

# **REPORT OF THE AUDITOR-GENERAL ON KENYA AGRICULTURAL AND LIVESTOCK RESEARCH ORGANIZATION (KALRO) FOR THE YEAR ENDED 30 JUNE 2017**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Adverse Opinion**

I have audited the accompanying financial statements of Kenya Agricultural and Livestock Research Organization (KALRO) set out on pages 1 to 21, which comprise the statement of financial position as at 30 June 2017, and the 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 purposes of the audit.

In my opinion, because of the significance of the matters discussed in the Basis for Adverse Opinion section of my report, the financial statements do not present fairly, the financial position of Kenya Agricultural Research Organization as at 30 June 2017 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 do not comply with the Public Finance Management Act, 2012 and Kenya Agricultural and Research Organization Act, 2013.

In addition, as required by Article 229(6) of the Constitution, based on the audit procedures performed, I confirm that public money has not been applied lawfully and in an effective way.

### **Basis for Adverse Opinion**

#### **1. Receivables from Non-Exchange Transactions**

##### **1.1 Long Outstanding Imprests**

As reported in the previous year, included in receivables from non-exchange transactions balance of Kshs.367,169,000 as at 30 June 2017 and disclosed under Note 22 to the financial statements, are staff imprests totalling Kshs.35,258,000 that have not been supported with dates of issue and due dates. Similarly, and as reported in the previous years, temporary imprests includes amount of Kshs.1,558,396 held by former employees of Sugar Research Institute and long outstanding imprests of Kshs.5,980,161 out of which Kshs. 2,964,822 relates to imprests issued in the financial year 2009/2010 to the Sugar Research Institute.

##### **1.2 Debt Recovery**

As previously reported, the receivables from non-exchange transactions balance still includes an amount of Kshs.124,495,782 due from Kenya Planters Co-operative

Union (KPCU) – (in receivership) and Kshs.23,445,376 due from Coffee Board of Kenya relating to Coffee Research Institute. Although the organization has made a full provision of Kshs.124,445,376 in respect of KPCU debt and forwarded a claim to the receiver manager, no meaningful progress has been reported towards recovery of this debt as at the date of this report.

### **1.3 Commodity Levy**

Similarly, and as previously reported, receivables from non - exchange transactions includes an amount of Kshs.314,569,000 in respect of commodity levy representing 86% of the total receivables from non - exchange transactions. This figure, however, includes Kshs.7,073,687 from Nyambene Mills which is under receivership. The management has not provided any evidence on the steps being taken to ensure that these debts are recovered. In addition, no provision for bad and doubtful debts in respect to commodities levy whose recovery remains doubtful has been made in these financial statements.

Consequently, it has not been possible to confirm whether receivables from non-exchange transactions balance of Kshs.367,169,000, in these financial statements is fairly stated.

## **2. Receivables from Exchange Transactions**

The receivables from exchange transactions balance of Kshs.132,998,000 and as disclosed under Note 21 to the financial statements includes like in the previous year amounts of Kshs.12,649,000 and 33,287,000 owed by various debtors and Kenya Seed Company respectively which have remained outstanding for over five years. The receivable figure also includes long outstanding debts of Kshs.537,700 owed by former Members of Parliament. In addition, included in the balance of other receivables of 16,787,000 disclosed under Note 21 is an amount of Kshs.1,760,000 due from Sugar Research Institute, a department within KALRO.

In view of the above, it is not possible to confirm whether receivables from exchange transactions' balance of Kshs. 132,998,000 as at 30 June 2017 is fairly stated.

## **3. Biological Assets**

Biological Assets balance of Kshs.471,519,000 as at 30 June 2017 includes assets within KALRO headquarters of Kshs.264,486,280 and Tea Research Institute (TRI) of Kshs.197,585,000. This figure, however, excludes undetermined value of assets held at Coffee Research Institute (CRI) and Sugar Research Institute (SRI). The balance of Kshs.471,519,000 as at 30 June 2017 is, however, more than the figure of Kshs.388,203,000 reported as at 30 June 2016 by Kshs.83,316,000. No documentary evidence or explanation has been provided to confirm whether the balance of biological assets reported was determined in compliance with paragraph 16 of International Public Sector Accounting Standard (IPSAS) No.27, which requires biological assets to be measured on initial recognition and at each reporting date at its fair value less costs to sell. In addition, the biological assets do not include amounts of Kshs.149,236,000 and Kshs.6,371,000 relating to animals and plants

respectively, which have been disclosed in these financial statements under inventories.

