to force majeure and termination payments.
- Additional sources of fiscal risks result from the inclusion of government guarantees to the private partner (e.g., guarantees for private partner's debt, minimum revenue guarantees).

³¹ For a detailed discussion on accounting for PPPs, refer to Section 3.c and Annex 4.

³² Government-funded PPPs are contracts where the government pays back the private partner through fixed or variable routine payments over the life time of the project. Government payments can take different forms such as viability gap, availabilities, output-based payments.

63. A common misconception is to believe that user-funded PPPs generate fiscal risks, but not fiscal costs. User-funded projects³³ typically do not require government payments during operation, and they might even generate revenues for the government if royalties are agreed in the contract. As all other PPP, user-funded PPPs are exposed to risks related to force majeure, termination payments, and guarantees if applicable. However, modern international accounting standards prescribe that, under certain conditions, user-funded PPPs also generate fiscal costs (Section 3.C).

64. No systematic assessment of fiscal costs and risks of Namibia's PPP portfolio has been performed so far. Although the size of the PPP portfolio is very small, the PPP unit is aware of the need to have a systematic process to assess future PPP projects in the pipeline. During the mission, the analytical tool *PPP Fiscal Risk Assessment Model* (PFRAM)³⁴ was used to assess two projects in Namibia, one in operation (UNAM's hostel student accommodations) and one at the concept level (the CSP 135 MKW plant being promoted by Nampower).³⁵ Annex 5 summarizes main features of the PFRAM.

65. The PPP unit should consider applying the PFRAM to estimate the government exposure to existing and future PPPs. The PFRAM could be applied to assess the list of projects included in Table 4. This would provide an estimation of the macro fiscal costs from PPP projects —i.e., their impact on the fiscal deficit, gross and net debt, and stock and flows of contingent liabilities for government.

66. Once project risks are identified, the PFRAM allows estimation of the fiscal impact for each risk, using alternative evaluation techniques, including the likelihood of those risks materializing. The quantification of the fiscal impact depends on the type of fiscal cost or risk, and to what extent the analysis incorporated the probability of occurrence or likelihood. Table 6 summarizes examples of different methods to quantify fiscal implications of PPPs based on international experience, and Annex 6 details the experience of Chile.

- When likelihood is not considered, or the future event is regarded as certain, fiscal costs and risks are estimated at maximum exposure (face value).
- If likelihood of the risks materializing is considered in the analysis, fiscal exposure is estimated as fiscal impact times likelihood.

Both maximum exposure (face value) and expected fiscal exposure (weighted by likelihood) are important measures to fully understand the overall fiscal implications of a PPP project.

³³ User-funded PPPs are contracts where the private partner recoups its investment, operating costs, and a profit margin, through direct payments by users of the assets and/or services (e.g., road tolls).

³⁴ The PFRAM, developed by the IMF and the WB, is based on international accounting and statistical standards (IPSAS32 and GFSM2014), as well as in good practices in assessing project risks.

³⁵ The assessment was done with readily available information provided by the authorities with the purpose of training them on the use of the tool.

Table 6. Namibia: Assessing Fiscal Costs and Risks from PPPs

Type	Example	Fiscal impact	Likelihood
Fiscal costs	Gap viability payments Availability payments Output-based payments	Present value of annual payments over the project life	Certain, probability=1
Fiscal risks	Guarantees	<u>Scenario analysis:</u> Present value of estimated annual payments (baseline)	Under alternative scenarios for main risk trigger variables (e.g. GDP, inflation)
		<u>Probabilistic analysis:</u> Expected value of estimated annual payments	Stochastic simulations modeling changes in risk trigger variables (e.g. GDP, inflation)
		<u>Option-valuation techniques:</u> Estimate probability of default	Structure model
	Termination payments	Maximum value of termination payment under baseline assumptions	Contract dependent

Sources: Fund staff and World Bank, "Implementing a Framework for Managing Fiscal Commitments from PPPs," 2016.

67. In Namibia, the PFRAM could be used as an starting point to assess fiscal impact and risks likelihood of large PPP projects in a simple way. International experience suggests that simpler, more intuitive methodologies are the best options for estimating fiscal costs and risks from PPPs. Scenario analysis tends to be the best option. Probabilistic and more complex techniques require a significant amount of data on the underlying variables triggering risks (long-term series, assumptions of steady state levels, etc.). As a result, they can be difficult to implement and interpret, reducing the credibility of the analysis. In practice only a few countries use sophisticated analysis to access risk exposure to PPP portfolio.

Step 3. Checking fiscal space

68. The third step is checking whether the project under evaluation can be accommodated within a established ceiling for the overall PPP portfolio. This step requires comparing the fiscal costs and risks of the new PPP project estimated in the second step, against the established PPP ceilings. By doing that, fiscal space is assessed, e.g., whether the expected fiscal costs and risks from this project can be accommodated within a preexisting ceiling. These limits, while not a substitute for medium-term planning, budgeting and a strong public investment framework, can help contain fiscal risks and limit overall government commitments for PPPs to levels that are fiscally affordable.

69. Namibia does not have a specific ceiling for the government’s fiscal exposure to PPPs, which makes the assessment of new PPP projects difficult. The existing ceiling of 10 percent of GDP set by law, only refers to government’s loan guarantees. As such, it would not cover all contingent liabilities arising from PPP contracts, particularly those that are not in form of

guarantees. As discussed above, PPP involve other contingent liabilities beyond guarantees, such as termination payment. Moreover, the overall government exposure to PPPs goes beyond contingent liabilities. It includes also fiscal costs, such as government payments in the case of government-funded PPPs and firm liabilities when the PPP-related assets are regarded as public assets (see Table 6 and Annex 4).

70. Setting the PPP ceiling is a technical decision within a policy discussion and requires political support. As such, it needs to be grounded on a comprehensive macro-fiscal model and, at the same time, have a high level of political endorsement (e.g., Cabinet). The public entity responsible for monitoring compliance with the ceiling (i.e., PPP unit at the MoF) can participate in the process of designing and discussing an adequate PPP ceiling for Namibia. However, to avoid potential conflict of interests, should not be assigned the role of setting it. This responsibility needs to be given to a different unit in the MoF.

71. There is no simple benchmark for setting PPP ceilings, but international experience suggests that they should have the following key features. They should: have a broad coverage (both in terms of transactions and entities covered); be legally grounded; easy to communicate and monitor; be linked to main macro-fiscal concerns (i.e., debt sustainability, liquidity); be commensurate to the country's PPP portfolio structure and future project pipeline; and be consistent with short, medium, and long-term fiscal targets. Annex 7 discusses in detail these key features of PPP ceilings and summarizes some international experiences.

72. Given Namibia's macro-fiscal concerns as well as the magnitude and composition of the PPP portfolio, a potential PPP ceiling could have the following key features:

- **Coverage:** It should cover all PPPs, regardless of their funding structure (i.e., both government-funded and user-funded PPPs);
- **Integrated to existing ceiling on contingent liabilities:** Consideration should be given to (i) maintain the existing ceiling on loan guarantees; (ii) extend its coverage to include all government contingent liabilities, including PPPs; and (iii) clearly identify a "sub-ceiling" within the overall ceiling for PPPs. By doing so, PPPs would compete—instead of add—to other sources of fiscal risks, while keeping the level of the overall fiscal risk exposure.
- **Target:** Ceilings should target the main macroeconomic concern of the country: public debt sustainability and/or capacity to repay. Given that public debt sustainability is the main concern in Namibia at this time, and that existing PPP are mainly user-funded, it would make sense to set a PPP ceiling on the stock of total fiscal costs (direct liabilities) and risks (contingent liabilities) as percent of GDP. However, if in the future the PPP portfolio would largely comprise government-funded PPPs, concerns about the capacity to repay could justify adding a second layer to the PPP ceiling. If that is the case, a ceiling on total government payments related to PPPs as percentage of total revenues, could also be considered.
- **Valuation:** To maintain simplicity and given capacity constraints in Namibia, ceilings should be set on maximum exposure of total costs and risks from PPPs, while accompanied by a

sensitivity analysis to changes in main risks drivers (e.g., GDP, triggers for contract termination).

- **Disclosure:** Both maximum exposure and sensitivity analysis should be disclosed together with the budget documents.

73. Once a PPP ceiling is designed and a level determined, a process to manage the available fiscal space needs to be agreed. Particularly, if a new PPP project exceeds the existing fiscal space (headroom), a decision should be made about how to proceed. Options are: (i) postponing the new PPP project and accommodate it as is further in the future; (ii) requesting the procuring entity to redesign the contract so that it fits the ceilings; or (iii) withdrawing the government support for the PPP project. Every PPP proposal should follow the same process. Afterwards, all proposals should be consolidated to calculate the impact on the PPP portfolio of new projects. Such management of the PPP portfolio is precisely what PPP ceilings could be expected to bring about, to optimize the government's capacity for absorbing risk. An example of how Colombia manage the fiscal space for PPP commitments in the context of the MTFF is detailed in Annex 8.

Step 4. Developing risk management and mitigation measures

74. The fourth step comprises developing a comprehensive strategy for fiscal risk management and mitigation. It entails the determination of who will absorb the costs and risks if they materialize, what is the process to manage them, and what kind of mitigation tools are available (e.g., budget provision, contingency reserves). General principles for managing fiscal costs and risks from PPPs should be included in the regulations supporting the PPP Law. In turn, for managing risks arising from specific contract structures, collaboration between implementing and monitoring entities will be necessary (i.e., line ministries, public entities, PPP unit, regulators).

