Governance in Public Expenditure Management: Key Issues and Challenges in Kenya

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Abstract

This paper develops a conceptual framework for applying good governance to systems of public expenditure management (PEM), and analyses governance in public expenditure management in Kenya. An overview of some key governance challenges in public expenditure management in Kenya is provided. The framework identifies three key stages in PEM: national budget formulation and preparation; execution and reporting; and monitoring and evaluation. Good governance is one of the principal inputs in the PEM system that is often neglected, particularly with regard to the principles of transparency, accountability, predictability and participation. While the country has made considerable progress in strengthening governance in PEM, this paper argues that various challenges need to be addressed. Some of the key challenges require enhancement of predictability and accountability in budget formulation and preparation. In the 'bottom up' process, this can be done through strengthening the legal and administrative framework. The paper also argues that there is room for strengthening the link between monitoring and evaluation, and the budget planning process so as to enhance transparency, accountability and predictability. The adoption of results based management (RBM) systems in PEM has improved accountability and performance but needs to be further institutionalized and properly anchored within the PEM system. While the various PEM reforms that have been initiated have an important bearing on enhancing good governance, the greatest challenge relates to further deepening of the current reforms and continuous improvement.

Abbreviations and Acronyms

AIEs	Authority to Incur Expenses
APR	Annual Progress Review
APRM	Africa Peer Review Mechanism
AUCPCC	Africa Union Convention for Prevention and Combating Corruption
BMD	Budget Monitoring Department
BOPA	Budget Outlook Paper
BSP	Budget Strategy Paper
C&AG	Controller and Auditor General
CGD	Centre for Governance and Development
DDC	District Development Committee
DFRDS	District Focus for Rural Development Strategy
DIDCs	District Information Dissemination Centres
ERS	Economic Recovery Strategy
FOs	Financial Officers
GFRP	Government Financial Regulations and Procedures
IEA	Institute of Economic Affairs
IFMIS	Integrated Financial Management Information Systems
IMF	International Monetary Fund
IP ERSWEC	Investment Programme of the Economic Recovery Strategy for Wealth and Employment Creation
KACC	Kenya Anti-Corruption Commission
KIPPRA	Kenya Institute for Public Policy Research and Analysis
KNAO	Kenya National Audit Office
M&E	Monitoring and Evaluation
MTEF	Medium Term Expenditure Framework
MTR	Medium Term Review
NCPB	National Cereals and Produce Board
NEPAD	New Partnership for Africa's Development
ODA	Overseas Development Assistance
OECD	Organization for Economic Cooperation and Development
PAC	Public Accounts Committee
PEM	Public Expenditure Management
PER	Public Expenditure Review
PIC	Parliamentary Investment Committee
PPOA	Public Procurement Oversight Authority
PRSP	Poverty Reduction Strategy Paper
QBRs	Quarterly Budget Reviews
UNCAS	United Nations Convention Against Corruption
UNPSA	United Nations Public Service Award

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1. Introduction

The concept of governance covers the social, economic, corporate, political and cultural aspects of how power is exercised in an organization or society. In the literature on governance, the common principles in the exercise of power include: accountability, transparency, participation, performance, fairness, predictability, legitimacy and voice. Some of these principles overlap and are interrelated. Due to the multi-faceted nature of the concept, there is no accepted definition of governance, but different authors tend to emphasize different aspects. However, researchers at the World Bank Institute have attempted to bring together the different dimensions of governance (political, economic, and institutional), into six aggregate governance indicators: voice and accountability; political stability and absence of violence; government effectiveness; control of corruption; rule of law; and regulatory quality. Using these indicators, Kaufmann, Kraay, and Zoido-Lobatón (1999) and World Bank (2006) have established a large causal effect running from improved governance to better development outcomes. These empirical analyses support the now widely accepted principle that good governance plays an important role in the development process. In Kenya, enhancement of good governance was identified as one of the three pillars of the Economic Recovery Strategy (ERS) adopted by the government in 2003, the key areas being reforms in the Judiciary, strengthening the rule of law, fight against corruption, and improved security as well as enhancing transparency and accountability in public administration systems (Government of Kenya, 2003b).

The concept of governance as described above can be applied in different levels of the society or institution. This paper applies the concept of governance to systems of Public Expenditure Management (PEM) using Kenya as a case study. Public Expenditure Management is one of the key policy instruments of public policy concerned with how resources are allocated and used, while at the same time ensuring that economic stability is not undermined. It is, therefore, one of the key instruments in realising the general public policy goals of growth, stability and poverty reduction. Macroeconomic stability is maintained by ensuring fiscal discipline while the other goals (growth and equity) are impacted upon directly through the allocation and utilization of public expenditure. Whereas recent PEM reforms have focused more on the technical infrastructure such as skills, accounting systems, and development of better macroeconomic projections upon which the processes of planning and budgeting are embedded, this paper provides a governance perspective to PEM reforms. Consequently, it attempts to contribute to a better understanding of the importance of good governance in the systems of PEM. The paper is organized as follows: After the introduction in section 1, section 2 discusses the problems of public expenditure management in Kenya while section 3 discusses a conceptual/analytical framework. The framework is used to explore the relevance of good governance in public expenditure management, with special reference to Kenya's PEM system. Section 4 summarizes the key conclusions and makes recommendations.

