The World Bank Group
Integrity Vice Presidency

Forensic Audit Report

Arid Lands Resource Management Project – Phase II

Redacted Report

July 2011

This report details the findings and observations of the investigation conducted by the Africa Regional Team and the Forensic Services Unit of the Integrity Vice Presidency into the USD120m ALRMP II

Contents

Acronyms and Abbreviations

AIE	Authorisation to Incur Expenditure
ALRMP	Arid Lands Resource Management Project
ALRMP II	Arid Lands Resource Management Project – Phase II
ATM	Automatic Teller Machine
CBI	Confidential Business Information
CDC	Community Development Committee
CDD	Community Driven Development
CDF	Constitutional Development Fund
DCA	Development Credit Agreement
DMI	Drought Management Initiative
DMO	Drought Management Officer
DSG	District Steering Group
EDRP	Emergency Drought Recovery Project
FMR	Financial Management Report
FMS	Financial Management Specialist
FSU	Forensic Services Unit, Integrity Vice Presidency
FY06/07	Financial year – 1 July 2006 to 30 June 2007
FY07/08	Financial year – 1 July 2007 to 30 June 2008
GOK/GoK	Government of Kenya
IAD	Kenyan Treasury – Internal Audit Department
IDA	International Development Association
IFMIS	Integrated Financial Management Information System
INT	World Bank's Integrity Vice Presidency
KACC	Kenyan Anti-Corruption Commission
KACCAL	Kenya: Adaption to Climate Change in Arid and Semi-Arid Lands Project
KCB	Kenya Commercial Bank
KESSP	Kenya Education Sector Support Program
KRA	Kenyan Revenue Authority
KSH/Ksh	Kenyan Schillings
LOA	Loans and Disbursements
MOH	Ministry of Health
NGOs	Non-Government Organisations
PIP	Project Implementation Plan
PIU	Project Implementation Unit
Q	Questionable Expenditures
RFQ	Request for Quotations
SFE	Suspected Fraudulent Expenditure
SLD	Support for Local Development
TTL	Task Team Leader
USD	United States dollars
VAT	Value Added Tax
VFM	Value for Money
WKCDD	Western Kenya Community Driven Development and Flood Mitigation Project
WCRS	Wajir Community Radio Station

Executive Summary

In April 2009 INT initiated a forensic audit of the Kenyan Second Arid Lands Management Project (ALRMPII), a $120 million Bank-supported effort approved in May 2003 to enhance food security and reduce vulnerability in drought-prone and marginalized communities through a combination of institutional reforms and community empowerment. The purpose of the audit was to identify any expenditure that appeared to be fabricated, or inflated, or invalid. The audit proceeded in two stages. Where the documentation supporting an expenditure was complete and appeared authentic, the transaction was deemed to be valid and was not subject to further analysis.

On the other hand, where the documentation supporting transactions was either insufficient or questionable, it was subject to further examination to determine whether it was a "suspected fraudulent expenditure" or SFE. If this further examination showed there were inconsistent documents supporting the expenditure, or inconsistent information, or documents obtained through third parties or field research raised doubts about its genuineness, it was classified as an SFE. Fuller descriptions of the basis upon which documented expenditure was initially 'questionable' or determined to be a SFE are set out under the 'scope' section of this report.

Because the project involved a large number of relatively small transactions, managed at the district level and spread across Kenya, the forensic audit did not examine all project expenditures. Instead, for the fiscal years 2007 and 2008 (the audit period),[1] auditors reviewed all expenditures made in seven of the 28 districts covered by the project. These seven accounted for almost half the project's total expenditure, and for the two year period reviewed, there were approximately 28,000 transactions in these seven districts.

The audit initially questioned transactions worth Ksh514m (Ksh251m and Ksh263m for FY07 and FY08 respectively). Following further analysis, SFEs of Ksh362m (Ksh176m and Ksh186m for FY07 and FY08 respectively) were established. This represents about 29% or a little less than one-third of the total expenditures reviewed.

The fraudulent behaviors in the transactions identified were broadly consistent across all districts sampled and the headquarters itself and were found in all categories of expenditures including fuel, vehicle repairs, training (capacity building), allowances and per diem, payroll, noncurrent assets. In relation to the community empowerment component, SFEs included income generating activities (matching grants), restocking activities, infrastructure (white elephants such as butcheries which were not certified by MOH or dispensaries which were never used), and in the drought management component of the project including allowances, training and data analysis. The audit did not group transactions by category of expenditure for headquarters because some SFE exhibited multiple risks and the categorization of expenditures by headquarter office was inconsistent (as explained later in the report,

[1] A Supplementary Report dealing with specific allegations has been produced for Bank operations to assist in enhancing project design.

expenditures were often allocated to categories on what appears to be a subjective basis – this may have occurred in some districts as well).

INT FINDINGS: SUSPECTED FRAUDULENT EXPENDITURES

KSH 000s

	Q	#	SFE	#	Total Q + SFE	#	FMR Expenditure	
Garissa	11,662	*220*	33,190	*230*	44,852	*450*	67,846	*66%*
Isiolo	14,962	*94*	23,852	*99*	38,814	*193*	61,204	*63%*
Kajiado	1,468	*31*	5,768	*50*	7,236	*81*	22,021	*33%*
Nyeri	3,170	*45*	12,574	*54*	15,744	*99*	13,912	*113%*
Samburu	9,431	*114*	17,310	*81*	26,741	*195*	52,311	*51%*
Tana River	4,744	*39*	16,354	*71*	21,098	*110*	40,055	*53%*
Wajir	9,437	*123*	59,358	*187*	68,795	*310*	89,403	*77%*
Headquarters	19,289	*64*	17,680	*39*	36,969	*103*	84,784	*44%*
Payroll	2,863		-		2,863	-	223,577	*1%*
FY07/08	**77,026**	*730*	**186,086**	*811*	**263,112**	*1,541*	**655,113**	*40%*
Garissa	4,498	*124*	27,432	*147*	31,930	*271*	55,848	*57%*
Isiolo	10,108	*122*	39,091	*218*	49,199	*340*	57,313	*86%*
Kajiado	9,307	*40*	9,421	*86*	18,728	*126*	21,299	*88%*
Nyeri	1,310	*43*	7,100	*39*	8,410	*82*	20,459	*41%*
Samburu	15,520	*176*	27,362	*95*	42,882	*271*	50,551	*85%*
Tana River	7,792	*56*	8,643	*40*	16,435	*96*	44,681	*37%*
Wajir	11,428	*180*	39,150	*240*	50,578	*420*	69,451	*73%*
Headquarters	15,788	*69*	17,424	*41*	33,212	*110*	77,239	*43%*
Payroll	-		-		-	-	176,769	*0%*
FY06/07	**75,751**	*810*	**175,623**	*906*	**251,374**	*1,716*	**573,610**	*44%*
TOTAL FY07 & FY08	**152,777**	*1,540*	**361,709**	*1,717*	**514,486**	*3,257*	**1,228,723**	*42%*

The non-transactional issues audited included payroll, FMR issues, bank/cash and noncurrent assets.

The detailed analytical review of payroll identified questionable transactions for FY08 of Ksh2.9m. This sum consisted of two groups of transactions, those relating to the incorrect classification of allowances and backdated salary adjustments. A number of issues surrounding specific individuals were not resolved during the audit process because there were insufficient contemporary records made available to INT to substantiate the allegation(s) and the lack of adequate response by project staff and GOK to such issues.

Manipulation of bank statements and cash appears systemic across many of the districts sampled, possibly to avoid GOK regulations or defraud the project. There is a motive to under-report cash balances as under GOK rules unused funds must be repaid to the exchequer at the end of the financial year. While the audit does not prove that embezzlement occurred, it found that opportunities to embezzle cash from districts bank accounts existed in a number of ways - principally through the use of imprest accounts; but also via encashing cheques payable ostensibly to suppliers and the Commissioner of VAT. One district simply cashed cheques not recorded in the cashbook; another district used an ATM facility and drew funds equating to cheques written in the name of Commissioner of VAT (which were never subsequently presented).

The audit found a disconnect between the underlying vouchers provided and the financial management reports or FMR expenditures reported. While the FMRs were the basis for withdrawal applications from IDA, INT found that insufficient vouchers were provided to substantiate the expenditures reported in the FMRs and that the districts did not maintain sufficient workpapers to reconcile any differences arising. The project's acknowledgement that IFMIS was not working and that only some of the districts operated ledgers, further confirmed the unreliability of the information.

Noncurrent assets was a risk identified in the planning stages of the audit, and indeed the audit found that this risk was realized due to the inadequacy of the financial and accounting systems of the project for the relevant periods. In particular, the audit could not determine whether fixed assets, principally vehicles and computers, were properly used for the project. It also determined that there are no accountability mechanisms within the loan documents to ensure that, if project assets are disposed of, the proceeds revert to the project and/or GOK, and similarly on closure of the project, no accountability mechanisms were identified to ensure that assets of the project are transferred to another project or GOK. Because the accounting and financial management systems were inadequate and because the proper use of project assets acquired was not demonstrated, an argument could be raised that the total expenditures under this category are questionable, as the borrower has failed to meet the financial covenants in Article 4 of the original Development Credit Agreement (DCA). This may be an observation relevant to all Bank projects where inadequate FM systems are subsequently found. The audit also identifies that GOK regulations were intermittently applied, which appeared to assist the project management to avoid accountability issues.

INT views the issues identified in this audit as systemic and serious, supported by the fact that total suspected fraudulent expenditures represented approximately 29% of those sampled. The issues identified are consistent with findings in other recent audits conducted by the GOK authorities.

Background

1. Arid Lands Resource Management Project – Phase II (ALRMP II), project number P078058, was the successor project to ALRMP (P001331) which operated from July 1996 to June 2003 and was funded by the Bank, covered 22 districts with total IDA disbursements of USD19.24m. ALRMP was, in turn, a successor project to the Emergency Drought Recovery project (EDRP) (P001369) which operated from April 1993 to June 1997. ALRMP II was initially approved for an IDA loan of USD65.99m. Additional IDA financing of USD52.4m and a trust fund of USD5.59m was sought and approved under this project by the Board in late 2006 which made the ALRMP II a USD124m Bank funded project and increased the number of districts covered from 22 to 28. A successor project to ALRMP II, Kenya: Adaption to Climate Change in Arid and Semi-Arid Lands (KACCAL), project number P091979, has been approved by the Board but implementation is pending the outcome of this audit and any follow-up measures required. ALRMP II was made up of three components – drought monitoring, community driven development (CDD) and support for local development (SLD). Significantly CDD was the single largest activity (21.9%) of the project after funding the National and district co-ordination units (23.2%) (source: PIP for ALRMP II page 14).

2. The first two anticipated benefits of the project relate to CDD project goals, the original PIP stated the project was *"expected to generate a variety of social, economic and institutional benefits, which will strengthen sustainable livelihoods of the target population:*

    1. *Community Empowerment: The Beneficiary Assessment of ALRMP I highlighted the importance of empowerment as a benefit per se. ALRMP II will, through design improvements, further strengthen social capital and the voice of marginalized communities and increase their capacity to determine and implement their own development priorities.*

    2. *Improved enabling environment for wealth creation: Reducing conflict and insecurity will create a more favorable environment for enterprise development. Greater access to financial services will also stimulate income diversification and open up new opportunities for innovators and entrepreneurs. This will lead to an increase in incomes and employment opportunities.(source: PIP, page 10, Anticipated Benefits)*

3. The drought monitoring initiative component for ALRMP II was to build on the work of phase I of ALRMP, namely the implementation and strengthening of data collection and to institutionalize the drought management initiatives within GOK systems. The project acknowledged that in addition to data collection and analysis, interventions at the community level were also required, hence the need for the remaining components. Due to a number of issues, including governance, phase I designed the drought monitoring system by establishing its own District structure, through the establishment of District Steering Committees (DSGs) with the responsibility to determine the local interventions. The DSG is a government committee chaired by the District Commissioner whose members are the various district departmental heads, and whose function is to coordinate

cross-cutting project activities (both government and donor) at the district level and to engage with communities on development matters.

4. CDD can be characterized by a number of different criteria which can sometimes cause confusion when projects are generically described as a CDD project or there is reference to the CDD 'model'. It is important therefore to define, from INT's perspective, the CDD features of ALRMP II which justify this label. CDD projects incorporate the "empowerment of communities" by giving them the capacity to choose projects, and making them responsible for these choices, selecting leaders, implementing and fiscally managing their projects. Within ALRMP II there was a specific CDD component which was designed to empower local villages or community groups in the 28 arid and semi-arid districts. In addition there were several other components of the ALRMP II project not peculiar to the CDD model, namely an early warning data collection component for drought management purposes, a significant capacity building component, and the drought contingency fund component. Significantly, the CDD manual was used for all components of the project.

5. The effectiveness of the CDD approach hinges on the transparency and mechanisms that ensure the community has adequate information about the project: how to apply for funding, who can participate, the decision- making process, and, once the funding decisions are made, on the transparency and efficiency of the payment systems, to get the funds to the intended beneficiaries.

Allegations and INT's initial assessment

6. A forensic audit was commenced by INT into allegations arising in ALRMP II in early 2009 which covered the FY06/07 and FY07/08 years (audit period). INT decided to take this course of action after reviewing and assessing allegations, project financial statements, and a report of the GoK's Internal Audit Department (IAD) relating to project activities in the Tana River District from the 2003/2004 financial years to the date of the Report (June 25, 2007).

7. Because the allegations extended beyond the periods audited, the INT audit did not address all allegations. However, where a specific significant transaction, which was the subject of the allegations, was identified but may have partially fallen outside the audit period, the entire transaction was examined and is in this report.

8. The initial planning for the ALRMP II forensic audit identified a number of issues within the financial monitoring reports (FMRs) and supervision missions which provided useful leads. This assessment enabled INT to retain a focus on specific allegations and design a work program for non-transactional issues such as noncurrent assets, HR/payroll, procurement, cash/bank, VAT and financial management reporting. For example, the FMRs on the FY07/08 financial statements for ALRMP II, dated 15 January 2009, referred to issues raised by the auditor and the auditors reasoning for a qualified opinion – those issues were considered as part of the assessment.

9. Several issues not identified in the FMR or the auditor's management letter included the errors in note 7 to the annual financial statements on non-current assets and no comment on the lack of any accounting policies disclosing the treatment of non-current assets. Additionally, the FMR did not address the inadequate management responses to audit issues raised such as the 'cash balance carried forward' and the 'non-current assets'. The management responses to the auditor's management letter raised in themselves serious concerns for INT over the credibility of the annual financial statements and the underlying accounting records.

10. INT's concerns over the accounting processes were further heightened when project management proposed to rectify the fixed assets note by processing a journal. Management should have been reconciling the correct and true position rather than 'correcting' the position with a journal. In this instance, the correct approach may have necessitated an inventory count of all project vehicles. In relation to the concern expressed in the FMR and auditors' letter on the cash position, the true cash position could have been reconstructed from bank statements and cashbooks, however there appears to have been no attempt to undertake this reconciliation. Further, INT was also concerned there was no evidence to suggest a reconciliation of the annual financial statements of the project to the quarterly FMRs had been undertaken, particularly given the importance of the FMRs in the report-based disbursement process.

11. Under the DCA, Article IV - Financial Covenants, the borrower was required to maintain a financial management system, including records and accounts, and prepare financial

statements which were adequate to reflect the operations, resources and expenditures related to the project. As reported in FM supervision reports, the financial information management systems was inadequate and not fully functioning during the relevant period, resulting in project officials relying on what was effectively a manual system. This failing may constitute a breach of the DCA.

Scope

12. Due to the range and extent of allegations, INT determined that extensive sampling was required. The behaviors described in the allegations suggested relatively small amounts were being defrauded in large volumes and in a systemic manner. To capture the range of behaviors and to form a solid understanding of the potential quantum of alleged fraud, a significant portion of the population of transactions had to be reviewed.

13. Although the project covered 28 arid and semi-arid districts within Kenya, it was necessary to audit a sample of districts to manage the quantity of the transactions ultimately reviewed. Initially 13 districts and headquarters were selected for audit but, due to the volume of work required, ultimately only 7 districts and headquarters were reviewed. While it was accepted this would not capture and identify all offending transactions, with the reduction in scope, INT would be better placed to ensure a more timely notification of significant issues which could be addressed on an ongoing basis to the project team, incorporated into the planning for the successor project, enable management decisions to be made based on preliminary findings, reduce the impact on INT's resources and finalize the investigation in a shorter timeframe. The 7 districts sampled included 2 semi-arid districts (Nyeri and Kajiado) and 5 arid districts (Tana River, Samburu, Isiolo, Garissa and Wajir).

14. The focus of this audit was to identify SFEs, i.e. project expenditures that based on a combination of desk reviews, third party verification and field work, appear to either be fabricated (not real expenditures), inflated or not valid project expenditures. It was not the objective of the audit to form a view on whether the dishonest intent existed for these 'suspected fraudulent expenditures', such enquiries are better left to the appropriate enforcement authority. SFEs normally had either inconsistent documents supporting the transaction or inconsistent information or documents were obtained through third parties or field work, which raised doubts as to the genuineness of the transaction.

15. During the course of the audit, questionable transactions were also identified. These transactions included SFEs but also included expenditures that were not supported by sufficient documents or, for other reasons, all or part of the expenditures did not meet the legal definition of eligible expenditure under either the DCA, or the subsequent Agreement Amending Development Credit Agreement, or breached GOK regulations. Whether the 'ineligible' portion of the transaction was 1% or 100%, the entire transaction was classified as questionable (Q), if part of it was established as such. This approach was necessary due to the volume of transactions under review and to enable greater analysis of the SFE. (This approach is also in line with normal auditing approaches.)

16. Consequently, INT identified expenditures that were Q or SFE. These were categorized by district and expense category, to the extent possible, but due to the issues highlighted in part I of this report, these expenses could not be fully reconciled to the categories in the FMRs, especially headquarters.

Suspected Fraudulent Expenditures (SFEs)

17. SFE was defined as expenditure for which, based on the work performed in the course of the audit, there is prima facie evidence that the expenditure (or part of it) had been misappropriated through fraud and corruption, or embezzled, or incurred for purposes other than the purposes of the project. SFE is also 'questionable expenditure' as defined below, but is reported separately within this report. An example of an SFE may be where the supporting documents provided for a voucher are inconsistent with the voucher or are false.

18. Transactions identified by INT as SFE do not necessarily imply knowledge by all or any project staff of the underlying potential dishonesty, as the various staff involved in preparing and/or processing the relevant vouchers and obtaining the relevant approvals may not have had any role in the underlying transaction. It may even be the case that the project itself was potentially defrauded, due to false misrepresentations of suppliers or actions of another party to the transaction.

Questionable Expenditure (Q)

19. For the purposes of this audit, eligible expenditure was defined as an expenditure that met the requirements under the DCA and complied with relevant GOK regulations and law. Expenditures that did not meet this initial threshold were questioned, by applying the formal definition of an ineligible expenditure under Bank rules and procedures, namely *"any amount of the loan/credit … used to pay for an expenditure that is not eligible pursuant to the Loan Agreement/Development Credit Agreement ('ineligible expenditure')".*

20. As well as this formal legal definition, INT relied on the Bank guidelines 'Disbursement Guidelines for Projects' published by LOA May 2006 and terms of reference applied by FM and LOA in their own in-depth reviews of statements of expenditures and withdrawal applications when analyzing the transactions.

21. In addition to the Bank's requirements under the DCA, the project also operated in accordance with GOK regulations. While the project's activities and administration were captured under Kenya's Government Financial Management Act 2004, it is recognized that this Act was never fully operationalized and in practice, there is still a reliance on the Government Financial Regulations and Guidelines along with Treasury Circulars.

