

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

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Opinion**

I have audited the accompanying financial statements of Kenya Pipeline Company Limited set out on pages 52 to 103, 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, 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, the financial statements present fairly, in all material respects, the financial position of Kenya Pipeline 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 (IFRS) 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 Kenya Pipeline 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**

#### **1. Parcels of Land Without Title Deeds**

As disclosed in Note 17 to the financial statements, the statement of financial position reflects several leasehold parcels of land valued at Kshs.4,835,251,272. As reported in the previous audit reports, the land includes two parcels originally valued at Kshs.1,100,000,000 but have no title deeds. Further, available information indicates that the Title Deeds of two plots on which the Company's Embakasi and Mombasa depots are located were issued in the name of Kenya Airports Authority (KAA) who are the legal owners of the larger piece of land from which the two parcels were hived-off. Although, Management have explained that the National Lands Commission (NLC) has requested the Kenya Airport Authority (KAA) to surrender the original title for issuance of sub-titles for the two parcels, no Title Deeds have been issued to the Company yet.

#### **2. Pending Contract Variation Claims**

As analyzed in Note 16 to the financial statements, the Property, Plant and Equipment balance of Kshs.100,274,854,331 reflected in the statement of financial position as at 30 June, 2019 includes an amount of Kshs.51,416,165,547 incurred on cost of works on a new Mombasa-Nairobi Oil Pipeline commonly referred to as Line 5. As highlighted in the previous audit, construction of Line 5 commenced in July, 2014, following the award of the tender at a cost of US\$ 484,502,887 equivalent to Kshs.49,563,821,685. At the time of completion of the pipeline in June, 2018, the Project Engineer had submitted eight (8) variation orders totalling US\$.38,109,717 (Kshs.3,898,559,263) out of which only a sum of US\$.17,445,639 (Kshs.1,784,659,212) was approved for payment. The orders were reported to have resulted from change of design specifications and omission of works in the initial contract.

Further, the contractor submitted five (5) Extension of Time (EoT) with claims amounting to US\$.204,511,827 (Kshs.20,921,212,232). However, the claims were contested by the Project Engineer resulting in the appointment of an independent expert scheduler in January, 2018 to verify the claims. The expert scheduler assessed the total amount payable to the contractor for four of the EoTs to be US\$.44,019,025 (Kshs.4,503,071,425) down from the contractor's claim of US\$.189,290,732 (Kshs.19,364,120,089). The fifth EoT claim of US\$.15,221,095 (Kshs.1,557,092,143) was not reviewed by the expert scheduler. Construction of the pipeline (Line 5) was completed and the line commissioned during the year ended 30 June, 2018. However, the contractor has filed a petition at the High Court seeking payment of the all claims amounting to Kshs.19,364,120,089.

At the time of conclusion of the audit, the ruling on the petition had not been made and the matters may affect the carrying value of the pipeline in future.

### **3. Supply of Hydrant Pit Valves**

As previously reported, the Company awarded a US\$.6,409,492 (Kshs.655,680,136) contract for the supply of hydrant pit valves and spare parts for two years' operations to a vendor through direct procurement in February, 2015 but, the procurement process and award of the contract was found to have contravened the requirements of the Public Procurement and Asset Disposal Act, 2015. In mitigation, the Management indicated that the vendor was invited to bid for the tender on account of being the original manufacturer of the equipment, but no evidence was made available to validate this assertion. In the circumstances, the basis for the award of the tender to the vendor could not be confirmed.

Whereas the spare parts delivered by the vendor were subject to EACC investigation, the Company put them to use but only after the EACC authorized their use. However, the value of the items is yet to be recorded in the Company books and are not included in the assets reflected in the financial statements.

In addition, the Management did not provide a plausible explanation for procurement of spares parts to cover two years of operations.

At the time of concluding this audit, the matter was in Court after investigation by the Ethics and Anti-Corruption Commission (EACC) for prosecution.

### **4. Unused New Kisumu Oil Jetty**

The statement of financial position as at 30 June, 2019, reflects property, plant and equipment with a net book value of Kshs.100,274,854,331. The assets include an oil jetty at Kisumu built at a cost of Kshs.2,056,719,681. Construction works on the jetty were executed from May, 2017 to March, 2018 when the jetty was completed and handed over to the Company by the Contractor. The assets were thereafter capitalized in 2017/2018, and as at 30 June, 2019 had been depreciated by Kshs.158,039,409.87. The jetty was constructed under the Northern Corridor Integration Projects portfolio of the East African Community with a view to improve the distribution of refined petroleum products to Uganda and other neighbouring countries. However, the jetty has remained unused due to lack of infrastructure for receipt and storage of the products in Uganda. Although Management have indicated that some progress has been made in construction of one of the two planned similar jetties in Uganda, there is no certainty when these will be completed and operationalized.

