



Department of Institutional Integrity
The World Bank

Government of Kenya

Kenya Detailed Implementation Review Report (As Supplemented)

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ABBREVIATIONS AND ACRONYMS

BEC	Bid Evaluation Committee
BER	Bid Evaluation Report
BoQ	Bill of Quantities
CACC	Constituency AIDS Control Council
CBO	Community Based Organization
CTDA	Canadian International Development Agency
CRBC	China Road and Bridge Corp.
D&T	Deloitte and Touche, L.T.P
DARE	Kenya Decentralized Reproductive Health and HIV/AIDS Project
DDC	Department of Development Cooperation (The Netherlands)
DEO	District Education Offices
DfID	Department for International Development (United Kingdom)
DIR	Detailed Implementation Review
DIRDB	Detailed Implementation Review Database
EMIS	Education Management Information Systems
EMU	Efficiency Monitoring Unit
FBO	Faith-Based Organization
FMA	Financial Management Agent
FMR	Financial Management Report
FPESP	Free Primary Support Project
GoK	Government of Kenya
GTZ	Geellschaft für Technische Zusammenarbeit
ICB	International Competitive Bidding
IDA	International Development Association
INT	Department of Institutional Integrity
KAA	Kenya Aviation Authority
KCAA	Kenya Civil Aviation Authority
KESSP	Kenya Education Sector Support Program
KHADREI	Kenya HIV/AIDS Disaster Response Project
KES	Kenya Shilling
KIE	Kenya Institute for Education
KUTIP	Kenya Urban Transport Infrastructure Project
MoE	Ministry of Education
MoH	Ministry of Health
MoRPW	Ministry of Roads and Public Works
MoTC	Ministry of Transport Communication
MP	Member of Parliament
NACC	National AIDS Control Council

NCTIP	Northern Corridor Transport Improvement Project
NGO	Non-Governmental Organization
NOL	No-Objection Letter
OPCRP	Procurement Policy and Services Group
PIU	Project Implementation Unit
PMR	Project Management Report
PwC	PricewaterhouseCoopers
RFP	Request for Proposal
SIMBA	School Instructional Materials Bank Account
SIMPC	School Instructional Materials Procurement Committee
SIMU	School Instructional Materials Unit at the MoE
SOE	Statement of Expenditure
STI	Sexually Transmitted Infections Project
ToR	Term of Reference
TOWA	Total War on Aids Project
TTL	Task Team Leader
WBCN	World Bank Contact Number
WHO	World Health Organization

CURRENCY EQUIVALENTS

Currency Unit	=	Kenya Shilling (KES)
US\$1	=	70 KES (as of January, 2006)

EXECUTIVE SUMMARY

This Report presents the World Bank Group Department of Institutional Integrity's (INT) findings resulting from a Detailed Implementation Review (DIR) of four projects in the World Bank's Kenya portfolio. INT undertook this DIR at the request of the Government of Kenya (GoK) due to the high level of fraud and corruption uncovered by INT in an earlier investigation concerning a specific Bank-financed urban transport project that was ultimately suspended,¹ and as found in three health projects from a forensic audit conducted by Deloitte & Touche LLP (D&T).² Moreover, there have been previous concerns about theft or misuse of funds, insufficient accountability, and a lack of successful investigations or prosecutions by Kenyan agencies.

A DIR is a proactive diagnostic tool that examines Bank-financed projects in a specific country where initial concerns of fraud or corruption have previously been raised. The objective of a DIR is to determine a project's susceptibility and possible exposure to fraud, corruption and harmful mismanagement within the project's procurement and contract implementation activities. The DIR identifies the types, diversity and characteristics of potential irregularities as well as specific contracts susceptible to irregularities, so that actions may be taken to mitigate such activities in those and other projects. In addition, the DIR assesses a project's vulnerability, if any, to fraud and corruption in the execution of its financial management and contracting processes.

A DIR is not an in-depth investigation for occurrences of fraud and corruption in the traditional sense. However, oftentimes the DIR will uncover credible and serious allegations of fraud and corruption that are referred to INT and/or the borrower country for a follow-on investigation. In addition, the DIR process itself will often uncover actual instances of fraud and corruption. Actual findings of fraud and corruption, whether from the DIR or follow-on investigations, in contracts identified by the OIR as "at risk" go to confirm and validate the DIR's rigorous methodology and assessment of a project's overall fraud risk.

It is hoped that the findings of this Report will stimulate the Bank and GoK to implement measures that will mitigate further risks and exposure, as well as to improve future project design, implementation, supervision, and monitoring.

KENYA DIR

In January 2006, INT commenced a DIR in Kenya with the objective of: (i) determining to what extent fraud and corruption may have impacted Bank-financed activities in Kenya; (ii) identifying any vulnerability in design, implementation, and supervision of projects; and (iii)

¹ The Kenya Urban Transport Infrastructure Project (KUTIP) investigation by INT and follow-on forensic audit by D&T substantiated fraud and corruption by the project director, project consultants and Bank staff. Following criminal referrals by INT, Bank staff were convicted in the United States and two consultants were convicted in Sweden. No convictions have yet occurred in Kenya and only one trial is pending.

² Kenya HIV/AIDS Disaster Response Project (KHADREP), Decentralized HIV/AIDS and Reproductive Health Project (DARH); and Public Sector Management Technical Assistance Project (PSM-TAP). The D&T report did not review the Free Primary Education Support Project (FPESP).

recommending mitigating measures to be implemented by the Bank and the GoK in ongoing or future Bank-financed activities.

Four Bank-financed projects were selected for review:

- I. Kenya HIV-AIDS Disaster Response Project (KHADREP) IDA 34150;
- II. Kenya Decentralized Reproductive Health and HIV/AIDS Project (DARE) IDA 34400;
- III. Northern Corridor Transport Improvement Project (NCTIP) IDA 39300;
- IV. Free Primary Education Support Project (FPESP) CR H0500.

Three of the four projects selected—KHADREP, DARE and NCTIP—had findings of wrongdoing in previous project reviews, which was their primary criteria for selection. The fourth project—FPESP—was added at the request of Country Management in view of its proposed successor project, the Kenya Education Sector Support Program (KESSP). Therefore, the DIR also included an assessment of the fraud and corruption safeguards introduced in KESSP. Additional criteria used in selecting the projects were that the projects had (i) well-advanced implementation; (ii) upcoming successor projects; and (iii) multiple procurement methodologies including International Competitive Bidding (ICB), National Competitive Bidding (NCB), and shopping procedures.

DIR APPROACH

The value of a broad-based fraud risk assessment is best derived from performing a comprehensive and in-depth review of a project's contracting process. However, the large volume of contracts generally within a Bank-financed project renders a manual review of all individual contracts unrealistic.

The DIR methodology uses computerized data mining of a project's contracting data and a combination of objective and subjective criteria to identify from a project's portfolio of contracts a subset of individual contracts or disbursement activities (i.e., grants) that are at risk of having been mismanaged or corrupted. The DIR's in-depth examination of the contracts or activities "at risk" provides the borrower country critical information as to the types, diversity and characteristics of the irregularities—as well as their proliferation—to which its projects may be subjected. Combined with its review of a project's financial management process and control environment, the DIR provides a valuable assessment of a project's vulnerabilities and exposure to fraud and corruption. This purposeful approach differs from an investigation in the traditional sense and from random-sampling based auditing techniques and should not be similarly interpreted.

To identify the subset of contracts or activities to undergo a detailed manual review, INT collects and inputs into a database (DIRDB) large volumes of detailed and comprehensive data and information pertaining to the procurement and implementation of a project's individual contracts. It analyzes the information using a set of specific broad-based objective and subjective fraud-like criteria, referred to as 'Indicators of Irregularities' (or 'indicators'). An '*indicator*' is any meaningful event, document, object, statement, correlation or observation—both objective and subjective—that creates a *probability* or *likelihood* that an irregularity has occurred. An '*irregularity*'—for purposes of a DIR and as used throughout this Report—is defined as (i) the

misuse of Bank funds or their diversion from their intended purposes, or (ii) improper or unsatisfactory implementation. Contracts exhibiting indicators of irregularities are, in general, more susceptible of being exposed to irregularities than contracts not exhibiting such indicators. See Table 8 for examples of DIR indicators and irregularities utilized by INT during this process. The specific set of indicators used in a DIR is tailored depending on circumstances and characteristics specific to each project and country under review.

INTERPRETATION OF FINDINGS

The number of contracts within a project found to exhibit indicators of irregularities is certainly an important statistic. It can be generally surmised that a high number of various indicators identified in multiple contracts within a Bank-financed project signal possible wide-spread and/or systemic breakdowns and irregularities in contract procurement within the project. More important, however, are the types, diversity and characteristics of the indicators found, rather than just their proliferation, so as to better understand the various types of weaknesses, vulnerabilities and corruption that might be plaguing a project's contracting process on the whole. Armed with such knowledge, appropriate steps may be taken by the borrower country to tighten controls and procedures and mitigate the occurrence of those types of indicators thereby reducing the risk of irregularities on current and future projects.

A DIR's findings should not be misconstrued. It would be wrong to assume that contracts within a project not outwardly exhibiting the specific indicators of irregularities looked for by the DIR are free of any fraud risk or have not been subjected to any irregularities. Just as the presence of indicators does not conclusively demonstrate the presence of fraud, so too the absence of indicators does not conclusively demonstrate the absence of fraud. The contracts may still have been subjected to fraud and corruption, especially in an environment of weak controls and systemic mismanagement. Therefore, additional investigative steps beyond the DIR must be performed before reaching any definitive conclusions on the contracts not selected for manual review.

Finally, a DIR's findings on contracts exhibiting indicators of irregularities in relation to all of the contracts within the Bank-financed project under review as well as an assessment of the project's overall contracting process must be interpreted with appropriate consideration for the project's numerous qualitative factors, which differ significantly across projects, project components, and borrower countries. For these and other reasons, the DIR's statistical results alone are not easily comparable across the individual projects under review. Nor should they be extrapolated as representative of the borrower country's entire loan portfolio or directly compared with the statistical results from DIRs conducted within other borrower countries.

The DIR's general methodology, strengths and limitations and specifics related to the Kenya DIR are described in more depth in the methodology sections of this Report.

FINDINGS

The DIR found that a meaningful number of contracts among those reviewed within three of the four projects—KHADREP, DARE and NCTIP—contained numerous indicators of serious irregularities. More importantly, the DIR found actual occurrences of fraud and corruption consistent with findings of previous forensic audits and examinations of these and other Bank-

financed projects in Kenya. Not surprisingly, the DIR found the financial management and control environment within those three projects to be exceptionally weak and highly vulnerable to fraud and corruption.

On the other hand, the DIR found that the contracting process for FPESP contracts and textbook procurement to be reasonably well-executed, safeguarded and supervised from the perspective of minimizing the potential for fraud and corruption.

These findings continue to portray a consistent message that projects with weak controls, procedures and oversight exhibit more outward indicators of irregularities and have a higher risk of being corrupted.

The specific findings under each project reviewed are as follows:

I. KHADREP

The DIR found a number of strong indicators within the project's contracting for internal procurement and grantmaking activities that were consistent with potential fraud, corruption, and collusion. The review of the National AIDS Control Council's (NACC) internal procurement found indicators of collusive practices, biased bid evaluation and fraud. The Team's financial management review also found severe weaknesses in the NACC's internal control environment, accounting procedures, staff capacity and record keeping. These indicators remained consistent before and after investigations by the GoK and the resulting staff changes in the NACC in 2004.

Table 1. Summary of DIR statistics – KHADREP internal procurement

Total Contracts	Contracts Reviewed	% Reviewed	Contracts	Contracts Reviewed	% Reviewed	Value of Contracts (USD)	Value of Contracts (USD)
384	36	9%	29	80%	80%	\$658,000	\$562,000

*Ten of the 36 contracts selected for review had a noticeable lack of documentation which hampered a more thorough review for indicators of irregularities.

