GOVERNMENT OF KENYA

STRATEGY ON VERIFICATION AND CLEARANCE OF PENDING BILLS/DOMESTIC ARREARS

MAY 2024

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1. INTRODUCTION

The stock of pending bills for both the National government and the County governments have continued to accumulate despite numerous Circulars and Directives by the National Treasury requiring MDAs, State Corporations and Counties to prioritize the payment of pending bills. This has affected the overall liquidity of the private sector and led to the deterioration of financial positions of businesses, in particular micro and small enterprises.

1.1 The Objective of the Strategy

The purpose of this strategy to comprehensively address the persistent problem of pending bills. The strategy encompasses the verification of the current stock of arrears, identifying the underlying causes, attendant corrective reforms and the plan to clear the stock of arrears. This will help the Government to bring the issue of pending bill to finality in a structured manner and by taking appropriate measures to avoid accumulation of arrears in the future.

1.2 Implementing Institutions

The National Treasury and the entities from which the pending bills emanated will be involved in the implementation of the strategy. The broad categories are:

- Ministries, Departments and Agencies (MDAs)
- State Corporations, Semi-Autonomous Government Agencies (SAGAs) and Public Funds
- County Governments
- Specialised areas- includes pensions, legal bills and tax refunds.

1.3 Definition of Arrears/Pending bills

These are unsettled financial obligations that occur at the end of a financial year as a result of failure to pay for goods and services that have been procured and delivered provided the bills have not exceeded agreed credit period. It also includes unpaid obligations such as pensions, other payroll deductions and outstanding verified overpaid tax owed to tax payers.

1.4 Accumulation of Arrears and Impact on the Economy

Accumulation of arrears emerged as a serious problem with major concerns to government in the 1990s. Since then, the problem has grown steadily to a point where today it poses serious structural and financial constraints on the economy. The management of this challenge, is an important benchmark upon which the overall integrity of Government's financial management is judged.

Over the years, the Government had set up several committees and verification teams to advise the Government on how to resolve the problem of pending bills. In the period between 1998 and 2003, eight (8) different teams comprising four (4) Committees and (4) Taskforces were set up to examine and validate pending bills and make recommendations for resolving them and stop their recurrence and escalation. However, despite the work carried out by these teams, there was still no clarity of the actual size and composition of these bills and no comprehensive plan presented for resolving the existing stock of the bills and contain their recurrence and escalation.

Such was the scenario that led to the establishment of the Pending Bills Closing Committee through Gazette Notice No.297 dated 14^{th} January, 2005.The Committee was mandated to deal will all pending bills that existed at the time the Gazette Notice was published. The Committee succeeded in analysing the pending bills submitted by 31^{st} May, 2005, which was the deadline set for submission, and provided clear procedures and guidelines for conclusively resolving the bills challenge.

Despite the good progress made towards improving service delivery and unlocking growth of the rural economy, it has been noted that National Government MDAs and County Governments have persistently failed to pay for goods and services supplied. In addition, there are arrears in pensions, payroll deductions, payments due to third parties, tax refunds, and other legal pending bills.

The delay in clearance of arrears has led to deterioration of financial positions of businesses and in particular the MSEs, including businesses owned by women, youth and persons with disabilities. This has had negative impact on the economy, including less than optimal levels of employment and escalation of poverty.

1.5 Current Status of Pending Bills/Arrears

The Pending Bills Verification Committee has received a total of 94,996 claims valued at Kshs.571.63bn from Accounting Officers of National Government entities for the period up to June 2022. The pending bills have been disaggregated into four categories as shown in table 1 below:

Table 1: Summary of Pending Bills Submitted to PBVC

Description	Goods	Services	Works	Labour Related	Totals
No. of Claims	32,082	38,705	2,278	21,932	**94,996**
Amount (Ksh. Mn)	117,172.67	147,636.16	202,327.85	104,492.13	**571,628.81**

2. PREVENTION OF ARREARS ACCUMULATION

The National Treasury will seek to strengthen the enforcement of these measures aimed at avoidance of accumulation as listed below:

2.1 Issuance of Circulars and Guidelines

(i) Issuance and enforcement of Circulars which direct that pending bills carried over from the prior year to form the first charge against the budget allocation before entering into new commitments.

(ii) Strict adherence to the Public Finance Management Act and its Regulations 2015; Public Procurement and Assets Disposal Act of 2015 and other relevant laws and regulations on public finance management.

(iii) Enforcement of the requirement for all contracts including international contracts to be cleared by the Office of the Attorney General in accordance with the law and as per the Attorney General Circular Ref: AG/CIRCULAR/2018 "Guidelines on Provision of Legal Services by the Office of the Attorney General & Department of Justice" dated 1st March, 2018.