2. Public Expenditure Management in Kenya

Public Expenditure Management is concerned with how public resources are utilized in the realization of public policy goals. A properly functioning PEM system contributes to economic growth, stability and poverty reduction by enhancing aggregate fiscal discipline, improving strategic allocation or prioritization, and operational efficiency in terms of maximizing 'value for money' or realizing outputs or delivery of public services at the least cost. In this regard, PEM is a key public policy instrument in realizing national development goals. A sound PEM system encourages prudent management by instilling fiscal discipline that supports a stable macroeconomic environment that will not result in unsustainable fiscal deficit that can lead to high inflation, unstable interest rates and excessive current account deficits and, thus, undermine a country's economic growth.

One of the early attempts to assess systems of Public Expenditure Management in Kenya was the 1997 Public Expenditure Review (PER). The PER sought to assess whether expenditure trends were consistent with sustainable fiscal management, and growth and equity strategies as articulated in different government policy documents following Sessional Paper No.1 of 1986 on *Economic Management for Renewed Growth.*[1] On PEM, the Sessional Paper lamented "*...there is not adequate provision for supplementary resources, such as transport, typewriters, even paper and pencils, that are required to make these officers productive ...Eventually many services may cease to be offered at all, while officers continue to draw salaries*'. To address this problem, the government started implementing public service reforms that included, among other things, retrenching staff and rationalizing the wage bill as well as increasing budgetary allocations to operations and maintenance. By 2000, 23,448 civil servants had been retrenched. The core civil service was reduced from 272,000 in 1992 to 191,670 in 2003. However, in spite of the retrenchment programme, public service delivery continued to degenerate (Government of Kenya, 2003a).

[1] The Sessional Paper No.1 of 1986 proposed, among other reforms, economic liberalization to spur private sector development, and public sector reforms to enhance efficiency and effectiveness of the public sector.

The review revealed that the composition and trends in public expenditure were not consistent with policy goals, especially growth and equity. In particular, there was a big divergence between the budget and its implementation. Public expenditure allocations did not reflect policy priorities, and investments were of poor quality. The government had adopted informal fiscal management systems that led to an accumulation of pending bills and weak institutions of expenditure control that bred rampant corrupt practices (Government of Kenya, 1997). The annual reports on government accounts by the Controller and Auditor General continued to reveal massive corruption. Based on these reports covering the period between 1990/91 and 1996/97, the Centre for Governance and Development (CGD) estimated that the government had lost about US$ 4 billion through fraud and wasteful spending through payment for non-existent items or goods, irregular payments and un-surrendered or uncollected revenue (*The East African*, 23 June 1999). The government had nevertheless been able to restore macroeconomic stability following the economic disruptions of early 1990s, which included the 'Goldenberg Scandal'.

Although the 1997 PER made important recommendations to strengthen PEM systems, uneven commitment undermined reform efforts and it was not until 2000/01 that the government started adopting the reforms. These included: the adoption of the MTEF budget process; establishment of a Directorate of Public Procurement; introduction of Integrated Financial Management Information System (IFMIS); and efforts towards institutionalization of the PER process as an integral component of the national budget process.

Another Public Expenditure Review conducted in 2003 concluded that most problems (notably ministerial) that had been identified in PER 1997 still persisted. Ministerial expenditure reviews revealed many instances where the composition of public expenditure was not consistent with public goals, and there was weak budget implementation, low development expenditure allocations, large payment arrears and stalled projects, and inadequacies in reporting and audits. Since 1997, the Kenyan economy stagnated, with GDP growing at an average rate of about 1.3 percent per annum; much lower than population growth rate. This dismal economic performance contributed to increasing poverty. The percentage of those living in poverty increased from 51 per cent in 1997 to over 56 percent in 2002 (Government of Kenya, 2003c).

When the NARC government came to power in December 2002, good governance was identified as one of the three pillars of the Economic Recovery Strategy (ERS) that was unveiled in 2003. According to the ERS, most of the problems bedeviling Kenya and its people arose from the many years of bad governance and poor economic management. Improving governance has, thus, remained one of the key focus area for the government. Through the implementation of the ERS, various measures have been undertaken to enhance fiscal discipline, expenditure prioritization and operational efficiency.

Table 2.1 shows selected fiscal indicators for the period 1999/00 to 2006/07. It can be seen that the fiscal that had turned into a surplus in 2002/03 has not been maintained. Between 2005/06 to 2006/07, the fiscal deficit (commitment basis) is estimated at an average of about 3.8 per cent. The country also relies more on domestic than foreign financing of the fiscal deficit. There have been deliberate government efforts to enhance strategic allocation of public expenditure by allocating more resources to the development budget and also enhancing

Table 2.1: Key indicators of aggregate fiscal indicators (as % of GDP)

