Government of the Republic of Kenya

Public Expenditure and Financial Accountability (PEFA) Assessment

Final Report

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CURRENCY AND EXCHANGE RATES

Currency unit = Kenya Shillings (Kshs)

€1 = Kshs. 83.05 (as of 31 March, 2012)

Government Fiscal Year (FY): 1 July-30 June

Abbreviations and Acronyms

ADB	African Development Bank
ADF	African Development Fund
AGD	Accountant General's Department
AiA	Appropriations in Aid
AIE	Authority to Incur Expenditure
APM	Accounts Payables Module (of IFMIS)
BCC	Budget Call Circular
BOPA	Budget Outlook Paper
BPS	Budget Policy Statement
BROP	Budget Review and Output Paper
BSD	Budget Supplies Department
BSP	Budget Strategy Paper
CAMIS	Cargo Management Information System
CBK	Central Bank of Kenya
CCRS	Common Cash Receipting System
CDF	Constituency Development Fund
CI	Compliance Index
CIT	Corporate Income Tax
CMM	Cash Management Module
COSIS	Customs Oil Stocks Information System
CRA	Committee on Revenue Allocation
CS-DRMS	Commonwealth Secretariat Debt Reporting and Management System
DANIDA	Danish International Development Agency
DMD	Debt Management Department
DPC	Documents Processing Centre
DGIPE	Department for Government Investment and Enterprises (in the Ministry of Finance)
EAC	East Africa Community
EAD	Economic Affairs Department
EACCMA	East Africa Commodity Customs Management Act
EBO	Extra Budgetary Operation
EC	European Commission
ECTS	Electronic Cargo Tracking System
EFT	Electronic Funds Transfer
ERD	External Resources Department
EU	European Union
FRP	Financial Regulations and Procedures, 1989
GBS	General Budget Support
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GiZ	German Investment Agency
GL	General Ledger (of IFMIS)
GoK	Government of Kenya
GPAY	Government Payments System
GHRIS	Government Human Resource Information System

HPA	Higher Performance Account
IA	Internal Audit
IA-G	Internal Auditor General
IEA	Institute for Economic Affairs
IFMIS	Integrated Financial Management Information System
INTOSAI	International Organisation of Supreme Audit Institutions
IPPD	Integrated Payroll and Personnel Database
IMF	International Monetary Fund
IT	Information Technology
ITMS	Integrated Tax Management System
JICA	Japan International Cooperation Agency
KACC/EACC	Kenya Anti-Corruption Commission/Ethics and Anti-Corruption Commission
KENAO	Kenya National Audit Office
KRA	Kenya Revenue Agency
KNBS	Kenya National Bureau of Statistics
LA	Local Authority
LAIFOMS	Local Authority Integrated Financial and Operational Management System
LASDAP	Local Authorities Service Delivery Action Plan
LATF	Local Authority Transfer Fund
LGIS	Local Goverment Information System
LPO	Local Purchase Order
LTO	Large Taxpayers' Office
MDA	Ministries, Departments and Agencies
M&E	Monitoring and Evaluation
MoA	Ministry of Agriculture
MoE	Ministry of Education
MoF	Ministry of Finance
MoMS	Ministry of Medical Services
MoP	Ministry of Planning
MSPS	Ministry of State for Public Service
MTEF	Medium Term Expenditure Framework
MTO	Medium Taxpayers' Office
NA	National Assembly
NGO	Non-Government Organisation
PAC	Public Accounts Committee
PAYE	Pay As You Earn
PBO	Parliamentary Budgetary Office
PE	Procurement Entity
PEFA	Public Expenditure and Financial Accountability
PFMA	Public Finance Management Act
PFMB	Public Finance Management Bill
PI	Performance Indicator
PIN	Personal Identification Number
PIT	Personal Income Tax
PPDA	Public Procurement and Disposal Act
PPDR	Public Procurement and Disposal Regulations
PPOA	Public Procurement Oversight Agency

PRBS	Poverty Reduction Budget Support
PSC	Public Service Commission
PV	Payments Voucher
QEBR	Quarterly Economic Budget Review
RLGO	Regional Local Government Officer
RMLF	Roads Maintenance Levy Fund
SAGA	Semi Autonomous Government Agency
SCOA	Standard Chart of Accounts
SDU	Service Delivery Unit (e.g. school, health centre)
SIDA	Swedish International Development Agency
SME	Small and Medium Scale Enterprise
SO	Standing Orders
SWG	Sector Working Group
TA	Technical Assistance
TB	Treasury Bill
TC	Treasury Circular
TIN	Taxpayer Identification Number
TSA	Treasury Single Account
TSC	Teachers Service Commission
UNDP	United Nations Development Programme.
USAID	United States Agency for International Development
USD	US dollar
VAT	Value Added Tax
VoA	Vote on Account
WB	World Bank

SUMMARY ASSESSMENT

(i) Integrated Assessment of PFM Performance

Policy-based budgeting (PIs 11-12): The annual budget preparation process appears to work well and continues to strengthen. The main thing missing is a meaningful medium term perspective (low ratings for PI-12) facilitating strategic resource allocation decisions. A Medium Term Expenditure Framework (MTEF) is formally in place, but ministries tend to ignore the second year of the MTEF, with preparation of next year's budget effectively starting from square 1 again. Introducing a meaningful medium perspective would be facilitated through mainstreaming of the indicative programme budgeting framework on the basis of the new chart of accounts (currently underway, through the FY2012/13 budget preparation process, and preparing formal forward spending estimates (projections of the situation as is) which, *inter alia*, clearly identify the future recurrent costs implied by capital projects already committed to, including those financed by donors and the Constituency Development Fund (CDF).

Predictability and control in budget execution

Revenue administration is gradually strengthening in terms of PIs 13 and 14, supported in part by new IT-based systems and tax-payer education programmes. Issues relate to the highly complex tax structure, including the system of waivers, exemptions, zero ratings and debt write offs, the administration of which is costly, and, moreover, increases the costs of doing business and the costs to the taxpayer of complying with the system. Collection of tax debts and accounting for this (PI-15) remain as issues, but implementation of the second phase of the Integrated Tax Management System (ITMS) may help to resolve these.

Budget execution and cash management (PIs 4, 16-17, and PI-20 dimension (i)) face issues that impact on the in-year predictability and efficiency of budget execution. A major improvement since late 2011 has been strengthened controls on cash disbursements, facilitated by the first stage of the implementation of the IFMIS Re-engineering Strategy, whereby processing of payments vouchers and requests for cash advances/imprests is controlled within IFMIS, rather than, as previously, manually outside IFMIS. Funds are now released into MDA bank accounts on the basis of actual needs (i.e. to make payments), rather than the monthly needs estimated by MDAs. Supporting this improvement was the establishment of an automated interface between IFMIS and GPAY/EFT (GoK's payment system, established in 2008). The MoF has tightened the administrative procedures for imprests.

Nevertheless, budget execution still faces issues. Commitment control systems are in principle based on approved budgets, not projected cash availability, leading to the risk of payment arrears (end-year pending bills), in the event of revenue shortfalls and budget reallocations during the year through the supplementary budget exercise, both of which seem to be the case every year. Decisions to enter into spending commitments tend to be outside IFMIS, with Local Purchase Orders/contracts being prepared and approved manually on the basis of the approved budget, and only then entered into IFMIS. End-year pending bills have to be paid out of next year's budget at the likely expense of planned service deliveries.

Lack of liquidity appears to be the main reason for pending bills outstanding at the end of the year, but lack of budget provision is also a reason, indicating a violation of the commitment control system. Whatever the reason, pending bills could be avoided if IFMIS was used as the main instrument of budget execution control, with proposed expenditure commitments being approved through IFMIS on the basis of both the approved budget and projected cash availability. The system of government-held bank accounts may also hinder efficient budget execution through insufficient liquidity. Thousands of bank accounts (including those of schools and health care units) are held in commercial banks. The MoF doesn't have information on the balances in these and, in any case, does not have the power to access these balances for the purpose of using them to help finance budget execution without having to borrow.

This situation is likely to change for the better in the near future:

- Under the new Constitution and Public Finance Management Act (PFMA), once the PFM Bill is enacted, budgets will have to approved by June 30th, so MDAs in principle should be able to plan budget execution within a complete one year horizon, rather than a much shorter horizon due to the budget not being approved until well into the new fiscal year;
- The quality of monthly cash flow forecasting should improve with the assistance of the new computerised budget preparation module (Hyperion) that is being introduced, enabling the establishing of meaningful monthly cash expenditure limits based on those forecasts;
- The on-going re-engineering of the IFMIS, resulting in it handling all budget execution processes
- The planned introduction of program performance budgeting should result in a reduction in the number of line items and more flexibility in reallocating between them; and
- The enactment of the PFM Bill would pave the way for the introduction of a Treasury Single Account (TSA) (in principle, possibly also including the bank accounts of the new 47 Counties), which would support more efficient cash management

Effective internal control systems (other than for commitment controls) are partly in place. Payroll and pensions management controls have strengthened in recent years through the Integrated Payroll and Personnel Database (IPPD) and the IT-based pensions management system introduced in 2009. The incidence of ghost workers has decreased markedly and arrears in pension payments are now largely a thing of the past.

Other internal control systems appear to be only partially understood and complied with. The systems, based on the 1989 Financial Regulations, cover all financial management procedures, for examples for bank reconciliation and clearance of imprests. Many are out of date, however, having being replaced by a number of Treasury Circulars, which may not be well-understood due to the ad-hoc way in which they are stored. Non-compliance runs the risk of leakage of funds and wasteful spending. The reports of the Auditor General observe instances year after year of non-compliance with regulations in a number of areas, including, in particular, bank reconciliation, imprest clearance, procurement and accuracy of trial balances. The new PFMA combined with a re-engineered IFMIS would help to address these issues.

Accounting, recording and reporting systems

These are beset with issues, related to compliance with procedures and IFMIS-system errors, and damage the credibility of the Government in terms of its perceived capabilities in PFM management:

Bank reconciliations and clearance of suspense accounts *(D rating for PI-22):* Improvements have been made in terms of accuracy and timeliness due to the move towards electronic payments (GPAY/EFT) away from payment by cheques to electronic. Problems remain, however, in the form of insufficient accounting discipline in terms of ensuring: (i) that bank reconciliations are up to date; (ii) accounting for expenditures at the district level are posted regularly into IFMIS, thereby clearing district suspense accounts (transfers from the centre in the form of advances); (iii) travel related imprests are cleared on time; and (iv) recommendations of the Auditor General and Public Accounts Committee are implemented. The Auditor General in his reports repeatedly points out the above issues.

Reports on resources received by service delivery units (PI-23): An internal allocation system guides the delivery of inputs (e.g. textbooks and drugs) to primary service delivery units (SDUs), but no mechanism is in place to check that the inputs are being delivered and used as planned. The SDUs are not cost centres (i.e. do not have their own budget classification codes), though they have their own bank accounts. The scope for misuse and fraud is potentially significant, as already evidenced under the donor-supported Free Primary Education Programme.

In-year budget execution reports (PI-24): Regular management reports are available and execution – including outstanding expenditure commitments - can be compared to budget but they are not accompanied by any commentary that would inform management perceptions as to the extent that budget execution is on track. They may not be accurate also, particularly in ministries where significant amounts of budget funds are spent at district level and there are delays in clearing district suspense accounts (which correspond to the funds transferred from the centre).

Preparation of end-year final accounts *(D rating for **di**mensions (i) and (iii) under PI-25):* Problems in preparing accurate end-year accounts are also partly due to lack of accounting discipline, but also relate to incomplete data in IFMIS some of which date back several years, and also to the data still held in manual records that together with IFMIS data are used to prepare the final accounts. The final accounts are prepared somewhat hastily in accordance with regulations but are subject to adjustment by line ministries after they have been submitted for audit. Accounting standards are not disclosed and the format used to prepare the accounts does not readily conform to IPSAS or similar standards. The completeness of the accounts is questionable given the disclaimer of opinion issued by the Auditor-General in respect of more than half the accounts in 2009-10.

External scrutiny and audit functions

These have many strengths but leave something to be desired, though this is partly due to the weight placed on them through MoF and line ministries not detecting and addressing irregularities at an earlier stage.

Though the external audit function is well-established and professional, the reports of the Auditor General do not, however, accord with auditing standards for several reasons: unqualified and disclaimer opinions in the same statement; reasons for disclaimer opinions not adequately explained; matters reported not properly explained; and the reporting requirements of Kenyan law not disclosed.

Legislature scrutiny is improving, partly due to the provisions of the 2009 Fiscal Management Act (FMA), which provided for the establishment of the Parliamentary Budget Office (PBO) and strengthened Standing Orders. The PBO has been in place for 2 years now and provides useful analytical capacity to the PFM-related Committees Scrutiny includes the Budget Policy Statement, which outlines the parameters of the draft budget. The Public Accounts Committee (PAC) is more or less up to date in its review of audit reports. Hearings involve all relevant officials and at the end of the process the PAC makes many recommendations.

However, as the PAC itself notes, the same errors recur each year, indicating that its recommendations are not being addressed. The new requirement for the MOF to report progress on implementing audit recommendations as part of the draft budget submissions to Parliament is a step towards greater leverage on the executive.

Comprehensiveness and Transparency

Though improving, the comprehensiveness and transparency of the budget is still lacking in many respects, potentially detracting from peoples' belief in the budget. On the positive side, fiscal information is increasingly available to the public -- for example, the reports of the Auditor General. On the not so positive side:

- The voluminous detailed budget documents entirely in tabular form tend to obscure the purpose of government spending; the situation is improving, however, as GoK is endeavouring to make data more accessible through the open data portal.
- Non-transparent extra-budgetary operations under SAGAs abound; budgets are available to the public but information on actual spending is limited; the same holds true for many donor-funded operations (PI-7 and D2). The operations of the Constituency Development Fund (CDF) lack transparency, though the situation is improving, through constituencies beginning to publish on their websites what the CDF is being used for.
- The fiscal risks posed by state owned enterprises and local authorities are non-transparent.
- Many procurement operations in line ministries are non-transparent, though the situation is improving through the Public Procurement Oversight Authority (PPOA) posting tender notices, contract awards and its procurement reviews on its website.

(ii) Assessment of the impact of PFM weaknesses

The main impacts of the identified PFM weaknesses are on the strategic allocation of resources and efficient service delivery, particularly the latter:

Strategic allocation of resources: The lack of a meaningful medium term perspective in budgeting hinders the linking of spending to policy objectives, the development of forward spending estimates (including the recurrent costs implied by committed capital investments) that can guide strategic resource allocation, and the availability of a mechanism for adjusting the strategic allocation of resources over time in line with changes in priorities.

Efficient service delivery: The budget execution weaknesses noted above impact on the predictability of financial resources available for budget execution to the detriment of service delivery. Non-compliance with internal control systems, are likely to result in wastefulness, to the detriment of actual service delivery relative to planned. Lack of transparency and comprehensiveness of planned and actual public spending raises the risk of wasteful spending not being detected. Weaknesses in accounting systems also imply that wasteful and inefficient spending may not be detected and hinder the ability of the external scrutiny function to hold the executive branch of the government to account.

(iii) Prospects for reform planning and implementation

These are discussed in detail in Section 4. Kenya is basically at a cross-roads. Progress in PFM reform has been limited in recent years for reasons related to the political economy, delays in approving a new PFM act and IFMIS-related problems. This situation may now change significantly as the result of the new Constitution, the imminent PFMA a re-engineered IFMIS and the implementation of Devolution. On the other hand, this ambitious agenda, by virtue of its complexity and demands, poses many risks. Strong political leadership of the PFM reform strategy combined with a well-thought out change management strategy are perhaps essential pre-requisites for success, but neither are guaranteed.

Summary of Performance Indicator Ratings, 2008 and 2012 PEFA Assessments

	A: BUDGET CREDIBILITY	Score 2008 PEFA	Score 2012 PEFA	Performance changes
PI-1/M1	Aggregate expenditure out-turn compared to original approved budget	**B**	**B**	**No change:** Revenue shortfalls resulted in actual aggregate expenditure being reduced relative to the approved budget.
PI-2/ M1	Composition of expenditure out-turn compared to original approved budget	**B**	**C+** **(i) C** **(ii) A**	**This indicator was revised in 2011, and thus the assessment is not directly comparable with the 2008 assessment**, which, under the previous methodology, may have scored too high. The composition of variance was significantly higher in 2010/11 (16.6%) than in the previous two years, mainly related to increased defence expenditure. Dimension (ii) refers to the extent of unallocated contingency items, but the contingency was zero in any case.
PI-3/ M1	Aggregate revenue out-turn compared to original approved budget	**A**	**B**	**Performance deteriorated slightly,** due to challenges in forecasting the economic base variables during a period of both global and domestic economic uncertainty.
PI-4/ M1	Stock and monitoring of expenditure payment arrears	**B** **(i) B** **(ii) B**	**C+** **(i) C** **(ii) B**	**Performance deteriorated:** The stock of arrears has increased since the 2008 PEFA assessment to 4.6% of total primary expenditure at the end of FY

				2011 from 2-3% at the end of FY 2008. MDAs generate the data, though the figures seem to differ according to the source of information.
	B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency	**Score 2008 PEFA**	**Score 2012 PEFA**	**Performance changes**
PI-5/ M1	Classification of the budget	**C**	**C**	**No change:** The budget classification system is mainly based on an administrative and economic classification basis and doesn't clearly indicate the intended purpose of government spending.
PI-6/ M1	Comprehensiveness of information included in budget documentation	**C** *(revised from B)*	**C**	**No change**. The budget documents fulfil four of the nine benchmarks. The 2008 rating has been revised downwards, because the previous PEFA indicated that element 7 was satisfied, which was not the case.
PI-7/ M1	Extent of unreported government operations	**D** **(i) D** **(ii) D**	**D** **(i) D** **(ii) D**	**No change**. Information is available on the budgets of SAGAs and donor agencies, but far less so on actual spending. Very little information available on CDF.
PI-8/ M2	Transparency of Inter-Governmental Fiscal Relations	**B** **(i) B** *(revised from A)* **(ii) A** **(iii) D**	**B** **(i) B** **(ii) A** **(iii) D**	**No change.** Transparency of LATF is rated at B in 2008 assessment, as LA appear to have less than full understanding of LATF allocation criteria.
PI-9/ M1	Oversight of aggregate fiscal risk from other public sector entities	**C▲** **(i) C** **(ii) C▲**	**C** **(i) C** **(ii) C**	**No change:** Consolidated reports on fiscal risk still not prepared. The 2008 assessment indicated a trend towards strengthening under dimension (ii) in terms of the preparation of consolidated fiscal risk reports on local governments, but no such reports were actually prepared.
PI-10/ M1	Public access to key fiscal information	**B**	**B**	**No change:** Four out of the six information elements are met: Annual budget document, budget execution reports, audited financial statements and external audit reports. Procurement contract awards are only published on the PPOA website, but not by the MDAs awarding the contracts.
	C. BUDGET CYCLE	**Score 2008 PEFA**	**Score 2012 PEFA**	**Performance changes**
	C (i) Policy-Based Budgeting			

PI-11/ M2	Orderliness and participation in the annual budget process	**C+** **(i) C** **(ii) A** **(iii) D**	**B** **(i) B** **(ii) A** **(iii) D**	**Performance improved** through the strategic phase of budget preparation adding to the time available for budget preparation
PI-12/ M2	Multi-year perspective in fiscal planning, expenditure policy and budgeting	**C** *(revised from C+)* **(i) C** **(ii) B** **(iii) C** *(revised from B)* **(iv) D**	**C+** **(i) C** **(ii) A** **(iii) C** **(iv) D**	**Performance improved** through increased frequency and greater GoK ownership of DSA. The 2008 rating for dimension (iii) has been revised downwards to C, as the evidence appears to suggest this. The overall score is therefore revised downwards to C from C+.
	C (ii) Predictability & Control in Budget Execution			
	Revenue Administration			
PI-13/ M2	Transparency of taxpayer obligations and liabilities	**B+** **(i) B** **(ii) A** **(iii) B**	**B+** **(i) B** **(ii) A** **(iii) B**	**No change in terms of ratings,** but tax payer education and the tax appeals mechanism has strengthened (ii and iii).
PI-14/ M2	Effectiveness of measures for taxpayer registration and tax assessment	**B** **(i) C** **(ii) A** *(revised from B)* **(iii) B**	**B** **(i) C** **(ii) A** **(iii) B**	**No change in terms of ratings,** but performance is improving (e.g. through further linkages to other data base systems, though not yet to those in the financial sector), and improving quality of audits. Dim (ii) in 2008 assessment was rated as B on account of the waivers system, which falls, however, under PI-13 (i). The rating has been revised upwards to A.
PI-15/ M1	Effectiveness in collection of tax payments	**D+** **(i) D** **(ii) B** **(iii) A**	**D+** **(i) D** **(ii) B** **(iii) A**	**No change** as large stock and low collection rates of tax debts continue to be an issue. Strengthening continues, e.g. IT-based streamlining of tax collection, planned integration of tax debt management with ITMS.
	Budget Execution & Cash/Debt Management			
PI-16/ M1	Predictability in the availability of funds for commitment of expenditures	**B+** **(i) A** **(ii) B** **(iii) B**	**B** **(i) B** **(ii) B** **(iii) B**	**Performance slightly lower** as frequency of updates of cash flow forecasting appears to have diminished.
PI-17/ M2	Recording and management of cash balances, debt and guarantees	**B** **(i) B** *(revised from A)* **(ii) C** **(iii) B**	**B▲** **(i) B▲** **(ii) C** **(iii) A**	**No change, but strengthening occurring under (i) and (iii);** The improved rating under (iii) mainly reflects the new Loan Guarantees Act and the quality of the Medium Term Debt Strategy. The A rating under dim (i) in the 2008 PEFA assessment should have been a B, but this does not change the overall rating.

	Internal Controls			
PI-18/ M1	Effectiveness of payroll controls	**C+** **(i) B** **(ii) B** **(iii) B** *(revised from C)* **(iv) C**	**B+** **(i) A** **(ii) B** **(iii) A** **(iv) A**	**Performance improved** through increased coverage of IPPD (mainly in reference to TSC), initial roll out of GHRIS and establishment of payroll audit functions in MSPS and TSC. The evidence for (iii) suggests this should have been rated B in 2008.
PI-19/ M2	Competition, value for money and controls in procurement	**B** **(i) NA** **(ii) B** **(iii) NA** **(iv) A**	**C+** **(i) B** **(ii) D** **(iii) B** **(iv) B**	**Indicator revised (Jan. 2011) and ratings not directly comparable, but the system has strengthened** (e.g. introduction of a procurement manual and guidelines for framework contracts).
PI-20/ M1	Effectiveness of internal controls for non-salary expenditures	**C** **(i) C** **(ii) C** **(iii) C**	**C** **(i) C** **(ii) C** **(iii) C**	**No change:** (i) Expenditure commitment controls are not yet linked to projected cash availability; (ii) The extent of the applicability of the 1989 Financial Regulations & Procedures and successive Circulars is unclear and staff appear to place heavy reliance on accumulated knowledge and experience rather than a widely available well-documented system; (iii) Compliance with rules/procedures continue to be deficient in a number of areas, as documented in Auditor General reports. The relative importance of non-compliance in terms of fiduciary risk is difficult to determine.
PI-21/ M1	Effectiveness of internal audit	**C+** **(i) B** **(ii) B** **(iii) C**	**C+▲** **(i) B** **(ii) B** **(iii) C**	**No change in terms of ratings, but the IA function is gradually strengthening.** Capacity is improving and Audit Committees, where successfully established, are influencing the extent of implementation on Action Plans in MDAs, as recommended in audit reports.
	C. BUDGET CYCLE	**Score 2008 PEFA**	**Score 2012 PEFA**	**Performance changes**
	C (iii) Accounting, Recording and Reporting			
PI-22/ M2	Timeliness and regularity of accounts reconciliation	**C** *(revised from C+)* **(i) B** **(ii) D** *(revised from C)*	**D** **(i) D** **(ii) D**	**Performance has deteriorated** for (i) and appears to have deteriorated for (ii) which appears, however, to have been mis-scored in the 2008 assessment.

PI-23	Availability of information on resources received by service delivery units	**D**	**D**	**No change:** The data are available, but are not collated into reports.
PI-24/ M1	Quality and timeliness of in-year budget reports	**C+** **(i) A** *(revised from B)* **(ii) B** **(iii) C**	**C+** **(i) A** **(ii) A** **(iii) C**	**No change, though the timeliness of reports (dim ii) has improved.** The quality of data at district level continues to be an issue. Dim (i) in 2008 appears to have been underscored.
PI-25/ M1	Quality and timeliness of annual financial statements	**D+** **(i) D** **(ii) B** **(iii) D** *(revised from C)*	**D+** **(i) D** **(ii) B** **(iii) D**	**No change:** The revision of dim (iii) for the 2008 assessment is because accounting standards are not disclosed.
	C (iv) External Scrutiny and Audit			
PI-26/ M1	Scope, nature and follow-up of external audit	**D+** *(revised from C+)* **(i) C** *(revised from B)* **(ii) B** **(iii) D** *(revised from C)*	**D+** **(i) C** **(ii) B** **(iii) D**	**No change, but capacity is strengthening:** The ratings for dims (i) and (iii) appear to have too high in the 2008 assessment. Dim (i) made little reference to compliance with INTOSAI standards. Dim (iii) is concerned with management implementing recommendations, not KENAO making them.
PI-27/ M1	Legislative scrutiny of the annual budget law	**C+** *(revised from D+)* **(i) B** **(ii) B** **(iii) B** *(revised from D)* **(iv) C**	**C+** **(i) A** **(ii) A** **(iii) A** **(iv) C**	**Performance improved due to the introduction of the BPS, more rigorous Standing Orders under the 2009 FMA, and more time for reviewing the draft budget.** The D rating for dim (iii) in the 2008 PEFA assessment appears too low, a B rating is more appropriate.
PI-28/ M1	Legislative scrutiny of external audit reports	**D+** **(i) D** **(ii) B** **(iii) C**	**C+** **(i) C** **(ii) A** **(iii) C**	**Performance improved** due to a shortening of the time taken (though still long) to review audit reports and the greater in-depth nature of the hearings.
	D. DONOR PRACTICES	**Score 2008 PEFA**	**Score 2012 PEFA**	**Performance changes**
D-1/ M1	Predictability of Direct Budget Support	**D**	**D**	**No change:** Planned EU budget support was not disbursed.
D-2/ M1	Financial information provided by donors for budgeting and reporting on project and program aid	**D** *(revised from D+)* **(i) D**	**D** **(i) D** **(ii) D**	**No change:** The C rating for dim (ii) in the 2008 assessment is likely too high. About 2/3rds of aid shown in the budget estimates is in the form of

		(ii) D *(revised from C)*		Appropriations in Aid, the information on which is not comprehensive or timely, and does not provide a breakdown according to GoK's budget classification system,.
D-3/ M1	Proportion of aid that is managed by use of national procedures	**D**	**D**	**No change**. Donors continued to use less than 50 percent of country PFM (including procurement) systems.

The table below summarises the reasons for revisions of some of the 2008 PEFA ratings. The changes are marginal and do not impact upon the story line of PFM performance since the 2008 assessment.

Revisions to 2008 PEFA ratings

PI	Original Score	Revised Score	Reasons
PI-6	B	C	The assessment indicated that element 7 was satisfied, which was not the case.
PI-8 (i)	A	B	Data underlying fiscal transfer mechanisms not fully transparent. Overall score unchanged.
PI-12 (iii)	B	C	Suggested by evidence. Overall score reduced to C from C+
PI-14 (ii)	B	A	Assessment in 2008 was related to waivers system, which falls under PI-13, not PI-14. Overall score unchanged.
PI-17 (i)	A	B	Debt reconciliation is less than monthly
PI-18 (iii)	C	B	Dimension had been assessed in terms of linkage between IPPD and IFMIS, which is not a relevant link for this dimension. Overall score unchanged.
PI-22 (ii)	C	D	Appears to have been mis-scored for dimension (ii), the score for which has been revised to D from C. The overall score has been revised downwards to C from C+.
PI-24 (i)	B	A	Appears to have been mis-scored, as it included SAGAs within its scope, when it applies only to central government. Overall score of C+ unchanged.
PI-25 (iii)	C	D	PEFA assessment said that accounting standards were disclosed, when they were not. Overall score of D+ unchanged.
PI-26 (i) PI-26 (iii)	B C	C D	(i) Little reference made to adherence to INTOSAI standards. (iii) Dimension concerns response by management, not follow up by Auditor General. Overall score reduced to D+ from C+.
PI-27 (iii)	D	B	Appears to be a mis-score. Overall score increased to C+ from D+.
D-2 (ii)	C	D	Appears to be a mis-score. Overall score reduced to D from D+.

1. Introduction

1.1. Objective

The purpose of the assessment is to assess the PFM system performance of the Government of Kenya, using the PEFA assessment methodology, and to gauge progress in strengthening performance since the last PEFA assessment conducted in 2008. The results of the assessment will principally be used by the Government to inform the new PFM reform strategy and by the donors to inform their development assistance strategies. In particular, the EU will use the results of the assessment as input into decisions to be made about the timing of the last tranche of support under its General Budget Support (GBS) Programme.

1.2. Process of preparing the report

Under contract to ACE (funded by EU) and Ecorys (funded by GIZ) a team of four consultants visited Nairobi during 5-30 March, 2012. The team consisted of Peter Fairman (team leader), Christopher Vanderweele, Ferry Philipsen and Corina Certan. The team held meetings with the key Ministry of Finance (MoF) Departments, four line ministries (Agriculture, Medical Services, Education, Roads), Public Procurement Oversight Authority (PPOA), Kenya Revenue Agency (KRA), Kenya National Audit Office (KENAO), Parliamentary Budget Office (PBO), Public Accounts Committee, Ministry of Public Services, Ministry of Local Government, Local Authority Trust Fund, Fiscal Decentralisation Committee, Teachers Service Commission, Central Bank of Kenya, Ministry of Planning, Taxpayer Foundation, Institute of Economic Affairs, Chamber of Commerce, PFM Reform Secretariat, the IMF Resident Representative and the PFM Development Partner Group. The team also visited the District Accountant in Machakos District and the County Accountant in Thika County Council, and the two municipal councils around those districts.

The PFM Reform Secretariat, located in the Ministry of Finance, played the key coordinating role for the mission in terms of organising meetings and workshops. On the donor side, the EU Delegation in Nairobi and GIZ financed the consultants. The EU Delegation arranged the initial meeting with the PFM donors' group, of which the World Bank is the Chair, and was responsible for co-ordinating with the PFM Reform Secretariat and transmitting for review the draft reports to PFM Reform Secretariat, the PEFA Secretariat, and those development partners involved in assisting with PFM reform.[1] It also provided logistical support in the form of printing of documents for the first (training) workshop. The GIZ PFM team, located in the Ministry of Finance, provided temporary office space, printing facilities, relevant documentation – e.g. budget documents - and transportation to Machakos and Thika. It also provided the PEFA assessment team with many useful insights on the progress being made in PFM reform. The PEFA assessment team gratefully acknowledges all of the above.

The team conducted an inception workshop on 12 March and a de-briefing workshop on 26 March. The first draft of the report was submitted to the EU and PFM Reform Secretariat on 12

[1] The draft ToRs of the PEFA assessment were discussed on several occasions by the PFM donor group, comprising all donors active in the PFM sector in Kenya (World Bank, SIDA, IMF, DANIDA, JICA, GIZ and ADB) and the working group on PFM, comprising the relevant GoK departments and the above-mentioned donors and chaired by the Economic Secretary in the Ministry of Finance. Furthermore, the working group agreed that the PFM Secretariat would play the role of PEFA 'contact point' on behalf of the GoK.

April. Subsequent comments from PEFA Secretariat, EU, PFM Reform Secretariat, and Accountant General's Department were incorporated into the draft report. The team then returned to Nairobi during 21-25 May in order to:

- Hold meetings that it had not been possible to schedule during the previous mission:- Ministry of Public Health, Public Investment Committee in Parliament; the team also had an appointment with Institute of Chartered Public Accounts of Kenya (ICPAK), which unfortunately it had to cancel;
- Obtain some more information from Kenya Revenue Authority in order to complete the scoring of the tax collection indicator;
- Prepare and deliver a one-day workshop on 24 May, at which it presented the main findings of the assessment and discussed these with the many participants at the workshop (MoF, Central Bank, Ministry of Public Service, PPOA, KRA, KENAO, PFM Reform Secretariat, EU, GIZ and IMF). The workshop was opened by the Economic Secretary of MoF); and
- Commence incorporating the comments of participants at the workshop and written comments received by the team during the week (from Internal Auditor General, Ministry of Public Service, Teachers' Service Commission, PPOA, Ethics and Anti-Corruption Commission (EACC), and World Bank). Incorporation of comments continued into June and a second draft was submitted to PFM Reform Secretariat, EU, GIZ and PEFA Secretariat on 10 June. Further comments were subsequently received from the PFM Reform Secretariat, EU Delegation and PEFA Secretariat. This final draft was submitted to the EU Delegation at the end of June.

The team would like to express its appreciation for the excellent support provided by the PFM Reform Secretariat, EU Delegation and GIZ, and the excellent cooperation of the large number of interviewees.

1.3. Scope of the Assessment

This PEFA assessment is focused on the Government of Kenya, comprising the central government ministries, departments and agencies and their district offices. It does not cover the decentralised 175 local authorities, whose expenditure comprises about 5 percent of general government expenditure, nor the large number of Semi Autonomous Government Agencies (SAGAs) and Special Funds.

The assessment is mainly backward looking, assessing PFM performance to date. Depending on the context, the assessment under an indicator may be concerned with the current status of PFM (e.g. revenue administration, PIs 13-14) or performance over the last completed fiscal year (e.g. PI-16, concerning the in-year predictability of the budget), or performance over the last three completed fiscal years (e.g. PIs 1-3, concerning expenditure and revenue performance relative to the approved budget).

2. Kenya Background Information

2.1. General Information

Kenya is a country in East Africa with a land area of 580,000 km^2 and a population of nearly 41 million inhabitants, representing 42 different peoples and cultures. The country lies on the equator and is bordered by Tanzania, Uganda, South Sudan, Ethiopia and Somalia. The agriculture sector employs 80 percent of the population and accounts for 50 percent of all exports and 25 of GDP. Key exports are tourism services, tea and coffee, horticultural products and industrial exports such as refined petroleum products.

In recent years, Kenya's economy has been recovering from a number of shocks in the form of post-election violence which erupted at the end of 2007, droughts in 2009 and 2011, and the global financial crisis from 2008. To address the macroeconomic/macro-fiscal effects of these shocks, Kenya received financial assistance from the IMF under the Rapid Access Exogenous Shocks Facility in May 2009.

The economy grew by 4.1 percent and 5.3 percent respectively during 2009/10 and 2010/11, the reasons being good rainfall, higher prices for Kenyan exports on international markets and increased public investment under the economic stimulus programme implemented by Government of Kenya (GoK) at the end of 2009. The peaceful and transparent manner in which the 2010 referendum on the Constitution was held also helped the business climate to benefit from improved perceptions of political stability. Total public debt did not increase drastically as a result of the economic stimulus programme, rising to 45.9 percent of GDP in 2010/11 from 40 percent of GDP in 2008/09. Real GDP growth has fallen back somewhat since 2010/11 due to the drought in the Horn of Africa.

Inflation, which had been very high in 2008/09, fell during the following two years. It is increasing during 2011/2012 due to increases in import prices, particularly for food (reflecting the drought and increasing domestic demand) and oil (increasing domestic demand). The external current account deficit has increased since 2010/11 due to both the higher global oil and food prices and weakened global economic circumstances. The drought reduced 0.2 percentage points from GDP growth in 2011.[2] At GoK's request, the IMF approved a follow-up loan in January 2011 to support Kenya's efforts to deal with vulnerabilities that could impact on economic growth. The size of the loan was increased significantly in December 2011. Partly as a result, inflation has started to decline, and economic growth has continued.

[2] World Bank, Kenya Economic Update, December 2011.

Table 1: Kenya: Selected Economic Indicators

Population and unemployment	***2008/09***	***2009/10***	***2010/11***	***2011/12***
Total population, millions	38.46	39.46	40.51	n/a
Annual population growth, %	2.6	2.6	2.6	n/a
National income and prices				
GDP current prices (billion Kshs.)	2,176	2,458	2,777	3,281
GDP, annual real growth, %	2.1	4.1	5.3	5.3
CPI (annual average), %	15.0	6.7	6.9	16.2
GDP per capita, Kshs current prices	35,625	35,481	36,179	37,156
GDP per capita, Kshs constant prices	55,438	58,904	64,050	70,829
GDP per capita, U.S. dollars current prices	801	761.503	809.3	874.8
External sector (US$, billions)				
Current account balance	-2,359.7	-1,778.8	-3,138.4	-2,957.7
Capital account balance	258.2	260.1	201.6	411.1
Financial account balance	1,676.8	2,114.5	3,176.5	2,086.1
Overall balance of payments	-424.7	595.7	239.7	-460.5
Gross official reserves (end of period)	3,219	3,799	4,120	4,181
Gross official reserves (in months of imports)	3.1	3.1	3.1	2.9
Current account balance (excl. official transfers) as % of GDP	-7.9	-5.5	-9.6	-8.7
Debt				
Stock of domestic debt, net (end of period), % of GDP	17.9	21.8	22.5	22.4
NPV of total public debt, % of GDP	31.0	37.2	39.1	40.5
Total public debt, net of deposits, % of GDP	40.6	44.8	45.9	44.7

(*Sources*: World Bank, World Development Indicators Database; IMF, Country Report No. 12/14, January 2012, IMF Country Report No. 11/48, February 2011, World Bank, Kenya Economic Update, December 2011, World Economic Outlook, various years – for GDP per capita data..

2.2 Description of Budgetary Outcomes

Strengthened revenue collection has been a key instrument for controlling the fiscal deficit, collection increasing from 22.2 percent of GDP in 2007/08 to 24 percent of GDP in 2010/11. KRA-led revenue administration reforms such as the introduction of e-registration and e-filing, improved information systems, and continuous efforts to raise taxpayer awareness contributed to higher collections, as did strengthened non-tax revenue collection. These gains helped to finance increased spending on urgent Medium Term Plan (MTP) priorities under Vision 2030, but the magnitude of these priorities means that the overall fiscal deficit (excluding grants) is projected to rise to 8.5 percent of GDP in 2011/12 from 5.2 percent in 2010/11, and the primary deficit to 5.4 percent of GDP from 1.8 percent. GoK considers this to be sustainable in the context of the medium term macro-fiscal programme. Tables 2a and 2b elaborate.

Table 2a: Central government budget (in mn Kshs.)

	2007/08	2008/09	2009/10	2010/11*	2011/12**
A.TOTAL REVENUE	**432,220**	**487,893**	**586,377**	**667,539**	**792,100**
1.Domestic Revenue	396,489	455,780	538,836	609,223	718,200
2.Appropriations in Aid	35,731	32,113	47,541	58,316	73,900
B.EXPENDITURE& NET LENDING	**534,842**	**595,719**	**725,201**	**811,849**	**1,071,600**
1.Recurrent	*403,368*	*435,542*	*510,516*	*592,427*	*664,200*
Non-interest expenditure	*355,491*	*383,484*	*446,993*	*516,229*	*580,100*
Interest Payments	*47,877*	*52,058*	*63,523*	*76,199*	*84,100*
2.Development & Net Lending	***131,473***	***160,177***	***214,685***	***219,422***	***407,400***
D.DEFICIT EXCL. GRANTS (commitment basis)	-102,622	-107,826	-138,824	-144,310	-279,500
E.GRANTS	25,449	18,065	31,190	18,769	18,800
F.DEFICIT INCL.GRANTS (commitment basis)	**-77,173**	**-89,761**	**-107,634**	**-125,541**	**-260,700**
G. ADJUSTMENT TO CASH BASIS	84,738	-27,259	-66,740	6,768	24,500
H.DEFICIT INCL.GRANTS (cash basis)	**7,566**	**-117,020**	**-174,374**	**-118,773**	**-236,200**
I.FINANCING	**-7,566**	**117,020**	**174,374**	**118,773**	**236,200**
Foreign Financing	6,326	41,143	22,895	28,390	116,700
Domestic Financing	-13,891	75,876	151,479	90,383	119,500
Of which Domestic Borrowing		*69,427*	*117,037*	*90,383*	*119,500*
Use of GoK bank deposits			*34,442*		
Primary budget balance *** (billions Kshs)	*-29.3*	-37.7	-44.1	-49.3	--176.6
GDP, current prices (billions Kshs)		2,176	2,458	2,777	3,281

* Provisional out-turn; ** Revised estimates, ***Including grants, excluding interest payments. (commitment basis)

Table 2b: Central government budget (in percent of GDP)

	2007/08	2008/09	2009/10	2010/11*	2011/12**
A.TOTAL REVENUE	**22.0**	**21.8**	**23.9**	**24.0**	**24.1**
1.Revenue	20.2	20.4	21.9	22.0	21.8
2.Appropriation–in–Aid	1.8	1.4	1.9	2.1	2.2
B.EXPENDITURE & NET LENDING	**27.3**	**26.6**	**29.5**	**29.3**	**32.6**
1.Recurrent	*20.6*	*19.5*	*20.8*	*21.3*	*20.2*
Non-interest expenditure	18.1	17.1	18.2	18.6	17.6
Interest Payments	2.4	2.3	2.6	2.8	2.6
2.Development & Net Lending	*6.7*	*7.2*	*8.73*	*7.9*	*12.4*
D.DEFICIT EXCL. GRANTS (commitment basis)	-5.2	-4.8	-5.7	-5.2	-8.5
E.GRANTS	1.3	0.8	1.3	0.7	0.6
F.DEFICIT INCL. GRANTS (commitment basis)	**-3.9**	**-4.0**	**-4.4**	**-4.5**	**-7.9**
G. ADJUSTMENT TO CASH BASIS	4.3	-1.2	-2.7	0.2	0.7
H.DEFICIT INCL. GRANTS (cash basis)	**0.4**	**-5.2**	**-7.1**	**-4.3**	**-7.2**
I.FINANCING	**-0.4**	**5.2**	**7.1**	**4.3**	**7.2**
Foreign Financing	0.332	1.84	0.93	1.02	3.54
Domestic Financing	-0.7	3.4	6.2	3.3	3.6
Of which Domestic Borrowing	-	3.1	4.8	3.3	3.6
Use of GoK bank deposits	-	-	1.4	-	-
Memorandum item: Primary budget balance * **		-1.7	-1.8	-1.8	-5.4

* Provisional out-turn; ** Revised estimates, *** Deficit excluding interest payments. (commitment basis)
Sources: QEBR, Second Quarter 2011/12, February 2012; IMF, Country Report No. 12/14, January 2012

Functional classification of the budget

The priorities of the Government have led to higher shares of public spending on economic affairs, education and also health to a slight extent. Shares have been lower for general public services and interest payments, and have stayed the same for defence spending and expenditure on public order and safety. Table 3 summarises.

