PUBLIC FINANCE

CPA Section 2
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STUDY NOTES

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CHAPTER ONE

INTRODUCTIONS TO PUBLIC FINANCIAL MANAGEMENT LEGAL FRAMEWORK

INTRODUCTION

Public finance can be defined as the collection of revenue by the government and all the expenditure of revenue in the provision of public utilities.

Public finance is a theory of government economic functions in an economy i.e. the proper role of government in an economy provides a starting point for the analysis of public finance. Under certain circumstances, private markets will allocate goods and services among individuals efficiently (in the sense that no waste occurs and that individual tastes are matching with the economy's productive abilities). If private markets were able to provide efficient outcomes and if the distribution of income were socially acceptable, then there would be little or no scope for government. In many cases, however, conditions for private market efficiency are violated for example, if many people can enjoy the same good at the same time (non-rival, non-excludable consumption), then private markets may supply too little of that good. National defense is one example of non-rival consumption, or of a public good.

NATURE OF PUBLIC FINANCE

The scope of public finance can be divided into four categories namely:-

- Public income/ revenue
- Public expenditure
- Public debt
- Financial administration

a) Public income/revenue

This refers to government income collected from various sources. The main sources of public revenue include taxes, fees, fines and penalties, income from properties, interest from loans repayment, sale of real assets and royalties.

INTRODUCTION TO PUBLIC FINANCIAL MANAGEMENT LEGAL FRAME WORK

Public Finance Management in Kenya is covered in the constitution of Kenya 2010, Chapter 12 and Public Finance Management Act, 2012. This Act of parliament provides effective management of public finances by the national and county governments; the oversight responsibility of Parliament and county assemblies; the different responsibilities of government entities and other bodies, and for connected purposes

Interpretation of terms

"Accounting officer" means—

(a) an accounting officer of a national government entity referred to in section 67;
(b) an accounting officer of a county government entity referred to in section 148;
(c) in the case of the Judiciary, the Chief Registrar of the Judiciary; or
(d) in the case of the Parliamentary Service Commission, the Clerk of the Senate;

"Accounting Standards Board" means the Public Sector Accounting Standards Board

"Appropriation" means—

(a) Authority granted by Parliament to pay money out of the Consolidated Fund or out of any other public fund; or
(b) authority granted by a county assembly to pay, money out of the relevant County Revenue Fund or out of any other county public fund;

"Appropriation Act" means an Act of Parliament or of a county assembly that provides for the provision of money to pay for the supply of services;

"Authorized officer"—

(a) in relation to the National Treasury, means any of its members or officers authorised by the National Treasury in accordance with section 13; or
(b) in relation to a County Treasury, means any of its officers authorised by the County Treasury in accordance with section 105;

"Borrower" means a person to whom a loan has been or is to be made;

"Budget Policy Statement", in relation to a financial year, means the Budget Policy

Statement referred to in section 25;

"Cabinet Secretary" means the Cabinet Secretary responsible for matters relating to finance;

"chart of account" means a structured list of accounts used to classify and record budget revenue and expenditure transactions as well as government assets and liabilities on a standard budget classifications system;

"Chief Officer" means the person appointed by the County Governor to administer the County department responsible for financial affairs;

"commitment" means entering into a contract or other binding arrangement under which expenses or liabilities may be incurred;

"collector of revenue"—

(a) in relation to the national government, means a person authorised under section 76 to be a collector of revenue for the national government;

(b) in relation to a county government, means a person authorised under section 158 to be a collector of revenue for that county government;

"Contingencies Fund" means the Contingencies Fund established by Article 208(1) of the Constitution;

"county corporation" means a public corporation within a county established by an Act of Parliathent or county legislation;

"County Emergency Fund" means a Fund established under section 110;

"County Exchequer Account" means a County Exchequer Account referred to in section 109;

"County Executive Committee member for finance" means the member of a County Executive Committee responsible for the financial affairs of the County and for the County Treasury;

"County Fiscal Strategy Paper", in relation to a county government, means the County Fiscal Strategy Paper referred to in section 117;

"county government entity" means any department or agency of a county government, and any authority, body or other entity declared to be a county government entity under section 5(1);

