



Kenya National Highways Authority

Quality Highways, Better Connections

PARLIAMENT
OF KENYA
LIBRARY

**RESPONSES TO THE AUDITOR GENERAL'S REPORT
ON ACCOUNTS OF KeNHA FOR THE FINANCIAL YEARS
2008/2009 – 2011/2012**

THE PUBLIC INVESTMENTS COMMITTEE

AUGUST 2013





Office of the Director General

KeNHA/Fin/PIC/Vol. 1/ (01)

9th August, 2013

The Chairman
Public Investment Committee
National Assembly
NAIROBI

Dear *Sir*

RE: APPEARANCE BEFORE THE PUBLIC INVESTMENTS COMMITTEE

I refer to the Clerk of the National Assembly's letter ref. KNA/PIC/CORR/2013/ (51) dated 24th July, 2013 inviting us to appear before the Public Investments Committee on Tuesday 13th August, 2013 from 2.30pm. in the above letter, we were asked to submit twenty seven (27) hard copies and a soft copy of our detailed submission in response to the relevant paragraphs on issues raised by the Auditor General in his reports for the periods 2008/2009 – 2011/2012.

The following paragraphs contain issues under scrutiny as raised by the Auditor General and our detailed response in the chronological order of financial periods.

15 MONTHS PERIOD ENDED 30.06.2010

Related Party Disclosures

Observation: *The trade and other receivable balance of Kshs. 758,504,369 as at 30th June 2010 excludes an amount of Kshs. 423,526,040 reflected in note 8 to the financial statements of Kenya Roads Board as payable to the Authority. The exclusion of the amount is contrary to international Accounting Standard No. 24, with regard to related party disclosures.*

15 16 17 18 19 20 21 22 23 24 25 26 27 28 29 30 31 32 33 34 35 36 37 38 39 40 41 42 43 44 45 46 47 48 49 50 51 52 53 54 55 56 57 58 59 60 61 62 63 64 65 66 67 68 69 70 71 72 73 74 75 76 77 78 79 80 81 82 83 84 85 86 87 88 89 90 91 92 93 94 95 96 97 98 99 100



Kenya National Highways Authority

Quality Highways, Better Connections

Blue shield Towers, Hospital Road, Upper Hill P.O. Box 49712 - 00100 Nairobi
Tel 020 - 8013842 Email dg@kenha.co.ke, info@kenha.co.ke Website www.kenha.co.ke

Office of the Director General

KeNHA/Fin/PIC/Vol. 1/ (01)

9th August, 2013

The Chairman
Public Investment Committee
National Assembly
NAIROBI

Dear Sir,

RE: APPEARANCE BEFORE THE PUBLIC INVESTMENTS COMMITTEE

I refer to the Clerk of the National Assembly's letter ref. KNA/PIC/CORR/2013/ (51) dated 24th July, 2013 inviting us to appear before the Public Investment Committee on Tuesday 13th August, 2013 from 2.30pm. in the above letter, we were asked to submit twenty seven (27) hard copies and a soft copy of our detailed submission in response to the relevant paragraphs on issues raised by the Auditor General in his reports for the periods 2008/2009 - 2011/2012.

The following paragraphs contain issues under scrutiny as raised by the Auditor General and our detailed response in the chronological order of financial periods.

15 MONTHS PERIOD ENDED 30.06.2010

Related Party Disclosures

Observation: The trade and other receivable balance of Kshs. 758,504,369 as at 30th June 2010 excludes an amount of Kshs. 423,526,040 reflected in note 8 to the financial statements of Kenya Roads Board as payable to the Authority. The exclusion of the amount is contrary to international Accounting Standard No. 24, with regard to related party disclosures.

Our response on the above observation made by KENAO is that our relationship with the Kenya Roads Board does not meet the threshold of related parties as per IAS 24 (*reproduced and marked Appendix I*) as the two entities are independent of each other and their Board of Directors operate independently. The management of the two organizations are also independent of each other as none controls the other. The relationship between the Kenya Roads Board and the Authority is best accounted for under IAS 20: Accounting for Government Grants and Disclosure of Government Assistance.

However, our non-disclosure of Kshs. 423,526,040 receivable from KRB was based on the fact that we were not aware of these funds as at the close of the financial year and subsequent preparation of the financial statements. This amount which related to KRB's surplus collections for financial year 2007/2008 was eventually received by the Authority in financial year 2010/2011 and appropriately treated as income for that year.

FINANCIAL YEAR 2010/2011

I. Emergency Markings on Mombasa Road

***Observation:** A Construction firm was awarded a contract for the emergency marking on Mombasa Road as a contract price of Kshs. 29,575,128. As per schedule provided for audit review, three payments totaling Kshs. 35,690,871 were made to the firm resulting to an over payment of Kshs. 6,115,743 (21%) over and above the contract price of Kshs. 29,575,125. However, the authority of the Tender Committee authorizing the 21% variation was not produced for audit verification. Consequently, it was not possible to determine the rationale of the over payment of Kshs. 6,115,743.*

We wish to respond to the above observation by our external auditors stated below;

The tender for Road Marking of Mombasa Road and Uhuru Highway (Between JKIA Gate and University way Round about) at a total cost of Kshs 29,575,128.00 to Ms Shengli Engineering Construction dated 18th August 2010 (*Copy of letter of Award attached in Appendix II*).

Owing to the urgency of the work, the order to commence was issued on 19th August 2010. (*Copy of letter attached in Appendix III*)

It is true, as per schedule provided for audit review; three payments totaling Kshs. 35,690,871.20 were made to the firm resulting to an overpayment of Kshs. 6,115,743.20 (21%) over and above the initial contract price of Kshs.

29,575,128.00. However, the authority of the Tender Committee authorizing the 21% variation was not produced for audit verification.

Due to the promulgation of the constitution which was to take place on 27th August 2010; we learnt that numerous VIPs including various Heads of State from Africa and beyond were invited to grace the occasion. There was thus need to urgently mark the road from the Jomo Kenyatta International Airport to Uhuru Park (the venue of promulgation) enable smooth flow of expected high traffic and to enhance road safety. The need to mark the road was also to create a positive image of the country in view of the road being gateway for the Mombasa Port to the country and Greater East African Region.

Arising from the receipt of short notice and most important in line with the Public Procurement and Disposal Act, the emergency work was procured through direct procurement process in order to meet the given deadline of six days at initial estimated cost of Kshs. 29,575,128.00 as per below detailed bill of quantities:-

ITEM	DESCRIPTION	UNIT	QTY	RATE	AMOUNT
1	Provide approved reflectorized white paint, and paint 100m3m wide white continuous lines at the road edge as directed by Engineer.	M ²	4,320	2,300	9,936,000.00
2	Approved reflectorized paint and paint 100mm wide Centre lines on the road as directed by the Engineer.	M ²	5,400	2,300	12,420,000.00
3	As item 20.01 but 200mm wide bus bays separation marking.	M ²	20	2,300	46,000.00
4	As item 20.01 but 500mm wide give way lines at junctions	M ²	120	2,300	276,000.00
5	As item 20.01 but 500mm wide pedestrian crossing marking	M ²	200	2500	500,000.00
	SUB-TOTAL				23,178,000.00
6	Add 10% of sub-total 1 for supervision and contingencies				2,317,800.00
	SUB-TOTAL				25,495,800.00
	Add 16% of Sub-Total 2 for VAT				4,079,328.00
	GRAND TOTAL				29,575,128.00

Upon receiving of orders to commence, the Regional Manager then reviewed the works through an explicit inventory (*attached in Appendix IV*), an appraisal and critical breakdowns submitting a variation of Kshs 6,171,833.60 to address the shortage of quantities which were underestimated, (*Copy of communication attached in Appendix V*).

The Key items which were underestimated were,

1. Increase of quantities for Provision of approved reflectorized white paint, and paint 100mm wide white continuous lines at the road edge as directed by Engineer. This was a result of omission in measurements for painting on round about at Nyayo, Bunyala, Haile Sellasie, and Kenyatta Avenue and several junctions along the road.
2. Provision of 500mm wide give way lines at junctions to enhance Safety in traffic speed change lanes through give away lines. The expected upsurge in traffic necessitated road furniture measure that would increase safety at turning points and acceleration and deceleration lanes. The quantity of this bill item increase of from 120m² to 1051.80m²
3. Increased pedestrian traffic expected at the function made it necessary to provide wider, longer and sufficient visible marked pedestrian (Crossing) zebra crossing with adequate reflective ballotini beads in order to improve visibility. The quantity for this Bill item increased from 20m² to 292.40m²
4. With the expected increase in motorized traffics and varied unmarked busbays along the road, they was need to introduce a bill item to provide for marking of the bus bays for the dropping and picking of passengers at designated bus stops/ bus bays. This quantity increased from 20m² to 1051.80m²
5. The expected traffic especially from expected visitors (Both Local and Foreign) to the city, there was need to provide directional signs so as to ease motoring by smoothly guiding drivers through the city highway. For this a new bill item on "Providing varied width for Directional Signs" which had been omitted in the original bills was added.

The appraisal captured not only items which had been underestimated but also included additional quantities for road marking of the section between University Way and Museum Hill Roundabout to create uniform new standards in view of the expected pedestrian traffic from along Thika Road towards Uhuru

Park attending the promulgation and also traffic and pedestrians arising from an approaching graduation ceremony of University of Nairobi that was scheduled for 17th September 2010 which was also to be graced by VIPs from within and without.

Upon receipt of the request and review, the General manager – Maintenance (as the AIE Holder of the fund) via memo reference KeNHA/MTCE/EAST dated 9th November 2010 (*Copy in Appendix VI*) wrote to the undersigned requesting approval to expend additional money to cater for the increased scope of works.

The variance in the quantities can be summarized in the table Summary of the changed BOQ was as below

ITEM	DESCRIPTION	UNIT	ORIGINAL QTY	APPRAISED QUANTITY	INCREASE IN QUANTITY	ORIGINAL RATE	APPRAISED RATE
1	Provide approved reflectorized white paint, and paint 100mm wide white continuous lines at the road edge as directed by Engineer.	M ²	4,320	5476	1156	2,300	2,300
2	Approved reflectorized paint and paint 100mm wide Centre lines on the road as directed by the Engineer.	M ²	5,400	5,894.50	494.5	2,300	2,300
3	As item 20.01 but 200mm wide bus bays separation marking.	M ²	20	398.41	378.41	2,300	2,300
4	As item 20.01 but 500mm wide give way lines at junctions	M ²	120	1051.80	931.80	2,300	2,300
5	As item 20.01 but 500mm wide pedestrian crossing marking	M ²	200	292.40	92.40	2500	2,300
6	As item 20.01 but varied width for Directional Signs	M ²	0	168	168	-	2,300

This necessitated the revision of the BoQs as shown in the table below;

ITEM	DESCRIPTION	UNIT	QTY	RATE	AMOUNT
1	Provide approved reflectorized white paint, and paint 100mm wide white continuous lines at the road edge as directed by Engineer.	M ²	5476	2,300	12,594,800.00
2	Approved reflectorized paint and paint 100mm wide Centre lines on the road as directed by the Engineer.	M ²	5,894.50	2,300	13,557,350.00
3	As item 20.01 but 200mm wide bus bays separation marking.	M ²	398.41	2,300	916,349.00
4	As item 20.01 but 500mm wide give way lines at junctions	M ²	1051.80	2,300	2,418,013.00
5	As item 20.01 but 500mm wide pedestrian crossing marking	M ²	292.40	2500	731,000.00
6	As item 20.01 but varied width for Directional Signs	M ²	168	2500	420,000.00
SUB-TOTAL					30,637,512.00
Add 16% of Sub-Total 2 for VAT					5,053,359.00
GRAND TOTAL					35,690,871.20

The Variation was found reasonable and given a go ahead for processing vide a note in the letter marked *Appendix VII* by Director General approving expenditure of Kshs 6,171,833.60.

Whereas we fully appreciate the concerns raised the external auditors that extra costs in terms of additional bills of quantities required KeNHA's Tender Committee approval, we wish to clarify that the Authority endeavored to follow due process in assessing additional costs arising from the submitted appraisal. However owing to urgency of the works and strict timelines to complete the works on scheduled time as to avoid wanton delays to traffic while executing works to specifications and most importantly for security reasons as the

promulgation of the constitution involved the Heads of States and other invited dignitaries , there was delay in seeking Tender Committee approval. Arising from the above it was found far from possible to seek Tender Committee approval as:-

- (i) Expenditure had already been incurred and the contractor had raised a claim for payment for works measured as executed, therefore authority to vary would be post facto
- (ii) Delay in payment of the contractor for the works measured as executed would have resulted in tentative costs arising from interest due to delayed payments..
- (iii) Similarly, it would not have been possible to complete the works within the given deadline of six days due to long procurement process.
- (iv) Identification of different contractor would result in additional costs arising from delay in procurement and mobilization process.
- (v) Re-packaging of a new contract for additional quantities within the execution time was not feasible given the time limits.

Given the circumstances under which the emergency works were contracted and subsequently carried out within short notice we are of the view that the decision arrived at to allow additional work to be done to facilitate opening of the Road, was done at the safety and economic benefit of this country. Similarly, the unit price rate had not changed as per contract and KeNHA went to great lengths in checking and verifying that variations were cost effective and obtained value for money.

The nature of procurement and execution was by then unprecedented and as such an error of omission occurred. Indeed KeNHA learnt from the experience and such an occurrence has never been witnessed ever since.

II. Projects Accounts for The Financial Year Ending 30th June, 2011 Commitment fees

1. Nairobi – Thika Highway Improvement Project No. P-KE-DBO-018

During the year under review, the Government paid commitment fees of Kshs.43, 487,020 (US\$ 483,942) against the undisbursed portion of the loan, pursuant to Article III, Section 3.03 of the Loan Agreement. This payment in effect increased the cumulative commitment fees paid against the loan to Kshs. 174,315,874 (US\$ 2,176,645) as at 30 June 2011.

2. Arusha – Namanga – Athi River Road Development Project No P-ZI-DB0-040

As similarly reported in 2009/2010 the Government incurred commitment charges of Kshs. 25,744,900 (US\$ 289,500) on account of the undisbursed portion of the loan pursuant to section 3.03 of the Loan Agreement.

3. Northern Corridor Transport Improvement Project (IDA CREDIT NOs.3930 KE AND 4572KE)

As reported in 2009/2010, a commitment fee of Kshs. 55,651,395 (US\$ 647,938) was paid in the year under review against the undisbursed portion of the loan, pursuant to Article 11 Section 2.04 (a) of the Credit Agreement. This payment in effect increased the credit to Kshs. (201,582,717 (US\$ 2,652,677) as at 30 June 2011.

Management has explained that the commitment fee is attributable to circumstances beyond the Authority's control such as:-

- a. Procurement procedures applicable which are prolonged and require prior review by the financier.*
- b. The implementation period extends over several years and,*
- c. Budgetary constraints due to inadequate allocations to facilitate completion of projects in time.*

However, with proper planning such nugatory expenditures by the Authority could be minimized.

Commitment fees in the context of Development Financing Credit are fees charged by a Development Partner to the Government for an unused credit line or undisbursed loan. A commitment fee is generally specified as a fixed percentage between 0.10% to 1.0% per annum on the undisbursed loan amount. These lenders charge commitment fees as compensation for keeping a line of credit open or to guarantee loan proceeds at a specific date in future within the life of the financing agreement. The borrower pays the fee in return for the assurance that the lender will supply the loan funds at the specified future date and at the contracted interest rate, regardless of conditions in the international financial and credit markets. For our two major Development Partners, i.e AfDB and IDA, Commitment fees commence accruing 120 and 42 days respectively from the date of signing the Financing Agreement. Commitment fees can therefore not be totally avoided since it is impractical to draw down the entire Development Credit within 42 to 120 days. It is also important to take cognizance of the fact that draw downs on credit have an ascending tendency within the development project life cycle.

The following is our response on the commitment fees accrued on the individual projects picked by the Auditor General;

1. Commitment fees on Nairobi – Thika Highway improvement project

The Financing Agreement for the above project was signed between the Government of Kenya and the African Development Bank on 26th November, 2007 to finance works for lots 1 and 2 of the project. The procurement process for contractors to carry on construction works began shortly thereafter with the necessary No-Objections at each stage of the procurement process from AfDB. Over 12 months had lapsed between the time the procurement process started to receipt of the first interim payment certificate which led to the first draw down. During this time, commitment fees were accruing on the gross credit.

The project's proximity to the city center was affected by the following challenges;

- Numerous service lines such as underground sewage lines, fresh water lines, telephone etc which the local Authorities had no idea or data of their locations. This therefore led to frequent interruptions on the project.
- High prices of land and buildings as a result of high levels of development along the new corridor increased the cost of compensation of the Project Affected Persons,
- Inability by the Government to allocate adequate financial resources to compensate PAPs led to frequent interruptions of the project progress,
- Location of the large water reservoir serving a highly populated area located along the new road corridor whose relocation involved numerous stakeholders hence project time.

During the life cycle of the project, GOK budgetary allocations were not sufficient to carter for certified works. Further, there had been delays in the release of Exchequer which was tied to Economic performance. In most instances, the Project exhausted its annual budgetary allocation within the first three months of the financial year. This led to further delays in payments which could only be effected upon the release of supplementary budget which was again inadequate to settle all payment certificates generated during the financial year leading to pending bills at the close of the financial year. This vicious cycle led to excessive delays in the settlement of contractors' dues leading to slow progress of work culminating to the slowing down of works which led to the accumulation of

commitment fees. Attached and marked *Appendix VIII* and *IX* are the Financing Agreement and Project summary.

2. Commitment fees on Arusha-Namanga-Athi River Road development project

The financing agreement was signed on 8th February, 2007 between AfDB and GOK. This project was also affected by factors similar to the Nairobi – Thika Highway on:

- a) Delayed commencement of works due donor procedures,
- b) High price of compensating Project Affected Persons at Athi River , Kitengela, Kajiado and Namaga towns and,
- c) Insufficient Budgetary allocations leading to a vicious cycle of delayed payments

The above factors slowed down the contractor which led to low drawdowns resulting to accumulating commitment fees. Attached and marked *Appendix X* is the Financing Agreement for the project.

3. Commitment fees on Northern Corridor Transport Improvement Project –Kshs. 55,651,395

The Financing Agreement was signed on 25th June, 2004 between GOK and IDA. This project was also affected by factors similar to the above two projects leading to the accumulation of commitment fees. Attached and marked *Appendix XI* is the project's Financing Agreement.

FINANCIAL YEAR 2011/2012

Property, Plant and Equipment

- i. **Observation:** *Note 2 to the financial statements, discloses that all investments on road constructions and rehabilitations have been captured under work-in-progress awaiting formalization of capitalization policy of road assets. However, included in the work-in-progress amount of Kshs.87.7 billion as at 30 June 2012 are roads which have been completed and handed over to the Authority by contractors. Besides, note 1(g) to the financial statements, discloses that the assets and liabilities vesting process by Ministry of Roads to the Authority has been completed. However, the vested assets mainly roads have not been valued and incorporated in the financial statements. Management has not explained why*

the roads have not been capitalized and depreciated over the estimated useful life of the roads in line with the requirements of International Accounting Standards no. 16. In consequences, the surplus for the year ended 30 June 2012 of Kshs. 1,391,219,850 is overstated by undetermined amount of depreciation.

Our response on the Kenya National Audit Office Report on our financial statements for the year ended 30th June, 2012 on Property, Plant, and Equipment is as indicated below

I. Non capitalization hence depreciation of Road Assets. Contrary to IAS 16.

We agree with the auditor's observation that a total of Kshs. 87.9 Billion is included as Work-In-Progress in respect of the Authority's Development Expenditure investments in class A, B and C road network in the financial statements of the Authority for the year ended 30th June, 2012. Whereas it is also true that a few of these roads have since been completed and formerly handed over to the Authority, it is important to note that majority of the investments in these roads were undertaken by the Parent Ministry prior to the establishment of the Authority.

We however disagree with the suggested recommendation of applying the provisions of the International Accounting Standard 16 on the accounting treatment of road assets since this is outside the scope of IAS 16 as analyzed from its provisions detailed below;

• **IAS 16 – Recognition**

“The cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:

- a) It is probable that future economic benefits associated with the item will flow to the entity; and
- b) The cost of the item can be reliably measured.”

Challenges;

- 1) It is impossible to ascertain & measure how future economic benefits arising from the use of the roads by the public accrues to the Authority.
- 2) The actual financial investments by the Parent Ministry cannot be ascertained with accuracy since these have been accumulated over a long

period of time. KeNHA's investments as indicated in the WIP are therefore a very small portion of the total investment in the individual roads.

- 3) Capitalizing the individual amounts invested by the Authority hence depreciation will be undervaluing the road asset and mislead users of our financial statements.
- 4) Road works is an area of significant accounting judgments which have substantial impact on financial outturn. These areas include;

- ***Valuation of the trunk road network***

These assets require full valuations at certain specified intervals. This process requires the use of estimates. On most occasions there will be a reduction in the value of the network which we are a result of efficient and better value design and construction processes resulting in construction cost reductions subsequently a realignment of costs to actual rather than indexed values. (Pre-determined values). This therefore calls for an Asset Valuation System that is not developed in Kenya.

- ***Recognition & valuation of provisions***

Due to the long-term nature of the road improvement activities, certain assumptions, judgments and estimates are made in the recognition and valuation of legal and constructive obligations that are of uncertain timing or amount, such as provisions relating to compensation claims and acquisition of land. These calculations may require the use of indices such as a resource cost index for road construction, Contract costs adjustment index and land indices, which may not be readily available in Kenya. The Authority can also be subject to contractual and damages claims. Assessing the likelihood of adverse judgments or outcomes, as well as the ranges of probable and estimated losses are matters that may require policy direction by the Government.

- **Depreciation**

Capitalization and subsequent valuation of road works may necessitate calculation of the depreciation charge in two parts;

- The valuation of the road network is adjusted to reflect the deterioration of improvements in pavement conditions and
- The value of service potential replaced through substantive maintenance programmes.

These computations require a comprehensive annual road conditions survey, which is not frequently conducted in Kenya.

In this regard, since none of the International Accounting Standards cover the treatment of road assets, the Authority is currently taking the following measures so as to develop a policy that will adequately address road asset management;

- Consulting with professional bodies e.g ICPAK, IEK, ISK etc on the treatment of the road asset,
- International benchmarking with countries which have advanced road asset management system,
- Exploring the possibility of engaging a professional valuer to ascertain the fair value of the entire road network under our jurisdiction. This is however a costly endeavor as it will require substantial budgetary allocations and will take a long time to complete. Attached and marked *Appendix XII* is the International Accounting Standard no. 16.

It is for this reason that Development Expenditure Investments in the road network will be treated as a WIP until a comprehensive national policy is developed or an appropriate International Accounting Standard is issued

- ii. **Observation:** Note 2 to the financial statements discloses that, work-in-progress (others) a balance of Kshs.26,874, 804 as at 30 June 2012, includes Kshs. 16,015,322 incurred on the construction of a regional office in Lower Eastern Province. However, the value of the land on which the construction is being undertaken has not been included in the financial statements.


It is also true that Kshs. 16,015,322.00 has been included as WIP-others in respect of construction of regional office at Lower Eastern. The certificate of practical completion was issued at the year-end hence no depreciation was charged in the period under audit, see attached certificate. Note that the office block was constructed on Government land which is also occupied by KURA, KeRRA, Housing & Public Works and the regional Mechanical & Transport Fund all of which are Government Institutions.

Further, no financial consideration was made to the Government by the Authority hence the non-recognition of the cost of land in our books. This is also the same principal applied on Road Assets which are constructed on Government land.

Last but not least, the land where the office block was constructed is yet to be sub-divided (which could facilitate individual valuations hence change of ownership) to the Government institutions currently occupying the land.

We hope the above have clarified all issues retained by the Kenya National Audit Office in our financial statements from inception to 30th June, 2012.

Yours *faithfully*


Eng. M. O. Kidenda MBS, HSC
DIRECTOR GENERAL

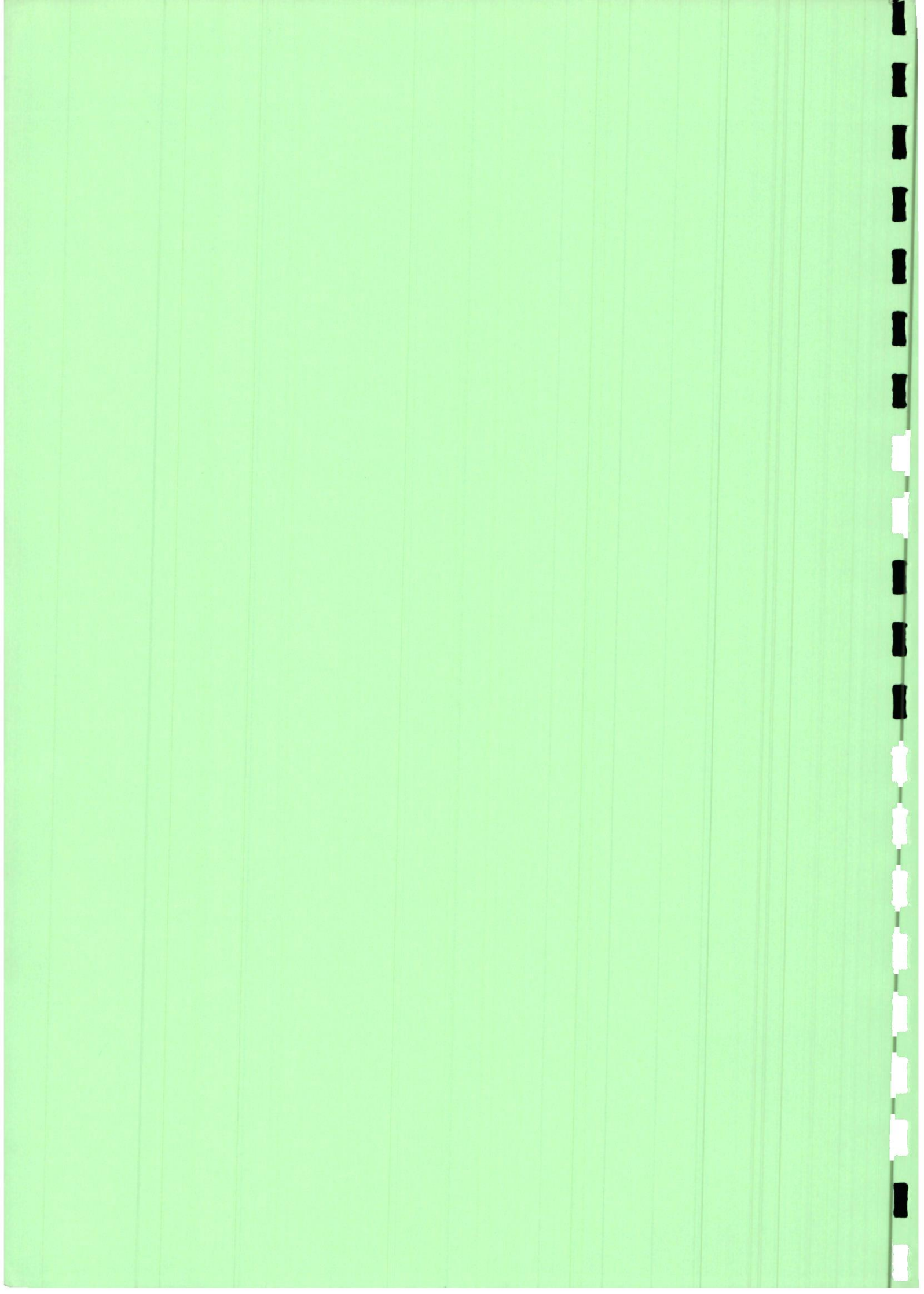
Enc.

