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 SPECIAL AUDIT REPORT	
THE NATIONAL ASSEMBLY PAPERS LAID	
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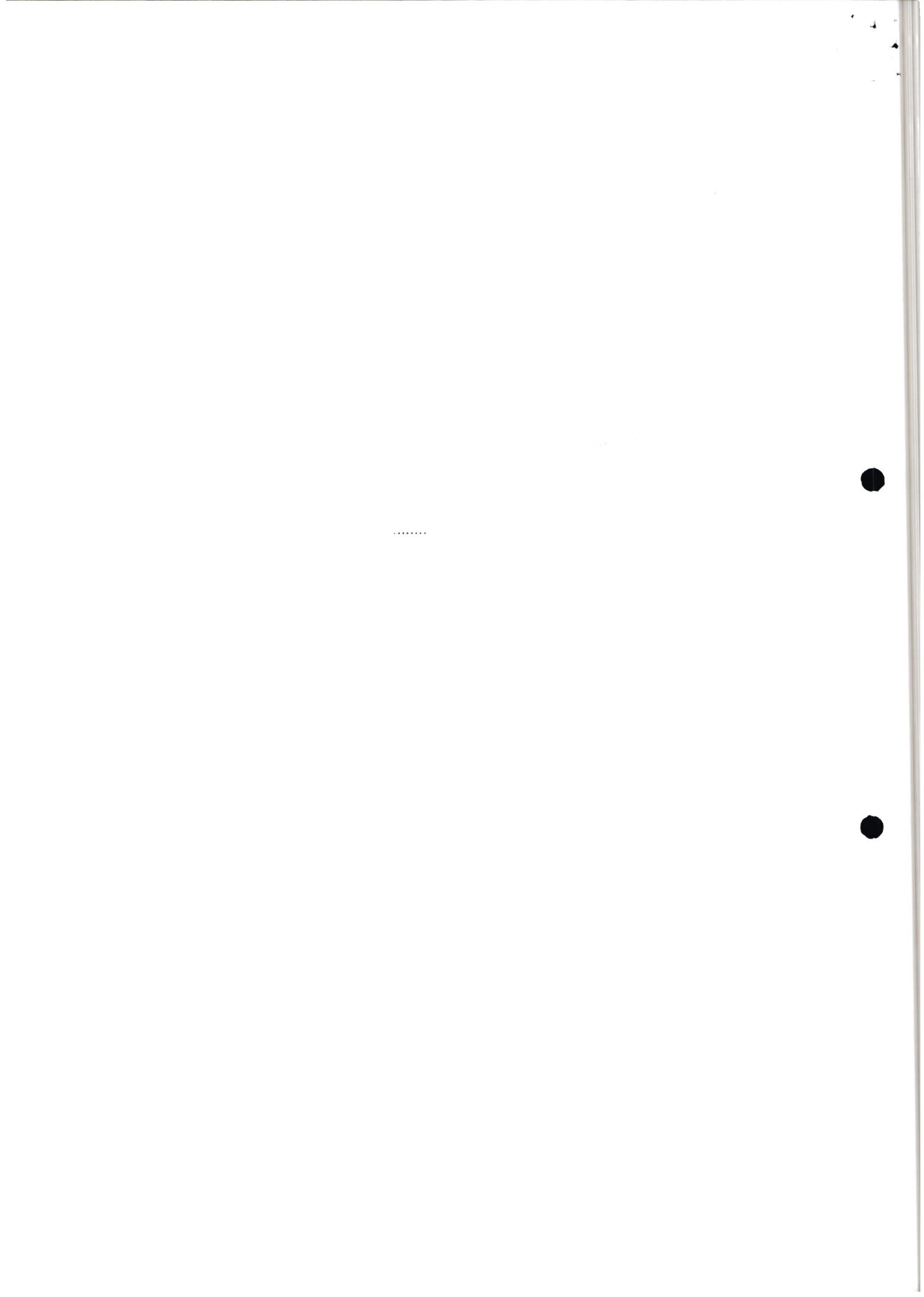
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THE AUDITOR-GENERAL

