REPORT OF THE AUDITOR-GENERAL ON ENERGY AND PETROLEUM REGULATORY AUTHORITY FOR THE YEAR ENDED 30 JUNE, 2021

PREAMBLE

I draw your attention to the contents of my report which is in three parts:

A. Report on the Financial Statements that considers whether the financial statements are fairly presented in accordance with the applicable financial reporting framework, accounting standards and the relevant laws and regulations that have a direct effect on the financial statements.

B. Report on Lawfulness and Effectiveness in Use of Public Resources which considers compliance with applicable laws, regulations, policies, gazette notices, circulars, guidelines and manuals and whether public resources are applied in a prudent, efficient, economic, transparent and accountable manner to ensure Government achieves value for money and that such funds are applied for intended purpose.

C. Report on Effectiveness of Internal Controls, Risk Management and Governance which considers how the entity has instituted checks and balances to guide internal operations. This responds to the effectiveness of the governance structure, the risk management environment, and the internal controls developed and implemented by those charged with governance for orderly, efficient and effective operations of the entity.

An unmodified opinion does not necessarily mean that an entity has complied with all relevant laws and regulations, and that its internal controls, risk management and governance systems are properly designed and were working effectively in the financial year under review.

The three parts of the report are aimed at addressing the statutory roles and responsibilities of the Auditor-General as provided by Article 229 of the Constitution, the Public Finance Management Act, 2012 and the Public Audit Act, 2015. The three parts of the report, when read together constitute the report of the Auditor-General.

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Energy and Petroleum Regulatory Authority set out on pages 55 to 86, which comprise of the statement of financial position as at 30 June, 2021, and the statement of financial performance, statement of changes in net assets, statement of cash flows and the 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 effect of the matters described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respects, the financial position of the Energy and Petroleum Regulatory Authority as at 30 June, 2021, and of its financial performance and its cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (Accrual Basis) and comply with the Public Finance Management Act, 2012 and the Energy Act, 2019.

Basis for Qualified Opinion

1.0 Inaccuracies in Property, Plant and Equipment

The statement of financial position reflects property, plant and equipment amount of Kshs.211,238,288 as disclosed in note 23 to the financial statements .Included in the balance is an amount of Kshs.79,067,020 in respect of partitions works in four (4) regional offices whose contract value totalled to Kshs.69,343,570 resulting to unreconciled variance of Kshs.9,723, 450.

Further, the final accounts by the supervising consultant in respect of the works above indicated the work done to be valued at Kshs.58,130,808 resulting in an unexplained and unaccounted for variance of Kshs.11,212,762 compared to the contract sum of Kshs.69,343,570.

In addition, examination of the final certificate of completion indicates that the works were certified as complete on 27 August, 2021, but the partitions were capitalized in the year under review. Management has not explained the reasons for capitalizing the works yet the final certificate of completion had not been issued.

In the circumstances, the accuracy, completeness and regularity of the property, plant and equipment balance of Kshs.211,238,288 could not be confirmed.

2.0 Inaccuracies in Employee Costs

The statement of financial performance reflects employee costs of Kshs.630,822,709 as disclosed in Note 12 to the financial statements. However, review of the payroll details indicated total employee costs of Kshs.516,536,406 resulting to a variance of Kshs.114,286,303.

In the circumstances, the accuracy and completeness of employee costs of Kshs.630,822,709 could not be confirmed.

3.0 Unsupported Expenditure on Consultancy

The statement of financial performance reflects contracted services balance of Kshs.120,872,750 as disclosed in Note 16 to the financial statements. Included in this balance is an amount of Kshs.10,245,718 incurred on Consultancy for Development of Environmental Health Safety (EHS) guidelines for Petroleum Upstream Sector. The contract was awarded to a company on 11 June, 2019 at a contract sum of Kshs.17,076,196. However, Management did not provide documents to support payment of Kshs.10,245,718 for audit.

In the circumstances, the accuracy, completeness and regularity of the consultancy expenditure of Kshs.10,245,718 could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the Energy and Petroleum Regulatory Authority 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 qualified opinion.

