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# MECHANISMS AND CRITERIA FOR TRANSFER OF ASSETS AND LIABILITIES OF GOVERNMENT AND OTHER PUBLIC ENTITIES





## **Transition Authority**

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**Mechanisms and Criteria for Transfer of Assets and Liabilities of Government and Other Public Entities**

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Stamp Duty Act, Chapter 480 Laws of Kenya

The Arbitration Act, 1995

The Government Proceeding Act, Chapter 40 Laws of Kenya

The Transition County Allocation of Revenue Act, 2013

The Transition to Devolved Government, Act No. 1 of 2012

## ACRONYMS

<b>ATC</b>	-	Agricultural Training Centres
<b>ADR</b>	-	Alternative Dispute Resolution
<b>ESAAG</b>	-	East and Southern African Association of Accountants General
<b>IAS</b>	-	International Accounting Standards
<b>IASB</b>	-	International Accounting Standards Board
<b>IFRS</b>	-	International Financial Reporting Standards
<b>IPSAS</b>	-	International Public Sector Accounting Standards
<b>IPSASB</b>	-	International Public Sector Accounting Standards Board
<b>IT</b>	-	Information Technology
<b>ITA</b>	-	Income Tax Act, Chapter 470 Laws of Kenya
<b>KRA</b>	-	Kenya Revenue Authority
<b>LAPFUND</b>	-	Local Authorities Provident Fund
<b>LAPTRUST</b>	-	Local Authority Pension Trust
<b>MTC</b>	-	Medical Training College
<b>NLC</b>	-	National Land Commission
<b>PIN</b>	-	Personal Identification Number
<b>PP&amp;E</b>	-	Property, Plant and Equipment
<b>TA</b>	-	The Transition Authority
<b>TCTAL</b>	-	The Technical Committee on the Transfer of Assets and Liabilities
<b>NHIF</b>	-	National Hospital Insurance Fund
<b>NSSF</b>	-	National Social Security Fund
<b>AMIS</b>	-	Asset Management Information System
<b>CoK</b>	-	Constitution of Kenya

## **EXECUTIVE SUMMARY**

The Transition Authority (TA) is a statutory body established under Section 4 of the Transition to Devolved Government Act, (TDGA) 2012.

Pursuant to Section 7 (1) of the TDGA, 2012 the TA is mandated to facilitate and coordinate the transition to devolved system of government in Kenya as provided under Section 15 of the Sixth Schedule to the Constitution. Section 7 (2) (g) and (h) (ii) of the TDGA provides for the TA to develop mechanisms for transfer of assets and liabilities of Government and Other Public Entities during the transition period as well as, determine the criteria for transfer of previously shared assets and liabilities of Government and Defunct Local Authorities.

The mechanisms and criteria for transfer of public assets and liabilities contains the following; definition of public assets and liabilities; classification of public assets and liabilities; legal process for transfer and securing of various classes of assets belonging to the defunct local authorities; legal process for securing and transfer of assets and liabilities from National to County Governments; modalities for transfer and handling of court cases involving the defunct local authorities; addresses modalities for public assets identification, verification, validation, valuation and audit; procedural rules for transfer and sharing of public assets and liabilities; an institutional framework to support the transfers of public assets and liabilities, and recommendations on waiver of taxes and other fees during the transfer of assets to either level of Government during the transition period.

The mechanisms and criteria contained herein will facilitate seamless transition of resources between the National and County Governments taking into consideration the existing legal provisions.

## INTRODUCTION

### *1.1 Transition Phases*

The Transition to Devolved Government Act, 2012, under the Fourth Schedule provides for two transition phases. The mechanisms and criteria for transfer of public assets and liabilities is to be implemented in the second phase. The two phases can be summarized as follows:

#### **1.1.1 Phase One**

During Phase One of the transition period, the Authority was required to carry out the following activities in relation to management, audit and transfer of public assets and liabilities, out of which the underlined activities below represent the scope of the mechanisms and criteria for transfer of public assets and liabilities:

1. audit assets and liabilities of the Government, to establish the asset, debts and liabilities of the Government;
2. audit assets and liabilities of defunct Local Authorities, to establish the asset, debts and liabilities of each Local Authority;
3. audit local authority infrastructure in the counties, to establish the number and functionality of plant and equipment in defunct Local Authorities;
4. audit the Government infrastructure in the Counties, to establish the number and functionality of plant and equipment for the purpose of vesting them to either level of Government;
5. provide for a mechanism for the transfer of Government net assets and liabilities to National and County Governments;
6. provide mechanisms for the transfer of assets and liabilities which may include vetting the transfer of assets during the transitional period;
7. provide for a mechanism that will secure assets and liabilities held by the defunct Local Authorities.

#### **1.1.2 Phase Two**

During Phase Two of the transition period the Authority is expected to, among other activities; complete any activity that may be outstanding from Phase One.

### **1.2 Mechanism Approach**

Development of the mechanisms and criteria for transfer of public assets and liabilities was both consultative and participatory. It involved extensive discussions, interviews, research and close collaboration with key stakeholders.

There was also the use of both primary and secondary methods of data collection, analysis and dissemination.

### 1.3 Expected Outcomes

The mechanisms and criteria for securing, vetting, and transfer of public assets and liabilities developed. It includes among others:

1. The definition of public assets and liabilities;
2. Classification of assets (moveable, immovable, tangible, intangible, etc.);
3. Legal process for securing and transfer of various classes of assets belonging to the defunct Local Authorities;
4. Legal process for securing and transfer of assets and liabilities from National to County Governments;
5. Mechanism for transfer of court cases involving the defunct Local Authorities;
6. Manner of handling court cases involving defunct Local Authorities;
7. Mechanism for public assets identification, verification, validation, valuation and audit;
8. Procedural rules for transfer and sharing of public assets and liabilities;
9. Institutional framework to support the transfer of public assets and liabilities;
10. Dispute resolutions arising from the transfer or sharing of public assets and liabilities;
11. Recommendations on waivers on taxes and other fees during the transfer of public assets and liabilities to either level of Government during the transition period.

## 2.0 METHODOLOGY

The work of developing a Mechanism and Criteria for transfer and/or sharing of public assets and liabilities was premised on Five key focus areas

The key focus areas for analysis are enumerated in Table 1 below:-:

*Table1: Focus Areas*

Focus Area	Description
1	Definition and classification of public assets and liabilities
2	Legal process for securing and transfer of public assets and liabilities
3	Mechanism for transfer and handling of court cases involving the defunct Local Authorities
4	Dispute resolution arising from the transfer or sharing of assets and liabilities
5	Waivers on taxes and other fees during the transfer of public assets and liabilities to either level of Government

### 2.1 Focus Area 1:

#### **Definition and classification of public assets and liabilities**

This focus area --- entails the definition, categorization and contextualization of public assets and liabilities in light of the proposed transfers between the two levels of government.

In undertaking to define and categorize the public assets and liabilities, a three-pronged approach was adopted:

- a) A list of assets and liabilities held by the defunct local authorities and the National Government as submitted to the TA was obtained;
- b) Benchmarking the proposed definitions with the globally accepted International Financial Reporting Standards (IFRS) as well as the International Accounting Standards (IAS) on the recognition of assets and liabilities;
- c) Classification of identified and confirmed assets as either moveable, immovable, tangible, intangible, inventory (IAS 2), PP&E [property, plant and equipment (IAS 16)], intangibles (IAS 36), investment property (IAS 40) and financial assets (IFRS 9).

The above source documents and Counties visited as listed in Appendix 1 formed the basis of analysis, review and categorization for the purposes of the proposed transfers.

## **2.2 Focus Area 2:**

### **Legal process for securing and transfer of public assets and liabilities**

This focus area entails securing and transfer of public assets and liabilities within various contexts. The specific topics include:

- a) The legal process for securing and transfer of various classes of assets belonging to the defunct Local Authorities;
- b) The legal process for transfer and securing of assets and liabilities from National to County Governments;
- c) The procedural rules for transfer and sharing of public assets and liabilities;
- d) The institutional framework to support the transfer of public assets and liabilities.

This was done by identifying and evaluating the various legal processes on transfer of assets and liabilities as espoused within the framework of various statutes. The status of the defunct Local Authorities vis-à-vis their capacity to facilitate the transfer of assets and liabilities to other administrative organs was also assessed. This is of particular importance since legally, upon the final announcement of all the results of the first elections held under the 2010 Constitution, the provisions of section 134(1) of the County Governments Act repealed the Local Government Act immediately rendering the Local Authorities defunct raising queries about how their assets and liabilities would be managed and finally transferred or shared between the two levels of Government.

The Constitutional and legislative framework for the transfer of functions from the National to the County Governments as espoused in the Fourth Schedule of the Constitution of Kenya 2010, on County functions, inform the subsequent transfer or sharing of relevant public assets and liabilities.

