OFFICE OF THE AUDITOR-GENERAL

Enhancing Accountability

PERFORMANCE AUDIT REPORT ON

MANAGEMENT OF LOCAL EMPLOYMENT AND TRAINING PROVISIONS IN THE PRODUCTION SHARING CONTRACTS

BY

THE STATE DEPARTMENT FOR PETROLEUM

OCTOBER 2021

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Foreword by the Auditor – General

I am pleased to present this performance audit report on Management of Local Employment and Training Provisions in the Production Sharing Contracts by the State Department for Petroleum. My Office carried out the audit under the mandate conferred on me by Section 36 of the Public Audit Act, 2015. The Act mandates the Office of the Auditor - General to examine the economy, efficiency and effectiveness with which public money has been expended pursuant to Article 229 of the Constitution.

Performance, financial and compliance audits form the three-pillar audit assurance framework that I have established to give focus to the varied and wide scope of the audit work done by my Office. The framework is intended to provide a high level of assurance to stakeholders that public resources are not only correctly disbursed, recorded and accounted for, but their use results in positive impacts on the lives of all citizens. The main goal of our performance audits is to ensure effective use of public resources and promote service delivery to citizens.

The audit has a local content perspective on employment and training of Kenyan nationals in the petroleum sector. I am hopeful that corrective action will be taken in line with recommendations in the report. This will contribute towards development of local technical capacity in petroleum operations.

The report is submitted to Parliament in accordance with Article 229 (7) of the Constitution and Section 39 (1) of the Public Audit Act, 2015. In addition, I have submitted copies of the report to the Cabinet Secretary, Ministry of Petroleum and Mining, the Principal Secretary, National Treasury and the Secretary, President's Delivery Unit.

CPA Nancy Gathungu, CBS
AUDITOR – GENERAL

25 October, 2021

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Executive Summary

Background of the Audit

1. Petroleum exploration in Kenya dates back to the 1950s. However, interest in the sector increased significantly after the discovery of commercially viable quantities of oil in blocks 10BB and 13T, in 2012. As at the time of audit, the Government had identified 60 blocks, out of which 23 were at different stages of exploration.

2. To align itself with the current developments in the Petroleum Sector, the Government established the State Department for Petroleum (SDP), in 2016. The State Department is responsible for management of upstream petroleum products, including licensing and monitoring the operations of International Oil Companies (IOCs).

3. The basis for the contractual relationship between the Government and IOCs is the Production Sharing Contract (PSC). PSCs provide a framework for contracting and outline the rights and obligations of each party. One of the contractual obligations is on local employment and training. The local employment and training provisions require international oil companies to give preference to employment and training of Kenyans. In addition, the companies are required to make annual payments towards the Training Fund, which is managed by the State Department for Petroleum.

Audit Design

4. The audit assessed the measures put in place by the State Department for Petroleum to manage the implementation of local employment and training provisions, as outlined in the Production Sharing Contracts. The assessment of this objective was guided by the following two main audit questions;
   a) To what extent are Kenyans benefitting from the local employment provision in the Production Sharing Contracts?
   b) To what extent do Kenyans benefit from the Training Fund?

5. The audit assessed how the State Department for Petroleum managed implementation of local employment and training provisions. It focused on all the licensed active blocks and covered the period July 2015 to June 2019. However, four International Oil Companies, with operations in fourteen out of the twenty-three active blocks, were sampled for the audit. The sampled IOCs were; A-Z Petroleum (Kenya) Ltd, Eni E&P Holdings, Tullow Oil (Kenya) B.V and Zarara Oil and Gas Ltd. Data was collected through interviews and document review. The assessment criteria were drawn from the Petroleum (Exploration and Production) Act, Revised Edition, 2012 and its model PSC.

Summary of Audit Findings

a) Inadequate Monitoring of the Progress in the Implementation of the Local Employment Provision

6. Section 5 (3) (c) of the Petroleum (Exploration and Production) Act, Revised Edition, 2012, requires the State Department for Petroleum to supervise the operations of oil companies, which also includes their progress in the implementation of Clause 13 (1) of the PSC. The clause requires oil companies to give preference to the employment and training of Kenyan nationals.

7. The audit revealed that SDP relied on quarterly and annual reports submitted by International Oil Companies to monitor the implementation of the local employment provision. However, interviews with the management of the companies and review of correspondence files, for the sampled companies, revealed that while some oil companies submitted reports with information on local employment and training, SDP did not review the submitted reports. In addition, the submission of quarterly reports was inconsistent, however, there was no evidence of the State Department following up on reasons for inconsistent submission.

8. Further, the State Department for Petroleum had not developed a standard format for reporting progress in the implementation of local content provisions in general. The information provided varied across IOCs. Interviews with IOCs management revealed that they were not aware of the specific information they were required to provide on local employment and training provisions.

9. The audit identified three problems affecting monitoring of activities of the International Oil Companies. First, as of June, 2019, SDP had only 18 out of the required 138 technical staff in the Upstream Petroleum Department. Due to inadequate staff, there was minimal monitoring of upstream petroleum operations, as efforts were mainly directed towards monitoring of provisions relating to technical aspects. However, it was noted that SDP had recruited 29 technical staff as at the time of finalizing this report. Second, SDP maintained a manual filing system which did not only make retrieval of information from the files time consuming, but also did not allow for ease of tracking of the companies' performance over the years. However, information availed as at the time of finalizing this report revealed that SDP had developed an Electronic Data Management System, though it was not yet operational. Third, SDP had not developed regulations on local content and standard operating procedures to guide monitoring activities. However, it was noted that in April 2019,

the Government enacted the Energy Act, 2019 and the Petroleum Act, 2019. Both Acts have requirements for local content and provisions for monitoring and enforcement. Information obtained from SDP's management as at the time of finalizing this report further revealed that the State Department had started the process of developing a Petroleum Policy, Upstream Petroleum Regulations and Local Content Regulations.

10. As a result of inadequate monitoring, SDP had limited information on the level of compliance of International Oil Companies on local employment obligations against which it could initiate corrective actions. Besides, the inadequate monitoring of the companies makes an impression of leniency, which creates room for future noncompliance.

b) Inadequate Regulation of the Employment of Expatriates by International Oil Companies

11. Clause 13 (1) of the Production Sharing Contract require the contractors to give preference to employment and training of Kenyan nationals. It is the responsibility of the State Department for Petroleum to supervise the implementation of Clause 13 (1); to ensure that International Oil Companies only hire expatriates for skills sets that are not locally available.

12. While the correspondence files reviewed had instances of International Oil Companies applying for work permits through SDP, the applications did not have information on the qualifications of the expatriates and the job description for the positions being filled. With missing information on the skill sets required, it was not clear how SDP arrived at a decision to recommend the approval of work permits to the State Department of Immigration (SDI). Good practice requires that the State Department for Immigration consults SDP during work permit processing, to ensure that permits are only issued to expatriates whose skills were not locally available. However, the files reviewed did not have any evidence of correspondence between the two state departments.

13. Document review revealed that some of the jobs taken up by expatriates were for skills that were locally available. For example, Tullow Oil (Kenya) B.V requested work permits for expatriates in areas such as Supply Chain Management, Security Advisor and Environmental Health and Safety. These positions could have been competitively filled with locally available skills.

14. Further, International Oil Companies are required to submit to the State Department for Petroleum a clear succession plan on replacement of expatriates by Kenyans. However, the files reviewed did not have evidence of succession plans. Nevertheless, there was no indication of the State Department following up to ensure that the companies develop and

implement succession plans. Interviews with IOCs revealed that only Tullow and Eni Energy and Petroleum Holdings had a policy on replacement of expatriates, however, no documented succession plans were provided for audit.

15. The inadequate regulation of the employment of expatriates was attributed to a weak legal framework on local content. The State Department for Petroleum had relied on the now repealed Petroleum Act, Revised Edition, 2012 which did not have enforcement mechanisms for local content. Further, there was no requirement for the State Department for Immigration to consult SDP when processing work permits. The inadequate regulation of the employment of expatriates has denied Kenyan nationals employment opportunities, as International Oil Companies continued to employ expatriates for jobs whose skill sets are locally available.

c) Insufficient Collection of Training Fees from International Oil Companies

16. Section 11 (1) of the Petroleum (Exploration and Production) Act, Revised Edition, 2012, establishes a Training Fund and Clause 13(2) of PSC require contractors to pay an agreed amount of money per contract year, being payment for training fees, to the Fund.

17. Analytical review of documents provided for audit revealed that arrears in training fees amounted to USD 6.7 million, during the period under audit. Clause 6 (1) (a) of the Production Sharing Contract provides for termination of a contract if the contractor fails to make any payment to the Government for a period exceeding one month. However, despite some companies having arrears dating back to four years, SDP had not terminated any of the contracts for non-payment of training fees.

18. The State Department for Petroleum did not have a defined procedure for collection of training fees and relied on the model PSC as the sole guide. While the Production Sharing Contract had a provision on payment of training fees, it did not outline the procedure to be followed by SDP for collection of the fees.

19. The non-payment of training fees denies the Government revenue, which can be used to build local capacity in the oil and gas sector. Further, SDP's inability to take a firm action on non-complying companies makes an impression of leniency, which creates room for future noncompliance.

d) Insufficient Utilization of the Training Fund

20. Section 11 (1) of Petroleum (Exploration and Production) Act, Revised Edition, 2012, establishes a Training Fund for purposes of training Kenyan nationals in petroleum operations.

21. Analytical review of documents availed for audit revealed that receipts into the Training Fund amounted to Ksh. 2.6 billion, while expenditure amounted to Ksh. 1.48 billion, giving a utilization rate of 56% cumulatively, during the period under audit. However, the data availed for audit, as presented in the annual reports and financial statements of the Training Levy Fund, had revenue training fees and surface fees consolidated as levies from IOCs. Hence, the audit observation is not limited to training fees, but covers all revenues into and expenditures from the Training Fund account. Further, the audit revealed that the Fund had been mainly used to build capacity for SDP staff, leaving out other key public sector stakeholders in the petroleum value chain. Out of the 61 courses sponsored by the Fund during the period under audit, 93% of the courses benefited SDP staff.

