Towards Strengthening Public Financial Management in County Governments in Kenya

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Towards Strengthening Public Financial Management in County Governments in Kenya

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KIPPRA in Brief

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Acknowledgement

A fundamental objective of every government is maintenance of fiscal discipline, resource mobilization, strategic resource allocation, and efficient delivery of public services. When the devolved system of government was adopted in Kenya, the importance of establishing strong and effective public financial systems at the county level became inevitable. This report was prepared following the first sub-national Public Expenditure and Financial Accountability (PEFA) assessment carried out in six county governments, namely: Makueni, Kajiado, Nakuru, Baringo, Kakamega and West Pokot. The assessment was done with financial support from the International Development Research Centre (IDRC) in collaboration with the World Bank (Kenya Office).

The report was prepared under the guidance of the Executive Director of KIPPRA Dr Rose Ngugi by the following KIPPRA staff: Christopher Hugh Onyango, Manasse Otieno, and Paul Odhiambo. We also acknowledge the contributions of Simon Githuku and Bernadette Wanjala during the assessment period. We would like to appreciate the PEFA Secretariat (Washington, DC), National Treasury, Council of Governors Secretariat, Office of Auditor General, Office of Controller of Budget, Kenya School of Government, Public Financial Management Reforms (PFMR) Secretariat for useful contributions, particularly during the assessments. Most importantly we appreciate the six county governments which volunteered to have the exercise conducted in their respective counties.

Executive Summary

This report contains the findings of the sub-national Public Expenditure and Financial Accountability (PEFA) assessment carried out in six (6) counties in Kenya by the Kenya Institute for Public Policy Research and Analysis (KIPPRA) in collaboration with the World Bank. The rationale of the assessment is to evaluate the county governments' public Public Finance Managemment (PFM) systems, processes and institutions with a view to improving the outcomes of government transfers within the devolved units. The findings provide an entry point for PFM reforms with respect to enhancing capacities in planning, budget preparation and execution for effective delivery of services. Effective public financial management systems in the national and county governments are a key priority if aggregate fiscal discipline, strategic resource allocation, and efficient use of resources for service delivery are to be attained.

There has been considerable effort towards establishing the foundations of a sound PFM system in many areas within the devolved system of government in Kenya. Although implementation of the PFM systems in the counties is still in its formative stages, considerable achievements have been made in many fronts. Among the notable achievements include the establishment of various PFM structures, and timely preparation of budget documents including County fiscal strategy papers, County budget review and outlook papers, and budget estimates as per the PFM Act 2012 guidelines and timelines. These measures, together with the implementation of the IFMIS, have facilitated timely and systematic budget preparation and execution by County governments.

However, much more efforts are required to achieve the level of performance to ensure that the PFM system impacts significantly on the achievement of outcomes of aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery at local, regional and national levels. Specifically, addressing revenue and expenditure deviations and strengthening management of assets and liabilities; technical capacities; linkages between policy making, planning and budgeting; transparency; and oversight roles have been identified as constraining effective implementation of the PFM system in the counties. The report makes several recommendations ranging from capacity building to establishment of appropriate structures for effective implementation, oversight and monitoring and evaluation frameworks.

Abbreviations and Acronyms

CRA	Commission on Revenue Allocation
CoG	Council of Governors
CBIRR	County Governments Budget Implementation Report
CIDPs	County Integrated Development Plans
IFMIS	Integrated Financial Management Information System
IPPD	Integrated Payroll Personnel Data
ITRC	Intergovernmental Technical Relations Committee
IDA	International Development Association
IDRC	International Development Research Centre
IPSAS	International Public Sector Accounting Standards
KADP	Kenya Accountable Devolution Programme
KDSP	Kenya Devolution Support Programme
KSG	Kenya School of Government
MTEF	Medium Term Expenditure Framework
MCAs	Members of the County Assembly
NHIF	National Hospital Insurance Fund
NSSF	National Social Security Fund
OAG	Office of the Auditor General
OCoB	Office of the Controller of Budget
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PFMR	Public Financial Management Reforms
PSASB	Public Sector Accounting Standards Board
SRC	Salaries and Remuneration Commission
SCOA	Standard Chart of Accounts
SOP	Standard Operating Procedure

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1. Background

The Kenya Institute for Public Policy Research and Analysis (KIPPRA) in collaboration with the World Bank undertook a public financial management and performance assessment based on a sub-national Public Expenditure and Financial Accountability (PEFA) framework in six (6) selected county governments in Kenya, namely: Nakuru, Kajiado, Baringo, Makueni, West Pokot and Kakamega. The framework developed by the PEFA programme is based on a set of seven (7) pillars, namely: (i) budget reliability; (ii) comprehensiveness and transparency; (iii) management of assets and liabilities; (iv) policy-based fiscal strategy and budgeting; (v) predictability and control in budget execution; (vi) accounting and reporting; and (vii) external scrutiny and audit. These pillars together cover the entire budget cycle and are drawn from international good practices.

Effective public financial management (PFM) systems in the national and county governments is a key priority if aggregate fiscal discipline, strategic resource allocation and efficient use of resources for service delivery are to be attained. The guiding principles and framework for distribution and management of public finances in Kenya are clearly stipulated in Chapter 12 of the Constitution.

