ICPAK POSITION PAPER ON THIRD BASIS FOR REVENUE SHARING

The information contained in this publication has been prepared by the Institute of Certified Public Accountants of Kenya.

11th December 2019

BACKGROUND INFORMATION

The Institute of Certified Public Accountants of Kenya (ICPAK) is a statutory body of accountants with the mandate to develop and regulate accountancy profession in Kenya. The Institute is further mandated under Sec 8 of the Accountants' Act of 2008 to advise the Cabinet Secretary for Finance on matters relating to governance and accountability in all sectors of the economy.

The Institute robustly participated in the development of Recommendation Concerning the Third Basis for Revenue Sharing among County Governments. The Institute views enriched the earlier drafts developed by the Commission on Revenue Allocation (CRA). We observed that it is from the total revenue basket that counties would henceforth allocate funds for county development. However, an allocation by itself cannot produce results; the results would come from the amounts absorbed in the different allocations. This would further determine the level and quality of investments in the county. It would be from the investments in a given county that the county's GDP would be determined. This would also form a basis for counties to collect revenues. Hence, an increase in a county's GDP would mean an increase in the own revenue basket holding all factors constant and in the longrun increasing the national GDP. Fiscal discipline in this regard, is the only performance-based parameter that acts as an incentive for improved management of devolved resources.

The Institute supports the proposed formula as provided by the Commission. However, we make the following observations:

Table 1: Summary of Submissions

Parameter	Assigned Weight	Issue of Concern	Recommendations	Justification
Health Services	**17%**	Ongoing ICPAK Devolution study focusing on 24 counties indicates, counties allocated an average of 25% of their total budgets to the Health Sector for the period between FY 2014/15 to FY 2018/19. However, significant amounts of the allocation go to the wage bill and recurrent expenditure as opposed to development and health service delivery.	There's need for further analysis and costing of the health function to determine adequacy of funds allocated to the sector. The Institute proposes weighting to increase to 20%	Achievement of Universal Health care is a critical function under Big Four Agenda. Moreover, counties are currently utilizing most of their allocations to health for recurrent expenditure. There's need to increase funding to this sector

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Agricultural Services	**10%**	**Agriculture** Purely urban counties like Nairobi and Mombasa will be denied allocation due to the measurement indicator assigned as "rural population" yet these counties are urban. Losing out 10% is huge	There's need for clarity on gains that Mombasa and Nairobi Counties will get to compensate for possible loss of revenue through this parameter	A World Bank Report on Kenya Urbanization Review shows that there are only two purely urban counties in Kenya with a population of over 500,000, that is Nairobi and Mombasa. The Report observed then that despite rapid urbanization, most counties are pre-dominantly rural.
Fiscal Effort	**2%**	The Institute supports this parameter to enhance county own source revenue collection.	We can make modifications to this parameter by considering the following proposals: i. Counties that realize 80% or above of their projected revenue targets out of own sources should be allocated 100% of the funds available under this parameter. ii. Counties that realize between 50% and 80% of their projected revenue targets out of own sources should be allocated 50% of the funds available under this parameter iii. Counties that realize below 50% of their projected revenue targets out of own sources should get nil allocation under this parameter.	To incentivize counties to focus on growing Own Source Revenue (OSR)

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Fiscal Prudence	**2%**	**Prudent use of public resources** The Institute supports the fact that this indicator is based on audit reports and some PFM provisions. However, establishment of audit committees and CBEF is necessary but not a sufficient condition to measure prudence On audit reports, we note Qualified Opinion has been assigned a score of 2, yet this is a type of modified opinion. ***Qualified Opinion*** - this means that the Auditor-General was unsatisfied with the veracity of certain expenditures, which may not have been significant. According to ISA 705, the auditor shall express a qualified opinion when: ▪ The auditor, having obtained enough appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or ▪ The auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.	▪ Need to focus on effectives of Audit Committees and CBEFs as a determinant. Focus on frequency of meetings and follow-up on recommendations thereof; and reporting arrangement ▪ Qualified Opinion should be assigned zero scores ▪ Add element of measuring county level budgetary allocation in line with the CRA parameters e.g. at least 10% of the budget should be allocated to Agricultural services ▪ The formula should also consider *Proportion of The Direct Personnel Costs Against Total Recurrent Expenditure:* We propose that County Governments seek to curb their direct personnel costs to the internationally acceptable benchmark of 40%. The proposal will mean that Counties whose personnel costs are: i. Below the 40% threshold should be allocated 100% of the funds available under this parameter. ii. At 40% threshold should be allocated 75% of the funds available under this parameter	▪ Though some counties have put in place these structures, little has been done to make them effective ▪ Assigning any modified opinion a score is close to rewarding fiscal imprudence ▪ To align county spending with approved CRA revenue allocation parameters

Parameter	Assigned Weight	Issue of Concern	Recommendations	Justification
		▪ This should not be rewarded	iii. Above 40% but not more than 50% should be allocated 50% of available funds under this parameter iv. Above 50% should not be considered for allocation of available funds under this parameter. ▪ In general, in line to realize article 201 of the Constitution on prudent utilization of public resources; and Section 107 of the PFMA on fiscal responsibility, the Institute had proposed an increase in weighting to this parameter to above 15%	