

# **REPORT OF THE AUDITOR-GENERAL ON BUSIA WATER AND SEWERAGE SERVICES COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2018**

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## REPORT ON THE FINANCIAL STATEMENTS

### **Adverse Opinion**

I have audited the accompanying financial statements of Busia water and Sewerage Services Company Limited set out on pages 1 to 38, which comprise the statement of financial position as at 30 June 2018, and statement of 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, because of the significance of the matters discussed in the Basis for Adverse Opinion section of my report, the financial statements do not present fairly, the financial position of Busia Water and Sewerage Services Company Limited as at 30 June 2018, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards (Accrual Basis) and do not comply with the Kenyan Companies Act, 2015.

### **Basis for Adverse Opinion**

#### **1. Late Submission of Financial Statements**

According to Section 47(1) of the Public Audit Act, 2015 and the Public Finance Management Act, 2012, the financial statements are required to be submitted to the Auditor-General within three months after the end of the fiscal year to which the accounts relate. However, it was noted that contrary to the stated provision of the law, the financial statements were submitted on 25 January, 2019, almost four (4) months after the statutory deadline of 30 September 2018.

The company was therefore in breach of the law.

#### **2. Non-Revenue Water Sales (NRW)**

During the year under review, the company produced a total of 883,290 cubic metres (m<sup>3</sup>) valued at Kshs.87,445,710 for distribution. However, it was noted that out of the total production of 883,290m<sup>3</sup>, only 382,545m<sup>3</sup> or 43% valued at Kshs.37,871,955 formed the authorized consumption. The balance of 500,745m<sup>3</sup> or 57% valued at Kshs.49,573,755 was not billed and therefore represent non-accounted for production.

Further, after allowing standard leaks, bursts, and other unforeseen but acceptable losses which can be tolerated at about 25% or 219,625m<sup>3</sup> valued at Kshs.21,742,875, the balance of unauthorized consumption is 281,120m<sup>3</sup> (32%) valued at Kshs.27,830,880 which represent direct commercial losses which should have been billed and realized as analysed below:

Description	Vol in Cubic Metres (m <sup>3</sup> )	Unit Cost Kshs.	Total Cost Kshs.	% age
Total Volume Produced	883,290	99	87,445,710	100%
Authorized Consumption	382,545	99	37,871,955	43%
Unauthorized Consumption	500,745	99	49,573,755	57%
Other allowable losses/Leaks/Bursts	219,625	99	21,742,875	25%
<b>Unaccounted for Water(NRW)</b>	<b>281,120</b>	<b>99</b>	<b>27,830,880</b>	<b>32%</b>

Further, the Water Company has 826 small and 6 bulk non-functioning water meters for which no effort seems to have been made to replace these and thereby aggravating the non-revenue water situation. Some of the 6 (six) bulk non-functioning water meters includes;

Treatment Plant	Meter Size
Nambale	-(outlet B/M) 6"
Mundika Treatment Works	-Backwash meter 450mm -Matayos line 200mm
Malaba Malakisi Treatment Works	- Backwash 10" -Production 10"
Amukura Scheme	-Production 2"

In the circumstances, it was not possible to ascertain completeness and accuracy of the reported sales during the year under review.

### 3. **Property Plant and Equipment**<sup>[FGW1]</sup>

The non-current assets balance of Kshs.885,459 was not supported by an up to date assets register indicating the nature, dates of acquisition, cost, unique identification number, current value, current location/user accumulated depreciation and net book value. Further, no valuation report indicating the current value of the assets was availed for review.

Moreover, the assets records revealed that land and buildings were not included in the asset movement schedule and the ownership documents for land were not availed for review.

In addition, the service provision agreement signed between Lake Victoria North Water Service Board and the Company on hand over of assets and liabilities did not specify the land sizes and valuation on which various water schemes under Busia Water Company operate from.

Further, the Schedule of movement of assets at note 11 on page 26 should be showing comparison in the movement of the assets for two financial years, however, only one financial year, 2017/2018, was presented in the financial statements.

In the circumstances, it was not possible to ascertain valuation and ownership of the non-current assets balance of Kshs.858,098 as at 30 June 2018.

#### **4. Inventories**

The inventories balance as at 30 June 2018 reflects Kshs.440,997. However, a scrutiny of the inventories record revealed the following anomalies;

- i) There were no stock sheets for stocks recorded at the end of the year under review to confirm computation of the quantities of the closing stock.
- ii) There were no stock ledger cards maintained for confirming the receipt of stock and subsequent issuance of stock to confirm the reported cost of sales incurred during the year under review.

