REPORT OF THE AUDITOR-GENERAL ON KENYA ELECTRICITY TRANSMISSION COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Opinion

The accompanying financial statements of Kenya Electricity Transmission Company Limited (KETRACO) set out on pages 30 to 63, which comprise the statement of financial position as at 30 June 2018, and the statement of profit or loss and other comprehensive income, statement of changes in equity and statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, have been audited on my behalf by Ernst and Young, auditors appointed under Section 23 of the Public Audit Act, 2015. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

In my opinion, the financial statements present fairly, in all material respects, the financial position of Kenya Electricity Transmission Company Limited as at 30 June 2018, 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 State Corporations Act, Cap 446 (Revised 2013).

Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kenya Electricity Transmission Company Limited in accordance with ISSAI 30 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with the ISSAI and in accordance with other ethical requirements applicable to performing audits of financial statements in Kenya. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Key Audit Matters

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

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. Pending Wayleave Compensations

Information available indicates that the Company had pending wayleave compensations totalling Kshs.4,588,425,101 as at 30 June 2018 incurred in the years 2012 to 2018. The compensations relate to the projects listed in the appendix to my report. Management has explained that the failure to pay the sums due resulted from insufficient budgetary allocations, incomplete documentation and disputes with Project Affected Persons (PAPs).

Delays in compensating PAPs may lead to project delays, cost escalations and legal suits.

2. Delays in Completion of Projects

As reported in the previous year, significant delays were noted in completion of four (4) of the projects under implementation by the Company, as detailed below:

2.1. Nairobi Ring Project

Completion of Nairobi Ring Project, which entails construction of a transmission line from Suswa to Isinya, together with five (5) sub-stations at Suswa, Kimuka, Isinya, Athi River and Komarock was behind schedule as at 30 June 2018. Four contractors were assigned to implement the project at a combined contract price of approximately Kshs.10,512,241,235. The works commenced in May 2012 and the initial scheduled completion date was November 2014. However, by the time of concluding this report, the Suswa and Isinya substations had been completed, while Athi River, Kimuka and Komarock (Malaa) substations were 99%, 92% and 37% complete respectively.

2.2. Lessos-Tororo Line: Kenya-Uganda Interconnector

Similarly, completion of the Lessos-Tororo Transmission Line Project which entails construction of a transmission line from Lessos sub-station in Kenya to Tororo sub-station near the Kenya-Uganda border was behind schedule. The Project, which is under implementation by a Spanish contractor at an initial contract price of EUR 24,220,004.29 and Kshs.941,168,910 commenced in September 2013 and was scheduled to be completed in April 2015. However, as at 30 June 2018, only 37% of the transmission lines and 40% of the substations had been completed. The contract was terminated in April 2016 due to non-performance by the contractor, following which the contractor obtained court orders stopping KETRACO from accessing the site or hiring a new contractor until a final settlement on the dispute is reached. At the time of concluding this audit, the dispute had not been resolved.

2.3. Power Transmission System Improvement Project

Further, the Power Transmission System Improvement Project (PTSIP), comprises works on six (6) transmission lines, fourteen (14) associated sub-stations and consultancy services at a total cost of Kshs.7,203,142,864. Included in the works are Nyahururu-Nanyuki, Lessos-Kabarnet, Olkaria-Narok and Wote-Kitui-Mwingi Transmission Lines which were due to be completed in December 2017 but were still ongoing by the time of concluding this audit. According to management, the completion of the four transmission lines was delayed due to inadequate counterpart funding for wayleave acquisition and contractor financial challenges which led to slow delivery of materials. The contract with initial contractor has since been terminated and a new contractor procured to complete the projects. However, it is not clear why these risks were not identified at the project planning stage and mitigation measures taken to minimize their expected impact on project completion.