The objective of this exercise was to assess the PFM systems rather than to evaluate and score the performance of specific county governments or individuals. The findings of the study provide a baseline of current state of PFM within the counties and for the entire financial system, and indicate areas that require improvement. The assessment may also be used to determine whether the reforms in the financial sector and action plans in the county governments need to be adjusted. This would facilitate fair distribution of resources and enhancement of economic development and poverty reduction across the entire country as envisioned in Kenya Vision 2030, and the Constitution.

The main rationale of the assessment is to give a better understanding of the PFM systems, processes and institutions that could provide an entry point for PFM reforms at the county level. This would then be used to leverage on existing capacity building efforts, for example public financial management reform (PFMR) strategy, National Capacity Building Framework, World Bank's Kenya Accountable Devolution Programme (KADP), and Kenya Devolution Support Programme (KDSP).

The results of the analysis provide useful insights into relevant entry points for desired PFM-related reforms, and a benchmark for necessary upgrade of the PFM systems which are still in early stages of development within Kenya's devolved units of government.

2. Assessment of Performance of the PFM

2.1 Budget Reliability

Budget reliability measures the extent to which the budget is realistic and implemented in accordance with the approved estimates before the beginning of the financial year. Three indicators were used for analysis, including the aggregate expenditure outturn, expenditure composition outturn, and revenue outturn for 2013/14, 2014/15 and 2015/16. Expenditure variances were mainly in consumption of fixed assets attributed to delays in procurement processes, and disbursement of funds by The National Treasury. While counties have not established contingency funds, they have emergency funds and adhere to the discipline required by the PFM Act. Equitable share makes the largest source of revenue for counties. However, revenue forecasting is weak due to technical limitations.

Budget Composition and Expenditure Outturns

Counties prepare budgets according to economic, programme and administrative classification, but budget execution follow-up is based on economic and administrative classification. In terms of expenditure by economic types, consumption of fixed capital, use of goods and services, and employee compensations constitute the largest share of expenditures, ranging between 95 per cent and 100 per cent total expenditures across the counties. There were fluctuations during 2013/14 and 2014/15, which were heavily influenced by consumption of fixed capital and compensation of employees, while compensation of employees and consumption of goods and services caused the largest deviation in 2015/16.

The absorption rate of expenditures improved over time but has remained low for development spending. As indicated in Table 1, the year 2013/14 had the lowest absorption given that this was the first year of implementing the devolved system of government and the counties faced challenges of putting in place appropriate PFM institutional and regulatory structures. Major expenditure deviations were recorded under the economic classifications as opposed to administration and functional classifications. The low rates of capital consumptions affected absorption rates for public works, transport and housing and industrial and enterprise development functions over the period under review. This was mainly attributed to delays in release of funds by the National government and the complicated procurement processes associated with implementation. Considering the functional classification, finance and economic planning, and agriculture and water development achieved relatively higher rates of absorption.

Table 1: Aggregate expenditure outturns between 2013/14 and 2015/16

Year	Lowest absorption rate (%)	Highest absorption rate (%)
2013/14	43.0	79.5
2014/15	83.0	96.2
2015/16	77.0	92.2

Although Article 206 of the Constitution provides for the establishment of a Contingency Fund at the National level, County governments were yet to officially approve such Fund. Instead, some counties have set up emergency funds following the enactment of the PFM Act 2012 and others have established special funds, such as the Disaster Fund, which are assimilated as contingency funds and appear as a regular budget item. Generally, the County governments maintained discipline and contained emergency expenditures under exceptional circumstances to less than 2 per cent of the total of the County government's revenue required by law.

Going forward, most County governments plan to improve the quality of strategic plans by widening the scope of consultations and considering departmental and public participation proposals. Besides, considerations will be given towards specific projects, which was not the case during the first strategic plans.

Revenue Outturns

The main sources of revenue for the County governments are equitable share, conditional grants, and own source revenues.[1] Overall, the equitable share constitutes the highest revenue source for the county, accounting for about 84 per cent of total County government revenues, on average, during the three years. The conditional grants and own source revenues accounted for over 9.8 per cent and 6.2 per cent, respectively. This indicates that County government operations are heavily reliant on transfers from the National government resources, with very limited own-source revenues. However, allocation of equitable revenues is based on latest audited accounts of the National government, approved by Parliament. There presently exists a three-year lag in approval by the National Assembly.

1 *Equitable Share*: This constitutes revenue raised by the National government and equitably allocated to all county governments in accordance with Article 203 of the Constitution. The allocation should be at least 15 per cent of national revenue based on the most recent audited accounts of revenue received, as approved by the National Assembly. *Conditional Grants:* These are provided for under Article 202 of the Constitution, and constitutes additional allocations from the National government share of revenue, either conditionally or unconditionally. Conditional allocations are tied to implementation of specific national policies with specific objectives by the National government. *Own Source Revenue:* Article 209 of the Constitution provides that a county may impose: Property rates; entertainment taxes and charges for the services they provide. However, the taxation and other revenue-raising powers of a county shall not be exercised in a way that prejudices national economic policies, economic activities across county boundaries, or the national mobility of goods, services, capital or labour.

