Republic of Kenya

Report of
The Controller and
Auditor General

On The Appropriation Accounts,
Other Public Accounts and
The Accounts of the Funds of
The Republic of Kenya
For the Year
2006 / 2007

Summary

Kenya National Audit Office (KENAO)

VISION

To be a lead agency in promoting good governance and effective accountability in the management of public resources.

MISSION

KENAO is a statutory agency which seeks to build professional excellence in the provision of audit services through objective, reliable and timely audit reports as a contribution to enhanced accountability and transparency in the use of public resources

MOTTO

Promoting accountability in the Public Sector

CORE VALUES

- Integrity
- Professional Excellence
- Cooperation
- Creativity
- Confidentiality
- Objectivity and Independence

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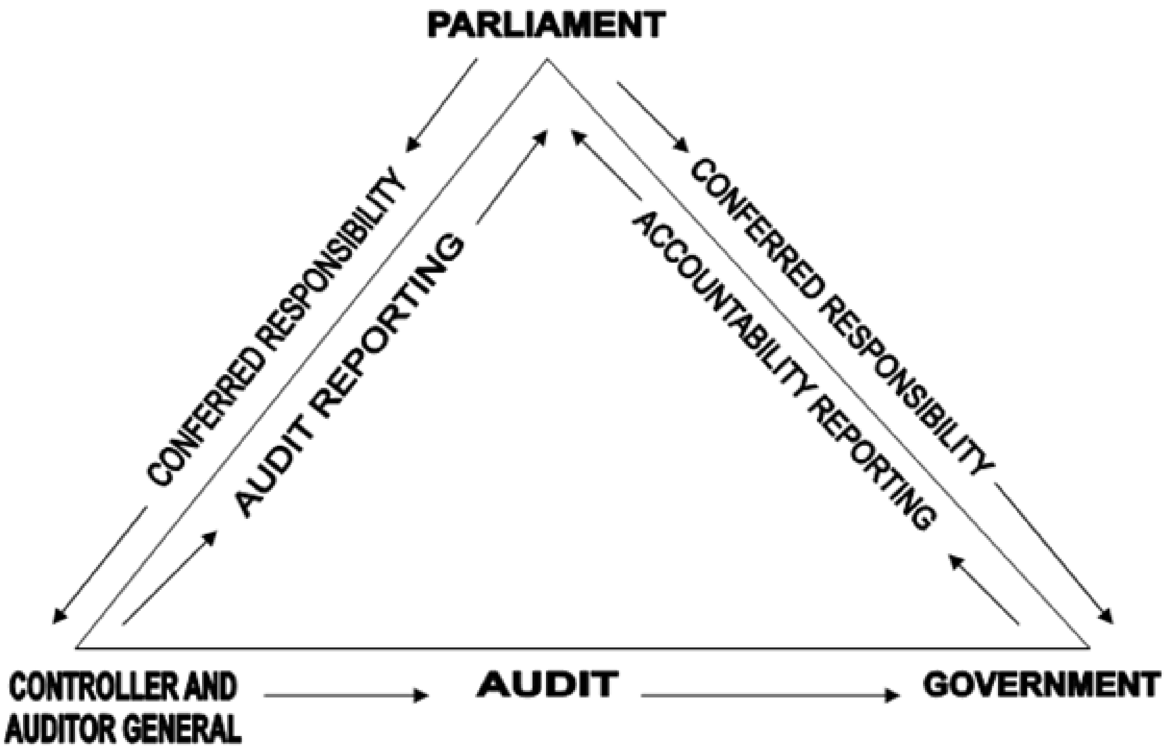
SUMMARY

REPORT OF THE CONTROLLER AND AUDITOR GENERAL 2006/2007

Preface

ACCOUNTABILITY RELATIONSHIPS BETWEEN PARLIAMENT, GOVERNMENT AND THE CONTROLLER AND AUDITOR GENERAL



Source: An Approach to Comprehensive Auditing - OAG Canada

Accountability is fundamental to good governance in any modern, open society. It is derived from the constitution and legal structure with the underlying assumption of the accountability of the Executive to Parliament and of Parliament to the people. Accountability relationship in Kenya can be depicted by the above diagram and is simply described below.