Table 3: Actual budgetary allocations by COFOG function (as % of total expenditures)

	2007/08	2008/09	2009/10	2010/11*
General public services	17.2	10.8	13.3	13.0
Public debt transactions	21.4	18.1	18.7	20.2
Transfers	1.3	1.4	1.4	1.0
Defence	5.6	5.9	6.8	5.7
Public order and safety	7.7	8.7	7.6	7.8
Economic affairs	14.5	18.9	19.4	19.0
Environmental protection	0.9	0.8	0.7	0.9
Housing and community amenities	2.0	2.7	2.5	2.8
Health	4.1	4.6	4.7	5.2
Recreation, culture and religion	0.9	0.7	0.4	0.4
Education	19.2	20.8	20.2	20.2
Social protection	5.2	6.4	4.2	3.4
TOTAL	100	100	100	100

* Provisional out-turn; ** Revised estimates (Source: Kenya National Bureau of Statistics, Economic Review 2011)

Economic classification of the budget

The economic classification of the budget shows a decrease of the share of recurrent spending in total spending from 75.4 percent in 2008/09 to 73 percent in 2010/11. It is projected to fall sharply to 62 percent in 2011/12. The share of development spending increased to 27 percent from 24.6 percent over the same period, and is projected to increase its share sharply to 37.3 percent in 2011/12.

Table 4: Actual budgetary allocations by economic classification (% of total)

	2007/08	2008/09	2009/10	2010/11*	2011/12
EXPENDITURE& NET LENDING					
1.Recurrent Expenditure	**75.4**	**73.1**	**70.4**	**73.0**	**62.0**
Wages, salaries, pensions	31.8	30.7	27.8	27.2	24.0
Interest Payments	9.0	8.7	8.8	9.4	7.8
Non-wage recurrent, subsidies & transfers	34.6	33.7	33.8	36.0	30.1
2.Development & Net Lending **	**24.6**	**26.9**	**29.6**	**27.0**	**37.3**

(*Source*: QEBR, Second Quarter 2011/12, February 2012); * Prel. Out-turn; ** Up to 40% of this is recurrent expenditure.

2.3. Legal and Institutional Framework for PFM

Legal framework for PFM

2010 Constitution

A major reform of PFM has been brought about by the 2010 Constitution that envisages further legislative changes over a number of years and which will replace most or all of the existing legislation. In the meantime, existing laws prevail, except where they are in conflict with the Constitution.

The new Constitution addresses the composition of the legislature, the appointment of the executive and judiciary, independent posts, and the public service. A major area of change will be the devolution of government, replacing the existing de-concentrated arrangements, which give local government only a minor spending role.

Following the next election, the Parliament will comprise a **National Assembly** of 392, principally, elected members, and a **Senate** of 67 members (47 of whom are elected). Matters solely affecting counties will be dealt with by the Senate. Devolved government will comprise 47 county governments with their own county assembly and elected governor, and revenue sharing arrangements will be introduced whereby funds are transferred from national to county level.

The **executive** comprises an elected President and deputy president, and the rest of the cabinet who are appointed by the President with the approval of the National Assembly. At present, ministers are still MPs and able to speak in the House. When the new constitution takes full effect, cabinet members will not be members of parliament and will only be able to speak before committees of the House.

Laws can emanate from either house, subject to being limited to county matters in the case of the Senate, or the executive and, when approved by both (if necessary), are then approved by the President.

The Judiciary is appointed by the President with the approval of the National Assembly in the case of the most senior appointments. The Judicial Service Commission is involved in the recruitment exercise.

The Constitution provides for two independent appointments: the Auditor-General (Article 229) and a new post, the Controller of Budget (Article 228). Both are appointed by the National Assembly and report to it. The Controller of Budget, a position almost unique to Kenya, is responsible for the oversight of implementation of the budgets of the national and county governments by authorising withdrawals from public funds and reporting to Parliament, the principle being that the authority for the spending of public funds ultimately derives from Parliament.[3] The role was previously performed by the Controller and Auditor-General, a position that implied conflicting responsibilities. The Auditor-General remains accountable to Parliament as before (presenting audit reports directly to Parliament in respect of the financial statements of all the organisations for whose audit he is responsible, within six months of the end of the financial year) but in addition will be accountable to the new county assemblies.

The Constitution also provides (Article 215) for a Commission on Revenue Allocation (CRA), which will make recommendations on the equitable sharing of revenues between: (i) the national

[3] As emphasized in Section 2.1 of the Government Financial Regulations and Procedures (1989).

and the sum of the county governments, the share (i.e. the vertical share) being no less than 15 percent of national revenue (Article 203); and (ii) the county governments (horizontal share). On the basis of such recommendations, a Division of Revenue Bill and County Allocation of Revenue Bill are to be introduced to Parliament at least two months before the end of the financial year (Article 218).

PFM-related laws and regulations

Existing legislation relevant to PFM, and much of which has been updated in minor ways in 2009 without significantly changing earlier laws is referred to in the previous PEFA:

- *Government Financial Management Act, 2004 (revised 2009)*; prescribes the accounts to be maintained and the accounts to be produced by different types of account holders.
- *Government Financial Regulations and Procedures, 1989*; these are based on the Exchequer and Audit Act (1955) and the Paymaster General's Act (1960), and serve effectively as the regulations and procedures supporting the Government Financial Management Act, 2004.
- *Procurement*: covered by the Procurement and Disposal of Public Assets Act 2005 and associated regulations (both effective in 2007 after gazetting.
- *Revenue Sharing* between central and local government; Local Government Act 1998
- *Fiscal Management Act, 2009* introduced fiscal responsibility principles. It establishes the Budget Policy Statement (BPS), outlines the timetable for submission of the BPS and detailed budget estimates to Parliament and prescribes some of the content. It prescribes a requirement for quarterly compliance reports to be submitted to Parliament in terms of the extent to which objectives and targets in the BPS were met, and revenue and expenditure performance relative to targets. It also contains rules about reporting of actions taken on external audit recommendations. It establishes the Parliamentary Budget Office. Appended to the Act are Regulations.
- *Public Audit Law 2009* prescribes the accounts that shall be prepared by the Treasury and submitted to the Controller and Auditor General (now simply the Auditor General under the 2010 Constitution) as well as those of local government and state corporations. The matters on which the Auditor-General shall report and the opinion he is expected to give (if any) are also detailed.
- *External Loans and Credit Act, 2009* to authorize the Government to raise loans outside Kenya;
- *Internal Loans Act 2009* to provide for borrowing by the Government
- *Kenya Revenue Authority Act* setting up the Authority and conferring its powers and responsibilities.

Further details of these acts are provided under the relevant PI.

Chapter 12 of the 2010 Constitution sets out the principles of PFM under seven parts: principles of public finance; other public funds, revenue raising powers, revenue allocations, borrowing and the public debt; revenue allocation; budgets and spending; control of public money; and Financial Officers and Institutions. It provides for a new Public Finance Management Act.

At the time of the PEFA assessment, the Public Finance Management Bill (PFMB), 2012 had been introduced to Parliament, following its gazetting on 23rd February, 2012. The PFMB contains many of the provisions of the 2004 Government Finance Management Act and the 2009 Fiscal Management Act and adds new provisions based on the new Constitution, including in particular in relation to PFM in the newly created 47 County governments. Key provisions under the PFMB in relation to the National Government are provided below, with details provided under the relevant PI in Section 3. Part II of the PFMB provides for Parliamentary oversight of national finances, Part IV provides for PFM at County government level. Part V provides for relations between national and county governments, including through the establishment of an Intergovernmental Budget and Economic Council and the preparation of annual Division of Revenue and County Allocation of Revenue Bills. Part VI provides for an Accounting Standards Board to be established.

Part III of PFMB: National Government Responsibilities with respect to the management and control of public finance:

- *Article 11*: Establishment of National Treasury (NT) (Article 225 of Constitution), headed by the Cabinet Secretary, to be in charge of responsible fiscal policy and management, and managing public finances;
- *Articles 25 and 33:* NT to prepare and submit to Cabinet the Budget Policy Statement (BPS) and Debt Management Strategy by 15th February each year. Parliament shall discuss the BPS within 2 weeks and NT will publish/publicize this within 15 days.
- *Article 26*: NT to prepare a Budget Review and Outlook Paper (BROP) and submit to Cabinet by 30th September each year. Cabinet to discuss within 14 days, then NT to submit to Parliament within 7 days, then NT to publish/publicise within 15 days.
- Articles 28-29: NT to establish a Treasury Single Account (TSA) and associated cash management framework.
- *Articles 36, 37 & 39*: (i) Circular setting out guidelines on budget preparation process issued to national government entities by 30th August each year; (ii) budget estimates and Appropriations Bill to be submitted to Parliament by 30th April each year, representing a change from the previous deadline of 20th June (separate procedures for Parliament and Judiciary); (iii) National Assembly to approve by 30th June each year, representing a change from the 30th August deadline stipulated in the 2009 Fiscal Management Act.
- *Articles 40 & 41:* NT to submit Finance Bill to National Assembly (NA) setting out revenue raising measures, the NA to approve, with or without amendment, within 90 days of the approval of the Appropriations Bill;
- *Article 42:* Parliament to consider Division of Revenue and County Allocation of Revenue Bills not later than 30 days after their introduction.[4]
- *Articles 43-45* describe procedures for adjustments to the budget, including through Supplementary budgets, based on Article 223 in the Constitution. Procedures for these were not stipulated in the earlier PFM legislation.
- *Articles 47-65* prescribe for: the receipt and use of grants and loans, guaranteeing loans, lending money, entering into derivatives transactions, and the establishing of a fully-fledged Public Debt Management Office in the NT.
- *Articles 67-85* prescribe for: (i) the PFM responsibilities of accounting officers and disciplinary measures against these, (ii) appropriate arrangements in place for effective internal audit; (iii) the designation by Cabinet Secretary of receivers and collectors of

[4] Articles 41-42 appear to indicate an anomaly, in that the Appropriations Bill is approved prior to the end of the FY, but the other bills are approved after the end of the FY. It is not clear how the approved budget can be implemented, when the Finance Bill and Division of Revenue Bills have not yet been approved.

national revenue and the annual accounting for this to the Auditor General; (iv) the preparation of consolidated annual financial statements by NT and of financial statements by each national government entity, and the submission of these to the Auditor General, and (v) quarterly reporting requirements of national government entities.

- *Articles 86-101* prescribe for the monitoring of the financial performance of state corporations and County governments, including the preparation of a consolidated report each year, and for the preparation and implementation of fiscal risk mitigation measures. Article 100 provides for the establishment of a Joint Intergovernmental Technical Committee.

Institutional Framework for PFM

The Ministry of Finance has the main governance responsibility for PFM, divided into a number of departments: Budget Supplies, Accountant General, Debt Management, Economic Affairs, Economic Resources, Internal Audit, Public Procurement, and Inspection of Public Enterprise. The KRA administers the revenue administration Acts. Line ministries are in charge of implementation of PFM functions. The PPOA administers the PPDA and associated Regulations.

Payroll matters for most civil servants fall under the mandate of Ministry of State for Public Service, formerly under the Office of the President. Staffing matters are dealt with by the Public Service Commission (PSC) and the Teachers Service Commission (TSC) both of whose roles are laid down in the Constitution; the TSC also handles payroll matters. The PSC has powers to establish and abolish offices in the public service; and appoint persons to hold or act in those offices, and to confirm appointments. The TSC performs similar functions in relation to registered teachers employed in the public sector.

Local government and Devolution

At present, the primary functions of the 176 local authorities are delivery of specific, defined local services (e.g. maintaining recreational facilities, parks and open spaces), as elaborated on in Section 3 under PI-8. Central Government provides some financing through the Local Authority ‘Transfer Fund. (LATF). LATF monies comprise 33 to 40 percent of the total financial resources of local authorities. Other local government revenues include fees (business permits, vehicle parking, markets, etc.) and property rates.

The financing arrangements that will apply once devolution has been implemented are to be prescribed. The CRA has been established to make recommendations concerning the basis for the equitable sharing of revenue raised by the national government, as referred to above.

2.4. The key features of the PFM system

Budget execution, accounting and reporting, and the role of IFMIS

The MoF leads in the budget execution process, which starts with the detailed budget estimates being prepared in a separate stand-alone database and then being entered into the General Ledger (GL) system contained in IFMIS.

The IFMIS was supposed to have played a key control role in budget execution, but hasn’t, even though the two key budget execution modules (Purchasing and Accounts Payables) and the GL have been in place. The inter-linkages between these modules had limitations, resulting in line ministries continuing to use manual processes for preparing and approving local purchase orders (LPOs)/contracts outside IFMIS, and then loading these into IFMIS after the fact. Payments

Vouchers (PVs) were supposed to be prepared within IFMIS on the basis of invoices and receipts of goods and services, but this was not happening. Cash advances/imprests were also supposed to be controlled through IFMIS, but this was also not happening. Officers in line ministries with responsibilities for budget execution did not have access to IFMIS terminals, these being manned generally by accountants for the purposes of generating reports and accounts. Part of the problem was that business processes were never re-organised in support of IFMIS.

This situation has changed, however, as a result of the start of implementation of the IFMIS Re-engineering Strategy, designed during 2010-11, with officers having budget execution responsibilities being able to access IFMIS since late 2011. Payments vouchers are now being prepared within IFMIS, an immediate beneficial consequence being strengthened cash management, through funds being released into MDA bank accounts when needed, rather than on the basis of MDAs' estimates of the funds they need. Control over cash advances/imprests has strengthened, through MoF limiting cash imprests of MDAs to a fixed threshold per month, and through imprests to staff being paid into their bank accounts, thus enabling strengthened tracking.

Further strengthening was achieved at the same time through the automation of the interface between IFMIS and GPAY/EFT (the IT-based payments system established in 2008).[5] The combination of the manual process for PVs and the manual interface between IFMIS and GPAY, presented a significant risk of payments being made that were not covered by the approved budget. Evidence of this includes the accumulation of stocks of unretired imprests and instances of fraud (e.g. the misappropriation of Free Primary Education funds). [6]

The interface between IFMIS and other (in addition to GPAY) functionalities not covered by IFMIS has been largely manual, raising the possibility of errors in reports and accounting statements and perhaps also opportunities for manipulation. Functionalities not covered have been budget preparation, cash flow forecasting, cash plans, procurement, revenue collection payroll management (IPPD), debt management (CS-DRMS) and bank reconciliation. Accordingly, the IFMIS is being expanded to form a multi-functional integrated system for budgeting, procurement, cash planning and commitment control, payroll control, accounts receivable, accounts payable, bank reconciliation, reporting and accounting and fixed assets management. The three basic modules that were supposed to have been part of the IFMIS at the outset will be added: Budget Preparation, Accounts Receivables and Cash Management. The six modules are to be interlinked according to four conceptual themes: Plan to Budget, Procure to Pay, Revenue to Cash, and Records to Report.

Payroll and Pension management

The interface between IFMIS and the payroll management system (Integrated Payroll and Personnel Database -- IPPD) is currently achieved through manual journal entry posting following each payroll run. Postings are made to charge salaries, allowances etc. to the relevant vote head and economic classification. IPPD is the payroll system used by government to pay all government employees (except military personnel) and all teachers electronically by transfer; around 480,000 in total. It is administered centrally in terms of maintaining the system and issuing password to users, but each ministry is responsible for its own payroll input and for operating user controls and reviewing user reports.

[5] Electronic Funds Transfer Encryption Software.

[6] Instances had apparently occurred where payments had been effected on GPAY without going through IFMIS (apparently justified by MDAs on the basis of IFMIS being 'down' at a time when payments needed to be made urgently; Ministry of Public Health mentioned to the assessment team that it was not uncommon for IFMIS to be down).

An electronic interface between IFMIS and the payroll management system is clearly desirable. It seems likely that this will be achieved through the new Government Human Resource Information System (GHRIS) that is currently being rolled out (PI-18 in Section 3). An electronic interface between the IT-based pension management system (established in 2009) is planned to be developed and should be feasible as both systems are Oracle-based.

Revenue collection

Revenue collection systems are discussed under PI-15 in Section 3. Revenue collection data provided by KRA to MoF at present is manually entered into IFMIS, raising the possibility of errors in revenue performance reports and hindering the timeliness and accuracy of cash flow forecasting exercises - and hence monthly cash plans – and also the accuracy of bank reconciliation statements. The Strategy therefore provides for the development of an interface between KRA and IFMIS.

Cash*/debt management and bank reconciliation*

The Central Bank of Kenya (CBK) manually provides daily information to MoF on the balances on GoK bank accounts held in CBK and monthly bank statements. Cheques are no longer used at central government level, thereby enabling more timely and accurate bank reconciliation, but an automated system for providing the information would reduce the scope for errors.

The Cash Management Module (CMM), one the three IFMIS modules that was not introduced at the outset of the IFMIS project, is in the process of being established, enabling electronic provision of bank balance data and bank reconciliation statements. It has been tested in a few pilot MDAs but, at the time of the PEFA assessment, had yet to be rolled out. The system would be able to upload bank statements electronically and then automatically attempt to reconcile them to Cash Book transactions. Any reconciliation errors/differences detected would remain a task outside the CMM. The greater the extent that budget execution is controlled through IFMIS, the greater the probability of accuracy and timeliness of budget execution data and the lower the probability of reconciliation errors.

A further necessary condition for strengthened cash management is the establishment of a Treasury Single Account (TSA) system, which will become possible once the PFMB is enacted.

Because CBK does not have branches in all locations where there are government operations, commercial bank accounts are used with the approval of the Ministry of Finance. For these accounts, ministries receive monthly bank reconciliation returns from the district government accountant. Cheques are still being used with bank reconciliations performed locally and returns made to the ministry HQ.

CBK is co-ordinating the implementation of a country-wide e-banking project (known as T-24), which will enable ministries to have electronic access to their bank accounts. The T-24 project will have a significant impact on district banking arrangements, with the prospect of being able to bring all the accounts within the CBK. It is not clear yet how the T-24 project will interact with the CMM.

External and domestic debt are managed by MoF and CBK respectively, using the Commonwealth Secretariat Debt Reporting Management System (CS-DRMS), as discussed under PI-17 in Section 3. The system is not yet electronically interfaced with IFMIS, but is expected to become so under the Re-engineering Strategy.

Reporting

Budget performance reports are prepared on a monthly, quarterly and annual basis, but the sources of information tend to be different; a fully comprehensive IFMIS would help to provide uniformity. Monthly expenditure outturn statistics are based on 'Net Issues', representing amounts transferred from MoF to the accounts of MDAs, not actual expenditures. Quarterly expenditure data are based on expenditure outturn data collected from returns prepared by MDAs. Expenditure incurred through commercial bank accounts is submitted monthly electronically using a standard form and is then entered into IFMIS by the ministry, which is responsible for ensuring returns are made promptly. User reports can be generated at any time. Returns may not be complete, particularly at district level. Quarterly reports are published (Quarterly Economic and Budget Review, QEBR).

Annual expenditure data are based on audited and unaudited appropriations accounts. The different sources mean that comparisons are problematic. Moreover, the monthly budget outturns are prepared on a cash basis, whereas much expenditure information is on a commitment basis, and non-transparent manual adjustments are required to convert the data to a cash basis. [7]

Annual accounts

These are prepared by each accounting officer in respect of his/her votes and submitted to the Auditor-General. The Auditor-General publishes his report on matters he discovered during the audit and audit certificate together with the detailed accounts. The report and accounts are reviewed by the Public Accounts Committee (PAC) of the National Assembly, which then reports its recommendations to the full House.

Issues in the validity of these accounts abound. A major issue is that the accounting functionality in IFMIS has been deficient, due to system errors in IFMIS right at the outset, through the incorporation of large unexplained suspense accounts on the opening balance sheet that continue to be carried forward year after year. The end-year accounts statements generated by IFMIS thus have thus limited validity, resulting in manual methods also being used to prepare the statements. A further issue is at district level, associated with the time lag between the classification of transfers to districts as advances and their regularisation as expenditures. The relevant PIs in Section 3 and in Annex D elaborate. The re-engineered IFMIS should greatly facilitate the resolution of reporting and accounting issues.

The main advantage of the IFMIS is the automation and integration of countless mechanical manual processes for budget execution, recording, reporting and accounting and the resultant reduction of errors. Though a necessary condition for strengthening PFM systems, the re-engineering of IFMIS is not, however, a sufficient condition. Other conditions where IFMIS is less suitable -- due to the policy nature of these, risk and uncertainty in the external environment and the considerable human interactions and judgements required -- include:

- A sound macro-fiscal framework, including accurate year-on-year and in-year forecasting of revenues and financial resources provided by donors,
- Accurate budget expenditure estimates based on sound budget preparation procedures;
- Accurate in-year monthly cash flow forecasts prepared by MDAs;

[7] See "Kenya: Report on the Governance Finance Statistics Mission (September 28-October 22, 2011)" prepared by Alberto F. Jimenez de Lucio and Felipe P. Bardela, dated January 11, 2012, provided to the assessment team by BSD.

- Establishment of reliable monthly limits on cash availability to MDAs derived from the cash flow forecasts and time horizons for which expenditure commitments can be made (the greater the in-year predictability of resource inflows and the fewer the expected reallocations between MDAs during the year, the longer the horizon allowed); these limits would be entered into IFMIS for the purposes of budget execution control.
- Predictability of in-year adjustments to MDA budgets determined above the level of MDA management; and, fundamentally
- Skilled, well organised and well-facilitated managers and staff anchored within coherent administrative and institutional systems

3. Assessment of the PFM Systems, Processes and Institutions

3.1. Introduction

The following sub-sections provide the detailed assessment of the PFM indicators contained in the PFM PMF (Public Finance Management-Performance Measurement Framework). The scoring methodology only takes into account the existing situation and does not cover on-going and planned activities that may result in higher scores under future assessments, but these are summarized at the end of the discussion on each section.

Each indicator contains one or more dimensions in order to assess the key elements of the PFM process. Two methods of scoring are used. Method 1 (M1) is used for all single dimensional indicators and for multi-dimensional indicators where good performance on one dimension of the indicator is likely to undermine the impact of good performance on other dimensions of the same indicator (in other words, by the weakest link in the connected dimensions of the indicator). A plus sign is given where any of the other dimensions are scoring higher.

Method 2 (M2) is based on averaging the scores of individual dimensions of an indicator. It is prescribed for multi-dimensional indicators, where a low score on one dimension of the indicator does not necessarily undermine the impact of a high score on another dimension of the same indicator. A conversion table for 2, 3 and 4 dimensional indicators is used to calculate the overall score. The PEFA handbook ("PFM Performance Measurement Framework, www.pefa.org) provides detailed information on the scoring methodology. Effective January 2011, a revised methodology is being used for PIs 2, 3 and 19.

3.2. Budget Credibility

Good practice in public financial management emphasizes the importance of the budget being credible so that planned Government policies can be achieved. Budget credibility requires actual budgetary releases to be similar to voted budgets and requires appropriate fiscal discipline to be in place. The indicators in this group assess to what extent the budget is realistic and implemented as intended.

Assessment of Performance Indicators of Budget Credibility

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-1: Aggregate expenditure performance	B	B	**No change in performance**.
PI-2: Composition of variance of expenditure (M1)	B	C+ (i) C (ii) A	**The 2008 assessment was according to a previous methodology and the results are not directly comparable.** The variance increased sharply in 2010/11 due mainly to defence expenditure related to the security situation in Somalia. Dimension (ii) applies to contingency items, but, as the budget does not explicitly contain a contingency, an A rating is given, the overall rating is C+
PI-3: Domestic revenue performance	A	B	**Performance weakened slightly**, due to challenges in forecasting the economic base variables during a period of both global and domestic economic uncertainty.
PI-4: Extent of expenditure arrears (M1)	B (i) B (ii) B	C+ (i) C (ii) B	**Performance weakened slightly**. The stock of arrears has increased since the 2008 PEFA assessment to 4.6% of total primary expenditure at the end of 2010/11 from 2-3% at the end of 2008/9. MDAs generate the data, though the figures seem to differ according to the source of information. A B rating for dimension (i) would require that the stock of arrears constitutes 2-10% of total expenditure and has fallen significantly in recent years.

3.2.1. PI-1: Aggregate expenditure out-turn compared to original budget; and PI-2: Expenditure composition variance and average contingency

Table 5: Budget execution rate for total primary expenditures

Kshs. Millions	2008/9	2009/10	2010/11
Original Budgeted total primary expenditure	532,401	624,581	716,696
Actual primary expenditure	506,444	577,922	630,004
Difference between actual & original budgeted primary expenditure	-26,568	-46,659	-86,692
Difference as % of original budgeted primary expenditure (%)	-5%	-7.5%	-12.1%

Sources: Annual budget estimates, audited Appropriations Accounts and unaudited Appropriations Accounts for 2010/11).

Note: Primary expenditures are defined as total expenditure less debt service payments less donor-funded Appropriations in Aid (AiA)

Table 6: PI-2: Expenditure Composition Variance & Average Contingency

FY	Average Contingency (% of budget) **1/**	Composition Variance **2/**
2008/9	0	3.9%
2009/10	0	6.6%
2010/11	0	16.6%

1/: No explicit contingency item in the budgets; implicitly the rating is A.
2/: Defined as the sum of the absolute deviations for each MDA from the 'adjusted' budget, defined as the original budget for the MDA plus/minus the aggregate deviation (as assessed under the revised methodology for PI-2 that came into effect in January 2011).
Source: Appropriations Accounts, as prepared by Accountant General's Department, MoF. The data for 2010/ 2011 are unaudited.

Actual aggregate expenditure fell short of the originally approved budgets by 5 percent, 7.5 percent and 12.1 percent in 2008/9-2010/11 respectively. One reason was shortfalls in domestic revenue relative to budgeted amounts (PI-3). This reason doesn't apply, however, in 2010/11, as the revenue shortfall was the smallest in this year and the aggregate deviation the highest. The main reasons were a shortfall in domestic financing due to difficulties faced by GoK in selling treasury bills at the interest rates on offer (this problem continued into the first half of 2011/12, affecting budget execution, as indicated under PI-16), and (ii) shortfalls in EU-financed budget support (D1) due to GoK not meeting mainly policy –related conditionalities.

The variance in expenditure composition was 3.9 percent, 6.6 percent and 16.6 percent in 2008/09, 2009/10 and 2010/11 respectively. Actual expenditures of MDAs did not fall short by the same amount of the aggregate deviation, with the actual expenditures of many MDAs falling short of their approved budgets by larger than the aggregate deviation, enabling some MDAs – Ministries of Education, Defence (the two largest MDAs), Local Government and the National Security Intelligence Service -- to have expenditure reductions that were less, in percentage terms than the aggregate deviation. The security situation in Somalia was one reason why the defence budget faced a relatively small cut and was the main reason why the variance was much higher in 2010/11 than in the other two years. The detailed tables underpinning PI-2 are shown in Annex A.

The variance in expenditure composition was somewhat higher than that during the three years covered by the 2008 PEFA. The estimation methodology in effect during that period (and replaced by a strengthened methodology in January 2011) had a downward bias in terms of scores, if the deviations were nearly all the same sign (i.e. nearly all negative, as was the case in Kenya). It is not valid therefore to conclude that performance was worse during the last three completed fiscal years than the period covered by the previous PEFA.

Another way of analysing budget predictability is simply to estimate the sum of the differences between actual and originally budgeted expenditures for each MDA and then to express this sum as a percentage of the approved budget. The results are 5 percent, 8 percent and 15 percent for 2008/9, 2009/10 and 2010/11 respectively.

3.2.2. PI-3: Aggregate revenue out-turn compared to original approved budget

Accurate forecasting of domestic revenue is a critical factor in determining budget performance, since budgeted expenditure allocations are based on that forecast. A comparison of budgeted and actual revenue provides an indication of the quality of revenue forecasting.

Table 7: Domestic Revenue Performance

Kshs millions	**2008/9 Budget**	**2008/9 Actual**	**% Diff.**	**2009/10 Budget**	**2009/10 Actual**	**% Diff.**	**2010/11 Budget**	**2010/11 Actual**	**% Diff.**
Taxes on income,	184,261	184,447	0.1	209,267	209,098	-0.1	254,877	258,091	1.3
Taxes on goods & services	206,804	196,726	-4.9	*227212*	*216083*	-4.9	258,679	252,474	-2.4
Taxes on international trade	52,051	51,131	-1.8	*57746*	*57206*	-0.9	67520	66643	-1.3
Property-related revenue	33,310	21,920	-34.2	*39518*	*17894*	-54.7	39491	22279	-43.6
Sales of goods & services	10,303	2,661	-74.2	*9265*	*2221*	-76.0	1928	2558	32.6
Other	20,616	22,746	10.3	25,277	26,789	6.0	26,635	28,171	5.8
Total	**507,345**	**479,630**	**-5.5**	***568285***	***529291***	**-6.9**	**649,131**	**630,217**	**-2.9**

Source: Accountant General's Department, MoF.

Domestic revenue has been persistently over estimated, unlike during the period covered by the last PEFA assessment (FYs 2005-07), when revenue outturns exceeded budget estimates in two out of the three years. The main shortfalls were under taxes on goods and services, partly due to the difficulties faced in accurately forecasting GDP and domestic demand growth during a period of economic uncertainty related to the global financial crisis.

3.2.3. PI-4: Stock and monitoring of expenditure payment arrears

Payments arrears can arise from financial resource inflow unpredictability, combined with problems with budgeting and budget execution systems. The arrears have to be paid off at some point (providing that the original commitments were legally entered into) out of future budgets, thereby reducing the resources available for financing the delivery of services in future years. In general, a persistent arrears problem reduces the credibility of the budget as a tool for providing for the public goods and services required by society.

In Kenya, unpaid bills owed to suppliers of goods and services are deemed to be arrears – 'pending bills' – if, during the year, they are outstanding for more than three months. At year-end, however, all pending bills are deemed to be arrears, as funds are not available to pay them off and so they have to be paid out of future budgets; unlike in many countries, there is no carry-over facility for paying invoices that were submitted and approved too late in the year for suppliers to be paid by the end of the year.

The stock of pending bills outstanding at the end of the financial year was reported in the Quarterly Economic and Budgetary Reviews (QEBR) until the end of 2007/08. Since then, they have not been reported, as the MoF considers that it is the responsibility of MDAs to pay their bills on time. The only available source of comprehensive information has been the annual report of KENAO on the Appropriations Accounts. These are not yet available for 2010/11 as KENAO is still auditing the accounts (it expects to submit its report to the National Assembly in May). Another source is the Public Expenditure Reviews prepared by MDAs during the strategic phase of budget preparation. Obtaining the information, however, requires going through each Review and adding up the data. Eventually, at the end of the assessment mission, the BSD provided information on pending bills outstanding at the end of FY2011. None of these sources of information indicate the age profile of pending bills.

A system is clearly in place for MoF to monitor the stock of pending bills at any one time, as the MDAs are able to track these, including according to age, based on an invoice aging register that they maintain. The issues are the provision of information to MoF, the ability of MoF to collate this, and, as indicated below, the accuracy of the information.

Meetings with the Ministry of Public Service and the Pensions Department in MoF indicated no arrears in wage, salary and pension payments. These have first priority on available cash, and the political consequence of delaying these by more than a few days would perhaps be significant. The Pensions Department has been using an IT-based system for managing the pension bill for the last few years, and this has improved operational efficiency.[8] Debt service payments are made on time.

According to KENAO's report, the stock of pending bills was Kshs. 16.6 billion at the end of 2009/10representing 2.9 percent of actual aggregate expenditure (as defined under PI-1). Two-thirds of these came under the development budget. The ratio was 3.2 percent at the end of 2008/09. The information provided by BSD indicates higher amounts of pending bills, reaching: (i) Kshs. 23.1 billion at the end of 2009/10 (82 percent under the development budget), equivalent to 4.4 percent of actual 2009/10 expenditure; and (ii) Kshs.28.9 billion at the end of 2010/11 (81 percent under the development budget), equivalent to 4.6 percent of actual aggregate expenditure.

The pending bills analysis distinguishes between pending bills due to lack of liquidity and due to lack of budgetary provision (i.e. not covered by the approved budget). In 2009/10 and 2010/11 85.4 percent and 82.7 percent of pending bills respectively were due to lack of budgetary provision, with the Ministries of Roads and Special Programmes accounting for the bulk of this. The Ministry of Roads' own figures, provided to the assessment team are however, substantially different from those provided to the assessment by BSD: pending bills outstanding of Kshs. 12.3 billion and Kshs. 6.3 billion at the end of 2009/10 and 2010/11 respectively, against BSD's figures of Kshs. 9.5 billion and Kshs. 11.9 billion respectively, the main reason being lack of liquidity, not lack of budgetary provision.

According to the Ministry of Roads, the reasons for its pending bills are: (i) inadequate budgetary provision for road construction/maintenance/rehabilitation, partly because the increasing capacity of local contractors combined with their increasingly easier access to credit is resulting in faster project implementation than foreseen at the time of budget preparation; and (ii) 'procrastination' by MoF in releasing funds combined with the requirement that unspent appropriations balances be surrendered to the MoF at the end of the year. Added to this appears to be the detailed line item structure of the budget that hinders timely flexibility in reallocating appropriations balances from surplus situations to deficit situations. The Ministry claims that it strives to pay its pending bills on a first come-first served basis in order to minimise accrued interest.

Table 8 represents the pending bills situation provided by BSD to the assessment team.

[8] The fiscal sustainability of the pension scheme is an issue, however, and GoK is considering changing the civil service pension scheme to a contributory scheme from the current non-contributory scheme.

Table 8: Pending Bills due to lack of liquidity

Vote		Recurrent	Development			Total	
	Kshs. Millions	**2009/10**	**2010/11**	**2009/10**	**2010/11**	**2009/10**	**2010/11**
01	Office of President & Ministry of Internal Security	884		154	274	1038	274
02	State House	77	129			77	129
03	Ministry of State for Public Service		15			0	15
04	Ministry of Foreign Affairs	72				72	0
05	Ministry of Home Affairs			8	63	8	63
06	Ministry of Planning	15	5			15	5
09	Ministry of Regional Development Authorities	332	206	323	419	655	625
13	Ministry of Roads	152	60		1801	152	1861
14	Ministry of Transport	33	25		300	33	325
15	Ministry of Labour	12	98	36	6	48	104
16	Ministry of Trade		12	19		19	12
18	Ministry of Gender & Children	30	27	4	1	34	28
23	Cabinet Office	9	6			9	6
32	Ministry of Information	510	623			510	623
33	Independent Electorate & Boundaries Commission	291	71			291	71
43	Ministry of Higher Education & Technology	293	284	69	247	363	531
48	Office of Prime Minister	87	23			87	23
57	Nairobi Metropolitan				247	0	247
59	Ministry of Public Works	7	15			7	15
60	Industrialisation				59	0	59
Total		***2804***	***1600***	***614***	***3416***	***3418***	***5016***
Pending Bills due to lack of budgetary provision							
Vote		**Recurrent**	**Development**		**Total**		
	Kshs. Millions	**2009/10**	**2010/11**	**2009/10**	**2009/10**	**2009/10**	**2010/11**
01	Office of President & Ministry of Internal Security	4	58			4	58
04	Ministry of Foreign Affairs	4	147			4	147
05	Ministry of Home Affairs			1140	1140	1140	1140
06	Ministry of Finance	1150				1150	0
09	Ministry of Regional Development Authorities	54	31			54	31
11	Ministry of Medical Services			1000	636	1000	636
13	Ministry of Roads	377	35	9000	10000	9377	10035
14	Ministry of Transport				1013	0	1013

	Kshs. Millions	2009/10	2010/11	2009/10	2009/10	2009/10	2010/11
24	East African Community		41			0	41
32	Ministry of Information				178	0	178
35	Ministry of Special Programmes			6500	9402	6500	9402
42	Ministry of Youth Development	17	86	8	60	25	146
49	Ministry of Public Health			11	5	11	5
59	Ministry of Public Works			740	1080	740	1080
60	Industrialisation		16			0	16
Total		***1606***	***414***	***18399***	***23514***	***20005***	***23928***
	Grand total	***4410***	***2014***	***19013***	***26930***	***23423***	***28944***
	% Lack of liquidity	***63.6***	***79.4***	***3.2***	***12.7***	***14.6***	***17.3***
	% Lack of budget provision	***36.4***	***20.6***	***96.8***	***87.3***	***85.4***	***82.7***
	Recurrent expenditure PBs as % Total PBs	***18.8***	***7.0***				
	Development expenditure PBs as % Total PBs			***81.2***	***93.0***		
	Aggregate Expenditure (from PI-1)					**527922**	**630004**
	Pending Bills as % aggregate expenditure					**4.4**	**4.6**

Source: Data provided by BSD.

3.3. Comprehensiveness and transparency

The indicators in the Comprehensiveness and Transparency dimension of PFM assess to what extent the budget and fiscal risk oversight are comprehensive, as well as to what extent fiscal and budget information is accessible to the public. The matrix below summarises the assessment of indicators under this dimension.

Assessment of Performance Indicators for Comprehensiveness and Transparency

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-5: Budget classification	C	C	*No change in performance.*
PI-6: Budget documentation	C *(Revised from B)*	C	*No change in performance.*
PI-7 (M1): Extent of un-reported government operations	D (i) D (ii) D	D (i) D (ii) D	*No change in performance*
PI-8 (M2) Transparency of inter-governmental relations	B (i) B *(revised from A)* (ii) A (iii) D	B (i) B (ii) A (iii) D	*No change in performance.* Dim (i) in 2008 assessment revised to B.
PI-9 (M1): Oversight of aggregate fiscal risk	C▲ (i) C (ii) C▲	C (i) C (ii) C	*No change in performance.* The strengthening trend indicated in the 2008 assessment did not

			materialise into actual improvement.
PI-10: Public access to fiscal information	B	B	*No change in performance*

3.3.1. PI-5: Classification of the budget

This indicator assesses the extent to which the budget classification system enables the tracking of budgeted expenditure on an administrative, functional and economic classification basis. The assessment is based on the classification system in place for 2010/11 and the 2011/12 budgets. In line with the IFMIS Re-engineering project and planned decentralisation, a new chart of accounts has been designed, which is being used for the preparation of the 2012/13 budget.

Budget documentation separately covers the budgets of MDAs and state corporations.

- *MDA budgets*: The budget estimates for recurrent expenditure are structured on the basis of vote (MDA), sub-vote, administrative (heads and sub-heads), economic and geographical classifications. They include expenditures financed by Appropriations in Aid (AiD) through internally generated resources. The economic classification goes down to very detailed line item detail, but without a summary at broad classification level.[9] Functional classifications are represented by sub-votes, but non-transparently without any summary. Functional classifications are reflected more transparently in the Budget Outlook Paper (now known as the Budget Review and Outlook Paper –BROP), which is a separate document submitted to Parliament for approval early in the budget process; the eleven MTEF sectors (based on sector working groups) represented in the BROP are not consistent with the COFOG functions.
- The budget estimates for the development budget are shown for each vote in a separate budget document, by head and sub-head, but without any distinction between what is recurrent expenditure (e.g. text books funded under a donor project) and capital expenditure. About 40 percent of the development budget is in fact recurrent expenditure.[10] Compliance with GFS 2001 requires capital expenditure (acquisition of fixed assets) to be one of the four broad items of economic classification (the others are personnel emoluments, purchases of goods and services and transfers). Using the GFS 2001 classification, as many countries do (including some that neighbour Kenya), greatly enhances the transparency of the budget and facilitates planning and budgeting for expenditure within a medium-term perspective. [11]
- An indicative programme-performance budgeting framework is in place (PBB) on a pilot basis, using a programme, sub-programme and economic classification structure. It was not part of the formal budget preparation process prior to the preparation of the 2012/13 budget. A manual has been prepared and circulated to ministries, but more work is necessary to clearly distinguish between programme outputs and the inputs required for those programmes.
- Revenues are classified according to recurrent and development revenues, by type of tax.

[9] Financial Regulations (1989) section 5.3.3.
[10] As noted in "Public Expenditure Review, Popular Version 2010", prepared by Minister of State for Planning and National Development.
[11] As also noted in "Kenya: Report on the Governance Finance Statistics Mission,(September 28-October 11, 2011", prepared by Alberto Jimenez de Lucio and Felipe Bardela, Statistics Department, IMF, January 11, 2012.

- Estimates of revenue and expenditure of State Corporations are not presented based on economic classification. A distinction is made between internally generated income and government resources (grants, loans), and expenditure.

Table 9:.GoK budget classification system 1/

Categories	Description	Reflected in budget estimates	Reflected in reporting
Administrative	Vote (ministry, statutory/autonomous agency); Sub-vote (basically functional); Head (department); Sub-head (division);	Yes	Yes (QEBR)
Economic	*Recurrent expenditures*: Personnel, non-wage recurrent and transfers, drilling down to item and line item level under each vote, head and sub-head. *Development expenditures*: Under each vote, mainly on a project/programme basis, with no economic classification. *Revenues*: Recurrent & development, by type, including AiA. *Donor funding*: Identified under development budget, according to whether on-budget or off-budget (categorised as AiA).	Yes	Yes (BROP, QBER, Economic Survey (ES))
Functional	Shown as sub-vote and in BROP (Eleven MTEF sectors) but not consistent with COFOG.	MTEF sectors reflected in BOPA	Yes (KNBS)
Geographic	Province; District.	Yes	No
Programme	Vote; Programme; Sub-programme; Programme output; Performance indicator.	Indicative not formalised in the budget	No, only on core poverty programmes by vote (QEBR)

1/ Source: Annual Budget Estimates.

