

# **REPORT OF THE AUDITOR-GENERAL ON COMMODITIES FUND FOR THE YEAR ENDED 30 JUNE, 2019 – STATE DEPARTMENT FOR CROP DEVELOPMENT**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Adverse Opinion**

I have audited the accompanying financial statements of Commodities Fund set out on pages 29 to 66, which comprise of the statement of financial position as at 30 June, 2019, 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, 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 the Commodities Fund as at 30 June, 2019, and of its financial performance and its cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (Accrual Basis) and do not comply with the Crop Act, 2013 (Amended in May 2016) and the Public Finance Management Act, 2012.

### **Basis for Adverse Opinion**

#### **1. Loans and Related Issues**

##### **1.1 Variance Between Loans Repaid and Loans Received**

The statement of financial position reflects current receivables from exchange transactions-Loans and advances of Kshs.343,020,000 (2018: 829,483,000) and long-term receivables from exchange transactions-Loans and advances of Kshs.423,113,000 (2018: Kshs.7,854,811,000) as disclosed under Note 16(iii) and 16(iv) respectively. However, an analysis of extracts of loan repaid schedules reflects total loan repayments of Kshs.3,410,147,914.29 while the total bank receipts of loan repayments by the farmers amounted to Kshs.2,003,326,274.91, resulting to a difference of Kshs.1,406,821,639.38. The loan movement which is largely attributable to provision for loans and advances during the year amounted to Kshs.9,113,571,000 against total opening loan balance of Kshs.8,684,294,000.

Further, the bank statements did not include a unique loan numbers or identifier against repayment receipts. It is not possible to corroborate loan repayments in the system with the loanees' bankings making it difficult for reconciliation to be done.

In the circumstances, it has not been possible to determine the loan and advances issued and repaid on the basis of the provisions made during the year.

##### **1.2 Long Outstanding Reconciliation Loan Balances**

The statement of financial position reflects current and long-term receivables from exchange transactions-Loans and advances of Kshs.343,020,000 and Kshs.423,113,000 respectively and as disclosed under Note 16(iii) and 16(iv). An extract of amount received in the system and the bank receipts reflects unidentified receipts amounting to Kshs.13,463,098.91 which dates back to 2017 when the Management migrated to the new system. However, Management has not investigated what the balances relate to or made recommendations for clearance from the books. No explanation was provided for the non-reconciliation and identification of farmers' loan repayment.

### **1.3 Freezing of Interest on Loans**

The statement of financial position reflects current and long-term receivables from exchange transactions-Loans and advances of Kshs.343,020,000 and Kshs.423,113,000 respectively and as disclosed under Note 16(iii) and 16(iv). A review of extracted loans data revealed that the Fund had frozen interest on 62,731 loans with outstanding principal balance of Kshs.261,053,043 and interest balance of Kshs.141,997,009. The Fund does not have proper guidelines or policy to regulate the freezing of interests. The loans included 63 loans on coffee portfolio with a total balance of Kshs.91,451,530 issued during the year, out of which 34 loans with a loan balance of Kshs.59,593,738 had the interests frozen.

### **1.4 Loans with Outstanding Balances Reflected as Cleared in the System**

The statement of financial position reflects current and long-term receivables from exchange transactions-Loans and advances of Kshs.343,020,000 and Kshs.423,113,000 respectively and as disclosed under Note 16(iii) and 16(iv).

The above balances excludes the principle loan balance amounting to Kshs.595,062,000 which has been cleared. The above loan balance had accumulated interest of Kshs.2,203,538,506 out of which only Kshs.7,417,810 had been repaid resulting to Kshs.2,196,120,696.52 cleared without supporting documents.

No explanation was provided on how the accumulated interest was cleared and the corresponding repayments.

### **1.5 Amortization of Loans**

The statement of financial position reflects current and long-term receivables from exchange transactions-Loans and advances of Kshs.343,020,000 and Kshs.423,113,000 respectively and as disclosed under Note 16(iii) and 16(iv). The Fund's credit policy manual provides that for all loans disbursed, repayment would be on a reducing balance method. However, it was observed that the management treated loans differently with some loan balances being amortized contrary to provisions of the credit policy. Approved loans totalling Kshs.1,769,626,283 with balances totalling to Kshs.967,028,087 were amortized using straight line method during the loan period contrary to the credit policy manual.