In the circumstances, it is not possible to confirm whether biological asset's figure of Kshs.471,519,000 is fairly stated.

#### **4. Property, Plant and Equipment**

- (i) Included in the property, plant and equipment balance of Kshs.24,536,196,000 as at 30 June 2017 is an amount of Kshs.2,932,785,960 as previously reported, in respect of six parcels of land relating to the former Kenya Agricultural Research Institute for which the Organization has no ownership documents. The parcels include L.R. No.5212 which, although the Institute holds an allotment letter, was allocated to a private developer.
- (ii) Further, part of the Organization's land at Manera and Olmagogo farms in Naivasha-Mai Mahiu Road, was illegally acquired by private developers in the year 2000 and another property in Katumani Centre measuring approximately 100 hectares has been occupied by private developers since the year 2000. In addition, part of this land is being used as a dumping site by the County Government of Machakos and construction of a power station is taking place on the same land.
- (iii) Similarly, in January 2011, a group of individuals forcibly invaded the Organization's land L.R.5210 and L.R.5211 in Naivasha, claiming ownership. The organization filed a case in court to have them evicted, and a ruling in favour of the Organization was made on 29 March 2012. However, a review of the position as at the date of this report revealed that the invaders had not vacated the land.
- (iv) As reported in the previous years, a review of available information and documentation of the Organization's land ownership documents as at 30 June 2017, still revealed that the organization does not have title to 32 parcels of land across the country, some of which have not been surveyed.
- (v) The property, plant and equipment balance of Kshs.24,536,196,000 as at 30 June 2017 excludes undetermined value of parcels of land located in Azani and Koru measuring 99 ha and 127 ha respectively which the Coffee Research Institute uses for farming. The titles to the parcels of land however are in the name of Coffee Board of Kenya (CBK) which has since merged to form Agricultural Food Authority.
- (vi) The Agricultural Mechanization Services (AMS) - a department within the Ministry of Agriculture-occupies a portion of the Organization's land at Rukera and has set up its own buildings. Although management clarified that the value of the constructions/improvements by the AMS are not included in the assets balances, and that AMS was devolved from the National Government to the County Government, the County Government had not signed any lease

agreement and has not paid any rent to Coffee Research Institute for use of the land as at the date of this report.

- (vii) The property, plant and equipment figure of Kshs.24,536,196,000 as at 30 June 2017, also excludes the value of twenty acres piece of land developed by Tea Research Institute in Kirinyaga County with an estimated value of Kshs.8,430,634. Available information indicates however that the land belongs to Kenya Forest Service.
- (viii) The property, plant and equipment net book value of Kshs.24,536,196,000 includes a figure of Kshs.81,650,080 representing the value of buildings allocated to Kenya Plant Health Inspectorate Service in 1998. The net book value is, therefore overstated by Kshs.81,650,000.
- (ix) The property, plant and equipment balance of Kshs.24,536,196,000 also includes the value of an office block completed in the year 2012/2013 at a cost of Kshs.663,772,203 in respect of Sugar Research Institute. However, as previously reported, the valuation report on the building placed the value as Kshs.447,992,751 resulting in an unexplained difference of Kshs.215,779,453. It is not clear how the value of a new building could drop below the actual cost of construction with such a high margin.
- (x) The value of land reported under Coffee Research Institute is inclusive of undetermined value of coffee bushes thus violating the International Public Sector Accounting Standard (IPSAS) No.1 on presentation, which requires various classes of assets to be shown separately on the face of the financial statements.
- (xi) As reported in the previous year, the Organization's residential building at Kisii Sub-Centre of Coffee Research Institute has been taken over by the Kisii County Government with no benefit accruing to the Organization.
- (xii) Included in additions for the period of Kshs. 253,798,000 under Note26 to the financial statements is an amount of Kshs.109,765,000 in respect to buildings described as arbitration award to a company and relates to disputed values of certificates of completion of the new office block at Sugar Research Institute. This figure however differs with the amount of Kshs.122,920,000 in respect of the award disclosed under Note 37 (ii) to the financial statements. The difference of Kshs.13,155,000, between the arbitration amount and the amount provided in these financial statements has not been accounted for.

