REPORT OF THE AUDITOR-GENERAL ON COUNTY ASSEMBLY OF LAMU FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Adverse Opinion

I have audited the accompanying financial statements of County Assembly of Lamu set out on pages 1 to 26, which comprise the statement of financial assets and liabilities as at 30 June 2018, and the statement of receipts and payments, statement of cash flows and summary statement of appropriation 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 County Assembly of Lamu as at 30 June 2018, 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 do not comply with the Public Finance Management Act, 2012 and the County Government Act, 2012.

Basis for Adverse Opinion

1. Inaccuracies of Financial Statements

The financial statements reflected a total expenditure of Kshs.425,226,521 as at 30 June 2018 while the Integrated Financial Management Information System (IFMIS) ledgers and vote-book report indicate Kshs.410,827,661 thereby resulting to an unexplained difference of Kshs.14,398,860. In addition, the financial statements reported transfers from the County Treasury/Exchequer releases of Kshs.432,094,041 while the County Executive financial statements reflected an amount of Kshs.432,085,042 resulting in unreconciled difference of Kshs.8,999. Also, the surplus reported in the statement of receipts and payments of Kshs.6,867,521 differed with the balance reflected in the statement of financial assets and liabilities of Kshs.7,068,580 by Kshs.201,059. Further, included in the reported receipts balance of Kshs.432,094,041 is a development expenditure of Kshs.130,957,848 that was paid directly to the suppliers from the County Executive Treasury's development account and was not a transfer to the Assembly's accounts as the management did not operate a development account.

Consequently, the accuracy and completeness of the balances for the financial statements for the year ended 30 June 2018 could not be confirmed.

2. Cash and Cash Equivalents

2.1. Bank Balances

Included in cash and cash equivalents balance of Kshs.43,455,709 is Kshs.40,000,000 in respect of car loan & mortgage account held at Gulf African Bank. The Assembly's management indicated that the funds were held by the bank as collateral for car and mortgage funds issued to the Members of County Assembly. Although the bank balances certificate and bank statement were availed for audit review, the agreement between the Assembly and the bank was not made available for audit review to confirm any obligations for the same.

2.2. Payments from Imprest Account

Note 13 A to the financial statements reflects a balance of Kshs.2,483.044 for imprest account held at Kenya Commercial Bank. However, a review of the Kenya Commercial Bank account cash books indicated that Kshs.618,000 was paid to a supplier contrary to section 82 (1) of the Public Finance Management (County Governments) Regulations, 2015 which states that the imprest account should only be used for payments of petty cash.

Consequently, the security, accuracy and completeness of the cash and cash equivalents balance of Kshs.43,455,709 as at 30 June 2018 could not be confirmed.

3. Pending Bills

The financial statements under Annex 2 to the financial statements reflects an amount of Kshs.97,004,709 in relation to pending accounts payables/bills. However, the schedule provided for audit review did not contain details relating to the pending bills and voucher numbers, local purchase orders and invoices were not indicated making it not possible to confirm the authenticity of the information. Further, the creditor's reconciliation statements were not made available to ascertain the creditors' movement from the previous year of Kshs.108,139,223 to the year under review figure of Kshs.97,004,709.

In view of the foregoing, the source, completeness, authenticity and existence of the pending bills balance of Kshs.97,004,709 as at 30 June 2018 could not be ascertained.

4. Outstanding Imprests

The statement of assets and liabilities reflects Kshs.3,612,872 in respect of accounts receivables – outstanding imprest. However, the Assembly did not use Integrated Financial Management Information System (IFMIS) to manage imprest transactions. Further, the imprest register maintained by the Assembly recorded issuance of imprest but did not indicate date imprest were surrendered and any outstanding imprest.

In the circumstances, the accuracy, propriety and completeness of the outstanding imprest balance of Kshs.3,612,872 as at 30 June 2018 could not be confirmed.

5. Use of Goods and Services

5.1 Foreign Travel and Subsistence

Note 5 to the financial statements reflects foreign travel and subsistence totaling to Kshs.18,543,599 incurred in the financial year under review. However, no reports were made available for audit indicating the benefits from the various trainings abroad to the Assembly. Further, the Assembly spent Kshs.14,698,038 on trainings abroad for trainings that were available locally. In addition, an expenditure of Kshs.2,412,500 on purchase of air tickets for the foreign travel was not supported by boarding passes.

Consequently, the accountability and propriety of the Kshs.18,543,599 expenditure on foreign travel and subsistence as at 30 June 2018 could not be confirmed.

5.2 Domestic Travel and Subsistence

The domestic travel and subsistence of Kshs.46,520,757 had the following anomalies:

- **Various Retreats**

During the year under review, the Assembly incurred an expenditure for staff and Members of County Assembly of Kshs.17,258,650 while attending various retreats in Mombasa. The Assembly did not explain why the retreats had to take place in Mombasa and not in Lamu where it is located. In the circumstances, the expenditure was wasteful contrary to Section 197 of the Public Finance Management Act, 2012 and Section 210 of the Public Finance Management Regulations, 2015 as it could have been avoided.

