

**Kenya Good Governance Support Programme 2010-15
Public Finance Management Component**

Country: Kenya

Title: Kenya Governance Support Programme -
Public Finance Management (PFM)
Component

Implementing Partners:

1. National Treasury
2. Office of the Auditor General
3. Office of the Controller of Budget
4. Kenya Revenue Authority

Start date: March 2014

Duration: 2014 – 2015

Overall budget: DKK 36 million

Signatures:

On behalf of
the Government of Kenya

On behalf of
the Government of Denmark

Signature

Signature

Title

Title

Date

Date

Abbreviations

AGD	Accountant General Department
CoB	Controller of Budget
CPIA	Country Policy & Institutional Assessment
DKK	Danish Kroner
DP	Development Partner
GoK	Government of Kenya
IAD	Internal Audit Department
IFMIS	Integrated Financial Management Information System
KENAO	Kenya National Audit Office
KGGP	Kenya Good Governance Programme
KGSP	Kenya Governance Support Programme
KRA	Kenya Revenue Authority
M&E	Monitoring and Evaluation
MoF	Ministry of Finance
MTEF	Medium Term Expenditure Framework
MTP II	Second Medium Term Plan (2013-2017) of Kenya's Vision 2030
NT	National Treasury
OAG	Office of the Auditor General
PEFA	Public Expenditure and Financial Accountability
PFM	Public Financial Management
PFMR	Public Financial Management Reform
PPOA	Public Procurement Oversight Authority
SWAp	Sector-wide approach
TA	Technical Assistance

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1. Introduction

The Public Finance Management (PFM) component is the second component of the Kenya Governance Support Programme (KGSP) 2010-2015. Implementation of the KGSP commenced in January 2011 following signing of the Programme Support Agreement between the Government of Denmark and the Government of Kenya regarding development cooperation concerning KGSP in December 2010. The KGSP aims to support implementation of the Constitution of Kenya and strengthen checks and balances in Kenya's governance structure by supporting government agencies, quasi-government and oversight agencies and non-state actors.

The KGSP was subjected to a mid-term review in May 2013 whose purpose was to assess developments in the KGSP programme context and programme performance (results, progress, challenges, developments in risk factors, need for adjustment, etc.). Following the mid-term review, the PFM component has now been reformulated to align to changes in the PFM environment. These changes include the revised PFM legal and institutional framework particularly the PFM Act (2012); the devolved governance structure; and, the new policy framework notably the second Medium Term Plan (MTP II) and the successor strategy for Public Finance Management Reforms (2013-2018).

2. Justification

Kenya is considered to have the largest, most diversified and innovative economy in East Africa. The country has potential to reduce poverty and increase job opportunities not only to its citizenry but also to other countries within East Africa and beyond. Kenya has made significant strides in improving the overall economic environment with a performance always above that of the Sub-Saharan Africa (SSA) average.¹ The Government of Kenya, through the MTP II, plans to continue the growth trajectory and has prioritised, amongst others, governance and public finance management reforms to enhance transparency, accountability, service delivery and cost efficiency.

Further, Kenya is at a critical stage of implementing the devolved system of governance as espoused in the Constitution of Kenya (CoK) 2010. In addition to introducing 47 County governments with fiscal responsibility, the Constitution also established new PFM institutions such as the Commission on Revenue Allocation (CRA), Salaries and Remuneration Commission and Office of the Controller of Budget (COB) and expanded the mandate of the Auditor General. Additionally, the PFM Act 2012 has specified roles for the National Treasury and Parliament on public financial management. Capacity building is therefore required to enable various players fulfil their PFM responsibilities. Furthermore, so as to meet the enlarged financing demands of both the National and 47 County Governments there is need for increased efficiency and effectiveness in utilisation of scarce public resources.

¹ Country Policy & Institutional Assessment (CPIA) Reports, 2006-2012

Since 2006, the Government has undertaken PFM reforms which have contributed to the realisation of increased tax revenues, enactment of the first ever overarching PFM law and improved management of public funds through the re-engineered IFMIS and strengthening of control, audit and oversight institutions. To take forward the reform agenda, the Government in early 2013 approved the successor public financial management reforms (PFMR) Strategy (2013-2018), which aims to strengthen PFM systems in line with the CoK 2010 requirements.

Continued support to PFM reforms is essential to further entrench these successes and address existing and emerging gaps occasioned by the enhanced accountability and transparency requirements for PFM as enshrined in the CoK 2010 and the PFM Act 2012. Possible areas for support include:

- (i) Support implementation of the **PFM Act (2012)** and of the **Integrated Financial Management Information System (IFMIS)** at national and county levels.
- (ii) **Capacity building at national and county government levels** to address inadequate PFM capacity for fiscal decentralisation. County Governments are facing problems while operationalizing financial management, partly due to capacity problems.
- (iii) **Strengthening of control, audit and oversight due to the expanded mandate to cover both national and county governments.** In line with the extended scope in terms of numbers and required skills, control, audit and oversight institutions are likely to face challenges in carrying out audits and submitting reports on a timely basis due to capacity issues.
- (iv) **Strengthening tax administration in order to raise adequate revenues to finance the national and county governments.** The country is currently experiencing increased financing demands associated with implementation of the Constitution.

