NATIONAL CLIMATE CHANGE ACTION PLAN

REPUBLIC OF KENYA

Finance

Section C: Absorptive Capacity Development Plan

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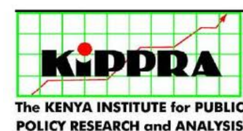
: vivideconomics



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Abbreviations

ACCPAC	Accounting Package
AFD	French Development Agency
AfDB	African Development Bank
AFREPREN FWD	Energy Environment and Development Network for Africa
AG	Auditor General
AIA	Appropriations In Aid
ATP	Alternative Technologies Project
BOT	Board of Trustees
BPS	Budget Policy Statement
BSD	Budget Supply Department
CALP	Community Adaptation Learning Programme
CBK	Central Bank of Kenya
CBO	Community Based Organisation
CDF	Constituency Development Fund
CDKN	Climate and Development Knowledge Network
CDTF	Community Development Trust Fund
COB	Controller of Budgets
Cogen	Co-generation
COMESA	Common Market for East and Southern Africa
CPC	Community Project Cycle
CRA	Commission for Revenue Allocation
CSG	County Steering Group
CSO	Civil Society organisation
CT- OVC	Cast Transfer Orphans and Vulnerable Children
CUBRESA	Capacity Building for Renewable Energy SMEs
DANIDA	Danish International Development Authority
DFID	UK Department for International Development
DMA	Draught Management Authority
EC	European Commission
EDF	European Development Fund
ERD	External resources Department
FAO	Food and Agriculture Organisation
GBM	Green Belt Movement
GEF	Global Environment Facility

GIZ	German Development Cooperation
GoK	Government of Kenya
HR	Human Resource
IFMIS	Integrated Financial Management Information System
IT	Information Technology
JFA	Joint Financing Agreement
KAM	Kenya Association of Manufacturers
KENAO	Kenya National Audit Office
KFS	Kenya Forestry Service
KfW	German Development Bank
KIPPRA	Kenya Institute of Public Policy and Analysis
KLGRP	Kenya Local Government Reform Programme
KOSIP	Kimira Oluch Small Holder Farm Improvement Project
KWS	Kenya Wildlife Service
KYEP	Kenya Youth Empowerment Project
LA	Local Authority
LATF	Local Authorities Transfer Fund
M&E	Monitoring and Evaluation
MEMR	Ministry of Environment and Mineral Resources
MFW	Ministry of Forestry and Wildlife
MGCSD	Ministry of Gender Children and Social Development
MIS	Management Information System
MOA	Ministry of Agriculture
MoE	Ministry of Energy
MoEd	Ministry of Education
MoF	Ministry of Finance
MoLG	Ministry of Local Government
MoPHS	Ministry of Public Health and Sanitation
MOU	Memorandum of Understanding
MoWI	Ministry of Water and Irrigation
MOYAS	Ministry of Youth and Sports
MPV2030	Ministry of Planning and Vision 2030
MRDA	Ministry of Regional Development Authorities
MTEF	Medium Term Expenditure Framework
NCCRS	National Climate Change Response Strategy

NEMA	National Management Environmental Authority
NGO	Non- Governmental Organisation
OPM	Office of the Prime Minister
PIU	Project Implementation Unit
PM	Project Manager
PS	Permanent Secretary
SAP	Integrated Enterprise Planning System
SIDA	Swedish Development Authority
SWG	Sector Working Group
UNDP	United Nations Development Programme
UNEP	United Nations Environmental Programme
UNICEF	United Nations International Children Education Fund
UPC	Urban Project Cycle
VAT	Value Added Tax
WDC	Water Users Association Development Cycle
WRMA	Water Resources Management Authority
WSTF	Water Services Trust Fund

1. Introduction

The objective of this section is to provide an understanding of the operations, practices and capacity of key Kenyan public institutions involved in the management of climate finance at the national and the local level, and to draw out key lessons for reform and improvement. These lessons will be integral to the full design and establishment of the National Climate Fund for Kenya and for its successful operation, as well as to efforts to strengthen the broader public financial management framework for climate finance. In essence, therefore, the purpose of the section is to ascertain how to spend available climate finance resources effectively and efficiently.

The section emerges from a review and analysis of literature and discussions with representatives of selected government ministries and other government agencies. Organisations were selected based on their involvement in the management of finance and the implementation, projects and programmes in sectors relevant to climate change – notably energy, environment, agriculture, water and forestry; thereby shedding light on the dynamics of the public management of climate finance. As such, government ministries included in the review were the:

- Ministry of Finance (MoF), specifically the External Resources Department (ERD);
- Ministry of Environment and Mineral Resources (MEMR);
- Ministry of Energy (MoE);
- Ministry of Regional Development Authorities (MRDA);
- Ministry of Forestry and Wildlife (MFW), mainly the Kenya Forest Service (KFS);
- Ministry of Agriculture.

Government of Kenya (GoK) authorities and trust funds included were the:

- Recently-constituted National Drought Management Authority (DMA) under the Ministry of Northern Kenya Development (MNKD);
- Local Authorities Transfer Fund (LATF) in the Ministry of Local Government (MoLG);
- Community Development Trust Fund (CDTF) under the Ministry of Planning and Vision 2030 (MPV2030);
- Water Services Trust Fund (WSTF) under the Ministry of Water and Irrigation (MWI).

For each of the organisations reviewed, discussions focused on budgeting processes, fund flow processes, disbursement practices, absorptive capacity, perspectives on public financial management under the new constitution, project and programme implementation arrangements, and accounting, reporting and audit arrangements. The analysis involved the collection and examination of data and information from reports, websites, legal notices, acts of parliament, draft bills, and the new (and to some extent the old) constitution. Interviewed representatives included those financial, accounting and technical staff involved in the management and implementation of climate change financing streams in government organisations.

2. Government Budgeting Processes

The allocation of government and development partner resources is guided by the government's short, medium and long-term priorities. These plans include Annual Budget Estimates in the short-term, Medium-Term Expenditure Frameworks (MTEFs) in the medium-term and Vision 2030 in

the long-term. The formulation of the annual budget is largely driven by a Budget Policy Statement (BPS) and the MTEF. The MTEF outlines the broad strategic macroeconomic issues that form the basis for budgeting in the coming financial year and the medium-term. A BPS goes into greater detail on the overall projected targets for total revenue, aggregate expenditure, domestic and external borrowing, and total resources to be allocated to individual programmes within a sector or ministry for the coming financial year and the medium term. It also defines the criteria used to allocate or apportion available public resources among the various programmes, proposes how to finance any deficits, and provides indications of borrowing intentions.

