

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

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Embu Water and Sanitation Company Limited set out on pages 1 to 25 which comprise the statement of financial position as at 30 June 2018, and the statement of profit and loss and other comprehensive income, statement of changes in equity, statement of cash flows and statement of comparison of budget and actual amounts 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 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 2018 and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with Water Act, 2016 and the Companies Act, 2015.

Basis for Qualified Opinion

1.0 Property, Plant and Equipment

1.1 Motor Vehicles Ownership

Note 3 to the financial statements reflects property, plant and equipment balance of Kshs.363,471,346 as at 30 June 2018 which includes Kshs.11,437,535 in respect to motor vehicles and cycles which further includes Kshs.2,561,668 in respect to motor vehicles and whose ownership documents were not availed for audit verification.

In the circumstances, it has not been possible to confirm the ownership status of motor vehicles and cycles worth Kshs.2,561,668 as at 30 June 2018.

2.0 Cash and Cash Equivalents

Note 19 to the financial statements reflects a cash and cash equivalents balance of Kshs.129,616,806 comprising of Kshs.129,611,249 held in seventeen (17) bank accounts and Kshs.5,557 cash at hand. Included in the Kshs.129,616,806 is a balance of Kshs.4,464,984 in respect to postal corporation whose bank balance confirmation certificate was not availed for audit verification.

Further, included in the Kshs.129,616,806 cash and cash equivalents balance is an MPESA account balance of Kshs.1,301,674. However, the reconciliation statement reflects a balance of Kshs.1,740,578 resulting to unsupported variance of Kshs.438,904.

In addition, included in the Kshs.129,616,806 cash and cash equivalents balance is a cooperative current account with a balance of Kshs.11,082,368 whose bank reconciliation statement for the month of June 2018 reflects outstanding stale cheques amounting to Kshs.2,429,279. Further, there was no evidence availed for audit review in that the cheques had either been replaced or reversed.

In the circumstances, the validity and accuracy of the cash and cash equivalents balance of Kshs.129,616,806 as at 30 June 2018 could not be confirmed.

3.0 Loss of Fund in Kiritiri Office

Records made available showed that during the year under review, the Company lost Kshs.1,027,310 in the Kiritiri Office which was occasioned by an officer who collected revenue from various Company customers but did not remit the revenue to the Company. Further, records made available showed that the officer accepted liability and committed to refund the whole amount. However, as at the time of this audit in February 2019, the officer was still in service an indication that the management did not uphold integrity of its officers. It is not clear why such a case was not reported to police as this is a clear misappropriation of public funds contrary to Section 162(2)(b) of the Public Finance Management Act 2012 which stipulates that the resources within the officer's area of responsibility are used in a way that is lawful and authorized.

In the circumstance, the revenue amounting to Kshs.1,027,310 remained unaccounted for as at 30 June 2018.

4.0 Doubtful Expenditure

Note 13 to the financial statements reflects Kshs.72,485,822 in respect to maintenance and production cost which includes Kshs.19,684,962 in respect to output based assistance(OBA). However, included in Kshs.19,684,962 is an expenditure of Kshs.1,652,186 and whose supporting documents were not availed for audit verification. In the circumstances, the propriety and value for money for the Kshs.1,652,186 expenditures for the year ended 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 Embu Water and Sanitation Company 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 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 section, I have determined that there are no other key audit matters to communicate in my report.

Other Matter

1.0 Budgetary Controls and Performance

1.1 Income Analysis

The statement of comparison of budget and actual amounts for the year under review reflects a budgeted income of Kshs.330,683,090 and actual income of Kshs.351,015,813 or 106% of the budgeted income resulting to a net revenue over collection of Kshs.20,332,723 comprising of Kshs.29,984,649 and Kshs.9,651,926 in respect to over-realized budget by one item and an under- realized budget by two other items respectively as shown below:

Item	Budget (Kshs)	Actual (Kshs)	Under (Kshs)	Overs (Kshs)	%
Turnover	312,872,276	305,181,924	7,690,352	0	2
Water related income	8,707,012	6,745,438	1,961,574		23
Other income	9,103,802	39,088,451	0	29,984,649	329
Totals	330,683,090	351,015,813	9,651,926	29,984,649	

The excess collection of Kshs.29,984,649 or 329% over the budgeted revenue may be a pointer to low set targets hence there is need for the management to review its budgeting mechanism with a view to coming up with a more realistic revenue budget to achieve higher revenue growth. Further, the under collection of Kshs.9,651,926 or 2.9% of the budgeted income could be revenue collected but not remitted to the Company and this may affect delivery of the services to the intended beneficiaries. Therefore, there is need for the Company to relook at its budget making process with a view of establishing proper controls to prevent instances of revenue leakage.

