

REPORT OF THE AUDITOR-GENERAL ON KENYA REINSURANCE CORPORATION LIMITED FOR THE YEAR ENDED 31 DECEMBER, 2019

REPORT ON THE FINANCIAL STATEMENTS

Opinion

The accompanying financial statements of Kenya Reinsurance Corporation Limited set out on pages 21 to 92, which comprise the consolidated and company statements of financial position as at 31 December, 2019, and the statements of profit or loss and other comprehensive income, statements of cash flows and the statements 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 Ernst 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 and 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, 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 Companies 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 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 opinion.

Emphasis of Matter

1. Tax Assessment by Kenya Revenue Authority (KRA)

As reported in the previous years, I draw attention to Note 43 of the financial statements which describe a contingent liability in relation to tax assessment by the Kenya Revenue Authority (KRA). The Corporation 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 contingent tax liability remains uncertain, even though discussions to resolve the contentious matter continue between the Corporation and KRA, with the assistance of professional advisors.

2. Investment Properties in Dispute

As disclosed in Note 42 to the financial statements, the Corporation is the registered owner of the following properties which are currently in dispute and are subject to ongoing court cases.

a) Land LR. No 27269 - Ngong Road

The Corporation invested Kshs.350,000,000 in L.R. No. 27269 measuring approximately 59.87 hectares along Ngong Road which is a subject of dispute between the Corporation and Kenya Forest Service. The dispute of ownership of LR No 27269 is before the National Land Commission. Although the Corporation has obtained confirmation from the Director of Surveys that the Corporation land is distinct from that of Kenya Forest Service, the matter remains unresolved until the National Land Commission adjudicates and provides its verdict. The Corporation may not be realizing the benefits that accrue from ownership of land and the management may not be in a position to make long term investment plans.

b) Land LR No.12236 Kiambu Road

The Corporation is the registered owner of land LR No.12236 of approximately 99.5813 hectares along Kiambu Road valued at Kshs.563,077,000. The Corporation is in dispute with one of the directors of the vendor of the land and the case is in court. The Corporation is therefore, not realizing the full value of funds invested in the property.

c) Land LR MN-1-9141- Shanzu Mombasa

The Corporation is the registered owner of land LR MN-1-9141 of approximately 17.3 hectares located at Shanzu Mombasa valued at Kshs.23,000,000. The Corporation is in dispute with the Kenya Prisons Department and the case is in court. The Corporation is therefore, not realizing the full value of funds invested in the property.

3. Investment Property not in Use

As disclosed in Note 18 to the financial statements, the Corporation is the registered owner of land LR No.9042/222 within the precincts of Jomo Kenyatta International Airport (JKIA) valued at Kshs.700,000,000 as at 31 December, 2019. However, management has disclosed that it has restricted access to the land as imposed by the Kenya Airports Authority (KAA) mainly due to security reasons. The Corporation is therefore, not realising the full potential of the investment.

4. Lack of Payables Ageing Analysis

The Corporation's consolidated statement of financial position reflects Kshs.1,807,874,000 being the balance of payables arising out of reinsurance arrangements which, as disclosed under Note 35 to the financial statements, comprise of Kshs.397,870,000 and Kshs.1,410,004,000 owed to local and international companies respectively. However, the accounts payable module cannot generate an

ageing analysis report for the payables. Consequently, errors and irregularities, if any, in supplier balances may not be detected and corrected on a timely basis.

Key Audit Matters

No.	Key Audit Matter	How our Audit addressed the Key Audit Matter
1.	Reinsurance Contract Liabilities	
	<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 Group and Company 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. 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 company 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 group and company financial statements.
2.	Revenue Recognition - Premiums Income and Un-earned Premium Reserves	

No.	Key Audit Matter	How our Audit addressed the Key Audit Matter
	<p>The Group's business involves underwriting policies with tenure that do not align with the reporting period. The group has estimated unearned premium reserves as disclosed in Note 38 to the Group 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. I 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 considering 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, 2019, the carrying amount of the Group's investment property was Kshs.12.080 billion as disclosed in note 18 to the Group and Company Financial Statements.</p> <p>The investment property is measured at fair value in accordance with International Accounting Standard (IAS) 40 Investment Property. The group's policy is to revalue the investment property annually using an external valuer. The basis adopted in the valuation of investment property was open market value based on active</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 industry and nature of the investment property. • Assessing whether the valuation methodologies and assumptions adopted in determining the fair values

No.	Key Audit Matter	How our Audit addressed the Key Audit Matter
	<p>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>of the investment property were in accordance with IFRS.</p> <ul style="list-style-type: none"> • 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.	Credit Risk and Impairment of Reinsurance Receivables Balances	
	<p>Impairment of receivables is a subjective area due to the significant judgement and assumptions applied by management. The estimation of impaired receivables is made based on review of outstanding amounts at year-end.</p> <p>As disclosed in Note 2, to the consolidated and company financial statements, judgement is applied in determining the appropriate parameters and assumptions used to calculate impairment of the receivables. For example, the assumptions of customers that will default, the expected future cash flows from the customers and the timing of the cash flows.</p> <p>Due to the significance of the reinsurance receivable balances to the consolidated and company financial statements, and the significant judgement involved in calculating impairment losses on the receivables, particularly regarding the estimation of the amount and timing of expected future cash</p>	<p>The audit procedures included the following:</p> <ul style="list-style-type: none"> • Testing and evaluation of controls over the underwriting process, recording and ageing of outstanding reinsurance receivables, and monitoring of the receivables by the Group's credit control department. • Evaluating the adequacy of the allowance for doubtful accounts, including the appropriateness of the methodology used and assumptions made to calculate the allowance. • Testing, on a sample basis, whether the Group's assumptions on the expected future cash flows and timing of the cash flows were supported. • Evaluating whether the disclosures made in the consolidated and company financial statements reflect the Group's credit risk and impairment provision on the receivables.

No.	Key Audit Matter	How our Audit addressed the Key Audit Matter
	<p>collections, this was considered a key audit matter.</p> <p>I also considered there to be a risk that the disclosures in Notes 2 and 24 on impairment of receivables are not complete.</p>	

Other Information

The Directors are responsible for the other information, which comprises the corporate report, report of the directors, statement of Directors' responsibilities and Director's remuneration report as required by the Kenya Companies Act, 2015, statement of corporate governance and the report of the consulting actuary. The other information does not include the Corporation's financial statements and my audit report thereon.

My opinion on the Corporation's financial statements does not cover the other information and I do not express any form of assurance conclusion thereon.

In connection with my audit of the Corporation's financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the Corporation's financial statements or my knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

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, 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 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 OVERALL GOVERNANCE

Conclusion

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 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Kenya Companies 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;
- ii. In my opinion, adequate accounting records have been kept by the Corporation, so far as appears from my examination of those records; and,
- iii. The Corporation's financial statements are in agreement with the accounting records and returns.

Responsibilities of Management and the 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 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 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 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

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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 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 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 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 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.

From the matters communicated with management, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. These matters are described in my auditor's

report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.



Nancy Gathungu
AUDITOR-GENERAL

Nairobi

14 August, 2020