REPORT OF THE AUDITOR-GENERAL ON NATIONAL OIL CORPORATION OF KENYA 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 National Oil Corporation of Kenya set out on pages 1 to 88, which comprise of the statement of financial position as at 30 June, 2021, and the statement of profit or loss and other comprehensive income, statement of changes in equity, 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 National Oil Corporation of Kenya 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. Inaccuracies in Bank and Cash Balances

The statement of financial position and as disclosed in Note 28 to the financial statements reflects bank and cash balances of Kshs.405,017,000. The balance includes an amount of Kshs.257,355,000 in respect of staff car loan and mortgage scheme. However, Management did not prepare separate financial statements for the Corporation's staff car loan and mortgage scheme.

Further, bank reconciliation statements, cash books and certificate of bank balances for bank accounts with total bank balances of Kshs.45,320,000 were not provided for audit.

In the circumstances, the regularity, accuracy and completeness of the bank and cash balances of Kshs.405,017,000 could not be confirmed.

2. Decline in Value of Freehold Land

As reported previously, the statement of financial position reflects property, plant and equipment with a net book value of Kshs.5,783,569,000. The values are based on revaluation of assets that resulted in decline in value of ten (10) parcels of freehold land by an amount of Kshs.145,640,000 or 43%, from a previous value of Kshs.336,140,000 to Kshs.190,500,000. The decline was not justified since it did not result from change in sizes due to alienation of the parcels or any other adverse conditions. Management attributed the decline to premiums paid on acquisition of the parcels. However, the reason could not be justified by the prevailing market conditions and differences in land measurements cited in the valuation reports and those in the title deeds.

In the circumstances, the accuracy and valuation of property, plant and equipment balance of Kshs.5,783,569,000 could not be confirmed.

3. Unsupported Provisions in Inventories Balance

The statement of financial position and as disclosed in Note 24 to the financial statements reflects net inventories valued at Kshs.652,917,000. Inventories with a gross value of Kshs.3,001,637,000 were adjusted for provisions of Kshs.2,348,693,000 which included an amount of Kshs.31,715,000 relating to full cost provision of the book value on defective gas cylinders.

Further, included in the inventory gross value of Kshs.3,001,637,000 is inventories balance of Kshs.1,494,624,827 written off from the books. This represents the amount carried forward in the books without corresponding physical inventories. The Board of Directors in a meeting held in October, 2016, passed a resolution and approved the write off of inventories totalling to Kshs.1,023,891,492 resulting to an unapproved write off valued at Kshs.470,733,335.

In addition, despite having made provisions of Kshs.2,316,977,535, the historical non-reconciling items continue to be carried in the books against the requirements of Regulation 168(d) of Public Procurement and Asset Disposal Regulations, 2020. Further, Management did not provide an approved policy for the provisions.

In the circumstances, the regularity, accuracy and completeness of the inventories balance of Kshs.652,917,000 could not be confirmed.

4. Inaccuracies in Trade and Other Receivables

The statement of financial position and as disclosed in Note 25 to the financial statements reflects trade and other receivables balance of Kshs.720,336,000. The balance was arrived at by adjusting gross receivables balance of Kshs.1,239,883,000 for provision of bad and doubtful receivables of Kshs.519,547,000. However, there was an unreconciled variance between the ledger and the trial balance of Kshs.13,707,690 made up of Value Added Tax - Output of Kshs.13,291,421 and trade debtors' control account of Kshs.416,269.

In the circumstances, the accuracy and completeness of the trade and other receivables balance of Kshs.720,336,000 could not be confirmed.

5. Unsupported Deferred Income

The statement of financial position and as disclosed in Note 26 to the financial statements reflects deferred income balance of Kshs.1,638,984,000. The balance comprises of training fund grant, oil exploration grants and Government downstream grant of Kshs.10,225,000, Kshs.1,625,659,000 and Kshs.3,100,000 respectively. During the financial year under review, an expenditure of Kshs.217,906,000 was incurred under oil exploration grants component. It was explained that expenditure which is not directly attributable to exploration costs is absorbed into the downstream and upstream operations on 80% and 20% basis. However, the approved policy guidelines were not provided to support the absorption of the indirect costs.

