Evaluation of Factors Affecting Management of Public Funds in the County Government of Nairobi

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Abstract

The Nairobi County government has been losing hundreds of millions of shillings due to poor management of public funds. The purpose of the study was to evaluate factors affecting management of public funds within the county government of Nairobi. The objectives of the study were to assess the effect of revenue administration, examine the influence of budgetary controls, the link between financial reporting system and the level of oversight on management of public funds. The research was guided by three theories namely Wagner's theory of finance, the Keynesian theory and the Agency theory. The study used descriptive research design and data was collected through use of questionnaires. The study was conducted within the Nairobi County. The target population was 245 respondents from various departments within the County government of Nairobi was used. A sample size of 125 respondents which is 50% of the target population was selected through stratified sampling. The data collected was analyzed using both descriptive and inferential statistics with the aid of Statistical Package for Social Science (SPSS) 21.0 Version. The research revealed that there was a positive relationship between revenue administration and management of public funds. There was also a positive relationship between oversight and management of public funds. It was also concluded that there was a positive relationship between budgetary controls and management of Public funds. The research also established a weak relationship between financial reporting and management of public funds. The research concluded that revenue administration, budgetary controls and level of oversight had a significant effect on management of public funds in Nairobi County. It is recommended that the county government should evaluate and put in place more effective controls in relations to management of public funds. The county government should re-evaluate the existing allocation procedures so as to ensure that resources are allocated to projects that have more priority. The County government should invite Nairobi residents to contribute to budget making process. The county government should also improve on revenue administration methods so as to prevent leakages and increase collections. The Nairobi county assembly should also be more vigilant on its oversight functions so as to check on any form of misuse of public funds. The findings of this study may be significant to both the national and county governments as it will enable them formulate laws and controls geared towards promoting effectiveness in management of public funds in the public sector in Kenya.

Key Words: Management of Public Funds, Public Finance, Public Finance Management, County Government of Nairobi

1. BACKGROUND OF THE STUDY

The Kenya Constitution promulgated in 2010 created two levels of government which were the National and County level. The County Governments Act 2012 which governs the operations of the counties came into force in March 2013 immediately the final results of the first General Elections under the new constitution promulgated in 2010 were announced. The devolution process is underway but is facing challenges. Devolution effectively commenced in March 2013 with the election of the County governments.

The Financial Year (FY) 2013/14 total budget of Kshs. 1.6 trillion is the first budget to implement the devolution process, from which an amount of Kshs. 210billion was set aside for the 47 Counties. This amount was distributed to the Counties on the basis of a revenue sharing formula drawn up by the Commission of Revenue Allocation (CRA). Urban communities face a wide range of challenges, which in many cases require significant financial resources to combat (Morgan, England, and Pelissero 2011). The County governments were never satisfied with the allocation given to them because of the many financial challenges they continue facing and have been agitating to be allocated at least 40% of the total expenditure of the national budget for each financial year.

The County Governments are headed by Governors. County governments are now the fastest growing level of government in Kenya. The administrative and development responsibilities of county governments have expanded as national programs have been devolved to the local level. Management of public funds within the county governments in Kenya is a very challenging initiative. Sustainability initiatives compete with other proposed spending programs, and such characteristics as non-excludability and often lack of immediate benefits for local officials and median voters are among some challenges in finding support for local government sustainability efforts (Hawkins and Wang 2012; Sharp, Daley and Lynch 2011). Financial capacity, defined as the financial ability of organizations to carry out their missions and achieve their aims is a critical condition for implementing sustainability projects (Wang, Hawkins, Lebredo & Berman 2012).

