

REPORT OF THE AUDITOR-GENERAL ON NATIONAL OIL CORPORATION OF KENYA LIMITED FOR THE YEAR ENDED 30 JUNE, 2023

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

Qualified Opinion

I have audited the accompanying financial statements of National Oil Corporation of Kenya Limited set out on pages 1 to 126, which comprise of the statement of financial position as at 30 June, 2023, and the statement of profit or loss and other comprehensive income, statement of changes in equity, statement of cash flows and statement of comparison of budget and actual amounts for the year then ended, and a summary of significant accounting policies and other explanatory information in accordance with the provisions of Article 229 of the Constitution of Kenya and Section 35 of the Public Audit Act, 2015. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit.

In my opinion, except for the effect of the matters described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respects, the financial position of the National Oil Corporation of Kenya Limited as at

30 June, 2023, and of its financial performance and its cash flows for the year then ended, in accordance with the International Financial Reporting Standards (IFRS) and comply with the Companies Act, 2015 and the Public Finance Management Act, 2012.

Basis for Qualified Opinion

1. Non-Compliance with IAS 40 on Investment Property

The statement of financial position and as disclosed in Note 19 to the financial statements reflects investment property balance of Kshs.9,635,000. The property has been accounted for using the cost basis based on the International Accounting Standards (IAS) 16. However, International Accounting Standard (IAS) 40 and the Corporation accounting policy on investment property provides for a fair value model of accounting.

In the circumstances, the accuracy and completeness of the investment property balance of Kshs.9,635,000 could not be confirmed.

2. Unsupported Decline in Value of Freehold Land

The statement of financial position reflects property, plant and equipment with a net book value of Kshs.5,405,623,000. As previously reported, the values are based on a revaluation of assets which resulted in decline in value of ten (10) parcels of freehold land by Kshs.145,640,000 or 43%, from a previous value of Kshs.336,140,000 to Kshs.190,500,000. The decline was not supported or justified since it did not result from change in sizes from 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.5,405,623,000 could not be confirmed.

3. Inaccuracies in the Tax Recoverable Balance

The statement of financial position and as disclosed in Note 14(b) to the financial statements reflects tax recoverable amount of Kshs.32,661,000. However, based on the corporation's iTax account at the Kenya Revenue Authority, as at 30 June, 2023, there were no credits to be carry forward. Management indicated that reconciliation is currently ongoing with the tax authority to determine the correct position.

In the circumstances, the accuracy of the tax recoverable amount of Kshs.32,661,000 could not be confirmed.

4. Hived-Off Petroleum Products

The statement of financial position and as disclosed in Note 21(a) to the financial statements reflects inventories valued at Kshs.237,251,000. Included in the inventory gross value of Kshs.2,586,057,000 is Kshs.1,494,624,828 being the value of products captured as hived off in the books of the Corporation. In October 2016, the Corporation Management resolved to hive-off all historical non-reconciling items in a separate no-

trading stock point to ensure new variances were not created. These historical non-reconciling items continue to be carried in the books of the Corporation. However, they lack documentation to support their physical existence. Although the Board of Directors approved the write-off through its resolution dated 24 May, 2017, which was also forwarded to the Cabinet Secretary for the Ministry of Petroleum and Mining on 23 September, 2022, the matter was still pending.

In the circumstances, the accuracy and completeness of the inventories balance of Kshs.237,251,000 could not be confirmed.

5. Inaccuracies in Deferred Income Computations

The statement of financial position reflects deferred income balance of Kshs.3,134,782,000 which includes an amount of Kshs.3,052,754,000 in respect of exploration grants as disclosed in Note 23 to the financial statements. Over the years, the Corporation utilized an amount of Kshs.2,209,278,000 as capital expenditures which were capitalized as Exploration Expenditure- Block 14T. However, the capitalized expenditures were not deducted from the deferred income and thus overstated the reported deferred income amount of Kshs.3,134,782,000 by Kshs.2,209,278,000.

Further, Management did not disclose in the notes to the financial statements the accounting policy adopted for grants, including method of balance sheet presentation, the nature and extent of grants recognized in the financial statements and unfulfilled conditions and contingencies attaching to recognized grants as required under paragraph 39 of the International Accounting Standards (IAS) 20- Accounting for Government Grants and Disclosure of Government Assistance.

In the circumstances, the accuracy of the reported deferred income balance of Kshs.3,134,782,000 could not be confirmed.

