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REPORT OF THE STANDING COMMITTEE ON FINANCE AND BUDGET

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ON

THE DIVISION OF REVENUE BILL (NATIONAL ASSEMBLY BILLS NO. 7 OF 2021)

PAPERS LAID

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PREFACE

Mandate and Functions of the Committee

Article 124 of the Constitution of Kenya, provides for the establishment of Committees by either House of Parliament. Committees are central to the workings, roles and functions of Parliament as set out in Article 94 and more specifically in Article 96 of the Constitution in regard to the Senate.

Parliamentary Committees consider policy issues, scrutinize the workings and expenditure of the national and county governments and examine proposals for legislation. The end result of any process in Committees is the report, which is tabled in the House for consideration.

The Standing Committee on Finance and Budget is established pursuant to standing order 218(3) of the Senate Standing Order and is mandated –

a) *To investigate, inquire into and report on all matters relating to coordination, control and monitoring of the county budgets and to examine –*
    i) *the Budget Policy Statement presented to the Senate;*
    ii) *report on the Budget allocated to Constitutional Commissions and independent offices;*
    iii) *the Division of Revenue Bill, County Allocation of Revenue Bill, and cash disbursement schedule for county governments.*
    iv) *to consider all matters related to resolutions and Bills for appropriations, share of national revenue amongst the counties and all matters concerning the National Budget, including public finance and monetary policies and public debt, planning and development policy; and*

b) *To pursuant to Article 228 (6) of the Constitution, to examine the report of the Controller of Budget on the implementation of the budgets of county governments.*

Further, the public Finance Management Act, 2012 section 8 (1)(b) on the responsibility of the Senate Budget Committee in public finance matters provides that- *The Committee of the Senate established to deal with budgetary and financial matters has responsibilities to review the County Allocation of Revenue Bill and the Division of Revenue Bill in accordance with Article 218(1)(b) of the Constitution at least two months before the end of the financial year.*

Membership of the Committee

The Standing Committee on Finance and Budget was constituted by the House on Thursday, 14th December, 2017 during the First Session of the Twelfth Parliament. The Committee was later reconstituted on Wednesday, 24th June, 2020, during the Fourth Session of the Twelfth (12th) Parliament. The Committee as currently constituted, comprises the following Members-

1. Sen. Charles Kibiru, MP - Chairperson
2. Sen. (Dr.) Ochillo Ayacko, MP, - Vice Chairperson
3. Sen. Wetang'ula Moses Masika, EGH, MP - Member
4. Sen. Kimani Wamatangi, MP - Member
5. Sen. Mutula Kilonzo Junior, CBS, MP - Member
6. Sen. Aaron Cheruiyot, MP - Member
7. Sen. Rose Nyamunga, MP - Member
8. Sen. CPA Farhiya Haji, MP - Member
9. Sen. Milicent Omanga, MP - Member

BACKGROUND AND EXECUTIVE SUMMARY

Article 218 of the Constitution provides for introduction of Division of Revenue Bill and the County Allocation of Revenue Bill to Parliament, at least two months before the end of each financial year.

The Budget Policy Statement (BPS), is the precursor to the Division of Revenue Bill, sets the fiscal framework underpinning the sharing of revenue between the two levels of government. The adoption of the 2021 BPS Report paved way for the publication and subsequent introduction of the Division of Revenue Bill to the House.

The Division of Revenue Bill (National Assembly Bills No. 7 of 2021 was published and introduced in the National Assembly. The National Assembly passed the Bill on 23rd March, 2021. Following the passage by the National Assembly, the Bill was submitted to the Senate for concurrence.

The Bill was read a First Time in the Senate on Tuesday, 30th March, 2021, and thereafter stood committed to the Standing Committee on Finance and Budget pursuant to standing order 140 (1) of the Senate Standing Orders for consideration and facilitation of public participation.

Pursuant to Article 118 (1) (b) of the Constitution and standing order 140(5) of the Standing Orders of the Senate, the Standing Committee, in its consideration of the Bill, invited key stakeholders, including the National Treasury, the Attorney General, the Council of County Governors, the Commission on Revenue Allocation, County Assembly Forum to submit their views on the Bill. The Committee also invited other non–state actors and the general public who similarly participated and submitted their memoranda on the bill.

The Bill provides for the division of nationally raised revenue between the two levels of government, allocation to the Equalization Fund as well as setting out specific resources to be provided to counties as conditional grants from national government share of revenue and from proceed of loans and loans from development partners. In addition, the Bill is accompanied by an explanatory memorandum pursuant to Article 218(2) of the

Constitution. The memorandum sets out the explanation of revenue allocation as proposed by the Bill along with the evaluation of the Bill in relation to the criteria provided under Article 203(1) of the Constitution. It also provides a summary of any significant deviation from the recommendations from the Commission on Revenue Allocation with an explanation for each such deviation.

The enactment of the Division of Revenue Bill is critical in setting the stage for the preparation of the national government budget and publication of County Allocation of Revenue Bill. It also informs on the preparation of respective county governments' budget documents in a manner that is timely and enable fiscal clarity and planning.

The Bill proposes-

a) Shareable revenue Kshs. estimated at Kshs 1,775.624 billion which is proposed to be shared as below
    i) National Government Kshs. 1,398.798 billion of which Kshs. 7.532 billion is given to counties as conditional allocations;
    ii) County Equitable Share Kshs 370.0 billion which is 27.3% of the Financial Year 2016/17 audited and approved revenue;
    iii) Equalization Fund – Kshs 6.825 billion;
b) Additional Conditional allocations (loans & grants from Development Partners) Kshs. 32.343 billion

Cognizant of the High Court Ruling in Petition No. 252 of 2016, the Committee considered the Bill and further held two consultative meetings with the National Treasury, the Attorney General, the Council of County Governors, the Commission on Revenue Allocation. The consultations were mainly to achieve an amicable mechanism to deal with the provisions of the Bill while respecting the High Court Ruling.

