

REPORT OF THE AUDITOR-GENERAL ON KENYA REINSURANCE CORPORATION LIMITED FOR THE YEAR ENDED 31 DECEMBER 2018

REPORT ON THE FINANCIAL STATEMENTS

Opinion

The accompanying financial statements of Kenya Reinsurance Corporation Limited set out on pages 20 to 99, which comprise the consolidated and Company statements of financial position as at 31 December 2018, the consolidated and Company statements of profit or loss and other comprehensive income, the consolidated and Company statements of cash flows and the consolidated and Company statement of changes in equity for the year then ended, and a summary of significant accounting policies and other explanatory information have been audited on my behalf by Ernest and Young LLP, auditors appointed under Section 23 of the Public Audit Act, 2015. The auditors have duly reported to me the results of their audit on the basis of their report, I am satisfied that all information and explanations which, to the best of my knowledge and belief were necessary for the purpose of the audit were obtained.

In my opinion, the financial statements present fairly, in all material respects the financial position of Kenya Reinsurance Corporation Limited as at 31 December, 2018, and its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with Company's Act, 2015.

Basis for opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kenya Reinsurance Corporation Limited 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 a basis for my opinion.

Emphasis of the Matter

1. Tax Assessment by Kenya Revenue Authority (KRA)

As reported in the previous years, I draw attention to note 44 of the financial statements which describe a contingent liability in relation to tax assessment by Kenya Revenue Authority (KRA). The group is involved in a tax claim dispute with KRA, arising from KRA's demand of Kshs.1, 272,488,000 relating to withholding tax on cedant acquisition costs and brokerage fees. The outcome of the tax remains uncertain even though the company continues to hold discussions with KRA in an attempt to resolve the matter in contention with the assistance of professional advisers.

Key Audit Matters

No.	Key audit matter	How our audit addressed the key audit matter
1.	<p>Reinsurance contract liabilities</p> <p>The valuation of the Group's reinsurance contracts is dependent on a number of subjective assumptions about future experience as disclosed in notes 2, 35 and 36 to the consolidated and separate financial statements. Some of the economic and non-economic actuarial assumptions used in valuing insurance contracts are judgemental, in particular persistency (the retention of policies over time), longevity (the expectation of how long an annuity policyholder will live and how that might change over time), expenses (future expenses incurred to maintain existing policies to maturity).</p> <p>The Group uses external actuaries to value both the life and non –life reinsurance contract liabilities.</p> <p>This matter was considered significant to the audit because of the sensitivity of the valuation of the reinsurance contract liabilities to changes in the key assumptions.</p> <p>I also considered there to be a risk that the disclosures in notes 2, 34 and 35 to the consolidated and separate financial statements which are significant to the understanding of the Group's reinsurance contract liabilities are not complete.</p>	<p>The audit procedures included the following:</p> <ul style="list-style-type: none"> • Testing, on a sample basis, the key controls around the processes for analysing the economic and noneconomic assumptions used in the valuation of the reinsurance contract liabilities. • Using our actuarial specialists, assessing the appropriateness of management's liability adequacy testing which is a key test performed to check that the liabilities are adequate as compared to the expected future contractual obligations. Our audit procedures on the liability adequacy testing included reviewing the assumptions adopted in the context of both the Group and industry experience and specific product features. • Considering recent experience and the reasonableness of the judgements applied by management on how future experience will evolve. • Assessing the completeness of the disclosures regarding the reinsurance contract liabilities in the consolidated and separate financial statements.
2.	<p>Revenue recognition - premiums income and un-earned premium reserves</p>	

