

REPORT OF THE AUDITOR-GENERAL ON EXPORT PROCESSING ZONES AUTHORITY FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Export Processing Zones Authority set out on pages 1 to 42, which comprise the statement of financial position as at 30 June 2018, and statement of financial performance, statement of changes in net assets, 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 Export Processing Zones Authority 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 (Accrual Basis) and comply with the Export Processing Zones Authority Act, Cap 517 of 2015 (Revised) of the Laws of Kenya.

Basis for Qualified Opinion

1. Property, Plant and Equipment

1.1 Land

As previously reported, included in property, plant and equipment balance of Kshs.10,644,679,186 as at 30 June 2019 are two parcels of land Ref: LR.No. Ololoitokoshi/Kitengela/61 and 70, measuring two hectares with a book value of Kshs.2,250,000. Although the parcels of land were acquired and gazetted through Gazette Notice Nos. 2802 and 2803 of July 1991, the Authority had not obtained the respective ownership documents as at 30 June 2018. As a result, it is not possible to confirm the two pieces of land are legal property of the Authority.

1.2 Valuation of Assets

Although the statement of financial position reflects a balance Kshs.10,644,679,186 under property, plant and equipment as at 30 June 2018, the last valuation of the Authority's assets was conducted in 2011. Consequently, the Authority has not valued its assets in the last seven (7) years to take cognizance of the drastic change in their value contrary to International Accounting Standard No.16 which requires property, plant and equipment to be revalued after every five years.

1.3 Acquisition of Land No. LR 337/2917

The Authority acquired land L.R No 337/2917 at Kshs.6,500,000. The acquisition process started in 2015/2016 but the ownership documents had not been obtained as at 30 June 2018. The Authority hurriedly acquired this land measured 0.08 Ha (0.197 acres) without the transfer documents when it trespassed on it, while constructing a sewer line through Athi River. The Authority risk losing both the land and the money paid unless the lawful transfer process is expedited.

1.4 Boreholes

In 2007, the then Ministry of Water and Irrigation Development sunk two boreholes on EPZA land, one at a disputed parcel of land in Kitengela Township and the other on the Authority's premises adjacent to the police post. The management has indicated that ownership of the boreholes was handed over to the Authority without formal documentation and that the boreholes have been tested and confirmed to be viable. However, no evidence has been provided for audit review to confirm that the two boreholes have been valued and recognized as assets of the Authority.

In view of the above, it has not been possible to confirm the accuracy, valuation, existence and ownership of property, plant and equipment balance of Kshs.10,644,679,186 as at 30 June 2018.

2. Project Management

The Authority has uncompleted projects some dating back to 2014 which have some anomalies as summarized below:

2.1 Decommissioning of Dumpsite and Construction of Other Civil Works

EPZA Tender No. 12/2016-2017 was awarded to Marcann Contractors Co. Ltd for decommissioning of dumpsite and construction of other civil works at Athi-River EPZ at a contract sum of Kshs.150,260,710. The commencement date of the contract was 21 September 2017 to be completed by 20 June 2018. At the time of audit, an amount of Kshs.31,810,320 had been paid the works were at 20% complete. However, the report on feasibility study on recommending the decommissioning of the dumpsite was not availed for audit review. In addition, no alternative site for dumping was identified and dumping was still being done at the same site. The source for the water to feed the dam and its sustainability was also not been explained. Further, no certificates from the relevant government agencies mainly NEMA and WARMA approving the construction of the dam was availed for audit review. Though the contract includes the construction of a swimming pool and a mini golf course, it does not include changing rooms which are a necessity for such facilities to operate. A visit to the site revealed that no works were on going and the contractor was not on site despite having been paid Kshs.31,810,320. In addition, the amount paid as per the first certificate appears excess in comparison with the work already done on the ground since only part excavations have been done on the site thereby casting doubt on the validity and the full execution of this contract.

2.2 Construction of Procurement Store

Quotation No.312/2016-2017 was awarded to M/S Home Team Ltd at a contract sum of Kshs1,913,348. The work was to commence on 1 December 2017 to be completed by 31 July 2018 as per the contract agreement. The Authority paid the contractor an amount of Kshs.648,499 as an advance payment but abandoned the site after being paid. Further, our audit review of the project file revealed that the contractor had no financial capacity to undertake the project raising doubt on whether due diligence was done before awarding of the contract. Also, our site visit and perusal of the bills of quantities revealed that the project price could have been exaggerated. No evidence of action taken by the management as a follow up to ensure the work is completed by the contractor was availed for audit verification.

Failure to follow the procurement law in awarding and the execution of this projects to ensure that they are fully completed as per the contract terms, results in poor management of the project and cost over runs due to contract variations, thus the value for money on these incomplete projects may not be realized. The delay in project completion also lead to losses from incomes that could have been generated from the projects as envisaged at the time of commencement.

3. Trade and Other Receivables

As previously reported, included in trade and other receivables balance of Kshs.565,846,662 as at 30 June 2018 is an amount of Kshs.11,990,573 which relates to advances, outstanding imprest and salary advances issued to ex-staff. The balance further includes Kshs.8,690,785 being salary advance of Kshs.7,709,866 and imprest of Kshs.980,919 issued to the former Chief Executive Officer (CEO) of the Authority without approval from the Board of Directors. The advances were issued in disregard to Government Regulation (H10) in existence then and the Authority's staff manual governing salary advances. The sum of Kshs.980,919 granted to the CEO as imprest was supposed to have been surrendered within 48 hours after completion of the assignment. Failure to surrender the imprest amounted to violation of regulations and abuse of office by the former Chief Executive Officer.

Consequently, the accuracy and recoverability of the staff debtors' balance of Kshs.11,990,573 as at 30 June 2018 cannot be confirmed.

