



Budget Brief

Drafting Regulations for Kenya's *Public Financial Management Act 2012*: Key Concerns Related to Transparency

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Introduction

On 27 June 2012, Kenya's parliament passed the long awaited Public Financial Management Act (the Act). About a month later, on July 23, the Act was signed into law by the President. The new PFM law provides a framework for the budget process at both the national and county level. Like other PFM laws around the world, often known as "organic budget laws," Kenya's 2012 PFM Act is a comprehensive piece of legislation that establishes how much formal discretion the executive branch of government has, which information related to public finances is to be made available to whom and when, how and when the government should consult with the legislature or with citizens about public spending, and how government officials will be held to account for mismanagement of public funds.

Although the law is over 200 pages long, it nevertheless still leaves many important matters to be determined by regulations. Given that such implementing regulations can often enhance or undermine key provisions of statutes, and given that they are already likely under consideration by government, it is imperative that civil society analyze the legislation and advocate for regulatory provisions that preserve and expand (where possible) the transparency and public participation provisions of the new PFM law.

The purpose of this Brief is to offer a preliminary assessment of the law (based on the last known version and amendments, as we do not yet have access to the final approved language) in order to guide civil society advocacy around the regulations related specifically to public disclosure of financial information. While the primary audience is civil society organizations in Kenya, the analysis and recommendations are relevant to those in other countries who are advocating for budget systems that are transparent and foster public participation. For those in Kenya, the Brief is meant to be read along with the legislation, as it refers to specific clauses in detail. The main recommendations are:

1. **The regulations should specify that all documents mentioned in the new law are to be made publicly available within a specific timeframe, preferably seven days after release.** The law's provisions for some budget documents already contain a timeframe for publication, but a number of critical documents are not required to be released within a specific timeframe. For example, the law mandates the production of Budget Estimates, new reports on state corporations, and a supplementary budget, but does not specify when these should be made public.

2. **The regulations should specify that some additional documents will be produced and published beyond what is contained in the law.** International best practice guidelines, including the IMF's *Code of Good Practices on Fiscal Transparency* and the OECD's *Best Practices for Fiscal Transparency*, recommend that all governments produce an expansive set of budget documents. Drawing on these guidelines, the International Budget Partnership recommends that all governments produce at least two documents that are not required by the PFM Act: a Mid-Year Review of budget performance, and a simplified Citizens Budget. These documents should be required and defined in the regulations.
3. **The regulations should clarify the structure of documents and ensure that the definition of public availability is expansive.** The regulations should ensure that all documents are prepared in a user-friendly format, with clear and simple language to the extent possible. All documents containing figures should also contain narrative explanations of these figures. Moreover, the regulations should go further than the law to ensure that all documents are published online as well as being physically available in government offices. It should be mandatory for budget documents to be available at the lowest level of government office (county, ward, etc.) to ensure that they are easy to obtain.

It is to be hoped that this Brief can be modified as more information becomes available about the final law and the process of drafting the regulations. The next section of the Brief provides an overview of the new budget process as laid out in the law. Readers may wish to skim this section and then refer back to it as they consider the recommendations presented in the remaining sections.

Box 1: Kenya's Budget Process Under the new PFM Act

Before assessing the Act's transparency and participation provisions, it is important to outline the key steps in the budget process as they are envisioned by the law. In this section, therefore, I start by reviewing the national budget process, and then quickly provide an overview of the county process. The national process is mirrored substantially at the county level.

The financial year in Kenya will continue to start on July 1. The budget process will begin with a circular from the Treasury that will define the schedule for the entire year. The circular is also intended to identify "key policy areas and issues that are to be taken into consideration when preparing the budget." This circular is to be issued by August 30. In other words, the budget process for the coming year formally begins with a timetable and an overview of main themes two months after the beginning of the current fiscal year.

From August to February, the budget process is largely run by the executive as an internal process. On February 15, the Act requires the tabling in the National Assembly of the Budget Policy Statement (BPS), which is known internationally as a **Pre-Budget Statement** (25:2). The purpose of this document is to provide a forecast for the economy that serves as the basis for expectations about revenues and expenditures in the coming budget year. The document is intended to stimulate a debate about the broad outlines of the budget prior to the tabling of the detailed estimates of spending.

