

# REPORT OF THE AUDITOR-GENERAL ON CHEMELIL SUGAR COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2018

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## REPORT ON THE FINANCIAL STATEMENTS

### Qualified Opinion

The accompanying financial statements of Chemelil Sugar Company Limited set out on pages 18 to 43, which comprise the statement of financial position financial as at 30 June 2018, and the 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, have been audited on my behalf by Matengo & Associates, auditors appointed under Section 23 of the Public Audit Act, 2015. The auditors have duly reported to me the results of their audit and on the basis of their report, I am satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

In my opinion, except for the effects of the matter described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respects, the financial position of Chemelil Sugar 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 and comply with the Companies Act, 2015.

### Basis for Qualified Opinion

#### 1. Inaccuracies of the Financial Statements

The opening balance for the borrowings item differs with the audited closing balance for 2016/2017 as follows;

	<b>Audited 30 June 2017 Kshs.</b>	<b>Comparative 30 June 2017 Kshs</b>	<b>Difference Kshs</b>
Borrowings	3,370,400,742	3,373,400,742	(3,000,000)

The difference of Kshs.3,000,000 is not explained. In consequence, the accuracy of the financial statements as at 30 June 2018 cannot be ascertained.

#### 2. Current Liabilities

As reported in the previous years, the Company is unable to meet its statutory liabilities due to Kenya Revenue Authority and other creditors as total current liabilities stand at Kshs.3,085,598,122 (2017 – Kshs.2,806,709,855). In addition to the liabilities, the Company has not quantified interest and penalties on the outstanding balances. Therefore, the current liabilities do not include all payables owed by the Company. Consequently, the accuracy of financial statements as at 30 June 2018 is in doubt.

#### 3. Going Concern

The statement of Comprehensive Income for the year ended 30 June 2018 had a loss of Kshs.821,999,016 resulting to accumulated losses of Kshs.6,057,853,932. The current liabilities balance of Kshs.3,085,598,122 exceeds the current assets figure of Kshs.545,892,701 resulting in a negative working capital of Kshs.2,539,705,421 as at 30 June 2018. The Company is therefore technically insolvent and its continued operation as a going concern is therefore dependent upon financial support from the National Government and its creditors.

#### **4. Irregular Sugar Exports**

As reported in the previous years, the Company on diverse dates between the months of March and May 2008, irregularly and in contravention of the VAT Act, Cap 476 of the laws of Kenya, sold 118,144 units of 50kgs bags of sugar valued at Kshs.256,440,648 net of VAT to three companies ostensibly for export to Southern Sudan. However, the sugar was not exported but was apparently sold in the local market as a result of which, the Kenya Revenue Authority demanded a sum of Kshs.43,768,675 from the Company in unremitted VAT and penalties, which the Company has indicated was paid to the Authority. No satisfactory explanation has been provided by the Company on how sugar meant for export ended up in the local market. Although the issue was subsequently handed over to the Ethics and Anti-corruption Commission for investigation, the matter has not been concluded to date.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Chemelil Sugar 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 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 matter(s) described in the Basis for Qualified Opinion section, I have determined that there are no other key audit matters to communicate in my report.

#### **Emphasis of Matter**

#### **Budgetary Performance and Control**

During the year under review, the Company budgeted for an income of Kshs.4,603,620,899 but only received Kshs.654,685,465 resulting to a variance of Kshs.3,948,934,535 and also planned to spend Kshs.4,328,867,001 but only spent Kshs.1,420,805,639 resulting to a variance of Kshs.2,908,061,361 as indicated in the table below:

<b>Revenue</b>	<b>Budget Kshs.</b>	<b>Actual Kshs.</b>	<b>Variance Kshs.</b>
Net Gross Sales	4,573,970,899	637,406,869	3,936,564,030

Operating Income	26,000,000	13,775,715	12,224,285
Finance Income	3,650,000	3,502,881	147,119
<b>Total Income</b>	<b>4,603,620,899</b>	<b>654,685,465</b>	<b>3,948,935,434</b>
<b>Expenses</b>			
cost of sales and loss in fair value of cane	3,593,012,283	1,071,111,391	2,521,900,892
Administration expenses	317,435,464	114,622,601	202,812,862
Human Resources Costs	267,714,260	150,910,228	116,804,032
Financing Costs	150,704,994	84,161,419	66,543,575
<b>Total Expenditure</b>	<b>4,328,867,001</b>	<b>1,420,805,639</b>	<b>2,908,061,361</b>
<b>Surplus/(Deficit) for the period</b>	<b>274,753,898</b>	<b>(766,120,174)</b>	<b>1,040,874,073</b>

In view of the foregoing, the company does not adhere to the budgeting principles and this is likely to have a negative impact on the final performance of the company activities. In addition, the budget statement was omitted in the financial statement report for the year under review.

