

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

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Karuri Water and Sanitation Company Limited set out on pages 20 to 44, which comprise the statement of financial position as at 30 June 2018, and the statement of profit or 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 effects 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 Karuri 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 the Kenyan Companies Act, 2015.

Basis for Qualified Opinion

1. Trade and Other Payables

1.1. Non-Remittance of Regulatory, Lease Fees and Billing Charges

The statement of financial position as at 30 June 2018 reflects trade and other payables balance of Kshs.57,811,425 which includes lease fees payable to Athi Water Service Board, regulatory fees payable to Water Services Regulatory Board and billing service charges payable to Thika Water and Sewerage Company Limited amounting to Kshs.22,904,252, Kshs.2,820,517 and Kshs.960,365, respectively that have been outstanding for a long period. No satisfactory explanations were provided for failure to remit the outstanding amounts to the respective organizations.

In addition, lease agreement between Athi Water Service Board (AWSB) and the Company was not provided for audit review. Consequently, the validity of the lease could not be ascertained.

2. Property, Plant and Equipment

The statement of financial position as at 30 June 2018 reflects property, plant and equipment with a net book value balance of Kshs. 16,491,675 and as disclosed in Note 7 to the financial statements. However, the audit revealed that other fixed assets with undetermined value and comprising land, water pipes and vehicles were not included in the balance or disclosed in the financial statements.

3. Failure to Disclose Material Uncertainty in Relation to Going Concern

The statement of comprehensive income indicates that the Company incurred a loss of Kshs.6,919,546 for the year ended 30 June 2018 (2017: a loss of Kshs.4,353,388). The loss depleted further the retained earnings from negative Kshs.21,270,016 as at 30 June 2017 to negative Kshs.28,189,562 as at 30 June 2018. The Company's current liabilities balance of Kshs.72,338,695 exceeded its current assets balance of Kshs.28,634,962 resulting in a negative working capital of Kshs.43,703,733 as at 30 June 2018.

The precarious financial situation described above is an indication of the existence of a material uncertainty which may cast a significant doubt on the Company's ability to continue as a going concern and to meet its obligations as and when they fall due. The financial statements have been prepared on a going concern basis on the assumption that the Company will continue to receive financial support from the Kiambu County Government and its creditors. However, this material uncertainty in relation to going concern and any mitigating measures put in place by the Company's directors to reverse the undesirable precarious financial position have not been disclosed in the notes to the financial statements.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Karuri 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 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 and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and Effectiveness of Internal Controls, Risk Management and Governance sections, I have determined that there are no Key Audit Matters to communicate in my report.

Other Information

The directors are responsible for the other information. The other information comprises the report of directors as required by the Companies Act, 2015, and the statement of the directors' responsibilities which are obtained prior to the date of this report, and the annual report which is expected to be made available after that date.

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

In connection with the audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent

with the financial statements or the knowledge obtained in the audit, or otherwise appears to be materially misstated. Based on the work I have performed on the other information obtained prior to the date of this auditor's report, if I conclude that there is material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

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 and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and 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 public resources have not been applied lawfully and in an effective way.

Basis for Conclusion

1. Budget Performance

During the financial year ended 30 June 2018, Karuri Water and Sanitation Company Ltd had an approved budget of Kshs.95,870,846 comprising operational cost, administrative expenses and general expenses. The summary statement of comparison of budget and actual amounts reflects a final budget of Kshs.95,870,846 against actual expenditure of Kshs.85,684,736 which is equivalent to 89.4%. This means that the approved budget was not fully utilized as planned and which in consequence denied the residents effective delivery of water and sanitation services.

2. Unaccounted for Water

During the year under review, the Company produced 1,475,038 cubic meters of water. However, out of the above volume of water, 1,029,932 cubic meters of water was billed to customers and the balance of 446,970 cubic meters (or approximately 30% of total water produced) represented unaccounted for water (UFW), which is 5% above the allowable loss of 25% in accordance with water service regulatory guidelines. This unaccounted for water may have resulted in a loss of sales estimated at Kshs.24,532,090. Had the unaccounted for water been sold, the Company would have reported an operating profit of Kshs.17,919,544 instead of the operating loss of Kshs.6,919,546 now shown.

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 Qualified Opinion and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and 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

1. Failure to Appoint Board of Directors

Information available indicate that the Board of Directors of Karuri Water and Sanitation Company Ltd was dissolved in March 2018. As a result, there has been a lack of formulation of the Company's new policies, procedures and execution of the functions of the board contrary to section 79(1) of Water Act 2016.

The board had not been reconstituted as of January 2019. In the absence of board of directors, board functions such as; establishing and reviewing strategies and goals of the Company; review and evaluation of present and future opportunities, risks and threats and; general oversight of finance and audit committee functions among others may not be implemented.

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 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 Kenyan 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 my audit;
- (ii) In my opinion, proper books of account have been kept by the Company, so far as appears from the examination of those books;
- (iii) The Company's statement of financial position and statement of profit or loss and other comprehensive income are in agreement with books of account; and
- (iv) In my opinion the information given in the report of the directors on page 18, is consistent with the financial statements.

Responsibilities of Directors and Those Charged with Governance

The directors are 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 the directors 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, the directors responsible for assessing the ability of Karuri Water and Sanitation Company to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intends to liquidate Karuri Water and Sanitation Company or to cease operations, or have no realistic alternative but to do so.

The directors are 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, the directors are 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 manner.

Those charged with governance are responsible for overseeing the 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 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 Karuri Water and Sanitation Co. 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 directors.
- Conclude on the appropriateness of the directors 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 ability of Karuri Water and Sanitation Company 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 Karuri Water and Sanitation Company to express an opinion on the financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

I communicate with the directors 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 the directors 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

09 April 2019