

# **REPORT OF THE AUDITOR-GENERAL ON KENYATTA NATIONAL HOSPITAL FOR THE YEAR ENDED 30 JUNE 2018**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Qualified Opinion**

I have audited the accompanying financial statements of Kenyatta National Hospital set out on pages 85 to 142, which comprise the statement of financial position as at 30 June 2018, and the statement of financial performance, statement of changes in net assets, statement of cash flows and statements 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 effect of the matters described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respects, the financial position of Kenyatta National Hospital as at 30 June 2018, and of its financial performance and its cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (Accrual Basis) and comply with Legal Notice No. 109 of 1987.

### **Basis for Qualified Opinion**

#### **1. Borrowings**

As previously reported, the borrowings balance of Kshs.1,199,863,000 reflected in the statement of financial position as at 30 June 2018 relates to a loan received in 2007/2008 from the Kingdom of Spain in form of medical equipment. According to information available, the loan was repayable by the Hospital at an interest rate of 3% per annum on a reducing balance for the first six (6) years and thereafter the interest plus principal for the next nine (9) years with effect from 1 July 2008. However, records examined indicated that, no interest has been paid or accrued in the ten financial years between 2008/2009 and 2017/2018. Further, the accrued interest, loan repayment and loan balance confirmation certificate as at 30 June 2018 were not availed for audit review. Although indications are that the management has sought assistance from the Ministry of Health towards settlement of the loan, the response from the Ministry on the matter was not availed for audit review.

Under the circumstances, it has not been possible to confirm the validity, accuracy and completeness of the borrowings balance reflected in the statement of financial position as at 30 June 2018 and that the balance of Kshs.1,199,863,000 is fairly stated as at the same date.

#### **2.0 Property, Plant and Equipment**

##### **2.1 Land**

As previously reported, the property, plant and equipment balance of Kshs.11,298,812,000 included in the statement of financial position as at 30 June 2018 includes four (4) parcels

of land with a total of 0.7847 hectares valued at Kshs.50,600,000 which were excised and allocated to other parties as detailed below:-

LR No.	Location	Hectares	Value Kshs.
8RN-209/11460	Upper hill	0.316	23,000,000
LRN-209/12767	Upper hill	0.226	17,000,000
LRN-209/12822	Upper hill	0.221	9,000,000
LRN-13319	Upper hill	0.0217	1,600,000
<b>Total</b>		<b>0.7847</b>	<b>50,600,000</b>

Further, the property, plant and equipment balance of Kshs.11,298,812,000 also includes land measuring 1.3 hectares with title deed in the name of National Quality Control Laboratory rather than Kenyatta National Hospital.

Although the issue has been discussed by the Parliamentary Public Investment Committee (PIC), no action seems to have been taken on the PIC recommendations in the 19<sup>th</sup> report that the National Land Commission revoke title deeds irregularly issued to private entities, Ethics Anti-Corruption investigate how the hospital land was allocated to individuals and that the then hospital Chief Executive Officer be surcharged for any loss that may have been incurred. Further, and as indicated in the property, plant and equipment movement schedule at note 28 to the financial statements, the Hospital has made an adjustment of Kshs.100,087,000 in respect to the National Quality Control Laboratory land portion. However, the adjustment has not been supported with documentary evidence. Consequently, the validity of the adjustment could not be confirmed.

## **2.2. Acquisition of KNH Land for Construction of Hospital Road and Mbagathi Way Link Road**

As previously reported, the Kenya Urban Roads Authority (KURA) in their Gazette Notice No. 9340 of 18th December, 2015 and 6441 of August, 2016 compulsorily acquired seven (7) acres of Kenyatta National Hospital (KNH) land with Hospital's internal valuation of Kshs.4,219,257,210 for construction of Hospital Road and Mbagathi Way Link Road. According to available information, KURA was to pay compensation of Kshs.1,859,297,000 to Kenyatta National Hospital (KNH) for the acquired portion of land. However, no compensation had been made to KNH as at the time of audit in March 2019 despite commencement of the road construction. The excised land has been included in the property plant and equipment balance of Kshs.11,298,812,000.

Under the circumstance, ownership and accuracy of the property, plant and equipment balance of Kshs.11,298,812,000 in the statement of financial position as at 30 June 2018 could not be confirmed.