Regarding the procedure on transfer of public assets and liabilities, all the applicable rules and guidelines on conveyance law and practice in Kenya as well as, the rules on transfer of property by defunct and other corporate Government bodies were adhered to. Since the

envisaged public assets and liabilities go beyond land, hence the consideration of other laws dealing with the transfer of assets and liabilities including but not limited to:

- Auctioneers Act, Chapter 526 Laws of Kenya
- Banking Act
- Capital Markets Act, Chapter 485A, Laws of Kenya
- Chattels Transfer Act, Chapter 28 Laws of Kenya
- Civil Procedure Act, Chapter 21 Laws of Kenya
- Companies Act, Chapter 486 Laws of Kenya
- Competition Act, Chapter 504 Laws of Kenya
- County Governments Act, No. 17 of 2012
- County Governments Public Finance Management Transition Act, No. 8 of 2013
- Criminal Procedure Code, Chapter 75 Laws of Kenya
- Debts (Summary Recovery) Act, Chapter 42 Laws of Kenya
- Disposal of Uncollected Goods, Chapter 38 Laws of Kenya
- Environment and Land Court Act, Chapter 12A Laws of Kenya
- Ethics and Anti-Corruption Commission Act, Chapter 65A, Laws of Kenya
- Evidence Act, Chapter 80 Laws of Kenya
- Government Contracts Act, Chapter 25 Laws of Kenya
- Government Proceedings Act, Chapter 40 Laws of Kenya
- Government Securities Act, Chapter 421 Laws of Kenya
- Income Tax Act
- Intergovernmental Relations Act Chapter 5G Laws of Kenya
- Kenya Revenue Authority Act Chapter 469 Laws of Kenya
- Land Act No 6 of 2012
- Land Registration Act No 3 of 2012
- Law of Contract Act, Chapter 23 Laws of Kenya
- Local Authorities (Recovery of Possession of Property) Act Chapter 273 Laws of Kenya
- Local Authorities Provident Fund, Chapter 272 Laws of Kenya
- Local Authorities Transfer Fund, Chapter 272A Laws of Kenya
- Local Government Loans Act, Chapter 270 Laws of Kenya
- National Land Commission Act No 5 of 2012
- National Social Security Fund, Chapter 258 Laws of Kenya
- Sale of Goods Act, Chapter 31 Laws of Kenya
- State Corporations Act, Chapter 446 Laws of Kenya
- Stamp Duty Act, Chapter 480 Laws of Kenya
- Transition to Devolved Government Act of 2012
- Unclaimed Financial Assets Act, No 40 of 2011

The institutional framework to be considered in analyzing the proposed transfer of public assets and liabilities was arrived at through an in-depth investigation of the mandate of relevant existing bodies involved with the transfer of public assets and liabilities to determine their viability and adequacy so as to propose recommendations on institutional requirements in aid of this process. This involved discussions with the officials from such institutions which were considered as key stakeholders in this process. The institutions included:

- Commission for the Implementation of the Constitution(CIC)
- Commission on Revenue Allocation(CRA)

- Ethics and Anti-Corruption Commission(EACC)
- Kenya National Audit Office(KeNAO)
- Kenya Revenue Authority(KRA)
- Ministry of Devolution and Planning
- National Land Commission(NLC)
- National Treasury
- Office of Attorney General(OAG)
- Public Procurement Oversight Authority(PPOA)

### 2.3 Focus Area 3:

#### **Mechanism for transfer and handling of court cases involving defunct Local Authorities**

The approach in addressing this focus area can be summarized as follows:



The source documents used to develop the mechanism for transfer and handling of court cases involving the defunct Local Authorities include:

- a) A list of on-going cases and disputes pending determination
- b) A list of advocates contracted in the cases involving defunct Local Authorities.

There were also county visits to 40 counties as listed on Appendix 1.

#### 2.4 Focus Area 4:

### Dispute resolution arising from the transfer or sharing of public assets and liabilities

This focus area can be summarized as follows:



#### 2.5 Focus Area 5:

### Waivers on taxes and other fees during the transfer of public assets and liabilities during the transition period to either level of Government

The approach involved an assessment of the applicable taxes and fees on the transfer of assets within government. This was followed by an in-depth inquiry as to whether the said taxes and fees can be waived in the current legislative dispensation as well as assessing the applicable procedures for waiver both by the National Treasury, KRA, Ministry of Land, Housing and Urban Development, NLC and other bodies which charge fees during the transfer of assets (such as for example the Land Control Board where applicable).

Additionally considerations were made on which level of Government (National or County) bears the burden of tax and fees, if any, resulting from the transfer of specific assets.

This was achieved by reviewing existing tax and other legislation as well as interviewing technocrats from the National Treasury, KRA, NLC, Ministry of Land, Housing and Urban Development dealing with remissions and waiver of taxes and applicable fees.

Analysis of the position as concerns the liability of pre-existing taxes was done. This was meant to answer the question, *who bears the tax liability for outstanding taxes owed to the KRA by the now defunct Local Authorities given the provision of Sub-article 33 of the Sixth Schedule to the Constitution, Section 134 (1) of the County Governments Act and Sections 55,56,57,58 and 59 of the Urban Areas and Cities Act?*

### 3.0 KEY FINDINGS

The following are the key findings from the research undertaken in developing mechanisms and criteria for the transfer of public assets and liabilities:

1. The 40 Counties visited have similar assets.
2. There is no complete and authoritative assets and liabilities inventory held by the defunct local authorities. This makes it difficult to ascertain true ownership hence the need to Audit these assets before transfer to the either level of Government.
3. In some defunct Local Authorities e.g. Narok County Council, the former clerk-registered more liabilities than assets.
4. The amount owed to KRA from the defunct Local Authorities as unpaid taxes is the subject of ongoing negotiations.
5. There is money owed by the defunct Local Authorities to the National government and vice versa as rates and rent respectively.
6. The KRA is keen on collecting outstanding taxes due from the defunct Local Authorities from the bearer of such liabilities.
7. The 40 counties visited have peculiar assets such as cultural and heritage assets as well as biological assets.
8. More than 50% of the 40 counties visited had defunct Local Authorities whose borders transcend more than one county, thereby raising questions on sharing of assets and resources.
9. The existing disputes arising out of the defunct Local Authorities assets and liabilities can be settled via ADR mechanisms since most of them are of civil nature.
10. County officials interviewed were concerned that if all liabilities from the defunct Local Authorities were inherited by the County Governments they are likely to weigh down the County Government finances, restricting their service delivery.
11. A significant portion of public land has been transferred to private developers in questionable transactions. This was also captured in the Report by the Commission of Inquiry into the Illegal/Irregular Allocation of Public Land (the Ndung'u Land Commission).
12. There are reported cases of unpaid salaries owed to the former employees of the defunct Local Authorities.
13. Most defunct Local Authorities have not remitted monies owed to LAPTRUST, LAPFUND, NHIF and NSSF.
14. There are cases of some defunct Local Authorities deducting monies from the former employees of these defunct Local Authorities to remit to Banks where the employees had secured personal loans. The deducted monies were not remitted to Banks as such; the Banks have sued the former employees of these defunct Local Authorities.

### 4.0 PUBLIC ASSETS AND LIABILITIES

As highlighted earlier, Focus Area No.1 in the development of mechanisms and criteria for the transfer of public assets and liabilities dwelt on the definition and classification of public assets and liabilities.

Assets and liabilities are defined and classified below:-.

#### 4.1 Definitions of assets

“**Asset**” means a resource capable of ownership. It is a resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow. An asset may directly generate revenue for the entity (e.g. a machine) or it may support the primary operations of the organization (e.g. office building). An asset may also be **tangible** or **intangible**.

“**Biological assets**” are flora and fauna and can be defined to include living plants and animals including agricultural produce and products. An entity shall only be deemed to be owner of a biological asset if it controls the biological asset as a result of past events, future economic benefits of the biological assets will flow to the entity and the fair value of the asset can be measured reliably.

“**Cash**” includes:

- a) Coins, paper currency and readily negotiable instruments such as money orders, cheques and bank drafts;
- b) Amounts on demand deposits with banks or other financial institutions and
- c) Foreign currencies.

“**Cash generating assets**” are assets held to generate a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-making entity. Holding an asset to generate a ‘commercial return’ indicates that the entity intends to generate positive cash inflows from the asset (or if the unit of the asset is a part) and earn a return that reflects the risk involved in holding the asset.

“**Contingent public asset**” is a public asset that arises from past events, and whose existence will be confirmed only by the occurrence or nonoccurrence of one or more uncertain future events not wholly within the control of the entity. Contingencies result from such matters as pending or threatened litigation, guarantees of the indebtedness of others, indemnities and provisions related to insurance programs. They also include grants or contributions that are recoverable if certain future events occur or fail to occur.

“**Current Assets**” are assets that an entity expects to use within one year’s time from the reporting date including cash, receivables and inventory. An asset shall be classified as current when it satisfies any of the following criteria:

- a) It is expected to be realized in, or is held for sale or consumption in, the entity’s normal operating cycle;
- b) It is held primarily for the purpose of being traded;
- c) It is expected to be realized within twelve months after the reporting date; or
- d) It is cash or a cash equivalent (as defined in IPSAS 2, unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.

“**Heritage assets**” are assets with some cultural, environmental, historical, artistic or scientific significance including historic buildings and monuments, archeological sites, conservation areas and nature reserves as well as works of art. An asset will be deemed to be a heritage asset if described as above or if they display the following characteristics:

- a) Their economic benefit in cultural, environmental, educational and historic terms is unlikely to be fully reflected in a financial value based purely on market price;
- b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;
- c) They are often irreplaceable and their economic benefit may increase with time even if their physical condition deteriorates; and
- d) It may be difficult to estimate their useful lives.

**“Human Capital/Assets”** - This refers to the human resource personnel previously under the charge of the defunct Local Authorities, Ministries, Departments and Agencies (State Corporations).

**“Infrastructure assets”** are assets which are:

- a) part of a system or network;
- b) specialized in nature and do not have alternative uses;
- c) immovable and
- d) they may be subject to constraints on disposal.

Significant infrastructure assets are frequently found in the public sector. Infrastructure assets meet the definition of property, plant, and equipment and include road networks, sewer systems, water and power supply systems, and communication networks.

**“Intangible assets”** are identifiable non-monetary assets without a physical substance for example computer software, patents, copyrights, mortgage servicing rights, licenses, franchises, goodwill and marketing rights.

**“Non cash generating assets”** are all assets other than cash-generating assets.

**“Non-Current Assets”** are those assets whose benefits are expected to last more than one year from the reporting date.

**“PP&E”** refers to tangible assets that:

- (a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) Are expected to be used during more than one reporting period.

Assets that are captured under the broad classification of PP&E include Land, Operational buildings, Roads, Machinery, Electricity transmission networks, Ships, Aircraft, Specialist military equipment, Motor vehicles, Furniture and fixtures and Office equipment.

**“Property”** in the public sector will comprise of conventional cash generating and non-cash generating property assets as well as, specialized property assets including heritage and conservation assets, infrastructure assets, public buildings, public utility plants and recreational assets

**“Public asset”** is an asset owned and/or controlled by public institutions to provide goods or services to the general public, including a contingent public asset. Public assets will typically include:

- a) Assets which have a typical tenure, are irreplaceable, are non-cash – generating, or provide goods or services in the absence of any market competition;
- b) Land with restrictions on its sale or leasing; and
- c) Land, which is designed for a specialized use that is not necessarily its highest and best use, for example, idle land.

