MINISTRY OF ENERGY

REPORT

OF THE

TECHNICAL AND FINANCIAL AUDIT COMMITTEE

FOR

NATIONAL OIL CORPORATION OF KENYA [NOCK]

30TH SEPTEMBER, 2003

ACKNOWLEDGEMENT

Having identified a need to examine in detail the activities of Kenya Pipeline Company (KPC) and National Oil Corporation of Kenya, (NOCK), the Minister for Energy appointed a Committee, through a communication Ref ME/CONF/1/1/7 VOL. XI dated 10th March, 2003 to carry out a Technical and Financial Audit of the two Corporations.

On behalf of myself and that of the entire committee I sincerely thank the Minister, Hon. Ochilo Ayacko, for having appointed us to carry out this onerous task and for his support throughout the entire period of the exercise.

I further wish to thank the Permanent Secretary, Mr. Patrick Nyoike, for his guidance and personal involvement throughout the exercise. In particular, I wish to express my sincere gratitude to him for providing good support staff and other facilities that the committee needed.

I wish also to thank the Permanent Secretary, Ministry of Public Works, Roads and Housing for having availed two additional Quantity Surveyors to assist the Committee.

Finally, I would like to express my appreciation to those members of staff of both KPC and NOCK, who co-operated with the committee and made the task less onerous.

HON. DARIUS M. MBELA, EGH
CHAIRMAN

LETTER OF TRANSMITTAL

The Ministry of Energy carried out a quick review of projects undertaken by Kenya Pipeline Company and National Oil Corporation. The results, coupled with presentations by interested parties, revealed that irregularities in following procedures were common. Further, instead of making profit as expected, the organizations were making losses and their financial positions were deteriorating.

The Ministry therefore established a Committee to carry out a Technical and Financial Audit on the two corporations. The Committee was supposed to examine all projects undertaken by the two corporations for the past seven years and establish whether there were malpractices. It had the following Terms of Reference.

TERMS OF REFERENCE

1. Review contract award modalities for consistency with overall Government procurement guidelines and with the company's procurements guidelines and establish whether procurements were done in accordance with the laid down regulations and procedures.

2. For each contract awarded establish whether it was completed on time and as per the contract amount and; if not establish any variations made leading to over expenditure and whether such variations were justifiable, cost effective and regularized.

3. Review any payments made as regards their consistency with procurement guidelines and work done or services rendered.

4. Review the relevance to the core business of all contracts awarded and any in house procurements made.

5. Review any financial irregularities and impropriety.

6. The Committee in the course of its work should regularly report to the Ministry any cases of impropriety requiring either prosecution or disciplinary action or both; and

7. Prepare a comprehensive report on findings and recommendations on actions to be taken to ensure efficiency in resources allocations.

8. Review the effectiveness of Boards and management performance and recommend measures to ensure accountability.

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CHAPTER ONE (1)

THE EXECUTIVE SUMMARY

AND

AN OVERVIEW

1.0 EXECUTIVE SUMMARY

National Oil Corporation of Kenya (NOCK), was established under the Companies Act –CAP 486 in 1981 to act as a strategic arm of Kenya Government on procurement of crude oil. Later, the responsibility of coordinating petroleum oil exploration in the country, was delegated to the corporation.

During the period under review 1995 to March, 2003, the Corporation undertook four major investment projects related to its plan to start processing crude and retailing petroleum products in Kenya, in competition with other oil companies such as Shell/BP; Esso, Kobil/Kenol, Total, Caltex and Agip. The investment activities were:

i. Purchasing and/or leasing of plots for construction of retail outlets;
ii. Construction of six retail outlets and
iii. Initiation of petroleum product retailing including recruitment of service station dealers.
iv. Oil exploration

These activities involved billions of shillings, all of which was taxpayer's money.

In most cases, the management of the Corporation completely flouted the provisions of the State Corporation Act, viz:

i. There was no properly constituted Board of Directors from initiation to 1995 and then 1999 to 2000.

ii. The Corporation did not adhere to the procurement procedures in purchasing and/or leasing of plots for construction of retail outlets. The total expenditure on this item was **Kshs.70,750,000.**

iii. Although the Corporation awarded contracts for construction of retail outlets (service stations) through competitive tendering, there was an over expenditure of **Kshs.167,668,332.00 (over**

100% of approved expenditure) without the authority of the Board.

iv. The Corporation hired consulting firms without following the laid down procedure. These consulting firms that designed and supervised construction of service station overcharged NOCK of Kshs.29,591,465.00.

v. When the Corporation started retailing of petroleum products, it had no credit policy, which resulted in lending of products recklessly. The Corporation contracted service station dealers without proper screening and without legal protection of the company assets. The result is that it is owed **Kshs.345.0 million,** most of which may never be recovered.

vi. The Corporation did not have an approved establishment, personnel policies and codified personnel manual such that, the hiring of employees was random and favoured one ethnic group. The administration of benefits for management staff had no clear policy guidance and in most cases the benefits were not approved by Government.

vii. In the year 2001, the Corporation retrenched 43 employees without following the requirements of Government's laid down procedures leading to litigation by the dissatisfied retrenched staff. The retrenched staff were immediately replaced by relatives of top managers.

viii. The Company accounts remain in a draft form and have not been approved by the Board of Directors for the last four financial years.

The Committee believes some of the senior employees were beneficiaries of the irregular and inflated payments and recommends surcharge of the officials who were in charge of the company over the years when the procurement procedures were violated.

The Committee recommends that NOCK should remain a strategic parastatal in petroleum industry and that the Government undertakes surgical review and, restructure to ensure first and foremost that proper and qualified personnel take charge. There is need to inject additional finance estimated at **Kshs.750,000,000** into this Corporation to refinance its operations to enable it carry out its mandate.

NOCK is in a vital sector of the Kenyan economy and has a strategic role to play. In order to carry out this role it must be re-engineered. The Board of Directors should be made up of competent people who understand the World of business and who must promote modern business practices. In a rapidly changing oil industry environment and business parameters, external relationships that affect quantity and cost of supply of petroleum products need to be re-examined with unparalleled rigor and be redefined appropriately. NOCK must re-organize by redefining internal functions of each unit to relate closely and productively to its objectives.

To this end there is need to pay special attention to the injection and cultivation of relevant skills and attitudes in NOCK. The Committee recommends that due to the amount of specialized work required in this area and in order to free the Managing Director to concentrate on strategic development, a person or persons with wide experience in oil industry trading, operations and marketing functions be hired for a limited time- not more than one year, to oversee restructuring and training of staff in vital areas of the company such as trading, management of retail business and generally oversee the production of relevant manuals.

1.2 The Overview

Petroleum oil forms over 60% of the energy requirement in the Kenyan economy. For many years and up to now the supply of petroleum to the National economy continues to be controlled by multi-national corporations without patriotic affinity to Kenya and only bound to the country by profit motive.

National oil Corporation of Kenya was incorporated in 1981 as strategic arm of the Government in petroleum industry initially to facilitate procurement of 30% of the crude oil requirements of the country. While the objective of the Government in establishing NOCK was clear, little attention was given to the importance of its internal organization and management. The result was that people were appointed to the position of Chief Executive of the Corporation who had no knowledge of oil industry. This affected the quality of staff and therefore its ability to perform the tasks to which it was assigned. For many years the Board of Directors was not properly constituted. And even then those who were appointed on the Board had little knowledge about the industry to be able to take prudent commercial decisions. From inception to 1994 when the organization had a monopoly of importing 30% of the crude oil, it did not need entrepreneurship and the staff, inexperienced as they might have been, was able to make profits. When the industry was liberalized, the Corporation was unable to cope with the challenge and has never turned a profitable year.

Between the years 1995 to 1999 NOCK purchased plots to build service stations. They constructed service stations, engaged dealers and built a Truck Loading Facility at Nairobi. While some effort was made in some cases to follow government procurement guidelines, it was a half-hearted measure and the procedure would be abandoned mid-way. Government procurement procedures were not followed in purchasing plots for construction of service stations. It is not clear how they identified the plots that they bought and in some cases how they arrived at the price they paid. Even when they attempted to value the plot, they did not adhere to the valuation price, as was the case of plot number 16/263 in Nakuru.

The Corporation attempted to follow procurement procedure in securing contractors for the construction of service stations at Embakasi (Nairobi), Ravine road (Nakuru), Bondeni and Langas (Eldoret); Lakeview (Kisumu) and Kaplong (Sotik) by inviting tenders as is required by Government guidelines. However, when the construction was carried out, there was gross over expenditure, which was not approved by the Board.

NOCK management spent money recklessly. There was no professional valuation for most of the plots they bought e.g. Shanzu, Ravine Road (Nakuru) and Ukunda. The service stations they built were too costly clearly showing no effort to control costs. At Nairobi loading facility they hired Décor and Petals Contractors under very dubious conditions. The contractors were found to be incompetent and were removed from the job before they were able to complete it but were still paid over Kshs.15.0 million.

Over the period under review NOCK had no financial and credit policies and procedures in place at all. The Board of Directors appears to have made no effort to ensure that these were in place. In marketing, the company gave away products without vetting customers and dealers and as a result it is owed over **Kshs.345.0 million** most of which may never be recovered.

The Corporation has been making losses for the last three years and it is not expected to do any better this year. A study of the accounts reveals that it is being kept alive by creditors and the Government grants and interest earned from monies meant for exploration. It is not making money from its core activity; marketing of petroleum products. The source of the problem is historical: misuse of resources, mainly through over expenditure in construction of service stations, lost funds in collapsed banks and a bloated labour force.

The Corporation has not paid adequate attention to the development of its employment policy and procedures. In fact to date no employment policy exists. The Corporation has no approved establishment and employee manuals to guide in decision-making.

The effect was that the corporation hired more employees than it required and benefits administration has been haphazard. In the year 2001, NOCK retrenched 43 employees at a cost of **Kshs.8,397,094.50** without seeking Government authority. Relatives of top managers immediately replaced the retrenched employees. Some employees have challenged the action in court of law, which may lead to serious loss for the company.

It is quite clear from the above information that NOCK has a major business management problem. The Corporation failed to observe simple good business practices including failure to adhere to the provisions of the State Corporation Act. It needs to be restructured beginning with refocusing on its main objectives and establishment of standards for recruitment of those to be charged with the responsibility of ensuring that those objectives are met.

CHAPTER TWO (2)

ORIGIN OF NATIONAL OIL CORPORATION OF KENYA

2.0 ORIGIN OF NATIONAL OIL CORPORATION OF KENYA

2.1 Introduction

In the 1970s Organization of Petroleum Exporting Countries (OPEC) was formed. The purpose of the Organization was to ensure that member countries reaped maximum benefits from petroleum exports. One effect of the formation of the cartel was the control of member countries' production levels leading to a disproportionate increase in the prices of petroleum products. At that time and many years later multinational companies i.e. Shell, British Petroleum, Caltex, Esso, Mobil, Total, and Agip dominated the petroleum products market in Kenya. It was also found out that these companies were acting as a cartel.

In order to deal with this problem Kenya Government felt that the country needed a local company, which would help to stabilize prices. This led to the formation of National Oil Corporation of Kenya (NOCK).

2.2 Incorporation

NOCK was registered as a limited liability company on 3rd April, 1981.