The Embassy proposes to support reform efforts in select actors with a key mandate for PFM capacity building; fiscal decentralisation; control, audit & oversight; and, tax administration under the re-formulated PFM component. The support will be provided over the remaining two years of the KGSP, and will entail both financial and technical assistance towards implementation of key reform activities of the organisational strategic plans and/or reform documents within the broader framework of the PFMR Strategy (2013-2018) including the institutional and implementation arrangements contained therein.

These efforts are intended to contribute towards improved collection, management and scrutiny on use of public funds. This will support the efficient delivery of services, and improve the accountability of public funds, both of which are key to development and poverty reduction in Kenya. This is consistent with the strategy for Denmark's Development Cooperation, The Right to a Better Life.

3. Summary of design

The Embassy, through the (reformulated) PFM component, aims to sustain and build upon previous Danish support for PFM reforms. Moreover, the Embassy seeks to continue support of GoK's efforts to enhance accountability and transparency by supporting targeted PFMR reform activities within the PFMR Strategy. The PFMR Strategy outlines the following seven thematic areas: (i) Resource mobilisation; (ii) Resource allocation, (iii) Budget execution, accounting and reporting, (iv) Independent audit and oversight (v) fiscal decentralisation and intergovernmental fiscal relations, (vi) legal and institutional framework; and (vii) IFMIS re-engineering. Of the seven thematic areas, this PFM Component emphasises support to specific areas within four themes of Independent audit, fiscal decentralisation, IFMIS re-engineering and resource mobilisation.

The PFM component is therefore expected to contribute towards the overall KGSP; as well as sector programmes on health and natural resources management being undertaken by the Embassy. Going forward, as the Danish Embassy progresses towards country programming and increased use of country systems, continued strengthening of PFM systems is fundamental.

As its predecessor, this PFM component seeks to uphold aid effectiveness principles. As such, the proposed support is aligned to GoK's **PFMR Strategy 2013-2018**, which in turn speaks to Vision 2030, Kenya's long term development blueprint. Additionally, the PFM component seeks to use country systems for financial management and procurement to the extent possible. Any deviations are proposed as a transient measure. The Embassy will maintain close collaboration and coordination with other development partners supporting PFM reforms, and especially Sweden and World Bank, who jointly intend to support for the Office of the Auditor General. The Embassy will also maintain active participation in the PFM Joint Government-DPs Working Group and DPs Group for policy dialogue and coordination respectively. Finally, the PFM component encourages a results orientation and will provide support to develop the M&E framework for the PFMR Strategy; and support PFMR M&E.

The PFM component is in line with The Strategy for Denmark's Development Cooperation² which presents four priority areas and four fundamental principles. The PFM Component places particular emphasis on transparency and accountability principles as mirrored in the overall goal of PFM reforms in Kenya. Further, the component addresses the three core areas identified in the Danish strategy on Effective and Accountable Public-Sector Management. The support will primarily target public financial management, and by so doing address both the fight against corruption and local service delivery and governance.

² The Right to a Better Life – Strategy for Denmark's Development Cooperation presents four interconnected four priority areas for Danish Development cooperation namely: Human rights and democracy; Green Growth; Social Progress; and, stability and protection. The Strategy further identifies four fundamental principles as non-discrimination, participation and inclusion, transparency and accountability.

The Embassy is in process of developing its country Policy Paper for future support to the Kenya for the period 2015-2019. Going forward, Danish support is to be formulated under a single country programming approach, a departure from past practise, whereby support was sector based. The Country Policy Paper identifies ‘implementing the Constitution towards a prosperous and equitable Kenya’ as a strategic focus area, amongst others³. The Paper notes that implementation of devolution will require effort and recognises the possible role that external support can play in supporting the transition to devolution in areas such as policy development, institutional strengthening, capacity building and public financial management.

As such, the PFM component will seek to bridge the move to country programming and support the transition to devolution through targeted support for PFM institutions, system and capacity building. The Embassy’s general support for devolution is channelled through the first component of the KGSP.

4. National sector context

Political environment: Kenya promulgated the new **Constitution** following a referendum in August 2010, which introduced a two-tier government - a national government and 47 county governments - with distinct functions outlined in the Fourth Schedule. Devolution is hoped to bring best opportunity to build trust in government and improve services and this lies with the performance of the 47 new county governments.

The Constitution is supported by the **PFM Act (2012)**, which covers National and County Governments. The Act clearly specifies the new roles of the National Treasury and Parliament for the oversight of public finances. The Act includes strict provisions on budget preparation; regular reporting to parliament; stakeholder consultations; information sharing; and intergovernmental fiscal relations. The Act also provides for the establishment of a Treasury Single Account at the national level and in each of the counties, a vital measure to strengthen cash management, reduce borrowing costs, and increase transparency in public finances. The accompanying regulations are yet to be finalised. Other key laws relevant for PFM include the Public Procurement and Disposal Act (2005) and Public Audit Act (2003).

As expected, changes in the political leadership and appointments to key public institutions, including the key institutions such as the National Treasury, have at times, undermined policy continuity and the overall performance of the key organizations and the economy.

PFM is instrumental in the fight against wasteful spending and corruption as it improves access of financial data, audit related to risks and results, open and competitive procurement processes, and commitment control. A good PFM system assists the country in delivering quality services to its citizens. A major link between PFM functions and government impact on the macro economy is control of fiscal deficits and overall debt management. PFM

³ The Danish Country Policy Paper presents three strategic focus areas of (i) Implementing the constitution towards a prosperous and equitable Kenya; (ii) Inclusive green growth and employment; and (iii) Regional cooperation and stability.

systems that support effective fiscal management and a debt strategy aimed at sustainability can contribute to an improved macroeconomic situation by avoiding unsustainable deficits.

