

REPORT OF THE AUDITOR-GENERAL ON KILIFI-MARIAKANI WATER AND SEWERAGE COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Adverse Opinion

I have audited the accompanying financial statements of Kilifi–Mariakani Water and Sewerage Company Limited set out on pages 21 to 63, which comprise the statement of financial position as at 30 June 2018, and the statement of profit and loss and other 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 Kilifi–Mariakani Water and Sewerage 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 and do not comply with the Water Act, 2016 and the Companies Act of 2015.

Basis for Adverse Opinion

1.0 Financial Performance

The statement of profit and loss and other comprehensive income for the year ended 30 June 2018 reflects loss of Kshs.55,956,028 (2016/2017 - Loss of Kshs.99,364,006). As at the same period, accumulated loss increased to Kshs.296,088,450 from Kshs.240,132,422 as at 30 June 2017. If strategies are not put in place to reverse the trend the Company is likely to experience financial challenges in the near future.

The Company's financial statements have therefore been prepared on the going-concern basis which assumes the continued financial support from the Government, bankers and creditors.

2.0 Presentation of the Financial Statements

The financial statements for the year ended 30 June 2018 contained the following presentation anomalies;

- 2.1 The statement of changes in equity where by the movement for the prior year is omitted contrary to the requirement of International Accounting Standard No. 1 Paragraph 38 which states that, "Except when IFRSs permit or require otherwise, an entity shall disclose comparative information in respect of the previous period for all amounts reported in the current period's financial statements. An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements".

2.2 The statement of comparison of budget and actual amounts for the year ended 30 June 2018 indicates, 'as at 30 June 2018' instead of 'for the year ended 30 June 2018'.

Consequently, the presentation of the financial statements do not comply with International Financial Reporting Standards No. 1 as prescribed by the Public Sector Accounting Standards Board.

3.0 Inaccuracies in the Financial Statements

The statement of cashflows for the year ended 30 June 2018 indicates the comparative WSTF project under investing activities of Kshs.5,821,099 while year 2016/2017 audited financial statements reflects Kshs.3,798,610, resulting to unexplained nor reconciled variance of Kshs.2,022,489.

Consequently, the accuracy and completeness of the statement of cashflow for the year ended 30 June 2018 could not be confirmed.

4.0 County Government Grants

The statement of profit and loss and other comprehensive income for the year ended 30 June 2018 reflects Kshs.6,915,535 in respect of Kilifi County Government grants as disclosed under Note 4. However, no documents were availed for audit review to confirm that the grants were all receipted and the purpose of the grant. The management indicated that the grants were utilized for payment of power bills.

Further, the financial statements of the County Government of Kilifi do not reflect this grant to Kilifi-Mariakani Water and Sewerage Company.

Consequently, the accuracy, completeness and validity of Kshs.6,915,535 County Government Grants for the year ended 30 June 2018 could not be confirmed.

5.0 Cost of Water

The statement of profit and loss and other comprehensive income for the year ended 30 June 2018 reflects Kshs.254,998,692 in respect of cost of sales as disclosed in Note 2 to the financial statements. Included in this amount is lease fees amount of Kshs.41,914,618. However, audit review of water bills records and monthly invoices from Coast Water Services Board for supply of bulk water revealed a constant monthly fee of Kshs.3,296,526 which translates to an annual charge of Kshs.39,558,312, resulting to a variance of Kshs.2,356,306 which has not been reconciled or explained.

Consequently, the accuracy and completeness of Kshs.254,998,692 in respect of lease fees for the year ended 30 June 2018 could not be confirmed.

6.0 Property, Plant and Equipment

6.1 Leased Assets From Coast Water Services Board

As previously reported, included in the property, plant and equipment figure of Kshs.142,079,670 (2016/2017 – Kshs.144,727,256) is an amount of Kshs.34,256,900

representing leased assets from Coast Water Services Board in accordance with Clause 3 and 4 and Schedules F and G of the unsigned Service Provision Agreement (SPA). The Company neither availed ownership documents for these assets nor a professional valuation report in support of the values attached to them.

Consequently, it has not been possible to ascertain the ownership and valuation status of property, plant and equipment balance of Kshs.34,256,900 as at 30 June 2018.

