

REPORT OF THE AUDITOR-GENERAL ON LAMU WATER AND SEWERAGE COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE, 2019

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Lamu Water and Sewerage Company Limited set out on pages 1 to 31, which comprise the statement of financial position as at 30 June, 2019, and the statement of profit and loss and other comprehensive income, statement of cash flows, statement of changes in net assets and the 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 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 Lamu Water and Sewerage Company Limited as at 30 June, 2019, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards (IFRS) and comply with the Public Finance Management Act, 2012 and the Water Act, 2016.

Basis for Qualified Opinion

1. Unconfirmed Balances

1.1 Revenue

The statement of profit and loss and other comprehensive income reflects revenue totalling Kshs.42,583,210 generated from water sales during the year. However, included in the balance are estimated sales totalling Kshs.1,113,877 from eight hundred and two (802) faulty meters reported to have malfunctioned. As a result, the accuracy and completeness of the water sales balance could not be confirmed.

1.2 Trade and Other Receivables

The statement of financial position as at 30 June, 2019 reflects trade and other receivables balances totalling Kshs.19,664,177, as further reflected in Note 13 to the financial statements. However, the respective aging debtors' schedule was not presented for audit review and the Company did not maintain an updated receivables' ledger for trade and other receivables transactions.

In addition, no provision for bad and doubtful debts was made in the financial statements and the Company did not have an approved policy for such debts.

Further, the trade and other receivables balance included Kshs.3,000,000 in respect of 3,000 ordinary shares issued to the defunct Lamu County Council that were not paid for. The sum may no longer be recoverable.

In view of these issues, the accuracy and recoverability of the trade and other receivables balance totalling Kshs.19,664,177 reflected in the statement of financial position as at 30 June, 2019 could not be confirmed.

1.3 Payables

1.3.1 Long Term Payables

The statement of financial position and Note 16 to the financial statements reflects long-term payables balance totalling Kshs.7,770,210 as at 30 June, 2019 being infrastructure lease fees owed to the Coast Water Services Board. Examination of the records of the Company revealed that the Company did not maintain a long term payables ledger. In addition, the lease agreement, repayment schedules and lease fee invoices were not provided for audit review.

Consequently, the accuracy of the long-term payable balance totalling Kshs.7,770,210 as at 30 June, 2019 could not be confirmed.

1.3.2 Trade and Other Payables

The statement of financial position reflects trade and other payables balance totalling Kshs.17,431,243 as at 30 June, 2019, as further disclosed in Note 18 to the financial statements. Included in the balance is Kshs.2,586,080 relating to customer deposits. However, the deposits schedule provided for audit review reflected deposits totalling Kshs.659,500 resulting to an unexplained difference of Kshs.1,926,580 between the two records. In addition, the Management did not carry out cut-off procedures to ensure that only the creditors related to the year under review were included in the balance. The trade and other payables balance totalling Kshs.17,431,243 as at 30 June, 2019 may therefore, not be fairly stated.

In view of the foregoing, the accuracy of the customer deposits totalling Kshs.2,586,080 as at 30 June, 2019 could not be confirmed.

2.0 Incomplete Disclosure of Property, Plant and Equipment

The statement of financial position and Note 12 to the financial statements reflect property, plant and equipment balance totalling Kshs.5,172,520 as at 30 June, 2019. However, ownership documents for the Company's land, motor vehicles and motor cycles were not provided for audit.

In addition, the property, plant and equipment balance excludes the values of five (5) plots of land, nine (9) buildings, five (5) motor vehicles, eight (8) motorcycles, thirty-four (34) wells with pumps, six (6) boreholes with pumps and ten (10) collapsible tanks.

Further, the non-current assets have not been revalued to reflect the correct balances and the Company does not maintain an updated fixed asset register contrary to Regulation 136(1) of the Public Finance Management (County Governments) Regulations, 2015.

In the circumstances the accuracy, ownership and valuation of property, plant and equipment balance totalling Kshs.5,172,520 reflected in the statement of financial position as at 30 June, 2019 is not fairly stated.

Emphasis of Matter

Going Concern Status

During the year under review, the Company recorded a deficit of Kshs.6,276,406 after it recognized a current grant amounting to Kshs.4,368,740 received from Lamu County Executive resulting in negative capital and reserves amounting to Kshs.425,836 as at 30 June, 2019. Further, the Company's approved budget for the year under review reflected a deficit of Kshs.5,822,958. The two occurrences denote the existence of a material uncertainty which, if not mitigated, may cast doubt on the Company's ability to continue as a going concern.

The mitigating measures put in place by the Board of Directors and Management to reverse the undesirable financial performance have not been disclosed in the notes to the financial statements as required by the International Accounting Standards (IAS) 1, Presentation of financial statements.

