STRENGTHENING DEBT ACCOUNTABILITY IN KENYA

STUDY REPORT

Acknowledgement

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EXECUTIVE SUMMARY

Kenya's public debt has increased significantly, surpassing 50% of GDP by the 2023/2024 fiscal year. The surge has constrained the government's ability to finance socio-economic services. Between FY 2019/20 and FY 2023/24 spending on health, education, and social protection rose by Ksh 243 billion while debt servicing costs skyrocketed by Ksh 1.3 trillion. This creates a vicious cycle of borrowing to cover deficits and meet debt obligations, further increasing the debt burden. Equally, despite counties not procuring public debt, they have accumulated pending bills amounting to Ksh 156.34 billion consequently impeding counties from efficient investment in development projects. To address these challenges, enhancing debt accountability at both national and county levels is crucial to breaking the cycle of borrowing and ensuring sustainable fiscal management.

The study analyses official documents both at the national and county level, to examine public debt accountability as the processes and mechanism for ensuring responsibility, and answerability in a country's public debt decisions. At the national level, the study identified significant policy incoherence between key policy documents. The MTDS, Budget Policy Statement (BPS), and ABP, which are essential documents that guide government's borrowing and debt management, lacked coherence with respect to targets for domestic versus external borrowing. This lack of coherence undermined debt accountability in several ways. First, such deviations cast doubt on the credibility of government information. Secondly, inconsistences across documents in setting of debt targets limit accountability in debt management because it remains unclear which targets the actual borrowing should be benchmarked against. The report equally highlights that parliament's ability to effectively oversee debt and ensure accountability is undermined by the legal and regulatory framework. In particular, the lack of a legal requirement for individual loan contracts to be ratified by parliament before the Cabinet Secretary contracts debt hampers effective oversight. This report also highlights gaps in debt reporting in Kenya and lessons from other countries, specifically Uganda and Benin.

Using Isiolo county as a case study, we found that although counties have not incurred any debt, they face significant challenges with timely payments for goods and services, leading to a build-up of pending bills. County governments are required to finance their budgets through a combination of equitable share, own source revenue (OSR), and grants. However, 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. 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. This challenge of pending bills

is further aggravated by poor fiscal planning, diversion of resources using supplementary budgets, failure to prioritize settlement of verified pending bills, poor documentation, corruption, weak public procurement practices and limited transparency.

We recommend to the national government that:

- *The National Treasury ought to ensure consistency in key policy documents, such as the Medium-Term Debt Management Strategy, Budget Policy Statement, and the Annual Borrowing Plan.*
- *Parliamentary oversight ought to be enhanced by strengthening the legislative and approval process of debts. Improved reporting from executive agencies would enhance oversight as well.*
- *The office of the Auditor General ought to be adequately financed and its independence from the executive assured, to enable it to perform its mandate effectively.*
- *There is a need to foster collaboration between public and private sector institutions such as civil society, and other stakeholders such as independent oversight institutions, judiciary, development partners and the public. Additionally, continuous engagement and capacity building for civil society and members of the public is critical in sustaining pressure on the policymakers.*

For the County Government, it is recommended:

- *To put in place mechanisms to ensure transparency in PFM at large- both from revenue estimations and actual revenues collected, to expenditures and financial commitments (procurement and contract awards).*
- *To set up comprehensive and transparent systems for documenting and reviewing all pending bills to facilitate audit, oversight, and ultimately, payment of these pending bills.*
- *To ensure that oversight institutions at the county levels (especially the County Assembly and non-state actors) are proactive in reviewing audit reports and demanding answers to audit queries raised.*
- *That Isiolo county enhance OSR mobilization to be able to meet financial obligations even in times when there are delays in the disbursement of equitable share*

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LIST OF ABBREVIATIONS

OCOB	-	Office of Controller of Budget
PFM	-	Public Finance Management
OSR	-	Own Source Revenue
IPPD	-	Integrated Payroll and Personnel Database
PIC	-	Public Investment Committee
PAC	-	Public Accounts Committee
OAG	-	Office of Auditor General
ABP	-	Annual Borrowing Plan
MTDS	-	Medium Term Debt Management Strategy
PFMA	-	Public Finance Management Act
BPS	-	Budget Policy Statement
GDP	-	Gross Domestic Product
CSOs	-	Civil Society Organizations
PDMO	-	Public Debt Management Office
APDMR	-	Annual Public Debt Management Report
SOE	-	State Owned Enterprises
PPP	-	Public Private Partnerships

GDP

INTRODUCTION

Over the last decade, Kenya's public debt has surged, reaching over 50% of GDP by the 2023/2024 fiscal year. This rise has strained the country's fiscal space, limiting the government's ability to finance social and economic development programs to just 25% of its revenue. Increased spending on social services like health, education, and social protection only rose by Ksh 243 billion between FY 2019/20 and FY 2023/24, while debt servicing costs soared by Ksh 1.3 trillion over the same period. Increased debt service creates a vicious cycle of borrowing to cover deficits and meet debt obligations, further increasing the debt burden.

Equally, although county governments have not procured public debt, they are grappling with financial obligations, namely, pending bills, which have accumulated to Ksh 152.37 billion by 31st March 2024. This is 68% percent of the annual equitable share transfer they received during the first nine months of FY 2023/24. These unpaid obligations strain the counties' fiscal space, limiting their capacity to invest in development projects and raising concerns about efficiency, transparency, and accountability. To address these challenges, enhancing debt accountability at both national and county levels is crucial to breaking the cycle of borrowing and ensuring sustainable fiscal management.

For purposes of the assessment, the study examines public debt accountability as the processes and mechanisms for ensuring responsibility, and answerability in a country's public debt decisions. This involves transparency as a building block for accountability, i.e. providing comprehensive and timely information about debt levels and terms. Coherence of policy documents is critical for oversight of borrowing by parliament, by the auditor through robust independent audits of fund utilization, and by an active public involved in decision-making processes related to debt. [1,2]

This paper reviews the accountability ecosystem that governs the management of public debt in Kenya. From the national level perspective, the paper examines the key policy documents for debt management and the institutions involved in debt decision making and oversight, reviews how each has performed, , and recommends opportunities to strengthen accountability. From the county perspective, the paper examines on pending bills as financial obligations.