22. Good practice requires that SDP provides technical expertise to institutions of higher learning, to ensure that petroleum courses being offered are market oriented. However, the audit did not find any evidence of collaboration between SDP and these institutions.

e) Revenue from the Training Fund was Spent on Non-Training Items Leading to a Decline on Expenditure on Training Over the Years

23. Section 11 (4) of the Petroleum Act, Revised Edition, 2012, states that all monies from the Training Fund shall be used only for the purpose for which the Fund is created, that is, training Kenyans on petroleum operations.

24. The audit revealed that in addition to training government officers, SDP used monies from the Fund to procure specialized equipment and offer grants to the National Oil Corporation of Kenya (NOCK). However, the expenditure on procurement of specialized equipment and grants to the National Oil Corporation of Kenya (NOCK) is voted for by parliament and should come from surface fees, which is also deposited in the Training Fund account. As a result, the allocation towards training declined from 88% of total expenses in the year 2015/16 to 36% in 2018/19. During the same period, expenditures on other items increased from 12% to 64%.

25. Further, the audit revealed that SDP spent approximately Ksh. 944 million for training during the period under audit. However, examination of documents availed for audit revealed that only 14 out of the 61 courses sponsored were on petroleum operations. Other skill set areas in which officers were trained on were Public Finance and Human Resource Management. Some of the Human Resources and Administration skills in which staff were trained on included Secretarial Management, Office Management and Hygiene, Protocol and Event Management and Customer Care.

26. The insufficient and irregular utilization of the Training Fund was attributed to the fact that SDP had not developed regulations on utilization of the Fund. The State Department relied on the Public Service Training Policy, which was general to the training of civil servants. Besides, SDP did not have a documented procedure on utilization of moneys from the Training Fund.

Conclusion

27. The Government, through the State Department for Petroleum, has enacted the Petroleum Act, 2019 and the Energy Act, 2019. The Acts are expected to give a clear policy guideline on the implementation of local content in the oil and gas sector. New players, such as the Energy and Petroleum Regulatory Authority(EPRA) have been identified where SDP will be left with the role of policy development and monitoring, to a limited extent. The monitoring role will be carried out in collaboration with EPRA, established under Section 9 of the Energy Act, 2019.

28. However, as at the time of the audit, the State Department for Petroleum had not put in place adequate systems to manage local employment and training provisions. The State Department lacked adequate systems for monitoring the International Oil Companies' progress, in the implementation of the local employment provision. Besides, SDP was not able to adequately regulate the employment of expatriates by International Oil Companies. In addition, the State Department did not have adequate systems to facilitate the collection and utilization of training fees

Recommendations

29. Based on the audit findings, the Auditor-General proposes the following recommendations, to improve the management of the implementation of local employment and training provisions.

I. To address the inadequacies in monitoring and enforcement of local employment provision, the State Department for Petroleum should: -

   i) Work closely with the Public Service Commission to recruit more technical staff;
   ii) Fast track the operationalization of the Electronic Data Management System;
   iii) Develop and implement standard operating procedures for monitoring the operations of International Oil Companies;
   iv) Develop and implement mechanisms to enhance consultation with the State Department of Immigration, during the processing of work permits; and
   v) Fast track the development of the Petroleum Policy and related regulations.

II. For efficient management of the Training Fund, the State Department for Petroleum should: -

   i) Come up with stringent measures for enforcing Clause 13 (2) of the Production Sharing Contract, on payment of training fees;
   ii) Develop and implement standard operating procedures for the collection of training fees; and
   iii) Develop and implement regulations on management of the Training Fund.

Chapter 1: Background of the Audit

Introduction

1.1 Oil and gas exploration in Kenya dates back to the 1950s and is conducted in four sedimentary basins: Lamu, Mandera, Anza and Tertiary Rift. From the 1950s, there were decades of disappointing results, which led to a decline in interest in the petroleum industry. This was until the year 2012, when commercially viable quantities of oil were discovered in blocks 10BB and 13T, in Turkana County. As at the time of the audit, the Government had identified 60 blocks, out of which 23 were at different stages of exploration.

1.2 The basis for a contractual relationship between the Government and International Oil Companies (IOCs) is the Production Sharing Contract (PSC), issued as a schedule to the regulations enshrined under the Petroleum Act. The current operational PSCs were issued under the Petroleum (Exploration and Production) Act Cap 308, which was revised in 2012 and has since been replaced by the Petroleum Act, 2019. The PSC provides a framework for the contracting, exploration, development and production of petroleum resources and outlines the rights and obligations of each party. Among the contractual obligations are provisions on local employment and training. The local employment and training provisions require contractors and their subcontractors to give preference to the employment and training of Kenyans, where possible. In addition, contractors are required to pay, on an annual basis, a levy of an agreed amount of money towards the Training Fund, which is managed by SDP.

1.3 To align itself with current developments in the oil and gas sector, the Government established State Department for Petroleum vide the Executive Order No. 1 of 2016. The State Department is responsible for the management of upstream petroleum products, which includes licensing and monitoring the operations of International Oil Companies. As such, the State Department has to ensure that the companies adhere to contractual obligations outlined in the Production Sharing Contracts.

1.4 While the oil and gas industry has the potential to revolutionise the Kenyan economy, effective and efficient implementation of provisions relating to local content, such as local employment and training, is necessary to ensure that the benefits trickle down to citizens. The Government has an obligation to manage the expectations of citizens by protecting their rights and sharing information on the potential benefits accruing from the exploration of petroleum resources.

Motivation of the Audit

1.5 The Auditor-General authorized the audit after considering the following factors:

i) Petroleum exploration is a capital-intensive and high-risk venture undertaken by International Oil Companies with the hope of recouping their investments, once production begins. The industry has the potential of generating significant revenue for the Government but stringent measures need to be put in place to ensure timely and full submission of the payments. Information obtained from the 2017/18 audited accounts of the Petroleum Fund shows that International Oil Companies owed the Government license fees arrears amounting to Ksh. 1,021,813,827, which had accumulated over the years. Therefore, monitoring of the provisions that highlight what should be submitted to the Government by these companies would be of great help.

ii) Information obtained from media reports also indicates that International Oil Companies have been hiring expatriates to bridge the skills gap in Kenya. It is not only expensive to hire expatriates, but this cost is recoverable, hence reducing the Government's profit share. Therefore, it is necessary to establish the measures put in place by SDP to ensure that International Oil Companies only hire expatriates for skills that are not available in the country.

iii) Media sources indicated that there has been a continued uproar against International Oil Companies by the communities around their respective exploration blocks. This was attributed to the Government not adequately managing expectations of local communities on benefits accruing from the exploration of petroleum resources. Some of the complaints were linked to non or partial implementation of some provisions, which include but are not limited to; employment of local communities and purchase of Kenyan manufactured goods and services. For instance, a Daily Nation article dated 30 June 2018 reported that Turkana residents broke into Ngamia 8, an oil site in block 10BB, aggrieving over lack of consideration for jobs, tenders, insecurity and the community's proposed percentage share of proceeds from the sale of oil, once production begins.

Chapter 2: Design of the Audit

Objective of the Audit

2.1 The audit assessed the measures put in place by the State Department for Petroleum to manage the implementation of local employment and training provisions, as outlined in the Production Sharing contracts. The assessment of this objective was guided by the following two main audit questions:

a) To what extent are Kenyans benefitting from the local employment provision in the Production Sharing Contracts?
b) To what extent do Kenyans benefit from the Training Fund?

Scope of the Audit

2.2 The audit assessed how the State Department for Petroleum (SDP) managed the implementation of local employment and training provisions, as outlined in the Production Sharing Contracts. The audit covered the period July 2015 to June 2019 and focused on the licensed active blocks, in the four oil and gas basins, across the country, namely; Anza, Lamu, Mandera and Tertiary Rift. Four International Oil Companies, with operations in fourteen out of the twenty-three active blocks, were sampled for the audit.

Assessment Criteria

2.3 The Production Sharing Contracts for the IOCs sampled for audit were concluded before the enactment of the Petroleum Act, 2019 and the Energy Act, 2019. Therefore, the audit assessment criteria were drawn from the Petroleum Act, Revised Edition, 2012, and its annexed model PSC. Details of the criteria are presented in chapter four.

Methods used to Gather Audit Evidence

2.4 The audit was conducted in accordance with performance auditing guidelines issued by the International Organization of Supreme Audit Institutions (INTOSAI), which states that the audit and the SAI must be independent, possess required competence and exercise due care to provide a guide on execution and reporting of audit findings.