The primary authority for raising revenue or other monies and their appropriation for the services of the Government of Kenya is vested with Parliament. In this regard, Parliament approves the Government annual estimates and authorizes appropriation of funds in accordance with the Constitution of Kenya. According to the constitution all revenue or other monies raised or received for the purpose of the Government of Kenya shall be paid into and form a consolidated fund from which no monies shall be withdrawn except as may be authorized by the Constitution, by an Act of Parliament (including an Appropriation Act) or by a vote on account passed by the National Assembly.

By voting funds for various services of Government, Parliament confers responsibility on Government (Ministries and Departments) to spend funds for the services of Government and the taxpayers. The Ministries and Departments are required to report back to Parliament annually on how they executed the responsibility conferred on them. They do this by way of preparing financial statements which indicate how they used the money voted for them for various services. Parliament further confers responsibility on the Controller and Auditor General to confirm that what the Ministries and Departments report is a true position. The Controller and Auditor General does this by way of examining records and auditing the financial statements prepared by the Government Ministries and Departments and reporting to Parliament. In this process, all the parties involved are ultimately accountable to the people of Kenya, the taxpayers.

The Office of the Controller and Auditor General was established under Section 105 of the Constitution of Kenya as an Office in the public service. Section 105(2) sets the duties of the Controller and Auditor General as:-

(a) to satisfy himself that any proposed withdrawal from the Consolidated Fund is authorized by law, and, if so satisfied, to approve the withdrawal;

(b) to satisfy himself that all moneys that have been appropriated by Parliament and disbursed have been applied to the purposes to which they were so appropriated and that the expenditure conforms to the authority that governs it; and

(c) at least once in every year to audit and report on the public accounts of the Government of Kenya, the accounts of all officers and authorities of that Government, the accounts of all courts in Kenya (other than courts no part of the expenses of which are defrayed directly out of moneys provided by Parliament), the accounts of every Commission established by this Constitution and the accounts of the Clerk of the National Assembly.

This role is elaborated on in the Public Audit Act, 2003 which also renamed the Office, ***Kenya National Audit Office (KENAO).*** The Act specifies the role of the Controller and Auditor General as Audits of Government, Audits of State Corporations, Audits of Local Authorities and Economy, Efficiency and Effectiveness Examinations.

The Act specifies what the Controller and Auditor General is required to do under each of these audits. The reports on Audits of State Corporations and Local Authorities are prepared and issued separately for each State Corporation or Local Authority.

In making this report, I am fulfilling the part of the responsibility conferred on me by Parliament in the accountability relationship. I am also fulfilling my duty as set out in Section 105(2)(b) and (c) of the Constitution of Kenya as indicated above and Sections 8 and 9 of the Public Audit Act, 2003.

This report relates to the year 2006/2007 and it results from the audit of the Central Government, that is, Ministries, Departments, Commissions and the National Assembly.

P.N. KOMORA, C.B.S.
<u>CONTROLLER AND AUDITOR GENERAL</u>

TREASURY'S AND ACCOUNTING OFFICERS' RESPONSIBILITIES

As indicated in the ***Preface,*** Ministries and Departments are required to report to Parliament annually on how they discharged responsibilities conferred on them. In accordance with the Government Financial Management Act, 2004, the overall management of Government Finance is vested with the Minister for Finance and the Treasury. The Treasury appoints Accounting Officers for all Ministries and Departments to manage finances allocated to them. Accounting Officers therefore report to Parliament on behalf of Government on how they utilize funds allocated to them for the services of their particular votes.

The Public Audit Act, 2003, Sections 3 and 4 and the Government Financial Management Act, 2004, Section 18 require the Treasury and the Accounting Officers to prepare and sign accounts for each financial year relating to their areas of responsibility within three months after the end of the year and transmit them to the Controller and Auditor General for audit. The responsibilities of Accounting Officers are set out in the Treasury letter appointing the Accounting Officers in the provisions contained in various laws, Government Financial Regulations and Procedures and in Treasury circulars issued from time to time. They include propriety and regularity of the public finances, keeping proper financial and accounting records, safeguarding the assets within their responsibility and ensuring funds entrusted to them are applied only for the purposes intended and approved by Parliament.