CC: Mr. Justin N. Bundi
Clerk of the National Assembly
Parliament Buildings
NAIROBI

Mr. Edward R. Ouko
Auditor General,
Kenya National Audit Office,
Anniversary Towers
NAIROBI.



APPENDIX I



International Accounting Standard 24**Related Party Disclosures**

In April 2001 the International Accounting Standards Board (IASB) adopted IAS 24 *Related Party Disclosures*, which had originally been issued by the International Accounting Standards Committee in July 1984.

In December 2003 the IASB issued a revised IAS 24 as part of its initial agenda of technical projects that included amending disclosures on management compensation and related party disclosures in separate financial statements. The IASB revised IAS 24 again to address the disclosures in government-related entities.

In December 2009 the IASB issued a revised IAS 24 to simplify the definition of 'related party' and to provide an exemption from the disclosure requirements for some government-related entities.

Other IFRSs have made minor consequential amendments to IAS 24. They include IAS 1 *Presentation of Financial Statements* (as revised in September 2007).

CONTENTS

INTRODUCTION

**INTERNATIONAL ACCOUNTING STANDARD 24
RELATED PARTY DISCLOSURES**

OBJECTIVE

SCOPE

PURPOSE OF RELATED PARTY DISCLOSURES

DEFINITIONS

DISCLOSURES

All entities

Government-related entities

EFFECTIVE DATE AND TRANSITION

WITHDRAWAL OF IAS 24 (2003)

APPENDIX

Amendment to IFRS 8 *Operating Segments*

FOR THE ACCOMPANYING DOCUMENTS LISTED BELOW, SEE PART B OF THIS EDITION

APPROVAL BY THE BOARD OF IAS 24 ISSUED IN NOVEMBER 2009

BASIS FOR CONCLUSIONS

APPENDIX

Amendment to the Basis for Conclusions on IAS 19 *Employee Benefits*

DISSENTING OPINION

ILLUSTRATIVE EXAMPLES

TABLE OF CONCORDANCE

International Accounting Standard 24 *Related Party Disclosures* (IAS 24) is set out in paragraphs 1-29 and the Appendix. All of the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. IAS 24 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

The revised Standard was issued in November 2009. It supersedes IAS 24 (as revised in 2004). The text of the revised Standard, marked to show changes from the previous version, is available from the IASB's Subscriber Website at www.ifrs.org for a limited period.

Introduction

IN1 International Accounting Standard 24 *Related Party Disclosures* (IAS 24) requires a reporting entity to disclose

- (a) transactions with its related parties, and
- (b) relationships between parents and subsidiaries, irrespective of whether there have been transactions between those related parties.

IN2 The International Accounting Standards Board revised IAS 24 in 2009 by:

- (a) simplifying the definition of a related party, clarifying its intended meaning and eliminating inconsistencies from the definition,
- (b) providing a partial exemption from the disclosure requirements for government related entities.

IN3 In making those revisions, the Board did not reconsider the fundamental approach to related party disclosures contained in IAS 24 (as revised in 2003).

International Accounting Standard 24

Related Party Disclosures

Objective

- 1 The objective of this Standard is to ensure that an entity's financial statements contain the disclosures necessary to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties.

Scope

- 2 **This Standard shall be applied in:**
- (a) identifying related party relationships and transactions;
 - (b) identifying outstanding balances, including commitments, between an entity and its related parties;
 - (c) identifying the circumstances in which disclosure of the items in (a) and (b) is required; and
 - (d) determining the disclosures to be made about those items.
- 3 **This Standard requires disclosure of related party relationships, transactions and outstanding balances, including commitments, in the consolidated and separate financial statements of a parent or investors with joint control of, or significant influence over, an investee presented in accordance with IFRS 10 *Consolidated Financial Statements* or IAS 27 *Separate Financial Statements*. This Standard also applies to individual financial statements.**
- 4 Related party transactions and outstanding balances with other entities in a group are disclosed in an entity's financial statements. Intragroup related party transactions and outstanding balances are eliminated, except for those between an investment entity and its subsidiaries measured at fair value through profit or loss, in the preparation of consolidated financial statements of the group.

Purpose of related party disclosures

- 5 Related party relationships are a normal feature of commerce and business. For example, entities frequently carry on parts of their activities through subsidiaries, joint ventures and associates. In those circumstances, the entity has the ability to affect the financial and operating policies of the investee through the presence of control, joint control or significant influence.
- 6 A related party relationship could have an effect on the profit or loss and financial position of an entity. Related parties may enter into transactions that unrelated parties would not. For example, an entity that sells goods to its parent

at cost might not sell on those terms to another customer. Also, transactions between related parties may not be made at the same amounts as between unrelated parties.

- 7 The profit or loss and financial position of an entity may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the entity with other parties. For example, a subsidiary may terminate relations with a trading partner on acquisition by the parent of a fellow subsidiary engaged in the same activity as the former trading partner. Alternatively, one party may refrain from acting because of the significant influence of another—for example, a subsidiary may be instructed by its parent not to engage in research and development.
- 8 For these reasons, knowledge of an entity's transactions, outstanding balances, including commitments, and relationships with related parties may affect assessments of its operations by users of financial statements, including assessments of the risks and opportunities facing the entity.

Definitions

- 9 The following terms are used in this Standard with the meanings specified:

A related party is a person or entity that is related to the entity that is preparing its financial statements (in this Standard referred to as the 'reporting entity').

- (a) A person or a close member of that person's family is related to a reporting entity if that person:
- (i) has control or joint control of the reporting entity;
 - (ii) has significant influence over the reporting entity; or
 - (iii) is a member of the key management personnel of the reporting entity or of a parent of the reporting entity.
- (b) An entity is related to a reporting entity if any of the following conditions applies:
- (i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).
 - (ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).
 - (iii) Both entities are joint ventures of the same third party.
 - (iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

- (v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.
- (vi) The entity is controlled or jointly controlled by a person identified in (a).
- (vii) A person identified in (a)(i) has significant influence over the entity or is a member of the key management personnel of the entity (or of a parent of the entity).

A *related party transaction* is a transfer of resources, services or obligations between a reporting entity and a related party, regardless of whether a price is charged.

Close members of the family of a person are those family members who may be expected to influence, or be influenced by, that person in their dealings with the entity and include:

- (a) that person's children and spouse or domestic partner;
- (b) children of that person's spouse or domestic partner; and
- (c) dependants of that person or that person's spouse or domestic partner.

Compensation includes all employee benefits (as defined in IAS 19 *Employee Benefits*) including employee benefits to which IFRS 2 *Share-based Payment* applies. Employee benefits are all forms of consideration paid, payable or provided by the entity, or on behalf of the entity, in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity. Compensation includes:

- (a) short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;
- (b) post-employment benefits such as pensions, other retirement benefits, post-employment life insurance and post-employment medical care;
- (c) other long-term employee benefits, including long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation;
- (d) termination benefits; and
- (e) share-based payment.

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity.

Government refers to government, government agencies and similar bodies whether local, national or international.

A *government-related entity* is an entity that is controlled, jointly controlled or significant influence by a government.

The terms 'control' and 'investment entity', 'joint control' and 'significant influence' are defined in IFRS 10, IFRS 11 *Joint Arrangements* and IAS 28 *Investments in Associates and Joint Ventures* respectively and are used in this Standard with the meanings specified in those IFRSs.

10 In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely the legal form.

11 In the context of this Standard, the following are not related parties:

- (a) two entities simply because they have a director or other member of key management personnel in common or because a member of key management personnel of one entity has significant influence over the other entity.
- (b) two joint venturers simply because they share joint control of a joint venture.
- (c)
 - (i) providers of finance,
 - (ii) trade unions,
 - (iii) public utilities, and
 - (iv) departments and agencies of a government that does not control, jointly control or significant influence the reporting entity,
 simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process).
- (d) a customer, supplier, franchisor, distributor or general agent with whom an entity transacts a significant volume of business, simply by virtue of the resulting economic dependence.

12 In the definition of a related party, an associate includes subsidiaries of the associate and a joint venture includes subsidiaries of the joint venture. Therefore, for example, an associate's subsidiary and the investor that has significant influence over the associate are related to each other.

Disclosures

All entities

13 Relationships between a parent and its subsidiaries shall be disclosed irrespective of whether there have been transactions between them. An entity shall disclose the name of its parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces consolidated financial statements available for public use, the name of the next most senior parent that does so shall also be disclosed.

14 To enable users of financial statements to form a view about the effects of related party relationships on an entity, it is appropriate to disclose the related party relationship when control exists, irrespective of whether there have been transactions between the related parties.

15 The requirement to disclose related party relationships between a parent and its subsidiaries is in addition to the disclosure requirements in IAS 27 and IFRS 12 *Disclosure of Interests in Other Entities*.

16 Paragraph 13 refers to the next most senior parent. This is the first parent in the group above the immediate parent that produces consolidated financial statements available for public use.

17 **An entity shall disclose key management personnel compensation in total and for each of the following categories:**

- (a) short-term employee benefits;
- (b) post-employment benefits;
- (c) other long-term benefits;
- (d) termination benefits; and
- (e) share-based payment.

18 If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to those in paragraph 17. At a minimum, disclosures shall include:

- (a) the amount of the transactions;
- (b) the amount of outstanding balances, including commitments, and:
 - (i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
 - (ii) details of any guarantees given or received;

- (c) provisions for doubtful debts related to the amount of outstanding balances; and
- (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

19 The disclosures required by paragraph 18 shall be made separately for each of the following categories:

- (a) the parent;
- (b) entities with joint control of, or significant influence over, the entity;
- (c) subsidiaries;
- (d) associates;
- (e) joint ventures in which the entity is a joint venturer;
- (f) key management personnel of the entity or its parent; and
- (g) other related parties.

20 The classification of amounts payable to, and receivable from, related parties in the different categories as required in paragraph 19 is an extension of the disclosure requirement in IAS 1 *Presentation of Financial Statements* for information to be presented either in the statement of financial position or in the notes. The categories are extended to provide a more comprehensive analysis of related party balances and apply to related party transactions.

21 The following are examples of transactions that are disclosed if they are with a related party:

- (a) purchases or sales of goods (finished or unfinished);
- (b) purchases or sales of property and other assets;
- (c) rendering or receiving of services;
- (d) leases;
- (e) transfers of research and development;
- (f) transfers under licence agreements;
- (g) transfers under finance arrangements (including loans and equity contributions in cash or in kind);
- (h) provision of guarantees or collateral;
- (i) commitments to do something if a particular event occurs or does not occur in the future, including executory contracts¹ (recognised and unrecognised); and
- (j) settlement of liabilities on behalf of the entity or by the entity on behalf of that related party.

¹ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* defines executory contracts as contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

- 22 Participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities is a transaction between related parties (see paragraph 42 of IAS 19 (as amended in 2011)).
- 23 Disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such terms can be substantiated.
- 24 **Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.**

Government-related entities

- 25 A reporting entity is exempt from the disclosure requirements of paragraph 18 in relation to related party transactions and outstanding balances, including commitments, with:
- (a) a government that has control or joint control of, or significant influence over, the reporting entity; and
 - (b) another entity that is a related party because the same government has control or joint control of, or significant influence over, both the reporting entity and the other entity.
- 26 If a reporting entity applies the exemption in paragraph 25, it shall disclose the following about the transactions and related outstanding balances referred to in paragraph 25:
- (a) the name of the government and the nature of its relationship with the reporting entity (ie control, joint control or significant influence);
 - (b) the following information in sufficient detail to enable users of the entity's financial statements to understand the effect of related party transactions on its financial statements:
 - (i) the nature and amount of each individually significant transaction; and
 - (ii) for other transactions that are collectively, but not individually, significant, a qualitative or quantitative indication of their extent. Types of transactions include those listed in paragraph 21.
- 27 In using its judgement to determine the level of detail to be disclosed in accordance with the requirements in paragraph 26(b), the reporting entity shall consider the closeness of the related party relationship and other factors relevant in establishing the level of significance of the transaction such as whether it is
- (a) significant in terms of size;
 - (b) carried out on non-market terms;
 - (c) outside normal day-to-day business operations, such as the purchase and sale of businesses;

- (d) disclosed to regulatory or supervisory authorities;
- (e) reported to senior management;
- (f) subject to shareholder approval.

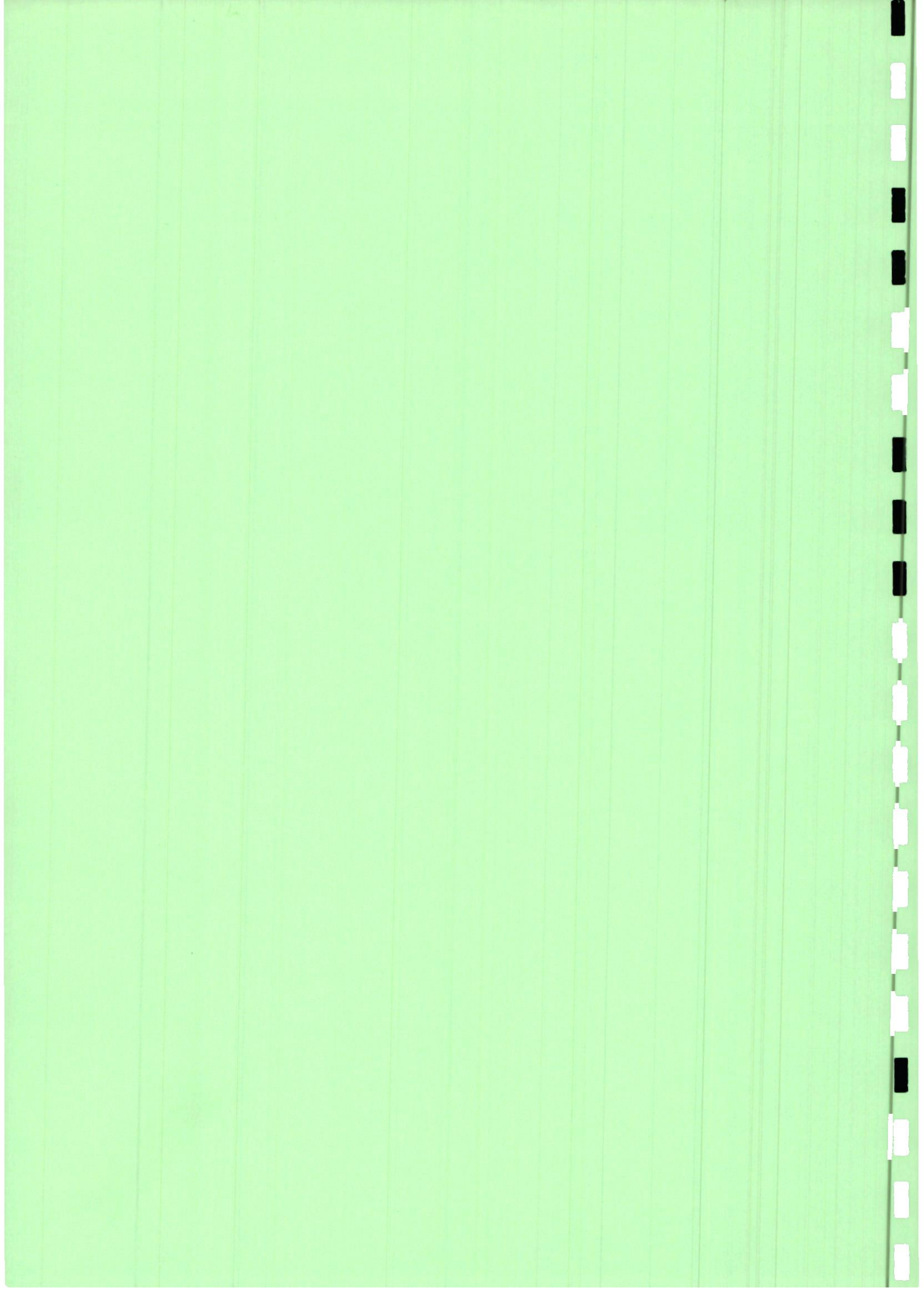
Effective date and transition

- 28 An entity shall apply this Standard retrospectively for annual periods beginning on or after 1 January 2011. Earlier application is permitted, either of the whole Standard or of the partial exemption in paragraphs 25-27 for government-related entities. If an entity applies either the whole Standard or that partial exemption for a period beginning before 1 January 2011, it shall disclose that fact.
- 28A IFRS 10, IFRS 11 *Joint Arrangements* and IFRS 12, issued in May 2011, amended paragraphs 3, 9, 11(b), 15, 19(b) and (e) and 25. An entity shall apply those amendments when it applies IFRS 10, IFRS 11 and IFRS 12.
- 28B *Investment Entities* (Amendments to IFRS 10, IFRS 12 and IAS 27), issued in October 2012, amended paragraphs 4 and 9. An entity shall apply those amendments for annual periods beginning on or after 1 January 2014. Earlier application of *Investment Entities* is permitted. If an entity applies those amendments earlier it shall also apply all amendments included in *Investment Entities* at the same time.

Withdrawal of IAS 24 (2003)

- 29 This Standard supersedes IAS 24 *Related Party Disclosures* (as revised in 2003).

APPENDIX II





Kenya National Highways Authority

Quality Highways, Better Connections

Blue Shield Towers, Hospital Road, Upper Hill P.O. Box 49712 – 00100 Nairobi
Tel 020 – 8013842 Email dg@kenha.co.ke / info@kenha.co.ke Website www.kenha.co.ke

18th August, 2010

KeNHA/D/121/2010

**M/s Shengli Engineering Construction
(Group) Co. Ltd of Shengli Oilfield
P.O. Box 48297-00100
NAIROBI**

URGENT

Dear Sir/Madam,

**RE: TENDER FOR ROAD MARKINGS OF MOMBASA ROAD AND UHURU
HIGHWAY (BETWEEN JKIA GATE AND UNIVERSITY WAY
ROUNDAABOUT)**


We refer to your offer for the above Tender and wish to inform you that Kenya National Highways Authority has awarded you the **tender for Road Markings of Mombasa Road and Uhuru Highway (Between JKIA Gate and University Way Roundabout) at a total cost of Kshs.29,575,128.00** (Kenya Shillings twenty nine million , five hundred and seventy five thousand, one hundred and twenty eight only) inclusive of VAT and supervision.

Please acknowledge receipt of this letter of notification as a confirmation of your acceptance.

The contract shall be signed by the parties upon receipt of your acceptance.

You may contact our Head of Procurement on the subject matter of this letter of notification of award.

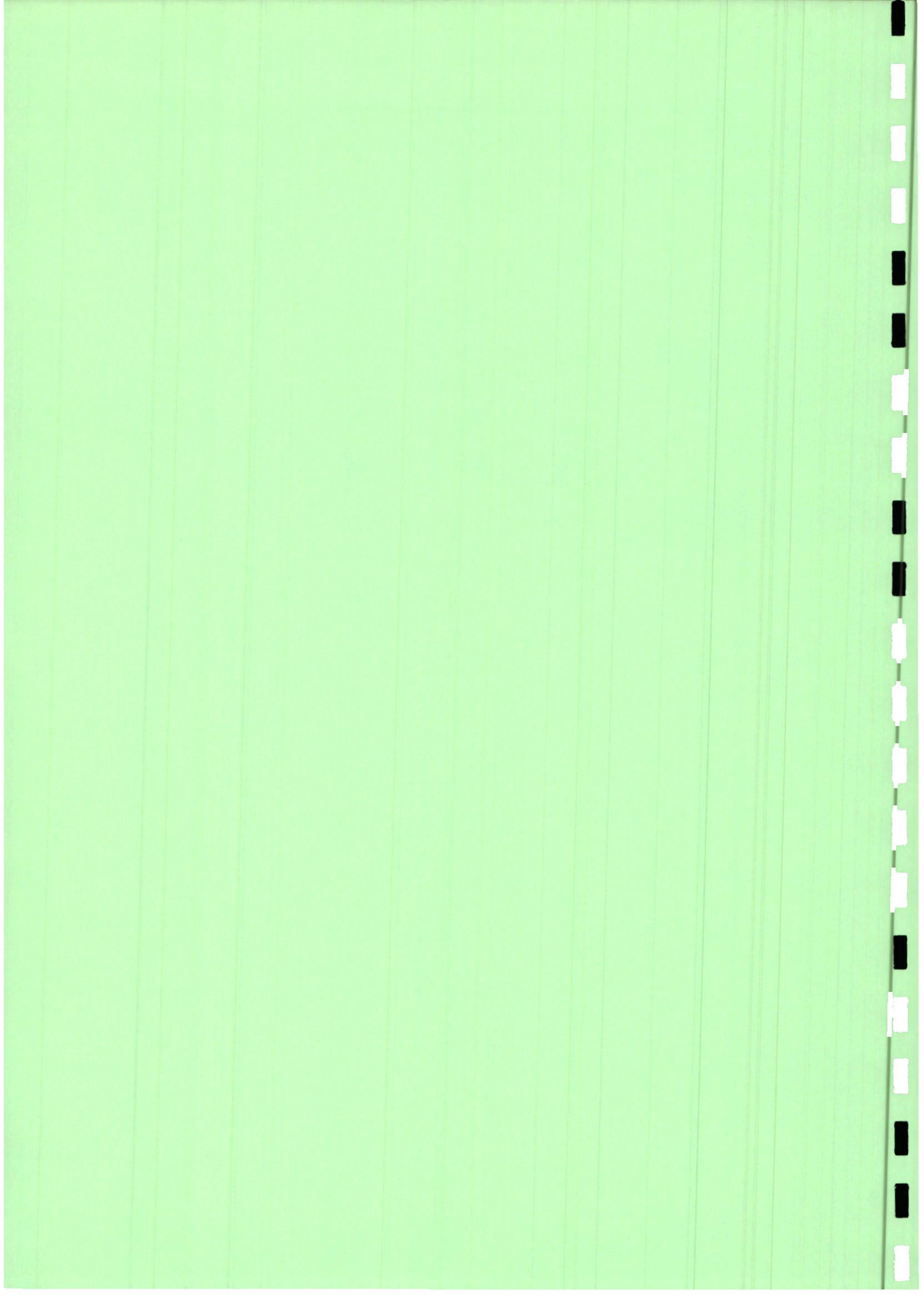
Yours faithfully,


**Eng. M.O. Kidenda, HSC
DIRECTOR GENERAL**

C.c - GM/M - You may issue letter of commencement to the contractor



APPENDIX III





KenHA/RD/MM/2010/002

19th August, 2010

Shengli Engineering Construction
(Group) Co. Ltd of Shengli Oilfield
P.O. Box 48297-00100

NAIROBI

Dear Sirs,

ROAD MARKING OF MOMBASA ROAD AND UHURU HIGHWAY
(BETWEEN JKIA AND UNIVERSITY WAY ROUNDABOUT)
ORDER TO COMMENCE WORKS AND POSSESSION OF SITE THERETO.

Pursuant to Clause 41.1 and 42.1 of the Conditions of Contract you are hereby instructed to commence the works immediately.

You are also hereby given possession of site and access thereto.

Yours faithfully

Eng. K. I. Mudulia.

