ADVANCED PUBLIC FINANCIAL MANAGEMENT



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For permissions or licensing inquiries, please contact:
Synapse Global Institute
P.O Box 25970, 00100, Nairobi, Kenya
admin@sgi.ac
+254 100000050

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PREFACE

This comprehensive student guide for CPA Paper No. 16 (S4) Advanced Public Financial Management is designed to equip learners with the knowledge, skills, and practical understanding required to master the complexities of public sector financial management in Kenya. Drawing on the provisions of the Constitution of Kenya, 2010, the Public Finance Management Act, 2012, the Public Procurement and Asset Disposal Act, 2015, the Public Audit Act, 2015, and other relevant legal frameworks, this guide offers a detailed exploration of the multifaceted aspects of managing public finances within devolved government structures.

The book covers the foundational principles and scope of public financial management, emphasizing compliance with regulations, the evolving local and global financial environment, and the application of advanced tools and techniques in managing public investments, debt, procurement, and enterprise governance. It addresses critical institutional roles, including those of accounting officers, the National Treasury, the Controller of Budget, the Office of the Auditor General, and parliamentary oversight committees, highlighting their interconnected responsibilities in ensuring transparency, accountability, and fiscal discipline.

Readers will find in-depth discussions on the establishment and management of public funds, the operational cycle of budgeting and expenditure control, and the stewardship of consolidated and county revenue funds. The guide also delves into best practices and challenges associated with public debt management, procurement processes, internal auditing standards, and the evolving frameworks that underpin reforms in Kenya's public financial management landscape.

Special attention is given to the roles and interactions among key stakeholders—National and County Governments, Parliament, development partners, and civil society—underscoring the importance of coordination, public participation, and continuous capacity building in achieving sustainable fiscal outcomes.

Each section is carefully structured to not only provide theoretical insights but also practical applications, supplemented by complex practice questions and solutions aimed at preparing students for examination success and real-world public financial management challenges.

This guide is an essential resource for CPA candidates, ACCA students, and all public finance practitioners seeking to deepen their understanding of Kenya’s advanced public financial management system and contribute effectively to the governance and economic development of the country.

CPA Ronoh Benson Benhard
Synapse Global Institute
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CHAPTER ONE

INTRODUCTION TO PUBLIC FINANCIAL MANAGEMENT

1.1 The Scope, Objective, and Principles of Public Financial Management (PFM)

Learning Outcome

By the end of this section, you will be able to:

- Define comprehensively the scope of Public Financial Management (PFM).
- Understand the detailed objectives that PFM seeks to achieve in the public sector.
- Explain, with examples, the core principles guiding PFM and how they are enforced by the Public Finance Management Act, 2012.

What is Public Financial Management?

Public Financial Management (PFM) describes the entire process by which public funds are planned, acquired, allocated, spent, and accounted for by government institutions. It is more than just accounting or budgeting; it encompasses all financial activities that ensure public money is managed legally, effectively, and transparently to support government policy objectives.

1.1.1 Scope of Public Financial Management

The scope of PFM is broad and covers the following key areas:

- **Budgeting and Financial Planning:** Preparing annual and medium-term budgets that align with government policies and priorities as laid out in national development plans. This involves revenue forecasting, expenditure planning, and setting fiscal targets. The PFM Act mandates the preparation of realistic budgets and medium-term expenditure frameworks to foster fiscal discipline.
- **Revenue Collection and Management:** Efficient systems to collect taxes, fees, and other government revenues. This includes the operations of the Kenya Revenue Authority and the Integrated Tax System (ITS), which support transparency and efficiency in revenue collection.
- **Public Expenditure Management:** Managing how funds are released, spent, and controlled. This includes procurement of goods and services, payment controls, and adherence to expenditure limits. The Act requires accounting officers to control appropriations and ensure funds are used strictly for authorised purposes.
- **Public Debt Management:** Borrowing and managing government debt sustainably to finance budget deficits or development projects without jeopardising fiscal stability. The Public Debt Office oversees this, ensuring compliance with legal limits and risk management practices.

- **Accounting and Financial Reporting:** Maintaining accurate financial records through Integrated Financial Management Information Systems (IFMIS) to produce timely and reliable reports for stakeholders, including the Auditor General and Parliament.
- **Internal Controls and Auditing:** Establishing procedures to safeguard public resources and detect irregularities. Internal audit functions and audit committees play a key role here, as outlined in the PFM Act and related regulations.
- **Financial Oversight and Accountability:** Parliamentary committees, the Office of the Auditor General, and public participation mechanisms monitor and hold government entities accountable for their financial management.
- **Public Procurement:** Following legal frameworks and institutional guidelines to ensure value for money, fairness, and transparency in purchasing public goods and services.

