

# **REPORT OF THE AUDITOR-GENERAL ON NATIONAL HOSPITAL INSURANCE FUND FOR THE YEAR ENDED 30 JUNE, 2019**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Qualified Opinion**

I have audited the accompanying financial statements of National Hospital Insurance Fund set out on pages 34 to 86, which comprise the statement of financial position as at 30 June, 2019, and the statement of comprehensive income, statement of changes in equity, 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 discussed in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respect the financial position of National Hospital Insurance Fund 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 (Accrual Basis) and comply with the Public Finance Management Act, 2012 and the National Hospital Insurance Fund Act, 1998.

### **Basis for Qualified Opinion**

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

During the year under review, the Fund reported a deficit of Kshs.3,671,996,374 (2017/2018-surplus Kshs.295,922,867) resulting in reduction of retained earnings from Kshs.23,043,974,174 as at 30 June, 2018 to Kshs.19,371,977,800 as at 30 June, 2019. The Fund's performance is on a downward trend and if strategies are not put in place to reverse the trend, the Fund is likely to experience financial difficulties in future.

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

##### **2.1 Land Situated at Karen – 10 Hectares**

As previously reported, included in the property, plant and equipment balance of Kshs.13,325,730,197 reflected in the statement of financial position as at 30 June, 2019 is an amount of Kshs.298,589,665 in respect of land which in turn includes an amount of Kshs.93,712,675 for land Ref. No.LR 24968/2 measuring 10 hectares situated at Karen. However, the ownership of the parcel of land is in dispute and the matter is in court. Information available indicates that, as per the Public Investment Committee (PIC) recommendations in its 21<sup>st</sup> and 22<sup>nd</sup> Reports, the Directorate of Criminal Investigations (DCI) has commenced investigations to establish whether there was fraud in the transfer of ownership of the land and prosecute any person who may have been identified as having breached the law. However, progress made on the investigations has not been disclosed in the financial statements.

##### **2.2 Proposed Resource Centre at Karen Land**

Included in the property, plant and equipment balance of Kshs.13,325,730,197 as at 30 June, 2019 is a work-in-progress balance of Kshs.1,444,687,484 being payments for drawings and designs for the proposed Resource Centre whose construction is yet to commence although the land was acquired fifteen years (15) ago. As previously reported, the Management has explained that construction of the Resource Centre has not yet commenced due to lack of approval from the parent Ministry and the dispute on land ownership.

Although the issue had been discussed by the Public Investment Committee (PIC), no action appears to have been taken on the PIC recommendations in its 22<sup>nd</sup> Report that the Fund should expeditiously pursue the prosecution and conclusion of the case to its logical conclusion.

### **2.3 Construction of Multi Storey Car Park**

As previously reported, the National Hospital Insurance Fund entered into an agreement with a local construction firm for construction and completion of a multi storey car park at a contract sum of Kshs.909,709,305. The project commenced in May, 2002 and was scheduled for completion in August, 2003. The contract sum was later revised to Kshs.1,179,611,756 or approximately 30% above the original contract sum of Kshs.909,709,305.

Records available indicate that the car park was completed in July, 2008 at a total cost of Kshs.3,342,120,239. Additional amounts of Kshs.626,635,998 and Kshs.4,706,521 were incurred in 2009/2010 financial year and 2010/2011 financial year, respectively on the car park increasing the total expenditure to Kshs.3,973,462,758 as at 30 June, 2011. This resulted into an increase of approximately 337% over and above the original contract sum of Kshs.909,709,305. The costs escalation was not justified.

Although the issue has been discussed by the Public Investment Committee, no action has been taken on the Committee recommendations as per the 19<sup>th</sup> and 21<sup>st</sup> Reports which recommended that the Director of Ethics and Anti-Corruption Commission should institute and fast track investigations on the project with a view to preferring charges against all those who will be found culpable.

In the circumstances, it has not been possible to ascertain whether the property, plant and equipment balance of Kshs.13,325,730,197 as at 30 June 2019 is fairly stated.

### **3. Unquoted Investments**

As previously reported, the statement of financial position reflects a balance of Kshs.394,654,576 under unquoted investments which, as disclosed in Note 28 to the financial statements, includes an amount of Kshs.340,454,576 in respect of a loan advanced by the Fund to the Moi Teaching and Referral Hospital (MTRH) at an interest rate of 3% per annum. However, the loan was not supported with a signed loan agreement between the Fund and MTRH. Although the Fund Management has acknowledged the omission, explanations on how the anomaly will be resolved and the fall back plan in case of default by the Hospital was not provided. Further, available information indicate that the loan balance has not been reflected in MTRH financial statements for the year ended 30 June, 2019. The unquoted investments balance of Kshs.394,654,576 also includes

shares of Kshs.54,200,000 in Consolidated Bank of Kenya for which no dividend has been paid in the past.

Under the circumstances, the investments in consolidated bank shares is impaired. Consequently, the validity of unquoted investments balance of Kshs.394,654,576 as at 30 June, 2019 could not be confirmed as fairly stated.