Committee's Recommendations

The Committee recommends that the Division of Revenue Bill (National Assembly Bills No. 7 of 2021) be approved with the amendment to the schedule. The new schedule should provide for the following four items only-

a) Total sharable revenue;

b) National Government share;

c) Equalization fund; and

d) County equitable share.

This recommendation is in compliance with the Ruling in High Court Petition No. 252 of 2016, where the court held that it cannot be permissible to provide for conditional grants in the Division of Revenue Act and therefor it follows that conditional grant cannot be proposed in Division of Revenue Bill.

Acknowledgements

The Committee acknowledges the Commission on Revenue Allocation, the Institute of Certified Public Accountants (ICPAK), the International Budget Partnership (IBP), the National Treasury, the Attorney General, the Council of County Governors, the and members of the public who made insightful contributions and recommendations. Further, the Committee thanks the Offices of the Speaker and Clerk of the Senate for the support extended to the Committee in execution of its mandate.

Appreciations to the Members of the Committee for their patience, sacrifice and commitment to public service, which enabled the Committee complete the assigned task within the stipulated time.

It is now my pleasant duty and privilege, on behalf of the Standing Committee on Finance and Budget, to present to the Senate, this Report of the Committee on the Division of Revenue Bill (National Assembly Bills No. 7 of 2021).

SIGNATURE: _____

SEN. CHARLES KIBIRU, MP.

(CHAIRPERSON, STANDING COMMITTEE ON FINANCE AND BUDGET)

DATE: **12th April, 2021**

CHAPTER ONE

1.0 VERTICAL ALLOCATION OF REVENUE FOR FINANCIAL YEAR 2021/22

HIGHLIGHTS OF THE DIVISION OF REVENUE BILL, 2021

1. Article 218 of the Constitution provides for the submission of the Division of Revenue Bill and the County Allocation of Revenue Bill to Parliament, at least two months before the end of a financial year. The Division of Revenue Bill divides revenue raised by the national government among the two levels of government. The Division of Revenue Bill further sets out specific resources to be provided to counties as conditional grants, and the Equalization Fund.
2. In addition, section 191 of the Public Finance Management (PFM) Act, 2012, provides that each year when the Budget Policy Statement (BPS) is introduced, the Cabinet Secretary shall submit to Parliament a Division of Revenue Bill and County Allocation of Revenue Bill prepared by the National Treasury for the financial year to which that Budget relates.
3. The adoption of the 2021 BPS Report by both Houses paved way for the publication and subsequent introduction of the Division of Revenue Bill, 2021 in National Assembly.
4. The Division of Revenue Bill (National Assembly Bills No. 7 of 2021) was published on 8th March, 2021 and passed by the National Assembly on 23rd March, 2021. The total shareable revenue for the FY 2021/2022 is estimated at Kshs 1,775.62 billion proposed to be allocated as shown in table 1;
5. In addition, several conditional allocations (loans & grants) from development partners allocated to the County Governments for the FY 2021/22 have been listed as memo items in the Bill. The total allocation for these conditional grants amounts to Kshs. 32.34 billion.

Table 1: Allocation of revenue raised nationally between the national and county governments for the financial year 2021/22.

Type/level of allocation	Amount in Ksh.	Percentage (%) of 2016/17 audited and approved Revenue i.e. Ksh. 1,357,698 Million
A. Total Sharable Revenue	1,775,624,173,860	
B. National Government	1,398,798,856,427	
C. Equalization Fund	6,825,317,433	0.50%
D. County equitable share	370,000,000,000	27.3%

1.1 Equitable Share of Revenue

6. Pursuant to Article 202 (1) of the Constitution, the nationally raised revenue is shared equitably among the national and county governments. Article 203 (2) further stipulates that the equitable share of the revenue raised nationally that is allocated to county governments shall be not less than fifteen per cent of all revenue collected by the national government and shall be calculated on the basis of the most recent audited accounts of revenue received, as approved by the National Assembly. The proposed Equitable Share for FY 2021/22 is Kshs. 370 billion which is equivalent to 27.3 percent of the last audited accounts (**Kshs. 1,357,698 million for FY 2016/17**) as approved by the National Assembly.

7. In calculating the County Governments' equitable revenue share allocation for FY 2021/22, the following factors have been put into consideration;
   a) Growth in the County Governments' equitable share for 2020/21 of Kshs. 316.5 billion by Kshs. 36.1 billion or 11.4 %. This growth derived from anticipated improvement in revenues raised nationally in FY 2021/22. This increase is expected

to facilitate post covid-19 economic recovery at the counties as well as ensure sustained service delivery by the devolved governments.

b) Conversion of some of the ongoing county governments' additional conditional allocations with no contractual obligations to equitable share. The converted conditional grants amount to Kshs. 17.4 billion.

1.2 GOK Conditional Allocations to County Governments

8. The Division of Revenue Bill 2021, proposes to allocate Kshs. 7,537 million from the National Government shareable revenue for the following conditional allocations to support specific national policy objectives to be implemented by County Governments-

   a) Conditional Allocation to facilitate the leasing of medical equipment of **Kshs. 7,205 million**. The grant is in its seventh year of implementation.

   b) Conditional allocation to supplement county allocation for the construction of county headquarters of **Kshs. 332 Million** in five counties. The five counties facilitated under this grant are Lamu, Nyandarua, Tana River and Tharaka Nithi. The allocation is in the fourth year of implementation.

1.3 Equalisation fund

9. Kshs. 6.8 billion has also been set aside for the Equalization Fund in FY 2021/22 which translates to 0.5 per cent of the last audited revenue accounts of governments, as approved by the National Assembly. This Fund is used to finance development Programmes that aim at reducing regional disparities among beneficiary counties.

10. The operationalization and administration of the Equalization Fund was suspended in 2016 with the annulment of the guidelines by the High Court due to their unconstitutionality. The National Treasury should fast-track processing and submission of the Public Finance Management (Equalization Fund) Regulations to Parliament for approval to ensure that the marginalized areas access equalization funds as there is a danger of the fund lapsing having not achieved its objective.