75. Currently, Namibia does not have a documented strategy for managing and mitigating costs and risks from PPPs, but some general practices are emerging and practices in some sectors are relatively standardized. Given that the authorities are currently developing the regulations of the PPP Act, this could be an opportunity to discuss and standardize these practices, including them in the regulations (i.e., existing contracts on the water sector have a standard indexation clause).

76. Mitigation strategies should be implementable; thus, it is necessary to establish a clear intervention process if large fiscal risk materialize. A clear process should be in place to trigger mitigation actions promptly, to either provision in the budget, adjust contract or abandon the project. Interventions should be standardized to the extent possible. Some countries have introduced mechanisms to reduce risks, such as creating additional budget flexibility by including a contingency reserve in the budget that can be used to meet calls on contingent liabilities. Other countries have insured against the need to make such payments by creating a fund upfront from which contingent liabilities will be paid if materialize (see Annex 8 for the case of Colombia).

Step 5. Checking fiscal affordability

77. The fifth step is to consider the fiscal affordability of a new PPP project. In a scenario in which fiscal costs and risks materialize, determine to what extent would it be possible to meet required payments from the line ministry's budget or estimated expenditure envelopes. This assessment comprises comparing the estimated annual costs of PPPs, both direct and contingent, with the annual and medium-term budget ceilings of the procuring entity.

78. To effectively manage fiscal risks, new PPPs should be assessed within the budget process and MTF. Cash-based budget systems, like in the case of Namibia, do not fully capture fiscal implications of multiannual projects and long-term contracts. The annual budget and the medium-term expenditure framework cover three years and capture only those commitments falling into this three-year period. Large investment projects, and in particular PPPs, often entail commitments that reach far beyond this horizon. In Namibia, PPPs are not reflected in budget documents, unless they require budget cash appropriations. However, most PPPs so far have been user-funded, thus fully off-budget.

79. Budgeting for fiscal costs and risks arising from PPPs can be challenging. In the case of government-funded PPPs, budgeting for future government payments (e.g., availability) is relatively straight forward, since the timing and approximate value of the payments are known. However, in the case of user-funded PPPs is more challenging, and would mostly depend on whether the budget process can accommodate long-term commitments. Box 8, describes options for budgeting long-term commitments from PPPs.

80. Given that significant changes in budget procedures are not in the horizon, the government should make explicit the fiscal costs and risks of PPPs before procuring a contract, and disclose this information with the budget documents. To capture existing and newly proposed long-term commitments for government, the projects should be presented openly in the budget documents.

Box 8. Budgeting for long-term PPP Commitments

Three possibilities to budget for long-term commitments arising from PPPs can be considered:

1. A medium budget framework that treats PPPs in the same way as publicly financed projects. In doing so, it ensures that PPPs require the same approvals in the budget and budget plans as publicly financed projects.
2. Commitment budgeting, in which the legislature approves not only the government's cash expenditures in the budget year, but also the future commitments to spend money in later years.
3. A two-stage budgeting process, in which all projects must first be approved in budget planning on the assumption that they will be publicly financed, and only then a decision is made about the financing method.

Source: Funke, Irwin, Rial, International Transport Forum, OECD 2013.

Step 6. Accommodating residual impact

81. The last step is to identify the residual impact of the PPP project on main fiscal aggregates (i.e., expenditure composition, deficit and debt) and determine potential policy

actions. If PPP fiscal costs and risks materialize, and following national budgeting, accounting, and reporting practices cannot be accommodated within the line ministry's existing budget, additional policy actions should be triggered (e.g., increase in taxes, or reduce other expenditures, if a higher deficit is not a policy option). If the value of residual risks is too large to be accommodated under current policies, the project might need to be reconsidered, or even abandoned.

Recommendations

Recommendation 11. Introduce a process to support informed decision-making in assessing fiscal costs and risks of PPPs. The proposed six-step process detailed above could be considered as a starting point. The process introduced should be linked to an integrated public investment and budget framework.

- Take stock of existing PPPs and PPP projects in the pipeline, and collect detailed data for each project. (MoF, PPP Unit).
- Agree on a process to assess PPP proposals. (MoF, PPP Unit).

Recommendation 12. Estimate the government's exposure to fiscal risks and costs from the current PPP portfolio. Fiscal costs and risks at a project, and portfolio level should be identified and quantified in a systematic way.

- Use the PFRAM to identify and quantify costs and risks from existing PPP contracts. (MoF PPP Unit).

Recommendation 13. Design a PPP ceiling, against which PPP proposals can be assessed. So far, the current ceiling on contingent liabilities does not specifically address PPPs, which makes it difficult to assess project proposals.

- Research and analyze options for ceilings on fiscal risk exposure to PPPs. The PPP ceiling should be integrated with a broader ceiling for government contingent liabilities. (MoF, PPP Unit).
- Discuss PPP ceiling options within relevant departments in MoF (MoF, PPP Unit, Macroeconomic Department, others).
- Approve PPP ceiling, and present to Cabinet for endorsement. (MoF, Cabinet).

Recommendation 14. Develop and approve a risk management and mitigation strategy for fiscal costs and risks arising from PPPs. So far, there is neither a documented strategy to manage PPPs, nor a predetermined set of mitigation measures to implement in case that risks materialize.

- Summarizes current practices in managing and mitigating fiscal risks in PPPs, and discuss them internally (MoF, PPP Unit).
- Approve an overall strategy for managing risks from PPPs and identify potential mitigation measures (MoF).

- Issue directives with general policies for managing and mitigating fiscal risks in PPPs (MoF, PPP unit).

Recommendation 15. Check fiscal affordability of PPP proposals by comparing estimated fiscal costs and risks against the fiscal envelop of the corresponding procuring entity. The PPP Unit, in collaboration with the procuring entity promoting the project, and other divisions within the Treasury (budget, ACDM) should check that, if risks materialize, they can be accommodated in the medium to long-term fiscal framework of the procuring entity. To do this, information for on-going and proposed projects should be collected and used to improve the decision-making process.

- For on-going PPP projects, compile a database on fiscal costs and risks from PPPs, and disclose this information within budget documents.
- For projects under evaluation, estimate fiscal costs and risks of PPP, and use this information in the decision process, before the project goes to procurement stage.
- Develop a PPP chapter to be included in the Fiscal Risks Statement.

C. Strengthening Supporting Institutions

82. To implement the proposed framework for managing fiscal costs and risks from PPPs, supporting institutions should be in place. These include a supportive legal and regulatory framework, strong institutional arrangements, and transparent accounting and reporting practices. This section discusses strength and weaknesses of Namibia’s supporting institutions.

Supporting legal and regulatory framework

83. To support an effective risk management function, PPP laws and/or regulations should entail and reflect the following features: (i) a clear definition of PPP and their scope; (ii) a full integration of PPPs into the government’s overall investment strategy, medium-term fiscal framework, and budget cycle; (iii) a clear assignment of the budgetary authority’s role and responsibility to safeguard public finance against fiscal costs and risks from PPPs; (iv) transparent mechanisms for competitive processes; (v) explicit guidelines for conclusion, renegotiation, and termination of PPP contracts including dispute resolution mechanism; (vi) standard mechanisms in place to facilitate project finance; (vii) limits/ceilings on aggregate public sector PPP exposure; and (viii) transparent accounting, reporting, and auditing procedures in line with international standards.

84. Namibia published the Public Private Partnership Policy in 2013, and approved the Public Private Partnership Act in 2017.³⁶ The policy outlines the objectives, key principles, definitions, benefits, procuring process, and roles and responsibilities of all stakeholders involved

³⁶ FAD commented on the Act in December 2017, after the Act had been approved. The comments had been shared with the AFR and the authorities.

in PPPs. The regulations of the Act, currently being drafted, will come into effect at the beginning of the 2018/19 budget year. At the same time, a Public Financial Management Act is currently has been drafted and is under revision.

85. The PPP Act and related regulations follow—to a certain degree—good international practice; but it can be strengthened to support a more effective PPP risk management function.³⁷ The report focuses in those areas that are relevant from the standpoint of building a stronger and more effective PPP risks management function. The mission did not review the draft PFM Bill to check consistency between the key legislative pieces regulating PPPs (Public Procurement Act, the PPP Act and the draft PFM Bill). The PPP unit should consider reviewing the draft PFM Law to ensure consistency between the PPP Act, its upcoming regulations.

86. Important aspects related to contract termination are not covered by either the Act or the draft regulations. There are no guidelines or general principles for procuring agencies to follow, leaving contracts to rule on case-by-case basis. Namibia is particularly vulnerable to this, given that contract termination is one of the largest sources of risks in PPP contracts. A PPP law should state the general principles for termination of a PPP contract and provide for a list of possible grounds for termination. While this list would be non-exhaustive, it would set the ground for termination causes from the private sector side (e.g., serious breach or failure of private partner) and the public sector (e.g., public interest). Consideration should be given to include some general guidelines for contract termination in the context of the revision of draft regulations.

87. Similarly, the legislation does not provide limits to amendments to PPP contracts after awarding. Good practices suggest that amendments to the PPP contracts following contract awarding should be permitted, but always within a limit, as a way to avoid renegotiation. Small changes to original contracts might be necessary to cover for a wide variety of contingencies. However, beyond a reasonable threshold, contract amendments might change original risk sharing agreement, and implicitly result in a new contract being procured in a non-competitive way. Countries have included ceilings to PPP contract amendments to limit government exposure, on average in a range of 5–15 percent of the construction costs of the PPP-related asset. Considerations should be given to introduce ceiling to contract amendments in the context of the revision of the draft regulations and simulations should be done by the authorities to estimate potential ceilings.