In the circumstances, the accuracy and completeness of the deferred income balance of Kshs.1,638,984,000 could not be confirmed.

6. Inaccuracies in Trade Payables

The statement of financial position and as disclosed in Note 34 to the financial statements reflects trade and other payables balance of Kshs.3,209,825,000. However, the amount differs with the supporting schedules provided totalling to Kshs.954,536,000 resulting in an unexplained variance of Kshs.2,091,877,000.

Further, from a sample of trade payables totalling to Kshs.802,214,962 selected for verification, purchase orders, invoices, supplier invoices and contracts were not provided to support a balance of Kshs.798,304,734.

In addition, the trade creditors balance include creditors with debit balances amounting to Kshs.42,324,706 reflected in the aged creditors listing report.

In the circumstances, the regularity, accuracy and completeness of the trade and other payables balance of Kshs.3,209,825,000 could not be confirmed.

7. Unsupported Funds

The statement of financial position and as disclosed in Notes 40, 42, 43, 44, 45 to the financial statements reflects non-current liabilities in respect of Block 14T Fund balance of Kshs.1,133,769,000, Single Buoy Mooring Jetty Fund balance of Kshs.11,443,000, Corporate Social Responsibility (CSR) Projects Fund balance of Kshs.30,238,000, Exploration and Production Capacity Building Fund balance of Kshs.72,955,000 and Laboratory Equipment Fund balance of Kshs.425,480,000 all totalling to Kshs.1,673,885,000. However, the corresponding cash and bank balances were not provided. Management explained that the Funds were mixed up with the rest of the Corporation's funds.

Further, the Funds relate to activities and projects initiated in partnership with Government agencies and lacked guidelines on utilization and liquidation of balances upon closure of such projects. The Corporation continue to hold funds for projects that are yet to be implemented or surplus funds for completed ones in its books, thereby denying citizens access to services intended or additional services that can be implemented using the idle funds.

In the circumstances, the regularity, accuracy and completeness of the Special Funds Projects balance of Kshs.1,673,884,000 could not be confirmed.

8. Inaccuracies in Staff Costs

The statement of profit or loss and other comprehensive income and as disclosed in Note 12 to the financial statements reflects staff costs of Kshs.504,459,000. Review of records indicated that the costs relate to downstream operations. In addition, Note 14 to the financial statements reflects exploration costs - staff costs of Kshs.129,572,000, bringing the total staff costs to Kshs.634,031,000.

Further, review of staff records revealed variances between the ledger and the payroll details amounting to Kshs.50,731,794.

In the circumstances, the accuracy and completeness of staff costs of Kshs.634,031,000 could not be confirmed.

9. Inaccuracies in Exploration and Operating Expenses

The statement of profit or loss and other comprehensive income and as disclosed in Note 14 to the financial statements reflects exploration costs of Kshs.217,906,000. Further, Note 13 to the financial statements reflects operating expenses of Kshs.581,314,000. The exploration costs comprise of exploration staff costs and other exploration costs of Kshs.129,572,000 and Kshs.88,333,000 respectively.

Management explained that the total costs incurred under each expenditure item are absorbed between downstream and upstream operations on 80% and 20% basis respectively. However, the approved policy was not provided to support the absorption of the costs to either upstream or downstream and the rates applied. Therefore, the basis for the separation of exploration costs from other operating expenses could not be ascertained.

Further, review of the supporting invoices revealed that an expenditure of Kshs.12,757,802 related to 2019/2020 financial year while an amount of Kshs.12,340,903 was not supported by relevant documentation.

In the circumstances, the accuracy and completeness of exploration costs and operating expenses of Kshs.217,906,000 and Kshs.581,314,000 respectively could not be confirmed.

10. Payment of Unspecified Allowances

The ledger and the trial balance provided for audit reflected total payments to staff amounting to Kshs.112,743,168 described as “other allowances.” However, the basis of payment of the allowances, and the applicable rates were not provided for audit. In addition, approval from State Corporations Advisory Committee (SCAC) was not provided to support the allowances.

In the circumstances, the accuracy, completeness and regularity of the allowances amounting to Kshs.112,743,168 could not be ascertained.

