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Opposition Coalition for Reforms and Democracy (CORD) leader Raila Odinga revives allegations that government cannot account for \$1 billion in previous international bond issues. Odinga warns President Uhuru Kenyatta (2013- present) against attempts to oust auditor general Edward Ouko. Kenya Airways Ltd appoints former Safaricom Ltd CEO Michael Joseph as chairman, and records reduced first half losses of \$47m. The Islamic State militant group claims responsibility for an attack on the United States (US) embassy in Gigiri District, Nairobi, in which a General Service Unit (GSU) officer is stabbed.

Odinga resurrects allegations of missing Eurobond funds

Opposition **Coalition for Reforms and Democracy (CORD)** leader **Raila Odinga** on 17 October cautioned transaction advisers and investors against participating in a proposed **Eurobond** offer.¹ Odinga will probably contest the August 2017 presidential election, and his allegations are indicative of how political and fiscal policy uncertainty will increase either side of the polls deterring both market and foreign direct investors. Odinga repeated previous allegations that the government cannot account for approximately \$1 billion of \$2.8 billion raised in previous international bond issues in 2014.² Odinga alleged that the government failed to deposit the funds in the **Central Bank of Kenya's (CBK)** consolidated fund as legally required.³ In January, Odinga alleged senior government officials had benefited from the funds:

- Presidential chief of staff **Joseph Kinyua**;
- Treasury cabinet secretary **Henry Rotich**;
- Treasury permanent secretary **Kamau Thugge**;
- CBK chairman **Mohammed Nyaoga**;
- CBK financial markets director **John Birech**;
- CBK financial markets manager **Moses Muthui**;
- Controller of budget **Agnes Odhiambo**;
- Treasury cabinet secretary **Bernard Muiruri Ndungu**;
- Treasury chief accountant **Julius Kilinda**;
- Former CBK governor **Njuguna Ndung'u**.⁴

The government has denied the funds are missing, saying it used the funds to pay off a \$600m syndicated loan, finance road, rail and port construction, and expand electricity generation.⁵ In May, director of public prosecutions **Keriako Tobiko** declined to investigate allegations about misappropriated funds, citing a lack of evidence.⁶

Related to the Eurobond funds, Odinga has threatened to hold protests in **Nairobi** over perceived ruling **Jubilee Party** attempts to oust auditor general **Edward Ouko**.⁷

¹ Bloomberg, 17 Oct 2016.

² Bloomberg, 17 Oct 2016.

³ Bloomberg, 17 Oct 2016.

⁴ Daily Nation, 16 Jan 2016.

⁵ Bloomberg, 17 Oct 2016.

⁶ Bloomberg, 17 Oct 2016.

⁷ Citizen TV, 24 Oct 2016.

*“There was an attempt to remove Ouko from office by recommending that he be charged for inflating an audit software that was purchased by his department. The plan was thwarted after directors in the **Ethics and Anti-Corruption Commission (EACC)**, the state body that investigates graft, differed on the sensitive matter. Ouko has a reputation for being apolitical and a thorough professional, having been the auditor general at the **African Development Bank**.”⁸*

Odinga alleged that the Jubilee Party is looking to oust Ouko to derail investigations into government corruption.⁹ In October, President **Uhuru Kenyatta** (2013- present) publically criticised Ouko for wanting to question **Federal Bank of New York** officials over allegedly misappropriated international debt issuances.¹⁰

*“At a **State House**-organised accountability summit that was ignored by top governance experts including whistle-blower **John Githongo**, the president took the opportunity to lash out at the judiciary, the EACC, Tobiko and Ouko. Kenyatta publically mocked Ouko.”¹¹*