22. Sections 15 and 25 of the Government Financial Management Act 2004 specifically dealt with withdrawals from the Consolidated Fund, and the duration of appropriations, which was applicable to at least the GOK counterpart funding, and even IDA funding; as those funds appeared to have flowed from the Special Account to the exchequer account (The Treasury) before being released to the Ministry for the project and the local project bank account itself.

23. Section 15 stated that withdrawals could not exceed appropriations in any one year, section 25 stated:

> ***25 - Duration of appropriations.***
> *25. (1) The following apply with respect to every appropriation by Parliament for a financial year -*
> *(a) the appropriation ceases to have effect at the end of the financial year; and*
> *(b)* ***any appropriated amounts that have been withdrawn from the exchequer account but that have not been expended at the end of the financial year shall be paid into the exchequer account****.*
> *(2) The application of this section is subject to any specific provision in an Act relating to an appropriation.*

[Extract of Government Finance Management Act 2004 of Kenya]

That said, we understand from our discussions in Kenya that the practice is not to transfer unspent balances to the exchequer account, but rather, have unspent balances certified by the Board of Survey at the end of the financial year, and any uncommitted balances deducted from the following years allocation.

24. In essence a payment voucher for expenditure for a project was questioned and required further analysis if: the goods or services purchased did not meet one of the categories defined in the Credit Agreement; there was insufficient evidence that the expenditure was incurred; there was evidence that some or all of the expenditure was embezzled; the goods or services had not been provided; the funds had not been expended as at the end of the financial period; and or the expenditures breached GOK regulations.

25. Even if only a portion of the transaction was questioned, INT categorized the entire expenditure pertaining to the transaction as questionable. For example, if a payment voucher claimed reimbursement for allowances and per diems for a training event for all participants, but INT found that one alleged participant had claimed allowances and per diems for multiple events on the same day, then the entire value of the payment voucher was treated as questionable — not just the portion that pertained to the one participant.

26. Examples of questionable expenditure for this audit would include: misappropriation through apparent fraud and corruption; funds that have been embezzled (where there is evidence that it is more likely than not that embezzlement has occurred); funds that have not been used for the intended purpose (e.g., buying textbooks rather than fixing the roof); funds spent for goods not provided or services not rendered at the time of payment (e.g., purchasing fuel on account); funds spent for expenditures that breach GOK regulations (e.g. failure to comply with imprest requirements).

27. The identification and quantification of this questionable expenditure is seen to provide insight to the key risk areas detailed in this report. It is recognized that further work is required on these transactions, to extract the ineligible component amount in accordance with Bank guidelines.

Methodology

28. INT recognizes that, throughout the audit process, assistance was provided by PIU staff. Both PIU and ministry staff have responded to many queries and provided support and information to allow INT to conduct its audit as effectively as it was able.

29. A common characteristic of the CDD model relevant to INT from an investigative perspective, is the decentralization of the payment systems within the project and the fact that there are significant numbers of relatively small transactions, because there are significant numbers of relatively small interventions. An investigation of fraud and corruption allegations requires each individual transaction to be identified, evidenced and then quantified i.e. the requirement of legal systems (as in Kenya) is for specific acts of dishonesty (transactions) to be subject to the judicial process with sufficient proof (evidence) of the dishonest act and or intent, and then quantified (establishing the amount of the offending or impact on a project).

30. A 100% voucher review for headquarters and the districts sampled was planned as part of an initial desk review. Selected transactions would then be subject to a field review and/or third party verification. Subsequently, during the course of the voucher review, it was agreed that any voucher transaction involving Ksh20,000 (approximately USD260) or less would <u>not</u> be reviewed on grounds of immateriality, unless the document on its face was suspected to be fraudulent, or was related to other questionable expenditures requiring further analysis.

31. On the basis of the underlying examination of each transaction, the total amounts of questionable expenditures requiring further examination under the loans or grants for ALRMP II were quantified. Transactions were questioned when it was not apparent they had been used for the purposes intended, and may also include expenditures that involved a technical infringement of either the Loan Agreement or of GOK regulations, such as a prepayment for goods not yet delivered. The classification of each transaction will be dependent upon the evidence made available.

32. A team comprising forensic accountants and investigators was formed to perform the initial desk-based review of the vouchers and accounting records of the project. A mission in May/June 2009 resulted in the review of 3 districts (Nyeri, Kajiado and Tana River) and part of Headquarters. Following this review the documents for 4 further districts were scanned (Wajir, Garissa, Isiola, Samburu) along with the significant documents identified during the intial review of the 3 districts.

33. A further team was formed that comprised initially of 4 Nairobi-based forensic accountants to complete the desk-based review of the remaining 4 districts. In addition, the first round of field work was performed in February 2010 to validate the assumptions and findings arising from the initial desk work and to gain a greater understanding of the actual operations of the project at district and community level. Contact was also made with various third parties to attempt to verify certain transactions. The desk-based review

of the remaining districts was completed during February, March and April 2010. Field work was conducted in missions undertaken in February, April and September 2010.

34. INT designed the field work to validate a number of transactions as well as the assumptions underlying the desk-based review. When the desk review found that the documentary evidence supporting various transactions was incomplete or was suspected to be inaccurate or not genuine, samples of those transactions and their supporting documents were subjected to an in-depth analysis. This deeper analysis frequently included field work, during which the authenticity of the documents was tested against other documentary records (including records held by third parties) and the roles of specific individuals in handling those records was determined to the extent possible. (For example, quotations held by the project would be compared to quotations provided by the named vendor, to see whether they matched; and handwriting and other identifying markers would be examined to see whether ostensibly different quotations may have come from a single source). Where INT was not able to confirm that the documentary evidence supporting a transaction was in good order, the transaction remained classified as inconclusive. Such cases warrant further investigation by the authorities in Kenya.

35. INT's field work addressed a number of the allegations received to establish whether the behavior purportedly occurring across districts was present. To demonstrate, INT were advised that a common practice in paying grants to a recipient CDC was for the senior committee members to visit the DMO's office to collect the cheque and deposit it into the CDC's bank account; the senior committee members would allegedly remain in town until the funds were cleared, usually 1-2 days, and then immediately withdraw a large cash amount and make a payment to the DMO. While INT were reviewing documents relating to an approved livestock restocking project by one of the CDCs, it was established that the day following receipt of the approved grant (Ksh493,750), 27% of the funds were withdrawn from the community bank account. During field work, the chairman of the CDC was unable to provide any explanation for this withdrawal, and an analysis of further records showed that restocking actually took place 2 months later. Although the above example provides weight to this allegation, based on INT's investigative work, it is not clear how widespread this practice was and whether it occurred across districts not audited.

36. Third party verification provided independent verification of a transaction through the analysis and comparison of records not controlled by the party subject to audit (i.e. the project). INT sourced bank statements and cheques issued from commercial banks as a means to establish if the project cash book and payment vouchers correctly identified the recipient of the funds. Supplier verification, which was also undertaken as part of the field work, sought to confirm the legitimacy of the documents and establish actual supply of the goods and services. In addition, Kenya Revenue Authority (KRA) records were sought to compare payments recorded as being made by the districts against those received at KRA, mainly Value Added Tax (VAT).

37. The information and records from these external parties, together with the results of the field work and various interviews, enabled the auditors to verify the authenticity of

transactions and identify behaviors from the desk-based review performed on a more selective basis.

38. On completion of the desk review, field work and verification through third party records, transactions were categorized provisionally as being either (i) eligible or (ii) questionable or (iii) both questionable and suspected to be fraudulent. Observations were captured for each transaction that was deemed either questionable and or suspected to be fraudulent, to justify the analysis, ensure consistency of approach amongst the forensic auditors, assist readers of this report, and identify recurring behaviors evidenced.

39. Once this provisional categorization had been made, INT provided a schedule of payments, principally involving district staff, to the relevant DMO in order to provide an opportunity for further explanation for the transaction. Responses, which in some cases included the provision of additional documents not previously provided, were received from the DMOs of the 7 districts sampled.

40. Following a review of the DMO responses, a categorization of the transactions was made.

Other audit work and procedures

41. In addition to the transaction work, the audit included work to reconcile the vouchers reviewed, to the project's FMRs, which form the basis for withdrawal applications from IDA by GOK. This audit approach was largely substantive, verifying individual transactions, and consequently avoided the reliance on the financial systems of the project or GOK but required quarterly prepared District FMRs to be vouched via work-papers to the underlying vouchers.

42. Specific audit procedures were devised for noncurrent assets, due to the risks identified in the initial assessment by INT. Requests for all District Fixed Asset Registers were made, so that INT could attempt to reconcile the asset registers to the annual financial statements. All disposals of fixed assets were targeted to ensure that Government procedures were followed and proceeds were properly accounted for. Procedures were devised to identify assets donated to the project from other closing projects.

43. Payroll and human resource (HR) issues were also subjected to specific audit procedures and reviewed analytically rather than on a transactional basis. In addition, INT responded to specific allegations relating to the preponderance of certain regionally-originated employees performing finance and supply roles in the project, by reviewing and analyzing the ethnicities of employees in these roles.

44. Cash and bank records for the districts sampled were subjected to additional tests, due to an initial INT assessment that the only bank accounts reported on the FMRs were in fact the special account and headquarters Citibank account. That is, none of the individual district bank accounts were captured in the FMR reporting. Due to the substantive nature of the work performed, cleared cheque vouchers were also requested.

45. VAT records and elements of transactions were also subjected to additional procedures, due to the project's VAT status during FY06/07 and FY07/08. The project was VAT exempt i.e. was not liable for VAT but dispensation processes existed, which required that each supplier to the project needed to receive specific KRA confirmation that the project was exempt (so that supplier could issue an exempt invoice). The alternative was that when a supplier issued the project an invoice including VAT, the project would withhold the VAT (paying the supplier the net amount) and then pay the VAT liability to KRA direct (all VAT payments were to be funded from Counterpart funds), and the project was to issue a VAT withholding certificate to the supplier. A reconciliation of the VAT paid to KRA by ALRMP should have matched the VAT it withheld from the supplier payments. INT's audit found that neither KRA's nor ALRMP's records adequate to perform the reconciliation and that there were discrepancies between what ALRMP withheld for VAT purposes and what it paid to KRA. Within the Credit Agreement it was clear that if a VAT liability arose then it was to be funded by GOK (counterpart funds).

46. Although value-for-money issues were not specifically included as part of the forensic work, the audit makes some comments on value-for-money, in light of the findings of its field work. A differentiating factor between INT's field work and the normal Bank supervision mission was that, where possible, the visit to a CDC was not pre-arranged.

PART I – Overview of Transactions Reviewed and Findings

47. This section of the report quantifies the findings of the transactions reviewed during the audit. Underpinning these findings are INT's detailed work-papers, which itemize each transaction and the rationale for the classification of the expenditure which are attached as an annexure to this report.

48. The selection of the seven districts (five arid and two semi-arid districts) together with headquarters expenditure enabled the forensic audit to cover a significant portion of project expenditures for the periods FY06/07 and FY07/08. None of the new districts added as a result of the Amending Development Credit Agreement in late 2006 - Taita-Taveta, Kwale, Kilifi, Malindi, Lamu and Meru North – were sampled due to the low volume of expenditure and the fact that they were at an establishment stage.

Table 1

ALRMP II Forensic Audit
FMR Expenditure Reviewed by transactions and analytically

District - Ksh 000s	**FY08**		**FY07**	
Garissa	67,846	*5.1%*	55,848	*5.2%*
Tana River	40,055	*3.0%*	44,681	*4.2%*
Nyeri	13,912	*1.0%*	20,459	*1.9%*
Kajiado	22,021	*1.7%*	21,299	*2.0%*
Samburu	52,311	*3.9%*	50,551	*4.7%*
Isiolo	61,204	*4.6%*	57,313	*5.4%*
Wajir	89,403	*6.7%*	69,451	*6.5%*
Headquarters - other	84,784	*6.4%*	77,239	*7.2%*
Transaction expenditure reviewed	**431,537**	***32.5%***	**396,842**	***37.1%***
Payroll	223,577	*16.8%*	176,769	*16.5%*
Analytical expenditure reviewed	**223,577**	***16.8%***	**176,769**	***16.5%***
Total expenditure reviewed	**655,114**	***49.3%***	**573,611**	***53.7%***
Other districts	673,553	*50.7%*	494,951	*46.3%*
Total expenditure per FMRs	**1,328,667**	*100.0%*	**1,068,562**	*100.0%*

49. An analysis of the FMRs provided to the Bank indicated that for FY06/07 and FY07/08 the expenditure coverage of the audit was 53.7% and 49.3% respectively. The above Table 1 sets out the reported expenditure for each district sampled, and for headquarters with the payroll expense shown separately. All expenditure from the districts sampled and the headquarters (with the exception of payroll) were analyzed on a transactional basis. The payroll was a significant expense, representing 16-17% of total costs of the project for the relevant periods. Due to the nature of payroll expenditure, INT dealt with it principally on an analytical basis rather than a transactional basis.

50. Both IDA and GOK funded transactions were reviewed. The DCA dated June 26, 2003 (reference 3795 KE) refers under Schedule Two to the 'description of the project'

recording that the project consists of a number of parts and then refers Part A as ‘Natural Resource and Drought Management (NRDM)’, Part B as ‘Community –Driven Development (CDD)’, and Part C as ‘Support to Local Development’. Part D is not referred to in the original agreement but is inserted under the amending agreement as ‘Emergency Recovery’. The GOK counterpart funding component was set out within Schedule One of the Agreement Amending Development Credit Agreement dated October, 25, 2006. Within category 6 (b) ‘other operations and maintenance’ for Parts A, B and C of the project of ‘incremental operating costs’, 50% of these expenditures incurred before 30 June 2007 and 40% thereafter, were to be met by IDA. Note that Part D of the project under 6(b) was to be funded 100% by IDA. Within category 6(a) ‘vehicle operation and maintenance’ 80% of the expenditures were to be financed by IDA. Identifying payment vouchers during the course of the audit which related to ‘Emergency Recovery’ and therefore 100% funded by IDA was problematic as there was no notation on the face of the vouchers that indicated whether the underlying transaction related to part A, B, C or D. This made it difficult to delineate or identify the counterpart funding requirement or check whether the counterpart element was correctly calculated.

51. Another issue which made it difficult to check the counterpart funding allocation and analysis was the way certain expenses were allocated to certain categories. An example was fuel. If the fuel was purchased to drive a coach of participants to a training event, the cost could (and was) allocated to either ‘Transport Operating Expenditures’ (TOE) or ‘Training’ categories. If the expense was categorized as ‘Training’ there would be no counterpart funding requirement as that category was 100% funded by IDA compared with the TOE category which was only 80% funded by IDA and required counterpart funding of 20% from GOK. The purpose of this forensic audit was not to comment on the correctness or otherwise of the categorization of expenditures but problems arose during the course of the audit, as what appeared as inappropriately categorized expenditures, were identified. This did not mean the incorrectly categorized expenditure was an SFE or an eligibility issue, but simply whether expenditures were properly accounted for. However, this did impact the issue of the GOK counterpart liability and may be an issue, if SFE are requested to be reimbursed to the Bank.

52. Due to the lack of proper audit trails and insufficient supporting work-papers, no detailed reconciliations were performed between vouchers provided and the reported FMRs (for some or all of the districts no detailed supporting FMR work-papers were provided or ledgers were maintained). Consequently for this forensic audit, INT cannot illustrate systemic issues against the reported FMRs by category, but rather point to specific transactions and their similar nature to other transactions reviewed, across all the districts sampled and headquarters. While INT’s approach did allow it to summarise its findings at a district level (refer to Table 2 below), headquarters could not be analyzed this way, because it incorporates transfers to the districts and centralised procurements.

Table 2

ARID LANDS RESOURCE MANAGEMENT PROJECT II
SUMMARY OF INT ANALYSIS OF EXPENDITURES SUBJECT TO TRANSACTION REVIEW

KSH 000s	AIE's Authorised	FMR Expenditure	Surplus or (Insufficient) Vouchers	Vouched Expenditure	Q	SFE	Eligible Expenditure
Garissa	70,085	67,846	651	68,497	11,662	33,190	23,645
Isiolo	61,925	61,204	(4,842)	56,362	14,962	23,852	17,548
* Kajiado	21,978	22,021	(12,843)	9,178	1,468	5,768	1,942
Nyeri	29,989	13,912	3,028	16,940	3,170	12,574	1,196
Samburu	52,800	52,311	(21,469)	30,842	9,431	17,310	4,101
Tana River	57,847	40,055	1,916	41,971	4,744	16,354	20,873
Wajir	90,330	89,403	1,056	90,459	9,437	59,358	21,664
* Headquarters	na	84,784	(14,458)	70,326	22,152	17,680	30,494
TOTAL FY07/08		431,536	(46,961)	384,575	77,026	186,086	121,463
Garissa	57,389	55,848	(8,628)	47,220	4,498	27,432	15,290
Isiolo	58,900	57,313	3,009	60,322	10,108	39,091	11,123
* Kajiado	21,580	21,299	334	21,633	9,307	9,421	2,905
Nyeri	21,857	20,459	(11,390)	9,069	1,310	7,100	659
Samburu	50,643	50,551	1,415	51,966	15,520	27,362	9,084
Tana River	55,979	44,681	12,969	57,650	7,792	8,643	41,215
Wajir	70,027	69,451	(5,991)	63,460	11,428	39,150	12,882
* Headquarters	na	77,239	(21,294)	55,945	15,788	17,424	22,733
TOTAL FY06/07		396,841	(29,576)	367,265	75,751	175,623	115,891

*Kajiado district & Headquarters – Payment Vouchers were not available to confirm 'vouched expenditure' amount for either FY06/07 or FY07/08.

53. The desk based review approached the analysis from the original payment vouchers provided in early 2009. The results of the desk based review were tabulated on a district by district basis creating detailed INT work-papers, which allowed analysis of each category (component of the FMR) for which vouchers were provided. Districts were not consistent in the way the vouchers were prepared for the audit, for example the Garissa district incorporated the vouchers relating to vehicle maintenance, maintenance of station and maintenance of equipment within a single lever arch folder – even though these expenditures are different categories. Likewise expenditure relating to support for local development was on some occasions captured within civil works, CDC payments and or the drought contingency fund, and or in its own 'file', depending on the district approach. For these reasons and for the reasons set out in the section headed FM issues it was not possible to reconcile by category the vouchers provided against the FMRs.

54. These issues also made it difficult for INT to reconcile, at a district level, the value of the vouchers provided against the reported FMR expenditure for that district. A number of valid reasons could explain variances. For example if there was an indication that surplus vouchers were provided for the audit, then an innocent double counting of transactions could have occurred as payment vouchers may have been provided within the accounting records of the district, and further payment vouchers may have been

provided at the CDC level (if the payment to the CDC was captured as well as the payment by the CDC for the project itself then the transaction was captured twice). Likewise, if insufficient vouchers were provided, then it may indicate that a file of vouchers were inadvertently not provided to INT or not scanned by INT for analysis (for Isiolo, Samburu, Wajir and Garissa districts) or inadvertently not reviewed or scanned by INT (for Tana River, Kajiado and Nyeri).

