

REPORT OF THE AUDITOR-GENERAL ON KENYA BUREAU OF STANDARDS FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Kenya Bureau of Standards set out on pages 43 to 70, which comprise the statement of financial position as at 30 June 2018, and 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 purpose of the audit.

In my opinion, except for the effect 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 Kenya Bureau of Standards as at 30 June 2018, 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 comply with the Standards Act, Cap 486 of the Laws of Kenya.

Basis for Qualified Opinion

1. Receivables from Exchange Transactions

- i. As reported in the previous year, receivables from exchange transactions balance of Kshs.438,443,599 as at 30 June 2018 includes long outstanding debts of Kshs.17,500,000 owed by a law firm under receivership in respect of a payment made to the firm for purchase of land at Donholm Estate in Nairobi. Although the transaction turned out to be fraudulent, recovery of the money had not been made as at 30 June 2018. Further, the Public Investments Committee recommended that the Ethics and Anti-Corruption Commission investigates the matter and recommend for prosecution any person found culpable in defrauding the organization and also report progress on this matter to the National Assembly within six (6) months. The outcome of this investigation has not been disclosed. In addition, the organization requested for write-off of the long outstanding amount, but is still awaiting approval by the National Treasury.
- ii. As previously reported, prepayments of Kshs.2,697,529 to three firms for goods and services that were never supplied or rendered has also not been recovered or written off while the adequacy of provision for bad and doubtful debts of Kshs.49,137,406 made in the financial statements could not be ascertained.
- iii. A review of the Bureau's records revealed that debtors amounting to Kshs.213,159,161 have remained outstanding for more than ninety (90) days

contrary to the Bureau's credit policy. The amount of Kshs.213,159,161 includes Kshs.27,874,303 that did not have any movement from previous year. Although the board had approved the write off of debts amounting to Kshs.42,034,269, Treasury approval has however not been obtained.

In view of the above, it has not been possible to confirm the accuracy and recoverability of receivables from exchange transactions balance of Kshs.438,443,599 as at 30 June 2018.

2. Plant, Property and Equipment

The plant, property and equipment balance of Kshs.3,232,918,593 as at 30 June 2018 includes work-in-progress figure of Kshs.115,972,720 which excludes preliminary cost amounting to Kshs.101,938,209 being consultancy costs incurred on the construction of coast region laboratories. As previously reported, the Bureau abandoned the project and instead acquired a new building for its operations in Mombasa with the preliminary cost of Kshs.101,938,209 remaining as work in progress since 2012/2013. During the year 2016/2017, management expensed the preliminary costs in the financial statements and charged it under project and consultancy expenses.

In the circumstances, no value for money was obtained on the expenditure of Kshs.101,938,209.

3. Legal Matters – Procurement of Legal Firms

During the year under review, the Bureau incurred Kshs.132,888,962 on legal services including services obtained from Rachier & Amollo and Advocates on 28 July 2017 via letter ref: KEBS/COA/132/2017 (4) which sought further legal support from Iseme Kamau and Muema Advocates) to represent the Bureau in the Court of Appeal Civil application No.132 of 2017 between the and Geo Chem Middle East when the High court declined to set aside an arbitral award made in favour of Geo Chem Middle for a total sum of US Dollars 15,401,504.71 plus interest.

Further, the management wrote to the Office of Attorney General on 28 July 2017 via letter ref: KEBS/CONF/IMP/INSP/1 VOL 3(49) seeking approval to appoint the two firms to represent the Bureau in the above stated case. The Office of the Attorney General via response letter referenced AG/CON/6/D/144/Vol.II dated 31 July 2017 granted a conditional approval subject to the Bureau providing the AG with the minutes and report of the evaluation committee on the method of procurement and justification for the appointment of the two firms. However, no evidence was availed for audit review to confirm whether the Office of the Attorney General approved the appointment of the firms or whether the seeking of approval by the Bureau from Attorney General was a mere ratification of procurement decision KEBS had already made.

In the circumstances, it was not possible to confirm that the above procurement was done in line with the procurement law.

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

Emphasis of Matter

1. Restricted Bank Balances

As previously reported, cash and cash equivalents balance of Kshs.2,677,706,819 as at 30 June 2018 include Kshs.391,801,342 held in Kenya Commercial Bank, Cooperative Bank of Kenya and National Bank of Kenya attached by a court order dated 14 June 2017 issued in the case of GeoChem Middle East versus Kenya Bureau of Standards (KEBS). Information available indicates that GeoChem Middle East was in 2009 contracted to inspect petroleum products but the contract was suspended by the Government of Kenya. GeoChem Middle East filed arbitration proceedings against KEBS in 2015 claiming loss of earnings and was awarded about Kshs.1.5 billion in July 2016. The management of the Bureau appeal against the award in the High Court was dismissed and GeoChem Middle East application to enforce the award was allowed. GeoChem Middle East managed to have the funds held in the three bank accounts frozen all with a cumulative balance of Kshs.391,801,341 which the Bureau has not been able to access as at 30 June 2018 but the court case was still ongoing.

2. Supply and Implementation of Application Software for KEBS Integrated Quality Assurance and Inspection Operation

As reported in the previous year, the Management paid Kshs.13,497,120 being 60% of contract sum Kshs.22,495,200 to a local company for the supply and implementation of applications software for Bureau's integrated quality assurance and inspection operations. The contract was signed in the year 2012 and was to take duration of 8 months with a provision of extension of not more than 14 days. The amount has remained as work in progress since 2012/13 and it appears the project stalled. This is a clear indication of weak contract administration controls which may lead to loss of funds already paid in the event the contract is not completed. Consequently, the Bureau is likely to lose Kshs13,497,120 already paid as part of the contract.

3. Pre-Export Verification of Conformity (PVOC) for Exports to Kenya

As reported in the previous year, the statement of financial performance for the year ended 30 June 2015 reflected revenue from exchange transactions amounting to Kshs.3,707,985,187 out of which Kshs.2,375,571,667 was earned from PVOC

Program. Available information revealed that a local freight company imported goods with a custom value Kshs.187,652,754 but were not subjected to Destination Inspection (DI) and duty thereof at 15% on value. Had the goods been subjected to the inspection and duty levied, the Bureau would have recorded additional revenue of Kshs.28,147,193. Consequently, an amount of Kshs.28,147,193 was not collected or accounted for as receivables. The management has not made any efforts to recover the amount.

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 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, except for the matters described in the Basis for Qualified Opinion 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

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 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.

Basis for Conclusion

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.

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 Public Sector Accounting Standards (Accrual Basis) 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 governance.

In preparing the financial statements, management is responsible for assessing the Bureau's ability to continue to sustain services, disclosing, as applicable, matters related to sustainability of services and using the applicable basis of accounting unless the Bureau either 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 standard which govern them, and that public resources are applied in an effective way.

Those charged with governance are responsible for overseeing the Bureau'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 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 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.

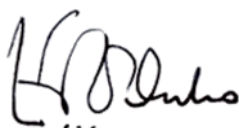
As part of an audit conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional skepticism throughout the audit. I also:

- 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 sustainability of services, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Bureau'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 Bureau to cease 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 Bureau 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 August 2019