6. Unsupported Fund Balances

The statement of financial position and as disclosed in Notes 23,39,40,41,42 and 43 to the financial statements reflects non-current liabilities in respect of deferred income fund balance of Kshs.3,134,782,000, Ministry of Energy headquarters construction fund balance of Kshs.704,000, single buoy mooring jetty fund balance of Kshs.11,443,000, corporate social responsibility fund balance of Kshs.34,885,000, exploration and capacity building fund balance of Kshs.72,955,000 and laboratory equipment fund balance of Kshs.425,480,000 respectively, all totaling to Kshs.3,680,249,000. However, the corresponding cash and bank balances were not provided for audit. Management explained that the Funds were included in other Corporation's funds and some invested in fixed deposits at various commercial banks.

Further, the funds relate to activities and projects initiated in partnership with Government agencies and other donors. However, guidelines on utilization and liquidation of balances upon closure of such projects were not provided for audit. The Corporation continue to hold funds for projects that were 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 accuracy, and completeness of the special fund's projects balance of Kshs.3,680,249,000 could not be confirmed.

7. Inaccuracies in Legal Expenses

The statement of profit and loss and other comprehensive income reflects administration expenses amounting to Ksh.952,922,000 as disclosed in Note 10(a) to the financial statements. Included in this amount is Kshs.113,134,000 in respect of legal expenses. Review of the expenses revealed that an arbitral award of Kshs.40,934,867 was issued against the Corporation in a matter of breach of contract in respect of transportation of petroleum products filed by a private company. The award was delivered on October, 2018 with subsequent appeal dismissed during the year under review and the award affirmed. The decretal amount, interest arbitration costs, court fees and collection fees amounted to Ksh.66,505,181. However, the amount of Kshs.70,000,000 was expensed, resulting in an unexplained and unreconciled variance of Kshs.3,494,819. Further, Management was directed by the arbiter to make an upfront payment of Kshs.2,000,000 and come up with a payment plan towards settlement of the award. However, this amounted to double expense since the amount had already been accrued and expensed.

In addition, the Corporation was sued for unfair termination by a former staff member. The matter went to trial and a ruling was delivered on 29 July, 2021, where the Court ordered to the Corporation to pay the claimant his salary arrears. Review of documents relating to the case revealed that salary arrears due to the claimant amounted to Kshs.1,700,000. However, the legal expense reflected compensation of Kshs.5,000,000. The resultant variance of Ksh.3,300,000 was not explained or reconciled.

In the circumstances, the accuracy and completeness of legal expenses amounting to Kshs.113,134,000 could not be confirmed.

8. Misclassification of Exploration Grants

The statement of profit or loss and other comprehensive income and as disclosed in Note 11 to the financial statements reflects exploration expenditure of Kshs.215,395,000. Included in the amount is Kshs.118,455,000 that was irregularly spent on payment of salaries and allowances of permanent employees contrary to the approved work plan upon which the disbursement was made. According to the approved work plan, the grants disbursed ought to have been utilized on exploration study for geology, geophysics, geochemistry, petroleum engineering, data packaging and marketing, software license annual renewal, community engagement activities and purchase of motor vehicles.

In the circumstances, the accuracy and completeness of the expenditure of Kshs.215,395,000 could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the National Oil Corporation of Kenya Limited Management in accordance with ISSAI 130 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with the ISSAI and in accordance with other ethical requirements applicable to performing audit of financial statements in Kenya. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

Emphasis of Matter

1. Uncertainty Relating to Going Concern

The Corporation recorded a loss before taxation of Kshs.2,342,637,000 during the year under review (2022: Kshs.1,503,068,000) raising its accumulated losses to Kshs.6,841,090,000 from Kshs.5,174,530,000 in 2022. In addition, the Corporation's current liabilities totalling Kshs.11,456,781,000 exceeded the current assets balance of Kshs.2,344,088,000 by an amount of Kshs.9,112,693,000. These events or conditions indicate material uncertainty regarding the Corporation's ability to continue as a going concern. Therefore, the Corporation was 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.

Further, this material uncertainty in relation to going concern and any mitigating measures put in place by the directors to address the matter were not disclosed in the notes to the financial statements as required by the International Accounting Standards (IAS 1), presentation of financial statements.

