

REPORT OF THE AUDITOR-GENERAL ON NATIONAL ENVIRONMENT TRUST FUND FOR THE YEAR ENDED 30 JUNE 2017

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of National Environment Trust Fund set out on pages 1 to 30, 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 flow and the statement of comparative 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 National Environment Trust Fund 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 Environment Management Coordination Act, 1999.

In addition, as required by Article 229(6) of the Constitution, except for the matters described in the Other Matter section, based on the procedures performed, I confirm that, 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. Property Plant and Equipment (PPE)

The statement of financial position reflects property, plant and equipment (PPE) balance of Kshs.10,101,122 as at 30 June 2017. In addition, Note 21 to financial statements reflects Property, Plant and Equipment additions during the year amounting to Kshs.475,380 which relate to additional furniture, fittings and equipment. However, IPAD tablets worth Kshs.388,600 procured during the year under review were not recognized in the fixed asset register as additions, hence understating the netbook value at year end. Further, the IPADS were in the custody of the outgoing board members.

Further, note 21 includes disclosure of two motor vehicles that are fully depreciated, still in use and in good condition thus the Fund has not dealt with review of economic useful lives of assets that are still in use though fully depreciated and write-offs of assets no longer in use.

Consequently, it has not been possible to confirm the accuracy and completeness of property, plant and equipment balance of kshs.10,101,122 as at 30 June 2017.

2. Unsupported Employees Costs

The statement of financial performance reflects employee costs of Kshs.92,746,565 for the year ended 30 June 2017. Included in this amount is Kshs.18,404,524 relating to gratuity payments to employees. However, no provision for gratuity was provided as short term liability that is due to be settled within 12 months after the reporting date contrary to the requirements of IPSAS 1.

In addition, the amount also includes Kshs.761,840 relating to commutation of leave days' by employees for the year under consideration. However, the amount was not supported by a summary of accrued leave days, leave days paid during the year and long outstanding leave days.

Further, the employee costs of Kshs.92,746,565 in statement of financial performance differ with the figure of Kshs.93,909,960 in cash flow statement resulting to an unexplained and unreconciled variance of Kshs.1,163,395.

Consequently, it has not been possible to confirm the accuracy and completeness of the employees' costs of kshs.92,746,565 as at 30 June 2017.

3. Long Outstanding Trade and Other Payables from Exchange Transactions

The statement of financial position reflects trade and Other payables balance of Kshs.13,977,966 as at 30 June 2017 whileas note 23 to the financial statements reflects trade payables balance of Kshs 8,809,507 as at 30 June 2017. The balance increased from Kshs 5,715,082 in the previous year representing an increase of Kshs.3,094,515 or 54%. No explanation was provided on the cause of the increase. In addition, analysis of the trade payables indicated long outstanding trade payables from year 2012 amounting to Kshs.3,261,135.

Further, the note also reflects other payables relating to PAYE, gratuity and other deductions from the salary amounting to Kshs.5,125,871 as at 30 June 2017. Included in this figure is a PAYE amount of Kshs.2,145,159 which had been outstanding for one year. The Fund is therefore in breach of the Income Tax Act, Cap 470 and is likely to incur penalties and interest as a result of non-payment of the tax.

In view of the foregoing, it has not been possible to confirm the accuracy, validity and completeness of trade and other payables from exchange transactions of Kshs.13,977,966 as at 30 June 2017.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of National Environment Trust Fund 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. These matters were addressed in the context of the audit of the financial statements, and in forming my opinion thereon, and I do not provide a separate opinion on these matters. For each matter below, a description of how the audit addressed the matter is provided in that context.

I have fulfilled the responsibilities described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of the report, including in relation to these matters. Accordingly, the audit included the performance of procedures designed to respond to the assessment of the risks of material misstatement of the financial statements. The results of the audit procedures, including the procedures performed to address the matters below, provide the basis for my audit opinion on the accompanying financial statements.

No.	Key Audit Matter	How the Audit Addressed the Key Audit Matter
1	Project Costs	
	<p>The statement of financial performance indicates that during the year ended 30 June 2017, the Fund expended Kshs.87,509,578 as project costs to support:</p> <ul style="list-style-type: none"> • Eleven projects that been up scaling their initiatives in various parts of the country; • 36 projects under the pre-incubation phase to establish technical and market viability. • 3 projects under the Green Growth initiative • Micro, Small & Medium Enterprises (MSMEs) under the Green Enterprise Programme (NETGEP) to enhance access to financial resources through affordable credit facilities. <p>The fund transfers money directly to the projects located in different parts of the country to implement their activities. We considered this to be a key audit matter since these are transfer payments and accountability for the funds was not possible due to lack of documents to support implementation of the projects activities. There is a risk therefore of fraudulent transfers being made to projects, non-implementation of projects and poor monitoring of the projects activities.</p>	<ul style="list-style-type: none"> • Inspected the transaction-level detail of ledger accounts for each expense account sampled. • Reviewed the ledger detail to assist identifying transactions that may not belong or were posted incorrectly to project costs. • Vouched a sample of projects related expenses by requesting documentation which includes invoices, journal entries, cancelled checks, payment vouchers and procurement documents among others. • Where possible, carried a site visit to a sample of projects. • Audit marked netfund project costs as a keep in view (KIV) item in 2017/2018 audit.

