REPORT OF THE AUDITOR-GENERAL ON KENYA RAILWAYS CORPORATION FOR THE YEAR ENDED 30 JUNE, 2019

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Kenya Railways Corporation set out on pages 52 to 94, which comprise the statement of financial position as at 30 June, 2019, statement of profit or loss and other comprehensive income, statement of changes in equity, 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 the Kenya Railways Corporation as at 30 June, 2019, 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 and Public Finance Management Act, 2012

Basis for Qualified Opinion

1.0 Non-Disclosure of Material Uncertainty Related to Going Concern

Note 17.5 (f) to the financial statements on critical accounting estimates and judgements indicates that the financial statements for the year have been prepared on a going concern basis. However, the statement of financial position as at 30 June, 2019 reflects current liabilities balance of Kshs.238,801,126,787 (2018-Kshs.182,008,328,365) which exceeds the current assets balance of Kshs.40,396,237,135 (2018-Kshs.55,738,371,368) resulting to a negative working capital of Kshs.198,404,889 (2018-negative Kshs.126,269,997). Further, the Corporation continue to perform dismally where the statement of comprehensive income for the year ended 30 June, 2019 reflects an operating loss of Kshs.8,608,414,719 (2018: loss - Kshs.5,562,892,452).

The above conditions are indicative of material uncertainty 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. The continued survival of the Corporation is therefore dependent on the creditor goodwill and Government support.

2.0 Illegal Allocation of Land

As disclosed under Note 15 to the financial statements, the statement of financial position reflects property, plant and equipment balance of Kshs.24,665,643,871 but as previously reported, various parcels of land were allocated to private persons 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 nine (9) industrial plots measuring approximately three (3) acres, a piece of land within Kikuyu railway station measuring approximately two (2) acres and several parcels of land adjacent to Mombasa railway station measuring between 0.75 to one (1) acre have been irregularly allocated to private persons with some having been developed.

Further, another five hundred and twenty-nine (529) parcels of land had been illegally allocated across the country. However, Management has sought court intervention to repossess twenty-seven (27) parcels.

From the foregoing, the accuracy and the fair presentation of property, plant and equipment balance of Kshs.24,665,643,871 as at 30 June, 2019 could not be confirmed**.**

3.0 Classification and Fair Statement of Short-Term Investments

As disclosed under Note 21 to the financial statements, the statement of financial position reflects short term investments balance of Kshs.770,000,000 (2018-Kshs.2,172,135,077). As previously reported, included in the balance is Kshs.204,643,995 (original amount Kshs.818,575,979) under fixed deposit with Chase Bank Limited (in Receivership) that was subsequently taken over by State Bank of Mauritius Bank (SBM) in an arrangements where 75% of the value of deposits was taken over by SBM Bank to be made available over a 3-year period. The balance representing 25% of the deposit remained under moratorium and whose accessibility remains uncertain.

Consequently, the continued classification of the deposit as short-term investments and the fair statement of the investments of Kshs.770,000,000 as at 30 June, 2019 is therefore not accurate.

4.0 Unsupported Inventories

The statement of financial position reflects stores inventories balance of Kshs.3,609,982,659 (2018-Kshs.3,616,531,816). However, the balance was not supported by stock take sheets and reports.
In the circumstances it has not been possible to confirm the validity and accuracy of inventories valued at Kshs.3,609,982,659 as at 30 June, 2019.

5.0 Trade and Other Receivables

As disclosed under Note 20 to the financial statements, the statement of financial position reflects trade and other receivables balance of Kshs.16,115,602,420. Examination of available records revealed the following unsatisfactory matters:

5.1 Unreconciled Trade and Other Receivables

The trade debtors balance of Kshs.4,816,657,949 includes an amount of Kshs.3,055,838,896 owed by the Kenya Ports Authority (KPA) compared to a balance of Kshs.1,881,239,000 reflected in Kenya Ports Authority books thereby resulting to unreconciled variance of Kshs.1,174,599,896.

