COMMISSION FOR THE IMPLEMENTATION OF THE CONSTITUTION (CIC)

Stakeholders' Forum for the Review of the Public Financial Management Bill, held on Monday, 27th June 2011 at the Kenya Commercial Bank Training School, Karen.

An event organised by the Commission for the Implementation of the Constitution (CIC)

Rapporteur's Report

By

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Introduction

The Commission on the Implementation of the Constitution (CIC) held a Stakeholders Forum to review and critique the Draft Public Financial Management (PFM) Bill. The forum brought together representatives of civil society organisations (CSOs), private sector, development partners and government, including government institutions with specific roles in public financial management under the current legal framework, such as, the Commission on Revenue Allocation (CRA), the Kenya Revenue Authority (KRA) and Parliament. This forum was the third such forum organised to review the Bill and followed other stakeholders forums held on 17th and 21st June 2011.

Discussion focussed on four substantive issues covering important contentious issues arising from the forums held on 17th and 21st June 2011. Participant in the Forum evaluated the Draft PFM Bill and made proposals for amendment with regard to: (i) the design and functions of key PFM Institutions, such as, the National Treasury, County Treasury, Cabinet Secretary for Finance, the Controller of Budget, and others (ii) the budget process, (iii) Public Participation in the proposed PFM framework and (iv) Revenue Sharing and Collection as well as borrowing by the national and county governments. Discussions also touched on the Draft Controller of Budget Bill which is closely related to the Draft PFM Bill.

Speakers

The Forum attracted speakers from individuals and organisations with expert knowledge in public financial management. The Forum was formally opened by the Permanent Secretary to the Treasury. In his opening remarks he outlined the participatory process through which the Draft PFM Bill was prepared and underscored the importance of the Bill in facilitating the realisation of the country's Vision 2030. The Permanent Secretary to the Treasury then invited participant at the Forum to be candid, objective and realistic in the evaluation of the Bill. Other speakers at the Forum were: (i) Dr. Kamau Thugge, Advisor to the National Treasury, Mr. John Mutua, Programme Officer at Institute of Economic Affairs, Dr. David Ndii, an Independent Research Consultant, Ms. Wanjiru Gikonyo, the CEO of the Institute on Social Accountability and Mr. Micah Cheserem, Chairman of the CRA. Following the formal opening of the Stakeholders' Forum, the speakers made presentations and thereafter participants were divided into four groups and each group was asked to further analyse one of the four contentious issues and make recommendations to the Plenary for further discussion. The purpose of this report is to summarise the main points made during the one-day Forum.

Summary of the Presentations made to the Plenary

The first presentation by Dr. Kamau Thugge provided the overview and highlights of the Draft PFM Bill. It was pointed out that in drafting the Bill the team involved was guide by three considerations. The first was the international best practice in public financial management. As an illustration, it was explained that the reason why the National Treasury opted for one overarching PFM law instead of several pieces of PFM legislations, was primarily because this was the emerging best practice around the world. Second, Treasury was guided by 'Principles of Public Finance Management' as out in Chapter 12 of the Constitution of Kenya. The third consideration was the requirement to adhere to the letter and spirit of the Constitution which required that legislation is put in place to operationalise constitutional provisions relating to among other issues, the Contingencies Fund, borrowing by national and county Governments, format and content of the national and county budgets, the National Treasury and Parliamentary Controls, among others.

It was explained that the Bill included provisions on: (i) Key PFM Institutions (ii) Fiscal Responsibility Principles; (iii) Macro Economic and Fiscal Policy (iv) Intergovernmental Fiscal relations framework (v) Budget Process at the national and county government level (vi) Financial management and control, including national and sub-national borrowing (vii) Financial Reporting and (viii) Financial management in State corporations. Some of the laws that will be repealed upon the enactment of the PFM Bill include: the Government Financial Management (GFM) Act of 2004, the Fiscal management Act of 2009, the Internal Loans Act, the External Loans and Credits Act, the Guarantees Act and the Civil Contingencies Act.