Table 2: Average revenue allocations by source (%)

	2013/14	2014/15	2015/16	2016/17
Equitable share (%)	85.7	84.7	81.8	
Conditional allocations (%)	6.8	9.3	13.3	
Own-source (%)	7.5	6.0	4.9	
Total (Ksh millions)	198,698	226,660	287,044	302,198
% Total approved revenue collection	29.1[a]	43[b]	37[c]	32.3[d]

Source: Various Revenue Division Acts.

a - *Based on 2011/2012 audited revenues*

b - *Based on 2009/10 audited revenues approved by the National Assembly, the County Allocation of Ksh 226.66 billion represents 43 per cent of Ksh 529.3 billion audited revenue approved by the National Assembly in accordance with Article 203(3) of the Constitution.*

c - *2012/2013 audited revenues*

d - *2013/14 audited revenues*

The revenue performance for the three financial years have been lower than budgeted in most counties. This is partly because of unrealistic estimates attributed to limited capacity in revenue forecasting. Despite the delays in disbursement from the National Government, transfers from the National Government were 100% for the three financial years.

The county governments have enacted County Revenue Administration and Collection legislation laws, which provide them with the basis for imposition of taxes and levies. Own-source revenues, however, performed poorly mainly because of delays in automation of revenue collection, cases of delays in passage of finance bills in some counties, over-projection of non-specified revenues, lack of valuation rolls to determine appropriate property rates, low compliance rates, and pilferages due to weak revenue collection systems.

The conditional allocations to counties were notably tied towards provision of National government programmes, including free maternal healthcare, leasing of medical equipment, compensation for user fees foregone and level 5 hospitals as well as special purpose grants supporting access to emergency medical services, allocations from Fuel Levy Fund, and loans and grants. However, the performance of the conditional grants was rather low over the review period, with actual disbursements by the National government and international organizations ranging between 0 and 54 per cent of budgeted revenues.

To enhance own-source revenue performance, County governments have embarked on various reforms. In order to expand the tax revenue base, counties are preparing valuation rolls, upgrading infrastructure to improve tourisms revenues, and strengthening management and regulation of parking charges. To improve on compliance, there are ongoing efforts to automate revenue collection, train and improve the terms of service for revenue collectors, and sensitize the public and private sector on County governments' revenue generation programmes. Further, to enhance capacity, some counties have entered into agreement with the Kenya Revenue Authority to collect revenue on their behalf.

2.2 Comprehensiveness and Transparency of Public Finances

The key focus is on comprehensiveness of budget and fiscal risk oversight, and accessibility by the public to fiscal and budget information. Comprehensive budget classification, transparency of County government revenues and expenditure, published information on service delivery performance, and ready access to fiscal and budget documentation are imperative in an effective PFM system.

Generally, County governments have adopted the GFS/COFOG standard of budget reporting which reflects the most important classifications as stipulated in the PFM Act 2012. This allows transactions to be tracked through the budget's formulation, execution and reporting cycle according to administrative unit, economic category, function, or programme. However, budget execution and reporting is made only based on administrative and economic classification. In addition, IFMIS connectivity affected timely preparation of budget implementation review reports and oversight on budget implementation.

Budget documentation is still a major challenge. For example, budget documentation is hardly sufficient to provide a complete picture of the County government fiscal forecasts, budget proposals, and outturn of the current fiscal year. There are no records of expenditures outside financial reports because extra-budgetary units do not prepare any kind of financial reports. Besides, not all counties have aggregation of revenues and expenditures presented in the CFSP and CBROP according to the main heads of the budget classification. In addition, there were no debt stock records since counties are not allowed to borrow, although there were inherited debts.

Although extra budgetary units existed in the county governments, they were not included in the main budgets and, therefore, they were not subjected to scrutiny by the County assemblies. While some of these units were inherited by the counties either from the National government or defunct local authorities, some have been established by the counties. The County governments did not prepare financial reports on extra budgetary units.

The County governments generally use programme-based budgeting (PBB) that shows performance plans for service delivery. However, many County governments do not articulate indicators for outputs and outcomes, and the allocation of resources to specific programmes are not guided by clear economic analysis on investment projects and other activities before the financial resources are deployed. Furthermore, County governments lack effective Monitoring and Evaluation Units. In many cases, counties use Evaluation Committees with representation from various departments, while others hire independent agencies to carry out performance evaluation.

During the preparation and approval process of the annual budget, the public participates through various forums in most counties. To ensure effective communication, some County governments hire translators during the public participation forums. Local radio discussions are also made in the local dialect where the public can call in and contribute on the fiscal documents before and after being tabled in the County assembly.

County governments have developed websites from where the public can access copies of the enacted budgets and other documents such as ADP, CFSP, CIDP, and CBROPs. Although the Appropriation Act is gazetted and made available to the public, it is not posted on the County government website or the sub-county notice boards. Allso, most counties do not publish budget execution reports on their websites. Some County governments also keep budget documents at the Ward offices for easy access by the public. Some County assemblies also have libraries where the documents can be accessed by the public.

2.3 Management of Assets and Liabilities

Effective management of assets and liabilities is necessary to ensure that public investments provide value for money. This requires that assets are recorded and managed efficiently, fiscal risks are identified, debts and guarantees are prudently planned, approved and managed. The assessment carried out in the six counties showed that management of assets and liabilities is weak, mainly because there is no comprehensive asset register, contingent liabilities are not quantified, investment projects are not subjected to economic analysis, and debt management infrastructure is yet to be established.

