

REPORT OF THE AUDITOR-GENERAL ON KENYA MEDICAL RESEARCH INSTITUTE FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Kenya Medical Research Institute set out on pages 1 to 43, which comprise the statement of financial position as at 30 June 2018, 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 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 Medical Research Institute 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 Public Finance Management Act, 2012 and the Science, Technology and Innovation Act, 2013.

Basis for Qualified Opinion

1.0 Administrative Costs

1.1 Legal Expenses

Included in the administrative costs of Kshs.439,947,248 in the statement of financial performance for the year ended 30 June 2018 is Kshs.20,752,239 paid as legal expenses to private legal firms. However, approval and issuance of no objection from the Attorney General's office on engagement of the private legal firms was not given as required by the Attorney General's Circular reference AG/CON/6/D/144/VOL.II dated 16 April 2014. Further, during the year, the institute's legal expenses went up by 87% from Kshs.11,083,791 in the previous year. This was occasioned by the Institute's debt owed to vendors amounting to Kshs.222,865,183 for CDC Centre program that was terminated. The Centre's suppliers sort redress in courts and the courts ordered the Institute to pay principal amount, cost of the cases and interest at 14% on the outstanding amount of the invoices notwithstanding legal fee for the Institute's own lawyers. No justifiable reason was provided for not paying the suppliers in order to avoid the escalation of the legal costs.

In the circumstances, the propriety of legal expenses totalling to Kshs.20,752,239 could not be confirmed for the year ended 30 June 2018.

1.2 Contracted Cleaning Services

As disclosed at note 6 to the financial statements, administrative costs of Kshs.439,947,248 includes expenditure on contracted cleaning services of Kshs.19,230,756. Available

information indicate that the Institute contracted a company in September 2014 for cleaning services which was to run for eleven months up to 31 July 2015 at a monthly charge of Kshs.1,602,563. The contract was however extended for four months to November 2015 to allow a fresh tender by the Institute. However, it was noted that the Company continued offering services from December 2015 up to the time of our audit in March 2018. Available information indicate that there arose a dispute between the Company and the Institute where upon the Company sought legal redress upon which the Institute was directed to pay the Company for services rendered outside the contract from December 2015 to May 2018 totalling to Kshs.48,076,890.

Consequently and in the absence of a valid contract, the validity of the contracted cleaning services expenditure of Kshs.19,230,756 for the year ended 30 June 2018 could not be confirmed.

2.0 Trade and Other Receivables

2.1 Deposit with the Institute Lawyers

As reported in 2016/2017, trade and other receivables balance of Kshs.442,875,202 included in the statement of financial position as at 30 June 2018 is net of an amount of Kshs.120,000,000 in respect of a deposit placed with the Institute's lawyers in the year 2000 while the Institute was following up issues related to the stalled residential staff housing project. Although the institute has fully provided for this amount as doubtful debts, the matter is still under police investigation. A further review of the statements indicates that the interest accumulated over time on the amount of Kshs.120,000,000 was not taken into account in arriving at the balance.

2.2 Long outstanding Receivables

The trade and other receivables balance of Kshs.442,875,202 as at 30 June 2018 includes capitation recurrent balance of Kshs.139,371,856 which have been outstanding for more than one year. No supporting document was provided to confirm the recoverability of this amount. Further, the trade and other receivables balance includes customers/suppliers control account balance of Kshs.42,398,005 and over remitted statutory deduction of Kshs.368,394 which have also been outstanding for more than one year.

Consequently, it has not been possible to confirm the validity and full recoverability of trade and other receivables balance of Kshs.442,875,202 as at 30 June 2018.

2.3 Staff Advances

The trade and other receivables from non-exchange transactions balance of Kshs.442,875,202 as at 30 June 2018 includes staff advances amounting to Kshs.44,428,853 which had not been surrendered as at 30 June 2018. Included in the unsurrendered balance of Kshs.44,428,853 are imprests totalling to Kshs.4,082,914 which relate to officers who either retired, resigned, died, absconded or jobs were terminated and therefore recoverability of this amount is in doubt. In addition, trade and other receivables balance includes advances to Centres totalling to Kshs.23,487,268 out of which

Kshs.2,908,714 were standing imprests issued to Centres and which had not been surrendered as at 30 June 2018.

