REPORT OF THE AUDITOR-GENERAL ON RURAL ELECTRIFICATION AND RENEWABLE ENERGY CORPORATION 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 the 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

Adverse Opinion

I have audited the accompanying financial statements of Rural Electrification and Renewable Energy Corporation set out on pages 1 to 48, which comprise of the statement financial position as at 30 June, 2021, and the statement of financial performance, statement of changes in net assets, statement of cash flows and the statement of comparison of budget and actual amounts for the year then ended, and a summary of significant accounting policies and other explanatory information in accordance with the provisions of Article 229 of the Constitution of Kenya and Section 35 of the Public Audit Act, 2015. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit.

In my opinion, because of the significance of the matters discussed in the Basis for Adverse Opinion section of my report, the financial statements do not present fairly, the financial position of the Rural Electrification and Renewable Energy Corporation as at 30 June, 2021 and of its financial performance and its cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (Accrual Basis) and do not comply with the Public Finance Management Act, 2012 and the Energy Act, 2019.

Basis for Adverse Opinion

1. Variance Between Financial Statements and Ledgers

Comparison of balances reflected in the financial statements with those in ledgers reflect unexplained and unreconciled variances of Kshs.8,595,681,628 as detailed below;

Component	Financial Statements Figure (Kshs.)	Ledger Balance (Kshs.)	Variance (Kshs.)
Advance to Vendors	950,734,000	277,909,373	672,824,627
Deposits - Rent	14,627,000	14,437,436	189,564
Other Receivable - Sale of Power	586,864,000	522,963,843	63,900,157
Insulators	227,804,000	229,590,026	(1,786,026)
Surge Diverters	585,720,000	584,845,734	874,266
Work in Progress	16,252,778,000	8,858,353,460	7,394,424,540
Tax payable - Withheld tax 5% Prof.Fees	2,793,000	1,793,000	1,000,000
Tax Payable - Withheld VAT	172,536,000	13,516,000	159,020,000
Tax Payable- Withheld tax 2% Agency	2,572,000	343,000	2,229,000
Kenya Commercial Bank Escrow US Dollar Account Balance	1,252,985,000	1,326,847,276	(73,862,276)
Co-operative Bank Fixed Deposit Account	1,300,231,000	1,299,999,999	231,001
Inventories	5,014,548,000	3,479,650,840	1,534,897,160
Staff Advances	5,052,000	15,045,185	(9,993,185)
Sale of Electricity	487,394,000	515,181,000	(27,787,000)
Comparative Sale of Electricity	509,614,000	535,624,000	(26,010,000)
Revenue 5% - Rural Electrification Projects Levy	5,201,872,000	6,296,342,200	(1,094,470,200)
Total	**32,568,124,000**	**23,972,442,372**	**8,595,681,628**

In the circumstances, the accuracy and completeness of the financial statements could not be confirmed.

2. Inaccuracies in the Financial Statements

The following variances in the financial statements were noted;

i. Note 32 to the financial statements reflects computers net book value of Kshs.59,307,000 while re-computation revealed Kshs.55,483,000 resulting in an unexplained and unreconciled variance of Kshs.3,824,000.

ii. Note 33 to the financial statements reflects intangible assets net book value of Kshs.61,212,00 while re-computation revealed Kshs.37,981,000 resulting in an unexplained and unreconciled variance of Kshs.23,231,000.

iii. The Corporation's Escrow US Dollar cashbook was adjusted by Kshs.46,172,436 to cater for exchange rate gain which was not reported as exchange gain in the statement of financial performance.

In the circumstances, the accuracy and completeness of the financial statements could not be confirmed.

