

REPORT OF THE AUDITOR-GENERAL ON KIBWEZI-MAKINDU WATER AND SANITATION COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2017

REPORT ON THE FINANCIAL STATEMENTS

Adverse Opinion

I have audited the accompanying financial statements of Kibwezi-Makindu Water and Sanitation Company Limited set out on pages 15 to 33, which comprise the statement of financial position as at 30 June 2017, and the statement of comprehensive income, statement of changes in equity, statement of cash flows and statement 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, because of the significance of the matters discussed in the Basis for Adverse Opinion section of my report, the financial statements do not present fairly, the financial position of Kibwezi - Makindu Water and Sanitation Company Limited as at 30 June 2017, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and do not comply with the County Government Act, 2012 and the Public Finance Management Act, 2012 .

In addition, as required by Article 229(6) of the Constitution, based on the audit procedures performed, I confirm that public money has not been applied lawfully and in an effective way.

Basis for Adverse Opinion

1. Non-disclosures in the Financial Statements

The statement of comprehensive income for the year ended 30 June 2017 reflects finance income and finance cost of Kshs.20,405 and Kshs.56,476, respectively. The statement of financial position as at 30 June 2017 also reflects inventories balance of Kshs.1,690,628 and retained earnings balance of negative Kshs.3,096,998. However, no disclosure notes in respect of these four account items and amounts have been provided in the financial statements. Consequently, the financial statements have not been prepared fully in accordance with the guidelines issued by the Public Sector Accounting Standards Board.

2. Inaccuracies in the Financial Statements

The following inaccuracies have been noted in the financial statements:

- i) The statement of financial position as at 30 June 2017 reflects retained earnings balance of negative Kshs.3,096,998. However, the statement of changes in equity does not reflect retained earnings account or the amount.

- ii) Capital reserve and revenue reserve balances of Kshs.2,498,835 and negative Kshs.5,595,833, respectively as at 30 June 2017 shown in the statement of changes in equity are not reflected in the statement of financial position as at that date. No satisfactory explanation has been given for this omission.
- iii) The reconciliation of operating profit/loss to cash generated from/used in operations at Note 15(a) to the financial statements cast to Kshs.1,106,375 but is reflected as Kshs.1,106,189 resulting in a casting difference of Kshs.186. Further, the reconciliation reflects increase in payables of Kshs.9,716,983 but the statement of financial position indicates a movement of Kshs.6,292,339, resulting in un-explained difference of Kshs.3,424,644.
- iv) Net decrease in cash and cash equivalents is reflected in the statement of cash flows as Kshs.4,016,320 but cast to Kshs.3,884,636 resulting in an unexplained difference of Kshs.131,684.
- v) The statement of changes in equity reflects unexplained prior year adjustment of Kshs.3,292,919 for which the nature and amount of the error corrected have not been disclosed. It is also not clear why the prior year error was not corrected retrospectively by restating the comparative figures as required.

Consequently, the accuracy of the financial statements for the year ended 30 June 2017 could not be confirmed.

3. Trade and Other Receivables

The trade and other receivables' balance of Kshs.24,767,158 as at 30 June 2017 includes trade receivables amounting to Kshs.23,387,894 out of which accounts with balances totalling Kshs.13,924,445 or 60% were inactive. However, the general provision of 10% for bad and doubtful debts amounted to a paltry Kshs.2,338,789 or equivalent to 17% of the inactive accounts. Consequently, the accuracy and full recoverability of the trade and other receivables balance of Kshs.24,767,158 as at 30 June 2017 could not be confirmed.

4. Customer Deposits

The statement of financial position reflects customer deposits' balance of Kshs.10,680,800 as at 30 June 2017 and as disclosed in Note 16 to the financial statements. However, the corresponding deposit bank account maintained with Kenya Commercial Bank reflect a balance of Kshs.4,088,757, resulting in an un-reconciled variance of Kshs.6,592,043.

