

# **REPORT OF THE AUDITOR-GENERAL ON ISIOLO WATER AND SEWERAGE COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2018**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Qualified Opinion**

I have audited the accompanying financial statements of Isiolo Water and Sewerage Company Limited set out on pages 1 to 24 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 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 effects of the matter described in the Basis for Qualified Opinion section of my report, the financial statement's present fairly, in all material respects, the financial position of Isiolo Water And Sewerage 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 the Water Act, 2016 and Companies Act, 2015.

### **Basis for Qualified Opinion**

#### **Payables and Accruals**

Note 15 to the financial statements reflects a balance of Kshs.424,990 in respect to payables and accruals as at 30 June 2018 which includes a negative balance of Kshs.101,819 attributed to value added tax (VAT) control. However, supporting documents such as creditor's ledger or a schedule of payees' particulars have not made available for audit verification.

Further, included in the Kshs.424,990 is audit fees totaling Kshs.417,152 for two financial years commencing 2015/2016 and 2016/2017 which is due but has not been paid. No explanation was provided as to why the Company has taken too long to settle the audit fees raising doubts as to whether it was able to settle its debts as and when they fell due. This is contrary to Section 41 (1) (e) of the Public Audit Act, 2015 which stipulates that the audit fees charged shall be at the rates prescribed by the Auditor-General. The management is therefore in breach of the law.

In the circumstances, validity and the accuracy of the payables and accruals balance of Kshs.424,990 reflected in the financial statements as at 30 June 2018 cannot not be ascertained.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the Isiolo Water And Sewerage 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 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 matter 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 Control and Performance

The statement of comparison of budget and actual amounts reflected a total approved receipts budget of Kshs.75,112,400 and an expenditure budget of Kshs.83,859,220 resulting in to a deficit of Kshs.8,746,820. No explanation was provided on how the Company intended to finance the Kshs.8,746,820 deficit during the year under review. Further it is not clear and the management has not explained why unbalanced budget was approved by the board and the County Government.

#### 1.1 Income

The statement of comparison of budget and actual amounts reflected approved budgeted income of Kshs.75,112,400 and actual receipt of Kshs.79,537,994 (106%) resulting in an over collection of Kshs.4,425,594 as follows;

Items	Current year Final Budget Figures Kshs.	Actual Income Figures Kshs.	Variance Kshs.	Performance %
Water and Sewerage	71,051,400	74,210,626	3,159,226	104%
Other Revenue	4,061,000	4,409,064	348,064	109%
Gain in Investments	0	286,875	286,875	100%
Grants from County Government	0	631,429	631,429	100%
<b>Total Income</b>	<b>75,112,400</b>	<b>79,537,994</b>	<b>4,425,594</b>	<b>106%</b>

The excess collection of 6% over the revenue 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 a more realistic revenue budgets to achieve higher revenue growth hence reversing the accumulated deficit of Kshs.18,848,834 as at 30 June 2018.

## 1.2 Expenditure

The statement of comparison of budget and actual amounts reflected an approved budgeted expenditure of Kshs.83,859,220. However, only Kshs.81,445,313 (78.1%) was spent resulting in an under-expenditure of Kshs.2,413,907 as follows;

Items	Budgeted Expenditure Kshs.	Actual Expenditure Kshs.	Variance Kshs.	Performance %
<b>Expenses</b>				
Administration	54,386,500	52,870,669	-1,515,831	<b>97%</b>
Operations, maintenance and distribution	29,472,720	28,574,644	-898,076	<b>97%</b>
<b>Total Recurrent Expenditure</b>	<b>83,859,220</b>	<b>81,445,313</b>	<b>-2,413,907</b>	<b>97%</b>
Development Expenditure	0	0	0	
<b>Total Expenditure</b>	<b>83,859,220</b>	<b>81,445,313</b>	<b>-2,413,907</b>	<b>97%</b>

In overall, the Company under spent its budget by Kshs.2,413,907 of the total budget allocation. The funds could have been allocated to other deserving areas that would have improved delivery of goods and services to the residents of Isiolo County. There is need therefore for the management to re-look at its budgeting mechanism with a view of focusing on areas which will improve service delivery to the citizens of Isiolo County.

In the circumstances the residents of the County did not get expected services equivalent to the Kshs.2,413,907 under expenditure for the year ended 30 June 2018.

## 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 Conclusion on lawfulness and effectiveness in use of public resources section of my report, I confirm that, 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

*Report of the Auditor-General on the Financial Statements of Isiolo Water and Sewerage Company Limited for the year ended 30 June 2018*

## **1.0 Presentation of the Financial Statement**

The International Financial Reporting Standards (IFRS) reporting template revised in 2018 prescribed by the Public Sector Accounting Standards Board (PSASB) require the Head of Finance to include his/her Institute of Certified Public Accountant of Kenya (ICPAK) membership number in the financial statements. However, a review of the financial statements revealed that the membership number of the Head of Finance was not included.