FOR GENERAL MANAGER (MAINTENANCE)

Copy: Director General

Kenya National Highways Authority

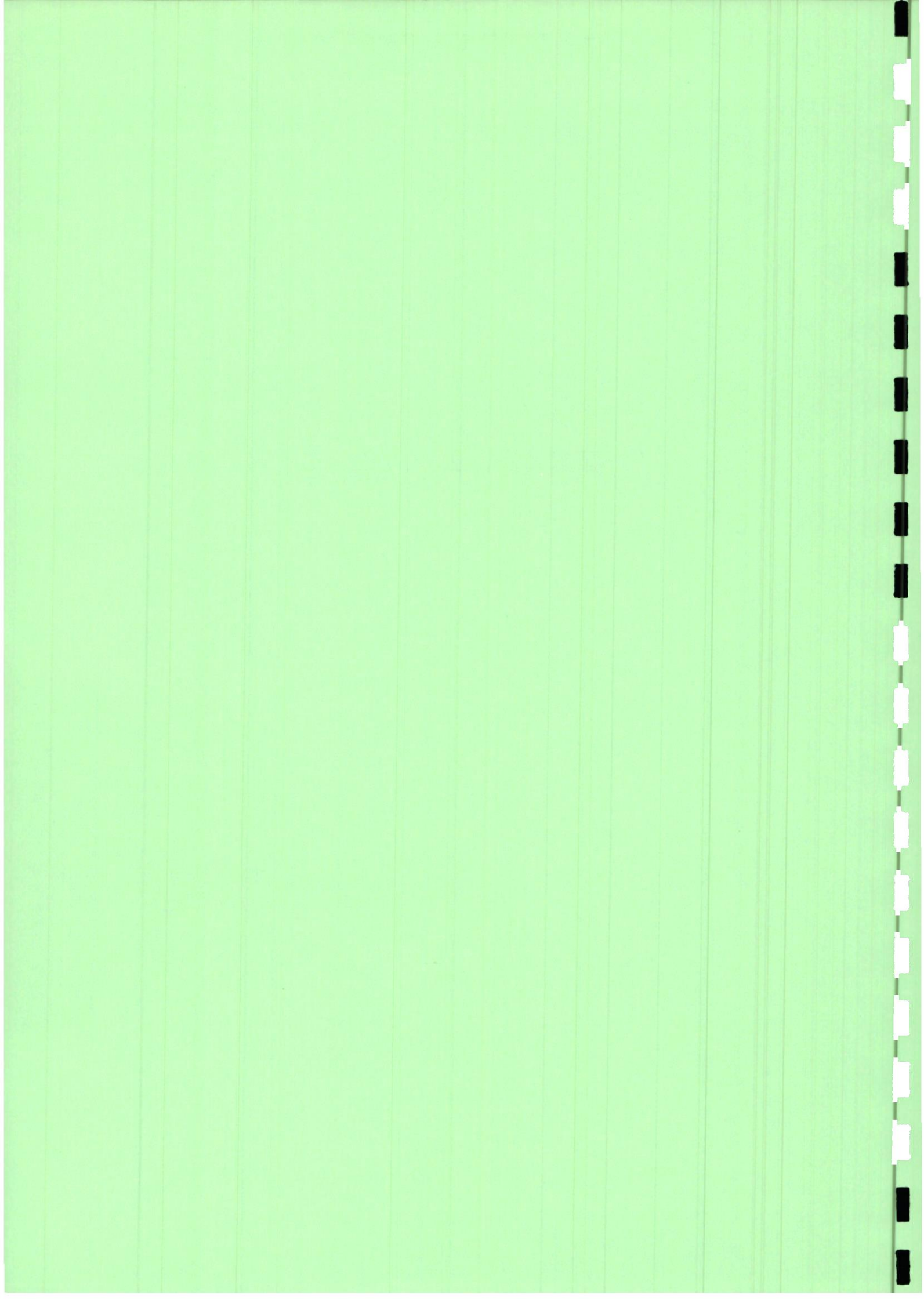
P. O. Box 49712-00100

NAIROBI.

-Regional Manager, NAIROBI ✓



APPENDIX IV



APP 3.

8

100



Kenya National Highways Authority

Quality Highways Better Connections

Machakos Road, Industrial Area P.O. Box - 42267 - 00100 Nairobi,
Tel 020 - 559783 Ext 50162/50328 Website www.kenha.co.ke

Office of the Regional Manager (Nairobi)

Our Ref. RM/NBI/MSA.RD/14
Director General
KeNHA
P.o Box 49712 - 00100
NAIROBI

08TH September, 2010
SEP 2010

dealt

Attn: General Manager (M)

① forwarded + recommended
~~referred~~ 9/9/10

RE: ROAD MARKING ON MOMBASA ROAD (A104) SECTION BETWEEN UNIVERCITY WAY AND JKIA

CONTINGENCIES AND PROJECT SUPERVISION

We refer to our request ref RM/NBI/EM/50 of 20th August 2010 in which you wanted to know the balance of contingency and supervision provision once the supervision expenses are paid.

The balance is as follows:

1. Provision for contingency and Supervision	Kshs. 2,317,800.00
2. Superintendence Expenses	Kshs. <u>575,782.00</u>
Balance	Kshs. <u>1,802,018.00</u>

The second issue regarding marking between University Way and Museum Hill has become urgent due to the impending Graduation at University of Nairobi on 17th September 2010. We therefore carried out an appraisal of the ongoing works between JKIA and Nyayo Stadium and included the said together with the section to Museum Hill in the appraisal.

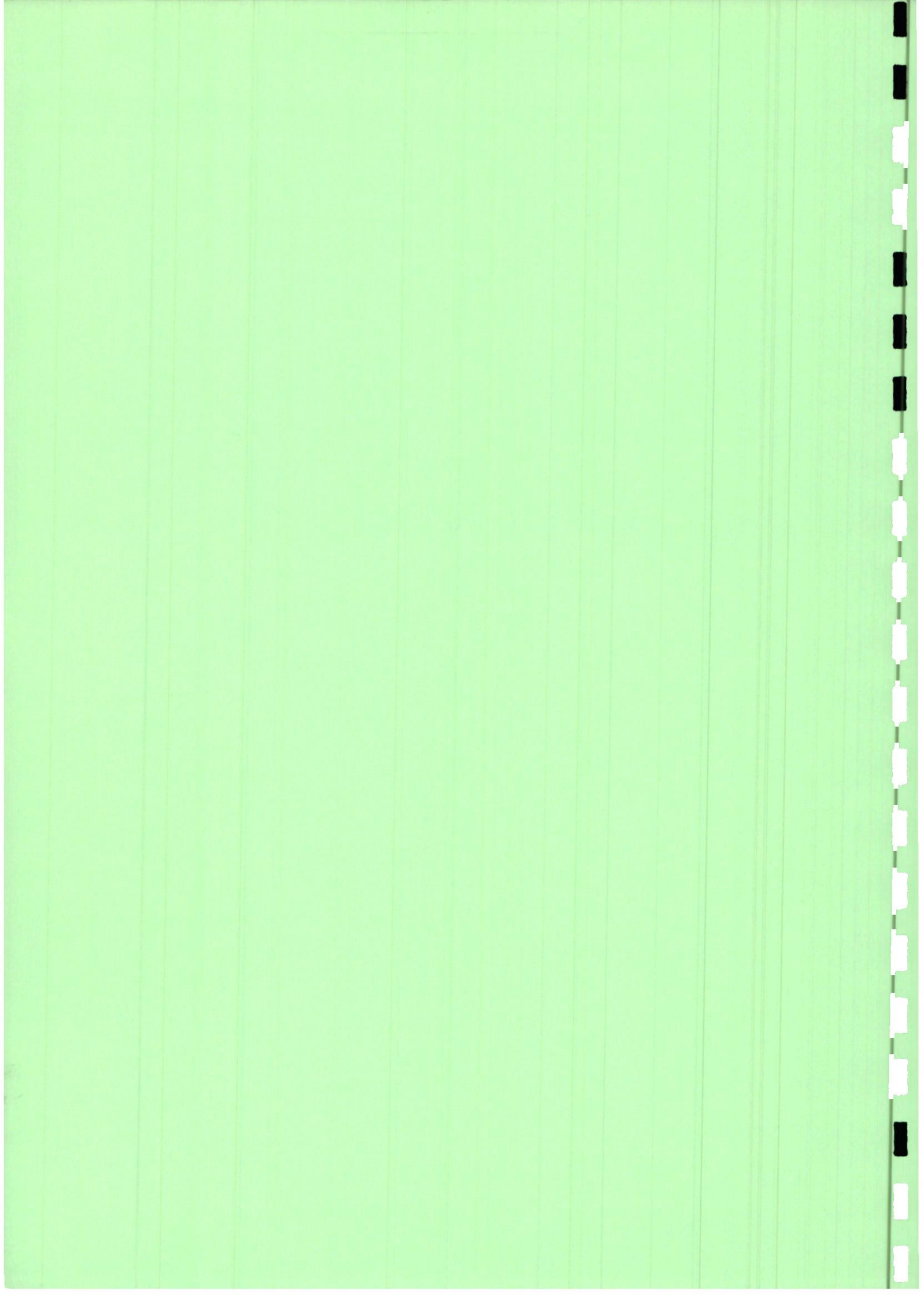
The total requirement is Kshs. 13,600,000.00.

We have communicated this in our letter Ref. RM/NBI/MSA/RD/12 of 07th September, 2010 (copy attached)

Eng J. O. Otiato
REGIONAL MANAGER



APPENDIX V



APP4.

12

RUB



Kenya National Highways Authority

Quality Highways, Better Connections

Machakos Road, Industrial Area P.O. Box - 42267 - 00100 Nairobi,
Tel 020 - 559783 Ext 50162/50328 Website www.kenha.co.ke

Office of the Regional Manager (Nairobi)

Our Ref. RM/NBI/MSA.RD/18

29th September, 2010

Director General,
KeNHA,
P.O Box 49712-00100,
NAIROBI.

Attn: General Manager (Maintenance)

**RE: EMERGENCY ROAD MARKING ON MOMBASA ROAD (104)
APPRAISAL REPORT FOR CONTRACT NO. KENHA/RD/150/2010 AND
EXTRA WORKS UP TO MUSEUM HILL**

We refer to our letter ref RM/NBI/MSARD/14 of 8th September, 2010 (copy attached)

We worked out the pending works including the extra section to Museum Hill and gave the total amount of money required to complete all the works as Ksh. 13,600,000.00 without showing the breakdown. We have now separated the components of this amount (See attached BOQs) which we breakdown as follows:

Item Description	Contract Amount (A)	Appraisal Amount (B)	Difference = (B-A)
Appraisal for contracted works from JKIA to University Way	29,257,128.00	33,918,632.00	4,343,504.00
New works due to Extension up to Museum Hill Round About	-	3,630,347.60	3,630,347.60
TOTAL			7,973,851.60

Pending Contracted work after
payment of Certificate No. 1
as at 26/08/2010 was

$(29,575,128.00 - 24,198,760.00) = (5,376,368.00)$

This amount was included in the total in the above table, resulting in the Ksh. 13,600,000.00 previously submitted.

Considering our request for authority to utilize contingency items through letter Ref RM/NBI/EM/50 dated 20th August 2010 (copy attached) and communication to you on contingencies and project supervision, Ref RM/NBI/MSA.RD/14 dated 8th September 2010 (copy attached), in which a saving balance of **Kshs 1,802,018.00** was identified, the additional amount of funds required to cater for the variation in appraisal and additional works from table above is Kshs 7,973,851.60 less **Kshs 1,802,018.00**, resulting in **Kshs 6,171,833.60** i.e. (7,973,851.60 - 1,802,018.00).

We are thus requesting for Kshs **Kshs 6,171,833.60** to enable us settle the variations and claims arising additional works for the Road marking contract.



Eng. J.O.Otiato
REGIONAL MANAGER

EMERGENCY ROAD MARKINGS ON MOMBASA AND UHURU HIGHWAY

CONTRACT NO. KeNHA/RD/150/2010

CONTRACTOR: SHENGLI ENGINEERING CONSTRUCTION (GROUP) LTD

BILL OF QUANTITIES FOR WORKS FOR SECTION BETWEEN UNIVERSITY WAY ROUNDABOUT AND MUSEUM HILL ROUNDABOUT

Pay Item	DESCRIPTION	Unit	Quantity	Rate (Ksh.)	Contract Amount (Ksh.)
	BILL NO. 20 : ROAD FURNITURE				
20.01	Provide approved reflectorised white paint, and paint 100 mm wide white lines at the road edge as directed by the engineer.	m ²	560	2,300.00	1,288,000.00
20.02	Provide approved reflectorised white paint, and paint 100 mm wide centre lines on the road as directed by the engineer.	m ²	372	2,300.00	855,600.00
20.03	As item 20.01 but 200 mm wide bus bays separation marking .	m ²	20	2,300.00	46,000.00
20.04	As item 20.01 but 400 mm wide give way lines at junctions.	m ²	35	2,300.00	80,500.00
20.05	As item 20.07 but 500 mm wide pedestrian crossing marking.	m ²	60	2,500.00	150,000.00
20.06	As item 20.01 but varied width for directional signs	m ²	170	2,500.00	425,000.00
	SUBTOTAL 1				2,845,100.00
	Add 10% for Allowances and Contingencies				284,510.00
	SUBTOTAL 2				3,129,610.00
	Add 16% V.A.T				500,737.60
	GRAND TOTAL				3,630,347.60

EMERGENCY ROAD MARKINGS ON MOMBASA AND UHURU HIGHWAY

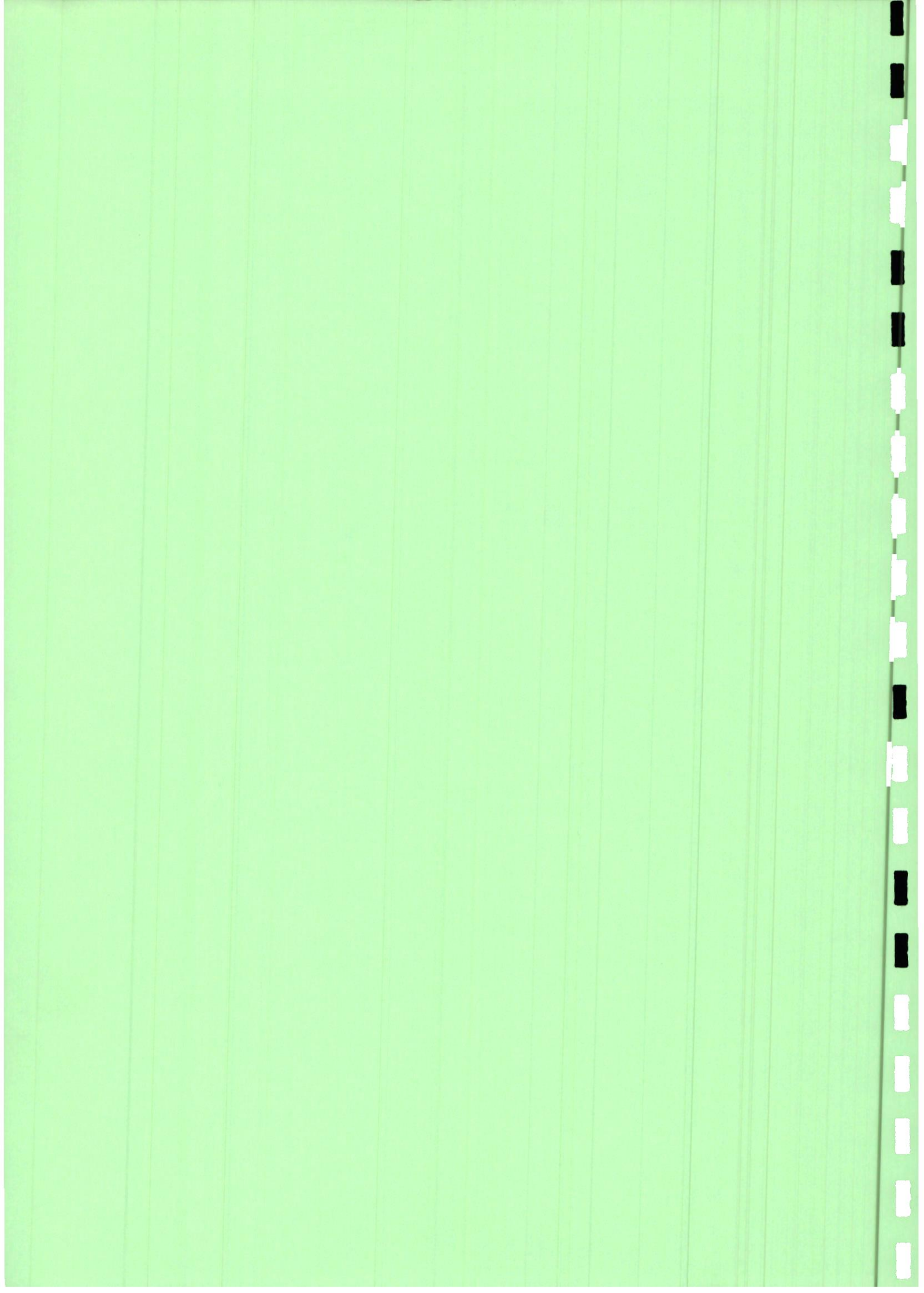
CONTRACT NO. KeNHA/RD/150/2010

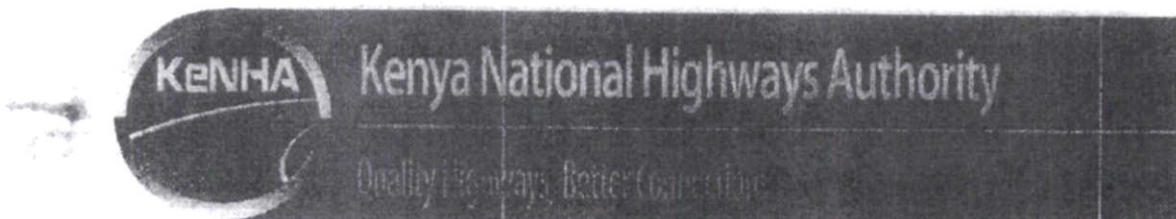
CONTRACTOR: SHENGLI ENGINEERING CONSTRUCTION (GROUP) LTD

APPRAISED BILL OF QUANTITIES FOR ROAD MARKING WORK FOR SECTION BETWEEN UNIVERSITY WAY ROUNDABOUT AND JKIA AIRPORT

Pay Item	DESCRIPTION	Unit	Quantity	Rate (Ksh.)	Contract Amount (Ksh.)	Appraised Quantity	Appraised Amount (Ksh.)	Increase (Decrease) (Ksh.)
BILL NO. 20 : ROAD FURNITURE								
20.01	Provide approved reflectorised white paint, and paint 100 mm wide white lines at the road edge as directed by the engineer.	m ²	4320	2,300.00	9,936,000.00	4,860.00	11,178,000.00	1,242,000.00
20.02	Provide approved reflectorised white paint, and paint 100 mm wide centre lines on the road as directed by the engineer.	m ²	5400	2,300.00	12,420,000.00	5,240.00	12,052,000.00	(368,000.00)
20.03	As item 20.01 but 200 mm wide bus bays separation marking .	m ²	20	2,300.00	46,000.00	200.00	460,000.00	414,000.00
20.04	As item 20.01 but 400 mm wide give way lines at junctions.	m ²	120	2,300.00	276,000.00	1,040.00	2,392,000.00	2,116,000.00
20.05	As item 20.01 but 500 mm wide pedestrian crossing marking.	m ²	200	2,500.00	500,000.00	200.00	500,000.00	0.00
SUBTOTAL 1					23,178,000.00		26,582,000.00	3,404,000.00
Add 10% for Allowances and Contingencies					2,317,800.00		2,658,200.00	340,400.00
SUBTOTAL 2					25,495,800.00		29,240,200.00	3,744,400.00
Add 16% V.A.T					4,079,328.00		4,678,432.00	599,104.00
GRAND TOTAL					29,575,128.00		33,918,632.00	4,343,504.00

APPENDIX VI





Internal Memo

TO: Director General
FROM: General-Manager (Maintenance)
DATE: 9th November, 2010
REF: KeNHA/MTCE/EAST

RE: EMERGENCY ROAD MARKING ON MOMBASA ROAD (A104)
CONTRACT NO. KeNHA/RD/150/2010
APPRAISAL REPORT AND EXTRA WORKS UPTO MUSEUM HILL

Further to our memo Ref. KeNHA/MTCE/EAST of 8th September, 2010 upon which you sought clarifications and details concerning the extra amount required to extend the roadmarking upto Museum Hill Roundabout (attached for your reference).

The Regional Manager Nairobi has since revised and clarified that the additional amount required is Kshs. 6,171,833.60 and not Kshs.13.6million. A copy of their letter Ref. RM/NBI/MSA.RD/19 of 28th October, 2010 enclosing the details is attached for your perusal.

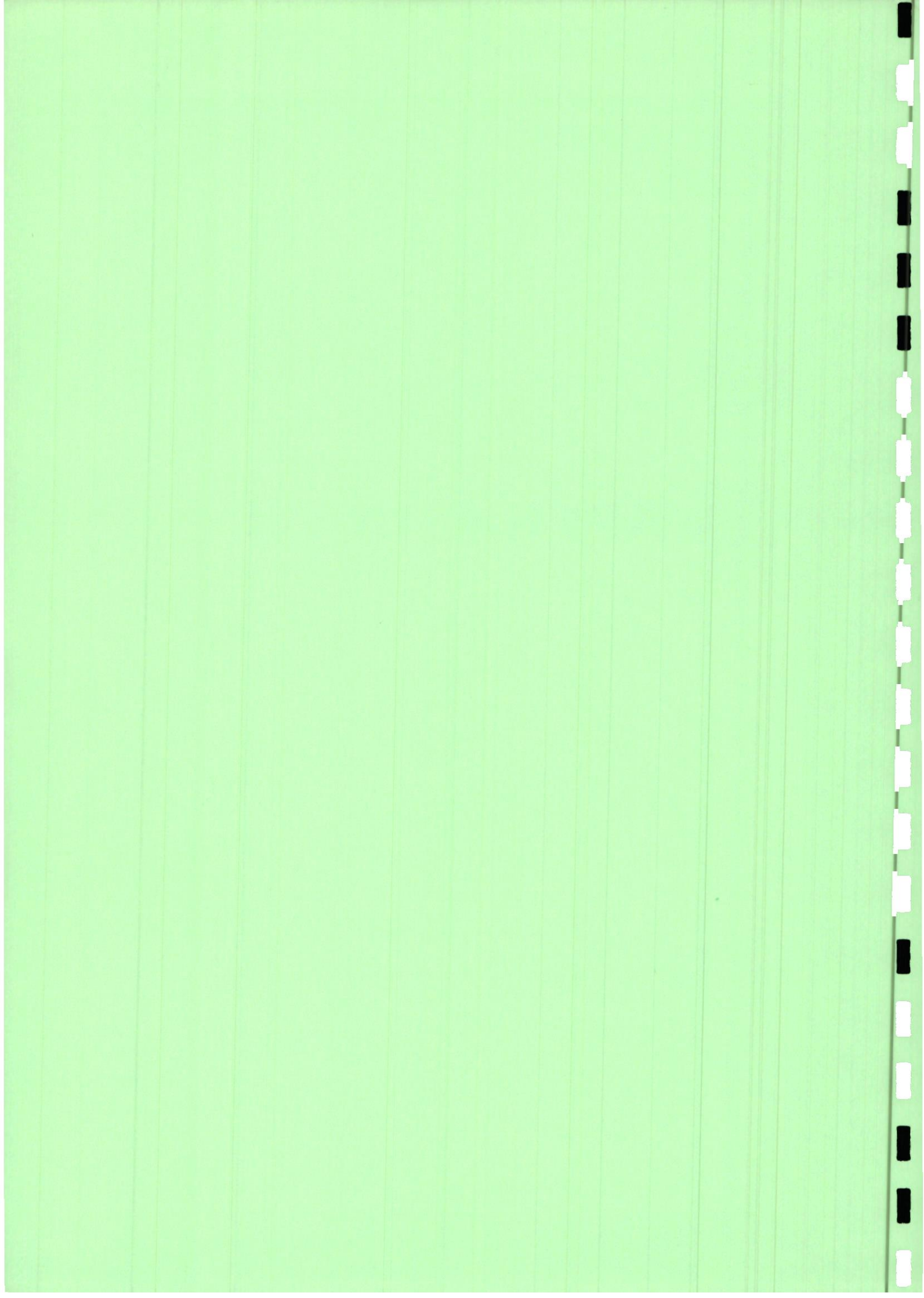
This is therefore to seek your authority to use Ksh. 6,171,833.60 from the Headquarters' emergency provision to settle the payments arising from the revised bills and the additional works necessitated by the request from the University of Nairobi.

Eng. S. O. Ogege
GENERAL MANAGER (MAINTENANCE)

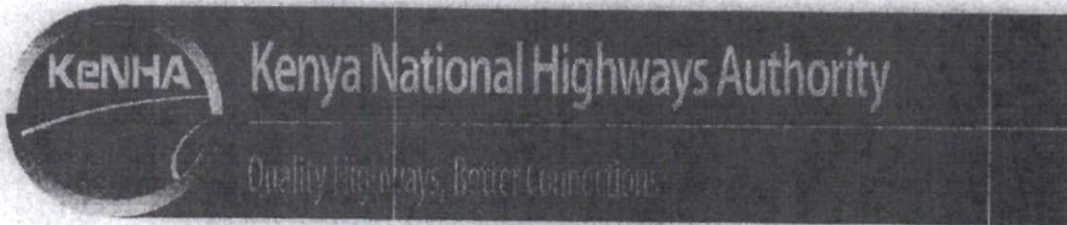
Encls.



APPENDIX VII



6



Internal Memo

TO: Director General
FROM: General-Manager (Maintenance)
DATE: 9th November, 2010
REF: KeNHA/MTCE/EAST

② ~~M-B~~
 the deal
 GM (M)
 12/11-01
 Approved, you may
 spend Ksh 6,171,833.60
 Dh 10/11/2010.

RE: EMERGENCY ROAD MARKING ON MOMBASA ROAD (A104)
CONTRACT NO. KeNHA/RD/150/2010
APPRAISAL REPORT AND EXTRA WORKS UPTO MUSEUM HILL

Further to our memo Ref. KeNHA/MTCE/EAST of 8th September, 2010 upon which you sought clarifications and details concerning the extra amount required to extend the roadmarking upto Museum Hill Roundabout (attached for your reference).

The Regional Manager Nairobi has since revised and clarified that the additional amount required is Kshs. 6,171,833.60 and not Kshs.13.6million. A copy of their letter Ref. RM/NBI/MSA.RD/19 of 28th October, 2010 enclosing the details is attached for your perusal.