#### **4. Short Term Investments**

As previously reported, included in the statement of financial position as at 30 June, 2019 is short term investments balance of Kshs.13,625,153,816 which is net of provision for impaired investments of Kshs.1,304,410,609. The provision includes an amount of Kshs.49,500,000 which had been deposited by the Fund on 26 June, 2001 in Consolidated Bank of Kenya. The entire deposit of Kshs.49,500,000 was off-set by the Bank against a guarantee executed by the former Chief Executive Officer of the Fund on behalf of Euro Bank Limited. The circumstances under which the Fund's deposit was used as a guarantee by the then Chief Executive Officer has not been explained.

Although the Public Investment Committee recommended in the 21<sup>st</sup> Report as follows;

- (i) The then CEO of NHIF be held accountable for any losses incurred in the irregular investment of the surplus funds in Consolidated Bank of Kenya and therefore be surcharged for Kshs.40,065,205, being the value of the un-deposited cheque No.022477 of 23 September, 2002 from Euro Bank;
- (ii) The then Consolidated Bank of Kenya CEO and Finance Manager should be held accountable for colluding with NHIF to mismanage the invested funds;
- (iii) In view of the fact that the Fund had no capacity to provide guarantee for a loan to a private bank, Consolidated Bank of Kenya should pay the amount of Kshs.49.5 million owed to the Fund;
- (iv) The then senior Management of Consolidated Bank of Kenya including the then Managing Director, and the Finance Manager should also be held accountable for colluding with NHIF to mismanage the invested funds.
- (v) The former Managing Director of Consolidated Bank of Kenya should be surcharged for the funds that were advanced to Euro Bank Limited in overnight lending. He should further be held accountable for the Kshs.49.5 million which the Bank could not recover from Euro Bank Limited and consequently offset the same against the fixed deposits of NHIF.
- (vi) NHIF should relentlessly pursue Consolidated Bank of Kenya for recovery of Kshs.49.5 million;
- (vii) NHIF CEO must ensure that all financial investments by the Fund are done in accordance with the Treasury Circular No.10 of 1992 and Section 28(1) of the Public Finance Management Act, 2012.

No action appears to have been taken to recover the Kshs.49,500,000 the Fund lost. In the circumstance, it has not been possible to confirm whether the short-term investment balance of Kshs.13,625,153,816 is fairly stated.

## 5. Long Outstanding Return to Drawer Cheques

The statement of financial position reflects a balance of Kshs.6,730,698,196 under trade and other receivables which, as disclosed in Note 29 to the financial statements, includes R.D. Cheques amounting to Kshs.19,061,721 which had been outstanding for more than six (6) months and were therefore stale.

Consequently, the accuracy and validity of return to drawer balance of Kshs.19,061,721 as at 30 June, 2019 could not be confirmed.

## 6. Staff Costs

### 6.1 Unsupported Expenditure

The staff costs expenditure of Kshs.4,865,435,027 reflected in the statement of comprehensive income and expenditure includes an amount of Kshs.6,680,160 paid to twelve (12) officers employed during the year. However, documents supporting the recruitment including advertisements of the vacancies, short listing, interviewing and recruitment reports were not availed for audit verification.

Consequently, the propriety of the expenditure totalling Kshs.6,680,160 included under staff cost for the year ended 30 June, 2019 could not be confirmed.

### 6.2 Staff Welfare

As disclosed in Note 18 to the financial statements, included under the staff costs of Kshs.4,865,435,027 is an expenditure amount of Kshs.50,408,079 relating to staff welfare. The latter balance includes an amount of Kshs.21,762,000 paid to staff as Christmas gift and appreciation token to retirees during the year under review. Management did not provide justification or the basis for the payment.

Consequently, the propriety of the expenditure totaling to Kshs.21,762,000 paid as Christmas gift and included under staff welfare could not be confirmed.

## 7. Board Expenses

The statement of comprehensive income and expenditure reflects an expenditure of Kshs.32,081,129 under Board expenses which, as disclosed in Note 19 to the financial statements, includes an amount of Kshs.12,450,000 relating to sitting allowances which were not supported with signed minutes. Further the Board did not adhere to approved Board calendar as detailed below:

Board	Planned Meetings	Actual Meetings
Full Board	5	35
Audit Committee	4	7

Under the circumstances, the propriety of Board expenses of Kshs.32,081,129 for the year ended 30 June, 2019 could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am Independent of the National Hospital Insurance Fund

*Report of the Auditor-General on National Hospital Insurance Fund for the year ended 30 June, 2019*

Management in accordance with ISSAIs 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 Key Audit Matters to report in the year under review.

### **Other Matter**

#### **Budgetary Control and Performance**

During the year under review, the Fund's actual revenue amounted to Kshs.55,412,319,242 against budgeted revenue of Kshs.66,858,395,349 resulting in a revenue shortfall of Kshs.11,446,076,107 or 17%. Further, actual expenditure for the year amounted to Kshs.61,132,941,242 against a budgeted expenditure of Kshs.58,098,379,876 resulting in an over absorption of Kshs.3,034,561,366. There is need for the Fund to review its budget making process with a view to developing a vibrant budget implementation follow up mechanism and feedback process with a view to ensuring that all projects and activities are implemented as planned for the Fund to meet its mission and objectives for the benefits of the citizens of Kenya.

