

REPORT OF THE AUDITOR-GENERAL ON KENYA POST OFFICE SAVINGS BANK FOR THE YEAR ENDED 31 DECEMBER 2016

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Kenya Post Office Savings Bank set out on pages 32 to 66, which comprise the statement of financial position as at 31 December 2016, and the statement of 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 matter 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 post office savings bank as at 31 December 2016, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with Kenya post office savings bank Act 493B of the law(s) of Kenya.

In addition, as required by Article 229(6) of the Constitution, based on the procedures performed, I confirm that, except for the matters described in the Qualified Opinion and Other Matter sections of my report, nothing has come to my attention to cause me to believe that public money has not been applied lawfully and in an effective way.

Basis for Qualified Opinion

1. Going Concern

As noted similarly in the previous year, the bank reported a loss of Ksh.1,287,021,979 (year 2015 loss Kshs.1,255,609,767) and an increase in revenue reserve deficit to Kshs.9,599,351,297 (year 2015 Kshs.8,342,815,180). The bank also reported a negative total shareholders' equity of Kshs.7,171,095,436 as of 31 December 2016 (year 2015 Kshs.5,923,993,905). In view of the above circumstances, the bank's ability to continue operating on a going concern basis and deliver on its mandate both in the short and long run is dependent on the support of the depositors and the Government.

2.0 Cash and Bank

The cash and bank balances of Kshs.571,762,339 reflected in the statement of financial position as at 31 December 2016 and as disclosed in Note 28 includes cash on hand of Kshs.331,554,969 (year 2015 Kshs.370,456,515). As reported in the previous year, the cash count certificates were availed to support the Kshs.370,456,515 but on review the certificate availed supported Kshs.375,465,302 leaving an unexplained difference of Kshs.5,008,787. In the circumstances, the correctness of the comparative figure for cash and bank balance of Kshs.662,922,538 cannot be confirmed.

3.0 Account Receivables and Prepayments

The statement of financial position reflects accounts receivable and prepayment net balance of Kshs.2,873,129,934 as at 31 December 2016 and as disclosed in Note 34 after a provisions of doubtful debt of Kshs.664,623,725. The basis of the provision of Kshs.662,922,538 has not been provided for review.

3.1 Long Outstanding Balances

The Accounts Receivables includes long outstanding balances totaling Kshs.1,910,859,696 which is made of excess deposits - Kshs.780,399,108, GOK pension (KP & TC) - Kshs.405,231,629, prepaid GOK pension (payroll) - Kshs.456,675,801 and GOK pension cheques receivable Kshs.268,553,158 owed over the years by Postal Corporation of Kenya and the defunct Kenya Posts and Telecommunications Corporations. The accounts receivables and prepayments balances also includes loan advances to two former directors totaling Kshs.3,327,044 that has similarly been outstanding over the years. It has not been possible therefore to ascertain the recoverability of these long outstanding balances and directors' loans of Kshs.1,910,859,696 and Kshs.3,327,044 respectively.

3.2 Trade Debtors

The statement of financial position reflect accounts receivables of Kshs.2,873,129,934 which includes trade debtors' of Kshs.219,927,482 as at 31 December 2016. As reported in the year 2014 and 2015, the opening balance of Kshs.172,623,647 was taken into consideration in arriving at the 2015 closing account of Kshs.138,481,371. The closing balance of trade debtors Kshs.172,623,647 as at 31 December 2014 has not yet been reconciled to the 2014 debtors' schedules which reflected a balance of Kshs.213,134,700 , thus resulted to a difference of Kshs.40,511,053 which has remained unexplained by 31 December 2016.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kenya Post Office Savings Bank 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 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 of the current year. These matters were addressed in the context of the audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters. For each matter below, a description of how the audit addressed the matter is provided in that context.

Key Audit Matter	How the audit addressed the key audit matter
Information Technology (IT) Systems and Controls of Financial Reporting	
The bank operates two IT systems one core banking system	We assessed and tested

Key Audit Matter	How the audit addressed the key audit matter
<p>and Financial reporting system. These systems are again integrated with many other banking related financial systems. There is a risk that the controls around the integration of these systems may not operate effectively. Under Note 38 to the financial statements reflects customer savings and deposits balance of Kshs.17,944,644,853 while the core banking system (CBS) reflects a balance of Kshs.17,927,788,031. The difference of Kshs.6,856,822 has not been explained or reconciled and therefore the accuracy of the customers' savings and deposits account balance could not be confirmed.</p> <p>In the statement of Comprehensive Income for the year then ended, is Interest expense amounting to Kshs.562,788,544. The Core banking system has Kshs.554,235,080 thus differing by Kshs.8,553,464. Due to the inherent nature of the banking operations and the reporting systems, this was considered a key audit matter.</p>	<p>the financial reports generated from these systems where various differences in the reports were observed. Within the scope of our audit we performed reliance on key controls and substantive procedures to assess the reliance placed on completeness and accuracy of system generated information.</p>

Other Matter

Prior Year Issues

1.0 Misstatement of Customers' Savings and Deposits

The statement of financial position reflects customers' savings and deposits balance of Kshs.17,944,664,853 as at 31 December 2016. As reported in the year 2014 the opening balance of Kshs.17,503,279,455 on customers savings and deposits was not reconciled with the ledger balance as at 31 December 2014. Also in the year 2014, the customers savings and deposits balance of Kshs.17,503,279,455 differed with the core banking system (CBS) balance of Kshs.17,515,289,299 by Kshs.12,009,845 as at 31 December 2014. The difference of Kshs.12,009,845 remained unexplained as at 31 December 2015 and 2016.

2.0 G.O.K. Pension Reserve Fund

The statement of financial position and as disclosed in note 40 reflects GOK Pension Reserve Fund balance of Kshs.183,942,031 (2015 Kshs.204,348,685). The balance is made up of inactive accounts, accounts for deceased cases, Books on hand (BOH) and suspected fraud cases over the years which should be remitted back to The National Treasury upon confirmation. The amount of Kshs.183,942,031 has not been remitted back to exchequer at The National Treasury. No explanation has been provided as to why the corporation has not remitted the balance of kshs.183,942,031 to the Exchequer.

3.0 Interest Expense

The statement of comprehensive income and as disclosure in Note 15 reflect interest expense of Kshs.562,788,544. As reported in the year 2014 the interest expense of Kshs.1,086,132,043 excluded CBS interest from Money Market of Kshs.656,264,332 and the manual interest adjustments of Kshs.31,897,660.50. The corporation has so far demonstrated that the money market interest of Kshs.656,264,332 and manual interest adjustment of Kshs.28,760,305 was included and figures have been supported and reviewed leaving only a balance Kshs.3,137,356 as unexplained difference. However the comparative value for the year 2015 of Kshs.459,833,282 has not been restated, further the unexplained difference of Kshs.3,137,356 has not been explained/clarified thus the correctness of the comparative value of Kshs.459,833,282 could not be ascertained.

Responsibility 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 Financial Reporting Standards 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 Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the management either intends to liquidate the Bank 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 Bank'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 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.

As part of an audit conducted in accordance with ISSAIs, I exercise professional judgment 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.

- 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 on the effectiveness of the Bank'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 Bank'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 Bank 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 bank 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

03 July 2018