

# **REPORT OF THE AUDITOR-GENERAL ON SCHOOL EQUIPMENT PRODUCTION UNIT FOR THE YEAR ENDED 30 JUNE, 2023**

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## **PREAMBLE**

I draw your attention to the contents of my report which is in three parts:

- A. Report on the Financial Statements that considers whether the financial statements are fairly presented in accordance with the applicable financial reporting framework, accounting standards and the relevant laws and regulations that have a direct effect on the financial statements.
- B. Report on Lawfulness and Effectiveness in Use of Public Resources which considers compliance with applicable laws, regulations, policies, gazette notices, circulars, guidelines and manuals and whether public resources are applied in a prudent, efficient, economic, transparent and accountable manner to ensure Government achieves value for money and that such funds are applied for the intended purpose.
- C. Report on the Effectiveness of Internal Controls, Risk Management and Governance which considers how the entity has instituted checks and balances to guide internal operations. This responds to the effectiveness of the governance structure, the risk management environment and the internal controls, developed and implemented by those charged with governance for orderly, efficient and effective operations of the entity.

An unmodified opinion does not necessarily mean that an entity has complied with all relevant laws and regulations and that its internal controls, risk management and governance systems are properly designed and were working effectively in the financial year under review.

The three parts of the report are aimed at addressing the statutory roles and responsibilities of the Auditor-General as provided by Article 229 of the Constitution, the Public Finance Management Act, 2012 and the Public Audit Act, 2015. The three parts of the report, when read together constitute the report of the Auditor-General.

## **REPORT ON THE FINANCIAL STATEMENTS**

### **Qualified Opinion**

I have audited the accompanying financial statements of School Equipment Production Unit set out on pages 1 to 23, which comprise the statement of financial position as at 30 June, 2023, and the statement of profit or loss and other comprehensive income, statement of changes in equity, statement of cash flows and statement of comparison of budget and actual amounts for the year then ended, and a summary of significant accounting policies and other explanatory information in accordance with the provisions of Article 229 of the Constitution of Kenya and Section 35 of the Public Audit Act, 2015. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit.

In my opinion, except for the effect of the matters described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material

respects, the financial position of the School Equipment Production Unit as at 30 June, 2023, and its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Companies Act, 2015, and the Public Finance Management Act, 2012.

## **Basis for Qualified Opinion**

### **1. Encroachment on the Unit's Land**

As previously reported, the statement of financial position reflects property, plant and equipment balance of Kshs.110,305,296 as disclosed in Note 13 to the financial statements. Included in the balance is land parcel with historical cost of Kshs.63,000,000 situated at Industrial Area, Nairobi allocated to the Unit in 1996. However, the land parcel is yet to be developed due to encroachment by informal settlers. Management has however sought assistance from the National Land Commission in order to develop the land. No response has been provided to indicate the progress made in reclaiming the land parcel by the end of the year.

In the circumstances, ownership and fair statement of the property, plant and equipment balance of Kshs.110,305,296 could not be confirmed.

### **2. Unsupported Long Outstanding Trade Receivables**

As previously reported and as disclosed in Note 15 to the financial statements, the statement of financial position reflects receivables and prepayments net balance of Kshs.102,804,148 which includes trade receivables amounting to Kshs.28,531,621, out of which of Kshs.27,971,058 or 94% has been outstanding for more than ten (10) years. However, no supporting documents were provided for audit review. Further, as disclosed in the same Note, the trade receivables balance includes Kshs.75,086,881 due from the Ministry of Education, State Department for Early Learning and Basic Education and has been outstanding since the financial year 2018/2019 but is not reflected as a pending bill in the State Department's financial statements for the year ended 30 June, 2023.

Further, the trade receivables balance includes staff advances balance of Kshs.1,207,650, out of which an amount of Kshs.840,484 or 70% relates to staff advances due from employees who have since left the service or are deceased.

Note 15 to the financial statements also discloses reduction in provision for bad and doubtful debts from Kshs.30,413,424 in the prior year to Kshs.2,022,004 which represents a decrease of Kshs.28,391,420. However, the write back of the provisions of Kshs.28,391,420 was not recognized in the statement of changes in net equity or supported. No explanation was provided for the material adjustment of the provisions for bad and doubtful debt.