**“Recreational assets”** are properties held in public ownership that:

- a) Are managed by or on behalf of the defunct Local Authorities; and
- b) Provide for recreational use by the general public.

Recreational assets include parks, playgrounds, walks and trails, swimming pools, playing courts, fields and courses and other properties equipped with recreational and athletic facilities.

**“Tangible assets”** are assets that have a physical form or physical substance including fixed assets such as machinery, PP&E and current assets such as stock or supplies.

#### **4.2 Classifications of Assets**

The following Table 2 summarizes the categorization of assets which was sampled together with a listing of some of the specific assets under each categorization.

Table 2: Classification of assets

ASSET CLASSIFICATION	IDENTIFIED ASSETS
<b>Land and Buildings</b>	Public Land, Trust land, Commercial buildings, Offices and office blocks Operational buildings, Buildings under construction, Residential buildings, Rental houses, Boreholes, Water and sanitation infrastructure, Water reservoir sites, Water sites, Water tank sites, Water distribution networks, Water treatment plants Sewerage treatment works, Pump houses and pumping stations, Public toilets and latrine blocks, Dams, Stores, Various site works, Markets, Quarry mines, Dry river banks, Learning institutions, Health facilities, Abattoirs, Cemeteries, Security installations, Sports facilities, Livestock sale yards and Fire stations.
<b>Property, Plant and Equipment</b>	Office equipment, Water distribution networks and equipment, Electronic equipment, Household equipments, Kitchen/ Domestic equipment and appliances, Agricultural mechanization equipment, Fishing equipment, Sports equipment, First aid equipment, Laundry equipment, Firefighting equipment, Workshop equipment and Medical equipment.
<b>Heritage and cultural assets</b>	City parks, Tourist lodges and hotels, Museums, Historical monuments, Recreational parks, Historical buildings and towns, Caves, Works of art, Antiquities, Rare books and manuscripts, Historical burial sites, Unique natural landscape and coastlines and Libraries.
<b>Infrastructure assets</b>	Road networks, Airports, Sea ports, Sewer systems, Water supply systems, Power supply systems, and Communication networks.
<b>Furniture, fixtures and furnishings</b>	Tables, Chairs, , Stools, Steel cupboards, Cabinets, , Gas burners, Bookshelves, Computers & their accessories, Benches, Kitchen equipment, Steel cabinets, Wall clocks and Stationery.
<b>Motor and other vehicles</b>	Saloon cars, Lorries, Vans, Motorbikes, Pick-ups, Tractors, Boats, Combined harvesters, Ambulances and Fire trucks.
<b>Information Technology and Telecommunications equipment</b>	Laptops, Desktops and computer peripherals, Telephone and Communication equipment, Transmission equipment, Smart phones, Fax machines, Photocopiers, Shredders, Money counting machines, Projectors.

<b>Financial assets (IFRS 9)</b>	Cash, Bank accounts, Investments, Shares, Rent and Rates, Staff loans owing to the defunct Local Authorities, Car park charges, Fines and Penalties.
<b>Human Capital</b>	Employees of defunct Local Authorities and National Government.
<b>Biological assets (IAS 41)</b>	Flora and fauna, Livestock, Forests, Agricultural produce and Agricultural products.

### 4.3 Definitions of Liabilities

“**Liability**” refers to a present obligation, arising from a past event, the settlement of which is expected to lead to an outflow of future economic benefits to the entity. Liabilities are obligations that legally bind public offices including contingent liabilities.

“**Current Liability**” is a liability in which the entity expects to pay off within one year from the reporting date. A liability shall be classified as **current** when it satisfies any of the following criteria:

- (a) It is expected to be settled in the entity’s normal operating cycle;
- (b) It is held primarily for the purpose of being traded;
- (c) It is due to be settled within twelve months after the reporting date; or
- (d) The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.

Current liabilities include bank overdrafts, short-term loans, trade payables and taxes payable.

“**Contingent liability**” refers to:

- (a) A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity or
- (b) A present obligation that arises from past events, but is not recognized because:
  - (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
  - (ii) The amount of the obligation cannot be measured with sufficient reliability.

“**Employee benefits**” are all forms of consideration paid for services of employees or for termination of employment.

“**Non-Current Liability**” is a liability which the entity expects to settle after one year from the reporting date. These include debentures and long-term bank loans.

“**Provision**” refers to a liability of uncertain timing or amount (i.e. recognition is uncertain). Such a liability may be a legal obligation or a constructive obligation. A constructive obligation arises from the entity’s actions, through which it has indicated to others that it will accept certain responsibilities, and as a result has created an expectation that it will discharge those responsibilities.

**“Public liability”** is a liability borne by a public entity. It is also defined as a present obligation, arising from a past event, the settlement of which is expected to lead to an outflow of future economic benefits from the public entity.

#### 4.4 Classifications of Liabilities

The table below summarizes the categorization of liabilities which was sampled together with a listing of some of the specific liabilities under each categorization.

Table 3: Classification of Liabilities

LIABILITY CLASSIFICATION	IDENTIFIED LIABILITIES
Debts	Debts owing to unremitted statutory deduction to LAPTRUST and LAPFUND, Unremitted staff pension deductions, Salaries owing to staff, Taxes owed to KRA, Outstanding commercial loans, Outstanding utility bills, Consultants fees, and Professional services fees.
Contingent Liabilities	Loan guarantees, Court cases, Agreed settlements, Potential tax liabilities, Fines and Penalties on unpaid taxes.
Leases	Existing property and space leases.
Employee benefits	Salaries, Staff benefits, Gratuity and Honorarium, Motor vehicle grants, Mortgages, NHIF, NSSF and PAYE.
Fixed liabilities	Long term Loans or Mortgage, and Debentures.
Current liabilities	Trade creditors, Bills payable, Outstanding expenses and Bank overdrafts.

Remunerations

#### 4.5 Recommendations

Based on research and analysis of the potential public assets and liabilities, the following are the adopted definitions of public assets and public liabilities:

**“Public asset”** is an asset owned and/or controlled by public institutions to provide goods or services to the general public, including a contingent public asset. Public assets will typically include:

- a) Assets which have a typical tenure, are irreplaceable, are non-cash – generating, or provide goods or services in the absence of any market competition;
- b) Land with restrictions on its sale or leasing; and
- c) Land, which is designed for a specialized use that is not necessarily its highest and best use, for example, idle land.

**“Public liability”** is a liability borne by a public entity. It is also defined as a present obligation, arising from a past event, the settlement of which is expected to lead to an outflow of future economic benefits from the public entity.

Table 4: Adopted classification of Public Assets

PUBLIC ASSET CLASSIFICATION	IDENTIFIED PUBLIC ASSETS
<b>Land and Buildings</b>	Public Land, Commercial buildings, Offices and office blocks Operational buildings, Buildings under construction, Residential buildings, Rental houses, Boreholes, Water and sanitation infrastructure, Water reservoir sites, Water sites, Water tank sites, Water distribution networks, Water treatment plants Sewerage treatment works, Pump houses and pumping stations, Public toilets and latrine blocks, Dams, Stores, Various site works, Markets, Quarry mines, Dry river banks, Learning institutions, Health facilities, Abattoirs, Cemeteries, Security installations, Sports facilities, Livestock sale yards and Fire stations.
<b>Property, Plant and Equipment</b>	Office equipment, Water distribution networks and equipment, Electronic equipment, Household equipments, Kitchen/ Domestic equipment and appliances, Agricultural mechanization equipment, Fishing equipment, Sports equipment, First aid equipment, Laundry equipment, Firefighting equipment, Workshop equipment and Medical equipment.
<b>Heritage and cultural assets</b>	City parks, Tourist lodges and hotels, Museums, Historical monuments, Recreational parks, Historical buildings and towns, Caves, Works of art, Antiquities, Rare books and manuscripts, Historical burial sites, Unique natural landscape and coastlines, Libraries.
<b>Infrastructure assets</b>	Road networks, Airports, Seaports, Sewer systems, Water supply systems, Power supply systems, and Communication networks.
<b>Intangible assets</b>	Intellectual property such as computer software, patents, copyrights, mortgage servicing rights, licenses, franchises, goodwill and marketing rights.
<b>Furniture, fixtures and furnishings</b>	Tables, Chairs, Stools, Steel cupboards, Cabinets, Gas burners, Bookshelves, Computers & their accessories, Benches, Kitchen equipment, Steel cabinets, Wall clocks and Stationery.
<b>Motor and other vehicles</b>	Used and unused Saloon cars, Lorries, Vans, Motorbikes, Pick-ups, Tractors, Boats, Combined harvesters, Earth moving equipment (e.g. excavators, bull dozers, rollers), Ambulances and Fire trucks.
<b>Information Technology and Telecommunications equipment</b>	Laptops, Desktops and computer peripherals, Telephone and Communication equipment, Transmission equipment, Smart phones, Fax machines, Photocopiers, Shredders, Money counting machines and Projectors.
<b>Financial assets (IFRS 9)</b>	Cash, Bank accounts, Investments, Shares, Rent and Rates, Staff loans owing to the defunct Local Authorities, Car park charges, Fines and Penalties.
<b>Human capital</b>	Employees of the defunct Local Authorities and National Government.

<b>Biological assets (IAS 41)</b>	Living flora and fauna, Livestock and Forests.
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Table 5: Adopted Classification of Public Liabilities

<b>PUBLIC LIABILITY CLASSIFICATION</b>	<b>IDENTIFIED PUBLIC LIABILITIES</b>
<b>Debts</b>	Debts owing to unremitted statutory deductions to LAPTRUST and LAPFUND, Unremitted staff pension deductions, Unremitted employees loan deductions to Banks, Salaries owed to former staff, Taxes owed to KRA, Outstanding commercial bank loans, Outstanding utility bills, Consultants fees and Professional services fees.
<b>Contingent Liabilities</b>	Loan guarantees, court cases, agreed settlements, potential tax liabilities, fines and penalties on unpaid taxes.
<b>Leases</b>	Existing property and space leases.
<b>Employee benefits</b>	Salaries, Staff benefits, Gratuity and Honorarium, Motor vehicle grants, Mortgages, NHIF, NSSF and PAYE.
<b>Fixed liabilities</b>	Long term loans or Mortgage, and Debentures.
<b>Current liabilities</b>	Trade creditors, Bills payable, Outstanding expenses and Bank overdraft

*Some of the liabilities of the defunct Local Authorities also include legal obligations. A legal obligation, under the IPSAS framework is an obligation that is derived from a contract (through its explicit or implicit terms), legislation or other operation of law.*

## **5.0 MECHANISM FOR ASSETS IDENTIFICATION, VERIFICATION, VALIDATION, VALUATION AND AUDIT**

### ***5.1 Introduction***

It is imperative that both the County and National Governments are knowledgeable about the assets they own or are responsible for, so that those assets can be used to provide the quality service- to the citizenry. This information is vital to both levels of Governments when making sound financial decisions that touches on public assets and liabilities.