## **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 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. Cash and Bank Balances**

The statement of financial position reflects cash and bank balances of Kshs.2,640,702,789 which is net of a negative bank balance of Kshs.8,350 in the Kenya Commercial Bank (KCB) settlement account. Management has not provided an explanation for overdrawing the bank account contrary to Section 28 (4) of the Public Finance Management (National Government) Regulations, 2015 which states that an Accounting Officer of a national government entity shall not cause a bank account of the entity to be overdrawn.

The Management was therefore in breach of the law.

## **2. Other Operating Expenses**

The statement of comprehensive income and expenditure reflects an expenditure of Kshs.2,493,573,826 under other operating expenses which, as disclosed in Note 20 to the financial statements, includes an amount of Kshs.156,424,194 paid as legal expenses to private legal firms. However, approval and issuance of no objection from the Attorney General's office on engagement of the private legal firms was not given as required by the Attorney General's Circular reference AG/CON/6/D/144/VOL.II dated 16 April 2014.

In the circumstances, the propriety of legal expenses totalling to Kshs.156,424,194 could not be confirmed.

## **3. Procurement of Integrated Revenue Management System**

As previously reported, on 4 June, 2018, the Fund entered into a contract with an IT Solutions firm for provision of Integrated Revenue Management System at a contract sum of Kshs.495,205,588. Further information indicates that the procurement of the system was single sourced as no evidence of competitive bidding was provided for audit verification. This is contrary to Section 96 of the Public Procurement and Assets Disposal Act, 2015 which require the Accounting Officer to take such steps as are reasonable to bring the invitation to tender to the attention of all those who may wish to submit tenders. Further, although direct procurement method was used, no evidence was provided to support that the underlying circumstances met the conditions set for direct procurement as laid down in Section 91 of the Act.

Under the circumstances, the Fund was in breach of the law and may not have obtained value for money on the procurement of the system.

## **4. Temporary Imprest**

The trade and other receivables balance of Kshs.6,730,698,196 reflected in the statement of financial position as at 30 June, 2019 includes temporary imprest of Kshs.20,384,020 out of which an amount of Kshs.1,057,280 has been outstanding for many years and whose recoverability is doubtful. This is contrary to Section 93 (5) of the Public Finance Management (National Government) Regulations, 2015 which states that a holder of a temporary imprest shall account or surrender the imprest within seven (7) working days after returning to duty station. Section 93 (6) further provides that in the event of the imprest holder failing to account for or surrender the imprest on the due date, the Accounting Officer shall take immediate action to recover the full amount from the salary of the defaulting officer with an interest at the prevailing Central Bank Rate. Consequently, the recoverability of the imprest amount of Kshs.1,057,280 is doubtful.

## **5. Excessive Deductions**

Analytical review performed on the payroll for twelve (12) months from July 2018 to June 2019 revealed a total of 2,458 instances where staff were paid net salaries that were less than one third (1/3) of their basic salaries. This is contrary to Section 6.1.4 of the Fund Human Resource Policy that stipulate that any advance will be granted subject to the

employee remaining with at least a third of the basic salary. The Fund is therefore in breach of its own policy.

## **6. National Health Scheme Benefits Expenses**

The statement of comprehensive income and expenditure reflects an expenditure of Kshs.37,716,058,407 under National Health Scheme (NHS) Benefits expenses which includes legal fees of Kshs.336,339,000 paid to a law firm in respect of drawing 6,700 contracts with health providers at a negotiated total instruction fee of Kshs.432,800,000. The law firm was to further charge an amount of Kshs.43,260,000 being cost for company search, printing, binding, travels costs and stamp duty and distribution of the contracts. On 5 November, 2018, the firm reviewed the terms of engagement and added 309 contracts for drafting, with an additional cost of Ksh.26,749,302 as legal fees. There was no consent from NHIF for the variation.

Further, the legal service was not in the approved procurement plan for 2018/2019 financial year which is contrary to Section 45(3)(a) of the Public Procurement and Assets Disposal Act, 2015 which states that all procurement process shall be within the approved budget of the procuring entity and shall be planned by the procuring entity concerned through the Annual Procurement Plan.

In addition, the law firm was not in the prequalified list of suppliers in contravention of Section 93(1) of the Public Procurement and Assets Disposal Act, 2015 that states that an Accounting Officer of a procuring entity, where applicable, may conduct a prequalification procedure as a basic procedure prior to adopting an alternative procurement method other than open tender for the purpose of identifying the best few qualified firms for the subject procurement.

Under the circumstances, the Fund was in breach of the law and the propriety of legal fee of Kshs.336,339,000 paid to the law firm could not be confirmed.

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, 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**

The audit was conducted in accordance with ISSAI 2315 and ISSAI 2330. 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 overall 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 Financial Reporting 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, risk management and governance.

In preparing the financial statements, Management is responsible for assessing the Fund's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless Management is aware of the intention to terminate the Fund 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.

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



**Nancy Gathungu**  
**AUDITOR-GENERAL**

**Nairobi**

**19 August, 2021**