88. Finally, current legislation does not provide guidelines in terms of accounting and reporting of PPPs in the public accounts. The way PPPs are accounted for and reported in the government's accounts is an important factor contributing to fiscal transparency, and ultimately, to the ability of the government to manage them. The legal framework should include—or refer

³⁷ Comments to the Act have been provided to the authorities in the context of the 2017 Article IV Consultation Report, while comments to the draft regulations were discussed during the mission and are being shared as a separate document.

to—clear procedures for accounting and reporting PPP-related operation in the government’s accounts, including future flows and contingent liabilities. While international standards should serve as benchmarks for national accounting (Public Sector Accounting Standards (IPSAS)) and reporting practices (IMF’s Government Finance Statistical Manual 2014 (GFSM 2014)), most countries are not yet applying these standards. To ensure transparency around PPPs, the legal framework could require full disclosure of current government commitments (including guarantees) and expected budgetary costs of existing PPP contracts.

Supporting institutional arrangements

89. A PPP unit was established under the MoF in 2015. The unit’s core functions are to (i) provide analytical support to the MoF; (ii) assist in issuing regulations; (iii) assist public entities in preparing and taking PPP projects to the market; (iv) ensure consistency in the project preparation and the evaluation processes with requirements of the PPP policy; and (v) promote PPPs within the Government.

90. The PPP unit is involved in overseeing and promoting PPPs, which are two conflicting functions. Control and promotion functions related to PPPs should be separated and the MoF should be focusing on the oversight, i.e., on assessing, controlling, and managing firm and contingent fiscal implications of PPPs.

91. The PPP Act legislates the creation of a PPP Committee, which approves PPP projects at various stages. The Minister nominates the seven members of the committee and the presiding member has a deliberative vote. The committee approves projects (i) after feasibility assessment; (ii) before issuing request for qualification; (iii) before issuing request for proposal; (iv) evaluation of bids; and (v) the PPP agreement. An additional approval is required for amendments to the PPP agreement. This approval process is not linked to the PIM and budget process, it should.

92. The PPP process should be integrated with the budget and the PIM process, with a clear delegation of the mandate of the different stakeholders. The process introduced by the PPP Act runs in parallel to the PIM process and outside the budget cycle.³⁸ However, PPPs often cause important firm and contingent commitments, which must be provided for in the budget. To allocate resources efficiently and in line with government priorities, decisions on all public investment projects, including PPPs should be taken through an integrated PIM and budget process. In this process, the role of the MoF should be clearly delineated from the line ministries’ role to promote policies and project, and the policy coordination role of the National Planning

³⁸ In Namibia, PPP projects can be appraised, selected and approved through by a parallel process to that of regular public investment projects, which is not aligned with good practices.

Commission (NPC). Figure 6³⁹ illustrates an integrated framework, reflecting the roles and responsibilities of the key stakeholders. Given the ambitious investment program, limited resource envelope, co-existence of multiple actors and level of institutional capacity, Namibia would benefit from a Public Investment Management Assessment (PIMA).⁴⁰

93. Decisions within the PPP approval framework are supported by the risks assessment steaming from the six-step process (as defined in Section III.B). The decision on whether to move forward with a PPP project at the different gateways is informed by the assessment of a project's firm and contingent fiscal implications, which is undertaken through the six-step process described earlier in this chapter. This assessment should be updated or repeated as the project moves from appraisal, though selection and to implementation.

³⁹ The VFM analysis under the project proposal and project appraisal stages are done with different set of data. The first one with preliminary data, the second one with more solid project information. Therefore, they are not different in nature, but in the quality of the data they are based on.

⁴⁰ The PIMA is a tool designed by the IMF, FAD to evaluate fifteen key institutional aspects representing three stages of the public investment cycle: (i) planning sustainable level of public investment, (ii) allocating public resources to the right sectors and projects, and (iii) delivering productive and durable public assets. The PIMA provides a summary of the strengths and weaknesses and targeted recommendations in a sequenced reform action plan.

Figure 6. Illustrative Integrated PPP Appraisal and Approval Process

	Implementing Institution (II)	Ministry of Finance (MoF)	National Planning Commission (NPC)	Council of Ministers (COM)
Project proposal	II prepares project Project Information Note (PIN) indicating whether the project would be envisaged as a PPP and submits for approval to the NPC	MoF assesses PIN for viability and affordability , and indicates whether a PPP might provide VfM	Based on the PIN, NPC assesses project for compliance National Development Plan (NPC)	
		MoF provides opinion on the project, based on assessments from MoF		
Project pre-selection	II includes project in its budget proposal to request allocations for further studies (appraisal)		NPC includes project in II development budget for further study	COM approves budget including public investment projects suggested for appraisal
Project appraisal	If project was approved, II prepares feasibility study (FS), including a value for money (VfM) assessment if a PPP is considered	MoF assesses FS for viability and affordability , and VfM	Based on the FS, NPC assesses project for compliance with NDP	
Pipeline of appraised and approved projects		Gateway 1: In case of a positive assessment, MoF includes the project in the project pipeline		
Project selection	II includes project in its budget proposal	MoF assesses budget proposal (current and development budget) for consistency, viability and affordability	NPC includes projects in development budget if for compliance with NDP and development budget envelope	
Budgeting		Gateway 2: In case of a positive assessment approves budget including PPP		COM approves budget including new public investment projects
Project procurement	II prepares tender	MoF reviews tender documents and assesses viability, affordability and VfM	Based on the tender documents, NPC assesses project for compliance with NDP	
		Gateway 3: In case of a positive assessment of the tender documents, PISC approves project for tendering		
Procurement contract	II prepares contract with preferred bidder	MoF assesses draft contract for viability, affordability and VfM	Based on the draft contract, NPC assesses project for compliance with NDP	
		Gateway 4: In case of a positive assessment of contract, MoD/NPC approves contract for signature		
Project implementation	II implements project with selected bidder, II is responsible monitoring and managing project implementation	MoF monitors project implementation and assesses and manages fiscal risks	NPC monitors performance in relation to NDP	
Project amendment / renegotiation	II suggests changes to project / contract	MoF assesses suggested changes to contract for viability, affordability, and VfM	MoD/NPC assesses whether changes to project are in line with NDP	
		Gateway 5: In case of a positive assessment of changes to the contract, MoF approves the change		

Supporting accounting and reporting systems

94. Transparent accounting and reporting systems are key supportive elements of an effective risk management function. The widespread misperception that PPPs can be used to provide public infrastructure without increasing reported government deficit and debt, has created a bias in favor of PPPs, reducing the quality of project selection and, more broadly, exposing governments to excessive risks. The way PPP transactions are accounted for and reported in the government's accounts, is an important factor contributing to the bias in favor of using PPPs. Countries with pure cash accounting, such as Namibia, may underestimate fiscal costs and risks from PPP transactions, particularly during the construction of the related asset. In this case, the main fiscal aggregates—fiscal deficit and debt—do not fairly portray the level of risk undertaken by the government.

95. International standards for accounting and statistics differ, but have broadly converged over the years. In accounting, International Public Sector Accounting Standards (IPSAS) "*Service Concession Agreements: The Grantor*" (IPSAS32), published in 2011, sets the best practice for accounting PPPs operations. For reporting purposes, the IMF's Government Finance Statistics Manual 2014, and the 2011 Guide on Public Sector Debt Statistics (PSDS 2011) prescribe best practices.

96. IPSAS 32 covers both, government-funded and user-funded PPP contracts. It is expected that under IPSAS32 most PPP contracts would result in assets and liabilities being regarded as belonging to the government. According to this standard, the government recognizes an asset and a liability (with the corresponding flows) in its financial statements when the following conditions are met: (i) the grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and (ii) the grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement. Experience suggests that most PPP contracts would comply with these conditions.

97. If IPSAS 32 conditions are met, both the deficit and gross debt would be affected during the construction of a PPP asset, as in the case of a publicly financed project. A detailed analysis of the implications on government deficit and debt of the implementation of IPSAS 32 is detailed in Annex 4.

98. Like Namibia, most countries deviate from international standards—IPSAS 32 and GFSM 2014—when accounting and reporting for PPP transactions, which increases the bias towards PPPs. Reasons for such deviations vary on a country-by-country basis, as well as countries' capacity to avoid the PPP bias. However, public sector accounting and statistical practices are not fully aligned in Namibia with international standards, resulting in all existing PPPs being accounted off-budget.

99. To reduce the bias in favor of PPPs, Namibia should compile information about fiscal costs and risks of PPPs and disseminate it in the Fiscal Risks Statement. The PPP unit can prepare and publish forecasts of future cash flows under existing and planned PPP contracts and ensure those forecasts are incorporated in medium- and long-term fiscal projections and analyses of debt sustainability. More challenging, but critical in the long-term, Namibia should start working toward migrating to international standards, both in accounting (IPSAS) and statistics (GFSM 2014).

Recommendations

Recommendation 16. Strengthen the legal and regulatory framework to support a more effective PPP risk management framework. In the context of the revision of the draft regulations of the PPP Act, the PPP Unit should:

- Include general guidelines for contract termination.
- Introduce ceiling to contract amendments.
- Provide guideline in terms of accounting and reporting PPPs in the public accounts.
- Review and provide comments regarding the consistency between the draft PFM law, the PPP Act, and the upcoming regulations.

Recommendation 17. Access PPP projects within the public investment management (PIM) framework and budget process, and clarify roles and responsibilities of main institutional actors involved in evaluating PPPs. In the context of the revision of the draft regulations of the PPP Act, the PPP Unit should:

- Separate monitoring and promotion function for PPPs, assigning the promotion function outside the MoF.
- To effectively manage fiscal risks, new PPPs should be integrated with the PIM and budget process.