2.5 To get a sample for the audit, purposive sampling was used to select four out of the fourteen companies operating the twenty-three active blocks. The sampling criteria required that for a company to be included in the audit sample, it had to be an International Oil Company with operations in more than one active block. The sampled IOCs were A-Z Petroleum (Kenya) Ltd, Eni E&P Holdings, Tullow Oil (Kenya) B.V and Zarara Oil and Gas Ltd. Details of the blocks ownership status, of the sampled companies, are provided in **Appendix 1.**

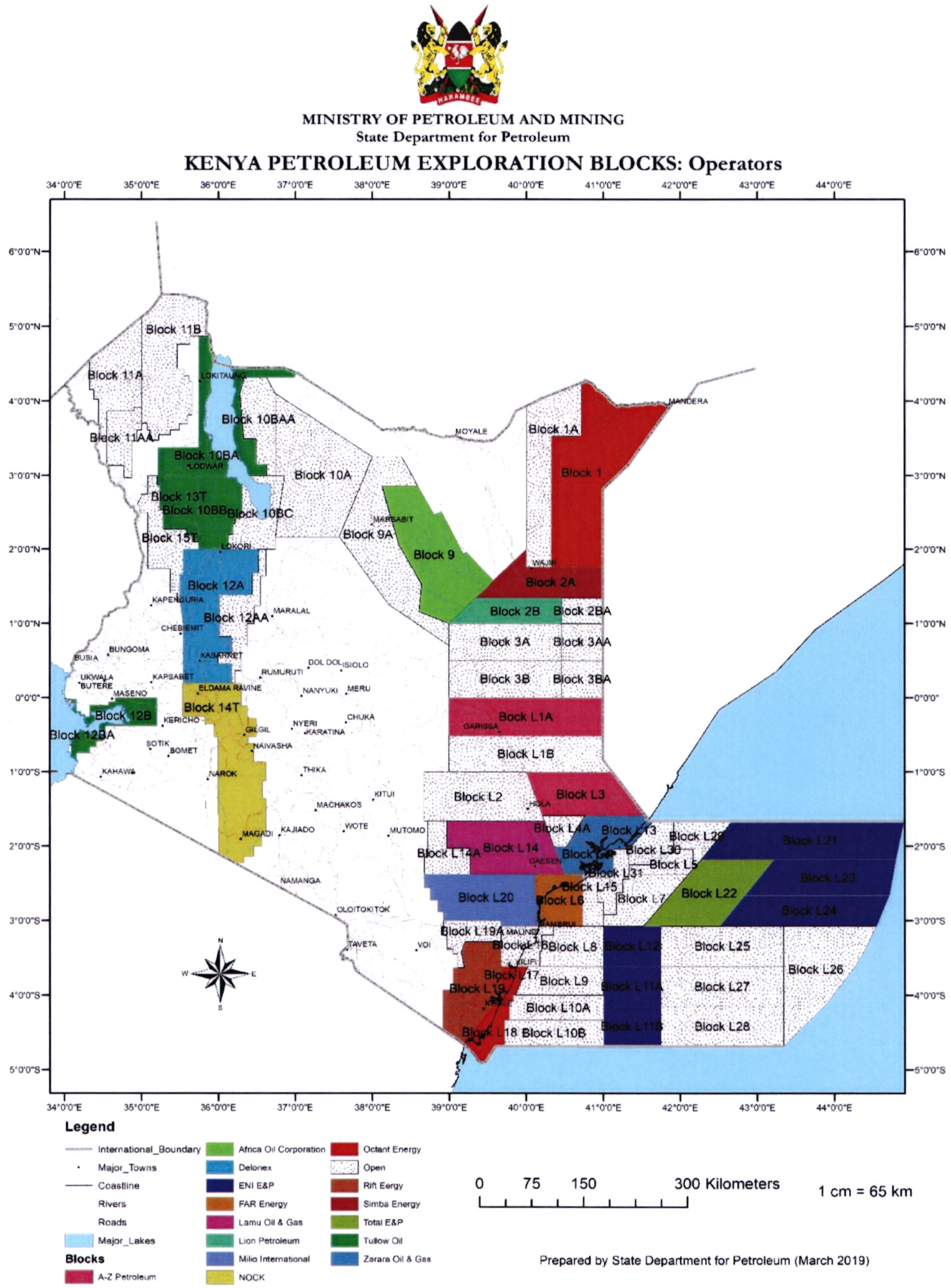
2.6 To understand and obtain information on the roles and responsibilities of SDP in managing the implementation of local employment and training provisions in the PSC, the audit team conducted interviews with SDP staff and reviewed various documents, as outlined in **Appendix 2.** The audit team also conducted interviews with the management of the sampled oil companies, as well as Tullow Oil B.V staff.

Chapter 3: Description of the Audit Area

Petroleum Exploration in Kenya

3.1 Exploration for oil and gas in Kenya dates back to the 1950s and is conducted in four sedimentary basins; Lamu -both onshore and offshore, Mandera, Anza, and Tertiary Rift. As of the time of the audit, Kenya had sixty-one oil blocks. Out of this, eighteen had never been licensed while twenty had been licensed before, but were open. The remaining twenty-three were active licensed blocks, out of which commercially viable oil had been discovered in two blocks, 10BB and 13T. **Figure 1** shows the petroleum exploration blocks in Kenya. The list of International Oil Companies and the respective blocks they operate in is outlined in **Appendix 1.**

Figure 1: *Petroleum Exploration Blocks*



Key Actors and Stakeholders involved in Management of the Implementation of Provisions outlined in Production Sharing Contracts

3.2 The key actors involved in the management of implementation of local employment and training provisions are as outlined in the process description section of the report. The other stakeholders are outlined in **Appendix 3.**

The State Department for Petroleum's Organizational Structure

3.3 The Public Service Commission is in the process of developing an organizational structure for SDP to align with Executive Order No.1 of 2016, which elevated it from a directorate in the Ministry of Energy and Petroleum to a state department.

3.4 The Public Service Commission has approved the developed staff establishment for SDP, it categorizes staff into Technical and Support Personnel. Under the Technical Personnel, the approved establishment provides for Upstream Petroleum and Mid/ Downstream Petroleum Departments. The management of Production Sharing Contracts is currently under the Technical Directorate, as per the old organisational structure.

Process Description

3.5 The implementation of local employment and training provisions is managed through a system that involves several players as outlined in **Figure 2**. The Ministry of Petroleum and Mining (MoPM) is the main institution charged with the responsibility for providing policy direction and regulating oil and gas exploration in Kenya. The Ministry discharges this mandate through one of its departments, the State Department for Petroleum (SDP).

3.6 Established in 2016, vide Executive Order No. 1 of 2016, SDP is responsible for overseeing operations in the entire petroleum value chain. Specifically, SDP is responsible for the following:

i. Policy development and implementation;

ii. Licensing of petroleum and handling;

iii. Management of upstream petroleum products, including establishing Production Sharing Contracts with International Oil Companies;

iv. Capacity development in the oil and gas sector; and

v. Quality control of petroleum products.

3.7 The State Department for Petroleum relies on the provisions in the Petroleum (Exploration and Production) Act, Revised Edition, 2012, and the signed Production Sharing Contracts to monitor IOCs' progress in the implementation of local employment and training, among other provisions.

3.8 International Oil Companies are required to provide quarterly reports of their operations to SDP. The State Department for Petroleum's officials are then supposed to review the reports against the local employment and training plans earlier submitted and advise the companies on the gaps noted with regards to progress in implementation. In addition, the State Department is supposed to undertake physical monitoring of the companies' status in the implementation of their contractual obligations on local employment and training.

3.9 The enactment of the Energy Act, 2019, introduced another important actor in the upstream petroleum operations, the Energy and Petroleum Regulatory Authority (EPRA). Among its functions is the regulation, monitoring and supervision of upstream petroleum operations in Kenya. Once operationalised, SDP will be expected to work closely with EPRA in monitoring operations the operations of oil companies.

3.10 The State Department for Immigration is responsible for issuing work permits to foreigners employed by oil companies. Where the employment of expatriates is concerned, International Oil Companies are required to formally apply for a work permit for the staff in question, providing a justification that the skill being sort is not locally available. The State Department for Petroleum and the State Department for Immigration are therefore supposed to work closely during the processing of work permits, to ensure that a careful analysis of the applications is done and that permits are only issued for deserving cases.

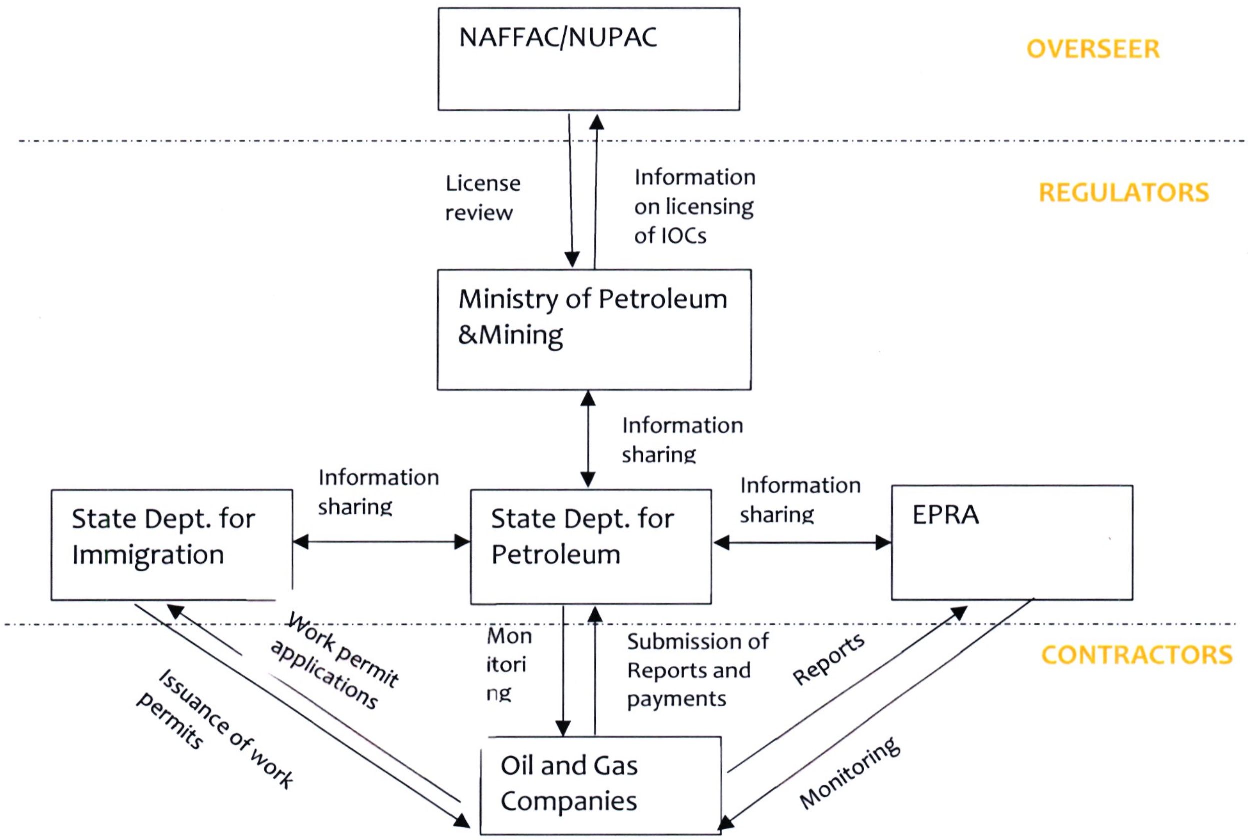
3.11 Where work permits are issued, the hiring company should develop a succession plan detailing how it intends to mentor Kenyans to take up the positions being filled by expatriates. Therefore, SDP should monitor progress in the implementation of such succession plans, while the State Department for Immigration is supposed to provide SDP with information on expatriates' work permit status, to facilitate monitoring.