6.2 Motor vehicles

Note 11 to the financial statements for the year ended 30 June 2018 reflects Kshs.2,623,000 in respect of motor vehicles additions during the year. Records availed for audit review indicated that the Company acquired five (5) motor cycles and one saloon car during the year ended 30 June 2018. However, the cost and terms of sale of the motor cycles and the car were not availed for audit review. Further, logbooks for the five (5) motorcycles indicated that they were registered under a private company while the logbook for the saloon car was not availed for audit review.

Consequently, the accuracy, ownership and rights and obligations of motor vehicle assets additions of Kshs.2,623,000 as at 30 June 2018 could not be confirmed.

6.3 Fixed Assets Register

The statement of financial position as at 30 June 2018 reflects Kshs.142,079,670 in respect of property, plant and equipment as disclosed in Note 11 to the financial statements. However, the assets register availed for audit indicated assets totaling to Kshs.27,353,576, which varies with the value disclosed in the financial statements by Kshs.114,726,094. The variance has not been explained, nor reconciled.

Consequently, the accuracy, completeness and validity of property, plant and equipment valued at Kshs.142,079,670 as at 30 June 2018 could not be confirmed.

7.0 Trade and other receivables

7.1 Support Schedules

As previously reported, included in the trade and other receivables balance of Kshs.187,861,521 as at 30 June 2018 is other receivables balance of Kshs.15,237,455 as detailed in note 14 to the financial statement. However, schedules in support of this balance were not availed during the audit review.

Further, included in trade and other receivables balance is Kshs.172,284,670 in respect of trade receivables, out of which Kshs.139,232.85 relates to customers whose water connections have been terminated by the Company. Records availed for audit review indicate that the Company did not have existing contracts with these customers and therefore could not institute legal process of recovery.

Consequently, the accuracy and recoverability of trade and other receivables balance of Kshs.187,861,521 as at 30 June 2018 could not be confirmed.

7.2 Provision for Bad and Doubtful Debts

Note 14(a) to the financial statements for the year ended 30 June 2018 reflects Kshs.3,516,014 in respect of provision for bad and doubtful debts. However, audit review of provision for doubtful receivables indicates an increase of Kshs.786,916 or 28.8% from the previous year's provision of Kshs.2,729,098. The management therefore wrongly charged the full amount of provision to the statement of profit and loss and comprehensive income for the year under review instead of the increase therefore overstating the provision by Kshs.2,729,098.

Further, audit analysis of the calculation of provision for doubtful receivables indicated that it was calculated at 2% of the total debtors, contrary to the Company's Finance and Accounting Manual which provides that provision for doubtful receivables be provided at 25% for 6-12 months, 50% for those over one (1) year and 100% for receivables over two (2) years.

Under the circumstances, the accuracy and validity of Kshs.3,516,014 in respect of provision for doubtful receivables for the year ended 30 June 2018 could not be confirmed.

8.0 Capital and Reserves

The statement of financial position as at 30 June 2018 reflects negative Kshs.281,370,742 in respect of capital and reserves. Audit review of the capital and reserves balances revealed the following:

8.1 Ordinary Share Capital

As previously reported, and reflected in the statement of financial position as at 30 June 2018, the Company is registered as a Limited Company with an authorized share capital of Kshs.5,000,000. According to the Memorandum and Articles of Association, share capital worth Kshs.100,000 had been fully subscribed and issued to Kilifi County Government as at 30 June 2018. Available information indicates that as at 30 June 2018, the County Government had not paid for the shareholding. Further, in accordance with the statement of corporate governance, the company has not updated its new shareholding portfolio with the Registrar of Companies.

Under the circumstances, the accuracy of the Kshs.100,000 share capital as at 30 June 2018 could not be ascertained.

8.2 Coast Water Services Board Liability

The statement of financial position as at 30 June 2018 reflects Kshs.35,476,311 in respect of Coast Water Services Board Liability as disclosed in Note 26 to financial statements. The balance was arrived at after deducting total assets of Kshs.376,277,590 and capital

and reserves of Kshs.245,894,431 from total current and non-current liabilities of Kshs.657,648,333 whose details were not availed for audit review. This figure therefore appears to be a balancing item in the statement of financial position as at 30 June 2018. Consequently, the accuracy and completeness of Kshs.35,476,311 Coast Water Services Board liability as at 30 June 2018 could not be confirmed.