The Government MTEF is a budgeting tool used to translate government policies and plans into expenditure programmes within a coherent, multi-year macro framework. The Government of Kenya adopted the Medium Term Expenditure Framework (MTEF) in June 2000 following a public expenditure review in 1997. It provides guidance on how to divide up total national resources and how to trade off sectors against one another based upon certain priorities. A number of benefits concerned with the improvement of Kenyan fiscal management have been attributed to the MTEF. These include:

- The promotion of the predictability of resources in priority areas;
- Improved stakeholder consultation in decision-making;
- Efficient and predictable resource allocation mechanisms;
- Enhanced accountability;
- Transparency; and
- Fiscal discipline.

However, the MTEF has been faced with a number of challenges, including limited resources, which in turn leads to:

- The allocation of the national resources based on equality as opposed to equity;
- A lack of attention paid in ministries to the accurate fiscal projections in the later years of the MTEF;
- Political interference;
- Disruption due to national emergencies;
- The failure of Sector Working Groups (SWGs) to allocate adequate resources to priority areas; inflation and price changes;
- Fluctuations in the exchange rates;
- A failure to support and anchor MTEF in legislation.

Within the budget, expenditure is broadly-speaking classified as being either under the ‘development’ or the ‘recurrent’ vote. For example, development projects and capital investments are budgeted under the development vote, whereas operational and maintenance costs are budgeted under the recurrent vote. Funding from development agencies, whether for capital investments or operational costs, is always budgeted under the development vote. Development agency funding is further classified as either ‘revenue’ or ‘appropriations in aid’ (AIA), depending on the disbursement mechanism being used. Funding classified as revenue is exclusively channelled through the government’s consolidated fund (the fund into which all government revenue from all sources is initially pooled). Funding classified as AIA has been agreed and negotiated with the government and factored into the budget but is usually disbursed directly from development agencies to implementing agents (for example line ministries, government departments, parastatals, firms,

NGOs, community-based organisations (CBOs), bypassing the consolidated fund. Government funding earmarked for development and investment projects is also budgeted under revenue.

The government's budgeting process has faced a number of challenges, some of which have to do with the relationship with development agencies. These include:

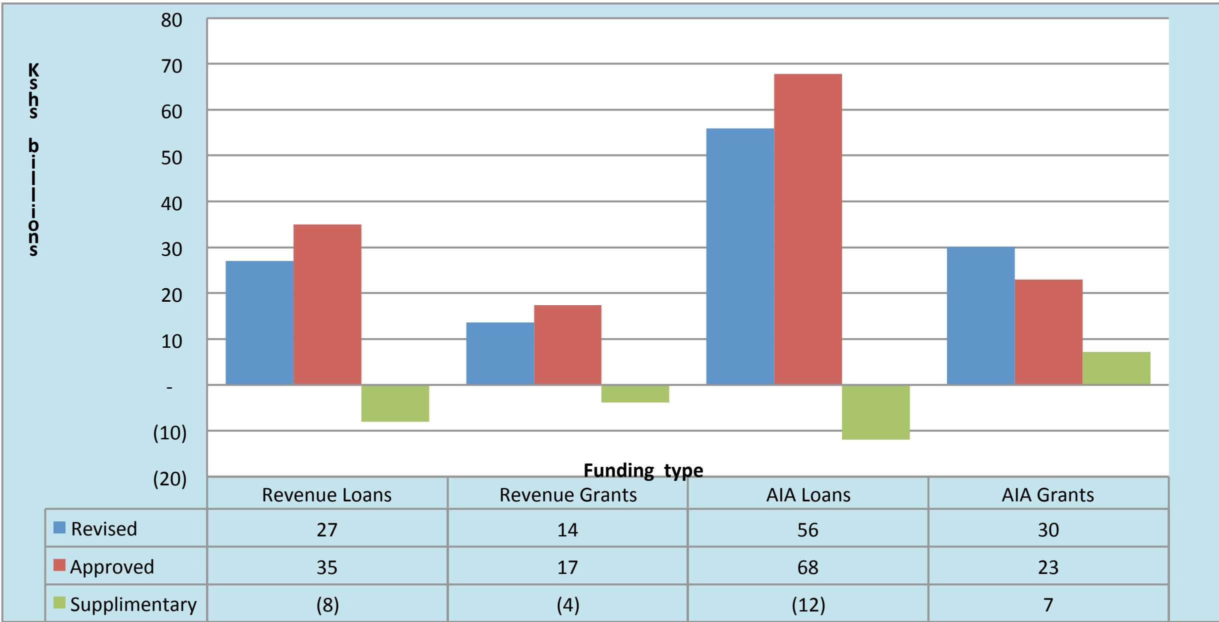
- Inadequate budgetary allocations by the government;
- Conditions placed on development partner funding;
- The inability of development partners to provide accountability for funding disbursed as AIA;
- Arbitrary government and development partner funding allocations or the failure to use detailed implementation plans and estimates as the basis for funding allocations;
- Difficulties in the harmonisation of resource allocations; and
- The harmonisation of fiscal years between the government and various development partners.

External development partner funding can be incorporated into the government's budget through two 'windows' – during the formulation of budget estimates or during supplementary revisions. The formulation of budget estimates takes place towards the beginning of the Kenyan fiscal year, whilst supplementary revisions are usually tabled two months before the end of the fiscal year. The standardisation of systems would facilitate a reduction of the need for supplementary revisions, which would make the budgeting and financial management process smoother and more efficient.

It is also important to ensure that annual budget estimates submitted by implementing agents to the Treasury at the beginning of the fiscal year are supported by detailed work plans and realistic cost estimates, which in many cases they currently are not. This would again reduce the need for supplementary revisions.

Figure 1 below provides a comparative analysis of the 2010-2011 financial year approved development partner budget estimates against supplementary revisions. Overall there was a downward revision of the approved budget allocation for revenue loans, revenue grants and AIA loans amounting to KSh 24 billion. During the same period there was a general increase in funding under AIA grants from KSh 23 billion to KSh 30 billion – an increase of KSh seven billion. The downward revision was brought about by the need for implementing agencies to scale back budgets to minimise audit queries relating to a lack of expenditure from the previous year – in other words it was a result of government institutions' inability to absorb external, development partner funding, which is addressed below. The increase in funding for AIA grants can be explained by the fact that additional funding was included in the budget during the supplementary revisions process.

