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POLICY BRIEF
STRENGTHENING DEBT ACCOUNTABILITY IN KENYA

2024

EXECUTIVE SUMMARY

This policy brief investigates two aspects of debt management: policy coherence and oversight institutions. Do these factors contribute to enhancing accountability for debt decisions? Although county governments have not incurred public debt (as defined in the law), the brief also examines the policy issues regarding pending bills as financial obligations for counties.

At the national level, we found:

- Key guiding documents such as the Medium-Term Debt Strategy, the Budget Policy Statement and the Annual Borrowing Plan lack consistency in their annual projections for debt.
- The actual deficit incurred frequently surpasses the approved deficit.
- Although the Public Debt Management Office has progressively improved in preparing and publishing debt data, information gaps persist. For instance, there is limited information about public private partnerships and contingent liabilities.
- Parliament's role is limited in various ways:
    1. Parliament approves the MTDS after which the Cabinet Secretary is not required to seek approval at the time of borrowing. That is, there is no requirement for individual loan contracts to be ratified by Parliament,
    2. Oversight is limited due to inadequate information tabled before parliament,
    3. Parliament lacks a focused mandate for overseeing the debt of State-Owned Enterprises debt
- Whereas the Auditor General raises audit queries and recommendations, there is not a robust follow-up mechanism to ensure that the OAG's recommendations are systematically acted upon.

To address these challenges, we propose several recommendations.

- The National Treasury should ensure consistency across key policy documents, such as the Medium-Term Debt Management Strategy (MTDS) and Budget Policy Statement (BPS).
- There is also a need for improved debt reporting from executive agencies.
- The executive should be reporting on borrowing against the MTDS on a quarterly basis. If there are deviations, an explanation should be tabled before Parliament how the executive will ensure the adjustments back into alignment.
- Robust mechanisms need to be developed and institutionalized for implementation of audit recommendations.

- Additionally, transparent systems for tracking revenues, expenditures, and pending bills must be established to facilitate audits and accountability.

At the county level, County Governments have not at the time of this report borrowed money that can be treated as debt as is the case for the National Government. However, counties have high levels of unmet financial obligations in the form of pending bills that pose fiscal risks each financial year. If pending bill were to be cleared all at once, it would require significant resources, leaving counties at risk of failing to finance operations and critical programmes. The challenge of pending bills persists because of poor fiscal planning, delays in the disbursement of equitable share, failure by county assemblies to provide effective oversight of the executive and ensure PFM processes are streamlined to seal gaps flagged by the Auditor General, and low OSR performance.

We therefore recommend:

- National Government should ensure timely disbursement of the equitable share
- Counties should enhance OSR mobilization and prioritize settlement of verified pending bills
- National Government should provide continuous capacity enhancement for county governments on proper fiscal planning to minimize use of supplementary budgets
- County assemblies should play their oversight role to combat poor documentation and unexplained variances, critically analyze audit reports and hold the executive to account

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1.0 INTRODUCTION

Kenya has encountered increasing challenges in managing its national debt and the accumulation of pending bills in counties in recent years. In the FY2023/24, net borrowing for the government stood at Ksh. 818 billion bringing the total debt stock to Ksh. 10.6 trillion (a sharp increase from Ksh. 10.3 trillion in June 2023). As of June 2024, total public and publicly guaranteed debt service reported in the Annual Public Debt Management Report amounted to Ksh. 1.6 trillion. Unsettled financial obligations in the form of pending bills reported by the Controller of Budget at the county level amounted to Ksh. 182 billion by June 2024, with Isiolo county having Ksh. 1.1 billion. If pending bills were treated as a first charge, it would have required 37 percent of Ksh. 492 billion available funds to the County governments in FY 2023/24. This is a significant percentage relative to the size of county funds and would constrain resources for other critical sectors and programs.

The pending financial obligations, both national and county, keep straining the country's fiscal space, and thus impede efficient provision of key services such as health, education, and social protection. To ensure sustainable economic growth and prevent further fiscal strain, there is an urgent need for enhanced accountability mechanisms for debt management and borrowing practices. Key aspects of accountability discussed here include the need for coherent strategy documents for debt management, the importance of institutions in debt management and mechanisms for tracking, managing, and resolving pending bills in the county government. Our assessment of county practices is based on a case study of Isiolo county.

