REPORT OF THE AUDITOR-GENERAL ON THE KENYA POWER AND LIGHTING 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

Opinion

The accompanying financial statements of The Kenya Power and Lighting Company PLC set out on pages 12 to 89, which comprise of the statement of financial position as at 30 June, 2021, the statement of profit or loss and other comprehensive income, the statement of changes in equity and the 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 Ernst and Young 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 the Kenya Power and Lighting 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 Companies Act, 2015 and the Public Finance Management Act, 2012.

Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of The Kenya Power and Lighting 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 audits of financial statements in Kenya. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Emphasis of Matter

1. Material Uncertainty Relating to Going Concern

I draw attention to Note 2(a) to the financial statements which discloses that the Company's current liabilities of Kshs.116,114,111,000 exceeded its current assets of Kshs.49,634,944,000 by Kshs.66,479,167,000 (2020: Kshs.74,848,822,000). The Company has remained in a negative working capital position for the fifth consecutive year. The Board of Directors and Management in the past and in the year under review, indicated strategic initiatives that were being undertaken to improve the financial results of the Company. However, these initiatives appear not to have yielded the intended results as at 30 June, 2021. As further stated in Note 2(a), this condition, along with other matters as set forth in Note 2(a), indicates existence of material uncertainty that may cast significant doubt on the Company's ability to continue as a going concern.

2. Capacity Charge on Power Purchase Agreements

The financial statements reflect cost of sales of Kshs.94,220,014,000, as disclosed under Note 8 to the financial statements. Included in these power purchase costs is Kshs.49,237,105,566, which relates to capacity charge as per Power Purchase Agreements (PPAs). These charges, which account for 52% of the total cost of sales are significant and, considering their fixed nature, may have adversely affected the Company's performance during the year. In the previous financial year, the Management indicated that plans were underway to re-negotiate downwards the capacity charges on the existing PPAs but there were no revisions during the year under review. In addition, Management indicated that plans were underway to align the commercial operation dates of the PPAs in line with the Company's medium-term power demand such that there is no excess power generation. However, until these strategies are implemented, the Company will continue bearing the high fixed capacity charges.

In addition, the capacity charge cost for Independent Power Producers (IPPs) during the year under review was higher than the cost of the energy purchased clearly indicating the IPPs were operating below their capacity resulting in payment for idle capacity which negatively impacts on the profitability or sustainability of the Company.

My opinion is not qualified with respect to these matters.

Key Audit Matters

Key audit matters are those matters which, 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 these matters. For each 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 opinion on the accompanying financial statements.

Key Audit Matter	**How My Audit Addressed the Key Audit Matter**
Provision for Expected Credit Losses on Trade and Other Receivables As at 30 June, 2021, the Company's gross current trade and other receivables amounted to Kshs.62,597,075,000, as disclosed in Note 21(b) to the financial statements. The Company recognized an allowance for expected credit losses on these trade and other receivables of Kshs.23,884,517,000 in accordance with IFRS 9 - *'Financial Instruments*'. Focus was given to the Expected Credit Losses (ECL) due to the materiality of these balances and the associated allowances for ECL. In addition, compliance with IFRS in this area involves significant judgement and estimates to be made by the Company. The most significant areas identified with greater levels of management judgement included: i. Determining the criteria for Significant Increase in Credit Risk (SICR).	**We performed the following Procedures: -** i. Obtained an understanding of the Company's process for estimating the ECL; ii. Tested the key controls over the administration of the expected credit loss model; iii. Tested the accuracy and completeness of the Company's data used for the ECL model; iv. Analysed the expected credit loss models against IFRS 9 guidelines; v. Selected a sample of trade and other receivables and performed procedures to determine the reasonableness of the impairment assessed based on the model; vi. For forward looking assumptions used by the Company, we held discussions with Management and corroborated the

Key Audit Matter	How My Audit Addressed the Key Audit Matter
ii. Application of future macro-economic variables reflecting a range of future conditions; and iii. Techniques used to determine the Probability of Default (PD) and Loss Given Default (LGD). Relevant disclosures were included in Notes 3(j), 4(b), 6(a), 9(d) and 21(b) to these financial statements which give a description of the accounting policies, credit risk management and analysis of the expected credit losses for trade and other receivables.	assumptions using both internal and publicly available information; and vii. Assessed the disclosures included in the financial statements, including their compliance with the requirements of IFRS.

Other Information

The other information comprises the Chairman's Statement and the Managing Director & Chief Executive Officer's Statement, which I obtained prior to the date of this report, and the rest of the other information in the Annual Report which is expected to be made available 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 doing so, 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 the Board of Directors.

