

# **REPORT OF THE AUDITOR-GENERAL ON NATIONAL OIL CORPORATION OF KENYA LIMITED FOR THE YEAR ENDED 30 JUNE, 2019**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Qualified Opinion**

The accompanying financial statements of National Oil Corporation of Kenya Limited set out on pages 10 to 53, 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 and 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, 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 National Oil Corporation of Kenya 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 and the Public Finance Management Act, 2012.

### **Basis for Qualified Opinion**

#### **Unaccounted for Petroleum Products**

As reported in my report for 2017/2018, the statement of financial position reflects inventories valued at Kshs.831,802,000 held by the Corporation. As disclosed under Note 23 to the financial statements, a provision for impairment of inventories valued at Kshs.2, 422,102,000 (2018: Kshs.2,104,335,000) was made in the year under review. As similarly reported in my report for 2017/2018, the provision was in respect of unreconciled stock variances.

Further, the Management had separately contracted three Consulting firms namely KPMG Limited, Ernest and Young and Geomatrix Consulting Limited for a contract sum of Kshs.3,366,000, Kshs.11,398,400 and Kshs.4,050,000 respectively, to investigate the stock variances covering the period between July, 2017 and December, 2018. The scope of the investigations by the three firms is largely similar and were to run within the same period thereby casting doubt on the value for money for the total value of Kshs.18,814,400.

According to reports by three consultants, at least 2,280,017 litres of Automotive Gas Oil (Diesel) and 230,458 litres of Premium Motor Spirit (Super Petrol) valued at Kshs.2,270,337,573 in aggregate based on the pump prices at the time of audit in December, 2018, could not be accounted for.

The scope of the special audits by the Consultancies covered the period between July, 2017 and December, 2018. The audit reports attributed the variances to

systemic weaknesses characterized by inadequate record keeping and failure to adhere to Company policies governing order processing. Other internal control weaknesses reported included failure to schedule vehicles transporting petroleum products and to undertake daily and monthly stock reconciliations. Instances of malpractices were, in addition, identified in generation and processing of unauthorized credit notes, illegal diversion of product consignments and dispatches not supported by transporter documentation or not delivered to intended sites.

In the circumstances, I am unable to confirm the existence of control measures put in place by Management to safeguard public resources.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of National Oil Corporation of Kenya 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 qualified my opinion.

### **Emphasis of Matter**

#### **Going Concern Status**

The Management made a disclosure under Note 8 to the financial statements, which indicates that the Corporation incurred a loss of Kshs.352,492,000 (2018: Kshs.225,340,000) during the year under review and thus raised its accumulated losses from Kshs.2,035,131,000 in 2018 to Kshs.2,560,934,000 as at 30 June, 2019. As a result, the Corporation's current liabilities exceeded its current assets by Kshs.3,797,210,000 (2018: Kshs.2,581,506,000). These events or conditions, along with other matters set forth in the note indicate that there exists material uncertainty regarding the Corporation's ability to continue as a going concern.

However, The National Treasury has issued the Corporation with a letter of comfort and committed to support the Corporation achieve its mandate.

My opinion is not modified in respect 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. There were no key audit matters to report in the year under review.

### **Other Matter**

#### **Accounting for Mwananchi Gas Project**

As similarly reported in my report for 2017/2018, the State Department for Petroleum in 2018 delegated to the Corporation the responsibility of implementing Mwananchi Gas Project. The Project was intended to promote the use of modern cooking fuels among low income households. It entailed distribution of subsidized Liquefied Petroleum Gas (LPG) cylinders, grills and burners to low-income households. In addition to offering storage facilities of the cylinders, the Corporation was expected to fill the gas cylinders and supply the households with cooking gas at subsidized prices.

Records made available by the Corporation indicated that a total of 144,092 six-kilogramme (6kgs) gas cylinders, 357,360 cylinder grills and 357,336 gas burners valued at Kshs.539,741,103 were received from the State Department for Petroleum. Of these quantities, the Corporation jointly with the State Department for Petroleum inspected and certified for use 45,797 (6kg) cylinders, 40,484 gas burners and 114,680 grills with an aggregate value of Kshs.56,419,124

The remainder of the items had not been included in the Agency's financial statements and the Management has attributed the omission to lack of formal authority from the State Department for Petroleum to transfer ownership of the items to the Corporation.

## 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 matter 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**

#### **Unclaimed Financial Assets**

The Corporation as at 30 June, 2019 held financial assets amounting to Kshs.21,159,895 disclosed as part of prepayments in Note 24 to the financial statements. These were customer bank deposits dating from 2011 to 2015, that ought to have been reported and submitted to the Unclaimed Financial Assets Authority (UFAA), as required by the Unclaimed Financial Assets Act, 2011. According to the Act, failure to comply attracts a penalty of 25% of the value of assets withheld, in addition to interest at the Central Bank Rate (CBR) prevailing at 30 September of the relevant year plus 1% (CBR + 1%). Failure to report and submit the assets to the Authority could attract interest and penalties to the Corporation by the Unclaimed Financial Assets Authority.

Consequently, the Management is in breach of the 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

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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, except for the effects on the matter described in the Basis for Qualified Opinion 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**

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 Company's financial statements are in agreement with the accounting records and returns.

### **Responsibilities of Management and Board of Directors**

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 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 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.

The Board of Directors is responsible for overseeing the financial reporting process, reviewing the effectiveness of how the Company 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 overall 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 are in compliance 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 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 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. 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**

**24 September, 2020**