8.3 Capital Reserve Fund

The statement of financial position as at 30 June 2018 reflects Kshs.50,094,019 in respect of capital reserves as disclosed under Note 27 to the financial statements. Audit review of the reserves composition indicated that Kshs.34,256,900 relates to the assets at formation of the Company and Kshs.15,837,119 is for expenses incurred in the first year after formation. However, expenses incurred during the year of formation should have been recognized as revenue grant and not capital grant in line with paragraph 20 of International Accounting Standard No. 20 which states that, 'A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognized in profit or loss of the period in which it becomes receivable'.

Further, capital reserves of Kshs.34,256,900 which relates to financing of assets during formation of the Company was not treated in compliance with International Accounting Standard No. 20 paragraph 26 on presentation of grants related to assets which requires recognition of the grant as deferred income that is recognized in profit or loss on a systematic basis over the useful life of the asset or Paragraph 27 which requires deduction of the grant in calculating the carrying amount of the asset. The grant is recognized in profit or loss over the life of a depreciable asset as a reduced depreciation expense.

Under the circumstances, the accuracy and completeness of capital reserve fund of Kshs.50,094,019 as at 30 June 2018 could not be confirmed.

9.0 Non-Current Liabilities

The statement of financial position as at 30 June 2018 reflects Kshs.467,714,976 in respect of capital and reserves, being an increase of Kshs.93,919,659 or 25.1% from the balance of Kshs.373,795,317 reported in the previous year. Audit review of the non-current liabilities balances revealed the following:

9.1 Bulk Water

The statement of financial position as at 30 June 2018 reflects Kshs.247,785,948 in respect of bulk water as disclosed under Note 24 to the financial statements. Information provided in Note 24 indicated that the total outstanding bulk water liability is Kshs.265,329,908 and the Company had classified Kshs.247,785,948 as non-current and Kshs.17,543,960 as current liability. However, the management did avail for audit review any agreement between the Company and Coast Water Services Board suspending immediate settlement of the outstanding amount of Kshs.247,785,948 for a period of more

than 12 months from 30 June 2018. The management therefore, disclosed Kshs.247,785,948 as non-current liability, contrary to International Accounting Standard No. 1 Paragraph 69 which states that, 'An entity shall classify a liability as current when: (c) the liability is due to be settled within twelve months after the reporting period'. Further, the total amount due from the Company was disclosed as a current liability in Coast Water Services Board's financial statements.

Consequently, the accuracy and completeness of bulk water non-current liability of Kshs.247,785,948 as at 30 June 2018 could not be confirmed.

9.2 Licensee Fees

The statement of financial position as at 30 June 2018 reflects Kshs.207,633,307 in respect of licensee fees as disclosed under Note 23 to the financial statements. Information provided in Note 23 indicates that the total outstanding licensee fees is Kshs.249,547,925 which differs from the general ledger balance of Kshs.248,496,104 by Kshs.1,051,821 and which has not been reconciled, nor explained variance.

Further, under Note 23 to the financial statements, an amount of Kshs.207,633,307 is classified as non-current while Kshs.41,914,618 is classified as current liability. However, the management did not avail for audit review any agreement between the Company and Coast Water Services Board suspending immediate settlement for the outstanding amount of Kshs.207,633,207 for a period of more than 12 months from 30 June 2018. The management therefore, disclosed as non-current liability of Kshs.207,633,307 contrary to International Accounting Standard No. 1 Paragraph 69 which states that, 'An entity shall classify a liability as current when: (c) the liability is due to be settled within twelve months after the reporting period'. This total amount due from the company was disclosed as a current liability in Coast Water Service Board's financial statements.

Consequently, the accuracy and completeness of Kshs.207,633,307 non current licensee fees as at 30 June 2018 could not be confirmed.

