

REPORT OF THE AUDITOR-GENERAL ON CONSOLIDATED FUND SERVICES - PENSION AND GRATUITIES FOR THE YEAR ENDED 30 JUNE 2017

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Consolidated Fund Services-Pension and Gratuities set out on pages 20 to 27, which comprise the statement of financial assets and liabilities as at 30 June 2017, and the statement of receipts and payments and statement of cash flows 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 effects of the matters described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respects, the financial position of Consolidated Fund Services-Pension and Gratuities as at 30 June 2017, and of its financial performance and its cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (Cash Basis) and comply with the Public Finance Management Act, 2012.

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

Basis for Qualified Opinion

1. Pension Payables

The statement of financial assets and liabilities reflects accounts payables of Kshs.3,243,545,200. Included in the accounts payables is Kshs.785,603,571 being pensions returned to the department's bank account from various banks since the payee's accounts were not credited. Further an amount of Kshs.395,604,287.62, being part of returned pension in the previous years was paid during the year under review. Thus, the net of the returned pension during the year was Kshs.389,999,284. Thus the closing balance of returned pensions as at 30 June 2017 increased to Kshs.3,243,545,200 from the previous year balance of Kshs.2,853,521,960. The balance is not supported by schedules showing details such as names of pensioners, the pension numbers, and amounts owed to each Pensioner. It was therefore, not possible to establish the validity of the outstanding balance of Kshs.3,243,545,200.

2. Cash and Cash Equivalent

a) Bank Balance

The Statement of Financial Assets and Liabilities reflects a credit cash and cash equivalent balance of Kshs.633,366,137. The Cashbook balance, bank reconciliation and board of survey report reflects a debit balance of Kshs.11,437,908 as at 30 June 2017. This has led to a difference between the cash book balance and cash and cash equivalent balance of Kshs.644,804,045 which has not been explained or reconciled and, the properly reconciled closing balance reflected in the statement of asset and liability. The credit balance of Kshs.633,366,137 can therefore not be confirmed.

b) Bank Reconciliation Statement

i) Payments in Cash Book not in the Bank Statement

Bank reconciliation statement reflects payments in the Cashbook not in the Bank Statement of Kshs. 633,058,933. Some of the payments in the cash book that have not cleared in the bank are dated as back as 2014. No valid reason has been provided as to why the payments have not cleared through the bank system.

ii) Receipts in Bank not in Cash Book

The bank reconciliation as at 30 June 2017 reflects receipts in bank statement not posted to the Cashbook totalling Kshs. 450,762,272.75. Some of the receipts in the bank statement that have not been recorded in the cashbook dates as far back as November 2011. No reason has been provided by management as to why the receipt in the bank have not been recorded in the cashbook.

iii) Receipts in Cashbook not in the Bank Statement

The bank reconciliation statement as at 30 June 2017 reflects receipts in the cashbook not recorded in the bank statement of Kshs.103,104,394. Some of the receipts that have remained outstanding in cash book date as far back as August 2007. Management have not provided any explanation as to why the receipts that have remained outstanding in the cashbook have not been cleared.

The accuracy of cash and cash equivalent credit balance of Kshs.633,366,137, reflected in the statements of assets and liabilities could not be ascertained due to un-reconciled balances and unexplained long outstanding bank reconciliation items.

3. Irregular Payment of Pension

In the statements of receipts and payments for the period under considerations, payment of pension of Kshs. 59,757,695,779 was made. Included in this expenditure is civil pension of Kshs.22,901,547,520 as indicated in Note 8.2 to the financial statement. An examination of pension payments revealed that an amount of

Kshs.1,306,966,518 was paid to retired teachers during the financial year 2016/2017 without being properly supported by documents such as the last pay slips as required by Pension Act 189, Section 10 (1) for proof that the payees were once teachers. The Management has not explained the basis of calculating the pensions and why the payments were made without adherence to the laid down pension payment procedures. Therefore, the payment of civil pension of Kshs.22,901,547,520 cannot be confirmed correct.

4. Military Gratuity

The statement of receipts and payment reflect payment of pension of Kshs.59,757,695,779 during the year under consideration. Included in the payment is military gratuity of Kshs. 4,562,597,165 which is overstated by Kshs.86,584,111. It has not been explained as to why there was overstatement and subsequent overpayment of Kshs.86,584,111.

5. Unsupported Expenditure

The statement of receipts and payment reflect payment of ordinary pension of Kshs.34,074,626,471 and as supported by Note 8.2. Included in ordinary pension of Kshs. 34,074,626,471 is pension Kshs. 58,656,973 paid to Asian and European Pensioners who retired due to Africanization of public sector after independence in 1963. Their life certificates were not availed as required by the pension internal controls to confirm that the pensioners are still a life before payments were effected. The propriety of the expenditure could not, therefore, be confirmed.

6. Excess Expenditure

The Statement of Receipts and Payments reflects an over expenditure of Kshs.1,270,093,379 for the year ended 30 June 2017. The excess expenditure over the receipts for the year was funded from returned pension. However, the returned pension should be receipted in a deposit account awaiting the payment of claims from the respective pensioners.

Previous Year's Matters

The Management has also not responded satisfactorily to the issues for the previous years which are highlighted below.

1. Un-supported Clearance of Prior Year Adjustment

The statement of financial assets for the year 2015/2016 shows a prior year adjustment of Kshs.297,889,272.00 under the comparative balances for the financial year 2014/2015. The amount was cleared during the period 2015/2016 but the transaction was not supported or explained. The balance was cleared without following the requirement of the Public Financial Management Act 2012, and the financial statement may not therefore have presented fairly the financial position as at 30 June 2016.

Other Matter

1. Failure to Submit Audited Parliamentary Pension Accounts

During the period under review, Civil and Commuted pension of Members of Parliament of Kshs.182,438,610 and 11, 2238,732 respectively were paid to the retiring/retired members of parliament. The audited Parliamentary Pensions Accounts were not submitted before payments were made as required by the Parliamentary Pension Act Cap 196, Section 21 (1) and (2). It was therefore not possible to confirm the validity and accuracy of the expenditure incurred.

2. Weak Payroll Internal Controls

Examination of the pension records reviewed revealed the following weaknesses;

- Validity of the pension paid is not confirmed with the retiree data from other government agencies' databases such as registrar of persons for identification data, KRA for PIN number and IPPD for employment details.
- Military personal files from the department of Defence are not submitted to the pension department to enable verification of the retirement claim details and basis of pension computation.
- Live certificates for pensioners are not availed to confirm pension is not paid to deceased pensioners. Due to weak internal controls in the department, this may lead to irregular payments of pension to non-existence pensioners.

There are weak controls which could lead to irregular payments of pension.

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

Key Audit Matters

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

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

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

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

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

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

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

The audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement and weakness when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances and for the purpose of giving an assurance on the effectiveness of the Fund's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the sustainability of services 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 Fund's ability 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 to continue 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 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.



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

Nairobi

02 July 2018