1.4 Conditional grants from loans and grants from development partners

11. The bill proposed several conditional grants from loans and grants from development partners. These conditional grants are-

i) IDA-Kenya Devolution Support Program (KDSP) ("level 2") Grant of Kshs. 4.60 billion;

ii) IDA-Transforming Health Systems for Universal Care Project, World Bank credit of Kshs. 2.23 billion;

iii) DANIDA-Primary Health Care in Devolved Context Kshs. 701.25 million;

iv) IDA-National Agricultural and Rural Inclusive Growth Project (NARIGP), World Bank credit of Kshs. 6.39 billion;

v) EU-Instruments for Devolution Advice and Support (IDEAS) grant of Kshs. 230.73 million;

vi) IDA (World Bank) - Kenya Climate Smart Agriculture Project (KCSAP) of Kshs. 7.84 billion;

vii) World Bank- Kenya Informal Settlement Improvement Project II (KISIP II) of Kshs. 2.80 billion;

viii) IDA – Water and Sanitation Development Project (WSDP) World Bank Credit of Kshs. 5.00 billion;

ix) Sweden Agricultural Sector Development Support Programme (ASDSP) II- Kshs. 1.30 billion;

x) Drought Resilience Programme in Northern Kenya (DRPNK) - Kshs. 370 million;

xi) Emergency Locust Response Project (ELRP), World Bank Credit of Kshs. 800 million;

xii) UNFPA - 9th Country Programme Implementation: - Kshs. 73.9 million.

CHAPTER TWO

2.0 SUBMISSIONS FROM STAKEHOLDERS

This Chapter presents the deliberations of the Committee with various stakeholders. It highlights the views and recommendations submitted to the Committee.

Submission by the National Treasury and Planning

12. The Committee invited the Cabinet Secretary, National Treasury and Planning to deliberate on the proposed Division of Revenue Bill, 2021, in light of the High Court Ruling on Petition No. 252 of 2016 on Division of Revenue Act, 2016. The Cabinet Secretary submitted as follows:

On the proposed Division of Revenue Bill, 2021

13. The Division of Revenue Bill (DoRB), 2021 proposed to allocate to County Governments Ksh.409.88 billion in the financial year (FY) 2021/22, which relative to the financial year 2020/21 allocation, reflected an increase ofKsh.53.5 billion or 16.9%. That allocation comprises: equitable share ofKsh.370 billion; additional conditional allocations from the National Government share of revenue raised nationally amounting to Ksh.7.53 billion; and additional conditional allocations from proceeds of loans and grants from development partners amounting to Ksh.32.34 billion.

County Governments ' Equitable Share

14. The bill proposed to allocate County Governments an equitable share of revenue raised nationally for the financial year 2021/22 of Ksh.370 billion. That was premised on Parliament having approved the Third Basis for allocation of the share of national revenue among the County Governments in September, 2020 on condition that the formula's implementation would be preceded by a Ksh.53.5 billion increase in the Counties' equitable revenue share.

15. The proposed County Governments' equitable share of revenue raised nationally for the financial year 2021/22 was arrived at by:

    i. adjusting the Counties' FY 2020/21 allocation (i.e., Ksh. 316.5 billion) by Ksh 36.1 billion or 11.4 percent. That growth was premised on the anticipated improvement in revenues raised nationally in FY 2021/22 when the effects of Covid-19 pandemic were expected to ease. That increase was expected to facilitate post Covid-19 economic recovery at the Counties as well as ensure sustained service delivery by the devolved governments; and,

    ii. converting four existing conditional grants to County Governments into unconditional grants, and allocating the respective amounts totaling Ksh. 17.4 billion towards the Counties' FY 2021/22 equitable revenue share. The four conditional allocations are: Road Maintenance Levy Fund (RMLF); the level-5 hospital grant; the compensation for user fees foregone; and, the grant funding rehabilitation of village polytechnics.

16. Conversion of the four conditional allocations to Counties equitable revenue share as proposed above had several advantages. Firstly, it would afford the Counties more autonomy to budget and prioritize allocation of resources.

17. Secondly, it would achieve a more consolidated approach to funding of devolved functions- while also enabling the tracking of performance and attribution of outcomes. Thirdly, it would help to address a number of challenges that were experienced including suboptimal absorption of conditional allocations; and failure by Counties to allocate sufficient resources in areas receiving supplemental funding by the National Government through conditional allocations.

18. Moreover, the fact that the approved Third Basis for allocation of the share of national revenue among the County Governments effectively linked resources to devolved functions (specifically with weighted parameters for health, roads and agriculture) meant that it was now possible to achieve policy objectives of some conditional grants directly through the equitable share in health and agriculture, for instance. The new parameters to be used in distributing the equitable revenue share

among Counties closely resembled those that were being used to distribute sectoral conditional allocations. In addition, the approved revenue distribution criteria contained a parameter, 'population' with a weight of 18% which was specifically designed to reflect costs of 'other County Services' including village polytechnics.

19. The position at the time was besides the composite of equal share, the allocation criteria for the rehabilitation of village polytechnics conditional grant was also based on total trainee enrolment in the respective county governments, which was similar to the use of population parameter in the Third Basis for Revenue Sharing among Counties. That meant that village polytechnics being a devolved function, and also a composite of the population parameter of the formula should be directly financed from each County's equitable share of revenue.

20. After making the above adjustment, County Governments' equitable share of revenue in the financial year 2021/22 was estimated to be Ksh. 370 billion

21. The above proposed equitable share for FY 2021/22 ofKsh370 billion was equivalent to 27.3 percent of the last audited accounts (Ksh.1.358 billion for FY 2016/17) as approved by Parliament. The proposed allocation met the requirement of Article 203(2) of the Constitution that equitable share allocation to counties should not be less than 15 per cent of the last audited revenue raised nationally, as approved by the National Assembly.

Additional Conditional Allocations

22. Article 202(2) of the Constitution provides for additional allocation to County Governments from the National Government's share of revenue, either conditionally or unconditionally.