1.1.2 Objectives of Public Financial Management

The objectives of PFM broadly reflect the need to manage public resources effectively to foster good governance and economic development. They include:

1. **Efficient Allocation of Resources:** Ensuring that government funds are directed to priority sectors such as health, education, infrastructure, and security. PFM ensures alignment of budget allocations with policy goals, avoiding waste and duplication.
2. **Fiscal Discipline:** Maintaining control over government spending and borrowing to avoid unsustainable deficits and debt burdens. The PFM Act requires balanced budgets and sets ceilings on government expenditure.
3. **Transparency:** Making financial information accessible to citizens, Parliament, and oversight bodies to build trust and enable informed participation in governance.
4. **Accountability:** Holding public officials responsible for the use of funds, requiring them to report and justify their financial decisions. The Act enforces this through mandatory reporting and sanctions for misuse.
5. **Effectiveness and Efficiency:** Using public funds to achieve maximum outputs and outcomes, whether through service delivery or infrastructure development.
6. **Equity and Fairness:** Distributing resources to promote social and regional equity, reducing disparities across counties and social groups.
7. **Sustainability:** Managing finances to meet current needs without compromising future generations' ability to meet theirs, especially through prudent debt management.

1.1.3 Principles of Public Financial Management

The following principles are the foundation of sound PFM systems:

- **Accountability:**
  Every public officer entrusted with resources must explain and be responsible for their financial actions. For example, accounting officers must prepare and submit financial reports to Parliament under the PFM Act. Failure to comply can lead to disciplinary measures.
- **Transparency:**
  Government financial activities must be open to scrutiny. The PFM Act requires publication of budget documents and audit reports, and encourages public participation in budget processes. This openness reduces corruption and mismanagement.
- **Fiscal Discipline:**
  Governments must plan and control spending within available resources. The PFM Act enforces fiscal discipline by requiring that spending does not exceed approved budgets and that borrowing is within legal limits.

- **Efficiency and Effectiveness:**
  Ensures that resources are used to achieve the best possible outcomes. This is supported by regular monitoring and evaluation of public investments and programmes, as required by the PFM Act and related guidelines.
- **Equity:**
  Public resources should be distributed fairly across regions and population groups. The Constitution and the PFM Act support this by guiding resource allocation formulas and county revenue sharing.
- **Legal Compliance:**
  All financial management activities must comply with the PFM Act, Procurement Act, and other relevant laws. This includes adherence to procurement procedures and regulations to ensure fairness and legality.
- **Sustainability:**
  Public debt and expenditures should be managed so that future generations are not burdened. The PFM Act and Public Debt Management regulations set limits and conditions on borrowing to achieve this.

1.1.4 The Public Finance Management Act, 2012 and its Role in PFM

The PFM Act is a crucial legal instrument that institutionalises the objectives and principles of PFM in Kenya. Key features include:

- **Clear Roles and Responsibilities:**
  The Act defines the duties of Cabinet Secretaries, Accounting Officers, the Controller of Budget, the Treasury, and the Parliament in managing public funds.
- **Budgeting Framework:**
  It mandates preparation of annual and medium-term budgets, requiring alignment with policy priorities and transparency in the approval process.
- **Financial Reporting and Audit:**
  The Act requires timely production of financial statements and submission to the Auditor General for independent audit. Reports must be tabled in Parliament for oversight.
- **Internal Controls and Oversight:**
  Establishes internal audit functions, audit committees, and the role of the Controller of Budget to monitor compliance and performance.
- **Public Participation:**
  Promotes involvement of citizens and stakeholders in budget preparation and monitoring, enhancing transparency and ownership.
- **Debt and Contingency Fund Management:**
  Sets rules for borrowing and management of public funds including special funds such as the Contingency Fund and Equalisation Fund.

Practical Example: Application of PFM Principles

Consider a county government preparing its budget. Using PFM principles:

- It must **allocate resources equitably** across wards to promote balanced development (Equity).
- The budget estimates must be **realistic and within projected revenues** (Fiscal Discipline).
- The budget documents should be **publicly available** and citizens involved in discussions (Transparency and Public Participation).
- The accounting officer is **accountable** for spending according to the approved budget and must report regularly (Accountability).
- Procurement of goods must follow **legal procurement procedures** to ensure value for money (Legal Compliance and Efficiency).

