

REPORT OF THE AUDITOR-GENERAL ON KENYA ENERGY-SECTOR ENVIRONMENT AND SOCIAL RESPONSIBILITY PROGRAMME FUND FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Opinion

I have audited the accompanying financial statements of Kenya Energy-Sector Environment and Social Responsibility Programme Fund set out on pages 1 to 15, which comprise the statement of financial position as at 30 June 2018, and the statement of financial performance, statement of changes in net assets, 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, Section 35 of the Public Audit Act, 2015 and Government Financial Management (Kenya Energy-Sector Environment and Social Responsibility Programme Fund) Regulations, 2007. 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, the financial statements present fairly, in all material respects, the financial position of Kenya Energy-Sector Environment and Social Responsibility Programme Fund as at 30 June 2018, 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 comply with the Government Financial Management (Kenya Energy-Sector Environment and Social Responsibility Programme Fund) Regulations, 2007.

Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kenya Energy-Sector Environment and Social Responsibility Programme Fund 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.

Emphasis of Matter

Interest on Bank Deposits

The financial statements reflect interest income of Kshs.12,971,469 under revenues from exchange transactions, as disclosed in note 7. According to information available, Kenya Commercial Bank (KCB) computed this amount using interest rate of 2.5% p.a. This was in breach of the agreement entered into between the management of the Fund and KCB on 14 November 2007 which stipulated that deposits in bank accounts held at KCB Kipande House Branch shall earn interest at the rate of 4% p.a. effective from 15 November, 2007. Had the interest on the Fund's deposits been calculated using the agreed rate of 4% p.a, the Fund would have earned interest income of Kshs.20,753,995 instead of Kshs.12,971,469. The Fund was therefore underpaid by

Kshs.7,782,526. Further, as reported in my 2016/2017 audit report, the Fund received interest amounting to Kshs.92,623,311 on account of its deposits placed with KCB between 2007 and 2016. Included in this figure is a balance of Kshs.80,017,446, for which management is yet to provide satisfactory evidence of how it was computed. Consequently, it has not been possible to confirm whether the Fund received value for its deposits with KCB for the prior years.

Key Audit Matters

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

Other Matter

Tender for the Exploratory Coal and Coal Bed Methane Drilling Services in Kwale, Kilifi and Taita Taveta Counties (Tender No. MOEP/GED/NOT/01/2014-2015)

Background

Lot 1 of the above tender which entailed Exploratory Coal Diamond Core Drilling Services in Kwale County, was awarded to a local company on 19 May 2015 at a tender sum of Kshs.322,839,600, following a competitive tendering process. The company accepted the award on 26 May 2015 and the resultant contract agreement between the Ministry of Energy and Petroleum and the Company was signed on 29 June 2015. According to the Special Condition of Contract, the Contract was to run for a period of fifteen (15) months, from 29 June 2015 to 29 September 2016. The contractor started mobilizing to the drilling site in July 2016, but was stopped, pending full acceptance of the project by Kwale County leadership. The contractor then commenced work after drilling sites were identified in a kick-off meeting held on 16 January 2018 and was expected to complete the work in a period of eighteen (18) months. The scope of work entailed mobilizing drilling equipment and personnel to the contract site; drilling fifty-four (54) wells across nine (9) coal blocks within the sedimentary basins for coal exploration in Kwale County as per the sites selected by the client; and submission of inception report, logs and descriptions of each well drilled, well completion report, semi-feasibility report and demobilization report.

Payments

During the year under review, the contractor was paid Kshs.22,272,000 (inclusive 16% VAT) vide voucher No.166, dated 14 December 2017. According to the invoice submitted by the contractor, this payment was for mobilization of plant, equipment and personnel and submission of inception report. However, management did not avail certificates of work done as evidence that mobilization was done to the agreed standards. Further, there was no evidence that an acceptable inception report was submitted by the contractor to management. Under the circumstances, it was not

possible to confirm the regularity of the payment of Kshs.22,272,000 made to the contractor.

Further, according to documents supporting the payment, the Kshs.22,272,000 was part of pending bills totaling Kshs.71,987,853 brought forward from the 2016/2017 financial year and payable from this Fund. However, the Fund's financial statements under review and those for the previous year do not disclose any pending bills. Consequently, the completeness of financial statements for the year ended 30 June 2018 could not be confirmed.

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. Expenditure not Included in the Annual Work Programme

The statement of comparison of budget and actual amounts for the year ended 30 June 2018 reflect total expenditure of Kshs.451,007,436 against approved budget of Kshs.202,720,000 shown in the Fund's annual work programmes for the year under review. The Fund, therefore, incurred excess expenditure of Kshs.248,287,436, contrary to Section 6 of the Government Financial Management (Kenya Energy-Sector Environment and Social Responsibility Programme Fund) Regulations, 2007, which stipulates that the expenditure incurred on the Fund shall be on the basis of, and limited to, annual work programmes and cost estimates which shall be prepared by the officer administering the Fund at the beginning of the financial year to which they relate.

2. Ineligible Expenditure

Included in the afforestation – tree planting expenses of Kshs.364,784,387 disclosed in Note 8 to the financial statements are legal fees amounting to Kshs.256,387,419 (Kshs.32,864,585 in 2016/2017), relating to Kinangop Wind Power Project Vs Government of Kenya and Walam Energy Inc. Vs Republic of Kenya cases; and Kshs.22,272,000 relating to a contract for exploratory coal diamond core drilling services in Kwale County. This is contrary to Section 4 of the Government Financial Management (Kenya Energy-Sector Environment and Social Responsibility Programme Fund), Regulations 2007, which provides that the object and purpose of the Fund is to finance activities relating to: (a) the production of wood fuel, power

distribution poles and energy crops for production of bio-fuel; and (b) growing of trees in order to conserve soil and preserve catchment areas for hydro-power dams, including provision of a sink for carbon dioxide generated through combustion of fossil fuels; and Section 5 of the Regulations which states: "There shall be paid out of the Fund payments in respect of any expenses incurred in pursuance of the object and purpose for which the Fund was established. Information available indicates that the National Treasury advised the State Department for Energy to realign its 2017/2018 approved budget with a view to identifying savings to cater for expenditure on legal/arbitration fees relating to the above mentioned cases. The Fund, therefore, incurred expenses amounting to Kshs.278,659,419, which were not in pursuance to the objects and purposes for which the Fund was established.

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, nothing has come to my attention to cause me to believe that internal controls, risk management and governance were not effective.

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.

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 Public Sector Accounting Standards (Accrual Basis), and for maintaining effective internal control as management determines is necessary to enable the preparation of financial statements which are free from material misstatement, whether due to fraud or error and for assessment of the effectiveness of the internal control, risk management and governance.

In preparing the financial statements, management is responsible for assessing the Fund's ability to continue sustaining services, disclosing as applicable, matters related to sustainability of services and using the going concern basis of accounting unless

the management either is aware of intention to terminate the Fund, or have no realistic alternative but to do so.

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.

Those charged with governance are responsible for overseeing the Fund's financial reporting process, reviewing the effectiveness of management's systems for monitoring 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 which 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 review is planned and performed to express a conclusion on whether, in all material respects, 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, 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 which 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 which 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 Fund's policies and procedures may deteriorate.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence which 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 which may cast significant doubt on the Fund's ability to continue sustaining 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 Fund to cease sustaining 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 which achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Fund 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 which 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 which may reasonably be thought to bear on my independence, and where applicable, related safeguards.



FCPA Edward R. O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

8 September 2021