

REPORT OF THE AUDITOR-GENERAL ON EMBE WATER AND SANITATION COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Adverse Opinion

I have audited the accompanying financial statements of Embe Water and Sanitation Company Limited set out on pages 15 to 31 which comprise the statement of financial position as at 30 June 2018, and the statement of comprehensive income, statement of changes in equity, statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information in accordance with the provisions of Article 229 of the Constitution of Kenya and Section 35 of the Public Audit Act, 2015. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit.

In my opinion, 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 Embe Water and Sanitation Company Limited as at 30 June 2018 and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards (Accrual Basis) and do not comply with the Water Act, 2016 and the Companies Act, 2015.

Basis for Adverse Opinion

1.0 Inaccuracies in the Financial Statements

1.1 Variances Between Prior Year Retained and Loss Balances and the Respective Comparative Figures

Note 9 to the financial statements for the year ended 30 June 2018 reflects an opening balance of Kshs.102,971,382 on retained earnings while the audited 2016/2017 financial statements had a closing balance of Kshs.102,977,682 resulting to unexplained variance of Kshs.6,300.

Further, the statement of comprehensive income for the year under review reflects a comparative balance of Kshs.11,637,625 in respect to the 206/2017 operating profit/loss while the audited 206/2017 financial statements indicates a balance of Kshs.11,643,926 resulting to unexplained variance of Kshs.6,301.

In the circumstances, the accuracy of Kshs.108,372,026 in respect to retained earnings as at 30 June, 2018 cannot be ascertained.

1.2 Accuracy of the Statement of cash flows

The statement of cash flows for the year ended 30 June 2018 reflects a deficit of Kshs.8,020,966 for the year under review while the statement of comprehensive income reflects a deficit of Kshs.8,022,767 resulting to unexplained variance of Kshs.1,801.

In addition, the statement of cash flows reflects Kshs.2,626,622 restatement/adjustment on non- cash items. However, the respective details and supporting documents were not availed for audit review.

In the circumstances, the validity and accuracy of the statement of cash flows for the year ended 30 June 2018 cannot be ascertained.

1.3 Accuracy of the Comparative Balances Between the Statement of Cash Flows and Statement of Financial Position

The statement of cash flows reflects Kshs.4,029,307 in respect to closing cash and cash equivalents as at 30 June, 2017 while the statement of financial position reflects Kshs.1,029,307 comprising of cash and bank balance of Kshs.3,051,233 and a bank overdraft of Kshs.4,080,540 resulting in unreconciled variances of Kshs.3,000,000.

In the circumstances, the accuracy of Kshs.1,944,758 in respect to cash and bank balances in the statement of financial position as at 30 June, 2018 cannot be ascertained.

2.0 Cash and Bank Balances

Note 5 to the financial statements reflects Kshs.1,944,758 in respect to cash and cash equivalents which includes Kshs.309,724 held in a current account in a bank. However, the bank reconciliation statement for the same current account reflects a negative cashbook balance of Kshs.3,169,252 resulting to unexplained and unreconciled balance of Kshs.3,478,976. In addition, the bank reconciliation statement reflects unrepresented cheques totaling to Kshs.1,174,253 which became stale cheques as at 31 December 2018 but were not reversed in the cashbook and hence understating the cash at bank with the same amount.

Further, note 5 to the financial statement reflects Kshs.4,441 in respect to cash in hand while the petty cashbook reflects a negative cash balance of Kshs.314,065 as at 30 June 2018 resulting to unexplained and unreconciled variance of Kshs.318,506.

In the circumstances, the validity and accuracy of the Kshs.1,944,758 cash and bank balances as at 30 June 2018 cannot be ascertained.

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.

However, except for the copies of the letters to the culprits, no other documents were made available to show actions is being taken to recover the amount.

In the circumstances, recoverability of the Kshs.782,385 is in doubt as at 30 June 2018.

4.0 Payables and accruals

The statement of financial position as at 30 June 2018 reflects Kshs.10,701,093 in respect to payables and accruals which includes Kshs.3,478,976 and whose supporting documents including supplier invoices and creditor ledgers were not availed for audit review.

In the circumstances, the validity and accuracy of the Kshs.3,478,976 in respect to payables and accruals as at 30 June 2018 cannot be ascertained.

5.0 Account Receivables

Note 4 to the financial statements reflects Kshs.16,072,915 in respect to accounts receivables as at 30 June 2018. However, as reported in the previous years, the receivables balance of Kshs.16,072,915 as at 30 June 2018 included gross account receivables of Kshs.1,893,821 inherited from the Ministry of Water and Irrigation in 2006 and which remained outstanding for 13 years.

Further, included in the Kshs.16,072,915 accounts receivables is a general provision for bad and doubtful debts of Kshs.845,943 being 5% on gross receivables which is deemed inadequate considering that the receivables have been outstanding for a considerably long period of time.