55. Table 2 also sets out the AIE for each district sampled for each year, this should approximate to the FMR expenditure as it represented the funds each district was authorized to spend. The district with the largest variances between AIE and FMR expenditures was Tana River district. Significant amounts by value of surplus vouchers were also identified for Tana River (both FY06/07 and FY07/08). INT performed additional work to try and ascertain whether double counting of transactions occurred – this could be observed when analyzing individual categories of expenditures for these districts. INT also reconfirmed the FMR expenditures reported for Tana River district. INT was aware of IAD's Report on Tana River district which related to an earlier period but was reported and acted on during FY06/07 and FY07/08. The actual audit and results of that report on the Tana River district's operations were significant as key members of that district office were replaced, the district's records were reviewed (allowing for audit fatigue i.e. lost, missing or misfiled records), and certain activities were curtailed, e.g. the district ceased issuing Matching Grant payments. Consequently INT was not surprised with the results of Tana River district in respect of these analytical findings. Even the 'Development Expenditure Estimates – 2007/2008' set out in 'Vote D 35 Ministry of State for Special Programmes' for Tana River district reported 'approved estimates 2006/2007' of Ksh52,793,902 and for 'estimates 2007/2008' Ksh57,296,377 which did not approximate closely to actual expenditures reported. Unlike Garissa district where 'approved estimates 2006/2007' were Ksh55.98m and 'estimates 2007/2008' were Ksh65.49m, close to reported FMR expenditures of Ksh55.85m and Ksh67.85m respectively.

56. Despite the inability to reconcile the FMR expenditures for each district to vouchers actually provided, all Qs and SFEs have been separately identified by transaction and summary schedules of this information is set out above. INT reached its conclusion in relation to 'questionable' and 'suspected fraudulent' expenditures on a transaction basis and did not rely on the differences identified at an analytical level – rather using those observations to confirm detailed findings where possible.

Table 3

INT FINDINGS OF QUESTIONABLE AND SUSPECTED FRAUDULENT EXPENDITURES					
KSH 000s	Q	SFE	Total	FMR Expenditure	
Garissa	11,662	33,190	44,852	67,846	*66%*
Isiolo	14,962	23,852	38,814	61,204	*63%*
Kajiado	1,468	5,768	7,236	22,021	*33%*
Nyeri	3,170	12,574	15,744	13,912	*113%*
Samburu	9,431	17,310	26,741	52,311	*51%*
Tana River	4,744	16,354	21,098	40,055	*53%*
Wajir	9,437	59,358	68,795	89,403	*77%*
Headquarters	19,289	17,680	36,969	84,784	*44%*
Payroll	2,863	-	2,863	223,577	*1%*
FY07/08	77,026	186,086	263,112	655,113	*40%*
Garissa	4,498	27,432	31,930	55,848	*57%*
Isiolo	10,108	39,091	49,199	57,313	*86%*
Kajiado	9,307	9,421	18,728	21,299	*88%*
Nyeri	1,310	7,100	8,410	20,459	*41%*
Samburu	15,520	27,362	42,882	50,551	*85%*
Tana River	7,792	8,643	16,435	44,681	*37%*
Wajir	11,428	39,150	50,578	69,451	*73%*
Headquarters	15,788	17,424	33,212	77,239	*43%*
Payroll	-	-	-	176,769	*0%*
FY06/07	75,751	175,623	251,374	573,610	*44%*
TOTAL FY07 & FY08	152,777	361,709	514,486	1,228,723	*42%*

57. Table 3 indicates, SFE for the expenditure sampled for FY06/07 were Ksh176m and FY07/08 were Ksh186m. When contrasted against total expenditures reported in the FMRs for those districts, these figures represented 30.6% and 28.4% respectively of expenditures. The percentage of total (Q and SFE) was in excess of 100% for Nyeri in FY07/08 – this was due to the fact that more vouchers were reviewed than claimed in the FMR for that district for that period.

58. As Table 3 indicates SFEs and Qs were present in all districts sampled, as well as headquarters. For reasons set out below, the two transactions relating to the payroll amounting to Kshs2,863,000 for FY07/08 were simply treated as Qs because it was not possible to verify the expenditures sufficiently through third party verification or field work in the timeframe of the audit. Additional non-quantifiable payroll issues were identified and have been addressed in the payroll section of this report.

59. The analysis of these findings indicates that the behaviors were prevalent across all districts sampled and headquarters, which is an indicator that these are systemic. INT is also aware that these findings are consistent with behaviors found in the recent WKCDD

and KESSP forensic audits – to the extent that the behaviors relate to 'CDD' type projects in Kenya.

60. Although the behaviors may be systemic, that is not and adequate basis for INT to extrapolate the findings of the forensic audit to the remaining districts or to other periods. As noted elsewhere in this report, some districts were at an early stage of implementation (the six new districts incorporated in this project under the Agreement Amending Development Credit Agreement dated October 25, 2006) and the nature of the different activities or project components implemented in arid versus semi-arid districts may mean that certain behaviors will not exist, simply because the opportunity did not exist.

61. In relation to behaviors identified as relating to common expenditure incurred in many if not all projects or GOK ministries referred to in the Report of the Controller and Auditor General on the Appropriation Accounts, Other Public Accounts and the Accounts of the Funds of the Republic of Kenya for the Year Ended 30 June, 2009 (dated 19 May 2010), such as fuel, vehicle maintenance, training, payroll, vehicle and computer purchases, management and disposals, imprest warrants, and allowances and per diem, it appears to INT that the behaviors are not unique to this project.

Detailed findings by project categories

62. To the extent possible expenditures were analyzed by the categories across all districts sampled, relying on the coding of the vouchers by the districts. An attempt was made to reconcile the coding against the original categories as per the loan documents; however due to the accounting by the districts, this was not possible based on workpapers provided to INT during the audit. The analysis could not be performed by INT on headquarter expenses as the vouchers were not organized by category or expense type, but were provided to INT in chronological order.

63. Based on INT's analysis of the transactions, the following categories have been used: civil works; goods and equipment; support for local development (SLD); CDD grants; drought contingency fund (DCF); training; transport operating expenditures (TOE), travel and other. For the purposes of this report and to assist operations reconcile the results against FMRs and project documents – civil works, goods and equipment and SLD formed category 1 & 2; CDD grants was Category 3; DCF was Category 4, Training was Category 5, TOE was Category 6a and all other expenses were captured as Category 6b.

64. The analysis of the expenditures by category, set out in Table 4, demonstrates that SFE expenditures were identified across all categories. The summary demonstrates that the largest component of the project was also subjected to the most SFEs, i.e. civil works, purchases of equipment and SLD (cat. 1 & 2) represented the largest category of SFEs by value i.e. Ksh128m and 447 transactions (representing 64% of all expenditures reported for the districts sampled). CDD (cat. 3) with 324 suspect transactions worth Ksh101m (USD1.26m @ 80:1) represented 75% of all expenditures on this component of the project (for the districts sampled).

65. Significantly TOE (cat. 6a) had 365 transactions worth Ksh49.2m considered to be SFEs (cat. 5) while training had 172 transactions worth Ksh21.9m and DCF (cat. 4) had 84 transactions worth Ksh15.4m.

Table 4

ANALYSIS OF SFE & Q BY LOAN CATEGORIES FOR DISTRICTS SAMPLED AGAINST DISTRICTS EXPENDITURE REPORTED IN FMRs

	Cat. 1 & 2	*Cat. 3*	*Cat. 4*	*Cat. 5*	*Cat. 6a*	*Cat. 6b*	*Total*
FY08							
Garissa	19,904	11,999	7,348	10,462	9,401	8,731	**67,845**
Samburu	16,645	10,000	2,789	10,789	6,264	5,824	**52,311**
Tana River	10,491	9,550	2,160	6,376	5,819	5,660	**40,056**
Isiolo	17,807	12,000	6,210	10,790	8,450	5,947	**61,204**
Wajir	36,520	11,999	11,068	12,850	8,653	8,314	**89,404**
Kajiado	11,019	-	2,799	3,458	1,944	2,802	**22,022**
Nyeri	6,176	-	339	1,858	1,937	3,602	**13,912**
Total FY08	**118,562**	**55,548**	**32,713**	**56,583**	**42,468**	**40,880**	
FY07							-
Garissa	11,512	17,922	4,355	7,113	7,733	7,213	**55,848**
Samburu	11,366	18,000	2,907	7,312	5,795	5,171	**50,551**
Tana River	11,209	9,410	5,961	6,230	5,730	6,141	**44,681**
Isiolo	10,778	17,999	4,230	6,919	10,563	6,824	**57,313**
Wajir	16,892	18,000	9,788	8,159	8,659	7,953	**69,451**
Kajiado	10,457	-	2,914	3,117	1,685	3,127	**21,300**
Nyeri	10,277	-	2,809	2,525	1,872	2,976	**20,459**
Total FY07	**82,491**	**81,331**	**32,964**	**41,375**	**42,037**	**39,405**	
Totals	**201,053**	**136,879**	**65,677**	**97,958**	**84,505**	**80,285**	**666,357**
SFE	128,438	101,998	15,418	21,893	49,242	9,618	**326,607**
	64%	*75%*	*23%*	*22%*	*58%*	*12%*	*49%*
Q	48,762	12,487	14,272	12,838	10,429	16,053	**114,841**
	24%	*9%*	*22%*	*13%*	*12%*	*20%*	*17%*
Total	**177,200**	**114,485**	**29,690**	**34,731**	**59,671**	**25,671**	**441,448**
	88%	*84%*	*45%*	*35%*	*71%*	*32%*	*66%*

PART II – Non-Transactional Issues and Findings

66. This segment of the report captures the non-transactional aspects of the audit which include a review of payroll/HR issues, cash and bank issues, non-current assets, VAT and financial management reporting issues.

Bank and Cash Issues

67. The way bank accounts were operated and the handling of cash by the districts sampled were the focus of additional work in INT's forensic audit. There were a number of issues which are set out below that were identified across multiple districts. The significant use of cash to settle transactions made it difficult for INT to substantiate the transactions retrospectively, let alone identify and locate recipients. INT understands that working in remote parts of Kenya requires the use of cash, especially when communities do not have access to local banking facilities.

Use of AIEs in the project

68. As the project was operated under GOK ministries, latterly the Ministry of State for the Development of Northern Kenya and Other Arid Lands, GOK regulations applied and the project was subject to GOK's estimates, appropriations rules and procedures, and financial management regulations. In respect of cash and funding, that meant that the IDA component (as well as the GOK component) of the project funds were channeled through the exchequer account. Before authorized accounting officers could spend the money 'Authorized to Incur Expenditures' (AIEs) were required.

69. Under the project before any money was released to the districts by headquarters, AIE's were required for each DMO (the 'AIE holder') for each district, setting out by category upper limits of expenditure that could be incurred. The AIEs should have matched the funds released by headquarters to each district. Typically the AIEs were issued around the same time as when the remittances occurred.

70. AIE enabled the project (and GOK generally) to control who (which district) and when funds were spent. An AIE specified for the district the categories on which the funds could be spent. For example if the disbursement related to the Drought Contingency Fund, then the AIE would specify that category (see sample Table 5 for Tana River district below – in Ksh). Set out below is a table of the remittances made by headquarters to the districts sampled by INT for both FY06/07 and FY07/08.

Table 5

ARID LANDS RESOURCE MANAGEMENT PROJECT II - REMITTANCES TO DISTRICTS FROM HEADQUARTERS

FY07/08 Pmt dates	Total for all districts	Tana River	Kajiado	Nyeri	Wajir	Samburu	Ijara	Isiolo	Garissa	Total for Districts Sampled
14-Aug-07	222,700,000	10,000,000	5,700,000	5,800,000	12,500,000	11,350,000	11,400,000	12,200,000	12,900,000	81,850,000
30-Aug-07	205,633,024	3,974,855	3,959,878	6,535,035	13,203,809	11,789,793	11,584,312	11,827,321	13,027,581	75,902,584
31-Oct-07	66,450,937	4,089,619	1,201,163	1,396,082	4,347,950	3,084,280	3,356,415	3,638,228	4,864,370	25,978,106
3-Nov-07	6,055,180	595,770			555,770	555,770	555,770	933,500	595,770	3,792,350
11-Feb-08	3,452,000							2,052,000	1,400,000	3,452,000
15-Feb-08	5,612,600				4,368,000					4,368,000
23-Feb-08	244,247,438	12,279,285	4,894,023	6,799,142	16,529,134	11,657,750	12,102,385	14,277,180	13,257,439	91,796,338
8-Apr-08	19,926,487				15,614,487	1,672,000			2,640,000	19,926,487
2-May-08	67,371,637	4,089,619	1,201,163	1,396,083	4,347,950	3,084,280	3,356,415	3,638,228	4,543,370	25,657,107
10-Jun-08	244,054,400	12,829,945	4,894,023	6,799,143	13,129,135	11,657,750	12,102,385	14,757,180	14,899,080	91,068,641
24-Jun-08	8,236,000				5,736,000					5,736,000
	1,093,739,702	**47,859,093**	**21,850,249**	**28,725,485**	**90,332,234**	**54,851,623**	**54,457,682**	**63,323,636**	**68,127,610**	**429,527,612**
		4.38%	*2.00%*	*2.63%*	*8.26%*	*5.02%*	*4.98%*	*5.79%*	*6.23%*	*39.27%*
FY06/07 Pmt dates	**Total for all districts**	**Tana River**	**Kajiado**	**Nyeri**	**Wajir**	**Samburu**	**Ijara**	**Isiolo**	**Garissa**	**Total for Districts Sampled**
23-Aug-06	340,180,281	22,603,998	9,150,696	8,865,803	23,809,923	22,229,476	22,561,862	22,705,428	23,208,647	155,135,833
23-Aug-06	6,866,737									-
12-Oct-06	131,320								131,320	131,320
30-Oct-06	53,683,251	3,623,477	1,247,581	1,316,939	6,771,700	2,647,619	2,741,490	4,535,425	3,747,300	26,631,531
30-Oct-06	51,316,019	3,133,475	1,247,573	1,316,940	4,243,500	2,689,616	3,043,790	4,535,428	3,876,800	24,087,122
7-Mar-07	48,323,031	3,832,302	1,425,730	1,466,099	7,055,500	2,058,423	2,332,865	2,750,153	3,454,675	24,375,747
12-Mar-07	317,267,315	20,931,173	8,116,843	8,145,841	21,658,000	20,427,744	19,456,525	21,705,275	20,861,000	141,302,401
7-Jun-07	39,360,000	2,640,000	2,640,000	2,640,000		2,640,000				10,560,000
14-Jun-07	18,693,900	1,195,200			5,895,000	187,500	2,970,100	918,000	1,508,120	12,673,920
	875,821,854	**57,959,625**	**23,828,423**	**23,751,622**	**69,433,623**	**52,880,378**	**53,106,632**	**57,149,709**	**56,787,862**	**394,897,874**
		6.62%	*2.72%*	*2.71%*	*7.93%*	*6.04%*	*6.06%*	*6.53%*	*6.48%*	*45.09%*

71. An analytical review of the FMR expenditures reported for each district should match or reflect the issuance of AIEs, and later in this section, in relation to the observation that significant FMR expenditure is reported in the fourth quarter, this appears generally consistent with the timing of the remittances to district offices. For example Tana River district received Ksh24.7 million in March 2007 and a further Ksh3.8 million in June 2007, which represented 64.7% of the total Ksh58 million remitted to Tana River for that financial year (FY06/07).

72. Using Tana River district FY06/07 as an example, the AIEs provided to INT for that period (refer to Table 6 below – in Ksh) amounted to almost Ksh56 million yet remittances to the district amounted to almost Ksh58 million (see Table 5 above), resulting in a Ksh2 million difference. There were possible obvious explanations, such as missing AIEs, but neither the district nor headquarters appeared to have conducted reconciliations and consequently expenditure could have potentially occurred without appropriate AIEs, therefore making the expenditure unauthorised. There was a control in relation to AIEs issued, as each Payment Voucher captured the category to which the payment would be accounted for, which kept a running total of the AIE value for that category to ensure no overspending occurred. But no part of the district FMR reporting package captured the remittance information and compared it with the AIEs issued.

Table 6

ARID LANDS RESOURCE MANAGEMENT PROJECT II - TANA RIVER DISTRICT
AUTHORISED TO INCURR EXPENDITURE (AIE) 2006/07

	IDA	GOK	IDA	GOK	GOK(DCF)	IDA	GOK	IDA?	IDA	GOK	IDA	**TOTAL**
Civil works	2,475,450	412,575				2,475,450	412,575					**5,776,050**
Purchase of equipment	2,474,550	412,425			280,000	2,474,550	412,425					**6,053,950**
Purchase of furniture	180,000	30,000				180,000	30,000					**420,000**
CDC pmts	9,000,000					9,000,000						**18,000,000**
DCF pmts	1,400,000	70,000				1,400,000	70,000					**2,940,000**
Training	3,500,000	175,000				3,500,000	175,000				899,700	**8,249,700**
Transport Operating Expenditure	654,328	163,582	654,328	163,582	525,000	654,328	163,582	136,700	654,328	163,582	156,000	**4,089,340**
MV Repairs	428,800	192,960	428,800	192,960	85,000	428,800	192,960		428,800	192,960		**2,572,040**
Travelling	325,000	325,000	325,000	325,000	610,000	325,000	325,000	353,100	325,000	325,000	139,500	**3,702,600**
Bank charges?	25,000	25,000	25,000	25,000		25,000	25,000		25,000	25,000		**200,000**
Postal charges	2,500	2,500	2,500	2,500		2,500	2,500		2,500	2,500		**20,000**
Telephone	65,250	86,130	65,250	86,130		65,250	86,130		65,250	86,130		**605,520**
Catering	8,750	8,750	8,750	8,750		8,750	8,750		8,750	8,750		**70,000**
Electricity	57,720	76,190	57,720	76,190		57,720	76,190		57,720	76,192		**535,642**
Stationary	66,825	80,190	66,825	80,190		66,825	80,190		66,825	80,190		**588,060**
Newspaper subs	3,750	3,750	3,750	3,750		3,750	3,750		3,750	3,750		**30,000**
Cleaning	6,250	6,250	6,250	6,250		6,250	6,250		6,250	6,250		**50,000**
Maintenance of equipment	50,000	55,000	50,000	55,000		50,000	55,000		50,000	55,000		**420,000**
Maintenance of station	37,500	37,500	37,500	37,500		37,500	37,500		37,500	37,500		**300,000**
Drought monitors	94,500	94,500	94,500	94,500		94,500	94,500		94,500	94,500		**756,000**
Mobile teachers	75,000	75,000	75,000	75,000		75,000	75,000		75,000	75,000		**600,000**
	20,931,173	**2,332,302**	**1,901,173**	**1,232,302**	**1,500,000**	**20,931,173**	**2,332,302**	**489,800**	**1,901,173**	**1,232,304**	**1,195,200**	**55,978,902**

73. It was noted that in general AIEs and remittances were not issued or made based on either a seasonal or cyclical basis, but on historical practice as a proportion of the authorized appropriations. For discretionary components of the project the timing of the remittances was less predictable.

74. When reviewing the AIE issued and remitted on 14 June 2007 to Tana River of Ksh1,195,200, it covered training (Ksh899,700), TOE (Ksh156,000) and travel (Ksh139,500). INT found that a number of vouchers in these categories dated between 14 and 30 June 2007 were questionable and some, suspected to be fraudulent. INT questions how for example, training events could be planned/proposed, approved, venues confirmed, participants invited and confirmed, events to occur and paid for, all within two weeks, when prior to the issuing of the AIE there would have been no anticipation of such funding.

75. AIEs were not the focus of the INT audit but the fact that they appear to have been used in the district FMR to calculate a proxy for the district bank balances or undisbursed funds (see below), make them relevant, especially to the authorization process of expenditures generally. INT was concerned that remittances did not match exactly the AIEs issued, as the FMRs tracked to AIEs issued.

Balances of project bank accounts as at 30 June 2007

76. During the forensic audit it was noted that the bank balances as per project bank records were much higher than the balance reported in the FMR or the annual financial statements. The formal FMR package sent to IDA contained bank information about Headquarters Project Bank Account (with Citibank) – Part Three of the FMR package; and the IDA Special Account – Part Four of the FMR package. Part Six of some of the FMR package reports related to 'reconciled cashbook closing balances per districts' (March 2007), but importantly not for June

2007's FMR Report package. No actual bank account information was provided for any other Headquarter bank accounts or for any of the district bank accounts; yet during INT's review of cleared cheques (see below), it was noted that the project had, at the time, an account with KCB Nairobi. INT had not been made aware of the existence of this account by project management.