The second presentation by Mr. John Mutua of the Institute of Economic Affairs provided a critique of the design and roles of the proposed PFM Institutions as provided for in the Draft PFM Bill and the Draft Controller of Budget (COB) Bill. A key concern with the COB Bill was the lack of guiding principles for the COB. Unlike the Constitution which incorporates Principles of Public Finance in Article 201 and the Draft PFM Bill which incorporate the Fiscal Responsibility Principles in Section 23, the COB Bill did not provide for the principles that would guide the operations of the office. Further, it was explained that COB Bill in its current form might be construed to mean that the COB has powers to oversee the implementation of the national and county level budgets beyond approval of withdrawals. This could create confusion and result in possible conflicts with other institutions that were expected to exercise control over public financial management, such as, the National and County Treasuries. The presenter also questioned the rationale behind the separation of the COB Bill from the PFM Bill. In order to further enhance public accountability, it was felt that the COB Bill should require the COB to make his/her reports accessible to the public within 15 days of submitting the same to Parliament.

With regard to the Draft PFM Bill, it was suggested that the drafters should consider including two additional fiscal responsibility principles under section 23 of the Bill — (i) ensuring value for money and (ii) reporting and accountability to the public and Parliament. It was felt that by refocusing the attention of the key PFM institutions to these two principles would lead to higher levels of efficiency and effectiveness in the use of public funds. Further, it was explained that there is no requirement for the National Treasury to share information with the Parliamentary Budget Office. If this is left to the discretion of the National Treasury, it may hinder effective parliament oversight.

The **third** presenter, Dr. David Ndii, while providing a critique of the budget process spelt out by the Draft PFM Bill, emphasised that the key consideration that informed the drafting of the Public Finance chapter in the Constitution should as much as possible be taken into account in drafting the PFM Bill. The considerations that informed the Public Finance chapter included: (i) growing demand for devolution (decentralisation of decision making on resources and public services) (ii) Demands for democratisation of governance through inclusion and greater public participation in decision making. (iii) Pressure to redress historical injustices with regard to distribution of public resources, (iv) the need to correct accountability failure and pervasive conflict of interest in the public sector (for example where leaders determined their compensations).

It was explained that the Bill introduces four fundamental changes in the budget process. First, the Bill, in line with the Constitution, shifts more budget preparation powers from the Executive (National Treasury) to other arms of Government (Legislature and Judiciary), Counties, CRA and the general public. Second, the Bill by creating a bi-cameral of Parliament creates a mechanism through which the two chambers can check each other and thus enhance accountability in the planning, approval and use of public funds. Third, the Bill introduces shifts of some fiscal powers from the national government to the county governments. Fourth, the Bill in operationalising chapter 12 of the Constitution improves the framework for financial management and control by separating the ex-ante controls from the ex-post controls. Fifth, unlike in the past, where revenue and expenditure estimates were prepared and approved simultaneously, under the Draft PFM Bill, the revenue estimates will be prepared and approved before the expenditures. The former system where revenues and expenditures were approved simultaneously, created a perception that revenues were elastic and often created pressure for more revenue, leading to higher deficits. The proposed shift, where revenues will be determined first, imposes a hard budget constraint on expenditures and could help to contain the budget deficit.

It was explained that the Draft PFM Bill does not emphasise the process of division of revenue since it does not provide guidelines on how this will happen. The process of determining and approving the formula for sharing revenue is likely to attract attention and controversy since its happening for the first time and it involves sharing of resources which are scarce. Clear guidelines must therefore be included in the draft Bill.

Although parliament and the Judiciary under the Constitution are required to prepare and present their budgets directly to Parliament for approval, the requirement for justification of their budgets are not entrenched in the Draft PFM Bill. The Bill should include provisions that require Parliament and the Judiciary to provide justification for their budget requests.