Up until 2010/11, a budget classification issue had been a discrepancy between the budget classification system used by BSD, as shown in Table 9, and that used by AGD for budget execution and accounting, as indicated in Footnote 10. The differences had arisen due to the budget classification system having being developed in the pre-IT age and changes in organisational structures since then, particularly the separation and merging of MDAs, which had required changed coding structures. These had been reflected differently in the two systems, the changes in IFMIS in accordance with numerical sequencing but then being out of synch with the changes in the BSD system. Though the items covered under the two systems were basically the same, the codes and names were different in some cases, resulting in reporting errors vis-a-vis the approved budget. [12]

[1212] Take the Ministry Vote 07. The five sub-votes are numbered 070,071,075,076 & 077 under the classification system used by BSD. The head codes number 17 in total, starting at 135 and ending at 165 (i.e. not in chronological order). The IFMIS codes integrate the sub-vote and head codes in numerically sequenced order. For example, the

The issue was rectified in time for the preparation of the 2011/12 budget, enabling the adoption of a new budget preparation software package –Hyperion - which is to be interfaced with the re-engineered IFMIS; the draft budget can be uploaded into IFMIS, following which budget execution can be tracked relative to the approved budget. Thus, budget execution would be unambiguously based on the approved budget. .

Ongoing and planned activities

Taking into account the provisions of the new Constitution as reflected in the PFMB (greater focus on programme budgeting) the MoF has developed a new Standard Chart of Accounts (SCOA), which, along with Hyperion, was used to prepare the draft 2012/13 budget (submitted to Parliament in April). A summary of the main changes is shown in Table 10.

Table 10: Changes in Chart of Accounts 2/

Proposed SCOA	Old CoA	Comments
Segment 1 Class	Segment 1 (Class)	**No change in principle.** The segment will enable classification of budget into Recurrent, Development, Revenue and Below the line items.
Segment 2 Vote	Segment 2 (Vote)	**No change in principle.** But digits increased from 2 (99) to 3 (999) to allow future expansion. Though the current 99 digits are adequate to cover the current votes and even the counties, there is need to create room for future expansion and flexibility, hence the 3 digits.
Segment 3 Administrative	Segment 2 (Vote) Segment 3 (Head) Segment 7 (Cost Centre)	**Three segments have been combined** to form the administrative segment in the new SCOA, which has a total of 9 digits to accommodate the projects. “Sub-Vote” which denoted functional classification will be dealt with under Segment 5 (Programmes)
Segment 4 Source of Funding	Segment 5 (Source)	**No change in principle.** The segment has been retained, but has been restructured into 4 levels and 8 digits for more clarity in capturing all the six data fields required.
Segment 5 Programme	Segment 6 (Programme/ Activity)	**No change in principle.** The segment was provided for in current COA but was not used. It has now been re-structured to support programme based budgeting (PBB). Each sub-programme will be mapped to COFOG.
Segment 6 Economic	Segment 4 (Item)	**No change in principle.** The current structure generally resembles GFS, as used in the budget estimates. The detailed values have been cleaned up in line with GFSM 2001.
Segment 7 Geographical Location	N/A, this segment is a new addition	This is a **new segment** that has been introduced to enable generation of expenditure reports by geographical location of beneficiaries. This will be important especially in a devolution environment.

2/ The Old CoA refers to that contained in IFMIS, not the budget classification system used by BSD.
Source: Revised Standard Chart of Accounts (SCOA), Final Structure and Configuration, 13 January, 2012, Task Force on Chart of Accounts, Office of the Deputy Prime Minister and Ministry of Finance.

second Sub Vote (Financial Services), under which five heads fall, is coded as: 070201, 070202, 070203, 070204, 070205, whereby 07 is Vote, 02 is Sub-function, and 01-05 are Heads 1-5. Sub-heads under BDS are referred to as Cost Centres under IFMIS. Source: ‘Program Budget Classification and IFMIS Coding Structure: Review and Next Steps”, Alan Pearson, IMF/East Afritac Consultant, October 2009, as provided to the team by BSD.

An IMF Statistics Department mission to Kenya in late 2011 identified several issues with GoK's financial statistics, the most important ones of which are identified in Section 2.4 (Institutional Framework for PFM) and in footnote 6 above. As one of their outputs, the mission compiled bridge tables aligning GOK's budget classification system with GFS 2001. The exercise showed that alignment was possible, but several adjustments were required. The team recommended that MoF revise the tables to reflect filling of remaining information gaps and the new Chart of Accounts.

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-5: Budget classification	C	C	**No change in performance**. The budget formulation is in principle based on administrative, economic, functional, geographic and programme classifications. Only the economic and administrative classifications are consistently used, the economic classification in most respects aligned with GFS, except for capital expenditure (capital expenditure is captured under the Development Budget, but is mixed up with expenditure items of a recurrent nature). The system does not clearly indicate the intended purpose of government spending.

3.3.2. PI-6: Comprehensiveness of information included in budget

Annual budget documentation should inform the executive, the legislative, and the general public and assist in informed budget decision making and transparency and accountability. In addition to the detailed information on revenues and expenditures, the annual budget documentation should include information on the elements in Table 11. The assessment is based on the last budget presented to the legislature for 2011/12.

The Fiscal Management Act (2009) provides for the main budget documents which have to be submitted to the National Assembly and their timing:

- The Budget Outlook Paper- sets out the background and broad fiscal parameters for the budget and the medium-term, consistent with Government strategies and policies. Starting with the preparation of the 2012/13 budget this was replaced by the Budget Review and Outlook Paper (BROP);
- The Budget Policy Statement (BPS), known as the Budget Strategy Paper until 2010/11. The BPS provides firm sector and ministerial ceilings, which are used for the preparation of the draft budget estimates. The BPS presents an assessment of the current economic situation and broad macroeconomic and fiscal parameters for the next budget and the medium-term as well as strategic policy initiatives and resource allocation criteria consistent with the national strategic objectives;
- The Budget Statement ("Budget Speech") including a Statistical Annex delivered to the National Assembly by the Minister of Finance at the same time as the submission of the Estimates, noted below: The Statement underscores the policy priorities for the respective budget year and outlines all new tax policy initiatives;
- The Estimates of Recurrent Expenditure in 3 volumes (due to the large number of Votes, and the detailed nature of the Estimates).
- The Estimates of Development Expenditure in 2 volumes;

- The Estimates of Revenue ;
- The Annex of Estimates of Revenue and Expenditure of State Corporations;
- The Finance Bill (revenues) and the Appropriation Bill (expenditures);
- The Debt Management Strategy;
- The latest Quarterly Economic and Budgetary Review;
- The *Financial Statements* and the report of the Auditor General on these.

Table 11 summarises the main elements of the budget and their availability in the budget information.

Table 11: **Information Provided in the Budget Documentation**

No.	Budget documentation benchmarks	Availability	Notes
1.	*Macro-economic assumptions*, incl. at least estimates of aggregate growth, inflation and exchange rate	Yes	The (BOPA) BPS indicates the assumptions for the Budget Framework i.e. real GDP growth and inflation. The exchange rate is projected to be stable on the grounds of prudent macroeconomic management.
2.	*Fiscal deficit*, defined according to GFS or other internationally recognised standard	Yes	The projected fiscal deficit, defined according to GFS, is included in the Budget Policy Statement, which is issued in March, as stipulated under the 2009 Fiscal Management Act. It is also shown in the Statistical Annex to the Budget Statement, though not completely according to GFS. The projected fiscal deficit shown in BPS is defined both including and excluding grants on both commitment and cash basis.
3.	*Deficit financing*, describing anticipated composition	Yes	The anticipated composition of deficit financing (broken down by foreign and domestic financing, and privatisation proceeds) is included in the (BOPA) BPS.
4.	*Debt stock*, incl. details at least for the beginning of the current year	Yes	Details on domestic and external debt outstanding and debt service (included debt guaranteed by GoK) by creditor and instrument are included in the Statistical Annex to the Budget Statement for FY (t+1).
5.	*Financial assets*, incl. details at least for the beginning of the current year	No	The budget documentation does not include information on financial assets.
6.	*Prior year's budget out-turn*, presented in the same format as the budget proposal	No	The fiscal outturn for the previous year (2009/10) was presented in the BPS for 2010/11 but not in the budget estimates.
7.	*Current year's budget* (revised budget or estimated out-turn), presented in the same format as the budget proposal	No	Neither revised estimates nor the estimated outturn for the current year's budget are presented in the estimates for the next year's budget.

No.	Budget documentation benchmarks	Availability	Notes
8.	*Summarised budget data for both revenue and expenditure* according to the main heads of the classification used, incl. data for current and previous year	No	Consolidated summarised data are included in the BPS, but only according to economic classification, and are not contained in the budget estimates. For 2009/10, provisional data for outturns were presented, but for 2010/11 only the BPS forecasts were presented, with no provisional data or revised estimates for the current/previous fiscal years.
9.	*Explanation of budget implications of new policy initiatives*, with estimates of the budgetary impact of all major revenue policy changes and/or some major changes to expenditure programs	No	The BPS includes a summary of the government policy initiatives. The Budget Statement/Speech includes an overview of the proposed tax policy measures. Neither of these, however, provides an assessment of the fiscal implications of new policy measures.

The detailed budget estimates, though comprehensive, lack transparency due to the huge amounts of tabular detail provided with no accompanying narrative. Considerable streamlining is needed in order to strengthen the readability of the documentation. Ideally, as is the case with many countries, the budget documentation should fit into one book, rather than a multitude of books, as is the case at present. In addition, transparency would be enhanced through presenting the development budget for each Vote in the same section as for the recurrent budget, and modifying the development budget so that it represents only genuine capital expenditure (doing this would also considerably ease the development of a robust MTEF).

Ongoing and planned activities

The PFMB requires that the BROP includes an analysis of the fiscal implications of the new proposed tax policies.

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-6: Budget documentation	C *(revised from B*	C	**No change in performance**. The budget documents fulfil four of the nine benchmarks. The difference in scoring arises because the previous PEFA indicated that element 7 was satisfied, which is not the case.

3.3.3. PI-7: Extent of unreported government operations

Annual budget estimates, in-year execution reports, year-end financial statements and other fiscal reports for the public should cover all budgetary and extra-budgetary activities of governments to allow a complete picture of government revenue, expenditures across all categories, and financing.

This indicator assesses the level of unreported extra-budgetary operations (EBOs) at the central government level as defined by IMF GFS[13]. Reporting of EBOs should cover planned/budgeted expenditure, actual expenditure, and annual financial statements either through consolidation with other central government expenditure, or shown in a separate document presented to the legislature. The spending by MDAs of own-source revenues also potentially represents an EBO, if they are allowed to retain the revenue for spending, rather than surrendering it to MoF. Own-source revenues include user fees and charges, fines and rental income. The assessment covers 2010/11 (the last completed fiscal year).

(i) Level of extra-budgetary expenditure (other than donor-funded projects), which is unreported, i.e. not included in fiscal reports

The main areas of EBOs relate to the operations of State Corporations and Special Funds (collectively termed as Semi-Autonomous Government Agencies (SAGAs)). The State Corporations Act of 1986 provides for public finance management of State Corporations but the defining line between central government and SAGAs is not clear. The delineation between state corporations of a financial and non-financial nature is also unclear.

The Department for Government Investment and Public Enterprises (DGIPE) in MoF is responsible for the overall management and monitoring of State Corporations while the Accountant General’s Department in MoF is responsible for Special Funds. Every State Corporation since 2005/2006 has entered a performance contract with their parent ministry, co-signed by the Minister of Finance. The Permanent Secretary of the parent ministry is a member of the Management Board for State Corporations.

The DGIPE’s inventory of State Corporations (shown to the assessment team) included 163 State Corporations as of December 2011. This inventory may not be complete, as indicated by another list of corporations, which indicated a total of 165 corporations (according to the revenue and expenditure reports that they submitted for the second quarter of 2011/12), and KENAO records indicating about 175 corporation. Other informal sources suggest more than 200 state corporations and more than 40 special funds. One of the possible reasons for the difference in these numbers is the different interpretation of the definition of State Corporations by different actors.

The Fiscal Management Act 2009 (section 12) stipulates that the approved budgets for state corporations should be annexed to the annual estimates of revenue and expenditure laid before the National Assembly in the form of the ‘Annex of Estimates of Revenue and Expenditure of State Corporations.’ A summary of these is shown in Table 12.The actual revenues and expenditures are not reported on and are not summarised in any budget execution reports or in the annual appropriation accounts. Total expenditures of Kshs.481.6 billion planned for 2010/11 were equivalent to 67 percent of central government budgeted expenditures that year (see PI-1). Budgeted central government transfers to State Corporations amounted to Kshs. 117.7 billion in 2010/11, representing about 13 percent of total budgeted central government expenditure,

[13] In GFS terminology, central government comprises all units at central level carrying out government policies including not only MDAs, but also non-market non-profit institutions that are controlled by and mainly financed by government (statutory funds, trust funds, special funds, social security funds and other autonomous agencies) but excluding local authorities and public business enterprises).

including net lending. Furthermore, transfers to SAGAs would be subject to much greater scrutiny during the budget preparation process.[14]

Table 12: Summary of Estimates of Revenue and Expenditure of State Corporations (Kshs, thousands)

	2008/09	2009/10	2010/11	2011/12
Internally generated income	228,597,297	271,855,532	321,755,289	383,248,284
Government resources	*59,357,392*	*88,036,820*	*117,714,108*	*139,294,965*
Grants – recurrent	48,876,698	67,629,081	67,980,276	62,493,439
Grants – development	10,480,694	20,407,739	49,733,832	76,801,526
Loans	-	-	-	-
Other Incomes	-	-	-	-
Grants	6,626,742	10,897,081	18,086,621	23,370,392
Loans	-	1,863,821	7,645,000	64,373,032
Total income	**294,581,431**	**372,653,254**	**465,201,018**	**610,286,673**
Total expenditure	**272,899,609-**	**324,067,402-**	**481,565,849**	**774,067,825-**
Recurrent	257,246,682	297,133,172	336,439,743	381,857,984
Capital	15,652,927	26,934,230	145,126,106	392,209,841
Surplus or (deficit)1/	**25,405,155**	**51,990, 428**	**76,798,548**	**87,325,089**

Source: GOK, Annex of Estimates of Revenue and Expenditure of State Corporations of the Kenya Government for the Year Ending 30th June 2011.
1/: The total income and expenditure figures in this table do not sum up to the surplus/deficit. Apparently while the loans are not explicitly reflected in the table they are taken into account in the calculation of the surplus/deficit calculations.

In addition, the budgets of the SAGAs do not disclose the potential contingent liabilities of GoK, except for debt guaranteed by it. These are potentially very significant, if pension liabilities are included, but, given the lack of monitoring of the financial position of state corporations it is difficult to assess the total size of contingent liabilities. DGIPE contracted a consulting company in 2009 to conduct a study on contingent liabilities in 24 state corporations and the national Social Security Fund (NSSF)[15]. The study identified Kshs. 57.6 billion of actual liabilities and about Kshs. 28.2 billion of contingent liabilities, outstanding as of 30 June 2007.

Another EBO is the Constituency Development Fund (CDF), through which Members of Parliament channel funds to their constituencies for development projects. The CDF is a fully-fledged parastatal under the Ministry of State for Planning. The CDF is managed by the CDF Board and CDF Committee. The Board is a corporate body responsible for the effective and efficient management of the Fund including approving funding proposals. The CDF Committee, constituted and convened by an elected Member of Parliament, deliberates on project proposals and ultimately monitors their implementation. Transfers from CDF are funded from the budget of the Ministry of State for Planning through the CDF Board. The Board disburses funds to the Committee upon approval of projects, which, in turn, disburses funds to the Project Management Committees (PMC) through District Treasuries. Transfers from CDF are funded from the budget of the National Assembly, which itself is funded by a transfer from the budget of Ministry of Planning. The transfer is recorded in the annual budget, but the planned and actual expenditures

[14] Treasury Circular No. 5/2010 on Guidelines for Preparation of the 2010/11-2012/13 MTEF Budget, April 16, 2010.
[15] Deloitte, Comprehensive financial review/study to identify state corporations' related contingent liabilities. Summary debt, liability and policy report, final report, December 2009.

funded by the transfer, though reported on internally to Ministry of Planning, are not reported on in public (though some constituencies are beginning to do so). The CDF is a significant amount of money, about 2.5 percent of total government expenditure, slightly higher than the transfers to local authorities.[16][17]

The CDF has financed useful development projects (e.g. construction of primary schools and health care centres) but tends not to consult with the line ministries under whose responsibility these projects fall. The Ministry of Public Health indicated to the assessment team that this was an issue, not only because the CDF-financed projects may not fit into the overall sector strategy, but also because the recurrent costs associated with operating the new infrastructure have to be financed out of GoK's budget.

An EBO can be construed as one where a significant item of expenditure is included in the budget, but in such aggregated form that the omission of important detail itself represents an un-reported EBO. The obvious example in the case of Kenya is the defence budget, where military expenditure is shown as a one line, but significant, item; Kshs. 40 billion in the 2010/11 budget, representing about 8 percent of total planned GoK expenditure.

Own source revenue collected by line ministries can be retained in most cases by the ministries and then spent according to AiA provisions. Such spending is reflected explicitly in budget documentation and therefore, if regulations are followed, does not constitute unreported EBOs. The KENAO reports indicate instances of own source revenue collected that was not surrendered to MoF and was not spent in terms of an approved budget. The magnitudes of such instances are difficult to gauge.

Public Private Partnerships (PPP) are a potential source of contingent liabilities for GoK, but at present no PPPs have been agreed to. The GoK is promoting PPPs through its Vision 2030; Sector Plan for Public Sector Reforms 2008-2012. Legal Notice No.38 of March 2009 provides the legal framework under which these partnerships can be entered, but has not yet been finalised. PPP arrangements, if planned properly, can benefit society through an enhanced quantum and quality of public services. If not planned and managed properly, the government runs the risk of the quantum and quality of public services being lower than what they would have been if the government had spent the money itself, and of contingent liabilities becoming actual liabilities.

(ii) Income/expenditure information on donor-funded projects which is included in fiscal reports

Donor support is provided in the form of budget support (EU only), cash-funded operations within the recipient country using budgetary channels (known 'revenue grants and loans'), cash-funded operations not using government budgetary channels (misleadingly termed as Appropriations in Aid), and aid in-kind (off-shore payments). Donor-funded expenditure is

[16] As per the formula stated in the CDF Act, three quarters of CDF is allocated equally between the constituencies, the other remaining quarter according to poverty ratios. The funds are mainly spent on small infrastructure projects; e.g primary schools, roads maintenance, water boreholes (as described in 'Popular version of Public Expenditure Review, 2010'', prepared by Minister of State for Planning and National Development).

[17] The CDF was not covered by the 2008 PEFA assessment, as the transfers from CDF were considered to be non-governmental, as neither LAs nor the central government had the power to decide on the use of the CDF funds. The funding, however, comes from government through the budget for the National Assembly, which also provides for the salaries of the MPs involved in determining the allocation of CDF funds. As it is funded by taxpayers' money, the expenditures financed by transfers from CDF should therefore be subject to the same transparency and scrutiny criteria as expenditures financed by transfers from LATF and RMLF.

significant in Kenya and represented about 45 percent of total budgeted development expenditure for 2010/11, as indicated in Table.13.

Table 13: Development expenditures (Kshs million)

	2010/11 Budget	%
GOK	170,352	53%
Donor loans	102,722	32%
Donor grants	40,491	13%
Local AIA	7,147	2%
Gross	**320,712**	**100%**

With the exception of aid-in-kind, planned donor operations are included in the budget estimates to an extent, but actual donor spending is not included in budget execution reports. Some donors (USAID in particular) operate completely off-budget (regardless of whether the assistance is in the form of aid-in-kind or cash) and information on their support is included neither in the budget estimates nor in the budget execution reports. According to rough estimates, USAID off-budget support amounted perhaps to about 30 percent of budgeted development expenditure for 2010/11. Much of health sector expenditure appears to be off-budget; the 2012 Health Sector Report mentions that more than 77 percent of KEMRI's funds are coming from donors (mainly USAID) and that the planned and actual expenditures of such funds are not reported on at all.[18]

As indicated to the assessment team in its visits to line ministries (particularly Ministry of Public Health, as much of USAID assistance is focused on the health sector) such non-transparent donor practices complicate the efforts of line ministries to prepare robust sector development plans and annual budgets. Moreover, the future recurrent budgets of these ministries are saddled with the recurrent costs of operating the new infrastructure put in place under the donor-financed projects that they had little say in.

Ongoing and planned activities

The Government has introduced a number of measures following the 2009 report on contingent liabilities referred to above. These are described under PI-9.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-7	D	D	**No change in performance**.
(i)	D	D	*Performance unchanged.* Information on the budgets of SAGAs is reported on in annexes to the GOK budget documentation, but information on actual revenue and expenditure performance is not available. Expenditures by SAGAs are partly funded by budgeted transfers (for recurrent and development expenditures) from central government, which amounted to 13 percent (Kshs. 117.7 billion) its budget in 2010/11. While the transfers are included in the budget estimates, actual transfers are not reported. In addition, contingent liabilities arising from state corporations are not reported on, and are probably significant given the large numbers of SAGAs.
(ii)	D	D	*Performance unchanged*. Information on donor financed projects and

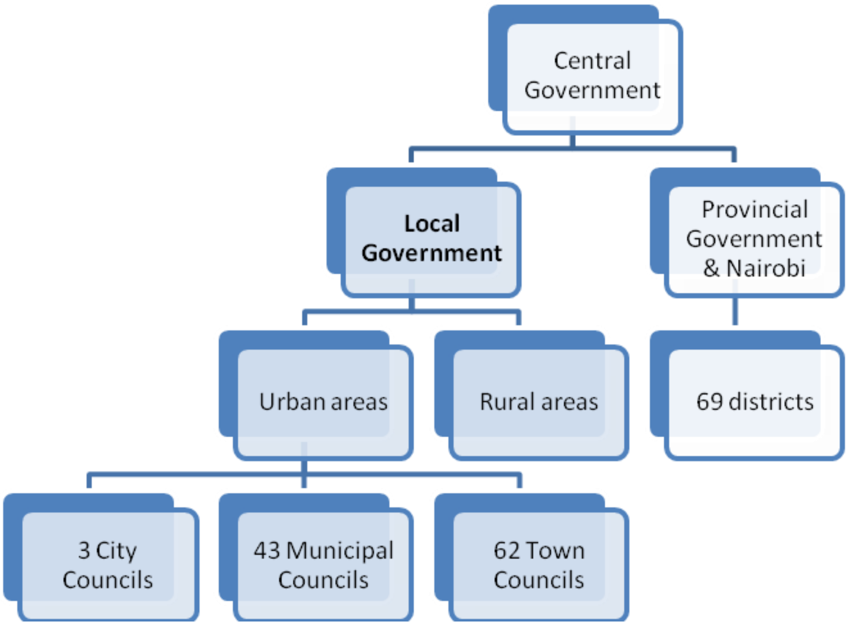
[18] The PER 2010, Popular Version provides a good summary of development partner involvement in each sector and the issues involved.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
			programmes included in fiscal reports is deficient, particularly in terms of actual spending.

3.3.4. PI-8: Transparency of Inter-Governmental Fiscal Relations

This indicator assesses the transparency of transfers from central government to sub-national governments (SNG) for the use of these funds during the last completed FY 2010/2011.

Sub-national government in Kenya consists of 175 local authorities (LA) including 67 county councils, which represent the rural LAs, and 43 municipal councils, 62 town councils, and three city councils representing the urban LAs. Central government activities are de-concentrated throughout Kenya, through seven provinces and the city of Nairobi, and, in turn, through 69 districts. District offices, reporting to their parent line ministries in Nairobi, provide mainly public health and education services. District offices are not covered by PI-8, but are included in the central government assessment. The diagram below indicates the structure of local government (on the left hand side).



The activities of the LAs are governed by the Local Government Act (1998, revised 2010), Local Authorities Transfer Fund (LATF) Act (1998) and LATF Regulations. The LAs have the mandate to provide the following basic services to their communities: solid waste management, public markets, bus parks, slaughter houses, social welfare programmes. A few larger municipalities also provide some health and education related services. Local authorities use the same fiscal year as the central government, but they use accrual accounting basis as opposed to the cash accounting basis used by the central government. MoLG is responsible for the administration of the LATF Fund. MoLG is currently developing an M&E system for local authorities and is implementing the Local Authority Integrated Financial and Operational Management System (LAIFOMS).

The main source of revenue of LAs is from the central government through the Local Authorities Transfer Fund (LATF) grants. LAs used to receive funds from the Road Maintenance Levy Fund (RMLF) and generate own revenue (e.g. revenue from different taxes, fees and charges).

Table 14 shows the distribution of shareable revenue, taking into account the new decentralised situation that will arise in 2012/13 as a result of the new Constitution (see discussion on on-going reform efforts below).

Table 14: Revenue sharing in Kenya (Kshs, billion)

	2009/10 Prov.	2010/11 Rev. Budg.	2011/12 Proj.	2012/13 Proj.
Total shareable revenue	465.0	618.8	703.0	800.9
National Government	425.5	571.9	649.4	670.9
Local Authorities	*26.7*	*31.8*	*36.2*	*130.0*
LATF	10.4	12.9	15.0	-
RMLF	1.7	2.4	2.7	-
Country Revenue Fund (15% of revenue)	-	-	-	105.5
Equalization Fund (0.5% of revenue)	-	-	-	3.5
Local revenues (own sources)	14.6	16.5	18.7	21.0
CDF	12.7	15.1	17.2	-

Source: Republic of Kenya, Budget Policy Statement, March 2011.

The LATF represents about 40 percent of total LA revenues (excluding CDF). The LATF Act (No. 8 of 1998) provides for transfer of 5 percent of national income tax revenues to LAs through the LATF, which is managed by the Ministry of Local Government and Ministry of Finance.

(i) Transparency and objectivity in the horizontal allocation among Sub-national governments

The LATF is an unconditional "block grant" and is therefore not earmarked for the provision of specific services. The LATF Act provides for 0.5% of the annual LATF amount to be used for operational expenditures. The LATF *distribution criterion* provides for:

- A basic minimum lump-sum of Kshs 1.5 million be allocated to each LA;
- 60 percent of the total sum be allocated based on the *relative population* of each LA;
- The balance be allocated based on the *relative urban population* of each LA.

The amount allocated to each LA is further divided into *three components*:

- The *Higher Performance Account* (5 percent of the annual allocation to LATF) – disbursement is linked to fulfilment of 6 conditionalities (see below) and serves as a vehicle for the facilitation of performance improvement in LAs through the extension of conditions of access beyond the ones in force, so as to focus on qualitative improvement based on results, rather than inputs.
- The *Service Delivery Account* (60 percent of the balance) – disbursed if the LA fulfils 3 budget conditions:
    - i. At least 65 percent allocated for capital projects;
    - ii. Not more than 50 percent of the total budget allocated to personnel expenditure,
    - iii. All statutory obligations paid within the year in which they are due.
- The *Performance Account* (40 percent of the balance) – disbursed when the LA meets five additional conditionalities:

i. A statement of receipts, payments, and balances for the previous FY, *by 30th September*;

ii. A statement of debtors and creditors for the previous FY with an explanation of progress towards meeting the previously agreed debt reduction plan, *by 30th September*;

iii. A Local Authorities Service Delivery Action Plan (LASDAP) documenting that the LA conducted a participatory planning process and identified a 3-year rolling programme of projects and activities, *by 30th November*:

iv. An Abstract of Accounts for the previous year to the Auditor General for audit with copies to MoLG and MoF, *by 31st Dece*mber;

v. A Revenue Enhancement Plan outlining how the LA is going to improve its revenue mobilisation during the forthcoming FY, *by 28th February*.

The Higher Performance Account (HPA) was introduced in 2010/11 with first disbursements made to qualifying LAs in the same FY. The rules for its allocation are described in the HPA circulars. Disbursement is linked to fulfilment of the following conditionalities[19]:

1. 30% dependent on evidence of completion of more than 75% (by number and value) of projects;
2. 20% dependent on evidence that actual expenditure on Civic and Personnel expenses did not exceed the approved budget for such expenses by more than 5%;
3. 12.5% dependent on evidence that its actual own revenue is at least 90% of the budgeted amount;
4. 12.5% dependent on evidence that its actual own revenue received for the previous year from local sources exceeds that earned in the year before that by not less than 10%;
5. 5% dependent on evidence that the LA has a Strategic Plan in place and is being implemented;
6. 20% dependent on evidence that the LA received an unqualified external audit report for the previous year.

The pool of funds available for each condition is allocated to each qualifying LA pro rata to the amount allocated for the Service Delivery and Performance Accounts for the corresponding FY. It is the responsibility of the LA to apply for the HPA resources.

Any undisbursed funds remain in the LATF Fund and increase the total amount available to be disbursed in the subsequent year.

The above mentioned allocation criteria for LATF funds are described in the corresponding legal and regulatory framework. Any changes and clarifications are provided in legal notices, the MoLG circulars and summarised in the LATF Annual Reports. The MoLG also publishes in the newspapers the LATF allocations, allocation criteria and conditions, and planned and actual disbursements. In addition, the Fund publishes the LATF Annual Report that summarises the operations of the Fund and provides summary financial profile information on planned and actual revenues and expenditures for all LAs.

[19] MoLG, LATF the Higher Performance Account Circular – 2012 / 2013, 20 February 2012.

That being said, however, no single document summarises the allocation and disbursement criteria spread over the multiple laws, regulations and legal notices. No list is automatically made available to the LAs with the total and urban population of each LA (although this information can be requested from Ministry of Local Government), which could be contested by the LAs as part of the allocation process, while the rapidly increasing population, particularly in the urban areas, may exert service delivery pressures, which are growing faster than the LATF Fund. Representatives of a LA visited suggested that they are not fully aware of the allocation criteria. An example dating back to 2004 was provided to the team illustrating that the actual allocation differed from what the LA thought it would receive, based on the criteria.

(ii) Timeliness of reliable information to SN governments on their allocation

The Local Government Act establishes the framework for the budget formulation, approval and execution process, financial accounting and reporting, budget monitoring and audit, and issues of procurement and project/service implementation. These provisions apply to all LA funds including the LATF allocations. The Minister for Local Government is particularly responsible for the approval of LA budgets and the monitoring and evaluation of LAs' performance. LAs are required to prepare and submit their normal LATF budget submission forms; the 95 LAs using LAIFOMS are required to submit their budgets using its coding system and procedures.

The broad fiscal parameters as well as indicative ceilings are elaborated in the Budget Outlook Paper (BOPA), which is generally issued early in the budget preparation process, i.e. by the end of October (but now issued later through the BROP, which has succeeded the BOPA). At this stage, however, the MoLG does not communicate the indicative allocations to the LAs. The allocations from LATF to LAs are only communicated after the ceilings are finalised in the Budget Policy Statement in March. This is when the MoLG distributes its circular to the LAs with the LATF allocations and the detailed budgeting process for the LAs formally starts. In the case of the LAs, which follow the same fiscal year as the central government, this represents a missed opportunity since at the time when the MoLG gets the Budget Circular from the Treasury with the indicative ceilings in February, it could provide the LAs also with indicative ceilings. The LA budgets are very small relative to the budgets of central government line ministries (total LA expenditure is only about 5 percent of central government expenditure) and thus preparing detailed budgets quickly is manageable.

LAs have less than 4 weeks to submit their budget estimates, passed by their Councils, to the relevant Regional Local Government Officer (RLGO). The RLGO in turn distributes copies to members of the Regional Budget Committee, which has about 6 weeks to review the budget submissions and provide recommendations to the MoLG, which has finally to approve the LA budgets. LAs then have 5 days to finalise their budgets, and face penalties if they delay. The budget for LAs must be approved before the start of the FY and a summary of budget estimates must be published by the end of July in at least two national newspapers.

The LATF Annual Report mentions that all disbursements in 2009/2010 were made in time. The visited LAs reported, however, in recent years that disbursements were regularly delayed by about one month.

(iii) Extent of consolidation of fiscal data for general government according to sectoral strategies

The LATF Act and regulations require the LAs to produce regular reports that can be used in the monitoring, investigation, and audit of LAs. The LAs are required to submit the following information to MoLG:

- A Statement of Revenues, Expenditures and Cash and Bank Balances (annually),
- An Abstract of Accounts (annually, within 6 months from year-end),
- A Statement of Debtors and Creditors and a Debt Reduction Plan (annually by 30th December),
- An annual Revenue Enhancement Plan (annually),
- A Local Authority Service Delivery Action Plan (LASDAP) (annually),
- A quarterly financial report (within 15 days from quarter-end).

The MoLG is responsible for the management of the LATF Fund, in particular for maintaining relevant records, including a computerised database of submitted information. MoLG reports annually to KENAO on all financial aspects of the LATF Fund. All LAs are, however, required to submit their Appropriations Accounts directly to KENAO within three months from the year-end. In practice these are generally submitted by the end of December. KENAO subsequently signs a confirmation receipt that is submitted to Kenya Local Government Reform Programme of the MoLG together with the Accounts.

MoLG captures the information flows from the LAs in a computerised Local Government Information System (LGIS), but the fiscal information on LAs is not consolidated into annual reports consistent with central government fiscal reporting; LGIS is not yet integrated with MoF information systems. The LGIS has some reporting and analysis features -- reporting on financial performance and position, and the status of services being provided by LAs -- but limited capacity for preparing a consolidated analysis.

The release of LATF funds to LAs is dependent upon their timely fulfilment of reporting requirements. Failure to comply can result in the loss of 15%, 40% or even 100% of LATF allocation if the submissions are delayed by more than 1, 30 and 60 days respectively. The LATF Annual Report for 2009/2010 shows that four councils were penalised for late submission of some required documents.

Ongoing and planned activities

A number of measures have been introduced since the last PEFA assessment, which cannot yet be reflected in the scoring of PI-8:

- The Higher Performance Account was added to LATF in 2010/11, as described above.
- A revised uniform annual financial reporting template in accordance with IPSAS and in line with the LAIFOMS Chart of Accounts was introduced for the preparation of the 2009/10 financial statements.
- KENAO developed a checklist on accounts submission for all LAs to adhere to.
- Increased regularity of internal audits conducted at LA level.

- The LGIS is being developed further so that it can provide wider physical and financial performance reporting and analysis capability and be integrated with information systems in the Ministry of Finance and elsewhere within Government. .

The new 2010 Constitution provides for fiscal decentralisation through devolved governments and the setting up of the *Commission on Revenue Allocation (CRA).* The CRA is in charge of making recommendations concerning the basis for equitable sharing of revenue raised by the national government. The new legal framework stipulates that a minimum of 15 percent of national revenue should be allocated to the 47 counties. It also establishes an Equalization Fund comprising 0.5 percent of national revenue to allow marginalised areas to provide basic public services.

PI (M2)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-8	**B**	**B**	**No change in performance. Dimension (i) in 2008 PEFA is revised to B, as the multiplicity of criteria and lack of clear information on the source data detract from transparency, but this makes no difference to the overall score.**
(i)	*B (revised from A)*	B	*No change in performance:* This dimension covers LATF and RMLF. The criteria for allocating LTAF and RMLF are transparent and rules based on paper. The multiplicity of the criteria and the lack of clear information on the source data (e.g. population and urban population) detract, however, from transparency to the extent that the criteria are not necessarily well understood by LAs. For this reason, the A rating for 2008 assessment has been revised down to B.
(ii)	A	A	*No change in performance:* LAs commence their detailed budgeting process in March, following the receipt (based on BPS) of reliable information on the LATF allocations to be transferred to them.
(iii)	D	D	*No change in performance:* MoLG collects fiscal information from LAs, the classification of this is not comparable to the central government classification and is therefore not consolidated with central government fiscal reports on either an *ex-ante* (budgeted) or *ex-post* (actual) basis.

3.3.5. PI-9: Oversight of aggregate fiscal risk from other public sector entities

This indicator assesses the extent to which central government monitors and manages fiscal risks with national implications arising from activities of autonomous government agencies (AGAs), public enterprises (PEs) and activities at SNG level. Fiscal risk can take the form of debt service defaulting (with or without government guarantee), operational losses caused by quasi-fiscal operations, expenditure payment arrears and unfunded pension obligations. The assessment is based on the last completed FY (2010/11).

(i) Extent of central government monitoring of AGAs and PEs

At least 165 State Corporations (see PI-7) fall under the State Corporations Act, which contains various reporting requirements. Every corporation is required by the end of February to submit to the Minister of Finance for approval, estimates of its revenue and expenditure for the following FY accompanied by proposals for funding all projects, including those currently being implemented (Section 11, State Corporations Act). Since 2005 (Treasury Circular No. 1/2005) corporations have also been required to submit quarterly revenues and expenditures within one month from the quarter-end and financial statements within three months from the year- end.

Under the Public Audit Act 2003, State Corporations and Statutory Bodies are required to submit their financial accounts to the Ministry of Finance, their parent line ministry, and KENAO within 3 months of the year end.

The DGIPE in MoF is the body charged with overseeing State Corporations, but in practice its oversight seems limited. While most of the corporations submit quarterly and annual reports[20], DGIPE does not monitor, consolidate or analyse this information, and does not even maintain a logbook on the submission of these reports.

The audit reports on State Corporations prepared by KENAO are reviewed by the Public Investment Committee (PIC) of the Parliament, the process taking about a year. The PIC gives 60 days to DGIPE to respond to its queries. Based on the responses from State Corporations, DGIPE compiles a Treasury Memorandum (i.e. a status report on the measures taken by the State Corporations) signed by the Permanent Secretary of MoF and tabled in the Parliament. An Inter-ministerial Committee will then prepare a response to PIC on general policy matters. The PIC may then follow-up on remaining recommendations/issues not yet addressed in the Treasury Memorandum. Furthermore, the FMA requires the Minister of Finance to lay before the Parliament a quarterly and cumulative compliance report on a quarterly basis. None of the reports, however, address the overall fiscal risk.

(ii) Extent of central government monitoring of SN governments' fiscal position

The Local Government Act (sections 222 and 225) empowers LAs to borrow on the domestic market, with prior approval from MoLG, followed by the approval of the Minister of Finance. Failure to honour repayment obligations for two months may result in the winding up and dissolution of the concerned LA. Other remedies include the appointment of receivers by the High Court to collect revenues and allocate these towards payment of outstanding balances.

The issue of debt amongst LAs has been always a source of concern for GoK. Poor financial management, inadequate collection enforcement, low local revenues and inadequate central monitoring were responsible for earlier debt crises. A study on LA debt[21] was carried out in 2009 with assistance from EC. Strategies were then prepared to encourage the reduction of LA debt burden through the requirement to prepare debt resolution plans and obtain certification of settlement of current statutory debts each year in order to qualify for LATF allocations. The LATF Regulations required LAs to eradicate outstanding debt by 30th June 2010. According to the LATF Annual Report 2009/10, the overall reported debt burden fell from Kshs. 37.8 billion in 2008/09 to Kshs 7.3 billion in 2009/10, the decrease mainly being terms of long term debts. The 13 most indebted LAs make up 81 percent of the debt, the City of Nairobi accounting for 47 percent of this.

LAs are also required to provide evidence that they are up to date with current liabilities to statutory creditors. According to the MoLG, although reports of most LAs make it appear that they have cleared their debts, in practice a number of them haven't as they have refinanced their debts through commercial banks.

LAs report regularly on their debt position through the Statement of Debtors and Creditors and the Debt Reduction Plan, but it is not clear how comprehensive the information is. According to

[20] *Source*: DGIPE: a list of State Corporations which submitted the 2nd quarterly report for 2011/2012.

[21] MoLG, Kenya Local Government reform Programme, Support to the Development of Debt Resolution Plans for Local Authorities, technical Support through EC, June 2009.

the LATF Annual Report for 2009/10, amounts reported by LAs are not audited or harmonised with the creditors. According to the Institute for Economic Affairs (IEA)[22], some LAs have entered into PPPs.[23]. However, as no GoK and/or LA policy on PPP is in place, it is not clear how these are incorporated in the budgeting and reporting of the LAs, and consequently it is not clear what the fiscal risks are for GoK arising from these PPPs.

While the MoLG monitors the fiscal position of the LAs on an annual basis it does not make a consolidated overview of the overall fiscal risks arising from LAs.

Ongoing and planned activities

Dimension (i): The PFMB mentions that one of the functions of MoF (formally to be known as National Treasury) is to monitor the financial performance of state corporations (Section 12, 2 k).

The Government has introduced a number of measures following the 2009 report on contingent liabilities referred to under PI-7.

- *Strict monitoring and evaluation of State Corporations linked to performance contracting*: State Corporations must take debt service and statutory obligations as a first charge on their revenues and other income (Treasury Circular 23/2009) with effect from 2010/11. A new target was introduced in the performance contracts related to the obligation to include liabilities in financial statements and to report on a quarterly basis;
- *Change in the nature of state corporations pension schemes*: All State Corporations operating Defined Benefit (DB) Pension Schemes were required to convert to the Defined Contribution (DC) Pension Schemes (Treasury Circular No.18/2010) and to report on the status of implementation of the conversion (Treasury Circular No. 17/2011) with effect from 2012/13;
- *Conclusive vesting of assets and liabilities*: DGIPE, with World Bank assistance, is preparing an inventory of all assets and their valuation as a basis for the planned vesting;
- *Privatisation of some State Corporations*: During 2009/10 the government approved privatisation programmes for 26 State Corporations. Privatisation is on-going for some of them, others will privatise during 2012/13;
- *Review the framework of governance for State Corporations*: A draft policy has been developed and approval is expected in 2012/13, following which a new State Corporations Act will be prepared;
- *New reporting templates*: New templates for reporting by State Corporations will be prepared once the PFMA Bill has been approved and supporting Financial Regulations prepared;

Other: (i) Commercial State Corporations should formulate dividend policies (Treasury Circular No. 17/2011) to be in effect for 2012/13 and (ii) State Corporations with outstanding liabilities should put in place plans and initiate restructuring proposals and other remedial measures (Treasury Circular No. 17/2011) to be in effect for 2012/13

Dimension (ii): Following the recommendations of the Debt Resolution report, strategies were prepared to encourage the reduction of LA debt burden through the requirement to prepare debt resolution plans and obtain certification of settlement of current statutory debts each year in order

[22] Institute of Economic Affairs, Understanding the Local Government System in Kenya, A Citizen's Handbook, 2009.

