

# **REPORT OF THE AUDITOR-GENERAL ON INDUSTRIAL AND COMMERCIAL DEVELOPMENT CORPORATION FOR THE YEAR ENDED 30 JUNE, 2019**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Qualified Opinion**

The accompanying financial statements of Industrial and Commercial Development Corporation (ICDC) set out on pages 21 to 75, which comprise the statement of financial position as at 30 June, 2019, statement of profit or loss and other comprehensive income, statement of changes in equity and the statement of cash flows for the year then ended, and a summary of significant accounting policies and other explanatory information, have been audited on my behalf by Deloitte and Touché, auditors appointed under Section 23 of the Public Audit Act, 2015. The auditors have duly reported to me the results 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, except for the effects of the matter described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respects, the financial position of Industrial and Commercial Development Corporation 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 (IFRS) and comply with the Industrial and Commercial Development Corporation Act, Cap 445 of the Laws of Kenya and the Public Finance Management Act, 2012.

### **Basis for Qualified Opinion**

#### **1. Unconfirmed Value of Lending Portfolio**

The statement of financial position as at 30 June, 2019 reflects loans and advances totalling Kshs.1,814,627,000 being outstanding loans advanced by the Corporation to borrowers. Other records of the Corporation show that on the said date, approximately Kshs.31,000,000,000 (thirty-one billion) or 94 % of the Corporation's total loans portfolio estimated at Kshs.33,000,000,000 (thirty-three billion) was considered by Management as non-recoverable. Securities related to some of the old non-performing loans were reported to be missing, impaired or irredeemable being borrowers' ancestral lands. The Board of Directors has since approved a full provision for the losses totalling Kshs.31,000,000,000 against the Corporation's reserves as required in International Financial Reporting Standard No.9.

In the absence of records on the old grants and loans, it is not possible to confirm the validity, accuracy and completeness of the loans and advances balance totalling Kshs.1,814,627,000 reflected in the statement of financial position as at 30 June, 2019.

Further, the high ratio of non-performing portfolio points to failure by the Corporation to collect loans lent to its customers. As a result, the Corporation's capacity to achieve its mandate and purpose has been constrained. Management have explained that a large proportion of the non-performing loans arose from Government policy that required the Corporation not to follow strict commercial lending criteria. Management

further say they have since put in place new control measures to stem the high rate of default experienced in the past.

## **2. Unsupported Government Loans and Grants Balance**

The statement of financial position as at 30 June, 2019 reflects loans and grants totalling Kshs.391,850,000. The balance includes grants and loans totalling Kshs.381,147,000(2018:Kshs.832,791,000) and accrued interest expenses totalling Kshs.7,928,000 (2018:Kshs.7,928,000) owed to the Government of Kenya (GoK). As reported in previous years, the GoK grants and loans have been outstanding for many years. However, the agreements between the GoK and the Corporation on the loans and grants have not been made available for audit review.

In the circumstance, it is not possible to verify the terms and division of the loans and grants totaling Kshs.391,850,000 and accrued interest expense totalling Kshs.7,928,000 reported in the statement of financial position as at 30 June, 2019. Further, I am unable to confirm the accuracy, validity and completeness of the said grant and loan balances as well as the related interest expenses.

In addition, Note 25 to the financial statements shows that during the year under review, the Corporation wrote back loans totalling Kshs.459,572,000 owed to the GoK and credited these to 'Other Income' in the statement of profit or loss and other comprehensive income for the year, as disclosed in Note 8 to the financial statements. The write-back followed authority granted to the Corporation by the Cabinet to reconfigure old loans, grants and accrued interest expenses owed to the GoK. The Cabinet made its decision after having considered a memorandum on the matter submitted by the Cabinet Secretary to the National Treasury in October, 2017. The memorandum had requested the Cabinet to restructure loans totalling Kshs.391,848,560, write-off others totalling Kshs.863,087,559, convert into grants those totalling Kshs.268,184,200 and waive accrued interest totalling Kshs.300,928,682, all totalling Kshs.1,824,049,001. The authority granted by the Cabinet called on Management to review the debtors list to include all qualifying loans and reject invalid ones, if any.

However, the financial statements have not disclosed how the sum of Kshs.459,572,000 written back and credited to income was arrived at in light of the authority granted by the Cabinet. Further, as at the time of signing this report, the process of reconfiguring the loans and grants had not been completed as the subsidiary agreement between the National Treasury and the Corporation had not been finalized.

In view of the missing information, I am not able to confirm the nature of Government loans and grants liabilities totalling Kshs.459,572,000 that the Corporation wrote back and recognized as income in the year under review. In addition, I have not confirmed that the advice of the Cabinet on treatment of the loans and grants was followed. Therefore, I am not able to confirm the accuracy, validity and completeness of the grants and loans balance totalling Kshs.391,850,000 reflected in the Corporation's statement of financial position as at 30 June, 2019.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions. I am independent of Industrial and Commercial Development Corporation 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 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 other key audit matters to communicate in my report.

## **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, I confirm that, except for the matters described in the Basis for Qualification section of my report, nothing 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 and Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance sections 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**

### **Long Overdue Rental Receipts**

The statement of financial position as at 30 June, 2019 reflects outstanding debts totalling Kshs.226,331,000 owed by tenants at the Corporation's Head Office at Uchumi House in Nairobi. In the year under review, the Corporation made a provision for bad debts totalling Kshs.58,573,000 equivalent to 24% of the sum owed by the tenants. The provision has put at risk public resources of equivalent amount. Management has not established effective controls to ensure timely and effective collection of rental income.

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.

### **Responsibilities of Management and Board of Directors**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with 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 overall governance.

In preparing the financial statements, Management is responsible for assessing the Corporation'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 is aware of the intention to liquidate the Corporation or have its operations cease.

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 Corporation 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**

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*Report of the Auditor-General on Industrial and Commercial Development Corporation for the year ended 30 June, 2019*

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 Corporation'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 Corporation 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 Corporation 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 communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.



**Nancy Gathungu**  
**AUDITOR-GENERAL**

**Nairobi**

**07 October, 2020**