

CONFORMED COPY

CREDIT NUMBER 4146-KE

Development Credit Agreement

(Institutional Reform and Capacity Building Project)

between

REPUBLIC OF KENYA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated April 24, 2006

CREDIT NUMBER 4146-KE

DEVELOPMENT CREDIT AGREEMENT

AGREEMENT dated April 24, 2006, between the REPUBLIC OF KENYA (the Borrower) and INTERNATIONAL DEVELOPMENT ASSOCIATION (the Association).

WHEREAS (A) the Association has received from the Borrower, a letter dated October 24, 2005, describing a program of actions, objectives and policies designed to reform, strengthen and improve the Borrower's capacity in the delivery of public services (the Program);

(B) the Borrower, having satisfied itself as to the feasibility and priority of the Project described in Schedule 2 to this Agreement, has requested the Association to assist in the financing of the Project;

(C) the Borrower intends to obtain from various development partners grants or loans to assist in the financing of Parts A and C.1 of the Project;

(D) the Borrower and the Pooling Development Partners (as hereinafter defined) intend to enter into a Joint Financing Agreement providing for common arrangements and procedures on procurement, disbursement, accounting, monitoring, reporting, auditing, coordination and exchange of information required for the implementation of Parts A and C.1 of the Project;

(E) the Borrower, the Pooling Development Partners and Non-Pooling Development Partners (as hereinafter defined), shall enter into a Memorandum of Understanding (as hereinafter defined), which shall, *inter alia*, provide for exchange of information, reporting and coordination required for the effective implementation of the Program;

WHEREAS the Association has agreed, on the basis, *inter alia*, of the foregoing, to extend the Credit to the Borrower upon the terms and conditions set forth in this Agreement;

NOW THEREFORE the parties hereto hereby agree as follows:

ARTICLE I

General Conditions; Definitions

Section 1.01. The “General Conditions Applicable to Development Credit Agreements” of the Association, dated January 1, 1985 (as amended through May 1, 2004) constitute an integral part of this Agreement.

Section 1.02. Unless the context otherwise requires, the several terms defined in the General Conditions and in the Preamble to this Agreement have the respective meanings therein set forth and the following additional terms have the following meanings:

(a) “Capacity Building Facility” or “CBF” means the facility set up under Part B.1 of the Project;

(b) “Capacity Building Subprojects” means a program of activities to be financed by the CBF under Part B.1 of the Project in Schedule 2 to this Agreement;

(c) “Capacity Building Facility Technical Committee” means the committee referred to in paragraph 1(c) of Schedule 4 to this Agreement;

(d) “Capacity Building Facility Manual” or “CBF Manual” means the manual of procedures outlining the rules for accessing the CBF including information on ineligible activities, as the same may be amended from time to time with prior agreement of the Association;

(e) “DFID” means the United Kingdom Government Department for International Development;

(f) “Economic Recovery Strategy” means a policy document establishing the Borrower’s economic development priorities for 2003-2007;

(g) “External Resources Department” means a department within the Ministry of Finance responsible for coordinating foreign assistance;

(h) “EU” means the European Union;

(i) “Eligible Categories” means Categories (1), (2), (3), (4) and (5) set forth in the table in Part A.1 of Schedule 1 to this Agreement;

(j) “Eligible Expenditures” means the expenditures for goods and services referred to in Section 2.02 (a) of this Agreement;

(k) “Finance Committee” means a committee established pursuant to Standing Order No. 151 of the Standing Orders of the National Assembly of the Republic of Kenya or any legal successor thereto;

(l) “Financial Monitoring Report” or “FMR” means each report prepared in accordance with Section 4.02 of this Agreement;

(m) “Fiscal Year” or “FY” means the Borrower’s fiscal year commencing on July 1 and ending on June 30 of the following year;

(n) “GTZ” means the Gesellschaft für technische Zusammenarbeit;

(o) “IAPSO” means the Inter-Agency Procurement Service Organization of the United Nations;

(p) “Internal Audit System” means the internal audit functions undertaken by the Internal Auditor General’s department in the Ministry of Finance pursuant to the Borrower’s Financial Management Act 2004;

(q) “Investment Program for the Economic Recovery Strategy” means a framework for implementing the Borrower’s Economic Recovery Strategy;

(r) “Kenya Institute of Administration” means a body corporate established and operating pursuant to the State Corporation Act, Cap 446 of the Laws of Kenya or any legal successor thereto;

(s) “Kenya National Audit Office” means an agency of the Borrower established and operating pursuant to the Public Audit Act, 2003 of the Laws of Kenya or any legal successor thereto;

(t) “Kenya Revenue Authority” or “KRA” means a body corporate established and operating pursuant to Cap. 469 of the Laws of Kenya or any legal successor thereto;

(u) “KEPSA” means the Kenya Private Sector Alliance;

(v) “Kenya Shilling” or “KES” means the currency of the Borrower;

(w) “Ministerial Audit Committees” means the committees established by the Borrower pursuant to Circular No. 16/2005 of October 4, 2005;

(x) “MOF” means the Borrower’s Ministry of Finance;

