REPUBLIC OF KENYA

PUBLIC FINANCIAL MANAGEMENT PERFORMANCE REPORT AND PERFORMANCE INDICATORS

PEFA EVALUATION

FINAL REPORT

July 2006

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ACRONYMS AND ABBREVIATIONS

AFDB	African Development Bank
AG	Accountant General
AGA	Autonomous Government Agencies
AIE	Authority to Incur Expenditure
A-IN-A	Appropriations in Aid
BMU	Budget Monitoring Unit
BOPA	Budget Outlook Paper
BSP	Budget Strategy Paper
C&AG	Controller and Auditor General
CBK	Central Bank of Kenya
CDF	Constituency Development Fund
CFO	Chief Finance Officer
CFS	Consolidated Fund Services
CIFA	Country Integrated Fiduciary Assessment
CMU	Cash Management Unit (MOF)
COFOG	Classification of the Functions of Government (UN)
CS-DRMS	Commonwealth Secretariat Debt Recording and Management System

ACRONYMS AND ABBREVIATIONS

DFID	Department for International Development
DGIPE	Department of Government Investment and Public Enterprises
DPM	Department of Personnel Management
EFMAP	Enhanced Financial Management Action Plan
ERPFM	External Review of Public Financial Management
FA	Fund Account
FS	Financial Statements
FY	Financial Year
GDP	Gross Domestic Product
GFS	Government Finance Statistics
GJLOS	Governance Justice Law and Order Sector Reform Programme
GOK	Government of Kenya
GTZ	Deutsche Gesellschaft für technische Zusammenarbeit/ German Technical Cooperation
HIPC	Heavily Indebted Poor Country
IAG	Internal Auditor General (MOF)
IDA	International Development Association
IFMIS	Integrated Financial Management Information System
IIA	Institute of Internal Auditors
IMF	International Monetary Fund
INTOSAI	International Organisation of Supreme Audit Institutions
IP-ERS	Investment Programme for the Economic Recovery Strategy (for Wealth and Employment Creation)
IPPD	Integrated Personnel and Payroll Database
IPR	Independent Procurement Review
KACC	Kenya Anti-corruption Commission
KES	Kenya Shillings
KIPRA	Kenya Institute of Public Policy Research and Analysis
KRA	Kenya Revenue Authority
LA	Local Authority
LATIF	Local Authorities Transfer Fund
LTO	Large Taxpayer Office
M&E	Monitoring and Development
MDAG	Ministries, Departments and Agencies
MDG	Millennium Development Goals
MOF	Ministry of Finance
MPER	Ministerial Public Expenditure Reviews
MPND	Ministry of Planning and National Development
MTBSP	Medium Term Budget Strategy Paper
MTEF	Medium Term Expenditure Framework
NFA	Net Foreign Assets
NPV	Net Present Value
PAC	Public Accounts Committee
PE	Public Enterprise
PEFA	Public Expenditure and Financial Accountability
PEMAAP	Public Expenditure Management and Accountability Action Plan
PER	Public Expenditure Review

ACRONYMS AND ABBREVIATIONS

PETS	Public Expenditure Tracking
PFM	Public Financial Management
PFM-PR	Public Financial Management - Performance Report
PFMR	Public Financial Management Reform
PPD	Public Procurement Directorate
PRGF	Poverty Reduction Growth facility (IMF)
PRSP	Poverty Reduction Strategy Paper
QBR	Quarterly Budget Review
RBM	Results Based Management
SAGA	Semi-Autonomous Government Agency
SIDA	Swedish International Development Agency
STATCAP	Statistical Capacity Building Programme
SWAP	Sector Wide Approach
SWG	Sector Working Group
USD	United States Dollar
VAT	Value Added Tax
VFM	Value for Money
WB	World Bank

SUMMARY ASSESSMENT

1. The Public Expenditure and Financial Accountability (PEFA) assessment has been undertaken as an exercise initiated by the Government of Kenya (GoK). It has been carried out in the context of the 2006 Review of the GoK Draft strategy conducted by the donors. The assessment was prepared on the basis of

(a) guidance on the Public Financial Management Performance Measurement Framework issued by the PEFA multi-donor programme in June 2005; and,

(b) the demonstrated observable public financial management (PFM) practices in Kenya at the time of the assessment as determined through interviews and reviews of official documents and reports.

A large amount of documentary evidence was provided by the government to support the study. Where possible, corroborating evidence was sought from a variety of sources. Extensive discussions were held with stakeholders to determine the appropriate scoring for each indicator.

2. The purpose of the PFM Performance Report is to assess at a given point in time the status of the public financial management system, to set a baseline for the continued use and assessment of the set of 31 high-level indicators of the PEFA performance measurement framework. The PEFA assessment is particularly timely as the GoK is planning to implement a comprehensive PFM reform strategy programme, and the assessment should assist in guiding the sequencing of reform activities as well as complement the reform programmes monitoring and evaluation. It is important to underline that the objective of the assessment has not been to evaluate and score the performance of specific institutions or individuals, but rather to assess the PFM systems themselves.

i) Integrated assessment of PFM performance

3. Kenya's legal and regulatory framework for public financial management, along with its institutional arrangements, has many features that facilitate sound PFM practice. There have recently been a number of reforms carried out to strengthen the legal and regulatory framework. Notable, though is the absence of an organic budget law. The inclusion of a budget law should contribute greatly to the PFM performance.

4. There has been considerable effort made towards establishing the foundations of a sound PFM system in many areas. While such achievements have not been inconsiderable, there is still much work to be done in order to achieve the level of performance to ensure that PFM system impacts significantly on the achievement of outcomes of aggregate fiscal discipline, strategic allocation of resources and efficient service delivery. Table 1 summarizes the overall assessment against the PEFA Performance Indicators benchmarks. Whilst predictability of overall revenues and expenditures has been maintained in aggregate over the last three years, credibility of the budget is undermined by significant in-year variations across budget heads. Significant progress has been made in the procurement law and regulations, but procurement practice remains weak. An integrated personnel and payroll system has been deployed, but it remains not fully comprehensive, and does not have fully effective controls.

5. Measured against the six core PFM objectives examined by the assessment, it is clear that the PFM system has the potential for significant improvement. There have been significant improvements in many areas in recent years, which have served to reinforce transparency and comprehensiveness of fiscal management. However, it is also apparent that it will require a sustained and focused effort that properly recognizes the links between the different areas of PFM to achieve the desired PFM performance objectives. Further improvements will be needed to achieve better budget outcomes as follows:

- ***Credibility of the budget.*** The credibility of the budget depends on the government's ability to realise its revenue and expenditures plans. There have been significant differences between both planned revenue and expenditure against outturns in the last three years (2002/03 to 2004/05). An unfavourable domestic revenue performance in two previous years was reversed in 2004/05. Expenditure outturn was below planned levels for all the three years at both aggregate and individual ministerial levels.

The impact of the overall fiscal discipline resulted in a non-uniform re-distribution of budgetary resources across sectors. In the same period the under-spending also impacted on the operational efficiency of ministries leading to accumulation of arrears, amounting to 9 per cent of actual expenditures in 2002/03 and 2003/04. Government made efforts to reduce these outstanding bills to about 4 per cent in 2004/05 with further projected decreases in the current year.

- ***Comprehensiveness and transparency of the budget***. The administrative and economic classifications of the budget are comprehensive and very detailed. Although some functional classification has been introduced in the pre-budget documents, this kind of classification is not incorporated in the annual budget documentation. All pre-budget documentation and annual budget documents are transparent and available to public by a variety of means. There are some expenditures unreported to the ministry of finance by semi-autonomous government agencies that are financed through certain earmarked tax and non-tax revenues, though a start has been made in reporting these transactions.

  Inter-governmental fiscal relations, i.e. transfers from central to sub-national governments (Local Authority Transfer Fund) are timely, fully rule-based, and transparent. There is little information available on the reporting of the Constituency Development Fund operations to the ministry of finance. It should be noted that the operations of Constituency Development Fund in this report is not considered as a central/local fiscal relations issue because the fund's projects are not approved by local councils nor are implemented by them, but the central government agencies in the localities.

  No fiscal risks are posed by semi-autonomous government agencies and local authorities. However there are potential and actual fiscal risks from public enterprises. A new privatization bill was enacted in 2005, which has already been implemented in few industries. With extension of privatization to other major state holdings the fiscal risks from this sector is expected to be reduced gradually.

- ***Policy-based budgeting.*** Extensive macrofiscal and sectoral analysis work is undertaken before budget preparation begins. Debt sustainability analysis is indirectly undertaken in the context of the International Monetary Fund-supported Poverty Reduction Growth Facility programmes with a scope that is required for such programmes when they are prepared and/or when they are in force and are reviewed. Forecast of fiscal aggregates on the basis of economic and main functional classifications are prepared for three years on a rolling basis. On the basis of these policies, medium term expenditure strategies are costed, but not fully funded, resulting in financing gaps that are normally expected to be financed through external concessional assistance. These, along with short term economic fluctuations, result in a lack of strong linkage between medium term expenditure forecasts and annual budgets, which are more realistic, and based on firmer forecast revenues and expenditures.

  There does not appear to be demonstrated linkage of the recurrent and development budgets. Budgeting for investment and recurrent are two separate processes with no recurrent cost estimates being completely calculated. Two different documents are prepared and published without being linked. There is a clear and detailed budget preparation calendar but, in part due to late submission of the budget to parliament, the budget has always been approved well after start of fiscal year.

- ***Predictability and control in budget execution***. The budget process incorporates involvement between the line ministries and the ministry of finance. However, the intra-ministerial budget process remains weak. An effective participatory process occurs at the headquarter levels but much less so at the district levels. The budget releases between the Treasury and the line ministries is timely and predictable, but much less so within the line ministries. The commitment control system is not tied to actual spending limits, but rather to the budget votes. Given the high variance between budget releases and budget votes this remains a threat to the accrual of pending bills. Major improvements have been made to the legal framework for procurement and there is some evidence that the procurement regulatory and institutional framework should support sound procurement practice. There is an appeals and review process that is in place. As evidenced from recent market studies though and the Independent Procurement Review, procurement practice remains poor and will require the completion of the regulatory framework and much more capacity building.

The tax legislation is clear and comprehensive and administrative guidelines are widely distributed. A tax appeals mechanism has been implemented. There is very close coordination between the Kenya Revenue Authority and the Treasury and weekly reconciliations are carried out.

The government has implemented an Integrated Personnel and Payroll Database system for the civil service. However it covers less than 35 per cent of the government employees. No effective reconciliation occurs between personnel records and payroll data.

The internal audit has recently established a comprehensive platform in line with international standards and best practice. It needs now to be further consolidated in the years to come before more material results on a broad scale can be clearly visible.

- ***Accounting, recording and reporting***. The government public accounting system maintains adequate records to meet the needs of controlling expenditures. The remaining challenge is whether it could maintain, produce and disseminate adequate information to meet the needs of operational decision making to improve service delivery. The traditional cash-based system coupled with the government's own standards of accounting limits budget reporting.

  Accounting transactions are captured through the 'vote book' system and are reported on the same basis as the budget. In-year budgetary reports are generally submitted on time to the ministry of finance by line ministries, but they are not reconciled with bank records and are of poor quality in terms of accuracy. Year-end financial statements are prepared from ledger accounts and presented to the Controller and Auditor General seven months after the close of the financial year.

- ***External scrutiny and audit***. External oversight still suffers from a severe delay in the submission of the Controller and Auditor General's reports to parliament. The Controller and Auditor General's audit is still basically a transaction and account balance audit. Risk-based audit is not in place and audit opinion does not accord with international standards and best practice. Legislative scrutiny of the annual budget law is very limited. The time for the legislature review is insufficient for a meaningful debate. Parliament scrutiny of external audit reports still struggles with a substantial backlog and effective follow-up procedures for getting action on audit findings and recommendations are not in place.

ii) Assessment of the impact of PFM strengths and weaknesses

6. The government maintains aggregate fiscal discipline by controlling overall expenditure levels through introducing a new cash management system. It also has made significant progress in collecting tax revenues.

Whilst significant progress has been made in these areas, the assessment indicates areas which require continued attention. Weaknesses in budget planning prevent resources from being effectively utilised to meet government policy priorities. Incomplete and unfunded costing of sector strategies and weaknesses in monitoring of budget performance make it difficult to allocate resources across and within sectors appropriately. At the same time, detailed budget plans are made but they are not implemented as planned. The resulting large expenditure deviations across budget heads reduce budget credibility and potentially undermine the legitimacy of these original budget plans.

There are further weaknesses in the areas of in-year reporting, accounts reconciliation, external auditing, , late submission of the Annual Audit Reports by the Controller and Auditor General to the Public Accounts Committee, severe backlogs in the committee's scrutiny of Controller and Auditor General's annual reports and lack of sufficient time and procedures for parliament for legislative scrutiny.

iii) Prospects for reform planning and implementation

7. The government has not yet (June 2006) officially launched its new comprehensive PFM reform strategy. There has been substantial progress made towards finalising the Strategy Report which is currently being reviewed by the donors. The working draft of the donor review identifies a number of significant reforms that have already been undertaken. These reforms include:

- Enactment of the Public Financial Management Bill 2004 into law, which provides a platform for improved public financial management;

- Implementation of an Enhanced Financial Management Action Plan, which detailed activities necessary to strengthen budget formulation, execution, monitoring and evaluation;

- Annual assessments of progress against an international set of performance benchmarks using the Public Expenditure Management and Accountability Action Plan framework;

- Development of strategic plans that stipulate the core functions and form the basis of performance contracting for heads of ministries/departments.;

- Accelerated clearance of audit backlogs through the Kenya National Audit Office;

- Introduction of an Integrated Financial Management Information System to help improve financial management through improved data accuracy, timeliness and access to financial management information;

- Enactment of the Public Officers Ethics Act that enhances personal integrity on the part of public officers;

- Establishment of anti-corruption institutions while strengthening existing ones to enhance good governance and accountability;

- Opening of the budget process to greater stakeholder participation through channels such as the Budget Outlook Paper, sector hearings and the Budget Strategy Paper;

8. Institutionally, the reforms are directed and owned by senior management within the Ministry of Finance, a strategy which has proved effective, as evidenced by the success of a number of reform measures. As the reforms continue, it will be important for the government to ensure that sufficient analytical capacities exist to lead and manage the reform process.

Table 1: Summary of PFM Performance Scores[1]

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

[1] See Annex 1 for explanations of scores and Annex 2 for details of the calibration of the scores.

1. INTRODUCTION

1.1.1. Since the 1980s, the Kenyan economy has performed below its potential, with low economic and employment growth and a decline in productivity. The factors underlying the weak economic performance and widespread poverty include the persistence of pervasive governance failures, the slow pace of economic reforms, low savings and investment, intermittent shortages and high costs of power, and deficient infrastructure.

1.1.2. In December 2002 Kenyan citizens elected a new government that committed itself to improving the living standards of all, especially the poor. Despite inheriting with severe resource constraints, the Government of Kenya (GOK) has begun implementing a wide ranging and deep set of reforms. Top on the reform agenda has been measures to improve governance and to provide universal primary education.

1.1.3. The public financial management (PFM) system has been improving steadily under the new government. As measured against the Government's 2003 Public Expenditure Management Action Plan (PEMAP), with a framework of 16 performance benchmarks, it met three in 2003, four in 2004 and six in 2005.

1.1.4. Since July 2005 the government, with the support of a number of development partners, has been developing a comprehensive PFM reform strategy based upon existing reform efforts by government departments, the Country Integrated Fiduciary Assessment (CIFA) and Independent Procurement Review (IPR) diagnostic tools.

1.1.5. The comprehensive aspect of the PFM reform programme makes it stand out from previous efforts. While this approach is more demanding, its integrated approach provides an opportunity for achieving the significant improvements in the quality that have eluded many of the past efforts made at improving public expenditure management in Kenya. This new PFM reform is to be launched during 2006. The GOK PFM reform programme is in a finalising phase, and most development partners are keen to align, and even pool funds in support.

1.2. OBJECTIVE OF THE PFM PERFORMANCE REPORT (PFM-PR) PROCESS

1.2.1. The purpose of this evaluation has been to assess the current status of the Kenya PFM system based on the PEFA indicators in order to set a baseline for the continued use and assessment of these indicators. The report set out herein and the baseline established will also be an important contributory element of the integrated monitoring and evaluation (M&E) framework that will be developed for the PFM reform.

1.2.2. It is important to underline that the purpose of this evaluation has not been to assess and score different institutions or individuals responsible in the government. The focus is on the PFM system as itself and the results of the evaluation should serve, not only as a baseline for measuring the impact of the reform programme in future evaluations, but also as an important input in the process of steering the GOK PFM reform programme and prioritising within it.

1.3. METHODOLOGY FOR THE EVALUATION

1.3.1. The PEFA evaluation was carried out in two missions. The first during the period 13-24 March 2006 and the second from 29 May to 5 June. The first mission was conducted in parallel with the joint donors' assessment of the GOK's draft PFM Reform Strategy. The PEFA evaluation partially shared terms of reference (TOR) with the donors' assessment. The second mission was launched to collect missing information and validate observations and scorings already done. The evaluation was carried out by a team of international and Kenyan consultants[2].

1.3.2. The evaluation involved:

- Collecting and analysing existing documentation and reports on the Kenya PFM;
- Collecting data and information from interviews with key stakeholders and individuals with key responsibilities within the PFM system;
- Quality assurance by seeking independent confirmation on data and information either from complementing interviews or from available recent reports;
- Discussions within the team for reaching and consolidating a common approach, interpretation of data and presentation of information;
- Discussions with a few donor experts and local experts on scoring of the PEFA indicators and about quality of the information;
- Producing a working draft during the first mission with limited circulation for comment, which helped the team in the second mission to follow-up and elaborate the issues.
- Producing a final draft that was circulated for comments to GoK institutions and Cooperation Partners before consolidation of the Final Report.

1.4. SCOPE OF THE ASSESSMENT

1.4.1. The assessment of Kenya's PFM covers all operations of the central government and the institutions responsible for such. Public expenditure in Kenya is highly centralised but also highly de-concentrated. The structure of the report is as follows:

- Section 2 provides background information for the evaluation;
- Section 3 explains the scores for individual performance indicators;
- Section 4 describes the government's reform programme;
- A series of annexes provide more detailed reference information, including a summary of the scoring of the performance indicators (annex 1), a summary of the PEFA scoring calibration (annex 2), the TORs for the evaluation (annex 3), and a list of the stakeholders visited by the team (annex 4).

2 The team was composed of: Göran Steen, consultant and teamleader; Bo Sandberg, consultant; Kojo Oduro, consultant and Iris Mueller, GTZ (full time during first and second mission), and Ron Quist, consultant, Feridoun Sarraf, consultant and Nicholus Imbugwa, consultant (full time during second mission). Lennart Bjerknér, consultant was a part-time team member during the first mission. Josphat Mwaura, consultant, supported the team and also contributed to the report.

2. BACKGROUND

2.1. DESCRIPTION OF COUNTRY ECONOMIC SITUATION

2.1.1. Over the last three years (2003-2005), the Kenyan economy has been on a slow but consistent recovery with real gross domestic product (GDP) rising by 0.4 per cent in 2002, 2.8 per cent in 2003, 4.3 per cent in 2004 and a decade high of 5.8 per cent in 2005. The positive performance has been fuelled by increased credit to the private sector, positive consumer and investor sentiments, low interest rates, a stable macro-economic environment and structural reforms over the period.

2.1.2. With a population of 32.4 million, the country's economy had consistently been declining for the better part of the last decade prior to 2002.. Growth in GDP averaged a mere 1.3 per cent per annum compared to an average annual population growth rate of 2.0 per cent over the decade.. As a consequence, the percentage of people living below the poverty line had increased to 56 per cent by 2002. Investments were low and declining, with gross investment as a proportion of GDP at a mere 13.6 per cent in 2002,. Public sector investment stood at 4.8 per cent of GDP in 2002. At the same time, public consumption had increased to 19 per cent of GDP by 2002..

2.1.3. In 2003, a new government with a challenge to restore economic growth, create employment opportunities and reduce poverty levels assumed office after elections in December 2002. As a first step towards economic recovery, the government formulated a Poverty Reduction Strategy Paper (PRSP), titled the Investment Programme for the Economic Recovery Strategy for Wealth and Employment Creation (IP-ERS), through a wide consultative and participatory process involving major stakeholders. Ownership of the strategy is high both within and outside government, a critical pre-requisite for successful implementation. The strategy is anchored on three inter-linked pillars:

(i) Economic growth;

(ii) Poverty reduction and equity; and,

(iii) Governance.

2.1.4. The strategy identifies key institutional and structural reforms necessary for economic recovery. To improve public expenditure management, the strategy identifies three core fiscal objectives to be pursued over the period 2003-2007:

(i) Fiscal sustainability;

(ii) Expenditure restructuring for growth and poverty reduction; and,

(iii) Improving public service delivery. This is aimed at enhancing governance in the public sector through efficient and effective utilization of public resources.

2.1.5. The continued implementation of key structural and institutional reforms, despite a volatile political environment, has resulted in an economic turnaround, though its impact on poverty reduction and equity is yet to be felt. The challenge however, is how to ensure that the growth momentum is scaled-up in a sustainable manner to levels that will ensure all citizens share in the benefits of growth.

Table 2: Selected Economic Indicators 2001-2004 [3]

Indicator	2001	2002	2003	2004
1. Population				
People (Millions)	30.41	31.30	32.23	33.18
Growth (%)	2.98	2.93	2.97	2.92
2. National Accounts				
GDP at Current Prices (KES. bn)	1,026	1,039	1,142	1,274
GDP at Constant 2001 Prices (KES. bn)	1,026	1,030	1,056	1,104
GDP growth rate at Constant Prices (%)	4.4	0.4	2.8	4.3
Per Capita Income (USD)	429	427	432	431
3. Domestic Saving and Investment				
Gross Domestic savings/GDP (%)	6.2	8.4	9.8	10.7
Gross Domestic Investment/GDP (%)	14.4	13.4	13.4	6.2
4. Balance of Payments (USD million)				
Current Account Balance	-383	-181	68	-382
Capital Account Balance	348	-32	537	233
Overall Balance	166	3	412	63
5.Foreign Exchange Reserves(USD million)				
Official Reserves	1,064	1,067	1,480	1,519
Commercial Banks	396	546	408	620
Official Reserves in months of imports	-3.2	-3.3	-4.2	3.5
6. Average annual inflation rate (%)	5.8	2	9.8	11.6
7. Treasury Bills rates (91 Days)	10.8	8.4	1.4	8.3
8. Average Exchange rate (KES/USD)	78.6	77.1	76.1	77.3

2.1.6. The resurgence in economic performance as reflected in Table 2 is attributed to improved performance in virtually all sectors. The strong performance across sectors points to a consolidation of recovery gains realized in the last three years as reflected by the 5.8 per cent expansion in real GDP in 2005 despite a severe drought during the year.

