REPORT OF THE AUDITOR-GENERAL ON EAST AFRICAN PORTLAND CEMENT PLC FOR THE YEAR ENDED 30 JUNE, 2020

REPORT ON THE FINANCIAL STATEMENTS

Opinion

The accompanying consolidated and the company financial statements of East African Portland Cement PLC (the Company) and its subsidiary (together with the Group) set out on pages 25 to 71, which comprise the consolidated and the Company's statement of financial position as at 30 June, 2020 and the consolidated and the Company's 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 PricewaterhouseCoopers 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 East African Portland Cement PLC as at 30 June, 2020 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 East African Portland Cement PLC 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

Material Uncertainty Related to Going Concern

I draw attention to Note 2(a) to the financial statements, which indicates that the Group and Company incurred a net loss from operations of Kshs.2,769,347,000 (2019: Kshs.3,361,888,000) and Kshs.2,768,466,000 (2019: Kshs.3,327,605,000) respectively during the year ended 30 June, 2020. Further, the Group and Company's current liabilities exceeded the current assets by Kshs.13,829,524,000 (2019: Kshs.10,170,657,000) and Kshs.13,868,616,000 (2019: Kshs.10,189,500,000) respectively.

The Company defaulted on a loan from one of the key lenders and in September, 2019, the Company obtained approval from shareholders to dispose some of the idle land to retire the debt. Factors that have affected performance have been explained in the Directors' Report and Managing Director's Report. In particular, the cement production plant continues to operate significantly below capacity due to working capital constraints, lack of essential spare parts and loss of market share to competitors. Further, due to the cash flow constraints, the Company has been unable to settle the amounts due to its key suppliers and regulatory authorities including Kenya Revenue Authority and pension liabilities.

The Company had significant litigations and claims against it which, if successful, may result in claims that are unlikely to be settled, given the entity's current financial position. Details of the significant claims include employee related claims arising from unpaid salaries based on the Collective Bargaining Agreement (CBA) terms with an estimated total exposure of Kshs.1.5 billion, debt claims by suppliers for unpaid bills for services rendered and goods delivered totalling to Kshs.397 million and claims arising from disputed deliveries, breach of distribution contracts and termination of supplier contracts totalling Kshs.196 million. Most of these claims have been provided for in the financial statements.

In addition, the Company has been unable to settle amounts due to statutory authorities which include Pay As You Earn (PAYE) of Kshs.1,347,853,000, Value Added Tax (VAT) of Kshs.356,000,000 and pension liabilities of Kshs.39,000,000 being principal, penalties and interests.

These events or conditions, along with other matters as set forth in Note 2(a), indicate that a material uncertainty exists that may cast significant doubt on the Group's and Company's ability to continue as a going concern.

My opinion is not modified in respect of this matter.

Key Audit Matter

Key audit matters are those matters that, in my professional judgment, were of most significance in my audit of the financial statements of the current period. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters. In addition to the matter described in the material uncertainty related to going concern section above, I have determined the matters described below to be the key audit matters to be communicated in my report.

Key Audit Matter	How the Audit Addressed the Key Audit Matter
Fair Valuation of Investment Properties As disclosed in Note 15 to the financial statements, the Group's and Company's investment properties consist of investment in land carried at fair value. The Directors engaged Independent Professional Valuers to determine the fair value as at 30 June, 2020. The valuers determined the open market value using recent property transactions prices within the vicinity of the Group's land. A significant portion of the Group's land is occupied by informal settlers. As disclosed in Note 15 to the financial statements, the Directors have exercised judgement in determining the classification of the encroached land as investment property. The fair value of the land occupied by informal settlers is based on open market values, determined by the independent valuers, as adjusted by the Directors' estimated cost of evicting the informal settlers and securing the land. The determination of the cost of evicting the informal settlers involved estimates and significant judgements.	I have performed the following audit procedures; • Assessed competency, capabilities and objectivity of the independent valuers. • Reviewed the terms of the engagement of valuers to ascertain whether there were matters affecting their objectivity or whether there was a scope limitation that would have a significant impact on their work. • Assessed the appropriateness of the methodology used by the independent valuers and its consistency with the International Financial Reporting Standards (IFRS). • Assessed the relevance and reasonableness of the independent findings or conclusions, and their consistency with other audit evidence obtained during the audit. • Assessed the results of the expert's work in light of the knowledge of the real estate sector and the properties owned by the Company. • Reviewed Management's estimate of eviction costs for reasonableness. • Reviewed the adequacy of the disclosures in Note 15 to the financial statements.