77. It is unclear why all district and some Headquarter bank accounts were not reported to IDA as part of the formal FMR package sent to IDA, INT can only surmise that it may have been because it was simply assumed that these balances would be minimal or nil. If Part Six of the FMR package had been provided, i.e. the reconciled cashbook balances per district, then it should have contained the reconciliations themselves and a copy of the bank statement showing the closing period balance. The FMR packages appeared to capture a proxy for district bank balances by reporting 'unaccounted for advances to districts'. 'Unaccounted for advances to districts' represented the difference between AIEs and reported expenditure within the FMRs themselves. The two assumptions that would validate the use of this information as a proxy for the actual bank balances in the districts would be that the districts had nil balances at the start of the period and that transfers equating to the value of the AIEs had occurred to the districts.

78. Even the Headquarters Citibank bank balance which was reported in the FMR appeared understated. For example the 31 December 2007 FMR reported the balance as Ksh51,410,674, which incorporated within unpresented cheques, a cheque that was 18 months old ('Pann Printers' for Ksh193,965) and two other significant cheques which were 6 months old ('Scangraphics' for Ksh286,262.90 and 'Ramco Printings' for Ksh700,258.60).

79. INT determined that district bank account balances were not necessarily minimal or nil as at the beginning or end of a financial period (see Wajir example below). Even the cashbook reported balances as reported in Part Six of the FMR were not insignificant (e.g. as at 31 March 2007 total cashbook balance was Ksh540.6 million). INT also determined that significant numbers of unpresented cheques existed on project bank accounts, many of which should have been 'written back' or cancelled (this would be good business practice), which raised concerns about the validity or correctness of the original payment voucher. INT also identified cheques presented on bank accounts which did not appear in the cashbook. Considering the controls and role of the District Accountant (one of the mandatory dual signatures required to operate the bank account and sign cheques) in the operation of district project bank accounts, such issues are indicators that a significant degree of collusion or mutual ineptness existed on a systemic basis, as these problems were identified across a number of the districts sampled.

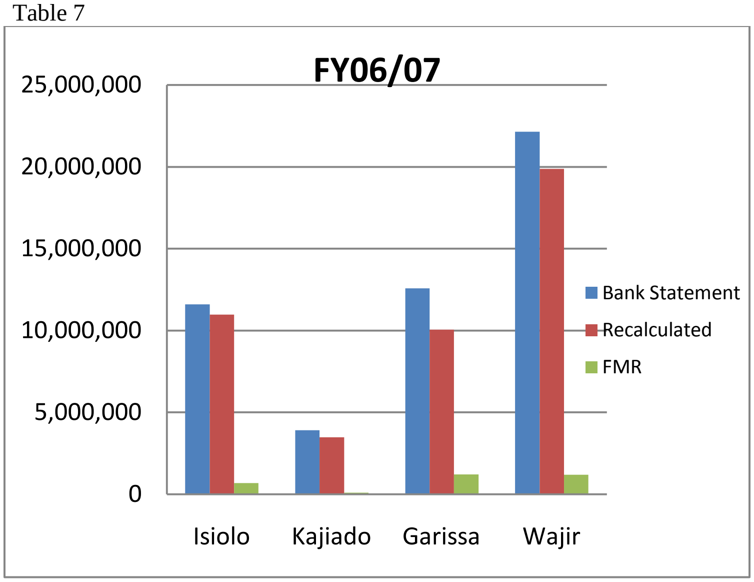
80. Wajir district's bank balance, as per its own district FMR (FY06/07: Ksh816,665, FY07/08: Ksh1,189,695) had balances that were significantly less than the actual balance as per the local banks' records for both FY06/07 (Ksh16,898,926) and FY07/08 (Ksh22,148,996), the reported FMR balances were approximately 5% of the local banks' records.

81. Normally (standard banking and accounting practice) the differences between bank statement balances and cashbook balances are reconcilable due to cheques written, but not yet presented, as at balance date ('unpresented cheques'). Normally unpresented cheques would be subtracted from the bank balance to arrive at a true balance, simply because those cheques may have been in the mail as at 30 June and therefore the cheques may have been presented to the bank several days after 30 June. This will be even more problematic if the 30 June was a Saturday, or Sunday, or if the bank(s) were closed around that time.

82. In this project many of the unpresented cheques were not presented within days of 30 June but up to several months later, if at all (refer to para.s 88 – 91 dealing with 'unpresented cheques'). This raises a concern that the cheques were not issued as at 30 June despite appearing in the cashbook. In accordance with GOK regulations and the project manual, a cheque would not be issued if the underlying goods or services were not in fact delivered as at that date. A cheque would also not be issued if there was insufficient funds in the bank account, but this was not the case in this project.

83. As part of the forensic audit bank balances for some districts (Isiolo, Kajiado, Garissa and Wajir) were recomputed using reasonable assumptions regarding unpresented cheques - by taking into account only the cheques that were presented within a reasonable time period after cut-off date (7 days). Reconstructions of other districts could not occur, as no bank account reconciliations were provided to INT as part of the audit and/or bank statements for these accounts were not available for the period following 30 June 2008 (to identify the presentation of unpresented cheques).

Table 7



84. The conclusion from this analysis was that significant amounts of cash were held in district bank accounts. This supports the contention that either the underlying assumptions regarding the 'unaccounted for advances to districts' were invalid or that the expenditure reported in the district FMRs was inflated. It is unlikely that Headquarters would have disbursed more funds than AIEs issued to districts, so if that assumption

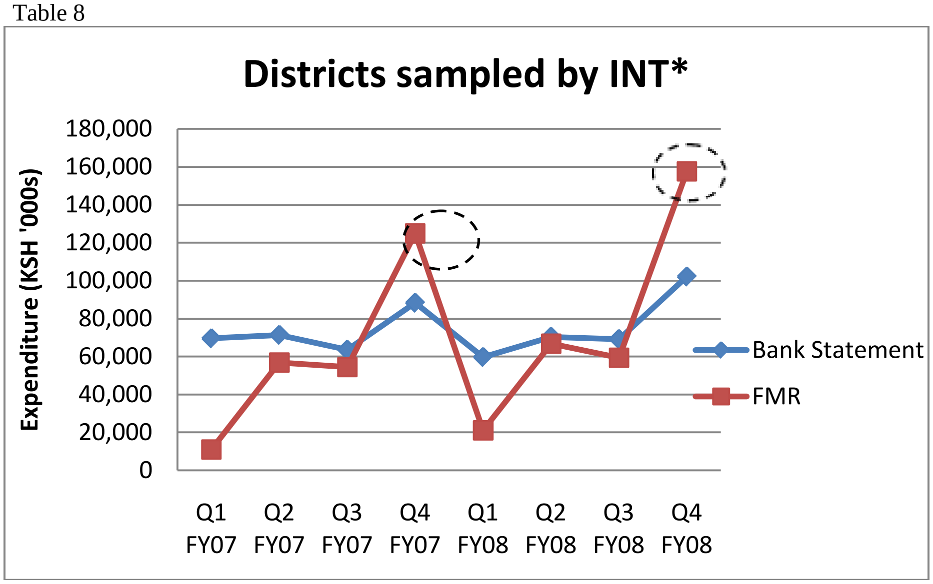
remains valid, then the possibility that the district had either funds at the commencement of the financial reporting period, and/or overstated its expenditure within the reported FMRs was highly likely. This finding was also consistent with the concerns raised earlier in this report over the operation of the district bank accounts.

85. There were possible motives behind reporting nil or minimal bank balances as there was a need to spend the funds as under GOK regulations any unspent funds would have been required to be reimbursed to the Consolidated Fund – refer s.25(1) (b) of the Government Financial Management Act 2004.

Funds flow

86. Total bank debits (payments) were generally consistent with total expenditure by FMR. However, bank records and FMRs showed different trends of funds flow. The FMR expenditure by quarters showed a consistent pattern in FY06/07 and FY07/08 that expenditures were highly concentrated in Q4. According to the FMRs, Q4 expenditures were a little over 50% of annual expenditures for both FY06/07 and FY07/08, whereas the Q1 expenditures were both less than 10% of annual expenditures. In contrast, according to bank debits quarterly expenditures were relatively stable from quarter to quarter, showing only a moderate increase in Q4 (see Table 8 below).

Table 8



*Note:
1. Samburu was excluded from the chart as INT was not provided a complete set of bank statements;
2. HQ Nairobi was also excluded, because the bank account was used to receive and distribute funds for all districts, therefore the bank debits do not represent HQ expenditures; and
3. Tana River Q1 and Q2 FY06/07 was excluded as INT was not provided with appropriate FMR data.

Unpresented cheques

87. As mentioned above, in the section on bank balances (para.s 77 – 86), often delays in the presentation of cheques may be an indicator that either the goods or services for the underlying transaction were not provided (i.e. the cheque was prepared in advance); or that the entity had liquidity issues and could not meet creditor obligations. Based on the actual project bank account balances, the delay in presenting cheques did not appear to relate to liquidity issues as the liquidity of all districts and headquarters appeared to be satisfactory.

88. Under GOK regulations if approved estimates were not spent, the difference was lost to that ministry i.e. the unspent funds were to be returned to the Consolidated Fund. It was not clear to INT what would have occurred to unspent monies in this project, simply because the project always recorded expenditures that effectively matched AIEs, or approved estimates, for each financial year. It appeared to INT that all funds allocated to the projects under approved estimates had to be spent by 30 June, hence the behavior observed in the final quarter and captured in the June FMR for all districts sampled.

89. During the audit INT determined that significant numbers of unpresented cheques existed on project bank accounts, many of which should have been 'written back' or cancelled, using best accounting practice, which raised concerns about the validity or correctness of the original payment voucher which gave rise to the cheque initially. The cancellation of a cheque would be like reflecting income in the cashbook, i.e. inflating the reportable bank balance.

90. When the cheque date and its presentation date were separated across the financial cut-off date, the expense would be captured in the FMR but not in the bank record, thus causing the differences as noted in bank balance analysis and the fund flow analysis. See below a summary of cheques presented over 30 days after being written (see detail in Table 9 below).

Table 9 Summary of cheques presented after 30 days provided to INT

	Number of cheques provided to INT	Number of cheques not provided to INT	Number of cheques presented +30 days	Longest unpresented cheque (days)	Average (number of days)
HQ-Nairobi	712	199	99	178	71
Isiolo	217	235	30	115	68
Wajir	483	300	72	172	62
Garissa	53	1,000	8	105	53
Kajiado	179	255	50	253	68
Tana River	59	722	7	175	120
Nyeri	53	730	15	181	95

Cheques banked not appearing in cashbook or supported by payment vouchers

91. During the audit INT also identified cheques presented on bank accounts which did not appear in the cashbook. Within Tana River district, eight cheques appeared on the district bank statements that were not in the district's cashbook (see Table 10 below). No supporting documents (payment vouchers) were provided for these cheques. Each of the eight cheques was for Ksh330,000, Ksh2,640,000 in total, and the cheques were deposited between July 2007 and March 2008. Three of the cheques were dated on or about the date of the general election, i.e. 21 December 2007. According to education sector specialists there was no coordination of community interventions by ALRMP II with the KESSP team which, if the beneficiaries were as purported on the cheque butt, raises the risk of double dipping. The cheque details (according to the cheque stubb) were as follows:

Table 10

Tana River district
Cheques for which no payment vouchers were provided to INT

Date (per butt)	Date (per BS)	Cheque Number	Payee	Amount (KSH)
	9-Sep-07	1577	Kumbi Primary School	330,000
	7-Sep-07	1578	Lenda Primary School	330,000
	8-Sep-07	1579	Chanani Primary School	330,000
9-Sep-07	3-Oct-07	1601	Subo Primary School	330,000
31-Oct-07	6-Nov-07	1627	Kumbi Primary School	330,000
21-Dec-07	2-Jan-08	1686	Lenda Primary School	330,000
21-Dec-07	12-Mar-08	1687	Chanani Primary School	330,000
21-Dec-07	5-Mar-08	1688	Subo Primary School	330,000
				2,640,000

92. Although requested, the original cleared cheques for these transactions have not been provided to INT, despite an original request and a number of follow-up enquiries. The KCB branch at which Tana River's district bank account was located has only provided 59 'cleared cheque vouchers' while 722 original vouchers for that district remain outstanding (refer to Table 13 above for a summary of the voucher requests and the responses). As these payments were not supported by payment vouchers or recorded in the cashbook, INT treated them as SFEs.

93. Considering the controls and role of the District Accountant in the operation of district project bank accounts (they were one of the joint mandatory signatures for all cheques), such issues are possible indicators that a degree of collusion existed on a systemic basis, as these problems were identified across a number of the districts sampled.

Use of Cash Cheques

94. Encashing of cheques was observed in most districts which was not surprising considering the need for regular cash payments such as the compensation of individuals for their transport and per diem expenses incurred to attend a training event in a remote part of the district.

95. The procedures around districts issuing cheques involving the District Accountant appeared robust but the sheer volume of expenditure paid in cash for some districts – Kajiado (35%), Tana River (28%) and Isiolo (17%), as percentage of total expenditures, raised concerns for INT. An 'open' cheque allows it to be cashed rather than directly credited to an account, and requires the two original signatories to endorse or re-sign the 'closed' cheque. A 'closed' cheque was crossed 'not negotiable account payee only'. All cheques should have been issued 'closed'. The volume of cashed cheques for Kajiado, Tana River and Isiolo was determined from the narration on the bank statements but it was noted that there were additional cheques of which INT was aware had been cashed but which were not reflected in the bank statement.

96. The most commonly observed cheques cashed were those cheques for imprest cash for the district office itself. INT's understanding is that these cheques would be drawn in the name of the DMO and jointly signed and 'opened' by both the DMO and the District Accountant. INT performed tests on these cheques to ensure that the cash was recorded within the imprest records. It was noted during the review of cleared cheques that imprest cash cheques were written to persons other than the DMO.

97. INT also identified cheques which were cashed that were drawn to individuals other than the DMO, and in some cases not even project staff. In Kajiado, Henry K. Muthoka, Gad Kinuthia, and James Kaniaru cashed project cheques – neither Muthoka or Kaniaru were recorded as district staff. In Isiolo, Evangeline Njura Nyaua, Florence Karimi Mwenda, John Wachira Muriithi, and Nephet Mwangi Gchee cashed project cheques – none of whom were recorded as district staff. In Tana River, Mohamed Kala Hep cashed a cheque but was not district staff.

98. A number of cheques written to suppliers were cashed, see Table 11 below. Note that a number of the cheques listed, pre-date the transaction date and some of the differences in the dates span the financial year end date (see the last two entries in the table in relation to Nyeri district). Some of the payees of the cashed cheque shown in Table 11 below actually had bank accounts as it was noted that there are payee cheques written to the same suppliers which were not cashed.

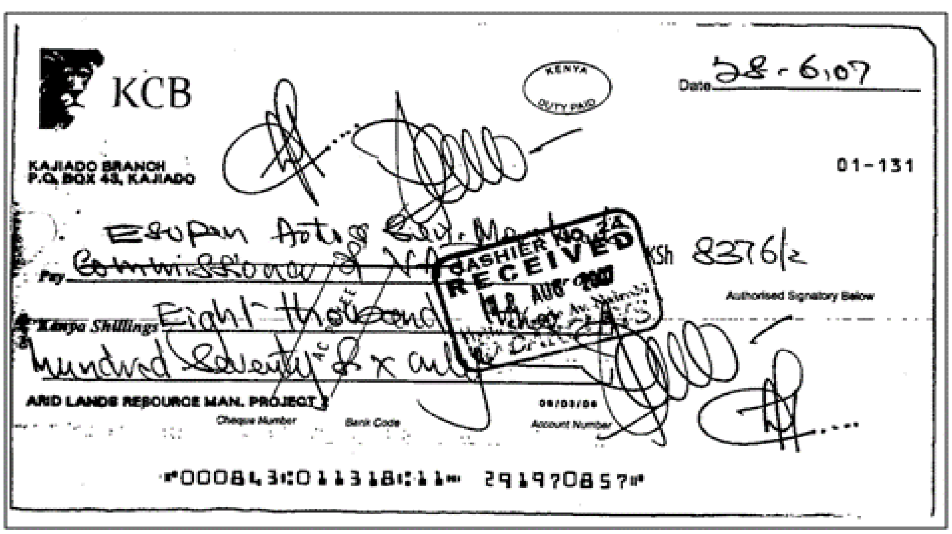
Table 11

District	Transaction Date (per bank statement)	Amount (Ksh)	Cheque #	Payee (as per stubb)	Cheque Date (per cheque)
Kajiado	30-Dec-06	44,000.00	571	Bititec Systems & Supplies	20-Dec-06
Kajiado	26-Jan-07	242,468.00	582	Masai Stores Ltd.	26-Jan-07
Kajiado	1-Aug-07	17,600.00	836	Kick Start International Inc	28-Jun-07
Kajiado	26-Jul-07	149,980.00	851	Masai Stores Ltd.	24-Jul-07
Kajiado	31-Oct-07	130,000.00	863	Elangata enkima Primary School	4-Sep-07
Isiolo	20-Nov-06	329,023.00	662	Madiba Engineering Works	17-Nov-06
Nyeri	6-Aug-07	284,159.00	1149	Wisa General Merchants	26-Jun-07
Nyeri	12-Jul-07	572,586.00	1189	Patent General Services	26-Jun-07

Some Other Behaviors Observed in Reviewing Cleared Cheques

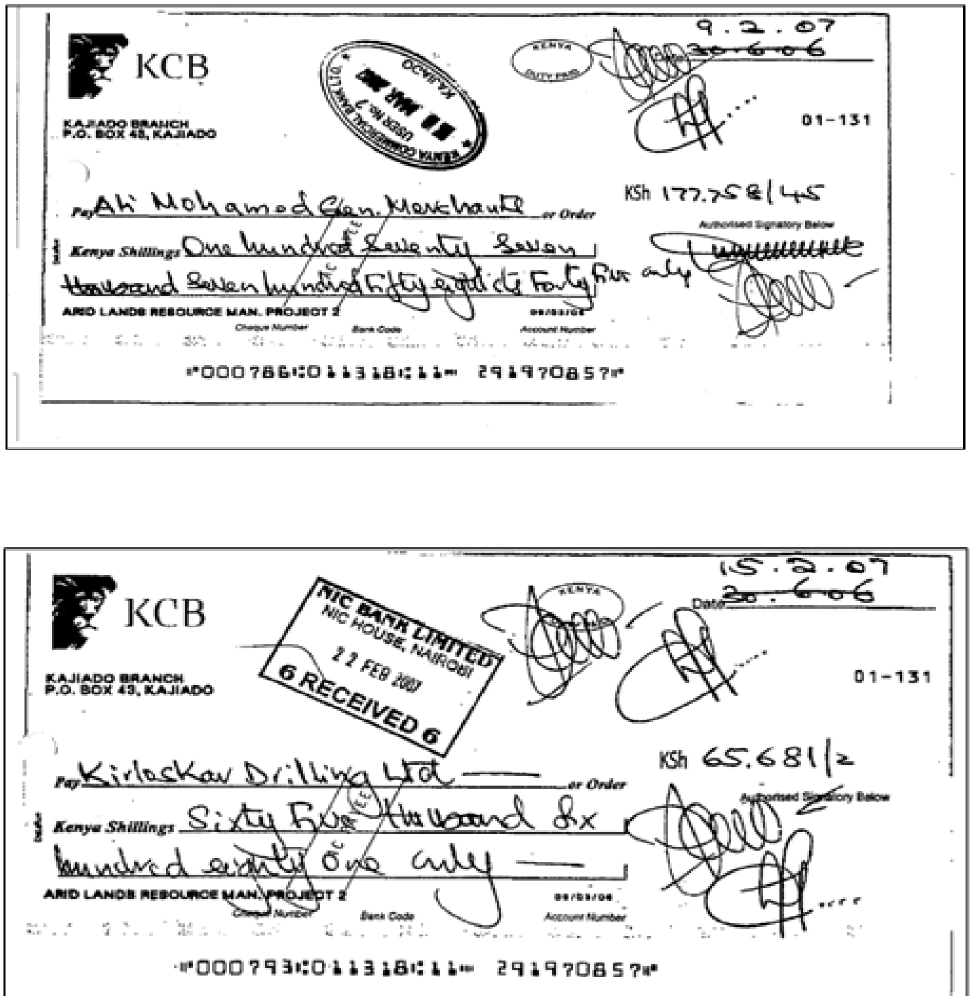
99. As part of the third party verification exercise INT sought all cleared cheques (i.e. all original cheques presented to the bank) for all districts sampled and Headquarters Citibank accounts for the period 1 July 2006 to 30 June 2008. This was an important part of the audit to enable INT to verify that the payees recorded on the cheques were the ultimate beneficiaries of the funds and that the payee was the same party recorded in the cashbook and was the party that provided the goods or services to the project. As referred to above, the response from the banks has not been completely satisfactory as a significant number of cleared cheques have not been provided to date, some nine months after the initial request.