The presenter argued that it was really not necessary to require counties to prepare Fiscal Strategy Papers. Experience from the current local governments suggests that there is limited capacity at the sub-national level for the preparation of Fiscal Strategy Papers. Further, it was explained that a formula for horizontal allocation of national revenue may not be necessary and perhaps what is needed is a more flexible arrangement that allows for negotiation. Whereas the formula would enhance predictability of county revenue, it would limit flexibility for addressing national objectives.

One other issue that the Bill does not address is the mechanism for dealing with revenue shocks. Perhaps the Bill should have established thresholds that would necessitate intervention and the Institution(s) that would be mandated to intervene as well as the mechanisms for intervention when revenue shocks set in.

With regard to disbursement of funds, the Draft PFM Bill stipulates that funds will be released promptly. This is vague and allows for too much discretion with regard to the timing of disbursements. The Bill needs to eliminate the need for discretion and clarify the timelines for disbursements.

The **fourth** presenter, Ms. Wanjiru Gikonyo of the Institute for Social Accountability made a presentation on how to enhance public participation in the PFM framework set out in the Draft PFM Bill. The presenter noted that the standards for citizens' participation as provided in the Constitution need to be entrenched in the Draft PFM Bill. It was suggested that the provisions on public participation should be guided by four key considerations. These considerations include: (i) the need to promote open governance by increasing citizens' awareness on PFM, (ii) allowing sufficient time for citizen engagement, (iii) adequately resourcing citizens' engagement framework and (iv) setting high standards with regard to government responsiveness to citizens' demands.

In order to ensure that public participation is entrenched in the budget process, the presenter recommended that the realisation of citizens' participation should be included as an objective/function of the National and County Treasuries.

Besides adequately resourcing citizens' engagement frameworks, it was suggested that the National Treasury should recruit citizens' liaisons officers to support realisation of citizens' participation. Further, it was proposed that the Draft PFM Bill should require the National Treasury to provide a circular on citizens' participation, every five years.

Although Section 38 and 47 require the National and County Treasury to publish and publicize the budget estimates 21 days following legislative approval, the Draft PFM Bill does require the National and County Treasury to publicize the budget estimates prior to the approval. This could limit public scrutiny of the budget estimates. It was therefore proposed that the Draft PFM Bill includes a provision to require the National and County Treasury to publicize the budget estimates after finalisation by the respective Treasuries but prior to the approval by the relevant legislatures. Further, it was also noted that the Bill's provisions on County reporting does not require citizens' participation prior to the publication of the Accounting Officers' reports. The reporting requirements for Accounting Officer provided for under Section 56(1) of the Draft PFM Bill should require that citizens validate the reports prior to their publication and publicising.

The **fifth** and last presenter, Mr. Micah Cheserem, emphasised the need to ensure county governments are able to perform their functions from the outset. This will require careful costing of functions for both the national and county governments and apportioning resources accordingly. There is need for National Treasury and CRA to work closely on this. It was explained that the results of the costing would inform the legal provisions on sharing of revenue. The need for lean county and national governments was also underscored.

It was further explained that in drafting the revenue collection and sharing laws, the drafters must pay attention to the possible challenges that are likely to be encountered in collecting and sharing revenues. These include; (i) the county governments are expected to have weak capacity to collect revenue. It was explained that experience from the current local authorities indicates that there is limited capacity for revenue collection, (ii) there is likely to be challenges of enforcing tax compliance, (iii) most counties may lack credit sources of data to inform revenue collection and sharing decisions, (iv) there is presently a weak link between tax collection and service delivery. It was explained that if tax payers do not enjoy effective and efficient service delivery, then they may be reluctant to pay tax.

Since evidence suggests that most county governments may not have the necessary capacity to collect revenue, it was suggested that in the formative stages of the PFM law implementation, the responsibility of revenue collection should be assigned to the Kenya Revenue Authority. The Authority would therefore collect the revenue on an agency basis as counties develop capacity to collect tax.