2.2. BUDGETARY OUTCOMES

Fiscal Performance

2.2.1. Kenya's ability to mobilize domestic resources has been impressive over the last three years with taxation revenues averaging between 21-22 per cent of GDP, well above the sub-Saharan average. This has resulted from enforcement of tax legislation and broadening of the tax base. Reliance on external concessional financing has been low enabling the country to achieve a sustainable fiscal framework. The government's fiscal objective in the medium-term is to contain increases in overall expenditure, sustain the revenue to GDP ratio around 21 per cent and use external financing to retire domestic debt.

Table 3: Budgetary Trends 2003/04 - 2004/05 – Central Government Budget (% of GDP)

	2002/03	2003/04	2004/05
Total Revenue	21.9	23.4	22.9
-Own revenue	19.8	21.1	21.3
-Grants	2.1	2.3	1.6
Total Expenditure + net lending	24.4	22.9	22.3
Aggregate deficit (incl. grants)	-3.7	0.0	0.1
Primary Deficit	-5.1	-1.8	-1.0
Net Financing	6.0	3.0	1.1
-external	2.1	2.3	1.6
-domestic	3.9	0.7	-0.5

3 Sources: Central Bureau of Statistics, Economic Survey 2005; Central Bank of Kenya Monthly Economic Review, March 2006.

Allocation of Resources

2.2.2. The IP-ERS aims to restructure public expenditure to make it more growth oriented and pro-poor. Over the last three years, there has been a marginal shift towards development expenditures with its share of GDP increasing from 2.7 per cent in 2001/02 to 2.8 per cent in 2002/03 and 2003/04. This has been accompanied by corresponding but marginal increases in allocations to the social sectors (education, and health) and agriculture where aggregate allocation averaged 46 per cent of total expenditures over the last three years. The challenge is the low absorption capacity for the development budget by most ministries.

2.2.3. As depicted in Table 4, the composition of expenditure by economic classification is still highly skewed towards recurrent items despite the restructuring efforts. Less than 20 per cent of total expenditure is available to finance development activities. Salaries and wages, interest payments and pension payments continue to rise, keeping recurrent expenditures high.

Table 4: Actual Budgetary Allocations by Economic Classification (as % of total expenditures) [4]

	2002/03	2003/04	2004/05
Recurrent Expenditures	83.5	87.6	85.0
-Wages and Salaries	32.2	34.3	34.8
-Domestic Interest	10.4	8.3	7.7
-Foreign Interest	3.2	2.3	2.3
-Pensions	3.6	4.9	4.1
-Operations and Maintenance	34.1	37.7	36.0
Development expenditures	16.5	12.4	15.0

Non Ministerial Expenditures.

2.2.4. A significant proportion of government expenditure is spent outside the control of ministries. These includes the Constituency Development Fund (CDF) and the local authorities transfer fund (LATF). Combined the two account for over 5 per cent of ordinary revenue generated within a financial year. Although the idea of decentralizing funds to local levels is well thought out, there is no evidence yet to determine the contribution or otherwise of these funds towards the achievement of the ERS objectives and the Millennium Development Goals (MDGs). Fiduciary risks with CDF are high as the fund is not subject to the same controls, reporting and accountability procedures like other public funds.

2.3. LEGAL AND INSTITUTIONAL FRAMEWORK FOR PFM

Legal Framework

2.3.1. The legal framework governing the management of public finances in Kenya is spelt out in chapter 7 of the Constitution. The operational details are provided for by the Financial Management Act 2004. The Act makes provisions with respect to the exchequer account and the consolidated fund, persons responsible for government resources and other related matters. The Financial Management Act is complemented by The Public Audit Act 2003, the Public Procurement and Disposal of Public Assets Act 2005, the Kenya

[4] Source: Quarterly Budget Reviews (fourth quarters) 2002/03, 2003/04 and 2004/05.

Revenue Authority Act, Local Government Act and various financial regulations and legal notices issued from time to time by the Minister for Finance.

Institutional Framework

The executive

2.3.2. Kenya has a presidential system of government whereby a president, elected every five years through direct universal suffrage, is the chief executive accountable for all government actions including public finances. The President is constitutionally limited to two five-year terms.

2.3.3. The President is empowered by the constitution to appoint a Vice-President and constitute a cabinet from among the members of parliament, to help him execute the mandate of running government. The Minister for Finance is responsible for managing the consolidated fund and all matters relating to public financial affairs that are not assigned to any other minister. Permanent secretaries appointed by the President are the accounting officers for the various ministries. However the Ministry of Finance (MOF) retains the overall responsibility of financial management operations through accountants, procurement officers and internal auditors posted to the various line ministries.

The legislature

2.3.4. Parliament approves public expenditure and provides expenditure oversight on behalf of the people. The Public Accounts Committee (PAC) and the Public Investment Committee are the main vehicles through which parliament scrutinizes public spending. A Fiscal Analysis and appropriations committee of the House has been constituted and A fiscal management Bill is a waiting debate, which if passed as its most likely will allow for greater involvement of the legislature in the budget formulation process. The Kenya National Audit Office, an autonomous agency provided for in the constitution, audits all government accounts and reports directly to parliament.

3. ASSESSMENT OF PFM SYSTEMS, PROCESSES AND INSTITUTIONS

3.1. BUDGET CREDIBILITY

3.1.1. The budget instrument serves to translate policy goals of economic growth and poverty reduction into actual achievements through the delivery of public services. One measure of the government's ability to deliver public services is reflected in the performance of aggregate outturn against budget. In the following paragraphs budget credibility is examined in terms of expenditure, revenue and arrears (pending bills).

Expenditure

3.1.2. The original budget figures compared to outturn indicated that there has been a systematic under-expenditure measured at an aggregate level in the last three years. In 2004/05 the variance was 14 per cent of the original budget, 13 per cent in 2003/04, and 13 per cent in 2002/03. This indicates a marginal increase in the expenditure deviation in the immediate past. Notably, expenditure deviations were negative for all budget heads as was the aggregate deviation, consequently leading to a zero discrepancy between measured deviation and variance. These variances may be attributed to factors both internal and external to the government's budgetary procedures.

3.1.3. With regards to internal factors, concerns have been expressed about the uncertainty associated with budget forecasts especially with respect to donor flows and Appropriations-in-Aid (A-in-A). Additional factors for under-spending include poor project planning in the line ministries[5] and late releases from the exchequer accounts caused by government liquidity problems and poor cash management. While relevant to the three years considered, this latter factor should be much less of an issue for the current year given the marked improvement in the timing and predictability of budget releases.

3.1.4. For external factors, difficulties relating to harmonisation of donor procedures and the tying of aid flows to benchmarks have prevented the effective utilization of aid (which represents between 50.5 per cent and 62.3 per cent of the development expenditure in the last four to five years). The high variances of actual expenditure against planned expenditure bring the credibility of the budget and the budget process into question.

Table 5:Comparison of Budgeted and Actual Expenditure (2002/03 to 2004/05) [6]

	2004/05	2003/04	2003/02
Budgeted Expenditure (Billion KES)	**300,574**	**251,441**	**231,964**
Actual Expenditure(Billion KShs)	**259,731**	**219,178**	**202,580**
Difference between actual and budgeted expenditure	**40,843**	**32,263**	**29,384**

5 See Republic of Kenya PER, 2005 (page 22).

6 Source: Treasury, Ministry of Finance, Government of Kenya. These percentages were computed from gross estimates and actual expenditure figures (which included Appropriation -in-Aid) provided by the Treasury. We checked it against figures used in compiling the Public Expenditure Review and attempted to reconcile the total actual expenditures with figures given to us by the Economic Affairs Unit in Ministry of Finance. Reconciling one data source to another was not possible therefore the source data from the Treasury was used because they had been compiled consistently from one year to another in the last three years and they are subjected to external audit scrutiny.

(BKES)			
Difference as % of Budgeted Expenditure	14%	13%	13%

3.1.5. An examination of the detailed composition of the variance between budget and outturns shows a wide variation. For example:

- Ministry of Roads and Public Works (with a high proportion of development budget), under-spent its budget by as much as 40 per cent in 2002/03. The level of under-spend was reduced to 24 per cent in 2004/05;
- Ministry of Finance recorded an under-spend of 45 per cent;
- Ministry of Transport and Communication 24 per cent in 2004/05.

3.1.6. The average deviations for the period under consideration were 14 per cent, 13 per cent and 13 per cent in 2004/05, 2004/03 and 2002/03 respectively (Table 5). As stated above in spite of the relatively large aggregate deviations, the deviations for all line ministries were consistently negative. The significance of this is that all ministries, departments and agencies under-spent their budgets, even if it was not uniform across government. It suggests that the shortfall in expenditure was allocated somewhat consistently even if not evenly across all budget heads. This results in a percentage difference of zero between total expenditure deviation and composition variance for all the three years.

Table 6: Comparison of Deviation in Budgeted and Actual Outturn for Budget Heads[7]

	Deviations as % of original budget		
	2004/05	2003/04	2003/02
Office of the President	7.8%	12.9%	14.6%
Dir of Pers. Management	23.5%	25.7%	25.7%
Foreign Affairs	3.6%	5.4%	5.8%
Home Affairs	6.1%	6.8%	6.0%
Finance	44.5%	7.3%	8.4%
Defence	1.1%	2.3%	0.2%
Agriculture	17.4%	9.3%	17.5%
Health	12.8%	0.3%	20.5%
Local Government	31.2%	9.6%	23.3%
Roads and Public Works	24.1%	29.2%	40.1%
Transport and Comm.	24.3%	9.1%	10.2%
Labour and Human Res.	10.7%	24.8%	3.5%
Trade and Indus	8.8%	39.3%	26.3%
Water Resources	18.4%	23.7%	24.2%
Environmental and Natural Res.	1.5%	14.2%	9.0%
National Assembly	19.8%	12.2%	10.1%
Energy	0.4%	19.8%	18.1%
Education Science and Tec.	4.3%	7.3%	4.4%
Elec. Comm.	8.1%	19.5%	17.8%
National Serv. I Serv.	0.8%	4.4%	4.4%
All the others	19.8%	38.1%	20.4%
Total Expenditure Deviation	13.6%	12.8%	12.7%
Composition Variance	13.6%	12.9%	12.7%

7 Source of data: Treasury, Ministry of Finance, Government of Kenya.

Table 7: Variation in Expenditure Composition

	2004/05	2003/04	2003/2002
Total Expenditure Deviation	13.6%	12.8%	12.7%
Total Composition Variance	13.6%	12.9%	12.7%
Variance in Excess of Total Deviation	0.0%	0.0%	0.0%

Revenue

3.1.7. The main source of domestic revenue is from customs and excise, income tax, and value added tax collected by the Kenya Revenue Authority (KRA). The performance of domestic revenue collection was good in 2004/05 with the out-turn exceeding the budgeted figure by 9 per cent. In 2003/04 and 2002/03 there were under-performances of 6.4 per cent and 6.3 per cent respectfully.

Table 8: Comparison of Budgeted and Actual Revenue Receipts (Domestic)

	2004/05	2003/04	2002/03
Budgeted Receipts (Billion KES)	251.09	249.07	210.30
Actual Receipts (Billion KES)	274.86	233.21	197.04
Difference between actual and budgeted (Billion KES)	+23.77	-15.86	-13.26
Difference as % of budgeted receipts	+9.5%	-6.4%	-6.3%

3.1.8. Table 8 is based on revenue collection against out-turn data provided by the Treasury and used for compiling final government accounts. Such revenue data is compiled by MOF as either development or recurrent revenue but excludes the appropriations-in-aid. It should be noted that the inclusion of appropriations-in-aid would almost certainly have led to higher under-performance figures. However the Accountant General's reports do not include revenue figures for appropriations-in aid and so it was not possible to obtain official figures for revenues inclusive of appropriations-in-aid.

Pending Bills

3.1.9. Managing expenditure arrears (pending bills) has always posed a problem for the government .Due to its persistent nature, in the last four years the government has 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 from private sector contractors). As a result of the work of the Pending Bills Committee the stock of pending bills has been reduced from 9 per cent through the years 2002/03 and 2003/04 to 4 per cent in 2004/05 (see Table 9). The stock of pending bills was KES19.7Bn in 2003/04 and was reduced to KES11.7Bn in 2005. The trend, in percentage terms, has been reduced from 9 per cent in the preceding two years to 4 per cent in 2004/05.

3.1.10. The accrual of pending bills is determined by a number of factors. The most important is the predictability and timeliness of budget releases. Since 1st July 2005 there has been remarkable improvement in the predictability of funds from MOF to the MDAs but there is some evidence that suggests that predictability with respect to intra-ministry transfers remains poor. The commitment control system employed is based upon the vote book. As demonstrated by the comparison of expenditure outturns to budget provisions, using the vote book to set commitment controls can be expected to accrue pending bills as long as significant variations remain between budget provisions and expenditure outturns.

Table 9: Pending Bills (Millions of KES)

	2002/03	2003/04	2004/05
Total Outstanding arrears	18,308	19,690	11,668
Actual Expenditure	202,580	219,178	259,731
% Arrears	9%	9%	4%

3.1.11. There is some evidence that in spite of a circular issued by Treasury on using a 90 day delay in unpaid bills as the basis of definition of a pending bill, that different MDAs use different definitions. These definitions call into question the reliability of the official figures reported on pending bills. The reported figures in the Quarterly Budget Review (QBR) used in the analysis do not include late payments on pensions and other personnel emolument payments. Further, as is the case of any cash based accounting system, the source document is the payment voucher. Consequently many MDAs may only be reflecting an unpaid bill as arrears if no cheque payment is reflected in the payment voucher. However, this does not take into account the float of expenditure files for which goods and services have been delivered but for which no payment vouchers have been issued. The upshot of this is that the pending bills reported may be understated.

3.1.12. The most recent published data available in the QBR (2nd Quarter 2005/06) indicates that the stock of pending bills have increased from KES11. 7Bn to KES12.15Bn (an increase of about KES 450m) from the end of June 2005 to the end of December 2005. The evidence suggests that whilst arrears in development expenditure have been brought under control, the government has not been equally successful to bring arrears in recurrent expenditure under control. Persistent problems in the recurrent expenditure have been attributed to inadequate provision being made for utilities and shortage of liquidity to meet these payments.

Table 10: PEFA Indicator/Dimension - Score

Indicator /Dimension	Score	Brief Explanation
PI-1 Aggregate expenditure out-turn compared to original approved budget	C	The percentage deviation between actual and budgeted expenditures as a proportion of the original approved budget were: 2002/03: 13%(actual expenditure) 2003/04: 13% (actual expenditure) 2004/05: 14% (actual expenditure)
PI-2 Composition of expenditure out-turn compared to original approved budget.	A	The variances in the composition of primary expenditures budget heads were respectively: 2002/03: 0%; 2003/04: 0% 2004/05: 0%
PI-3 Aggregate revenue out-turn compared to original approved budget	C	The domestic revenue collection was below 94% in 2 of the last 3 years.. 2002/03: 93,7%; 2003/04: 93,6% 2004/05: 109,5%
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	Stock of arrear was 8.97 % in 2003/04 and 4.40% in 2004/05. The debt stock was reduced from KES19,690.2M KES 11,668.1M.
(ii) Availability of data for monitoring the stock payment arrears	B	Data for monitoring available and published in the QBR. There is delayed publication of the QBR but the information available is comprehensive

3.2. TRANSPARENCY AND COMPREHENSIVENESS

Classification of the Budget

3.2.1. Both recurrent and development budgets are classified on an administrative basis and since financial year 2005/06 on a complete GFS-based economic classifications basis, which are incorporated into the government budget execution process and its chart of accounts.

3.2.2. To date no attempts have been made to incorporate in the annual budget and accounting processes a functional classification of government operations or a programmatic classification. However, several other budgeting-related working papers such as Ministerial Public Expenditures Reviews, Medium-Term Budget Strategy Paper, and the Budget Outlook Paper contain some information about government functions that are used for pre-budget sectoral analysis and medium-term expenditure forecasting purposes but which are not incorporated in the government budget and accounts coding structure.

3.2.3. In a statistical context only, through bridging administrative and economic classifications to a standard functional classification, government produces data on actual expenditures for a COFOG-based functions for the purpose of publication in the IMF's annual statistical yearbook.

3.2.4. In a related matter, core poverty-reducing expenditures are identified by the line ministries and are documented using selected expenditure items of the existing administrative and economic classifications. However, these are not incorporated into the annual budget and accounts coding structure. This implies that the relevant data can only be produced manually by extracting some selected relevant expenditure items from the government budget reporting system.

Table 11: Classification of Budget - Score

Indicator	Score	Brief Explanation
PI-5 Classification of the Budget	**C**	**The budget formulation and execution is based on administrative and a GFS-based economic classification, but there is not a full functional and a programmatic classification in the budget and accounts.**

Comprehensiveness of the Budget

3.2.5. Budget documentation that is submitted to parliament comprises a budget speech document, and separate volumes for revenues, recurrent expenditures, and development expenditures.

3.2.6. The Finance Minister's budget speech contains necessary information on:

(i) macroeconomic assumptions of the budget, including GDP data, inflation, monetary targets, balance of payments and international reserves, foreign exchange policy, etc;

(ii) a fiscal deficit, though unclear whether it is GFS-based because there is no supporting fiscal table;

(iii) deficit financing and its composition;

(iv) several new policy initiatives, some of which have either revenue or expenditure implications, which are already calculated and incorporated in the relevant tables of the three budget volumes mentioned above; and

(v) Current year's revised budget presented in the same format as the budget proposal.

3.2.7. Recurrent and development budget volumes cover detailed budget data on both recurrent and development expenditures as per classifications mentioned in P1-5. However, none of the budget documents contain data on budget out-turn for the previous year, but only on the current year's revised budget. No data is provided on the government debt stock and its financial assets.

Table 12: Comprehensiveness of Budget Documentation - Score

Indicator	Score	Brief Explanation
PI-6 Comprehensiveness of information included in budget documentation	**B**	**Recent budget documentation contains information on: Macroeconomic assumptions; fiscal deficit, deficit financing, revenue and expenditure implications of new policies mentioned in the budget speech, and detailed data on revenues and expenditures, but no information is provided on previous year's actual; debt stock; and government financial assets.**

Extent of Unreported Government Operations

3.2.8. Transactions of the Semi-Autonomous Government Agencies (SAGAs [8]) and Fund Accounts (FAs [9]), which constitute general government operations are not properly reported. Transfers from the government budget to these institutions and accounts are included in the government budget and its reporting system when transfers are made. However, the portions of their operations that are financed through earmarked revenues are not captured by the reports prepared for the government operations. In the absence of reporting, no firm data is available. However, a World Bank mission in April 2004 in the context of PEMAAP work estimated this to be 10 per cent of total government expenditures[10].

3.2.9. Unlike expenditures financed through external loans that are captured in fiscal reports through debt management data, donor grants are only partially captured during the budget preparation and execution processes. This is mainly due to incomplete information at the time of preparing the budget, and several accounting, banking and reporting systems are operated in parallel to the government's systems. This includes part of in-country expenditure and all payments made directly by donors to providers of

[8] **A relatively large number of government agencies that have semi-autonomous status are not included in the budget documents in its reporting system except for the amounts that are transferred to them from the government budget.** SAGAs receive lump-sum transfers from the their parent ministries and/or collect and spend some earmarked tax and non-tax revenues. There are about 75 SAGAs engaged in activities related to regulatory functions, research, regional development, education, health, and other social services, several of them include poverty-reducing expenditures. Some SAGAs have begun reporting their transactions to the MOF, but it appears that until now no mechanism has been worked out to reconcile these reports.

[9] **Similarly, there are a number of fund accounts (FAs), which are credited with lump-sum transfers from the government budget and/or by earmarked tax and non-tax revenues.** There are about 35 fund accounts. These funds are not separate organizations, but simply accounts that are operated by the line ministries outside their budget. Expenditures of these FAs that are not financed through transfers from the budget, but rely, at least in part, on earmarked revenues, considered to be funded from extrabudgetary sources. This is because the earmarked revenues are not included in the budget. Although transactions of these fund accounts are reported to the Controller and Auditor-General (C&AG) for auditing purpose, they are not submitted in a standard format, and are normally delayed. The MOF does not collect reports of these accounts, and, therefore, is not able to prepare report for all transactions of the general government.

[10] Kenya: Public Expenditure Management--Second Assessment and Action Plan, April 2004.

goods and services outside the country which would not appear in the government's or donors' domestic reporting systems.

Table 13: Unreported Government Operations - Score

Indicator	Score	Brief Explanation
PI-7 Extent of unreported government operations	$\boxed{C}$	
(i) The level of extra-budgetary expenditure (other than donor-funded projects) which is unreported i.e. not included in fiscal reports.	**C**	**The level of unreported expenditures (other than donor-funded projects) constitutes 5 – 10 per cent of government expenditures.**
(ii) Income/expenditure information on donor-funded projects, which is included in fiscal reports.	**C**	**Only information on external loan-financed projects is included in the fiscal reports, as information on grant-funded projects are not available.**

Transparency of Inter-governmental Fiscal Relations

3.2.10. The scope of sub-national government is small, with the Local Authorities (LA), established several decades ago, remaining the only decentralized level of government. These consist of 175 LAs, providing primarily municipal services. LAs' budgets are comprised of their own revenues (about 50 per cent in 2005/06) with the rest being supported through transfers from the central government. In the 2005/06 budget, expenditures of sub-national governments, including grants from the central government budget , constituted less than 4 per cent of the total government budget (central and LA budgets).

3.2.11. The government had planned to steadily increase the share of LA expenditure in the total expenditure, but further decentralization is likely to await finalization of the constitutional review, which has been in process for a number of years.