Those who incorporated the company appear to have had preconceived ideas on how to keep the company under the control of a few people. This is evidenced by the way they deleted clauses 24, 53, 75, 86 to 97 of the Regulations for Management of a Limited Liability Company under Cap 486.

The effect of these deletions was to keep the number of directors to the minimum, take away the requirement to keep records of the meetings, to avoid retirement of directors from initiation to 1995. The directors were the Managing Director, the Chairman, the Permanent Secretaries of the Ministries of Energy and Finance. Also between 1999 to 2000, there were only four members of the Board of Directors against the required eleven under Section 6(1) of The State Corporation Act, Cap 446.

2.3 Management

While the Board is vested with policy formulation and direction, the day to day running of the affairs of the corporation is the responsibility of the chief executive. Since inception, NOCK has had the following chief executives:-

	Name	Period
i.	Mr. J. Shamalla	1981 – 1987
ii.	Mr. J.K. Kwambai	1987 – 1997
iii.	Mr. F.K Moiywo	1998 – 2001
iv.	Mr. D.K Ng'enoh	2001 – 2002
v.	Mr. K. Bommet	2002 – March, 2003
vi.	Mrs. M.K M'Mukindia	2003 – to date.

2.4 Observations

i. Viewed in the context Section 8(1)(e) of the State Corporations Act-Cap.446, the legality of all decisions made by the directors may be questionable due to lack of a quorum.

ii. We have noted that apart from the current Managing Director, Mrs. M'mukindia, none of the other Managing Directors had any petroleum industry experience prior to being appointed. This contributed to the poor management of the Corporation.

iii. The company lacks oil industry business versatility and culture, a situation, which has led to inability to take advantage of market opportunities.

2.5 Recommendations

i. ***It is recommended that the Articles and Memorandum of Association be reviewed so that areas of inconsistency be amended to be in line with the State Corporations Act Cap.446. More specifically clauses 24, 53, 75, 86 to 97 of the regulations for the management of a limited liability company under Cap.486 should be restored.***

ii. ***The Board of Directors should be made up of competent people with knowledge of modern business practices. Future appointments to the position of Managing Director of NOCK must have as a requirement, experience in the petroleum industry among other requisite qualifications.***

iii. ***There is need to pay special attention to injection and cultivation of relevant skills and attitudes in NOCK. To this end the Committee recommends that due to the amount of specialized work required in this area and in order to free the Managing Director to concentrate on strategic development, a person or persons with wide experience in oil industry trading, operations and marketing be hired for a limited time-not more than one year to oversee restructuring and training of staff in vital areas of the company such as trading, management of retail business and generally oversee the production of relevant manuals.***

2.6 EFFECTIVENESS OF THE BOARD OF DIRECTORS

The State Corporation Act (Cap 446) Section 6 (1a) gives the President the power to appoint the Chairman of the Board while Section 6 (1e) gives the power to the Minister to appoint other members of the Board.

The Committee has found out that in many cases, the Board could not be described as effective in terms of Section 15 of the State Corporation Act. In order to understand the causes of such ineffectiveness, the Committee perused various records of activities of the Board of Directors and has interviewed some previous members of the Boards. The Committee found out that:

i. Meetings were erratic and appeared to be poorly planned and uncoordinated, without proper notices and advance preparation and distribution of Board papers.

ii. There was lack of clear and continuous pursuit of issues to logical conclusion.

iii. There were cases of Chief Executive Officers withholding crucial information from the Board as in the case of purchase of Hyrax plot in Nakuru where Mr. Joseph Kwambai did not inform the Board about the valuation report of the subject plot. In the alternate, Board members lack inquisitiveness.

iv. Members were often intimidated by their colleagues on the Board and members of the public through political influence.

v. There were clear cases of some members who were ignorant and did not understand their role on the Board.

Recommendations

i. **Board members be trained as soon as they are appointed so that they understand clearly their rights and responsibility.**

ii. **Appointment of Board members be staggered and overlap with the appointment of the Chief Executive Officer to maintain continuity.**

iii. **The Chairman and the Chief Executive Officer should prepare and table a schedule of meetings to the Board of Directors for approval. This will improve for the Board meetings in financial discipline and preparation.**

iv. **The Board of Directors be empowered to source the Chief Executive Officer competitively and recommend to the Minister for approval.**

v. **The Board of Directors should enter into a performance contract for a period of four (4) years with the Chief Executive Officer which should be subject to annual review.**

vi. **The Board should strictly adhere to provisions of Section 8 of the State Corporation Act.**

CHAPTER THREE (3)

ACQUISITION AND MANAGEMENT OF ASSETS

3.0 ACQUISITION AND MANAGEMENT OF ASSETS

At the time that NOCK was formed, it was given a mandate by the Government to import 30% of the crude oil requirements of the country. This was done to dilute the monopoly of the multinational corporations in Kenya as they had used this monopoly to frustrate Government policy. The importation of Crude oil with a guaranteed market allowed NOCK to make easy profits and had strong ability to sustain itself. In1994, the Government liberalized the Kenyan petroleum business, which meant NOCK lost its 30% monopoly of Crude oil imports. It had to look elsewhere to survive and therefore it was decided that it had to enter the downstream activities of processing crude and marketing refined products.

In 1996, NOCK engaged the services of Wardreed, an energy consulting firm, to develop a strategy for entry into downstream activities. While we have not been shown the report and the documents showing how much they were paid and it is on record that Wardreed was paid **Kshs. 24.0 million,** unconfirmed reports are that they were paid **Kshs. 32.0 million** for the consultancy. One of its recommendations was that NOCK acquires plots countrywide to develop retail outlets. They further recommended that the Commissioner of Lands allocates NOCK plots in appropriate places for this purpose. When the Commissioner of Lands was approached, he stated that there was no land to be allocated to NOCK.

At this stage NOCK had apparently no choice but to purchase and/or lease plots countrywide for development of the retail outlets. It will be noted that the plots purchased by NOCK were actually allocated to individuals by Ministry of Lands. The Commissioner could have saved NOCK money by allocating the plots directly to the Corporation.

3.1 Acquisition of Land Plots

From our investigation, management of NOCK simply requested employees to be on the lookout for plots either to be leased or purchased in appropriate places in Kenya for purposes of retail outlets development. There was no competitive bidding contrary to established Government procurement procedures.

NOCK purchased four plots;-

1. Plot 16/263 – Nakuru	-	0.267 ha.	Kshs.14.5m
2. Plot 21/581-Nakuru	-	0.341 ha.	Kshs.7.0m
3. Plot 3061/Kwale	-	0.17 ha	Kshs.3.0m
4. Plot Nairobi LR 209/1228	-	–	Kshs. 21.0m

Neither plot 21/581 nor Plot 3061/Kwale were valued and in the circumstances, it is not possible to confirm whether the amounts paid really reflected the true value of the plots at the time of buying.

Of the above only Plot No.21/581 on Eldama Ravine Road in Nakuru was developed into a Service Station and Nairobi LR/209/1228 developed into Truck Loading Facility

Four plots have not been developed. These are:

i. Plot no.16204 (0.67ha.) at Ongata Rongai leased for 20 years from 1997
ii. Plot no. MN.1/9427 (0.3300ha.) at Shanzu leased for 20years from 1995.
iii. Plot no. 3061 (0.17ha.) at Kwale – outright purchase in 1996.
iv. Plot no. 16/263 (0.267 ha.) at Nakuru – outright purchase in 1994.

The acquisition of the following two plots, that is, plot number MN.1/9427 at Shanzu , Mombasa and plot number 16/263 at Nakuru appear to have been fraudulent.

3.1.1 Plot no. MN.1/9427 (0.3300 ha.) at Shanzu, Mombasa

On 12th April, 1995, the then Managing Director, Mr. Joseph K. Kwambai presented a request to the Board of Directors to allow him to lease the above mentioned plot for development of a retail outlet. The Board approved the request.

By a lease agreement dated 25th April, 1995, a Mr. Mathew Kiptum purportedly leased the above mentioned plot to National oil Corporation of Kenya for 20 years. To support his purported ownership of the plot he presented a sketch map allegedly prepared by the Ministry of Lands and Housing on 12th June, 1992 (appendix 4i.) and a Title Deed of 1st May, 1994. Apparently the plot was to be hived off the land owned by the Prisons Department, at Shimo La Tewa.

The Committee visited the site in order to see the plot but could not identify it. A legal officer of NOCK confirmed that they had twice tried to hire surveyors to delineate the subject plot, but both surveyors declined to do so on grounds that the area map did not show the division and that the said land belonged to Prisons Department.

The committee has reached the conclusion that no such plot existed and that the whole charade may have been simply to siphon money from NOCK.

A former Commissioner of Lands Mr. S.K. Mwaita who was interviewed by the Committee stated that in fact roadside land of the Prisons Department had been allocated to individuals even though the change of ownership had not been gazetted.

3.1.2 Observations

Mr. J.K Kwambai failed to ensure that the company received a plot before paying the lessor. He should have made sure that the lessor surveyed the plot and that it was delivered without encumbrances. He did not even disclose to the Board that the land had not been surveyed. In an interview by the Committee, Mr. Kwambai admitted that he had not seen the land but had relied on his officers in approving the payments.

3.1.3 Recommendations

i. ***Mr. Kwambai be directed forthwith to arrange with Mr. Kiptum to deliver the plot to National Oil Corporation of Kenya, failure to which they be prosecuted for fraudulently obtaining money from the Corporation.***

ii. *If the plot is delivered, the lease period be extended by at least the lost time in which it was not available for development.*

3.1.4 Plot no. 16/263 (16/300) (0.267 ha.) at Nakuru

On 12th April, 1995, Mr. Kwambai, recommended to the Board that the above mentioned plot be purchased for the purpose of construction of a service station. The Board approved a purchase price of Kshs.14,500,000.00.

From the record a professional firm, Highland Valuers valued the plot for Kshs.11,500,000.00. The Ministry of Lands also valued the same plot at Kshs.10,000,000. The record of the minutes does not show that this fact was disclosed to the Board. The difference in prices between the valuer's price and what the company paid has been a subject of several reports by the Parliamentary Public Investment Committee. In conclusion PIC recommended that Mr. Kwambai be surcharged for the difference of Kshs.2.0 million. Mr. Kwambai has maintained that he paid what the Board approved and therefore he should not be held responsible. What is not disclosed is that he did not tell the Board about the valuation report (at least from the minutes of the Board meeting in which the approval was given). It is also strange that the Board did not demand the valuer's report.

There is a more serious problem pertaining to this plot, which has hitherto not been addressed. The location of this plot was not critically examined and investigated. This was the responsibility of Highland Valuers. The Valuers reported thus We hereby certify that we inspected the above property and we are of the opinion that the current market value of the unencumbered leasehold title interest in the property **(NAKURU MUNICIPALITY/ BLOCK 15/263 NAKURU MUNICIPALITY)** for mortgage purpose is at :- Kshs.11,800,000."

The Committee has learned that three years after the purchase of plot number 16/263, Mr. Kwambai realized that what they had purchased was unusable. He arranged to buy the adjacent plot number 16/264A (of similar size as 16/263) at **Kshs.3,850,000** which was surveyed and combined with plot 16/263 to create plot number 16/300.