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

Emphasis of Matter

Uncertainty in the Corporation’s Ability to Continue as a Going Concern

The Corporation recorded a loss of Kshs.969,798,000 during the year under review (2020: Kshs.494,502,000) raising its accumulated losses to Kshs.4,025,234,000 from Kshs.3,055,436,000 in 2020. In addition, the Corporation’s current liabilities balance of Kshs.8,954,268,000 exceeded the current assets balance of Kshs.2,648,708,000 by amount of Kshs.6,305,560,000. These events or conditions, along with other matters set forth in the Note indicate material uncertainty regarding the Corporation's ability to continue as a going concern.

The Corporation is therefore, technically insolvent and its continued existence as a going concern is dependent upon the financial support of the Government, bankers, and its creditors unless Management puts in place measures to improve the performance of the Corporation and to reduce reliance on financial support from the shareholders.

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 Information

The Directors are responsible for the other information, which comprises, the Chairman's Statement, Managing Directors Statement, a review of Company's Performance, Corporate Governance statement, Management discussion analysis and Corporate Social Responsibility Statement. 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.

Other Matter

1. Budgetary Control and Performance

The statement of comparison of budget and actual amounts reflects final receipts budget and actual on a comparable basis of Kshs.26,142,188 and Kshs.9,618,087 respectively, resulting to an under-funding of Kshs.16,524,101 or 63% of the budget. Similarly, the Corporation spent an amount of Kshs.10,941,764 against an approved budget of Kshs.26,041,054 resulting to an under-expenditure of Kshs.15,099,290 or 58% of the budget.

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

2. Unresolved Prior Year Matters

In the audit report of the previous year, several paragraphs were raised under the Report on Financial Statements, Report on Lawfulness and Effectiveness in Use of Public Resources, and Report on Effectiveness of Internal Controls, Risk Management and Governance. However, Management has not resolved all the issues nor given any explanation for failure to adhere to the provisions of the Public Sector Accounting Standards Board templates.

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. Measurement of the Corporation's Defined Benefit Scheme

Review of records reflected that the Corporation had put in place a defined benefit scheme as part of the employees long-term benefits. However, the Scheme had not been accounted for in line with the provisions of paragraph 50 of IAS 19 which requires an entity to recognise the net defined benefit liability or asset in its statement of financial position.

In the circumstances, it was not possible to ascertain the net defined liability or asset, defined benefit obligation or current service costs and gains or losses on the Scheme.

2. Breach of Repayment Terms on Borrowings

The statement of financial position and as disclosed in Note 31 to the financial statements reflects borrowings of Kshs.5,731,821,000 comprising of non-current and current borrowings of Kshs.5,727,876,000 and Kshs.3,945,000 respectively. However, the Corporation has not been servicing the loan which may further increase the cost of borrowings. Further, records indicated that Management had negotiated with a commercial bank for the restructuring of the outstanding loan and moratorium given.

In addition, as a result of default on loan and interest repayment, a commercial bank confirmed that the Corporation had accrued a penalty of Kshs.198,001,365 for failure to service the loan thereby increasing the Corporation's liabilities.

In the circumstances, the Corporation could potentially be exposed if financiers were to take action on non-compliance with the loan agreements.

3. Payment of Avoidable Penalties

The statement of profit or loss and other comprehensive income and as disclosed in Note 7 to the financial statements reflects cost of sales totalling to Kshs.8,701,777,000. Included in the cost are indirect costs totalling to Kshs.206,893,915 which further includes penalties and fines totalling to Kshs.63,562,520. This amount mainly relates to penalties paid to Commissioner of customs for late payment of duties and penalties paid to Kenya Pipeline. The expenditure of Kshs.63,562,520 increases the Corporation's cost of sales and affects its cash flows negatively.

In the circumstances, efficiency and effectiveness in financial management could not be confirmed.

4. Long Outstanding Payables

The statement of financial position and as disclosed in Note 34 to the financial statements reflects trade payables balance of Kshs.3,209,825,000. Included in the balance is an amount of Kshs.365,855,203 which relates to payments to vendors that are outstanding for more than 360 days. This was contrary to Regulation 139(2) of the Public Procurement and Asset Disposal Regulations, 2020 which provides that a procuring entity shall make prompt and timely payments to a contractor that meets its contractual obligations. Further, Regulation 139(4) requires that unless the contract provides otherwise, a procuring entity shall pay interest on the overdue amounts. Management did not explain the reasons for non-payment of the trade payables.