1.2 Expenditure Analysis

The statement of comparison of budget and actual amounts for the year ended 30 June, 2018 reflects a budgeted expenditure of Kshs.373,244,082 and actual expenditure of Kshs.344,136,001 resulting to a net over expenditure of Kshs.29,108,081 comprising of

Kshs.13,571,151 and Kshs.42,679,232 over expenditure on two (2) items and under expenditure on three (3) other items respectively as shown below:-

Item	Budget (Kshs)	Actual (Kshs)	Under (Kshs)	Over (Kshs)	%
Administration expenses	180,153,519	192,805,676	0	12,652,157	7
Establishment cost	73,053,580	73,972,574	0	918,994	1.3
Maintenance and production cost	75,382,137	72,485,823	2,896,314	0	4
Other operating expenses	4,992,446	3,505,091	1,487,355	0	30
Finance cost	39,662,400	1,366,837	38,295,563	0	97
Totals	373,244,082	344,136,001	42,679,232	13,571,151	

The under expenditure of Kshs.42,679,232 translates to planned activities that were not executed for the benefit of citizens of Embu County. In addition, the over expenditure of Kshs.13,571,151 is an indicator of the Company's improper budget planning process. Further, the over expenditure is not supported by a supplementary budget contrary to Section 43(2) of the Public Finance Management (County Governments) Regulations 2015 which states that County government entities shall execute their approved budgets based on the annual appropriation legislation, and the approved annual cash flow plan with the exception of unforeseen and unavoidable spending dealt with through Emergency Fund, or supplementary estimates.

Consequently, the Company was in breach of the law.

2.0 Trade and Other Receivables

Note 18 to the financial statements shows that the trade and other receivables increased by Kshs.42,923,428 (20%) from Kshs.215,365,420 as at 30 June 2017 to Kshs.258,288,848 as 30 June 2018. Evidently, the Company did not institute proper and effective revenue collection mechanism during the year under review.

Further, the trade and other receivables balance of Kshs.258,288,848 as at 30 June 2018 included Kshs.86,245,217 and Kshs.1,968,130 both totaling to Kshs.88,213,347 in respect to KRA refunds and Cash loss respectively which has been outstanding for more than four (4) years. The Company is not desirous to recover these debts.

Consequently, the recoverability of the trade and other receivable balance of Kshs. 258,288,848 as at 30 June 2018 could not be confirmed.

3.0 Outstanding Corporation Tax

Note 24 to the financial statements reflects an outstanding corporation tax of Kshs.11,795,660 as at 30 June 2018. The amount has been accumulating over the years and no explanation was given for none payment of the tax when it fell due. The Company

therefore risks being charged with interest and penalties, and possible attachment of its property by Kenya Revenue Authority for delay in payment of the taxes.

In the circumstances, the management has exposed the Company to possible confrontation with the Kenya Revenue Authority which may result to huge financial losses.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229(6) of the Constitution, based on the procedures performed, except for the matters described in the Basis for Conclusion on Lawfulness and Effectiveness in 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

1.0 Over Commitment of Salaries

Analysis of the payroll for the June 2018 and July 2018 revealed that eleven (11) officers were earning below one third of their basic salary contrary to Section 19(3) of the employment Act, 2007 which stipulates that the total amount of all deductions made by an employer from the wages of his employees at any one time shall not exceed two-thirds of such wages.

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

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 matter described in the Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance section of my

report, I confirm that, nothing has come to my attention to cause me to believe that internal controls, risk management and overall governance were not effective.

Basis for conclusion

1.0 Non-Revenue Water (NRW)

Note 5 to the financial statements reflects Kshs.305,181,924 in respect to sale of water for the year ended 30 June 2018. Records made available showed that the Company produced a total of 6,644,635 cubic meters (m³) of water at a production cost of Kshs.10.91 per cubic meter during the year under review out of which only 4,232,793 cubic meters was billed to customers. The balance of 2,411,842 cubic meters (approximately 36%) of the total water produced, with a production cost of Kshs.26,313,196 represents Non-Revenue Water(NRW). However, schedule E of the Water Service Regulatory Board (WASREB) guidelines allows a maximum loss of 25% of every cubic meter of water produced and hence out of the 6,644,635 produced by the Company, only 1,661,159 (25%) water loss was allowable while the 750,683 cubic meter (11%) of non-revenue water with a production cost of Kshs.8,189,952 is not allowable.

In the circumstances, the Company significantly exceeded the allowable NRW loss of 25% by 11% or approximately Kshs.8,189,952 which if not addressed will negatively impact on the Company's profitability and its long- term sustainability

2.0 Lack of Disaster Recovery Plan, Information Technology (IT) Strategic Committee and IT Security Policy

During the year under review, the Company did not have in place a disaster recovery plan. In the absence of the disaster recovery plan there is no mitigation on any loss of data and assets in the event of a disaster.

Further, IT strategic committee was not in place and in the absence of the committee, it is not possible to ascertain how the IT strategies and all investment in IT are aligned to strategic goals of the Company.

In addition, IT security policies were not in place, hence confidentiality, integrity and availability of data of the Company could not be ascertained during the year ended 30 June 2018.

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.

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;
- ii. In my opinion, adequate accounting records have been kept by the Company, so far as appears from my examination of those records; and
- iii. The Company's financial statements are 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 (IFRS) 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 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 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 money is applied in an effective way.

Those charged with governance are responsible for overseeing 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 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 review is planned and performed to express a conclusion with limited assurance as to 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 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 review 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 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 offering 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 Company to cease to continue offering services.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the consolidated and separate financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or 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

17 April 2019