REPUBLIC OF KENYA

KENYA NATIONAL AUDIT OFFICE

REPORT
OF
THE CONTROLLER
AND AUDITOR-GENERAL

ON

FINANCIAL STATEMENTS OF
KENYA PIPELINE COMPANY (KPC)
LIMITED FOR THE YEAR
ENDED 30 JUNE 2009

KENYA PIPELINE COMPANY LIMITED

FINANCIAL STATEMENTS

30 JUNE 2009

KENYA PIPELINE COMPANY LIMITED

FINANCIAL STATEMENTS

FOR THE YEAR ENDED 30TH JUNE 2009

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KENYA PIPELINE COMPANY LIMITED

CORPORATE INFORMATION

DIRECTORS	Mr. Samuel Manzi Maluki - Chairman Mr. Selest N. Kilinda - Managing Director Mrs Rukia Ahmed Mohamed Subow Mr. Joseph L. Kinyua Eng. Ngeso Okolo Abok Mr. Bernard Kipkirui Sang Mr. Waithaka Kioni Mr. Rafi Abdalla Salim Ali Mr. Joseph K. Kinyua (alternate - F. King'ori) Mr. Patrick M. Nyoike (alternate - W. Deche)
SECRETARY	Mrs Flora Okoth (Ag.) P O Box 73442 - 00200 Nairobi
REGISTERED OFFICE	Kenpipe Plaza Sekondi Road Off Nanyuki Road Industrial Area P O Box 73442 -00200 Nairobi
AUDITORS	Kenya National Audit Office P O Box 30084 - 00100 Nairobi
PRINCIPAL BANKERS	Commercial Bank of Africa Limited Wabera Street P O Box 30437 - 00100 Nairobi CfC Stanbic Bank Limited CFC Centre Chiromo Road P. O. Box 72833 – 00200 Nairobi Equity Bank Kenpipe Plaza Nanyuki Road, Off Lunga Lunga Road, Industrial Area, Nairobi
PRINCIPAL ADVOCATES	Mohammed & Kinyanjui Advocates Corner House, 9th Floor P. O. Box 79692 - 00200 Nairobi Kipkenda Lilan & Company Advocates Teleposta Towers, 19th Floor P. O Box 52832 - 00200 Nairobi Ochieng, Onyango, Kibet & Ohaga 5th Floor Block C, ACK House 1st Ngong Avenue, Off Bishop's Road P O Box 43170- 00100 Nairobi Mohamed Muigai Advocates MM Chambers 4th Floor P. O Box 61323-00200 Nairobi

KENYA PIPELINE COMPANY LIMITED

REPORT OF THE DIRECTORS

The directors present their report together with the audited financial statements for the year ended 30 June 2009.

ACTIVITIES

The principal activity of the company is transportation and storage of refined petroleum products.

RESULTS

	Sh'000
Profit before taxation	3,852,287
Taxation charge	(1,460,067)
Profit for the year transferred to revenue reserve	2,392,220

DIVIDEND

The directors do not recommend payment of a dividend (2008 - Ksh 150,000,000 payable) in respect of the year.

DIRECTORS

The current board of directors is shown on page 2. The following changes took place during the year:

Mr. Selest N. Kilinda	Managing Director	Appointed - 09/01/2009 Confirmed - 06/08/2009
Mr. George J. Okungu	Managing Director	Ceased 09/01/2009
Mr. Samuel Manzi Maluki	Board Chairman	Appointed - 09/01/2009
Ms. Rukia Subow	Director	Appointed - 26/10/2007
Mr. James Kenani	Director	Retired - 09/01/2009
Eng. Ngeso Okolo Abok	Director	Appointed - 12/06/2009
Mr. Waithaka Kioni	Director	Appointed - 13/03/2009
Mr. Rafi Abdalla Salim Ali	Director	Appointed - 13/03/2009
Mr. Bernard Kipkirui Sang	Director	Appointed - 13/03/2009
Mr. Alex Kazongo	Director	Appointed - 13/03/2009 Ceased - 12/06/2009
Mr. John M. Mathenge	Director	Retired - 13/03/2009
Mr. George Wachira	Director	Retired 13/03/2009
Mr. Ahmed Mohamed Msallam	Director	Retired - 13/03/2009

AUDITORS

The Controller and Auditor General

BY ORDER OF THE BOARD

Secretary

Nairobi 2009

KENYA PIPELINE COMPANY LIMITED

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Companies Act requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company as at the end of the financial year and of the operating results of the company for that year. It also requires the directors to ensure that the company keeps proper accounting records which disclose with reasonable accuracy at any time the financial position of the company. They are also responsible for safeguarding the assets of the company.

