ICPAK SUBMISSION ON THE DIVISION OF REVENUE BILL 2021

6TH APRIL 2021

Introduction

The Institute of Certified Public Accountants of Kenya (ICPAK) is a statutory body of accountants established under by the Accountants Act of 1978 and repealed under the Accountants Act Number 15 of 2008, mandated to develop and regulate the Accountancy Profession in Kenya. It is also a member of the International Federation of Accountants (IFAC), the global umbrella body for the accountancy profession. The Institute is further mandated under Section 8 of the Act to advise the Cabinet Secretary on matters relating to financial accountability in all sectors of the economy.

The Institute would first and foremost like to appreciate the two Houses and the Executive for reaching a consensus on the 3rd basis of revenue sharing on September of 2020 which has consequently increased the total equitable share. This Bill comes amidst fiscal stress in the country exacerbated by the COVID-19 crisis which has ravaged almost all sectors of the economy including transport, trade, hospitality among others. Some of the issues herein were aptly raised in our earlier memoranda including the DORB 2020 submission.

In this memorandum we raise the following key issues:

1. Basis for revenue projections
2. Leasing of medical equipment
3. Conditional grants
4. Public debt, pensions, and other charges of the consolidated fund services
5. Status of Nairobi City County
6. Equalization Fund
7. Budget transparency and National Interest
8. Strengthen fiscal accountability.

Detailed Submissions

1. **Basis for revenue projections.** Kenya has consistently registered a positive growth in its revenue collection with it doubling from Ksh. 0.7 Trillion in FY 2011/12 to Ksh. 1.5 Trillion over a seven-year period (2018/19) (KRA, 2019). However, the actual revenue receipts have continuously fallen below the targets (KNBS, 2020). Coming from a global pandemic that necessitated most governments, the Kenyan one included, to adopt expansionary fiscal policy measures, it is highly unlikely that in the coming FY 2021/22, the Kenyan economy will have rebounded. The Government should therefore conduct a trend analysis of revenue growth to inform revenue projections for the subsequent years.

Table 1: Revenue Projections vs Actual Collections 2012-2019

Year	**Total Exchequer Revenue (Ksh millions)**	Ordinary Revenue Estimates (Ksh millions)
2013/14	918,982	**1,006,404**
2014/15	1,021,974	**1,070,515**
2015/16	1,136,833	**1,184,368**
2016/17	1,273,060	**1,380,199**
2017/18	1,340,248	**1,560,276**
2018/19	1,474,673	**1,688,492**

Year	Total Exchequer Revenue (Ksh millions)	Ordinary Revenue Estimates (Ksh millions)
2019/20	1,607,000	**1,776,637**
2020/21		**1,883,694**

Source: Kenya Revenue Authority Annual report FY 2018/19 and 2019/20 & the National Treasury – BPS

The ambitious revenue forecast has among other ramifications contributed to budget deficits which have in turn worsened the pending bills problem.

- A special audit by Office of the Auditor General (OAG) verified eligible pending bills by County Governments amounting to Ksh.51.2 billion as at 30th June 2018 and another Ksh.37.7 billion worth of pending bills was found to be ineligible for payment due to lack of documentation to support services rendered or work done.
- A report by the Controller of Budget (CoB) indicates that by 10th November 2020, the Counties had settled Ksh.39.07 billion (76.2% of the eligible pending bills) leaving an outstanding balance of Kshs.12.22 billion.
- According to the Kenya Enterprise Survey 2018, approximately 12 percent of the 1,001 firms surveyed have had a contract with government that was in arrears.

The government should therefore review realism of revenue forecasts for predictability in expenditure across the two levels of government.

2. **Inadequate utilization of the Leased medical equipment.** The conditional allocations are tied to the implementation of specific national policies, and are mainly from both government and donor community. One of the items catered for is the leasing of medical equipment, which has been receiving allocation from the FY 2015/16.

    - The grant is managed by the national government and is aimed at facilitating the county governments to acquire modern specialized medical equipment for two level 4 health facilities in each county with a focus on theatre, central sterile services department (CSSD), renal, ICU and radiology equipment. This was expected to ease access to specialized healthcare services at county level as well as reduce travel distances by Kenyans in search of the services.
    - However, a Senate report on 'The Managed Equipment Service (MES) Project' indicates that the equipment have been under-utilized owing to inadequate health personnel and insufficient infrastructure (water and electricity).
    - The report also highlights the exaggerated cost of equipment supplied in comparison to prevailing market rates.