It was also noted that the board of directors had given the Company authority to spend the deposits through various board minutes to pay for electricity and a deposit for a motor vehicle. Although the deposits were refundable in monthly instalments, no evidence was provided to show that the company had made any repayment.

5. Non-Revenue Water (UFW)

During the year under audit, the Company produced 1,201,189 cubic meters (m³) of water. However, only 844,494m³ of water was billed to customers. The balance of 356,695 cubic meters or approximately 30% of the volume represented Unaccounted For Water (UFW) and was thus higher than the allowable ratio of 25% as prescribed under the Water Services Regulatory Board guidelines. The UFW may have resulted in loss of revenue estimated at Kshs.24,397,938 at prevailing rates. The significant level of UFW may negatively impact on the Company's profitability and its long term sustainability.

6. Un-disclosed Material Uncertainty Related to Going Concern

During the year under review, the Company recorded a deficit of Kshs.628,362 (2015/16- deficit Kshs.98,774) which caused a decrease in the revenue reserves from negative Kshs.8,260,390 as at 30 June 2016 to negative Kshs.5,595,833 as at 30 June 2017 after considering an unexplained prior year adjustment of Kshs.3,292,919. The current deficit trend if not reversed may cast significant doubt on the Company's ability to continue as a going concern. This matter or arrangements in place to reverse the deficit trend have, however, not been disclosed in the note to the financial statements.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kibwezi-Makindu Water and Sanitation Company Limited management 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 adverse audit opinion.

Key Audit Matters

Key audit matters are those matters that, in my professional judgement, are of most significance to the audit of the financial statements for the current year. Except for matters described in the Basis for Adverse Opinion and Other Matter sections, I have determined that there are no other Key Audit Matters to communicate in my report.

Other Matter

1. Appointment of Board of Directors

Clause 4.2.1 of the Water Services Regulatory Board's Corporate Governance Guidelines for the Water Services Sector requires that, "the boards of the water service providers (WSP) shall have a minimum of seven members and a maximum of eleven members with a professional mix of directors appointed from the county government and directors appointed from the stakeholders through a competitive stakeholder participation procedure such that no individual or group of individuals or interests can dominate its decision making". Clause 4.2.5 further states that the water service providers shall avoid a situation where all board members retire at the same time. In

order to avoid this situation, one third of the board members other than those from the county government, shall retire from office by rotation every year starting from the third year of operation. The retiring members shall be determined on the basis of those who have served longest and, if they have served for the same period of time, then the retirement will be determined by lot.

It was, however, noted that the Company's directors were appointed on 14 January 2011 and were still in office as at 30 June 2017, more than seven years after appointment. In addition, the management did not provide copies of appointment letters for the directors. Consequently, the Company was in contravention of the Water Services Regulatory Board Corporate Governance Guidelines.

2. Budgetary Control and Performance

2.1. Revenue Collection

A review of the revenue collection records indicated that the Company's annual revenue target for the year under review was Kshs.75,635,976. However, the company collected Kshs.65,022,645 only resulting in an under collection of Kshs.10,613,331 or approximately 14% as shown below:

	Budgeted Amount Kshs.	Actual Amount Collected Kshs.	Amount Under Collected Kshs.	%age of Under Collection
Water Sales	64,389,272	56,867,563	7,521,709	12
Grants from National & County Government	10,450,848	4,137,829	6,313,019	60
Other Income	795,856	4,017,253	(3,221,397)	-405
	75,635,976	65,022,645	10,613,331	14

Consequently, the company was unable to meet its performance target in revenue collection for the year ended 30 June 2017 which could have adversely affected execution of programs during the year.

