REPORT OF THE AUDITOR-GENERAL ON LAMU COUNTY EXECUTIVE FOR THE YEAR ENDED 30 JUNE, 2019

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Lamu County Executive set out on pages 1 to 47, which comprise the statement of assets and liabilities as at 30 June, 2019, statement of receipts and payments, statement of cash flows, and the summary statement of appropriation: 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, except for the 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 Lamu County Executive 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 (Cash Basis) and comply with the Public Finance Management Act, 2012 and County Governments Act, 2012.

Basis for Qualified Opinion

1. Unsupported Own-Generated Receipts

The statement of receipts and payments for the year ended 30 June, 2019 reflects own-generated revenue totalling Kshs.73,222,437, as further disclosed under Note 9 to the financial statements. The balance was reportedly, generated through two (2) electronic accounting systems as well as manual receipts. However, Management did not present the electronic reports for audit review.

In the absence of reports showing how the balances were arrived at, the accuracy and completeness of own generated revenue totalling Kshs.73,222,437 reflected in the statement of receipts and payments for the year ended 30 June, 2019 has not been confirmed.

2. Use of Goods and Services

The statement of receipts and payments for the year ended 30 June 2019 reflects use of goods and services expenditure totalling Kshs.698,569,368, as further disclosed under Note 12 to the financial statements. However, the following unsatisfactory matters were observed in relation to the expenditures:

2.1 Unsupported Airtime Expenses

Management paid for mobile phone airtime valued at Kshs.7,609,398 during the year under review. However, payment receipts and records showing the persons to whom the airtime was granted were not presented for audit.

In the circumstance, the occurrence and validity of the expenditure has not been confirmed.

2.2 Unsupported Domestic Travel and Subsistence

Management paid for domestic travel and subsistence allowances totaling Kshs.118,068,851 during the year under review. However, invitation letters for training and other seminars and workshops attended, attendance registers and travel documents for expenditure totaling Kshs.13,710,750 were not presented for audit review.

2.3 Unsupported Hospitality Supplies and Services

Management paid for hospitality supplies and services totaling Kshs.24,852,947. However, expenditures totalling Kshs.1,654,170 were not supported with requisitions, local purchase orders, invoices and evidence of services offered.

2.4 Unsupported Insurance Costs

Payments totalling Kshs.150,478,771 were recorded as having been incurred on insurance costs during the year under review. However, included in the expenditure were domestic travel allowances totalling Kshs.4,999,700 and purchase of computers valued at Kshs.7,425,400 which were not valid charges to the insurance account.

Also charged to the insurance account were subscriptions to the National Hospital Insurance Fund (NHIF) Universal Health Scheme totalling Kshs.101,202,000. However, no evidence was presented for audit review to show that the persons who benefited from the NHIF Universal Health Scheme payments were vulnerable and deserving residents of Lamu as provided for in the memorandum of understanding signed between the management and the NHIF. Therefore, the validity of the expenditure could, similarly, not be confirmed. In addition, Kshs.33,577,592 was paid as part payment of a premium valued at Kshs.42,977,592 purchased for a medical scheme provided by the NHIF to six hundred and sixteen (616) employees. However, Management did not present the medical cover agreement for audit review. Furthermore, there was no evidence that all employees of the County Executive were covered by the scheme and therefore its fairness and equity could not be confirmed.

2.5 Unsupported Fuel, Oil and Lubricant

The purchase of goods and services expenditure balance totalling Kshs.698,569,368 reflected in the statements of receipts and payments includes expenditures totaling Kshs.30,781,409 which amount however, differs from the sum of Kshs.41,425,950 shown in the primary fuel consumption records maintained by the Transport Department. The difference of Kshs.10,644,541 between the two sets of records has not been explained.

Further, the fuel sales were invoiced before they were drawn from the suppliers. Management did not present evidence linking the payments made for fuel reported to have been drawn, and user documents such as work tickets, fuel registers and detailed orders for audit review. In the absence of relevant evidence, the receipt and use of the fuel paid for by the County Assembly has not been confirmed.