The DIR Team also found strong indicators of irregularities within the small number of KHADREP's grant-financed activities it reviewed. In addition, the DIR identified actual findings of: (i) payments of bribes by grant recipients to public officials; (ii) duplicate, fabricated, or inflated claims by grant recipients; (iii) significant grant funds unaccounted for; (iv) conflicts of interest; and (v) abuse of power by public officials. Furthermore, the Team observed that grant recipients were forced to divert grant funds towards corruption, thus undermining the project's objectives.

Table 2. Summary of DIR statistics – KHAIDREP grant activities

Total Grant Activities	Grant Activities Reviewed	% of Total Activities	Total Activities with Irregularity Indicators	% of Contracts Reviewed	Value of Contracts with Irregularity Indicators (USD)	Value of Contracts with Irregularity Indicators (m USD)
6,036	53	<1%	38	72%	\$2,899,000	\$2,079,000

+ A total of 225 activities of the largest 150 recipients of grant funds were initially slated for review.

However, the number of activities reviewed was significantly hampered due to time, resource and

logistical constraints as well as lack of available documentation and grant recipients for interviews.

II. DARE

Credible information and evidence of widespread corruption was found throughout the project that implicated all levels of the Ministry of Health (MoH). Credible witnesses informed the Team that Ministry officials at all levels were engaging in corruption in virtually every component of the project. This is corroborated by the fact that a high proportion of the 21 contracts reviewed exhibited indicators of irregularities, as shown in Table 3. While the international procurement agent carried out its narrow responsibilities in accordance with Bank guidelines and maintained a well-organized and complete collection of documents, the Team found evidence that MoH officials circumvented the limited oversight of the procurement agent. This was done by: (i) supplying pre-bid information to potential bidders and soliciting kickbacks from winners; and (ii) soliciting further kickbacks throughout the implementation process. Bidders complied with corrupt demands by inflating bid prices and paying bribes. The Team also found evidence that bidders engaged in fraudulent misrepresentation and collusive practices. Credible witnesses also confirmed that under public procurement MoH high level officials steered contracts to specific bidders in exchange for kickbacks.

Table 3. Summary of DIR statistics – DARE

Total Contracts	Contracts Reviewed	% of Total Contracts	Contract with Irregularity Indicators	% of Contracts Reviewed	Value of Contracts with Irregularity Indicators (USD)	Value of Contracts with Irregularity Indicators (m USD)
35	21	60%	13	62%	\$7,300,000	\$5,210,000

III. NCTIP

Multiple indicators of collusion were identified under the project. The DIR identified actual findings of fraud by two companies that submitted protective bids by inflating unit prices in order to permit other companies to win contracts. The DIR also found critical indicators of irregularities in four of the five contracts reviewed. Due to a pending No-Objection Letter (NOL) for four civil works contracts, the Kenya Country Team requested that INT produce an interim report summarizing the DIR's initial findings in relation to NCTIP, which was produced by INT in May 2006. Based on the Interim Report, the NCTIP Task Team Leader (TTL) and the

Kenya Country Management Team entered into a dialogue with INT and reported having conducted additional due diligence.

Table 4. Summary of DIR statistics – NCTIP

Total Contracts	Contracts Reviewed	% of Total Contracts	Contracts with Irregularity Indicators	% of Contracts Reviewed	Value of Contracts Reviewed (in USD) #	Value of Contracts with Irregularity Indicators (in USD) #
13	5	38%	4	80%	\$218 million	\$216 million

Value of contracts is based on bidding prices. Contracts had not been awarded as of date of DIR review.

IV. FPESP

A satisfactory level of accountability from the local communities to the national Ministry contributed to the proper use of funds under FPESP. As shown in Table 5, only a small portion of the eight contracts reviewed that were tendered by the MoE under internal procurement exhibited indicators of minor irregularities, such as improper procurement procedures and conflicts of interest. However, internal procurement comprised a minor portion of the overall project expenditures, since 80% of the project funds were allocated for textbook procurement at the school level. Also, the MOE has taken measures to both identify and correct irregularities, and this approach has clearly benefited the project. Overall, the project appeared to be reasonably safeguarded and supervised.

Table 5. Summary of DIR statistics – FPESP internal procurement

Total Contracts	Contracts Reviewed	% of Total Contracts	Contracts with Irregularity Indicators	% of Contracts Reviewed	Value of Contracts Reviewed (in USD) #	Value of Contracts with Irregularity Indicators (in USD) #
18	8	44%	3	38%	\$527,000	\$257,000

* Three of the eight contracts selected for review had a critical lack of documentation, which hampered a thorough review for indicators of irregularities and reduced the statistical number and percentage of contracts with irregularities.

For textbook procurement, the DIR found that Ministry of Education (MoE) staff was well-trained and motivated, and that the MoE adequately monitored and supervised this project. Hence, textbook procurement at the school level exhibited only minor irregularities that were identified and rectified by the MoE. However, the Team also observed discrepancies in the disbursements of funds from the MoE to the schools, which indicate possible irregularities at the Ministry level.

Table 6. Summary of DIR statistics – FPESP procurement of textbooks

Total Number of Schools	Schools Reviewed	Schools Reviewed with Irregularities
18,100	35	2

*These were actual findings of irregularities rather than only indicators.

Safeguards in the Kenya Education Sector Support Program (KESSP) could be strengthened.
The Team also reviewed the fraud and corruption safeguards built into FPESP's proposed successor project, KESSP. Based upon its findings in FPESP, INT suggests the Bank enters into discussions with the GoK to strengthen some KESSP provisions.

* * *

The Team wishes to thank the Government of Kenya and all the staff at the Ministry of Education, Ministry of Health, Ministry of Transport and Communications and at the National Aids Control Council, who facilitated or contributed to the execution of the DIR.

GENERAL DIR METHODOLOGY

1. ***The DIR mechanism.*** As the Bank has increased its focus on anti-corruption, to better ensure that Bank funds are used for their intended purposes, INT has developed the Detailed Implementation Review (DIR), a proactive diagnostic tool designed to review Bank-financed projects to evaluate their risk of exposure to fraud and corruption and harmful mismanagement of the contracting process.
2. The DIR's methodology is a compilation of widely-accepted practices within the forensic accounting, audit, and investigative disciplines. The DIR is performed by a highly specialized team (DIR Team) of INT investigators and forensic accountants, procurement and financial management specialists, lawyers, engineers, operational staff from a variety of disciplines, Bank staff from the relevant Country Office, as well as implementation specialists.
3. The DIR methodology employs a combination of computerized and manual review and assessment techniques to identify from contract data and information objective and subjective criteria that indicate a risk of possible mismanagement, fraud or corruption.
4. INT has conducted four such reviews since 2001 and has updated its methodology with lessons learned from each review.
5. ***Review objectives.*** The DIR is conducted on selected Bank-financed projects within a borrower country. Generally, to be considered for selection, the projects must have: (i) well-advanced implementation; (ii) upcoming successor projects; and (iii) multiple procurement methodologies including International Competitive Bidding (ICB), National Competitive Bidding (NCB), and shopping procedures. Projects with findings of wrongdoing in previous project reviews may also be strongly considered. These criteria may be adjusted depending on the conditions and needs of the borrower country. Also, other projects not adhering to the criteria may be included as part of the review at the request of the Country Office or borrower country.
6. The objective of the DIR is to identify a subset of contracts, or disbursement activities (i.e., grants), within the selected Bank-financed projects that exhibit specific indications, or 'red flags', that in INT's opinion render them susceptible to irregularities, as defined below. Contracts exhibiting indicators of irregularities experience, in general, a higher exposure to fraud and corruption than contracts not exhibiting such indicators.
 - (a) ***Indicators of irregularities*** are any event, document, object, statement, correlation or observation that creates a meaningful *probability* or *likelihood* that an irregularity has occurred.³ The DIR's methodology examines contracts for a set of specific indicators, which were drawn from INT experience, team member experiences, the investigation

³ The threshold for sufficiency may be met either through a single indicator, or through a combination of several indicators, depending upon the seriousness of the indicator(s) found. The Team ceases to search for additional indicators once the threshold of sufficiency has been reached.

industry and professional literature.⁴ The indicators used in the DIR process are consistent with the indicators commonly used by national, state, and local law enforcement, as well as specialized audit agencies and the professional fraud control community in many member countries.⁵ See Table 7 (page 13) and Table 8 (page 14) for examples of objective and subjective indicators considered by INT for its review. The specific set of indicators used in a DIR may differ in number and type, depending on circumstances and characteristics specific to each project and country under review. Indicators suggest different probability levels that an irregularity occurred depending on their nature and the context in which they appear. Furthermore, when indicators corroborate each other, they further augment the probability.

- (b) *Irregularities*, for purposes of a DIR, are defined as any action, behavior, or arrangement that causes, or creates the risk of causing: (i) misuse of Bank funds or their diversion from their intended purposes or (ii) deficient project implementation. The DIR employs the term "irregularity," to encompass three problem areas—corrupt and fraudulent practices,⁶ non-compliance,⁷ and implementation deficiencies⁸—all of which put Bank projects at risk.⁹ Since the DIR ultimately seeks to better protect Bank-financed projects from diversion or misuse of funds and deficient implementation, it seeks to maximize the scope of possible conclusions that it identifies as problematic. See Table 8 for examples of irregularities.

⁴ Unlike a traditional investigation, it is not the objective of the DIR to uncover actual findings of irregularities. However, often the DIR process does uncover actual irregularities and classifies that evidence as indicators for purposes of summarizing the DIR's findings.

⁵ See, e.g., Bhutan's Royal Audit Authority, "RAA Papers" "Paper on Nature and magnitude of corruption" (noting that the "International Organization of Supreme Audit Institutions (INTOSAI) and other Auditing Bodies generally agree that one or more of the following factors provide a favorable environment for perpetrating fraud and corruption")

<http://www.bhutanaudit.gov.bt/contents/papers/pnmc.php#detection%20of%20Fraud%20and%20Corruption>; <http://www.srac.org.za/Anti-corruption%20booklet.pdf>; "Preventing and Detecting Bid Rigging, Price Fixing, and Market Allocation in Post-Disaster Rebuilding Projects: An Antitrust Primer for Agents and Procurement Officials" U.S. Department of Justice. Available at: http://www.usdoj.gov/atr/public/guidelines/disaster_primer.htm; <http://www.wmkkramer.com/lbasics.html>.

⁶ Corrupt and fraudulent practices are defined by the current World Bank Anticorruption Guidelines.

⁷ Non-compliance refers more broadly to the failure to abide by (i) any Bank policies, controls, requirements, or rules, or (ii) the purposes underlying these policies, requirements, or rules.

⁸ Implementation deficiencies refer to any improper or unsatisfactory project implementation as compared to the implementation requested.

⁹ Irregularities include, but are not limited to, the definitions of corrupt, fraudulent, collusive, coercive practices contained in the Guidelines, Procurement under IBRD Loans and IDA Credits, May 2004, Section 1.14 (a) (i)-(iv). Whereas the definitions in the Procurement Guidelines apply to the investigation and sanctions process, the DIR as a proactive diagnostic tool to identify risks in Bank projects, seeks to detect a broader spectrum of anomalies. Irregularity indicators identified in a DIR may result in subsequent investigations, but they primarily serve to provide the Bank with information and recommendations designed to reduce the risks in ongoing and future projects.

7. A DIR also provides a review of the project's financial management processes and control environment. The Team will examine specific transactions, interview management and review various financial and audit reports, among other things. In addition, a DIR undertakes a review of contract implementation, including site visits and interviews of stakeholders and beneficiaries.