2. Long Outstanding Trade Payables

The statement of financial position reflects trade and other payables balance of Kshs.5,070,372,000 as disclosed in Note 31 to the financial statements. The balance includes trade payables balance of Kshs.898,494,000 out of which, Kshs.777,085,321 related to amounts due to vendors that have been outstanding for more than 60 days. No explanations were provided as to why the creditors were outstanding for more than 60 days.

My opinion is not modified in respect of these matters.

Key Audit Matters

Key audit matters are those matters that, in my professional judgment, are of most significance in the audit of the financial statements. There were no key audit matters to report in the year under review.

Other Matter

Unresolved Prior Year Matters

In the audit report of 2022/2023 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.

Other Information

The Directors are responsible for the other information. The other information comprises the report of directors as required by the Companies Act, 2015, and the statement of the

Directors' responsibilities which are obtained prior to the date of this report, and the annual report which is expected to be made available after that date.

The other information does not include financial statements and my audited report thereon.

My opinion on the financial statements does not cover the other information and I do not express an audit opinion or any form of assurance thereon.

In connection with the audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements, or the knowledge obtained in the audit, or otherwise appears to be materially misstated. Based on the work I have performed on the other information obtained prior to the date of this auditor's report, if I conclude that there is material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229(6) of the Constitution, based on the 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. Unaccounted for Mwananchi Gas Project Equipment

The Ministry of Petroleum and Mining delegated to the Corporation the responsibility of implementing Mwananchi gas Project on behalf of the National Government vide letter from the Ministry of Petroleum and Mining dated 16 September, 2021. The project was intended to promote the use of modern cooking fuels among low-income households, and entailed distribution of subsidized LPG cylinders, grills and burners purchased by the Ministry of Petroleum and Mining. According to the Ministry, funds realized from sales were to be used to purchase additional gas.

The pilot programme for the project roll out was expected to kick off during the 2020/2021 financial year but the Corporation lacked sufficient working capital to purchase liquefied petroleum gas to be used in filling of the cylinders. Review of stores records revealed inventories comprising of 161,448 6kg cylinders, out of which 5,444 had been filled with gas, 329,303 burners, 330,115 6kg grills, 60,000 horse pipes and 84,499 double burner stoves. As at 30 June, 2023, only 11,675 6kg cylinders, 12,869 burners and 87,147 grills with an aggregate value of Kshs.20,501,191 had been included in the Corporation's financial statements. The rest of the items were not included in the Corporation's financial statements, a position Management attributed to lack of formal authority from the Ministry of Petroleum and Mining to transfer ownership of the items to the Corporation. Management also indicated that 22 burners were said to have been collected as samples

by Kenya Bureau of Standards and Directorate of Criminal Investigation in 2018 and 2019 respectively but were not supported with any documentary evidence.

In addition, review of records and physical verification revealed that the 6kg cylinders purchased in Module I and two-burner low pressure table top cookers purchased under Module II of the project together with its accessories were yet to be distributed and were lying at the warehouses. There is uncertainty in the implementation of the project due to lack of sufficient working capital.

In the circumstances, the value for money on the expenditure incurred on the project could not be confirmed.

2. Irregular Payment of Unspecified Allowances

The statement of profit or loss and other comprehensive income and as disclosed in Note 10(a) to the financial statements reflects staff cost of Kshs.395,297,000. Review of the ledger and the trial balance for the year under review reflects total payments to employees amounting to Kshs.62,258,868 described as “other allowances.” However, the basis for the payment of these allowances, and the applicable rates were not provided for audit. Further, approval from State Corporations Advisory Committee (SCAC) was not provided to support the allowances.

In the circumstances, the regularity of the other allowances payments amounting to Kshs.62,258,868 could not be confirmed.

3. Breach of Repayment Terms on Borrowings

The statement of financial position and disclosed in Note 28 to the financial statements reflects borrowings balance of Kshs.6,376,024,000. Review of the loan account revealed that the Corporation was not servicing the loan contrary to the loan agreement, which may further increase the cost of borrowings. Further, records provided indicated that Management had negotiated with the bank to restructure the outstanding loan and extension of the moratorium which had lapsed on 3 May, 2022. Management further requested the lender, a commercial bank, for extension of loan moratorium for an additional period of seven (7) months on both the principal and interest. However, the bank declined the extension until management undertakes recommendations of the Liquidity and Independent Business Review which was conducted by a consultant on behalf of the lenders. The recommendations included: overhaul and modernization of ICT systems including effective stocks control systems, upgrade of management stocks control processes, customer service and product costing and pricing; re-organize the Corporation for effectiveness and efficiency while upgrading management capabilities and culture, and reducing overall payroll costs; address the matter of inadequate working capital; and come up with a business model that mostly focuses on prime retail stations, while paying attention to brand image enhancement.

