REPUBLIC OF KENYA

PARLIAMENT

THE SENATE

TWELFTH PARLIAMENT

REPORT OF THE STANDING COMMITTEE ON FINANCE AND BUDGET

ON

THE DIVISION OF REVENUE BILL (NATIONAL ASSEMBLY BILLS NO. 3 OF 2020)

CLERK CHAMBERS
THE SENATE
PARLIAMENT OF KENYA
NAIROBI

APRIL 2020

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PREFACE

Mandate and Functions of the Committee

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

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

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

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

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

Membership of the Committee

The Committee was constituted by the House on Thursday 14th December, 2017, during the First Session of the Twelfth (12th) Parliament. The Committee as currently constituted, comprises the following Members-

1. Sen. (Eng) Mohamed M. Mahamud, CBS,MP - Chairperson
2. Sen. (Dr) Isaac Mwaura, CBS, MP - Vice Chairperson
3. Sen. Wetang'ula Moses Masika, EGH, MP - Member
4. Sen. Mutula Kilonzo Junior, MP - Member
5. Sen. Aaron Cheruiyot, MP - Member
6. Sen. (Dr.) Ali Abdullahi Ibrahim, CBS, MP - Member
7. Sen. (Dr) Rose Nyamunga, MP - Member
8. Sen. Boniface Mutinda Kabaka, MP - Member
9. Sen. CPA Farhiya Haji, MP - Member

BACKGROUND AND EXECUTIVE SUMMARY

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

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

The Division of Revenue Bill, (National Assembly Bills No. 3 of 2020 was published and introduced in the National Assembly. The National Assembly passed the Bill on 17th March, 2020.

Following the passage by the National Assembly, the Division of Revenue Bill (National Assembly Bills No. 3 of 2020), was submitted to the Senate for concurrence.

The Bill was read a First Time in the Senate on Tuesday, 31st March, 2020, and thereafter stood committed to the Standing Committee on Finance and Budget pursuant to standing order 140 (1) of the Senate Standing Orders for consideration and facilitation of public participation.

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

The Bill provides for the division of nationally raised revenue between the two levels of government as well as setting out specific resources to be provided to counties as conditional grants and loans, and the Equalization Fund. In addition, the Bill is accompanied by an explanatory memorandum as required in Article 218(2) of the Constitution. The memorandum sets out the explanation of revenue allocation as proposed by the Bill along with the evaluation of the Bill in relation to the criteria mentioned in Article 203(1) of the Constitution. It also provides a summary of any significant deviation from the recommendations from the Commission on Revenue Allocation with an explanation for each such deviation.

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

The Bill proposes follows-

a) Shareable revenue Kshs. estimated at Kshs 1,856.7 billion which is proposed to be shared as below
    i) National Government Kshs. 1,533.41 billion of which Kshs. 13.73 billion is given to counties as Conditional allocations;
    ii) County Equitable Share Kshs 316.5 billion;
    iii) Equalization Fund – Kshs 6.78 billion;
b) Road Maintenance Fuel Levy Fund Kshs. 9.43 billion; and
c) Additional Conditional allocations (loans & grants from Development Partners) Kshs. 30.20 billion

The Bill also has an allocation to Nairobi City County form the County Equitable Share and proposes that this intended allocation be retained in the Consolidated Fund. This is allocation would be used to fund the functions which Nairobi City County transferred to National Government.

Committee's Recommendations

The Committee recommends that the bill be approved with amendments as follows-

Clause 4

(a) deleting subclause (2); and

(b) deleting subclause (3).

Consequently, the Schedule to the bill be amended by deleting the allocation set aside for Nairobi City County.

Acknowledgements

The Committee acknowledges the Commission on Revenue Allocation, Institute of Certified Public Accountants (ICPAK), International Budget Partnership (IBP), Open Governance Institute (OGI), Expertise Global Consulting Ltd and members of the public who made insightful contributions and recommendations to the Bill. Further, the Committee thanks the Offices of the Speaker and Clerk of the Senate for the support extended to the Committee in execution of its mandate.

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

It is now my pleasant duty and privilege, on behalf of the Standing Committee on Finance and Budget, to present to the Senate, this Report of the Committee on the Division of Revenue Bill (National Assembly Bills No. 3 of 2020).

SIGNED: ……………………………………………………………………………………

SEN. (ENG) MOHAMED M. MAHAMUD, CBS, M.P.