It is noteworthy that in all his protestations, Mr. Kwambai failed to disclose the purchase of plot 16/264A either to the Board of Directors or Public Investment Committee

The Committee has visited this site and carried out thorough investigation. This plot appears to be a road reserve that may have been irregularly allocated. If that is the case then, it is a candidate for repossession under the ongoing exercise by the Government where irregularly allocated land and road reserves will be returned to their original use. Furthermore, investigation revealed that this plot is the right of way for the Ministry of Water. Running through this plot are several large and small water pipelines carrying water into and out of the adjacent municipal water tank. There is no way that a service station can be constructed on this plot as it is. Employees of the Ministry of Water whom the committee found on site were unaware that the plot belonged to somebody else. The committee reached the conclusion that this plot cannot qualify as unencumbered. In effect Highland Valuers failed to disclose material facts about the plot and Mr. Kwambai failed to disclose the valuation price to the Board.

Furthermore there is no information on how Highland Valuers (based in Eldoret) were selected to carry out the valuation of the said plot.

The committee strongly feels that NOCK does not have a usable plot here and the whole charade by Mr. Kwambai and Highland Valuers was just to siphon money from NOCK. The action of buying a second adjacent plot and combining it with the first is a confirmation that the first plot was unusable.

3.1.5 Recommendations

Mr. Joseph Kwambai together with his Board of Directors and Highland Valuers made to refund the whole amount of Kshs.14,500,000.00 as the Committee believes the first part of now 16/300 is virtually useless.

3.1.6 Other leased plots.

	KSHS.	YEARS
1. Plot XLVIII/158 – Mbaraki Mombasa	_	33 years from 1991
2. MN 1/9427/Shanzu/ Mombasa	7.2m	20 years from 1995
3. Plot No.9042/162 Nairobi Outer Ring	7.0m	20 years from 1997
4. Plot 2275/Sotik (0.277 ha.)	6.0m	20 years from 1997
5. Plot 3/63 – Kisumu (0.17 ha.)	6.0m	20 years from 1995
6. Plot 16204 – Ongata Rongai (0.67 ha.)	3.7m	20 years from 1997
7. Plot 5/541-3 –Eldoret (0.29 ha.)	7.0m	20 years from 1995
8. Plot 14/1519 Eldoret (0.4212 ha.)	6.0m	20 years from 1995
9. Plot Gem/Nyam/494 Siaya	1.5m	10 years from 1995

Five of the leased plots and one purchased plot have been developed into operational Service Stations i.e.

i. Outer Ring Road Nairobi;
ii. Eldama Ravine Road-Nakuru,
iii. Bondeni (Eldoret/Busia Road) in Eldoret;
iv. Langas (Eldoret-Kapsabet Road) in Eldoret
v. Lakeview Station in Kisumu.
vi. Kaplong Service Station, Sotik

Construction started on Gem/Nyam/494 Siaya and stalled in 2001.

3.1.7 Observations

i. All leased plots were not valued and in all cases the company could have bought the same plot on outright basis at much lower cost than what they spent on leasing thus recklessly spending company money.

ii. Leased plots which are yet to be developed are halfway their lease life – NOCK never got value for the money.

3.1.8 Recommendations

i. ***NOCK should make every effort to develop the plots they leased and in that case they should renegotiate the lease period.***

ii. **NOCK may consider joint development with a developer if they do not have adequate funds to do it by themselves.**

3.2.0 Development of retail outlets

Retail outlets were developed between 1996 and 2001. These outlets have been developed at excessive cost such that it may be impossible in the foreseeable future to recover the costs. These retail outlets are as follows:

3.2.1 Outer Ring Road Service Station (Embakasi)

In 1994, on request by National Oil Corporation, Northline Ltd, a consulting firm undertook a feasibility study of plots LR: 9042/102, 9042/103, with a view to establishing a retail outlet

The study was completed in December,1994 and several key recommendations were made:-

- Lease plot for 30 years
- Initial investment of Kshs.20.0million would be required.
- Build a basic station (without a canteen and shopping center), consisting of 1 single pump for kerosene, 2 single pumps for diesel, 3 twin pumps for super/regular motor gasoline and 4 underground tanks of capacity of 20,000 litres each.
- They also recommended allied greasing equipment, car washing facilities and puncture repair facilities.
- Estimated throughput would be about 255,000 litres per month of fuels.

Apparently when the feasibility was carried out NOCK had not yet leased a plot. A plot number LR 9042/162 was finally leased on 15th

March, 1997. Records show that the plot (0.4272) was acquired at a cost of (including rates and taxes) **Kshs.8,459,562.70** from Ms Saki Ltd. The Board had approved the lease for **Kshs.7,456,582.00** for 20 years on 21st December, 1994.

3.2.1.0 Construction

NOCK invited bids for construction and on 8th January,1998, tenders were awarded and construction started in February 1998 and was completed in March 1999. The cost structures are shown in the table below:

Item	Tender Price (Kshs)	Over expenditure(Kshs)
Civil and Structure	31,988,286	10,877,488
Mechanical Installations	2,580,855	776,916
Electrical	3,439,966	721,806
Signage	1,049,286	592,647
Auto Tyre Changer	239,000	(91300)
Power Generator	625,305	363,313
Wheel A/Machine	93,454	(47,624)
Battery Charger	32,000	(2200)
Comp Wheel/Balancer	458,000	37,000
Rubber Vulcaniser	145,000	(50,000)
TOTAL	40,651,259	13,177,046

The company paid consultants **Kshs.11,747,948.00** without the approval of the Board. It can be seen from the table below that all the consultants overcharged NOCK based on the tariffs then.

CONSULTANT	AMT PAID(kshs)	EXPECTED FEES LEVEL	OVER PAYMENT
ARCHITECT	4,417,520	3,341,300	1,076,220
Q/SURVEYOR	2,409,063	1,670,650	738 413
M &E	4,921,365	2,205,800	2,715,565
TOTAL	**11,747,948**	**7,217,750**	**4,530,198**

There were other items, which were supplied to the station, which were not subject to bids and we have no record of Board approval. These items were:

Item	**Kshs.**
❖ An oven	21,000.00
❖ Hot dog roller	50,000.00
❖ Cash register	90,794.00
❖ Coffee maker	38,000.00

❖ Freezer	258,750.00
❖ Chiller	181,000.00
❖ Shelves	1,000,000.00
❖ Mobile Drain Unit	57,000.00
❖ Other equipment	3,531,370
Total	**5,227,914. 00**

When we visited the station none of these items were available and no explanation was given to us as to where they were.

The total amount spent on construction of this retail outlet was **Kshs.70,804,167.00** out of which **Kshs.30,152,908.00** was spent without Board approval.

3.2.1.1 Activities at the Station

The Petrol station is selling **95,000 litres** per month as opposed to anticipated **255,000 litres** per month. In the first year of operation this service station was selling on average **200,000 litres** per month.

The canteen is rented to the dealer at Kshs.40,000/= per month. The canteen has been divided into two activities. A small canteen for meals and an apparently very active bar with well stocked alcoholic drinks. The large parking space is appropriately being used by the bar patrons!!!

3.2.1.2 Observations

i. The service station is built on a large plot such that money was invested in space that was not required for core business.

ii. The feasibility study was done on the basis of a retail outlet without a canteen and was to cost Kshs.20.0 million. This was the basis of its profitability. The outlet was finally built at a cost of over Kshs.80.0 million without reference to the original feasibility study.

iii. The company spent **Kshs.30,152,908.00** on this outlet without the approval of the Board.

3.2.2.0 Ravine Road Service Station Nakuru

Ravine Road is built on a 0.341 ha plot along Nakuru – Eldama Ravine Road, outside Nakuru town.

The plot was purchased for **Kshs.7,000,000/=** after the Board of Directors approved on 21st December, 1994.

Northline Consultants were commissioned by NOCK to carry out a feasibility study which was done in 1994 and determined that:-

- A fully fledged station with all facilities plus canteen, restaurant and adequate parking for buses and Heavy Commercial Vehicles and shop to be constructed

- Estimated capital expenditure was **Kshs.25,000,000.**

- It had to have 6 pumps for motor gasoline, 3 pumps for diesel, one pump for Kerosene, greasing equipment, 2 Tyre pressure gauges, one compressor, puncture repair equipment and wheel balancing equipment.

- Estimated througput was 3,000,000 litres/year.

3.2.2.1 Construction

NOCK invited bids for construction and in a meeting held on 30th May, 1996 the following tender was awarded:-

Item	Tender Price (Kshs)	Over Expenditure (Kshs)
Civil and Buildings	15,256,000	5,527,575
Mechanical Installations	529,435	111,447
Electrical Installations	871,225	277,875
Plumbing/Drainage	316,224	151,626
Signage	-	1,843,146
TOTAL	**16,972,884**	7,911,669

There were other costs, which were incurred without prior approval of the Board. These are in Kshs:

- Oven 56,925.00
- Hot dog roller 50,715.00
- Cash register 45,397.00
- Coffee Maker 50,715.00
- Freezer 129,375.00
- Chiller 10,500.00
- Shelves 380,880.00

Total **724,507.00**

Other expenses were in Kshs:

CONSULTANT	AMT PAID(kshs)	EXPECTED FEES LEVEL	OVER PAYMENT
ARCHITECT	2,798,779	1,493,073	1,305,706
Q/SURVEYOR	2,048,423	746,540	1,301,883
ENGINEERS (M &E	2,881,600	2, 488,455	393,145
TOTAL	**7,728,802**	**4,728,068**	**3,000,734**

Total consultants fees **Kshs.7,728,802.00** all paid without the Board approval.

Total amount paid without the approval of the Board was **KShs16,364,978.00**

3.2.2.1 Observations

i. When the construction was completed, the total cost was **Kshs.33,637,862.00** nearly two times the cost proposed by the consultant who did the feasibility.

ii. NOCK acquired two plots and developed only one, the other was not needed.

iii. The plots, though purchased outright, they appear to be a road reserve.

iv. The station is selling about 42,000 litres per month as opposed to projected 250,000 litres. When this station was opened it was selling over 250,000 litres per month.

v. The estimated cost of the service station was **Kshs.25,000,000** on which basis the profitability of the station was calculated. Now that the total expenditure rose to **Kshs.33,637,862.00** and the sales have dropped, the investment may never be recovered.

3.2.3.0 Bondeni Service Station Eldoret

Bondeni Service Station site [0.2926 h] was leased afterBoard approval of 20th July, 1995 for Kshs.7.0 million.

A feasibility study was carried out by NOCK staff which determined the following:-

- Kshs.27.0 million would be required for development.
- Estimated monthly volume was 200,000 litres.
- Recommended an ordinary retail outlet.
-

3.2.3.1 Construction

In 1997, bids were invited for construction of the service station and on 8th January, 1998 the Board awarded tenders.

Construction commenced in March 1998 and was completed in February 1999. The costs were as follows:

Item	Tender Price (Kshs)	Over Expenditure (Kshs)
Civil and Buildings	30,908,458	11,451,751
Mechanical	2,732,730	785,702
Electrical Installations	2,873,652	16,142
Signage	1,150,148	119.012
Power Generator	625,305	363,313
Comp. Wheel Balancer	458,000	37,000
TOTAL	**38,748, 293**	**12,772,920**

Other items for the canteen and shop, which were not subject of tendering and were bought without Board approval. These items are: in Kshs.

