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# Factors Affecting Budget Execution by County Governments in Kenya

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**Abstract:** ***The study was carried out to identify the factors affecting the execution of budgets by county governments. The study used a cross-sectional descriptive research design and used regression analysis with robust standard errors to examine the relationship between the dependent and independent variables.Findings indicated that 'internal audit functions', and 'County fiscal responsibility' were significant in determining county budget execution. Recommendations include the need facilitate effective organization and operation of internal audit functions at the county government level and need to strengthen the legal framework for anti-corruption, ethics and integrity.***

**Keywords:** Budget Execution; Internal audit; Public funds; E-procurement; and, Fiscal responsibility

## 1. Introduction

County governments (CGs) in Kenya refer to the forty seven counties created by the Constitution of Kenya (CoK) (2010) under the system of devolved governance. These county governments form one level of governance with the other level being the national government. The national government is made up of the Executive, Parliament including the National Assembly and the Senate, and the Judiciary. County governments on the other hand are made up of the County Executive and the County Assembly. According to Article 6 (2) of the CoK (2010), the two levels of government are distinct and interdependent. They are interdependent as policies formulated by one level of government affects the other level. They are also interdependent as both levels of government serve the same clients (Government of Kenya, 2010).

The planning and budgeting by the counties is guided by various laws, policies and regulations key among them being the CoK (2010) and the Public Finance Management (PFM) Act (2012). The CoK (2010) under Article 201 for example gives among other provisions the principles that should govern all aspects of public finance in Kenya

## 2. Literature Survey

### Theoretical literature review

The key theoretical underpinnings that would help explain the budgeting process and the factors affecting the same are namely - bureaucracy, resource dependency and institutional theories. All these theories are inter-related. The Agency theory also helps explain the principal-agency relationship that exists and the emergent agency costs.

### Bureaucracy

Bureaucracy, an organizational perspective, is viewed as the epitome of rationality. Its primary value is its focus upon structural characteristics which attempt to bring order to a system of activities intended to achieve a goal. Rationality is manifested in structural characteristics such as formalization, hierarchical structure, and specialization. In other words, the system should be ordered on the basis of "logic and science" in order for the successful and efficient implementation of a certain goal or goal (Bolon, 1998). The various statutes provides for the structures of county government with a little flexibility. Kiambu County Government for example has twelve accounting departments under the county executive arm of the government and the county assembly, which is also considered to be department on its own. The PFM Act (2012) also gives the role of each entity in the county government with the county treasury given the principle mandate of coordinating budget implementation in the county. In this case, county government bureaucracy may be too small to manage larger budgets or too big thus causing inefficiencies in budget executions.

### Agency theory

The principal and agent theory emerged in the 1970s from the combined disciplines of economics and institutional theory. There is some contention as to who originated the theory, with theorists Stephen Ross and Barry Mitnick claiming its authorship (Mitnick 2006). The theory explains why conflicts exist between principals (shareholders/owners) and their agents (managers) leading to agency costs. The theory aims at reducing information asymmetry so that both the principal and the agent read from the same script through the threat of sanctions and the possibility of incentives (Karimi 2012). The County Treasury oversees budget execution including giving guidelines to all county departments. County departments can be seen as agents of the County Treasury (the principal) because they are required to produce a certain level of public output - including the quality of this output. In the last decade there has been a growing public interest by various stakeholders in the budget making process. These can be seen embodied through civic groups' and the legislature's involvement in the budget making process in most developing countries including Kenya. The CoK (2010) in Article 201 (a) makes it mandatory for the government to involve the public in all public financial matters.

### Empirical literature review

### Budget execution

The COB is mandated to produce quarterly and annual county governments 'Budget Implementation Review Report (BIRR)'. In her latest county governments BIRR, for

financial year 2014/15, the COB singled out underperformance of local revenue collections as one of the factors affecting the budget execution by the counties (COB 2015). The findings by the COB were however theoretical as opposed to empirical.