In addition, as a result of default on loan and interest repayment, the lenders charged default interest rate of 23% which is higher than previous year interest rate of 13%. Further, as confirmed the Corporation had accrued a penalty of Kshs.1,342,310,000 thereby increasing the Corporation’s liabilities.

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

4. Stalled Liquefied Petroleum Gas (LPG) Project

Review of documents revealed that the Corporation incurred an expenditure of Kshs.5,604,000 in respect of construction of LPG skid at Kipkaren Service Station which comprised of cost of civil works, two LPG Mini skids and associated works. However, only the skid foundation had been completed and the contractor had abandoned the site. Management did not assess the stalled project for impairment. In addition, no clear road map was provided on how the Management intends to address the matter, neither was a plausible explanation provided on why the project has been abandoned before completion.

In the circumstances, value for money was yet to be realized on the expenditure of Kshs.5,604,000 spent on civil works at Kipkaren Service Station which remained unutilized and the objective for which the project was intended to achieve remains unattained.

5. Unauthorized Over-Expenditure

Review of the budget against expenditures incurred during the year under review revealed instances of over-expenditure on legal fees and finance costs amounting to Kshs.848,156,000. However, no supplementary budget nor approval were provided to support the over expenditure. Further, the Corporation budgeted to collect sales revenue amounting to Kshs.33,030,070,000. However, only Kshs.3,141,120,000 was realized resulting in under-collection of Kshs.29,888,950,000.

The under collection may have affected the planned activities during the year.

6. Non-Compliance with the One-Third of Basic Salary Rule

During the year under review, eleven (11) employees were paid net salaries that were less than a third (1/3) of their basic pay. This contravened Section 19(3) of the Employment Act, 2007. No sufficient explanation was provided for failure to comply with the law on payment of salaries and allowances.

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

7. Officers Acting for More than Six Months

Review of the payroll data revealed that seven (7) employees had been in acting positions for more than six (6) months and were paid a total of Kshs.2,248,485 acting allowances during the year which contravened Section 8.8.3 of the Corporation's Human Resources and Procedures Manual which provides that acting allowance will be payable to an employee for a period of not more than six (6) months within which the position should be advertised and competitively filled.

In the circumstances, Management was in breach of the procedure's manual.

8. Lack of an Approved Career Progression Guidelines

During the year under review, the Corporation filled nine (9) open vacancies and promoted three (3) employees to various grades. However, an approved career progression guideline watermarked and sealed by State Corporations Advisory Committee was not provided for audit review and verification. Although Management explained that the approved document was misplaced and yet to be replaced, the considerations that were used for the promotions and recruitment could not be confirmed.

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

9. Delays in Implementation of Initial Exploration Period

The statement of financial position and as disclosed in Note 37 to the financial statements reflects exploration expenditure on block 14T of Kshs.2,209,278,000. Review of documents relating to the Block revealed that the Corporation signed a Production Sharing Contract (PSC) with The Ministry of Energy and Petroleum on 15 November, 2010. The Corporation was authorized to conduct exploration operations within the contract area during an initial exploration period of three (3) years from the effective date. The Initial Exploration Period expired on 15 February, 2014 and subsequently, the PSC was extended with the latest one expiring on 14 February, 2023.

However, the Corporation has spent over thirteen (13) years in conducting exploration operations within the contract area contrary to clause 2(1) of the Production Sharing Contract (PSC) which provides that the contractor is authorized to conduct exploration operations within the contract area during an initial exploration period of three (3) years from the effective date. The several extensions have been caused by the Corporation's failure to fulfil work and expenditure obligations under the contract during the initial exploration period of three (3) years. This is an indication of the Corporation's lack of the capacity to undertake exploration activities in block 14T despite receiving funding from the Government of Kenya and Japan Oil, Gas and Metal National Corporation (JOGMEC).

In addition, Japan Oil, Gas and Metal National Corporation (JOGMEC), which has been supporting the Corporation through a joint survey agreement terminated the agreement and decided not to exercise its right to participate in the Production Sharing Agreement (PSC) citing lack of interest from Japanese investors in the data obtained from the joint survey.