3.12 Further, the State Department for Petroleum is required to monitor, collect and utilize training fees for purposes of building local capacity in the petroleum sector. The Principal

Secretary, Petroleum is accountable to the Cabinet Secretary, MoPM, on the utilization of the funds collected.

3.13 There was an inter-ministerial body known as the National Fossil Fuels Advisory Committee (NAFFAC) that oversees the oil and gas sector. However, NAFFAC has been replaced by the National Upstream Petroleum Advisory Committee (NUPAC) following the enactment of the Petroleum Act, 2019. NUPAC plays an advisory role during the issuance or revocation of Production Sharing Contracts.

Figure 2: *Framework for Monitoring the Implementation of Local Employment and Training Provisions*



Source: OAG Audit Team's Conceptualisation

Funding

3.14 The State Department for Petroleum is funded by the Government through the budgetary allocation process of the National Treasury. The State Department's budget for monitoring the operations of International Oil Companies is under the feasibility studies budget line.

In addition, the State Department receives revenue on behalf of the Government in form of signature bonus, training fees and surface fees, whose payment default attracts penalties. During the period 2015/16 to 2018/19, the revenues received from the companies kept fluctuating as shown in **Table 1**.

Table 1: *Receipts from International Oil Companies during the Period 2015/16 to 2018/19*

Year	Training Fees (Ksh.)	Surface Fees (Ksh.)	Penalties (Ksh.)	Totals (Ksh.)
2015/16	257,129,007	172,235,882		**429,364,889**
2016/17	131,745,169	71,537,552	994,996,866	**1,198,279,587**
2017/18	206,533,600	78,294,812		**284,828,412**
2018/19	77,672,500	42,425,138		**120,097,638**
Totals	**673,080,276**	**364,493,384**	**994,996,866**	**2,032,570,526**

Source: OAG analysis of SDP's documents

3.15 The audit team requested for SDP's information on budgets and expenditures for the years 2015/16 to 2018/19, but none had been provided as of the time of finalising this report. The State Department instead provided the annual report and financial statements for the Petroleum Training Fund. The revenues and expenditures from the Fund were as shown in **Table 2.** The Fund's revenue basket includes both training and surface fees.

Table 2: *Training Fund Revenue and Expenditure during the Period 2015/16 to 2018/19*

	Revenue			
Financial Year	**Receipts from IOCs (Ksh.)**	**Other Receipts (Ksh.)**	**Total Revenue (Ksh.)**	**Expenditure (Ksh.)**
2015/16	558,349,996	62,743,042	621,093,038	650,928,996
2016/17	215,705,546	1,025,044,634	1,240,750,180	306,232,260
2017/18	496,693,141	42,960,426	539,653,567	381,676,415
2018/19	195,212,722	42,467,153	237,679,875	145,756,415
Total	**1,465,961,405**	**1,173,215,255**	**2,639,176,660**	**1,484,594,086**

Source: OAG analysis of SDP's documents

Chapter 4: Audit Findings

4.1 The audit revealed that the State Department for Petroleum was monitoring Production Sharing contract provisions related to the technical aspects of exploration. However, there were inadequacies in how SDP was managing the implementation of local employment and training provisions. Below are the detailed findings.

1. Inadequate Measures to Ensure that Kenyans Benefit from the Local Employment Provision

a) Inadequate Monitoring of the Progress in the Implementation of the Local Employment Provision

4.2 Section 9 (1) (g) of the Petroleum (Exploration and Production) Act, Revised Edition, 2012, and Clause 13 (1) of the Production Sharing Contract require contractors to give preference to the employment and training of Kenyan nationals. Section 5 (3) (c) of the Petroleum (Exploration and Production) Act, Revised Edition, 2012 requires the Cabinet Secretary, Petroleum, to supervise petroleum operations carried out under the signed PSCs. For effective supervision, good practice requires that SDP:

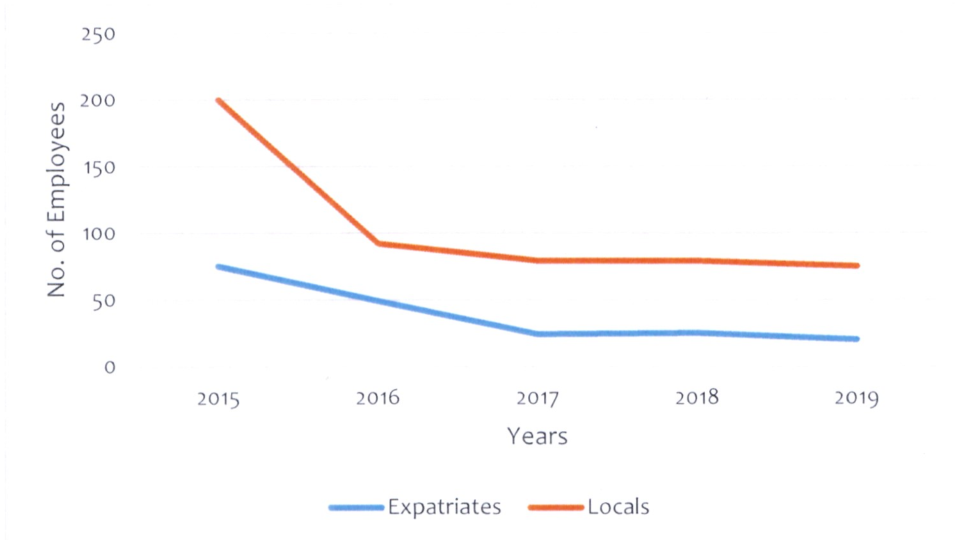
i) Puts in place measures to facilitate the monitoring of the local employment provision as outlined in Production Sharing Contracts;

ii) Reviews the monitoring and progress reports submitted by International Oil Companies to assess their level of compliance with the local employment provision; and

iii) Initiates corrective action on the companies that do not comply with the local employment provision.

4.3 Interviews and documentary reviews revealed that International Oil Companies had, to some extent, employed Kenyan nationals. For instance, Eni E&P Holdings had 10 employees, out of which 8 were Kenyans, while Tullow Oil B.V workforce constituted more Kenyans than expatriates, as shown in **Figure 3.** However, 90% of the workforce at Tullow was subcontracted. Despite the requirement that IOCs should provide information on employees of their contractors and sub-contractors, Tullow's data did not have information on employees of subcontractors.

Figure 3: *Trend of Expatriates Vs Local Employed at Tullow Oil B.V during the Period 2015 to 2019*



Source: Tullow Oil B.V documents and audit minutes

4.4 The audit revealed that the State Department of Petroleum did not undertake physical monitoring of IOCs' implementation of local employment and training provisions, but instead relied on the quarterly and annual reports submitted by the companies. A review of correspondence files, for the sampled companies, revealed that some companies submitted quarterly reports with information on their progress on implementation of the provisions on local employment and training. However, the reviewed files did not have any evidence of SDP reviewing the submitted reports. Further, interviews with the management of International Oil Companies indicated that there was no feedback from SDP on the submitted quarterly reports. Besides, the submission of quarterly and annual reports was inconsistent. However, there was no evidence of SDP following up with IOCs on the reasons for the inconsistent submission.

4.5 Clause 13(1) of the model Production Sharing Contract further requires that the companies, in consultation with the Cabinet Secretary, Ministry of Petroleum and Mining, develop training programmes for the training of Kenyan employees. In addition, good practice requires International Oil Companies to develop and implement local employment plans to facilitate the implementation of the local employment provision. These documents should be submitted to SDP to facilitate monitoring of the companies' progress on their implementation. However, document review revealed that the companies had not submitted local employment plans and training programmes against which SDP could measure their performance when reviewing quarterly reports. However, the reviewed files did not have evidence of SDP following-up to ensure that the companies comply.

4.6 Further, interviews and review of correspondence files for the sampled International Oil Companies revealed that SDP had not provided the oil companies with a standard format for reporting on their progress on implementation of local content provisions in general. While Tullow Oil (Kenya) B.V submitted separate quarterly and annual reports on local employment and consumption of local goods, Eni E&P Holdings provided this information as a section within its quarterly progress reports, while Zarara and A-Z did not provide this information at all. However, there was no evidence of SDP providing a reporting format in the files. Interviews with the management of International Oil Companies revealed that they were not conversant with the information they were expected to provide as pertains to local employment and training provisions.

4.7 As a result of inadequate monitoring, the State Department for Petroleum had limited information on the company's level of compliance, on local employment obligations, against which it could initiate corrective actions. Besides, the inadequate monitoring of the companies made an impression of leniency and therefore creating room for future noncompliance.