Key Audit Matters

Key audit matters are those matters that, in my professional judgement 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

Budgetary Control and Performance

The statement of comparison of budget and actual amounts reflects budgeted total revenue of Kshs.1,887,092,149 and actual revenue of Kshs.1,510,183,486 resulting to under receipts by Kshs.376,908,663 or 20% of the budget. Similarly, the Authority projected to spend Kshs.1,388,936,050 but incurred Kshs.1,354,664,883 resulting to under expenditure of Kshs.34,271,167 or 2% of the budget.

The underfunding affected the planned activities and may have impacted negatively on service deliver to the public.

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 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

1.0 Irregular Expenditure on Contract for Monitoring of Domestic Kerosine

The statement of financial performance reflects contracted services balance of Kshs.120,872,750. Included in this balance is an amount of Kshs.77,812,262 incurred on provision of petroleum fuels marking and monitoring services. An amount of Kshs.56,041,963 was paid in the financial year 2019/2020 resulting in total payments of Kshs.133,854,225. According to the tender documents, the contract was awarded to a company on 28 March, 2019 at a contract sum of Kshs.68,512,520 in the two years resulting to an unexplained over expenditure of Kshs. 65,341,705.

Further, according to Part I section 8 of the contract agreement, the Authority had committed to bear the cost of services offered to independent and unbranded retail stations. The Authority was exposed to the risks of additional costs in respect to independent and unbranded stations.

In the circumstances, value for money for the contract could not be confirmed.

2.0 Irregular Extension of Inspection of Liquefied Petroleum Gas Storage and Cylinder Contract

The statement of financial performance reflects contracted services balance of Kshs.120,872,750. Included in this balance is an amount of Kshs.45,529,384 incurred on inspection of Liquefied Petroleum Gas (LPG) storage facilities and LPG cylinders. According to the tender documents, the contract was awarded to a company on 28 March, 2019 at a contract sum of Kshs.35,809,200. The contract duration was for two (2) years commencing 28 March, 2019 to 28 March, 2021. The contract was extended for a period of one (1) year on 25 March, 2021 for a contract sum of Kshs.35,809,200. This was contrary to Section 139, 2 (a) of the Public Procurement and Asset Disposal Act, 2015 which provides that an accounting officer of a procuring entity, on the recommendation of an evaluation committee, may approve the request for the following, which request shall be accompanied by a certificate from the tenderer making a justifications for such cost.

Review of the financial records revealed the firm has been paid a total of Kshs.85,515,453 since inception of the contract resulting in an unexplained overpayment of Kshs.13,897,053.

In the circumstances, the Authority was in breach of law.

3.0 Unutilized Office Space

The Authority entered into a lease agreement with a landlord for office rent fifth (5th) floor at an amount of Kshs.2,785,050 per month payable quarterly in advance. However, a physical verification of the premises confirmed that the Authority had not occupied the office as from 1 July, 2020 until the time of the audit in March, 2022 despite paying rent of Kshs.6,684,120. According to the Management, the non-occupancy was as a result of long period of partitioning, fittings and remodelling of the office to conform to the Authority's needs and brand.

In the circumstances, the Authority did not obtain value for money on the expenditure.

4.0 Failure to Remit Surplus Funds to Kenya Revenue Authority

Examination of expenditure records revealed that the Kenya Revenue Authority through a notice dated 25 August, 2020 demanded remittance of surplus funds amounting to Kshs.240,041,236. The Authority failed to remit the funds contrary to Sec 219(2) of Public Finance Management Act, 2012 on dividend policy and surplus funds. Further, in a letter dated 6 November, 2020 Kenya Revenue Authority (KRA) required the Authority to pay tax owed of Kshs. 276,731,953. The Management has explained they had communicated with The National Treasury indicating that they cleared the issue. However, no official communication from KRA confirming the clearance of the issue was provided for audit.

In the circumstances, Management was in breach of law.