100. Cleared cheques provided by Kenya Commercial Bank's (KCB) Kajiado branch for the project's Kajiado district office did show alterations to the payee on the face of the cleared cheque. In several instances it appears that the alteration was due to the incorrect spelling of a payee's name, but another cleared cheque showed the original payee (Commissioner of VAT) crossed out and a totally different payee (Esopan Auto Gen Merchants) inserted.


KCB
KAJIADO BRANCH
P.O. BOX 43, KAJIADO
Date 28-6-07
01-131
Pay Esopan Autos Gen. Merchants
~~Commissioner of VAT~~
KSh 8376/=
Kenya Shillings Eight thousand
hundred Seventy six only
Authorised Signatory Below
CASHIER RECEIVED
ARID LANDS RESOURCE MAN. PROJECT
Cheque Number
Bank Code
Account Number

101. In addition to the alteration of payees, some of the cleared cheques' dates appear altered. Two cheques written on KCB's Kajiado branch for the Project's district office were originally dated 30 June 2006 and were payable to 'Ali Mohamed General Merchants' and 'Kirloskav Drilling Ltd' for Ksh177,758 and Ksh65,681 respectively. The cleared cheques had new dates of 9 March 2007 and 15 February 2007 and were presented 10 March 2007 and 22 February 2007 respectively.

Examples: Checks with Altered Date



ATM Withdrawals related to Commissioner of VAT cheques

102. It was observed in Tana River district that multiple ATM withdrawals which totaled Ksh541,661.40, matched (in value terms) unpresented cheques written to "Commissioner of VAT". The review of Tana River district bank statements with KCB Hola branch showed that on March 23, 2007 and April 16, 2007, the cash was withdrawn from the account by using an ATM facility. These cash withdrawals do not appear to be reflected in the cashbook.

103. INT's review of the cheques recorded in the cashbook written indicated that there are many cheques written to "Commissioner of VAT" that were never presented – in Tana River district and other districts. In relation to the Tana River district, when comparing the ATM withdrawals with the unpresented 'VAT' cheques, it was found that for each ATM withdrawal there was an unpresented cheque (made payable to Commissioner of VAT) that exactly matched the amount. Furthermore, on the relevant bank statement provided to INT by the project, the matching unpresented cheque number was written by hand next to the ATM transaction, indicating that for someone within the project there was a relationship between the cheque and the ATM withdrawal. The total value of the Tana River district ATM withdrawals linked to the unpresented cheques were Ksh541,661.40. These facts are consistent with fraud behavior.

Bank charges

104. It was observed in some districts that cheques were drawn ostensibly for bank charges. The project's Wajir district office drew two cheques to pay for bank charges, when bank charges had already been debited to the bank account automatically and drawn from the bank account. Copies of two cleared cheques # 1977 and #1978 issued 30 December 2006 for Ksh7,500 each by KCB Wajir were provided to INT by KCB's Wajir branch. The payee for these two cheques was "Aridlands Res. Management Project" and the supporting payment vouchers indicated that the payments were for bank charges. It was not clear why cheques were written for bank charges already drawn from the project account. Interestingly, both cheques were written on a weekend.

Integrity of Bank Statements records

105. During the course of the audit, INT requested commercial banks who provided services to the project, to provide bank records, including bank statements, to independently verify the accuracy and completeness of the records maintained by the district offices and headquarters. However, it was noted that within the copy bank statements that were provided to INT by the banks, transactions details had been altered, removed or changed. This was observed from comparing the original bank statements received by INT from the project with the copy bank statements received from the bank. In some cases the narrative for a transaction's description was different, for example the client version made reference to the transaction being a cash withdrawal, where the bank version of the bank statement has no reference to the fact that the transaction was a cash withdrawal.

106. For the districts sampled, with the exception of Isiolo district who banked with Consolidated Bank, the district offices all banked with local branches of KCB. KCB was and still is partly GOK owned and was a preferred bank due principally to its significant branch network which was an important consideration for a project operating in remote regions of the country.

107. One difference observed was that the transaction description was different or omitted. Consolidated Bank's Isiolo branch provided August 2007 copy bank statements which

contained no transaction descriptions at all, and significantly where a cheque was cashed, the cheque number was removed from the description field when in the original bank statement provided to the Isiolo district office (which was in turn provided to INT as part of the initial request for documents) the cheque number appeared. Both KCB's Maralal and Garissa branches which held the project's Samburu and Garissa district offices bank accounts respectively, also provided copy bank statements where the words 'cash withdrawal' were removed from the transaction description field. KCB's Garissa branch also altered descriptions from 'cash withdrawal' to 'MISC. DEBIT'.

Example: Transaction Description being altered in Bank Statement

Statement dated
Page: 1

Account Number
0120048119900

ARID LANDS RESOURSE MGT PROJEC

TRANSACTION DATE	DESCRIPTION	VALUE DATE	DEBIT	CREDIT	BALANCE
2006-07-01	Balance Brought Forward				8,155,383.90 CR
2006-07-03	VAT CHQ100578	2006-07-03	23,448.30		8,131,935.60 CR
2006-07-03	VAT CHQ 100569	2006-07-03	5,558.60		8,126,377.00 CR
2006-07-03	VAT CHQ100575	2006-07-03	9,160.80		8,117,216.20 CR
2006-07-03	VAT CHQ100567	2006-07-03	4,784.00		8,112,432.20 CR
2006-07-03	VAT CHQ100582	2006-07-03	196,432.00		7,916,000.20 CR
2006-07-04	CHQ. NO.100568	2006-07-04	34,741.40		7,881,258.80 CR
2006-07-05	CHQ. NO.100579	2006-07-05	32,758.60		7,848,500.20 CR
2006-07-05	CHQ 100600	2006-07-06	186,034.50		7,662,465.70 CR
2006-07-07	CHQ. NO.100590	2006-07-07	94,395.00		7,568,070.70 CR
2006-07-10	100587	2006-07-11	225,982.70		7,342,088.00 CR
2006-07-11	CHQ. NO.100596	2006-07-11	100,948.30		7,241,139.70 CR
2006-07-11	CHQ. NO.100591	2006-07-11	288,910.20		6,952,229.50 CR
2006-07-11	CHQ. NO.100597	2006-07-11	35,800.00		6,916,429.50 CR
2006-07-11	CHQ. NO.100595	2006-07-11	50,250.00		6,866,179.50 CR
2006-07-11	CHQ. NO.100605	2006-07-11	360,344.80		6,505,834.70 CR
2006-07-11	CHQ. NO.100594	2006-07-11	652,931.00		5,852,903.70 CR
2006-07-11	CHQ. NO.100589	2006-07-11	24,956.90		5,827,946.80 CR
2006-07-12	CHQ. NO.100574	2006-07-12	57,255.20		5,770,691.60 CR
2006-07-15	100588	2006-07-18	216,690.00		5,554,001.60 CR
2006-07-17	LFA Underchgd	2006-07-17	1,225.00		5,552,776.60 CR
2006-07-21	VAT-CHQ 100565	2006-07-21	7,456.50		5,545,320.10 CR
2006-07-21	VAT-CHQ 100599	2006-07-21	4,321.40		5,540,998.70 CR
2006-07-25	CHQ. NO.100602	2006-07-25	206,896.60		5,334,102.10 CR
2006-07-27	LEDGER FEE REV	2006-07-27		1,225.00	5,335,327.10 CR
2006-08-03	CHQ. NO.100598	2006-08-03	27,008.60		5,308,318.50 CR
2006-08-04	CQ 100607	2006-08-04	200,000.00		5,108,318.50 CR
2006-08-07	CASH WITHDRAWAL (CHQ)	2006-08-07	120,000.00		4,988,318.50 CR
2006-08-10	CASH WITHDRAWAL (CHQ)	2006-08-10	300,000.00		4,688,318.50 CR
2006-08-11	CHQ 100612	2006-08-15	592,531.80		4,095,786.70 CR
2006-08-18	CQ 100616	2006-08-18	250,000.00		3,845,786.70 CR
2006-08-22	CASH WITHDRAWAL (CHQ)	2006-08-22	150,000.00		3,695,786.70 CR
2006-08-24	CASH WITHDRAWAL (CHQ)	2006-08-24	200,000.00		3,495,786.70 CR

Isiolo Bank statement provided by Project

Isiolo Branch
NAME ARID LANDS RESOURSE MGT PROJEC
ACCOUNT NUMBER 012/00/481199/00
ACCOUNT DESCRIPTION Current Individual
OPENING BALANCE 0.000

Consolidated Bank of Kenya Ltd

STATEMENT OF ACCOUNT

STATEMENT
DATE 31 AUG 06
TYPE 50
PAGE 1
CURRENCY

removed

TRANSACTION DATE	DESCRIPTION	VALUE DATE	DEBIT	CREDIT	BALANCE
	BALANCE BROUGHT FORWARD				5,335,327.10CR
03 AUG 06	CHQ. NO. 100598	03 AUG 06	27,008.60		5,308,318.50
04 AUG 06	CQ 100607	04 AUG 06	200,000.00		5,108,318.50
07 AUG 06	CASH WITHDRAWAL (CHQ) CHQ W/D 100608	07 AUG 06	120,000.00		4,988,318.50
10 AUG 06	CASH WITHDRAWAL (CHQ) CHQ W/D 100609	10 AUG 06	300,000.00		4,688,318.50
11 AUG 06	CHQ 100612	15 AUG 06	592,531.80		4,095,786.70
18 AUG 06	CQ 100616	18 AUG 06	250,000.00		3,845,786.70
22 AUG 06	CASH WITHDRAWAL (CHQ) CHQ W/D 100617	22 AUG 06	150,000.00		3,695,786.70
24 AUG 06	CASH WITHDRAWAL (CHQ) CHQ W/D 100618	24 AUG 06	200,000.00		3,495,786.70
25 AUG 06	Credit GOK	25 AUG 06		1,946,217.00	5,442,003.70
25 AUG 06	Credit IDA	25 AUG 06		20,759,211.00	26,201,214.70
25 AUG 06	Commission	25 AUG 06	150.00		26,201,064.70
25 AUG 06	Commission	25 AUG 06	150.00		26,200,914.70
28 AUG 06	CHQ W/D 100619	28 AUG 06	200,000.00		26,000,914.70
29 AUG 06	CHQ W/D 100620	29 AUG 06	300,000.00		25,700,914.70
29 AUG 06	CHQ. NO. 100606	29 AUG 06	57,327.60		25,643,587.10
29 AUG 06	CHQ 100614	29 AUG 06	15,193.20		25,628,393.90
29 AUG 06	CHQ 100613	29 AUG 06	67,525.00		25,560,868.90
30 AUG 06	cq 100621	30 AUG 06	400,000.00		25,160,868.90
31 AUG 06	CHQ 100593	31 AUG 06	1,031,159.00		24,129,709.90

E-Cellbanking-your 24hr mobile service gives you access to your A/C at all times. From bal enquiry to airtime top-up.

Statement provided by Consolidated Bank at INT's request.

108. INT noted that for the districts of Kajiado, Isiolo and Wajir, bank statement records failed to capture all cashed cheques. It was found that in these districts, some cash cheques are described in the bank statement as *"cash withdrawal chq no. xxx"*, however for some cash cheques, the word *"cash withdrawal"* was dropped. In other instances, where a commission was charged for each separate cash withdrawal on copy bank statements the commission charges for the same cashed cheques were removed but a general bank charge capturing the value of the charges of a number of 'commissions' was debited to the bank statement instead.

Delay in recording cash withdrawals in Isiolo's cashbook

109. In August 2006, all cashed cheques (ie. cheques numbered 100607, 100609 100616, 100617, 100618 and 100619) worth Ksh1.3 million, were recorded in the cashbook on 30 August 2006 despite the withdrawals occurring on different dates during the month. This is an indicator that the cashbook was not completed contemporaneously, but at some later date. This observation is consistent with the posting dates of transaction on the ledgers (for Garissa) which occurred quarterly to enable the district to prepare its FMR package and workpapers.

110. Sundry deposits and subsequent cash cheques, recorded as related to George Otieno, the DMO for Kajiado, appear to be contras, see Table 12 below. INT does not understand why, for example, would Kajiado's DMO make a cheque deposit of Ksh576,500 into Kajiado's district office bank account on 23 March 2007, and on the same day draw a cash cheque for Ksh576,500 to himself. If the cheque deposited to Kajiado's district office bank account was made out to the project then, on its face, those funds were the Project's (as at the date of this report INT had not received the vouchers supporting the deposit).

Table 12

Transaction Date (per BS)	Money In	Money Out	Detail (per BS)	Details recorded in the cashbook
23-Mar-07	576,500		Chq pay-in	Cheque DMO
23-Mar-07		576,500	Cash chq 626	George Otieno (DMO)
11-Apr-07	1,750,000		Chq pay-in	Cheque George Otieno (DMO)
17-Apr-07		900,000	Cash chq 635	George Otieno (DMO)
4-May-07		850,000	Cash Chq 636	George Otieno (DMO)

111. Insufficient information was provided to INT to determine whether the sundry receipts were in fact the property of the Kajiado DMO, for example if the sundry receipts were proceeds from boarding vehicles then those receipts were the property of the Project. INT also noted that other donors or Ministries would often give funds direct to district offices for reimbursement of expenses, or for services provided, or for program expenditures (in addition to those funded by IDA) yet nowhere in the district project records reviewed by INT was any such income or revenue recorded. In all districts it was noted that the cashbook failed to record sufficient information about sundry receipts, there was also no provision in the FMRs prepared by the districts quarterly to record that information.

Tana River District Bank Reconciliation

112. No bank reconciliations were provided for the quarterly FMRs prepared by Tana River district and the year end bank reconciliations did not reconcile. Other districts sampled appeared to produce proper bank reconciliations but the failure to perform or check bank reconciliations heightens concerns over the accuracy of the bank balances reported and the underlying cashbook record. It was observed in several districts, including Tana River that the cashbook had not been produced contemporaneously and specifically for Tana River – significant parts of the cashbook had been completely re-written (the old cashbook pages were left in the book).

Payroll/HR issues

113. Payroll represented the single largest expense of ALRMP II accounting for Ksh223.6 million in FY07/08 (16.8%) and Ksh176.8 million in FY06/07 (16.5%) of total project expenditures set out in the FMRs. It was also the largest expenditure item reviewed by INT, Ksh223.6 million out of Ksh655.1 million (FY07/08) i.e. (34% of expenditures) and Ksh176.8 million out of Ksh573.6 million (FY06/07) (31% of expenditures). Over the period audited the number of staff grew from 326 staff as at 1 July 2006 to 418 staff as at 30 June 2008 (an increase of 92 individuals or 28%).

114. It was difficult to retrospectively audit the validity of payroll costs simply because the existence or attendance of staff could not be verified retrospectively without contemporary records capturing that information, for example time records. Consequently the payroll expenditure was subjected to a detailed analytical review with queries put to project management.

115. The detailed analytical review required the extraction of the monthly payroll information from the payment vouchers for all staff. The extraction and review of this information, combined with responses from queries put to project management enabled comment on individual staff issues (recruitment processes, pay levels, staffing levels) but did not enable INT to unequivocally conclude as to the validity of the expenditure; or whether it was suspected fraudulent expenditure except in several isolated instances. If, for example a staff member was recruited when he or she was older than the GOK mandatory retirement age at that time, and if the GOK regulations were applicable, then questions over the eligibility of this entire salary arise.

116. A significant number of payroll/staff related allegations were received by INT and corroborated to some extent by INT's own work, or by another source, were put to project management in writing (by email). Project management did not respond despite follow-up requests, based on their own knowledge, as to the validity of these allegations. INT also requested a complete list of the ages of all staff. When this request was made verbally, INT received a positive response that it could be done, after confirming the request in writing, no response to date has been received.

117. The total payroll costs extracted from the payment vouchers of headquarters represented slightly different total payroll expenditures for the respective periods (refer Table 13 below). The total payroll costs for FY07/08 were scheduled as Ksh 221.1m and for FY06/07 Ksh174.4m respectively. The difference for FY07/08 of approximately Ksh2.5m is mainly represented by a late journal adjustment referred to below under the heading 'March Quarter 2008 FMR and Payroll schedule variance (Ksh 2,265,501.50)'. The difference of approximately Ksh2.4m for FY06/07 was not identified or explained.