Management of liabilities

In most cases, fiscal risks from liabilities are not identified and monitored. Thus, county governments face fiscal risks associated with adverse macroeconomic situations, financial positions of public corporations, and contingent liabilities from the County government's own programmes and activities, including extra-budgetary units. For example, while there exists public corporations in most County governments which are either owned or are in the process of being transferred from the National to the County governments as highlighted in Table 3, there are no financial statements for the corporations, and therefore it is not possible to assess their financial performances.

Table 3: Public utilities in various County governments

County	Public corporations	Ownership
West Pokot	1. Kapenguria Water and Sewerage Company (KWSC)	Not yet transferred to the county though supports its operations
Makueni	1. Makueni Sand Harvesting Authority	Owned by the County
Nakuru	1. Eldama Ravine Water and Sanitation Company (ERAWASCO)	National government
Kajiado	None	
Kakamega	1. Kakamega County Water and Sanitation Company 2. Bukura Agriculture Training and Development College	Undergoing transfer from National to County government
Baringo	1. Eldama Ravine Water and Sanitation Company (ERAWASCO) 2. Chemsusu Water and Sanitation Company 3. Kirandic Water and Sanitation Company	Owned by National government Being established by the County government

Source: Various County government reports

County governments have a variety of contingent liabilities, but the values of such liabilities are neither quantified nor are the risks associated with them clearly articulated. The County governments have devised different methods of offering car loans and mortgages to their Members of County Assembly (MCAs) and other county officials. Other common contingent liabilities being implemented by the counties include NSSF, NHIF, LAPFUND, LAPTRUST, small medium loans, students' loans, agriculture loans, and *Mkopo Mashinani* loan schemes. While some counties have managed to offer guarantees to contingent liabilities, others are yet to develop mechanisms of eliminating fiscal risks associated with the liabilities. In most cases, no information was provided on contingent liabilities and other fiscal risks from programmes and projects in the annual reports (CBOP and CFSP) and financial statements.

Investment projects

Counties are yet to develop effective tools for economic analysis of projects. As such, there is no standard criterion for investment project selection in most of the counties assessed. The common practice is reliance on consultation through public participation before the counties implement their investment projects. In some counties, the budget and planning unit is responsible for project selection, and needs-based analysis is conducted at the Ward level to determine the kind of projects to be prioritized. In many counties, feasibility studies are carried out by some agency in the county or external agency. including development partners operating in the county. Furthermore, counties are yet to develop a system in which both capital and recurrent costs of an investment project are included in the budget documents.

Counties are yet to put in place standard procedures and rules for project implementation. Monitoring and Evaluation Departments are yet to be established in the counties assessed, except for West Pokot where such a unit was established in 2016/17. As such, different institutions or agencies undertake monitoring and evaluation of major investment projects, for instance the Public Investment Committee Directorate of Economic Planning, and even community members.

Financial and non-financial assets

Generally, counties maintained good records for financial assets, including cash in hand, cash in bank and its equivalents and outstanding imprests, which are published in annual financial statements and bank reconciliation statements. Nonetheless, there are no up-to-date records on imprests and arrears, and diversity of financial assets is limited. In addition, some counties have financial liabilities that include loans offered to students and micro and small business entrepreneurs.

Management of non-financial assets is still a challenge in many counties. By and large, the Executive and the County Assembly keep a separate non-financial asset register. Even though most counties have tried to maintain some form of asset 'register,' they are yet to undertake annual age and value analysis. Effective management is further undermined by delays in transferring assets and liabilities from the defunct local authorities to the counties. Though the 2015 Assets and

Liabilities Report produced by the defunct Transition Authority was handed to counties, it was not complete. The counties must work together with the Inter-Governmental Relations Technical Committee to ensure that the transfer of assets and liabilities to the counties from former local authorities is completed.

Some counties have adopted procedures for asset disposal from the Public Procurement and Assets Disposal Act 2015, including establishing assets disposal committees to oversee the disposal exercise. Those that have not established standard operating procedures for assets disposal contend that counties are prohibited from disposing their assets until complete transfer of assets from the defunct local authorities is finalized.

Debt management

County governments had not incurred debts from domestic or external sources by the time the assessment was being undertaken. However, they had inherited debt from the defunct local authorities. In this regard, some counties have devised various mechanisms of dealing with inherited debt, including repayment initiatives, but others have not taken any action as there were no clear record of inherited debts from former local authorities.

The counties have made little progress in establishing debt management infrastructure, including debt management strategy and unit to guide borrowing.[2] The counties have to work with the National Treasury and Central of Bank of Kenya to guide in establishing debt management infrastructure.

2.4 Policy-Based Fiscal Strategy and Budgeting

Macroeconomic and fiscal forecasting, including estimating fiscal impact are crucial to developing a sustainable fiscal strategy. Counties prepare their budget documents including the CFSP, CBROP and budget estimates in line with the Public Financial Management Act 2012. However, counties do not carry independent macroeconomic forecasting, neither do they undertake macro-fiscal sensitivity analysis due to technical capacity gaps.

Forecasting

County governments prepare the County Fiscal Strategy Papers (CFSP) annually, which are expected to be aligned to the national Budget Policy Statement (BPS).

2 County governments can borrow funds to meet financial obligations under Article 212 of the Constitution and Section 140 of the PFM Act 2012 and the County PFM Regulations (Nos. 176-196) 2015.