"county government revenue" means all money derived by or on behalf of a county government from levies, rates, fees, charges or any other source authorised by the Constitution or an Act of Parliament;

"county government security" means a security issued by the county government under section 144 and includes a treasury bill, treasury bond, treasury note, government stock and any other debt instrument issued by the county government;

"County Public Debt" means all financial obligations attendant to loans raised and securities issued by the county government;

"County Treasury" means a County Treasury established under section 103;

"development expenditure" means the expenditure for the creation or renewal of assets;

"development partner" means a foreign government, an international organisation of states or any other organization prescribed by regulations for the purpose of this Act;

"financial statements", in relation to a financial year or other accounting period of the national government, county government, or a national government or county government entity, means—

(a) the financial statements referred to in Part III and Part IV of this Act; and

(b) the financial statements prescribed by the Accounting Standards Board;

"fiscal responsibility principles" means the principles of public finance specified in Article 201 of the Constitution, together with—

(a) the principles of fiscal responsibility referred to in section 15, in relation to national government; and

(b) the principles of fiscal responsibility referred to in section 107, in relation to a county government;

"financial objectives" means the financial objectives set out in a Budget Policy Statement of the national government or in the County Fiscal Strategy Paper of the county governments;

"Intergovernmental Budget and Economic Council" means the Council established under section 187;

"internal auditing" means an independent, objective assurance and consulting activity

(b) in relation to the county government, means a centralised bank account system established in each county where all deposits and payment transactions are processed for county departments and any other county entity which draws directly from the County Revenue Fund;

"Urban Board" means a city or municipal board within the meaning of the Urban Areas and Cities Act, 2011;

"Vote" means money authorised by an appropriation Act for withdrawal from the Consolidated Fund or a County Revenue Fund; and

"Wasteful expenditure" means any expenditure that was incurred which could have been avoided had due care and diligence been exercised.

Overview of public financial management Act

The Public Financial Management (PFM) Act is an Act of Parliament meant to provide for effective management of public finances by the national and county governments. In developing the PFM Act, Parliament was keenly aware of the importance of having a good PFM system in determining the success or failure of devolution. To ensure a good PFM system, two objectives were taken into account:

i. That the PFM was consistent with the Constitution and in particular provide for safe-guarding autonomy in financial management at both levels of government but within a unitary system of devolution. This autonomy is supported by articles 6 and 189 of the Constitution. Article 6(2): The governments at the national and County levels are distinct and inter-dependent and shall conduct their mutual relations on the basis of consultation and cooperation; article 189(1)(a): Government at either level shall per-form its functions, and exercise its powers, in a manner that respects the functional and institutional integrity of government at the other level, and respects the Constitu-tional status and institutions of government at the other level.

The spirit of these articles is that both levels of government should not interfere in the day-to-day management of finances and other affairs in the other level of government. Specifically, each level of government should be able to formulate, plan, implement and report on their budgets and plans without the interference of the other government. To operationalize this concept and to avoid favouring one level of government over the other, the Act has mirrored many of the institutional structures for financial management of the national government at the county government level as shown below:

PRINCIPLES OF PUBLIC FINANCE

The following principles shall guide all aspects of public finance in the Republic—

1. There shall be openness and accountability, including public participation in financial matters;
2. The public finance system shall promote an equitable society, and in particular—

   i. the burden of taxation shall be shared fairly;
   ii. revenue raised nationally shall be shared equitably among national and county governments; and
   iii. expenditure shall promote the equitable development of the country, including by making special provision for marginalised groups and areas;

3. the burdens and benefits of the use of resources and public borrowing shall be shared equitably between present and future generations;
4. public money shall be used in a prudent and responsible way; and
5. financial management shall be responsible, and fiscal reporting shall be clear

Equitable sharing of national revenue

Revenue raised nationally shall be shared equitably among the national and county governments.

County governments may be given additional allocations from the national government's share of the revenue, either conditionally or unconditionally.