8. These reviews combined with the analysis for indicators provide a general assessment of the overall effectiveness of the project's contracting process as well as its vulnerabilities to irregularities. It also identifies contracts that may warrant further follow-up investigation by the borrower country and/or INT.

9. *Review approach.* Due to the nature of fraud and corruption and the manner in which it is practiced, the contracting process must be manually examined by experienced investigators and specialists—including the manual examination of documents, site visits and conducting interviews—in order to render definitive conclusions about the contract's risk exposure to irregularities. However, the large number of contracts in most Bank-financed projects renders it unfeasible and too costly to conduct a manual review of the contracting process for *each* contract within the project.

10. Therefore, the DIR employs data mining techniques to first identify and isolate a subset of contracts whose known characteristics fit certain objective criteria and fraud-like conditions that render those contracts more susceptible to irregularities. Over a period of several weeks, critical procurement and contracting related data and information from all of the contracts within a project are inputted into a comprehensive database ("DIRDB"). The data is then mined for contracts outwardly exhibiting a specific set of indicators of irregularities. See Table 7 for examples of the objective criteria used in the initial data mining review.

11. Next, the contracting processes for all or a large portion of those individual contracts within the subset of contracts undergo a detailed manual examination by the DIR's multidisciplinary Team of experienced investigators and specialists to confirm the initial indicators and to determine the nature and full extent of the irregularities and vulnerabilities—potential and actual—that may be plaguing the project on the whole.¹⁰ The two-step DIR approach differs from an investigation in the traditional sense and from random-sampling based auditing techniques and should not be similarly interpreted.¹¹

12. *Basis of Findings.* As stated previously, the objective of the DIR is to identify contracts and funding activities that are susceptible to, or have been impacted by, procurement irregularities, namely in the form of fraud, corruption or harmful mismanagement. This is accomplished by identifying which contracts exhibit specific indicators, or 'red flags', obtained from the procurement data or from interviews and site visits and other review activities that render the contracts susceptible to potential irregularities. The DIR also identifies any contracts where *actual findings* of irregularities were discovered as part of the DIR process.

¹⁰ Although INT's goal in a DIR is to manually review all of the contracts identified by the initial review, resource and timing as well as logistical restrictions can limit the number of contracts ultimately reviewed.

¹¹ A DIR is a more efficient and cost-effective method than traditional investigations or random-sampling based auditing techniques of identifying and understanding the broadest measure of the types and characteristics of irregularities.

13. INT reports indicators when the DIR Team determines that, based on the confirmation and type of indicator, it reasonably believes that an irregularity is probable. INT reports its indicators at this threshold of persuasion because it seeks to provide the Bank and other stakeholders with the maximum reliable observations of risks to Bank funds and implementation, so as to facilitate the most appropriate policy, design, and system response. Indicators identified in a DIR may also result in subsequent INT investigations, in which investigators further identify indicators to establish, with reasonable sufficiency (more likely than not),¹² that Bank rules have been violated.

14. *Interpretation of Findings.* It should be noted that the identification of a contract exhibiting strong indicators of irregularities does not signify that the contract—or project itself—has actually been subjected to any irregularities; rather the contract merely possesses an elevated risk or likelihood that irregularities have occurred during the contracting and/or implementation processes. On the other hand, given the manner in which corrupt actors may have concealed their improper acts, the *absence* of any indicators does not imply that a contract or project has not been subjected to an irregularity.

15. Contracts exhibiting indicators of irregularities are, in general, subject to a higher risk of being exposed to irregularities than contracts not exhibiting such indicators.¹³ Therefore, the number of contracts within a project found to exhibit indicators of irregularities is certainly an important statistic. It can be generally surmised that a high number and diversity of indicators identified in multiple contracts signals possible wide-spread and systemic breakdowns and irregularities in contract procurement within a Bank-financed project. More important, however, are the types, diversity and characteristics of indicators found, rather than only their proliferation, so as to better understand the various types of weaknesses, vulnerabilities and corruption that might be plaguing a project's contracting process on the whole. Armed with such knowledge, appropriate steps may then be taken by the borrower country to tighten controls and procedures and mitigate the occurrence of those types of indicators thereby reducing the risk and occurrence of irregularities on future projects.

16. More critically, a DIR's findings should not be misconstrued. It would be wrong to assume that contracts within a project not outwardly exhibiting any of the objective indicators that were part of the data mining detection process—such as objective indicators of collusion (i.e., sequential bid guarantees, pricing patterns)—are not necessarily free of any fraud risk, or have not been subjected to any irregularities. A manual review of these contracts may uncover indicators of fraud not previously detected in the data mining process, such as ghost vendors, fake invoices, over-charging or under-delivery. Therefore, additional investigative steps beyond the DIR must be performed on those contracts before a definitive conclusion can be rendered on whether those contracts actually were at risk or have been impacted by fraud or corruption.

17. More importantly, a DIR's findings on contracts exhibiting indicators of irregularities in relation to all of the contracts within the Bank-financed project under review as well as an assessment of the project's overall contracting process must be interpreted with appropriate

¹² This standard of persuasion is dictated by the World Bank Sanctions Procedures.

consideration for the project's numerous qualitative factors, which differ significantly across projects, project components and borrower countries, including: the project's type of contracts (or disbursement activities); the complexity or simplicity of its contracting process; the number and size of contracts; the proportion of contracts that are ICB, NCB or local shopping; the strength of the project's financial management process and personnel as well as vulnerabilities to fraud and corruption; the quality of its documentation and record-keeping; the degree of direct involvement of senior government officials in the process; the use of any procurement consultants or specialists; and other important considerations.

18. For these and other reasons, the DIR's statistical results alone are not easily comparable across the individual projects under review. Nor should they be extrapolated as representative of the borrower country's entire loan portfolio or directly compared with the statistical results from DIRs conducted within other borrower countries.

Table 7. Examples of objective indicators used in data mining

• Multiple bidders sharing common addresses or phone numbers
• Bid securities issued by same bank, on same date and with sequential numbers, often utilized by different companies bidding for the same contract
• Bid amounts clustered close to cost estimate
• Common names of officers of different companies bidding for the same contract
• Bid Evaluation Committee members having interests in companies bidding
• Patterns of same company(ies) winning bids
• Patterns same company(ies) losing bids
• Patterns of rotation of contract award amongst limited number of companies
• Unexplained variations in cost of same /similar goods amongst contracts awarded in same time period or throughout a certain period of time
• Identical/similar bid prices for same line items
• Companies sharing same bank account number
• Uniformity in bid proposal format
• Bid proposal missing
• Forgeries in bids
• Same mistakes in bid proposals
• Bill of quantities changed by PMU and contractor before contract award
• Different data on bid proposal compared to bid evaluation report
• Bid evaluation report bias
• Bidders representatives names missing in bid evaluation report
• Bidders representatives names the same in different bids
• Bid prices rounded

Table 8. Examples of irregularities and objective and subjective indicators

Examples of Irregularities	Description of Common Indicators
Bid Security Weaknesses	Signs of bid security weakness include: insufficient bid security of a winning bidder; a missing bid security; a bid security that was not on Bank letterhead and/or lacked a serial number; bid securities with sequential serial numbers; and/or false bid securities.
Lack of Competitive Bidding	Lack of competitive bidding is found when the bidding process appears to be manipulated for the purpose of simulating competition. Indicators include similarities in bid proposals such as identical spelling, grammatical, and arithmetic errors, unit prices, and formats.
Inappropriate Bid Evaluation Review	An inappropriate Bid Evaluation Review consists of: favoring a specific bidder; disqualification of bidders without proper justification; evaluation of bidders who should have been disqualified; omission of an arithmetic verification as part of the BER; inconsistencies in the evaluation of similar procurements; and/or discrepancy between an original bid proposal and the one disclosed in the BER.
Poor Document Management	Indicators of poor document management include the absence of procurement and contract documents; bills of quantities (BoQ) or other bid proposal documents; the retention of bids in their entirety; sufficient number of evaluated bid proposals with documentation to conduct a review; records of the number of bid receipts; and/or accounting documents.
Implementation Weaknesses	Implementation weaknesses are indicated by: non-compliance with technical specifications; less work performed than required by the contract without a price reduction; poor workmanship; and/or significant project design changes after the contract has been awarded.
Financial Management Weaknesses	Financial management weaknesses include the failure to pay invoices on a timely basis; lack of management supervision; and authorized payments differ from the contract amount without any justification being provided.
Conflict of interest	Conflict of interest occurs when one person, or close family members, are holding positions or playing roles that impact on how the person conducts himself or herself due to the interests inherent in the roles. Examples include holding positions in multiple companies, competing under the same contract, or project officials influencing the procurement process for the advantage of their own company or that of a close family member.
Protective Bid	Protective bids are bids submitted by one or more bidders, possibly cartel members, who do not intend to win the contract, but rather "protect" the designated winner (and the cartel). To accomplish this, winning bidders submit bids close to the estimated contract value and losing bidders submit considerably higher-priced bids compared to the winning bidder in order to simulate a competitive procurement process.

KENYA DIR METHODOLOGY

19. Kenya's DIR began in January 2006. Details of the two-step contract review process for Kenya's DIR were as follows:

20. *Phase One – Data collection, entry and selection of subset of contracts to review.* The DIR Team, led by INT, with the support of other Bank Units including the Procurement Policy and Services Group (OPCRP) and the Kenya Country Office, met with Ministry officials for each project selected to secure government cooperation while undertaking the review. The Team then obtained comprehensive data and information related to each project's contracts and disbursement activities in order to review that data for objective indicators to identify and isolate the subset of contracts and activities eligible for manual examination. The data collection process took place from January to March 2006.

- (a) Over a ten-week period utilizing six staff, data and information specific to the contracting process for internal or external contract procurement were collected and inputted into INT's DIR database (DIRDB) for subsequent data mining for indicators of irregularities. This consisted of data and information for 384 contracts for KHADREP, 35 for DARE, 13 for NCTIP and 18 for FPESP. In total, the DIRDB contained contracting data and information related to 450 contracts, 1,137 companies and 2,104 individuals associated with contract procurement for the four projects under review.
- (b) In addition to contracts, data and information from pre-existing database sources were collected related to the procurement and disbursement activities for over 6,000 grant activities under KHADREP (as compiled by NACC-FM) and textbook procurement under FPESP for 18,100 schools across Kenya .

21. *Selection of contracts to review.* The procurement-related data within the various databases was mined to identify a subset of contracts and activities that warranted further manual examination by the DIR Team. The criteria and method used to select the subset of activities differed depending on the project and type of contracts or activities.

- (a) *Procurement Contracts.* The DIRDB was mined to determine which of the 450 contracts related to internal or external procurement within the four projects should be selected for review. The DIR Team searched for contracts that exhibited specific objective indicators consistent with potential irregularities, such as deviations from agreed upon procurement procedures, unusual or inconsistent pricing, collusion and conflicts of interest. See Table 7 for a sample list of these indicators. Of the 450 contracts entered into DIRDB for the four projects, 135 contracts exhibited one or more of these indicators.¹⁴

¹⁴ Refer to the guidance provided in the General DIR Methodology section as to how to interpret the findings of the initial objective review and data mining. Also refer to the guidance related to the limitations of the DIR contract review selection process. The presence of objective indicators is not necessarily indicative that irregularities exist. Conversely, the absence of objective indicators is not indicative that irregularities, or the risk of them, do not exist.

(b) *KHADREP Grant Activities*. From an activity list provided by the NACC, the DIR Team sought to review the grant activities of the 150 largest grant recipients ranked by currency value which represented Non-Governmental Organizations (NGO), Community Based Organizations (CBO) and Faith Based Organizations (FBO). There were 225 grant activities financed among this group of 150 recipients. Due to time, resource and logistical limitations, and the absence of a large number of documentation files, the DIR Team was able to review only 53 of the 225 grant activities. The activities reviewed represented those where either supporting documentation was available or interviews of grant recipients could be conducted. Ultimately, only a small portion of the total grant activities that were funded were subjected to a manual review by the DIR Team.