The BPS is also intended to serve as the basis for an agreement between the executive and the National Assembly about the broad outlines of the budget because the National Assembly must actually pass a report adopting the BPS (with amendments, if desired) within two weeks of tabling (thus by the end of February). The National Assembly should also receive a report on the government's debt management strategy by February 15, to consider along with the BPS (33:1).

In addition to the BPS and the debt management paper, the National Assembly will receive the Division of Revenue Bill and the County Allocation of Revenue Bill at the same time. These are the bills, mandated by the Constitution, that will determine the division of revenue between the national and county levels of government, and among the county governments. This is logical: in order to start the debate over the budget, a proposed division of revenue between the two levels of government must have been decided. And a proposal for how that money will then be divided between counties is also directly linked to the overall

resources available.

The full Budget Estimates (the **Executive Budget Proposal**, in international parlance) are to be tabled in the National Assembly by April 30. This date is fixed by the Constitution, which requires that the National Assembly have two months to debate the budget before the beginning of the fiscal year. A new feature of the budget process is that the estimates for the National Assembly and the Judiciary are no longer to be submitted by Treasury, instead they are to be prepared independently by each branch. They are also, according to the Act, to be submitted by April 30 (37:3-4). Treasury is to submit its comments on these independent submissions by May 15 (37:6).

The National Assembly must pass the estimates (again, with amendments if desired) by June 30 (39:1). Note, however, that the procedure is for these estimates to be first considered by the Budget Committee in the National Assembly, which will then submit its report and recommendations to the full Assembly for debate prior to the June 30 deadline (39:2). The Constitution (221:5) requires that this committee also “seek representations from the public” before tabling its report. The Constitution is not entirely clear, but it appears that the National Assembly can only amend the Executive Budget Proposal in line with the recommendations made by the Budget Committee (see the Constitution, 114:2).

In the past, the budget was read in parliament by the Minister of Finance in early June. This date is set by the East African Community as the common date for all member countries to read their budgets in their respective legislatures. This practice is no longer of much significance in Kenya, since the National Assembly will have already had the budget for over a month, but it is noteworthy that the Cabinet Secretary for Finance will still, according to Article 40, make a “pronouncement” in the National Assembly in accord with the EAC regulations and timetable. This means that the Budget Estimates are likely to be released by April 30, but the Budget Statement or Speech, which is the narrative explanation of the budget, will come only in early June.

The next milestone in the budget process is the release of the Budget Review and Outlook Paper (BROP). This is both a backward and a forward looking paper: it is released at the end of the first quarter of the financial year (by September 30), and it is intended to serve as a kind of year-end review for the previous financial year. However, it is also supposed to contain proposals to address “deviation from the financial objectives” in the previous fiscal year, and to update the forecasts that informed the current year’s budget, as contained in the Budget Policy Statement from February (26:1).

In addition to these key dates, the National Assembly will receive reports 45 days after the end of every quarter that assess budget implementation during the course of the financial year (83:5). These reports, known as **In-Year Reports** in international jargon, allow the National Assembly to exercise oversight of spending throughout the year to monitor government achievement of targets.

The Bill also lays out a budget process at county level, and this is substantively quite similar to the national process. There are some minor deviations described below. Though this Brief does not focus on the county level, it is important to note that the limitations identified at the national level apply equally to the county level. Each county will have a county Treasury, similar to the national Treasury, which is responsible for managing the budget process at county level. The budget process starts at county level, as at the national level, with a circular from the county Treasury on August 30. At the county level, however, there are a few additional elements to this process. First, the county executive is to table a “development plan” by September 1. It is not entirely clear what the purpose of this plan is, but it is potentially designed to put the county budget process in a medium-term perspective, like the Medium Term Expenditure Framework (MTEF) process at the national level, which establishes a three-year budget timeframe (this is implied in 126:1(a)).