2	Deferred Income	
	<p>The statement of financial position reflects deferred income for the current year of Kshs.13,602,698 which reduced by Kshs 93,000,000 from Kshs.106,602,698 in the previous year.</p> <p>We considered this to be a key audit matter since there is a risk that the revenue is inappropriately reported to achieve desired budgetary performance. We assessed that the opportunity to misrepresent revenue creates a heightened risk where the receipts from development partners are recorded in the improper period by not observing the matching principle and the requirements of IPSAS 23.</p>	<p>The following audit procedures were performed in response to this matter:</p> <ul style="list-style-type: none"> • Reviewed the financing agreement and annual work plans. • Comparing current year grants with prior period at lowest level of detail. • Inquiring about grants near year-end versus appropriate revenue cutoff procedures • Analyzing deferred revenue versus agreements terms that might affect the grants.
3	Assets Management and Control	
	<p>National Environment Trust Fund has acquired assets totaling Kshs.35,087,843 over the years. Management control of these assets presents a great challenge and risk to National Environment Trust Fund management.</p> <p>Judgements and controls needs to be effective to appropriately recognize the revenue costs from these significant acquisitions including:</p> <ul style="list-style-type: none"> • Assessment of the economic useful lives of assets which are still in use and those that have been fully depreciated. • Whether to recognize impairments and write-offs for assets which are no longer in use. 	<p>The following audit procedures were performed in response to this matter:</p> <ul style="list-style-type: none"> • Evaluated management’s judgements and assumptions used in determining the future benefits expected from the assets and ensured they are appropriate. • Reviewed the assets register for selected assets to ensure existence and completeness of balance sheet figures. • Reviewed whether or not capitalization of costs is appropriate. • Considered whether at any stage assets need to be impaired or written off to the change in useful lives. • Considered whether there were any assets which were still in use but their useful lives had expired. • Performed detailed testing on a sample of expenditure incurred to source documents.
4	Information Technology Systems and Controls	
	<p>In line with the National Environment Trust Fund’s, Charter on creativity and innovation the Fund had been using the Responsive Ledger software for managing financial operations. However, the Fund migrated to Sage 300 ERP. The Sage system currently has the Finance and the</p>	<p>Our planned audit approach assumed reliance on the IT Control environment and therefore our audit procedures to address the matter included:</p> <ul style="list-style-type: none"> • Examining the framework of governance over IT controls, access

<p>Human Resource modules that are integrated. The sage also has components for adding the Customer Relationship Management System (CRM), Procurement and Project Management Modules to enable effective and efficient delivery of services.</p> <p>We considered this to be a key audit matter since there is an inherent risk of loss of integrity of key financial data being imported manually from the Responsive Ledger software into SAGE 300. There is also breakdown in operation or monitoring of IT dependent controls within critical business processes such as payroll, financial management and recording of transactions, which could lead to financial errors or misstatements and inaccurate financial reporting.</p> <p>The Fund's financial reporting process is heavily dependent on these systems and there is a risk that automated accounting procedures and related IT dependent manual controls are not designed and operating effectively. There is also a risk that the systems may not meet management intentions. In addition, there is a risk that the IT systems governance has not been addressed to reap the full benefits of the IT Investment.</p>	<p>to programs and data and IT operations, where required;</p> <ul style="list-style-type: none"> • Assessing and testing the design and operating effectiveness of the controls over the continued integrity of the systems that were relevant to financial accounting and reporting during the year; • Assessment and testing of the general IT control environment, including IT access and segregation of duties, as well as IT dependent controls within critical business processes; • Carrying out direct tests of certain aspects of the security of the IT systems including access management and segregation of duties; • Re-performing selected automated computations and compared our results with those from the systems and the general ledger and trial balance; and • Testing the significant system interfaces to ensure accuracy and completeness of the data transfer.
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Other Matter

1. Public Participation in National Environment Trust Fund Budget Implementation

Article 201(a) of The Constitution of Kenya requires that there should be openness and accountability, including public participation in financial matters. Further, Section 36 (3) (d) of the Public Finance Management Act, 2012 provides for public participation in the budget process. There is no evidence of public participation during budget formulation.

2. Internal Controls Not Implemented

The following observations were made during a review of the internal control systems of the National Environment Trust Fund:

- a) No risk assessment was carried out to identify and address key areas of concern for operations of NETFUND and document specific controls in response to identified risks.
- b) National Environment Trust Fund has no formal, documented and tested disaster recovery plan/emergency procedure in place and therefore in case of an emergency. The personnel involved might not be aware of what is expected of them.

Responsibilities of Management and those Charged with Governance for the Financial Statements

The Management is responsible for the preparation and fair presentation of the financial statements in accordance with International Public Sector Accounting Standards (Accrual Basis) and for such internal control as the 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 Fund'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 terminate the Fund 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.

Those charged with governance are responsible for overseeing the Fund'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 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.

As part of an audit conducted in accordance with ISSAIs, I exercise professional judgment and maintain professional scepticism 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 our 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 Fund'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 Fund's ability to continue 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 report. However, future events or conditions may cause the Fund 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 Fund 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 the 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.

From the matters communicated with the management, I determine those matters that were of most significance in the audit of the financial statements of the current period and are therefore the Key Audit Matters. These matters are described in my auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.



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

Nairobi

20 September 2018