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

5. Stalled Liquefied Petroleum Gas (LPG) Project and Uncapitalized Equipment

The statement of financial position reflects property, plant, and equipment net book value of Kshs.5,783,569,000. The balance includes capital work-in-progress balance of Kshs.26,283,750 in respect of construction of LPG Skid at Kipkaren Service Station comprising costs of civil works, two LPG Mini Skids and associated works. However, physical inspection revealed that although the skid foundation had been completed, no other works had been carried out, and the contractor had abandoned the site.

Further, it was established that the skids acquired for the project at a cost of Kshs.20,209,874 inclusive of installation costs were being used at the Corporation's Nairobi Terminal and Kabete Technical Training College resulting into unutilized expenditure of Kshs.6,073,876.

In the circumstances, value for money was not realized on the expenditure of Kshs.6,073,876 spent on civil works at Kipkaren Service Station which remain unutilized.

6. Stalled Single Buoy Mooring Facility Project

As previously reported, included in Note 42 to the financial statements is a Single Buoy Mooring Fund balance of Kshs.11,443,275. The Fund was established in July, 2010 after the Ministry of Energy and Petroleum through the Corporation expressed an interest to construct the facility near Kilindini, Mombasa for offloading crude oil and refined fuel. The Ministry in consultation with the Kenya Ports Authority (KPA) and the Corporation agreed on a suitable location for the facility upon which funds were committed for the feasibility study.

Further, the Corporation tendered for a feasibility study for the construction of a single buoy mooring offshore facility in June, 2011 despite KPA raising concerns about duplication of projects as there existed plans for expansion of port facilities capacity in handling petroleum products. Another feasibility was ordered by the Ministry of Finance in December, 2012 despite a consultant having carried a similar one in the previous year.

In addition, following stakeholder consultative sessions to review the feasibility report in 2013 and 2014, The National Treasury recommended engagement of a Public Private Partnership Advisor. The project was not executed despite expenditure of Kshs.69,556,725 during the preliminary stages. The balance of Kshs.11,443,275 out of an amount of Kshs.81,000,000 received from the Ministry of Energy and Petroleum for the project has been carried in the books of the Corporation as a liability.

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

7. Irregular Award of Tender for Supply of Laboratory Equipment

The tender for supply and delivery of laboratory equipment (Geochemical and Petro physical) was awarded to a company at a contract sum of Kshs.405,755,455. Review of procurement records revealed the following anomalies:

i. Under preliminary evaluation, it was a requirement that all tenders be bound. However, a firm submitted a tender in a box file without bidding. The evaluation committee indicated in the evaluation report that it as minor variation. This was however part of the criteria to be adhered to.

ii. Under technical evaluation, bidders where required to prove their financial capability as supported by providing audited accounts for the last three (3) years, out of which 10 marks would be awarded for compliance. The firm was awarded 10 marks, yet audited financial statement were not attached.

iii. Bidders where required to demonstrate maximum accumulated volume handled for the last two (2) years, by proving a gross turnover above an amount of Kshs.3,000,000 as evidenced by audited accounts. The firm was awarded 15 marks, yet audited financial statement were not attached.

iv. Bidders where required to attach a list and curriculum vitae of four (4) key personnel for purpose of tender if awarded. The firm was awarded the full 8 marks under the criteria, yet as detailed in the curriculum vitae most of the employees were not from the company.

v. Bidders where required to demonstrate delivery schedule (shipment) in weeks and in weeks/months from receipt of order out of which 5 marks would be awarded under the criteria. The company was awarded 5 marks yet no commitment was made on any delivery schedule. The bidder only indicated that delivery will be as per the terms of the contract.

In the circumstances, the propriety and value for money of the contract sum of Kshs.405,755,455 could not be confirmed.

8. Non-remittance of Statutory Deductions

The Corporation has not been paying fringe benefit tax since inception of the car loan and mortgage scheme as required by section 12B of Income Tax Act. This is despite the fact that the interest charged on car loan and mortgage issued is 3% which was below the prescribed market lending rate of 7%.