Figure C1: Overall development partner funding budget analysis for the 2010-2011 financial year



	Revenue Loans	Revenue Grants	AIA Loans	AIA Grants
Revised	27	14	56	30
Approved	35	17	68	23
Supplimentary	(8)	(4)	(12)	7

Source: ERD

3. Government Fund Flow Processes

Delays in the disbursement of development partner funding via government systems have been a major hindrance to the absorption of funding. The revenue vote has been characterised by delays of as much as six to nine months from the preparation of reports and submission and funding requests to development partners by the government, to the actual receipt of funds by implementing agents. These delays can be attributed to:

- Lengthy bureaucracy within government systems;
- Inadequate financial management capacity within implementing agencies;
- Inadequate awareness and understanding of project needs as well as development agency rules and regulations.

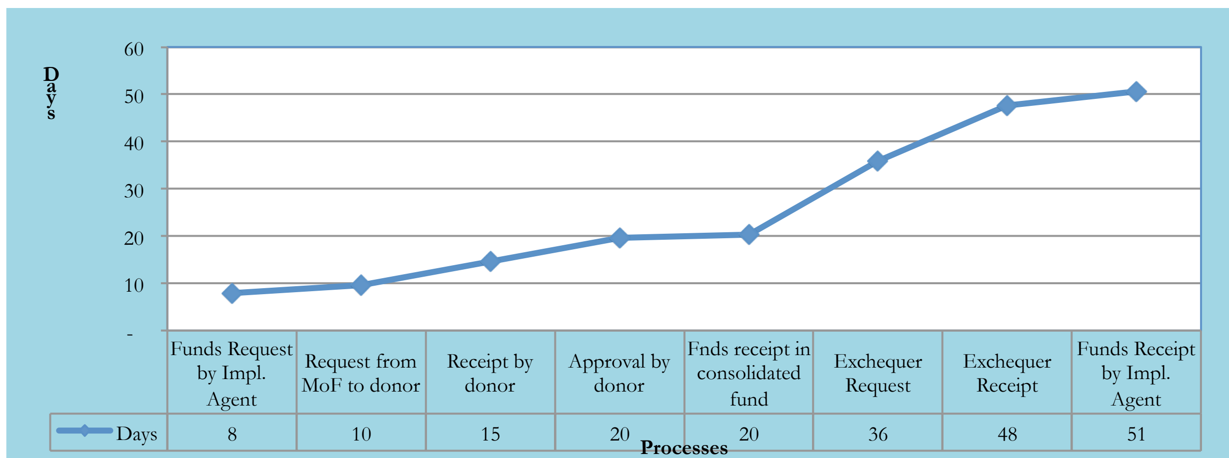
However, the government and development partners have taken a number of measures to address these delays, including:

- Agreement that development partners will close off-shore bank accounts and replace them with domestic accounts;
- The introduction of a more robust payments system at the Central Bank of Kenya, which is integrated with government's Integrated Financial Management System (IFMIS), in order to speed up payments;
- The development of a web-based portal to enable implementing agents to track the status of disbursement request from development partners to government;
- Hands on capacity building and training in public financial management; and

- The reengineering of the government's IFMIS to enhance information sharing and awareness.

However, the longest delay to the disbursement of funds via government systems is caused by processes in Treasury. Figure 2 is an analysis of the average timeline involved for two projects funded through the government systems and classified as 'revenue': Cash Transfers for Orphans and Vulnerable Children (CT-OVC) and the Kenya Youth Empowerment Programme (KYEP). The CT-OVC is implemented by the Ministry of Gender, Children and Social Development, while KYEP was implemented by the Office of the Prime Minister (OPM) and six line ministries (MoWI, the Ministry of Youth (MOYAS), MRDA, MoLG, the Ministry of Roads (MOR), and MEMR). The analysis shows that 20 days elapsed from the preparation of the funding request until the approval of the same by the development agency and the transfer of funds to the Treasury's consolidated fund. A further 31 days elapsed before the disbursement of funds from the consolidated fund to the implementing agent. The whole process took two and a half months. The majority of the delay can thus be attributed to the lengthy processes in the Ministry of Finance to process payments, authorise the release of funds and to actually release them from the line ministry exchequer bank account.

Figure C2: Cumulative fund flow timelines under the revenue vote funding mechanism