## **3. Intangible Assets - Hospital Management Information Systems**

The statement of financial position include intangible assets of Kshs.10,326,000 net of amortization charge of Kshs.21,082,000 as disclosed in note 29 to the financial statements. As previously reported in 2016/2017, the balance includes Kshs.26,986,031 which relate to payment made to systems partners for the provision of Hospital Management Information

Systems. However, out of Kshs.26,986,031, Kshs.5,397,206 relate to 15% paid in addition to 60% paid earlier as a result of an amendment to the original contract which had provided for 20% payment to be made after testing and commissioning of the system. Further, the project was to take a period of 6 months in 2013, but was commissioned in June 2017 when it was only 70% complete and therefore, having not achieved its intended purpose. In addition, the original contract and performance bond expired before completion of the project. No explanation has been provided for breach of the contract.

Consequently, it has not been possible to determine the accuracy and propriety of the balance of intangible assets of Kshs.10,326,000 included in the statement of financial position as at 30 June 2018.

#### **4.0 Medical Service Contract Loss**

##### **4.1 Contracts with National Hospital Insurance Fund (NHIF)**

As previously reported, the statement of financial performance for the year ended 30 June 2018 includes medical services contracts loss of Kshs.268,405,000 out of which Kshs.88,178,000 relate to loss from National Hospital Insurance Fund (NHIF). This loss is net of rebate received from the NHIF and the amount the Hospital spent in the treatment of NHIF members. According to information available, the Hospital entered into a contract with NHIF in August 2008 to treat NHIF members at a rebate rate of Kshs.2,400 for inpatient care per day with the contract ending in August 2010. However, information available indicate that on 1 August 2016 the rebates were increased to Kshs.4,000. No explanation has been provided as to why it took the hospital eight years to review the NHIF contract. In addition, management has not availed measures taken to mitigate the loss.

Under the circumstance, the NHIF loss of Kshs.88,178,000 in the statement of financial performance for the year ended 30 June 2018 could have been avoided had the management taken action in time.

##### **4.2 Free Maternity Program**

As previously reported, the medical services contracts loss of Kshs.268,405,000 also includes Kshs.177,237,000 relating to loss on free maternity program offered by the Hospital, as disclosed in note 22 to the financial statements. This follows from a letter ref. ACC/FCM HS/1/28A dated 1 April 2014 from the Cabinet Secretary, Ministry of Health which communicated the decision of the Government to reimburse an amount of Kshs.17,500 for every delivery. However, Kenyatta National Hospital being a referral hospital receives complicated maternal referrals and as a result the costs are higher and the reimbursable amount of Kshs.17,500 per delivery has remained the same despite the high costs.

Consequently, the hospital will continue to incur losses if the reimbursable amounts are not reviewed.

#### **5.0 Administrative and General Expenses**

##### **5.1 Security Investigation Expenses**

As previously reported, the statement of financial performance include administrative and general expenses of Kshs.667,189,000 out of which as disclosed in note 18 to the financial statements, Kshs.15,607,000 relate to security investigation expenses in respect of meal allowances paid to the hospital police security officers for the year ended 30 June 2018. However, authority in support of the payments was not availed for audit review. No explanation has been provided for paying security officers meals allowances for working in their duty station.

Under the circumstance, the accuracy and propriety of security investigation expenses of Kshs.15,607,000 included in the statement of financial performance for the year ended 30 June 2018 could not be confirmed.

## **5.2 Legal Expenses**

Note 18 to the financial statements also reflects legal expenses of Kshs.9,525,000 paid to various law firms during the year. However, the evidence that the Board sought approval and issuance of no objection from the Attorney General's office on engagement of the private legal firms as required by the Attorney General's Circular reference AG/CON/6/D/144/VOL.II dated 16 April 2014 was not availed for audit review.

In the circumstances, the propriety of legal expenditure totalling to Kshs.9,525,000 paid to the private legal firms could not be confirmed for the year ended 30 June 2018.

## **6. Cash and Cash Equivalent**

Included in cash and cash equivalent balance of Kshs.851,478,000 as at 30 June 2018 as disclosed at note 24 to the financial statements is National bank recurrent account balance of Kshs.5,887,874 for which the reconciliation statement reflects receipts in bank statement not in cashbook of Kshs.32,035 and payments in bank statement not in cashbook of Kshs.149,986 and whose clearance status during the time of this audit in the month of March 2019 was not disclosed. Further, the cash and cash equivalent balance include National bank revenue account balance of Kshs.450,578,049 for which the reconciliation statement reflects un-presented cheques totalling Kshs.578,049 and receipts in bank statement not in cashbook totalling to Kshs.5,351,543 and whose clearance status was also not availed for audit review.

In the circumstances, the accuracy of cash and cash equivalent balance of Kshs.851,478,000 as at 30 June 2018 could not be confirmed.