Further, review of the corporations' payables ageing analysis revealed that there were long outstanding taxes totalling to Kshs.22,175,274. The amount comprised of custom duty of Kshs.20,797,159 and Value Added Tax (VAT) of Kshs.1,378,115. Some of the taxes had been outstanding since year 2009.

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

9. Failure to File Annual Returns

The Corporation has not filed annual returns since the year 2018. This was contrary to Sections 705 and 708(1) of Companies Act, 2015, which provides that every company shall submit to the Registrar successive annual returns each of which is made up to a date not later than the date that is from time to time the company's return date.

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

10. Petroleum Strategic Stock

Regulation 4 of the Energy (Petroleum Strategic Stock) Regulations, 2008 states that, strategic stock shall be maintained in respect of each of the following petroleum products, at a level equivalent to up to ninety (90) days of consumption of each of these products, namely; (a) premium motor spirit; (b) illuminating kerosene; (c) jet fuel (kerosene); (d) automotive gas oil; and (e) liquefied petroleum gas. Further, Regulation 5 stipulates that the strategic stock shall be procured by the National Oil Corporation of Kenya and stored by the Kenya Pipeline Company Limited, and, in case of consumption or draw down, shall be replenished accordingly to its optimal level. However, Management has not been able to meet the provisions of the law. Management attributed the non-compliance to lack of sufficient budgetary allocation. It was further noted that the Corporation's license to import and export Petroleum Products (Except LPG) under EPRA/PET/4048 expired on 28 July, 2021 and has not been renewed.

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

11. Irregular Procurement

The Corporation purchased 3,549,979 litres of white products valued at Kshs.279,983,104 in the financial year 2020/21 through spot purchase. Although Management explained that they had been exempted by Public Procurement and Review Authority (PPRA) on use of procurement procedures, documents provided for audit revealed that, on 11 July, 2011, NOCK requested from the then PPOA, for approval to use Specially Permitted Procurement Procedure for the purchase of petroleum products but the same was not granted by the Authority as evidenced by response dated 13 September, 2011. In addition, these requests where done under the repealed Public Procurement and Disposal Act, 2005 and therefore the Corporation could not rely on the same.

Further, there was no evidence that the Corporation used one of the methods of procurement prescribed under part IX of Public Procurement and Asset Disposal Act, 2015.

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

12. Database and ERP Application System

Review of the Corporation's information technology systems revealed that two (2) systems in use were outdated necessitating an upgrade. The use of an outdated system increases vulnerability of losing crucial data and interruption of business operations.

Further, during financial year 2016/2017, the Corporation advertised for tender for the implementation and upgrading. The tender had not been budgeted for during the 2016-2017 budget. A company won the tender at an amount of Kshs.95,624,321 for a period of fifteen (15) months and post-implementation services for a period of three (3) years at a price of Kshs.24,654,456 per annum. A contract was signed on 2 June, 2017 and was valid up to 2 September, 2021. However, a letter dated 10 July, 2020 by the company indicated that Corporation withdrew system access and therefore they were unable to perform as per the contract. Documents presented for audit could not confirm that there was recommendation from Contract Implementation team on termination of the contract as per Section 151(2)(g) of the Public Procurement and Asset Disposal Act, 2015. The company filed a suit in the High Court against the Corporation for non-payment of outstanding invoices totalling Kshs.102,462,096 inclusive of interest.

In addition, the Corporation owed a firm a total of Kshs. 52,729,147 in Annual Software Update and Technical Support fees for the period between 1 June, 2019 and 30 June, 2021. Additionally, the Corporation owed a total of Kshs.37,207,471 in licenses fees for additional licenses purchased. It was also noted that there was continuous billing of unused licenses from the firm due to the incomplete project implementation. There is risk of loss of data and business interruption in the case of a security attack.

In the circumstances, there may have been loss of public funds and value for money was not achieved for the investment in information technology systems.

13. Exploration Expenditure - Block 14T

The statement of financial position and as disclosed in Note 40 to the financial statements reflects an amount of Kshs.2,423,039,000 in respect of exploration expenditure Block 14T. This amount represents the total capitalized exploration expenditure for block 14T as at 30 June, 2021.