No.	Key audit matter	How our audit addressed the key audit matter
	<p>The Group's business involves underwriting policies with tenure that does not align with the reporting period. The Group has estimated unearned premium reserves as disclosed in note 39 to the consolidated and company financial statements using a rate of 40% of the written premiums to defer premium income written but not earned during the reporting period. We considered this to be a key audit matter since the Group's financial results are significantly sensitive to changes in this assumption.</p> <p>I also considered there to be a risk that revenue is inappropriately reported to achieve desired financial results. I assessed that the opportunity to manipulate revenue creates a heightened risk in the area of recording premium income in the improper period by not observing proper cut off procedures.</p>	<p>The audit approach included controls testing and substantive procedures covering, in particular:</p> <ul style="list-style-type: none"> • Testing, on a sample basis, key controls over the underwriting process. • Performing an analysis of premium income and unearned premiums based on the industry knowledge and forming an expectation of revenue based on key performance indicators taking into account changes in the Group's business. • Reviewing supporting documentation for premium income on a sample basis. • Checking that adjustments to premium income after year-end were supported and processed in the correct period. • Involving actuarial specialists in checking whether the assumptions used to determine the un-earned premium reserves were supported.
3.	Valuation of investment property	
	<p>As at 31 December 2018, the carrying amount of the Group's investment property was KShs.10 billion as disclosed in note 18 to the consolidated and separate financial statements.</p> <p>The investment property is measured at fair value in accordance with International Accounting Standard (IAS) 40 <i>Investment Property</i>. The Group's policy is to revalue the</p>	<p>The audit procedures included the following:</p> <ul style="list-style-type: none"> • Evaluating the objectivity and independence of the external valuer. • Assessing whether the underlying assumptions applied in the determination of the fair value were supported in the context of the

No.	Key audit matter	How our audit addressed the key audit matter
	<p>investment property annually using an external valuer. The basis adopted in the valuation of investment property was open market value based on active market prices, significantly adjusted for differences in the nature, location or condition of the specific property.</p> <p>Given that the fair value of investment property involves significant estimation and assumptions, such as comparative active market prices and adjustments for differences in the nature, location or condition of the property, and the importance of the disclosures in notes 3(ii) and 18 relating to the assumptions used in the valuation, I considered this as a key audit matter.</p>	<p>industry and nature of the investment property.</p> <ul style="list-style-type: none"> • Assessing whether the valuation methodologies and assumptions adopted in determining the fair values of the investment property were in accordance with IFRS. • Evaluating whether the determined fair values were comparable to the market values for similar property in similar locations. • Assessing the adequacy of the Group's disclosures in respect of the methodology and assumptions used in valuation.
4.	Implementation of new information technology (IT) system	
	<p>During the year, Kenya Reinsurance Corporation implemented a new IT system, Storebrand International Contract System (SICS) in Kenya and in countries in which its subsidiaries operate in.</p> <p>The change of IT system entails new processes, controls and delegation of authority being set up as well as the migration of operational and financial data from the legacy systems to the new system.</p> <p>As such, the change presents inherent risks of breakdown of IT dependent controls and loss of integrity of financial data being migrated, which could lead to errors in financial reporting.</p>	<p>The audit procedures included the following:</p> <ul style="list-style-type: none"> • Considering the Group's processes and project governance over the new system implementation. • Involving IT specialists to test the controls over change management and the migration of key financial data from the legacy system to SICS. Training the general IT control environment in SICS, including access controls and backup operations. • In addition, performing independent validation of the account balances being migrated and testing the reconciliation control in place.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

As required by Article 229(6) of the Constitution, based on the audit procedures performed, 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 of Conclusion

The audit was conducted in accordance with ISSAI 4000. The standard requires that I comply with ethical requirements and plan to 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

As required by Section 7(1) 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 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 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 maintaining 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 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 Corporation'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 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 provision 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 Corporation's 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 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 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 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 220(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 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 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 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 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 of the Corporation or business activities 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by Company's Act 2015, I report based on my audit, that:

- i. 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; and,
- ii. in my opinion, proper books of account have been kept by the company, so far as appears from my examination of those books; and,
- iii. the company's statement of financial position is in agreement with the books of account.



FCPA Edward R. O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

28 March 2019