Under the circumstances, the accuracy and completeness of the account balances of Kshs.343,020,000 reflected in the statement of financial position could not be confirmed.

## **2. Write-off of Receivables from Non-Exchange**

As disclosed under Note 17 to the financial statements, the statement of financial position reflects a balance of Kshs.45,455,000 under receivables from non-exchange transactions, which includes an amount of Kshs.34,753,000 indicated as funds held by intermediaries yet the amount was fully provided for during the year. Examination of records held by the Fund revealed that these loans were disbursed to farmers through intermediaries. However, no details were provided on the specific farmers given the loans by the intermediaries. In addition, it is not clear how the provision was made and how the loans will be collected. Further, management made provision on receivables from non-exchange contracts of Kshs.34,753,000 without any justifiable reason. The validity of the provision could not therefore be confirmed.

### **3. Misclassification of Expenditure**

As disclosed under Note 9 to the financial statements, the statement of financial performance reflects an amount of Kshs.114,432,000 in respect to employee costs. A review of the account revealed that the above balance which includes travel, accommodation, subsistence and other allowances amounting to Kshs.25,135,049. The above expenses are operational expenses and do not relate to employee costs.

In the circumstances, the employee costs have been overstated by Kshs.25,135,049 while the general expenditure has been reduced by a similar margin.

### **4. Revenue Shortfall and Unauthorized Expenditure**

The statement of comparison of budget and actual amounts reflects approved receipts budget and actual on comparable basis amount of Kshs.853,753,000 and Kshs.549,870,000, respectively, resulting to shortfall in receipts of Kshs.303,883,000 or 36%. Further, the Fund's approved expenditure budget was Kshs.757,577,000 while the actual expenditure was Kshs.9,372,289,000, resulting to over-expenditure of Kshs.8,614,712,000 or 1137%. There is no evidence that the Management sought for any authorisation to overspend excessively over an above the approved budget.

The underfunding and underperformance affected the planned activities and has impacted negatively on service delivery to the public.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Commodities Fund Management in accordance with ISSAI 130 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**

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

### **Other Matters**

## Unresolved Prior Year Matters

In the audit report of the previous year, a number of issues were raised under the Report on Financial Statements. However, Management has not resolved the issues or disclosed all the prior year matters as provided by the Public Sector Accounting Standards Board templates and firmed by The National Treasury's Circular Ref: PSASB/1/12 Vol.1(44) of 25 June, 2019.

## 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. Legal Case by Kibos Sugar & Allied Industries

The receivables from exchange transactions - loans, advances and interests' balances totaling Kshs.787,183,000 as at 30 June, 2019 includes loan advances amounting to Kshs.133,972,375 advanced to Kibos Sugar & Allied Industries as detailed below:

Client Name	Loan Account	Approved Amount (Kshs.)
Kibos Sugar & Allied Industries	LN_00159131	53,588,950
Kibos Sugar & Allied Industries	LN_00159132	40,191,712
Kibos Sugar & Allied Industries	LN_00159133	40,191,712
<b>Total</b>		<b>133,972,375</b>

It was noted that the Company has never repaid any of the stated loans. Further the Company sued the Commodities Fund and the Agriculture and Food Authority in the High Court of Kisumu vide Petition No. 19 of 2019, in which it denied receiving any money by the Fund. However, the petitioner acknowledged that the loans were instead advanced by the Kenya Sugar Board and not Commodities Fund. It is not clear how the loan will be paid and why the Company resorted to legal action. Further no accrued interest has been made on the amount advanced.

In the circumstances, the Fund may not realise the amount classified as loans.

#### 2. Irregular Procurement of General Insurance Services

The provision of general insurance services was procured vide Tender No. COMFUND/T/02/2018/19 dated 12 March, 2019 and thirteen bidders responded. The

evaluation was based only on premium and excess on the quoted amount. The lowest bidder as per the evaluation was awarded the contract for a sum of Kshs.861,323.