9.3 Deferred Income

The statement of financial position as at 30 June 2018 reflects Kshs.12,295,721 in respect of deferred income as disclosed under Note 3 (b) to the financial statements. However, the management did not provide an analysis and details of the grants received from Water Services Trust Fund, nor explain how the same were utilized as a capital expenditure to justify the treatment as deferred income in line with International Accounting Standard No. 20 paragraph 24 which states that, 'Government grants related to assets, including non-monetary grants at fair value, shall be presented in the statement of financial position either by setting up the grant as deferred income or by deducting the grant in arriving at the carrying amount of the asset'.

Consequently, the accuracy and completeness of deferred income balance of Kshs.12,295,721 as at 30 June 2018 could not be confirmed.

9.4 Un-Explained Coast Water Services Board Liability Variance

The statement of financial position as at 30 June 2018 reflects a total liability of Kshs.479,401,522 due to Coast Water Services Board which differed with the amount disclosed in Coast Water Services Board financial statements of Kshs.585,294,551 by Kshs.105,893,029, that has not been reconciled nor explained as detailed below:

KIMAWASCO financial statements			
	Statement of Financial Position Component as at 30 June 2018	Statement of Financial Position item as at 30 June 2018	Amount due to CWSB (Kshs)
1	Capital and Reserves	CWSB Liability	(35,476,311)
2	Non - Current Liabilities	Bulk Water	247,785,948
3	Non - Current Liabilities	Licencee Fees	207,633,307
4	Trade and Other Liabilities	Bulk Water	17,543,960
5	Trade and Other Liabilities	Licencee Fees	41,914,618
	Total owed to CWSB		479,401,522
CWSB financial statements			
	Trade and Other Receivables	Kilifi-Mariakani Water and Sewerage Ltd	585,294,551
Variance			105,893,029

Consequently, the accuracy and completeness of the amount of Kshs.479,401,522 owing to Coast Water Service Board as at 30 June 2019 could not be confirmed.

10.0 Long Term Customer Deposits

As previously reported, included in the Kshs.188,437,743 trade and other payables balance as at 30 June 2018 is long term customer deposits balance of Kshs.40,951,861. However, audit review of the bank account maintained for purposes of holding customer deposits held at Kenya Commercial Bank Limited indicated a balance of Kshs.14,369,175 as at 30 June 2018, resulting to variance of Kshs.26,582,686 which had not been reconciled nor explained. This is an indication that the Company utilized customer deposits amounting to Kshs.26,582,686 on operations.

Consequently, the completeness and validity of long term customer deposits of Kshs.40,951,861 as at 30 June 2018 could not be confirmed.

11.0 Retirement Benefits Obligations

The statement of financial position as at 30 June 2018 reflects Kshs.1,495,614 in respect of retirement benefits obligations as disclosed under Note 25 to the financial statements. Note 25 disclosed that the Company operated a defined contribution scheme where employees contributes 12% of the basic salary and the employer contributed 15% of the same. However, the management did not provide an analysis or details of how the liability disclosed in the financial statements for the year ended 30 June 2018 was determined.

Consequently, the accuracy, completeness and validity of retirement benefits obligations balance Kshs.1,495,614 as at 30 June 2018 could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Kilifi-Mariakani Water and Sewerage 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 adverse 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 Adverse Opinion section, I have determined that there are no other Key Audit Matters to communicate in my report.

Other Matter

1.0 Budgetary Controls and Performance

1.1 Revenue Budget

During the year under review, the Company had a revenue budget of Kshs.548,540,400 against actual collections of Kshs.478,739,939, resulting to Kshs.69,800,461 or 12.7% under collections as detailed below:

Revenue	Approved Final Budget (Kshs)	Actual Collections (Kshs)	Under Collections (Kshs)	%
Sale of water	522,000,000	465,717,976	56,282,024	10.8
Other income	26,540,400	13,021,963	13,518,437	50.9
Total	548,540,400	478,739,939	69,800,461	12.7

The above table indicates under collection of Kshs.56,282,024 or 10.8% on sales of water while other income under collection amounted to Kshs.13,518,437 or 50.9% of the budget. The management did not provide evidence to confirm that the County Executive Member for Water had been informed of the circumstances likely to cause the budget variation, contrary to Section 46. (1) of the Public Finance Management Act, 2012 which states that, 'The Accounting Officer shall inform his or her responsible County Executive Committee Member immediately of any circumstances that are likely to affect materially the budgetary results either through revenue and expenditure or other receipts and payments of the county government entity'.

