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THE DIVISION OF REVENUE BILL, 2014

A Bill for

AN ACT of Parliament to provide for the equitable division of revenue raised nationally between the national and county governments in 2014/15 financial year, and for connected purposes

ENACTED by the Parliament of Kenya, as follows—

Short title and commencement.

1. This Act may be cited as the Division of Revenue Act, 2014 and shall come into operation upon publication.

Interpretation.

2. (1) In this Act, unless the context otherwise requires—

"Cabinet Secretary" means the Cabinet Secretary for the time being responsible for matters relating to finance;

"county allocation" means the share of national revenue computed in accordance with article 203(2) of the Constitution that is allocated for the use of the County government consisting of the County Executive and the County Assembly;

"national allocation" means the share of national revenue computed in accordance with Article 203(2) of the Constitution that is allocated for the use of the national government consisting of the Executive, Parliament and the Judiciary;

"revenue" has the meaning assigned to it under section 2 of the Commission on Revenue Allocation Act, 2011; No. 18 of 2012

"State Organ" has the meaning assigned to it under Article 260 of the Constitution;

"wasteful expenditure" has the meaning assigned to it under section 2 of the Public Finance Management Act, 2012.

Object and purpose of this Act

3. The object and purpose of this Act is to provide for the equitable division of revenue raised nationally between the national and county levels of government for the financial year 2014/15 in accordance with Article 203(2) of the Constitution.

Allocations to county government

4. Revenue raised by the national government in respect of the financial year 2014/15 shall be divided among the national and county governments as set out in the Schedule to this Act.

Variation in revenue

5. (1) If the actual revenue raised nationally in a financial year falls short of the expected revenue set out in the Schedule, the shortfall shall be borne by the National Government, to the extent of the threshold prescribed in the regulations by the Cabinet Secretary.

(2) If the shortfall in revenue referred to in sub-section (1) exceeds the threshold prescribed by the Cabinet Secretary, the shortfall in excess of that threshold shall be apportioned between the national and county governments on a *prorata* basis.

(3) If the actual revenue raised nationally in a financial year exceeds the expected revenue set out in the Schedule, the excess revenue shall be apportioned between the national government and county governments on a *prorata* basis.

SCHEDULE (s. 4)

ALLOCATION OF REVENUE RAISED NATIONALLY BETWEEN THE NATIONAL AND COUNTY GOVERNMENTS FOR FINANCIAL YEAR 2014/15

Type/Level of Allocation	**Amount in KSh. billions**	**Article 203(2) (*Minimum threshold -15%*)1**
Total Shareable Revenue	1,026.31	
A. National Allocation	**799.65**	
of which:		
Economic Stimulus Package 2	1.45	
Equalization Fund	3.4	
B. County Allocation	**226.66**	**43%**

[1] Based on 2009/10 audited revenues approved by National Assembly (KSh. 529.3 billion)

[2] For completion of centers of excellence under the Economic Stimulus Package in all 290 constituencies (5 million per constituency)

MEMORANDUM OF OBJECTS AND REASONS

The principal object of this Bill is to provide for the equitable division of revenue raised nationally among the national and county levels of government as required by Article 218 of the Constitution, and to provide for additional resources in accordance with Article 202(2) of the Constitution in order to facilitate the proper functioning of county governments and to ensure on-going services are provided for.

Clauses 1 and 2 of the Bill provides for the short title of the Bill and the interpretation of terms used in the Bill.

Clause 3 of the Bill contains the provisions on the objects and purpose of the Bill.

Clause 4 of the Bill prescribes the allocations from the national government to the county governments in 2014/15 financial year.

Clause 5 of the Bill deals with mechanisms for adjusting for variations in revenues.

Clause 6 of the Bill contains general provisions which emphasize on dispute resolution before instituting court proceedings and includes provisions on personal liability on public officers who cause a State Organ to incur costs because of referring disputes relating to division of revenue to courts prior to exhausting available alternative dispute resolution mechanism.

This Bill is a Bill concerning county government.

Dated the 15th April 2014.

KITHURE KINDIKI,
Senate Majority Leader.

APPENDIX

EXPLANATORY MEMORANDUM TO THE DIVISION OF REVENUE BILL, 2014

The Division of Revenue Bill, 2014 has been prepared in fulfilment of the requirements of Article 218(1) of the Constitution and Section 191 of the Public Finance Management Act, 2012. Article 218(2) of the Constitution requires that the Bill be submitted to Parliament every year together with a memorandum explaining—

(a) the proposed revenue allocation set out in the Bill;

(b) the extent to which the Bill has taken into account the provisions of Article 203 (1) of the Constitution; and

(c) any significant deviations from the recommendations of the Commission on Revenue Allocation (CRA).