(CHAIRPERSON, STANDING COMMITTEE ON FINANCE AND BUDGET)

Date: ……8/07/20……………………………………………………

8 |*Report on division of Revenue Bill (National Assembly Bills No. 3 of 2020)*

Adoption of the Report

Pursuant to standing order 213 (2) of the Senate Standing Orders, the Senate Standing Committee on Finance and Budget Committee adopted the report on Division of Revenue Bill, (National Assembly Bills No. 3 of 2020). The Members of the Committee hereby affix their signatures to this Report to affirm the support for the Report –

Sen. (Eng) Mohamed M. Mahamud, CBS, MP	-Chairperson
Sen. (Dr) Isaac Mwaura, CBS, MP	-Vice Chairperson
Sen. Wetang'ula Moses Masika, EGH, MP	- Member
Sen. Mutula Kilonzo Junior, MP	- Member
Sen. Aaron Cheruiyot, MP	- Member
Sen. (Dr.) Ali Abdullahi Ibrahim, CBS, MP	- Member
Sen. (Dr) Rose Nyamunga, MP	- Member
Sen. CPA Farhiya Haji, MP	- Member
Sen. Boniface Mutinda Kabaka, MP	- Member

CHAPTER ONE

1.0 VERTICAL ALLOCATION OF REVENUE FOR FINANCIAL YEAR 2020/21

HIGHLIGHTS OF THE DIVISION OF REVENUE BILL, 2020

1. Article 218 of the Constitution provides for the submission of the Division of Revenue Bill and the County Allocation of Revenue Bill to Parliament, at least two months before the end of each financial year. The Division of Revenue Bill divides revenue raised by the national government among the two levels of government while the County Allocation of Revenue Bill divides among the counties the revenue allocated to the county governments as equitable share. The Division of Revenue Bill further sets out specific resources to be provided to counties as conditional grants and loans, and the Equalization Fund.

2. In addition, section 191 of the Public Finance Management (PFM) Act, 2012, provides that each year when the Budget Policy Statement (BPS) is introduced, the Cabinet Secretary shall submit to Parliament a Division of Revenue Bill and County Allocation of Revenue Bill prepared by the National Treasury for the financial year to which that Budget relates.

3. The adoption of the BPS Report by both Houses paved way for the publication and subsequent introduction of the Division of Revenue Bill, 2020 in National Assembly.

4. The Division of Revenue Bill (National Assembly Bills No. 3) was published on 9th March, 2020 and passed by the National Assembly on 17th March 2020. The total shareable revenue for the FY 2020/2021 is estimated at Kshs 1,856.7 billion proposed to be allocated as follows

- **a)** National Government — Kshs. 1,533.41 billion
- **b)** County Equitable Share — Kshs 316.5 billion

c) GoK Conditional allocations Kshs. 13.73 billion;

d) Road Maintenance Fuel Levy Fund Kshs. 9.43 billion

e) Additional allocations (loans & grants) Kshs. 30.20 billion.

f) Equalization Fund – Kshs 6.78 billion

1.1 Equitable Share of Revenue

5. Pursuant to Article 202 of the Constitution, the nationally raised revenue is shared equitably among the national and county governments. Article 203 (2) further stipulates that the equitable share of the revenue raised nationally that is allocated to county governments shall be not less than fifteen per cent of all revenue collected by the national government and shall be calculated on the basis of the most recent audited accounts of revenue received, as approved by the National Assembly. The proposed Equitable Share for FY 2020/21 is Ksh. 316.5 billion which is equivalent to 23.3 percent of the last audited accounts **(Ksh 1,357,698 million for FY 2016/17)** as approved by the National Assembly.

6. In calculating the County Governments' equitable revenue share allocation for FY 2020/21, the following factors have been put into consideration;

(i.) Continued underperformance in ordinary revenue, which forms the base for the annual division of revenue;

(ii.) The fact that the National Government continues to solely bear shortfalls in revenue in any given FY;

(iii.) There being a Ksh 161 billion funding gap in the FY 2019/20 budget;

(iv.) A 10.3% projected contraction in National Government's net spending in FY 2020/21 vis-à-vis FY 2019/20; and

(v.) The proposal by National Treasury that the entire incremental revenue in FY 2020/21 be earmarked for CFS, specifically debt repayment and pensions.

1.2 GOK Conditional Allocations to County Governments

7. Article 202(2) of the Constitution stipulates that the County Governments may be given additional allocations from the National Governments share of revenue either conditionally or unconditionally. In line with these provisions the Bill, proposes to allocate **Kshs. 23.16 billion** for the following additional conditional allocations to support specific national policy objectives to be implemented by County Governments:

   (i.) Additional Conditional Allocation to facilitate the leasing of medical equipment of **Kshs 6.20 billion**;

   (ii.) Additional Conditional allocation for level-5 hospitals of **Ksh. 4.33 billion**.;

   (iii.) Additional Conditional allocation of **Kshs. 900 million** to compensate county health facilities for user fees foregone.

   (iv.) Additional Conditional Allocation for Rehabilitation of Youth Polytechnics of **Kshs. 2.00 billion**:

   (v.) Additional Conditional allocation to supplement county allocation for the construction of county headquarters of **Kshs. 300 Million** in five counties; and

   (vi.) Additional Conditional Allocation from the Road Maintenance Fuel Levy Fund of **Ksh. 9.43 billion**.