[23] An example of PPP is the partnership of Nairobi City Council on street beautification.

to qualify for LATF allocations. LAs were required to eradicate outstanding debt by 30th June 2010 (substantially reduced, but not eliminated). These activities do not impact on the scoring relative to the 2008 PEFA assessment.

PI (M 1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-9	**C▲**	**C**	**No change in performance**
(i)	C	C	*No change in performance:* Most major AGAs/PEs submit fiscal reports to central government quarterly and annually, but DGIPE does not prepare a consolidated overview and analysis of fiscal risk arising from their operations.
(ii)	C▲	C	*No change in performance.* The net fiscal position of LAs is monitored annually but the MoLG does not prepare a consolidated overview of the overall fiscal risks arising from LAs and the available information is not comprehensive. The debt position of the LAs has improved but problems still persist. The strengthening trend indicated in the 2008 assessment did not materialise into actual improvement.

PI-10: Public access to key fiscal information

This indicator assesses the extent to which information on the budget and its execution by the government is easily accessible to the general public or at least the relevant interest groups. Transparency requires that the Government makes relevant information widely available in a comprehensive, understandable and timely fashion. The assessment is based on 2010/11.

Access to information has been a major issue for a long time in Kenya and belongs to a history of secrecy emanating from the Official Secrecy Act which is still in place and explains the poor access to some information including fiscal information. Non-government representatives suggest that good journalism expertise and experience in Kenya has yet to evolve, mainly due to the Secrecy Act-related difficulty to access information. The *new Constitution* of 2010 (section 35) establishes citizens' right to access information while the *PFM Bill* makes specific proposals on how that could be done. To accommodate that, a *Freedom of Information Bill* and *Data Protection and Management Bill* are currently under development. When approved, these two Acts are supposed to repeal the Secrecy Act. It is expected that they will be sent to the Parliament by August 2012.

The information available to the public covers the entire budget cycle, but key fiscal information is generally not presented in a transparent, comprehensive, user-friendly and timely manner. It tends to be very technical and not comprehensible to non-professionals. The main source of information for budget documentation is the Government Printer (only one office in the whole of Kenya) and other means such as university libraries, ministries, departments and districts' libraries. Increasingly more information is being placed on internet, for example, the MoF's website. The assessment team found the information to be cumbersome to download, however, and many links do not work.

Budget documents are made available to the public mainly through printed copies at the time they are tabled in the Parliament. Representatives of the Government Printer reported that the stock has never been exhausted so far. The main customers, however, are government and private institutions, rather than members of the general public. Parliamentary sessions on budget discussions are broadcasted on national TV and radio. Proceeding of the meetings of some

Committees are available on-line though with delay. The budget is discussed to an extent in the printed media but to a lesser extent than in some other countries (Uganda, for example). In June 2011 the Government published for the first time a Citizens' Guide - Budget Highlights 2011/12, which represents an important milestone in access to budget information and was positively received by many stakeholders including NGOs; Uganda, in contrast, is 10 years ahead, having published its first Citizens' Guide in 2002 (in English and local languages). All available information in Kenya is in Kiswahili only.

Information on procurement contract awards is generally accessible to the public through the PPOA website (PI-19), though it mainly covers SAGAs, rather than MDAs and is perhaps not complete. NGO representatives met by the team consider, however, that little information on procurement is available to the public. Information on tender announcements is easier to come by, through national newspapers, as well as through the PPOA website.

Table 15 summarises the availability of the six elements of information stipulated under the PEFA methodology.

Table 15: Fiscal information available to the public

Elements of information for public access	Availability	Assessment
Annual budget documentation when submitted to the legislature	Yes	The package of annual budget documentation which is submitted to the parliament (see PI-6) is made available in *printed copies* through the Government Printer immediately after their presentation to Parliament. While the prices are based on cost recovery, they appear high (partly because of the sheer size of the documentation), and perhaps unaffordable to the general public. Little budget information is available through the MoF's website (www.treasury.go.ke). Even when available, it is not available immediately, and in many cases the downloading of the corresponding documents from the MoF website ((www.treasury.go.ke) can be very cumbersome, even impossible. The website publishes generally only the Budget Outlook Paper (now Budget Review and Outlook Paper), Budget Policy Statement, the Budget Speech and its annex; but with delay. The situation has improved through the Kenya Open Data Initiative (KODI) established in June 2011 (www.opendata.go.ke); the data available includes the budget estimates themselves.
In-year budget execution reports within one month of their completion	Yes	Quarterly budget execution reports are available to the public through Quarterly Economic and Budgetary Review (QEBR) reports published by the MoF on its website within six weeks from the quarter-end (within a month of completion). The latest reports were made available on the following dates: QEBR 2010/11 Q1: 12 November 2010 QEBR 2010/11 Q2: 12 February 2011 QEBR 2010/11 Q3: 16 May 2011 QEBR 2010/11 Q4: 12 August 2011 QEBR 2011/12 Q1: 15 November 2011 QEBR 2011/12 Q2: 15 February 2012

Elements of information for public access	Availability	Assessment
Year-end financial statements within 6 months of completed audit	Yes	The annual reports of KENAO on the Appropriations Accounts are made available to the public through the Government Printer and other outlets within 6 months following their submission to the National Assembly. The reports, minus the detailed tables, are available on the KENAO website
External audit reports within 6 months of completed audit	Yes	The audit reports for each MDA are included in the annual report of the Auditor General, as referred to above.
Contract awards (app. USD 100,000 equivalent) published at least quarterly	No	Contract awards above Kshs. 5 million (the threshold above which competitive tendering is required) are published by PPOA on its website (www.ppoa.go.ke) on a regular basis, though not necessarily quarterly, but are not published by the MDAs that award contracts. It is not clear whether the list of such contracts is comprehensive, as nearly all the contracts are for SAGAs. The MDAs visited by the team do not publish contract awards; they claim that they don't have the resources to publish them in the newspapers and other media, although they don't seem to consider publishing on their own websites.
Resources available to primary service unit at least annually	No	Information on planned and actual resources for primary health centres and primary schools is not readily available to the public. These are not cost centres in terms of the budget classification system; resources are delivered through the internal allocation mechanisms of the parent ministries. As part of the Free Education Programme, however, primary schools are requested to place information on the resources they receive and use on their announcement boards. NGO representatives suggested that such information is generally available but in some cases may be outdated. Primary health care centres do not provide such information yet; but a similar programme is being planned for them.

Ongoing and planned activities

A number of measures to improve access to budget information by the public took place recently and others are on-going, but these are not yet reflected in the score:

- In June 2011 the government published a Citizens' Guide to the Budget for the first time; the 'Citizens' Guide - Budget Highlights 2011/12' represents an important milestone in access to budget information and was well- received by many stakeholders including non-government organisations.
- Sector Working Groups commenced public hearings in Nairobi in 2008. These were introduced into districts during the current financial year.
- The Kenya Open Data Initiative (KODI) was launched on 8 July, 2011. This is a joint WB-Government initiative to facilitate making key government data freely available to the public through a single online portal. The assessment team attempted to access this, but unsuccessfully (either because something was wrong with the system or because of lack of understanding of how to use it; the front page was accessed, but it didn't seem possible to go further).

A Freedom of Information Bill and Data Protection and Management Bill are currently under development. It is expected that they will be sent to the Parliament by August 2012 and will repeal the current Official Secrecy Act.

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-10	B	B	**No change in performance**
(i)	B	B	The government makes available to the public 4 out of 6 elements.

3.4. Policy based budgeting

The indicators in this group assess to what extent the central budget is prepared with due regard to government policy. The table below summarises the assessment.

Assessment of Performance Indicators for Policy Based Budgeting

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-11: Budget preparation	C+ (i) C (ii) A (iii) D	B (i) B (ii) A (iii) D	*Performance improved* through the strategic phase of budget preparation adding to the time available for budget preparation.
PI-12: Medium term perspective in budgeting	*C (revised from C+)* (i) C (ii) B (iii) C *(Revised from B)* (iv) D	C + (i) C (ii) A (iii) C (iv) D	*Performance improved* through increased frequency of DSA under dimension (ii).

3.4.1 PI-11: Orderliness and participation in the annual budget process

This indicator assesses the organisation, clarity and comprehensiveness of the annual budget preparation process.

The budget preparation process starts early. The process is guided by a *budget calendar and budget circulars*, which are clear and comprehensive and serve as useful preparation guidelines that are generally adhered to. The main milestones are described below.

Strategic Phase

1) Undertaking ministerial and sector public expenditure reviews (PER) to assess efficiency and effectiveness of public spending and eventually identify areas for efficiency savings: While all MDAs carry out their PER they are considered as a routine which has little added value in practice in terms of budget preparation. MoF does not have the capacity to review and analyse the ministerial PERs including consolidation and analysis of the information provided, such as pending bills and the fiscal position of SAGAs.

The review of public expenditures is accompanied by elaboration by the MoF of the *Budget Outlook Paper* (BOPA) which serves as a basis for the discussions in the sector working groups (SWG). The political involvement starts early in the budget preparation process, as reflected by the deliberation in the Parliament on the BOPA.

2) Identification and agreement upon sector priorities by SWGs, based on Vision 2030, MTP 2008-2012 and 5-year sector plans, with the participation of both government and non-government stakeholders. During the preparation of the budget for 2012/13, SWG consultations were held in a broader context for the first time and moved outside Nairobi, encompassing all 47 counties. The consultations are summarised into publicly available sector reports. Though the SWG consultations are useful in determining priorities, a feedback mechanism has not yet developed, whereby the public is informed of the main findings of the consultations and which were taken on board by the sectors and how MoF appreciates the need for such a mechanism and is currently considering how this could be done.

3) Preparation of the Budget Policy Statement (BPS): Subsequent to the SWG consultations, the sector groups allocate the available resources to the MDAs that fall under the corresponding sector. Based on these allocations, MDAs can start preparing their BPS submissions. These are then reviewed by a sector desk officer in the MoF to ensure that the submission reflects the policy priorities of the existing strategic documents. The internal *Budget Procedures Group* ensures that all MDA budget expenditures adhere to the set ceilings. The *Budget and Economic Steering Committee* reviews and approves the overall framework, i.e. revenues, expenditures, fiscal deficit. The MoF then prepares the BSP, which contains the three year MTEF ceilings for each ministry (the two outer years are indicative), taking into account any adjustments required to the macro-fiscal framework. If and when new resources (fiscal space) become available, the BPS indicates how this may be applied. The BPS is approved by the Cabinet, prior to its submission to Parliament.

Estimation and approval stage

4) Preparation of the detailed budget estimates: MDAs prepare their detailed budget estimates on the basis of ceilings contained in the BSP and the subsequent Budget Call Circular (BCC). Much of the estimation work has been conducted during (3) above. The MoF then consolidates the submissions from the MDAs, and submits the finalised estimates to Cabinet for approval, and then to the Parliament (see PI-6).

(i) Existence of and adherence to a fixed budget calendar

The scoring of this dimension is based on the last budget approved by legislature, 2011/12.

The budget calendar (Table 16) is described in the Treasury Circular “Budget Preparation Guidelines for the MTEF” prepared by the MoF and disseminated to the MDAs early in the fiscal year. The calendar includes the timetable for the preparation of the revised/supplementary budget for the current year. It is generally adhered to while some delays may occur in practice.

Table 16: Budget calendar for FY 2011/12 and FY 2012/13)

Planned time frame 2011/2012	Actual time frame 2011/2012	Responsibility	Activity	Timeframe 2012/2013
July - August		MPND, Ministries, Departments	Update Ministerial Strategic Plans.	Aug-Sep 2011
August	12 October 2010	MPND	Develop and issue ***MTEF Guidelines.***	Aug-Sep 2011
August		MoF	Launch of Sector Working Groups (SWGs).	Sep 2011
September		Ministries, Departments	Undertake Ministerial Public Expenditure Reviews.	Sept 2011
September – October	November 2010	Macro Working Group	Develop ***Budget Outlook Paper*** (BOPA); changed to BROP for FY 2012.	Sep 2011
October		MoF, Macro Working Group	Finalize ***BOPA*** and present to Cabinet for approval.	Oct 2011
October		Departments in the Districts	Departments in Districts to submit their inputs to relevant Ministry Headquarters.	
By end of October		MoF	Circulate approved BOPA (FY 2011)/BROP (FY 2012) to Accounting Officers.	End Oct 2011
Mid November		MoF	Issue ***Circular on Revised (Supplementary) Budget***	Dec 2011
By end of October		Sector Chairpersons	Submission of initial Sector reports to MoF.	
December		MoF, MPND	Hold Sector Hearings.	Nov 2011
By Mid January		Sector Working Groups	Submit Final Sector Reports.	Nov 2011
By end of January		MoF	Publish Final Sector Reports.	Nov 2011
7th January- 28th February		Line Ministries/MoF	Submission of Supplementary Budget Proposals to MoF, review of these, submission to Cabinet and then to Parliament.	Dec 2011
By Mid Feb 2011		Macro Working group	Prepare the ***Budget Strategy Paper*** (BSP); (***Budget Policy Statement*** (*BSP*)**) f**or FY 2013).	Jan 2012
By end of February		MoF	Submit ***BSP/BPS to Cabinet*** for approval.	End Jan 2012
By 21st March	March 20, 2011	MoF	Submit ***BPS*** to Parliament, and circulate to Accounting Officers.	March 22, 2012
March	17 March 2011	MoF	Issue ***Treasury Circular*** for preparation of detailed budget/MTEF and PBB estimates on basis of ceilings in BPS.	End-March 2012
By 30th April	According to the circular, by 17 April, 2011	Ministries	Deadline for submission of detailed estimates to MoF.	By early April, 2012

Planned time frame 2011/2012	Actual time frame 2011/2012	Responsibility	Activity	Timeframe 2012/2013
By 15th May		MoF	Review and finalize detailed estimates	Mid April 2012
By 20th May		Minister of Finance	Submission of Budget Estimates to Cabinet for Approval.	Mid April 2012
By End of May	8 June, 2011	Minister of Finance	Budget Estimates submitted to Parliament; Budget Speech	30th April, 2012

Source: Ministry of Finance, Treasury Circular no. 16/2010, Budget Preparation Guidelines for the MTEF, 2011/12-2013/14; and Treasury Circular no. 10/2011 (September 9, 2011)

The budget calendar allowed MDAs four weeks to prepare their budget submissions for the 2011/12 budget. This appears to be insufficient time, in terms of the PEFA methodology benchmark (6 weeks). In practice, however, MDAs have already done much of the estimation work during the strategic phase of budget preparation. When the final ceilings are announced, MDAs only have to make a few changes to their final submissions. Line ministries interviewed by the assessment team for the most part indicated that the time available was sufficient to finalise their submissions. Some line ministries indicated insufficient time, though this may indicate they were less organised than those who had sufficient time (as pointed out by some participants at the workshop on 24th May.

(ii) Clarity/comprehensiveness of and political involvement in the guidance on the preparation of budget submissions

The two budget circulars are clear and comprehensive in guiding the MDAs in preparation of their BPS submissions and later the detailed budget estimates. The Treasury Circular "Budget Preparation Guidelines for the MTEF" prepared by the MoF and disseminated to the MDAs early in the fiscal year provide essential guidelines on the preparation of expenditure estimates and emphasize the need to enhance efficiency, effectiveness and economy of public spending. The Circular provides a background for the general context under which the budget is expected to be prepared and the following guidelines;

- Preparation of the ministerial PERs (including a format);
- Recruitment and replacement of staff;
- Preparation of programme based budgets (including a format);
- Prioritisation and allocation of resources;
- Selection of capital projects;
- Consultation with various stakeholders;
- Preparation and submission of sector reports;
- Preliminary aggregate, recurrent and development sectoral expenditure ceilings
- The budget calendar;
- The composition and ToR for the SWGs (including a format for the SWG reports).

The second Treasury Circular with final ceilings (disseminated in March) reiterates the policy framework underpinning the Budget, informs the MDAs on their *final recurrent and development* *budget ceiling* and the form of their submissions as well as the deadline by which ministerial budget estimates should be submitted to the MoF. This circular particularly underlines the following:

- Key macro-fiscal assumptions underpinning the fiscal framework;
- Further guidelines on wages and salaries, new recruitment, use of goods and services and capital expenditures;
- Guidelines on transfers to SAGAs (including a format);
- Further guidelines on the timing of submission of budget proposals.

(iii) Timely budget approval by the legislature or similarly mandated body

The assessment of this dimension is based on the last three years' budgets i.e. 2009/10; 2010/11; 2011/12. The Fiscal Management Act (2009) requires the Minister to present the annual estimates of revenue and expenditure for the succeeding FY to the Parliament by the 20th June. Table 17 shows the dates on which the budget estimates were presented to Parliament and the dates of the approval of the Appropriations Bills (according to the Appropriations Acts published in the Kenya Gazette) for each of the last three budgets.

Table 17: Dates of submission and approval of the Budget Estimates

FY	Budget submitted to the Parliament	Approval of Appropriations Bill
2009/2010	June 20, 2009.	Oct/ Nov 2009
2010/2011	June 20, 2010	23 November 2010
2011/2012	8 June 2011	17 September 2011

Submission of the budget estimates to Parliament in late June meant that the budget could not be approved by the end of the fiscal year. The Vote on Account provisions allowed the Parliament to debate the draft budget for up to 6 months (very long compared to the three month provision in some other Anglophone African countries, such as Uganda). Under the new Constitution (2010), however, the budget estimates have to be submitted by 30th April and approved by Parliament by 30th June. The draft estimates for 2011/12 were submitted on 31st of May, 2011 which reflects a delay of one month. These new dates await formalisation through the yet to be enacted PFM bill.

Ongoing and planned activities

The 2010 Constitution has implications for the budget calendar, and some changes have already been introduced in terms of the preparation of the 2011/12 and 2012/2013 budgets. The BOPA was replaced with the Budget Review and Outlook Paper (BROP) which in essence has the same content but is expected to include specific information on the fiscal impact on the budget of the proposed policies. The BSP and BPS (which used to have more or less the same purpose and content) were combined into the BPS. This used to be submitted to Parliament in mid April, but under the 2009 FMA, the deadline is now mid-March. Also the date for the submission of budget estimates to the MoF and subsequently to Parliament has been moved ahead allowing at least two months for debating the budget and approving it by the end of the FY. This, however, did not happen in terms of the preparation of the 2011/12 budget, which was presented to Parliament in early June, 2011 and approved in September.

MoF also issued two publications in 2011, which should facilitate the understanding of the budget preparation process in Kenya and consequently improve its efficiency and effectiveness:

- The MTEF Manual (March 2011) which presents the Kenya MTEF/ budget process and serves as a point of reference and guide to public officers and the various stakeholders involved in the budget making process;
- The Programme Based Budgeting manual (November 2011) which intends to serve as a guide towards the full development of programme based budgeting.

PI (M2)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-11	**C+**	**B**	**Performance has improved through dimension (i).**
(i)	C	B	*Performance has improved:* This dimension covers the total amount of time for preparing budget submissions, taking into account both the strategic phase and the detailed estimation phase. A clear and orderly budget calendar is in place, which is generally adhered to while small deviations can occur. For preparation of the detailed 2011/12 budget estimates, MDAs were provided four weeks. For some MDAs, this was insufficient time, but for others the time was sufficient, as they had started the estimation process during the strategic phase of budget preparation. This phase was not as well developed at the time of the 2008 PEFA assessment, and thus a longer period was required for the detailed estimation phase, but insufficient time was provided.
(ii)	A	A	*No change in performance*: The Ministry of Finance issues comprehensive and clear budget circulars including sector ceilings for both recurrent and development budget estimates. The ceilings are approved through a Cabinet Memorandum prior to their dissemination to the MDAs.
(iii)	D	D	*No change in performance*: The budget has been approved within three, four and five months after the start of the FY in relation to the FYs being assessed. This is longer that the two months threshold required for a "C" score.

3.4.2. Multi-year perspective in fiscal planning, expenditure policy and budgeting

This indicator considers the link between budgeting and policy priorities in the medium-term perspective and the extent to which costing of the implications of policy initiatives is integrated into the budget formulation process.

(i) Preparation of multi -year fiscal forecasts and functional allocations

Kenya has in principle adopted a multi-year perspective to its budget formulation process which facilitates the integration of some elements of strategic content into the budget through the linkage to the five year Medium Term Plan (MTP, itself to Vision 2030) via sector strategic plans and a three year forward looking MTEF, but in practice the extent of this perspective is limited. The MTEF itself, along with the programmes contained within it, have only limited linkage with the MTP, indicating, perhaps, limited political commitment to the MTEF.

With regard to the MTEF itself, this is supposed to have a medium term sector perspective, in line with MTP, but this in fact is somewhat lacking.. While a mechanism for Sector Working Groups

(SWGs) is in place, most ministries do not perceive themselves as part of a sector. The MTEF forecasts are allocated on the basis of sector, administrative and economic classifications but are not presented on a truly rolling basis. The multi-year estimates are linked to the annual budget ceilings and are updated annually but the links between multi-year estimates and subsequent settings of the annual budget are weak. The differences between the medium-term forecasts and the budget ceilings are not explained in budget-related documents. Line ministries interviewed by the assessment team indicated that the second year of the MTEF counted for very little in terms of annual budget preparation.

(ii) Scope and frequency of debt sustainability analysis

Public borrowing is informed by a formal rolling three year Medium Term Debt Strategy (MTDS) prepared jointly by MoF and CBK, which is tabled in Parliament during the presentation of the Budget Estimates. The Government published its first formal MTDS in June, 2009. The key strategic drivers in pursuit of debt sustainability were a desire to minimize refinancing risk by lengthening the maturity profile of the domestic debt portfolio and to develop the domestic debt market further. Debt Sustainability Analysis (DSA) is undertaken by the IMF/WB more or less annually (as indicated in publications on the IMF website, dated November 23, 2011, January 14, 2011, May 15, 2009, and August 20, 2008) in full collaboration with GoK.

The PFM Bill, 2012 provides weight to responsible debt policy; section 15 (2) outlines a number of fiscal responsibility principles.

(iii) Existence of sector strategies with multi-year costing of recurrent and investment expenditure

All sectors and ministries within each sector are required to develop a five year strategy aligned to the Vision 2030 and the MTP 2008-2012. In practice, all ministries have developed a MTP but not all sectors (e.g. education). The annual MoF circular on preparation of the MTEF includes a bridging table which aligns administrative structures to the MTEF sectors.

Most of the MTPs include cost estimates but none of the strategies includes an explanation and/or assumptions which serve as a basis for the calculations. Interviews with selected line ministries indicated that the cost estimates do not include the future recurrent expenditure implications of capital investments. A review of selected strategic plans indicated that costed strategies are not necessarily consistent with MTP forecasts and thus with the binding constraints imposed by fiscal realities.

(iv) Linkages between investment budgets and forward expenditure estimates

While sector strategies and the BPS generally guide the inclusion of programmes and projects into the MTEF, ministries interviewed indicated that a clear process of selection of investments for inclusion in the budget is not in place. Selection appears to be based on qualitative and intuitive considerations, such as removing completed projects from the baseline and replacing them with new ones in order to reach the MTEF ceilings, rather than being quantitative or reasonably justified.
The preparation of the recurrent and development budget is conducted separately. The development budget is not a capital investment budget, as it non-transparently includes a significant component of recurrent costs (about 40 percent, according to the Popular Version of the 2010 PER). Not only does this hinder the process of selection of capital investments for

inclusion in the budget, but also the calculation of the forward expenditure estimates of recurrent costs generated by committed capital expenditures; the interviews suggested that forward linked recurrent cost implications are not fully and consistently taken into account.

Ongoing and planned activities

No reform efforts have been undertaken in this area during the period of assessment. Ministries and sectors recently started to update their 5-year strategies and plans.

PI (M2)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-12	**C** *(revised from C+)*	**C+**	**Improvement in performance under dimension (ii). The 2008 rating for dimension (iii) has been revised downwards to C from B.**
(i)	C	C	*No change in performance*. Forecasts of fiscal aggregates are prepared on the basis of sector, administrate and economic classifications for three years. The linkages between the multi-year estimates and subsequent setting of annual budget ceilings are very limited and any adjustments are not explained.
(ii)	B	A	*Improvement in performance*. DSA has been undertaken annually by the IMF/WB during the last three years in full collaboration with GoK. Previously, the DSA was not undertaken annually.
(iii)	C *(revised downwards from B)*	C	*No change in performance*: Sector and ministerial strategies have been prepared and are updated when they expire. The estimated costs tend to exceed what is fiscally realistic, even more so as they tend not to include the recurrent cost implications of proposed investments. This situation has changed little since the 2008 assessment; the previous rating should have been C rather than B.
(iv)	D	D	*No change in performance*. Development budgets are qualitatively linked to sector strategies, but budgeting for investment and recurrent expenditure are separate processes with no recurrent cost implications of investment projects being transparently taken into account.

3.5. Predictability and control in budget execution

This set of indicators reviews the predictability of funds for budget execution and the internal controls and measures in place to ensure that the budget is executed in an accountable manner. The set is divided into three sub-components: Revenue administration, budget execution and cash/debt management, and internal control systems.

3.5.1. Revenue Administration (PIs 13-15)

PI	Score	Score	Assessment

	2008 PEFA	2012 PEFA	
PI-13:Transparency (M2)	B+ (i) B (ii) A (iii) B	B+ (i) B (ii) A (iii) B	*No change in performance*, in terms of ratings, but performance is improving through on-going strengthening efforts
PI-14: Controls (M2)	B (i) C (ii) A *(revised from B)* (iii) B	B (i) C (ii) A (iii) B	*No change in performance* in terms of ratings, though system performance is improving through on-going strengthening efforts.
PI-15: Collection and Accounting (M1)	D+ (i) D (ii) B (iii) A	D+ (i) D (ii) B (iii) A	*No change in performance* due to continuing D rating under (i). Tax collection strengthening measures continue to be implemented/are planned for implementation.

3.5.1.1. PI-13: Transparency of taxpayer obligations and liabilities

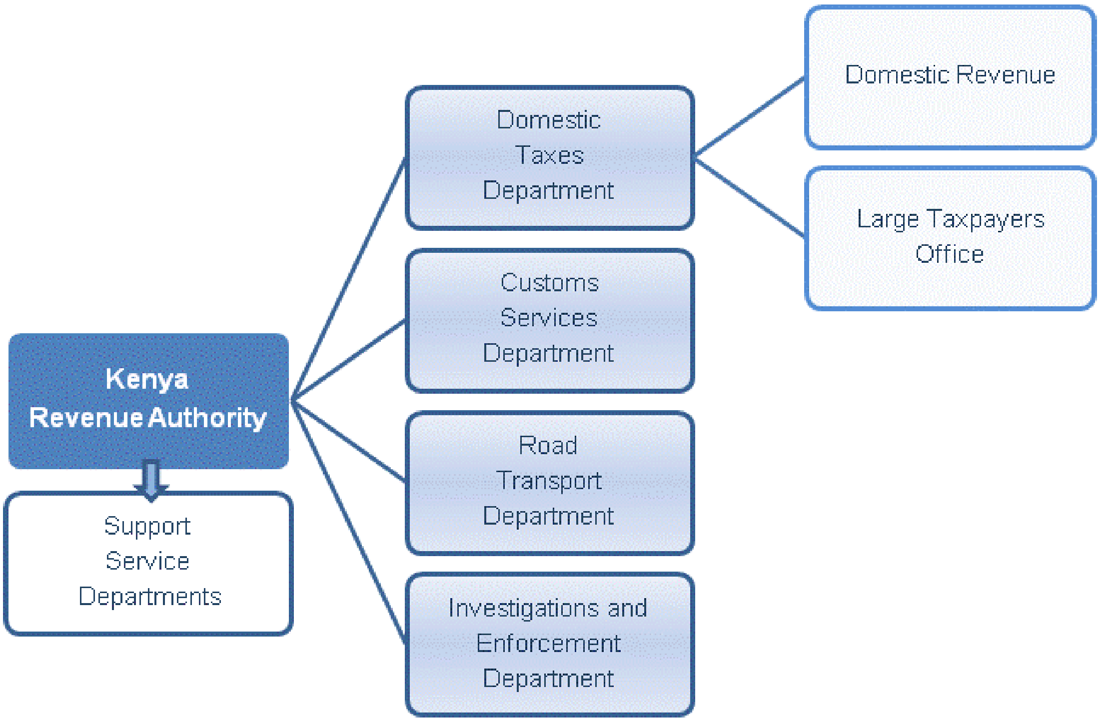
This indicator assesses the level of clarity and comprehensiveness of major tax legislation and regulations; access of taxpayers to this information; and the existence and functioning of the tax appeals mechanism

Background

The Kenya Revenue Authority (KRA) is the responsible agency (a SAGA) for tax revenue administration and advises the Minister of Finance on the same. KRA administers 17 Revenue Acts, including the Value Added Tax (VAT), the Income Tax Act, the East African Community Customs Management Act (EACCMA), the Customs and Excise Act and the Traffic Act.

KRA is divided into four key tax collection departments and seven service departments (including internal audit and ICT) (Figure 1). A Medium Taxpayer Office (MTO) for medium sized taxpayers (turnover of Kshs. 300 million - Kshs. 750 million) was created in November 2010. KRA has five Regional Offices: Southern, Central, Rift Valley, Western, and Northern.

Figure 1: Structure of the Kenya Revenue Authority



KRA has been implementing its Revenue Administration Reform and Modernisation Programme (RARMP) since 2004, resulting in a significant increase of revenue collection. It prepares an Annual Report and Financial Statements each year; the Statements are audited.

KRA funding is appropriated by Parliament. Funding is limited, by law, to 2 percent of estimated revenue collections. The cost of collection averaged 1.6-1.8 percent during the last few years. Under its performance contract, KRA can earn up to a 2 percent bonus.[24] The KRA is mandated to enter into bilateral agency collection arrangements with other public bodies and charge 1.5 percent of revenue collected as the cost of collection.

(i) Clarity and comprehensiveness of tax liabilities

Legislation and procedures

Kenya's tax system is highly complex, at first sight much more so relative to other African countries, due to the existence of multiple tax rates, zero-rating of certain goods and services and a variety of tax exemptions. Changes in all the above occur frequently through the annual Finance Bill discussed by Parliament. Generally, the more complex is the tax system, the more costly is its administration, the more expensive it is for people to comply with it, and the greater the extent of distortions of incentives and rent seeking opportunities, all with associated loss to the economy.

Corporate Income Tax (CIT): The base rate is 30%. The rate for a branch of a foreign company is 37.5%. Reduced rates (20-27%) are applicable to newly listed companies for 3 to 5 years depending on the amount of capital listed. Companies can apply for 100% investment deduction

[24] Extract from Performance Contract Between The Government Of Kenya Through The Ministry Of Finance And The Kenya Revenue Authority.

on hotel buildings and buildings and machinery used in manufacturing. Manufacturing investments in building and machinery located in towns next to Nairobi, Mombasa, or Kisumu are eligible for a 150% investment allowance. Enterprises in export processing zones enjoy a tax holiday of 10 years as well as a lower corporation tax rate of 25% for the subsequent 10 years.

Personal Income Tax (PIT) is based on graduated income scales, with tax rates ranging between 10% and 30%. Besides a personal deduction, deductible allowances comprise interest on mortgages on owner-occupied housing, contributions to registered pension fund, and premium payments for health, education and life insurance.

The VAT system comprises multiple tax rates. The standard rate is 16%. A 12% rate applies to electricity and fuel. Zero rates apply to exports of goods and taxable services, the supply or import of specified goods, including goods used in agriculture, health and education (e.g. textbooks), computer hardware and software, international air travel and supplies to licensed oil exploration companies. Financial services provided by banks, unprocessed or preserved agriculture produce are exempt. A presumptive regime exists for small and micro businesses, which pay turnover tax of 3 percent of gross sales if their turnover falls between Kshs. 500,000 and Kshs. 5 million.

Withholding taxes are levied on interest, royalties, dividends, management or professional or training and contractual fees, commissions, pensions, rent received by non-resident person, and other payments specified. The rates vary according to income source and whether the income recipient is a resident or non-resident.

Despite the complexity of the tax system, the different Revenue Acts are comprehensive and clear in terms of the procedures concerning obligations and liabilities. The laws are available to the public and further explanation is available, for instance, by means of brochures and step-by-step guides (as noted under (ii) below). Updates of Revenue Acts and associated regulations are quickly available to the public. KRA ensures that taxpayers are made aware of their rights and responsibilities. It provides support to register and comply and only where that fails does KRA take rule-based administrative enforcement measures.

Administrative discretion

The Revenue Acts provide some discretionary powers to the KRA and the Minister of Finance:

Waivers on customs warehouse rent, penalties and interest

In practice, the discretionary powers are limited by the acts, administrative guidelines and procedures in order to minimize discretion and ensure uniformity in the granting of waivers. The waiver system is regulated under section 94(4) of the Income Tax Act, section 15(2) of the VAT Act and section 158B of the Customs and Excise Act. The KRA Compliance and Debt Procedures Manual and special Guidelines provide further details on the application of the waiver system. Different waiver approval levels exist for different decision-making levels.

KRA is required to submit quarterly reports to the Minister of Finance on the amounts of penalties and interest waived/remitted. It did not grant any tax write-offs between 2008/9 and 2010/11. The Fiscal Administration and Private Sector Issues Division in MoF administer requests over Kshs. 1.5 million. The Division has not prepared a consolidated overview of the waivers that it has provided over the last few years.

The 2010 Constitution (Section 210) provides for revisions to the waiver system. The PFMB accordingly includes a provision on the “powers of the Cabinet Secretary to waive or vary tax, fees or charges in accordance with criteria prescribed in regulations" (still to be prepared) and stipulates that a public record of each waiver will be maintained and an annual report prepared.

Tax exemptions: These are regulated by the Revenue Acts. With regard to income tax, each request is reviewed by the KRA. VAT exemptions on capital goods investments and Low Income Housing require prior MoF approval. The MoF uses additional guidelines for approving exemptions concerning donor-funded projects, NGOs and charities (the relevant sector ministry applies to MoF).

Tax debt write-offs: These require prior Ministry of Finance approval. No tax debts were written off during 2008/09- 2010/11.

VAT refunds:
In accordance with international best practice, VAT refunding should be automatic, if warranted according to the law and procedures. The VAT Act does not contain a legal provision for a time limit for settlement of VAT refunds. Delays in refunding VAT tax claims have been a contentious issue in Kenya. In its contribution to the 2011/12 budget preparation process the Kenyan Private Sector Association (KEPSA) proposed that the VAT refund system should be simplified so that any amount of money owed to taxpayers should be refunded by KRA within 30-60 days after the submission of the claim. Companies entitled to VAT refunds were experiencing long delays in payment of refunds claims. KEPSA also recommended that delays in refunds should result in penalties being imposed on KRA, just as KRA imposes penalties on late tax payment.

VAT refunds are a challenge for KRA as MoF provides a monthly and annual ceiling in the budget on refunds (inconsistent with the principle that VAT refunds should be classified as negative revenues and not as expenditures). Nonetheless actual refunds are much higher than budgeted refunds.[25]

In order to address the delay in VAT refunding, the withholding system, whereby a taxpayer is assigned to withhold VAT payable to a supplier and remit it directly to the KRA, was abandoned in August 2011. The withholding system provided an incentive for firms to register for the VAT. Suppliers who fell below the turnover threshold but who sold to withholding agents were induced to register in order to receive refunds on inputs.

Parliament is discussing a VAT Bill that reduces drastically the extent of zero-rating and exemptions and consequently the extent of VAT refunds.

(ii) Taxpayer access to information on tax liabilities and administrative procedures

Taxpayers have access to Revenue Acts and procedures. A taxpayer education team is in place in every KRA 'care' region. A Taxpayers' Charter stipulating taxpayer rights has been developed. Guidance is provided in the form of booklets and brochures, step-by-step guides, and other information material available at KRA offices and on the user-friendly (functioning) KRA website (www.kra.go.ke). Usage of this increased between 2009 and 2010, but the majority of people still visit KRA offices. LTO staff visit individual companies. KRA provides special education for Small and Medium Scale Enterprises (SMEs) and NGOs, for example, through workshops. KRA also conducts monthly taxpayer education workshops, conducts an Annual Kenya Taxpayers' week, and raises awareness through the media. To educate future taxpayers, it

[25] The culprit is the current VAT Act containing lots of exemptions (e.g. in exports 80% are exempted or zero-rated)

also visits Youth Careers Fares and organises meetings at schools and universities. KRA published *'Revenue Administration Reforms in Kenya: Experiences and Lessons'* in 2010. A recent development has been the provision of mobile taxpayer services throughout the country via a Mobile Services Unit (bus).

Taxpayers can make enquiries by phone, email and by visiting the Customer Care Desks at the KRA offices. The KRA Contact Centre, established in 2008, has four access lines reachable throughout the country as well as a single point of access via email.

According to the 2010 Customer Satisfaction survey, businesses and the general public are quite aware of KRA services. Despite KRA's achievements, the 'general public' indicated in the Survey that the speed of service delivery is not yet as good as it could be.

(iii) Existence and functioning of a tax appeals mechanism

The tax legislation provides for a clear dispute resolution mechanism covering objections and appeals on assessments. The different steps in the objection and appeal process are defined. A taxpayer can formally object to KRA's tax assessment within 30 days. If the taxpayer does not agree with KRA's decision he/she may appeal to the Local Committee or Income Tax Appeals Tribunal, which was established two years ago. If the taxpayer disagrees with the verdict he/she may appeal to the High Court, but only in respect of the interpretation of the law. All outstanding tax must be first paid in full. A final right of appeal is through the Court of Appeal. Local committees and tax tribunals are all functioning. The members are appointed by the Deputy Prime Minister and Minister for Finance.

Separate information for taxpayers on the dispute resolution mechanism does not exist. Brochures only contain very brief information.

Data on objections and appeals are registered (on stand-alone Excel-based systems) by each relevant KRA department and contain information on the taxpayer, period covered, data of objection, amount objected to, ageing analysis, and comments. As of 15 March 2012, for example, the LTO had 39 outstanding objections covering a number of years and amounting to Kshs. 19.4 billion (about € 175 million). The Policy Unit in the Domestic Revenue Department has a full overview of objections made at the different KRA stations and also monitors appeals filed at local committees, the VAT Tribunal, and the High Court Information provided to the assessment team indicates the system is functioning and that decisions are acted upon. KRA considers that the conflict resolution system works well. The Chamber of Commerce and Industry did not provide any indication that the system has flaws. Since the Income Tax Appeals Tribunal was only instituted two years ago, it may be too early to provide a full assessment of the access and fairness of the appeal system.

On-going and planned activities

The VAT Bill is being discussed in Parliament. Proposals include drastic reduction of the number of zero-rated supplies. This may result in a decline of the number of claims for refund. A vast number of goods that are currently zero-rated will be standard-rated (at 16%). Moreover changes are foreseen in the listing of VAT exempt goods. An Income Tax Bill is being prepared, as well as an Excise Bill to separate it from the present Excise and Customs Act.

KRA has prepared a procedures code and manual in order to harmonise and simplify all the administrative procedures concerning objections and appeals, and has forwarded this to MoF.

In order to harmonise dispute resolution procedures and streamline the appeals process, the KRA prepared a draft Tax Appeal Tribunal Bill a few years ago for consideration by MoF, but the proposal has not yet been approved. The benefit is that taxpayers would have only one dock to refer to for issues concerning all types of taxes.

To promote further the provision of information to taxpayers in interior towns KRA intends to purchase extra buses to provide mobile taxpayers services.

PI (M2)	Score 2008 PEFA	Score 2011 PEFA	Assessment
PI-13	**B+**	**B+**	**No change in performance, which was already good at the time of the last assessment**
(i)	B	B	*No change in performance:* For all main taxes the rights and obligations are well specified in the Revenue Acts and in regulations. . Waivers, tax exemptions, debt write-offs, and imposition of penalties are subject to additional procedures and internal guidelines. Delays of VAT refunding occur due to under-budgeting rather than through administrative discretion. The VAT Act does not contain time limits for VAT refunding. Thus, discretionary powers exist but are fairly limited.
(ii)	A	A	*No change in performance*. The means of information provision has increased, through the provision of mobile taxpayer services and contact centres. KRA provides support to taxpayers for all major taxes through various means (website, brochures, guides, enquiries online, Customer Care Desks). KRA is also educating present and future taxpayers by means of workshops, mass media and mobile offices. KRA branch organisations target SMEs, while the LTO maintains a one-to-one relationship with large taxpayers. Awareness and education activities are planned and reported upon.
(iii)	B	B	*No change in performance*: Since the 2008 PEFA assessment, the members and the Secretary of Customs and Excises Tribunal have been gazetted and the Income Tax Appeals Tribunal established (2010/11). Data demonstrates that the system is operational and decisions are acted upon. Since the Income Tax Appeals Tribunal was only instituted two years ago, it may be too early to provide a full assessment of access and fairness of the appeal system.

3.5.1.2. PI-14: Effectiveness of measures for taxpayer registration and tax assessment

(i) Controls in the taxpayer registration system

A personal/company identification number (PIN) is required to register for the VAT, the local service tax, PIT and CIT. Registration for VAT is compulsory where the turnover of taxable supplies is Kshs. 5 million or more per year. Taxpayers can apply for a PIN, either online or through the KRA offices The PIN is automatically generated; the process (cost free) takes 1-2 days. Application for a *single* PIN and VAT registration can be done on-line (registration of companies requires PIN certificates of at least 2 directors, or 2 shareholders, and a copy of the memorandum and articles of association). On-line application has been possible since December 2008, when the Integrated Tax Management System (ITMS) was established, and has resulted in a significant number of new taxpayers (1,747,726 to date), both individual and non-individual.

Starting in 2011/12 KRA commissioners have had the authority to register taxpayers who refuse/avoid to apply for a PIN in an effort to widen the tax net. Door-to-door visits are made to locate unregistered tax payers.