Annex I. Matrix of Prioritized Actions

Impact	Likelihood		
	Low	Medium	High
Low PE's total liabilities less than 0.5% of GDP	Irrelevant: <ul style="list-style-type: none"> Standard monitoring No disclosure on individual company 	Low: <ul style="list-style-type: none"> Standard monitoring regime No disclosure of risk associated with the individual company in FRS Disclosure in the semi-annual analytical report desirable 	Medium: <ul style="list-style-type: none"> Standard monitoring regime Disclosure of risks associated with individual company in FRS desirable Disclosure in semi-annual analytical reports required
Medium PE's total liabilities between 0.5% and 1% of GDP	Low: <ul style="list-style-type: none"> Disclosure of risk associated with individual company in analytical reports and FRS required No additional effort from the FRAD required 	Medium: <ul style="list-style-type: none"> Disclosure of risks associated with individual company in analytical reports and FRS required Analytical reports should contain recommendations to company's board and executives 	High: <ul style="list-style-type: none"> Disclosure of risks associated with individual company required in analytical reports and FRS. Analytical reports should contain recommendations to company's board and executives
High PE's total liabilities more than 1% of GDP	Medium: <ul style="list-style-type: none"> Disclosure of risks associated with the individual company in both analytical reports and FRS essential Analytical reports should contain recommendations to company's board and executives 	High: <ul style="list-style-type: none"> Disclosure of risk in analytical reports and FRS is essential Analytical reports should contain recommendations to company's board and executives Analytical reports should contain FRAD recommendations for reducing risks Considerable monitoring by FRAD required 	Critical: <ul style="list-style-type: none"> Disclosure of risk in analytical reports and FRS is essential Analytical reports should contain recommendations to company's board and executives Extensive monitoring from FRAD is required

Source: Fund Staff

Annex II. Illustrative Example of a Fiscal Risk Statement

Macro-economic risks

The economic and fiscal forecasts presented in the Budget incorporate assumptions and judgments based on information available at the time of preparation. These medium-term forecasts are subject to uncertainty around the future evolution of economic conditions and implementation of government policies.

Unanticipated changes in macroeconomic conditions will cause fiscal forecasts to differ from those presented in the budget. For example, risks to the macro-economic outlook could arise from lower demand for key exports and subdued commodity prices, a slower recovery in mining and construction activities and if growth in South Africa deteriorates or if growth in Angola and other trading partners slows.

[For addition in subsequent statements: The following scenarios provide an indication of the sensitivity of expenditures, revenues and the budget balance to changes in the economic outlook over the medium-term forecast period. The first scenario incorporates weaker external conditions, lower commodity prices, reduced exports, a lower exchange rate, and nominal GDP. The second scenario assumes stronger than anticipated domestic growth because of more favorable trade conditions with major trading partners.

The remainder of this section would summarize the alternative scenarios developed, by presenting a comparison table of the key macroeconomic assumptions for the key aggregates – GDP, prices, employment, net exports – under the baseline and two scenarios, and showing the implications for total revenue, expenditure, budget balance, and debt].

An alternative approach to publishing these scenarios would be to include a summary table of the impacts on revenues and expenditures of changes in discrete macroeconomic parameters including GDP, Inflation, Exchange Rate, and key commodity prices.

Public Debt

General government debt is forecast to continue growing, reaching [61.9] percent of GDP by 2020. Deviations in macroeconomic parameters from forecasts will impact on government debt and debt servicing obligations. In particular, the debt portfolio is susceptible to a decline in the Southern African Customs Union (SACU) revenue.

External debt has been increasing, reading [xx] percent in 2016/17. Non-rand debt reaching [32] percent of total debt, increasing the exposure to a deterioration in the exchange rate. The majority of debt denominated in foreign currency is denominated in [set out currency composition, i.e. share in USD, EUR for major currencies]. [Provide a quantification of the impact

of a change in the exchange rate on the value of the debt portfolio]. The impact of changes in real interest rates is small due to a sizeable share of fixed-rate debt.

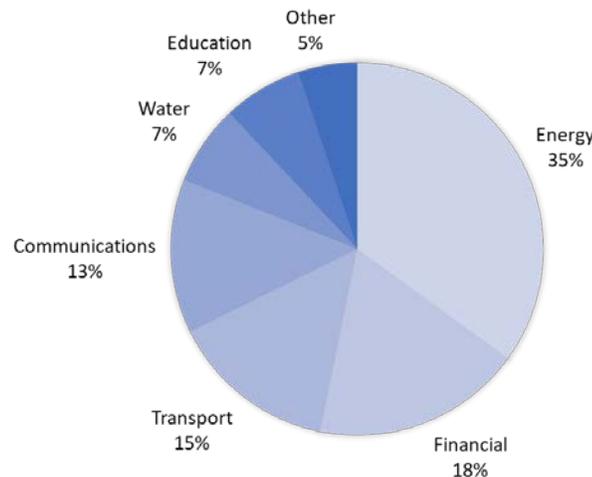
The portfolio has some exposure to refinancing risks. The short-term debt comprises [42] percent of domestic debt and [27] percent of total debt. Refinancing risk has been mitigated somewhat, through the government diversifying its funding sources and borrowing instruments and extending maturities, including through the issuance of debt in the international capital markets.

[For inclusion in subsequent statements: Table X shows the sensitivity of the debt portfolio to changes in interest rates and the exchange rate.]

Public Enterprises

Namibia has [71] public enterprises of which [38] are classified as non-commercial enterprises, [22] as commercial, and [11] as financial institutions and extra-budgetary funds. Public enterprise assets total NAD [89.2] billion ([25] percent of GDP). The public enterprises are active in a range of sectors, with those in the energy, financial, transport and communications sectors accounting for just over [80] percent of the total public enterprise assets (see Figure A1).

Figure A1. Sector Breakdown of Public Enterprises Based on Assets^{1/}

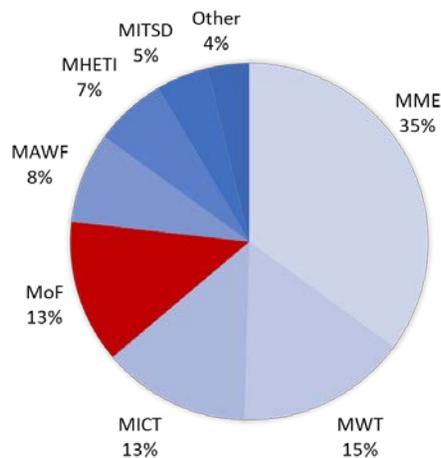


Source: Ministry of Public Enterprises.

1/ Size of assets as per latest available information.

The Public Enterprises Governance Act (PEGA) provides an overarching framework governing public enterprises and specifies the role played by government in their oversight. For each public enterprise, responsibility for exercising the ownership function has been assigned to a shareholding minister, with the Minister of Public Enterprises acting in an advisory capacity. Shareholder responsibilities are distributed as indicated in Figure A2. The government is in the process of amending the PEGA with the intention of moving all the commercial enterprises under the shareholder oversight of the Minister of Public Enterprises.

Figure A2. Responsibility for Public Enterprise Oversight Based on Assets^{1/}



Source: Ministry of Public Enterprises.
1/ Size of assets as per latest available information.

In terms of the PEGA, board members are appointed by the shareholding Minister. The shareholding Minister enters into a performance agreement with each board member and a governance agreement with the board as a whole, which set out the government's performance expectations for the enterprise. Annually, public enterprises are required to submit a business and financial plan for approval by the shareholding Minister as well as audited annual financial statements. Dividends are decided by the shareholding Minister based on proposals from the board.

There are [x] incorporated public entities,¹ which are governed by the Companies Act. The Companies Act specifies the fiduciary duties of directors, processes for the appointment of auditors and circumstances where shareholder approvals are required. Many of the public enterprises are also regulated in terms of their own founding legislation. The majority of the public enterprises report on the basis of International Financial Reporting Standards (IFRS).

[Provide any further details on institutional arrangements, legal framework and ownership policy for overseeing public enterprises]

Financial Relations between the Central Government and Public Enterprises

Transfers to public enterprises

Subsidies to public enterprises that are included in the initial budget proposal, have been declining. During 2016/17 funding totaling NAD [6.4] billion was allocated to public enterprises, a

¹ The remaining public entities have other legal forms including funds, trusts and cooperatives.

[20] percent reduction as compared to 2015/16 when NAD [8.0] billion was allocated. The 2015/16 allocation was [16] percent lower than the allocation made in 2014/15 allocation of NAD[9.5] billion. In 2016/17 the main recipients were the Namibia Students' Financial Assistance Fund (NSFAF), University of Namibia (UNAM), Air Namibia, the Namibia Training Authority (NTA) and the Namibia University of Science and Technology. The funding for NSFAF was to provide loans and financial assistance to students. The universities received funding to cover operational and capital expenditure. The allocations to Air Namibia and NTA were for operational expenditure.

[Provide a table summarizing the main allocations, preferably covering 3-5 years of history as well as forward looking projections that cover the MTEF. Also add in information regarding the actual allocations and explain any areas where these deviated from the budgeted allocations]

Loans to public enterprises

[Explain the government's policy on providing both on budget loans as well as on-lending to public enterprise (e.g. under what circumstances would the government provide a loan to a public enterprise? What interest rate is the public enterprise charged? If the government is required to service an on-lent loan on behalf of the public enterprise, does the amount paid by the government become a debt owned by the public enterprise to the government? How is the debt that is raised for on-lending reflected in the government's accounts? What process are in place to mitigate risks, e.g. assessments of the public enterprises ability to repay? How does the government monitor and manage the outstanding loan portfolio?]

