

# **REPORT OF THE AUDITOR-GENERAL ON EAST AFRICAN PORTLAND CEMENT PLC FOR THE YEAR ENDED 30 JUNE, 2019**

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## **REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS**

### **Opinion**

The accompanying consolidated and the company financial statements of East African Portland Cement PLC (the Company) and its subsidiary (together with the Group) set out on pages 25 to 75, which comprise the consolidated and the Company's statement of financial position as at 30 June, 2019 and the consolidated and the Company statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, have been audited on my behalf by PricewaterhouseCoopers, auditors appointed under Section 23 of the Public Audit Act, 2015. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

In my opinion, the financial statements present fairly, in all material respects, the financial position of East African Portland Cement PLC as at 30 June, 2019 and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Companies Act, 2015.

### **Basis for Opinion**

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of East African Portland Cement PLC in accordance with ISSAI 130 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with the ISSAI and in accordance with other ethical requirements applicable to performing audits of financial statements in Kenya. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

### **Emphasis of Matter**

#### **Material Uncertainty Related to Going Concern**

I draw attention to Note 2(a) in the financial statements, which indicates that the Group and Company incurred a net loss from operations of Kshs.2,062,381,000 (2018: Kshs.3,479,298,000) and Kshs.2,028,098,000 (2018: Kshs.3,804,171,000) respectively during the year ended 30 June, 2019. Further, the Group and Company's current liabilities exceeded the current assets by Kshs.10,170,657,000 (2018: Kshs.6,136,393,000) and Kshs.10,189,500,000 (2018: Kshs.6,208,657,000) respectively.

This movement was largely due to transfer of long-term loans to current liabilities on account of default on existing loan covenants. The Company defaulted on a loan from one of the key lenders, and subsequent to year end, obtained approval from shareholders to dispose some of the idle land to retire the debt.

Other factors that have affected performance have been explained in the Director’s Report and Managing Director’s Report. In particular, the plant continues to operate significantly below capacity due to working capital constraints, lack of essential spare parts and loss of market share to competitors. Due to the cash flow constraints, the Company has been unable to settle the amounts due to its key suppliers and regulatory authorities including Kenya Revenue Authority and pension liabilities.

In addition, the Company has significant litigations and claims against it which, if successful, may result in claims that are unlikely to be settled, given the entity’s current financial position. Details of the significant claims include employee related claims arising from unpaid salaries based on the Collective Bargaining Agreement (CBA) terms with an estimated total exposure of Kshs.1.7 billion, debt claims by suppliers for unpaid bills for services rendered and /or goods delivered totalling Kshs.411 million and claims arising from disputed deliveries, breach of distribution contracts and termination of supplier contracts totalling to Kshs.173 million.

These events or conditions, indicate that a material uncertainty exists that may cast significant doubt on the Group’s and Company’s ability to continue as a going concern.

My opinion is not modified in respect of this matter.

### Key Audit Matter

Key audit matters are those matters that, in my professional judgment, were of most significance in my audit of the financial statements of the current period. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters. In addition to the matter described in the material uncertainty related to going concern section above, I have determined the matters described below to be the key audit matters to be communicated in my report.

Key Audit Matter	How our Audit addressed the Key Audit Matter
<p><b>Fair Valuation of Investment Properties</b></p> <p>As disclosed in Note 15, the Group’s and Company’s investment properties consist of investment in land carried at fair value. The Directors have engaged an Independent Professional Valuer to determine the fair value as at 30 June, 2019. The valuer has determined the open market value using comparable property prices within the vicinity.</p> <p>Determination of fair value on investment properties involves significant judgement and assumptions. Judgement and</p>	<p>I have performed the following audit procedures;</p> <ul style="list-style-type: none"> <li>• Assessed competency, capabilities and objectivity of the independent valuers.</li> <li>• Reviewed the terms of the engagement of valuers to ascertain there were no matters affecting their objectivity or imposed scope limitation that would have a significant impact on their work.</li> </ul>