1.3 Additional Conditional Allocations (Loans & Grants)

8. County Governments also receive conditional allocations from development partners which are disbursed through State Departments at the National Government level according to the respective financing agreements and in fulfilment of the set conditions. In the FY 2020/21, the following additional conditional allocations amounting to **Kshs. 30.20 billion** will be transferred to counties in the form of loans and grants;

   (i.) Transforming Health Systems for Universal Care Project conditional allocation of **Kshs. 4.34 billion** (World Bank credit);

(ii.) DANIDA-Universal Healthcare for Devolved System Program of **Kshs. 900 million**;

(iii.) National Agricultural and Rural Inclusive Growth Project; NARIGP of **Kshs. 4.26 billion** (World Bank credit);

(iv.) Kenya Urban Support Program (KUSP) – Urban Development Grant (UDG) additional conditional allocation of **Kshs.6.36 billion;**

(v.) Kenya Devolution Support Program (KDSP) County Capacity Building ("level 1") Grant of **Kshs. 2.15 billion;**

(vi.) EU-Instruments for Devolution Advice and Support (IDEAS) grant of **Kshs. 216 million;**

(vii.) IDA (World Bank) **-** Kenya Climate Smart Agriculture Project (KCSAP) of **Kshs. 7.12 billion;**

(viii.) IDA – Water and Sanitation Development Project (WSDP) World Bank Credit of **Kshs. 3.4 billion;**

(ix.) Agricultural Sector Development Support Programme (ASDSP) II- **Kshs. 652 million;**

(x.) EU- Water Tower Protection and Climate Change Mitigation and Adaptation Programme (WaTER) **- Kshs. 528 million;**

(xi.) Drought Resilience Programme in Northern Kenya (DRPNK) **- Ksh. 300 million.**

1.0 IMPLICATIONS OF THE NAIROBI CITY COUNTY TRANSFERRED FUNCTIONS

9. In accordance to Article 187(2) of the Constitution and Gazette Notice No. 1609 of 25th February 2020, some functions of the Nairobi City County (NCC) as given in schedule four of the Constitution were transferred to the National Government.

10. The County Governments have a preserve of 14 functions out of which four functions have been transferred, while ten functions have remained with the Nairobi county government. The details of the functions transferred from Nairobi County to the National Government is shown in table 1

Table 1: Breakdown of Nairobi City County transferred functions

S/No	Transferred functions	Details
1.	County Health Services	i.) County health facilities and pharmacies ii.) Ambulance services iii.) Promotion of primary health care iv.) Licensing and control of undertakings that sell food to the public v.) Veterinary services (excluding regulation of the profession) vi.) Cemeteries, funeral parlours and crematoria vii.) Refuse removal, refuse dumps and solid waste disposal
2.	County Transport Services	i.) County roads ii.) Street lighting iii.) Traffic and parking iv.) Public road transport v.) Ferries and harbours, excluding the regulation of international and national shipping and matters related thereto
3.	County Planning and Development Services	i.) Statistics ii.) Land survey and mapping iii.) Boundaries and fencing iv.) Housing and v.) Electricity and gas reticulation and energy regulation
4.	County Public Works, Utilities	i.) Storm water management systems in built-up areas ii.) Water and sanitation services

	and Ancillary services	

Source: Constitution of Kenya, Gazette Notice No. 1609 of 2020

11. Article 187 (2) (a) of the constitution requires that arrangements are put in place to ensure that the resources necessary to undertake or perform the functions transferred is provided. The Nairobi County has three main sources of revenue which are the equitable share, conditional grants and own source revenue.

12. The BPS 2020 was approved by the Senate on 27th February, 2020. For the FY 2020/21 the House approved a quantum amount of Kshs. 316.50 billion as equitable share going to counties. This is similar to the amount provided as county equitable share for the FY 2019/20. If the formula for sharing resources remains the same, and considering the fiscal effort, the Nairobi City County has a proposed allocation of **Kshs. 15.95 billion** as equitable share for the FY 2020/21.

13. It is important to note that the transferred functions may have budgetary allocation which is higher than what the county is expected to receive from the equitable share. Thus, part of the financing of the transferred function would be through Nairobi City County Own Source Revenue (OSR).

14. Article 207 (1) of the Constitution establishes a revenue fund for each county government into which shall be paid all money raised or received by or on behalf of the County Government. The Nairobi County own source revenue is remitted to the county Revenue fund. It is therefore important to develop a framework that transfers the monies received from Own Source Revenue which is meant to fund the transferred functions to the National Government.

CHAPTER TWO

2.0 SUBMISSIONS FROM STAKEHOLDERS

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

STAKEHOLDER	OBSERVATIONS AND RECOMMENDATIONS
Joint Submission by the International Budget Partnership-Kenya, The Institute for Social Accountability (TISA) and Institute of Certified Public Accountants of Kenya -ICPAK	**Despite devolution being a key aspect of service delivery in Kenya, the allocations to the county governments have been declining**. This is despite the fact that the growth in national revenue has remained stable over the last six years. FY 2020/21 will see a zero per cent growth in allocations. This does not reflect the increased growth in demand for services at that level of governance, especially with resource demands under the Big Four and emergent risks to the country's economy. They proposed that Parliament arrests this state.
	The realism of the revenue forecast remains a gamble. The organizations noted that revenue forecasts at both national and county level were ambitious and often led to budget deficits. This was exacerbated by the failure by the Tax Authority to meet the set targets over the years. This would need to be further revised due to the effect of COVID-19 to Kenya's economic productivity. This situation is mirrored at the County Government level where Counties collection of own revenue has been uncertain. Available data shows that only 13 out of 47 counties can meet more than 10 per cent of their annual budget from their own sources of revenue. This means that into the foreseeable future, they will be dependent on the national transfers and hence the more reason to safeguard the allocations.