3.2.12. This situation has been further complicated by the creation of the Constituency Development Fund (CDF) in 2003. The CDF is receiving 2.5 per cent of total government ordinary revenue, which is spent by national members of parliament (MPs) for small community-based capital propjets. Projects are identified by a 10-member committee (any citizen), selected by a MP in his/her constituency. They are implemented by the regional agencies of the central government ministries. In 2005/06 the CDF budget amounted to KES7.2Bn compared to KES5.6Bn for the Local Authority Transfer Fund. This parallel system is not considered as a sub-national government issue, because LA councils do not approve the CDF projects, and their executive branches do not implement them. The responsibility, therefore, remains with MPs, their appointed committee members, and central government agencies.

3.2.13. Central government transfers (2.5 per cent of total income tax in any fiscal year) to LAs is open (gazetted), and rule-based. It includes the transfer of a fixed amount of KES1.5M to each LA with the rest being calculated based on population and its rural/urban composition. Three months before the beginning of a fiscal year, the share of each LA 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. After the central government budget is approved, the transfers are made from the Local Authority Transfer Fund vote to each LA on quarterly basis.

3.2.14. Apart from external audit reports of local governments which are incomplete and delayed for a number of years, there is not a comprehensive budget reporting mechanism either to the MOF or the Ministry of Local Government, as the LAs have an independent status and are responsible to their councils. In the statistical context, however, the Government Statistics Office may be able to collect some aggregated data for compilation with the central government data. This is not considered to be a budget reporting system.

Table 14: Transparency of Inter-governmental Fiscal Relations - Score

Indicator	Score	Brief Explanation
PI-8 Transparency of Inter-governmental Fiscal Relations	**B**	
(i) Transparency and objectivity in the horizontal allocation among SN governments	**A**	**The horizontal allocation of transfers from central government to LAs is fully transparent, and rule-based.**
(ii) Timeliness of reliable information to SN governments on their allocations.	**A**	**LAs are provided reliable information on the allocations to be transferred to them before the start of their detailed budgeting process.**
(iii) Extent of consolidation of fiscal data for general government according to sectoral categories.	**D**	**Fiscal information of LAs that is consistent with central government fiscal reporting is not collected and consolidation does not occur for general government.**

Oversight of Aggregate Fiscal Risk from Other public Sector Entities

3.2.15. As mentioned at paragraph 3.2.8 above (indicator 6) there are 75 SAGAs. These, along with about 35 main public enterprises, are called collectively state corporations. Whereas because of their operations and legal status according to the GFS definitions, SAGAs should be classified as government institutions and are part of general government, they are grouped with public enterprises, which are not part of the general government. In principle and practice, SAGAs do not pose fiscal risk because they do not have borrowing power, and their expenditure commitments are limited to transfers from government budget and some earmarked tax and non-tax revenues. Moreover, they have begun to report to the Ministry of Finance on their operations (as mentioned earlier in indicator 6). Similarly, LAs do not pose fiscal risks because their operations are very small and they do not have borrowing power.

3.2.16. The main fiscal risk may originate from public enterprises because of their large scale commercial activities, as well as government-owned financial institutions because of their possible quasi-fiscal operations, including possible directed lending, interest rate subsidy and the like. Although the parent ministries of the public enterprises and, to a certain degree the MOF, have a form of supervisory function on the operations of the public enterprises this does not prevent potential and actual fiscal risks. It is noted that after a long process the privatization bill was enacted in 2005, and some important progress has been made on the divestment of part of the state’s holding in Kenya Electricity Generating Company, and awarding of concession for Kenya Railways to a private operator.

Table 15: Oversight of Aggregate Fiscal Risk - Score

Indicator	Score	Brief Explanation
PI-9 Oversight of Aggregate Fiscal Risk	**C+**	
(i)Extent of central government monitoring of autonomous government agencies and public enterprises.	**C**	**Some SAGAs submit fiscal reports to the Ministry of Finance annually, though a consolidated overview is missing, which has already been scored in indicator 7, but because of the nature of their operations, SAGAs do not pose fiscal risk. However, reporting by public enterprises (major fiscal risk areas) is very weak and incomplete.**

(ii) Extent of central government monitoring of sub national governments' fiscal position	A	No annual monitoring of LAs fiscal position takes place, which has already been scored in indicator 8, but because of the size and nature of their activities, as well as the fact that LAs do not have borrowing power, the fiscal risk is almost nil.

Public Access to Fiscal Information

3.2.17. Key fiscal information is accessible to the general public or to relevant interest groups. The budget documents (revenues, recurrent and development budgets and budget speech) are available for purchase by the public from the Government Printer after they are submitted to parliament. The budget speech is also available on the website of the MOF.

3.2.18. Further, there are in-year budget execution reports (as in the Quarterly Budget Reviews), which are published within one month of their completion although not in detailed classification. Year-end financial statements are available through the Government Printer within six months of completed audit. The external audit reports are also available to the public through the Government Printer within six months of their completion

3.2.19. The award of all contracts with value above approximately USD100,000 equivalent are not routinely published on at least a quarterly basis through the appropriate means. No data is available to the public on the issue of information of resources on primary service units for any sector (such as primary schools, health clinics etc.).

Table 16: Public Access to Fiscal Information - Score

Indicator	Score	Brief Explanation
PI-10 Public access to fiscal information	B	Fiscal information is available to the public in a timely fashion, through the Government Printer for purchase and/or from the Government's website, including: (i) Budget documents (ii) In-year budget execution reports (iii) Year-end financial statements (iv) External audit reports The following are not available: (iv) Resources available to primary service units (v) A comprehensive list of procurement contract awards is not published

3.3. POLICY-BASED BUDGETING

Orderliness and Participation in the Annual Budget Process

3.3.1. There exists a comprehensive budget calendar, which is generally adhered to by both central and line ministries. The budget preparation process begins with preparing a Budget Outlook Paper (approved by the cabinet), which, in addition to macro-fiscal issues, includes indicative ministerial ceilings for the budget year and two forward years. This is followed by a budget circular issued by the MOF to line ministries and government agencies for the preparation of the budget. Line ministries are provided with clear technical guidance as well as sufficient time for the preparation of the budget.

3.3.2. The introduction of policy based budgeting has been accommodated by extending the time allocated to the preparation of the budget by the government but according to the budget calendar its submission to parliament has always been later than is necessary for timely scrutiny. As a consequence insufficient time is available for the budget debate and approval process by parliament, and the budget has never been approved by parliament before the beginning of the budget year**.** According to the Constitution

(Section 101) the National Assembly may authorize the withdrawal from the Consolidated Fund of moneys not exceeding in total one-half of the sums included in the estimates of expenditure for the year that have been laid before the Assembly, if the Appropriation Act for a financing year has not come into operation or is not likely to come into operation by the beginning of that financial year**.**

Table 17: Orderliness and Participation in the Budget Process - Score

Indicator	Score	Brief Explanation
C(i) Policy-Based Budgeting		
PI-11 Orderliness and participation in the annual budget process	B	
(i) Existence of, and adherence to, a fixed budget calendar	**A**	**A clear annual budget calendar exists and is generally adhered to but some delays are often experienced in its implementation. The calendar allows line ministries more than 6 weeks to complete their detailed estimates.**
(ii) Guidance on the preparation of budget submissions.	**A**	**Guidance on the preparation of budget submissions is comprehensive. A clear budget circular is issued to line ministries, which reflects ceilings approved by cabinet prior to the circulars distribution to them.**
(iii) timely budget approval by the legislature	**D**	**However, due to late submission of the budget to parliament the budget has been approved with more than two months delay in two of the last three years.**

Multi-year perspective in Fiscal Planning, Expenditure Policy and budgeting

3.3.3. Kenya has relatively a long history of producing a multi-year perspective in fiscal planning and expenditures policy analysis both in central and line ministries. These can be demonstrated by several pre-budgeting exercises and documents (including Ministerial Expenditure Reviews, Medium-term Budget Strategy Paper, and Budget Outlook Paper). In these exercises and documents useful multi-year information is provided on:

(i) fiscal forecasts, and functional allocation of government resources; and,

(ii) multi-year sector strategies and their costing (not necessarily funded).

3.3.4. However, no medium-term debt sustainability analysis is undertaken in these documents, but only in the context of the IMF-supported Poverty Reduction Growth Facility (PRGF) programmes, limited to the needs of such programmes when these programmes are prepared and/or are in force and monitored. Moreover, in part due to short-term fluctuations in the fiscal stance, no clear links can be demonstrated between these pre-budget exercises and annual budgets, including long-term recurrent expenditures of the investment projects.

3.3.5. For example, the Medium-Term Budget Strategy Paper for 2005/06 contains resource allocation to sectors broken down into wages, core poverty reduction expenditures, transfers, and operation and maintenance. There is also a summary resource requirement for the period of 2005/06- 2007/08 and the financing gap. Also, the Budget Outlook Paper provides similar information for the budget year and two forward years. Apart from financing gap, there does not appear to be a demonstrated linkage between recurrent and development expenditures, especially given that the annual budgets are prepared separately, and the two different documents are produced and published without necessarily being linked to each other.

3.3.6. One reason for uncertainty about the medium-term financing gap is the unknown size of the external concessional assistance. Moreover, the assumptions and economic analysis underlying the fiscal framework are not sufficiently rigorous due to lack of sufficient data. The sensitivity of the economy to weather conditions, as well as external shocks make the exercise more difficult, which requires frequent adjustments to documents prepared.

Table 18: Multi-year Perspective in Fiscal Planning etc. - Score

Indicator	Score	Brief Explanation
PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting	C	
(i) multi-year fiscal forecast and functional allocations	**C**	**Forecast of fiscal aggregates on the basis of economic and main functional classifications are prepared for three years on a rolling basis. Differences between these forecasts and annual budgets are clear (optimistic forecasts, revenue shortfalls, unutilized external assistance), and to a certain degree are explained in the budget speech, but not on one to one basis and their exact calculations.**
(ii) scope and frequency of debt sustainability analysis	**C**	**Debt sustainability analysis is indirectly undertaken in the context of the IMF- supported PRGF programmes with a scope that is required for such programmes when they are prepared and/or when they are in force and are reviewed.**
(iii) existence of costed sector strategies	**B**	**The medium term expenditures strategies are costed, but not fully funded, resulting in financing gaps that are normally expected to be financed through external concessional assistance.**
(iv) linkages between investment budgets and forward expenditure estimates	**D**	**There does not appear to be a demonstrated linkage of the development and the recurrent budget. Budgeting for investment and recurrent are two separate processes with no recurrent cost estimates being completely calculated. Two different documents are prepared and published without being linked.**

3.4. PREDICTABILITY AND CONTROL IN BUDGET EXECUTION

Transparency of Taxpayer Obligations and Liabilities

3.4.1. Legislation and procedures are comprehensive and clear. Discretionary powers are limited, the waiver of Kshs 500,000 is limited to the penalties and interest accrued and not on the principle sum. KRA implements the exemptions and waivers as authorised by the Minister for Finance. KRA has identified tax compliance as an important area and has created a special unit for compliance development.

3.4.2. However, according to observations recorded in the report from the Windsor workshop in preparation of the PFM reform, general compliance with tax policies and legislation is low and the informal sector is evading taxation. Also, legal provisions for tax exemptions and waivers are being abused.

3.4.3. Taxpayer education was initially undertaken by respective revenue departments but in 2005 the function was centralized under a Taxpayer Services Division. It is a centralized approach with systematic and effective communication as a target. Information is widely distributed through guidelines and pamphlets and is also posted on KRA´s website. A Large Taxpayer Office (LTO) was formed in 1998 in order to create a one-stop-shop highly efficient and customer oriented tax office. In addition, KRA is also planning to establish a central information bureau.

3.4.4. A clear complaints and appeals system has been established. Should a taxpayer for example, be aggrieved by an assessment raised by the Commissioner, the Income Tax Act allows for re-examination by way of raising an objection – appealing against the tax decision to a Local Committee. The tax payer can also appeal against the decision of the Local Committee to the High Court. The High Court has some appeal cases in balance but not the Local Committee. Kenya tax administration has a low frequency of appeals.

Table 19: Transparency of Taxpayer Obligations and Liabilities - Score

Indicator	Score	Brief Explanation
PI-13. Transparency of taxpayer obligations and liabilities	$\boxed{B}$	
(i) Clarity and comprehensiveness of tax liabilities	**B**	**The tax legislation is clear and comprehensive. The discretionary powers are limited. KRA implements the exemptions and waivers as authorised by the Minister of Finance. There is a waiver of 500,000 Kshs which is limited to the penalties and interest accrued.**
(ii) Taxpayer access to information on tax liabilities and administrative procedures	**B**	**The tax laws and administrative procedures are clearly stated and information and guidelines are widely distributed.**
(iii) Existence and functioning of a tax appeals mechanism	**B**	**A tax appeals mechanism is in place. Tax administration has a very low frequency of appeals**

Effectiveness of Measures for Taxpayer Registration and Tax Assessment

3.4.5. Effectiveness in tax assessment is ascertained by an interaction between registration of liable taxpayers and correct assessment of tax liability for those taxpayers. There are about 50,000 active taxpayers registered for VAT. Taxpayers in general are more than two million. The current taxpayer registration system in Kenya is not linked to any other government license or registration system. A section in KRA is analyzing information and development on non-compliance. There is a low level of effort to collect non-tax revenue.

3.4.6. KRA has established a system of penalties that varies with the seriousness of the default. Late submission of a return for example attracts a penalty of KES10,000 or 5 per cent of the tax due, whichever is higher, plus an additional tax of 2 per cent per month cumulative on unpaid tax. The system of penalties does not seem to be sufficiently high to have the desired impact.

3.4.7. The existence of tax audit activities has crucial importance for compliance. The KRA has a National Audit Work plan with risk assessment criteria (low, medium and high risk) for different business activities. Only high and medium risk sectors are being considered for audit. An audit handbook (first edition 2005) contains audit case selection criteria, but the criteria are not complete and comprehensive.

3.4.8. Large taxpayers' compliance is very important for the total amount of tax revenue. The LTO was formed in 1998. The basic objective was to increase and coordinate control over the largest taxpayers, improve large taxpayers' compliance and increase yield. The LTO accounts for over 61 per cent of total KRA revenue collections, the target is 70 per cent. LTO is responsible for all tax affairs of the top/specialized 400 taxpayers, including compliance monitoring, audit, debt collection, dispute resolutions as well as technical advice and taxpayer services. There is no long-term planning for the audit of large taxpayers. KRA is auditing the large taxpayers regularly but not systematically.

Table 20: Effectiveness of Measures for Taxpayer Registration and Tax Assessment - Score

Indicator	Score	Brief Explanation
PI-14. Effectiveness of measures for taxpayer registration and tax assessment	$\boxed{C+}$	

(i) Controls in taxpayer registration system	C	The current taxpayer registration system is not linked to any other government license or registration system.
(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations	B	There is a system with penalties that has been harmonized across all taxes but not sufficiently high to have the desired impact.
(iii) Planning and monitoring of tax audit and fraud investigation programmes	C	There is a National Audit Work plan with risk assessment criteria but the criteria are not complete

Effectiveness in Collection of Tax Payments

3.4.9. Accumulation of tax arrears can be a critical factor undermining high budgetary outturns, while the ability to collect tax debt lends credibility to the tax assessment process and reflects equal treatment of all taxpayers. The annual arrears is approximately 8 per cent of the total revenue. Of tax arrears cases in dispute, the percentage collected is less than 1 per cent. The average debt collection ratio in the two most recent fiscal years was 16 %.

3.4.10. Prompt transfer of the collected taxes to the Treasury is essential for ensuring that the revenue is available for expenditure. Revenue collected by KRA is deposited with Commercial Banks across the country. Where there is a Central Bank of Kenya (CBK) branch the transfer has minimal lag. KRA reports every day on the revenue. However, the chain of transfer involving Cemmercial Banks takes up to 3 days which means that only then does the Treasury have full information, even if the treasury gets reports about the amounts before the money arrives.

3.4.11. KRA and Treasury meet every week when monitoring of tax collection is discussed. Treasury, the commercial bank and CBK have meetings every fortnight.

3.4.12. It is noted that in the report from the Windsor workshop that non-tax revenue is often not remitted to Treasury, but used by the collecting institution and contributing to excess expenditure.

Table 21: Effectiveness in Collection of Tax Payments - Score

Indicator	Score	Brief Explanation
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 average debt collection ratio in the two most recent fiscal years was 16%, and the total amount of tax arrears is significant.
(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. However, the chain of transfer involving Commercial Banks takes up to 3 days.
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury	A	KRA ,CBK and Treasury have meetings every week for accounts reconciliation. The Treasury gets monthly reports on how much of the arrears have been paid.

Predictability in the Availability of Funds for Commitment of Expenditures

3.4.13. The MOF has since 1st July 2005 instituted a cash management system to address the predictability and availability for the commitment of funds to the line ministries, through the exchequer. The Cash Management Unit (CMU) in the MOF prepares a consolidated annual cash plan showing the revenue seasonality, 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 it remains unpredictable and for various reasons can be expected to remain so.

3.4.14. The cash release system is based upon the set up of mirror accounts within the central bank. For each of the line ministries a recurrent and development mirror-account is set up. These mirror-accounts reflect the activities of the line ministry’s zero-balance accounts. Through this mechanism the exchequer, by way of instruction to the central bank, refunds the ministry zero-balance accounts as draw-downs on the account are made. The level of replenishment is subject to the set monthly ceilings. Beyond providing the exchequer with accurate and timely information on the daily status of each ministry’s account, monitoring the mirror-accounts on a daily basis also ensures that the government does not have to borrow money, while it has idle cash sitting in line ministry accounts.

3.4.15. The daily reporting of the activity of the ministry accounts through the central bank mirror-accounts facilitates prudent cash management. The mechanism for the cash release system may be described as follows:

(i) each line ministry provides cash flow projections based upon procurement plans to the MOF at the beginning of each year;

(ii) on the basis of the ministries’ cash flow projections, budget provisions, revenue projections and domestic borrowing limits, the MOF prepares and communicates monthly spending limits to the line ministries on a three month in advance rolling basis;

(iii) the mechanism assures some confidence in meeting the committed funding to meet the set spending limits because it has its back up mechanisms including an overdraft facility from the central bank that is limited to 5 per cent of the previous year’s revenue achievement;

(iv) and a modification of budget releases vis-à-vis the committed funding based upon a monitoring of bank balances in the mirror-accounts to mitigate any borrowing requirements when the level of idle funds in line ministry accounts remain high.

3.4.16. Consequently the cash management mechanism adopted has all of 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. The qualification of the headquarters is because the mechanism is only applied to line ministry headquarters’ accounts.

3.4.17. Further, while the mechanism does include some unannounced adjustments to budget releases, these are strictly a function of the line ministry’s bank balance in which case such adjustments should not affect commitment control. Having implemented it for almost a year, officials of the Office of the Accountant General state that they have been able to meet their funding commitment to the stipulated monthly spending limits without fail for all ministries and for each of the months since implementation, subject to those adjustments that arose as a consequence of the line ministry already having large bank balances.

3.4.18. In spite of these remarkable improvements in the predictability of fund flows from the exchequer to the line ministries, it is important to emphasize that the predictability of funds to facilitate an effective commitment control throughout all levels of government remains weak. The mechanism described above does not address intra-ministry releases – the flow funds from the line ministry headquarters to the district offices, facilities or sub-vented agencies. This is of major consequence in a country such as Kenya because of the level of de-concentration.

3.4.19. The high level of funds maintained in the line ministry accounts point to flow stoppages and delays within the line ministries. Accountants in MOF informed the team that there was indication through monitoring the changes in bank balances in the mirror-accounts that there were delays in transfers as long as two months and often at least a month long. The reasons for these delays include delays in check clearing between Nairobi commercial banks and their branch offices in the districts and delays that arise through intra-ministry funding requests being submitted through the mail:

3.4.20. Under this system the CMU monitors bank balances on daily basis. Reports go to the Controller and Auditor General (C&AG) on a weekly basis, who in turn reports to the exchequer committee every two weeks.

Table 22: Predictability in the Availability of Funds for Commitment of Expenditures - Score

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. 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 commitment	**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**	**Above the level of management of MDAs the central ministry performs a semi-annual budget review in conjunction with the line ministries on whose basis a supplemental budget is submitted to parliament for approval in December.**

Recording and Management of Cash Balances, Debt and Guarantees

3.4.21. The cash management mechanism is fully described earlier in paragraph 3.4.13 above (PI-16). Under these arrangements ministries/departments prepare and submit cash requirements based upon their budgeted expenditure and revenue flows. The CMU in the MOF prepares a consolidated annual cash plan showing the revenue seasonality, expenditure shortfalls or surpluses and the proposed domestic borrowing. The CMU subsequently prepares monthly credit limits on quarterly basis and advises line ministries at the beginning of each quarter. These arrangements have replaced the old arrangements where the Exchequer Release Committee provided cash to ministries on weekly basis based on available cash and requests received from line ministries. Under this improved system the CMU monitor bank balances on daily basis whereby all balances on government accounts are reduced to zero overnight and reports go out to the Exchequer Committee every two weeks.

3.4.22. The CS-DRM system is used for recording and reporting both domestic and foreign transactions. The MoF manages external debt while domestic debt is managed by CBK on agency basis. The Debt Management Department within the MoF is being transformed into a Debt Management Office under a five-year reform programme that started in August 2004. The objective is to establish a fully-fledged office capable of undertaking front, middle and back Office operations.

3.4.23. Government external borrowing are undertaken within the legal framework of the External Loans & Credit Act (1967) as emended from time to time while the guarantee are issued under the Guarantees (Loans) Act. Under the law, the MoF is responsible for contracting all external debt and giving guaranteed. The Internal Loans Act governs contracting of domestic debt. The reforms have identified that there is need to consolidate the various laws and update them to take case of electronic commerce and borrowing ceiling..

3.4.24. Domestic debt management is delegated to the CBK which acts as an agent for MOF. Domestic debt data is accurate and reliable however at present MOF, as principal, appears to lack the capacity to define the parameters of operation. The same problem of inadequate capacity to undertake debt sustainability analysis is associated with middle-office operations of external debt.