In view of the foregoing, it has not been possible to confirm the occurrence, measurement and validity of use of goods and services expenditures totalling Kshs.698,569,368 reflected in the statement of receipts and payments for the year ended 30 June, 2019.

3. Unsupported Acquisition of Assets

The statement of receipts and payments for the year ended 30 June, 2019 reflects acquisition of assets expenditure totalling to Kshs.382,746,356, as further disclosed under Note 17 to the financial statements. However, a payment amounting to Kshs.124,071,835 made to Kenya Power and Lighting Company for street lighting was not supported by details of scope of works and services supplied by the Company. Similarly, purchase of certified seeds, breeding stock and live animals valued at Kshs.32,636,000 was not supported by records confirming that the supplies were delivered to farmers. In view of these anomalies, the propriety of the expenditures has not been confirmed.

Consequently, the valuation and validity of the acquisition of assets expenditure totalling Kshs.382,746,356 reflected in the statement of assets and liabilities as at 30 June, 2019 has not been confirmed.

In addition, as indicated in Annexure 5 to the financial statements, the County Executive held fixed assets valued at Kshs.1,475,781,079 in aggregate as at 30 June, 2019. However, Management maintained a fixed-asset register on assets valued at Kshs.16,711,000 being those in the finance department only. Therefore, assets valued at Kshs.1,459,070,079 were not on record as property of the County Executive and therefore, their ownership and existence as at 30 June, 2019 could not be confirmed.

4. Unsupported Accounts Payable – Deposits and Retentions

The Statement of Assets and Liabilities as at 30 June, 2019 reflects accounts payable-deposits and retentions totalling Kshs.76,771,029. However, Management did not present for audit review, deposits and retentions ledgers that the amounts included in the aggregate balance were extracted from.

In the absence of primary records, the accuracy, completeness and validity of the accounts – payable deposits and retentions totalling Kshs.76,771,029 reflected in the Statement of Assets and Liabilities as at 30 June, 2019 has not been confirmed.

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

1. Budgetary Control and Performance

The summary statement of appropriation: recurrent and development combined for the year ended 30 June, 2019 reflects final receipts budget and actuals on comparable basis totalling Kshs.4,845,226,224 and Kshs.4,427,642,913 respectively, resulting to a revenue shortfall amounting to Kshs.419,096,764 or 9% of the budget. Similarly, out of the receipts totaling Kshs.4,427,642,913 received during the year, only Kshs.2,916,249,263 was spent leaving Kshs.1,511,393,650 or 34% of the receipts unspent.

The low spending ratio curtailed execution of many planned activities and had an adverse effect on service delivery.

2. Pending Bills

Annex 2 to the financial statements reflects pending bills totalling Kshs.114,277,332. However, the schedule provided for audit review did not show the original amounts billed, date contracted, amounts paid as well as local purchase and service orders and invoices. As a result , it was not possible to confirm the authenticity of the bills. Further, creditors' ledgers were not made available for audit and therefore movement of the balance from Kshs.101,781,106 as at 30 June, 2018 to Kshs.114,277,332 as at 30 June, 2019 could not be confirmed. Failure, to pay the pending bills is bound to constrain financing of other programs in the year(s) the bills shall be paid.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229(6) of the Constitution, based on the audit procedures performed, except for the matters described in the Basis for Qualification and Basis for Conclusion on Lawfulness and Effectiveness in the Use of Public Resources section of my report, I confirm that, nothing else has come to my attention to cause me to believe that public resources have not been applied lawfully and in an effective way.

Basis for Conclusion

1. Failure to Implement Budgeted Projects

A review of the status of the projects budgeted to be implemented during the year under review established that projects for various departments valued at Kshs.1,342,033,875 had not started or were not implemented during the year. As a result, funds expected to be spent in the local economy and services that the residents were to enjoy were not actualized.

No plausible explanation has been provided by Management for the delays in executing planned projects.