5.0 Irregular Appointment of the Director General

Review of human resource records and minutes of the Board of Directors meetings revealed irregularities in the appointment of the Director General of the Authority. The details are provided below:

i. The Board held 79th special Board meeting on the 14 of December, 2020 and confirmed the interdiction of the former Director General. Upon further deliberations, the members unanimously resolved that a recommendation be made to the Cabinet Secretary in Charge of the Ministry of Energy, for appointment of one of their own who was representing the Cabinet Secretary in the Board as the Acting Director General. The appointment was to take effect as from 9 December, 2020. It was however noted that the Board Members did not declare a conflict of interest in the matter since the person to be appointed Acting Director General was a member of the Board and was in the meeting. This was contrary to Section 1.16(1b) of the Code of Governance for State Corporations (Mwongozo) which requires that a Board Member disclose all real or perceived conflict of interest and manage these within an agreed framework.

ii. Further review indicated that the special Board meeting held on 14 December, 2020 ended at 8p.m, while the letter from the Board seeking approval for appointment of Acting Director General was done and sent to the Cabinet Secretary on the same day. The Board issued an appointment letter on 14 December, 2020 to one of their own to act as Managing Director on 14 December, 2020 before the approval was granted. The Acting Managing Director who was a member of the Board and was present in the meeting accepted the appointment the same day. However, the letter from the Ministry on the appointment was issued on the 15 of December, 2020. This implies that the Board appointed him before getting the Ministry's approval. This was contrary, to Part 13(1) of the Energy Act 2019, that stipulates that the Board shall subject to the approval of the Cabinet Secretary, appoint a Director General who shall be the Chief Executive Officer of the Authority.

iii. The position of the Director General was declared vacant by the Board during its 109th regular meeting held on 31 March, 2021 and subsequently the position was advertised on 27 April, 2021. The 83rd special meeting of the Board held on 20 May, 2021 delegated the task of shortlisting the applicants to the Finance and Administration Committee (FAC) which in turn formed a team consisting of Management to open and compile the applications. The team prepared the report dated 28 May, 2021 which indicated there were 23 applicants.

iv. The Board sought approval of the Cabinet Secretary on 28 June, 2021 to appoint the Director General. However, the Cabinet Secretary appointed the Director General on 28 June, 2021 whose terms of offer were accepted and signed by the nominee on the same day instead of the Board of Directors as required by Section 13 (1) of the Energy Act, 2019.

v. According to Section 13 (3)(c) (d) of the Energy Act, a person shall be qualified for appointment as a Director-General if such person has at least seven (7) years management experience at a senior level and at least two (2) years of experience in petroleum and energy. However, review of the applicant's documents confirmed that the person lacked the requisite management experience at senior level for appointment as a Director General.

In view of the foregoing, the regularity and suitability in the appointment of the Director General could not be confirmed and Management was in breach of law.

6.0 Irregular Payment of Retention Money

Review of financial records confirmed that the works for partitioning the regional offices in Nyeri, Mombasa, Kisumu and Eldoret had accrued bills amounting to Kshs.21,207,345 out of which an amount of Kshs.5,077,257 was paid to the contractor as retention monies leaving a closing balance of Kshs.16,130,088. However, payment of retention monies was done before issuance of the final certificate of completion contrary to Section 151, (2),(h) of the Public Procurement and Asset Disposal Act, 2015.

In the circumstances, Management was in breach of 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 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 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 controls, 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.

Responsibilities of Management and Board of Directors

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Public Sector Accounting Standards (Accrual Basis), and for maintaining effective internal controls 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 its assessment of the effectiveness of internal controls, risk management and overall governance.

In preparing the financial statements, Management is responsible for assessing the Authority's ability to continue to sustain its services, disclosing, as applicable, matters related to sustainability of services and using the applicable basis of accounting unless Management is aware of the intention to terminate the Authority 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.

The Board of Directors is responsible for overseeing the Authority's financial reporting process, reviewing the effectiveness of how Management 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 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 controls 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 controls would not necessarily disclose all matters in the internal controls 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 controls 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 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 controls.

- 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 aplicable 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 Authority's ability to continue 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 Authority to cease to continue to sustain its services.

- 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 Authority 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 controls that are identified during the audit.

I also provide Management with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.

CPA Nancy Gathungu, CBS
AUDITOR-GENERAL

Nairobi

12 September, 2022