4.8 The causes to inadequate monitoring were; limited number of technical staff, lack of relevant guiding documents and insufficient records management. The causes are discussed below.

i) Insufficient number of technical staff to monitor the operations of International Oil Companies

4.9 For efficient monitoring of the operations of the oil companies, SDP requires staff with technical skills. According to SDP's approved staff establishment, the State Department is supposed to have 318 staff, out of which 138 are technical personnel in the Upstream Petroleum Department. However, as of June, 2019, an analytical review of the staff establishment revealed that SDP had only 18 out of the 138 approved technical staff. Hence, monitoring was only carried out for provisions related to technical aspects, like the acquisition of seismic data. The shortage of technical staff is outlined in **Table 3**.

Table 3: *Approved Vs. Actual Number of Staff in the Upstream Petroleum Department*

Designation	**Authorized No.**	**In-post**	**Shortage**
Technical Personnel	21	4	-17
Petroleum Geologist Personnel	22	7	-15
Petroleum Geophysicist	22	5	-17
Petroleum Geochemist Personnel	22	0	-22
Petroleum Engineers Personnel	17	0	-17
Petroleum Technologist Personnel	34	2	-32
Total	**138**	**18**	**-118**

Source: SDP Staff Establishment, 2019

4.10 Information provided by SDP's management as at the time of finalising this report revealed that the State Department had finalised the recruitment of 29 technical staff.

ii) Lack of relevant guiding documents on monitoring the operations of International Oil Companies

4.11 The State Department for Petroleum relied on the Petroleum (Exploration and Development) Act, Revised Edition, 2012, as the sole guide in monitoring activities of International Oil Companies. While the Act indicates the obligations of the companies and the role of the Ministry, it does not give details on operating procedures and measurable targets. The SDP had not developed regulations providing specifics on how the local employment and training provisions in the Act were to be enforced. Therefore, SDP staff did not have a guide on how to review submitted reports and recommend corrective measures, where necessary. However, it was noted that in April 2019, the Government enacted the Energy Act, 2019 and the Petroleum Act, 2019. Both Acts have requirements for local content, as well as provisions on monitoring and enforcement. Further, information obtained from SDP's management as at the time of finalising this report revealed that the SDP had started the process of developing a Petroleum Policy, Upstream Petroleum Regulations, and Local Content Regulations. The process was still at the inception stages, except for the Local Content Regulations, which had been drafted.

iii) Inefficient records management

4.12 For efficient monitoring, good practice requires that SDP develops and operates a records management system that does not only provide for safe custody but also ensures efficient retrieval of information.

4.13 It was observed that SDP did not have an integrated electronic database. The State Department maintained a manual filing system, which did not provide for a systematic way of obtaining information. Besides, a review of files revealed inconsistency and mixing up of documents in various correspondence files. Consequently, retrieval of information from the files was time-consuming and did not allow for ease of tracking the performance of each IOC over the years. Information obtained from SDP's management, as at the time of finalizing this report, revealed that SDP had finalized the development of an Electronic Data Management System. However, it was not yet operational.

b) Inadequate Regulation of the Employment of Expatriates by International Oil Companies

4.14 Clause 13 (1) of the Production Sharing Contract requires the contractor, its contactors and sub-contractors, where possible, to employ Kenyan nationals in petroleum operations. Section 5 (3) (c) of the Petroleum (Exploration and Production) Act, Revised Edition, 2012, requires the Cabinet Secretary, Petroleum, to supervise petroleum operations carried out under the signed PSCs. Supervision is necessary to ensure that International Oil Companies only hire expatriates for skill sets not locally available.

4.15 A review of correspondence files revealed that International Oil Companies channelled work permit application requests through SDP. However, interviews with SDP staff revealed that this was not a mandatory requirement. The management of the oil companies requested SDP to write a supporting letter to the State Department for Immigration accompanying the work permit application. Therefore, SDP had copies of applications for work permits requested through its office. However, it was observed that the applications filed in the correspondence files did not have information on the qualifications of the expatriates and the job description for the positions being filled. With missing information on the skill sets required, it was not clear how SDP arrived at a decision to recommend the approval of work permits to the State Department for Immigration. Good practice requires that the State Department for Immigration consults SDP during work permit processing, to ensure that permits were only issued to expatriates whose skills were not locally available. However, the files reviewed did not have any evidence of correspondence between the two state departments.

4.16 Document review revealed that some of the jobs taken up by expatriates were for skills that were available locally. For example, a review of correspondence files revealed that Tullow Oil (Kenya) B.V requested and was granted work permits for skills that were available in the country. The work permit requests required skills including, but not limited to; Supply Chain Management, Security Advisor and Environmental Health and Safety.

4.17 Good practice requires that International Oil Companies develop and implement succession plans for positions held by expatriates. Further, copies of the succession plans should be submitted to the State Department of Petroleum, to facilitate monitoring of IOCs progress on their implementation. Files reviewed did not have evidence of succession plans. In addition, there was no indication of the State Department making follow up to ensure that IOCs develop and implement succession plans.

4.18 Interviews with IOCs revealed that only Tullow Oil (Kenya) B.V and Eni E&P Holdings had a policy on replacement of expatriates. However, no documented succession plans were provided for audit. The audit observed that as much as Tullow Oil B.V managed to localize some positions as outlined in **Table 4**, information on the number of positions that were supposed to be localized each year was not provided. It was, therefore, not possible to assess the company's progress on the replacement of expatriates.

Table 4: Status of localization of positions by Tullow Oil B.V

Year	No. of positions localised	Positions Localized
2015	2	National Content Advisor, Water Management Supervisor
2016	5	Facilities Manager, Environmental Health and Safety (EHS) Advisor, EHS Lead Assurance, Field Social Performance Manager, International Investment Relations Manager
2017	10	Field EHS Advisor, Contract and Procurement Lead, Senior Cost Engineer, Field Logistics, Information Systems Lead, Field EHS Advisor, Finance Manager, Logistics Manager, Field Camps Manager, Social Performance Manager, Business Performance Manager
2018	1	Supply Chain Lead
2019	3	Financial Planning Manager, Asset Protection Manager, EHS Manager

Source: Audit minutes

4.19 International Oil Companies continued to employ expatriates on skill sets available locally due to inadequate regulation of the employment of expatriates. As a result, Kenyans nationals were denied employment and skills development opportunities. For example, during a visit to Block 10BB, the audit observed that Tullow B.V had employed on permanent basis, an expatriate holding the position of Field Facilities Management. This was a locally available skill and hence the position should not have been held by an expatriate.

4.20 The inadequate regulation of the employment of expatriates was attributed to a weak legal framework on local content. SDP relied on the Petroleum (Exploration and Production) Act, Revised Edition, 2012, which did not have enforcement mechanisms for local content. In addition, it was noted that there was no requirement for the State Department for Immigration to consult SDP when processing work permits. However, as at the time of finalizing this report, SDP was in the process of developing local content regulations.

2. Inefficient Systems to Ensure that Kenyans Benefit from the Training Fund

4.21 Section 11 of the Petroleum (Exploration and Production) Act, Revised Edition, 2012 require SDP to collect and utilize the training levy for purposes of enhancing capacity in the petroleum sector. However, the audit observed several inefficiencies, which denied Kenyans the opportunity to benefit from the Fund as discussed below.

a) Insufficient Collection of the Training Fees from International Oil Companies

4.22 Section 11 (1) of the Petroleum (Exploration and Production) Act, Revised Edition, 2012, establishes a Training Fund for the purpose of training Kenyan nationals in petroleum operations. In addition to employing Kenyans, where possible, Clause 13(2) of the Production Sharing Contract require contractors to pay an agreed amount of money, each contract year, being payment for training fees.

4.23 Interviews and documentary review revealed that some International Oil Companies had not submitted training fees as required in the signed Production Sharing Contracts. For the period 2015/16 to 2018/19, analytical review, of documents provided for audit, revealed that training fees arrears amounted to USD 6.7 million. **Table 5** shows the training fees arrears, owed to the State Department for Petroleum by various International Oil Companies, during the period under audit.

Table 5: *Arrears in Training Fees during the Period 2015/16 to 2018/19*

Company or Operator	Block No.	Arrears Owed in USD				TOTAL (USD)
		2015/2016	**2016/2017**	**2017/2018**	**2018/2019**	
AFREN OCTANT	1, L17, L18	375,000	375,000	375,000	175,000	**1,300,00**
SIMBA ENERGY	2A	175,000	175,000	175,000	175,000	**700,000**
A-Z PETROLEUM	L1A, L3	350,000	350,000	350,000	350,000	**1,400,00**
SOHI/ZARARA OIL & GAS	L4, L13	350,000	350,000	350,000	350,000	**1,400,00**
LAMU OIL & GAS	L14	0	175,000	175,000	175,000	**525,000**
RIFT ENERGY	L19	175,000	175,000	175,000	175,000	**700,000**
MILIO CASTAC	L20	175,000	175,000	175,000	175,000	**700,000**
TOTAL		**1,600,000**	**1,775,000**	**1,775,000**	**1,575,000**	**6,725,00**

Source: OAG analysis of SDP's documents

4.24 Clause 6(1)(a) of the model PSC provides for termination of a contract if the contractor fails to make any payment to the Government for a period exceeding one month. Documentary review revealed that SDP had not terminated any of the contracts for non-payment of training fees, despite the companies having arrears for up to four years. However, the audit revealed that SDP had written demand letters to the noncomplying companies. In line with Clause 34(2) of the PSC, a penalty is to be charged to a contractor for late payment of training fees. For International Oil Companies that had defaulted on payment of training fees, SDP had collected penalties amounting to Ksh. 994 million, during the period under audit.

4.25 The SDP did not have a defined procedure for collection of training fees and therefore relied on the model PSC as the sole guide. While the model PSC had a provision on payment of training fees, it did not outline a procedure to be followed by SDP during collection of the fees.

