The Institute of Certified Public Accountants of Kenya

SUBMISSIONS

ON

THE BUDGET POLICY STATEMENT 2020

<table>
<tr><th>PARAGRAPH OF BPS 2020</th><th>ISSUE OF CONCERN</th><th>ICPAK RECOMMENDATIONS</th></tr>
<tr><td>Para 9: Domestic Economic Development</td><td>The Institute notes stable and consistent economic growth for the past 6 years. However, the country has failed to attain the double-digit growth to meet the Vision 2030 target.

The BPS 2020 projects the economy to expand to 6.1 percent in 2020 up from 5.6 percent in 2019, and 7.0 percent over the medium term.

However, the impression by the public is that the growth has not been felt on the ground. There is therefore need to consider the macroeconomic variables to ensure the growth is cascaded to all sectors of the economy that affect the common man's purse, voice and aspirations. There is need to look at the real lives beyond the statistics.

(a) Profit Warning

For instance, a total of 17 companies of the 63 listed firms on the Nairobi Securities Exchange issued profit warnings in the 2019 indicating that investors should expect earnings to decline significantly (by at least 25%) when compared with that of the previous year, or the company may even make a loss.

The drop-in firms earnings can be expressed in other terms such as net profits, sales, earnings before interest and taxes among others.

The profit warnings were attributed to tough economic conditions as well as slow economic activity. A number of Kenyans lost their jobs in the last one year through retrenchments, involuntary retirements and business closures. 17 Firms represents approximately 26% of listed firms. This is pointer to sluggish performance in the financial services sector. This could in the long run impact negatively to economic</td><td>Although this projection is consistent with World Bank's data of to 5.9% in 2020 and 6.0% in 2021, there is need to lower our expectations due to the following factors:
▪ Impact of locust invasion to food security in the medium term.
▪ Continued charged political climate as a result of ongoing campaigns for Building Bridges Initiative (BBI)
▪ Changing and unpredictable weather patterns given that Kenya still relies heavily on rainfed agriculture.</td></tr>
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<tr><td></td><td>growth.

b) Drop in corporate tax indicates sluggish economic growth
Over the years, contribution of corporation tax to total tax revenue has been on a decline as highlighted below:
Contribution to total tax revenue
<table>
<tr><th>Tax Head</th><th>2016/17</th><th>2017/18</th><th>2018/19</th></tr>
<tr><td>Pay As You Earn (PAYE)</td><td>26.4%</td><td>27.2%</td><td>26.6%</td></tr>
<tr><td>Other Income Tax</td><td>22.9%</td><td>20.8%</td><td>20.1%</td></tr>
<tr><td>VAT</td><td>26.4%</td><td>26.6%</td><td>27.8%</td></tr>
<tr><td>Excise Duty</td><td>12.8%</td><td>12.5%</td><td>13.3%</td></tr>
<tr><td>Import Duty</td><td>6.8%</td><td>7.0%</td><td>7.1%</td></tr>
<tr><td>Other</td><td>4.6%</td><td>5.9%</td><td>5.1%</td></tr>
</table>
Source: Kenya Revenue Authority (KRA)</td><td></td></tr>
<tr><td>Para 10: value of Per Capita Income and Job creation</td><td>According to the BPS 2020, Per capita income rose from Ksh 113,539 in 2013 to an estimated Ksh 202,859 in 2019, a 79 percent increase. This enabled generation of around 831,000 new jobs per year in the period 2013 - 2018 up from 656,500 new jobs per year in the period 2008 -2012. This means that a meagre increase of 9000 jobs were created.

It is evident that the informal sector accounts for a significant proportion of workforce and contributes immensely to the growth of economy.

The informal sector in Kenya comprises of all small-scale activities that are semi-organized, unregulated and use low and simple technologies.