PFM Assessments: The Country Policy and Institutional Assessment (**CPIA**) **2012** report notes that Kenya has realized significant strides in improving the overall economic environment with a performance always above that of Sub-Saharan Africa (SSA) average. This improvement is attributed to better economic management and proactive policies that increase opportunities for higher growth with equity. Although there have been some improvements in the Public Sector Management and Institutions cluster, it has continued to record the lowest performing cluster scoring 3.4 out of the CPIA score of 6. The cluster has continued to lag all the others reflecting persisting governance challenges.

Additionally, the Public Expenditure and Financial Accountability (**PEFA**) **2012** Assessment report shows that although there has been substantial improvement in comprehensiveness and transparency of the budget, many procurement operations in line ministries are still non-transparent. Moreover, Kenya's performance in the accounting and reporting aspects has persistently deteriorated and scored below average. The report further notes that the budget performance reports are prepared on, monthly, quarterly and annual basis, but the sources of information tend to be different. It further notes that there were problems in preparing accurate end-year accounts, partly due to lack of accounting discipline, and also incomplete data in IFMIS, some of which date back several years while in some cases the data is still held in manual form.

These PEFA results are in tandem with the findings of the **Use of Country System (UCS) report 2012**⁴. According to this report, there is widespread concern about weak accounting and record keeping in government ministries, departments and agencies for donor funded projects. Additionally, DP projects' classification systems and expenditure codes (which are based on inputs, programs, components, outputs, outcomes, and functions) are not always compatible with the GOK Chart of Accounts (containing financial items only).

First PFMR Strategy: Between 2006 and 2012, the Embassy supported implementation of the Government of Kenya's PFM reforms through the 'Strategy for the revitalisation of public financial management system in Kenya'. This Strategy sought to provide a comprehensive framework and guide for PFM reforms in Kenya with the aim to strengthen PFM systems to enhance transparency, accountability and responsiveness of expenditure to policy priorities. It was structured along 15 components, grouped into 6 pillars comprising government ministries, departments and agencies. The Strategy was expected to cost US\$114.5m with joint donor support being channelled through a PFMR Basket Fund administered by the PFMR Secretariat, housed at the Ministry of Finance.

⁴ The Use of Country Financial Management Systems by Donor-Financed Projects was commissioned by the Government of Kenya's Ministry of Finance (MOF) and the Public Finance Management – Donor Group (PFM-DG). The World Bank and Embassy of Denmark-Nairobi (DANIDA) provided technical and financial support.

Several development partners – World Bank, EU, DFID, SIDA, Norway, JICA, GIZ, USAID and the Embassy (DANIDA) – supported implementation of the Strategy. Of the total US\$23.74m availed by development partners, the Embassy provided financial support of DKK 14.2million (approx. US\$ 2.8m). However, the bulk of the Danish contribution was utilised during the transitional workplan period (January 2012-March 2013) co-funded jointly with SIDA/Embassy of Sweden and Canadian CIDA.

Key achievements during the period included (i) the establishment of a sound PFM legal and regulatory framework by the enactment of the Public Financial Management Act (2012) (ii) National level roll-out of the Integrated Financial Management System (IFMIS) & adoption of a new Chart of Accounts; (iii) roll out of Program Based Budgeting; (iv) Use of Country Systems (UCS) study; (v) Strengthening of the Office of the Auditor General (OAG); and, (vi) development of the successor PFMR Strategy (2013-2018).

Lessons Learnt

The final evaluation report⁵ of the implementation of the first PFMR Strategy noted the following challenges to the successful implementation of the first Strategy: (i) low levels of ownership of the programme attributed to lack of involvement in development of the Strategy; (ii) poor absorption of development partner funds attributed to delayed disbursements and lengthy procurement procedures; (iii) low levels of communication between the Components and Secretariat as well as development partners; and, (iv) the lack of a clear monitoring plan. Similarly, the KGSP Lessons Learnt Review⁶ highlighted the need for senior management ownership and buy-in; strategic human resource management planning appropriate institutional and implementation arrangements; and, establishment of an M&E framework as key factors for successful implementation of the next PFMR programme.

As such, the KGSP mid-term review report⁷ notes that the successor PFMR Strategy (2013-2018), alone will not be sufficient to entrench PFM reforms. Rather, the following three critical elements need to be developed and put in place, namely: (i) leadership and management structures for PFM reforms; (ii) Monitoring & Evaluation framework and procedures; and (iii) integration of PFMR operational workplans including allocation of responsibilities and deliverables within existing GoK department activities and performance contracts. The Embassy proposes to support implementation of the above elements of the current PFMR Strategy through this PFM Component. Additionally, the Embassy will seek to maintain close engagement and dialogue with participating agencies and support the use of country financial management systems.

⁵ Strategy to Revitalise Public Financial Management Reforms, 2006 to 2011 (including the transition period to June 2012, Evaluation Report. December 2012. By KPMG.

⁶ Kenya Good Governance Programme (KGGP) Lessons Learned Review, Final Report, May 2013. The Consulting House.

⁷ Ministry of Foreign Affairs, Denmark. Review Aide Memoire: Review of Kenya Governance Support Programme (2010-2015). June 2013

PFMR Strategy 2013-2018: The current Strategy emphasizes consolidation of gains made under the first PFMR Strategy. It also provides a framework for implementing PFM reforms envisaged in the Constitution, the Public Finance Management Act 2012 and other relevant legislation. Most importantly, the Strategy addresses areas of concern highlighted by the report of the Public Expenditure Finance and Accounting Assessment (PEFA), 2012.