<p>assumption in the following areas were of most of significant importance to the audit.</p> <ul style="list-style-type: none"> <li>• Impact of informal settlers – a significant portion of the Group’s investment properties are occupied by informal settlers. In arriving at the fair value of the investment properties, the Directors have deducted the estimated cost of evicting the informal settlers. Significant judgement was exercised by the Board of Directors in determining the cost of evicting the informal settlers and securing the land.</li> <li>• In arriving at the market value, the independent valuers considered sales of comparable properties in the vicinity of the Group’s land. However, the properties considered are smaller than the Group’s properties and may not be comparable. Assumptions have been made in adjusting sales values of the comparable properties to factor in the size of the Group’s land.</li> </ul>	<ul style="list-style-type: none"> <li>• Assessed the appropriateness of the methodology used by the independent valuers and consistency with the International Financial Reporting Standards (IFRS).</li> <li>• Assessed the relevance and reasonableness of the independent findings or conclusions, and their consistency with other audit evidence obtained during the audit.</li> <li>• Ascertained that results of the expert's work in light of our knowledge of the business and industry.</li> <li>• Reviewed Management’s estimate of eviction costs for reasonableness.</li> <li>• Reviewed the adequacy of the disclosures in Note 15 of the financial statements.</li> </ul>
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## Other Matter

### Loss in Sale of Land

In 2012, the Company entered in a consent to sell 337 acres of land to a local buyer at a price of Kshs.2.2 million per acre against the carrying value of Kshs.5.2 million per acre. However, the buyer defaulted on the provisions of the consent by not providing an acceptable bank security within the period of consent. The case was taken to court after which the parties settled at a renegotiated price of Kshs.4.5 million per acre on 3 May, 2019 leading to a loss of Kshs.233 million against the carrying value.

### Other Information

The Directors are responsible for the other information, which comprises the statement of corporate governance, Directors’ report and the statement of Directors’ responsibilities. The other information does not include the financial statements and my auditor’s report thereon.

My opinion on the financial statements does not cover the other information and I do not express any form of assurance or conclusion thereon.

## REPORT ON COMPLIANCE WITH LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

As required by Article 229(6) of the Constitution, based on the audit procedures performed, except for the matters described in the Basis for Conclusion on Lawfulness and Effectiveness in Use of Public Resources section of my report, I confirm that, nothing else has come to my attention to cause me to believe that public resources have not been applied lawfully and in an effective way.

### **Basis for Conclusion**

#### **Non-Compliance with Laws and Regulations**

##### **1. Tax Matters**

###### **1.1 Non-Remittance of Pay As You Earn (PAYE) Tax**

Sections 3(2)(a)(ii), 5 and 37 of the Income Tax Act Cap 470 requires employers to deduct PAYE at source and remit the same to the tax authorities before the 9th day of the subsequent month of pay. However, as at 30 June, 2019, the Company had not remitted PAYE amounting to Kshs.376 million for the 12 months' period (1 July, 2018 to 30 June, 2019). Cumulatively, the Company holds a provision of Kshs.945 million of unremitted PAYE and Kshs.496 million being the penalties there on. The Company is in breach of law and is exposed to the consequences of non-compliance with the income tax law.

###### **1.2 Non-Remittance of Value Added Tax (VAT)**

Section 13(3) of Value Added Tax Act Cap 476 requires entities to remit VAT payable to tax authorities before the 20th day of the subsequent month of collection. However, as at 30 June, 2019, the Company had not remitted VAT balances totalling to Kshs.221 million in principal and penalties and interest of Kshs.63 million. The Company is in breach of law and is exposed to the consequences of non-compliance with the value added tax law. Further, and as disclosed in Note 30(1) to the financial statements, the Kenya Revenue Authority carried out an audit on the Company, covering corporate tax, employees' taxes, withholding tax and VAT for the period from 2005 to 2008. KRA raised an assessment of Kshs.25 billion out of which Kshs.1.7 billion has been resolved with the tax authorities. The Company has paid Kshs.122 million and appealed a further Kshs.473 million through the local tax committee which subsequently ruled in favor of the Company. KRA later appealed in the High Court against the local committee ruling, but the matter is yet to be determined. Additional liabilities may arise from this matter.

##### **2. Non-Remittance of Employees' Pension Contributions**

Sections 53 and 53A of the Retirement Benefits Act, 1997 requires entities to timely remit contributions by the employee's, failure to which, the entities will be penalized. However, as at 30 June, 2019, the Company had accrued pensions of Kshs.91 million in principal, penalties and interest. These unremitted contributions date back to August, 2018. The Company is in breach of law and is exposed to the consequences of non-compliance with the retirement benefits law.

### **3. Non-Remittance of Mining Levies**

Legal Notice No. 222 of the Mining Act (Cap 306) dated 18 December, 2013 requires cement producers to pay a cement mineral levy at the rate of Kshs.140 per ton of cement with effect from 1 January, 2014. As at 30 June, 2019, the Company had accruals of non-remitted mining levy amounting to Kshs.327 million. The Company is in breach of law and is exposed to the consequences of non-compliance with the mining regulations.

