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PEFA Public Financial Management Performance Assessment Report for Kenya

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Final Report

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REPORT COVER PAGE

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Introduction and acknowledgements

This is the final performance assessment report of the Kenyan Public Financial Management Systems with rating towards 31 different performance indicators. It is the second PEFA report for Kenya, the previous assessment was published in 2006. This exercise has been funded by the European Commission, as well as by the German GTZ that provided one of the consultants.

The process leading up to this report has involved an introductory workshop and a dissemination seminar in Nairobi and the circulation of the draft assessment report to main stakeholders. The assessment team has carried out two missions in Nairobi and one field trip to Machakos District. A final data collection of budget data for indicators 1 and 2 has also been carried out through a visit by the team leader at the end of the assessment.

The team has interacted with the Ministry of Finance task force (Mr Kubai Khasiani (Deputy Director/BSD), Mr Henry Rotich (Deputy Director Economic Affairs Department), Mrs Judith A.M.Nyakawa (PFM Reform Manager), Moses K.Mwangi (PFM Reform M&E Specialist), Mr Kenneth Waithiru (Senior Economist, EAG), and Elizabeth Nzioka, Budget Specialist/BSD) assisting in the exercise and with the Public Finance Development Partner Group throughout the assessment. Valuable comments to the draft report have also been received from the PEFA Secretariat in Washington as well as from Government of Kenya and donor representatives.

The PEFA assessment team would like to acknowledge its warm and sincere gratitude to all efforts made to support this exercise and make it a fruitful endeavour. The team has met interest and engagement from the many entities and persons visited and has had useful discussions throughout. Both the team and many of the groups met have explained that this also was a learning exercise – for the benefit of Kenya and the performance of its PFM system.

The PEFA assessment team

Finn Hedvall Göran Steen Maurice O Ochieng Jennifer Sharpley

Acronyms and Abbreviations

AGD	Accountant General Department
AO	Accounting Officer
AiAs	Appropriations-in-Aid
Bn	Billion
BOPA	Budget Outlook Paper
BSD	Budget Supplies Department
CAG	Controller and Auditor General
CBK	Central Bank of Kenya
COFOG	Classification of Functions of Government
CDF	Constituency Development Fund
CAG	Controller and Auditor General
DMD	Debt Management Department
DSA	Debt Sustainability Analysis
DGIPE	Department of Government Investment and Public Enterprises
DPM	Department of Personnel Management
EAD	Economic Affairs Department
EU	European Union
ERD	External Resources Department
EBF	Extra Budgetary Fund
FY	Financial Year
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GFMA	Government Financial Management Act
GFRP	Government Financial Regulations and Procedures
GFS	Government Financial Statistics
GoK	Government of Kenya
GDP	Gross Domestic Product
ICT	Information and Communication Technology
IIA	Institute of Internal Auditors
IFMIS	Integrated Financial Management Information System
IPPD	Integrated Payroll and Personnel Database
IAG	Internal Auditor General
IAGD	Internal Auditor General Department
IFAC	International Federation of Accountants
IMF	International Monetary Fund
INTOSAI	International Organisation for Supreme Audit Institutions
IPPD	Integrated Personnel and Payroll Data System
IPSAS	International Public Sector Accounting Standards (of IFAC)
ISPPIA	International Standards for the Professional Practice of Internal Auditors
KACC	Kenya Anti-Corruption Commission
KIPPRA	Kenya Institute for Public Policy Research and Analysis
KENAO	Kenya National Audit Office
KNBS	Kenya National Bureau of Statistics
KEPSA	Kenya Private Sector Alliance

KRA	Kenya Revenue Authority
LATF	Local Authorities Transfer Fund
BSP	Medium-Term Budget Strategy Paper
MTEF	Medium-Term Expenditure Framework
Mn	Million
MDAs	Ministries, Departments and Agencies
MoF	Ministry of Finance
MDG	Millenium Development Goal
MOLG	Ministry of Local Government
NGO	Non Government Organisations
PAYE	Pay-as-You-Earn
PFM	Public Finance Management
PI	Performance Indicator
PS	Permanent Secretary
PRS	Poverty Reduction Strategy
PAC	Public Accounts Committee
PAA	Public Audit Act
PE	Public Enterprises
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PFMPR	Public Financial Management Performance Report
PFM	Public Financial Management
PIC	Public Investment Committee
PSM	Public Service Management
QBR	Quarterly Economic and Budget Review
QFAs	Quasi-Fiscal Activities
ROSC	Reports on the Observance of Standards and Codes
SAGA	Semi-Autonomous Government Agency
STA	Single Treasury Account
SN	Sub National Government
TOR	Terms of Reference
WB	World Bank

Currency: Throughout the report KES have been used indicating Kenyan Shillings. As at 31 October 2008 100 KES = 1,02 €=1,33 US$ (Oanda website)

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SUMMARY ASSESSMENT

The main rationale for a PEFA assessment is to identify strengths and weaknesses in the Public Financial Management system. The assessment shall serve as a basis for the further identification and revision of a feasible reform programme which, where needed, can receive donor support. An efficient PFM system is a key factor to the efficient use of a nation's scarce public resources and the realization of public sector objectives such as poverty reduction, and support towards national growth and prosperity. A trustworthy and efficient national PFM system is also one important prerequisite for donors to provide general budget support and to use the national systems.

The PFM systems will never in themselves provide results such as achieving the Millennium Development Goals or reach the vision 2030 for Kenya. The PFM systems are support processes to other main processes in Health, Education etc. The PFM systems performance is however an important prerequisite to achieve results for the main processes. Wasteful spending, allocative inefficiency, poor revenue, payroll or payment systems can harm all efforts to reach results for the public sector at large.

PFM system assessment using the PEFA indicators becomes more useful when the instrument is used repeatedly, as progress and set-backs can be spotted and the general development assessed. In this regard this second external assessment for Kenya is of particular interest.

(i) Integrated assessment of PFM performance

Credibility of the budget

There are indications that the budget has become a more credible instrument in terms of revenue collection and distribution of resources. There is evidence that arrears are contained and reduced, that the timeliness in release of funds has improved, and that the system of direct disbursements to institutional levels has improved budget access.

Problems in this field are budget variation in comparison to outturn and unpredicted freezes of certain cost items that were imposed after the post election crisis. The overview and consolidated budget reporting is poor in the current situation when the IFMIS system is being implemented, but has not yet reached full coverage and functionality.

Improved allocative efficiency related to millennium development goals and Vision 2030 for Kenya will depend on more efficient MTEF implementation and analysis. This needs to include mechanisms for budget analysis of transfers and extra budgetary funds, different cost categories such as personnel costs and measures for redeployment and re-skilling of the public service towards prioritized areas. Co-ordination with the national planning instruments and structures of the funds distributed to Constituency Development Funds and improved capture of the recurrent implications of investments are other areas for improvement.

In essence therefore the budget releases are more reliable and credible, but the budget needs improvement in terms of accuracy, allocative efficiency and flexibility. To move from incremental towards more programmatic budgeting remains a major challenge. Parliament's involvement in the budget process is hampered due to the late tabling of the budget in accordance with the legislation, as well as the short time available for debate.

Comprehensiveness and transparency of the budget

More than 10 % of the central government budget is allocated towards different statutory boards and state corporations. Even if the transfers to these are clearly denominated in the state budget, they are not regularly reported in any detail in the periodic reports, nor included in any functional reporting. Some of these extra-budgetary funds cover essential government functions, such as for universities or central hospitals. Most of these institutions produce their own periodic and annual report, are under the scrutiny of the Controller and Auditor General, etc. They are hence not "unreported", rather "insufficiently" reported in terms of the PEFA definitions and benchmarks.

On the whole functional reporting does not currently take place, although sector clusters are used to determine and discuss the MTEF framework. Large segments and votes in the budget however cover allocations to several sectors, such as to Provincial administration, Local Government or Constituency Development and hence do not reveal the intended or achieved functional purpose.

The most essential budget documents can be downloaded from government websites or purchased at Government Printer's shop in Nairobi at a reasonable price. The state and overview of the documents on the websites leaves a lot to be desired. Also the documents provide little overview and editorial consistency. The information is essentially published, but analysis, overview and compilation is problematic.

Parliamentary committees and members of Parliament are involved at earlier stages in the budget process and hearings, but the formal process in Parliament comes late in the process although in accordance with the constitution. Work is currently undertaken to review the legislation and process.

The budget can therefore not be said to be comprehensive or provide much overview, although the trend is towards better political involvement and openness.

Policy-based budget

The work of the sector groups and the preparation of sector strategic papers that are costed over a three year period is a major step forward. They contain both the costed and ambitious strategies, as well as a clear comparison and break-down of the available ceilings to the various votes. In doing so, they reveal the gap between the desired and the available resources. They however do not demonstrate what the gap implies in terms of altered priorities or scaling down on ambition. An additional element where discretionary cost elements are analysed or where the implications of different cost scenarios are studied and presented for possible external funding is not included. The current position taken where unpredictable donor funding is excluded from the MTEF framework is understandable, but may forfeit the purpose of realistic planning and the use of the MTEF instrument for fund-raising.

The post election conflict had several unpredicted effects in terms of revenue collection, the availability of donor funding, freezes on spending of certain items and the bond market. The situation has however stabilized and has now been normalized to the point where policy-based budget mechanisms could be further developed. The on-going effort to introduce performance contracts is one line of development in this regard where desired results are clearly defined and eventually can be related to the budget available. Accounting officers do encounter problems to reach the results of the performance contracts due to bureaucratic procedures, fragmentation of powers and incrementalism.

Predictability and control in budget execution

Apart from the recent post election conflict the mobilization of revenue is showing good progress with better tax systems and collection going up with 29 % over the past three years. (2004/05-2006/07). This coupled with more prudent management of the domestic debt and reduced arrears has meant that at large the budget has been predictable. The improved control of cash management and the release of funds to budget holders is maintained, as already observed in the previous PEFA assessment of 2006.

Although in-year adjustments take place, often at a rate of 2-3 changes per vote, they do not constitute a major problem, and are presented to Parliament once a year in the supplementary estimates. The use of the contingency fund for other purposes than emergencies has been observed and subject to audit queries.

Two important spending areas within Budget execution have improved since the last PEFA assessment: Payroll and Procurement. The new pay-roll system has meant a big improvement, but it is not fully rolled out yet and it is not integrated with IFMIS. It has however, the potential to become a complete and well functioning system in the future, partly dependent on how well it is implemented and managed as a distributed system in several centres within Government. New Procurement legislation has started to be implemented as from 2007 and some improvements in the practise have been evidenced in the PEFA assessment.

The Internal Control system, including commitment control that is in place has not been very effective in the past and there is evidence to show that many deficiencies still prevail. The new IFMIS system is expected to strengthen the commitment control once it is completely rolled out and implemented, but that has still to happen. The legal framework for PFM and guidance of operations is neither clear nor comprehensive and fragmented into successive Treasury Circulars over a long time. The Internal Audit, especially on central level, has developed well and is showing a commendable professional ambition although they still have a way to go. The effectiveness of Internal Control is thus still an area of concern, especially when it comes to management responsibility together with follow-up and enforcement as a result of external and internal audit. Introduction of Audit Committees in ministries the last years would be promising but has still to prove its effectiveness and usefulness. Issues raised by the Auditor General in the annual audit reports also raises concern about the overall quality of at least parts of the financial records.

Accounting, recording and reporting

Accounting and reporting is currently being reformed with the introduction both of the IFMIS – Integrated Financial Management Information System, and the IPPD – Integrated Personnel and Payroll System. The two systems are not between them integrated. They are built on different platforms and IFMIS is a centralised system whereas IPPD is a distributed system with servers in most ministries, and one at DPM headquarters where all data is collected and captured into one database.

The IPPD system has been rolled out since 2005 and is now about to cover the last few establishments (Judiciary and doctors). IFMIS has been installed in most central ministries, but has during 2007/08 still been used as a pilot in parallel with the previous systems. The recent split of some ministries remains to be reflected in the system. The main IFMIS functions/modules for General Ledger, Accounts Payable and Purchasing are installed in the on-going first phase, other modules are to follow.

The current situation is characterized by a number of teething problems, related to the parallel introduction of the two new systems, in terms of capacity building, distribution of licences, connectivity, virus protection, code structures etc. The IPPD has already resulted in improved integration of personnel and payroll records, better opportunities for payroll audit and increased security and audit trails. IFMIS has not yet reached its potential and is hampered by few access points and lack of competent staff and licences, which some large ministries are not yet fully on board – like Ministry of Public Health and Sanitation, Ministry of Works and Provinces and Districts. The split reporting - where some still use the old systems - makes the IFMIS less useful for budget analysis and reporting on the aggregate level. The potential of the system is also not utilized, e.g. for bank reconciliation and cash management as the cash management module still isn't in use. In essence IFMIS can currently mainly be used for expenditure returns and commitment control. The processing of imprests is a problem area where reconciliation problems are experienced between IFMIS and IPPD.

At large, important system developments are hence taking place and the implementation is at an advanced stage. There will be need to monitor the roll-out carefully, identify problem areas and to mobilize support where needed. The systems are in our assessment sound and the roll-out of them deserves all backing possible.

An area of concern is the continuous observations from the Controller and Auditor General in his/her Annual reports regarding the quality of financial records, bank reconciliation and fund accounts. In the latest report – for 2006/07 - the CAG in the conclusion of findings announces that a number of funds and votes could not be audited due to the status of financial reporting. These funds and votes are listed in a separate annex to her report. It has been difficult from the annual report to establish whether these problems are accumulated and on the increase, or merely represents old problems which remain unattended. However discussions with the KENAO indicate that they to a large extent relate to older problems and previous years. It will be necessary to clear these anomalies from the accounts, and to find ways to establish a sound basis for the continued accounts, that can be prudently and efficiently monitored by use of the new systems coming into place.

Procurement legislation and oversight is now coming in place, but the new institutional framework is not yet fully operational.

External scrutiny and audit

The efficiency of the Office of the Auditor General has improved through better organisation, increased systematic training, the introduction of new and computer assisted audit methods and the adoption and successive application of international auditing standards. KENAO has substantially increased its audit coverage and is now covering 100% of Central Government Annually whilst there is still a huge backlog when it comes to Local Authorities. A performance audit unit has been established at KENAO and use is being made of risk assessment to determine audit plans. KENAO does not yet have access to the IFMIS system database.

A main weakness has been timely presentation of the annual audit report to Parliament, but this process is now timely. A remaining problem area is the long delay after which Parliament attends to the audit report and queries and the even longer delay before Government responds, as well as in many instances the poor response given. The slow process and long delays together with lack of enforcement seriously undermines the value of the process.

Donor practices

The donor-related indicators are still rated low as there is little and unpredictable budget support, poor reporting back even on some of the loan financed development projects and large flows provided as appropriations in aid using donor systems.

(ii) Assessment of the impact of PFM weaknesses

There is much evidence that the PFM institutional framework in Kenya is under transition, and that a number of important improvements are being implemented, as reflected in the improved rating of several of the sub-dimensions to the performance indicators. The changes have the potential to improve system performance much further.

The prioritization of reforms related to payment and cash flows, debt management, revenue and payroll systems and preparation for an albeit simplified IFMIS roll out, coupled with more fundamental legislative changes related to procurement and budget and public finance administration creates a basis for further progress.

The weaknesses observed for programmatic MTEF implementation and budgeting, comprehensiveness and consolidated budgeting and reporting and the poor status of annual financial statements reflect mismanagement and poor control. It is difficult to determine the extent to which this relates to the past, to initial problems in the roll out of new systems or are symptoms of a more profound lack of financial control and discipline. The tools and systems are however coming into place – what remains to see if they are being used with the intended purpose and give the desired end result. The current weaknesses of the budget process, the budget documents and reports hamper the implementation of the political goals of Kenya's vision 2030, and of MDGs. The lack of co-ordinated approaches between donor funding, constituency development projects and governments own capital planning results in wasteful spending where the recurrent implications are poorly catered for. The almost total absence of statistics and plans related to the civil service human resource dimension in planning and budget strategies is also noted as a short-coming.

Critical in this regard is to move towards improved analytical reports, towards more analysis reflected in budget documents and reports giving overview and direction within restricted and realistic financial frames.

The current situation is also marked by procurement incidents and numerous audit queries that haven't been resolved, by erroneous financial records and poor final accounts. This affects confidence in the public administration. Many of these problems may be resolved by improved systems, methods and analytical approaches. This will however not suffice – also management and political leadership will need to be engaged in the analysis, in prioritization and in action on audit recommendations and detected cases of fraud and corruption. The most obvious area in need of immediate attention might be the constitutional but badly functioning oversight and follow-up process which involves both the Parliament and the Government. It does not necessarily mean a witch-hunt throughout the public service, rather to state examples and introduce a new culture. There are already commendable efforts made in this direction through the anti-corruption campaigns, results for Kenyans and performance contracts.

The PFM system contains a number of sub-systems and dimensions which support one another. Orderly financial data and accounting facilitates budget calculation and monitoring. The availability of accurate and current data on expenditure in relation to budget improves the quality of decision-making and public oversight, and promotes accountability. As sub-systems improve, they can impact PFM performance in a number of aspects, and Kenya has the opportunity to see marked improvements in the near future.

In contrast, mal-functioning systems and poor fiscal discipline undermines the strategic allocation of resources and hampers efficient service delivery. It is important for the systems to support all aspects of financial management – the credibility of the budget, comprehensiveness and transparency for analysis and public control, policy based budget decisions which improve allocative efficiency, predictability and control in budget execution to enable local managers to deliver and manage their resources, timely and accurate accounting, recording and reporting as well as effective scrutiny and audit of the system, to identify breaches of control, improve systems and assist management and Parliament in their managerial and oversight roles.

(iii) Prospects for reform planning and implementation

Current reform efforts related to PFM include:

Box 3. Summary of Reforms Since 2003

Prior to 2003, Kenya faced serious weaknesses in institutions, including those in the area of public financial management. The PEM-AAPs, undertaken in 2003 and 2004, showed that Kenya met only 4 out of 16 benchmarks.[1] Governance problems culminated in a number of notorious scandals such as the Goldenberg and Anglo-Leasing scams. **Since 2003, a number of key reforms have been initiated** aimed at improving public financial management and fiscal transparency more generally, although important challenges remain. **The key reforms to address weaknesses in the area of PFM have been**:

Situation in 2003	Key actions taken	Status
1. Outdated PFM legal framework	-*Government Financial Management Act (2004)*: addressed some urgent PFM issues, mainly in accounting, but its coverage remains limited	Revision underway
	-*Public Procurement Act (2003)*: introduced modern procurement processes and standards	Being implemented in 2007
	-*Public Audit Act (2003)*: established independence of National Audit Office	Implemented
2. Limited availability of fiscal information	-strengthened monthly expenditure returns process: significant improvements but still delays of up to two months	On-going
	-improvements in reporting on SAGAs and EBFs: reports more readily available – but information still incomplete and only occasionally published	On-going
	-publication of Quarterly Budget Review on MoF website: available between 2 and 4 months from end of quarter	Implemented, but needs improvement
	-computerization: legacy systems gradually being replaced by modern IFMIS system – roll out to ministries/agencies, districts in second phase	On-going
3. Significant discretionary powers of the Treasury during budget execution	-implementation of stricter limitations on tax expenditures through tightened legal framework and improved controls at KRA	Implemented, but needs monitoring
	-improved cash management: releases based on cash flow projections from ministries/agencies	On-going
	-strengthened accountability of ministries/agencies: less discretionary power at Treasury to make budgetary changes	On-going
4. Significant discretionary powers in personnel policy	-Public Service Commission Regulations 2005: tightened up on qualifications and established procedures for recruitment – greater transparency	Implemented
	-cleanup of payroll: integrated payroll and personnel system introduced, although functioning in decentralized mode	Implemented, but needs further effort
5. Lack of budget realism	-improved fiscal framework: greater reliability of macro-economic forecasts, improved revenue projections, realistic ceilings for budget preparation, MTEF	Good progress made, on-going
	-wider consultation during budget preparation: review of SAGA/EBF budgets, consultation of civil society groups, strengthened budget cycle	On-going

There have also been key reforms in other areas which have helped meet the requirements under the fiscal transparency code. Key legal reforms: (i) the *Public Officer Ethics Act (2003)*, which introduced a code of conduct and compulsory filing of annual declarations of assets and income for public officers; (ii) the *Anti-Corruption and Economic Crimes Act (2003)*, which established the Kenya Anti-Corruption Commission (KACC); (iii) the *Privatization Act (2005)*, which makes a Commission responsible for privatization, thereby increasing accountability and transparency; (iv) the *Statistics Act (2006)*, which established an independent National Bureau of Statistics. In addition, various administrative reforms have been implemented, including outlawing *harambees* (political fund-raising events), establishing a ministerial code of conduct, introducing performance contracts for all SAGAs and SOEs, reforming tax administration (KRA), and simplifying licensing regimes for businesses. **Remaining challenges** include making public the wealth declarations of senior officials, and operationalizing the Privatization Commission and the Pubic Procurement Oversight Authority.

[1]This compared with 8 benchmarks in neighboring Uganda and 11 in Tanzania (www.imf.org).

(Source IMF ROSC report on Fiscal Transparency module March 2008:

Other on-going improvements relate to:

- Widened IFMIS use, introduction of additional modules such as for cash management, and roll-out to provinces and districts. Refined code and reporting structures.

- Full coverage of IPPD – the new payroll system - through roll-out to the remaining entities.

- A new Public Finance Administrative Act, revising responsibilities, budget calendar and process.

The situation pertaining to IFMIS and IPPD is likely to need a period of consolidation, reinforcement of support, communication, security and access as well as capacity building. Training will be more fruitful in the up-coming phase as workstations and opportunities to apply the new knowledge improve.

There is potential for further systems improvements and better accuracy if an interface can be established between IPPD and IFMIS. The interface could capture financial transaction data from IPPD, generate the required salary payments in IFMIS automatically and reconcile imprest data. It could also align and update financial code structures in IPPD.

The efforts to reinforce PFM reform efforts have been widely disseminated after the draft PEFA report and in connection with the PFM reform review in November-December 2008. The outcome of these discussions has resulted in new work plans for the PFM reform components for 2009. Comprehensive documentation of the review is available at the Ministry of Finance reform secretariat.

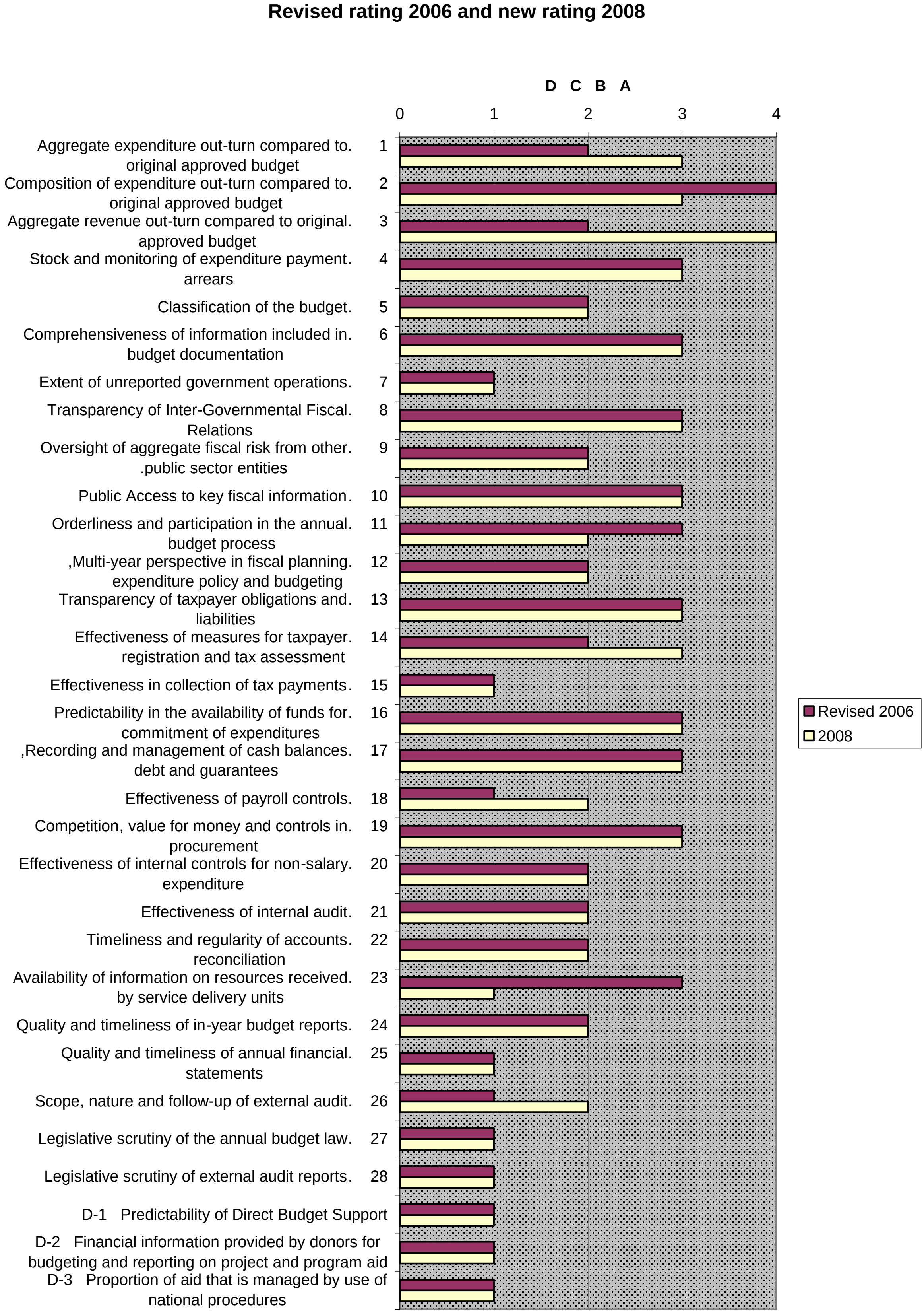
Some main reform efforts in the further PFMR work planning involves further support to the roll-out and implementation of IFMIS and IPPD systems, development of debt management and external resources strategies, improved use, competence and access by auditors of computerized systems, further roll-out of risk based and value for money audit approaches, computerization at the Kenya Revenue Authority of systems for driver's licences and number plates, computer support to Pensions systems, capacity building in a number of subjects such as project management, computer knowledge, and through benchmarking and study visits. Also capacity building to enhance Parliament's oversight function is included.

iii) ***SUMMARY OF PFM PERFORMANCE SCORES - KENYA 2008***

Table (i) Summary of PFM Performance Scoring	Original Score 2006	Revised Score 2006	Score 2008
A. Credibility of the Budget			
1. Aggregate expenditure out-turn compared to original approved budget	C	C	**B**
2. Composition of expenditure out-turn compared to original approved budget	A	A	**B**
3. Aggregate revenue out-turn compared to original approved budget	C	C	**A**
4. Stock and monitoring of expenditure payment arrears	B	B	**B**
B. Comprehensiveness and Transparency			
5. Classification of the budget	C	C	**C**
6. Comprehensiveness of information included in budget documentation	B	B	**B**
7. Extent of unreported government operations	C	D+	**D**
8. Transparency of Inter-Governmental Fiscal Relations	B	B	**B**
9. Oversight of aggregate fiscal risk from other public sector entities.	C+	C	**C•**
10. Public Access to key fiscal information	B	B	**B**
C. Budget Cycle			
C (i) Policy-Based Budgeting			
11. Orderliness and participation in the annual budget process	B	B	**C+**
12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	C	C	**C+**
C (ii) Predictability and Control in Budget Execution			
13. Transparency of taxpayer obligations and liabilities	B	B	**B+**
14. Effectiveness of measures for taxpayer registration and tax assessment	C+	C+	**B**
15. Effectiveness in collection of tax payments	D+	D+	**D+**
16. Predictability in the availability of funds for commitment of expenditures	B+	B+	**B+**
17. Recording and management of cash balances, debt and guarantees	B	B	**B**
18. Effectiveness of payroll controls	D+	D+	**C+**
19. Competition, value for money and controls in procurement	B	B	**B**
20. Effectiveness of internal controls for non-salary expenditure	C	C	**C**
21. Effectiveness of internal audit	C	C	**C+**
C (iii) Accounting, Recording and Reporting			
22. Timeliness and regularity of accounts reconciliation	C	C	**C+**
23. Availability of information on resources received by service delivery units	B	B	**D**
24. Quality and timeliness of in-year budget reports	C+	C+	**C+**
25. Quality and timeliness of annual financial statements	D+	D+	**D+**
C (iv) External Scrutiny and Audit			
26. Scope, nature and follow-up of external audit	D+	D+	**C+**
27. Legislative scrutiny of the annual budget law	D+	D+	**D+**
28. Legislative scrutiny of external audit reports	D+	D+	**D+**
D. Donor Practices			
D-1 Predictability of Direct Budget Support	D	D	**D**
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	D	D	**D+**
D-3 Proportion of aid that is managed by use of national procedures	D	D	**D**

The column " Revised score 2006" reflects adjustments due either to new knowledge of 2006 conditions, data coverage provided from PFM systems, or revised guidelines for rating that have been issued by the PEFA secretariat since the 2006 rating which would have altered the rating made. See Appendix A for further detail. A + indicates that a sub-dimension has received a higher score.

