

# **REPORT OF THE AUDITOR-GENERAL ON MALINDI WATER AND SEWERAGE COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2017**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Qualified Opinion**

I have audited the accompanying financial statements of Malindi Water and Sewerage Company Limited set out on pages 16 to 50, which comprise the statement of financial position as at 30 June 2017, and the statement of financial performance, statement of changes in net assets, 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 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 Malindi Water and Sewerage 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 (IFRS ) and comply with the Water Act, 2016.

In addition, as required by Article 229(6) of the Constitution, except for the matters described in the Basis for Qualified Opinion and Other Matter sections of my report, based on the procedures performed, I confirm that, nothing has come to my attention to cause me to believe that public money has not been applied lawfully and in an effective way.

### **Basis for Qualified Opinion**

#### **1. Financial Performance**

As previously reported, the statement of financial performance for the year ended 30 June 2017 reflects a net loss of Kshs.100,648,607. This results to a cumulative retained deficit of Kshs.289,588,221. In addition, the statement of financial position reflects total current liabilities of Kshs.487,559,071 which exceeds the total current assets balance of Kshs.215,964,072, resulting to a negative working capital of Kshs.271,594,999, an indication that the Company may be experiencing financial difficulties in settling financial obligations as and when they may fall due. The Company's financial statements have therefore been prepared on the going-concern basis which assumes continued financial support from the Government, bankers and creditors.

#### **2. Property Plant and Equipment**

As previously reported, the statement of financial position as at 30 June 2017 reflects property, plant and equipment balance of Kshs.68,728,599. However, included in the balance is an amount of Kshs.31,861,567 representing leased assets from Coast Water Services Board. The Company neither availed ownership documents for these assets or professional valuation reports to support the values assigned to these assets.

Consequently, it has not been possible to ascertain the accuracy, valuation and ownership of property, plant and equipment balance of Kshs.31,861,567.

### **3. Non-Current Receivables**

As reported previously, note 7 to the financial statements reflects non-current receivables balance of Kshs.57,134,125 as at 30 June 2017. This is in respect of debtors' balances inherited from Coast Water Services Board at the inception of the Company. However, no documentary evidence was availed for audit review in support of this figure.

As a result, the completeness and recoverability of non-current receivable amounting to Kshs.57,134,125 could not be confirmed.

### **4. Share Capital Receivable**

As previously reported and disclosed in Note 10 to the financial statements for the year ended 30 June 2017, the Company's authorized share capital stood at Kshs.5,000,000 divided into 5,000 shares of Kshs.1,000 each, all issued to County Government of Kilifi but which had not been paid for as at 30 June 2017. During this audit, the same remains outstanding.

In the circumstances, it was not possible to confirm whether or not the subscribers are desirous of having the Company meet its objectives as outlined in the Memorandum and Articles of Association of the Company.

### **5. Delegated Works**

As previously reported, the statement of financial position as at 30 June 2017 reflects a balance of Kshs.18,313,354 in respect of delegated works carried out at various sites by the Company on behalf of Coast Water Services Board. However, records available from the Board do not reflect these debts. Any provision that would have been necessary in relation to this uncertainty has not been incorporated in these financial statements to date.

Consequently, the accuracy and validity of Kshs.18,313,354 in respect of delegated works carried out could not be ascertained.

### **6. Customer Deposit Receivable**

As previously reported, Note 11 to the financial statements for the year ended 30 June 2017 reflects customer deposit receivable amount of Kshs.8,443,600. These were deposits for the existing customers which were taken over from Coast Water Services Board when the company was incorporated. However, no schedule was availed for audit review to support this figure during the audit.

Consequently, the accuracy and validity of customer deposit receivable amount of Kshs.8,443,600 could not be ascertained.

## **7. Trade and Other Payables**

Note 19 to the financial statements for the year ended 30 June 2017 reflects trade and other payable balance of Kshs.413,561,785. Included in this figure is trade payables amount of Kshs.409,826,922 which has an amount of Kshs.376,374,074 due to Coast Water Services Board. However, records and financial statements for Coast Water Services Board as at 30 June 2017 reflect an amount of Kshs.466,207,577 as due from the Company resulting to an unreconciled and an unexplained variance of Kshs.89,833,503. In addition, records availed for audit by Coast Water Services Board (CWSB) indicated that Kshs.126,369,204 was received from Malindi Water Company (MAWASCO) for the financial year ended 30 June 2017 whereas the records from the MAWASCO indicated that the company paid Kshs.120,465,454 to CWSB resulting to an unreconciled overpayment of Kshs.5,903,750.

Further, schedule to support tax payable balance of Kshs.3,734,863 was not availed for audit verification.

Consequently, the accuracy and validity of trade and other payables balance of Kshs.413,561,785 could not be confirmed.

## **8. Non-Revenue Water**

During the year under review, the company produced a total of 6,961,564 cubic meters of water. However, a total of 4,825,782 cubic meters was billed to customers resulting to Non-Revenue Water (NRW) of 2,135,782 cubic meters or 31%. The allowable NRW rate according to Water Service Regulatory Board (WASREB) guidelines is 25% resulting to 6% over and above the allowable rate. Therefore, the unallowable 6% or 395,391 cubic meters of water may have resulted to the Non-Revenue Water (NRW) loss of water sales estimated at Kshs.28,970,299 at a rate of Kshs.73.27 per cubic metre.

This significant level of NRW may negatively impact on the Company's profitability and is a risk to sustainability of its operations.