In order to develop comprehensive information on public assets, there must be a clear mechanism for identification, verification, validation, valuation and audit of all public assets.

### ***5.2 Asset identification, verification, validation, valuation and audit***

This is the process of validating, confirming and corroborating information on the existence of assets and specifically confirming that the assets carried in the books of the defunct Local Authorities are in existence and their valuations.

This will involve among other things, counter-checking the title documents of immovable assets to ascertain their true ownership.

Asset identification plays an important role in an organization's ability to quickly correlate different sets of information about assets.

This specification provides the necessary constructs to uniquely identify assets based on known identifiers and/or known information about the assets. This specification describes the purpose of asset identification, a data model for identifying assets, methods for identifying assets and guidance on how to use asset identification. It also identifies a number of known use cases for asset identification.

### ***5.3 Benefits of asset identification, verification, validation, valuation and audit exercise***

This exercise, if conducted well and diligently, will give a clear picture of the status of assets held by the National and County Governments.

It will generate up-to-date inventory on the types of assets, number, location, value as well as useful life, and these parameters will assist the transition of resources as well as give both the National and County Governments their validated assets and liabilities register including an opening balance sheet for the County Governments as at 27<sup>th</sup> March, 2013.

The asset verification, validation and audit process will also shed light on any instances of asset misappropriation or wastage and even highlight cases where assets which are carried on paper only but in reality do not exist.

The exercise will also be beneficial in tracking high value moveable assets with relative ease. For the kinds of assets that require specialist service, management and replacement of parts, the asset inventory will give a clear indication of the maintenance and repair schedules.

#### 5.4 Observations and recommendations

From the reviews, interviews and discussions, it was noted that not all Government institutions (Ministries, Departments and Agencies) had submitted their inventories of assets and liabilities to the TA.

The Auditor General has financial statements of assets and liabilities of MDAs which can be used as the referencing point when embarking on audit of public assets and liabilities.

Verification, validation, valuation and audit of all existing public assets and liabilities is a mammoth task that requires competent experts (like: valuers, surveyors, land economists, engineers, auditors, lawyers etc.) with in-depth knowledge in specific areas to undertake these specialized tasks.

The data on assets and liabilities from MDAs and defunct Local Authorities are to be maintained and routinely updated in a secure and central Assets and Liabilities Information Management System. The AMIS is expected to be secure and generate reports and easily accessible to both the County and National Governments on user rights basis.

##### 5.4.1 Adopted Methodology for Asset Identification, Verification, Validation, Valuation and Audit

Generally, assets and their documents of title are to be physically verified and ascertained by a team composed of TA, OAG & Consultants.

The following is the methodology for verification, validation, valuation and audit of public assets:

Table 6: Mechanisms for asset identification, verification, validation, valuation and audit

Type of Asset	Identification, Verification, Validation, Valuation and Audit Mechanism
Land	<ul style="list-style-type: none"> <li>• Physical verification</li> <li>• Conducting a search at the Ministry of Land, Housing and Urban Development</li> <li>• Land Surveyor to confirm the size of the land</li> <li>• Obtain a valuation report from a certified valuer</li> </ul>
Buildings	<ul style="list-style-type: none"> <li>• Physical verification</li> <li>• Conducting a search at the Ministry of Land, Housing and Urban Development</li> <li>• Verify Title Deed against alleged ownership</li> <li>• Obtain valuation report to ascertain true value from a certified valuer</li> <li>• Confirm Certifications from relevant authorities</li> </ul>

	<ul style="list-style-type: none"> <li>•</li> </ul>
<b>Equipment</b>	<ul style="list-style-type: none"> <li>• Physical verification to confirm tagging</li> <li>• Due diligence with Registrar of Motor Vehicles where applicable</li> <li>• Crosschecking with inventory of assets held by the defunct Local Authorities</li> <li>• Cross-checking receipts, where relevant</li> <li>• Review audited financials to confirm they are captured in Fixed Assets Register</li> <li>• Assess their working conditions, KEBS certification and calibration certificates if necessary</li> <li>• Ascertain insurance status with Insurance Company</li> <li>•</li> </ul>
<b>Motor and other vehicles</b>	<ul style="list-style-type: none"> <li>• Physical verification and validation</li> <li>• Due diligence with Registrar of Motor Vehicles where applicable including Log Book</li> <li>• Review audited financials to confirm that the Motor Vehicles are carried in the Fixed Assets Register</li> <li>• Ascertain insurance status with Insurance Company</li> <li>•</li> </ul>
<b>Furniture, fittings and fixtures</b>	<ul style="list-style-type: none"> <li>• Physical verification and validation</li> <li>• Due diligence with registrar of Motor Vehicles where applicable</li> <li>• Crosschecking with inventory of assets held by the defunct Local Authorities</li> <li>• Cross-checking receipts, where relevant</li> <li>• Review audited financials to confirm the carrying amounts</li> <li>• Check working conditions</li> <li>•</li> </ul>
<b>Heritage and cultural assets</b>	<ul style="list-style-type: none"> <li>• Physical verification</li> <li>• Confirm with enacting Legislation</li> </ul>
<b>Infrastructure assets</b>	<ul style="list-style-type: none"> <li>• Physical verification</li> <li>• Economic and Competitive Clustering as discussed in 5.4.2 herein</li> </ul>
<b>Information Technology and Telecommunications equipment</b>	<ul style="list-style-type: none"> <li>• Physical verification and validation</li> <li>• CCK certificates where necessary</li> <li>• Due diligence on instruments of purchase</li> <li>• Review audited financials to confirm they are captured in Fixed Assets Register</li> <li>• Assess their working conditions, KEBS certification and calibration certificates if necessary</li> <li>• Ascertain insurance status with Insurance Company</li> </ul>

<b>Bank balances</b>	<ul style="list-style-type: none"> <li>• Obtain direct bank confirmation on balances</li> <li>• Cross-checking with certified bank statements</li> </ul>
<b>Cash balances</b>	<ul style="list-style-type: none"> <li>• Obtain cash counts – witnessed and attested to</li> </ul>

The above process can be automated by using barcodes and scanners. The Team composed of TA, OAG and Consultants, while physically verifying the assets, will be required to attach barcodes on the assets and scan the assets. The information scanned will be relayed to TA's IT department who will be in a position to feed the same onto the AMIS.

The barcodes together with additional parameters will offer asset tracking solutions and will be useful in categorization of assets as discussed in section 4.4. With a bar code system consisting of printers, scanners, and labels, the process of cataloging and counting fixed assets is greatly streamlined. This will assist in the capture of important information about each asset including location, maintenance and repair schedules, cost, warranties, valuations and depreciation.

Bar-coding offers several important advantages over manual inventories because fixed asset physical inventories involve accumulation and manipulation of large amounts of data. Some of the benefits of bar-coding are improved efficiency, improved quality of data, ease of reconciliation, improved staff morale due to ease and speed of implementation and cost effectiveness. The barcodes will easily account for the valuable assets.

#### 5.4.2 Clustering of Infrastructure Assets

The clusters are geographic concentrations of interconnected assets that were present in the boundaries of the defunct Local Authorities that now traverses County boundaries.

As mentioned in section 4.1, infrastructure assets are assets which are part of a system or network, specialized in nature and do not have alternative uses, immovable and which may be subject to constraints on disposal. Infrastructure assets meet the definition of property, plant, and equipment and include road networks, sewer systems, water and power supply systems, communication networks etc.

The clustering of infrastructure assets provides a framework for an extensive valuation and audit of these unique assets.

The Team composed of TA, OAG and Consultants engaged in identifying, validating valuation and auditing assets should conduct an economic and competitive clustering of assets within the counties to ensure that the assets are '*owned, shared and funded*' on the basis of *service over ownership*. This should take the functional approach as envisaged in the Constitution so as to ensure that resources follow functions.

Below is a clustering of infrastructure assets.

Table 7: Sample Clustering of Infrastructure Assets

Infrastructure Asset	Clustering methodology
<b>Transport Infrastructure (such as Road network)</b>	<ul style="list-style-type: none"> <li>• Classification of roads as either County Roads or National roads.</li> </ul>
<b>Social Infrastructure (such as Schools and health facilities)</b>	<ul style="list-style-type: none"> <li>• Grading the Schools depending on upgrade requirement (A,B,C)</li> <li>• Those needing upgrading</li> <li>• Those in need of electrification</li> <li>• Shared social infrastructure</li> <li>• MTC's or ATC's</li> </ul>
<b>Economic Infrastructure (such as Markets)</b>	<ul style="list-style-type: none"> <li>• Shared economic infrastructure</li> </ul>
<b>Environmental Infrastructure</b>	<ul style="list-style-type: none"> <li>• Forests</li> <li>• Water Towers</li> </ul>

## 6.0 PUBLIC ASSET AND LIABILITIES TRANSFER GUIDELINES

### 6.1 Introduction

The promulgation of the Constitution of Kenya, 2010 and the adoption of the devolved system of governance comprising of National and County Governments created the need to establish a criteria for securing transferring and/ or sharing of assets and liabilities belonging to both the defunct local authorities and National Government.

