

REPORT OF THE AUDITOR-GENERAL ON NAIROBI CITY WATER AND SEWERAGE COMPANY LTD FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Nairobi City Water and Sewerage Company Ltd set out on pages 14 to 41, which comprise the statement of financial position as at 30 June 2018, and the statement of comprehensive income, statement of changes in equity and 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, except for the effects of the matters described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respects, the financial position of Nairobi City Water and Sewerage Company Ltd 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 comply with the Kenyan Companies Act, 2015.

Basis for Qualified Opinion

1. Failure to Disclose Material Uncertainty in Relation to Going Concern

During the financial year ended 30 June 2018, the Company recorded a net operating loss of Kshs.634,895,405 (2017: a net operating loss of Kshs.295,911,7498), which depleted further the revenue reserve from negative Kshs.3,005,132,991 as at 30 June 2017 to negative Kshs.4,524,091,163 as at 30 June 2018. The current liabilities balance of Kshs.4,536,415,303 exceeded the current assets balance of Kshs.3,167,964,349 and thus, resulting in a negative working capital of Kshs.1,368,450,954 as at 30 June 2018.

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

2. Trade and Other Receivables

The statement of financial position reflects a net balance of Kshs.2,510,067,254 against trade and other receivables as at 30 June 2018. The balance includes long outstanding trade receivables amounting to Kshs.549,615,629.06 as shown below:

Account	Amounts Kshs
KRA receivable	478,001,144.53
IDA receivable	5,935,309.00
Postal Corporation of Kenya	64,069,175.53
EACC	350,000.00
Other receivables	1,260,000.00
Totals	549,615,629.06

Although specific provisions have been made for all known doubtful debts, recoverability of the above amounts in full appear to be uncertain given that they been outstanding for more than one year.

Further, in the audit report for 2016/2017 reference was made to the amount of Kshs.478,001,144.53 due from KRA in respect of claims receivable on unassessed lodgements. No explanations were provided for failure to resolve this matter with KRA in the year under review.

3. Amounts Due to Related Parties

The statement of financial position as at 30 June 2018 reflects under current liabilities and non-current liabilities balances of Kshs.1,146,615,016 and Kshs.3,619,665,878 in respect of amounts due to related parties. As disclosed in Note 25 to the financial statements the amounts were due to Athi Water Services Board(AWSB) for lease fee as at 30 June 2018.

Although the management explained that lease fee was based on an arbitrary figure during tariff settings by AWSB, the lease agreement was not provided audit review and therefore, the basis upon which lease fee was determined could not be ascertained.

4. Property, Plant and Equipment

4.1. Water Infrastructure Assets

The statement of financial position reflects property, plant and equipment balance of Kshs.2,949,972,964 as at 30 June 2018. The balance includes buildings, plant and machinery, and equipment valued at Kshs.63,790,389, Kshs.586,591,708 and Kshs.224,595,626, respectively comprising improvements to the water and sewerage transmission works and other infrastructure belonging to the defunct Nairobi City Council, but otherwise assigned to the Nairobi City Water and Sewerage Company Limited. However, the parcels of land including dams on which the expansion and improvements had been carried out have not been disclosed or reflected in the financial statements under review.

The audit also revealed that some other water infrastructure assets of undetermined values including land, dams, water pipelines, sewer system and water treatment plants owned by

the Nairobi City Water and Sewerage Company Limited and used in revenue generation have not been disclosed or included in the financial statements.

4.2. Encroachment on Company's Land.

As previously indicated in the audit report for 2016/2017, various parcels of land belonging to the Company meant for expansion, storage, water and sewerage treatment works have been encroached on by private developers. The affected parcels of land include:

- (i) Loresho water reservoir (Nairobi Block 90/587) which was subdivided into six sub plots-block 90/596 (currently where the reservoir is located), 90/591, 90/592, 90/593, 90/594 and 90/595. The five blocks were subsequently transferred and issued out to new owners. This was irregular as the original block of land was reserved for future water works expansion.
- (ii) Kariobangi North Sewerage and treatment works, where the land was allocated to several groups including Kariobangi Sewage Farmers Self-help Group, Provincial Administration (chief's camp), Our Lady of Fatima Secondary School, Alice Nursing Homes and Kariobangi Catholic Church for Polytechnic construction. Records relating to allocation, survey and subdivision of the land have, however, to date not been made available for audit review. Consequently, the purported subdivision and allocation can still not be verified.
- (iii) Encroachment on LR No.13119/2 –Booster Station II. The parcel of land is situated off Kabete Road where water from Ruiru Dam is pumped into Kabete treatment works for redistribution. Information available indicate that a complaint had been lodged by the Company in June 2007 concerning the encroachment. However, records of the land have still not been made available for audit review. Consequently, the status of resolution on the reported encroachment cannot be established.
- (iv) Ruiru Dam - Kabete pipeline transmission has been encroached at Good Shepherd and Kiangima area. The structures under construction have been erected on top of 16” and 24” pipes at AV (Air Valve) number 42 (Good Shepherd area), 9”, 12” and 24” pipes between wash out 38 and AV(Air Valve) number 38 (Kiangima area).

In view of the circumstances described above, the completeness, accuracy and ownership of property, plant and equipment balance of Kshs. 2,949,972,964 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 Nairobi City 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 judgment, are of most significance in the audit of the financial statements. Except for the matters described in the Basis for Qualified Opinion and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and Effectiveness of Internal Controls, Risk Management and Governance sections, I have determined that there are no Key Audit Matters to communicate in my report.

Other Information

The directors are responsible for the other information. The other information comprises the report of directors as required by the Companies Act, 2015, and the statement of the directors' responsibilities which are obtained prior to the date of this report, and the annual report which is expected to be made available after that date.

My opinion on the financial statements does not cover the other information and I do not express an audit opinion or any form of assurance thereon.

In connection with the audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or the knowledge obtained in the audit, or otherwise appears to be materially misstated. Based on the work I have performed on the other information obtained prior to the date of this auditor's report, if I conclude that there is material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229(6) of the Constitution, based on the audit procedures performed, except for the matters described in the Basis for Qualified Opinion and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and Effectiveness of Internal Controls, Risk Management and Governance sections 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. Budget Performance - Under Collection of Revenue

During the financial year ended 30 June 2018, Nairobi City Water and Sewerage Company Ltd had an approved budget of Kshs.10,761,000,000 for operating revenue. The statement of comprehensive income for the year ended 30 June 2018, however, reflects an operating income of Kshs.8,478,139,252. This implies that an amount of Kshs.2,282,860,748 or 21%

of the budgeted revenue was not realized, an indication that the Company did not use the public resources at its disposal efficiently and effectively to collect the revenue.

2. Budget Performance - Under Absorption of Capital Expenditure Budget

During the financial year ended 30 June 2018, Nairobi City Water and Sewerage Company Ltd had an approved budget of Kshs.16,339,360,000 comprising of operating expenditure of Kshs.9,927,866,000 and capital expenditure of Kshs.6,471,494,000. Although the statement of comprehensive income for the year under review reflects operating including finance costs totalling Kshs.9,113,034,657 or a 92% budget absorption, the assets movement schedule reflects additions of Kshs.1,030,262,148 only on capital expenditure. The latter situation therefore means that only 16% of the capital expenditure budget was absorbed. Failure to execute 84% (Kshs.5,441,231,852) of the capital expenditure budget resulted in an ineffective delivery of water and sewerage services to the resident of Nairobi City County.

3. Non-Revenue Water

During the year under review, the Company produced a total volume of 172,767,812 cubic meters (m3) of water. Out of this volume, 106,803,022 cubic meters (m3) was billed to customers. The balance of 65,964,740 cubic meters or approximately 38% of the total volume produced represented Non-Revenue Water (Unaccounted for Water). The Non-Revenue Water is 13% over and above the allowable loss of 25% as provided for in the Water Services Regulatory Board guidelines.