3.4.25. There are also problems in the management of contingent liabilities and the MOF has begun recording on-lending loans into CS-DRMS. These weaknesses are associated with the way the loans are issued, recorded and reported by the MoF.

Table 23: Recording and Management of Cash Balances, Debts and Guarantees - Score

Indicator	Score	Brief Explanation
PI-17 Recording and management of cash balances, debt and guarantees	**B**	
(i)Quality of debt recording and reporting	**B**	**Improving the quality of debt recording and reporting has been the primary focus of reform efforts in the last two years. Presently data is being migrated onto a new platform and reconciliation is undertaken on daily basis. Debt data reporting is done on quarterly basis or at the request of the IMF. There are still some weaknesses in the quality and comprehensiveness of statistical reporting.**
(ii) Extent of consolidation of the Government's cash balances	**B**	**The MOF monitors the cash position of the line ministries on daily basis and maintains a zero balance policy for line ministries accounts held at the central bank on daily basis.**
(iii) Systems for contracting loans and issuance of guarantees	**B**	**There is a borrowing limit which has been updated periodically and is currently set at 500Bn KES in aggregate; while ceiling on loan guarantee is set at KES80Bn. 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 Financial Secretary (MOF) submits final accounts to the Controller and Auditor General on all transactions on annual basis and these are adhered to.**

Effectiveness of Payroll Controls

3.4.26. In this section reference is made to only (approximately) 45 per cent of the civil service. There are some 235,000 teachers which accounts for 55 per cent of the civil service wage bill. Government policy is to reduce the wage bill to below 7 per cent of the GDP in the medium-term by downsizing the civil service by 21,000. A wage setting strategy is being implemented from 2005/06, which takes into account performance and productivity. As part of the performance management all senior managers are required to sign performance contracts.

3.4.27. The government started to implement an integrated Personnel and Payroll Database (IPPD) in 1995 to replace the old manual system which used cards to record personnel data. Implementation started in the central payroll and was eventually extended to the all ministries. However, the ministry systems are not interconnected with the Department of Personnel Management (DPM) server. There are twenty seven systems located in the ministries for processing civil service pay. Integration is achieved on a batch basis to a centralised processing unit. To-date the Ministry of Defence payroll and teachers are not on the IPPD.

3.4.28. The IPPD system is managed by the DPM. The department has trained about 80 officers as trainers and subsequently 300 officers who are posted to operate the ministry systems. In the past the system has had a large number of ghost-workers (for example 5,000 ghost names were found in the Ministry of Culture and Social Services). However during this exercise the DPM reported that they have been able to eliminate all ghost names from the payroll. Some of the current controls include the requirement that every newly appointed civil servant is given a personnel number which is issued by the DPM to ensure that only authorised personnel get on the government payroll. Monthly reconciliation of payroll records is also undertaken even if no effective reconciliation occurs between personnel records and payroll data. However, delays are often encountered in processing changes to the payroll and nominal roll. Payroll audit has been undertaken within the last three years but the report is still under review and no action has been taken. Limited and partial payroll audits are as from now made on a rolling basis.

Table 24: Effectiveness of Payroll Controls - Score

Indicator	Score	Brief Explanation
PI-18 Effectiveness of payroll controls	D+	
(i) Degree of integration and reconciliation between personnel records and payroll data	D	The Government has implemented an IPPD system for the core civil service. To-date the teachers' payroll and Ministry of Defence is still not on the system. Monthly reconciliation of payroll data is undertaken but no effective reconciliation occurs between personnel records and payroll data.
(ii) Timeliness of changes to personnel records and the payroll	D	Delays in processing changes to the payroll and nominal roll are often significantly longer than three months and require widespread retroactive adjustments.
(iii) Internal controls of changes to personnel records and the payroll	B	The DPM has the sole authority to make changes to payroll records and controls the issuance of unique personnel numbers.
(iv) Existence of payroll audits to identify control weaknesses and /or ghost workers.	C	Payroll audits have been undertaken within the last three years.

Competition, Value for Money and Controls in Procurement

3.4.29. Public procurement has been undergoing reform over the past decade. In 2001 the MOF issued the Public Procurement Regulations that are currently applied. In 2005 an Independent Procurement Review (IPR) was carried out that identified a number of weaknesses in the regulations and in the practice of procurement.. A new Public Procurement and Disposal Act was gazetted in October 2005. It responded to many of the weaknesses highlighted in the IPR. However, the new procurement Act will only become operational after regulations emanating from it are issued. Draft regulations are currently being prepared. They are comprehensive and emphasize transparency and accountability, aimed at achieving value-for-money procurement, and providing a basis for the establishment of unambiguous audit standards. The institutional arrangements specify oversight bodies, administrative review boards and panels and a clear separation of authorities with respect to procurement initiation, selection, commitment and acceptance. Contract administration and records management and filing are addressed.

3.4.30. Under the current regulations (2001) the institutional framework for public procurement is well established and reflects all of the main features of sound procurement practice. In addition, the regulations set out the detailed procurement procedures to facilitate competitiveness and fairness, including procurement thresholds that dictate the appropriate procurement method to be applied. In spite of the significant strides made in improving the legal and regulatory framework, there are indications that competition is not effective and VFM is not being achieved. In 2004/05 a report by the PPD on a market survey carried out for three ministries on common user items and equipment, identified savings for a few items but the variation in government supply prices over market prices ranged from 11 per cent to 89 per cent for the majority of items. The PPD reports that given the outcomes of the Review and Appeals Board there is reason to believe that effective competition introduced to public procurement would lead to very significant savings.

3.4.31. The standard public procurement method is the open tender method designed to give the highest potential for value for money (VFM) through open competition. However, considerations of countervailing factors including transaction costs, administrative burden and process delay justify the use of other restricted procurement methods. The justification for the use of each method is set out within the regulations and is instructed through the use of a procurement thresholds table.

3.4.32. The Public Procurement Complaints, Review and Appeals Board has well established operating procedures available to the public. An appeals register is maintained by the secretariat (PPD) and each appeal must be resolved within 30 days as set out in the regulations. A minute book of the board proceedings is maintained and board rulings maintained and filed by appeal number. A review of the appeal register indicated that 50 rulings had been filed out of the 52 appeals submitted by 31 December 2005. It was noted that while rulings are made within the stipulated period, the signed rulings for filing are sometimes delayed while they await finalising and confirmation by the Chairman of the Review Board.

3.4.33. In fulfilment of its oversight role, PPD has issued instructions requiring all procuring entities to file returns for all procurements of amounts exceeding KES5M. PPD compiles these returns and publishes them on the PPD section of the Treasury website. However, interviews with the PPD team together with a review of some of the data indicated that PPD is currently not in a position to attest to the completeness of the data submitted by procuring entities. Efforts are currently underway to establish a procurement journal that will require all procuring entities to file their advertisements with PPD to ensure that returns can be assessed against the advertised contracts. In addition, whilst departments are required to obtain approval for use of other non-competitive methods, data on the use of such methods is not fully available at PPD.

Table 25: Competition, Value for Money and Controls in Procurement - Score

Indicator	Score	Brief explanation

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 threshold for small purchases	**C**	**The Regulations instruct on the use of open competition procurement thresholds. There is some sample data on the procurement methods employed. The IPR data suggests a number ratio less than 50%.**
(ii) Justification for use of less competitive procurement methods	**B**	**Where other non-competitive methods are to be used by procuring entities, the 2001 procurement regulations provides thresholds as the basis for justification as to when each kind of alternative procurement method is to be used.**
(iii) Existence and operation of a procurement complaints mechanism	**A**	**The Public Procurement Complaints, Review and Appeals Board is provided for within the 2001 procurement regulations under the Exchequer and Audit Act. Whilst not specifically provided for within the Act, the Board is subject to oversight by the courts at the discretion of the complainant. A record of all cases filed with the Board and their determination is maintained and available for public scrutiny through the Director of Public Procurement who also serves as the Secretary to the Board.**

Effectiveness of Internal Controls for Non-Salary Expenditure

3.4.34. Internal controls are provided for under the Constitution, Exchequer and Audit Act, Financial Regulations, Public Procurement Regulations, and 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 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.

3.4.35. 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 whilst internal auditors provide independent checks as part of the transaction approval process.

3.4.36. The government has faced a particular challenge on the management of expenditure commitment controls resulting in considerable accumulation of pending bills. The government took efforts to address this through audit and institutionalisation of new commitment controls with effect from 1 July 2005.

Table 26: Effectiveness of Internal Controls for Non-Salary Expenditure - Score

Indicator	Score	Brief explanation
PI-20: Effectiveness of internal controls for non-salary expenditure (M1)	**C**	
(i) Effectiveness of expenditure commitment controls	**C**	**Whilst expenditure commitment controls exist and were complied with, these were not sufficiently robust to limit commitments to actual cash available. Partly due to short-comings of the commitment control system, the government accumulated a considerable amount of pending bills estimated at KES18Bn (about 2% of GDP) being KES6Bn and 12Bn in recurrent and development expenditure respectively. A new commitment control system is being implemented with effect from 1 July 2005 to avoid further accumulation of pending bills.**

Indicator	Score	Brief explanation
(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures	**C**	**The Financial Regulations of the Exchequer and Audit Act include comprehensive rules to regulate financial management. These include segregation of duties between finance officers, accounts controllers and internal auditors. However, weaknesses in procurement controls together with mechanical (box-ticking) application of these controls has considerably reduced their effectiveness.**
(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 as evidenced by internal audit reports, there is no consolidated position for government to provide sufficient evidence that adequate justification is provided for use of simplified or emergency procedures.**

Effectiveness of Internal Audit

3.4.37. The newly created platform of internal audit should give the internal audit good conditions for its future work. Major milestones achieved have been:

- 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.

3.4.38. Although the 2004 government financial management act establishes an internal audit function, it does not set out specific provisions relating to its functioning, including its charter, reporting arrangements, and relationship with ministerial audit committees. These issues have, however, not been dealt with up to date by the Treasury.

3.4.39. The new platform, complying with the Institute of Internal Auditors (IIA) standard, represents a major achievement. It is not yet fully operational for all central government entities. However, at least 50 per cent of staff time is now estimated to be focused on systemic issues. The progress, however, differs between internal Audit units. The previous set up of Internal Audit had a problem getting a proper attention by the top management. The new platform will, however, need more time to be able to deliver more targeted audit findings and recommendations on a broad scale. The establishment of Audit Committees should also increase the demand for audit findings and results.

3.4.40. In the annual work plans, which are subject to quality assurance by the Internal Auditor General (IAG), the different audit areas are presented. Systemic audits have priority. There are, however, still both pre-audits and transaction based audits planned and performed during 2005-2006.

3.4.41. The coverage of the internal audit demonstrates some deviations from best international practice:

(i) It is not in the IAG remit to monitor and coordinate the internal audit at KRA (tax and customs). This means in practice almost the whole revenue side of the government budget;

(ii) There is no 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.

(iii) There is no valid information available about the frequency of the reporting. With the previous set up mainly focusing on pre-audits there were few reports. The issuing of reports today is, however, improving during the last half year. It is, however, too early to assess how this will develop. The new type of reports is distributed to the accounting officers and the IAG.

Table 27: Effectiveness of Internal Audit - Score

Indicator	Score	Brief Explanation
PI-21. Effectiveness of internal audit	C	
(i) Coverage and quality of the internal audit function	C	A new platform, complying with the IIA's standard, has been established. It is not yet fully operational for all central government entities. At least 50% of staff time is focused on systemic issues.
(ii) Frequency and distribution of reports	C	Internal Audit Reports are issued in government entities with copies to the IAG in accordance with the new platform. It is too early to assess how this will develop.
(iii) Extent of management response to internal audit findings	C	It is too early to establish the extent of management response to internal audit findings. However, there is a growing interest in internal audit reporting by many managers. The new audit concept still has not permeated fully and the old type of audit reports does not receive much interest.

3.5. ACCOUNTING, RECORDING AND REPORTING

Timeliness and Regularity of Accounts Reconciliation

3.5.1. The AG makes arrangements for bank accounts to be opened for each line ministry at the central bank, or if the need be, 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.

3.5.2. 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. In 2003 the permanent secretary of MOF issued a circular to line ministries to submit bank account reconciliations. This was enforced by the 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. Recent samples taken from the permanent records maintained by the Treasury indicated that at least 50 per cent of ministries submit their reconciled accounts on timely basis and the majority submit within a month. There were only two or three ministries where delays were of about two months' duration.

3.5.3. Reconciliation and clearance of suspense accounts are done at the year end when ministries submit their records for final accounts. However, it should be noted that this process does not appear to be very effective given the Auditor Generals findings and the large suspense figures reported in the appropriations accounts.

Table 28: Timeliness and Regularity of Accounts Reconciliation - Score

Indicator	Score	Brief Explanation
PI-22 Timeliness and regularity of accounts reconciliation	C	
(i) Regularity of Bank reconciliations	B	Most ministries submit their accounts within four weeks from the end of each month. Sometimes delays occur because commercial banks do not send the bank statements to line ministries on time.
(ii) Regularity of reconciliation and clearance of suspense accounts and advances	D	Reconciliation and clearance of suspense accounts and advances take place less frequently, usually annually with some delays.

Availability of Information on Resources Received by Service Delivery Units

3.5.4. Recently two Public Expenditure Tracking Surveys (PETS) have been undertaken to determine efficiency of public spending and the quality and quantity of service delivery at the point of delivery. The Kenya Institute of Public Policy Research and Analysis (KIPRA) undertook surveys in the education and health sectors in 2003. The results of the KIPRA health survey showed that resources were not reaching the front line, especially in the rural areas. The schools survey was more favourable to the education sector in the sense that non-wage funds were, to a greater degree, reaching schools (even though the survey did not rule out some leakages occurring with regards to the allocation of bursaries and school supplies in kind). A PricewaterhouseCoopers study (in 2004/05) in the education sector, also confirmed a positive results for schools.

Table 29: Availability of Information on Resources Received by Service Delivery Units - Score

Indicator	Score	Brief Explanation
PI-23 Availability of information on resources received by service delivery units	B	At least two Public Expenditure Surveys (PETS) have been undertaken in the last three years. One was undertaken by KIPRA in the health and education sectors (2003). The second was undertaken by Price Waterhouse Coopers (2004) in education. These special surveys demonstrated the level of resources received in cash and in kind by both schools and clinics across most of the country.

Quality and Timeliness of In-year Budget Reports

3.5.5. Line ministries are required by the financial regulations to collate their monthly expenditures and revenues returns and those of their de-concentrated districts for submission to the Budget Supplies Division by the 15th day of the succeeding month. These returns are copied to the Accountant General's office. The Monthly Expenditure Returns reports both payments and commitments against budget estimates and is submitted by all line ministries. It is apparent though that many of the expenditures reported on are merely intra-ministry transfers. The consequence of this is that these reports do not guarantee that actual expenditure emanating from such transfers conformed with the intended purpose nor the precise achievements reported in the Monthly Expenditure Returns.

3.5.6. The returns are not always done accurately or may be incomplete, even though they may be submitted on a timely basis. Bank balances are not incorporated into the Monthly Expenditure Returns and so there is no basis for reconciliation. The only checks performed by the Budget Supply Division are ad-hoc checks made against other data sources. Capacity weaknesses in the line ministries and at the district level are singled out as the source of the difficulty, but also some of the recent difficulties that caused unusual delays for a period of a few months are attributed to the recent changes in the budget classification system and the time it took for line ministries to adjust their Monthly Expenditure Returns to conform with the new budget classifications. The problem of accuracy is compounded by the manual basis for compiling information.

3.5.7. The returns constitute the source document for a number of budget reports including the semi-annual expenditure performance report and the quarterly budget reviews (QBR). While these are produced regularly and on a fairly timely basis, they do of course propagate any inaccuracies found in the Monthly Expenditure Returns.

Table 30: Quality and Timeliness of In-Year Budget Reports - Score

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	Budget returns from line ministries were compiled from the 'vote-book' system which covered all the items in the budget. This was compatible with the budget estimates. Therefore reports allowed comparison of expenditure to the original budget. Information included all items of budget estimates. Expenditure is covered at both commitment and payment stages.
(ii) Timeliness of the issue of reports	C	Officials stated that submittals were made on a timely basis and there was some corroborative evidence to support that budget reports are prepared monthly and quarterly in a timely fashion. However there were no specific schedules tracking the receipt of monthly expenditures or the issuance of quarterly budget reports.
(iii) Quality of information	C	The Monthly Expenditure Returns do not include bank balances and so there is no basis for reconciliations. There is information on committed funds as well as payments made against approved estimates. There is concern about the accuracy and consistency of data, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness.

Quality and Timeliness of Annual Financial Statements

3.5.8. Annual financial statements are prepared from the ledger accounts and expenditure returns are compiled from the "vote-book" system which is a stand-alone system located in the Treasury and in all line ministries. The Accountant General's department issues year-end closing procedures with specific deadlines and instructions to ensure smooth and consistent reporting on expenditure. Monthly cash book and bank balances are submitted to the Accountant-General on a monthly basis for reconciliation.

3.5.9. The source document for accounting entries is the payment voucher. Entries are dated using the date on the cheque. These year-end closing procedures involve the creation of new accounts each year, and the freezing of the old accounts. The old accounts continue to be drawn upon by line ministries into the new-year and the accounts are kept open for six months after the close of year to ensure that all cheques issued against the old account can be honoured. One consequence of this is that when financial statements are prepared within three months of the close of the year, there is neither precise information on actual expenditure (expenditure figures are projected on the basis of a schedule of issued cheques rather than actual payments made) nor subsequently on the ministry bank balances to be returned to the Treasury. While such imprecision is acknowledged, it is argued that the differences remain insignificant.

3.5.10. The line ministries independently prepare financial statements for submission to the Accountant-General and also to the Auditor General. Officials report that this is being done within three months. The Accountant General summarises the accounts which are then signed of by the PS and submitted to the Auditor General within seven months of the close of the fiscal year. The account summary procedure does not force the reconciliation discipline that a complete consolidation of accounts would require. There is no reference to any suspense accounts or advances made in the summary statements. Further, the financial statements do not reflect separately the revenues from appropriations-in-aid.

3.5.11. The government employs a cash based accounting system and has adopted its own accounting standards for public service institutions. Standard and consistent formats have been adopted and are used across all line ministries.

Table 31: PI-25 Quality and Timeliness of Annual Financial Statements - Score

Indicator	Score	Brief Explanation
PI-25 Quality and timeliness of annual financial statements	**D+**	
(i) Completeness of the financial statements	**D**	**A summarised government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete. Essential information may be missing from the financial statements or the financial records are too poor to audit.**
(ii) Timeliness of submission of the Financial statements	**B**	**The submission of financial statements by the line ministries and also from the Accountant General of the summarised financial statements to the Auditor General occurs within seven months. It should be noted though that this does not necessarily imply that the books are fully reconciled and closed.**
(iii)Accounting standards used	**C**	**The accounting system employed is cash-based and adopts their own set of public sector accounting standards. Statements are presented in consistent format over time.**

3.6. EXTERNAL SCRUTINY AND AUDIT

Scope, Nature and Follow-up of External Audit

3.6.1. The C&AG, the MOF, the Accounting Officers (AO) at the line ministries and the PAC in parliament have different roles to play in the accountability chain of the public sector. The Public Financial Management Act, 2004; and the Public Audit Act, 2003, apply to this. The AOs and the MOF are responsible for closing their accounting at the end of the financial year and sending them to the C&AG within a statutory deadline (three months after the FY). The C&AG should, within a statutory deadline (six months after the end of the FY), audit and certify them. The C&AG then submits his Annual Report to the MOF for his tabling of the C&AG Annual Report in parliament. That should be done within a week but as the C&AG report is regarded as "tabled" in parliament only when printed, it can take longer. The PAC should then discuss the C&AG report and issue recommendations (PAC Minutes) if motivated and send them to the MOF for action. The MOF should report back to the PAC annually what actions have been taken. There are no deadlines for the two latter.

3.6.2. The C&AG needs to develop his capacity on modern audit in line with INTOSAI standards and best practice. System based financial/attestation audit is successively being introduced. Basically however, it is still a transaction/accounts balance based audit. The audit findings are often material. No performance audit has been carried out to date. As the government does not make their own consolidated Financial Statements (FS) on the execution of the budget that means that the C&AG receives all accounting officers' accounts and is to issue an opinion on their reliability. For the FY 2003/04 the

C&AG was only able to certify 60 per cent of the accounts, statements and funds due to the problems pertaining in the remaining accounts.

3.6.3. The C&AG reporting to parliament is in principle an Annual Audit Report (in 2005/06 there were two special audits on corruption related issues). The Annual Report needs an up-grading to enable parliament and government to get a better focus on material issues. The audit and the reporting needs to focus more on how to improve accounting and internal control on a systemic base. Today many of the more detailed technical comments in the Annual Report should preferably be presented in the C&AG Management Letter, which is however, not widely applied. The format of the audit opinions needs to be developed more in line with the INTOSAI auditing standards.

3.6.4. The C&AG does not present an annual activity report to the PAC. Such a report would describe the situation for the external audit area annually and the C&AG audit performed. It is therefore indispensable.

3.6.5. The scope of audit mandate includes central government entities, funds accounts, autonomous agencies (SAGAs) and local authorities. The factual coverage seems to be that all central government receipts, expenditures and balances, and fund accounts are subject to audit annually. The SAGAs are subject to separate reporting procedures but the extent and the quality cannot be assessed. To treat the SAGAs as public enterprises rather than central government agencies (they are not public enterprises, but enjoy some financial independence) is not motivated.

3.6.6. The audit of the local authorities is still in its infancy owing to the limited resources available (just a few percentage points of the central government budget and no borrowing powers), and weak or non existing accounting and financial statements.

3.6.7. The last three C&AG’s Annual Audit Reports (for the FY 2001/02—2003/04) tabled in parliament have not been submitted to legislature within the statutory deadline contained in the Public Audit Act 2003, (i.e., six months after the end of the FY and for the previous Act, within seven months). The average was some twenty-two (22) months implying a passing of the statutory deadlines by some fifteen to sixteen (15-16) months.