2.0 COHERENCE OF NATIONAL POLICIES RELATED TO PUBLIC DEBT

Policy coherence refers to the alignment and integration of policies across different sectors and levels of government for harmony and to avoid contradictions, overlaps and gaps. It ensures various government documents communicate the same message aimed at achieving a common goal. An example is having a Medium-Term Debt Strategy that aligns with the financing framework and objectives outlined in a Budget Policy Statement.

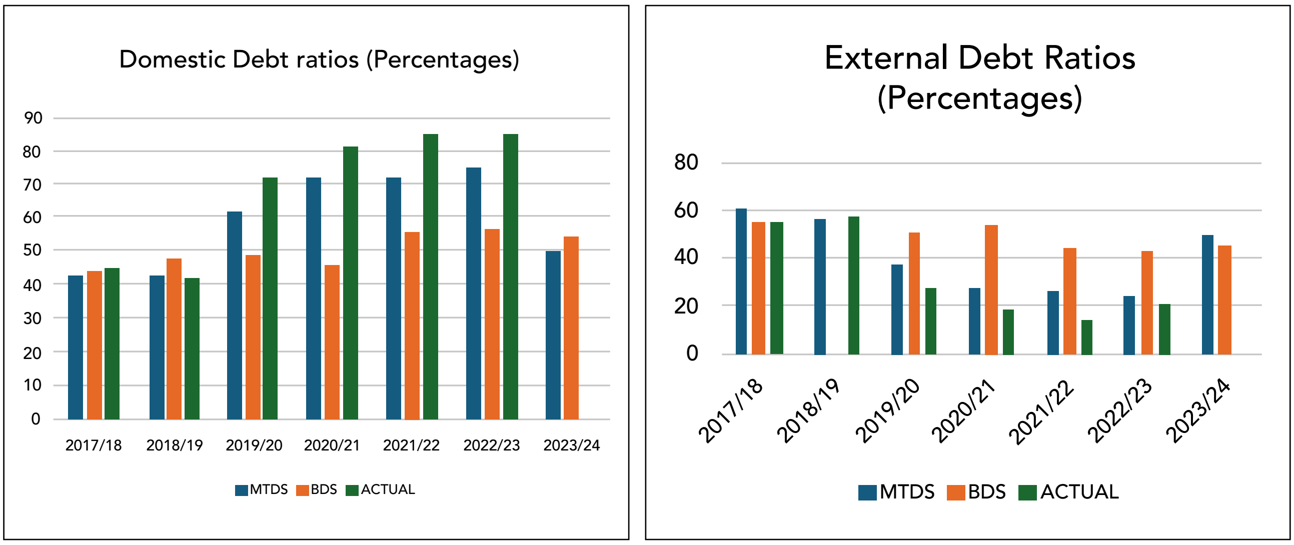
To achieve debt accountability, policy coherence is essential to guide decision making in borrowing, and to provide clear benchmarks for holding government accountable whenever deviations arise. We observe incoherence in Kenya's debt framework both in the policy/ strategy documents, as well as in the actual deficits incurred during the financial year.

There are different policy documents that are prepared yearly to facilitate debt management. The first one is the Medium-Term Debt Strategy (MTDS), which sets out the government's borrowing and debt management strategy over the medium term. It focuses on securing the government's long-term debt sustainability through setting targets for critical debt indicators, including the debt-to-GDP ratio and debt service costs. There is also the Budget Policy Statement (BPS), that outlines the government's fiscal policy objectives and priorities for the upcoming fiscal year. It outlines the government's expenditure plans and revenue projections for the upcoming financial year, including budget deficits and how to finance them, effectively updating the MTDS targets for the specific year. Third, the Annual Borrowing Plan is developed to provide details of the financing requirements for a given financial year, based on the borrowing framework in the MTDS and the BPS. The ABP aims to inform debt market participants about Kenya's financing needs for a given year.