STAKEHOLDER	OBSERVATIONS AND RECOMMENDATIONS
	There is no clear growth factor on the division of revenue allocation basis, and this leaves it to individual actors in the national government to decide how much should be allocated to county governments. The Organizations proposed that the growth factor or the criteria for determining the same be established. As a minimum, allocations to county governments should be informed by the average year on year growth of ordinary national revenue for 3 years.
	The allocation process for functions that were transferred by Nairobi City County to the National Government is opaque and explanations are inadequate. The Division of Revenue makes proposals on how to handle the funding for functions that were transferred to the national government to run them. These proposals do not give a clear and practical direction of how county revenue would be handled where functions will be run by two separate levels of government. Therefore, there are some challenges to the approach and the level of details provided on this issue that the Senate needs to address: **(i) Unconstitutional Retention of Equitable Share Allocation:** The DOR proposes to retain the full equitable share for Nairobi in the consolidated fund which would be in violation of Article 207 of the Constitution of Kenya and Section 109 of the Public Finance Management Act. These PFM related laws create the County Revenue Fund and direct its management and instances when county funds can be exempted from being remitted in the County Revenue Fund. Transfer of functions between two levels of government do not fall under the given exemptions. Nairobi City

STAKEHOLDER	OBSERVATIONS AND RECOMMENDATIONS
	Government thus has full responsibility on any revenue raised on its behalf including transfers under the equitable share. Any transfer of monies from the county should therefore be from the County Revenue Fund. **(ii) Adherence to Funding Follows Function Principle** The county transferred four functions, namely, health, transport, planning and development, public works, utilities and ancillary functions to the national government according to the Deed of Transfer, Gazette dated 25th February 2020. This means the county still has budgetary responsibilities to run ten other functions that remain under its management. Therefore, the proposal to retain all funds in the consolidated account leaves a lot of confusion on how the other services will be funded. **(iii) Spending levels for the transferred functions** The process notwithstanding the amount to be withheld by the national government at KES. 15.9 Billion seems to be on the higher side. Spending levels for the four functions over the last 4 years show that the amounts have been lower. Further, there is a huge variance between approved estimates and actual expenditures in Nairobi County. As such the amounts to be transferred should be based on the actuals and for which the proposed KES. 15.9 billion would be on the higher side. **(iv) Conditional Grants for Transferred Functions** Given the separation of powers principle in devolved governance and assignment of functions under Schedule Four of the Constitution, the organizations proposed that the bill's Section 4 (3) (a) be amended to make the transfer of the monies to the national government as conditional grants

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	for the performance of the transferred functions. Amend the section to read as follows: *4(3) "For avoidance of doubt where the transfer of functions is –* *(a) From a county government to the national government, the requisite funds shall be retained in the consolidated fund for appropriation respective County Revenue Fund and transferred to the national government as conditional grants to meet the costs of the transferred functions"* This would be in line with Article 187 (2) of the constitution that leaves the constitutional responsibility for the delivery of the transferred function with the level it is assigned to in the Fourth Schedule of the Constitution. **(v) Amendment to the PFM Act** Given the confusion this has created, the PFM Act section 109 should be amended to make provisions for the resourcing of transferred functions. Specifically, the transfer should be as a conditional grant from the government transferring the function
	The conditional grants have been maintained even though the criteria of how they are set up and the conditions for their use remains unclear: concerns a) There seem to be no clear criteria as to how they are set up. A closer look at them indicates that they are to facilitate functions that are assigned to the counties by the constitution. As such the resources should be part of the unconditional share for the county governments. b) There is no clarity of the conditions of how the resources are to be utilized once they are at the county level or a clear monitoring framework that can

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	be followed even by citizens. As a result, it is impossible to establish if the objectives they are supposed to actualize have been accomplished. c) How they grow from one year to another is unclear, and the process of their disbursement to counties is uncertain. Some like compensation for user fees foregone has remained the same for the 6 years, and this does not reflect the demand for primary health care. Generally, the growth and decline in allocations to conditional grants seem as arbitrary as the equitable share. This makes medium-term budgeting at the county level quite difficult due to unpredictability in the allocations at the point when counties are working through their County Fiscal Strategy Papers.
	There is a need for publicly available information on the performance of each conditional grant from the national government's share of revenue to provide oversight on the execution of the grants at the county level. It is noteworthy that the recipients of conditional grants are required to submit reports, and thus the national treasury should ensure that this performance information is included in DORA. Such information would include; the amount of grants previously received, the status of fiscal gap, how they performed in terms of spending and absorption over the years. The reports should also report on attainment of Key Performance Indicators.
	Public debt, pensions and other charges of the consolidated fund services are crowding out the amount available for the division of revenue and hurting counties allocation. Further, while public borrowing has a very direct impact on the size of the sharable revenue, the National Treasury remains the only body that decides on this vital national instrument.