The central government provides loans financed from budget resources to public enterprises and on-lends funds borrowed from International Financial Institutions (IFIs). As at [date], the total debt outstanding to public enterprises totaled NAD[xx] million.

[Provide a summary explanation and table of the main loans to public enterprises, preferably providing data covering the preceding 3-5 years. Highlight where any new loans were provided in the reporting period and the purpose of these loans?]

[Outline what the repayment has experience is. Indicate where any companies are in arrears on their repayments, the reasons and remedial actions that have been taken].

Guarantees and contingent liabilities issued in favor of public enterprises

[Explain the government's policy on issuing guarantees (e.g. under what circumstances would the government provide a guarantee to a public enterprise? Are guarantee fees charged? If the government is required to service loan on behalf of a public enterprise, does the amount paid by the government become a debt owned by the public enterprise to the government? What process are in place to mitigate risks, e.g. assessments of the public enterprises ability to repay the

guaranteed debt? How does the government monitor and manage the outstanding guarantee portfolio?]

To date, the government had an outstanding contingent liability exposure to public enterprises totaling NAD[8.6] billion ([6] percent of GDP). The most significant exposures are to Air Namibia, the Development Bank of Namibia (DBN) and the Namibia Ports Authority. The details of the main exposures are summarized in Table A1 below.

[Insert table showing the main guarantee exposures by PE. Ideally, expand the table to provide historical information on the beneficiaries and guarantee exposures over the preceding 3-5 years]

[Highlight where any new guarantees were provided during the reporting period and the purpose of these guarantees?]

[Indicate whether any companies are not up-to-date in servicing their guaranteed debt]

Dividends

Each year the boards of commercial public enterprises are required to submit a proposal on the distribution of profits for the past financial year to the Minister of Public Enterprises, who agrees the final amount that is payable with the board and submits recommendations to Cabinet. Cabinet may also direct public enterprises to pay dividends. The Companies Act prohibits companies from paying dividends where this would result in them becoming insolvent or being unable to meet their debts.

[Further explain the government's dividend policy, in particular has a percentage of profits that public enterprises are required to pay as dividends been set?]

[Provide a summary explanation and a table indicating the dividends that have been paid to government, ideally including historical information for the preceding 3-5 years and ideally projections of the dividends that are expected to be received over the MTEF period]

Public policy activities

Public enterprises may undertake non-commercial activities to fulfill public policy objectives. If public enterprises are not properly compensated for the costs incurred, their financial position can be eroded, increasing the likelihood of unanticipated fiscal support being required. Currently, provision has been made to cover the costs of some of these activities from the budget in line with international best practice. The government has begun identifying other non-commercial public policy activities being undertaken by public enterprises. The main examples include:

- Nampower smooths and moderates electricity price increases using funds collected through the long-run marginal cost levy and a grant that was previously provided by government;

- DBN and Agribank manage a number of different facilities, which were funded by government and donors, that provide support to clients and farmers, finance project preparation and other similar activities;
- Air Namibia operates a number of unprofitable routes with the aim of promoting connectivity to support trade and tourism, to which the government makes a contribution through servicing the lease payments on the aircraft used by the airline;
- Transnamibia provides freight transportation services on which it does not fully recover the costs. The governments provide some support through annual allocations in addition to being responsible for the rehabilitation of the rail network;
- UNAM has been expanding its reach through the construction of new campuses, contributing to develop the skills for a knowledge-based economy; and
- Several public enterprises are undertaking public investment projects on behalf of the government.

[Discuss any other non-commercial activities, if possible quantifying the annual costs of the activities, and provide any further details on the government's policy relating to the mandating and funding of public policy objectives executed by public enterprises.]

Fiscal Risk Assessment

Public enterprises can be a source of fiscal risk. Poorer-than-anticipated financial performance, liquidity pressures or a weakening in the financial position of public enterprises could result in lower dividends and taxes being received, an increased need for funding, or an unanticipated call on government guarantees. This would result in actual budget outcomes and key fiscal metrics deviating from the forecasts.

A fiscal risk assessment was undertaken based on the [2015/16] financial results of the ten public enterprises with the largest outstanding liabilities (both guaranteed and unguaranteed). As at [31 March 2016], these public enterprises' liabilities totaled NAD[31.4] billion and account for approximately [80] percent of the total liabilities of public enterprises.

The public enterprises were classified into three risk categories, based on five key financial indicators. The five indicators examine the enterprise's dependency on fiscal support, and assess its profitability, solvency, and liquidity (see Box A1). Each of the indicators was assessed as being either (i) sound; (ii) low risk; (iii) moderate risk; (iv) high risk; or (v) very high risk. The assessment of the five indicators was consolidated into an overall risk rating for the public enterprise. of high, medium, or low.

Box A1. Key Indicators for Assessing Financial Soundness of Public Enterprises

The assessment was based on the following five key financial indicators:

- **Financial dependence:** Indicates whether the company depends on fiscal support through subsidies, equity, loans, guarantees to remain financially viable.

Profitability

- **Return on equity:** Determines the relationship between profit and equity and indicates whether the company is generating profits and whether these are in line with commercial rates of return. For loss making companies, it indicates how quickly the equity is being eroded.

Solvency

- **Debt ratio:** Determines the relationship of liabilities to assets and indicates whether the company is solvent (assets are larger than the liabilities) and the degree to which the company is leveraged. Highly leveraged companies have less financial flexibility.
- **Debt to EBITDA:** Determines the relationship between debt to profit and indicates the company's ability to service its debt from operating cash flows.

Liquidity

- **Current ratio:** Determines the relationship of current assets to current liabilities and indicates the company's ability to meet its short term liabilities using its short-term assets.

Based on this analysis [five] of the public enterprises were classified as high risk, with their total outstanding debt amounting to NAD[11.5] billion or [xx] percent of GDP as of the end of the [2015/16] financial year. The remaining companies were assessed as being of low risk.

The government is taking to improve the financial condition of the high-risk entities. Plans for restructuring Air Namibia and Transnamib are being developed. In addition, reforms to the legislative framework governing public enterprises are in the pipeline, which will strengthen supervision and financial controls.

[Indicate any other remedial actions that are being taken]

Aggregate Financial Results of the largest Public Enterprises

In [2015/16], the [ten] top public enterprises generated NAD[11.8] billion in revenue, a [9.7] percent increase from [2014/15] when revenues totaled NAD[10.8] billion. However, the profit generated by the public enterprises declined from NAD[828] million in 2014/15 to NAD[220] million in 2015/16 due to the growth in costs ([19.2] percent) outpacing the growth in revenues ([9.6] percent). The return on equity of [0.9] percent was also lower than in 2015 ([4.8] percent).

The performance of Nampower had a significant influence on the aggregate performance of the public enterprises sector. In 2016, Nampower's financial performance was temporarily negatively impacted by higher than anticipated costs relating to power imported from Mozambique to ensure energy security. The costs are being recovered through adjusted electricity tariffs. The company's performance recovered in 2017.

The leverage of the sector improved slightly with [just over half] of the public enterprises funding coming from debt (2015: [58] percent), but the ability of the public enterprises to generate cash and liquidity remains low.

Summary financial statistics are presented in the table below.

Table A1. Summary Financial Statistics for the Largest Public Enterprises

	2014	2015	2016
Income statement			
Revenue (NAD)	3,967,840,000	4,480,514,000	5,005,992,000
Net profit after tax (NAD)	616,379,000	531,247,000	(296,388,000)
Profitability			
Growth in revenue	20.03%	12.92%	11.73%
Growth in costs	21.24%	19.28%	42.20%
EBITDA margin	26%	21%	5%
Operating costs to revenue	34%	34%	47%
Return on capital	4.65%	3.85%	-1.59%
Balance sheet			
Equity (NAD)	13,262,833,000	13,807,725,000	18,584,930,000
Liabilities (NAD)	9,805,094,000	9,908,100,000	11,648,273,000
Liquidity			
Current Ratio	3.40	3.12	6.24
Solvency			
Debt ratio (Debt to assets)	43%	42%	39%
Interest Coverage	0.82	1.02	-1.09
Debt to EBITDA	2.55	2.62	10.09

Source: Analysis of public enterprises' annual financial statements.^{1/}

1/ Current metrics based on staff analysis of public enterprises' annual financial statements that were available, to be updated by the authorities before publishing.

Financial Results of Selected Public Enterprises

The financial performance and financial position of the major state-owned enterprises, particularly those with significant debt exposures, is discussed in more detail below to provide a fuller picture of the financial sustainability of these specific enterprises and the potential fiscal risks.

[Add in an analysis of as many as possible of the public enterprises – try to cover all of the top-10 public enterprises]

University of Namibia

[Update based on the 2016 annual financial statements]

The University of Namibia (UNAM) is the largest institution of higher education in the country, with 12 campuses nationwide and 7 regional centers serving 24,759 students. It is overseen by the Minister of Higher Education. The company's [2014/15] financial statements received an [unqualified audit opinion].

In [2014/15] the entity's performance improved with a surplus of NAD[72] million being achieved (2014: NAD[68] million shortfall). This was the result of an increase in the government grant to NAD[871] million to cover operating expenditure of the university (2014: NAD[608] million) as well as an increase in student fees due to both an increase in the number of students and the fee per student.