The accounts are prepared on cash basis and must properly present receipts and payments for the relevant financial year and the surplus or deficit. Accounting Officers sign ***Statements of Accounting Officers' Responsibilities*** when they submit the accounts for audit, where they accept responsibility for the accuracy of the accounts they present for audit.

INTRODUCTION

It is not the usual practice to do a summary of the Report of the Controller and Auditor General. Indeed matters observed during the audit can be said to be summarized in the ***Introductory and General*** paragraphs which come at the beginning of the report.

The purpose of this summary is to provide an overview of observations made in the report to those who may not find time to read the main report. The summary further seeks to highlight issues which have been reported on over and over again but on which Government has not taken action.

In writing this summary, I am pleading with Government to specifically address these issues which have an implication on the expenditure control and the accountability process. As indicated earlier, all parties in the accountability relationship have a role to play. The accountability will only be fully achieved if all players play their part effectively. It is not enough for the Controller and Auditor General to continue writing reports and making recommendations which are not acted on. It would help a great deal if such reports are received positively and where they may appear inconsistent with the Accountability relationship or not practical, such inconsistencies and impracticabilities be addressed.

It is also relevant to add that reports are made to Parliament after giving the relevant Ministries and Departments an opportunity to explain the issues observed. Matters that are satisfactorily explained or corrected in the course of audit and preparation of the report are omitted. Only matters that have not been satisfactorily explained are included in the report.

For those who would like to read the full report, it will be available for sale at the Government Printer. It will also be posted to our website at ***www.kenao.go.ke*** after it is laid before the National Assembly.

REPORT

Most of the Appropriation and Other Accounts were submitted for audit by the deadline of 30 September as required by the Public Audit Act, 2003. Government Ministries and Departments also performed satisfactorily during the year, guided by the performance contracts introduced in Government in 2004.

Observations included in the report, therefore, only refer to exceptions rather than the rule. Such observations were made on test checks during the audit of the Ministries' and Departments' records. They cannot, therefore, be considered to have brought out all the issues that a comprehensive review would bring out. However, they bring out issues which, if properly addressed, would considerably improve the accounting and utilization of public funds.

1. EXPENDITURE CONTROL

Compared to the overall approved budget, the year 2006/2007 ended with a net under-expenditure of Kshs.49,523,218,371.00 on the Recurrent and Development Votes and the Consolidated Fund Services.

Only one Ministry reflected an excess Vote of Kshs.118,072,874.31 under its recurrent vote during the year.

The position reflected in the accounts would tend to indicate there was considerable expenditure control during the year.
However, this seeming control may not reflect the true position for reasons indicated below.

Pending Bills

Ministries and Departments continued to carry forward bills relating to the financial year, meaning that expenditure was incurred but not paid for. In 2006/2007, pending bills in both Recurrent and Development votes totalled Kshs.10,566,271,209.00 The accounts did not, therefore, reflect a true position of the expenditure during the year as it was understated by Kshs.10,566,271,209.00 Further, failure to settle bills when they occur gives Government bad image and may also attract interest from suppliers of goods and services resulting in additional cost.

Exclusion of Expenditure

Information available from the Ministries' and Departments' records, and disclosed in the footnotes to the Accounts, indicate that some data on expenditure incurred, mainly from the districts, was not captured in the ledgers. Such expenditure was therefore excluded from the relevant Appropriation Accounts.

However, the extent of the expenditure excluded from the Accounts could not be confirmed. Similarly the true position of actual expenditure can not be ascertained. In addition, since Government Accounts are prepared on cash basis, it has not been possible to confirm how expenditure excluded from the Accounts is subsequently dealt with.

Control over Imprests

Government has clear regulations on usage and accounting for imprests. Temporary/Safari imprests are moneys given to officers proceeding on duty outside their duty station, to mainly cater for their accommodation and subsistence. Government requires that such imprests be accounted for within 48 hours after officers return to their duty stations. If officers do not Account for the imprests, the Accounting Officers are required to recover the money from their salaries. Further, no officers should be given additional imprests before they account for previous ones.

However, over the years, these regulations are repeatedly flouted. During the year under review, records seen indicate that imprests totalling Kshs.200,340,976.50 which ought to have been accounted for on or before 30 June, 2007 in sixteen Ministries were still outstanding as at that date. Further, some Ministries continued to issue multiple imprests before officers had cleared previous ones. The amount of Kshs.200,340,976.50 does not include imprests held in District Treasuries particularly those that relate to “Old Cash Fund”. It does not also include balances reflected in Statements of Assets and Liabilities as outstanding but which are not supported by records in the Ministries and Departments.