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	The recommendation was therefore that counties and the Senate should be involved in the discussion on national borrowing as that has an impact on the revenue that is shared between the two levels of government.
	Pensions and other CFS Services have equally grown, and their administration is of concern. Pension is a non-discretionary obligation which has a bearing on the size of revenue that is eventually shared between the two levels of government. The higher the share of ordinary revenue that is taken up by these national obligations, the lower the sharable revenue and allocations to counties.
	A mechanism for cushioning cities and urban areas still needs to be established. CRA recommended a KES. 5 billion conditional grant for the 5 cities of Nairobi, Mombasa, Kisumu, Nakuru and Eldoret. While this has not been allocated for, Parliament needs to relook the matter. These cities continue to bear the heavy costs of service delivery given their populations and are critical centres for economic growth in the country and their regions.
	Significance of Audited Financial Statements in the division of revenue should be underscored. The DORB 2020 uses the 2016/17 audited accounts as the most recent, yet the Auditor General finalized and submitted to Parliament reports up to FY 2017/18. The use of FY 2017/18 audited accounts will guarantee a higher minimum allocation. ICPAK, TISA and IBP-K proposed an amendment to the Public Finance Management Act to rectify that situation as follows: *The National Assembly shall within three months after receiving an audit report adopt and approve the report; Where the audit report is not adopted and approved by the National Assembly within the three months, it shall be deemed as the most recent audited accounts for purposes of division of revenue.*

STAKEHOLDER	OBSERVATIONS AND RECOMMENDATIONS
	Lack of transparency, accountability and meaningful public engagement has affected the division of the revenue process Although Parliament has embraced public participation in the legislative process and made efforts towards facilitating public participation, public engagement in the division of revenue process is not effective but tokenistic and inconsequential in the ultimate decision-making process. There is a need for clear guidance on how the public should engage during the division of the revenue process in a manner that they can influence decisions made and the kind of information that government institutions should provide to enable the citizens to engage accordingly. In addition, a feedback mechanism is required informing on how submissions and inputs from the public are handled. Further, pursuant to Article 201 and section 35(2) of the Public Finance Management Act the cabinet Secretary should enact regulations to provide for meaningful public participation in the national budget and include sanctions for failure to undertake meaningful public participation in the budget process including division of revenue process.
	Budget Transparency is critical for the objective division of revenue The lack of a clear definition and objective criteria for determining national interest has been exploited by the national government to starve counties of resources. Additionally, the framework for the management of conditional grants continues to be weak and indeed does not meet the constitutional requirements for fiscal prudence and transparency. On performance evaluation, there is a need to ensure that funds are traceable to avoid double funding and blurring of reporting. National departments must

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	report to Parliament the outcome of grants allocated for a specific purpose. Inclusion of an implementation work plan and monitoring and evaluation mechanism in the existing framework for the management of conditional grants would go a long way. Finally, further allocations and introduction of conditional grants should be based on past performance data.
	The leasing medical equipment repayments allocation amounting to Kshs. 6,205,000,000/- should be stopped and classified as odious debt on account of queries raised by the Auditor General and Senate Finance Committee. A report by the Institute for Economic Affairs reviewing the office of the Auditor General reports revealed that the lawfulness and accuracy of expenditure amounting to Kshs. 4.57 billion on the leasing of medical equipment project could not be verified due to lack of important supporting documents, such as the contract, the Attorney General's legal opinion on the contract, the procurement and the progress reports were not availed during the audit review process. Additionally, numerous audit queries have been raised regarding the operationalization and implementation of the MES project by county governments. These include ineffective and unlawful utilization of public funds allocated to implementation of the MES project; violation of the financial laws and regulations, including unlawful procurement processes; the total amount of the lease (rental payments deducted at the source) for the respective counties; lack of supporting documents. The numerous audit queries imply that the value for money could not be ascertained regarding the medical equipment delivered but remain idle or those that have been paid for but not delivered

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	It was therefore the considered view of the stakeholders that the MES project was solely crafted as a corruption scheme to benefit corrupt individuals on the pretext that it would meet the health care needs of the population, and as such Kenyans ought not to be saddled by its debt. Instead, the people responsible, companies contracted, and government officials involved, ought to be prosecuted for their actions or inaction. It should be classified as odious debt because it was contracted and spent against or not in the interests of the people of Kenya, without their consent, and with full awareness of the government.
Expertise Global Consulting Ltd (EGCL)	**Schedule 4 on Equalization Fund: Ksh.6.7billion provided towards the fund** a) The allocation should be disbursed directly in the form of a conditional grant to the affected counties as guided by the marginalization policy developed by the Commission on Revenue Allocation and as per the High Court judgement of 12th November 2019 on the appropriation of the Fund. b) The allocation should not be appropriated by the national government until the High Court judgement and recommendation on the need to prepare new administration guidelines are adhered to. c) Parliament should urgently institute a special audit through the office of the Auditor General to review the expenditures associated with the Fund.
	Schedule 4 on Nairobi City County Equitable share to cater for transferred function: Ksh.15.9billion provided for exclusion from