Registration for PIN is linked to the systems of the National Identity Card (for individuals), Company Registrar (for enterprises) and Immigration Department (alien registration). KRA receives information every month from these entities and uploads the data into ITMS. KRA is also linked to pension schemes and the NGOs Coordination Board. The KRA registration system is not linked to the banking system.

By law, certain transactions require a PIN, including clearance of goods through Customs, the installation of water, telephone, and electricity meters (KRA recently made an agreement with Kenya Power, enabling the linkage of customers to its registration system) and the purchase of land. Without a PIN, companies and individuals cannot participate in public tenders. Students can only apply for a loan at the Higher Education Loans Board if they have a PIN. Comparable linkages have been made with other bodies, such as Law Society of Kenya.

Income taxes are collected by self-assessment and by withholding tax. Taxpayer software can be downloaded from the KRA website. Deadlines are stipulated for self-assessment returns.[26] Starting 2011/12 employees who have no other income are captured under the Pay As You Earn (PAYE) regime, resulting in administrative efficiency gains; employers are required to withhold and account for income tax on employee remuneration and benefits every month. Withholding tax and VAT are due to KRA each month (by the 20th of the following month).Presumptive taxpayers should submit quarterly returns.

Taxpayers can file their returns online for PAYE and VAT. VAT taxpayers are obliged to use the ‘Electronic Tax Register’ (ETR), which records sales and stocks and issues receipts (and can generate daily, monthly and annual reports).

For customs duties, the web-based customs information system, Simba (2005), and subsidiary systems are used to streamline collection, in terms of both speed and accuracy: Cargo Management Information System (CAMIS), and Customs Oil Stocks Information System (COSIS), Electronic Cargo Tracking System, and RADDEx (for exchange of customs data within the East African Community (EAC), Cargo X-ray scanners assist in verification and detection. Simba facilitates self-assessment and enables post clearance audit. Tax payers are served 24 hours per day anywhere in the world through the Document Processing Centre (DPC). Entries are processed within 24 hours of being lodged. .

Improving information systems benefits taxpayers as well as KRA. According to ‘Doing Business’ (periodically prepared by World Bank), Kenya eased the burden on businesses of clearing customs and on taxpayers by merging the income tax and value added tax registration procedures in 2011.

(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations

Failure to register, file, pay and other non- or partial fulfilment of taxpayers obligations leads to penalties as stipulated in great detail under the Revenue Acts for various offences. Penalties are in

[26] Within 6 months of the end of the company’s accounting period in the case of CIT, and by 30 June in the case of PIT returns.

the form of fixed amounts, percentage of tax assessed, and prison. For example, for CIT and PIT, late payments of self-assessed tax are subject to a 20% penalty, plus 2% per month and late filing is subject to a 5% penalty. Penalties are automatically imposed for VAT. For income tax, penalties are imposed when the tax has been assessed. General penalties are highest in case of custom and excise duties.

According to 'Doing Business', penalties are not very high. Even so, a punitive interest of two percent per month is charged on tax arrears, starting from the date the tax was due. This interest rate charge is the largest deterrent element in the penalty system. Penalties are imposed consistently. About 50 percent of the stock of tax arrears comprises penalties and interest, as discussed under PI-15.

(iii) Planning and monitoring of tax audit and fraud investigation programmes

Audit plans cover all main taxes. Case selection and risk profiling are described in detail in KRA's audit handbook, and are applied in the annual audit plans. KRA targets certain areas or sectors, such as credit institutions, sectors with lot of PAYE, and sectors with a high rate of non-compliance, such as religious organizations, the tea industry and certain government institutions (e.g. water bodies).

Audit selection is currently done manually or through ad hoc sector-based compliance checks, but in future audit selection will be an automated process integrated in ITMS. KRA aims to develop an integrated KRA-wide risk management function.

The Domestic Tax Department conducted 2,757 tax audits in 2010/11, resulting in an increase of tax collected of more than Kshs. 7 billion. In auditing VAT refund cases, it reduced the amount of refunds given by Kshs. 502 million during 2010/11. Its target is to audit annually at least 3 percent of registered tax payers. During the first half of 2011/12 KRA conducted 1,518 audits, an increase from the previous year.

The strategy of LTO is to audit about one-third of firms subject to its control each year. Its normal case coverage declined in 2009/2010 (95) compared to 2008/09 (151) in order to improve the balance between the coverage and quality of audits. Its audits yielded Kshs. 14, 16.2 and 17.8 billion during 2008/09, 2009/10 and 2010/11 respectively.

The Post-Clearance Audit manual (concerning customs duties) provides detailed guidance on audit phases, risk-based case selection, and procedures. 133 audits were conducted in 2010/11, resulting in increased revenue collection of Kshs. 1.6 billion.

The Investigations & Enforcement (I&E) Department deals with special fraud investigations. These are based on intelligence gathering, feedback from respective KRA departments, and the local knowledge of the KRA stations.

Ongoing and planned activities

KRA is planning further arrangements to link KRA systems to information systems of other public bodies, such as water bodies. It also continues to strengthen its case selection and risk profiling framework. Since each department has its own risk profiling framework, KRA aims to develop an integrated KRA-wide risk management function. Moreover KRA intends, under Phase II of ITMS implementation, to extend ITMS' capabilities to include a module on audit, so that audit selection will be an automated process.

PI (M2)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-14	**B**	**B**	**No change in performance in terms of ratings, but strengthening has occurred under (i) and (iii).** The B rating in 2008 for (ii) has been revised to A, as the existence of a waiver system is covered by PI-13 (i).
(i)	C	C	*No change in performance in terms of ratings*: Nevertheless, some improvements have been made: One PIN for Income Tax and VAT, e-registration and filing, efforts to capture non-registered taxpayers, increasing links with other databases and arrangements with other bodies to ensure that a PIN is required before certain transactions can be done, and strengthening of Customs systems. No link has been established yet with the financial sector, required in order to receive a higher score.
(ii)	A *(revised up from B)*	A	*No change in performance in terms of ratings*: The B rating in the 2008 PEFA was incorrect, as it was awarded due to the existence of waiver system, which falls, however, under PI-13 (i) as it relates to discretionary powers, and is not part of the penalty system as such. The penalties for all major taxes are effective, automatically applied and deter against non compliance with registration, filing, late or non-payment and other violations to the tax laws committed by taxpayers. A penalty of 2% interest per month on late/non-payments is the most significant deterrent element of the penalty system.
(iii)	B	B	*No change in performance in terms of ratings, but the quality of audit is improving:* Audit plans exist and each department implements its plan. Tax audit and fraud investigations are based upon clear risk assessment criteria. The focus on the quality of audit has increased, and therefore the number of audits conducted by Domestic Tax Department has declined. Case selection and risk profiling are being further strengthened.

3.5.1.3. PI-15: Effectiveness in collection of tax payments

This indicator assesses the effectiveness of the tax administration authorities to control the level of tax arrears and collect them when they occur, to transfer tax collection to the Treasury on a timely basis and to undertake reconciliation exercises to ensure that the collection system works as intended. This indicator analyses the last two completed fiscal years for the first dimension and the situation at the time of this assessment (March 2012) for the other two dimensions.

(i) Collection ratio for gross tax arrears

The stock of tax arrears or tax debt constitutes a significant problem. The stock at the start of 2009/10 and 2010/11 amounted to Kshs. 99.1 billion to Kshs. 85.9 billion respectively. In terms of total actual revenue (PI-3 data) the proportion was 20.6 percent and 19.8 percent respectively, representing a decline in the total debt stock by 10 percent in 2009/10 and by a further 3.7 percent in 2010/11. Table 18 elaborates.

Table 18: Tax debt (in Kshs. mln)

	2008/09	2009/10	2010/11
Tax debt stock at Start of FY	**99,143**	**89,230**	**85,919**
Change in Tax debt stock		-9,913	-3,311
Debt collection	9,858	9,569	12,995
Details for Domestic Revenues			
1. Debt Stock Domestic Revenue Dept. (DR) per 30 June		63,342	57,954*
2. Debt Stock LTO per 30 June		18,848	25,134
Total Debt Stock per 30 June - DR + LTO		*81,190*	*83,088*
3. Cash collections – DR + LTO		8,645	12,349
4. Other reductions – DR + LTO		51,234	37,510
Total Debt reductions - DR + LTO		*59,879*	*49,657*
Details for Customs Revenues			
5. Debt Stock at Start FY – Customs	4,795	5,107	5,933
6. Cash collections – Customs	471	702	315
7. Other reductions – Customs	64	681	1,169
Total Debt reductions – Customs	*534*	*1,383*	*1,693*
Total tax debt collections		*9,347*	*12,664*
% of stock of tax arrears at beginning of FY		10.5	14.7
Total tax debt reductions		*61,261*	*51,350*
% of stock of tax arrears at beginning of FY		68.7	59.8
Total tax revenues (PI-3)	*432,300*	482,300	577,200
Tax debts at start of FY as % of total tax revenues in FYt-1		20.6	17.8

Source: KRA. Domestic Revenue Department provided detailed data on the outstanding tax debt as per 30th June 2011, in terms of the category of arrears (arrears prior 1992, self assessment, additional assessment, estimated assessment, PAYE, VAT, Penalties, Interest) as well as per tax head: Income tax principal amount, VAT principal amount, and Penalties and Interest. The latter information shows that penalties and interest represent more than 46% of the outstanding tax arrears; principal of Income Tax 50% and principal VAT only 3.5%

Tax arrears collected in the last two fiscal years amounted to 10.5 percent and 14.7 percent of the stock of tax arrears respectively (on average only 12.6 percent of tax debt stock). In the first half of 2011/12 KRA collected Kshs. 7.2 billion of tax arrears[27], which may indicate some greater effort in addressing tax arrears. Total tax debt reductions, taking into account waivers and write-offs, were much larger, comprising 68.7 percent and 59.8 percent of the stock of tax arrears at the beginning of 2009/10 and 2010/11 respectively.

For PAYE and VAT data on arrears can be generated from the main information system. KRA produces a Statement of Arrears annually and sends it to the Minister of Finance. The Statement of Arrears of Revenue Uncollected of the Domestic Taxes Department provides information on principal, penalty, interest and total for each main tax head (corporate income tax, VAT, PAYE and excises). The report indicates that almost 50% of revenue arrears comprise penalty and interest (as of 30th June 2011). It shows also that the main problem is in collecting Corporate Income Tax. The report does not include unpaid tax that is disputed in the conflict resolution mechanism (i.e. objections and appeals) as this information is registered in a separate stand-alone (Excel-based) system. It is not clear whether a relation has been established between uncollected corporate income taxes and the number of outstanding objections and appeals. Reports of the Auditor General raise concerns on the reporting on tax arrears.

In theory, part of the slight decline of the stock of tax arrears may be write-offs. As mentioned under PI-13, no tax was written off during 2008-2011. According to KRA, its approach to tax debt reduction makes it difficult to separate out collection, movement of credits, error correction of the data, provision of waivers and write offs.

(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration

Taxpayers can pay taxes through cash-receiving centres or through the banking system. The KRA is facilitating easy payment of taxes, through four cash-receiving centres for Income Tax payments in its regions. Tax payers fill in a payment slip and present that at the cash point together with payment and receive a receipt in return from the cashier. Reconciliation takes place at the end of each day. Taxes collected are transferred the following day to the Exchequer accounts at the CBK. Large Taxpayers pay directly to the Exchequer accounts at the CBK if tax payment is higher than Kshs. 1 million. With regard to VAT and customs duties, taxpayers are required to pay self-assessed taxes directly to a bank.

In the case of e-payment / bank payments, transfer of tax payments from KRA agent banks (National Bank of Kenya, Cooperative Bank of Kenya) to CBK take up to two days. In the case of e-payment, the system automatically generates an e-slip with a unique number. Taxpayers still go with the e-slips to the agent bank for payment. Electronic bank payment is not yet fully possible for all in Kenya

Payments of domestic taxes through KRA agent commercial banks represented only 8 percent of total tax collected (as of the second quarter of 2011/2012). The majority of the payments are done through the corresponding Exchequer accounts at the CBK directly or via the cash-receiving offices. In the case of customs duties, 96 percent of payment takes place through KRA agent banks.

[27] KRA Revenue Performance Report

Table 19: Revenue collected through agent banks and Central Bank of Kenya/cash collection points, Dec 2011 - Feb 2012

Department	% collections through Agent commercial banks	% collections through Central Bank and cash collection points
Domestic Taxes	8%	92%
Customs Services	96%	4%
Road Transport	35%	65%

Source: KRA

(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury

Each KRA department periodically reconciles tax assessed and tax collected. Any difference between tax due and tax paid results in automatic application of penalties and (monthly) interest (PI-14, dimension ii). Reports on unpaid taxes can be generated showing information of tax assessed, additional tax assessed and the various penalties, including for late or non-payment as well as interest compounded. The information is sent to KRA senior management and discussed during the regular monthly meeting. KRA produces a Statement of Arrears of Revenue (see PI-15, dimension i) at least annually and sends it to MoF.

Weekly reconciliation meetings between KRA, CBK and MoF take place with regard to records of taxes collected. The reconciliation statement for every account shows the total collections as per the KRA report, the total balance of the Exchequer accounts held in CBK, and the amount reported by MoF, as per the Treasury report. Additional information shows the balance of the account for every day that changes in the balance occurred. Errors may arise due to, for instance, amounts omitted or under- or overstated by MoF, mis-posting by MoF (e.g. VAT local to VAT imports and vice versa), receipts in MoF but not in CBK, and receipts in CBK but not in MoF; errors may include cash in transit, for example. Attached to the statement is the monthly financial cumulative report. A consolidated reconciliation statement reconciles for all taxes the KRA collections as per Treasury Report and total Central Bank receipts.

The reconciliation of KRA collections and balances at the CBK Exchequer accounts are subject to audit by the Auditor General. KENAO reports indicate differences (in nominal terms) between the Statement of Revenue for different tax heads (as per the MoF report) and the records maintained at the KRA. The differences are very minor in percentage terms.[28]

Ongoing and planned activities

- Tax debt management will be part of ITMS in the near future under the framework of Phase II of the implementation of ITMS.

- Discussions are underway with the banking sector to launch e-payments with banks.

- KRA has developed the Common Cash Receipting System (CCRS) that integrates all payments by taxpayers, thereby enabling a single online view of the taxpayer and make payment of taxes less burdensome for the taxpayer. CCRS is an electronic platform that allows tax payments in appointed banks for taxes that are due. CCRS will integrate with business systems including

[28] Based on own calculations using data mentioned in OAG report.

Customs Simba 2005 system (see PI-14) and ITMS where the payment processes are initiated. In turn, CCRS will update the business systems with information on payments received in the banks. Moreover, the implementation of CCRS will ensure automated reconciliation both at the commercial banks and CBK. The online system (https://ushuru.kra.go.ke/CCRS/) has been tested and is being rolled out.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-15	**D+**	**D+**	**No change in performance, but some strengthening under (ii).**
(i)	D	D	*No change in performance*. Tax arrears remain a significant problem. The total tax debt stock stood at 17.81% of tax revenue collection at the end of 2010/11 and the tax debt collection ratio averaged only 12.6% over the last two completed financial years.
(ii)	B	B	*Minor change in performance* through the introduction of value capping and the requirement for large taxpayers to pay taxes directly into the Exchequer Account. The KRA operates a very efficient collection system that enables an effective transfer of tax collection to the Exchequer Accounts at CBK. KRA agent commercial banks take up to two days to transfer tax collected by them to the Exchequer account.
(iii)	A	A	According to information provided by KRA, reconciliations between tax assessment and collections within KRA are carried out by KRA departments and are reported to KRA management on a monthly basis.

3.5.2. Budget Execution and Cash/Debt Management (PIs 16-17)

Summary of assessment of indicators for PIs 16-17

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-16: Budget execution	B+ (i) A (ii) B (iii) B	B (i) B (ii) B (iii) B	*Performance slightly worsened* as frequency of updates of cash flow forecasting appears to have diminished.
PI-17: Cash/Debt management	B (i) B *(revised from A)* (ii) C (iii) B	B▲ (i) B▲ (ii) C (iii) A	*Trend towards increasing performance.* The improved rating under dimension (iii) mainly reflects the new Loan Guarantees Act and the Medium Term Debt Strategy. The downward revision of (i) in 2008 assessment is due to scoring error: An A rating requires monthly reconciliation.

3.5.2.1. PI-16: Predictability in the availability of funds for the commitment of expenditures

Effective execution of the budget in accordance with work plans requires that spending ministries and agencies receive reliable information on the availability of funds within which they can commit expenditure.

(i) Extent to which cash flows are forecast and monitored

Line ministries are required to prepare a detailed monthly cash flow forecast (weekly for the first month) for the first six months of the year (as per the Vote on Account period) and an indicative monthly forecast for the second half of the year.[29] This requirement is in accordance with a TC issued in June, 2009/10 on cash flow forecasting and Budget Implementation Circulars issued every July. The forecasts are required to be based on annual work plans, including procurement plans. Updates are required quarterly.

The line ministries adhere to this requirement, but the quality of the forecasts appears to vary somewhat between ministries. The Roads Ministry, at least, appears to do a good job. The BSD and AGD appear not to analyse the forecasts with rigour or to compel ministries to improve the quality of their forecasting, including through periodic updates of their forecasts. At the time of the PEFA assessment, cash flow forecasting appeared to have fallen by the wayside, though this is partly due to large uncertainties in projected financial resource receipts related to domestic treasury bill sales falling far short of projections.

The Cash Management Committee (formerly known as the Exchequer Committee), consisting of EAD, DMD, as well as AGD and BSD, prepares a monthly cash plan at the beginning of each year on the basis of the cash flow forecasts submitted by line ministries as well as tax revenue forecasts and then prepares a schedule of monthly expenditure limits for each line ministry. This is potentially a very useful exercise, as it facilitates orderly budget execution, with ministries receiving funds when they need them, consistent with their approved budgets. A cash plan is only as good, however, as the quality of the cash flow forecasting exercises that underpin it, and, as noted above, the quality has been problematic.

(ii) Reliability and horizon of periodic in-year information to Spending Agencies on ceilings for expenditure commitment

The Vote on Account (VoA) system that, until recently, has covered the first half of the year, has effectively limited the time horizon of expenditure commitments to the first half of the year in aggregate, reflecting 50 percent of the draft budget estimates. Ministries can commit over a longer period for individual items as long as the aggregate is not exceeded. In the period leading up to the preparation of the Supplementary Budget, the MOF may impose blocks on line ministries expenditure commitments into IFMIS on the basis of projected financial resource shortfalls and ensuing expenditure cutbacks. In such instances, the reliability of information provided by MoF to MDAs on ceilings for expenditure commitments is somewhat low and the time horizon short.

A quarterly budget allocation system is in effect at District level through the Authority to Incur (AIE) financial control mechanism.[30] District offices thus have a quarterly time horizon for commitments, though they can enter into commitments with a longer horizon up to 6 months (e.g. for commonly used items and capital projects) with the approval of the Accounting Officer of the relevant MDA.

(iii) Frequency and transparency of adjustments to budget allocations, which are decided above the level of management of MDAs

Formal adjustments to budget allocations to MDAs decided above the level of management of MDAs (excluding reallocations within MDAs that require approval of MoF) are reflected in an

[29] Sections 2.2.2. and 15.13, Financial Regulations and Procedures (FRP), 1989.
[30] Sections 5.5.2, 15.16 and Appendix 15.16, Financial Regulations and Procedures (FRP), 1989.

annual Supplementary Budget that must be submitted to the National Assembly for approval; adjustments may be through reallocations between votes or increases in spending financed by surpluses on AiA [31] Only one such budget is submitted each year, but the number of adjustments made in it is large (i.e. hundreds) and the explanations provided are very brief, usually only one line. Section 15.22 of the Financial Regulations and Procedures (FRP), 1989 stipulates that the Supplementary Appropriations Act has to be approved first, followed by the issue of a Treasury supplementary estimate warrant prior to the supplementary spending actually taking place.

Many of the recurrent expenditure changes are in the form of increases in salaries and travel allowance. Development budget adjustments tend to be downwards, reflecting in part slower progress than planned in project implementation. Although adjustments to budget allocations appear to lack transparency, the sum of the changes in MDA expenditures is only about 1 percent of the original budget.

Ongoing and planned activities

The PFM Bill (PFMB) soon to be enacted, will enable the National Assembly to approve draft annual budgets prior to the end of the fiscal year. This, combined with hopefully improved cash flow forecasts (required under sections 17 (6) and 17 (7) of the Bill) and movement towards a Treasury Single Account (TSA) (discussed under PI-17), that the approved PFMB would also enable would permit line ministries to enter into expenditure commitments with up to a one year time horizon, leading to improved in-year predictability of funds for line ministries

Section 44 of PFMB provides for supplementary budgets in support of money spent under Article 223 of the Constitution. Article 223 specifies that the national government may spend money that has not been appropriated if: (i) the money appropriated is not sufficient to meet the original purpose of the expenditure or if a new need has arisen for which no appropriation had been provided; or (ii) money has been withdrawn under the Contingencies Fund (provided for under Article 208 of the Constitution and Section 19 of PFMB), the Fund consisting of appropriations to the proposed Equalisation Fund related to devolution). The approval of Parliament should be sought within two months after the initial spending of the money.

Perhaps the still-to-be finalised Regulations supporting the PFMB will clarify Section 44, but at first sight – and of concern -- the Section appears to go against the provisions of the FRP that require approval of a Supplementary Appropriations Act prior to the money being spent. Furthermore, the Section appears to go against the fiscal responsibility provisions specified in the PFMB.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-16	B+	B	**Performance slightly lower as the frequency of updates of cash flow forecasting appears to have diminished.**
(i)	A	B	*Performance lower*. Line ministries prepare detailed monthly cash flow forecasts for the first half of the year and provide the basis for the establishment of monthly cash expenditure limits. The forecasts are updated quarterly, are of variable quality and are not analysed by MoF officials. Indicative cash flow forecasts are prepared for the second half of the year. The uncertain financial resource situation during the current

[31] Section 15.20 of FRP 1989.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
			year appears to have undermined the usefulness of the cash flow forecasting exercise.
(ii)	B	B	*Performance unchanged*. Line Ministries have been able to enter into spending commitments at the beginning of the year with at least a 6 month time horizon, based on the 6 month VoA, which sets an aggregate limit on ministry spending (50 percent of the draft budget). However, depending on the actual cash flow situation, the MoF can unilaterally block proposed LPOs/contracts, particularly during the preparation of the Supplementary budget during the middle of the year. This thereby effectively reduces the time horizon to zero until the Supplementary Budget is approved, which is only about 3 months from the end of the fiscal year. The rating, on average, is B
(iii)	B	B	*Performance unchanged.* Although only one Supplementary Budget is submitted to the National Assembly each year, the number of allocations is large, and the reasons for the reallocations non-transparent. Though the reallocation process appears non-transparent, the total amount of changes to MDA budgets is small relative to their originally approved budgets.

3.5.2.2. PI-17: Recording and management of cash balances, debt and guarantees

Efficient management of debt and debt guarantees is an essential component of fiscal management. Poor management of debt and debt guarantees can create unnecessarily high debt service costs. With regard to efficient cash management, an important requirement for avoiding unnecessary borrowing and interest costs is that balances in all government held bank accounts are identified and consolidated (including those for extra-budgetary funds and government controlled donor-funded project accounts.

(i) Quality of Debt Recording and Management

Under the control of the Debt Management Department (DMD) in MoF, debt reporting is timely and comprehensive. The DMD prepares monthly Debt Bulletins (the team received a copy of the December 2011 edition) and the Annual Public Debt Management Report, the last of which was for 2010/11). The DMD reports regularly to the senior management of MoF, mainly in its role as a member of the Cash Management Committee (along with BSD, EAD and AGD). It receives daily reports on domestic debt management from Central Bank of Kenya (CBK), which acts as a fiscal agent for GoK. The quality of debt management in Kenya has some international recognition; Kenya continues to be one of the handful of countries to be included in the World Bank Quarterly External Debt Statistics report.

Since the 2008 PEFA assessment, domestic debt management and reporting has been incorporated into the Commonwealth Secretariat Debt Reporting and Management System (CS-DRMS), which is managed by DMD. CBK manually transmits data on daily domestic debt operations, which are then uploaded into CS-DRMS. Electronic transfer of data will become possible soon through the T-24 project (as indicated under dimension ii). The CS-DRMS is not linked to IFMIS, but interfacing is planned as part of the IFMIS Re-engineering Strategy.

Reconciliation of DMD external debt data with creditor data takes place with varying frequencies, depending on the ease of access to data; errors are minor, as indicated in a reconciliation report provided to the team for calendar year 2011. Reconciliation with some donor agencies is frequent, at least quarterly, particularly in the case of the World Bank, as DMD is able to access its website. Reconciliation with Middle East lender data takes place only annually.

Domestic debt reconciliation exercises in principle take place monthly through comparison of MoF Cash Book data and bank statement data (as per PI-22). The annual reports of the Auditor General note significant reconciliation errors, in large part representing the carry-forward from earlier years. [32]

(ii) Extent of consolidation of the government's cash balances

The MoF has daily knowledge of the balances on its accounts and the balances of line ministries held in CBK, but has no access to dis-aggregated information on the balances held by district offices of line ministries in commercial banks and on the balances held by SAGAs, donor projects and local authorities in commercial banks. The number of line ministry bank accounts held in commercial banks is in the several thousands, as service delivery units such as schools and hospitals also hold bank accounts. The monthly Monetary Survey prepared by CBK indicates that, on aggregate, balances held by GoK-related agencies in commercial banks comprise about 60 percent of all banking system balances held by these agencies.[33] Commercial banks are used, partly because CBK has very few branches outside Nairobi (four altogether) and partly because of the greater extent of access and flexibility relative to accounts held in CBK.

The MoF holds 19 accounts at CBK, but as yet these do not constitute a Treasury Single Account (TSA). The main account is the Exchequer Account, from which funds are released into line ministry accounts and into which funds are released from the revenue deposit account held by MoF. Other accounts include the Treasury Bill account, the Treasury Loan Account, and the Loan Maintenance Levy Account. The Exchequer Account does not yet have the authority to switch surplus (relative to payments needs) balances from the MoF's other accounts and from line ministry accounts on a daily basis in the interests of efficient liquidity management. A nominal attempt was made to establish a TSA a few years ago, through the establishment of a Treasury Funding Account covering both MoF and line ministry bank balances. The legal framework did not permit this to work, however. The new PFM Act (once it comes into law) provides for the establishment of a TSA.[34]

(iii) Systems for contracting loans and issuance of guarantees

The MoF is solely in charge of debt management. The criteria for incurring loans and issuing loan guarantees are contained in the Medium Term Debt Strategy. This forms part of the macro-fiscal

[32] As noted in paras. 274-279 on pages 57-58 of the Auditor General's report on the GoK's accounts for 2009/10. The Treasury Bills Bank Reconciliation Statement indicated significant payments recorded in Cash Books, but not in bank statements, and vice versa. Most of the discrepancies relate to earlier years, as referenced in the text, and as confirmed through looking at the Auditor General's report for 2008/09.

[33] As of the end of February, 2012, bank balances held by GoK-related MDAs were: Khs. 66 billion in CBK; Khs. 38 billion in commercial bank accounts held by district offices of line ministries in commercial banks; Khs. 68 billion held by SAGAs in commercial banks; and Khs. 4 billion held by local authorities in commercial banks.

[34] In contrast, in neighbouring Rwanda, the Ministry of Finance has daily information on the stock of balances in all Government of Rwanda-held bank accounts. A TSA is in operation, and, with the assistance of East Afritac, its scope will soon be expanded to include the balances in donor-project accounts (as reported in the IMF's PFM blog spot in April 2012).

framework (as outlined in the Budget Policy Statement and Budget Outlook Paper), which is tabled each year before Parliament during the presentation of the Budget Estimates. Conditions for loan guarantees are now more rigorous than they used to be, and take into account contingent liabilities arising from PPP arrangements.

Ongoing and planned activities

As indicated in the 2008 PEFA assessment, DMD was intending to transform itself into a full Debt Management Office, with front, middle and back office functionalities. This is still work-in-progress, as indicated in the 2010/2011 Public Debt Management Report, the most progress having been made in strengthening back office operations: CS-DRMS has been upgraded, the external debt service payment's advice system (DMD's system of notifying CBK of debt service payments to make and CBK's system of notifying that payments had been made) was computerised, a Back Office operations manual was developed, and a fibre optic link between MoF and CBK was activated.

CBK is leading the development of a banking system wide IT system, known as T-24 (24 hour banking), which will provide for a complete on-line electronic banking system covering all bank accounts, including GoK-held accounts. All expenditure accounts could be held in CBK, as physical access by line ministries to their bank accounts would no longer be necessary. The project has been in a pilot phase over the last four years and is due to be mainstreamed on 2 April 2012. It will facilitate the introduction of a TSA and will result in the phase out of the GPay/EFT system. Some donor agencies have indicated that they may start to open accounts at CBK as a result of the project.

Also facilitating strengthened cash management will be the introduction of a Cash Management Module (CMM) into IFMIS, which would link with a TSA (as required under the PFM Bill (Section 28 (2)). The CMM (combined with Hyperion) would support strengthened cash flow forecasting (the need for which was indicated under PI-16) and associated monthly cash plans for each MDA. The IFMIS Re-engineering Strategic Plan (2011-2013) emphasises the importance and urgency of the CMM. Section 29 of the PFM Bill 2012 provides for the establishment of a cash management framework,

Debt managed-related legislation is in the process of being revised in order to reflect the 2010 Constitution. The National Loans and Guarantee Act (2011) replaced the old Guarantee (Loans) Act (2004). The External Loans and Credit Act (1979) are to be revised. Sections 30-33 of the PFM Bill 2012 require effective debt management, including loan guarantees, and accountability of this to Parliament.

PI (M2)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-17	B	B▲	**Progress has been made in terms of dimensions (i) and (iii). The improved rating under dimension (iii) mainly reflects the new Loan Guarantees Act and the Medium Term Debt Strategy. The A rating under dim (i) in the 2008 PEFA assessment should have been a B, but this does not change the overall rating.**
(i)	B *(revised from A)*	B▲	*No change in performance in terms of ratings, but the trend is towards strengthening.* The rating in the 2008 assessment should have been a B, as an A rating required monthly reconciliation. The rating has therefore not changed, but debt management has improved due to the integration of domestic debt management into CS-DRMS, increase in

PI (M2)	Score 2008 PEFA	Score 2012 PEFA	Assessment
			the experience of staff, and progress being made in strengthening Back Office operations (e.g. through upgrading CS-DRMS) as part of the strategy of establishing a full Debt Management Office.
(ii)	C	C	*No change in performance*. More than 50 percent of GoK bank balances are held in commercial banks and MoF does not have regular and timely access to the amounts of these balances. The impending enactment of the draft PFM Bill, combined with the T-24 project will pave the way towards establishing of a TSA.
(iii)	B	A	*Performance has improved.* A sound Medium Term Debt Strategy is in place and the National Assembly is regularly briefed by MoF on debt issues. Conditions for loan guarantees are more rigorous than before, as a result of the 2011 Loans and Guarantees Act. The External Loans and Credit Act (1979) are to be revised, in line with the 2010 Constitution. The criteria for contracting loans are already sufficiently transparent, however, to merit an A rating for this dimension.

3.5.3. Internal control systems

Summary of assessment

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-18: Payroll control (M1)	C+ (i) B (ii) B (iii) B *(revised from C)* (iv) C	B+ (i) A (ii) B (iii) A (iv) A	*Performance has improved* through increased coverage of IPPD, initial roll out of GHRIS and establishment of payroll audit units. The evidence for (iii) in 2008 suggests a B.
PI-19: Procurement controls (M2)	B (i) NA (ii) B (iii) NA (iv) A	C+ (i) B (ii) D (iii) B (iv) B	*The indicator ratings are not directly comparable, as the indicator has been revised*, with effect from January 2011. Nevertheless, the rating for (ii) in 2008 (justification for restricted completion methods) seems overstated. Progress has been made (manuals, procurement audits, increased transparency) but is not captured in the scoring criteria.
PI-20: Non-salary expenditure controls (M1)	C (i) C (ii) C (iii) C	C (i) C (ii) C (iii) C	*No change in performance*
PI-21: Internal audit (M1)	C+ (i) B (ii) B (iii) C	C+▲ (i) B (ii) B (iii) C	*Progress being made* in strengthening internal audit, but not by enough yet to increase the scores.

3.5.3.1. PI-18: Effectiveness of payroll controls

As a major component of expenditure, effective control of the payroll is an important indicator of sound financial management.

Background

Most of the civil service falls under two payrolls. About 220,000 civil servants, including all those at district level, fall under the auspices of the Ministry of State for Public Services (MSPS), earlier under the Office of the President. The Judiciary is now included; at the time of the 2008 PEFA assessment, it had a separate payroll system. About 270,000 teachers fall under another payroll, managed by the Teachers' Service Commission (TSC). All teachers are appointed as permanent staff and are pensionable; i.e. no temporary/supply teachers.

The military has its own payroll. Military expenditure as a whole is included in the annual budget as a one line item, with no differentiation between personnel and other expenditure. Statutory Commissions, such as the Public Service Commission (PSC) fall outside the MSPS payroll, but their personnel expenditures are very small in relation to total government expenditure. The payrolls of SAGAs also fall outside the MSPS payroll. This PEFA assessment therefore covers only the MSPS and TSC payrolls.

The MSPS manages the Integrated Personnel and Payroll Database (IPPD), as described in the 2008 PEFA assessment. The IPPD was originally established in 1998, comprising the following components: staff list, payroll processing, budgeting, establishment list, and a skills inventory. In practice, only the first three elements were used and IPPD was never linked to the establishment list. The management of IPPD was devolved to line ministries, which simplified checking of the monthly payroll against the staff list maintained by each ministry.

In principle, a person can only be on the staff list if his/her appointment has been approved by the Public Service Commission (PSC), which is in charge of the establishment list. The PSC can only appoint people to existing positions (i.e. on the establishment list), leaving open the possibility of line ministries creating new positions on the staff list who are not on the establishment list.

The IPPD system in each ministry is not electronically linked to MSPS, so manual work is involved in checking that payroll and personnel data match. In order to provide for an electronic linkage, the MSPS has developed a Government Human Resource Information System (GHRIS). This also includes the establishment list, and so provides for a more complete integration between the payroll and personnel data than under the IPPD system. Electronic generation of payslips began in February, 2012.

As in all payroll management systems, removing staff from the system in the event of resignation or termination requires a human action and cannot be done automatically through an IT-based system (staff who are on contract or who retire are, on the other hand, captured through the system, as the IPPD captures the retirement and end-of-contract dates). With delivery of basic services being carried out country-wide through a multitude of district offices, a risk that some people may remain on the payroll when they should have been removed cannot be entirely eliminated. The MSPS sends a check list of the payroll to line ministries each month, but this doesn't completely remove the risk.

A development within the last three years has been the establishment of a payroll audit unit under the Management Consulting Services Department, which manages the IPPD in MSPS. The department checks the monthly payroll records submitted each month by line ministries. Any abnormal ‘spikes’ or apparent duplicate use of personal identification numbers (PINs) – or other identifying numbers such as birth dates and bank account numbers -- detected are then checked against the personnel records kept by the Human Resources Services Department in MSPS. This Department can then check with line ministry records. Loopholes have been virtually eliminated as a result.[35]

TSC: The TSC has been using IPPD since July 2008; prior to that it was using a semi-computerised system. The TSC staff interviewed by the assessment team provided thorough documentation on the use of the IPPD, addressing directly the four PEFA payroll control dimensions. The staff want the IPPD system to be integrated into GHRIS and also to have other current stand-alone systems, such as its Education Management Information System (EMIS) integrated. It also wants to develop human resource audit capacity in relation to being better able to measure performance.

Establishment lists are less relevant for teachers, who are recruited in relation to demand, based on pupil enrolments and forms of entry, which are not known with certainty. The annual budget, however, sets a ceiling on the total teacher wage bill and thus provides a control.

Most teachers operate at district level. Geographical factors may result in a delay of 1-2 months between a teacher leaving (through resignation or termination) and his/her removal from the payroll.

(i) Degree of integration and reconciliation between personnel records and payroll data

Through IPPD, changes in personnel records are quickly reflected in the payroll data. Following appointment, an appointment record, showing designation, grade and pay-station, is first captured under a personnel ID number, which is then reflected in personnel records (‘complement’, using TSC terminology), on the basis of which earnings and statutory deductions are automatically determined. Subsequent amendments of personnel records (e.g. due to promotion) automatically generate the corresponding adjustments in earnings and deductions calculations. Personnel records and payroll are reconciled monthly.

In terms of the system maintained by MSPS, complete integration is not yet achieved, as it is possible that staff may be appointed by MDAs who are not on the establishment list, though this would be against the rules and MSPS would eventually find out anyway. Adoption of the GHRIS, still ongoing, should provide complete integration between the establishment list, personnel records and the payroll.

(ii) Timeliness of changes to personnel records and the payroll

Changes to personnel records are quickly reflected in the payroll, through IPPD. The main issue is delays in changes to personnel records in response to resignations and terminations. The TSC indicated that it could occasionally take 1-2 months for personnel records to be changed in such circumstances, particularly in districts.

(iii) Internal controls of changes to personnel records and the payroll

A system of authorisations, designated passwords and records of changes made (audit trail) indicates strong controls over changes, such that the risks of leakage through unauthorised changes are low. Access rights to the system by payroll staff are uniquely defined based on

[35] A typical loophole would be a promoted staff person being paid twice in both his/her new and previous position, or a person accepting two job offers, one later than the other.

individual employees' PINs. Validity checks are in place (e.g. date of birth versus date of first appointment, marital status, use of look up tables). External controls on the data capture sheets have five levels of authorisation (modifier, authoriser, acceptor, data capturer and the verifier); i.e. four levels of checking. These are hierarchical in nature, so that the work of one is checked by another. The IPPD records all the amendments made on both the personnel data and payroll components, and who made the amendments, and a report on this is produced. The Accounts Department in a ministry, which is responsible for organising the actual payments (through IFMIS/GPay) cannot tamper with the payroll run submitted to it.

(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers

The establishment of a payroll audit unit in MSPS in 2009 (i.e. since the 2008 PEFA assessment) and the development of the internal audit function in GoK in general indicate significant step forwards; the issue of 'ghost' workers has significantly diminished as a result. The detailed information provided by TSC indicates an active payroll audit function (e.g. detection of over payments made to teachers, errors in keying in data, teachers not being removed from payroll upon retirement, inadequate verification of qualifications of newly appointed teachers). The Internal Audit Department in MoF has also undertaken payroll audits centrally, using interrogation software, while payrolls are a standard area of review by the IADs in each ministry (see PI-21).

Ongoing and planned activities: The GHRIS only came into being one year ago and is still being rolled out. In time, the IPPD will be integrated into the GHRIS (which may, in time, interface with the re-engineered IFMIS).

A leave management control and performance management system (PMS) is scheduled to go on-stream under GHRIS in June, 2012. In principle, a PMS can help mitigate the risk of unauthorised leave during the day, as non-attendance would mitigate against performance and thus reduce the chances of merit-based pay awards.

MSPS is planning more frequent physical inspection visits to the districts in order to check the payroll against the staff actually working.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-18	**C+**	**B+**	**Improvement through increased coverage of IPPD, initial roll out of GHRIS and establishment of payroll audit units.**
(i)	B	A	*Improved performance*. Through IPPD, changes in the personnel database directly result in changes in the payroll, Improvement since the 2008 assessment is due to more staff being covered by IPPD, particularly TSC staff, who moved to IPPD at about the same time as the 2008 assessment.
(ii)	B	B	*No change in performance*. Changes to personnel files due to recruitment, promotions, retirement and death are quickly recorded in the payroll. Changes to personnel files due to resignations/terminations may take some time to be reflected in the payroll as a manual action has to be undertaken first in order to lead to the change. Changes may take longer to make at district level.
(iii)	B *(revised*	A	*Improved performance*. As indicated in the text, a tight control regime is in place with regard to authority to change personnel records and the

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
	from C)		payroll, and each change results in an audit trail. The rating in the 2008 assessment appears to understate the actual situation, as it refers to the manual link between IPPD and IFMIS regarding actual payroll payments, which is not the relevant link in terms of this dimension. A B rating for 2008 PEFA would appear to be more appropriate, the improvement since then reflecting the full adoption by TSC of IPPD.
(iv)	C	A	*Improved performance*. Full establishment of payroll audit units in both MSPS and TSC as well as increased focus by IAD (MoF) on payroll indicates significant improvement since the 2008 PEFA assessment. Increased physical checking in districts (as planned by MSPS) might yield benefits, though perhaps limited as terminations/resignations are generally captured in the payroll within 2 months. Internal audit units in MDAs may be in a better position to undertake such checks

3.5.3.2. PI-19: Competition, value for money and controls in procurement

A well-functioning procurement ensures that money is used efficiently and effectively.

Background

The 2005 Public Procurement and Disposal Act (PPDA) became operational on 1 January 2007 upon its gazetting. The Act makes it mandatory for procurement entities (PE) to use open competitive tenders as the preferred method of procurement for procurements between Kshs. 3-6 million (according to the three classes of tenders described below). The PPDA is clear on separation of duties in respect of Accounting Officers, tender committees, procurement committees, evaluation committees and inspection and acceptance committees.

The PPDA is supported by the Public Procurement and Disposal Regulations (PPDR), which came into effect also on 1 January 2007. The first schedule of these sets out the threshold matrix according to three classes of PEs:

- *Class A*, State Corporations and Ministries;
- *Class B*, City Councils (Nairobi, Mombasa, Kisumu), Cooperative Societies, Universities, Colleges, Judiciary, Commissions, Parliament, Districts, Provincial Hospitals, and SAGAs; and
- *Class C*, Other Local Authorities (Municipal, County, Town Councils), Schools, District Hospitals, Health Centres/Dispensaries, Polytechnics, CDF Committees, and Voluntary Organisations/Institutions.

