

REPORT OF THE AUDITOR-GENERAL ON KENYA MEDICAL SUPPLIES AUTHORITY FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Kenya Medical Supplies Authority set out on pages 26 to 67, 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 statements 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 Supplies Authority 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 Kenya Medical Supplies Authority Act. 2013.

Basis for Qualified Opinion

1. Staff Costs

The staff costs of Kshs.765,607,575 as disclosed in the statement of financial performance for the year ended 30 June 2018 includes Kshs.9,326,710 paid to forty (40) officers employed during the year and two (2) who were promoted during the year. However, the approved staff establishment for the forty two (42) vacancies filled was not availed for audit review. Further, the Authority had seven hundred and fifty nine (759) employees as at 30 June 2018 against an approved staff establishment of three hundred and forty one (341) resulting in unapproved over employment of four hundred and eighteen (418) officers.

In addition, the staff cost expenditure of Kshs.765,607,575 includes Kshs.8,787,805 paid to twenty six (26) seconded staff who have been working for the Authority for over six (6) years contrary to the Authority's human resource policies and procedures paragraph 7.3 which restricts secondment to a period not exceeding three years and renewable once. Further, the seconded twenty six (26) staff include twelve (12) staff with no special skills contrary to paragraph 7.3 of the human resource policies and procedure which provides for secondment of employees with special skills that are not available within the Authority.

Consequently, the propriety of the staff cost of Kshs.765,607,575 for the year ended 30 June 2018 could not be confirmed.

2. Expired/Damaged Drugs

As previously reported, the net sales balance of Kshs.709,435,073 for the year ended 30 June 2018 is arrived at after deducting cost of sales (pharms) of Kshs.2,441,247,836. The cost of sales figure includes an amount of Kshs.150,423,159 for expired/damaged drugs that were unsaleable due to expiry or damage. No explanation has been provided for stocking expired/damaged drugs. Consequently, the accuracy and validity of the net sales balance of Kshs.709,435,073 for the year ended 30 June 2018 could not be confirmed.

3. Board Expenses

Note 14 to the financial statements reflects board expenses of Kshs.8,379,185 for the year ended 30 June 2018 and which include sitting and lunch allowance of Kshs.6,095,999. Further, the sitting and lunch allowance of Kshs.6,095,999 include an amount of Kshs.1,660,999 paid to four (4) board members whose supporting invitation letters and minutes of meetings held were not availed for audit verification.

Consequently, the validity of sitting and lunch allowance expenses totalling to Kshs.1,660,999 paid to the four board members could not be confirmed for the year ended 30 June 2018.

4. Property, Plant and Equipment

4.1 Land

As previously reported, the property, plant and equipment balance of Kshs.3,968,606,648 as at 30 June 2018 includes land at a cost of Kshs.1,786,967,270 which includes various parcels of land spread across the country and valued at Kshs.158,000,000 for which the Authority does not possess ownership documents as detailed below:

Location	LR No./Allotment No.	Value Kshs.
Eldoret	BLOCK 10/155/6	25,000,000
Garissa	PDP Ref.No.326/2003/58	6,500,000
Kakamega – Green Site	4/168	7,500,000
Kakamega – PGH	4/168	3,000,000
Kisumu	209163/IX	25,000,000
Location	LR No./Allotment No.	Value Kshs.
Mombasa	209163/A	76,000,000
Nyeri	3/173/174	15,000,000
Total		158,000,000

Report of the Auditor-General on the Financial Statements of Kenya Medical Supplies Authority for the year ended 30 June 2018

Further, the property, plant and equipment balance of Kshs.3,968,606,648 excludes unspecified value of parcel of land in Meru Municipality measuring 0.3 Ha which also belongs to the Authority. No explanation has been provided for failure to obtain the title deeds for these parcels of land and to bring into account the parcel of land in Meru.

In the circumstances, it has not been possible to confirm the ownership of the eight (8) parcels of land and whether the land cost of Kshs.1,786,967,270 is fairly stated as at 30 June 2018.

4.2 Motor Vehicles

The property, plant and equipment balance of Kshs.3,968,606,648 includes motor vehicles net book value of Kshs.62,315,900 which include four (4) vehicles with a net book value of Kshs.2,574,000 that are owned by the National Government as detailed below:

Registration No.	Make & Model	Year of Manufacture	Net Book Value Kshs
GK A538G	Isuzu FVR 23 Lorry	1998	928,125
GK A539G	Isuzu FVR 23 Lorry	1998	945,000
GK A960B	Toyota Landcruiser	1998	391,500
GK U127	Isuzu TX Lorry	1998	309,375
Total			2,574,000

No explanation has been provided for failing to transfer the ownership documents of these vehicles to the Authority.