STAKEHOLDER	OBSERVATIONS AND RECOMMENDATIONS
	the total counties' equitable share of revenues. Amount to be retained in the consolidated fund to meet part of the cost of the functions transferred to the national government. a) The Nairobi City County Equitable share of allocation should directly be disbursed to the County's Revenue Fund account without any deduction as mandated by the constitution under Article 219. b) Appropriation for the transferred functions to be done through the County's budget and Appropriation Act passed by the County Assembly as mandated by the Constitution and the PFM Act 2012. c) Allocations for the implementation of the transferred functions should directly be disbursed through the County Revenue Fund Account to the Nairobi Metropolitan Services.
	Schedule 4 on the Grant towards Level 5 hospitals: Ksh. 4.3billion provided for support of the level 5 hospitals Expand the allocation to the additional gazetted level 5 hospitals. The Allocation has consistently since 2014/15 targeted 11 facilities without consideration of newly gazetted Level 5 facilities such as the Bungoma Level 5 Hospital.
Commission on Revenue Allocation (CRA)	Given the non- performance of revenues and the likely poor performance of revenues in financial year 2020/21 that may arise from the impact of COVID-19 pandemic on the economy, **the Commission has no objection to the proposal of equitable share allocation to county governments at Ksh. 316.5 billion.** An allocation of Kshs.316.5 billion is equivalent to 23 per cent of the most recent audited approved accounts for financial year 2016/17 and therefore

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	meets the provision of Article 203(2) of the Constitution of allocation at least 15 per cent.
	The Commission recommended for a new conditional grant of Ksh. 5.0 billion to finance cities, in line with the provisions of the Urban Areas and Cities Act. The five cities namely: Nairobi, Mombasa, Kisumu, Nakuru and Eldoret are centres of economic growth that provide unique services such as provision of sewerage systems, water reticulation, solid waste disposal, and storm water drainage and management to the residents be given additional resources. The COVID-19 pandemic, though a health crisis, has brought to the fore the dire situation of collapsed infrastructure in the urban informal settlements. These include; increased respiratory infections in slums, heaps of garbage, poor sanitation, lack of roads, lack of clean water, and poor drainage, among other challenges. The Senate needs to set up a grant to provide infrastructure in urban informal settlements.
	Transfer of functions of the Nairobi City County to the National Government The National Assembly DORB 2020, allocates the entire of Nairobi county government equitable share of Ksh. 15.95 billion to run the four transferred functions. The Commission noted that a provision in National Assembly DORB 2020, allocating Nairobi County's entire equitable share of Ksh. 15.949 billion to only four transferred functions did not amount to equity in financing of the 14 functions assigned to Nairobi County governments. The Commission recommended that the budget estimate of the transferred functions be financed from both Nairobi's equitable share, 50 percent and 50 per cent from Nairobi's own revenue.

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	To enable national government to access revenues from the county revenue fund (CRF), there is need to provide in the DORB under Clause 4, a requirement for the County Executive Committee Member for finance to establish a Fund unto which, 50 per cent of the equitable share shall be deposited to finance the four transferred functions. The Senate approves a cash disbursement schedule for all county governments. The Senate needs to also provide another cash disbursement schedule of 50 per cent of Nairobi county governments' equitable share to be deposited to the special fund to run the transferred functions
	In accordance with the provisions of Article 217, the Senate is to determine the basis for sharing of the county governments' equitable share. Due to the COVID-19 pandemic, the consultations earlier scheduled by the Senate were suspended. The Commission recommends that the Senate considers the third basis for sharing revenue among county governments. This will ensure equity in sharing revenue among counties through the use of the most recent data relating to population, households and poverty.
Open Governance Institute (OGI) Kenya	**The basis for freezing county revenue growth in 2020/21 is contradictory**: a. That, paragraph eight discusses potential revenue underperformance as a basis for denying county governments increase in revenue, however, that is contradicted by paragraph 14 which estimates revenue growth of Ksh. 89.8 billion. b. That, by county governments not, directly or indirectly, receiving a share of loans borrowed by National Government, at least not according to the bill, renders paragraph (7) (e) unreasonable basis for

STAKEHOLDER	OBSERVATIONS AND RECOMMENDATIONS
	denying county governments additional revenue in 2020/21. (it states any increase in revenue in 2020/21 will be applied for the repayment for debt and pensions.) c. That, paragraph nine (9) punishes county governments for not having been affected by shortfalls in national revenue in the past. In light of lack of properly costed county and national functions to determine the actual budgetary requirements for respective functions, and that county governments receives just under a third of the nationally raised revenue is unreasonable factor for denying county government an increase in its revenue.
	The bill must take the following factors into account: a. That, county governments incur incremental cost annually as a result of various factors including inflation rates. b. That, county governments have registered an average of 12% increase in personnel emoluments (PE) since 2016/17. Using expenditure base of 2018/19 of Ksh. 162.77 billion according to Controller of Budget (COB), county governments will require Ksh. 185 billion for 2019/20 for PE costs, and subsequently an increase of Ksh. 22 billion, representing Ksh. 207 billion in 2020/21. c. That, public servants are entitled to 1.5% annual salary increment. Using the estimated cost for personnel emoluments for 2020/21 at Ksh. 207 billion, 47 county governments will require Ksh. 3 billion for salary increments bringing the budget to Ksh. 210.3 billion. d. That, county governments receiving smaller portions of equitable share and low OSR, have in the past had tight budgets, struggled to meet the requirements of Public Finance Management (PFM) Act 2012 on budget ration of 30:70 for development to recurrent budget