(iv) Enforcement of the law on commitment of funds as per PFM Act and Regulations, 2015 which states that "All commitments for supply of goods or services shall be done not later than 31st May each year except with the express approval of the Accounting Officer in writing."

2.2 Public Financial Management Reforms

The Government is committed to deepening reforms to avoid accumulation of arrears which include:

(i) **Migration from Cash Basis of Accounting to Accrual Basis Accounting by National and County Governments and their respective entities**

Currently, the National Government MDAs and County Governments do not recognize pending bills as payables in their balance sheet since they are on cash basis of accounting.

Accrual Accounting will enhance the management of pending bills as it will require pending bills at each reporting period to be recognized in the balance sheet. This will facilitate subsequent tracking of payments against the bills by the Accounting Officers and facilitate decisions on long outstanding bills. It will also make it possible to apply the law on first charge of the budget to pending bills. In addition, information on pending bills will also be easily available at any given point in time.

(ii) **Reforms in Public Sector Pensions' Sector**

The Government has operated a non-contributory Pension Schemes since independence fully financed through the Exchequer. As part of the reforms in the Public Service Pensions' Sector, the Government enacted the Public Service Superannuation Scheme Act, 2012. The Act established the Public Service Superannuation Scheme (PSSS) as a new contributory Scheme in line with the policy direction issued by Government. The Government directed the conversion of all Defined Benefit Schemes in the Public Sector to Defined Contributory Schemes. The objective was to align public service pension schemes with best practice in the retirement benefits industry. The PSSS commenced on 1st January, 2021.

The objective of the Public Service Superannuation Scheme is to: -

- Pay retirement benefits to members of the Scheme;
- Ensure timely payment of benefits to members as and when they become due;
- Improve the social security of members; and

- Establish a uniform set of rules, regulations and standards for the administration and payment of retirement benefits for members of the Scheme.

The contributions are paid into a Fund established and managed under the Act and regulated in accordance with the Retirement Benefits Act.

(iii) **SOE Reforms**

- Identify opportunities and encourage State Owned Enterprises (SOE) and county government to mobilize own source revenue.
- Assist SOEs to identify and use their assets to clear pending bills/arrears
- Introduce expenditure rationalization in order to create space to fund clearance of pending bills.

(iv) **Tax refunds**

The tax refund claims processed and awaiting payment amounted to Kshs.16.3 billion as at end of 31st October 2023. The measures in place or being implemented to enhance tax refund processing and payments include: -

- Ensure optimal allocation for settlement of refunds by The National Treasury
- Implementation of the Finance Act 2023 (Tax Procedures Act, 2015 - Section 47) allowing taxpayers to offset refund claims against outstanding tax debt or future tax liabilities where Commissioner has not paid approved refunds within 6 months. As of 31st October 2023, there were approved unpaid VAT claims worth Kshs.13.6 billion, out which Kshs.8.6 billion were eligible for offset against tax liabilities on 1st January 2024 in compliance with new law.
- Establish dedicated teams at Regional Audit Centers for timely tax refund audits.
- Implement a risk-profiling tool to identify high-risk cases deserving pre-payment audits, rather than auditing all first-time claimants.
- Establishment of dedicated teams for continuous reconciliation of taxpayer ledgers given that debt validation after claim lodgment causes delays in refund processing.

- System integration (iTax and iCMS) for real-time confirmation of exports given that exports are the key driver of refunds.
- Implement tax policy and structure reforms in order to reduce or eliminate tax exemptions.

3. PENDING BILLS CLEARANCE PROCESS

3.1 Verification and Validation

The National Treasury with the approval of the Cabinet has established a Pending Bills Verification Committee to to carry out a thorough analysis of the stock of National Government pending bills that have accumulated from June 2005 to June 2022 with a view to advising the Government on settlement of the same. The pending bills for the period July 2022 to June, 2023 will be verified by MDAs and National Treasury and settled as a first charge in the FY2023/2024 and FY2024/2025 budgets.

The Pending Bills Verification Committee was inaugurated on 7th November, 2023 and has commenced the exercise. All the claims submitted to the committee will be subjected to thorough verification and analysis with a view to establishing the integrity of each bill while recognising each bill as unique in its own right. The committee will establish a clearly defined criteria for detailed examination and analysis of such pending bills or claims with a view to determining the genuineness of each or otherwise.

The committee will identify causes of pending bills and make recommendations on policy, legal framework and procedures it considers appropriate to curtail escalation of and avoidance of pending bills. In addition, the Committee will identify the causes of the pending bills, make recommendations to the National Treasury on the necessary actions to be taken for satisfactory disposal or settlement of the identified pending bill and propose procedural, policy and legal measures/reforms to avoid future accumulation of pending bills.