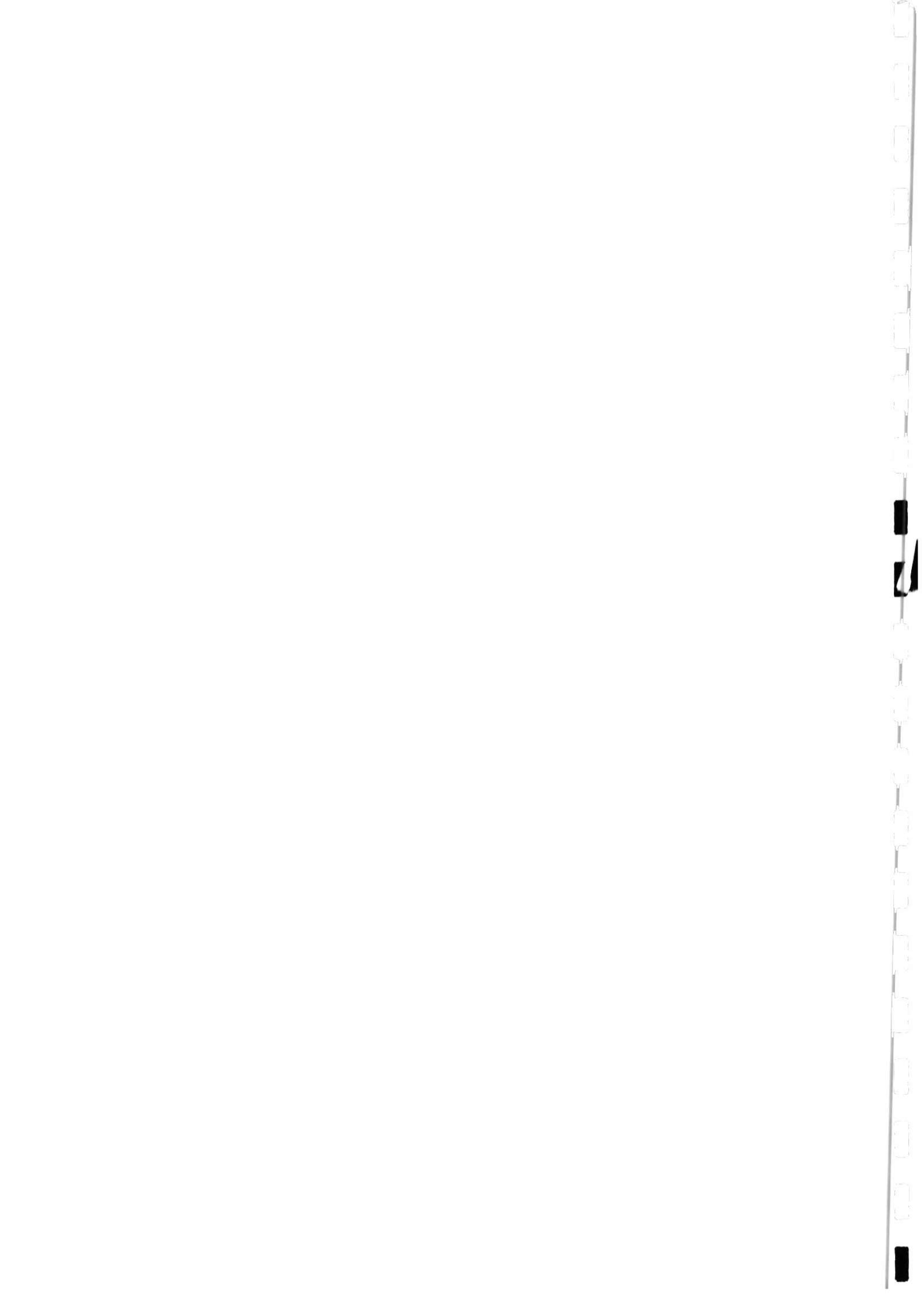
This is therefore to seek your authority to use Ksh. 6,171,833.60 from the Headquarters' emergency provision to settle the payments arising from the revised bills and the additional works necessitated by the request from the University of Nairobi.

Eng. S. O. Ogege
GENERAL MANAGER (MAINTENANCE)

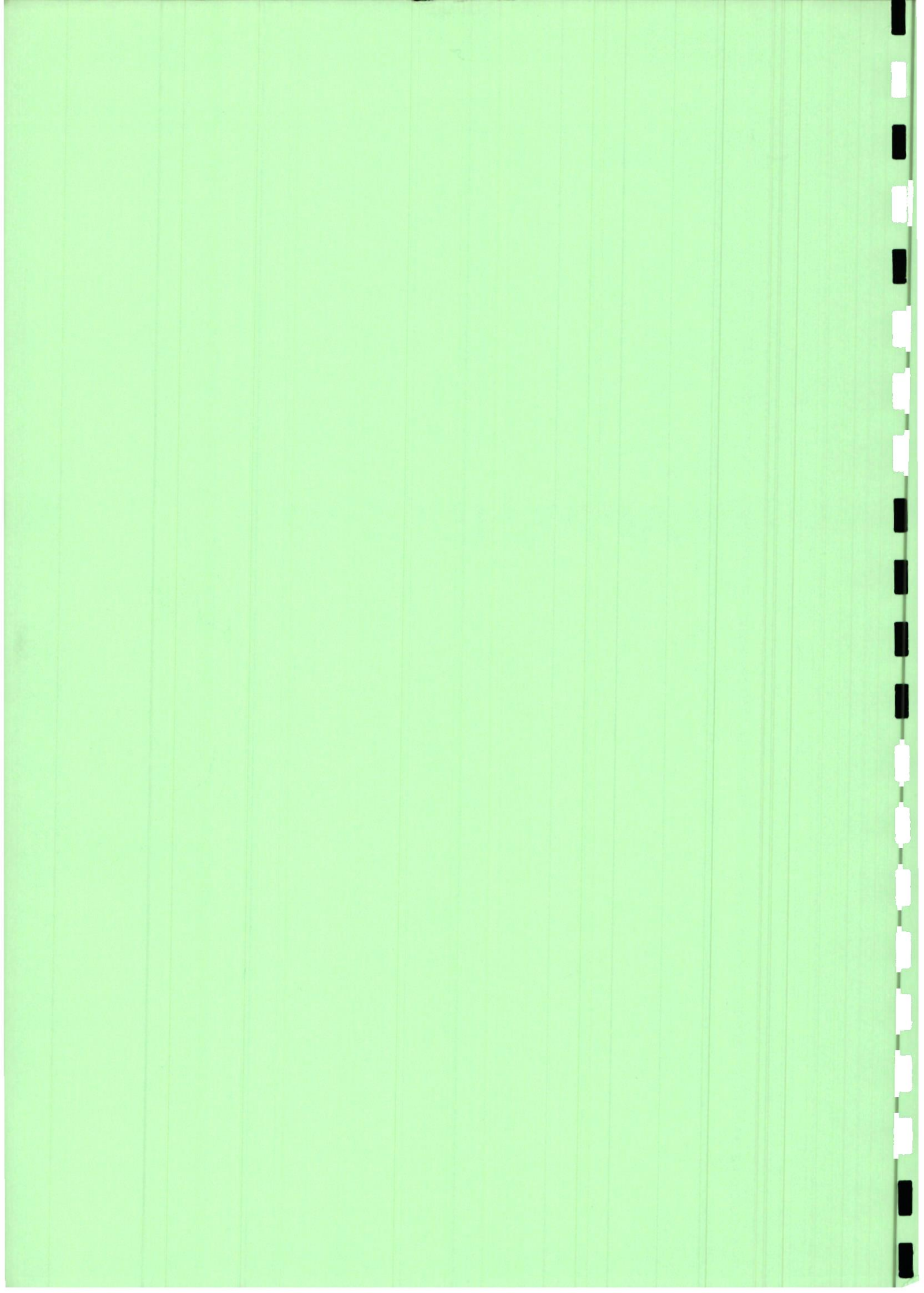
③ RM Nairobi
 Please note and deal.
 15/11

Encls.

KENYA NATIONAL HIGHWAYS AUTHORITY
 DIRECTOR GENERAL
 10 NOV 2010
 P. O. Box 49712-00100, NAIROBI.
RECEIVED



APPENDIX VIII





*Reg No. 61
0512-68*

*Registered in Kenya
on 20th 2029
1/10*

**LOAN AGREEMENT
BETWEEN
THE REPUBLIC OF KENYA
AND
THE AFRICAN DEVELOPMENT FUND
NAIROBI-THIKA HIGHWAY IMPROVEMENT
PROJECT**



**LOAN AGREEMENT
BETWEEN
THE REPUBLIC OF KENYA
AND
THE AFRICAN DEVELOPMENT FUND
NAIROBI-THIKA HIGHWAY IMPROVEMENT
PROJECT**

**PROJECT ID N° : P-KE-DB0-018
LOAN N° : 2100150015544**

This LOAN AGREEMENT (hereinafter called "the Agreement") is entered into this 26 November 2007 between the REPUBLIC OF KENYA (hereinafter called the "Borrower") and the AFRICAN DEVELOPMENT FUND (hereinafter called the "Fund").

1. WHEREAS the Borrower has requested the Fund to finance the entire foreign currency cost and part of the local currency cost of the Nairobi-Thika Highway Improvement Project (hereinafter called the "Project") by providing a Loan to the Borrower in the amount specified hereunder:

2. WHEREAS the Loan will contribute to improve the accessibility, affordability and reliability of the transport infrastructure system to promote economic growth and socio-economic development in Kenya.

3. WHEREAS the Project is technically feasible and constitutes a suitable basis for financing under the activities of the Fund.

4. WHEREAS the Borrower has declared its commitment to the execution of the Project.

5. WHEREAS the Executing Agency for the Project will be the Ministry of Roads and Public Works ("MoRPW").

6. WHEREAS the Fund has agreed on the basis, inter alia, of the foregoing to grant a Loan to the Borrower upon the terms and conditions hereinafter set forth.

NOW THEREFORE the parties hereby agree as follows:

ARTICLE I

GENERAL CONDITIONS-DEFINITIONS

Section 1.01 General Conditions. The parties to this Agreement accept all the provisions of the General Conditions Applicable to Loan and Guarantee Agreements of the Fund.

dated 23 November 1989, as amended, (hereinafter called the "General Conditions") with the same force and effect as if they were fully set forth herein.

Section 1.02. Definitions. Whenever used in this Agreement, unless the context otherwise requires, the several terms defined in the General Conditions shall have the respective meanings therein set forth.

ARTICLE II **THE LOAN**

Section 2.01. Amount. The Fund agrees to lend to the Borrower in various convertible currencies other than the currency of the Borrower an amount not exceeding the equivalent of One Hundred and Seventeen Million Eight Hundred and Fifty Thousand Units of Account (UA 117,850,000) (the Unit of Account being defined in Article 1(1) of the Agreement Establishing the Fund).

Section 2.02. Purpose. The purpose of the Loan is to finance the entire foreign currency cost and part of the local currency cost of the Project as described in Annex I of this Agreement.

Section 2.03: Allocation The Loan shall be allocated to the categories of expenditure in conformity with Annex II of this Agreement.

ARTICLE III
REPAYMENT OF THE PRINCIPAL, SERVICE
CHARGE AND COMMITMENT CHARGE
AND DATES OF PAYMENT

Section 3.01: Repayment of the Principal The Borrower shall repay the principal of the Loan over a period of forty (40) years, after a ten (10) year grace period commencing from the date of this Agreement, at the rate of one per cent (1%) per annum from the 11th to the 20th year inclusive and at the rate of three per cent (3%) per annum thereafter.

Section 3.02: Service Charge The Borrower shall pay a service charge at the rate of three-quarters of one per cent (0.75%) per annum on the principal amount of the Loan disbursed and outstanding from time to time.

Section 3.03. Commitment Charge. The Borrower shall pay a commitment charge at the rate of one-half of one per cent (0.50%) per annum on the un-disbursed portion of the Loan, which shall begin to accrue one hundred and twenty (120) days after the date of signature of this Agreement.

Section 3.04. Dates of Payment. The principal of the Loan shall be repaid in equal and consecutive semi-annual instalments, the first of which shall be payable on 1 May or 1 November, whichever immediately follows the expiration of the grace period referred to in Section 3.01 above. The service charge and the commitment charge shall be payable semi-annually on 1 May and 1 November of each year.

ARTICLE IV
CONDITIONS PRECEDENT TO ENTRY
INTO FORCE

Section 4.01. Conditions Precedent to Entry into Force. The entry into force of this Loan Agreement shall be subject to the fulfilment by the Borrower of the provisions of Section 5.01 of the General Conditions.

ARTICLE V
CONDITIONS PRECEDENT TO DISBURSEMENT

Section 5.01. Conditions Precedent to First Disbursement of the Loan. The obligation of the Fund to make the first disbursement of the Loan shall be conditional upon the entry into force of this Agreement as provided in Section 4.01 above and upon the Borrower submitting evidence satisfactory to the Fund of:

- (i) the appointment of the following members of the Project Implementation Team, with qualifications and experience acceptable to the Fund:
 - (a) a project Team Leader;
 - (b) one procurement specialist;
 - (c) one financial specialist;
 - (d) one engineer (contracts);
 - (e) one environmental officer;
 - (f) one engineer (design).

- (ii) having opened a local currency account and deposited therein the initial sum of One Billion Kenyan Shillings (KES 1,000,000,000) as counterpart funds to finance expenditure for the civil works under the Project;
- (iii) relocation, resettlement and compensation plan acceptable to the Fund together with a payment schedule for the compensation and relocation/resettlement of all project affected persons; and
- (iv) having compensated and/or relocated/resettled in accordance with the relocation, resettlement and compensation plan persons affected in the first Lot/Section of the civil works to start.

Section 5.02 Other Conditions: The Borrower:

- (i) shall not later than 31 December 2008 provide evidence to the Fund that the Roads Authorities established by the Kenya Roads Act 2007 are operational by 31 December 2008;

- (ii) shall at quarterly intervals, replenish the Project Account by the amounts required to finance its contribution and ensure that funds deposited into the Project Account shall be used exclusively to finance expenditures under the Project, and
- (iii) shall, prior to disbursement of funds for commencement of civil works for any subsequent Lot/Section of the Project, submit evidence of its having fully compensated and/or relocated or resettled all persons affected by the works on such Lot/Section of the Project.

ARTICLE VI
DISBURSEMENTS AND APPLICATION
OF AMOUNTS DISBURSED

Section 6.01. Disbursements. The amount of the Loan shall be disbursed by the Fund, subject to the provisions of this Agreement and the General Conditions for the purposes set forth in this Agreement.

Section 6.02. Deadline for Final Disbursement. For the purposes of Section 9.01 paragraph (a)(iv) of the General Conditions, 31 December 2012 is specified, or such later date as shall be agreed between the parties.

Section 6.03. Application of Disbursements. Amounts disbursed on account of the Loan shall be applied by the Borrower solely for the purposes for which they were disbursed.

ARTICLE VII
PROCUREMENT OF GOODS, WORKS
AND SERVICES

Section 7.01. The Borrower shall ensure that the proceeds of the Loan are used exclusively for procurement in the territories of the State Participants or Members (the terms "State Participant" and "Member" being defined in Article I(1) of the Agreement Establishing the African Development Fund).

Section 7.02: The procurement of goods, works and services shall be carried out in accordance with the *Rules of Procedure for Procurement of Goods and Works* and the *Rules of Procedure for the Use of Consultants* adopted by the Fund on the 15th of July 1996, as amended, as follows:

- (i) civil works will be carried out under International Competitive Bidding procedures;
- (ii) audit services will be procured on the basis of short-lists. Financial audit services will be subject to clearance by the Controller and Auditor General of Kenya prior to call for bids.

ARTICLE VIII **MISCELLANEOUS PROVISIONS**

Section 8.01: Where an extraordinary or unforeseeable situation has arisen, which, in the opinion of both parties, is likely to be prejudicial to the execution of the Project, the Fund may, in order to cover the cost of any specialized inspection or other action required to redress the situation, allocate out of the proceeds of the Loan an amount not

S
2
f
1
exceeding the equivalent of one per cent (1%) of the Loan amount or One Million One Hundred and Seventy-Eight Thousand Five Hundred Units of Account (UAI,178,500). These expenses shall be met without the necessity of any advance application by the Borrower, but the Fund shall promptly transmit to the Borrower the corresponding information.

Section 8.02 Authorized Representatives. The Minister of Finance of the Borrower or such other person as the Minister may designate in writing shall be the authorized representative for the purposes of Section 14.03 of the General Conditions.

Section 8.03 Date of the Agreement. For all purposes of this Agreement, the date of the Agreement shall be that appearing in the opening sentence hereof.

Section 8.04 Addresses. The following addresses are specified for the purposes of Section 14.01 of the General Conditions.

For the Borrower:

Mail Address:

Ministry of Finance/Treasury
Treasury Building
Harambee Avenue
P.O. Box 30007-00100
NAIROBI - KENYA
Tel: (254) 20 252299/20 246 148
Fax: (254) 20 240045/20 316 415

For the Fund:

Mail Address:

African Development Fund
01 B.P. 1387
ABIDJAN 01
COTE D'IVOIRE
Cable Address: AFDEV ABIDJAN
Tel: (225) 20 20 44 44
Fax: (225) 20 20 46 99/20 20 51 60

Temporary Relocation Agency:

African Development Fund
13, Avenue du Ghana
BP 323
1002 Tunis Belvedere
TUNISIA
Tel: (216) 71 10 21 23
Fax: (216) 71 33 33 64

IN WITNESS WHEREOF the Borrower and the Fund, each acting through its authorized representative, have signed this Agreement in two original counterparts in English on the date first above written.

FOR THE REPUBLIC OF KENYA



JOSEPH KANJA KINYUA
PERMANENT SECRETARY/TREASURY

FOR THE AFRICAN DEVELOPMENT FUND

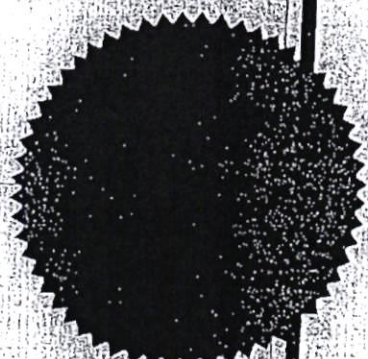


MANDLA S. V. GANTSHO
VICE PRESIDENT

ATTESTED BY:



MODIBOU TOURE
SECRETARY GENERAL



ANNEX I
PROJECT DESCRIPTION

The project comprises the following components:

A Nairobi - Thika Highway Upgrading Works - This component involves: (i) The provision of additional capacity through construction of additional lanes (from four-lane to a six/eight-lane highway), and reconstruction of the existing carriageway pavement; (ii) the construction of services roads to segregate through traffic from local traffic; (iii) the construction of traffic interchanges at six (6) locations to replace the existing roundabouts at Pangani, Muthaiga, GSU, Kasarani, Githurai, and Eastern Bypass; and (iv) The rehabilitation of some existing bridges, execution of drainage structures, road safety devices, and environmental and social mitigation measures.

B Nairobi City Arterial Connectors - This component involves the improvement of major arterial connectors linking Pangani to Uhuru Highway in Nairobi CBD including (i) Pangani-Museum Roundabout with

interchanges at Limuru Road and Museum; (ii) Pangani-University Way with a fly-over at the Globe Cinema roundabout; (iii) Widening/dualling of Ring Road Ngara from Pangani to Haile Selassie Avenue; (iv) Traffic Management.

C. Construction Supervision of the Civil Works - An experienced engineering consulting firm on behalf of MORPW will carry out the construction supervision. The consulting firm will administer the construction contract, inspect the works, supervise the necessary quality control testing performed by the contractor, track progress and costs, and maintain close liaison with MORPW and relevant ministries responsible for the project.

D. Nairobi Metropolitan Transit System (Nairobi Metro Study) - This component is a follow-up to the Nairobi Urban Transport Master Plan study funded by JICA. This component will focus on public transportation system. A comprehensive public transportation study will be undertaken. The study will include an economic feasibility, environmental and social impact assessment (ESIA),

financial and institutional arrangements for various options including Light Rail Transit System, Bus Rapid Transit System, Enhanced Commuter Rail, etc. Detailed engineering design and tender documents will be prepared for the most viable options to address the immediate and medium term Public Transit needs.

E. Private Sector Participation in the Nairobi-Thika Highway Project – Under this consultancy component, the consultant will conduct alternative financial and institutional analyses for the proper management, operation and maintenance of the Nairobi-Thika Highway. The consultant will be responsible for preparing the necessary bidding and contractual documents and advising the government in the transaction process.

F. Project Technical and Financial Audits. The purpose of the financial audit will be to ensure that the proceeds of the loan are used economically, efficiently and solely for the purpose for which they are intended. The purpose of the technical audit is to ensure that the contractor and consultant perform according to specifications.

financial and institutional arrangements for various options including Light Rail Transit System, Bus Rapid Transit System, Enhanced Commuter Rail, etc. Detailed engineering design and tender documents will be prepared for the most viable options to address the immediate and medium term Public Transit needs.

F. Private Sector Participation in the Nairobi-Thika Highway Project. Under this consultancy component the consultant will conduct alternative financial and institutional analyses for the proper management, operation and maintenance of the Nairobi-Thika Highway. The consultant will be responsible for preparing the necessary bidding and contractual documents and advising the government in the transaction process.

G. Project Technical and Financial Audits. The purpose of the financial audit will be to ensure that the proceeds of the loan are used economically, efficiently and solely for the purpose for which they are intended. The purpose of the technical audits is to ensure that the contractor and consultant perform according to specifications.

G. Compensation and Resettlement of Project Affected People - This component makes provision for the adequate compensation and resettlement of Project Affected People identified in the Project Environmental and Social Impact Assessment.

ANNEX II
ALLOCATION OF THE LOAN

The present Annex indicates the categories of expenditure to be financed out of the resources of the Loan, each amount being inclusive of the respective physical and price contingencies.

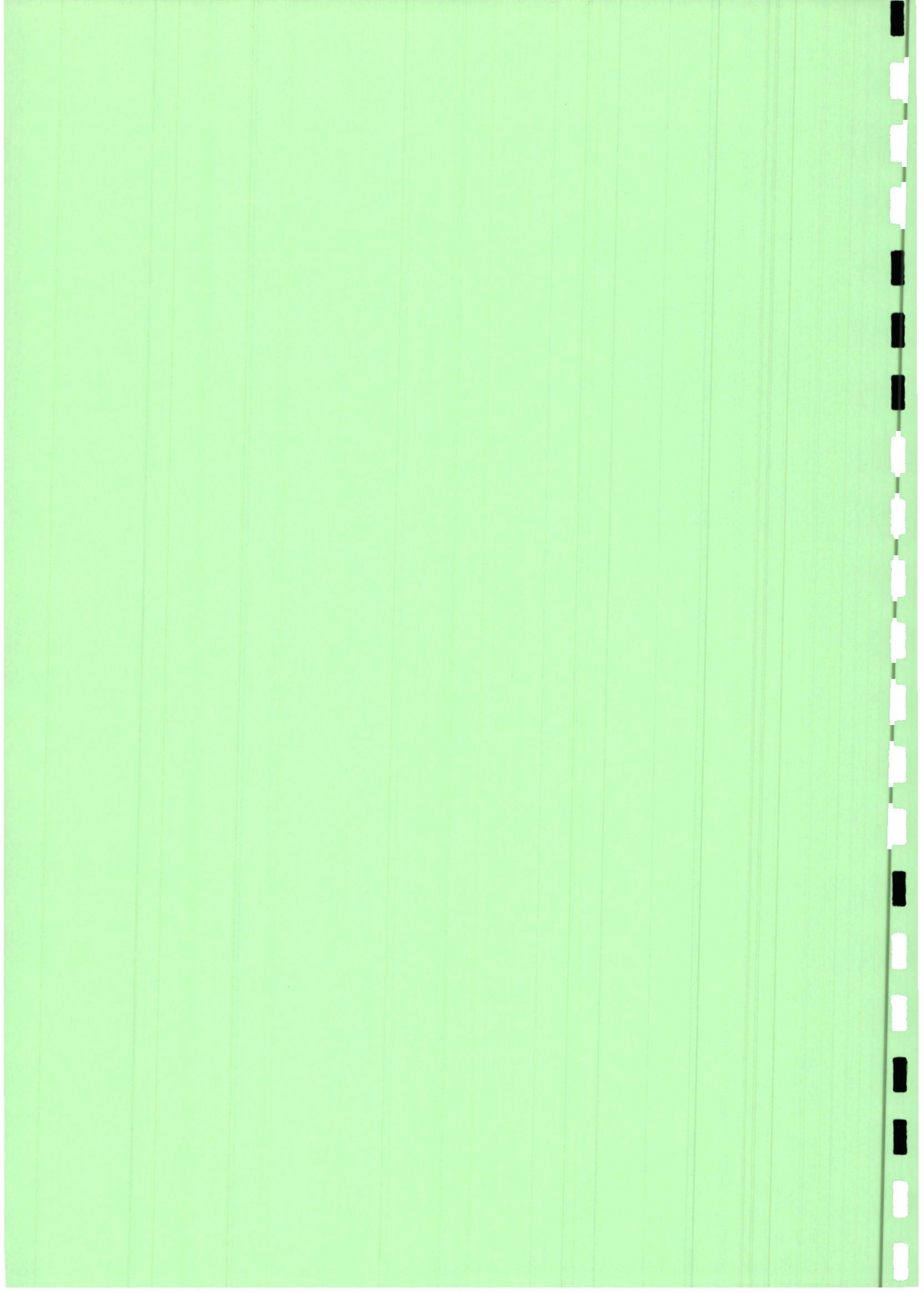
Project Cost Estimates by Category

**Summary of Allocation of Loan Proceeds
by Category of Expenditure**

Category of Expenditure	Million UA		
	Foreign Exchange	Local Cost	Total Cost
	(U.A.)	(U.A.)	(U.A.)
A. Civil Works			
Civil Works Nairobi-Thika	85.30	15.41	100.71
Civil Works Urban Sections	13.40	3.60	17.00
B. Consultancy Services			
Audit Services	0.14	0.00	0.14
Total Project Costs	98.84	19.01	117.85