3.6.8. The real big problem with the C&AG's late submission of audit reports is, however, the huge volume of audit work and audit reports to be undertaken by the C&AG within a very limited period of three months, from October to December each year. The number of Financial Statements to be audited including Statements of Assets and Liablities of Ministries are for: (a) Central Government Audit 237; (b) Local Authorities Audit 175; (c) State Corporations & SAGAs 147; and (d) Donor Funded Project Accounts & Special Accounts 116. In practice this means that it is impossible with the present audit approach to deal with this within the statutory deadline.

3.6.9. The previous arrears of audits of central government accounts have only partially been contained as the C&AG has finalised the audit of the accounts for the FY 2004/05 in April 2006 and is currently still being princted in June 2006. This means at best that the C&AG Annual Report could be tabled in Parliament some 13 months after the end of the financial year. Some notable progress has been made in clearing the previous audit backlogs for SAGAs and local authorities. The C&AG expects to complete the audit of all Local Authorities for the period 1999/2000 to 2004/2005 by the end of 2006. .

3.6.10. Implementation of recommendations of audit work has been weak, especially through the PAC´s recommendations to the executive (MOF). The problems in the PAC's late handling aggravate the situation. The same types of errors in the basic accounting are repeated year after year despite the criticism of the C&AG. The C&AG has introduced a query system to meet C&AG's need for follow-up where the auditees report back what actions they have taken on audit findings and recommendations. There is, however, no summing-up in the following year's annual audit report to parliament of the extent to which the audit recommendations have been implemented.

Table 32: Scope, Nature and Follow-up of External Audit - Score

Indicator	Score	Brief Explanation
PI-26. Scope, nature and follow-up of external audit	D+	
(i) Scope/nature of audit performed (incl. adherence to auditing standards)	C	Central government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only.
(ii) Timeliness of submission of audit reports to the legislature	D	The latest three C&AG's Annual Audit Reports tabled before Parliament have not been submitted within the statutory deadline for the last three year (6-7 months from the end of the FY). The last three years has averaged 22 months from the end of the FY.
(iii) Evidence of follow-up on audit recommendations	D	There is little evidence of response or follow-up from PAC and the Ministry of Finance. The same type of errors and mismanagement occurs year after year despite being repeatedly criticized by the C&AG. There is no summing-up in the next year's annual audit report to Parliament of the extent to which the audit's recommendation has been implemented.

Legislative Scrutiny of the Annual Budget Law

3.6.11. The role of parliament during the budget approval process is not clear. This is partly because the budget timetable leaves only a limited time for parliamentary scrutiny and the existing law permits ministries to spend half of their estimates after the budget is presented to parliament. Parliamentarians find themselves in a position of debating a budget the execution of which may already be well underway. There are procedural issues and concern was expressed during this review that some members may not fully appreciate their role regarding budgetary oversight. The absence of an organic budget law means that some aspects of the budget preparation and implementation procedures are more fluid than warranted. However, there are signs that things are changing for the better. Since 2003 the Finance Bill and the Annual Budget Law has been vigorously, if not comprehensively and thoroughly, debated in parliament. Also many proposals have been made to enhance the role of parliament in examining public accounts.

Table 33: Legislative Scrutiny of the Annual Budget Law - Score

Indicator	Score	Brief Explanation
PI-27 Legislative scrutiny of the annual budget law	D+	
(i) Scope of the legislature's scrutiny	C	The legislature's review is very limited.
(ii) Extent to which the legislature's procedures are well-established and respected	C	Procedures for the legislature's review do exist but need to be further developed to be supportive of an appropriate budget review. Also the Parliament's capacity for analysis is weak.
(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	D	The time allowed for the legislature review is clearly insufficient for a meaningful debate.

aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined)		
(iv) Rules for in-year amendments to the budget without ex-ante approval by the legislature.	C	Rules regarding in-year budget amendments exist, but the assessment has not been able to get information about how well they are functioning.

Legislative Scrutiny of External Audit Reports

3.6.12. Parliament's interest in annual accounts has increased over the last three (3) years, particularly in the context of corruption. There are still however, many remaining problems to be solved.

3.6.13. The PAC was, as at March 2006, discussing the C&AG report for the FY 2001/02 and still two reports (FY 2002/03 and FY 2003/04) are pending. There are many factors behind this problem with timeliness. The PAC:

- convenes too seldom following parliament’s agenda;
- has problem with the quorum rules - many meetings have been cancelled.

3.6.14. The backlog seems to have stabilized on this level, i.e. it is not increasing or decreasing. That means that the PAC would probably be able to deal with C&AG’s reports provided they managed to finish the present backlog. No pro-active measures have been taken by the PAC to solve the situation. The late submission of the C&AG´s reports has also had an adverse effect.

3.6.15. There are some other imbedded problems in the legislative scrutiny that might explain this state of affairs. There are frequent changes on the posts of the accounting officers. The average time in the same office is just a few years. That makes it difficult to uphold accountability for parliament. With the present backlog at the PAC the accounting officers have often been transferred when it is time to be summoned to PAC (and it is even difficult to find them). The members of PAC are appointed for just one session (year). They often lack sufficient knowledge about financial management, accounting and/or auditing. The PAC is therefore, assisted by a technical team from the C&AG and MOF.

3.6.16. Follow-up of the C&AG’s reporting by the PAC is weak. The most recent Treasury memorandum on actions taken due to PAC Minutes concerns 1996/97. The big backlogs in the PAC are seriously hampering the final link in the accountability chain. Thus the present procedures in PAC are not functioning well and the whole system design needs to be reviewed to reinforce accountability.

3.6.17. The Ministerial Audit Committees could be given the responsibility to follow up and act upon the PAC’s Minutes and/or the C&AG’s report as well as the reports by the Internal Audit. Once a year the MOF sums up the actions taken on the PAC Minutes and reports back in writing to the PAC and the C&AG.

Table 34: Legislative Scrutiny of External Audit Reports - Score

Indicator	Score	Brief Explanation
PI-28. Legislative scrutiny of external audit reports	D+	
(i) Timeliness of examination of audit reports by legislature (for reports received with the last three years)	D	There is a, seemingly permanent, backlog of 2-3 years.

(ii) Extent of hearings on key findings undertaken by legislature	C	The present procedures in PAC are not functioning well. The PAC members are only appointed for one year. The Accounting Officers are often transferred too soon. The PAC convenes too seldom and has problems with the quorum rules.
(iii) Issuance of recommended actions by the legislature and implementation by the executive	C	Follow-up of the C&AG's reporting by the PAC is weak. The most recent Treasury Memorandum on actions taken due to PAC Minutes concerns 1996/97. The backlogs at PAC are seriously hampering the final link in the accountability chain.

3.7. DONOR PRACTICES

Predictability of Direct Budget Support

3.7.1. Direct budget support constitutes an important source of revenue for central government in many countries. In Kenya, budget support represents just a small proportion of the total revenue. General budget support to Kenya is still limited and mostly provided by the European Union, World Bank and African Development Bank (AfDB). Sector Budget Support is provided by World Bank, Sweden, Germany, United Kingdom, Canada and Norway.

3.7.2. Direct budget support outturn falls short of the forecast by more than 15% (estimated) during the last three years. This was attributed to delayed implementation of donor conditionalities. During the last fiscal year, the MOF has not included bilateral budget support estimates and later on budget support estimates from all donors in the budget, because of shortfalls and delays in donor inflows. Donor disbursement estimates have been agreed annually with the government 2-3 months before the beginning of the fiscal year However, there are also delays in donor inflows attributed to delayed implementation of donor conditionalities. The disbursement delays were more than estimated 50% during the last three years, because of the conditionalities were not reached.

Financial Information Provided by Donors for Budgeting and Reporting on Project and Programme Aid

3.7.3. The deviation of actual project support by donors from the estimates is about 55%. Only a few donors provide budget estimates for disbursement of projects and programme aid consistent with the Kenyan fiscal year. Information for estimates are only given for one year but for the Kenyan system forecasts of three years are necessary. Only two of the donors provide information for three years.

3.7.4. For at least 70% (estimated) of the externally financed projects estimates in the budget donors provide quarterly reports within two months, but the reports are only provided on inquiry not automatically. This is also contributed to the incompatible budget cycle of the donors and the Government of Kenya.

3.7.5. Neither the estimates for disbursement of project aid or the quarterly reports are consistent with the classification system of the Government of Kenya. Donors mainly use their own classification system for their estimates and reports.

Proportion of Aid that is Managed by Use of National Procedures

3.7.6. The use of national procedures means that the banking, authorization, procurement, accounting, audit, disbursement and reporting arrangements for donor funds are the same as those used for government funds.

3.7.7. In Kenya flows of external aid to the government are presently captured in the development estimates of the government budget. The estimates for those flows are split into Development Revenues and Appropriations in Aid. The former covers all transfers of funds from loans and grants that pass through the government's exchequer system. Procurement and accounting for expenditure will in the case of Development Revenues follow the Government's own system, but may be required to respect special arrangements demanded by the donor. For Appropriations in Aid national procedures are not used, estimated at nearly 56% of the total external aid. So, less than 50% (estimated) of aid funds to central government are managed by use of national procedures.

Table 35: Predictability of Donor Support - Scores

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 (or equivalent approving body).	**D**	**Direct budget support outturns fall short of the forecast by more than 15% (estimated) in the last three years.**
(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates	**D**	**Donor disbursements estimates have been agreed with the government 2-3 months before the beginning of the fiscal year. But there were delays in donor inflows attributed to delayed implementation of donor conditionalities.**
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	**D**	
(i) Completeness and timeliness of budget estimates by donors for project support.	**D**	**Not all major donors provide budget estimates for disbursement of projects and programme aid for only one year consistent with the Kenyan fiscal year. For the Kenyan system information is required for three years and only two donors provide information for three years.** **The estimates for disbursement of project aid are not consistent with the classification system of the Government of Kenya. Donors mainly use their own classification system for their estimates.**
(ii) Frequency and coverage of reporting by donors on actual donor flows for project support.	**D**	**For at least 70% (estimated) of the externally financed projects estimates in the budget donors provide quarterly reports, but the reports are only provided on inquiry, not automatically.** **The quarterly reports are not consistent with the classification system of the Government of Kenya. Donors mainly use their own classification system for their reports.**
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% (estimated) of aid funds to central government are managed by use of national procedures. This is also mainly due to predominantly project support aid which rarely uses national procedures in terms of banking, procurement, accounting, audit, disbursement and reporting arrangements.**

4. GOVERNMENT REFORM PROCESS

4.1. GENERAL DESCRIPTION OF RECENT AND ON-GOING REFORMS

4.1.1. The capacity of the public sector to play its catalytic role in development has been hampered by structural and institutional constraints. This has contributed to high cost of doing business, slowed down the level of economic growth and development, and increased the number of people living under the poverty line. To improve the efficiency and effectiveness of the sector, the government has been implementing wide ranging reforms over the last 15 years with modest outcomes. Some of the reforms include: structural adjustment programmes, political reforms, privatization of state enterprises, ministerial right sizing, voluntary early retirement and retrenchment of civil servants all of which have had implications on public expenditure.

4.1.2. In 2003, the government drafted a medium term poverty reduction strategy, the IP-ERS that outlines the political priorities over the period 2003-2007. It identifies institutional and structural reforms critical to economic recovery and poverty reduction. Various reform programmes anchored on the strategy and building on past efforts have been designed and are either being implemented or are in the process.

Governance Justice Law and Order Sector Reform (GJLOS) Programme)

4.1.3. The GJLOS reform programme currently under implementation is a government led initiative and seeks to reform sector institutions for enhanced protection of human rights, efficient transparent and accountable governance and justice. The programme lays out a sector-wide, coordinated and coherent five-year plan to reform public sector institutions in the justice and legal sector to be able to execute their mandate effectively. The key outcomes of the programme include

- Responsive and enforceable policy, law and regulation;
- More effective GJLOS institutions;
- Reduced corruption related impunity;
- Improved access to justice;
- A fair, humane and expeditious justice delivery system;
- More informed and participative citizenry and non-state actors;
- Safe and secure environment.

Statistical Capacity Building Programme (STATCAP)

4.1.4. This project is designed to develop improved statistical information on governance issues as well as strengthen and harmonize the monitoring and evaluation framework, and mainstream governance statistics as a way to monitor and evaluate the implementation of anti-corruption measures. One objective of STATCAP relevant to expenditure management is the improvements in collection of Government Financial Statistics (GFS) which usually is manual, slow and unreliable. GFS data comes out late, takes a long time to be corrected and audited, which hinders corrective measures by oversight bodies.

Public Sector Management Reforms

4.1.5. In order to support the implementation of the IP-ERS, the government is undertaking public sector management reforms under the Institutional Reform and Capacity Building Project. The objective of the project is to strengthen public financial management systems to enhance transparency, accountability and responsiveness to public expenditure policy priorities as well as enhance public service delivery through the effective implementation of Results Based Management (RBM). The programme is being implemented under the following components

(i) Results Based Management (RBM). The long term objective of RBM is to improve public sector management for more efficient, transparent and accountable delivery of public services. The intended outcomes of this component are:

- Institutionalized RBM in the public service;
- An enabling environment for RBM to achieve national goals and policy targets;
- Restructured cabinet Office and rationalized functions in support of the Presidency;
- A developed longer term public service strategy including a national vision;
- Enhanced capacity of public service leaders to champion chance in the implementation of RBM and mainstreaming of values and ethics in the public service;
- An information, Education and Communication strategy for disseminating results.

(ii) Public Financial Management Reforms. The government has been implementing financial management reforms as part of PEM-MAP and the accompanying matrix of corrective measures developed out of various diagnostic studies that revealed weakness in the expenditure management system The measures undertaken by the Government have resulted in modest but encouraging outcomes which the current reform initiatives will build on. These include:

- Clearance of audit backlogs through the Kenya National Audit Office;
- Enactment of the Public Financial Management Act which provides a framework for improved expenditure management;
- Enactment of the Public Officers ethics Act;
- Establishment of the Kenya Anti-corruption commission (KACC) with real power to investigate cases of corruption and mismanagement of public funds;
- Enactment of a Public Procurement and Disposal of Public Assets law;
- Piloting of risk based audits in Ministries to help in identifying potential for fraud in advance;
- Roll out of an Integrated Financial Management Information System in selected ministries;
- Opening of the budget process to greater stakeholder participation;
- Constitution and functioning of sector working groups;
- Re-orienting public expenditure towards pro-poor and pro-growth programme.

4.1.6. The reforms in PFM have so far adopted an isolated and incremental approach with little scope for a coordinated approach. The result has been little impact as a result of fragmented funding, poor planning and little attention to critical cross cutting issues like training, decentralization and legal framework. The expenditure management system still remains weak despite the ambitious efforts.

4.1.7. To address the weaknesses associated with the isolated and incremental approach, the government has finalized a comprehensive, integrated, prioritized and sequenced public financial management reform strategy. The strategy covers 15 components in public financial management including cross-cutting issues. The strategy is anchored on six inter-linked pillars namely

(i) Macro-economic forecasting and budgeting which includes macro-fiscal framework, budget formulation and preparation, Debt and guarantee management and External resources components;

(ii) Resource mobilization only focusing on the revenue component;

(iii) Budget execution comprising of budget execution, accounting and reporting, payroll and pensions;

(iv) Procurement;

(v) Audit and oversight which has parliamentary oversight, external audit and internal audit components.

(vi) Cross-cutting issues that covers IFMIS, legal framework and training, professional accreditation and conditions of service.

4.1.8. The Public Financial Management Reform programme is expected to last between seven to nine years. Other reform initiatives being implemented by the government include Water and Sanitation, Local government, Education and Health.

4.2. INSTITUTIONAL FACTORS AFFECTING REFORM PLANNING AND IMPLEMENTATION

4.2.1. Institutional factors play an important role in the successful implementation and sustainability of any reform efforts. The design of the Institutional Reform and Capacity Building Program of which PFMR programme is a component has been informed by lessons learnt from previous projects both in Kenya and other countries

Government Ownership and Leadership of the Reform Programme

4.2.2. The financial management reform programme is anchored on the government's broader policy priority, the IP-ERS which has strong ownership and support at the political level due to its participatory and consultative preparation. A cabinet sub-committee on reforms has been formed to provide policy leadership in the implementation of reforms in the public sector. Other institutional arrangements for implementing the programme cut across government and the MOF. The preparation of the PFMR has been led by the MOF to ensure that component managers own what is being implemented.

Partnership Arrangements

4.2.3. A number of development partners have come together to support the PFMR programme through a common framework by aligning behind the government strategy. In addition to allowing for better coordination between the government and the development partners, the framework will improve the effectiveness of external support and strengthen local ownership of the reform process.

Sequencing and Prioritization

4.2.4. A holistic integrated comprehensive approach has been adopted in the design of the PFMR programme. This will provide an opportunity for significant improvements in public expenditure management, allowing for a coordinated approach that ensures different components within the programme are complementary. The integrated approach provides a mechanism for managing effectively the sequencing and synchronization required for implementing the different activities of the programme.

Reform Implementation Capacity

4.2.5. The capacity to implement reforms is critical to success and sustainability. To build local capacity, the PFMR programme is being implemented within existing government structures as opposed to previous approaches that relied on project implementation units. The challenge however will be retention of the capacity that is built. Various government initiatives to mitigate against high staff turn-over are being implemented throughout the public service.

Stakeholder Involvement and External Scrutiny.

4.2.6. To build demand driven accountability mechanism, the preparation of the IP-ERS and the reform strategy was participatory and inclusive of major stakeholders within and without government. This has ensured inbuilt tracking mechanisms by various stakeholders and a demand driven accountability framework. As with any public effort parliament and civil society will play an important oversight role on behalf of the people of Kenya to ensure that the reforms succeed.

ANNEX 1

SUMMARY OF PFM PERFORMANCE INDICATORS

Indicator /Dimension	Score	Brief Explanation
A. PFM-OUT-TURNS: Credibility of the Budget		
PI-1 Aggregate expenditure out-turn compared to original approved budget	**C**	The percentage deviation between actual and budgeted expenditures as a proportion of the original approved budget were: 2002/03: 13%(actual expenditure) 2003/04: 13% (actual expenditure) 2004/05: 14% (actual expenditure)
PI-2 Composition of expenditure out-turn compared to original approved budget.	**A**	The variances in the composition of primary expenditures budget heads were respectively: 2002/03: 0%; 2003/04: 0% 2004/05: 0%
PI-3 Aggregate revenue out-turn compared to original approved budget	**C**	The domestic revenue collection was below 94% in 2 of the last 3 years.. 2002/03: 93,7%; 2003/04: 93,6% 2004/05: 109,5%
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	Stock of arrear was 8.97 % in 2003/04 and 4.40% in 2004/05. The debt stock was reduced from KES19,690.2M to KES11,668.1M.
(ii) Availability of data for monitoring the stock payment arrears	B	Data for monitoring available and published in the QBR. There is delayed publication of the QBR but the information available is comprehensive
B. KEY CROSS-CUTTING ISSUES: Comprehensiveness and Transparency		
PI-5 Classification of the Budget	**C**	The budget formulation and execution is based on administrative and a GFS-based economic classification, but there is not a full functional and a programmatic classification in the budget and accounts.
PI-6 Comprehensiveness of information included in budget documentation	**B**	Recent budget documentation contains information on: macroeconomic assumptions; fiscal deficit, deficit financing, revenue and expenditure implications of new policies mentioned in the budget speech, and detailed data on revenues and expenditures, but no information is provided on previous year's actual; debt stock; and government financial assets.
PI-7 Extent of unreported government operations	**C**	
(i) The level of extra-budgetary expenditure (other than donor funded projects) which is unreported i.e. not included in fiscal reports.	C	The level of unreported expenditures (other than donor-funded projects) constitutes 5– 10 per cent of government expenditures.
(ii) Income/expenditure information on donor-funded projects which is included in fiscal	C	Only information on external loan-financed projects is included in the fiscal reports, as information on grant-

reports.		funded projects are not available.
PI-8 Transparency of inter-governmental fiscal relations	**B**	
(i) Transparency and objectivity in the horizontal allocation among SN governments	A	The horizontal allocation of transfers from central government to LAs is fully transparent, and rule-based.
(ii) Timeliness of reliable information to SN governments on their allocations.	A	LAs are provided reliable information on the allocations to be transferred to them before the start of their detailed budgeting process.
(iii) Extent of consolidation of fiscal data for general government according to sectoral categories.	D	Fiscal information of LAs that is consistent with central government fiscal reporting is not routinely collected and consolidation is therefore not full and complete.
PI-9 Oversight of aggregate fiscal risk	**C+**	
(i) Extent of central government monitoring of autonomous government agencies and public enterprises.	C	Some SAGAs submit fiscal reports to the Ministry of Finance annually, though a consolidated overview is missing, which has already been scored in indicator 7, but because of the nature of their operations, SAGAs do not pose fiscal risk. However, reporting by public enterprises (major fiscal risk areas) is very weak and incomplete.
(ii) Extent of central government monitoring of sub national governments' fiscal position	A	No annual monitoring of LAs fiscal position takes place, which has already been scored in indictor 8, but because of the size and nature of their activities, as well as the fact that LAs do not have borrowing power, the fiscal risk is almost nil.
PI-10 Public access to fiscal information	**B**	Fiscal information available to the public in a timely fashion, through the Government Printer for purchase and/or to the Government's website, include: (i) Budget document's (ii) In-year budget execution reports (iii) Year-end financial statements (iv) External audit reports The following are not available. (v) A comprehensive list of procurement contract awards is not published (vi) Resources available to primary service units.
C. Budget Cycle		
C(i) Policy-Based Budgeting		
PI-11 Orderliness and participation in the annual budget process	**B**	
(i) Existence of, and adherence to, a fixed budget calendar	A	A clear annual budget calendar exists and generally adhered to but some delays are often experienced in its implementation. The calendar allows line ministries

