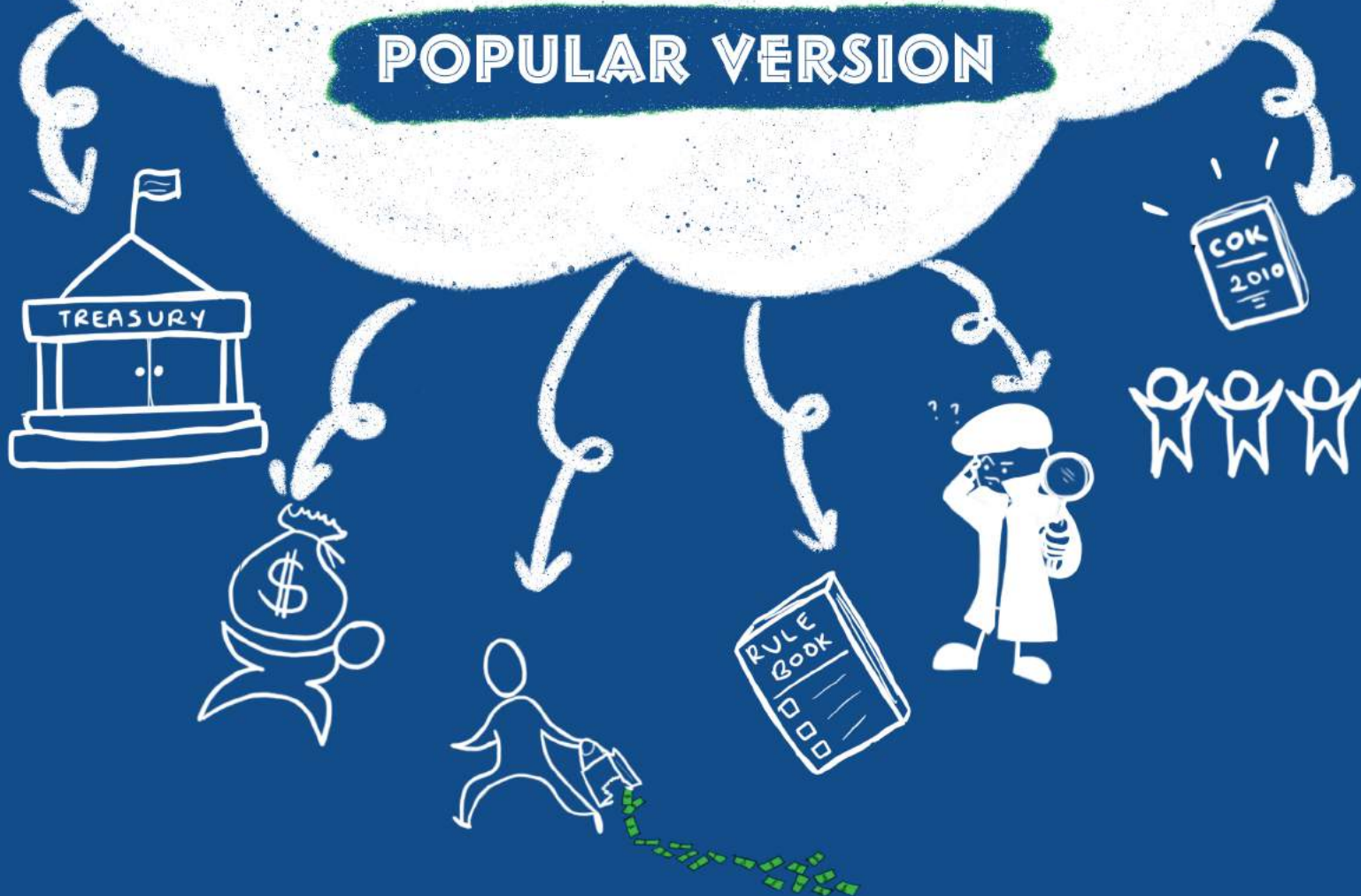


ANALYSIS OF NATIONAL GOVERNMENT AUDIT REPORT 2019/20

POPULAR VERSION



Institute of
Economic Affairs



NATIONAL
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INSTITUTE

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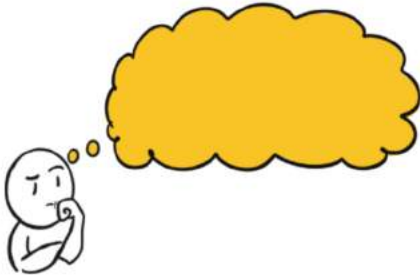
LEGEND



This symbol represents a question that is meant to provoke a thought and cause the reader to try and think of the said question.