The development of the criteria informing the transfer and/or sharing of public assets and liabilities should take into consideration the following issues including the need to:

- Imbue transparency and accountability through a practical framework which facilitates the transfer of public assets and liabilities;
- Facilitate the devolution of resources;
- Assist county governments in building their capacity to govern effectively and provide the services for which they are responsible;
- Prevent the indiscriminate or unsustainable transfer or disposal of a public asset in order not to undermine the ability of the County or State entity to render or expand its utility in the long term;
- Transfer the risk relating to a public asset/liability in conjunction with the transfer of the asset/liability;
- Ensure the uninterrupted continuance of a service when an asset that is being used in the delivery of that service, is transferred or disposed of;
- Attach a value to the transfer or disposal of an asset, in order to ensure that the interests of the National or County Governments and its citizenry are not prejudiced by the transfer or disposal;
- Assess the adequacy and efficacy of the current institutional frameworks on their ability to facilitate and oversee this process;
- Analyze the availability or lack thereof, of procedural rules to aid in the aforementioned transfer and/or sharing;
- Develop a process that incorporates all the key stakeholders to minimize the probability of future conflicts;
- Consider the constitutional rights and legal interests of all parties; and

### 6.2 Background

The issues identified earlier are best appreciated when contextualized within the scope of the prevalent challenges that present themselves in an attempt to find solutions on the procedures and mechanisms to be adopted in transferring and/or sharing of public assets and liabilities.

Before looking at these challenges, it is important to appreciate the environment around which these challenges emerged. In achieving this objective, a consideration of the chronological order of events inspired by legal transformative processes that led to the present conundrum shall be taken into account as shown below:

1. 30<sup>th</sup> August 2010 – Promulgation of the New **Constitution of Kenya**:

- a. This led to the creation of the National and County Governments [to facilitate devolution] which would consequently come into effect after 4<sup>th</sup> March 2013 elections;
  - b. Article 174 further outlines the objects of devolution as:
    - i. to promote democratic and accountable exercise of power;
    - ii. to foster national unity by recognising diversity;
    - iii. to give powers of self-governance to the people and enhance the participation of the people in the exercise of the powers of the State and in making decisions affecting them;
    - iv. to recognise the right of communities to manage their own affairs and to further their development;
    - v. to protect and promote the interests and rights of minorities and marginalised communities;
    - vi. to promote social and economic development and the provision of proximate, easily accessible services throughout Kenya;
    - vii. to ensure equitable sharing of national and local resources throughout Kenya;
    - viii. to facilitate the decentralization of State organs , their functions and services, from the capital of Kenya; and
    - ix. to enhance checks and balances and the separation of powers.
  - c. Article 187 provided for the transfer of functions and power between the two levels of Government;
  - d. The Fourth Schedule of the Constitution which provides for the Distribution of Functions between the National Government and the County Government;
  - e. Part 4 of the Sixth Schedule which addressed modalities on devolved government; these are the modalities that inform the legislation and institutional framework that was established consequentially and identified hereunder.
2. 9th March 2012 - Commencement of The Transition to Devolved Government Act No 1 of 2012:
- a. **Established the Transition Authority** under Section 4 of the Transition to Devolved Government Act, 2012 as a statutory body with the general mandate of facilitating and coordinating transition to devolved system of government in Kenya.
  - b. The functions of the Transition Authority is contained in Section 7 (2) (a) - (o) while the activities are enumerated in the Fourth Schedule of the Act to be undertaken in **Two Phases**.
  - c. Section 35 (1) of the TDGA provides that a State organ, public office, public entity or local authority shall not transfer assets and liabilities during the transition period [three years after the first general election after the 2010 Constitution] unless any exception under subsection 2 applies;

- d. Section 35 (2) (a) & (b) of the TDGA provides that a State organ, public office, public entity wishing to transfer an asset during the transition period would only do so after seeking an approval from TA.
3. March 2013 [After General Elections] – Commencement of **the County Governments Act No. 17 of 2012:**
    - a. Section 134(1) **repealed Cap. 265 (Local Government Act)** upon the final announcement of all the results of the first elections held under the CoK, 2010; the immediate effect of this provision rendered the Local Authorities [defunct] raising queries into how their assets and liabilities would consequently be distributed between the two levels of Government.
    - b. Section 134(2) provided that **all issues that may arise as a consequence of the repeal** under subsection(1) shall be dealt with and discharged by the body responsible for matters relating to transition; As has been elucidated above, this body is the **Transition Authority**.
  4. March 2013 [After General Elections] – Commencement of the **Intergovernmental Relations Act No. 2 of 2012:**
    - a. This Act was enacted to establish a framework for consultation and co-operation between the National and County Governments and amongst County Governments and to establish mechanisms for the resolution of intergovernmental disputes;
    - b. It is therefore a key Statute that will undoubtedly inform the way that potential disputes informing the transfer and/or sharing of assets and liabilities will be canvassed.

On account of the processes underlined under the various Constitutional and Statutory provisions as expressed earlier, a series of contemporary challenges have emerged particularly in this case on the nature of the following:

1. Legal process for securing and transfer of various classes of assets and liabilities belonging to the defunct local authorities;
2. Legal process for securing and transfer of assets and liabilities from National to County Governments;
3. Procedural rules for transfer and/ or sharing of public assets and liabilities between the two levels of Government; and the
4. Institutional framework to support the transfer of public assets and liabilities.

### 6.3 Key Challenges

Based on the research that was conducted encompassing at least 40 Counties and other key stakeholders, various challenges were unearthed on the legal processes and implications of the transfer and/or sharing of assets and liabilities between the National and/or the County Governments.

Some of these challenges are underlined hereunder:

1. According to **Nairobi City County** Government, liabilities inherited from the defunct Nairobi City Council (NCC) are weighing down the County Government, making it difficult to provide services to residents of Nairobi.
2. In **Nyandarua County**, most of the defunct Local Authorities have no proper documentation on their assets. Therefore there is a lot of dispute as to whether they are owned by the defunct Local Authority or other persons as some of the members in that County have allotment letters on the same immovable assets.
3. The **Marsabit County Government**, the report reflected that they are experiencing difficulties as result of not having an office space where they can efficiently operate.
4. In **Kajiado County**, some assets have ownership tussles between the defunct Local Authorities and members of the county claiming ownership of the same. Some defunct Local Authorities have no title deeds of their lands and have allotted the same to the communities. Other lands have issues as the local communities have encroached on the same. Other defunct Local Authorities in the County have misplaced the register on assets while others have wrongly indicated their assets and liabilities.
5. In **Narok County**, some clerks of the defunct Local Authorities submitted more liabilities than assets, therefore raising many ethical questions.
6. In **Bomet County**, there are various defunct Local Authorities that are partly in other Counties, raising questions about sharing of these assets with neighbouring Counties.
7. Most County Governments have received very many liabilities allegedly owed by the defunct Local Authorities that are raising very many questions from County Government.
8. In **Murang'a County**, some assets (public land) have been transferred to private developers. The assets of Gatanga which is in Murang'a County have the documents registered in Kiambu County.
9. In **Migori County**, there is lack of clarity as to Chiefs offices standing on public land and constructed using public funds collected through *harambees* specifically to whom such land should belong - National or County government.

10. In **Turkana County**, there are disputes over the ownership of certain assets such as the *Nelan* piece of land.

In most counties, there were liabilities that were incurred by the defunct Municipal Councils that were not settled. There have been so many court cases that have been lodged in the courts pertaining to liabilities and this has taken a toll on the county government. Among the liabilities they have a huge problem of unremitted statutory deductions **In most counties there are** many unpaid arrears in form of land rent and rates that are supposed to have been paid to the defunct Local Authorities but were never paid.

#### 6.4 *Key Principles Informing the Transfer and/or Sharing of Public Assets and Liabilities*

The positions below will be informed by some key principles and procedures and deal with the process to be followed when transferring public assets and liabilities. These principles have been critical to the process of transfer and/or sharing of assets in other jurisdictions such as South Africa and Canada.

To assist in the identification and management of risks associated with the transfer (including disposals) and sharing of assets and liabilities, the following key principles which must be considered and implemented in the context of any asset and/or liability sharing and/or transfer:

- **Equity principle**, i.e. in under-arching all the under mentioned principles, this principle facilitates a balance in the transfer process by considering substance over form and ensuring that the interests of one party in the transfer process do not override the interests of the other; in promoting fairness, this principle also ensures that the government does not punish itself, by advancing undue liability in the transfer process, and therefore ultimately, the ends must justify the means;
- **Valuation principle**, i.e. the need to attach a value to the transfer or disposal of a public asset, in order to ensure that the interests of the public entity and each of its stakeholders are not prejudiced by the transfer or disposal;
- **Continuity of service principle**, i.e. the need to ensure the uninterrupted continuance of a public service when a public asset that is being used in the delivery of that service, is transferred or disposed of, particularly when the asset is used in the provision of a minimum level of basic public service;
- **Risk transfer principle**, i.e. the need to transfer the risk relating to an asset/liability in conjunction with the transfer of the asset/liability; and
- **Asset preservation principle**, i.e. the need to prevent the indiscriminate or unsustainable transfer or disposal of an asset in order not to undermine the ability of the public entity to render or expand its services in the long term.

These five principles present key guidelines to any relevant entity intending to transfer or dispose of any asset and/or liability. Any doubt over the interpretation or application of the regulations should be resolved within the context of these principles so that the 'spirit' of the Constitution and legislation always prevails.

This means that the public entity should ensure that all assets and liabilities are first verified, validated, valued, audited and then transferred and or shared. All of the consequences of each transfer (including disposal) or sharing are carefully considered.

## **6.5 Public Asset and Liabilities Transfer Guide**

### **6.5.1 Assets And Liabilities Belonging To The Defunct Local Authorities/ National Government**

The transfer of these assets and liabilities should be informed by the following aspects which will be discussed in more detail below:

- a) Identification and Classification of assets and liabilities;
- b) Due Diligence;
- c) Utility of the Functional Approach [resources to follow functions];
- d) Right of permanent disposal;
- e) Right of Use, Control or Management of assets;
- f) Economic viability and sustainability of the immediate transfer of assets and liabilities to County Government;
- g) Exceptions to transfer thereby necessitating sharing;
- h) Criteria for sharing of assets and/or liabilities;
- i) Mutual cooperation and public participation

#### **6.5.1.1 Identification and Classification of assets and liabilities;**

Assets and liabilities may be classified as shown on Table 2 page 27 and Table 3 on page 30 respectively.