2. Stalled Health Projects

As previously reported, the Management received a conditional grant amounting to Kshs.200,000,000 in the financial year 2016/2017 from the National Government to upgrade Lamu County Hospital and health facilities. However, the funds received were not released to the project bank account or special purpose account contrary to Section 74(5) of the Public Finance Management (County Government) Regulations, 2015. Part of the grant was to finance the outpatient and maternity wings at Faza Sub-County Hospital and Mpeketoni Sub-County Hospital. Physical verification confirmed that the projects had stalled after the respective contractors abandoned the project sites.

Under the circumstances, the residents of Lamu County are yet to obtain improved services from the grants amounting to Kshs.200,000,000 disbursed to the County by the National Government.

3. Failure to Publish Financial Manuals

During the period under review, the management did not avail evidence that the County Treasury published financial manuals as required by Section 91(1) of the Public Finance Management (County Governments) Regulations, 2015.
Consequently, Management breached public financial management regulations and the omission has raised the risk of irregular and ineffective management of public funds in the County.

4. Irregular Payments

4.1 Irregular Purchase of Goods and Services

Available records indicated that during the year under review, Management spent Kshs.10,288,000 on hire of security and cleaning services. However, procurement records in respect of seven (7) suppliers that provided cleaning services were not presented for audit review. In addition, goods and services amounting to Kshs.16,625,972 were procured and paid for but requisitions from user departments were not made available for audit review. In addition, Kshs.1,019,400 was spent on purchase of firefighting items even though the County has no fire station. This was contrary to Section 68 of the Public Procurement and Assets Disposal Act, 2015.

In the circumstances, the Management may have breached laws on procurement and economic and effective management of public funds.

4.2. Irregular Funding of Council of Governors

Management spent Kshs.2,425,841 on behalf of the Council of Governors for rental payments for the Counties Liaison Office located in Nairobi. The payment contravened Section 37 of the Inter-governmental Relations Act, 2 of 2012 which requires that such operational expenses in respect of the structures and institutions established under the Act be provided for in the annual estimates of the revenue and expenditure of the National Government.

Therefore, Management's action was irregular.

5. Irregular Bank Accounts

During the year under review, Management operated thirty (33) bank accounts out of which twenty-two (22) were with commercial banks and eleven (11) with the Central Bank of Kenya. This was contrary to the Public Finance Management (County Governments) Regulations, 2015 Section 82(1)(b) which stipulates that all County Government bank accounts shall be opened at the Central Bank of Kenya except for imprest bank accounts for petty cash. In the circumstance, Management's action was irregular.

6. Irregular Spending of Revenue at Source

During the year under review, own generated revenue totalling Kshs.13,419,870 was spent on collection contrary to Section 102 of the Public Finance Management Act, 2012.

Therefore, Management acted contrary to the law on management of revenue generated by public entities.

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, based on the audit procedures performed, except for the matters described in the Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance section of my report, I confirm that, nothing else has come to my attention to cause me to believe that internal controls, risk management and overall governance were not effective.

Basis for Conclusion

1. Ineffective Internal Controls on Expenditure

The audit noted that the accounting office did not serialize (number) payment vouchers. Further vote book certificates cited on the payment vouchers did not indicate approved estimates for the respective items as well as total expenditure commitments and the balance thereof.

The omissions raised the risk of overspending and misappropriation of funds and showed that Management did not have effective control on expenditure.

2. Ineffective Internal Control on Revenue

Examination of revenue records revealed that ten (10) receipt books issued to two (2) revenue collectors in the public health and fisheries departments were not surrendered. In the circumstance, revenue collected through the receipt books was not accounted for.