Table 13

Payroll Analysis for FY06/07 & FY07/08 - ALRMP II by District (Ksh)

Staff # as at 1 Jul 06	Employees	Staff # as at 30 June	Total FY06/07	Staff # as at 30 June	Total FY07/08
52	Headquarters	54	47,837,862	59	58,383,900
7	NYERI	7	3,337,238	9	4,100,060
17	TANA RIVER	16	7,697,722	14	6,531,023
7	KAJIADO	7	3,182,623	8	3,784,638
-	KILIFI	4	733,287	9	3,603,279
-	KWALE	4	674,414	10	3,586,039
-	LAMU	2	373,941	11	3,554,736
-	TAITA-TAVETA	4	683,608	9	3,601,783
-	MALINDI	3	542,784	10	3,668,385
8	MBEERE	7	3,219,518	9	3,574,521
17	ISIOLO	16	7,876,020	17	8,395,822
7	KITUI	7	3,182,623	9	3,842,649
18	MARSABIT	18	8,889,767	18	10,001,564
19	MOYALE	19	8,613,544	18	9,218,698
6	THARAKA	7	2,869,965	8	3,553,059
7	MAKUENI	7	3,182,623	9	3,842,180
-	MERU-NORTH	3	518,417	9	3,537,753
7	MWINGI	7	3,182,623	7	3,639,784
19	GARISSA	14	7,667,226	20	8,994,714
16	IJARA	17	7,579,978	17	8,245,908
18	MANDERA	21	8,005,032	22	10,489,309
20	WAJIR	20	8,886,876	19	9,771,318
7	LAIKIPIA	7	3,182,623	10	4,138,035
7	NAROK	7	3,182,623	9	3,792,438
7	TRANSMARA	7	3,182,623	8	3,784,638
18	BARINGO	17	7,703,263	19	8,673,677
18	SAMBURU	18	7,943,022	19	9,365,912
16	TURKANA	19	7,619,477	20	9,321,367
8	WEST POKOT	9	2,859,519	12	4,056,286
326	**TOTALS**	**348**	**174,410,841**	**418**	**221,053,475**

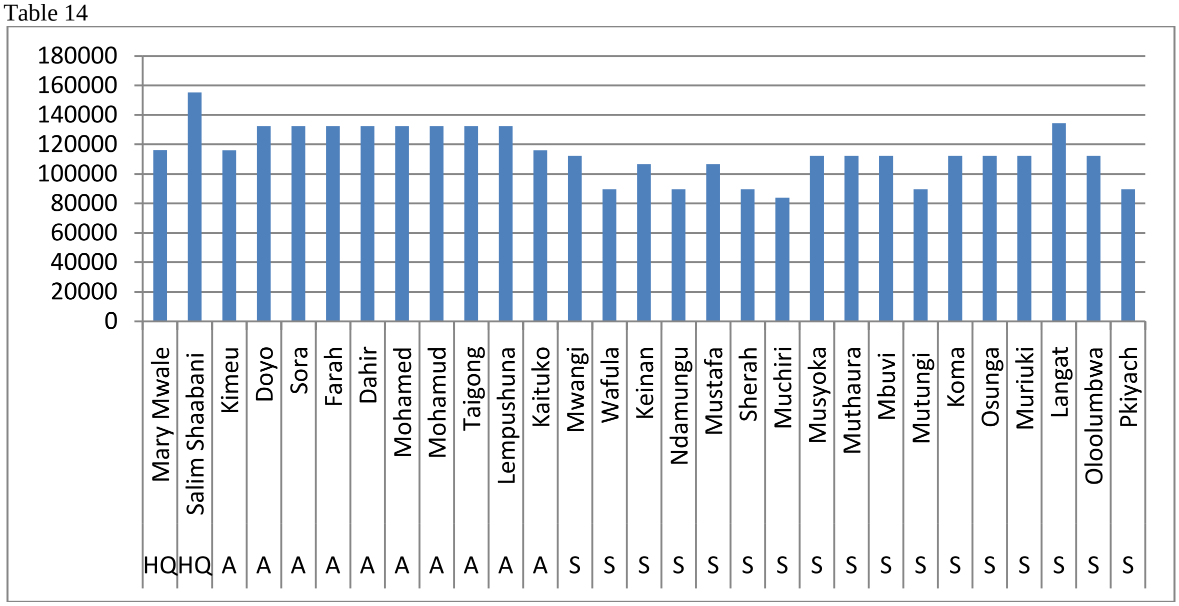
118. The increase in both staff levels and payroll costs between FY06/07 and FY07/08 can be partially explained by the six new semi-arid districts added to the project in early 2007 after the Agreement Amending Development Credit Agreement was signed October 25, 2006, namely Kilifi, Kwale, Lamu, Taita-Taveta, Malindi and Meru-North. Staff for these districts received their first salary in April 2007. But in the same period there were significant increases in staff levels at Headquarters (7 more people or 13%), and in the following districts Nyeri; Kitui; Tharaka; Makueni; Narok; Laikipia; West Pokot; Mandera; and Turkana increased their staff levels by 2 or more (representing increases of between 28.6% and 50%) from their staff levels as at 1 July 2006. Some districts maintained or reduced their staff levels, namely Tana River; Isiolo; Marsabit; Moyale; Mwingi; and Wajir.

119. Because of the addition of six new semi-arid districts, the total payroll costs increased in FY07/08 by Ksh18m, but that only explains less than half of the total increase in payroll of 26.7% or Ksh46.6m between FY06/07 and FY07/08 and there is no clear explanation for this increase. Although Headquarters payroll costs as a percentage of total payroll costs tracked flat or even dipped – from 27.4% (FY07) to 26.4% (FY08) of the total payroll cost - because the total payroll had grown significantly, Headquarters payroll actually increased by 22% or Ksh10.5m during this period.

120. It is also unclear on what basis certain staff salaries are established. For example, no explanation was given in response to a specific request as to why the monthly salary of the finance assistant at Headquarters (Josephat Onyari), as at 30 June 2008, was Ksh119,709 when a finance assistant in an arid district received only Ksh100,601 (e.g. Obieri in Turkana, or Ogutu in Samburu, or Ngungi in Baringo). There were no finance assistants in semi-arid districts.

121. Apart from the different components provided between arid and semi-arid districts, it is unclear why certain positions such as DMOs within headquarters and across the arid and semi-arid districts received different monthly salaries (refer Table 14). The following graph compares the salary for DMO staff at headquarters (H), arid districts (A) and semi-arid districts (S).

Table 14



122. It was noted that between arid or semi-arid districts there are differences in salary and although Langat transferred from headquarters, it is unclear why the highest paid DMO outside Nairobi resides in a semi-arid district where fewer services and project components are implemented.

123. A number of changes in personnel occurred in response to audit reports and similar matters. Mr Githaiga, the former DMO at Nyeri was replaced by John Mwangi due to

"*an audit report prepared and submitted on Nyeri Drought Management Office led to the termination of D.M. Githaiga*". Despite the replacement occurring during the period under audit and despite Nyeri being sampled by INT to audit, the aforementioned report was never provided to INT.

124. In project management's response to certain payroll queries, dated 9 March 2010, in relation to *"July 2007 new hires in Garissa and Meru North"* project management stated that *"the first 2 clerks were recruited to support the UNDP funded Projects in Dadaab Joint Host Community Project and also the Armed Violence and Small Arms Reduction Project both based in Garissa"*. Management commented that these projects supplemented ALRMP II initiatives in these matters. From INT's perspective, if these clerks were funded by the UNDP, then INT expected income from UNDP to be reflected within the project's accounts for these costs. No income from any other projects or donors has been reflected within the FMRs or annual financial statements of the project. It is still unclear to INT why these clerks could not be employed by the UNDP projects directly and whether the work is still ongoing. A query was sent by INT to UNDP regarding this issue but no response has been received to date.

125. INT is concerned about the reliability and integrity of the supporting schedules for the payroll payment vouchers provided under audit. If the supporting schedules do not represent the actual payments made to staff then the integrity of the total payroll costs is in doubt. It is unclear how Mbeke received Ksh25,180, if the purported payroll schedule confirmed she was actually due to pay the project Ksh2,820. INT have requested the revised payroll schedules for June 2007 that indicate the payment to Mr Mbeke and that reconcile to the bank statement but to date no documents have been provided. If the underlying schedules do not support the payroll costs debited to the project's bank account then INT cannot place any reliance on the payroll schedules.

126. The payment vouchers for staff salary in June 2007 recorded that Aggrey Mbeke (the assistant Supplies and Procurement Officer in Garissa) had a negative pay of Ksh-2,820. On enquiry with project management, INT received the following response *"this underpayment was not real. It must have been a computer error which was corrected through a revised payroll. Mr Mbeke's actual net salary in June 2007 was Kshs 25,180. Please find the attached a certified copy of the relevant payslip."*

OFFICE OF THE PRIME MINISTER (ALRMP II)
GARISSA

NUMBER: 510-040
NAME: AGGREY J. MBEKE
P.I.N.:
MONTH: JUN-2007

EARNINGS		AMOUNT
BASIC PAY		75,216.00
GROSS PAY		75,216.00
DEDUCTIONS	BALANCE	AMOUNT
PAYE		16,496.00
NHIF		320.00
NSSF		0.00
JOMEIS		100.00
JOGOO SHARES	359,300.00	5,000.00
JOGOO N-LOAN	585,000.00	23,020.00
JOGOO E-LOAN	2,000.00	2,040.00
JOGOO S-LOAN	3,000.00	3,060.00
TOTAL DEDUCTIONS		50,036.00
NET PAY		25,180.00

For National Project Co-ordinator
ARID LANDS RESOURCE MANAGEMENT PROJECT
P. O. Box 53547 - 00200
NAIROBI

B.B.K - QUEENSWAY HOUSE
8334402

JOGOO N-LOAN - PRINCIPAL	17,000.00
JOGOO N-LOAN - INTEREST	6,020.00
JOGOO E-LOAN - PRINCIPAL	2,000.00
JOGOO E-LOAN - INTEREST	40.00
JOGOO S-LOAN - PRINCIPAL	3,000.00
JOGOO S-LOAN - INTEREST	60.00

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OFFICE OF THE PRESIDENT (ALRMP II)

PAYROLL SUMMARY

YEAR: 2007
MONTH: June
Page: 7

NO.	NAME	SALARY	OTHER EARNINGS	GROSS PAY	PAYE	NHIF	NSSF	OTHER DEDUCTIONS	TOTAL DEDUCTIONS	NET PAYMENT
470-150	DANIEL K. MBUVI	83,931.00	0.00	83,931.00	19,111	320	0	0.00	19,431.00	64,500.00
470-178	BONIFACE MUMINA MUSAU	40,716.00	0.00	40,716.00	6,146	320	0	5,000.00	11,466.00	29,250.00
470-193	RAPHAEL MURITHI MUTUGI	40,716.00	0.00	40,716.00	6,146	320	0	16,506.00	22,972.00	17,744.00
470-208	MARTIN MUSEMBI KAMWANZA	40,716.00	0.00	40,716.00	6,146	320	0	26,690.00	33,156.00	7,560.00
470-242	PAUL MWONGELA MBILI	23,328.00	0.00	23,328.00	2,008	320	0	12,510.00	14,838.00	8,490.00
470-244	WINFRED MUTAVE KYULE	12,458.00	0.00	12,458.00	198	260	0	3,630.00	4,088.00	8,370.00
470-297	AGATHA KALUKI NZIVO	27,078.00	0.00	27,078.00	2,758	320	0	14,580.00	17,658.00	9,420.00
490-381	JACOB KIMATHI MUTUNGI	83,931.00	0.00	83,931.00	19,111	320	0	0.00	19,431.00	64,500.00
490-396	HENRY GATOBU ALAINE	40,716.00	0.00	40,716.00	6,146	320	0	15,100.00	21,566.00	19,150.00
490-404	MICHAEL MURITHI MWONGERA	40,716.00	0.00	40,716.00	6,146	320	0	0.00	6,466.00	34,250.00
495-152	FRANCIS MUNYWOKI KOMA	83,931.00	0.00	83,931.00	19,111	320	0	15,100.00	34,531.00	49,400.00
495-174	SAMUEL KIHARA KUNGU	40,716.00	0.00	40,716.00	6,146	320	0	5,300.00	11,766.00	28,950.00
495-192	BERNARD CHERUIYOT KORIR	40,716.00	0.00	40,716.00	6,146	320	0	14,600.00	21,066.00	19,650.00
495-203	HERMMERN WAWERU MAINA	40,716.00	0.00	40,716.00	6,146	320	0	10,100.00	16,566.00	24,150.00
495-245	LENAH KAMENE JOSEPH	12,458.00	0.00	12,458.00	198	260	0	2,100.00	2,558.00	9,900.00
495-280	JANE JEMUTAI TERER	27,078.00	0.00	27,078.00	2,758	320	0	0.00	3,078.00	24,000.00
495-307	MIMATHU M KABERA	23,328.00	0.00	23,328.00	2,008	320	0	0.00	2,328.00	21,000.00
510-011	AHMED FARAH	98,931.00	0.00	98,931.00	23,611	320	0	2,800.00	26,731.00	72,200.00
510-033	ABBAS M. ABDINOOR	75,216.00	0.00	75,216.00	16,496	320	0	33,960.00	50,776.00	24,440.00
510-040	AGGREY J. MBEKE	75,216.00	0.00	75,216.00	16,496	320	0	61,220.00	78,036.00	-2,820.00
510-069	MOHAMED GURHAN	28,528.00	0.00	28,528.00	3,048	320	0	0.00	3,368.00	25,160.00
510-070	SAID GONA BAGANA	15,281.00	0.00	15,281.00	621	320	0	7,800.00	8,741.00	6,540.00
510-071	BISHAR M. AHMED	10,560.00	0.00	10,560.00	0	220	0	3,240.00	3,460.00	7,100.00
510-085	SIYAT O. DIMBUL	28,528.00	0.00	28,528.00	3,048	320	0	0.00	3,368.00	25,160.00
510-128	HASSAN MOHAMED MATO	15,281.00	0.00	15,281.00	621	320	0	3,200.00	4,141.00	11,140.00
510-142	HASSAN MAALIM MOHAMED	10,560.00	0.00	10,560.00	0	220	0	1,100.00	1,320.00	9,240.00
510-157	SAADI NOOR ODOWA	84,216.00	0.00	84,216.00	19,196	320	0	2,266.00	21,782.00	62,434.00
510-267	HASSAN GEDI OSMAN	28,528.00	0.00	28,528.00	3,048	320	0	14,600.00	17,968.00	10,560.00

Other earnings to staff – adjustments June 2008

127. In project management's response to a clarification of 'other earnings' paid to staff on 30 June 2008 (paragraph 17 of ALRMP II's letter dated 9 March 2010) it stated *"all employees listed here below under this item had changes in their Job Descriptions/Terms of Reference between January 2004 and August 2007 which had the effect of increasing their responsibilities. At the time of the Cost of Living Adjustment increases were being calculated in September 2007 to compensate staff for part of the erosion of their disposable income through a 45% increase in inflation, the change in TORs was inadvertently omitted as a factor requiring consideration. This only came to light after the affected employees raised their concerns leading to a re-calculation in June 2008…"*.

128. INT is concerned that the basis for the adjustment is not only invalid, but unsupportable and possibly a misrepresentation of what in fact occurred. If the change in job descriptions or terms of reference at relevant times for the affected employees did not warrant a change in salary or income at the time, then it is unclear on what basis a subsequent 'increase' could be warranted and justified. If it was not a factor at the time the changes were made to the pertinent job descriptions or terms of references, then it should not have been a factor when the cost of living adjustment was made. No evidence was provided to INT that the issue about the change in TORs was "inadvertently omitted" and no explanation was provided as to why the omission took another 9 months to rectify, if these individuals believed that they were entitled to such an adjustment then they would have followed this matter up in September 2007. Furthermore no documentary evidence was provided that these specific individuals received additional responsibilities or had their terms of reference changed at any time, in fact many of them maintain generic roles within the project. In at least one case (Langat – Norok) the role and responsibilities appeared in fact to reduce when the employee moved to Narok as the DMO in June 2008. In INT's view the related expenditures and all supplementary payments to the employees based on this decision are questionable and may be fraudulent if the backdating was done to avoid proper authorization (e.g. evade scrutiny from the TTL when the No Objection letter was issued) or to conceal the nature of the transaction. If the June 2008 payroll schedule provided to INT is accurate, that would mean 'other earnings' of Ksh597,427 are ineligible.

March Quarter 2008 FMR and Payroll schedule variance (Ksh2,265,501.50)

129. In a letter dated February 19, 2010, INT queried an additional amount (Ksh2.2 million approximately) charged to payroll component of the project. INT requested copies of the original vouchers relating to these payments. In response Fatuma Abdikadir, the National Project Coordinator, responded in a letter dated March 9, 2010 in relation to the above issue that it "was made up of allowances paid to Mobile School Teachers and to Drought Monitors". No vouchers were provided but the response re-iterated that "the supporting vouchers are available at the listed Districts and the same vouchers were submitted alongside other documents forwarded to the World Bank Country Office for verification". The response further stated that the 'Mobile School Teachers allowances and those paid to Drought Monitors appear in the same code in the Government Printed estimates Schedule as for salaries (i.e. Code No. 2.110.100)".

130. INT has formed the view that the adjustment of Ksh2,265,501.50 to allocate this amount to the salaries code may allow the project to capture the expense correctly under salaries but as there were no corresponding journal credits removing the same expense from the original allocation under the FMRs provided by the districts, the expenditure has been captured twice. As the adjustment currently stands, gives rise to an ineligible amount.

131. INT has also received information that all Mobile School Teacher allowances were funded by the Ministry of Education from 1 July 2007 via the Kenya Education Sector Support Program (KESSP) which would indicate that any purported allowances paid in FY08 would be assessed as potentially fraudulent from INT's perspective and would form part of the transactions referred to the appropriate enforcement agency.

Noncurrent Assets

132. The initial review of the financial statements for the Projects for FY07 and FY08 raised concerns regarding noncurrent assets as there were significant errors on the face of the annual financial statements and an absence of any record of disposals. These concerns along with issues flagged in FM correspondence, and allegations received by INT concerning vehicle and computer procurements, warranted the extension of the audit procedures of noncurrent assets.

133. In meetings with project staff, INT was initially informed that:
   - vehicles from the initial ALRMP project were inherited by ALRMP II;
   - no disposals had occurred of any vehicles prior to 30 June 2008;
   - since June 2008 some vehicles had been ‘boarded’ or sold;
   - the project staff were unaware of a policy with regard to the recognition of the disposal proceeds; and
   - vehicles were centrally procured but ‘allocated’ to Districts.

134. INT determined that there does not appear to be a consistent approach or any policies or procedures governing the management and disposal of vehicles funded by the project or its predecessors. It is unclear why all or some GOK regulations were not applicable to noncurrent assets of the Project, especially as it was within a Ministry at all times.

135. The inability of the project to produce a comprehensive fixed asset register for the project raises real risks that assets may not be fully utilized for the purposes of the project. Subsequent to initial meetings in May/June 2009 between INT and project staff, some fixed asset records for some districts were supplied to INT.

Project accounting records for noncurrent assets

136. Although the project recently adopted International Public Sector Accounting Standards (IPSAS), no accurate record of the project’s noncurrent assets exists, for the project as a whole, nor for each District. Although some districts maintained fixed asset registers the audit found no evidence that regular stock takes occurred and not all information has been captured or can be substantiated by reference to original vouchers.

137. Vouchers were identified during the course of the period audited that vehicles were prepared for boarding (expenses were incurred to have the vehicles inspected which was a prequalification to boarding and advertising expenses were incurred to advertise the impending sale of the vehicles) prior to 30 June 2008. While the lack of a comprehensive asset register makes the tracking of assets difficult, the obvious assumption to draw from these expense items is vehicles have been ‘boarded’ prior to 30 June 2008, and in contradiction of statements made by project staff. ‘Boarding’ is the term used by GOK to describe its procedures for the disposal of government owned assets, especially vehicles.

138. Within the GOK Estimates for the Ministry, INT was advised that there is an estimate which budgets for sundry income including bank interest and proceeds from the sale of assets. No information, vouchers or other supporting documents were provided by the project to INT for either FY07 or FY08 to indicate that any sundry income was received under the project at either headquarters or at district level. The financial statements for FY07 do not record any sundry income from either bank interest or the disposal of assets. The FY08 financial statements record only interest income from the project account with Citibank, Nairobi. It was noted that this interest earnings were not transferred over into the statement of comparative budget and actual amount. ..

139. During the course of the audit it was confirmed that the project inherited assets (including vehicles) from DMI, JIKA, and UNDP. It is clear from the financial records of the project that assets donated to the project from other projects which were closing, are always properly recorded.

IDA requirements on project asset disposals

140. Within the DCA there are no stated policies on the treatment of the sale proceeds of Project assets, either during the life of the Project or on its closure, as no mechanism is provided for transferring the ownership of those assets formally to the relevant government ministry or to another successor project. An absence of clarity in relation to dealing with project assets generally, creates an opportunity for embezzlement and dissipation without proper accounting. The PAD, loan agreement, or other project documents could benefit from more transparency, possibly specifically stating appropriate policies or guidelines, and both the borrower (GOK in this instance) and the Bank needs to agree on such policies or guidelines, and the ability to review or audit such procedures. Under the IDA Credit Agreement the Bank may form the view that the assets are the property of the government, but if the project is run by an independent PIU outside of government systems, or by a PIU that does not apply relevant government regulations to its asset management, then there may be additional requirements for the Bank to ensure that accountability is maintained.

141. The failure to require by the Bank to stipulate within the DCA or project documents, how the projects are to account for non-current assets, which comply with appropriate accounting standards, increases the risk of mismanagement and loss of the underlying assets, without attributing any accountability.