In the circumstances, the value for money on the expenditure of Kshs.2,209,278,000 spent on the initial exploration could not be confirmed.

10. Failure to Hold Minimum Operational Stock

Review of records revealed that Management did not meet the minimum operational stocks of the petroleum contrary to Regulation 3(1) and (2) of the Energy (Minimum Operational Stock) Regulations, 2008 which states that all importers of petroleum products intended for use in Kenya shall maintain at all times physical operational stock, to be known as the minimum operational stock, in quantities not less than the minimum amounts specified in the Schedule. The minimum operational stock shall be maintained in order to ensure short term supply of petroleum products in the event of disruption of supply of the products.

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

11. Database and ERP Application System

Review of the Corporation's information technology systems revealed that two (2) main 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, a contract signed during 2016/2017 financial year at a cost of Kshs.95,624,321 for a period of fifteen (15) months and post-implementation services was terminated 10 July, 2020 by Management on the basis of non-performance. In addition, there was no evidence of recommendation from contract implementation team to terminate the contract as per Section 151(2)(g) of the Public Procurement and Asset Disposal Act, 2015. The Contractor filed a suit in the High Court against the Corporation for non-payment of outstanding invoices totalling Kshs.102,462,096 inclusive of interest.

Subsequently, the systems had attained their End of Life (EOL) which meant that updates and patches that enhance the system's security or any technical support from Oracle could no longer be received. Further, the Corporation had not paid the software vendor for three financial years and had accrued debts amounting to Kshs.157,039,695 in respect of annual software updates, technical support and additional license fees risking the data and business interruption in the case of a security attack.

In the circumstances, the value for money on the amount of Kshs.95,624,321 incurred on the system could not be confirmed.

12. Payment of Avoidable Penalties

The statement of profit or loss and other comprehensive income reflects cost of sales totaling to Kshs.3,035,390,000 as disclosed in Note 7 to the financial statements. The costs include Kshs.14,833,000 in respect of penalties and fines incurred by the Corporation paid mainly to the Commissioner of Customs. This expenditure which could have been avoided with proper financial management led to increase in the cost of sales and affected cash flows negatively.

In the circumstances, the value for money on expenditure of Kshs.14,833,000 in respect of penalties and fines incurred by the Corporation could not be confirmed.

13. Encroached Corporation Land

Review of records relating to a parcel of land valued at Kshs.126,697,274 revealed that the Corporation granted a six (6) month lease agreement on 15 September, 2017 to an individual to operate a car wash and garage at a monthly rent of Kshs.60,000 exclusive of Value Added Tax (VAT). The lease agreement was extended for a further six (6) months from 1 April, 2018 to 30 September, 2018. However, upon expiry of the agreement, management continued to receive rents without renewing the agreement or giving notice of intention not to renew the lease. Management later issued notice of intention not to renew the license, but the tenant took the Corporation to court and obtained a temporary order restraining and prohibiting the Corporation from trespassing on, entering into, taking possession, harassing, intimidating and or evicting the claimant from the plot. The Corporation issued a new termination notice on 22 December, 2023 which required the tenant to within one month after receipt of the notice, to notify the

Corporation in writing on whether he agrees to comply or not with the notice. As at the time of audit, the tenant had not complied with the termination notice. Therefore, the tenant continues to operate business on the Corporation land without paying any rent.

In the circumstances, the public may not realize value for money on the rented property while the ownership of the parcel of land is at risk.

14. Irregularities in Donation of Funds

Review of records revealed that an amount of Kshs.3,316,000 was utilized as donations out of which Kshs.2,000,000 was donated to a Golfing Society. However, the donation was not in the approved work plan for the year. In addition, there was no documentary evidence to confirm that the donations benefited the coastal communities as required in the Production Sharing Contract (PSC) signed between the Government of Kenya and ENI Energy.

In the circumstances, the regularity of the corporate social responsibility project fund balance of Kshs.34,885,000 could not be confirmed.

15. Expired Contracts

Review of records revealed that the Corporation entered into agreement with several dealers to operate Corporation owned petrol stations. Review of a sample of the agreement revealed that three (3) of the agreements had expired. However, the Corporation continued to transact with the three parties without a valid lease contract. It is not clear under what terms the Corporation and the three entities engaged with each other in the absence of the leases.

