REPORT OF THE AUDITOR-GENERAL ON KENYA ELECTRICITY GENERATING COMPANY PLC 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, gazetted 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

The accompanying financial statements of Kenya Electricity Generating Company PLC set out on pages 56 to 141, which comprise of the statement of financial position as at 30 June, 2021, statement of profit or loss and other comprehensive income, statement of changes in equity, statement of cash flows, and a summary of significant accounting policies and other explanatory information, have been audited on my behalf by Deloitte & Touché, 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 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 Kenya Electricity Generating Company PLC as at 30 June, 2021, 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 Public Finance Management Act, 2012 and the Companies Act, 2015**.**

Basis for Qualified Opinion

1. Non-Valuation of Property, Plant and Equipment

The statement of financial position as at 30 June, 2021 reflects property, plant and equipment amounting to Kshs.356,135,476,000 as disclosed under Note 13 to the financial statements. The Company carries its fixed assets on the revaluation model based on its accounting policy. As a result, the assets are carried at revalued amounts less accumulated depreciation and accumulated impairment losses in accordance with International Accounting Standard (IAS 16): property, plant and equipment. The revalued amounts are determined based on market valuations carried out by independent expert valuers on a regular basis. According to the Company's Assets Management Policy, the recommended frequency of revaluation is after every 3-5 years. However, no revaluation has been conducted since the year 2015.

Management indicated that the Company was unable to secure services of an appropriate expert to carry out its assets' valuation during the year since the exercise is highly technical and requiring experts who meets international standards. The delay has been mainly attributed to the implications of Covid-19 pandemic since the qualified experts are domiciled outside the country, and the complex procurement process of such a service. However, a tender has been awarded to a foreign consultant after re-tendering and the valuation exercise is expected to be completed by 31 December, 2021.

Consequently, it has not been possible to determine the accuracy of the values of property, plant and equipment of Kshs.356,135,476,000 included in the financial statement as at 30 June, 2021 and disclosed under Note 13 to the financial statements.

2. Capital Work in Progress

Note 13 to the financial statements reflects capital work in progress balance of Kshs.99,343,863,000. Included in this balance are projects totaling Kshs.94,805,804,977 in respect of capital projects initiated several years back but had no movement over the last 2-10 years and which may have stalled. Management did not provide explanations on why the projects have not been completed and capitalized.

A further review of the work in progress schedules and records revealed the following anomalies:

i. The work in progress balance includes Kshs.4,481,056,467 in respect of transmission lines that were done in financial year 2008/2009 or earlier and which are not used in the furtherance of Company's business but are essentially used by another company for revenue generation. Although the Management indicate that there has been negotiation for transfer of the assets to the other company, Kenya Electricity Generating Company PLC continues to service a loan and accruing interest in respect of these assets, thereby increasing the operations costs of the Company and cash outflows without corresponding revenue being realized.

ii. In addition, the work in progress balance includes an amount of Kshs.79,324,783,562 incurred on drilling of wells for geothermal power, financed by a loan from Export-Import Bank of China (EXIM). The wells were drilled between the year 2011 and 2015 and have never been connected to any plant for generation of power. The Company has in the meantime continued to pay the principal sum and interest while no corresponding revenue has been realized to date. Further, the Management has not given the details of when the wells are likely to be utilized in generation of power. As a result, there is no value for money obtained on the investment of Kshs.79,324,783,562 on drilling wells.

iii. Included in the work in progress balance of Kshs.99,343,958,491 is an amount of Kshs.645,975,453 incurred on feasibility studies for wind power projects. Out of this balance, Kshs.592,918,565 and Kshs.82,023,761 was incurred in respect of Meru Wind power project in financial year 2011/2012 and Karura Hydro Power Plant project in financial year 2013/2014 respectively. Although expenditures are said to relate to the feasibility studies on the two projects no contract documents and feasibility studies reports were provided for audit verification in support of the projects. The Management has not provided reasons for the delay in conclusion of the feasibility studies for over eight years.

iv. The work in progress balance further includes Kshs.78,647,502 in respect of a building referred to as Hydro Plaza whose construction work commenced in 2010. The building was indicated to be under the defects liability period, implying that it had been handed over by the contactor. Management partially capitalised the building with a sum of Kshs.293,529,602. However, certificates of completion for the capitalised were not provided for audit review. Further, a review of procurement records revealed the works were initially awarded at a cost of Kshs.150,005,216 but the contract was terminated on non-performance and subsequently awarded to another contractor at a contract sum of Kshs.261,264,205, an increase of Kshs.111,258,989 or 74% of the earlier contract sum. The Management did explain the cause of the significant increase in the cost of the building.

In view of the foregoing, the accuracy, completeness and valuation of work in progress balance of Kshs.99,343,863,000 as at 30 June, 2021 could not be confirmed.

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

Amounts Due from The Kenya Power and Lighting Company PLC

The financial statements reflect gross amounts due from the Company's main customer, The Kenya Power and Lighting Company PLC amounting to Kshs.25,141,317,000 as disclosed in Note 19 to the financial statements. This outstanding balance is billed as per respective Power Purchase Agreements (PPAs) between the two companies. However, KPLC confirmed Kshs.24,899,964,656 as the amount owing resulting in unreconciled variance of Kshs.241,352,344.