- Oven 21,000.00
- Hot dog roller 50,715.00
- Cash register 90,794.00
- Coffee maker 38,000.00
- Freezer 258,750.00
- Chiller 181,000.00
- Shelves 1,142,640.00
- Mobile Drain Unit 57,000.00

Total **Kshs.1,839,899.00**

Other unauthorized expenditure to consultants were: **Kshs.15,709,999.00** as shown in the table below. This reflects an overcharge of Kshs.6,048,081.00

CONSULTANT	AMT PAID(kshs)	EXPECTED FEES LEVEL	OVER PAYMENT
ARCHITECT	5,705,041	3,091,273	2,613,768
Q/SURVEYOR	3,884,770	1,545,440	2,339,330
M &E	6,120,188	5,025,205	1,094,984
TOTAL	**15,709,999**	**9,661,918**	**6,048,081**

In essence NOCK spent **Kshs.30,322,818.00** without Board approval on this service station.

3.2.3.3 Observations

i. The service stations feasibility was based on an investment of **Kshs.27.0 million** and expected payback was 6.5 years. With total cost of **Kshs.69,071,111.00** the investment may never be recovered.

ii. The Committee has evaluated the work done on this site and has found out that the contract sum was wrongly increased by **Shs 11,101,345.00** The consultant who prepared the final accounts erred to the tune of **Kshs 3,220,080.00** and the contractor was overpaid **Kshs 385,830.00** (see appendix 4.iii).

iii. The service station is currently selling nearly 30,000 litres a month against projected 200,000 litres which lengthens the payback period.

iv. NOCK installed an oversized generator at this station, which they did not require –a waste of public funds.

3.2.4.0 Langas Service Station – Eldoret

This station is on a 0.4212-hectare plot along Eldoret/Kapsabet Road. The plot was leased for 20 years from 1st May 1995 for Shs.6.0 million vide Board approval of 12th April, 1995.

There is no evidence of feasibility studies to establish the potential of the plot.

3.2.4.1 Construction

A Board meeting held on 30th May, 1996 awarded a tender for the construction of the station. Construction of the Service Station commenced in July, 1996 and was completed in February, 1999.

The actual costs incurred are as follows;-

Item	Tender Price (Kshs)	Overexpenditure (Kshs)
Civil and Buildings	22,883,000	12,610,477
Mechanical Installations	648,985	633,727
Electrical Installations	1,098,400	1,197,107
Plumbing/Drainage	609,690	85,499
TOTAL	**25,080,945**	**14,526,810**

NOCK spent the following additional amounts without the Board approval Kshs.

❖ Signage	2,005,049.00
❖ Power Construction	630,000.00
❖ Equipment	8,369,616.00
Total	**11,004,665. 00**

The following items for the canteen (part of the equipment above) were bought without Board approval. These items are: in Kshs.

❖ oven	56,925.00
❖ Hot dog roller	50,715.00
❖ Cash Register	90,794.00
❖ Coffee Maker	50,715.00
❖ Freezer	258,750.00
❖ Chiller	310,500.00
❖ Shelves	1,142,640.00
Total	**1,964,039.00**

NOCK also paid consultants **Kshs.10,855,555.00** and as shown below they were all overpaid.

CONSULTANT	AMT PAID(kshs)	EXPECTED FEES LEVEL	OVER PAYMENT
ARCHITECT	3,787,450 00	2,386,013	1,401,437
Q/SURVEYOR	3,423,780	1,193,007	2,230,773
ENGINEERS M &E	3,644,325	3,976,89	--
TOTAL	**10,855,555**	**7,555,709**	**3,632,210**

3.2.4.2 Observations

(i) There was no feasibility study carried out and therefore there was no prior indication of the potential profitability.

(ii) The station cost a whooping **Kshs.63,432,015.00** an over expenditure of **Kshs.38,351,070.00** over and above Board approved amounts.

(iii) When we visited the station in June, 2003, there was no dealer and NOCK was running it. The sales are currently very low, only 31,000 litres per month, although the station was selling, an average of 300,000 litres per month during its first year of operation.

(iv) The canteen and the shop were not operational at the time of our visit.

(v) The station is built on a much larger plot than was needed.

3.2.5.0 Kaplong Service Station - Sotik

The Station is built on a 0.277-hectare plot along Kericho/Sotik Road, leased for 20 years from 1st July, 1997 vide a Board Minute of 1st September, 1995.

There is no evidence of a feasibility study on this plot prior to development.

The Board called for bids and vide the meeting of 8th January, 1998, tenders were awarded. Construction was carried out and the following were actual costs:

Item	Tender Price (Kshs)	Over expenditure (Kshs)
Civil and Buildings	22.928,718	5,589,494
Mechanical Installation	2,197,930	1,657,359
Electrical Installations	3.077.773	(368,809)
Signage	1.039,675	503,017
TOTAL	29,244 096	7,381,061

On construction, the company exceeded planned costs by **Shs.7,381,061.00** without the authority of the Board.

The consultants were paid **Kshs 14,250,673.00** as shown below without the authority of the Board of Directors. It is also shown that the consultants were overpaid.

CONSULTANT	AMT PAID(kshs)	EXPECTED FEES LEVEL	OVER PAYMENT
ARCHITECT	3,972,284	2,41,770	1,730,314
Q/SURVEYOR	4,067,506	1,120,885	2,946,621
M &E	6,210,883	3,736,278	2,474,605
TOTAL	**14,250,673**	**7,098,933**	**7,151,540**

The Company also incurred **Shs.6,168,947.00** of which the following were neither approved by the Board nor properly tendered for;-Kshs.

- Oven 21,000.00
- Hot dog roller 50,715.00
- cash register 90,794.00
- Coffee Maker 38,000.00

- Freezer 258,750.00
- Chiller 181,000.00
- Shelves 300,000.00
- Power and water 594,430.00

Total **Shs.1,534,689.00**

By the time the construction was completed, the Service Station and Canteen cost the company **Kshs.57,044,777.00** an over expenditure of **Kshs.27,800,681.00** without approval of the Board.

3.2.5.1Observations

i. The Corporation overspent **Kshs.27,800,681.00** on construction and purchase of equipment on this station without the approval of the Board.

ii. When the station open in the year 2001 it was selling on average 250,000 litres per month but currently it is selling only 38,500 litres per month.

3.2.6.0 Lakeview Service Station Kisumu

The service station is located on plot LR No.3/63 Kisumu of 0.66 ha. It was leased vide board approval of 12th April 1995 for 20 years at Kshs.6 million.

NOCK, carried out feasibility and the following were determined:

- a medium size service station to cost Kshs.25.0 million
- Payback period 6.5 years
- Expected throughput minimum of 150,000 litres per month.

In a meeting of the Board of Directors held on 30th May 1996 a tender was awarded for the construction of Lakeview Service station.

3.2.6.1 Construction

Construction commenced in July 1996 and the following costs were incurred:

Item	Tender Price (K shs)	Over expenditure (Kshs)
Civil and Buildings	11,322,000	4,505,251
Mechanical Installations	744,490	1,340,457
Electrical Installations	960,269	397,187
Plumbing/Drainage	450,380	147,790
Equipment	5,552,870 18	-
TOTAL	**19,030,009.18**	**6,390,685**

There were other costs consumed which apparently were never approved by the board:

- Power re-routing 642,061.00
- Cash register 45,397.00
- Shelves 380,880.00
- Other equipment 8,293,382.00

TOTAL Kshs.9,361,720.00

Further, **Kshs.8,923,472** was paid to consultants without approval of the Board, as shown below.

CONSULTANT	AMT PAID(kshs)	EXPECTED FEES LEVEL	OVER PAYMENT
ARCHITECT	3,227,447	1,166,770	2,060,677
Q/SURVEYOR	2,303,882	583,385	1,720,497
ENGINEERS(M &E	3,392,143	1,944,615	1,447,528
TOTAL	**8,923,472**	**3,694,770**	**5,228,702**

3.2.6.2 Observations

i. The construction of the station cost **Kshs.43,705,886.00** an over expenditure of **Kshs.24,675,877.00** which was not approved by the Board.

ii. The economics of this investment was based on capital expenditure of **Kshs.25.0 million** and a payback of 6.5 years. Now, with an expenditure of over **Kshs.43.0.0** million it will take much longer to recover the investment.

iii. In the first two years of operation the station was selling, on average, 180,000 litres per month, but now at only 20,000 litres per months, the payback period is untenable.

3.2.7.0 Yala Service Station - Yala

This was to be constructed on a plot Gem/Nyam/494 leased in Yala town. Construction contract was given to M/s Petals and Décor Ltd for **Kshs.10,099,688.00.** So far **Kshs.4,600,090.50** has been paid and the construction work stalled in 2001. The explanation given for stoppage was that the contractor was actually not competent [skills and financially] to carry out the work and that he was given the contract irregularly.

3.2.7.1 Observation

There were no tenders and it appears management did not follow the right procedure in awarding this contract to an incompetent construction company, which had once failed to perform at Nairobi Truck Loading Facility.

3.2.7.2 Recommendations

This site is suitable for good business and should be developed urgently as there is no other outlet within a radius of 50 kilometers. The project should be revaluated on the basis of incremental cost of completion.

3.2.8.0 Kayole Service Station

Early last year NOCK started looking around for independent dealers, that is people who had developed filling stations using their own funds, who could agree to be contracted. The Company identified one in Kayole (Mr. Peter Kiarie) who was developing his own service station. At the time he was identified, the construction was very advanced. The company agreed to lease the station for 15 years at Kshs.320,000 per month payable five years in advance. This translated to approximately Kshs.20,000,000 every five years. This deal received Board approval.

NOCK advanced the landlord Kshs.10.0 million to assist him complete the construction and agreed to give him another lump sum payment as soon the station was ready for commissioning. When the landlord completed the construction and asked for pumps and remaining Kshs.10.000,000, NOCK reneged having realized that they entered into an expensive deal from which they might never recover the investment.

The then Managing Director, Mr. Ng'enoh, signed this deal while Mr. Khalid Bommet was a member of the Board of Directors' Technical Committee. When Mr. Bommet took over as the Managing Director he started questioning the deal. The current Managing Director is trying to renegotiate the deal and the landlord is threatening legal action, for breach of contract.

3.2.8.1 Observation

This is an example of poorly evaluated investment into which NOCK rushed and committed Kshs.20.0 million every five years for 15 years only to realize that they could not sustain it and yet they cannot get out of the deal.

Kayole is a new and expanding settlement with increasing population and has a potential for growth.

3.2.8.2 Recommendations

NOCK should revaluate this project on the basis of loss minimization. They should open the service station and negotiate payment from proceeds of sales.