According to the study done by Institute of Economic Affairs (2016), informal sector has particular characteristics such as; a majority of the</td><td>Since majority of Kenyans are employed in the informal sector, the Institute recommends as follows;
Improve the regulatory environment for the informal sector to support stability and growth of MSMEs to overcome start-up challenges and contribute to economic development.
Consider limiting cash-based transactions as a means to capture all business activities in the economy.
KRA to device mechanism to capture data on informal sector for purposes of tax revenue given that so many jobs are created in this sector, yet it isn’t considered in the expansion of tax base.
Since the informal sector is growing at a rapidly faster rate than the formal sector, more research needs to be done to establish feasible data the sector’s potential can be harnessed for economic growth.</td></tr>
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PARAGRAPH OF BPS 2020	ISSUE OF CONCERN	ICPAK RECOMMENDATIONS
	employees do not register or comply with any regulations; they make sales and pay for inputs including labor in cash; they do not have bank accounts and cannot access facilities provided for by banks and; they do not pay income tax.	
Para 50: Modernized Income Tax Bill	The Institute is concerned with the delay in the enactment of the Income Tax legislation. This has been pending for the last three years. ICPAK recognizes that legislation, including subsidiary legislation, traces its foundation on an agreed policy framework, to establish the most appropriate approach to resolve a problem. As such, the review of the Income Tax Act should be predicated on an overarching Tax policy as a precursor to the review of the law. The Institute is of the opinion that enactment of a modernized Income Tax Legislation is critical due to the following: i. The Kenyan Economy has diversified and grown since 1975 when the current Act was enacted ii. Emergence of digital economy and its implication to tax revenue iii. International taxation issues -such BEPS and transfer pricing iv. Kenya has a new Constitution and attendant laws that require modernization of income tax	The Institute proposes the following: ▪ Expedite tabling of the Income Tax Bill to Parliament. ▪ Commence initiatives to finalize an overarching tax policy for Kenya.
Para 50: Government Policies to support Fiscal Consolidation	The reduction in the fiscal deficit will reduce the pace of growth of the public debt. In FY 2020/21, The BPS 2020 targets a fiscal deficit of 4.9 percent of GDP down from 6.3 percent of GDP in FY 2019/20. The fiscal deficit is projected to decline further to 3.3 percent of GDP over the medium term. The Institute takes note and commends the Government for recognizing the need for fiscal consolidation to reduce budget deficit. The recent expenditure rationalization measures adopted by the National Treasury such as controlling foreign travel, hospitality cleaning and regular audit of the payroll register among others.	According to the World Bank's Economic Update: ▪ There is need to re-ignite private sector led growth and ensure that fiscal consolidation is growth friendly ▪ Fiscal consolidation needs to be recalibrated towards recurrent spending such as - lowering of transfers to state owned enterprises, cleaning and regular audit of the payroll register, keeping wages, salaries and allowance adjustments in line with recommendations from the Salaries and Remuneration Commission (SRC)

<table>
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<tr><td></td><td>However, these measures should have tangible targets and outcomes and should not be seen as measures to hinder service delivery. Efficiency gains, not additional funding, is the key to effective implementation of government projects without further accumulation of debt.

The BPS 2020 has indicated a commitment to fiscal consolidation through limiting government spending as well as enhancing revenue collection. Efficiency gains entail effective utilization of public resources such that the country is able to achieve more with fewer resources</td><td>▪ There is need to assess the uptake and impact of already established austerity measures by the National Treasury in 2019</td></tr>
<tr><td>Para 61 and Annex table 1: Macroeconomic Indicators</td><td>Data from the Economic Survey 2019 indicates total domestic credit recorded a decelerated growth of 4.6 per cent in December 2018 compared to a growth of 7.2 per cent in December 2017.</td><td>The evidence shows that domestic credit has been declining. This can be attributed to several factors including the increase in Government borrowing from the domestic market.

The Institute proposes that the Government should reduce domestic borrowing to allow the banks lend to the private sector and MSMEs for sustained growth.</td></tr>
<tr><td>Risks to the Economy

Corona virus</td><td>The global economy is also facing dangers from the outbreak of the novel coronavirus that was first reported from Wuhan, China in December 2019

According to the latest situation report by World Health Organization (WHO), by 10th February 2020, globally, there were 40,554 confirmed cases, with 40, 235 of these cases reported in China, 909 deaths reported.

The spread of the Corona Virus has indirectly affected international trade with China. This is because all countries, by an advisory from WHO, are required to observe caution. In early February, the Kenya Airways suspended its flights to Guangzhou, China</td><td>A ripple effect is expected in different sectors of the economy even as trade between Kenya and China has been growing rapidly. According to the Economic Survey 2019, China is the largest contributor of imports to Kenya for the past 5 years.