In the circumstances, the recoverability of the account receivables balance of Kshs.16,072,915 as at 30 June 2018 and the adequacy of the provision for bad and doubtful debts of Kshs.845,943 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 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 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

1.0 Budget Control and Performance

1.1 Revenue Analysis

The approved budget for the year ended 30 June 2018 reflects budgeted revenue of Kshs.36,187,961 and actual revenue of Kshs.27,650,702. The Company under-realized the budget by Kshs.9,085,812 on four (4) items and over- realized the revenue by Kshs.548,553 on three (3) other items as shown below:

Item	Budget (Kshs)	Actuals Amounts (Kshs)	Over (Kshs)	Under (Kshs)	%
Water Sales	35,210,885	26,140,069		9,070,816	25.8%
Reconnection Fees	615,196	632,200	17,004		2.8%
Application Fees	36,188	63,937	27,749		76.7%
Deposits	0	503,800	503,800		100.0%
Labour	108,564	99,775		8,789	8.1%
Penalties	180,940	175,832		5,108	2.8%
Others	36,188	35,089		1,099	3.0%
Total Incomes	36,187,961	27,650,702	548,553	9,085,812	

The revenue over-realization of Kshs.548,553 (1.5%) may be a pointer to very low set targets hence there is need for the management to review its budgeting mechanism with a view to coming up with more realistic revenue budgets to achieve higher revenue growth. In addition, the Kshs.9,085,812 in respect to under- realization revenue budget may be revenue collected but not accounted for and could also be an indication of improper budget planning process.

1.2 Expenditure analysis

The approved budget for the year ended 30 June 2018 reflects a budgeted expenditure of Kshs.34,106,051 and actual expenditure of Kshs.28,155,614 resulting to an under expenditure of Kshs.6,332,658 on thirty- three (33) items and over expenditure of Kshs.382,221 on three (3) other items as shown below:

Item	Budget (Kshs)	Actuals Amounts (Kshs)	Over (Kshs)	Under (Kshs)	%
Regulatory Fees	3,373,160	3,150,318		222,842	6.6
Raw Water Charges Fees	414,459	245,232		169,227	40.8
Water Systems Repairs	2,319,996	1,485,420		834,576	36.0
Directors Allowances	988,600	666,000		322,600	32.6
Salaries	12,300,000	11,185,906		1,114,094	9.1
Casual Labour	3,166,573	3,159,423		7,150	0.2
Staff Welfare	270,080	266,400		3,680	1.4
Staff Travel and Subsistence	2,410,900	2,408,107		2,793	0.1

Item	Budget (Kshs)	Actuals Amounts (Kshs)	Over (Kshs)	Under (Kshs)	%
Electricity	266,904	226,990		39,914	15.0
Printing & Stationery	238,000	217,283		20,717	8.7
Telephone, Fax and Mobile	590,000	499,600		90,400	15.3
Advertising and Publicity	121,600	14,640		106,960	88.0
Transport & Equipment Hire	238,000	235,800		2,200	0.9
Insurance	224,992	308,060	83,068		36.9
Office Cleaning & Misc.	30,000	19,560		10,440	34.8
Postage and Courier	43,840	22,880		20,960	47.8
Stakeholders Meeting and Exhibition	608,080	0		608,080	100.0
Consultant and Freelance	320,000	0		320,000	100.0
Chemicals and Lab Reagents	1,377,080	1,616,463	239,383		-17.4
Computer Repairs	140,000	138,450		1,550	1.1
Building, Ground & General Repairs	40,000	30,865		9,135	22.8
Motor Vehicle and Cycle Running Costs	600,000	362,751		237,249	39.5
Motor Vehicle Fuel	861,600	750,200		111,400	12.9
Security Services	553,000	418,500		134,500	24.3
Miscellaneous Penalties and Contingencies	24,000	9,970		14,030	58.5
Staff Uniforms & Protective Clothing	274,000	0		274,000	100.0
Bicycle Repairs	30,000	19,800		10,200	34.0
Bank Charges	513,727	258,756		254,971	49.6
Audit Fees	100,000	0		100,000	100.0
Gratuity	707,920	0		707,920	100.0
Entertainment	407,540	378,470		29,070	7.1
Staff Training	224,000	0		224,000	100.0
Deposit Refund	0	59,770	59,770		100.0
Legal Fees	120,000	0		120,000	100.0
Office Furniture/ Fittings Repairs	48,000	0		48,000	100.0
Water Quality Analysis	160,000	0		160,000	100.0
	34,106,051	28,155,614	382,221	6,332,658	

The under-spending of the budget by Kshs.6,332,658 reflected equivalent services denied to the customers by the Water Company. Further, no approval was availed for audit review for the Kshs.382,221 over-expenditures. There is therefore need for the management to re- look at its budgeting mechanism with a view to focusing on areas which will improve service delivery to the citizens of Embu County.