(y) “Non Pooling Development Partners” means USAID, UNDP, GTZ and any other development partners who will support the Program through bilateral arrangements with the Borrower or channel their support through multilateral development partners;

(z) “Public Accounts Committee of Parliament” means a committee established and operating pursuant to Standing Order No. 147 of the Standing Orders of the National Assembly of Kenya or any legal successor thereto;

(aa) “Public Financial Management Coordination Unit” means the unit referred to in paragraph 1 (f) of Schedule 4 to this Agreement;

(bb) “Public Financial Management Reform Strategy” or “PFMRS” means a plan describing the Borrower’s comprehensive program of prioritized and sequenced reform efforts in public financial management for the period 2006-2010;

(cc) “Public Financial Management Reform Technical Advisory Committee” means a committee set up under the PFMRS to advise the Borrower on the PFM reform strategy;

(dd) “Public Investment Committee” means a committee established pursuant to Standing Order No. 148 of the Standing Orders of the National Assembly of Kenya or any legal successor thereto;

(ee) “Public Procurement Oversight Authority” means a body corporate established and operating pursuant to the Public Procurement and Disposal Act of 2005, or any legal successor thereto;

(ff) “Public Procurement Review Board” means a procurement review board established and operating pursuant to the Procurement and Disposal Act of 2005 or any legal successor thereto;

(gg) “Public Service Reform Secretariat” means a secretariat set up in the Borrower’s Cabinet Office for the purpose of coordinating public civil service reforms;

(hh) “Public Sector Service Reform and Development Secretariat Strategic Plan” means a plan for 2005-2008 for coordinating public services reforms, implementing and institutionalizing Results Based Management, and transformative leadership and ethics in the Borrower’s public service;

(ii) “Public Sector Governance Trust” means the trust referred to in paragraph 1 (c) of Schedule 4 to this Agreement;

(jj) “Pooling Development Partners” means collectively, the Association, DFID, SIDA, EU and any other international agency or organization pooling at least a part of their funds for financing Parts A and C.1 of the Project, who have signed the Joint Financing Agreement and Memorandum of Understanding;

(kk) “Procurement Plan” means the Borrower’s procurement plan, dated November 8, 2005 covering the initial 18-month period (or longer) of Project implementation, as the same shall be updated from time to time in accordance with the provisions of Section 3.02 to this Agreement, to cover succeeding 18-month period (or longer) of Project implementation;

(ll) “Program Procurement Manual” means the Borrower’s guidelines for procuring goods, works and services and referred to in paragraph 1 of Schedule 3 to this agreement as the same may be amended from time to time;

(mm) “Report-based Disbursements” means the Borrower’s option for withdrawal of funds from the Credit Account referred to in Part A.5 of Schedule 1 to this Agreement;

(nn) “Results Based Management” or “RBM” means a management approach for achieving agreed upon targeted results in the public sector;

(oo) “SIDA” means the Swedish Agency for International Development Corporation;

(pp) “Special Accounts” means Special Accounts A and B referred to in Section 2.02(b) of this Agreement;

(qq) “Subprogram” means a set of eligible public sector institutional related reforms and capacity building, project management and coordination activities set out under Parts A and C.1 of the Project as set forth in Schedule 2 to this Agreement, and included in the Work Plan;

(rr) “Transformative Leadership and Ethics for Results Based Management Program” means a capacity building program to institutionalize RBM, change management, values and ethics in the public service;

(ss) “Transformative Leadership and RBM Review Committee” means a committee referred to in paragraph 1(d) of Schedule 4 to this Agreement;

(tt) “UNDP” means the United Nations Development Program;

(uu) “USAID” means the United States Agency for International Development; and

(vv) “Work Plan” means each program of work and budget prepared annually by the Borrower in accordance with paragraph 5 of Schedule 4 to this Agreement;

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in this Agreement, an amount in various currencies equivalent to seventeen million three hundred thousand Special Drawing Rights (SDR 17,300,000).

Section 2.02. (a) The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable costs of: (i) goods and services required for Parts A and C of the Project and (ii) goods and services required for the Capacity Building Subprojects under Part B of the Project.

(b) The Borrower may, for the purpose of Parts A and C.1, and Part B of the Project, open and maintain in Dollars two special deposit accounts in a commercial bank on terms and conditions satisfactory to the Association, including appropriate protection against set-off, seizure or attachment. Deposits into, and payments out of the Special Account for Parts A and C.1 (hereinafter referred to as Special Account A) shall be made in accordance with the provisions of the Joint Financing Agreement and payments out of the Special Account for Part B.2 and C.2 (hereinafter referred to as Special Account B) shall be made in accordance with the provisions of Part B of Schedule 1 to this Agreement.

Section 2.03. The Closing Date shall be November 30, 2010 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

Section 2.04. (a) The Borrower shall pay to the Association a commitment charge on the principal amount of the Credit not withdrawn from time to time at a rate to be set by the Association as of June 30 of each year, but not to exceed the rate of one-half of one percent (1/2 of 1%) per annum.