23. Accordingly, and in addition to the equitable share of revenue raised nationally, the National Treasury proposed that County Governments received additional conditional allocations amounting to Ksh. 39.88 billion. That reflected a decrease of Ksh 13.52 billion. That decrease was occasioned by the proposal to convert some of the ongoing additional conditional allocations to county governments, amounting

to Ksh. 17.4 billion to the equitable share in FY 2021/22. That comprised: i) additional conditional allocations from the National Government share of revenue raised nationally amounting to of Ksh 7.54 billion and, ii) conditional allocation from proceeds of external loans and grants amounting to Ksh. 32.34 billion.

The Inclusion of Conditional Grants in the Division of Revenue Bill

24. The National Treasury had proposed an allocation of Ksh. 39.88 billion as additional conditional allocations to county governments. The allocation comprised of: -

(a) Ksh. 7.5B billion as additional conditional allocations to county governments financed from the national government share of revenue raised nationally to finance: - i). Leasing of Medical Equipment at Ksh.7.2 billion; and ii) Supplement for construction of county headquarters at Ksh. 332 million. Those additional conditional allocations, were not converted into equitable share of County Governments because they had ongoing contractual obligations.

(b) Ksh. 32.3 billion as additional conditional allocations to County Governments financed from proceeds of loans and grants by development partners.

Treatment of the additional conditional allocations in the Division of Revenue Bill

25. The National Treasury treated the above additional conditional allocations as memo items to the Schedule of the Bill.

26. They averred that the memo items were not part of the main Division of Revenue Bill and was intended as a disclosure to the public of additional allocation of revenue from the national government share of revenue and loan & grants from development partners.

27. Division of revenue are:

i. Item A: Total Sharable Revenue Ksh. 1,775,624,173,860

ii. Item B: National government share of revenue raised nationally amounting to Ksh. 1,398,798,856,427 of which 7,537,0000 shall be

transferred to County Governments as additional conditional allocations pursuant to Article 202 (2) of the Constitution.

iii. Item C: Allocation to Equalisation Fund (pursuant to Article 204) amounting to Ksh. 6,825,317,433; and,

iv. Item D: County equitable share amounting to Ksh. 370,000,000,000

Alternative Mechanism for Disbursement of Conditional Grants to Counties if they were to be Omitted in the Bill

28. Article 96 (3) of the Constitution provides that the Senate is responsible for determining the allocation of national revenue among Counties and exercising oversight over national revenue allocated to the County Governments;

29. Article 114 (3) of the Constitution excludes the Division of Revenue Bill and County Allocation of Revenue Bill from the definition of a money Bill. Article 218(1) (b) requires a County Allocation of Revenue Bill be introduced in Parliament to divide among Counties the revenue allocated to the County level of Government.

30. Section 191 (1) as read with Section 25 of the Public Finance Management Act (PFMA), 2012 provides that, *each year when the Budget Policy Statement is introduced, the Cabinet Secretary responsible for finance shall submit to Parliament a Division of Revenue Bill and County Allocation of Revenue Bill as provided in the PFMA for the financial year to which that Budget relates.*

31. Section 191 (3) of the PFMA also provides that, *'the County Allocation of Revenue Bill shall specify — (a) each county's share of that revenue under subsection (2) and (b) any other allocations to the counties, from the national government's share of that revenue, and conditions on which those allocations shall be made.*

32. The import of paragraph 24 was that any additional conditional allocations to County Governments should be contained in County Allocation of Revenue Bill and approved by Parliament.

33. They argued that pursuant to Regulation 24 and 25 of the Public Finance Management (National Government) Regulations, 2015, National Government Accounting Officers could issue Authority to Incur Expenditure to respective accounting officers of the respective county governments. Particularly, Regulation 25 (1) of PFM(NG) Regulations 2015 also provides *An accounting officer may authorize a public officer under their national government entity to be an Authority to Incur Expenditure Holder (AIE).; while regulation 25 (2) provides that, An Accounting Officer who finds it necessary to authorize a public officer in another Ministry or county government to incur official expenditure on his or her behalf, shall do so b) issuing an Authority to Incur expenditure addressed to the Accounting Officer of the national government or county government entity.*

34. However, Regulation 25 (3) and (5) gives clarity that designation of AIE Holder shall be in writing in the form prescribed by the National Treasury; and *Where an Accounting Officer delegates this authority, the accounting officer shall remain responsible for any expenditure incurred as a result or that delegation.*

35. In the doctrine of separation of powers under devolved system of government, emphasis is placed on independence of the two levels as envisaged in Article 189 of the Constitution, However, is this option visible and how can the doctrine be respected?

36. Article 226 (2) of the Constitution provides that, *"The accounting officer or a national public entity is accountable to the National Assembly for its financial management, and the accounting officer of a county public entity is accountable to the county assembly for its financial management"*.

37. Accordingly, the Article suggests that that arrangement posed a challenge not only on accountability mechanism if an AIE were to be issued by a National Government Accounting Officer to a County Government Accounting Officer, but would also offend principles of the Constitution on independence of County Governments.

38. It was for the above reason that the National Treasury was of the considered opinion that the only legal instrument to disburse allocations to County Governments was

the County Allocation of Revenue Act, which must be approved by the Senate, and as such allocations should be disclosed in the Division of Revenue Act as memo items.

The increased Allocation to the Conditional Grant on the Leasing of Medical Equipment Programme

39. That additional conditional allocation which was in its seventh year of implementation, was proposed to increase from Ksh.6.205 billion in FY 2020/21 to Ksh.7.205 billion in FY 2021/22 and was intended to facilitate the payment of lease amounts in respect of modern specialized medical equipment in at least two health facilities in each County Government over the medium term. That would facilitate easy access to specialised health care services and significantly reduce the distance that Kenyans travel in search of such services today.

40. The significant increase in allocation was to cater for pending bills related to MES programme occasioned by lack of provision in previous years. For instance, in FY 2019/20, Ministry of Health closed with pending bills of Ksh. 1.17 billion which was treated as a first charge in FY 2020/21 from the allocation to MES of Ksh. 6.02 billion.

