

# **REPORT OF THE AUDITOR-GENERAL ON KIKUYU WATER COMPANY LIMITED 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 Kikuyu Water Company Limited set out on pages 16 to 35, which comprise the statement of financial position as at 30 June 2018, 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, except for the effects 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 Kikuyu Water Company Limited as at 30 June 2018, 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 Kenyan Companies Act, 2015 and Public Finance Management Act, 2012.

### **Basis for Qualified Opinion**

#### **1. Electricity Expenses**

Included in Note 9 to the financial statements under operational expenses is an amount of Kshs.42,009,651 relating to electricity expenses. An examination of billing statements from Kenya Power and Lighting Company for the period July 2017 to June 2018 revealed total electricity bills amounting to Kshs.31,245,031 and thus, resulting in an unexplained expenditure difference of Kshs.10,764,620.

Further, an analysis of the payment records revealed that cheques amounting to Kshs.39,962, 826 were made in favour of Kenya Power and Lighting Company (KPLC) during the period under review. The variance of Kshs.8,717,795 between the actual payments made from the cash book of Kshs.39,962,862 and the total bills of Kshs.31,245,031 was also not explained.

The completeness and accuracy of electricity expenses totalling Kshs.42,009,651 as disclosed in Note 9 could not, therefore, be ascertained.

#### **2. Payables Relating to Water Regulatory Bodies**

According to Note (xvii) to the financial statements on related parties in the summary of significant accounting policies, the Company operates under a regular tariff signed

between Water Service Regulatory Board (WASREB), Water Resources Management Authority(WARMA), Athi Water Services Board (AWSB) and Kikuyu sub-county whereby, WASREB is paid 1% of all revenues generated from provision of water and sanitation services, AWSB and Kikuyu sub-county are paid a fixed fee on monthly basis and WARMA is paid at fifty (50) cents per cubic meter of water produced.

Disclosed in Note 20 to the financial statements are trade and other payables which includes, Lease fee to AWSB - Kshs.19,977,411, Regulatory Levy - Kshs.2,722,185 and WARMA charges (abstraction levy) – Kshs.1,451,564 as at 30 June 2018. Although, it was explained by the management that lease fee to AWSB and Kikuyu sub-county is based on a fixed fee, lease agreement and service agreement between Kikuyu Water Company Limited and AWSB, WARMA and WASREB were not provided for audit review. As a result, the basis upon which the lease and levy fees were determined and, the validity and accuracy of the balances payable as at 30 June 2018 could, therefore, not be confirmed.

### **3. Failure to Disclose Material Uncertainty in Relation to Going Concern**

In the financial year ended 30 June 2018, the Company recorded a net loss of Kshs.7,018,040 (30 June 2017: a net loss of Kshs. 547,365), which as a result depleted retained earnings from negative Kshs.6,517,946 as at 1 July 2017 to negative Kshs.13,535,986 as at 30 June 2018. Further, the current liabilities of Kshs.57,616,442 as at 30 June 2018 exceeded the current assets of Kshs.37,001,769 resulting in a negative working capital of Kshs.20,614,673.

The precarious financial position highlighted above is an indication of the existence of a material uncertainty which may cast a significant doubt on the Company's ability to continue as a going concern and to meet its obligations as and when they fall due. The financial statements have been prepared on a going concern basis on the assumption that the Company will continue to receive financial support from the Kiambu County Government and its creditors. However, this material uncertainty in relation to going concern and any mitigating measures put in place by the Company's directors to reverse the undesirable precarious financial position have not been disclosed in the notes to the financial statements.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kikuyu Water Company 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 qualified opinion.

### **Key Audit Matters**

Key audit matters are those matters that, in my professional judgment, are of most significance in the audit of the financial statements. Except for the matters described in the Basis for Qualified Opinion and Basis for Conclusions on Lawfulness and

Effectiveness in Use of Public Resources and Effectiveness of Internal Controls, Risk Management and Governance sections, I have determined that there are no Key Audit Matters to communicate in my report.