- **Budgeting and Planning Training**

During the year under review, the Assembly incurred an expenditure of Kshs.2,516,300 paid to Assembly's officers as subsitence allowance while on budget and planning training at a resort in Mombasa. However, the Assembly did not explain why the training had to take place in Mombasa and not in Lamu. Further, there was no documentary evidence of how the hotel was procured.

In the circumstances, the expenditure was wasteful contrary to Section 197 of the Public Finance Management Act, 2012 and Section 210 of the Public Finance Management Regulations 2015.

- **Personal Financial Management and Pre-Retirement Training**

During the year under review, the Assembly incurred an expenditure of Kshs.2,412,000 on Personal Financial Management and Pre-Retirement Training at Mombasa to train Members of County Assembly. There was no justifiable reason for the training of MCAs on retirement. Further, the Assembly has not explained why the training had to take place in Mombasa and not in Lamu where the assembly is located. In the circumstances, the expenditure was wasteful contrary to Section 197 of the Public Finance Management Act, 2012 and Section 210 of the Public Finance Management Regulations 2015.

Consequently, the probity of the Kshs.22,186,950 expenditure on domestic travel and subsistence as at 30 June 2018 could not be confirmed.

5.3 Rental of Produced Assets

Note 5 to the financial statements reflects expenditures of Kshs.2,412,800 for rental of produced assets incurred in the year under review. However, an expenditure of Kshs.1,200,000 being rent for ward offices was not accounted for as there was no valuation report from department of housing to confirm the amount paid was economical and fair. Further, lease agreements between the tenants and the landlords were not made available for audit review.

Consequently, the propriety of the Kshs.1,200,000 expenditure on rental of produced assets as at 30 June 2018 could not be confirmed.

5.4 Training Expenses

Included in the use of goods and services balance of Kshs.382,498,286 as disclosed under note 5 to the financial statements were expenditures for training expenses of Kshs.24,422,544 incurred in the year under review. However, Kshs.4,092,000 was incurred for the provision of training services. Also, there was no documentary evidence of how the training services were identified. Further, the Assembly incurred Kshs.14,725,700 for training in Dubai and Arusha for courses that are locally available resulting in a wasteful expenditure contrary to Section 197 of the Public Finance Management Act, 2012 and Section 210 of the Public Finance Management Regulations 2015.

Consequently, the propriety of expenditure of Kshs.18,817,700 on training as at 30 June 2018 could not be confirmed.

5.5 Insurance Cost

Included in insurance costs of Kshs.15,985,517 under note 5 to the financial statements is Kshs.8,307,474 being medical cover for the assembly staff. However, a review of the expenditure indicated that the contract was renewed without any evidence of a competitive process being undertaken contrary to Article 227 (1) of the Constitution of Kenya. Although the Assembly explained that the renewal was based on a contract clause which provided for renewal based on quality of service, there was no documentary evidence of evaluation of quality of service.

Consequently, it has not been possible to ascertain the probity of expenditure of Kshs.8,307,474 on insurance cost as at 30 June 2018.

5.6 Fuel, Oil and Lubricant

Included in the use of goods and services balance of Kshs.147,491,884 as disclosed in Note 5 to the financial statements were expenditures for fuel, oil and lubricants totaling to Kshs.2,906,820 incurred in the financial year under review. However, a review of the expenditure revealed that an expenditure amounting to Kshs.2,750,000 had no work-tickets attached to the payment vouchers. Further, Local Purchase Orders (LPO's) were issued after fuel had been drawn.

In view of the foregoing, it has not been possible to ascertain the probity of the Kshs.2,906,820 expenditure on fuel, oil and lubricants as at 30 June 2018.

5.7 Routine Maintenance - Vehicles and Other Transport Equipment

Included in the goods and services balance of Kshs.147,491,884 is routine maintenance-vehicles and other transport equipment figure of Kshs.10,152,424 incurred in the year under review. An audit verification revealed that motor vehicle work tickets did not indicate the driver's/ coxswain's report of defects and action taken by the officer-in-charge. It is not clear how routine maintenance - vehicles and other transport equipment was requisitioned.

In the circumstances, the accountability and the propriety of the expenditure of Kshs.10,152,424 could not be confirmed.

6. Acquisition of Assets

Included in the acquisition of assets figure of Kshs.149,617,213 is an amount of Kshs.55,996,848 incurred for construction of buildings as disclosed in Note 10 to the financial statements. The expenditure related to construction of Assembly Offices. However, contract agreement was not made available for audit review to confirm whether the construction was within the contract period. Further, bill of quantities were not made available for audit verification to confirm whether the works were as per the bill of quantities. In addition, the payments were paid by the County Executive and therefore should not have been reported in the County Assembly's financial statements.

Consequently, the propriety and validity of the expenditure on construction of buildings amounting to Kshs.55,996,848 as at 30 June 2018 could not be confirmed.