(c) *FPESP Textbook Procurement*. Similar to the grant activities, due to timing, resource and logistical constraints, the DIR was able to examine textbook procurement for only a limited number of schools out of the 18,100 schools within Kenya. The DIR Team used data from the comprehensive FPESP database developed by PwC to select schools for its sample to review that were at a higher risk of exposure to irregularities. In doing so, the DIR Team looked at enrollment figures, the school's use of its bank accounts, geographic locations and other criteria and selected 35 schools for site visits. The DIR Team ultimately visited only 30 schools within four provinces due to logistical restrictions. Again, similar to KHADREP grant activities, only a small number of possible schools were manually reviewed as part of the DIR process.

22. As discussed previously, the objective of the DIR is to identify a subset of contracts and activities for a project that are at risk of exposure to irregularities. The DIR bases its findings on a manual examination of the contracting process for a subset/sample of contracts within the project. The DIR methodology selects contracts for its sample based on the presence of specific objective fraud-like criteria that are detected through data mining procedures, rather than random sampling-based techniques. The sample of contracts initially selected is not intended to represent only those contracts susceptible to irregularities, but it merely reflects those contracts that outwardly exhibit the set of known fraud-like indicators looked for by the DIR, and thus are more susceptible to irregularities than the contracts not exhibiting such indicators.

23. *Phase Two – Procurement, financial management and implementation reviews.* The second phase of the DIR took place in Kenya from March to April 2006. For each of the projects under review, the subset of contracts or activities identified in Phase One was subjected to a detailed manual review. The review involved the examination of available documentation relating to procurement, financial management, and implementation; interviews with project staff, government officials, contractors, and beneficiaries; site inspections and field visits. Detailed records of the Team's review and supporting documentation are retained by INT.

(a) The DIR Team conducted a detailed manual review using forensic examination techniques on 70 of the 135 procurement contracts highlighted from Phase One. The

The data mining process is merely a powerful tool utilized by the DIR to determine which contracts exhibit a risk of irregularities and thus warrant additional manual review.

Team was unable to review all 135 contracts mainly due to time and resource constraints.

- (b) The Team also reviewed the procurement of textbooks and the financial management in 30 of the 18,100 schools under FPESP, as well as 53 of the 225 grant activities of the largest 150 grant recipients (ranked by currency value of grant funds received) under KHADREP.
24. The second phase was divided into three reviews:
- (a) **Procurement review.** For each contract reviewed, the Team examined the contract bidding and award phases in order to identify indicators of irregularities. The review examined the full procurement packages, including contracts, Bid Evaluation Reports (BER), winning and losing bids, and any correspondence between the Bid Evaluation Committee (BEC) and the bidders;
 - (b) **Financial management review.** The aim of the review was to identify any weaknesses in the control environment as well as discrepancies between formally codified procedures and daily execution. The process consisted of a review of the financial control environment, identification of weak fiduciary practices/adequacy of internal controls, and a review of audits. The Team examined specific transactions related to the contracts selected under the procurement review; interviewed management of the implementing organizations; and reviewed financial reports, audit reports, and project financial management reports; and
 - (c) **Implementation review.** The Team undertook site visits for the contracts selected for review to physically verify the results of implementation, interviewed stakeholders and beneficiaries, and reviewed implementation-related documentation. The Team was limited in the extent to which it could verify implementation given the nature of the services and goods provided under the projects (e.g., feeding programs for HIV/AIDS orphans, awareness programs, distribution of condoms, and purchase of textbooks), and the geographical spread of project sites.

PROJECT DETAILS

I. Kenya HIV/AIDS Disaster Response Project (KHADREP) CR 3415-KE

INTRODUCTION

25. *The Project.* The Kenya HIV/AIDS Disaster Response Project (KHADREP) is part of a larger multi-country HIV/AIDS program for the Africa Region, which aims to significantly increase HIV/AIDS prevention, health care, and treatment, particularly for vulnerable groups—youth, women of child-bearing age, and high-risk communities. KHADREP supported five priority areas: (i) prevention and advocacy; (ii) treatment and support to the infected and affected; (iii) management and coordination; (iv) mitigation of socio-economic impacts; and (v) research, monitoring, and evaluation. The project was approved on December 9, 2000 and closed on December 31, 2005.

Table 9. KHADREP: Disbursement summary (amounts in US\$ millions as of April, 2006)

Loan	Status	Amount	Disbursed	Undisbursed	Cancellations
IDA-34150	Closed	56.63	56.63	0.00	0.00

26. *Project structure.* Funds under KHADREP were disbursed in the form of grants that funded anti-HIV/AIDS activities (hereinafter “activities”). The GoK’s Project Implementation Unit (PIU), the National AIDS Control Council (NACC), and its local affiliates, the Constituency AIDS Control Councils (CACC), were responsible for awarding the grants and monitoring the implementation of the activities. NGOs, Community-Based Organizations (CBO), and Faith-Based Organizations (FBO) (hereinafter “grant recipients”) implemented the activities.

27. *Previous reviews.* Both a GoK review and an independent review of the NACC showed serious program shortcomings. In 2003, the Efficiency Monitoring Unit (EMU) of the Office of the President of Kenya began an investigative review of the NACC and noted serious irregularities, including instances of fraudulent practices in financial management, procurement, and the award of grants.¹⁵ The EMU review resulted in investigations and the replacement of NACC staff. In 2005, the Bank requested that the GoK review internal control systems and identify any instances of fraud and corruption under KHADREP. In April 2005, the GoK hired D&T to conduct the review. D&T identified evidence of malfeasance and serious shortcomings in the governance and control environment.¹⁶

¹⁵ The report was ultimately issued in April 2005, and transmitted to the Bank on May 27, 2005.

¹⁶ Based on the findings of the D&T report, the Kenya Country Team requested that KHADREP be included in this DIR.

APPROACH

28. ***DIR scope.*** The Team reviewed three operations under the project:

- (a) **Grant award and execution.** The DIR reviewed the grant award process as well as the execution of activities by the grant recipients;
- (b) **Internal procurement.** The NACC and the CACCs also conducted procurement of contracts for services and goods, which they needed in order to function properly as institutions. The DIR reviewed this internal procurement; and
- (c) **Financial Management.** The Team reviewed the financial management arrangements within the NACC and the CACCs. It also reviewed the activities of the NACC's Financial Management Agent (FMA), responsible for managing the disbursement of funds to organizations receiving support from NACC under the Community Initiative Account for KHADREP. The financial controls, the organizational structure, and the institutional capacity of NACC and NACC-FMS were also reviewed.

29. ***Comparison before and after the 2004 EMU review.*** The DIR tested whether significant changes had occurred in the level of irregularity indicators before and after the 2004 EMU review, which resulted in investigations and the replacement of NACC staff. The Team, therefore, selected contracts and activities prior to and post 2004.

GRANT AWARD AND EXECUTION REVIEW

30. ***Selection of grant activities and recipients for review.*** From an activity list provided by the NACC, the DIR Team sought to review the grant activities of the 150 largest grant recipients ranked by currency value which represented Non-Governmental Organizations (NGO), Community Based Organizations (CBO) and Faith Based Organizations (FBO). There were 225 grant activities financed among this group of 150 recipients. Due to time, resource and logistical limitations, and the absence of activity documentation files, the DIR Team was able to review only 53 of the 225 grant activities. The activities reviewed represented those where either supporting documentation was available or interviews of grant recipients could be conducted.

Table 10. KHADREP: Summary of grant award review

Number of Grant Recipients Selected for Review	Total Number of Activities Represented by Selected Grant Recipients	Total Activities Reviewed	Total Selected Grant Recipients Interviewed	Other Organizations Interviewed	Site Visits
150	225	53	18*	12	4

*Note: Three of these grant recipients were interviewed twice, resulting in a total of 21 interviews.

31. ***Interviews and extended review.*** The Team interviewed 18 grant recipients. Three of these were interviewed twice, resulting in a total of 21 interviews. Based on information received in their initial interviews, the DIR Team extended its review to 12 additional NGOs, CBOs, and

FBOs, some of which applied for but were not awarded grants under the project. In interviews, their representatives disclosed information about their experiences in submitting proposals to either the NACC or the CACCs for grant financed activities under KHADREP. The Team also conducted interviews with NACC officials, representatives of NACC-FMA, auditors, and other witnesses.

32. *The NACC's inadequate record keeping hampered the DIR.* The review of selected grant activities was significantly hampered by lack of documentation and inadequate record keeping within the NACC. For example, based on the list of activities provided by the NACC, the Team selected the implementing grant recipients and requested to review the documents related to their activities. However, the NACC's internal filing system did not allow for a prompt or at times complete retrieval of the documents requested. Furthermore, it appeared that the NACC did not maintain electronic data about grant recipients that submitted activity proposals and were unsuccessful in obtaining grants. Insufficient documentation hampered the review of WBCN 333, grant recipient 7;¹⁷ and WBCN 359 and 362, grant recipient 8. However, in the absence of other indicators, the Team determined that inadequate record keeping did not meet the threshold of an irregularity indicator.

INTERNAL PROCUREMENT REVIEW

33. *DIRDB.* The DIRDB contained information about 384 contracts internally procured by the NACC. Based on data input and mining, the DIRDB identified 36 contracts with specific objective indicators of irregularities, or approximately 10% of the NACC contracts, and subjected them to further manual review.

34. *The NACC's inadequate document management hampered the review.* The review was partially hampered by a lack of documentation, an inadequate internal filing system and poor record keeping. In the case of WBCN 51 for rent of three computers, one color printer, etc., the review could not be completed due to a missing contract and insufficient information in the evaluation form. Missing documentation, most often the BER and contracts, limited the review of WBCN 69 for procurement of auditors; WBCN 74, for procurement of supply of tires and tubes; and WBCN 90 for provision of insurance brokerage services. However in the absence of other indicators, the Team did not classify inadequate record keeping as an irregularity indicator.

FINANCIAL MANAGEMENT REVIEW

35. *The financial management review followed standard methodology.* The process consisted of a review of the financial control environment, identification of weak fiduciary practices/adequacy of internal controls, and a review of audits. The Team examined 29 specific transactions related to the contracts selected under the procurement review;¹⁸ interviewed

¹⁷ Names of witnesses, interviewees, and grant recipients or applicants are not disclosed in this report in order to protect the physical and economic safety of these individuals or organizations. Witnesses or grant recipients/applicants will be therefore identified by number throughout this report.

¹⁸ Of the 29 contracts analyzed under the financial management review, 24 were also analyzed under the procurement review.

management of the implementing organizations; and reviewed financial reports, audit reports, and project financial management reports.

FINDINGS

36. ***DIR outcome.*** As shown in Table 11 and Table 13 below, the DIR found that the large majority of grant contracts and the internal procurement contracts reviewed exhibited irregularity indicators, including fraud, corruption, and collusion. The DIR also found instances of actual activities of fraud and corruption, including bribery and falsified invoices. These findings remained consistent before and after the 2004 staff investigations and organizational changes that occurred in the NACC. The financial management review found weaknesses in the NACC's internal controls environment, accounting procedures, and staff capacity.

GRANT AWARD AND IMPLEMENTATION

37. ***Most of the grants reviewed in the DIR exhibited one or more indicators of irregularity.*** The Team found that out of the 53 grant activities reviewed, 38 contained irregularity indicators. The findings are outlined below.