(b) The commitment charge shall accrue: (i) from the date sixty days after the date of this Agreement (the accrual date) to the respective dates on which amounts shall be withdrawn by the Borrower from the Credit Account or canceled; and (ii) at the rate set as of the June 30 immediately preceding the accrual date and at such other rates as may be set from time to time thereafter pursuant to paragraph (a) above. The rate set as of June 30 in each year shall be applied from the next date in that year specified in Section 2.06 of this Agreement.

(c) The commitment charge shall be paid: (i) at such places as the Association shall reasonably request; (ii) without restrictions of any kind imposed by, or in the territory of, the Borrower; and (iii) in the currency specified in this Agreement for the purposes of Section 4.02 of the General Conditions or in such other eligible currency or currencies as may from time to time be designated or selected pursuant to the provisions of that Section.

Section 2.05. The Borrower shall pay to the Association a service charge at the rate of three-fourths of one percent (3/4 of 1%) per annum on the principal amount of the Credit withdrawn and outstanding from time to time.

Section 2.06. Commitment charges and service charges shall be payable semiannually on May 15 and November 15 in each year.

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each May 15 and November 15 commencing May 15, 2016 and ending November 15, 2045. Each installment to and including the installment payable on November 15, 2025 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for

Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

- (A) requiring the Borrower to repay twice the amount of each such installment not yet due until the principal amount of the Credit shall have been repaid; and
- (B) requiring the Borrower to commence repayment of the principal amount of the Credit as of the first semiannual payment date referred to in paragraph (a) above falling six months or more after the date on which the Association notifies the Borrower that the events set out in this paragraph (b) have occurred, provided, however, that there shall be a grace period of a minimum of five years on such repayment of principal.

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

(d) If, at any time after a modification of terms pursuant to paragraph (b) above, the Association determines that the Borrower's economic condition has deteriorated significantly, the Association may, if so requested by the Borrower, further modify the terms of repayment to conform to the schedule of installments as provided in paragraph (a) above.

Section 2.08. The currency of the United States is hereby specified for the purposes of Section 4.02 of the General Conditions.

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end, shall carry out the Project with due diligence and efficiency and in conformity with appropriate

administrative and financial practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project.

(b) Without limitation upon the provisions of paragraph (a) of this Section and except as the Borrower and the Association shall otherwise agree, the Borrower shall carry out the Project in accordance with the Implementation Program set forth in Schedule 4 to this Agreement.

Section 3.02. For the purpose of implementing the Project, the Borrower shall:

(a) open and maintain an account (Project Account) in Kenya Shillings in a commercial bank acceptable to the Association, wherein it shall deposit an amount from its own resources sufficient to cover the portion of counterpart financing requirements for local expenditures for which the Borrower is responsible under the Project financing plan and which are projected to be made under the Project in the three months succeeding the preceding Project quarter. The balance in the Project Account, as of the first day of each quarter, shall not be less than three million Kenya Shillings (KES 3,000,000) or such other amount as may be approved by the Association on the basis of criteria agreed upon with the Borrower.

(b) ensure that funds deposited in the Project Account in accordance with paragraph (a) of this section shall be used only to finance the Borrower's contribution to the expenditures under the Project which are not financed out of the proceeds of the Credit.

Section 3.03. For the purpose of implementing Parts A and C of the Project, the Borrower shall open and maintain an account (the Pooled Account) in Kenya Shillings in a commercial bank acceptable to the Association on terms and conditions satisfactory to the Association, including appropriate protection against set-off, seizure or attachment wherein it shall deposit development partners' financial contribution to the Project. Deposits into, and payments out of, this Pooled Account shall be made in accordance with the provisions of the Joint Financing Agreement.

Section 3.04. (a) Except as the Association shall otherwise agree, procurement of the goods, works and services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 3 to this Agreement as said provisions may be further elaborated in the Procurement Plan.

(b) The Borrower shall update the Procurement Plan in accordance with guidelines acceptable to the Association, and furnish such update to the Association not later than 12 months after the date of the preceding Procurement Plan, for the Association's approval.

Section 3.05. For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the Borrower shall:

(a) prepare, on the basis of guidelines acceptable to the Association, and furnish to the Association not later than six (6) months after the Closing Date or such later date as may be agreed for this purpose between the Borrower and the Association, a plan ; and

(b) afford the Association a reasonable opportunity to exchange views with the Borrower on said plan.

ARTICLE IV

Financial Covenants

Section 4.01. (a) The Borrower shall maintain a financial management system, including records and accounts, and prepare financial statements in accordance with consistently applied accounting standards acceptable to the Association, adequate to reflect the operations, resources and expenditures related to the Project.

(b) The Borrower shall:

- (i) have the financial statements referred to in paragraph (a) of this Section for each Fiscal Year audited, in accordance with consistently applied auditing standards acceptable to the Association, by independent auditors acceptable to the Association;
- (ii) furnish to the Association as soon as available, but in any case not later than six months after the end of each such year (or such other period agreed to by the Association), (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or other period agreed to by the Association), as so audited, and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Association; and
- (iii) furnish to the Association such other information concerning such records and accounts, and the audit of such financial statements, and concerning said auditors, as the Association may from time to time reasonably request.