Tied to local revenue collection is the issue of compliance by the county residents to paying the various fees, licenses and charges imposed by the county government and administered by the county treasury as per the statutes. Rotich (2015) through a descriptive research study sought to investigate the factors affecting budget utilization in Kericho government by collecting analyzing primary data collected from 33 accounts, finance and county executives in the County. The findings indicated that there existed a positive and statistically significant relationship between tax compliance and budget utilization and a weak negative correlation was observed between Value Added Tax (VAT) policy and budget utilization. Government policy and inflation were also found to affect budget utilization negatively. The study however did not single out the role played by the county treasury in local revenue collection and administration neither did it recognize the role of the County Assembly in the budgeting process among other stakeholders' roles.

Ndunda, Ngahu, & Wanyoike (2015) in their descriptive study on the factors influencing optimal revenue collection by Nakuru County investigated how tax compliance influenced optimal revenue collection in Nakuru County. The study was conducted amongst account/financial employees, revenue clerks, and administrative staff of Nakuru county government and established that tax compliance only marginally affected optimal revenue collection and this in turn affected the overall budget execution by the county.

**Internal audit functions**

Hailemariam (2014) did a study on the determinants of internal audit effectiveness in the public sector, case study in selected Ethiopian public sector offices. From his analysis he found out that management support, the existence of adequate and competent internal audit staff, and the availability of approved internal audit charter were positively related to the internal audit effectiveness in the public sector andstatistically significant. The remaining two variable; the managements perception for the internal audit value and the organizational independence of internal auditors were positively related with the internal audit effectiveness but their contribution for the internal audit effectiveness were statistically not significant. From his results, a strong positive linkage can be seen between internal audit functions and the budget execution. The factors identified as positively affecting internal audit effectiveness and statistically significant can also be said to be positively related to the budget execution in an organization.

The Institute of Internal Auditors (IIA) in its practice guide for measuring internal audit effectiveness and efficiency reveals a strong positive relationship between internal audit and budget execution or budget performance. For example the IIA prescribes 'costs savings as a percentage of departmental budget' to be used as measure of internal audit efficiency within an organization under the 'services to stakeholders' performance category. This thus implies that the more the costs to be saved as a percentage of departmental budget' the better the efficiency of the internal audit and consequently the better the budget execution (Institute of Internal Auditors, 2010).

**Administration of County Public Funds**

Adkins & Obadiah (2015) found out that well execution of public funds was bound to positively impact the overall budget execution of an organisation if well implemented. This they pointed out was due to some positive attributes associated with the public funds that include:- resources cannot be redirected or diverted to non-targeted purposes; a better approach/option in political systems undergoing leadership changes; ability of public funds to take advantage of existing frameworks, and administrative skill-sets in the government and thus attain high legitimacy among governments and further help stimulate reforms and strengthen institutions; and, synergies through reliance on existing budgetary channels used to deliver funds or benefits to the local people.

They also pointed out some of the negative attributes associated with public funds that were consequently bound to affect the overall budget implementation of a public organisation. These include: - Setting up a new fund would require a legal process which may be lengthy; possibility of overly complex operating procedures; complications in funding of activities at both levels of government if the fund is at one level of government; possibilities of inefficiencies and high transaction costs in setting up a parallel system in form of a fund; concerns associated with a fund based approach include it not being appropriate in cases where decisions about a large fraction of the Country's forest land use are not coordinated within the Country's general decision making structures and land use policy; and, susceptibility to corruption in cases where corruption is prevalent in the government systems and thus demanding tighter governance structures.

**Use of IFMIS e - procurement**

According to Vaidya (2006) public sector agencies worldwide had identified e-procurement as a priority e-Government agenda and have implemented or are in the process of implementing buy side e-procurement systems. However, the use of e-procurement in public sector is little or in-existent. To this regard, Vaidya (2006) recommended that public procuring entities fully assesses the e-procurement enablers that are likely to influence the success of e-procurement execution.

Oketch (2014) observed that e-procurement has many operational and financial attractions, and these will only be realized, if the ground has already been well set through the cultivation of facilitators and the elimination or dilution of all issues that pose challenges to it. She further states that the success of an e-procurement initiative will ultimately rely on a range of factors, such as the organization's ability/inability to re-engineer its procurement processes, the presence/ absence of the appropriate competencies among its employees, the appropriateness/inappropriateness of the organization's culture and the availability/unavailability of appropriate standards.