Odinga threatened to hold protests in an attempt to oust Kenyatta should the president remove Ouko.¹² Kenyatta has repeatedly moved to curb the authority of Ouko who has provided increasingly effective oversight of spending at government ministries, department and agencies. In December 2015, a presidential directive allowed government ministries access to **Kenya National Audit Office (KNAO)** reports before the auditor general tables them in parliament.¹³ Presidential chief of staff Kinyua issued the directive that requires the KNAO to make reports available to the government seven days before tabling them in parliament.¹⁴ Political pressure on Ouko has increased since July 2015, when his audit of the 2013/2014 budget revealed that only 26% of government funds and 1.2% of government expenditure were properly accounted for.¹⁵ Treasury cabinet secretary Henry Rotich published a statement criticising the accuracy of the audit. According to the constitution, only a presidential tribunal convened on the recommendation of the national assembly can remove the auditor general. The office is otherwise politically independent, with Ouko, who was appointed in August 2011, due to complete his eight-year mandate in 2019.¹⁶

The Kenyan government is considering raising \$4.6 billion in debt to bridge a budget deficit expected to increase to 9.3% of gross domestic product in 2016 from 7.9% in 2015. Analysts forecast that the government will look to issue a Eurobond before a likely **United States (US) Federal Reserve** rate increase in December.¹⁷ Officials began a US roadshow in October. Political pressure may, however, encourage the government to look to alternative sources of financing. However, investors have downplayed the impact of the allegations, noting that they have factored in Kenya’s traditionally volatile domestic politics into their considerations.

It is not just investor sentiment that corruption undermines, with popular frustration increasing at the government’s failure to curb corruption. A leaked audit report in October revealed that over \$50m was lost at the health ministry through the awarding of contracts to ghost companies, prepayments for goods not supplied, and theft.¹⁸

*“The health ministry scandal has resulted in a rare show of unity amongst Kenyans due to the difficulties that most Kenyans face as a result of the poor state of the country’s healthcare system. The latest scandal is also reading from the same script as the \$8m **National Youth***

⁸ Source, journalist, Nairobi

⁹ Citizen TV, 24 Oct 2016.

¹⁰ Citizen TV, 24 Oct 2016.

¹¹ Source, journalist, Nairobi

¹² Citizen TV, 24 Oct 2016.

¹³ Business Daily, 5 Jan 2016.

¹⁴ Business Daily, 5 Jan 2016.

¹⁵ Auditor general 2013 – 2014 report

¹⁶ Citizen TV, 24 Oct 2016.

¹⁷ Bloomberg, 17 Oct 2016.

¹⁸ Source, journalist, Nairobi

*Service (NYS) scandal that followed the same lines of dud companies, prepayments for services not rendered and overpricing of goods and services.*¹⁹

The health ministry scandal has also damaged the reputation of the **State Law Office**. Records of **Estama Ltd**, one of the companies that allegedly fraudulently benefited, are missing from the **Registrar of Companies**.

*“Estama and other companies were paid despite hefty amounts not having legal documents such as tax compliance certificates, a mandatory requirement for companies that are tendering for government services. Records for **Medafrica**, another supplier, are also missing despite the firm similarly receiving millions of shillings in payments.”*²⁰

Esaki Ltd, a company connected to former EACC chairman **Philip Kinisu**, was a suspect supplier to NYS and appears to be additionally linked with the health ministry corruption.²¹

Kenya Airways appoints Michael Joseph chairman

Nairobi Securities Exchange-listed **Kenya Airways Ltd** on 26 October confirmed the appointment of former **Safaricom Ltd** CEO **Michael Joseph** as chairman.²² Kenya Airways reportedly requires a \$1 billion cash injection and MPs have demanded changes at senior management level before approving more financial support.²³ Joseph’s predecessor, **Dennis Awori**, had announced on 16 October that he would stand down before the end of the year.²⁴ Joseph only joined the Kenya Airways board in October.²⁵

Tourism cabinet secretary **Najib Balala** said on 17 October that there would be major unspecified restructuring of Kenya Airways before the end of the month.²⁶ The cabinet is currently considering a **Deloitte** audit of Kenya Airways completed in August that reportedly calls for criminal and disciplinary action against the company’s senior and mid-tier management.²⁷ The government is reportedly ready to act on the conclusions and recommendations of the audit in early November.²⁸ The audit reportedly recommends disciplinary action against CEO **Mbuvi Ngunze** for contravening company regulations for opening a **Dubai Bank Kenya Ltd** account with a \$7m bank guarantee letter in breach of the board’s approved \$5m limit.²⁹ A Kenya Airways senior accountant faces criminal charges related to personally gaining from foreign exchange transactions at Dubai Bank without the board’s approval. The CBK placed Dubai Bank under receivership in August 2015. The audit reportedly accuses Dubai Bank chairman **Hassan Zubedi** and operations manager **Deeraj Baghel** of defrauding Kenya Airways.³⁰