(c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of reports referred to in Part A.5 of Schedule 1 to this Agreement (Report-based Disbursements) or on the basis of statements of expenditure, the Borrower shall:

- (i) retain, until at least one year after the Association has received the audit report for, or covering, the Fiscal Year in which the last withdrawal from the Credit Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
- (ii) enable the Association's representatives to examine such records; and
- (iii) ensure that such statements of expenditure are included in the audit for each Fiscal Year (or other period agreed to by the Association), referred to in paragraph (b) of this Section.

Section 4.02. (a) Without limitation upon the Borrower's progress reporting obligations set out in Paragraph 6 (b) of Schedule 4 to this Agreement, the Borrower shall prepare and furnish to the Association a Financial Monitoring Report (FMR), in form and substance satisfactory to the Association, which:

- (i) sets forth sources and uses of funds for the Project, both cumulatively and for the period covered by said report, showing separately funds provided under the Credit, and explains variances between the actual and planned uses of such funds;
- (ii) describes physical progress in Project implementation, both cumulatively and for the period covered by said report, and explains variances between the actual and planned Project implementation; and
- (iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

(b) The first FMR shall be furnished to the Association not later than 45 days after the end of the first calendar quarter after the Effective Date, and shall cover the period from the incurrence of the first expenditure under the Project through the end of such first calendar quarter; thereafter, each FMR shall be furnished to the Association not later than 45 days after each subsequent calendar quarter, and shall cover such calendar quarter.

ARTICLE V

Remedies of the Association

Section 5.01. Pursuant to Section 6.02 (l) of the General Conditions, the following additional events is specified; namely; a situation has arisen which shall make it improbable that the Program or a significant part thereof, will be carried out.

ARTICLE VI

Effective Date; Termination

Section 6.01. The following events are specified as additional conditions to the effectiveness of the Development Credit Agreement within the meaning of Section 12.01 (b) of the General Conditions:

(a) the Borrower has pursuant to Section 3.02 (a) of this Agreement opened a Project Account and deposited therein an initial amount of KES 3,000,000;

(b) the Borrower has signed a Joint Financing Agreement with at least one Development Partner satisfactory to the Association;

(c) the Borrower has selected short term consultants for procurement, project accounting and project management; all under terms of reference and recruitment processes that are open, transparent and satisfactory to the Association;

(d) the Borrower has submitted a Public Financial Management Reform Strategy and Public Sector Service Reform and Development Secretariat Strategic Plan with their relevant work plans satisfactory to the Association;

(e) the Borrower has submitted reports indicating outputs of the completed pilot activities under the Transformative Leadership and Ethics for Results Based Management Program satisfactory to the Association; and

(f) the Borrower has finalized a Financial Management Manual and a Program Procurement Manual satisfactory to the Association.

Section 6.02. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VII

Representative of the Borrower; Addresses

Section 7.01. The Minister of Finance of the Borrower is designated as representative of the Borrower for the purposes of Section 11.03 of the General Conditions.

Section 7.02. The following addresses are specified for the purposes of Section 11.01 of the General Conditions:

For the Borrower:

Ministry of Finance
P.O Box 30007
Nairobi
Kenya

Cable address:

Facsimile:

FINANCE
NAIROBI

254 20 330 426
254 20 218 475

For the Association:

International Development Association
1818 H Street, N.W.
Washington, D.C. 20433
United States of America

Cable address:

Telex:

Facsimile:

INDEVAS
Washington, D.C.

248423 (MCI) or
64145 (MCI)

(202) 477-6391

IN WITNESS WHEREOF, the parties hereto, acting through their duly authorized representatives, have caused this Agreement to be signed in their respective names in the District of Columbia, United States of America, as of the day and year first above written.

REPUBLIC OF KENYA

By: /s/ Amos Kimunya
Authorized Representative

INTERNATIONAL DEVELOPMENT ASSOCIATION

By: /s/ Colin Bruce
Authorized Representative

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

Part A. General

1. The table below sets forth the Categories of items to be financed out of the proceeds of the Credit, the allocation of the amounts of the Credit to each Category and the percentage of expenditures for items so to be financed in each Category:

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(1) Subprograms under Parts A and C.1 of the Project	11,030,000	90% of Eligible Expenditures for FY 2006/2007 and thereafter such % of Eligible Expenditures as the Association may determine from time to time;
(2) Capacity Building Facility under Part B.1 of the Project	3,700,000	90% of expenditures of amounts disbursed
(3) Goods under Parts B.2 and C.2 of the Project	450,000	100% of foreign expenditures and 94% of local expenditures
(4) Consultants Services & Training under Part B.2 of the Project	1,200,000	100% of foreign expenditures and 94% of local expenditures
(5) Operating Costs	20,000	90%
(6) Unallocated	900,000	

Total	<u>17,300,000</u> =====
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2. (a) the term “foreign expenditures” means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower;

(b) the term “local expenditures” means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower;

(c) the term “Operating Costs” means the costs incurred for the purpose of the Project management and coordination under Part C of the Project, maintaining vehicles, fuel, equipment, office supplies, utilities, consumables, travel per diems and allowances, travel and accommodation, and office rental but excluding salaries of the Borrower’s civil servants.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments:

(a) made for expenditures prior to the date of this Agreement; and

(b) under category 2 unless, the beneficiaries have complied with the set of broad eligibility criteria and rules of access developed by the Borrower pursuant to paragraph 2 (a) of Schedule 4 to this Agreement.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures under contracts for: (a) goods costing less than \$200,000 equivalent per contract; (b) services of individual consultants costing less than \$50,000 equivalent per contract; and (c) services of consulting firms under contracts costing less than \$100,000 equivalent per contract, all under such terms and conditions as the Association shall specify by notice to the Borrower.