Ideally, these documents should be consistent with each other to ensure coherence in the government's overall financial management, and to demonstrate transparency and predictability in government borrowing operations, thus establishing effective communication with market players. The alignment of the BPS and MTDS encourages coordinated fiscal policies and planning, incorporating debt management techniques into budget decisions, and improving monitoring and transparency in public finances management, hence increasing debt accountability. This coordination should promote prudent financial management and sustainable debt levels in the long run.

Our analysis, however, finds that these three policy documents have different projections without sufficient justifications for these divergences over the past six years. Actual borrowing also deviates from the forecasts provided in the strategy and policy documents (see Figure 1).

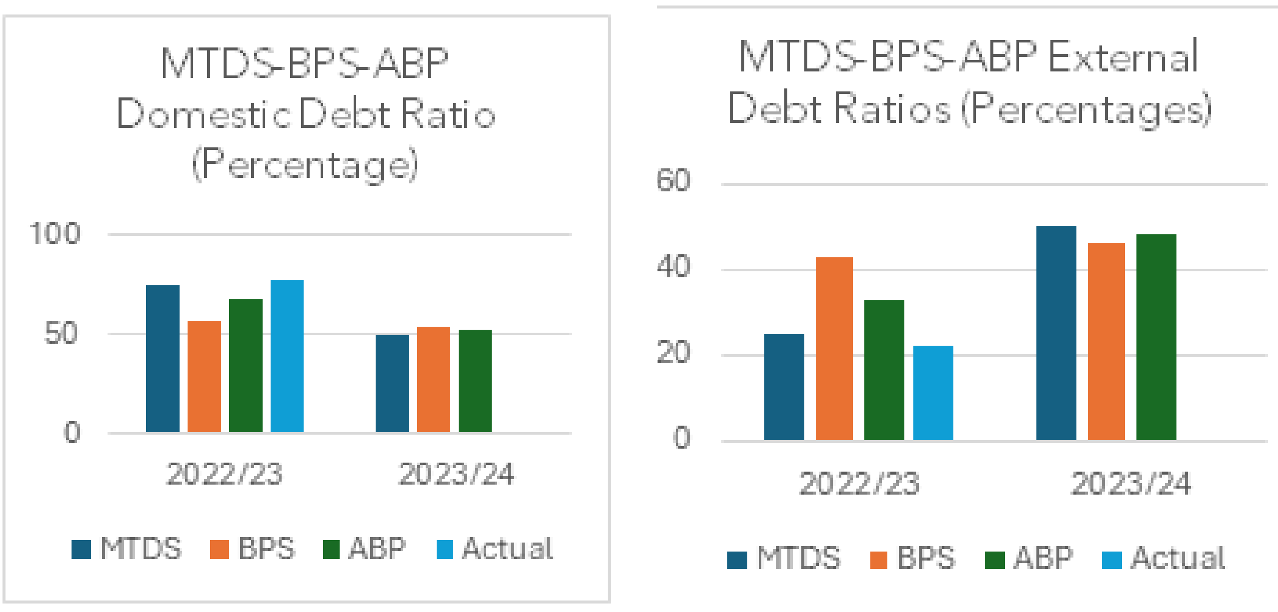
Figure 1: MTDS-BPS Borrowing Ratios (External and Domestic)



Source: MTDS and BPS

Notably, although the government has only published the ABP for two years, similar variations in borrowing targets and actuals are observed. Findings show that the government tends to align their policies more to the MTDS as compared to the BPS, again raising concerns on the effectiveness of the BPS in determining spending.