This is contrary to Section 93 (5) of the Public Finance Management Regulations, 2015 which states that a holder of a temporary imprest shall account or surrender the imprest within 7 working days after returning to duty station. Section 93 (6) further provides that in the event of the imprest holder failing to account for or surrender the imprest on the due date, the Accounting Officer shall take immediate action to recover the full amount from the salary of the defaulting officer with an interest at the prevailing Central Bank Rate.

In the circumstance, the Institute is in breach of the law and full recoverability of the trade and other receivables balance of Kshs.442,875,202 as at 30 June 2018 could not be confirmed.

3.0 Property, Plant and Equipment

3.1 Land

As previously reported, the property, plant and equipment balance of Kshs.20,022,026,419 included in the statement of financial position as at 30 June 2018 includes various parcels of land totaling Kshs.4,240,135,760 as summarized below:

No.	Location	County	Acreage	Valuation (Kshs)
1	Mbagathi Road	Nairobi	2.4282 Ha	4,143,768,160
2	Taita Taveta	Taita Taveta	15 Acres	8,400,000
3	Busia	Busia	100 Acres	87,967,600
Total				4,240,135,760

However, the title/ownership documents in respect of the above parcels of land were not availed for audit verification.

3.2 Residential Staff Housing

As previously reported, the property, plant and equipment balance of Kshs.20,022,026,419 as at 30 June 2018 also include a staff housing project valued at Kshs.476,001,556 located on a 2.4282 ha area along Mbagathi Road - Nairobi and against which a developer had used the title documents as collateral to borrow funds from the National Bank of Kenya. In an effort to have the documents discharged, and as similarly reported in 2016/17, the Government spent a sum of Kshs.280 million in the year 1993 and a further amount of Kshs.142 million in the year 2000 towards settling the developer account with the Bank. However, and in spite of payments totaling Kshs.422 million having been made thus settling the debt in full, the documents had not been discharged to KEMRI as at 30 June 2018.

In the circumstance, it has not been possible to ascertain the ownership status of the parcels of land and whether the property, plant and equipment balance of Kshs.20,022,026,419 as at 30 June 2018 is fairly stated.

4.0 Intangible Assets Software - Payment for Intangible Assets Not Delivered

As previously reported, included in the statement of financial position as at 30 June 2018 is intangible assets with a cost Kshs.68,151,763 as disclosed at note 21 to the financial statements and out of which Kshs.22,904,126 relate to payment for an Enterprise Resource Planning (ERP) software for use in KEMRI. KEMRI had sourced for this service from a company on 24 August 2011 at a contract sum of Kshs.24,865,500. The installation and commissioning of this software was to take one year up to 2 July 2012. Despite the 92% payment of the contract sum by 30 June 2018, only 4 out of 14 modules had been installed. It was further noted that even the 4 modules installed were not operational as at 30 June 2018. KEMRI, therefore, had paid and amortized intangible assets not received. It's not clear and the management has not explained the rationale of making payment and amortizing for a product that is not operational. Currently, the net book value is Kshs.22,811.

Consequently, it has not possible to confirm the validity and accuracy of intangible asset net book value 22,811 as at 30 June 2018 and if the Institute obtained value for money on the entire cost of the asset of Kshs.68,151,763.

5.0 Bank Overdraft

The statement of financial position reflects bank overdraft balance of Kshs.158,854 as at 30 June 2018. However, treasury approval for the overdraft was not availed for audit verification. This is contrary to Section 51(2) of the Public Finance Management Act, 2012 which require a national government entity to obtain approval of the Cabinet Secretary-Treasury, for its intended program of borrowing, refinancing and repayment of loans.

Consequently, the management was in breach of the law and the validity of the bank overdraft balance of Kshs.158,854 as at 30 June 2018 could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kenya Medical Research Institute 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 Section, I have determined that there are no other key audit matters to communicate in my report.

Other Matter

1. Financial Performance

During the year under review, the Institute reported a deficit of Kshs.132,621,755 (2016/17-deficit Kshs.26,917,549) resulting in reduction in accumulated surplus from Kshs.1,622,192,844 as at 30 June 2017 to Kshs.1,489,571,089 as at 30 June 2018.