From the national level analysis, the paper seeks to answer the following questions:

- *To what extent are Kenya's debt management policies coherent?*
- *To what extent have Kenya's institutions enhanced accountability in debt decisions?*
- *The analysis of county pending bills seeks to answer the following questions:*
- *How effective are the budgeting and auditing mechanisms for tracking, managing, and resolving pending bills in Isiolo County?*

1 International Monetary Fund. (2014). Revised Guidelines for Public Debt Management. Available at: IMF Public Debt Guidelines

2 World Bank. (2009). Debt Management Performance Assessment (DeMPA) Tool. Available at: World Bank DeMPA

To answer these questions, the study undertook an in-depth desk analysis of key documents such as the Constitution of Kenya, 2010 (CoK), Public Finance Management Act (PFMA), 2012 and the PFMA Regulations, to understand the legal framework governing public debt accountability. We also reviewed the Annual Public Debt Management Reports, Annual Borrowing Plans (ABP), Medium Term Debt Management Strategy (MTDS) to identify policy coherence. The National/ County Government Budget Implementation Review Reports produced by the Office of the Controller of Budget (OCOB), were used to examine the relation between unmet OSR targets for Isiolo county and the accumulation of pending bills, and audit reports published by the Auditor General were analysed to identify the audit queries raised concerning the lack of accountability within the National Government.

The pending bills analysis was enriched through engagement and consultation with the Isiolo County Department of Finance and Economic Planning, the County Assembly's Budget and Finance committee and budget champions in Isiolo. Although Isiolo is not the highest-ranking county in accumulation of pending bills, the county has made significant progress in prioritizing clearance of pending bills and therefore provided a good case study to understand what implication this had on service delivery.

2.0 COHERENCE OF POLICIES RELATED TO PUBLIC DEBT AND ROLE OF INSTITUTIONS IN PUBLIC DEBT ACCOUNTABILITY AT THE NATIONAL LEVEL

Kenya' overarching legal framework for governing the management of public debt is anchored in the Constitution 2010. First, the Constitution establishes the principles of public finance, including transparency, accountability, and prudence in the management of public resources. Article 201 of the Constitution explicitly mandates that public borrowing, and the management of public debt must be conducted in a manner that ensures fiscal responsibility. Secondly, the Public Finance management (PFM) Act 2012 gives effect to Article 201 of the Constitution by providing comprehensive guidelines on the processes, institutions, and responsibilities involved in managing public finances, including public debt. Specifically, the PFMA obligates the National Treasury to ensure that public debt is managed in accordance with established principles of fiscal responsibility.

The legal framework also creates safeguards, among them, the limit on the total amount of public debt that the national government can incur over a given period. This is done through the setting of a statutory debt ceiling that is subjected to periodic review by Parliament. Through this ceiling, the PFM Act intends to safeguard against unsustainable borrowing and ensure that public debt remains within manageable levels. While National Treasury is allowed to raise the debt ceiling, a comprehensive justification and an assessment of the potential impact on fiscal sustainability is required. These provisions are designed to prevent excessive borrowing and to promote long-term fiscal sustainability.

The Constitution and the PFM Act prescribe the role of key institutions, and key policy documents (the Medium-Term Debt Strategy, the Budget Policy Statement, the Annual Borrowing Plans and Annual Debt Reports) that must be developed to facilitate debt accountability. Three key institutions play a pivotal role in debt oversight in Kenya. First, Kenya's Parliament has a constitutional mandate for the approval for borrowing targets by the national government but has no legal mandate to ratify individual loan

contracts. Parliament also receives and reviews debt reports presented to it by the executive, including audit reports. Second, the Public Debt Management Office (PDMO) within the National Treasury is responsible for the development and implementation of the Medium-term Debt Management Strategy (MTDS) to guide borrowing and debt management decisions, monitor debt levels, and ensure that debt is sustainable. Additionally, the PFM Act mandates the PDMO to regularly report on public debt, including the preparation and submission of Annual Debt Management Reports to Parliament and the public, thereby enhancing transparency and accountability. Third, the Office of the Auditor-General (OAG), established under part six of Chapter 12 of the Constitution, is charged with public financial reporting. In particular, the OAG has a broad obligation to audit and report on the accounts of all public entities, including the national and county governments, and any other body funded by public funds. The auditing of the accounts related to public debt, which encompasses both domestic and external borrowing by the government is a crucial part of this obligation.

Overall, Kenya's debt stock indicates that while Kenya's oversight framework for public debt management is robust on paper, its effectiveness is often undermined by incoherence in policy and reporting, weak enforcement and limited oversight by responsible institutions.

2.1 GAPS IDENTIFIED IN POLICY COHERENCE

2.2.1 Alignment of the Budget Policy Statement (BPS) and Medium-Term Debt Management Strategy (MTDS)

Every financial year, in February, the National Treasury releases the Budget Policy Statement (BPS) and the Medium-Term Debt Management Strategy (MTDS) as policy documents to guide revenue and borrowing for the year and medium-term. The MTDS 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. The BPS outlines the fiscal policy objectives and government priorities for the upcoming financial year. It outlines the government's expenditure plans and revenue projections for the forthcoming financial year, including budget deficits and how to finance them, effectively updating the MTDS targets for the specific year. During the formulation of the BPS, the government considers the objectives and strategies delineated in the MTDS, especially those pertaining to debt management.

On the other hand, Section 63 (d) of the Public Finance Management (PFM) Act, 2012 requires the Public Debt Management Office to prepare an Annual Borrowing Plan (ABP) underpinning the Budget approved by the National Assembly while Section 186 of PFM (National Government) Regulation, 2015 provides that the Medium-Term Debt Management Strategy (MTDS) will be implemented through the ABP.

In a well-functioning policy ecosystem, these documents should be coherent to ensure credibility in the government's overall financial management. Aligning the Medium-Term Debt Strategy with the Budget Policy Statement ensures that government's fiscal policies and strategies for debt management are harmonized and are mutually supportive. Aligning the Medium-Term Debt Strategy (MTDS) with the Annual Borrowing Plan (ABP) ensures that decisions about how much to borrow at any given moment are made within the framework of long-term strategic goals, promoting consistency, risk management, fiscal discipline, improved coordination, and policy coherence. This alignment ought to promote prudent financial management and sustainable debt levels in the long run by being consistent with the long-term fiscal objectives and rules. Where there is a misalignment, it is necessary that the National Treasury provides sufficient justifications.