County Governments receive a minimum of 15% of the total budgetary expenditure of the national budget of last audited Government financial statement. This amount is supplemented by revenues collected by counties within their boundary jurisdictions. Main challenges to the implementation of the devolution process to date include human capacity constraints and large budget deficits, as the funding requirements of many Investment and Development Plans (IDPs) exceed the transfers received from the central government. The deficits are expected to be mitigated by raising local taxes, to which the Counties are entitled to by the Kenya Constitution. The Kenya Constitution requires citizens' participation in the budget process. Questions of how county governments include residents in budget the processes before making important decisions have been the subject of an extensive debate on County politics and governance. Much of the engagement on county financial management sustainability, however, has tended to focus on policies and practices of the County Government, while the financial capacity for sustainability in general, and the citizen engagement strategies employed by County Government of Nairobi to generate support for building this capacity more specifically, has received far less attention. Nonetheless, many of the arguments made for greater participation in local policy decision making as per the requirements of the Constitution are transferable to the context of this study. In particular, understanding the effect of citizen engagement strategies on financial capacity is important as the study of urban sustainability shifts to understanding the conditions for implementing a change (Wang et al. 2012).

2. STATEMENT OF THE PROBLEM

The Auditor General report of 2013/2014 for the Nairobi County Executive lists cases of losses of hundreds of millions of shillings through poor management of public resources which include under banking of revenue amounting to Kshs 253million, Kshs. 96million in outstanding rates, non-remittance of statutory deductions amounting to Kshs 5billion, irregular allocation and disposal of county land, issuing tenders at inflated costs to contractors, irregular employment of staff, failure to follow budgetary ceilings which are intended to cap expenditures and operation of unauthorized bank accounts.

Various studies have been done in the area of management of public funds. Mathiba (2011) did a study to evaluate management of public funds practices in the department of correctional services in South Africa in which he focused on the evaluation of financial management practices pertaining to strategic budgeting, supply chain management, movable asset management and control in the Department of Correctional Services (DCS). Lawson (2012) in a study Commissioned by Swedish International Development Agency (Sida), Danish International Development Agency (Danida) and African Development Fund (AfDB) did an evaluation of public financial management reforms in Burkina Faso, Ghana and Malawi for a period between 2001 and 2010. The study focused on the importance of good public financial management in supporting good governance, transparency and effective delivery of services on which human and economic development rely.

Locally, Kiilu and Ngugi (2014) conducted a study on the effect of public financial management reforms in the effective management of public funds in Kenya National Treasury. The study focused on the effect of procurement laws, adoption of IFMIS, budgeting reforms on effective management of Public Funds in Kenya National Treasury. Muendo (2012) carried out a study on factors affecting Financial Management Systems in the defunct local authorities in Kenya which focused on budget preparation, local authority funding, management practices and employee capacity. The shortcoming in this study is that it focused on local authorities which ceased to exist in the year 2013 with the first election under the new constitution. Further the system of management of funds under the new constitutional dispensation is quite different due to requirements of greater transparency and accountability expected in managing public funds.

All the studies stated above researched on management of funds in the public sector. However, none of the researchers evaluated the critical factors in detail involved in management of public funds which include proper administration of revenues, the budgeting process, financial reporting systems and oversight over the use of public resources. This is an indication that a research gap exists in the management of public funds in the county government of Nairobi. Therefore, this study sought to evaluate the factors affecting management of public funds in the county government of Nairobi. Unless the study is carried out, the county government of Nairobi may continue loosing hundreds of millions of shillings every year.

3. OBJECTIVES OF THE STUDY

The study aimed at evaluating factors affecting management of public funds in the county government of Nairobi. Specifically, the study sought:

i. To assess the effect of revenue administration on management of public funds in the county government of Nairobi.
ii. To examine the influence of budgetary controls on the management of public funds in the county government of Nairobi
iii. To establish the link between financial reporting and management of public funds in the county government of Nairobi.
iv. To assess the level of oversight on the management of public funds in the county government of Nairobi.

4. THEORETICAL FOUNDATION

The theories for this study included the Wagner's Theory of Finance, the Keynesian Theory and Agency Theory.

4.1 Wagner's Theory of Finance

Wagner's theory is a principle named after the German economist Adolph Wagner (1835-1917). Wagner advanced his theory of rising public expenditures by analyzing trends in the growth of public expenditure and in the size of public sector. Wagner's theory postulates that; the extension of the functions of the states leads to an increment in public expenditure on administration and regulation of the economy; and the development of modern industrial society would give rise to increasing political pressure for social progress and call for increased allowance for social consideration in the conduct of industry.