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

### Conclusion

As required by Article 229(6) of the Constitution, based on the procedures performed, except for the matter(s) described in the Basis for [Conclusion on Lawfulness and Effectiveness in Use of Public Resources/Qualified Opinion] 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

#### 1. Cash Management

##### 1.1 Unbanked Revenue

During the year under review, the Company collected revenue totaling Kshs.152,740,581. However, only Kshs.64,518,787 was banked leaving Kshs.88,221,794 unbanked against the Public Finance Management Act, 2012 requires that all cash collected be banked intact.

##### 1.2 Cash Advance/Imprest

During the year under review, it was noted that nine (9) staff were advanced Kshs.8,425,172 for purchase of goods which has not been accounted for as at 30 June 2018. The

management therefore were in breach of the law, that requires imprests be surrendered or be accounted for within seven (7) days after issue.

## **2. Long Outstanding Receivables**

It was noted that the Company has debts which are long overdue running for over five (5) years back totaling Kshs.29,513,990 in respect to sugar debtors and molasses debtors of Kshs.23,138,303 and Kshs.6,375,687, respectively. This is mainly due to lack of effective debt management policy in place.

## **3. Use of Non-Prequalified Suppliers**

The Public Procurement and Disposal Act, 2015 Section 93 states that an accounting officer of a procuring entity where applicable may conduct a prequalified procedure as a basic procedure prior to adopting an alternative procurement method other than open tender for the purposes of identifying the best few qualified firms for the subject procurement. However, it was noted that the Company had 175 active suppliers out of which 22 were pre-listed, eight (8) open tendered and 145 were non-prequalified suppliers representing 72% of the total active suppliers with contract valued at Kshs.98,191,284.

Non adherence to the procurement rules and regulations may lead to the Company procuring substandard goods and services.

## **4. Fixed Asset Register**

**4.1** The Company did not keep updated Fixed Asset Register to include the following;

- i. Location of the asset and user department
- ii. Expected life
- iii. Depreciation rate
- iv. Net book values
- v. Working conditions

The non update of the fixed assets register is against the Company fixed asset management policy section 8 (asset register) which provides all details to be included in the register. Further, the tagging of the fixed assets were not done to three namely; heavy implements, medical clinic and academy school equipment with various items amounting to Kshs.506,000, Kshs.387,195 and Kshs.1,231,090 respectively all totaling to Kshs.2,124,285 were not tagged.

## **4.2 Company Land**

Note 21 to financial statement under property, plant and equipment reflects the value of Company land as Kshs.1,400,000,000. However, there is no evidence of survey to determine its boundaries, in spite of some neighbors or squatters making claim on a portion of the Company's parcel of land.

## **5. Loan Default**

During the year, the company defaulted on loan agreements relating to Kenya Sugar Board by not honoring the repayment of principal and interest amounting to Kshs.150,686,039 due to cash flow constraints. Therefore, the Company management is in breach of the law.

## **6. Pension Contribution**

During the year under review, the Company failed to remit pension contributions and interest accruing thereof totaling Kshs.143,018,069. Non-compliance with pension regulations will continue to attract penalties and interests.

## **7. Prior Year Issues**

The Company did not resolve all the previous year issues recommended by the Auditor-General, that is, progress on follow-up of the Auditor-General recommendations contrary to the Public Accounting Reporting Template requirement. The management is therefore in breach of the regulation.

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 INTERNAL CONTROLS, EFFECTIVENESS, GOVERNANCE AND RISK MANAGEMENT SYSTEMS**

### **Conclusion**

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

### **Basis for Conclusion**

#### **Governance**

- i. The Company uses an old Cobol Computer Language that does not use the SQL in order to gain access to inter ICT system. The Company hardware and software has become obsolete, the Company uses server which is outdated – WIN Server 2003 and not Windows Server 2016 developed with WIN 10.
- ii. The internal audit department had the following weaknesses:
  - Not exposed to the requirement of good audit working papers
  - Has not carried out any survey on the services of the Company
  - Has not prepared risk based audit plans

- It was noted that the department intended to carry out 36 audits during the year, but only 13 were carried out.

Lack of effective audit department compromised governance and oversight responsibility with the Company.

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 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 the Company 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 Company, so far as appears from the examination of those records; and
- iii. The Company's statements are in agreement with the accounting records and returns.
- iv. In my opinion, the information given in the report of the directors is consistent with the financial statements.

## **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 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 to continue as a going concern/ sustain services, disclosing, as applicable, matters related to going concern/ sustainability of services and using the going concern basis of accounting unless the management either intends to liquidate the 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 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 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 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**

**30 May 2019**