This symbol indicates an informational definition of a text.



This symbol indicates a recall bubble to help the reader recall information previously cited.

ABBREVIATIONS

COK	Constitution of Kenya
GOK	Government of Kenya
MDAs	Ministries, Departments and Agencies
SOEs	State-Owned Enterprises
IFMIS	Integreated Financial Management Information Systems

1.0. INTRODUCTION

Kenya has made significant strides in creating the legal and institutional framework to manage public finance. The Office of the Auditor General was created under Article 229 to audit and report on the use of public resources by all entities funded from public funds. The Auditor General is mandated to assess and confirm whether the public entities have used the public resources entrusted to them lawfully and effectively.

THESE ENTITIES INCLUDE:

- THE NATIONAL GOVERNMENT
- COUNTY GOVERNMENTS
- THE JUDICIARY
- PARLIAMENT
- STATUTORY BODIES/ STATE CORPORATIONS
- COMMISSIONS & INDEPENDENT OFFICES
- PUBLIC DEBT
- POLITICAL PARTIES FUNDED BY PUBLIC FUNDS

WHAT IS PUBLIC AUDIT?

It is an independent examination of financial statements and relevant supporting documents, and physical verification of the assets, liabilities and internal control systems to ascertain whether or not, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the law. The audit reports for the national government are required to be submitted to Parliament by 31st December, every year.



WHY IS PUBLIC AUDIT DONE?

To promote accountability and transparency of public funds.



The audit reports are a mirror through which citizens can check if public money has been spent well.



To assure citizens on the effectiveness of internal controls, risk management and overall governance in national entities.



To protect the sovereignty of the people; to secure the observance by all State Organs of democratic values and principles; and to promote constitutionalism.



1.1. BACKGROUND OF THE STUDY

Since the promulgation of the COK 2010, public institutions have failed to manage public resources effectively, transparently and with accountability. There have been numerous reports of mismanagement of public funds both at the National and County Government levels. The release of audit reports tends to lag behind by approximately one year, and oversight authorities have failed to effectively monitor the financial reporting process, compliance, and the effectiveness of the systems in place.

1.2. SIGNIFICANCE OF THE STUDY

This study examines the audit reports for the National Government Entities including all the Ministries, Departments and Agencies (MDAs), National Funds, Donor Funded Projects and Revenue Statements. It aims to simplify the findings and give recommendations for stakeholders such as Civil Society Groups, Academia, Members of the Legislature, Development Partners and Government Officials and Media.

2.0. METHODOLOGY

2.1. TYPES OF AUDIT OPINIONS



A) UNQUALIFIED OPINION

The financial statements and supporting documents present a fair and true position of the government entity. They can be relied upon.



C) ADVERSE OPINION

There is significant disagreement between the financial statements and the underlying books of accounts and/or standards.

B) QUALIFIED OPINION

The financial transactions are to a large extent in agreement with the underlying records, except for cases where material misstatements or omissions are noted in the financial statements.

MOSTLY IN AGREEMENT



A FEW ISSUES

D) DISCLAIMER OF OPINION

The financial statements exhibit serious and significant misstatements that may arise from inadequate information, limitation of scope, inadequacy or lack of proper records such that the auditor is not able to form an opinion on the financial operations.