Value of Imports by Origin in Kshs. Millions
<table>
<tr><th>Country</th><th>2014</th><th>2015</th><th>2016</th><th>2017</th><th>2018</th></tr>
<tr><td>China</td><td>248,648.3</td><td>320,815.5</td><td>337,450.1</td><td>390,622.3</td><td>370,826.4</td></tr>
<tr><td>Indonesia</td><td>48598.4</td><td>45939.0</td><td>45372.5</td><td>56861.9</td><td>46,104.6</td></tr>
<tr><td>Japan</td><td>86553.6</td><td>88239.2</td><td>82409.6</td><td>81662.8</td><td>99822.7</td></tr>
<tr><td>Singapore</td><td>14623.8</td><td>9612.3</td><td>6794.6</td><td>5829.2</td><td>10105.0</td></tr>
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Free movement of people is one of the key success factors in international trade. This pandemic will impact on the global economy greatly given a shutdown in manufacturing, tourism, hospitality and service industry.</td></tr>
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<tr><td></td><td></td><td>According Economic Survey, arrivals from China have been increasing over time as illustrated below:

Hotel Bed-Nights Occupancy by Country of Residence, 2016-2018

<table><tr><th>Year</th><th>2016</th><th>2017</th><th>2018</th></tr><tr><td>China</td><td>131,900</td><td>192,300</td><td>230,500</td></tr></table>Source: Economic Survey 2019</td></tr>
<tr><td>Risks to the Economy – Brexit</td><td>The Brexit process began on June 23, 2016 when the United Kingdom voted to leave the EU. The UK finally left the EU on January 31st, 2020.

It is worth noting that U.K is one of the Kenya's leading trade partner and has been one of the top export destinations, buying products like flowers, vegetables, fruit, tea and coffee.

According to the latest Foreign Investment Survey by the Kenya National Bureau of Statistics (KNBS), at least 100 UK based firms operate in Kenya, bringing in Sh15 billion in 2015.

According to latest data by the Central Bank of Kenya, Kenya exported goods worth Sh32.28 billion to UK in a period between January to October in 2019 but imported goods worth Sh24.34 billion during the same period.

In conclusion, there are both positive and negative consequences of Brexit as summarized below</td><td>Post-Brexit Opportunities
Kenya can negotiate new bilateral trade deals directly with the UK. More Kenyan produce, like snow peas, French beans and bananas, can then reach the UK market without barriers and regulations which were enforced by the EU
Agricultural sector- Britain has been a critic of the EU's Common Agriculture Policy (CAP) which allows subsidies to European farmers. The CAP reduced access of African farmers to the EU which might change with Brexit. African farmers will also get easier access to the UK.
Countries which were buying Kenyan export produce through UK can now directly trade directly with Kenya. This could see Kenya increase its overall wallet-share of the European market and potentially enjoy better margins from direct trade with the end buyers and also lead to less reliance on the UK for exports.
Potential Post-Brexit Challenges
Kenya exports tea, coffee and flowers to the UK which equals to 27% of fresh produce and 56% of black tea to the UK. Any renegotiations of the deals may lead to export delays and probable loss of revenue. Even worse, it may lead to the current account deficit widening, as well as less inflows of foreign exchange.</td></tr>
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		▪ It may lead to the current account deficit widening, as well as less inflows of foreign exchange. Kenya's main market for cut flowers is the EU with about 60% of the exports. In the EU, Britain is one of the largest consumers of these flowers thus the market is likely to suffer.
Para 74: Food and Nutrition Security The Government will continue to implement measures in the agricultural sector in order to ensure food and nutrition security.	According to Global Hunger Index (GHI) 2018, Kenya is classified as a food deficit country. Currently, close to 1 in every 3 Kenyans (14.5 million) suffer from chronic food insecurity and poor nutrition annually. In addition, about 30% of the children countrywide are stunted, 13% moderately wasted, while 7% are moderately underweight. Approximately 20% of the population does not attain the minimum dietary requirements to sustain a healthy and productive life. Agricultural sector has faced numerous challenges lowering its productivity in the recent years. Stagnation in productivity has been largely due to frequent droughts in parts of the country, high costs of domestic food production due to high costs of inputs especially fertilizers and farming equipment, rural-urban migration of young energetic population, low purchasing power for large proportions of the population due to high poverty levels, lack of incentives and lack of diversified agricultural activities.	▪ The sector legal, policy and institutional capacity should be strengthened in realization of core mandates. This is more so with, regard to devolved functions which require guidelines for implementation. ▪ Build and improve rural infrastructure to open space for movement of goods and services. ▪ Revisiting policies on trade agreements to boost export of some agricultural products. ▪ Improve access to financial services and credit in agriculture and rural development. ▪ Kenya still relies heavily on rainfed agriculture. Irrigation should be enhanced; more dams to be constructed to cushion the country in times of drought. ▪ Taxation incentive--waive taxes on water harvesting accessories, borehole drilling equipment, waive approval permits for drilling of boreholes, no metering and charging for borehole water purely for agriculture purposes, reduce soil testing costs by KALRO from 1500m to sh500 per sample. Raw material for Plastic tanks like ROTTO, etc. should be tax exempt. Companies that manufacture and sale irrigation related accessories should be incentivized. ▪ There is need for introduction of subsidies to farmers especially on inputs such as fertilizers and high yield seeds. ▪ Increase funding levels especially to the sectors that contribute to food security such as Agriculture and manufacturing. Exchequer releases should be within the prescribed timeline to