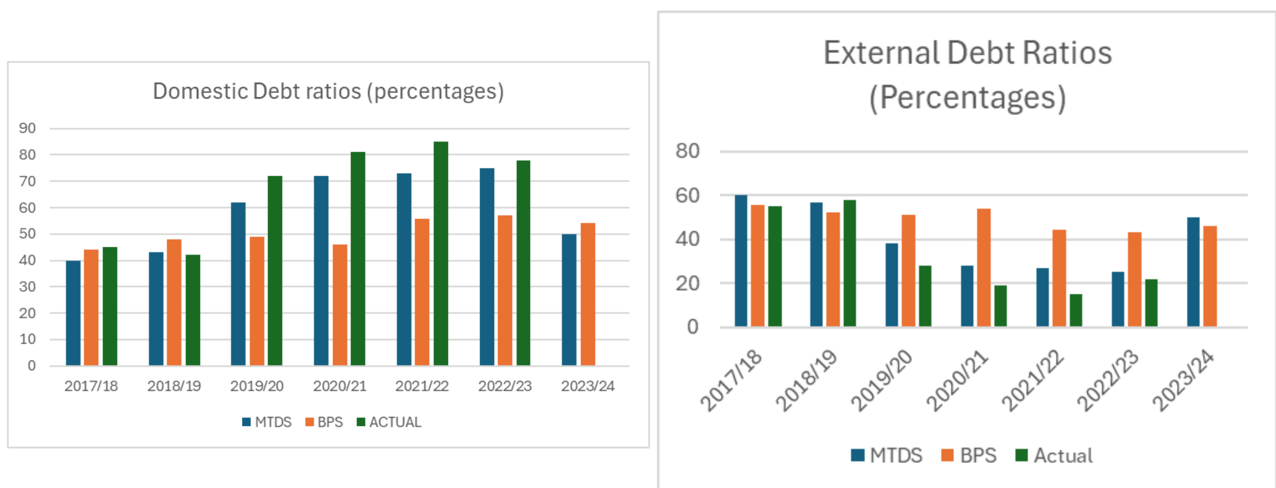
Statistics as presented in figure 1 show that all three documents - the MTDS, BPS and the ABP have over the years have been inconsistent with one another in spelling out policy guidelines for domestic versus external borrowing. This lack of coherence is concerning, given the significant implications of leaning heavily toward either domestic or external debt.

Secondly, analysis also shows deviation in the ratios of actual debt incurred from the borrowing targets approved by the parliament (in the budget approval stage) and no sufficient justification is given by the National Treasury. In most cases the government cites changing market and economic conditions as variables affecting revenue performance hence deviation from borrowing targets but this points to weak or unrealistic macro frameworks projections.

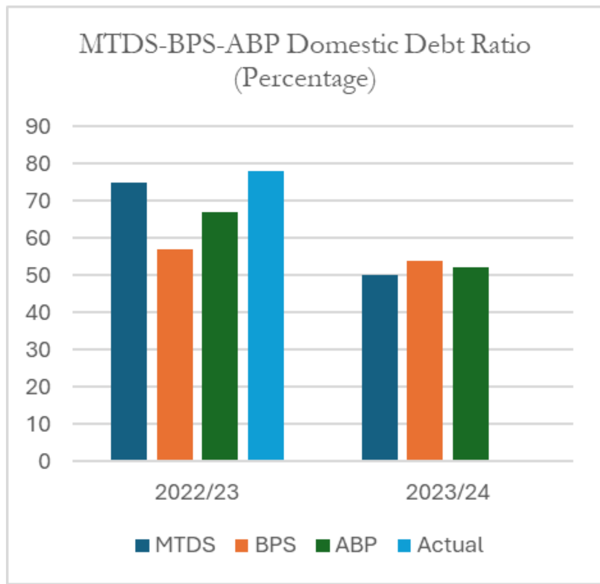
To illustrate, during the post covid FY 2021/22, the MTDS projected a domestic borrowing of 73 percent, and the BPS projected 56 percent. On the other hand, for the same year, the MTDS projected external borrowing of 27 percent, while the BPS projected 44 percent. In another example, in the FY 2022/23, the MTDS provided that 25percent of the public debt would be financed externally, however the BPS for the same financial year projected to have 43percent Such was a similar case for FY2023/24, where MTDS had projected50:50 ratio for domestic and external debt, while the BPS projected 46 percent external and 64 percent domestic borrowing levels.

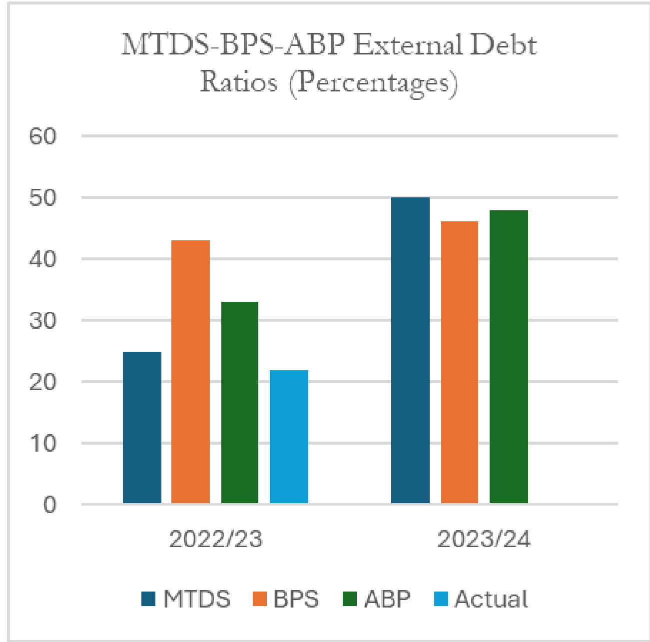
To add to this, there are significant variances between the actual debt borrowed and the projections made. Between the FYs 2019/2020 up to 2022/2023, the actual domestic borrowing exceeded the projected ratios, and consequently, the external borrowing levels were lower than projected.

Fig 1: MTDS-BPS- ABP External and Domestic borrowing ratios



Similar variations are observed when we introduce the Annual Borrowing Plan into the analysis. The National Treasury published the Annual Borrowing Plans at the beginning of FY 2022/2023. For the two FYs published we note that the ratios of domestic to external borrowing varied across the three documents but narrowed in the FY 2023/24. Notably, the variations reveal that the government tends to follow the MTDS as compared to the BPS. This brings into question the effectiveness of the BPS in determining spending, and if the MTDS does in reality influence the policy structure of the BPS as is expected.





As a best practice, the implementing document which is the annual borrowing plan (ABP) should not deviate since it is derived from long-term strategies set out in the MTDS. The MTDS is revised annually, and the assumptions made in February in the BPS are not expected to significantly change debt dynamics by the time of publishing the ABP. The necessity of having both documents produced is that the MTDS provides more comprehensive information as compared to the BPS, this includes information such as the debt sustainability analysis, analysis on macroeconomic assumptions and key risks, and effects of shocks on the costs and risks characteristics of debt.