A diagrammed comparison between the revised 2006 score and the score for 2008 is made in the following (4=A, 3=B, 2=C, 1=D).



1. INTRODUCTION

1.1 Objective of the Public Financial Management Performance Report Process

The main rationale for a PEFA assessment[1] is to identify strengths and weaknesses in the Public Financial Management system. The assessment shall serve as a basis for further PFM reform programming and planning. An efficient PFM system is a key factor to the efficient use of a nation's scarce public resources and the realization of public sector objectives such as poverty reduction, and support towards national growth and prosperity. A trustworthy and efficient national PFM system is also one important prerequisite for donors to provide general budget support and to use national PFM systems.

The decision to carry out this PEFA assessment results from the GoK's recent commitments to improve their good governance even further. The last PEFA in Kenya was carried out in 2006, and both development partners and the Kenyan Government see the value added by performing a second PEFA to follow-up two years later on the progress achieved on the indicators and the PFM reform.

In the short-term, the PEFA assessment will follow–up on progress against the PEFA indicators from the 2006 assessment and will be used as a basis for information and monitoring so as to:

(i) facilitate and update the dialogue on PFM between Government and development partners;
(ii) *help* donors assess the eligibility of a country for budget support programmes, or to verify whether general or specific PFM conditions of an ongoing budget support programme are met.

In the medium-term, the PEFA assessment will be useful to assist the Government in strategizing and prioritising the implementation of the PFM Revitalisation strategy, and in the PFM reform review and planning.

It is important to underline that the purpose of the assessment hasn't been to evaluate and score different institutions or responsible individuals in the Government. The focus is on the PFM system and institutions' performance.

1.2 Methodology for the Evaluation

The PEFA assessment has been organized and financed by the European Union supported by other donors at the request of the Kenyan Government and PFM reform donors. After a tender process EU contracted LINPICO, to carry out the assessment. Additional technical assistance to the mission was granted by GTZ, that provided for the assistance of Maurice Ochieng. The assessment mission took place between 11 September and 24 October 2008. The team carried out two missions in Kenya, 13-26 September 2008, and 12-24 October 2008. In addition a 2 day follow up visit by the team leader took place in February 2009 to ascertain data for assessment of indicators 1 and 2.

The assessment exercise involved:

- Collection and analysis of existing documentation concerning Kenya's Public Financial Management System
- A one day seminar to present the methodology and indicators, 18 September 2008
- Hearings with key stakeholders with responsibilities within the PFM system and with co-operating partners
- Independent confirmation on data and information either from additional interviews or from recent reports

[1] The PEFA PFM Performance Measurement Framework was developed in conjunction with a group of co-operating partners as a tool for the measurement and monitoring of PFM systems performance. It defines the content of a PFM performance report, and a set of high-level indicators covering all aspects of public financial management. See further www.pefa.org.

- Discussions within the assessment team to reach and consolidate a common approach and interpretation of data and presentation of information
- First feedback sessions of preliminary findings with MoF and co-operating partners in Nairobi 26 September 2008
- Questions to and answers from the PEFA secretariat in Washington on key definitions and scoring method
- Continued hearings and a field visit to Machakos (District, hospital and school) 16 October 2008
- Presentation of conclusions, preliminary findings and major observations presented in an aide memoire 24 October 2008 to Government and donor representatives
- Presentation of the first draft report 3 November 2008
- A referral procedure to all the concerned officials to safeguard that facts are correct.
- Referral of the draft report to the PEFA secretariat in Washington
- Revisit data definitions and data for indicators 1 and 2 to ascertain consolidated data, adjustment of data calculations and scoring.
- Finalization of the report incorporating relevant and accepted comments

TOR for the assessment can be found in Annexure A.

1.3 Scope of the Assessment

The assessment covers most of the public financial management systems and processes including budgeting, accounting and reporting, payment, procurement, debt management, tax administration and audit.

The public sector in Kenya comprises the central government, distributed national government Provincial and District level administration, local authorities, state-owned public enterprises, semi-autonomous government entities as well as special funds. The assessment focuses on central government PFM, although the relationship and oversight of other public entities is included.

1.4 Structure of the report

The evaluation report has been structured as follows:

Section 2 provides country background information for the evaluation;
Section 3 summarizes the assessment in terms of main performance for the seven aspects of the PFM system studied by the PEFA instrument;
Section 4 describes government's reform programme and institutional factors supporting that programme.

A series of annexes provide more detailed reference information;

- A. TORs for the evaluation
- B. Summary of the scoring of the performance indicators with comparison towards the 2006 assessment
- C. List of the stakeholders visited by the team
- D. Sources of information

2. COUNTRY BACKGROUND INFORMATION

2.1 Description of Kenya's Economic Situation

The following table presents some main economic indicators for Kenya for the period 2003/04-2007/08.

Table 1 : Selected Economic Indicators 2003/04-2007/08

	2003/04	2004/05	2005/06	2006/07	2007/08
	Annual percentage change, unless otherwise indicted				
National Accounts and Prices					
Real GDP growth (market prices)	2.6	5.4	6.1	6.7	3.9
Consumer Price index (annual average			11.1	10.4	18.5
Consumer Price Index (end of period)	5.9	11.9	10.9	11.1	29.3
KES per US$ exchange rate (end of period)			69.3	62.6	64.6
	In percent of GDP, unless otherwise indicated				
Investment and Saving					
Investment	17.9	17.0	18.0	19.1	20.0
Central Government	1.9	3.1	4.2	4.6	6.7
Other	15.9	13.9	13.8	14.5	13.3
Gross National Saving	16.9	15.3	16.0	16.7	15.4
Central Government	1.2	0.2	0.0	2.0	1.2
Other	15.7	15.1	16.0	14.8	14.3
Central Government Budget					
Total Revenue	21.1	21.5	20.5	21.7	22.3
Total Expenditure and net lending	22.9	22.6	25.2	24.4	28.3
Overall balance (commitment basis) excl grants	-1.8	-1.0	-4.7	-2.7	-6.0
Overall balance (commitment basis) incl. grants	0.0	0.1	-3.4	-1.8	-4.8
Net domestic borrowing	0.7	-0.5	1.9	2.0	1.6
Total donor support (grant and loan)	2.3	1.6	1.9	1.5	3.8*
Foreign Grants			1.3	0.9	1.5
Balance of Payments					
Exports value, goods and services	23.8	28.1	26.6	25.5	24.9
Imports value, goods and services	29.1	35.1	35.9	35.2	36.6
Current external balance, incl. official transfers	-1.0	-1.7	-2.0	-2.4	-4.6
Current external balance, excl, official transfers	-1.4	-1.7	-2.3	-4.8	-6.7
Gross international reserve coverage in months of next year imports (end of period)	2.8	2.6	3.3	2.9	3.1
Public Debt					
Nominal central government debt (eop), net	45.7	51.0	42.3	38.8	38.0
Domestic (net)	21.1	18.7	18.4	19.5	18.5
External (end of period)	24.3	32.3	26.7	22.8	20.3
Nominal GDP (in KES billion)	1,208	1,346	1,519	1,717	2.077
Source: Ministry of Finance, Medium Term Budget Strategy Paper (various) Ministry of Finance, Quarterly Economic and Budgetary Review (various) IMF, Staff Report for the 2008 Article IV Consultation. (Aug 2008)					

Kenya has experienced a period of considerable GDP growth, with a slow-down 2007/08 mainly attributed to the post election crisis. 2007/08 also involved a considerable rise of consumer prices.

The recently presented ROSC report – fiscal transparency module – by IMF from January 2008 presents the main elements of the total public spending or general government budget as follows:

Box 1. General Government in Kenya	Percent of GDP# 2007/08
General government in Kenya comprises the following :	
Central Government Units Covered by the Budget	
1. Parliament, president's office, judiciary, 31 ministries, 9 departments, and 3 statutory commissions (approximately Ksh 500.4 billion) *	**24.3**
2. Consolidated Fund Services – public debt, pensions, statutory obligations (Ksh 154.2)	**7.5**
Central Government Units with Individual Budgets	
3. Over 140 fund accounts, semi-autonomous government agencies, extra-budgetary funds, and regional development authorities (estimated at Ksh 60 billion) **	**2.9**
Local Government	
4. 175 local authorities (estimated at Ksh 20 billion, including LATF transfer)	**1.0**
5. Constituency Development Fund (Ksh 10 billion)	**0.5**
Total General Government	**36.2**

GDP projection for 2007/08 is set at Ksh 2,059 billion, according to BSP 2007.
* excluding Consolidated Fund Services, transfers to semi-autonomous government agencies and extra-budgetary funds (estimated), and transfers to local authorities (LATF)
** exact number not available.

It can be observed that Local Government (i.e. Local Authorities) with a fairly limited mandate only caters for 1 % of GDP or some 3 % of the total general government budget. The transfer to the Constituency Development Fund, which is included in central government expenditure above, amounted to KES 9.7 bn in 2006/07.

The central government budget – being the main public budget - has been contained at around 24 % of GDP with an overall negative balance averaging –2 % of GDP, except for 2007/08 when it rose to - 4.8 % of GDP. The public debt has dropped as a %-age of GDP from figures between 42 and 51 % in 2003-2006 to 38 % of GDP in 2006-2008. The balance between external and internal debt has been fairly stable with external debt slightly more than domestic debt.

A specific feature is the grant to Constituency Development Funds (CDFs), which is funding made available for smaller development projects at Parliamentary Constituency levels, where the MP's have an influence on how this support is used. Although some of that funding is used for "traditional" government projects, such as the building of schools and clinics, it has been regarded as non-government transfers for the purpose of the analyses in this report. This is in accordance with advice provided by the PEFA secretariat. In 2006/07 the total transfers from Central Government for CDF was KES 9.7 bn (which represented 2.3 percent of actual Total Expenditure and Net Lending in the same financial year). Central government and LA councils do not decide on the use of CDF resources or approve CDF projects. The responsibility remains with the 10-member CDF committees which consist of non-government representatives including MPs, local political activists, businessmen, representatives of community groups, etc. Under the 2006 PEFA, the Constituency Development Fund (CDF) was not considered a sub-national government transfer, and more recently the PEFA Secretariat has confirmed that CDF transfers are not inter-governmental transfers under PI-7 and are reflected under PEFA PI-1.

Local Authorities finance around 40 % of their budgets through grants from central government, the largest being to the Local Authority Trust Fund (LATF).

The LAs have large outstanding debts which rose from 10.6 KES bn at the end of June 2006 to KES 12.9 bn at the end of June 2007, mainly due to the increased coverage of Nairobi City Council which is responsible for nearly half of all debt outstanding and the 10 most indebted LAs are responsible for 79% of the total outstanding debts.

The LA total outstanding debt includes: arrears in statutory contributions to NSSF; Superannuation Fund and Provident Fund plus salary arrears; arrears in income tax payments (e.g. unremitted P.A.Y.E deductions); and other outstanding bills. The MOLG has recently commissioned two separate studies from consultants: (i) to consolidate and update the latest figures on LA debt; and (ii) to analyse policy options for addressing the high level of debt outstanding among LAs.

Over the four year period 2003/04-2006/07 total external support (loans and grants) has averaged 2 % of GDP and foreign financed development aid and net lending averaged 6,5 % of the actual total expenditure and net lending over the same period. It is estimated to contribute to some 50 % of central government's development expenditure.

Following the Paris declaration and the Accra conference in July 2008 efforts should be made to replace more of the external aid with general or sector budget support. Such a shift would require that Kenya has a well functioning PFM system to provide the donors with guarantees that the added and domestic resources are handled with great care and in line with best financial management practices. Currently only the EU provides limited general budget support.

2.2 Description of Budgetary Outcomes

Fiscal performance

Public spending in Kenya has averaged around 24 % of GDP in recent years (See table overleaf). Both revenue and expenditure as a %-age of GDP has been fairly stable over the three year period.

Kenya: Central Government Operations
by Economic Classification (KES billions)

	2003/04	2004/05	2005/06	2006/07	2007/08	2007/08
	Actual	Actual	Actual	Actual	EBS/ 07/124	IMF Staff proj
Revenue	**255,1**	**289,8**	**311,3**	**373,0**	**427,2**	**442,2**
Expenditure and Net Lending	**276,5**	**303,7**	**382,8**	**419,5**	**557,3**	**562,0**
Recurrent Expenditure	240,8	258,1	315,1	339,2	403,8	422,1
Interest Payments	30,8	30,8	41,2	42,5	49,7	47,9
Wages and Salaries	95,9	95,9	112,3	127,3	144,0	146,4
Civil Service Reform	0,3	0,3	1,3	1,4	0,5	0,8
Pensions	12,2	12,2	19,8	20,4	24,4	24,3
Other	81,1	81,1	111,8	119,0	139,6	157,1
Defense and NSIS	20,2	20,2	29,3	28,7	45,7	45,8
Pending Bills (change)	0,3	-3,0	-0,5	-0,1	0,0	-0,2
Development and Net Lending	**35,8**	**45,627**	**67,7**	**80,3**	**147,8**	**140,0**
Domestically financed	21,2	22,6	40,5	53,5	81,1	87,8
Foreign financed	17,1	22,1	23,1	26,1	60,3	45,8
Net Lending	1,4	0,9	1,0	1,4	2,4	2,4
Pending Bills (change)	-3,9	0,0	-1,0	-0,7	0,0	0,0
Civil Contingency Fund			0,0	0,0	2,0	0,0
Drought Expenditure	0,0	0,0	0,0	0,0	3,7	0,0
Balance (commitment basis excl grants)	**-21,5**	**-13,903**	**-71,6**	**-46,5**	**-130,1**	**-119,8**
Grants	15,8	14,9	20,1	15,5	30,7	24,2
Balance (commitment basis incl grants)			-51,5	-31,0	-99,4	-95,7
Adjustment to cash basis	1,5	0,4	14,2	1,6	0,4	0,4
Adjustment to cash basis (incl grants)	-4,2	1,4	-37,2	-29,4	-99,0	-95,3
Financing	**-4,9**	**-7,298**	**35,0**	**35,5**	**99,0**	**99,2**
Net foreign financing	-8,9	-0,625	-0,2	-3,1	29,0	9,9
Net Domestic financing	8,8	-6,673	28,3	34,7	34,0	21,8
Financing Gap	-4,9	0	2,2	-6,2	0,0	-3,9
Source:						
IMF Staff Report for the 2008 Article IV Consultation (Aug 2008)						
Ministry of Finance, Budget Strategy Paper and Quarterly Budget Review						

The table includes all development and recurrent spending as well as contingency fund spending including interest payments, for both central and local government.

The same figures presented as %-age of total expenditure give the following picture:

Kenya: Central Government Operations - by Economic Classification (Percent of Total Expenditure and Net Lending)

	2003/04	2004/05	2005/06	2006/07	2007/08	2007/08
	Actual	Actual	Actual	Actual	EBS/07/124	IMF Staff proj
		as percent of Total Expenditure and Net Lending				
Revenue	**92,2**	**95,4**	**81,3**	**88,9**	**76,7**	**78,7**
Expenditure and Net Lending	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**	**100,0**
Recurrent Expenditure	87,1	85,0	82,3	80,9	72,5	75,1
Interest Payments	11,1	10,1	10,8	10,1	8,9	8,5
Wages and Salaries	34,7	31,6	29,3	30,3	25,8	26,0
Civil Service Reform	0,1	0,1	0,3	0,3	0,1	0,1
Pensions	4,4	4,0	5,2	4,9	4,4	4,3
Other	29,3	26,7	29,2	28,4	25,0	28,0
Defense and NSIS	7,3	6,7	7,7	6,8	8,2	8,1
Pending Bills (change)	0,1	-1,0	-0,1	0,0	0,0	0,0
Development and Net Lending	**12,9**	**15,0**	**17,7**	**19,1**	**26,5**	**24,9**
Domestically financed	7,7	7,4	10,6	12,8	14,6	15,6
Foreign financed	6,2	7,3	6,0	6,2	10,8	8,1
Net Lending	0,5	0,3	0,3	0,3	0,4	0,4
Pending Bills (change)	-1,4	0,0	-0,3	-0,2	0,0	0,0
Civil Contingency Fund	0,0	0,0	0,0	0,0	0,4	0,0
Drought Expenditure	0,0	0,0	0,0	0,0	0,7	0,0
Balance (commitment basis excl grants)	**-7,8**	**-4,6**	**-18,7**	**-11,1**	**-23,3**	**-21,3**
Grants	5,7	4,9	5,3	3,7	5,5	4,3
Balance (commitment basis incl grants)	0,0	0,0	-13,5	-7,4	-17,8	-17,0
Adjustment to cash basis	0,5	0,1	3,7	0,4	0,1	0,1
Adjustment to cash basis (incl grants)	-1,5	0,5	-9,7	-7,0	-17,8	-17,0
Financing	**-1,8**	**-2,4**	**9,1**	**8,5**	**17,8**	**17,7**
Net foreign financing	-3,2	-0,2	-0,1	-0,7	5,2	1,8
Net Domestic financing	3,2	-2,2	7,4	8,3	6,1	3,9
Financing Gap	-1,8	0,0	0,6	-1,5	0,0	-0,7

The central government expenditure distribution related to main administrative classification gives the following distribution for 2006/07 (This table includes expenditure covered by external financing – AiA and Revenue, grants and loans, but excludes debt service, source: Original estimates and CAG:s annual reports, compiled by the PEFA team.)

		2006/07		**percent of**
Vote	Ministry, Dept. Agency	**budget**	**actual**	**total actual expenditure**
31	Min of Education	98 987	101 042	25%
07	Min of Finance	51 389	41 235	10%
13	Mind of Roads	45 996	30 447	8%
11	Min of Medical Services	33 327	27 530	7%
01	Office of the President	29 191	26 688	7%
08	Min of Defence	27 490	25 123	6%
10	Min of Agriculture	10 282	10 014	3%
20	Min of Water and Irrigation	10 481	9 504	2%
12	DPM and Min of Local Government	9 416	9 189	2%
30	Min Of Energy	8 776	8 576	2%
14	Min of Transport	5 413	7 913	2%
05	VP and Min of Home Affairs	7 910	7 157	2%
04	Min of Foreign Affairs	7 740	6 588	2%
35	Min of Special Programmes	6 418	6 029	2%
45	National Security Intelligence Service	6 000	5 927	1%
29	National Assembly	4 404	4 533	1%
42	Min of Youth Affairs and Sports	4 190	4 154	1%
19	Min of Livestock Development	4 923	4 132	1%
21	Min of Environment and Mineral Resources	4 022	3 557	1%
CFS	Excl debt service	22 179	20 692	5%
	All the rest	44 638	39 637	10%
		443 172	**399 668**	100%

With the growing economy, the government has been able to expand on government revenue collection and expenditure. There has been a marked increase in the share allocated to development (from 12% to 25 % of the budget over the five year period) whereas the share towards recurrent expenditure has dropped from 85% to 75 % of the budget. Although increasing in total figures the shares for interest and salaries and wages of the total budget have decreased. The largest increase also in terms of share of the budget is for domestically financed development expenditure and for defence and national security costs.

On the whole the budget situation is favourable with increased mobilization of revenue, contained public debt, no alarming increases in the public salaries, wages and pension costs, share of the budget and a public resource envelope for central government at a stable level of 21 % of GDP. The problems from the post election conflict are however visible as evidenced by a drop in GDP growth and an increase in the budget deficit, and it remains to be seen how the Kenyan economy might be affected by the current global financial crisis.

2.3 Description of the legal and institutional framework for PFM

The legal framework

A current presentation of the legislation as at the end of 2007 can be found in the IMF ROSC – fiscal transparency module - report of 29 January 2008 (IMF Country Report 08/99).

Box 2. Legal Framework for Public Finance Management in Kenya

The current PFM legal framework in Kenya includes:

- The **Constitution of 1963**, which sets out the broad responsibilities of the executive and legislature in matters concerning public finance (Chapter VII).
- The **Government Financial Management Act of 2004**, which assigns responsibility for the Consolidated Fund and matters related to public financial management to the Minister of Finance, as well as 'Treasury' responsibilities for public finance management procedures and powers to access documentation. It assigns responsibilities to Accounting Officers for effective, efficient, economical and transparent management of monies appropriated to them by Parliament, and establishes the key offices of Accountant General, Budget Director and Internal Auditor General. The Act focuses on withdrawals from the Consolidated Fund and payments, but does not cover budget formulation and hardly covers budget execution processes. Regulations under this Act have not yet been issued and compliance as well as application of sanctions remain weak.
- **Government borrowing is regulated under 4 separate Acts:** the **External Loans and Credit Act of 1967**, which requires Parliamentary approval for all external loans entered into by the government,[14] the **Internal Loans Act of 1978**, which regulates domestic borrowing, the **Central Bank Act (1966, revised 1996)** which caps government overdraft borrowing to 5 percent of the latest audited revenues, and the **Guarantee (Loans) Act (1961)**, which regulates the ability of government to issue loan guarantees to third parties.
- The **Public Audit Act of 2003,** which provides the legal framework for the external audit oversight function across the whole of the public sector.
- The **Public Procurement and Disposal of Public Assets Act of 2005** which sets out the legal framework for public procurement across the whole of the public sector.
- The **Kenya Revenue Authority (KRA) Act which** establishes the KRA and assigns it responsibilities for revenue administration.
- The **Local Government Act of 1986 (revised 1998)** provides for public finance management within Local Authorities, while the **State Corporations Act of 1986** does the same for SAGAs and EBFs.

Other PFM regulations:

- ***In practice***, for day to day public finance management staff still refer to the outdated **Government Financial Regulations and Procedures of 1989 (revised in 1992)**, which derive their authority directly from the Constitution or from older fully or partly repealed legislation, notably the Paymaster General Act, and the Exchequer and Audit Act (repealed when the GFMA was adopted), as well as the multitude of treasury circulars which have modified these regulations and procedures over the years.

[14] **The External Loans and Credit Act (Cap 422) was amended to effect increases from KES 320 bn to KES 500 Billion the maximum amount the Minister can borrow from external resources. Similarly the maximum amount under (Cap 461) guaranteed Loans Act, was increased from KES 40 billion to KES 80 billion in July 1993.**

The Institutional Framework for PFM

The Legislature and Cabinet

Kenya is a multi-party democracy and a Republic with a population of approximately 33 million inhabitants (2008, projected by the Kenya National Statistics Office). The Constitution of Kenya provides for the establishment of a National Assembly with 224 members. The President is elected through an electoral system. Cabinet consists of the President, vice President and other ministers including the Prime Minister. There are currently 29 ministers and 43 assistant ministers appointed by the President among the Members of the National Assembly.

Parliament elects a Public Accounts Committee and a Budget Committee. The Public Accounts Committee scrutinizes the report of the Controller and Auditor General and has the power to call persons and records and take evidence.

Regional and Local Government

Kenya has one local government layer consisting of 175 local authorities. The local authorities have limited functions compared to many other countries. Primary Education and Health is for example not a local government responsibility.

The Executive

The executive authority of Kenya is vested in the President or through officers subordinate to him/her. The President appoints the Vice President amongst members of the National Assembly.

The Revenue functions are organised under the Kenyan Revenue Authority led by a Commissioner General. There remains a revenue oversight function in the Ministry of Finance.

Debt management is the mandate of the Debt Management Department in Ministry of Finance.

The external audit function is exercised by the Controller and Auditor General who is appointed by the President, but reports to the National Assembly. The CAG heads the Kenya National Audit Office (KENAO).

The Central Bureau of Statistics Office publishes national statistics for Kenya including some national and public finance statistics.

With a few exceptions, The National Bank of Kenya operates Government's bank accounts.

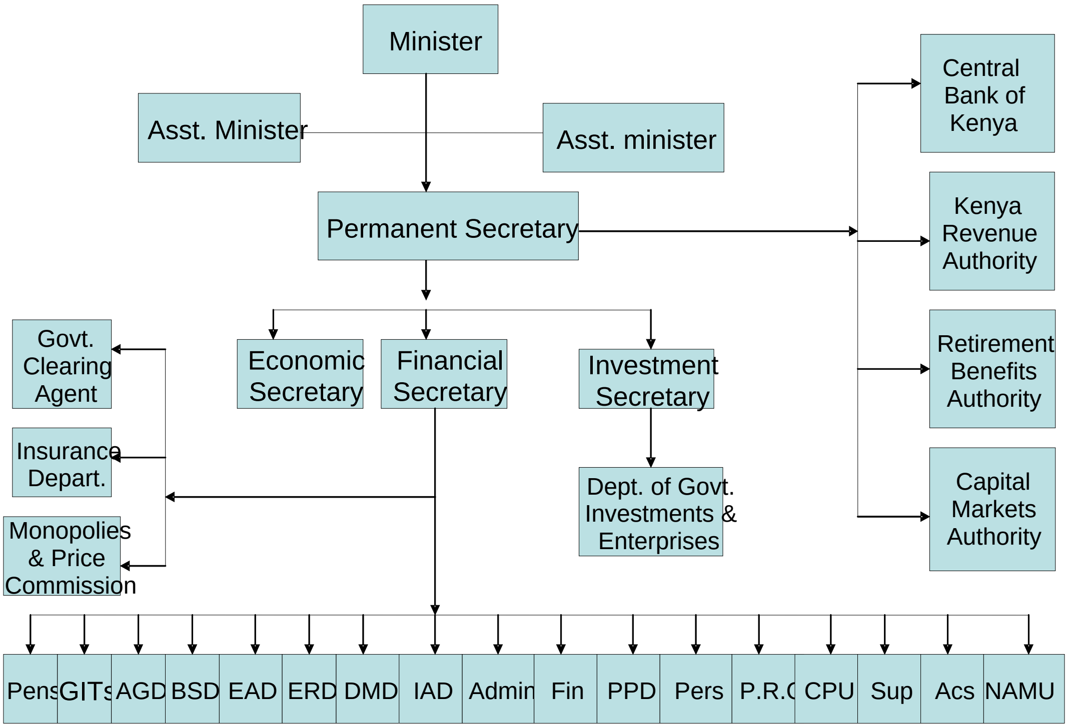
The Public Procurement Oversight Authority (PPOA) has recently been establish to oversee that the public procurement legislation is implemented and issues further guidance.