3. Misclassification in the Financial Statements

The following misclassifications in the financial statements were noted;

i. Note 32 to the financial statements reflects capital work in progress balance of Kshs.16,252,778,000 which includes misclassified amounts of Kshs.419,290,463 for staff costs, Kshs.48,406,107 for rent and Kshs.20,521,543 for security of yards.

ii. Intangible assets balance of Kshs.61,212,000 in Note 33 to the financial statements includes misclassified expenditure of Kshs.38,446,015 for annual maintenance cost software support and SAP cloud platform subscriptions.

iii. Note 29 to the financial statements reflect interest receivable of Kshs.335,406,000 classified under receivables from non-exchange transactions instead of receivables from exchange transactions. In addition, Kshs.303,599,495 had been paid and, therefore, should not have been classified as a receivable.

iv. Note 28(a) reflects other accrued revenues of Kshs.10,437,436,000 being 5% Rural Electrification Projects Levy due from Kenya Power Company Limited classified under receivables from exchange transactions instead of receivables from non-exchange transactions.

v. Note 8 to the financial statement reflects revenue 5% - Rural Electrification Projects Levy of Kshs.5,201,872,000 which includes misclassified amount of Kshs.393,105,574 for financial year 2019/2020.

In the circumstances, the presentation and disclosure of the financial statements is inaccurate in respect of the above transactions and balances.

4. Inaccuracies in Cash and Cash Equivalents

The statement of financial position reflects cash and cash equivalents of Kshs.5,773,477,000 as disclosed in Note 27(a) to the financial statements. However, review of the Standard Chartered Bank cashbook revealed transactions amounting to Kshs.175,442,006 which were reversed to clear outstanding unpresented cheques but details of the corresponding accounts affected by the reversal and the journal vouchers were not provided for audit. The Corporation continued to maintain four (4) dormant bank accounts without adequate explanations and for which the respective certificates of bank balances were not provided for audit. Further a call account with Kenya Commercial Bank with an amount of USD926,378 equivalent to Kshs.99,909,819 and accrued interest of USD 1,949 equivalent of Kshs.210,226 which were not disclosed in the financial statements.

In the circumstances, the accuracy and completeness of cash and cash equivalent balance of Kshs.5,773,477,000 could not be ascertained.

5. Unsupported Inventories

The statement of financial position reflects inventories valued at Kshs.5,014,548,000 as disclosed in Note 30 to the financial statements. However, inventories valued at Kshs.4,970,939,000 were not supported with stock valuation reports, ledgers balances, and stock movement schedules. Further, stock items valued at Kshs.11,072,015 were issued to Kenya Power Company Limited without updating the SAP System. Physical verification revealed that one hundred and forty-five (145) faulty transformers replaced from already commissioned projects had not been accounted for in the SAP inventory system. In addition, the Corporation did not have a valuation policy to guide on accounting for the faulty transformers.

In the circumstances, the accuracy, completeness, and valuation of inventories balance of Kshs.5,014,548,000 could not be confirmed.

6. Inaccuracy of Receivables from Exchange Transactions

The statement of financial position reflects receivables from exchange transaction of Kshs.12,010,567,000 as disclosed in Note 28(a) to the financial statements. Included in this balance were advances to vendors totalling Kshs.1,869,574,000 in respect of contracts for works, goods, and services that had been completed, certificates of work done issued, and deliveries made. However, the advances had not been recovered and the respective ledgers were not updated with the completed works, goods, and services. Further, the amount includes deposits-rent of Kshs.14,627,000 out of which Kshs.14,437,436 was in respect to expired leases whose refunds had not been received or leases renewed.

In the circumstances, the accuracy and completeness of receivables from exchange transactions balance of Kshs.1,884,011,436 could not be confirmed.

7. Unsupported Staff Advances

The statement of financial position reflects receivables from non-exchange transactions amount of Kshs.340,458,000 as disclosed under Note 29 to the financial statements. The amount includes staff advances of Kshs.5,052,000 in respect of per diems issued to staff. Although some of the staff surrendered the per diems, the general ledgers were not updated with the same. Further, it was noted that the Corporation maintained two general ledgers for staff advances in which accounting staff expenses was made.