**County fiscal responsibility**

In their monograph, Wagner & Tollison (1980), argued that governments should be explicit and responsible about how much it spends and how it spends it and that a balanced budget idea was fiscally sound and democratically nessecary. Their analysis and results were following various states of America calls for adoption of Constitutional ammendments requiring government to balance its budget.

Palmer & Penner (2012) while investigating the current fiscal problems of the United States found out that without significant changes in revenue and spending policies, the country was headed for a sovereign debt crisis similar to those afflicting countries in Southern Europe.

## 3. Problem Definition

The county governments in Kenya, since their inception, have been reporting sub-optimal performance in execution of their budgets many at times failing to implement all their intended programs and projects for a particular financial year. The COB (2015) singled out five main factors that continued to hamper effective budget execution by counties i.e. - inadequate internal audit functions and internal audit committees; inadequate administration and reporting on public funds established by counties; high expenditure on personal emoluments; capacity challenges in the use of Integrated Financial Management Information System (IFMIS) e-procurement module; and, delay in disbursement of funds by National Treasury.

The challenges facing the counties which result in them not achieving their budgets execution targets are the basis of this study. However and despite identifying the factors/ challenges as well as recommendations for addressing the challenges the OCOB did not empirically investigate the factors/challenges causing or resulting into the sub-optimal performance by the counties (COB, 2015). The OCOB instead relied on financial reports submitted to her by the county treasuries, approved county budgets, and reports generated from the IFMIS. There also does not exist any empirical studies that have investigated these assertions by OCOB. Moreover, it is also likely that the identified challenges by COB (2015) may not all be present or may have varying impact levels on budget execution by different counties.

This status of affairs motivated the need to conduct this study so as to fill this knowledge gap and aid in ensuring the effectiveness of county budgeting and budget execution. The study therefore assessed the factors affecting budget execution at the counties, with a view of giving appropriate recommendations. Of the five factors affecting budget execution that were identified by COB (2015), the study singled out three i.e. - internal audit functions; administration of county public funds; and, capacities for use of IFMIS E-procurement. The other two factors cited by COB (2015) – personnel emoluments and delay of release of funds by the National Treasury - were considered rather obvious and thus were omitted as variables. The study also picked on the parameter county fiscal responsibility which is used in the formula of equitable revenue sharing among counties. Literature review also confirmed the possibility of this variable in influencing budget execution at the county level.

## 4. Research Objectives of the Study

The general objective of this research was to identify the factors affecting the execution of budgets by county governments in Kenya. Specific objectives of the Study were:

1) To establish the effect of internal audit functions on the counties' budget execution.
2) To evaluate the effect of administration and reporting of county public funds on counties' budget execution.
3) To investigate the effect of use of IFMIS E-procurement on counties' budget execution.
4) To find out whether fiscal responsibility of a county affects her budget execution

**Significance of the Study**

This study provides a systematic and comprehensive insight into the budget execution processes at the county level in Kenya. Given the paucity of previous research on area of county planning and budgeting, and its scale and significance, it is important to shed greater light on how county's overall performance can be enhanced through effective budget execution by counties.

The study findings and recommendations thereof are therefore important in informing all budget execution stakeholders at both the county and national governments on the internal factors affecting the execution of budgets at the counties. The county governments and all other stakeholders should consider adopting the recommendations put forward in this study in their budgeting processes. Scholar and researchers in the field should also use this study as a reliable point of reference.

## 5. Methods/Approach

The study employed a cross-sectional descriptive research design. A cross-sectional indicates a onetime interaction with groups of people while descriptive infers the collection of information without changing the environment.

The target population of the study was thepublic officers in the forty seven county governments which included the county assembly and county executive departments within each county. The choice of the population was guided by the fact that every county was unique in its way with regards to the factors being studies. The CoK (2010) also stipulates that the two arms of government make a county government and thus the need to consult both arms of each county government.