In the circumstances, it was not possible to ascertain accuracy and completeness of the inventories balance of Kshs.440,997 as at 30 June 2018.

#### **5. Bank and Cash Balances**

The bank and cash balances of Kshs.2,774,091 is derived from three (3) bank accounts and an MPesa pay bill No.689872. However, comparison of the reported cash and cash equivalents balance with the adjusted cash book balances revealed that balances reported on revenue account No.01141237264000 of Kshs.689,258 were as per the bank statement and not as per the adjusted cash book balance which was Kshs.1,190,640.

Consequently, it was not possible to ascertain that the bank and cash balance of Kshs.2,774,091 as at 30 June 2018 is fairly stated.

#### **6. Payables and accruals**

The payables and accruals balance of Kshs.54,683,074 reflected under note 17(d)) to the financial statements includes a balance brought forward of Kshs.7,347,705 for customer deposits which was not supported with requisite documents.

In the circumstances, it was not possible to confirm the accuracy of the payables and accruals balance of Kshs.54,683,074 as at 30 June 2018.

## 7. Inaccuracies in the Statement of Cash Flows

The statement of cash flows was noted to be completely inaccurate for most of the items and therefore in contravention with International Accounting Standard No. 7 .

In the circumstances, it has not been possible to confirm that of cash and cash equivalents balance of Kshs.2,774,091 as at 30 June 2018 is fairly stated.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Busia Water and Sewerage Services Company Limited 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 adverse opinion.

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 matter(s) described in the Basis for Adverse Opinion and Emphasis of Matter section, I have determined that there are no other key audit matters to communicate in my report.

## Other Matter

### Budget Control and Performance

The Company revenue was budgeted at Kshs.65,084,456 against actual receipt of Kshs.39,200,447 representing an overall under collection of 25,884,009 or 40%. Further, the Company spent a total Kshs.58,338,268 against a budget of Kshs.147,783,139 representing under expenditure of Kshs.89,444,871.

It is worth noting however that the actual on comparative basis analysis in the table below is not in agreement with the figures reflected in the statement of profit and loss and other comprehensive income:

Income/ Revenue	Budget Figure 2017/18 Kshs.	Actual Income Kshs.	Variance Kshs.	% Variance	Remarks
Water Sales	43,331,414	28,384,364	14,947,050	34.49	Under collection
Sewerage	6,120,000	6,120,433	-433	-0.01	

<b>Income/ Revenue</b>	<b>Budget Figure 2017/18 Kshs.</b>	<b>Actual Income Kshs.</b>	<b>Variance Kshs.</b>	<b>% Variance</b>	<b>Remarks</b>
Meter Rent	3,648,600	3,234,300	414,300	11.36	Under collection
Water bowsers	1,200,000	746,450	453,550	37.80	Under collection
Other Income:	2,500,000	714,900	1,785,100	71.40	Under collection
Debt Recovery	8,284,442	0.00	8,284,442	100.00	
<b>Total Revenues</b>	<b>65,084,456</b>	<b>39,200,447</b>	<b>25,884,009</b>	<b>39.77</b>	Under collection
<b>Expenditures</b>					
Board of Directors expenses	4,699,000	1,255,070	3,443,930	73.29	Under expenditure
Staff Remuneration	42,799,997	26,412,082	16,387,915	38.29	Under expenditure
Operation and Maintenance	7,000,000	908,320	6,091,680	71.35	Under expenditure
Levies & Licenses	3,688,000	2,354,187	1,333,812	36%	Under expenditure
Electricity	19,200,000	12,730,410	6,469,590	33.70	Under expenditure
Chemicals	7,205,954	3,998,450	3,207,504	44.51	Under expenditure
Motor Vehicle Expenses	2,984,000	1,612,307	1,371,693	40.87	Under expenditure
Office Running Expenses	12,906,188	9,067,442	3,838,746	51.89	Under expenditure
<b>Totals</b>	<b>100,483,139</b>	<b>58,338,268</b>	<b>42,144,871</b>		
<b>Development</b>					
Motor Vehicles	8,600,000	0	8,600,000	100.00	
Furniture and Fittings	1,000,000	0	1,000,000	100.00	
Computers & Other IT Equipment	1,280,000	0	1,280,000	100.00	
General Equipment	500,000	0	500,000	100.00	
Water Meters	4,320,000	0	4,320,000	100.00	
Buildings and Offices	3,500,000	0	3,500,000	100.00	

