

REPORT OF THE AUDITOR-GENERAL ON KENYA PIPELINE COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2017

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Kenya Pipeline Company Limited set out on pages 35 to 75, which comprise the statement of financial position as at 30 June 2017, and the statement of profit or loss and other comprehensive income, statement of changes in equity, statement of cash flows and statement of comparison of budget and actual amounts for the year then ended, and a summary of significant accounting policies and other explanatory information in accordance with the provisions of Article 229 of the Constitution of Kenya and Section 35 of the Public Audit Act, 2015. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit.

In my opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respects, the financial position of Kenya Pipeline Company Limited as at 30 June 2017, 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.

Further, as required by Article 229(6) of the Constitution, based on the procedures performed, except for the matter described in the Basis for Qualified Opinion and Other Matter sections, I confirm that public money has been applied lawfully and in an effective way.

Basis for Qualified Opinion

Trade and Other Receivables

As reported in my 2015/2016 audit report, the company's financial statements reflect trade and other receivables amounting to Kshs.12,048,271,443 (2016 Kshs.8,444,841,722), as disclosed under Note 20. Included in this balance is Kshs.4,314,146,056 (2016 Kshs.4,200,000,000) due from an Oil Marketing Company (OMC) but which claim is disputed and has been subjected to arbitration. The arbitrator in 2016 ruled in favor of the OMC with an award of US\$.19,758,595, equivalent to Kshs.2,053,137,310 at the ruling exchange rate as of 30 June 2017. Subsequently, the Company has lodged an appeal in court against the ruling of the arbitrator but determination of the appeal was pending at the time of finalizing the audit. The contingent liability resulting from the arbitrator's ruling has not been recognized in the financial statements. Further, it has not been possible to confirm whether and when the company will recover the Kshs.4,314,146,056 owed by the OMC. No provision has been made in the financial statements in relation to this uncertainty.

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

in accordance with ISSAI 30 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with the ISSAIs 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 qualified opinion.

Emphasis of Matter

Land without Title Deeds

As reported in the prior year's audit, included in the leasehold land balance of Kshs.5,167,287,314 (2015/2016 Kshs.4,766,260,609) disclosed under Note 15 to the financial statements are parcels of land valued at Kshs.1,928,677,778 which have no title deeds. Further, available information indicates that Plots No.LR.9042/225 and 114/113/114, where the Company's Embakasi and Mombasa depots are located and which are carried in the books at Kshs.869,759,420 and Kshs.130,257,924 respectively, have their titles issued in the mother title in the name of Kenya Airports Authority (KAA). Although, according to the management, the National Lands Commission (NLC) has written to KAA to surrender the mother title to facilitate the issuance of the sub-titles, this is yet to be done. Under the circumstances, it is not possible to confirm that the Company owns the two parcels of land in its possession, and indeed the carrying value of land as stated in the financial statements as at 30 June 2017.

Key Audit Matters

Key Audit Matters are those matters that, in my professional judgement, are of most significant in the audit of financial statements. There were no Key Audit Matters to report in the year under review.

Other Matter

Hydrant Pit Valves

As highlighted in my report for 2015/2016, the Company awarded a USD.6,409,492 (Kshs.655,880,009) contract for the supply of hydrant pit valves - C/W isolation valves - and two-year operational spare parts, to a company through direct procurement, contrary to the requirements of the Public Procurement and Asset Disposal Act, 2015. Although the company, which was based in the United States of America, was reportedly invited to bid for the tender on the basis that it was the original manufacturer of the equipment, no documentary evidence has been availed in support of this assertion. Further, there has been no documented justification for the need to procure operational spares parts to cover two years. Also, although the spares parts were delivered to the Company on 14 July 2015, they were not formerly inspected and received for use. As at the time of concluding this audit, the matter was still under investigation by the Ethics and Anti-Corruption Commission. Under the circumstances, I am not able to confirm the Company's compliance with procurement procedures, and the propriety of the contract amount of Kshs.655,880,009 incurred on supply of hydrant pit valves.

Other Information Included in the Annual Report

The directors are responsible for the other information, which comprises the report of directors as required by the Kenyan Companies Act, 2015. 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.

In connection with my audit of the financial statements, my responsibility is to read the other information 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 that 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.

Responsibilities of the Directors and those charged with Governance for the Financial Statements

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, and for such internal controls as directors determine are necessary to enable the preparation of financial statements which are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are 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 accounting assumption. The directors are responsible for the Company's financial reporting process.

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

Auditor-General's Responsibilities for the Audit of the Financial Statements

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 that 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 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.

As part of an audit in accordance with ISSAIs, I exercise professional judgement and maintain professional scepticism 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 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 which are appropriate in the circumstances and for the purpose of giving an assurance on the effectiveness of 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 directors' 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. 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 that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities to express an opinion on the financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

I communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that are identified during the audit.

I also provide to the directors a statement that I have complied with relevant ethical requirements regarding independence, and communicate to them all relationships

and other matters which may reasonably be thought to bear on my independence, and where applicable, related safeguards.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

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

- (i) I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of my audit;
- (ii) In my opinion, proper books of accounts have been kept by the Company, so far as appears from the examination of those books;
- (iii) The Company's statement of financial position and statement of profit or loss and other comprehensive income are in agreement with the books of account; and
- (iv) In my opinion, the information given in the report of the directors is consistent with the financial statements.



FCPA Edward R. O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

12 January 2018