Table A2. Summary Financial Statistics for UNAM

	2014	2015	2016 ^{1/}
Income statement			
Revenue (NAD)	1,088,262,000	1,477,727,000	
Net profit after tax (NAD)	(67,692,000)	72,432,000	
Profitability			
Growth in revenue	0.00%	35.79%	
Growth in costs	0.00%	24.46%	
EBITDA margin	-7%	5%	
Operating costs to revenue	109%	100%	
Return on capital	-275.22%	75.78%	
Balance sheet			
Equity (NAD)	24,596,000	95,579,000	
Liabilities (NAD)	2,476,877,000	2,733,533,000	
Liquidity			
Current Ratio	1.05	0.85	
Solvency			
Debt ratio (Debt to assets)	99%	97%	
Interest Coverage	-82.62	22.32	
Debt to EBITDA	-24.36	24.53	

Source: Analysis of annual financial statements.

1/ 2015/16 annual results not yet available.

UNAM has high levels of debt, especially relative to its cash generating ability: the debt to EBITDA ratio in [2014/15] was [25] times. The liquidity position is weak with current liabilities

[exceeding] current assets at the end of [2014/15]. Trade payables increased by [67] percent from NAD[140] million in [2013/14] to NAD[235] million in [2014/15].

The university is undertaking a significant investment in physical infrastructure to expand its campuses. This has been funded from its operations and cash reserves. UNAM entered into a public-private partnership (PPPs) for the construction and operation of student accommodation at the University of Windhoek and is investigating the possibility of using similar arrangements to expand student accommodation at its other campuses.

Transnamib

Transnamib provides rail and road transport solutions within and across the borders of Namibia. It was established in terms of the National Transportation Service Holding Company Act, 28 of 1998. The company is wholly owned by the Namibian government with the Minister of Works and Transport exercising the ownership function on behalf of the government. In [2015/16] the company received a qualified audit opinion.

In 2015/16 the company realized a loss of NAD[83] million, however this was an improvement compared with the previous year when a loss of NAD[456] million was realized. The improvement was due to a reduction in operating costs despite a NAD[181] million increase in the provision for retirement benefits having to be made. The improvement was also a result of the increase in the grant from government to NAD[353 million] (2015: NAD[150] million) *[Note this amount is larger than the NAD[301] million that was budgeted]*. The grant was for the maintenance of the railways and the management of the Northern Railway station.

Transnamib is technically insolvent, with its liabilities exceeding its assets by NAD[282] million ([21] percent). The company is currently revaluating its assets which are currently reflected at depreciated historical book value. The company has loans from the government amounting to NAD[410] million. Of this NAD[328] million was originally on-lending, but the government has already settled the underlying loan, whilst the remaining NAD[81] million relates to financial assistance provided to Transnamib to finance its payroll and the settlement of creditors. The company's liquidity position is weak: current liabilities exceed current assets, but the company did reduce outstanding arrears during the 2015/16 financial year.

The company has developed a restructuring plan aimed at returning the company to profitability over a 5-year period through *[downsizing the business, investing in rolling stock complemented by investments in rehabilitating the rail infrastructure by the government and growing the volumes transported by rail.]* The proposal is currently being considered by government.

Table A3. Summary Financial Statistics for UNAM

	2014	2015	2016
Income statement			
Revenue	0	425,391,000	435,085,000
Net profit after tax	0	(455,972,000)	(83,327,000)
Profitability			
Growth in revenue	0.00%	0.00%	2.28%
Growth in costs	0.00%	0.00%	-14.35%
EBITDA margin	0%	-95%	-8%
Operating costs to revenue	0%	202%	176%
Return on capital	0.00%	226.99%	29.32%
Balance sheet			
Equity	0	(200,875,000)	(284,202,000)
Liabilities	0	1,368,090,000	1,636,938,000
Liquidity			
Current Ratio	0.00	0.73	0.92
Solvency			
Debt ratio (Debt to assets)	0%	117%	121%
Interest Coverage	0.00	-26.85	-5.93
Debt to EBITDA	0.00	0.00	0.00

Source: Analysis of annual financial statements.

Financial sector

Financial sector risks would arise should the government decide to provide support to troubled banks that was not anticipated in the budget, to protect depositors and prevent the crisis spilling over into the rest of the financial sector. Vulnerabilities arise from the strong interlinkages between the sovereign and the banking sector as well as the close integration with the South African financial market, which can result in economic or financial shocks there being transmitted to Namibia.

Generally, the banks remain profitable and well-capitalized. Under baseline and adverse scenarios, the capital adequacy ratio remains above [16] percent. However, banks' reliance on wholesale funding creates a vulnerability to liquidity shocks: moderate liquidity shortfalls could be experienced by some of the big banks within one or two months after a shock. The banks are also exposed to counterparty and portfolio concentration risks.

To mitigate these risks, financial sector oversight is being strengthened. The legislation governing the sector is being overhauled in line with international norms, which will improve regulation. The quality of on-site supervision of banks has been enhanced. A new deposit guarantee scheme is being established, which will be managed by the Bank of Namibia in line with international norms.

Annex III. Managing Contingent Liabilities in Colombia

At the turn of the century, Colombia experienced an economic recession paired with a fiscal crisis and materialization of large fiscal contingencies. As a result, authorities were forced to implement a framework for managing contingent liabilities to strengthen the government's capacity to identify, assess, mitigate and monitor contingent liabilities.

Four areas were recognized as the main sources of fiscal risks during the economic crisis of 1999-2002: natural disasters, legal proceedings against the state, debt guarantees and PPP's guarantees, particularly those related to infrastructure, transport and electricity.

A procedure was defined for the identification and recording of fiscal risks to guarantee that new liabilities were appropriately recorded. Comprehensive databases were permanently updated, and a management software to store and analyze the information was designed. The contingent liabilities databases have played a key role in the strategy to strengthen the country's legal defense to mitigate (reduce) payments of claims against the Government.

Additionally, the MoF was given the mandate to review all contracts that have the potential to constitute a contingent liability for the government; without the MoF approval, the contract cannot move forward.

Specific methodologies based on probabilistic models for assessing each one of the four types of contingent liabilities were developed and are constantly reviewed for improvement. A common feature is the estimation of expected costs, which is calculated based on the gross exposure that would impact the fiscal accounts and the probability of the event occurring. This estimate is fundamental for determining the viability of the contract, the commitments that will be required from the interested party and the overall risk assumed by the government.

Mitigation strategies for each type of risk were developed:

Natural disasters: additional resources for strengthening public infrastructure were appropriated, insurance coverage increased and a financial strategy with contingent lines of credit, CAT bonds was implemented.

Debt guarantees and PPP contracts: a state contingency fund was created, to which entities make contributions based on the risk assessment carried out by the MoF. These contributions are updated periodically to reflect changing economic conditions.

Legal contingencies: appropriating of resources in the annual budget to cover the expected payout.

Monitoring was strengthened with the approval of the Fiscal Responsibility Law in 2003 which requires the government to present a 10-year rolling forecast with detail of contingent liabilities and lump-sum amount for future years, distributing the commitments' information between sectors, projects and/or type of risk. In 2012, a PPP Law was approved with clear guidelines for the presentation, analysis and approvals of PPPs and, in particular, it requires that all contingent liabilities be assessed and valued.

Source: "Ministry of Finance and Public Credit, *Colombia "Contingent Liabilities: The Colombian Experience,"* 2011.

Annex IV. Accounting for PPPs: IPSAS32

This annex summarizes main features of IPSAS32. The accounting standard IPSAS 32, Service Concession Arrangements: Grantor, issued in 2011, provides a framework for accounting for and reporting PPP transactions in a government's accounts that reduces significantly the bias in favor of PPPs.¹

If IPSAS 32 conditions are met,² both the deficit and gross debt would be affected during the construction of a PPP asset, as in the case of a publicly financed project. As detailed in the table below, if the government compensates the operator by making a predetermined series of payments during the life of the PPP (a government-funded PPP), it recognizes a liability equal to the full value of the asset (transaction 1 in the table below). Similarly, if the government grants the operator the right to earn revenues from users (a user-funded PPP), the value of the liability recognized equals the full value of the asset. In both cases, the counterpart entry for the increase in the government's liabilities is the net acquisition of a nonfinancial asset, which increases the overall deficit—that is, a measure of the deficit that includes investment as spending—but not the net operating deficit. In turn, government's gross debt increases by the amount of the liability, while net worth remains unchanged (i.e., increase in liability is compensated by the acquisition of a nonfinancial asset).

¹ http://www.ifac.org/system/files/publications/files/B8%20IPSAS_32.pdf

² Please check the conditions for asset recognition in the above link.

Table A4. Accounting for PPPs in Public Sector Accounts

Transaction	Accounting treatment 1/	Impact on Government Deficit		Impact on Government Balance Sheet	
		Net operating deficit 2/	Overall deficit 3/	Gross debt	Net worth 4/
A. Construction of the PPP asset (both government and user-funded PPPs)					
1. Recognition of asset/liability	*Increase in non-financial assets (service concession asset); *Increase in liabilities by full value of the asset	None	Increases by the full value of the asset/liability	Increases by the full amount of the asset/liability	None (increase in nonfinancial asset compensates increase in liability)
B.1. Contract operation (government-funded PPPs)					
2. Payment to operator for services provided	*Expense, purchase of goods and services *Decrease in cash	Increases by expense, purchases of goods and services	Increases by expense, purchases of goods and services	None	Decreases by expense, purchases of goods and services
3. Payment to operator for financial charges 5/	*Expense, interest *Decrease in cash	Increases by expense, interest	Increases by expense, interest	None	Decreases by expense, interest
4. Repayment of principal (amortization)	*Decrease in liability *Decrease in cash	None	None, it is a financial transaction (below the line)	Decreases (debt amortization)	None
5. Depreciation of the asset	*Expense, consumption of fixed capital *Decrease in non-financial assets	Increases by expense, consumption of fixed capital	None, internal transaction 6/	None	Decreases by consumption of fixed capital
B.2. Contract operation (user-funded PPPs)					
6. Revenue recognition and reduction of liability	*Decrease in liability *Revenue, capital grant (imputed)	Decreases by revenues, capital grant	Decreases by revenues, capital grant	*Decreases (debt amortization)	Increases by revenues, capital grant
7. Depreciation of the asset	*Expense, consumption of fixed capital *Decrease in non-financial assets	Increases by expense, consumption of fixed capital	None, internal transaction 6/	None	Decreases by the amount of consumption of fixed capital
C. End of Contract (both government and user-funded PPPs)					
8. End of service provision by the operator	Not a specific transaction	None	None	Equal to zero	Net cumulative impact from previous transactions

Source: Funke, Irwin, and Rial, "Budgeting and Reporting for PPPs", OECD/ITF Discussion Paper 2013/07.