Although this matter has featured in previous reports of the Controller and Auditor General, no meaningful efforts have been made to ensure that Ministries and Departments comply with Government Financial Regulations and Procedures and the Treasury Circulars. Unaccounted for imprests include some expenditure incurred but not included in the Appropriation Accounts of the Ministries and Departments.

2. EXCHEQUER SYSTEM AND APPROPRIATION ACCOUNTS

As indicated above, Parliament is the Supreme body in the control of use of public finances. All moneys collected in form of taxes, revenue, loans and grants are paid to the Consolidated Fund which is placed in the Exchequer Account, currently kept at the Central Bank of Kenya. The Consolidated Fund is managed by the Minister of Finance.

Withdrawal of such funds from the Exchequer Account must be by authority of the Constitution or an Act of Parliament or Vote on Account of the National Assembly.

Presently, money applied for the services of Government Ministries and Departments is authorized through the Appropriation Act. This Act allows use of specified amounts of money from the Exchequer and some classes of revenue collected by Ministries/Departments referred to as Appropriations-In-Aid.

Parliament enacts an Appropriation Act and Supplementary Appropriation Act every year to enable Government business to continue.

The Appropriation Act and Supplementary Appropriation Act are only effective for the financial year ending June 30. Any amounts appropriated and issued from the Exchequer but not utilized by 30 June are required to be paid back to the Exchequer. Similarly, any amounts not issued from the Exchequer by 30 June lapse and are not owing to the Ministries. Further, any Appropriations-In-Aid collected above those authorized in the Appropriation Act should be paid to the Exchequer as Extra Exchequer Receipts. This way, Parliament keeps control and is sure that Ministries and Departments utilize only amounts appropriated in the Appropriation Act. Any projects not completed during the year have funds re-voted the following year.

Treasury, being the custodian of public funds, is required to establish procedures and systems for proper and effective management of government money and property.

In the past, Treasury used to require Accounting Officers to pass entries in their books of Account for Exchequer under issues at the close of the financial year and surpluses indicated in the audited Appropriation Accounts. Treasury would also follow up and ensure balances not utilized during the year are surrendered back to the Exchequer and Appropriations-In-Aid collected above the authorized amounts are paid over as Extra Exchequer Receipts. Ministries would also justify reasons for excess votes and if such reasons are accepted by Parliament, Treasury would make arrangements for the moneys to be voted by Parliament through "statements of excess" to clear such excesses from the books of the Ministries. It was then possible to confirm that Ministries/Departments only utilized funds appropriated by Parliament.

However, over the last 10 years or so, this has not happened. The Statements of Assets and Liabilities for practically every Ministry and Department reflect billions of shillings owed from the Exchequer and equally huge sums of surplus balances which have not been paid over to the Exchequer for more than a decade. They also reflect excess Appropriations- In-Aid also going back, at times to the eighties, which were never paid to the Exchequer as required by law. These balances are not, however, supported by cash in bank. I have therefore been unable to understand what they represent. I believe they also have an implication on the financial control because the Ministries/Departments may be illegally using such balances in addition to voted provisions.

Although these issues have been reported on in details over the years under each Ministry (including in this report), no action has been taken to clear these balances from the books of account. Some of the Accounting Officers, in response to our reports, indicate they are awaiting instructions from the Treasury.

3. OLD CASH FUND ACCOUNTS STILL OUTSTANDING

Previously, District Accountants under the Office of the President provided accounting services to Ministries and Departments through a centralized bank account for Recurrent and Development services and claimed reimbursements from the Paymaster General's account at the Treasury. However, in year 2000, District Treasuries were instructed to open accounts to facilitate operations of projects directly with funds allocated to them. This arrangement worked well and Government decided that separate bank accounts be opened for each vote at every District Treasury.

Consequently, the Treasury through circular No.7/2001 of 25 April, 2001 directed the Accounting Officer, Office of the President, to issue instructions to freeze the district bank accounts with effect from 15 July, 2001 pending reconciliations to be carried out by District Treasuries with a view to closing these accounts. The Office of the President in turn issued a circular dated 11 December, 2001 to all Provincial and District Commissioners directing them to surrender the District cash funds for Recurrent and Development votes before 15 January, 2002.