5.2 Unsupported Balances - Other Receivables

Further, trade and other receivables balance of Kshs.5,898,805,053 constitutes an amount of Kshs.10,000,000 and Kshs.194,845,459 owed by National Land Commission and Rift Valley Transition Revenue respectively, which had not been supported. Similarly, trade and other receivables balance includes an amount of Kshs.8,196,769,846 which has not been supported with a schedule to explain how the balances have been computed as shown below:

Item	**Amount (Kshs.)**
Prepayment	2,329,551,044
Tax Receivable	5,546,536,660
Staff debtors	55,960,846
Other receivables	264,721,296
Total	**8,196,769,846**

5.3 Long Outstanding Receivables

The trade and other receivables balance includes amounts totalling to Kshs.3,899,118,725 which have been outstanding for periods exceeding one year, and whose recovery is doubtful. The provisions for doubtful debts amounting to Kshs.1,082,946,451 was not supported and the adequacy of the provision could not be confirmed.

5.4 Receivables with Negative Balances

The reported trade debtors and other receivables balance of Kshs.16,115,602,420 is net of debtors with negative balances of Kshs.56,299,642. This is contrary to the provisions of International Financial Reporting Standard (IFRS) 1 which states that assets and liabilities; and income and expenditure, shall not be offset unless required or permitted by International Financial Reporting Standards.

In the circumstances, the accuracy and fair statement of the reported trade and other receivables balance of Kshs.16,115,602,420 as at 30 June, 2019 could not be confirmed.

6.0 Irregular Land Compensation

The Capital Works-in-Progress balance of Kshs.673,287,818,576 includes a balance of Kshs.12,000,000,000 being land compensation under SGR Phase 1. The supporting documents for compensations amounting to Kshs.1,043,439,897 to Project Affected Persons (PAPS), by way of beneficiary copies of National Identity Cards, Kenya Revenue Authority (KRA) Personal Identification Number (PIN) certificates and title deed surrenders from the National Land Commission were not provided.

Further, overpayments of Kshs.14,669,748 were made to Project Affected Persons (PAPS) who were paid Kshs.15,752,406 instead of the entitlement Kshs.1,082,658. Although recovery of Kshs.5,698,770 has been subsequently made, a balance of Kshs.8,970,978 was outstanding as at 30 June, 2019.

In the circumstances, the legality of the unsupported payments of Kshs.1,043,439,897 and full recovery of Kshs.8,970,978 on land compensation could not be ascertained.

7.0 Unsupported Railway Operational Expenses

As disclosed under Note 10 to the financial statements, the statement of profit or loss and other comprehensive income reflects rail operational expenses amounting to Kshs.19,245,624,853. The expenditure constitutes rail operational expenses amounting to Kshs1,886,006,401 which had not been supported with schedules for audit review. The above balance constitutes SGR insurance, Channel occupancy and Opex Indexation of Kshs.482,875,835, Kshs.9,692,170 and Kshs.1,393,438,396 respectively.

Consequently, it has not been possible to confirm the accuracy, completeness and legality of the reported railway operational expenditure of Kshs.1,886,006,401 included as rail operational expenses during the year under review.

8.0 Unreconciled Standard Gauge Railway (SGR)- Freight Revenue

As disclosed under Note 5(a) to the financial statements, the statement of profit or loss and other comprehensive income reflects main income of Kshs.11,934,389,382. However, the balance constitutes an amount of Kshs.10,214,491,874 in respect of SGR freight revenue out of which a balance of Kshs.8,391,554,200 differs with Kenya Ports Authority (KPA) figure of Kshs.8,883,724,017 resulting into an unexplained variance of Kshs.492,169,817. Although the Corporation generates invoices to KPA using the Freight Management System (FMS), the debtor's statement showing the level of indebtedness was not provided for audit review.

In the circumstances, the accuracy and completeness of the main income of Kshs.10,214,491,874 for the year ended 30 June, 2019 could not be confirmed.