4.26 The non-payment of training fees denied the Government revenue which can be used to build local capacity in the oil and gas sector. Further, the State Department for Petroleum's inability to take a firm action on non-complying companies makes an impression of leniency, which creates room for future noncompliance.

b) Insufficient Utilization of the Training Fund

4.27 Section 11(1) of Petroleum (Exploration and Production) Act, Revised Edition, 2012, establishes a Training Fund for purposes of training Kenyan nationals in petroleum operations.

4.28 The audit revealed that SDP did not adequately utilize moneys collected into the Fund. Analytical review of annual reports and financial statements of the Petroleum Training Fund availed for audit revealed that receipts into the Fund amounted to Ksh. 2.6 billion, while expenditures amounted to Ksh. 1.48 billion, giving a utilization rate of 56% cumulatively, during the period under audit. However, from the data availed, discussions, representations from Ministry officials and information in the Financial Statements for the period as presented in the Annual Reports for audit the Training Levy Fund, had revenue training fees and surface fees consolidated as levies from IOCs.

4.29 Since we do not interrogate Financial Statements, our observations could not be limited to training fees which ideally should be the case but covered all revenues into and expenditures from the Training Fund account.

4.30 As detailed in **Table 6**, there has been a downward trend in utilization of the training fund. For instance, in 2016/17 the utilization rate was only 25%. However, it would be prudent to separate the figures pertaining to training fund to confirm actual expenditure. The insufficient utilization of the Training Fund was attributed to limited needs being presented during budgeting to absorb the money. Interviews with SDP staff revealed that expenditure from the Fund was based on the approved budget, which was informed by the needs presented during the budgeting period.

Table 6: *Utilization Rate of Training Fund Revenue During the Period 2015/16 to 2018/19*

Financial Year	Total Revenue (Ksh)	Expenditures (Ksh.)	% Utilization Rate
2015/16	621,093,038	650,928,996	105
2016/17	1,240,750,180	306,232,260	25
2017/18	539,653,567	381,676,415	71
2018/19	237,679,875	145,756,415	61
Total	2,639,176,660	1,484,594,086	56

Source: OAG analysis of SDP's documents

4.31 As a way of enhancing capacity in the petroleum sector, good practice requires SDP to provide technical expertise to other public sector employees in the sector and develop linkages with higher learning institutions; to ensure that petroleum courses being offered are market oriented. The audit revealed that the Fund was mainly used to enhance capacity for SDP staff, leaving out other key public sector stakeholders in the petroleum value chain. During the period under audit, out of the 61 courses sponsored through the Fund, 93% of the courses benefitted SDP staff.

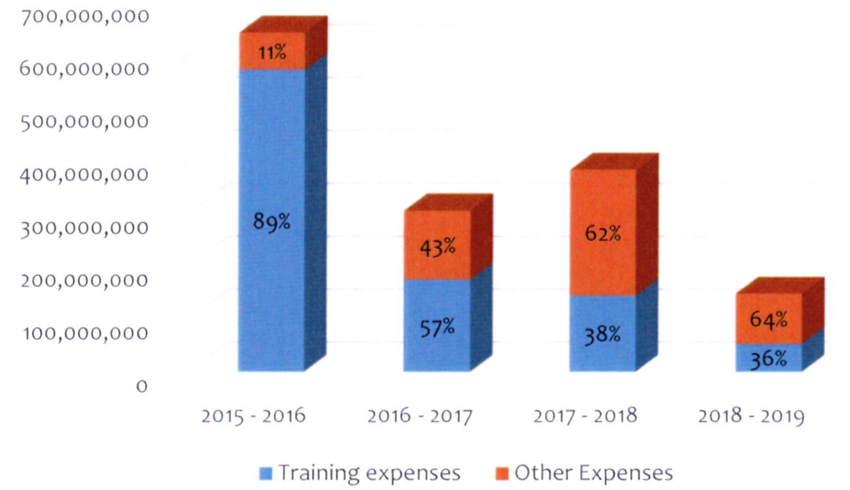
4.32 Further, the audit did not establish evidence of collaboration between SDP and higher learning institutions. However, interviews with SDP officials revealed that the Kenya Pipeline Corporation had established a middle level college, Morendat School of Oil and Gas, where courses on oil and gas are offered, to enhance technical capacity in the sector.

c) Revenue from the Training Fund was Spent on Non-Training Items Leading to a Decline on Expenditure on Training Over the Years

4.33 Section 11(4) of the Petroleum (Exploration and Production) Act, Revised Edition, 2012, states that all moneys from the Training Fund shall be used only for the purpose for which the Fund is created, that is, training Kenyan nationals on petroleum operations.

4.34 In addition to training government officers on various skills in the petroleum industry, interviews and document review revealed that SDP used monies from the Training Fund to procurement specialized equipment and offer grants to the National Oil Corporation of Kenya (NOCK). However, the expenditure on procurement of specialized equipment and grants to the National Oil Corporation of Kenya (NOCK) was voted for by parliament and should come from surface fees. As reported, this was also deposited in the Training Fund account. Consequently, the expenditure on training declined while that on non-training items increased during the audit period. During the period 2015/16 to 2018/19 analytical review of expenditures from the Fund revealed that expenditure on training declined from 89% to 36% of the total expenditure while that on non-training items increased from 11% to 64%, of total expenses, as shown in **Figure 4.**

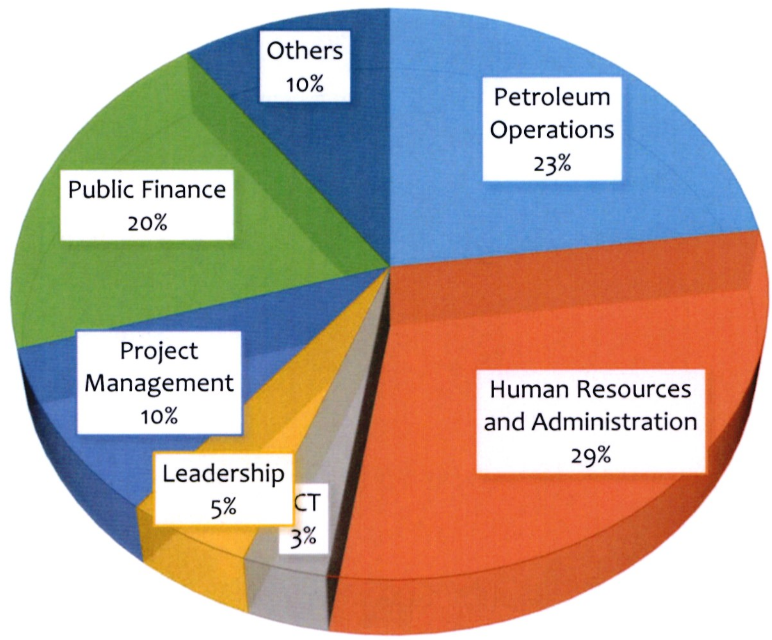
Figure 4: *Comparison of Expenditures from the Training Fund during the Years 2015/16 to 2018/19*



Source: OAG analysis of SDP's documents

4.35 Further, examination of annual reports and financial statements of the Petroleum Training Fund availed for audit revealed that SDP spent approximately Ksh. 944 million for training during the period under audit. Review of training reports covering the period 2016/17 to 2018/19 revealed that the government officers were trained on several skills set, including; Petroleum Operations, Public Finance and Human Resource Management, as shown in **Figure 5**. However, only 14 courses, representing 23% out of the 61 courses sponsored, were in Petroleum Operations, whereas 29% of the courses sponsored were in Human Resource Management and Public Administration. Some of the Human Resource Management and Administration skills in which officers were trained on included Secretarial Management, Office Management and Hygiene, Protocol and Event Management and Customer Care. These courses were not enhancing capacity in the petroleum sector, as they were not on technical aspects of the petroleum industry.

Figure 5: *Skill Areas in which SDP used the Training Fund to Sponsor Officers during the Years 2016/17 to 2018/19*



Source: OAG analysis of SDP's documents

4.36 The narrow selection of beneficiaries, mismatch of skills being developed and underutilization of the Fund cast doubt on SDP's preparedness to effectively collect and utilize monies collected into the Fund. The objective of the Training Fund, to develop skills in petroleum operations, may thus not be realised.

4.37 The insufficient utilization of the Training Fund and expenditure on non-training items was attributed to the fact that SDP had not developed regulations outlining how the Fund should be utilised. SDP relied on the Public Service Training Policy, which was general for the training of civil servants. Besides, SDP did not have a documented procedure on utilization of moneys from the Training Fund.

SDP's Response to Audit Findings

4.38 At the conclusion of the audit, the Office sent a management letter to SDP requesting for comments on the audit findings. The comments from SDP's management are presented in **Appendix 4.**

Chapter 5: Conclusion

5.1 The Government, through the State Department for Petroleum, has enacted the Petroleum Act, 2019 and the Energy Act, 2019. The Acts are expected to give a clear policy guideline on the implementation of local content in the oil and gas sector. New players, such as the Energy and Petroleum Regulatory Authority(EPRA) have been identified where the State Department will be left with the role of policy development and monitoring, to a limited extent. The monitoring role will be carried out in collaboration with the Energy and EPRA, established under Section 9 of the Energy Act, 2019.

5.2 However, as at the time of the audit, the State Department had not put in place adequate systems to manage local employment and training provisions. The State Department lacked adequate systems for monitoring the International Oil Companies' progress, in the implementation of the local employment provision. Besides, the State Department was not able to adequately regulate the employment of expatriates by International Oil Companies. In addition, the State Department did not have adequate systems to facilitate the collection and utilization of training fees. More specific conclusions include:

i) The State Department for Petroleum's ability to monitor the implementation of the local employment provision is hampered by three factors; the limited number of technical staff, non-availability of standard operating procedures and other important guiding documents, and inefficient records management. Moreover, the lack of local content enforcement mechanisms in the Petroleum (Exploration and Production) Act, Revised Edition, 2012, has hindered SDP's regulation of the employment of expatriates by International Oil Companies. Given the inadequacies, the ability of Kenyan nationals to benefit from employment in upstream petroleum operations is limited.

ii) The establishment of the Training Fund was a step towards enhancing the country's local capacity in the petroleum sector. However, the Fund was not well managed as evidenced by; non-submission of training fees dating back to several years, the narrow selection of beneficiaries, irregular expenditure on non-training items, and sponsorship for courses that are not petroleum-related. This has affected the Fund's ability to enhance the country's local capacity in petroleum operations.