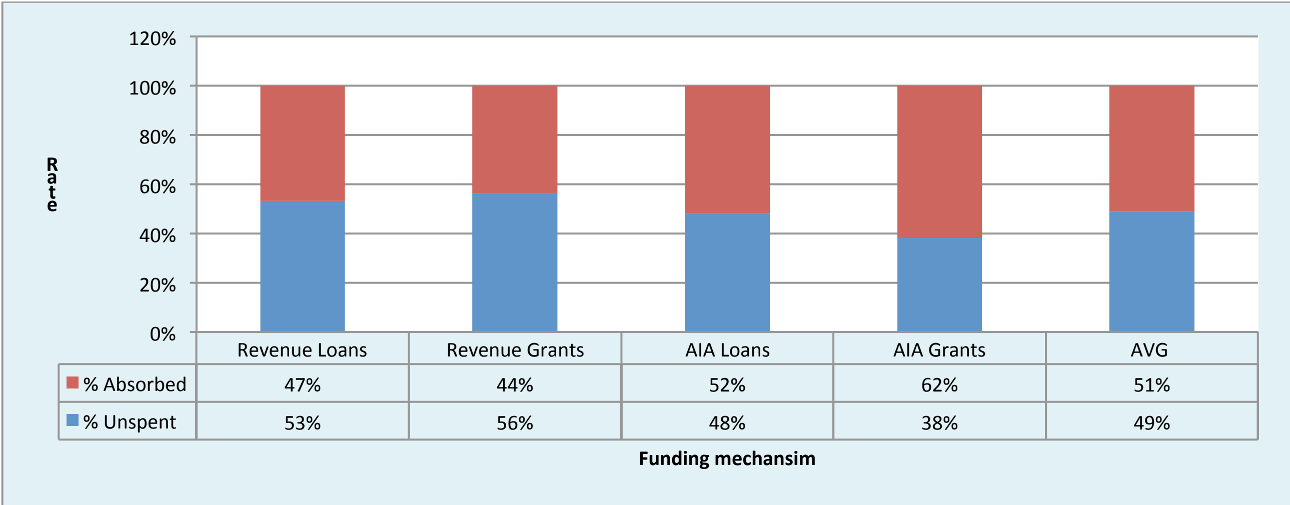
Source: ERD/MGCSD/OPM

The Treasury has taken a number of steps to address delays in disbursement of funds through the government systems. These measures include the agreement with development partners to close off-shore accounts with a view to eliminating unnecessary steps in the delivery of funds; the appointment and training of dedicated ERD staff to handle specific development partner projects; the disbursement of funds directly from the consolidated fund to implementing agencies, that is without the physical movement of funds through line ministry exchequer bank accounts; and quarterly disbursement and absorption tracking and monitoring. Although the Treasury has taken a number of steps in addressing these challenges, it should consider the deployment of dedicated trained finance, accounting and internal audit personnel to line ministries and implementing agents to deepen and expand necessary reforms throughout government.

4. Disbursement and Absorption Capacity

The government's overall capacity to absorb external development partner funding is low. Based on discussions with, and data from, the Ministry of Finance's External Resources Department, the absorptive capacity for the current financial year 2011-2012 is expected to be in the range of 40-45 per cent, that is of the total development partner funding made available to the Government of Kenya, only 40-45 per cent will be used. Figure 3 is a depiction of absorption rates for 2010-2011. The overall average absorption rate in that year was 51 per cent. AIA grants recorded the highest rate of absorption while revenue grants posted the lowest absorption. The absorption rate for revenue loans was 47 per cent while AIA loans recorded 52 per cent.[i]

Figure C3: Overall government absorption rate for the 2010-2011 financial year



Source: ERD

The absorptive capacity of Government of Kenya trust funds is higher than that of the government as a whole. Figure 4 shows indicative absorption rates for trust funds. From the figure, it is clear that the average absorption rate of the Water Services Trust Fund and the European Commission (EC) and Danish International Development Agency (Danida)-funded Community Development Trust Fund was 59 per cent, that is eight per cent higher than the government. Even so, this level of finance uptake should be considered low given that these trust funds are special purpose vehicles with specific service delivery mandates, and as such should operate at a high level of efficiency.

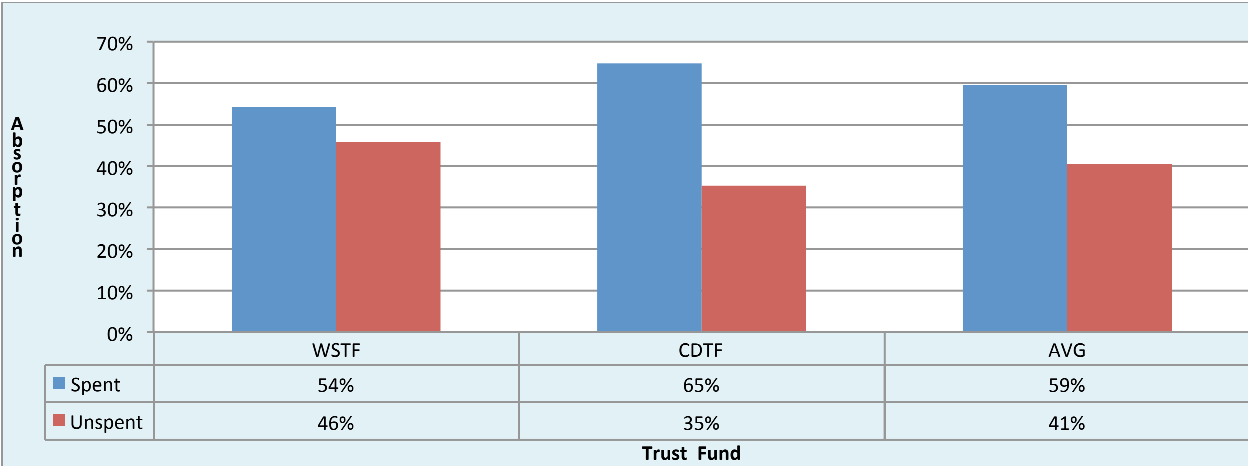
Downward pressure on trust fund absorption rates rate is attributable mainly to factors inherent to the overall government system, on which disbursement to trust funds is dependent. For instance, the CDTF's funding requests are prepared and submitted to the EC but are also submitted in parallel the Ministry of Planning and Vision 2030. The requests are then cleared by MPV2030 before being forwarded to the Authorising Officer in the Ministry of Finance for approval. It is the MPV2030 and MoF stage of the process that takes the time. The second major challenge facing trust funds is largely to do with delays in the identification and implementation of projects, largely due to low technical, project management and financial

management capacity amongst implementing agents, especially at the local level. Trust funds have taken a number of steps to address these challenges, including:

- Development partner harmonisation through joint financing agreements;
- Targeted, hands-on capacity building support;
- The moving of operations and the provision of support to the regional or local level.

The CDTF, for instance, has opened regional offices in Mombasa, Eldoret and Meru with the aim of transferring the provision of technical support to the local level, and the WSTF works through the regional Water Services Boards, who act as support organisations to local implementing agents.