<table>
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<tr><td></td><td></td><td>facilitate implementation of development programs. Agriculture should be at least 10% as per Maputo Declaration</td></tr>
<tr><td>Para 81-84: Universal Health Coverage</td><td>In 2018, the Government promised to review and amend the NHIF Act,1998 to align it to the universal health coverage as well as review the laws governing private insurance companies to encourage investment by private health insurers and bring the cost of cover within the reach of every Kenyan. The Institute is keen to know whether this has been achieved

According to the Economic Survey 2019, only 7.5 million Kenyans are registered with NHIF Scheme from a population of 47 Million Kenyans, a paltry 15.8% of the population. This is illustrated below:

TABLE 1: REGISTERED NHIF MEMBERS
<table><tr><th>Year</th><th>Principal Members</th></tr><tr><td>2013/2014</td><td>4,713,662</td></tr><tr><td>2014/2015</td><td>5, 475,180</td></tr><tr><td>2015/2016</td><td>6, 136,256</td></tr><tr><td>2016/2017</td><td>6, 817,888</td></tr><tr><td>2017/2018</td><td>7657,463</td></tr></table>Source: Economic Survey 2019</td><td>▪ The government should complete reconfiguration and digitization of NHIF to ensure the system is ready for roll out before fully implementing the UHC.
▪ Reform NHIF to support public health care by:

i. Ensuring that at least 70% of NHIF disbursements go to public health institutions and service providers; with 30% going to the private sector. This will help build capacity of public health institutions as opposed to utilizing public funds to support private entities. According to the Health Financing Reforms Expert Panel (HEFREP) Report, private hospitals received KES 22 billion from NHIF while government and mission hospitals received KES 7 Billion and KES 8 Billion respectively out of the KES 37.7 billion expenditure in FY 2018/19. This implies that government health facilities received only 18.6% allocation of NHIF disbursement in that year.
ii. Putting in mechanism to enroll more Kenyans to the scheme. The current 15.8% is very far from the target 100% universal health coverage which NHIF is central to.
iii. Strengthen accountability mechanisms in the disbursement and utilization of NHIF funds.

▪ There is need to increase the health budgetary allocation to the recommended 15% of the total annual budget as recommended by the AU under the auspices of Abuja declaration.
▪ Sector players should dialogue to end persistent labour unrest in the sector. We urge Labour Unions, National Government and County Governments to work together to address the concerns of the doctors, nurses and other cadres within the</td></tr>
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<tr><td></td><td></td><td>health sector.</td></tr>
<tr><td>Para 165: Realism of revenue forecast --- it is ambitious and leads to budget deficit</td><td>The Institute is concerned with the accuracy and the ambitious nature of National Treasury's revenue projections. This exacerbated by failure by the Tax Authority to meet the set targets over the years.

A trend analysis of revenue growth is critical in informing revenue projections for the coming years. Kenya's budget process has inadequately facilitated accurate forecasts for resource collection. The common tendency has therefore been to make overly optimistic revenue projections leading to an increased uncertainty of resource flows.

