

# **REPORT OF THE AUDITOR-GENERAL ON MERU COUNTY ALCOHOLIC DRINKS CONTROL BOARD FOR THE YEAR ENDED 30 JUNE 2017**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Adverse Opinion**

I have audited the accompanying financial statements of Meru County Alcoholic Drinks Control Board set out on pages 11 to 28, 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 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 Meru County Alcoholic Drinks Control Board as at 30 June 2017, and of its financial performance and its cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (Accrual Basis) and comply with the Public Finance Management Act, 2012 and the Meru County Alcoholic Drinks Control Act, 2016.

### **Basis for Adverse Opinion**

#### **1.0 Accuracy of the Financial Statements**

##### **1.1 Bank Balances**

Note 9 to the financial statements reflects Kshs.11,347,162 in respect of cash and cash balance as at 30 June 2017 comprising Kshs.6,494,084 and Kshs.4,853,078 held in a family bank account and co-operative bank respectively. However, the cash book for the co-operative bank account was not availed for audit review while the cash book for the family bank account had not been balanced.

Further, no bank reconciliation statements were availed for audit review.

In the circumstances, the validity, accuracy and completeness of the cash and cash equivalents balance of Kshs.11,347,162 as at 30 June 2017 could not be confirmed.

##### **1.2 Opening Balance of Cash and Cash Equivalents**

Note 8 to the financial statements reflects Kshs.12,673,080 in respect to the comparative 2015/2016 financial year cash and cash equivalents balance. However, the audited 2015/2016 financial statements reflected a closing balance of Kshs.12,750,323 resulting to an unexplained and unreconciled variance of Kshs.77,243.

In the circumstances, the validity, accuracy and completeness of the opening cash and cash equivalents balance of Kshs.12,673,080 as at 30 June, 2017 could not be confirmed.

### **1.3 Net Assets**

The statement of changes in net assets and the statement of financial position reflects Kshs.16,221,387 and Kshs.12,562,506 in respect of net assets as at 30 June 2017 respectively resulting to an unexplained and unreconciled variance of Kshs.3,658,881 which has resulted in an imbalanced of the statement of financial position by the same amount.

In the circumstances, the validity, accuracy and completeness of the financial statements balances for the year under review could not be ascertained.

### **2.0 Revenue Customer Ledgers**

Note 1 to the financial statements reflects Kshs.50,180,320 in respect to income from liquor licensing for the year ended 30 June 2017. However, the revenue cash book and ledgers for the period under review were not availed for audit verification.

In the circumstances, the validity, accuracy and completeness of the Kshs.50,180,320 revenues for the year ended 30 June 2017 could not be confirmed.

### **3.0 Unaccounted Expenditure**

#### **3.1 Training**

Note 7 to the financial statements reflects Kshs.31,065,577 in respect to general expenses which includes Kshs.3,921,300 for training which further includes Kshs.2,743,000 in respect to training and undertaking public awareness on abuse of alcoholic drinks for the year ended 30 June 2017.

However, no evidence was availed for audit review that the training need assessments was done to ascertain the areas of training priority. Further, travelling details to show how the officers got to the training centres, attendance registers / schedules, training programmes, public notices were not availed for audit.

In the circumstances, the propriety and value for money for the Kshs.2,743,000 expenditure for the year ended 30 June 2017 could not be confirmed.

#### **3.2 Consultancy Services to Conduct Governors Business Challenge**

Note 7 to the financial statements reflects Kshs.31,065,577 in respect to general expenses which includes Kshs.16,940,265 for consultancy services to conduct business challenges study (Governors Business Challenge) for the year ended 30 June 2017 which further includes Kshs.5,732,759 paid to a consultancy firm. The amount related to the

second installment of payment on consultancy services to conduct Governors Business Challenge study through the Board for a contract sum of Kshs.19,000,000 awarded in the previous period.

However, the contract was terminated on 20 June 2017 and the consulting firm ordered to refund Kshs.5,732,759 but at closure of audit exercise in December 2018, there was no evidence availed for audit review to show that the amount had been refunded. Further, the firm had received part payment of Kshs.6,112,553 in the previous year which also ought to have been refunded as it had no value for money. In addition, the Kshs.6,112,553 has not been reflected as a comparative balance under Governors Business Challenge item in the year under review.

In the circumstances, the accountability and value for money for the Kshs.5,732,759 expenditure for the year ended 30 June 2017 and Kshs.6,112,553 for the period ended 30 June 2016 could not be confirmed.

### **3.3 Other Expenses**

Note 7 to the financial statements reflects Kshs.31,065,577 in respect to general expenses which includes Kshs.1,104,705 for other expenses for the year ended 30 June 2017.