The procurement methods are: international open tender, national open tender, restricted tender, requests for proposals/quotations, direct (single source) procurement, and low value procurement. The matrix provides minimum and maximum thresholds for each procurement method under each class as noted in the footnote below.[36] The approval of Tender Committees in each PE is required

[36] The threshold above which open tendering is required for procurement of goods and works is Kshs. 6 million for Class A, Kshs. 4 million for Class B and Kshs. 3 million for Class C. With regard to procurement of services, the thresholds are Kshs. 3 million, Kshs. 2 million and Kshs. 1 million for the three classes respectively. The thresholds

for use of alternative procurement methods for procurements above the thresholds for open tendering (e.g. using restricted tendering), which must be justified according to the provisions of PPDA. The Public Procurement and Oversight Authority (PPOA) has the authority to approve 'special' procurement procedures through permitting exemptions from the provisions of PPPA; it approved four such requests during 2008/09.

The PPOA was established as a state corporation in 2007 to administer the provisions of PPDA, playing a monitoring, regulatory, advisory, sensitization and training role. Since 2008, it has issued manuals and guidelines through circulars:

- :A procurement manual (March, 2009 and sector specific users' manuals and records management protocols;
- Guidelines for: preparing procurement plans and implementation reports; framework contracting (for of common user items, in response to the 'rampant' use of by PEs of the Request for Quotations (RFQ) procurement method;, the hire of professional services; preference and reservation scheme guidelines for local contractors and SMEs; the 'disposal of surplus & obsolete stores, equipment and other assets', the issue being the transition to the new decentralised governance structure in Kenya; and the procurement of professional services, following complaints from professional bodies over the manner in which PEs procure professional services; and
- Revised standard tender documents.[37]

The PPOA has benefited from donor assistance: GIZ, SIDA (through UNDP), USAID/MCA and the African Development Bank. Outcomes include the development of an e-procurement strategy, a public procurement e-learning system and establishment of a well-functioning web-site (www.ppoa.go.ke).

All procurement is carried out by the PEs. They are required (PPOA Circular, 4-2009) to report quarterly to PPOA all procurements over Kshs. 5 million, indicating the type of procurement method used; all direct procurements (single sourcing) over Kshs. 500,000 (within 14 days); termination of procurement proceedings (within 14 days of termination) and reasons thereof; and within 14 days on disposal of assets to employees.

only make open tendering the default procurement method and do not prevent PEs from using open tendering below the threshold.

[37] The specific circulars issued since 2008 are: (i) PPOA 6 -2010 on "Framework Contracting ", (ii) PPOA 7- 2011 on "Disposal of surplus & obsolete stores, equipment & other assets", (iii) PPOA 10 -2011 on "Mandatory reports on the implementation of the public procurement and disposal (Preference and Reservations) regulations', 2011, (iv) PPOA Circular 1 - 2012 on "Procurement of Professional services" (v) PPOA CIRCULAR NO. 1- 2009 on "Management of Procurement Records" (vi) PPOA Circular No. 4-2008 on Guidelines On Mandatory Reporting Requirements of Procurement Activities (vii)PPOA Circular No.1-2011 on "Verification of Tax Compliance Certificate During Evaluation of Tenders" (viii) PPOA Circular No.2-2009 on "Role of Boards of Management in The Procurement and Disposal Process" (ix) PPOA Circular No.4-2011 on "Instructions on Provision of Information on Public Procurement by Procuring Entities to PPOA" (x) PPOA Circular No.5-2009 on "Implementation Of Electronic Advertisement In The Public Sector" (xi) PPOA Circular No.5-2010 Market Price Index (xii) PPOA Circular No.8-2011 on "Issuance of Bid Bonds/Tender Securities by Insurance Companies" (xiii) PPOA Circular No.9-2011 on "Issuance of Bid Bonds/Tender Securities by Insurance Companies" (xiv) PPOA Circular No 2-2008 on "Issuance of Bid Bonds/Tender Securities by Insurance Companies" (xv) PPOA Circular No 2-2011 on "Public Procurement Code Of Ethics For Procuring Entities" (xvii) PPOA Circular No 3-2011 on "Issuance of Bid Bonds/Tender Securities by Insurance Companies" and (xviii) PPOA Circular No 4-2009 on "Reporting Requirement And Procurement Planning".

The PPOA is required to prepare an "Annual Report and Accounts", the last one of which is for 2009/10 (on the PPOA web-site). The Annual Report and Accounts for 2010/11 has been finalised. The assessment team was provided with a copy of the 2008/09 Report.

The PPOA also provided the team with a report on PEs, which submitted reports in 2010/11, in compliance with the PPDA/PPDR. The first class of reports covered contracts exceeding Kshs. 5 million. Out of 47,232 PEs 36 submitted reports on 184 contracts; out of the 36 PEs, 28 represented State Corporations and 2 were Ministries. The report mentions this represents a low rate of compliance, but this is unclear, as not all PEs necessarily have procurements exceeding Kshs. 5 million,[38] and in fact, according to PPOA, most contracts are below Kshs. 5 million. Nevertheless, as indicated by procurement reviews conducted by the Compliance Department (discussed below), some MDAs (e.g. Teachers' Service Commission) have entered into contracts exceeding Kshs. 5 million, without informing PPOA.

Out of the 184 contracts, 68 percent (by number) was for national competitive bidding, 18 percent for international competitive bidding, 11 percent was for request for proposals, and 3 percent was for restricted tender. The PPDA lays down the criteria for not using open tendering above the threshold, and PPOA indicated that similarly low percentage rates would probably apply to contracts over Kshs. 5 million that were not reported to it.

The second class of reports covered direct procurements exceeding Kshs. 500,000 (representing the threshold above which request for quotations is required).Twenty six PEs submitted reports covering 31 procurements. The justifications were the need for urgency, associated with the end-year rush to complete the execution of procurement plans, the rush being due to the approval of the Revised Budget only 2 months or so before the end of the fiscal year. The PPDA defines the meaning of 'urgency'. The third class of reports covered termination: 16 PEs reported terminations for various reasons, such as change in composition of work required.

A requirement of PPDA is the preparation of budget-linked annual procurement plans on a quarterly basis. The assessment team received a copy of the plan prepared by the Ministry of Medical Services, covering 2011/12 in great detail.

The Compliance Department of PPOA has the authority to carry out procurement reviews (effectively audits) of MDAs in order to check whether they are complying with PPDA/PPDR, The PPOA has conducted 36 procurement reviews to date, all posted on its website, indicating a significant extent of non-compliance with regulations. The number of reviews is a tiny percentage of all the PEs in terms of numbers, but in terms of value is much higher. Reviews, essentially representing audits, follow a standardised format resulting in the calculation of a compliance index (CI). The minimum acceptable CI is 60 percent. The reviews are intensive exercises and can take several weeks.

The assessment team looked at a sample of five of these reviews, covering Thika District Hospital, Ministry of Water and Irrigation, Social Security Fund, Teachers' Service Commission and Ministry of Justice. The CIs for all of these fell below 60 percent, the Ministry of Justice having the lowest at 21 percent. Typical areas of non-compliance include inadequate justification for using restricted tendering procedures, inadequate linkages between procurement plans and budgets, and inadequate filing systems, resulting in unsatisfactory compiling and collating of procurement records.

[38] PPOA later clarified that PEs are required to report quarterly, even if no procurements are carried out. These reports are not part of the 36 mentioned above and are not captured on the PPOA website.

In addition to conducting procurement reviews, the Compliance Department conducts numerous procurement assessments of MDAs, typically taking 2-3 days. So, although PEs only report formally to PPOA on procurements above Kshs. 5 million and on use of direct procurement above Kshs. 500,000, the PPOA is generally able to check whether reporting requirements are being met. The assessments are not on PPOA's website and PPOA has not prepared a consolidated report on its assessments. As PPOA's capacity strengthens, its scope of compliance coverage should improve.

The audit reports prepared by KENAO also indicate a number of instances of departures by PEs from the provisions of the PPDA/PPDR. The still largely manual procurement processes used by PEs and the voluminous amounts of procurement documentation slow up the audit process.

The Kenyan procurement system was also assessed using the OECD-DAC Four Pillar methodology during 2007. Aspects of the procurement systems that were rated most positively were the introduction of a legal and regulatory framework, the establishment of PPOA, the development of a framework for contract administration, and the introduction of an appeals system. Weak points were the institutional framework, procurement capacity, the functioning of the procurement market in terms of private sector participation, poor enforcement and follow-up on external audit recommendations, and limited public access to procurement information. The assessment is now clearly dated, and a repeat assessment would appear to be desirable.

The Kenyan Chamber of Commerce and Industry (and Transparency International to an extent) indicated that the procurement system had improved in transparency in recent years, but nevertheless full transparency had not yet been reached. The tendering system has become more transparent (tenders are opened in public and the appointment of members of the PPARB is transparent, the appointments being broadcast on public TV). Nevertheless, government personnel have been suspected of interfering with the bidding process. Not all contracts are necessarily being published.

(i) Transparency, comprehensiveness and competition in the legal and regulatory framework

Table 20 explains the legal and regulatory framework for procurement in terms of six minimum requirements, and whether these are met.

Table 20: Legal and regulatory framework for procurement

Minimum Requirements (M2)	Meet requirements? (Yes/No)	Explanation
(i) be organized hierarchically and precedence is clearly established;	Yes	PPDA, PPDR, PPOA circulars
(ii) be freely and easily accessible to the public through appropriate means;	Yes	PPOA website, through districts & schools
(iii) apply to all procurement undertaken using government funds;	Yes	See text above in relation to 3 procurement classes
(iv) make open competitive procurement the default method of procurement and define clearly the situations in which other methods can be used and how this is to be justified;	Yes	Part IV of PPDA provides for permissible justifications for use of alternative procurement methods.

(v) provide for public access to all of the following procurement information: government procurement plans, bidding opportunities, contract awards, and data on resolution of procurement complaints;	Partial	Bidding opportunities and contract awards in the case of open tendering are shown on PPOA website and two national newspapers. Publicising by PPOA of tender notices has been limited, due to PEs being slow to provide tender notices to it (in contravention of PPOA Circular 4 of 2009). Administrative Review Board decisions are shown on PPOA website. The information was updated in April, 2012; prior to the PEFA assessment, the last recorded entry was for July 2010. Procurement plans not shown on PPOA website, as it is currently not a requirement for PEs to submit them. Some appear on PE websites.
(vi) provide for an independent administrative procurement review process for handling procurement complaints by participants prior to contract signature.	Yes	- Section VII of PPDA

(ii) Use of competitive procurement methods

Tender Committees in PEs have the authority to approve/deny the use of alternative procurement methods for planned procurements above the thresholds above which open tendering is required. The criteria that they use are specified under Section VI of PPPA and Regulations 53-66 of PPDR. PPOA's report noted above indicated that only 3 percent of procurements over Kshs. 5 million (the threshold for reporting contracts to PPOA) reported to PPOA were undertaken using restricted tendering procedures. Not all contracts over Kshs. 5 million are necessarily reported to PPOA, but PPOA considers that the percentage of contracts using restricted tendering procedures would not be very different, due to the conditions stipulated in PPDA under which restricted tendering can be used. If the data were available, the rating would likely be B (justification of using restricted competition provided for at least 80 percent of the value of the contracts awarded).

As noted above (under 'Background'), the 36 procurement reviews conducted to date by the Compliance Department of PPOA indicate instances of use of restrictive tendering practices with insufficient justification. PPOA does not prepare a document that consolidates the findings of the 36 PEs reviewed.

The justifications for using restrictive tendering above the threshold provided to the assessment team by the five line ministries visited were mainly the shortage of time available to execute procurement plans due to supplementary budgets not being approved by Parliament until near the end of the fiscal year.

The annual reports of KENAO indicate instances of procurement being carried out by restrictive tendering practices in some instances without sufficient justification, but the analysis is on a ministry by ministry basis and thus it is difficult for the outside reader to obtain an insight of the extent to which use of restrictive tendering practices are used without sufficient justification.

(iii) Public access to complete, reliable and timely procurement information

Procurement information comprises government procurement plans, bidding opportunities, contract awards and data on resolution of procurement complaints. Information on procurement plans is not available, except on some PE websites. Currently, PEs are not required to provide PPOA copies of their procurement plans. Bidding opportunities in relation to open tenders are posted on PPOA's website and in national newspapers. The website currently only shows a handful of tenders, but this is because PEs have been slow in providing information to PPOA, though such provision is required (see box under dimension (i) giving the impression that it is not being fully maintained. Contract awards in relation to open tenders are indicated on PPOA's website (although bringing up the information on to the screen is challenging). Data (recently updated) on resolution of procurement complaints are available on the website.

(iv) Existence of an independent administrative procurement complaints system

This dimension is scored according to whether a body reviewing complaints on procurement satisfies the following requirements:

(i) is comprised of experienced professionals, including members drawn from outside government.

(ii) is not involved in procurement transactions or in the process leading to contract award decisions;

(iii) does not charge fees that prohibit access by concerned parties;

(iv) follows processes for submission and resolution of complaints that are clearly defined and publicly available;

(v) exercises the authority to suspend the procurement process;

(vi) issues decisions within the timeframe specified in the rules/regulations; and

(vii) issues decisions that are binding on all parties (without precluding subsequent access to an external higher authority).

As indicated in the 2008 PEFA assessment and on the PPOA website, the Public Procurement Administrative Review Board (PPARB) has been in place for some time (covered by Sections 93-100 of PPDA) and appears to function well. The requirements for (i), (ii), (iv), (v) and (vi) are met, as indicated under the provisions stipulated in PPDA/PPDR and according to the "Decisions" posted on the PPOA's website.[39] With regard to criterion (iii), charges are levied, but are not considered by PPOA to be prohibitive. The fees vary between Kshs. 12000-82,000 and have been in effect since the PPDA and PPDR came into effect. The authorities consider that fees (or else the use of some other kind of safeguard, such as security bonds) are warranted in order to deter 'mischievous' complaints aimed at de-railing projects they are opposed to).[40]

[39] PPOA provided an update of the table shown in the 2008 PEFA assessment on the status of appeals (total number, successful/annulled appeals, dismissed appeals, withdrawn appeals and appeals taken for judicial review

[40] Comment provided by Ministry of Local Government on the first draft report.

Progress since 2008 PEFA assessment

In terms of the PEFA assessment rating, the situation now is little different from that in 2008, but some improvements have occurred that do not as yet impact upon the scoring: the preparation of procurement manuals, the publication of a number of clarifying circulars, the establishment of rigorous procurement reviews (audits), and the establishment of e-training.

Ongoing and planned activities

- The PPDA is to be reviewed to take into account the 2010 Constitution and the new decentralised system of governance that is to be established.
- The PPOA is likely to establish regional offices in line with the impending decentralisation of governance. It has already started to hold Regional fora.
- A Procurement to Pay (P2P) module is planned as part of the IFMIS Re-engineering project. Computerisation of procurement processes will hopefully facilitate greater transparency in procurement practices, including a more transparent electronic reporting system that PPOA is planning to introduce; this would in time cover all procurement activities of line ministries;
- PPOA is currently collecting information on procurement activities with values of Kshs. 2 million and above, thus expanding its scope of oversight;
- An e-procurement strategy is being prepared as one of the components of GoK's e-governance programme;
- PPOA is planning to issue a Circular, reminding PEs of their obligation under PPDA to provide PPOA with copies of their tender notices. In this regard, PPOA is developing a reporting portal that will enable PEs to upload their procurement notices themselves;
- In response to the assessment team's observation concerning the lack of a consolidated compliance report, PPOA indicated its intention to prepare a consolidated procurement review report; and
- The impending review of PPDA (noted above) will address the issue of MDA's submitting procurement plans to PPOA.

PI (M2)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-19 (M-2)	B	C+	**This indicator has been revised, with effect from January 2011. The indicator ratings are therefore not directly comparable**. Nevertheless, the B rating for dimension (ii) under the 2008 assessment concerning justification for using restricted competition procurement methods appears overstated. The A rating under dimension (iv) in 2008 was assessed under slightly different criteria than for the 2012 rating; the situation now is probably much the same is in 2008. The scoring criteria do not capture progress being made in some areas, as noted above.
(i)	NA	B	5 out of the six requirements (Table 20) met.
(ii)	B	D	The B rating in the 2008 assessment (the dimension is broadly equivalent to the new dimension) indicates sufficient justification provided for restricted tenders, but the rating was based on Tender Committee approval of such tenders, and PPOA's procurement

PI (M2)	Score 2008 PEFA	Score 2012 PEFA	Assessment
			reviews had not started. The rating may still be B (justification is provided for at least 80% of contracts awarded using restricted competition), but the data are not available to demonstrate this (and therefore a D). PPOA's procurement reviews have identified instances of non-compliance in terms of using restrictive tendering methods without sufficient justification, even though the Tender Committees approved them. .
(iii)	NA	B	Bidding opportunities are published in national newspapers and are available to an extent on PPOA's website (PEs tend to be slow in providing these to PPOA). Contract awards are shown on an up-to-date basis on the website. The decisions on the ARB are available on the website; the data were recently updated. Procurement plans are not published.
(iv)	A	B	Six out of the seven criteria concerning the transparency of Administrative Review Boards are met. The ratings are not strictly comparable, as the criteria used under the previous PI-19 were far less specific.

3.5.3.3. PI-20: Effectiveness of internal controls for non salary expenditure

Controls concerning payroll, debt and revenue management have been discussed under PIs 14-15, and PIs 17-18.

(i) Effectiveness of expenditure commitment controls

Expenditure commitments are entered into through LPOs and contracts. They are entered by line ministries into IFMIS, but only after they have been approved manually at line ministry level. The commitments are supposed to be consistent with the approved budget, but, as noted in PI-4, this is not always the case. Approval of commitments is not linked to projected cash availability, as the mechanism for such linkage has yet to be developed (as is planned to happen under the IFMIS Re-engineering Strategy (see Section 2).

At district level, a quarterly budget allocation system is in place. Central government MDAs allow district offices to spend up to the limits provided by Authorities to Incur Expenditure (AIE).[41] At least in Machakos District, the District Accountant will not permit any proposed expenditure commitments with a time horizon of more than 3 months (12 months is possible in the case of the procurement of commonly used items through framework contracts, and 6 months is possible for capital items) and funds are required to be already available in bank accounts in order to cover the payables arising from such commitments.

(ii) Comprehensiveness, relevance and understanding of other internal controls and processes

Other internal control systems are mainly covered by the very detailed and comprehensive 1989 Financial Regulations and Procedures (FRP)) and a multitude of Circulars issued by different

[41] 1989 FRP, Section 5.2.3.3.

ministries, including Treasury Circulars (TCs) issued by MoF. The FRP and Circulars cover a multitude of items, controls in budget preparation and execution, payment of bills, holdings of bank accounts, bank reconciliation requirements, accounting practices in general, procurement, receipts issued for own source revenues of line ministries and the deposit of these into bank accounts, the use of imprests/advances, the use of real assets, and personnel matters such as vacation, study and sick leave.

Apparently some of the FRP are no longer applicable but have not been replaced, but the extent of this is unclear, as the full document is still available from the Government Printer. The completeness, availability and the continued applicability of the TCs issued by MoF is doubtful. A disciplined approach to the filing of circulars appears to be lacking, and heavy reliance is placed on accumulated knowledge and experience rather than a well-documented system that is widely available.

The understanding of rules and procedures probably varies between central government ministries and districts; the understanding of the Machakos and Thika District Administrations – visited by the assessment teams - appeared to be good, perhaps because of their relatively small size.

(iii) Degree of compliance with rules for processing and recording transactions

Compliance with rules and procedures appears to be deficient, partly perhaps because of insufficient understanding of them. The annual reports of the Auditor General on the Appropriations Accounts of line ministries make countless references to non-compliance with rules/procedures in the areas referred to above; the assessment team read the reports for 2008/09 and 2009/10; the report for 2010/11 had not yet been completed at the time of the field visit in March. The areas of non-compliance tend to repeat themselves each year.

Ongoing and planned activities

The PFMB currently before Parliament would, once enacted, provide the legal basis for strengthened budget execution systems (PIs 16-17). New FRP are being drafted to support the new Act, replacing the largely out-dated 1989 FRP. The on-going expansion of the scope of IFMIS, through the IFMIS Re-engineering Strategy will play a strong instrumental role in supporting strengthening budget execution (also noted under PIs 16-17).

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-20	C	C	**No change in performance.**
(i)	C	C	*No change in performance.* Line Ministries enter expenditure commitments into IFMIS, but after they have been approved at line ministry level and the procurement process has already begun. The commitments are legally supposed to be consistent with the approved budget (which, for the first half of the year, has tended to be the Vote on Account), but, as noted under PI-4, pending payments have arisen due to 'lack of budget provision)'. Approval of commitments is not yet integrally linked to projected cash availability (as per PI-16), which would only come after proposed commitments start being entered into IFMIS. The MoF can, however, unilaterally block line ministries from entering commitments into IFMIS if it anticipates a need for expenditure cutbacks through a Supplementary Budget. This, however, is a very arbitrary and disruptive

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
			commitment control system. District administrations have a more orderly commitment control system based on quarterly allocations and cash availability, but District administration expenditures cover only about 5 percent of total central government expenditures. This dimension scores no higher than C, as a B grade requires commitments to be linked to projected cash availability.
(ii)	C	C	*No change in performance.* Rules and procedures are documented in the 1989 FRP and successive Circulars, including TCs issued by MoF. Their continued applicability is doubtful and heavy reliance appears to be placed on accumulated knowledge and experience rather than a well-documented system that is widely available. The rules and procedures appear to be well understood in Machakos and Thika Districts visited by the assessment team.
(iii)	C	C	*No change in performance.* Compliance is clearly deficient in many respects, as indicated in several instances in the reports of the Auditor General on the annual Appropriations Accounts. The various weaknesses in the IFMIS, as laid out in the IFMIS Re-engineering Strategy, appear to facilitate non-compliance. The audit reports do not indicate any order of magnitude in terms of financial wastage.

3.5.3.4. PI-21: Effectiveness of internal audit

Regular and adequate feedback to management is required on the performance of the internal control systems, through an internal audit function (or equivalent systems monitoring function).

(i) Coverage and quality of the internal audit function

The Internal Audit function is established under the direction of the Internal Auditor-General who is responsible to the Permanent Secretary, MoF, and whose role is established in the Government Financial Management Act, 2004. Treasury Circular 4/08 sets out the objectives of Internal Audit, the duties and responsibilities of staff. Internal audit (IA) staff total around 550, most of whom are located in ministries and district offices and who have dual reporting responsibilities; functionally to the Internal Auditor-General (IA-G) and line reporting to the senior management/accounting officer in the MDAs where they are located. To deal with the significant management and control issues that attach to such a large internal audit service, the HQ staff under the IA-G are organised into seven divisions. These supply support to field staff, who may have come from different backgrounds and experiences, and monitor performance and quality. Field staff provide audit coverage for the whole of central government, but excluding SAGAs (including KRA) and local authorities, who have their own internal auditors.

An Audit Manual is in place, in accord with the International Institute of Internal Auditors (IIA) Standards. The first volume is generic, the second includes a comprehensive range of audit programme covering standard systems. Further guidance has been developed on planning individual audits and on the format of reports. There are standard annual planning forms and quarterly monitoring returns. Sample sizes and approach to risk are entirely theoretical with no specific guidance on sample sizes. As a consequence it is likely that there will be differences in approach.

Audits are planned annually using a risk based approach in relation to standard audit heading based on systems including: budgetary performance; procurement; cash management; payroll; IT, all of which are categorised as high risk. Audit days are allocated to each audit within each activity group (an internal audit unit). There are standard person-day allocations for members of staff in each unit and on this basis available audit resources and planned audits are reconciled. A time recording system is not in place, which somewhat undermines the audit days' planning approach since efficiency in performance cannot be measured and reasons for under-performance assessed. This shortfall is to be addressed with the introduction of a software product called Teammate.

The consolidated annual plan produced by the IA-G shows the time to be spent on different types of systems across all the activity groups. Through the process of quarterly monitoring he is able to keep track of the numbers of audits completed, even though, as noted above, he is not able to determine the inputs required to produce the reports. Table 21 shows the number of IA units planning to undertake audits across the key systems based on the risk methodology in use. All 44 ministries are planning work on IT, payroll, cash management, and Authority to Incur Expenditure (AIE) and most are planning work on other key systems. The picture is mirrored at districts and provinces.

Table 21: Activity workplan by system showing the number of Internal Audit Units planning audits of key systems

Activity Title	Ministry	Provinces and Districts	Total
Budgetary Performance	42		42
Procurement	40	219	259
Cash Management	44	256	300
AIE Processing	44		44
Payroll Audit/HRM System	44		44
Transport Management System	44	105	149
AIA/Revenue	35	256	291
Donor Funds	33	102	135
Grants	25		
Projects	12	200	212
Pending Bills	44		44
Asset Management	44		44
Information Technology System	44		44
Economic Stimulus Program	10		10
Supplies		209	209
Expenditure reviews		260	260
Deposits		219	219
Contracts		201	201
Revenue		229	229
Expenditure Review		260	

Reports are produced in accordance with a standard template, but this does not currently include an agreed action plan where the response from management can be included, although examples of reports that did include these were seen. Inevitably with such a large and dispersed service there will be variations in the quality of work and the extent to which auditors follow the prescribed methodology. Staff at the HQ receive copies of all reports and undertake quality control reviews.

Auditors in the field are still engaged in regular checking of cash books and cheques and the bulk of the reports, judging from the sample reviewed, still have a strong focus on transactions and transaction errors even when the main purpose of the audit is on the system. The continued emphasis on checking appears to be a justified and appropriate audit strategy in view of both the manual systems in use in many locations and the incidence of errors that are found by the external auditor. The level of errors found in systems reports suggests also that systems cannot readily be relied upon.

Reports on systems often do not attempt to assess systems against the control objectives, set out in the report, and thereby to identify the control weaknesses that gave rise to the errors. Consequently, recommendations are perhaps not as well focussed on identifying the underlying weaknesses. Set against this, however, is the fact that in many cases the problem is non-compliance with a clear and well-understood control (as indicated also under PI-20). The reports reviewed were clear and demonstrated that the testing was well directed and reflected an understanding of how the system was supposed to work. Meetings with a small sample of internal auditors demonstrated they had good levels of insight and understanding and all shared the same understanding of the role of internal audit and what they were seeking to achieve. Many are being encouraged to undertake professional qualifications and 80 have qualified as Certified Fraud Investigators.

(ii) Frequency and distribution of reports

Draft reports are supposed to be issued within 14 days of the completion of field work and management are required to respond within 14 days to the draft report. The timing of audits, including when they should be completed, is contained in the annual plan which is held both locally and centrally, so that HQ staff are able to monitor progress both by receiving copies of reports but also by reviewing quarterly returns from IA units.

Reports at the national level are sent to the accounting officer and copied to the IA-G. At district level reports are addressed to heads of department and the IA-G. This reporting arrangement enables IA-G to monitor performance both numbers and quality of report. Although not formally copied in, KENAO staff obtain reports when they visit the IA department of the entity they are auditing.

(iii) Extent of management response to internal audit findings

Accounting officers are under instruction from the PS of MoF to respond to draft audit reports within two weeks of receiving the draft report. In ministries, but not at district level, audit committees have been established whose role is to monitor IA reports and the responses to them by management. The committees include independent members and are supposed to meet at least quarterly. The head of IA in the ministry acts as secretary to the committee. Audit committees have been given a template to monitor action on reports but no evidence of this operating was seen in the very small number of committee minutes reviewed. However, some minutes did show efforts at tracking implementation. Audit Committees in some ministries are not fully functioning; the Committee in Ministry of Medical Services had not met for two years.

Little ready evidence is available about the extent of responses across all the entities serviced by the IAG staff; the numbers of reports and the detail required to present an accurate picture about each significant recommendation represents a major data gathering exercise. Reports have not routinely included action plans, though some may, and so finalised reports do not indicate the extent of agreement, if any, to take action and if so by when and by whom. It was asserted by some auditors that all recommendations are accepted, while evidence of minutes indicated that, at least in one instance, two consecutive reports by the internal auditor had been completely ignored by management.

No mechanisms currently exist that can provide the quantitative information necessary to address this indicator with any confidence. However, discussions with senior staff in the IA-G department suggest that while action in response to all recommendations is not the norm, some success had been achieved. Development of agreed action plans and structured monitoring by audit committees with quarterly or six monthly returns to IAG HQ by local heads of internal audit would perhaps put greater pressure on management to take action to address weaknesses. However, as the rest of this assessment report indicates, dealing with persistent problems has not been a strong feature of the management culture. Where Audit Committees have been firmly established in ministries (not always the case), they have, in the view of IA-G, improved management implementation.

Progress since last assessment

Technical developments relate to advice to auditors about procurement, value for money, standard reporting format, engagement planning and tracking or outstanding audit recommendations by audit committees. IAD has prepared publications under the PFM Reform Programme: guidelines on institutional risk management; handbook on value for money; handbook of framework for audit and risk committees. An Audit Committee template has been developed to track action on recommendations. Usage of audit interrogation software (IDEA) to investigate payroll has been improved. IT capacity has strengthened, though the assessment team had no specific evidence on this.

Ongoing and planned activities

The PFMB includes a detailed and strengthened role for internal audit, thus providing it with legal base. IT audits are being developed. Teammate software is to be introduced to improve time recording and automate working papers.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-21	C+	C+▲	**Progress is being made in strengthening internal audit, though not yet by enough to increase the scores.**
(i)	B	B	*No change in performance.* The audits are directed at risk areas and there is an attempt to use control objectives as the basis for assessment, but reporting still tends to focus on the error and is less effective in identifying the control weakness. Reports are professional and detailed and of a good standard.
(ii)	B	B	*No change in performance.* Auditors are required to issue draft reports within 14 days of the completion of the audit, which takes place within an

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
			agreed time frame set out in the annual plan. Audit units submit reports and regular returns to IA HQ who are able to monitor progress against plan. Copies are sent to senior management of the audited body but are not routinely sent to KENAO, which collect reports when visiting ministries and other bodies.
(iii)	C	C	*No change in performance.* While management provide written responses to most reports, action does not always follow. The introduction of audit committees in ministries, where it has been successful, appears to be a factor in improving action by management

3.6 Accounting, recording and reporting

Summary of assessment

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-22: Accounts reconciliation (M2)	*C (revised from C+)* (i) B (ii) D *(revised from C)*	D (i) D (ii) D	*Performance lower with regard to bank reconciliations*. The rating in 2008 for dimension (ii) appears to have been too high, and has been revised to D.
PI-23: Information on resources received by service delivery units (M1)	D	D	*No change in performance*
PI-24: In-year budget reports (M1)	C+ (i) A *(revised from B)* (ii) B (iii) C	C+ (i) A (ii) A (iii) C	*No change in performance apart from an increased frequency of reports*: The delays in the reporting of, and accounting for, expenditure at district level, along with the only partial use of the IFMIS functions, raise concern about the quality of data, as also indicated in the reports of the Auditor General. Rating for (i) in 2008 revised upwards to A, as the B rating was based on inclusion of SAGAs, which are not covered by this dimension.
PI-25: Annual financial statements (M1)	D+ (i) D (ii) B (iii) D *(revised from C)*	D+ (i) D (ii) B (iii) D	*No change in performance.* Rating for (iii) revised downwards, as accounting standards are not disclosed.

3.6.1. PI-22: Timeliness and regularity of accounts reconciliation

Reliable reporting of financial information requires constant checking and verification of the recording practices of accountants – this is an important part of internal control and a foundation for good quality information for management and for external reports. Timely and frequent reconciliation of data from different sources is fundamental for data reliability.

(i) Regularity of bank reconciliations

A circular from the PS of MoF requires ministries to submit details of reconciliations in respect of their accounts held in CBK by the 15th of each month to the Accountant General. [42] All ministries hold accounts with CBK. In turn, ministries require their subordinate bodies at district level that use commercial bank accounts, to submit reconciliation data by the 10th of each month (15th at the latest). Although MoF authorises the opening of these accounts it is unable, apparently to state the numbers of accounts there are. Since schools each have two or more banks accounts, the total number of accounts held in commercial banks nationally must exceed 30,000. These accounts are funded through transfers from central ministry accounts in CBK. By reconciling the CBK accounts the government is able to account for all disbursements from the Exchequer account, even if a significant number represent transfers to district and other units of ministries. The expenditure of transfers is accounted for at a later date and in the meantime the amounts sit in suspense accounts until they can be cleared by a detailed account from the district of how the money was disbursed (CR suspense, DR service accounts).

The transfers to districts are easy to account for as they are made by EFT. The use of EFT also means that reconciliations are not troubled by the problem of un-presented cheques. The accounting for the expenditure of those transfers to districts is another matter, however (dim (ii)).

The MoF wrote to all heads of accounting units in June 2010[43] noting with concern arrears in preparing bank reconciliation statements and advising that reconciliations should be performed daily and reconciling items cleared promptly, and that arrears should be reduced to two days (the Accountant General maintains a record of when reconciliations are received and also receives a copy of the reconciliation). A review of the position in February 2012 showed that of the 79 recurrent bank reconciliations listed in the status report only 5 were up to date, 11 were one month in arrears, while some were apparently 12 or more months in arrears. Uncertainty exists in AGD as to whether the return is not up to date but ministries are making regular returns, or if ministries are really failing to make returns but are reconciling, or if they are not reconciling when they fail to make returns. Whatever the answer, bank reconciliations appear not to be under the control and supervision from the centre; and no central review of old reconciling items appears to be taking place.

(ii) Regularity of reconciliation and clearance of suspense accounts and advances

Suspense accounts are defined in MoF's Financial Regulations and Procedures (FRP) issued in 1989 as any expenditure or revenue that cannot for the time being be carried to the vote accounts. They include imprests (standing and individual), advances and transfers to districts of funds in discharge of authority to incur expenditure (AIE), as explained in (i) above. [44] The errors and the

[42] Based on Section 5.9.2. (Bank Reconciliation) of the 1989 FRP.
[43] Letter 3 June 2010 ref AG.17/05/vol (110)
[44] Sections 5.4.24-25 of FRP. Sections 5.4.26-30 elaborate.

failure to reconcile and clear advances and suspense accounts appear with monotonous regularity in KENAO reports. Almost every account has problems with suspense, bank reconciliation or statements of assets and liabilities. The audit report on the 2009-10 accounts made 141 separate references to suspense accounts, which term includes advances to officers for travel expenses. Advances for travel are meant to be cleared within 48 hours of return from the trip to which the advance relates,[45] but some of the advances outstanding go back months and in a few cases years.

Accounting for transfers to districts is meant to take place monthly by means of flash disks that are taken to the District Reimbursement Section of the Treasury. It appears, however, that delays occur in posting these transactions; anecdotally up to three months. In the meantime, these transfers, representing cash that has to be accounted for, appear as suspense items. At the end of the financial year, the delay has an adverse effect upon the final accounts as expenditure not posted to the year to which it relates is carried forward to the following financial year while the cash advance has been made in the year just closed.

Further reconciliation problems can arise in relation to certain types of income that are collected nationally in up to nearly 250 locations but paid into a single commercial account. While the locations may make a return to the central ministry of the income it has paid into the accounts, because a single bank account is used it is practically impossible to identify individual remissions in the many hundreds or maybe thousands of transactions that appear. Apart from the reconciliation problems this creates, it also opens the way for manipulation; claiming to have paid funds into the bank, but in reality never having done so, and supplying false banking slips.

Further problems arise in IFMIS because it does not contain all the accounting information that appears in the accounts submitted to the Auditor-General in relation to Statement of Assets and Liabilities. This situation arises because not all balances were entered into IFMIS; some are held manually and relate to earlier years. Consequently there is a variance in the balances contained in the IFMIS system and the financial statements submitted to the Auditor General. In addition, the IFMIS statements do not balance in many cases. When the balances were entered, in some cases the contra entry was not known and so it was posted to a general suspense account, thus creating the problem. A task force has been set up to tackle this problem.

The KENAO reports indicate a pervasive failure to undertake basic accounting procedures that must throw into doubt the completion of those procedures during the year. Some of the responsibility for this lies with accounts staff who fail to monitor the position on suspense accounts to make sure that those charged to clear them do so on a timely basis. But part of the problem, as noted above, relates to the carrying of balances outside IFMIS, some of which are several years old and may be unsupported by any documentation or any cash. These issues need to be resolved before the wider introduction of IFMIS and before the introduction of counties, since in some cases, the balances may need to be allocated to central or county government.

Changes in scoring the previous PEFA assessment: The 2008 assessment was mis-scored by not recognising the failure to resolve problems with suspense accounts and advances that dated back several years, and instead carrying them forward.

On-going and planned activities: The cash management module in the IFMIS, once operational through the IFMIS re-engineering strategy, as well as other aspects of the strategy will help to strengthen accounting and reporting.

[45] Section 5.6.5. of 1989 FRP.

PI (M2)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-22	C *(revised from C+)*	D	**Performance lower since 2008 with regard to bank reconciliations**. The rating in 2008 for dimension (ii) appears to have been too high, and has been revised to D, resulting in overall rating for 2008 being revised down to C.
(i)	B	D	*Performance lower.* The monitoring report held by the Accountant-General indicates that reconciliations by ministries may be several months in arrears in some cases. The position may have deteriorated since 2008 because of lack of effective monitoring by the Accountant-General
(ii)	D *(Revised from C)*	D	*Performance unchanged.* Reconciliation and clearance of suspense is problematic because it comprises entries in both IFMIS and in separate manual records. In addition it appears that accounting by districts for transfers may be in arrears. The financial statements contain many uncleared suspense balances, some dating back many years. It is likely 2008 was mis-scored in not recognising the failure to resolve problems with suspense accounts and advances that dated back several years

3.6.2. PI-23: Availability of information on resources received by service delivery units

Problems can arise in front-line service delivery units in obtaining resources that were intended for their use. The indicator covers primary education and health care service delivery units that are under the responsibility of the GoK.

Staff at schools and health facilities are all paid through the IPPD system by the Teacher Service Commission or through their ministry. Staff costs account for the bulk of expenditures. In respect of schools, money is transferred to their bank accounts directly by the Ministry of Education for items such as books and maintenance in accordance with a formula. Schools are, therefore, clear about the funding they should receive. Because funding is from the centre to GOK offices and service delivery units in districts, the problems of leakage that a Public Expenditure Tracking Survey might seek to identify may be fewer. Direct payment of funds to schools, while efficient and easily controllable, still resulted, however, in a huge fraud where Free Primary Education funds provided by other donors were misdirected to other bank accounts. The payments were done outside IFMIS, hence bypassed the rigorous controls in Government system. This loophole has hopefully been closed by the requirement that all payments go through IFMIS/GPay.

The Ministry of Public Health, which is responsible for primary healthcare, including health clinics, has no system for identifying expenditure incurred by its 3000 dispensaries, 600 Health Centres and 487 hospitals as it does not have any cost centre codes that would identify individual establishments. The expenditure is accounted for through the district system and at district level. All expenditure on salaries and much of the expenditure on drugs is incurred and controlled centrally so that the amounts spent at local level are relatively minor. Details of the distribution of drugs are maintained at establishment level. However, the fact remains that no overall picture of expenditure at delivery unit level is available.

No reports are currently available on resources received by service delivery units that can be reviewed by management, the legislature or the public

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-23 (i)	D	D	**Performance unchanged**. No reports have been prepared that indicate to the public and legislature the cash and in-kind resources received by service delivery units. In principle, however, it should be possible to prepare such reports as the data are available, at least in respect of schools.

3.6.3. PI-24: Quality and timeliness of in year budget reports

The ability to "bring in" the budget requires timely and regular information on actual budget performance to be available both MoFEP (and Cabinet), in order to monitor performance and if necessary to identify new actions to get the budget back on track, and to line ministries for managing the affairs for which they are accountable.

(i) Scope of reports in terms of coverage and compatibility with budget estimates

Expenditure and expenditure commitments entered into IFMIS are matched against the budget estimates. For historical and anomalous reasons, until this current year, the budget was prepared by Budget Supplies Department and ministries using a one coding structure on a stand-alone piece of software. The final results of this were then fed into IFMIS using a one for one conversion table; the two systems used the same descriptors but the codes that related to them were different (see discussion in PI-5). In principle, therefore, the budget estimates in IFMIS were the same (and now are the same as those prepared by BSD in terms of preparing the 2011/12 budget). However, errors could still arise.

Users with access to IFMIS, presently confined to the central ministries, can call for on-screen or hard copy reports of expenditure and commitments at whatever level they wish. So it is possible to generate a report at department level and at ministry level, and such reports are generated internally for the information of senior management. User capability to generate other reports they require or to request special reports appears limited and requests have to be channelled via the IFMIS team.[46]

The Quarterly Economic and Budget Reviews (QEBR) are the only published reports that contain budget performance information, including information on outstanding expenditure commitments.

(ii) Timeliness of the issue of the reports

Users reports can be generated at any time. Ministries are required to submit signed reports to the MoF by the middle of the month; the signature indicating ownership of the report. Data from districts about expenditure incurred at that level should be submitted each month between the 10th and 15th and contains both expenditure and commitments. The information is then posted into IFMIS. Assuming data are received and posted promptly then complete reports should be available in the third week of the month or earlier. The extent to which reports contain complete, accurate and up-to-date information is dealt with in (iii).

[46] For example, the Ministry of Medical Services provided the assessment team with an example of a 'Vote Book Status Report', prepared monthly. The report, covering July 2011-January 2012, shows the approved expenditure estimate, expenditure for the latest month, cumulative expenditure to date, commitments and the appropriations balance remaining.

(iii) Quality of information

Both expenditure and commitments are included in reports and reflect the most current position in IFMIS; for many ministries the reports appear likely to be reliable, although delays may occur between the conversion of an expenditure commitment into an actual expenditure and the recording of this in IFMIS, resulting in inaccuracies in the figures for both.[47] For ministries that transfer funds to districts, however, some expenditure may be unreported for some time and the position may be misleading. Expenditure remains in the suspense accounts until it is posted by means of the returns from districts; delays may be substantial, according to the QEBR report for the last quarter of 2010/2011, and as anecdotally related to the assessment team.

Useful commentary or analysis that highlights variations from budget and performance issues appears to be largely absent from the reports, which mainly comprise financial data only. The usefulness of the reports to management appears, therefore, to be limited.[48] It is not clear to what extent consideration is given to the quality of the data that underpin the reports.