5. The Borrower may request withdrawals from the Credit Account to be made on the basis of reports to be submitted to the Association in form and substance satisfactory to the Association, such reports to include the FMR and any other information as the Association shall specify by notice to the Borrower (Report-based Disbursements). In the case of the first such request submitted to the Association before any withdrawal has been made from the Credit Account, the Borrower shall submit to the Association only a statement with the projected sources and applications of funds for the Project for the six-month period following the date of such request.

B. Special Accounts

1. After the Association has received evidence satisfactory to it that the Special Account A and Special Account B have been opened, withdrawals from the Credit Account of amounts to be deposited into the Special Accounts shall be made as follows:

(a) if the Borrower is not making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex A to this Schedule 1; and

(b) if the Borrower is making Report-based Disbursements, withdrawals shall be made in accordance with the provisions of Annex B to this Schedule 1.

2. Payments out of the Special Accounts shall be made exclusively for Eligible Expenditures. For each payment made by the Borrower out of the Special Accounts, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for Eligible Expenditures.

3. Notwithstanding the provisions of Part B.2 of this Schedule, the Association shall not be required to make further deposits into the Special Accounts:

(a) if the Association, at any time, is not satisfied that the reports referred to in Part A.5 of this Schedule 1 adequately provide the information required for Report-based Disbursements;

(b) if the Association determines at any time that all further withdrawals for payment of Eligible Expenditures should be made by the Borrower directly from the Credit Account; or

(c) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01 (b) (ii) of this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of: (A) the records and accounts for the Special Account; or (B) the records and accounts reflecting expenditures with respect to which withdrawals were Report-based Disbursements or were made on the basis of statements of expenditure, as the case may be.

4. The Association shall not be required to make further deposits into the Special Account in accordance with the provisions of Part B.2 of this Schedule if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to Section 6.02 of the General Conditions. Upon such notification, the Association shall determine, in its sole discretion, whether further deposits into the Special Account may

be made and what procedures should be followed for making such deposits, and shall notify the Borrower of its determination.

5. (a) If the Association determines at any time that any payment out of the Special Accounts was made for an expenditure which is not an Eligible Expenditure, or was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association, provide such additional evidence as the Association may request, or deposit into the respective Special Accounts (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment. Unless the Association shall otherwise agree, no further deposit by the Association into the Special Accounts shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association determines at any time that any amount outstanding in the Special Accounts will not be required to cover payments for Eligible Expenditures during the six-month period following such determination, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

(c) The Borrower may, upon notice to the Association, refund to the Association all or any portion of the funds on deposit in the Special Accounts.

(d) Refunds to the Association made pursuant to subparagraph (a), (b) or (c) of this paragraph 6 shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the provisions of this Agreement.

Annex A

to

SCHEDULE 1

**Operation of Special Account
When Withdrawals Are Not
Report-based Disbursements**

1. For the purposes of this Annex, the term “Authorized Allocation” means the amount of \$ 400,000 allocated to Parts B and C of the Project to be withdrawn from the Credit Account and deposited into the Special Account B pursuant to paragraph 2 of this Annex.

2. Withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the Special Account B shall be made as follows:

(a) For withdrawals of the Authorized Allocation, the Borrower shall furnish to the Association a request or requests for deposit into the Special Account B of an amount or amounts which in the aggregate do not exceed the Authorized Allocation. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account B such amount as the Borrower shall have requested.

(b) For replenishment of the Special Account B, the Borrower shall furnish to the Association requests for deposit into the Special Account B at such intervals as the Association shall specify. Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to Part B.3 of Schedule 1 to this Agreement for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account B such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the Special Account B for Eligible Expenditures. Each such deposit into the Special Account B shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.

3. The Association shall not be required to make further deposits into the Special Account B, once the total unwithdrawn amount of the Credit allocated to Eligible Categories (2), (3), 4 and 5 minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General

Conditions shall equal the equivalent of twice the amount of the Authorized Allocation. Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the Special Account B as of the date of such notice will be utilized in making payments for Eligible Expenditures.

Annex B

to

SCHEDULE 1

**Operation of Special Accounts
When Withdrawals Are
Report-based Disbursements**

1. Withdrawals from the Credit Account shall be deposited by the Association into the Special Account in accordance with the provisions of Schedule 1 to this Agreement. Each such deposit into the respective Special Accounts shall be withdrawn by the Association from the Credit Account under one or more of the Eligible Categories.

2. Upon receipt of each application for withdrawal of an amount of the Credit, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the Special Account an amount equal to the lesser of: (a) the amount so requested; and (b) the amount which the Association has determined, based on the reports referred to in Part A.5 of this Schedule 1 applicable to such withdrawal application, is required to be deposited in order to finance Eligible Expenditures during the six-month period following the date of such reports.