Figure 2: MTDS-BPS-ABP Domestic and External Debt Ratios

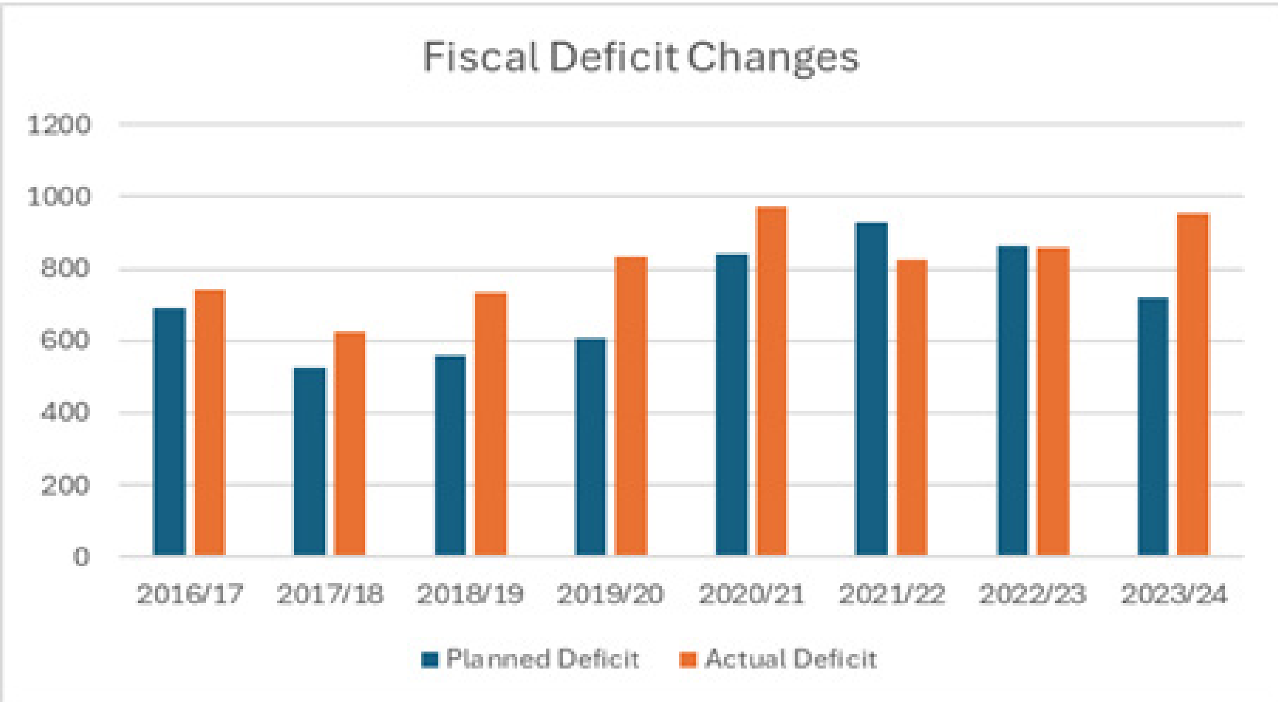


Source: MTDS, BPS, and ABP

When such deviations arise, they raise concerns, not only on the credibility of the planning process, but also on how effectively actors can hold government accountable for its borrowing decisions when different policy documents provide different guidelines. The MTDS is designed to manage debt in a sustainable way over the medium term, considering interest rates, currency risks, and debt repayment schedules. Under a situation where government fiscal documents speak to each other, short-term fiscal targets set out in the BPS need to be aligned with the multi-year borrowing plan outlined in the MTDS. Divergences between the two can signal inconsistency in government planning, leading to confusion over fiscal priorities and credibility issues with stakeholders.

Deviations in the country's fiscal framework also occur between the target fiscal deficits in the approved budget estimates and the actual borrowing incurred by the end of the year (Figure 3). As a result, the country's debt burden continues to rise beyond that projected, leading to increased debt service and limited resources for social services. Such variations have impactful implications that dictate Parliament to hold the government to account for any variations.

Figure 3: Except for FY2021/22, actual deficits have always exceeded planned deficits.



3.0 STRENGTHENING THE ROLE OF INSTITUTIONS IN DEBT ACCOUNTABILITY

Three key institutions discussed here play critical roles in the debt accountability space in Kenya. These are the Public Debt Management Office, the Office of the Auditor General and the Parliament.