The Public Service Commission has an independent status and decides on matters pertaining to career structures and salaries and major appointments and promotion. The Department of Personnel Management in the Office of the President is responsible for administrative matters related to the public service establishment and overall questions related to the pay-roll.

The person answerable to the National Assembly in respect of any Government Department is the Minister charged with the responsibility for that department. The public officer responsible for the running of any department in the charge of a Minister, including the management of its financial affairs, is the Accounting Officer – in most cases a Permanent Secretary.

The organizations of the Ministry of Finance and of the Ministry of Planning are depicted overleaf:

Ministry of Finance Organization Structure

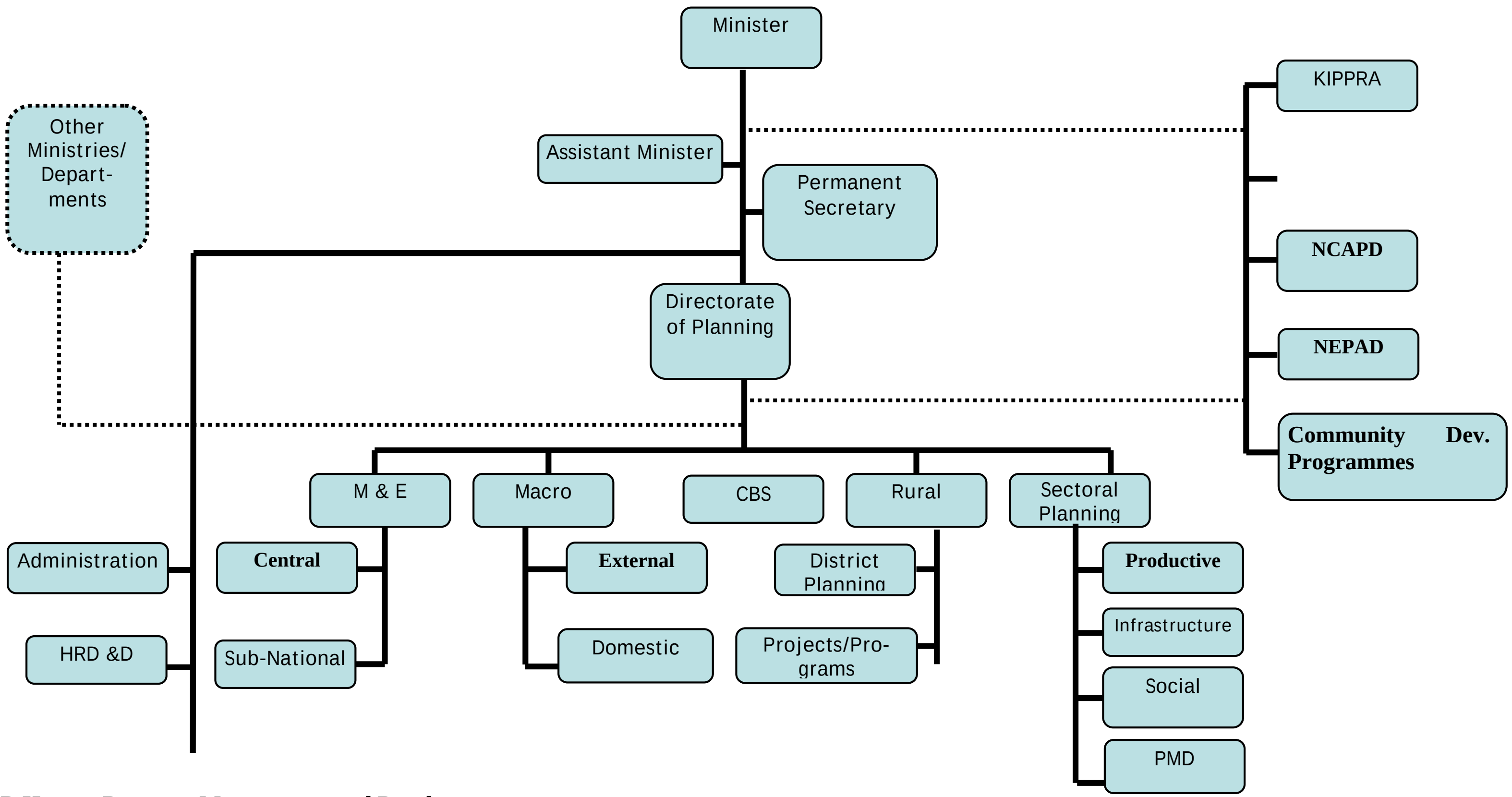


KEY:

ACs	Accounts Division
Admin	Administration Division
AGD	Accountant General Department
BSD	Budgetary Supply Department
DMD	Debt Management Department
ERD	External Resources Department
Fin	Finance Division
EAD	Economic Affairs Department
GITs	Government Information Technology Services
IAD	Internal Auditor Department
Ins	Insurance Department
MPC	Government Clearing Agency
PD	Pensions Department
M &PC	Monopolies and Price Commission
Pers	Personnel Division
PPD	Public Procurement Directorate
PRO	Public Relations Officer
Sup	Supplies Division

In addition GDIPE (Department of Investments and Public Enterprises) and a Business regulatory reform unit have recently been established in the Ministry of Finance. An Insurance Regulatory Authority has also been created under MoF.

Ministry of Planning Organizational Structure



KEY:
HRD&D **Human Resource Management and Development**
M & E **Monitoring and Evaluation**
PMD **Programme Management and Development**
KIPRA **Kenya Institute for Public Policy Research and Analysis**
NCAPD **National Council for Population Development**
NEPAD **New Partnership for Africa Development**

Key features of the PFM system

In essence a PFM system is composed of a series of more or less integrated processes and systems for:

- Macroeconomic planning and long term fiscal projections
- Revenue mobilization
- Budget preparation and MTEF
- Budget execution and monitoring, including accounting, payments, procurement, payroll management and commitment control
- External control and audit

In the case of Kenya, the institutional set-up is based on the UK Westminster model.

Some specific features worth noting are:

Macro-economic planning
Is a shared responsibility between the Ministries of Planning and Finance?

All Government revenue shall according to the Constitution be paid into and form the Consolidated Fund. Expenditure can be covered through the consolidated fund by authorization in Parliament of an Appropriation Law based on Annual Estimates or by an approved supplementary appropriation law. Capital expenditure is appropriated from the Capital Fund. There is also a contingency fund that is used for extraordinary and emergency expenses to be covered by supplementary estimates.

Section 100 of the Constitution mandates the Ministry of Finance to table before Parliament for consideration and approval, an annual budget before the 20th June each year. It involves three years of expenditure estimates. The revenue estimates are presented through the Finance Bill and approved in the Finance Act. The budget year runs from 1 July to 30 June.

The budget is divided into a Capital and a Recurrent budget, the estimates for which are prepared by the Ministries and Departments. Three year MTEF ceilings for each vote are issued before the budget process as a guideline to the sector working groups in the Budget Outlook Paper (BOPA) which is released around January. The finalization of Sector Reports is undertaken in January followed by Sector Hearings in February. This is followed by the development of the Budget Strategy Paper in March and of the itemized budget in April. Cabinet approves the budget proposal in May before it is presented to Parliament.

The capital budget contains development/investment projects and around 50 % is financed by external grants and external loans. The recurrent budget covers running costs and transfers.

Budget execution
Additional resources to the budget can be sought for emergency issues from the Contingency Fund or in other cases by a supplementary appropriation from Parliament.

Most central Government Ministries/Departments headquarters have recently been connected to a central automated Financial Management Information System (IFMIS), based in the Treasury. The connected ministries/departments can access the information and feed data into the system. The system rolled out currently includes the General Ledger, Accounts payable/commitment control and Purchasing. It generates regular reports on expenditure returns and answers specific queries on-line. Accounts are prepared on a cash basis. The GFS standard is used for the structure of reports and cost item division. Modules which are included in the present license agreement for the IFMIS system, but not yet utilized, are the modules for cash management, accounts receivable, asset management and public sector budgeting.

Government's Payments are mainly made by the Central Bank of Kenya. Salaries are paid through employees' personal accounts in commercial banks or in cash.

The Integrated Personnel and Payroll Database (IPPD) is also being rolled out, and now covers around 95 % of central government employees including education and medical staff at district level, the military and police services. The system is automated and integrates the payroll with personnel records, but is not integrated with the IFMIS system. Currently around 490,000 employees are included in the system.

A separate debt management system contains a database for domestic and external debt.

The central government's annual accounts are prepared and forwarded to the Controller and Auditor General individually by each ministry and in summary by the Treasury. The annual financial statements and appropriations account is prepared by the Controller and Auditor General as part of the audit process. The audit report is submitted as the "The report of the Controller and Auditor General to Parliament on the appropriations accounts, other public accounts and the accounts of the funds of the Republic of Kenya." to Parliament.

External control and audit
The Controller and Auditor General heads Kenya National Audit Office (KENAO). All central Government Accounts are subject to external audit by KENAO. Audit reports are submitted to Parliament and are scrutinized by the Public Accounts Committee.

3. ASSESSMENT OF PUBLIC FINANCIAL MANAGEMENT USING THE PEFA FRAMEWORK

This chapter contains the detailed rating for each indicator and dimension. Two methods are used to calculate the overall score of an indicator in accordance with the PEFA guidelines. Method 1 (M1) bases the overall rating on the weakest of the sub-dimensions for that indicator, whereas method 2 (M2) averages the dimensions to arrive at the overall rating. Where methodology M2 is used this has been shown by insertion of M2 in the rating tables. In all other cases method M1 is used or the indicator is one-dimensional.

3.1 Budget Credibility

PI-1: Aggregate Expenditure Outturn compared to original approved budget

In line with the PEFA guidelines, debt service payments have been excluded from the figures presented below as they represent costs over which the government has little control. Foreign Finance Development (ie donor funded projects) expenditure has also been excluded. As external support increasingly is provided on budget, using governments' PFM systems, it is becoming difficult to extract external project funding from the data. In the case of Kenya, external support is registered in the estimates either as appropriations in aid [AiA] (either loans or grants) or as revenue (also loans and grants). AiA's are clearly distinguishable in the accounts, whereas external support registered as revenue doesn't distinguish for source of revenue in the expenditure accounting.

As the external revenue constitutes the major portion received for these projects (> 80 %), an approximation has been made of all revenue received to each project to extract foreign revenue. A cross-check has been made using information compiled by IMF and GoK where direct disbursements to treasury from donors for the projects are listed. Both methods give a similar result in terms of budget actuals.

The data include data for the Consolidated Fund Services for Pensions and Expenses for the Judiciary, but exclude debt service expenditure.

The following table presents the aggregate budget deviation:

Comparison of Original Budgeted and Actual Expenditure, 2004/05-2006/07, *KES bn*			
	2004/05	**2005/06**	**2006/07**
Original Budgeted total primary expenditure	279 179	324 877	377 043
Actual primary expenditure outcome	249 250	306 750	361 412
Difference between actual & original budgeted primary expenditure	-29 928	-18 126	-15 632
Difference as % of original budgeted primary expenditure (%)	-11%	-6%	-4%
Note: 1. Primary expenditures exclude debt servicing payments and donor funded projects. Source: Original Budget Estimates and the CAG Annual reports of final accounts, MoF/IMF tables of external project revenues – grants and loans for 2004/05, 2005/06 and 2006/07			

The deviation in actual expenditure as compared to the approved estimate on aggregate level, excluding interest on public debt and foreign donor funding on development was – 11 % for 2004/05, - 6 % for 2005/06, and -4 % for 2006/07. Hence, in one out of the last three years the total actual expenditure deviated by more than 10 % of budgeted expenditure. For all three years the outturn represented underutilization of the originally approved budget. The score for this indicator is hence a B. This is an improvement compared to the C scoring of 2006. It can also be noted that the trend for this indicator over the last years studied is positive.

The 2006 PEFA assessment did in fact not deduct external funding. Therefore a comparison has also been made for 2008 figures without deduction of foreign financing; still the resulting deviations remain at the same scale and give the same rating, i.e. a B rating for the period 2004/05-2006/07.

PI-2 Composition of expenditure outturn as compared to original approved budget

The PEFA guidelines mention for indicator PI-2 that the administrative basis is preferred, but the functional classification is accepted. For accountability purposes the administrative structure is more fruitful for analysis of the responsibility for deviations. In the case of Kenya there is no estimate or regular actual outturn published related to the functional classification.

The following table depicts the variance by administrative structure for the main government Ministries, Departments and Agencies (MDAs) as well as for the Consolidated Fund Services (CFS) for Pensions and Expenses for the Judiciary, and calculates the overall total variance neutralized for over-spending or under-spending of the aggregate budget.

The data covers the 20 largest administrative votes for the three years, including CFS.

Total Central Government Expenditure excluding debt service and foreign financed development projects over the period 2004-05-2006/07						
Bn KES		**2004/05**				
Vote	Ministry, Dept. Agency	**budget**	**actual**	difference	absolute	percent
31 Total	Min of Education	79 549	77 634	-1 915	1 915	2,4%
01 Total	Office of the President	24 086	27 752	3 666	3 666	15,2%
08 Total	Min of Defence	20 394	20 979	585	585	2,9%
11 Total	Min of Medical Services	16 966	17 071	105	105	0,6%
07 Total	Min of Finance	33 474	16 852	-16 622	16 622	49,7%
13 Total	Min of Roads	13 987	11 416	-2 571	2 571	18,4%
05 Total	VP and Min of Home Affairs	8 044	7 334	-710	710	8,8%
30 Total	Min Of Energy	1 065	1 167	102	102	9,6%
04 Total	Min of Foreign Affairs	5 506	5 835	329	329	6,0%
10 Total	Min of Agriculture	5 420	4 256	-1 164	1 164	21,5%
20 Total	Min of Water and Irrigation	3 779	3 683	-96	96	2,5%
12 Total	DPM and Min of Local Government	5 456	4 936	-520	520	9,5%
29 Total	National Assembly	5 500	4 413	-1 087	1 087	19,8%
45 Total	National Security Intelligence Service	4 145	4 163	17	17	0,0%
14 Total	Min of Transport	4 109	3 235	-875	875	21,3%
19 Total	Min of Livestock Development	5 222	2 671	-2 550	2 550	48,8%
21 Total	Min of Environ-ment and Mineral Resources	2 538	2 504	-34	34	1,3%
16 Total	DPM and Min of Trade	2 097	2 285	188	188	9,0%
46 Total	Tourism and Wildlife	1 662	1 941	279	279	16,8%
CFS	Excl debt service	19 768	14 954	-4 814	4 814	24,4%
	All the rest	16 412	14 171	-2 241	2 241	13,7%
		279 179	**249 250**	**-29 928**	**29 928**	**10,7%**
		279 179	**249 250**		**40 469**	**14,5%**

Bn KES		2005/06				
Vote	Ministry, Dept. Agency	**budget**	**actual**	difference	absolute	percent
31 Total	Min of Education	89 307	87 289	-2 018	2 018	2,3%
01 Total	Office of the President	30 500	36 983	6 483	6 483	21,3%
07 Total	Min of Finance	34 001	25 711	-8 290	8 290	24,4%
08 Total	Min of Defence	26 652	25 609	-1 043	1 043	3,9%
11 Total	Min of Medical Services	22 692	22 367	-325	325	1,4%
13 Total	Mind of Roads	17 863	13 347	-4 517	4 517	25,3%
30 Total	Min Of Energy	1 370	5 130	3 761	3 761	274,6%
05 Total	VP and Min of Home Affairs	8 403	7 381	-1 022	1 022	12,2%
10 Total	Min of Agriculture	6 397	5 527	-870	870	13,6%
12 Total	DPM and Min of Local Government	7 068	6 677	-390	390	5,5%
20 Total	Min of Water and Irrigation	6 172	5 194	-978	978	15,8%
04 Total	Min of Foreign Affairs	6 357	6 302	-55	55	0,9%
45 Total	National Security Intelligence Service	5 200	5 101	-99	99	0,0%
29 Total	National Assembly	5 556	4 764	-792	792	14,2%
14 Total	Min of Transport	3 973	3 604	-370	370	9,3%
19	Min of Livestock Development	2 736	2 817	81	81	3,0%
21 Total	Min of Environment and Mineral Resources	2 865	2 793	-72	72	0,0%
36 Total	Lands	713	2 479	1 766	1 766	247,7%
46 Total	Tourism and Wildlife	1 788	1 915	127	127	7,1%
CFS	Excl debt service	23 341	19 248	-4 093	4 093	17,5%
	All the rest	21 924	16 513	-5 410	5 410	24,7%
		324 877	**306 750**	**-18 126**	**18 126**	**5,6%**
		324 877	**306 750**		**42 562**	**13,1%**

Bn KES		2006/07				
Vote	Ministry, Dept. Agency	**budget**	**actual**	difference	absolute	Percent
31	Min of Education	93 938	94 497	559	559	0,6%
07	Min of Finance	49 220	40 751	-8 468	8 468	17,2%
13	Mind of Roads	26 062	21 070	-4 992	4 992	19,2%
11	Min of Medical Services	23 642	22 777	-865	865	3,7%
01	Office of the President	29 191	26 688	-2 503	2 503	8,6%
08	Min of Defence	27 490	25 123	-2 367	2 367	8,6%
10	Min of Agriculture	7 261	7 857	595	595	8,2%
20	Min of Water and Irrigation	7 081	7 413	333	333	4,7%
12	DPM and Min of Local Government	8 604	8 979	375	375	4,4%
30	Min Of Energy	2 027	3 713	1 686	1 686	83,2%
14	Min of Transport	4 800	5 507	708	708	14,7%
05	VP and Min of Home Affairs	7 669	7 144	-525	525	6,8%
04	Min of Foreign Affairs	7 590	6 583	-1 008	1 008	13,3%
35	Min of Special Programmes	2 920	4 718	1 798	1 798	61,6%
45	National Security Intelligence Service	6 000	5 927	-73	73	1,2%
29	National Assembly	4 404	4 533	129	129	2,9%
42	Min of Youth Affairs and Sports	4 190	4 154	-36	36	0,8%
19	Min of Livestock Development	3 422	3 382	-40	40	1,2%
21	Min of Environment and Mineral Resources	3 131	3 369	238	238	7,6%
CFS	Excl debt service	22 179	20 692	-1 487	1 487	6,7%
	All the rest	36 223	36 533	310	310	0,9%
		377 043	**361 412**	**-15 632**	**15 632**	**4,1%**
		377 043	**361 412**		**29 095**	**7,7%**

	for PI-1 by MDAs and CFS (excluding donor funds and debt service)		for PI-2 by MDAs and CFS (excluding donor funds and debt service)
Year	Total exp. Deviation	Total exp. Variance	**Total exp. variance in excess of Total exp. deviation**
2004/05	10,7%	14,5%	3,8%
2005/06	5,6%	13,1%	7,5%
2006/07	4,1%	7,7%	3,6%

The resulting rating for indicator PI-2 is a B as the variance in expenditure composition exceeded 5 % in no more than one of the last three years. This represents a change downward as the rating in 2006 was an A. The considerable reallocations noted in 2005/06 relate to the Office of the President, and the ministries of Finance, Roads, Energy and Lands.

The following table from the Controller and Auditor General's annual report covering the year 2005/06 revealed the following comparison between the final budget (after adjustments in the supplementary estimates) and actual outturn in relation to the development and recurrent budgets as well as for the consolidated fund services (Debt service, pensions and judiciary):

	GROSS Kshs.	AIA Kshs.	NET Kshs.	UNDER (OVER) Kshs.
RECURRENT				
Estimated	293,882,571,271	34,404,157,601	259,478,413,670	
Actual	271,920,103,101	29,828,429,741	242,091,673,360	
Under (Over)	**21,962,468,170**	**4,575,727,860**	**17,386,740,310**	**17,386,740,310**
DEVELOPMENT				
Estimated	142,542,042,258	38,673,341,278	103,868,700,980	
Actual	105,839,813,298	23,342,555,971	82,497,257,327	
Under (Over)	**36,702,228,960**	**15,330,785,307**	**21,371,443,653**	**21,371,443,653**
CONSOLIDATED FUND SERVICES				
Estimated	140,672,584,403		140,672,584,403	
Actual	129,907,549,995		129,907,549,995	
Under (Over)	**10,765,034,408**		**10,765,034,408**	**10,765,034,408**
Net overall position				**49,523,218,371**

As can be seen all three budgets were under spent, even if the development budget had the largest share - of around 20 %.

Score: B

PI-3 Aggregate revenue outturn compared to original approved budget

The main sources of domestic revenue collected by the Kenya Revenue Authority (KRA) are from: income tax, value added tax, excise duty, import duty; and also revenues collected under Appropriations in Aid. The following table compares actual domestic revenue receipts with the original budgeted estimates over the last three years (excluding revenue to LATF).

Table Comparison of Original Budgeted and Actual Domestic Revenue Receipts, 2004/05 to 2006/07

	2004/05	**2005/06**	**2006/07**
Original Budgeted receipts (KES bn)	273,188	303,202	368,831
Actual receipts (KES bn)	284,839	306,267	366,421
Difference between actual and budgeted receipts (KES bn)	11,651	3,065	-2,410
Difference as % of budgeted receipts (%)	4,3%	1,0%	-0,7%

Note: Data refer to total domestic receipts (excluding loans and LATF)
Source: MOF, Economic Affairs Department, and Quarterly Economic and Budgetary Review (draft 4th Quarter 2007/08)

A comparison of actual receipts against the original budgeted figures indicates that, in aggregate, the budget has been successful to forecast the actual revenue receipts. In two of the past three years, actual revenue received exceeded the budgeted amount; and in only one of the past three years was revenue collection below 99.7% of budgeted domestic revenue estimates. The performance has been good, with a positive trend both in the budgeted and actually collected amounts.

Historically, revenue as a share of GDP has be maintained around 22-24 per cent of GDP in Kenya, and the country's revenue performance has been much higher than in neighbouring countries (Tanzania and Uganda), and higher than the average for all Sub-Saharan Africa countries. The IMF (Staff Report, August 2008, page 5) reports that: "Strong revenue performance has benefited from continued tax administration improvements, a buoyant economy through end-2007, which particularly improved income tax collections, and a 0.3 percent of GDP one-off transfer of collected road fees.

Score: A

PI-4 Stock and monitoring of expenditure payment arrears

Managing expenditure arrears (pending bills) has posed a problem for the Government, and after 2003 it set up a Pending Bills Committee to help manage the problem. The Committee is a hybrid of various working groups such as the Closing Committee and the Vendor Committee (made up of private contractors).

In accordance with Treasury Circular No 13/2005 (Guidelines for the Implementation of the 2005/06 Budget and Prudent Public Financial Management) issued in November 2005, Pending Bills are defined as central government commitments that remain outstanding for more than 3 months, and should be reported to the Director, Budget Supply Department by the 10th day of every month using the format attached to the Treasury Circular.

Pending Bills as defined in the Report of the Comptroller and Auditor-General refers to excess carried forward at the end of the financial year, and the payments have been outstanding for less than 90 days.

The information on pending bills published in the latest Quarterly Economic and Budgetary Review (QEBR draft 4th quarter 2007/08) shows the stock of pending bills has declined from 10.16 KES bn at the end of June 2006 to 8.94 KES bn at the end of June 2008. In absolute terms, this is a reduction of about 13% in the total stock of pending bills. In relative terms, pending bills outstanding at the end of the financial year have also declined as a share of annual Total Expenditure and Net Lending from (2.8%) FY 2005/06; (2.2%) 2006/07; and (1.6%) 2007/08. The latest data in the annual Controller and Auditor General annual report for 2005/06 presents that KES10.6 Bn expenditure incurred, or 2.1 % of the total actual outturn for that year, were remaining unpaid at year end. In accordance with the PEFA guidelines this indicator should however also include salary and pension arrears.

In assessing this indicator the team has made the following observations: In terms of processing of the old stock of arrears which had been identified at the time of the previous PEFA assessment much progress appears to have been made, arrears have been analysed, written off or taken for legal action, and the old stock has been substantially reduced. In terms of new arrears the ministries are reporting arrears using the new IFMIS system for central ministries. However the reporting is not made with reference to age profile and it is not known to what extent the commitment control system has been utilized for this, and how accurate that control currently is. If commitment control figures are used they would contain arrears younger that the stipulated three month period, and could be exaggerating the arrears.

To determine salary arrears the new IPPD system should be able to reveal the amount of salary arrears and delayed salary payments that have been authorized - for the entities IPPD now covers. It was witnessed that some fairly marginal salary arrears exist pertaining to delays in the capture of district data for salaries to new teachers and health staff. No consolidated data for salary arrears exists however.

The reported figures in the QEBR used in the analysis do not include late payments due on pensions or salaries. As in the case of any cash based accounting system, the source document is the Local Supply Order (payment voucher). Where goods and services may have been delivered for which no payment vouchers have been issued, the government has not incurred a legal commitment. Statutory Boards and State Corporations are required to report their pending bills to the Line Ministries, but the coverage may be incomplete.

In conclusion the 2006 assessment did not take all the relevant arrears for this indicator into account. At the same time there are indications that the total outstanding bills have been reduced, and that old pending arrears have been cleared. We are with the current uncertainties related to the age profile of the arrears and the lack of data for salary and pension arrears not in a position to make a final qualified assessment. Oral information received indicates that pension and salary arrears do not constitute any substantial amount or problem. We have chosen to retain the previous assessment of a tentative B for this sub dimension, but recommend a further prudent recording of all these types of arrears, including age profiles for the future.

As for sub dimension ii) data on the stock of arrears is generated annually, but may not be complete for the identified expenditure categories and is hence rated a B.

Performance towards credibility of the budget

The following summary table presents the scoring towards the four indicators that assess the credibility of the Kenya State Budget.

Indicator	Score	Brief Explanation
A. Credibility of the Budget		
PI-1. Aggregate expenditure out-turn compared to original approved budget	**B**	The percentage deviation between actual and originally budgeted primary expenditures were: 2004/05: - 10.7 % 2005/06: - 5.6 % 2006/07: - 4.1 %
PI-2. Composition of expenditure out-turn compared to original approved budget	**B**	The variances in the composition of actual and originally budgeted expenditure across budget heads for the 20 largest MDAs including Consolidated Fund Services for Pensions and Expenses for the Judiciary, but excluding debt service and donor funding of development projects were: 2004/05: 3.8 % 2005/06: 7.5 % 2006/07: 3.6 %
PI-3. Aggregate revenue out-turn compared to original approved budget	**A**	The percentage deviation between actual revenue collected and originally budgeted domestic revenue: 2004/05: 4.3 % 2005/06: 1.0% 2006/07: -0.7 %
PI-4. Stock and monitoring of expenditure payment arrears	**B**	
(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and a recent change in the stock.	*B*	QEBR Pending Bill Stock outstanding KES bn; and share of total Expenditure and Net Lending (percent) End June 2008 8.8 KES bn (1.6%), excluding salary and pension arrears, total estimate 2-3 %
(ii) Availability of data for monitoring the stock of expenditure payment arrears.	*B*	Data for monitoring pending bills is available and published regularly in QEBR; but information is not available on the age profile of pending bills; and complete data on the stock of arrears including Statutory Bodies and State Corporations, pensions and salaries is not reported

3.2 Transparency and Comprehensiveness

PI-5 Classification of the budget

The budget classification follows the following pattern:

Level	Category/Dimension	Representing
1	Recurrent/Development	Recurrent or development
2	Vote	Ministries and Main Funds
3	Subvote	Government sub-function/funds
4	Head	Departments/admin function
5	Sub-head	Lower Administrative unit
6	Item	Nature of cost
-	Geographic	Province, subdivided into Districts

The cost item structure is in line with the GFS 1986 manual and the structure reflected in level 1 through to 5 reflect the budget and governments administrative structure. In addition the geographic coding introduced provides information on spending at Provincial and District level. The structure is reflected both in the budget and in reporting from the IFMIS system that is currently being rolled out. IFMIS had by 1st July 2008 a coverage of 81 % of the budget, calculated as the percentage of the total budget volume for the government entities then using IFMIS. The district administrations and their budgets are still not on the system and have been excluded from the figure. Entities not yet on IFMIS are using the vote-book and general ledger systems, which also allow for reporting according to the main budget structure.