The sampling frame used in this study was the county assembly and the county executive departments. This sampling frame was informed by the need to engage the all departments that make up a county government.

Purposive sampling technique was used to get the respondents within the sampling frame. Representatives from the finance, procurement and internal audit dockets in the two arms of the county governments were targeted as they

are the personnel conversant with the areas investigated by the study.

The study usedprimary data for the three independent variables - $X_1$ 'the internal audit functions'; $X_2$ 'administration of public funds'; and, $X_3$ 'use of IFMIS E-procurement. Secondary data was used for Y 'budget execution' and $X_4$ 'county fiscal responsibility.The secondary data was collected from the published revenue and expenditure estimates of the counties as well as from the reports of the COB and CRA. The primary data was collected through a self-administered semi-structured questionnaire. The questionnaire had both closed and open-ended questions. The open-ended questionnaire sought to encourage respondents to share as much information as possible in an unconstrained manner while the closed-ended questionnaire involved questions that could be answered by simply checking a box from a pre-determined set of responses.

**Data analysis**

The linear form of the estimated model was represented as follows:

$$Y = \beta_0 + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + \varepsilon \ldots (1)$$

Where the Y was the dependent variable – budget execution by counties and the explanatory variables were: - $X_1$ is 'the internal audit functions'; $X_2$ isthe administration of public funds; $X_3$ isthe use of IFMIS E-procurement; and, $X_4$ is the county fiscal responsibility.

The measures of the dependent and the four independent variables is based on provisions in the various Kenyan statutes.

## 6. Results/Discussions

The research targeted all the forty seven counties and thus the questionnaires were electronically distributed to relevant persons in the counties. All questionnaires were duly filled and returned representing 100% response rate.

**Descriptive statistics**

Descriptive statistics for the dependent and independent variables were computed and summarized as shown in Table 1.

**Table 1:** Descriptive statistics summary

| Variable | Obs | Mean | Std. Dev | Min | Max |
|---|---|---|---|---|---|
| Internal Audit functions ($X_1$) | 47 | 3.787234 | 1.828948 | 2 | 7 |
| Admin, of public funds ($X_2$) | 47 | 4.212766 | 1.64286 | 2 | 6 |
| Use of IFMIS e-proc ($X_3$) | 47 | 2.340426 | 0.700205 | 2 | 4 |
| Fiscal Responsibility ($X_4$) | 47 | 0.021279 | 0.021839 | 0 | 0.1057 |

The results are in line with COB (2015) in that majority of counties continued to perform poorly with regards to County budget execution. While the desired score would have been 100%, the best performing County – West Pokot had only 28% score.The findings are also in line with ICPAK (2015) on internal audit functions that many counties are yet to fully operationalize their internal audit functions.

**Test for normality**

Table 2 gives the results of normality test on the data. All variables except Y were found not to be normally distributed at 95% confidence interval.

**Table 2:** Skewness/kurtosis tests for normality

| | | | | | Joint | |
|---|---|---|---|---|---|---|
| **Variable** | Skewness | Kurtosis | Pr (Skewness) | Pr (Kurtosis) | Adj chi2 (2) | Prob>chi2 |
| Y | 0.459 | 2.451 | 0.163 | 0.497 | 2.55 | 0.2798 |
| $X_1$ | 0.4693 | 1.662137 | 0.155 | 0.000 | 15.77 | 0.0004 |
| $X_2$ | -0.1464 | 1.6018 | 0.647 | 0.000 | 18.04 | 0.0001 |
| $X_3$ | 1.73544 | 4.3214 | 0.000 | 0.057 | 15.97 | 0.0003 |
| $X_4$ | 1.71042 | 6.366104 | 0.000 | 0.002 | 19.50 | 0.0001 |

Test for heteroskedasticity

The data was tested for heteroskedasticity using the Breusch-Pagan test and the results are shown under Table 3. The chi-square value of 0.01 and the p-value of 0.9219 indicated the absence of heteroscedasticity.