The Public Debt Management Office (PDMO) is responsible for developing and publishing key documents on debt management, including the Medium-Term Debt Strategy (MTDS) and Annual Public Debt Management Reports (APDRs). These documents are essential for forecasting Kenya's debt management strategies and promoting transparency and oversight in public debt decisions. Over time, the PDMO has made significant progress in enhancing debt transparency, such as introducing the Annual Borrowing Plan in 2022/23 and improving the information contained in the MTDS and APDRs. Notably, the PDMO began reporting on non-guaranteed debt in FY 2020/21, which has since become a standard practice. The APDRs for FY 2022/23 also detailed creditor types, amounts, and new loans contracted, marking an improvement in reporting and a positive step toward accountability in public debt management.

However, while efforts to improve debt transparency have been commendable, the quality and completeness of the information published is still insufficient for effective oversight. Since FY 2020/21, the APDRs have lacked details on Public-Private Partnerships (PPPs), including critical information such as project specifics, duration, value, status, and government financial implication in cases of default or termination. Additionally, the MTDS remains vague about debt liabilities that may arise in future, offering no clarity on whether the data includes implicit guarantees or details on canceled guarantees, to ensure that they are not scheduled for any payment which would lead to mismanagement of public funds. To strengthen the PDMO's role in ensuring sustainable debt management, full transparency in debt data publication is essential. This would empower oversight bodies to accurately assess the debt situation and identify areas for improvement in debt decision-making. For example, in each financial year debt reporting need to be structured in a manner is simple to follow and hold the government to account in respect to adhering to approved limits when contracting new debt. The table below gives such a proposed breakdown:

	Financing from the External market	Financing from the Domestic market
Proposed fiscal deficit		
Actual fiscal deficit		
New commitments		
Disbursements		
Redemptions		
Net financing		
Total debt stock		
Change in debt stock		

On the other hand, the Office of the Auditor General (OAG) functions as an independent entity tasked with auditing and reporting on the management of public funds. These audit reports play a crucial role in promoting accountability by detailing how public resources are used. However, despite the OAG's consistent efforts in auditing and recommending improvements, many of these recommendations have not been fully implemented, weakening the overall effectiveness of the audit process in enforcing accountability. While the government has acted on some reports, such as launching investigations into financial irregularities and prosecuting officials involved in scandals like the National Youth Service (NYS) and the Kenya Medical Supplies Agency (KEMSA), these efforts have not been sufficient to address the recurring issues highlighted by the OAG.

For instance, significant discrepancies continue to appear in audit reports year after year. In the 2019/2020 financial year, the OAG flagged Ksh 2 billion in unexplained variances related to short-term loans, inaccurate Treasury Bonds balances amounting to Ksh 26 billion, and the non-disclosure of public debt. Similarly, in the 2020/2021 and 2021/2022 financial years, large sums were lost through commitment fees on undrawn amounts and defaults on debt repayments. To enhance accountability and curb such losses, the government should establish a more robust follow-up mechanism to ensure that the OAG's recommendations are systematically acted upon, alongside greater transparency and public involvement in the audit process.

Finally, Kenya's legislative framework, including the Constitution of Kenya, 2010, the Public Finance Management Act (PFMA), 2012, and PFMA regulations (Art. 211-214), assigns Parliament a crucial role in fiscal responsibility and public debt oversight. Parliament, through its committees, is tasked with reviewing submissions from the National Treasury and ensuring that borrowing and spending are transparent and accountable. Under Article 211, Parliament is empowered to legislate the terms on which the national government may borrow, including debt reporting requirements. Despite this robust framework, Parliament has struggled to fully exercise its oversight role, limiting the effectiveness of Kenya's debt management legal and policy frameworks.

Several key gaps hinder effective debt oversight.

- First, there is no requirement under Section 49 of the PFMA for individual loan contracts to be ratified by Parliament before the Cabinet Secretary contracts debt, allowing debt to be contracted without sufficient scrutiny. One best practice is Section 36 of Uganda's Public Finance Management Act, 2015 that requires all loan agreements to be approved by Parliament. This includes a requirement for the terms and conditions of a loan raised by the Minister to be laid before Parliament and that any loan cannot be enforceable except where it is approved by Parliament, by a resolution. This applies to both domestic and external borrowing and it has helped the country to keep public debt within sustainable limits.
- Second, although Section 59 mandates that new contingent liabilities, such as guarantees, be reported to Parliament within 14 days, this information is often absent from key budget documents like the Medium-Term Debt Strategy (MTDS) and Annual Borrowing Plan (ABP).
- Third, there is no dedicated parliamentary committee overseeing State-Owned Enterprises (SOEs) with guaranteed debt.
- Finally, National Treasury prepares MTDS and BPS which are approved by the Parliament. However, Parliament fails in it oversight role by not requesting for justification in cases where the National Treasury deviates from the approved targets and ceilings.