They adopt the national forecasts used in Budget Policy Statement; they do not carry out independent macroeconomic forecasting mainly because there are no county level macroeconomic indicators. Besides, no macro-fiscal sensitivity analysis is undertaken mainly due to lack of technical capacities and baseline data.

Further, in line with the Medium-Term Expenditure Framework, counties prepare forecasts of revenue (by type), expenditure and budget balance for the three MTEF financial years and provide explanation of differences in forecasts. The information is contained in the CFSP, CBROP and the budget estimates. The fiscal forecasts are provided as part of budget documentation submitted to the County Assembly. However, the forecasts tend to be unrealistic, given the limited technical capacity.

Fiscal strategy

County governments prepared County Fiscal Strategy Papers (CFSPs) annually in accordance with Section 117 of the Public Financial Management Act 2012. However, some of the counties failed to publish their current CFSPs online for public access.

In addition, County governments prepared the County Budget Review and Outlook Paper (CBROP) in accordance with Section 118 of the Public Financial Management (PFM) Act 2012. However, most of the CBROPs did not provide clear explanations of deviations in fiscal performance and action plans. Further, some of the current CBROPs were not published as required by law.

Counties prepared annual budget estimates (including programme-based budgets) for the budget year and the two following years allocated by administrative, economic, and programme or functional classification. However, not all County governments align their strategic plans to the medium-term budgets, and estimates for over-lapping MTEF periods were not consistent.

Budget preparation

County governments have budget calendars which stipulate key steps in the budget process with specific timelines drawn from the PFM Act 2012 and are generally adhered to. Comprehensive budget circulars are issued, spelling out the following: the budget calendar; strategies that inform the budget; instructions for expenditure reviews; criteria for project identification; preparation and submission of sector reports; requirements of PFM regulations and standing orders; the format of all strategy documents; and linkages of planning documents. Guidance on budget preparation in some counties have sufficient information in advance, including budget ceilings.

The legal framework for scrutiny of County budget by County assembly is set in the PFM Act 125 (1). The scope of budget scrutiny covers review of fiscal policies, medium-term fiscal forecasts, and medium-term priorities as well as expenditure and revenue estimates. These elements are included in the documents (ADP, CFSP, CBROP and detailed budget estimates) that are submitted to the County assembly for consideration and approval. The submission of these documents by all the counties adheres to set timelines.

A County assembly can approve changes in budget estimates not exceeding 1 per cent of the vote ceiling as guided by PFM Regulation 37 (1) of County Governments, 2015. The County Treasuries also issue guidelines on capital project reallocation. Some County governments are developing a policy for reallocation across budget lines within appropriation heads.

2.5 Predictability and Control in Budget Execution

This focuses on whether the budget is implemented within a system of effective standards, processes, and internal controls, ensuring that resources are obtained and used as intended.

Revenues

Revenue raising measures relating to county taxes, licenses, fees and charges and provisions for the general administration of raising revenue are contained in the County Finance and County Revenue Administration Acts. Some counties are also in the process of enacting a County Rating Act. Information about the rights and obligations of taxpayers are also contained in the County Finance Acts, but information on tax obligations such as: (i) registration; (ii) timely filing of declarations; (iii) payment of liabilities on time; and (iv) complete and accurate reporting of information in declarations provided to tax payers is not customized to meet stakeholder needs in all counties. The information is disseminated through circulars, public barazas, radio announcement, churches, and websites. However, the County governments do not have a formalized redress handling mechanism, but individual complaints can be channeled to the Chief Officer of Finance and Economic Planning Ministry individually or through common interest groups.

In addition, there is no documented risk management system for revenue collection across all the counties. Revenue departments have not put in place comprehensive, structured and systematic approaches for assessing and prioritizing compliance risks. Furthermore, revenue payers have not been classified into various categories of small, medium and large payers to effectively and efficiently facilitate prioritization of compliance risks and mitigation measures. However, most counties have automated or are in the process of increasing automation of revenue collection streams to increase coverage and minimize revenue pilferage. For instance, some counties use a computerized system called ZIZI for collection of market and parking fees, which generates a Z-report daily whose totals equal the total collection for the day for each revenue collector.

All monies raised or received by or on behalf of County governments is paid into the County Revenue Fund, except those excluded by an Act of Parliament. This is in accordance with Article 207 of the Constitution; a County Revenue Fund is established under Section 109 of the PFM Act 2012 The revenue collectors deposit money collected on daily basis in the collection accounts maintained at the commercial banks. The monies are transferred to the County Revenue Fund held at the Central Bank of Kenya either on weekly or monthly basis. The revenue collectors present the daily banking slips to the County Revenue Office for recording.

The revenue accounts reconciliations are done monthly or bi-monthly after the bank statements are received. The reconciliation entails assessment of collections, arrears and transfers even though reconciliation of arrears has not been done for almost all the counties. This is because most County governments do not keep proper records of revenue arrears, except for land rents and house rents, making it difficult to ascertain the value, age and composition of revenue arrears. Nevertheless, revenue arrears were quite significant for those counties that kept records.