3.2.9.0 General Observations On Retail Outlets Development

This project was poorly conceived planned, carelessly and extravagantly executed National Oil Corporation had **Kshs.337,395,818.00** at their disposal and at an average expenditure of **Kshs.25,000,000** per service station, NOCK would have built 15 service stations which would have given NOCK enough sales to operate viably.

i. NOCK purchased three plots and leased ten. Those which were bought were neither valued or even if they were, the valuations were very unsatisfactory and smacked of fraud. An example is the Nakuru plot at Hyrax hill.

ii. NOCK lost focus from their core business. The sizes of plots purchased or leased showed that they started investing in real estate which is not their core business. There was no need for the second plot on Eldama Ravine Road [Nakuru] and Embakasi plot is oversized.

iii. Expenditure on development of canteens and shops was unnecessary. There is no study that has been carried out to show positive correlation in petrol stations between presence of canteens and shops and petroleum product sales. NOCK was copying what other petrol stations had earlier done without realizing that companies like Caltex, Total and Shell added these facilities long after they had depreciated their main structures. NOCK should have concentrated on building retail outlets and not entertainment centres.

iv. NOCK did not develop in-house "Order of Magnitude" cost to act as a standard around which the tenders for building of service station would be evaluated. NOCK confirmed that they relied on bidders to fix the costs. The cost for buildings and civil works was too high. Informal contact with a new entrant into Kenya Market which has built similar outlets indicated an "Order of Magnitude" of Kshs.20.0 million to complete a reasonable service station. Spending over Kshs.60,000,000 on a retail outlet was outlandish and outright fraud.

v. NOCK failed to maintain proper cost control in construction of retail outlets.

a) In most cases there was no Board approval

b) There are many cases where NOCK paid for services and equipment at prices which were higher than tender prices.

c) In other cases NOCK bought equipment with higher capacities than was necessary e.g. Generators in Bondeni and Lakeview in Kisumu, freezers, Chillers and

Shelves were bought at exorbitant prices for non-core activities.

vi. Consultants overcharged NOCK by Kshs.29,591,465.00

vii. Summary of NOCK's Service Stations construction costs were follows;-

RETAIL OUTLET	APPROVED EXPENDITURE	ACTUAL EXPENDITURE	OVER EXPENDITURE
EMBAKASI	40,651,259 00	70,804,167.00	30,152,908 00
RAVINE RD NKR	16,972,884 00	33,637,862.00	16,664,978 00
BONDENI-ELDO.	38,748,293 00	69,071,111.00	30,322,818 00
LANGAS-ELDO	25,080,945 00	63,432,016 00	38,351,070 00
KAPLONG-SOTIK	29,244,096 00	57,639,209 00	27,800,681 00
LAKEVIEW-KSM	19,030,009 00	43,705,886.00	24,675,877 00
TOTAL	**169,727,486.00**	**337,395,818.00**	**167,668,332.00**

NOCK overspent **Kshs.167.7 million** (100% over the approved amounts) on construction of service stations and purchase of equipment without the approval of the Board.

vi. The records on the construction of retail outlets are poorly kept and several cases have not been reconciled and therefore not capitalized in the draft accounts of NOCK.

3.2.8.1 Recommendations

i. ***The office of the Controller and Auditor-General should carry out detailed audit of the retail outlets construction accounts to establish exactly how much was overspent and the then respective Managing Directors be surcharged accordingly.***

ii. ***NOCK should make every effort to maximize utilization of these outlets in order to recover their investments.***

iii. ***Consultants be identified and be made to refund a total of Kshs.29,591,465.00 which was overcharged above the*** *professional rates and they be reported to the relevant professional bodies for displinery action..*

3.3.0 Management of other assets:

3.3.1 Company House

The company purchased a residential house in January, 1992 at a cost of Kshs.4,612,400.00. The house on L.R No. 330/621 situated on Kunde Road; Thompson Estate, Nairobi is the official residence of the Managing Director. It is not clear how the property was identified for acquisition.

Currently this house is vacant because the Managing Director has her own house and does not wish to live in it.

3.3.2 Recommendations

It is recommended that it be rented out to generate some income.

CHAPTER FOUR (4)

TRUCK LOADING FACILITY AT MBARAKI, MOMBASA

4.0 TRUCK LOADING FACILITY AT MBARAKI, MOMBASA

4.1 Introduction

In 1991, the Government through Kenya Ports Authority granted National Oil Corporation of Kenya 1.5 acres of land for development of an import/export terminal incorporating truck loading facilities. This is prime land next to a jetty at Mbaraki, Mombasa. NOCK was granted a 33 year lease effective 1991. The corporation however, did not develop the proposed terminal, allegedly due to lack of funds. After eleven years, in 2002, KPA wrote to NOCK indicating an intention to repossess the plot, should it continue being idle. Following this notice, NOCK came up with an idea of getting a developer who would be willing to develop the site on "Build, Operate and Transfer" [BOT] terms.

4.2 The agreement

NOCK identified a company, Tecaflex Ltd which was willing to develop the plot. Subsequently, Tecaflex sub leased the plot for twenty years effective 2002 at a monthly rent of Kshs.125,000/=. During this period, Tecaflex was supposed to develop the plot at a cost not exceeding Kshs.250,000,000. Under the terms of the Agreement they would then operate the depot for 20 years during which period they would recover their costs. There is an underlying assumption that NOCK pegged the 20 year lease period to an investment of Kshs.250,000,000.

4.3 Development

Tecaflex ltd developed the plot into a bulk storage depot for refined petroleum products and vegetable [edible] oils. The facility comprises the following:

- 2 No. 1190m3 tanks for Diesel [AGO]
- 1 No. 1190m3 tanks for Premium Gasoline [PMs]
- 1 No. 1450m3 tanks for Kerosine

- 2 No. tanks for Vegetable Oils

- Pipework to the jetty and truck-loading facilities.

There are two separate loading gantries – one for vegetable oils and the other for petroleum products. The total cost of the facility was approximately Kshs.80 million and it is currently fully operational.

4.4 Earnings

Tecaflex pays Kshs.125,000/= per month to NOCK. This translates to Kshs.1.5 million per year. NOCK in turn is responsible for paying Government land rent and Mombasa council rates for the plot. Attached is a schedule of expected net income to NOCK over the 20 year period [attachment A in the next Page]

INCOME VS EXPENDITURE SCHEDULE

Assessment of Mombasa City Council charges on plot no. 158 (0.6163 hactares)

	INCOME	EXPENDITURE			
		MOMBASA CITY COUNCIL		K.P.A	
	RENTAL	LAND RATES	PENALTY	RENT	NET INCOME
	KSHS.	KSHS.	KSHS.	KSHS.	KSHS.
1991	-	(47,894.00)	-	(54,266.00)	(102,160.00)
1992	-	(89,800.00)	-	(59,199.00)	(148,999.00)
1993	-	(89,800.00)	-	(121,600.00)	(211,400.00)
1994	-	(98,780.00)	-	(121,600.00)	(220,380.00)
1995	-	(98,780 00)	-	(120,000.00)	(218,780.00)
1996	-	(268,600 00)	(112,812.00)	(120,000 00)	(501,412 00)
1997	300,000.00	(268,600.00)	(64,464.00)	(120,000.00)	(153,064.00)
1998	300,000 00	(327,121 90)	(8,441 00)	(120,000 00)	(155,562 90)
1999	390,000.00	(320,320 00)	-	(120,000.00)	(50,320 00)
2000	480,000.00	(320,320.00)	-	(120,000.00)	39,680.00
2001	480,000.00	(317,474 00)	-	(120,000.00)	42,526.00
2002	1,115,000.00	(376,040.00)	-	(120,000.00)	618,960.00
2003	1,500,000 00	(376,040 00)		(913,726.35)	210,233.65
2004	1,500,000.00	(376,040.00)		(913,726 35)	210,233.65
2005	1,500,000.00	(413,644.00)		(913,726.35)	172,629.65
2006	1,500,000.00	(413,644 00)		(913,726.35)	172,629 65
2007	1,500,000 00	(413,644 00)		(913,726.35)	172,629 65
2008	1,500,000 00	(413,644 00)		(1,005,099 00)	81,257.00
2009	1,650,000.00	(413,644.00)		(1,005,099 00)	231,257.00
2010	1,650,000.00	(455,008.40)		(1,005,099.00)	189,892.60
2011	1,650,000.00	(455,008.40)		(1,005,099 00)	189,892.60
2012	1,650,000.00	(455,008 40)		(1,005,099.00)	189,892 60
2013	1,650,000.00	(455,008.40)		(1,105,608.90)	89,382.70
2014	1,650,000.00	(455,008.40)		(1,105,608 90)	89,382.70
2015	1,815,000.00	(500,509.20)		(1,105,608 90)	208,881.90
2016	1,815,000.00	(500,509.20)		(1,105,608.90)	208,881.90
2017	1,815,000.00	(500,509.20)		(1,105,608.90)	208,881.90
2018	1,815,000.00	(500,509.20)		(1,216,169.80)	98,321.00
2019	1,815,000.00	(500,509.20)		(1,216,169.80)	98,321.00
2020	1,815,000.00	(550,560.20)		(1,216,169.80)	48,270 00
2021	1,996,500.00	(550,560.20)		(1,216,169 80)	229,770.00
2022	1,331,000.00	(550,560.20)		1,216,169.80)	(435,730.00)
TOTAL	**36,182,500.00**	**(11,873,098.50)**	**(185,717.00)**	**(22,519,685.25)**	**1,603,999.25**

NOTE:

1. Rental income will increase by 10% after every six years
2. land rates will increase by 10% after every five years.
3. KPA rent will increase by 10% after every five years
4. In the year 2022 rent will be received for 8 months only.
5. 1997 plot leased to Baharini oil services for use as a parking for its tanks
6. 2002 – 2022 plot under B. O. T a terminal for NOCK under a management services contract to Tecaflex Ltd.

(Table courtesy of NOCK Management)

4.5 Observations

i. The idea of NOCK putting up a terminal at Mombasa was, and still is, a very good idea. This would not only help NOCK which has no truck-loading facility in Mombasa but would also help local oil companies enter the Mombasa retail market. NOCK, Nairobi Terminal is a good reference.

ii. The Tecaflex depot cost approximately Kshs.80 million. Since NOCK did not need to include vegetable oil facilities, it would have cost them approximately Kshs.60 million to put up a similar depot. It is therefore not convincing for NOCK to claim that they failed to develop the plot due to lack of funds, when they spent huge sums of money developing service stations. For instance the Nairobi Outer Ring Road Station cost approximately Kshs.80 million.

iii. The amount that NOCK is earning from the plot translates to a pathetic Kshs.5,000/= per month. The amount is hardly enough to cover any management costs that NOCK may incur as the primary owners of the plot.

iv. NOCK held the plot on a 33 year lease from 1991. They in turn gave the plot to Tecaflex on a 20 year sublease effective 2002. This means that the sublease will expire around the same time as the lease. The plot is therefore very unlikely to ever revert to NOCK.

v. Given that NOCK is earning nothing from the plot, [observation 3 above] and that they sublet it for the remaining part of the lease [observation 4], the company then literally gave out a prime property for free. It is on this basis that we give the following recommendation.

4.6 Recommendations

NOCK is the Primary stakeholder in this BOT venture. The agreement entered into with the developer was skewed to deny NOCK any benefit from the venture. Since the representatives of NOCK i.e. the Managers were only trustees of a public property, the corporation should challenge the said agreement. NOCK should aim to achieve one of the following:

Either (i) Take full possession of the facility and compensate Tecaflex for any developments thereon,

Or (ii) Be recognized as having put in a valuable investment in the venture and therefore earn a commensurate share of the income generated i.e. enter into a profit sharing arrangement. A legal opinion will be required as to whether this can be done under Clause 2.2 of the agreement which states:

"The Manager shall exclusively render management services over the oil depot for purposes of recouping its capital expenditures and making a profit for itself and the proprietor".

iv. NOCK gave Tecaflex this site on assumption that it would spend Kshs.250 million in constructing the depot and that was the basis of negotiating the monthly payment . Now that Tecaflex spent only Kshs.80.0 million, NOCK should renegotiate on the basis of shortened payback period for Tecaflex.