Therefore, the country is not deriving any value from the use of the jetty. Further delay in operationalization of the Project may require the Kisumu Jetty assets to be assessed for impairment of their book values.

My opinion is not qualified in respect of the effects of these matters.

### **Key Audit Matters**

Key audit matters are those matters that, in my professional judgment, are of most significance in the audit of the financial statements. I have determined that there are no other key audit matters to communicate in my report.

## **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 Compliance with 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**

#### **Un-procedural Procurement of Consultancy Services**

Note 10 to the financial statements reflected expenditure on consultancy fees totalling Kshs.488,236,993. The amount includes Kshs.15,087,804 paid to a Consultant for undertaking forensic and security investigations at the Company. A review of the procurement process revealed that the request for proposal was issued out on 8 March, 2018, evaluation of technical and financial proposals was done on 18 and 19 March, 2018 while the contract award letter was issued on 8 May, 2018. Subsequently, the contract was signed on 12 June, 2018.

However, examination of documents submitted by the Consultant for payment, implied that the Consultant was hired way before the procurement process started. For instance, the first payment amounting to Kshs.1,500,000 was made on 8 March, 2018,

the same date the request for proposal was issued. This payment was supported by an invoice dated 5 March, 2018 which was long before the contract was signed.

In addition, the advance payment was not supported by a bank guarantee as required in the contract and as provided under Section 146 of the Public Procurement and Disposal Act, 2015.

In view of the foregoing, the Management is in breach of Section 146 and 147 of the Public Procurement and Disposal Act, 2015.

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

### **Basis for Conclusion**

#### **1. Poor Project Management**

##### **1.1 Delays in Completion of Projects**

During the year under review, 74 Projects were listed as ongoing in the Company's records. Sixteen (16) of the Projects were audited and eleven (11) Projects with an accumulated costs of Kshs.1,874,440,186.11 and representing 69% of the sample were found to be behind their respective execution schedules. Three (3) of the delayed Projects with an accumulated costs of Kshs.122,290,830.04 had stalled after their contracts expired or were terminated.

Further, a review of the Company's Project Management System disclosed absence of robust, documented risk assessment and Project monitoring during Project life cycles. Project delay risks were not identified and mitigated in time. In addition, no monitoring through a matrix designed to assess Project management controls and feed the information into a Project risk register for action was put to use.

Delays in Project completion deny taxpayers expected services and could result in increased Project costs overruns and wastage of public resources.

##### **1.2 Delays in Granting Extension of Time Requests**

There were delays in processing of Extension of Time (EoT) requests filed by contractors and as a result, some contracts expired before the respective Projects were completed. For example, at the time of the audit, contracts for five (5) Projects had expired but the works could not continue before extension of time requests were granted. Similarly, works on two (2) projects were ongoing although the respective expired contracts had not been extended.

Execution of Projects outside their respective contracted periods pose significant legal and material risks to the Company and, further, may cause undue delay in completion of works.

## **2. Lack of Financial Expert in the Board**

The Mwongozo, a code of governance for state corporations outlines governance principles on appointment of Directors to State Corporations. The principles require at least one board member to be a financial expert, with necessary qualifications and expertise in financial management or accounting and in addition, be a bona fide member of a profession compliant with the requirements of the profession's membership. However, biodata of the existing Company's Directors during the year under review, indicated that none possessed formal financial expertise as defined in the Mwongozo guidelines.

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 my 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 the audit;
- ii. In my opinion, adequate accounting records have been kept by the Company, so far as appears from the examination of those records; and
- iii. The financial statements are in agreement with the accounting records and returns.

## **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 that are free from material misstatement, whether due to fraud or error; and for assessment of the effectiveness of internal control, risk management and overall governance.

In preparing the financial statements, Management are responsible for assessing the ability of the Company 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 the 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 preparing and presenting the financial statements described above, Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements comply 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 financial reporting process, reviewing the effectiveness of how the entity monitors 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 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. 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 audit is planned and performed to express a conclusion about whether, in all material respects, the activities, financial transactions and information reflected in the financial statements comply with the authorities that govern them and that public resources are applied in an effective way, in accordance with the provisions of Article 229(6) 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 overall 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 that 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 that 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 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 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.
- 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 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.
- 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 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 that 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 that may reasonably be thought to bear on my independence, and where applicable, related safeguards.



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

**Nairobi**

**29 September, 2020**