The under collections indicate a budget which was not realistic. The shortfall in revenue collections could negatively affect the operations and sustainability of Kilifi-Mariakani

Water and Sewerage Company Limited and delivery of water services to the residents of Kilifi County.

1.2 Expenditure Budget

During the year under review, the Company had an expenditure budget of Kshs.531,982,404 against actual expenditure of Kshs.525,327,167 or 98.7% resulting to net under expenditure of Kshs.6,655,237 or 1.3% as detailed below:

Expenditure	Final Budget Kshs.	Actual Comparable Basis Kshs.	Over Expenditure Kshs	Under Expenditure Kshs	%
Compensation of employees	163,637,824	175,789,479	12,151,655	-	7.4
Use of goods and services	327,430,652	339,502,999	12,072,347	-	3.7
Finance costs	17,564,943	19,224	-	17,545,719	99.9
Rent paid	1,620,000	1,717,229	97,229		6.0
Directors expenses	8,900,000	5,044,747	-	3,855,253	43.3
Other payments	12,828,985	3,253,489	-	9,575,496	74.6
Totals	531,982,404	525,327,167	24,321,231	30,976,468	1.4

The table above indicates that the Company over spent on compensation of employees by Kshs.12,151,655 or 7.4%, use of goods and services by Kshs.12,072,347 or 3.7% and rent paid by Kshs.97,229 or 6% while underspending by Kshs.17,545,719 or 99.9% on finance costs, Kshs.3,855,253 or 43.3% on Directors' expenses and Kshs.9,575,496 or 74.6% on other payments.

The management did not provide evidence to confirm that the County Executive Member for Water was informed of the circumstances likely to cause the budget variation, contrary to Section 46. (1) of the Public Finance Management Act, 2012 which states that, 'The Accounting Officer shall inform his or her responsible County Executive Committee Member immediately of any circumstances that are likely to affect materially the budgetary results either through revenue and expenditure or other receipts and payments of the county government entity'. Further, there was no evidence to confirm that the over expenditure of Kshs.24,321,231 was approved by the County Executive Member for Water as per the same Section 46 (1) of Public Finance Management Act, 2012. The net under expenditure of Kshs.6,655,237 is likely to negatively impact on delivery of goods and services to the residents of Kilifi County.

1.3 Deficit

The statement of comparison of budget and actual for the year ended 30 June 2018 indicates that the Company had a deficit of Kshs.46,587,228 compared to the planned surplus of Kshs.16,557,995. However, the actual deficit of Kshs.46,587,228 varies with Kshs.55,956,028 deficit reported in the statement of profit and loss and other

comprehensive income for the year ended 30 June 2018 by Kshs.9,368,800. The variance has not been reconciled nor explained.

Further, the statement of comparison of budget and actual amounts for the year ended 30 June 2018 reflects nil balance for County Government grant while the statement of financial performance reflects Kshs.6,915,535 and WSTF grant of Kshs.534,597, all totaling to Kshs.7,450,132.

Under the circumstances, the accuracy and completeness of the statement of comparison of budget and actual amounts for the year ended 30 June 2018 could not be confirmed.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229(6) of the Constitution, because of the significance of the matters discussed in the Basis for Adverse Opinion and Conclusion on Lawfulness and Effectiveness in Use of Public Resources sections of my report, based on the audit procedures performed, I confirm that public resources have not been applied lawfully and in an effective way.

Basis for Conclusion

1.0 Audit Fees

Included in the trade and other payables balance of Kshs.188,437,743 as at 30 June 2018 is audit fees of Kshs.2,571,200, out of which Kshs.1,898,400 is more than one (1) year over due. The management did not provide a satisfactory explanation of failure to settle the long overdue fees. This is contrary to the Public Audit Act, 2015 Section 41(c) which states that, 'The funds of the Office of the Auditor-General shall consist of—audit fees charged at the rates prescribed by the Auditor-General'.

Consequently, the Company is in breach of the law.