Figure C4: Absorption rates for trust funds

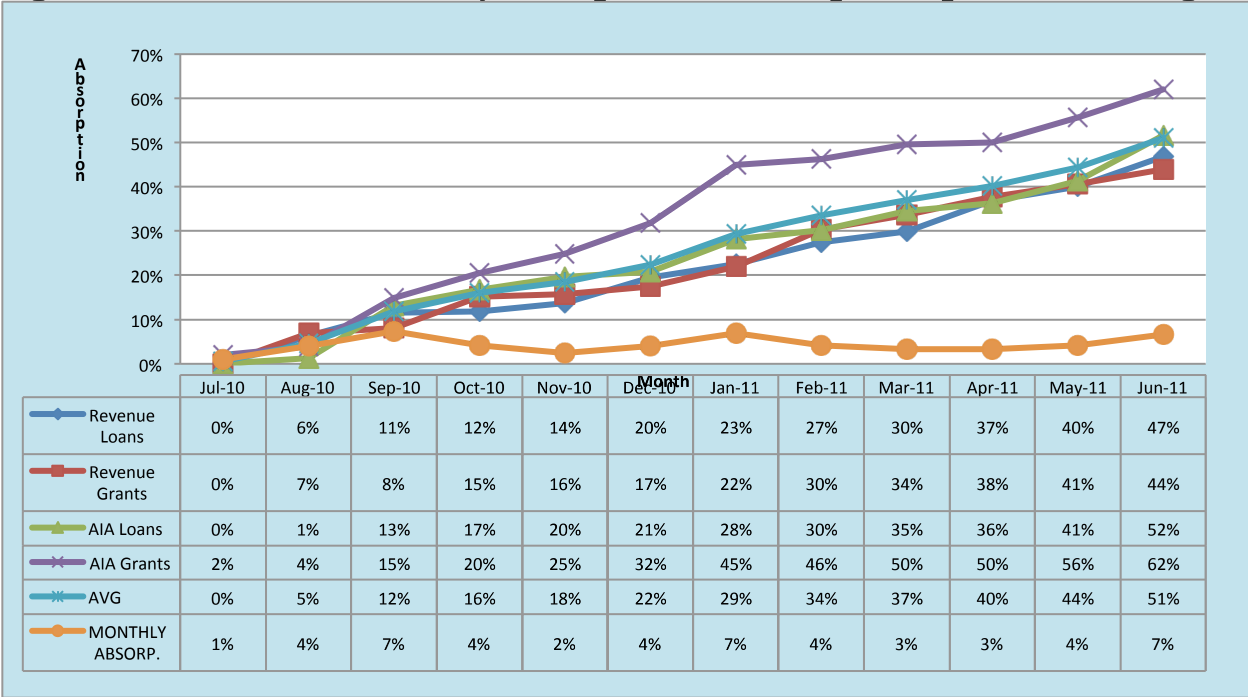


	WSTF	CDTF	AVG
Spent	54%	65%	59%
Unspent	46%	35%	41%

Source: ERD

Monthly absorption rates have generally been unpredictable and erratic. A principal cause of the unpredictability in spending patterns of line ministries and other government agencies, with concomitant knock-on effects for project and programme effectiveness and sustainability, is the volatility of revenue vote inflows from development agencies. For instance, looking cumulatively at the 2010-2011 financial year, the average monthly absorption rate was four per cent, with July recording the lowest rate at one per cent while January, June and September scored the highest rate at seven per cent.

Figure C5: Cumulative monthly absorption of development partner funding

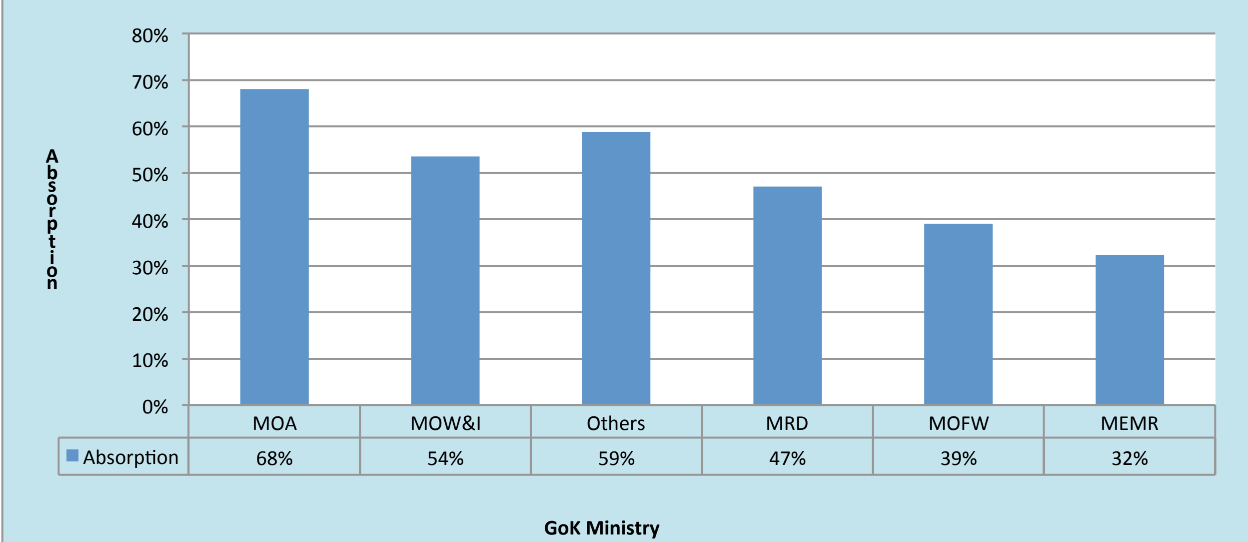


	Jul-10	Aug-10	Sep-10	Oct-10	Nov-10	Dec-10	Jan-11	Feb-11	Mar-11	Apr-11	May-11	Jun-11
Revenue Loans	0%	6%	11%	12%	14%	20%	23%	27%	30%	37%	40%	47%
Revenue Grants	0%	7%	8%	15%	16%	17%	22%	30%	34%	38%	41%	44%
AIA Loans	0%	1%	13%	17%	20%	21%	28%	30%	35%	36%	41%	52%
AIA Grants	2%	4%	15%	20%	25%	32%	45%	46%	50%	50%	56%	62%
AVG	0%	5%	12%	16%	18%	22%	29%	34%	37%	40%	44%	51%
MONTHLY ABSORP.	1%	4%	7%	4%	2%	4%	7%	4%	3%	3%	4%	7%

Source: ERD

The 2010-2011 absorptive capacity amongst those line ministries involved in the management of climate finance and the implementation of climate change initiatives was varied. The Ministry of MoA posted the highest absorption rate at 68 per cent, whereas MEMR posted the lowest absorption rate of 32 per cent, representing a 36 per cent variation in total (compared to the overall government average of 51 per cent). Figure 6 provides an overall overview of development partner funding absorptive capacity for government ministries involved in climate change activities.