ON

**THE PROPOSED PRIVATELY INITIATED
INVESTMENT PROPOSAL (PIIP) BETWEEN
KENYA AIRPORTS AUTHORITY (KAA) AND
KENYA AIRWAYS (KQ)**

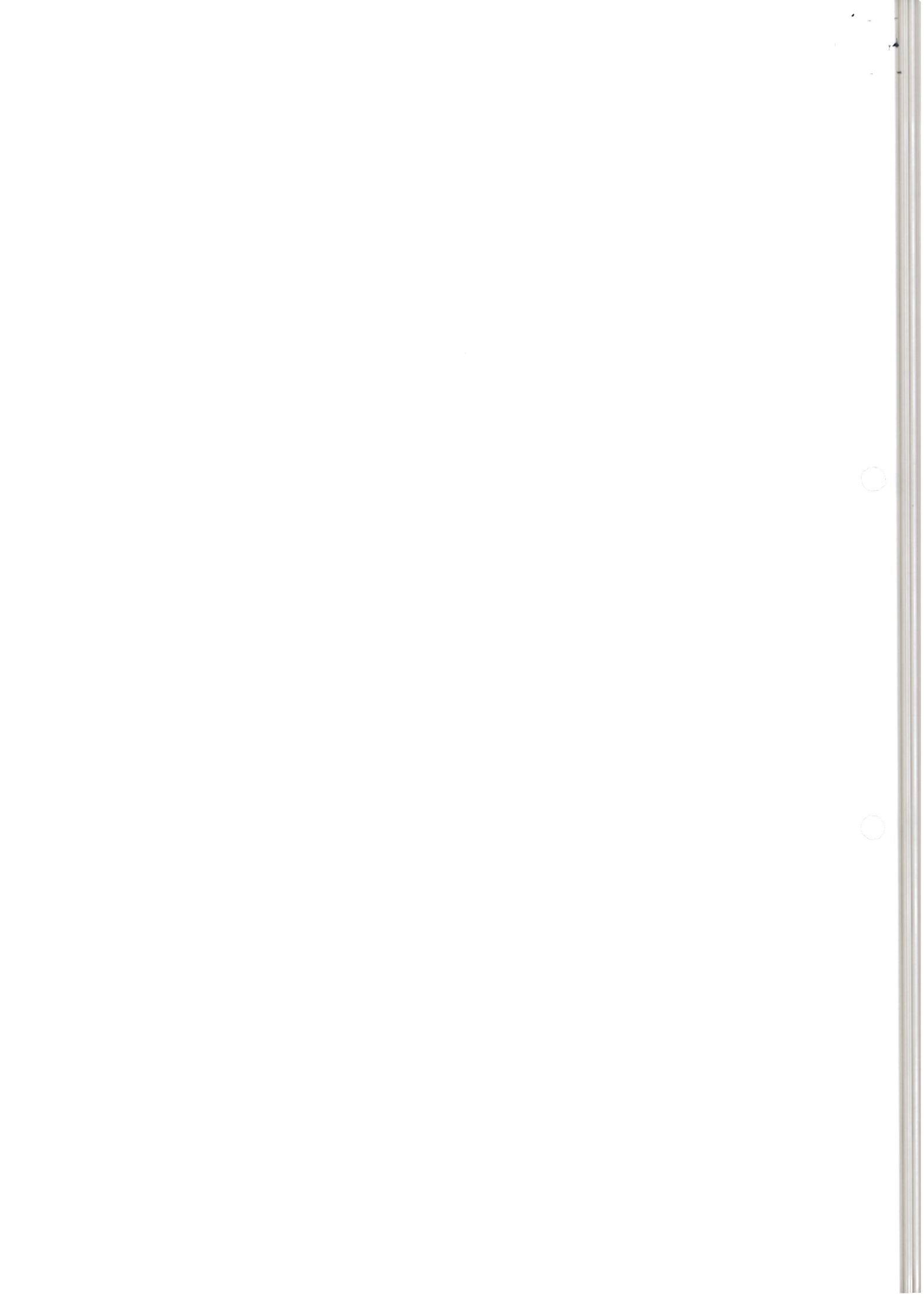
14 MARCH 2019



**SPECIAL AUDIT REPORT OF THE AUDITOR-GENERAL ON THE PROPOSED
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OFFICE OF THE AUDITOR-GENERAL