Deviations between approved borrowing plan and long-term strategic goals undermine debt accountability in multiple ways. First, such discrepancies cast doubt on the credibility of government information, creating uncertainty about its reliability for accountability purposes. They also raise concerns about the government's commitment to fiscal policy, its creditworthiness, and the market's trust in its ability to manage debt prudently. Furthermore, when these deviations occur across key guiding documents like the MTDS, BPS, and ABPs, they limit the government's accountability in debt management because it remains unclear which targets the actual borrowing should be benchmarked to. This inconsistency hinders the promotion of prudent financial management and sustainable debt levels, which rely on the alignment of long-term fiscal objectives and rules.

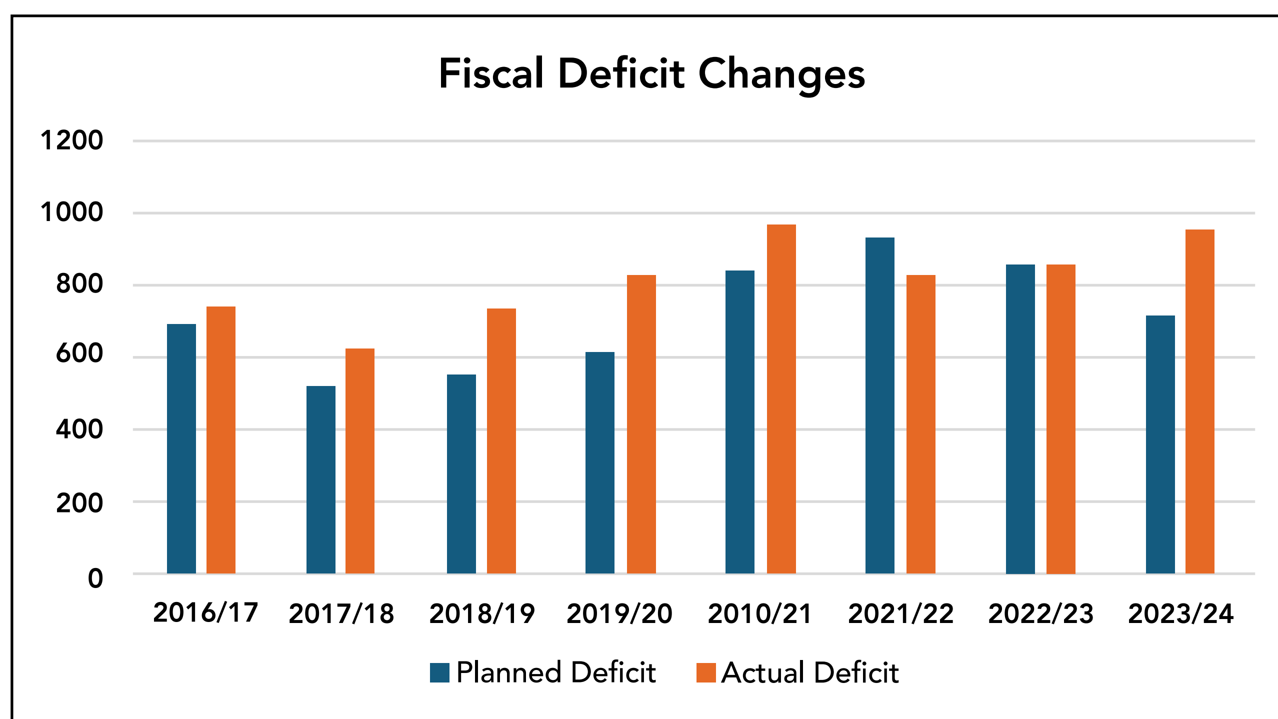
Furthermore, without sufficient justification for these deviations, it becomes difficult for the public, policymakers, and civil society organizations to understand the rationale behind financial decisions, thus impairing their ability to hold the government accountable. Moreover, the lack of clear reasons for these discrepancies impedes oversight institutions from fulfilling their legal mandate effectively.

2.2.2 Inconsistency in implementing target deficits as guided by policy documents

With the lack of coherence between the policy directions outlined in the MTDS, BPS, and ABPand the actual debt incurred, a broader challenge unfolds in the deviations between planned/ approved fiscal deficits at the beginning of the financial year and the actual deficits incurred at the end of the financial year. Although the afore-discussed policy documents set borrowing limits that are incorporated into the approved budget estimates, the Quarterly Economic and Budget Review Reports published by the National Treasury show that the government has consistently borrowed more than the planned deficits at the start of each fiscal year for the last eight years. For instance, as illustrated in Figure 2 below, between FY 2016/17 and FY 2023/24, with the exception of FY 2021/22 and 2022/23, actual government borrowing consistently exceeded the projected deficits. While these deviations are often attributed to economic shocks that lead to higher-than-planned expenditures and lower-than-anticipated revenues, there are deeper issues at play. It is highly probable that government incurs other undisclosed expenditure. A case in point is failure by the government to submit to the OAG credit agreements for loans worth Ksh 5.1 billion for audit in FY 2020/21 and concealing whether the termination of the credit was conducted in accordance with the provisions in the respective agreements and any costs charged against public funds for the termination.1

Recurrence and failure to resolve debt related queries by the OAG calls into question the government's accountability for its decisions and the use of public resources, and whether officials are held responsible for adhering to the approved fiscal plans.

Fig 2: Fiscal Deficits typically exceed target



1 Report of the Auditor General for the National Government MDAs for the FY 2020/21. Link

2.3 GAPS IDENTIFIED IN REPORTING

Section 62 (1) (2) (3) and Section 63 of the Public Finance Management (PFM) Act, 2012 provide for the establishment of the Public Debt Management Office (PDMO) with a broad mandate of managing the country's public debt to ensure it remains sustainable and beneficial for both current and future generations. Its primary objectives include minimizing the cost of public debt and borrowing over the long term while considering associated risks. The PDMO also promotes the development of market institutions for government debt securities and ensures transparent and accountable debt management practices. Additionally, it coordinates borrowing activities, both domestic and external, to finance fiscal deficits and manage maturing debts, including reporting.

Despite these efforts, significant gaps remain in the reporting of key documents. Kenya can look to other countries for best practices to enhance the quality and transparency of its debt reporting.