Revenue Projections FY 2017-18- 2019-2020

<table>
<tr><th>Fiscal Year
Revenue</th><th>FY 2017/18</th><th>FY2018/19</th><th>FY 2019/2020</th><th>FY 2020/2021</th></tr>
<tr><td>Total Revenue including A-I-A</td><td>Ksh1,643.1 billion</td><td>Ksh1,831.5 billion</td><td>Ksh2,084.2 billion</td><td>Ksh2,133.5 billion</td></tr>
<tr><td>Ordinary Revenue</td><td>Ksh1,486.3 billion</td><td>Ksh1,651.5 billion</td><td>Ksh1,843.8 billion</td><td>1843.8 billion</td></tr>
</table>

The Institute notes the need to address the issue of revenue leakages caused by various factors including complicated tax systems, discretionary power on exemptions as well as a dampened morale to pay taxes occasioned by the culture of corruption.</td><td>According to ICPAK's, "Kenya Revenue Analysis Report, 2015". The role of Parliament is critical in providing oversight over the revenue projections. According to the Parliamentary report on the Budget Policy Statement, the Budget and Appropriations' Committee expressed concerns over the revenue projections provided by the executive in the FY 2014/2015 which the Committee thought of as ambitious and not backed by economic fundamentals.

This calls for a holistic approach and a review of economic data and macroeconomic trends when setting revenue targets.

ICPAK proposes that a clear, consistent and standard forecasting model should be adopted by the country as a basis for determining revenue projections based on either inflationary adjustments or the average revenue performance over the years.

In order to enhance tax administration and seal leakages, the Institute proposes the following:
proper controls and monitoring of taxpayer activities through a single identifier will lead to enhanced efficiency in tax administration.
Review the penalty system on tax evasion
Develop a change management strategy to address income tax matters
Leverage on simplified technological solutions to enhance integration of taxpayer information systems.</td></tr>
<tr><td>Contribution of Tax Revenue to GDP</td><td>Decline in Tax Revenue to GDP

Data from KRA indicate that Tax Revenue/GDP ratio peaked in 2013/14 at 19.0%, before declining to about 16.7% in FY 2018/19</td><td>There is need to design a targeted, measurable and transparent criterion for granting exemptions
Periodically align the tax policy with the county's economic</td></tr>
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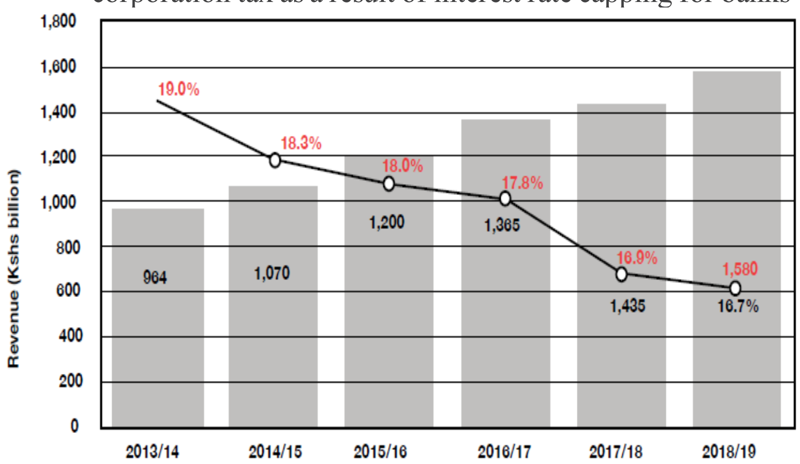
	According to KRA, the decline in revenue to GDP ratio has been attributed to among other factors, a) Sharp increase tax exemptions and remissions leading to erosion of the taxable base; and b) Sharp drop in FY 2017/18 attributed to underperformance of corporation tax as a result of interest rate capping for banks  SOURCE 1: KRA Revenue Performance Report FY 2018/19 ▪ The Institute notes that the exemptions framework within the income tax law lacks clarity thus hindering its proper implementation. In the absence of an objective criteria to determine eligibility, the granting of exemptions is discretionary. This creates room for private interests to supersede the national good.	agenda to realize economic development.
Para 167-168: **Deficit financing**	The fiscal deficit (including grants), is projected at Ksh 569.4 billion (4.9% of GDP) in FY 2020/21 which will be financed by net external financing of Ksh 247.3 billion (2.1% of GDP), Ksh 318.9 billion (2.7% of GDP) net domestic borrowing and other net domestic receipts of Ksh 3.2 billion.	▪ Re-negotiate debt repayment by stretching the debt tenure quantum. According to Parliamentary Budget Office. the bulk of Kenya's external public debt carries concessional terms, recent commercial borrowing entails significant repayment needs in in 2019 and 2024 (2014 sovereign bond issuance).