In the circumstances, it has not been possible to confirm the ownership the four (4) motor vehicles and whether the motor vehicles net book value of Kshs.62,315,900 is fairly stated as at 30 June 2018.

4.3 Work in Progress

The work in progress balance of Kshs.494,320,413 as at 30 June 2018 include Kshs.321,360,535 paid to a consultant engineer for design and supervision of construction of warehouse and office block. However, according to documents availed, the amount payable for the design was Kshs.126,279,953 (being 4.1% cost of works of Kshs.3,079,998,859) resulting in over payment of Kshs.195,080,582 that was not explained or supported. The work in progress also include Kshs.22,466,643 paid to a consultant engineer for supervision of renovations. However, according to documents availed, the amount payable is Kshs.5,754,638 (12% of cost of work Kshs.47,955,316) again resulting to overpayment of Kshs.16,712,005 as detailed below:

	Cost of Works	Amount Paid	Recalculated Amount (12%)	Over Payment

Project Description	Kshs.	Kshs.	Kshs.	Kshs.
Caging & Partitioning of Embakasi Depot	11,586,870	3,966,320	1,390,424	2,575,896
Renovation of Quality Assurance Lab	4,839,975	1,716,320	580,797	1,135,523
Renovation of Eldoret Depot	13,528,230	3,662,040	1,623,387	2,038,653
Renovation of Mombasa Depot	7,391,370	3,883,872	886,964	2,996,908
Renovation of Kakamega Depot	10,608,870	9,238,091	1,273,064	7,965,027
Total	47,955,315	22,466,643	5,754,636	16,712,007

Further, the cost price for the consultant engineer for supervision of renovation and construction of the warehouse and office block has not been specified in the contract agreement.

In the circumstance, the propriety of Kshs.211,792,587 charged to work in progress as at 30 June 2018 could not be confirmed.

5. Receivable from Exchange Transactions

As previously reported, the receivables from exchange transactions balance of Kshs.4,122,083,110 reflected in the statement of financial position as at 30 June 2018 includes long outstanding receivables totalling Kshs.3,400,428,351 comprising of counties Kshs.2,345,622,268 and the Ministry of Health Kshs.1,054,806,083 whose recovery is doubtful as detailed below:

S/No	County	2017/2018 Kshs	2016/2017 Kshs
1	Baringo County	48,068,556.43	(6,337,929.22)
2	Bomet County	35,463,332.10	63,841,235.45
3	Bungoma County	25,712,619.50	39,213,362.00
4	Busia County	8,259,252.00	33,722,894.09
5	Eelgeyo Marakwet County	29,942,996.00	36,220,062.10
6	Embu County	10,672,646.59	28,809,712.29
7	Garissa County	20,697,722.42	29,435,980.42
8	Homa Bay County	111,584,756.40	91,620,619.40
9	Isiolo County	20,076,759.38	13,833,202.38
10	Kajiado County	47,641,962.32	72,910,137.77
11	Kakamega County	76,030,623.96	62,823,047.46
12	Kericho County	26,210.66	26,210.66
13	Kiambu County	84,195,731.60	40,718,540.60
14	Kilifi County	78,855,087.48	96,332,760.43
15	Kirinyaga County	43,983,030.50	31,781,035.50
16	Kisii County	68,542,061.55	82,125,996.55
17	Kisumu County	87,447,971.98	35,748,735.98
18	Kitui County	84,983,062.26	97,925,471.37
19	Kwale County	48,031,472.16	59,002,946.16
20	Laikipia County	1,685,940.33	20,477,607.33