The criteria set by the procurement unit was that, the evaluation and final ranking of the bid would consider the scope of the cover in relation to the premium which was to have a weight of 70% and excess which was to have a weight of 30%. The cost of items not priced would be assumed to be included in other costing in the proposal. The award was to be made to the lowest evaluated bidder.

The Procurement Act provides for both technical and financial evaluation with regard to such services. It was noted that only financial evaluation was done. It was therefore not possible to ascertain the capability of the winning firm without assessing its technical capability.

In the circumstances, the Management contravened Section 46(4)(a) of the Public Procurement and Asset Disposal Act, 2015.

### **3. Employee Costs - Staff Establishment Shortfall**

The Fund had forty-four employees against staff establishment of one hundred and fifty-four during the year under review, resulting in a shortfall of staff totalling to one hundred and ten (110) or 71%. The Management had serious challenges of staffing especially in procurement, transport and credit control units.

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 Internal Controls, Risk Management and Governance section of my report, based on the audit procedures performed, I confirm that internal controls, risk management and overall governance were not effective.

### **Basis for Conclusion**

#### **1. Functionality of the Board of Trustee**

The Crops Act, No.13 of 2013, which created the Fund did not adequately expound the mandate of the Fund's Board of Trustees as well as its powers and responsibilities. The Fund is not established as a body corporate having perpetual succession and a common

seal and may not, in its corporate name, sue and be sued, which hinders its operations. Consequently, the Fund's Board of Trustees ability to work independently and effectively in the absence of clear laws on its mandate, powers and responsibilities is doubtful.

## **2. Weakness of the Internal Controls**

### **2.1. Missing Numbers in Loans Issues**

The Fund operated through a Microsoft Navision System in the daily operations. However, examination of records on the loans issued revealed a series of Loan Number (LN)\_00000001 to LN\_00159265. However, it was noted that there were 17,676 gaps in the issuance of the loans which could not be accounted for. The gaps in the loan series were neither invalidated nor cancelled in the system. No documentary evidence was provided to show how the missing gaps in loans issuance arose. The gaps in the system could have led to issuance of some loans and deleting of the same loan amounts without a trail of repayments.

### **2.2. Issuance of Multiple Account Numbers to Loan Account Holders**

Examination of the farmers' loans accounts and identification numbers revealed that the Commodities Fund was issuing different account numbers to the same farmer. A sample of forty-seven loans accounts had same identification number but different accounts. No explanation was provided for issuance of different account numbers to the same farmer.

### **2.3. Missing Loan Records**

An analysis of the Navision System (Loan Management System) revealed missing loan records totalling 30,027 which might have been deleted from the system without explanation. These series were system generated and unique for each loan issued. The analysis of these numbers revealed gaps in numbering. In addition, no record was provided to show how much those loan records represented since they were deleted completely from the system. No explanation was provided for the missing loan records which could translate into loss of funds.

In the circumstances there was no audit trail of the number of loans issued to the farmers.

## **3. Ineffective Debt Recovery**

The statement of financial performance reflects general expenses totalling Kshs.9,197,022,000 and which includes provision for bad debts of Kshs. 9,113,574,000 as disclosed under Note 13 to the financial statements. Although the loan balances have been outstanding for a long time, and the provision was made as per the Fund's policy, no meaningful effort appears to have been made towards full recovery of the loan balances.

The audit was conducted in accordance with ISSAI 2315 and ISSAI 2330. The standard requires 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 overall governance.

In preparing the financial statements, Management is responsible for assessing the Fund's ability to continue to sustain its services, disclosing, as applicable, matters related to sustainability of services and using the applicable basis of accounting unless Management is aware of the intention to terminate the Fund or to cease operations.

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

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

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 non-compliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with 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 applicable 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 Commodities Fund to continue 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 Fund 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 Fund 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.



**Nancy Gathungu**  
**AUDITOR-GENERAL**

**Nairobi**

**01 February, 2021**