Further, the Management in an attempt to explain the variance above, indicated that there are disputed charges with The Kenya Power and Lighting PLC over the years denominated in Kenya shillings amounting to Kshs.506,183,865 and denominated in United States dollars amounting to USD 178,092. Therefore, reconciliation of the differences with the customer and collection of the disputed amount is in doubt.

My opinion is not qualified with respect to 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. 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 them. For the matter below, a description of how the audit addressed the matter is provided in that context.

I have fulfilled the responsibilities described in the Auditor's Responsibilities for the Audit section of the report, including in relation to these matters. Accordingly, the audit included the performance of procedures designed to respond to the assessment of the risk of material misstatement of the financial statements. The results of the audit procedures, including the procedures performed to address the matters below, provide the basis for my qualified opinion on the accompanying financial statements.

Key Audit Matter	How My Audit Addressed the Key Audit Matter
Capitalisation of Costs The Company undertook different capital projects during the year under audit, mainly Olkaria V power plant project, Olkaria 1 Unit 6 and drilling of wells. The Company capitalised part of the costs it incurred during the year which it	The following procedures were performed, among others, to address the key audit matter: **Capitalised Payroll Costs** • The accuracy of total payroll amounts was tested and the reasonableness of management's assessment of the

Key Audit Matter	How My Audit Addressed the Key Audit Matter
considered to be directly related to the construction of these projects. Capitalisation of costs (payroll costs, borrowing costs and depreciation) identified as a key audit matter due to the significance of the amount capitalised in the financial statements as well as the significant judgements and assumptions in determining the amounts to be capitalised. Significant judgment is required by the directors in determining the following: • Assets that qualify for depreciation capitalisation and the quantum of depreciation to charge. Significant judgement is also required in determining capitalisation rates to be applied on shared service centers. • Element of staff costs directly attributable to the ongoing projects. Additionally, the key assumption applied in capitalising the employee costs is the time spent by qualifying employees on the capital projects. • Borrowing costs to capitalise in line with the requirements of IAS 23.	payroll costs directly attributable to the ongoing projects assessed. • An assessment of the capitalised payroll costs was performed including testing the classification, measurement and disclosure requirements of the relevant accounting standards – IAS 16. **Capitalised Borrowing Costs** • Accuracy of the interest charges was tested and the reasonableness of the amount capitalised assessed in line with the requirements of IAS 23. **Capitalised Depreciation** • Existence of the underlying assets was tested and their valuation and accuracy of the cost of the assets assessed including the reasonableness of the assets' useful lives and depreciation rates used. The assets were also verified to confirm they were being used in the manner intended by Management. It was concluded that the assumptions and judgements made by the Management in capitalisation of costs were appropriate.

Other Information

The other information comprises the corporate information, shareholding, report of the Directors, statement of Directors' responsibilities and the Directors' remuneration report, which I obtained prior to the date of this audit report, and the rest of the other information in the annual report which is expected to be availed to me after that date, but does not include the financial statements and my auditor's report thereon. The Directors are responsible for the other information. My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information identified above and, in so doing, consider whether the other information is materially inconsistent with the financial statements or my knowledge obtained in the audit, or otherwise appears to be misstated. If, based on the work I have performed on the other information 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. I have nothing to report in this regard.

When I read the rest of the other information in the annual report and I conclude that there is a material misstatement therein, I am required to communicate the matter to those charged with governance.

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 Qualified Opinion and 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

Non-Compliance with Capital Markets Authority Regulations

A review of the statement of profit or loss and other comprehensive income as at 30 June, 2021 revealed that the profits declined from Kshs.18,377,093,000 in the previous year to Kshs.1,188,407,000 in the year under review, a decline of Kshs.17,188,686,000 representing 93.5%. However, the Management of the Company has not issued a notice to the shareholders in line with paragraph G.05(1)(f) of the fifth schedule of the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002.

Further, the First Schedule of the Capital Markets (Securities) (Public Offers, Listing and Disclosures) Regulations, 2002 (Amended 2016) sets out the minimum requirements for a company at the time of listing, as well as continuing obligations of the listed entity. The First Schedule provides that the listed company must have prepared financial statements for the latest accounting period on a going concern basis and that the related audit report must not contain a qualified opinion or emphasis of matter in this regard. However, the audit opinion on the Company's financial statements for the year under review is qualified and includes an emphasis of matter.
In the circumstances, the Management of the Company was in breach of the regulations.

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, except for the matters described in the Basis for Qualified Opinion and Basis for Conclusion on Lawfulness and Effectiveness in Use of Public Resources sections of my report, I report based on the audit that:

(i) In my opinion, the information given in the report of the directors on pages 21 to 22 is consistent with the financial statements.

(ii) In my opinion, the auditable part of the directors' remuneration report on pages 24 to 25 has been properly prepared in accordance with the Companies Act, 2015 and are in agreement with the accounting records.

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 its 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 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 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 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 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 which may reasonably be thought to bear on my 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, 2021