Audit verification, however, indicates that these instructions have not been adhered to by quite a number of Provincial and District Accountants visited, despite repeated reports from this Office. The reports for 2005/2006 and 2006/2007 mention many cases where old Cash Funds were not surrendered. Further, such funds are being misused as they are held in form of IOUs, unsurrendered imprests, partly paid vouchers and sometimes they are indicated as cash losses.

I have been unable to understand why this matter, which is well known to Government, has not been resolved for now over seven years.

4. FUND ACCOUNTS

Dormant Funds

As indicated in my Report on the Accounts for 2005/2006, some Funds are dormant and are no longer fulfilling the purposes for which they were created. Yet these Funds tie up substantial sums of money which could be utilized for other development activities.

Perhaps, Government will look at these Funds which were established some years back with a view to either revamping them or winding them up if they no longer serve the purposes for which they were created.

It is noted that the Public Accounts Committee discussing the report of the Controller and Auditor General on the Accounts for 1998/99 and 1999/2000 recommended that the Asiatic Widows and Orphans Pensions Fund be wound up "to avoid further maintenance and management costs". However, no such action has been taken almost ten years since then.

Preparation of the Fund Accounts

It has been observed that the Fund accounts are prepared as instructed by the Treasury as required by law. It is also observed that the format of the Financial Statements conveyed by the instructions of Treasury was designed in the early 1990s. As new Funds are created and as Treasury reviews outdated Funds with a view to winding them up, there is need to review the format of these Fund Accounts in accordance with modern way of preparing Accounts. I understand Treasury is looking into this, along with the format for Donor Funded Projects. I hope this will be done in time for the preparation of 2007/2008 Accounts.

5. STATEMENTS OF ASSETS AND LIABILITIES

The format for Statements of Assets and Liabilities also needs review to make them more understandable and user friendly.

In addition, these Statements contain balances representing billions of shillings which have been brought forward year after year and which have not been analysed. In addition to the Exchequer Account, General Account of Vote and Extra Exchequer Receipts balances mentioned above, Suspense Accounts and Clearance Accounts have built up over the years, instead of them being cleared as expenditure in those Below the Line Accounts is identified and charged to relevant Accounts. Reluctance or inability to analyse and clear these huge balances from Below the Line Accounts increases chances that misappropriation of funds and other malpractices, including outright theft, could go undetected for a long time.

The Statements of Assets and Liabilities further continue to reflect balances brought forward from previous years relating to Temporary Imprests and Salary Advances. As indicated above, usage of Temporary Imprests continues to be abused. Officers do not surrender imprests as required and in some cases multiple imprests are issued before previous ones are surrendered.

Salary Advances are provided for where officers find themselves in difficult financial position requiring assistance from Government. Regulations require that such Advances be recovered within a period of not more than 12 months after they are issued. In case of officers who are due to leave the service, advances must be fully paid in equal instalments within the remaining period of their service. However, Advances for previous years continue to be reflected in Statements of Assets and Liabilities, meaning they were not recovered. At times they are not even analysed to indicate who was given the Advance.

It is not clear why audit observations on these matters have been ignored over the years. Improvements can be made if we appreciate problems in our systems and work together as a team.

Perhaps, one of the reasons these issues have not been dealt with is that paragraphs on Accounting Matters have previously been dealt with outside the Main Public Accounts Committee meetings. I am in communication with the National Assembly with a request that these paragraphs be dealt with in the main committees. This way, the Accounting Officers will perhaps pay more attention to these issues and direct their staff to take action. It is unacceptable that Ministries continue to reflect large unsupported balances representing billions of shillings. Proper analysis and clearance of these balances, in my view, should be given some priority.

6. BANK RECONCILIATION STATEMENTS

Many Bank Reconciliation Statements seen continue to reflect receipts and payments in cash books not in bank statements and receipts and payments in bank statements not in cash books for previous financial years. Some of the reconciling items have remained outstanding for many years. Concerted efforts are not being made to analyse and clear reconciling items.