	1999/00	2000/01	2001/02	2002/03	2003/04	2004/05	2005/06	2006/07*
Total revenue	19.2	19.4	19.1	19.4	21.0	21.2	21.5	24.2
Recurrent exp.	16.8	20.1	19.5	20.3	20.2	18.9	20.4	21.0
Dev. exp.	2.0	3.4	2.4	4.0	3.1	3.3	5.6	6.3
Total expenditure	18.8	23.5	22.0	24.3	23.3	22.2	26.9	27.6
Domestic interest	2.2	2.3	2.3	2.5	1.9	1.7	1.8	2.3
Foreign interest	0.9	0.8	0.6	0.8	0.5	0.5	0.6	0.3
Deficit incl. grants (Comm. basis)	0.8	-1.7	-2.2	-3.7	-1.0	0.1	-4.1	-3.5
Deficit incl. grants (Cash basis)	0.2	-1.3	-2.7	-3.5	0.0	0.5	-3.2	-3.4
Financing	-0.2	1.3	2.7	3.5	0.0	-0.5	3.2	3.4
Foreign	-2.1	1.3	-1.3	-1.1	-0.7	0.0	0.4	0.5
Domestic	1.9	0.1	4.0	4.3	0.7	-0.5	2.4	2.9

* Authors' estimates

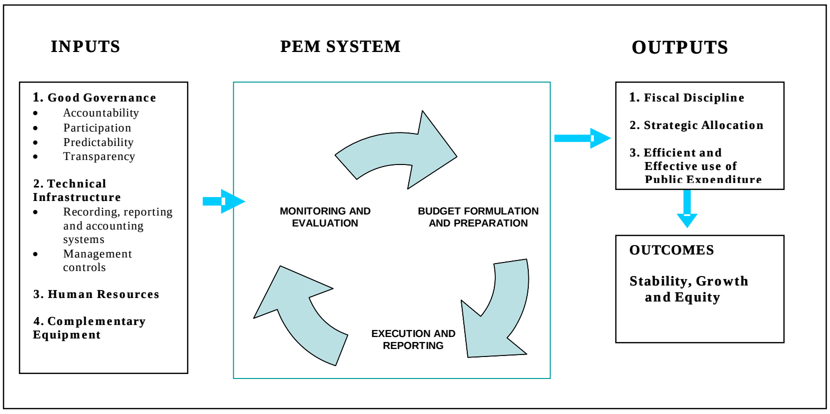
S*ource: Calculated from Quarterly Budget Reviews (QBRs), various* functional allocation of expenditure to social sectors and infrastructure, in line with the Economic Recovery Strategy. Development expenditure as a percentage of GDP that averaged about 3.5 per cent between 2002/03 and 2004/05 was increased to an average of about 6 per cent between 2005/06 and 2006/07.

A review of various Budget Strategy Papers indicate that the share of expenditure allocations to infrastructure in total government expenditure increased from about 11.2 per cent in 2002/03 to about 21.8 per cent in 2006/07. In addition, the social sectors (health and education) continue to take about one third of total public expenditure. In PEM, the government's initial efforts to enhance operational efficiency by introducing performance contracts dates back to 1989 and 1990 when performance contracting for Kenya Railways and the National Cereals and Produce Board (NCPB) was started. These initial efforts failed due to lack of political will, coupled with a weak performance incentive system. Performance contracting was re-introduced in 2003, after a new government came into power and was committed to enhancing public sector performance. By December 2004, 16 state corporations had signed Performance Contracts on a pilot basis. By 31 September 2005, performance contracting was extended to major municipalities, namely, Nairobi City Council, Mombasa, Kisumu, Nakuru and Eldoret. Significant improvements have been noted in the management of the participating public agencies (Kobia and Mohammed, 2006). On 26 June 2007, Kenya was among 14 countries that won the prestigious United Nations Public Service Award (UNPSA) for its extensive system of performance-based contracting for fostering responsiveness and accountability in the civil service. The other countries that won UNPSA are: Australia, Austria, Azerbaijan, Chile, India, Lebanon, Morocco, Korea, Singapore, South Africa, Switzerland and United Arab Emirates.

3. Conceptual Framework on Governance and Public Expenditure Management

Figure 3.1 provides a representation of the Public Expenditure Management system capturing its key features and how they relate in the realization of expenditure outcomes. In this study, the analysis of governance in the PEM relates to how the principles of good governance are applied or promoted within the PEM cycle. The PEM cycle consists of three main stages in the expenditure planning and budgeting processes: budget formulation and preparation; execution and reporting; and monitoring and evaluation. The PEM cycle is not uni-directional. In reality, processes at the various stages may be interactive and two or more budgets may overlap at any one time, and thus be at different stages of formulation and preparation, execution and monitoring or evaluation—depending on the nature of projects or progammes. For instance, the formulation and preparation stage for large infrastructure projects in Kenya spans more than one annual budget cycle; this has been blamed on lengthy procurement processes. PEM is mainly concerned with the management practices and the decision making processes, and how they impact on the goals of efficient allocation of public resources (according to national priorities), efficient and effective use of public expenditures while at the same time ensuring aggregate expenditure discipline that is supportive of macroeconomic stability. Governance principles include: accountability, transparency, participation, performance, fairness, predictability, legitimacy and voice (World Bank, 1994; 2006; Organization for Economic Cooperation and Development—OECD, 2001; and, International Monetary Fund *Code*

Figure 3.1: Governance and public expenditure management cycle



of Good Practice on Fiscal Transparency). These principles overlap and may be self-reinforcing. In this study, accountability, participation, predictability and transparency are considered.