Recurrent revenues are presented according to Heads and Income items, representing types of taxes and other revenue, in the revenue estimate in accordance with GFS standards. Development revenue have a separate coding according to Donor code and Donor item in the estimates, the latter representing a project level. Donor contributions are also categorized as Appropriations in Aid (AiA) or Revenue, and as either loans or grants.

There is no consistent application of a functional classification according to COFOG standard. In the Medium term expenditure framework expenditure ceilings are provided for sectors with a subdivision into the estimate expenditure votes. The sectors are:

Productive sector:
Physical Infrastructure
Education
Health
Governance, Justice, Law and Order
Public Administration
Manpower and special programmes
National Security
Information and Communication Technology

A recent development is that for 2009 MTEF planning; Medical Services, Public Administration, Education and Labour, will be grouped together in a sector working group for the “Human Resources Development Sector” with a sector ceiling.

The subsector grouping includes substantial votes for Finance, Local Government and Provincial administration and Internal security. Such headings don’t disclose what function the allocations refer to, and may contain substantial social security grants etc.

There is little reporting back in accordance with the MTEF sector working group structure, although it covers aspects of a functional classification. There is also no functional coding done yet in the IFMIS system. There is however an on-going discussion to introduce this in the IFMIS code structure.

The National Statistics office produces statistics according to the COFOG classification of government expenditure. The latest available data there is however some years old and doesn't feature in any other government financial reporting.

Indicator	Score	Brief Explanation
PI-5. Classification of the budget	**C**	The budget formulation and execution is based on administrative and economic classification using GFS standards and other standards for consistent reporting.

PI-6 Comprehensiveness of information included in budget documentation

The annual budget documentation for 2008/09 submitted to Parliament consists of the following documents: The Medium Term Strategy Paper, The Budget Speech with Statistical Annex, Estimates of Revenue, Estimates of Recurrent Expenditure, Estimates of Development Expenditure, the Finance Bill and supplement.

Scrutiny of the documents in relation to the assessment criteria gave the following result:

Table 08 - Information included in the budget documents

Aspect	Coverage	Criteria met?
1. Macro-economic assumptions, including at least estimates of aggregate growth, inflation and exchange rate.	Covered both by the Medium Term Budget Strategy Paper and the Budget Speech with appendix.	Yes
2. Fiscal deficit, defined according to GFS or other internationally recognized standard.	As above	Yes
3. Deficit financing, describing anticipated composition.	As above	Yes
4. Debt stock, including details at least for the beginning of the current year.	Details of the debt stock over a six year period covered by the annexure to the budget speech.	Yes
5. Financial Assets, including details at least for the beginning of the current year.	Not covered by budget documentation.	No
6. Prior year's budget outturn, presented in the same format as the budget proposal.	Only on very aggregate level in the Medium Term Budget Strategy Paper	No
7. Current year's budget (either the revised budget or the estimated outturn), presented in the same format as the budget proposal.	Yes, the current years revised budget figures are presented in the Recurrent and Development Expenditure Estimates. Actual outturn is presented in the revenue estimates.	Yes
8. Summarized budget data for both revenue and expenditure according to the main heads of the classifications used (ref. PI-5), including data for the current and previous year.	Summarized data of recurrent and development ceilings are presented in the Medium Term Budget Strategy paper. However it does not include outturn data for the previous year. (Yr -1)	No

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.	Although policies and reforms are presented in the budget speech, the financial implications of both tax related reform and other reforms are not covered in the documentation going to Parliament for Budget discussion. The sector strategies cover this but are not presented as budget documents to Parliament, and are not all up to date.	No

Five out of the nine benchmarks have hence been satisfied. Hence the requirements for level B are met.

Indicator	Score	Brief Explanation
PI-6. Comprehensiveness of information included in budget documentation	**B**	The 2008/09 Budget documents meet 5 of the 9 information benchmarks.

PI-7 Extent of unreported government operations

i) Extra budgetary expenditure other than donor funded projects

An analysis of central government extra budgetary funds in Kenya is important as there are numerous parastatals that receive resources directly from the central government annual budget and collect revenues. The GDIPE lists 161 Statutory Boards and State Corporations (with GOK shareholding of 50% or more) which may be grouped under: Commercial; Regulatory; Facilitating Agents; Government Revenue Collecting Agents; Appeals Boards; Research Institutes; Educational and Training Organisations; Regional Development Authorities; Social and Health Service organisations; and Commissions. In addition, the Government has minority shareholdings (of less than 50%) in several other financial institutions and commercial enterprises.

Recently, the PEFA Secretariat has issued a further Clarification on the scoring of PI-7. The guidance states that the expenditure is “reported” if it is included in the fiscal reports (budget estimates; in year budget execution reports; annual financial statements of central government), either in consolidation with other central government expenditure, or is shown in a separate section or annex of the document, or shown in a separate document presented to the legislature and published at the same time as the fiscal reports. Expenditure is therefore unreported when it fails to be captured in the fiscal reports. Non-tax revenues earned by MDAs (such as user fees; fines, dividends from State-Owned Enterprises; and revenues retained for their own expenditure) should also be reported comprehensively in fiscal reports.

Annex II to the Quarterly Economic and Budgetary Review (Fourth Quarter 2007/08) provides data for 61 parastatals out of a total of 161 parastatals, showing their Central Government Actual Expenditure in 2006/07 was 61.6 KES bn which represented 14.7 % percent of Central Government Total Expenditure and Net Lending in 2006/07 of 419.570 KES bn.

The Medium Term Budget Strategy Paper 2008/09 – 2010/11 (In its Appendix Table 11) covers a longer list of 120 parastatals out of 161 parastatals and provides data on the Current Grants for each parastatal as a single line item. In 2006/07 these current grants totalled 48.633 KES bn and represented 11.6 percent of Total Expenditure and Net Lending in the same year.

Under the Public Audit Act 2003 (Section 13.1 A), Statutory Boards and State Corporations are required to submit their financial accounts within 3 months of the end of their financial year to the

Ministry of Finance, Line Ministries, and the Office of the Controller and Auditor General. GDIPE provided a list of 113 parastatals out of the total number of 161 parastatals that had submitted to Parliament (and Ministry of Finance) audited accounts for the financial year ending June 2007.

The National Assembly Parliamentary Public Investment Committee prepares reports on the accounts of Statutory Boards and State Corporations, but with a time lag. The PIC Thirteenth Report (published in 2006) reported on the financial accounts for some parastatals mainly over the years 1995 – 2000. The PIC Fifteenth Report (published in 2007) covered financial accounts for more recent financial years, and the time-lag is decreasing.

A detailed breakdown of the budgets, actual spending, and actual revenues of these entities is not included in the budget execution reporting for central government, nor in the annual accounts of central government. Comprehensive details for the 161 Statutory Boards and State Corporations on their expenditure and non-tax revenues are not included in the fiscal reports, either in consolidation with other central government expenditure, or shown in a separate annex of the document, or shown in a separate document presented to the legislature and published at the same time as the fiscal reports.

The central government operations of statutory boards and state corporations are regarded as only partially reported. Against the calculations presented above such flows are assessed to constitute at least 10 % of central government total expenditure, rendering a rating at level D.

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

The table below highlights the extent of external donor funding of the budget 2007/08

2007/08	Estimates 07/08	Outcome 07/08 Q report IV
	Bn KES	Bn KES
Gross estimate Development Budget	201.7	131.6
Gross estimate Recurrent Budget	491.9	534.9
Totals	693.6	666.5
Out of which donor funding Development Bg		
Revenue Grants	15.2	22.9
Revenue Loans	17.3	22.8
AiA Grants	21.3	Not available
AiA Loans	27.9	Not available
Total foreign development support	81.7	Not available
Significance	12%	

Donor support to the budget is significant, i.e. above 1 % of total expenditure, even when general sector support is deducted. The support given as revenue grants and loans is provided on the budget, using treasury systems. Support provided as AiA - grants and loans is disbursed by donors using other payment systems. As can be seen from the budgeted figures, more than 50 % or 49.2 out of the 81.7 Bn KES were provided as AiA. Government officials report difficulties to get reliable reports on the disbursement of AiA. This relates also to loans where some donors pay contractors directly in their home countries without providing government with information. Much of the assistance provided as AiA is reported late, in different formats or not at all.

The Auditor General reported in the latest annual audit report covering financial year 2006/07 that payments as grants of 3.8Bn KES for 18 projects from 8 donors were not included in the original estimates.

We therefore conclude that information on donor financed projects included in fiscal reports is seriously deficient and does not cover all loan financed operations resulting in a D rating.

Indicator	Score	Brief Explanation
PI-7. Extent of unreported government operations	**D**	
(i) Level of unreported extra-budgetary expenditure	D	There are 161 parastatals (including SAGAs, Trust Funds, State Corporations with majority State ownership). SAGAs are estimated to represent less than 10 % of these. Preliminary actual expenditure and current grants represented more than 10% of total expenditure; Comprehensive details on their expenditure and non-tax revenues are not included in the fiscal reports, either in consolidation with other central government expenditure, or shown in a separate annex of the document, or shown in a separate document presented to the legislature and published at the same time as the fiscal reports.
(ii) Income/expenditure information on donor-funded projects	D	Information on donor financed projects included in fiscal reports is seriously deficient and does not even cover all loan financed operations

PI–8 Transparency of inter-governmental fiscal relations

In Kenya, the Local Authorities (LA) remain the only decentralised level of government. They consist of 175 LAs, providing primarily municipal services. In 2006/07 the total revenue of LAs was 20.6 KES bn, of which 60% was from own source revenue (12.9 KES bn) and 40% was from central government (Local Authority Transfer Fund 7.5 KES bn; Road Maintenance Fund 0.9 KES bn; and Contributions in Lieu of Rates 0.3 KES bn). In addition there are central government transfers under: Women's Fund; and HIV/AIDs Fund. In 2006/07, expenditures by LAs from own revenues and central government, represented less than 4.9 percent of Central Government expenditure and net lending for the same year.(IMF: Staff Report, August 2008, Annex 2).

The LATF Act (1998) and LATF Regulations (most recently updated in 2007) set out the transparent criteria for the allocation of funds to each LA under LATF; The LATF Distribution Criteria and Allocations for each FY follow the LATF Regulations and are published in the LATF Annual Reports. According to the LATF Annual Report for FY 2006-07 (page 23 – 31), the LATF criteria were:

- A basic minimum lump sum of KES 1.5 million was allocated to each LA
- Sixty percent was allocation based on the relative population of each LA
- The balance was allocated based on the relative urban population of each LA

The LATF Components are:

1. Service Delivery Component funds [60%] are released based on the submission of an annual budget, which meets certain minimum conditions, and confirmation that all statutory payments have been made on a current basis.
2. The Performance Component funds [40%] are released based on the submission of key financial and planning documents and the funds are released when the LA meets five additional conditionalities as outlined in the LATF Regulations.

Total LATF Allocation and Penalties if any - are set out in the 2006/07 Annual Report, Annex 2 page 25 – for each of the LAs.

The regulations also set the timetable for disbursements and reporting. Three months before the beginning of the fiscal year, the share of each LA under LATF is calculated and advised to LAs to enable them to combine these transfers with their own revenues, and prepare and submit their budgets to their councils. The completed budget proposals are submitted to the MOLG before 15th April; and after the central government budget is approved, the transfers are made from the LATF vote to each LA on quarterly basis.

Unaudited expenditure and revenue reports are submitted under LATF before 30th September. In addition, the LAs submit quarterly reports on LATF funds to MOLG; and must submit their annual accounts to the Office of the Accountant-General before 30th December each year.

Information on expenditure and revenues by 100% of LAs is collected and published within 10 months of the end year. The information is consolidated by economic classification only and not by sectoral/functional classification. The system of budget classification is not strictly based on GFS classification. The MOLG has gazetted a Financial Reporting template according to International Public Sector Accounting Standards (IPSAS), and is now training half of the 175 Las in its use. In 44 out of 175 LAs the Local Authorities Integrated Financial Operations and Management System (LIFOMS) is used, which is a separate system from the IFMIS used by central government.

The official document Vision 2030 (Chapter 6, part 6.2) launched in May 2008 indicates a commitment to devolved government and to providing more resources to LAs and Districts.

Indicator	Score	Brief Explanation
PI-8. Transparency of Inter-Governmental Fiscal Relations (M2)	B	
(i) Transparency and objectivity in the horizontal allocation amongst Sub National Governments	A	More than 90 % of the LATF transfer from central government to local authorities is fully transparent and, and rule-based.
(ii) Timeliness and reliable information to SN governments on their allocations	A	The SN governments are provided with reliable information on the allocations to be transferred to them before the start of their detailed budgeting process. Releases are made in accordance with this information.
(iii) Extent of consolidation of fiscal data for general government	D •	Fiscal information on LAs is consistent with central government fiscal reporting but is not collected and consolidated according to sectoral categories.

PI-9 Oversight of aggregate fiscal risk

(i) Extent of central government monitoring of autonomous government agencies and public enterprises.

As mentioned in PI-7 there are 161 parastatals, which are also referred to in Kenya as Statutory Bodies and State Corporations. They include semi autonomous government agencies, trust funds and public enterprises. In addition, the State has minority shareholdings in several banks and other financial institutions.

Under the Public Audit Act 2003, Statutory Bodies and State Corporations are required to submit their financial accounts to the Ministry of Finance, Line Ministries and Kenya National Audit Office within 3 months of the end of their financial year. The Ministry of Finance/GDIPE does not maintain a list of those parastatals which have complied; and those that have not submitted. The GDIPE does not prepare a consolidated overview of the (net) liabilities or fiscal risk of parastatals.

In 2007/08, the MOF DGIPE commissioned consultants to undertake a study of the contingent liabilities of the 24 major parastatals and NSSF. The interim reports did not provide consolidated figures, and the draft final report with consolidated figures has yet to be submitted. The net liabilities of these parastatals and financial institutions are assumed to be large; and they pose major fiscal risks because of their substantial commercial activities and net liabilities.

The Privatisation Act was enacted in 2005 and includes a framework for the privatisation of strategic public enterprises. The Act provided for the establishment of a Privatisation Commission which was set in early 2006 and is in the process of recruiting a CEO and staff; and for the preparation of a privatisation programme to be approved by Cabinet and submitted to Parliament for information. The Act defines clear modalities of an open and competitive privatisation process, and provides for an appeals tribunal. The privatisation receipts are to be paid into the Consolidated Fund.

Since 2006, there have been divestments of part of the State's holding in: Kenya Electricity Generating Company, Kenya Reinsurance; Safaricom; Kenya Telecommunications; Mumias Sugar Company; and the awarding of a concession for Kenya Railways to a private operator.

The GDIPE was of the view that most major AGAs/PEs submit fiscal reports to the central government (KENAO, and/or Line Ministries and/or MOF) at least annually, but acknowledged that a record of the fiscal reporting completed by each of Kenya's 161 parastatals was not available; and an overview of the consolidated fiscal assets and liabilities of the 162 parastatals (whether or not classified as AGAs or PE) is missing or significantly incomplete.

The score for PI-9 (i) in 2006 PEFA was C; and there have been some improvements since 2006 in reporting to KENAO; and a new study was commissioned of the contingent liabilities of 24 major parastatals and NSSF. But there has not been much if any improvement in "monitoring" and "consolidation" that GDIPE, Line Ministries and KENAO have done, which would be sufficient to improve the score of C.

Scoring: C Most major AGAs/PEs submit fiscal reports to central government at least annually, but a consolidated overview is missing or significantly incomplete.

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

In the 2006 PEFA sub-indicator (ii) was incorrectly scored as A on the assumption that LAs do not have the right to borrow. It was confirmed during the 2008 PEFA that LAs are entitled to borrowing under the Local Government Act (CAP 265, Loans Sanctions Section 222-226).

The major LAs have substantial borrowing/on lending/guarantees through MOF which are reported in the Annual Debt Report of the DMD, Ministry of Finance, and the LATF Annual Report. These mainly concern Nairobi City Council, and between them the 10 largest municipalities probably account for 80% of total debt. LAs also have arrears or pending bills to statutory and non-statutory creditors, and which have been reported under PI-8. In addition, LAs have overdrafts with local banks. The "authorisation" of the Minister of Local Government is required to operate a bank overdraft, which is usually sanctioned for one year, and renewable on request. Under the MOLG LA Reform Programme, a new reporting template is being prepared that will include LA bank balances including overdrafts.

Since 2006, there has been an improvement in the MOLG coverage and quality of financial reporting on LAs under LATF; and the MOF DMD coverage of external debt, on-lending and government guarantees. Central Government monitoring of LAs fiscal position (revenues, expenditure, assets and liabilities/debt) takes place annually under LATF with 100% compliance and this information is consolidated. The LAs also send quarterly reports to MOLG with about 40% compliance, but the gaps are not followed up, and the quarterly information is not consolidated. The MOLG Reform Programme is seeking to obtain reconciled balances of the assets and liabilities/debts held by the 175 LAs, and to strengthen the MOLG overall coverage of debts/arrears/overdraft.

Currently, the MOLG is undertaking two studies to be completed before the end of Dec 2008, that will (a) obtain the latest data on the status of total debt outstanding and establish harmonised balances among LAs; and (b) to outline options for resolving the LAs overall debt situation, including penalties that have accumulated on old debts that not being serviced. This information then will be used for by MOLG for the 2009/10 budget preparations.

Score: C with arrow. The net fiscal position is monitored at least annually for the most important level of sub-national government, but a consolidated view is missing or significantly incomplete. There has been an improvement in reporting since 2006.

Indicator	Score	Brief Explanation
PI-9. Oversight of aggregate fiscal risk from other public sector entities.	**C•**	
(i) Extent of central government monitoring of AGAs/PEs	**C**	**A consolidated overview is missing of the net liabilities and fiscal risk of parastatals and state holdings in financial institutions.**
(ii) Extent of central government monitoring of SN governments' fiscal position	**C•**	**The net fiscal position is monitored at least annually for LAs, but a consolidated overview of fiscal risk is missing or significantly incomplete.**

PI–10 Public access to key fiscal information

Key fiscal information is mainly provided through three sources – different web-sites of government entities, Government Printer's shop in central Nairobi or through direct contact with government entities when documents can be provided as e-mail attachments or as printed versions for free. When it comes to the availability of information provided to primary service institutions also the note board publication of estimates is utilised for schools in primary education. The table below reveals to what extent the key fiscal documents are available on websites and through Government Printer.

Documentation	**Website**	**Government Printer**	**Timeliness**	**Criteria met?**
Annual Budget Documentation				**Yes**
- Budget Outlook Paper	www.statehousekenya.go.ke		2008-06-12, 2008-03-26 MoF website	This document is outside formal budget proposal
- Medium Term Budget Strategy Paper	www.treasury.go.ke,	For Sale	At time of Budget presentation to Parliament at Govt Printer	Yes to some extent, but only old versions available at website
- Budget Speech	www.treasury.go.ke		2008-06-12	Yes
- Statistical Annex to Budget Speech	www.treasury.go.ke Outdated link - Not available	For Sale		Not a key document, but available at Government Printer
- Revenue, Recurrent and Development Expenditure Estimate Books		For Sale	Shortly after submission to Parliament	Yes
- The Finance Bill and supplement		For sale	Shortly after submission to Parliament	Yes
- Sector Strategic papers	www.treasury.go.ke Outdated link - Not available			Not a part of central budget document
In Year Budget execution reports				**Yes**
Quarterly Economic and Budgetary Reviews	www.treasury.go.ke		–Quarterly Expenditure returns IV Q 2006/07 available 2008-10-02, i e within a month of publication	Yes
Year End Financial Statements				**Yes**
CAGs Report on appropriation accounts for 2006/07	www.kenao.go.ke		2008-08-05, within 2 months of completion	Yes
External Audit Reports				**Yes**
CAGs Report on appropriation accounts for 2006/07	www.kenao.go.ke		2008-08-05	Yes
Contract Awards				**No**
List of major Contract Awards	www.ppoa.go.ke		Not up to date, nothing from 2008	No
Resources available to primary service units				**No, only one subsector**
Publication of annual budget on noteboard	Only done for primary schools		Not known	No

For four out of the six categories of documents there is evidence that the public has access to the documents. This has been verified through internet search, a visit to Government Printer and to a District.

A general observation is that the search for publications on especially the Treasury website is cumbersome, many documents presented as downloads have seized to be downloadable, and some documents appear on different segments of the website, and for different years of publication. There is no single library or menu on the website where for example all the budget documents can be downloaded. We have however been able to download all the documents indicated in the table, and the situation has since the first website visit in October 2008 improved. Budget documents now appear under one label on the MoF website.

As to time of publication a scrutiny of date of documents and interviews reveal that the publication on the whole appears to be timely. The exception seems to be the Public Procurement Oversight Authority that by October 2008 had not yet published any contract awarded year 2008 on their website.

Indicator	Score	Brief Explanation
PI-10. Public Access to key fiscal information	**B**	The government makes available to the public in time 4 of the 6 listed types of information.

The Budget Cycle

3.3 Policy-based Budgeting

PI–11 Orderliness and participation in the annual budget process

The budget calendar for the Kenyan Government is first presented as an annex to the Budget Outlook Paper which is discussed in Cabinet and then submitted to MDAs and other stakeholders in December or early January. The calendar contains a listing of the various activities and responsibilities and time frames leading up to the presentation of the budget to Parliament mid June. The timetable is not giving precise dates, but indicates in which month or week the activities fall. The budget preparation is further guided by the Treasury budget preparation guidelines circular which is to be issued in the first week of April. The circular stipulates the date and format to be used for budget submissions.

The latest Treasury circular was only issued 28 April 2008, requesting budgets to be submitted not later than 9^{th} May 2008, hence giving DMA:s 11 days to complete their submissions. This year's calendar was exceptionally short because of the special emergency situation in the country following the general elections. The timetable in the Budget Outlook Paper suggests that the budget preparation circular be issued in the first week of April and that budgets should be submitted before the end of April, giving MDAs four weeks to prepare their budgets.

In accordance with the constitution the budget is presented to Parliament on the 12^{th} of June for the up-coming budget year 1 July to 30 June. Parliament normally takes three months to discuss the budget. During the last three years Parliament has taken its decision on the budget by end of October each year.

Dimension i) Existence and adherence to a fixed budget calendar
There is a clear and known calendar for the budget preparation. The time given to prepare the budget according to the formats stipulated in the budget preparation circular from treasury is normally four weeks. However for the year under scrutiny the time allowed was only 11 days. The score of this dimension is hence a C.

Dimension ii) Guidance on the preparation of budget submissions

The budget preparation circular gives clear guidance and reflects three year ceilings. It is approved by Cabinet before being circulated. The dimension therefore scores an A.

Dimension iii) Timely approval by the legislature.

The legislature has, during the last three years, approved the budget later than two months after the start of the budget year. This renders the score D.

Policy-Based Budgeting		
Indicator	**Score**	**Brief Explanation**
PI-11. Orderliness and participation in the annual budget process (M2)	**C+**	
(i) Existence of, and adherence to, a fixed budget calendar	C	An annual budget calendar exists, but has only allowed MDA:s 11 days to submit their budget proposals 2008.
(ii) Guidance on the preparation of budget submissions	A	A comprehensive and clear budget circular is issued to MDA:s reflecting ceilings approved by Cabinet.
(iii) Timely budget approval by the legislature	D	The budget has been approved later than two months after the start of the budget year in all of the last three years.

PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting

Dimension i) preparation of multi-year fiscal forecasts and functional allocations

Since 2000 Kenya has produced a multi-year perspective in fiscal planning and expenditure policy both in central and line ministries, on a sector-wide basis. Since the 2006 PEFA exercise, the role of the Sector Working Groups in the functional allocations has been strengthened. This can be demonstrated by several pre-budgeting exercises and documents (including Treasury Circulars issuing Guidelines for MTEF Sector Working Groups; Ministerial Expenditure Reviews; Budget Outlook Paper; Medium Term Budget Strategy Paper; Budget Speech; and Quarterly Economic and Budgetary Review). In these documents, useful multi-year information is provided on:

> (i) fiscal forecasts, and functional allocation of government resources for Recurrent and Development Total Ministerial Ceilings which exclude debt service payments and other claims accounted for under Consolidated Fund Services which are dominated by debt service and pensions.
>
> (iii) multi-year sector strategies and their costing, not all of which are necessarily funded under the Total Ministerial Ceilings for the MTEF hard budget constraint which excludes donor funding for investment projects.

The projected medium term claims for external and domestic sovereign debt service, and the projected funding from donors, are both included in the overall fiscal framework and are estimated by GOK and IMF/WB in the context of the PRGF programme.

In the Budget Outlook Paper, a single table is published showing MTEF total expenditure (recurrent and development) for nine sector ceilings, but without any further breakdown into economic or functional classification.

The Budget Strategy Paper for 2008/09 -2010/11 and the Annual Recurrent Estimates 2008/09 (ie original budget) contain details of recurrent spending for three years broken down by sector and sector ministries by economic classification into: wages, transfers, operations and maintenance. The BSP and Annual Development Estimates 2008/09 contain details of development spending for three years broken down by sector and sector ministries by sources of funding into: GOK, Loans, grants, and local Appropriations-in-Aid; not broken down by economic classification.

There are no convenient summary tables for MTEF total expenditure by sectors and economic classification in the BSP, the annual Recurrent Estimates or the annual Development Estimates. The Budget Strategy Paper (BSP) does include a summary of the total resource requirement for the medium term period and financing gap.

The BSP is published shortly before the annual budget is finalised and has a firmer resource constraint and sectoral breakdown than the Budget Outlook Paper (BOP) that is produced earlier in the financial year. The BSP tries to reconcile the changes between the PRGF, BOP and BSP. The Budget Speech incorporates the latest information on the preliminary outturn for the previous financial year. The reconciliation is presented at an aggregated level by broad economic classification, and not by sectoral/ministerial ceilings or functional allocations.

Score: C with arrow Fiscal aggregates for recurrent and development are prepared for at least 3 years on a rolling annual basis, but summary details are not readily accessible for <u>total expenditure</u> by economic and functional/sectoral classification, under Ministerial Ceilings, and the aggregate fiscal framework (which includes Consolidated Fund Services and donor funding).

Dimension ii) Scope and frequency of debt sustainability analysis (DSA)

The IMF/World Bank undertook an external and fiscal DSA in May 2007, and in August 2008. The external DSA covered borrowing by the central government (including parastatal borrowing with a government guarantee) and the central bank; and also includes estimates for private sector borrowing. The fiscal DSA aims at assessing the sustainability of total debt – external and domestic – incurred or guaranteed by central government. It does not cover the entire public sector or parastatal borrowing without a government guarantee. The Government has accepted the results of the IMF/World Bank DSA.

In June 2008, the IMF demonstrated the Debt Sustainability Framework (DSF) to the DMD which expects to have the capacity to undertake a similar DSA annually in future.