### **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 after that date.

My opinion on the financial statements does not cover the 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.

## **REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES**

### **Conclusion**

As required by Article 229(6) of the Constitution, based on the audit procedures performed, except for the matter described in the Basis for Qualified Opinion and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and Effectiveness of Internal Controls, Risk Management and Governance 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. Unaccounted for Water**

Operational income increased by Kshs. 13,976,724 from Kshs.84,107,761 in the financial year 2016/2017 to Kshs.98,084,485 in 2017/2018. The total water production for the year under review was 2,053,652 cubic meters. However, only 1,043,780 cubic metres were billed during the year. This implies that unaccounted for water was 1,009,872 cubic metres or 49.17% of the total production. In essence, unaccounted for water was 24.17% over and above the 25% level recommended by WASREB. High unaccounted for water is an indication of inefficiency and ineffectiveness in operations and service delivery,

which may in turn impact negatively on the profitability and long term sustainability of the Company.

## **2. Customers' Deposits**

The statement of financial position shows that the customers' deposits increased by Kshs.2,080,000 from Kshs.12,198,440 as at 30 June 2017 to Kshs.14,278,440 as at 30 June 2018 and as disclosed in Note 21 to the financial statements. However, as disclosed in Note 15 to the financial statements under cash and bank balances, the customers' deposits bank account had a balance of Kshs.11,082,420 as at 30 June 2018. The difference of Kshs.3,196,020 apparently represents the amount borrowed by the management to pay electricity bills but had not been refunded to the account as of 30 June 2018. However, according to the Company's policy on borrowing and the board of directors meeting minute No. 4/KWCL/10/2015 – customers' deposits up to a maximum of Kshs.1,000,000 are allowed to be borrowed for the purpose of recurrent expenditure and the amount should be repaid within the financial year.

## **3. Audit Fees Arrears**

Included under trade and other payables in Note 20 to the financial statements are professional fees totalling Kshs.1,160,000 and which relates to arrears of audit fees that have not been paid by the Company for four financial years namely, 2013/2014, 2014/2015, 2016/2017 and 2017/2018. The Company has, therefore, been in persistence breach of Section 41(1)(c) of the Public Audit Act, 2015 which empowers the Auditor- General to charge audit fees at the rates prescribed and be paid accordingly by the auditee.

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 matter described in the Basis for Qualified Opinion and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and Effectiveness of Internal Controls, Risk Management and Governance sections of my report, I confirm that, nothing else has come to my attention to cause me to believe that internal controls, risk management and governance were not effective.

## **Basis for Conclusion**

### **1. Failure to Appoint Board of Directors**

A review of records of the board of directors of Kikuyu Water Company Limited revealed that the Company had in office nine board members, all had retired, the positions remained vacant and had not been filled as at the time of audit in January 2019. In the absence of full board, activities that require full board approval could not be implemented. As a result, there was lack of formulation of new Company policies, procedures and execution of the functions of the board contrary to Section 79(1) of the Water Act 2016.

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 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.

### **REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS**

As required by the Kenyan 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 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 in agreement with books of account; and
- (iv) In my opinion the information given in the report of the directors on pages 13 and 14, is consistent with the financial statements.

### **Responsibilities of Directors and Those Charged with Governance**

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for maintaining effective internal control as the directors 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, the directors are responsible for assessing the ability of Kikuyu Water Company Limited to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of

accounting unless the directors either intends to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

The directors are 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, the directors are 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 financial 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 and that public resources are applied in an effective way, in accordance with the provisions of Article 229(6) of the Constitution and submit the audit report in compliance with Article 229(7) of the Constitution.

Further, in planning and performing the audit of the financial statements and audit of compliance, I consider internal control in order to give an assurance on the effectiveness of internal controls, risk management and 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 noncompliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors 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 ability of Kikuyu Water Company Limited 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 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 Kikuyu Water Company Limited to express an opinion on the financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

I communicate with the directors 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 the directors 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.

Handwritten signature of Edward R. O. Ouko in black ink.

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

**Nairobi**

**31 May 2019**