STAKEHOLDER	OBSERVATIONS AND RECOMMENDATIONS
	vote shares. Thus, maintaining the revenue share means for the costs outlined in (a), (b) and (c), county governments will be forced to secure such costs from development votes, thus technically violating the PFM provisions.
	The cost of Leasing Medical Equipment must be borne by national government therefore increasing the portion of the sharable revenue available to county governments by Ksh. 6.2 billion.
	To cushion county governments against cost pressure on her recurrent budget votes and subsequently, ensure that county government meet the minimum legal requirements of 30:70 ratio of development to recurrent votes, the portion of the sharable revenue available to counties must, at least increase by 12%, raising the share of sharable revenue available to counties to Ksh. 354.5 billion from current financial year's share of Ksh. 316.5 billion.

CHAPTER THREE

3.0 COMMITTEE OBSERVATIONS AND RECOMMENDATIONS

3.1 OBSERVATIONS

From the submission made by the stakeholders, the Committee made the following observations-

a) Noting the prevailing economic situation arising from the impact of COVID-19 pandemic, the performance of revenues may be poor thus, the 2020/21 equitable share may be expected not to grow from the previous allocation. The proposed equitable share for FY 2020/21 is Kshs. 316.5 Billion.

b) Pursuant to Article 187(2) of the Constitution and Gazette Notice No. 1609 of 25th February 2020, four (4) functions of the Nairobi City County (NCC) as given in schedule four of the Constitution were transferred to the National Government. The functions are namely County Health Services; County Transport Services; County Planning and Development Services; County Public Works, Utilities and Ancillary services, to National Government. The County was left with ten (10) functions to perform.

c) Though the functions were transferred, no arrangements have been put in place to ensure that the resources necessary for the performance of the functions are transferred. However, constitutional responsibility, which includes budgeting, of the performance of the transferred function resides with the Nairobi City County government.

d) The Bill proposes retention of Nairobi City County equitable share allocation Ksh. 15.95 billion in the Consolidated Fund. The retained monies would be used to finance the implementation of programmes under the four (4) transferred functions.

e) Article 207(1) provides for establishment of a Revenue Fund for each county government, into which shall be paid all money raised or received by or on behalf of the county government, except money reasonably excluded by an Act of

Parliament. Further, section 109(2)(a)&(c) of PFM Act, 2012 provides that the County Treasury for each county government shall ensure that all money raised or received by or on behalf of the county government is paid into the County Revenue Fund, except money that is excluded from payment into that Fund because of a provision of the Act or another Act of Parliament, and is payable into another county public fund established for a specific purpose or is reasonably excluded by an Act of Parliament as provided in Article 207 of the Constitution.

f) Article 219 on Transfer of equitable share provides that a county's share of revenue raised by the national government shall be transferred to the county without undue delay and without deduction, except when the transfer has been stopped under Article 225. However, transfer of function(s) from county level to National Government is not one of the exceptions.

g) Allocation of Nairobi City County's entire equitable share of Ksh. 15.949 billion to only four transferred functions does not amount to equity in financing of the 14 functions assigned to the county governments. Secondly, the budget estimate for the functions should be financed from both Nairobi's equitable share and own Source Revenue; may be at ratio of 50:50.

h) Several stakeholders termed the proposal as 'unconstitutional' and they recommended that-

    i) The Nairobi City County Equitable share of allocation should directly be disbursed to the County's Revenue Fund account without any deduction as mandated by the constitution under Article 219.
    ii) Appropriation for the transferred functions to be done through the County's budget and Appropriation Act passed by the County Assembly as mandated by the Constitution and the PFM Act 2012.
    iii) Allocations for the implementation of the transferred functions should directly be disbursed through the County Revenue Fund Account to the Nairobi Metropolitan Services.

i) Article 218(1)(a) and PFM Act section 191(2) provides that Division of Revenue Bill divides the revenue raised by national government between the national and county levels of government. Article 218(1)(b) and PFM Act section 191(3)(a) provides that the County Allocation of Revenue Bill shall specify each county's share of revenue allocated to counties (county level of government) by Division of Revenue Bill. Thus, the basis for allocating the purported Ksh. 15.95 billion in Division of Revenue Bill to Nairobi City County is fault since the County Allocation of Revenue Bill, 2020 is yet to be approved.