Kenya has relatively limited reliance on external borrowing and faces a low risk of external debt distress. The face value of public external debt at end-June 2007 ($6.2 billion) represented 25% of GDP. Kenya's relatively low reported domestic debt to GDP ratio of around 18.5% at the end-June 2008 masks vulnerabilities from the realisation of contingent liabilities. The Government has launched a study of contingent liabilities in 24 parastatals and the National Social Security Fund. The government's pay-as-you-go pensions scheme for civil servants has accumulated claims estimated at 11.4% of 2008/09 GDP.

Score: B DSA for external and fiscal/domestic debt has been undertaken by IMF/WB within the last year, the results of which have been accepted by the Government.

Dimension iii) Existence of costed sector strategies

The MTEF is supported by eight Sector Working Groups as follows: Productive Sector; Governance, Justice, Law and Order; Health Sector; Education Sector; Physical Infrastructure; Public Administration Sector; Information Communication Technology Sector; Manpower and Special Programmes Sector. These cover approximately 75 % of the budget. The recent achievements and key priorities and some targets are summarised for each sector. The broad costings of sector strategies are indicated on a functional basis State budget votes are grouped according to these sectors in the Budget Strategy Paper and three year projections for recurrent and development costs. The costed sector strategies represent a priority list, and are not fully funded under the Ministerial Ceilings. The Kenya MTEF operates under a policy of a hard budget constraint from domestic revenue and within the overall fiscal framework,

A MTEF Manual is being prepared. The Ministry of Education is preparing a draft programme-based budget for the sector, with activity-based costings; and costings for each student/teacher.

Score: B Statements of sector strategies exist and are fully costed, [and broadly consistent but exceed with fiscal forecasts *i.e. hard budget constraints for Ministerial Ceilings and overall fiscal framework]*, for sectors representing around 75% of primary expenditure.

Dimension iv) Linkages between investment budgets and forward expenditure estimates

A single table showing MTEF total expenditure (recurrent and development) by sector and sector ministries and economic classification is not published in the BSP. The linkages between development projects and their recurrent funding for operations and maintenance funding over the medium term are difficult to assess. Such details although unpublished may be available from MOF Budget Supply Department which currently is preparing a more user-friendly version of the MTEF for total expenditure by sector and sector ministries. It is intended that the linkage between the Recurrent and Development Estimates will be demonstrated in connection with the 2009/10 annual budget preparations.

Score: D Budgeting for investment and recurrent expenditure are still mainly separate processes with unclear links between investments and recurrent implications.

Policy-Based Budgeting		
Indicator	**Score**	**Brief Explanation**
PI- 12. Multi-year perspective in fiscal planning, expenditure policy and budgeting (M2)	**C+**	.
(i) multi-year fiscal forecasts and functional allocations	*C* •	Forecasts for fiscal aggregates and sectoral/functional classification are prepared and published for 3 years, but economic classification is not reported for total expenditure (recurrent plus development). Difference between the hard resource constraint on Ministerial Ceilings set out in the Annual Budget, and the softer resource constraints for the first year of MTEF reported in earlier fiscal forecasts (BOP, BSP) are largely explained in the Budget Speech.
(ii) scope and frequency of debt sustainability analysis	B	DSA for external and fiscal/domestic debt undertaken within the last year.
(iii) existence of costed sector strategies	B •	Documentation available on web for nine Sector Strategy Papers. Existence of broadly costed strategies which include programmes and proposed activities that are in excess of the Ministerial Ceilings and hard budget constraint are presented in the Annual Budget. This is an improved situation as compared to 2006. Some costed activities may be funded if/when additional domestic revenue is collected, or additional donor resources materialise.
(iv) linkages between investment budgets and forward expenditure estimates	D	By law, two separate annual budget documents must be published for Recurrent and Development Estimates, and there does not appear to be a clear demonstrated linkage between the development budget and forward recurrent cost implications.

3.4 Predictability and Control in Budget Execution

PI-13 Transparency of taxpayer obligations and liabilities

Tax legislation and procedures for all major taxes (VAT, Customs and Excise duties and Income Tax) are comprehensive. Customs is administered under the East African Community Customs Management Act while Excise duties are still under the Kenya Customs & Excise Act. The Excise legislation has not yet been enacted. Kenya does not have a common tax procedure code which means that common administrative procedures are spread across the respective laws and regulations thus creating avenues for inconsistent treatment of taxpayers. KRA has powers to waive penalties and interest up to KES.1,500,000 effective 13th June 2008.This was previously limited to KES.500,000. Any waiver application in excess of KES.1,500,000 is referred to the Minister of Finance. The discretion is limited with the implementation of a waiver framework for scoring based on weights assigned to mitigating factors presented by taxpayers.

Tax assessments are issued whenever KRA makes adjustments to the self-assessment returns submitted by taxpayers. Statements of accounts are also issued when tax is demanded or upon request by taxpayers but not regularly. Thus, tax assessments are clear and tax liabilities are well communicated to taxpayers.

Absence of legislation in support of advance rulings means that KRA does not usually give advance rulings even when requested by taxpayers.

Taxpayers have easy access to information on all major taxes. Tax laws are available to the public at the Government Printers. KRA updates the tax laws in-house annually when the Finance Act is enacted and the updated versions are available in the KRA website. KRA conducts taxpayer education campaigns through radio, newspapers, TV and road shows; monthly seminars are conducted for newly registered taxpayers; brochures and leaflets on all taxes are available. The Large Taxpayers Office publishes a tax information bulletin which is electronically distributed to the public; Annual taxpayers' week with corporate social responsibility (CSR) activities and awards to distinguished taxpayers enhance tax awareness and compliance. Taxpayer service surveys are conducted at corporate level as well as revenue departments.

There is a clear dispute resolution mechanism covering objections and appeals on assessments. Taxpayers have a right to object to assessments by KRA all the way to the High Court. Tax appeals system is well developed for all major taxes (Customs, VAT & Income Tax); The Income Tax Local Committee (LC) and VAT Tribunals are active and members have been gazetted. Regular sittings for Income Tax Local Committees and VAT Tribunals take place. However, the Customs Tribunal remains inactive with members of the Tribunal not yet gazetted. Excise Tribunal members have also not been gazetted. Decisions of the appeals system are promptly acted upon by the KRA.

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

The taxpayer database is maintained through a unique Personal Identification Number (PIN). Traders registered for VAT also have a VAT registration number. The current taxpayer registration system is not linked to any other Government license or registration system electronically. There is however, legal requirement to secure a PIN before business registration and conclusion of specified transactions. However, there is linkage between KRA departments i.e. Customs Services, Domestic Taxes and Road Transport.

The penalty regime is very clear and covers all aspects of non-compliance. They are sufficiently high to act as deterrence. The interest on overdue accounts is systems generated and applied consistently. Waiver applications for penalties and interest are only considered after payment of full principal tax. A framework for scoring weights to determine percentage of waiver to be granted by KRA and the Minister for Finance has been implemented. The assessment to establish its consistent administration has however, not been conducted.

KRA tax regime is based on self-assessment system supported with risk profiling of taxpayers for audit. Besides the National Audit Plan, departmental audit work plans are in place. For Domestic

Taxes Department, the Large Taxpayers Office (LTO) audit work plan is fully implemented and is replicated in the Domestic Revenue (DR). Customs Services Department (CSD) has implemented Post Clearance Audits supported by the Authorised Economic Operator (AEO) system. The CSD audit plan for the Post Clearance Audit is work in progress. The Investigation & Enforcement Department responsible for fraud investigation implements its audit work plan with clear risk assessment criteria.

PI-15 Effectiveness in collection of tax payments

The accumulation of tax arrears can be a critical factor in undermining high budgetary outturns, while the ability to collect tax debt lends credibility to the tax assessment process and reflects equal treatment of taxpayers. The prompt transfer of the collections to the Treasury is essential for ensuring that the collected revenue is available to the Treasury for spending, and aggregate reporting on tax assessments, collections, arrears and transfers to Treasury must take place regularly and be reconciled.

The Revenue collection has improved over the last three years as shown in the table below:

	2007/08	2006/07	2005/06
Tax Collections by Department			
DTD (KES. Billion)	259.3	215.6	183.6
CSD (KES. Billion)	157.3	142.4	111.2
RTD (KES. Billion)	2.3	2.1	2.9
Totals and comparison			
Budgeted Target (KES. Billion)	409.6	356	301.1
Actual collections (KES. Billion)	418.9	360.1	297.7
Difference between Budgeted & Actural (KES. Billion)	+9.2	+4.1	-3.4
Difference as % of Budgeted targets	+2.2%	+1.2%	-1.1%

It is evident from the above table that the performance of domestic revenue was good in 2007/08 and 2006/07 exceeding the budgeted figures by 2.2% and 1.2% respectively.

The debt collection ratio in the most recent year (2007/08) was 16.4% (below 60%). The total amount of tax arrears (cumulative) is significant (exceeds 2% of total annual collections) at KES. 145.2 Billion (i.e. 34.7% of total annual collections KES. 418.9 Billion for 2007/08). Debt collected increased from KES. 9.3 Billion in 2006/07 to KES. 23.8 Billion in 2007/08.

The tax arrears are significant for income tax, corporate tax and VAT. The following table depicts the tax debt and debt collection as well as the total arrears for the last three years, based on data provided by the KRA.

Table ... - Tax arrears and collection , Kshs. Billion						
	2005/06	2005/06	2006/07	2006/07	2007/08	2007/08
	Outstanding debt	Amount Collected	Outstanding debt	Amount Collected	Outstanding debt	Amount Collected
DTD	101.9	10.1	158.9	8.9	136	22.9
Income tax						
Value Added Tax						
Excise duty						
CSD	1.8	0.004	5.5	0.4	9.2	0.8
RTD						
% collected Income tax debt						
% Collected VAT debt						
% collected Excise debt		9.91		5.60		16.84
% collected Customs duty		0.22		7.27		8.70
% collected Motor Vehicle revenue		%		%		%
Total debt and total collected debt	103.7	10.1	164.4	9.3	145.2	23.8
Total Debt collection ratio	9.70%		5.70%		16.40%	
Annual collection:						
DTD		183.6		215.6		259.3
Income tax (*** inclusive of negligible agency taxes)	120		138.8		173.5	
VAT	42.1		51.8		57.4	
Excise duty	21.5		25		28.4	
CSD		111.2		142.4		157.3
RTD		2.9		2.1		2.3
Total annual collection		279.7		360.1		418.9
% in arrears of total collection Income Tax	%		%		%	
% in arrears of total collection VAT	%		%		%	
% in arrears of total collection Excise duty	%		%		%	
% in arrears of total collection Customs	%		%		%	
Total Arrears as % of total collection		3.40%		2.60%		5.70%

Source: KRA

It is reported that there was an exceptional recovery of debt from a state corporation amounting to KES. 15 Billion which would increase the total revenue collected in 2007/08 by KRA to KES. 434 Billion. In the table above, the last row represents the total arrears collected as a percentage of total collection.

KRA reports tax collections to CBK on a daily basis. Electronic funds transfers are encouraged. Transfers involving commercial banks take up to 2 days.

KRA, CBK and Treasury hold meetings weekly for accounts reconciliation. Treasury obtains daily revenue collections for the previous day every morning from CBK. Reports on arrears collected by KRA are submitted to Treasury every month.

Indicator	Score	Brief Explanation
PI-13. Transparency of taxpayer obligations and liabilities (M2)	**B+**	
(i) Clarity and comprehensiveness of tax liabilities	B	Tax legislation and procedures for all major taxes (VAT; Customs and Excise duties and Income Tax) are comprehensive but the Excise Act has not been enacted since the East African Community Customs Management Act became operational in 2005. Procedures on issuance of tax assessments are clear and tax liabilities are communicated to taxpayers. Statements of accounts are issued when tax is demanded or upon request by taxpayers but not regularly. KRA's waiver limits for penalties and interest have been increased from KES. 500,000 to KES.1,500,000 effective 13 June 2008. Thus, discretion is limited through the waiver framework implemented. Advance ruling mechanism is not in place.

(ii) Taxpayer access to information on tax liabilities and administrative procedures	A	Taxpayers have easy access to information on all major taxes. Tax laws are available to the public at the Government Printers but also updated versions available in the KRA website. There is no common Tax Procedures Code which means that administrative procedures are spread across the respective laws and regulations. KRA supplements with taxpayer education campaigns through radio, newspapers, TV and road shows; monthly seminars are conducted for newly registered taxpayers; brochures and leaflets on all taxes are available. The Large Taxpayers Office publishes a tax information bulletin which is electronically distributed to the public; Annual taxpayers' week with corporate social responsibility (CSR) activities and awards to distinguished taxpayers enhance tax awareness and compliance. Taxpayer service surveys conducted at corporate level as well as revenue departments.
(iii) Existence and functioning of a tax appeals mechanism	B	Taxpayers have a right to object to assessments by KRA all the way to the High Court. Tax appeals system is well developed for all major taxes (Customs, VAT & Income Tax); The Income Tax Local Committee (LC) and VAT Tribunals are active and members gazetted. There are regular sittings for Income Tax Local Committees and VAT Tribunals. However, Customs Tribunal and Excise Tribunal members have not yet been gazetted. Decisions of the appeals system are promptly acted upon.

PI-14. Effectiveness of measures for taxpayer registration and tax assessment (M2)	**B**	
(i) Controls in taxpayer registration system	C	Taxpayer database is maintained through a unique Personal Identification Number (PIN). Traders registered for VAT also have a VAT registration number. The current taxpayer registration system is not linked to any other Government license or registration system electronically. There is however, legal requirement to secure a PIN before business registration and conclusion of specified transactions. However, there is linkage between KRA departments i.e. Customs Services, Domestic Taxes and Road Transport.
(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations	B•	The penalty regime is very clear and covers all aspects of non-compliance. They are sufficiently high to act as deterrence. The interest on overdue accounts is systems generated and applied consistently. Waiver applications for penalties and interest are only considered after payment of full principal tax. A framework for scoring weights to determine percentage of waiver to be granted by KRA and the Minister for Finance has been implemented. This represents a major improvement in the management of waivers and is currently in use by both the KRA and the Treasury. The assessment to establish its consistent administration has however, not been conducted.
(iii) Planning and monitoring of tax audit and fraud investigation programs	B	KRA tax regime is based on self-assessment system supported with risk profiling of taxpayers for audit. Besides the National Audit Plan, departmental audit work plans are in place. For Domestic Taxes Department, the Large Taxpayers Office (LTO) audit work plan is fully implemented and is replicated in the Domestic Revenue (DR). Customs Services Department (CSD) has implemented Post Clearance Audits supported by the Authorised Economic Operator (AEO) system. The CSD audit plan for the Post Clearance Audit is work in progress. The Investigation & Enforcement Department responsible for fraud investigation implements its audit work plan with clear risk assessment criteria.

PI-15. Effectiveness in collection of tax payments	**D+**	
(i) Collection ratio for gross tax arrears, being percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year	D	The debt collection ratio in the most recent year (2007/08) was 16.4% (below 60%). The total amount of tax arrears (cumulative) is significant (exceeds 2% of total annual collections) at KES. 145.2 Billion (i.e. 34.7% of total annual collections KES. 418.9 Billion for 2007/08). Debt collected increased from KES. 9.3 Billion in 2006/07 to KES. 23.8 Billion in 2007/08.
(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration	B	KRA reports tax collections to CBK on a daily basis. Electronic funds transfers are encouraged. Transfers involving commercial banks take up to 2 days. Considering that the bulk of the taxes are paid directly through banks with very minimal cash collections, the interbank transfer of revenue from KRA to Treasury is effective.
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury	A	KRA, CBK and Treasury hold meetings weekly for accounts reconciliation. Treasury obtains daily information on revenue collections for the previous day every morning from CBK. Reports on arrears collected by KRA are submitted to Treasury every month. Coverage includes reconciliation between tax assessed and amount sent to Treasury, taking into account tax assessed, tax arrears, and tax collected.

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

Cash flow planning was implemented at the beginning of 2005/06 to address the predictability and availability for the commitment of funds to the line ministries, through the exchequer. The cash flow planning process starts with the submission of annual cash plans by the Ministries. The Cash Management Unit (CMU) in the MOF prepares a consolidated annual cash plan predicting the cash flow, expenditure shortfalls or surpluses and the proposed domestic borrowing.

While the adopted mechanism provides a reliable basis for ministry headquarters to predict their funding in order to effect commitment control at that level, there is evidence to suggest that at the district level, through the link from headquarters to district, the forecast is not reliable. When looking at the district level the assessment found that that the health sector could not rely on the cash forecasts made, causing considerable problems in their planning, while the school sector's cash plans seemed more reliable.

The weekly exchequer releases are based on the rolling cash flow plans which are submitted and approved by the Exchequer Committee which meets every two weeks when they are reviewing and monitoring the situation. The level of replenishment is subject to the set monthly ceilings.

The daily reporting of the activity of the ministry accounts facilitates prudent cash management. Consequently the cash management mechanism adopted seem to have the elements necessary to ensure, reliably within a reasonable horizon, the spending limits to facilitate effective expenditure commitment by the line ministries - at the level of the headquarters.

In spite of this status of high predictability of fund flows from the exchequer to the line ministries, it is important to emphasize that the predictability of funds throughout all levels of government remains weak, as witnessed at the district level; this might i.a. impair and weaken commitment control and create a disjointed budget execution. This is a serious consequence in Kenya because of the level of de-concentration.

In-year adjustments above the level of the MDAs, are done with the approval of the Ministry of Finance 2 or 3 times per year for each Ministry and reported to the Parliament once a year in connection with the supplementary budget.

Indicator	Score	Brief Explanation
PI-16. Predictability in the availability of funds for commitment of expenditures	**B+**	
(i) Extent to which cash flows are forecast and monitored	A	At the beginning of the year the MOF prepares an annual cash flow based upon inputs from the MDAs. The exchequer committee is meeting every second week and is monitoring the execution of the plans. Spending limits are submitted each month to the MDAs on a three month rolling forecast basis based upon updated cash flows.
(ii) Reliability and horizon of periodic in-year information to MDAs on ceilings for expenditure	B	The MOF has been able to meet its budget release commitments against quarterly rolling spending limits to all of the line ministries each month save for those cases where the line ministries had excessive balances indicated in mirror-accounts. The reliability of meeting the budget release commitments is assured by the mirror-accounts, the cash management flexibility it facilitates, and the ability to fall back on a central bank overdraft facility.
(iii) Frequency and transparency of adjustments to budget allocations which are decided above the level of management of MDAs	B	In-year adjustments above the level of the MDAs, are done with the approval of the Ministry of Finance 2 or 3 times per year for each Ministry and reported to the Parliament once a year in connection with the supplementary budget. .

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

Information on gross government debt and financial assets is published regularly. Gross Government debt is published both by the CBK and MOF in weekly, monthly and quarterly reports. The CBK publishes total gross public external debt and guaranteed external public debt it its Monthly Economic Review (www.centralbank.go.ke). In addition, the MOF reports debt data in the Monthly Debt Bulletin; and the QBR which provides reports on government guarantees and stock of government debt by debt instruments, and by debt holder. Annual reporting by the DMD on public debt management has been introduced, and the report includes statements on the currency and maturity structure of government debt, the stock of debt and guarantees.

Domestic debt is only reported by DMD for central government and does not include domestic debt from state-owned enterprises and local governments. The CS-DRM system is used for recording and reporting both foreign and domestic sovereign debt. The Debt Management Department (DMD) of MOF manages external debt while domestic debt (Treasury bills and Treasury bonds) is managed by the CBK on an agency basis.

The Debt Management Department within the MOF is being transformed into a Debt Management Office (DMO) under a reform programme that started in August 2004. The objective is to establish a fully-fledged office within the MOF that is capable of undertaking front, middle and back Office operations. A proposal on DMO personnel structures and a separate scheme of service has been prepared and sent to the Office of the President, Department of Personnel Management for review.

Since 2006 the DMD has developed its own in-house software Payments Advice and Data Entry System (PADES) that has automated advice on the amounts due for debt service and the printing of cheques instructing the CBK to pay. Three staff members are undergoing training for middle office functions.

Under the law, the MOF is responsible for contracting all external debt and giving guarantees. Government external borrowing is undertaken within the legal framework of the External Loans and Credit Act (revised 1979) while guarantees are issued under the Guarantees Loans Act (revised 1977). The Internal Loans Act (revised 2007) governs the contracting of domestic sovereign debt. Since 2006, the DMD have drafted Regulations aimed at strengthening the External Loans and Credit Act and policy and guidelines for evaluating external loans within the ceiling set by Parliament. The Regulations are awaiting the Minister of Finance to Gazette.

Domestic debt management is delegated to the CBK which acts as an agent for MOF. In 2007 a draft agency agreement was drawn up, with MOF (principal) and CBK (agent), spelling out the responsibilities of both parties. The agency agreement is under review.

The external and domestic sovereign debt data is comprehensive, accurate and reliable, and Kenya is among only 14 countries to be included in the World Bank Quarterly External Debt Statistic. The DMD has published a National Public Debt Strategy (August 2007); an Annual Public Debt Management Report (May 2008); and Monthly Debt Bulletins (latest July 2008).

Kenya has received international credit ratings from Standards and Poor's and Fitch, and the Government intends to issue a $500 million Eurobond within the 2008/09 financial year. Apart from raising funds for infrastructure projects, and to partly bridge the fiscal deficit, the debut international sovereign bond issue will act as a benchmark for Kenya. Total external plus domestic sovereign debt outstanding represents about 35% of GDP.

Within MOF, contingent liabilities are not reported by DMD and are mainly the responsibility of DGIPE. There are weaknesses in the MOF coverage and reporting of real and contingent liabilities by Kenya's 166 parastatals (including SAGAs, State Corporations; public sector enterprises with majority Government shareholding; and private sector enterprises with minority Government shareholdings) and a lack of transparency with respect to government explicit (and implicit) liabilities.

As to consolidation of cash balances, the definition provided by the PEFA secretariat is that *"consolidation of cash balances exist when the government has information of the total of its cash and* *bank balances and can switch unused bank balances to meet overdrawn balances and minimize its borrowing. This requires that all balances are held centrally e.g. by the central bank (which may treat all government accounts as sub-accounts of one consolidated account and only apply interest charges and overdraft limits to the consolidated account balance), or that balances in outlying banks, such as commercial banks, are subject to electronic clearing and payment arrangements."*

The situation in Kenya is well described by the recent IMF ROSC study publicized in March 2008:
"The legal framework for a Consolidated Fund is in place but the principles of a Treasury Single Account are not being followed.
Significant cash balances are still being held outside the Exchequer Account. These are held on accounts managed by line ministries, some 40 public fund accounts and a number of donor-funded project accounts. While some of these accounts are held in the CBK, the bank accounts of district level units of line ministries, as well as a large number of project accounts and some public fund accounts are held in commercial banks. The Exchequer Account held in the CBK is also not functioning as a unitary account. Exchequer releases are held in a Treasury Funding Account with the CBK. From this account, cash is transferred to transitory zero-balanced sub-accounts of individual line ministries every day. At the end of the day the balance remaining in these accounts is returned to the Treasury Funding account. The Treasury Funding Account and the transitory cash balances lying in zero-balanced accounts are not considered a part of the Treasury Single Account. For local governments, cash balances of the General Rate Fund are held in commercial bank accounts, and local governments hold a number of accounts outside the General Rate Fund."

This picture has in all substance been verified in our visit to the District level and in interviews at MoF and line ministries. As consolidated data on all bank balances are not available it has not been possible to determine the exact level of the balances outside the Central Bank of Kenya. It is assessed that there is a system of bank consolidation of major bank balances which takes place on a daily basis, although substantial extra-budgetary funds and balances at District level remain outside the arrangement. Hence the rating of this dimension is a C.

There is a borrowing limit which is currently set at 500 bn KES and has been updated periodically. The systems for contracting loans and issuance of guarantees operate satisfactorily within these limits. The law requires the Minister to report to Parliament on the amount and purpose of each loan. The DMD have drafted Regulations aimed at strengthening the policy and guidelines for evaluating external loans within the ceiling set by Parliament. The Regulations are awaiting the Minister of Finance to Gazette.

Indicator	Score	Brief Explanation
PI-17 Recording and management of cash balances, debt and guarantees (M2)	**B**	
(i) Quality of debt data recording and reporting	A	Improving the quality of debt recording and reporting has been the primary focus of reform efforts in the last two years. In 2006 data was migrated from CS-DRMS 7.2 to a new platform CS-DMRS 2000+ and reconciliation is undertaken on daily basis. The quality and comprehensiveness of external and domestic sovereign debt statistical reporting is recognised as comprehensive, accurate and reliable.
(ii) Extent of consolidation of the government's cash balances	C	Major cash balances are consolidated on a daily basis, but substantial extra budgetary funds remain with balances outside the system.
(iii) Systems for contracting loans and issuance of guarantees	B •	Central government's contracting of loans and issuance of guarantees are made within limits for total debt and total guarantees, and approved by a single government entity – MOF.

PI-18 Effectiveness of payroll controls

Wages and salaries constitute around 25 % of central government expenditure – for 2007/08 around 145 bn KES out of the total expenditure of 550 bn KES. There are around 490 000 employees in central government including central ministry staff, teachers, police and military. Around half of these, or 245 000 constitute teaching staff in primary and secondary education falling under the Teachers Service Commission.

Almost all employees are registered and remuneration calculated through the Integrated Personnel and Payroll Database (IPPD) system which was introduced 2004. The introduction of the system has been a roll-out exercise up to now. A few government services are still in the process of receiving the system, namely the judiciary service and Kenyatta National Hospital.

The IPPD system integrates as the name suggests personnel and payroll data. The system captures data for each individual for

Type of data:	Includes:
Identification	Personal No, ID number, income tax PIN, names, date of birth, gender, marital status, address, ethnicity, Education peak, Home District and Photo
Employment	Employer – vote, designation, job group, dates of first and current appointment, salary scale, increment Month, house category, deployment data(work station, division, location, LA and pay-station, establishment/budget attachment (which contains reference to Subvote, Head and Subhead in the IFMIS system and budget), and contract end date.
Detachment data	Transferred to (vote), reason for non-salary, reason for deletion, detachment date.
Financial benefits and obligations	Various deductions for arrears, insurance policies, mortgage, Hire purchase, SACCO society, Save as You earn, Social welfare association with information related to amounts, account numbers , etc
Authorization and data capture ID:s	Data related to the persons modifying, authorising changes, data acceptance and data key-in authority are also entered.

IPPD calculates what is to be paid to the employee after deductions each month. The system produces payroll lists per institution, and groups staff to be paid from the same bank so that one monthly cheque per bank can be issued under IFMIS. At the same time IPPD provides summary data for manual entry into the IFMIS according to the accounting classification. IPPD also provides managers with staff lists for control purposes and statistics. Although the registration of academic qualifications and training is limited, IPPD provides most other data expected from a personnel database. The payroll and personnel databases are therefore regarded to be fully integrated in IPPD. The rating in this dimension will however be a B until also the judiciary has been entered to the system. The roll out of the system is a tremendous improvement in terms of data integration and access as compared to the previous situation. The IPPD is however a distributed system where each ministry and other entities like the Teachers service commission have their own database. The system is designed to handle 15 different pay structures – for different organizations and careers. DPM is compiling and has access to data for all the databases and employees.

The IPPD is not integrated with IFMIS, which has a different, centralized database structure. The systems are also built on different technical platforms, IPPD being a tailor-made or bespoken system, IFMIS an adjusted standard package solution on an Oracle database structure. Payroll data is entered manually into IFMIS following printouts from IPPD.