SPECIAL AUDIT REPORT OF THE AUDITOR-GENERAL ON THE PROPOSED PRIVATELY INITIATED INVESTMENT PROPOSAL (PIIP) BETWEEN KENYA AIRPORTS AUTHORITY (KAA) AND KENYA AIRWAYS (KQ)

1. Introduction

In a letter Ref .NA/DCS/PIC/2019/012 dated 21 February 2019, the Public Investments Committee requested the Auditor-General to conduct a Special Audit on the Proposed takeover of Kenya Airports Authority Jomo Kenyatta International Airport by Kenya Airways.

2. Terms of Reference

The letter requested the Auditor-General to carry out a Special Audit at Kenya Airports Authority with respect to the following:

- a) The Privately Initiated Investment Proposal by Kenya Airways to operate, maintain, develop, construct, upgrade, modernize, finance and manage the Jomo Kenyatta International Airport.
- b) The risks that Kenya Airports Authority and the Public is exposed to from this proposed takeover, and
- c) The procurement process by Kenya Airports Authority for the services of a Transactional Advisor for the proposed takeover.

The response to the above involved a review and a scrutiny of records and documents availed by Kenya Airports Authority. The review was limited in scope given the tight deadline within which Public Investments Committee required the report and hence Kenya Airways was not consulted.

3. First Letter from Principal Secretary, State Department of Transport Stating Approval was Granted

Evidence available indicates that on 19 June 2018, the Principal Secretary - State Department of Transport wrote a letter Ref: MOT&I/C/RAIL/007/3/ Vol.XXVIII/13 to Managing Director, Kenya Airways, Managing Director, Kenya Airports Authority and Director Air Transport State Department of Transport quoting reference of a letter CAB/GEN/3/1/1/Vol.XIV(261) dated 29 May 2018 from the Head of Public Service.

The letter from the Principal Secretary stated that in a Special Cabinet meeting held on 29 May 2018, the Cabinet Secretary for Transport, Infrastructure, Public Works, Housing and Urban Development presented a joint Cabinet Memorandum CAB(18) 28 together with the Cabinet Secretary for The National Treasury and Planning briefing the Cabinet on developments in Kenya Civil Aviation Sector. The Memorandum was seeking approval on actions Kenya should take to restore Kenya Aviation Competitiveness, reclaim the Country's position as an anchor economy in Africa, with Nairobi as the African Civil Aviation Hub.

The letter further stated that Kenya Airways and Kenya Airports Authority were granted approval to enter into negotiations with a view to agreeing on a framework to restore Nairobi as a Civil Aviation Hub of choice in Africa thereby contributing to Kenya's economic competitiveness.

A substantive Memorandum was to be submitted for consideration and approval once the framework was agreed upon, the letter stated.

4. Request for Data and Information by Kenya Airways from Kenya Airports Authority

On 3rd October 2018, Kenya Airways vide letter Ref. DD/064/K5-2018 wrote to Managing Director, Kenya Airports Authority stating that it had been proposed that KQ and KAA enter into an arrangement that will result in **KQ operating, maintaining, developing, constructing, upgrading, modernizing, financing and managing Jomo Kenyatta International Airport (the transaction) based on Public Private Partnership (PPP) Model.** The letter further stated that for purposes of implementing the transaction, KQ shall undertake a Due Diligence of JKIA followed by bilateral negotiations of the Privately Initiated Investment Proposal (PIIP). The letter requested KAA to provide data and information as and when required.

5. Second Letter from Principal Secretary Requesting Action

On 5 October 2018, the Principal Secretary, State Department of Transport, wrote to the Managing Director, Kenya Airports Authority and Managing Director, Kenya Airways vide letter Ref; MOT&I/S/ADM/086 Vol. XVIII headed Restructuring of the Kenya Civil Aviation Sector - Kenya Airways (KQ) Privately Initiated Investment Proposal (PIIP).