Table 1: Gaps in reporting and lessons from other countries

GAPS	DOCUMENT	KENYA'S WEAKNESSESBEST PRACTICES	COUNTRY	
Comprehensive information on contingent liabilities	MTDS	Does not clarify as to whether the published information is inclusive of implicit guarantees or not	Uganda's Annual Debt report liability section contains comprehensive information on a range of implicit liabilities, disaggregated into three sources i.e. non-guaranteed liabilities of SOE and local governments, financial sector bailouts, and natural disaster	UGANDA
		No section on called and canceled guarantees.	Has a comprehensive section on called and cancelled guarantees which is significant in identifying the guarantees that have been exercised by the beneficiary	
		Lack of core information on future guarantees approval.	Contains a section on information on guarantees in the pipeline waiting for Cabinet approval by creditor and beneficiary	

<table>
<tr><td rowspan="2">Reporting of comprehensive information on recently contracted loans</td><td rowspan="2">Monthly bulletins</td><td>Time-lag in the publishing.</td><td>Information on recently contracted loans is published in a timely manner</td><td rowspan="2">UGANDA</td></tr>
<tr><td>Lacks significant information on risks involving debt contraction</td><td>Uganda's reports include a section on analytical studies on the hazards associated with debt and on projected future borrowing, which Kenya lacks.</td></tr>
<tr><td rowspan="2">Reporting and oversight of SOEs debt</td><td>Annual Public Debt Management Report</td><td>Time lag in making public the SOE debt information</td><td>Provides regular public statistics on the stocks and movements of SOE debt</td><td rowspan="2">BENIN</td></tr>
<tr><td></td><td>No full realization of the commitment to expanding coverage of public debt reporting to include non-guaranteed debt owned by (SOEs), and contingency liability posted by Public Private Partnerships (PPPs) and guarantees.</td><td>Beninese Debt Management Agency (CAA) which implemented a new monitoring mechanism for guaranteed and non-guaranteed commercial debt of SOEs. This law requires authorization prior to generating commercial debt and the release of yearly audits of financial statements, as well as the annual publication of audited financial statements of SOEs within six months of the conclusion of the annual accounting exercise.</td></tr>
</table>

2.3.1 Roles and limitations of Parliament in debt accountability

Kenya's legislative framework (the Constitution of Kenya, 2010 (CoK), the Public Finance Management Act (PFMA), 2012 and the PFMA Regulations. Art. 211 to 214) spells out the overarching responsibility of Parliament in fiscal responsibility and public debt oversight, emphasizing the need for transparency and accountability in decisions impacting the country's finances. Parliament, through its committees, is responsible for reviewing submissions made by the National Treasury and ensuring that the borrowing and spending are transparent and accountable. Under Art 211, Parliament has the power to prescribe, by legislation, the terms on which the national government may borrow and imposes debt reporting requirements.

Although there is a robust framework including a clearly outlined mandate, Parliament still falls short in effectively overseeing the debt management, consequently, limiting the effectiveness of the debt management legal and policy frameworks.

Oversight of debt involves several key actions and corresponding legal and regulatory requirements.

First, in terms of debt ratification, there is no requirement under Section 49 of the Public Finance Management (PFM) Act for individual loan contracts to be ratified by parliament before the Cabinet Secretary contracts debt. In the absence of parliamentary involvement, there is insufficient oversight of public debt to ensure that it people centered.

Second, whereas section 59 of the PFM Act requires that not later than fourteen days after a guaranteed loan is entered into, the Cabinet Secretary shall submit to Parliament and publish a statement on new contingent liabilities for the budget year, such as new guarantees or insurance commitments, these are not tabled during the budget making process either in the MTDS or in the ABP.

Third, in the context of State-Owned Enterprises (SOEs) with guaranteed debt, there is no specific parliamentary committee exclusively responsible for their oversight of their debt. Instead, audit reports for SOEs are received by the respective committees overseeing the ministries under which those SOEs operate, rather than by the Public Debt and Privatization Committee.

Finally, and critically, whereas the National treasury fails to align the strategic direction in the policy documents, Parliament also lapses in it oversight role by not requesting for justification in cases where the National Treasury deviates from the approved targets and ceilings.

Overall, Parliament's ability to effectively oversee debt and ensure accountability is undermined by structural issues within the legal and regulatory framework. The inadequate requirements for information sharing between Parliament and the executive, and the consequent limited involvement weakens Parliament's oversight role and its capacity to scrutinize the necessity and potential impact of new debts. Moreover, Parliament's responsibility to approve key fiscal documents is compromised by the presence of unexplained deviations in these documents, particularly in instances where actual borrowing exceeds planned borrowing, further limiting its ability to enforce fiscal discipline and accountability.

2.3.2 Role of the Office of the Auditor General

Enshrined in Article 229 of the Constitution, the Office of the Auditor General (OAG) operates

as an independent watchdog responsible for auditing and reporting on the utilization and management of public funds. This constitutional mandate empowers the Auditor General to facilitate oversight for the lawful and effective use of public money, playing a crucial role in ensuring accountability. According to Article 229(7) of the Constitution, the Auditor General is mandated to audit and submit reports, to Parliament, on the use of public resources by all entities funded from public funds within six months after the end of the financial year.

The OAG has conducted a wide range of audits, including financial, compliance, and performance audits of government ministries, departments, agencies, and county governments. These reports are produced quarterly and are compiled and presented to Parliament, where they are scrutinized by the respective Parliamentary committees. It is expected that these committees use the findings to hold public officials accountable, often leading to investigations by the Ethics and Anticorruption Commission, Director of Criminal Investigations and Prosecutions by the Office of the Director of Public Prosecutions, and any further policy reforms. Additionally, the OAG's reports are publicly accessible on their website, fostering transparency and enabling civil society and the media to advocate for better governance and the prudent use of public resources.

The OAG's diligent work has been instrumental in uncovering corruption, mismanagement, and inefficiencies in different government institutions. For example, in 2015 the OAG revealed that Ksh 791 million was lost in a corruption scandal of stolen funds in the National Youth Service (NYS). Several senior NYS officials, including the Director General, were arrested and prosecuted for their roles in the scandal. In a separate case, several board members and top officials of KEMSA were suspended and faced prosecution following the Auditor General's report highlighting irregularities in the procurement process. These prosecutions demonstrate the government's efforts to hold individuals accountable and recover misappropriated funds.