142. GOK has strict controls and policies for Government owned vehicles (Ministry of Roads and Public Works) and it seems logical that the project should avail itself of these procedures. It seems that the project has adopted some procedures (such as in some instances obtaining inspection reports before procuring quotes for repairs) but it is unclear how consistent it is applying those procedures.

143. The Bank should undertake a stocktake of the current fleet for the Project, prior to embarking on the successor project to ascertain the true asset position. The stocktake

will enable the Bank to identify exactly how many vehicles have been boarded and will also confirm the location of remaining vehicles. The Bank should review its fleet management needs in respect of all projects in Kenya and in the interests of efficiency, consider funding Ministry of Roads and Public Works to acquire, maintain and manage the fleet of vehicles for use by Bank funded projects.

Boarding of vehicles

144. Evidence from the records provided to INT indicated that assets were boarded or being prepared for boarding during the period audited. Boarding is a term used by GOK to describe its procedures for the disposal of government owned assets, especially vehicles. Boarding involves a number of processes that are designed to ensure that appropriate vehicles are disposed of at appropriate times in a transparent manner free from conflicts of interest. The process involves (i) pre-sale inspections of the vehicle by the local GOK Ministry of Works garage to certify that the vehicle is not economic to repair, (ii) approval for disposal, and (iii) the tendering of the disposal must be announced publicly, normally in nationally distributed papers, which capture the details of the tender process together with the indicated reserve price. The boarding process together with the obligations under the Government Finance Management Act 2004 clearly set out the processes for dealing with the proceeds of any disposal of assets.

145. INT's audit showed that only some of the GOK boarding processes were followed. It is possible that the processes were circumvented because earlier vehicle purchases were not subject to these GOK regulations and because the vehicles were not registered as GOK vehicles (all GOK vehicles licence plates commence with the letters 'GKA'). It is also possible that the boarding of vehicles was a bit more complex i.e. the complete removal of a brand new engine from a new vehicle and placed into a private vehicle, or simply the switch of number plates. More prevalent and likely is simply the use of the vehicle for non-project purposes as then all its running costs were also met by the project.

Financial Management Report (FMR) issues

146. INT determined during the audit that there was a disconnect between the FMRs and underlying transaction vouchers. For all districts sampled, the vouchers provided could not be reconciled to the FMRs. It was also confirmed from reviewing project records and confirmed from interviews with appropriate project staff that ledgers were only operating in a few districts during the period audited and consequently the annual financial statements for both FY06/07 and FY07/08 were based on the FMRs. It is clear that during FY06/07 and FY07/08 inadequate accounting and financial systems existed. This was also the understanding reported by the FM Specialist in his Arid Lands (P078058) FM Supervision Report November 28 2007, in relation to the FY06/07 annual financial statements, where he stated *"the Ministry is using the IFMIS integrated software which is being rolled out for Central Government Accounting by the World Bank under the Institutional Reform and Capacity Building Project (IRCBP) as part of the PFM reforms. Previously, the ministries were using the Ledger Management System (LMS) which has now been phased out. The IFMIS computer is still in its infant stages and has been experiencing some 'teething' problems. The system has not been rolled out to the district level where the bulk of the accounting work for the project occurs. It had been envisaged that at the District level, the IFMIS as an integrated accounting computer system, would have handled voucher processing, Vote-book posting, cashbook (including bank and other reconciliations such as advances) expenditure report preparation and ledger management including the production of the trial balance (appropriations accounts). However, these functions are maintained at the District Treasury in manual form and the manual reports and stand alone computer systems. Even at the Ministry headquarters, the IFMIS Program has practically stalled. Only one module (the general ledger has been installed). The completeness, accuracy and reliability of information produced by the IFMIS system for the Ministry is questionable. For instance, the ledger report for June 2007 for the ALRMP II had omitted expenditure worth Ksh. 400 million. This is the ledger report that should have been used to prepare the project financial statements for the year 2007. The IFMIS system is therefore not adequate for purposes of project financial reporting. The Ministry has therefore been running a parallel system using stand alone computers using Excel Spreadsheets in order to meet the financial reporting requirements of the Project. This is not an integrated accounting system and is largely manual. The project produces expenditure reports per district using data obtained from the manual cashbook maintained by the district accountant at the district treasury. These reports are consolidated at the Ministry headquarters and used to prepare the FMRs which are sent to the Bank. These expenditure reports are also reconciled periodically to the ledger reports obtained from MOF and material variances are invariably revealed. The Ministry's expenditure reports are generated on a timely basis but the ledger reports from MOF tend to delay for periods of over 2 months and this has adversely affected the financial reporting system for the Project".*

147. Since January 2009, FM revised their supervision strategy in respect of projects in Kenya. This new strategy included leveraging the capacity of the Internal Audit Department (IAD) to conduct supervision (with FM guidance) of the World Bank

projects in Kenya. The use of country systems and oversight bodies in Kenya is possible due to the high level of independence with which they operate. INT acknowledges the difficulties faced in conducting supervision over CDD structured projects and recognized that during the period covered by the forensic audit, the FM capacity in Kenya was stretched. The project staff also confirmed to INT that all districts are now operating computerized ledgers.

148. INT is reasonably confident that, due to improvements in the project's own accounting and FM systems, and as a result of the recent changes in the IAD's mandate in Kenya, the current initiative by FM to use the existing country systems to conduct fiduciary and in-depth reviews, will improve supervision of any successor project and identify issues in a more timely manner which can be dealt with by the project team.

Reporting obligations of the project

149. The reporting obligations of the project set out in the design documents and the Aridlands website itself appeared comprehensive. The website set out the reporting process.

150. Monthly expenditure returns were compiled for GOK purposes which captured monthly expenditures and commitments which were then tracked against budget estimates. These returns were compiled by each district and then consolidated. At the end of every month the district was to prepare and submit the following reports:

- Monthly expenditure returns
- Uses of funds by project activity
- District progress reports
- Procurement Progress reports
- Bank Reconciliation & statement
- Computer Print outs (ledger)
- DSG minutes in case of expenditure on contingency funds
- Memorandum Cashbook

151. Quarterly financial monitoring reports (FMRs) were prepared by the project. Each district would prepare an FMR for each quarter which then was consolidated by headquarters, converting the reporting currency to US dollars. The FMRs differentiated the expenditure between IDA and GOK for each component or votehead. The FMRs were the main reporting mechanism to IDA and the basis for disbursements and withdrawal applications.

152. For the annual financial statements, after the closure of financial year, the Finance Officer prepared the final accounts based on the June Ledger and the FMRs as at the end of the financial year (30 June). The accounts were to be submitted to the Controller and Auditor General by 30th September of each year. The audited financial statements were to be furnished to IDA not later than 31st December of each year.

153. Monthly expenditure returns, FMRs and the annual financial statements were all purportedly based on vouchers, ledgers, cashbooks and fixed asset registers of the districts and headquarters.

154. During the course of the audit it became apparent that some of the project information was not readily useable and due to different underlying assumptions and purposes, the reports themselves did not easily reconcile with each other or the underlying transactions. To illustrate, the monthly expenditure returns did not match the quarterly FMRs as the returns included 'committed' expenditure when FMRs only include actual expenditure. The project activity and various progress reports did not refer back to annual work plans, making it difficult to identify whether approved projects were implemented or whether variations had occurred.

155. Computer printouts of ledgers, which were only available for two districts, supported the FMRs and not the expenditure returns. It was observed that in these two districts, there was no audit trail from the 'ledger' printouts to the vouchers, as unique computer generated voucher references replace the manually generated numbers created and written on the vouchers at the time of the transaction. When conducting a walk-through audit test commencing with the physical voucher, the auditor would be reliant on whether or not the computer generated reference was manually recorded or not – if it was not, then the audit trail was broken.

156. As is the case in many Ministries, the relevant Integrated Financial Management Information System (IFMIS) modules were not fully operational over this project. INT were advised by the Finance and Administration Coordinator for the project, Ruth Gathii, that the project did not have complete ledgers for the FY06/07 and FY07/08 years and further confirmed the annual financial statements for the project for those periods were based on the FMRs which were prepared from the payment vouchers and cashbooks. Despite several requests, no work-papers for either FY06/07 or FY07/08 were provided which reconciled the annual financial statements to the FMRs. In essence ledgers did not exist for all districts for the periods audited. The financial covenants set out in article 4.01(a) required the borrower to maintain a financial management system, including records and accounts, and prepare financial statements in a format acceptable to IDA, adequate to reflect the operations, resources and expenditures related to the Project. It is questionable whether this covenant was met.

157. As part of the forensic audit work program, tests were devised to determine the reasonableness and reliability of both the FMRs and annual financial statements. Given the FMRs were the trigger and supporting document for withdrawal applications submitted to the Bank, the degree to which these documents could be relied upon was important. Audit tests were performed to attempt to reconcile the FMRs to the underlying vouchers provided by the project, across the districts sampled. The 'findings' section of this report captures the observations of the underlying transaction vouchers reviewed, which were provided by the project.

158. The quarterly consolidated FMR reports relied upon by the Bank were prepared by the project. These FMRs were prepared by consolidating quarterly reports prepared by each district and by headquarters and were held out to represent the expenditure by the project in the relevant quarter. On the basis of this representation, disbursement by the Bank's LOA occurred. The FMRs themselves:

- Were prepared in Ksh and then converted to USD;
- Included bank reconciliation related solely to the Special Account and headquarters Citibank's account, no other bank reconciliation were provided for either headquarters or any of the 28 districts local bank accounts;
- Contained no separate disclosure of non-current assets detailing assets purchased or disposed during the relevant period;

Reconciliation of FMRs to vouchers provided

159. For the seven districts sampled, INT attempted to reconcile the FMRs to the vouchers originally provided to INT. The reconciliation of the FMRs was problematic in Garissa (see section below) and Tana River, due to the disconnect between ledger and voucher numbering system detailed above but it did reveal a number of issues and raised a number of concerns. Most notably, in some instances, there is little relationship between the vouchers and the expenditure reported in the corresponding district FMRs.

160. From an audit perspective as there was no audit trail between the transaction vouchers and the accounts of the projects and the FMRs, only significant substantive audit testing coupled with detailed analytical reviews would allow INT to determine whether the FMRs and annual financial statements were supported by actual expenditure.

161. All districts provided their original vouchers to INT, filed normally by the votehead in which that expenditure was captured. The FMRs had seven broad voteheads under which payments could be made in the project, in accordance with the loan and disbursement conditions. For some districts, the value of these vouchers were itemized in summary schedules. In turn, the schedules should have aggregated to the value of the payments set out in the FMRs. This did not occur. For those districts where there were no schedules linking the vouchers provided to the FMRs, a heightened risk existed that there was insufficient vouchers and/or the vouchers do not support the claimed expenditure.

162. A further issue encountered in the audit was the way in which multiple vouchers were created for the same transaction. A single transaction was normally split into 3 components – GOK funded, IDA funded and VAT. At the district level, separate vouchers were required for each component, however at headquarters a single voucher which recorded the component split was produced. Normally a typical transaction required either 1 or 2 or 3 cheques to be generated, depending on whether VAT was paid to the supplier or direct to the Kenya Revenue Authority (see the separate section for a fuller explanation of VAT implications and also the commentary of VAT cheques issued). Where separate vouchers were created, copies of supporting documents were

taken and filed. Given the nature of many of the documents provided, it is important that the document deemed to be the original is easily identifiable. Additonally, by splitting the transaction into components, the full cost of an activity cannot be readily established, which is of greater concern when the Bank may for example, not be funding some aspect of project expenditure.

163. For CDD projects the CDDO was required to submit a copy of the MOU, DSG minutes, and copy of the Registration certificate and micro-project proposal to the Finance Assistant. The Finance Assistant was to prepare a payment voucher based on the MOU and process the same through the District treasury. A cheque was then to be drawn in favor of the relevant CDC and the voucher entered into the main cashbook. The voucher was then to be keyed into the ledger. On receipt of the cheque the communities often opened a bank account (if not already opened) and deposited the cheque. The CDC was to incur expenditures as per the MOU, community procurement guidelines, make payments and post the same into the cashbook and ledger. On a monthly basis, the CDC committees with the help of the mobile extension team (MET) prepared monthly reports based on the agreed formats and submit the same to the district. The CDC committee maintained originals of expenditure documents and submitted copies of the same to the district office. The district was to file these documents in their own respective CDC files. The original documents retained by the CDC committees were to be subject to audit alongside payment vouchers kept at DCU.

Attempted reconciliation of Garissa district FMR to the vouchers provided

164. Work-papers for Garissa district FMRs were uplifted by INT staff during field work enquiries in early 2010. No explanation was provided as to why these documents were not provided previously when requested in early 2009 and when the actual vouchers were supplied in April/May 2009. The work-papers confirmed that Garissa had operated the ledger system during the relevant periods. When trying to reconcile the work-papers to the actual vouchers provided, issues arose due to the lack of an audit trail, the misfiling of vouchers, missing pages of the ledger printouts, and poor condition of the work-papers themselves (some ledger printouts were illegible due to the poor quality of the ink cartridge used). No electronic version of these records was provided despite being requested.

165. The Garissa FMR for FY06/07 indicated expenditure of Ksh7.1m on training expenses of which Ksh7.06m was funded by IDA. Two lever arch files (5A and 5B) were provided containing 43 and 40 vouchers each, to support this expenditure funded by IDA. The total value of the vouchers indicated on the summary schedules were Ksh3,385,760.02 and Ksh2,626,137.21 respectively. After removing transposition errors and adding omitted vouchers and removing missing vouchers, the actual value of the vouchers received for each folder was Ksh3,237,408.20 and Ksh2,626,137.21 respectively (there were no errors on the summary sheet for folder 5B). The total value of vouchers reviewed for training for Garissa District for FY06/07 was therefore Ksh5,863,545.41. There was thus a shortfall in vouchers provided of Ksh1,196,952.89 compared to the reported FMR amount of Ksh7.06 million. Within the supporting

documents for the FMRs for Garissa district, ledger printouts of the coded vouchers for each account were supplied under the audit. The ledger printout for the March 2007 FMR quarter work-papers omitted page 1 of the printout which would have contained the references to the vouchers relied upon, but December and June quarters were provided (no expenditure on training was incurred in September quarter), which resulted in INT not being able to complete the reconciliation to identify which transaction's payment vouchers had not being supplied to INT.

166. Likewise the FMR workpapers for Garissa for FY06/07 indicated expenditure of Ksh7,542,887.65 on civil works funded by IDA, and expenditure of Ksh838,884.55 funded by GOK. Two lever arch files(1A and 1B), each containing 54 vouchers, were supplied to support the expenditure funded by IDA. The total value of the vouchers were Ksh1,061,486.70 and Ksh5,426,082.90 respectively, Ksh6,487,569.60 in total. Thus there was a shortfall in the value of the vouchers provided of Ksh1,055,318.05 compared to the reported FMR. Within the supporting documents for the FMRs for Garissa district, ledger printouts of the coded vouchers for each account were supplied. The ledger printout supporting the FMR quarter work-papers were available (no expenditure on civil works was incurred in September quarter) which resulted in INT not being able to complete the reconciliation to identify which transaction's payment vouchers had not being supplied to INT.

167. Based on the results of the attempted reconciliation of the FMRs to the underlying vouchers, further work was done to assess whether the payments from the bank records (bank statements and cashbook) could be reconciled to either the FMRs and/or the vouchers (see bank and cash section of this report). This was necessary because the cashbook references on the vouchers were not captured on the ledger and therefore the audit trail between the ledger and the payment vouchers was broken. To perform this work INT sought, independently of the project, copies of bank statements and cleared cheques to assist in the reconciliation.

168. The mere fact that insufficient vouchers were provided to INT compared to the expenditure claimed by the project as detailed in the FMRs, across all the districts sampled, points to a systemic weakness in the financial management and accounting systems. The value of the 'missing' or unsubstantiated vouchers was also a concern as it amounted to a significant portion of the expenditure claimed to have been incurred and resulted in subsequent withdrawals approved by IDA.

169. The issues identified in this section indicate that there was a disconnect between the FMRs and the underlying vouchers for both FY06/07 and FY07/08.

VAT issues and the Kenya Revenue Authority

170. Under Bank principles for IDA funding it is normally the borrower's responsibility for any indirect tax liabilities imposed on a projects expenditures. Borrowers normally

implement appropriate legislation to exempt such projects from any liability or within the project itself a counterpart funding component will exist to meet these obligations. For FY07 and FY08 ALRMP II was exempt from VAT liability with the exception of fuel and oils in accordance with The Value Added Tax (Remission) (Official Aid Funded Projects) Order 2003 effective 13 June, 2003 (section 4(a) of the order dated 12 June 2003). In essence this meant that the project was not subject to VAT on its purchases and based on the design, any tax liability that did arise, was counterpart funded.

171. It appears that the project was required to obtain invoices exempt from VAT from suppliers where an exemption arrangement between the project and supplier had been approved by the KRA in advance. It appears some exemptions were sought and applied retrospectively.

172. If there was no advanced agreement approved by the KRA, a supplier was obliged to issue an invoice with VAT to the project. If ALRMP II received a VAT inclusive invoice from a supplier because no exemption had been received in advance from KRA, ALRMP II was liable to pay this VAT but under the project documents and loan agreement, any VAT payments would be funded from counterpart (GOK) funds. This means that any VAT payment (or element thereof) produced in support of expenditure incurred by ALRMP II would be ineligible expenditure from the Bank's perspective.

173. Under GOK regulations the project was defined as a collection agent for GOK and KRA for VAT purposes, and therefore when the project received an invoice which included VAT, it was entitled to make a payment net of VAT to the supplier but was required to provide the supplier with a VAT withholding certificate.

174. The Project was then required to report the VAT withheld in a weekly return filed with KRA (the VAT Return), and pay the VAT amount to the KRA. While weekly returns were filed by headquarters, no records from the district offices sampled indicated that they completed weekly returns, however, in some districts cheques were drawn out to the KRA or the 'Commissioner of VAT' which appears to have represented this liability in respect of some transactions. No districts supplied copies of any VAT withholding certificates which were an indicator that they were not issued.

175. It is unclear whether a single cheque was prepared weekly to accompany the VAT Return or whether individual cheques were prepared for each VAT amount set out on the VAT Return. The VAT Returns were prepared and filed on behalf of headquarters.

176. Irregularities over the handling of the cheques addressed to the Commissioner of VAT were observed (refer to the cash and bank section). In some instances these cheques were cashed in the districts, and records provided by KRA confirm that the same amounts were never received.

177. The records provided by KRA were problematic in themselves as they appear to be copies of documents previously supplied to INT by headquarters as compared to being

original vouchers received by KRA. The fact the documents did not cover the entire periods of FY07 and FY08 was also an indicator that the KRA has possibly failed to produce all the records pertaining to this project. The KRA did not provide any documents relating to returns or receipts from any districts.

178. No withholding tax certificates have been produced by headquarters or district offices sampled, or by suppliers contacted as part of the field work.

179. INT noted that under The Value Added Tax Act, Part VII 'Remission, rebate and Refund', section 23(3) and because the project was initially under the Minister for Special Programmes under the Office of the President, ALRMP II had the mandate to conduct the emergency relief as conceived in the component of the project relating to drought contingency relief. It is unclear whether the mandate or tax status of some or all expenditures were impacted by the subsequent transfer of the project to the Ministry of State for the Development of Northern Kenya and Other Arid Lands residing under the Office of the Prime Minister.

The risk of 'double dipping' or use of vouchers for multiple projects by the PIU

180. ALRMP II's PIU has also acted as the primary recipient for other non-Bank projects during the period audited (FY06/07 and FY07/08). For example, INT was aware that during FY06/07 and FY07/08 the Drought Management Initiative (European Union)(DMI) provided funding via the Bank. Within the Government estimates, this funding was budgeted for separately for the Ministry and ALRMP II's PIU.