2.2. CLASSIFICATION OF AUDIT QUERIES



Outstanding Obligations Guaranteed by Government (GoK)



Pending Bills



Non-Performing Loans issued to the Local Entities



Unsupported Expenditure



Stalled or Incomplete Projects



Outstanding Imprests

3.3.8 AUDIT QUERIES



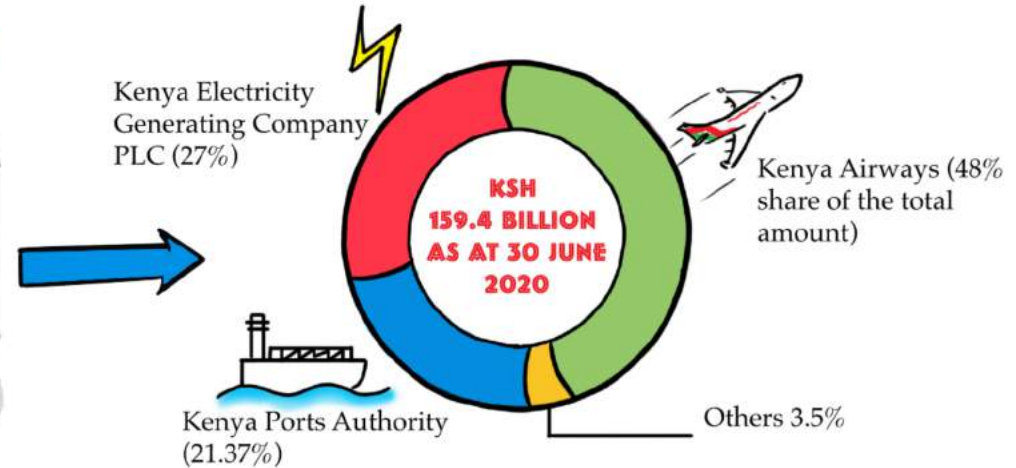
Audit queries are raised to flag out instances of violation of the relevant laws, regulations, policies and guidelines regulating public spending.

In 2018/19 a total of Ksh 398 billion of the spending was flagged as having been transacted unlawfully and/or ineffectively compared to Ksh 307 billion in 2019/20 representing an overall decline by 22.9%.

OUTSTANDING OBLIGATIONS GUARANTEED BY GOK



A guarantee obligation is a legal promise made by a third-party (Government of Kenya) to cover a borrower's (parastatal) debt or other types of liability in case of the borrower's default. The guaranteed obligation increases the contingent liabilities of the government in the event that the borrower defaults in payment of the debt.



PENDING BILLS (MDAS AND FUNDS)



A pending bill is an unsettled financial obligation by the government entity at the end of a financial year. Pending bills arise when an entity fails to settle invoiced amounts for the goods procured and delivered and services at the end of a financial year.



NON-PERFORMING LOANS ISSUED TO LOCAL ENTITIES



A Non-Performing Loan (NPL) is a loan in which the borrower the SOE is in default and hasn't made any scheduled payments of principal or interest for sometime.



Coast Water Service Board



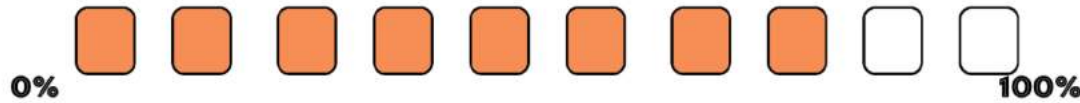
Tanathi Water Services Board



Mumias sugar Company



Lake Victoria South Water Services Board



The Non-Performing Loans for the top five SOEs make almost 80% of all Non-Performing loans.

STALLED/ INCOMPLETE PROJECTS



In 2019/20, the amounts incurred on stalled and incomplete projects amounted to Ksh 3.9 billion. However, the status of previously reported stalled incomplete projects such as the upgrading of the Othaya District Hospital has not been reported.



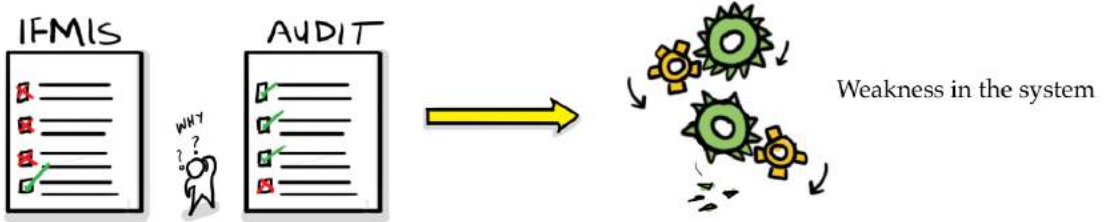
UNSUPPORTED EXPENDITURE



Validity of financial transactions ought to be verified through adequate supporting documents such as vouchers. Failure by the entities to fully support payments and or reconcile the records cast doubt on the authenticity of the reported expenditure and indicates weak internal controls and governance in the entities affected.