The Strategy has seven priority themes important for realizing effective public financial management reforms. Four of the themes relate to the annual budget cycle (resource mobilization; resource allocation; budget execution, accounting and reporting; audit and oversight) while the remaining three themes are cross-cutting (fiscal decentralization; the PFM legal framework and automation and integration). There are champions and actors identified within each thematic area that will be responsible for reform implementation and will ensure that reforms are mainstreamed within the Government planning and work processes.

Within these thematic areas, priorities identified for immediate implementation include: (i) full implementation and utilisation of the Integrated Financial Management Information System (IFMIS); (ii) Fiscal Decentralization – put in place a framework for identification, assigning and costing of functions that are to be decentralized from national to county governments as well as to provide a framework for intergovernmental fiscal relations; (iii) Independent Oversight enhancing the capacity of independent audit and oversight institutions at national and county government level; (iv) rollout of the national and county level Programme Based Budgeting; (v) enhancing revenue collection by broadening the tax base, improving tax compliance etc.; (vi) revision of the Procurement law; amongst others.

Implementation arrangements

A PFM Reform Steering Committee, chaired by the Cabinet Secretary of the National Treasury is expected to lead the Reform Programme, overseeing the work of the PFM reform Technical Committee. The participating agencies and department be responsible for implementation, while the PFM Secretariat is to support and coordinate funds flow, reporting and monitoring and evaluation. Development Partners are expected to engage with the Steering Committee as well as provide technical and financial support to implementing agencies.

Development partners: involvement, coordination mechanisms and capacities:

Currently, more than 10 development partners are active in the PFM ‘sector’ providing both technical and financial assistance. Key among these are IMF, World Bank, EU, USAID, GIZ and the Embassies of Sweden and Denmark. The Development partners meet monthly at the DPs Group, presently led by the EU with Denmark as the Deputy for the 2013/2014 financial year.

Aid effectiveness: Despite established PFM structures, use of country financial management and procurement systems is still relatively low and is often blamed for low performance in donor practices and accounting, recording and reporting in the OECD/DAC survey of the Paris Agenda. This is also often cited as the major reasons for

prevalence of off-budget spending. Furthermore, lack of a national aid policy has also been a contributing factor to minimal use of country systems by donors at national level as well as contributing to the lack of a comprehensive record of donors' off-budget support to Kenya. The latter problem may be exacerbated due to donor engagement at County level.

The approval of the draft Kenya External Resources Policy as well as full operationalization of E-ProMIS is hoped to improve donor practices, promote accountability and transparency by making all information on aid flows accessible online, to all actors in the country.⁸ Implementation of devolution brings the urgent need to move to more harmonized and coordinated donor support to sub-national PFM reform and, a strong basis for improved donor coordination for PFM reform to guard against problems with coordination, funding gaps and overlapping of donor support for certain reform activities.

Key sector institutions, their capacity and core mandates: Key institutions in the PFM 'sector' may be grouped under three broad categories of (i) Independent offices and Commissions; (ii) Ministries and departments; and, (iii) Semi-Autonomous Government Agencies.

Independent offices include the office of Controller of Budget and of the Auditor General. Prior to the CoK 2010, these were co-joined as the Controller & Auditor General, governed by the Public Audit Act 2003. Following the promulgation of CoK, 2010 two independent offices have since been set up. The **Controller of Budget (CoB)** is mandated to oversee implementation of budgets of National and County Governments by authorising withdrawals from public funds⁹; and is expected to report to Parliament every four months¹⁰ on the same. Also, the CoB is mandated to advise Parliament on stoppage of funds to any government entities. The **Auditor General** is mandated to audit and report on all national and county governments, Courts, Parliament and Public Debt within six months of completion of the financial year. The audit is also expected to confirm whether or not public funds have been applied lawfully and in an effective way.¹¹ Key independent commissions in PFM are the **Salaries and Remuneration Commission (SRC)**, established to set up and regularly review the remuneration and benefits of State Officers; and advise the national and county governments on the remuneration and benefits of all other public officers; and the Commission on Revenue Allocation (CRA), mandated to recommend the basis for equitable sharing of revenues raised nationally between the National and the County Governments; and sharing of revenue among the County Governments.

Ministries and departments: The **Ministry of Devolution and Planning** is responsible for capacity building within the broader mandate of supporting the county governments¹². **The**

⁸ The UCS report notes that many development partners have concerns principally with respect to budget execution, accounting, procurement and auditing practices.

⁹ Article 228(4) CoK 2010

¹⁰ Article 228 (6) CoK 2010

¹¹ Article 229 (6) CoK 2010

¹² Section 121, County Government Act

National Treasury is established by the PFM Act (2012) and is required to formulate, implement and monitor economic policies; enforce fiscal responsibility principles; coordinate preparation and execution of the budget; manage government assets, liabilities and risks; and, approve all government borrowing; amongst other roles. The National Treasury is currently being restructured to enable it deliver on its mandate.