1/ Accounting on an accrual basis.

2/ This is the deficit excluding net spending on nonfinancial assets (acquisitions minus disposals). Abstracting from some technical differences, it is the IPSAS definition of deficit and the statistical definition of the net operating balance.

3// The overall deficit corresponds to net lending/borrowing according to GFSM 2001 methodology.

4/ Net worth equal total assets (financial and nonfinancial) minus total liabilities (debt liabilities and others).

5/ Splitting asset and service component of service concession arrangements by fair value (estimation techniques).

6/ The increase in expenses—consumption of fixed capital—is compensated by the reduction in nonfinancial assets by the same amount, so net lending/borrowing is not affected.

Annex V. PFRAM: Summary Description

The PFRAM provides a systematic approach for assessing regular fiscal costs and risks, typically present in PPPs projects, in line with international standards and good practices.

Assessing fiscal costs

Fiscal costs (direct liabilities) of a PPP project are estimated following IPSAS 32 (*International Public Sector Accounting Standards No 32, Service Agreements*). Although PFRAM is modeled following accrual standards (IPSAS 32), it estimates the impact of a project both on an accrual basis (i.e., income statement, balance sheet) and on a cash basis (i.e., cash statement). PFRAM simulates the impact on fiscal deficit, gross/net debt, and contingent liabilities, using both cash and accrual accounting. Main fiscal aggregates are presented in the GFSM 2014 format (*Government Finance Statistics Manual, 2014*) and in line with the PSDG 2011 (*Public Sector Debt Guidelines for Users, 2011*).

PFRAM: PROJECT RISK MATRIX					
IDENTIFICATION OF RISKS	FISCAL IMPACT	LIKELIHOOD	RISK EXPOSURE <small>Likelihood*Impact</small>	MITIGATION STRATEGY	PRIORITY ACTIONS <small>Rating* Mitigation</small>
1 Governance risks	Low	Medium	Low	NO	Medium priority
2 Construction risks	Medium	Medium	Medium	YES	Medium priority
3 Demand risks	Medium	Low	Low	YES	Low priority
4 Operational and performance risks	Medium	Low	Low	YES	Low priority
5 Financial risks	Medium	Medium	Medium	YES	Medium priority
6 Force majeure	High	Low	Medium	YES	Medium priority
7 Material adverse government actions	High	Low	Medium	YES	Medium priority
8 Change in law	Medium	Low	Low	YES	Low priority
9 Rebalancing of financial equilibrium	Medium	Low	Low	YES	Low priority
10 Renegotiation	Medium	Medium	Medium	YES	Medium priority
11 Contract termination	High	Low	Medium	NO	High priority

Assessing fiscal risks

Eleven categories of fiscal risks (contingent liabilities) are evaluated and summarized in a project risk matrix (figure above, first column). Main categories of fiscal risks assessed by PFRAM are:

- **Governance risks.** Risks of the PPP project not being aligned to national investment strategies, or not being a priority project (low rate of return).
- **Construction risks.** Risks arising from the inability to implement the project, or to cope with some of the construction risks if they materialize (e.g. cost overruns in buying land, unexpected geological conditions, design errors, etc.).
- **Demand risks.** Risks arising from reduction in demand for services.

- **Operational and performance risks.** Risks of interruption of service delivery, or quality of services being below specification in contract agreement.
- **Financial risks.** Risks of the private partner failing to obtain finance for the project, or facing interest rate risk and other financing risks (e.g., exchange rate risk).
- **Force majeure.** Risks from unforeseeable circumstances that are beyond the control of the parties, and result in the impossibility for the affected party to perform its contractual obligations (e.g., natural disasters).
- **Material adverse government's actions (MAGA).** Also called "political force majeure," arise from any act or omission by the relevant public authority during the term of the contract, and which (i) renders the private partner unable to comply with all or a material part of its obligations under the PPP contract; and/or (ii) has a material adverse effect on the cost or the profits arising from such performance.
- **Change in law.** Following successful bid submission, change in law refers to any of the following events: (i) the enactment of new applicable laws; (ii) the repeal, modification or re-enactment of any existing applicable law; (iii) a change in the interpretation or application of any applicable law; (iv) the imposition by any government entity of any material condition in connection with the issuance, renewal or modification, revocation or non-renewal (other than in accordance with the existing applicable law) of any approval; or (v) the imposition or levying of any new taxes on the private partner or the increase or decrease in the rate or classification of any taxes.
- **Rebalancing of financial equilibrium.** Some contracts (or jurisdictions) allow for the rebalancing of the financial equilibrium of the project, when affected by several events (e.g. severe macroeconomic shock).
- **Renegotiation.** In the context of the PFRAM, renegotiation risks do not refer to the events that lead to renegotiation, but to the risks associated to the renegotiation process itself.
- **Contract termination.** Termination of the contract prior to the normal term, either (i) by the contracting authority in the event of failure by the private partner to comply with its obligations or for public policy reasons; (ii) by the private partner in case of occurrence of a failure of the contracting authority to comply with its obligations; or (iii) by either party in the event of prolonged Force Majeure Event, MAGA or change in law. Termination provisions define the rules for computing the amount which will be payable by the contracting authority to the private partner.

Identifying fiscal risks

Not all risks will be present in every single PPP contract. The PFRAM assist the analyst to identify which are the most likely fiscal risks arising from the contract under evaluation.

Estimating fiscal impact

What would be the potential fiscal impact if risks materialize? To the extent possible, the potential fiscal impact of a risk should be evaluated in a holistic manner, providing as much information as possible to support a simple 3-scale assessment: low, medium, or high. A possible practical example is shown below:

Scale	Value	Fiscal impact
Low	Up to 0.5% of GDP	Impact on fiscal deficit and gross debt is lower than 0.5% of GDP (asset total construction cost)
Medium	Between 0.5-1.0% of GDP	Impact on fiscal deficit and gross debt between 0.5 and 1.0 percent of GDP (asset total construction cost)
High	Above 1.0% of GDP	Impact on fiscal deficit and gross debt above 1.0% GDP

Likelihood

What is the likelihood of risks materializing in the future? Identifying whether the likelihood is low, medium, or high is a mainly a judgement call. There are several factors that can help determine the likelihood. For example, the following logic could be followed:

Scale	Likelihood	Parameters
Low	Very unlikely, not negligible. Require highly unusual conditions	0 – 5 %
Medium	Likely and possible, some precedents	0 – 30%
High	Almost certain, extensive precedents	Above 30%

Risks exposure

How big is the exposure of the government to this risk? This is estimated as fiscal impact times likelihood, resulting in a 5-scale ranking of risks in decreasing order: critical, high, medium, low, and irrelevant

Risk Rating = Likelihood x Fiscal Impact				
Fiscal Impact	HIGH	Medium	High	Critical
	MEDIUM	Low	Medium	High
	LOW	Irrelevant	Low	Medium
		LOW	MEDIUM	HIGH
		Likelihood		

Mitigation measures

Does the government have mitigation measures in place? PFRAM requires the user to assess only whether mitigations measures are in place or not.

Priority Actions = Risk rating x Mitigation measures						
Mitigation measures	NO	No action	Medium priority	High priority	High priority	Critical
	YES	No action	Low priority	Medium priority	Medium priority	High priority
		IRRELEVANT	LOW	MEDIUM	HIGH	CRITICAL
		Risk Rating				

Priority actions

Deciding what to fix. Once fiscal risks have been identified, rated, and mitigation measures checked, PFRAM assist the user to develop a prioritized list of required actions. As a general rule,

the more severe risks (i.e., those critical and high) should be addressed first. Addressing the less important risks, even if they are an easy fix, does not improve the overall risk profile of the project, thus, does not reduce the risks for government. Not all risks are worth addressing, and some loss for government is not only expected, but admissible based on the cost of fixing the issue.

Sensitivity analysis

PFRAM allows to input alternative assumptions about key macroeconomic variables (e.g. GDP, inflation, nominal exchange rate) and project parameters (e.g. contract termination clauses). This is also useful when contract information is limited and/or when the PPP project is still under negotiation, allowing the user to check results based on alternative scenarios.