## **9. Operating Costs**

### **9.1. Directors Emoluments**

The statement of financial performance reflects operating costs of Kshs.99,361,040. Included in this figure is directors' emoluments of Kshs.5,974,373 which includes Kshs.2,312,000 paid as committee sitting allowance. Analysis of sitting allowance payment register and vouchers availed for audit indicated that four (4) directors whose term of office had lapsed were irregularly paid Kshs.1,672,000 as sitting allowance for attending board meetings. According to the Memorandum and Articles of Association of the Company, Section 58(1) (i) and (ii), one third of the directors are supposed to retire in every annual general meeting and new directors appointed. Four (4) directors had served the Company for more than two (2) terms and as such, they were in the office illegally.

Further, two (2) directors appointed by the County Government of Kilifi to the Board were irregularly paid Kshs.620,000 as sitting allowance for attending board meetings since they were employees of the County Government.

In addition, the payments were being paid in cash with the main cashier withdrawing funds for the directors to sign cash payment schedules instead of using cheque or bank transfer.

Consequently, the propriety and validity of directors' emoluments of Kshs.5,974,373 for the year ended 30 June 2017 could not be ascertained.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Malindi Water and Sewerage Company in accordance with ISSAI 30 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with the ISSAI and in accordance with other ethical requirements applicable to performing audits of financial statements in Kenya. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified opinion.

### **Key Audit Matters**

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

### **Other Matter**

#### **1.0. Budgetary Control and Performance**

#### **1.1. Revenue Budget**

During the year under review, the Company's revenue budget was Kshs.447,649,943 against actual collections of Kshs.375,300,271 or 84%, thus resulting to under collection of Kshs.72,349,672 or 16% of the budget as detailed below:

Item	Budgeted Amount for 2016/2017 (Kshs)	Actual Amount Collected for 2016/2017 (Kshs)	Under Collection in Kshs	Under Collection in %
Water Sales	414,449,943	350,507,034	(63,942,909)	-15%
Meter Rent	12,500,000	11,981,245	(518,755)	-4%
Donation in Kind	3,700,000	3,233,136	(466,864)	-13%
Sale of tender documents	2,000,000	-	(2,000,000)	-100%
Miscellaneous Receipts	15,000,000	9,578,856	(5,421,144)	-36%
<b>Total</b>	<b>447,649,943</b>	<b>375,300,271</b>	<b>(72,349,672)</b>	<b>-16%</b>

It is clear from the above table that all revenue targets were not achieved.

## 1.2. Expenditure Budget

During the year under review, the Company had budgeted to spend a total of Kshs.447,649,943 on its various programs and activities. However, it spent Kshs.269,499,148, resulting to an overall under expenditure of Kshs.178,150,795 or 40% as summarized below:

Detail	Final Budget Kshs	Actual Kshs	Under Absorption Kshs	Over Absorption Kshs	%
Advertising, printing, stationery and photocopying	6,240,000	4,394,386	1,845,614		30%
Auditors' remuneration	680,000	644,828	35,172		5%
Bank charges and commissions	790,000	884,848		(94848)	-12%
Communication services and supplies	7,190,000	7,615,610		(425610)	-6%
Consultancy fees	205,000	144,800	60,200		29%
Directors' emoluments - Note 5 (a)	6,100,000	5,974,373	125,627		2%
Electricity and water	2,100,000	2,290,898		(190898)	-9%
Hospitality supplies and services	4,210,000	4,979,603		(769603)	-18%
Insurance costs	1,680,000	1,496,370	183,630		11%
Legal fees	1,000,000	140,000	860,000		86%
Minor works improvements	0	17,168,208		(17168208)	100%

Office and general supplies and services	15,150,000	15,223,844		(73844)	0%
Other operating expenses	160,630,956	6,425,553	154,205,403		96%
Rent expenses	360,000	240,000	120,000		33%
Repairs and maintenance	38,090,000	17,760,546	20,329,454		53%
Staff costs - note 5 (b)	159,053,987	162,853,979		(3799992)	-2%
Staff training expenses	2,050,000	2,087,887		(37887)	-2%
Transportation, travelling and subsistence	11,410,000	11,889,285		(479285)	-4%
Corporate Social Responsibility	710,000	0	710,000		100%
<b>Total Operation and Maintenance Expenditure</b>	<b>417,649,943</b>	<b>262,215,019</b>	<b>178,475,100</b>	<b>(23,040,175)</b>	<b>43%</b>
Buildings and civil works	10,000,000	670,683	9,329,317		93%
Plant and Machinery	10,000,000	4,453,445	5,546,555		55%
Motor vehicles including motor cycles	5,000,000	15,190	4,984,810		100%
Computers and related equipment	2,500,000	1,856,660	643,340		26%
Office equipment furniture and fittings	2,500,000	288,151	2,211,849		88%
<b>Total Investment Expenditure</b>	<b>30,000,000</b>	<b>7,284,129</b>	<b>22,715,871</b>		<b>76%</b>
<b>Total</b>	<b>447,649,943</b>	<b>269,499,148</b>	<b>201,190,971</b>	<b>(23,040,175)</b>	

The management has not provided satisfactory explanation for the failure to utilize all approved budgetary provisions of Kshs.201,499,148 or 45%. Underutilization of budget results in non-implementation of planned activities and programs to the detriment of the Company and other stakeholders. Further, approval for the over expenditure of Kshs.23,040,175 or 5% of the budget was not availed for audit review.

### **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 (IFRS) 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 to sustain its services, disclosing, as applicable, matters related to sustainability of services and using the applicable basis of accounting.

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 of Kenya. 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 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 offering services. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit report. However, future events or conditions may cause the Board to cease to continue offering 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 of the entities or business activities 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 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 the audit,
- ii. In my opinion, proper books of accounts have been kept by the Company, so far as appears from my examination of those books and,
- iii. The Company's statements of financial position and statement of financial performance are in agreement with the books of account.



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

**Nairobi**

**05 July 2018**