The Principal Secretary stated that she has reviewed records on the above matter and noted that Kenya Airports Authority and Kenya Airways were granted approval to enter into negotiations vide letter MOT&I/C/RALL/007/3/Vol. XXVIII/13 dated 19 June 2018 (see paragraph 1 above).

The Principal Secretary requested the Managing Directors of KAA and KQ to take necessary action.

6. Submission of Privately Initiated Investment Proposal (PIIP) by Kenya Airways

On 5 October 2018, Kenya Airways vide letter Ref. DD/065/K5-2018 wrote to the Managing Director, Kenya Airports Authority stating that it had been proposed that KQ and KAA enter into an agreement that will result in **KQ operating, maintaining, developing, constructing, upgrading, modernizing, financing and managing JKIA (the transaction) based on Public Private Partnership Model.**

The letter stated that in order to execute the Proposed Transaction, KQ had developed the Privately Initiated Investment Proposal with all appendices defining the key transaction principles and present detailed Vision of Kenya Airways PLC running everyday operations at JKIA.

The letter stated that the proposal approved by Kenya Airways PLC Board on 4th October 2018 consisted of the following documents:-

1. Main documents (Privately Initiated Investment Proposal).
2. Heads of Terms (HOTs).
3. Financial Model.

The letter requested that Kenya Airports Authority Board acknowledges receipt of the transaction Proposal as well as grant KQ the approval for Initiation of formal Due Diligence and Proposal Negotiations Process.

7. First Presentation of PIIP to Special Board of Directors (KAA) on 18th October 2018

Evidence available shows that during the 296th Special Board of Directors Meeting of KAA, the Principal Secretary, State Department of Transport reported that a policy decision was made by Government to restructure the country's aviation assets in light of regional competition particularly from Ethiopia and Rwanda and open Skies.

She further stated that the Board of KAA was required to move quickly to consolidate the country's aviation assets.

The General Manager – Finance, after request by the Managing Director (KAA) presented the following before the Board:-

- (i) A paper to the Board on the Cabinet directive.
- (ii) He also presented the Privately Initiated Investment Proposal (PIIP) received from KQ dated 5th October 2018 anchored on Private Public Partnership (PPP) Act, 2013 and which broadly envisages the following transaction structure:

- A 30 year Concession framework under which KQ will seek through a Special Purpose Vehicle (the Concessionaire) to manage and develop JKIA leaving KAA to manage all other Kenya Airports and Airstrips at a fee (Concession fee).
- Inclusion of JKIA's aviation infrastructure in the Concession.
- Retention of JKIA related liabilities (both actual and contingent) by KAA.
- Initial secondment and transfer thereafter at the discretion of the Concessionaire, of JKIA staff.
- Engagement by the Concessionaire of an External Airport Advisor to implement World Class Solutions and Airport Management best practices.

7.1. Strategic Rationale

The Board was informed that the main arguments in support of the proposed transaction is consolidation of key aviation assets to realize significant operational efficiencies and synergies, restoration of aviation sector's Regional and International competitiveness etc.

7.2. Preliminary Evaluation

The Board was informed that although a comprehensive risk assessment of the proposal will be conducted as part of due diligence, the following potential risks should be addressed: -

- (i) Currently, JKIA accounts for nearly 83% of KAA revenues and 51% of recurrent expenditure.

In the KQ financial model, annual concession fees have been set at US\$.28 million (Kshs.2.9 billion) in 2019, rising to US\$ 35 million (Kshs.3.6 billion) in 2028 and only peaks at US\$ 60 million (Kshs.6.1 billion) in 2033 i.e 15 years into the Concession term.

The Concession fee is therefore inadequate to cover the cost of running KAA other facilities.

- (ii) KQ's proposal assumes KAA will retain all contingent liabilities including those arising from JKIA's operations which will leave KAA worse off financially.

- (iii) KQ has not proposed definite Capital Investment Programme on the life of the concession but has instead proposed the minimum Investment levels to be negotiated for inclusion in the Project Agreement.
- (iv) The capacity for KQ to execute the transaction through a SPV will require careful assessment as KQ has proposed to engage an Airport Advisor in order to augment its airport management capacity.