Other Matter

1. Loss in Sale of Land

As previously reported, in 2012, the Company entered in a consent to sell land LR. No.8784/4, Athi River (measuring 337 acres) to a local buyer at a price of Kshs.2,200,000 per acre against the carrying value of Kshs.5,200,000 per acre. However, the buyer defaulted on the provisions of the consent by not providing an acceptable bank security within the period of consent. The case was taken to court after which the parties settled at a renegotiated price of Kshs.4,500,000 per acre on 3 May, 2019. The company thereafter revalued the investment property to a carrying value of Kshs.5,256,291 per acre. As a result, the renegotiated price of Kshs.4,500,000 per acre resulted to an impairment loss of Kshs.254,870,067.

2. Land Invaded by Informal Settlers

The investment properties LR No.8784/4 (1,330 acres) is almost 70% invaded by informal settlers while LR No.8786 (745 acres) and LR No 10424 (3,292 acres) are partially occupied by informal settlers. The Company continued to pursue several avenues to reclaim the occupied properties. An estimated cost of evicting the informal settlers amounting to Kshs.376,904,000 has been adjusted in the financial statements in arriving at the fair value of investment properties.

Other Information

The Directors are responsible for the other information, which comprises the Chairman's Statement, Managing Director's Statement, the Statement of Corporate Governance, Directors Remuneration Report and the Statement of Directors' Responsibilities. 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.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

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 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

1. Tax Matters

1.1 Non-Remittance of Pay as You Earn (PAYE) Tax Deductions

Sections 3(2)(a)(ii), 5 and 37 of the Income Tax Act Cap 470 requires employers to deduct PAYE at source and remit the same to the tax authorities before the 9th day of the subsequent month of pay. However, as at 30 June, 2020, the Company had not remitted PAYE amounting to Kshs.52,500,000 for the twelve (12) months period. Cumulatively the Company made a provision of Kshs.779,000,000 of unremitted PAYE and Kshs.571,000,000 being the penalties there on.

The Company was in breach of law and is exposed to the consequences of non-compliance with the income tax law.

1.2 Non-Remittance of Value Added Tax (VAT)

Section 13(3) of the Value Added Tax Act Cap 476 requires entities to remit VAT payable to tax authorities before the 20th day of the subsequent month of collection. However, the Company had not remitted VAT totalling Kshs.259,000,000 in principal and penalties and interest of Kshs.97,000,000 as at 30 June, 2020.

The Company was in breach of law and therefore exposed to the consequences of non-compliance with the value added tax law.

Further, and as disclosed in Note 29(1) to the financial statements, Kenya Revenue Authority carried out an audit on the Company, covering corporate tax, employees' taxes, withholding tax and VAT for the period from 2005 to 2008. KRA raised an assessment of Kshs.2.5 billion out of which Kshs.1.7 billion had been resolved with the tax Authority. The Company paid Kshs.122,000,000 and appealed against a further Kshs.473,000,000 through the local tax committee which subsequently ruled in favor of the Company. KRA later appealed in the High Court against the local committee ruling. The substantive appeal to the High Court had however not been filed by KRA. The Directors are of the view that no additional liabilities may arise from this matter.

2. Non- Remittance of Employees' Pension Contributions

Sections 53 and 53A of the Retirement Benefits Act, 1997 requires entities to timely remit contributions by the employee's, failure to which, the entities will be penalized. However, the Company had accrued pensions of Kshs.101,000,000 in principal, penalties and interest as at 30 June, 2020. These unremitted contributions date back to August, 2018.