7. Summary of Fixed Assets Register

The financial statements under Annex 4 on summary of fixed assets register reflects an amount of Kshs.308,130,670 as at 30 June 2018 compared to Kshs.158,513,456 as at 30 June 2017 being the balance for Assembly's non-current assets. The Assembly does not have in place policies and procedures relating to asset management. Non-current assets were not physically inspected on a regular basis. In addition, the Assembly did not maintain a register of land and buildings for each parcel of land and building and the terms on which it is held with reference to the conveyance, address, area, dates of acquisition, disposal or major change in use, capital expenditure, lease hold terms, maintenance contracts and other pertinent management details as required by Section 136(2) of the Public Finance Management (County Government) Regulations, 2015.

Consequently, the completeness, accuracy, correctness and security of the non-current assets balance of Kshs.308,130,670 as at 30 June 2018 could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of County Assembly of Lamu 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

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 Adverse Opinion section, I have determined that there are no other key audit matters to communicate in my report.

Other Matter

1. Budgetary Control and Performance

During the financial year 2017/2018, the County Assembly had an approved budget of Kshs.500,000,000 comprising of Kshs.350,000,000 (70%) for recurrent expenditure and Kshs.150,000,000 (30%)) for development expenditure. The County Assembly budget of Kshs.500,000,000 was 16.6% of the total County budget of Kshs.3,019,057,968 this exceeded 9.6% the limit set by Section 25 1(f) of the Public Finance Management (County Governments) Regulations, 2015. The County Assembly spent Kshs.291,659,632 on recurrent expenditure and Kshs.133,566,888 on development expenditure. Further, out of the Kshs.500,000,000 approved budget for the year, the Assembly received exchequer releases of Kshs. \432,094,041.The expenditure analysis is as detailed below;

	Budget (Kshs)	Actual (Kshs)	Variance (Kshs)	Absorption Rate
Recurrent	350,000,000	291,659,632	58,340,368	83%
Development	150,000,000	133,566,888	16,433,112	89%
Total	**500,000,000**	**425,226,520**	**74,773,480**	**85%**

The recurrent expenditure analysis above excludes outstanding commitments in the vote-book as at 30 June 2018 amounting to Kshs.11,253,498. In the circumstances, the County residents may not have received services equivalent to the unspent approved budget of Kshs.74,773,480 as at 30 June 2018. Further, Section 25 of the Public Finance Management (County Governments) Regulations, 2015 and Section 107 of the Public Finance Management Act, 2012 were not complied with.

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

Basic Wages of Temporary Employees

Included in the compensation of employees balance of Kshs.128,117,423 reflected in the statement of receipts and payments and as disclosed under note 4 to the financial statements were basic wages of temporary employees totaling Kshs.8,040,000 incurred in the year ended 30 June 2018. A review of the payment revealed that the funds were transferred to ward bank accounts for payment of monthly salaries for ward offices. However, documents showing the details of the employees, how the employees were hired, terms of engagement, evidence of receiving the pay and duties being performed were not provided for audit review.

In the circumstances the propriety of the basic wages of temporary employees of Kshs.8,040,000 as at 30 June 2018 could not be confirmed.

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. Cash and Bank

A review of the effectiveness of the internal controls of cash and bank established that bank reconciliations are prepared on an excel work sheet which the recording of the manual cashbook was incomplete as particulars of the payments, voucher number and allocation were not indicated. Further, bank reconciliations were not prepared in Integrated Financial Management Information System (IFMIS) but were done manually.

Consequently, the internal controls for recording of the cashbook were not operating in an effective way as at 30 June 2018.

2. Inventory Management

Included in the use of goods and services balance of Kshs.147,491,884 reflected in the statement of receipts and payments and as disclosed in Note 5 to the financial statements were expenditures for specialized materials and services totaling to Kshs.625,500 incurred in the financial year under review. However, goods supplied amounting to Kshs.608,500 were not taken on charge in the store ledger contrary to Section 162 of the Public Procurement and Assets Disposal Act, 2015.

Consequently, the propriety of Kshs.608,500 expenditure on specialized materials and services as at 30 June 2018 could not be confirmed.

3. Failure to Establish an Audit Committee

The Assembly did not have an audit committee in place, contrary to Section 155 (5) of the Public Finance Management Act, 2012, which states that a County Government entity shall establish an internal audit committee whose composition and functions are set out in Section 167 (1) of the Public Finance Management (County Governments) Regulations, 2015.

In the circumstances, the Assembly was in breach of law.

4. Non -Appointment of Internal Auditor

During the financial year under review, the Assembly did not have an internal audit Contrary to Section 155 of the Public Finance Management Act, 2015, which states that a County Government entity shall ensure that it complies with this Act and has appropriate arrangements for conducting internal audit according to the guidelines issued by the Accounting Standards Board.

In the absence of an Internal Auditor, the reliability of the internal control system could not be ascertained and consequently the risk of misappropriation of public resources entrusted to the Assembly was high.

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.

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 (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 Assembly's ability to continue 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 Assembly 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 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 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 Assembly'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 County Assembly 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 County Assembly's 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

23 January 2019