The operations of the PEM system have important consequences to the society in terms of realization of the broad goals of economic policy; that is growth, stability and equity. These consequences arise largely from the realization of PEM goals, which we refer to in the schematic presentation (Figure 3.1) as outputs. Good governance is a key 'soft' input in PEM system that is often neglected. Others include: technical infrastructure such as appropriate accounting systems; and human resources as well as complementary equipment such as information technology. These inputs give the PEM system its dynamic nature as information is processed, goals are set and public resources are allocated and utilized towards the realization of development goals. Good governance enhances the dynamism of a PEM system in realizing the expected outputs, as it helps address the inherent problems in PEM such as information asymmetry between different players within the system, high transaction costs involved in getting feedback from beneficiaries, civil society and implementing agencies, as well as incompatibilities in incentives or the agent-principal problem, where politicians and bureaucrats behave opportunistically. The dynamism of the PEM system should, therefore, be enhanced by developing formal mechanisms for transparency, participation, accountability and predictability.

As shown schematically above, the outputs of the PEM system are ideally aggregate fiscal discipline, efficient allocation of resources, and efficient and effective use of public expenditure. There is no guarantee that the system will aim at these goals or rather get captured for the benefit of special interests, say through corruption and inefficiencies. Development of formal systems that enhance good governance helps ensure that deviations from the stated goals are minimized.

Accountability requires that public officers are responsive and answerable. Effectiveness in accountability requires that performance measures are established and oversight mechanisms are effective to ensure that standards are met and maintained. The oversight mechanisms in PEM are mainly at two levels: financial and economic oversight. The latter function relates to whether public resources are being allocated strategically and being used efficiently and effectively. Some of the tools used at this stage for economic evaluation include: client service delivery surveys, expenditure tracking surveys and public expenditure reviews or other institutionalized performance monitoring and reporting mechanisms. Financial oversight ensures that the execution of plans meets proper accounting standards. It includes the audit functions as well the legislative oversight through parliament. These fall under the monitoring and evaluation stage within the PEM system. The principle of participation is key both in budget formulation, monitoring and evaluation. Involvement of stakeholders is important in identifying priorities as well as appraising performance. Transparency, on the other hand, requires that information is available on government processes, budgets and performance and thus supports accountability. The other important principle of good governance relates to predictability. This arises basically from not only a sound legal framework for PEM but also administrative regulations that provide clarity of roles and responsibilities for the different players within the PEM system. The legal and administrative frameworks should be applied fairly. Predictability is also important in the flow of resources from the centre to the implementing agencies. Various formal mechanisms can be adopted and enforced to enhance good governance in PEM.

3.1 Budget Formulation and Preparation

Budget formulation and preparation sets the framework for realization of the three goals: fiscal discipline, strategic allocation and operational efficiency. In PEM cycle, this is the stage at which the policy-budget link is initiated by translating policies into implementable expenditure programmes and projects. As noted above, governance institutions are necessary to mitigate political and/or bureaucratic expediency or opportunistic behaviour. Several countries have adopted 'fiscal responsibility' legislation aimed at ensuring discipline and efficiency through various fiscal rules and managerial processes. The rules apply to budget deficits, borrowing requirements and transparency clauses.[2]

One of the instruments that many countries employ is a Medium Term Budget Framework where a macro-fiscal framework underpins the budget. The macro-fiscal framework ensures that the budget is consistent with resource constraints and does not undermine macroeconomic stability, including price stability and sustainable debt position. It does this by ensuring that expenditure programming takes

[2] For OECD experiences, see OECD Economic Outlook No. 72 (2002).

into account revenue constraints and the macroeconomic implications of the different ways of financing the deficit. If revenue forecasts are over-estimated, payment of arrears may result at the budget execution stage. Therefore, for fiscal discipline to be achieved, the MTEF should be accompanied by hard budget constraints.

The key activities at budget formulation and preparation stage include: issuance of budget guidelines to line ministries and agencies, preparation of budgets, negotiations on budget issues with Ministry of Finance, finalization of the draft budget by the Ministry of Finance, Cabinet approval, and submission to Parliament.

The principle of participation is important in budget formulation and preparation so as to get feedback and help coordinate the activities of those involved in it. Key players should be involved in setting the goals to be pursued as it enhances 'ownership' and ensures that minimal alterations are made on the budget at the subsequent stages. Transparency of the budget is determined by the nature and amount of information that is available on the budget. Different players require reliable and timely information so as to give feedback. Reliable information on the costs of competing projects and programmes is critical for prioritization and design of projects and programmes. Accountability and predictability requires that the rules and regulations governing the budget formulation and preparation process are clear, and are respected uniformly. Clarity of roles and responsibilities of the different players is essential as it ensures that one can be held accountable in the budget planning process. Performance orientation or indicators is a formal mechanism that ensures that targets are set at this stage and enhances accountability in subsequent stages. Performance orientation in budget formulation may also involve making decisions on privatization, divestitures and contracting out certain services to improve performance, efficiency and effectiveness of public expenditure.