Regarding the proposal to establish an independent Grants and Loans Council to oversee, coordinate and monitor borrowing by the National and County Governments, there was no consensus and it was suggested that the issue be referred to a small team of expert for further consideration.

Summary of Issues Emerging from the Breakout Group Reports and Discussions

- **PFM Institutions**

It was emphasised that the Bill should as much as possible delineate responsibility over policy and implementation. In this regard, the Cabinet Secretary for Finance should take charge over policy matters while the Accounting Officers should be responsible for financial control and management. It was felt that some powers conferred upon the Cabinet Secretary responsible for Finance could be encroaching on the role Accounting Officer.

Some participants argued that the scope of work for the COB, as set out in the COB Bill should be expanded to include internal controls. It was noted that Article 228 (6) of the Constitution suggests that the functions of the COB were not restricted to approving withdrawals from established public funds. Article 228 (6) suggests that the COB could exercise control on other aspects of budget implementation, such as, internal controls. Other participants felt that the functions of the COB office should be restricted to approving and reporting on withdrawals from public funds established under the constitution. If the role of the COB is expanded to include internal controls, confusion and overlap of roles may occur. There was no consensus on this issues and it was proposed that it be referred to small team of experts for consideration.

Participants suggested that Section 11 of the Draft PFM Bill should be amended to transfer the role of setting accounting standards for the public sector from the National Treasury to an independent Accounting Board. This is the model adopted by the Republic of South Africa. It was explained that this will encourage objectivity in the formulation and enforcement of accounting standards.

Participants at the Forum were concerned that some provisions contained in the Fiscal Management Act had been dropped. It was suggested that since the Draft PFM Law will repeal the FMA, drafters of the Bill should retain some of the critical proposals relating to the Budget Committee and the Parliamentary Budget Office in order to ensure that gains made in strengthening the PFM framework are not lost. For example, Information requirement in the Draft PFM Bill should be scaled up to the standard of the FMA 2009.

It was observed that although the Bill includes several provisions on financial reporting, there is need to provide for an elaborate financial reporting framework.

It was also suggested that since the Fiscal Responsibility Principles are intended to underpin the operations of all the institutions established under the Draft PFM Bill, it is only logical that the principles are presented at the beginning of the Draft PFM Bill.

- **Budget process**

With regard to the provisions in the Draft PFM Bill relating to the sharing of revenue, it was noted that there is need for continued interaction between CRA and the National Treasury in order to develop criteria for sharing revenue. Further it was proposed that timelines for division of revenue should be included in the schedule of the PFM Bill in order to provide more clarity.

It was suggested that vertical revenue sharing should be on the basis of projected revenue and not historical revenue.

Participant underscored the need to cascade public participation in all phases of the budget process as set out in the Draft PFM Bill.

- **Revenue Collection and Sharing as well as Borrowing**

It was explained that whereas the Bill includes provision on Revenue sharing, there wasn't sufficient time allowed for consultations on all the pertinent issues relating to revenue sharing. An expert from Australia advised against inclusion of provision on revenue sharing in the Bill. It was explained that even in Australia provisions on revenue allocation were not included in the PFM Bill. Instead these were addressed in a separate Bill. It should, however, be noted that the fifth schedule of the Constitution requires that a law governing the Revenue Funds for County Governments be enacted by end of February 2012. This means there isn't much time anyway even if provisions relating to revenue sharing are not addressed in the PFM Bill they will have to be addressed in less than one year.

Some participant intimated that there was need to set a limit to recurrent spending in the PFM Bill in order to ensure that more public funds are directed to capital spending. Participant, however, were cautioned that such fiscal constraints on recurrent spending could limit the flexibility of government to respond to national demands.