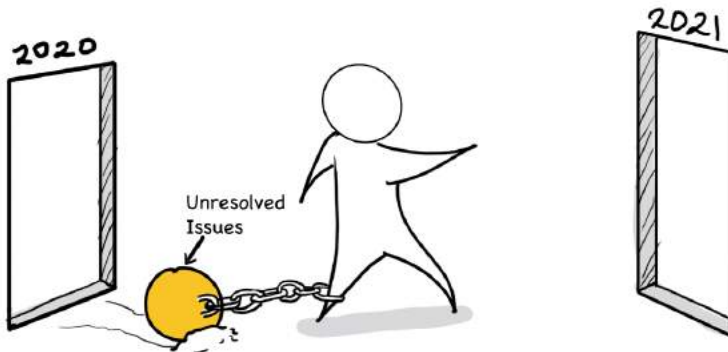
INEFFECTIVENESS AND INEFFICIENCY OF THE IFMIS

Balances reflected in the financial statements and amounts extracted from IFMIS have huge variances pointing to both control weaknesses in the system and transactions processed manually outside the system. The discrepancies are of material concern on the effectiveness and efficiency of the system. It may also be an indicator to lack of adequate internal controls and governance with no supervision nor consistent monthly reconciliations.



UNRESOLVED PRIOR YEAR AUDIT ISSUES

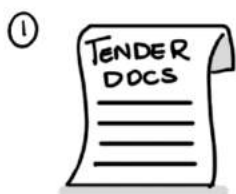
Numerous instances where prior year audit issues had not been resolved by the concerned entities. Such issues include, instances where no supporting evidence were availed. Failure to resolve audit issues may result in loss of public funds especially where the issues involve irregular use of public resources.



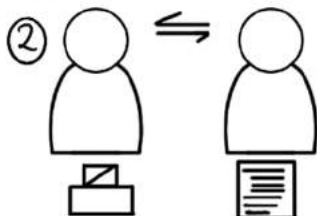
COMPLIANCE AND GOVERNANCE ISSUES

Non-compliance with the Public Procurement and Asset Disposal Act, 2015 and Disposal Regulations 2006.

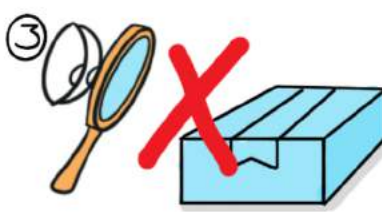
THE MAIN ISSUES:



① Contract and Tender documents were not provided



② Use of non-competitive procurement practices

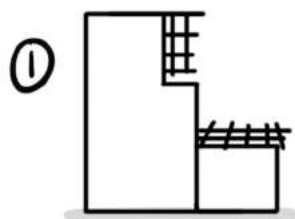


③ Goods received were not inspected



④ Irregular variations of contracts

VALUE FOR MONEY ISSUES



① Delays in project completion



② Unapproved over expenditures

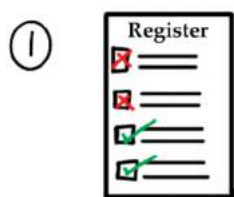


③ Idle cash in bank accounts



④ Unauthorized allowances

OTHER COMPLIANCE AND GOVERNANCE ISSUES



① Fixed assets registers not in existence or poorly maintained



② Non-establishment of Audit committees within MDAs



③ Ineffective Audit and Audit Committees



④ Non-establishment of IT Strategic Committees



⑤ Entities not maintaining documented enterprise wide risk management process

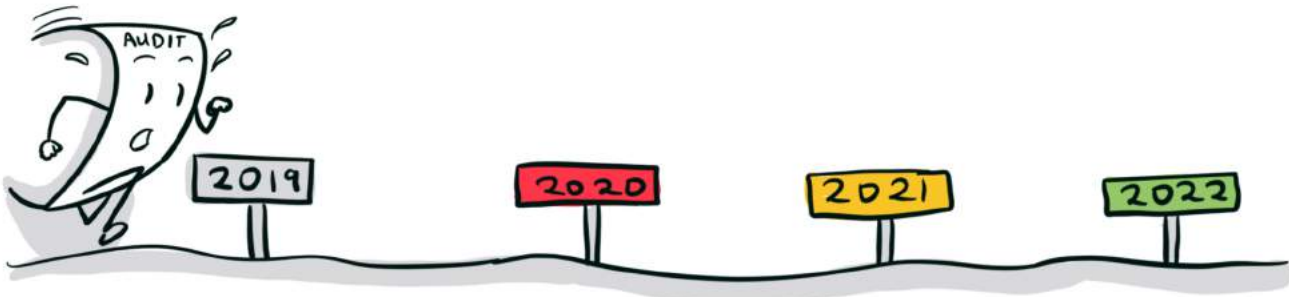
4.0. ADMINISTRATIVE ACTIONS AND SANCTIONS



Article 229(4) of the Constitution of Kenya mandates that within 6 months after the end of each financial year, the Auditor General shall audit and report on the accounts of any **entity** that is funded from public funds in respect of that financial year.

Once the Auditor General has prepared the audit reports, they are submitted to Parliament and relevant County Assemblies, who are then mandated to debate, consider the report and take appropriate action within three months after receiving an audit report.

See page 2 for the different entities covered.



However, the audit reports are not always prepared in a timely manner. For example, the most recent audit report as at June 2021 is the financial year 2019/20 audit report, indicating a lag of 2 years. The public entities are required to submit financial statements to the auditor general within three months after the end of the fiscal year. The lag is mostly attributed to failure by public entities to submit financial statements on time. Timeliness in audit report is needed to allow interrogation of the queried accounts to avoid continuous allocation of resources in subsequent budgets to entities flagged down. Public money should be spent in a prudent and responsible way as mandated under Article 201(d) of the Constitution.

THE AUDIT REPORT SHOULD IDENTIFY CASES IN WHICH:



Money has been spent in a way that was not efficient or economical;

The rules and procedures followed, or the records kept, were inadequate to safeguard property and collection of revenue;

Money that should have been paid to the exchequer account was not paid;

Money has been spent for purposes other than the purposes for which it was appropriated by Parliament;

Satisfactory procedures have not been established to measure and report on the effectiveness of programmes.



LEGAL PROVISIONS ON ADMINISTRATIVE ACTIONS AND SANCTIONS

PUBLIC AUDIT ACT 2015

This is an Act of Parliament that provides for the functions and powers of the Office of the Auditor-General in accordance with the Constitution. Where it is established that any entity is involved in fraud or corrupt practice, the Auditor General has the following powers:

1.

Sec. 64(1): The Auditor General is required to report to the police, EACC or the Public Procurement Oversight Authority (PPOA) for action.



2.

Sec. 64(2): Make a recommendation to the PPOA to debar the entity from future public procurement and asset disposal proceedings of a state or public entity.



Debarment is the exclusion from enjoying certain rights or privileges by legal means.



3.

Sec. 65: Recommend to Parliament or County Assemblies for payment of any deficiency by an entity in respect of any money or asset subject to the findings in the audit report.



4.

Sec. 66: Any person who is convicted of an offence under the act shall not be eligible to hold office or work with an entity owned in whole or part by the state for a period of ten years following the conviction.



A fine not exceeding two million shillings or imprisonment not exceeding one year or both is also imposed under sec.66.



5.

The Auditor General can also recommend to Parliament or County Assembly the withholding of funds to any state or public entity where there is a serious breach of the provisions of the Act.



PUBLIC FINANCE MANAGEMENT ACT 2012

Section 204 of the Public Finance Management Act 2012 provides various sanctions that the Cabinet Secretary for finance may apply to a public entity that fails to address issues raised by the Auditor General to the satisfaction of the Auditor-General. The sanctions include:

1. Imposing on the entity reporting requirements additional to those required by this Act or any other written law.
2. Suspending the ability of the entity to reallocate funds.
3. Withholding from the entity funds to which the entity would otherwise be entitled under the Constitution or this Act.
4. Suspending the entity's authority to borrow money.
5. Treating any accumulated liabilities as a charge on the entity's future revenues.
6. Appointing one or more administrators to administer the entity's financial affairs for such period as may be specified in the appointment.