## **7. Receivable from Exchange Transactions**

### **7.1 Long Outstanding Debts**

As previously reported in the year 2016/2017, the receivables from exchange transactions balance of Kshs.1,513,647,000 as at 30 June 2018 includes receivables of Kshs.192,926,279, Kshs.94,970,458 and Kshs.3,286,110 for National Hospital Insurance Fund (NHIF) rebate, Ministry of Health disaster debts and return to drawer (RD) cheques respectively which have been outstanding for more than two years.

No explanation has been provided by the management for failure to recover these long outstanding debts.

## **7.2 Absconded Patients Debts**

As previously reported in the year 2016/2017, the receivables from exchange transactions balance of Kshs.1,513,647,000 as at 30 June 2018 includes medical services receivables of Kshs.7,833,266,000. Further, the medical services receivables include Debt Management Unit (DMU) receivables of Kshs.5,206,499,000 which includes absconded patients debts of Kshs.695,548,891 as at 30 June 2018. No explanation has been provided by the management for failure to recover these long outstanding debts.

## **7.3 Receivables from National Hospital Insurance Fund (NHIF)**

As previously reported, the medical services receivables balance of Kshs.7,833,266,000 as disclosed at note 25 to the financial statements includes Kshs.712,187,000 due from NHIF while the NHIF financial statements as at 30 June 2018 reflects Kshs.55,277,000 thus resulting to unreconciled variance of Kshs.656,910,000. No explanation has been provided by the management for failure to reconcile the two sets of records.

Consequently, it has not been possible to determine the accuracy of the receivable from exchange transactions balance of Kshs.1,513,647,000 included in the statement of financial position as at 30 June 2018.

## **7.4 Prepayment**

### **7.4.1 Supply Contracts**

The receivables from exchange transactions balance of Kshs.1,513,647,000 includes prepayments of Kshs.159,746,000 out of which prepayments totaling Kshs.31,734,000 related to supply contracts awarded to three firms of Kshs.15,793,000, Kshs.2,213,000 and Kshs.13,728,000. As reported in the previous year, the first prepayment is in dispute while the second one is under investigation. The third pre-payment relates to micro filming project at the hospital which had not been completed as at 30 June 2018. Although the issue has been discussed by the Public Investment Committee, no action has been taken on the PIC recommendations that the three companies be investigated, prosecuted and the then hospital Chief Executive Officer be held accountable for the loss and be surcharged.

### **7.4.2 Letters of Credit**

Further, included in the prepayments balance of Kshs.159,746,000 is a sum of Kshs.96,361,633 in respect of letters of credit issued by the Hospital to foreign based firms for supply of various goods and services. As in the previous year, the goods and services have not been accounted for in these financial statements.

## **7.5 Impairment Allowance**

As in the previous year, the receivables from exchange transactions balance of Kshs.1,513,647,000 included in the statement of financial position as at 30 June 2018 is the net amount obtained from the gross balance of Kshs.8,044,810,000 less impairment allowance of Kshs.6,531,163,000 as disclosed in note 25 to the financial statements. The impairment allowance of Kshs.6,531,163,000 includes long outstanding debts of Kshs.3,759,665,000 and whose recoverability is doubtful. In addition, the impairment

allowance of Kshs.6,531,163,000 includes a provision of Kshs.1,248,877,758 whose supporting schedule of beneficiaries was not availed for audit review.

Under the circumstance, the accuracy of receivables from exchange transactions balance of Kshs.1,513,647,000 included in the statement of financial position as at 30 June 2018 could not be confirmed.

## **7.6 Ministry of Health (MoH) Staff Long Outstanding Debts**

As in the previous year, the receivables from exchange transactions balance of Kshs.1,513,647,000 include rental receivables balance of Kshs.27,651,000 as disclosed at note 25 to the financial statements. The rental receivables balance of Kshs.27,651,000 include MoH staff rent amounting to Kshs.4,036,000 that has been outstanding for periods ranging from 16 months to 59 months, and which ought to have been deducted from the payroll through the check-off system and forwarded to Kenyatta National Hospital. Also noted on the rent receivable are five officers who vacated the houses without paying rent arrears amounting to Kshs.991,000.

Under the circumstance, the accuracy and recoverability of the rental receivables of Kshs.27,651,000 as at 30 June 2018 could not be determined.

## **8. Receivables from Non-Exchange Transactions**

As previously reported, the receivables from non-exchange transactions balance of Kshs.136,011,000 as at 30 June 2018 includes staff receivables of Kshs.12,411,000 out of which temporary imprests and staff debtors amounting to Kshs.1,013,509 and Kshs.1,448,043 respectively have been outstanding for more than one year.