Further a rise in public expenditure will be more than lead to proportional increase in the national income (income elasticity of wants) and will thus result in a relative expansion of the public sector. Rising public expenditure thus calls for proper methods of revenue administration so as to satisfy demand for more money. This can be achieved by streamlining all revenue collection avenues so as to increase compliance in remittances to the county treasuries. Musgrave and Musgrave (1998), in support of Wagner's law, opined that as the level of industrialization in progressive nations increases, the share of the public sector in the national economy grows continually. The theory relates with the current study in that there has been uncontrolled spending in the county government without proper accountability.

Wagner's law suggests that a welfare state evolves from free market capitalism due to the population voting for ever-increasing social services as general income levels grow across broad spectrums of the economy. In spite of some ambiguity, Wagner's statement in formal terms has been interpreted by Richard Musgrave. As progressive nations industrialize, the share of the public sector in the national economy grows continually. The increase in State Expenditure is needed because of three main reasons. Wagner himself identified these as (i) social activities of the state, (ii) administrative and protective actions, and (iii) welfare functions. The material below is an apparently much more generous interpretation of Wagner's original premise (Musgrave, 1998).

4.2 The Keynesian Theory

The theory is based on the concept that in order for an economy to grow and be stable then active government intervention and participation is required. Keynes was among the most noted economists who studied the relationship between public expenditure and economic growth. Keynes regards public expenditure as an exogenous factor which can be utilized as a policy instrument to promote economic growth (Fitzgerald, 2006).

Keynes argued that because there was no guarantee that the goods that individuals produce would be met with demand, periodic unemployment could be expected from time to time, especially in the instance of an economy undergoing contraction. He saw the economy as unable to maintain itself at full employment automatically, and believed that it was necessary for the government to step in and put purchasing power into the hands of the working population through government spending. Thus, according to Keynesian theory, some individually rational microeconomic-level actions such as not investing savings in the goods and services produced by the economy, if taken collectively by a large proportion of individuals and firms, can lead to outcomes wherein the economy operates below its potential output and growth rate (Gallarza, Saura & Garcia, 2002).