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

16. Defective Cylinders

The statement of financial position and as disclosed in Note 21(a) to the financial statements reflects inventories gross value of Kshs.2,586,057,000. Included in this amount are 105,838 defective cylinders valued at Kshs.190,812,991 stored at the Corporation's Nairobi National Terminal. However, Management did not provide measures put in place regarding the defective cylinders, considering that their numbers have been increasing over the years.

In the circumstances, the value for money on the expenditure of Kshs.190,812,991 incurred on the defective cylinders of could not be confirmed.

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 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 a Governance Audit

During the year under review, the Board did not carry out any governance audit as per the Mwongozo guidelines. This audit is expected to address among other areas governance practices including Leadership and strategic management, transparency and disclosure, compliance with laws and regulations, Board independence and governance, consistent shareholder and stakeholders' value enhancement among others.

In the circumstances, the level of adherence to applicable laws, rules, regulations and standards by the Corporation could not be confirmed.

2. Lack of Strategic Plan

Review of documents revealed that the Corporation's strategic plan expired in the year 2020 and Management was yet to develop another strategic plan to cover the current period contrary to Section 68(2) of Public Finance Management Act, 2012. Therefore, achievement of the Corporation's strategic goal may not be possible. Management had indicated that the strategic plan is a draft form.

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

3. Lack of Information Communication Technology Steering Committee

During the year under review, Management did not establish Information Communication Technology Steering Committee which is mandated to oversee the development of the Information Communication Technology strategy of the Corporation. This implied that there exist gaps in information technology governance that might have affected the information technology management in achieving the organization's mandate.

In the circumstances, the effectiveness of the overall governance of the Corporation could not be confirmed.

4. Irregular Meetings Held by the Board of Directors

During the year under review, the board held thirty -five (35) board meetings. Out of these meetings, there were four extra full board meetings and one extra finance committee meetings which exceeded the maximum number of six (6) recommended by the Office of

the President circular referenced OP/CAB.9/1A dated 11 March, 2020. Although the board sought approval for the extra meetings, no approval by the relevant Cabinet Secretary, in consultation with State Corporation Advisory Committee (SCAC) was provided for the excess meetings held. The result of the irregular meetings held led to unauthorized expenditure of Kshs.1,450,730.

In the circumstances, the effectiveness of the overall governance of the Corporation could not be confirmed.

5. Irregular Composition of Board Committees

The Corporation's Board of Directors comprised thirteen (13) members. Review of membership and record of minutes of committee meetings revealed that the membership of board committees is expected to be a maximum of one third (1/3) of Board membership as guided by the Mwongozo code of governance for state corporations. However, the Audit committee has five (5) members, the Human Resource Committee and the Finance Committee have six (6) members each while the Strategy and Business Committee has seven (7) members instead of the Maximum four (4) members. Although the Board sought an exemption from one third (1/3) requirement in constitution of the board committees, no written approval of the respective Cabinet Secretary in consultation with State Corporation Advisory Committee (SCAC) was provided.

In the circumstances, the effectiveness of the overall governance of the Corporation could not be confirmed.

6. Poor Monitoring and Inspections of Dealer Operated Petrol Stations

The Corporation entered into agreements with several dealers to operate its service stations across the Country. According to the agreements, these dealers were expected to purchase fuel products from the Corporation and compensate the Corporation where they purchase products from other Oil Marketing Companies for what is referred to as dumping. According to the volume sales for Company Owned Dealer Operated service stations, Corporation did not have product from March, 2023 to June, 2023. However, during the year under review, Management did not carry out monitoring, inspections and meter reading of the Company Owned Service Stations which are operated by the dealers to ensure that instances of product dumping are detected and fees charged. Review of records and reports provided for audit revealed that the last inspections and meter reading were conducted in November, 2022.

In the circumstances, the effectiveness of the overall governance in managing the dealer operated petrol stations 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 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, 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 Board of Directors

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards (IFRS) and for maintaining effective internal controls as Management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error and for its assessment of the effectiveness of internal controls, risk management and overall governance.

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

Because of its inherent limitations, internal controls may not prevent or detect misstatements and instances of non-compliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the 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 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 Management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal controls that are identified during the audit.

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



FCPA Nancy Gathungu, CBS
AUDITOR-GENERAL

Nairobi

15 May, 2024