Source: Based on "Public-Private Partnerships Fiscal Risk Assessment Model—User Guide", IMF/WBG, April 2016. The tool and user manual are available for download at: www.imf.org/publicinvestment

Annex VI. Chile: Assessing Fiscal Costs and Risks from PPPs

Example	Quantification methods
Chile	Model base approach
<p>Option-valuation techniques. Default is assumed to happen when the asset value of the entity falls below its liabilities. Used to valuation of exchange rate guarantees provided to concessions</p>	
<p>The government prepares two reports that provide a great deal of information on the fiscal costs and risks of concessions. The first is an annual report on public finances. The second is an annual report on contingent liabilities (see link below for 2016 report). The report on public finances estimates the most the government could spend on revenue guarantees and estimates the net present value of the guarantees and revenue-sharing arrangement. The report also estimates the present value of committed subsidies and availability payments. The report on contingent liabilities discusses not only expected cash flows from revenue guarantees (see figure below, left panel) but also the variability of those cash flows (see figure below right panel). In addition, Chile publishes contracts and related documents, including changes made after renegotiations.</p>	
<p>Figure 2. Forecast Payments from Chilean Revenue Guarantees (million pesos)</p> <p>A. Expected payments</p>	<p>B. The 5th, 50th, and 95th percentiles of the forecast distributions</p> <p>Source: Government of Chile 2008b.</p>
<p>Sources: “Managing Contingent Liabilities in Public-Private Partnerships”, Timothy Irwin & Tanya Mokdad, WB. http://ppp.worldbank.org/public-private-partnership/library/managing-contingent-liabilities-public-private-partnerships-practice-australia-chile-and-sou Government of Chile. Informe de Pasivos Contingentes, 2016 http://www.dipres.gob.cl/598/articles-156067_doc_pdf.pdf</p>	

Annex VII. PPP Ceilings: International Experience

There is no simple benchmark for setting PPP ceilings, but international experience suggests that they should have the following key features.

- **Broad coverage.** PPP ceilings should cover both, fiscal costs and fiscal risks arising from PPPs, and should be applicable for all types of PPP, regardless how are they funded (i.e., government-funded or user-funded PPPs). UK caps overall fiscal exposure arising from overall PPP commitments (fiscal costs and risks) at about 7 percent of total annual expenditures (Table 7 includes international examples of PPP ceilings).
- **Legally grounded.** PPP ceilings can be specified in specific legislation (PPP laws and regulations), PFM Laws, Organic Budget Laws, Public Debt Management Laws, or even in annual budgets. While including ceilings in more permanent legislation seems prudent, lower level laws and regulations have the advantage of providing flexibility to test the adequacy of the limit and make it easier if a revision is warranted.
- **Easy to communicate and monitor.** PPP ceilings should be simple and measurable. It is important for the ceiling measure to be unambiguous, so that it is credible and can be monitored and verified by independent experts. This means that caution should be used in employing complicated measures that are difficult to interpret. If complex measures are used, clarity should be provided on the parameters (e.g., the discount rate and probabilities of contingencies) and methods used, and ensuring that the latter are publicly available. Simpler methods may be preferable initially. For example, ceilings can be applied to stocks or flows (e.g., percentage of GDP or government revenues), either on maximum exposure (face value) or taking into account likelihood in very simple ways. Experience suggest that ceilings are more credible and easier to monitor when they are set on maximum exposure, and accompanied with sensitivity analysis.
- **Linked to main macro fiscal concerns.** Ceilings on the overall size of the PPP program (stocks) and the annual PPP-related payments (flows) can increase the predictability of the government's exposure to PPPs and allow for a ready implementation of affordability tests. However, ceilings can be specified either in stocks or flows, depending on the objective that they want to achieve. If the main fiscal concern is debt sustainability—either because debt is on an unsustainable trend or the current level is dangerously approaching a debt ceiling—a ceiling expressed in terms of stock of total commitments of PPPs as ratio of GDP tends to be more effective. If the main fiscal concern is the government's capacity to repay—either due to cash liquidity issues, or due to a large number of government-funded PPPs (for example, roads, prisons, or hospitals that require government payments for a period of 15-25 years)—then, ceilings expressed in flows (e.g., PPP payments as a percent of government revenues) tend to be more effective in safeguarding long-term fiscal affordability. Similarly, concerns about the reduction in budget flexibility implied in long-term contracts, such as PPPs, are better addresses through flow ceilings expressed as percentage of government expenditures.

- **Commensurate to PPP portfolio structure and PPP project pipeline.** The effectiveness of a PPP ceiling in supporting short-term budget affordability and long-term sustainability will depend on the type of projects that comprise a PPP portfolio. A PPP portfolio with a high share of government-funded PPPs will have larger short-term implications in terms of budget affordability, which suggests that ceilings on flows relative to government revenues tend to be more effective. On the contrary, a PPP portfolio mostly comprising user-funded PPPs (concessions) tends to have a higher impact on government’s long-term fiscal sustainability, suggesting that ceilings on the stock of total PPP commitments might be better in safeguarding public finance.
- **Consistent with short, medium and long-term fiscal targets.** The assessment of the maximum size of a PPP program should be guided by long-term strategic plans and fiscal sustainability, the MTBF, and the short-term budget affordability. It should also capture the capacity to formulate and implement high-quality projects.

International Examples of PPP Ceilings

	Variable	Ceiling	Policy concern
UK	*Overall limit to annual payments PPP- related *Departmental (line ministries) ceilings on PPP fiscal commitments (costs and risks)	*Nominal, 0.8 % of GDP *6-7 % total annual spending	Long-term fiscal sustainability Budget flexibility
Brazil	Ceiling on projected stream of future payments	Projected accumulated payments < 5% of gov. annual revenues	Capacity to pay Budget flexibility
Greece	PPP current payments	15% of public investment	Budget flexibility
Colombia	Fiscal commitments (costs and risks) for all PPPs	0.4 % of GDP	Long-term fiscal sustainability
Turkey	Guarantees provided to PPPs (debt assumption mechanism)	In nominal terms in annual budget	Long-term fiscal sustainability
Hungary	Nominal value of new long-term commitments	3 % of state budget revenues in any given budget year	Capacity to pay
Peru	Net present value of the government’s total commitments (explicit spending and guarantees)	7 % of GDP	Long-term sustainability
Honduras	Net present value of the government’s total commitments (explicit spending and guarantees)	5 % of GDP	Long-term sustainability
Jordan Poland Indonesia	Total government debt and government-guaranteed debt, including explicit PPP guarantees	% of GDP	Long-term sustainability

Sources: Fund’ staff and Government’s documents.

Annex VIII. Colombia's Budget Commitments to PPPs through "Vigencias Futuras"

The mechanism of "*Vigencias Futuras*" (VF)—a possible but not precise translation would be future commitments—is a budget instrument in Colombia that allows the MoF and the budget, despite the fact that is a cash budget system, to guarantee the resources required, beyond the budget year, to complete a public investment or any multiannual program. This feature, is a cornerstone of the PPP agreements that the country has implemented for decades, since it provides certainty to the private party of the government's commitment to the project. These are closely regulated, recorded and monitored by the MoF to avoid an over commitment that may reduce the flexibility of the budget, create excessive fiscal pressures and reduce the maneuverability of future administrations.

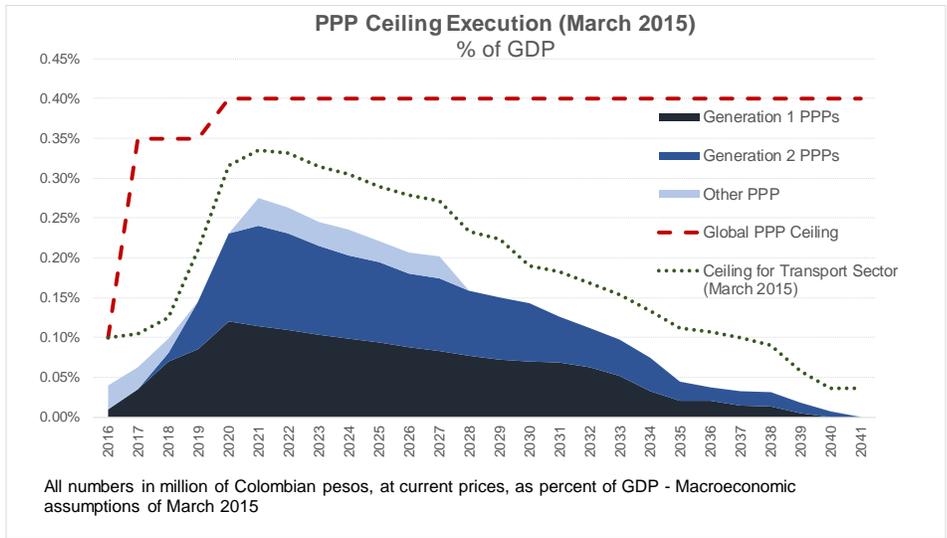
VFs are divided into three types depending on (i) the amount to be committed in the first year of the initiative; (ii) the number of commitment years; and (iii) if they are for a PPP. Strategic and fiscal consistency must be validated by two councils: the fiscal council (CONFIS) headed by the MoF and the CONPES, headed by the President, for the VF to be approved.

VF for annuities for PPP can extend up to 30 years into the future and the total amount that can be committed, can gradually increase up to a ceiling of 0.4 percent of GDP by 2020 and forward.

VFs can be used by any sector, most of the resources that have been approved thus far are for investments in transport (83 percent), including road infrastructures and public transportation systems. Other areas that have benefited from the use of this instrument are: housing, water and sanitation, and a reconstruction fund for flooded areas during 2010-11.

As any project that requires a commitment from the government, VF, even for PPPs, must adhere to the country's PIM framework and follow the guidelines for approval, execution and monitoring of public investment.

Existing regulation demands comprehensive disclosure of VF information. These are recorded in the information systems of the Ministry of Finance and the National Planning Department. The Medium-Term Fiscal and Expenditure frameworks must include a section on the amount of fiscal commitments that the VFs represent for the next 30 years, and how the resources are distributed between sectors and programs. They must also include a "pipeline" of projects that are in the process of securing VF. Below is a graph from the 2017 MTFF reporting VF for the PPP (Alianzas Publico Privadas) program.



Source: "Contingent Liabilities: The Colombian Experience," Ministry of Finance and Public Credit, 2011.

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