Failure to analyse and clear reconciling items from the books of account increases chances that malpractices could go undetected for a long time. Similarly, I will bring back Bank Reconciliation Statement matters to the main reports of the Ministries and Departments. This way, Accounting Officers will be aware of these issues and hopefully direct accounting staff to take action. This matter should also, in my view, be addressed urgently.

7. MAINTENANCE OF LOANS RECORDS ON OBLIGATIONS GUARANTEED BY THE GOVERNMENT OF KENYA

Government guarantees loans borrowed mainly by State Corporations through the parent or appropriate Ministry. Parent Ministries are required to prepare Statements of Obligations Guaranteed by the Government of Kenya through them indicating the contingent liabilities outstanding. However, some parent Ministries do not maintain records of the loans guaranteed. They rely on information from the lenders and borrowers, which sometimes is not forthcoming. Otherwise they just reproduce figures from the previous years' Accounts which are not supported by any documents. It is not clear how such Ministries monitor repayment and size of such loans if they have no records on them. It is also not clear why they have not made efforts to obtain and maintain the records.

I have indicated inability to confirm accuracy of such Statements under the respective Ministries. Indeed, at least one Ministry through which there are outstanding obligations did not prepare any Statement for audit in 2006/2007. This is a violation of the Public Audit Act, 2003.

8. STATEMENTS OF REVENUE

I am concerned by the lack of attention in the preparation of Statements of Revenue as indicated in the reports under each Revenue Head.

Many times Statements of Revenue reflect receipts which differ with those reflected in supporting records. For example, most of the Revenue is collected by Kenya Revenue Authority (KRA) but the Receiver of Revenue is the Financial Secretary. However, the Statements of Revenue received reflect receipts which materially differ from those reflected in the KRA records. They also reflect payments to the Exchequer which differ with amounts reflected in the Exchequer records. Further, amounts carried forward differ with those reflected in the relevant Statement of Assets and Liabilities. Such differences are not explained or reconciled and therefore cast doubts on the accuracy of the Statements of Revenue. As a result, many Statements of Revenue have been excluded from the General Certificate.

Presentation

Receipts are also at times lumped together under one item instead of being shown under each classified item as in the Estimates. In two cases, Revenue is accounted for under heads under which it was not estimated with the Head reflected in the Estimates reflecting nil receipts. This way one cannot tell which item recorded Over-Collections or Under-Collections and it defeats the purpose of estimating receipts according to Heads and Items. No explanation has been give for this unsatisfactory state of affairs.

9. PAYMENT FOR GOODS NOT RECEIVED

A number of Ministries and Departments pay for goods and services before they are received, contrary to the provisions of the Government Financial Regulations and Procedures. This happens all the time but mainly towards the end of the financial year. Sometimes this is presumably done to avoid surrendering money to the Exchequer. This action, however, ends up distorting the Financial Accounts as at 30 June which are charged with expenditure whose goods and services have not been received. In many cases, however, goods and services end up not being provided. Sometimes Ministries/Departments write cheques, charge the expenditure to the Accounts and hold onto them awaiting receipt of goods and services until some of them become stale. This should be discouraged.

10. PAYMASTER GENERAL ACCOUNT

The Paymaster General Act, Cap 413 of the Laws of Kenya established the Office of the Paymaster General as an officer subordinate to the Treasury, and through whom Treasury would control the issue of money to the Government Ministries and Departments.

According to the Paymaster General Regulations, the Paymaster General maintained and operated in his name the account with the Central Bank. He was the banker of all Ministries and Departments.

With the enactment of the Government Financial Management Act, 2004, the Paymaster General Act was repealed, and Ministries/Departments are operating their Bank Accounts directly. However, in the accounts for 2006/2007, Ministries and Departments continue to refer to their bank accounts as Paymaster General Account. It is not clear whether in this transition all PMG's accounts were closed to enable Ministries operate their accounts. However, considering that they continue to carry forward balances in PMG accounts from many years back, it appears this did not happen. Perhaps, the Treasury will hasten to sort this matter out so that we have accounts that represent the current position.

As noted previously, Treasury needs to effectively provide guidance and direction to Accounting Officers on how to reverse this clearly unsatisfactory state of affairs.

P.N. KOMORA, C.B.S.
<u>CONTROLLER AND AUDITOR GENERAL</u>

NAIROBI

29 May, 2008