2.4. Exim Bank of India Funded Projects

In addition, Exim Bank of India funded projects entail two (2) transmission lines and six (6) associated sub-stations. Among these is the Turkwel-Ortum-Kitale transmission line, which is under construction by KEC International Limited at a contract price of USD.11,861,976 (Kshs.1,230,225,696). The transmission line was scheduled to be completed by August 2015, but only 89% of the works had been done as at 30 June 2018. The Company's project portfolio further includes construction of two (2) substations at Kitale and Ortum at a contract price of USD.18,100,120 (Kshs.1,877,194,215). The two substations were scheduled to be completed by December 2017, but were at 70% level of completion as at 30 June 2018. According to management, delays in completion of the substations arose from right of way challenges, inadequate budgetary allocation for wayleave compensation and contractor underperformance that resulted from slow delivery of work materials. Information provided indicates that the contract for the Ortum and Kitale sub-stations has since been terminated by the Company because the contractor was bankrupt and the process of procuring a new contractor to finalize the two substations was underway. However, it is not clear why these risks were not identified at the project planning stage and mitigation measures taken to eliminate or minimize their adverse impacts on project completion.

Under the circumstances, completion of the four projects within the approved budgets and timelines cannot 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 audit procedures performed, I confirm that, except for the matters described in the Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance Section of my report, nothing else has come to my attention to cause me to believe that internal controls, risk management and governance were not effective.

1. Delays in Reconciliation of Bank and Cash Balances

Assessment of the control environment for cash and bank accounts revealed long outstanding unreconciled bank balances amounting to Kshs.74million as at 30 June 2018, with some of these dating back to 2016. Unreconciled balances increase the risk of undetected errors and irregular transactions. Management say they have prioritized the reconciliation of the balances and will monitor and adjust bank and cash records as per requirements of public financial management regulations and good accounting practice.

2. Unreconciled Goods Received/Invoice Received Transactions

Review of management of receipts and payments for goods and services reflected in the Company's electronic Systems Applications and Products (SAP) accounting system revealed critical control weaknesses as several large transactions for purchases of goods and services were not reconciled.

The unreconciled transactions were valued at Kshs.1,130,576,000 as at 30 June 2018 with some of the balances having been outstanding for more than four years. Also, sampling of the transactions revealed paid invoices totaling Kshs.25,462,500.

These anomalies reflect weak goods/invoice received controls that result from failure to check and reconcile SAP records with actual payments and receipts. In the absence of effective control, the risk of misstatements in the financial statements as well as occurrence of errors and fraudulent activities on the account is high. Management have indicated that they will enhance monitoring of the account and clear the outstanding items during the 2018/19 financial year.

3. Unreconciled Project and Organization Expenditure Records

Review of project records revealed that data on project expenditures maintained by project teams differed from that maintained by the finance department of the Company, thus indicating that reconciliations between the two sets of records were not carried out regularly. Failure to reconcile financial records increases risk of misstatement of the financial statements. Management have indicated that the anomaly was caused by exchange rate differences.

4. Absence of Policies on Aged Accounts Receivables

Assessment of controls on debtors' management including debt collection and reporting revealed significant weaknesses that included overdue accounts, lack of a published policy on receivables management and insufficient details on the nature of old debts.

Receivables totaling Kshs.1,555,212,000 were more than 90 days old as at 30 June 2018. Further, information provided in the accounts receivable aging report on balances older than 120 days was scanty as it did not outline efforts made in collecting the debts or indicate whether additional measures were to be taken with a view to recover the amounts.

Apparently, management have not established an accounts receivable management policy and as a result, debt collection efforts are neither elaborate nor consistent.

The large aging receivables balance could result in losses through bad debts and, in addition, weaken the Company's working capital position.

Management have undertaken to improve monitoring and reporting on accounts receivable. Also management have indicated that they have prepared the policy guidelines on management of debts and will present these to the Board for approval during the 2019/20 financial year.

5. Delays in Preparation of Monthly Management Accounts

Monthly management accounts were not prepared and reviewed on time and as a result, the risk of errors in financial statements was high with adjustments totaling Kshs.5,462,893,861 made to correct accounting records during the audit. Management have undertaken to prepare and review monthly management accounts on time.

