Ministry of Transport, Infrastructure Housing and Urban Development

State Department of Housing and Urban Development

Urban Development Department

# KENYA URBAN SUPPORT PROGRAMME (KUSP)

# FINANCIAL MANAGEMENT PROCEDURES MANUAL

(Draft 5 - September 2017)

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# 1. INTRODUCTION

## 1.1 Background

The Kenya Urban Support Programme (KUSP) is a USD300 million project whose objective is to establish and strengthen urban institutions to deliver improved infrastructure and services in participating counties in Kenya. The Operation will provide direct support to all counties other than the city counties of Nairobi and Mombasa, and to 59 potentially eligible urban areas within those counties. The proposed Operation will finance key parts of the KenUP (Kenya Urban Programme) (across its six thematic areas, including urban institutions, governance, management, finance, planning, and infrastructure and service delivery.

The total KenUP budget is estimated at US$1 billion. Of this, KUSP will provide US$300 million dollars or 30 percent of the total KenUP funding budget. The Operation will be implemented over a period of six years.

The aim of the project is to achieve the following objectives;

- Support for the establishment, operationalization and strengthening of the institutional framework for urban management as part of the national level interventions (Window 1);
- Strengthening management and administration of urban finances (including conditional grants) in Window 1;
- Provision of support for planning, urban infrastructure, and service delivery in Window 1;
- Assist County Governments Address Urban Development and Management Issues as part of the county level interventions (Window 2);
- Ensure Urban institutions are established and operational (UIG minimum conditions are achieved) in Window 2; and
- Ensure Urban institutions are performing effectively in delivering urban infrastructure and services (UDG performance standards are achieved) in Window 3.

The Operation will be implemented through institutional arrangements at the national, county and urban board levels. The primary responsibility for the implementation of window 1 will lie with the Urban Development Department (UDD) in the State Department of Housing and Urban Development (SDHUD) of the Ministry of Transport, Infrastructure, Housing and Development (MTIHUD). Window 2 and 3 will be implemented through the County and Urban Board levels respectively.

The proposed operation will be financed through a hybrid of the Investment Project Financing (IPF) in Window 1 and Programme for Results (PforR) instruments in Windows 2 and 3. The hybrid operation as a whole will be referred to as the “Operation” unless specified otherwise. Where necessary, the IPF element will be referred to as the “Project” and the PforR element will be referred to as the “Programme”. IPF will be used to fund a wide range of institutional and capacity development interventions at the national government level.

## 1.2 Purpose of the Financial Management Manual

The financial management manual's objective is to document the financial management arrangements and procedures to be applied in the Kenya Urban Support Programme (KUSP). The specific objectives of this manual are:

- To provide clear accounting policies and procedures to facilitate the smooth implementation of the project in an accountable and transparent manner at Project Co-ordination Team (PCT) level.
- accounting system capable of producing accurate and reliable financial statements free from errors and irregularities including fraud, for use in management decision making and financial reporting.
- Highlight the major components of the accounting systems including the books of account, chart of accounts, funds flow, disbursements, audit, receipts, records and key documents to be used.
- To describe the process of financial planning, budget preparation and execution including monitoring and control.
- To provide clear guidelines to KUSP implementation team members (management, staff and consultants) and key stakeholders including development partners on finance and accounting procedures relating to the project.
- Entrench good governance, transparency and accountability in the implementation of the project.

The users of this manual include the National Program Coordination Team (NPCT) in Urban Development Department (UDD), County Program Coordination Teams (CPCT)s in CEC Urban Ministries), Urban Administrations and other associated entities.

## 1.3 Foundations of the Manual

The Financial Management Manual (FMM) has its basic foundation in financial and accounting systems and procedures already in operation in Government of Kenya (GoK). The KUSP operation arrangement and Standard Conditions recognize this fact and there are provisions of the same in the related Disbursement letter. This financial management manual describes in detail the application of the regulations and procedures thereof. The basic foundations of this financial management manual are:

1. Constitution of Kenya 2010;
2. Public Financial Management Act 2012;
3. Government of Kenya Financial Regulations and Procedures (Revised 1996);
4. Treasury Circular No 3/2000 dated 1st March 2000;
5. Treasury Circular No 18/98 dated 22nd February 1999;
6. Standard Conditions for Loans by the World Bank July 2010;
7. World Bank Financial Management and disbursement policies, procedures and guidelines
8. Kenya Urban Support Program Financing Agreement;
9. Programme Appraisal document (PAD), 2017;
10. The Public Finance Management (PFM) Act, 2012;
11. County Allocation of Revenue Act (CARA); and
12. Other Circulars that may be issued by the Government of Kenya during the implementation period.

## 1.4 Scope of the Financial Management Manual

The policies and procedures covered by this Financial Management manual are varied but related. The extent of the relationships is dependent on the degree of control necessary to ensure that the information or the outputs of the proposed financial management systems or sub-systems are concise and clear.

This Financial Management Manual forms part of Project Operations Manual (POM) which is a legally binding document.

The manual has been categorized in two broad parts aligned to the NPCT and the CPCT to allow functionality in the use of the document. The subsequent discussions have been laid out in the six elements of financial management as listed below:

1. Budgeting System
2. Accounting System
3. Funds Flow
4. Internal Controls
5. Financial Reporting
6. External and Internal Audit

The linkages between those of other key stakeholders are prescribed in detail in each of the sections as relevant.

# 2. NATIONAL GOVERNMENT OPERATIONS

## 2.1 THE PROJECT BUDGETING SYSTEM

### 2.1.1 Annual Work Planning and Budget- Programme Based Budgeting (PBB)

In line with the new constitutional dispensation and Public Financial Management Act 2012, Accounting Officers are required to defend and support programmes and sub-programmes at the Budget Parliament Committee included in their votes (Ministries).

The Programme budgeting will be done in accordance with existing GoK procedures for national and county governments. Since window 1 under MTIHUD is IPF, a separate budget code will be provided for tracking of Investment Development Association (IDA) funds. In line with the existing GoK practice, the Programme funds under window 2 and 3 will be budgeted for as conditional grants from national to county governments. The design of the PforR will act as an incentive for GoK to allocate enough budget and ensure that resources are spent on achieving DLIs which will trigger subsequent funding.

There will therefore be dual budgeting approach with the funds reflected as transfers in the line ministry and as conditional grants at the county level.

Programme-specific budget codes will be configured in IFMIS for both the State Department of Housing and Urban Development (SDHUD) and the participating counties. This will form the basis for defining the Programme activities and ensuring that sufficient funds are allocated to achieve the agreed results. The allocation of funds and the budgeting will be subject to oversight by the Commission of Revenue Allocation (CRA) and the Controller of Budget (CoB) in line with normal GoK PFM procedures.

The aims of the Programme Based Budgeting (PBB) is first, to improve the prioritization of expenditure in the budget in order to help allocate government resources to those programmes of greatest benefit to the community and secondly to encourage Ministries, Departments and Agencies (MDAs) to improve the efficiency and effectiveness of service delivery by changing the focus of public spending from inputs to outputs and outcome.

The preparation of KUSP Annual Work plans and Budgets however provide the basis for project planning, implementation and progress monitoring. The project planning and budgetary process shall be implemented in accordance with the standard government fiscal year which begins on 1st July of each financial year as provided for by the Public Financial Management Act 2012 and the Government Financial Regulations and Procedures.

Based on standard government budget procedures, which are described and elaborated further by various Treasury circulars, Government financial regulation and procedures, the estimated cost of KUSP funded programmes and sub-program(s) expenditure shall be budgeted following calendar dates set by the MTEF Budget circular issued by the National Treasury. The indicative budget calendar dates are presented below:

**August – September**
The MTIHUD or its successor forms the Public Expenditure Review Committee (PER) and review ongoing programmes, evaluate/analyze past years expenditures of its program including that of KUSP. The PER report is forwarded to the National Treasury to inform the Macro Working Group.

**October – January**
During this period, KUSP activities, targets and indicative budgets requirements are reviewed at the Sector Working Groups level. These then form part of the Sector Reports of the Macro Working Group which forms the inputs to Budget Strategy Paper for the Cabinet and the Economic Management Committee. These are subsequently approved by Cabinet and then the National Assembly by the end of January.

The National Treasury then issues circular with detailed guidelines for line ministries, counties and agencies to prepare detailed budget estimates. The detailed budget from the Ministry of Transport, Infrastructure, Housing and Urban Development or its successor therefore includes KUSP.

**February – June**
The detailed budget submissions are forwarded to the National Treasury for review and finalization of the draft budget to the National Assembly and County Assemblies by respective Treasuries. The Budgets are approved by the National Assembly and County Assemblies.

### 2.1.2 Preparation of Detailed Expenditure Budget

The KUSP detailed expenditure budgets will be prepared under the overall guidelines issued by the Treasury to Ministries and the approved KUSP Project Implementation Manual Cost Table allocations and Disbursement Plans as well as the County budgets approved by the County Assemblies.

The project funds will be factored in the national annual budget under MTIHUD and captured in IFMIS on the basis of the line ministry and the respective counties. The budget will also capture the Projects activities in their respective annual budgets as detailed in the Project Appraisal Document (PAD).

All PforR resources will be allocated to counties in the form of conditional grants (UIGs and UDGs). Conditional grants form part of the national share of government resources and will therefore appear under the budget of the SDHUD. Actual expenditures under window 2 and window 3 financed by PforR resources will depend on (a) the number of counties which qualify for allocations and (b) the results of the annual performance assessment. The conditional grants would need to appear in the County Allocation of Revenue Act (CARA) and be transferred by the National Treasury directly from the Consolidated Fund to the counties on the notification of the Annual Performance Assessment (APA) results by the SDHUD.

For IDA resources to actually result in annual budget allocations for the programmes appropriated by the National Assembly, the SDHUD and the National Treasury need to work closely. In particular, UDD and the policy and planning unit in SDHUD will need to ensure that all three windows of the program are provided for in its budget proposals at each stage of the budget process. The Budget Supplies Departments in the National Treasury must ensure that SDHUD budget ceilings reflect program allocations; and the External Resources, Macro Fiscal, Intergovernmental Fiscal Relations (IGFR) of the National Treasury will need to ensure that grant allocations are captured in the CARA and the DORA. This joint effort and close coordination is geared towards ensuring that:

- All program resources are reflected in the budget ceilings and annual budget estimates for SDHUD from 2017/18 onwards.
- The maximum county UIG and UDG allocations are reflected in the County Allocation of Revenue Acts and Division of Revenue Acts from 2017/18 onwards.

**The APA and grant allocation recommendations will not be finalized until near the end of the budget process.** To ensure inclusion in the CARA, the SDHUD will need to communicate maximum UIG/UDG allocations determined by the initial APA by the November 30. If the initial APA is delayed, then the initial allocations proposed in the CARA and DORA should include maximum allocations. The final grant allocations will be less than or equal to Annual Appropriations and the CARA and DORA allocations – which will allow full disbursement during the FY.

The table below sets out the key deadlines:

### Table 1: The National budget process deadlines

| Step | Deadline | Responsible |
|---|---|---|
| **National Budget Process Deadlines** | | |
| Include UIG/UDG and Window 1 allocations in SDHUD MTEF proposals and Sector Reports in advance of budget hearings | 01 October, FY N-1 | SDHUD |
| Maximum UIG & UDG allocations determined based on initial APA. UIG/UDG allocations for FY N to NT & Commission on Revenue Allocation for inclusion in the CARB/DORB | 30$^{th}$ November, FY N-1 | SDHUD |
| Maximum UIG & UDG allocations for FYN included in CARB & DORB | 15$^{th}$ December, FY N-1 | National Treasury |
| UDD / SDHUD budget proposals prepared and submitted to NT including Window 1, UIG and UDG | 15$^{th}$ March, FY N-1 | SDHUD |
| Draft Budget estimates for UDD / SDHUD submitted to Parliament including Window 1, UIG and UDG | 30$^{th}$ April, FY N-1 | National Treasury |

In addition, UIGs and UDGs will need to be reflected in the annual budgets of counties that qualify for these allocations from the Programme. The SDHUD will thus ensure that counties are informed of their UIG/UDG allocations on a timely basis. To ensure that Program resources are fully reflected in the national and county budget frameworks, the following table provides deadlines for meeting key steps in the county budget process.

### Table 2: County Budget Process deadlines

| Step | Deadline | Responsible |
|---|---|---|
| **County Budget Process Deadlines** | | |
| UDD Communicates indicative UIG and UDG allocations to Counties (contingent upon APA) | July 31, FY N-1 | SDHUD |
| County annual development plan submitted to CEC, incorporating UIG/UDG allocations | September 1, FY N-1 | County Treasury |
| Budget Review and Outlook Paper submitted to CEC, incorporating UIG/UDG allocations | October 30, FY N-1 | County Treasury |
| UDD communicate maximum UIG/UDG based on initial APA to Counties. | November 30, FY N-1 | SDHUD |

| Step | Deadline | Responsible |
|---|---|---|
| County Treasury submits County Fiscal Strategy Paper to the CEC for approval | February 28, FY N-1 | County Treasury |
| CEC submits to the County Assembly budget estimates and other budget documents incorporating expected UIG/UDG allocations | April 30, FY N-1 | County Treasury/CEC |
| UDD communicates final UIG and UDG allocations to Counties | June 17, FY N-1 | SDHUD |
| County assembly approves county appropriations bill incorporating final UIG and UDG allocations. | June 30, FY N-1 | County Assembly |

The execution of the project budget (for Window 1) will be monitored through the GoK vote book of SDHUD of the MTIHUD as well as through quarterly Interim Financial Reports (IFR) submitted to the World Bank. An analysis of any variances between the budgeted and actual performance will be conducted every quarter and compiled into a report that will form part of the IFR.

The approved KUSP Programme Operations Manual (POM) has the disbursement plan, cost categories for each window and overall allocations for each cost category for each activity within the window. The annual budgetary allocations for each sub-component are to be based on the POM allocations except where prior approvals for cost category variation and allocations including through official World Bank / Development partner Aide Memoire have been received.

The POM disbursement table is one key tool used by the World Bank and other Development partners to assess KUSP performance on Programme Implementation. Budgeting outside of the POM categories and cost tables will not be approved.

## 2.2 KUSP - PROJECT FUNDS FLOW

The success of each project’s implementation depends greatly on how financial resources flow within the project. The funds flow process for KUSP therefore facilitates the flow of this critical resource for efficient and effective achievement of the programme objective.

### 2.2.1 Sources of Funds

The source of funds is The World Bank (IDA) financing amounting to US$ 300 Million. The majority of the Operation’s funds will be used to finance sub-national activities (windows 2 and 3). The Government’s contribution will consist of approximately US$20 million, in the form of SDHUD current expenditure (payroll, operating costs, etc.) for urban development.

IDA funds will be allocated to the three windows, as shown in the table below.

