

REPORT OF THE AUDITOR-GENERAL ON IDB CAPITAL LIMITED FOR THE YEAR ENDED 30 JUNE, 2019

REPORT ON THE FINANCIAL STATEMENTS

Opinion

The accompanying financial statements of IDB Capital Limited set out on pages 29 to 76, which comprise the statement of financial position as at 30 June, 2019, and the statement of profit or loss and other comprehensive income, statement of changes in equity, statement of cash flows and the statement of comparison of budget and actual amounts for the year then ended, and a summary of significant accounting policies and other explanatory information, have been audited on my behalf by KPMG Kenya, auditors appointed under Section 23 of the Public Audit Act, 2015. The auditors have duly reported to me the result of their audit and on the basis of their report, I am satisfied that all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit were obtained.

In my opinion, the financial statements present fairly, in all material respects, the financial position of IDB Capital Limited as at 30 June, 2019, 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 Kenya Companies Act, 2015.

Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of IDB Capital Limited management 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 opinion.

Emphasis of Matter

1. Loss for the Year

The statement of profit or loss and other comprehensive income reflects loss for the year of Kshs.47,727,000; (2018-Kshs.21,693,000) resulting in cumulative retained earnings deficit of Kshs.89,325,000 (2018 - Kshs.36,592,000). Although the Company's liquidity is adequate and covers the maturing obligations as and when they fall due, shareholder's funds continue to be eroded if the negative trend is not reversed.

2. Impending Merger

Note 2(c) to the financial statements discloses that on 15 May, 2018, the Government of Kenya approved the merger of IDB Capital Limited with Industrial and Commercial Development Corporation and Tourism Finance Corporation. The process of merger was

to commence in the 2018/19 financial year to create Kenya Development Bank (KDB) Limited. The incorporation of Kenya Development Bank (KDB) Limited would then be followed by the dissolution of IDB Capital. The process of incorporating Kenya Development Bank Limited had not been completed as at the time of finalizing this audit.

My opinion on these matters is not qualified.

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 of the current year. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters. For each matter below, a description of how the audit addressed the matter is provided in that context.

I have fulfilled the responsibilities described in the Auditor-General's responsibilities for the audit section of my report, including in relation to these matters. Accordingly, the audit included the performance of procedures designed to respond to the assessment of the risks of material misstatement of the financial statements. The results of the audit procedures, including the procedures performed to address the matters below, provide the basis for my audit opinion on the accompanying financial statements.

Key Audit Matters	How the matter was addressed
<p>Implementation of IFRS 9, financial Instruments.</p> <p>IFRS 9, financial Instruments was implemented by the Company on 1 July, 2019. This standard requires recognition of Expected Credit Losses (ECL) on financial instruments which involves making significant judgements and estimates. The carrying value of financial instruments within the scope of IFRS 9 ECL may be materially misstated if judgments or estimates made are inappropriate. I considered the impairment of loans and advances to customers to be a key audit matter due to the following:</p> <p>Significant Increase in Credit Risk (SICR)</p> <p>The criteria selected to identify a SICR are highly judgmental and can materially impact the ECL recognized for certain</p>	<p>Based on my risk assessment and industry knowledge, I have examined the impairment charges for loans to customers and evaluated the methodology applied as well as the assumptions made according to the description of the key audit matter.</p> <p>My audit procedures in this area included, among others:</p> <ul style="list-style-type: none"> ▪ Selecting a sample of facilities from the Company's loan book and performing tests to establish whether significant facilities are correctly classified and valued based on IFRS; ▪ Performing credit assessment on various categories of loans to ascertain the reasonableness of the forecast of recoverable cash flows, realization of collateral, and other sources of