In 2000/01, the Government of Kenya made an important step in strengthening the budget planning process by adopting the Medium Term Expenditure Framework (MTEF) budget process. The MTEF budget process was recommended in the 1997 Public Expenditure Review (PER) report. The key goals of the MTEF budget process are to enhance the policy-budget link, ensure aggregate fiscal discipline and efficiency in the allocation and use of public resources (World Bank, 1998). The MTEF budget process is, therefore, instrumental in realizing the goals of PEM. It provides a framework through which 'needs' can be reconciled with 'available resources' within an environment of macroeconomic stability, while at the same time ensuring that sector priorities are respected. The government also sought to improve the administrative framework by establishing the following institutions: MTEF Secretariat to coordinate the budget process; Budget Monitoring Department (BMD) to strengthen budget monitoring and reporting; Directorate of Public Procurement to enhance efficiency and transparency in procurement; and introduction of Finance Officers (FOs) to oversee budget management in line ministries (Government of Kenya, 2003c).

Since its introduction, the MTEF budget process has undergone various reforms to make it relevant and more effective. By and large, the Kenyan process has four important characteristics: a ministerial PER process; medium term framework; a top-down fiscal framework; a 'bottom up' process of preparing sectoral budgets for achieving sector policies and targets; and a bidding process for reconciling the 'bottom up' and 'top-down' processes. The adoption of MTEF has improved participation, as the process includes annual consultations through public sector hearings during the budget formulation and preparation stage. In addition, the Ministry of Finance requests and receives pre-budget submissions from key stakeholders. The 'bottom up' process of the MTEF requires that grassroot or sub-national prioritization and expenditure programming is undertaken as inputs to the budget process. Within Kenya's MTEF budget process, there are District MTEFs that are supposed to facilitate sub-national participation in the budget. The participation of civil society in the budget preparation process still falls short of expectations as the civil society is not effectively represented. The civil society participated actively in the Poverty Reduction Strategy Paper (PRSP) preparation process and in the consultations leading to the preparation of the final version of ERS. However, their participation in the annual budget process is limited. Further, District MTEF Committees that are supposed to provide forums for participation in the budget preparation process at the district level have not been fully operationalized and institutionalized. One of the leading civil society bodies that participates in the budget process is the Institute of Economic Affairs (IEA). However, the participation has been mainly through organization of pre-budget hearings rather than through the formal mechanisms of MTEF public hearings.

As indicated above, an important aspect of budget transparency relates to the nature of budget information, its coverage and documentation. In recent years, the government has made efforts to enhance transparency by providing more information through information communication technology. For instance, the Ministry of Finance provides budget documents on its website, such as Budget Outlook Paper (BOPA); Budget Strategy Paper (BSP) and the MTEF Sector Reports. However, although line ministries prepare Ministerial Public Expenditure Reviews that inform the budget, they hardly publish this information for public consumption. The MPERs review past expenditure trends and composition, and PEM at the ministry level and thus form an important basis for budget decisions. The presentation of the budget to Parliament provides the opportunity for the legislature, media and the public at large to see the budget and discuss it. The key documents that form the package that is presented to Parliament include: Budget Speech; Budget Estimate Books; Finance Bill and Statistical Annex to the budget. Beginning 2003, the government started implementing public finance reforms through which budget coverage and classification would be improved to enhance budget transparency. International budget classification systems include: economic classification, functional classification and territorial classification. They go beyond the traditional classification by ministries and departments (by votes, sub-votes, heads and line items). Although the traditional administrative classification is more useful for the purpose of control of budget by administrative units, it is limiting in terms of information and transparency if one needs to analyze the budget to understand the purpose of expenditure and geographical location. Problems still exist because of lack of reliable and consistent data on the budget's functional, programme and territorial or geographical classification. Once the key international budget classification systems are in place, the disclosure of fiscal information will be greatly improved, and it will be much easier to scrutinize and analyze fiscal decisions on allocation of expenditure, fiscal risks and impact on the economy.

Dissemination of information on government policy is done through various means, including sectoral and ministerial bulletins, dissemination seminars, conferences, workshops and press releases. A public communication office was also established in 2003 to inform, clarify and respond to information gaps. At the sub-national level, the District Information Dissemination Centres (DIDCs) are used as resource centres by the public and other institutions. Nonetheless, the governance survey conducted through Africa Peer Review Mechanism (APRM) revealed that more than half of Kenyans were not aware of District Development Committees (DDCs) that coordinate development activities at the sub-national level. It is not clear whether the Official Secrets Act (CAP 187), which provides for the preservation of state secrets by public officers, hampers public access to information. However, the government is now working on a Freedom of Information Policy to culminate in the development of a legal framework to enhance public access to information and transparency.

The New Partnership for Africa's Development's (NEPAD's) Africa Peer Review Mechanism country assessment revealed that parliamentary oversight over budget formulation was weak. There have been efforts to strengthen legislative oversight by establishing a budget office. The Fiscal Management Bill 2006 before Parliament aims at strengthening legislative oversight. In addition, it provides for the establishment of the Fiscal Analysis and Appropriations Committee. However, the bill in its current form does not provide for effective participation or involvement at the early stages of formulation that include PER processes and preparation of Budget Outlook Papers.