1.2 Relevance of the Public Finance Management (PFM) Act in Management of Public Finances

Learning Outcome

By the end of this topic, you should be able to:

- Explain the importance of the Public Finance Management Act, 2012 (PFM Act) in governing public financial management.
- Describe how the PFM Act enhances accountability, transparency, fiscal discipline, and efficiency in managing public funds.
- Discuss the role of the PFM Act in aligning public resource management with national development goals.
- Identify how the PFM Act supports oversight and control mechanisms in public finance.

Overview of the PFM Act, 2012

The Public Finance Management Act, 2012 is a comprehensive legal framework enacted to regulate the management of public funds in Kenya. It is aligned with the Constitution of Kenya (2010), particularly Article 201, which calls for openness, accountability, and prudent management of public resources.
The Act applies to both national and county governments, state corporations, and public entities, setting clear rules, roles, and procedures to ensure that public financial management is effective, transparent, and accountable.

Why is the PFM Act Relevant to Public Financial Management?

The PFM Act is critical because it:

8. **Establishes a Legal Framework for Managing Public Finances**
   The Act codifies the principles and processes of PFM into law, ensuring that all public financial operations follow a consistent, enforceable framework. It defines responsibilities for key players such as Cabinet Secretaries, Accounting Officers, the National Treasury, Parliament, and the Controller of Budget.
9. **Promotes Fiscal Discipline and Sustainability**
   Through setting spending ceilings, requiring balanced budgets, and regulating borrowing, the Act enforces fiscal discipline. This helps prevent excessive deficits and debt accumulation that could threaten economic stability. For example, the Act requires that expenditures match authorised appropriations and limits the national government's borrowing powers.
10. **Enhances Transparency and Accountability**
    The Act mandates timely preparation and submission of financial reports to Parliament and the Office of the Auditor General. It requires that budgets, procurement plans, and audit reports be made publicly accessible, enabling citizens and oversight bodies to monitor government financial activities. This transparency reduces corruption and mismanagement.
11. **Supports Efficient Allocation and Use of Resources**
    By requiring budgets to align with government policies and medium-term plans, the Act ensures that resources are allocated to priority sectors and programmes. It also mandates procurement procedures that promote value for money and competition, reducing wastage.
12. **Strengthens Public Financial Oversight**
    The PFM Act enhances the roles of oversight institutions such as the Auditor General, Parliament, and internal audit functions. It ensures these bodies have access to necessary information and authority to review, question, and report on public spending.

13. **Facilitates Public Participation and Inclusiveness**
    The Act encourages involvement of citizens and stakeholders in budget preparation and monitoring processes, fostering ownership and responsiveness to community needs.

Specific Features of the PFM Act that Strengthen Public Finance Management

- **Clear Roles and Responsibilities:**
  The Act assigns specific duties to accounting officers, requiring them to ensure efficient use and safeguarding of public funds. It also defines the role of the National Treasury in policy formulation and financial oversight.
- **Budget Preparation and Approval:**
  It requires that national and county governments prepare annual budgets, medium-term expenditure frameworks (MTEF), and submit them for parliamentary approval within specified timelines.
- **Public Debt Management:**
  The Act regulates the contracting and management of public debt, including the powers of the national government to borrow and the procedures for issuing guarantees. This reduces risks associated with uncontrolled borrowing.
- **Control of Expenditure:**
  The Controller of Budget is empowered by the Act to authorise withdrawals from public funds, ensuring that spending aligns with approved budgets. This control prevents unauthorised expenditures.
- **Financial Reporting and Audit:**
  Accounting officers must prepare quarterly and annual financial reports, which are audited by the Auditor General. Audit findings are tabled in Parliament for review and action.
- **Internal Audit and Risk Management:**
  The Act requires public entities to establish internal audit functions and audit committees to monitor and improve internal controls.
- **Public Procurement:**
  Although procurement has its own legal regime, the PFM Act integrates procurement controls into financial management by requiring procurement plans and budgets to be aligned and monitored.

How the PFM Act Aligns Public Finances with Government Policies

The Act ensures that public resources are not managed in isolation but are linked to the government's broader development objectives. For example:

- Budgets must be prepared in line with national development plans such as Kenya Vision 2030.
- Medium-term expenditure frameworks (MTEFs) enable governments to plan spending over three years, promoting consistency and predictability.
- Public investments and projects financed through public funds are monitored to ensure they deliver intended socio-economic benefits.

Challenges Addressed by the PFM Act

Before the Act's enactment, Kenya's public financial management faced challenges such as:

- Fragmented and non-transparent budgeting processes.
- Weak oversight and accountability mechanisms.
- Excessive borrowing without proper controls.
- Inadequate reporting and audit follow-up.
- Limited citizen participation in financial decisions.

The PFM Act addresses these by providing a clear, enforceable framework that strengthens institutions and processes.

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