2.0 Unaccounted for Water

The statement of profit and loss and other comprehensive income for the year ended 30 June 2018 reflects Kshs.465,717,976 in respect of sale of water. Records availed for audit review indicated that the Company received 8,907,256 cubic meters of water from Coast Water Services Board (CWSB), out of which 4,580,459 cubic meters (51.4%) was billed to its customers. The balance of 4,326,797 cubic meters or 48.6% represents Unaccounted for Water (UFW) which is 23.6% higher than the allowable loss of 25% by the Water Service Regulatory Board(WASREB) guidelines. The 4,326,797 cubic meters of Unaccounted For Water may have resulted to a loss of revenue estimated at Kshs.439,905,451 using the Company's average selling price of Kshs.101.67 per cubic meter.

This significant level of Unaccounted for Water may negatively impact on the Company's profitability and sustainability.

3.0 Board of Directors Expenses

3.1 Allowances Paid for Activities Not in the Board Calendar/Work Plan

Note 6(b) to the financial statement for the year ended 30 June 2018 reflects Kshs.5,044,747 in respect of Board of Director expenses. Included in this amount is Kshs.1,652,600 in respect to allowances paid to Board members for activities which were not included in the Board's calendar/work plan for the year, contrary to Mwongozo – The Code Of Governance for State Corporation. Further, the expenditure of Kshs.1,652,600 is unsupported as detailed below:

Date	Payment Voucher No.	Description	Amount (Kshs)	Observations
28/07/2017	22170, 22198, 22197, 22196, 22192, 22191, 22190	Being subsistence allowances and sitting allowance and air tickets facilitation on bench marking at Nyeri water	696,100	No documentary evidence of attendance, air travel, receipt of funds and report on the benchmarking were availed for audit review.
04/19/2018	23646	Payment of BOD sitting allowances and perdiems on attending training on corporate governance	380,000	No evidence of attendance nor training programme/schedule was availed for audit verification.
10/06/2017	22686	Payment of perdiem and taxi hire while on visit to Eldoret water and sewerage company	123,000	Receipt of taxi expenditure, proof of travel notice of invitation from Eldoret Water And Sewerage Company, minutes of the board resolutions were not availed for audit review.
12/22/2017	23010	Payment of sitting allowance and perdiem while visiting water projects in Kilifi on 22/12/2017	201,500	Report on the project inspection, proof of transport and program/schedule of project inspection not availed for audit review
03/21/2018	23520	Being sitting allowance on world water day	43,000	Proof of travel, invitation by CWSB, evidence of attendance and program

Date	Payment Voucher No.	Description	Amount (Kshs)	Observations
				of activities not availed for audit review.
03/21/2018	23578	Being facilitation on attending world water day at Mwasere girls	43,000	Proof of travel, invitation by CWSB, evidence of attendance and program of activities not availed for audit review.
07/14/2017	22106	Being facilitation to attend wasco games	166,000	Invitation letter and proof of travel not availed for audit review
Total			1,652,600	

Consequently, the propriety and validity of Kshs.1,652,600 Board of Directors expenses for the year ended 30 June 2018 could not be confirmed.

4.0 Legal Fees

Note 6 to the financial statements for the year ended 30 June 2018 reflects Kshs.810,415 in respect of legal fees. Included in this amount is Kshs.733,962 which was not supported by evidence of competitive procurement for the legal services through quotations from the list of prequalified law firms maintained by the Company.

Consequently the propriety and validity of Kshs.733,962 on legal fees for the year ended 30 June 2018 could not be confirmed.

5.0 Tax Expenses

As previously reported, Note 22 to the financial statements for the year ended 30 June 2018 reflects Kshs.188,437,743 in respect of trade and other payables. Included in this amount is tax liability of Kshs.18,300,794 (2016/2017 – Kshs.21,300,794), out of which Kshs.8,480,175 relates to fines and penalties. The Company was audited by Kenya Revenue Authority in 2016/2017 for compliance with tax laws. The Company was found not to have complied with various aspects of tax segments. This resulted to an assessment of Kshs.35,800,794 broken into Kshs.27,325,619 as principal taxes defaulted and Kshs.8,475,175 being the penalties and interest. Failure to comply with taxation laws had led to loss of Kshs.8,475,175 in form of penalties and taxes which is an irregular charge to public funds.

Consequently, the Company is in breach of the Law.