<b>Income/ Revenue</b>	<b>Budget Figure 2017/18 Kshs.</b>	<b>Actual Income Kshs.</b>	<b>Variance Kshs.</b>	<b>% Variance</b>	<b>Remarks</b>
Meter Testing Bench	1,000,000	0	1,000,000	100.00	
Water Tanks	1,000,000	0	1,000,000	100.00	
Tools & Equipment	600,000	0	600,000	100.00	
Laboratory Equipment	1,500,000	0	1,500,000	100.00	
Pump-Sets	3,000,000	0	3,000,000	100.00	
Pipes and Fittings (Pressure & Waste)	20,000,000	0	20,000,000	100.00	
Fencing of Sewerage ponds	1,000,000	0	1,000,000	100.00	
<b>Sub totals</b>	<b>47,300,000</b>		<b>47,300,000</b>	<b>100.00</b>	

In the circumstances, the Company failed to achieve revenue collection targets and low absorption of budget with the likelihood of not impacting positively on service delivery.

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

### Conclusion

As required by Article 229(6) of the Constitution, because of the significance of the matters discussed in the Basis for Conclusion on Lawfulness and Effectiveness in Use of Public Resources section of my report, based on the audit procedures performed, I confirm that public resources have not been applied lawfully and in an effective way.

### Basis for Conclusion

#### 1. Staff in Acting Positions

According to personnel data presented for audit review, it was noted that 4 (four) positions in the staff establishment of the Company were being held in acting capacity for periods longer than six months which is contrary to the provisions of Section C14 of the Public Service Human Resource Policy and Procedures Manual of May 2016.

Further, it was noted that the positions held in acting capacity are critical to the operations of the Company amongst which includes the office of the Managing Director, Technical Manager, Accounting and Scheme Manager-Bumala. It was not clear why these positions have not been substantively filled in view of their critical nature and importance in the running of the Company.

## **2. Staff Retained on Payroll one year Beyond Retirement Age**

An audit review conducted on the payroll and correspondences between staff and management on retirement age revealed that one member of staff was retained on the payroll one year longer than the retirement age.

However according to the letter on notice to retire, the officer's retirement age was indicated as 27 February 2018, leading to the company incurring additional salary expense on the officer of Kshs.345,085. Further, the same officer continued to be in occupation of the company house despite being non-employee of the company after having retired.

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, because of the significance of the matters discussed in the Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance section of my report, based on the audit procedures performed, I confirm that internal controls, risk management and governance were not effective.

### **Basis for Conclusion**

#### **1. Internal Audit Department**

The Internal Audit department is required to review the effectiveness of the financial and non-financial performance management systems of the entities. However, on the contrary, it was noted that the Company has not established an internal audit department as part of an integral internal control system to improve on effective and efficient management of resources.

#### **2. Lack of a Board Charter**

Mwongozo regulations on code of governance for state corporations requires that the board of directors should develop and adopt a board charter which defines the roles, responsibilities and functions of the board. The board should periodically review its Board

Charter. Contrary, to the regulations, it was observed that the board operated without a charter.

In the absence of the Board Charter, the board may not be able to execute their mandate as required.

### 3. IT Control Environment

Delivering enterprise stakeholder value requires good governance and management of information and technology (IT) assets. However, during the year under review, it was noted that the IT internal control environment had following weaknesses which were identified in the company;

- i. Lack of structured IT governance including non-existence of an Information Technology strategic and steering committee.
- ii. No IT officer responsible for overseeing the operations of the IT department in the Company.
- iii. Failure to implement an IT strategic plan that supports business requirements and ensures that IT spending remains within the approved IT strategic plan.
- iv. Lack of training program to build IT capacity.
- v. Lack of a formally documented and approved process to manage upgrades and system changes made to all financial / performance information systems.
- vi. The backups were not stored in a secure offsite storage facility.
- vii. Lack of a formally documented and approved user management standards and procedures in the organization.
- viii. Lack of documented schedule for routine maintenance for IT infrastructure.

Lack of good governance and management of information and technology (IT) assets may lead to [FGW2] non- adoption of information technology strategies.

The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. The standard requires that I plan and perform the audit to obtain assurance about whether effective 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.

### REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by Kenya Companies Act, 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 not been kept by the Company, so far as appears from the examination of those records; and,



- iii. The financial statements are not in agreement with the accounting records and returns.

### **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 Financial Reporting 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 Company'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 the management either intends to liquidate the corporation 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.

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 Company's 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 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.
- 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 Company's ability to continue as a going concern or 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 Company to cease to continue as a going concern or to sustain 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 Company 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**

**22 July 2019**