Each county shall have a County Fiscal Strategy Paper (CFSP), similar to the Budget Policy Statement. This document shall be tabled in the County Assembly by February 28. This presumably allows the County to take into consideration the BPS (released on February 15) when finalizing its own Fiscal Strategy Paper (this is implied by 117:2, which requires the County Treasury to “align” its CFSP with the “the national objectives” in the BPS). As at the national level, the CFSP must be adopted (with or without amendment) by the legislature within 14 days of tabling. The CFSP, as at the national level, will be accompanied by a report on the county’s debt management strategy (Article 123).

The county budget estimates must be submitted to the County Assembly by April 30, just like the national budget estimates. And they shall be approved, with or without amendments, by June 30, in time for the beginning of the new financial year. The county is also required to provide another document, a cash flow

projection, by June 15.

Just as at the national level, a County Budget Review and Outlook Paper should be tabled by the end of the first quarter of every fiscal year (118), and this is both a backward and forward looking document. Having outlined the budget process, we can proceed to assess areas where the Act is weak on transparency, and where regulations may be able to enhance its provisions.

Key Concerns About Transparency Provisions

Definitions

Some of the most important matters in the PFM Act are handled in the definitions section. For example, the law takes a step in the right direction by clarifying the meaning of the terms “recurrent” and “development” expenditures, which should end the confusing practice in Kenya (but not exclusive to Kenya) of labeling recurrent expenditures that are funded by donors as “development” spending. The country will now adopt the more conventional approach of labeling spending as either recurrent or capital, with “development expenditure” defined to mean “expenditure for the creation or renewal of assets,” regardless of funding source.

In this section, too, the law sets certain standards for publishing and publicizing information. It is proper to set standards in the definitions section of the Act that can be applied to all of the reports and documents that are discussed later. This can help to simplify and standardize what is meant by providing public access to financial information.

However, the contents of the standards adopted in the law are wanting. In the first place, the definition of “publicise” says that a document must be made known to the public “through the national or local media.” This definition (perhaps inadvertently) allows government to publicize important national documents through local media only, which is inappropriate. **The regulations should clarify that all documents pertaining to national financial matters must be published in national media.**

More critically, the definition of “publish” is to put the document in the newspaper, *or* to publish an abridged copy, *or* to make the document available in government offices/libraries, *or* to post it on the Internet. This means that if an important national document is stored in the archive of a government agency, this is equivalent to posting it on the Internet. **The regulations should clarify that all documents, in order to be considered “published,” must be available online, as well as in libraries and offices of government agencies in their unabridged version.** These documents should also be made available not only in national offices but also in the lowest level government office, whether that it is a county, a ward or some other office. Citizens should not have to go to Nairobi to obtain budget documents.

Finally, if the idea behind including a definition of publish is to standardize the meaning of public access to information, then the definition should also include a timeframe for release. For reasons that are difficult to understand, the timeframe given in the Act to Treasury and others to publish documents after they are tabled in the National Assembly ranges from seven, to 15, to 21 days, to whenever “practicable.” **It would be better to set a global standard that “publish” means to make available to the public immediately upon tabling in the National Assembly, and in no case later than seven days after tabling (or within seven days of reporting to the relevant oversight body where that is not the National Assembly).** Wherever the legislation indicates that a document shall be published “as soon as practicable,” the regulations should clarify that this means a period no longer than seven or 15 days. Moreover, the regulations could clarify that all documents referred to in the Act, unless otherwise specified, should be made available to the public. This would create a default bias in favor of disclosure, except where the National Assembly has raised specific concerns about publishing certain kinds of information.

The Budget Process

As described in Box 1, the budget process consists of several stages: formulation of a budget proposal by the executive that is tabled in the National Assembly; debate, amendment, and approval of the proposal; implementation of the approved budget; and audit of the implemented budget. This section discusses the documents associated with each stage of the budget process, assesses the associated transparency provisions, and makes recommendations for the related regulations.

