

REPORT OF THE AUDITOR-GENERAL ON KENYA ELECTRICITY TRANSMISSION COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE, 2019

REPORT ON THE FINANCIAL STATEMENTS

Opinion

The accompanying financial statements of Kenya Electricity Transmission Company Limited set out on pages 28 to 70, 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 Ernst and Young LLP, 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 Kenya Electricity Transmission 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 Public Finance Management Act, 2012 and State Corporations Act, Cap 446 (Revised 2013).

Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kenya Electricity Transmission 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 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

Contingent Liabilities

I draw attention to note 28 (b) to the financial statements which discloses that the Company's estimated contingent liabilities consist of ongoing court cases relating to acquisition of wayleaves and contractors' claims beyond the original contract period, amounting to Kshs.12,967,306,000. According to Management, the status

of these exposures is evaluated on a regular basis to assess the probability of incurring related liabilities. However, in the event that these contingent liabilities crystalize, the Company may be exposed to unforeseen project cost overruns, resulting to inability to meet its obligations when they fall due. This may affect service delivery capacity of the Company.

My opinion is not qualified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in my professional judgment, are of most significance in the audit of financial statements. There were no key audit matters to report in the year under review.

Other Information

The other information comprises the Report of the Directors, as required by the Companies Act, 2015, Chairman's Statement, Report of the Chief Executive Officer, Corporate Governance Statement, Management Discussion and Analysis and Corporate Social Responsibility statement. 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 an audit opinion or any other 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, 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.

Other Matters

1. Liquidation of Contractor under Exim Bank of India Projects

The contract for Lot 1A 220 KV Turkwel-Ortum-Kitale substations under the EXIM Bank of India Projects was entered into in April, 2013 with an expected completion date of 30 June, 2018. This contractor was contracted at a contract sum of USD 19,972,680, later revised downwards to USD 18,100,120. In July, 2018, the courts in India ordered liquidation of the contractor, resulting in financial challenges which made the contractor unable to complete the project. According to Management, by the time of liquidation in the home country, the contractor had achieved an overall completion status of 78% of the project. By the time of this audit, another contractor was in the process of being identified as a replacement to take over the remaining works. Consequently, the project may experience delays in completion as well as associated cost overruns.

2. Expiry of Loan Agreement

The loan agreement between the Company and African Development Bank for the construction of 132KM of 400KV double circuit transmission line from Lessos substation in Kenya, to Tororo substation in Uganda, which was effective from 20 September, 2010 expired on 31 December, 2017. At the time of expiry of the agreement, the loan account had an undrawn balance of Kshs.2,720,466,827. The

project has been at 61% level of completion since termination of the contractor for non-performance in April, 2016 and was at the same level at the time of audit. There was no evidence that the loan agreement had been renewed thus leaving an undrawn balance of Kshs.2,720,466,827. Consequently, the project which is already behind schedule may experience significant cost overruns. Further, delivery of services to the intended beneficiaries may not be achieved.

3. Arbitration on Terminated Contract

The arbitration case between the Company and Instalaciones Inabensa S. for termination of contract for the construction of 132KM of 400KV double circuit transmission line from Lessos substation in Kenya to Tororo substation in Uganda, has been unresolved since April, 2016. However, on 30 July, 2019, the tribunal issued an award in favour of the contractor amounting to Kshs.4.5 billion. Management considers the decision to be against public interest and have sought the Attorney General's office for assistance in setting aside the tribunal's award. The delay in resolution for the past three financial years (2017-2019) has resulted in an expenditure on legal fees amounting to Kshs.101,791,087.

In the circumstances, it is not certain whether the project will be completed in the near future. The Project is likely to incur additional costs, which would be necessary to complete the project, or losses which the Government of Kenya may suffer in the event that the project is not completed.

4. Pending Wayleave Compensations

According to information available, the Company has outstanding compensation to landowners for wayleaves amounting to Kshs.3,397,470,947. Management has attributed failure to pay this amount to lack of budgetary allocation from The National Treasury and long negotiations between land owners, the Company and various County Governments. The delays in compensating Project Affected Persons may lead to legal suits, cost escalations and project delays.

5. Delay in Completion of Projects

According to reports on the projects' physical progress, there were significant delays in completion of four (4) of the projects under implementation by the Company, details of which have been enumerated severally in the respective projects audit report. These Projects are: the 220KV and 132KV Transmission Lines and Substations Projects (Exim Bank) Project, Power Transmission System Improvement Project, Multinational Kenya Tanzania Power Interconnection Project; and Kenyan Section of Interconnection Project of Electric Grids of Nile Equatorial Lakes Countries Project.

Continued delay in the completion of these Projects may result in delayed delivery of services to the public and the incidental cost overruns.

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, 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 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

Lack of Contractual Agreements for Revenue Billing

The Company does not have a signed agreement with Kenya Power and Lighting Company (KPLC), which sets the terms for billing the wheeling revenue. Although, according to Management, wheeling revenue is based on a tariff determined by an independent party, Management should ensure that a contract is drawn and signed with KPLC, specifying the terms and conditions of the credit period.

In the absence of such a binding agreement, resolution of differences and disputes arising between the two parties may be difficult. Further, all other contracts between the Company and other third parties should be approved and signed to mitigate against any potential disputes which may arise.

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, except for the matters described in the Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance section of my report, confirm that nothing else has come to my attention to cause me to believe that internal controls, risk management and governance were not effective.

Basis for Conclusion

1. Lack of Projects and Company Inter-Reconciliation

The Company's financial reporting framework is International Financial Reporting Standards (IFRS), while the donor funded projects' financial reporting framework is

International Public Sector Accounting Standards (IPSAS Cash Basis). However, no periodic reconciliations are carried out between the Projects' and the Company's financial statements with the view of reconciling the balances in the two sets of financial statements, which are prepared under different reporting frameworks. Management has not explained why such reconciliations are not carried out on a regular basis, and any discrepancies investigated and resolved with relevant adjustments. This may result to accounting errors and irregularities not being identified and corrected on a timely basis.

2. Lack of Policy for Provision for Doubtful Accounts

The Company had trade receivables amounting to Kshs.24,263,000, as disclosed in Note 16 (b) to the financial statements. However, the assessment on the controls on debt management indicates that the Company does not have a clear documented policy for determining provision for doubtful receivables, against the trade receivables totaling Kshs.24,263,000. Management has not explained why they have not developed and applied such a policy, which would provide the Company with an objective valuation of its accounts receivables, to allow the monitoring of the collectability of receivables proactively and take appropriate action.

3. Lack of an Updated ICT Policy and Procedures Manual

Review of the Company's policy manuals revealed that the ICT policy and procedures manual was last reviewed in September, 2010. Although according to Management the policy review is on-going, the policy documents are yet to be formally signed off by Management. Management has not periodically reviewed and updated the ICT policies, which would guide both the ICT staff and business users on how to interact with the ICT systems. Management may not have adequate mechanisms to address emerging ICT threats to the Company's systems.

Further, a review of other policy manuals of the Company revealed lack of critical policies in change management, incident management policy and disaster recovery plan.

In addition, SAP access rights of 15 former employees were yet to be cancelled, posing a high risk of unauthorized use of the system.

Management has not formulated, documented, approved and widely circulated policy manuals covering the above specified areas to all staff members, to ensure compliance.

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 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, in my opinion, the information given in the report of the directors on page 24 is consistent with the financial statements.

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 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

29 September, 2020