Figure C6: Absorption rate according to GoK ministry in the 2010-2011 financial year



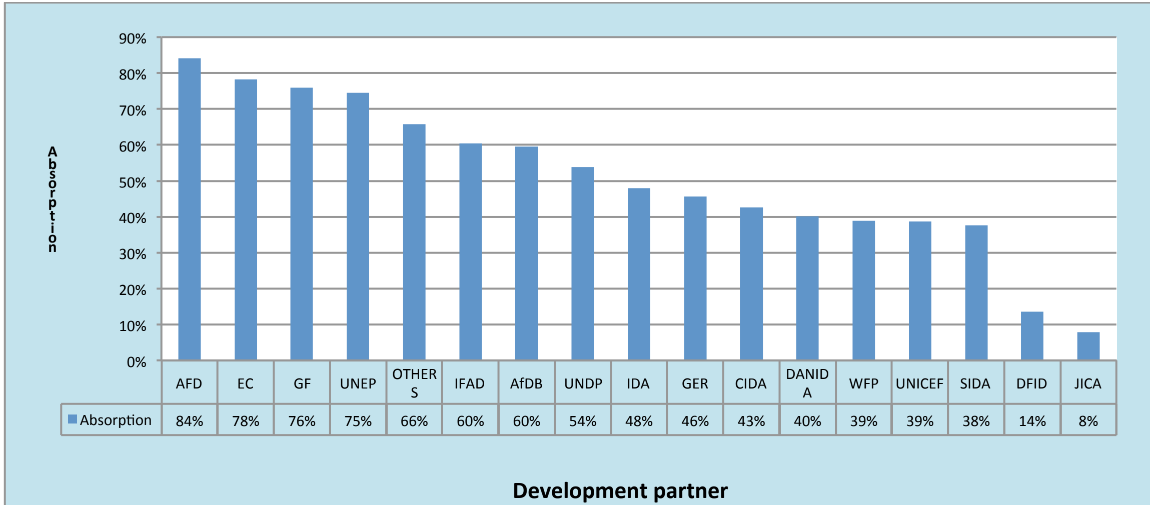
	MOA	MOW&I	Others	MRD	MOFW	MEMR
Absorption	68%	54%	59%	47%	39%	32%

Source: ERD

The uptake of the funding of different development partners by the Government of Kenya varies widely. For example, the absorption of funding provided by the French government (the Agence Franciase de Développement) was 84 per cent compared to 38 per cent, 14 per cent and eight per cent posted by the Swedish International Cooperation Agency (SIDA), the UK Department for International Development (DFID) and the Japan International Development Cooperation Agency (JICA) respectively. Figure 7 provides a detailed overview of development partner funding absorption for the 2010-2011 financial year.

The disparity in absorption rates is a reflection of the different budgeting and fund flow mechanisms, rules and regulations used by the different development agencies. Each development agency has its own set of requirements, demanding high levels of staffing and skills and causing delays to funds' release and disbursement. The volume of funds delivered per development agency can play a role, although the direction of causality varies – higher volumes can sometimes lead to better procedures (due to economies of scale) or to the Treasury being overstretched in complying with regulation. The disparity is also a factor of the activities and sectors in which development agencies work.

Figure C7: Absorption rate according to development partner for the 2010-2011 financial year



Source: ERD

5. Public Finance Perspectives under the New Constitution

Chapter 12 of the new constitution contains a number of provisions that introduce major changes in the public financial management arena. Article 201 of chapter 12 provides the guiding principles and framework for this arena. Some of these provisions and principles have been incorporated into the Public Financial Management Act 2012, which was passed in the summer of 2012. The principles and provisions under the new constitution are:

- Open accountability and public finance participation;

- The promotion of equity with the tax burden shared fairly between the national and the county levels;
- Public expenditure that promotes equitable development and addresses marginalised areas and groups;
- The equitable sharing of debt benefits and burdens between current and future generations;
- The prudent and responsible use of public resources;
- Responsible financial management with clear fiscal reporting.

At the county level, the new constitution and the Public Financial Management Act 2012 sets out criteria to be followed when sharing the revenues vertically between the national and county governments. The national government is required to prioritise the national interest with a particular focus on:

- National debt obligations;
- Addressing the needs of the national government;
- Ensuring that counties meet development needs and deliver on the responsibilities allotted to them;
- Maximising the fiscal capacity and efficiency of county governments;
- Developing affirmative actions to address the disparities between and within counties;
- Optimising county economic potentials;
- Guarantee stable and predictable revenue allocation; and
- Ensuring that there is flexibility in responding to emergencies.

The new constitution decrees that a minimum of 15 per cent of centrally-collected revenues, based on the last set of audited financial accounts, shall be allocated to the counties. (This does not apply to development partner funding, except possibly in the case of budget support.) The constitution further mandates additional allocations depending on the functions allotted to the counties. In addition, under the new dispensation, the government is required to establish an Equalisation Fund equivalent to 0.5 per cent of total national revenue collection. This fund shall be reserved for marginalised areas and to cater for basic services such as water, roads and electricity. The fund is expected to be maintained for at least the next 20 years with the possibility of an extension. The proposal released by the Commission on Revenue Allocation (CRA) in April 2012 suggests that 33 per cent of the total national revenue collection (or KSh 200 billion in 2010-2011) be allocated to the counties.

It is further proposed that the county allocation be distributed horizontally among the counties based on five key criteria, namely a baseline equal share, population, poverty levels, land areas and fiscal responsibility. Figures 8a and 8b provides an example distribution of KSh 200 billion to be allocated to the county governments FY 2012-20013. This institutional arrangement is paramount in avoiding discretionary decisions in the allocation of resources and reduces the influence of vested political interests in the process of resource allocation.

Figure C8a: Proposed county allocation in KSh

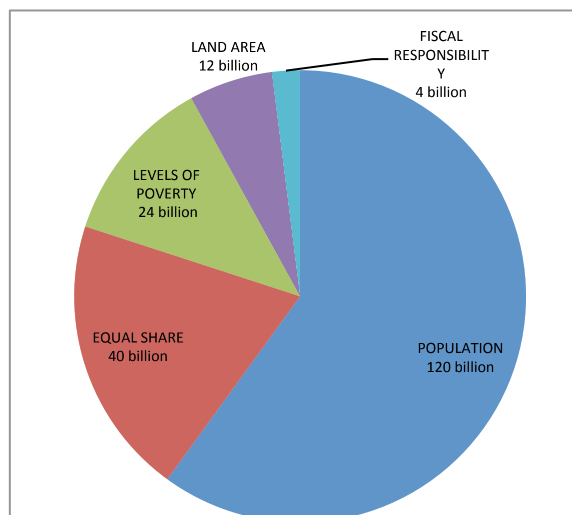
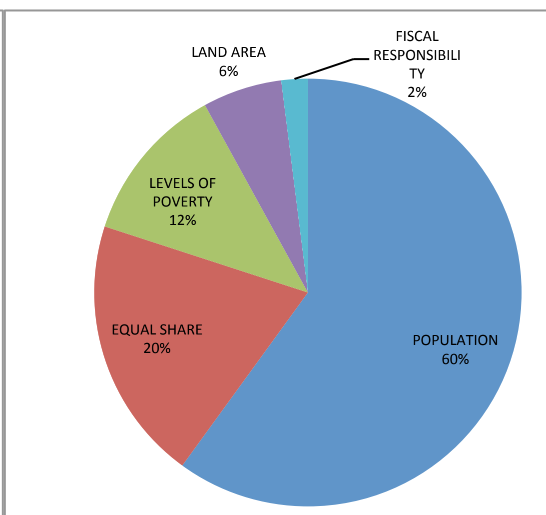