		more than 6 weeks to complete their detailed estimates.
(ii) Guidance on the preparation of budget submissions.	A	Guidance on the preparation of budget submissions is comprehensive. A clear budget circular is issued to line ministries, which reflects ceilings approved by cabinet prior to the circulars distribution to them.
(iii) timely budget approval by the legislature	D	However, due to late submission of the budget to parliament the budget has been approved with more than two months delay in two of the last three years.
PI-12 Multi-year perspective in fiscal planning, expenditure policy and budgeting	**C**	
(i) multi-year fiscal forecast and functional allocations	C	Forecast of fiscal aggregates on the basis of economic and a non-standard main functional classifications are prepared for three years on a rolling basis. Differences between these forecasts and annual budgets are clear (optimistic forecasts, revenue shortfalls, unutilized external assistance), and to a certain degree are explained in the budget speech, but not on one to one basis and their exact calculations.
(ii) scope and frequency of debt sustainability analysis	C	Debt sustainability analysis is indirectly undertaken in the context of the IMF- supported PRGF programs with a scope that is required for such programs when these programs are prepared and/or when they are in force and are reviewed.
(iii) existence of costed sector strategies	B	The medium term expenditures strategies are costed, but not fully funded, resulting in financing gaps that are normally expected to be financed through external concessional assistance.
(iv) linkages between investment budgets and forward expenditure estimates	D	There does not appear to be demonstrated linkage of the development and the recurrent budget. Budgeting for investment and recurrent are two separate processes with no recurrent cost estimates being completely calculated for investment projects. Two different documents are prepared and published without being linked.
C (ii) Predictability and Control in Budget Execution		
PI-13. Transparency of taxpayer obligations and liabilities	**B**	
(i) Clarity and comprehensiveness of tax liabilities	B	The tax legislation is clear and comprehensive. The discretionary powers are limited. KRA implements the exemptions and waivers as authorised by the Minister of Finance. There is a waiver of 500,000 Kshs which is limited to the penalties and interest accrued.
(ii) Taxpayer access to information on tax liabilities and administrative procedures	B	The tax laws and administrative procedures are clearly stated and information and guidelines are widely distributed.
(iii) Existence and functioning of a tax appeals mechanism	B	A tax appeals mechanism is in place. Kenya tax administration has a very low frequency of appeals
PI-14. Effectiveness of measures for taxpayer registration and tax	**C+**	

assessment		
(i) Controls in taxpayer registration system	C	The current taxpayer registration system in Kenya is not linked to any other government license or registration system.
(ii) Effectiveness of penalties for non-compliance with registration and declaration obligations	B	There is a system with penalties that has been harmonized across all taxes but not sufficiently high to have the desired impact.
(iii) Planning and monitoring of tax audit and fraud investigation programs	C	There is a National Audit work plan with risk assessment criteria but the criteria is not complete
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 average debt collection ratio in the two most recent fiscal years was 16%, and the total amount of tax arrears is significant.
(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. However, the chain of transfer involving Commercial Banks takes up to 3 days.
(iii) Frequency of complete accounts reconciliation between tax assessments, collections, arrears records and receipts by the Treasury	A	KRA ,CBK and Treasury have meetings every week for accounts reconciliation. The Treasury gets monthly reports on how much of the arrears have been paid.
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. 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 commitment .	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 the 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	Above the level of management of MDAs the central ministry performs a semi-annual budget review in conjunction with the line ministries on whose basis a supplemental budget is submitted to Parliament for approval in December.
PI-17 Recording and management of cash balances,	**B**	

debt and guarantees		
(i) Quality of debt recording and reporting	B	Improving the quality of debt recording and reporting has been the primary focus of reform efforts in the last two years. Presently data is being migrated onto a new platform and reconciliation is undertaken on daily basis. Debt data reporting is done on quarterly basis or at the request of the IMF. There are still some weaknesses in the quality and comprehensiveness of statistical reporting.
(ii) Extent of consolidation of the Government's cash balances	B	The MOF monitors the cash position of the line ministries on daily basis and maintains a zero balance policy for line Ministries accounts held at the central bank on daily basis.
(iii) Systems for contracting loans and issuance of guarantees	B	There is a borrowing limit which has been updated periodically and is currently set at 500Bn KES in aggregate; while ceiling on loan guarantee is set at KES80Bn. 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 Financial Secretary (MOF) submits final accounts to the Controller and Auditor General on all transactions on annual basis and these are adhered to.
PI-18 Effectiveness of payroll controls	**D+**	
(i) Degree of integration and reconciliation between personnel records and payroll data	D	The Government has implemented an IPPD system for the core civil service. To-date the teachers' payroll and Ministry of Defence is still not on the system. Monthly reconciliation of payroll data is undertaken but no effective reconciliation occurs between personnel records and payroll data.
(ii) Timeliness of changes to Personnel records and the payroll	D	Delays in processing changes to the payroll and nominal roll are often significantly longer than three months and require widespread retroactive adjustments.
(iii) Internal controls of changes to personnel records and the payroll	B	The DPM has the sole authority to make changes to payroll records and controls the issuance of unique personnel numbers.
(iv) Existence of payroll audits to to identify control weaknesses and /or ghost workers.	C	Payroll audits have been undertaken within the last three years.
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 threshold for small purchases	C	The regulations instruct on the use of open competition procurement thresholds. There is some sample data on the procurement methods employed. The IPR data suggests a number ratio less than 50%.
(ii) Justification for use of less competitive procurement methods	B	Where other non-competitive methods are to be used by procuring entities, the 2001 Procurement

		Regulations provides thresholds as the basis for justification as to when each kind of alternative procurement method is to be used.
(iii) Existence and operation of a procurement complaints mechanism	A	The Public Procurement Complaints, Review and Appeals Board is provided for within the 2001 Procurement Regulations under the Exchequer and Audit Act. Whilst not specifically provided for within the Act, the Board is subject to oversight by the Courts at the discretion of the complainant. A record of all cases filed with the Board and their determination is maintained and available for public scrutiny through the Director of Public Procurement who also serves as the Secretary to the Board.
PI-20: Effectiveness of internal controls for non-salary expenditure (M1)	C	
(i) Effectiveness of expenditure commitment controls	C	Whilst expenditure commitment controls exist and were complied with, these were not sufficiently robust to limit commitments to actual cash available. Partly due to short-comings of the commitment control system, the Government accumulated a considerable amount of pending bills estimated at KES18Bn (about 2% of GDP) being KES6Bn and 12Bn in recurrent and development expenditure respectively. A new commitment control system is being implemented with effect from 1 July 2005 to avoid further accumulation of pending bills.
(ii) Comprehensiveness, relevance and understanding of other internal control rules/ procedures	C	The Financial Regulations of the Exchequer and Audit Act include comprehensive rules to regulate financial management. These include segregation of duties between Finance Officers, Accounts Controllers and Internal Auditors. However, weaknesses in procurement controls together with mechanical (box-ticking) application of these controls has considerably reduced their effectiveness.
(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 as evidenced by internal audit reports, there is no consolidated position for Government to provide sufficient evidence that adequate justification is provided for use of simplified or emergency procedures.
PI-21. Effectiveness of internal audit	C	
(i) Coverage and quality of the internal audit function	C	A new platform, complying with the IIA's standard, has been established. It is not yet fully operational for all central government entities. At least 50% of staff time is focused on systemic issues.
(ii) Frequency and distribution of reports	C	Internal Audit Reports are issued in government entities with copies to the IAG in accordance with the new platform. It is too early to assess how this will develop.

(iii) Extent of management response to internal audit findings	C	It is too early to establish the extent of management response to internal audit findings however, there is a growing interest for Internal Audit reporting by many managers. The new audit concept still has not permeated fully and the old type of audit reports does not receive much interest.
C (iii) Accounting, Recording and Reporting		
PI-22 Timeliness and regularity of accounts reconciliation	**C**	
(i) Regularity of Bank reconciliations	B	Most ministries submit their accounts within four weeks from the end of each month. Sometime delays occur because commercial banks do not send the bank statements to line ministries on time.
(ii) Regularity of reconciliation and clearance of suspense accounts and advances	D	Reconciliation and clearance of suspense accounts and advances take placer less frequently, usually annually with some delays.
PI-23 Availability of information on resources received by service delivery units	**B**	At least two Public Expenditure Surveys (PETS) have been undertaken in the last three years. One was undertaken by KIPRA in the Health and Education sectors (2003). The second was undertaken by Price Waterhouse Coopers (2004) in Education. These special surveys demonstrated the level of resources received in cash and in kind by both schools and clinics across most of the country.
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	Budget returns from line ministries were compiled from the 'vote-book' system which covered all the items in the budget. This was compatible with the budget estimates. Therefore reports allowed comparison of expenditure to the original budget. Information included all items of budget estimates. Expenditure is covered at both commitment and payment stages.
(ii) Timeliness of the issue of reports	C	Officials stated that submittals were made on a timely basis and there was some corroborative evidence to support that budget reports are prepared monthly and quarterly in a timely fashion. However there were no specific schedules tracking the receipt of monthly expenditures or the issuance of quarterly budget reports..
(iii) Quality of information	C	The Monthly Expenditure Returns do not include bank balances and so there is no basis for reconciliations. There is information on committed funds as well as payments made against approved estimates. There is concern about the accuracy and consistency of data, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness.
PI-25 Quality and timeliness	**D+**	

of annual financial statements		
(i) Completeness of the financial statements	D	A summarized government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete. Essential information may be missing from the financial statements or the financial records are too poor to audit.
(ii) Timeliness of submission of the financial statements	B	The submission of financial statements by the line ministries and also from the Accountant General of the summarized financial statements to the Auditor General occurs within seven months. It should be noted though that this does not necessarily imply that the books are fully reconciled and closed.
(iii) Accounting standards used	C	The accounting system employed is cash-based and adopts their own set of public sector accounting standards. Statements are presented in consistent format over time.
C (iv) External Scrutiny and Audit		
Indicator	**Score**	**Brief Explanation**
PI-26. Scope, nature and follow-up of external audit	**D+**	
(i) Scope/nature of audit performed (incl. adherence to auditing standards)	C	Central government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only
(ii) Timeliness of submission of audit reports to the legislature	D	The latest three C&AG's Annual Audit Reports tabled before Parliament have not been submitted within the statutory deadline for the last three year (6-7 months from the end of the FY). The last three years has averaged 22 months from the end of the FY.
(iii) Evidence of follow-up on audit recommendations	D	There is little evidence of response or follow-up from PAC and the Ministry of Finance. The same type of errors and mismanagement occurs year after year despite being repeatedly criticized by the C&AG. There is no summing-up in the next year's annual audit report to Parliament of the extent to which the audit's recommendation has been implemented.
PI-27 Legislative scrutiny of the annual budget law	**D+**	
(i) Scope of the legislature's scrutiny	C	The legislature's review is very limited.
(ii) Extent to which the legislature's procedures are well-established and respected	C	Procedures for the legislature's review do exist but need to be further developed to be supportive of an appropriate budget review. Also the Parliament's capacity for analysis is weak.
(iii) Adequacy of time for the legislature to provide a response to budget proposals both the detailed estimates and, where applicable, for	D	The time allowed for the legislature review is clearly insufficient for a meaningful debate.

proposals on macro-fiscal aggregates earlier in the budget preparation cycle (time allowed in practice for all stages combined)		
(iv) Rules for in-year Amendments to the budget without ex-ante approval by the legislature.	D	Rules regarding in-year budget amendments may exist, but they are either rudimentary or unclear.
PI-28. Legislative scrutiny of external audit reports	**D+**	
(i) Timeliness of examination of audit reports by legislature (for reports received with the last three years)	D	There is seemingly a permanent, backlog of 2-3 years.
(ii) Extent of hearings on key findings undertaken by legislature	C	The present procedures in PAC are not functioning well. The PAC members are only appointed for one year. In-depth hearings on key findings take place only occasionally, cover only a few audited entities. The PAC convenes too seldom and has problems with the quorum rules.
(iii) Issuance of recommended actions by the legislature and implementation by the executive	C	Follow-up of the C&AG's reporting by the PAC is weak. The most recent Treasury Memorandum on actions taken due to PAC Minutes concerns 1996/97. The backlogs at PAC are seriously hampering the final link in the accountability chain.
D. Donor Practices		
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 (or equivalent approving body).	D	Direct budget support outturns fall short of the forecast by more than estimated 15% in the last three years.
(ii) In-year timeliness of donor disbursements (compliance with aggregate quarterly estimates	D	Donor disbursements estimates have been agreed with the government 2-3 months before the beginning of the fiscal year. But there were delays in donor inflows attributed to delayed implementation of donor conditionalities.
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	**D**	
(i) Completeness and timeliness of budget estimates by donors for project support.	D	Not all major donors provide budget estimates for disbursement of projects and programme aid for only one year consistent with the Kenyan fiscal year. For the Kenyan system information is required for three years and only two donors provide information for three years.

		The estimates for disbursement of project aid are not consistent with the classification system of the Government of Kenya. Donors mainly use their own classification system for their estimates.
(ii) Frequency and coverage of reporting by donors on actual donor flows for project support.	D	For at least 70% (estimated) of the externally financed projects estimates in the budget donors provide quarterly reports, but the reports are only provided on inquiry, not automatically. The quarterly reports are not consistent with the classification system of the Government of Kenya. Donors mainly use their own classification system for their reports.
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 estimated 50% of aid funds to central government are managed by use of national procedures. This is also mainly due to predominantly project support aid which rarely uses national procedures in terms of banking, procurement, accounting, audit, disbursement and reporting arrangements.

ANNEX 2

OVERVIEW OF PEFA SCORING CALIBRATION FOR INDIVIDUAL INDICATORS

Overview of PEFA Scoring Calibration for Individual Indicators[1]

PEFA SCORE		EXPLANATION OF CALIBRATION
PI-1 Aggregate expenditure out-turn compared to original approved budget	A	(i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 5% of budgeted expenditure.
	B	(i) In no more than one out of the last three years has the actual expenditure deviated from budgeted expenditure by an amount equivalent to more than 10 % of budgeted expenditure.
	C	(i) In no more than one of the last three years has the actual expenditure deviated from budgeted expenditure by more than an amount equivalent to 15% of budgeted expenditure.
	D	(i) In two or all of the last three years did the actual expenditure deviate from budgeted expenditure by an amount equivalent to more than 15% of budgeted expenditure.
PI-2. Composition of expenditure out-turn compared to original approved budget	A	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by no more than 5 percentage points in any of the last three years.
	B	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 5 percentage points in no more than one of the last three years.
	C	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in no more than one of the last three years.
	D	(i) Variance in expenditure composition exceeded overall deviation in primary expenditure by 10 percentage points in at least two out of the last three years.
PI-3. Aggregate revenue out-turn compared to original approved budget	A	(i) Actual domestic revenue collection was below 97% of budgeted domestic revenue estimates in no more than one of the last three years.
	B	(i) Actual domestic revenue collection was below 94% of budgeted domestic revenue estimates in no more than one of the last three years.
	C	(i) Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in no more than one of the last three years.
	D	(i) Actual domestic revenue collection was below 92% of budgeted domestic revenue estimates in two or all of the last three years.
PI-4. Stock and monitoring of expenditure payment arrears	A	(i) The stock of arrears is low (i.e. is below 2% of total expenditure) (ii) Reliable and complete data on the stock of arrears is generated through routine procedures at least at the end of each fiscal year (and includes an age profile).
	B	(i) The stock of arrears constitutes 2-10% of total expenditure; and there is evidence that it has been reduced significantly (i.e. more than 25%) in the last two years. (ii) Data on the stock of arrears is generated annually, but may not be complete for a few identified expenditure categories or specified budget institutions.
	C	(i) The stock of arrears constitutes 2-10% of total expenditure; and there is no evidence that it has been reduced significantly in the last two years. (ii) Data on the stock of arrears has been generated by at least one comprehensive ad hoc exercise within the last two years.
	D	(i) The stock of arrears exceeds 10% of total expenditure. (ii) There is no reliable data on the stock of arrears from the last two years.
PI-5. Classification of the budget	A	(i) The budget formulation and execution is based on administrative, economic and sub-functional classification, using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards. (Program classification may substitute for sub-functional classification, if it is applied with a level of detail at least corresponding to sub-functional.)
	B	(i) The budget formulation and execution is based on administrative, economic and functional classification (using at least the 10 main COFOG functions), using GFS/COFOG standards or a standard that can produce consistent documentation according to those standards.
	C	(i) The budget formulation and execution is based on administrative and economic classification using GFS standards or a standard that can produce consistent documentation according to those standards.
	D	(i) The budget formulation and execution is based on a different classification (e.g. not GFS compatible or with administrative break-down only).
PI-6.	A	(i) recent budget documentation fulfils 7-9 of the 9 information benchmarks

[1] Annex 1, PEFA PFM Performance Management Framework Guidelines, June 2005. PEFA Secretariat. www.pefa.org

PEFA SCORE		EXPLANATION OF CALIBRATION
Comprehensiveness of information included in budget documentation	B	(i) recent budget documentation fulfils 5-6 of the 9 information benchmarks
	C	(i) recent budget documentation fulfils 3-4 of the 9 information benchmarks
	D	(i) recent budget documentation fulfils 2 or less of the 9 information benchmarks
PI-7. Extent of unreported government operations	A	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) is insignificant (below 1% of total expenditure). (ii) Complete income/expenditure information for 90% (value) of donor-funded projects is included in fiscal reports, except inputs provided in-kind OR donor funded project expenditure is insignificant (below 1% of total expenditure).
	B	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 1-5% of total expenditure. (ii) Complete income/expenditure information is included in fiscal reports for all loan financed projects and at least 50% (by value) of grant financed projects.
	C	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes 5-10% of total expenditure. (ii) Complete income/expenditure information for all loan financed projects is included in fiscal reports.
	D	(i) The level of unreported extra-budgetary expenditure (other than donor funded projects) constitutes more than 10% of total expenditure. (ii) 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	A	(i) Transparency and objectivity in the horizontal allocation among SN governments The horizontal allocation of almost all transfers (at least 90% by value) from central government is determined by transparent and rules based systems (ii) Timeliness of reliable information to SN governments on their allocations SN governments are provided reliable information on the allocations to be transferred to them before the start of their detailed budgeting processes. (iii) Extent of consolidation of fiscal data for general government according to sectoral categories Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for 90% (by value) of SN government expenditure and consolidated into annual reports within 10 months of the end of the fiscal year.
	B	(i) Transparency and objectivity in the horizontal allocation among SN governments The horizontal allocation of most transfers from central government (at least 50% of transfers) is determined by transparent and rules based systems. (ii) Timeliness of reliable information to SN governments on their allocations SN governments are provided reliable information on the allocations to be transferred to them ahead of completing their budget proposals, so that significant changes to the proposals are still possible. (iii) Extent of consolidation of fiscal data for general government according to sectoral categories Fiscal information (ex-ante and ex-post) that is consistent with central government fiscal reporting is collected for at least 75% (by value) of SN government expenditure and consolidated into annual reports within 18 months of the end of the fiscal year.

PEFA SCORE		EXPLANATION OF CALIBRATION
	C	(i) Transparency and objectivity in the horizontal allocation among SN governments The horizontal allocation of only a small part of transfers from central government (10-50%) is determined by transparent and rules based systems. (ii) Timeliness of reliable information to SN governments on their allocations Reliable information to SN governments is issued before the start of the SN fiscal year, but too late for significant budget changes to be made. (iii) Extent of consolidation of fiscal data for general government according to sectoral categories Fiscal information (at least ex-post) that is consistent with central government fiscal reporting is collected for at least 60% (by value) of SN government expenditure and consolidated into annual reports within 24 months of the end of the fiscal year.
	D	(i) Transparency and objectivity in the horizontal allocation among SN governments No or hardly any part of the horizontal allocation of transfers from central government is determined by transparent and rules based systems. (ii) Timeliness of reliable information to SN governments on their allocations Reliable estimates on transfers are issued after SN government budgets have been finalized, or earlier issued estimates are not reliable. (iii) Extent of consolidation of fiscal data for general government according to sectoral categories Fiscal information that is consistent with central government fiscal reporting is collected and consolidated for less than 60% (by value) of SN government expenditure OR if a higher proportion is covered, consolidation into annual reports takes place with more than 24 months delay, if at all.
PI-9. Oversight of aggregate fiscal risk from other public sector entities	A	(i) All major AGAs/PEs submit fiscal reports to central governments at least six-monthly, as well as annual audited accounts, and central government consolidates fiscal risk issues into a report at least annually. (ii) SN government cannot generate fiscal liabilities for central government OR the net fiscal position is monitored at least annually for all levels of SN government and central government consolidates overall fiscal risk into annual (or more frequent) reports.
	B	(i) All major AGAs/PEs submit fiscal reports including audited accounts to central governments at least annually, and central government consolidates overall fiscal risk issues into a report. (ii) The net fiscal position is monitored at least annually for the most important level of SN government, and central government consolidates overall fiscal risk into a report.
	C	(i) Most major AGAs/PEs submit fiscal reports to central governments at least annually, but a consolidated overview is missing or significantly incomplete. (ii) The net fiscal position is monitored at least annually for the most important level of SN government, but a consolidated overview is missing or significantly incomplete.
	D	(i) No annual monitoring of AGAs and PEs takes place, or it is significantly incomplete. (ii) No annual monitoring of SN governments' fiscal position takes place or it is significantly incomplete.
PI-10. Public Access to key fiscal information	A	(i) the government makes available to the public 5-6 of the 6 listed types of Information
	B	(i) the government makes available to the public 3-4 of the 6 listed types of information
	C	(i) the government makes available to the public 1-2 of the 6 listed types of Information
	D	(i) the government makes available to the public none of the 6 listed types of Information

PEFA SCORE		EXPLANATION OF CALIBRATION
PI-11. Orderliness and participation in the annual budget process	A	(i) Existence of and adherence to a fixed budget calendar A clear annual budget calendar exists, is generally adhered to and allows MDAs enough time (and at least six weeks from receipt of the budget circular) to meaningfully complete their detailed estimates on time. (ii) Guidance on the preparation of budget submissions A comprehensive and clear budget circular is issued to MDAs, which reflects ceilings approved by Cabinet (or equivalent) prior to the circular's distribution to MDAs. (iii) Timely budget approval by the legislature The legislature has, during the last three years, approved the budget before the start of the fiscal year.
	B	(i) Existence of and adherence to a fixed budget calendar A clear annual budget calendar exists, but some delays are often experienced in its implementation. The calendar allows MDAs reasonable time (at least four weeks from receipt of the budget circular) so that most of them are able to meaningfully complete their detailed estimates on time, (ii) Guidance on the preparation of budget submissions A comprehensive and clear budget circular is issued to MDAs, which reflect ceilings approved by Cabinet (or equivalent). This approval takes place after the circular distribution to MDAs, but before MDAs have completed their submission. (iii) Timely budget approval by the legislature The legislature approves the budget before the start of the fiscal year, but a delay of up to two months has happened in one of the last three years.
	C	(i) Existence of and adherence to a fixed budget calendar An annual budget calendar exists, but is rudimentary and substantial delays may often be experienced in its implementation, and allows MDAs so little time to complete detailed estimates, that many fail to complete them timely. (ii) Guidance on the preparation of budget submissions A budget circular is issued to MDAs, including ceilings for individual administrative units or functional areas. The budget estimates are reviewed and approved by Cabinet only after they have been completed in all details by MDAs, thus seriously constraining Cabinet's ability to make adjustments. (iii) Timely budget approval by the legislature The legislature has, in two of the last three years, approved the budget within two months of the start of the fiscal year.
	D	(i) Existence of and adherence to a fixed budget calendar A budget calendar is not prepared OR it is generally not adhered to OR the time allowed for MDAs' budget preparation is clearly insufficient to make meaningful submissions. (ii) Guidance on the preparation of budget submissions A budget circular is not issued to MDAs OR the quality of the circular is very poor OR Cabinet is involved in approving the allocations only immediately before submission of detailed estimates to the legislature, thus having no opportunities for adjustment. (iii) Timely budget approval by the legislature The budget has been approved with more than two months delay in two of the last three years.