SCHEDULE 2

Description of the Project

The objectives of the Project are to: (a) strengthen the Borrower's public financial management systems to enhance transparency; accountability and responsiveness to public expenditure policy priorities, and (b) enhance public service delivery through effective implementation of Results Based Management.

The Project consists of the following parts, subject to such modifications thereof as the Borrower and the Association may agree upon from time to time to achieve such objectives:

Part A: Public Financial Management (PFM):

Carrying out of Subprograms for:

1. Strengthening the budget formulation process through: (a) capacity building of staff of institutions benefiting from the Project, simplification of policy tools and instruments for the budget process; development of information systems and databases; (b) embedding the budget structure into the chart of accounts and subsequent reports produced from the financial system; (c) provision of technical assistance to link ministerial strategic plans, annual work plans and annual budgeting processes; and (d) streamlining, target setting, policy planning, budgeting, and monitoring and evaluation within the Borrower's government.

2. Strengthening budget execution, accounting and financial reporting through: (a) providing technical support and other capacity building interventions to improve cash management, containing occurrence of further expenditure arrears; improving payment systems and ensuring proper payroll management and integrity; and (b) implementing an action plan for clearing expenditure arrears and preventing new ones which shall, *inter alia*, include (i) development of a policy for prevention of new expenditure arrears; (ii) reviewing contract administration procedures; (iii) establishing a project implementation and monitoring system; (iv) promulgating procurement regulations; (v) establishing a system for managing pending bills; and (c) capacity building and training of management consultancy staff services division staff on payroll management.

3. Strengthening the use of information technology in public financial management through: (a) establishing a public sector budget that is integrated with the core accounting system; (b) improving and automating controls to ensure the accuracy and reliability of information in files and reports to prevent or discourage fraud; (c) automating

reconciliation of bank accounts; (d) ensuring timely integration of payroll data; and (e) improving capacity of PFM staff.

4. Strengthening the external audit system through: (a) supporting ongoing initiatives to clear the substantial backlog of overdue local authorities' audit reporting and preventing occurrence of new audit arrears; (b) strengthening the relationship between the Public Accounts and Public Investments Committees of Parliament and the Kenya National Audit Office through technical and advisory services; (c) preparation and finalization of audit manuals; and (d) training in alternative audit approaches including performance, forensic audit, "value for money" audit risk based auditing and change management approaches.

5. Strengthening the Internal Audit System, through: (a) provision of support to the Internal Audit Department to complete its risk-based audits in order to develop and document a new internal audit methodology and plan and preparing for its implementation; (b) training staff and members of the Ministerial Audit Committees on the risk based internal audit methodology, and planning and preparing for its implementation; (c) reviewing audit processes and systems in order to align them; and, (d) establishing the core competencies to implement the revised audit approach.

6. Strengthening the national procurement system through: (a) implementing the new legal and regulatory framework for procurement; (b) provision of training to the Public Procurement Oversight Authority staff and other public procuring entities based on a training needs assessment; (c) supporting the implementation of capacity building and training programs for staff of public procuring entities, the Public Procurement Administrative Review Board and anti-corruption institutions; and (d) supporting the implementation of information, education and communication for the public procurement system.

7. Supporting key parliamentary committees for effective oversight of public financial management through: (a) provision of technical assistance training on macro-economic and financial management with a particular focus on budget processes, preparation, budget execution and expenditure control; (b) supporting an independent parliamentary budget office through training to ensure that members of parliament have access to independent budget information and analyses; (c) strengthening the capacity of the Public Accounts Committee to review audit reports and monitor corrective actions; (d) strengthening the capacity of the Finance Committee to oversee the budget process; and (e) provision of technical and logistical support to strengthen the relationship between the Public Accounts Committee and the Kenya National Audit Office.

8. Strengthening the capacity of the KRA to enhance its revenue collection and tax administration through: (a) provision of technical assistance, training and equipment to the Domestic Taxes Department in order to restructure its current tax-based structure

into a unified function-based tax administration; (b) acquisition and implementation of a new modern integrated information technology system for tax administration for KRA including a disaster recovery site; and (c) provision of training and technical assistance to upgrade and diversify the skill base requirements of the program to promote change management.

Part B: Capacity Building For Results

1. Setting up and providing financing to a Capacity Building Facility for the purpose of assisting selected ministries to achieve benchmarks set by the Borrower under its Economic Recovery Strategy and the ministries' performance contracts including the benchmarks on leadership and RBM.