Equitable share and other financial laws

The following criteria shall be taken into account in determining the equitable shares provided for under Article 202 and in all national legislation concerning county government enacted in terms of this Chapter—

i. the national interest;
ii. any provision that must be made in respect of the public debt and other national obligations;
iii. the needs of the national government, determined by objective criteria;
iv. the need to ensure that county governments are able to perform the functions allocated to them;
v. the fiscal capacity and efficiency of county governments;
vi. developmental and other needs of counties;
vii. economic disparities within and among counties and the need to remedy them;

CHAPTHER TWO

THE OPERATIONS OF THE NATIONAL AND COUNTY GOVERNMENTS ON MANAGEMENT AND CONTROL OF PUBLIC FINANCE

Establishment of the National Treasury

There is established, pursuant to Article 225 of the Constitution, an entity of the national government to be known as the National Treasury.

The National Treasury shall comprise of—

a) the Cabinet Secretary;
b) the Principal Secretary; and
c) The department or departments, office or offices of the National Treasury responsible for economic and financial matters.

The Cabinet Secretary shall be the head of the National Treasury.

General responsibilities of the National Treasury

1. formulate, implement and monitor macro-economic policies involving expenditure and revenue;
2. manage the level and composition of national public debt, national guarantees and other financial obligations of national government within the framework of this Act and develop a framework for sustainable debt control;
3. formulate, evaluate and promote economic and financial policies that facilitate social and economic development in conjunction with other national government entities;
4. mobilize domestic and external resources for financing national and county government budgetary requirements;
5. design and prescribe an efficient financial management system for the national and county governments to ensure transparent financial management and standard financial reporting as contemplated by Article 226 of the Constitution:
6. Provided that the National Treasury shall prescribe regulations that ensure that operations of a system under this paragraph respect and promote the distinctiveness of the national and county levels of government;
7. in consultation with the Accounting Standards Board, ensure that uniform accounting standards are applied by the national government and its entities;
8. develop policy for the establishment, management, operation and winding up of public funds;

9. within the framework of this Act and taking into consideration the recommendations of the Commission on Revenue Allocation and the Intergovernmental Budget and Economic Council, prepare the annual Division of Revenue Bill and the County Allocation of Revenue Bill;
10. strengthen financial and fiscal relations between the national government and county governments and encourage support for county governments in terms of Article 190(1) of the Constitution in performing their functions; and
11. Assist county governments to develop their capacity for efficient, effective and transparent financial management in consultation with the Cabinet Secretary responsible for matters relating to intergovernmental relations.

The National Treasury shall have the following functions, in addition:-

1. promote transparency, effective management and accountability with regard to public finances in the national government;
2. ensure proper management and control of, and accounting for the finances of the national government and its entities in order to promote the efficient and effective use of budgetary resources at the national level;
3. co-ordinate the preparation of annual appropriation accounts and other statutory financial reports by the national government and its entities;
4. prepare annual estimates of revenue of the national government, and co-ordinate the preparation of the budget of the national government;
5. consolidate reports of annual appropriation accounts and other financial statements of the national government and county governments and their entities;
6. report every four months to the National Assembly on the implementation of the annual national budget on areas not reported on by the Controller of Budget;
7. be the custodian of an inventory of national government assets except as may be provided by other legislation or the Constitution;
8. monitor the management of the finances of public enterprises and investments by the national government and its entities;
9. monitor the financial aspects of risk management strategies and governance structures for the national government and national government entities;
10. monitor the financial performance of state corporations; and
11. Issue guidelines to national government entities with respect to financial matters and monitoring their implementation and compliance.

The National Treasury shall take such other action, not inconsistent with the Constitution, as will further the implementation of this Act.

COUNTY GOVERNMENT RESPONSIBILITIES IN PUBLIC FINANCE

Each county government shall ensure adherence to—

a) the principles of public finance set out in Chapter Twelve of the Constitution;
b) the fiscal responsibility principles provided in section 107 under this Act;
c) national values set out in the Constitution; and
d) any other requirements of this Act.

The County Executive Committee shall observe principles of collective responsibility in exercising their functions under this Act.

In making decisions a county assembly shall take cognisance of Article 216 (2) of the Constitution.

Establishment of county treasuries

There is established for each county government, an entity to be known as County Treasury.

The County Treasury shall comprise—

a) the County Executive Committee member for finance;
b) the Chief Officer; and
c) The department or departments of the County Treasury responsible for financial and fiscal matters.

The County Executive Committee member for finance shall be the head of the County Treasury.