With the magnitude of the establishment, the wide distribution of staff from centre down to police stations, schools and dispensaries, the update of the IPPD can be time-consuming. Meetings with the police service, teaching service and new ministry of medical services bear testimony of a time lag in registration of changes, transfers etc of up to three months. This is however not the regular rule, normally changes and new appointments are captured in time for the up-coming salary payment. As the system settles and internet connection also with remote parts of the country improves, it is expected that the time for data entry also for remote work places is reduced. It is assessed that a B is a reasonable rating of the situation for sub-dimension ii).

The IPPD system facilitates control, and the system documents the persons that have been involved in making changes and that have authorised them. The authority to issue Personal ID numbers is solely with DPM, and the financial codes used in the system all refer to the IFMIS code structure, issued by the Accountant General. However the manual transfer of data between IFMIS and IPPD causes problems of control and reconciliation, also all employees have not yet been entered on IPPD. The rating of this indicator hence stands at C currently.

Internal and external payroll audits have been undertaken for several ministries and entities, e.g. the Ministry of Health. Recently the internal auditors have performed payroll audit on the IPPD system using specific IT-based computer programmes. This has detected errors and anomalies in the records that are now easy to identify and relate to earlier omissions and systems. DPM is also in the process of establishing its own payroll audit unit. There has not yet been any pay roll audit covering all government entities. The rating for dimension iv) hence is a C. There are however emerging opportunities for effective audits for the whole service with the use of IT-based audit, the authorization of the pay lists from IPPD by all field managers and through the up-coming payroll audit unit.

Indicator	Score	Brief Explanation
PI-18. Effectiveness of payroll controls	**C+**	
(i) Degree of integration and reconciliation between personnel records and payroll data.	B	Personnel data and payroll data are linked in IPPD to ensure data consistency and data reconciliation. However all entities are not yet included in the system. (95% of staff).
(ii) Timeliness of changes to personnel records and the payroll.	B	Personnel records and payroll data are updated monthly, generally in time for the following month's payments. Retroactive adjustments are rare.
(iii) Internal controls of changes to personnel records and the payroll.	C	Controls exist but are not adequate to ensure full integrity of data as the link between IFMIS and IPPD is manual, in addition all entities are not yet included in the system (95 %)
(iv) Existence of payroll audits to identify control weaknesses and/or ghost workers.	C	Both the internal audit and the external audit annually perform system based audit, including substantive testing, on the internal control of the annual payroll to identify possible control weaknesses. They have however not covered all entities.

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

The total value of public procurement in Kenya is currently estimated at 10% of the GDP. In 2006, Kenya's GDP was estimated at KES. 1,234.69 Billion putting the total expenditure on procurement by Government at around KES. 124 Billion annually according to the Ministry of Finance.
Public procurement reforms continue with the operationalisation of the Public Procurement and Disposal Act (2005) and the Public Procurement and Disposal Regulations, 2006 effective 1st January, 2007.

The Public procurement regulations have been gazetted and the Public Procurement and Disposal Act, 2005 became operational in 2007. The Procurement law makes it mandatory for entities to use open tenders as the preferred method of procurement. It is clear on separation of duties in respect of Accounting Officers, tender committees, procurement committees, evaluation committees, inspection and acceptance committees

Where alternative methods of procurement are used, the tender committee's approval must be obtained. In the case of direct procurement, Procuring Entities must report to the PPOA within 14 days. The PPOA has a compliance department that does reviews to assess the extent of compliance by procuring entities and prepare reports some of which have been availed during the assessment.

It is evident from the review reports that at this early stage following the operationalisation of the Procurement Act and Regulations, the procuring entities are making efforts to comply with the guidelines provided for within the legislative framework but there are non-compliance challenges. There is however a general feeling among stakeholders that there are significant improvement in the procurement environment under the oversight PPOA and other oversight institutions such as KACC, Internal Audit and KENAO. However, even with the new legislation and developed procedures for procurement, there were also concerns about the integrity of the procurement process with threats coming from individuals and groups trying to exploit the system, such as state employees acting behind front companies and leaking of qualified information thereby undermining the competitiveness of the process.

Within Government ministries, state corporations and local authorities, it was evident that the procurement process is frustrating despite the impressive legal framework. There are several bottlenecks affecting the smooth operation of the procurement process such as integrity issues which the legal framework seeks to redress. The Kenya Anti-Corruption Commission in its reports on systems, policies, procedures and practices in Government ministries and local authorities have identified irregularities in procurement matters ranging from procurement administration, prequalification of suppliers, consultants and contractors, evaluation and award of tenders.

The appeals procedure is clearly provided for under the Public procurement Regulations and a Public Procurement Administrative Review Board is established under the Act to deal with aggrieved stakeholders. The Act lays down the right to request for a review against decisions made by procuring entities. PPOA maintains information on appeals against procurement decisions. It is still too early to determine the efficiency and prudence of the appeals system, still there is no evidence as yet that it isn't implemented as intended. A summary of information on appeals against procurement decisions is shown in the table below (Source: PPOA):

Year	Total No. Of Appeals	Successful Appeals	Dismissed Appeals	Withdrawn Appeals	Appeals taken for Judicial Review
2001	12	2	8	2	0
2002	44	23	15	7	4
2003	33	22	10	1	10
2004	46	21	24	1	14
2005	52	28	22	2	4
2006	58	18	37	3	9
2007	70	22	44	4	10
To Sept 2008	32	13	13	3	5
TOTALS	311	128	149	22	54

Indicator	Score	Brief Explanation
PI-19. Competition, value for money and controls in procurement (M2)	**B**	
(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases	C	The Public procurement regulations have been gazetted and the Public Procurement and Disposal Act, 2005 became operational in 2007. Open tenders are the preferred method of procurement and is mandatory by law. However, irregularities still abound in the procurement system as evidenced by Kenya Anti-Corruption Commission reports and complaints by components in Ministries, State Corporations and Local Authorities.
(ii) Justification for use of less competitive procurement methods	B	Where alternative methods of procurement are used, the tender committee's approval must be obtained. In the case of direct procurement, Procuring Entities must report to the PPOA within 14 days.
(iii) Existence and operation of a procurement complaints mechanism	A	The appeals procedure is clearly provided for under the Public procurement Regulations and a Public Procurement Administrative Review Board is established under the Act to deal with aggrieved stakeholders. The Act lays down the right to request for a review against decisions made by procuring entities. PPOA maintains information on appeals against procurement decisions. Although the data on the resolution of complaints are available to the parties to the disputes, they are not easily accessible to public scrutiny as the posting of such information in the website is not regularly updated.

PI-20 Effectiveness of internal controls for non-salary expenditure

The legal framework for management of public funds is neither clear nor comprehensive. The Government Financial Management Act (GFMA) 2004 is currently the only general PFM act and it has a limited coverage of key areas and does not take into account important reforms implemented in recent years. The IMF has recently noted that the legal framework for PFM in Kenya requires significant revision to bring it in line with international best practice and to incorporate recent reforms.

Internal controls are provided for under the Constitution, Exchequer and Audit Act (partly outdated), Financial Management Act, Financial Regulations (partly outdated and complemented with successive Treasury circulars), Public Procurement and Disposal Act, and other Treasury circulars among other procedures. Internal controls are also linked to the budget process as all commitments are controlled against the budget approved by the National Assembly through the Finance (Appropriation) Act. It is also noteworthy that the Constitution (102) provides for excess expenditure over the amounts provided for within the Finance Act and submission of a supplementary estimate for approval by the National Assembly after such expenditure has been incurred.

The accounting officer within each MDA is delegated responsibility to manage finances by the Treasury supported by finance officers, accounts controllers and internal auditors seconded from MOF. The head of finance in each MDA, normally the Chief Finance Officer (CFO) is responsible for issuing, on behalf of the accounting officer, Authority to Incur Expenditure (AIE) to the authorised officers of the MDA. Accounts controllers have responsibility to control spending against the approved budget.

A commitment control system exists but seems not to have been very effective in the past as reflected in the numerous observations in the KENAO annual reports but also from the accumulation of pending bills in the past. The introduction of the IFMIS system, although not complete, seem to have strengthened the commitment controls on the central level while there is not enough evidence that the improvement is sustained through all the Government structures.

Although financial control procedures are in place, they may not be applied consistently or be completely adhered to, particularly given capacity constraints in MDAs, especially in deconcentrated offices where professional knowledge and experience sometimes is lacking. This can lead to errors in the accounts, particularly in terms of financial reporting, making reports less reliable although finance officers claim that most errors are detected and corrected. Another problem is the understanding of the rules and need for enforcement by MDA senior management. This is a major concern as lack of enforcement could undermine the function of the internal control system however well it might be designed. Also here KENAO annual reports are returning year after year to the same kind of problems which have not been attended to. Also the Internal Audit reports are evidencing lack of compliance with the rules for sound financial management.

Indicator	Score	Brief Explanation
PI-20. Effectiveness of internal controls for non-salary expenditure	**C**	
(i) Effectiveness of expenditure commitment controls.	C	Expenditure commitment control procedures exist and are effective when complied with, but there is evidence about lack of compliance in the Auditor General's reports. IFMIS, while having inbuilt effective commitment controls, is not yet covering all MDAs.
(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures.	C	The Finance Act, Financial Regulations and the Exchequer and Audit Act include rules to regulate financial management, but the latter are partly outdated and complemented with successive Treasury circulars. Although they include segregation of duties between finance officers, accounts controllers and internal auditors they are not easy to get an overview of and have not incorporated recent reforms.
(iii) Degree of compliance with rules for processing and recording transactions.	C	Whilst the rules for processing and recording transactions are largely complied with in accordance with the financial regulations, they may not be applied consistently or be completely adhered to as evidenced by external and internal audit reports.

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 that is appropriately structured, has adequate independence, mandate and power to report, utilises appropriate professional standards, and reports on significant systemic issues. Specific evidence of effective internal audit would also include assessment and monitoring of error rates, a focus on high risk areas, reporting on correction rates, and use by the External audit of the internal audit reports, and action by management on internal audit findings.

The current Office of the Internal Auditor General (IAGD) is, without much detail, established under the Government Financial Act 2004. Before the promulgation of the act the internal auditor's duties and responsibilities have been spelt out in i.a. Treasury Circulars. There is also a recent Treasury circular (May 2008) that gives a somewhat more detailed instruction about the Internal Auditor's duties and responsibilities in the Government Service. Apart from that circular there is no legal incorporation of the IAGD, and in an international perspective its legal base still seems weak.

The new platform for internal audit that was presented in 2005/2006 was deemed to give the internal audit good conditions for its future work. It included:
- the establishment of internal audit units and audit committees in all ministries;
- the regulation on internal audit;
- management action on internal audit reports;
- the adoption of internal audit standards for the private and public sectors;
- the issuing of an internal audit manual; and,
- the recruitment of additional qualified audit staff.

This new platform, which was complying with the Institute of Internal Auditors (IIA) standard, has successively been implemented and it now seems to be mostly operational for all central government entities while we have seen evidence that the modernisation might not yet have fully penetrated all departments and especially not down to district level. We did still find, e.g., instances where internal auditors were engaged in pre-audit.

However, the central IAGD itself has developed well and is showing a commendable professional ambition although they still have a way to go. Pre-audit is mostly phased out and the focus is more than 50 per cent of staff time on systemic issues as estimated from the reporting. There is a good number of reports issued in the last two years that show professional skills and substantially adherence to international auditing standards for internal auditing.

However, the lingering weaknesses about internal audit are primarily related to management follow up and delayed action to remedy deficiencies. The follow-up and response to the audit reports seem not to have improved much in spite of establishment of Audit Committees. The committees have been set up in almost all government organisations. Some committee meetings have taken place and follow up have been documented in minutes, but they have not been meeting regularly and according to a recent IMF report there is little ownership within the line ministries.

The coverage of the internal audit still demonstrates some deviations from advisable practice:
- It is not in the IAG remit to monitor and coordinate the internal audit at KRA as this is done exclusively by KRA´s own internal auditors (tax and customs). This means in practice almost the whole revenue side of the government budget.
- There is no consolidated Annual Activity Report by the Internal Auditor General about the state of affairs in his area of responsibility. Such a report would describe the situation for the whole Internal Audit area and is therefore indispensable.

It should also be noted that the coverage of IAD has improved significantly in the year 2008 in spite of the fact that it still does not meet international standards. Treasury has brought under IAD the school internal audit unit in the Ministry of Education, the internal auditors in all the over 175 local authorities, the Cooperative sector internal auditors and the Ministry of Finance internal audits units. All these Units were previously independent of the IAD. The Ministry of Finance, jointly with the Kenya Anti-

Corruption Commission (KACC) is also in the process of harmonizing corruption prevention activities in all public institutions through the IAD.

Indicator	Score	Brief Explanation
PI-21. Effectiveness of internal audit	**C+**	
(i) Coverage and quality of the internal audit function	B	The new platform for internal audit, which is complying with the Institute of Internal Auditors (IIA) standard, has successively been implemented and it now seems to be mostly operational for all central government entities guided by auditing standards while we have seen evidence that the modernisation might not yet have fully penetrated all departments and especially down to district level.
(ii) Frequency and distribution of reports.	B	Internal Audit Reports are issued to Accounting officers, the IAG, Ministry of Finance and the KENAO. Reporting is done without delay as audits are finished.
(iii) Extent of management response to internal audit findings.	C	The lingering weaknesses about internal audit are primarily related to management follow up and delayed of action to remedy deficiencies. The follow-up and response to the audit reports seem not to have improved much in spite of establishment of Audit Committees. The committees have been set up in almost all government organisations. Some committee meetings have taken place and follow up have been documented in minutes, but they have not been meeting regularly and according to a recent IMF report there is little ownership within the line ministries.

3.5 Accounting, recording and reporting

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. High quality bank reconciliation requires that large differences aren't left unexplained. Two critical types of reconciliation are: (i) reconciliation of fiscal data, held in the government's ledgers, with government bank account data held by central and commercial banks; (ii) reconciliation of suspense accounts, and advances.

The AG arranges for bank accounts to be opened for each line ministry at the central bank, or if needed, at a commercial bank. Commercial banks are often used at the district level where there are no sub-offices of the central bank. From 2004 the MOF has implemented a new cash management system requiring ministries to prepare and submit their reconciled bank accounts by the 15th day of each month. The Treasury, through the Exchequer Committee, monitors all line ministries back accounts including those held at the commercial banks.

Each ministry is required to submit their reconciliation to the AG on a monthly basis by the 15th of following month. The record of submission of account reconciliation by line ministries used to be poor. The circular guiding the bank reconciliation procedure included threat of sanctions whereby exchequer releases would be stopped and credit lines frozen for non-compliant ministries. These new arrangements were fully implemented in 2004 and the Treasury keeps a record of the dates of account submission of all ministries. The Treasury indicates that most of the ministries submit their reconciled accounts on timely basis - the majority within a month. There are however problems to reconcile payments related to imprests, and the auditor general's annual report for 2006/07 indicates that many bank accounts have not been cleared of old unexplained balances dated several years back.

It is worthwhile to note that the Ministry of Finance requirement that funds should not return to Treasury at the financial year end has also resulted in high levels of imprests and unreconciled balances in the accounts. Ministries tend to rush procurement and expenditures towards the year end in order to comply with these requirements. A substantial amount of these expenditures are not properly accounted for. This problem will not be addressed by changing the accounting system including IFMIS as it is an operational and budget execution issue.

The IFMIS system has a cash management module that has yet to be introduced. It is expected that the further roll out of IFMIS and the introduction of the cash management module will ease the work required and improve the quality of bank reconciliation. A budget preparation module also exists in the current IFMIS set-up, it has however not yet been implemented.

Although the old uncleared balances remain, the treasury managed bank accounts are normally reconciled within 4 weeks of end of month. Dimension i) is therefore deemed to be a fairly weak B.

Reconciliation and clearance of suspense accounts are done at the year end when ministries submit their records for final accounts. Outstanding imprests and some uncleared payments is apparently a problem as witnessed by both the Accountant General and Controller and Auditor General. The situation in general is that reconciliation and clearance of suspense accounts and advances take place annually in general, but a significant number of accounts have uncleared balances brought forward. Hence dimension ii) is rated a C.

Indicator	Score	Brief Explanation
PI-22. Timeliness and regularity of accounts reconciliation (M2)	**C+**	
(i) Regularity of bank reconciliations	B	Bank reconciliation for all treasury managed bank accounts takes place at least monthly, usually within 4 weeks from end of period.
(ii) Regularity of reconciliation and clearance of suspense accounts and advances	C	Reconciliation of suspense accounts and advances take place annually or more frequent but at least within two months of end of year, but a significant number of accounts have uncleared balances brought forward.

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

Studies of resources received by front line service delivery units like schools, hospitals, dispensaries and clinics in the format of PETS (public expenditure surveys) have not been systematically conducted since 2003, when KIPRA undertook two studies – one for the education and one for the health sector. The Ministry of Education however has designed a monitoring instrument for use of the Fund for Primary Education in the format of a questionnaire to primary schools. The questionnaire has been distributed the last two years and includes questions related to availability of instructional materials, allocation and use of funds, count of text books, storage and management of books etc. It has reference to the codes used by the TSC, but there is as yet no summary report on the result of the questionnaire.

The health sector has not conducted any such exercise during the latest three years.

The introduction of the new payroll and PFM systems can in the longer run provide some regular data as to resources at primary service institution level. This could for example already be the case for salary and staff distribution data provided by IPPD. The system has however only recently been introduced and such surveys are not yet made. They also need to be substantiated by institutional break down and details for other cost components and through special surveys/inventories. Such systems and code structures are not yet in place.

It can also be noted that at service delivery level the introduction of the school committees with representation of parents and teachers has resulted in local monitoring of resources. Similar arrangements are discussed for the health sector.

As the efforts in the Education sector remain unreported and only cover the resources delivered over the FPE fund, and as there is no evidence of any other major survey over the latest three years, the rating of this indicator is a D.

Indicator	Score	Brief Explanation
PI-23. Availability of information on resources received by service delivery units	**D**	No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last three years.

PI–24 Quality and timeliness of in-year budget reports

Previously the “Vote-book system” was utilised to enter and process expenditure data at Treasury, ministries and Districts. Data from the “Vote book system” was transferred to the “Ledger Management System” for production of periodic in-year and end of year summary reports. During the recent first phase of IFMIS introduction, IFMIS was run in parallel with the other two systems. Currently IFMIS is used by all central line ministries, although in some still in parallel with the old system. Districts are not on IFMIS and still use the “Vote book system”. Hence in total some 20 % of the total expenditure volume is still managed outside IFMIS.

For presentation of in year budget reports the current interim solution for Districts is to capture District data from the Vote Book system to the Ledger management system, from which data is entered to the IFMIS system.

The current status for most central ministries is that reporting of expenditure, commitments and payments in the structure of the estimates is made through IFMIS. Consolidated reports however need to combine data from the vote-book system and IFMIS.

In terms of production of expedient flash reports for most central ministries they can be produced instantly by use of IFMIS. To also get details of expenditure from the district level, the information is readily available at districts in their stand alone Vote book systems, that also captures both commitment and payment stages and can report accordingly. The consolidated expenditure reports are however produced with some time lag, as the District data needs to be brought on the central systems. This is normally done by disk, whereas methods using e-mail attachments are being discussed. In the longer run, plans exist to connect also districts to IFMIS through cable.

For the considerable group of SAGAS, including some hospitals and most universities, detailed reports are not included in the consolidated in-year reports. These entities are only featuring as transfers.

The score for the first dimension is rated a B as expenditure is covered at both commitment and payment stages, and as the in year reporting of the SAGAs is made on aggregate level.

Although a large portion of central government now can be reported instantly (80 %) the consolidated quarterly reports are normally produced within six weeks of end of quarter. Dimension ii) therefore scores a B.

As to the quality of information there are still concerns, many related to District’s reporting but at large the reports are deemed to be useful and the concerns would not compromise their basic usefulness. The rate of dimension iii) is therefore a C.

Indicator	Score	Brief Explanation
PI-24. Quality and timeliness of in-year budget reports	**C+**	
(i) Scope of reports in terms of coverage and compatibility with budget estimates	B	Classification allows comparison to budget but for SAGAs only with aggregation. Expenditure is covered at both commitment and payment stages.
(ii) Timeliness of the issue of reports	B	Reports are prepared quarterly, and issued within six weeks of end of quarter.
(iii) Quality of information	C	There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not fundamentally compromise their basic usefulness.

PI-25 Quality and timeliness of annual financial statements

Annual financial statements are prepared through a process where each line ministry presents its final accounts to the Controller and Auditor General. The accounts shall be presented to CAG within three months of year's end, i e by 30th September. According to the CAG the accounts are often incomplete and prepared in a haste to meet the deadline. The Controller and Auditor General scrutinizes and responds to the accounts and a process begins where some corrections are made to the statements. The final accounts from some ministries can therefore only be said to be complete later; from the experience of the last three years around mid November. The Ministerial accounts are simultaneously presented to Treasury, which prepares the central government summary accounts and submits them to CAG. The final consolidated accounts are thereafter audited and presented in "The report of the Controller and Auditor General to Parliament on the appropriations accounts, other public accounts and the accounts of the funds of the Republic of Kenya." This publication has over the last years been presented to Parliament 20/4, 14/5 and 29/5, i.e. around 10 months after the end of the financial year. Apart from the fourth quarterly expenditure review report, which would appear some six weeks after end of the year, no other consolidated and comprehensive annual report is available before the CAG report.

The Central Government financial statements are prepared on the base of formats prepared by the Office of the Accountant General. There is no Manual prescribing various "national" accounting policies, accounting treatment and disclosures.

The financial statement for the appropriations accounts contains detailed audit comments to each of the different ministries annual accounts. It also includes the CAGs summary conclusion and opinion. The subsequent section presents the accounts including the exchequer account and the consolidated fund services, details of the public debt and a summary of recurrent appropriation accounts, followed by the details of the ministerial votes. (Approved estimates and actual receipts). Finally a number of special fund accounts are presented.

In CAG:s summary opinion for the latest publication, for 2006/07, a division is made of the accounts in two groups listed in two appended lists, A and B respectively. For list A accounts the CAG draws the conclusion that except for reservations set out in the audit report, they fairly represent the financial position. As to the accounts in list B CAG notes that he is unable to express any meaningful opinion due to various unexplained discrepancies, omission of expenditure from the accounts and lack of documentation to support some of the figures shown in the financial statements.

It can be noted that many of the unexplained discrepancies etc. date several years back and that an exercise to clean government's records might be an essential contribution to produce more accurate accounts and statements.

Assessment
Dimension i) is concerned with the completeness of the financial statements. The existing statement does not include information on assets and bank account balances. As noted from the CAGs annual report for 2006/07 many of the financial records are too poor to enable audit (List B), and for these no qualified statement could be given. The rating of dimension i) is therefore a D.

As to ii) timeliness of submission of the financial statements for audit the issue is that it is the controller and auditor herself that both prepares the consolidated statement and audits it. All ministerial statements and the summary statement are delivered within six months of the end of the financial year. However the summary of those statements do not constitute a consolidated statement ready for audit. We therefore assess that a consolidated statement is ready for audit between six and 10 months after year end. This leads to a B rating.

The Government employs a cash based model and a national accounting standard which differs from IPSAS practices, e g related to disclosure of capital assets and bank balances, and financial status of externally funded projects. The accounts are presented in consistent format over time. This results in a C rating for dimension iii).

Indicator	Score	Brief Explanation
PI-25. Quality and timeliness of annual financial statements	**D+**	
(i) Completeness of the financial statements	D	Annual financial records are to a substantial extent too poor to enable audit.
(ii) Timeliness of submission of the financial statements	B	The consolidated government statement is ready for final audit within 10 months of the end of the fiscal year.
(iii) Accounting standards used	C	Statements are presented in consistent format using national standards which do not correspond to IPSAS standards..

3.6 External scrutiny and audit

PI-26 Scope, nature and follow-up of external audit
The external audit is carried out by Kenya National Audit Office (KENAO). The KENAO draws its authority from the Constitution from 1998 (revised 2001), which establishes the office and defines its responsibilities and mandates its powers but also provides for the independence of the Office. KENAO and its operations are further regulated by the Public Audit Act (PAA) from 2003. The Controller and Auditor General (CAG) is appointed by the executive President, not by Parliament. The CAG may be removed from office only under specific circumstances defined in the Constitution and only by the President on the recommendation of a tribunal.

The Public Audit Act of 2003 established the Kenya National Audit Commission (KENAC) which approves the budget of KENAO and determines the remuneration and other terms of appointment of staff of KENAO. For issues related to human resources management, however, the KENAO functions under the authority delegated by the Public Service Commission.

Under the PAA, KENAO is mandated to audit all central government ministries and departments, local authorities, semi autonomous government agencies, special funds, extra budgetary funds and state corporations. The mandate covers all entities for which the holdings of government and other public corporations are more than half the total equity. KENAO is independent of any other authority in carrying out its prescribed functions. The PAA also authorizes the CAG to conduct performance audits. This kind of audit, however, has only recently started.

In the past, until recent years, the KENAO has not been able to cover the whole central Government annually; the PEFA evaluation of 2006 noted that the coverage was between 50 and 75 %. KENAO has now substantially increased its coverage and is claiming that its financial audit is now covering 100% of central Government annually, which is also evidenced in the Annual Report. Approved auditing standards are applied and important systemic issues (e.g. payroll, procurement) are addressed. The KENAO has achieved this by using its resources better but also by better planning and by improved training of its personnel. When it comes to Local Authorities, KENAO still do not have the capacity for a full annually coverage and there are considerable backlogs dating years back. Contributing to this is also weak capacity in the Local Authorities for preparing their accounts with poor quality or non-existence of accounting and financial statements.

There have been queries raised as to the quality of audits for some entities. For instance the approach used in auditing donor-funded projects, some state corporations and local authorities including the issuance (or lack) of management letters, the format and content of these letters and the practicability of some of the recommendations have been issues of concern.

The timeliness of submission of audit reports has improved and KENAO has now completely cleared its backlog and is producing the annual report every year, but delays in legislative scrutiny, see PI 28, are still a problem in the chain of accountability. The reports have been submitted as follows:

Budget year	Financial statements received by KENAO	Audit report submitted to Parliament	Time from receiving Financial statements
2004/2005	25th November 2005	20th April 2006	5 months
2005/2006	10th November 2006	14th May 2007	6 months
2006/2007	7th November 2007	29th May 2008	7 months

The reports have not been submitted within the statutory limit (6 months from end of fiscal year), but when taking the PEFA framework measures into account (time from receiving financial statements), the scoring should still be raised compared to the 2006 scoring.

Once the audit report is completed and submitted to Parliament, the responsibility for making recommendations rests with the PAC (which is dealt with under PI 28). KENAO on its part, in its continued audit planning and subsequent reports, makes observations on whether or not action has been taken which also is reflected in the reports where observations and remarks are repeated year after year. This is demonstrating the weakness and lack of enforcement of the process after PAC´s deliberations.¨

Although the KENAO´s budget is prepared and submitted by the KENAC it can still be subject to budget cuts from the MoF (the auditee) before the budget is decided upon by the Parliament. It is thus not in full control of its own resources. According to the rules of INTOSAI (Lima Declaration), an Auditor General, while funded by and reporting to Parliament, must be independent of the executive and be able to control its own resources for a full and professional audit of the State budget and everything else within its audit mandate. Although the CAG reports to Parliament, it must do so through the Ministry of Finance which, however, must send the report to Parliament within 7 days. Another discrepancy in relation to international best practise is that KENAO is audited by the Internal Auditor General in the Ministry of Finance, a department which falls under KENAO´s audit mandate.

