

REPORT OF THE AUDITOR-GENERAL ON AGRICULTURE DEVELOPMENT CORPORATION FOR THE YEAR ENDED 30 JUNE 2017

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying consolidated financial statements of Agricultural Development Corporation (ADC) set out on pages 1 to 31, which comprise the consolidated statement of financial position as at 30 June 2017, and the consolidated statement of financial performance, statement of changes in net assets, statement of cash flows and statement of comparison of budget and actual amounts for the year then ended, and a summary of significant accounting policies and other explanatory information in accordance with the provisions of Article 229 of the Constitution of Kenya 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 effects 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 Agricultural Development Corporation and its Subsidiary as at June 30, 2017, and of their financial performance and cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (Accrual Basis) and comply with the Public Finance Management Act, 2012.

In addition, as required by Article 229(6) of the Constitution, based on the audit procedures performed, I confirm that, except for the matters described in the Basis for Qualified Opinion and Other Matter sections of my report, nothing has come to my attention to cause me to believe that public money has not been applied lawfully and in an effective way.

Basis for Qualified Opinion

1. Property, Plant and Equipment

(i) Repossessed Land

As reported in the previous year, property, plant and equipment balance of Kshs.684,283,000 as at 30 June 2017 includes farms managed by the Corporation valued at Kshs.37,910,000. These farms, referred to as ADC Private Forest Ndabibi L.R. 7281/3 & 20591/86 relates to 4,000 acres of land re-possessed from allottees who had been unable to pay allotment fees. In addition, land L.R. No.20591/86 in Ndabibi and the parcel in Molo do not have ownership documents including title deed, while LR 7281/3 has been encroached on by squatters although the Corporation has secured the title deed. Further, and according to information available, the process of exchanging 700 acres in Molo with 1,000 of the Corporation's land at Ndabibi had not

been finalized as at 30 June 2017. In the absence of title deeds for the land in Molo and in Ndabibi, it has not been possible to confirm their ownership.

(ii) Home Farm Land

As reported also in the previous year, the Corporation's land net book value of Kshs. 521,513,000 as at 30 June, 2017 disclosed under Note 22(a) excludes the value of land L.R. No.10668 measuring about 2,908.42 acres known as Home Farm. Further, the Corporation does not have ownership documents to this parcel of land. It is also not clear and the management has not explained how the home farm parcel of land was allocated to private developers in year 1994 and the effect on the operations of the Corporation in fulfillment of its mandate.

(iii) Garissa Irrigation Project Land

The property, plant and equipment balance of Kshs. 684,283,000 as at 30 June 2017 still exclude the value of land measuring 319.4 hectares located in Garissa Municipality whose value has not been determined, despite a disclosure under Note 19 to the financial statements for 2015/2016 that the unit's assets were merged and included in the Corporation's financial statements.

In view of the foregoing, the completeness and accuracy of property, plant and equipment balance of Kshs. 684,283,000 cannot be ascertained.

2. Capital Work in Progress

As reported in the previous year and as highlighted under Note 22 (c) to the financial statements, the capital work-in-progress balance of Kshs. 553,618,000 as at 30 June, 2017 includes a construction project at Suam Orchards farm in Kitale valued at Kshs. 9,978,000 that was started in 2006. In addition, the capital-work –in progress includes an amount of Kshs. 4,899,287 relating to projects that have remained idle for the last six (6) years. In the circumstances, I am unable to confirm the carrying value of the capital work-in-progress reflected in the financial statements of Kshs. 553,618,000 as at June 2017.

3. Investments

The investment balance of Kshs.467,283,000 reflected in the statement of financial position as at 30th June 2017 includes amounts relating to investments in shares held in Chemelil Sugar Co. Ltd Kshs.203,592,000, Development House Kshs.90,251,000, Muhoroni Sugar Company Kshs.41,342,000, Kenya Co-operative Creameries Kshs.4,151,000, Kenya Grain Growers' Co-op Union Kshs.1,404,000, Kenya Seed Company Ltd Kshs.114,014,000, Pyrethrum Board of Kenya Kshs.36,000, Kenya Planters' Co-op Union Kshs.31,000 and Agro-Chemical and Food Ltd 16,900,000, which were acquired between 1975 and 1995.

Information available indicates that Muhoroni Sugar Company, Kenya Grain Growers Co-op Union and Kenya Planters Co-op Union with investments totalling Kshs.42,777,000 are either in receivership or liquidation. In addition, Chemelil Sugar Company and the Agro-Chemical & Food Company with an investment totalling Kshs.220,492,000 have been making losses and have not paid dividend for a considerably long time. The value of the investments in these companies is, therefore, doubtful and may not be recovered. However, no provision has been made in the financial statements for the likely diminution in value of the investments.

4. Biological Assets

(i) Valuation

The consolidated statement of financial position reflects biological assets valued Kshs.1,471,633,000 as at 30 June, 2017. Included in this figure is an amount of Kshs.989,033,000 relating to crops as disclosed in Note 24 to the financial statements. It was noted that the value 'special crops- plantations' as at the end of the year under review remained the same at Kshs.772,336,240 as was similarly reported in the financial year 2015/2016. No valuation report was provided for audit to confirm how the value of Kshs. 772,336,240 was arrived at. Consequently, the accuracy of the valuation of 'special crops- plantations' during the year under review cannot be confirmed.