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards. This responsibility includes, designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error, selecting and applying appropriate accounting policies, and making accounting estimates that are reasonable in the circumstances.

The directors accept responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with International Financial Reporting Standards and in the manner required by the Companies Act. The directors are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the company and of its operating results. The directors further accept responsibility for the maintenance of accounting records which may be relied upon in the preparation of financial statements, as well as adequate systems of internal financial control.

Nothing has come to the attention of the directors to indicate that the company will not remain a going concern for at least the next twelve months from the date of this statement.

....	....
Director	Director
....................................2009	2009

REPUBLIC OF KENYA

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Date ....

KENYA NATIONAL AUDIT OFFICE

REPORT OF THE CONTROLLER AND AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF KENYA PIPELINE COMPANY (KPC) LIMITED FOR THE YEAR ENDED 30 JUNE 2009

I have audited the accompanying financial statements of Kenya Pipeline Company Limited set out at pages 4 to 32 which comprise the Balance Sheet as at 30 June 2009, the Income Statement, the Statement of Changes in Equity and the Cash Flow Statement for the year then ended, and a summary of significant accounting policies and other explanatory information, in accordance with the provisions of Section 14 of the Public Audit Act, 2003. 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.

Management's Responsibility for the Financial Statements

The Management is responsible for the preparation and fair presentation of the financial statements in accordance with the International Financial Reporting Standards and for such internal controls as management determines is necessary to enable preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Responsibility of the Controller and Auditor General

My responsibility is to express an independent opinion on the financial statements based on the audit. The audit was conducted in accordance with the International Standards on Auditing. Those standards require compliance with ethical requirements and that the audit be planned and performed with a view to obtaining reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal controls relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal controls. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by the Management, as well as evaluating the overall presentation of the financial statements.

I believe the audit evidence obtained is sufficient and appropriate to provide a basis for my opinion.

1. Line 1 Capacity Enhancement Project

1.1. Design, Installation of Pumps and the Associated Electrical, Mechanical, Instrumentation & Control Facilities

The line 1 Capacity Enhancement Project was conceived in December 2005 with the objective of increasing the capacity of the existing Mombasa-Nairobi line from 440m3/hr to 880m3/hr, by installation of four new pump stations along the pipeline, to meet the increasing demand for petroleum products.

According to the Company's records, only two bids were received against the tender for design, installation of pumps and the associated electrical, mechanical, instrumentation & control facilities. One of two was however rejected on account of not being responsive on general and technical requirements. The remaining bid by a consortium based in Khartoum, Sudan was considered as responsive and was moved forward to the next level of the procurement process; i.e financial evaluation. The consortium was later awarded the contract at a cost of Kshs.2,640,048,566.

Although the Management has defended the award of the contract to the consortium on the basis that this was an Open International Tender executed in accordance with Section 71 of the Public Procurement and Disposal Act 2005, it still has not been possible to confirm whether or not the Company obtained full value for money in the contract, considering the fact that the consortium was the sole bidder who reached the financial evaluation level of the procurement process.

1.2 Buildings and Civil Works Within the Pump Area

i. Records available indicate that nine bidders collected the bid documents but only one returned his. The Tender Committee proceeded and conducted both technical and financial evaluation on the sole bid, before awarding the tender on 11 December, 2006 at a contract price of Kshs.262,633,005. The bid documents however appear to have been floated before the works were designed by the Engineering, Procuring and Construction (EPC) contractor, thus raising the question of how the price of Kshs.262,633,005 had been arrived at in the absence of an approved design.

ii. Further, and according to information available, the bid price of Kshs.262,633,005 was to be negotiated downwards to Kshs.201,970,291 after an adjustment to bring it at par with the engineer's estimate. The adjustment was not however effected and the contract price remained at Kshs.262,633,005.

iii. Although the Management has explained that open competitive bidding could not have been used as this would have apparently delayed the project, the amount involved was substantial and therefore the open tender procedure should have been more appropriate in the procurement, as provided for under Section 54(2) of the Public Procurement and Disposal Act 2005.

In consequence, it has not been possible to ascertain that the contract price of Kshs.262,633,005 was fair and competitive.

1.3 Construction of Site Camps

In a meeting held on 19th April 2007, the Tender Committee recommended that site camps be constructed by a firm nominated as a sub-contractor by the main contractor, for the reason that this would save time. Consequently, instructions were issued to the consultant to raise a variation order for Kshs.171,359,232 to the main contract, to accommodate the site camps. As in the previous instance, this arrangement was in contravention of Section 54(2) of the Public Procurement and Disposal Act. Further and in the absence of competitive bidding, it has not been possible to confirm that full value for money was obtained from the expenditure of Kshs.171,359,232.