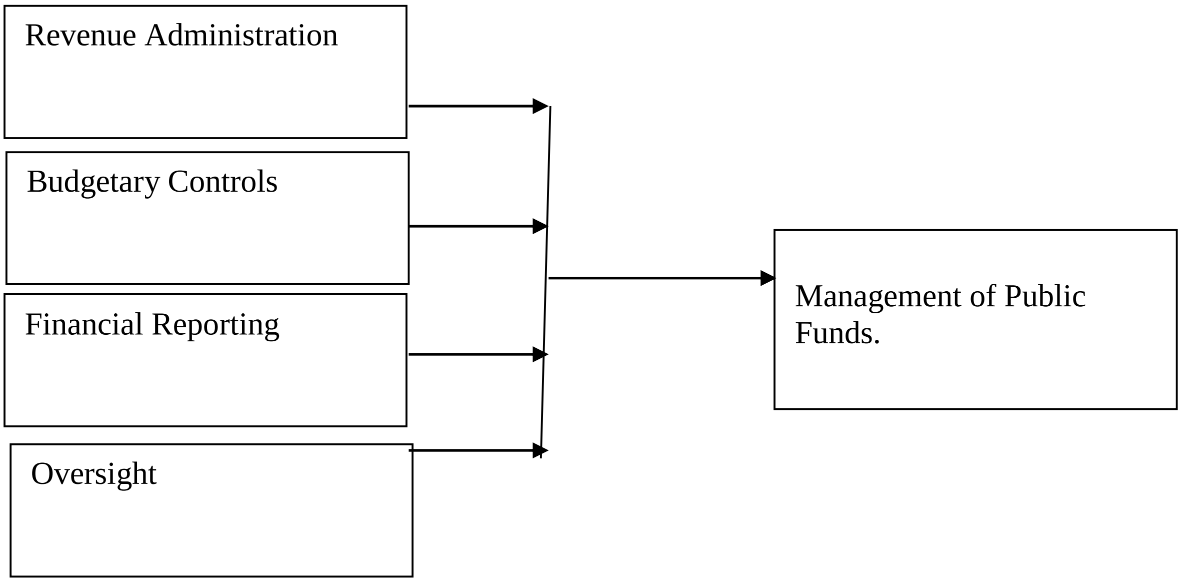
4.3 Agency Theory

Agency theory is part of the positivist group of theories which derives from the financial economics literature. It postulates that the firm consists of a nexus of contracts between the owners of economic resources (the people of Nairobi County) and managers (the County Government and the County Assembly) who are charged with using and controlling those resources. Further, agency theory is based on the premise that agents have more information than principals and that this information asymmetry adversely affects the principals' ability to monitor effectively whether their interests are being properly served by agents. It also assumes that principals and agents act rationally and that they will use the contracting process to maximize their wealth (Kayaga, 2007).

An agency, in general terms, is the relationship between two parties, where one is a principal and the other is an agent who represents the principal in transactions with a third party. Agency relationships occur when the principals hire the agent to perform a service on the principals' behalf. Principals commonly delegate decision-making authority to the agents. Because contracts and decisions are made with third parties by the agent that affect the principal, agency problems can arise. Agency theory handles numerous situations in which one party acts on the behalf of the other (Kayaga, 2007).

5. CONCEPTUAL FRAMEWORK

The researcher reviewed the revenue administration process within the County Government of Nairobi. The study was to investigate the procedures put in place to account for revenue collected locally and also the share received from the national government. The researcher reviewed the budgetary controls of the County Government of Nairobi. The study reviewed the management of the procurement and human resource function and whether they conform to the budgetary control requirements. The study was to review the internal controls system in place and whether there is public participation in planning, formulation and implementation of budgets in order to check on the financial management of public funds in the county government of Nairobi. The researcher was to review the financial reporting system being employed by the county government of Nairobi. It is a requirement that all government financial transactions be processed through the IFMIS in order to improve on the management, accountability and transparency in the usage of public funds. The researcher investigated the level of the adoption by the county government of Nairobi of the International Public Sector Reporting Standards (IPSAS) in the accounting and preparation of financial reports as required by law. The researcher investigated the roles of oversight agencies which include the Auditor General, Controller of Budget, County Assembly and the Senate in ensuring that public resources in the county governments are utilized economically, effectively and efficiently.



6. RESEARCH METHODOLOGY

This study employed quantitative research, and used a research design that is descriptive in nature. A descriptive study is concerned with finding out the what, where and how phenomena (Bernard, 2011). The target population used in the research study included staff in departments of Administration, Human Resource, Finance, Accounts, Revenue, Internal Audit, External Audit and County Executive. The target population was chosen to answer the research questions because they provided services that related to the research study on management of public funds within the Nairobi County. The target population was drawn from the Nairobi County Government. The research study adopted stratified sampling which involved dividing the population into homogenous subgroups and then taking a simple random sample in each subgroup. Proportionate sampling method was used. To ensure validity of the instrument the researcher shared the information in the questionnaires with the Supervisors to establish whether the questions were relevant. The ambiguous questions were discarded and harmonized to ensure that the questionnaire was valid.

The questionnaires were issued to twelve respondents and the reliability scores for these responses was calculated. The results of the pilot study were analyzed to determine the extent to which all the variables produce acceptable reliability scores. The questionnaires consisted of structured questions and Likert rating scales. The questionnaire was typed and taken to each respondent. Secondary data was obtained from literature sources or data collected by other people for some other purposes. Secondary data was collected through review of published literature such as journals articles, published theses, text books, excerpts from interviews and commentaries. The study made use of secondary data from library records. These sources were reviewed to give insight in the search for primary information. They gave insight on variables selection, development of instruments and discussion of the findings.

