

REPORT OF THE AUDITOR-GENERAL ON EMBE WATER AND SANITATION COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2017

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of the Embe Water and Sanitation Company Limited set out on pages 15 to 30, which comprise the statement of financial position as at 30 June 2017, and statement of comprehensive income, statement of changes in equity, statement of cash flows for the year then ended, together with 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 effect 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 Embu Water and Sanitation Company Limited as at 30 June 2017, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Water Act, 2016 and the Companies Act, 2015.

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

1.0 Property, Plant and Equipment

1.1 Ownership of Land and Buildings

Note 2 to financial statements reflects a decrease of Kshs.9,810,316 in respect to Property, Plant and Equipment from Kshs.95,674,758 as at 30 June 2016 to Kshs.85,864,442 as at 30 June 2017

However, as reported in previous years, the property plant and equipment balance of Kshs.85,864,442 as at 30 June 2017 included Kshs.4,850,000 and Kshs.14,051,507 for land and buildings respectively both totaling Kshs.18,901,507 inherited from the Ministry of Water and Irrigation and maintained by the Company but whose ownership had not been transferred to the Company as at 30 June 2017.

Consequently, the accuracy and ownership of the land and building valued at Kshs.18,901,507 as at 30 June 2017 could not be confirmed.

1.2 Water Distribution Infrastructure

The property, plant and equipment balance of Kshs.85,864,442 as at 30 June 2017 includes capital expenditure of Kshs.64,323,961 incurred in respect of plant and machinery which comprised of water distribution infrastructure. As per the vesting agreement, the ownership of water distribution infrastructure vests in Tana Water Services Board and that any capital expenditure relating to water distribution infrastructure needs prior approval of the Water Board before expenditure is incurred by the company which may then place a reimbursement claim of the expenditure with the Board. However, this prior approval was not made available for audit confirmation and therefore the Kshs.64,323,961 expenditure may not be reimbursed by the Board.

In view of the foregoing, the accuracy and ownership of the property, plant and equipment balance of Kshs.85,864,442 as at 30 June 2017 could not be confirmed.

2.0 Account Receivables

Note 4 to financial statements reflects an increase of Kshs.1,049,061 in respect to account receivables from Kshs.9,943,626 as at 30 June 2016 to Kshs.10,992,687 as at 30 June 2017. However, as reported in previous years, the receivables balance of Kshs.10,992,687 as at 30 June 2017 included gross trade receivables amounting to Kshs.1,893,821 inherited from the Ministry of Water and Irrigation and which has remained outstanding for a considerably long period of time.

Although a general provision for bad and doubtful debts of 5% of gross trade receivables amounting to Kshs.578,562 had been made in the financial statements. The respective debtors age analysis was not made available for audit review. Therefore, the bad and doubtful debts provision of 5% was deemed inadequate.

In view of the foregoing, the accuracy and recoverability of the account receivables balance of Kshs.10,992,687 as at 30 June 2017 could not be confirmed.

3.0 Loss of Cash

As reported in previous years, Minute 16/06/04 of the Board meeting held on 18 November 2014 stated that two cashiers had defrauded the Company of Kshs.782,385 as follows;

Name	Amount (Kshs)
Joseph Gitonga	341,750
Dennis Mugambi	<u>440,635</u>
Total	<u>782,385</u>

Except for the unreplied letters to the culprits, no other documents were made available to show actions being taken to recover the amount.

In the circumstances, the recovery of the Kshs.782,385 cash loss could not be ascertained.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Embe Water and Sanitation Company Limited 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 judgment, 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 of my report, I have determined that there are no Key Audit Matters to communicate in my report.

Other Matter

1. Non-Revenue Water (NRW)

During the year under review, the Company produced 842,241 cubic meter (m³) of water. However, only 431,108m³ was billed to customers. The balance of 411,133m³ or approximately 48.81% of the total volume produced represented Non-Revenue Water (NRW) which is over and above the allowable loss of 25% as provided by Schedule E, Section 85 of the Water Service Regulatory Board (WASREB) guidelines. Therefore, although 48.81% of the 842,241 cubic meter (m³) total water produced during the year was NRW, only 210,560m³ (25%) with an estimated sale price of Kshs.13,581,120 (Average price /m³ = Kshs.64.50) was an allowable loss while the balance of 200,573m³ (23.81%) with an estimated sale price of Kshs.12,936,959 was a non-allowable loss. The total NRW of 48.81% may have resulted in a loss of water sales estimated at Kshs.26,518,079.

In the circumstances, the significant high level of NRW if not addressed will negatively impact on the Company's profitability and its long-term sustainability.

2. Budget and Budgetary Control

During the year under review, the Company had an approved expenditure budget of Kshs.41,511,809. However, a comparison of the approved budget with the actual expenditures revealed that the Company over spent in nine (9) items by Kshs.1,631,496 as follows;

Components	Approved Budget (Kshs)	Actual Expenditure (Kshs)	Variance (Kshs)	Budget Absorption %
Daily Casuals Payments	2,828,256	3,616,536	(788,280)	128%
Electricity-Office	72,000	158,616	(86,616)	220%

Administration				
Travel and Accommodation	2,236,919	2,640,557	(403,638)	118%
Telephone, Fax, E-Mail/Mobile	438,400	481,400	(43,000)	110%
Director's Sitting Allowances	947,500	1,018,500	(71,000)	107%
Stakeholders Meeting, Exhibits and Marketing(Collaboration and Networking)	160,000	253,500	(93,500)	158%
Equipment and Transport Hire	122,000	158,616	(36,616)	130%
Computer and Equipment Maintenance & Repair	72,000	120,886	(48,886)	168%
Maintenance of Office Building and Grounds	60,000	119,960	(59,960)	200%
Total	6,937,075	8,568,571	(1,631,496)	124%

No supplementary budget approving the over-expenditure was made available.

In the circumstances, it was not possible to ascertain the source and authority of Kshs.1,631,496 over-expenditure.

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 Financial Reporting Standards 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 Company's ability to continue as a going concern/ 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 Company's 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 Company'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 Company'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 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 Company's ability to continue as a going concern. 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 Company to cease to continue as a going concern.
- 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 Company 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Companies Act 2015, I report based on the audit, that;

- i. 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; and
- ii. In my opinion, adequate accounting records have been kept by the Company, so far as appears from my examination of those books; and
- iii. The Company's financial statements are in agreement with the accounting records and returns.



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

Nairobi

07 June 2018