41. Accordingly, the balance would not be adequate to cater for the current year's contractual obligations, unless additional resources were provided in the supplementary. Secondly, the next FY being the final year of the project, there was need to make a full provision to ensure all contractual obligations were met before closure of the project so as not to attract pending bills and subsequent interest which would occasion loss of public funds in the long run.

The High Court Ruling on Petition No. 252 of 2016 on Division of Revenue Act, 2016

42. The National Treasury was cognisant and in agreement with the High Court Ruling on Petition No. 252 of2016 on Division of Revenue Act, 2016 as it related to the

Division of Revenue Bill, 2021 and submitted as follows with regards to compliance with the findings that: -

(a)the National Government cannot allocate itself funds for and undertake devolved functions, without first executing intergovernmental agreements required by Article 187 of the Constitution;

43. The Division of Revenue Bill, 2021 had not allocated any funds to the National Government to undertake any of the Devolved functions as contained in part II of the Fourth Schedule of the Constitution. The only additional conditional allocation whose expenditure would be made by the National Government on behalf of respective county governments was on Leasing of Medical Equipment. There existed duly signed Intergovernmental Agreements pursuant to Article 187 of the Constitution between the Ministry of Health (on behalf of the National Government) and the respective county governments to this effect.

(b)in accordance with Article 202 (2) of the Constitution all funds christened in the Division of Revenue Act as conditional or unconditional grants should be netted from national government's share of revenue and not from the overall revenues raised nationally;

44. The National Treasury had proposed allocation of Ksh. 7.5 billion additional conditional allocations to county governments financed from the national government share of revenue raised nationally to finance: - i). Leasing of Medical Equipment at Ksh.7.2 billion and ii) Supplement for construction of county headquarters at Ksh. 332 million.

(c)in accordance with Article 202(2) of the Constitution all funds christened in the Division of Revenue Act as conditional or unconditional grants should be disbursed to the Counties through the County Revenue Fund;

45. The National Treasury submitted that they shall- except for the leasing of medical equipment conditional allocation, disburse all allocations to county governments to

their respective County Revenue Fund Accounts as contained in the proposed County Allocation of Revenue Bill, 2021, which was before Parliament.

(d)funds christened as 'national interest' in the Division of Revenue Act 2016 or any other Division of Revenue Act enacted to implement the provisions of Article 202 and 203 of the Constitution cannot be apportioned on devolved functions without the same being channeled to the Counties as conditional or unconditional grants.

46. The National Treasury, through the Division of Revenue Bill, 2021 had not proposed an allocation christened "National Interest", Pursuant to Article 203, to the National Government, for functions devolved to county governments.

47. The National Treasury urged the Committee to consider and reinstate the definition of revenue under section 2 of the Bill to read that ""revenue" has the meaning assigned to it under section 2 of the Commission on Revenue Allocation Act, 2011; and *includes Roads Maintenance Levy Fund allocation under this Act.*

Submission by the Commission on Revenue Allocation

In accordance with the requirements of Article 205 of the Constitution, the Commission on Revenue Allocation considered the provisions of the Division of Revenue Bill (National Assembly Bills No. 3 of 2020) and made the following observations:

48. **Inclusion of conditional grants in DORB:** In line with the Court ruling on Petition no. 252 of 2016, conditional or non-conditional grants are not items to be provided for under the Division of Revenue Act. Implications of the ruling:

    a) The Division of Revenue Act should only reflect the equitable share allocations between the two levels of government, and

    b) That conditional and unconditional grants have to be provided for through an alternative intergovernmental transfer framework

49. **Alternative Mechanisms for disbursement for Conditional Grants**: Based on the following rulings (Petition no. 252 of 2016):

a) That the national government cannot allocate itself funds and undertake devolved functions without first executing intergovernmental agreements under Article 187 of the Constitution,

b) That following from (a) above, the national government's accounting officers' cannot spend money for conditional grants directly in the Counties to undertake devolved functions unless there is an agreement transferring functions under Article 187, 189 or 190 of the Constitution and section 21 of the County Governments Act,

c) That there ought to be a framework stating the purpose, the goal and the mechanism for the issuance of the conditional grant,

d) that all funds under Article (202) (2) of the Constitution (conditional or non-conditional) must be channeled through the County Revenue Fund (CRF) to the specific counties for the specific functions outlined by the national level of government,

e) The said funds should be channeled directly to the activities in question and accounted for, and

f) that conditional and unconditional funds cannot be appropriated by the County Assembly through a County Appropriation Bill.

50. Implications of the rulings:

a) That the relevant Ministry, Department or Agency under which the grants are accounted for should provide a schedule of disbursement to each of the county governments based on an agreed intergovernmental transfer framework

b) That the National Assembly has to approve the appropriation of the conditional and unconditional grants given that funds are being channeled directly to the activities in question and accounted for by the national government.

51. Increased allocation to Leasing of Medical Equipment Scheme: The Commission was not part of the signed contractual obligations between the National

Government, County Governments and the provider of the Medical Scheme. Thus the Council of Governors, the Ministry of Health and the National Treasury were better placed to provide more information on why the allocations for the payments kept on varying from one year to another. The Commission's understanding was that whilst the contracted amount remained the same, the annual variations could be informed by the nature and the number of equipments that were availed by the provider each year.

Submission by the International Budget Partnership, Kenya (IBP-Kenya)

52. Country Manager IBP appeared before the Committee on 6th April 2021 raising the following key concerns:

i. The allocations to counties were declining, and that would affect services. Parliament needed to address that situation so as not to lose the gains already made through devolution of public services.

ii. Public debt, pensions and other charges of the consolidated fund services were crowding out the amount available for sharing and hurting counties allocation.

iii. Unrealistic revenue projection had negatively affected revenue sharing.

iv. Lack of transparency, accountability and meaningful public engagement was affecting the division of the revenue process

53. Despite devolution being a key aspect of service delivery in Kenya, the allocations to county governments were declining. While the growth in national revenue remained stable over time, except for FY 2020/2021 and FY 2021/2022 due to the COVID-19 pandemic, the amounts approved to counties as a proportion of national revenue were declining. However, 2021/22 would see a 17% per cent growth in allocations despite a projected decline of 4% in ordinary revenue. They

therefore observed that that did not reflect a realistic situation and proposed that parliament arrests that state.