ADDITIONAL POINTS:

- Section 199: Prison term of up to five years or a fine of up to Kshs. 10 million for a person who is found guilty of an offence under the Act.
- Section 202: Personal responsibility is placed on public officers for any loss sustained by the national government that can be attributed to the fraudulent or corrupt conduct, or negligence, of the officer.
- Sec. 202 (2): The National Treasury can initiate civil proceedings to recover damages from a public officer for any loss for which the officer is liable for under the subsection.

CONSTITUTION OF KENYA 2010

THIS IS THE WAY

Chapter 12 provides guidelines on the control of public funds. Article 225(2) mandates Parliament to enact legislation to ensure expenditure control and transparency in all governments, and to establish implementation mechanisms.

Legislation may authorize the Cabinet Secretary for finance to stop transfer of funds to a state or public entity that is convicted of violating principles of public finance.

The CS may not stop the transfer of more than 50% of funds. This is to ensure that county governments can continue execution of functions and service delivery as interrogation takes place.

The decision to stop transfer of funds is limited to sixty days and Parliament may renew the decision to stop funds, sixty days at a time. For renewal, Parliament will do so only after the Controller of Budget has presented a report on the matter to parliament and the public entity in question has been given an opportunity to answer allegations against it and state its case before the relevant Parliamentary committee.



CS FINANCE



VIOLATED PUBLIC FINANCE PRINCIPLES



NO MORE THAN 50%



LIMITED TO 60 DAYS

CITIZENS' ROLE IN THE PUBLIC AUDIT PROCESS

HOW CAN CITIZENS CONTRIBUTE TO THE PUBLIC AUDIT PROCESS

1.



Partner with the OAG to sensitize the public about the public audit process to create interest in the process and the findings from the audit reports.



2.

The audit reports can be bulky for some to read and citizens can prepare sector specific short versions to increase citizen participation in the public audit process.



3.

Conduct evidence based media trainings. Media is an important tool that can play a critical role in creating public interest in the findings of the audit reports.

4.



Use of infographics, short videos, tweet chats and other social media platforms for dissemination of public audit reports. This will increase the audience outreach and create public discourse around the findings of the report.



5.

Increase advocacy initiatives and strategies towards enhancement of public audit function.

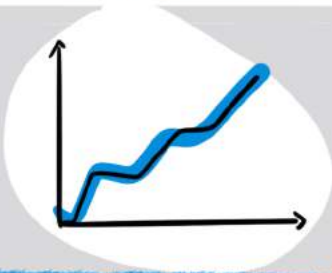
6.



The audit reports are prepared at the end of the financial year and is the last stage in the budget cycle. Citizens can scale up social audits and budget implementation auditing.

5.0. KEY MESSAGES.

1.



In 2019/20, there was an overall improvement in the way the financial statements were prepared.

This is attributed to use of IFMIS, guidance by the National Treasury through circulars and issuance of reporting templates to Ministries, Departments and Agencies (MDAs) by the Public Sector Accounting Standards Board (PSASB). The presentation of the financial statements is however, still below expectations when viewed holistically.

4.



Unresolved prior year audit issues and the lag in the timing of the Audited Accounts:

The audit also revealed numerous instances where prior year audit issues had not been resolved. Failure to resolve audit issues may result in loss of public funds especially where the issues involve irregular use of public resources.

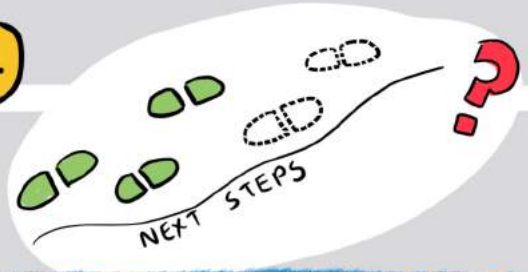
2.



The benefits of IFMIS are yet to be fully realized.