NOCK may wish to seek a second legal opinion on this subject.

CHAPTER FIVE (5)

PROCUREMENT OF CRUDE OIL AND PETROLEUM PRODUCTS,

DISTRIBUTION AND MARKETING

AND

BUSINESS PERFORMANCE

5.0 PROCUREMENT OF CRUDE OIL AND PETROLEUM PRODUCTS.

5.1.0. Procurement Practice

At the initiation of NOCK, Government mandated it to import 30% of the Crude Oil requirements for Kenya and at that time it was not engaged in downstream activities, that is, retailing of petroleum products. In those circumstances, it was able to load full cargoes of 80,000 metric tons at stated intervals into Kenya without having to seek cargo participation by any other industry member.

In 1994, the industry was liberalized and NOCK had to operate like any other petroleum company in Kenya including adhering to Kenya Petroleum Refineries rules and other regulations put in place by the Ministry of Energy.

After liberalization, the Ministry required that all imports (Crude oil and refined products) be subject to tendering by all companies. Major oil companies with affiliated organizations in petroleum producing countries always had price advantage whenever they bid and therefore invariably NOCK could not place a competitive bid in the tender. Another requirement is that NOCK has to obtain 70% of its products by processing at Kenya Petroleum Refineries and the rest - 30% by importation of refined products. In this case the amount of crude oil that NOCK has to import is very small – on average 5,000 tons per quarter and therefore they have invariably been forced to buy locally from competitors at high premiums most of the time. This obviously has a price disadvantage for NOCK. However this has been the only way NOCK has operated all along. The effect has been that NOCK continues to have more expensive products than other companies, which makes NOCK uncompetitive.

There were some cases when NOCK won tenders. However, such imports never materialized without some problems. There were cases when the industry could not agree with and pay NOCK prices. This often led to losses, which the Government had to compensate for. In other cases the prices raised by NOCK appeared unrealistic. Two such examples were the cases of vessels "Lavender" (1992) and "Erika Jacobs" (1995) which led to a loss of **Kshs.88,091,336.60** that had to be paid by the Government.

5.1.2 Settlement of Kshs.88,091,336.60

On Government instructions NOCK imported some petroleum products during the period 1990 to 1995. On several occasions, the other oil companies to whom the products were to be sold disagreed with the formula used in determining the prices and refused to settle some amounts. NOCK turned to the Government who agreed to compensate them. NOCK issued credit notes to the affected companies. It would appear that Kenol/Kobil and Caltex continued to hold the respective amounts in their books as owing to NOCK.

5.1.3 Conspiracy

At some point in early 2002, a company named Fadmaster Ltd appeared at NOCK and offered to collect on behalf of NOCK all the monies outstanding on crude oil and product import accounts with other oil companies on the basis of "NO CURE NO PAY". Initially the company was charging 17% but later changed to 1% of the amount collected. The then Chief Accountant at NOCK, Mr. Nyamongo, claims that he objected to the deal maintaining that there was no money to be collected as the Government had already agreed to pay the money, but the then Managing Director went ahead and contracted Fadmaster Ltd. Within a very short time Fadmaster Ltd invoiced NOCK for having collected **Kshs.61,220,570.00** from Caltex and Kenol/Kobil. NOCK promptly paid **Kshs.612,205.70**. Once again Mr. Nyamongo who was the Chief Accountant then claims that he refused to approve the payment but it was taken to another junior officer in his department who duly approved it and was paid. Investigation at NOCK shows that no money was received and indeed that is why NOCK has continued to press the Government for payment of **Kshs.88,091,336.60** and they have obliged by paying.

Given the conditions of Fadmaster Ltd, that is "**NO CURE NO PAY**" and seeing that they were paid, we are of the view that Kshs.61,220,570.00 was collected from some oil companies, most likely Caltex, Kobil and Kenol, but it did not reach NOCK.

The Committee strongly suspects that Fadmaster collected Kshs.61,220,570.00 but the money was not paid into NOCK.

5.1.4 Observations

i. NOCK has not been sourcing petroleum products competitively.

ii. A major fraud may have been committed in relation to Kshs.61,220,570.00

5.1.5 Recommendations

i. The Government together with NOCK should carry out a review of the mandate of the corporation in light of its role as a strategic national organization. Some of the options to be considered are finding a partner who can increase NOCK's capital base and/or increased funding from the Government to the tune of approximately Kshs 500.0 million. The Government could also develop long term Government to Government Crude oil or refined oil products supply with long term low interest financing option.

ii. Kenya Anti-Corruption Commission be mobilized immediately to pursue the issue of Kshs.61,220,570.00 which was apparently collected by Fadmaster Ltd but appears not to have reached NOCK. Investigations be centred on Caltex and Kobil/Kenol and the then Managing Director of NOCK Mr. D.K Ng'enoh

5.2.0. DISTRIBUTION AND MARKETING

5.2. 1 Overview

National Oil Corporation of Kenya was formed as a strategic arm of the Government in the oil industry to guarantee supply of petroleum products as well as stabilize prices in the face of profit driven multinational oil companies in the market place.

Initially this objective was to be achieved through supply of 30% of crude oil for refining at Kenya Petroleum Oil Refineries, Mombasa. Until 1994 when the oil industry was liberalized, NOCK played the intended role fairly reasonably. After liberalization, NOCK had to change policy and decided to go into marketing of petroleum products like other oil companies. It was faced with a problem of not having any retail outlets that it could use to enter the market. The company decided on three-pronged approach: seek for consumer market, enter into supply contract with already existing independent marketers and to build own retail outlets. The Company relied on Kenya Pipeline facilities for loading at Nakuru, Eldoret and Kusumu but was completely constrained in Nairobi and Mombasa where KPC did not have loading facilities. Up to now NOCK has no consumer or retail business in Coast Province.

To overcome the problem of loading facilities in Nairobi a depot has been built and this may rank as the most successful project carried out by NOCK with Government financial support. The company is earning approximately Kshs.8.0 million per month from this project. Secondly, the company developed six retail outlets, that is Embakasi in Nairobi, Ravine in Nakuru, Langas and Bondeni in Eldoret, Lakeview in Kisumu and Kaplong in Sotik. These outlets, while well intended, were built at exorbitantly high costs such that realizing full return on them is virtually impossible. These outlets will remain a burden on the company for many years to come. Finally the company searched for, and whenever they were able to find, an independent investor who had constructed the outlet on his own, the company would provide the pumps on the understanding that the said retailer would draw products from NOCK.

NOCK was very weak in what now was their core activity- buying and selling petroleum products. While procurement of products was more or less orderly and perhaps less loss making, marketing was where NOCK lost nearly all the money.

NOCK did not have experienced oil industry management and marketing staff and was without effective organizational structure. Credit policy was non-existent. Inexperienced employees who faco;ated theft staffed depots and service stations. Senior managers may even have just given away products to comrades without intention of receiving payment. Influential personalities of to paying and by the year 2002, total debtors bill exceeded Kshs.300.0 million.

Collection of debts has been difficult partly because of poor record keeping and partly because some of the employees may have been collaborators in these deals and do not wish to push for collection as such an act would expose them.

In an interview with Mr. Hosea Kili, a former Company Secretary, he maintained that the debtors' records were not accurate and did not reflect the real situation.

5.2. 2 Recommendations

i. ***NOCK should make every effort to ensure it fully utilizes the expensive service stations it built. In this connection NOCK should hire qualified and experienced high calibre supply planning and marketing staff.***

ii. ***The office of the Controller and Auditor General should immediately send auditors to NOCK to concentrate on creditors and debtors accounts and make specific recommendatiosn on action to be taken on every account including surcharging officers responsible for the loss of the Corporation's money.***

iii. ***NOCK should make every effort to enter retail , consumer and bunkering business in the Coast Province.***

iv. ***Every effort should be made to ensure NOCK is properly funded and the right staff and management systems are in place so that NOCK can effectively play its strategic role.***

5.4.0 BUSINESS PERFORMANCE

5.4.1 Financial Performance Indicators

Although the accounts indicate that NOCK made consistent profits in 1996/97 and 1997/98, the core activities of NOCK did not generate any profits. The profits arose from non-core incomes comprising revenue grants, interest income and other including sales proceeds from geological maps and report sales as shown below:

The following table shows how NOCK has performed over the listed years:

Item	1996/97	1997/98	1998/99	1999/2000	2000/2001	2001/2002
Turnover	564,237,635	1,547,380,083	1,327,991,476	1,728,567,066	1,628,001,435	1,175,484,408
Gross Trading Profit	91,064,226	143,306,163	62,055,037	144,760,694	21 856,558	49,196,153
Overhead Expenses	110,689,756	186,130,085	208,183,605	242,445,646	276,635,599	255,814,091
Govt Grants/ Interest income	57,486 917	72,067,353	40,922,556	29,585 458	28,591,580	30 992,864
Working Capital	585,464,998	477,920,455	277,972,871	226,982,289	153,202,976	(161,509 698)
Net Profit/Loss	37,861,387	29,243,431	(105,206,012)	(68,091,494)	(226,187,461)	(175,625,074)

5.4.2.Observations

During the period under review, the Corporation's expenses exceeded its gross income in the financial years 1998 to 2002. Further, the Corporation had a negative working capital of Kshs.161,509,698.00 in the financial year 2001/2002. This was due to the short-term loan of Kshs.137,560,675 received by the Corporation to finance its operations. Despite a turnover that has been rising impressively, the corporation is still a loss-making proposition and prospects for profitability are rather dim.

The Corporation has been recording a very low gross margin when compared to the industry average. This means that the contribution from operations to meet the operating expenses is very low. Consequently, the net margin, the return on investment and earnings per share are negative. This is unsuitable even in the short run since the corporation is already depleting its equity and soon lenders will be reluctant to extend more credit.

In 2002/2003 trading period NOCK had:

- Kshs.61.0 million loan at 14% per annum interest
- Kshs.247.0 million overdraft throughout the year
- Kshs.162.0 million miscellaneous creditors
- Kshs.338.0 million owed to Kenya Revenue Authority.

During the same period the Corporation spent Kshs.55.0 million to service the bank loan and overdraft. The overdraft represents the Corporation's continued reliance on credit to finance its trading activities. Due to high overhead expenses, the company is unable to make profits with which it can liquidate the overdraft.

The performance of NOCK has been adversely affected by serious mismanagement as indicated in the audited accounts. Such mismanagement involved irregular awards of tenders and contracts, misuse and outright embezzlement of funds, massive losses through investments in dubious financial institutions and purchase of assets at inflated costs among others. These irregularities can be attributed to lack of a proper constituted Board of Directors, well-trained staff in the oil industry, lack of procedures, internal controls and systems.

5.4.3 Recommendations

1. ***NOCK must take steps to reduce their overhead expenses. In this regard NOCK should reduce staff to around 80 persons and cede about 50% of office space currently occupied.***
2. ***NOCK should consider converting Kshs.247.0 million overdrafts to long term debt to reduce bank charges.***
3. ***As an alternative the Government should provide NOCK with additional Kshs.750.0 million. Kshs.500 million of this amount will be used to liquidate the bank loan, overdraft and the business creditors. The balance Kshs.250.0 million will be used to finance its operations. This will also save Kshs.55.0 million annually which is currently used to finance the bank loan and overdraft.***

CHAPTER SIX (6)

DISCOUNT NIGERIAN CRUDE OIL PURCHASE CONTRACT

6.0 DISCOUNT NIGERIAN CRUDE OIL PURCHASE CONTRACT

6.1 Introduction

In 1999 Nigerian National Petroleum Corporation [NNPC] offered Kenya Government 30,000 barrels per day of crude oil at a discount. The Government then gave the responsibility to National Oil Corporation of Kenya [NOCK] to implement the agreement.