The information collected was codified and entered into a spreadsheet and analyzed using Statistical Package for Social Sciences (SPSS) Version 21. SPSS Version 21 has got descriptive statistics features that assist in variable response comparison and gives a clear indication of response frequencies. Once the raw data was collected, the questionnaires were checked for proper recording of the responses and completeness. They were then coded and the response on each item was put into specific categories fitting the research questions. Data was then summarized using descriptive distribution of scores and measurements using a few indices and statistics so as to describe and compare variables numerically.

7. DATA ANALYSIS RESULTS

The study sought to establish the relationship between variables and the extent to which the independent variables influenced the dependent variables. Correlation analysis and multiple regression analysis were used to carry out the tests.

7.1 Correlation of Variables

The researcher established the relationship between Management of Public Funds and factors relating to Revenue Administration, Budgetary Controls, Financial Reporting and Oversight. Pearson correlation coefficient was used to show the relationship between the variables.

Table 4.2: Correlations of Variables

Correlations

		Management of Public Funds	Factors Relating to Revenue Administration	Factors Relating to Budgetary Controls	Factors Relating to Financial Reporting	Factors Relating to Oversight
Factors Relating to Revenue Administration	Pearson Correlation	.770**	1			
	Sig. (2-tailed)	.000				
	N	100	100			
Factors Relating to Budgetary Controls	Pearson Correlation	.163	.314**	1		
	Sig. (2-tailed)	.105	.001			
	N	100	100	100		
Factors Relating to Financial Reporting	Pearson Correlation	.073	.162	.565**	1	
	Sig. (2-tailed)	.471	.108	.000		
	N	100	100	100	100	100
Factors Relating to Oversight	Pearson Correlation	.109	.237*	.394**	.359**	1
	Sig. (2-tailed)	.282	.018	.000	.000	
	N	100	100	100	100	100

***. Correlation is significant at the 0.01 level (2-tailed).*
**. Correlation is significant at the 0.05 level (2-tailed).*

The study conducted correlation analysis on factors affecting management of public funds in the county government of Nairobi. There was strong positive relationship between factors relating to revenue administration and management of public funds. The relationship is significant (r = 0.770, p<0.01) thus revenue administration had great effect on management of public funds. The table shows positive relationship between factors relating to budgetary controls and management of public funds. The relationship was significant at (r = 0.163, p< 0.01), thus there is no proper budgetary controls in management of public funds in Nairobi county government. The table also shows a strong relationship between factors relating to financial reporting and management of public funds. The relationship is significant at (r = 0.073, p< 0.01), thus factors relating to financial reporting had great influence on management of public funds in Nairobi county. The table shows a positive relationship between factors relating to oversight and management of public funds, the relationship is significant at (r = 0.109, p< 0.01), thus factors relating to oversight had great influence on management of public funds in Nairobi county government.

7.2 Regressions Analysis

The researcher conducted a multiple regression analysis so as to test relationship among variables (independent) on the on performance of IFMIS in public sector. The study applied the Statistical Package for Social Sciences (SPSS) Version 21.0 to code, enter and compute the measurements of the multiple regressions for the study.

Table 2: Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.777[a]	.603	.586	.49234

Predictors: (Constant), Factors Relating to Oversight, Factors Relating to Revenue Administration, Factors Relating to Financial Reporting, Factors Relating to Budgetary Controls

The value of R^2 is 0.603, revealing 60.3% variability in factors relating to revenue administration, factors relating to budgetary controls, factors relating to financial reporting and factors relating to oversight accounted for management of public funds variables in the model developed. The adjusted R^2 is an improved estimation of R^2 in the population. The value of adjusted R^2 is 0 .586. This adjusted measure provides a revised estimate, 58.6% variability in management of public funds that is 0.586, revealing 58.6% variability in factors relating to revenue administration, factors relating to budgetary controls, factors relating to financial reporting and factors relating to oversight accounted for management of public due to the fitted model.

