

REPORT OF THE AUDITOR-GENERAL ON AGRICULTURAL DEVELOPMENT CORPORATION FOR THE YEAR ENDED 30 JUNE 2018

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 30, which comprise the consolidated statement of financial position as at 30 June 2018, 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 consolidated financial statements present fairly, in all material respects, the consolidated financial position of Agricultural Development Corporation and its Subsidiary as at 30 June 2018, and of its consolidated financial performance and its cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (Accrual Basis) and comply with the Public Finance Management Act, 2012.

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.1,122,714,000 as at 30 June 2018 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 were 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 No. 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 2018.

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 2018 disclosed under Note 23(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 the year 1994 and the effect on the operations of the Corporation in fulfilment of its mandate.

(iii) Garissa Irrigation Project Land

The property, plant and equipment balance of Kshs.1,122,714,000 as at 30 June 2018 still exclude the value of land measuring 319.4 hectares located in Garissa Municipality whose value has not been determined.

(iv) Variation of Contract on Bull Station

The property, plant and equipment balance of Kshs.1,122,714,000 also include as disclosed under Note 23(a) to the financial statements, additions to buildings amounting to Kshs.448,018,000 and others all totalling Kshs.492,566,000. The additions include an expenditure of Kshs.388,909,101 incurred in the construction of a Bull Station.

The contract for the construction of the Bull Station was varied by Kshs.86,049,388 from the original contract sum contrary to Section 139 (4) of Public Procurement and Asset Disposal Act. Although the variation was approved by the board, it was never subjected to any procurement proceeding as per Section 139 (1) of Public Procurement and Asset Disposal Act. The additional cost of Kshs.86,049,388 was therefore irregular.

In view of the foregoing, the completeness and accuracy of property, plant and equipment balance of Kshs.1,122,714,000 cannot be ascertained.

2. Capital Work in Progress

As reported in the previous year and as highlighted under Note 23 (c) to the financial statements, the capital work-in-progress balance of Kshs.296,925,000 as at 30 June, 2018 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 seven years. Further, the capital work-in- progress includes an amount Kshs.212,584,995 relating to equipment's that are in use at the bull station and which should have been capitalized.

In the circumstances, I am unable to confirm the carrying value of the capital work-in-progress reflected in the financial statements of Kshs.296,925,000 as at June 2018.

3. Investments

The investment balance of Kshs.467,283,000 (2017 – Kshs.476,283,000) reflected in the statement of financial position as at 30 June 2018 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 – Kshs.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.1,406,950,000 as at 30 June, 2018. Included in this figure is an amount of Kshs.818,183,000 relating to crops as disclosed in Note 25 to the financial statements. Management has asserted that the Corporation has increased the acreage under crops in the year under review in line with the government's big four agenda. However, the value of crops decreased by Kshs.64,683,000 or about 4.4% from last year's figure of Kshs.1,471,633,000 in these financial statements. The basis of valuation of the crops was not provided for audit review and no reason was given for the decreased value.

(ii) Purchase of Livestock

As was reported in the previous year, the Corporation received an amount of Kshs.250,000,000 from the government in the year 2017 for purchase of livestock as a mitigation to the pastoralists against loss due to drought. Schedules provided for audit showed 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.1,406,950,000 as at 30 June, 2018.

Consequently, the value of the biological assets of Kshs.1,406,950,000 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 2018 reflects trade and other payables balance of Kshs.1,348,701,000, which includes trade creditors and non-trade creditors of Kshs.895,515,000 and Kshs.453,186,000, respectively. As reported in the previous years, non-trade creditors' balance of Kshs.523,751,000 includes audit fees totalling Kshs.20,194,120 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.21,286,106, Kshs.18,000,171, Kshs.60,450,319 and Kshs.68,992,733 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 an amount of Kshs.2,784,786,000 under grants reserves and as disclosed under Note 29 to the financial statements the amounts include Kshs.137,500,000 received from the State Department for Livestock for off-take programme, less an amount of Kshs.15,330,000, where the Corporation had been instructed to pay identified farmers who had lost their livestock. The grant of Kshs.137,500,000 was meant for off-take programme for the year and was actually spent during the year. It is therefore not clear why the amount had to be capitalised.

7. Receivables from Exchange Transactions

- (i) As reported in the previous year, trade and non-trade receivables from exchange transactions balances of Kshs.444,152,000 and Kshs.113,526,000, respectively as at 30 June, 2018 disclosed under Note 20 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.113,526,000 is an amount of Kshs.5,839,329 (2016/2017 – Kshs.7,226,797) described as lost cash. The reduction of the lost cash by Kshs.1,387,468 was explained as receipt from debtors. It is not clear what the description of lost cash implies. No details of the debtors to whom the amounts were received was provided for audit scrutiny. Consequently, the validity of the account cannot be confirmed.
- (iii) As also reported in the previous year, the non-trade debtors include deferred grants of Kshs.70,000,000 receivable from the parent ministry. However, to date, no documentary evidence has been provided to indicate that the amount would be receivable in the foreseeable future.
- (iv) Included in the gross trade debtors of Kshs.501,560,000 disclosed in Note 20 to the financial statements is an amount of Kshs.312,144,802 described as head office balances. The head office balances include an amount of Kshs.154,804,812 due from long term leases entered

into between the Corporation and various entities which were later irregularly terminated since the government wanted to take over Galana/Kulalu ADC farms. Some of these firms have taken the Corporation to court for breach of contract, therefore the chances of recovering these debt is nil. No provision has been made in these financial statements for these balances.