Key departments within the NT include: the **Internal Audit Department** assists in the management of public resources appropriated by Parliament and enhance the level of transparency, accountability and governance through audit committees.¹³ The **IFMIS Department** is responsible for managing IFMIS, an automated system used for PFM. It interlinks planning, budgeting, expenditure management & control, audit and reporting.¹⁴ Professional development and training of IFMIS users is undertaken at the IFMIS Academy, located at the Kenya School of Government. The **Fiscal Decentralisation Unit** spearheaded the drafting of the PFM Act (2012) and is expected to be integrated as a department within National Treasury, to support intergovernmental fiscal relations and technical input for PFM capacity building. Other key departments include the Budget Supply Department and **Accountant General Department (AGD)**. The latter is responsible to ensure financial reporting by entities is credible and to prepare consolidated government financial statements. AGD is also supporting the formation of the Accounting Standards Board which will be responsible for the development and regulation of accounting standards for financial reporting. Other key departments include the Budget Supply Department (BSD) and External Resources Department (ERD). Finally, the **PFMR Secretariat** was established to coordinate PFM reforms and support the various implementers. It also serves as the main liaison point with development partners supporting PFM reforms.

There are several Semi-Autonomous Government Agencies (SAGAs) within PFM. The **Kenya Revenue Authority (KRA)** is the predominant government revenue collection agency accounting for over 96% of Government Ordinary revenues.¹⁵ KRA is likely to assist County Governments in the collection of local revenues, especially in urban areas. The **Public Procurement Oversight Authority (PPOA)** is established under the Public Procurement and Disposal Act, 2005 as a semi-autonomous body charged with ensuring that all procurement entities comply with procurement procedures; monitors the public procurement system and reports on the overall functioning. Since its inception, PPOA has undertaken extensive capacity building, which must now be enhanced to equip the County Governments. The **Central Bank of Kenya (CBK)**, responsible for formulating monetary policy, promoting price stability and issuing currency; amongst other functions is another key institution in this sector.

Ongoing and planned reforms: The GoK has undertaken various public finance reform initiatives. The first comprehensive PFM reforms were consolidated under the Strategy to revitalise public financial management reforms 2006-2011; and contributed toward notable

¹³ Draft Strategic Plan, 2012-2017, Internal Auditor General Department

¹⁴ IFMIS Strategic Plan, 2011-2013

¹⁵ Kenya Revenue Authority, Fifth Corporate Plan, 2012/13-2014/15.

successes including the PFM Act, 2012; introduction of Program Based Budgeting; IFMIS re-engineering amongst others. The strategy was estimated to cost US\$115m including both GoK and DP contributions. At programme end, including the transitional period, US\$20m of DP pooled funds was expended. This amount excludes the GoK element, which could likely match or double the DP contribution, but has not been comprehensively quantified. It also excludes direct support contributions by DPs, who did not utilise the basket pool fund.

The current **PFMR Strategy**, 2013-2018, outlines seven thematic areas (i) Resource mobilisation; (ii) Resource allocation, (iii) Budget execution, accounting and reporting, (iv) Independent audit and oversight (v) fiscal decentralisation and intergovernmental fiscal relations, (vi) legal and institutional framework; and (vii) IFMIS re-engineering. Implementing the strategy is estimated to cost KShs 20.3bn (US\$ 240million) for the five years. The 2013/14 budget estimates allocate KShs 240m (US\$2.8m) and KShs 1,290m (US\$15m) to PFM Reforms and IFMIS respectively. If future allocations are based on current FY estimates, the total GoK allocation for PFM reforms and IFMIS would be US\$14m and US\$75m respectively. This would not be sufficient to meet the needs presented in the PFMR Strategy.

5. Objectives

Development objective

The PFM component is expected to contribute towards the development objective of the KGSP, which in turn seeks to contribute to the economic, social, and political pillars of the Vision 2030, with emphasis on the political pillar. As such, KGSP's development objective is identical to the development objective of the political pillar:

'A democratic political system that is issue-based, people-centred, results-oriented and accountable to the public'.

Immediate objective

The (reformulated) PFM component will be implemented under MTP II of the Vision 2030, and aims to support 'governance and public financial management reforms' priority area¹⁶. Furthermore, the PFM Component will contribute towards the vision of the PFMR Strategy (2013-2018), adopted as the immediate objective below:

'A public finance system that is efficient, effective, and equitable for transparency, accountability and improved service delivery'.

¹⁶ GoK, Second Medium Term Plan (2013-2017), p5. The MTP II emphasizes implementation of the PFM Act (2012), full implementation of the integrated financial management information system (IFMIS) at both national and county levels, capacity building on PFM and tax reforms

Select objectives and indicators from the PFMR Strategy 2013- 2018 Results Framework¹⁷

Objective	Indicators	Source	Baseline
Increase tax collection through better compliance, review of tax incentives, tax regime and broadened tax base	Taxes collected by KRA Taxes as a % of GDP Cost of tax revenue collection	KRA annual reports, BPS, PEFA reports	PEFA indicator P1-15 rated D+ (2012)
Establish effective internal controls in PFM	No. of operational internal audit units & committees No. of staff recruited & capacitated.	IADG reports	Baseline: PEFA P1-21 rated C+ (2012) for internal audit.
Enhance quality and timeliness of audit reports	Risk Based Audit Approach implemented No. of staff trained	OAG reports	Baseline: To be determined
An excellent, secure, reliable, efficient, effective and fully IFMIS	Number of ministries and counties using IFMIS No. of users trained	IFMIS, NT reports	Baseline: To be determined.