The reports of the Auditor-General indicate concern for the quality of data. For a number of years the Auditor General has refused to give an opinion on a number of vote accounts. The reasons relate to unexplained discrepancies, omission of expenditure and lack of documentation. The specific reasons and the sums involved for each vote account are not given by the Auditor-General in his public reports, but, in his judgment, the issues are serious. Caution in regard to data quality is warranted.

Ongoing and planned activities

The re-engineering of the IFMIS will integrate budget execution and accounting and reporting functions into one seamless system, and should result in improved quality of in-year budget performance reports.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-24	C+	C+	**No change in performance apart from an increased frequency of reports**: The delays in the reporting of, and accounting for, expenditure at district level, along with the only partial use of the IFMIS functions, raise concern about the quality of data, as also indicated in the reports of the Auditor General.
(i)	A *(revised from B)*	A	*Performance unchanged.* Comparison of actual and budgeted revenue and expenditures is possible, and outstanding expenditure commitments are shown. The QEBRs include budget performance data, including data on commitments. The rating in the 2008 PEFA assessment includes consideration of SAGAs, which are outside the PI, and should have been A.
(ii)	B	A	*Performance improved.* Monthly budget performance reports for management are generated through IFMIS within a month after the end of the month. The QEBRs are prepared quarterly, the main audience

[47] As noted (para. 89) in the Review of IFMIS Report (2010) prepared by Michael Bitz and Godfrey Ssemugooma, August 2010 for MoF and GIZ.

[48] See also Sections 2.4 (Institutional Framework for PFM) and PI-5 (Budget Classification System) on data quality issues, including those raised by an IMF Statistics Department team in a mission during September-October 2011.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
			being the Parliament and the public.
(iii)	C	C	*Performance unchanged.* The delays in posting expenditure at district level give rise to concerns about the quality of data in budget performance reports for those ministries with operations at district level. The Auditor General clearly has some concerns about the quality of data, as indicated in his reports.

3.6.4. PI-25: Quality and timeliness of annual financial statements

Consolidated year-end financial statements are critical for transparency in the PFM system.

(i) Completeness of the financial statements

This dimension relates both to the content of the accounts and the quality of the financial records that support them. The requirements to present annual financial statements for both revenues and expenditure votes are set out in the Public Audit Act 2009 and the Government Financial Management Act 2004. The information includes budget estimate, actual revenue or expenditure, an explanation of the variation and other footnote disclosures to each financial statement -- this information is very brief -- and a statement of assets and liabilities. The accounts are produced in the same level of detail as the estimates and run to six volumes, each volume comprising around 800 pages.

The accounts begin with a summary Statement of Receipts and Issues from Exchequer Account, Receivers of Revenue etc and reports of Individual MDAs. However, there is no Government-wide consolidated accounts to show the overall budget execution (Revenue and Expenditure) as well as the Financial Position (Statement of Assets and Liabilities).

There is also a Statement of Assets and Liabilities for each vote– the balance sheet relating solely to imprest, advances, and similar items -- but **not** fixed assets, long-term liabilities, debtors and other items traditionally seen on a balance sheet.. The Statements of Assets and Liabilities for ministries generated from the IFMIS do not balance in many cases for reasons referred to in PI-22; the balancing entries are in suspense accounts of unidentified items where they were first posted when the items were entered into IFMIS. The statements are balanced, in many instances by the addition of manual accounting data held outside the system, much of it relating to earlier years and using excel spread-sheets. It is unclear what happens to the suspense accounts that were used to balance the input to IFMIS in the first instance.

In addition to the above, an analysis of debt and debt interest payments is provided that relates to the government's indebtedness as recorded by the Debt Management Department (see PI-17). Apart from this information, which does not appear on a balance sheet, no other data are provided about fixed assets or other information that would appear on a balance sheet in an IPSAS compliant set of accounts

Consideration of completeness of the accounts must have regard, in this instance, to the opinion of the Auditor-General. The accounts have been subject to disclaimer of opinion (the most unfavourable category of opinion) by the Auditor-General. The Auditor-General produces one opinion (see PI-26) which gives both an unqualified opinion and a disclaimer of opinion. The accounts falling into each category are shown in schedules to his opinion. Schedule A is for those accounts with an unqualified opinion and schedule B where there is a disclaimer of opinion "because of various unexplained discrepancies, omission of expenditure from the accounts and lack of documentation to support some of the figures shown in the financial statements and failure by the Accounting Officers to provide information and explanation considered necessary to the purpose of the audit". The Auditor-General reported some instances of ministries that were unable to provide a trial balance, suggesting more serious problems with IFMIS.

The Auditor-General has reported in similar terms in 2009-10, the most recent audited year. Those accounts not receiving an opinion outnumber those receiving an unqualified "presents fairly" opinion. In essence the auditor is saying that the accounts are too poor to express an opinion and part of the reason for this is that the accounts may not be complete, even in the limited form in which they are presented. Accordingly, the marking for completeness is affected.

(ii) Timeliness of the submission of the annual financial statements (AFS)

The accounts must be submitted within three months after the end of the financial year in the case of accounting officers and other accounts from the Treasury other than summary accounts. The Treasury summary accounts "showing fully the financial position of the government at the end of the financial year"[49] should all be submitted within four months.

These timescales are observed by ministries, though it appears they continue to make changes, but the summary has been consistently late, being received in early November (see P-I 26 (ii) for details) but still within six months of the end of the financial year. The previous PEFA assessment judged that these submissions to the Auditor-General did not constitute a consolidated statement ready for audit. The practice seems to be to leave the preparation of the accounts to the Auditor-General (previously the Controller and Auditor-General) with limited involvement by the government in ensuring the quality of the accounts.

(iii) Accounting standards used

Chapter 11 of the FRP on "Annual Accounts and Other Financial Statements" sets out the information to be included in the accounts and the format to be adopted. The requirements, as discussed in (i) above, combine reporting on variations in expenditure and income and simply reporting financial information. The chapter does not explicitly state that accounts are cash based. Not only are the standards rather dissimilar to international standards but the basis of the accounts is never disclosed anywhere in the accounts. Nor does the Auditor –General refer to these in his report.

The unusual situation where only the Auditor-General comments on performance – the government appears not to provide any public analysis or commentary on financial performance and reasons for variations in outturn compared to budget - creates the impression that the accounts are not "owned" by the government, a concept that is fundamental to accounting standards that clearly separate the responsibility of management and that of the auditor.

Changes in scoring the previous PEFA assessment. The previous score has been adjusted downwards from C to D on the basis that accounting standards are not disclosed in the accounts. The fact that the accounts are prepared on the basis of published regulations is not a substitute for including within the accounts themselves sufficient information on the basis of their preparation. There is no such disclosure of any kind.

[49] Public Audit Act 2009, s. 3(1)

Ongoing and planned activities

The PFMB envisages the setting up of a Standards Commission that will address issues of accounting standards. So far there has been no explicit commitment to IPSAS. The re-engineered IFMIS, once completed, will help to strengthen accounting practices

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-25	D+	D+	**No change in performance:** A key challenge is to derive a credible opening balance for IFMIS, but this hasn't happened yet. The rating for dim (iii) in the 2008 PEFA is revised downwards as accounting standards are not disclosed in the accounts.
(i)	D	D	*No change in performance.* Disclaimer of opinion by the Auditor-General for the majority of accounts because of errors, omissions and lack of supporting documentation.
(ii)	B	B	*No change in performance:* Accounts must, by law, be submitted for audit within 3 months (summary statement within four months) from the end of the financial year, but are not consolidated and may be subject to change.
(iii)	D *(Revised from C)*	D	*No change in performance.* Accounting standards are not disclosed, a point that was not included in the previous assessment scoring and hence the downwards revision of the scores. Format is consistent but is specific to Kenya. It does not include assets and liabilities in the sense that is understood internationally. Accounts are not user friendly

3.7. External oversight and legislative scrutiny

This set of indicators looks at the quality and timeliness of external scrutiny of the government's budget estimates as well as the public accounts.

Summary of assessment

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-26: External audit (M1)	D+ *(revised from C+)* (i) C *(revised from B)* (ii) B (iii) D *(revised from C)*	D+ (i) C (ii) B (iii) D	*No change in performance:* KENAO's capacity has strengthened in recent years, but this has not impacted on the PEFA ratings. The 2008 ratings for dimensions (i) and (iii) have been revised downwards in terms of compliance with INTOSAI standards and MDAs following up on KENAO recommendations,
PI-27: Legislative scrutiny of budget (M1)	C+ *(revised from D+)* (i) B (ii) B (iii) B *(revised from D)* (iv) C	C+ (i) A (ii) A (iii) A (iv) C	*Improvement under dimensions (i)-(iii).* Performance has improved as a result of the FMA 2009, the revision of the Standing Orders, and more time available to review the draft budget. Dimension (iii) appears underscored in 2008 assessment, a B rating appears more appropriate.
PI-28:	D+	C+	*Performance has improved* due to a shortening of the time

Legislative scrutiny of audit reports (M1)	(i) D (ii) B (iii) C	(i) C (ii) A (iii) C	taken by PAC to review audit reports and an increased depth of scrutiny.

3.7.1. PI-26: The scope, nature and follow up of external audit

A high quality external audit is an essential requirement for creating transparency in the use of public funds.

(i) Scope and nature of audit

External audit is carried out by KENAO under the direction of the Auditor-General, an independent post established under the 2010 Constitution (under the new arrangement he has relinquished his conflicted role as controller, which required him to authorise all releases of funds from the exchequer). The role and powers of external audit are also defined in the Public Audit Act 2009 (update on 2003). The Auditor-General and his 974 staff are responsible for the audit of government, SAGAs, state corporations special funds, extra-budgetary funds and Local authorities. His responsibilities for audit include not only regularity but also value for money.

The Kenya National Audit commission, established by the Public Audit Law, determines the remuneration and terms of appointment of the staff of KENAO and approves its budget. The legal arrangements for the Auditor-General and his staff give them the necessary independence required by INTOSAI standards.

KENAO operates in accordance with a manual that prescribes a risk-based approach to the audit of organisations and to setting materiality limits and sample sizes specific to each organisation. The manual prescribes a clear approach to planning and this is supported by a range of planning forms that address the audit approach, risk and the assessment of materiality. The plan relates to the whole audit but results are updated following the interim audit, and so state the extent of reliance on systems and the outstanding period of testing. Advice on sample sizes is given and these are rather on the high side reflecting the reality that non-compliance is a major problem. A range of standard working papers and clear arrangements for review and audit sign-off are apparent. The approach is comprehensive and professional.

The results of interim audits, which take place prior to the completion of the final accounts, are reported to management and agreement is reached on the action to be taken. Auditees are required to reply to reports within 14 days. Any matters not resolved at this stage are carried forward to the final accounts audit. Matters unresolved are reported to the Public Accounts Committee without recommendations (see dim (iii)). The audit approach to planning the interim and carrying out the final audit accords with international standards.

However, when it comes to reporting on the final accounts arrangements are less satisfactory. The problems relate both to the requirements of INTOSAI and the requirements of the Public Audit Act 2009. While KENAO policy is to operate within materiality limits and in accordance with INTOSAI and its standards, it is not evident in the report on the final accounts how material or fundamental matters have been determined in relation to each account examined. All 61 recurrent votes and all 60 development votes are given an opinion that is either unqualified or no opinion (disclaimer of opinion). As noted under PI-25, those receiving an unqualified opinion are listed on Schedule A of the audited Appropriations Accounts, and those receiving no opinion are listed on Schedule B. Individual reasons for exclusion are not given and it is not clear from the individual reports on each vote what the reason for exclusion is. This information no doubt exists in the KENAO audit files but its absence from the report as well as presenting a single opinion statement with two results does not accord with international standards.

On the second point, the Public Audit Act sets out the matters on which the Auditor-General must express his opinions, including whether proper records were maintained, and that the accounts are in agreement with records and reflected fairly the financial position of the entity. There are additional requirements to report on money not spent in an economical or efficient way and where rules and procedures were inadequate to safeguard property and the collection of revenue. These requirements appear to require both an opinion report relating solely to the financial statements and a management letter report relating to other issues, such as poor value for money.

The Auditor-General in his report includes a certificate on the account that states “the respective accounting officers are responsible for preparation of financial statements that present fairly their respective ministries”. The basis on which they achieve this position is not stated anywhere. Nor does the report at any point refer to the requirements of the Public Audit Act. Nevertheless, the final accounts report contains not only matters that appear to relate directly to the opinion but also matters that do not; for example procurement value for money issues. It would be preferable and clearer if the Auditor-general produced two reports: one relating to the opinion and another relating to other matters. By conflating the two the reader is left uncertain which matters have affected the opinion and which matters discharge other reporting responsibilities.

The audit report is unsatisfactory in other respects. The main criticism is that it contains a very large number of technical issues mostly relating to audit queries that have not been resolved before the submission of the report. The responsibility for this situation lies with the ministries that have failed to supply explanations, documentation or reconciliations despite several attempts by the auditor. (PI-28 refers to the comments of the Public Accounts Committee who have complained about the failures of accounting officers and their staff). In order to meet the tight deadline for reporting to the National Assembly, the auditor simply reports all the unresolved issues without comment and without first seeking to identify what action might improve the situation in the future. This approach both leaves the most troublesome issues unaddressed by the auditor, who might be expected to be well-placed to make recommendations, while leaving Parliament, and specifically the Public Accounts Committee, the task of trawling through the report (nearly 400 pages long) trying to work out what action should be taken. In the main the action required is for explanations and documentation to be provided by accounting officers.

The approach adopted also means that important observations relating to VFM and other matters that relate to his responsibilities under the Public Audit Act, do not receive adequate attention or recommendations. While it may be well established historically and may result from the requirement to complete the audit within six months, simply reporting all significant unresolved audit queries at a point in time, is entirely unsatisfactory for all parties and cannot represent a reasonable approach to the application of international standards.

(ii) Timeliness of submission of audit reports to legislature

Timeliness on Submission of summary Financial Statements

Budget Year	Consolidated (Summary) Financial Statements Received by KENAO	Audit Report Submitted to Parliament
2007/2008	05 November 2008	28 May 2009
2008/2009	16 November 2009	19 May 2010

2009/2010	09 November 2010	26 May 2011

Note that the financial Statements from the **individual ministries** were received by 30 September of each year. Only the Consolidated Financial Statements (Summaries) from the Ministry of Finance were received late in November. The Public Audit Act requires the auditor to report within six months of the end of the financial year, a deadline that is routinely breached as it is impossible to complete the work within a period of three months given the level of errors and omissions that appear in the accounts.

(iii) Evidence of follow up on audit recommendations

The Auditor-General, for the reasons explained above, makes no recommendations on the financial statements; this task is left to the Public Accounts Committee. However, during interim audit, management letters are produced and auditees are required to respond within 14 days. Matters not addressed immediately are carried forward to the final audit and, if still not resolved and important, through to the report to the National Assembly. The recurrence of the same audit points every year in the Auditor-General's report to the National Assembly is testimony to the lack of implementation.

Changes to scoring of previous PEFA assessment:

- *Dimension (i):* The scoring awarded in the previous PEFA has been downgraded on the basis that it failed to take into account significant areas of non-compliance by the Auditor-General with standards in relation to reporting his opinion and management letter issues (see above).
- *Dimension (iii):* The PEFA 2008 score has been downgraded on the basis that the report to PAC includes no recommendations and is not the subject of this PI. Reports to management issued by the A-G are followed up but there is no evidence of management responses and the A-G makes no reference to any of these matters raised with management in his report to PAC

On-going and planned activities

An updated manual is being developed and staff are receiving training in systems based auditing. Value for money work is being developed. Plans are being prepared to change the format of the final accounts report for the 2011-12 accounts.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-26	D+ *(revised from C+)*	D+	**No change in performance:** KENAO's capacity has strengthened in recent years, but this has not impacted on the PEFA ratings. Dimension (iii) is largely beyond KENAO's control; the lack of improvement is due to the ability and willingness of MDAs to follow up KENAO's recommendations. The 2008 ratings for dimensions (i) and (iii) have been revised downwards in terms of compliance with INTOSAI standards and in terms of line ministries following up on KENAO recommendations.
(i)	C	C	*No change in performance:* The approach to audit planning and the audit

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
	(revised from B)		work complies with international standards. However, the Auditor-General in his certificate on the accounts fails to indicate the specific reasons for his disclaimer of opinion sufficiently clearly in relation to each account to comply with the relevant audit reporting standard. His annual report fails to distinguish between opinion matters and reporting matters. He fails to comply with the requirements of the Public Audit Act and to disclose his reporting responsibilities. The situation has not changed since the 2008 assessment, indicating that the 2008 rating was too high.
(ii)	B	B	*No change in performance*. Audited accounts are presented just over 6 months of receipt of the consolidated statement.
(iii)	D *(revised from C)*	D	*No change in performance*: Management takes little if any action as evidenced by the recurring references by the Auditor-General to the same problems with the accounts. The previous PEFA marked action by the auditor in following up, not the action by management to implement changes.

3.7.2. PI-27: Legislative scrutiny of the annual budget law

The power to give the government authority to spend rests with the legislature, and is exercised through the passing of the budget law.

(i) Scope of the Legislature's Scrutiny

The scope of the legislature's scrutiny has strengthened in recent years, as laid down in the Fiscal Management Act 2009 (FMA) and the Standing Orders (SO) of the National Assembly (adopted in December 2008), which are also regarded as having the practical effect of law. The first example of intensified scrutiny was the 2008/09 Supplementary Appropriations Act. The 2010 Constitution has altered some of the requirements of the FMA and where there is conflict the Constitution takes precedence.

The first budget document requiring review is the budget policy statement (BPS) that has to be laid before the National Assembly not later than 21st March each year[50]. Section 7 of the FMA and Section 143 of the SO specify the content of the BPS as covering broad macro-fiscal issues and policies, a review of the economy, targets for overall revenues; allocations to programmes within a sector and criteria used to allocate resources among the various programmes, and statements of specific fiscal risks and contingent liabilities.

Consideration of the statement is the responsibility of the Budget Committee which comprises, ex-officio, all the chairpersons of departmental committees. The Budget Committee is assisted in its work by the Parliamentary Budget Officer, a post established by the FMA. The function of the Budget Office is to provide the National Assembly and Budget Committee with timely and objective information and analysis in connection with the national budget and economy.

The House also considers the detailed annual estimates of revenue and expenditure that must be laid before the House not later than 30th April each year, as per the Constitution (this deadline was supposed to have been effect for the first time for the preparation of the 2011/12 budget, but the

[50] Article 143 of SO.

deadline was exceeded by a month). When received these estimates are immediately referred to the respective departmental committees.

(ii) Extent to which the legislature's procedures are well-established and respected

The current Standing Orders (SOs) and the FMA were adopted at around the same time and were an initiative from the National Assembly to improve its powers of scrutiny. The SOs provide for a standardised process (four readings) of reviewing draft budgets after their submission by the Minister of Finance. The process appears to be well-understood and adhered to

(iii) Adequacy of time for the legislature to provide a response to budget proposals

The BPS is referred to the relevant committee without questions and it is required to lay its report before the House not later than 15th April, giving it just under one month to consider the document. The detailed estimates that should be received by 30th April are reported on by the departmental committees within 21 days after they were first laid before the National Assembly (FMA section 9). The House is expected to approve the budget before the start of the fiscal year, thus giving them two months to review the detailed estimates. Even if the budget is not approved before the start of the year (as has been the actual practice to date), the House still had at least two months for review.

(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature

Adjustments requiring changes in MDA appropriations require a Supplementary Appropriations Bill (one a year) to be approved by the National Assembly, by definition; as the Assembly had already approved the original Appropriations Bill, changing it also requires approval. Conversely, changes within approved Appropriations, which are listed by line ministry, do not require prior National Assembly approval.

Preparation of the supplementary budget starts in December, but approval is not until March/April. In principle, and as specified in the legislation/FRP, no spending can occur against the supplementary budget until the bill is approved and a Treasury supplementary estimate warrant issued (FRP 15.22), but in practice, the money is often committed before the supplementary appropriations bill is approved, as approval is late on in the year. But, as implied by the end-year rush to spend the budget prior to year-end, a portion of the budget appears to be spent after the Supplementary Budget is approved.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-27	C+ *(revised from D+)*	C+	**Improvement under dimensions (i)-(iii), mainly as a result of the FMA 2009 and the revision of the Standing Orders.** Performance under dimension (iv) is partly beyond the control of the Parliament, as GoK prepares the Supplementary Budgets late in the year and submits the Supplementary Appropriations Bills to Parliament after the money has been committed
(i)	B	A	*Performance improved.* The scrutiny covers both strategic budget issues as well as detailed estimates and has been assisted by the work of the Parliamentary Budget Officer
(ii)	B	A	*Performance improved.* The introduction of the FMA and Standing Orders in 2009 that allocates clear responsibilities to the Budget and

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
			departmental committees has reinforced the procedures
(iii)	B *(revised from D)*	A	*Performance improved.* Departmental committees have 3 weeks for consideration and the House a further 5 weeks, making a total of two months for consideration of detailed estimates. The 2008 rating appears too low, a B rating appears more appropriate.
(iv)	C	C	*No change.* Clear rules exist. Revisions to budgets that entail changes in appropriations ceilings by line ministry require *ex ante* approval by the National Assembly. But such approval is often *ex post*.

3.7.3. PI-28: Legislative scrutiny of external audit reports

The legislature has a key role in exercising scrutiny over the execution of the budget that is approved.

(i) Timeliness of examination of audit reports by the legislature

The role of scrutinizing the external audit reports is undertaken by the Public Accounts Committee (PAC) which is chaired by a member of the opposition. The backlog reported in the previous PEFA has been dealt with and the PAC is currently considering the accounts for 2009-10. The work on the 2008-9 Accounts is complete, but the report has not yet been laid before the House.

The Auditor-General is required by the Public Audit Act 2009 to submit the audited accounts to the National Assembly within 6 months of the end of the financial year, and this requirement is repeated in the Constitution 2010. The report is always late (see PI-26), generally being sent to the NA in May. There is a delay of 2-3 months before the report is tabled as the House has to find time to table the report.

Financial year	Auditor –General report tabled	PAC Consideration
2007-8	21/7/2009	Commenced August 2009. Published November 2010
2008-9	18/8/2010	Commenced late 2010. In final stages of editing
2009-10	19/7/2011	Hearings underway
2010-11	Awaited	

(ii) Extent of hearings on key findings undertaken by the legislature

The PAC holds hearings in respect of every account on which the Auditor-General has issued a report. Accounting officers and senior financial and other staff who have relevance to the issue under consideration are required to attend before the committee. The Auditor-General’s report on the 2007-8 accounts ran to nearly 400 pages and required 100 sittings of the PAC. The report contained reports in respect of both accounts receiving an unqualified opinion and those where there was a disclaimer of opinion (see PI-25) and the PAC reviews all; it was explained that, were the Committee not to give complete consideration to every matter raised, this might in some way render the report non-compliant with House procedures.

Because the Auditor-General reports in detail with the problems, in particular those of unreconciled, not balancing and unsupported items of expenditure, the PAC is obligated to consider highly detailed and technical matters. In many cases it requires officers to provide the information and documentation that ought properly to have been provided to the external auditor in the first instance. For this reason it is not easy for the PAC to obtain an overview of the issues. However, their report on the 2007-8 accounts in an introductory section provides an analysis of the key findings and problem. It notes with dissatisfaction the performance of many accounting officers ("some accounting officers repeatedly committed financial irregularities knowing very well that they would get away with them as they have done in the past and did not even waste time in admitting the irregularities before the committee and apologising").

(iii) Issuance of recommended actions by the legislature and implementation by the executive

The PAC issues recommendations both at a general level – thematic issues that it identifies from its work – and in relation to each account on which the Auditor-General issues a report. These recommendations can number hundreds as every issue is addressed by the PAC.

Under the Fiscal Management Act 2009 section 9 there is now a requirement that at the time the estimates are submitted (30th April) there should also be submitted by the MoF a report ('Treasury Memorandum") "specifying, by department, all the measures taken by the Government to implement the audit recommendations made by the Assembly in the previous year". The memorandum submitted on 26 April 2011 runs to 348 pages and dates back to recommendations made in 2006-7. Each recommendation receives some response.

In addition the PAC when it receives evidence from accounting officers it reviews the recommendations from previous years. Little evidence of this is shown, however, in the minutes of the meeting and a once a year opportunity is unlikely to be sufficient.

Review of the report on the accounts over a number of years reveals a depressing sameness in the numbers and extent of errors found; a point reflected in the exasperation of the PAC in its remarks on the 2007-8 accounts referred to above. The numbers of detailed recommendations that make the same point repeatedly are probably very great; each account has generally much the same problem. Overall, it is not evident that recommendations are having much impact. As indicated in PI-26 (which refers to the disclaimer of opinion, the measure of performance is not the Treasury Memorandum but the Auditor-General's annual report.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
PI-28	D+	C+	**Performance has improved** due to a shortening of the time taken by PAC to review audit reports and an increased depth of scrutiny.
(i)	D	C	*Performance improved.* The 2007-8 audited Appropriation Accounts took over a year to review. The latest PAC report relating to 2008-9 is complete (less than 12 months from receipt of the accounts) but it has not yet been laid before the House
(ii)	B	A	*Performance improved.* The report of the PAC on the 2007-8 Accounts indicates consideration of every item.
(iii)	C	C	*Performance unchanged.* Large numbers of recommendations are issued. Although the government claims to have addressed the points, the Auditor-General issues a disclaimer of opinion for more than half the

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
			accounts each year – latest 2009-10 – indicating little or no progress in addressing basic accounting issues.

3.8. Donor practices

This section assesses donor practices, which impact upon the performance of a country PFM system. These practices are the exclusive responsibility of the donors and are primarily outside the authority of the Government of Kenya.

Summary of assessment

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
D-1: Budget support	D	D	*No change*
D-2: Financial information provided by donors (M1)	D *(revised from D+)* (i) D (ii) D *(revised from C)*	D (i) D (ii) D	*No change:* C rating in 2008 seems too high
D-3: Use of country systems	D	D	*No change*

3.8.1. D-1: Predictability of Direct Budget Support

(i) Deviation of actual budget support from the forecasts and (ii) In-year timeliness of donor disbursements

EU is the only provider of budget support – in the form of General Budget Support (GBS)- in Kenya. Its € 125 million *Poverty Reduction Budget Support* programme – PRBS II– originated in 2005. The EU support comprised € 70 million in fixed tranches, € 50 million in variable tranches, and € 5 million as a contribution towards the World Bank Trust Fund to support the PFM Reform Strategy. The fixed tranches were disbursed early on. The PRBS was temporarily suspended in December 2007 following civic unrest after the presidential elections in December 2007. Remaining to be disbursed is the second variable tranche of € 29.375 million. Following some postponements (partly because of GoK addressing weaknesses identified by programme performance reviews), the EU expects to decide and disburse the last variable tranche in 2012, the exact amount depending on fulfilment of the conditions as mentioned in the Financing Agreement (i.e. progress in PFM and social sector performance).

On-going and planned activities

€ 126.8 million, revised down to € 70 million during the mid-term review of the 10th EDF, has been allocated under the 10th EDF for macroeconomic support (i.e. GBS and/or sector budget support). Details of a possible new programme have not yet been finalised.

The World Bank commenced discussions with the Ministry of Finance on a potential US$100 million development policy loan in 2011 but it is not yet confirmed as to whether or not a loan will be taken to the Board.

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
D-1	**D**	**D**	**No change**. The EU postponed planned disbursements of GBS under PRBS II, which GoK had incorporated into its annual budgets.
(i)	D	D	
(ii)	D	D	

3.8.2: D-2: Financial information provided by donors for budgeting and reporting on project and programme aid

The tables below present information on the budget estimates of external funding for each development partner for the last completed FY 2010/2011 and for 2011/12.

Table 22: Summary of External Funding, FY 2010/11 (in mln. Kshs)

	AIA	Revenue	Total	% of total	% AIA
WB - IDA	10,973	29,441	40,413	28.2	27.2
Global Fund	12	6,087	6,099	4.3	0.2
EDF/EEC	4,641	181	4,822	3.4	96.3
EIB	-	1,110	1,110	0.8	0.0
ADF*	22,273	5,838	28,111	19.6	79.2
KFW-Germany	5,252	216	5,468	3.8	96.0
AFD-France	4,831	1,585	6,416	4.5	75.3
Japan	4,511	310	4,821	3.4	93.6
China	16,786	-	16,786	11.7	100.0
Other	21,403	7,636	29,038	20.3	73.7
TOTAL	**90,681**	**52,403**	**143,084**	**100**	**63.4**

Source: ERD, MoF

* ADF: African Development Fund, the concessional window of the African Development Bank.

Table 23: Summary of External Funding, FY 2011/12 (in mln. Kshs)

	AIA	Revenue	Total	% of total	% AIA
WB - IDA	19,508	34,105	53,613	29.3	36.4
Global Fund	3,294	2,741	6,035	3.3	54.6
EDF/EEC	5,760	165	5,925	3.2	97.2
EIB	4,000	2,406	6,406	3.5	62.4
ADF	24,101	3,696	27,797	15.2	86.7
KFW-Germany	4,296	290	4,586	2.5	93.7
AFD-France	17,948	916	18,864	10.3	95.1
Japan	8,964	100	9,064	5.0	98.9

China	20,367	-	20,367	11.1	100.0
Other	22,627	7,799	30,426	16.6	74.4
TOTAL	**130,864**	**52,218**	**183,082**	**100**	**71.5**

Source: ERD, MoF

The tables show that almost all large donors and to some lesser extent the World Bank provide significant amount of AIA, representing about 2/3rds of all aid. Even smaller donors provide primarily AIA.

In order to obtain a sense of the amounts of foreign-funded project and program support, Table 24 presents data on GoK and external funding of development expenditure for 2010/2011 and the estimates for 2011/12.

Donors funded 45 percent of development expenditure in 2010/11, two thirds of which was through AiA. Actual disbursement of donor funding was 43-49 percent of planned funding.

Table 24: External funding of Development expenditure, 2010/11 and 2011/12 *(in mln. Kshs)*

	Estimate 2010/11	%	Revised 2010/11 *	%	Prel. Out-turn 2010/11 **	%	Col. %	Estimate 2011/12	%
GoK	170,232	53	167,797	55				210,252	53
Appropriations in Aid	98,594	31	95,169	31				136,081	34
External revenue (on budget)	52,403	16	40,643	14				52,218	13
Total Development expend.	**321,232**	*100*	**303,609**	*100*	198,528		62	**398,551**	*100*
Appropriations in Aid									
Grants	22,929	23	30,093	32	11,301		49	28,379	21
Loans	67,752	69	55,871	59	31,228		46	102,485	75
Local	7,913	8	9,205	10				5,217	4
Total	**98,594**	*100*	**95,169**	*100*				**136,082**	*100*
External revenue									
Grants	17,434	33	13,634	34	7,468	31	43	12,733	24
Loans	34,970	67	27,009	66	17,016	69	49	39,485	76
Total	**52,403**	*100*	**40,643**	*100*	**24,484**	100	**47**	**52,218**	*100*
TOTAL EXTERNAL FUNDING	143,084		126,607		67,013		47	183,082	
% of Total Dev Exp	45		42		34			46	
AIA as % of Total Ext Fund	63		68		63			71	

(Sources: Budget Estimates: MoF, Financial Statement for 2011/12, QEBR, 4th Quarter, 2010/2011.

(i) Completeness and timeliness of budget estimates by donors for project support

External Resources Department (ERD) prepares estimates of external funding. Donors provide indicative estimates to ERD by end February - March at the time MDAs prepare detailed budget estimates. ERD provides the information to line ministries. Projects for which a financing agreement has not been signed yet at time of budget preparation are not included in the budget estimates. During budget preparation, ERD vets the line ministries on their absorption capacity, based on implementation performance in the past and expected work plans for the forthcoming fiscal year.

The 2009/10 report of the Auditor General indicated that eleven projects from various development partners were executed for which no resources had been provided for in the approved estimates for 2009/2010. These amounted to 8% of the total amount of actual development revenue and 4% when compared to the total estimated amount.

The most problematic issue during budget preparation concerns the DP's provision of estimates for AIA-funded projects and programmes, which comprise about 63 percent of all donor assistance. Line ministries consider AIA an 'odd' item in the national government budget due to their lack of control on budgeting and spending. Although the approved budget estimates for externally funded projects have some economic classification disaggregation, most donors do not provide estimates in accordance with the budget classification of GoK, and some only provide single figure estimates.

Few donors operate almost completely off-budget. Large donors such as USAID infrequently provide ERD with figures of their support. USAID support to Kenya amounted to about US$ 480 million (about Kshs. 40 billion) in 2010, 75 percent of it as support for the health sector.[51] In the approved budget for 2010/11 AIA-grants provided by USAID amounted to Kshs. 644 million, which was just 1.6% of total USAID financial support to the country. USAID off-budget funding was therefore equivalent to 28 percent of the total external funding Kshs. 143.1 billion, contained in the approved budget.

Opposite to USAID off-budget funding is the practice of the African Development Bank (AFB). All its projects are on budget.[52]

(ii) Frequency and coverage of reporting by donors on actual donor flows for project support

ERD does not prepare any reports on actual external funding, although DPs provide information to it and to line ministries. The reporting is relatively accurate for most on-budget loans and grants, but less reliable and useful concerning AIA grants and loans, even less so than the spending estimates provided.

Some donors prepare a separate report together with GoK. For instance, the EU together with the National Authorising Officer prepares each year the 'Joint Annual Operational Review of Cooperation between the Republic of Kenya and the European Community'. The reports are produced at the beginning of the new calendar year (e.g. the 2009 report was prepared in February 2010). One line ministry informed the team that for some development partners (e.g. BADEA,

`51 USAID Kenya 2010 Annual Report. For 2011 US$ 499 has been allocated – see http://www.usaid.gov/policy/budget/money/ . Another source mentions as USAID budget for Kenya for 2010 US$471 million and for 2011 US$ 485 million – see http://kenya.usaid.gov/budget-usaid-kenya .

52 African Development Bank, Evaluation of Paris Declaration Implementation at the African Development Bank, May 2011

Saudi Fund, Kuwait Fund, OPEC) it can take a year to obtain information from them on their operations. According to this ministry the WFP has only recently improved the timeliness and comprehensiveness of their reports.

The 2010 comprehensive monitoring survey of the Paris Declaration indicated that 68% of scheduled aid disbursements were reported as disbursed by donors in 2010. It indicated also that in 2010, 45% of disbursed aid to Kenya was recorded in the public accounts, which was even lower than the percentage mentioned in the 2007 monitoring survey (i.e. 47%).

Continual shortfalls of aid disbursements relative to budgeted amounts will have adverse effects on service delivery. Line ministries prepare their own budgets on the basis of what donors have indicated that they would provide. Filling the gap in the cases where donor aid falls short of planned amounts is likely to be difficult due to the overall spending ceiling and the probable difficulty in re-allocating budgeted appropriations from other ministries.

On-going and planned activities

ERD has installed E-PROMIS, a very detailed M&E system for development projects, financed by GoK and donors. It is not yet linked to IFMIS. The database is currently being populated. Data are entered manually. Less than 25 percent of the projects have been included to-date, but ERD and the line ministries are making big efforts to increase the coverage of projects, so that they can be reflected in budget documentation. Ensuring data integrity in E-PROMIS will be crucial, but no specific mechanism is in place to guarantee this, except through cross-checking of information.

PI (M1)	Score 2008 PEFA	Score 2012 PEFA	Assessment
D-2	**D** *(revised from D+)*	**D**	**No change in performance**
(i)	D	D	*No change*. Most donors, including significant ones, had less than 50% of their funds recorded on budget. The share of budgeted foreign-funded AIA in total external funding in 2010/11 was 63%. If provided, funding estimates for AIA tend to be a single figure, lacking further itemization according to GoK budget classification. Some donors provide budget estimates end February-March, which is three months prior to the start of the new fiscal year.
(ii)	D *(revised from C)*	D	*No change*. The source of data used in PEFA 2008 is unclear; the score seems too high. According to the 2007 Paris Declaration survey, 47% of disbursed aid to Kenya was recorded in the public accounts. In 2010 this was even less, i.e. 45%. Donors providing AiA are even less likely to provide information on actual spending than on planned spending. Some donors provide reports very late, several months after the end of the fiscal year.

3.8.3. D-3: Proportion of aid that is managed by use of national procedures

The dimension to be assessed is the overall proportion of aid funds to the regional government that are managed through national procedures (banking, authorization, procurement, accounting, audit, disbursement and reporting).

The African Development Bank (ADB) uses country systems to some extent, with all its project on budget.[53] Its projects, however, are not using the accounting and treasury systems of GoK. The Bank uses the direct payment method for large infrastructure projects, but uses country procurement systems along with its procurement system. ADB projects are audited by Kenya National Audit Office, but require sign-off by the ADB's audit department. Some other donors prefer to use independent audits in addition to the KENAO audits.

The 2010 monitoring survey of the Paris Declaration indicated that 58% of aid disbursed used country PFM systems (i.e. budget execution, financial reporting and audit) in 2010, which represented a minor improvement compared to 2007 (i.e. 54%). For the two largest donors, the World Bank and United Nations, 70% of their financial support used GoK country systems. Reporting is most problematic in terms of budget execution and audit. Reporting on actual AIA, if reported at all, is done mostly on an aggregate basis at the end of the fiscal year and not on a quarterly basis. Development partners used only 38% of Kenya's country procurement systems (37% in 2007). France and ADB make significant use of country procurement systems, while the World Bank (the largest), United Nations, and the United Kingdom make little use of GoK procurement systems, (16%, 30%, and 8% respectively).

Kenya does not have a comprehensive external funding policy in place, which could include rules and procedures with regard to administrative, budgeting and financial management arrangements concerning the use of external money. ERD does not hold systematic records of the use of country systems by each individual Development Partner. Each desk officer dealing with one or more Development Partners has knowledge about the use of country systems for the countries they cover, but that knowledge is not documented.

On the whole no progress has been made compared to the previous PEFA assessment. Development partners are, nonetheless, very much aware of the importance of country PFM systems and have together with the Ministry of Finance commissioned a study to examine the use of country systems and the way forward, given the state of affairs of PFM systems in the country.

PI	Score 2008 PEFA	Score 2012 PEFA	Assessment
D3 (i)	**D**	**D**	**No change:** About 2/3rds of aid is provided off-budget in the form of AiA. Donors providing aid in this form prefer to use direct payment to contractors, thus circumventing the country's accounting/treasury systems. Moreover, according to the 2010 monitoring survey of the Paris Declaration, 58% of aid disbursed used country PFM systems (i.e. budget execution, financial reporting and audit) in 2010, but donors used only 38% of Kenya's country procurement systems.

[53] African Development Bank, Evaluation of Paris Declaration Implementation at the African Development Bank, May 2011

4. Government reform process

4.1 Recent and on-going reforms

Background

Many PFM reforms, including the development of IFMIS, IPPD, the modernisation of revenue administration and the introduction of an MTEF, started in the mid-nineties. Following these various isolated initiatives, the GoK launched its first formal "Strategy for the Revitalisation of Public Financial Management System in Kenya" in 2006 for a five-year period, which formally expired in June 2011. While clear progress has been achieved in several areas, the achievements cannot be in all cases directly attributed to the reform strategy as such. Many reforms have been on-going for many years; started prior to the strategy and continued in parallel to the strategy in a more or less isolated environment. Some reforms have also appeared to be more successful than the others (IPPD vis-à-vis IFMIS).

What was meant to have been a country-led comprehensive and coordinated reform strategy has *de-facto* remained fragmented with no high-level political leadership. A review of the strategy (Ecorys, 2010) underscored a number of elements which affected its implementation and effectiveness, including:[54]

- The lack of a clear direction for reform implementation and unclear linkages between various elements of the strategy;
- Unclear scope of the reform programme and insufficient consideration of its roll-out to ministries;
- Insufficient focus on the real problems and how they impact on the overall PFM system, and potential solutions;
- Skewed too heavily on project implementation and management of funds, rather than on technical advice required to ensure that efforts are prioritised, logically sequenced, coordinated, harmonised and aligned (glued together) and where necessary corrected. Associated with this, a mechanism was not in place for reconsidering and eventually correcting the prioritisation and sequencing of the proposed reforms;
- While management and institutional arrangements for the implementation of the strategy were well recognised in the strategy, in practice these were merely limited to project implementation and management of donors' basket-funds;
- Linkages with other reforms and associated changes were not adequately addressed.

The 'Project Completion Report' prepared by the PFM Reform Secretariat following the formal end of the Strategy in June 2011 also stated most of the points identified above. In addition, it emphasised the issues arising from the way in which the Strategy was financed. The costs of the implementation of the Strategy were estimated at $115 million, much of which was to be financed by donor partners, mainly through a pooling fund under the administration of the World Bank. The use of these funds was to be governed by the donors' procedures for procurement and financial management. Insufficient understanding of these procedures combined with high turnover of staff of the PFM Reform Secretariat – which required replacement staff to be trained

[54] Conducted by Ecorys (Rotterdam, Netherlands) under contract to EU.

in the use of these procedures – resulted in significant delays in the implementation of the Strategy due to the freezing of fund flows.

High staff turnover is an issue for GoK is a whole and is due to the remuneration and promotion structures that are not conducive to attracting and retaining skilled staff.

Moreover, the governance aspects of the Strategy were not fully implemented. The PFM Reform Secretariat was supposed to be headed by a Chief Executive Officer at Secretary level. This did not happen, however. As a result, the linkages and related sequencing and prioritising aspects of the Strategy did not materialise. The MDAs responsible for implementing the 15 different components of the Strategy did so without consideration of the linkages with activities being implemented by other components. Program working groups – one for each component – were not established. A Monitoring and Evaluation Framework was not established until very late on.[55]

Largely as a result of the above, the PFM reform strategy was only partially implemented. The IPPD was supposed to have been integrated/interfaced with IFMIS, and manual budget execution systems phased out, but these did not happen. Neither did program budgeting, which is still at the piloting stage in terms of budget preparation and has not reached the budget execution stage at all.

The new Constitution (2010) provides opportunities to move forward, in the area of PFM in particular, but at the same time implementing the proposed reforms faces daunting challenges due to their very ambitious scale and capacity constraints as well continuing concerns over high-levels of corruption.