Indicator	Score	Brief Explanation
PI-26 Scope, nature and follow-up of external audit	**C+**	
(i) Scope/nature of audit performed	B	KENAO has substantially increased its coverage and is claiming that its financial audit is now covering 100% of central Government annually, which is also evidenced in the Annual Report. Performance audit, however, has only recently started. When it comes to Local Authorities, KENAO still do not have the capacity for a full annually coverage and there are considerable backlogs dating years back.
(ii) Timeliness of submission of audit reports to legislature	B	For the last three fiscal years KENAO has submitted their annual reports 6 – 7 months from within the receipt of financial statements.
(iii) Evidence of follow-up on audit recommendations	C	Once the audit report is completed and submitted to Parliament, the responsibility for making recommendations rests with the PAC (which is dealt with under PI 28). KENAO on its part, in its continued audit planning and subsequent reports, makes observations on whether or not action has been taken which also is reflected in the reports where observations and remarks are repeated year after year. This is demonstrating the weakness and lack of enforcement of the process after PAC´s deliberations.

PI-27 Legislative scrutiny of the annual budget law

The role of the parliament during the budget approval process is still limited although it has improved during recent years when the Budget Committee have become more active and also got more resources in the Parliament Budget Office to support its work. The Parliaments role in the budget process is outlined in the Constitution and, when it comes to the procedures, in the Standing Orders of the Parliament. Within this framework the Parliament's budget process is taking place and there is also room for development over time.

The budget timetable leaves only a limited time for parliamentary scrutiny and the budget is only presented to the Parliament in the beginning of the fiscal year. Existing law permits ministries to spend half of the budget estimates after the budget is presented to parliament but before parliament approval, so the budget execution is already underway when the Parliament starts deliberating the budget. During recent time, however, the Budget Committee members have got some advance information and become involved in sector working groups that prepare the budget which has given them more detailed information before the formal budget scrutiny.

The legislature's scope of scrutiny covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue.

The time allocated for the legislature's review seems reasonable when you look at the table below. However, according to the Standing orders the time for debate on the annual estimates are very restricted, less than one month. According to the Parliamentarians from the Budget Committee that have been interviewed the time is clearly insufficient for meaningful debate and the time for debate has in reality for the last years come down to two weeks. Even so, the Parliament has become more engaged and active in the budget scrutiny and the parliamentarians are debating the Financial Bill and the Annual Budget to the extent possible within the limited time they have.

Budget proposal for	Submitted to Parliament	Decided by Parliament
2005/2006	Mid June 2005	End of October 05
2006/2007	Mid June 2006	End of October 06
2007/2008	Mid June 2007	End of October 07

There are rules allowing for budget amendments without ex-ante approval and the Government must then report this to the Parliament in the supplementary budget which is normally done once or twice a year. It seems that extensive administrative reallocations are taking place during the fiscal year. The rules allow for emergency spending resulting in expansion of the budget with ex-post approval by the Parliament. The CAG and the PAC has however pointed out that Ministries has used the Civil Contingencies Fund in an unintended way, thereby expanding their spending beyond their budgets.

Indicator	Score	Brief Explanation
PI-27 Legislative scrutiny of the annual budget law	**D+**	
(i) Scope of the legislature's scrutiny.	B	The legislature's review has increased somewhat and covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue
(ii) Extent to which the legislature's procedures are well-established and respected.	B	The Parliaments role in the budget process is outlined in the Constitution and, when it comes to the procedures, in the Standing Orders of the Parliament. Within this framework the Parliament's budget process is taking place and there is also room for development over time. The Procedures are respected but they are not addressing one major obstacle for a more effective budget review - the limited time.
(iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined).	D	The time allocated for the legislature's review seems reasonable when looking at the time span from when the budget is submitted to the final decision. However, according to the Standing orders the time for debate on the annual estimates are very restricted, less than one month. According to the Parliamentarians from the Budget Committee that have been interviewed the time is clearly insufficient for meaningful debate and the time for debate has in reality for the last years come down to two weeks
(iv) Rules for in-year amendments to the bud-get without ex-ante app-roval by the legislature.	C	There are rules allowing for budget amendments without ex-ante approval and the Government must then report this to the Parliament in the supplementary budget which is normally done once or twice a year. It seems that extensive administrative reallocations are taking place during the fiscal year. The rules allow for emergency spending resulting in expansion of the budget with ex-post approval by the Parliament. The CAG and the PAC has however pointed out that Ministries has used the Civil Contingencies Fund in an unintended way, thereby expanding their spending beyond their budgets.

PI-28 Legislative scrutiny of external audit reports

In most countries, the legislature is the constitutionally mandated institution through which governments are held to account to the electorate. In Kenya the Public Accounts Committee (PAC) is responsible for carrying out the legislative oversight of budget execution. Details of the PAC hearings are recorded in a report with recommendations, and these reports are submitted to the Parliament which then adopts the reports.

PAC has had a considerable backlog in its dealing with reports from the KENAO but is now trying to make up lost time; however the latest report from PAC is signed 16th October 2007 and concerns the audit report for 2003/2004. PAC is now working with reports from more than one year at a time but there is still three annual audit reports submitted that have not yet been finished by the committee.

The PAC conducts hearings on most cases that are brought up in the report from the KENAO and summons Accounting officers to appear and explain the cases. Representatives from the KENAO and Accountant General are permanent witnesses to explain and provide more information to assist the committee. The KENAO is also assisting the PAC in writing its report and formulating the recommendations.

Once the PAC report has been adopted by the Parliament, the report with observations and recommendations is sent to Government through the Treasury in the Ministry of Finance. Treasury notifies all the concerned MDAs about the remarks and the recommendations and then records all the observations from the PAC together with the answers from MDAs in the Treasury Memorandum which is then sent to Parliament. The answers have to be submitted within a time limit but implementation of recommendations is not time bound.

This process, however, is much delayed and several years have passed before any feedback is coming back to the Parliament; the last finished Treasury Memorandum comprises the years 1998/1999 and 1999/2000. The slow process and seemingly lack of enforcement seriously undermines the value of the follow-up. The annual audit report shows examples of how the same remarks in the same institutions are repeated year after year.

Indicator	**Score**	***Brief Explanation***
PI-28 Legislative scrutiny of external audit reports	**D+**	
(i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years).	D	*PAC has had a considerable backlog in its dealing with reports from the KENAO but is now trying to make up lost time, however the latest report from PAC is signed 16th October 2007 and concerns the audit report for 2003/2004. PAC is now working with reports from more than one year at a time but there is still three annual audit reports submitted that have not yet been finished by the committee.*
(ii) Extent of hearings on key findings undertaken by the legislature.	B	*The PAC conducts hearings on most cases that are brought up in the report from the KENAO and summons Accounting officers to appear and explain the cases. Representatives from the KENAO and Accountant General are permanent witnesses to explain and provide more information to assist the committee. The KENAO is also assisting the PAC writing its report and formulating the recommendation.*

(iii) Issuance of recommended actions by the legislature and implementation by the executive.	C	*Once the PAC report has been adopted by the Parliament, the report with observations and recommendations is sent to Government through the Treasury in the Ministry of Finance. Treasury notifies all the concerned MDAs about the remarks and the recommendations. This process, however, is much delayed and several years have passed before any feedback is coming back to the Parliament; the last finished Treasury Memorandum comprises the years 1998/1999 and 1999/2000. The slow process and seemingly lack of enforcement seriously undermines the value of the follow-up. The annual audit report shows examples of how the same remarks in the same institutions are repeated year after year.*

3.7 Donor Practices

The narrative for indicator I-7 provides an overview table of donor support to Kenya. It can be noted that donor support constituted 12 % of the overall estimates and 41 % of the development estimates. Half of this is provided as loans and half as grants.

The dominant donors in the estimates for 2008/09 are:

Donors 2008/09		
	Estimated grants and loans	
Donor	**bn KES**	%
IDA	24,5	30%
ADB/ADF	9,3	11%
China	5,3	7%
EDF/EEC	5,1	6%
AFD-France	4,8	6%
KFW-Germany	4,5	6%
Global Fund	3,7	5%
Danida	2,8	3%
SIDA	2,6	3%
UNICEF	2,1	3%
Others	16,3	20%
	81,0	

D-1 Predictability of Direct Budget Support

Direct budget support to Kenya Government is only provided by the European Union. Agreement for this support was reached by end of calendar year 2005 whereby the European Union would provide GBS of 120 mn € or 11,8 bn KES. The first tranche of 50 mn € was subsequently released during 2005/06, without having featured in the development estimates. The second tranche which was due the following year was withheld due to the investigation of irregularities in Government procurement. A next tranche is expected to be released 2008/09.

As to the scoring of the EU support related to both dimension i) – deviation of outturn from forecast there was never a forecast for the first tranche, and the second tranche fell short of the forecast. For dimension ii) the in-year timeliness of donor disbursements a similar situation exists. **Both sub-dimensions would rate a D.**

D–2 Financial information provided by donors for budgeting and reporting on project and programme aid

A comprehensive monitoring survey of the Paris Declaration implementation has recently (2008) been carried out by OECD-DAC for Kenya and other countries. The survey covered around 90 % of donor support including loans related to support provided 2006/07. The survey mapped 17 indicators like use of country public financial management systems, predictability of aid etc, through questions to the donors and to government.

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

The first question to government was How much estimated ODA (Overseas Development Aid) was recorded in the annual budget as grants, revenue or ODA Loans. The answer given was that 693 bn $ were put on budget FY 2006/07. This constituted 58 % of what was later disbursed which was a slippage from the level of 91 % experienced the previous year.

It has been experienced from the treasury that donors when requested are providing indicative figures to be included in the estimates, but that these figures are unreliable. There has however been an improvement, and better procedures have been agreed for the future.

The donor coordinator at WB assesses the compliance with the requirement to provide information on the project support at least three months prior to the start of the year to be around 50 % for project aid. In the final dissemination seminar of this PEFA report donor representatives agreed that the figure was less than 50 % compliance.

Against this information dimension i) is rated a D.

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

The reporting is accurate for most loan funded projects, and for those funded by grants. There are however significant problems to get reliable reports for loans of some donors and for most of the AiA grants. These constitute some 35 % of project support. The information is often not consistent with the government budget classification, although also in this regard agreement has been reached to improve reporting standards for the future support.

This dimension is rated a C.

D–3 Proportion of aid that is managed by use of national procedures

The OECD-DAC questionnaire contains several questions related to this indicator. It requests data on the portion of support that uses government budget execution system, financial reporting system, audit and national procurement. The questionnaire revealed that 53 % of aid to the government sector made significant use of country systems 2007. The requirement in the PEFA assessment is however that all the mentioned systems should be used. In addition some donors outside the survey make little use of government systems.

The indicator is therefore rated a D.

Indicator	Score	Brief Explanation
D-1 Predictability of Direct Budget Support	**D**	
(i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature.	D	*No comprehensive and timely forecast was provided by the donor agency for budget support.*
(ii) In-year timeliness of donor disbursements.	D	*No quarterly disbursement plan provided first year, and frozen disbursements the second.*

D-2 Financial information provided by donors for budgeting and reporting	**D+**	
(i) Completeness and timeliness of budget estimates by donors for project support	D	*At least half of the donors provide complete budget estimates for disbursement of project aid for the government's coming fiscal year, at least three months prior to its start. Estimates use donor classification and are often not consistent with the government's budget classification.*
(ii) Frequency and coverage of reporting by donors on actual donor flows for project support	C	*Donor provides quarterly reports within two months of end-of quarter on all disbursements for at least 50 % of the externally financed projects in the budget. The information does not provide a break-down consistent with the government budget classification.*
D-3 Proportion of aid that is managed by use of national procedures	**D**	
(i) Overall proportion of aid funds to central government that are managed through national procedures.	D	*Less than 50 % of aid funds to government are managed through national procedures.*

4. Government Reform Process

4.1 Description of recent and on-going reforms

For a number of years PFM reform has been ongoing and received substantial donor support. The PFM Action Plan of 2003/04 was an effort to put together all reform efforts in a comprehensive list for monitoring purposes. Many of the efforts were aimed to address weaknesses and conditions related to further donor support and debt relief, and the benchmarks set for that.

In 2004 to 2006 a comprehensive reform programme was initiated aiming for improvements for 16 different reform components:

Macro-fiscal forecasting
Budget formulation
Budget preparation
Budget execution
Revenue collection
Debt and guarantee management
Payroll and pensions
Procurement
Accounting and reporting
Internal audit
External audit
External resources
Parliamentary oversight
Accounting regulations and training
Consistent Legal framework for PFM
Electronic Service Delivery

A PFM Coordination Unit (PFM-CU) was created within Ministry of Finance, with a designated PFM reform co-ordinator and a secretariat, and a defined reform strategy. Donors support the effort through a pooled funding arrangement, although also other sources outside the pool exist. The donors are co-ordinating monitoring and supporting the reform through the Public Finance Development Partners' Group (PF-DPG).

The table below made by the recent IMF ROSC report, takes stock of the status of some of the major reform efforts being made:

Box 3. Summary of Reforms Since 2003

Prior to 2003, Kenya faced serious weaknesses in institutions, including those in the area of public financial management. The PEM-AAPs, undertaken in 2003 and 2004, showed that Kenya met only 4 out of 16 benchmarks.[1] Governance problems culminated in a number of notorious scandals such as the Goldenberg and Anglo-Leasing scams. **Since 2003, a number of key reforms have been initiated** aimed at improving public financial management and fiscal transparency more generally, although important challenges remain. **The key reforms to address weaknesses in the area of PFM have been:**

Situation in 2003	Key actions taken	Status
1. Outdated PFM legal framework	-*Government Financial Management Act (2004)*: addressed some urgent PFM issues, mainly in accounting, but its coverage remains limited	Revision underway
	-*Public Procurement Act (2003)*: introduced modern procurement processes and standards	Being implemented in 2007
	-*Public Audit Act (2003)*: established independence of National Audit Office	Implemented
2. Limited availability of fiscal information	-strengthened monthly expenditure returns process: significant improvements but still delays of up to two months	On-going
	-improvements in reporting on SAGAs and EBFs: reports more readily available – but information still incomplete and only occasionally published	On-going
	-publication of Quarterly Budget Review on MoF website: available between 2 and 4 months from end of quarter	Implemented, but needs improvement
	-computerization: legacy systems gradually being replaced by modern IFMIS system – roll out to ministries/agencies, districts in second phase	On-going
3. Significant discretionary powers of the Treasury during budget execution	-implementation of stricter limitations on tax expenditures through tightened legal framework and improved controls at KRA	Implemented, but needs monitoring
	-improved cash management: releases based on cash flow projections from ministries/agencies	On-going
	-strengthened accountability of ministries/agencies: less discretionary power at Treasury to make budgetary changes	On-going
4. Significant discretionary powers in personnel policy	-Public Service Commission Regulations 2005: tightened up on qualifications and established procedures for recruitment – greater transparency	Implemented
	-cleanup of payroll: integrated payroll and personnel system introduced, although functioning in decentralized mode	Implemented, but needs further effort
5. Lack of budget realism	-improved fiscal framework: greater reliability of macro-economic forecasts, improved revenue projections, realistic ceilings for budget preparation, MTEF	Good progress made, on-going
	-wider consultation during budget preparation: review of SAGA/EBF budgets, consultation of civil society groups, strengthened budget cycle	On-going

There have also been key reforms in other areas which have helped meet the requirements under the fiscal transparency code. Key legal reforms: (i) the *Public Officer Ethics Act (2003)*, which introduced a code of conduct and compulsory filing of annual declarations of assets and income for public officers; (ii) the *Anti-Corruption and Economic Crimes Act (2003)*, which established the Kenya Anti-Corruption Commission (KACC); (iii) the *Privatization Act (2005)*, which makes a Commission responsible for privatization, thereby increasing accountability and transparency; (iv) the *Statistics Act (2006)*, which established an independent National Bureau of Statistics. In addition, various administrative reforms have been implemented, including outlawing *harambees* (political fund-raising events), establishing a ministerial code of conduct, introducing performance contracts for all SAGAs and SOEs, reforming tax administration (KRA), and simplifying licensing regimes for businesses. **Remaining challenges** include making public the wealth declarations of senior officials, and operationalizing the Privatization Commission and the Pubic Procurement Oversight Authority.

[1]This compared with 8 benchmarks in neighboring Uganda and 11 in Tanzania (www.imf.org).

Source IMF ROSC report on Fiscal Transparency module March 2008

Other on-going improvements relate to:

Widened IFMIS use, introduction of additional modules such as for cash management, and roll-out to provinces and districts. Refined code and reporting structures.

Full coverage of IPPD through roll-out to the remaining entities.

A new Public Finance Administrative Act, revising responsibilities, budget calendar and process.

The situation pertaining to IFMIS and IPPD is likely to need a period of consolidation, reinforcement of support, communication, security and access as well as capacity building. Training will be more fruitful in the up-coming phase as workstations and opportunities to apply the new knowledge are improved.

There is potential for further systems improvements and better accuracy if an interface can be established between IPPD and IFMIS. The interface could capture financial transaction data from IPPD, generate the required salary payments in IFMIS automatically and reconcile imprest data. It could also align and update financial code structures in IPPD.

4.2 Institutional factors supporting reform planning and implementation

The PFM reform set-up includes a steering committee for the reform programme led by the Permanent Secretary MoF, as well as a technical co-ordination group headed by the reform co-ordinator.

Difficulties encountered and reported in the PEFA hearings include:

- few meetings have been held with the reform committees and there is little continuity in the component/department's representation, if they are at all represented in meetings.
- Many proposals, especially for training have been endorsed by the ministry management but are rejected in the approval procedure by the World Bank objection.
- Procurement takes long and is very bureaucratic
- In fact fairly limited resources are being utilized from the pooled fund as other sources are more easily accessed.
- Buy in and participation of line ministries and "clients" of PFM systems could be improved.
- Also the position as PFM co-ordinator is vacant and awaiting recruitment.

It appears that some of the expected co-ordination through the established institutional framework is lacking and that components don't meet to discuss important technical issues such as the linkage and data transfer between IFMIS and IPPD.

The arrangement with a co-ordinator that remains on a director position in MoF in addition to the task to co-ordinate the reform may not be ideal. Also the question of extra remuneration to the co-ordinator and secretariat seems to have been discussed but not resolved.

Although strong commitment and support to the reform efforts have been expressed from MoF and Government of Kenya, and with a demonstrated record of reform implementation, there seems to be a need to further reinforce this co-ordination mechanism and to find ways to improve co-ordination and use of available resources.

The PFM reform review (November 2008) has been be an important effort in this regard.

Appendix A Terms of reference for the PEFA assessment

Public Expenditure and Financial Accountability (PEFA) Assessment Mission to Kenya, 2008

1. Introduction

Within the framework of the programming of the Public Financial Management reforms and the discussions on good governance, the Government of Kenya is committed to the implementation of a second Public Expenditure and Financial Accountability (PEFA) Assessment. The PEFA assessment was carried out for the first time in 2006 and its results are available in the PEFA secretariat website (www.pefa.org).

A group of development partners support the GoK in implementing public finance reforms. The GoK, jointly with the development partners, is committed to applying PEFA as a means of monitoring improvements in Public Finance in the country. The group of donors working with GoK would like to retain the services of a Team of experts to undertake a second PEFA exercise. The group has asked the EC to recruit the team on its behalf, in line with the Paris Harmonisation agenda. The assessment process and the PEFA report will however be monitored and endorsed by the Public Finance Development Partner Group.

The second PEFA mission requires the services of a Team of three Experts with a one month input over a period of three calendar months. The core team will be recruited by the EC, while other donors will be free to provide any extra expertise required to complement the exercise, if need arises. It is expected that once the Team Leader is recruited, he/she will be consulted, as much as possible, in the selection of the additional team members, beyond the core team of experts.

2. Background

The Government of Kenya (GoK) is pursuing a national development agenda that seeks to instil rapid and sustained economic growth and reduce the high incidence of poverty through wealth and employment creation. This development agenda was well articulated in the Economic Recovery for Wealth and Employment Creation (ERS).

The need for a reform of the public finance management system was emphasized in the Economic Recovery Strategy for Wealth and Employment Creation, the ERS for 2003-2007, as a crucial element in order to achieve the following:

a. Fiscal sustainability and balance in the public economy,
b. Restructuring and reallocations for growth and poverty alleviation, and
c. Improved public sector performance, efficiency and effectiveness in the public sector, leading to improved service delivery and results for Kenyans.

The link between the ERS and the PFM reforms is further reflected in the following objectives:
1. Economic Growth and Poverty Reduction – achieved through policy based budget management and resource allocation, improved fiscal discipline and sustainable budget balance
2. Service delivery improvement – through the introduction of result based management

with results and program based budgets, accountability for results and performance audit.
3. Good governance – through improved transparency, accountability and efficient controls. The PFM reform is instrumental in the fight against wasteful spending and corruption as it improves access to financial data, audit related to risks and results, open and competitive procurement processes and commitment control.

The Government in 2005 created the PFM Coordinating Unit (PFMCU) to serve as a secretariat or focal point to coordinate all the reforms. To translate the above vision into reality, PFMCU coordinated the development of a "Strategy to Revitalize Public Financial Management". The PFM strategy was based on several diagnostic and analytical works carried out by Government and Development Partners. Some of the diagnostic and analytical works are EFMAP, CFAA, CIFA, PEMFA, CPPR, PEMAAP, and PEFA**.** The strategy also benefited from a wide range of consultations within Government, civil society and development partners.

Key elements of the PFM reform programme identified within the strategy include:

a. Strengthening budget formulation, execution, accounting and reporting**.**
b. Strengthening the political oversight of financial management (Parliamentary oversight).
c. Improving payroll and pension management
d. Continued strengthening of internal audit and external audit systems.
e. Strengthening the public financial management through the use of information technology including the roll out of Integrated Financial Management and Information System (IFMIS) to ministries, departments and agencies.
f. Improve domestic revenue mobilization through support to the Kenya Revenue Authority's (KRA)
g. Strengthening the National Procurement System
h. Strengthening the PFM legal regime
i. Strengthening the debt and guarantee management

A number of development partners are providing or are in the process of providing support to the PFM reform. Notable among these partners are the World Bank, DFID, Sida, UNDP, the European Commission, USAID, CIDA, Denmark, GTZ, Japan, Norway and AfDB. All of these development partners[1] have signed a Memorandum of Understanding (MoU) with the Government of Kenya to provide support in a coherent and consistent manner to the reform agenda.

In addition, the World Bank, DFID, Sida, CIDA, Denmark and GTZ have signed a Joint Financing Arrangement with the Government of Kenya establishing a pooled funding mechanism.

PEFA has the 3 following components:
i) An external diagnosis on public financial management;
ii) A country-led agenda;
iii) A coordinated programme of institutional support on the basis of the action plan prepared by the national authorities;

[1] Norway and AfDB have agreed in principle , but are still processing signatures

The three components are closely connected. It is important to note that in order to encourage partner country ownership of the reform process the external diagnosis does not include any recommendation or action plan.

The core of PEFA consists of the analysis of the indicators[2] which are referred to as "high level" because they cover the six essential dimensions to be analysed in an evaluation of public financial management. These dimensions are:

1. *The credibility of the budget* - the budget is realistic and implemented as intended;
2. *Comprehensiveness and transparency* - the budget and the fiscal risk oversight are comprehensive and fiscal and budget information is accessible to the public;
3. *Policy-based budgeting* - the budget is prepared with due regard to government policy;
4. *Predictability and control in budget execution* - the budget is implemented in an orderly and predictable manner and there are arrangements for the exercise of control and stewardship in the use of public funds;
5. *Accountancy, recording, and reporting* – adequate records and information are produced, maintained, and disseminated to meet decision-making control, management and reporting purposes;
6. *External scrutiny and audit* – arrangements for scrutiny of public finances and follow up by the executive are operating.

The PEFA evaluation is an *external* validation exercise which requires a *strong implication of the partner country* and, ideally, should be repeated every 3 years. In this connection the PEFA report is not co- written with the partner country or that, for example, the score on the indicators be negotiated.

It is important to underline that there is *no automatic link between the scoring and eligibility to budget support*. As regards the criteria applied to public financial management, the Commission bases itself not only on changes in the performance of the PFM system, but also on the political will of the government to reform these systems, on the design of the reforms, and on their implementation. In other terms the conclusions drawn from the Public Financial Management – Performance Measurement Framework" (PFMPMF) constitute an important element, necessary but not sufficient to determine the eligibility of the partner country to budget support. It is recalled that, apart from public financial management, other criteria are taken into account: the macroeconomic situation, the existence of national policies (such as a poverty reduction strategy) and sectoral policies.

The decision to carry out this PEFA assessment results from the GoK's recent commitments to improve their good governance even further. The last PEFA in Kenya was carried out in 2006, and both development partners and the Kenyan Government see the value added by performing a second PEFA to follow-up on progress on the indicators and on the PFM reform.

[2] There are three additional indicators looking at donor practices.

3. The rationale for carrying out a PEFA assessment
The main purpose of the PEFA assessment is to enhance effectiveness of all funds channelled through the Kenyan PFM systems.

In the short-term, the PEFA assessment will follow–up on progress against the PEFA indicators from the 2006 assessment and will be used as a basis for information and monitoring so as to: (i) facilitate and update the dialogue on PFM between Government and Development partners; (ii) *help* donors assess the eligibility of a country for budget support programmes, or to verify whether general or specific PFM conditions of an ongoing budget support programme are met.

In the medium-term, the PEFA assessment will be useful to assist the Government in strategizing and prioritising the implementation of the PFM Revitalisation strategy.

4. Stakeholders: development partners and national authorities
While it is expected that the Kenya Government will take the lead in the 2008 PEFA, the PF DPG will work closely with the government and the team of experts and provide financial assistance for the exercise. There will be division of labour as follows;

- The PF DPG has made the first contacts with the government to discuss and agree the TORs and the timetable of the PEFA assessment; will be responsible with the government for the organisation and the follow-up of the mission and will check the quality of the report in consultation with the PEFA Secretariat,[3] and the government;
- Liaison with the PF DPG will be through the Lead Donor. The European Commission: (i) acts as the Lead Donor; (ii) recruits the core team of experts, (iii) consolidates the comments of donors and the PEFA Secretariat and sends them to the experts and the government. The Lead Donor is represented by Ibrahim Laafia at the European Commission.
- The PF DPG will co-finance the PEFA assessment and recruit additional experts if necessary to complement the core team for the exercise,
- The main GoK partner for this exercise is the Ministry of Finance. Ministry of Finance who will nominate a Government focal point. The focal point will help in the organization of the work, will coordinate the Government's participation around this exercise and will provide full collaboration to the exercise. The Ministry of Finance (at head of department or higher level if necessary) will be responsible for liaising with other actors outside the management model. The government: (i) will indicate the names of the officials (Ministry of Finance MoF) who will be the interlocutors of the experts and of the donors during the assessment; (ii) will indicate whether any government officials will accompany the experts during the mission[4]; (iii) will comment on the draft and final reports and send its comments to the experts and the Commission trough it's Delegation in Kenya. Care should be taken to involve high-

[3] Should its advice be required
[4] It is strongly recommended that the Team identifies with the Government of Kenya relevant Officials who would accompany them during the whole field mission in order to build capacity.

level officials in the PEFA exercise. (iv) the government working with the main donors in Kenya disseminates the draft and final report.

• Other State structures: The Government Focal Point will specify the modalities for the involvement of other state structures with an interest in the PEFA assessment before mission start. These include but are not limited to the Kenya National Audit Office, the Public Accounts Committee of the Kenya National Assembly, The Kenya Revenue Authority (KRA) and the Public Procurement and Oversight Authority (PPOA) which is largely responsible for public procurement within Kenya.