The Presidential Circular No.1/2004 that spells out the key mandates of ministries, moved functions of MTEF and budget monitoring to the Ministry of Finance so as to address organizational problems in budget coordination. Initially, matters of budget preparation and execution used to be contained in the Government Financial Regulations and Procedures (GFRP) 1989. The GFRP remains out of date as reforms have been undertaken to strengthen the legal framework for PEM. For instance, matters related to audit are now covered under the Public Audit Act 2003, and execution and reporting under the Government Financial Management Act 2003. Likewise, procurement issues now fall under the Public Procurement and Disposal of Assets Act 2005, while budget formulation still lacks a clear legal framework, 'though it may be considered as an executive amendment to the Programme Review and Forward Budget procedure' (NEPAD, 2005). However, one key problem still remains; there is no clear legal framework underpinning the MTEF budget process that clearly gives the roles, responsibilities and procedures for the budget process. The process is mainly driven by Treasury Circulars that are sometimes delayed and do not clearly spell out the roles of different players in the budget process. Kenya, therefore, needs to consider developing an organic budget law to enhance predictability in the budget formulation and preparation process.

Budget transparency aims at full disclosure of relevant fiscal information on a timely and systematic manner. Additional areas where reforms have been initiated relate to coverage of the budget, so that it is made comprehensive enough to consolidate all the financial activities of the general government and those of all entities controlled by the government, including extra budgetary funds, special fund accounts, and expenditures financed through external sources.

3.2 Execution and Reporting

The budget is executed through the release of funds by Treasury to the spending agencies responsible for disbursement to contractors and suppliers. In the budget execution, spending agencies follow laid out rules and regulations to ensure that procurement procedures are followed and that there is compliance with parliamentary appropriations. The disbursement mechanisms may be slightly different if some transactions are centralized. At the spending agency level, the execution process involves the following steps: commitment of funds, verification (once approved, the spending agency can place an order or enter into contract), delivery of goods and services, and payment. Sometimes, there may be delays in the processing of payments that may result in pending bills or arrears. Additionally, difficulties may arise in bank reconciliations due to delays in presentation of data by spending agencies. At the end of the budget year, final accounts are prepared, which are audited by the Controller and Auditor General responsible to Parliament.

Within the context of PEM goals, this stage is important in ensuring that deviations from the budget are minimized. This is important because in most cases, those executing the budget may not have information about the policy priorities that are being implemented. At the execution level, it is important to have procedures and rules or governance institutions that ensure alterations to the budget are minimized and efficiency is promoted. Table 3.1 attempts to show governance principles that are key at different stages of PEM.

Sound budget execution requires that the management of procurement (purchase) and use of public resources is carried out efficiently and cost-effectively. This is the stage in PEM where good governance is even more key, as the avenues for corruption or misuse abound especially in the procurement and supply of goods and services.

Service delivery points have also been recognized as points where corruption occurs especially through bribes. Public expenditure tracking surveys have established that there have been leakages before reaching the intended recipients. For instance, a Kenya Institute for Public Research and Analysis (KIPPRA) study in 2003 established that in 2001/02, only about 59.1 per cent and 88 per cent of drug supplies reached dispensaries and health centres, respectively (Nafula *et. al.*, 2004). This could be explained by weak governance systems, as the study also established that there were lesser leakages where annual audits were regularly undertaken. In this regard, independent oversight institutions such as corruption control agencies, external auditing agencies, parliamentary oversight committees, and professionalizing the civil service may help reduce resource misuse.

Transparency in budget execution also ensures that irregularities are detected easily. Within any organization, management controls are put in place. However, management can circumvent those controls and misuse public resources. In an atmosphere of transparency and accountability, subordinate officers who detect such irregularities may report. This may also be provided for in legislation. The United Nations Convention Against Corruption (UNCAC) and the African Union Convention for Prevention and Combating Corruption (AUCPCC) provide for the protection of whistle blowers.

In Kenya, the governance institutions for budget execution have been strengthened with the enactment of the Public Audit Act 2003, Government Financial Management Act 2004 and Public Procurement and Disposal of Assets Act 2005. The Government Financial Management Act 2004 provides the legislative framework for management of public financial affairs, including reporting by accounting officers. The Public Procurement and Disposal of Assets Act 2005 establishes the framework for streamlining the procurement system. As part of its operationalization, Public Procurement and Disposal Regulations 2006 were developed and came into effect from 1 January 2007 through a Gazette notice. Although it is too early to assess the effectiveness of this piece of legislation, it provides for the creation of an autonomous Public Procurement Oversight Authority (PPOA) whose functions include, among others, ensuring compliance and monitoring performance of the procurement system. The law makes mandatory the publication of procurement information, including contract awards and gives a framework for disposal of public assets to minimize irregular disposal of public assets. The law also covers security procurements, which have been a major area of concern due to corruption scandals, including the Aglo-leasing scandal.[3]

Other recent reforms that have implications for governance in budget execution include: the enactment of the Anti-Corruption and Economic Crimes Act 2003, leading to the establishment of the Kenya Anti-Corruption Commission (KACC). The KACC annual reports reveal enormous cases of corruption within the public sector. For instance, according to the 2005/2006 report, KACC was undertaking investigations in cases of corruption estimated at about Ksh 75.1 billion.[4] The Commission also made some efforts to implement the Ndung'u report on irregular allocation of public land and recovered about 223 acres of land valued at about Ksh 144 million. The annual report also reports that 7,888 complaints had been received by KACC. However, only 15 per cent fell under the mandate of the Commission. This perhaps underscores the establishment of the Office of Ombudsman to help in resolving complaints against government authorities.