181. During the audit it was problematic at the voucher level to identify whether the expenditure was to be incurred and funded by IDA, DMI or some other donor. This issue arose when the underlying invoice or payment request was not addressed to the project, but was, for example, addressed to the DMO.

182. A significant component of the ALRMP II project also related to drought management and included activities such as the early warning data collection process and the management of the drought contingency fund. An overlap of activities and components therefore may have existed between expenditures incurred for ALRMP II, DMI and possibly other donors such as Oxfam (this was an allegation which INT received). Some of the funding from these donors was channeled via the Bank, but during the course of the audit, INT became aware that funds were being deposited directly to the bank accounts of headquarters and even some districts.

183. The format of the FMRs does not allow for revenue or expenditure to be accounted for 'other donors' with only funding by GOK and IDA captured. This suggests all expenditures for other donors has not been captured at all in FY07 and FY08 annual financial statements, given the FMRs formed the basis for these reports.

184. Risks arise when expenditure by a project implementation unit could relate to more than one project it manages and where the expense is not readily identifiable to a project or is of a more general nature, such as the purchase of fuel. That is, the expenditure may be claimed against the wrong project, or fraud could occur if the expenditure was claimed against more than one project.

185. As reported at page 101 in the recently released 'Report of the Controller and Auditor General on the Appropriation Accounts Other Public Accounts and the Accounts of the Funds of the Republic of Kenya for the Year Ended 30 June, 2009' evidence of double dipping was observed in relation to a component of the ALRMP II in the Transmara in the building of a water pan. The Transmara Constituency Development Fund (CDF) (a GOK funded national CDD type project) allegedly constructed a water pan at Elenkasoruai for *"an amount of Kshs.2,000,000… …however, audit of records maintained at the District Treasury in respect of the Water Pan revealed that, the project was one and same as that which had been undertaken by the Arid Lands Development Department under Ministry of State for Development of Northern Kenya and Other Arid Lands in 2007/2008, at a cost of Kshs.2,275,863… …the project was referred to as Emarti Water Dam under the Arid Lands Development Department"*.

186. In this instance, the payments disbursed by the CDF were dubious; however there is no reason why the roles between the CDF and ALRMP II could not be reversed.

187. There are also issues where a project is multi-sector such as ALRMP II, and where there are sector specific projects also operating in the country. In this instance as an example, INT was informed that there was no liaison between the KESSP task team and the ALRMP II task team about community interventions relating to education. A number of transactions relating to purported payments for Mobile School Allowances in FY07/08 by ALRMP II have been flagged by INT as suspected fraudulent expenditure because it was confirmed to INT that KESSP met those expenditures in FY07/08.

Government Response

188. After formally receiving the ALRMP II Redacted Report (the Redacted Report) on April 14, 2011, and following a May 13, 2011 request from GOK for a three-week extension of the review period and subsequent discussions between representatives of GOK and INT (including the discussions held with (i) the World Bank's Vice Presidents for the Africa Region and INT during their June 13-14 visit to Kenya, and INT's senior forensic accountant during his June 20-23 visit to Kenya), GOK sent its comments to INT on the Redacted Report on June 23, 2011(set forth in the Annex to this report). The main GOK comments are:

1. The perception that the report sets forth preliminary findings;

2. The failure by INT to provide supporting schedules and documents referred to in the report, including a Supplementary Report;

3. Possible misunderstandings by INT of GOK policy;

4. Failure to discuss conclusions with the line ministry (Ministry of Northern Kenya and Other Arid Lands) before reporting these conclusions; and

5. The need to perform a further review of the entire project using INT's findings as a roadmap.

189. INT appreciates the comments of the government and offers the following observations in response:

1. ***Preliminary nature of the report:*** INT would like to confirm that the findings in the Report are only preliminary to the extent that an appropriate enforcement agency needs to complete the relevant enquiries to determine whether sufficient evidence suggests that fraud occurred. INT's findings are not provisional and in INT's view the transactions identified as SFE contain sufficient indicia of fraud to enable a formal referral to be made.

2. ***Sharing of relevant information:*** To date, INT has shared the following additional information with GOK:

   - On 20 June, 2011, INT supplied to IAD detailed schedules of the 3,257 'questionable' transactions;
   - On 20 June and 22 June, 2011, INT supplied IAD with electronic images of all documents supplied to INT by the project; and
   - On 21 June, 2011, INT supplied ALRMP's project office with copies of the scanned images (with the exception of images of documents received from Samburu, which INT shared with IAD on 22 June, 2011, and IAD undertook to forward a copy of the said images to ALRMP's project office).

   In addition, to avoid any confusion, references to documents that do not form part of this Redacted Report, including Annexes or a Supplementary Report on 'Other Issues', have been removed.

3. ***Understanding the GOK policy:*** INT took a number of proactive steps and actions during the course of its investigation to confirm its understanding and interpretation of Government of Kenya (GOK) regulations and policies in order to have a clear understanding of local regulations or policies that were applied to the administration of the project. Such steps included the use of Kenyan certified Chartered Accountants with significant experience, reliance on local World Bank FM Specialist advice, INT's own research of GOK regulations and obtaining information from project staff, suppliers and Bank TTL staff to confirm project practices.

4. ***Prior discussions:*** INT did discuss its preliminary findings with ALRMP project staff during the course of the audit. As set out in the Report, INT conducted interviews and obtained documentary evidence before forming views in regard to the transactions it reviewed. INT also gave DMOs from each of the districts sampled an opportunity to respond and provide further explanations for the transactions (see para.39 above under the methodology section). DMO responses were taken into account when finalizing the categorization of the transactions as questionable and SFE.

5. ***Follow-up work by the GOK:***

   - Consistent with the recent joint press release made by the Bank and GOK, further work needs to be done on assessing the amount of ineligible expenditures, lessons learned, and whether further audit work is required within the ALRMP II project itself (either within the 7 districts sampled by INT and or within the other 21 districts). INT is aware that recent complaints have been received in respect of other districts which also need to be assessed, but, as stated above, INT does not consider its findings to be provisional, and has satisfied itself that the onus should be placed back on project officials to respond to these issues in accordance with Kenyan law.
   - The GOK will recall the dangers of attempting a validation exercise in both the WKCDD forensic audit and KESSP In-Depth Review Preliminary Findings where allegations relating to the manipulation of original evidence occurred. INT believes that the appropriate body to consider or assess the SFE transactions is KACC, given its enforcement powers. INT will be happy to collaborate with KACC as appropriate in the context of this work, consistent with the understandings it has with prosecuting authorities in Kenya.
   - It is also INT's view that IAD has the capacity to perform an In-Depth Review, with support from the Bank's FM team and other expertise, to review the questionable expenditures for ineligibility, increasing the scope and number of districts if necessary. INT has provided specific comments on the terms of reference for such work on 23 June, 2011, which it trusts will be taken into account. For the above reasons INT intends to make its referral to KACC on the SFE transactions.

190. INT looks forward to supporting the work of the joint technical team referred to in the government's response as well as the government's efforts to tackle systemic challenges in project design and execution.

REPUBLIC OF KENYA
OFFICE OF THE DEPUTY PRIME MINISTER AND MINISTRY OF FINANCE

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THE TREASURY
P O Box 30007-00100
NAIROBI

Ref. No. EA/FA 62/335/01 'G' 23rd June 2011

Mr. Johannes Zutt
Country Director
World Bank – Kenya Country Office
Upper Hill
NAIROBI

Dear Mr. Zutt,

RE: REDACTED INT FORENSIC AUDIT REPORT REGARDING ARID LANDS RESOURCE MANAGEMENT PROJECT II

1. Thank you for your letter dated 15th April 2011, forwarding the redacted INT forensic audit report into allegations of fraud and corruption under the second Arid Lands Resource Management Project (ALRMP2) for our review and comment. We wish to thank the World Bank Group, and particularly Integrity Vice Presidency (INT), for the work that is reflected in that report and also for sharing the preliminary findings that the report contains.

2. In consultation with the Ministry of State for Development of Northern Kenya and Other Arid Lands, which is the line ministry that had responsibility for implementing ALRMP2, we have undertaken an initial review of the draft INT report. Consequently, we have outlined several administrative and further audit steps, in light of the report's preliminary findings. In the course of this review, we have noted that the report, as provided to us, does not appear to be complete.

3. In our view, the report appears to lack some annexes that are referenced in the body of the report, and therefore the detail and the evidence needed for the Government to effectively conduct its own investigation on the basis of INT's preliminary findings. We also note that, in some cases, INT's preliminary findings are based on misunderstandings of government policy, are not sufficiently supported, or may have been significantly altered. We feel that the INT should have discussed the findings with Government officials in the project or the relevant line

ministry before reaching the conclusions reported. (Attached to this letter is a short note of some of our initial questions and impressions regarding the INT report).

4. In view of the above, we would like to recommend the following:

(i) First, to enable us to provide a comprehensive response to the INT report, we request the Bank to provide us with the "Supplementary Report – Other Issues" referred to in the main report, as well as detailed annexes on individual transactions. (A request to this effect was also sent on June 3, 2011).

(ii) Second, given these information gaps as well as some possible misunderstandings in the report, we wish to set up a joint technical team with the Bank (including INT) to review the INT report thoroughly as agreed with both Ms Obiageli Ezekwesili, Vice-President, African Region, and Mr. Leonard McCarthy, Vice-President, Institutional Integrity (INT) during their recent visit to Nairobi. The team will, among others, conduct a risk-based in-depth review of the project's financial management, using the INT report as a road map and focusing on the areas of highest risk. This team would also aim to understand any implications that these findings may have for possible future work in Kenya's arid and semi-arid lands. We hope that the report of the joint technical team, which will be led by the Government's Internal Audit Department, will be completed by the **15th of August, 2011.**

(iii) Third, in light of the need for the technical team to complete this work, we wish to request the Bank to provide a further extension for the submission of the Government's comments on the INT report to the **31st of August, 2011** or two months after the technical team completes its work (whichever is later). This extension would enable us to finalize our internal consultations.

(iv) Fourth, we request the Bank not to publicize the preliminary INT report at this time until the joint technical team completes its work and shares it with the Government and the Bank. This is because, it could well be that, some of the conclusions the technical team might come up with may require INT to make revisions in its original report, which would enhance its accuracy and credibility.

5. Let me at this point express our sincere gratitude to the Bank for the support we have received in building the forensic audit capacity of our

Internal Audit Department (IAD). It is through this support that the Treasury internal audit staff have been able to undertake various forensic audits that are of high standards. A good example is the audit on KESSP programme. We are, therefore, confident that the IAD staff will add value to this exercise.

6. We wish to assure you that, as agreed with your Vice-Presidents, if further work of the joint technical team finds that some individuals have engaged in fraud or corruption, the Government will refer any such allegations to the Kenya Anti-Corruption Commission (KACC) for further investigation, and possible prosecution. Moreover, the Government will continue to work with INT and the Bank, to identify systemic challenges in project design and execution, within both the Government of Kenya and the Bank, and devise robust methods to address them, drawing on best practices in Kenya and abroad.

7. In conclusion, I wish to reiterate strongly the Government's commitment to fighting corruption and the mismanagement of public resources. The Treasury in particular has made considerable investments to establish the necessary institutional, procedural and legislative mechanisms that will support the transparency and efficiency objectives we seek in public financial management. We take this opportunity to affirm that we will not condone any incidence of graft or misappropriation of funds, and where clear violations of financial procedure are discernible we will not delay implementing appropriate disciplinary procedures, in line with our laws.

Yours Sincerely,

JOSEPH KINYUA, CBS
<u>PERMANENT SECRETARY/TREASURY</u>

Copy to:

Amb. Francis Muthaura, EGH
Permanent Secretary/Secretary to the
Cabinet and Head of Public Service
Harambee House
<u>NAIROBI</u>

Dr. Mohamed Isahakia, CBS
Permanent Secretary
Prime Minister
NAIROBI

Mr. Lawrence Lenayapa, CBS
Permanent Secretary
Ministry of Development of Northern
Kenya & Other Arid Lands
KICC
NAIROBI

Mr. Hassan Taha
Executive Director
African Group I Constituency
World Bank

INITIAL GOVERNMENT OF KENYA REACTIONS TO THE INT REPORT ON THE ARID LANDS RESOURCE MANAGEMENT PROJECT ALRMP II PROJECT

The ALRMP II project was funded by the International Development Association (IDA) for an equivalent of US$124 million. It targeted 28 districts in the arid and semi-arid regions of Kenya. ALRMP II originally consisted of three components - drought monitoring, community driven development (CDD) and support for local development (SLD). (A natural resource management component was added later.) CDD was the largest single activity.

As part of an investigation into allegations of fraud and corruption in ALRMPII, the World Bank's Integrity Vice Presidency (INT) conducted a forensic audit, which analyzed approximately 28,000 transactions over the audit period FY06/07 and FY07/08.

Main issues in the INT Redacted Report:

a) The report identifies suspected fraudulent expenditures (SFE) of Kshs. 362 million. It finds that fraudulent behavior exhibited in the identified transactions was broadly consistent across all districts and in headquarters, and were in multiple categories of expenditures. The report notes the difficulty in delineating transactions by category of expenditure for headquarters because some SFE exhibited multiple risks and because of inconsistent categorization.

b) Key areas where fraudulent expenditures are suspected include: (i) at the community level, income generating activities (matching grants), restocking activities, and infrastructure, including buildings that were never certified and/or used; (ii) under the drought management component, allowances, training, and data analysis; (iii) questionable payroll transactions for FY2007/8, with the main issues identified being incorrect classification of allowances and backdated salary adjustments (no payroll questions for raised for FY2006/7); (iv) manipulation of bank/cash, including under-reporting of bank/cash balances (INT believes that there is a motive to under-report cash/bank balances because unutilized funds have to be repaid to exchequer).

c) Although the audit does not prove embezzlement, the redacted report finds that opportunities for embezzlement existed, especially through the use of imprest accounts and encashing of cheques payable to suppliers and the Commissioner of VAT.

d) There is a clear disconnect between the audited vouchers and the financial monitoring report (FMR) expenditures reported. (FMRs are the basis of withdrawal of funds from the donor.) Insufficient vouchers were provided to substantiate the expenditures reported in the FMRs, and the districts did not maintain sufficient work papers to reconcile any differences arising.

e) The audit also found that non-current assets were at risk due to inadequacies in the financial and accounting systems. The audit could not verify whether fixed assets (cars/computers) were properly used for the project. The report also finds that there were no mechanisms to ensure that, if project assets were disposed of, the proceeds would revert either to the project or to GoK; nor to ensure that on closure of the project, assets are transferred to another project or to the GoK in accordance with the requirements of the General Conditions of the Development Credit Agreement (DCA).

f) The audit also identifies that GoK financial regulations were intermittently applied.

GoK response to the issues raised;

1. The GoK appreciates the initiative behind the INT report on ALRMP II, outlining a systemic series of cases of poor record keeping, non-adherence to guidelines and regulation, non-response to audit queries, and also cases of suspected fraudulent expenditures.

2. INT has not provided other reports mentioned in the main report, such as the "Supplementary Report – Other Issues" referred to in the redacted report as well as annexes detailing INT's findings by transactions categorized by district, fiscal year and category. These documents form the bedrock of the redacted report.

3. The ALRMP II was designed around a community driven development (CDD) model, which poses considerable risk with regards to strict adherence to public financial management guidelines.

4. The INT methodology sampled a wide array of <u>relatively small-denomination transactions.</u>

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5. Expenditures were deemed questionable whether the ineligible portion of the expenditures was 1% or 100%.

6. Based on the draft report, it appears that INT may be unfamiliar with some government financial processes, especially as regards remission of VAT at district level.

7. The counterpart funding category structure was complicated, making the monitoring of implementation and expenditure apportioning difficult.

8. Filing of expenditures was not categorized correctly, making audit difficult.

9. Expenditures were categorized as ineligible by the simple fact of lack of documentation – and thereby suspected as fraudulent.

10. Some expenditures were deemed questionable simply because AIE's were issued and remitted, and activities undertaken in the 4th quarter of a financial year.

11. Use of cash cheques was queried.

12. The GoK believes that all documents requested were handed over to INT without delay. Where it was felt that provided documentation was not adequate, further requests could have been made, and the GoK was prepared to make the necessary submissions as stipulated in DCA. In fact, in response to INT's investigation, the GoK made a large volume of documents available to INT, including some original documents (such as vehicle log books) and a number of those original documents are still in the possession of INT.

13. The INT report infers that the potential for double-dipping was plausible during implementation of the project, despite GoK's clarification that respective donor-funded projects were administered separately and also audited separately.

14. INT alleged fraud on the basis that staff posted from headquarters to semi-arid areas continue to earn the same salary.

15. INT inferred that employment under the program was laced with nepotism, favouritism and ethnic inclination, based on a cursory review and juxtaposing of similarities in names of payroll data to well-known political and administrative leaders.

The GoK believes that the allegations in the draft report need to be carefully reviewed and investigated. Clearly, the lack of proper accounting records and poor filing according to the expected categories may have contributed to the report's findings that fraud and/or corruption may have taken place. In some cases, INT's preliminary findings may be based on an inadequate understanding of government policy, or may not be sufficiently supported, but it is difficult for the GoK to assess this without access to the report's annexes. A follow-up joint review, and further consultation with officials in the project and relevant line ministries, may lead to significant revision of the draft report findings.

GoK mitigation

The following are the immediate steps being undertaken to resolve the concerns raised in the INT report on ALRMP II.

1. **Investigation, Prosecution and Restitution**

The GoK will conduct a risk-based in-depth review of the project's financial management, using the INT report as a road map and focusing on the areas of highest risk. To this end, the GoK will constitute a joint technical team with the World Bank and INT to conduct the requisite review. The report of the joint technical team, which will be led by the GoK's Internal Audit Department, will be completed by the 15th of July, 2011.

The GoK commits to facilitating further investigation and prosecution of suspected cases of corruption, and contravention of the Anti Corruption and Economic Crimes Act as well as the Public Officers Ethics Act, through the Kenya Anti Corruption Commission (KACC) in collaboration with Kenya Police, and the responsible Ministry(s) implementing the ALRMP II project under reference.

Capacity building and Systems Enhancement

i. ***IFMIS roll out to all ministries and county governments***

The initial roll-out of IFMIS to 10 pilot ministries is expected to be completed as of June 2011, and the requisite procurement of hardware, software and capacity elements for the roll-out are currently on course. Consequently, all government financial transactions will be automated. Workflows that will provide an online based authorization framework will be integrated. Checks and balances will be inbuilt. The re-engineered IFMIS will also incorporate a Fixed Assets module.

ii. Stricter Oversight Controls

a. The office of the Permanent Secretary/Treasury will immediately communicate to all Accounting Officers its dissatisfaction with the enforcement of the Government Financial Management Act.

b. The GoK shall consider the redesign or development of new controls to address the identified risks viz a viz poor record management.

iii. Capacity Building

The Accountant General's Department within the Ministry of Finance, continues to provide the requisite capacity enhancement training to its officers both at national and decentralized levels.

iv. Review of programme designs

In light of the risk potential that CDD model projects portend for efficient and effective financial management, GoK shall initiate a review of the programme design, implementation and reporting framework for future GoK as well as joint GoK/donor funded projects. The GoK will further undertake a review and re-design of the FMR, based on the concerns raised.

v. Development of an Asset Management Framework

The GoK will fast track the development of an Asset Management Framework in line with its objectives, as stipulated in the Governance Strategy and Action Plan 2010.

vi. Intensified audits

IAD will undertake intensified audits of preliminary investigation of claims alleged.