Table 11. KHADREP: Review of activities financed by grants

Total Grant Activities	Grant Activities Reviewed	% of Grant Activities Reviewed	Grant Activities with Irregularity Indicators	% of Grant Activities Reviewed	Value of Activities Reviewed (in USD)	Value of Activities with Irregularity Indicators (in USD)
6,046	53	<1%	38	72%	\$2,899,000	\$2,079,000

38. ***The frequency of irregularities increased after the EMU review.*** The DIR found that, despite the staff changes within the NACC, irregularity indicators still appeared in most contracts reviewed, regardless of the year the grant was awarded. In fact, the review identified an increase in irregularity indicators towards the closing of the project. This increase can be attributed to a combination of factors, including the high value of grants awarded, and the close connections between grant recipients and the NACC. Table 12 below shows the annual number of indicators identified among the reviewed contracts.

Table 12. KHADREP: Breakdown by year of reviewed activities financed by grants

Year	Activities Reviewed	Indicators	
		Number	Percentage
year unknown*	9	4	44
2002	2	2	100
2003	11	6	54
2004	14	10	71
2005	17	16	94
Total	53	38	72

*Note: Year unknown due to insufficient data in the DIRDB.

39. *Grant recipients engaged in fraudulent and corrupt practices.* The Team found both evidence and indicators of irregularities in grant activities:

- (a) **Fraudulent practices existed in multiple activities financed by grants:**¹⁹
 - (i) **Grant recipients inflated or duplicated claims.** In the case of WBCN 368, the secretary of grant recipient 2 was paid in excess of KES 150,000 (US\$2,150) to conduct accounts compilation, but admitted to the Team that he had instead hired an external accountant to perform the service for only KES 50,000 (US\$714). Further review determined that the secretary and the chairman of grant recipient 2 also submitted numerous duplicate claims. Under WBCN 342, grant recipient 1 submitted payment vouchers where the voucher number and the date were out of sequence with each other. This implied potential misuse of funds and fraudulent misrepresentation. In certain instances, vouchers were not supported by receipts or invoices.
 - (ii) **Grant recipients submitted fraudulent claims.** In the case of WBCN 333, grant recipient 7 in its statement of expenditures (SOE), submitted payment vouchers supported by invoices allegedly issued by two grocery suppliers, Store 1 and Store 2. Upon verification, the Team ascertained that the invoices allegedly issued by Store 1 were fraudulent. Store 2 could not be located at the address indicated on its invoices, and representatives of other stores at the same address confirmed that no such company was ever located at that address. Under WBCN 375, grant recipient 17 fraudulently overstated the number of participants involved in each activity, the number of activities conducted, and the amounts paid to participants.

¹⁹ The Team's review of the activities financed by grants was based on the documentation provided by NACC, including the comment papers of NACC-FMA on the review of the statements of expenditures submitted by the grant recipients.

- (iii) **Grant recipients submitted unjustified expense claims.** In the case of WBCN 355, conducted by grant recipient 17, the Team identified indicators of lack of transparency in procurement of goods, unsupported transport expenses, and missing expense documents. Under WBCN 351, the majority of grant recipient 21 expenditures were not supported by proper documentation, and there were indicators of fraudulent claims for fuel and rental of cars.
- (b) **A grant recipient admitted to paying bribes in exchange for expediting disbursements.** The chairman and secretary of grant recipient 2 admitted to the Team that they had made corrupt payments in excess of KES 30,000 (US\$430) to the NACC-FMA disbursement officer in order to facilitate an immediate transfer of funds to the bank account of grant recipient 2.
- (c) **Significant portions of funds were unaccounted for.** At the time of the review, the entirety of one grant disbursed during the first week of December 2005 under WBCN 363 to grant recipient 5 was unaccounted for. Under WBCN 332 and 335, the grant funds disbursed to grant recipient 7 in the amounts of KES 350,000 (US\$5,000) and KES 4,200,000 (US\$60,000), respectively, were also unaccounted for at the time of the review.
- (d) **Conflicts of interest were identified.** In the case of WBCN 332, 333, and 335, the chairman of grant recipient 7 was also the chairman of a CACC, the approving authority for grant activities.
- (e) **Similarities in competing bid proposals indicated lack of competition in bidding.** In the case of WBCN 335 (grant recipient 7), 368 (grant recipient 2), and 381 (grant recipient 4), approved grant proposals were alike to the extent that entire paragraphs were identical. Interviews revealed that a CACC official was the author of multiple proposals for various grant recipients.

40. *The type and severity of irregularity indicators differed among the various types of grant recipients.* The Team observed less irregularity indicators amongst long-standing, reputable national/regional grant recipients with a proven history of achievements and institutional capacity compared to newly incorporated grant recipients with no record of prior achievements. The irregularity indicators found among the more reputable grant recipients consisted of the hiring of professional proposal writers suggested by the NACC or the CACC. These indicators are considered of lesser concern given that the review did not find that these recipients had paid bribes to NACC or CACC officials to ensure the approval of the proposal. Reputable grant recipients were often penalized by not receiving additional grants or complete funding for ongoing activities. By contrast, the grant recipients that appeared to be constituted solely for the purpose of benefiting from KHADREP grants, engaged in fraud and corruption, such as inflating claims for trainings or seminars and bribing NACC or CACC officials.

41. **NACC and CACC officials engaged in fraudulent and corrupt practices.** Twelve grant recipients and applicants described the following experiences in applying for grants under the project²⁰:

- (a) **NACC officials engaged in corruption and abuse of power.** Interviewees reported several irregularities, including the following:
 - (i) NACC officials would routinely request bribes in exchange for approval of grant proposals;
 - (ii) NACC officials would require grant applicants to hire either themselves or other professional proposal writers who were connected with the NACC. Proposals prepared by such insiders would effectively guarantee approval;
 - (iii) NACC officials would withhold payments, usually the second disbursements from the grant recipients, who nevertheless would receive an official letter acknowledging that all funds had been disbursed and properly accounted for by the grant recipient, thus creating a paper trail indicating that funds were fully disbursed;
 - (iv) A grant recipient admitted to paying bribes to NACC-FMA staff to expedite the disbursement of funds;
 - (v) Unclear procedures for awarding grants permitted the NACC (and CACCs) to abuse their authority. The NACC and NACC-FMA purported that grant proposals would be collected and prioritized at the CACC level, then passed to the NACC for final approval, which would occur on a first-come first-serve basis. However, many interviewees disputed this, asserting that either the NACC or the CACC withheld their proposals for months or years prior to approving them.
- (b) **Members of Parliament influenced the CACCs through nepotism and favoritism.** Interviewees reported that Members of Parliament (MPs) were personally involved as "patrons" of the CACCs. Each MP acted as a spokesman of the CACC under his/her constituency and accounted for the activities of the CACC in Parliament. Interviewees stated that nepotism and favoritism based on political affiliation was rampant within the CACCs at all levels, though since 2003 the MPs were not directly involved in the management of the CACC. As a result of the continued MP influence, project committees were often comprised of members loyal to the MP. Such members would lack formal education and knowledge of HIV/AIDS-related issues. Furthermore, grant applicants with ties to the MP were awarded grants to the detriment of other, genuinely committed NGOs, CBOs and FBOs.
- (c) **CACC officials engaged in corruption and abuse of power.** CACC officials were in charge of evaluating the grant recipients and monitoring the implementation of the activities. This aggregation of duties was conducive to abuse according to numerous interviewees:
 - (i) CACC officials would routinely request bribes in exchange for the inspection of grant applicants, which is required in order to qualify for a grant;

²⁰ The majority of witnesses interviewed under KHADREP expressed concerns for their physical and economic well-being, should their identity be disclosed.

- (ii) CACC officials would insist on becoming controlling authorities (e.g., secretary or treasurer) within the grant recipients' organizations, claiming that the recipient would benefit from their participation because they could influence the approval of grants at the CACC;
 - (iii) CACC officials, such as the CACC Secretary, would compel grant applicants to hire certain people, including himself or herself, to write grant proposals for a fee. Officials would also offer to steer the award of grants in exchange for bribes;
 - (iv) CACC officials would request that grant proposals be changed in order to allow for inflated amounts to be paid to trainees. CACC officials would then insist on participating in the course; and
 - (v) CACC officials would solicit bribes in anticipation of the upcoming project, TOWA, which has not yet been approved by the Bank.
- (d) **NACC and CACC selection processes lacked transparency.** Interviewees reported a lack of transparency in the criteria for awarding grants and the absence of feedback provided to the applicants whose proposals had been rejected.
- (c) **Unreasonably short implementation periods wasted funds.** The Team observed that on many occasions, the NACC awarded high value grants (above KES 5,000,000 or US\$71,400) to grant recipients near to the closing date of KHADREP with the expectation that the grant recipients would spend and account for the funds within a very short time period. This occurred under WBCN 333, grant recipient 7; WBCN 368, grant recipient 2; and WBCN 376, grant recipient 9. Under WBCN 376, the original proposal indicated that three months would be necessary to complete the activity, while the final agreement granted only one month for completion. Under WBCN 355, less than three weeks was given to grant recipient 17 to carry out activities in the amount of over KES 4,500,000 (US\$64,285) near the end of the year. Grant recipient 17 claimed having conducted 16 seminars ranging from one to 13 days in duration, some of which were allegedly carried out during the Christmas holidays.
- (f) **Corrupt practices of government officials negatively impacted the results of the project.** Grant recipients reported that the continuous requests for bribes made by the government officials diverted funds from the activities' objectives. One grant recipient explained that, instead of paying secondary school fees for orphans, it used grant money to pay bribes. They also stated that this caused orphans to drop out of school and engage in illegal activities, including prostitution, which would inevitably increase the exposure and risk of the HIV/AIDS infection.

NACC'S INTERNAL PROCUREMENT

42. *A significant majority of the internal procurement contracts reviewed exhibited one or more irregularity indicators.* The irregularities identified included fraudulent, collusive, and corrupt practices, as well as biased selection processes, manipulation of the procurement process, and other anomalies.

Table 13. KHADREP: Internal procurement review

Total Contracts	Contracts Reviewed	% of Total Contracts	Contracts Reviewed with Irregularity Indicators*	% of Contracts Reviewed	Value of Contracts Reviewed (in USD)	Value of Contracts with Irregularity Indicators (in USD)
384	36	9%	29	80%	\$658,000	\$562,000

* Ten of the 36 contracts selected for review had a noticeable lack of documentation which hampered a thorough review for indicators of irregularities and most likely reduced the number and percentage of contracts with indicators.

43. *The frequency of irregularities remained consistent before and after the EMU review.* The DIR found that irregularity indicators appeared in most contracts reviewed, regardless of whether they were procured before or after the 2004 EMU review. Table 14 below illustrates the annual percentage of indicators found within the contracts reviewed.

Table 14. KHADREP: Breakdown by year of reviewed contracts

Year	Contracts Selected	Contracts Reviewed	Irregularity Indicators	
			Number	Percentage
Year unknown*	1	1	0	0.0
2001	5	3	3	100
2002	2	2	2	100
2003	5	3	3	100
2004	15	14	11	79
2005	15	13	10	77
Total/Avg.	43	36	29	81

*Note: Year unknown due to insufficient data in the DIRDB.

44. *Indicators of collusive practices appeared in numerous procurements.* Collusive practices were indicated by similarities in bid proposals. Another indicator of collusive practices—protective bids²¹—was revealed in a comparison of bids across different tenders. The comparison revealed:

- (a) Similarities in the bids appeared in the templates, the formats utilized, and in the font and layout of documents. In the case of WBCN 13 for supply of decorations, all three quotations looked alike.
- (b) A comparison of bids across different tenders revealed indicators of collusion. In the case of WBCN 186 for the printing of newsletters, and WBCN 225 for printing services, the losing bidder under the first contract quoted prices up to five times higher compared to the winning bidder. Such discrepancies between bids indicated that the losing bidder

²¹ Protective bids are bids submitted by one or more bidders, possibly cartel members, who do not intend to win the contract, but rather "protect" the designated winner (and the cartel). To accomplish this, losing bidders submit high-priced bids in order to simulate a competitive procurement process.

may have submitted a protective bid that intended to favor another bidder. Under the second contract, WBCN 225, the two bidders appeared to have exchanged roles.

