

REPORT OF THE AUDITOR-GENERAL ON KENYA RAILWAYS CORPORATION FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Kenya Railways Corporation set out on pages 30 to 63 which comprise the statement of financial position as at 30 June 2018, and the statement of profit and loss and other comprehensive income, the statement of changes in equity, the statement of cash flow and the statement of budget and actual comparison 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 Railways Corporation as at 30 June 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 the Kenya Railways Corporation Act, Cap 397 of the laws of Kenya.

Basis for Qualified Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kenya Railways Corporation 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 annual report and financial statements in Kenya. I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

1.0 Non-Disclosure of Material Uncertainty Related to Going Concern

Note 17.5 (c) to the financial statements on critical accounting estimates and judgements – indicates that financial statements for the year have been prepared on a going concern basis. However, the statement of financial position as at 30 June 2018 reflects current liabilities balance of Kshs.182,008,328,365 (2017-Kshs.111,999,219,078) which exceeds the current assets balance of Kshs.55,738,371,368 (2017-Kshs.69,551,466,570) by Kshs.126,269,956,997 (2017-Kshs.42,447,752,508) resulting in a negative working capital. Further, the statement of comprehensive income for the year reflects an operating loss of Kshs.5,562,892,452 a deterioration from the 2017 operating profit of Kshs.273,676,747.

The statement of financial position also reflects payables and accrued charges balance of Kshs.34,094,795,493 (2017-Kshs.2,063,344,342) and as disclosed under Note 32 to the financial statements. This increase is significant amounting to Kshs.32,031,451,151 and representing a 1552% change from the prior year. Management hasn't rendered explanation for non payment. The conditions are indicative of material uncertainty exists that may cast significant doubt on the Corporation's ability to continue as a going concern unless satisfactory measures are taken to reverse the trend.

2.0 Property, Plant and Equipment

The statement of financial position as at 30 June 2018 reflects Property, Plant and Equipment balance of Kshs.24,941,511,520 and disclosed under Note 15 to the financial statements. However, the following concerns that casts doubt on the accuracy and validity of the balances were noted:

2.1 Illegal Allocations of Land

As reported in the previous year, various parcels of land were allocated to private developers without the consent of the Corporation by either the Commissioner of Lands or the defunct local authorities. For instance, land within Limuru railway station constituting 9 industrial plots No. 7882/2-10 and measuring approximately 3 acres; piece of land within Kikuyu railway station measuring approximately 2 acres; and parcels of land adjacent to Mombasa railway station measuring approximately 0.75 to 1 acres have been allocated to private developers irregular with some having been developed. Further, another 529 parcels of land have been illegally allocated across the country. However, management has sought court intervention to repossess 27 parcels.

From the foregoing, I am unable to confirm the accuracy and the validity of Property, plant and equipment balance of Kshs.24,941,511,520 as at 30 June 2018.

3.0 Current Assets (Short Term Investments)

As previously reported, the statement of financial position reflects short term investments balance of Kshs.2,172,135,077 as at 30 June 2018 and disclosed under Note 21 to the financial statements. Included in this amount is Kshs.818,575,979 that was held under fixed deposit with the Chase Bank Ltd In Receivership (CBLIR) and subsequently sold to SBM Bank. As part of the takeover arrangements 75% of the value of deposits was taken over by SBM Bank to be made available over a 3-year period. The balance value of deposit of 25% amounting to Kshs.204,643,995 remained under moratorium consequently, its accessibility remains uncertain.

4.0 Inventories

The statement of financial position reflects stores inventories balance of Kshs.3,616,531,816 as at 30 June 2018 (2017-Kshs.3,610,264,866). Management were unable to support the balance by way of requisite documents such as stock take sheets and reports. In the circumstances it has not been possible to confirm the validity of inventories valued at Kshs.3,616,531,816 as at 30 June 2018.

5.0 Trade and other Receivables

The statement of financial position as at 30 June 2018 reflects trade and receivables balance of Kshs.38,553,285,640 (2017-Kshs.54,740,819,906). However, the following inconsistencies were noted:

- i. No aging analysis was provided for audit review, consequently the adequacy of provisions that could arise from impairment losses could not be established;
- ii. Included in the balance is other debtors balance of Ksh.1,189,220,372 owed to the Corporation by Kenya Ports Authority (KPA). Confirmation received from KPA indicates Ksh.651,978,000 as owed to the Corporation as of financial statement date resulting in unexplained and unreconciled balance of Ksh.537,242,372;
- iii. Included in the balance is receivable amount of Kshs.10,000,000 from National Land Commission without supporting documents; and
- iv. Kshs.194,845,459 included in the balance and described as RVR Transition Revenue has no supporting documents.

In the circumstances, the accuracy and validity of the trade receivables balance of Kshs.38,553,285,640 as at 30 June 2018 could not be confirmed.

6.0 Land Compensation

Audit of Standard Gauge Railway (SGR) land compensations effected by the management between December 2014 and October 2016 revealed the following inconsistencies:-

6.1 Unsupported Payments

Included in the Capital Works-in-Progress balance of Kshs.523,946,281,115 is Kshs.12 billion incurred on land compensation under SGR Phase 1. Of this amount, Kshs.1,043,439,897 was paid out to Project Affected Persons (PAPS) without the requisite supporting beneficiary documents i.e. copies of National Identity Cards, Kenya Revenue Authority Personal Identification Number (PIN) certificates and title deed surrender from the National Land Commission.

6.2 Overpayments

Compensation amounting to Kshs.15,752,406 was paid to Project Affected Persons (PAPS) who were entitled to only Kshs.1,082,658 resulting into an overpayment of Kshs.14,669,748. Although management subsequently recovered Kshs.5,698,770 from the overpayment, the balance of Kshs.8,970,978 remained outstanding as of 30 June 2018.

In the circumstances, the probity of the land compensation expenditure amounting to Kshs.1,052,410,875 could not be ascertained.

Key Audit Matters

Key audit matters are those matters that, in my professional judgment, were 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.

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 discussed 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 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 INTERNAL CONTROLS EFFECTIVENESS, GOVERNANCE AND RISK MANAGEMENT SYSTEMS

Conclusion

As required by Section 7 (1) (a) of the Public Audit Act, 2015, based on the audit procedures performed 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

whether due to fraud or error and for its assessment of the effectiveness of internal control, Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for maintaining effective internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, risk management and governance.

In preparing the financial statements, management is responsible for assessing the Corporation's ability to continue as a going concern, disclosing, as applicable, matters related to sustainability of services and using the applicable basis of accounting unless the management either intends to liquidate the Corporation 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.

Those charged with governance are responsible for overseeing the 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 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 ability to continue as a going concern or 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 Corporation to cease to continue as a going concern or 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 Corporation 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

01 July 2019