Also, the proposed arrangement which brings KQ, JKIA and the Airport advisor's employees together needs to be carefully examined from labour management and governance perspectives.

7.3. Need for a Transaction Advisor

Due to the complexity and urgency of the proposed transaction, the Board was informed that the Authority was required to engage the services of a Transaction Advisor with skills, experience in airport concessions as well as legal and regulatory framework as per Board minutes.

7.4. Recommendations of Management to the KAA Board

To enable the Authority to move the Transaction to the next level, in terms of negotiations and due diligence, the Board was requested to consider and approve the following:-

- (i) Initiation of formal due diligence and engagement with KQ on the basis of PIIP already received.
- (ii) Authority's engagement with PPP unit for support and guidance as envisaged under the Public Private Partnership Act, 2013, and
- (iii) Engagement of a Transaction Advisor from amongst the Authority's prequalified panel of law firms taking into account availability, cost and the need to comply with procurement and other laws.

7.5. Board Observations and Deliberations

The Board deliberated and made several crucial observations as detailed as per the Board Minutes of 18 October 2018.

The observations are as summarized below:-

- (i) Will the Transaction require Kenya Airports Authority Act to be amended by Parliament?

- (ii) The Board pointed out that this was **the first time the Board was formally** encountering the matter and management ought to have informed the Board that information was available.
- (iii) KQ had in the various interventions geared at restructuring including engaging Mckinsey without success.
- (iv) Kenya Airports Authority is best placed to undertake Infrastructural Development.
- (v) The Board noted that KQ intends to engage a Consultant to run JKIA but Kenya Airports Authority has the expertise developed over time. As such, the Board wondered, why not bring the expert/advisor to work with KAA on how to strengthen KQ financially.
- (vi) Whether KAA ought to be responding to KQ proposal or presenting a Counter Proposal.
- (vii) That the Mandate to engage KQ should be on the basis of the Principal Secretary's letter and not KQ's Privately Initiated Investment Proposal (PIIP).
- (viii) No budget at the National Treasury for the services, thus KAA would utilize its legal services budget as a starting point.
- (ix) The Board noted that KQ has considered the proposed transaction from its own perspective as it has the right of first advantage.

7.6. KAA Board's Resolutions

The Board approved the following:-

- (i) Initiation of formal due diligence and engagement with KQ on the basis of the Cabinet decision and the Privately Initiated Partnership Proposal (PIIP).
- (ii) Engagement with the PPP Unit for support and guidance as envisaged in the PPP Act.
- (iii) Terms of reference (TORs) be issued to the three law firms to enable them submit proposals on Transaction Advisory Services for the Board's consideration.

8. Presentation on Transaction Advisory Services by Firms to the Board

During the 297th Special Board of Directors meeting of 2 November 2018, the following three firms did presentations to the Board on Transaction Advisory Services:-

- (i) MMC Africa Law
- (ii) Mohammed Muigai Advocates
- (iii) Iseme Kamau and Maemo Advocates

8.1. KAA Board's Resolution

The Board resolved that Management proceeds with the procurement process for Transaction Advisory Services.

9. Procurement of Transaction Advisory Services

On 19 October 2018, the Corporation Secretary and General Manager, Finance, wrote to the Managing Director, KAA requesting for approval to utilize Restricted Tendering Method for procurement of Transaction Advisory Services.

The request recommended, and we quote "Being Cognizant of the strict timeliness within which the transaction is to be realized it is proposed that the procurement process for a suitable firm to provide the transaction advisory services be sought through Restricted Method of Procurement from the Authority's prequalified panel of law firms/known law firms taking into account availability cost and the need to comply with applicable procurement and other laws".

The request further stated that Restricted Tendering Method is provided for under Section 102 of the Public Procurement and Asset Disposal Act, 2015.

The Managing Director (KAA) approved the recommendation on 19 October 2018 (same day).

9.1. Request for Proposals

On 5 November 2018, the General Manager, Procurement and Logistics sent Request for Proposal to the three firms (Paragraph 8). The request stated and I quote "Pursuant to Section 102(c) of the Public Procurement and Asset Disposal Act, 2015, you have been identified to participate in the Request for Proposals for the above referenced tender".