Most counties maintain accounts with the Central Bank of Kenya and other commercial banks. For instance, counties maintained various accounts with the Central Bank of Kenya, including: (i) Recurrent account; (ii) Development Account; (iii) Revenue Fund Account; (iv) Deposit Funds account; and (v) Road Maintenance Levy (RML) Fund Accounts. Local commercial banks accounts were mainly used for revenue collection. The counties reconcile the bank balances monthly and consolidate them on annual basis as they prepare the Annual Financial Statements.

The County Revenue departments conduct revenue audit and fraud investigation even though there are no documented compliance improvement plans through which fraud investigations are managed and reported. Internal Audit Departments conduct audit of the revenue in every sub-county through the conventional audit process of planning, field work and interviews with the auditee and discussion with management.

Expenditures

The approved CFSP paper sets the ceiling and levels of commitments for the next financial year. The CFSP is made available to the budgetary units in time for them to submit their budget expenditure commitments. Budgetary units plan and commit expenditure for at least three to six months in advance. The cash flow projections and procurement plans must be aligned to the budget appropriations.

All assessed counties had carried out in-year budget adjustments only once per year. Section 135 of the PFM Act 2012 provides that County governments shall submit a supplementary budget if the amount appropriated for any purpose under the County Appropriation Act is insufficient or need has arisen for expenditure purposes for which no amount had been appropriated by the Act. The in-year adjustments are approved by the County Assembly through the County Supplementary Appropriation Acts.

Counties have put in place mechanisms to monitor payments. A stock of expenditure arrears is then compiled by expenditure composition on a monthly, quarterly and annual basis. However, the expenditure arrears are not categorized by age and composition in all the counties.

Management of payroll

The county governments use the Integrated Personnel Payment Database (IPPD) management system to generate monthly payroll and staff payslip. The system is used for human resource management, including appointments/recruitment, personnel records management, career development and pension. In addition, it administers the records of benefits enjoyed by the officers such as loans, medical benefit, claims and personal advances, and allowances. The payslip data base is uploaded to Government Human Resource Information system (GHRIS), which is an online platform that enables staff to access their pay information. Reconciliation of the payroll with personnel records takes place on an annual basis through payroll audit. All the counties do not have an approved staff establishment but use existing staff and projected hires as a basis for the annual budget. In addition, staff hiring is done on need basis.

Amendments to personnel database and payroll changes are regularly done (mostly monthly) and reports captured in the Authorized Data Sheet (ADS). This is, however, applicable for employees who are on IPPD. Adjustments are done on time to reflect in the subsequent month's pay. Officers who interact with payroll have personal passwords to access the system to ensure a clear audit trail. However, the procedures are not documented in a manual but the roles and responsibilities are contained in the job description. Further, there are no restrictions in making of payroll changes for the staff who are paid through the manual system. The retroactive adjustments were negligible, ranging between 0.02 and 3 per cent.

The payroll section undertakes periodic payroll audits to ensure only bonafide employees are in the payroll. Departmental heads furnish the payroll section with lists of employees working in their respective departments, which enables the payroll section to compare the departmental lists with the one furnished to them by the public service board. Some Counties also carried out head counts to identify ghost workers.

Procurement

Most of the counties had information on items procured, value of procurement and procurement method, even though the accuracy and completeness of the data could not be ascertained. The procurement process is regulated by the Public Procurement and Asset Disposal Act 2015. Section 68 requires that an accounting officer of the procuring entity shall keep records for each procurement. The Procurement Directorate oversees supply chain management. The Directorate uses the IFMIS to monitor the procurement process. Information on the value of awarded contracts can be accessed through the IFMIS and the respective paper project files.

The counties assessed used different procurement methods as provided in the Public Procurement and Asset Disposal Act 2015, including open tendering, request for quotations, direct procurement and restricted tendering. The Act also provides for open and free access to information, the procurement plans, annual procurement statistics, and details of contracts awarded. However, these details were not posted on the website in all the counties, although the public can access the legal and regulatory framework for procurement freely from the Public Procurement and Regulatory Authority (PPRA) website. Data on resolution of procurement complaints is available online as published by the Public Procurement and Administrative Review Board (PPARB). The tendering opportunities are also available on county websites.

2.6 Accounting and Reporting

Accounting and reporting looks at whether accurate and reliable records are maintained and information is produced and disseminated at appropriate times to aid decision-making, management, and reporting. There are three indicators under this pillar: financial data integrity, in-year budget reports, and annual financial reports.

Generally, most counties adhere to the stipulated timelines where bank reconciliations for all active County government accounts takes place monthly.[3] Cases were however identified where counties continued to operate bank accounts of the defunct local authorities even after opening county bank accounts, in contradiction with the provisions of the County Government Public Finance Management Transition Act 2013. In addition, one county maintained suspense accounts which are reconciled monthly and are cleared before the end of financial year.[4] All counties also prepare reconciliation records monthly, and imprest accounts are also reconciled annually but in some cases the amounts are not cleared as the system of recovery through payroll has not been effected.[5]

Counties have established IFMIS as per Section 109 (1) and 110 of the PFM Act 2012. The IFMIS Department in the National Treasury is responsible for introduction of new users within the system with the approval of the accounting officer. The counties have examination units that ensure data integrity by pre-audit of payments before being passed into the system. These units are, however, not in charge of verifying financial data integrity. System users have passwords and the system maintains a log of users' (audit trail) together with their functions. Changes to reports must be approved by departmental heads. However, poor IFMIS connectivity affected timely preparation of budget implementation review reports and oversight on budget implementation.