Under the foregoing circumstances, the accuracy and completeness of the property, plant and equipment balance of Kshs.24,536,196,000 cannot be confirmed.

## **5. Trade and Other Payables**

- (i) The trade and other payables balance of Kshs.310,644,000 as at 30 June 2017 includes Kshs.3,771,786 as previously reported, owed to various hospitals that have remained unpaid for a very long time. Included also is an

amount of Kshs.4,547,866 in regard to penalty imposed by Kenya Revenue Authority on unremitted Pay As You Earn (PAYE). No explanation has been provided for failure to settle the long outstanding liabilities.

- (ii) Trade and other payables figure of Kshs.310,644,000 includes as disclosed in Note 31 to the financial statements an amount of Kshs.122,917,000 described as provision for liabilities relating to amounts owing to a contractor and arising from an arbitration ruling. However, Note 37(ii) to the financial statements shows an amount of Kshs.122,920,000 as having been the arbitrated amount and an additional amount of Kshs.14,600,000 being the arbitral tribunal fees.

The trade and other payables figure of Kshs.310,644,000 is therefore understated with an amount of Kshs.14,603,000.

## **6. Investments**

The investments balance of Kshs. 2,149,000 as at 30 June 2017 and as disclosed under Note 29 to the financial statements, includes a Kenya Planters Co-operative Union's (KPCU) unsecured loan stock of Kshs. 40,000 and KPCU redeemable ordinary shares of Kshs. 2,092,000 with a nil fair value as at 30 June 2017. Further, KPCU is under statutory management.

In the circumstances, it is not possible to confirm whether the investment figure of Kshs. 2,149,000 is fairly stated.

## **7. Cash and Cash Equivalents**

### **7.1 Unaccounted for Cash**

As previously reported, the cash and cash equivalents' balance of Kshs.854,795,000 as at 30 June 2017 still excludes cash withdrawals totalling Kshs.6,914,345 made in 2009/2010 in respect to Sugar Research Institute against which the related supporting documents were not provided for audit verification. Although management had indicated that the missing documents are a subject of investigation by the Sugar Research Institute and other arms of the Government, the amount of Kshs.6,914,345 nevertheless remains unaccounted for and as at the date of this report, no evidence had been provided on the status of investigations for verification.

### **7.2 Long Outstanding Unpresented Cheques and Uncredited Items**

Bank reconciliation statements for the bank balances of Kshs.854,795,000 disclosed under Note 20 to the financial statements includes unpresented cheques amounting to Kshs.452,634 dating back to 25 April 2015 and uncredited items totalling Kshs.126,255 dating back to 21 November 2008. The management has not explained why these long outstanding items have not been reversed and recorded in the cash book.

Under the circumstances, the accuracy of cash and cash equivalents' balance of Kshs.854,795,000 as at 30 June 2017 cannot be confirmed.

## **8. Inventories**

The statement of financial position and as disclosed under Note 24 to the financial statements reflects a balance of Kshs.288,304,000 against inventories as at 30 June 2017. Documents provided for audit, however, shows that included in the figure are amounts of Kshs.149,236,000 and Kshs.6,371,000 relating to animals and plants respectively. However, this treatment is contrary to the provisions of paragraph 9 of the International Public Sector Accounting Standard (IPSAS) No.27 which defines a biological asset as a living plant or animal. Although the management has explained that the livestock and plants have been classified as inventories since they are held for purposes of research, this explanation does not comply with the definition of inventories as provided for under paragraph 9 of the International Public Sector Accounting Standard (IPSAS) No.12.