2.2. Expenditure Control

The Company's approved expenditure budget for the year ended 30 June 2017 amounted to Kshs.76,588,169. However, budgetary provisions for items amounting to Kshs.59,364,169 and Kshs.13,224,000 were under-spent by Kshs.12,484,303 and over-spent by Kshs.4,604,251 respectively as detailed below:

Under-Expenditure

	Approved budget- Kshs	Actual on comparable basis Kshs	Performance difference Kshs	% age Difference	Budget Allocation- % age
Staff costs	32,303,856	27,679,491	-4,624,365	-14	42
Electricity and Water	300,000	94,740	-205,260	-68	0
Rent expenses	360,000	300,000	-60,000	-17	0
Property, plant and equipment	1,456,000	821,043	-634,957	-44	2
Office and general supplies and (stationery)	300,000	173,156	-126,844	-42	0
Auditors remuneration	250,000	150,000	-100,000	40	0
Repair and maintenance of water infrastructure	3,000,000	2,380,463	-619,537	-21	4
Pumping electricity	13,200,000	8,738,815	-4,461,185	-34	17
Water quality testing	200,000	26,120	-173,880	-87	0
Computer and Printer supplies	180,000	10,200	-169,800	-94	0
Revenue collection fees	1,200,000	461,121	-738,879	-62	2
Licensee remuneration fees to TAWSB	5,866,662	5,440,245	-426,417	-7	8
Regulatory levy to WASRB	747,651	604,472	(143,179)	23	1
Total Expenditure	59,364,169	46,879,866	(12,484,303)	8	78

Over-Expenditure

	Approved budget Kshs	Actual on comparable basis Kshs	Performance difference- Kshs	% age Difference	Budget allocation % age
Communication Services and Supplies	264,000	462,380	198,380	75	0
Travelling and accommodation	1,200,000	2,745,600	1,545,600	129	2
Advertising	240,000	261,610	21,610	9	0
Hospitality supplies and services	120,000	245,600	125,600	105	0
Motor vehicle insurance	600,000	709,241	109,241	18	1

Water abstraction fees	840,000	1,641,212	801,212	95	1
Hire of transport and equipment	300,000	332,500	32,500	11	0
Contracted Guarding services	360,000	360,000	-	0	0
ICT support services	60,000	414,500	354,500	591	0
Motor vehicle Fuel and maintenance	7,440,000	8,777,621	1,337,621	18	10
Other operating expenses	1,800,000	1,877,987	77,987	4	2
Total Expenditure	13,224,000	17,828,251	4,604,251	4	17

No plausible explanation has been provided for the overall under-expenditure of Kshs.7,880,052. It appears under the circumstances that the Company was not able to control and execute its budget effectively in the year 2016/2017.

3. Internal Audit Function and Audit Committee

Section 155 of the Public Finance Management Act, 2012 requires every county government entity to establish an internal audit unit for the purpose of carrying out in depth reviews of the internal control and the internal audit process. However, the Company did not have an internal audit function in place during the year under audit.

Further, Section 155 (5) of the Public Finance Management Act, 2012 requires a government entity to establish an audit committee whose composition and functions are to be prescribed under the Public Finance Management regulations. However, the Company did not have an audit committee to oversee the implementation of both the internal and external audit reports during the year under review.

Consequently, the reliability of the Company's systems of internal control in the absence of the internal audit unit and audit committee could not be confirmed.

Other Information

The directors are responsible for the other information. The other information comprises the report of directors as required by the Companies Act, 2015, and the statement of the directors' responsibilities which are obtained prior to the date of this report, and the annual report which is expected to be made available to me after that date.

My opinion on the financial statements does not cover other information and I do not express an audit opinion or any form of assurance thereon.

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

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 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.

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

Those charged with governance are responsible for overseeing the Company's financial reporting process.

Auditor-General's Responsibilities for the Audit of the Financial Statements

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.

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.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances and for the purpose of giving an assurance on the effectiveness of the Company's 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 Company's ability to continue 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 Company to cease to continue to 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 Company 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 the Kenya Companies Act, 2015 I report based on the 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 my audit;
- ii. In my opinion, proper books of account have not been kept by the Company, so far as appears from the examination of those books;
- iii. The Company's statement of financial position and statement of comprehensive income are not in agreement with books of account; and
- iv. In my opinion the information given in the report of the directors on page 12 and 13, is consistent with the financial statements.



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

Nairobi

11 July 2018