However, no supporting documentation such as ledgers, local purchase orders (LPOs), payment vouchers, invoices and delivery notes were not availed for audit review.

In the circumstances, the accountability and value for money for the Kshs.1,104,705 expenditures for the year ended 30 June 2017 could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Meru County Alcoholic Drinks Control Board 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 Omission of Details and Statements in the Financial Statements**

The financial statements for the year under review did not include the statement of comparison of budget and actual amounts as prescribed by the International Public Sector Accounting Standards Board (PSASB).

Further, the statement of directors' responsibilities included in the financial statements is not signed by directors contrary to the requirement of PSASB that signing of statement of directors' responsibilities be done by at least two directors.

In the circumstances, the presentation of the financial statements for the year under review was not in accordance with the prescribed accounting standards.

## 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 Conclusion on Lawfulness and Effectiveness in Use of Public Resources section 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 Late Submission of Financial Statements

The financial statements for the year under review were submitted for review on 18 May 2018 which is over eight (08) months after the constitutional deadline. This is contrary to Section 164(4) (a) of the Public Finance Management Act, 2012 and Section 47(1) of the Public Audit Act 2015 which requires entity's accounting officer to submit the entity's financial statements to the Auditor – General within three months after the end of each financial year. In addition, Section 11 of the Meru County Alcoholic Drinks Control Board Act, 2016 requires the Board to submit the accounts of the corporation to the Auditor-General within three months after the end of each financial year.

In the circumstance, the Board is in breach of the law.

#### 2.0 Human Resource

##### 2.1 Ethnicity

An analysis of ethnic composition of 20 employees of the Meru County Alcoholic Control Board in the period under review revealed that all (100%) workforce was from the dominant ethnic community in the county contrary to Section 65 (e) of County Government Act No. 17 of 2012 which requires the County Public Service Board to ensure that at least thirty percent of the vacant posts at entry level are filled by candidates who are not from the dominant ethnic community in the county.

In the circumstance, the Board is in breach of the law.

## **2.2 Payroll Deductions Below Statutory Requirements**

A review of the Board's payroll performance for the year under review revealed that in the month of June, 2017, one (1) employee's net pay fell below 1/3 of the basic salary contrary to Section 19 (3) of the Employment Act No. 17 of 2007 which advocates that at any one time deductions done by employer on employee's earnings shall not exceed two thirds.

In the circumstance, the Board is in breach of the law.

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 Conclusion on Effectiveness of Internal Controls, Risk Management and Governance section of my report, based on the audit procedures performed, I confirm that internal controls, risk management and governance were not effective.

### **Basis for Conclusion**

#### **1.0 Failure to Establish an Audit Committee**

The Board did not have an audit committee in place, contrary to Section 167 (1) of the Public finance management (County Governments) regulations 2015 which states that each county government entity shall establish an audit committee. Lack of an Audit Committee inhibits effective internal control as it distorts the reporting structure of the Internal Audit Department including action on the internal audit reports.

In the circumstances, the Board is in breach of law.

#### **2.0 Non Establishment of an Internal Audit Department**

During the financial year under review, the Board did not have internal audit unit Contrary to Section 155 of the Public Finance Management Act, 2015, which states that a County

Government entity shall ensure that it complies with this Act by instituting appropriate arrangements for conducting internal audit according to the guidelines issued by the Accounting Standards Board.

In the absence of an internal audit department, the reliability of the internal control system cannot be ascertained and consequently the risk of misappropriation of public resources entrusted to the Board is high.

In the circumstances, the effectiveness of internal controls, risk management and governance during the year under review could not be confirmed.

### **3.0 Bank Accounts Signatories**

The Meru County Alcoholic Drinks Control Board has three signatories to the bank - the board's chairman, the chief executive and an accountant for two bank accounts for the year ended 30 June 2017. However, the Board's chairman and the accountant were not full time employees of the Board hence there was inherent delays in operations of the Board.

In the circumstances, the two signatories created a weakness in the internal controls in relation to timely processing of payments for the year ended 30 June 2017.

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 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 those charged with Governance**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Public Sector Accounting Standards (Accrual Basis) 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.

In preparing the financial statements, management is responsible for assessing the Board's ability to continue to sustain its services, disclosing, as applicable, matters related to sustainability of services and using the applicable basis of accounting unless the management either intends to liquidate the Board's or to cease operations, or have no realistic alternative but to do so.

Management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 47 of the Public Audit Act, 2015.

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.

Those charged with governance are responsible for overseeing the Board'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 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 Board's 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 Board'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 the Board 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 the Board 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.

A handwritten signature in black ink, appearing to read 'E. O. Ouko', with a stylized flourish at the end.

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

**Nairobi**

**09 April 2109**