(ii) Purchase of Livestock

Information available indicate that the Corporation received an amount of Kshs. 250,000,000 from the government during the year under review for purchase of livestock as a mitigation to the pastoralists against loss due to drought. Schedules provided for audit shows that the Corporation acquired 4008 animals at a total cost of Kshs. 105,608,000. After effecting the loss of 60 animals and deaths of 770 animals, the management reported a net value of Kshs.86,714,000 for the animals. However, this amount is not reflected in the value of biological assets of Kshs.1,471,633,000 as at 30 June, 2017.

Consequently, the value of the biological assets of Kshs.1,471,633,000 reflected in the financial statements is not complete or fairly stated.

5. Trade and Other Payables-exchange Transactions

- (i) The consolidated statement of financial position as at 30 June 2017 reflects trade and other payables balance of Kshs.1,267,914,000, which includes trade creditors and non-trade creditors of Kshs.744,162,000 and Kshs.523,751,000, respectively. As reported in the previous years, non-trade creditors balance of Kshs.523,751,000 includes audit fees totalling Kshs.18,888,080 that have been outstanding since 1995. No satisfactory reason has been provided for failure to pay the fees.

- (ii) The non-trade creditors balance also includes unremitted statutory deductions of Kshs. 21,842,832, Kshs.26,932,145, Kshs.57,934,238 and Kshs.60,454,532 for Pay As You Earn (PAYE), National Social Security Fund (NSSF), pension scheme deductions and Agdeco Society deductions respectively dating back to 1998.
- (iii) The trade and other payables balance for the year then ended, like in the previous years, includes an outstanding balance of Kshs.267,279,416, payable to M/S Supplies and Services Limited in respect of fertilizer supplies. The amount includes Kshs.112,219,009 being interest charged at the rate of 18% per annum based on the number of days in default as at 30 June 2014. Any interest that may be accruing to the account has not been included in these financial statements from 1 July 2014 to date. The matter is still in court.

6. Grants Reserves

The consolidated statement of financial position reflects a balance of Kshs.2,732,616,000 (2015/2016 – Kshs.1,742,616,000) under grant reserves, and as disclosed under Note 28 to the financial statements, the amount includes grants from various sources. During the year, the amount of grant from Government of Kenya increased by Kshs.990,000,000. The amount of increase included Kshs. 50,000,000 in respect of drought mitigation grant recorded but not received as of 30 June 2017. Further, there is no documentary evidence that this amount would be received in future and consequently it is not possible to confirm the validity of the grant receivable to the extent of the Kshs. 50,000,000. In addition, the comparative figure for grant reserves of Kshs.1,742,616,000 included an amount of Kshs.31,414,000 that was not be supported.

Consequently, the accuracy and completeness of the grants reserve balance of Kshs.2,732,616,000 reflected in the financial statements cannot be confirmed.

7. Receivables from Exchange Transactions

- (i) As reported in the previous year, trade and non-trade receivables from exchange transactions balances of Kshs.394,087,000 and Kshs.194,150,000, respectively as at 30 June, 2017 and disclosed under Note 19 to the financial statements includes an amount of Kshs. 9,859,415 that has remained outstanding for a long period of time dating back to 1980. In addition, the management has not provided the analyses of the specific provision of Kshs.52,499,000 for bad and doubtful debts for audit review. Further, the basis for determining the general provision of Kshs.4,909,000 has not been explained.
- (ii) Included in the non-trade debtors figure of Kshs.194,150,000 is an amount of Kshs.7,226,797 (2015/2016 – Kshs.3,782,739) described as lost cash. The current financial year loss includes an amount of Kshs.2,065,000 that has been attributed to loss of imported potato seeds that were rotten on arrival and a further loss of Kshs.1,150,900 worth of potatoes that was destroyed in a fire. It is not clear why

the corporation had not insured the consignment to mitigate against such loss. Further, an amount of Kshs.4,507,635 described as provision for obsolete items/loss on investments' in the previous year has not been explained.

- (iii) In addition, the non-trade debtors includes deferred grants of Kshs.70,000,000 receivable from the parent ministry. However, no documentary evidence was provided during the audit to indicate that the amount would be received in the foreseeable future.
- (iv) As reported in the previous year, verification of records in 2015/2016 revealed that lease rental receivables totalling Kshs. 214,458,668 had not been included in the financial statements. No adjustment has similarly been made in the financial statements for 2016/2017 to record this omission.

In view of the above, it has not been possible to confirm the completeness, accuracy and recoverability of receivables from exchange transactions and non-trade transactions figures of Kshs. 394,087,000 and Kshs. 194,150,000 respectively.