In addition, the Company's policy on accruals for goods and services does not follow IFRS practice as some accruals are recognized in the accounts even before goods or services are received by the Company. In the year under review, the audit detected 'accruals' relating to unfulfilled local purchase orders totaling Kshs.205,491,066. Recognition of such transactions as finalized purchases override financial control, contravenes both IFRS requirements and Public Financial Management regulations and increases the risk of financial mis-statement and fraudulent expenditures. Management have undertaken to follow IFRS and Public Financial Management Regulations on accounting for accruals.

6. Unreconciled Tax Records

The tax-ledger account balance reflected in the trial balance was not reconciled with tax filing records with the later showing a balance of Kshs.39,401,427 and the former Kshs.51,477,224 leading to an unexplained variance of Kshs.12,075,797.

Understatement of the tax balance may lead to financial misstatement and cause the Company incur tax penalties.

7. Inadequacies in Information Technology (IT) System Controls

Assessment of the Company's Information communication technology control environment revealed several shortcomings and inadequacies. This included failure to incorporate key operations such as human resource and project management in the SAP reporting system because the relevant modules were not installed in the system. In the absence of the modules, the Company has not enjoyed all the benefits that the software system offers in way of enhanced data security, operational efficiency and effective use of resources.

Management has undertaken to fully integrate the system with the Company's operations including project reporting.

In addition, although most environment and physical controls on the Company's information technology assets are in place, some critical policies on use of the assets have either not been prepared or are yet to be approved by the Board. These include policies on user-access, including authorizations and roles, usage and visitor logs, reports on testing and monitoring of system changes as well as user activity and incident reports.

Also, SAP access rights of some former employees have not been cancelled, and therefore the risk of improper use of the system is high.

Management have undertaken to prepare the pending polices and have all IT policies approved by the Board before the end of the 2019/20 financial year**.**

Basis for Conclusion

The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. 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 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 Kenyan Companies Act, 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 Company, so far as appears from the examination of those records; and,

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

Responsibilities of Management and Those Charged with Governance

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

In preparing the financial statements, management is responsible for assessing the ability of the Company to continue as a going concern, disclosing, as `applicable, matters related to going concern and using the going concern basis of accounting unless the management either is aware of the intention to liquidate the Company or have its operations cease.

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 comply with the authorities which govern them, and that public resources are applied in an effective way.

Those charged with governance are responsible for overseeing the financial reporting process, reviewing the effectiveness of how the entity 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 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 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 ability of the Company to continue as a going concern or 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 Company to cease to continue as a going concern or 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 Company to express an opinion on the financial statements.

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

I communicate with the management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that are identified during the audit.

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

FCPA Edward R. O. Ouko, CBS
<u>AUDITOR-GENERAL</u>

Nairobi

10 July 2019

APPENDIX

Pending Wayleave Compensations

Project Name	Amount (Kshs)
Ethiopia-Kenya	641,182,625
Olkaria-Lessos-Kisumu	556,975,532
Lessos-Tororo	553,863,847
Loiyangalani-Suswa	546,941,106
Sondu-Homabay-Ndhiwa-Awendo	489,327,675
Isinya-Suswa	479,787,448
Nanyuki-Isiolo-Meru	456,363,540
Mombasa - Nairobi	299,708,447
Tukwel-Ortum-Kitale	187,338,217
Kisii -Awendo	142,293,685
Bomet-Sotik	56,948,587
Machakos-Konza-Kajiado-Namanga	29,337,881
Rabai-Malindi-Garsen-Lamu	29,207,217
Kilimambogo-Thika-Githambo	22,325,773
Ishiara-Kieni	22,081,650
Eldoret-Kitale	21,562,127
Kenya-Tanzania	17,430,562
Mumias Rangala	16,367,906
Mwingi-Kitui-Sultan-Hamud-Wote	4,228,513
Kindaruma-Mwingi-Garissa	3,912,731
Olkaria-Narok	3,745,137
Thika-Githambo	3,119,930
Lessos-Kabarnet	2,754,965
Olkaria-Suswa	1,500,000
Menengai-Soilo	120,000
Total	**4,588,425,101**