Results Chain: The Embassy will provide financial and technical assistance as inputs towards the above. These inputs will support capacity building, policy development and acquisition of infrastructure. Key outputs monitored from these processes will include numbers of staff trained; PFM training manuals developed; regional and county offices set up amongst others. These are all expected to result in the national county governments PFM capacity being strengthened, which in turn is to contribute towards national and county governments that are accountable to the public.

6. Description of component

The key institutions identified for this support include: (i) Office of the Auditor General (OAG), (ii) Controller of Budget (CoB) (iii) National Treasury (iv) Kenya Revenue Authority (KRA). Support to the National Treasury will target departments including Accountant General, IFMIS, Internal Audit, Fiscal Decentralisation and PFMR Secretariat.

Reports produced, including those by CoB and OAG, reveal the types of problems that counties are experiencing while operationalizing financial management. These problems

¹⁷ PFMR Strategy 2013-2018, Results Framework P. 55. Further refinement of the Results Framework is to be undertaken during implementation of the PFMR Strategy. Objectives, outcomes and indicators will be updated accordingly.

arise, partly due to lack of capacity, fragmented and weak financial systems, lack of effective links with the National Treasury systems, and lack of prior preparation. For these reasons, linking Counties to IFMIS together with capacity building, both human and technical, will mitigate some of the current problems. However, IFMIS will also need improvement to expand outreach and stabilize.

It is with this knowledge that the Embassy has targeted support to the aforementioned actors all of which are critical to success of the devolved system of government. The main objective for support to the CoB and OAG is to improve independent control, audit and oversight over public funds. Support to NT would be to enhance PFM institutional and human resource capacity for devolution and strengthen the PFM system.

The proposed areas for each institution are geared towards assisting the institutions to press ahead with implementing priority projects and may include the following:

Institution	Possible areas for support	Reference Document	Development Partners*
Controller of Budget (CoB)	<ul style="list-style-type: none"> • Institutional strengthening • Design a framework for social accountability/ engage with the public • Produce and disseminate reports 	<ul style="list-style-type: none"> • CoB's strategic plan for 2013-2017 • CoK (2010) 	GiZ (direct support)
Office of the Auditor General (OAG)	<ul style="list-style-type: none"> • Build technical capacity to expand its outreach to counties • Undertake change management • Institutional ICT 	<ul style="list-style-type: none"> • OAG's strategic plan • CoK (2010) 	Embassy of Sweden World Bank
National Treasury (AGD, IAD, IFMIS, FD departments)	<ul style="list-style-type: none"> • IFMIS efficiency at county level • Capacity building for devolution • Enhance financial reporting and consolidation. • Strengthen audit committees at national and county level • Develop & implement M&E for PFMR Strategy • Communication of PFM reforms • Joint activities e.g. annual review workshop, PFM forum 	<ul style="list-style-type: none"> • IFMIS Re-engineering Strategic Plan 2011-2013 • PFMR Strategy (2013-2018) • IAD Draft Strategic Plan (2012-2017) 	World Bank GiZ (direct support) African Development Bank (AfDB)

Institution	Possible areas for support	Reference Document	Development Partners*
Kenya Revenue Authority (KRA)	<ul style="list-style-type: none"> • Enhance capacity building in tax administration • Expand outreach with potential to support county governments • Expand capacity to in revenue collection at both national and county government levels 	<ul style="list-style-type: none"> • KRA Corporate Plan (2012/13-2014/15) 	Embassy of Sweden IMF (TA)

* Refers to on-going and planned support.

The Embassy therefore proposes to provide support through the PFMR fund coordinated by the PFMR Secretariat; and, a basket fund managed by the Office of the Auditor General. The PFMR Secretariat will consolidate annual work plans and budgets in consultation with participating government institutions. The work plans and budgets will be discussed at various levels within the programme with Danish funds channelled through the PFMR Secretariat. All Technical Assistance will be provided and managed by the Embassy through a separate budget for Technical Assistance (TA). This will allow for a quick response to possible sudden needs of relevance for one or more of the activities.

7. Specific measures to address other issues

Environment: The PFM component will support PFMR efforts within the PFMR Strategy, which is expected to spearhead the government’s capacity to achieve the MTP II targets which include green growth and climate change. Generally, PFMR are expected to contribute towards better links between sector policies/plans and resource mobilisation, allocation and execution.

Democratization: The PFM component seeks to directly contribute towards improvement in accountability and transparency of public funds. Implementation of the PFM Act, 2012 will enhance public debate and participation on use of public funds.

Human Rights: The CoK, 2010 enshrines fundamental human rights including economic and social rights such as health care services, reproductive health, accessible and adequate housing, reasonable standards of sanitation, adequate food of acceptable quality; clean water, social security and education. PFM reforms aims for the use of public resources for improved service delivery and economic development. The PFM component is thus expected to contribute towards human rights.

Good Governance: Sequencing PFM reforms is considered a good government practice, although “it is impossible to prescribe a sequence of reforms which is appropriate in all circumstances (DFID 2001).” PFM reform is acknowledged to be a mechanism to improve good governance. “The quality of public financial management (PFM) systems is a key determinant of government effectiveness. The capacity to direct, manage, and track, public

spending allows governments to pursue the national objectives and account for the use of public resources and donor funds (de Renzio & Dorotinsky 2007).”