Further, Management operated two (2) automated systems for collection of revenue, which however, had the following internal control weaknesses:

(i) Records showing how the point-of-sale machines were distributed to revenue collectors were not made available for audit review. As a result, the completeness and accuracy of collections made could not be established.

ii) There was no evidence to show that four (4) of the 27 point-of-sale machines used during the period under review were configured to the main system. As a result, an effective audit trail for revenue collected through the four machines was missing.

iii) Management did not present for audit review a system-generated consolidated batch report showing total collections per machine for the entire financial year. Therefore, collections made through each machine could not be verified independently.

iv) All collection modules for one of the two electronic systems were managed and controlled by the vendor. As a result, the revenue administrator relied on reports generated by the vendor. However, the accuracy of the reports could not be verified independently.

v) Although Management paid for all functionalities contained in the two systems, the contracts for the systems were not executed in whole as the mobile money payments function was not activated. Similarly, the USSD(Unstructured Supplementary Service Data) functionalities for payments and querying as well as integration and mobile short messaging SMS) alerts were not installed. Further, the two systems were not integrated with IFMIS. As a result, value for the money spent to procure the systems was not obtained.

vi) Management did not present for audit review accounts payable aged debtors, reconciliation as well as system audit reports. As a result, the actual debt balances as at 30 June, 2019 and internal control status of the system could not be confirmed.

vii) The front-end service portal for one system intended to enable county residents to access and procure county services, register individual profiles and manage their accounts was not operationalized. Therefore, the quality of service delivery experience enjoyed by the residents did not improve in spite of the investment made by the County in the system.

viii) Management did not present an updated lands register, business register as well as outstanding land rates. As a result, it was not possible to determine whether the revenues reported were complete and accurate.

ix) The backup policies and procedures for the system were not adequate and therefore the risk of losing electronic data was high.

In view of the foregoing, internal control on receipt books and the automated revenue systems were not operating in an effective way. Further, the value for the investments made in the automated system was obtained only in part.

5. Weak Controls on Cash and Bank

A review of cash and bank records established that entries to the manual cashbook were incomplete as particulars of the payments, voucher numbers, and allocations were not indicated. Further, bank reconciliations were prepared manually and not in IFMIS as required.

Consequently, the internal control over records was not effective and therefore the risk of misappropriation of funds was high all through the year under review.

6. Ineffective Internal Audit Function

The internal audit function had only three (3) officers who reported to the County Executive Committee Member for Finance instead of an Audit Committee. Further, Management did not avail an approved Internal Audit Charter detailing the scope, responsibilities and purpose of the internal audit function. As a result, existence of the charter could not be confirmed. This was contrary to the provisions of Section 155(2) of the Public Finance Management (County Governments) Regulations, 2015 which stipulate that an Accounting Officer shall ensure that an internal audit unit is facilitated with sufficient authority to promote independence and ensure broad internal coverage, and adequate consideration of audit reports.

In the circumstance, the Management was in breach of public finance management regulations. Further, the effectiveness of the County Executive's internal audit function was impaired.

7. Irregular Payroll Deductions

Examination of the Integrated Payroll and Personnel Database (IPPD) system revealed that one hundred and twenty (120) officers earned net salaries that were less than a third (1/3) of their basic pay during the month of June, 2019 contrary to the Human Resource Policies and Procedures Manual for Lamu County Public Service which prohibits officers from over-committing their salaries to check-off deductions.

As a result, Management flouted its own policies and put the staff at risk of pecuniary embarrassment.

8. Lack of Updated Fixed Assets Register

As highlighted elsewhere in my report, the Lamu County Executive does not maintain a complete record of its assets as only assets valued at Kshs.16,711,000 were on record in the assets register as at 30 June, 2019 against total assets valued at Kshs.1,475,781,079 shown in Annex 5 to the financial statements. In addition, the policies and procedures on management of assets were not availed for audit review. There were also no reports to indicate that the fixed assets were inspected from to time to establish their condition and security. Further, in the absence of a register for land and buildings, information on each parcel of land and building, including the terms on which it was held, the conveyance, location, dates and costs of acquisition and other details required by Section 136(2) of the Public Finance Management (County Government) Regulations, 2015 could not be confirmed.
In view of these omissions, internal control over the assets is weak and further, the assets are not managed in lawful and effective manner.

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

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

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 County Executive 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 overall 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 overall 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 Management.

- Conclude on the appropriateness of 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 County Executive’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 County Executive 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 Executive 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 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

16 October, 2020