Review of records indicated that the Corporation signed production sharing Contract with the Government of Kenya on 15 November, 2010 with effective date of 15 February, 2011. The initial exploration was for a period of three (3) years from effective date which was from 16 February, 2011 to 15 February, 2014 and as per clause 2(6), the contract was to expire automatically except as to any development area. The Management sought extension of initial exploration period from Cabinet Secretary which was granted from 15 February, 2021 to 14 February, 2023.

However, it was not possible to ascertain if the Corporation had a valid contract to carry out initial exploration for the period between 15 February, 2014 to 14 February, 2021, which could lead to ineligible expenditures. It was also not possible to ascertain if the Corporation had met the criteria for extension of the contract as per clause 2(6) of the production sharing contract. Further, the corporation did not provide Work plans and Progress reports for the exploration activities.

In the circumstances, non-adherence of contractual obligations may lead to ineligible expenditure.

14. Loss on Sale of Products

Review of the Inventory Transaction Report for the year under review showed that the Corporation sold some goods at price less than the cost price resulting to a loss of Kshs.14,740,696. Management explained that the sales related to products held by a commercial bank due to non-payment under Collateral Financing Arrangement (CFA) and which was released for sale after the prices had gone below the cost. However, no evidence was produced to support the explanation.

In the circumstances, the sale did not reflect prudent management of public resources.

15. Long Outstanding Staff Imprests

The trade and other receivables balance includes unsurrendered imprest totalling to Kshs.3,695,700. Some of the imprest were outstanding for more than one financial year. The receivables also include a balance of Kshs.5,163,882 in respect of staff prepayments related to imprests advanced to staff which had not been accounted for. Further, some of the staff members held multiple imprests contrary to the provisions of Public Finance Management (National Government) Regulations, 2015.

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

The audit was conducted in accordance with ISSAI 4000. The standard requires that I comply with ethical requirements and plan and perform the audit to obtain assurance 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 governance were not effective.

Basis for Conclusion

1. Lack of Strategic Plan

Review of the Corporation's Strategic Plan confirmed that it expired in the year 2020. The Management has not provided the current Strategic Plan contrary to Section 68(2) of Public Finance Management Act, 2012. Therefore, achievement of the Corporation's strategic goal may not be possible.

In the circumstances, the effectiveness and direction of the Corporations' strategy could not be confirmed.

2. Lack of Disaster Recovery Plan

Review of the Corporation's business processes revealed lack of a documented disaster recovery plan which can be implemented in the event of an emergency. In the absence of a disaster recovery plan, personnel affected in case of disaster might not have an awareness of what is expected of them. In addition, a risk matrix developed at the Corporation did not include responses to the risks or potential controls that would be implemented to address identified risks. This implied that risks identified in the control environment may recur.

In the circumstances, existence of effective disaster recovery mechanisms in the Corporation could not be confirmed.

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 overall governance were operating effectively, in all material respects. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Companies Act, 2015, I report based on my audit, that:

i. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit;

ii. In my opinion, adequate accounting records have been kept by the Corporation, so far as appears from the examination of those records; and

iii. The Corporation's financial statements are in agreement with the accounting records and returns.

Responsibilities of Management and the 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 controls, risk management and overall governance.

In preparing the financial statements, Management is responsible for assessing the Corporation'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 Corporation 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 Corporation'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 overall governance and risk management, and ensuring the adequacy and effectiveness of the control environment.

Auditor-General's Responsibilities for the Audit

The audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement and weakness when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

In addition to the audit of the financial statements, a compliance audit is planned and performed to express a conclusion about whether, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities that govern them and that public resources are applied in an effective way, in accordance with the provisions of Article 229(6) of the Constitution and submit the audit report in compliance with Article 229(7) of the Constitution.

Further, in planning and performing the audit of the financial statements and audit of compliance, I consider internal control in order to give an assurance on the effectiveness of internal controls, risk management and overall governance processes and systems in accordance with the provisions of Section 7(1)(a) of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution. My consideration of the internal control would not necessarily disclose all matters in the internal control that might be material weaknesses under the ISSAIs. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Because of its inherent limitations, internal control may not prevent or detect misstatements and instances of non-compliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the Corporation'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 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 Corporation'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 Corporation 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 Corporation 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.

CPA Nancy Gathungu, CBS
AUDITOR-GENERAL

Nairobi

28 September, 2022