Gender: Kenya’s current constitution promotes gender equity and women empowerment. The inclusion of gender mainstreaming in the performance contracting process has strengthened accountability for gender equity in public service. All the institutions targeted for support under the PFM component are already involved in a wide variety of gender interventions such as training both men and women. However, there is need for more evaluation of impacts of revenue raising and expenditure allocation to determine the different needs of men and women to inform resource allocation as appropriate. Analysis may be carried out at national or county levels but more awareness will be required to enable both genders take up their rightful roles in the county government.

8. Budget

The programme has a two year time-frame from March 2014 to 2015 with a total budget of DKK 36million. Of the total available funds, DKK 33million will be allocated for organizational activities. Further allocation of this amount will be made based on workplans submitted by the beneficiary institutions, including to the PFMR Secretariat for coordination and undertaking joint cross-cutting activities. The balance of DKK 3million will be retained at the Embassy for directly funded activities including technical assistance, externally contracted monitoring agents, consultancies, evaluations, external and special audits as required.

The Embassy will channel its support through the PFMR Account, administered by the PFMR Secretariat and domiciled at the National Treasury. However, for independent offices, namely the OAG and COB where independent joint basket arrangements exist, the Embassy may channel its support directly to these joint funds.¹⁸

Budget overview in DKK1,000

Activities	2011-2013*	2014	2015	Total
PFMR Account: National Treasury, KRA, CoB, OAG	0	19,000	14,000	33,000
Technical assistance, monitoring reviews, audit, consultancies	800	1,200	1,000	3,000
PFM Total	800	20,200	15,000	36,000

* Refers to funds already utilised for various short-term consultancy activities related to PFM.

¹⁸ The OAG is in process of setting up an OAG basket fund to finance its reform activities. The Embassies of Sweden and Denmark have indicated interest in supporting such a fund. The World Bank also intends to provide support to OAG reforms through a separate funding modality.

9. Management and organization

The Embassy will be responsible for oversight of the PFM component, within the KGSP framework. The role includes:

- Policy dialogue with GoK and implementing partner institutions
- Participation in relevant joint GoK-DP meetings e.g. steering committee and technical committee.
- Participation in relevant development partner group meetings
- Technical support when necessary
- Dialogue with civil society
- Overall programme management

Overall, the Embassy will work within the implementing arrangements specified in the PFMR Strategy. These include PFM Reform Steering Committee and PFM Reform Technical Committee.¹⁹ Development partners are expected to engage through the Development partners PFM Group, which is currently constituted and meeting as the PFM working Group.

In the event that the Embassy is the only development partner providing support through the PFMR account, the Embassy will seek the establishment of a Project Steering Committee (PSC) to provide oversight for the Danish support to PFM reforms under the PFM component. The PSC will consist of the PS National Treasury and the Ambassador/Deputy Head of Mission, Embassy of Denmark.

The PFMR Secretariat will provide administration support to the implementation of the reforms supported by the Danish funding. Each institution will prepare a two-year work plan that should be aligned to the institutional strategic plans as well as the annual plans. The implementing institutions will manage their day to day activities outlined in the agreed work plans which should be shared with RDE for the purposes of monitoring progress. The PFMR Secretariat will consolidate project work plans into an overall PFMR Programme work plan for the PFMR fund.

10. Financial management and procurement

Financial management and procurement will utilise country systems. All procurement of goods, works, services and selection of consultants by the institutions will be in conformity with the PFM law, including the Public Procurement Disposals Act.

¹⁹ Implementing arrangements for the PFMR Strategy are yet to be operationalised. However, plans include a PFMR Steering committee consists of heads of implanting agencies e.g. COB, OAG, IAG chaired by the Cabinet; PFMR Technical Committee, chaired by the PS, National Treasury consisting of reform managers/thematic leaders.

Financial management and procurement procedures are summarised below:

Aspect	Description
Planning and budgeting	On budget and on parliament
Funds flow & disbursements	On-Treasury: (PFMR fund) and (OAG fund)
Accounting & financial reporting	GoK systems and a PFMR project report
Internal controls	GOK systems
External audit	On audit
Procurement	GoK Public procurement

These aspects are elaborated below:

Planning and Budgeting

Danish support channelled through revenue system will be included in the annual GOK budget estimates that is appropriated by parliament. Implementing partners will prepare annual project work plans aligned to their institutional plans.

Funds flow & disbursements

The support will be provided to the PFMR Account to be channelled through a special account at the Central Bank of Kenya. Disbursements will be in accordance with GoK regulations, rules and directives for financial management of donor funds and against approved work plans. Initial support to the OAG will be through the PFMR Fund using revenue system, with a planned move to OAG fund (also revenue system) in FY 2014/15. Embassy managed technical Assistance (DKK3m) will be provided as Appropriations-in-Aid (A-in-A).

Accounting and Financial Reporting

Implementing partners will account and report for PFMR project activities using GoK reporting requirements. Additionally, the PFMR Secretariat will consolidate implementing partners' project reports into a quarterly PFMR Programme report.

The accounting system will be in accordance with the best international accounting practises as well as the GoK legislation, accounting manuals and systems for funds placed under its management. The individual institutions will submit quarterly narrative and financial reports to the PFMR Secretariat, which will be responsible for financial management.

The financial Report will include a comparison of budgeted and actual expenditures on the Program as a whole. Detailed expenditures will be disaggregated and activities referenced to the approved annual work plan. Any unspent balances will be carried forward to the next financial year and will be included in subsequent quarterly reports. Any unspent funds carried forward will be taken into account when requesting for additional funds. Other reports will be sent to Danida on request or as soon as they are available.

Internal control

Reliance will be placed on implementing partners' own governance and internal control arrangements.