As discussed in section 3.2, it is important to set legislative framework that encourages the society to participate in the fight against corruption. Kenya has already signed and ratified UNCAC and signed the AUCPCC, which is yet to be ratified. However, until the Witness Protection Act 2006 was passed into law, the Kenyan legislative system did not provide protection for whistle blowers.[5]

[3] A special Audit Report by the Controller Auditor General on financing, procurement and implementation of security-related projects, April 2004, established that government's financial commitments on 18 projects, as of 30 June 2005 totalled about Ksh 56.3 billion made outside the budget process and without the approval of Parliament. There was also no linkage between payments made and actual project implementation.

[4] Includes Anglo-leasing type of contracts.

[5] David Munyakei could not survive the aftermath of whistle-blowing on the Goldenberg Scandal. He was sacked from Central Bank of Kenya and remained unemployed until his death in 2006. The KACC Annual Report 2005-2006 also notes that prospective witnesses in corruption cases feign ignorance, which hampers the preparation of cases.

Since the introduction of the MTEF, information on budget execution has been improved through the Budget Monitoring Department (BMD) that publishes quarterly data on the budget. In 2000, the government started introducing the Integrated Financial Management Information System (IFMIS) aimed at integrating budget preparation, execution, control and financial accounting and reporting in one system. However, progress has been slow.

As noted above, the government introduced a performance contracting system to enhance efficiency and effectiveness in public sector management. However, the system is not anchored in the budget cycle, especially for the ministries, such that the targets are never clearly integrated in the budget formulation process. In practice, the performance contracting system does not work within the national MTEF budget process. For instance, MPERs require that ministries set up targets to be realized, yet the targets are rarely the same as those given in the performance contract. Although the system appears to be realizing improved performance, the parliamentary Public Investment Committee (PIC) has expressed concerns that some ministries micro-manage state corporations under them, thereby undermining board decisions and could dilute the principles that underpin the performance contracting system (National Assembly, 2006).

Weak governance institutions contribute to coordination problems in budget execution, which leads to poor absorption of donor funds by ministries and various government agencies. The absorption rate has been estimated at 33 to 40 per cent, especially with regard to Overseas Development Assistance (ODA). The government has been preparing an External Aid Policy whose implementation will partly improve absorptive capacity, management of ODA and donor coordination and harmonization. In the past, predictability in the flow of funds from Treasury to spending units has sometimes been untimely and unreliable. This was manifested in several ways, for example, through delays in the release of ministerial ceilings to districts, delays in the release of Authority to Incur Expenses (AIEs) to districts, release of AIEs not matched with corresponding exchequer, and AIEs not issued according to returns on output and set targets on performance. The Treasury Circular 5/2005 dated 26 April 2005 to all Accounting Officers introducing Cash Flow Planning System and Zero Balance Drawing Accounts was intended to tackle this problem.

3.3 Monitoring and Evaluation

Monitoring involves collection of relevant information on execution and implementation of public expenditure programmes and projects. Evaluation, on the other hand, relates to using monitoring and other information available to make improvements on expenditure management. It provides the feedback loop from M&E to plan formulation, whereby past experience can be used to inform and improve, use and allocate public resources (Figure 3.1). The monitoring and evaluation information is, therefore, important in enhancing transparency, accountability and predictability in the PEM system.

Monitoring and evaluation is mainly at two levels, monitoring of financial administration of the budget, and physically monitoring of the implementation of projects and programmes. Financial monitoring requires that the financial administration of the budget is monitored at various stages of budget execution, including release of funds, commitments, verifications, alterations/virements and payments. This information is useful in detecting difficulties in financial administration of the budget. It may provide important indications on whether fiscal targets and priorities are being respected during budget execution. Monitoring the implementation of projects and programmes at the physical level may look at the input process and output performance targets. Therefore, monitoring and evaluation should provide information on whether the goals of PEM are being realized. Some of the key tools for M&E include: public expenditure reviews; client surveys; expenditure tracking surveys; and cost-benefit analysis.

The monitoring and evaluation function within PEM management in Kenya has not received adequate attention despite efforts to establish a strong M&E system in early 1980s. Consequently, the link between M&E, planning and budget formulation has been weak. *First*, serious attempts to establish a M&E system came with the District Focus for Rural Development Strategy (DFRDS) that was adopted by the government in 1983. As a result, Provincial and District M&E Committees were established. Despite these early efforts, the M&E system was not integrated within the budget planning process. Therefore, M&E activities remained institution or project-based without serious attentions on data analysis and dissemination on budget execution and implementation and use of the same data for budget planning. Linkages between the different levels of government remained weak.

It is not surprising that the ERSWEC 2003 advocated for the establishment of a National Integrated M&E System that would provide the government with reliable mechanisms to measure efficiency and feedback on policy implementation (Government of Kenya, 2003a). As part of institutionalizing the M&E system, the government established the Monitoring and Evaluation Directorate in the Ministry of Planning and National Development to spearhead the process. In addition, Central Planning and Project Monitoring Units were established in all ministries to support the project monitoring function. The M&E Directorate has coordinated the preparation of Annual Progress Review (APR) reports and Medium Term Review (MTR) reports on the implementation of the government's economic recovery strategy. In addition, the M&E Directorate now coordinates the PER process, which is a diagnostic tool for assessing the realization of PEM goals. In spite of the progress, there exists challenges that require immediate attention.