4. Gap Detections on Revenue Generated through the Customer Management System

The Company's revenue data is generated through a Customer Management System. An analysis of the data generated through the system revealed several gaps in the system generated bill numbers contrary to Section 2.4.1. of the Nairobi City Water and Sewerage Company Ltd Commercial Operations Policy,2015. A summary of the missing gaps is as shown in the table below:

Gap Detection Summary	
Month	Missing Records/ Amount Kshs
July 2017	1,039,838
August 2017	845,199
September 2017	1,028,848

October 2017	978,736
November 2017	951,760
December 2017	1,224,785
January 2018	1,316,485
February 2018	1,176,441
March 2018	1,337,200
April 2018	1,143,868
May 2018	1,567,343
June 2018	1,061,161
Total	13,671,664

5. Construction Projects

5.1. Kasarani Sports View Sewer Reticulation

Nairobi City Water and Sewerage Company awarded a tender no. NCWSC/24/2013 for Kasarani Sports View Sewer Reticulation to a contractor at Kshs.24,523,677.51. The scope of the works involved construction of DN 225 sewerage reticulation 1300m within Kasarani Sports Drive estate near ICIPE.

The works started on 27 February 2014 and were due for completion within 153 calendar days from the commencement of the project. In October 2014, the contractor abandoned the site and gave a go ahead to the Company to terminate the contract citing unavoidable circumstances. The contract was terminated on 16 October 2018 vide letter Ref No. NCWSC/SCD/24/13/Vol.III/5584/BKK/rbm.

The engineer's report on the status of the project dated 28 July 2016 shows that the contractor had been paid Kshs. 13,860,545.94 which was 56.52% of the contract sum. The engineers' report also indicated the project to have been abandoned at 74% completion level.

Audit inspection of the project on 5 February 2019 revealed anomalies as follows:

- (i) There had been no activity on site after the contractor abandoned the project.
- (ii) Works had been left in a deplorable condition with gaping manholes, open trenches which posed danger to residents
- (iii) The Company had not recovered liquidated damages after termination of the contract.

Consequently, it was not possible to ascertain that value for money had been realized in respect of the expenditure of Kshs. 13,860,545.94 incurred on the project.

5.2. Proposed Sewer Extension in Utawala Area

Nairobi City Water and Sewerage Company awarded a tender no. NCWSC/41/2015 for Sewer Extension in Utawala to a contractor at Kshs. 144,075,079. The scope of the works involved DN225-450 sewer extension to Serve Utawala Estate, AP&GSU training Schools.

The works started on 26 September 2016 and were due for completion on 30 April 2018. However, the contractor suspended works on 5 March 2018 due to non-payment. A status report dated 30 June 2018 shows that the contractor had been paid Kshs.33,884,674.81 with unpaid certificates amounting to Kshs.40,328,902.50. The project was had been done 55% at the time the contractor suspended works.

Audit revealed that the performance bond of Kshs.14,475,017 issued by CFC Stanbic Bank expired on 12 Nov 2017. Consequently, clause 28 of the Condition of Contracts regarding submission of a valid performance bond security became inoperative. It was valid for 573 days from 19 April 2016 to 12 Nov 2017. However, the Contractor continued with works until 5 March 2018 when he suspended works due to non-payment of certificates.

Further, the Company may incur extra cost in payment of accrued interest of Kshs.1,628,634 due to delayed payment of certified works.

6. Termination of Directors' Contracts

Examination of human resource records revealed that the management terminated contracts of three functional directors vide termination letters dated 17 August 2017 contrary to the employment Act 2007 Section 45 (1) and (2). The three directors were in charge of Commercial Services, Human Resource and Administrative Services and Finance and Strategy. The three filed law suits at the Employment and Labor Relations Court under ELRC No 1726 of 2017, Petition No 32 of 2018 and Petition No. 118 of 2018, respectively upon termination of their contracts. The ruling of one of the cases- ELRC No. 1726 was delivered on 13 November 2017 which quashed his dismissal and reinstated him. Alternatively, he was to be paid for the full contract ending 11 September 2017 and for the full contract term commencing 11 September 2017. The other two cases are still pending in court.