Numerous instances are noted where balances reflected in the financial statements and amounts extracted from IFMIS had huge variances when ordinarily the balances should be the same thus casting doubt on the accuracy of the system.

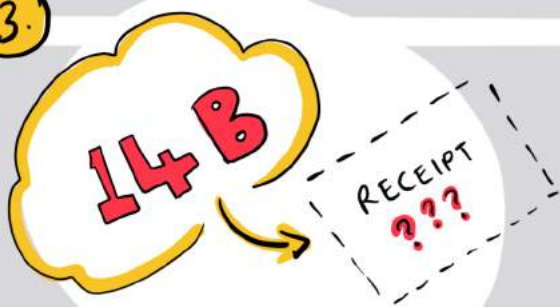
5.



Inadequate follow-up on audit recommendations:

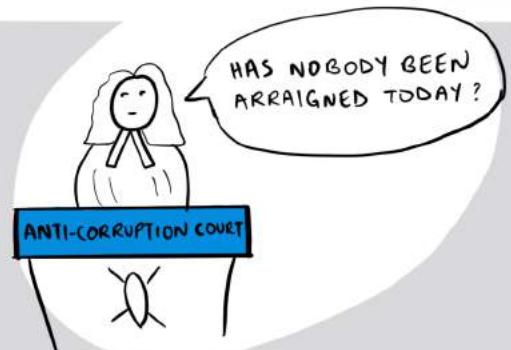
There is inadequate effective mechanisms (both at the oversight institutions such as National Assembly and also within the respective MDAs) to enhance follow up on the implementation of audit recommendations to address the recurrence of audit queries in subsequent audit reports due to lack of adequate action.

3.



Unsupported expenditure: In 2019/20, expenditure worth Ksh 14 billion was without supporting documentation thus casting doubt on the authenticity of the reported expenditure. It is also an indication of weak internal controls and governance in the entities affected.

6.



Failure to enforce the requisite sanctions

has led to perennial failure by some Accounting Officers to adequately account for the management and use of public resources.

5.0. KEY MESSAGES.

7.



Under-absorption of the budget has been on average at 8.2% of the gross estimated expenditure in the last 5 years implying that some development programmes and delivery of services were not implemented as planned. This has mainly been caused by overoptimistic revenue targets leading to shortfalls in revenue and hence delays in the disbursements to respective entities.

8.



State Owned Enterprises (SOEs) have continued to receive additional loans from government even when they are underperforming, thereby casting doubt on the criteria used to determine the advancement of additional loans.

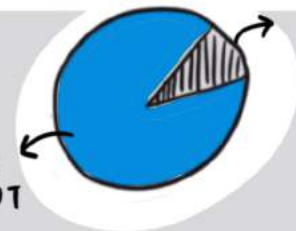
9.



Various Ministries, Departments and Agencies (MDAs) are encumbered by huge pending bills, mainly attributed to inadequate exchequer releases and lack of vital supporting documents such as purchase orders, delivery notes, inspection and acceptance certificates among others. Failure to settle the bills during the year to which they relate adversely affects the subsequent year's budgeted programmes as it may lead to reallocation of funds or non-delivery of critical services.

10.

MOSTLY IN AGREEMENT

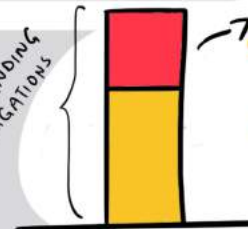


A FEW ISSUES

Majority of the public entities both among the MDAs obtained qualified opinion. This implies that most of the financial transactions are to a large extent in agreement with the underlying records, except for cases where material misrepresentation of facts or omissions are noted in the financial statements. The issues though material, are not widespread or persistent.

11.

OUTSTANDING OBLIGATIONS



UNDERSTATED BY

159.4
BILLION

Outstanding obligations guaranteed by the Government of Kenya reflected in the statement submitted for audit by the National Treasury was understated by Ksh 159.4 billion meaning that accuracy of the total Government Guaranteed debt could not be confirmed which is in breach of Sections 81 (1) and 81 (2) (c) of the Public Finance Management Act, 2012.