#### **6.5.1.2 Due Diligence**

One of the key challenges established earlier is that most of the defunct Local Authorities do not have proper documentation on their assets and liabilities. In this regard, there is need for verification of the same by undertaking a comprehensive due diligence exercise (Audit) to first establish the stake and ownership of an asset or liability and to consequently ascribe it to a specific defunct Local Authority.

#### **6.5.1.3 Utility of the Functional Approach [resources to follow functions];**

In adopting mechanisms for transfer of the listed assets and liabilities the key mechanism that shall be adopted will be a functional approach. Alongside this approach, the mechanism shall also be informed by the key principles enumerated in Chapter 6.4.

The **functional approach** is informed by the provisions in the Fourth Schedule of the Constitution which provides for the Distribution of Functions between the National Government and the County Government. In applying this approach, the afore-listed assets

and liabilities can be distributed from the Defunct Local Authorities to the National and County Governments respectively.

#### **6.5.1.4 Right of permanent disposal;**

Asset disposal refers to a process when ownership is lost other than by means of a transfer, for instance when an asset is sold to a private entity, demolished, dismantled or destroyed. In this situation, ownership of the asset is lost by one party but not passed on to another party. Alternatively, it may be adopted by doing away with unneeded fixed assets by selling them, trading them in as partial payments on new fixed assets, or junking them (throwing away assets that are totally worn out).

It is imperative that this be considered as an alternative to the option of transfer, by weighing the utility of an asset against its potential liability on the form of excessive maintenance and or unnecessary wastage.

#### **6.5.1.5 Right of Use, Control or Management of assets;**

A right to use, control or manage an asset may include a lease, letting or hiring out arrangement for longer than one month where ownership is not lost or transferred to another party but temporarily let for a purpose. In this situation, ownership of the asset is retained by the party that has the legal ownership of the asset.

Granting of such a right to use, control or manage the asset will be considered to be an asset transfer if the right to use the asset:

- is set for an indefinite or undetermined period,
- is for a period which effectively exceeds the life of the asset,
- confers an option to buy or acquire ownership in the asset; or
- allows the person using the asset to become the beneficiary (but not legal) owner.

This can be considered as a viable mechanism that could be adopted by the National Government during the transition period provided for in the Transition to Devolved Government Act, as the National Government assists county governments in building their capacity to govern effectively and provide the services for which they are responsible.

Conversely, it could be relied on to develop a system for asset management by either Government on behalf of the other on commission to facilitate the realization of the liabilities owed by that Government.

#### **6.5.1.6 Economic viability and sustainability of the immediate transfer to County Government;**

It is imperative that as consideration is paid to the process of transfer of assets and liabilities, that due regard is accorded to:

- prevent the indiscriminate or unsustainable transfer or disposal of an asset in order not to undermine the ability of the County or Public entity to render or expand its utility in the long term;
- establishing criteria that must be met before particular functions are devolved to county governments to ensure that those governments are not given functions which they cannot perform; and to

As per the conditions for transfer of assets and liabilities in the Legal Notice No. 45 of 22<sup>nd</sup> February, 2013 for the transfer of assets and liabilities during the transition period, before the Authority approves a request for transfer of an asset or liability, the public entity must satisfy the following conditions:

- a) The requirement of public participation has been met;
- b) There is value for money;
- c) The transfer is at market value;
- d) Service delivery will be improved;
- e) There is compliance with other relevant laws and
- f) The transfer is in the public interest.

For this to happen, the economic viability measured by considering the sustainability of transfer of assets and/or liabilities either on the asset or on the County is critical. This will enable a more sustainable approach to be adopted as part of the significant criteria of transfer.

#### **6.5.1.7 Exceptions to transfer thereby necessitating sharing**

In the challenges outlined earlier, some have raised concerns about how to transfer/apportion resources of defunct Local Authorities occurring in more than one County.

The other challenge arises when an asset occurring in a County serves more than the primary interests of that County, and other surrounding Counties or even the entire Country rely on that asset/resource for their own sustenance and survival.

In these cases, there is need for agreements, contractual or legislative framework that would advocate for mutual co-operation in the realization of these resources by all the concerned stakeholders.

#### **6.5.1.8 Criteria for sharing of assets and/or liabilities**

In developing a criteria for the sharing of assets and liabilities, there is need to adopt a functional approach so as to ensure that the resources follow the Constitutional functions.

### **6.5.1.9 Mutual Co-operation and Public Participation**

Any proposal on the process of transfer should be all-inclusive in terms of engaging all the relevant stakeholders in the realization of the aspirations and objectives. This would aid in enhancing the relevant Constitutional provisions on public participation and mutual co-operation between the National and County Governments. In this respect therefore, the involvement of the public in the decision making process by providing meaningful opportunities for them to give their views on issues under deliberation is critical.

### **6.5.2 Transfer of Assets Owned By Parastatals**

The transfer of these assets should be informed by the following aspects which will be discussed in more detail below:

- a) Adoption of appropriate transfer mechanisms [Fourth Schedule of the Constitution];
- b) Criteria for sharing of assets and/or liabilities.

#### **6.5.2.1 Adoption of appropriate transfer mechanisms [Fourth Schedule of the CoK];**

The National Government is in the process of restructuring parastatals to ensure efficiency. The transfer mechanisms to be adopted should take into consideration the parastatal reforms and in line with the Functional approach. In which transfer of assets owned by parastatals should evaluate what assets, out of those belonging to parastatals that are to be scrapped, can be transferred to either county or National Governments.

In regard to those assets in which there is contention between the National and County Governments as to whether they should be transferred, dialogue and negotiations should be held between the two levels bearing in mind the need for mutual co-operation and consultation.

### **6.6 Mechanism and Procedure(s) of public asset/liability transfer**

This section addresses the process that the Transition Authority will follow to facilitate the transfer of assets and liabilities:

#### **STEP 1: Identify and classify assets and liabilities**

This will merely involve a thorough investigation for purposes of:

- a) Assets and liabilities identification, verification, validation, valuation and audit as enumerated in Chapter 5 [informed further by the guideline on due diligence enumerated in chapter 6.5.1.2]; and then
- b) The assets and liabilities should be classified in accordance with the provisions of Chapter 4.

#### **STEP 2: Ascertain the status of the assets and liabilities**

- a) Shared (either between the National and County Government or between County Governments inter se)
- b) Contested (these are assets/liabilities whose status is disputed)
- c) Encumbered (these are assets that are not instantly transferable because there may be legal or financial obstacles preventing the instant transferability, e.g. Loans)
- d) Viability for transfer (this would entail a process of calculating the cost-benefit analysis of transfer in line with aspects identified under the Continuity of service, Risk transfer principle and the Asset preservation principles; this may further be informed by the guideline under Chapters 6.5.1.4, 6.5.1.5 and 6.5.1.6)

**STEP 2(a):** For the **Shared Assets** a joint management structure should be established to be guided by:

- a) The provisions of the equity principle as identified in Chapter 6.4;
- b) The guideline that provides for utility of the functional approach as identified in Chapter 6.5.1.3;
- c) The guideline that provides for a right to use, control or manage an asset as identified in Chapter 6.5.1.5 – this would particularly be critical in coming up with the terms of engagement that would inform the apportionment of responsibilities on sharing of assets;
- d) The guideline that provides for the Economic viability and sustainability as identified in Chapter 6.5.1.6 – to also aid in coming up with the terms of engagement that would inform the apportionment of responsibilities on sharing of assets;
- e) The guideline in Chapter 6.5.1.7 and 6.5.1.8 above which addresses exceptions to transfer necessitating sharing; and
- f) Most importantly, the guideline that provides for mutual co-operation and public participation as identified in Chapter 6.5.1.9 which raises the inherent need to involve all relevant stakeholder including the members of the public so as to reduce the potential for contestation/contention following an amicable resolution.

Ultimately, this process should yield a Memorandum of Understanding or an intergovernmental agreement that would be attested and executed by the representatives of all the key stakeholders present as an indication of their consensus and consent of all the terms in the memorandum and in which the guide specified above shall not be flouted.

**STEP 2(b):** For the **Contested Assets** whose status is disputed, the contention may be resolved in several ways including:

- a) In cases where the dispute is about interpretation of the utility of the functional approach as identified in Chapter 6.5.1.3 then this dispute may be referred through adjudication by a Court with competent jurisdiction for constitutional interpretation;
- b) Where the nature of the dispute is not about the function but one that relates to allocation and/or sharing of assets and liabilities then the Intergovernmental Agency identified above may adopt the dispute resolution mechanisms enumerated and explained in detail in Chapter 7.5.

**STEP 2(c):** For **Encumbered Assets** which are not transferrable unless and until the encumbrance is addressed, then:

- a) The encumbrance should be identified;
- b) Depending on the nature of the encumbrance, it may be renegotiated e.g. if the encumbrance is a loan, then the relevant money-lending institution may be approached and the contract that led to the creation of the loan renegotiated so that the liability in that case is then transferred from one entity to another. In this way, the encumbrance would itself become transferrable thereby facilitating the original transfer process;
- c) If the encumbrance yields contention, then the same may be resolved as per Step 2(b).

**STEP 2(d):** In considering the **Viability for transfer:**

- a) Calculation of the cost-benefit analysis of transfer in line with aspects identified under the Continuity of service, Risk transfer principle and the Asset preservation principles as well as the guideline in Chapter 6.5.1.6 on Economic Viability and sustainability of the transfer would be critical
- b) The guideline that provides for a right to use, control or manage an asset as identified in Chapter 6.5.1.5 –would be critical in assessment of the question of viability; and
- c) The guideline that provides for the right of permanent disposal as identified in Chapter 6.5.1.4 – could be instructive for instance by doing away with unneeded fixed assets by selling them, trading them in as partial payments on new fixed assets, or junking them (throwing away assets that are totally worn out).