This memorandum has therefore been prepared as an attachment to the Division of Revenue Bill, 2014 in fulfilment of the requirements of Article 218(2) of the Constitution.

I. Explanation of the Allocation of Equitable Share of Revenue Raised Nationally and Conditional Allocation between National and County Governments as Proposed in the Bill

The division of revenue between the two levels of government in the Bill has been arrived at after taking into account the following factors:

(a) **Adherence to the county allocations threshold set in the Article 203(2) of the constitution**: The bill considers the provision that revenue allocations to the counties should be at least 15% of nationally raised revenue calculated on basis of latest audited accounts in line with Article 203. The last audited revenues approved by the National Assembly are those of 2009/10. Based on these revenue figures, the allocation to counties is 43%.

(b) **Costing of functions**: Ideally, revenue allocations should be based on costing of the functions and needs of each level of government. Information on the real cost of functions to each level of government and their actual needs has not been done. This has made it difficult to determine the quantum of revenue that should be set aside for counties.

(c) **Adherence to criteria set out in Article 203(1):** The constitution requires that the revenue allocations take into account the elaborate provisions set out in Article 203(1). The explanation about how this was addressed is indicated below.

(d) **Determination of conditional or unconditional allocations (Article 202(2)):** the Constitution allows the national government to allocate resources to counties from its own revenue share as conditional or unconditional allocations. The National Assembly in its approved report on the Budget Policy Statement for 2014, had clearly set out amounts to be sent to counties as conditional allocations.

Broadly, the revenue allocations in the Bill are determined taking into account the following fiscal policy matters:

(a) **Need to ensure stable revenue allocations between the two levels of government:** revenue allocations between the two levels of government should be stable and predictable. In the absence of proper costing of functions or a needs-based framework for financing of the two levels of government, the revenue allocations are based on expected revenue collections in the 2014/15 financial year and revenue growth.

(b) **Observing fiscal austerity or hard budget constraints:** the bill considers that each level of government should efficiently spend available resources. The prevailing orientation in public sector budgeting is to simply increase resources to each level of government. But, such approach is inconsistent with fiscal prudence in the face of limited tax resources.

(c) **Fostering the cordial relationship envisaged in Article 187:** Sharing of functions and resources transfer should be based on cordial sharing of resources envisaged in Article 187 and 202(2) of the constitution.

After consideration of all these matters, the vertical distribution of nationally raised resources is set out as follows:

(a) **National Government:** Out of the estimated shareable revenues amounting to Ksh.1,026.31 billion, a total of Ksh.799.65 billion is allocated to the national government.

(i) Equalization Fund, KSh. 3.4 billion;

(ii) Provision of KSh. 5 million per constituency toward completion of centres of excellence under the Economic Stimulus Package, that is a total of KSh. 1.45 billion.

(b) The county allocation will amount to KSh. 226.66 billion, which is 43 % of recent audited revenues approved by National Assembly. These figures have been arrived at taking into account Article 202 and 203 of the constitution, revenue growth

for 2013/14 and 2014/15, and the allocations to counties for 2013/14.

(c) Given the amount of resources allocated to counties, constitutional provision of Article 203 (2) which requires county governments be allocated not less than 15 per cent of the revenue raised by the national government based on the last audited revenues approved by the National Assembly, has been met.

(d) The county allocation of Ksh. 226.66 billion reflects a growth of 19.3% over the Ksh. 190 billion allocated to counties in 2013/14. The national share rises by only 9.4% during the same period (that is, from Ksh. 730.4 billion in 2013/14 to Ksh. 799.65 billion in 2014/15). The growth of county allocation not only exceeds the projected revenue growth, but also is far much higher than the growth of the national government's share during the same period. The enhanced allocation will ensure that county governments are able to cover their development needs and the cost of the new salaries approved by the Salary and Remuneration Commission, and related personnel costs.

II. Evaluation of the Bill against Article 203 (1) of the Constitution

Article 218 (2) (b) of the Constitution requires that a Division of Revenue Bill be accompanied by a memorandum that explains how the provisions of Article 203 (1) of the Constitution have been taken into account in the Bill. In this section, an assessment of the extent to which the requirements of Article 203 (1) have been incorporated in the Division of Revenue Bill, 2014 is undertaken.

The amounts shown in Table 1 are drawn from the national government ceilings set out in the Schedule to the Budget and Appropriations Committee Report on the Budget Policy Statement, 2014 which was adopted by the National Assembly on 20th March, 2014. The requirements of the national government exceed its own revenue share, which means that the deficit will be covered through Appropriations in Aid, loans and grants.