9.0 Irregular Use of Revenue Collected (MGR) for Rail Operations

During the year under review, it was observed that cash collections from Kikuyu and Kahawa routes amounting to Kshs.24,301,990 were not banked. Although Management stated that the unbanked cash was used on payment for locomotive fuel and repair and maintenance of the locomotives and the railway track, the Corporation had contracted service providers on the same operational expenses.

In the circumstances, it has not been possible to determine propriety in the utilization of Kshs.24,301,990 allegedly spent directly to finance operations

10.0 Adjustments in the Statement of Changes in Equity

A review of the Statement of Changes in Equity revealed the following unsatisfactory matters:

10.1 Unexplained Prior Year Adjustments

The statement of changes in equity for the year ended 30 June,2019 reflects an opening balance of accumulated losses of Kshs.22,754,966,484 which was adjusted to Kshs.23,478,194,293 by a further loss of Kshs.723,227,809 without any disclosure or explanations. It was not ascertained whether the error(s) relate(s) or was noted during the year under review as the comparative accumulated loss is still maintained at Kshs.22,754,966,484. This is contrary to International Accounting Standard 8 which requires restating the comparative amounts for the prior period(s) in which the error occurred or if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

Consequently, the accuracy and the validity of the amount adjustment made cannot be confirmed and is contrary to the standard adjusted and accuracy of the accumulated losses in the statement of changes in equity for the year ended 30 June, 2019.

10.2 Unexplained Adjustment in Restructuring

Further, the statement reflects current adjustment reducing the restructuring balance from Kshs.20,255,346,086 to Kshs.20,239,260,616 by Kshs.16,085,470 on account of receipts in cash. However, the nature of the adjustment was not explained or disclosed in the financial statements. Further Note 26 in support of the restructuring balance reflects a varying opening balance of Kshs.20,251,469,298 and an adjustment of Kshs.12,208,682, which still totals to Kshs.20,239,260,616.

Consequently, the validity and correctness of the amount adjusted and accuracy of the restructuring balance of Kshs.16,085,470 in the statement of changes in equity for the year ended 30 June, 2019 could be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the Kenya Railways Corporation Management in accordance with ISSAI130 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 opinion.

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. 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 matter 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.

Delayed Completion of Projects

During the 2017/2018, the Corporation entered into a contract for the construction of a running room at Mtito Andei. The contract was awarded on 31 August, 2017 at a contract sum of Kshs.20,200,000 and contract duration of three (3) months to be completed by December, 2017 but was later revised to March, 2019. On 10 April, 2018, the contractor was paid Kshs.4,040,000 which was 20% advance payment.

However, the inspection and acceptance report dated 16 January, 2019 showed that the works were 64% complete. Physical verification of the project during the month of November, 2019 revealed that the project was not complete whereby doors, window panes, ceiling, painting and fittings had not been fitted or done. It was further noted that the contractor had abandoned the site in July, 2019 and the Management responded that the delays in completing the project were as a result of disagreements between the contractor and sub-contractor.

In the circumstances, the completion of the project may be doubtful and value for money may not be realized from the project.

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 comply, 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 matter described in the Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance 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.

Lack of Policy on the Management of Investment Property

Audit review on Management of investment property revealed that Kenya Railways does not have policies, procedures and regulations to guide and direct on management of investment properties. It was further noted that the management of the leases is not well documented and no proper records are kept for the investments.

In the circumstances, I am unable to determine whether proper procedures were in place to safeguard the Corporation resources under its control.

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 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 Corporation's ability to continue as a going concern, disclosing, as applicable, matters related to sustainability of services and using the applicable going concern basis of accounting unless Management is aware of the intention to liquidate the Corporation or cease operations.

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 are responsible for overseeing the financial reporting process, reviewing the effectiveness of how the Corporation 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 applicable 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 Corporation'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 Corporation 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 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.

Nancy Gathungu
AUDITOR-GENERAL

Nairobi

11 August, 2021