Evidence available indicates that on 7 November 2018, the G.M Procurement and Logistics sent another invitation informing each of the three firms that a decision had been made to issue them with a fresh tender document which had been sent on 5 November 2018.

9.2. Professional Opinion by General Manager Procurement and Logistics dated 12 November 2018

The General Manager (Procurement and Logistics) wrote a Professional Opinion dated 12 November 2018.

The General Manager stated that procurement was done through Restricted Tendering Procurement Method Pursuant to Section 102 of the Public Procurement and Asset Disposal Act, 2015.

The General Manager stated that the requirement satisfies condition C and the tender documents for Request for Proposal (RFP) as issued on 5 November 2018.

NB: (Condition C states “if there is evidence to the effect that there are only a few know suppliers of the whole market of the goods, works or services”).

The Managing Director (KAA) approved the opinion the same day i.e 12 November 2018.

9.3. Evaluation Report for Provision of Transaction Advisory Services

Out of the three proposals sent out, only two bids were returned by Iseme Kamau and Maema Advocates quoting Kshs.170,069,629.77 and MMC Africa Law quoting Kshs.150,348,440.

The Evaluation Committee recommended the tender for provision of Transaction Advisory Services be awarded to M/s MMC Africa Law at quoted price of Kshs.150,348,440.20 inclusive of all taxes.

9.4. Notification of Intention to Enter into a Contract

On 12 November 2018 (same day of opinion approval), the Managing Director (KAA) issued a letter of notification to enter into a contract to M/s MMC Africa Law which was accepted on 14 November 2018. The contract was to be signed after 14 days.

9.5. Signed Contract Between KAA and MMC Africa Law

The Contract between Kenya Airports Authority and MMC Africa Law was signed on 28 November 2018 for a contract Sum of Kshs.150,348,440.00.

9.6. Payment of 10% to MMC Africa Law

An amount of Kshs.15,034,844 was said to have been paid to MMC Africa Law as stipulated in the Contract Agreement but the original payment voucher and the supporting documents have not been availed for audit verification.

10. Letter to National Treasury Seeking Approval to Consider Privately Initiated Investment Proposal from Kenya Airways and Response from Treasury

On 10 December 2018, Director KAA wrote vide letter KAA/MD/GC/Vol.2(255) to National Treasury seeking approval to consider the PIIP from Kenya Airways without subjecting the proposal to a competitive process. On 19 December 2018, the Principal Secretary, National Treasury, vide letter DG/PE/PPP/22/3/1”B” responded to KAA.

The response advised Kenya Airports Authority that the application to the Cabinet Secretary should be preceded and informed by the outcome of an appraisal of the PIIP by the contracting Authority in line with Section 61(3) of the PPP Act 2013 and not approval for consideration of the proposal itself.

11. Public Participation on PIIP from Kenya Airways

Evidence available indicates that Kenya Airports Authority kicked off Public Participation on the above proposal on 23 January 2019 and the public was invited to participate in the following dates and locations: -

Location	Date	Venue
Kisumu	30/01/2019	Kisumu Social Hall
Eldoret	04/02/2019	Sirikwa Hotel
Mombasa	07/02/2019	Changamwe Social Hall
Wajir	11/02/2019	Wajir Community Centre
Lodwar	11/02/2019	Eliye Spring Resort
Nairobi	13/02/2019	Embakasi Social Hall