**Table 3: IDA funds allocation**

| Window/level | Expenditure Areas | Amount (US$ millions) | Amount (%) |
|---|---|---|---|
| Window 1: National government | · Policy development and urban management.<br>· Capacity development for urban institutions.<br>· Program coordination of UIGs and UDGs. | 30.0 | 10.0% |
| Window 2: County governments | · Sub-national urban development and planning.<br>· Institutional and capacity development.<br>· Technical and institutional support for urban infrastructure and service delivery. | 22.5 | 7.5% |
| Window 3: Urban boards (county government agencies) | · Infrastructure and service delivery. | 247.5 | 82.5% |
| | Total | 300.0 | 100.0% |

### 2.2.2 Responsibility of the National Treasury (Borrower)

The National Treasury acting as the Borrower shall be fully responsible to World Bank for the due and timely performance of all obligations ascribed to it in the Loan Agreement as the borrower. The obligations include:

- Appointing the signatory to sign the Withdrawal Applications and Designated Special Account;
- Apply for withdrawal of Funds from the Designated Special Account;
- Apply for withdrawal of Funds from the Advance Account to the Designated Account;
- Apply for withdrawal of Funds on Direct Payment to Contracts and Consultants;
- Ensure that the other parties perform their obligations;
- Open the Designated Account acceptable to the World Bank;
- Appoint the following officials of the External Resources Department (ERD) of the National Treasury as signatory to the Designated Special Account; and
- Pay the Loan service charge and the Principal.

### 2.2.3 Responsibility of World Bank in the Funds Flow

The World Bank on the other hand, shall be responsible in the funds flow as below:

- Extend a Project Loan amounting USD 300 million;
- Credit the Loan amount in the name of the borrower;
- Approve the Procurement Plan (as originally submitted and periodically updated) of KUSP; and
- To replenish Designated Special Account from time to time.

The KUSP loan funds would be channeled through the National Treasury and accounted for through Government budgetary regulations and procedures.

### 2.2.4 Flow of Fund Arrangements

In Window 1, the funds from IDA will be from to segregated USD denominated Designated Account (DA) in National Treasury and from there to a ring-fenced Project Account (PA) in SDHUD held at financial institutions acceptable to IDA or in the Central Bank of Kenya (CBK) from which eligible project expenditures will be made.

Unlike the PforR, funds under this component, that are deemed to have been used on activities not eligible for financing under the project would be declared ineligible and the Borrower would be required to refund these funds to the Bank.

In Window 2 and 3 there will be two levels of fund flows as listed below;

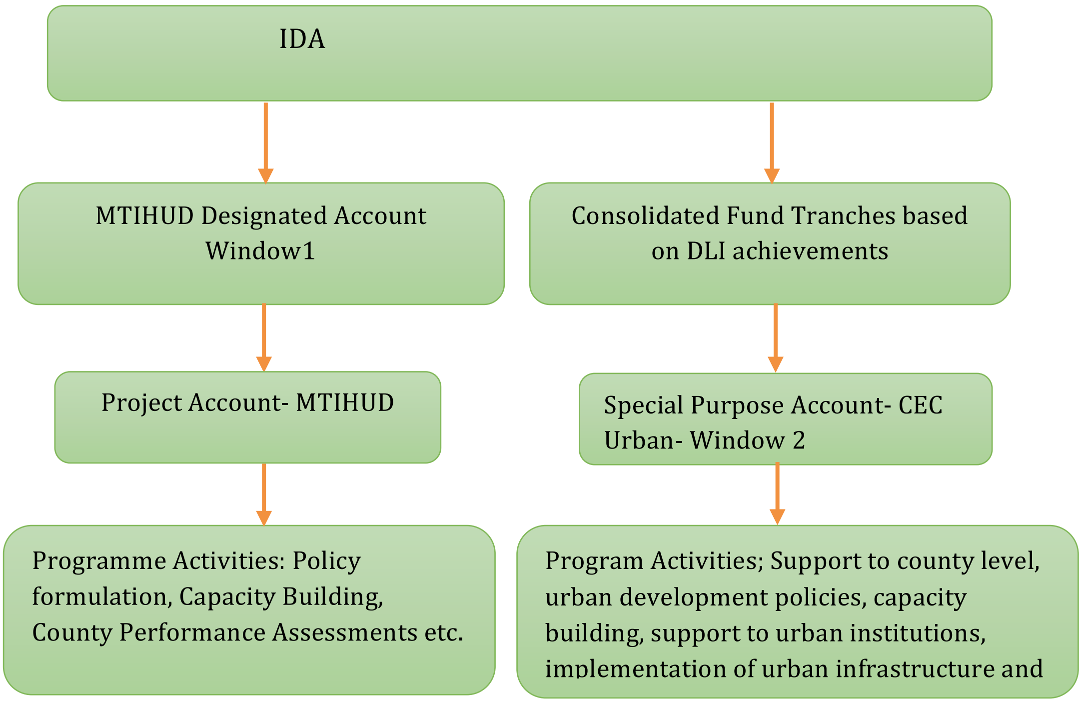
1. County-level funds flow from the National Treasury to counties for financing achievement of results as well as urban grants; and
2. Up-stream funds flows from the World Bank to the National Treasury on achievement of DLIs.

Window 2 and 3 are PforR funds and will be managed by counties on the basis of existing country PFM systems. The funds will flow directly from the exchequer in the National Treasury to the County Revenue Fund (CRF), to the County Operating Account (COA) in the County Treasury. The funds will eventually flow to the special purpose account opened by each county for these conditional grants in line with the GoK practice.

For all Programme activities under window 2 and 3, the funds will be spent by the county department responsible for implementation of various Programme activities in accordance with their approved annual plans and budgets.

The fund flow can be summarized below:

**Figure 1: The KUSP Fund Flow Arrangement**




The National Treasury is responsible for the timely disbursement of the funds to the counties.

### 2.2.5 Disbursement of funds

In Window 1, disbursement arrangements will be based on procedures that are consistent with IPF modalities. Upon receipt of a withdrawal application alongside a six-month cash-flow forecast, an initial IDA disbursement for window 1 will be made. The withdrawal application should be prepared within one month after Operation effectiveness.

Thereafter, IDA disbursements will be made into the respective Designated Account based on quarterly Interim Financial Reports (IFRs) which would provide actual expenditure for the preceding quarter (three months) and cash flow projections for the next two quarters (six months). The Bank's financial management specialist will review the IFR together with the withdrawal application. The task team leader will approve the request for disbursement, which will be processed by the Bank's Loan Department.

Being an IPF, IDA funds will be directly tracked to the inputs. The MTIHUD will adopt statement of expenditures (SOE) method of disbursement. In line with the World Bank disbursement Guidelines, the implementing may use advances, special commitments, reimbursement, and direct payments method as per GoK procedures.

The disbursements under Window 2 and 3 are subject to PforR procedures. They are scalable and will be based on the achievement of annual DLI targets. They will be made in a single tranche every year. DLIs 1, 2 and 3 are all scalable and amounts to be disbursed are determined on the basis of APA results and the subsequent estimate of annual UIG and IDG allocations for counties and their urban institutions.

DLIs will be verified by technical committee at the end of June each year. The steering committee and the Bank will endorse the results by July 31 of each year. Disbursements for DLIs 1, 2 and 3 will be made before August 15 of each year and will need to have been fully taken into account in national government budget framework, in CARA, DORA and in county government budgets

#### *2.2.5.1 Flow of World Bank Funds*

The flow of the World Bank funds to KUSP will be as provided for by the Public Financial Management Act 2012 and the Treasury Circular 3/2000 dated 1$^{st}$ March 2000 and 18/98 dated 22$^{nd}$ February 1999 on Donor funds.

KUSP expenditure qualifying for funding shall include only expenditure in the approved Procurement Plan and Budget and reflected in the Procurement plan which has been approved by the Principal Secretary through the Inter Ministerial Oversight Committee and World Bank to be eligible for financing by World Bank loan.

All the qualifying project expenditure would be reflected in the Government's annual printed estimates under Ministry of Transport, Infrastructure Housing and Urban Development or its successor to facilitate the flow of funds to the project.

To facilitate and delegate the financial and accounting responsibility, the Principal Secretary of the Ministry of Transport, Infrastructure Housing and Urban Development or its successor will issue Authority to incur Expenditures (AIEs) to the Project Manager of PCT as provided for by Government Financial Regulations and Procedures Chapter 15 on Budget and Budgetary control.

This delegation of responsibility will ensure that financial and accounting responsibility on KUSP funds is fully documented by PCT. The AIEs also places responsibility to project implementer to maintain the necessary financial records as provided for by this FMM and current Government Financial Regulation and Procedures.

This procedure will simplify greatly the flow of funds as only the MTIHUD would need to issue AIEs and Special Requisitions to the National Treasury during funds flow from the World Bank.

The process for submission of requests to World Bank will follow the standard operating procedures as provided for by the Project Financing Agreement, World Bank Financial Management Policy OP/BP 10.00 and Disbursement Letter on the Loan funds will be as hereunder:

A Designated Account shall be opened in the Central Bank of Kenya in line with the PFM Act 2012. It shall also be an interest bearing account, and is to be dominated in United States dollars.

#### *2.2.5.2 Authorized Representative*

Before presenting the first Withdrawal Application, for any loan proceeds or commitments to be effected from the Loan Account, the National Treasury will furnish the names of officials and authenticated signature specimens of the official of the Authorized Representative to the Bank. The Authorized representatives of the borrower are the authorized officials of External Resources Department of (National Treasury) who shall sign withdrawal applications. For purposes of KUSP the following will be the Authorized Representatives to sign applications for withdrawal and applications for special commitment:

- Director, External Resources Department
- Accounts Controller of Disbursement Unit
- World Bank Desk Officer

Replenishment of the Designated Account shall be triggered by a Withdrawal Application accompanied by statement of project expenditure (SOE) and a six months cash flow forecast.

#### ***2.2.5.3*** *Special Commitment*

KUSP may request the Bank to pay third party for eligible expenditures under special commitments entered between the project and a third party on terms and conditions agreed between the Bank and the borrower.

#### **2.2.5.4** ***Government of Kenya Flow of Funds***

The process to access the funds to the project shall be through the Treasury and accounted for through the same office under government budgetary procedures.

Ministry of Transport, Infrastructure Housing and Urban Development or its successor issues initial 6 (six) months Authority to Incur Expenditure (AIE) on the funds based on Annual Work plan and Budget.

Special exchequer requisition on Revenue based expenditures is prepared for both World Bank and GoK expenditure component on the following dates by Principal Accounts Controller (PAC) of the MTIHUD or its successor half yearly i.e. 1st half by 15th July and 2nd half by 15th December.

External Resources Department requests for transfer of funds from the Development Exchequer account to Pay Master General (PMG) who then transfer funds to the Ministry's Development account.

Ministry transfers funds through EFT to the SDHUD and the respective counties for utilization as per the approved Procurement Plans and Budgets as well as approved DLIs.

## 2.3 ACCOUNTING SYSTEM

The accounting responsibility will be executed by SDHUD and the Country treasuries for window 1 while the county treasuries will be responsible for the fiduciary duties of Window 2 and 3. The MTIHUD and each of the participating counties will designated suitably qualified Program accountant and budget finance officer to be responsible for the FM activities.

### 2.3.1 Accounting Standards and the Chart of Accounts

The standard accounting practice and the chart of accounts form the structure of recording, classifying and reporting receipts and expenditures to be used by KUSP at PCT level. The accounting system and the chart of accounts of the KUSP are based on Government financial and accounting procedures. As far as possible all financial statements will be produced and reported as provided for by Government of Kenya Financial Regulations and Procedures and International Public Sector Accounting Standards (IPSAS). All accounting and budgeting transactions for KUSP must be coded in accordance with the chart of accounts to ensure that information is consistently and accurately recorded.

The format of the chart of accounts is based on Government of Kenya, Standard Chart of Accounts User Manual 2012. The Standard Chart of Account is required to be used by all general Government agencies including development projects such as KUSP. It covers the entire fiscal cycle and includes budgeting, revenue collections, recurrent and development expenditures.

The nature of KUSP programme activities, size, approaches (Investment framework) and the transitional nature of the SDHUD - PCT imply that there is need to build the financial management and procurement capacity at the subnational level. Therefore, related capacity building activities and budgets will be included in the PCT work plans and budgets prior to presentation for approval. PCT will therefore focus on strengthening the counties and Municipal Boards to support financial management of KUSP like projects.

### 2.3.2 Accounting System

The National Government is implementing the Public Financial Management Reform program (PFMR) in the National Treasury. One of the main components of the PFMR is an IFMIS. Currently the system has implemented the General Ledger, Purchasing Order and Accounts Payable modules in all Ministries including MTIHUD.

The deployment of IFMIS is on-going and some modules of the system have not been fully developed, a separate project financial and accounting system to generate the necessary reports and to record the financial transactions for KUSP will therefore be implemented. This KUSP financial management system should be able to record and generate financial management information and reports to GoK and the World Bank. It could be based on off-the-shelf accounting package customized for KUSP or spreadsheet based accounting system for financial reporting as deemed suitable by PCT. In principle, the PCT shall design and operate the financial management and accounting information system as part of the overall project management information system. The system shall be used to guide PCTs in fulfilling their financial management obligations. This parallel method approach is not new within the GoK and has been used successfully by other projects including World Bank Funded projects such as the Public Financial Management Reform Program in Treasury and Mount Kenya East Pilot Project by International Fund for Agricultural Development (IFAD) among others.

However, all receipts and payment vouchers processed by KUSP will be posted to the IFMIS within the MTIHUD to provide consistency and completeness in recording financial information. The new system provides improved financial management capacity in the Ministry not only to record financial transactions but also to report budget execution which is critical in cash based systems. The IFMIS uses the Standard Chart of Accounts and the Standard Codes. PCT will use the Standard Code and Chart of Accounts for its budgeting and financial reporting to ensure uniformity.

KUSP will use Government of Kenya standard receipt and expenditure accounts classification codes. This accounting system is termed as Cash basis of accounting as opposed to normal accrual basis of accounting. KUSP will prepare periodic financial reports to GoK and World Bank on IPSAS (cash basis of accounting). The GoK accounting codes will therefore be used as the account numbers and form the chart of accounts for the KUSP. Detailed classifications to be used in the accounting system for KUSP are shown in ***Annex 1 – Chart of Accounts***.

### 2.3.3 Accounting Transactions and Records

Processing of financial transactions and maintenance of accounting records will be the responsibility of the PCT which bears the overall fiduciary responsibility for the project. In this regard, the PCT shall operate a project bank account denominated in Kenya Shillings for each Window.

The accounting system and the chart of accounts will be used by the PCT to maintain accurate and up-to-date records of all project financial transactions.

In addition, each PCT will maintain accurate and up-to-date inventory of assets/goods procured or received from KUSP funding including the condition of those assets/goods, location and responsible officer. All project related records at PCT, World Bank Supervision Missions, Ministry Internal Auditors and External Auditors or any other professional accounting or auditing consultancy service procured for the purposes of supporting PCT fiduciary responsibility.

