REPORT OF THE AUDITOR-GENERAL ON COUNTY ASSEMBLY OF MACHAKOS 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 Machakos set out on pages 1 to 39, 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 statement of comparison of budget and actual amounts (recurrent and development combined) 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 Machakos 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 County Government Act, 2012 and the Public Finance Management Act ,2012.

Basis for Adverse Opinion

1. Inaccuracies in the Financial Statements

1.1. Discrepancies Between the Financial Statements, Supporting Documents and IFMIS

The financial statements were prepared using a manual general ledger. However, there are material variances noted between IFMIS and the financial statements balances which cast doubt on the accuracy of the financial statements. Details of the variances are as described:

1) The IFMIS statement of receipts and expenditure shows that there was no money received by the entity during 2017/2018 financial year, and that total expenditure amounted to Kshs.689,692,241, while the audited statement of receipts and payments reflects amounts of Kshs.943,986,147 and Kshs.912,358,397 for receipts and total expenditure respectively. This results in variations of Kshs.943,986,147 and Kshs.254,293,906 for receipts and payments respectively. The IFMIS figures have not been reconciled with those reported in the financial statements.

2) The statement of financial assets and liabilities as per IFMIS shows net financial assets of negative Kshs.1,501,522,721, while the net financial assets as per the entity's financial statements are reflected as Kshs.22,007,041, a variation of Kshs.1,523,529,762.

3) The County Assembly maintains a manual general ledger from which the financial statements were prepared, but the ledger is not properly maintained since there are material variances noted between the totals for transactions as per primary documents and the totals as per the general ledger. For instance, there was a double posting of Kshs.393,966.55 in the compensation of employees account in the manual ledger, casting doubt on the reliability of the manual ledger and its closing balances thereon. The County Assembly has continued maintaining a manual ledger even when it is required to process all transactions using IFMIS and generate financial reports from IFMIS.

In view of the foregoing, the financial statements' completeness and accuracy could not be confirmed.

1.2. Unsupported Adjustments to Revised Financial Statements

Though the management of the County Assembly submitted adjusted financial statements, a revised trial balance was not submitted. Management also failed to provide journal vouchers to show the movement of figures and balances from the original financial statements to the revised ones.

The following are the affected figures and balances;

Statement of Receipts and Payments			
	Adjusted Financial Statements (Kshs)	**Original Financial Statements (Kshs)**	**Variance (Kshs) (Kshs)**
Transfers from County Treasury	943,986,147	921,592,147	22,394,000
Compensation of Employees	343,223,008	360,139,912	16,916,904
Acquisition of Assets	150,920,962	134,173,299	16,747,663
Statement of Financial Assets and Liabilities			
Accounts Receivables	0	982,099	982,099
Accounts Payables	9,620,709	72,989,306	63,368,597
Bank Balances (Total)	31,627,750	26,734,825	4,892,925

Consequently, the accuracy of the affected figures and account balances could not be confirmed.

1.3 Variances in Cash and Cash Equivalents' Balance

Misstatements were observed in the cash and cash equivalents' balance as follows;

1) The statement of financial assets and liabilities indicates a cash & cash equivalents' balance of Kshs.31,627,750 while the statement of cash flows indicates cash & equivalents' figure of negative Kshs.43,725,318 resulting in a variance of Kshs.75,353,067 which is equivalent to the balance at the end of 2016/17 financial year. The negative balance has not been explained in a note to the financial statements

2) Further, both reconciled recurrent and development cashbooks show a total bank balance of Kshs.2,560,062, which varies from the financial statements' figure by Kshs.29,067,687 as follows:

Variances Between Figures as per Financial Statements and Reconciled Cashbooks			
Details	**Bank Balance as per cash book (Kshs)**	**Bank Balance as per Note 13A (Kshs)**	**Variance (Kshs)**
Recurrent	902,528	9,218,456	8,315,928
Development	1,642,241	22,394,000	20,751,759
Commercial Bank Accs.	15,293	15,293	-
Total	**2,560,062**	**31,627,749**	**29,067,687**

3) The statement of financial assets and liabilities reflects a nil cash in hand balance as at 30 June 2018.The board of survey report for the year and note 13B to the financial statements however, indicate a cash in hand balance of Kshs.21,002 as at the same date. This amount has not been disclosed in the statement of financial assets and liabilities as at 30 June 2018.

In view of the above, the accuracy of cash and cash equivalents' balance could not be confirmed.

1.4 Failure to Observe Cut–off Procedures

The statement of receipts and payments includes transactions that occurred during 2018/2019, contrary to regulation 97(1) of the Public Financial Management (County Government Regulations 2015, that requires the accounts of the County Government entities to record transactions which take place during a financial year running from the 1st July to the 30 June of any financial year. This failure to observe cut-off procedures also contradicts IPSAS (Cash Basis) of accounting that requires receipts and payments to be recognized when they actually occur.