1.4 Variations to Contracts

Significant variations were noted on various contracts under the Line 1 Capacity Enhancement Project as at 30 March 2009. The contracts had been varied as follows;

Description	**Original Contract Amount (Kshs)**	**Amount Certified as at 30 March 2009 (Kshs)**	**Variation (Kshs)**	**%**
a. Site camps	171,359,232	242,905,990	71,546,758	42
b. Auxiliary Works for KPLC Station	11,433,238	31,134,027	19,700,789	170
c. Building and Civil Work Within Plant Area	262,633,005	610,659,470	348,026,465	132
Total			439,274,012	

While the Management has stated that the variations occurred due to changes in designs and scope of work, price fluctuations and claims yet to be finalized, the magnitude of these variations is clearly an indication of inadequate planning and weak administration of the Project, resulting in cost overruns totalling Kshs.439,274,012.

2. SAP Implementation Project

The Company contracted a firm at a contract price of Euro 1,566,185 inclusive of VAT (@Kshs.87.45 per Euro : Kshs.136,962,878.25) to implement the SAP Enterprise Resource Planning (ERP) system, within the Company in March 2006. As at 30 September 2008 however, the price had been varied to stand at Euros 1,939,302.40 (Kshs.169,591,994) due to apparent change of scope. The variation of Kshs. 32,629,116 exceeded the limit of 15% (or Kshs.20,544,431) allowed under Section 31 of the Public Procurement and Disposal Regulations (2006). Although the Management has indicated that the Project was a fixed time contract, the significant variation of the works was nevertheless in breach of the law.

3. Stalled Projects

Included under the Work-In-Progress balance of Kshs.1,041,867,000 as shown under note 14 to the financial statements are three stalled projects, for which the related costs had accumulated as follows; Kisumu Railway Siding Project; Kshs.51,236,835, Kisumu Improvement Works Project; Kshs.3,780,771 and Truck Loading Facility-Mombasa Project; Kshs.3,283,127. According to the Management, the Company does not intend to pursue the two projects in Kisumu, with accumulated costs totalling shs.55,017,606, and indications are that these particular projects may be abandoned and the respective costs written-off.

4. Debtors and Other Receivables

As disclosed in note 18 to the financial statements and as reported in the previous year, the Trade and Other Receivables balance of Kshs.3,211,152,000 includes an amount of Kshs.1,643,000,000 (2008-Kshs. 530,891,686) due from a petroleum company, which amount is subject of a court case.

A review of post- balance sheet events however indicates that the case was determined in favour of the petroleum company on 10 January 2010. The Management on its part has since indicated that it will appeal against the judgement. In the meantime, and until the appeal is heard and concluded, the recoverability of the amount Kshs.1,643,000,000 remains doubtful.

5. Staff Costs

The Company paid a sum of Kshs.50 million to staff in December 2008 as Christmas bonus without the approval of the Board. Although the approval was later granted subject to post-facto authorization by Treasury and the State Corporations Advisory Committee, no such authorization had, as at the time of audit, been given. Consequently, and in the absence of the authorization, the propriety of the expenditure could not be confirmed.

6. Non-Compliance With Collateral Financing Agreement (CFA) Requirements

6.1 Background

The Collateral Financing Agreement (CFA) was introduced by KPC in July 2004 as a side agreement to the Transport and Storage Agreement (TSA). The Financing Agreement was put to effect through contracts executed between KPC and Oil Marketing Companies which are signatories to the Transport and Storage Agreement. The financiers of the Oil Marketing Companies were however not in any way enjoined in the Financing Agreement, whose purpose was to facilitate financing of the Companies willing to import petroleum products. The stocks of the products were then to be held by KPC until they were released by the financiers through written release instructions by authorized persons.

In December 2008 however, it transpired that substantial quantities of petroleum products held in trust by KPC as discussed in the ensuing paragraphs amongst other aspects, had been released to an oil marketer without authorization by the respective financiers.

6.2 Accounting and Internal Control Systems

A review of the Accounting and Internal Control systems at KPC disclosed the following weaknesses with regard to the administration of the CFA:-

i. There was clear lack of segregation of duties on receipt and implementation of Release Authority, whereby the same person who received the Authority was also the one who administered it;

ii. There was also no defined approval process for release of the products. Further, no mechanism was in place to provide guidelines on how authorizations received from the financiers were to be processed and accounted for before release of the products to the oil marketers. For instance, some notifications on product release were received and acted upon by the Product Schedulers without the knowledge or consent of the Operations Manager who was in charge of the process;

iii. Clearly laid down procedures for authenticating information and other data from financiers were lacking. For example, there was no mechanism for verifying the authenticity of information received from financiers before release of the products;