The PCT shall maintain the following accounting records as applicable:

1. Cash book or record of transactions in the local project bank account
2. All bank statements for both the Project Account and the Designated Account
3. All SOE's submitted to the World Bank
4. All Direct Withdrawal Applications and Exchequer Requests made by the Project
5. All Commitment Letters by World Bank

6. All receipts and payment vouchers (including direct payments) and the supporting documentation
7. AIEs received
8. An overall inventory of goods procured under the project (Fixed Assets Register)
9. Community level grants financial management documentation

In performing the duties and functions necessary to fulfill its accounting and financial mandate, KUSP PCT will be responsible for checking the documents received from counties and Municipal Boards for:

- Accuracy;
- Completeness;
- Consistency;
- Timeliness; and
- Query any irregularities within 14 days of the documents' receipt.

### 2.3.4 Staffing

The PCT will be headed by the Project Coordinator while the financial management (FM) unit will be headed by a Project Accountant with the requisite skills and experience to execute all the finance functions under the project. The Project Accountant will be supported by experienced Accounts Assistants; all of whom will be full time employees of the project. This core team of financial management experts will ensure adequate segregation of functions within the accounting unit and efficiency in transaction processing.

The PCT has a new dedicated Grants Management function. It will deal with all aspects of the APA process and subsequent grants recommendations to both the National Technical Committee (NTC) and the National Steering Committee (NSC) for KUSP. The APA process is detailed in the Programme Operations Manual (POM).

On accounting arrangements, the SDHUD will designate qualified accountant and budget finance officers to the national PCT to support the Operation to handle both Window 1 and support Window 2 operations.

The SDHUD and participating counties will put in place program for annual capacity building training of staff at national and county level as well as the internal and external auditors supporting the Program. The training program will be financed out of Program and Project funds

### 2.3.5 Payment Processing

Payment processing under the project at the PCT will follow the general guidelines and procedures laid down in the GoK Financial Regulations and Procedures, with the PCT as the responsible unit. The PCT Project Accounts Assistant will raise a payment voucher when any of the following documents have been received:

- An original invoice from the supplier attached to an LPO and copies of quotations (where necessary) and evidence of receipt of the item purchased (supplier's delivery note and stores counter receipt voucher S.13) or satisfactory performance of services. He/She shall confirm that the prices and invoice calculations are correct and that the cost is a genuine obligation on the project.

- An original invoice from a travel agent attached to a properly approved travel authorization.
- In case of consultancy, the first installment will be based on the signed contract while subsequent payments will be based on an invoice reflecting payments already made and the remaining balance. This should be accompanied by a progress or final report of the assignment and a certificate of satisfactory performance.

The payment voucher will be approved first by the PCT Project Coordinator or his designate as the AIE holder before being subjected to voucher examination and vote book entry at the PCT. The PCT staff should have full rights to handle all project related transaction and reporting. Subsequently, the payment vouchers will be authorized by the Project Accountant or his designate before payment at the ministry's cash office. All payments exceeding Kshs.5,000/= shall be made by cheque or electronic funds transfer (EFT) while payments below this amount will be made in cash. The internal audit unit of MTIHUD and the respective counties shall conduct post audit of payment vouchers sampled in line with the project's risk profile.

### 2.3.6 Expenditure Data Capture and Recording

The payment vouchers will be recorded in the project cash book maintained by the PCT. The project expenditure will then be posted and reflected in the Ministry's records (appropriation accounts) and ledgers using the GoK accounting systems. A journal entry (JE) will be raised by the Principal Accounts Controller of MTIHUD to debit the expenditure accounts and credit the appropriate exchequer account to record the project expenditure. The accounting data and information captured will be used to produce the quarterly financial reports in addition to project annual financial statements.

In order to facilitate the External and Internal Audit of the project expenditure and to satisfy the requirement/guidelines of Treasury Circular No. 18/98 dated 22nd February, 1999 on processing of payment vouchers at the Ministry Headquarters, the original payment vouchers and original documents will be retained by KUSP PCT as provided for by the Treasury Circular on Donor funded projects.

The responsibility of securing the accounting information (payment and receipt vouchers) shall be the PCT as provided for by the current Government Financial Regulations and Procedures. A register of the original payment voucher and the their supporting/attachments will be maintained by PCT as part of the project financial documents in line with GoK and World Bank Standard Conditions on retention of Financial Documents. The permanent payment voucher register will record the number of payment vouchers and their transfer from one location to the other.

The PCT will ensure safe and secure custody of the payment vouchers and all other accountable documents as appropriate.

### 2.3.7 KUSP Expenditure Data

KUSP PCT will record the financial transactions in books of account to be maintained at its offices. The Data Section/IFMIS at the MHTUD headquarters shall ensure that expenditures in respect of each activity in the respective windows of KUSP expenditures are separately keyed-in to capture expenditure data in the MTIHUD ledgers based on the account codes provided elsewhere in this Manual.

All beneficiaries will use the same system as PCT when recording the transaction to ensure there is consistency in reporting.

### 2.3.8 Voucher Processing

The processing of vouchers in the project will be done in accordance with standard processing routines laid by this Manual. The objective of these procedures/regulations is to document and enforce strict control over the flow of vouchers. The vouchers shall be used as the original record to the accounting system.

The payments will be effected by completing appropriated forms F.O 20 or FO 22 (GoK Payment Vouchers) which have been designed for exclusive use in respect of expenditure on voted provisions. Different officers who are involved in their processing shall complete sections in the vouchers to signify action taken in the process. This process forms part of the internal control and internal check on expenditure of KUSP funds.

### 2.3.9 Voucher Movement Registers

Every movement of payment vouchers with the original supporting documentation shall be documented in registers and signed for by receiving persons/sections and evidence of each action taken is recorded on the face of the payment voucher.

The number of registers to be maintained for processing vouchers will depend on the organizational set up in each paying station. It is expected that there would be minimal difference as all stations shall be using the same Government Financial Regulations and Procedures or similar.

A minimum of three such registers must be in use to record movement of vouchers in each project paying stations of KUSP Executing Agencies as follows:

- One from voucher preparation point to be maintained at source at PCT;
- One from voucher preparation to Authorizing section at each payment station; and
- One from vote book/expenditure control section to Cash office for payment.

### 2.3.10 Voucher Preparation

Payments have to be processed immediately in respect of demands for settlement of goods and services which have been supplied/rendered to the KUSP project. The payment shall be effected against:

- Valid regulations;
- Scales;
- Tariffs;
- Contracts or agreements;

- Purchase orders;
- Suppliers invoices and certificate of origin;
- Evidence of receipt of goods or services;
- Contractors' and consultants' invoice or certificates of completion;
- Performance security documents such as bank guarantees in the case of advance payment if required under the terms of the contract;
- Procurement documents (bid document, invitation to bid, evaluation reports; and
- Letters of credit.

The above are to be supported by LPOs, LSOs, Invoices, Receipts, and Receipted bills duly confirmed by the receiving officers of the PCT. The payment vouchers will be prepared in at least triplicate copies for distribution as follows:

- The original to be retained to support the cash book entry and for posting of the transaction into the appropriate ministry/departments ledger account;
- One copy to accompany the remittance to the supplier/payee as the case may be; and
- Payment vouchers to indicate the supporting documents attached to it ;
- The vouchers will be authorized for payment by the Project Coordinator or his designate

### 2.3.11 Voucher Examination

The KUSP vouchers will be subjected to scrutiny by an Examiner within the finance unit of the MTIHUD to ascertain the following:

- That the expenditure is in conformity with the authority governing that payment. i.e. Contracts and Certificates, Government Financial Regulations and Procedures, Procurement procedures, Project Financing Agreement and Financial Management Manual.
- That there exists already an approved work plan and budget allocation to cover that expenditure and that the allocation has not and will not be exceeded as a result of the payment.
- That the payment is supported by appropriate certificate and /or duly certified:
    1. Invoices
    2. Receipts bills
    3. LPOs
    4. LSOs,
    5. Proof of acknowledgement of receipt of goods and services
- That the payment voucher is complete in all aspects and all payment procedures have been complied with.
- That the payment voucher is authorized for payment by the relevant authorized official.

The examining officer or section head will complete the appropriate certificates to indicate that the vouchers have been examined and passed for payment. The voucher moves to the vote book and expenditure control section for recording.

### 2.3.12 Commitment of Expenditures (Maintenance of Vote Book)

The approved KUSP Annual work plan and budget forms the source document to open Expenditure/Vote Book to be used for recording commitments and expenditures. As a control feature in budgetary control, this record provides information on the total commitments and total expenditures and the balance provided for activity or cost centre. Having opened the Expenditure/ vote book the Accountants must ensure that:

- Every payment voucher processed is entered in the vote book.
- After each voucher entry the actual total payment figure is amended.
- Every commitment is entered - realistic approximate values may be obtained from suppliers, stores catalogue, etc.
- After the entry of a commitment, the total commitment plus total payment is obtained from which the balance available is computed.
- When a commitment becomes an actual transaction the total payments figures are adjusted accordingly.
- Every voucher originated by PCT/ has a serial number allocated to it.
- Ideally, this will comprise four digits commencing at 0001 and will be that voucher's identity.
- A permanent record of all the payment vouchers and imprest warrants in a hard bound registers has to be maintained by PCT in addition to the movement registers.

### 2.3.13 Control of Expenditures

The KUSP PCT authorized officials appointed by the Principal Secretary MTIHUD should note the following:

- There must be no divided responsibility: only the authorized officials to whom the MTIHUD and subsequently the KUSP has mandated and authorized can commit or incur expenditure against KUSP funds.
- An Authorized official should regularly have his/her outstanding commitments checked and enquiries made from the suppliers. This is particularly important in the last three months of the financial year.

### 2.3.14 Expenditures/Vote Book Control

The Expenditures/Vote Book Control section will enter the payment in the vote book and complete the appropriate certificates.

The officer in-charge of the control section shall at all times ensure that allocation has not and will not be exceeded as a result of the payment. The payment vouchers which shall satisfy the requirements shall thereafter be passed to cash office where payments shall be effected.

### 2.3.15 KUSP Retention and Security of Payment Vouchers

The payment vouchers and their attachments form part of audit trail of the project expenditures. They constitute the original evidence of financial transactions and therefore are part of key information for accountability and transparency. To retain and secure these critical documents for both internal and external audit, secure filing and storage equipment will be availed e.g. fire proof cabinets etc will be provided by the project to store the payment documents.

### 2.3.16 Fixed Asset Register

A fixed assets register will be prepared and developed by the PCT for recording all the fixed assets of the Project. The External Auditor will review and verify the assets register during the Annual Audit. An updated and consolidated Fixed Assets record reflecting all the assets of the project will be produced by the PCT which will also ensure that project assets are safeguarded against misuse, theft or malicious damage.

In this regard, access to project assets shall be restricted to authorized persons only. Procedures will be put in place to ensure evidence of such authority such as the use of vehicle work tickets, while some assets will be put under lock and key at all times. Cash will be kept in an office safe under the custody of a responsible officer.

### 2.3.17 Tracking of Financial Data

The computerized financial management information system together with the information generated by the Government system shall be used to keep track of pertinent financial data including exceptions i.e. what has failed to happen. This data would create a tracking system on:

- Deadlines missed;
- Queries raised still outstanding;
- Documents not received;
- SOEs not received; and
- Project Accounts operations.

Information generated by the tracking system and other systems would allow PCT KUSP to monitor and report on the financial performance each implementing agency on monthly basis.

### 2.3.18 Eligibility of Expenditures

The PAD outlines some of the eligible and ineligible expenditures which will be allowed in the KUSP project to guide the PCT, the County Governments and the Municipal Boards in expensing the funds as per the agreement.

In window 1, the funds will be used to support national government in fulfilling its urban development functions which are; establishing and strengthening the institutional and policy framework for urban management, supporting the coordination of urban finances (including the management of APAs and conditional grants) and providing backstopping for urban planning, urban infrastructure delivery and for the provision of basic urban services.

In Window 2, Counties will be able to use their UIGs to finance a range of eligible expenditures, including costs related to capacity building, some incremental operating costs, hiring consultants, and the purchase of office equipment. The UIG expenditure menu is as stipulated in table 3.2 in Section 3.5 of the POM.

Window 3 will provide support to urban boards and administrations through their respective county governments for financing infrastructure investments in urban areas. Eligible investments will include waste management, drainage, connectivity infrastructure, urban economic infrastructure, and fire and disaster management.

The UDG expenditure menu is as stipulated in table 4.5 in Section 4.7 of the POM.

## 2.4 KUSP - INTERNAL CONTROLS

Internal controls are processes that are designed to provide reasonable assurance to the Project Management regarding the achievement of objectives in the following areas:

- Compliance with applicable laws and regulations
- Reliability of financial reporting
- Effectiveness and efficiency of the overall Project implementation
- Safeguarding project assets, and
- Adherence to established institutional and government policies and procedures.

The financial and accounting information systems should produce complete and accurate financial statements and reports and are part of the Internal Control regime. The PCT will implement internal control measures to address potential inherent risks, both organizational and operational risks. The Project will endeavor to enhance internal controls through:

- Properly documented procedures for approval and authorization of transactions within the project.
- Segregation of duties where one single individual may not be in-charge of initiation, authorization, execution, and recording of transactions without the active involvement of another person.
- Having effective management oversight bodies at all levels in the Project. This would include audit, finance committees and procurement committees.
- Systems of sound financial controls and internal checks including budgetary control systems and bank reconciliation.
- Internal audit (post audit) verifications and social audits of community projects by the public.

### 2.4.1 Approval and Authorization procedures and Segregation of duties

All project financial transactions at the National level shall be approved by the PCT Coordinator or his designate.

The Project Accountant or his designate will also be required to authorize all payments that have been approved by the PCT Coordinator.

In order to enhance transparency, no employee at PCT should authorize his/her own claims and all approvals and authorizations shall be made in writing. Payments at the PCT level will be initiated by the Project Accountants who will also maintain an up to date record in the cashbook. The PCT Project Accountant will check the cashbook on a daily basis and prepare monthly bank reconciliation statements.

### 2.4.2 Project Bank Accounts and Bank Operations

#### *2.4.2.1 Designated Account (US Dollars)*

To facilitate the operations of PCT two bank accounts shall be opened. A Designated Account at the Central Bank of Kenya shall be opened and operated by the National Treasury. The Designated Account will be denominated in US dollars and will receive the initial advance and subsequent receipts from World Bank. The counties' CRF accounts will be maintained in Kenya Shillings.

#### *2.4.2.2 Local Bank Accounts (Kshs.)*

KUSP's PCU shall open a Designated Account in Kenya Shillings for Window 1 operations. The banks where these KUSP accounts will be held must in line with the stipulations of the PFM Act and the Treasury Policies.