2.0 Financial Performance

The statements of comprehensive income for the year ended 30 June 2018 reflected Kshs.29,869,681 and Kshs.37,892,448 as total income and total expenditure

respectively resulting in a deficit of Kshs.8,022,767 or 26.9% of total incomes for the year ended 30 June 2018.

Although the deficit decreased by Kshs.3,616,660 from Kshs.11,637,626 as at 30 June 2017 to Kshs.8,022,767 as at 30 June 2018, the Company continue to operate at a loss which if not managed may affect its future existence.

3.0 Property Plant and Equipment

Note 2 to the financial statements reflects property, plant and equipment balance of Kshs.76,948,728 as at 30 June 2018. However, as reported in previous years, the property, plant and equipment balance of Kshs.76,948,728 as at 30 June 2018 included Kshs.4,850,000 and Kshs.13,700,219 for land and buildings respectively both totalling to Kshs.18,550,219 inherited from the Ministry of Water and Irrigation and maintained by the Company. However, evidence of transfer of ownership has not been confirmed as at 30 June 2018.

Consequently, the ownership of the land and buildings valued at Kshs.18,550,219 as at 30 June 2018 could not be confirmed.

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

1.0 Financial Statements Presentation and Disclosure

The Public Sector Accounting Standards Board (PSASB) recommends that the financial statements should;

- i) have a concise description of each Director's date of birth, key qualifications and work experience.
- ii) The General Manager and the head of finance should sign and indicate their names on the statement of financial position while the head of finance should also indicate his/her Institute of Certified Public Accountants (ICPAK) membership number.
- iii) have a heading "Statement of Cash Flows" in its cash flow statements.

iv) have a statement of comparison of budget and actual amounts.

However, the Company's financial statements for the year under review did not include the above statements and information in the financial statements for the year ended 30 June, 2018. Further, the statement of cash flows also does not have heading while Cash flows from financing activities are shown before cash flows from investing activities instead of after cash flows investing activities.

In the circumstances, the financial statements for the year under review are not prepared in accordance with the recommended PSASB format.

Irregular Payment of Casual Wages

Note 17 (ii) to the financial statements reflected Kshs.3,159,423 in respect to casual labor expenses. However, the casual workers were engaged for twelve months in the financial year under review contrary to Section 5.12 of the approved Human Resource Policy Manual of the Company which states that casuals should not be engaged for more than three (3) months. Further the respective engagement letters for the casuals were not made available for audit review.

In the circumstances, the Company is in breach of its human resource policy manual during the year ended 30 June 2018.

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

1.0 Lack of Internal Audit Unit

The Company did not have an internal audit section to carry out internal audit functions contrary to Section 1551(1) (a) of the Public Finance Management (PFM) Act 2012

which states that a County Government entity shall ensure that appropriate arrangements for conducting internal audit according to the guidelines issued by the Accounting Standards Board.

In the circumstances, the Company is in breach of the law.

2.0 Non-Revenue Water

Note 16 to the financial statements for the year ended 30 June 2018 reflects 876,337 cubic meters (m³) of water produced for consumption during the year. However, only 494,443m³ was billed to customers while the balance of 381,894m³ or approximately 44% of the total volume produced was lost as Non-Revenue Water(NRW) which is over and above the allowable loss of 25% as provided by schedule E of the Water Service Regulatory Board (WASREB) guidelines by 19%.

Therefore, although 381,894 m³ out of 876,337m³ total water produced during the year was NRW, only 219,084m³ (25%) with an estimated sale price of Kshs.12,787,948 (At Kshs.58.37 per cubic meter) was an allowable loss while the balance of 162,810m³ (19%) with an estimated sales price of Kshs.9,503,205 was a non-allowable loss. The total NRW of 381,894 m³ (44%) may have resulted in a loss of water sales estimated at Kshs.22,291,153. This huge non allowance water loss, if not addressed, may have a negative effect on the Company's future profitability and its long term sustainability.

Further, note 16 to the financial statements for the year ended 30 June 2018 reflected 494,443 cubic meters (m³) of water billed by the Company while monthly analysis of water billing showed that 474,365 cubic meters of water had been billed to customers resulting to unexplained and unreconciled variance of 20,078 m3 of water.

In the circumstances, the 494,443 cubic meters (m³) of water billed to by the Company may have been overstated.

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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Companies Act, 2015, I report based on my 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;
- ii. In my opinion, adequate accounting records have not been kept by the Water Company , so far as appears from the examination of those records; and,

- iii. The financial statements are not in agreement with the accounting records and returns.

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 Financial Reporting Standards (Accrual 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 Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the applicable basis of accounting unless the management either intends to liquidate the Company 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 Company'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 Company's 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 Company'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 Company's 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 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

04 March 2019