Management has further, indicated that a fire broke out at the Company's Headquarters in 2007 and destroyed supporting schedules relating to receivables. As a result, recovery of debtors is unlikely as it has been affected by lack of evidence.

In the circumstances, the accuracy and full recovery of the receivables and prepayments balance of Kshs.102,804,148 could not be confirmed.

### **3. Unsupported Long Outstanding Trade and Other Payables**

As previously reported, the statement of financial position reflects trade and other payables balance of Kshs.16,809,140 as disclosed in Note 22 to the financial statements. The balance includes trade payables balance of Kshs.11,187,790, out of which a balance of Kshs.7,209,566 or 64% has been outstanding for between fifteen (15) and twenty-seven (27) years and whose supporting documents were not provided for audit. Management indicated that a fire broke out in the Company's Headquarters in 2007 and destroyed supporting schedules relating to the accounts payable. Management had also placed advertisement in the daily newspapers in November, 2016 to inform relevant creditors to present documents supporting the services offered to the Company but with little success.

Further, the balance includes accrued retirement benefits (pensions), provision for dividend to The National Treasury, gratuity for pension scheme, provision for corporate tax and M. Korongo & Advocates of Kshs.816,066, Kshs.1,500,000, Kshs.1,404,070 and Kshs.70,711 respectively but there have been no movement over the last twenty-four (24) months.

In the circumstances, the accuracy, and fair statement of the trade and other payables balance of Kshs.16,809,140 could not be confirmed.

### **4. Deferred Special Grant**

As previously reported, the statement of financial position reflects deferred special grant balance of Kshs.44,167,394 as disclosed in Note 21 to the financial statements which has been in the books for over three (3) years. Management has not explained why the grant has remained deferred for over a long time.

In the circumstances, the accuracy, presentation and disclosure of the deferred special grant balance of Kshs.44,167,394 could not be confirmed.

### **5. Expired Inventories**

The statement of financial position reflects inventories balances of Kshs.30,959,810 as disclosed in Note 14 to the financial statements which includes chemical inventories worth Kshs.1,103,488. However, included in Kshs.1,103,488 is chemical inventories balance of Kshs.50,625 which had expired but not written off.

In the circumstances, the accuracy and completeness of inventories balance of Kshs.30,959,810 could not be confirmed.

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

## **Key Audit Matters**

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

## **Other Matter**

### **Unresolved Prior Year Matters**

In the audit report of the previous year, several issues were raised under the Report on Financial Statements, Report on Lawfulness and Effectiveness in Use of Public Resources and Report on Effectiveness of Internal Controls, Risk Management and Governance. However, the Management had not resolved the issues or given any explanation for failure to implement the recommendations.

## **REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES**

### **Conclusion**

As required by Article 229(6) of the Constitution, based on the audit procedures performed, except for the matter described in the Basis for Conclusion on Lawfulness and Effectiveness in Use of Public Resources section of my report, I confirm that, nothing else has come to my attention to cause me to believe that public resources have not been applied lawfully and in an effective way.

### **Basis for Conclusion**

#### **Unsurrendered Excess Receipts**

The statement of comparison of budget and actual amounts reflects actual sale of goods and budget amounts of Kshs.36,011,721 and Kshs.35,000,000 respectively, resulting to excess revenue amounting to Kshs.1,011,721 and which was not surrendered to The National Treasury. This was contrary to Regulations 117(1)(2) of the Public Finance Management (National Government) Regulations, 2015 which requires the Accounting Officer to surrender unutilized resources to The National Treasury and The National Treasury shall ensure that the funds are re-voted for the project in the following financial year in order to continue the implementation of the project.

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

The audit was conducted in accordance with ISSAI 4000. The standard requires that I comply with ethical requirements and plan and perform the audit to obtain assurance about whether the activities, financial transactions and information reflected in the financial statements are in compliance, in all material respects, with the authorities that govern them. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

## **REPORT ON THE EFFECTIVENESS OF INTERNAL CONTROLS, RISK MANAGEMENT AND GOVERNANCE**

## **Conclusion**

As required by Section 7(1)(a) of the Public Audit Act, 2015, based on the audit procedures performed, except for the matters described in the Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance section of my report, I confirm that, nothing else has come to my attention to cause me to believe that internal controls, risk management and governance were not effective.