2. Implementing the Transformative Leadership and Ethics for Results Based Management Program to enhance change management and mainstream public service values and ethics in service delivery through: (a) developing and implementing an analytical work to generate global best practices and comparative lessons to provide the Borrower with global knowledge to implement good practices in the content, pace and sequencing of reform initiatives; (b) purchasing of office equipment such as computers and their relevant software and vehicles; (c) strengthening the capacity of the participating ministries through: (i) conducting of analytical work in the participating ministry to understand the specific environment of reform in each ministry; (ii) establishing baseline, (iii) implementing and monitoring progress; (iv) conducting workshops/retreats for leaders to exchange ideas and enhance the political leadership for reforms to succeed; (v) establishing peer coaching or other close advisory relationship between reform leaders at various levels to have a ready network of technical, process and professional support; and (vi) provision of technical support for adoption of various re-engineering processes such as implementation of RBM, rapid results methodologies, that is, information, education and communication and stakeholder partnership; (d) implementing RBM, leadership and ethics capacity building in critical institutions of the Borrower such as the Kenya Institute of Administration through training on leadership and oversight and mainstreaming public sector ethics; (e) building capacity, coordinating, monitoring and evaluating activities to ensure the effective and continuous evaluation of leadership, value and ethics execution; and (f) capacity building of the Public Service Reform Secretariat staff to deliver the program.

Part C: Project Management and Coordination

1. Strengthening the capacity of the PFM Coordination Unit through provision of equipment, technical assistance and financing for contracting short term consultants to promote effective coordination and monitoring of the Project.

2. Strengthening the capacity of the Public Sector Reform Secretariat through provision of equipment, technical assistance and financing for contracting short term consultants to promote effective coordination and monitoring of Part B of the Project.

* * *

The Project is expected to be completed by May 31, 2010.

SCHEDULE 3

Procurement

Section I. General

A. All goods, works and services (other than consultants' services) shall be procured in accordance with the provisions of Section I of the "Guidelines: Procurement under IBRD Loans and IDA Credits" dated May 2004 (the Procurement Guidelines), and the Program Procurement Manual.

B. All consultants' services shall be procured in accordance with Sections I and IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" dated May 2004 (the Consultant Guidelines), and the Program Procurement Manual.

C. The capitalized terms used below in this Schedule to describe particular procurement methods or methods of review by the Association of particular contracts, have the meanings ascribed to them in the Procurement Guidelines, or Consultant Guidelines, as the case may be.

Section II. Particular Methods of Procurement of Goods, Works and Services (other than Consultants' Services)

A. International Competitive Bidding. Except as otherwise provided in Part B of this Section, contracts shall be awarded on the basis of International Competitive Bidding.

B. Other Procurement Procedures

1. National Competitive Bidding. Goods estimated to cost less than \$200,000 equivalent per contract may be procured under contracts awarded on the basis of National Competitive Bidding.

2. Shopping. Goods estimated to cost less than \$50,000 equivalent, may be procured under contracts awarded on the basis of Shopping.

3. Direct Contracting. Goods and works which the Association agrees meet the requirements for Direct Contracting may be procured in accordance with the provisions of said procurement method.

4. Procurement from UN Agencies. Goods estimated to cost less than \$100,000 equivalent per contract may be procured directly from IAPSO in accordance with the provisions of paragraphs 3.1 and 3.9 of the Procurement.

Section III. Particular Methods of Procurement of Consultants' Services

A. Quality and Cost-based Selection. Except as otherwise provided in Part B of this Section, consultants' services shall be procured under contracts awarded on the basis of Quality- and Cost-based Selection. For purposes of paragraph 2.7 of the Consultant Guidelines, the short list of consultants for services estimated to cost less than \$100,000 equivalent per contract may comprise entirely national consultants.

B. Other Procedures

1. Selection Under a Fixed Budget. Services for assignments which the Association agrees meet the requirements of paragraph 3.5 of the Consultant Guidelines may be procured under contracts awarded on the basis of a Fixed Budget in accordance with the provisions of paragraphs 3.1 and 3.5 of the Consultant Guidelines.

2. Least-cost Selection. Services for assignments which the Association agrees meet the requirements of paragraph 3.6 of the Consultant Guidelines may be procured under contracts awarded on the basis of Least-cost Selection in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

3. Selection Based on Consultants' Qualifications. Services estimated to cost less than \$100,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1, 3.7 and 3.8 of the Consultant Guidelines.

4. Single Source Selection. Services for tasks in circumstances which meet the requirements of paragraph 3.10 of the Consultant Guidelines for Single Source Selection, may, with the Association's prior agreement, be procured in accordance with the provisions of paragraphs 3.9 through 3.13 of the Consultant Guidelines.

5. Individual Consultants. Services for assignments that meet the requirements set forth in the first sentence of paragraph 5.1 of the Consultant Guidelines may be procured under contracts awarded to individual consultants in accordance with the provisions of paragraphs 5.2 through 5.3 of the Consultant Guidelines. Under the circumstances described in paragraph 5.4 of the Consultant Guidelines, such contracts may be awarded to individual consultants on a sole-source basis.

Section IV. Review by the Association of Procurement Decisions

Except as the Association shall otherwise determine by notice to the Borrower, the following contracts shall be subject to Prior Review by the Association: (a) each contract for goods and services (other than consultants' services) estimated to cost the equivalent of \$200,000 or more procured on the basis of International Competitive Bidding or Direct Contracting; (b) each contract for consultants' services provided by a firm estimated to cost the equivalent of \$100,000 or more; (c) each contract for an individual consultant estimated to cost the equivalent of \$50,000 or more; and (d) all contracts procured on the basis of Single Source Selection. All other contracts shall be subject to Post Review by the Association.