6.0 Water Infrastructure Services

Note 6(i) to the financial statements for the year ended 30 June 2018 reflects Kshs.22,620,196 in respect of water infrastructure services. However, records availed for audit indicated that the management procured water fittings costing Kshs.5,107,546 from suppliers who were not in the register of suppliers, contrary to Section 105 of the Public

Procurement and Asset Disposal Act, 2015 which states that, 'A procuring entity may use a request for quotations from the register of suppliers for a procurement'. Further, quotations, evaluation committee minutes and details of how the items were utilized were not availed for audit review.

Consequently, the lawfulness of Kshs.5,107,546 water infrastructure services procurement for the year ended 30 June 2018 could not be confirmed.

7.0 Intangible Assets

Note 12 to the financial statements for the year ended 30 June 2018 reflects Kshs.1,045,160 in respect of intangible assets additions, being cost of supply and installation of a meter reading system. However, the expenditure was not in the approved budget for the year under review.

Consequently, the lawfulness of meter reading system acquisition of Kshs.1,045,160 for the year ended 30 June 2018 could not be confirmed.

8.0 Corporate Governance

As previously reported, included in administration costs and disclosed in Note 6 to the financial statements for the year ended 30 June 2018 is Kshs.5,044,747 in respect to directors' emoluments. The following observations were made:

- 8.1** Kilifi-Mariakani Water and Sewerage Company Limited has not held any General Meeting since 2012, contrary to the Company's Memorandum and Articles of Association.
- 8.2** The Company has six (6) directors; three (3) of whom were appointed to the Board in 2011 and three (3) who joined the Board in 2013 who have held office since then. This is contrary to the requirement of the Company's Memorandum and Articles of Association that a third of Directors should retire every third Annual General Meeting. Further, no Director has been retired since 2010 as no Annual General Meeting has been held since 2012 nor gazette notice, appointment letters or acceptance letters availed to support the appointment of the Directors.
- 8.3** The Company provided for Kshs.720,000 in the budget for the Chairman's honorarium, which was not spent since the Company has been operating without a substantive Chairman for nine(9) years up-to 30 June 2018. No explanation was provided as to why the appointment of a Chairperson for the Board has not been done. Running the operations of the Board without a substantive Chairperson may negatively affect its performance or effectiveness.

The Company is therefore, in breach of its Memorandum and Articles of Association. Under the circumstances, the corporate governance of Kilifi - Mariakani Water and Sewerage Company Limited was not in line with its Memorandum and Articles of Association.

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, because of the significance of the matters discussed in the Basis for Adverse Opinion sections of my report, based on the audit procedures performed, I confirm that internal controls, risk management and governance were not effective.

The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. The standard 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Companies Act, 2015 of the laws of Kenya, 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 not been kept by Kilifi – Mariakani Water and Sewerage Company Limited, so far as appears from the examination of those records; and,
- iii. The financial statements are not in agreement with the accounting records and returns.

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 Financial Reporting Standards (IFRS) 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 Kilifi-Mariakani Water Company Limited's effectiveness of internal control.

In preparing the financial statements, management is responsible for assessing Kilifi – Mariakani Water and Sewerage Company Limited'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 Kilifi – Mariakani Water and Sewerage Company Limited 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, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them, and that public money is applied in an effective manner in line with Article 229(6) of the Constitution of Kenya, 2010.

Those charged with governance are responsible for overseeing Kilifi – Mariakani Water and Sewerage Company Limited’s 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 Kilifi – Mariakani Water and Sewerage Company Limited financial statements, a compliance review is planned and performed to express a conclusion with limited assurance as to 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. The nature, timing and extent of the compliance work is limited compared to that designed to express an opinion with reasonable assurance on the financial statements.

Further, in planning and performing the audit of Kilifi – Mariakani Water and Sewerage Company Limited financial statements and review of compliance, I consider internal

controls 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 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 Kilifi-Mariakani Water Company Limited 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 Kilifi – Mariakani Water and Sewerage Company Limited's ability to continue as a going concern or 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 Kilifi – Mariakani Water and Sewerage Company Limited to cease to continue as a going concern or to sustain its services.
- 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 Kilifi – Mariakani Water and Sewerage 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 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

30 April 2019