Whereas the OAG has documented improper financial management, challenges remain. First, the prosecutions of public officials found culpable for malpractices has been inconsistent because of political interests and interference. Second, the ability of the OAG to publish the reports on a timely basis is limited, and the OAG has commonly attributed this to inadequate financing for the office to run efficiently. Third, although audit queries over the years have established instances where the government could not account for discrepancies in matters relating to debt and generally, public finances, these incidences continue to surface, with limited evidence of action taken on audit queries and/or implementation of audit recommendations.

Table 2: Debt Audit Queries

Year	Total Debt Stock (Ksh trillion)	Key issues raised by OAG regarding debt	Importance of OAG issues
FY2019/20	6.69	Unexplained Ksh 2 billion variances of Short-Term borrowing. Inaccurate Treasury Bonds balances with unexplained variance of Ksh 26 billion Non-Disclosure of Public Debt Procured	These variances in reporting pose serious accountability concerns with a likelihood of mismanagement and inefficiency in handling of public funds
FY2020/21	7.70	Payment of Ksh 2.1 billion commitment fees on undrawn amounts.	The government lost 2.1 billion due to failure in absorption of borrowed funds. There must be strict policies on timely utilization of borrowed funds.
		Default on debt repayment on 3 loans amounting to 5.1 billion	The default on debt repayment exposes the Government to risks of legal suits that may lead to punitive penalties and subsequent loss of public resources.

FY2021/22	8.63	Payment of Ksh 379 billion commitment fees on undrawn amounts between 1st July 2019 and 31st dec 20220 but no drawdowns were done by June 2022. Amount incurred on commitment fees was 1.5 billion.	The country incurred expenses in terms of commitment fees which could have been avoided were the funds absorbed to their stipulated projects.
FY2022/23	10.28	Costly domestic debt: The cost of domestic debt was three times the cost of external borrowings even though it forms 47% of the total debt.	The mandated debt office should be held to account for not maintaining a debt mix or a financing model that minimizes cost. This diverts resources that could be used for development purpose to debt repayment.
		Loans with no drawdowns: Ksh 25.2 billion were made between 24th April 2017 and December 2022 but no drawdowns on these loans had been made by the various implementing agencies for the funded projects and programmes as of 30th June 2023. The amount paid as commitment fee was Ksh 1.4 billion.	This affects absorption of the loans into their stipulated purposes within the set timeframes, this would cut on expenditure of commitment fees.

In summary, whereas the OAG has contributed to the accountability landscape strategically through publication of independent audit findings on decisions on public debt and utilization of resources, the efficiency of the oversight role is limited, as insufficient actions have been taken to hold government officials accountable for their decisions and actions.

2.4 Recommendations for strengthening national level policy and institutional frameworks

Increasing debt obligations without proper accountability can lead to significant economic challenges, such as the inability to finance development projects and social programs. Therefore, it is crucial for the government to safeguard the progress made in prudent public finance management. Strengthening accountability mechanisms is essential to ensure resources are not wasted and decision-makers are held responsible for their actions.

The Constitution of Kenya and the Public Finance Management Act of 2012 have provided an elaborate legal and regulatory framework to aid Parliament and other institutions mandated with debt management and accountability responsibilities to ensure prudent use of public funds. National Treasury and its agents must closely align their policies and fiscal targets between Medium-Term Debt Strategy, the Budget Policy Statement, and the Annual Borrowing Plan in order to foster a cohesive fiscal framework environment in the management of debt. Further, the Public Debt Management Office should maintain and produce consistent, timely and coherent debt management reports and updated register.

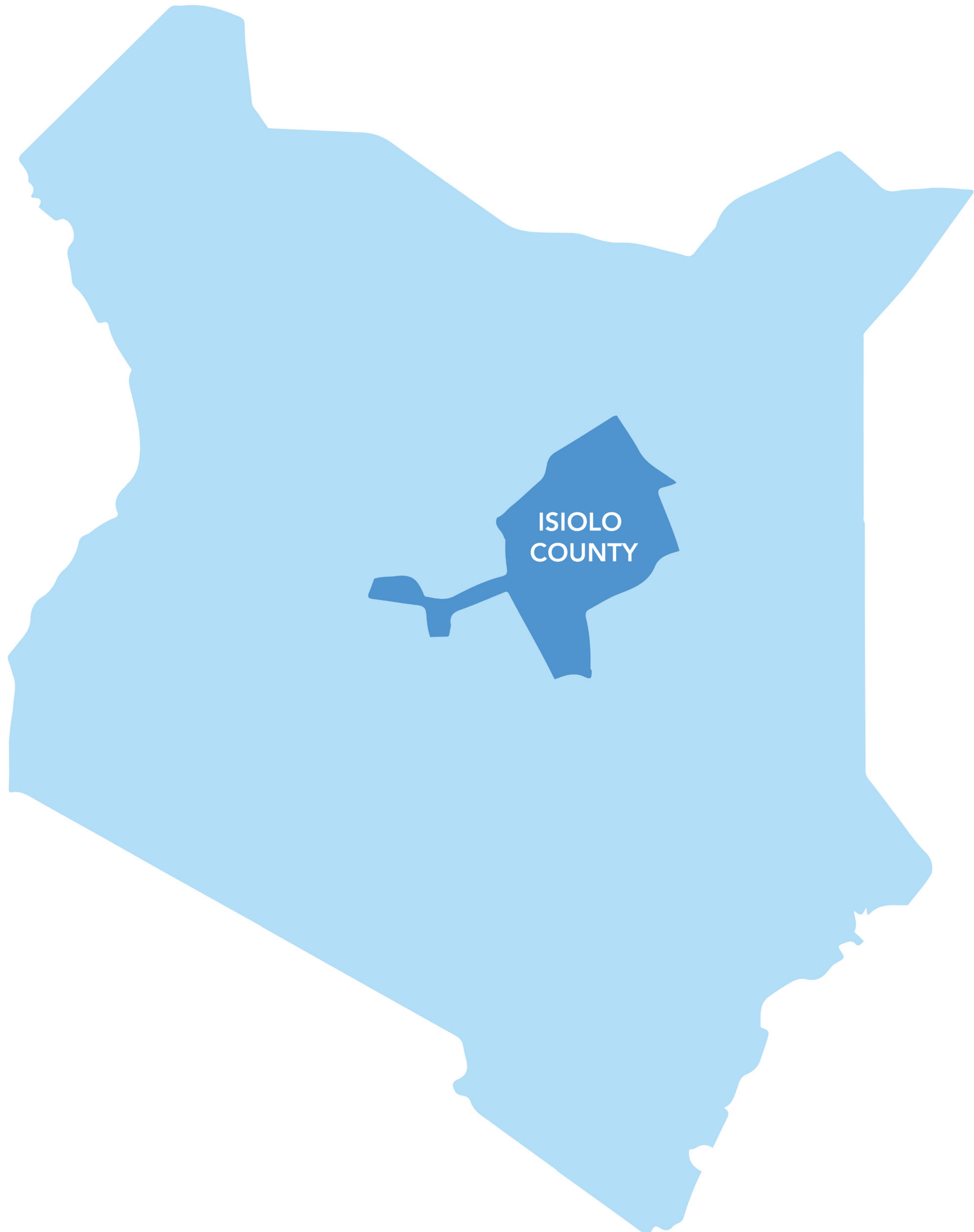
Parliament should ensure the alignment across policy instruments and reports through the legislative and approval process by ensuring that adequate reasons are given in case of any deviations. Parliament should develop and adopt a mechanism for demanding answers to audit queries reported. To strengthen the capacity of Parliament, non-state actors have the opportunity to offer technical assistance in breaking down and analysing debt management policies, reports and debt data to ensure that Parliament maintains its independence from the Executive.