The counties prepare monthly and quarterly budget reports, which indicate budgeted against actual expenditures.[6] The reports appear in their own template but it is possible to compare the original budget with expenditure at the main administrative headings. Besides, budget execution reports are prepared quarterly and issued at least within four weeks from the end of each quarter. There are instances, however, where counties budget execution reports are prepared quarterly and issued within eight (8) weeks from the end of each quarter.

3 The PFM Regulation No. 90(1), 2015 stipulates that bank reconciliations to all active accounts be prepared every month and submitted to the County Treasury with a copy to the OAG not later than the 10th of every subsequent month

4 Section 107(2b) of the PFM Act, 2012, stipulates that the accounting officer must ensure that monthly reconciliations are performed to confirm balances of each account

5 PFM Regulation No. 93(1&5), 2015 classifies imprests into; (i) Temporary Imprest which is advanced to officers going for official trips and is accounted for in 7 Days after returning to duty station and (ii) Standing Imprest which is advanced to authority to incur expenditure (AIE) holders and is replenished upon retirement and surrender. Imprest account is reconciled annually and presented in the Annual Financial Statements. Section 93(8) of PFM Act, 2012 clarifies that a second imprest should not be given to an officer before the first one is retired

6 PFM Act 166, 2012 requires counties to prepare quarterly reports and deliver copies to the National Treasury, COB and CRA while County Treasury Circular requires preparation of reports of performance of the entire budget during the implementation phase

The counties apply IPSAS cash, in line with the laws of Kenya, in preparing annual financial statements.[7] The Annual Financial Statements by the counties include a summary statement of appropriation, the original budget, and the adjustments which are compared with the actuals for a given financial year. The annual financial statements are prepared based on a template issued by the Public-Sector Accounting Standards Board. Meanwhile, the Public Accounting Standards Board in Kenya is designing a framework for all County governments to move to accrual-basis IPSAS.

2.7 External Scrutiny and Audit

These include assessment of external audit and legislative scrutiny of audit reports, specifically the arrangements for scrutiny of public finances and follow-up on the implementation of recommendations by the executive. The OAG has the primary oversight role of ensuring accountability in the use of public resources in all counties and is required to audit and report on the accounts of all County government entities, covering revenue, expenditure, assets, and liabilities within six months of the end of every financial year.

The external audit and scrutiny by the legislature as currently undertaken does not hold the County governments accountable for their fiscal and expenditure policies and their implementation. The public finances are independently reviewed by the OAG but the external follow-up on the implementation of recommendations for improvement by the executive has not been efficient. The audit reports are issued with delays of up to 12 months, are scrutinized late, and effective hearings are not confirmed. The delays are quite often occasioned by low staff levels at the OAG as well as the back and forth between the OAG and the counties in correction of errors identified in the submitted financial statements. The scrutiny by the County assemblies, the Senate and the Parliament do not result in actions to be taken up by the executive, nor is their work transparent to the public. Thus, the external audit is not effective to enable adjustments and corrections in the PFM system.

7 According to section 68 of the PFM Act 2012, all entities should prepare annual financial statements for each financial year within three months after the end of the financial year and submit them to the CoB and the OAG for audit. The Annual Financial Statements are prepared annually and submitted by 30th September every year in line with the PFM Act 2012.

3. Major Constraints and Challenges

a) Expenditure and revenue deviations

Expenditure deviations in the counties are mainly attributed to: (i) delay in the disbursement of funds from the National government; (ii) procurement delays related to capital projects; (iii) low collection of own source revenue; (iv) technical and human capacity constraints in relation to budget preparation and execution; (v) procurement delays that create a mismatch between the procurement plan and the implementation; and (vi) Poor IFMIS connectivity. which causes delays in processing of financial transactions and late submission of financial reports by counties. On the revenue side, discrepancies were largely attributed to: (i) inaccurate forecasts for own revenues, as evident by low collection of own source revenues; (ii) disconnect between donor agreements and the budgets; (iii) poor revenue collection systems; and (iv) inadequate sensitization of revenue payers.

b) Poor management of assets and liabilities

It was established that the counties have relatively clear records of financial assets (mainly cash in hand, cash equivalent in bank and outstanding imprests) in financial statements. This is not the case with regard to non-financial assets. Some counties have not yet established asset registers showing an inventory of all assets by market rate value and age.

Besides, there has been a slow pace of transfer of assets and liabilities from the defunct local authorities to the County governments. It was also established that the defunct Transition Authority (TA) made compilation of assets and liabilities in their 2015 report to all the counties, but the process was not completed. Incomplete transfer of assets and liabilities has made it difficult to clearly establish the amount of debts and pending bills inherited from the defunct local authorities.

c) Capacity gaps in the PFM system

Some of the gaps that were identified by the PEFA assessment team with regard to PFM at the County level include:

1. Lack of and/or weaknesses in macroeconomic forecasting, macro fiscal sensitivity analysis and assessment of impact of fiscal policies, with clear underlying assumptions. Further, forecasting of revenue and expenditure has also been a challenge given the wide variations between forecasts and actual revenues and expenditures.
2. Lack of consistency of Medium Term Expenditure Framework (MTEF) budgets with broad deviations between overlapping years across all the six counties. This can be attributed to weak forecasting and sensitivity analysis.