- (v) 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 2017/2018 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 balance of Kshs.557,678,000 as at 30 June 2018.

8. National Livestock Project

The consolidated statement of financial position and as disclosed in Note 21 to the financial statements reflects an amount of Kshs.47,758,000 (2016/2017 – 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.47,758,000 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.47,758,000 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.
- (iii) 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.28,064,000 under rental revenue from facilities for the year ended 30 June 2018, which is a drop by Kshs.61,702,000, from last year's figure of Kshs.89,766,000 (2015/2016 - revenue of Kshs.187,625,000). The declining trend in rental revenue has been attributed by management to the leases stopped in Galana by the Government to create space for the Galana/Kulalu Food Security Programme. However, there has been no additional drop in leased land in the year under review. In addition, 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.4,243,650 under management fees. This amount includes Kshs.2,367,660 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.2,367,660 as at 30 June 2018 cannot 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 in Relation to Sustainability of Services

According to the consolidated statement of financial performance the Corporation reported a loss Kshs.298,371,000 for the year ended 30 June 2018. The consolidated statement of financial position reflects accumulated deficit of Kshs.760,973,000 as at 30 June 2018 (2017: accumulated deficit of Kshs.462,602,000). As of 30 June 2018 the total current assets of Kshs.888,787,000 exceeded the total current liabilities of Kshs.1,464,516,000, resulting in a negative working capital of Kshs.575,729,000. The Corporation is, therefore, technically insolvent and its continued existence as a going concern or ability to sustain its services 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 (ADC) and its Subsidiary 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 judgment, are of most significance in the audit of the financial statements. Except for the matters described in the Basis for Qualified Opinion and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and Effectiveness of Internal Controls, Risk Management and Governance sections, I have determined that there are no Key Audit Matters to communicate in my report.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229(6) of the Constitution, based on the audit procedures performed, except for the matters described in the Basis for Qualified Opinion and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and Effectiveness of Internal Controls, Risk Management and Governance sections 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

Under-collection of Revenue

The statement of comparison of budget and actual for the year ended 30 June 2018 reflects an under collection of revenue of Kshs.1,262,423,000. This represents 61% of the gross estimated receipts of Kshs.2,065,958,000. The under collection of revenue was attributed to failure to collect income on rendering services Kshs.172,416,000, farming income Kshs.880,606,000, rent/eco-tourism Kshs.267,618,000 and investment income Kshs.64,800,000. The Corporation's resources were not efficiently and effectively used hence, the failure to meet revenue targets for these items during the financial year under review.

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

REPORT ON EFFECTIVENESS OF INTERNAL CONTROLS, RISK MANAGEMENT AND GOVERNANCE

Conclusion

As required by Section 7 (1) (a) of the Public Audit Act, 2015, based on the audit procedures performed, except for the matter described in the Basis for Qualified Opinion and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and Effectiveness of Internal Controls, Risk Management and Governance sections 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

Board Representation in Other Companies

Despite the Corporation controlling over 50% shareholding in four out of the eight companies shown in the table below, the composition of the board in these companies does not reflect this fact. According to the Corporation's management, only the chief executive represents the Corporation in the boards of these four companies.

S/No	Descriptions	Amount (Kshs)	% Ownership
1	Chemilil Sugar Company Ltd	203,592,000	96.22%
2	Development House	90,251,000	50.00%
3	Muhoroni Sugar Company	41,342,000	74.17%
4	Kenya Grain Growers Co-operative Union	1,123,000	1.92%
5	Kenya Seed Company Ltd	114,014,000	51.83%
6	Pyrethrum Board of Kenya	36,000	<1%
7	Kenya Planters Co-op Union	25,000	<1%
8	Agro-Chemical and Food Ltd	16,900,000	27%
	Total	467,283,000	

No reason was provided for the failure by the Corporation to have a sizeable representation in the boards of the entities indicated above.

The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. The standards require that I plan and perform the audit to obtain assurance about whether processes and systems of internal control, risk management and governance were operating effectively, in all material respects. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

Responsibilities of Management and Those Charged with Governance

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

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

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

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

Those charged with governance are responsible for overseeing the financial reporting process, reviewing the effectiveness of how the entity 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 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 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 control may not prevent or detect misstatements and instances of noncompliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

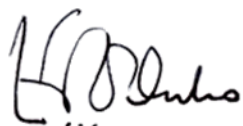
As part of an audit conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional scepticism throughout the audit. I also:

- 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.
- 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 ability of Agricultural Development Corporation to sustain its services. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit report. However, future events or conditions may cause the Corporation to cease sustaining its services.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Agricultural Development Corporation 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

16 April 2019