**Table 3:** Breusch-Pagan / Cook-Weisberg test for heteroskedasticity

Ho: Constant variance
Variables: fitted values of y
chi2(1) = 0.01
Prob> chi2 = 0.9219

**Regression analysis**

Following the tests conducted on the data, the study opted for the robust option for estimating the standard errors using the Huber-White sandwich estimators. Such robust standard errors are expected to deal with the problem of normality(IDRE, 2016).Table 4 represents summarized results obtained from running the regression with robust standard errors for the equation 1.The model in this study had an R-squared of 52.87% meaning that 52.87% of the dependent variables is well explained by internal audit functions, Administration of public funds, use of IFMIS e-procurement and county fiscal responsibility. The remaining variation of 47.13% is the error term and is unexplained and attributed to other factors not included in the model

**Table 4.4:** Results for regression with robust standard errors

| Y | Coef. | Robust Std. Error | t | P>t | [95% Conf.Interval] | |
|---|---|---|---|---|---|---|
| **$X_1$** | 0 | 0.000148 | 7.05 | 0.000** | . 0007436 | 0.0013394 |
| **$X_2$** | 0 | 0.000182 | 1.7 | 0.096 | -5.72E-05 | 0.0006752 |
| **$X_3$** | 0 | 0.000669 | 1.03 | 0.31 | -0.000663 | 0.002037 |
| **$X_4$** | -0.1 | 0.020494 | -5.69 | 0.000** | -0.158031 | -0.0753125 |
| **_cons** | 0.02 | 0.001475 | 11.44 | 0 | 0.0139003 | 0.0198547 |
| **Number of obs** | | 47 | | | | |
| **F( 4, 42)** | | 29.66 | | | | |
| **Prob> F** | | 0 | | | | |
| **R-squared** | | 0.5287 | | | | |
| **Root MSE** | **0** | | | | | |

***significant at 95% confidence interval*

**Effect of internal audit functions on the counties' budget execution**

From the results indicated in Table 4, it can be observed that the performance of a county on its internal audit functions is positively related to its budget execution. The coefficient of internal audit functions is 0.0010415 and its p-value is significant. From the individual regression model results, it's worthwhile noting that the p-value is insignificant.

With the foregoing, one can therefore not reject the null hypothesis that internal audit functions at the counties have significant effect on the counties' budget execution. We can therefore deduce from the model that internal audit functions of a county are indeed important to the county's budget execution. The results are in agreement with COB (2015) who had singled out internal audit functions as one of the factors affecting county budget execution. The results are also in agreement with Hailemariam (2014) who found a strong positive significant relationship between internal audit effectiveness and factors closely related to budget execution.

**Effect of administration and reporting of county public funds on counties' budget execution.**

From the results indicated in Table 4, it can be observed that the administration and reporting of county public funds is positively related tocounty budget execution. The coefficient of administration and reporting of county public funds is 0.000309 and its p-value is insignificant.From the individual regression model results, it is worthwhile noting that the p-value is also insignificant.

With the results the null hypothesisthat that administration and reporting of county public funds at the counties level have a significant effect on the counties' budget execution is rejected.We can therefore deduce from the model that administration and reporting of county public funds is not a significant factor in determininga county's budget execution. The results thus contradict earlier studies such as by Githinji (2012), COB (2015), and Adkins & Obadiah (2015) who pointed to the existence of a significant effect of administation of public funds on overall budget execution. The insignificance of administration and reporting of county public funds could be mainly due to their current relatively small size compared to the total county budget among other factors.

**Effect of use of IFMIS E-procurement on counties' budget execution.**

From the results indicated in Table 4, it can be observed that the use of IFMIS e-procurement by a county positively affects its budget execution.The coefficient of use of IFMIS e-procurement is 0.0006876 and its p-value is insignificant. From the individual regression model results it is worthwhile noting that the p-value is also insignificant.

With the results, the null hypothesis that use of IFMIS E-procurement by the counties has a significant effect on the counties' budget execution is rejected. These results contradicts Christianne (2008) who had found that the procurement policies employed by many public training institutions in UK determine the level of effectiveness in execution of the procurement practices and by their extension budget execution. The insignificant results however could be as a result of the fact that the counties have just recently adopted the IFMIS e-procurement system. The significance or insignificance of this variable is therefore bound to be tested with time.