3. Low absorption of development expenditures, which is largely hampered by inadequate technical capacities to prepare bill of quantities (BQs) and supervising projects.
4. Weak capacities to carry out economic analysis of investment projects to identify the costs and benefits of every investment proposal. The criteria for project selection are also lacking. This undermines strategic resource allocation and efficient use of public resources.
5. Weak internal audit systems because of low staffing levels and skills. In addition, the focus of the internal audit is mainly on compliance and regulatory issues and is not yet developed to provide full oversight (of all budget users) of the effectiveness of the internal control system. These undermine their efficiency and effectiveness in identifying irregularities and errors in the PFM.

d) Revenue and expenditure arrears

Most County governments do not keep proper records of revenue arrears, except for land rents and house rents, making it difficult to ascertain the value, age and composition of revenue arrears. Besides, the revenue arrears were quite significant, therefore affecting operations of various departments and effective implementation of some budget functions.

Counties are not able to monitor revenue arrears for most revenue streams, mainly because of lack of up-to-date databases on revenue payers, especially the lack of up-to-date business registers and valuation rolls.

e) Weak link between policy making, planning and budgeting

The link between policy, planning and budgeting is weak, especially the extent to which approved expenditure policy proposals are aligned to costed ministerial strategic plans or sector strategies as identified in County Integrated Development Plans (CIDP). Most counties have not prepared sectoral/ministerial strategic plans. There are inadequate mechanisms to monitor budget implementation and performance for service delivery. There is need for the county to publish service delivery reports within set timelines.

f) Low levels of transparency in the PFM

Public participation in the budget making process is also weak, especially about the communication channels for calls for meetings.

Public access to information is limited, especially the access to budget documents within set timelines, e.g. publishing of budget statements (including citizen's budget), budget execution reports, audit reports, macroeconomic assumptions, etc.

Moreover, performance indicators for measuring the outputs or outcomes of the different ministries have not been put in place. Consequently, no information related to performance achieved for service delivery is provided to the public.

4. Conclusion and Recommendations

4.1 Conclusion

The establishment of 47 County governments and implementation of the devolved system of government in Kenya as provided for in the Constitution commenced in 2013. The National government initiated the process of transferring responsibilities (powers and functions) to County governments as a mechanism for enhancing delivery of public services and promoting accountability.

There has been considerable effort towards establishing the foundations of a sound PFM system in many areas within the devolved system of government in Kenya. However, the implementation of the PFM systems in the counties is still in the initial phases, although considerable achievements have been made in many fronts. There is still much work to be done to achieve the level of performance to ensure that the PFM system impacts significantly on the achievement of outcomes of aggregate fiscal discipline, strategic allocation of resources, and efficient service delivery at local, regional and national levels.

The other area of focus in the PFM system in the counties is the internal and external audit systems. So far, the focus of the internal audit in many counties is mainly on compliance and regulatory issues as opposed to providing full oversight (of all budget users) of the effectiveness of the internal control system. Besides, the external audit and scrutiny by the legislature as currently undertaken do not hold the County governments accountable for their fiscal and expenditure policies and their implementation. These shortfalls undermine their efficiency and effectiveness in identifying irregularities and errors in the PFM.

4.2 Recommendations

Considering the findings of the assessment, the following recommendations are suggested:

1. Disbursement of revenues by the National Treasury, as well as submission and approval of audited reports, should be timely to enhance budget credibility and predictability in the County governments. Besides, the counties should automate revenue collection systems and enhance sensitization of revenue payers on existing levies, charges and fees and their importance in service delivery.
2. There is need to build capacity in macroeconomic forecasting (revenue and expenditure forecasting), MTEF budgeting, macro fiscal sensitivity analysis, fiscal impact analysis and economic analysis of investment projects.

3. The link between policy making, planning and budgeting needs strengthening. County governments need to prepare sectoral strategic plans that are in line with the CIDPs and link them to the Annual Development Plans (ADPs) and the budget. Identification of priorities within CIDPs should be in line with national development goals as per Vision 2030.
4. All budget documents should be availed to the public (posted on official websites) in a timely and user-friendly manner. Public participation should be enhanced by using effective means of communication (e.g. radio, notice boards, loudspeakers, public barazas and civic education), packaging budgets in a user-friendly manner, and giving adequate notices.
5. The identification, valuation, and keeping records of all non-financial assets should be improved, especially for land, machinery and equipment. In addition, the cooperation between Inter-Governmental Relations Technical Committee (IGRTC) and the counties is also critical in ensuring the transfer of assets and liabilities to the counties.
6. Systems to monitor revenue arrears should be established, especially through automation of revenue systems and updating of business registers and valuation rolls.
7. County governments should work closely with the Inter-Governmental Relations Technical Committee to resolve the issue of transfer of assets and liabilities from the former local authorities so that the counties address the issue of assets, liabilities and inherited debts.
8. There is need to maintain comprehensive records of revenue arrears including the value, age and composition of revenue arrears.
9. The legislative oversight role and scrutiny should be strengthened to ensure that all audit recommendations are implemented by County governments accordingly for accountability and improvement of service delivery.
10. The monitoring and evaluation units should be established/strenghthened to ensure effective implementation of various activities and programmes, and increase the value for money across various counties.

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