Under the circumstances, the accuracy of the inventories balance of Kshs.288,304,000 as at 30 June 2017 cannot be confirmed.

## **9. Deferred Income**

The statement of financial position reflects a balance of Kshs.122,992,000 against deferred income as at 30 June 2017 and as disclosed under Note 32 to the financial statements. The amount relates to grants received from donors for specific projects, classified as non-current liabilities and carried in the books net of amortization based on the life of the project. The amount of Kshs.122,992,000 is net of Kshs.112,554,000 relating to the expenditure incurred during the year, which should have been recognized as income in the statement of financial performance. Examination of supporting documents presented for audit in respect to different classes of revenues for the Organization during the year however did not reflect this figure as part of the income for the year under review.

In the absence of documentary evidence, the validity of the deferred income figure of Kshs.122,992,000 cannot be confirmed.

## **10. Statement of Changes in Net Assets**

The statement of changes in net assets reflects an amount of Kshs.112,694,000 relating to prior year adjustment and as disclosed in Note 38 to the financial statements. The figure relates to amounts owing from the former KARI to NSSF for failure to remit statutory deductions for the period January 1998 to January 2008 and the initial total was Kshs.206.49 million. As at the time of this report, it was indicated that the matter was still under negotiation to have the penalty waived, while management recognized the amount as a prior year adjustment. However, it is not clear where the corresponding entry on the provision were posted to. Consequently, the completeness and validity of the prior year adjustment cannot be ascertained.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kenya Agricultural and Livestock

Research Organization (KALRO) 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 adverse 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 Adverse Opinion and Other Matter sections, I have determined that there are no Key Audit Matters to communicate in my report.

### **Other Matter**

#### **KALRO Act, 2013**

As previously reported, the Cabinet Secretary Ministry of Agriculture, Livestock and Fisheries had set 1 August 2014 as the commencement date for the operation of the Organization. This Act repealed the Science and Technology Act 250-KARI, Coffee Act (No.9 of 2001) - CRF, Sugar Act (of 2001)-KESREF and the Tea Act, Cap 343-TRF.

However, other than the Kenya Agricultural Research Institute, which was operating under the Science and Technology Act Cap. 250 of the Laws of Kenya, the other parastatals were operating under the Companies Act, Cap 486 of the Laws of Kenya. According to Section 221 (1) of the then Companies Act, Cap. 486, "An application to the court for winding up of a company shall be by petition presented, subject to the provisions of this section, either by the company, by any creditor or creditors (including any contingent or prospective creditor or creditors), contributory or contributories, or by all or any of those parties, together or separately".

Management has, however, not provided evidence that this provision of the Companies Act, Cap 486 was complied with in the establishment of KALRO. Although the management has stated that the entities were not wound up but merged, this explanation seems to be in contradiction with Section 56 of the KALRO Act, 2013 which states that, " Any reference to the former institution in any written law or in any contract, document or instrument of whatever nature shall, on the commencement of this Act, be read and construed as a reference to the Organization". In the absence of such evidence therefore, Coffee Research Foundation (CRF), Tea Research Foundation (TRF) and Kenya Sugar Research Foundation (KESREF) are still legally in existence.

### **Responsibilities of Management and Those Charged with Governance for the Financial Statements**

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 such 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.

In preparing the financial statements, management is responsible for assessing the Organization's ability to sustain services, disclosing, as applicable, matters related to / sustainability of services and using the going concern basis of accounting unless the management either intends to liquidate the Organization 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.

Those charged with governance are responsible for overseeing the Organization's financial reporting process.

### **Auditor-General's Responsibilities for the Audit of the Financial Statements**

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 of Kenya. 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 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.

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 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.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances and for the purpose of giving an assurance of the effectiveness of the Organization's 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 Organization ability 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 report. However, future events or conditions may cause the Organization to cease sustaining its services.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, 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 Organization 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**

**13 June 2018**