- There is need to provide capacity strengthening sessions to the health personnel and fast-track the development of the required infrastructure in the respective health facilities.

Table 2: Amounts allocated towards the Leasing of Medical Equipment

FY	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Amount (Ksh. In millions)	3,080	4,500	4,500	9,400	6,200	6,205	7,205

Source: Division of Revenue Acts and Bills 2015-2020

3. **Conditional Grants for construction of county headquarters need to be clarified and accounted for**.

In the FY 2017/18, 5 counties (Isiolo; Lamu; Nyandarua; Tana River and Tharaka Nithi) were identified as being the only counties that did not inherit adequate office space for county headquarters and thus would be allocated funds to construct their headquarters over the span of three financial years (between 24-32 months).

According to a report on County Infrastructure by the Senate Standing Committee on Finance and Budget, the State Department of Public Works submitted that the implementation of this project would be carried out through the Ministry with the National Government contributing 70% of the amount while counties contribute the remaining 30%. The first disbursement of the agreed Ksh 518 million for construction of their headquarters was received in 2017/18 therefore, the final disbursement should have been in the FY 2019/20. Despite this, we note that DORB 2020/21 and 2021/22 still allocated the counties the amounts as shown in the table below.

Table 3: Allocation towards construction of county Headquarters

Financial Year	Allocation towards construction of county HQs (Ksh million)
2017/18	605
2018/19	605
2019/20	485
2020/21	300
2021/22	332

Source: Division of Revenue Bills, 2017 -2021

- There is thus need for an implementation report on the same to justify the continued allocation.
- Need for an indication on completion of this project.

4. Consider conditional Allocation to support ECDE:

In a Devolution Survey 2020 conducted by the Institute, several challenges were documented that are impeding the successful delivery of educational services, especially at the county level:

- high turnover rates for Early Child Development Education (ECDE) teachers
- low funding for ECDE, inadequate investment in succession planning within departments, low and unclear scheme of service for ECDE teachers,
- Inadequate infrastructure to support the learning of children living with disability; and
- inadequate number of trained instructors in most polytechnics.

There's need to provide conditional allocation to ECDE for purposes of the following:

a) increasing capitation for ECDE teachers
b) Employment of skilled and qualified instructors in polytechnics;
c) To support development of adequate monitoring and assessment of performance (quality assurance) of learning at that level.

5. Actual public debt service figures have always been higher than the projections:

As the table below indicates, the projections on the division of revenue bills have always been lower than what is contained in the actual budgeted amounts in the programme-based budgets. These figures have further been lower than the actual ones contained in the national government implementation review reports. In addition to this, the deviation of the projected amounts as contained in the division of revenue bills from the actual show an increasing trend which shows that the projections are highly underestimated.

This implies that additional borrowing has to incurred or provision of quality services will be compromised. There is need for more accurate projections for proper planning purposes as well as observance of transparency in public debt contracting.

Table 4: Public debt projections vs actual

FY	Division of Revenue Bills (Ksh. Millions)	Programme Based Budget (Ksh. Millions)	Office of the Controller of Budget (Actual in Ksh. Millions)	Deviation (Ksh. Millions)	% growth
2017/18	462,243	649,396	517,161	54,918	12%

2018/19	641,514	850,011	826,202	184,688	29%
2019/20	538,802	696,554	707,892	169,090	31%
2020/21	829,906	904,000	-		

Source: Controller of Budget, National Treasury and Planning

6. **Public debt repayment is crowding out the amount available for division of revenue and hurting counties allocation.**

Public borrowing has a very direct impact on the size of the sharable revenue as shown in the table below. On average, public debt servicing growth is higher at 30% than the growth in both the shareable revenue (7%) and the county allocation (5%). We call on the National Treasury to contract more loans from the multilateral lenders than from commercial lenders who are usually more expensive as compared to the former.

Since the National Treasury is the only body deciding on this vital national instrument, we recommend that counties through the Senate should be involved in the discussion on national borrowing as that has an impact on the revenue that is shared between the two levels of government.