This is contrary to Section 93 (5) of the Public Finance Management Regulations, 2015 which states that a holder of a temporary imprest shall account or surrender the imprest within 7 working days after returning to duty station. Section 93 (6) further provides that in the event of the imprest holder failing to account for or surrender the imprest on the due date, the Accounting Officer shall take immediate action to recover the full amount from the salary of the defaulting officer with an interest at the prevailing Central Bank Rate.

In the circumstance, the Hospital is in breach of the law and recoverability of staff receivable balance of Kshs.2,461,552 and the propriety of the same as at 30 June 2018 could not be ascertained.

## **9. Trade and Other Payables from Exchange Transactions**

As similarly reported in 2016/2017, the trade and other payables from exchange transactions balance of Kshs.1,049,120,000 in the statement of financial position as at 30 June 2018 includes long outstanding accounts payables totalling to Kshs.164,514,000 included under trade payables as per note 30 to the financial statements. No explanation has been provided for failing to clear these long outstanding account payables.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kenyatta National Hospital 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 qualified opinion.

### **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. Except for the matters described in the Basis for Qualified Opinion section on my report, I have determined that there are no other Key Audit Matters to communicate in my report.

### **Other Matter**

### **Budgetary Performance**

During the year under review, the Hospital's actual receipts amounted to Kshs.12,761,865,000 against budgeted receipts of Kshs.13,770,308,000 resulting in a revenue shortfall of Kshs.1,008,443,000. Further, actual expenditure for the year amounted to Kshs.12,508,853,000 against budgeted expenditure of Kshs.13,104,043,000 resulting in an overall under absorption of Kshs.595,190,000. It is therefore clear that the Hospital did not fully achieve its budget objectives which adversely affected delivery of the intended services to the public. Consequently, there is need for the Hospital to review its budget making process with a view to coming up with a vibrant budget implementation follow up mechanism and feedback process with a view to ensuring that all projects and activities are implemented as planned for the Hospital to meet its mission and objectives for the benefits of the Citizens of Kenya.

## **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 Qualified Opinion and Conclusion on Lawfulness and Effectiveness in use of Public Resources sections 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-Compliance with National Cohesion and Integration Act, 2008**

The statement of financial performance for the year ended 30 June 2018 reflect board expenses of Kshs.26,546,000. However, a review of records on the board members indicated that the Hospital had twelve board members with one community constituting 42% of the Board contrary to the National Cohesion and Integration Act, 2008 which state that no

single ethnic community should constitute more than 33% of members of a national institution. No explanation has been provided for breach of this requirement. In the circumstance, the Hospital failed to comply with the National Cohesion and Integration Act, 2008 on ethnic composition of the Board of Directors and, therefore, the Board as currently constituted is in breach of the law.

## **2. Approved Staff Establishment**

During the year, the Hospital had total staff of 4,684. However, the hospital did not have an approved staff establishment to support the staff deployed. This is contrary to State Corporations Advisory Committee (SCAC) circular No.OP/SCAC.9/21/1/1 dated 15 May 2017 that required all state corporations to have among others approved staff grading and establishment.

Management was therefore in breach of the SCAC circular.

## **3. Inconstancies in Depreciation Policy**

Section 7.3.4 of the approved Hospital Finance Manual stipulate that the straight-line method of depreciation shall be applied for property plant and equipment. However, a review of the depreciation method used during the year indicated that the reducing balance method has been applied as indicated in the property, plant and equipment movement schedule at Note 28 to the financial statements and significant accounting policy No. 4(c) on property, plant and equipment at page 94 of the financial statements which state that depreciation is calculated on reducing balance basis. In addition, computer and related devices as per the policy should be depreciated within three years at the rate of 33.33% using straight line method of depreciation. However, a rate of 30% has been applied using reducing balance method.

No justifiable explanations have been provided for these inconsistencies.

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 GOVERNANCE**

### **Conclusion**

As required by Section 7(1)(a) of the Public Audit Act, 2015, 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 else has come to my attention to cause me to believe that internal controls, risk management and overall governance were not effective. The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. The standards requires 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**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Public Sector Accounting Standards (Accrual Basis) 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 governance.

In preparing the financial statements, management is responsible for assessing the Hospital's ability to continue as a going concern / sustain services, disclosing, as applicable, matters related to sustainability of services and using the applicable basis of accounting unless the management either intends to liquidate the Hospital 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, revenue 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 Hospital's revenue 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 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 review 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 Hospital's policies and procedures may deteriorate.

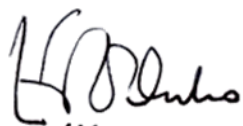
As part of an audit conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional skepticism throughout the audit. I also:

- 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 Hospital's ability to continue 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 Hospital to cease to continue to sustain its services.

- Evaluate the overall presentation, structure and content of the revenue 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 Hospital 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**

**06 May 2019**