To strengthen Parliament's role, there should be mandatory ratification of loan contracts, improved information sharing on contingent liabilities, and a dedicated committee for SOEs with guaranteed debt, which would enhance fiscal discipline and accountability.

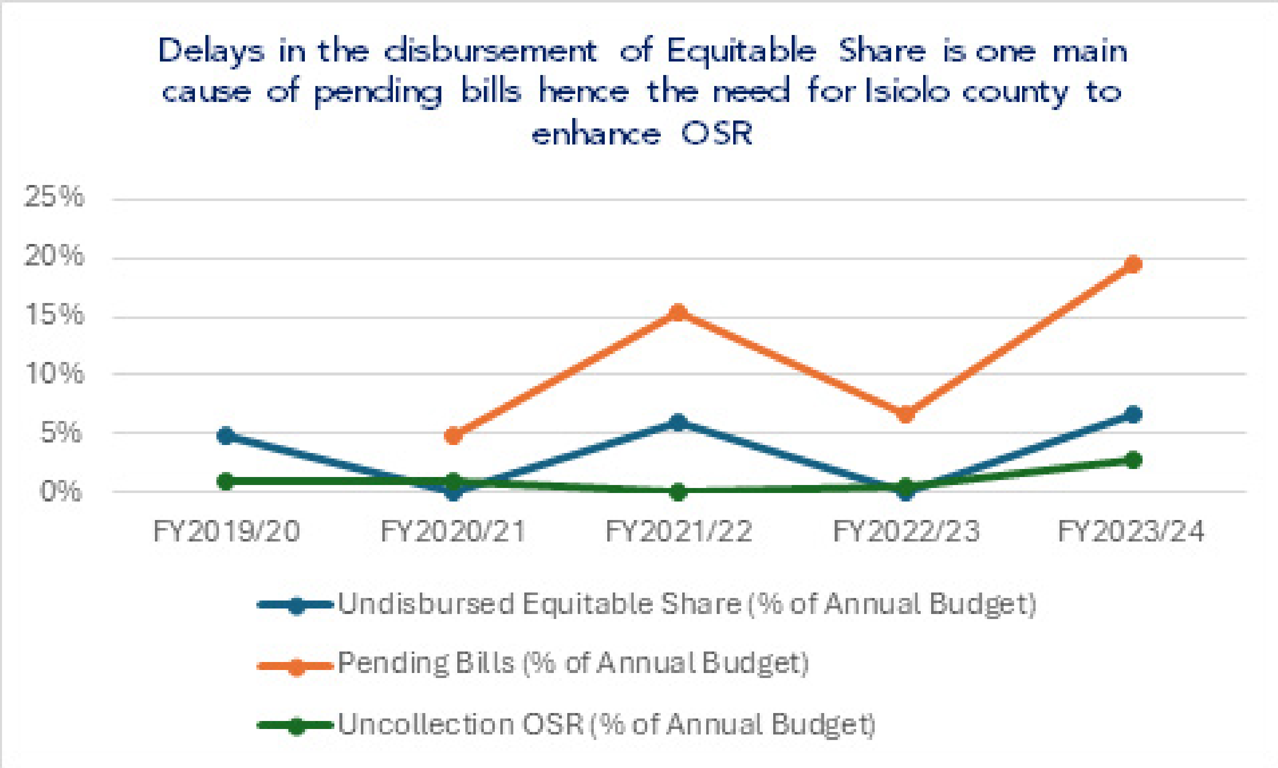
4.0 MECHANISMS FOR TRACKING, REPORTING AND MANAGING PENDING BILLS AS A FINANCIAL OBLIGATION IN THE COUNTY GOVERNMENTS TO ENHANCE ACCOUNTABILITY

Although counties have not incurred public debt, they face significant challenges with timely payments for goods and services, leading to the buildup of unpaid financial obligations. As a best practice, County governments should make realistic and achievable revenue projections against which their expenditure estimates are anchored. County governments have three main revenue sources to consider when formulating financial plans: equitable share transfers, own source revenue (OSR), and grants.