#### *2.4.2.3 Operations of US$ Designated Bank Account*

This would be an interest-bearing account operated by ERD at the Central Bank of Kenya. It will receive all loan funds to be disbursed to the local bank account. The signatories to the account would be the:

a) ERD Director
b) Accountant General to the National Treasury

The Authorized Allocation or the initial deposits by World Bank to the US$ Designated Account would be about USD 1.0 - 2.0 million.

The instructions for transfers from the Development Exchequer Account to the MTIHUD account would be by Payment Authorization (PA) issued by ERD to the Central Bank. These would be initiated by Special Exchequer Requisitions issued by MTIHUD or its successor.

The Central Bank of Kenya would send fortnightly statements of the US$ Special Account to ERD, for onward transmission to the PCT.

### 2.4.3 Operations of KUSP PCT/ Project Bank Account (KSH)

This would be an interest-bearing account operated by the PCT at a bank as per Treasury policies and PFM Act:

a) The signatories to the account would be the Project Coordinator at the PCT, Head of Accounting Unit (HAU) or at the ministry or designate and Project Accountant.
b) All transfers of funds into the PCT Project Account would be triggered by Payment Authorizations issued by ERD on receipt of Special Requisition from the MTIHUD or its successor.

c) Sufficient Designated Bank Account balance as demonstrated by a bank statement to be provided by the PCT to ERD.

All transactions through the project account shall be recorded in a cash book maintained at the PCT. This cashbook will be checked daily by the Project Accountant or designate. The PCT will monitor the project account and keep up-to-date management information in its KUSP Financial MIS.

### 2.4.4 Bank Reconciliation

The PCT will ensure that monthly bank reconciliation statements in respect of the Project Account are prepared to confirm the balance in the cashbook to the bank statement at the end of the month. For purposes of control, bank reconciliation statements should be prepared by someone other than the one involved in writing the cashbook. The bank reconciliation statements will be checked and approved by the Finance Manager or designate.

The PCT will also ensure that the Designated Account reconciliation statements are received from Treasury on a quarterly basis.

### 2.4.5 Accounting for Imprests and Staff Advances

#### 2.4.5.1 *Imprests*

An imprest is a form of cash advance or a "float" which the Project Manager may authorize to be issued to officers in furtherance of official duties and payments cannot be conveniently made through the cash office. Imprest is issued for specific purpose, and any payments made from it must be only for the purpose specified. Imprests are of three types:

- Temporary (safari imprests)
- Standing imprests
- Special imprests

The issuance of imprest to staff will be in conformity with Treasury circulars on Imprest and in particular Treasury circular on Control of Imprest No. 3/2010 dated May 2010.

#### *2.4.5.2 Temporary Imprests*

These are issued mainly in respect of official journeys and are intended to provide officers with funds with which they can meet traveling, accommodation and incidental expenses. Before issuing temporary imprests, it is necessary to ensure that:

- Adequate funds are available for the item of expenditure.
- The main objective of the journey cannot be achieved by other cheaper means.
- Applicants do not have outstanding imprests (that is previous imprests which they have not yet accounted for).
- Project Accountant confirms that the imprest applied for is for approved project activities.
- The PCT has approved the temporary imprest.

- Technical PCT member has signified the appropriateness of the imprest to the approved activities in the work plan and budget.
- The PCT member confirms that he/she has received all back to office reports and expenditures returns on the previous imprest issued to the applicant.
- The PCT member confirms in writing that a physical examination has been conducted on purchases of stores and services
- The Accountant in-charge of the imprest has certified on the imprest warrant (form FO. 24) that the applicant does not have an outstanding imprest and confirms that imprest applied for has been recorded in the imprest register.
- The vote book (commitments) controller has certified that adequate funds are available against the relevant items of expenditure to meet the proposed expenditure.
- A holder of temporary imprest is supposed to account for or surrender the imprest within 48 hours after returning to duty station or performing the task. In the event of the imprest holder failing to account for or surrender the imprest on the due date:
- The Programme Co-ordinator is required to take immediate action to recover the full amount from the salary of the defaulting officer.
- The head of PCT makes a follow up to ensure the imprest is surrendered before the expiry of 7 days.
- Where the Project Director does not control the payment of the officer's salary in question, and therefore would not be able to recover, the imprest issue is directed to the Principal Secretary for action.
- In order to effectively manage and control the issue of temporary imprests it is necessary for the Project Coordinator who is the overall AIE holder with the administrative support of the Project Accountant PCT to ensure that no second imprest is issued to any officer before the first imprest is surrendered or recovered in full from his salary.
- If imprest is to be recovered from any officer by installments then the Project Coordinator must personally authorize such recovery because it is no longer an imprest but unauthorized advance from KUSP funds. It is the responsibility of the Programme Coordinator and Project Accountant to safeguard project resources entrusted to them by:
- Ensuring that imprests are accounted for immediately and appropriate expenditure documents availed by all imprest holders.
- Where imprest has been recovered from defaulting imprest holders such amounts are banked in the Project Bank Accounts.
- The Programme Coordinator (PCT) must take appropriate disciplinary action against the PCT Officer concerned in the misuse and abuse of the imprest facility.

#### 2.4.5.3 *Standing Imprest*

The standing imprest involves personal responsibility as it is issued to an officer in his own name, and not to the holder of an office. The standing imprest is intended to be in operation for a time and requires bringing the cash level of the advance continuously up to the agreed fixed level by systematic re-imbursement of expenses.

- The holder of a standing imprest must keep:
  - Cash book
  - Record of all receipts and expenses
- Balance on hand must agree with the cash balance recorded in the cash book at all times. The actual cash balance plus expenses paid (represented by payment vouchers) should equal at all times the fixed level of the imprest. At monthly accounting dates, and also when the imprest holder needs to have his funds replenished:
- Send an abstract and analysis of his cash book attach originals of the supporting payment vouchers to the accounts section
- If the accounts section is satisfied that the expenditure has actually been incurred for the intended purposes, it will:
  - Arrange for the analyzed expenditure to be posted to the various expenditure heads and items.
  - Recommend for cash to be transferred to the imprest holder so as to "top up" his fund.
- In addition, the Project Accountant will also ensure that frequent surprise spot checks are made of the imprest cash by a responsible officer as follows:
  - Account for the cash; confirm that the actual cash on hand corresponds with the balance on hand as recorded in the cash book.
  - Confirm that all movements (expenses and receipts) since the last check have been properly recorded and are properly documented.
  - Ensure that the documents justify the difference between the fixed imprest level and the actual cash balance.

#### 2.4.5.4 *Disbursement from Standing Imprest*

Standing Imprest will be used for KUSP PCT office operations only, when payment by cheque becomes inconvenient. Standing Imprest is cash of a fixed sum kept to facilitate petty office expenses.

The amount of Standing Imprest will be determined by Project Manager and Finance Manager of PCT after assessing the volume of work and the expenditures requiring Standing Imprest. An amount sufficient to cover two weeks Standing Imprest expenditures could be the limit.

Attempts shall be made to effect expenditures by cheque. However, when payment by cheque becomes difficult it is necessary to have an amount of actual cash available for emergency use or for expenditures for which drawing cheques becomes impractical.

The KUSP Accounts Assistant will be advanced fixed sum which should always be represented by cash or Standing Imprest vouchers.

The standing Imprest for KUSP shall be Kshs. 100,000.00 and shall be placed in the custody of the Accounts Assistant. Standing Imprests under GoK regulations are used for urgent procurement for small office items of upto Kshs 10,000/= per item. In view of complexity of KUSP and number of parallel running activities at any one time, this amount is considered reasonable.

Only amounts up to Kshs. 10,000 will be paid from Standing Imprest.

### 2.4.6 Internal Control for Standing Imprest

- The cash representing the standing imprest must be kept in an official safe.
- The Standing Imprest fund must not be mixed with other funds and should not be used for loans and advances to employees.
- Standard GoK Payment Vouchers or similar must be used.
- All paid Standing Imprest vouchers must be stamped “paid” and initialed by the Financial Manager
- The KUSP PCT Accounts Assistant in charge must stamp all replenished Standing Imprest vouchers “Replenished”.
- Surprise cash counts should be conducted from time to time by a responsible official.

### 2.4.7 Standing Imprest Replenishment

Payments from Standing Imprest are authorized and recorded on payment vouchers. The vouchers shall be recorded in a Standing Imprest register.

Replenishment is requested when the cash available reaches about 20% of the fund. The Standing Imprest Request (Internal Memo) and report form will be passed to the Project Accountant for Replenishment. Upon receipt of the completed and totaled Standing Imprest report and request form attached to the paid Standing Imprest vouchers; the Project Accountant checks the analysis and prepares a Cheque payment voucher for the total amount of cash paid.

The replenishment is recorded as withdrawal in the cashbook and the expenses accounts are debited for each transaction. All vouchers will be stamped “replenished”.

The standing imprest shall be retired by June 30, every year and a fresh imprest issued at the beginning of a financial year.

### 2.4.8 Ineligible Expenditure

The World Bank defines ***Ineligible expenditure*** to mean amounts withdrawn from the Loan Account that has been used to finance expenditures that are not eligible for financing pursuant to the provisions of the financing agreement. Ineligible expenditure may arise from Questioned expenditure that are subsequently confirmed to be ineligible from financing following an often iterative follow-up process.

Questioned Expenditure– During review, the Bank may question expenditures because of (i) an alleged violation of the terms of the financing agreement; or (ii) a finding that, at the time of review or audit, the expenditure is not supported by adequate documentation. Questioned expenditure is considered to be ineligible expenditures following confirmation that the expenditure is not eligible for financing pursuant to the provisions of the financing agreement.

In determining ineligibility, the following guidelines will apply:

*"The KUSP project expenditure must comply with the Government of Kenya (GoK) Financial Regulations, Guidelines, and Treasury Circulars and where required (procurement) World Bank procedures. Breach of guidelines would render such a payment as ineligible unless acceptable justification is provided".*

### 2.4.9 Allowances in KUSP

Unless otherwise provided for in the Development Credit/Grant Agreement the following apply to KUSP on IDA credit and counterpart funds comprised in the total cost, and minimize incidences of ineligible expenditures and based on the guidance from the World Bank:

- Travel and Transport – This include local travel and air travel, receipts will be required for reimbursement and other incidental cost.
- Purchase of fuel for personal vehicles are not reimbursable.
- Salary Top to Civil/Public Servants is not Allowed in the Programme.
- Honorarium, Internal consulting by civil servants on GoK payroll and Sitting allowance not allowed for attending workshop, Programme Technical and Steering Committee meetings other committee meeting in line with OP/BP 6.00 and Consultant Guidelines of the World Bank. However, the above allowances are payable from Government funds to be budgeted for in the Project as GoK contribution.
- Internal consulting of public and civil servants currently on the government payrolls is not allowed as per OP/BP 6.00 and Consultant Guidelines of the World Bank. This could amount to double payments to government employees. The government should not be paying consulting fees to staff on its payroll. A government employee may take a leave of absence (without pay) to work in another sector and be paid consulting fees by the government/project. The General conditions for hiring Government officials and civil servants under consulting contracts in Bank financed projects are set forth in para. 1.11(d) of the Consultant Guidelines. The Government officials and civil servants cannot be hired under any circumstances by the agency for which they previously worked, or if their employment would create a conflict of interest. When hired as individual consultants, they would have to be on leave without pay for the expected duration of their consultant contract before signing it. When members of a team of a consulting firm, they would have to be on leave without pay at the time the consulting firm submits its proposal.
- Sitting allowances, honorarium, etc. to consultants financed under a project (for attending workshops, Project Steering Committee meetings, other committee meetings, etc.) is not allowed as per OP/BP 6.00 and Consultant Guidelines of the World Bank.

Consultants are contracted and paid reasonable fees to render services to the project. "Rate payable to individual Resources Persons to support PCT convened workshops/events to provide short term professional services based on TORs not limited to moderation, conducting or facilitating "training workshops" where external (none-PCT) expertise is required will be pegged at US$ 500 - 700 per day for a maximum of 10 days.

### 2.4.10 Per Diem

The rates for per diem for contracted consultant would be negotiated and reflected in the contracts and will be within the governing rates i.e. a rate agreed between the GoK and the Bank and other Development Partners or approved by the Bank or Development partner prior to the contract signing. This rate should not be higher than equivalent UNDP rate. The UNDP official rates will apply in exceptional unforeseen circumstances at the time of the consultant contract approval and signing. Among these circumstances may include international travel for official work.

### 2.4.11 KUSP Operational Costs

The operational costs for Project as per the Financing agreement are defined as " the **reasonable incremental** expenses as defined in the relevant (KUSP) Financing Agreements incurred by the PCT based on the Annual Work Plan and Budget and consisting of expenditures for vehicle operation and maintenance, equipment maintenance, communication and insurance costs, office administration costs, bank charges, advertising expenses, travel and per diem, administrative support staff salaries (excluding the salaries of the GoK civil or public servants). These therefore include all the **recurrent** costs that are budgeted for as operational.

The costs also include and are not limited to: Administrative/ Support staff salaries, Office services: cleaning, Postal service courier, security; Motor vehicles maintenance & Fuel, Insurance for equipment and Motor vehicles, office assets (fire & burglary), staff cover, Media/Advertisements, Per diem: approved rates for official travel out of Nairobi (local & international), Electricity and water, Communication , phone, internet bills, Office tea/coffee/water, All Stationery items, Travelling cost including Taxi costs.

Where Per diem and travel are incurred by the non PCT implementing officers or project beneficiaries (i.e. those recognized in the approved implementation approach/arrangement for the sub-component) in relation to carrying out approved activities that result in key KUSP deliverables, these do not qualify as operational costs.

### 2.4.12 DLI Disbursements

As discussed in the earlier sections, disbursements in Window 2 and 3 are dependent on Annual Performance Assessments (APAs) results unlike in Window 1. The APAs will be carried out by an independent consultant contracted by UDD through a transparent procurement process. The process will begin in August each year and end in May of the following year

The APA results will determine UIG and UDG allocations for all eligible counties and urban areas and will be made available on a timely basis. The Program Technical Committee (PTC) will be involved in the review of any progress reports in accounting and financial Management and provide guidance on implementation of the policies laid down.

### 2.4.13 Internal Audit function

To enhance fiduciary oversight, the Program will support counties in setting up functioning audit committees as per the PFM requirements. The audit committees would follow up on any audit queries and ensure the implementation of the audit recommendations.

In addition, the State Department of Housing and Urban development internal audit department (IAD) and the county internal audit units will;

- Include the audit of the Programme activities as part of their annual work plans
- Establish risk registers and report on implementation of recommended risk mitigation measures.
- Ensure that the Internal audit team has the right capacity and skillset to carry out the internal audit function; and
- Ensure that the IAD is adequately staffed to execute the function.

The Programme funds will be utilized to enhance the capacity of internal audit function at both the national and county level.

## 2.5 FINANCIAL REPORTING

KUSP financial reporting will be as stipulated by the International Public Sector Accounting Standards and Treasury Circular No MF/AG. 3/088 Vol. 5/ (85) dated 1st September, 2008 on Financial Statements of Accounts for Development Partners Funded Projects.