Key Audit Matters	How the matter was addressed
<p>portfolios as these criteria determine whether a 12-month or lifetime expected credit loss is assessed.</p> <p>Model Estimations</p> <p>Inherently, judgmental modeling is used to estimate ECLs which involves determining Probabilities of Default ('PD'), Loss Given Default ('LGD'), and Exposures at Default ('EAD') and ultimately the Expected Credit Loss (ECL). The LGD model used in the loan portfolio contains significant judgmental aspect of the entity's ECL modeling approach.</p> <p>Disclosure Quality</p> <p>The disclosures regarding the Company's application of IFRS 9 are key to understanding the change from IAS 39 as well as explaining the key judgements and material inputs to the IFRS 9 ECL results.</p>	<p>repayment for defaulted loans. I compared key assumptions to progress against business plans and my own understanding of the relevant industries and business environments;</p> <ul style="list-style-type: none"> ▪ Evaluating the appropriateness of the SICR criteria used; ▪ Testing the impairment calculations to check if the correct parameters – Probability of Default (PDs, Loss Given Default (LGDs), and Exposure at Default (EADs) were determined by considering local economic/portfolio factors; and ▪ Assessing whether the disclosers appropriately reflect key judgements and assumptions used in determining the expected credit losses.

Other Information

The Board of Directors is responsible for the other information. The other information comprises the information included in the annual report and financial statements, but does not include financial statements and our auditor's report thereon.

My opinion on the financial statements does not cover the other information and I do not express any form of assurance conclusion thereon.

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 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. Non-Monitoring of Client Transactions

Contrary to the requirements of Section 44 of Proceeds of Crime and Anti-Money Laundering Act No. 9 of 2009, that requires any person or entity, which conducts as a business, one or more of the following activities or operations:

- (a) accepting deposits and other repayable funds from the public;
 - (b) lending, including consumer credit, mortgage credit, factoring, with or without recourse, and financing of commercial transactions;
- to monitor on an ongoing basis all complex, unusual, suspicious, large or such other transactions as may be specified in the regulations, whether completed or not, and shall pay attention to all unusual patterns of transactions, and to insignificant but periodic patterns of transactions which have no apparent economic or lawful purpose as stipulated in the regulations.

IDB Capital Limited does not have a mechanism for monitoring of client transactions. To the extent, it is in breach of law and makes the Company susceptible to penalties and fines.

2. Compliance with the Dollar Credit Agreement Provisions

Section 3.1(e) of the Dollar Credit Agreement between the Government of the Republic of Kenya (GOK) and the Export-Import Bank of India requires the borrower (GOK) to confirm to Exim Bank that the eligible goods and services shall be exempt from all kinds of taxes and duties levied in the borrower's country to the seller in relation to the execution of the contract in the borrower's country. However, review of the Company's borrowing records and agreements indicates that one of its beneficiaries under the Dollar Agreement Line of Credit (LoC) paid taxes for imported machinery during the year contrary to the agreement provisions. It was also noted that the Company was experiencing challenges in obtaining tax exemption for other beneficiaries under the LoC arrangement. In the circumstance the Company is in breach of the signed agreement.

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 Overall 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. Non-Integrated Systems

The Loan Management System (LMS) and the Navision Accounting Systems used by the Company are not integrated. Consequently, transfer of data between the two systems requires manual intervention which are susceptible to errors and manipulations. Further, the Loan Management System (LMS) does not have an auto archiving functionality, necessitating historical monthly loan data to be maintained in hard copies, as the system overrides them.

2. Undocumented Policies and Procedures

Mwongozo Code of Governance for State Corporations guidelines stipulates requirements for company operations namely; policies on risk management, internal controls, enhancing corporate reputation and image and stakeholder relationship management. The code also requires the Company to addresses issues of Board effectiveness, transparency, disclosure, accountability, risk management, internal controls, ethical leadership and good corporate citizenship. However, the Company did not avail a risk management policy and documented internal control procedures.

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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by Kenya 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 been kept by the Company, so far as appears from the examination of those records; and,
- iii. The financial statements are in agreement with the accounting records and returns.

Responsibilities of Management and the Board of Directors

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards 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 Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the management either intends to liquidated the Company or 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.

The Board of Directors is responsible for overseeing the financial reporting process, reviewing the effectiveness of how the Company 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 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.

From the matters communicated with management, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. These matters are described in my auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication



Nancy Gathungu
AUDITOR-GENERAL

Nairobi

24 August, 2020