General responsibilities of a County Treasury

Subject to the Constitution, a County Treasury shall monitor, evaluate and oversee the management of public finances and economic affairs of the county government including—

1. developing and implementing financial and economic policies in the county;
2. preparing the annual budget for the county and co- ordinating the preparation of estimates of revenue and expenditure of the county government;
3. co-ordinating the implementation of the budget of the county government;
4. mobilising resources for funding the budgetary requirements of the county government and putting in place mechanisms to raise revenue and resources;

Limitation on power of County Executive Committee member for finance to make payments from Emergency Fund

The County Executive Committee member for finance may not, during a financial year, make a payment from the Emergency Fund under section 112 exceeding two per cent of the total county government revenue as shown in that county government's audited financial statements for the previous financial year, except for the first year.

ESTABLISHMENT, PURPOSE AND COMPOSITION OF THE INTERGOVERNMENTAL BUDGET AND ECONOMIC COUNCIL

There is established a council known as the Intergovernmental Budget and Economic Council comprising—

1. the Deputy President who shall be the Chairperson;
2. the Cabinet Secretary;
3. a representative of the Parliamentary Service Commission;
4. a representative of the Judicial Service Commission;
5. the Chairperson of the Commission on Reveille Allocation or a person designated by the Chairperson;
6. the Chairperson of the Council of County Governors;
7. every County Executive Committee member for finance; and
8. The Cabinet Secretary responsible for intergovernmental relations.

(The purpose of the Council is to provide a forum for consultation and cooperation between the national government and county governments on—

a. the contents of the Budget Policy Statement, the Budget Review and Outlook Paper and the Medium-Term Debt Management Strategy;
b. matters relating to budgeting, the economy and financial management and integrated development at the national and county level;
c. matters relating to borrowing and the framework for national government loan guarantees, criteria for guarantees and eligibility for guarantees;
d. agree on the schedule for the disbursement of available cash from the Consolidated Fund on the basis of cash flow projections;
e. any proposed legislation or policy which has a financial implication for the counties, or for any specific county or counties;
f. any proposed regulations to this Act; and
g. recommendations on the equitable distribution of revenue between the national and county governments and amongst the county governments as provided in section 190; and

THE ROLE OF THE COMMISSION ON REVENUE ON ALLOCATION (COR)

There is an established commission of revenue allocation; the Commission consists of the following persons appointed by the President—

a) a chairperson, who shall be nominated by the President and approved by the National Assembly;

b) two persons nominated by the political parties represented in the National Assembly according to their proportion of members in the Assembly;

c) five persons nominated by the political parties represented in the Senate according to their proportion of members in the Senate; and

d) The Principal Secretary in the Ministry responsible for finance.

The persons nominated are not be members of Parliament.

To be qualified to be a member of the Commission a person shall have extensive professional experience in financial and economic matters.

The principal function of the Commission on Revenue Allocation is to make recommendations concerning the basis for the equitable sharing of revenue raised by the national government—

a) between the national and county governments; and
b) Among the county governments.

The Commission also makes recommendations on other matters concerning the financing of, and financial management by, county governments, as required by this Constitution and national legislation.

In formulating recommendations, the Commission seeks—

a) To promote and give effect to the criteria mentioned the article relating to Equitable share and other financial laws.
b) when appropriate, to define and enhance the revenue sources of the national and county governments; and

c) to encourage fiscal responsibility.

CHAPTER THREE

ESTABLISHMENT OF PUBLIC FUNDS IN THE PUBLIC SECTOR

ESTABLISHMENT OF A COUNTY REVENUE FUND FOR EACH COUNTY GOVERNMENT

There is established, for each county a County Revenue Fund in accordance with the Constitution.

The County Treasury for each county government shall ensure that all money raised or received by or on behalf of the county government is paid into the County Revenue Fund, except money that—

a) is excluded from payment into that Fund because of a provision of this Act or another Act of Parliament, and is payable into another county public fund established for a specific purpose;

b) may, in accordance with other legislation, this Act or County legislation, be retained by the county government entity which received it for the purposes of defraying its expenses; or

c) is reasonably excluded by an Act of Parliament as provided in Article 207 of the Constitution.

The County Treasury shall administer the County Revenue Fund and ensure that the county government complies with the provisions of the Constitution.