Chapter 6: Recommendations

6.1 Based on the audit findings, the Auditor-General proposes the following recommendations, to improve the management of the implementation of local employment and training provisions.

I. To address the inadequacies in monitoring and enforcement of local employment provision, the State Department for Petroleum should: -

i) Work closely with the Public Service Commission to recruit more technical staff;

ii) Fast track the operationalization of the Electronic Data Management System;

iii) Develop and implement standard operating procedures for monitoring the operations of International Oil Companies;

iv) Develop and implement mechanisms to enhance consultation with the State Department of Immigration, during the processing of work permits; and

v) Fast track the development of the Petroleum Policy and related regulations.

II. For efficient management of the Training Fund, the State Department for Petroleum should: -

i) Come up with stringent measures for enforcing Clause 13 (2) of the Production Sharing Contract, on payment of training fees;

ii) Develop and implement standard operating procedures for the collection of training fees; and

iii) Develop and implement regulations on management of the Training Fund, separated from other fees.

Appendices

Appendix 1: List of International Oil Companies and respective blocks of operation

	Name of Company	Exploration blocks	Total number of blocks
1	AFREN/EAX/OCTANT	L17/L18, 1	2
3	A-Z PETROLEUM	L1A, L3	2
5	ENI E&P HOLDINGS	L11A,L11B,L12,L21, L23,L24	6
6	FAR Ltd	L6	1
7	LAMU OIL & GAS	L14	1
8	NOCK	14T	1
9	PACIFIC SEABOARD/MILIO	L20	1
10	RIFT ENERGY	L19	1
11	SIMBA ENERGY	2A	1
12	TULLOW OIL	10BA,10BB,12B, 13T	4
13	DELONEX	12A	1
14	ZARARA OIL & GAS	L4, L13	2
Total			**23**

Source: SDP's records on exploration blocks

Appendix 2: Methods of Collecting Evidence

c) Documents Reviewed

To understand the roles and responsibilities of the State Department for Petroleum the following documents were reviewed.

S/N	DOCUMENT REVIEWED	REASONS
1	Petroleum (exploration and production) Act, Revised Edition 2012	To understand the laws, policies and regulations governing the management of local employment and training provisions.
3	Ministry of Energy Strategic Plan, 2013-2017	To understand the Ministry's mission , vision, objectives, strategies, outcomes and performance benchmarks.
4	SDP's audited financial statements	To obtain information on how SDP is funded and their expenditures with regards to monitoring of operations and utilization of the Training Fund.
5	Petroleum exploration blocks correspondence files	To obtain the information on the levels of compliance with local employment and training provisions. To obtain information on SDP's monitoring of IOCs compliance with local employment and training provisions.
6	Model Production Sharing Contracts	To understand the contractual obligations on local employment and training.
7	Training reports	To gather information on the staff sponsored by the Training Fund.
8	Human Resources documents	To obtain information on the staffing levels at SDP.
9	Training Fund collection data	To obtain information on IOC's submission of the training levy.
10	IOCs Human Resources documents	To obtain information on employment of Kenyan citizens by IOCs.

d) Persons Interviewed and purpose for the Interview

To understand the roles and responsibilities of the State Department for Petroleum, the following personnel were interviewed.

PERSON'S INTERVIEWED	PURPOSE OF THE INTERVIEW
Officers from the Technical Department	To get an understanding on how the Technical Department monitors the implementation of local employment and training provisions in the PSCs.
Officers from SDP's Finance and Accounts sections	To get an understanding of the sources of funding for monitoring of local employment and training provisions. To obtain information on the receipts and expenditures from the Training Fund.
Director, Human Resources	To get an understanding of SDP's staffing levels as well as utilization of the Training Fund.
IOCs Management	To gather information on progress and challenges in the implementation of local employment and training contractual obligations.

Appendix 3: Stakeholders of the State Department for Petroleum

STAKEHOLDER	ROLE
National Oil Corporation of Kenya (NOCK)	In charge of petroleum exploration and marketing.
Energy and Petroleum Regulatory Authority	Monitoring and regulation of petroleum operations.
Energy and Petroleum Tribunal	Arbitrates on disputes between the Energy and Petroleum Regulatory Authority and aggrieved stakeholders.
National Fossil Fuel Advisory Committee (NAFFAC)/ National Upstream Petroleum Advisory Committee (NUPAC)	Advisory on licensing of International Oil Companies.
Other ministries and departments	Implementation of projects, resource mobilization & facilitation and the development of the necessary institutional, legal and regulatory framework in the petroleum sector.
County Governments	Enacting County bills relating to petroleum.
Learning Institutions	Petroleum skills development.
Development partners; Foreign governments, financial institutions, exploration companies etc.	Provide both financial and non-financial resources towards the development of the petroleum sector.
Civil Society	Advocating for the rights of host communities.
International Oil Companies (IOCs)	Exploration and development of petroleum exploration.
Parliament	Enacting laws and representing the greater Kenyan community.
Community	Providing local resources such as land. Benefits from exploration and production of petroleum resources.

Appendix 4: SDP's Management Response on Audit Findings

Ref. No.	Audit Observation	SDP Management response	OAG's Response
1(a) Inadequate monitoring of the progress in the implementation of the local employment provision			
Par. 4.3	Tullow Oil B.V workforce constituted of more Kenyans than expatriates. 90% of Tullow workforce was subcontracted and the company did not provide any data of its sub-contractors.	Tullow has a list of all sub-contractors that it sub-contracted. The list can be shared since it is an obligation under PSC if required. As stated in the report that Tullow Oil B.V workforce constituted of more Kenyans than expatriates, hence local employment requirement is achieved.	The finding is about the data on employees of sub-contractors, which was not provided. Instead Tullow Oil B.V provided a list of its subcontractors. The finding remains as reported.
Par. 4.4	Lack of physical monitoring of IOCs implementation of employment and training provisions. SDP neither provides feedback on submitted reports nor makes a follow up for submission of the reports.	Petroleum Local Content Regulations have been drafted. Once finalised they will provide the framework for local content as required under the Petroleum Act, 2019. During work program and budget presentation meetings, oil companies report on local employment. Feedback is normally given in such meetings.	The Office's understanding is that International Oil Companies submit progress reports, which SDP is expected to review and provide feedback. Hence, feedback given during presentation of work programmes cannot be treated as feedback on submitted progress reports. The finding remains as reported.
Par. 4.5	Lack of submission of local employment plans and training programmes to be used to measure performance against the reports submitted.		
Par. 4.6	Lack of a standard format for reporting on IOCs' progress on implementation of local employment and training provision.	SDP is currently developing standards and procedures for reporting formats. The new Petroleum Act was enacted in 2019. SDP is in the process of preparing and developing policies, regulations and standard operating procedures for monitoring International Oil Companies.	The finding remains as reported since the situation is still as was observed during the audit. However, the new developments are noted in paragraph 4.11.

Ref. No.	Audit Observation	SDP Management response	OAG's Response
Par. 4.8	***Causes of inadequate monitoring***		
Par. 4.9	Insufficient number of technical staff for monitoring the operations of International Oil Companies. SDP had only 18 out of the 138 approved technical staff.	More technical staff have been recruited and recruitment is also ongoing. So far, more than 30 technical staff have been recruited. Data relating to staff establishment was provided to the auditors during fieldwork.	The new developments are noted in the finding.
Par. 4.11	Lack of regulation on enforcement of local employment and training provisions	Local content regulations, standards and procedures currently being developed.	The new developments as pertains local content regulations have been noted. However, SDP has not provided any evidence regarding development of standard operating procedures.
iii)Par. 4.13	Inefficient records management SDP did not have an integrated electronic database, instead uses manual filling	An Electronic Data Management System has been developed and is being operationalised. The system will continue being improved to meet the requirements of SDP.	The new developments are noted in the finding.
	1(b) Inadequate regulation of the employment of expatriates by International Oil Companies		
Par. 4.15	Lack of correspondence between the State Departments for Petroleum and Immigration on work	There is consultation between the two state departments as all the work permits are approved by the State Department for Immigration. SDP has a dedicated desk officer who solely deals with exemptions to work permits and as such the officer scrutinizes the CVs of the expatriates since CV's for the expatriates are normally attached to work permit application.	In the documents provided in the response, annex 9a & 9b are forwarding letters from the State Department for Petroleum to the State Department for Immigration. Just as captured in

Ref. No.	Audit Observation	SDP Management response	OAG's Response
	permit application of expatriates. Work permit application by International Oil Companies did not have information on qualifications and job descriptions for expatriates.		the finding, the two annexures do not evidence any consultation during the processing of work permits. Besides, the documents are dated 2012, which is outside of the audit period. The finding remains as reported.
Par. 4.16	Jobs on skills available in the country have been taken up by expatriates. The skills include; Supply Chain Management, Security Advisor, Environmental Health and Safety and Field Facilities Manager.	Oil and gas business require highly skilled and experienced personnel who are not available in Kenya. However, the World Bank has provided SDP with funding through KEPTAP that has facilitated training of Kenyans and in the near future the skills will be available in the country.	While the Office agrees with SDP that oil and gas business require highly skilled personnel, the Office does not agree that Kenya does not have highly skilled personnel in areas such as Supply Chain Management, Security Advisor, Environmental Health and Safety and Field Facilities Manager. The finding remains as reported.
Par. 4.17	Lack of succession plans documentation by International Oil Companies and no follow up made by the State Department for Petroleum to ensure compliance.	Development of local content regulations that include technology transfer and succession plan is ongoing.	The developments are noted in paragraph 4.19.