### **4. Non-Remittance of Unclaimed Dividends**

Section 20 of the Unclaimed Financial Assets Act, 2011 requires entities to remit unclaimed assets, including but not limited to ownership interests (shares and dividends), with a period of abandonment of three (3) years. As at 30 June, 2019, the Company held in its books, accrued dividends payable amounting to Kshs.102 million. Part of this amount has been outstanding for more than three (3) years exposing the Company to increased penalties.

The Company was therefore in breach of Law.

The audit was conducted in accordance with ISSAI 4000. The standard requires that I comply with ethical requirements and plan and perform the audit to obtain assurance about whether the activities, financial transactions and information reflected in the financial statements are in compliance, in all material respects, with the authorities that govern them.

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

## **REPORT ON EFFECTIVENESS OF INTERNAL CONTROLS, RISK MANAGEMENT AND GOVERNANCE**

### **Conclusion**

As required by Section 7(1)(a) of the Public Audit Act, 2015, based on the audit procedures performed, I confirm that, nothing has come to my attention to cause me to believe that internal controls, risk management and overall governance were not effective.

### **Basis for Conclusion**

The audit was conducted in accordance with ISSAI 2315 and ISSAI 2330. The standards require that I plan and perform the audit to obtain assurance about whether effective processes and systems of internal control, risk management and overall governance were operating effectively, in all material respects. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

## **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

As required by the Companies Act, 2015, I report based on the audit that:

- (i) In my opinion, the information given in the report of the Directors on pages 14 to 16 is consistent with the financial statements.
- (ii) In my opinion, the auditable part of the Directors' remuneration report on pages 17 to 18 has been properly prepared in accordance with the Kenyan Companies Act, 2015.

### **Responsibilities of Directors and those Charged with Governance**

The Directors are responsible for the preparation and fair presentation of the consolidated and separate financial statements that give a true and fair view in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015, and for such internal control as the Directors determine are necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated and subsidiary's financial statements, the Directors are responsible for assessing the group's and the subsidiary's ability to continue as going concerns, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors are aware of the intention to liquidate the Company and its subsidiary or to cease operations.

The Directors are also responsible for the submission of the financial statements to the Auditor-General in accordance with the provision of Section 47 of the Public Audit Act, 2015.

In addition to the responsibility for the preparation and presentation of the financial statements described above, Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them, and that public resources are applied in an effective way.

Those charged with governance are responsible for overseeing the group's and the subsidiary's financial reporting process, reviewing the effectiveness of Management's systems for monitoring compliance with relevant legislative and regulatory requirements, ensuring that effective processes and systems are in place to address key roles and responsibilities in relation to governance and risk management, and ensuring the adequacy and effectiveness of the control environment.

### **Auditor-General Responsibilities for the Audit**

The audit objectives are to obtain reasonable assurance about whether the consolidated and company financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion in accordance with the provision of Section 48 of the Public Audit Act, 2015 and submit the report in compliance with Article 229(7) of the Constitution of Kenya. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or

in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

In addition to the audit of the financial statements, a compliance review is planned and performed to express a conclusion on whether, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them and that public resources are applied in an effective way, in accordance with the provisions of Article 229(6) of the Constitution, and submit the audit report in compliance with Article 229(7) of the Constitution.

Further, in planning and performing the audit of the financial statements and audit of compliance, I consider internal control in order to give an assurance on the effectiveness of internal controls, risk management and governance processes and systems in accordance with the provisions of Section 7(1)(a) of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution. My consideration of internal control would not necessarily disclose all matters in the internal control which might be material weaknesses under the ISSAIs. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level, the risk that misstatements caused by error or fraud in amounts which would be material in relation to the financial statements being audited, may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Because of its inherent limitations, internal control may not prevent or detect misstatements and instances of non-compliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the group's and the subsidiary's policies and procedures may deteriorate.

As part of an audit conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the consolidated and company financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the group's and the Company's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Directors.

- Conclude on the appropriateness of the Management’s use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company’s ability to continue as a going concern or to sustain its services. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor’s report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit report. However, future events or conditions may cause the Company to cease to continue as a going concern or to sustain its services.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the consolidated and Company financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information and business activities within the group to express an opinion on the consolidated and Company financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

I communicate with the management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

I also provide Management with a statement that I have complied with the relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with Management, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. These matters are described in my auditor’s report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.



**Nancy Gathungu**  
**AUDITOR-GENERAL**

**Nairobi**

**11 September, 2020**