JWK

APPENDIX IX

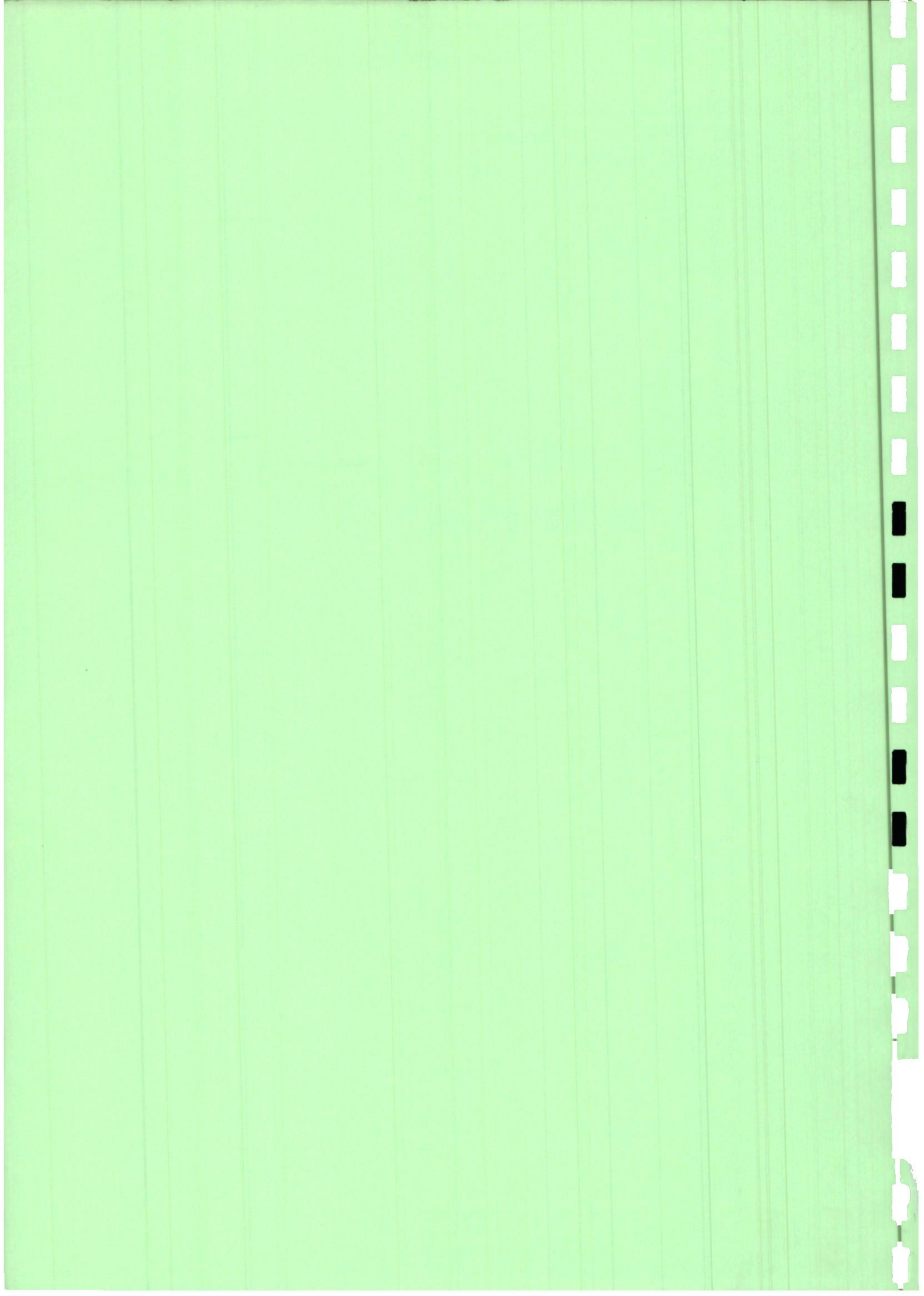


Project Details

Name of Project	Nairobi –Thika Highway Improvement Project		
Overall Co-ordination	Ministry of Roads (MoR)		
Project Funding	Lot 1 & 2 African Development Bank and Government of Kenya Lot 3 The People’s Republic of China and Government of Kenya		
Employer	Director General, Kenya National Highways Authority (KeNHA)		
Engineer	General Manager (Design & Construction), KeNHA		
Engineer’s Representative	Consulting Engineering Services (India) Pvt Ltd in association with APEC Ltd		
	Lot 1	Lot 2	Lot 3
Original Project Cost	Kshs. 8,030,386,596.64	Kshs. 8,690,568,489.73	Kshs. 9,441,732,008.29
Estimated Project Cost, as per PAR	Kshs.10.500 billion	Kshs. 12.100 billion	Kshs. 10.800 billion
Commencement Date	28 Jan ,2009	26 Jan ,2009	22 Jan ,2009
Scheduled Contract Period	30 Months	30 Months	30 Months
Scheduled Completion Date	27 July, 2011	25 July, 2011	21 July, 2011
Actual Completion Date	25 July, 2012	24 July, 2012	19 July, 2012
Actual Completion Period	42 Months	42 Months	42 Months



APPENDIX X



Eng. Kim



LOAN AGREEMENT
BETWEEN
THE REPUBLIC OF KENYA
AND
THE AFRICAN DEVELOPMENT FUND
(ARUSHA-NAMANGA-ATHI RIVER ROAD
DEVELOPMENT PROJECT)

1/2

LOAN AGREEMENT
BETWEEN
THE REPUBLIC OF KENYA
AND
THE AFRICAN DEVELOPMENT FUND
(ARUSHA-NAMANGA-ATHI RIVER ROAD
DEVELOPMENT PROJECT)

PROJECT ID No : P-Z1-DB0-040
LOAN No : 2100150013893

This LOAN AGREEMENT (hereinafter called "the Agreement") is entered into this 8th day February 2007 between the REPUBLIC OF KENYA (hereinafter called "the Borrower"), and the AFRICAN DEVELOPMENT FUND (hereinafter called "the Fund").

1. WHEREAS the Borrower has requested the Fund to finance the foreign currency cost and part of the local currency cost of the Arusha-Namanga-Athi River Road Development Project (hereinafter called the "Project") by providing a Loan to the Borrower in the amount specified hereunder;

2. WHEREAS the Loan will help improve regional transport infrastructure between Kenya and Tanzania and foster regional integration;

3. WHEREAS the Project is economically viable and constitutes a suitable basis for financing under the activities of the African Development Fund;

4. WHEREAS the Borrower has declared its commitment to the execution of the Project;

5. WHEREAS the Ministry of Roads and Public Works of the Borrower (MoRPW) shall be the Executing Agency for the Project; and

6. WHEREAS the Fund has agreed on the basis, inter alia, of the foregoing to grant a Loan to the Borrower upon the terms and conditions hereinafter set forth;

NOW THEREFORE the parties hereby agree as follows:

ARTICLE I
GENERAL CONDITIONS-DEFINITIONS

Section 1.01. General Conditions. The parties to this Agreement accept all the provisions of the General Conditions Applicable to Loan and Guarantee Agreements of the Fund, dated 23 November 1989, as amended, (hereinafter called "the General Conditions") with the same force and effect as if they were fully set forth herein.

Section .02. Definitions. Whenever used in this Agreement, unless the context otherwise requires, the several terms defined in the General Conditions shall have the respective meanings therein set forth.

ARTICLE II
THE LOAN

Section 2.01. Amount. The Fund agrees to lend to the Borrower an amount in various convertible currencies, other than the currency of the Borrower, not exceeding the equivalent of Forty Nine Million Two Hundred Forty One Thousand Units of Account (UA 49,241,000) (the Unit of

JKK

Account being defined in Article 1(1) of the Agreement Establishing the Fund).

Section 2.02. Purpose. The purpose of the Loan is to finance the foreign currency cost and part of the local currency cost of the Project as described in Annex I of this Agreement.

Section 2.03. Allocation. The Loan shall be allocated to the categories of expenditure in conformity with Annex II of this Agreement.

ARTICLE III
REPAYMENT OF THE PRINCIPAL, SERVICE
CHARGE AND COMMITMENT CHARGE
AND DATES OF PAYMENT

Section 3.01. Repayment of the Principal. The Borrower shall repay the principal of the Loan over a period of forty (40) years, after a ten (10) year grace period commencing from the date of this Agreement, at the rate of one per cent.

(1%) per annum from the 11th to the 20th year inclusive and at the rate of three per cent (3%) per annum thereafter.

Section 3.02. Service Charge. The Borrower shall pay a service charge at the rate of three-quarters of one per cent (0.75%) per annum on the principal amount of the Loan disbursed and outstanding from time to time.

Section 3.03. Commitment Charge. The Borrower shall pay a commitment charge at the rate of one-half of one per cent (0.50%) per annum on the un-disbursed portion of the Loan, which shall begin to accrue one hundred and twenty (120) days after the date of signature of this Agreement.

Section 3.04. Dates of Payment. The principal of the Loan shall be repaid in equal and consecutive semi-annual instalments, the first of which shall be payable on 1 May or 1 November, whichever immediately follows the expiration of the grace period referred to in Section 3.01 above. The service charge and the commitment charge shall be payable semi-annually on 1 May and 1 November of each year.

[Handwritten signature]

[Handwritten signature]

ARTICLE IV
CONDITIONS PRECEDENT TO ENTRY
INTO FORCE

Section 4.01. Conditions Precedent to Entry into Force. The entry into force of this Loan Agreement shall be subject to the fulfilment by the Borrower of the provisions of Section 5.01 of the General Conditions.

ARTICLE V
CONDITIONS PRECEDENT TO DISBURSEMENT

Section 5.01 Conditions Precedent to first Disbursement of the Loan. The obligation of the Fund to make the first disbursement of the Loan shall be conditional upon the entry into force of this Agreement as provided in Section 4.01 above; and, upon the Borrower submitting evidence satisfactory to the Fund of:

- i) The appointment of a Project Engineer/country coordinator by MoRPW, whose experience and qualifications are acceptable to the Fund.

- 7 -
- ii) Having fully compensated project affected persons in accordance with the Environmental and Social Impact Management Plan.
 - iii) The appointment of members of the Steering Committee and the Technical Committee.

Section 5.02 Other Conditions: The Borrower shall submit to the Fund not later than 31 December 2007, evidence of having executed performance agreements with the designated Road Maintenance Agencies.

ARTICLE VI
DISBURSEMENTS AND APPLICATION
OF AMOUNTS DISBURSED

Section 6.01. Disbursements. The amount of the Loan shall be disbursed by the Fund, subject to the provisions of this Agreement and the General Conditions for the purposes set forth in this Agreement.

[Handwritten signature]

[Handwritten signature]

Section 6.02. Deadline for Final Disbursement. 31 December 2012 or such later date as shall be agreed between the Borrower and the Fund is specified for the purposes of Section 9.01 paragraph (a) (iv) of the General Conditions.

Section 6.03. Application of Disbursements. Amounts disbursed on account of the Loan shall be applied by the Borrower solely for the purposes for which they were disbursed.

ARTICLE VII
PROCUREMENT OF GOODS, WORKS
AND SERVICES

Section 7.01. The Borrower shall ensure that the proceeds of the Loan are used exclusively for procurement in the territories of the State Participants or Members (the terms "State Participant" and "Member" being defined in Article 1(1) of the Agreement Establishing the African Development Fund).

Handwritten mark

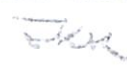

Handwritten mark

Section 7.02. The procurement of goods, works and services shall be carried out in accordance with the *Rules of Procedure for Procurement of Goods and Works* and the *Rules of Procedure for the Use of Consultants* adopted by the Fund on the 15th of July 1996, as amended, as follows:

- i) Civil works in respect of the Namanga – Athi River section shall be procured through International Competitive Bidding;
- ii) Services in respect of supervision consultancy for works in respect of the Namanga – Athi River section shall be procured through Short Listing;

ARTICLE VIII **MISCELLANEOUS PROVISIONS**

Section 3.01. Where an extraordinary or unforeseeable situation has arisen, which, in the opinion of both parties, is likely to be prejudicial to the execution of the Project, the Fund may, in order to cover the cost of any specialized



inspection or other action required to redress the situation, allocate out of the proceeds of the Loan an amount not exceeding the equivalent of one per cent (1%) of the Loan amount or four hundred and ninety two thousand four hundred and ten Units of Account (UA 492,410). These expenses shall be met without the necessity of any advance application by the Borrower, but the Fund shall promptly transmit to the Borrower the corresponding information.

Section 8.02 Authorized Representatives. The Minister of Finance of the Borrower or such other person as the Minister may designate in writing shall be the authorized representative for the purposes of Section 14.03 of the General Conditions.

Section 8.03. Date of the Agreement. For all purposes of this Agreement, the date of the Agreement shall be that appearing in the opening sentence hereof.

M

JRC

Section 8.04. Addresses. The following addresses are specified for the purposes of Section 14.01 of the General Conditions.

For the Borrower: Mail Address:
Ministry of Finance
Treasury Building
Harambee Avenue
P.O. Box 30007-00100-GPO
NAIROBI - KENYA
Tel: (254) 20 252299/ 20 246 148
Fax: (254) 20 240045

For the Fund: Mail Address:
African Development Fund
01 B.P. 1387
ABIDJAN 01
CÔTE D'IVOIRE
Cable Address: AFDEV ABIDJAN
Tel: (225) 20 20 44 44
Fax: (225) 20 20 51 60

Temporary Relocation Agency:
African Development Fund
13, Avenue du Ghana
BP 323 1002 Tunis Belvedere
TUNISIA
Tel: (216) 71 10 21 23
Fax: (216) 71 33 33 64

IN WITNESS WHEREOF the Borrower and the Fund, each acting through its authorized representative, have signed this Agreement in two original counterparts in English on the date first above written.

FOR THE REPUBLIC OF KENYA



JOSEPH KANJA KINYUA
PERMANENT SECRETARY/TREASURY

FOR THE AFRICAN DEVELOPMENT FUND



MANDLA S. V. GANTSHO
VICE PRESIDENT



ATTESTED BY:



MODIBO I. TOURE
SECRETARY GENERAL

ANNEX I
PROJECT DESCRIPTION

1. The principal components of the Project will be:
 - a) The rehabilitation/reconstruction of the Namanga - Arusha road section in Tanzania which is 104 km long and the rehabilitation / reconstruction of the 136 km long Athi River - Namanga road section. Both road sections will have 7m carriageway surfaced with asphalt concrete and 2m wide shoulders surfaced with single bituminous surface treatment. The total road length will be 240km.
 - b) Consultancy services for the supervision of the above works (2 consultancies, one for each lot of works).
 - c) Project Audit consultancy services for the whole project.
 - d) Consultancy services (in 2 packages) for feasibility study and detailed engineering design for 560 km of road (Arusha-Holili/Taveta -Voi road and Tanga - Horohoro/LungaLunga- Malindi road).
 - e) Consulting services in form of Technical Assistance for capacity building of East African Community Secretariat using two individual consultants.

- f) Consultancy services to evaluate the contracting capacity for civil works in East Africa and recommend measures to improve contracting capacity to participate in major projects.
- g) Compensation of people affected by the project.

2. Project Objectives

i) To improve the essential road transport infrastructure between Kenya and Tanzania, and particularly between Arusha and Nairobi, Arusha and Mombasa, and Malindi and Dar es Salaam. The indicators will be improved transport service and lower transport costs between the two countries which may be measured by assessing the road roughness, estimating vehicle operating costs, and counting traffic both to the border from both countries (national traffic) and across the border (international traffic).

ii) To support regional integration, cross border trade, tourism, socio - economic development of the zone of influence and a contribution to the reduction of poverty. The indicators of the sector goal will be enhanced cross border economic activity. The principal beneficiaries will be the

tourism industry in both countries, cross border trading, regional integration (social and economic aspects), population in areas of the Arusha region, Kajiado and Nairobi, Malindi, Mombasa, Tanga and Dar es Salaam districts. The project impact will include increased cross border traffic, increased cross border tourism, increased social-economic activities across the two countries

[Handwritten signature]

[Handwritten signature]

ANNEX II
ALLOCATION OF THE LOAN

The present Annex indicates the categories of expenditure to be financed out of the resources of the loan, each amount being inclusive of the respective physical and price contingencies.

Categories of Expenditure

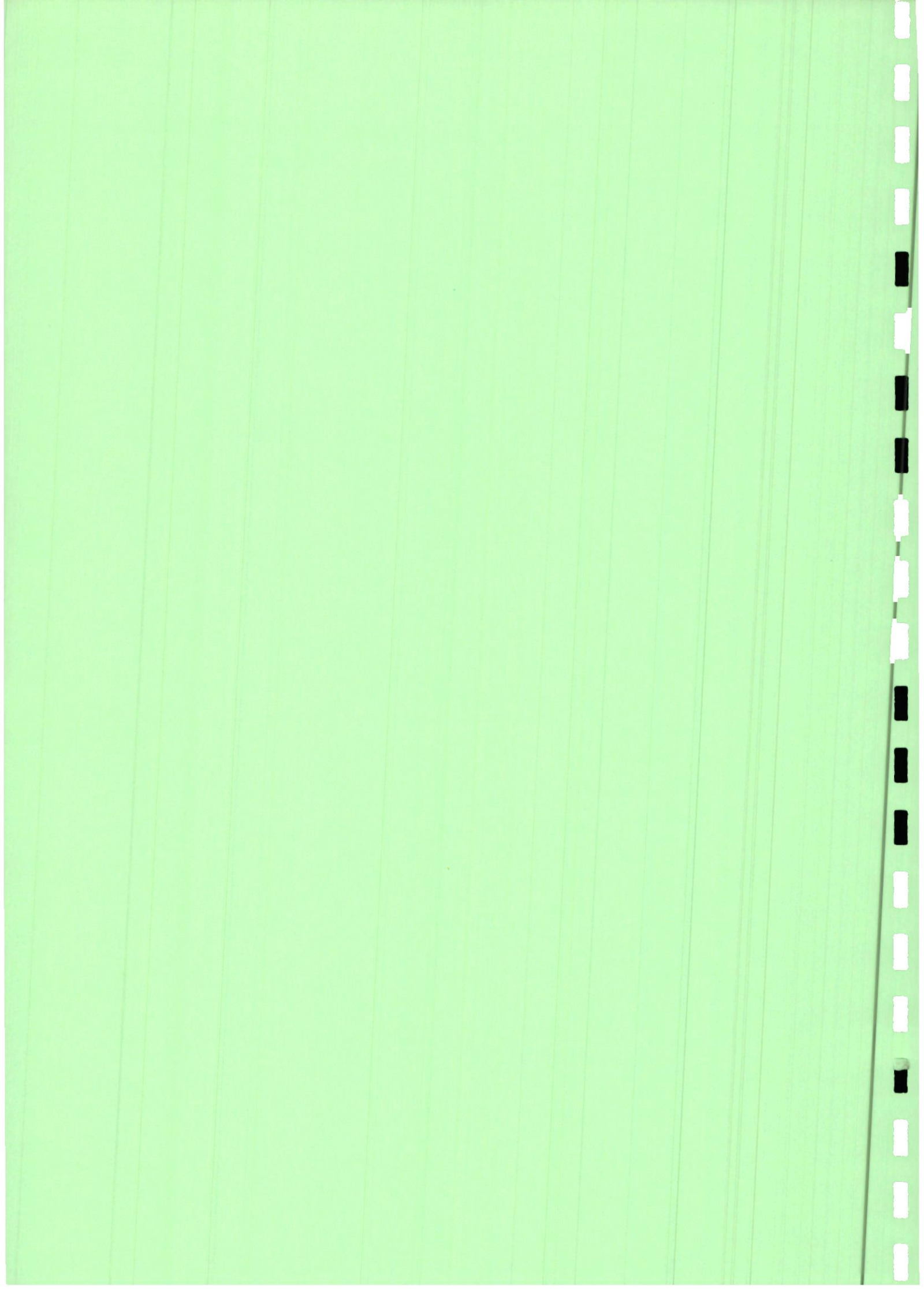
(In Million UA)

Category of Expenditure	F.E.	L.C.	Total
Works	44.827	1.226	46.053
Services	2.869	0.319	3.188
Total	47.696	1.545	49.241

180



APPENDIX XI



CONFORMED COPY

CREDIT NUMBER 3930 KE

Development Credit Agreement

(Northern Corridor Transport Improvement Project)

between

REPUBLIC OF KENYA

and

INTERNATIONAL DEVELOPMENT ASSOCIATION

Dated June 25, 2004

(a) "Bandari College" is the training institute established and operating within MOTC "as hereinafter defined";

(b) "Environmental Impact Assessment" or "EIA" means the Environmental Impact Assessment referred to in paragraph 13 (a) of Schedule 4 to this Agreement

(c) "EASA" means East African School of Aviation, the school established and operating within KCAA (as hereinafter defined);

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

(e) "GNSS" means global navigation satellite system;

(f) "GPS" means global positioning system;

(g) "HIV/AIDS" means human immuno-deficiency virus/ acquired immune deficiency syndrome;

(h) "Initial Deposit" means the initial amount to be deposited into the Project Account "as hereinafter defined" and referred to in Section 3.03 (b) of this Agreement;

(i) "KAA" means Kenya Airports Authority, the Borrower's airports authority established and operating pursuant to the Borrower's Airports Authority Act, 1991 (CAP 395);

(j) "KAA-PTT" means the Project Technical Team established within KAA and referred to in paragraph 6 of Schedule 4 to this Agreement;

(k) "KAA Subsidiary Loan Agreement" means the agreement to be entered into between the Borrower and KAA pursuant to Section 3.01 (c) of this Agreement, as the same may be amended from time to time, and such term includes all schedules to the Subsidiary Loan Agreement;

(l) "KCAA" means Kenya Civil Aviation Authority, the Borrower's civil aviation authority established and operating pursuant to the Borrower's Civil Aviation (Amendment) Act, 2002 (CAP 394);

(m) "KCAA-PTT" means the Project Technical Team established within KCAA and referred to in paragraph 8 of Schedule 4 to this Agreement;

(n) "KCAA Subsidiary Loan Agreement" means the agreement to be entered into between the Borrower and KCAA pursuant to Section 3.01 (d) of this Agreement, as the same may be amended from time to time, and such term includes all schedules to the Subsidiary Loan Agreement;

- (o) "Kenya Shilling" or "KES" means the currency of the Borrower;
- (p) "KRB" means Kenya Roads Board, the Borrower's body responsible for management of the road maintenance levy, established and operating pursuant to the Borrower's Roads Board Act, 1999;
- (q) "Maritime Authority" means the authority to be established within MOTC "as hereinafter defined" and to be supported under Part H of the Project;
- (r) "MORPWH" means the Borrower's Ministry of Roads Public Works and Housing;
- (s) "MORPWH-PTT" means the Project Technical Team established within MORPWH and referred to in paragraph 4 of Schedule 4 to this Agreement;
- (t) "MOTC" means the Borrower's Ministry of Transport and Communications;
- (w) "MOTC-PTT" means the Project Technical Team established within MOTC and referred to in paragraph 11 of Schedule 4 to this Agreement;
- (x) "NHA" means the National Highway Authority to be established by the Borrower and to be supported under Part E of the Project;
- (y) "Northern Corridor" means the transport corridor between the seaport of Mombasa and the Borrower's border with the Republic of Uganda;
- (z) "Northern Corridor Transit Agreement" means the 1985 Northern Corridor Transit Agreement between the Borrower, Burundi, Rwanda, Uganda and the Democratic Republic of Congo;
- (aa) "Operating Account" means each of the accounts referred to in Section 2.02 (c) of this Agreement;
- (bb) "Project Account" means the account referred to in Section 3.03 (a) of this Agreement;
- (cc) "Project Agreements" means the agreement between the Association and KAA and KCAA of even date herewith, as the same may be amended from time to time, and such term includes all schedules and agreements supplemental to the Project Agreement;
- (dd) "Project Affected Person" or "PAP" means any person who owns or occupies land, property or other assets or structures which are adversely affected by the Project, or whose livelihood, business, trade or other occupation is adversely affected as a

result of the Project, and who is declared accordingly eligible to compensation or other assistance under the relevant RAP (as hereinafter defined);

(ee) "Project Coordination Team" means the team established by the Borrower and referred to in paragraph 3 of Schedule 4 to this Agreement;

(ff) "Project Oversight Committee" means the committee established by the Borrower and referred to in paragraph 1 of Schedule 4 to this Agreement;

(gg) "Resettlement Action Plan" or "RAP" means a Resettlement Action Plan referred to in paragraph 13 (b) of Schedule 4 to this Agreement;

(hh) "Resettlement Policy Framework" or "RPF" means the Resettlement Policy Framework, dated November 2003 issued by the Borrower, and describing a program of actions, measures and policies designed to avoid or minimize any adverse impact or hardship to PAPs as a result of the Project or, if such adverse impact or hardship cannot be avoided altogether, provide for the compensation and resettlement of such PAPs as may be appropriate;

(ii) "Special Account A" means the Special Account "as hereinafter defined" for MORPWH and referred to in Section 2.02 (b) of this Agreement;

(jj) "Special Account B" means the Special Account "as hereinafter defined" for KAA, KCAA, and MOTC and referred to in Section 2.02 (b) of this Agreement; and

(kk) "Special Accounts" means the accounts referred to in Section 2.02(b) of this Agreement.

ARTICLE II

The Credit

Section 2.01. The Association agrees to lend to the Borrower, on the terms and conditions set forth or referred to in the Development Credit Agreement, an amount in various currencies equivalent to one hundred thirty eight million four hundred forty thousand Special Drawing Rights (SDR 138,440,000).

Section 2.02. (a) The amount of the Credit may be withdrawn from the Credit Account in accordance with the provisions of Schedule 1 to this Agreement for expenditures made (or, if the Association shall so agree, to be made) in respect of the reasonable cost of goods, works, and services required for the Project and to be financed out of the proceeds of the Credit.