National Oil Corporation of Kenya could not lift crude to bring it to Kenya because of :-

(i) **Logistics:** The distance from Nigeria by ship through South Africa or Mediterranean/Suez-canal would increase freight cost to the extent of making the Nigerian Crude uneconomic.

(ii) **Refining Limitation:** Kenya Petroleum Refinery in Mombasa is not designed to process Nigerian Crudes.

(iii). NOCK did not have the requisite trading skills in terms of personnel to be able to lift the crude oil from Nigeria and sell it on the open market for profit. Thus NOCK opted to engage the services of a reputable oil trading company VITOL S A to do this on their behalf. At this stage NOCK did not negotiate aggressively with VITOL for a more reasonable consideration.

6.2 The First Contract

In November 1999, NOCK entered into an agreement with VITOL SA of Geneva Switzerland to lift its allocation. The main ingredients of the contract were:-

(i) It was tripartite – NOCK, VITOL SA and NNPC for 30,000 barrels per day to be lifted on a monthly basis.

(ii) Assignee [i.e. VITOL] was to avail a bank draft for the sum of US$1,000,000 in favor of NNPC

(iii) The contract was for one year and renewable.

(iv) VITOL SA to pay NOCK US$0.03 per barrel and that US$0.01 was to be paid to NOCK for all the contracted liftings, on the day of signing the agreement. The rest of the payments [i.e. US$0.02] to be paid to NOCK 30 days after each monthly lifting. This amounted to a paltry Kshs.8.0 million assuming all the contracted crude would be lifted and paid for.

(v) VITOL SA was to provide an acceptable performance bond for a sum of up to US$500,000, in favor of NOCK.

(vi) Total premium paid in the first year of the contract was **Kshs.26,488,852.00**.

The contract ran from January 2000 to January 2001. In October 2001, NOCK was invited to sign a rollover contract. There is no record of what happened, but the following pieces of information have filtered through:-

(i) NNPC had production problems which reduced their production levels and so they were unable to meet their commitment to NOCK

(ii) That at some point, OPEC ordered a reduction of production of Nigerian crude to the tune of 124,000 barrels hence NNPC was unable to meet NOCK commitments

(iii) That NNPC allegedly cancelled the NOCK deal.

None of the above has been confirmed in writing. Those we asked said the Managing Directors had proprietary control of this information.

The question is, if NNPC actually cancelled the contract why did they not inform NOCK officially. If they did not cancel, who lifted the NOCK allocation and where is the premium? In an interview with the

Committee, the current Managing Director of NOCK, said she believes the contract was not cancelled at any time.

6.3 The Second Contract

The contract seems to have come up for renewal early this year. Off the record, it was initially awarded to Glencore [UK] Ltd at a consideration to NOCK of US$0.035 per barrel. This had been done without consultations. When the draft agreement reached MoE, it was rejected and NOCK was advised to call for bids. Letters inviting quotations went to eight [8] companies on 12th February 2003 but by closing date on 28th March 2003 only two companies had quoted as follows:-

(i)	Petroplus	US$0.035/barrel consideration
(ii)	Glencore	US$0.10/barrel consideration

The business has been awarded to Glencore Energy [UK] Ltd. Terms and conditions of the contract are a copy of those with VITOL SA except it is not tripartite.

6.4 Observations

(i) The Committee has not seen background working papers and calculations determining US$0.03 or US$0.10 per barrel considerations.

(ii) While the Committee is not aware of the price concession level allowed by NNPC, it is common practice in international Crude oil business that discounts are around US$1.00. If that is the case then the value of this deal to Kenya is US$10,950,000 [Shs.766,500,000]. Under the current deal Kenya will probably get only US$1, 000, 000, or a tenth of the real value. It is a national shame that NOCK would agree to give away over Kshs.700 million to a foreign company when the same has been kindly offered by a friendly nation to assist in Balance of Payments.

(iii) The genesis of Nigerian Crude was budgetary support to Kenya in the face of increasing cost of importation of Crude Oil. This focus is not evident in the previous undertakings.

(iv) Kenya's Petroleum Consumption is about 50, 000 barrels per day, which implies that Nigerian crude offer represents 60% of the national needs.

(vi) The committee has noted that the award of the contract to GLENCORE was not presented and approved by the Board prior to signing-contrary to section 15, subsection 1 of the State Corporation Act Cap 446.

6.5 Recommendation

i. ***The Ministry of Energy and National Oil Corporation needs to go into a detailed study of what transpired in the last three years and make a recommendation for the future [given the amounts of money involved], including a trip to Nigeria to hear directly from NNPC. Effort should be made to recognize the importance of this deal and its potential budgetary support to Kenya or second an officer to Kenya High Commission briefly to study this deal in details***

ii. ***Activities of Glencore must be monitored closely to ensure no loss of revenue to Kenya.***

iii. ***The Agreement with GLENCORE should be re-negotiated as it is lopsided and consideration should be made more equitable. GLENCORE should be receptive to this proposal especially if they are made aware that if they do not agree to renegotiate they would not be considered for future business.***

CHAPTER SEVEN (7)

PERSONNEL ADMINISTRATION

7.0 PERSONNEL ADMINISTRATION

7.1 Current Organization Structure

NOCK is currently undergoing a restructuring process with a view to meeting new challenges following liberalization and restructuring of the oil industry. The current structure was recommended by the Directorate of Personnel Management (DPM) after a study undertaken in the year 2000. The recommendations from the team once implemented were meant to make the corporation more focused and competitive in order to match the rivals in the market.

The structure has the following seven departments headed by Departmental Managers:-

i. Human Resources
ii. Company Secretary/Administration
iii. Finance/Accounts
iv. Supply Planning and Operations
v. Corporate Planning/Project Management
vi. Marketing and Sales
vii. Exploration and Production

7.2 Current Staff Establishment

According to information available, the Corporation has maintained overall labor force at Nairobi and outstations like Nakuru, Kisumu and Eldoret at around 150with the highest number reached being 164. It is not clear how these numbers were determined. The table below shows the changes over the years under review:-

Year	Non-Union	Unionizable	Staffing Level
31st Dec,1992	58	58	116
,, 1993	59	59	118
1994	63	53	116
1995	61	48	109
1996	85	50	135
1997	100	56	156
1998	104	60	164
1999	84	69	153
2000	69	36	105
2001	71	64	135
2002	77	41	118
Jan – August 2003	85	45	130

It is evident from the above table that the numbers are not based on any justifiable staffing levels nor on clear job specifications and descriptions.

In an interview with the Managing Director, Mrs. Mary M'Mukindia, she stated that the company was in the process of reviewing their staff strengths and they estimated that they would be reduced to about 80 staff members. The Committee believes the number of 80 would compare favourably with other small marketers such as Total who have a market share of 10%, which is higher than NOCK.

7.3 Recruitment of Staff

Over the period under review, we have noted that NOCK did not have a clear employment policy. It was haphazard leading to hiring of unqualified and unnecessary personnel.

7.4 Temporary and Casual Employment

Casual and temporary employment is undertaken by the Managing Director or his designate and is for specified period not exceeding six consecutive months. A list available to the committee indicated that out of 20 temporary employees in May, 2003, 14 belonged to one ethnic group. Top management of NOCK were using this type of employment to reward relatives and friends who were unemployed. This has an added effect of demoralizing other staff.

7.5 Retrenchment of Staff

During the financial year 2000/2001 National oil Corporation of Kenya irregularly retrenched forty three (43) employees at cost of Kshs.8,397,094.50. Out of the 43 retrenched employees, 30 were unionisable and 13 non-unionisable employees. Relatives of senior employees immediately replaced the retrenched employees.

Although the Board of Directors approved the exercise, management did not seek Government approval as required by Office of the President circulars Ref. No. OP.13/19A of 7th November, 1995 and Ref. No. OP.13/19A of 23rd June, 2000 on the administration of the

Reform Program in the public service and therefore the employees terminal benefits were taxed which should not have been the case. Mr. Moiywo , the former Managing Director said he was unaware of this requirement.

It is worth noting that computation of the terminal benefits both for unionisable and non-unionisable employees were pegged to the redundancy clause of the Collective Bargaining Agreement (CBA) which expired on 30th June, 2002.

The lowest and highest paid person for each cadre among those who were retrenched is as shown below:-

Cadre of Staff	Gross Pay	Net Pay
	Amount in Kshs	Amount in Kshs
Unionisable Staff		
Lowest paid	51,312.45	38.122.80
Highest Paid	765,990.00	563,500.00
Non-unionisable Staff		
Lowest paid	107,083.80	(190,115.10)
Highest paid	1,024,855.00	523,801.00

7.6 Observations

i. The following 3 management staff who were on redundancy list owed the company money as shown against their name but were cleared by Mr. Kili without any plans to recover the money:

Name	Net Pay
Joyce M. Kibathi	(73,562.00)
Kiprotich V. Chelimo	(190,115 10)
Capt Frameling Njeru	(38,776.10)

ii. The corporation funded the retrenchment exercise from the budgetary allocation that were made during the financial year 1999/2000.

7.7 Staff Loans and Advances

NOCK offers the following loans and advances to its staff:

		Minimum	Maximum	Payable
i.	Car Loans	400,000	850,000	5 years
ii.	Furniture loans	15,000	18,000	1 year
iii.	Motorcycle	250,000	300,000	5 years
iv.	Car insurance	1st Year-100%	5th Year- 20%	5 years

7.8 Observations

i. It is noted that 7% interest is charged on motor vehicles, bicycle, motorcycle, and car overhaul loans but furniture is interest free.

ii. The former company secretary Mr. Hosea Kili who was the chairman of the Finance and General Purpose Committee of Management awarded car loans indiscriminately and without safeguarding NOCK's interest.

iii. For that reason NOCK lost money to officers who have left the service as indicated below:

	Name of Staff	unpaid Car loan Balances (in Kshs)	Remarks
i.	Joseph Kwambai	2,072,363.80	Car repossessed
ii.	John Wangusi Wafula	77,669.00	Case in court
iii.	Joyce Kibathi	69,480.10	Not yet paid
iv.	H. Athongo	395,275.00	Case in court
v.	Pamela Nyaga	55, 263.70	Not paid.
	TOTAL	**2,670,051.60**	

7.9 Terms and Conditions of Service

The current terms and conditions of service were done in 1983 at the time of its establishment. Analysis of the terms and conditions of service indicate that the corporation had been undertaking piecemeal reviews and implementing the same without Government approval (except for salaries and House Allowances).

7.10 Union sable Staff

The terms and conditions of service for the unionisable staff are governed by the Collective Bargaining Agreement (CBA) which is renewed every two years.

7.11 The Position of a Company Secretary

Mr. Hosea Kili joined NOCK after graduation without any experience at all. During his tenure at NOCK, he recommended hiring of inexperienced lawyers, encouraged several suits most of which are stuck in courts with no hope of immediate conclusion. In other cases lawyers have been paid but have not filed the cases in courts.