Ref. No.	Audit Observation	SDP Management response	OAG's Response
Par. 4.19	***Causes of inadequate regulation on the employment of expatriates***		
	Weak legal framework on local content.	The Petroleum Act, 2019 has more provisions on local content. Local Content Regulations have been developed.	The developments are noted in the finding.
	There is no requirement for consultation between the State Department for Immigration and the State Department for Petroleum when processing work permits.	The directorate has a dedicated desk officer who deals with work permits in consultation with the State Department for Immigration. There is consultation between the two state departments as all the work permits are approved by the State Department for Immigration.	The finding remains as reported. The report is referring to a lack of legal requirement for consultation between the State Department for Petroleum and State Department for Immigration during processing of work permits.
2(a) Insufficient collection of training fees from International Oil Companies			
Par. 4.22	Failure of International Oil Companies to submit training fees resulting in arrears amounting to USD 6.7 million. Table 4- Training fee arrears for the years 2015 to 2019 for each IOC.	Most companies that comply with the PSC provision on training pay all the fees as required. However, the fluctuating crude oil prices resulted in companies scaling down operations and budgets. As stated in the audit report, demand letters have been written for non-complying companies and penalties amounting to Ksh. 994 million collected.	The Office's understanding is that since the companies did not surrender the blocks following fluctuating crude oil prices, they were obligated to submit the required annual statutory fees. Besides, SDP has not provided any evidence that it granted IOCs a moratorium. The finding remains as reported.

Ref. No.	Audit Observation	SDP Management response	OAG's Response
Par. 4.23	SDP has not terminated any contract for non-payment of surface fees and training fees. However, demand letters have been written for non-complying IOCs and penalty amounting to Ksh. 994 million collected.	SDP has terminated some contracts, for instance, Block L26, L2 contract was terminated due to non-compliance with the PSC provisions.	A look at Annexures 11a & 11b documents shows that the contract for blocks L26, L2 were terminated mainly due to the contractor's inability to deliver on work programmes. Table 4 has IOCs with arrears for the entire audit period, but still have their contracts intact. The finding remains as reported.
Par. 4.24	Lack of a defined procedure for collection of training fees. SDP relies on PSCs, which have no procedures to be followed on collection of fees.	Systems and standard operating procedures are currently being developed in addition to the development of Upstream and Midstream regulations under the Kenya Petroleum Technical Assistant Project (KEPTAP).	The new developments as pertains upstream petroleum regulations have been noted. However, SDP has not provided any evidence regarding the development of standard operating procedures. The finding remains as reported.
Par. 4.25	***Effect of insufficient collection of training fees from International Oil Companies***		
	The Government is denied revenue that can be used to build local capacity in Oil and Gas sector. Inability to take a firm action against non-complying IOCs creates	Most companies that comply with their PSC pay all the fees as required. However, the fluctuating crude oil prices resulted in companies scaling down operations and budgets. As stated in the audit report, demand letters have been written for non-complying IOCs and penalties amounting to Ksh. 994 million collected.	USD 6.7 million, which was in arrears is a significant amount of revenue denied to the Government. The finding remains as reported.

Ref. No.	Audit Observation	SDP Management response	OAG's Response
	room for future non-compliance.		
2(b) Insufficient utilization of the Training Fund			
Par. 4.27	Inadequate utilization of the Training Fund with a utilization of 56% cumulatively. Expenditure was based on approved budget, which was informed by needs presented during the budgeting period.	The amount in the Training Fund are to be utilized over a period of years and not in one financial year. The Petroleum (Exploration and Production), Training Fund Regulations, 2006 clause 8 stipulate that all receipts, savings and accruals to the Fund and the balance of the Fund at the end of each financial year shall be retained for purposes for which the Fund is established. This is also attributed by late approval of training projection by PSCs.	The training fee is paid by IOCs annually, hence the Office's expectation is that the absorption rate should be higher. Besides, SDP has not provided any documented long-term plan to show that the State Department has a plan to utilize the funds over a given period of years. The finding remains as reported.
Par. 4.28	Lack of capacity building for other key public sector stakeholders in the petroleum value chain. Lack of collaboration between SDP and higher learning institutions.	The objective and the purpose for which the Fund was established is to finance the training of Kenyans in petroleum operations. Requests for training from officers from other government agencies that are within petroleum operations have also been received and officers trained. SDP through Kenya Petroleum Technical Assistance Programme (KEPTAP) is involved in capacity building for government ministries and agencies involved in the oil and gas sector. It has over 21 agencies including Civil Society Organizations whose members of staff have benefitted from capacity building.	The finding remains as reported. The audit is on the Training Fund and not KEPTAP. The evidence provided by SDP clearly shows that 93% of the courses sponsored by the Fund solely benefitted SDP staff.
2(c) Revenue from the Training Fund was Spent on Non-Training Items Leading to a Decline on Expenditure on Training Over the Years			

Ref. No.	Audit Observation	SDP Management response	OAG's Response
Par. 4.30	Irregular use of the Training Fund to procure specialized equipment, pay salaries to staff and grants to the National Oil Corporation of Kenya (NOCK).	Use of the Training Fund is clear in the Act and regulations, which are strictly adhered to. The Petroleum Training Fund consists of surface fee and training fee paid by IOCs. Surface fees is used in procurement of software and specialised equipment used in the exploration phase. According to printed estimates for development account, SDP should issue grants to NOCK from royalties, that is surface fees, to finance petroleum exploration activities in Block 14T which is state owned. The accounting officer authorized payment of salaries of staff under KEPTAP from the Petroleum Training Fund due to projects account being frozen by National Treasury. The amounts paid from the Training Fund have since been paid back by KEPTAP to the Fund.	Section 11 (1) of the Petroleum (Exploration and Production) Act, Revised Edition 2012, established a Training Fund for the purpose of training Kenyan nationals in petroleum operations. Further, Section 11(4) of the Act states that all moneys from the Training Fund shall be used only for the purpose for which the Fund is created. The office has taken into consideration the comments and amended the finding so that the expenditure is not treated as irregular. Though authorised, utilization of revenue from the Training Fund on non-training items has had an impact on allocation of funds for training expenses. Hence, the observation remains as reported.
Par. 4.31	Inadequate reports on officers trained presented for audit.	Reports of officers trained are hereby provided.	The new information has been considered and incorporated in the finding.
	Use of the Training Fund to enhance non-technical skills capacity rather than technical skills capacity in	The Training Fund is utilized to train and develop skills in the petroleum value chain and build capacity in the entire sector. The value chain consists of both technical and non-technical skills.	Section 11 (1) of the Petroleum (Exploration and Production) Act, Revised Edition 2012, established a Training Fund for the purpose of training Kenyan

Ref. No.	Audit Observation	SDP Management response	OAG's Response
	petroleum operations, which is presumed to be the purpose of the Training Fund.	Both technical and non-technical officers in the SDP work together as a team to achieve the State Department's objective.	nationals in petroleum operations. The Office's understanding is that the purpose for which the Fund was created was to bridge the petroleum skills gap in the country. As such, sponsoring courses such as Customer Care does not amount to building skills in petroleum operations. The finding remains as reported.
Par. 4.32	The Training Fund had narrow selection of beneficiaries and mismatch of skills.	The Training Fund has benefited not only technical staff in SDP, but is widen to train officers from other sectors involved in oil and gas, such as; Kenya Revenue Authority (KRA), National Environment Management Authority (NEMA, Attorney General's Office, National Treasury and Office of the Auditor-General (OAG). Information on beneficiaries is attached.	The evidence provided by SDP clearly shows that 93% of the courses sponsored by the Training Fund during the period under audit solely benefitted SDP staff. The finding remains as reported.
Par. 4.32	The State Department for Petroleum lacks preparedness to effectively utilize the Training Fund.	The Public Service has recognised the need to fill positions approved in the establishment and expanded the technical team from 18 to 44. As the number of technical officers increase and petroleum function activities increase, the absorption of the Petroleum Training Fund will exceed the current figure. The Training Fund has been well managed and training has been conducted to various government officers within the petroleum value chain and the sector as listed above.	The capacity being referred to in the report is about having systems in place for effective management of the Fund. The finding remains as reported.

Ref. No.	Audit Observation	SDP Management response	OAG's Response
		SDP staff establishment has increased from 18 to 44 officers with various key vacant post being filled up as per approved staff establishment. Hence, SDP has an adequate capacity to effectively manage and utilize the Fund.	
Par. 4.33	***Causes of inefficient and irregular utilization of the Training Fund***		
	There is no regulation developed by SDP on utilization of the Fund. Lack of documented procedures on utilization of money from the Fund. Reliance on Public Service Training Policy which is general for Public Servants	Regulations, standards and procedures are currently being developed. All monies drawn from the Training Fund were approved by the Accounting Officer and proper financial management procedures according to the Public Financial Management Act, 2012 were compiled to. Whereas Public Service Training Policies and regulations are the guiding training and development documents, each individual case is dealt with according to merit and relevance to the petroleum function. The Ministerial Human Resource Advisory Committee (MHRMAC) is mandated to handle all Human Resource Management and Development maters. In view of this, Petroleum Fund requests have always been processed through MHRMAC. • If an officer is scheduled for a Petroleum Fund sponsored course but also gets KEPTAP sponsorship for the same or different course or training programme, KEPTAP takes preference, due to Bilateral relations. KEPTAP will wind up in early 2021. • As the number of technical officers increases and petroleum function activities increase in the field, absorption of the Petroleum Fund will exceed the current figure.	The report is referring to a documented procedure which would provide guidance on what type of courses to sponsor. The Office's understanding is that the Public Service Training policy provides an overall guidance for training officers in the public sector. However, SDP needed to have developed a fund specific policy or regulations to guide it in utilizing monies from the Fund. The finding remains as reported.

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