Given the crucial role that The Office of the Auditor General plays in accountability of public resources, this entity should be adequately financed and granted full independence from the executive, to enable it to perform its mandate effectively. Similarly, non-state actors can plug in any gaps in OAGs capacity through collaboration in the generation of reports, simplification and dissemination, and championing for greater budgetary allocation to the Office.

Further, a clear structure and mechanisms for dealing with public officials contravening the policy and regulatory framework would be instrumental in holding public officials answerable for their actions. These mechanisms should also provide for the timelines for recovering any mishandled public funds by officers and timely prosecution where necessary.

Finally, to strengthen debt accountability, especially the use of audit reports to demand for greater accountability, there is a need to foster collaboration and build synergies between public and private sector institutions such as civil society, and supreme audit institutions. Continuous engagement and capacity building for civil society and members of the public is critical in sustaining pressure on the policy holders. The recent uprising of young people to reject the 2024 Finance Bill offers a critical opportunity for strengthening capacity of the public to use the report. Enhancing Public Finance Management (PFM) knowledge among

university students is an example of how we can cultivate a culture of active citizenry, thus building an empowered group of PFM leaders and institutions that can participate actively in governance processes and hold governments accountable for their debt management practices.



3.0 DEBT ACCOUNTABILITY AT THE COUNTY LEVEL: CASE OF PENDING BILLS IN ISIOLO COUNTY

3.1 OVERVIEW OF DEBT AND PENDING BILLS IN THE COUNTY GOVERNMENTS

The Kenya Constitution and the Public Finance Management (PFM) Act provide clear guidelines for county governments regarding debt contracting. Article 212 of the Constitution stipulates that a county government can borrow only if the national government guarantees the loan; and if the county assembly approves it. Additionally, Regulation 25 1 (d) of the PFM (County Governments) Regulations 2015 restricts county debt to no more than twenty (20%) percent of the County Governments' total revenue at any given time. Within the limits of this guidelines, no county government had, as at the time of this report, successfully contracted debt.

Although counties have not incurred debt, they face significant challenges with timely payments for goods and services, leading to build up of unpaid financial obligations. This build-up of pending bills emerges from shortfalls in revenue collection due to unrealised Own-Source Revenue targets (or low collections) and delays in and shortfall of national transfers. Accumulation of debt in the form of pending bills contravenes Section 94 (1) (a) of the PFM Act, 2012 that requires payment of financial commitments when they fall due. If county governments were to fully comply with the PFMA regulations, the clearance of pending bills as a priority obligation would potentially impede the counties' ability to provide essential services and fund new development projects, affecting their fiscal health and future investment potential.

To illustrate this, we examine the case for Isiolo county in the FY 2021/22, where the Controller of Budget (COB) reported Isiolo County's pending bills to stand at Ksh 977 million, up from Ksh 283 million in FY 2020/21. In an effort to meet its obligations, Isiolo County offset Ksh 547 million of the pending bills in the FY 2022/23. Roughly half of this was achieved by cutting critical sectorsby more than 5 percent in FY2022/23. A list of thesectors that had more than 5 percent budget cuts is shown in Table 3.

Table 3: Sectors cut by more than 5 percent in FY 2022/23 Isiolo County Budget Cut to offset pending bills

	(*Budget for FY2021/22*	(*Budget for FY2022/23*	Budget Cut (B-A)	Percentage change
	Ksh million	Ksh million	Ksh million	
Livestock, Veterinary & Fisheries	211.31	141	-70.31	-33%
Education & Vocational Training	265.87	247.28	-18.59	-7%
Youth & Sports	170	61.65	-108.35	-64%
Culture & Social Services	53.07	27.1	-25.97	-49%
Water & Irrigation	203.14	177.77	-25.37	-12%
Environment & Natural Resources	83.64	70.52	-13.12	-16%
Total	**987.03**	**725.32**	**-261.71**	

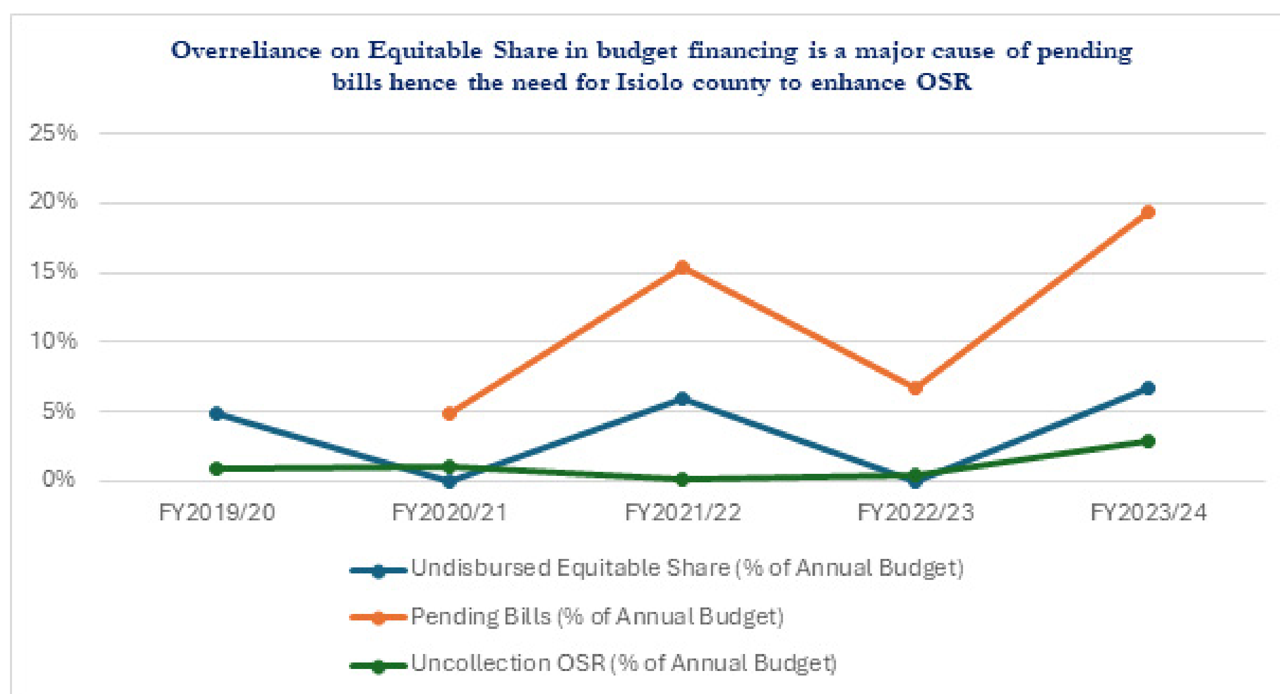
3.2 GAPS IN PLANNING AND POLICY DOCUMENT COHERENCE: EQUITABLE SHARE TRANSFERS, OWN SOURCE REVENUE AND PENDING BILLS