It was very clear from the interview that Mr. Kili saw himself more as a lawyer than a manager of NOCK with responsibility. He carried out legal transactions in the same way a street lawyer would handle pass-by clients. He signed land purchase documents without bothering to confirm the land's proper existence as in the case of Shanzu and Nakuru plots.

7.12 Recommendations

i. ***NOCK should establish operating procedure manuals to be adhered to by all employees.***

ii. ***NOCK should proceed diligently to recover Kshs.2,670,051.60 owed by employees who left the corporation.***

iii. ***The former Managing Director, Mr. Francis Moiywo and the former Company Secretary/Administration Manager Mr. Kili*** *should be surcharged for irregularly retrenchment exercise carried out in the year 2000 and the resultant loss of Kshs. 304,452.20 suffered by the corporation*

iv. *In future, qualification to the position of Company Secretary should include prior experience in similar position.*

CHAPTER EIGHT (8)

OIL EXPLORATION

8.0 OIL EXPLORATION

In 1981, the Government obtained a petroleum exploration project loan 2065KE from the World Bank for the purpose of stimulating oil exploration in Kenya. The credit 2065KE was later renewed as World Bank Credit 1675KE in mid 1980s. While the project was to be implemented by the Ministry of Energy, the ministry delegated the role to NOCK, which is currently still involved in administration of oil exploration, which is wholly funded by the Government.

While the corporation has carried out extensive geological classification of the country, it has not to date recorded significant success in spearheading exploration on behalf of the Government except in collection of massive data. Between 1984 and 1991 a number of oil companies carried out exploration work under production sharing contracts but again no positive results were realized.

8.1 Funding

World Bank Credit 1675KE funding ended in 1994 after which there was no direct funding for petroleum exploration activities until 1998 when the Government through the Ministry of Energy (MOE) undertook funding for the project. By the time the credit lapsed, in January 1994, a total of US$ 5,500,000 had been listed in Technical Services, Consultancy and laboratory equipment procurement as well as installation and training.

During the financial year 1997/98 to 2000/01 Treasury disbursed Petroleum Development Levy (PDL) Funds to the tune of Kshs.203,000,000 to MOE and counter cheques were drawn and remitted to NOCK for exploration activities as shown in the table below:

8.2 Ministry of Energy Funding

Year	Cheque Date	Amount (Kshs. million)
1997/98	30/06/1998	50
1998/99	27/01/1999	50
1998/99	25/06/1999	50
1999/2000	15/12/1999	30
2000/2001	29/03/2001	23
	TOTAL	**203**

8.3 Budgeting

The budgeting for the petroleum exploration project included the following:

i. Geological Studies
ii. Geochemical and geophysical studies
iii. Environmental Impact Assessment(AIA)
iv. Monitoring of exploration activities
v. Consultancy/contracted specialized services
vi. Project Equipment and material costs
vii. Acreage promotion
viii. Tape storage facility
ix. Training
x. Purchase of motor vehicles
xi. Administration costs

8.4 Observations

i. The exploration department has obviously done a commendable job in mapping hydrocarbons areas in Kenya but they seem still far from finding oil, the real reason for capital expenditure.

ii. There are substantial funds being utilized for training and its control is not clear.

8.5 Recommendations

i. *Stricter financial control mechanism should be put in place.*

ii. *There should be some control on training and where a person has been trained, such a person must be bonded to serve for a particular period of time before leaving the company,*

iii. *NOCK should prepare a programme of work with a budget which should be regularly monitored.*

CHAPTER NINE (9)

GENERAL OBSERVATIONS AND RECOMMENDATIONS

9.0 GENERAL OBSERVATIONS AND RECOMMENDATION

9.1 Problems facing NOCK.

The origin of NOCK'S problems was the Government's failure to appoint to effective positions people with oil industry management skills and experience. All Managing Directors from initiation in 1981 to 2003 had no experience in the oil industry operations and management. The matter was further complicated when those who were appointed relied on ethnicity to hire employees rather than on capability and competence leading to the following:

i. Unprofitable core activity. The Corporation does not generate profit from oil marketing.

ii. Poor corporate governance and corruption in hiring staff and utilization of company resources.

iii. Lack of internal and budgetary controls.

iv. Inadequate funding for trading activities

v. Lack of Truck Loading Facilities in key market areas; petrol service stations owned by NOCK have accordingly been concentrated in the Western part of the country along the pipeline where NOCK takes advantage of KPC loading facilities.

vi. NOCK lacks qualified, highly motivated and competent staff to handle critical tasks in order to achieve its objectives. Supply planning, Marketing, Finance and legal sections among others need to be strengthened.

9.2 General Recommendations

i. ***The Corporation's management should utilize the local facilities provided by Kenya Commercial Bank to procure petroleum products in large quantities to take advantage of economies of scale and improve on the gross margins.***

ii. ***NOCK should increase surveillance of retail outlets to ensure that they procure products from the Corporation's depots only and not from competitors.***

iii. ***NOCK should make project investment decisions based on thorough review of potential profitability and conduct progress reviews. The Board of Directors should be involved in both stages***

iv. ***NOCK should strengthen the internal audit department to help curtail theft and fraud at depots and service stations and ensure that the corporation does not overshoot the budget. A copy of internal audit reports should be sent to the Ministry of Energy headquarters regularly.***

v. ***NOCK should institute preparation, approval and implementation of various procedures and internal control manuals.***

vi. ***NOCK should develop proper information systems through the installation and integration of appropriate computer software. The purchase and immediate installation of a finance and accounting software that conforms to the requirements of the oil industry will go along way in ensuring the integrity of the corporation's accounting records.***

vii. ***It is the general policy of the Government that parastatal and state corporations be self sustaining. In this regard the corporation cannot take for granted continuation of Government support in meeting its operational needs. Operating costs must be reduced to fit the revenue that is generated and leave funds for expansion. This can only be possible if the corporation enhances efficiency in procurement, pricing, marketing and distribution of products; and maintenance of operational costs at a sustainable level.***

viii. *Ministry of Energy should strengthen the Board of Directors by ensuring that all the eleven competent members are appointed on a timely basis.*

ix. *National Oil Corporation of Kenya should be the nation's repository of petroleum industry's technology and data.*

APPENDICES

Appendix 1

MEMBERS OF THE COMMITTEE

NAME

Hon. Darius M. Mbela, EGH		Chairman
Mr. Alpheus M. Kagondu		Secretary
Mr. Charles N. Kariuki		Member
Gerishom L. Majanja		Member
Mr. Vincent Walubayi	-	Representing the Permanent Secretary, Ministry of Roads, Public Works and Housing.
Ms. Theodora K. Gichana	-	Representing the Inspector – General (corporations), Inspectorate of State Corporations.
Mrs. Christine M.W. Mwangi	-	Representing the Permanent Secretary, Ministry of Energy

Appendix II

PLACES VISITED BY MEMBERS OF THE COMMITTEE

1) NOCK Headquarter
2) Nairobi Plot No. LR 16024/Ongata Rongai
3) Managing Director's official Residential House.
4) Nairobi Truck Loading facility
5) Outer Ring Road Service Station
6) Kayole Service Station Site
7) Nakuru plot No. LR 16/300 [Hyrax]
8) Nakuru plot No. LR 21/581 on Ravine Road
9) Bondeni Service Station (Eldoret/Busia Road)
10) Langas Service Station (Eldoret/Kapsabet Road)
11) Lakeview Service Station (Kisumu/Busia Road)
12) Plot No. Gem/Nyan/494 situated in Yala Township.
13) Kaplong Service Station (Kericho/Sotik Road)
14) Mombasa Plot No. MN 1/9427/Shanzu/Mombasa
15) Mombasa Plot No. XLVIII/158 – Mbaraki/Mombasa
16) Plot No.3061/Ukunda/Kwale

Appendix III

LIST OF DOCUMENTS USED

1) Proposed NOCK Credit Policy
2) Proposed Procurement Procedure
3) Proposed Authorities manual
4) Bad & Doubtful Debt Summary
5) Stock Account Task Force Report
6) Downstream Implementation Project
7) Annual report/accounts 1995/96
8) Annual report/accounts 1996/97
9) Annual report/accounts 1998
10) Annual report/accounts 1999
11) Annual report/accounts 2000
12) Annual report/accounts 2001
13) Annual report/accounts 2002
14) Annual report/accounts 1^{st} Q 2003
15) Annual report/accounts 2^{nd} Q 2003
16) Annual report/accounts 3^{rd} Q 2003
17) Petroleum Exploration Report
18) NOCK management letter 17/07/01

19) NOCK organization chart of 19/05/03

20) Agreement between Glencore and NOCK

21) File NOCK (Y)

22) List of suits (A)

23) Training list

24) List of Suits (B)

25) List of plots

26) List of Redundant Employees.

27) Organization chart at Inception

28) Organization chart by DPM

29) Proposed organization Chart 2003

30) 1999 Management Audit Report

31) MoE Special Audit

32) Assignment of Nigerian Crude

33) Oil by NNPC/NOCK

34) Board Minutes 1994

35) Board Minutes April 1995

36) Board Minutes September 1996

37) Board Minutes January 1998

38) Board Minutes May 1996

39) Board Minutes May 2001

40) Board Minutes March 2003

41) Economic study Kisumu/ Busia Road

42) Economic study Uganda Road/Eldoret

43) Northline feasibility study Embakasi

44) Northline Feasibility Study Ravine Road

45) Petroplus/NOCK Agreement (A)

46) Petroplus/NOCK Agreement (B)

47) Petroplus proposal to PS

48) Proposed MoU-Petroplus/NOCK

49) NOCK Human Resources Procurement manual

50) Ngeno/Bomett Rent Memo

51) Rent Assessment for MD House

52) Pension Trustee Document

53) Retirement Benefits Scheme

54) Investment Management Service

55) Staff Retirements Benefits accs 2000

56) Staff Retirement BenefitsAccs 2001

57) List of employees

58) Staff Retirement Benefits Acs 2002

59) Revised car loan scheme

60) CBA of 2002

61) DPM Re-organisation Study

62) Tecaflex Agreement

63) Petroplus Africa

64) NOCK organization chart in 2002

65) Dealer Licence Ravine Rd

66) NIGERIAN CRUDE OIL

67) NOCK file (P)

68) NOCK Way forward Memo

69) Developed Retail Outlets

70) Note on Euro Bank

71) Internal memo (22/5/2002)

72) Auditor General Ext

73) Letter/attachments to PS (17/3/2003)

74) NOCKs letter to PS on Petroplus

75) Document on TAMCON Consultants

76) Legal opinion TECAFLEX

77) TECAFLEX Management contract

78) NOCK Inspection report

Appendix IV

LIST OF PERSONS INTERVIEWED

1.	Mr. Joseph K. Kwambai	Former Managing Director.
2.	Mr. F.K Moiywo	Former Managing Director
3.	Mrs. M. K. M'Mukindia	Current Managing Director
4.	Mr. James Nyamongo	Former Chief Accountant
5.	Mr. Evanson Obare	Marketing Manager
6.	Mrs. Mary W. Murathe	HRD
7.	Mr. George O Mogaka	Legal Officer
8.	Mrs. Carolyne C. Misoi	HRD
9.	Mr. John N. Masibo	Supply Planning
10.	Mrs. Faith Njuguna	Accountant