Achievements since the last PEFA assessment

While not all achievements can be necessarily reflected in the scoring, important results include:

- Improvements in the legal and regulatory framework for PFM, including the new Constitution, the Fiscal Management Act (2009), and the draft PFM Bill and Devolution Bill.
- The budget process was improved; the budget calendar was adjusted to allow sufficient time for the scrutiny of the budget by the legislature, and increased public participation at County level.
- Controller of Budget and Commission on Revenue Allocation (CRA) were established in line with the new Constitution and the provisions of the draft PFM bill.
- In line with the Devolution Bill and the new CRA, progress is being made towards realisation of the decentralised environment. The new Constitution provides for creation of 47 Counties as autonomous governments by mid-2012, and several other new offices, Commissions and Independent offices. In addition, the Constitution provides for a maximum of 22 Ministries, which implies that the current number of ministers will be reduced sharply through mergers or re-organisations after the coming election.
- The Medium Term Debt Management Strategy (MTDS) was prepared in June 2009 for the first time, and has since been updated on an annual basis. Domestic debt is now managed in

[55] Project Completion Report, under Public Financial Management Reforms Programme, Office of the Deputy Prime Minister and Ministry of Finance, January 2012. To implement the Programme, GoK obtained financial assistance from World Bank, EU, DFID, DANIDA, SIDA, Norway, CIDA, JICA, GIZ and USAID. Financing from the World Bank was through a credit under the Institutional Reform and Capacity Building Technical Assistance Project (IRCBP). The other DPs, apart from USAID and JICA, entered into a joint financing agreement with GoK, with WB as administrator, with WB procurement and financial management procedures being used.

CS-DRMS in MoF instead of by CBK. The new "National Loans and Guarantee Act" 2011 replaces the Guarantees Act. DSA is conducted on an annual basis by IMF/World Bank, with the full corroboration of MoF.

- Some improvement in transparency and access to budget information through the increased use of internet and, most importantly, the development of a Citizen's Guide to Budget. Also, other manuals and guides on MTEF and PBB were published for the general public. Public participation in SWGs has been broadened since 2011; the discussion now includes development partners and districts.
- Indicative program based budgets were prepared during the last two years, though in parallel to the line item budget and not yet integrated in the budget execution.
- An External Aid Policy was developed and gazetted, and the E-Promis system was developed and launched for recording and monitoring of donor operations;
- The implementation of the Integrated Tax Management System (ITMS) at KRA started in February 2009. Although not yet complete; it is at an advanced stage of implementation and rolling out.
- The project to re-engineer the IFMIS, through addressing the weaknesses identified in the IFMIS Re-engineering Strategy, commenced in 2011. In support, a new unified Standard Chart of Accounts was prepared. This will form the basis for a uniform budget preparation, execution and reporting system based on GFS principles and a programs structure, and for bringing into the budget, various budget operations which are at the moment off-budget e.g. SAGAs, donor funds, and newly decentralised entities.
- The EFT (G-Pay) system was introduced in 2009 and finalised in 2010. All payments are now done through G-Pay with prior first check through IFMIS.
- A new payroll audit unit within the Ministry for Public Service was established and a new Pension Management Information System (PMIS) was installed in February 2008 and rolled-out in January 2009.

It is beyond the scope of the PEFA assessment to evaluate the quality, effectiveness and sustainability of these reforms, many of which are still on-going. The PEFA assessment suggests that most of the procedures/systems are in place and in line with international good practices. One of the major shortcomings which influence the performance of PFM systems, however, appears to a significant degree of non-compliance with rules and systems, as also pointed out in successive audit reports prepared by KENAO.

4.2. Institutional factors supporting reform planning and implementation

The second PFM Reform Strategy, covering 2012-2016 is being prepared. Preparation is being slowed to allow for the changes required by the Constitution and the PFM Bill to be reflected and incorporated to the extent possible. The new strategy is being prepared on the basis of the lessons learned in the course of the implementation of the first strategy and the legal requirements of the new Constitution and PFM Bill.

Government leadership and ownership

Lack of political championship at the highest level has been a major reason for the fragmentation of PFM reforms and the failure of the PFM reform strategy to serve as a guiding document in the implementation of the overall PFM reforms. A good example of the importance of political leadership to the success of PFM reforms can be found right next door in Rwanda. Reforms have proved to be successful in Kenya in the PFM areas where there was strong leadership and ownership of reforms: revenue administration, payroll and pension management, debt management, internal audit, external audit and legislative oversight. A very prominent example of the importance of political leadership is the IFMIS, which had not worked as well as had been envisaged. The Minister of Finance then announced IFMIS re-engineering to be of top priority, and much progress has since been made in implementing it.

That said, the risk still exists that reforms in Kenya will remain being implemented in a fragmented and uncoordinated way if no clear leadership at the high political level is established, particularly important for the overall reforms as opposed to individual reform efforts. It is questionable whether there is enough leadership at the right political level. While senior management appears genuinely interested and committed to developing a PFM strategy, responsibilities in practice are often delegated to subordinate staff, resulting in reduced effectiveness of the process. The pace of reforms and their substance may be affected by the upcoming elections which are expected by the end of 2012 or early 2013.

Coordination across governments

The role of the PFM Reform Secretariat remains unclear. The draft PFM reform strategy suggests that it will continue to operate mainly as a coordination unit mainly responsible for the operational management and monitoring of the reform implementation. This poses the risk, however, that beyond operational coordination, coordination at high-political and technical level may be lacking. Further, the strategy, in its current draft, seems to be deficient in terms of integrating various stakeholders at various levels into the PFM reform process and clearly delineating their role and responsibilities in the rolling out of reforms from the MoF to MDAs and lower levels of government.

The development of the strategy also appears to not have been very inclusive and participatory. Extensive discussions involving various stakeholders on issues related to sequencing and prioritisation of PFM reforms have been lacking.

Challenges

The current agenda for reform is extremely demanding. Simultaneous implementation of decentralisation, re-engineering of IFMIS (including establishment in new counties) e-governance, implementation of BPR recommendations (associated with IFMIS re-engineering) and provision of greater PFM-related powers to Parliament in a politicized environment may prove to be very difficult. The major risks will presumably be associated with the technical ability to implement all these reform, combined with capacity constraints, potential lack of political will, and vested interests against change.

A well-defined and robust change management strategy will be fundamental to managing the risks, but one does not appear to be in place. A clear change management strategy would address the readiness of institutions to embracing new rules, standards and practices and thus achieve buy-in to the reforms. A clear change management strategy would address issues such as creating a greater understanding of the need for change, management of expectations, scope of reforms and their implications, and appropriate incentive frameworks In concrete terms, reform results should be part of existing performance contracts and reforms should be part of daily work, rather than being undertaken as extra tasks.

Another challenge is to link the PFM reform strategy with public administration and legal/judiciary strengthening and capacity building strategies. Some capacity building on-going (e.g. through IFMIS Academy) but there is no capacity needs analysis (e.g. for procurement) which can eventually inform institutional and capacity development.

Annex A: Budget performance tables

Expenditure Data for year =	2008/09					
MDA	**budget**	**actual**	**adjusted budget**	**deviation**	**absolute deviation**	**%**
Ministry of Education	114410761730	112924854357	108746812976	4178041381	4178041381	3.8%
Ministry of Defence	41209457500	41183206659	39169367460	2013839199	2013839199	5.1%
Office of the President	43736952271	43002602281	41571737630	1430864651	1430864651	3.4%
Ministry of Higher Education, Science & Tech.	22607090000	22317528674	21487917316	829611358	829611358	3.9%
Ministry of Medical Services	25826297383	24766633771	24547756600	218877171	218877171	0.9%
Ministry of Roads	44782957864	41879304221	42565960314	-686656093	686656093	1.6%
Office of DPM & Ministry of Local Government	12891840810	12630368056	12253625273	376742783	376742783	3.1%
Office of DPM & Ministry of Finance	26763946106	22314193217	25438986662	-3124793445	3124793445	12.3%
Office of Vice President & Ministry of Home Affairs	10661331690	10329787906	10133538365	196249541	196249541	1.9%
National Security Intelligence Service	7702000000	7695661406	7320709528	374951878	374951878	5.1%
Ministry of Agriculture	14050444192	12391419351	13354871549	-963452198	963452198	7.2%
Ministry of Foreign Affairs	9644092441	8022630526	9166657936	-1144027410	1144027410	12.5%
National Assembly	6782455550	6533228785	6446687480	86541305	86541305	1.3%
Ministry of State for Special Programmes	15820069160	14636575446	15036890553	-400315107	400315107	2.7%
Ministry of Forestry & Wildlife	5313240900	4865929916	5050206866	-184276950	184276950	3.5%
Ministry of State for Planning, Nat. Development	13923876160	13183868486	13234569316	-50700830	50700830	0.4%
Ministry of Public Health & Sanitation	7113683247	7029635031	6761517622	268117409	268117409	3.8%
Ministry of Youth Affairs & Sports	7344322200	6796976623	6980738705	-183762082	183762082	2.5%
Ministry of Livestock Development	4912173790	4535382089	4668994738	-133612649	133612649	2.7%
Ministry of Water & Irrigation	17529016160	14171588843	16661235474	-2489646631	2489646631	14.2%
21 (= sum of rest)	79374939933	74832859732	75445453009	-612593277	612593277	0.8%
Total expenditure	532400949087	506044235376	506044235376	0	19947673349	
contingency	0	0				
overall (PI-1) variance						5.0%
composition (PI-2) variance						3.9%
contingency share of budget						0.0%

Expenditure Data for year =	2009/10					
MDA	**budget**	**actual**	**adjusted budget**	**deviation**	**absolute deviation**	**%**
Ministry of Education	127574201680	125001537357	118043780040	6957757317	6957757317	5.9%
Ministry of Defence	48525815000	48246612724	44900697450	3345915274	3345915274	7.5%
Office of the President	45903691471	39356902325	42474459473	-3117557148	3117557148	7.3%
Ministry of Higher Education, Science & Tech.	27027071300	26884575930	25008015866	1876560064	1876560064	7.5%
Ministry of Medical Services	25115687813	24920224897	23239422146	1680802751	1680802751	7.2%
Ministry of Roads	53321682900	48159557091	49338290381	-1178733290	1178733290	2.4%
Office of DPM & Ministry of Local Government	11803945430	13334508355	10922132528	2412375827	2412375827	22.1%
Office of DPM & Ministry of Finance	29725818910	24583013507	27505153728	-2922140221	2922140221	10.6%
Office of VP & Ministry of Home Affairs	11517453258	8882410394	10657042734	-1774632340	1774632340	16.7%
National Security Intelligence Service	10118300000	10105773386	9362413120	743360266	743360266	7.9%
Ministry of Agriculture	14169579852	12788519773	13111042399	-322522626	322522626	2.5%
Ministry of Foreign Affairs	8584108884	7686141304	7942833642	-256692338	256692338	3.2%
National Assembly	7153893530	6587722846	6619462424	-31739578	31739578	0.5%
Ministry of State for Special Programmes	10182743446	8912584253	9422042323	-509458070	509458070	5.4%
Interim Independent Electoral Commission	6855301000	6776782616	6343176228	433606388	433606388	6.3%
Ministry of State for Planning, Nat. Development	23714690350	22911593274	21943086098	968507176	968507176	4.1%
Ministry of Public Health & Sanitation	15801896495	11785263397	14621416944	-2836153547	2836153547	17.9%
Ministry of Youth Affairs & Sports	10415976540	10128644554	9637851755	490792799	490792799	4.7%
Ministry of Livestock Development	5899430775	5589875093	5458714220	131160873	131160873	2.2%
Ministry of Water & Irrigation	19070851551	16967300914	17646164946	-678864032	678864032	3.6%
21 (= sum of rest)	112099081756	98312382300	103724727846	-5412345546	5412345546	4.8%
Total expenditure	624581221941	577921926290	577921926290	0	38081677471	
contingency	0	0				
overall (PI-1) variance						7.5%
composition (PI-2) variance						6.6%
contingency share of budget						0.0%

Expenditure Data for year =	2010/11					
MDA	**budget**	**actual**	**adjusted budget**	**deviation**	**absolute deviation**	**%**
Ministry of Education	140287465800	134884889360	123318291568	11566597792	11566597792	9.4%
Ministry of Defence	50393661500	50327478402	44298043354	6029435048	6029435048	13.6%
Office of the President	52185889921	44588037400	45873483795	-1285446395	1285446395	2.8%
Ministry of Higher Education, Science & Techn.	48426263680	31821052919	42568622007	-10747569088	10747569088	25.2%
Ministry of Medical Services	29530422463	25109174120	25958422063	-849247943	849247943	3.3%
Ministry of Roads	60655062100	59336611919	53318224764	6018387155	6018387155	11.3%
Office of DPM & Ministry of Local Government	18268305000	17443983834	16058570519	1385413315	1385413315	8.6%
Office of DPM & Ministry of Finance	37372072895	30682546261	32851546327	-2169000066	2169000066	6.6%
Office of Vice President & Ministry of Home Affairs	13791712510	13425884695	12123466732	1302417963	1302417963	10.7%
National Security Intelligence Service	10627055950	10609488687	9341607083	1267881604	1267881604	13.6%
Ministry of Agriculture	19630852650	17056010203	17256304382	-200294179	200294179	1.2%
Ministry of Foreign Affairs	8787033316	8524058241	7724153618	799904623	799904623	10.4%
National Assembly	7555776040	7383874469	6641829243	742045226	742045226	11.2%
Ministry of State for Special Programmes	9950607916	9459901952	8746982214	712919738	712919738	8.2%
Interim Independent Electoral Commission	7103333000	7103468967	6244113720	859355247	859355247	12.1%
Ministry of State for Planning, Nat. Development	18975672120	6909251500	16680374500	-9771123000	9771123000	51.5%
Ministry of Public Health & Sanitation	20073559200	17125310925	17645461140	-520150215	520150215	2.6%
Ministry of Youth Affairs & Sports	9301918280	6820062518	8176758088	-1356695570	1356695570	14.6%
Ministry of Livestock Development	7027180832	5853934885	6177172920	-323238035	323238035	4.6%
Ministry of Water & Irrigation	52353895607	20979478826	46021167510	-25041688684	25041688684	47.8%
Sum of rest	94397931955	104559651975	82979556512	21580095463	21580095463	22.9%
Total expenditure	716695672735	630004152058	630004152058	0	104528906350	
Contingency	0	0				
total expenditure	716695672735	630004152058				
overall (PI-1) variance						12.1%
composition (PI-2) variance						16.6%
contingency share of budget						0.0%

Annex B: Documents list

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- Handbook on Value for Money
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- Auditor General's Reports, 2008/09, 2009/10
- Ministry of Education, IA-G district office interviews.
- AGD: Sample of monitoring reports, sample of financial statements as submitted to Auditor General
- KENAO: Audit working papers, related to audit planning; copy of management letter response;
- PAC report on KENAO 2007/08 audited Appropriation Accounts
- Treasury Memoranda, 2006/07 and 2007/8, submitted 26/4/2011
- Standing Orders, 2008

Annex C: List of Stakeholders Visited

Name	Organisation	Position
Ministry of Finance		
Paul B. M. Ngugi	Budget Supply Department	Director of Budget
Onderi N. Ontweka	Budget Supply Department	Senior Deputy Director of Budget
John F. Olinga	Budget Supply Department	Deputy Director
Francis Anyona	Budget Supply Department	Chief Economist
Elisabeth M. Nzioka	Budget Supply Department	Principal economist
Samuel Kiru	Budget Supply Department	Principal economist
Victor Ontango	Budget Supply Department	Economist
Josiah Babu	Budget Supply Department	Economist
Henry K. Rotich	Economic Affairs Department	Deputy Director (re: macro-fiscal framework)
Wanyambura K. Mwambia	Economic Affairs Department	Deputy Director (re: tax / penalties waivers)
S.O. Omenda	Economic Affairs Department	Chief Monopoly and Price Officer
Peter Chacha Wankuru	Economic Affairs Department	Senior Economist
Kenneth Kibet	ERD	
Jane K. Nderito	ERD, Disbursement unit	Accountant
Kenney O. Ondieki	DGIPE	Director
Susan Karanja	DGIPE	Assistant Director, Investment Officer
Peter Njoroge	PFM Reform Secretariat	Programme Manager
Warui Maina	PFM Reform Secretariat	M&E officer
M. Gatumi	Accountant-General’s	Accountant-General
D. Ogot	Accountant-General’s	Deputy A-G
T. Nyalameba	Accountant-General’s	Senior Assistant A-G (SAAG)
J. Kilinda	Accountant-General’s	SAAG
Geoffrey Malombe	Accountant-General’s	AAG
Mary Wanyonyi	Accountant-General’s	Chief Accountant
M. Njogu	Accountant-General’s	PA Ministry of Industrialisation
P.G. Ndungu	Internal Auditor General	Internal Auditor-General
S. M. Nyachiro	Internal Auditor General	Senior IAG
P. Owiti	Internal Auditor General	SAIAG
A. Ngugi	Internal Auditor General	AIAG
Willis Okwacho	Internal Auditor General	
Ann Waiguru	IFMIS	Director
Moses Gitari	IFMIS	
Henry Mobegi	IFMIS	
Ministry of Planning		
Joshua O. Opiyo	Macro Directorate	Chief Economist, Statistician
Cleopus M. Wangombe	Macro Directorate	Senior economist
Fransis Muteti	Monitoring and evaluation directorate	Principal economist
Peter M. Kamau	Directorate of e-Government / GITS department	Assistant Director, ICT
Kenya Revenue Authority		
Daniel K. Kagira	KRA, Programme Management & Business Analysis Office (PMBO)	Deputy Commissioner

Name	Organisation	Position
Monika Kuyo	DTD	Policy unit technical
Maximilla Onyango	M&C	Taxpayer services
Fiona Mshai	M&C	Contact centre
Mugo Victor	Office of the Commissioner General	PMBO
Vincent Kiptalam	Office of the Commissioner General	PMBO
Patrick O. Mumbo	DTD-DR	Debt Management Programme
S. Ondari	DTD-DR	Taxpayer Audit
Alice Etole	DTD-DR	Taxpayer registration & Recruitment
Thomas Bifwoli	CSD-RNDL	NTC section
John Karani	KRA	R&CP
Gespe Muie	KRA	Investment & Enforcement
Franklin Ombaka	CSD-PCA	Post Clearance Audit
Hannington Odere	KRA	Finance
Abdul R. Bonaya	Customs Service Department	Debt Management
Ministry of Education (MOE)		
Peter Ndundo	Chief Financial Officer	
Ministry of Agriculture		
Alice Gichu	Finance	Senior chief finance officer
Susan Mucheru	Human Resources	Deputy director HR
W. Lubira		
Dr Isaiah Okeyo	Policy	Deputy director policy
Mohammed Choti		
D. Wagai		Deputy director audit
Jackson Ngoko		FOI
B. A. Andayi		Accounts
C. N. Mekala		FO
Douglas Oliech		HRM Office
Ministry of Medical Services (MOMS)		
David Nyambok	Finance Department	Chief Finance Officer
J. Chegebabu	Accounting Department	Accounts
Mageto Mirieri	Supply Change Management Dept	Procurement
Peter Messoh	Finance Department	Finance officer
Peterson M. Ogega	Internal Audit Department	Head of IA
Eikana Onguti		Chief economist
Sam Munga	Hospital Finance Secretariat	Head
Ministry of Public Health		
Juddie Nyakawa	Finance	Deputy Chief finance Officer
Dr. Samuel Were	TPMD	Head of TPMD
Hannah Kimemia	Human Resources	Deputy Director HR
Edward Wene	Accounts	AAG
John Odonah	PHS	SDDMs
Nzoya Munguti	Planning	Economist
Caroline Wachiro	SCM	SAD
Ministry of Roads (MOR)		
B.H. Abdi	Finance Department	Chief Finance Officer
L.N. Aura	Supply Chain Management Unit	Head of Unit

Name	Organisation	Position
Alfred Muhindi	Finance Department	
Philip Wachira	Finance Department	Senior Finance officer
Margret Ngangu	Accounts Department	
Arthur G. Karagu	Internal Audit Department	Internal auditor
Stanley Mbaka	Internal Audit Department	Internal auditor
Jane K.	HRM department	
Anne Mwaniki	HRM department	
Ibrahim Ongaki	Finance Department	
Ministry of Local Government (MOLG)		
Prof. Karega Mutahi, CBS	MOLG	Permanent Secretary
Amb. P.R.O Owade	Local Authorities Administration	Secretary
Salim A. Molla	MOLG	Senior Deputy Secretary
Jimmu M. Iuamba	MOLG	ATU Treasurer (not known)
J.N. Omuga	MOLG	
G.A. Kamasana		
John K. Waithaka		
Thomas Nyariki		
Angeline A. Hongo	Kenya Local Government Programme	Programme coordinator
Ministry of State for Public Service		
Henry Ogega	Management Consultancy Services	Director
Andrew Mwairiri	Management Consultancy Services	
Jackline Meso	Management Consultancy Services	
PPOA		
Morris Duma		Director-General
Nathan Soita		ARB
Lucy Barno		Corporate Services
Pauline Opiyo		ARB
Charles Chama		Compliance Officer
Robert Kanyi		Policy and Research
Rose Ndirangi		Compliance Officer
Peter Ndungu		Compliance Manager
Haron Oenga		Senior Compliance Officer
Jane Njoroge		Technical service
Charles Kamande		Policy and Research
Martin Okwatha		Procurement Officer
Teachers Service Commission		
Simon Kavisi		
Shem Motuka		
Franklin Choge		
Evelyn Mitei		
Jennifer Ndeje		
Geoffrey Wanjohi		

Name	Organisation	Position
Ali Kombe		
Mary Rotich		
Josephine Maundu		
Pending Bills Committee		
Samuel Wagitu	Pending Bills Committee	Secretary to the Committee
KACC/EACC		
Beatrice Kamau	Planning and Budgets	Principal officer
Jackson Mue	Investigation	Principal officer
Vincent Okongo	Research and policy	Principal officer
Felix Onjoma	Prevention	Prevention officer
Sophia Muturi	Prevention	Prevention officer
Jason Akoyo	Planning & Budgets	Planning and budgets officer
Auditor-General Office		
Jesse Mutua		
Charles Merande		
Parliament		
Phyllis Makau		Parliamentary Budget Office
Central Bank of Kenya		
Lawrence Rweria		
S. Karem		
Bertha Muchemu		
Hellen Chepkwony		
Moses Mathu		
Leonard Thotho		
Autonomous entities		
Dickson Khainga	KIPRA, Macroeconomic Division	Head of Division, Senior Policy Analyst
Benson Kiriga	KIPRA, Macroeconomic Division	Policy analyst
Government printer		
Benedict Munywoki		Administrative officer
Vincent Murani	ICT	Senior printer
Beatrice A. Mabane		Bookshop
Samuel Oringo		Dispatch
Julius Wandera Chesa		Publication
John Ongwara		Planning
Paul Sang		Proof reading
Non-state Institutions		
Mr. John Mutua	Institute of Economic Affairs	Programme Officer, Budget Information Programme
Bernard Ndungu	PWC	Consultant, Chart of Accounts project (GIZ)
Samuel Mbithi Kimeu	Transparency International Kenya	Executive Director
Michael Otieno Oloo	National Taxpayers Association	NTA Advisor
James Mwangi Ndegwa	Kenya National Chamber of Commerce and Industry	Programme Manager

Name	Organisation	Position
	(KNCCI)	
Dr. Benson Momenyi	KNCCI	CEO
Julius Mbithi Kituku	KNCCI	Membership & Resource Mobilisation
Donors		
Tracey Lane	WB	
Stuart Tips	DFID	
Giulia Pietrangeli	EC	
Achim Blum	GIZ	
Arne Fraemk	GIZ	
Kristian Rosbach	GIZ	
District of Thika West		
Wilson Njega		Commissioner
Peter Wambugu		
Julius Njaramba		
John Mutie		
James Oino		
Priscillah Kanyiri		
Reginalda Onono		
County Council of Thika		
R. G. Ngigi		
Anne Ngige		
Josiah Karanja		
Victoria Chege		
Mary Makau		

Annex D: Note on Accounting and Control Issues

1. **Balancing issues concerning statements of assets and liabilities**.

These statements form part of the accounts and represent minor cash amounts of moneys owed, in the form of individual advances. The statement is, like a balance sheet, supposed to balance. In IFMIS, however, this frequently/occasionally does not occur and to satisfy the auditor additional manual records are used to balance the accounts.

The background to this problem is that several years ago (date unclear) when data relating to these statements were entered into IFMIS it was not complete; data were missing or not available in the manual records. Rather than not enter anything, the decision was made to enter incomplete data and to put the necessary balancing entry into a suspense account. (We have assumed this must be the case as the alternative would be an entry into the accounts that did not include both debits and credits). These balancing suspense accounts have never been resolved.

A number of points arise:

- The accounts presented are currently a combination of computerised (IFMIS) and manual records, contrary to the objective of the accounts being entirely generated by IFMIS.
- It is unclear how, if manual data are used to balance the statements, the remaining suspense accounts in IFMIS are accounted for. If they are not then the system would appear to be out of balance.
- The data – both manual and computerised – that make up these statements are, in some cases, very old and unexplained. A task force has been established to "clean up" these data and write-off old unexplained balances.
- In moving forward with IFMIS it is very important that old, unsupported data are not entered into IFMIS and, where they do exist, that they be reviewed and cleared out. The unresolved problems of the past are impeding the current system in producing reliable end of year accounts.

2. Some ministries unable to produce a Trial Balance

A Trial balance (TB) is proof that every debit is balanced by a credit. It is fundamental to double-entry book keeping and without it there is no assurance that the system is in balance. It is not clear why some ministries have not been able to produce TBs and Auditor General staff we interviewed could not assure us that IFMIS was in balance as they were not responsible for that area of work. The combination of point 1 about requiring additional manual data and the lack of TBs raises serious concerns that should be resolved.

3. Revenues not reconciled

We were informed that some revenues that are collected locally, in up to 245 different locations, are paid into one commercial bank account which then transfers the money to the CBK account of the ministry concerned. Effectively this means that all 245 locations are paying into one big bucket account that cannot distinguish the paying in branch and, therefore, the location. This approach makes reconciliation of revenues impossible with the following consequences:

- The actual amounts of revenues claimed as remitted by a location cannot be reconciled to the actual revenues received by the bank;
- Amounts claimed as remitted cannot be proved – a location could submit forged documentation to support claimed bankings and it would be impossible to prove if this was so.

This weakness can easily be overcome: paying directly into a bank before receiving the service, or giving each branch a deposit sub-account that would then tip into the main account. These solutions have been rejected.

4: Reversing commitments prior to a payment

When a purchase order is raised in IFMIS it creates a commitment that reserves budget funds so that these are available for when the goods ordered come to be paid for. The normal way such systems work is that when the payment request is entered, after the goods have been received, the commitment number is also entered. When the payment is approved the commitment is reversed and the budget provision released is available for the payment of goods; this happens automatically with no user intervention. We understand that IFMIS has been configured such that a commitment can be reversed prior to the payment being approved. If release of the payment is then delayed, then it may not be possible for the funds to be committed again.

It is not clear why this practice has been allowed to happen, if it is, and what possible advantage it confers for operational procedures. There are only disadvantages to such a process. It must, of course, be possible to cancel commitments, for example because a supplier is unable to complete an order. Such circumstances need to be strictly controlled. The situation described to us was not like this and, if it exists, represents a weakness that could mean that a payment could be rejected because the committed funds were no longer available.

5. Problems with clearance of District suspense accounts

The process by which funds to be expended by districts has two problems:

1) Budgetary control problem

An MDA (indicated by a Vote in the Appropriations Act), when transferring funds to its Spending Units/offices located in Districts, raises an AIE for the designated officer (AIE Holder) in each Spending Unit. AIEs are mere papers informing an AIE Holder of how to spend funds allocated to his/her Spending Unit (i.e. allocation is on a line item basis). An AIE becomes real spending power through the MDA transmitting an equivalent amount of funds to a bank account in the District, usually held in a commercial bank. An MDA may have one or more AIE Holders in a District; some have up to 20. AIE Holders in a District from the same MDA share one bank account, although they all know what their share is in that account.

An MDA consolidates all AIEs raised by it for each District, and then prepares one suspense payment voucher Form FO 21 (as per FPR 1989) covering the consolidated AIE. The suspense voucher is basically a transfer/advance of funds that has yet to be accounted for. It shows in the ledger until cleared by actual expenditures as submitted by the District, which are then charged to the service accounts (codes) as indicated in the budget estimates for the MDA (the accounting entries are a Credit under the suspense account and Debit under the service accounts).

What causes the budgetary control problem is the MDA lumping together all AEIs issued by it to each District in one payment voucher, without recognising the various expenditure items on which the actual expenditures will be incurred under each AIE. The system relies on control of AEIs at district level. It may be that expenditure under an AIE may exceed the amount allowed, but when the actual expenditures under the AIE are posted into the service account in IFMIS the only criteria for validity will be the code and a budget balance sufficient to meet the expenditure. Even if there were insufficient funds, by then the expenditure will have been incurred.

The best way to avoid this problem would be to maintain a District memorandum cash book through which the District Suspense accounts would be controlled (this is possible within Oracle cash management system on which IFMIS is based), then on a monthly basis to clear actual expenditures under each AIE from the suspense and then charge them into the main cash book. This will ensure that the memorandum cash book is also reconciled accurately while the main cash book is also reconciled accurately, and both balances captured in the ledger.

2) Delays in posting District expenditure

The second problem relates to delays in posting District expenditure, i.e. clearing suspense and posting into the service accounts (as noted under the Accounting and Reporting Core Dimension in Section 3). The process is sometimes three months in arrears which sometimes creates year-end cut-off problems; expenditure incurred in one year but posted into the next. It also gives a misleading picture of spending in ministries. It is important, therefore, that ministries monitor suspense accounts and ensure they are cleared on a regular basis.

Accounting and reporting: Bank reconciliation is currently conducted outside the IFMIS. Once CMM is operational, the system would be able to upload bank statements electronically and then automatically attempt to reconcile them to Cash Book transactions. Any reconciliation errors/differences detected would remain a task outside the CMM. The greater the extent that budget execution is controlled through IFMIS, the greater the probability of accuracy and timeliness of budget execution reports and the lower the probability of reconciliation errors. The accuracy, comprehensiveness and timeliness of annual financial statements prepared by line ministries and MoF should strengthen considerably if the processes discussed above are strengthened through the Re-engineering Strategy.

As noted in the main text, there are accounting issues at district level, associated with the time lag between the classification of transfers to districts as advances and their regularisation as expenditures. The introduction of a re-engineered IFMIS into districts would help to resolve these issues.

E: Minutes of PEFA Validation Workshop held on May 24, 2012

1. *Introduction* by the head of the PFM Reform Secretariat with remarks by the Economic Secretary of the Ministry of Finance.
2. *Summary of Findings* – overview of the main points followed by questions relating to resources available to service delivery units (PI-23) and the financial statements and reporting to Parliament. Discussion of the reasons for and problems raised by re-scoring earlier PEFA assessment.
3. *Credibility of the Budget* – questions relating to the method of scoring and the impact of recent economic uncertainties on the score. Regarding PI-4 (expenditure arrears), GoK mentioned that the absence of wage and salaries arrears was due more to the strong tradition of paying wages and salaries on time than to the influence of trade unions.
4. *Transparency and comprehensiveness of the budget* – questions about the treatment of Constituency Development Fund (CDF). GoK staff confirmed that the transfer of funds to Parliament for CDF comes under the budget for Ministry of Planning. An annual report on CDF operations is sent to Ministry of Finance every year, but the report is not made public.
5. *Budget preparation* – discussion about whether the cabinet approved budget ceilings before the figures went to Parliament. GoK confirmed that Cabinet approves the Budget Policy Statement, which contains the ceilings, prior to its submission to Parliament. Some ministries complain that they do not have enough time to prepare their budget submissions, but this is mainly because they did not organise themselves properly; as mentioned in the PEFA report, line ministries in practice do much of the estimation work during the strategic phase (preparation of BPS) of budget preparation.
6. *Revenue Administration* – discussion of arrears collection and how other countries fared.
7. *Budget Execution and cash management* – discussion of the frequency with which forecasts are updated and the requirements of the scoring system, the problems of cash flow forecasting currently; the extent to which commitments can be made beyond 6 months. Accountant General's Department said that cash flow forecasts were updated monthly at the time of the previous assessment, not quarterly, as indicated in the draft PEFA report (this comment was reflected in the next draft of the report under PI-16). Regarding the use of GPAY, GoK staff said that, unlike all other MDAs, the security institutions do not use GPAY.
8. *Internal Control system* – procurement scoring and the statistics collected by PPOA and how this affected the scoring; extent to which regulations were understood and not complied with and their comprehensiveness (subsequent discussion with PPOA and agreement reached). PPOA mentioned that, in addition to the intensive procurement audits (carried out over several weeks) referred to in the PEFA report, the Compliance Department of PPOA also carries out procurement assessments lasting 2-3 days each covering a larger number of MDAs. So far 74 had been carried out; these are not

published on PPOA's website (the subsequent PEFA draft report reflects this point). Agreement on conclusions in relation to internal audit from Internal Auditor-General (IAG) representative.

9. *Accounting recording and reporting.* Discussion of: non-IFMIS balances; extent of reporting at service delivery unit level, the extent to which old out of date data is still held in IFMIS rather than being written off; use of IPSAS as the comparator for the annual accounts (GoK staff said that a Committee has been established to prepare for the adoption of IPSAS); failure to disclose the legal basis for the accounts within the accounts themselves (GoK acknowledged that accounting standards are not disclosed); proposals to change responsibility for publishing accounts and make it that of each MDA. Regarding the accounting for imprests (PI-22), GoK confirmed that many of the outstanding imprests are old and cannot be recovered, thus representing losses. Apart from these, end-of-year imprests may carry over to the next year for a few weeks prior to their clearance.
10. *External audit and legislative oversight.* Changes to reporting and opinion being proposed by KENAO. The extent to which the Auditor-General could make recommendations to Parliament, the nature of the issues that should be raised and the proper role of parliamentarians in relation to technical matters.
11. *Donor practices*- discussion of the instructions awaited by donors from GoK on how aid should be accounted for within in-country system.

Annex F: PEFA Secretariat comments and assessment team response

Government of Kenya – PEFA PFM Assessment (June 2012)

Evaluation of response to the PEFA Secretariat comments of April 25, 2012

This note provides a follow up to the PEFA Secretariat comments of April 25, 2012 on the Draft Report of the PEFA assessment of the Government of Kenya (April 2012). It assesses the changes made to the draft following the Secretariat's comments and any other changes to indicator scores which the Secretariat had considered appropriate during its original review (but does not address issues raised by other reviewers). All of the suggested improvements of the Secretariat's previous comments are listed in the tables below along with our corresponding assessment of the response.

In summary, the revised version of the report has fully responded to 9 comments, while there are thirteen partial or inadequate responses.

PEFA Secretariat comments on evidence and rating (and comparison)	Secretariat's evaluation of the responses as contained in 2nd draft report	Assessment team's response to Secretariat's evaluation of responses
Overall impression		
This is an excellent draft report which shows a very good understanding of the methodology and closely follows the standard PEFA PR format. The ratings are very well supported by the evidence provided, although in places, this is excessive.	None required.	
It is a repeat assessment, and the table at the end of the Summary Assessment tracks changes in the ratings, with generally clear explanations: 12 scores in the 2008 assessment have been transparently re-rated for better comparison.	None required.	
Despite the length of the report (which is rather too long in places, e.g. 38 pages on revenue administration (PI-13-15 and Annexe A,	No response (& report is even longer!).	*Annex A on Revenue*

which appears unnecessary)), a little more could be said on the methodology of the assessment (donor coordination, Government involvement, Quality Assurance arrangements, etc.).		*Administration has been scrapped and the narrative in PI 13-15 shortened.* *Narrative on donor coordination and Government involvement has been added.*
General observations		
Documents reviewed are specified in Annex B, and there is a list of the many government stakeholders consulted (as well as representatives from several non-government sources, always valuable for triangulating information). Evidence is awaited on PI-15 (iii).	Full response (PI-15 now 'NR')	
The fiscal year is stated and a list of abbreviations is included, but is not yet comprehensive. The exchange rate is missing.	Partial response (no exchange rate)	*List updated. Exchange rate included*
Section 1 – Introduction		
The purpose of the report is clearly stated: *"to assess the PFM system performance of the Government of Kenya, using the PEFA assessment methodology, and to gauge progress in strengthening performance since the last PEFA assessment conducted"*, as is the scope of the assessment: central government MDAs and their District offices, which covers the majority of general government expenditure.	None required	
Donor coordination for the assessment could be explained. There are two funding agencies (EC and GIZ), but there is no explanation how they coordinated with each other, nor with other active donors	Partial response.	*Text updated to include follow-up activities*

(such as WB and DFID). Government involvement is not described, beyond mentioning the inception workshop on 12 March, a de-briefing workshop on 26 March and the numerous officials who provided information.		
It would be useful to mention arrangements to quality assure the work, and also the 'snapshot date' – which by inference is 30 March 2012 (the last day of the country mission).	. Partial response	*Text updated*
Section 2 – Background information		
The country's economic context is described, and key economic and social data is included. The structure of the public sector – which is being reshaped under the new constitution – is outlined: the number and aggregate expenditure of SNGs is explained, and some AGAs are mentioned.	None required	
Partial information on budgetary outcomes is provided for the government budget, but not in the 'standard format' – although Table 0A shows 5 years' data, the economic classification is incomplete (no separation of salaries, other goods and services, transfers); Table 4 is not correctly titled; the functional classification is partial ('economic affairs' covers several functions). There is insufficient information to assess the links between the budgetary outcomes and the operation of the PFM systems.	. Full response	
The links between the executive, judiciary and oversight institutions are all briefly described, as are the legal and institutional arrangements for PFM. The legal framework is explained (existing legislation from the old Constitution still applies, and there is a PFMA bill before Parliament) but the division of responsibilities within the Ministry of Finance is not.	Full response	

Section 3 – Assessment of PFM systems, processes and institutions

PI/dim	PEFA Secretariat Comments on evidence and rating	Secretariat's evaluation of the responses as	Assessment team's response to

		contained in 2nd draft report	**Secretariat's evaluation of responses**
PI-1	Rated 'B', but apparent error in calculating deviation in 2009/10 (should be 15.5% giving 'C'). Total primary expenditure does not agree with Table 0A after excluding interest and appropriations in aid. Has donor project expenditure been excluded? Rating uncertain	Full response.	
PI-2 (i)	Appears correctly rated as 'A' on the basis of adequate evidence, but it would be useful to see the figures to check calculations on new method. (there is no 'Annex 1').	Full response.	
(ii)	Not rated and only 'narrative' is footnote stating there is no contingency – but 'clarification' suggests this should be 'A'.	Full response.	
Overall	Not shown separately, but by default, correctly combined to A.	Full response.	
PI-3	Appears correctly rated as 'B' on the basis of adequate evidence, but not clear what comprised *"Development revenue"* included in the calculation: please clarify.	Partial response.	*Changed to 'Property revenue'.*
PI-8 (i)	Rated as 'C' on the basis that CDF allocations are not transparent: however, these amounts do NOT form part of SNG budget & are not within their control. Rating uncertain.	Partial response.	*Response: The CDF issue has been moved to PI-7.*
PI-10	Rated as 'B' on the basis of 4 items published, but it appears that contract awards are published by PPOA, and as there is no requirement for MDAs to publish separately, this would make 5 & hence qualify for 'A'. Rating uncertain.	No response.	*Response: Procurement contract awards are only published on the PPOA website, but not by the MDAs awarding the contracts. It is unclear whether all*

			procurement contracts are published on the PPOA website, nearly all the ones that are published are for SAGAs, very few line ministries are shown..
PI-11 (i)	The 'B' rating allocated is not in accordance with the methodology, which requires 4 weeks rather than the two quoted. Time before notification of ceilings does not count in this indicator. Rating uncertain.	No response	*Response: The strategic phase of budget preparation adds to the time available for budget preparation. It does not make sense to exclude the strategic phase period in terms of rating this dimension, as, in practice, much of the detailed estimation takes place during this phase/*
(ii)	Rated A, but text unclear that Cabinet approval is always given before issue of Budget Circular. Rating uncertain.	No response	*Response: Text was modified after the closing workshop to indicate that the Cabinet approves the Budget Policy Statement through a Cabinet Memo, prior to it being sent to Parliament. The BPS*

			contains the ceilings.
PI-15 (i)	May be correctly rated as 'D', but the narrative does not explain the figures in Table 18.	Full response.	
(iii)	Awaiting evidence.	Full response	
PI-17 (i)	Rated as 'B↑', but the evidence states that reconciliation with creditor data takes place *"usually once a year"*: this meets the requirements for a 'C' rating. Rating uncertain.	Partial response	*Text amended to "with varying frequencies, depending on the ease of access to data". Reconciliation is very quick in the case of some donors, particularly World Bank.*
PI-18 (iv)	Appears correctly rated as 'B' on the basis of adequate evidence.	Now rated 'A', but uncertain: unclear if a) improvements constitute full payroll audit; b) relate only to TSC.	*Text amended. Payroll audits in both TSC and MPS*
PI-27 (iv)	The statement that *"approval is very late on in the year"* suggests that approval is **usually** rather than 'often' ex post. Rating uncertain.	. No response.	*Response. Text modified, keeping the rating at C*

Section 4 – Government Reform Process

PEFA Secretariat comments	Secretariat's evaluation of the responses as contained in 2nd draft report	Assessment team's response to Secretariat's evaluation of responses
Section 4 provides a detailed review of the reforms underway and of the progress made since the 2008 assessment, together with an analysis of the institutional factors	None required.	

that will support the reform program, as well as the challenges going forward.		

Summary Assessment

PEFA Secretariat comments	Secretariat's evaluation of the responses as contained in 2nd draft report	Assessment team's response to Secretariat's evaluation of responses
The Summary Assessment brings together the impact of the main strengths and weaknesses of the PFM system across the six 'critical dimensions' very well, although the implications of these weaknesses for each of the three main budgetary outcomes is extremely brief.	Partial response.	*Text amended*
There is, however, a clear 'story line' – even if many of the changes since 2008 are fairly marginal, the legal foundations to allow progress are now in place.	None required.	