(b) The Borrower shall open and maintain, in Dollars, two separate special deposit accounts (Special Account A and Special Account B) in one or more commercial banks on terms and conditions satisfactory to the Association, including appropriate

protection against set-off, seizure or attachment. Deposits into, and payments out of each respective Special Account shall be made in accordance with the provisions of Schedule 5 to this Agreement.

- (c) (i) The Borrower shall open or cause to be opened and maintain or cause to be maintained in Kenya Shilling an Operating Account for each of MORPWH, KAA, KCAA, and MOTC, in one or more commercial banks, on terms and conditions satisfactory to the Association (including appropriate protection against set-off, seizure or attachment).
- (ii) The Borrower shall, in accordance with procedures acceptable to the Association, withdraw from time to time from the respective Special Account and deposit into each Operating Account, an amount required to finance eligible expenditures for a period of 90 days of Project implementation.
- (iii) Payments out of the respective Operating Account shall only be made for eligible expenditures.
- (iv) In the event that the Association, after consultation with the Borrower, determines that any outstanding amount in any Operating Account is not further required to cover payments for eligible expenditures, the Borrower, upon notice from the Association shall promptly refund such outstanding amount to the respective Special Account.

Section 2.03. The Closing Date shall be December 31, 2009 or such later date as the Association shall establish. The Association shall promptly notify the Borrower of such later date.

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

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

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

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

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

Section 2.07. (a) Subject to paragraphs (b), (c) and (d) below, the Borrower shall repay the principal amount of the Credit in semiannual installments payable on each May 15 and November 15 commencing November 15, 2014 and ending May 15, 2044. Each installment to and including the installment payable on May 15, 2024 shall be one percent (1%) of such principal amount, and each installment thereafter shall be two percent (2%) of such principal amount.

(b) Whenever: (i) the Borrower's per capita gross national product (GNP), as determined by the Association, shall have exceeded for three consecutive years the level established annually by the Association for determining eligibility to access the Association's resources; and (ii) the Bank shall consider the Borrower creditworthy for Bank lending, the Association may, subsequent to the review and approval thereof by the Executive Directors of the Association and after due consideration by them of the development of the Borrower's economy, modify the repayment of installments under paragraph (a) above by:

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

(c) If so requested by the Borrower, the Association may revise the modification referred to in paragraph (b) above to include, in lieu of some or all of the

increase in the amounts of such installments, the payment of interest at an annual rate agreed with the Association on the principal amount of the Credit withdrawn and outstanding from time to time, provided that, in the judgment of the Association, such revision shall not change the grant element obtained under the above-mentioned repayment modification.

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

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

ARTICLE III

Execution of the Project

Section 3.01. (a) The Borrower declares its commitment to the objectives of the Project as set forth in Schedule 2 to this Agreement, and, to this end:

- (i) shall carry out Parts A, B, C, D, and E of the Project through MORPWH, and Part H through MOTC with due diligence and efficiency and in conformity with appropriate administrative, financial, engineering, and environmental practices, and shall provide, promptly as needed, the funds, facilities, services and other resources required for the Project;
- (ii) without any limitation or restriction upon any of its other obligations under the Development Credit Agreement, shall cause KAA to perform in accordance with the provisions of the KAA Project Agreement all the obligations of KAA therein set forth, shall take and cause to be taken all actions, including the provision of funds, facilities, services and other resources, necessary or appropriate to enable KAA to perform such obligations, and shall not take or permit to be taken any action which would prevent or interfere with such performance; and
- (iii) without any limitation or restriction upon any of its other obligations under the Development Credit Agreement, shall cause KCAA to perform in accordance with the provisions of the KCAA Project Agreement all the obligations of KCAA therein set forth, shall take and cause to be taken all actions, including the provision of funds, facilities, services and other resources,

necessary or appropriate to enable KCAA to perform such obligations, and shall not take or permit to be taken any action which would prevent or interfere with such performance

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

(c) The Borrower shall relend part of the proceeds of the Credit to KAA under a subsidiary loan agreement to be entered into between the Borrower and KAA (KAA Subsidiary Loan Agreement), under terms and conditions which shall have been approved by the Association which shall include: (i) repayment of principal in 23 years including a grace period of 8 years; (ii) the payment of interest at the rate of 7% per annum; and (iii) the foreign exchange risk to be borne by the Borrower.

(d) The Borrower shall relend part of the proceeds of the Credit to KCAA under a subsidiary loan agreement to be entered into between the Borrower and KCAA (KCAA Subsidiary Loan Agreement), under terms and conditions which shall have been approved by the Association which shall include: (i) repayment of principal in 23 years including a grace period of 8 years; (ii) the payment of interest at the rate of 7% per annum; and (iii) the foreign exchange risk to be borne by the Borrower.

(e) The Borrower shall exercise its rights under KAA Subsidiary Loan Agreement, and KCAA Subsidiary Loan Agreement in such manner as to protect the interests of the Borrower and the Association and to accomplish the purposes of the Credit, and, except as the Association shall otherwise agree, the Borrower shall not assign, amend, abrogate or waive the KAA Subsidiary Loan Agreement, KCAA Subsidiary Loan Agreement or any provision thereof.

Section 3.02. Except as the Association shall otherwise agree, procurement of the goods, works and consultants' services required for the Project and to be financed out of the proceeds of the Credit shall be governed by the provisions of Schedule 3 to this Agreement.

Section 3.03. Without limitation upon the provisions of paragraph (a) of Section 3.01 of this Agreement, and except as the Borrower and the Association shall otherwise agree, the Borrower shall:

(a) open an account in Kenya Shillings in a commercial bank acceptable to the Association (the Project Account), and thereafter maintain the Project Account under terms and conditions acceptable to the Association until the completion of the Project;

(b) deposit into the Project Account: (i) an initial amount of KES 90,000,000 (the Initial Deposit); and (ii) thereafter, at quarterly intervals, replenish the Project Account by the amounts required to finance the Borrower's contribution for expenditures under the Project other than those financed from the proceeds of the Credit, as shall be agreed upon between the Borrower and the Association; and

(c) ensure that funds deposited into the Project Account in accordance with paragraph (b) of this Section shall be used exclusively to finance expenditures under Parts A through E of the Project other than those financed from the proceeds of the Credit.

Section 3.04. For the purposes of Section 9.06 of the General Conditions and without limitation thereto, the Borrower shall:

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

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

Section 3.05. The Borrower and the Association hereby agree that the obligations set forth in Sections 9.03, 9.04, 9.05, 9.06, 9.07 and 9.08 of the General Conditions (relating to insurance, use of goods and services, plans and schedules, records and reports, maintenance and land acquisition, respectively): (i) in respect of Part F of the Project shall be carried out by KAA; and (ii) in respect of Part G of the Project shall be carried out by KCAA pursuant to Section 2.03 of the Project Agreements.

ARTICLE IV

Financial Covenants

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

(b) The Borrower shall:

(i) have the financial statements referred to in paragraph (a) of this Section for each fiscal year (or other period agreed to by the Association), audited, in accordance with consistently applied auditing standards acceptable to the Association, by independent auditors acceptable to the Association;

- (ii) furnish to the Association as soon as available, but in any case not later than six months after the end of each such year (or such other period agreed to by the Association), (A) certified copies of the financial statements referred to in paragraph (a) of this Section for such year (or other period agreed to by the Association), as so audited, and (B) an opinion on such statements by said auditors, in scope and detail satisfactory to the Association; and
 - (iii) furnish to the Association such other information concerning such records and accounts, and the audit of such financial statements, and concerning said auditors, as the Association may from time to time reasonably request.
- (c) For all expenditures with respect to which withdrawals from the Credit Account were made on the basis of statements of expenditure, the Borrower shall:
- (i) retain, until at least one year after the Association has received the audit report for, or covering, the fiscal year in which the last withdrawal from the Credit Account was made, all records (contracts, orders, invoices, bills, receipts and other documents) evidencing such expenditures;
 - (ii) enable the Association's representatives to examine such records; and
 - (iii) ensure that such statements of expenditure are included in the audit for each fiscal year (or other period agreed to by the Association), referred to in paragraph (b) of this Section.

Section 4.02. (a) Without limitation upon the Borrower's progress reporting obligations set out in paragraph 17 of Schedule 4 to this Agreement, the Borrower shall prepare and furnish to the Association a financial monitoring report, in form and substance satisfactory to the Association, which:

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

(iii) sets forth the status of procurement under the Project, as at the end of the period covered by said report.

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

ARTICLE V

Remedies of the Association

Section 5.01. Pursuant to Section 6.02 (l) of the General Conditions, the following additional events are specified:

(a) KAA shall have failed to perform any of its obligations under the KAA Project Agreement.

(b) KCAA shall have failed to perform any of its obligations under the KCAA Project Agreement.

(c) As a result of events which have occurred after the date of the Development Credit Agreement, an extraordinary situation shall have arisen which shall make it improbable that KAA will be able to perform its obligations under the Project Agreement.

(d) As a result of events which have occurred after the date of the Development Credit Agreement, an extraordinary situation shall have arisen which shall make it improbable that KCAA will be able to perform its obligations under the Project Agreement.

(e) The Borrower's Airports Authority Act, 1991 (CAP 395) shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of KAA to perform any of its obligations under the Project Agreement.

(f) The Borrower's Civil Aviation Authority (Amendment) Act, 2002 (CAP 394) shall have been amended, suspended, abrogated, repealed or waived so as to affect materially and adversely the ability of KCAA to perform any of its obligations under the Project Agreement.

(g) The NDF Loan Agreement shall have failed to become effective by December 31, 2004 or such later date as the Association may agree; provided, however, that the provisions of this paragraph shall not apply if the Borrower establishes to the

satisfaction of the Association that adequate funds for the Project are available to the Borrower from other sources on terms and conditions consistent with the obligations of the Borrower under this Agreement.

Section 5.02. Pursuant to Section 7.01(h) of the General Conditions, the following additional events are specified:

(a) any event specified in paragraphs (a) and (b) Section 5.01 of this Agreement shall occur and shall continue for a period of 60 days after notice thereof shall have been given by the Association to the Borrower; and

(b) the events specified in paragraphs (c), (d), (e) and (f) of Section 5.01 of this Agreement shall occur.

ARTICLE VI

Effective Date; Termination

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

(a) the KAA Subsidiary Loan Agreement has been executed on behalf of the Borrower and KAA;

(b) the KCAA Subsidiary Loan Agreement has been executed on behalf of the Borrower and KCAA;

(c) The Borrower has opened the Project Account and has deposited therein the Initial Deposit referred to in Section 3.03 of this Agreement; and

(d) The Borrower has established a financial management system for the Project in form and substance satisfactory to the Association.

Section 6.02. The following are specified as additional matters, within the meaning of Section 12.02 (b) of the General Conditions, to be included in the opinion or opinions to be furnished to the Association:

(a) that the KAA Project Agreement has been duly authorized or ratified by KAA, and is legally binding upon KAA in accordance with its terms;

(b) that the KAA Subsidiary Loan Agreement has been duly authorized or ratified by the Borrower and KAA and is legally binding upon the Borrower and KAA in accordance with its terms;

(c) that the KCAA Project Agreement has been duly authorized or ratified by KCAA, and is legally binding upon KCAA in accordance with its terms; and

(d) that the KCAA Subsidiary Loan Agreement has been duly authorized or ratified by the Borrower and KCAA and is legally binding upon the Borrower and KCAA in accordance with its terms;

Section 6.03. The date ninety (90) days after the date of this Agreement is hereby specified for the purposes of Section 12.04 of the General Conditions.

ARTICLE VII

Representative of the Borrower; Addresses

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

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

For the Borrower:

Ministry of Finance
Treasury Building
P.O Box 30007-00100
Nairobi, Kenya

Cable address:	Telex:	Facsimile:
FINANCENairobi	22921minfin-ke	+ (254) 20 330426

For the Association:

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

Cable address:	Telex:	Facsimile:
INDEVAS Washington, D.C.	248423 (MCI) or 64145 (MCI)	(202) 477-6391

SCHEDULE 1

Withdrawal of the Proceeds of the Credit

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

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(1) Works		75%
(a) under Parts A through E of the Project	76,640,000	
(b) under Part F of the Project	11,150,000	
(2) Goods		100% of foreign expenditures and 90% of local expenditures
(a) under Parts A through E of the Project	450,000	
(b)(i) under Part F of the Project	8,800,000	
(ii) under Part G of the Project	2,550,000	
(iii) under Part H of the Project	500,000	
(3) Consultants' services including audits		100% of foreign expenditures and 94% of local expenditures
(a) under Parts A through E of the Project	15,900,000	
(b)(i) under Part F of the Project	350,000	
(ii) under Part G of the Project	3,000,000	
(iii) under Part H of the Project	350,000	

<u>Category</u>	<u>Amount of the Credit Allocated (Expressed in SDR Equivalent)</u>	<u>% of Expenditures to be Financed</u>
(4) Training		100%
(a) under Parts A through E of the Project	650,000	
(b)(i) under Part F of the Project	250,000	
(ii) under Part G of the Project	500,000	
(iii) under Part H of the Project	500,000	
(5) Unallocated		
(a) under Parts A through E of the Project	13,300,000	
(b)(i) under Part F of the Project	2,700,000	
(ii) under Part G of the Project	700,000	
(iii) under Part H of the Project	150,000	
	<u><u>138,440,000</u></u>	

2. For the purposes of this Schedule:

(a) the term "foreign expenditures" means expenditures in the currency of any country other than that of the Borrower for goods or services supplied from the territory of any country other than that of the Borrower; and

(b) the term "local expenditures" means expenditures in the currency of the Borrower or for goods or services supplied from the territory of the Borrower.

3. Notwithstanding the provisions of paragraph 1 above, no withdrawals shall be made in respect of payments made for expenditures: (a) prior to the date of this Agreement, except that withdrawals, in an aggregate amount not exceeding the equivalent of SDR 5,000,000, may be made on account of payments made for expenditures before that date but after December 31, 2003; and (b) under categories (2)

(b) (ii), (3) (b) (ii), and (4) (b) (ii), until the KCAA has appointed staff to its office of aviation security oversight in accordance with paragraph 12 of Schedule 4 to this Agreement.

4. The Association may require withdrawals from the Credit Account to be made on the basis of statements of expenditure for expenditures under contracts for: (a) goods costing less than \$250,000 equivalent per contract; (b) works costing less than \$1,000,000 equivalent per contract; (c) services of individual consultants costing less than \$50,000 equivalent per contract; (d) services of consulting firms under contracts costing less than \$100,000 equivalent per contract; and (e) training, all under such terms and conditions as the Association shall specify by notice to the Borrower.

SCHEDULE 2

Description of the Project

The objective of the Project is to enhance the efficiency and effectiveness of the Borrower's transport sector through: (a) increasing the efficiency of road transport; (b) enhancing aviation safety and security to meet international standards; and (c) promoting private sector participation in the management, financing, and maintenance of road assets.

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

Part A: Rehabilitation of the Northern Corridor

1. Rehabilitation of infrastructure and provision of services for the improvement of approximately 373 kilometers of roads in selected sections along the Northern Corridor, including construction of approximately 8-kilometers of roads connecting the old Embakasi Airport terminal to Nairobi-Mombasa highway.
2. Implementation of the mitigation measures specified in the EIA and provision of support to PAPs including provision of support for resettlement activities and compensation.

Part B: Roadside Amenities and Mitigation of HIV/AIDS

1. Construction of facilities to enhance the socioeconomic impact on local communities and improve safety of road users, including bus and truck stops, parking areas, utilities, merchandise booths for use by local communities, bicycle paths, and pedestrian sidewalks.
2. Development and implementation of measures to mitigate effects of HIV/AIDS, including awareness and information dissemination, distribution of condoms, strengthening of local health centers, facilitation of voluntary testing and counseling including construction of kiosks for these purposes, and provision of support to infected and affected people.

Part C: Private Sector Participation in Road Management and Maintenance

Provision of technical advisory services for the preparation of bid documents for and facilitation of the concessioning of selected road sections of the Northern Corridor; and performance-based maintenance of approximately 300 kilometers of selected roads by the private sector.

Part D: Road Safety Improvement

Improvement of safety conditions in selected locations along the Northern Corridor, including carrying out of a road safety and awareness campaign, construction of approximately 5 children's traffic safety parks, rehabilitation of about 5 existing children's traffic safety parks, and improvement of safety conditions of hazardous locations.

Part E: Institutional Strengthening

Development and implementation of institutional and policy reforms through provision of technical advisory services, carrying out of studies, and training, including:

1. Establishment and strengthening of NHA through provision of technical advisory services.
2. Strengthening KRB including reforming its mandate through carrying out of studies and reviews and provision of technical advisory services and training.
3. Designing Kibwezi-Kitui-Mwingi-Maua-Isiolo road corridor.
4. Designing alternative route linking northern Tanzania to Narok in the territory of the Borrower, and designing the widening of the access road to the Moi International Airport in Mombasa.
5. Preparation of a ten-year national transportation development plan.
6. Strengthening the Department of Materials Research and Development at MORPWH and External Resources Department of the Borrower's Ministry of Finance.
7. Capacity building for MORPWH, NHA, the External Resources Department of the Borrower's Ministry of Finance and KRB in management and financing of roads including axle load monitoring and control.
8. Monitoring, evaluation and impact assessment of the Project.
9. Carrying out of feasibility and sector studies for the transport sector including Mombasa bypass study.

Part F: Support to the Kenya Airports Authority

Provision of support to KAA to improve aviation security, safety, and operations at major airports through acquisition of equipment and vehicles; carrying out of civil works; provision of technical advisory service, and training, including:

1. Rehabilitation and reconfiguration of old Embakasi Airport terminal and the main terminal at Jomo Kenyatta International Airport and construction of the road linking the two terminals.
2. Installation of fencing, lighting, and surveillance systems at Jomo Kenyatta International Airport, Moi International Airport, Wilson Airport, Kisumu Airport, Malindi Airport, and Ukunda Airport.
3. Rehabilitation of and reconfiguration of terminal buildings at Kisumu and Wilson Airports, and rehabilitation and extension of the runway at Kisumu Airport.
4. Enhancing aviation security and safety, flight information system, search and rescue capacity, communications, and emergency operations centers at Jomo Kenyatta International Airport, Moi International Airport, Wilson Airport, and Kisumu Airport.
5. Capacity building for staff in airports operations, security and management.

Part G: Support to Kenya Civil Aviation Authority

1. Development and implementation of reforms at KCAA aimed at enhancing aviation safety and security oversight, and safety inspection through provision of technical advisory services and training.
2. Provision of support to KCAA and EASA through acquisition of training and operations equipment including equipment for accident investigation laboratory.
3. Implementation of GNSS-GPS enroute and approach procedures through provision of technical advisory services.
4. Carrying out of training of trainers in airworthiness inspection, flight operations inspection, personnel licensing and security oversight.

Part H: Support to the Ministry of Transport and Communications

Capacity building for MOTC in procurement, Project management, financial management; implementation of the national transportation policy and maritime law; and compliance with conventions of the International Maritime Organization; establishment and strengthening of the Maritime Authority; assisting the Borrower to comply with the Northern Corridor Transit Agreement; and provision of support to Bandari College, through provision of technical advisory services and training, and acquisition of equipment.

* * *

The Project is expected to be completed by June 30, 2009.

SCHEDULE 3

Procurement

Section I. Procurement of Goods and Works

Part A: General

Goods and works shall be procured in accordance with the provisions of Section I of the "Guidelines for Procurement under IBRD Loans and IDA Credits" published by the Bank in January 1995 and revised in January and August 1996, September 1997 and January 1999 (the Guidelines) and the following provisions of Section I of this Schedule.

Part B: International Competitive Bidding

1 Except as otherwise provided in Part C of this Section, goods and works shall be procured under contracts awarded in accordance with the provisions of Section II of the Guidelines and paragraph 5 of Appendix 1 thereto.

2. The provisions of paragraphs 2.54 and 2.55 of the Guidelines (Domestic Preference) and Appendix 2 thereto shall apply to goods manufactured in the territory of the Borrower and works to be carried out by domestic contractors.

Part C: Other Procurement Procedures

1. Limited International Bidding

Goods which the Association agrees can only be purchased from a limited number of suppliers, regardless of the cost thereof, may be procured under contracts awarded in accordance with the provisions of paragraph 3.2 of the Guidelines.

2. National Competitive Bidding

(a) Goods estimated to cost less than \$150,000 equivalent per contract; and (b) works estimated to cost less than \$2,000,000 equivalent per contract, may be procured under contracts awarded in accordance with the provisions of paragraphs 3.3 and 3.4 of the Guidelines.

3. International or National Shopping

Goods estimated to cost less than \$50,000 equivalent per contract may be procured under contracts awarded on the basis of international or national shopping procedures in accordance with the provisions of paragraphs 3.5 and 3.6 of the Guidelines.

Part D: Review by the Association of Procurement Decisions

1. Procurement Planning

Prior to the issuance of any invitations to bid for contracts, the proposed procurement plan for the Project shall be furnished to the Association for its review and approval, in accordance with the provisions of paragraph 1 of Appendix 1 to the Guidelines. Procurement of all goods and works shall be undertaken in accordance with such procurement plan as shall have been approved by the Association, and with the provisions of said paragraph 1.

2. Prior Review

(a) With respect to: (i) each contract for works estimated to cost the equivalent of \$1,000,000 or more; and (ii) the first two contracts for works estimated to cost less than \$1,000,000 equivalent, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

(b) With respect to each contract for goods estimated to cost the equivalent of \$250,000 or more, the procedures set forth in paragraphs 2 and 3 of Appendix 1 to the Guidelines shall apply.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Guidelines shall apply.

Section II. Employment of Consultants

Part A: General

Consultants' services shall be procured in accordance with the provisions of Sections I and IV of the "Guidelines: Selection and Employment of Consultants by World Bank Borrowers" published by the Bank in January 1997 and revised in September 1997, January 1999 and May 2002 (the Consultant Guidelines), paragraph 1 of Appendix 1 thereto, Appendix 2 thereto and the following provisions of Section II of this Schedule.

Part B: Quality- and Cost-based Selection

1. Except as otherwise provided in Part C of this Section, consultants' services shall be procured under contracts awarded in accordance with the provisions of Section II of the Consultant Guidelines, and the provisions of paragraphs 3.13 through 3.18 thereof applicable to quality- and cost-based selection of consultants.

2. The following provision shall apply to consultants' services to be procured under contracts awarded in accordance with the provisions of the preceding paragraph: the short list of consultants for services, estimated to cost less than \$200,000 equivalent per contract, may comprise entirely national consultants in accordance with the provisions of paragraph 2.7 and footnote 8 of the Consultant Guidelines.

Part C: Other Procedures for the Selection of Consultants

1. Least-cost Selection

Audit services and services estimated to cost less than \$50,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.6 of the Consultant Guidelines.

2. Selection Based on Consultants' Qualifications

Services estimated to cost less than \$200,000 equivalent per contract may be procured under contracts awarded in accordance with the provisions of paragraphs 3.1 and 3.7 of the Consultant Guidelines.

3. Single Source Selection

Services for monitoring and evaluation, HIV/AIDS mitigation, and training, may, with the Association's prior agreement, be procured in accordance with the provisions of paragraphs 3.8 through 3.11 of the Consultant Guidelines.

4. Individual Consultants

Services of individual consultants shall be procured under contracts awarded in accordance with the provisions of paragraphs 5.1 through 5.3 of the Consultant Guidelines.

5. Training

Training shall be carried out on the basis of annual work programs which shall have been approved by the Association, and which shall identify: (a) the training envisaged; (b) the personnel to be trained; (c) the selection methods of institutions or individuals conducting such training; (d) the institutions which will conduct the training, if already selected; (e) the duration of proposed training; and (f) the cost estimate of the training.

Part D: Review by the Association of the Selection of Consultants

1. Selection Planning

A plan for the selection of consultants, which shall include contract cost estimates, contract packaging, and applicable selection criteria and procedures, shall be furnished to the Association for its review and approval prior to the issuance to consultants of any requests for proposals. Selection of all consultants' services shall be undertaken in accordance with such selection plan as shall have been approved by the Association.

2. Prior Review

(a) With respect to: (i) all terms of reference for each contract for services; (ii) each contract under single source selection; and (iii) each contract for the employment of consulting firms estimated to cost the equivalent of \$100,000 or more, the procedures set forth in paragraphs 2, 3 and 5 of Appendix 1 to the Consultant Guidelines shall apply.

(b) With respect to each contract for the employment of individual consultants estimated to cost the equivalent of \$50,000 or more, the report on the comparison of the qualifications and experience of candidates, and terms of employment of the consultants shall be furnished to the Association for its prior review and approval. The contract shall be awarded only after the said approval shall have been given. The provisions of paragraph 3 of Appendix 1 to the Consultant Guidelines shall also apply to such contracts.

3. Post Review

With respect to each contract not governed by paragraph 2 of this Part, the procedures set forth in paragraph 4 of Appendix 1 to the Consultant Guidelines shall apply.

SCHEDULE 4

Implementation Program

I. Overall Project Oversight

1. The Borrower shall maintain at all times during the implementation of the Project, a Project Oversight Committee which shall be chaired by the Permanent Secretary of MORPWH, co-chaired by the Permanent Secretary of MOTC, and include a representative from the Ministry of Finance, the Managing Director of KAA, the Director General of KCAA, and the Chief Engineer "Roads" of MORPWH.

2. The Project Oversight Committee shall: (a) provide strategic guidance for Project implementation; (b) review and approve annual work plan for the Project; and (c) review financial reports of Project implementation.

3. The Borrower shall maintain at all times during the implementation of the Project, a Project Coordination Team which shall be chaired by the team leader of MORPWH-PTT and co-chaired by the team leader of MOTC-PTT and include the team leaders of KAA-PTT and KCAA-PTT and which shall be responsible for the overall Project coordination and reporting.

II. Project Administration and Management

4. The Borrower shall maintain at all times during the implementation of the Project, a MORPWH-PTT to oversee the day-to-day implementation of Parts A through E of the Project, and appoint thereto, staff having qualifications and experience satisfactory to the Association, including a team leader, a pavement/materials specialist, a construction specialist, an economist/social development specialist, a design engineer, an environmental specialist, a procurement specialist and a financial management specialist.