Kenya Airways on 27 Octobers published its first half results showing that pre-tax losses had decreased to \$47m from \$117m in the corresponding period in 2015.³¹ Kenya Airways cites a 3.3% increase in flight occupancy, with passenger numbers increasing by 89,000 to 2.2 million, and lower operating costs. Kenya Airways recorded a 56.6% increase in profit to KSh963m (\$9.5m) compared to KSh2.2 billion (\$22m) operating loss in 2015.³² However, revenue decreased to KSh54.7 billion

¹⁹ Source, journalist, Nairobi

²⁰ Source, journalist, Nairobi

²¹ Source, journalist, Nairobi

²² Capital FM, 26 Oct 2016.

²³ Financial Times, 16 Oct 2016.

²⁴ Financial Times, 16 Oct 2016.

²⁵ Business Daily, 18 Oct 2016.

²⁶ Business Daily, 18 Oct 2016.

²⁷ East African, 16 Oct 2016.

²⁸ East African, 16 Oct 2016.

²⁹ East African, 16 Oct 2016.

³⁰ East African, 16 Oct 2016.

³¹ Daily Nation, 27 Oct 2016.

³² Daily Nation, 27 Oct 2016.

(\$539m) from KSh56.7 billion (\$559m) the previous year.³³ Overheads rose 14.5% to \$125m, which Kenya Airways attributed to its **Operation Pride** turnaround plan.³⁴ Kenya Airways received a \$17m cash injection in the first half from the sale of non-core assets. Kenya Airways said its three priorities are closing its profitability gap, refocusing the business model, and optimising capital.³⁵ Joseph confirmed that Kenya Airways will prioritise extending debt repayments over securing a strategic partner, a long-standing requirement.³⁶

The company said the figures are evidence that its Operation Pride turnaround plan, including cutting 600 jobs and reducing its fleet by approximately one third, is working.³⁷ As part of the plan, Kenya Airways on 14 October announced the suspension of flights to **Abuja (Nigeria)** and **Gaborone (Botswana)** as part of the restructure.³⁸ However, the turnaround plan has resulted in increased labour action. On 15 October, outsourced contract staff, who are calling for better wages and benefits, failed to turn up for work, resulting in the cancellation of flights.³⁹ The **Kenya Airline Pilots Association (KALPA)** on 17 October cancelled a planned seven-day strike scheduled for the next day.⁴⁰ KALPA had demanded the replacement of Awori and Ngunze over perceived mismanagement at the company.⁴¹ KALPA had previously committed to going ahead with the strike despite a court ruling on 14 October declaring it illegal.⁴² It is unclear what, if any, concessions the government made to avert the strike. Similar labour action over a single day in April had cost Kenya Airways \$2m.⁴³

The government holds 29.8% of Kenya Airways.⁴⁴ **Air France-KLM** is still looking to reduce its 27% stake.⁴⁵ This may involve a partnership with a **Gulf**-based airline. Observers have mooted **Emirates**, **Qatar Airlines** and **Etihad** as potential partners. A possible concern for the government is that Gulf-based airlines tend to seek an integrated model in which they control airport operations. It is uncertain whether the **Kenya Airways Authority** is to cede control over **Jomo Kenyatta International Airport (JKIA)** in particular in exchange for the required investment.

Islamic State claims responsibility for attack on US embassy

The **Islamic State** militant group on 30 October claimed responsibility for an attack on the US embassy in **Gigiri District (Nairobi)** on 27 October.⁴⁶ The exact involvement of the Islamic State, whether it provided inspiration or more direct support, is unclear at this stage. During the incident, a **General Service Unit (GSU)** officer shot dead a man who had stabbed him as he guarded the US embassy.⁴⁷ The incident occurred near the public entrance to the visa section of the embassy as the attacker reportedly tried to force his way into the building. The visa section was closed at the time of the incident. The unnamed attacker was a Kenyan national, of **Somali** ethnicity, from **Wajir County**, reportedly known to security services.⁴⁸ The GSU officer suffered severe injuries.