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The Government will utilize and maximize the official external sources for loans on concessional terms. ICPAK is concerned that the Public debt portfolio is large and may pose substantial risk to the government's balance sheet and the country's financial stability.
<table>
<tr><th>Fiscal Year</th><th>FY 2018/2019</th><th>FY 2019/2020</th><th>FY 2020/2021</th></tr>
<tr><td>Net External financing</td><td>214.7 billion</td><td>306.5billion</td><td>247.3 billion</td></tr>
<tr><td>Net Domestic Borrowing</td><td>368.8 billion</td><td>277.5 billion</td><td>318.9 billion</td></tr>
</table>
BPS 2018/2019/2020
According to the Controller of Budget, Annual National Government Budget Implementation Review Report for financial year 2018/19, the revised allocation for public debt was Kshs.848.3 billion, recording 30.6% growth compared to Kshs.649.4 allocated in FY 2017/18.
Public debt repayment obligations and interests charged from the disbursed borrowed loans crowd out service delivery as they are paid from the consolidated funds. Compared with revenue generated, the remaining amount cannot be sufficient to fully fund the government's programmes. For the two financial years, 2018/19 and 2019/20, the budget estimates indicate performance as follows:
PUBLIC DEBT REDEMPTION
<table>
<tr><th>Debt</th><th>2018/19</th><th>2019/20</th></tr>
<tr><td>Interest</td><td>399,980,973,122</td><td>441,481,154,086</td></tr>
<tr><td>Public debt redemption</td><td>470,634,984,624</td><td>255,073,007,901</td></tr>
<tr><td>Total</td><td>870,615,957,746</td><td>696,554,161,987</td></tr>
</table>
Source: Budget estimates 2019
</td><td>

The government needs to scale down domestic borrowing which crowds out private investments. Prioritize increase in debt maturity profiles by opting for longer term external debt rather than domestic debt to increase debt sustainability, and lower risks of crowding out private sector
Pre-approval of projects financed through public borrowing: no new debt financed projects should be introduced within the budget cycle as these may fail to go through proper appraisal.
There's need to rationalize expenditure. In the past few years, public expenditure has been growing at a faster pace than revenue. The major outcome has been huge budget deficits.
Rely more on concessional loans and grants rather than on expensive bilateral loans that are non-concessional, thus reduce high interest rates payments, averting possibility of debt overhang.
Implement government-to-government partnerships and other Public Private Partnerships (PPP) models based on independent cost-benefit, Cost-Effectiveness and value-for-money studies, to prevent expensive low priority bilateral, donor-led investments funded by debt.
Diversifying the currency mix in which debt is denominated to reduce exposure to foreign exchange risks.
Enhance debt transparency and accountability in order to enhance management of public debt in Kenya.
An audit of current projects is critical to wipe out white elephant projects. A clear framework for tracing and auditing debt financed projects is needed for equity.
The government should also consider the following measures to enhance public financial management.

a) Expenditure Vs Revenue: In the past few years, public expenditure has been growing at a faster pace than revenue. The major outcome has been huge budget deficits. We should
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<tr><td></td><td></td><td>
b) Implementation of budget monitoring reports: Act on Auditor General and Controller of Budget recommendations in respect to public debt
c) Audit of the Public Debt Register: Establishing the authenticity of the public debt register including the true debt sustainability position is critical. Government sources and the world bank continue to give conflicting statistics of Kenya’s debt situation.
d) Accounting for debt: The public is not sure on the accuracy and completeness of the debt register. National Treasury and Central Bank of Kenya have conflicting statistics on national public debt. The Auditor General in its Report for the Financial Year 2017/18 pointed out misstatements and differences between the financial statements and the confirmed balances. Further, Further, a comparison of the statement of receipts and payments and the ledger for the period under review reflected different account balances as indicated below:
<table>
<tr><th>Item Description</th><th>Financial Statement Balance KSh.</th><th>Ledger Balance KSh.</th><th>Variance KSh.</th></tr>
<tr><td>Interest Payments on Foreign Borrowings</td><td>84,357,487,111</td><td>84,725,600,971</td><td>368,113,860</td></tr>
<tr><td>Principal Repayment on Domestic Loans</td><td>111,700,845,296</td><td>294,836,376,343</td><td>183,135,531,047</td></tr>
<tr><td>CBK -Pre-1997 Loans</td><td>1,110,000,000</td><td>2,220,000,000</td><td>1,110,000,000</td></tr>
<tr><td>Repayment of Principal</td><td>141,532,524,729</td><td>141,360,882,966</td><td>171,641,763</td></tr>
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<tr><td></td><td></td><td><table><tr><td>from Foreign Lending and On-Lending</td><td></td><td></td><td></td></tr><tr><td>Exchequer Releases</td><td>517,161,876,534</td><td>-</td><td>517,161,876,534</td></tr></table>Source: Auditor General Report for National Government- FY 2017-2018</td></tr>
<tr><td>Para 223: Absorption of Development Funds</td><td>This has been a worrying trend at the two levels of government. One of the main causes cited by the Controller of Budget is the delay in Exchequer Releases.