4. Issuance of Licenses

The Authority issued an Export Processing Zone Business Service Permit to a local company, Net Gas and Energy Ltd to run a petrol station and convenience store on lands L.R No.18474/10 and L.R 184744/11 owned by EPZA and gazzeted as Export Processing Zone along Namanga road. The company has already embarked on the construction of the petrol station. The degazetement of the above two parcels of land was not done before issuing the business permit to exempt it from the provision of EPZA Act. No clear explanation as to how the business of a petrol station fits and complies with the Export Processing Zones Authority Act, Cap 517 of 2015 (Revised) of the laws of Kenya. This also contradicts Section 9(c) of the EPZA Act which states that the principal objective of the Authority shall be the protection of government revenue and foreign currency earnings and Section Sec 23(2)a of the EPZA Act that states that a license shall be granted by the Authority if the proposed business

enterprise is incorporated in Kenya and whether or not it is one hundred percent foreign owned for the sole purpose of producing goods or services for export within an export processing zones. The Authority was therefore in breach of the law.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Export Processing Zones Authority 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 section. I have determined that there are no Key Audit Matters to communicate in my report.

Other Matter

1. Lack of Clarity on Establishment of Leather Industrial Park

The Authority entered into a Memorandum of Understanding (MOU) with the Kenya Leather Development Council on 8 December 2015 for the establishment of a leather industrial park in Machakos County. The MOU provided that the park was to be built on a portion of plot LR No.23961 measuring 301.1 hectares owned by EPZA and located at Kinanie in Machakos County. However, the actual acreage of the land to be alienated for the purpose was not indicated and the MOU did not outline the specific roles to be performed by each party and the agreed time frame for construction works. The manner in which the park was to be managed and the revenues expected to be generated therefrom and how these would be shared were not defined. In addition, it was not clear which of the two institutions was to incorporate in its books the operations and the ownership of the industrial park.

In the circumstances, there is lack of clarity on this major investment expected to be established on the Authority's land.

2. Construction of New Industrial Sheds

EPZA Tender No. 04/2014-2015 awarded to China National Aero Technology International Corporation (CATIC) for construction of 43,832 square meters of new industrial sheds at a contract price of Kshs.1,367,710,473. The works were to commence on 1 February 2015 and be completed on 31 August 2015 as per the initial contract agreement which was later extended to 31 December 2018 and contract varied upward by Kshs.267,710,473. However, the work had not yet been completed and the contractor was not on site by the time of the audit. It was observed that dumping of excavated soil was done on EPZA premises instead of carrying it to offsite as per the contract agreement which is also an indication that the contractor did not conduct construction in accordance with the bills of quantities.

Further, the contractor was instructed to handover an incomplete project mainly cluster 3 and a certificate of partial completion be issued to him. This certificate was however not issued to the contractor as per their letter CATIC/EPZA/2018-423/A dated 23 April 2018. In addition, it's not clear which clause the project manager was invoking to demand the partial handover and who will bear the costs of any damages to the premises as the contractor has already stated they will not take responsibility.

3. Construction of 7.5 Kms Long Trunk Sewer for Phase II Lot 3

EPZA Tender No.04/2016-2017 awarded to Dexterous Limited for Construction of 7.5 Kms long Trunk Sewer for Phase II Lot 3 at Athi-River Textile Hub at a contract sum of Kshs.213,278,865. The commencement date as per the contract was 13 February 2017 with revised completion date of 30 April 2019. However, the project had not been completed due to delays in getting relevant approval from other government agencies. It is not clear why the approvals were not sort from the relevant authorities before the award of tender and commencement of projects.

4. Construction of New Water Supply and Distribution Pipeline and Storage Tank

EPZA Tender No. 03/2014-2015 was awarded to Hirola Investments Ltd for construction of 8.3 Kms of new water supply and distribution pipeline and 6,500 cubic meters storage tank at a contract price of Kshs.310,008,576 which was later varied upward by Kshs.74,420,212 (24%) to Kshs.384,428,790. At the time of variation, the contractor had billed the Authority by almost 97% of the original contract price. As at 30 June 2018, the contractor's bill amounted to Kshs.389,318,805 over and above the varied price by Kshs.4,890,015. Further, though the validity period of the contract expired, the handing over of the project by the contractor to the Authority had not been done. The project commencement period was 15 January 2015 and was to be completed on 15 June 2015. It was noted that the total contract amount was paid before inspection and acceptance approval and only the retention money that had not been paid.

No explanation was provided as to why the contractor was paid the total amount before completion of the project.

5. Construction of Kenya Leather Park Internal Access Roads and Civil Works

EPZA Tender No. Roads- 29/2015-2016 was awarded to Marcann Contractors Co. Ltd for construction of Kenya Leather Park internal access roads and civil works at a contract price of Kshs.146,111,497. The work was to commence on 26 September 2016 and be completed on 25 September 2017 as per the initial contract but later extended to 31 December 2018. The Authority introduced additional work for box culvert and construction of temporary holding ponds and varied the contract upward by Kshs.26,075,000. Public Procurement and Assets Disposal Act, 2015 requires that the contract variation be approved by the tender committee. No minutes were availed for audit review in respect of approval of variations by the tender committee. In addition, it is not clear how the amount of contract variation was arrived at as the contractor was not requested to quote for the additional works as required by

procurement laws. Further, the bills of quantities for the additional works were not availed for audit verification.

In the circumstances, it was not possible to confirm whether the Authority followed the procurement law in the execution of this contract.

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 Qualified Opinion 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

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 Qualified Opinion 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

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 (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 Authority's ability to continue 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 the Authority 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 Authority'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 sustainability of services, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Authority's ability to continue 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 Authority to cease 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 Authority 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

26 August 2019