54. **There was no clear growth factor on the division of revenue allocation basis. This was left to individual actors in the national government to decide how much should be allocated to county governments.** Except for FY 2015/2016, Commission on Revenue Allocation (CRA) and the National Treasury have always used different factors to determine how the share of county governments should grow. Of great concern was the allocation for FY 2021/2022 which was arbitrary and had no basis given the declining ordinary revenue occasioned by the Covid-19 pandemic. As much as the increase of Ksh. 53.5 billion was a condition for the approval of the Third Basis for Revenue Allocation, there was no explanation on how it was arrived at. IBP therefore proposed that as Parliament considered the Division of Revenue Bill 2021, the growth factor or the criteria for determining the same be established and made clear. They suggested that as a minimum, allocations to county governments should be informed by the three-year average growth of ordinary national revenue.

55. **Public debt, pensions and other charges of the consolidated fund services were crowding out the amount available for the division of revenue and hurting counties allocation.** Total debt service was growing at a very high rate and that was limiting allocation to devolved services. The growth in county allocation over the years was very minimal which affected service delivery. They also noted that the growth in ordinary revenue was very marginal. More importantly, while public borrowing has a direct impact on the size of the sharable revenue, the National Treasury was the only body deciding on that vital national instrument. They therefore recommended that counties and the Senate should be involved in the discussion on national borrowing as that has an impact on the revenue that is shared between the two levels of government.

56. **Pensions and other CFS Services have equally grown, and their administration was of concern.** Pension was a non-discretionary obligation that had a bearing on

the size of revenue that was eventually shared between the two levels of government. The higher the share of ordinary revenue that is taken up by these national obligations, the lower the sharable revenue and allocations to counties. An analysis of government expenditure on pensions between 2016-2021 indicated an increasing trajectory over time, as illustrated below

Government Fiscal Framework- Pension and other CFS

Year	2016	2017	2018	2019	2020	2021
Pension and other CFS	43,429 Millions	60,169 Millions	91.1 Billions	109.5 Billions	118.7 Billions	137.0 Billions

Source: Budget Policy Statements 2016-2021

57. **Recommendations by CRA on harmonization of functions should be used to justify adjustment of equitable share.** CRA recommended harmonization of functions as provided for in the Fourth Schedule of the Constitution to be used as a basis for increasing the equitable share. IBP welcomed the recommendation and urged Parliament to consider that approach as it would ensure that funds follow functions that are assigned to the county governments.

58. **Conditional Grants for construction of county headquarters needed to be clarified**. The Division of Revenue Bill 2021 allocated Kshs. 332 million towards the construction of county government headquarters for five counties namely, Isiolo, Lamu, Nyandarua, Tana River and Tharaka Nithi. There was need for clarity on the criteria used to identify the counties and the amount to be allocated to each. From the bill, it was clear the five counties received a similar grant in the previous financial years. For instance, the Division of Revenue Bill 2020 allocated Kshs. 300 million to these counties. How far has their construction gone? An annexure of the same should provide the requisite information that indicated the progress made over

the years. They therefore urged the Senate to compel the National Treasury to provide an annex with detailed information on the above.

59. **Lack of transparency, accountability and meaningful public engagement was affecting the division of the revenue process.** Although Parliament had embraced public participation in the legislative process and made efforts towards facilitating public participation, public engagement in the division of revenue process was not effective but tokenistic and inconsequential in the ultimate decision-making process. In some instances, parliament did not explain its actions or give reasons for certain decisions. For instance, on 9th March 2021, parliament approved to reduce the publication time of the Division of Revenue Bill from 7 days to 1 day. Although that may be well within the Standing Orders of Parliament, such actions needed to be explained for the public to understand why the decision was made.

60. **The realism of revenue forecast remained a gamble.** Revenue forecasts at both national and county level were ambitious and often led to budget deficits. This was exacerbated by the failure by the Tax Authority to meet the set targets over the years. That would need to be further revised due to the effect of COVID-19 to Kenya's economic productivity. A trend analysis of revenue growth was critical in informing revenue projections for the coming years. Kenya's budget process had inadequately facilitated accurate forecasts for resource collection. The common tendency was, therefore, to make overly optimistic revenue projections leading to increased uncertainty of resource flows. An analysis of total revenue collection including Appropriation in Aid (A.i.A) showed shortfalls in each financial year since 2015.

Performance of Total Revenue including A-i-A (Figures in Billions of Kshs)

Year	Dec-15	Sep-16	Nov-17	Nov-18	Dec-19	Feb-21
Target Revenue	642.9	328	611	677	1059.3	907.7
Actual	575.2	313.6	558.4	633.7	920.6	810.6
Shortfall	67.7	14.4	52.6	43.3	138.7	97.1

Submission by the Institute of Certified Public Accountants of Kenya

61. **Basis for revenue projections:** Kenya has consistently registered a positive growth in its revenue collection with it doubling from Ksh. 0.7 Trillion in FY 2011/12 to Ksh. 1.5 Trillion over a seven-year period (2018/19) (KRA, 2019). However, the actual revenue receipts have continuously fallen below the targets (KNBS, 2020). Coming from a global pandemic that necessitated most governments, the Kenyan one included, to adopt expansionary fiscal policy measures, it is highly unlikely that in the coming FY 2021/22, the Kenyan economy will have rebounded. The Government should therefore conduct a trend analysis of revenue growth to inform revenue projections for the subsequent years. The ambitious revenue forecast has among other ramifications contributed to budget deficits which have in turn worsened the pending bills problem.

62. **Inadequate utilization of the Leased medical equipment:** The conditional allocations are tied to the implementation of specific national policies, and are mainly from both government and donor community. One of the items catered for is the leasing of medical equipment, which has been receiving allocation from the FY 2015/16. However, a Senate report on 'The Managed Equipment Service (MES) Project' indicates that the equipment has been under-utilized owing to inadequate health personnel and insufficient infrastructure (water and electricity).