45. *Indicators of biased bid evaluation were identified.* The BEC failed in several instances to award contracts to the lowest bidder or provide explanations for rejecting lower bids as illustrated by the following examples:

- (a) Under WBCN 116 for printing services, the NACC's former director overruled the decision of the BEC to award the contract to the first lowest bidder, and awarded the contract to the next lowest bidder;
- (b) Under WBCN 160 for design and printing services, the first lowest bidder was declared unsuitable to perform the contract because it had never handled a previous job for the NACC; although the NACC had invited it to submit a proposal. This contract was eventually awarded to the third lowest bidder, without any explanation for the rejection of the second lowest bidder; and
- (c) Under contracts WBCN 267, 268, and 269, for the procurement of a financial contractor, the BEC ignored the first lowest bid and awarded contracts to the second or the third lowest bidder without proper justification.

46. *Indicators of inconsistent bid evaluation were identified.* Indicators of inconsistent bid evaluation were identified under WBCN 178 and WBCN 190, for the selection of financial contractors. Under WBCN 178, the BEC evaluated both services of the provider, while under the WBCN 190 only one service was evaluated.

47. *Indicators of fraudulent misrepresentation were observed when two or more companies could be linked to the same ownership or control.* For example, under WBCN 288, two bidders shared the same shareholder, the same address, and had bank accounts at the same branch of the same bank. By submitting two bids instead of one, these bidders created the appearance of competition and thus increased their likelihood of being awarded the contract.

FINANCIAL MANAGEMENT REVIEW

48. *Introduction.* The Team reviewed the NACC's financial management arrangements and a selection of transactions. The review indicated the following weaknesses.

49. *Organizational weaknesses.*

- (a) The flat department structure did not allow the Finance Manager to effectively delegate tasks and responsibilities to officers in the NACC. The Finance Manager was unavailable to address both overview and managerial issues because of the amount of time he spent reviewing and approving "urgent" documents. The flat structure also created an environment conducive for management and staff to bypass internal controls when processing transactions;
- (b) The Team observed, and grant recipients confirmed, a lack of clear separation of responsibilities between the NACC and the NACC-FMA, the consultant managing the disbursement of funds to grant recipients from within the NACC. Grant recipients also

- reported that some NACC and NACC-FMA staff took advantage of this lack of transparency to obtain additional compensation for their regular services;
- (c) The Team observed that insufficient technical skills amongst staff impacted adversely on the department's efficiency; and
 - (d) An internal audit function was never established, despite provisions in the project design.

50. *Disbursement weaknesses.*

- (a) The NACC managed funds from various donors and agencies with an outdated computerized accounting system, which did not automatically link disbursements to sources of funding, contracts, and the procurement process. NACC's outdated accounting system was also not integrated with budgeting, cash management, and payroll.²² As a result, basic internal fiduciary controls could not be executed and management reports were not produced.
- (b) The lack of a formal budget process heightened the risk that management would not be able to identify unapproved or inflated payments.
- (c) NACC officials lacked adequate capacity to effectively review the financial returns submitted by the various CACCs against which disbursements had been made. The capacity gaps included the lack of dedicated and properly trained staff to effectively review and audit the financial returns. As a consequence, when the CACCs did not submit their quarterly reports as required, no follow-up was performed.
- (d) NACC's external audit reports did not include management letters. International audit standards require management letters as a minimum assurance that controls are in place and are being implemented.

51. *Review of selected financial transactions.* The Team selected 29 transactions for financial review. The Team found the following irregularity indicators in 14 transactions:

- (a) Six transactions (21%), could not be traced to a payment voucher;
- (b) Four transactions (14%), were funded by the GoK, despite being coded as Bank-funded;
- (c) Three transactions (10%) were paid in cash. Two of them were paid through petty cash and one was paid through a personal expenses form. The use of cash in a high risk environment such as KHADREP increases the likelihood of inappropriate payments; and
- (d) One transaction (3%) was made to a losing bidder.

²² PwC reported that they have conducted a review of NACC's financial management system and that weaknesses in NACC's existing accounting system were identified. The accounting was over five years old and PwC commented that NACC should acquire a more up to date and fully integrated system, rather than upgrading the old system. The service of the old system had been less than satisfactory and the system itself was not amenable to full integration, which would leave an unacceptable level of financial risk. PwC also reported that an internal audit function was needed.

The D&T report stated that NACC had a sophisticated accounting system; however fraud risk was not considered in the project design, therefore the fraud risk was considered high (see D&T report pages 8 and 42)

II. Kenya Decentralized Reproductive Health and HIV/AIDS Project (DARE) CR 3440-KE

INTRODUCTION

52. *The Project.* The Decentralized Reproductive Health and HIV/AIDS Project (DARE) aims to: (i) improve maternal and child health through the increased delivery of integrated child survival, reproductive health, and HIV/AIDS services; (ii) enhance the efficiency of the GoK in delivering these services; (iii) slow the increase of HIV prevalence rates; and (iv) create an enabling environment for decentralized managed delivery of child survival, reproductive health, and HIV/AIDS services to and within districts. The project was approved on December 12, 2000 and closes on December 31, 2006. The project consists of three components:

- (a) Support for the GoK's decentralization policy;
- (b) Focus on the medical aspects of the HIV/AIDS epidemic; and
- (c) Substantively addressing reproductive health.

Table 15. DARE: Disbursement summary (amounts in US\$ millions as of April, 2006)

Loan ID	Status	Amount	Disbursed	Undisbursed	Cancellations
ID-34400	Effective	57.28	29.24	27.99	0.00

53. *Project structure.* The MoH is the implementing agency under the project and an international procurement agent, *Gesellschaft für Technische Zusammenarbeit* (GTZ), conducted most of the procurements. GTZ compiled bidding documents based on the MoH's technical specifications and estimates, prepared tender advertisements, and collected the bids. GTZ also conducted the bid evaluation with the participation of MoH officials. Once the evaluation was completed, GTZ would recommend that the lowest evaluated bidder be awarded the contract. The MoH would subsequently award the contract on the basis of that recommendation. Payments under the contracts were executed by the MoH.

54. *Previous reviews.* In 2005, the Bank requested that the GoK review internal control systems as well as identify any instances of fraud and corruption under DARE.²³ In April 2005, the GoK hired D&T to conduct the review. D&T identified a preponderance of fraud and corruption related indicators as well as serious shortcomings in the governance and control environment.²⁴

²³ In mid-2003 the Bank and the MoH identified problems with the District grants component of the project. In March 2004, the Bank agreed with the MoH that: (i) the project was unlikely to achieve its development objectives by the initial closing date of June 30, 2005; (ii) that the District grants component should be cancelled; and (iii) that the project needed to be restructured. In July 2004, the Bank formally suspended the District grants component of the project.

²⁴ Based on the findings of the D&T report, the Kenya Country Team requested that DARE be included in this DIR.

APPROACH

55. *DIR scope.* The Team reviewed the procurement of contracts, and financial management. The Team also intended to review implementation of one contract for the supply of medical equipment. The Team made repeated requests to meet with MoH officials, whose assistance was necessary for the completion of the implementation review.²⁵ The limited availability of MoH officials combined with the tight schedule of the review resulted in the Team being unable to conduct the implementation review for this project.

PROCUREMENT REVIEW

56. *Selection and review.* Data covering all 35 DARE contracts was entered into the DIRDB. Based on data input and mining from the DIRDB, 21 contracts for condoms, medical equipment, and consultancy services exhibited specific indicators of irregularities. The Team also interviewed two witnesses.

57. *Procurement documentation availability at GTZ was satisfactory.* GTZ provided well-organized and complete procurement documentation, thus facilitating the conduct of the review.

FINANCIAL MANAGEMENT REVIEW

58. *The financial management review followed standard methodology.* The process consisted of a review of the financial control environment, and identification of weak fiduciary practices/adequacy of internal controls.

59. *Inadequate documentation management by the MoH.* The Team selected one contract for the financial management review. During its review, the Team requested access to accounting records and for MoH staff to accompany the Team to visit the relevant location. The MoH did not respond until three days before the DIR mission's end. The Team obtained access to partial accounting records at the MoH, but no official was available to assist the Team in physical verification. Ultimately, the Team gained access to the necessary accounting records from GTZ.

IMPLEMENTATION REVIEW

60. *MoH staff were unavailable until the end of the mission, therefore the Team was unable to conduct the implementation review.* Although the MoH had provided a distribution list of goods and equipment procured under the project, the Team needed to be accompanied by MoH officials to gain access to the premises where medical equipment purchased under the project was supposedly delivered. The Team was unable to undertake the implementation review because MoH staff were unavailable until the end of the mission to assist in physical verification.

FINDINGS

61. *DIR outcome.* Similar to its findings on the KHADREP project, the DIR found that the majority of contracts reviewed under the DARE project exhibited irregularity indicators or actual

findings of fraudulent and corrupt behavior. The Team collected evidence from a witness that MoH officials manipulated the procurement process by supplying pre-bid information and soliciting kickbacks from bidders, thus circumventing the limited oversight of the international procurement agent. Bidders engaged in corrupt and fraudulent practices, which resulted in inflated bid prices. The international procurement agent carried out its responsibilities in accordance with Bank guidelines, thus significantly reducing the risk of corruption in the bid evaluation process.

PROCUREMENT REVIEW

62. *Irregularities existed in a majority of the contracts reviewed.* Table 16 summarizes the indicators of possible irregularities under DARE.

Table 16. DARE: Results of the procurement review

Total Contracts	Contracts Reviewed	% of Total Contracts	Contracts Reviewed with Irregularity Indicators	% of Contracts Reviewed	Value of Contracts Reviewed (in USD)	Value of Contracts with Irregularity Indicators (in USD)
35	21	60%	13	62%	\$7,200,000	\$5,200,000

63. *GTZ performed its functions according to Bank guidelines, without indicators of fraud or corruption.* GTZ has been the procurement agent under DARE since its inception. At the time of the DIR review, GTZ had managed the procurement process of contracts ranging from the purchase of medicine, vaccines, HIV/AIDS test kits, and condoms to consulting assignments and training courses. Procurement under GTZ appeared to have been carried out according to Bank guidelines, thus significantly reducing the risk of corruption in the bid evaluation phase of the procurement process. Nevertheless, fraud and corruption affected the procurement stages before and after bid evaluation.

64. *Government officials are implicated in fraudulent and corrupt practices.* Interviews with the witnesses revealed the following allegations of fraudulent and corrupt practices:

- (a) **Ministry officials provided price estimates to bidders in exchange for future kickbacks.** A few weeks before contract tenders were floated, MoH officials or their agents approached companies that were likely to bid under a tender and provided them with draft copies of the bidding documents and price estimates. Officials knew which bidders to approach based upon their previous participation in tenders. The MoH official or the agent would demand a kickback for each item provided under the bid. The witness gave the example that if the World Health Organization (WHO) suggested that the final item price for an HIV/AIDS rapid test should be between US\$1.00 and US\$1.30, the official or agent would require a US\$0.20 kickback on each item procured.
- (b) **Bid Evaluation Committee members circumvented competitive bidding procedures.** The BEC would disqualify any bidders, especially first-time bidders, who did not include the cost of the bribe in their bid price. MoH officials participating in the

BEC would remove key documents from such bids in order to disqualify the bidder as non-responsive;

- (c) **Government officials ensured that all bidders would submit inflated bids in order to pay for kickbacks.** All bids submitted by bidders that had been approached by the corrupt official would all be equally inflated by the amount of the kickback. Since non-inflated bids would be excluded, the result was that any company, which GTZ declared to be the lowest evaluated bidder, would be prepared to pay kickbacks;
- (d) **High level officials in the MoH favored contractors in the bidding process.** One centrally positioned witness informed the Team that contractors experienced that the high level officials were personally involved in issues regarding public procurement and that they steered contracts to specific bidders in exchange for kickbacks;
- (e) **Ministry officials solicited bribes from winning bidders.** Upon completion of the bid evaluation, GTZ would inform the MoH of its recommendation for the award of a contract. The Team obtained documentary evidence that high-level officials in the MoH, who participated in the BEC and had first-hand information about the identity of the recommended winner, would contact the winner prior to official contract award. The officials would then solicit bribes by pretending that they could influence the bid evaluation and guarantee the award of the contract; and
- (f) **Ministry officials solicited bribes throughout the implementation process.** Once companies were awarded contracts, in addition to paying the already-agreed upon bribes, MoH officials required that bribes be paid throughout the duration of the contract, e.g., for the delivery of goods to the warehouse and for ensuring the payment of invoices.