In light of the of the foregoing the Committee observes that-

a) Clause 4(2) and (3) of the Bill as read together with the Schedule to the Bill proposes to retain in the Consolidated Fund Nairobi County Government's equitable share of nationally raised revenue. However, Article 202(1) of the Constitution provides that *"revenue raised nationally shall be shared equitably among the national and county governments"*. Further Article 219 of the Constitution provides that *"a county's share of revenue raised by the national government shall be transferred to the county without undue delay and without deduction, except when the transfer has been stopped under Article 225"*. These provisions of the Constitution therefore contemplate that in every financial year nationally raised revenue shall be divided between the national government and the county government and each county shall receive its share of nationally raised revenue without deduction or delay except for stoppage of funds under Article 225. The Constitution therefore does not contemplate the retention of any county government's share of nationally raised revenue by reason of a transfer of functions under Article 187 of the Constitution.
b) The Committee further notes that Article 218 of the Constitution sets out a two-tier system for the division of revenue. In the first instance, the Division of Revenue Bill proposes a vertical division of revenue between the national and county governments. In the second instance, the County Allocation of Revenue proposes

the horizontal division of revenue between the forty-seven counties. Clause 4(2) and (3) of the Bill as read together with the Schedule proposes to retain Ksh.15,951,600,000 in the Consolidated Fund as Nairobi City County share of nationally raised revenue. However, it is through the County Allocation of Revenue Bill that the allocation made to each of the counties is determined. It would therefore be unconstitutional to purport to provide for the retention of Nairobi City County's equitable share before the introduction and consideration of the County Allocation of Revenue Bill.

c) Article 187(2)(b) of the Constitution provides that *"if a function or power is transferred from a government at one level to a government at the other level constitutional responsibility for the performance of the function or exercise of the power shall remain with the government to which it is assigned by the Fourth Schedule"*. Constitutional responsibility entails the preparation of budgets and accountability for the expenditure of funds as contemplated under Article 226 of the Constitution. A retention of the equitable share of nationally raised revenue for Nairobi City County at the national government would amount to a usurpation of the constitutional mandate of the county government to prepare its own budget and the power of the county assembly to approve said budget and exercise oversight over expenditure.

d) The Committee is further cognizant of the provisions of the Deed of Transfer of Functions of Nairobi County Government to the National Government and in particular Article 5 on financing the delivery of the transferred functions. In particular, Article 5.2 of the Deed provides that "*the Nairobi City County Government shall ensure that the transferred functions are fully funded from the County Revenue Fund"*. This would therefore imply that appropriation shall be made from the County Revenue Fund to cater for the transferred functions.

3.2 RECOMMENDATIONS

The Committee recommends that the bill be approved with the following amendments-

Clause 4

a) Delete Clause 4(2)
b) Delete Clause 4(3)

Following the proposed amendments, the new schedule referred in Clause 4 will be as follows-

Allocation of Revenue Raised Nationally Among the National and County Governments for the Financial Year 2020/21

Type/level of allocation	**Amount in Ksh.**	**Percentage (%) of 2016/17 audited and approved revenue i.e. Ksh. 1,357,698 Million**
A. Total Sharable Revenue	**1,856,700,000,000**	
B. National Government*	**1,533,411,510,000**	
Of which:		
1. Leasing of Medical Equipment	6,205,000,000	
2. Compensation for user fees forgone	900,000,000	
3. Level 5 hospitals	4,326,000,000	
4. Supplement for construction of county headquarters	300,000,000	
5. Rehabilitation of Youth Polytechnics	2,000,000,000	
C. Equalization Fund	**6,788,490,000**	**0.50%**
D. County equitable share	316,500,000,000	**23.31%**
Memo items		
1. County equitable share	***316,500,000,000***	
2. Additional conditional allocations(National Government share of Revenue) of which;	***13,731,000,000***	
2.1. Leasing of Medical Equipment	6,205,000,000	
2.2 Compensation for user fees forgone	900,000,000	

2.3 Level 5 hospitals	4,326,000,000	
2.4 Supplement for construction of county headquarters	300,000,000	
2.5 Rehabilitation of Youth Polytechnics	2,000,000,000	
3. Allocation from Fuel Levy Fund (15%)	*9,433,265,625*	
4. Conditional allocations (Loans & grants) of which:	***30,204,347,510***	
4.1 IDA-Kenya Devolution Support Program (KDSP) (Level 1)	2,115,000,000	
4.2 IDA-Transforming Health Systems for Universal Care Project	4,345,375,741	
4.3 DANIDA-Universal Healthcare For Devolved System Program	900,000,000	
4.4 IDA-National Agriculture & Rural Inclusive Growth Project (NARIGP)	4,261,646,438	
4.5 EU-Instruments for Devolution Advice and Support (IDEAS)	216,014,391	
4.6 IDA (World Bank) - Kenya Climate Smart Agriculture Project (KCSAP)	7,119,726,782	
4.7 World Bank- Kenya Urban Support Program(KUSP)- UDG	6,366,000,000	
4.8 IDA- Water and Sanitation Development Project (WSDP)	3,400,000,000	
4.9 Sweden Agriculture Sector Development Programme II (ASDP II)	652,584,158	
4.10 EU- Water Tower Protection and Climate Change Mitigation and Adaptation Programme (WaTER)	528,000,000	
4.11 Drought Resilience Programme in Northern Kenya	300,000,000	
Total County Allocations= (1+2+3+4)	**369,868,613,135**	

APPENDIXES

(a) Minutes of the Committee sittings

(b) Submission from Public Institutions and Members of Public

(c) Committee Stage Amendments