iv. Record keeping particularly at the Scheduling Office was poor, with the result that it has been considerably difficult to establish a meaningful audit trail;

v. There was evidence of lack of reconciliations for stocks of petroleum products under the CFA arrangement. The existing stock accounting procedures did not provide for separate reporting on stocks of products under CFA as would have been expected. In addition, there was no system in place to facilitate reconciliation of stock balances in the books of KPC and those of the financiers;

vi. There were no guidelines on how the Oil Marketing Companies were to issue Adjustment Stock Entitlements, which would have differentiated self-financed products from those under CFA. As a result and with the weak controls discussed above, the Oil Marketing Companies could easily draw more products than they were actually entitled to;

vii. Administrative and other expenses associated with accepting, holding and releasing product stocks held in trust do not appear to have been addressed and accounted for under CFA; and,

viii. Data on various operations of KPC was kept by individual staff in their personal computers. This arrangement exposed such data to unintended manipulation.

6.3 Irregular Release of Petroleum Products

According to available information, KPC released without authority 95,965.23 metric tons of petroleum products valued at Kshs.6,037,022,132 to an oil marketer in the period between January 2007 and December 2008. It has not however been explained why the Management failed to detect, for approximately two years, the irregular release of such significant stock of products to a single marketer.

6.4 Liabilities to Financiers

As a result of the irregular release of products to one of the Oil Marketing Companies, six financiers represented by four international creditors and two local banks have lodged claims for stock totalling to 122,217.57 metric tons, with an estimated value of Kshs.7,600,000,000. According to available information however, only four financiers appear to have valid claims of 95,965.23 metric tons valued at Kshs. 6,037,022,132. No indication has been provided as to how these claims will be settled by KPC, as and when they crystalize.

6.5 Contingent Liability

The disclosure under note 31 in respect of pending law suits shows that provisions for such law suits increased from Kshs.395,855,000 in the previous year to Kshs.3,841,614,000 in 2008/2009. Additional information indicates that the bulk of the contingent liabilities on the suits relates to the disputed claims lodged by various parties, on account of unauthorized release of products to an Oil Marketing Company. The outcome of the suits is still unknown.

6.6 Going Concern

In view of the issues discussed above, and in particular the liabilities relating to CFA ,the going concern assumption of KPC appears threatened unless immediate corrective measures are undertaken by the Company to mitigate the risks associated with the Financing Agreement.

Opinion

Except for the foregoing reservations, in my opinion, the financial statements give a true and fair view of the financial position of the Company as at 30 June 2009, of its financial performance and its cash flows for the year then ended in accordance with the International Financial Reporting Standards and comply with the Kenya Companies Act, Cap 486 of the Laws of Kenya.

A.S. M. Gatumbu
CONTROLLER AND AUDITOR GENERAL

Nairobi

26 February 2010

(49)

KENYA PIPELINE COMPANY LIMITED

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FI/AC/11/3 29th October, 2009

The Controller and Auditor-General
Kenya National Audit Office
Anniversary Towers
NAIROBI

(Att: Mr. P.G. Gichuki)

Dear Sir,

RE: MANAGEMENT LETTER FOR THE COMPANY'S 2008/2009 FINANCIAL STATEMENT AUDIT

Further to our telephone conversation, kindly give the bearer of this letter (Mr. Edwin Sitara I/D No. 22419294) the soft copy (in flash disk) of the above mentioned audit.

Yours faithfully,

JOYCE W. OWUOR
FOR: MANAGING DIRECTOR

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(48)

REPUBLIC OF KENYA

KENYA PIPELINE Co.
26 OCT 2009
P. O. Box 73442 - 00200
NAIROBI
CENTRAL REGISTRY

P. O. Box 30084-00100
NAIROBI

KENYA NATIONAL AUDIT OFFICE

KPC/64/2008/2009/(17) **22 October 2009**

The Managing Director,
Kenya Pipeline Company Limited,
Sekondi Road, Off, Nanyuki Road,
Industrial Area,
P. O. Box 73442-00200,
NAIROBI.

Dear Sir,

RE: MANAGEMENT LETTER FOR THE COMPANY'S 2008/2009 FINANCIAL STATEMENTS AUDIT

1.0 INTRODUCTION

The audit of the Kenya Pipeline Company Ltd for the year 2008/2009 is complete. We are pleased to submit our findings and recommendations for your comments and necessary action.

We will appreciate to receive your comments on issues raised herein within five (5) days from the date of this letter.

2.0 FINDINGS AND RECOMMENDATIONS

3.0 FIXED ASSETS:

PROPERTY PLANT & EQUIPMENT

OBSERVATIONS