### 2.5.1 Quarterly Interim Financial Reports (IFRs)

KUSP PCT shall prepare and submit the quarterly unaudited Interim Financial Reports (IFRs) in form and content satisfactory to the Bank within 45 days after the end of the quarter.

The format of the IFRs has been agreed between the Bank and MTIHUD. The contents of the IFR will include a section to report on the Accountability of Funds utilized and a section to assess funds report based method of disbursement. The reports will also include a physical progress report of the Projects.

The reporting section will include; (i) Statement of Sources and Uses of Funds, and (ii) Statement of Uses of Funds by project Activities.

The disbursement section of the IFRs will include;

i. Designated Account Activity Statement;
ii. Bank statements for both the Designated Account and Project Account;
iii. Summary statement of Designated Account expenditures for contracts subject to prior review;
iv. Summary statement of Designated Account expenditures not subject to prior review; and
v. Six month's cash flow forecast.

KUSP will implement a real time financial management system to improve efficiency in reports. The quarterly IFRs will be submitted to the Bank within 45 days after the end of each calendar quarter.

The annual financial statements will be submitted to the OAG by not later than September 30 being 3 months after the year end. The format of the financial reports will remain the same as that being used for the current Bank-financed projects being implemented currently by the 3 agencies.

### 2.5.2 Annual financial statements

The KUSP PCT will prepare and submit to the World Bank annual Program-specific financial statements. Window 1 activities will be captured in separate financial statements. Activities under windows 2 and 3 will disaggregate funds disbursed to each participating county under the various categories, in the financial year under review.

The format of the financial statements will be in line with the IPSAS format used for Bank projects. The Program financial reporting arrangements will be aligned to existing GoK arrangements.

In addition, the normal consolidated financial statements on the operations and position of the project shall be prepared by KUSP PCT and submitted by SDHUD in line with the requirement of International Public Sector Accounting Standards as below:

i. Each financial year i.e. 1st July to 30th June.
ii. PCT will consolidate all financial information in to the financial statements.
iii. Deliver to the MTIHUD and the National Treasury and other project parties (co financiers) the Financial Statements and schedules.
iv. The financial statements to be prepared by PCT are as per Treasury letter Ref No. MF/AG.3/088 Vol. 5/ (84) dated 1st September, 2008 on Development Partners Funded Projects.

## 2.6 AUDIT REPORTS

### 2.6.1 Internal Audit of KUSP

The Internal Auditor seconded to the MTIHUD by the IAD Treasury will conduct annual fiduciary reviews on the project funds based on an annual risk assessment of the project. The Annual Fiduciary review report by the Internal Audit will inform the PCT and the Principal Secretary MTIHUD on operational and organizational risks in the project.

Similarly, the internal audit functions will ensure risk-based fiduciary review of project activities at the PCTs. In addition, quarterly internal audit reports will be submitted by the PCTs to the World Bank.

### 2.6.2 Statutory Annual Audits

To satisfy the legal requirement on government funds and to maintain a level of control on the expenditures necessary to remove any discrepancies that might delay disbursements there is need to conduct statutory Annual Audits as provided for by the PFM Act and Public Audit Act (2003). These procedures are in addition to internal audit function performed to project transaction at the PCT and Executing Agency level. The appointment of the External auditor is a condition of Loan Agreement.

The audit of the project account shall be performed as follows:

i. The KENAO shall perform the annual project audit in accordance with the International Standards of Auditing (ISAs) and issue the audit report before expiry of six months after the end of the financial year. The KENAO audit shall cover the PCT's verification of outputs through field inspection.

ii. Project specific financial statements (KUSP) including Designated Accounts with appropriate notes and disclosures and Management letter shall be submitted at the same time - six months after the end of each fiscal/financial year.

iii. The audit report shall be in the Long Form based on the financial statements prepared in accordance with international public sector accounting standards (IPSAS).

iv. The audit report will refer to:

- The SOEs
- Utilization of the Special Account
- The project accounts
- Verification of supporting documents
- Examine the consolidated project accounts

v. The external auditor shall certify the accounts and incase of any qualifications offer professional advice on efficiency and transparency of accounting procedures.

vi. Management letters issued by the External audit shall be responded to before one month of its receipt and copied to the World Bank.

vii. KUSP PCT bank accounts shall be audited by the Auditor General or External Auditors appointed for the first six-month period of each financial year to maintain the level of control required by Government and to remove any discrepancies that might delay the reimbursement process.

viii. Internal physical audit shall be performed to ensure conformity to contracts on procurement of equipment and materials.

# 3. COUNTY LEVEL OPERATIONS

## 3.1 THE PROJECT BUDGETING SYSTEM

### 3.1.1 Annual Work Planning & Budget – Programme Based Budgeting (PBB)

The Programme budgeting will be done in accordance with existing GoK procedures for county governments. The Programme funds under window 2 and 3 will be budgeted for as conditional grants from national to county governments. The design of the PforR will act as an incentive for GoK to allocate enough budget and ensure that resources are spent on achieving DLIs which will trigger subsequent funding.

There will therefore be dual budgeting approach with the funds reflected as transfers in the line ministry and as conditional grants at the county level. For the counties, the Programme funds will be captured as conditional grants and will be reflected in the Division of Revenue Act (DORA) and County Allocation of Revenue Act (CARA). As a minimum Condition (MC), counties will be required to create a vote for Municipal Boards (MB) once set up as part of the county annual budget presented to the county assembly.

Programme-specific budget codes will be configured in IFMIS for the participating counties. This will form the basis for defining the Programme activities and ensuring that sufficient funds are allocated to achieve the agreed results. The allocation of funds and the budgeting will be subject to oversight by the Commission of Revenue Allocation (CRA) and the Controller of Budget (CoB) in line with normal GoK PFM procedures.

The preparation of KUSP Annual Work plans and Budgets however provide the basis for project planning, implementation and progress monitoring. The project planning and budgetary process shall be implemented in accordance with the standard government fiscal year which begins on 1st July of each financial year as provided for by the Public Financial Management Act 2012 and the Government Financial Regulations and Procedures.

Based on standard government budget procedures, which are described and elaborated further by various Treasury circulars, Government financial regulation and procedures, the estimated cost of KUSP funded programmes and sub-program(s) expenditure shall be budgeted following calendar dates set by the MTEF Budget circular issued by the National Treasury. The indicative budget calendar dates are presented below:

**August – September**
The MTIHUD or its successor forms the Public Expenditure Review Committee (PER) and review on-going programmes, evaluate/analyze past years expenditures of its program including that of KUSP. The PER report is forwarded to the National Treasury to inform the Macro Working Group.

**October – January**
During this period, KUSP activities, targets and indicative budgets requirements are reviewed at the Sector Working Groups level. These then form part of the Sector Reports of the Macro Working Group which forms the inputs to Budget Strategy Paper for the Cabinet and the Economic Management Committee. These are subsequently approved by Cabinet and then the National Assembly by the end of January.

The National Treasury then issues circular with detailed guidelines for line ministries, counties and agencies to prepare detailed budget estimates. The detailed budget from the Ministry of Transport, Infrastructure, Housing and Urban Development or its successor therefore includes KUSP.

**February – June**
The detailed budget submissions are forwarded to the National Treasury for review and finalization of the draft budget to the National Assembly and County Assemblies by respective Treasuries. The Budgets are approved by the National Assembly and County Assemblies.

### 3.1.2 Preparation of Detailed Expenditure Budget

The KUSP detailed expenditure budgets will be prepared under the overall guidelines issued by the Treasury to Ministries and the approved KUSP Project Implementation Manual Cost Table allocations and Disbursement Plans as well as the County budgets approved by the County Assemblies.

The project funds will be factored in the national annual budget under MTIHUD and captured in IFMIS on the basis of the line ministry and the respective counties. The budget will also capture the Projects activities in their respective annual budgets as detailed in the Project Appraisal Document (PAD).

All PforR resources will be allocated to counties in the form of conditional grants (UIGs and UDGs). Conditional grants form part of the national share of government resources and will therefore appear under the budget of the SDHUD. Actual expenditures under window 2 and window 3 financed by PforR resources will depend on (a) the number of counties which qualify for allocations and (b) the results of the annual performance assessment. The conditional grants will need to appear in the County Allocation of Revenue Act (CARA) and be transferred by the National Treasury directly from the Consolidated Fund to the counties on the notification of the Annual Performance Assessment (APA) results by the SDHUD.

The joint effort and close coordination between the national and county governments is geared towards ensuring that the maximum county UIG and UDG allocations are reflected in the County Allocation of Revenue Acts and Division of Revenue Acts from 2017/18 onwards and that subsequently all program resources are reflected in the budget ceilings and annual budget estimates for SDHUD from 2017/18 onwards

Each UIG will be captured as a vote under the full vote captured as one budget line in the County budget while each of the Municipalities qualifying for the UDG will also be reflected as a separate budget line from the UIG. Each of these will subsequently be assigned a SPA to allow for transparency and accountability in the use of the funds.

The APA and grant allocation recommendations will not be finalized until near the end of the budget process. To ensure inclusion in the CARA, the SDHUD will need to communicate maximum UIG/UDG allocations determined by the initial APA by the November 30. If the initial APA is delayed, then the initial allocations proposed in the CARA and DORA should include maximum allocations. The final grant allocations will be less than or equal to Annual Appropriations and the CARA and DORA allocations – which will allow full disbursement during the FY.

In addition, UIGs and UDGs will need to be reflected in the annual budgets of counties that qualify for these allocations from the Programme. The SDHUD will thus ensure that counties are informed of their UIG/UDG allocations on a timely basis. To ensure that Program resources are fully reflected in the national and county budget frameworks, the following table provides deadlines for meeting key steps in the county budget process.

**Table 4: County Budget Process deadlines**

| Step | Deadline | Responsible |
|---|---|---|
| **County Budget Process Deadlines** | | |
| UDD Communicates indicative UIG and UDG allocations to Counties (contingent upon APA) | July 31, FY N-1 | SDHUD |
| County annual development plan submitted to CEC, incorporating UIG/UDG allocations | September 1, FY N-1 | County Treasury |
| Budget Review and Outlook Paper submitted to CEC, incorporating UIG/UDG allocations | October 30, FY N-1 | County Treasury |
| UDD communicate maximum UIG/UDG based on initial APA to Counties. | November 30, FY N-1 | SDHUD |
| County Treasury submits County Fiscal Strategy Paper to the CEC for approval | February 28, FY N-1 | County Treasury |
| CEC submits to the County Assembly budget estimates and other budget documents incorporating expected UIG/UDG allocations | April 30, FY N-1 | County Treasury/CEC |
| UDD communicates final UIG and UDG allocations to Counties | June 17, FY N-1 | SDHUD |
| County assembly approves county appropriations bill incorporating final UIG and UDG allocations. | June 30, FY N-1 | County Assembly |

The approved KUSP Programme Operations Manual (POM) has the disbursement plan, cost categories for Window 2 and 3 and the overall allocations for each cost category for each activity. The annual budgetary allocations for each sub-component are to be based on the POM allocations except where prior approvals for cost category variation and allocations including through official World Bank / Development partner Aide Memoire have been received. The POM disbursement table is one key tool used by the World Bank and other Development partners to assess KUSP performance on Programme Implementation. Budgeting outside of the POM categories and cost tables will not be approved

## 3.2 KUSP - PROJECT FUNDS FLOW

The success of each project's implementation depends greatly on how financial resources flow within the project. The funds flow process for KUSP therefore facilitates the flow of this critical resource for efficient and effective achievement of the programme objective.

### 3.2.1 Sources of Funds

The source of funds is The World Bank (IDA) financing amounting to US$ 300 Million. The majority of the Operation's funds will be used to finance sub-national activities (windows 2 and 3). The Government's contribution will consist of approximately US$20 million, in the form of SDHUD current expenditure (payroll, operating costs, etc.) for urban development.

IDA funds will be allocated to the three windows, as shown in the table below.

**Table 5: IDA funds allocation**

| Window/level | Expenditure Areas | Amount (US$ millions) | Amount (%) |
|---|---|---|---|
| Window 1: National government | · Policy development and urban management.<br>· Capacity development for urban institutions.<br>· Program coordination of UIGs and UDGs. | 30.0 | 10.0% |
| Window 2: County governments | · Sub-national urban development and planning.<br>· Institutional and capacity development.<br>· Technical and institutional support for urban infrastructure and service delivery. | 22.5 | 7.5% |
| Window 3: Urban boards (county government agencies) | · Infrastructure and service delivery. | 247.5 | 82.5% |
| | Total | 300.0 | 100.0% |

### 3.2.2 Responsibility of the County Governments

According to the PAD the County Governments are expected to play a pivotal role in the implementation of the program. The County Governments are expected to;

- establishing urban institutions for effective urban management;
- capacity building and technical backstopping of Municipal Boards/Administrations;
- supporting and guiding Municipal Boards/Administrations in preparing budgets and forwarding them for approval by the County Assembly;
- managing the flow of Program funds at this level, and consolidating the fiscal reporting from Municipal Boards for onward submission to the National Treasury; and
- generally exercising oversight on the performance of the Municipal Boards.

To facilitate within-county coordination and coordination with the national government, a County Program Coordination Team (CPCT) will be formed in the county government, under the overall responsibility of the county executive committee (CEC) member responsible for urban development, with the Director of Urban Development (or equivalent) as a coordinator and a chief officer providing an oversight.

Other members of the CPCT include: a Municipal Manager (once appointed), an engineer, an accountant, county environment and social officers, and an economist for monitoring and evaluation.

Municipal Boards and Municipal Managers are new entities to be established by County Governments and will implement the Program's window 3 activities. Municipal Boards and Administrations will be responsible for investment planning, budgeting and implementation, and for day-to-day implementation of activities funded under the Program. They will also be responsible for compliance of operations with all financial management.