## **Basis for Conclusion**

### **1. Poor Inventory Controls and Stores Management**

As reported in the previous year, the statement of financial position reflects a balance of Kshs.30,959,210 in respect of inventories as disclosed in Note 14 to the financial statements. However, review of the inventories management controls in place revealed the following weaknesses;

- i. Lack of ledger or bin cards as well as reconciliation of stocks to ascertain stock movement.
- ii. No policy on management of stock levels such as re-order levels to prevent wastage, losses, stock outs and unprofitable lock-up of funds.
- iii. No segregation of duties in main stores whereby the officer receiving either finished or raw materials is the same officer issuing or dispatching.

In the circumstances, the existence of an effective inventory management internal control system to safeguard losses, wastage, and theft of stocks could not be confirmed.

### **2. Lack of an Automated Accounting System**

As previously reported, the Unit did not have either an automated accounting system, an ICT Committee or an ICT Policy. This might lead to loss of revenue due to lack of a proper accounting system and lack of accountability of funds since there is no electronic trail of expenditure. This was contrary to Section 4 (4.4) of the National ICT Policy Guidelines, 2020 on public service delivery which states that 'the ICT Policy requires all arms of the Government to build, deploy, operate and manage locally built back-end and front-end systems to deliver services'.

In the circumstances, the effectiveness of internal controls systems and risk management of the Unit's accounting system could not be confirmed.

### **3. Lack of an IT Strategic Committee and an IT Steering Committee**

The Unit did not have an IT strategic committee and an IT steering committee in place, contrary to Section 6.2 of the IT Governance Standard by ICT Authority on ICT Governance. The absence of a strategic committee may lead to deficiency in planning, controls and oversight on IT spending and allocation of costs while the absence of an IT steering committee means the needs of the IT department may not be addressed at budgeting stage. In addition, without IT strategic and steering committees, the Unit may not identify potential security problems and mitigate these IT issues.

#### **4. Understaffing of the Unit**

The statement of profit or loss and other comprehensive income reflects staff costs amount of Kshs.41,733,009 as disclosed in Note 7 to the financial statements. Further, the staff establishment list provided for audit revealed staff-in-post of forty-nine (49) against an approved establishment of one hundred and twelve (112), resulting to understaffing of sixty-three (63).

Lack of adequate human labour may negatively affect service delivery and the organizational goals including unachieved targets.

The audit was conducted in accordance with ISSAI 2315 and ISSAI 2330. The standards require that I plan and perform the audit to obtain assurance about whether effective processes and systems of internal controls, risk management and overall governance were operating effectively, in all material respects. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

#### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

As required by Kenya Companies Act, 2015, I report based on my audit, that:

- i. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit;
- ii. In my opinion, adequate accounting records have been kept by the Unit, so far as appears from the examination of those records; and,
- iii. The Unit's financial statements are in agreement with the accounting records and returns.

#### **Responsibilities of Management and Board of Directors**

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

In preparing the financial statements, Management is responsible for assessing the Unit's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless Management is aware of the intention to liquidate the Unit or cease its operations.

Management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 47 of the Public Audit Act, 2015.

In addition to the responsibility for the preparation and presentation of the financial statements described above, Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them, and that public resources are applied in an effective way.

The Board of Directors is responsible for overseeing the Unit's financial reporting process, reviewing the effectiveness of how Management monitors compliance with relevant legislative and regulatory requirements, ensuring that effective processes and systems are in place to address key roles and responsibilities in relation to overall governance and risk management, and ensuring the adequacy and effectiveness of the control environment.

### **Auditor-General's Responsibilities for the Audit**

The audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement and weakness when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

In addition to the audit of the financial statements, a compliance audit is planned and performed to express a conclusion about whether, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities that govern them and that public resources are applied in an effective way in accordance with the provisions of Article 229(6) of the Constitution and submit the audit report in compliance with Article 229(7) of the Constitution.

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

Because of its inherent limitations, internal controls may not prevent or detect misstatements and instances of non-compliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become

inadequate because of changes in conditions, or that the degree of compliance with policies and procedures may deteriorate.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Unit's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit report. However, future events or conditions may cause the Unit to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Unit to express an opinion on the financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

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



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



**FCPA Nancy Gathungu, CBS**  
**AUDITOR-GENERAL**

**Nairobi**

**25 March, 2024**