SCHEDULE 4

Implementation Program

Institutional Arrangements

1. The Borrower shall:

(a) designate the Public Financial Management Coordination Unit in the Ministry of Finance, (consisting of staff from the public service and short-term consultants (in charge of staff training) with the overall coordination of the Project, monitoring and evaluating the reform process, integrating the various donor activities into the Project and publishing progress reports on a regular basis;

(b) establish a Steering Committee comprising the Permanent Secretaries of the selected beneficiary ministries with the responsibility for overseeing the implementation of all reform programs/initiatives including the RBM;

(c) set up a Capacity Building Facility Technical Committee with representatives from the ministries participating in the Project, representatives from KEPSA and the Public Sector Governance Trust with the responsibility for reviewing all proposals for accessing the CBF and making final recommendations to the Steering Committee which shall finally approve the use of the funds;

(d) set up a Transformative Leadership and Results Based Management Review Committee consisting of the five Permanent Secretaries from the participating ministries being fast tracked in the leadership and capacity building program chaired by the Secretary, Public Sector Reform and Development, with the responsibility for providing leadership in the implementation of RBM and providing advice on broader leadership, ethics, and effective Project implementation;

(e) set up a PFM Technical Advisory Committee with representatives from stakeholder agencies involved in PFM implementation both within and outside the government, with the responsibility for providing advice on financial management and effective Project implementation;

(f) no later than June 30, 2006 or any other date to be agreed with the Association set up a National Public Procurement Oversight Authority to oversee public procurement.

Capacity Building Facility

2. In implementing Part B.1 of the Project, the Borrower shall: (a) develop a set of broad eligibility criteria and rules of access, and (b) indicate the amount of funds to be allocated each year to selected ministries that will benefit from the CBF including their requirements for participating the CBF which shall *inter alia* include: (i) developing a strategic plan oriented towards achieving the Economic Recovery Strategy objectives; (ii) preparing a capacity building plan including its costs and an implementation/procurement plan; (iii) developing an asset register; (iv) preparing a capacity building report for the previous year; and (v) submitting an annual financial statement.

3. The Borrower shall monitor and supervise the use of the CBF and ensure that it is managed and used in a financially prudent manner; and meets the CBF objectives.

Annual Joint Reviews

4. The Borrower shall:

(a) in respect of Parts A and C.1 of Schedule 2 of this Agreement, conduct a technical and financial performance progress for the previous year to inform the annual joint review involving Pooling Development Partners;

(b) carry out jointly with the Association, on or about February 28 each year, or such later date as the Association may agree, a comprehensive review (annual review) aimed at: (i) reviewing the technical and financial performance progress report on the Project; (ii) documenting progress towards Project objectives; (iii) identifying and resolving obstacles to Project implementation; and (iv) adjusting, in agreement with the Association, targets and corresponding Subprograms to reflect progress achieved in the implementation of the Project as of the date of the review; and

(c) promptly after completing the annual review, take all measures required to fulfill the recommendations arising out of said reviews, with due diligence and efficiency and in accordance with appropriate practices, taking into account the Association and other development partners' comments thereon.

Annual Work Plan Planning Meeting

5. The Borrower shall:

(a) following the annual joint review, held not later than October 31, of each year or such other date as the Association may agree, jointly in consultation with the

Association and the other Development Partners conduct a budget planning meeting to discuss the draft annual Work Plan for the coming Fiscal Year for Parts A and C of the Project.

(b) not later than March 31 of each Fiscal Year during the implementation of the Project or such later date as the Association may agree in consultation with the development partners, prepare and furnish to the Association for its approval a final Work Plan containing each proposed Subprogram to be carried out in the following Fiscal Year, modified in a manner satisfactory to the Association, taking into account the comments and views of the Association and the development partners.

6. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with the indicators set forth in Schedule 5 to this Agreement, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Association, and furnish to the Association, on or about October 31, 2007 or any other date to be agreed with the Association, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and

(c) review with the Association, by November 15, 2007, or such later date as the Association shall request, the report referred to in paragraph (b) of this Section, and, thereafter, take all measures required to ensure the efficient completion of the Project and the achievement of the objectives thereof, based on the conclusions and recommendations of the said report and the Association's views on the matter.

SCHEDULE 5

Monitoring Indicators

1. National budget is aligned with explicitly stated Borrower's priorities in the Investment Program for the Economic Recovery Strategy;
2. Budget allocation and actual expenditure disparities are reduced;
3. Improved predictability of the Borrower's Treasury department's annual/mid term allocation flows to line ministries;
4. Risk based external audit reports prepared and published in a timely fashion in accordance with the Public Audit Act, 2003;
5. Adoption of a risk based internal audit approach and establishment of effective Ministerial Audit Committees;
6. Skilled Public Accounts, Public Investment and Finance Committees of Parliament that undertake their statutory functions meet in a timely manner to discuss and act on reports;
7. Procurement entities adhere to the national procurement law.
8. Accountability and capacity of public servants are enhanced for the delivery of public services through the introduction of RBM, which are linked to the delivery of specific outputs/results;
9. Ministries accessing funds under the Credit develop strategic plans and show good performance in implementing them;
10. External Resources Department is strengthened and develops and adopts an aid policy that brings order to donor support for capacity building.