### 3.2.3 Flow of Fund Arrangements

Window 2 and 3 are PforR funds and will be managed by counties on the basis of existing country PFM systems. In this phase there will be two levels of fund flows as listed below;

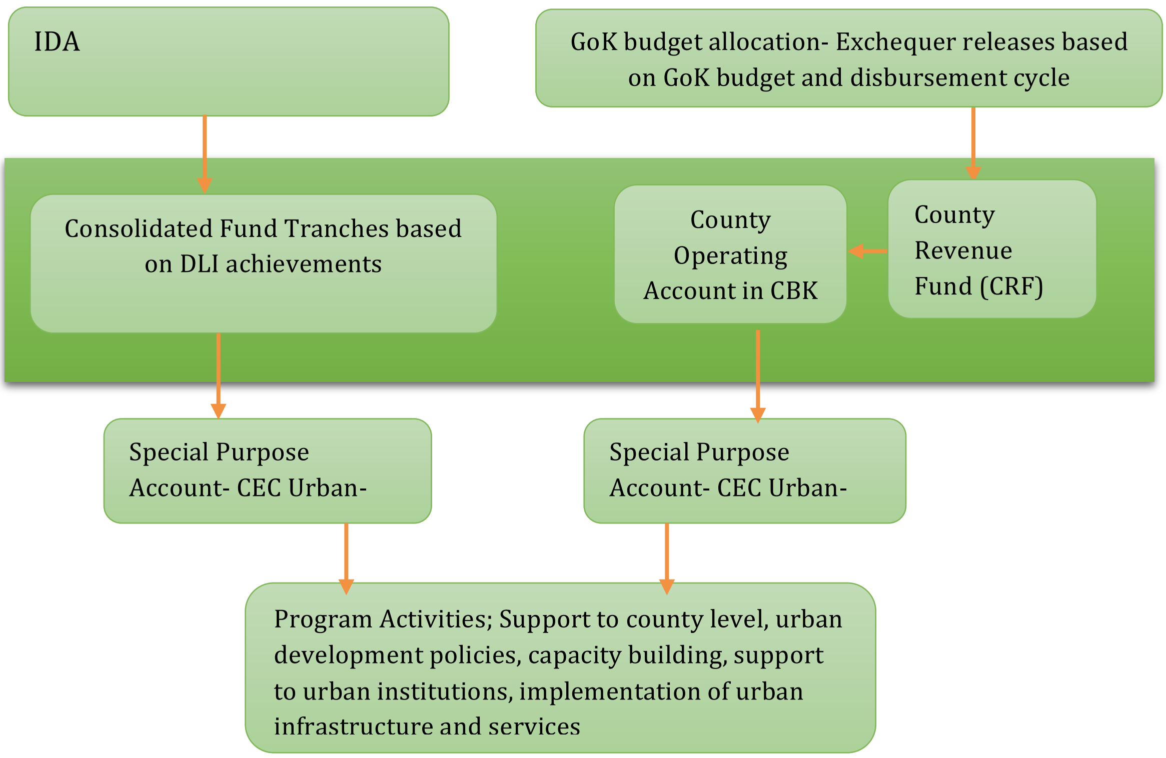
1. Country-level funds flow from the National Treasury to counties for financing achievement of results as well as urban grants; and
2. Up-stream funds flows from the World Bank to the National Treasury on achievement of DLIs.

The funds will flow directly from the exchequer in the National Treasury to the County Revenue Fund (CRF), to the County Operating Account (COA) in the County Treasury. The funds will eventually flow to the Special Purpose Account- Urban opened by each county for these conditional grants in line with the PFM Act and Treasury Policies.

For all Programme activities under window 2 and 3, the funds will be spent by the county department responsible for implementation of various programme activities in accordance with their approved annual plans and budgets.

The fund flow can be summarized below:

**Figure 2:** ***The KUSP Fund Flow Arrangement***




While the National Treasury is responsible for the timely disbursement of the funds to the counties, the County Governments must manage the flow of Program funds at the county level.

### 3.2.4 Disbursement of funds

The disbursements under Window 2 and 3 are subject to PforR procedures. They are scalable and will be based on the achievement of annual DLI targets. They will be made in a single tranche every year. DLIs 1, 2 and 3 are all scalable and amounts to be disbursed are determined on the basis of APA results and the subsequent estimate of annual UIG and UDG allocations for counties and their urban institutions respectively..

DLIs will be verified by technical committee at the end of June each year. The steering committee and the Bank will endorse the results by July 31 of each year. Disbursements for DLIs 1, 2 and 3 will be made before August 15 of each year and will need to have been fully taken into account in national government budget framework, in CARA, DORA and in county government budgets

### 3.2.5 Authorized Representatives

Each of the counties will be required to open a Special Purpose Account (SPA) in which the UIG funds will be received. The signatories of these accounts will be the County Treasurer and CEC Urban ministry or their respective alternatives.

The disbursement of the UIG funds will be triggered by the achievement of the MCs by each of the 59 qualifying municipalities. Each of the County Governments will be required to open a SPA for each of the municipalities qualifying for the UDG. The signatories in each case will be the Chief Officers in Finance and Urban Ministries or their designates, and the appointed Municipal Manager of the qualifying municipality.

Each county will therefore have one UIG SPA and varying number of UDG SPA accounts.

## 3.3 ACCOUNTING SYSTEM

The county treasuries will be responsible for the fiduciary duties of Window 2 and 3. The MTIHUD and each of the participating counties will designated suitably qualified Program Accountant and Budget Finance Officer to be responsible for the FM activities.

### 3.3.1 Accounting Standards and the Chart of Accounts

The standard accounting practice and the chart of accounts form the structure of recording, classifying and reporting receipts and expenditures to be used by KUSP at County level. The accounting system and the chart of accounts of the KUSP are based on Government financial and accounting procedures. As far as possible all financial statements will be produced and reported as provided for by Government of Kenya Financial Regulations and Procedures and International Public Sector Accounting Standards (IPSAS). All accounting and budgeting transactions for KUSP must be coded in accordance with the chart of accounts to ensure that information is consistently and accurately recorded.

The format of the chart of accounts is based on Government of Kenya, Standard Chart of Accounts User Manual 2012. The Standard Chart of Account is required to be used by all general Government agencies including development projects such as KUSP. It covers the entire fiscal cycle and includes budgeting, revenue collections, recurrent and development expenditures.

The nature of KUSP programme activities, size, approaches (Investment framework) and the transitional nature of the SDHUD - PCT imply that there is need to build the financial management and procurement capacity of the Counties and Municipal Boards executing officers. Therefore, related capacity building activities and budgets will be included in the national PCT work plans and budgets prior to presentation for approval. The National PCT will therefore focus on strengthening existing capacity of the CPCT to support financial management of KUSP like projects.

### 3.3.2 Accounting System

Following the implementation of the Public Financial Management Reform program (PFMR) in the National Treasury, IFMIS has implemented the General Ledger, Purchasing Order and Accounts Payable modules in all Ministries including the counties.

The deployment of IFMIS is ongoing and some modules of the system have not been fully developed, a separate project financial and accounting system to generate the necessary reports and to record the financial transactions for KUSP will therefore be implemented.

This KUSP financial management system should be able to record and generate financial management information and reports to GoK and the World Bank. It could be based on off-the-shelf accounting package customized for KUSP or spreadsheet based accounting system for financial reporting as deemed suitable by PCT. In principle, the PCT shall design and operate the financial management and accounting information system as part of the overall project management information system for use by the counties. The system shall be used to guide PCTs in fulfilling their financial management obligations. This parallel method approach is not new within the GoK and has been used successfully by other projects including World Bank Funded projects such as the Public Financial Management Reform Program in Treasury and Mount Kenya East Pilot Project by International Fund for Agricultural Development (IFAD) among others.

However, all receipts and payment vouchers processed by KUSP County officer will be posted to the IFMIS against the respective budget lines to provide consistency and completeness in recording financial information. The new system provides improved financial management capacity in the Ministry not only to record financial transactions but also to report budget execution which is critical in cash based systems. The IFMIS uses the Standard Chart of Accounts and the Standard Codes. The Counties will use the Standard Code and Chart of Accounts for its budgeting and financial reporting to ensure uniformity.

In accounting for the KUSP expenditures, the Counties will use Government of Kenya standard receipt and expenditure accounts classification codes. This accounting system is termed as Cash basis of accounting as opposed to normal accrual basis of accounting. KUSP will prepare periodic financial reports to GoK and World Bank on IPSAS (cash basis of accounting). The GoK accounting codes will therefore be used as the account numbers and form the chart of accounts for the KUSP. Detailed classifications to be used in the accounting system for KUSP are shown in ***Annex 1 – Chart of Accounts***.

### 3.3.3 Accounting Transactions and Records

Processing of financial transactions and maintenance of accounting records will be the responsibility of the Counties' PCT which bears the fiduciary responsibility of the project at the county level. The PCT will delegate to the County, the financial management responsibility within approved procedures as stipulated in this manual. In this regard, the County shall operate a project bank account denominated in Kenya Shillings for each of the UIG and the UDG qualified for.

The accounting system and the chart of accounts will be used by the Counties' PCT to maintain accurate and up-to-date records of all project financial transactions.

The County PCT will maintain accurate records to provide accountability over project funds received from the PCT. In addition, each County will maintain accurate and up-to-date inventory of assets/goods procured or received from KUSP funding including the condition of those assets/goods, location and responsible officer. All project related records at CPCTs and Municipal levels shall be made available for inspection by PCT, World Bank Supervision Missions, Ministry Internal Auditors and External Auditors or any other professional accounting or auditing consultancy service procured for the e purposes of supporting PCT fiduciary responsibility.

In effect, CPCTs will therefore be responsible for the following main accounting and financial functions as applicable:

1. Recording and reporting all the financial transactions of KUSP at the county level;
2. Receiving financial resources and recording the funds;
3. Preparing Annual Work plans and Budgets based on PCT/ plans and budgets and adhere to GoK budgetary cycle;
4. Preparing cash flow forecasts;
5. Effecting disbursements;
6. Exercising budgetary control;
7. Coding accounting transactions and data management;
8. Setting up the Internal controls and internal checks;
9. Preparing financial reports and statements; and
10. Expediting External Audits.

In performing the duties and functions necessary to fulfill its accounting and financial mandate, KUSP PCT will be responsible for checking the documents received from the CPCTs for:

- Accuracy;
- Completeness;
- Consistency;
- Timeliness; and
- Query any irregularities within 14 days of the documents' receipt.

### 3.3.4 Staffing

Each county will designate a qualified Project Accountant and Budget Finance Officer to the County Program Coordination Teams to support the county programme activities. The CPCT is responsible for meeting responsibilities and obligations as stipulated in KUSP.

The SDHUD and participating counties will put in place program for annual capacity building training of staff at national and county level as well as the internal and external auditors supporting the Program. The training program will be financed out of Program and Project funds

### 3.3.5 Payment Processing

Payment processing under the project at CPCT will follow the general guidelines and procedures laid down in the GoK Financial Regulations and Procedures. The CPCT accountant will raise a payment voucher when any of the following documents have been received:

- An original invoice from the supplier attached to an LPO and copies of quotations (where necessary) and evidence of receipt of the item purchased (supplier's delivery note and stores counter receipt voucher S.13) or satisfactory performance of services. He/She shall confirm that the prices and invoice calculations are correct and that the cost is a genuine obligation on the project.
- An original invoice from a travel agent attached to a properly approved travel authorization.
- In case of consultancy, the first installment will be based on the signed contract while subsequent payments will be based on an invoice reflecting payments already made and the remaining balance. This should be accompanied by a progress or final report of the assignment and a certificate of satisfactory performance.

The payment voucher will be approved first by the County's Project Coordinator or his designate as the AIE holder before being subjected to voucher examination and vote book entry at the PCT. The PCT staff should have full rights to handle all project related transaction and reporting. Subsequently, the payment vouchers will be authorized by the Project Accountant or his designate before payment at the ministry's cash office. All payments exceeding Kshs.5,000/= shall be made by cheque or electronic funds transfer (EFT) while payments below this amount will be made in cash. The internal audit unit of respective counties shall conduct post audit of payment vouchers sampled in line with the project's risk profile.

### 3.3.6 Expenditure Data Capture and Recording

The payment vouchers will be recorded in the project cash book maintained by the CPCT. The project expenditure will then be posted and reflected in the county and subsequently the Ministry's records (appropriation accounts) and ledgers using the GoK accounting systems.

In order to facilitate the External and Internal Audit of the project expenditure and to satisfy the requirement/guidelines of Treasury Circular No. 18/98 dated 22nd February, 1999 on processing of payment vouchers at the Ministry Headquarters, the original payment vouchers and original documents will be retained by the CPCT as provided for by the Treasury Circular on Donor funded projects.

The responsibility of securing the accounting information (payment and receipt vouchers) shall be the CPCT as provided for by the current Government Financial Regulations and Procedures. A register of the original payment voucher and the their supporting/attachments will be maintained by CPCT as part of the project financial documents in line with GoK and World Bank Standard Conditions on retention of

Financial Documents. The permanent payment voucher register will record the number of payment vouchers and their transfer from one location to the other.

The CPCT will ensure safe and secure custody of the payment vouchers and all other accountable documents as appropriate.

### 3.3.7 KUSP Expenditure Data

The CPCT will record the financial transactions in books of account to be maintained at its offices. The Data Section/IFMIS at the MHTUD headquarters shall ensure that expenditures in respect of each activity in windows 2 and 3 of KUSP expenditures are separately keyed-in to capture expenditure data in the MTIHUD ledgers based on the account codes provided elsewhere in this Manual.

All CPCTs will use the same system as the National PCT when recording the transaction to ensure there is consistency in reporting.

### 3.3.8 Voucher Processing

The processing of vouchers in the project will be done in accordance with standard processing routines laid by this Manual. The objective of these procedures/regulations is to document and enforce strict control over the flow of vouchers. The vouchers shall be used as the original record to the accounting system.

The payments will be effected by completing appropriated forms F.O 20 or FO 22 (GoK Payment Vouchers) which have been designed for exclusive use in respect of expenditure on voted provisions. Different officers who are involved in their processing shall complete sections in the vouchers to signify action taken in the process. This process forms part of the internal control and internal check on expenditure of KUSP funds.

### 3.3.9 Voucher Movement Registers

Every movement of payment vouchers with the original supporting documentation shall be documented in registers and signed for by receiving persons/sections and evidence of each action taken is recorded on the face of the payment voucher.

The number of registers to be maintained for processing vouchers will depend on the organizational set up in each paying station. It is expected that there would be minimal difference as all stations shall be using the same Government Financial Regulations and Procedures or similar.

A minimum of three such registers must be in use to record movement of vouchers in each project paying stations of KUSP Executing Agencies as follows:

- One from voucher preparation point to be maintained at source at CPCT;
- One from voucher preparation to Authorizing section at each payment station; and
- One from vote book/expenditure control section to Cash office for payment.

The detailed movement registers to be used in each accounting section will depend on the systems in place at the counties.

### 3.3.10 Voucher Preparation

Payments have to be processed immediately in respect of demands for settlement of goods and services which have been supplied/rendered to the KUSP project. The payment shall be effected against:

- Valid regulations;
- Scales;
- Tariffs;
- Contracts or agreements;
- Purchase orders;
- Suppliers invoices and certificate of origin;
- Evidence of receipt of goods or services;
- Contractors' and consultants' invoice or certificates of completion;
- Performance security documents such as bank guarantees in the case of advance payment if required under the terms of the contract;
- Procurement documents (bid document, invitation to bid, evaluation reports; and
- Letters of credit.

The above are to be supported by LPOs, LSOs, Invoices, Receipts, and Receipted bills duly confirmed by the receiving officers of the CPCT. The payment vouchers will be prepared in at least triplicate copies for distribution as follows:

- The original to be retained to support the cash book entry and for posting of the transaction into the Urban department ledger account;
- One copy to accompany the remittance to the supplier/payee as the case may be; and
- Payment vouchers to indicate the supporting documents attached to it ;
- At the county level, authorization will be done by the head of the respective PCT.