Auditing

The OAG will undertake the annual audit of the project support. This may include the use of delegated/sub-contracted external audit arrangements as agreed with the OAG. The OAG fund will be audited by the OAG's external auditor, either as part of the institutional audit or as a project audit.

Audit of the funded expenditures and financial statements will be carried out in accordance with international auditing standards and GoK rules and regulations. A signed audit report will be provided to the Secretariat and the Embassy within six (6) months following the end of the GoK financial year. The Embassy may request for a Special Audit (performance related audit, Value for Money audit, etc.) to be carried out.

Procurement

All procurements, other than those initiated directly by the Embassy, will utilise public procurement procedures. Beneficiary institutions will apply procurement processes in line with GoK established rules and procedures and PFMR Secretariat will provide a consolidated Procurement Report.

11. Monitoring, reporting, reviews and evaluations

Each institution is responsible for collecting and analysing data to monitor achievements and implementation of the target activities as outlined in the workplans. Each institution will also submit the reports and findings to the PFMR Secretariat. On its part the Secretariat will submit consolidated M&E reports to the Embassy, coordinate annual assessment and submit a consolidated report. Good reporting will be a central element of the dialogue between implementing partners and the Embassy and will therefore be stressed upon

Monitoring will be based on:

- Financial and audit reports from the organisations (all quality assured by the PFMR Secretariat).
- Regular dialogue with partner organisations.
- Regular (suggested bi-annual) monitoring visits by the Danida Programme Manager to the organisations.
- External and/or special audit reports (at the behest of the Embassy).

The Embassy will participate in quarterly technical review meetings; and annual joint reviews. Additionally, the Embassy in conjunction with the PFMR Secretariat may arrange for broader PFM forum of PFM reforms.

12. Key assumptions and risks

Risks have been analyzed and presented at two levels, that is, within the PFMR Strategy and KGSP Programme Document.

Firstly, the PFMR Strategy (p. 53) presents a risk analysis (risk rating and mitigation measures) for the comprehensive PFMR Programme. Key risks identified include political will and commitment to the Strategy; inadequate human and financial capacity to implement the reform programme and delays occasioned by the public procurement procedures. Mitigating measures identified at lobbying for support of all PFM legislation; establishing a capacity building framework for PFMR implementation and a revision of the Public Procurement Act, respectively.

Secondly, the KGSP Programme Document (p.47) had identified delays in designing and activating a new funding modality for the PFMR Strategy; mismanagement of funds and limited reform progress as key risks for the PFM component. Mitigating measures suggested include enhanced harmonization with like-minded development partners; additional external audit reviews; and enhanced alignment and possible use of bilateral funding respectively.

The key risks are re-assessed and summarized below:

Risk	Likelihood	Impact	Mitigation
Lack of sustained commitment and political will to undertake PFM reforms	Medium	High	Update and implementation of the PFMR Strategy for buy-in and coverage at National and County Government. Sustained high level dialogue between GoK and DPs
Lack of capacity to coordinate and implement PFM reforms	Medium	Medium	Capacity Building. Operationalization of PFMR Strategy implementation arrangements.
Inadequate financing for priority PFM reforms: (i) Competing multiple priorities for GoK financing (ii) Inadequate, un-coordinated donor funding	Medium	High	Refinement of PFMR Strategy for buy-in. Sustained high level dialogue between GoK and DPs. Full adoption and use of PFMR Strategy as the main framework for PFMR coordination and funding.
Operational aspects (i) lack of M&E framework; (ii) Low absorption rates (iii) Low value for money	Medium	Medium	Use of country systems, complemented by limited intrusive fiduciary safeguards e.g. external audits in a delegated arrangement with OAG.

Risk	Likelihood	Impact	Mitigation
in procurement (iv) Insufficient reporting			Allow and provide for procurement and value for money audits. Agree reporting timelines and templates in advance.
Fraud, misuse or misappropriation of funds	Low	High	Use of country governance, control and internal audit procedures.

Annex A: Reference Documents

1. The Strategy for Public Finance Management Reforms in Kenya (2013-2018). Ministry of Finance
2. Constitution of Kenya (2010). GoK
3. The Public Finance Management Act (2012). GoK
4. Kenya Governance Support Programme, Programme Document (2010-2015). Embassy of Denmark, Nairobi
5. Guidelines for Programme Management. September 2011. Ministry of Foreign Affairs, Denmark
6. IFMIS Re-engineering Strategic Plan (2013-2018). IFMIS, Ministry of Finance, GoK.
7. Government of the Republic of Kenya Public Expenditure and Financial Accountability (PEFA) Assessment, Final Report, 2012
8. Use of County Financial Management Systems Report. April 2013.
9. Final Evaluation Report of the Strategy to Revitalise Public financial Management Reforms 2006 to 2011 (including the transition period to June 2012). December 2012. KPMG
10. The Kenya Good Governance⁴ Programme: Lessons Learnt Review Final Report. May 2013. The Consulting House.
11. Review Aide Memoire. Review of Kenya Governance Support Programme (2010-2015). June 2013. Ministry of Foreign Affairs, Denmark.
12. Background papers developed for the PFM component reformulation:
 - a. Political economy of PFM reforms in Kenya
 - b. Legal framework for PFM reforms
 - c. An assessment of CPIA and PEFA assessments since 2006
 - d. Review of PFM Control, Audit and oversight actors
 - e. PFM capacity building for devolution