

# **REPORT OF THE AUDITOR-GENERAL ON KENYA POST OFFICE SAVINGS BANK FOR THE YEAR ENDED 31 DECEMBER, 2018**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Qualified Opinion**

I have audited the accompanying financial statements of Kenya Post Office Savings Bank set out on pages 19 to 63, which comprise the statement of financial position as at 31 December, 2018 and statement of comprehensive income, statement of changes in equity, statement of cash flows and the 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 matters described in the Basis for Qualified Opinion section on my report, the financial statements present fairly, in all material respects the financial position of Kenya Post Office Savings Bank as at 31 December, 2018 and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards (IFRS) and comply with Kenya Post Office Savings Bank Act, CAP 493B and Public Finance Management Act, 2012 of the laws of Kenya.

### **Basis for Qualified Opinion**

#### **1. Overdue Accounts Receivable**

As reported previously and as disclosed under Note 24 to the financial statements, the statement of financial position reflects accounts receivable balance of Kshs.2,637,847,618; (2017-Kshs.2,723,077,613). Included in the rent receivables balance of Kshs.66,069,753 is Kshs.47,113,844 owed by tenants who have since vacated the Bank's premises without recourse as provisioned for in the lease agreements being exercised. The likelihood of the amount being collected is doubtful, and adjustments necessary by way of provisions for the uncertainty have not been incorporated in the financial statements.

In the circumstances, the accuracy of the accounts receivable balance of Kshs.2,637,847,618 as at 31 December, 2018 could not be confirmed.

#### **2. Customer Savings and Deposits**

As disclosed under Note 28 to the financial statements, the statement of financial position reflects customer's savings and deposits accounts balance of Kshs.20,018,428,732; (2017 - Kshs.18,901,102,775). However, the supporting schedules provided reflects a balance of Kshs.20,124,809,988 resulting to an unexplained and unreconciled variance of Kshs.106,381,256.

Consequently, the accuracy of customer's savings and deposits accounts balance of Kshs.20,018,428,732 as at 31 December, 2018 could not be confirmed.

### **3. Property and Equipment**

As disclosed under Note 26 to the financial statements, the statement of financial position reflects property and equipment balance of Kshs.2,360,260,775; (2017-Kshs.1,714,998,172). The following issues were observed:

#### **3.1. Land without Title Deed**

As previously reported, included in the Land balance of Kshs.854,500,000, is a parcel of land valued at Kshs.5,000,000 located in Dandora Phase II allotted to the Bank in 1993. Physical visit to the land during the audit revealed that it continues to remain unfenced and has since been encroached on by informal settlers. There is no evidence of actions taken by management to secure the land and obtain a title deed. The Bank's ability to access the land in the future as its rightful owner is doubtful.

#### **3.2. Land in Dispute**

Land Reference No. 209/11908(I.R No.59328) in Nairobi, Upper Hill, Mara Road, and registered in the Name of the Bank valued at Kshs.550,000,000 has its title deed encumbered (The encumbrance was registered vide a caveat dated 15 August, 2014 claiming interest absolutely). Available information indicates that this relates to an ongoing court case No.2834 of 1995 between the Bank and another. The outcome of the case had not been determined at of the date of the financial statements, however management has not disclosed this by way of contingent liability in the financial statements.

In the circumstance, the absolute ownership to the two parcels of land by the Bank could not be confirmed.

### **4. Motor Vehicle without Log Book**

Also included in the property and equipment balance of Kshs.2,360,270,775 as at 31 December, 2018 are motor vehicles valued at Kshs.19,361,255. As reported previously, the motor vehicles schedule includes a motor vehicle registration number KAJ 078Y valued at Kshs.400,000 whose log book has not been issued to the Bank by the National Transport and Safety Authority (NTSA). This is despite the Bank having paid the requisite duty to register the vehicle in its own name in November, 1997.

In the circumstances, the accuracy of property and equipment balance of Kshs.2,360,270,775 as at 31 December, 2018 could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Post Office Savings Bank management in accordance with ISSAI 130 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**

### **Material Uncertainty Related to Going Concern**

The statement of comprehensive income reflects loss for the period of Kshs.1,589,099,239; (2017-loss of Kshs.1,364,952,385) resulting in further widening of the revenue reserve deficit to Kshs.12,588,190,816; (2017-Kshs.11,020,457,848). Further, the statement of financial position reflects total assets and liabilities balances of Kshs.14,083,708,567; (2017-Kshs.13,361,911,330) and Kshs.23,276,530,380; (2017-Kshs.21,932,184,649) respectively, resulting in negative shareholder's equity of Kshs.9,192,821,813; (2017- Kshs.8,570,273,319). I also draw attention to Note 2 (e) (i) on going concern which discloses the Bank's future performance is dependent on restructuring and government support in defraying the losses incurred from the year 2012 to 2018.

These conditions, along with other matters as set forth in Note 2 (e) (i), indicate that a material uncertainty exists that may cast significant doubt on the Bank's ability to continue as a going concern.

My opinion is not qualified in respect of this matter

## **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. There were no key audit matters to report in the year under review.

## **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 Conclusion on Lawfulness and Effectiveness in Use of Public Resources 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**

#### **1. Non-Adherence to One Third Rule of Basic Salary**

Contrary to the provisions of Section 19(3) of the Employment Act, 2007, four hundred and twenty-eight (428) employees of the Bank out of the total six hundred and seventy-four (674) employees earned less than a third (1/3) of their basic pay. No explanation has been provided for the anomaly.

## **2. High Employee Cost**

Contrary to the provisions of Section 26(1)(a) of the Public Finance Management (National Government) Regulations, 2015 that requires compensation of employees not to exceed 35% of revenue, the Banks employee expenses amounted to Kshs.1,185,075,279 or 92% of the total revenue of Kshs.1,294,337,793.

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 OVERALL GOVERNANCE**

#### **Conclusion**

As required by Section 7(1)(a) of the Public Audit Act, 2015, based on the audit procedures performed, 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 2315 and ISSAI 2330. 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 overall 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 Board of Directors**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards (IFRS) 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 overall governance.

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.

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 authorities which govern them, and that public resources are applied in an effective way.

The Board of Directors is responsible for overseeing the financial reporting process, reviewing the effectiveness of how the Bank 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 overall 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 overall 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 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 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 the 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.



**Nancy Gathungu**  
**AUDITOR-GENERAL**

**Nairobi**

**14 August, 2020**