The BPS 2020 indicates that while absorption rate of recurrent budget has remained high over the last five years (i.e. more than 80 percent in each year), absorption of development budget initially increased from 53.1 percent in FY 2014/15 to 65.2 percent in FY 2015/16 before declining to 48.1 percent in FY 2017/18 and then increasing to 57.8 in FY 2018/19.The low absorption rate is attributed to procurement challenges at the County Government level and capacity deficits, especially in terms of planning.</td><td>To increase absorption of development finds, the National Treasury should ensure that funds allocated to the MDAs and Counties are released in a timely manner
Parliament has continued to use FY 2013/14 audited accounts until FY 2019/20 when it used FY 2014/15. The National Assembly must expedite its process of considering the most recent audited financial statements as submitted by the Auditor General.
In the distribution of the Equalization Fund there is need to relook at the unit of disbursements. The Government should adopt CRA’s proposal to use locations as the smallest units.</td></tr>
<tr><td>Para 225-229: County Government’s Own Source Revenue</td><td>The BPS 2020 indicates many counties have not met their revenue targets in the past mainly due to challenges in OSR forecasting.</td><td>Revenue forecasting and mapping: a clear, consistent and standard forecasting model needs to be adopted by the country as a basis for determining revenue projections. There is further need for a comprehensive analysis and mapping of counties’ revenue potential.
Revenue collection systems: There is need to standardize revenue collection management systems across counties for uniformity and easy reporting. In addition, counties should strive to automate revenue collection systems to seal loopholes and leakages. This standardized ICT-based system prescribed should provide real time revenue information in a consistent</td></tr>
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		manner to enable consolidation and analysis, as well as periodic reports for use by the National Treasury, the Controller of Budget, the CRA and the Office of the Auditor General, and also easily accessible by the general ▪ **Collaboration with KRA**: To enhance efficiency and effectiveness in revenue collection and administration, county units should consider engaging KRA for technical support. ▪ **Public Participation in Revenue collection:** Counties should empower citizens with revenue information through revenue clinics- for citizens to understand the importance of taxes and charges to county service delivery. ▪ County Treasuries should continuously review the performance of revenue collection vis-à vis targets and shall include a status report in the Quarterly and Annual reports which shall be published in various media.
Para 227: Reasons for underperformance of OSR	BPS 2020 indicates that lack of effective internal controls and audit mechanisms among other challenges contributes to the underperformance of OSR among the Counties. The absence and/or ineffectiveness of internal audit committees contravenes part XIII of the PFM (County Governments) Regulations, 2015 as one of the county financial risks.	▪ Continuously lobby County entities to establish audit committees. ▪ Capacity build established audit committees on their roles. ▪ Support CRA's proposals to have this as a parameter under the Fiscal Prudence criterion for revenue share. This will obligate counties to establish and operationalize these committees.
Para 232-238: Pending Bills	The National Treasury in December 219 released a Pending Bills Update which revealed that County governments owed Sh88.9 billion. Of this amount, Ksh 51.2 billion (58%) was reported as payable while Ksh 37.7 billion (42%) lacked sufficient documentation to support services rendered or work done and therefore were not recommended for payment. As at 8th January 2020, the amount of eligible pending bills paid was Ksh 30.35 billion leaving an outstanding balance of Ksh 20.94 billion. According to the Kenya Enterprise Survey 2018, approximately 12	▪ The National Treasury should consider accrual accounting as opposed to cash accounting which presents challenges in terms of monthly and annual financial reporting on pending bills and other liabilities. ▪ There is need to develop a database of all owed dues to counties and MDAs, and assess the multiplier effect/impact to the economy ▪ The Institute supports recent efforts by the National Assembly to amend the Public Procurement and Assets Disposal Act 2015, compelling the National and County