63. The report also highlights the exaggerated cost of equipment supplied in comparison to prevailing market rates. There is need to provide capacity strengthening sessions to the health personnel and fast-track the development of the required infrastructure in the respective health facilities.

64. **Conditional Grants for construction of county headquarters need to be clarified and accounted for:** In the FY 2017/18, 5 counties (Isiolo; Lamu; Nyandarua; Tana River and Tharaka Nithi) were identified as being the only counties that did not inherit adequate office space for county headquarters and thus

would be allocated funds to construct their headquarters over the span of three financial years (between 24-32 months).

65. According to a report on County Infrastructure by the Senate Standing Committee on Finance and Budget, the State Department of Public Works submitted that the implementation of this project would be carried out through the Ministry with the National Government contributing 70% of the amount while counties contribute the remaining 30%. The first disbursement of the agreed Ksh 518 million for construction of their headquarters was received in FY2017/18 therefore, the final disbursement should have been in the FY 2019/20. Despite this, DORB 2020 and 2021 still allocated the counties the amounts Ksh 300 million and Ksh 332 million respectively as shown in the table below.

66. ICPAK thus proposed that there was need for an implementation report on the same to justify the continued allocation. Further, there was need for an indication on completion of this project.

67. **Consider conditional Allocation to support ECDE:** In a Devolution Survey 2020 conducted by the Institute, several challenges were documented that were impeding the successful delivery of educational services, especially at the county level:

- high turnover rates for Early Child Development Education (ECDE) teachers
- low funding for ECDE, inadequate investment in succession planning within departments, low and unclear scheme of service for ECDE teachers,
- Inadequate infrastructure to support the learning of children living with disability; and
- inadequate number of trained instructors in most polytechnics.

68. ICPAK proposed that there was need to provide conditional allocation to ECDE for purposes of the following:

a) increasing capitation for ECDE teachers
b) Employment of skilled and qualified instructors in polytechnics;
c) To support development of adequate monitoring and assessment of performance (quality assurance) of learning at that level.

69. **Public debt repayment crowding out the amount available for division of revenue and hurting counties allocation:** Public borrowing has a very direct impact on the size of the sharable revenue as shown in the table below. On average, public debt servicing growth was higher at 30% than the growth in both the shareable revenue (7%) and the county allocation (5%).

70. The Institute thus called on the National Treasury to contract more loans from the multilateral lenders than from commercial lenders who are usually more expensive as compared to the former.

71. Further, since the National Treasury was the only body deciding on that vital national instrument, ICPAK recommended that counties through the Senate should be involved in the discussion on national borrowing as that had an impact on the revenue shared between the two levels of government.

Growth in Pubiic debt, ordinary revenue and counties allocation

FY	Public Debt Service (Ksh. Billions)	Ordinary Revenue (Ksh Billions)	Counties Allocation (Ksh Billions)	Growth in Public Debt Service	Growth in Shareable Revenue	Growth County Allocatio
2017/18	462.24	1365.06	302.00			
2018/19	641.51	1499.76	304.96	39%	10%	1%
2019/20	538.80	1573.42	310.00	-16%	5%	2%
2020/21	829.91	1574.01	316.50	54%	0%	2%
2021/22	1174.01	1775.62	370.00	41%	13%	17%
Average				**30%**	**7%**	**5%**

Source: Division of Revenue Bill 2021

72. **Actual public debt service figures have always been higher than the projections:** public debt repayment projections contained in the division of revenue bills were always been lower than what was contained in the programme-based budget documents. These figures have further been lower than the actual ones contained in the national government implementation review reports. In addition to this, the deviation of the projected amounts as contained in the division of revenue bills from the actual show an increasing trend which shows that the projections are highly underestimated.

Public debt projections vs actual

FY	Division of Revenue Bills (Ksh. Millions)	Programme Based Budget (Ksh. Millions)	Office of the Controller of Budget (Actual in Ksh. Millions)	Deviation of the actual from the projections in the DORB (Ksh. Millions)	% growth
2017/18	462,243	649,396	517,161	54,918	12%
2018/19	641,514	850,011	826,202	184,688	29%
2019/20	538,802	696,554	707,892	169,090	31%
2020/21	829,906	904,000	-		

Source: Controller of Budget, National Treasury and Planning

73. This implies that additional borrowing has to be incurred or provision of quality services would be compromised. There was need for more accurate projections for proper planning purposes as well as observance of transparency in public debt contracting

74. **Pensions and other CFS Services have equally grown, and their administration is of concern:** As shown in the table below, servicing of non-discretionary CFS had grown at a high rate and that was limiting how much wass available for allocation to devolved services. The institute commended the National Treasury for rolling out

the super annuity Scheme for all civil servants below the age of 45 to ease the burden of pension payments in future.

Government Fiscal Framework- Pension and other CFS

Year	2016	2017	2018	2019	2020*
Pension and other CFS (Ksh billion)	64.0	65.1	70.8	89.6	123.4

Source: National Treasury and Planning -BPS 2019.2020,2021

75. The Institute also noted with concern that the payout amounts to retirees was below the budgeted amount. For instance, data from the National Treasury indicated that pension and gratuities paid to the retirees in the six months to December was 42.8 billion that represented 38.5% of the current year's retirements payouts budget pointing to delays in processing the claims. The Institute therefore recommended as follows;

- There should be transparency and accountability in processing and payment of pension and gratuities for the retirees as per the budget. Accurate schedule and proper records of retired personnel and amounts disbursed should be fast-tracked to aid early disbursement of such funds to the retirees who require them to better their livelihoods.
- Following the trend of budget for the payment of pensions and gratuities, it was projected that this cost could go even higher in the next five years. There was need for the management and administration of retirement benefits for employees to be transferred to the respective employment commissions. For instance, the pension for public servants should be administered by the Public Service Commission while that for teachers should be administered by the Teachers Service Commission, etc.