At the formulation stage, as we have seen, the Act requires the tabling in the National Assembly of the Budget Policy Statement by February 15, six weeks before the Budget Estimates. The Act further states that the BPS must be made available to the public within 15 days of tabling. This gives the public at least one month to review the document before the Estimates are tabled, which is consistent with international best practice.^{1,2}

However, the 15-day grace period for publishing the BPS is problematic, as the PFM Act requires the National Assembly to debate and adopt the BPS within 14 days of tabling. Therefore, this clause allows for the possibility that the BPS could be debated and approved before the public had ever seen it. The BPS should be made available to the public immediately upon tabling in the National Assembly (and no later than seven days after it is tabled). **Regulations could state that the BPS must be made available to the public before it is adopted by the National Assembly.** This would avoid any contradiction with the statute but effectively prevent a situation where the National Assembly debates and passes the BPS without public scrutiny. Curiously, the Act already states that the analogous paper at county level, the County Fiscal Strategy Paper, should be published within seven days of tabling in the County Assembly (Article 117:8).

Perhaps the most important moment in the budget process is when the Estimates are tabled in the National Assembly, and the National Assembly has two months to debate and amend them. This is the main opportunity for the public to have a voice: the National Assembly is required by the Constitution to “seek representations from the public.” In order to make representations, however, the public needs to be able to see the Estimates. Yet the Act provides no explicit deadline for making the Estimates available to the public. In fact, it only says that these shall be “publicise[d]” by Treasury “as soon as practicable” (Article 37:8). Thus total discretion is left to the Cabinet Secretary as to when to share the single most important budget document with the public. This year, the public had not received the estimates over five weeks after they were tabled, and several weeks after they were requested to make “representations.” In fact, they were not made available until after the budget was approved. **The regulations should ensure that the Estimates are published immediately after they are tabled in the National Assembly, and no later than seven days after tabling.**

Another problem that has surfaced this year and that should be remedied by the regulations is that the Estimates are now tabled by April 30, but they are not accompanied by any narrative. Traditionally, the Estimates would be tabled with the Budget Speech or Budget Statement, which provides narrative explanation of the many figures, and also synthesizes and highlights key provisions of the budget. This may continue to be made available in early June, as per EAC practice, but that means in effect that the Estimates are available for five weeks without the summary documentation that is typically used to analyze them. This weakens the value of disclosure by allowing a practice that should be prohibited: dumping data on the public without the qualitative information needed to understand it. **The regulations should require either that the Estimates and the Budget Statement should be made available together by April 30 to the National**

¹ “International best practice” in this Brief refers to guidelines for budgeting that have been drawn upon to construct the International Budget Partnership’s Open Budget Index. These include the IMF’s *Code of Good Practices on Fiscal Transparency*, the OECD’s *Best Practices for Fiscal Transparency*, and the International Organization of Supreme Auditing Institutions’ (INTOSAI) *Lima Declaration of Guidelines on Auditing Precepts*. The strength of such guidelines as the IMF Fiscal Transparency Code and the Lima Declaration lies in their universal applicability to differing budget systems around the world and to countries with differing income levels.

² However, this year, the BPS was tabled late in the National Assembly and made available to the public only one day before the Estimates were tabled in the National Assembly. Obviously, the provisions in the PFM Bill are only relevant if they are followed.

Assembly and the public, or at a minimum, that the Estimates be accompanied by some narrative information if not the official Budget Speech/Statement itself.

After the budget is approved, Treasury has 21 days to make the approved budget available to the public. **It would be preferable that all documents are made available in a standardized time period, ideally within seven days.** The bigger problem is that the Act does not require the production of what is known as a Citizens Budget, a simplified, readily accessible presentation that highlights key revenue and expenditure elements of the new budget for average citizens.

Treasury produced such a document last year for the first time, which was an encouraging sign, and it has produced a new version for FY 2012/2013. **It would be even more encouraging if the regulations committed the Treasury to produce a Citizens Budget every year.** Moreover, the regulations could specify some of the minimum contents of this document. For example, a Citizens Budget should contain, at least, the figures from last year and the new budget year for all major administrative units so citizens can identify any changes between the two years in government priorities. Kenya's Citizens Budgets have not consistently met this minimum standard. The regulations could also require Treasury to periodically consult with citizens about the kind of information they would like to see in a Citizens Budget.