Our analysis of revenue and expenditure planning yields two critical insights in relation to the management and accountability for pending bills. First, delays in disbursement of the equitable share and counties' failure to meet their OSR targets have led to revenue shortfalls, which are an important factor in the accumulation of pending bills. According to reports from the Controller of Budget (COB), counties like Isiolo experience substantial jumps in pending bills when they do not receive full disbursement of their equitable share.

Second, while unmet OSR targets contribute a smaller portion to the budget gap, they equally play a role in the growing pending bills. Furthermore, the Commission for Revenue Allocation (CRA) has indicated that many counties set OSR targets far below their actual revenue potential, exacerbating the financial strain. For example, Isiolo County collected 49% of its CRA-estimated revenue potential in FY 2023/24, collecting Ksh. 285 million against a potential Ksh. 582 million. Had the county collected a significantly higher percentage of its OSR potential and prioritised payment of pending bills using the additional revenue collected, it would have helped reduce the currently high level of pending bills.

Figure 4: Isiolo county pending bills, uncollected OSR and undisbursed equitable share as a percentage of budget over FY2019/20 - FY2023/24



Data Source: Controller of Budget

The challenge of pending bills is further aggravated by poor fiscal planning, using supplementary budgets to divert resources initially allocated to settle pending financial obligations, failure to prioritize settlement of verified pending bills, poor documentation, corruption, weak public procurement practices and limited transparency.1

Therefore, county governments need to strengthen public finance management institutions and enhance oversight as ways to complements strategies aimed at aligning. To raise the level of accountability, persistent issues raised by the Auditor General especially in relation to inadequate documentation in support for some expenditures and unexplained variances in financial records require immediate attention. Additionally, county governments have not been publishing contract agreements and procurement documents, which consequently impede scrutiny of pending bills by oversight institutions. Limited transparency creates significant gaps in the ability to track who is owed, the amounts due, and the reasons behind the accrued liabilities. Consequently, it limits efforts to address existing pending bills hence perpetuate the risk of future accumulations, undermining fiscal discipline and eroding trust in public financial management.

1 Pending bills in counties in Kenya: persistent gaps in policy implementation. link

5.0 CONCLUSION

The issue of debt accountability is critical to Kenya in light of rising debt. The constitution and the PFM Act 2012 lays out a legal and regulatory framework on prudent public debt management to ensure debt sustainability. Parliament must exercise oversight on the country's debt and use of public resources to ensure that all funds are utilized for the benefit of the citizens and overall national development. Concurrently, the Office of the Auditor General plays a critical role in auditing public finances, providing independent assessments of how borrowed funds are utilized, and highlighting any discrepancies or inefficiencies. The timeliness of the OAG's audit reports helps the oversight bodies and the public scrutinize accountability in the use of public funds by public officials. Despite having a legal framework and institutions with a mandate of keeping a check on public finance management, high debt levels and debt service are increasingly diverting resources from social spending. Potentially, this will push more people at the bottom of the pyramid into poverty as health care and education become expensive and the vulnerable fail to be adequately cushioned.

6.0 RECOMMENDATIONS:

- The National Treasury ought to ensure consistency in the key policy documents, that is, the Medium-Term Debt Management Strategy, Budget Policy Statement, and the Annual Borrowing Plan.
- Parliamentary oversight ought to be enhanced especially in the process of debt approval and tracking implementation of audit recommendations.
- County governments should set up comprehensive and transparent systems for documenting and reviewing all pending bills to facilitate audit, oversight, and ultimately, payment of these pending bills.
- Oversight institutions at the county levels (especially the County Assembly and non-state actors) should be proactive in reviewing audit reports and demanding answers to audit queries raised

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The findings and conclusions contained within are those of the authors and do not necessarily reflect positions or policies of the Christian Aid-Kenya.

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