76. **Progress of the Equalization Fund:** Article 204 of the Constitution of Kenya 2010 establishes an equalization fund to provide basic services such as water, roads, health facilities and electricity to the marginalized areas as identified by the

Commission on Revenue Allocation. The fund has a 20-year period within which it should be operational. Time is thus a key factor in as far as the success of the fund is concerned. According to a report on the Consideration of the Equalisation Fund Bill by the Departmental committee on Finance and National Planning, the current composition of the Equalisation fund oversight Board was not been effective in administering the Fund. To this end, progress implementation reports should be publicly availed to provide the status of the projects financed by the Fund.

77. **Way forward for Nairobi City County:** There was need for clarity on how revenue would be allocated considering the transfer of four crucial functions (County Health Services; County Transport Services; County Planning and Development Services; and County Public Works, Utilities and Auxiliary services) to Nairobi Metropolitan Service. This was important to curb any stand-off between the County and NMS that could derail service delivery.

78. **Budget Transparency was critical for objective division of revenue:** The lack of a clear definition and objective criteria for determining national interest has been exploited by national government to starve counties of resources. Additionally, the framework for the management of conditional grants continues to be weak, and indeed does not meet the constitutional requirements for fiscal prudence and transparency.

- The Division of Revenue bill should include performance and accountability information on conditional grants to adhere with constitutional and statutory requirements. For example, categorization of conditional grants in terms of their type, nature, administration and trends in allocations.
- Prudent utilization of grants and access to information. Include key accountability information on conditional grants.
- Establish explicit principles which inform conditional grants or transfers which are subject to specific conditions that may include; targets use, by sector or purpose; requirement for matching (i.e. matching grants) which require recipients to contribute part of costs; requirement to meet specified targets,

outputs or results; one off-funding or over a period, may be open ended, like the case with LATF but with requirements to achieve specified performance ratios e.g. debt, revenue etc

- On Performance evaluation there is a need to ensure that funds are traceable to avoid double funding and blurring of reporting. National departments must report to Parliament the outcome of grants allocated for specific purpose.

79. **Fiscal Accountability:** There was need to strengthen the fiscal accountability structures across both the national and county governments. The recommendations from oversight bodies including the Controller of Budget and the Auditor General should be followed so as to ensure prudent use of public funds. These include full compliance with the Public Financial Management Act (2012).

Submission by Mr. Robert Wakungwi Sakwa, Senior Medical Laboratory Scientist, Masinde Muliro University

80. Mr. Sakwa observed that considering the government focus on universal health coverage and enhanced reproductive health to the citizenry, and in view of the COVID 19 pandemic it would be wise to have sufficient man power to improve on evidence based medicine that is more objective as opposed to curative.

81. There have been efforts to engage intern Doctors, nurses and clinical officers but the engagement of medical laboratory personnel under the same arrangement for one year has not been forthcoming due to lack of attendant resources budgeting compromising diagnostic services across public health facilities.

82. He therefore proposed that the internship of medical laboratory personnel be considered and implemented this time round now that the SARS COV 2 transmission was actively in the community. The presence of intern diagnostic personnel within the community on a continuous basis as they work under mentorship and gain competence would assist in having youth develop skills to venture into the private sector later in case they fail to be absorbed into public service.

CHAPTER THREE

3.0 COMMITTEE OBSERVATIONS AND RECOMMENDATIONS

3.1 OBSERVATIONS

83. The Committee made the following observations/ findings-

a) That the proposed county equitable share is Ksh. 370 billion. This is in line with the Resolution on the Basis for allocating among the counties the share of national revenue annually allocated to county governments approved by the Senate on 17th September, 2020.

b) That some provisions contained in the Bill contravenes the Ruling in High Court Petition No. 252 of 2016. The ruling paragraph 72 stated-

> *"When allocating funds to the county 'evel of government as either a conditional or non-conditional grant, it is expected that the allocation is made from the national level of government's share. Secondly, it is trite from the language used in Article 202 as read with Article 218(1)(a) of the Constitution,* ***conditional or non-conditional grants are not an item to be provided for under the Division of Revenue Act.*** *Conditional and non-conditional grants can be issued to the county level of government under the auspices of Article 190 of the Constitution or through an agreement between the two levels of government that respects the institutional and functional integrity of the either level of government."*

c) That the increment by Ksh. 1 billion to the MES programme was to cater for pending bills incurred by the Ministry of Health in the FY 2019/20. Thus, to ensure the contractual obligation was fulfilled, additional resources are required since pending bills must be treated as a first charge.

3.2 RECOMMENDATIONS

84. The Committee recommends-

a) the Division of Revenue Bill (National Assembly Bills No. 7 of 2021) be approved with the amendment to the schedule as follows; '*that the schedule to the bill be deleted and substituted therefor with new schedule as attached here below.*'

Type/level of allocation	Amount in Ksh.	Percentage (%) of 2016/17 audited and approved revenue i.e. Ksh. 1,357,698 Million
A. Total Sharable Revenue	**1,775,624,173,860**	
B. National Government	**1,398,798,856,427**	
C. Equalization Fund	**6,825,317,433**	**0.50%**
D. County equitable share	**370,000,000,000**	**27.3%**

This recommendation is in compliance with the Ruling in High Court Petition No. 252 of 2016, where the court held that it cannot be permissible to provide for conditional grants in the Division of Revenue Act and therefore it follows that conditional grant cannot be proposed in Division of Revenue Bill.

b) An enactment of bill to provide for a legal mechanism to enable the transfer of conditional grants to the respective County Revenue Funds (CRFs) and withdrawal from CRFs by county governments. The Bill should also provide a framework for the management, control and accounting for conditional and unconditional grants.

c) That the proposed nascent legal instrument will address the modalities of allocation, expenditure and reporting on conditional grants to county governments. It will therefore be within the purview of Article 110(4) of the Constitution.

APPENDIXES

(a) **Committee Stage Amendments**

(b) **Minutes of the Committee sittings**

(c) **Submission from Public Institutions and Members of Public**