Table 5: Growth in Public debt, ordinary revenue and counties allocation

FY	Public Debt Service (Ksh. Billions)	Ordinary Revenue (Ksh Billions)	Counties Allocation (Ksh Billions)	Growth in Public Debt Service	Growth in Shareable Revenue	Growth in County Allocation
2017/18	462.24	1365.06	302.00			
2018/19	641.51	1499.76	304.96	39%	10%	1%
2019/20	538.80	1573.42	310.00	-16%	5%	2%
2020/21	829.91	1574.01	316.50	54%	0%	2%
2021/22	1174.01	1775.62	370.00	41%	13%	17%
Average				**30%**	**7%**	**5%**

Source: Division of Revenue Bill 2021

7. **Pensions and other CFS Services have equally grown, and their administration is of concern.** As the table 6 below shows, servicing of non-discretionary CFS has been growing at a high rate and that is limiting how much is available for allocation to

devolved services. We commend the National Treasury for rolling out the super annuity Scheme for all civil servants below the age of 45 to ease the burden of pension payments in future.

Table 6: Government Fiscal Framework- Pension and other CFS

Year	2016	2017	2018	2019	2020*
Pension and other CFS (Ksh billion)	64.0	65.1	70.8	89.6	123.4

Source: National Treasury and Planning -BPS 2019.2020,2021

The Institute notes with concern that the payout amounts to retirees is usually below the below the budgeted amount. For instance, data from the National Treasury indicates that pension and gratuities paid to the retirees in the six months to December was 42.8 billion representing 38.5% of the current year's retirements payouts budget pointing to delays in processing the claims. The Institute therefore recommends as follows;

- There should be transparency and accountability in processing and payment of pension and gratuities for the retirees as per the budget. Accurate schedule and proper records of retired personnel and amounts disbursed should be fastracked to aid early disbursement of such funds to the retirees who require them to better their livelihoods.
- Following the trend of budget for the payment of pensions and gratuities, it is projected that this cost could go even higher in the next five years. There is need for enhanced revenue generation mechanisms to help raise enough funds for the pensions.

8. **Progress of the Equalization Fund:** Article 204 of the Constitution of Kenya 2010 establishes an equalization fund to provide basic services such as water, roads, health facilities and electricity to the marginalized areas as identified by the Commission on Revenue Allocation. The fund has a 20-year period within which it should be operational. Time is thus a key factor in as far as the success of the fund is concerned. According to a report on the Consideration of the Equalisation Fund Bill by the Departmental committee on Finance and National Planning, the current composition of the Equalisation fund oversight Board has not been effective in administering the Fund. To this end, progress implementation reports should be publicly availed to provide the status of the projects financed by the Fund.

Table 7: Equalisation fund allocations

Year	2014	2015	2016	2017	2018	2019	2020	2021

Amount (Ksh billions)	3.4	6.0	6.0	7.73	4.7	5.76	6.79	6.83

Source: Division of Revenue Bill 2014 – 2021

.

9. **Way forward for Nairobi City County.** There is need for clarity on how revenue will be allocated considering the transfer of functions four crucial functions (County Health Services; County Transport Services; County Planning and Development Services; and County Public Works, Utilities and Ancillary services) to Nairobi Metropolitan Service. This is important to curb any stand-off between the County and NMS that could derail service delivery.

10. **Budget Transparency is critical for objective division of revenue.** The lack of a clear definition and objective criteria for determining national interest has been exploited by national government to starve counties of resources. Additionally, the framework for the management of conditional grants continues to be weak, and indeed does not meet the constitutional requirements for fiscal prudence and transparency.

    - The Division of Revenue bill should include performance and accountability information on conditional grants to adhere with constitutional and statutory requirements. For example, categorization of conditional grants in terms of their type, nature, administration and trends in allocations.
    - Prudent utilization of grants and access to information. Include key accountability information on conditional grants.
    - Establish explicit principles which inform conditional grants or transfers which are subject to specific conditions that may include; targets use, by sector or purpose; requirement for matching (i.e. matching grants) which require recipients to contribute part of costs; requirement to meet specified targets, outputs or results; one off-funding or over a period, may be open ended, like the case with LATF but with requirements to achieve specified performance ratios e.g. debt, revenue etc
    - On Performance evaluation there is a need to ensure that funds are traceable to avoid double funding and blurring of reporting. National departments must report to Parliament the outcome of grants allocated for specific purpose.

11. **Fiscal Accountability.** There is need to strengthen the fiscal accountability structures across both the national and county governments. The recommendations from oversight bodies including the Controller of Budget and the Auditor General should be followed so as to ensure prudent use of public funds. These include full compliance with the Public Financial Management Act (2012).