Table 3: ANOVA

ANOVA[b]					
Model	Sum of Squares	Df	Mean Square	F	Sig.

1	Regression	34.972	4	8.743	36.068	.000[a]
	Residual	23.028	95	.242		
	Total	58.000	99			

a. Predictors: (Constant), Factors Relating to Oversight, Factors Relating to Revenue Administration, Factors Relating to Financial Reporting, Factors Relating to Budgetary Controls

b. Dependent Variable: Management of Public Funds

Significant level denoted by significant F in the ANOVA box 0.000, F critical was 36.068 which shows that the model was highly significant on factors affecting management of public funds in the county government of Nairobi.

The estimates of the regression coefficients, t-statistics, standard errors of the estimates and p values are presented below.

Table 4: Coefficients of Variables

Coefficients[a]

Model	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
1 (Constant)	2.045	.264		7.741	.000
Factors Relating to Revenue Administration	.649	.055	.805	0.709	.015
Factors Relating to Budgetary Controls	.068	.082	.069	.828	.032
Factors Relating to Financial Reporting	.002	.099	.001	.018	.045
Factors Relating to Oversight	.076	.099	.055	.767	.035

a. *Dependent Variable: Management of Public Funds*

Results of a linear regression analysis determining the effect of the independent variables (revenue administration, budgetary controls, financial reporting and oversight) on the dependent variable (actual/budgeted public funds management). Using the results, we have the regression equation as: $Y=2.045+0.649X_1 +0.068X_2 +0.002X_3-0.076X_4$, where Y is the dependent variable (public funds management), X_1 is revenue administration, X_2 is budgetary controls, X_3 is financial reporting and X_4 is oversight. According to the regression equation established, taking all factors into account with constant at zero, actual

/budgeted public funds will be 2.045. The data findings analyzed also show that public funds management is greatly about revenue administration followed by oversight and budgetary controls. Taking all other independent variables at zero, a unit increase in revenue administration will lead to a 0.649 percentage increase in the ratio of actual /budgeted public funds saved while a unit increase in oversight will lead to a 0.076 percentage increase in the ratio of actual/budgeted public funds recovered. Further a unit increase in budgetary controls will lead to 0.068 percentage in ratio of actual/budgeted public funds saved.

Revenue Administration contribute most to performance of Management of Public Funds at Nairobi County. At 5% level of significance, revenue Administration showed a level of significance of 0.015, budgetary controls had a 0.032 level of significance; Oversight showed a 0.035 level of significance, and Financial Reporting showed a level of significance of 0.045 hence the most significant factor was Revenue Administration.

8. Recommendations

There is need to evaluate and put in place more effective controls in relations to management of public funds. The county government of Nairobi should evaluate the staff professionalism in management of public funds; training should be provided so as to improve their management skills. The county government should review the staff salary upward so as to minimize the cases of corruption in management of public funds.

The county government should re-evaluate the existing allocation mechanisms so as to ensure that there are proper procedures in place to allocate resources to projects that have more priority. The county government should engage a consultant so as to ensure that there are regular reconciliations to account for revenues receipts. The county government should outsource all revenue collection services so as to address the cases of revenue collection leakages. Nairobi through the county government should invite Nairobi residents to contribute to budget making process. The budget allocations should be published on the local dairies for the public to scrutinize. Public procurement laws should be observed in awarding of tenders for goods and services. The internal control methods should be strengthened to ensure that there is no wastage. The county government of Nairobi should outsource the recruitment of staff members joining the organization.

There is need to improve the financial reporting by the county government through adoption of procurement and accounting systems. The county government should publish how funds are spent on projects so as to enable the public scrutinize how the funds are utilized. Nairobi county government should publish its audited financial reports each year in the mainstream media for public scrutiny. The assembly of Nairobi County should be more vigilant on the oversight relating to use of public funds. The controller of budget should ensure that the budget is followed when allocating funds to various projects. The budget controller should also ensure that the cost of the projects is not inflated. The senate should scrutinize the budget allocation for various projects and ensure that the funds are used for the intended purpose.

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