The County Treasury shall—

a) arrange for the County Revenue Fund to be kept in the Central Bank of Kenya or a bank approved by the County Executive Committee member responsible for finance and shall be kept in an account to be known as the "County Exchequer Account; and

b) ensure that all money authorised to be paid by the county government or any of its entities for a public purpose is paid from that account without undue delay.

The County Treasury shall ensure that at no time is the County Exchequer Account overdrawn.

The County Treasury shall obtain the written approval of the Controller of Budget before withdrawing money from the County Revenue Fund under the authority of—

(a) an Act of the county assembly that appropriates money for a public purpose;

(b) an Act of Parliament or county legislation that imposes a charge on that Fund; or

The approval of the Controller of Budget to withdraw money from the County Revenue Fund, together with written instructions from the County Treasury requesting for the withdrawal, is sufficient authority for the approved bank where the County Exchequer Account is held to pay amounts from this account in accordance with the approval and the instructions.

Any unutilised balances in the County Revenue Fund shall not lapse at the end of the financial year but shall be retained for the purposes for which it was established.

Financial reports shall be submitted to the Commission on Revenue Allocation with a copy to the Controller of Budget.

County Government Executive Committee may establish county government Emergency Fund.

A County Executive Committee may, with the approval of the county assembly, establish an emergency fund for the county government under the name "…………………… County Emergency Fund" and the fund shall consist of money from time to time appropriated by the county assembly to the Fund by an appropriation law.

The purpose of an Emergency Fund is to enable payments to be made in respect of a county when an urgent and unforeseen need for expenditure for which there is no specific legislative authority arises.

County Executive Committee member for finance to administer the Emergency Fund

The County Executive Committee member for finance shall administer the county government Emergency Fund for the county government in accordance with a framework and criteria approved by the county assembly.

The County Executive Committee member for finance shall establish and maintain a separate account into which all money appropriated to the Emergency Fund shall be paid.

CONSOLIDATED FUND

There is established Consolidated Fund into which all monies raised or received by or on behalf of the national government, except money that—

a) is reasonably excluded from the Fund by an Act of Parliament and payable into another public fund established for a specific purpose; or
b) May, under an Act of Parliament, be retained by the State organ that received it for the purpose of defraying the expenses of the State organ.

Money may be withdrawn from the Consolidated Fund only—

a) in accordance with an appropriation by an Act of Parliament;
b) in accordance with the constitution
c) As a charge against the Fund as authorised by this Constitution or an Act of Parliament.

Money is not withdrawn from any national public fund other than the Consolidated Fund, unless the withdrawal of the money has been authorised by an Act of Parliament.

Money is not withdrawn from the Consolidated Fund unless the Controller of Budget approves the withdrawal.

Revenue Funds for county governments

There is also established Revenue Fund for each county government, into which payment of all money raised or received by or on behalf of the county government, except money reasonably excluded by an Act of Parliament is kept

Money may be withdrawn from the Revenue Fund of a county government only—

a) as a charge against the Revenue Fund that is provided for by an Act of Parliament or by legislation of the county; or
b) As authorised by an appropriation by legislation of the county.

Money cannot be withdrawn from a Revenue Fund unless the Controller of Budget has approved the withdrawal

An Act of Parliament may—

a) make further provision for the withdrawal of funds from a county Revenue Fund; and
b) Provide for the establishment of other funds by counties and the management of those funds.

CHAPTER FOUR

SUPPLY CHAIN MANAGEMENT IN PUBLIC ENTITIES

Procurement of public goods and services

When a State organ or any other public entity contracts for goods or services, it shall do so in accordance with a system that is fair, equitable, transparent, competitive and cost-effective.