(a) National Interest

Table 1 lists some of the functions that fall under the category of national interest. These include: national defence services, the National Intelligence Services (NIS), police services, judicial services, national elections and parliamentary services as well as other national services rendered by various government ministries, constitutional commissions and independent offices. The total amount for the national needs amount

to KSh. 1,139.9 billion. This will be financed through the national revenue share of Ksh. 799.65 billion, foreign financing and Appropriations-in-Aid.

(b) Public Debt and Other National Obligations

The Bill has fully provided for all debt related costs as well as other national obligations mandated by the Constitution such as pension contributions, salaries for constitutional office holders and contributions to international organizations. In 2014/15, the allocation for public debt and other national obligations is Ksh. 414.4 billion, up from Ksh. 381.5 billion in 2013/14.

(c) Fiscal Capacity and Efficiency of County Governments

Fiscal capacity for county governments, that is, the potential revenues that can be generated from the tax bases assigned to the counties when a standard average level of effort is applied to those tax bases, has not been assessed. It is still early to measure county governments' fiscal efficiency. Despite the reports of the Controller of Budget and Auditor General, there is no sufficient official data on county fiscal capacity and efficiency owing to the fact that county governments are fairly new and therefore, this criterion has not been taken into account in the determination of the division of revenue between the national and county governments.

(d) County governments' ability to perform the functions assigned to them and meet other developmental needs of the county governments

In determining the vertical allocation of revenue for the county governments, the imputed cost of the functions transferred to counties was used as a guideline for the initial equitable share allocation of Ksh. 190 billion in 2013/14. The real costing of the functions to counties and the costing of needs is yet to be determined. The total resources available to counties (Ksh. 226.66 billion) will fairly help counties perform their functions and meet required developmental needs. Any deficiencies will be considered under the auspices of Intergovernmental Relations Act, and Article 187 of the constitution.

(e) Economic Disparities within and among counties and the need to remedy them

Allocation of the sharable revenue (i.e. county allocation of Ksh. 226.66 billion) among counties is based on the formula approved by Parliament which takes into account disparities among counties and aims at equitable distribution of resources. The formula takes into account population (45%), land area (8%), poverty (20%), a basic equal share (25%), and fiscal responsibility (2%). Ksh. 3.4 billion has been set aside for the Equalization Fund in 2014/15. This Fund will be used to finance

development programmes that aim to reduce regional disparities among counties.

(f) Need for Economic Optimization of Each County

The critical principle in the revenue allocations was the need to achieve economic efficiency within hard budget constraints or limited resources in the face of limited tax resources. This is achieved by ensuring that each county receives substantial resources under the equitable share compared to the 2013/14 allocation. Equitable revenue share to counties will rise by an average of 15% growth rate. Together with conditional allocations, each county government will have its own discretionary resources which each county can allocate to its priority developmental programs. County governments will therefore be able to optimise on their economic development programmes by channelling their resources to high priority areas.

(g) Stable and Predictable Allocations of County Governments' Vertical Share of Revenue

Need to ensure stable and predictable revenue allocations between the levels of government and particularly to counties is a critical principle of the 2014/15 allocations. Apart from the fact that allocations to counties exceed estimated revenue growth, the county governments' equitable share of revenue raised nationally has been protected from cuts that may be necessitated by a shortfall in the collections of ordinary revenue (Clause 5 of the bill). In addition, the county governments are assured of getting at least the same amount allocated the previous year which, therefore, enhances predictability.

(h) Need for Flexibility in Responding to Emergencies and Other Temporary Needs

Included in the equitable share of revenue for the national government is an allocation of Ksh. 5 billion for the Contingencies Fund. This Fund will be used to meet the demands arising from urgent and unforeseen needs in all Counties that suffer from calamities in the manner contemplated under Section 21 of the Public Finance Management Act, 2012. In addition, the Public Finance Management Act, 2012 requires each county government to set up a County Emergency Fund. County governments are expected to set aside part of their resource allocation for this purpose.