The claims by the three directors amounting to Kshs.186,204,338.60 is as tabulated below:

Director In-charge of	Claims Kshs
Commercial Services	53,757,039.00
HR & Administrative Services	70,299,083.60
Finance & Strategy services	62,148,216.00
Total	186,204,338.60

In addition, the Company incurred expenditure totalling Kshs.484,400 in respect of legal fees as per the internal memo from legal department dated 8 October 2017-Ref LEG/394/2017.

7. Payment of Allowances to Nairobi City County Assembly Members

Examination of expenditure documents revealed that a total of Kshs.33,264,115 was irregularly paid to members of the county assembly in form of allowances to carry out legislative and oversight duties. In addition, the Company did not provide any authority to support payment of the allowances to members of the county assembly.

8. Employees in Acting Positions for More Than Six months

Examination of the expenditure and the human resource records revealed that, several employees have been in an acting capacity for the period exceeding six months contrary the Company's Human Resource Policy as indicated below:

P/F No	Acting Appointment Date	Confirmed Date	No. of Days in Acting Capacity
02675	05/09/2016	1/08/2017	1 year
02807	16/08/2016	1/08/2017	1 year
02615	16/08/2016	1/08/2017	1 year
08939	17/08/2017	None	1 year 6 months
18693	17/08/2017	None	1 year 6 months
17289	02/03/2018	None	11 months
13200	18/08/2017	None	1 year 5 months
19402	18/08/2017	None	1 year 5 months
18888	12/02/2016	None	1 year 11 months
09059	01/12/2015	None	3 years
01903	02/03/2017	None	1 year 9 months

9. Non-Payment of Audit fees

Trade and other payables balance of Kshs.2,845,143,931 as at 30 June 2018 includes outstanding audit fees balance of Kshs.25,951,293 that has accumulated for seven years contrary to the requirement of Section 41 (c) of the Public Audit Act, 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 Qualified Opinion and Basis for Conclusions on Lawfulness and Effectiveness in Use of Public Resources and Effectiveness of Internal Controls, Risk Management and Governance sections of my report, I confirm that, nothing else has come to my attention to cause me to believe that internal controls, risk management and governance were not effective.

Basis for Conclusion

1. Non-existence of Board of Directors

Examination of records relating to the Company's governance revealed that the board of directors' operations were suspended vide the letter ref: NCC/CS/LOM/1067/2017 dated 27 September 2017. As a result, there has been lack of formulation of the Company's new policies, procedures and execution of the functions of the board contrary to section 79(1), Water Act 2016.

The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. The standards require that I plan and perform the audit to obtain assurance about whether processes and systems of internal control, risk management and governance were operating effectively, in all material respects. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Kenyan Companies Act, 2015 I report based on the audit, that:

- (i) I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of my audit;
- (ii) In my opinion, proper books of account have been kept by the Company, so far as appears from the examination of those books;
- (iii) The Company's statement of financial position and statement of comprehensive income are in agreement with books of account; and
- (iv) In my opinion the information given in the report of the directors on pages 5 and 6, is consistent with the financial statements.

Responsibilities of Directors and Those Charged with Governance

The directors are responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for maintaining effective internal control as directors determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error and for its assessment of the effectiveness of internal control, risk management and governance.

In preparing the financial statements, the directors are responsible for assessing the ability of Nairobi City Water and Sewerage Company Ltd to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intends to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

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

In addition to the responsibility for the preparation and presentation of the financial statements described above, the directors are also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them, and that public resources are applied in an effective way.

Those charged with governance are responsible for overseeing the Nairobi City Water and Sewerage Company Ltd 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 Nairobi City Water and Sewerage Company Limited policies and procedures may deteriorate.

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.
- Conclude on the appropriateness of the directors use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the ability of Nairobi City Water and Sewerage Company Ltd to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit report. However, future events or conditions may cause the Company to cease to continue as a going concern 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 Nairobi City Water and Sewerage Company Ltd to express an opinion on the financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

I communicate with the directors regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that are identified during the audit.

I also provide the directors with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.



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

Nairobi

24 April 2019