My opinion is not qualified in relation to this matter.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Lamu Water and Sewerage Company Limited Management in accordance with ISSAI 130 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with the ISSAI and in accordance with other ethical requirements applicable to performing audits of financial statements in Kenya. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my 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. There were no other key audit matters to report in the year under review.

Other Matter

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 Conclusion on Lawfulness and Effectiveness in the Use of Public Resources section 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

1.0 Non-Revenue Water

Records on water production indicated that the Company produced 848,253m³ of water during the year under review. However, only 454,445m³ or 54% of the total volume was billed to customers resulting in revenue totalling Kshs.42,583,210. The balance totalling 393,808m³, or approximately 46% of total production was Non-Revenue-Water (NRW) which was 21 percentage points above the allowable loss of 25% set in guidelines issued by the Water Services Regulatory Board. At the average billing rates for the year under review, the Non-Revenue-Water may have resulted in an estimated loss on water sales amounting to Kshs.17,030,192.

The significant level of NRW is an indication that water in the Company's system is lost before it is billed or a large portion of residents do not pay for the water they consume. The NRW is a major hindrance to the Company's profitability and poses a significant risk to its ability to sustain its services.

2.0 Unapproved Budget Deficit

The Company's budget for the year under review, reflected a budget deficit of Kshs.5,822,958 resulting from revenue and expenditure budgets of Kshs.79,299,885 and Kshs.85,122,843 respectively. However, there were no records on approval of the budget deficit by the County Executive Committee Member responsible for the Company and the County Treasury as required by Section 205(1) of the Public Finance Management (County Governments) Regulations, 2015.

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 described in the Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance 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.

Basis for Conclusion

1. Weaknesses in Internal Control

1.1 Expenditure Controls

Examination of vote book management indicated that control procedures for expenditure were not applied continuously contrary to Regulation 51 of the Public Finance Management (County Governments) Regulations, 2015.

Therefore, there is a risk of the Company committing or spending unauthorized funds.

1.2 Revenue Controls

Revenue records examined indicated that the revenue was collected manually and the respective transactions recorded in an electronic spreadsheet. However, management of the billing system was not supervised and further, alterations on the records were made without written approval. In addition, policies and procedures on backup of data were not clearly set out and as a result, the risk of data loss and disruption of work on occurrence of unexpected events was high.

In view of the foregoing, internal controls on revenue management were inadequate.

2. Lack of Scheme of Service for Employees

Audit review of personnel records indicated that the Company had forty seven (47) workers, thirty one (31) of whom were employed by the Company and sixteen (16) seconded from the County Executive. However, Management did not provide an approved Scheme of Service for audit review and its existence could not therefore be confirmed. In the absence of the documented scheme, effective management of personnel matters may not be attainable.

In the circumstance, it was not possible to confirm the sufficiency of controls on the staff establishment to ensure objective and effective use of public resources in its maintenance.

3. Failure to Establish an Audit Committee

Audit review of the Internal Audit Function confirmed that the Company did not have an Audit Committee, contrary to Section 155(5) of the Public Finance Management Act, 2012 and Regulation 167(1) of the Public Finance Management (County Governments)

Regulations, 2015. In the absence of an Audit Committee, oversight and other governance systems were inadequate and did not conform to the Law.

4. Lack of Internal Audit Unit

In addition, the Company did not have an Internal Audit Function contrary to Section 155 of the Public Finance Management Act, 2012, which states that a County Government entity should have appropriate arrangements for conducting internal audit according to the guidelines issued by the Public Sector Accounting Standards Board.

In the absence of an Internal Audit function, the Company's internal control system is incomplete and poses a risk to effective management of public funds.

5. Lack of Board of Directors

Contrary to the requirements of Section 79 and Section 80 of the Water Act, 2019, the Company did not have a Board of Directors at the time of the audit in February, 2020 after the term of five (5) Directors nominated to the Board in May, 2016 expired in April, 2019.

In the absence of a Board, the governance and strategic leadership in the Company is inadequate.

The audit was conducted in accordance with ISSAI 2315 and ISSAI 2330. 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.

Responsibilities of Management and Board of Directors

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 the effectiveness of internal control, risk management and governance.

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 sustainability of services and using the applicable basis of accounting unless Management is aware of the intention to liquidate the Company or to cease operations. 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 resources are applied in an effective way.

The Board of Directors is 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 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 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 Company's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit report. However, future events or conditions may cause the Company to cease to continue 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 the Company to express an opinion on the financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

I communicate with 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 communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.



Nancy Gathungu
AUDITOR-GENERAL

Nairobi

19 August, 2021