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. Impairment Loss on Stalled Projects

The statement of profit or loss and other comprehensive income and Note 9(a) to the financial statements reflects network management expense of Kshs.10,237,382,000 which includes an impairment loss on capital Work-In-Progress (WIP) totalling Kshs.205,561,000. The impairment was in respect of projects that had part of the contract sum paid for but had no activity for the last three years. Management indicated that part of the impaired amount totalling Kshs.159,195,364 related to fraudulent payments made to contractors and which was subject of a court case against former employees of the Company.

In the circumstances, the objectives for which these projects were intended to achieve remains unattained and the Company may not have obtain value for money incurred on the projects.

2. Comparative Cost of Power Purchase-Kenya Electricity Generating Company PLC and The Independent Power Producers

Analysis of electricity units purchased during the year under review against the cost of purchase revealed a disparity between the cost of power procured from Kenya Electricity Generating Company Plc and the power procured from Independent Power Producers (IPPs). Records availed by the Company shows Kenya Electricity Generating Company PLC supplied a total of 8,443 Gigawatt hours (GWh) or 70% of the total power purchased while the IPPs supplied the remaining 3,688GWh (30%). However, the cost of the total power purchased from Kenya Electricity Generating Company PLC was Kshs.44,805,190,000 which was only 44%, compared to the purchase cost of power from IPPs totalling Kshs.56,345,169,000 or 56%. The analysis clearly shows that it cost KPLC an average of Kshs.5.3 per Kilowatt hours (KWh) of power purchased from Kenya Electricity Generating Company PLC while it cost the Company an average of Kshs.15.3 per KWh of power from the Independent Power Producers. It was noted that the effective unit cost of power purchased from some Independent Power Producers was as high as Kshs.195 per KWh, 136 per KWh and 118 per KWh while the same was sold at an average of Kshs.15.66 per KWh. The Company, therefore, entered into very expensive contracts with Independent Power Producers (IPPs) and was in some instances selling power below the cost price.

Further analysis of the payments in respect of power purchased showed that the capacity charge component of the energy paid to Independent Power Producers was always more than the charge for actual energy supplied and, especially for three Independent Power Producers, whose ratio of capacity charge to energy procured was as high as 110:1, 99:1 and 30:1 times respectively. The fuel cost paid to these firms was similarly higher than the cost of energy/power procured.

3. Non-Compliance with the Unclaimed Financial Assets Act, 2011

As reported in the prior years, the Company held in their books unremitted qualifying financial assets amounting to Kshs,691,000,000 (2020: Kshs.1,292,074,000), included under other payables of Kshs.2,269,799,000 (2020: Kshs.1,635,236,000), as disclosed under Note 28 to the financial statements. These assets include deposit refunds, unidentified receipts, unpaid customer electricity deposits, unpaid wayleaves compensation, unclaimed dividends, and stale cheques, which 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 assets held, in addition to a daily penalty of between Kshs.7,000 and Kshs.50,000 for each day a report is late in submission.

Management has, however, indicated that various measures have subsequently been taken to comply with the requirements of the Act, including submission of financial assets totalling Kshs.143,030,237 to the Unclaimed Financial Assets Authority.

4. Non-Compliance with the Capital Markets Authority Listing Rules

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 any qualification or emphasis of matter in this regard. However, the audit opinion on the Company's financial statements includes an emphasis of matter.

In addition, the Regulations provide that the Company must not be in breach of its loan covenants, particularly in regard to the maximum debt capacity and should have adequate working capital. However, as was similarly reported in the prior years, the Company's current liabilities of Kshs.116,114,111,000 exceeded current assets of Kshs.49,634,944,000 by Kshs.66,479,167,000 resulting in a negative working capital of a similar margin.

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

Basis for Conclusion

1. Power Losses in the System

Note 7(a) to the financial statements reflects electricity sales of Kshs.105,348,505,000 and Kshs.20,578,339,000 in postpaid and prepaid sales respectively. A review of units of electricity purchased against units sold revealed a total of 12,102GWh purchased from power producers out of which, 9,203GWh was sold to customers resulting in a loss variance of 2,899GWh or 23.95% which translates to approximately Kshs.39,667,708,000 using the average sale price for the 9,203GWh sold.

The industry regulator, Energy and Petroleum Regulatory Authority (EPRA) approved for the Company to recover from consumers system losses of up to 19.9% (approximately Kshs.32,959,807,000) that is deemed to be normal loss. The excess of 4.05% above the allowed loss (23.95-19.9) translates to a loss of approximately Kshs.6.707 billion had the same energy been sold to the consumers. The loss variance of 23.95% was attributed to systems inefficiencies arising from commercial or technical operations. These losses contribute to high power charges to the consumers since the industry regulator allows the Company to charge up to 19.9% of the power loses to consumers.