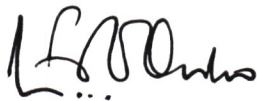
12. Unresolved Matters

- (i) There is no evidence of Kenya Airports Authority Management and the Board being involved in the Joint Cabinet Memorandum that was prepared and tabled in the Cabinet Meeting of 29 May 2018.
- (ii) We have not been presented with a feasibility study which could have informed the Joint Cabinet Memo Meeting of 29 May 2018 even though the letter from the Principal Secretary State Department of Transport dated 19 June 2018 stated that the Cabinet Memorandum was seeking approval on actions Kenya should take to restore Kenya Aviation competitiveness and reclaim the Country's position as an anchor economy in Africa, with Nairobi as the African Civil Aviation Hub.
- (iii) The Joint Cabinet Memorandum, CAB (18) 28 presented by Cabinet Secretary for National Treasury and Cabinet Secretary for Transport, Infrastructure and Housing and Urban Development was not availed for verification.
- (iv) A letter reference No. CAB/GEN/3/1/1/Vol.XIV(261) dated 29 May 2018 from the Head of Public Service to Managing Directors of Kenya Airports Authority and Kenya Airways quoted in the letter dated 19 June 2018 Ref. MOT&I/C/RAIL/007/3/Vol.XXVIII(13) was not availed for audit verification.

- (v) The Privately Initiated Investment Proposal (PIIP) submitted by Kenya Airways as per letter Ref. DD/065/K5-2018 dated 5 October 2018 was not availed for verification.
- (vi) There is no evidence that Kenya Airports Authority Management ever prepared and submitted any proposal to the Board. In fact, there is no evidence of any intervening exchange by Kenya Airports Authority from 19 June 2018 when the Principal Secretary, Transport communicated the decision of the Cabinet until 18 October 2018 when the Special Board of Directors was presented with the information.
- (vii) It is not clear and Management has not satisfactorily explained why Restricted Procurement Method was necessary as opposed to Open Tendering when procuring the Services of Transaction Advisor for a Contract Sum of Kshs.150,348,440. The request to Managing Director (KAA) as stated in Paragraph 9 stated that the reason was due to strict timeliness while the Professional Opinion by G. M. Procurement and Logistics (Paragraph 9.1) stated Condition C of Section 102 of the Public Procurement and Asset Disposal Act, 2015 which gives the condition as “if there is evidence to the effect that there are only a few known suppliers of the whole market of the goods, works or services”.
- (viii) In addition, we were informed that the payment of 10% was paid after presentation of an Inception Report which has not been availed for audit verification. Further, the payment voucher and the supporting documents for payment of the advance of Kshs. 15,034,844 were not availed for audit.
- (ix) Also, there was no evidence that the Procurement of Transaction Advisor was in budget for 2018/2019. The Board of Directors Meeting of 18 October 2018 also reiterated that there was no budget and that KAA was to utilize its legal services budget as a starting point.
- (x) Evidence available indicates that the General Manager Procurement and Logistics invited certain firms on 25 October 2018 which had done a Presentation to the Board on 2 October 2018 but the details of the Invitation for Proposal, and what transpired were not made available. In addition, there is confusion as to which Board a presentation was made on 2 October 2018, given that in the Board Minutes of 18 October 2018, the Board expressed concern that the issue was being brought to their attention for the first time.

However, Management has explained that the date of 2 October 2018 was a typing error and the presentation was made on 2 November 2018.

- (xi) Although a contract for Transaction Advisory Services was signed on 28 November 2018, no Preliminary/Inception Report from the Transaction Advisor was availed for audit verification despite a payment of 10% (i.e. Kshs15,034,844) having been paid by KAA.
- (xii) The Public Participation exercise was to take place in six locations in the Country between 30 January 2019 and 13 February 2019. Although Management has explained that the Public Participation exercise has been suspended, it is still nevertheless questionable what such Public Participation should have achieved.
- (xiii) In 2017/2018, Kenya Airports Authority reported Operating Revenue amounting to Kshs.16.9 billion and a surplus of Kshs.5.4 billion (after tax). As at 30 June 2018, Kenya Airways owed Kenya Airports Authority Kshs.2.1 billion rising to Kshs.3.8 billion as at 31 December, 2018. As observed in the Board Minutes dated 18 October 2018, JKIA accounts for nearly 83% of KAA revenues and therefore a Concession could deprive KAA of significant amount of revenues.
- (xiv) It is not clear and there is no evidence on how the observations/concerns raised by the Board of Directors of KAA sitting on 18 October 2018 as per the Board Minutes and as summarized in Paragraph 7.5 above were subsequently addressed.



FCPA Edward R. O. Ouko, CBS
AUDITOR-GENERAL

14 March 2019