- The M&E function is not well integrated in the PEM cycle. Currently, the production of the annual and medium term progress reports are not clearly synchronized within the budget cycle. There is a PER process that precedes the preparation of ministry budgets. However, this process runs parallel with the APR and MTR process. The integration of the M&E system with the PEM cycle would be an important step in institutionalizing the system.
- The PER provides the diagnostic review of expenditures that inform the preparation of MTEF sector reports for the budget. The weakness of the process is that it is still localized at central Ministries and few parastatals undertake this diagnostic review.
- Those that have undertaken the system is yet to be fully extended to the district level. Most of the indicators are output rather than efficiency-oriented. As a result, the system does not promote the practice of collecting data on unit cost or least time incurred to provide a service or output.

As already discussed, there are two levels of monitoring and evaluation, namely financial and economic. The financial oversight function is mainly undertaken through the Kenya National Audit Office (KNAO), where the Controller and Auditor General reports to Parliament. The KNAO has focussed on the traditional financial audits but there are efforts to introduce performance audits. The PAC and the

PIC have been the most active committees of Parliament. They play an oversight role that ensures the Executive is accountable to Parliament in the use of public finances as voted by the House. While PAC examines the Controller and Auditor's General (C&AG) report on all accounts of government ministries, PIC examines the accounts of State corporations and reports on the state of government investments. To play their roles effectively, the two committees are dependent on the quality, accuracy and timeliness of the audit reports of KNAO. After reviewing the reports, when need arises, the Committees summon accounting officers to explain any irregularities. They then report to Parliament on such irregularities and recommend necessary actions. However, the 13th report of PIC, Volume 1, 2006 decries the slow pace of implementation by government of recommendations from previous reports. The Fiscal Management Bill 2006 is an important innovation in strengthening governance. Related to the oversight functions of Parliament, it proposes the establishment of a parliamentary budget office as well as strengthening the oversight function of the legislature over the budget process.

Table 3.1 summarizes the key dimensions of governance at each stage in PEM. For instance, during budget formulation and preparation, accountability and predictability are enhanced through a sound legal and administrative framework for budget formulation and preparation with clear roles and responsibilities for the different players. In addition, it is important to set performance or expected outputs at the budget formulation and preparation stage. Participation is important to ensure that budget formulation benefits from past experience as well as feedback from key stakeholders, including monitoring and evaluation information. Transparency requires that reliable information is available on the budget and its coverage is comprehensive.

Table 3.1: Key aspects of governance in PEM

	Formulation and preparation	**Execution and Reporting**	**Monitoring & Evaluation**
Accountability	Clarity of roles and responsibilities in budget formulation and preparation Establishment of performance indicators/orientation	Management controls include: internal accountability systems for expenditure controls and implementation (commitment, verification, payment and delivery of goods and services)	External financial audit Economic audit of performance
Participation	Feedback and coordination of budget inputs. Stakeholders include: civil society, private sector players, legislative review and donors		Feed back on quantity and quality of services (e.g. client surveys, public expenditure reviews)
Predictability	Sound legal and administrative frameworks for budget formulation and preparation	• Timely release of funds and payments • Deviations from the budget • Rules and regulations for budget execution are clearly applied	M&E information is used to improve PEM
Transparency	Budget coverage, classification and documentation	Regular fiscal reporting on budget execution and implementation Transparent procurement procedures	M&E information is available and used to improve PEM

4. Conclusions and Recommendations

This paper presents a conceptual framework that views good governance as one of the key inputs in a PEM system. Good governance in public expenditure management has the potential of enhancing budget outcomes while improving confidence and legitimacy in public institutions. Good institutions of governance help mitigate the problems that arise due to information asymmetry between different players in PEM, incompatibility of incentives especially relating to political and or bureaucratic expediency, and high transaction costs involved in obtaining feedback on the planning and budgeting process. In recent years, the Government of Kenya has been undertaking a different approach in PEM reforms that impacts positively on governance.

Fiscal transparency contributes significantly to the achievement of good governance. It also leads to better-informed public debate about the design and results of fiscal policy. In addition, fiscal transparency makes the government accountable, strengthens credibility and improves public understanding of fiscal policies and choices. Predictability requires the legal and administrative processes that govern expenditure management to provide clarity on the roles of the different players in the PEM system, hence encouraging accountability. Governance institutions that encourage participation enhance feedback and use of M&E information to enhance decision making.

To enhance wider public participation in PEM, there is need to promote and strengthen non-state actors' capacity in the PEM process. Currently, the MTEF process provides that window. There is need to build output and performance-based data so as to support performance orientation. An important area of research in this regard relates to how Chief Executives are given some flexibility in budget execution to reach their targets while not undermining accountability. To improve on the oversight role of parliamentary committees over PEM, PAC and PIC reports, the capacity of parliamentarians needs to be enhanced in the ongoing reforms to establish a parliamentary budget office. Predictability in budget formulation and preparation should be enhanced through the development of a legal framework for budget formulation, which should be synchronized with the Fiscal Management Bill 2006.

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