Table 1: Evaluation of Revenue Allocation in Relation to Article 203 (1) of the Constitution (KSh. billions)

	BUDGET ITEM	2014/15
A	**Ordinary Revenue (excluding AIA)/Shareable revenue**	**1,026.31**
B	**National Interest [Article 203 (1)(a)]**	**1,139.92**
	1. Defence and NIS	79.46
	2. Parliament	25.80
	3. Judiciary	17.0
	4. Presidency	4.38
	5. Office of the Attorney General Office & Department of Justice	2.98
	6. DPP	2.48
	7. Police Services	67.51
	8. Teachers Service Commission	160.77
	9. Other Constitutional Commissions and Independent offices	11.90
	10. Elections	3.78
	11. Other National Services	76.39
C	**Public Debt and Other Obligations (Article 203 [1][b])**	**414.39**
	1. Debt Payment	353.48
	2. Pensions, constitutional salaries & other	60.91
D	**Emergencies [Article 203 (1)(k)]**	**5.0**
E	**Equalisation Fund [Article 203 (1) (g) and (h)]**	**3.4**
F	**County Allocations [Article 203 (1) (f)}]**	**226.66**

III. Explanation on the Deviations from the Recommendations of the Commission on Revenue Allocation

There are several significant deviations in the bill with the CRA's recommendations on the division of revenue between the national and county governments for the financial year 2014/15. The differences stem from the different approaches or principles used in the computation of the equitable revenue shares and the actual amounts allocated.

(a) **Allocations to each level of government:** The Commission on Revenue Allocation has proposed revenue allocation to counties of KSh. 279.1 billion in financial year 2014/15. This is approximately 53% of most recent audited revenue approved by National Assembly. The bill instead allocates KSh. 226.66 billion to counties, or 43% of the said revenue. The differences arise from the approaches used in determining the resources for counties. The resources to counties as contained in the bill are

based on average revenue growth, while those by the CRA are based on forward estimates of expenditure (2014/15) contained in the printed estimates of 2012/13 (before counties were fully in place). That approach is not current or realistic given that the expenditure estimates for 2013/14 for National government are available and that the counties already received Ksh. 190 billion in 2013/14.

(b) **Adherence to the county allocations threshold set in the Article 203(2) of the constitution by applying the correct audited accounts approved by National Assembly in line with Article 203(2).** The CRA uses 2011/12 revenues while the bill uses the recently approved revenues of 2009/10 financial year. Consequently, the bill shows that the allocation to counties is 43% of revenues receipts of 2009/10.

(c) **Costing of functions:** In absence of proper costing of functions, the bills applies revenue growth as a basis for revenue allocation together with other factors so as to ensure stability of allocations to each level of government. However, CRA uses ad hoc unbundling of forecasted allocations to national government using, as a baseline, the forward year (2014/15) of the Printed Estimates of Recurrent and Development Expenditure for 2012/13. This baseline may not be appropriate since it is dated and budgets change from year to year. It, therefore, does not reflect the most recent changes in national policy and the economy. The CRA approach ignores the revenue allocations for 2013/14 as the basis for future allocations, hence moving away from the need to ensure stability and predictability of revenue allocations for both levels of government. It is further that the noted an attempt to cost some of the services of county governments is inadequate. For example, CRA's costing of the new administrative structures is overstated. The CRA estimates that the additional cost of new administrative structures at the county level will be Ksh. 48.3 billion, comprising of Ksh. 38.1 billion for remuneration and Ksh.. 10.1 billion for other administrative costs.

(d) **Adherence to criteria set out in Article 203(1):** The bill clearly takes into account the needs of the national government and those of counties in determining the allocations to each level of government. In Contrast, the CRA approach first estimates the county allocations and obtains the national government allocation as a residual. By not taking into account the Criteria in Article 203(1) of the Constitution, some functions of the

national government are likely to remain unfunded or underfunded.

(e) **Determination of conditional or unconditional allocations (Article 202(2)):** The constitution allows the national government to allocate resources to counties from its own revenue share as conditional or unconditional allocations. The bill does not incorporate conditional or unconditional allocations, rather the bill provides total county allocations for sharing in accordance with the County Allocation of Revenue Act.

IV. Explanation on How the Bill deviates from the Resolution of the House on the Budget Policy Statement, 2014

The Bill deviates from the resolution of the National Assembly on the Budget Policy Statement, 2014 in the following ways:

(a) **Allocation to County governments:** The allocation to counties has increased from KSh. 217.87 billion to KSh. 226.66 billion.

(b) **Allocation to National Government;** The allocation for national government declines from KSh. 808.4 billion to KSh. 799.65 billion on account of increased amount to county governments.

Allocation to REA: The allocation to REA is not shown under the National Allocation in the Bill. Instead, the amount of KSh. 7.3 billion which was contained in the House Resolution as part of National government revenue share is divided equally among the two levels of government since rural electrification is a shared function.

(c) **Conditional Allocations:** the bill drops the amounts set out as "Conditional Allocations" in the House Resolution. This is done so as to consolidate the total allocation to counties as a block figure. The "County Allocation" will be shared upon the enactment of the County Allocation of Revenue Bill, 2014.