5. Notwithstanding its overall reporting obligations to the Project Oversight Committee, MORPWH-PTT shall report on its day-to-day operations directly, in consultation with the Chief Engineer "Roads" of MORPWH with regard to technical matters, to the Permanent Secretary of MORPWH in his or her capacity as a member of the Project Oversight Committee.

6. The Borrower shall cause KAA to maintain at all times during the implementation of the Project, a KAA-PTT to oversee the day-to-day implementation of Part F of the Project, and appoint thereto, staff having qualifications and experience satisfactory to the Association, including a team leader, a construction engineer, an electrical engineer, airport operations specialist, an architectural specialist, an airport security specialist, a procurement specialist and a financial management specialist.

7. Notwithstanding its overall reporting obligations to the Project Oversight Committee, KAA-PTT shall report on its day-to-day operations directly to the Managing Director of KAA in his or her capacity as a member of the Project Oversight Committee.

8. The Borrower shall cause KCAA to maintain at all times during the implementation of the Project, a KCAA-PTT to oversee the day-to-day implementation of Part G of the Project, and appoint thereto, staff having qualifications and experience satisfactory to the Association, including a team leader, the principal of EASA, a procurement specialist and a financial management specialist.

9. Notwithstanding its overall reporting obligations to the Project Oversight Committee, KCAA-PTT shall report on its day-to-day operations directly to the Director General of KCAA in his or her capacity as a member of the Project Oversight Committee.

10. The Borrower shall maintain at all times during the implementation of the Project, a MOTC-PTT to oversee the day-to-day implementation of Part H of the Project, and appoint thereto, staff having qualifications and experience satisfactory to the Association, including a team leader, a procurement specialist and a financial management specialist.

11. Notwithstanding its overall reporting obligations to the Project Oversight Committee, MOTC-PTT shall report on its day-to-day operations directly to the Permanent Secretary of MOTC in his or her capacity as a member of the Project Oversight Committee.

12. The Borrower shall cause KCAA to appoint and thereafter retain at all times during the implementation of the Project staff with adequate experience and qualifications satisfactory to the Association to manage and operate KCAA's office of aviation security oversight.

13. For purposes of Parts A and C of the Project, the Borrower shall prior to the approval of bid documents, prepare and submit to the Association:

(a) an Environmental Impact Assessment (EIA), acceptable to the Association, giving details of the social and environmental status, and potential environmental risks and adverse impacts, which are specific to Parts A and C of the Project, along with proposed mitigation measures; and

(b) wherever applicable, a Resettlement Action Plan (RAP), acceptable to the Association, giving details of measures consistent with the RPF, and designed to facilitate the compensation and resettlement of PAPs, including the magnitude of displacement, proposed compensation and resettlement arrangements, and budget and cost estimates, together with adequate institutional, monitoring and reporting

arrangements capable of ensuring proper implementation of, and regular feedback on compliance with, the RAP; and

14. The Borrower shall implement: (a) the applicable RAP in accordance with the guidelines, timetable, and other specifications set forth in the RAP; and (b) the mitigation measures specified in the EIA in accordance of the guidelines, timetable, and other specifications set forth in the EIA.

15. Without limitation upon the Borrower's other reporting obligations under Section 4.02 of this Agreement, the Borrower shall submit quarterly consolidated reports on compliance with social and environmental safeguard measures under the Project, giving details of measures taken in furtherance of the RAP and the mitigation measures specified in the EIA, conditions, if any, which interfere or threaten implementation of the RAP or the mitigation measures specified in the EIA, and remedial measures taken or required to be taken to address such conditions.

16. The Borrower shall take all measures necessary to establish NHA on or about June 30, 2007.

III. Project Monitoring and Evaluation

17. The Borrower shall:

(a) maintain policies and procedures adequate to enable it to monitor and evaluate on an ongoing basis, in accordance with indicators satisfactory to the Association, the carrying out of the Project and the achievement of the objectives thereof;

(b) prepare, under terms of reference satisfactory to the Association, and furnish to the Association, on or about July 15, 2006, a report integrating the results of the monitoring and evaluation activities performed pursuant to paragraph (a) of this Section, on the progress achieved in the carrying out of the Project during the period preceding the date of said report and setting out the measures recommended to ensure the efficient carrying out of the Project and the achievement of the objectives thereof during the period following such date; and

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

SCHEDULE 5

Special Accounts

1. For the purposes of this Schedule:
 - (a) the term "eligible Categories" means: (i) Categories (1)(a), (2)(a), (3)(a), and (4) (a) set forth in the table in paragraph 1 of Schedule 1 to this Agreement for Special Account A in respect of Parts A through E of the Project; (ii) Categories (1)(b), (2)(b), (3)(b), and (4) (b) set forth in said table for Special Account B in respect of Parts F through H of the Project;
 - (b) the term "eligible expenditures" means expenditures in respect of the reasonable cost of goods, works, and services required for Parts A through H of the Project and to be financed out of the proceeds of the Credit allocated from time to time to the eligible Categories in accordance with the provisions of Schedule 1 to this Agreement; and
 - (c) the term "Authorized Allocation" means an amount equivalent to \$8,000,000 in respect of Special Account A for Parts A through E of the Project; and an amount equivalent to \$5,000,000 in respect of Special Account B for Parts F through H of the Project; to be withdrawn from the Credit Account and deposited into the Special Accounts pursuant to paragraph 3(a) of this Schedule, provided, however, that unless the Association shall otherwise agree, the Authorized Allocation shall be limited to an amount equivalent to \$4,000,000 in respect of Special Account A; and an amount equivalent to \$2,500,000 in respect of Special Account B, until (i) in respect of the Special Account A, the aggregate amount of withdrawals from the Credit Account allocated to Categories (1)(a), (2)(a), (3)(a), and (4) (a) plus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions for Parts A through E of the Project shall be equal to or exceed the equivalent of SDR 30,000,000; and (ii) in respect of Special Account B, the aggregate amount of withdrawals from the Credit Account allocated to Categories (1)(b), (2)(b), (3)(b), and (4)(b) plus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions for Parts F through H of the Project shall be equal to or exceed the equivalent of SDR 10,000,000.
2. Payments out of the respective Special Account shall be made exclusively for eligible expenditures in accordance with the provisions of this Schedule.
3. After the Association has received evidence satisfactory to it that the respective Special Account has been duly opened, withdrawals of the Authorized Allocation and subsequent withdrawals to replenish the respective Special Account shall be made as follows:

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

(b) (i) For replenishment of the respective Special Account, the Borrower shall furnish to the Association requests for deposits into the respective Special Account at such intervals as the Association shall specify.

(ii) Prior to or at the time of each such request, the Borrower shall furnish to the Association the documents and other evidence required pursuant to paragraph 4 of this Schedule for the payment or payments in respect of which replenishment is requested. On the basis of each such request, the Association shall, on behalf of the Borrower, withdraw from the Credit Account and deposit into the respective Special Account such amount as the Borrower shall have requested and as shall have been shown by said documents and other evidence to have been paid out of the respective Special Account for eligible expenditures. All such deposits shall be withdrawn by the Association from the Credit Account under the respective eligible Categories, and in the respective equivalent amounts, as shall have been justified by said documents and other evidence.

4. For each payment made by the Borrower out of the respective Special Account, the Borrower shall, at such time as the Association shall reasonably request, furnish to the Association such documents and other evidence showing that such payment was made exclusively for eligible expenditures.

5. Notwithstanding the provisions of paragraph 3 of this Schedule, the Association shall not be required to make further deposits into any Special Account:

(a) if, at any time, the Association shall have determined that all further withdrawals should be made by the Borrower directly from the Credit Account in accordance with the provisions of Article V of the General Conditions and paragraph (a) of Section 2.02 of this Agreement;

(b) if the Borrower shall have failed to furnish to the Association, within the period of time specified in Section 4.01 (b)(ii) of this Agreement, any of the audit reports required to be furnished to the Association pursuant to said Section in respect of the audit of the records and accounts for the Special Accounts;

(c) if, at any time, the Association shall have notified the Borrower of its intention to suspend in whole or in part the right of the Borrower to make withdrawals from the Credit Account pursuant to the provisions of Section 6.02 of the General Conditions; or

(d) once the total unwithdrawn amount of the Credit allocated to the eligible Categories for the respective Special Account, minus the total amount of all outstanding special commitments entered into by the Association pursuant to Section 5.02 of the General Conditions with respect to the Project, shall equal the equivalent of twice the amount of the Authorized Allocation.

Thereafter, withdrawal from the Credit Account of the remaining unwithdrawn amount of the Credit allocated to the eligible Categories shall follow such procedures as the Association shall specify by notice to the Borrower. Such further withdrawals shall be made only after and to the extent that the Association shall have been satisfied that all such amounts remaining on deposit in the respective Special Account as of the date of such notice will be utilized in making payments for eligible expenditures.

6. (a) If the Association shall have determined at any time that any payment out of any Special Account: (i) was made for an expenditure or in an amount not eligible pursuant to paragraph 2 of this Schedule; or (ii) was not justified by the evidence furnished to the Association, the Borrower shall, promptly upon notice from the Association: (A) provide such additional evidence as the Association may request; or (B) deposit into the respective Special Account (or, if the Association shall so request, refund to the Association) an amount equal to the amount of such payment or the portion thereof not so eligible or justified. Unless the Association shall otherwise agree, no further deposit by the Association into any Special Account shall be made until the Borrower has provided such evidence or made such deposit or refund, as the case may be.

(b) If the Association shall have determined at any time that any amount outstanding in any Special Account will not be required to cover further payments for eligible expenditures, the Borrower shall, promptly upon notice from the Association, refund to the Association such outstanding amount.

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

(d) Refunds to the Association made pursuant to paragraphs 6 (a), (b) and (c) of this Schedule shall be credited to the Credit Account for subsequent withdrawal or for cancellation in accordance with the relevant provisions of this Agreement, including the General Conditions.

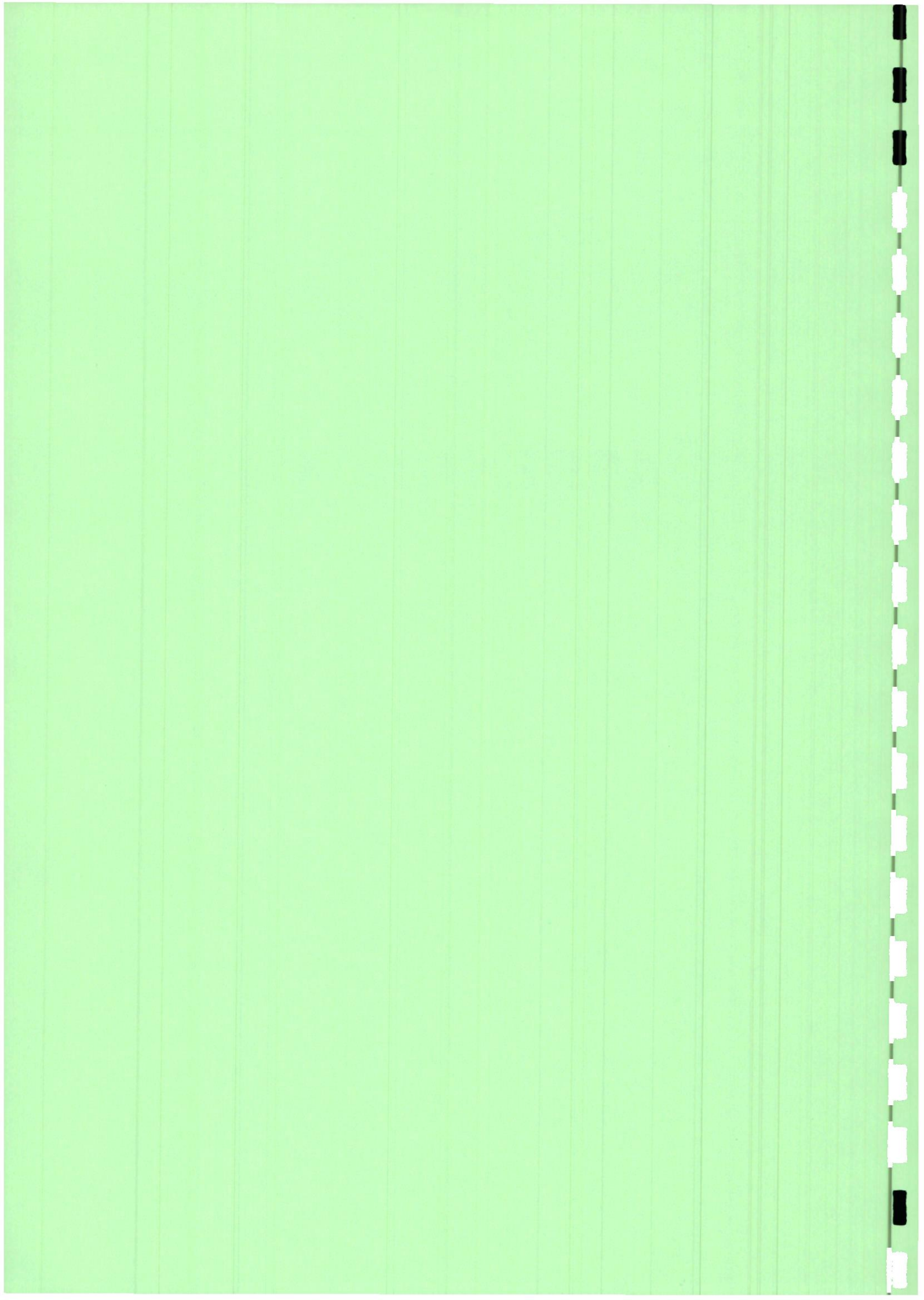
SCHEDULE 6

Performance Indicators

The performance indicators for the Project shall include the following, said indicators being subject to modifications by agreement between the Borrower and the Association:

1. Travel time by road from Mombasa to Malaba and Busia reduced by 25%.
2. KCAA is cleared as category 1 safety status under the International Aviation Safety Assessment of the United States Federal Aviation Administration.
3. Jomo Kenyatta International Airport in Nairobi is cleared by the United States Transportation Security Agency for direct flights to and from United States airports.
4. One long term performance based road management and maintenance contract awarded to the private sector and is effectively under implementation.
5. One road segment along the Northern Corridor is offered for concession to the private sector.

APPENDIX XII



International Accounting Standard 16

Property, Plant and Equipment

In April 2001 the International Accounting Standards Board (IASB) adopted IAS 16 *Property, Plant and Equipment*, which had originally been issued by the International Accounting Standards Committee in December 1993. IAS 16 *Property, Plant and Equipment* replaced IAS 16 *Accounting for Property, Plant and Equipment* (issued in March 1982). IAS 16 that was issued in March 1982 also replaced some parts in IAS 4 *Depreciation Accounting* that was approved in November 1975.

In December 2003 the IASB issued a revised IAS 16 as part of its initial agenda of technical projects. The revised standard also replaced the guidance in three Interpretations (SIC-6 *Costs of Modifying Existing Software*, SIC-14 *Property, Plant and Equipment—Compensation for the Depreciation or Loss of Items* and SIC-23 *Property, Plant and Equipment—Major Inspection or Overhaul Costs*).

Other IFRSs have made minor consequential amendments to IAS 16. They include IFRS 3 *Business Combinations* (issued March 2004 and as revised in January 2008), IFRS 5 *Non-Current Assets Held for Sale and Discontinued Operations* (issued March 2004), IAS 1 *Presentation of Financial Statements* (as revised in September 2007), *Improvements to IFRSs* (issued May 2008) and IFRS 13 *Value Measurement* (issued May 2011).

IAS 16

CONTENTS

	from paragraph
	IN1
INTRODUCTION	
INTERNATIONAL ACCOUNTING STANDARD 16 <i>PROPERTY, PLANT AND EQUIPMENT</i>	
OBJECTIVE	
SCOPE	1
DEFINITIONS	2
RECOGNITION	6
Initial costs	7
Subsequent costs	11
MEASUREMENT AT RECOGNITION	12
Elements of cost	15
Measurement of cost	16
MEASUREMENT AFTER RECOGNITION	23
Cost model	29
Revaluation model	30
Depreciation	31
Depreciable amount and depreciation period	43
Depreciation method	50
Impairment	60
Compensation for impairment	63
DERECOGNITION	65
DISCLOSURE	67
TRANSITIONAL PROVISIONS	73
EFFECTIVE DATE	80
WITHDRAWAL OF OTHER PRONOUNCEMENTS	81
APPENDIX	82
Amendments to other pronouncements	

FOR THE ACCOMPANYING DOCUMENTS LISTED BELOW, SEE PART B OF THIS EDITION

APPROVAL BY THE BOARD OF IAS 16 ISSUED IN DECEMBER 2003
BASIS FOR CONCLUSIONS

International Accounting Standard 16 *Property, Plant and Equipment* (IAS 16) is set out in paragraphs 1–83 and the Appendix. All the paragraphs have equal authority but retain the IASC format of the Standard when it was adopted by the IASB. IAS 16 should be read in the context of its objective and the Basis for Conclusions, the *Preface to International Financial Reporting Standards* and the *Conceptual Framework for Financial Reporting*. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

- IN1 International Accounting Standard 16 *Property, Plant and Equipment* (IAS 16) replaces IAS 16 *Property, Plant and Equipment* (revised in 1998), and should be applied for annual periods beginning on or after 1 January 2005. Earlier application is encouraged. The Standard also replaces the following Interpretations:
- SIC-6 *Costs of Modifying Existing Software*
 - SIC-14 *Property, Plant and Equipment—Compensation for the Impairment or Loss of Items*
 - SIC-23 *Property, Plant and Equipment—Major Inspection or Overhaul Costs.*

Reasons for revising IAS 16

- IN2 The International Accounting Standards Board developed this revised IAS 16 as part of its project on Improvements to International Accounting Standards. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the project were to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements.
- IN3 For IAS 16 the Board's main objective was a limited revision to provide additional guidance and clarification on selected matters. The Board did not reconsider the fundamental approach to the accounting for property, plant and equipment contained in IAS 16.

changes

The main changes from the previous version of IAS 16 are described below.

scope

This Standard clarifies that an entity is required to apply the principles of this Standard to items of property, plant and equipment used to develop or maintain (a) biological assets and (b) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

Recognition: subsequent costs

An entity evaluates under the general recognition principle all property, plant and equipment costs at the time they are incurred. Those costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service an item. The previous version of IAS 16 contained two recognition principles. An entity applied the second recognition principle to subsequent costs.

Measurement at recognition: asset dismantlement, removal and restoration costs

IN7

The cost of an item of property, plant and equipment includes the costs of its dismantlement, removal or restoration, the obligation for which an entity incurs as a consequence of installing the item. Its cost also includes the costs of its dismantlement, removal or restoration, the obligation for which an entity incurs as a consequence of using the item during a particular period for purposes other than to produce inventories during that period. The previous version of IAS 16 included within its scope only the costs incurred as a consequence of installing the item.

Measurement at recognition: asset exchange transactions

IN8

An entity is required to measure an item of property, plant and equipment acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, at fair value unless the exchange transaction lacks commercial substance. Under the previous version of IAS 16, an entity measured such an acquired asset at fair value unless the exchanged assets were similar.

Measurement after recognition: revaluation model

IN9

If fair value can be measured reliably, an entity may carry all items of property, plant and equipment of a class at a revalued amount, which is the fair value of the items at the date of the revaluation less any subsequent accumulated depreciation and accumulated impairment losses. Under the previous version of IAS 16, use of revalued amounts did not depend on whether fair values were reliably measurable.

Depreciation: unit of measure

IN10

An entity is required to determine the depreciation charge separately for each significant part of an item of property, plant and equipment. The previous version of IAS 16 did not as clearly set out this requirement.

Depreciation: depreciable amount

IN11

An entity is required to measure the residual value of an item of property, plant and equipment as the amount it estimates it would receive currently for the asset if the asset were already of the age and in the condition expected at the end of its useful life. The previous version of IAS 16 did not specify whether the residual value was to be this amount or the amount, inclusive of the effects of inflation, that an entity expected to receive in the future on the asset's actual retirement date.

Depreciation: depreciation period

IN12

An entity is required to begin depreciating an item of property, plant and equipment when it is available for use and to continue depreciating it until it is derecognised, even if during that period the item is idle. The previous version of

IAS 16 did not specify when depreciation of an item began and specified that an entity should cease depreciating an item that it had retired from active use and was holding for disposal.

Derecognition: derecognition date

IN13 An entity is required to derecognise the carrying amount of an item of property, plant and equipment that it disposes of on the date the criteria for the sale of goods in IAS 18 *Revenue* would be met. The previous version of IAS 16 did not require an entity to use those criteria to determine the date on which it derecognised the carrying amount of a disposed-of item of property, plant and equipment.

IN14 An entity is required to derecognise the carrying amount of a part of an item of property, plant and equipment if that part has been replaced and the entity has included the cost of the replacement in the carrying amount of the item. The previous version of IAS 16 did not extend its derecognition principle to such parts; rather, its recognition principle for subsequent expenditures effectively precluded the cost of a replacement from being included in the carrying amount of the item.

Derecognition: gain classification

IN15 An entity cannot classify as revenue a gain it realises on the disposal of an item of property, plant and equipment. The previous version of IAS 16 did not contain this provision.

International Accounting Standard 16

Property, Plant and Equipment

Objective

- 1 The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of the financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognised in relation to them.

Scope

- 2 This Standard shall be applied in accounting for property, plant and equipment except when another Standard requires or permits a different accounting treatment.
- 3 This Standard does not apply to:
- (a) property, plant and equipment classified as held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*;
 - (b) biological assets related to agricultural activity (see IAS 41 *Agriculture*);
 - (c) the recognition and measurement of exploration and evaluation assets (see IFRS 6 *Exploration for and Evaluation of Mineral Resources*); or
 - (d) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in (b)–(d).

4 Other Standards may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, IAS 17 *Leases* requires an entity to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

5 An entity using the cost model for investment property in accordance with IAS 40 *Investment Property* shall use the cost model in this Standard.

Definitions

6 The following terms are used in this Standard with the meanings specified:

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, eg IFRS 2 *Share-based Payment*.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Entity-specific value is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. (See IFRS 13 *Fair Value Measurement*.)

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Property, plant and equipment are tangible items that:

- (a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period.

Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.

The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life is:

- (a) the period over which an asset is expected to be available for use by an entity; or
- (b) the number of production or similar units expected to be obtained from the asset by an entity.

Recognition

- 7 The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:
- (a) it is probable that future economic benefits associated with the item will flow to the entity; and
 - (b) the cost of the item can be measured reliably.

8 Items such as spare parts, stand-by equipment and servicing equipment are recognised in accordance with this IFRS when they meet the definition of property, plant and equipment. Otherwise, such items are classified as inventory.

9 This Standard does not prescribe the unit of measure for recognition, ie what constitutes an item of property, plant and equipment. Thus, judgement is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value.

10 An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.

Initial costs

11 Items of property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits from related assets in excess of what could be derived had those items not been acquired. For example, a chemical manufacturer may install new chemical handling processes to comply with environmental requirements for the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset because without them the entity is unable to manufacture and sell chemicals. However, the resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with IAS 36 *Impairment of Assets*.

Subsequent costs

12 Under the recognition principle in paragraph 7, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.

13 Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a nonrecurring replacement. Under the recognition principle in

paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 67-72).

- 14 A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

Measurement at recognition

- 15 An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.

Elements of cost

- 16 The cost of an item of property, plant and equipment comprises:
- (a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
 - (b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
 - (c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.
- 17 Examples of directly attributable costs are:
- (a) costs of employee benefits (as defined in IAS 19 *Employee Benefits*) arising directly from the construction or acquisition of the item of property, plant and equipment;
 - (b) costs of site preparation;
 - (c) initial delivery and handling costs;
 - (d) installation and assembly costs;

- (e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
- (f) professional fees.

An entity applies IAS 2 *Inventories* to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with IAS 2 or IAS 16 are recognised and measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

Examples of costs that are not costs of an item of property, plant and equipment are:

- (a) costs of opening a new facility;
- (b) costs of introducing a new product or service (including costs of advertising and promotional activities);
- (c) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and
- (d) administration and other general overhead costs.

Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment:

- (a) costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;
- (b) initial operating losses, such as those incurred while demand for the item's output builds up; and
- (c) costs of relocating or reorganising part or all of an entity's operations.

Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.

- 22 The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale (see IAS 2). Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. IAS 23 *Borrowing Costs* establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of property, plant and equipment.

Measurement of cost

- 23 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognised as interest over the period of credit unless such interest is capitalised in accordance with IAS 23.
- 24 One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired item is measured in this way even if an entity cannot immediately derecognise the asset given up. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.
- 25 An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows are expected to change as a result of the transaction. An exchange transaction has commercial substance if:
- (a) the configuration (risk, timing and amount) of the cash flows of the asset received differs from the configuration of the cash flows of the asset transferred; or
 - (b) the entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
 - (c) the difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows. The result of these analyses may be clear without an entity having to perform detailed calculations.

- 26 The fair value of an asset is reliably measurable if (a) the variability in the range of reasonable fair value measurements is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably

assessed and used when measuring fair value. If an entity is able to measure reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.

27. The cost of an item of property, plant and equipment held by a lessee under a finance lease is determined in accordance with IAS 17.

28. The carrying amount of an item of property, plant and equipment may be reduced by government grants in accordance with IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

Measurement after recognition

29. An entity shall choose either the cost model in paragraph 30 or the revaluation model in paragraph 31 as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.

Cost model

After recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.

Revaluation model

After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the end of the reporting period.

[Deleted]

The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.

When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is treated in one of the following ways:

- (a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of applying an index to determine its replacement cost (see IFRS 13).
- (b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. This method is often used for buildings.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with paragraphs 39 and 40.