**Effect of county fiscal responsibility budget execution by counties.**

From the results indicated in Table 4, it can also be observed that a county's fiscal responsibility is negatively related to its budget execution. The coefficient of county fiscal responsibility is -0.1166717 and its p-value is significant. It is worthwhile noting that the p-value in the individual regression model is also significant.

With the results, the null hypothesis that the county fiscal responsibility affects the county budget execution is not rejected. A county's fiscal responsibility does indeed have a significant effect on its budget execution. The negative relationship with county budget execution is however unexpected and this could be as a result of how the CRA measured the variable. The CRA used the percentage increase in revenue collected by counties over two consecutive years. Nevertheless, these results are in line with Wagner &Tollison (1980) on the need for governments to be explicit and responsible in their fiscal matters and that was likely to translate into a fiscally sound and balanced budgets.

## 7. Conclusions

The objective of this study was to identify the factors affecting the execution of budgets by county governments. The independent variables investigated this study were

primarily based on the non-empirical findings by the Controller of Budget's report (COB, 2015) and the parameters chosen by the Commission on Revenue Allocation for sharing of the equitable share of revenue among the counties. The dependent variable in this case was 'budget execution by counties' while the independent variables on the other hand were: - performance on internal audit functions; administration of public funds; use of IFMIS-e-procurement; and, county fiscal responsibility.

Primary data was collected from the counties through the use of a questionnaire for three variables – internal audit arrangements, reporting and administration of county public funds and use of IFMIS e-procurement - while the study also relied on secondary data from the OCOB for the dependent variable - budget execution and from the CRA for thecounty fiscal responsibility independent variable.

Analytical techniques employed included descriptive statistics to analyze the factors affecting budget execution by county governments, andregression analysis with robust standard errors to examine the relationship between the dependent and independent variables.

Findings of regression analysis indicated that 'internal audit functions', 'administration of public funds' and 'use of IFMIS e-procurement'positively affected budget execution by the county governments. On the other hand, county fiscal responsibility was found to negatively affect budget execution by county governments. However, of all the four independent variables investigated by the study, only two were found to be significant at 95% confidence level in influencing county budget execution. These are: - Internal audit functions and county fiscal responsibility.

The study can thus conclude that internal audit functionswas an important factor in determining either the success of budget execution by counties.

The intuition drawn was that internal audit functions helps provide independent assurance that an organization's risk management, governance and internal control processes are operating effectively. Financial, operational among other types of internal audits all provide useful feedback that guide economic and financial planning as well as budgets implementation by counties.
On the fiscal responsibility - which was also found to be significant in determining the budget execution level by a county - implementation of sound economic and budgetary practices is expected to ensure citizens get value for money and this translates to increased absorptions of funds among other positive outcomes.

In the light of the findings from the study, it is recommended that both levels of government should facilitate effective organization and operation of internal audit functions at the county government level in order to enhance budget execution and thus achieve their development agenda. In particular Part XIII of the Public Finance Management (County Governments) Regulations 2015 should be fully implemented by the County Governments. The counties should also be properly sensitized on the same and adequate funds set aside to cater for internal audit functions.

In regards to use of IFMIS e-procurement by counties, and even though found to be insignificant in determining county budget execution,there should be adequate efforts to technically capacity build the personnel in the procurement departments and build the requite infrastructure including internet connectivity. This is also given that it is now mandatory (starting the 2017/18 financial year) for county governments to use IFMIS e-procurement.

For counties to achieve fiscal responsibility there will be need for deliberate measures to strengthen the legal framework for anti-corruption, ethics and integrity; promotion of results based management within the county governments; allowing public access to information and data; and, strengthening the county assembly's legislative and oversight capacity.

## 8. Future Scope

There is need to establish the other factors that determine the county's budget execution besides those investigated by this study. With also the revision of the equitable revenue sharing formula that is to be used for sharing revenues starting financial year 2017/18, a relook on the performance of counties with regards to budget execution would also be necessitated.

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