Once the budget has been approved, the focus of the budget process shifts to monitoring its implementation. The Act requires the national Treasury to table in-year budget execution reports in the National Assembly on a quarterly basis. International best practice would be to table these reports every month, but the Act is still within the realm of good practice. Moreover, 83:5(b) requires that these reports be published and publicized, and the language of the clause implies that both the National Assembly and the public will have access to these within 45 days of the end of the quarter. Again, this is not best practice, but it is still good: best practice would be to publish within 30 days. However, note that the same report at county level is to be published within 30 days (Article 166:4). **It is hard to see why the national Treasury should not be required to meet the same standard as the county Treasuries, and regulations should be used to ensure that these in-year budget execution reports are produced more frequently and more rapidly (within 30 days).** The regulations should also insist that in-year budget execution reports follow the same classification system used for the Estimates to facilitate comparison.

The Constitution actually sets out the basic procedure for requesting a supplement to the budget. A supplementary budget is a revised set of estimates that is tabled during the budget year to adjust the original budget due to unforeseen circumstances. The Act adds little to the process of approving a supplementary budget beyond what is described in the Constitution, but oddly, it makes no provision for the supplementary budget to be published. Nor does it require the budget to be accompanied by an explanation of why the requested allocations were not foreseen in the original budget (Article 44). Supplementary budgets are often necessary, but they can undermine the budget process, since certain expenditures are not balanced against the rest of the budget along with all other spending items. **Regulations should require that government explain the need for each item in the supplementary budget to ensure that the use of supplementary budgets does not unduly undermine the budget process. The regulations should also insist that the supplementary budget is published within seven days of tabling.**

In some countries, a supplementary budget is normalized as an event that regularly occurs around the middle of the financial year, and it is sometimes linked to a Mid-Year Review of the budget. In Kenya, the BROP has some elements of the MYR, because it reviews the assumptions of the BPS about six months later. However, this is only the end of the first quarter and it is often too early to get a good sense of whether the budget is being implemented appropriately and the assumptions and forecasts were correct. It, therefore, is considered good practice to release a MYR after the second quarter that updates the assumptions of the approved budget itself. This report should also include an update of, and explanations for deviations from, the original estimates. **The regulations should introduce a MYR after the second quarter in keeping with international best practice.**

The final stage of the budget process is when accounts are audited. The Act introduces a set of actions that “may” indicate that a public entity is in “serious material breach” of its obligations. These include a failure to submit financial statements to be audited by the Auditor General within 60 days of the required date. **This is welcome, but it would be better if the regulations established that the list of enumerated actions that may be taken by a state agency, including failure to submit financial reports, shall indicate, rather than may indicate, a material breach.**

The Act otherwise does not say much about the audit phase of the budget process. Some audit matters are handled in separate legislation on the Auditor in Kenya. **However, it is appropriate to use the regulations to legislate publication of audit reports, which are part of the budget process, and to ensure the publication of reports that highlight the follow up (or lack thereof) on adverse audit findings.** This is the only way to bring sufficient public pressure to bear on wayward public agencies that are repeatedly cited by the Auditor for poor performance.

Other Fiscal Matters

Beyond the traditional budget process, there are various other areas of fiscal policy that are regulated by the PFM Act. Some of these relate to funds that are part of the budget (such as debt or tax subsidies) and others relate to funds that are “extra-budgetary,” meaning that they are public but do not form part of the budget and often do not flow through Treasury. For example, when a public agency charges citizens a fee for a good or service it provides and does not remit these funds to the Treasury, they are considered “extra-budgetary.” Traditionally, Kenya has referred to many such fees as “Appropriations in Aid.” In this section, I look at the transparency provisions around these other areas of fiscal policy.

The Act has good disclosure requirements for government loan guarantees. According to Article 59, Treasury must report to the National Assembly and publish a statement detailing any loan guarantees that have been entered into by government within 14 days of entering into the guarantee. This statement must include a risk assessment, as well as the basic details of the guarantee. This is exactly the kind of disclosure that should be more common within the Act.