PEFA SCORE		EXPLANATION OF CALIBRATION
PI-12. Multi-year perspective in fiscal planning, expenditure policy and budgeting	A	(i) Multi-year fiscal forecasts and functional allocations Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least three years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences explained (ii) Scope and frequency of debt sustainability analysis DSA for external and domestic debt is undertaken annually. (iii) Existence of costed sector strategies Strategies for sectors representing at least 75% of primary expenditure exist with full costing of recurrent and investment expenditure, broadly consistent with fiscal forecasts. (iv) Linkages between investment budgets and forward expenditure estimates Investments are consistently selected on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.
	B	(i) Multi-year fiscal forecasts and functional allocations Forecasts of fiscal aggregates (on the basis of main categories of economic and functional/sector classification) are prepared for at least two years on a rolling annual basis. Links between multi-year estimates and subsequent setting of annual budget ceilings are clear and differences are explained. (ii) Scope and frequency of debt sustainability analysis DSA for external and domestic debt is undertaken at least once during the last three years. (iii) Existence of costed sector strategies Statements of sector strategies exist and are fully costed, broadly consistent with fiscal forecasts, for sectors representing 25-75% of primary expenditure. (iv) Linkages between investment budgets and forward expenditure estimates The majority of important investments are made on the basis of relevant sector strategies and recurrent cost implications in accordance with sector allocations and included in forward budget estimates for the sector.
	C	(i) Multi-year fiscal forecasts and functional allocations Forecasts of fiscal aggregates (on the basis of the main categories of economic classification) are prepared for at least two years on a rolling annual basis. (ii) Scope and frequency of debt sustainability analysis A DSA for at least for external debt undertaken once during last three years. (iii) Existence of costed sector strategies Statements of sector strategies exist for several major sectors but are only substantially costed for sectors representing up to 25% of primary expenditure OR costed strategies cover more sectors but are inconsistent with aggregate fiscal forecasts. (iv) Linkages between investment budgets and forward expenditure estimates Many investment decisions have weak links to sector strategies and their recurrent cost implications are included in forward budget estimates only in a few (but major) cases.

PEFA SCORE		EXPLANATION OF CALIBRATION
	D	(i) Multi-year fiscal forecasts and functional allocations No forward estimates of fiscal aggregates are undertaken (ii) Scope and frequency of debt sustainability analysis No DSA has been undertaken in the last three years (iii) Existence of costed sector strategies Sector strategies may have been prepared for some sectors, but none of them have substantially complete costing of investments and recurrent expenditure. (iv) Linkages between investment budgets and forward expenditure estimates Budgeting for investment and recurrent expenditure are separate processes with no recurrent cost estimates being shared.
PI-13 Transparency of Taxpayer Obligations and Liabilities	A	(i) Clarity and comprehensiveness of tax liabilities Legislation and procedures for all major taxes are comprehensive and clear, with strictly limited discretionary powers of the government entities involved. (ii) Taxpayers' access to information on tax liabilities and administrative procedures Taxpayers have easy access to comprehensive, user friendly and up-to-date information tax liabilities and administrative procedures for all major taxes, and the RA supplements this with active taxpayer education campaigns. (iii) Existence and functioning of a tax appeals mechanism. A tax appeals system of transparent administrative procedures with appropriate checks and balances, and implemented through independent institutional structures, is completely set up and effectively operating with satisfactory access and fairness, and its decisions are promptly acted upon.
	B	(i) Clarity and comprehensiveness of tax liabilities Legislation and procedures for most, but not necessarily all, major taxes are comprehensive and clear, with fairly limited discretionary powers of the government entities involved. (ii) Taxpayers' access to information on tax liabilities and administrative procedures Taxpayers have easy access to comprehensive, user friendly and up-to-date information tax liabilities and administrative procedures for some of the major taxes, while for other taxes the information is limited. (iii) Existence and functioning of a tax appeals mechanism. A tax appeals system of transparent administrative procedures is completely set up and functional, but it is either too early to assess its effectiveness or some issues relating to access, efficiency, fairness or effective follow up on its decisions need to be addressed..
	C	(i) Clarity and comprehensiveness of tax liabilities Legislation and procedures for some major taxes are comprehensive and clear, but the fairness of the system is questioned due to substantial discretionary powers of the government entities involved. (ii) Taxpayers' access to information on tax liabilities and administrative procedures Taxpayers have access to some information on tax liabilities and administrative procedures, but the usefulness of the information is limited due coverage of selected taxes only, lack of comprehensiveness and/or not being up-to-date. (iii) Existence and functioning of a tax appeals mechanism. A tax appeals system of administrative procedures has been established, but needs substantial redesign to be fair, transparent and effective.

PEFA SCORE		EXPLANATION OF CALIBRATION
	D	(i) Clarity and comprehensiveness of tax liabilities Legislation and procedures are not comprehensive and clear for large areas of taxation and/or involve important elements of administrative discretion in assessing tax liabilities. (ii) Taxpayers' access to information on tax liabilities and administrative procedures Taxpayer access to up-to-date legislation and procedural guidelines is seriously deficient. (iii) Existence and functioning of a tax appeals mechanism. No functioning tax appeals system has been established
PI-14 Effectiveness of measures for taxpayer registration and tax assessment	A	(i) Controls in the taxpayer registration system. Taxpayers are registered in a complete database system with comprehensive direct linkages to other relevant government registration systems and financial sector regulations. (ii) Effectiveness of penalties for non-compliance with registration and tax declaration Penalties for all areas of non-compliance are set sufficiently high to act as deterrence and are consistently administered. (iii) Planning and monitoring of tax audit programs. Tax audits and fraud investigations are managed and reported on according to a comprehensive and documented audit plan, with clear risk assessment criteria for all major taxes that apply self-assessment.
	B	(i) Controls in the taxpayer registration system. Taxpayers are registered in a complete database system with some linkages to other relevant government registration systems and financial sector regulations. (ii) Effectiveness of penalties for non-compliance with registration and tax declaration Penalties for non-compliance exist for most relevant areas, but are not always effective due to sufficiently scale and/or inconsistent administration. (iii) Planning and monitoring of tax audit programs. Tax audits and fraud investigations are managed and reported on according to a documented audit plan, with clear risk assessment criteria for audits in at least one major tax area that applies self-assessment.
	C	(i) Controls in the taxpayer registration system. Taxpayers are registered in database systems for individual taxes, which may not be fully and consistently linked. Linkages to other registration/licensing functions may be weak but are then supplemented by occasional surveys of potential taxpayers. (ii) Effectiveness of penalties for non-compliance with registration and tax declaration Penalties for non-compliance generally exist, but substantial changes to their structure, levels or administration are needed to give them a real impact on compliance. (iii) Planning and monitoring of tax audit programs. There is a continuous program of tax audits and fraud investigations, but audit programs are not based on clear risk assessment criteria.
	D	(i) Controls in the taxpayer registration system. Taxpayer registration is not subject to any effective controls or enforcement systems (ii) Effectiveness of penalties for non-compliance with registration and tax declaration Penalties for non-compliance are generally non-existent or ineffective (i.e. set far too low to have an impact or rarely imposed). (iii) Planning and monitoring of tax audit programs. Tax audits and fraud investigations are undertaken on an ad hoc basis if at all.

PEFA SCORE		**EXPLANATION OF CALIBRATION**
PI-15 Effectiveness in collection of tax payments	A	(i) The average debt collection ratio in the two most recent fiscal years was 90% or above OR the total amount of tax arrears is insignificant (i.e. less than 2% of total annual collections). (ii) All tax revenue is paid directly into accounts controlled by the Treasury or transfers to the Treasury are made daily. (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least monthly within one month of end of month.
	B	(i) The average debt collection ratio in the two most recent fiscal years was 75-90% and the total amount of tax arrears is significant. (ii) Revenue collections are transferred to the Treasury at least weekly. (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least quarterly within six weeks of end of quarter.
	C	(i) The average debt collection ratio in the two most recent fiscal years was 60-75% and the total amount of tax arrears is significant (ii) Revenue collections are transferred to the Treasury at least monthly. (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury takes place at least annually within 3 months of end of the year.
	D	(i) The debt collection ratio in the most recent year was below 60% and the total amount of tax arrears is significant (i.e. more than 2% of total annual collections). (ii) Revenue collections are transferred to the Treasury less regularly than monthly (iii) Complete reconciliation of tax assessments, collections, arrears and transfers to Treasury does not take place annually or is done with more than 3 months' delay.
PI-16 Predictability in the availability of funds for commitment of expenditures	A	(i) A cash flow forecast is prepared for the fiscal year, and are updated monthly on the basis of actual cash inflows and outflows. (ii) MDAs' are able to plan and commit expenditure for at least six month in advance in accordance with the budgeted appropriations. (iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a transparent and predictable way.
	B	(i) A cash flow forecast is prepared for the fiscal year and updated at least quarterly, on the basis of actual cash inflows and outflows. (ii) MDAs are provided reliable information on commitment ceilings at least quarterly in advance. (iii) Significant in-year adjustments to budget allocations take place only once or twice in a year and are done in a fairly transparent way.
	C	(i) A cash flow forecast is prepared for the fiscal year, but is not (or only partially and infrequently) updated. (ii) MDAs are provided reliable information for one or two months in advance. (iii) Significant in-year budget adjustments are frequent, but undertaken with some transparency.
	D	(i) Cash flow planning and monitoring are not undertaken or of very poor quality. (ii) MDAs are provided commitment ceilings for less than a month OR no reliable indication at all of actual resource availability for commitment. (iii) Significant in-year budget adjustments are frequent and not done in a transparent manner.
PI-17. Recording and management of cash balances, debt and guarantees	A	(i) Quality of debt data recording and reporting Domestic and foreign debt records are complete, updated and reconciled on a monthly basis with data considered of high integrity. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least quarterly (ii) Extent of consolidation of the government's cash balances All cash balances are calculated daily and consolidated. (iii) Systems for contracting loans and issuance of guarantees. Central government's contracting of loans and issuance of guarantees are made against transparent criteria and fiscal targets, and always approved by a single responsible government entity.

PEFA SCORE		EXPLANATION OF CALIBRATION
	B	(i) Quality of debt data recording and reporting Domestic and foreign debt records are complete, updated and reconciled quarterly. Data considered of fairly high standard, but minor reconciliation problems occur. Comprehensive management and statistical reports (cover debt service, stock and operations) are produced at least annually. (ii) Extent of consolidation of the government's cash balances Most cash balances calculated and consolidated at least weekly, but some extra-budgetary funds remain outside the arrangement. (iii) Systems for contracting loans and issuance of guarantees. Central government's contracting of loans and issuance of guarantees are made within limits for total debt and total guarantees, and always approved by a single responsible government entity.
	C	(i) Quality of debt data recording and reporting Domestic and foreign debt records are complete, updated and reconciled on at least annually. Data quality considered of fair, but some gaps and reconciliation problems are recognized. Reports on debt stocks and service are produced only occasionally or with limited content. (ii) Extent of consolidation of the government's cash balances Calculation and consolidation of most government cash balances take place at least monthly, but the system used does not allow consolidation of bank balances (iii) Systems for contracting loans and issuance of guarantees. Central government's contracting of loans and issuance of guarantees are always approved by a single responsible government entity, but are not decided on the basis of clear guidelines, criteria or overall ceilings.
	D	(i) Quality of debt data recording and reporting Debt data records are incomplete and inaccurate to a significant degree. (ii) Extent of consolidation of the government's cash balances Calculation of balances takes place irregularly, if at all, and the system used does not allow consolidation of bank balances. (iii) Systems for contracting loans and issuance of guarantees. Central government's contracting of loans and issuance of guarantees are approved by different government entities, without a unified overview mechanism.
PI-18 Effectiveness of payroll controls	A	(i) Personnel database and payroll are directly linked to ensure data consistency and monthly reconciliation. (ii) Required changes to the personnel records and payroll are updated monthly, generally in time for the following month's payments. Retroactive adjustments are rare (if reliable data exists, it shows corrections in max. 3% of salary payments). (iii) Authority to change records and payroll is restricted and results in an audit trail. (iv) A strong system of annual payroll audits exists to identify control weaknesses and/or ghost workers.
	B	(i) Personnel data and payroll data are not directly linked but the payroll is supported by full documentation for all changes made to personnel records each month and checked against the previous month's payroll data. (ii) Up to three months' delay occurs in updating of changes to the personnel records and payroll, but affects only a minority of changes. Retroactive adjustments are made occasionally. (iii) Authority and basis for changes to personnel records and the payroll are clear. (iv) A payroll audit covering all central government entities has been conducted at least once in the last three years (whether in stages or as one single exercise).

PEFA SCORE		EXPLANATION OF CALIBRATION
	C	(i) A personnel database may not be fully maintained but reconciliation of the payroll with personnel records takes place at least every six months. (ii) Up to three months delay occurs in processing changes to personnel records and payroll for a large part of changes, which leads to frequent retroactive adjustments. (iii) Controls exist, but are not adequate to ensure full integrity of data. (iv) Partial payroll audits or staff surveys have been undertaken within the last 3 years.
	D	(i) Integrity of the payroll is significantly undermined by lack of complete personnel records and personnel database, or by lacking reconciliation between the three lists. (ii) Delays in processing changes to payroll and nominal roll are often significantly longer than three months and require widespread retroactive adjustments. (iii) Controls of changes to records are deficient and facilitate payment errors. (iv) No payroll audits have been undertaken within the last three years.
PI-19 Competition, value for money and controls in procurement	A	(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases Accurate data on the method used to award public contracts exists and shows that more than 75% of contracts above the threshold are awarded on the basis of open competition. (ii) Justification for use of less competitive procurement methods Other less competitive methods when used are justified in accordance with clear regulatory requirements. (iii) Existence and operation of a procurement complaints mechanism A process (defined by legislation) for submission and timely resolution of procurement process complaints is operative and subject to oversight of an external body with data on resolution of complaints accessible to public scrutiny.
	B	(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases Available data on public contract awards shows that more than 50% but less than 75% of contracts above the threshold are awarded on basis of open competition, but the data may not be accurate. (ii) Justification for use of less competitive procurement methods Other less competitive methods when used are justified in accordance with regulatory requirements. (iii) Existence and operation of a procurement complaints mechanism A process (defined by legislation) for submitting and addressing procurement process complaints is operative, but lacks ability to refer resolution of the complaint to an external higher authority.
	C	(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases Available data shows that less than 50% of contracts above the threshold are awarded on an open competitive basis, but the data may not be accurate. (ii) Justification for use of less competitive procurement methods Justification for use of less competitive methods is weak or missing. (iii) Existence and operation of a procurement complaints mechanism A process exists for submitting and addressing procurement complaints, but it is designed poorly and does not operate in a manner that provides for timely resolution of complaints.

PEFA SCORE		EXPLANATION OF CALIBRATION
	D	(i) Use of open competition for award of contracts that exceed the nationally established monetary threshold for small purchases Insufficient data exists to assess the method used to award public contracts OR the available data indicates that use of open competition is limited. (ii) Justification for use of less competitive procurement methods Regulatory requirements do not clearly establish open competition as the preferred method of procurement. (iii) Existence and operation of a procurement complaints mechanism No process is defined to enable submitting and addressing complaints regarding the implementation of the procurement process.
PI-20 Effectiveness of internal controls for non-salary expenditure	A	(i) Comprehensive expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations (as revised). (ii) Other internal control rules and procedures are relevant, incorporates a comprehensive and generally cost effective set of controls, which are widely understood. (ii) Compliance with rules is very high and any misuse of simplified and emergency procedures is insignificant.
	B	(i) Expenditure commitment controls are in place and effectively limit commitments to actual cash availability and approved budget allocations for most types of expenditure, with minor areas of exception. (ii) Other internal control rules and procedures incorporates a comprehensive set of controls, which are widely understood, but may in some areas be excessive (e.g. through duplication in approvals) and lead to inefficiency in staff use and unnecessary delays. (iii) Compliance with rules is fairly high, but simplified/emergency procedures are used occasionally without adequate justification.
	C	(i) Expenditure commitment control procedures exist and are partially effective, but they may not comprehensively cover all expenditures or they may occasionally be violated. (ii) Other internal control rules and procedures consist of a basic set of rules for processing and recording transactions, which are understood by those directly involved in their application. Some rules and procedures may be excessive, while controls may be deficient in areas of minor importance. (iii) Rules are complied with in a significant majority of transactions, but use of simplified/emergency procedures in unjustified situations is an important concern.
	D	(i) Commitment control systems are generally lacking OR they are routinely violated. (ii) Clear, comprehensive control rules/procedures are lacking in other important areas. (iii) The core set of rules are not complied with on a routine and widespread basis due to direct breach of rules or unjustified routine use of simplified/emergency procedures.
PI-21. Effectiveness of internal audit	A	(i) Internal audit is operational for all central government entities, and generally meet professional standards, It is focused on systemic issues (at least 50% of staff time).. (ii) Reports adhere to a fixed schedule and are distributed to the audited entity, ministry of finance and the SAI. (iii) Action by management on internal audit findings is prompt and comprehensive across central government entities.
	B	(i) Internal audit is operational for the majority of central government entities (measured by value of revenue/expenditure), and substantially meet professional standards. It is focused on systemic issues (at least 50% of staff time). (ii) Reports are issued regularly for most audited entities are distributed to the audited entity, the ministry of finance and the SAI. (iii) Prompt and comprehensive action is taken by many (but not all) managers.
	C	(i) The function is operational for at least the most important central government entities and undertakes some systems review (at least 20% of staff time), but may not meet recognized professional standards. (ii) Reports are issued regularly for most government entities, but may not be submitted to the ministry of finance and the SAI. (iii) A fair degree of action taken by many managers on major issues but often with delay
	D	(i) There is little or no internal audit focused on systems monitoring. (ii) Reports are either non-existent or very irregular. (iii) Internal audit recommendations are usually ignored (with few exceptions).

PEFA SCORE		EXPLANATION OF CALIBRATION
PI-22. Timeliness and regularity of accounts reconciliation	A	(i) Regularity of bank reconciliations Bank reconciliation for all central government bank accounts take place at least monthly at aggregate and detailed levels, usually within 4 weeks of end of period. (ii) Regularity of reconciliation and clearance of suspense accounts and advances Reconciliation and clearance of suspense accounts and advances take place at least quarterly, within a month from end of period and with few balances brought forward.
	B	(i) Regularity of bank reconciliations Bank reconciliation for all Treasury managed bank accounts take place at least monthly, usually within 4 weeks from end of month. (ii) Regularity of reconciliation and clearance of suspense accounts and advances Reconciliation and clearance of suspense accounts and advances take place at least annually within two months of end of period. Some accounts have uncleared balances brought forward.
	C	(i) Regularity of bank reconciliations Bank reconciliation for all Treasury managed bank accounts take place quarterly, usually within 8 weeks of end of quarter. (ii) Regularity of reconciliation and clearance of suspense accounts and advances Reconciliation and clearance of suspense accounts and advances take place annually in general, within two months of end of year, but a significant number of accounts have uncleared balances brought forward.
	D	(i) Regularity of bank reconciliations Bank reconciliation for all Treasury managed bank accounts take place less frequently than quarterly OR with backlogs of several months. (ii) Regularity of reconciliation and clearance of suspense accounts and advances Reconciliation and clearance of suspense accounts and advances take place either annually with more than two months' delay, OR less frequently.
PI-23 Availability of information on resources received by service delivery units	A	(i) Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by both primary schools and primary health clinics across the country. The information is compiled into reports at least annually.
	B	(i) Routine data collection or accounting systems provide reliable information on all types of resources received in cash and in kind by either primary schools or primary health clinics across most of the country with information compiled into reports at least annually; OR special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by both primary schools and primary health clinics across most of the country (including by representative sampling).
	C	(i) Special surveys undertaken within the last 3 years have demonstrated the level of resources received in cash and in kind by either primary schools or primary health clinics covering a significant part of the country OR by primary service delivery units at local community level in several other sectors.
	D	(i) No comprehensive data collection on resources to service delivery units in any major sector has been collected and processed within the last 3 years.
PI-24. Quality and timeliness of in-year budget reports	A	(i) Classification of data allows direct comparison to the original budget. Information includes all items of budget estimates. Expenditure is covered at both commitment and payment stages. (ii) Reports are prepared quarterly or more frequently, and issued within 4 weeks of end of period. (iii) There are no material concerns regarding data accuracy.
	B	(i) Classification allows comparison to budget but only with some aggregation. Expenditure is covered at both commitment and payment stages. (ii) Reports are prepared quarterly, and issued within 6 weeks of end of quarter. (iii) There are some concerns about accuracy, but data issues are generally highlighted in the reports and do not compromise overall consistency/ usefulness.