8. National Livestock Project

The consolidated statement of financial position and as disclosed in Note 20 to the financial statements reflects an amount of Kshs.32,412,000 in respect of National Livestock Project account that is claimable from the parent ministry by the Corporation. The project started in 2006 when the Government granted ADC an amount of Kshs. 198,000,000 to purchase livestock under the emergency off-take programme in drought stricken arid areas. The Corporation subsequently incurred costs totalling Kshs.32,412,000 during the year on maintenance and daily running of the project operation. The following unsatisfactory matters have been noted:

- (i) The project has been reporting losses over the years while a similar livestock enterprise under ADC is ever reporting profits.
- (ii) The current account balance of Kshs.32,412,000 is not supported by demand notes to the parent ministry or State Department of Livestock and as such it is not possible to confirm the validity and accuracy of the debt.

The project did not prepare financial statements during the year, and as a result, it is not clear how the operating overheads were apportioned between ADC and the National Livestock Project. In addition, the state of financial performance and financial position of the project cannot be ascertained in absence of the financial statements.

9. Rental Revenue from Facilities

The consolidated statement of financial performance reflects an amount Kshs.89,766,000 under rental revenue from facilities for the year ended 30 June 2017, which is a drop of Kshs.97,859,000, from last year's figure of Kshs.187,625,000. The

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management attributes the shortfall to the stopped leases in Galana by the Government to create space for the Galana/Kulalu Food Security Programme. Evidence available indicate that the lessees are still occupying the land and it is therefore not clear why the management has stopped accruing and receipting the income.

10. Management Fees

The consolidated statement of financial performance reflects an amount of Kshs.1,634,000 in respect of management fees. This amount is attributed to an agreement entered into between Agricultural Development Corporation (ADC) and National Disaster Management Authority (NDMA) on 'Commercial Destocking for Drought Mitigation on 8 March 2017. According to Clause 5 on Costs and Payments, the Corporation was to receive Kshs.19,136,867 on signing of the agreement. This amount was to be used for purchase, translocation and managing 1,000 heads of cattle for three months and a further Kshs.38,273,733 thereafter for the additional 2,000 heads of cattle. ADC was to be compensated at Kshs.30/= per cow per day as management fees. Examination of the Corporation documents did not disclose details of amounts received from this agreement and how it was applied.

In view of the foregoing, the completeness and accuracy of the management fee figure of Kshs.1,634,000 as at 30 June 2017 can not be confirmed.

11. Loss of Fertilizer

As reported in the previous years, the Corporation lost a sum of Kshs.24,447,500 through fake bank deposit slips in respect of sale of fertilizer in Eldoret. The fertilizer, which was part of 40,000 bags of imported grade worth Kshs.111,680,000 had for unclear reasons been stored in a private store in the town. According to information available, the mode of payment was to be either through direct bank deposits where bank slips would be issued and later used for collection of the fertilizer, or by banker's cheques which had to be confirmed before the sale. The Corporation, however adopted the direct bank deposits method but due to weak controls, fertilizer worth Kshs.24,447,500 was released before the respective bank deposits had been confirmed. Although the management has indicated that the criminal case on the matter opened at Eldoret High Court and that some of the accused persons were acquitted, a warrant of arrest against one of the accused who absconded during the trial, has not yet been effected. Consequently, and until the matter is concluded, the recovery of the loss of Kshs.24,447,500 remains doubtful.

12. Undisclosed Material Uncertainty

The statement of financial position as at 30 June 2017, reflects total current assets of Kshs.1,162,086,000 and total current liabilities of Kshs.1,377,944,000 resulting in a negative working capital of Kshs.215,858,000 (2015/2016 - Kshs.891,890,000). The

Corporation is, therefore, technically insolvent and its continued existence as a going concern is dependent upon support from the National Government and its creditors. However, this material uncertainty has not been disclosed in the notes to the financial statements.

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

Key Audit Matters

Key audit matters are those matters that, in my professional judgement, are of most significance in the audit of the financial statements. Except for the matters described in the Basis for Qualified Opinion section, I have determined that there are no Key Audit Matters to communicate in my report.

Other Matter

1. Under-collection of Revenue

The statement of comparison of budget and actual for the year ended 30 June 2017 reflects an under collection of revenue of Kshs. 577,835,000. This represents 34% of the gross estimates of Kshs. 1,669,742,000. The under collection of revenue was attributed to failure to collect income on rendering services Kshs. 14,113,000, farming income Kshs.430,324,000, investment income Kshs.60,228,000 and other income 72,063,000.

Consequently, the Corporation might not have been able to achieve the objectives set during the financial year under review.

Responsibilities of Management and Those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Public Sector Accounting Standards (Accrual Basis) and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, management is responsible for assessing the Corporation's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the applicable basis of accounting unless the management either intends to liquidate the Corporation's or to cease operations, or have no realistic alternative but to do so.

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

Those charged with governance are responsible for overseeing the Corporation's financial reporting process.

Auditor-General's Responsibilities for the Audit of the Financial Statements

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.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances and for the purpose of giving an assurance on the effectiveness of the Corporation's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Corporation'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 Corporation's 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 Corporation's to express an opinion on the financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

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

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



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

Nairobi

13 June 2018