Figure C8b: Proposed county allocation criteria in per cent



Source: CRA

The new dispensation sets out provisions for the central government to withhold up to 50 per cent of the county allocation on the basis of persistent breaches of financial management policies and procedures. Parliament is authorised to suspend such transfers on the basis of recommendations by the COB. The framework further allows for sanctions intended to improve county-level financial management, one of which is the allocation of two per cent of county revenue on the basis of fiscal responsibility (as depicted in figure 8b above).

6. Project and Programme Implementation Arrangements

The implementation arrangements that development partners choose for their projects and programmes affect governance structures, financial management controls and fund flow mechanisms. These factors in turn have a great impact on absorption capacity if not carefully managed. Projects with more complex designs involving several players require greater financial and technical coordination. The most common types of implementation arrangement are described below.

Government trust funds are a popular means of support amongst development partners and the GoK. They can be established either with an act of parliament or a ministerial decision/legal notice. The CTDF was established with a legal notice whereas LATF and WSTF were established through acts of parliament. The CTDF is primarily funded by the EC and Danida with no government contribution, whilst LATF is a fiscal transfer mechanism funded primarily by the government consolidated fund to the sum of five per cent of total national revenue, and currently makes up approximately 24 per cent of local authority revenue. WSTF is funded by the Government of Kenya and a number of development partners including the EC, Danida, GIZ, KfW, SIDA, UNICEF, the Finnish government and the Dutch government.

Project Implementation Units (PIUs), charged with coordination and delivery of the projects at the national and local level, are another popular means of development partner support. PIUs are set up within government ministries and agencies at the behest of development agencies to provide dedicated day-to-day management of and support to development programmes, with specific results and outputs mapped according annual ministry and agency performance targets. The MEMR was identified as the leading ministry involved in the implementation of climate change projects funded by government as well as a cross-section of development agencies including the World Bank, EU, the UN Development Programme and the UN Environment Programme. These projects are specifically focused on environmental rehabilitation, conservation efforts and research, via technical assistance and other uses of funds. A large number of development agency projects are coordinated and implemented through the PIUs, and, there may be one or several PIUs within a single ministry or agency. PIUs are coordinated by a lead focal person supported by technical and administrative staff. They operate at the national level with significant decentralisation to the local level. Mostly, PIUs are managed and staffed by government, but in some cases development partners engage staff directly or supply technical assistance to them. For example, the UNDP-funded Wood Fuel Resource Development Programme in the Ministry of Energy is supported by a full-time UNDP project manager based at MoE offices.

PIUs face a number of challenges and are ineffective. These include:

- Complex and varying requirements for every development partner, using up valuable government resources;
- Inadequate deployment and rapid turnover of finance, accounting and internal audit staff with the result that knowledge of development rules and regulations at any one time is low;
- Unclear staff secondment policies from government to PIUs;
- Loss of good quality staff from government to PIUs due to higher pay scales;
- Often inadequate operations and maintenance budgets to support PIUs administrative functions; and
- Bureaucratic decision-making processes leading to delays.

Over the last 10 years, there has been a shift in implementation arrangements from a direct to a multi-tier model. Whereas direct implementation involves development agencies directly partnering with government institutions, the multi-tier model involves a single or combination of development agencies partnering with a consortium of government institutions, along with local and international NGOs, community-based organisations, civil society and in some cases the private sector, to carry out joint implementation of projects and programmes. Non-government consortium members are brought on board on the basis of sector expertise whilst government institutions are incorporated with view of facilitating policy guidance. Under this arrangement, development agencies delegate implementation arrangements to intermediary organisations or via consortium arrangements, and simply maintain broad oversight authority, supervision and monitoring responsibility. The SIDA-funded Fast Action Network Environmental Support Programme is a good example of this model.

The shift from a direct to multi- tier model has been driven by a number of factors. These factors include the

- Need for development partner harmonisation and coordination of funding efforts to maximise the achievement of results;
- Pressure to harness existing capacity and expertise to promote knowledge and cross-learning;

- Need to promote and coordinate efforts to shape national sectoral policies;
- Drive to minimise duplication of efforts;
- Need for better resource allocation and utilisation;
- Need to demonstrate and promote better accountability of resources and results;
- Need to tap into local expertise, particularly in the identification of localised sustainable interventions.
- However the multi-tier model has had its issues, including:
- Internal competition among implementing institutions;
- Complex and bureaucratic decision-making processes;
- Differences in the design and nature of financing instruments preferred by development partners;
- Competing development partner priorities and global strategies.

7. Accounting and Reporting

The current IFMIS does not have a specific code to track and report climate change budgets and expenditures. Climate change budgets and expenditures are not delineated and instead are bundled up into overall ministerial expenditures. As for trust funds and government agencies, the LATF relies on the IFMIS as funds are disbursed directly from Treasury with transfer requests originating from the MoLG. KFS has an oracle-based customised IFMIS deployed at the level of regional field offices.The IFMIS has been undergoing reengineering with a view to extending the system's functionalities to include end-to-end processes.

There are a number of accounting and reporting challenges due to lack of capacity that cause low absorptive capacity, especially at the local level. These include:

- Delays in reporting, particularly at the local level;
- The poor quality of reporting;
- Insufficient supporting documentation;
- The misappropriation of funds at times leading to suspension or closure of projects;
- Manual financial management systems at the local level;
- Manual monitoring and evaluation (M&E) systems;
- Complex shared cost allocation criteria;
- The inability of the current systems to track specific programmes costs;
- Delays in obtaining bank statements especially for accounts held at the Central Bank;
- Delays in obtaining authority from Treasury to open bank accounts; and
- Delays in obtaining tax exemptions, certificates and refunds[ii].