### 3.3.11 Voucher Examination

The KUSP vouchers will be subjected to scrutiny by an Examiner within the finance unit of the CPCT to ascertain the following:

- That the expenditure is in conformity with the authority governing that payment. i.e. Contracts and Certificates, Government Financial Regulations and Procedures, Procurement procedures, Project Financing Agreement and Financial Management Manual.
- That there exists already an approved work plan and budget allocation to cover that expenditure and that the allocation has not and will not be exceeded as a result of the payment.
- That the payment is supported by appropriate certificate and /or duly certified:
    1. Invoices
    2. Receipts bills

3. LPOs
4. LSOs,
5. Proof of acknowledgement of receipt of goods and services

- That the payment voucher is complete in all aspects and all payment procedures have been complied with.
- That the payment voucher is authorized for payment by the relevant authorized official.

The examining officer or section head will complete the appropriate certificates to indicate that the vouchers have been examined and passed for payment. The voucher moves to the vote book and expenditure control section for recording.

### 3.3.12 Commitment of Expenditures (Maintenance of Vote Book)

The approved County's KUSP Annual work plan and budget forms the source document to open Expenditure/Vote Book to be used for recording commitments and expenditures. As a control feature in budgetary control, this record provides information on the total commitments and total expenditures and the balance provided for activity or cost center. Having opened the Expenditure/ vote book the Accountants must ensure that:

- Every payment voucher processed is entered in the vote book.
- After each voucher entry the actual total payment figure is amended.
- Every commitment is entered - realistic approximate values may be obtained from suppliers, stores catalogue, etc.
- After the entry of a commitment, the total commitment plus total payment is obtained from which the balance available is computed.
- When a commitment becomes an actual transaction the total payments figures are adjusted accordingly.
- Every voucher originated by CPCT has a serial number allocated to it.
- Ideally, this will comprise four digits commencing at 0001 and will be that voucher's identity.
- A permanent record of all the payment vouchers and imprest warrants in a hard bound registers has to be maintained by CPCT in addition to the movement registers.

### 3.3.13 Control of Expenditures

The County's KUSP PCT authorized officials appointed should note the following:

- There must be no divided responsibility, only the authorized officials to whom KUSP has mandated and authorized can commit or incur expenditure against KUSP funds.
- An Authorized official should regularly have his/her outstanding commitments checked and enquiries made from the suppliers. This is particularly important in the last three months of the financial year.

### 3.3.14 Expenditures/Vote Book Control

The Expenditures/Vote Book Control section will enter the payment in the vote book and complete the appropriate certificates.

The officer in-charge of the control section shall at all times ensure that allocation has not and will not be exceeded as a result of the payment. The payment vouchers which shall satisfy the requirements shall thereafter be passed to cash office where payments shall be effected.

### 3.3.15 KUSP Retention and Security of Payment Vouchers

The payment vouchers and their attachments form part of audit trail of the project expenditures. They constitute the original evidence of financial transactions and therefore are part of key information for accountability and transparency. To retain and secure these critical documents for both internal and external audit, secure filing and storage equipment will be availed e.g. fire proof cabinets etc will be provided by the project to store the payment documents.

### 3.3.16 Fixed Asset Register

A fixed assets register will be prepared and developed by the CPCT for recording all the fixed assets of the Project. The External Auditor will review and verify the assets register during the Annual Audit. An updated and consolidated Fixed Assets record reflecting all the assets of the project will be produced by the CPCT which will also ensure that project assets are safeguarded against misuse, theft or malicious damage.

In this regard, access to project assets shall be restricted to authorized persons only. Procedures will be put in place to ensure evidence of such authority such as the use of vehicle work tickets, while some assets will be put under lock and key at all times. Cash will be kept in an office safe under the custody of a responsible officer.

### 3.3.17 Tracking of Financial Data

The computerized financial management information system together with the information generated by the Government system shall be used to keep track of pertinent financial data including exceptions i.e. what has failed to happen. This data would create a tracking system on:

- Deadlines missed;
- Queries raised still outstanding;
- Documents not received;
- SOEs not received; and
- Project Accounts operations.

Information generated by the tracking system and other systems would allow the National PCT to monitor and report on the financial performance each county on a monthly basis.

### 3.3.18 Eligibility of Expenditures

The PAD outlines some of the eligible and ineligible expenditures which will be allowed in the KUSP project to guide the counties in expensing the funds as per the agreement.

In Window 2, Counties will be able to use their UIGs to finance a range of eligible expenditures, including costs related to capacity building, some incremental operating costs, hiring consultants, and the purchase of office equipment. The UIG expenditure menu of eligibility is as stipulated in table 3.2 in Section 3.5 of the POM

Window 3 will provide support to urban boards and administrations through their respective county governments for financing infrastructure investments in urban areas. Eligible investments will include waste management, drainage, connectivity infrastructure, urban economic infrastructure, and fire and disaster management. The UDG expenditure menu is as stipulated in table 4.5 in Section 4.7 of the POM.

## 3.4 KUSP - INTERNAL CONTROLS

Internal controls are processes that are designed to provide reasonable assurance to the Project Management regarding the achievement of objectives in the following areas:

- Compliance with applicable laws and regulations
- Reliability of financial reporting
- Effectiveness and efficiency of the overall Project implementation
- Safeguarding project assets, and
- Adherence to established institutional and government policies and procedures.

The financial and accounting information systems should produce complete and accurate financial statements and reports and are part of the Internal Control regime. The CPCT will implement internal control measures to address potential inherent risks, both organizational and operational risks. The Project will endeavor to enhance internal controls through:

- Properly documented procedures for approval and authorization of transactions within the project.
- Segregation of duties where one single individual may not be in-charge of initiation, authorization, execution, and recording of transactions without the active involvement of another person.
- Having effective management oversight bodies at all levels in the Project. This would include audit, finance committees and procurement committees.
- Systems of sound financial controls and internal checks including budgetary control systems and bank reconciliation.
- Internal audit (post audit) verifications and social audits of community projects by the public.

### 3.4.1 Approval and Authorization procedures and Segregation of duties

All project financial transactions at the County level shall be approved by the CEC Finance or his designate.

The Project Accountant or his designate at CPCT level will also be required to authorize all payments that have been approved by the CEC Finance.

In order to enhance transparency, no employee at CPCT level should authorize his/her own claims and all approvals and authorizations shall be made in writing. Payments at CPCT level will be initiated by the Project Accountants who will also maintain an up to date record in the cashbook. The CPCT Project Accountant will check the cashbook on a daily basis and prepare monthly bank reconciliation statements.

### 3.4.2 Project Bank Accounts and Bank Operations

### 3.4.3 Local Bank Accounts (Kshs.)

Each CPCT shall open a Special Purpose Account (SPA) as stipulated by the PFM Act and the Treasury policies.

Each of the counties will be required to open a SPA to handle the UIG funds and another account for each of the qualifying Municipalities for UDG funds. The signatories of the SPA to handle UIG funds will be the Chief Officers Finance and Urban Ministries or their designates while the signatory of the SPA for each UDG qualifying municipality will be the Chief Officer Finance and Urban Ministries or their designates and the appointed Municipal Manager.

All transactions through the project accounts shall be recorded in a cash book maintained at the CPCT. This cashbook will be checked daily by the Project Accountant or designate. The accountant will monitor the project account and keep up-to-date management information in its KUSP Financial MIS.

### 3.4.4 Bank Reconciliation

The CPCT will ensure that monthly bank reconciliation statements in respect of the Project Account are prepared to confirm the balance in the cashbook to the bank statement at the end of the month. For purposes of control, bank reconciliation statements should be prepared by someone other than the one involved in writing the cashbook. The bank reconciliation statements will be checked and approved by the Finance Officer or designate.

### 3.4.5 Accounting for Imprests and Staff Advances

#### *3.4.5.1 Imprests*

An imprest is a form of cash advance or a “float” which the Project Manager may authorize to be issued to officers in furtherance of official duties and payments cannot be conveniently made through the cash office. Imprest is issued for specific purpose, and any payments made from it must be only for the purpose specified.  Imprests are of three types:

- Temporary (safari imprests)
- Standing imprests
- Special imprests

The issuance of imprest to staff will be in conformity with Treasury circulars on Imprest and in particular Treasury circular on Control of Imprest No. 3/2010 dated May 2010.

#### *3.4.5.2 Temporary Imprests*

These are issued mainly in respect of official journeys and are intended to provide officers with funds with which they can meet traveling, accommodation and incidental expenses. Before issuing temporary imprests, it is necessary to ensure that:

- Adequate funds are available for the item of expenditure.
- The main objective of the journey cannot be achieved by other cheaper means.
- Applicants do not have outstanding imprests (that is previous imprests which they have not yet accounted for).
- Project Accountant confirms that the imprest applied for is for approved project activities.
- The County Programme Coordinator has approved the temporary imprest.
- Technical member has signified the appropriateness of the imprest to the approved activities in the work plan and budget.
- The County Program Coordinator or their designate confirms that he/she has received all back to office reports and expenditures returns on the previous imprest issued to the applicant.
- The County Program Coordinator or their designate confirms in writing that a physical examination has been conducted on purchases of stores and services
- The Accountant in-charge of the imprest has certified on the imprest warrant (form FO. 24) that the applicant does not have an outstanding imprest and confirms that imprest applied for has been recorded in the imprest register.
- The vote book (commitments) controller has certified that adequate funds are available against the relevant items of expenditure to meet the proposed expenditure.
- A holder of temporary imprest is supposed to account for or surrender the imprest within 48 hours after returning to duty station or performing the task. In the event of the imprest holder failing to account for or surrender the imprest on the due date:
- The County Programme Coordinator is required to take immediate action to recover the full amount from the salary of the defaulting officer and makes a follow up to ensure the imprest is surrendered before the expiry of 7 days.
- Where the Project Coordinator does not control the payment of the officer's salary in question, and therefore would not be able to recover, the imprest issue is directed to the CEC Finance and Urban for action.
- In order to effectively manage and control the issue of temporary imprests it is necessary for the Project Coordinator who is the overall AIE holder with the administrative support of the Project Accountant PCT to ensure that no second imprest is issued to any officer before the first imprest is surrendered or recovered in full from his salary.
- If imprest is to be recovered from any officer by installments then the Project Coordinator must personally authorize such recovery because it is no longer an imprest but unauthorized advance from KUSP funds. It is the responsibility of

the Programme Coordinator and Project Accountant to safeguard project resources entrusted to them by:

- Ensuring that imprests are accounted for immediately and appropriate expenditure documents availed by all imprest holders.
- Where imprest has been recovered from defaulting imprest holders such amounts are banked in the Project Bank Accounts.
- The County Programme Coordinator must take appropriate disciplinary action against the Officer concerned in the misuse and abuse of the imprest facility.

#### *3.4.5.3 Standing Imprest*

The standing imprest involves personal responsibility as it is issued to an officer in his own name, and not to the holder of an office. The standing imprest is intended to be in operation for a time and requires bringing the cash level of the advance continuously up to the agreed fixed level by systematic re-imbursement of expenses.

- The holder of a standing imprest must keep:
  - Cash book
  - Record of all receipts and expenses
- Balance on hand must agree with the cash balance recorded in the cash book at all times. The actual cash balance plus expenses paid (represented by payment vouchers) should equal at all times the fixed level of the imprest. At monthly accounting dates, and also when the imprest holder needs to have his funds replenished:
- Send an abstract and analysis of his cash book attach originals of the supporting payment vouchers to the accounts section
- If the accounts section is satisfied that the expenditure has actually been incurred for the intended purposes, it will:
  - Arrange for the analyzed expenditure to be posted to the various expenditure heads and items.
  - Recommend for cash to be transferred to the imprest holder so as to "top up" his fund.
- In addition, the Project Accountant will also ensure that frequent surprise spot checks are made of the imprest cash by a responsible officer as follows:
  - Account for the cash; confirm that the actual cash on hand corresponds with the balance on hand as recorded in the cash book.
  - Confirm that all movements (expenses and receipts) since the last check have been properly recorded and are properly documented.
  - Ensure that the documents justify the difference between the fixed imprest level and the actual cash balance.

#### *3.4.5.4 Disbursement from Standing Imprest*

Standing Imprest will be used for CPCT office operations only, when payment by cheque becomes inconvenient. Standing Imprest is cash of a fixed sum kept to facilitate petty office expenses.

The amount of Standing Imprest will be determined by Project Manager and Finance Manager of CPCT after assessing the volume of work and the expenditures requiring Standing Imprest. An amount sufficient to cover two weeks Standing Imprest expenditures could be the limit.

Attempts shall be made to effect expenditures by cheque. However, when payment by cheque becomes difficult it is necessary to have an amount of actual cash available for emergency use or for expenditures for which drawing cheques becomes impractical.

The County KUSP Accountant will be advanced fixed sum which should always be represented by cash or Standing Imprest vouchers.

The standing Imprest for KUSP shall be Kshs. 100,000.00 and shall be placed in the custody of the Accounts Assistant. Standing Imprests under GoK regulations are used for urgent procurement for small office items of upto Kshs 10,000/= per item. In view of complexity of KUSP and number of parallel running activities at any one time, this amount is considered reasonable.

Only amounts up to Kshs. 10,000 will be paid from Standing Imprest.

### 3.4.6 Internal Control for Standing Imprest

- The cash representing the standing imprest must be kept in an official safe.
- The Standing Imprest fund must not be mixed with other funds and should not be used for loans and advances to employees.
- Standard GoK Payment Vouchers or similar must be used.
- All paid Standing Imprest vouchers must be stamped “paid” and initialed by the Financial Manager
- The CPCT Accountant in charge must stamp all replenished Standing Imprest vouchers “Replenished”.
- Surprise cash counts should be conducted from time to time by a responsible official.

### 3.4.7 Standing Imprest Replenishment

Payments from Standing Imprest are authorized and recorded on payment vouchers. The vouchers shall be recorded in a Standing Imprest register.

Replenishment is requested when the cash available reaches about 20% of the fund. The Standing Imprest Request (Internal Memo) and report form will be passed to the Project Accountant for Replenishment. Upon receipt of the completed and totaled Standing Imprest report and request form attached to the paid Standing Imprest vouchers; the Project Accountant checks the analysis and prepares a Cheque payment voucher for the total amount of cash paid.

The replenishment is recorded as withdrawal in the cashbook and the expenses accounts are debited for each transaction. All vouchers will be stamped “replenished”.

The standing imprest shall be retired by June 30, every year and a fresh imprest issued at the beginning of a financial year.

### 3.4.8 Ineligible Expenditure

The World Bank defines ***Ineligible expenditure*** to mean amounts withdrawn from the Loan Account that has been used to finance expenditures that are not eligible for financing pursuant to the provisions of the Financing Agreement. Ineligible expenditure may arise from Questioned expenditure that are subsequently confirmed to be ineligible from financing following an often iterative follow-up process.