6.0. RECOMMENDATIONS

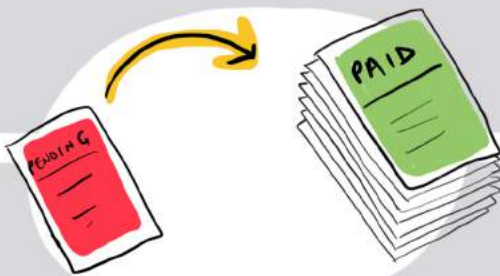


1.



The National Treasury in collaboration with relevant stakeholders should ensure that the financial statements and reporting templates are configured to conform with the IFMIS system in order to enhance accuracy in the financial controls and reporting.

2.



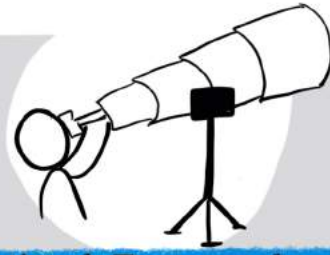
MDAs should put in place strict measures to minimize the occurrence of pending bills. Failure to settle the bills has had an effect of withholding circulation of cash in the economy and affected smooth operations of suppliers and Small Medium Enterprises (SMEs).

3.



The National Treasury should address issues pertaining to the maintenance of the public debt records. The issues include: comprehensive maintenance of loan registers, reconciliation of the variances between figures reflected in the loan registers, other supporting schedules and the financial statements and providing supported prior years' adjustments.

4.



The National Treasury should ensure more realistic and effective forecasts of revenue and cash flows. The revenue shortfall contributes to delayed Exchequer releases and budget under-absorption. To enhance the quality and accuracy of fiscal forecasting, there is need for greater coordination between Treasury and other stakeholders contributing critical information and macro-economic data for fiscal forecasting, especially the Kenya Revenue Authority (KRA).

5.



MDAs should adopt a more rigorous criteria in determining the advancement of additional loans. This is important in order to minimize on awarding loans to underperforming institutions which has led to continued write offs of the loans as bad debts and eventual loss of public funds.

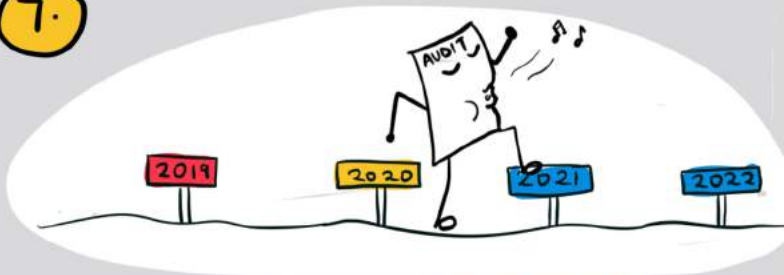
6.



The National Treasury should ensure that the outstanding obligations guaranteed by the Government of Kenya are accurate. This is key in presenting a true picture of the total Government Guaranteed debt as required by Sections 81 (1) and 81 (2) (c) of the Public Finance Management Act, 2012.

6.0. RECOMMENDATIONS

7.



Ensure Unresolved Prior Year Audit Issues are addressed and the lag in the timing of the Audited Accounts reduced. National Assembly should put in place measures to ensure that audit reports are approved and reviewed at least within a year which is instrumental in ensuring that the unresolved prior year issues are adequately addressed.

8.



CSOs should put more pressure on the MDAs and agencies such as EACC to develop an effective mechanism for following up on the implementation of audit recommendations. This is as required by Section 204(1)(g) of the PFM Act 2012 in order to ensure that audit queries do not recur in subsequent audit reports due to lack of adequate action.

9.



Early warning systems: CSOs and academia can utilize administrative data, such as quarterly Budget Implementation and Review reports, and other data in databases such as the Public Procurement Information Portal, to develop risk indicators that can act as early warning systems.

10.



Enhance political goodwill: MDAs together with Parliament and oversight institutions need to enhance their goodwill in order to collectively ensure adherence to the rule of law with regards to financial reporting and accountability.

The Institute of Economic Affairs is a public policy think tank which seeks to promote pluralism of ideas through open, active and informed debate on public policy issues by conducting policy research and analysis. IEA is independent of political parties, pressure groups and lobbies, or any other partisan interests.

With support from



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