The difference/excess of 4.05% power loss above the approved recovery rate of 19.9% constitutes unaccounted for power which though the cost is not passed on to the consumers, it increases the operating costs of the Company.

Management explained that the difference between the actual system losses of 23.95% and the allowed system losses of 19.9% is borne by the Company without any billing impact to the customers/consumers. This loss has, however, been persistent for the last four years.

2. Failure to Observe Guidelines on Board of Directors Meetings

The Office of the President in a circular referenced OP/CAB.9/1A dated 11 March, 2020 provided that Board meetings should be restricted to a minimum of four (4) as provided for in the State Corporations Act and capped at a maximum of six (6) for each financial year or as maybe specified in the enabling legal instruments. The same principle should apply to respective Committees of the Board.

The Circular further requires that any extra Board meeting (including Special Board meetings) above the maximum number specified shall require a justification by the Board as well as the source of funds and the implications thereof, which request shall be submitted for approval to the relevant Cabinet Secretary, in consultation with the State Corporations Advisory Committee. However, during the year under review, the Board of Directors held ninety (90) meetings translating to a Board meeting every four days hence becoming operational in nature. Out of the 90 Board meetings, twenty-one (21) were full Board meetings and sixty-nine (69) were held by Board Committees.

Although the justification for approval request to the Cabinet Secretary was submitted and granted, the source of funds and the cost implication due to the high number of extra meetings was not factored as there were no approved budget reallocation.

3. Weaknesses in Information Technology (IT) Systems

The Management has implemented several IT systems for its various operations. However, an audit review of the systems revealed that user activity monitoring process did not include critical elements such as review of privileged accounts with access to the applications and databases, review of issuance of access to the applications commensurate to job designation, while review for dormancy for one application was not done. Further, several inactive user accounts in one application had not been disabled despite exceeding the prescribed dormancy period.

In view of the above, it was not possible to confirm the effectiveness of IT controls and related risk management including governance.

4. Long Outstanding Trade and Other Receivables

As disclosed under Note 21(b) to the financial statements, the statement of financial position reflects gross trade and other receivables of Kshs.62,507,075,000. Included in this balance is an amount of Kshs.418,461,268 (analysed in progress reports in Annexure 1) which had been outstanding for more than 150 days. Management indicated that measures had been put in place to enhance collection of amounts owed to the Company. However, until these measures yield results, the Company will continue holding long outstanding receivables which have a negative impact on its liquidity.

In the circumstances, it has not been possible to confirm the effectiveness of internal controls measures put in place to collect outstanding debts.

5. Implementation of Last Mile Connectivity Project

The Company implements the Last Mile Connectivity Project under a financing agreement signed between the Government of Kenya and the African Development Bank (AfDB).

A number of weaknesses and governance lapses in implementation of the project were observed as follows:

(i) Lack of public participation by the communities targeted in the project which led to lack of project ownership by members of the public thus hampering implementation.

(ii) There was no evidence of engagement with key regulatory, oversight and stakeholder agencies such as the Energy and Petroleum Regulatory Authority (EPRA) and Rural Electrification and Renewable Energy Corporation (REREC) an omission which can lead to duplication of projects.

(iii) Documents that are key to procurement of services and works including feasibility studies and surveys, progress reports for projects, technical specifications, bills of quantities and architectural drawings, and environmental and social impacts assessment reports were not provided for audit review.

(iv) The Company procured consultancy services for supervision and management of civil works and installation of meters at a cost of Kshs.274,380,500. However, site visits by the audit team revealed no evidence of consultants' personnel's presence at those sites, raising doubt on whether they had been deployed as per the contract.

(v) The project had received a total of Kshs.28,272,249,380 representing 63% of the approved loan amount of Kshs.44,797,955,760. However, documents in respect of disbursement and payments to contractors were not provided for audit verification. In addition, although the project had a projection of connecting 525,796 customers by the end of the project, only 213,432 had been connected representing 41% of the projection yet disbursement was at 63%.

(vi) Single prepaid meters procured from a Chinese Company at a cost of US$.10,073,000 (Kshs.1,086,373,050) and installed at customers premises were not vending even though they had been activated by the contractor thereby implying that customers were purchasing tokens but the Consumer Interface Units (CIU) were not picking the tokens and thus had no access to power. Other meters had taken as far as three years without vending.

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 under the Basis for Conclusion on Lawfulness and Effectiveness in Use of Public Resources and Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance 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 2 to 4 is consistent with the financial statements.

(ii) In my opinion, the auditable part of the Directors' remuneration report on pages 5 to 7 has been properly prepared in accordance with the Kenyan Companies Act, 2015.

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 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 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 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 to communicate with them all relationships and other matters that 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 and internal controls of the current year 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

29 October, 2021