65. Contractors engaged in fraudulent and corrupt practices. Evidence and indicators of corrupt and fraudulent practices included the following:

- (a) **Contractors inflated bid prices to cover the cost of kickbacks to government officials.** Once local agents or distributors obtained the draft bidding documents and cost estimates from MoH officials, they began preparing the bid. In calculating the item prices, the local agents would consider the manufacturer's price, inclusive of costs and profit; the agent's commission, as well as the kickback amount demanded by the MoH official. As long as the final bid prices remained within the price range suggested by the WHO, the bids raised no red flags. In the case of the procurement of certain items, the cost of corruption was US\$1,172,090,²⁶ equivalent to 24% inflation of the bid price. The Team collected documentary evidence substantiating this practice (see Table 17).

²⁶ This example is based on information provided by a confidential witness; however the item description has been cancelled and prices have been changed to ensure witness confidentiality.

Table 17. DARE: Price composition including kickbacks/commissions

Quantity	Item	Cost CIP US\$	Quote CIP US\$	Commission US\$	Total Commission US\$
2,000,000	Item 1	0.85	1.24	0.39	785,000
2,000,000	Item 2	1.05	1.24	0.19	378,200
50,000	Item 3	1.06	1.24	0.18	8,890
				Total	1,172,090

Note: CIP - Carriage and Insurance Paid To

(b) **International contractors were complicit in the preparation of corrupt bids.** A witness informed the Team that corrupt arrangements were typically made between MoH officials and local representatives or distributors. Unit prices for items such as HIV/AIDS test kits would be marked up by the costs of kickbacks. The companies would agree to reimburse the costs of the corrupt payments, which the local agents would claim as general expenses. The agent explained that the parent companies were willing to pay the markups, but did not want to be told that corrupt payments were required in order to win the contracts;²⁷

(c) **Contractors engaged in fraudulent misrepresentation.** The Team found that under WBCN 13, 14 and 15, an individual represented four different companies bidding under the same lot and, in one instance, two companies linked to the individual submitted bids for the same contract. The Team confirmed the individual's conflicting ownership interests by determining that he drew bid securities from his personal bank account at a bank in Nairobi, Kenya, for the four different companies. In certain instances, he acted on behalf of these companies without proper authorization. (The Team obtained documentary evidence substantiating this finding.);

(d) **A contractor submitted fraudulent manufacturer's authorizations.** The Team identified and confirmed that a company submitted false manufacturer's authorizations, thereby committing fraud. One of the alleged issuers of the authorization confirmed that the authorizations were false (The Team obtained documentary evidence substantiating this finding.); and

(e) **Contractors appeared to be colluding in the bidding process.** Under WBCN 13, 14 and 15; and WBCN 19, 20, 21 and 22, three companies appeared to be colluding. These companies presented sequential bid securities issued by the same bank, and the ownership of these companies appeared to be related. Ultimately, none of these companies won contracts due to GTZ's fair and transparent bid evaluation process, even though GTZ did not detect these indicators.

²⁷ The witness's statements are consistent with INT's findings world-wide and other international companies' disclosures that local agents are used as a channel for bribe payments.

FINANCIAL MANAGEMENT REVIEW

66. ***Financial reporting weaknesses.*** Since the launch of DARE in 2001, the MoH has never produced Project Management Reports (PMRs) or Financial Monitoring Reports (FMRs) for the Bank. The Bank, therefore, conducted its financial monitoring of the project only by reviewing audit reports, by sampling and reviewing SOEs, and by conducting financial supervision missions.

III. Northern Corridor Transport Improvement Project (NCTIP) CR3930-KE

INTRODUCTION

67. The Project. The Northern Corridor Transport Improvement Project (NCTIP) aims to: (i) increase the efficiency of road transport along the Northern Corridor to facilitate trade and regional integration; (ii) enhance aviation safety and security to meet international standards; and (iii) promote private sector participation in the management, financing and maintenance of road assets. The project was approved on June 17, 2004 and closes on December 31, 2009. The project consists of the following eight components:

- (a) Rehabilitation of the Northern Corridor;
- (b) Roadside amenities and HIV/AIDS mitigation;
- (c) Private sector participation in road management and maintenance;
- (d) Road safety improvement;
- (e) Institutional strengthening in the roads sector;
- (f) Support for the Kenya Airports Authority (KAA);
- (g) Support for the Kenya Civil Aviation Authority (KCAA); and
- (h) Support for the Ministry of Transport and Communications (MoTC).

Table 18. NCTIP: Disbursement summary (amounts in US\$ millions as of April, 2006)

Loan	Status	Amount	Disbursed	Undisbursed	Cancellations
IDA-39300	Effective	206.85	7.25	199.60	0.00

68. Project structure. Four agencies within the GoK are responsible for the implementation of separate project components. The Ministry of Roads and Public Works (MoRPW) oversees components (a) through (e); the KAA oversees component (f); the KCAA oversees component (g); and the MoTC oversees component (h).

APPROACH

69. DIR scope. The Team reviewed project procurement, as well as financial management under the MoRPW. The DIR review was limited to the four large civil works procurements with pending NOLs under the roads transport component and to one contract for the supply of fire engines under the KAA component. The Bank's Kenya Country Management Team specifically requested that the Team review these four civil works contracts because of concerns that certain bids were 25% to 90% higher than the engineers' estimates.

70. The financial management review followed standard methodology. The process consisted of a review of the financial control environment, identification of weak fiduciary practices/adequacy of internal controls, and a review of audits.

FINDINGS

71. ***DIR outcome.*** Based on a price analysis and unit cost comparison of four Bank-funded civil works contracts with pending NOLs and one EU-funded civil works contract, the DIR found indicators of collusive behavior. This pointed to companies having submitted protective bids with inflated prices to the advantage of other, lower bidding companies. Due to the time-sensitive nature of these contracts, the Team shared the indicators of collusion with the Kenya Country Team in a meeting three days after the return from the DIR mission. In light of the discussion, and due to the pending NOLs for the four contracts, the Kenya Country Team requested that INT produce an interim report summarizing the DIR's initial findings in relation to NCTIP.

72. ***INT Interim Report.*** In response to the Country Team's request, INT produced an Interim Report on May 2, 2006. The Kenya Country Team responded to the Interim Report, informing INT that they had conducted a review of the project and taken steps to mitigate the risks of corrupt practices.

PROCUREMENT REVIEW

73. ***Four out of the five contracts reviewed exhibited one or more indicators of irregularities.*** The following table summarizes the identification of indicators of fraud and collusion.

Table 19. NCTIP: Initial identification of indicators of collusion

Total Contracts	Contracts Reviewed	% of Total Contracts	Contracts Reviewed with Irregularity Indicators	% of Contracts Reviewed	Value of Contracts Reviewed (in USD) #	Value of Contracts with Irregularity Indicators (in USD) #
13	5	38%	4	80%	\$218 million	\$216 million

Value of contracts are based on bidding prices. Contracts had not been awarded as of date of DIR review.

FINANCIAL MANAGEMENT REVIEW

74. ***Insufficient data existed for assessing financial management.*** NCTIP commenced operations recently, with only a limited number of contracts having been awarded, and few payments executed at the time of the DIR. These payments were for the purchase of vehicles and supervision consultants. The Team concluded that the financial control environment could not be tested, and no assessment could be produced.

IV. Free Primary Education Support Project (FPESP) CR H0500-KE

INTRODUCTION

75. *The Project.* The Free Primary Education Support Project (FPESP) is a GoK initiative aimed at providing free primary schooling to all children throughout Kenya. The project goal is to provide a full course of primary schooling by the year 2015 and to improve pupil performance and retention rates. The project supports 7.2 million children in 18,100 schools in all 101 districts of the country. Specifically, the project aims to improve pupil performance and retention by ensuring an adequate supply, and improved use, of instructional materials, including textbooks. One of the main goals of the project is to reduce the ratio of textbooks per student to 1:3 in lower primary school and 1:2 in upper primary school. The project was approved on June 19, 2003 and closes on June 30, 2007. The Kenya Education Sector Support Program (KESSP) is the proposed successor project to FPESP.

Table 20. FPESP: Disbursement summary (amounts in US\$ millions as of April, 2006)

Loan	Status	Amount	Disbursed	Undisbursed	Cancellations
IDA-H0500	Effective	54.84	54.65	0.18	0.00
IDA-Q2590	Closed	1.19	0.00	0.00	1.19

76. *Project structure.* The MoE is the implementing agency for this project. The project consists of the following three components: (i) strengthening of the textbook program; (ii) capacity building; and (iii) oversight, *i.e.*, monitoring, evaluation, and external auditing. The local schools are responsible for textbook procurement. The MoE and the local schools interact in the following manner:

- (a) **MoE provides funding and project oversight.** Approximately 80% of the project funds are dedicated to the textbook program. Each school is allocated yearly KES 1,020 (US\$14.58) per pupil in FPESP funding based on the semi-annual MoE survey of enrollment. Every school maintains two bank accounts: one strictly for managing the purchase of textbooks, instructional material and stationery (Account 1 – SIMBA)²⁸; and the other for general purpose expenses (Account 2 – General Purpose). The MoE transfers funds directly into the school SIMBA account, which is held by a commercial bank. PricewaterhouseCoopers (PwC) assists the MoE in managing the database that records enrollment data and financial disbursements to the schools (FPESP database). FPESP only provides funds for the purchase of textbooks, instructional material and stationery.
- (b) **Schools are responsible for the procurement of textbooks.** The procurement of textbooks and instructional material is decentralized. Each school is required to establish a School Instructional Materials Procurement Committee (SIMPC), comprised of

²⁸ School Instructional Materials Bank Account

representative teachers and parents, which is responsible for the procurement of textbooks. Procurement must follow guidelines issued by the MoE, and textbooks must be selected from a list approved by the Kenya Institute for Education (KIE) and published in the "Orange Book." The Orange Book also indicates the maximum retail price for the listed books. The procurement guidelines stipulate that discounts may only be granted in the form of books, not cash. Each Head Teacher is ultimately responsible for the procurement of textbooks and for the proper use of FPESP funds.

APPROACH

77. *The DIR focused on the textbook acquisition component and the MoE's procurement and financial management of the project.* The Team reviewed the following project components: (i) KIE's textbook selection process; (ii) financial management and textbook procurement of a selection of schools in four different provinces as well as the MoE's oversight of textbook procurement; (iii) the MoE's internal procurement; and (iv) fraud and corruption safeguards incorporated into KESSP, FPESP's proposed successor project.

78. *Initial interviews and document review.* The Team obtained background information on the project's execution during interviews with FPESP stakeholders, such as the Permanent Secretary for Education and senior ministry officials. Additionally, the Team reviewed the MoE audit reports issued by internal and external auditors.