**STEP 3:** Once the status of the assets and liabilities has been ascertained as per Step 2 above, a joint team working in tandem with other relevant stakeholders would be engaged in facilitating the **Execution of inter-governmental transfer instruments** subject to the type of assets and/or liability. In this respect they would be guided by the provisions of the following legislation:

- Auctioneers Act, Chapter 526 Laws of Kenya
- Banking Act, Chapter 488, Laws of Kenya
- Capital Markets Act, Chapter 485A, Laws of Kenya
- Chattels Transfer Act, Chapter 28 Laws of Kenya
- Civil Procedure Act, Chapter 21 Laws of Kenya
- County Governments Act, No. 17 of 2012
- County Governments Public Finance Management Transition Act, No. 8 of 2013
- Debts (Summary Recovery) Act, Chapter 42 Laws of Kenya
- Disposal of Uncollected Goods, Chapter 38 Laws of Kenya
- Government Contracts Act, Chapter 25 Laws of Kenya
- Government Securities Act, Chapter 421 Laws of Kenya

- Income Tax Act, Chapter 470 Laws of Kenya
- Intergovernmental Relations Act Chapter 5G Laws of Kenya
- National Land Commission Act No. 5 of 2012
- National Social Security Fund, Chapter 258 Laws of Kenya
- Sale of Goods Act, Chapter 31 Laws of Kenya
- State Corporations Act, Chapter 446 Laws of Kenya
- Stamp Duty Act, Chapter 480 Laws of Kenya
- Unclaimed Financial Assets Act, No. 40 of 2011

### **6.7 Recommendations**

In view of the earlier discussion, the following recommendations are hereby adopted: solutions proposed are as enumerated hereunder:

1. This Mechanism and criteria for Transfer of Assets and liabilities be adopted as a policy instrument to guide the process of transfer of public assets and liabilities.
2. The process of transfer of public assets and liabilities should fundamentally be informed by the five principles enumerated above as:
  - a. The Equity principle,
  - b. The Valuation principle,
  - c. The Continuity of service principle;
  - d. The Risk transfer principle; and
  - e. The Asset preservation principle.
3. There is need to imbue the constitutional and statutory provisions on dispute resolution to minimize on the potential conflicts that may arise.
4. The assets and liabilities transfer process should also incorporate all-inclusive and participatory.
5. The guidelines on the transfer of public assets and liabilities should be informed primarily by a functional approach as identifiable under Schedule 4 of the CoK.
6. The liabilities transfer should accompany the assets transfer in cases where the liabilities were incurred in respect of the assets [inducting the functional approach];
7. Where the liabilities are too extensive and thereby likely to weigh down on a County's ability for progressive development, the same should be established and that the respective County Government to negotiate with the National Government to consider support.
8. In aspects where the mandate of a Parastatal falls within the functions of a County Government, it should be assimilated within that County Government along with its assets and liabilities.

## 7.0 TRANSFER OF COURT CASES INVOLVING DEFUNCT LOCAL AUTHORITIES

### 7.1 Introduction

Article 6(2) of CoK describes the governments at the two levels as being distinct and inter-dependent and which are required to conduct their mutual relations on the basis of consultation and cooperation. This is therefore a devolution not based on the principle of absolute autonomy but instead, on that of inter-dependence and cooperation. In form therefore, it is a system that combines a certain measure of autonomy and inter-dependence. The end result of this combination is what may be called a cooperative system of devolved government. Cooperative devolved government may be said to be founded upon three relational principles; namely, the principle of distinctness; the principle of inter-dependence; and the principle of oversight.

Article 174 of CoK therefore creates a new level of local government that marginalizes traditional provincial and district administration and effectively replaces the past structure of local governments that functions through municipalities and town councils, and replaces that with a well-defined, structured and directed county government system enshrined in the Constitution, the supreme law.

### 7.2 Legal Provision for Dispute Resolution

#### 7.2.1 Constitution of Kenya 2010

Article 189 of the Constitution of Kenya envisages a scenario wherein a dispute has arisen between the National Government and the County Government; and between a county government and (an) other(s). It is imperative to mention the clear intention on the Constitution to exhaust all available means of dispute resolution before opting for a judicial mechanism *vide* Litigation in court. Art 189 states:-

*(3) In any dispute between governments, the governments shall make every reasonable effort to settle the dispute, including by means of procedures provided under national legislation.*

*(4) National legislation shall provide procedures for settling intergovernmental disputes by alternative dispute resolution mechanisms, including negotiation, mediation and arbitration.*

#### 7.2.2 Intergovernmental Relation Act 2012

This Act makes it imperative for the National and County Governments to provide in any agreements entered into between the National and County Governments a provisions for a mechanism for dispute resolution . The Act Provides that.....<sup>1</sup>

*(1) Any agreement between the National Government and a County Government or amongst County Government's shall—*

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<sup>1</sup> Intergovernmental Relation Act 2013, S. 32(1)

*(a) include a dispute resolution mechanism that is appropriate to the nature of the agreement; and*

*(b) provide for an alternative dispute resolution mechanism with judicial proceedings as the last resort.*

*(2) Where an agreement does not provide for a dispute resolution mechanism or provides for one that does not accord with subsection (1), any dispute arising shall be dealt with within the framework provided under this Part.*

At Section 33, the Act provides for the procedure to be followed in redressing the dispute. It provides as follows:

*(1) Before formally declaring the existence of a dispute, parties to a dispute shall, in good faith, make every reasonable effort and take all necessary steps to amicably resolve the matter by initiating direct negotiations with each other or through an intermediary.*

*(2) Where the negotiations under subsection (1) fail, a party to the dispute may formally declare a dispute by referring the matter to the Summit, the Council or any other intergovernmental structure established under this Act, as may be appropriate.*

#### **7.2.4 The Transition to Devolved Government Act, 2012 No. 1 of 2012**

Finally this Act is directive on the Transition Authority to take advantage of the alternative dispute resolution mechanism provided in the Intergovernmental Relation Act to solve any dispute without necessarily resorting to litigation in Courts. It provides under Section 34:

*A dispute regarding the performance by the Authority of its functions under this section shall be resolved using the procedure set out in the law relating to intergovernmental relations.*

The above provision makes it necessary that in the period prior during and after the transfer of assets and liabilities and to foster the spirit of devolution the National and County Governments shall strive to settle any dispute by a less adversarial means and resort to other alternative dispute resolution mechanism.

#### **7.3 Mechanism for Transfer of Court Cases Involving the Defunct Local Authorities**

The mechanism for the transfer of cases involving the defunct local authorities shall follow the procedure and provisions provided under the constitution.

The Constitution of Kenya in Article 187(2) (a) provides that resources shall follow functions. Once functions are transferred to the County Governments for instance, it is expected that the assets and liabilities accompanying those functions shall accompany the transferred function.

Some of the liabilities that follow the assets are the cases that were initiated for or against the defunct Local Authorities. It will be right to argue that the cases will follow the assets as they follow the function transferred either to the National Government or the County Government.

In order to determine the mechanism for the transfer of cases involving the defunct Local Authorities, it is imperative to first determine the nature of the cases involving the defunct Local Authorities. The reported cases include but are not limited to:

1. Personal injury claims
2. Employment and Labour Relation issues
3. Cancellation and denial of trade Licenses
4. Breach of Contractual Obligations
5. Land matters
6. Non - Remittance of Statutory Deductions

#### **7.4 Manner of Handling Court Cases Involving Defunct Local Authorities**

S. 134 of the County Government Act No. 17 of 2012 provides that:

(1) *The Local Government Act is repealed upon the final announcement of all the results of the first elections held under the Constitution.*

(2) *All issues that may arise as a consequence of the repeal under Subsection (1) shall be dealt with and discharged by the body responsible for Matters relating to transition.*

Transfer of court cases involving the defunct Local Authorities, need to follow the principle that the functions against which the case has been premised, must also be devolved so as to ascertain what cases belong to what function and which organ is the duty bearer for that function.

Secondly having devolved the functions the Provision of the Civil Procedure Code,<sup>2</sup> and the Government Proceeding Act,<sup>3</sup> will offer a guide to aid in the transfer of court cases.

Under Order 1 Rule 10, the civil procedure provides that:

*Where a suit has been instituted in the name of the wrong persons as plaintiff, or where it is doubtful whether it has been instituted in the name of the right plaintiff, the court may at any stage of the suit, if satisfied that the suit has been instituted through a bona fide mistake, and that it is necessary for the determination of the real matter in dispute to do so, order any other person to be substituted or added as plaintiff upon such terms as the court thinks fit.<sup>4</sup>*

Where the function has been transferred and therefore the cases, it will be imperative that a substitution be made to replace the defunct Local Authority with either the County Government or the National Government<sup>5</sup>. As illustrated earlier the court cases would follow the functions and consequently apportion the duty or the burden to the respective level of the Government.

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<sup>2</sup> Civil Procedure Code Cap 21

<sup>3</sup> Cap 40

<sup>4</sup> Civil Procedure Code Cap 21 , Order 1 Rule 10(1)

<sup>5</sup> Ibid

Thirdly the court may at its own discretion or on application or invitation of any party make an order of substitution to replace, remove and enjoin any party, whose presence or absence would facilitate the speedy resolution of the matter at hand. The Code provides:

*“The court may at any stage of the proceedings, either upon or without the application of either party, and on such terms as may appear to the court to be just, order that the name of any party improperly joined, whether as plaintiff or defendant, be struck out, and that the name of any person who ought to have been joined, whether as plaintiff or defendant, or whose presence before the court may be necessary in order to enable the court effectually and completely to adjudicate upon and settle all questions involved in the suit, be added”<sup>6</sup>.*

Lastly in the letter and spirit of Art 189 it may be advisable for both the National Government and the County Governments to engage the parties in the Court cases in an amicable settlement of the disputes. This can be done by setting up or involving the TCTAL to identify, collect, collate and register all cases involving the defunct Local Authorities. The TCTAL will then seek to establish:

1. The Nature of the Claims
2. Stage of the Case where the matter is already in court
3. Chances of success/failure
4. Willingness of the parties to negotiate a compromise to facilitate settlement

Finally the Committee will then advise both governments on whether to withdraw and settle the cases out of court or transfer them to the respective government as per the function and proceed with the cases to their logical conclusion.

### ***7.5 Dispute Resolution Arising From the Transfer or Sharing Of Public Assets and Liabilities***

It is anticipated that in the transfer of assets and liabilities from either level of the Government, disputes may arise. Consequently in order to resolve such disputes, the provision of the constitution and the Intergovernmental relation Act should be taken into account.