Participants expressed dissatisfaction in the oversight mechanisms for grants and loans as provided for in the Draft PFM Bill. It was argued that by allowing the National Treasury to control borrowing by the county governments, the Bill was clawing back into the powers of the County governments. It was therefore proposed that the drafters of the Bill should consider establishing a Grants and Loans Council, independent from the National Treasury, to control borrowing by the national and county governments. Some participants also suggested that the Bill should allow borrowing limits for county governments to be determined by market fundamentals. It was, however, explained that the Bill does not lock out the all the county governments from borrowing in the market but that experience from existing local authorities indicates that there is rampant indiscipline in the management of debt and therefore by allowing counties to borrow in the market, the fiscal position of the county governments could deteriorate. It was, however, recommended that under the Draft PFM Bill sub-national units, especially cities or urban centres that demonstrate ability to borrow and pay, should be allowed to borrow within a well defined regulatory framework. The Bill, however, does not provide for such a framework.

With regard to the proposal to establish an independent Grants and Loans Council, some participants expressed doubt such an institution would add any value. It was explained that such an institution would only result in institution inflation and duplication of roles and would add little value since the oversight role over borrowing had been assigned to Parliament.

- **Public Participation**

It was explained that the success of the implementation of the Draft PFM law will largely depend on the level of public involvement. For the general public to participate in public financial management there is need to create awareness on the proposed PFM reforms as set out in the Constitution and the Draft PFM Bill. It was therefore suggested that the Draft PFM Bill should require the National Treasury to create awareness among the general public on the proposed Draft PFM Bill.

Participant recommended that the Draft PFM Bill should require the National Treasury to provide adequate budgetary allocation to facilitate public engagement in public financial management. For the public to have a well structured, sustained and effectiveness engagement with the PFM Institutions, it was proposed that the Draft PFM Bill should require the National Treasury to provide citizens' liaison offices.

It was explained that the fact the Draft PFM Bill does not define public participation, leaves it open to many interpretations. This could lead to conflicting interpretations which may defeat the objectives of the Bill in respect of public participation provisions. It was therefore proposed that the Draft PFM Bill should include a definition of public participation in Part I.

Participants felt that the Budget Policy Statement (BPS) should be circulated to the general public for comments by 28th January to allow for public scrutiny prior to its presentation to Parliament on 28th February. Other participants, however, noted that Section 24 (3b) provides an opportunity for public input into the BPS prior to its finalisation and submission to Parliament. It is, therefore, not clear why it would be necessary to allow for further public consultation after the Bill is finalised.

It was observed that Section 28 of the Draft PFM Bill does not provide for timelines for the finalisation, submission, publication and publicising of the Counties' Annual Plans. This allows too much discretion to the County Executive. There is need for timelines for Annual Plans preparation at the county level.

Whereas Article 221 of the Constitution requires the National Assembly to consult the public during the process of reviewing and approval the Budget Estimates, Section 38 of the Draft PFM Bill does not provide for public participation in the Parliamentary process of reviewing the Budget Estimates. There is need to require The National Assembly to consult the public as they review and approve the Budget Estimates.

It was further suggested that there is need to provide for a link between the National Budget and Economic Council and the County Budget and Economic Forum. Since the National Budget and Economic Council will be reviewing plans of government ministries and departments, the Cabinet Secretary and/or the Principal Secretary responsible for planning should also be a member of the Council. Further, participants also recommended that the Council should also include a civil society representative. In this regard, it was recommended that Section

32(1) and 33(1) of the Draft PFM Bill be amended to provide for the recruitment of representatives of citizens. Further, Section 32(1) should be amended to require the inclusion of the Cabinet Secretary and/or the Principal Secretary responsible for Planning.

With regard to reporting, it was suggested that the Draft PFM Bill should require the relevant institutions to publish and publicize the financial statement of accounts and auditor's reports at the county and national levels. In addition, the reports of Accounting Officers to the National Treasury and County Treasury should be published and publicized.

Way forward

It was suggested that the CIC puts together a small team of experts to further evaluate the contentious issues and make recommendations to the CIC on how best to address the issues.