8. Audit Arrangements

Climate change funding through government systems is audited through existing government internal and external audit arrangements. Constitutionally the Kenya National Audit Office, now the Auditor General under the new constitution, is charged with the responsibility of carrying out external audits on all the accounts of public institutions and reporting them directly to parliament. Internal audits of all government institutions are carried out by the Office of Internal Auditor General, which is a department within Treasury. Both of these institutions are largely decentralised

with offices across the line ministries and at the local level. Projects in line ministries are audited both internally and externally as an integral part of the audit procedure.

The internal audit function has evolved over time with the latest focus being placed on risk-based systems audits. Government-managed finances and government-funded trust funds are exclusively audited through the government's own audit arrangements. The CDTF and WSTF, which have development partner involvement, have in-house internal audit capability, and employ independent external audit firms, normally appointed by the development partners with agreement from government, to carry out external audits.

9. Conclusions and Way Forward

The analysis of this paper contains important conclusions for the absorption and management of climate finance in Kenya. This relates both to the full design, establishment and mode of operation of the proposed climate Kenya National Climate Fund, and to the broader public financial management framework through which climate finance will flow. These conclusions are presented below (with proposed lead implementing agents in brackets).

i. *Create the Kenya National Climate Fund as a separate legal entity (MoF).*

   The higher absorption rates of GoK trust funds compared to the GoK as a whole, the ability of trust funds to facilitate pooled funding, as well as trust funds' higher levels of efficiency and effectiveness than other modes of project delivery (at the local level in particular), support the creation of a National Climate Fund for Kenya as a separate legal entity.

ii. *Establish a joint financing agreement with development partners with regard to the Fund (MoF and MEMR)*

   In the context of the Fund, and to increase funds absorption, it will be necessary for the GoK to establish the parameters and dynamics of pooling development agency (and government resources) within a common envelope through a joint financing agreement.

iii. *Integrate climate finance, within and beyond the Fund, into the broader government public financial management framework (MoF and Ministry of Planning (MoPl)).*

   It will be important for the government, development partners and other stakeholders to integrate and account for the Fund's finances within the annual budget and budget policy statement from the 2013-2014 financial year onwards and the MTEF 2013-2017. This should take account of the Public Financial Management Act 2012.

iv. *Prioritise climate change funding within the annual budget, including the creation of specific climate change code (MoF and MoPl).*

   The annual budget and budget policy statement provides a valuable avenue to prioritise climate change funding, and for the GoK and development partners to engage on climate

finance issues. This includes the creation of unique code to track and report climate expenditures, both for internal government purposes and for purposes of reporting on climate expenditure to the development partners and the UNFCCC.

v. *Harmonise and standardise government and development partner funding requirements (MoF and development partners).*

   It is necessary to address difficulties in complying with development agency requirements to increase overall absorption rates to at least 75 per cent and reduce the disparity in absorption rates between development partners, in terms of both delays in, and transaction costs of, requesting and disbursing funding. This should happen according to the principles of the Kenya's Joint Assistance Strategy.

vi. *Harmonise development partner and government fiscal calendars (MoF and development partners).*

   For the reasons under (iv), the GoK and development partners should work to synchronise allocations to the Fund with the GoK fiscal calendar, i.e. to ensure that funding is proffered at the right time of year to either fit into the 'formulation of budgetary estimates' fiscal window or the 'supplementary revisions' window.

vii. *Enhance integrity, predictability, sustainability and mutual accountability of fund flows between development partners and the government (MoF and development partners).*

   This is especially with regard to the timely and accurate reporting of funding channelled into projects as AIA but is relevant to the revenue vote as well. The Fund's design should take this into account.

viii. *Improve the level of financial management and project implementation capacity within trust funds, with a focus on the design of the Kenya National Climate Fund (MoF and MEMR).*

   Continued reform efforts should include targeted, hands-on capacity building support, especially in financial management practices; a balance of transfer of operations and the provision of support to the regional or local level; and the provision of support to implementing agents (especially at the local level) to improve the identification and implementation of projects.

ix. *Reduce the overall duration of the fund flow process, particularly where government systems are involved.*

   The government needs to establish the means to significantly reduce the current fund flow duration from an average of 51 working days to less than 15 days, with a particular focus on funding channelled through the MoF as revenue (rather than AIA). This may include new practices and procedures, the improvement of the IFMIS (provide detailed, programme-specific information), as well as the elimination of any redundant processes. This applies to the GoK, development agency and trust fund funding.

x. *Improve accounting and auditing capacity in the GoK (MoF).*

In order to improve accounting and auditing capacity, it will be necessary to implement the following recommendations.

a. Identify opportunities and develop a single registry management information system platform for climate change initiatives in the country;
b. Harmonise MoF, Fund and development partner reporting and banking arrangements;
c. Build in-house Fund internal audit capability and employ independent external audit firms, following the lead of the CDTF and WSTF, with development partner involvement.
d. Develop simplified financial management and operations manuals to be used in the training of implementing agencies (especially) at the local level.

xi. *Ensure Fund harmonisation with the new constitution (MoF and MEMR).*

The implications and impacts of the new constitution and associated legislation will need to be taken into account, particularly with regard to the redesign of public financial management frameworks (notably the Public Financial Management Act 2012) the impact of the devolution of certain functions to the county level, and other key issues identified in part V of this section.

xii. *Promote transparency and anti-corruption in climate finance flows and expenditure.*

It is imperative that the management of climate finance, like all public and development partner finance, is transparent and free from corruption. The National Climate Fund places transparency and openness as one of its guiding principles.

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- Kenya Forestry Service
- Kenya Forest Service
- Local Authorities Transfer Fund
- Ministry of Agriculture
- Ministry of Energy
- Ministry of Environment and Mineral Resources
- Ministry of Finance
- Ministry of Forestry and Wildlife
- Ministry of Local Government
- Ministry of Regional Development Authorities
- Nature Kenya
- Swedish International Development Cooperation Agency
- UK Department for International Development
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- World Bank

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i Under the public financial framework introduced by the new Public Financial Management Act 2012, a scion of the new constitution which passed in the summer of 2012, it is expected that absorption rates could rise to over 75%.

ii Exemptions and refunds, particularly VAT exemptions and refunds.