PEFA SCORE		EXPLANATION OF CALIBRATION
	C	(i) Comparison to budget is possible only for main administrative headings. Expenditure is captured either at commitment or at payment stage (not both). (ii) Reports are prepared quarterly (possibly excluding first quarter), and issued within 8 weeks of end of quarter. (iii) There are some concerns about the accuracy of information, which may not always be highlighted in the reports, but this does not fundamentally undermine their basic usefulness.
	D	(i) Comparison to the budget may not be possible across all main administrative headings. (ii) Quarterly reports are either not prepared or often issued with more than 8 weeks delay. (iii) Data is too inaccurate to be of any real use.
PI-25. Quality and timeliness of annual financial statements	A	(i) A consolidated government statement is prepared annually and includes full information on revenue, expenditure and financial assets/liabilities. (ii) The statement is submitted for external audit within 6 months of the end of the fiscal year. (iii) IPSAS or corresponding national standards are applied for all statements.
	B	(i) A consolidated government statement is prepared annually. They include, with few exceptions, full information on revenue, expenditure and financial assets/liabilities (ii) The consolidated government statement is submitted for external audit within 10 months of the end of the fiscal year. (iii) IPSAS or corresponding national standards are applied.
	C	(i) A consolidated government statement is prepared annually. Information on revenue, expenditure and bank account balances may not always be complete, but the omissions are not significant. (ii) The statements are submitted for external audit within 15 months of the end of the fiscal year. (iii) Statements are presented in consistent format over time with some disclosure of accounting standards.
	D	(i) A consolidated government statement is not prepared annually, OR essential information is missing from the financial statements OR the financial records are too poor to enable audit. (ii) If annual statements are prepared, they are generally not submitted for external audit within 15 months of the end of the fiscal year (iii) Statements are not presented in a consistent format over time or accounting standards are not disclosed.
PI-26. Scope, nature and follow-up of external audit	A	(i) All entities of central government are audited annually covering revenue, expenditure and assets/liabilities. A full range of financial audits and some aspects of performance audit are performed and generally adhere to auditing standards, focusing on significant and systemic issues. (ii) Audit reports are submitted to the legislature within 4 months of the end of the period covered and in the case of financial statements from their receipt by the audit office. (iii) There is clear evidence of effective and timely follow up.
	B	(i) Central government entities representing at least 75% of total expenditures 12 are audited annually, at least covering revenue and expenditure. A wide range of financial audits are performed and generally adheres to auditing standards, focusing on significant and systemic issues. (ii) Audit reports are submitted to the legislature within 8 months of the end of the period covered and in the case of financial statements from their receipt by the audit office. (iii) A formal response is made in a timely manner, but there is little evidence of systematic follow up.
	C	(i) Central government entities representing at least 50% of total expenditures are audited annually. Audits predominantly comprise transaction level testing, but reports identify significant issues. Audit standards may be disclosed to a limited extent only. (ii) Audit reports are submitted to the legislature within 12 months of the end of the period covered (for audit of financial statements from their receipt by the auditors). (iii) A formal response is made, though delayed or not very thorough. but there is little evidence of any follow up.
	D	(i) Audits cover central government entities representing less than 50% of total expenditures or audits have higher coverage but do not highlight the significant issues. (ii) Audit reports are submitted to the legislature more than 12 months from the end of the period covered (for audit of financial statements from their receipt by the auditors). (iii) There is little evidence of response or follow up.

PEFA SCORE		EXPLANATION OF CALIBRATION
PI-27 Legislative scrutiny of the annual budget law	A	(i) The legislature's review covers fiscal policies, medium term fiscal framework and medium term priorities as well as details of expenditure and revenue. (ii) The legislature's procedures for budget review are firmly established and respected. They include internal organizational arrangements, such as specialized review committees, and negotiation procedures. (iii) The legislature has at least two months to review the budget proposals. (iv) Clear rules exist for in-year budget amendments by the executive, set strict limits on extent and nature of amendments and are consistently respected.
	B	(i) The legislature's review covers fiscal policies and aggregates for the coming year as well as detailed estimates of expenditure and revenue. (ii) Simple procedures exist for the legislature's budget review and are respected. (iii) The legislature has at least one month to review the budget proposals. (iv) Clear rules exist for in-year budget amendments by the executive, and are usually respected, but they allow extensive administrative reallocations.
	C	(i) The legislature's review covers details of expenditure and revenue, but only at a stage where detailed proposals have been finalized. (ii) Some procedures exist for the legislature's budget review, but they are not comprehensive and only partially respected. (iii) The legislature has at least one month to review the budget proposals. (iv) Clear rules exist, but they may not always be respected OR they may allow extensive administrative reallocation as well as expansion of total expenditure.
	D	(i) The legislature's review is non-existent or extremely limited, OR there is no functioning legislature. (ii) Procedures for the legislature's review are non-existent or not respected. (iii) The time allowed for the legislature's review is clearly insufficient for a meaningful debate (significantly less than one month). (iv) Rules regarding in-year budget amendments may exist but are either very rudimentary and unclear OR they are usually not respected.
PI-28 Legislative scrutiny of external audit reports	A	(i) Scrutiny of audit reports is usually completed by the legislature within 3 months from receipt of the reports. (ii) In-depth hearings on key findings take place consistently with responsible officers from all or most audited entities, which receive a qualified or adverse audit opinion. (iii) The legislature usually issues recommendations on action to be implemented by the executive, and evidence exists that they are generally implemented.
	B	(i) Scrutiny of audit reports is usually completed by the legislature within 6 months from receipt of the reports. (ii) In-depth hearings on key findings take place with responsible officers from the audited entities as a routine, but may cover only some of the entities, which received a qualified or adverse audit opinion. (iii) Actions are recommended to the executive, some of which are implemented, according to existing evidence.
	C	(i) Scrutiny of audit reports is usually completed by the legislature within 12 months from receipt of the reports. (ii) In-depth hearings on key findings take place occasionally, cover only a few audited entities or may include with ministry of finance officials only. (iii) Actions are recommended, but are rarely acted upon by the executive.
	D	(i) Examination of audit reports by the legislature does not take place or usually takes more than 12 months to complete. (ii) No in-depth hearings are conducted by the legislature. (iii) No recommendations are being issued by the legislature.
D-1 Predictability of Direct Budget Support	A	(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 5%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years.
	B	(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 10%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 25% in two of the last three years.

PEFA SCORE		EXPLANATION OF CALIBRATION
	C	(i) In no more than one out of the last three years has direct budget support outturn fallen short of the forecast by more than 15%. (ii) Quarterly disbursement estimates have been agreed with donors at or before the beginning of the fiscal year and actual disbursements delays (weighted) have not exceeded 50% in two of the last three years.
	D	(i) In at least two of the last three years did direct budget support outturn fall short of the forecast by more than 15% OR no comprehensive and timely forecast for the year(s) was provided by the donor agencies. (ii) The requirements for score C (or higher) are not met.
D-2 Financial information provided by donors for budgeting and reporting on project and program aid	A	(i) All donors (with the possible exception of a few donors providing insignificant amounts) provide budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification. (ii) Donors provide quarterly reports within one month of end-of-quarter on the all disbursements made for at least 85% of the externally financed project estimates in the budget, with a break-down consistent with the government budget classification.
	B	(i) At least half of donors (including the five largest) provide complete budget estimates for disbursement of project aid at stages consistent with the government's budget calendar and with a breakdown consistent with the government's budget classification. (ii) Donors provide quarterly reports within one month of end-of-quarter on the all disbursements made for at least 70% of the externally financed project estimates in the budget with a break-down consistent with the government budget classification.
	C	(i) At least half of donors (including the five largest) provide complete budget estimates for disbursement of project aid for the government's coming fiscal year, at least three months prior its start. Estimates may use donor classification and not be consistent with the government's budget classification. (ii) Donors provide quarterly reports within two months of end-of-quarter on the all disbursements made for at least 50% of the externally financed project estimates in the budget. The information does not necessarily provide a break-down consistent with the government budget classification.
	D	(i) Not all major donors provide budget estimates for disbursement of project aid at least for the government's coming fiscal year and at least three months prior its start. (ii) Donors do not provide quarterly reports within two month of end-of-quarter on the disbursements made for at least 50% of the externally financed project estimates in the budget.
D-3 Proportion of aid that is managed by use of national procedures	A	(i) 90% or more of aid funds to central government are managed through national procedures.
	B	(i) 75% or more of aid funds to central government are managed through national procedures.
	C	(i) 50% or more of aid funds to central government are managed through national procedures.
	D	(i) Less than 50% of aid funds to central government are managed through national procedures.

ANNEX 3

TERMS OF REFERENCE

2,1 nd draft: Terms of reference for an assessment of the Government of Kenya's draft "Strategy for the reform of Public Financial Management".

Overall objective:

- **To support the Kenya Government's (GoK) efforts to reform their public financial management system in order to increase efficiency in government spending and minimise risks for corruption.**

The assessment will consist of two parts:

One part shall assess the strategy in terms of: relevance, effectiveness, feasibility, sustainability, institutional framework and risk mitigation. The other part shall focus on the strategy's proposed M&E system as well as establishing a base-line for performance measurement in relation to the Public Expenditure and Financial Accountability (PEFA) framework.

Objectives of the joint assessment of the strategy:

- **To produce a joint development partner (DP) position on support to the reform, which can assist in securing donor funds for the implementation of the reform.**
- **To ensure effective use of the various available funding mechanisms (e.g. further define donor co-ordination mechanisms as well as decide on DP-GoK relations (here the draft MoU is the base document) (Pooling DPs also need to establish a Joint Financing Arrangement (JFA) – and there must be a link between the JFA for pooling DPs and other funding mechanisms).**
- **To minimise transaction costs on the part of both the Government and the donors.**

Objectives of the M&E and base-line/PEFA assessment

- **The PEFA PFM Performance Measurement Framework incorporates a PFM performance report, and a set of high level indicators which draw on the HIPC expenditure tracking benchmarks, the IMF Fiscal Transparency Code and other international standards that allows measurement of Country PFM performance over time. It forms part of the Strengthened Approach to supporting PFM reform, which emphasizes country led reform, donor harmonization and alignment around the country strategy , and a focus on monitoring and results. The Information provided by the framework would also contribute to the Government reform process by determining the extent to which reforms are yielding improved performance and by increasing the ability to identify and learn from reform success.(www.pefa.org)**

To be able to monitor the strategy a baseline has to be created. The baseline should be created in relation to the objectives of the strategy (overall and specific). There is also a need to design the Monitoring and Evaluation system so that progress towards reaching objectives is coordinated and relates to the benchmark created. Lastly, the PFM reform strategy should be related to the internationally agreed PEFA-assessment system. The Government of Kenya has recognised that the PEFA system is mainly used to monitor at a higher level, but would still like the strategy to be related to the PEFA system. This is mainly for two reasons: 1) given the international status of the PEFA system, Kenya would like to officially score against that system; 2) if the PEFA assessment was kept outside the strategy, the pressure to meet more PEFA benchmarks may undermine the original prioritisation/sequencing within the strategy.

Given the limited time available, and based on existing material, this part of the mission is expected to:

1. **give recommendations on consistency between the PEFA benchmarks and the M+E system,**
2. **Create a "baseline" – related to the strategy objectives- which should be possible to update on annual basis**
3. **to as large extent possible finalise a PEFA assessment. If finalisation is not possible based on existing material and complementary interviews, the report should include what has been established and what needs further review. .**
4. **Give recommendations on an "annual review" cycle.**

Background

The PFM system has been improving steadily under the NARC government. Against the Government's 2003 Public Expenditure Management Action Plan (PEMAP) framework of 16 performance benchmarks, it met 3 in 2003, 4 in 2004 and 6 in 2005. The 6 now met include: (1) clear identification of poverty reducing expenditure; (2) classification of budget expenditure on an administrative, economic and functional basis; (3) use of tracking surveys; (4) routine reconciliation of fiscal and banking records; (5) regular internal fiscal reporting; (6) well maintained accounting records.

Since July 2005 the Government of Kenya, with the support of a number of development partners, has been developing a comprehensive public finance management reform strategy based upon existing reform efforts by Government departments, the Country Integrated Fiduciary Assessment (CIFA) and Independent Procurement Review (IPR) diagnostic tools. The <u>comprehensive</u> aspect of the PFM Reform Program makes it stand out from previous efforts. While this approach poses many more risks, its <u>integrated</u> approach provides an opportunity for achieving the significant improvements in the quality of public expenditure management that have eluded many of the past efforts made at improving public expenditure management in Kenya. By addressing key <u>inter-linkages</u> between reform activities it aims to ensure that all activities along a critical path are sequenced and timed in the right order. This avoids achieving significant reforms in one activity which then causes a roll back in the over all quality of public expenditure management because other process are then made ineffective by the newly introduced process.

Key PFM weaknesses to be addressed include: delivering the budget as originally programmed, the procurement system, and following up on audited accounts. Key activities under the reform programme include an overhauling of the Legal and Regulatory Framework, the implementation of the new accounting system, IFMIS, a substantial reform of the public procurement system and several reforms to the overall budgeting as well as oversight processes in Kenya.

The GoK program should be finalised by (end) March and most development partners are keen to align, and even pool funds, behind the GoK reform program. Issues to resolve includes: the role and structure of the secretariat, improved sequencing of reforms amongst 16 components, and prioritisation against resource constraints, etc.

The PFM Development Partner Group (DPG) is very active and growing in size (now 14 agencies). The DPG is keen to do a joint assessment and appraisal of the GoK reform program in March to further assess the strategy, make effective use of the various available funding modalities and also assess the PFM system against the new PEFA framework of 28 benchmarks so that a "base-line" could be established.

In order to achieve the overall objectives, the assessment must be of relevance to all funding partners (both present and future).

Point of departure:
The assessment will be done in two phases: Preparation and appraisal/assessment.

The preparation phase includes organising the mission and dividing tasks. Furthermore, existing diagnostic material should be used as much as possible to further focus the actual mission. Such material includes the WB project document (ICRB project), the draft CIFA report and previous PEMAP reviews, etc.

The assessment/appraisal part of the mission will take its focus from the preparation phase. The mission will at first concentrate on validation of earlier assessments and emerging issues.

There will be (at least) three areas to assess: i) General assessment of "generic" issues such as sequencing and feasibility etc. ii) assessment of key components, iii) inter-development partner (DP) and Gok-DP arrangements for administration of support (basket funds and earmarking, joint reviews, legal arrangements etc).

The output of the review will be a report which follows a format provided by Sida (see annex 1).

Time perspective:
Preparation phase: 1 week (6-10 March)
Assessment/review : 1 week (13-17 March)
Report writing and editing: (20-24 March)

Proposed program
Day 1) Meetings of the team: agree on the scope and format, purposes, objectives and focus. Introductory meeting with the GoK.

Day 2-3) review of each components (this may include a stakeholder workshop)
Day 4) The mission should be split in 2; a) general conclusions b) administration, reviews etc of the co-operation.
Day 5) continuation, including wrap-up meetings with the GoK.

Size of mission:
***For the overall mission*:**
A facilitator will be required to prepare and pursue the objectives. (see attachment) The facilitator should prepare and organise the mission and be responsible for delivering the final report.

An editor would be required to ensure consistency of the review report.

***For the "strategy" part*: Ideally all of the components will be reviewed during a 2-3 days period for the general conclusion to be prepared as a result of the input from the components. Thus at least 3 teams need to be created, consisting of at least 2-3 members. At least one member of the review team should have experience of DP-DP and GoK-DP arrangements (legal expertise). DPs are encouraged to strengthen the mission with external consultants as needed.**

***For the "PEFA/Benchmark/M+E" part*:**
To be able to carry out a PEFA assessment, experts on PEFA methodology need to be contracted. Also, there is a need for some independence to ensure as objective an assessment as possible. A "sub-mission leader" will therefore be appointed for this part of the mission.

Annex 1) Assessment criteria – proposed structure/format. (15-20 pages)

Summary

Background

Assessment

1. RELEVANCE, which assesses how appropriate a development strategy, or a specific programme/project, is in relation to the cooperation partner's and poor people's priorities and existing needs.

2. EFFECTIVENESS AND COST EFFICIENCY, which assesses
a) whether the set objectives of the programme/project are likely to be achieved; and
b) whether the implementation strategy is an appropriate and cost-effecient way of achieving the objectives under the prevailing circumstances and given possible alternatives.

3. FEASIBILITY, which assesses if the practical conditions exist for successful implementation of the programme/project and the Swedish contribution, respectively. Do the implementing parties have the required capacity, resources and will for successful implementation? Apart from these ownership aspects, assessments of the institutional environment for implementation come to the fore;

4. SUSTAINABILITY, which assesses if a supported development effort maintains its effects at a reasonable level after the cessation of external support (or the completion of the programme/project), in terms of impact on human, environmental, institutional and financial resources. Ownership issues at an impact level are addressed, including the influence that poor people exert during planning, implementation and follow-up;

5. COORDINATION AND CONSULTATIONS, which assesses strengths and weaknesses in the interaction between the cooperation partner, its national stakeholders and development partners, including Sida. Particular attention should be given to issues of ownership and control, for example how to arrange consultations without hampering the cooperation partner's internal management structures.

6. RISKS AND RISK MANAGEMENT, which assesses internal and/or external risks and proposes measures to avoid or reduce such risks.

Annexes: brief reviews of each components/platforms

ANNEX 4

LIST OF INSTITUTIONS VISITED AND PERSONS INTERVIEWED

List of institutions visited and persons interviewed

Office of the President/ Directorate of Personnel Management

Mr. Andrew K. Metho, Senior Deputy Director (MCS)
Mr. D.M Kitele, Snr. Assistant Director (MCS)
Mr. David Kanji, Assistant Director, MCS
Mr. Nelson Wem, Assistant Director, MCS
Mr. Absalom Ayado, senior Assistant Director, MCS
Mr. Henry Ogega, Deputy Director

KRA

Mrs. Esther Pahmba

MOF

Office of the Auditor General for Internal Audit
Mr. Billy Mwencha, Internal Auditor General
Mr. Peter. G. Ndungo, Deputy Auditor General
Mr. John. P. Ogwel, Assistant Internal Auditor General
Mrs. Doreen A. Omollo, Quality Assurance
Mr. Stephen. M. Nyanchiro, Finance and Administration

Accountant General's Department

Mr. M.M Gatimu, Ag. Accountant General
Mrs. T. K.Nyakweba, Chief Accountant
Mr. Achido Kepha, Accountant
Mr. Francis M. Mithamo, Accountant
Mr. J.M Kilinda, Principal Accountant II
Mr. H.W. Pamba, Principal Accountant I
Mr. G. K. Mothemba, Principal Accountant II

Budget Supplies Division

Mr. Kubai Khasiani, Deputy Director of Budget
Mrs. Phyllis Makau, Senior Budget Officer
Mr. Simon Mithia, Budget Officer

Debt Management Department

Mr. John Murugu, Director, DMB
Mr. Haron Sirima , Deputy Director, DMB
Mrs. Felister Kivisi, Senior Assistant Secretary
Mr. Jairus Muaka, Economist

External Resource Department

Mr. Moses K. Kanagi, Deputy Chief Economist
Mr. Samuel Mugambi, Assistant

Economic Affairs Department

Dr. Kamau Thugge, Economic Secretary
Mr. Moses K. Kanagi

Mrs Josephine Kanyi
Mr. John Njera
Mr. Christopher N Wamwea
Mr. Richard Gakunya

DGIPE

Mr. Charles M. Onchoke, Director, Finance, DGIPE
Ms. Charity Muya, Restructuring Expert

Ministry of Planning and National Development

Mr. George J. Anyango, Head, CPCD & National MDG Secretariat.
Mr. Moses K. Kanagi, Deputy Chief Economist, External Resource Department

Office of the C&AG

Mr.Winston Ogere, Deputy C&AG

Parliament

Mr. P.C. Omollo, Deputy Clerk
Mr. Irungu, Kigurdu, Finance Officer
Mr. P.N. Onayongo, Senior Finance Officer
Ms. Christine. Mwambua, Principal Clerk
Mrs Irene Muraguri, Head of Finance
Mr.F. Abonyo, clerk assistant

Ministry of Local Government

Mr. H.S. Chavera, Finance Officer
Mr. Kipruto Yegon, Reform Officer

Ministry of Health

Mr. Felix M.M. Karimba, Chief Finance Officer
Mr. Muchiru, Economic Officer

Ministry of Education

Prof. Karega Mutahi, Permanent Secretary
Mrs Miriam Mwirotsi, director of Planning
Mr. Simon Karanga, Principal Economist
Mr. Kimathi Mugambi, Deputy Chief Finance Officer
Ms. Nancy Kinyua, Principal Accountant

External cooperation partners

Mrs Birthe E. Larsen, Technical Advisor Financial Management, Ministry of Foreign Affairs of Denmark
Mr Carl Hellman, Economist, Sida
Mr. John Randa, World Bank
Mr. Jan Hansen, EC
Mr. Achim Blume, GTZ
Mr. Tim Lamont, DFID

ANNEX 5

DOCUMENTS CONSULTED

Documents Consulted

Kenya: Country Integrated Fiduciary Assessment, World Bank, February 2006

Kenya Poverty Reduction Strategy Paper: 'Investment Program for the Economic Recovery Strategy for Wealth and Employment Creation and Joint IDA-IMF Staff assessment, April 9, 2004

Government of Kenya, Strategy for the reform of Public Financial Management, December 2005 respective February 2006

Project Appraisal Document, Institutional Reform and Capacity Building Technical Assistance Project, December 2005

Kenya: Public Financial Management Performance Report, working draft, World Bank, May, revised August, 2004

National Audit Workplan, KRA, 2005

Internal Audit Manual, IA, November 2005

Public Audit Act, 2003

Government Financial Management Act, 2004

Regulations to the Government Financial Management Act (The Internal Auditing Department), 2006

Payroll Audit Review Police Department, IAG, January 2006

Payroll Audit Review Ministry of Agriculture, February 2006

The Report of the C&AG for the FY 2003/2004

Draft Strategic Development Plan for the Internal Audit

Strategic Development Plan (2004-2009) for the Kenya National Audit Office, July 2004

Sida at Work, September 2003

The Audit Handbook, KRA, 2005

Handbook on Governing responsibility in Kenya, GoK. November 2005

Kenya PRSP, World Bank, April 2004

DAC guidelines: Strengthening Procurement capacities in Developing Countries, OECD, 2005

Budget Outlook Paper, GoK, 2005

Budget Strategy Paper, GoK, May 2005

Log Frame from July Workshop, Ministry of Finance, PFM Reform Secretariat, 2005

Status Report on satisfying PEM-AFF 16 Bench Marks for the Government of Kenya – October 2005 (spreadsheet)