Clearly, the institute's performance is on a downward trend and if strategies are not put in place to reverse the trend, the Institute is likely to experience financial difficulties in the near future.

2. Budgetary Performance

During the year under review, the Institute's actual receipts amounted to Kshs.6,663,515,583 against budgeted receipts of Kshs.8,130,300,710 resulting in a revenue shortfall of Kshs.1,466,785,127. Further, actual expenditure for the year amounted to Kshs.6,699,317,763 against budgeted expenditure of Kshs.8,064,071,783 resulting in an overall under absorption of Kshs.1,364,754,020. It is therefore clear that the Institute did not fully achieve its budget objectives which adversely affected delivery of the intended services to the public. Therefore, there is need for the Institute to review its budget making process with a view to coming up with a vibrant budget implementation follow up mechanism and feedback process with a view to ensuring that all projects and activities are implemented as planned for the Institute to meet its mission and objectives for the benefits of the Citizens of Kenya.

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 Conclusion on Lawfulness and Effectiveness in Use of Public Resources 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. Employee Costs

A review of the Institute's payroll indicated that employee costs amounted to Kshs.2,004,428,482 as disclosed at note 4 to the financial statements. However, a review of the Institute's staff basic salary revealed that a total of 256 employees suffered deductions beyond a third (1/3) of their basic salary contrary to Public Service Commission Human Resource Policies and Procedures manual (sec Ci sub sec 3) which require employees to retain at least a third of their salary. The Institute is therefore in breach of the law.

2. KEMRI NCG – Service Level Agreement Loss

As previously reported, the Institute signed an MOU with Nairobi City County Government and subsequently entered into a Service Level Agreement (SLA) effective 11 March 2015 with an objective to collaborating with one another to improve standards of testing food handlers in the County of Nairobi with a view of ensuring provision of quality and hygienic services to the residents of the County. The Institute committed itself to clause 7.7 (service level credits/penalties) that stipulated that KEMRI was to examine 50,000 food handlers per month which translate to Kshs.50,000,000 at the charge rate of Kshs.1,000 per client. The amount was to be shared at the ratio of 75:25 for KEMRI and Nairobi County Government respectively. Out of the KEMRI share of Kshs.750 per client, Kshs.500 was to cater for operational costs. The clause further stipulated that should KEMRI fail to reach the target

of 50,000 people, they were to forfeit their share of the proceeds so as to cover Nairobi County Government share fully. This clause appears to have favored the Nairobi City County Government given that the target of 50,000 people that KEMRI was expected to certify was unrealistic and was not based on any baseline survey.

Further, a scrutiny of the implementation process revealed that the last review reflected a performance shortfall which resulted to KEMRI owing Kshs.120,000,000 to Nairobi County Government emanating from this biased Service Level Agreement. This may result to a loss of Kshs.120,000,000 should KEMRI pay Nairobi City County Government since there was no service rendered on the amount owing.

Available information further indicate that the County Government vide their letter to the Institute ref:CHS/CECM/BNM/1/016 dated 14 January 2016 terminated the Agreement citing non-performance by the Institute.

Under the circumstances, the Institute is likely to suffer a loss of Kshs.120,000,000 should the County Government sue for damages arising from non-performance of the contract agreement.

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

Board Composition

A review of the Institute's current board of directors indicate that none of the board members have finance and accountancy background as outlined in paragraph 4.1 of the Kenya Gazette No.2690 dated 15 April 2016, which require that the board should satisfy itself that at least one member of the audit committee has relevant qualifications and expertise in audit, financial management, or accounting with experience in public service or devolved system of government and knowledge in risk management and is a member of a professional body in good standing.

Under the circumstances, the board as currently constituted may experience challenges in executing its mandate due to the limitations arising from the non-compliance with the requirement of paragraph 4.1 of the gazette notice.

The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. The standards requires 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 Institute's ability to continue as a going concern / 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 Institute 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 financial statements described above, management is also responsible for ensuring that the activities, revenue 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 Institute's revenue 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 review 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 Institute'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 Institute ability to continue 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 Institute to cease to continue to sustain its services.

- Evaluate the overall presentation, structure and content of the revenue 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 Institute 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 May 2019