The Constitution in Art 189 Provides that:

*(3) In any dispute between governments, the governments shall make every reasonable effort to settle the dispute, including by means of procedures provided under national legislation<sup>7</sup>.*

Further the Intergovernmental relation Act asserts this position by providing under Art 32:

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<sup>6</sup> Ibid, Order 1 Rule 10(2)

<sup>7</sup> Constitution of Kenya, Art 189(3)

*(1) Any agreement between the national government and a county government or amongst county governments shall—*

*(a) Include a dispute resolution mechanism that is appropriate to the nature of the agreement; and*

*(b) Provide for an alternative dispute resolution mechanism with judicial proceedings as the last resort.*

*(2) Where an agreement does not provide for a dispute resolution mechanism or provides for one that does not accord with subsection (1), any dispute arising shall be dealt with within the framework provided under this Part.*

### **7.7 Recommendations**

It is anticipated that any dispute arising from the transfer or sharing of public assets and liabilities shall be subjected to the provisions of the CoK and other legislation as enacted by parliament and discussed earlier. The overriding and common principle cutting across the legislation is that the judicial mechanism for resolution of dispute should only be pursued as a remedy of last resort after exhaustion of all other relevant effective and applicable dispute resolution mechanisms.

The following are the recommendations:

1. The judiciary through the chief justice may as a short term measure create a special division or constitute special bench to hear , determine and dispose of all matters involving the defunct Local Authority . This will enable the Transition Authority determine the issues of duty bearer depending on the liability function.
2. As a long term measure the Chief justice may constitute a division/bench to hear and determine any issue arising from the defunct Local Authority with the powers to apportion liability to either the National or the County Government.
3. Notwithstanding the recommendations above, a further recommendation that the KRA, NHIF, NSSF, Ministry of Land, Housing and Urban Development and other statutory agencies waives their claims to the pending statutory obligations incurred before assumption of office by the County Governments - March 27<sup>th</sup> 2013. Demanding for this payment is counterproductive and self defeatist as it will only delay the realization of the devolved units as they are heavily straddled with debt. This will be akin to the Government punishing itself, a defeatist approach.
4. The TA to work with the Ethics and Anti- Corruption Authority to investigate and trace the whereabouts of funds realized from employees and have not yet been submitted to the relevant statutory body, i.e. NHIF, NSSF. The culprits should be prosecuted for abuse of office and where possible recovery proceeding be commenced against them.
5. Approaching the court to substitute the defunct Local Authority with either the National or County Government following the function approach as provided for under Order 1 rule 10(2) of the Civil Procedure. This will allow the cases to proceed

to their natural conclusion. The duty bearer will have been determined through the nature of the case which ordinarily will fit to one of the functions as provided under the fourth schedule.

6. On transfer of cases, it is recommended that a functional approach be adopted, for those cases which are unlikely to be settled within the period of transition<sup>8</sup>. The cases can be categorized to fit within the provision of the fourth schedule and then transferred to the respective Government There should be vetting of all the cases by the defunct Local Authorities to determine:
  - I. Cases where judgment have been delivered.
    - a. If the judgment is for or against the defunct Local Authorities, parties should be made to comply with the law and honor the award.
  - II. Cases Pending Judgment
    - a. Upon delivery the responsibility should be assigned as per the function or in the alternative the National and County government should agree on the burden bearer.
  - III. Ongoing cases
    - a. Substitution of parties should be made as per the functional approach.
7. On contractual obligations there should be a verification and vetting of the contract should be done to ascertain:-
  - (i) Whether the contracts are lawful and capable of execution.
    - It is proposed that where the contracts are lawful the contract must be allowed to be executed to conclusion to avoid cases of breach, otherwise they should be cancelled without any consequential cost.
  - (ii) Whether they have been executed but are yet to be performed
    - It is proposed that parties agree on whether the contracts are capable of performance and if they are the mode and timelines for performance. The nature of the function shall determine the duty bearer.
    - Modalities for cancellation should also be pursued after verifying the cost of such cancellation, Where money has been paid then specific performance must follow.
  - (iii) Whether they have partly been performed and the extent pending completion.
    - Parties to be allowed to finish the contract and hand over to the respective government.
    - If impossible to complete payment to be done on a Quantum merit basis.
  - (iv) Whether any payments have since been made
    - Where payments have been made and the work has not been done, the contract should be cancelled to allow for fresh tendering by the proper level of Government.

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<sup>8</sup> Constitution of Kenya, Schedule Six, Part IV S.15(1)

## 8.0 WAIVER OF TAXES AND FEES DURING THE TRANSFER OF PUBLIC ASSETS AND LIABILITIES

### 8.1 Background

Taxes and other fees are generally due during the transfer of assets in Kenya. However we do have exceptional circumstances whereby the transfer of assets will not be subject to taxes and or fees.

Another equally important tax area to be addressed is that of liability of other pre-existing taxes. This is meant to answer the question, who bears the tax liability for outstanding taxes owed by to the KRA by the now defunct Local Authorities given the provision of section 134 (1) of the County Governments Act?

Additionally, the transfer of assets from one Government Agency to another is usually not subject to taxes or transfer fees. This is as envisaged in Section 117 of the Stamp Duty Act<sup>9</sup> which provides that:

*“(1) There shall be exempt from stamp duty under this Act –*

*(a) an instrument executed by or on behalf of or in favour of the Government in any case in which, but for this exemption, the Government would be liable to pay the duty;”*

What is clear from the reading of the above Section is that the transfer of assets from Government to the Government does not attract Stamp Duty. It is therefore that the other levies, charges, fees and to a large extent taxes, should not apply in these inter-governmental transactions.

The NLC and bodies affiliated with the Ministry of Land, Housing and Urban Development also levy some charges and fees in the transfer of assets and buildings, which form a significant portion of the assets to be transferred. Given the spirit of the Stamp Duty Act as read with the Constitutional provisions interrogated in 8.2, the TA can petition the NLC to waive the attendant taxes, fees and charges that would ordinarily arise in the transfer of assets from the National Government to the County Government and vice versa.

### 8.2 Constitutional backing

The TA, KRA and the National Treasury ought to be alive to the principles and framework of public finance in the Constitution. Article 201 of the Constitution provides as follows:

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<sup>9</sup> Chapter 480 Laws of Kenya

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

- (a) there shall be openness and accountability, including public participation in financial matters;
- (b) 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 marginalized groups and areas;
- (c) the burdens and benefits of the use of resources and public borrowing shall be shared equitably between present and future generations;
- (d) public money shall be used in a prudent and responsible way; and
- (e) financial management”

Taxation has understood to include government charges, fees and levies.

It is evident that equity in taxation is paramount in the Constitutional provisions on Public Finance which dictates cannot be ignored and should be invoked in the settlement of this dispute.

### **8.3 Recommendations**

Taxes, charges, fees and other statutory liabilities once assessed are due to the National Government through the collection agencies such as the KRA, NLC and Ministry of Land, Housing and Urban Development.

However based on review of the substantive laws and practice, the TA will lobby the KRA, the National Treasury, the NCL and Ministry of Land, Housing and Urban Development on this basis on behalf of the defunct Local Authorities to either waive the taxes, charges and fees or levy the taxes, charges and fees equitably.

This will mean that:

1. The taxes, charges and fees ordinarily arising from the transfer of assets do not apply or are exempted in the transfer of assets from either level of government.
2. The County governments having taken up the assets of the defunct Local Authorities should bear the outstanding liabilities on taxes, charges and fees .
3. Where the County Governments do not have the revenues to pay the outstanding taxes, charges and fees as evidenced by audited financials, then the National Government need to intervene in the manner described in 4 below.
4. Government intervention in this case includes:

- a) Where applicable, the Government agreeing to offset the tax outstanding with the rates and fees owing to the defunct Local Authorities;
  - b) The Government granting abandonment of principal taxes, charges and fees, conditionally or otherwise;
  - c) The Government offering financial grants to County Governments to settle the outstanding taxes, charges and fees;
  - d) The National Treasury, KRA, NLC, Ministry of Land, Housing and Urban Development and County Governments entering into an arrangement where a flexible long-term payment plan is developed to assist the County Governments settle the outstanding taxes, charges and fees;
  - e) The Government granting tax refunds to County governments which pay the taxes due, on application and on a case by case basis. This will ensure that the KRA achieves its revenue targets, this being the key reason behind the push to collect these taxes; or
  - f) The Government may also consider waiving the penalties and interests levied on late payment of taxes as an incentive to pay the taxes and fees
5. In the short-term, the Counties contribute 10% of their revenues into a pool of resources with the specific aim of offsetting the taxes owing to the National Government. This can be done for 3 years and the amounts used to pay off the debt owed to the National Government.

The taxes, statutory fees and charges owing by the defunct Local Authorities be written-off provided such liabilities meet a certain criteria. The recommendation is hinged on the reality that such payment will be akin to the government punishing itself. However for this to happen, the liabilities must be strictly identified, ascertained and verified. The monies owing must also be audited through a special audit commissioned by TA and the Kenya National Audit Office to ascertain how the debt was incurred or arose.

The following liabilities be must subjected to special audit by the TA as provided for in the TDGA, 2012

- Unpaid Salary arrears
- Unremitted employees bank loan deductions
- LAPFUND and LAPTRUST contributions
- NSSF and NHIF contributions
- Unpaid suppliers and contractors

## Appendix 1: List of Counties Visited

1. Baringo County
2. Bomet County
3. Bungoma County
4. Embu County
5. Garissa County
6. Homa Bay County
7. Isiolo County
8. Kajiado County
9. Kakamega County
10. Kericho County
11. Kiambu County
12. Kilifi County
13. Kirinyaga County
14. Kisii County
15. Kisumu County
16. Kitui County
17. Kwale County
18. Laikipia County
19. Machakos County
20. Makueni County
21. Mandera County
22. Marsabit County
23. Meru County
24. Migori County
25. Mombasa County
26. Murang'a County
27. Nairobi City County
28. Nakuru County
29. Nandi County
30. Narok County
31. Nyandarua County
32. Nyeri County
33. Samburu County
34. Siaya County
35. Taita Taveta County
36. Tharaka Nithi County
37. Trans Nzoia County
38. Turkana County
39. Uasin Gishu County
40. Vihiga County

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