3.2 Other Pending Bills

The Committee's mandate includes only pending bills in respect of MDAs, State Corporations and Semi-Autonomous Government Agencies. Accordingly, the verification of the other arrears will be dealt with by the National Treasury as follows:

(i) **County Governments**

The county governments have mechanisms already in place for verifying their arrears in accordance with Intergovernmental Budget and Economic Council (IBEC) resolution of 18th June 2019 which directed every County to establish a pending pills resolution committee.

Upon verification of the bills, the National Treasury in fulfilment of its role under the law, will ensure prompt transfer of equitable share. It should be noted that all funds allocated to counties up to June, 2023 have been transferred without fail. The National Treasury will also liaise with the Office of the Controller of Budget on reporting and monitoring pending bills at county level.

(ii) **Tax Refunds**

The Kenya Revenue Authority had verified tax refund claims amounting to Kshs.16.3 billion as at 31st October, 2023 comprising of Kshs.2.8 billion income tax and 13.6 billion in respect of VAT. The measures in place are being implemented to enhance refund processing and payments is set out in section 2.2 (iv) above.

(iii) **Pensions Arrears**

The Retirement Benefits Regulations require pension contributions be remitted to a custodian or guaranteed fund within ten days of every calendar month. As of 30th June, 2023, the outstanding National Government schemes contributions amounted to Kshs.40.8 billion excluding penalties and interest charged for late remittances. The National Treasury will liaise with the individual entities and the Retirement Benefits Authority for the verification of pension arrears.

(iv) **Legal liabilities**

The legal arrears are handled by a taskforce in the Office of the Attorney General. As at June, 2020, the total legal bills amounted to Kshs.151.0 billion which included a claim of Kshs.56.0 billion awarded to a litigant and which the Attorney General has challenged in the Court of Appeal. It is notable that legal bills are very fluid and some have since been paid while others have arisen from court and arbitral awards. The National Treasury will obtain information from the concerned public entities and collaborate with the Attorney General's Office in order to incorporate all the information on arrears.

3.3 Payment and Decision-Making Process

The National Treasury will explore mechanisms to clear the stock of verified arrears preferably within five years. The clearance of arrears will be implemented within the broader fiscal consolidation plan of the Government and will be supported by the implementation of the zero-audit fault regime including:

- Ensuring that the Accounting Officers strictly observe the National Treasury guidelines on arrears forming the first charge at the beginning of every financial year;
- Appropriation of funds to clear the arrears through a dedicated budget line; and,
- Securitization – issuance of Treasury bonds to the claimants.
- Taxpayers with outstanding tax debt owed to them will be allowed to offset with future tax liabilities

4. PLAN FOR FUNDING ARREARS

It is expected that the arrears will be significant and unlikely to be accommodated in one financial year. Accordingly, it is proposed that the payment be staggered over a period of five years commencing from FY2025/2026.

The National Treasury will create fiscal space over the five-year period to facilitate the settlement of the verified pending bills by way of exchequer resources or through securitization.

For MDAs that hold mutual liabilities, priority will be to offset such liabilities. The National Treasury will also explore opportunities of writing off pending bills that are owed to another Government entity, provided such a write off will not compromise the sustainability of the entity.

Government will enter into negotiations with the entities owed with a view to explore options of scaling down or writing off accrued penalties and interests. Negotiations will also explore options of entering into a phased-out payment plan with the entities owed.

The National Treasury shall also explore opportunities for swapping expenditure arrears for assets on a case by case basis.

4.1 Criteria for prioritization of the settlement of the pending bills shall be as follows:

In settling the pending bills, priority shall be accorded to the small amounts. The thresholds applicable shall be determined upon conclusion of the on-going pending bills verification. This is to ensure the small and micro-enterprises (SMEs) are not starved of the essential working capital which is critical to the sustainability of their businesses. Whereas the large business may have access to alternative sources of capital, SMEs have limited access to finance. Prioritizing settlement of SMEs will help to sustain economic activity and therefore support economic growth. This is also the sector that constitute the majority of the vulnerable groups, that is, women, youth and persons with disabilities.

Priority shall also be accorded to the settlement of bills due to non-governmental organizations. This will go along way in supporting private sector driven growth and avert liquidations and declaration of job redundancies.

Exchequer support will be prioritized for MDAs with limited capacity to structure 'assets for debt swaps' arrangements. This will go a long way in minimizing pressure on exchequer resources.

In addition to any other criteria that may be recommended by the Pending Bills Verification Committee, in settling the pending bills. Priority will also be given to the following:

- Age of the claim by prioritizing older claims over new claims; and
- Claims which attract interest and penalty charges.

5. PROPOSED WAY FORWARD

The Pending Bills Verification Committee is expected to release its interim report soon which will provide initial findings and recommendations. Based on the report, the National Treasury will firm up the strategy on clearing arrears especially on the schedule and sequencing of payment.