It is unclear whether the motivation behind the attack is criminal or terrorist in nature. However, the Islamic State through its **Amaq** media channel claimed responsibility for the attack.⁴⁹ The Islamic

³³ Daily Nation, 27 Oct 2016.

³⁴ Daily Nation, 27 Oct 2016.

³⁵ Daily Nation, 27 Oct 2016.

³⁶ Capital FM, 26 Oct 2016.

³⁷ Bloomberg, 14 Oct 2016.

³⁸ Financial Times, 16 Oct 2016.

³⁹ Financial Times, 16 Oct 2016.

⁴⁰ Daily Nation, 18 Oct 2016.

⁴¹ Financial Times, 16 Oct 2016.

⁴² Standard, 15 Oct 2016.

⁴³ Bloomberg, 14 Oct 2016.

⁴⁴ The Star, 29 Jul 2015.

⁴⁵ The Star, 29 Jul 2015.

⁴⁶ Standard, 30 Oct 2016.

⁴⁷ Standard, 30 Oct 2016.

⁴⁸ Standard, 30 Oct 2016.

⁴⁹ The Star, 30 Oct 2016.

State does not have a record of claiming attacks that it did not carry out.⁵⁰ The Islamic State said the attacker was “*responding to calls to target coalition countries*”.⁵¹ This is identical language to statements following attacks in **Europe**.⁵² The “*coalition*” in this case refers to the **African Union Mission in Somalia (AMISOM)** to which Kenya contributes forces, linking the incident to Islamic State’s ongoing – but largely unsuccessful – battle to supplant **al Shabaab** in Somalia. While there is no information to indicate that Islamic State has the capacity to conduct major terror attacks in Kenya, it is increasingly looking to conduct lower-level attacks through **East Africa**-based affiliate **Jahba East Africa**. Jahba East Africa first emerged in April 2016 and appears to consist of al Shabaab defectors.⁵³ The Islamic State first demonstrated this strategy of utilising militants in September when three women conducted an unsuccessful knife and petrol bomb attack on the central police station in **Mombasa**.

In response to the embassy incident, the US embassy closed on 28 October, and issued a statement calling on all US citizens to review their personal security plans. The GSU is responsible for guarding embassies and key installations in Kenya. There is a heavy domestic and international security presence at all major embassies, many of which are clustered in Gigiri. Near simultaneous **al Qaeda** car bombs attacked US diplomatic missions in both Nairobi and **Dar es Salaam (Tanzania)** in August 1998.

Implications

Transaction advisers and investors are unlikely to pay much heed to Odinga’s allegations; they are more likely to consider the positive performance of the 10-year 2014 Eurobond due to mature in 2024. Roadshows will give the government a platform to justify the expenditure. Nevertheless, Odinga raising historical allegations is ominous ahead of next year’s elections. Firstly, they indicate the failure of the Kenyatta administration to meaningfully address corruption through successful prosecutions and convictions. The pressure that Kenyatta is placing upon Ouko is indicative of an administration that would rather limit oversight than admit the extent to which it faces a deep-rooted culture of corruption. Secondly, Odinga raising previous allegations solely to disrupt a current debt issue suggest he is happy to run an election campaign that will disturb and delay effective government business until August.

The appointment of Joseph and reduced losses indicate that Kenya Airways is on a more positive commercial footing. However, the decreased revenue signals that structural issues including management and labour challenges persist despite Operation Pride.

It is difficult for security services to stop low-level attacks using knives as they are quick to prepare and implement. While such attacks are unlikely to breach a secure site as an embassy, they increase risks in public spaces. Likely targets include foreign expatriates from both western and AMISOM-contributing countries, government and military officials, and Christians.

⁵⁰ Source, security consultant, UK

⁵¹ VOA, 30 Oct 2016.

⁵² www.memrijttm.org

⁵³ Independent, 8 Apr 2016.

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