The following transactions occurred after the year end yet they were treated as if they occurred within the financial year:

1) The statement of receipts and payments reflects Kshs.943,986,147 in respect of receipts which includes Kshs.107,596,591 posted in the cash book on 16 July 2018.

2) The financial statements reflect an expenditure of Kshs.150,920,962 for acquisition of assets which includes Kshs.67,928,945 for construction of buildings. This expenditure for construction of buildings includes an amount of Kshs.15,828,399 paid by the County Assembly to a construction company in July and August 2018, thereby overstating the expenditure for 2017/2018 by Kshs.15,828,299 as follows:

Failure to Observe Cut -off Procedures- Construction of Buildings			
Date Paid	**Payment Voucher Number**	**Details**	**Amount Paid (Kshs)**
19 July 2018	314 & 315	Payment for proposed construction of County Assembly office block as per interim certificate number 10	2,618,945
1 August 2018	322 &324	Payment for proposed construction of County Assembly office block as per interim certificate number 11	13,209,454
Total payments (Kshs)			**15,828,399**

There was no evidence that Treasury issued a circular that allowed payments made and receipts received after the year end to be recognized during the financial year. The financial statements have therefore not been prepared in accordance to IPSAS (Cash Basis).

2. Unsupported Expenditure – Kshs.261,355,771

The statement of receipts and payments reflects an expenditure of Kshs.358,214,428 in respect of use of goods and services which includes expenditure items with a total of Kshs.261,355,771 as detailed in Note 5 to the financial statements and as detailed below:

Payments Lacking Supporting Documents	
Expenditure item	**Expenditure (Kshs)**
Domestic travel and subsistence	190,156,002
Foreign travel and subsistence	21,240,013
Utilities, supplies and services	2,166,014
Hospitality supplies and services	2,323,163
Routine maintenance-vehicles and other transport equipment	2,242,994
Insurance costs	31,854,130
Office and general supplies and services	8,107,140
Fuel, oil and lubricants	3,266,315
Total Expenditure	**261,355,771**

However, these amounts are not supported with expenditure analyses or schedules showing details of the payments.

Consequently, regularity of the expenditure of Kshs.261,355,771 could not be confirmed.

3. Un-updated Fixed Assets Register

The statement of receipts and payments reflects Kshs.150,920,962 in respect of acquisition of assets, and which includes an amount of Kshs.58,108,944 for purchase of office furniture and general equipment. The availed fixed assets' register shows that additions for the year for the same asset item category amounted to Kshs.56,864,443 thus resulting in an unexplained variance of Kshs.1,244,501. The fixed assets' register availed for audit was not properly maintained to ensure that all procured items are taken on charge, properly accounted for and put in proper use as intended by the procuring entity. Further, physical inspection carried out and a check on the items delivered revealed various variances.

4. Differences in Transfers to Other Government Entities (Car and Housing Funds for MCA's)

The statement of receipts and payments reflects an amount of Kshs.60,000,000 in respect of transfers to other Government entities which includes Kshs.50,000,000 for transfers to Car Loan and Housing Funds for MCA's. Availed payment vouchers and the bank statements for the same reflect an amount of Kshs.60,000,000 resulting in an unexplained difference of Kshs.10,000,000.

5. Failure to Maintain Motor Vehicle Records

The statement of receipts and payments reflects an expenditure of Kshs.358,214,428 for use of goods and services, which includes Kshs.2,242,994 for routine maintenance of vehicles and other transport equipment. However, review of availed records revealed that vehicle repair details are never entered in their respective service logbooks, and further vehicles service logbooks and fuel registers were not maintained as a measure to safeguard the County Assembly from risk of losing funds through fictitious payments for repairs and fueling. It was therefore not possible to confirm that the amount of Kshs.2,242,994 relates to repairs and maintenance of only the County Assembly motor vehicles.

6. Unresolved Prior Year Audit Issues

The following issues which relate to 2016/2017 have remained unresolved to date. These issues have an effect on the current year's financial statements because they have been presented as opening balances and comparative figures.

6.1 Presentation and Disclosures

The financial statements did not include explanations on significant under-utilisation and over-utilisation of budgeted provisions as prescribed in the reporting template issued by the Public Sector Accounting Standards Board. The statement of financial assets and liabilities, statement of receipts and payments and statement of cash flows indicate that the comparative figures had been restated while the statement of financial assets in addition indicates that the current year balances have been restated and reasons and extent of restatement were not given.

