

# **REPORT OF THE AUDITOR-GENERAL ON GEOTHERMAL DEVELOPMENT COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE, 2019**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Opinion**

The accompanying financial statements of Geothermal Development Company Limited, set out on pages 32 to 90 which comprise the statement of financial position as at 30 June, 2019, and the 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 Deloitte & Touche, 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 Geothermal Development Company Limited 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 Geothermal Development Company Limited Management 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 audit 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**

#### **1. Long outstanding Corporation Tax and Related Penalties**

The Company being a state corporation is required to comply with tax laws and other related regulations, including remission of taxes to Kenya Revenue Authority (KRA), as per the prescribed due dates. The statement of financial position reflects current tax liability of Kshs.4,042,976,000 (2018: Kshs.3,220,274,000) for the years ended 30 June, 2015, 2016, 2017 and 2018, and quarterly instalments due as at 30 June, 2019.

Further as disclosed in Note 15 to the financial statements, the financial statements reflect other tax liabilities amounting to Kshs.2,578,205,000 which include interest and penalties of Kshs.1,440,807,350 (2018: Kshs.1,114,508,658) arising from non-payment of income taxes. According to Management, request for abandonment of the liability was not granted and subsequently the Company paid an instalment of Kshs.50,000,000 during the year under review. However, the outstanding liability is yet to be settled in full. The delayed payment of income taxes has exposed the Company to penalties and interest, which continues to increase with the continued delay.

#### **2. Unproductive and Abandoned Wells**

As similarly reported in the 2016/2017 audit report and as disclosed in Note 9 to the financial statements, the statements of profit or loss and other comprehensive income reflect Other Expenses amounting to Kshs.1,703,973,000 which constitutes an amount of Kshs.917,002,000 (2018: Nil) which relates to the cost of unproductive and abandoned wells, written off during the year under review. According to Management in past responses, success rates for geothermal wells increase as more wells are drilled to provide surface information. The cost of unproductive and abandoned wells written off by the Company are significant and requires enhanced management attention, with the aim of minimizing drilling losses.

### **3. Cost of Non-Productive Time**

As reported in the 2016/2017 audit report and as disclosed in Note 9 to the financial statements, the statement further reflects other operating expenses of Kshs.1,703,973,000 which includes an amount of Kshs.116,288,000 (2018: Kshs.49,087,000), being the cost of Non-Productive Time (NPT) during drilling activities, which was written off during the year under review. According to Management in past responses, the causes of the NPT were mainly operational and part of the drilling program, while others were as a result of logistical challenges. The Management has in the past committed to develop a formal policy on what should constitute acceptable levels of NPT based on international best practices. However, by the time of concluding this audit, no such policy had been developed to guide the management of NPT associated with staff costs. Costs of NPT are voidable costs which increases the cost of drilling wells, and the costs ought not to have been incurred by the Company.

### **4. Wasteful expenses**

As disclosed in Note 9 to the financial statements, the statement of profit or loss and other comprehensive income reflects other operating expenses of Kshs.1,703,973,000 which constitutes an amount of Kshs.338,688,000 (USD 2,853,177.33) which further includes interest on unpaid invoices of Kshs.62,041,000 and arbitration costs of Kshs.45,486,000, on account of a GDC vs Cluff Geothermal case. Further, as disclosed in Note 8 to the financial statements, the legal expenses balance of Kshs.118,009,000 includes an amount of Kshs.104,454,000 incurred on account of the above case, which brings the total expenses on account of the case to Kshs.211,981,000.

Further, and as disclosed in Note 23(a) to the financial statement the case arose from alleged breach of contract by the Company, for non-payment of USD 26,177,935 relating to provision of top holing services by the contractor at Menengai field. According to Management, the case has since been determined through arbitration. The above expenses which are significant, have negatively affected the operating results of the Company and calls for Management to relook its management of contracts and related obligations, to avoid such legal expenses.

My opinion is not qualified in respect of these matters

### **Key Audit Matters**

Key audit matters are those matters which, in my professional judgment, were of most significance in the audit of the financial statements. There were no Key Audit Matters to report in the period under review.

### **Other Information**

The other information comprises the Report of the Directors as required by the Kenyan Companies Act, 2015. The other information does not include the financial statements and my auditor's report thereon.

The Directors are responsible for the other information. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information identified above and, in doing so, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work I have performed on the other information which I obtained prior to the date of this auditor's report, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

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

### **Conclusion**

As required by Article 229(6) of the Constitution, based on the audit procedures performed, I confirm that, nothing 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**

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 on whether the activities, financial transactions and information reflected in the financial statements are in compliance, in all material respects, with the authorities which 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 governance, were not effective.

### **Basis for Conclusion**

The audit was conducted in accordance to ISSAI 2315 and 2330. The standards require that I plan and perform the audit to obtain assurance on whether effective processes and systems of internal control, risk management and 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 26 to 27 is consistent with the financial statements.
- ii. In my opinion, the auditable part of the Directors' remuneration report on page 17 has been properly prepared in accordance with the Kenyan Companies Act, 2015.

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

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards, and for maintaining effective internal control as Management determines is necessary to enable the preparation of financial statements which are free from material misstatement, whether due to fraud or error and for assessment of the effectiveness of the internal control, risk management and governance.

In preparing the financial statements, Management is responsible for assessing the Company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the Management is aware of any intention to liquidate the Company or to cease operations.

Management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions 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 Company'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's Responsibilities for the Audit**

The audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report which includes my opinion in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution. 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 and weakness

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 the 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 Company'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 financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence which 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.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management.
- 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 which may cast significant doubt on the Company's ability to continue as a going concern. 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.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner which achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Company to express an opinion on the 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 which are identified during the audit.

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



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

**Nairobi**

**31 August, 2020**