79. *Identifying internally procured contracts.* The Team mined the DIRDB for specific indicators of irregularities on the internally procured contracts and selected eight out of 18 FPESP contracts internally procured by the MoE for review.

80. *Identifying schools.* The Team then obtained a copy of the comprehensive FPESP database containing details of 18,100 schools, including enrollment figures, account numbers, locations, and teachers. PwC developed the database as part of an assignment to support FPESP. The database is held at the MoE. The Team selected 35 schools for site visits based on specific objective and subjective criteria that subjected these few schools to more risk for irregularities.

81. *School visits.* The Team visited 30 schools in four provinces; Nairobi, Eastern, Nyanza and Western. In addition, five Head Teachers from other schools in Nyanza province were interviewed in the Provincial Education Office, in Kisumu, Nyanza.

FINDINGS

82. *DIR outcome.* The review determined that a satisfactory level of accountability existed from the community level upwards, which contributed to the proper use of funds under FPESP. The project was consistently monitored and audited. The Team noted that FPESP had been frequently audited by internal auditors from the MoE and by both PwC and Ernst & Young, Kenya. In addition, MoE officials stated that they promptly addressed any issues encountered during project execution. For example, they stated that Head Teachers who falsified records were immediately terminated. Finally, the Team found that GoK project staff appeared adequately trained and motivated, and that the MoE reasonably monitored and supervised the project.

MINISTRY OF EDUCATION OPERATIONS

83. *MoE's mechanism for selecting textbooks appeared sound.* The KIE, which is situated within the MoE, appeared to have created a sound mechanism for ensuring that the selection of textbooks was carried out in a transparent manner, mitigating the risk of fraud, corruption and conflicts of interest. The evaluation panel responsible for selecting textbooks was comprised of seven members with relevant training and background, all vetted beforehand to avoid conflicts of interest. Once the textbook selection process was complete, the list of approved textbooks was sent to the Ministry Textbook Vetting Committee for final approval. The titles of the selected textbooks and the maximum allowable price are included in the Orange Book submitted to the Head Teachers to assist them in making cost-effective textbook procurement decisions.

84. *There were instances of erroneous enrollment data; however, it appears to have been caused by inadequate data entry.* The Team's initial analysis of the MoE enrollment data identified improbable increases in the numbers of pupils enrolled within certain schools.²⁹ However, upon verification, the Team observed no instances of intentional misrepresentation. In the case of Arya Primary School in Nairobi, the enrollment increased from 729 to 1729 because the MoE had entered an additional 1000 pupils by mistake. At the time of the DIR, the error had already been identified and rectified.

85. *FPESP funds were disbursed to the wrong accounts however, the MoE and schools eventually corrected these mistakes.* The Team's initial data analysis of the FPESP database indicated a number of discrepancies in the transfer of funds into the bank accounts of some schools. It appeared that funds intended for the SIMBA accounts were actually disbursed to the General Purpose accounts, and vice-versa. The Team found many instances, where the Head Teacher identified an irregularity and subsequently informed the MoE district affiliates, the District Education Offices (DEO), in order to obtain a letter authorizing the money to be transferred to the proper account. However, this process often took a long time. In the case of Matulo Primary School, the problem was first identified in 2003 and was not resolved until 2005. In other instances, funds were transferred to the wrong school because two schools had the same name, as seen in the district of Machakos. Where this had occurred, the DEO amended the name of the school to avoid future disbursement problems. Only in the case of Etono Primary School in Nyanza, did the (former) Head Teacher admit to using funds that were placed in the wrong account for illegitimate purchases. In that case, the DEO had already removed the Head Teacher before the DIR was conducted.

86. *Banks levied charges on school accounts in breach of the Memorandum of Understanding with the MoE.* The MoE and the commercial banks agreed that bank charges would not be levied on the school accounts. However, banks did in fact charge fees, which in some cases caused accounts to be overdrawn and subsequently closed. While the financial charges were relatively modest, they did impact the ability of some schools to make proper and complete payments. Furthermore, while the individual amounts are small, the sheer number of schools involved in FPESP has the potential of creating a very large amount of fees overall.

²⁹ The Team's initial analysis of enrollment data from February 2004 to December 2005, observed sizable variations from 11,939 % (Unit school in Asa Division of Mombassa from 18 enrolled pupils to 2,167 enrolled pupils) to 0%.

SCHOOL OPERATIONS

87. *Minor irregularities were identified in schools' textbook procurement and financial management.* The Team reviewed procurement and financial documentation related to 35 schools in four provinces and found evidence of only two instances of irregularities: at the Etono School and Arya Primary School, Nairobi. In the first case, the Head Teacher admitted to having misused funds, while in the second instance the Head Teacher accepted a discount for textbooks in cash. These situations appear to have occurred due to a lack of understanding of the MoE guidelines, rather than intentional misconduct. The overview listed in Table 21 summarizes these findings.

Table 21. FPESP: Overview of irregularities related to textbook procurement and financial management

Provinces	Schools Visited	Schools with Irregularities
Nairobi	12	1
Eastern	2	0
Nyanza	13	1
Western	3	0
Total	30	2
Head Teachers*	5	0
Overall Total	35	2

*Note: The Team interviewed Head Teachers from schools in the Nyanza province in the Provincial Education Office, in Kisumu, Nyanza, rather than at the local school.

88. *Some Head Teachers did not comply with MoE bidding and disclosure policies.* A number of Head Teachers were unaware of the MoE requirement stipulating competitive bidding, while others felt there was no need to change their supplier of textbooks if the current one performed well. Head Teachers are required to post expenditures on school premises for public viewing in order to aid transparency and avoid misuse of funds. In nine out of the 30 schools visited, the Team was not able to verify that such information was routinely publicly displayed. However, certain Head Teachers explained that publicly displayed documents tended to be stolen, and therefore the information was instead displayed within the Head Teacher's office.

89. *Some Head Teachers had difficulty managing school accounts.* A number of Head Teachers reported having difficulties in performing the bookkeeping and managing the school accounts, and felt that the training provided at the beginning of FPESP was inadequate. Some schools, such as Matulo Primary School, were able to hire a book-keeper (either on a part-time or full-time basis), whereas other schools, such as Kyaani Primary School in Machakos District and Gesabakwa Primary School, Nyanza Province, struggled with the process and clearly needed additional training.

90. *The textbook discounting system has the potential of being manipulated.* The Team found indications that the current discounting system could be manipulated, although only one

instance of irregular behavior was identified. In this case, it appeared that the Head Teacher in Arya Primary School, Nairobi, was given discounts in cash in violation of MoE guidelines that required discounts to be extended in the form of books.

MINISTRY OF EDUCATION INTERNAL PROCUREMENT

91. *Internal procurement contracts reviewed had indicators of minor procurement irregularities.* Under internal procurement, three out of the four contracts tendered by the MoE with sufficient documentation on which INT could render a finding exhibited indicators of minor irregularities, such as improper procurement procedures and conflicts of interest. However, internal procurement comprised a minor portion of the overall project expenditures:

Table 22. FPESP: Overview of irregularity indicators in the MoE's internal procurement

Total Contracts	Contracts Reviewed	% of Total Contracts	Contracts with Irregularity Indicators	% of Contracts Reviewed	Value of Contracts Reviewed (in USD)*	Value of Contracts with Irregularity Indicators (in USD)
18	8	44%	3	38%	\$527,000	\$257,000

* Note-worthy is that of the eight contracts selected for review, three of them had a critical lack of documentation which hampered a thorough review for indicators of irregularities.

92. *The MoE failed to disqualify improper bids.* In some instances, bidders failed to meet the specifications outlined in the Request for Proposal (RFP), however they were not disqualified. In the case of World Bank Contract Number (WBCN) 6, Education Management Information Systems (EMIS), the signature of one of the experts was missing from the CV as required in the RFP. Under WBCN 17, one bidder was short listed despite failing to meet the minimum points for the technical evaluation. Finally, under WBCN 18, firms were bidding for contracts and being evaluated although the ToR stated that only individuals could bid. In all instances, the BEC failed to disqualify the bidders.

93. *The MoE signed contracts before the Bank issued No-Objection Letters (NOLs).* In three instances, WBCN 3, WBCN 6 and WBCN 9, contracts were signed before the Bank issued its NOLs.

94. *The MoE maintained inadequate record keeping.* The Team found a noticeable lack of documentation in three of the eight contracts.³⁰ This hampered further review of those contracts for indicators and irregularities.

95. *Some Bidders had conflicts of interest.* The Team identified at least two instances of conflicts of interest. First, under WBCN 17, individuals listed as staff of one bidder appeared to be also actively involved in teaching for the winning bidder, namely Egerton University. Neither party disclosed this information. Second, under WBCN 18, two individuals submitted bids for

³⁰ WBCN 10, SbTD – Desktop Publishing; WBCN 11 -- Decentralization-Institutional Arrangement for Service Delivery; and WBCN 17 – Study of Instructional Material Provision in Secondary Education.

consultancy services both as firms and as individuals, in violation of the provisions contained in the bidding documents.

FINANCIAL MANAGEMENT REVIEW

96. *Schools used the majority of Bank funds for their intended purposes.* Most schools had adequate accounting records. In a few instances, the Team found that the accounting records were not available. Only one Head Teacher had utilized the funds for unintended purposes.

97. *Some schools exhibited indicators of irregularities in their financial management.* Nine percent of schools exhibited one or more of the following indicators of irregularities in their financial management: (i) funds were not used for the purchase of books; (ii) discounts were given in cash; or (iii) invoices were paid in cash instead of check. However, FPESP funds were generally managed in a transparent manner as evidenced by the following practices: (i) records of received funds were publicly posted at schools; (ii) minutes signed by SIMPC committee members were readily available; (iii) Head Teachers attended training; and (iv) audits or bank reconciliations were completed by third-parties, e.g., parents or external accountants.

98. *MoE and DEOs exhibited weak fiduciary capacity.* Members of the MoE project team were relatively inexperienced in managing Bank projects, and therefore lacked sufficient understanding of Bank procurement and financial management procedures.

99. *Annual disbursements to the schools did not conform to the project agreement.* The project calls for the annual disbursement of KES 650 per pupil in FPESP funding into the SIMBA account and for KES 370 per pupil in MoE funding into the General Purpose Account. However, data collected by PwC indicated that only 506 KES per pupil was disbursed in 2005. This issue will need to be reviewed further by the project team in order to determine whether any irregularities took place as a consequence.

Table 23. FPESP: MoE disbursement per pupil to the textbook account (SIMBA)

	Date	Amount KES	
2003	02-Jun-03	449	799
	26-Sep-03	350	
2004	05-Jul-04	150	650
	25-Aug-04	150	
	31-Dec-04	350	
2005	10-Jun-05	156	506
	19-Jan-06	350	

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100. *Proposed successor project review.* The Team also assessed the fraud and corruption safeguards built into KESSP, the proposed successor project to FPESP.

ASSESSMENT

101. *The MoE demonstrated commitment to proper administration of the project.* Overall, the Team was impressed by the level of commitment to KESSP, and the fight against corruption and collusion shown by the Permanent Secretary, his Ministry officials and the project staff.

102. *The MoE and the Bank integrated the lessons learned from FPESP into the project design of KESSP.* The Team confirmed through document reviews and interviews with stakeholders that the Bank had incorporated the risk mitigation measures it had derived from FPESP into the design of KESSP.

103. *INT believes that the safeguards of the KESSP are reasonable, provided that the project is enhanced with additional provisions derived from DIR findings.* To further ensure that the solid project design and the GoK commitment continues to benefit the KESSP objectives, the Team suggests that the Bank enters into discussion with the GoK to strengthen some KESSP provisions based on DIR findings of weaknesses within the FPESP.