S/No	County	2017/2018 Kshs	2016/2017 Kshs
21	Lamu County	18,692,662.32	15,670,912.32
22	Machakos County	70,202,331.55	59,655,732.55
23	Makueni County	38,136,508.15	32,164,680.94
24	Mandera County	(0.25)	22,737,929.75
25	Marsabit County	25,243,360.85	37,529,431.85
26	Meru County	90,164,923.80	78,779,433.55
27	Migori County	77,285,902.86	29,009,389.86
28	Mombasa County	16,828,306.00	269,109.00
29	Murang'a County	46,944,447.50	61,944,447.50
30	Nairobi County	285,663,343.28	285,501,728.28
31	Nakuru County	96,371,414.27	147,204,788.57
32	Nandi County	23,488,911.39	56,766,202.39
33	Narok County	104,584,708.18	98,524,087.18
34	Nyamira County	44,956,895.68	28,491,247.68
35	Nyandarua County	722,767.79	19,945,667.69
36	Nyeri County	4,381,675.81	90,593,134.31
37	Samburu County	30,397,881.62	21,986,744.62
38	Siaya County	28,868,646.40	51,161,954.00
39	Taita Taveta County	49,409,857.11	24,231,712.11
40	Tana River County	38,282,273.86	38,282,273.86
41	Tharaka Nithi County	8,692,559.12	33,907,404.12
42	Trans Nzoia County	41,407,560.59	41,407,560.59
43	Turkana County	87,473,020.45	1,554,131.45
44	Uasin Gishu County	(21,000.02)	9,313,763.78
45	Vihiga County	78,513,730.22	47,547,096.22
46	Wajir County	65,200,386.02	56,669,456.52
47	West Pokot County	41,827,398.03	28,633,244.57
	Sub Total	2,345,622,268.20	2,349,714,900.98
	Ministry of Health	1,054,806,083.00	-
	Grand Total	3,400,428,351.20	2,349,714,900.98

No explanation has been provided for failing to recover these long outstanding debts. In the circumstances, the accuracy and validity of the receivable from exchange transactions balance of Kshs.4,122,083,110 reflected in the statement of financial position as at 30 June 2018 is doubtful.

6. Trade and Other payables

Trade and other payables from exchange transactions balance of Kshs.833,920,091 as at 30 June 2018 includes long outstanding Medical creditors of Kshs.22,888,538.84 and operation creditors of Kshs.35,681,976.80 that have been outstanding for a long period of time. Further, the trade and other payable from exchange transaction balance includes long outstanding customer prepayment of Kshs.3,829,479 termed as direct deposit dated as far back in 2016 and suppliers retained fund of Kshs.9,858,300 which has been outstanding since 30 June 2012.

Consequently, the accuracy and validity of the trade and other payables from exchange transactions balance of Kshs.833,920,091 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 Supplies Authority in accordance with ISSAIs 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 judgement, are of most significance in the audit of the financial statements. Except for the matters described in the Basis for Qualified Opinion section on my report, I have determined that there are no other Key Audit Matters to communicate in my report.

Other Matter

Budgetary Performance

During the year under review, the Authority's actual receipts amounted to Kshs.3,059,979,000 against budgeted receipts of Kshs.3,861,226,000 resulting in a revenue shortfall of Kshs.801,247,000 equivalent to 21% of the budget. The bulk of the revenue shortfall was from net sales which had actual collection of Kshs.709,435,000 against budgeted receipts of Kshs.1,162,381,000 resulting in a shortfall 452,946,000. Further, the Authority's actual expenditure for the year amounted to Kshs.2,222,683,000 against budgeted expenditure of Kshs.2,605,105,000 resulting in an overall under absorption of Kshs.382,422,000. It is therefore clear that the Authority did not fully achieve its budget objectives which adversely affected delivery of the intended services to the public. Therefore, there is need for the Authority to review its budget making process with a view to coming up with a realistic budget to support the attainment of the core mandate of procuring, warehousing and distribution of medical commodities to public health activities in the Country.

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

Insurance Expenses

The insurance costs of Kshs.97,896,057 for the year ended 30 June 2018 include staff group life assurance of Kshs.4,343,068. However, the staff group insurance service was single sourced as no evidence of competitive bidding was availed for audit verification. This is contrary to Section 96 of the Public Procurement and Assets Disposal Act, 2015 which require the accounting officer to take such steps as are reasonable to bring the invitation to tender to the attention of all those who may wish to submit tenders. Further, although direct procurement method was used, the circumstances did not meet the conditions set for direct procurement as laid down in Section 91 of the Act. Management was therefore in breach of the law and the validity of the staff group life assurance expenses of Kshs.4,343,068 for the year ended 30 June 2018 could not be confirmed.

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 discussed 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 internal controls, risk management and overall governance were not effective.

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 Authority 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 Authority 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 Authority'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 Authority 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 Authority's 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 Authority 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 Authority 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

24 April 2019