Further, Appendix I to the International Financial Reporting Standards (IFRS) Annual Financial Reporting Template for Commercial Government Owned Entities require progress on follow up of auditor recommendations to include status of audit issues raised and the date when issues are expected to be resolved. However, appendix I to the financial statements on progress on follow up of auditor recommendations indicated that issue raised on the certificate for year 2016/2017 were all resolved. However, documentary evidence showing how and when the issues were resolved was not provided for audit review.

In view of the foregoing, the presentation of the financial statements did not conform to the approved standard.

## **2.0 Property Plant and Equipment**

Note 9 to the financial statements reflects a balance of Kshs.14,717,556 in respect to property plant and equipment which includes Kshs.1,876,536 and Kshs.1,519,896 relating to sewer and water extension respectively all totaling to Kshs.3,396,432 as at 30 June 2018. However, as per the vesting agreement, the ownership of water distribution infrastructure vests in Northern Water Services Board and any capital expenditure relating to distribution infrastructure needed prior approval by the Water Services Board. No documents were made available to show that prior approval for the Kshs.3,396,432 expenditure was sought and granted by the Board. Further, no explanation was provided why the sewer and water extensions which are owned by the Northern Water Services Board were included as part of the Company's property plants and equipment.

In addition, the Company owned two (2) motor vehicles registration numbers KAW 970G and KBY 744Q valued at Kshs.1,463,079. However, the Water and Sewerage Company is a state corporation, the vehicles had private number plates instead of blue number plates which are legally reserved for state corporations as required by the Traffic (Registration Plates) Rules, 2016 which stipulates that the registration plate for a state corporation vehicle shall bear the required number of optical recognizable characters, embossed and printed in white on blue aluminium reflective sheet.

In the circumstances the ownership of the plant property and equipment's balance of Kshs.3,396,432 reflected in the financial statements as at 30 June 2018 could not be ascertained.

Further, the management is in breach of the law in respect to private registration of motor vehicles.

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, GOVERNANCE AND RISK MANAGEMENT SYSTEMS

### Conclusion

As required by Section 7 (1) (a) of the Public Audit Act, 2015, based on the procedures performed, except for the matters described in the Conclusion on Effectiveness of Internal Controls 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.

### 1.0 Unaccounted for Water (UFW)

Note 6 to the financial statements reflects a Kshs.59,116,630 balance in respect to water revenue for the year under review. Documents provided for audit revealed that the Company produced a total of 1,317,699 cubic meters (m<sup>3</sup>) of water during the year under review at a production cost of Kshs.5.77 per cubic meter. However, out of this volume, only 917,925 M<sup>3</sup> was distributed and billed to customers while the balance of 399,774 or approximately 30% of the total volume produced was not billed and was therefore unaccounted for or a loss. However, Annex I of Water Services Regulatory Board (WASREB) guidelines on Service Performance Standards 2006 allows a maximum loss of 25% for every cubic meter (M<sup>3</sup>) of water produced and hence only 329,425 M<sup>3</sup> loss was allowed out of 1,317,699 cubic meters (m<sup>3</sup>) produced by the Company. The loss of 70,349 (M<sup>3</sup>) (5%) of water produced at a cost of Kshs.405,915 was therefore non-allowable loss.

In the circumstance, the significant high level of unaccounted for water negatively impacted on the Company's profitability and its long term sustainability.

### 2.0 Financial Performance

During the year under review, the Company's financial performance resulted into a deficit of Kshs.1,907,319 (2017:- deficit of Kshs.3,546,890) resulting to accumulated deficit of Kshs.18,848,834 as at 30 June 2018. If strategies are not put in place to reverse the trend, the Company is likely to face financial challenges in future.

### **3.0 Overdrawn Cash Balances**

Note 16 to the financial statements reflects overdrawn cash balances of Kshs.1,337,416. Further, the note indicates that the Company does not have an overdraft with consolidated bank. This is an indication that the Company is making payments in cheques yet the same cheques are withheld an indication of window addressing in accounting for cash at bank. Further this is contrary to Section 43 (2) of the Public Finance management (County Government) regulation which stipulates that County Government entities shall execute their approved budgets based on the annual appropriation legislation, and the approved annual cash flow plan.

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 Kenya Companies Act 2015, I report based on the audit, that;

- (i) I have obtained all the information and explanation 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 and for maintaining effective internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, 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 Isiolo Water and Sewerage Company Limited'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 the Isiolo Water and Sewerage Company Limited 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 Isiolo Water and Sewerage Company Limited's 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 Isiolo Water and Sewerage Company Limited'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 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 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 noncompliance. 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 Isiolo Water and Sewerage Company Limited'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 Isiolo Water and Sewerage Company Limited'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 Isiolo Water and Sewerage Company Limited to cease to continue 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 Isiolo Water and Sewerage Company Limited 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 February 2019**