The Company was in breach of law and is exposed to the consequences of non-compliance with the retirement benefits law through penalties and non-payment of retirement benefits to its employees upon retirement.

3. Non- Remittance of Mining Levies

Legal Notice No. 222 of the Mining Act (Cap 306) dated 18 December, 2013 requires cement producers to pay a cement mineral levy at the rate of Kshs.140 per ton of cement with effect from 1 January, 2014. The Company had accruals of non-remitted mining levy amounting to Kshs.363,000,000 as at 30 June, 2020.

The Company was in breach of law and exposed to the consequences of non-compliance with the mining regulations.

4. Non-Remittance of Unclaimed Dividends

Section 20 of the Unclaimed Financial Assets Act, 2011 requires entities to remit unclaimed assets, including but not limited to ownership interests (shares and dividends), with a period of abandonment of three (3) years. As at 30 June, 2020, the Company held in its books, accrued dividends payable amounting to Kshs.102,000,000. Part of this amount has been outstanding for more than three (3) years exposing the Company to increased penalties.

The Company was therefore in breach of law.

5. Loans Exceeding Bank Borrowing Limits

The Company's agreement with Kenya Commercial Bank sets out the approved borrowing limits for the various facilities advanced by the Bank to the Company. As at 30 June, 2020, the Company had exceeded the approved borrowing limit by Kshs.2,770,882,000 (outstanding amount is Kshs.6,040,524,000 while the approved limit is Kshs.3,269,702,000). The non-compliance with the debt arrangement exposes the Company to consequences such as recall of facilities and adverse credit rating, hence difficulties in obtaining additional financing as well as possible loss of the assets charged as security for the debt.

6. Lack of Executed Agreement for Government Loan

Note 23 to the financial statements indicates that the Company holds in its books a Government debt of Kshs.1,483,077,000 (2019: Kshs.1,079,799,000) payable to the Government of Kenya as at 30 June, 2020. The loan amount accumulated from the interest and principal repayment made on Japanese - OECT loan by the Government of Kenya on behalf of the Company as the Government was the guarantor. The loan agreement between the Company and the Government indicating the terms of the loan and the agreed amount was not availed for audit verification. Interest on this Government loan was not accrued during the year under audit.

As a result, it was not possible to ascertain the terms of the loan or the actual outstanding loan amount due to the Government as at 30 June, 2020.

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 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, I confirm that, nothing 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 the audit that:

(i) In my opinion, the information given in the report of the Directors on pages 14 to 16 is consistent with the financial statements.

(ii) In my opinion the auditable part of the Directors' remuneration report on pages 17 to 18 has been properly prepared in accordance with the Kenyan Companies Act, 2015.

Responsibilities of Directors and those charged with Governance

The Directors are responsible for the preparation and fair presentation of the consolidated and separate financial statements that give a true and fair view in accordance with International Financial Reporting Standards and the requirements of the Kenyan Companies Act, 2015, and for such internal control as the Directors determine are necessary to enable the preparation of consolidated and separate financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated and subsidiary's financial statements, the Directors are responsible for assessing the group's and the subsidiary's ability to continue as going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless Directors are aware of the intention to liquidate the Company and its subsidiary or to cease operations.

The Directors are also responsible for the submission of the financial statements to the Auditor-General in accordance with the provision 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 group's and the subsidiary'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 Responsibilities for the Audit

The audit objectives are to obtain reasonable assurance about whether the consolidated and Company 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 provision of Section 48 of the Public Audit Act, 2015 and submit the 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.

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 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 group's and the subsidiary'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 consolidated and company 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 that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the group's and 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 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 consolidated and Company's 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 within the group to express an opinion on the consolidated and Company's 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 we identify during our audit.

I also provide Management with a statement that I have complied with the relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.
From the matters communicated with Management, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. These matters are described in my auditor's report unless law or regulation precludes public disclosure about the matter or when in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

CPA Nancy Gathungu CBS
AUDITOR-GENERAL

Nairobi

30 October, 2020