In the circumstances, the accuracy and completeness of staff advances of Kshs.5,052,000 could not be confirmed.

8. Unsupported Trade and Other Payables from Exchange Transactions

The statement of financial position reflects trade and other payables from exchange transactions of Kshs.1,963,600,000 as disclosed in Note 35 to the financial statements. The amount includes trade creditors not invoiced of Kshs.1,115,603,000 which were not supported by ledgers. Further, included in the balance is an amount of Kshs.847,284,000 reported as trade creditors – invoiced and ageing analysis presented for audit revealed that an amount of Kshs.573,854,028 relating to payables had been outstanding for over one hundred and twenty (120) days without explanations.

In the circumstances, the accuracy and completeness of trade and other payables from exchange transactions balance of Kshs.1,963,600,000 could not be confirmed.

9. Unsupported Property Plant and Equipment

The statement of financial position reflects property, plant and equipment balance of Kshs.96,732,161,000 as disclosed in Note 32 to the financial statements. Included in the balance are overhead distribution lines of Kshs.80,116,501,000 whose breakdown and details indicating the contract sum, starting and completion dates, payments made and current status were not provided for audit. In addition, the balance includes capital work in progress of Kshs.16,252,778,000 which includes some projects that were initiated five years ago and which remained incomplete. Also, a fixed assets register was not provided to support asset balances.

In the circumstances, the accuracy and completeness of property, plant, and equipment balance of Kshs.96,732,161,000 could not be confirmed.

10. Irregular Expenditure on Land Survey Services

The statement of financial position reflects property, plant and equipment balance of Kshs.96,732,161,000 as disclosed in Note 32 to the financial statements. The amount includes additions to capital work in progress of Kshs.2,657,467,000 out which Kshs.571,062,727 was paid to three (3) firms for land survey services to unspecified projects. In addition, there was no evidence of budgeting for the services, their inclusion in the annual procurement plan and competitive procurement. This was contrary to Section 45(3)(a) of the Public Procurement and Asset Disposal Act, 2015 which states that all procurement processes shall be within the approved budget of the procuring entity and shall be planned by the procuring entity concerned through an annual procurement plan. Further, the services were not supported by local services orders, contract agreements and reports by the three (3) firms indicating the topographical maps and way leaves.

In the circumstances, the regularity of the expenditure of Kshs.571,062,727 paid to three (3) firms for land survey services could not be confirmed.

The audit was conducted in accordance with the International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the Rural Electrification and Renewable Energy Corporation Management in accordance with ISSAI 130 on the 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 adverse opinion.

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. There were no key audit matters to report in the year under review.

Other Matter

1. Budgetary Control and Performance

The statement of comparison of budget and actual amounts expended amount of Kshs.744,199,000 against final expenditure budget of Kshs.881,574,000 resulting to an under-expenditure of Kshs.137,375,000 or 16% of the budget. In addition, sale of electricity from Garissa Solar Plant of Kshs.487,394,000 reflected in Note 11 to the financial statements was not supported by budgetary provision on sales of power.

The 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 2019/2020 financial year, several issues 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, the Management has not resolved the issues or given any explanation for failure to resolve them.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229 (6) of the Constitution, because of the significance of the matters discussed in the Basis for Adverse Opinion and Basis for Conclusion on Lawfulness and Effectiveness in Use of Public Resources sections of my report, based on the audit procedures performed, I confirm that public resources have not been applied lawfully and in an effective way.

Basis for Conclusion

1. Delay in Implementation of Projects

Review of the project status report indicated that the Corporation was in the process of implementing four hundred and thirty-six (436) projects at a total cost of Kshs.2,937,355,534. Physical verification of some of the projects on 18 February, 2022 revealed delay in implementation of the projects.

In the circumstances, value for money has not been realised due to the delay in implementation.