County governments have three main sources of revenue – Own Source Revenue (OSR), Equitable share (national transfers), and conditional grants. OSR represents the revenue collected from streams under the management and administration of counties, while the equitable share is the share of nationally collected revenue that flows to the 47 counties.

As part of their devolved mandate, counties estimate their annual OSR target at the beginning of the year to finance a portion of the budget. In practice, a county should run a balanced budget that is financed with equitable share, own source revenue (OSR) and grants (conditional and unconditional allocations from national government and development partners). However, according to COB reports, most counties, including Isiolo, experience delays in the disbursement of equitable share by the National Treasury while they also fail to meet their OSR targets. This results in shortfalls in revenue

to meet budgetary requirements, which is an important factor contributing to the accumulation of pending bills. As shown in Fig. 3 below, pending bills jump remarkably whenever Isiolo county fails to receive full disbursement of the equitable share from the exchequer. Similarly, although the proportion of uncollected OSR as a percentage of required budget financing is low, increases in unmet OSR also contribute to growth in pending bills. Nevertheless, pending bills exceed these uncollected resources by a large margin, so there are also other causes at work, requiring further investigation.

Fig 3: Isiolo county pending bills, uncollected OSR and undisbursed equitable share as a percentage of budget over FY2019/20 - FY2023/24



Source: OCOB Reports

To add to this, the Commission for Revenue Allocation (CRA) highlights that most counties, Isiolo included, set their OSR target far below the county revenue potential. For example, in the FY 2023/24 Isiolo county collected Ksh. 285 million, accounting for 49 percent of the CRA potential of Ksh 582 million,1 further straining the county resourcing. Low OSR collection featured in the 2023 COB report together with other factors, such as diversion of funds for payment of pending bills to other activities, delays by the National Treasury in the disbursement of funds to Counties and approval of supplementary budgets as some of the main reasons for accumulation of Counties' pending bills.

These challenges, compounded by other gaps such as malpractices and corruption, poor fiscal planning and weaknesses in public procurement have led to the accumulation of pending bills as a financial obligation facing the counties[2].

1 Comprehensive Own Source Revenue Potential and Tax Gap Study on County Governments. Link

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

3.4 CRITICAL GAPS IN DOCUMENTING AND REPORTING TRANSACTIONS A MAJOR OBSTACLE IN THE OVERSIGHT FOR PENDING BILLS

Effective reporting plays a vital role in ensuring that governments make sound fiscal decisions and that oversight institutions can provided the necessary checks and balances. To effectively address the issue of existing pending bills and minimize its accumulation in the future, it is imperative that the county governments provide sufficient, accurate, reliable and comprehensive data and information on pending bills.

A review of the auditor general reports shows that county governments have failed to provide supporting documents for some expenditures, explain variances in financial records and maintain creditor's ledger and creditor's registers. Also, failure to publish contract agreements and procurement documents impedes scrutiny of pending bills to establish whom the county owes, the amount of money and the purpose for which the accounts payable have been accrued.

For example, for Isiolo's FY2022/23, supporting documents including purchase, and service orders, contract agreements and procurement documents for accounts payable amounting Ksh 415 million were not provided for audit review. Additionally, in the FY2021/22, invoices that dated between March 2019 and September 2020 were not listed or disclosed as part of the pending bills in the year when they were incurred. Similarly, in FY2021/22, supporting documents for the pending bills paid during the year under review of Kshs.297 million were not provided for audit. Further, in the FY2022/23, financial statements did not include balances in respect to analysis of pending accounts payable, other pending payables, related party transactions and contingent liabilities. Additionally, in FY2021/22, the financial statements for the year ended 30 June 2022 did not include figures in respect to analysis of pending staff payables, other pending payables, related party transactions and contingent liabilities register. Other significant issues flagged by the OAG include inability to reconcile variances in pending bills. Pending bills reported by the Controller of Budget and the Auditor General are hard to reconcile even if they originate from one source. Before FY2020/21, the amount reported by the Auditor General more than doubled that of the Controller of Budget. For example, in FY2021/22, pending bills reported by OAG amounted to 1,262 million while COB reported 283 million.

Overall, the lack of accurate and comprehensive reporting by county governments inhibits the oversight and accountability of pending bills, and this is a common trend across all 47 counties. Without proper documentation and transparency, it is difficult for oversight institutions to effectively monitor and scrutinize the accumulation and settlement of the bills. Limited transparency creates significant gaps in the ability to track who is owed, the amounts due, and the reasons behind the accrued liabilities, not only limiting efforts to address existing pending bills but also perpetuates the risk of future accumulations, undermining fiscal discipline and eroding trust in public financial management.

3.5 RECOMMENDATIONS

In order to strengthen the oversight and accountability of pending bills in the counties, two broad-based strategies should be implemented.

First, full transparency should be institutionalized in all the counties, both from revenue estimations and actual revenues collected, to expenditures and financial commitments (procurement and contract awards). As a first step, transparency is an enabler of oversight, and without which, oversight entities are rendered incapable of performing their role.

Secondly, the government 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. Finally, 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.