Article 82 of the Act addresses the matter of tax exemptions or waivers, and is a positive step toward greater disclosure of tax expenditures. The Act requires an annual report within three months of the end of the financial year that will lay out all tax waivers, the beneficiaries, and the reasons for the waiver. **The regulations could be tightened to ensure that this report includes all tax expenditures, and a full costing of the loss in revenues associated with each (this may be intended by 82:5b, but it is not specific enough).** The language of the Article is not entirely clear with respect to when the report should be published, however, and this should be remedied. In line with other reports, there is no reason that it should not be published immediately upon tabling in the National Assembly or within seven days.

The PFM Act allows the government to engage in derivatives transactions. This is not necessarily problematic, but international evidence suggests that derivatives are complex, risky, and opaque instruments and that governments (and private actors) have not always handled them well. It is, therefore, a positive step that Article 56 requires publication of “derivative transactions entered into.” However, no further instructions are given for how or when this information should be published, and this opens the door for government to engage in risky operations without disclosure until it is too late for effective oversight from the National Assembly or the public. **In order to manage the risk associated with these instruments, the regulations should state that if the government is to engage in derivatives transactions, it should produce a strategy document that explains why and how it will use these derivatives on an annual basis, and it should report to the National Assembly and the public on the use of derivatives on a monthly basis.** An alternative would be to follow the reporting requirements for loan guarantees specified in Article 59, which requires that these be reported to the National Assembly within 14 days of entering into the guarantee.

The Act has put in place some useful requirements for disclosure around debt, including the tabling of a debt management paper in the National Assembly by February 15 each year along with the BPS. However, the Act does not go far enough to ensure the public transparency of debt information. For example, in addition to the main report to be tabled in February, the Act seems to require the Public Debt Management Office to table additional reports (Article 64:2). However, no timetable is provided for making these public. **This should be remedied in the regulations, by requiring all debt-related reports to be published within seven days of tabling.**

One advance in the PFM Act is that it requires extensive financial reporting by state corporations (Article 89). The Bill would require an annual report, 4 months after the close of every financial year, on all state corporations, the subsidies they receive, the rationale for these, and a discussion of the links, whether through shareholding or otherwise, between government and each corporation. Every three years, an assessment of the value of continued government support is also to be done. These are good provisions, but there is no requirement that these reports be made public. **This should be addressed in the regulations, by requiring that all legislated reports related to state corporations be published within seven days of tabling in the National Assembly.** It is also noteworthy that Article 81, which requires all the national government entities to publish audited financial statements, does not seem to require the same of state corporations (see Article 81:5). **All state corporations must be required by regulation to publish their audited financial statements, and at least the previous five years' worth of statements should be readily available.**

Kenya's state corporations manage over 600 billion Ksh every year, of which approximately 140 billion takes the form of direct transfers from the budget. Yet these corporations manage their finances with very limited public scrutiny. In spite of adverse audit findings, many state corporations and quasi-independent agencies of government are never sanctioned or held to account. This is unlikely to change if basic information about these institutions is not made public.³

Conclusion

The PFM Act is an advance over current legislation and practice in Kenya, but it still falls short when it comes to transparency and public participation. The time is now to ensure that disclosure and participation are expanded, not undermined, through the subsidiary regulations. There is a need to ensure that all important budget documents are produced (including a Citizens Budget and Mid-Year Review), published within a week of tabling or submission, and readily available on an ongoing basis. This Brief has only covered regulations related to transparency, but there are also numerous regulations related to public participation and accountability that require scrutiny and public input. We hope that government will set up an open process to solicit views on all of the regulations required to implement the PFM Act now that it has been signed by the President.

³ Our recent Brief on National Hospital Insurance Fund found that the public cannot easily access the financial statements of state corporations in Kenya. See Jason Lakin and Vivian Magero, "Kenya's the National Hospital Insurance Fund Must Become More Transparent if it is to Anchor Universal Health Coverage," Budget Brief 14, International Budget Partnership, May 2012.