6.2 Inaccuracies in the Financial statements

The following issues, relating to inaccuracies in the financial statements are still outstanding**.**

i. While total expenditure as per statement of receipts and payments amounted to Kshs.936,140,270, IFMIS (vote book) reflected Kshs.882,860,547 resulting in an unexplained difference of Kshs.53,279,723.

ii. The statement of comparison of budget and actual amounts for recurrent excluded an amount of Kshs.703,316 being actual expenditure on other payments, but the amount was included in the statement of receipts and payments.

iii. The statement of financial assets reflects cash and cash equivalents' balance of Kshs.15,385,230 as at 30 June 2017, but the following material omissions were observed:

- The cash books closing balances as at 30 June 2017 in virtually all the cash books were not certified by the board of survey members.
- A balance of Kshs.4,492,190 as at 30 June 2017 in Account No.1144054559 at the Kenya Commercial Bank was excluded from the schedule of bank balances.
- A balance of Kshs.14,977,079 as at 30 June 2017 held in a Deposit Account No.000264543 at the Central Bank of Kenya was also excluded from the schedule of bank balances.

Consequently, the accuracy of the financial statements for the year ended 30 June 2017 could not be confirmed.

6.3 Inaccurate Basic Salaries for Permanent Employees

While financial statements reflected a figure of Kshs.169,962,923 under basic salaries for permanent employees, the Integrated Payroll and Personnel Database (IPPD) reflected Kshs.167,227,229, resulting in a variance of Kshs.2,735,694 which was not explained. The unreconciled figure of Kshs.169,962,923 is still appearing as comparative figure in the 2017/18 financial statements.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of County Assembly of Machakos 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 of the current year. 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. Inadequate Funding for the County Assembly

The County Assembly's approved budget for the year under review was Kshs.1,227,670,184 while the amount received was Kshs.943,986,147 resulting in an under funding of Kshs.283,684,037. Part of the money not received was to be utilized in; advancing loans (Kshs.35 million), purchase of motor vehicles (Kshs.48 million), purchase of land for putting up the speaker's residence, (Kshs.16 million), and establishment of a broadcasting unit for the County Assembly (Kshs.20 million). These activities were not undertaken.

2. Lack of Footnotes to Explain Variances Between Budgeted and Actual Amounts

The statement of comparison of budget and actual amounts reflects amounts of Kshs.397,278,781 and Kshs.358,214,428 for budgeted and actual figures respectively for use of goods and services expenditure item.

The County Assembly has not given explanations for the variance of Kshs.39,064,353.

3. Failure to Remit Statutory Deductions

Note 4.10(1) to the financial statements reflects a figure of Kshs.67,542,430 under other disclosures. This figure includes an amount of Kshs.5,805,653 being PAYE deductions (payable to Commissioner of Income Tax) that were made from County Assembly employees in the month of February 2017, but which had not been remitted as at the close of audit.

Delay in remittance of the PAYE deductions to Commissioner of Income Tax will result in penalties to the entity.

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 and Adverse Opinion 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. Failure to Appoint an Audit Committee

During 2017/2018 the County Assembly operated without an audit committee contrary to regulation 42(1) and 168 (a and b) of Public Finance Management Regulations, 2015. The regulations require an Accounting Officer to ensure appointment of an audit committee, whose main function is to offer support with regard to the Accounting officer's responsibilities on issues of risk management, control and governance and associated assurance.

The Accounting Officer failed to comply with regulations, and as such, the duties and responsibilities of audit committee as stipulated in regulation 168 (a and b) of Public Finance Management Regulations of 2015 were not undertaken during the financial year.

2. Irregular Reallocation of Funds

The Accounting officer authorized transfers of Kshs.101,723,500 appropriated in the 2017/2018 budget from the wages to non-wages expenditure contrary to section 154(1c) of Public Financial Management Act, 2012. There was no explanation as to what necessitated the transfer and there was no evidence that the County Treasury had been consulted on the matter.

3. Failure to Prepare a Performance Report

Section 164 (f) of the Public Finance Management Act, 2012 requires County Governments to prepare and submit to the Auditor-General a report on the entity's performance against pre-determined objectives. The County Assembly did not prepare and submit this report to the Auditor-General.

4. Prior Year Issue – Irregularly Paid Acting Allowances

During 2016/2017 three officers were irregularly paid a total of Kshs.642,717 as acting allowance, contrary to provisions of Chapter 14 of the Human Resource Policies and Procedure Manual for the Public Service. The amount remains unrecovered to date.

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

1. Lack of a Risk Management Policy

In addition to issues discussed in other sections on my report, the County Assembly does not have a risk management policy. Failure to develop a risk policy means that the County Assembly does not have a framework for management of risk and hence it is not possible to identify, assess and control risk. As a result, it is not possible to define the entity's risk appetite and set the risk tolerance levels by identifying boundaries against unacceptable exposure to risk.

2. Lack of an ICT Policy

The County Assembly has not prepared and implemented an ICT policy as a commitment to the process of implementing digital technology. An ICT policy would also provide confidentiality, integrity and ensure availability of the entity's data.

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.

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 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 County Assembly's ability to continue sustaining services, disclosing, as applicable, matters related to sustainability of services and using the going concern basis of accounting unless the management either intends to liquidate the County 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 County Assembly'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 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 County 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 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 County Assembly 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
<u>AUDITOR-GENERAL</u>

Nairobi

18 February 2019