Questioned Expenditure– During review, the Bank may question expenditures because of (i) an alleged violation of the terms of the financing agreement; or (ii) a finding that, at the time of review or audit, the expenditure is not supported by adequate documentation. Questioned expenditure is considered to be ineligible expenditures following confirmation that the expenditure is not eligible for financing pursuant to the provisions of the financing agreement.

In determining ineligibility, the following guidelines will apply:

"*The KUSP project expenditure must comply with the Government of Kenya (GoK) Financial Regulations, Guidelines, and Treasury Circulars and where required (procurement) World Bank procedures. Breach of guidelines would render such a payment as ineligible unless acceptable justification is provided*".

### 3.4.9 Allowances in KUSP

Unless otherwise provided for in the Development Credit/Grant Agreement the following apply to KUSP on IDA credit and counterpart funds comprised in the total cost, and minimize incidences of ineligible expenditures and based on the guidance from the World Bank:

- Travel and Transport – This include local travel and air travel, receipts will be required for reimbursement and other incidental cost.
- Purchase of fuel for personal vehicles are not reimbursable.
- Salary Top to Civil/Public Servants is not Allowed in the Programme.
- Honorarium, Internal consulting by civil servants on GoK payroll and Sitting allowance not allowed for attending workshop, Programme Technical and Steering Committee meetings other committee meeting in line with OP/BP 6.00 and Consultant Guidelines of the World Bank. However, the above allowances are payable from Government funds to be budgeted for in the Project as GoK contribution.
- Internal consulting of public and civil servants currently on the government payrolls is not allowed as per OP/BP 6.00 and Consultant Guidelines of the World Bank. This could amount to double payments to government employees. The government should not be paying consulting fees to staff on its payroll. A government employee may take a leave of absence (without pay) to work in another sector and be paid consulting fees by the government/project. The General conditions for hiring Government officials and civil servants under consulting contracts in Bank financed projects are set forth in para. 1.11(d) of the Consultant Guidelines. The Government officials and civil servants cannot be hired under any circumstances by the agency for which they previously worked, or if their employment would create a conflict of interest. When hired as individual consultants, they would have to be on leave without pay for

the expected duration of their consultant contract before signing it. When members of a team of a consulting firm, they would have to be on leave without pay at the time the consulting firm submits its proposal.

- Sitting allowances, honorarium, etc. to consultants financed under a project (for attending workshops, Project Steering Committee meetings, other committee meetings, etc.) is not allowed as per OP/BP 6.00 and Consultant Guidelines of the World Bank.

Consultants are contracted and paid reasonable fees to render services to the project. "Rate payable to individual Resources Persons to support CPCT convened workshops/events to provide short term professional services based on TORs not limited to moderation, conducting or facilitating "training workshops" where external (none-CPCT) expertise is required will be pegged at US$ 500 - 700 per day for a maximum of 10 days.

### 3.4.10 Per Diem

The rates for per diem for contracted consultant would be negotiated and reflected in the contracts and will be within the governing rates i.e. a rate agreed between the GoK and the Bank and other Development Partners or approved by the Bank or Development partner prior to the contract signing. This rate should not be higher than equivalent UNDP rate. The UNDP official rates will apply in exceptional unforeseen circumstances at the time of the consultant contract approval and signing. Among these circumstances may include international travel for official work.

### 3.4.11 KUSP Operational Costs

The operational costs for Project as per the Financing agreement are defined as " the **reasonable incremental** expenses as defined in the relevant (KUSP) Financing Agreements and incurred as per the respective County Annual Work Plan and Budget. It consists expenditure for vehicle operation and maintenance, equipment maintenance, communication and insurance costs, office administration costs, bank charges, advertising expenses, travel and per diem, administrative support staff salaries (excluding the salaries of the GoK civil or public servants). These therefore include all the **recurrent** costs that are budgeted for as operational.

The costs also include and are not limited to: Administrative/ Support staff salaries, Office services: cleaning, Postal service courier, security; Motor vehicles maintenance & Fuel, Insurance for equipment and Motor vehicles, office assets (fire & burglary), staff cover, Media/Advertisements, Per diem: approved rates for official travel out of Nairobi (local & international), Electricity and water, Communication , phone, internet bills, Office tea/coffee/water, All Stationery items, Travelling cost including Taxi costs.

Where Per diem and travel are incurred by the non-CPCT implementing officers or project beneficiaries (i.e. those recognized in the approved implementation approach/arrangement for the sub-component) in relation to carrying out approved activities that result in key KUSP deliverables, these do not qualify as operational costs.

### 3.4.12 DLI Disbursements

As discussed in the earlier sections, disbursements in Window 2 and 3 are dependent on Annual Performance Assessments (APAs) results. The APAs will be carried out by an independent consultant contracted by UDD through a transparent procurement process. The process will begin in August each year and end in May of the following year

The APA results will determine UIG and UDG allocations for all eligible counties and urban areas and will be made available on a timely basis. The Program Technical Committee (PTC) will be involved in the review of any progress reports in accounting and financial Management and provide guidance on implementation of the policies laid down.

### 3.4.13 Internal Audit function

To enhance fiduciary oversight, the Program will support counties in setting up functioning audit committees as per the PFM requirements. The audit committees would follow up on any audit queries and ensure the implementation of the audit recommendations.

In addition, the county internal audit units will;

- Include the audit of the Programme activities as part of their annual work plans
- Establish risk registers and report on implementation of recommended risk mitigation measures.
- Ensure that the Internal audit team has the right capacity and skillset to carry out the internal audit function; and
- Ensure that the IAD is adequately staffed to execute the function.

The Programme funds will be utilized to enhance the capacity of internal audit function at the county level.

## 3.5 FINANCIAL REPORTING

KUSP financial reporting will be as stipulated by the International Public Sector Accounting Standards and Treasury Circular No MF/AG. 3/088 Vol. 5/ (85) dated 1st September, 2008 on Financial Statements of Accounts for Development Partners Funded Projects. The counties will not be required to prepare any IFRs.

### 3.5.1 Annual financial statements

The CPCT will be required to prepare an Income and expenditure statement on the basis of which the APA will be carried out to assess the performance on the DLIs. These reports will be given to the National PCT for consolidation.

KUSP PCT will prepare and submit to the World Bank annual Program-specific financial statements. Window 1 activities will be captured in separate financial statements. Activities under windows 2 and 3 will disaggregate funds disbursed to each participating county under the various categories, in the financial year under review.

The format of the financial statements will be in line with the IPSAS format used for Bank projects. The Program financial reporting arrangements will be aligned to existing GoK arrangements.

## 3.6 AUDIT REPORTS

### 3.6.1 Internal Audit of KUSP

The internal audit functions in each of the counties will ensure risk-based fiduciary review of project activities at the PCTs. As a result, the quarterly internal audit reports will be submitted by the PCTs to the World Bank.

### 3.6.2 Statutory Annual Audits

To satisfy the legal requirement on government funds and to maintain a level of control on the expenditures necessary to remove any discrepancies that might delay disbursements there is need to conduct statutory Annual Audits on each of the counties as provided for by the Public Financial Management Act2 012 and Public Audit Act 2003. These procedures are in addition to internal audit function performed to project transaction at the CPCT level. The appointment of the External auditor is a condition of Loan Agreement.

The audit of the project account shall be performed as follows:

i. The KENAO shall perform the annual project audit in accordance with the International Standards of Auditing (ISAs) and issue the audit report before expiry of six months after the end of the financial year. The KENAO audit shall cover the CPCT including verification of outputs through field inspection.
ii. Project specific financial statements including SPA with appropriate notes and disclosures and Management letter shall be submitted at the same time - six months after the end of each fiscal/financial year.
iii. The audit report shall be in the Long Form based on the financial statements prepared in accordance with international public sector accounting standards (IPSAS).
iv. The audit report will refer to:
    - The SOEs
    - Utilization of the Special Account
    - The project accounts
    - Verification of supporting documents
    - Examine the consolidated project accounts
v. The external auditor shall certify the accounts and incase of any qualifications offer professional advice on efficiency and transparency of accounting procedures.
vi. Management letters issued by the External audit shall be responded to before one month of its receipt and copied to the World Bank.
vii. KUSP PCT bank accounts shall be audited by the Auditor General or External Auditors appointed for the first six-month period of each financial year to maintain the level of control required by Government and to remove any discrepancies that might delay the reimbursement process.
viii. Internal physical audit shall be performed to ensure conformity to contracts on procurement of equipment and materials.

# 4. SUMMARY PROCUREMENT PROCEDURES

All services financed from the World Bank Loan would be procured following Government regulations and in accordance with World Bank guidelines. Government tender boards would be responsible for awarding tenders at the Project and Executing Agency levels as applicable at both the national and county levels.

The procurement process for PCT shall be as provided for by the KUSP Procurement Manual. Proper records shall be kept by the PCTs for Audit review.

# ANNEXES

## Annex 1: KUSP Chart of Accounts

i. Class of Account

This is the main division of GoK accounts and budget estimates code designating what kind of data is contained in the accounts within each class. The following codes represent the class of account in the RGAS coding structure:

0 - Recurrent Expenditure

1 - Development Expenditure

2 - Recurrent Revenue

3 - Development Revenue

4 - Funds, Schemes, Deposits and Sundries

5 - Provisioning Recurrent Votes

6 - Provisioning Development Vote

7 - Proof Development Vote

8 - Proof and Control

The Class of Account for the KUSP project is Class 1 Development Expenditure and Class 3 Development revenue.

ii. Vote

These are the main division of programmes (activities) between Ministries on which parliament's voting procedure is based. Vote codes do not form part of the account code but is used in the budgetary system. The vote codes are used for budgets and the printed estimates.

iii. Sub-Vote

These correspond with a major objective or a set of objectives or a set of related objectives within a vote, or it may correspond to/with a major responsibility of the ministry concerned. The sub votes are not part of the account number of KUSP but are used as a means of grouping the heads in the outputs of the system.

iv. Head Code

A head shall consist of the activities of an organizational unit or a group of similar units contributing to the accomplishment of objectives of a sub vote. The Head will be used as the second group of the account number for KUSP.

v. Items Codes

The item codes describe the expenditure type.

vi. Sub-head

The sub head can be used for as an organizational unit in the project. However, in the project the sub head will be used for geographical analyses. Sub-head will also be used as third group of the account number in account codes for the project accounting system.

vii. Item Codes

The items specify the necessary types of expenditures and revenue relevant to the activities of a head e.g. travelling and accommodations, telephone expenses etc under the Government Financial Statistics (GFS) In KUSP the items codes will be used to classify the relevant expenditure item and assist in the in the preparation of the financial statements and reports. Item are shared in both classes of accounts namely Recurrent and Development Expenditures.

Standard Items codes in GoK accounting: The relevant Items codes for the KUSP are as:

**10 – 99 Financing/Income**

01 - Loan Funds from World Bank

02 - Grant funds from other Development Partners

03 - Government of Kenya Grants

**100 – 109 Transport Operating and Maintenance**

100 – Operating and Maintenance Expenses of Vehicles

103 – Fuel, Oils and Lubricants

105 – Spares

106 – Batteries

107 – Repairs

108 – Minor and Accident Vehicle Repairs

**110 – 119 Traveling and Accommodation Expenses**

110 – Traveling and Accommodation Expenses

112 – External Travel and Accommodation

114 – Air Travel Fares and Insurance

115 – Taxis/ Bus Fares

**120 – 129 Postal and Telecommunication Expenses**

120 – Postal and Telegrams

121 – Telephones and Email and Internets

123 – Box Rentals

**130- 139 Official Entertainment**

130 – Official Entertainment

133 – National celebrations

131 – Cultural visits

**140 – 149 Electricity, Water and Conservancy**

140 – Electricity, water and conservancy

141 – Electricity

142 – Water

The codes specified above forms the accounting structure to be used by KUSP. The accounting structure will consist of 11 digits as in the GoK and is grouped as follows. The accounts codes on the project shall be used at the Lead Agency Level for budget purposes and AIE stages.

The accounting code is designed as follows:

C-HHH-SSS-III

| | |
|---|---|
| C | = Class of account |
| HHH | = Head |
| SSS | = Sub – head |
| III | = Item |
| V | = Check digit |

# List of Abbreviations and Acronyms

| ABBREVIATION | DETAIL |
|---|---|
| AIA | Appropriations in Aid |
| AIE | Authority to Incur Expenditure |
| APA | Annual Performance Assessments |
| CARA | County Allocation of Revenue Act |
| CBK | Central Bank of Kenya |
| CEC | County Executive Chief |
| CoB | Controller of Budget |
| CPCT | County Program Coordination Teams |
| CRA | Commission of Revenue Allocation |
| DA | Designated Account |
| DLI | Disbursement Linked Indicators |
| DORA | Division of Revenue Act |
| ERD | External Resources Department |
| FM | Financial Management |
| FMM | Financial Management Manual |
| FY | Financial Year |
| GoK | Government of Kenya |
| HAU | Head of accounting unit |
| IDA | Investment Development Association |
| IFAD | International Fund for Agricultural Development |
| IFMIS | Integrated Financial Management Information system |
| IFR | Interim Financial Reports |
| IGFR | Intergovernmental Fiscal Relations |
| IPF | Investment Project Financing |
| IPSAS | International Public Sector Accounting Standards |
| ISA | International Standards of Auditing |
| JE | Journal Entry |
| KENUP | Kenya Urban Program |
| KES | Kenyan Shilling |
| KSH | Kenyan Shilling |
| KUSP | Kenya Urban Support Program |
| LPO | Local Purchase Order |
| MB | Municipal Boards |
| MC | Minimum Condition |
| MDA | Ministries, Departments and Agencies |
| MTIHUD | Ministry of Transport, Infrastructure, Housing and Urban Development |
| NPCT | National Program Coordination Team |
| NTC | National Technical Committee |
| NSC | National Steering Committee |
| Operation | Both IPF and PforR |
| PA | Programme Account |

| | |
|---|---|
| PAC | Principal Accounts Controller |
| PAD | Programme Appraisal Document |
| PBB | Programme Based Budget |
| PCT | Programme Co-ordination Team |
| PER | Public Expenditure Review Committee |
| PFM | Public Finance Management |
| PFMR | Public Financial Management Reform |
| PforR | Programme for Results |
| PMG | Paymaster General |
| POM | Programme Operations Manual |
| Programme | Performance for Results (P4R) |
| Project | Investment Project Financing (IPF) |
| SDHUD | State Department of Housing and Urban Development |
| SOE | Statement of Expenditure |
| UDD | Urban Development Department |
| UDG | Urban Development Grant |
| UIG | Urban Investment Grant |
| USD | United States Dollar |
| WB | World Bank |
| Window 1 | National Level Support |
| Window 2 | County Level Support |
| Window 3 | Urban and Municipal Board Level Support |