5. Objective of the assessment mission

The last PEFA mission for Kenya was undertaken in 2006. The objective of the assessment mission is i) to draft of a comprehensive[5] "Public Financial Management – Performance Report" (PFM-PR) prepared according to the PEFA methodology (see point 5 below), so as to provide an analysis of the overall performance of the PFM systems of Kenya as well as follow–up on progress against the PEFA indicators from the 2006 assessment that permits the measuring over time of changes in performance; and ii) to build capacity in the Government and development partners in the area of PFM assessment.

6. Specific tasks in the preparation of the PFM-Performance Report

In order to meet the objective of the assessment mission the following tasks shall be carried out:

• Documentation. Before the mission in Kenya the experts will consult on the PEFA website (www.pefa.org) and collect all basic documentation that they deem necessary for the mission's work in-country. They will also let the Government know, through the Government Focal Point and the Lead Donor, any need for additional information. The experts will specify the time-span they deem necessary between the date of reception of this basic documentation and the actual start of the mission in-country, especially taking into account the organisation of the training/information workshop to be held upon arrival in Nairobi (see below). The Lead Donor will particularly follow up this issue with the national authorities so as to minimize the risk of disrupting the mission which could be entailed by an important delay in providing this basic documentation.

• Information gathering and analysis: The Experts will spend two weeks in Kenya to continue collecting and analysing the required information, hold a training/information workshop, hold meetings with key stakeholders, and prepare an aide-mémoire which will be presented to key stakeholders at the end of the field mission.

• Training/information workshop.

The mission in-country will start with a 1 or 2 days information/training workshop gathering all the stakeholders and enabling the latter to understand the challenges and the modalities of the PEFA assessment and how it relates with PFM. This workshop will be run by the experts and its organisation and financing will be taken care of by the successful consortium. The pedagogical material used by the experts will be that worked out by the PEFA Secretariat and posted on its website. This workshop is expected to comprise: (i) a general session with all the stakeholders aiming at

[5] This PFM PR is composed of the detailed analysis of the 31 indicators of the « PFM Performance Measurement Framework » and of the performance report itself which summarises this analysis of the indicators and includes other elements relevant for the assessment.

providing a general understanding of what PFM and a PEFA assessment is about; (ii) a technical session with the national authorities (government and external control body) to explain the indicators and (iii) a technical session with the Government counterparts to discuss data requirements. At the end of the assignment, the experts will also organise a 1 day workshop in Kenya where the Government, other key local institutions and development partners will analyses the PEFA Report and discuss possible options for addressing the indentified weaknesses. The workshop will include an information session on PFM reform. The Expert will produce minutes of the workshop, which will be forwarded to the Government.

The Consortium will be responsible for the logistics of the workshop and will be assisted as far as possible by the counterpart (to be nominated by the PS Finance) and the Lead Donor and the other participating donors.

• Work-plan: On arrival the experts will submit to the national authorities and the involved donors a work-plan describing the main steps of the mission, notably specifying the list of the interlocutors to meet, the tentatively scheduled meetings and the list of required information not yet collected and to be provided in-country. The work-plan will also need to take into account the Government staff who will be closely involved in the PEFA assessment (see below). This work-plan may foresee a mid-term meeting gathering all the stakeholders so as to report on the work's progress and possible difficulties faced. A final debriefing session presenting the aide-mémoire will be planned.

• Capacity Building: Two officials appointed from the Government, will work closely with the mission in order to build capacity in the Government for PFM assessment and reporting.

7. Methodology

• Documents of reference: the experts, in close coordination with government services involved, will undertake the required analysis while rigorously following the structure, the methodology and the guidelines (annexes 1 § 2) of the document adopted by the PEFA Steering Committee and entitled " Public Financial Management – Performance Measurement Framework", the related amendments and clarifications subsequently adopted, as well as the document entitled "Guidance on evidence and sources of information to support the scoring of the indicators". These documents can be found on the website www.pefa.org. (The original version of this document is in English). In addition the IMF Report on the Observance of Standards and Codes on Fiscal Transparency (ROSC) for Kenya of March 2008 will be useful reference material and can be found on the website www.imf.org/external/pubs/ft/scr/2008/cr0899.pdf.

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• Differences in Methodology. If the particular situation of the country requires the addition of specific indicators and/or, for some indicators, to diverge from the prescribed methodology, this shall be duly justified by the experts and require the agreement, during the mission, of the Lead Donor and the participating donors. In any case, only a very limited number of additional indicators would be acceptable. In this case, as well as for any possible proposed difference in methodology, the experts will ask for the written opinion of the PEFA Secretariat in Washington. In Kenya for example, last PEFA exercise reported that the Kenyan budget is highly centralised, but there is a growing significant part of the budget that is decentralised, and sometimes controlled by SAGAs. This PEFA exercise will need to pay some attention on decentralised budgets, the policy issues around fiscal decentralisation, and audit and reporting of the same.

- Interpretation. Any question on the interpretation of the guidelines, which the experts cannot resolve with the available documentation, should be addressed to the PEFA Secretariat and/or to the Lead Donor
- Supporting information. In the report the experts will justify the scoring and describe, in an annex, for each indicator, the analytical work which has been carried out mentioning the sources of information and documentation used. Furthermore, for each indicator, the experts will mention the any possible difficulties encountered during the assessment, the approach used to overcome these difficulties, and, as appropriate, the additional investigative work judged necessary to complete the analysis carried out.

8. Reporting

Reporting requirements are set out below:

- In view of the final session of debriefing at the end of the mission, the experts will provide the government and the donors with an *aide mémoire* (10 pages maximum, excluding annexes), in 20 copies, indicating the main findings and reflections which will be developed in the draft report. This *aide mémoire* will be complemented by the detailed analysis of the 31 indicators of the PFM-PR.
- Within one week after the end of the mission in-country, the experts will send to the government and the donors a draft PFM-Performance Report, in 10 copies, based on Annexes 1 and 2 of the above-mentioned PEFA document.
- The Government and other stakeholders will then have 4 weeks to consider the draft report and send their comments to the experts.
- Within 1 week after the reception of the comments, the experts will revise the report taking into account the comments received. The Final Report will be discussed during the final workshop and the expert will make a final revision according to possible comments from the workshop. The latter version will be sent in 20 copies to the government and the donors. It will contain, in an annex, the observations of the government on the points where the latter disagrees with the findings of the experts.
- The report will be written in English.
- The final report with be published in the HAC website www.hackenya.org.

9. Calendar (see annex 1)

- Mission duration: The mission should start at the end of August 2008 and covers 3 calendar months:
- Global calendar of the team of experts:
  - o Preparation phase: 3 days including one day briefing by the PF DPG. The Team Leader and Expert 2 will prepare the workshop and the schedule of meetings, collect the necessary information, and finalise the work plan for the study.
  - o Mission in-country: maximum duration of 2 weeks. This will include the information/training workshop and an end-of-mission debriefing meeting presenting an aide-mémoire.
  - o Report drafting: 4 days of input over a period of 3 months. After the field mission, the experts will have one week to finalise and submit the draft report. The Government will be given up to 1 month to consider the report and submit

comments. The experts will then have one week to revise the report according to comments received.

o Training/workshop: one day for the Team Leader in Kenya to present and facilitate discussions around the PEFA Report

o Final debriefing in EC HQ: one day for the Team Leader only after having submitted the Final Report.

• The TOR include, for each week of work, a tentative table indicating the dates and key steps in preparing the PFM-PR (see annexe 1).

10. Composition and professional profile of the core team

• The core team will be composed of three experts.

• The team leader, international expert, will have at least 10 years of experience in public finance management, of which 7 years should be on analysis and/or audit of PFM in developing countries.

• It will be of great added importance if the team has great country knowledge (or has a member on team with country knowledge).

• It will be of added advantage if a member of the last PEFA exercise would be part of the team.

• The other experts will have at least 5 years of experience in the area of PFM.

• The cumulated experience of the experts should ensure that the team is able to cover the analysis of the different areas of the PFM-Performance Report.

• The international experts will have an excellent command of English

• It would be an asset for one of the experts to have good prior knowledge of the specific budget and PFM situation in Kenya, or at least in Anglophone countries with similar PFM system.

• Experience in conducting PFM assessment using the PEFA methodology is indispensable (at least for the team leader).

• University degree in economics or related field is required

• The team must possess good organisational, communication and relational skills

Other Administrative information

• Most in country mission will be based in Nairobi, however an intercity budget should be foreseen for missions in regions (around € 1000)

• Two workshops with stakeholders to be organised and budget should be foreseen for their organisation. A maximum of 40 participants per workshop can be expected.

Annexe 1: Detailed calendar

This calendar is indicative and will be refined at the start of the mission to take into account the team's suggestions and <u>availability</u>.

Activities/ Weeks	1	2	3 - 4	5	6	7	8	9	10	11 -	12
Debriefing with [donors and government]	X										
Preparatory work: workshop organisation & documentation review (home-based)	X	X									
Workshop		X									
Analysis / Stakeholder consultations			X	X	X						
Report/Aide-mémoire Drafting			X	X	X						
Submission and presentation of Aide-mémoire						X					
Finalisation of Draft Report (home-based)							X				
Submission of Draft final report								X			
Consideration of draft report by Government and submission of comments								*X*	*X*		
Revision/Submission of Final Report (home-based)								X	X		
Workshop on PEFA Report										X	
Final revision of report (if applicable)										X	
Debriefing at EC HQ											

Experts/ Weeks	1	2	3 - 4	5	6	7	8	9	10	11 - 14	Total working days	Total Per Diem
Team Leader	2	4	4	4	4	4	4	1	1	2	30	
Expert 2		4	4	4	4	4			1	1	22	
Expert 3				4	4	4			2		14	

Appendix B Detailed table of comparison between scoring of 2006 and 2008

Indicator/subindicator	Rating 2006	Rating 2006 Adjusted	Rating 2008	Reasons for changes from 2006
PI-1. Aggregate expenditure out-turn compared to original approved budget	**C**	**C**	**B**	Reduced difference on aggregate level between budgeted expenditure and actual outturn over three years.
PI-2. Composition of expenditure out-turn compared to original approved budget	**A**	**A**	**B**	Increased difference on ministry/vote level between budgeted expenditure and actual outturn over three years.
PI-3. Aggregate revenue out-turn compared to original approved budget	**C**	**C**	**A**	Reduced difference on aggregate level between budgeted revenue and actual outturn over three years.
PI-4. Stock and monitoring of expenditure payment arrears	**B**	**B**	**B**	
(i) Stock of expenditure payment arrears (as a percentage of actual total expenditure for the corresponding fiscal year) and a recent change in the stock	*B*	*B?*	*B?*	Tentative new rating at B, but insufficient information already at 2006 rating. Old arrears have however been significantly reduced.
(ii) Availability of data for monitoring the stock of expenditure payment arrears	*B*	*B*	*B*	
PI-5. Classification of the budget	**C**	**C**	**C**	
I-6. Comprehensiveness of information included in budget documentation	**B**	**B**	**B**	
PI-7. Extent of unreported government operations	**C**	**D+**	**D**	
(i) Level of unreported extra-budgetary expenditure	*C*	*D*	*D*	In 2008 PEFA Secretariat issued Clarification on the definition of “unreported government operations” and required reporting; - lack of information – comprehensive and consolidated – for statutory boards and state corporations
(ii) Income/expenditure information on donor-funded projects	*C*	*C*	*D*	a) Door funding is significant. 12 %. b) Exceptionally even large donor loans not reported. Besides CAG reported 8 major donor projects as unreported for budget representing 3,8 bn.
PI-8. Transparency of Inter-Governmental Fiscal Relations	**B**	**B**	**B**	
(i) Transparency and objectivity in the horizontal allocation amongst Sub National Governments	*A*	*A*	*A*	
(ii) Timeliness and reliable information to SN governments on their allocations	*A*	*A*	*A*	
(iii) Extent of consolidation of fiscal data for general government according to sectoral categories	*D*	*D*	*D•*	MOLG has commissioned two separate studies on outstanding debt of SNs; and improvement in annual fiscal reporting on unaudited revenues and expenditures. Fiscal information is consolidated by economic classification but not according to sectoral/functional categories.

PI-9. Oversight of aggregate fiscal risk from other public sector entities.	**C+**	**C**	**C•**	
(i) Extent of central government monitoring of AGAs/PEs	*C*	*C*	*C*	
(ii) Extent of central government monitoring of SN governments' fiscal position	*A*	*C*	*C•*	Incorrectly scored A in 2006 PEFA based on the false assumption that SNs could not borrow. Whereas Nairobi City Council, Mombasa City Council etc have large borrowings and on-lending.
PI-10. Public Access to key fiscal information	**B**	**B**	**B**	
PI-11. Orderliness and participation in the annual budget process	**B**	**B**	**C+**	
(i) Existence of, and adherence to, a fixed budget calendar	*A*	*A*	*C*	An annual budget calendar exists, but has only allowed MDA:s 11 days to submit their budget proposals 2008.
(ii) Guidance on the preparation of budget submissions	*A*	*A*	*A*	
(iii) timely budget approval by the legislature	*D*	*D*	*D*	
PI- 12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	**C**	**C**	**C+**	
(i) multi-year fiscal forecasts and functional allocations	*C*	*C*	*C•*	
(ii) scope and frequency of debt sustainability analysis	*C*	*C*	*B*	Debt Sustainability Analysis for both external and fiscal/domestic undertaken within the last year.
(iii) existence of costed sector strategies	*B*	*B*	*B•*	Documentation available on web for nine Sector Strategy Papers. Existence of broadly costed strategies which include programmes and proposed activities that are in excess of the Ministerial Ceilings and hard budget constraint are presented in the Annual Budget. This is an improved situation as compared to 2006. Some costed activities may be funded if/when additional domestic revenue is collected, or additional donor resources materialise.
(iv) linkages between investment budgets and forward expenditure estimates	*D*	*D*	*D*	By law, two separate annual budget documents must be published for Recurrent and Development Estimates, and there does not appear to be a clear demonstrated linkage between the development budget and forward recurrent cost implications.
PI-13. Transparency of taxpayer obligations and liabilities	**B**	**B**	**B+**	
(i) Clarity and comprehensiveness of tax liabilities	*B*	*B*	*B*	
(ii) Taxpayer access to information on tax liabilities and administrative procedures	*B*	*B*	*A*	Information to tax payers has improved, more means are used.
(iii) Existence and functioning of a tax appeals mechanism	*B*	*B*	*B*	

PI-14. Effectiveness of measures for taxpayer registration and tax assessment	**C+**	**C+**	**B**	
(i) Controls in taxpayer registration system	*C*	*C*	*C*	
(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations	*B*	*B*	*B•*	The penalty and interest regime is quite stiff and deterrent. There has been a major improvement in the management of waivers with the development and implementation of waiver scoring framework currently in use by both the KRA and the Treasury.
(iii) Planning and monitoring of tax audit and fraud investigation programs	*C*	*C*	*B*	KRA tax regime is based on self-assessment system supported with risk profiling of taxpayers for audit. Besides the National Audit Plan, departmental audit work plans are in place. For Domestic Taxes Department, the Large Taxpayers Office audit work plan is fully implemented and is replicated in the Domestic Revenue. Customs Services Department (CSD) has implemented Post Clearance Audits supported by the Authorised Economic Operator (AEO) system. The CSD audit plan for the Post Clearance Audit is work in progress. The Investigation & Enforcement Department responsible for fraud investigation implements its audit work plan with clear risk assessment criteria.
PI-15. Effectiveness in collection of tax payments	**D+**	**D+**	**D+**	
(i) Collection ratio for gross tax arrears, being percentage of tax arrears at the beginning of a fiscal year, which was collected during that fiscal year	*D*	*D*	*D*	
(ii) Effectiveness of transfer of tax collections to the Treasury by the revenue administration	*B*	*B*	*B*	
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury	*A*	*A*	*A*	
PI-16. Predictability in the availability of funds for commitment of expenditures	**B+**	**B+**	**B+**	
(i) Extent to which cash flows are forecast and monitored	*A*	*A*	*A*	
(ii) Reliability and horizon of periodic in-year information to MPSAs on ceilings for expenditure	*B*	*B*	*B*	
(iii) Frequency and transparency of adjustments to budget allocations which are decided above the level of management of MDAs	*B*	*B*	*B*	
PI-17 Recording and management of cash balances, debt and guarantees	**B**	**B**	**B**	
(i) Quality of debt data recording and reporting	*B*	*B*	*A*	Since 2006 data was migrated to a new platform CS-DRMS 7.2; and quality and comprehensiveness of external and domestic sovereign debt statistical reporting is recognised as comprehensive and accurate.
(ii) Extent of consolidation of the government's cash balances	*B*	*B*	*C*	
(iii) Systems for contracting loans and issuance of guarantees	*B*	*B*	*B•*	The DMD has drafted Regulations aimed strengthening the policy and guidelines for evaluating external loans; and these are awaiting the Minister of Finance to Gazette.

PI-18. Effectiveness of payroll controls	**D+**	**D+**	**C+**	
(i) Degree of integration and reconciliation between personnel records and payroll data.	*D*	*D*	*B*	IPPD means massive improvement, but not fully rolled out yet.
(ii) Timeliness of changes to personnel records and the payroll	*D*	*D*	*B*	Also in this regard IPPD has improved the situation
(iii) Internal controls of changes to personnel records and the payroll.	*B*	*B*	*C*	Controls exist but are not adequate to ensure full integrity of data as the link between IFMIS and IPPD is manual, in addition all entities are not yet included in the system (95 %)
(iv) existence of payroll audits to identify control weaknesses and/or ghost workers	*C*	*C*	*C*	
PI-19. Competition, value for money and controls in procurement	**B**	**B**	**B**	
(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases	*C*	*C*	*C*	The Public procurement regulations have been gazetted and the Public Procurement and Disposal Act, 2005 became operational in 2007. Open tenders are the preferred method of procurement and is mandatory by law. However, irregularities still abound in the procurement system as evidenced by Kenya Anti-Corruption Commission reports and complaints by components in Ministries, State Corporations and Local Authorities.
(ii) Justification for use of less competitive procurement methods	*B*	*B*	*B*	Where alternative methods of procurement are used, the tender committee's approval must be obtained. In the case of direct procurement, Procuring Entities must report to the PPOA within 14 days.
(iii) Existence and operation of a procurement complaints mechanism	*A*	*A*	*A*	The appeals procedure is clearly provided for under the Public procurement Regulations and a Public Procurement Administrative Review Board is established under the Act to deal with aggrieved stakeholders. The Act lays down the right to request for a review against decisions made by procuring entities. PPOA maintains information on appeals against procurement decisions. Although the data on the resolution of complaints are available to the parties to the disputes, they are not easily accessible to public scrutiny as the posting of such information in the website is not regularly updated.
PI-20. Effectiveness of internal controls for non-salary expenditure	**C**	**C**	**C**	
(i) Effectiveness of expenditure commitment controls.	*C*	*C*	*C*	
(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures.	*C*	*C*	*C*	
(iii) Degree of compliance with rules for processing and recording transactions.	*C*	*C*	*C*	

PI-21. Effectiveness of internal audit	**C**	**C**	**C+**	
(i) Coverage and quality of the internal audit function	*C*	*C*	*B*	Marked improvement in capability and scope of audit.
(ii) Frequency and distribution of reports.	*C*	*C*	*B*	Also frequency and distribution of report has improved.
(iii) Extent of management response to internal audit findings.	*C*	*C*	*C*	
PI-22. Timeliness and regularity of accounts reconciliation	**C**	**C**	**C+**	
(i) Regularity of bank reconciliations	*B*	*B*	*B*	
(ii) Regularity of reconciliation and clearance of suspense accounts and advances	*D*	*D*	*C*	Some improvement but remains a problem area.
PI-23. Availability of information on resources received by service delivery units	**B**	**B**	**D**	No PETS, only Education, doing something.
PI-24. Quality and timeliness of in-year budget reports	**C+**	**C+**	**C+**	
(i) Scope of reports in terms of coverage and compatibility with budget estimates	*B*	*B*	*B*	Remains a B until full roll-out of IFMIS
(ii) Timeliness of the issue of reports	*C*	*C*	*B*	Expenditure returns quarterly, but only within 6 weeks, IFMIS roll out will improve the timeliness further
(iii) Quality of information	*C*	*C*	*C*	
PI-25. Quality and timeliness of annual financial statements	**D+**	**D+**	**D+**	
(i) Completeness of the financial statements	*D*	*D*	*D*	
(ii) Timeliness of submission of the financial statements	*B*	*B*	*B*	
(iii) Accounting standards used	*C*	*C*	*C*	
PI-26 Scope, nature and follow-up of external audit	**D+**	**D+**	**C+**	
(i) Scope/nature of audit performed	*C*	*C*	*B*	Scope of audit widened.
(ii) Timeliness of submission of audit reports to legislature	*D*	*D*	*B*	Reports delivered more timely.
(iii) Evidence of follow-up on audit recommendations	*D*	*D*	*C*	There is now some evidence of this, but still problematic area.
PI-27 Legislative scrutiny of the annual budget law	**D+**	**D+**	**D+**	
(i) Scope of the legislature's scrutiny.	*C*	*C*	*B*	Parliamentary committees involved in budget process at earlier stages and are consulted.
(ii) Extent to which the legislature's procedures are well-established and respected.	*C*	*C*	*B*	Procedures have improved
(iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined).	*D+*	*D+*	*D*	
(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.	*C*	*C*	*C*	

PI-28 Legislative scrutiny of external audit reports	**D+**	**D+**	**D+**	
(i) Timeliness of examination of audit reports by the legislature (for reports received within the last three years).	*D*	*D*	*D*	
(ii) Extent of hearings on key findings undertaken by the legislature.	*C*	*C*	*B*	Hearings now take place.
(iii) Issuance of recommended actions by the legislature and implementation by the executive.	*C*	*C*	*C*	
D-1 Predictability of Direct Budget Support	**D**	**D**	**D**	
(i) Annual deviation of actual budget support from the forecast provided by the donor agencies at least six weeks prior to the government submitting its budget proposals to the legislature.	*D*	*D*	*D*	
(ii) In-year timeliness of donor disbursements.	*D*	*D*	*D*	
D-2 Financial information provided by donors for budgeting and reporting	**D**	**D**	**D+**	
(i) Completeness and timeliness of budget estimates by donors for project support	*D*	*D*	*D*	
(ii) Frequency and coverage of reporting by donors on actual donor flows for project support	*D*	*D*	*C*	Some improvement noted in accordance with the OECD DAC report
D-3 Proportion of aid that is managed by use of national procedures	**D**	**D**	**D**	

It can be noted that in total the rating of the key 31 indicators has gone up for five of the indicators (no PI-1 Aggregate expenditure outturn, PI-3 Aggregate revenue outturn, PI-14 Effectiveness of measures for tax registration and tax assessment, PI-18 payroll and PI-26 Scope, nature and follow-up of external audit) with a total of 6 steps (a step defined as a rise from one level to the next, e.g. from D to B is counted as two steps).

The rating has gone down for four of the indicators with a total of – five steps. This is for indicators PI-2 Variation in composition of expenditure outturn, PI-7 Extent of unreported government operations, PI-11 Orderliness and participation in the annual budget process, and PI-23 Availability of information on resources received by service delivery units.

There are however many more movements on sub-dimension level where the rating has gone up for 14 sub-indicators with a total of 23 steps (including indicators where there is only one main indicator). The same count for sub-indicators going down indicates 7 indicators going down with a total of 11 steps.

In two cases are the changes related to different interpretation of data, or the emergence of new data which was not known to the previous PEFA team 2006. The secretariats clarified for indicator PI-7 that government entities would be regarded as unreported if they didn't submit consolidated and as well as regular in year financial reports. This has now drawn down the rating from a C to a D. The previous assessment of risk for sub-national government level, i.e. municipalities, under PI-9, sub-indicator ii), didn't take into account loans taken by some municipalities. This has lowered the rating for one subdimension but not the indicator. In both these cases it is assessed that in reality the situation has not worsened. Instead the previous assessment should have been lower. In the light of this the statistics and figures for lower rating should be reduced, for two of the sub-indicators and by three steps. On the main indicator level however the result would not change as another sub-dimension also has lowered in one case, and because the method M1 is applied for the second, with another sub-indicator scoring low. In addition for PI-4, where the stock of expenditure arrears is assessed, the situation pertaining to unpaid bills has improved, but none of the ratings has been able to take salary and pension arrears into account.

Appendix C Documents consulted

Reports of the Controller and Auditor General on the Appropriation Accounts, 0ther Public Accounts and the Accounts of the funds of the Republic of Kenya for the years ended 30 June, 2004, 2005, 2006, and 2007

Reports of the Public Accounts Committee on the Government of Kenya Accounts for the Years 2001/2002, 2002/2003, 2003/2004

Standing Orders of Parliament

Kenya National Audit Office (KENAO)
- Sample of planning documents and working schedules
- Clearance sheets for audits and financial statements
- Examples of training activities

Treasury Memorandum for the years 1978/1979 – 1995/1996 (one volume), 1996/97 – 1997/1998

Internal Audit reports (13 different from various audits) from the Internal Audit Department in the Ministry of Finance, 2006 – 2008

Treasury Circular No 16/2005, Establishment and operationalisation of Audit Committees in the Public Service

Guidelines for Audit Committees in the Public Sector, 1st edition, July 2006, Ministry of Finance

Treasury Circular No 18/2005, Re: Management action on Internal Audit Reports

Treasury Circular No 4/2008, Re: Strengthening of Internal Audit Function in Government Service

Internal Auditor General Circular No 1/2008, Re: Schedule of Duties & Responsibilities

Minutes (2 samples) from Ministerial Audit Committee meetings in 2008

Public Financial Management Reform, Kenya. Aide Memoire from Joint Review Mission 5th to 9th November 2007

Assessment of the Procurement system in Kenya, October 2007, prepared by Ramboll Management A/S

Standing orders of Parliament

National Assembly's members handbook

Constitution of Kenya, revised edition, 2001

The Government Financial Act, 2004

The Public Audit Act

The Public Procurement and Disposal Act, 2005

The Supplies Practitioners Management Act, 2007

The Exchequer and Audit Act, Chapter 412. Revised Edition 1980

Kenya Anti-Corruption Commission
- Strategic Plan 2006 – 2009
- A sample of information material

Transparency International Kenya
- Bribery index 2006 – 2008
- A sample of other recent reports
- A sample of information material

Machakos District Administration, Kenya
- A sample of accounting and financial reports

Strategy to revitalize Public Finance Management (PFM) – PFM Reform Secretariat 2008

Kenya: Report on Observance of Standards and Codes — Fiscal Transparency Module, IMF March 2008

The Budget Outlook Paper 2008/09 – 2010/11, GoK

The Mid Term Budget Strategy Paper, GoK

The annual estimates of recurrent and development expenditure and revenue, 2004/05, 2005/06, 2006/07, and 2007/08. GoK

Kenya Vision 2030 – First Medium Term Plan 2008-2012, GoK

The Annual Debt Management Report July 2006-June 2007, GoK

Quarterly Economic and Budgetary Review Reports up to 4th Quarter 2007/08

- Ministry of Finance, Departments: BSD, AGD, DMD, GDIPE, IFMIS, EAD, ERD, IAD
- External Central PFM Actors: Local Government, Kenya Revenue Authority, Kenya National Audit Office, Department of Personnel Management,
- Parliament - Public Accounts Committee - PAC, Budget Committee, Budget Office
- Clients to MoF: Ministry of Public Health & Sanitation, Police, Teachers Service Commission, Kenya Anti Corruption Commission, District, School and hospital in Machakos
- Donors: PFM Donor Group members (World Bank, DFID, Sida, UNDP, the European Commission, USAID, CIDA, Denmark, GTZ, Japan, Norway and AfDB), IMF
- NGOs: Kenya Private Sector Alliance (KEPSA), Transparency International

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