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	percent of the 1,001 firms surveyed have had a contract with government that was in arrears. Pending bills if allowed to persist, could reduce firm liquidity and cause postponement of new investments. It could also increase firms' default rate (in business to business transactions), which can be associated with a rise in non-performing loans for the banking sector.	Governments to pay suppliers and contractors within 30 days. **Legislative Proposals** The Institute proposes Amendment to 17 of Public Finance Management Act 2012. Amend 8(b) to read "by inserting the following new subsection immediately after subsection (7)— *"(8) (a) six months prior to a general election, no procurement shall be carried out by the national and county governments, or their respective entities, in respect of their respective development votes unless with the approval of the National Treasury".* *(8) (b) All pending bills incurred by the national and county governments, or their respective entities, in respect of their respective development votes, shall be cleared not later six months prior to a general election* This amendment will help curb pilferage of public resources during an election year and increase of pending bills during the same period. Such an Amendment was first introduced through the Public Finance Amendment Bill 2017. The Majority Leader, Hon. Aden Duale in his submission to the National Assembly (captured in the **Hansard Report dated 13th February 2019 indicated** the following: "Clause 8 of the Bill proposes to amend Section 7 of the principal Act, which is the PFM Act, by inserting a new subsection to prohibit procurement at both levels of Government during the three months period before a general election. Any procurement

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		during that time may only be done with the approval of the National Treasury. You have seen that people commit public expenditure three months to general elections. An example is even with governors. They use that money to campaign. This amendment says that there will be no use of public funds three months to general elections. No procurement will be done. Procurements are done left, right and centre even two weeks to the general elections. The moment the governor loses, he takes away money. That is why we have huge pending bills, some of which cannot be verified. Some of them cannot be seen. The amendment to Section 7 of the PFM Act prohibits procurement at both levels of the Government three months before general elections. If there will be necessity, if that procurement is important and there will be an emergency, the approval of the Cabinet Secretary of the National Treasury must be sought" – HON Aden Duale, Majority Leader
Para 240: Status of transfer of devolved functions	BPS 2020 provides the status of unbundling and transfer of functions. Completion of this exercise is critical for the success of devolution.	Expedite completion of the functional assignment and unbundling of functions exercise.
Para 246 and table 4.2: County governments Equitable Share	The National Treasury proposes that County Governments be allocated an equitable share of revenue raised nationally of Ksh 317.8 billion in the FY 2020/21 which is a 1.3 billion increase from Ksh 316.5 billion in the FY 2019/20. ICPAK's analysis of the Division of Revenue Process shows that for the past three years, the Division of Revenue Act (DORA) has used FY 2013/14 audited accounts as the basis for equitable share, and in 2019, used audited accounts for the FY 2014/15.	▪ It is our considered opinion that as we commence the process of revenue share FY 2020/21, National Treasury, Commission on Revenue Allocation (CRA) and Parliament should use the most recent audited financial statements as the basis for revenue allocation. ▪ Consider amending Section 37 (9) of the PFM Act 2012 to enable prior enactment of DORA before Appropriations Bill. ▪ National Assembly to consider, expedite scrutiny and adoption of these reports from the Auditor General. This will enable not only the revenue share to rely on the most recent and approved

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<tr><td>Division of Revenue Act (DORA)</td><td>Audited Financial Statements</td></tr>
<tr><td>DORA 2016</td><td>935, 653 million</td></tr>
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<tr><td>DORA 2019</td><td>1,038,035 million</td></tr>
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This affects fairness and equity in the revenue share. These disadvantages county governments given that any surplus accrues to the national government.
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financial statements, but also enhance accountability of public funds on a timely manner.
The Institute recommends further amendment to Section 191 of the Public Finance Management Act
The National Assembly shall within three months after receiving an audit report adopt and approve the report;

In the event that the audit report is not adopted and approved by the National Assembly within three months, it shall be deemed as the most recent audited accounts for purposes of determining sharable revenue.

Therefore, the National Assembly must expedite its process of considering the audited financial statements as submitted by the Auditor General
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