36 If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.

37 A class of property, plant and equipment is a grouping of assets of a similar nature and use in an entity's operations. The following are examples of separate classes:

- (a) land;
- (b) land and buildings;
- (c) machinery;
- (d) ships;
- (e) aircraft;
- (f) motor vehicles;
- (g) furniture and fixtures; and
- (h) office equipment.

38 The items within a class of property, plant and equipment are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.

39 If an asset's carrying amount is increased as a result of a revaluation, the increase shall be recognised in other comprehensive income and accumulated in equity under the heading of revaluation surplus. However, the increase shall be recognised in profit or loss to the extent that it reverses a revaluation decrease of the same asset previously recognised in profit or loss.

40 If an asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognised in profit or loss. However, the decrease shall be recognised in other comprehensive income to the extent of any credit balance existing in the revaluation surplus in respect of that asset. The decrease recognised in other comprehensive income reduces the amount accumulated in equity under the heading of revaluation surplus.

The revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the asset is derecognised. This may involve transferring the whole of the surplus when the asset is retired or disposed of. However, some of the surplus may be transferred as the asset is used by an entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. Transfers from revaluation surplus to retained earnings are not made through profit or loss.

The effects of taxes on income, if any, resulting from the revaluation of property, plant and equipment are recognised and disclosed in accordance with IAS 12 *Income Taxes*.

Depreciation

Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.

An entity allocates the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease. Similarly, if an entity acquires property, plant and equipment subject to an operating lease in which it is the lessor, it may be appropriate to depreciate separately amounts reflected in the cost of that item that are attributable to favourable or unfavourable lease terms relative to market terms.

A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.

To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an entity has varying expectations for these parts, approximation techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.

An entity may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.

The depreciation charge for each period shall be recognised in profit or loss unless it is included in the carrying amount of another asset.

The depreciation charge for a period is usually recognised in profit or loss. However, sometimes, the future economic benefits embodied in an asset are absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see IAS 2). Similarly,

depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognised in accordance with IAS 38 *Intangible Assets*.

Depreciable amount and depreciation period

- 50 The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.
- 51 The residual value and the useful life of an asset shall be reviewed at least at each financial year-end and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in an accounting estimate in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.
- 52 Depreciation is recognised even if the fair value of the asset exceeds its carrying amount, as long as the asset's residual value does not exceed its carrying amount. Repair and maintenance of an asset do not negate the need to depreciate it.
- 53 The depreciable amount of an asset is determined after deducting its residual value. In practice, the residual value of an asset is often insignificant and therefore immaterial in the calculation of the depreciable amount.
- 54 The residual value of an asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's depreciation charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.
- 55 Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.
- 56 The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:
- (a) expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.
 - (b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

related leases.

57 The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of the entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgement based on the experience of the entity with similar assets.

58 Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.

59 If the cost of land includes the costs of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits obtained by incurring those costs. In some cases, the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits to be derived from it.

Depreciation method

60 The depreciation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity.

61 The depreciation method applied to an asset shall be reviewed at least at each financial year-end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate in accordance with IAS 8.

62 A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss.

64 [Deleted]

65 Compensation for impairment

65 Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall be included in profit or loss when the compensation becomes receivable.

66 Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:

- (a) impairments of items of property, plant and equipment are recognised in accordance with IAS 36;
- (b) derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;
- (c) compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining profit or loss when it becomes receivable; and
- (d) the cost of items of property, plant and equipment restored, purchased or constructed as replacements is determined in accordance with this Standard.

Derecognition

67 The carrying amount of an item of property, plant and equipment shall be derecognised:

- (a) on disposal; or
- (b) when no future economic benefits are expected from its use or disposal.

68 The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised (unless IAS 17 requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.

68A However, an entity that, in the course of its ordinary activities, routinely sells items of property, plant and equipment that it has held for rental to others shall transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale. The proceeds from the sale of such assets

shall be recognised as revenue in accordance with IAS 18 *Revenue*. IFRS 5 does not apply when assets that are held for sale in the ordinary course of business are transferred to inventories.

69 The disposal of an item of property, plant and equipment may occur in a variety of ways (eg by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an entity applies the criteria in IAS 18 for recognising revenue from the sale of goods. IAS 17 applies to disposal by a sale and leaseback.

70 If, under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognises the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.

71 **The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.**

72 The consideration receivable on disposal of an item of property, plant and equipment is recognised initially at its fair value. If payment for the item is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue in accordance with IAS 18 reflecting the effective yield on the receivable.

Disclosure

73 **The financial statements shall disclose, for each class of property, plant and equipment:**

- (a) the measurement bases used for determining the gross carrying amount;
- (b) the depreciation methods used;
- (c) the useful lives or the depreciation rates used;
- (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and
- (e) a reconciliation of the carrying amount at the beginning and end of the period showing:
 - (i) additions;
 - (ii) assets classified as held for sale or included in a disposal group classified as held for sale in accordance with IFRS 5 and other disposals;
 - (iii) acquisitions through business combinations;

- (v) impairment losses recognised in profit or loss in accordance with IAS 36;
- (vi) impairment losses reversed in profit or loss in accordance with IAS 36;
- (vii) depreciation;
- (viii) the net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and
- (ix) other changes.

74 The financial statements shall also disclose:

- (a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;
- (b) the amount of expenditures recognised in the carrying amount of an item of property, plant and equipment in the course of its construction;
- (c) the amount of contractual commitments for the acquisition of property, plant and equipment; and
- (d) if it is not disclosed separately in the statement of comprehensive income, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in profit or loss.

75 Selection of the depreciation method and estimation of the useful life of assets are matters of judgement. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other entities. For similar reasons, it is necessary to disclose:

- (a) depreciation, whether recognised in profit or loss or as a part of the cost of other assets, during a period; and
- (b) accumulated depreciation at the end of the period.

76 In accordance with IAS 8 an entity discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to:

- (a) residual values;

77 If items of property, plant and equipment are stated at revalued amounts, the following shall be disclosed in addition to the disclosures required by IFRS 13:

- (a) the effective date of the revaluation;
- (b) whether an independent valuer was involved;
- (c) [deleted]
- (d) [deleted]
- (e) for each revalued class of property, plant and equipment, the carrying amount that would have been recognised had the assets been carried under the cost model; and
- (f) the revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders.

78 In accordance with IAS 36 an entity discloses information on impaired property, plant and equipment in addition to the information required by paragraph 73(e)(iv)–(vi).

79 Users of financial statements may also find the following information relevant to their needs:

- (a) the carrying amount of temporarily idle property, plant and equipment;
- (b) the gross carrying amount of any fully depreciated property, plant and equipment that is still in use;
- (c) the carrying amount of property, plant and equipment retired from active use and not classified as held for sale in accordance with IFRS 5; and
- (d) when the cost model is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.

Therefore, entities are encouraged to disclose these amounts.

Transitional provisions

80 The requirements of paragraphs 24–26 regarding the initial measurement of an item of property, plant and equipment acquired in an exchange of assets transaction shall be applied prospectively only to future transactions.

- ... beginning before 1 January 2005, it shall disclose that
- 81A An entity shall apply the amendments in paragraph 3 for annual periods beginning on or after 1 January 2006. If an entity applies IFRS 6 for an earlier period, those amendments shall be applied for that earlier period.
- 81B IAS 1 *Presentation of Financial Statements* (as revised in 2007) amended terminology used throughout IFRSs. In addition it amended paragraphs 1 and 73(e)(iv). An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. If an entity applies IAS 1 (revised 2007) for an earlier period, the amendments shall be applied for that earlier period.
- 81C IFRS 3 *Business Combinations* (as revised in 2008) amended paragraph 44. An entity shall apply that amendment for annual periods beginning on or after 1 January 2009. If an entity applies IFRS 3 (revised 2008) for an earlier period, that amendment shall also be applied for that earlier period.
- 81D Paragraphs 6 and 69 were amended and paragraph 68A was added in *Improvements to IFRSs* issued in May 2008. An entity shall apply those amendments for annual periods beginning on or after 1 January 2009. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact and at the same time apply the amendments to IAS 7 *Statement of Cash Flows*.
- 81E Paragraph 5 was amended by *Improvements to IFRSs* issued in May 2008. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 January 2009. Earlier application is permitted if an entity also applies the amendments to paragraphs 8, 9, 22, 48, 53, 53A, 53B, 54, 57 and 85B of IAS 1 at the same time. If an entity applies the amendment for an earlier period it shall disclose that fact.
- 81F IFRS 13, issued in May 2011, amended the definition of fair value in paragraph 13 and amended paragraphs 26, 35 and 77 and deleted paragraphs 32 and 33. An entity shall apply those amendments when it applies IFRS 13.
- 81G *Annual Improvements 2009–2011 Cycle*, issued in May 2012, amended paragraph 13. An entity shall apply that amendment retrospectively in accordance with *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after 1 January 2013. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.

Withdrawal of other pronouncements

- 82 This Standard supersedes IAS 16 *Property, Plant and Equipment* (revised in 1992).
- 83 This Standard supersedes the following Interpretations:
- (a) SIC-6 *Costs of Modifying Existing Software*.

- (b) SIC-14 *Property, Plant and Equipment—Compensation for the Impairment or Loss of Items*; and
- (c) SIC-23 *Property, Plant and Equipment—Major Inspection or Overhaul Costs*.

1 January 2005. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

* * * * *

The amendments contained in this appendix when this Standard was issued in 2003 have been incorporated into the relevant pronouncements published in this volume.

IAS 16

IASB documents published to accompany

International Accounting Standard 16

Property, Plant and Equipment

The text of the unaccompanied IAS 16 is contained in Part A of this edition. Its effective date when issued was 1 January 2005. The effective date of the latest amendments is 1 July 2013. This part presents the following accompanying documents:

**APPROVAL BY THE BOARD OF IAS 16 ISSUED IN DECEMBER 2003
BASIS FOR CONCLUSIONS**

Basis for Conclusions on IAS 16 *Property, Plant and Equipment*

This Basis for Conclusions accompanies, but is not part of, IAS 16.

Introduction

- BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in reaching its conclusions on revising IAS 16 *Property, Plant and Equipment* in 2003. Individual Board members gave greater weight to some factors than to others.
- BC2 In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 16. The project was undertaken in the light of queries and criticisms raised in relation to the Standards by securities regulators, professional accountants and other interested parties. The objectives of the Improvements project were to reduce or eliminate alternatives, redundancies and conflicts within Standards, to deal with some convergence issues and to make other improvements. In May 2002 the Board published its proposals in the Exposure Draft of *Improvements to International Accounting Standards*, with a comment deadline of 16 September 2002. The Board received over 160 comment letters on the Exposure Draft.
- BC3 Because the Board's intention was not to reconsider the fundamental approach to the accounting for property, plant and equipment that was established by IAS 16, this Basis for Conclusions does not discuss requirements in IAS 16 that the Board has not reconsidered.

Scope

- BC4 The Board clarified that the requirements of IAS 16 apply to items of property, plant and equipment that an entity uses to develop or maintain (a) biological assets and (b) mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources. The Board noted that items of property, plant and equipment that an entity uses for these purposes possess the same characteristics as other items of property, plant and equipment.

Recognition

- BC5 In considering potential improvements to the previous version of IAS 16, the Board reviewed its subsequent expenditure recognition principle for two reasons. First, the existing subsequent expenditure recognition principle did not align with the asset recognition principle in the *Framework*.¹ Second, the Board noted difficulties in practice in making the distinction it required between expenditures that maintain, and those that enhance, an item of

BC6 The Board ultimately decided that the separate recognition principle for subsequent expenditure was not needed. As a result, an entity will evaluate all its property, plant and equipment costs under IAS 16's general recognition principle. Also, if the cost of a replacement for part of an item of property, plant and equipment is recognised in the carrying amount of an asset, then an entity will derecognise the carrying amount of what was replaced to avoid carrying both the replacement and the replaced portion as assets. This derecognition occurs whether or not what is replaced is a part of an item that the entity depreciates separately.

BC7 The Board's decision on how to handle the recognition principles was not reached easily. In the Exposure Draft (ED), the Board proposed to include within IAS 16's general recognition principle only the recognition of subsequent expenditures that are replacements of a part of an item of property, plant and equipment. Also in the ED, the Board proposed to modify the subsequent expenditure recognition principle to distinguish more clearly the expenditures to which it would continue to apply.

BC8 Respondents to the ED agreed that it was appropriate for subsequent expenditures that were replacements of a part of an item of property, plant and equipment that an entity depreciated separately to be covered by the general recognition principle. However, the respondents argued, and the Board agreed, that the modified second principle was not clearer because it would result in an entity recognising in the carrying amount of an asset and then depreciating subsequent expenditures that were for the day-to-day servicing of items of property, plant and equipment, those that might commonly be regarded as for 'repairs and maintenance'. That result was not the Board's intention.

BC9 In its redeliberation of the ED, the Board concluded it could not retain the proposed modified subsequent expenditure recognition principle. It also concluded that it could not revert to the subsequent expenditure principle in the previous version of IAS 16 because, if it did, nothing was improved; the *Framework* conflict was not resolved and the practice issues were not addressed.

BC10 The Board concluded that it was best for all subsequent expenditures to be covered by IAS 16's general recognition principle. This solution had the following advantages:

- (a) use of IAS 16's general recognition principle fits the *Framework*.
- (b) use of a single recognition principle is a straightforward approach.
- (c) retaining IAS 16's general recognition principle and combining it with the derecognition principle will result in financial statements that reflect what is occurring, ie both the flow of property, plant and equipment through an entity and the economics of the acquisition and disposal process.
- (d) use of one recognition principle fosters consistency. With two principles, consistency is not achieved.

of property, plant and equipment and others might regard it as a subsequent cost of an existing item of property, plant and equipment.

BC11 As a consequence of placing all subsequent expenditures under IAS 16's general recognition principle, the Board also included those expenditures under IAS 16's derecognition principle. In the ED, the Board proposed the derecognition of the carrying amount of a part of an item that was depreciated separately and replaced by a subsequent expenditure that an entity recognised in the carrying amount of the asset under the general recognition principle. With this change, replacements of a part of an item that are not depreciated separately are subject to the same approach.

BC12 The Board noted that some subsequent expenditures on property, plant and equipment, although arguably incurred in the pursuit of future economic benefits, are not sufficiently certain to be recognised in the carrying amount of an asset under the general recognition principle. Thus, the Board decided to state in the Standard that an entity recognises in profit or loss as incurred the costs of the day-to-day servicing of property, plant and equipment.

Classification of servicing equipment

BC12A In *Annual Improvements 2009–2011 Cycle* (issued in May 2012) the Board responded to a request to address a perceived inconsistency in the classification requirements for servicing equipment. Paragraph 8 of IAS 16 was unclear on the classification of servicing equipment as inventory or property, plant and equipment and led some to think that servicing equipment used during more than one period would be classified as part of inventory. The Board decided to clarify that items such as spare parts, stand-by equipment and servicing equipment shall be recognised as property, plant and equipment when they meet the definition of property, plant and equipment. If they do not meet the definition they are classified as inventory. In the light of respondent comments to the June 2011 exposure draft, the Board did not make explicit reference to the classification of particular types of equipment, because the definition of property, plant and equipment already provides sufficient guidance. The Board also deleted from paragraph 8 the requirement to account for spare parts and servicing equipment as property, plant and equipment on the basis that if they were used in connection with an item of property, plant and equipment because this requirement was too restrictive when compared with the definition of property, plant and equipment.

Measurement at recognition

Asset dismantlement, removal and restoration costs

BC13 The previous version of IAS 16 provided that in initially measuring an item of property, plant and equipment at its cost, an entity would include the cost of dismantling and removing that item and restoring the site on which it is located to the extent it had recognised any liability for such costs.

IAS 16 BC

- (c) requiring or permitting the recognition of gains from such exchanges enables entities to 'manufacture' gains by attributing inflated values to the assets exchanged, if the assets do not have observable market prices in active markets.

BC19 The approach described above raised issues about how to identify whether assets exchanged are similar in nature and value. The Board reviewed this topic, and noted views that:

- (a) under the *Framework*, the recognition of income from an exchange of assets does not depend on whether the assets exchanged are dissimilar;
- (b) income is not necessarily earned only at the culmination of an earning process, and in some cases it is arbitrary to determine when an earning process culminates;
- (c) generally, under both measurement bases after recognition that are permitted under IAS 16, gain recognition is not deferred beyond the date at which assets are exchanged; and
- (d) removing 'existing carrying amount' measurement of property, plant and equipment acquired in exchange for similar assets would increase the consistency of measurement of acquisitions of assets.

BC20 The Board decided to require in IAS 16 that all items of property, plant and equipment acquired in exchange for non-monetary assets or a combination of monetary and non-monetary assets should be measured at fair value, except that, if the exchange transaction lacks commercial substance or the fair value of neither of the assets exchanged can be determined reliably, then the cost of the asset acquired in the exchange should be measured at the carrying amount of the asset given up.

BC21 The Board added the 'commercial substance' test in response to a concern raised in the comments it received on the ED. This concern was that, under the Board's proposal, an entity would measure at fair value an asset acquired in a transaction that did not have commercial substance, ie the transaction did not have a discernible effect on an entity's economics. The Board agreed that requiring an evaluation of commercial substance would help to give users of the financial statements assurance that the substance of a transaction in which the acquired asset is measured at fair value (and often, consequentially, a gain on the disposal of the transferred asset is recognised in income) is the same as its legal form.

BC22 The Board concluded that in evaluating whether a transaction has commercial substance, an entity should calculate the present value of the post-tax cash flows that it can reasonably expect to derive from the portion of its operations affected by the transaction. The discount rate should reflect the entity's current assessment of the time value of money and the risks specific to those operations rather than those that marketplace participants would make.

discussed whether to change the manner in which its 'reliable measurement' test is described. The Board observed this was unnecessary because it believes that its guidance and that contained in US GAAP are intended to have the same meaning.

- BC24 The Board decided to retain, in IAS 18 *Revenue*, its prohibition on recognising revenue from exchanges or swaps of goods or services of a similar nature and value. The Board has on its agenda a project on revenue recognition and does not propose to make any significant amendments to IAS 18 until that project is completed.

Measurement after recognition

Revaluation model

- BC25 The Board is taking part in research activities with national standard-setters on revaluations of property, plant and equipment. This research is intended to promote international convergence of standards. One of the most important issues is identifying the preferred measurement attribute for revaluations. This research could lead to proposals to amend IAS 16.

Depreciation: unit of measure

- BC26 The Board's discussions about the potential improvements to the depreciation principle in the previous version of IAS 16 included consideration of the unit of measure an entity uses to depreciate its items of property, plant and equipment. Of particular concern to the Board were situations in which the unit of measure is the 'item as a whole' even though that item may be composed of significant parts with individually varying useful lives or consumption patterns. The Board did not believe that, in these situations, an entity's use of approximation techniques, such as a weighted average useful life for the item as a whole, resulted in depreciation that faithfully represents an entity's varying expectations for the significant parts.
- BC27 The Board sought to improve the previous version of IAS 16 by proposing in the ED revisions to existing guidance on separating an item into its parts and then further clarifying in the Standard the need for an entity to depreciate separately any significant parts of an item of property, plant and equipment. By doing so an entity will also separately depreciate the item's remainder.

Depreciation: depreciable amount

- BC28 During its discussion of depreciation principles, the Board noted the concern that, under the cost model, the previous version of IAS 16 does not state clearly why an entity deducts an asset's residual value from its cost to determine the asset's depreciable amount. Some argue that the objective is one of precision, ie reducing the amount of depreciation so that it reflects the item's net cost. Others argue that the objective is one of economics, ie stopping depreciation if, because of inflation or otherwise, an entity expects that during its useful life an

amount. In doing so, the Board did not adopt completely either the 'net cost' or the 'economics' objective. Given the concept of depreciation as a cost allocation technique, the Board concluded that an entity's expectation of increases in an asset's value, because of inflation or otherwise, does not override the need to depreciate it. Thus, the Board changed the definition of residual value to the amount an entity could receive for the asset currently (at the financial reporting date) if the asset were already as old and worn as it will be when the entity expects to dispose of it. Thus, an increase in the expected residual value of an asset because of past events will affect the depreciable amount; expectations of future changes in residual value other than the effects of expected wear and tear will not.

Depreciation: depreciation period

- BC30 The Board decided that the useful life of an asset should encompass the entire time it is available for use, regardless of whether during that time it is in use or is idle. Idle periods most commonly occur just after an asset is acquired and just before it is disposed of, the latter while the asset is held either for sale or for another form of disposal.
- BC31 The Board concluded that, whether idle or not, it is appropriate to depreciate an asset with a limited useful life so that the financial statements reflect the consumption of the asset's service potential that occurs while the asset is held. The Board also discussed but decided not to address the measurement of assets held for sale. The Board concluded that whether to apply a different measurement model to assets held for sale—which may or may not be idle—was a different question and was beyond the scope of the Improvements project.
- BC32 In July 2003 the Board published ED 4 *Disposal of Non-current Assets and Presentation of Discontinued Operations*. ED 4 was published as part of the Board's short-term convergence project, the scope of which was broader than that of the Improvements project. In ED 4, the Board proposed that an entity should classify some of its assets as 'assets held for sale' if specified criteria are met. Among other things, the Board proposed that an entity should cease depreciating an asset classified in this manner, irrespective of whether the asset is idle. The basis for this proposal was that the carrying amount of an asset held for sale will be recovered principally through sale rather than future operations, and therefore accounting for the asset should be a process of valuation rather than allocation. The Board will amend IAS 16 accordingly when ED 4 is finalised.

Depreciation: depreciation method

Derecognition

Derecognition date

- BC34 The Board decided that an entity should apply the revenue recognition principle in IAS 18 for sales of goods to its gains from the sales of items of property, plant and equipment. The requirements in that principle ensure the representational faithfulness of an entity's recognised revenue. Representational faithfulness is also the appropriate objective for an entity's recognised gains. However, in IAS 16, the revenue recognition principle's criteria drive derecognition of the asset disposed of rather than recognition of the proceeds received. Applying the principle instead to the recognition of the proceeds might lead to the conclusion that an entity will recognise a deferred gain. Deferred gains do not meet the definition of a liability under the *Framework*. Thus, the Board decided that an entity does not derecognise an item of property, plant and equipment until the requirements in IAS 18 to recognise revenue on the sale of goods are met.

Gain classification

- BC35 Although the Board concluded that an entity should apply the recognition principle for revenue from sales of goods to its recognition of gains on disposals of items of property, plant and equipment, the Board concluded that the respective approaches to income statement display should differ. The Board concluded that users of financial statements would consider these gains and the proceeds from an entity's sale of goods in the course of its ordinary activities differently in their evaluation of an entity's past results and their projections of future cash flows. This is because revenue from the sale of goods is typically more likely to recur in comparable amounts than are gains from sales of items of property, plant and equipment. Accordingly, the Board concluded that an entity should not classify as revenue gains on disposals of items of property, plant and equipment.

Assets held for rental to others²

- BC35A The Board identified that, in some industries, entities are in the business of renting and subsequently selling the same assets.
- BC35B The Board noted that the Standard prohibits classification as revenue of gains arising from derecognition of items of property, plant and equipment. The Board also noted that paragraph BC35 states the reason for this is 'users of financial statements would consider these gains and the proceeds from an entity's sale of goods in the course of its ordinary activities differently in their evaluation of an entity's past results and their projections of future cash flows.'
- BC35C Consistently with that reason, the Board concluded that entities whose ordinary activities include renting and subsequently selling the same assets should

IAS 16 BC

recognise revenue from both renting and selling the assets. In the Board's view, the presentation of gross selling revenue, rather than a net gain or loss on the sale of the assets, would better reflect the ordinary activities of such entities.

BC35D The Board concluded that the disclosure requirements of IAS 16, IAS 2 and IAS 18 would lead an entity to disclose relevant information for users.

BC35E The Board also concluded that paragraph 14 of IAS 7 *Statement of Cash Flows* should be amended to present within operating activities cash payments to manufacture or acquire such assets and cash receipts from rents and sales of such assets.

BC35F The Board discussed the comments received in response to its exposure draft of proposed *Improvements to International Financial Reporting Standards* published in 2007 and noted that a few respondents would prefer the issue to be included in one of the Board's major projects such as the revenue recognition project or the financial statement presentation project. However, the Board noted that the proposed amendment would improve financial statement presentation before those projects could be completed and decided to add paragraph 68A as previously exposed. A few respondents raised the concern that the term 'held for sale' in the amendment could be confused with the notion of held for sale in accordance with IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*. Consequently, the Board clarified in the amendment that IFRS 5 should not be applied in those circumstances.

Transitional provisions

BC36 The Board concluded that it would be impracticable for an entity to determine retrospectively whether a previous transaction involving an exchange of non-monetary assets had commercial substance. This is because it would not be possible for management to avoid using hindsight in making the necessary estimates as of earlier dates. Accordingly, the Board decided that in accordance with the provisions of IAS 8 an entity should consider commercial substance only in evaluating the initial measurement of future transactions involving an exchange of non-monetary assets.

Summary of changes from the Exposure Draft

BC37 The main changes from the ED proposals to the revised Standard are as follows:

- (a) The ED contained two recognition principles, one applying to subsequent expenditures on existing items of property, plant and

- lack of commercial substance is cause for an entity to measure the acquired asset at the carrying amount of the asset given up.
- (c) Compared with the Standard, the ED did not as clearly set out the principle that an entity separately depreciates at least the parts of an item of property, plant and equipment that are of significant cost.
 - (d) Under the approach proposed in the ED, an entity derecognised the carrying amount of a replaced part of an item of property, plant and equipment if it recognised in the carrying amount of the asset the cost of the replacement under the general recognition principle. In the Standard, an entity also applies this approach to a replacement of a part of an item that is not depreciated separately.
 - (e) In finalising the Standard, the Board identified further necessary consequential amendments to IFRS 1, IAS 14, IAS 34, IAS 36, IAS 37, IAS 38, IAS 40, SIC-13, SIC-21, SIC-22 and SIC-32.