2. Irregular Utilization of Petroleum Development Levy Funds

Note 8 to the financial statements indicates that the Corporation received an amount of Kshs.1,359,000,000 from the Petroleum Development Fund which were utilized on implementation of two hundred and forty-five (245) rural electrification projects. This was contrary to Section 4(4) of the Petroleum Development Fund Act, 2012 which states that there shall be paid out of the Petroleum Development Funds such monies as are necessary for the development of common facilities for distribution or testing of oil products and matters relating to the development of the oil industry.

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

3. Unconnected Customers

Review of the project status report and verification of sampled projects revealed that fifty-one (51) projects valued Kshs.220,898,613 had been completed and commissioned by the Corporation. However, the metering and connection of target customers to power by Kenya Power Company Limited had not been done as required by the Service Level Agreement (SLA).

In the circumstances, value for money on these projects could not be confirmed.

4. Delayed Replacement of Defective Poles

During the financial year under review, eighteen thousand, seven hundred and fifty-six (18,756) defective poles were reported and in March, 2022 verification revealed replacements of only fifteen thousand and thirty-five (15,035) resulting to three thousand, seven hundred and twenty-one (3,721) unreplaced poles. In addition, the procurement of the poles was not supported with contract documents, tender evaluation report and inspection and acceptance committee reports.

In the circumstances, value for money has not been realised.

5. Abandoned Project

The contract for proposed building and civil works of go-down, ablution block, perimeter wall, yard and cabro pavement in Kisumu was awarded at a contract cost of Kshs.123,000,000 on 11 May, 2017 for a duration of thirty (30) weeks. Inspection of the project on 30th March 2022 revealed that there were no ongoing activities and the contractor was not on site after partly constructing perimeter wall and one go-down. Management terminated the contract through a letter dated 30 March, 2022 but no evidence of retendering was provided for audit. Further, the cost incurred so far had not been reflected under capital work in progress.

In the circumstances, value for money for this project has not been realised.

6. Non-remittance of Taxes

The Corporation earned from Garissa Power Plant sale of power valued at Kshs.189,040,868 which was paid into escrow account as required by the project financing agreement. However, necessary Value Added Tax was not withheld and remitted to Kenya Revenue Authority as required by Value Added Tax Act, 2013

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

7. Over-Representation in Committees

The Corporation's four (4) committees had five (5) members each as opposed to the maximum of four (4). This was contrary to Paragraph B (4) of the Head of public service circular Ref. OP/CAB.9/1A dated 11 March, 2020 on management of State Corporations which states that the number of members to any committees should be no more than one third (1/3) of the full board which translates to four (4) members. There was no evidence of approval by the cabinet secretary in consultation with SCAC as required by the circular for increase in the number of members of the committees.

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

REPORT ON EFFECTIVENESS OF INTERNAL CONTROLS, RISK MANAGEMENT AND GOVERNANCE

Conclusion

As required by Section 7(1)(a) of the Public Audit Act, 2015, because of the significance of the matters discussed in the Basis for Adverse Opinion and Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance section of my report, based on the audit procedures performed, I confirm 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 standard requires 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.

Responsibilities of Management and Board of Directors

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Public Sector Accounting Standards (Accrual Basis) and for maintaining effective internal 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 to sustain its services, disclosing, as applicable, matters related to sustainability of services and using the applicable basis of accounting unless Management is aware of the intention to terminate the 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 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 controls may not prevent or detect misstatements and instances of non-compliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the Corporation policies and procedures may deteriorate.

As part of an audit conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management.

- Conclude on the appropriateness of the Management's use of the applicable 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 to sustain its services. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor’s report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit report. However, future events or conditions may cause the Corporation to cease to continue to sustain its services.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Corporation to express an opinion on the financial statements.

- Perform such other procedures as I consider necessary in the circumstances.

I communicate with 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 that may reasonably be thought to bear on my independence, and where applicable, related safeguards.

CPA Nancy Gathungu, CBS
AUDITOR-GENERAL

Nairobi

26 September, 2022