The public procurement and disposal act prescribe a framework within which policies relating to procurement and asset disposal are to be implemented and provides the following—

a) categories of preference in the allocation of contracts;
b) the protection or advancement of persons, categories of persons or groups previously disadvantaged by unfair competition or discrimination;
c) sanctions against contractors that have not performed according to professionally regulated procedures, contractual agreements or legislation; and

Sanctions against persons who have defaulted on their tax obligations, or have been guilty of corrupt practices or serious violations of fair employment laws and practices

Definitions and terminologies

―accounting officer‖ means—

(*a*) for a public entity other than a local authority, the person appointed by the Permanent Secretary to the Treasury as the accounting officer or, if there is no such person, the chiefexecutive of the public entity; or

(*b*) for a local authority, the town or county clerk of the local authority;

―Advisory Board‖ means the Public Procurement Oversight Advisory Board established under section 21;

―Authority‖ means the Public Procurement Oversight Authority established under section 8; ―candidate‖ means a person who has submitted a tender to a procuring entity;

―citizen contractor‖ means a natural person or an incorporated company wholly owned and controlled by persons who are citizens of Kenya;

―contractor‖ means a person who enters into a procurement contract with a procuring entity; ―corruption‖ has the meaning assigned to it in the Anti Corruption and Economic Crimes Act,

2003 and includes the offering, giving, receiving or soliciting of anything of value to influence the action of a public official in the procurement or disposal process or in contract execution.

PROCUREMENT GUIDELINES AS ENVISAGED BY PPD ACT
GENERAL PROCUREMENT RULES

Choice of procurement procedure

For each procurement being done, the procuring entity should use open tendering under or an alternative procurement procedure and the, procuring entity can use an alternative procurement procedure only if that procedure is allowed.

A procuring entity can also use restricted tendering or direct procurement as an alternative procurement procedure only if, before using that procedure, the procuring entity—

(*a*) Obtains the written approval of its tender committee; and

(*b*) Records in writing the reasons for using the alternative procurement procedure.
A procuring entity can use such standard tender documents as may be prescribed

Procurement not to be split or inflated

No procuring entity may structure procurement as two or more procurements for the purpose of avoiding the use of a procurement procedure.

Any person who contravenes the provisions of this section shall be guilty of an offence.

Standard goods, services and works with known market prices shall be procured at the prevailing real market price.

Public officials involved in transactions in which standard goods, services and works are procured at unreasonably inflated prices shall, in addition to any other sanctions prescribed in this Act or the regulations, be required to pay the procuring entity for the loss resulting from their actions.

Qualifications to be awarded contract

A person is qualified to be awarded a contract for a procurement only if the person satisfies the following criteria—

a) the person has the necessary qualifications, capability, experience, resources, equipment and facilities to provide what is being procured;
b) the person has the legal capacity to enter into a contract for the procurement;
c) the person is not insolvent, in receivership, bankrupt or in the process of being wound up and is not the subject of legal proceedings relating to the foregoing;
d) the procuring entity is not precluded from entering into the contract with the person under section on Limitation on contracts with employees,

CHAPTER FIVE

OVERSIGHT FUNCTION IN PUBLIC FINANCE MANAGEMENT

Role of National Assembly

National assembly has established budget committee in public finance matters meant to oversee public finance management.

The committee is established to deal with budgetary matters and has responsibility for the following matters, in addition to the functions set out in the Standing Orders—

a) discuss and review the Budget Policy Statement and budget estimates and make recommendations to the National Assembly;
b) provide general direction on budgetary matters;
c) monitor all budgetary matters falling within the competence of the National Assembly under this Act and report on those matters to the National Assembly;
d) monitor adherence by Parliament, the Judiciary and the national government and its entities to the principles of public finance and others set out in the Constitution, and to the fiscal responsibility principles of this Act;
e) review the Division of Revenue Bill presented to Parliament and ensure that it reflects the principles of the Constitution;
f) examine financial statements and other documents submitted to the National Assembly and make recommendations to the National Assembly for improving the management of Kenya's public finances;
g) make recommendations to the National Assembly on "money Bills", after taking into account the views of the Cabinet Secretary; and
h) table in the National Assembly a report containing the views of the Cabinet Secretary
i) Introduce the Appropriations Bill in the National Assembly.

Role of Senate

There is established Committee of the Senate set to deal with budgetary and financial matter's, it has responsibilities for the following matters, in addition to the functions set out in the Standing Orders—

a) present to the Senate, subject to the exceptions in the Constitution, the proposal for the basis of allocating revenue among the Counties and consider any bill dealing with county financial matters;
b) review the County Allocation of Revenue Bill and the Division of Revenue Bill in accordance with the Constitution at least two months before the end of the financial year;