

REPORT OF THE AUDITOR-GENERAL ON NATIONAL QUALITY CONTROL LABORATORY FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of National Quality Control Laboratory set out on pages 1 to 34, which comprise the statement of financial position as at 30 June 2018, and the statement of financial performance, statement of changes in net assets, statement of cash flows and statement of comparison of budget and actual amounts for the year then ended, and a summary of significant accounting policies and other explanatory information in accordance with the provisions of Article 229 of the Constitution of Kenya and Section 35 of the Public Audit Act, 2015. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit.

In my opinion, except for the effect of the matters described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respects the financial position of National Quality Control Laboratory as at 30 June 2018, 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 Public Finance Management Act, 2012 and Section 35D of the Pharmacy and Poisons Amendment Act, 1992.

Basis for Qualified Opinion

1. Inaccuracies in the Financial Statements

1.1 Statement of Cash Flows

The statement of cash flow for the year ended 30 June 2018 reflects increase in payables-staff gratuity of Kshs.4,246,947. However, the movement of Kshs.4,246,947 in payables-staff gratuity was not supported as it could not be traced in the statement of financial position as at 30 June 2018.

In the circumstances, the accuracy of the statement of cash flows for the year ended 30 June 2018 could not be confirmed.

1.2 Statement of Comparison of Budget and Actual Amounts

The statement of comparison of budget and actual amounts reflects total budgeted revenue of Kshs.273,523,000 and total budgeted expenditure of Kshs.531,463,000 resulting in a budget deficit of Kshs.257,940,000. Management did not however explain

how they expected to finance the budget deficit of Kshs.257,940,000. Further, the 2016/17-2018/19 medium term budget from where the budget figures were extracted reflect total budgeted expenses of Kshs.318,161,000 which differ with the figure reflected in the statement of comparison of budget and actual amounts of Kshs.531,463,000 resulting in unexplained difference of Kshs.213,302,000.

In the circumstances, the accuracy of the statement of comparison of budget and actual amounts for the year ended 30 June 2018 could not be confirmed.

2. Property, Plant and Equipment

As previously reported, the property, plant and equipment balance of Kshs.68,419,666 in the statement of financial position as at 30 June 2018 excludes an undetermined value of a parcel of land measuring four (4) hectares situated at Upper Hill, Nairobi which was allotted to National Quality Control Laboratory in 1992. The parcel of land was re-allocated to National Quality Control Laboratory in 1995 but was reduced to 2.61 hectares. Available information indicates that out of 2.61 hectares, 1.26 was sold to Kenya- Re by Kenya Media Trust and the remaining 1.35 hectares was taken over by Kenyatta National Hospital. However, a total of 2.35 hectares has since been surrendered back; Kenya-Re 1.0 hectares and Kenyatta National Hospital 1.35 hectares. Further, the National Land Commission has taken part of 1.35 hectares surrendered by Kenyatta National Hospital and donated it to Kenya Urban Road Authority for construction of road without consent of National Quality Control Laboratory. Further information indicates that the 1.35 hectares parcel of land surrendered by Kenyatta National Hospital is under the survey process. In addition, Kenya Re has since surveyed the 1.0 hectare, for purposes of subdivision for the laboratory, and the subdivision process is ongoing at the National Land Commission. The laboratory has not obtained any ownership documents for the remaining 1.65 hectares and no evidence that the processing of the same is on course.

Consequently, it has not been possible to determine that the property, plant and equipment balance of Kshs.68,419,666 included in the statement of financial position as at 30 June 2018 is fairly stated.

3. Cash and Cash Equivalent

The statement of financial position as at 30 June 2018 reflects cash and cash equivalent balance of Kshs.7,916,853. However, the adjusted cash book balance after casting the entire cash book indicates a cash balance of Kshs.7,986,098 leading to an understatement of Kshs.69,245.

In the circumstance, it has not been possible to confirm the validity and accuracy of the cash and cash equivalent balance of Kshs.7,916,853 included in the statement of financial position as at 30 June 2018.

4. Receivables from Exchange Transactions

As previously reported, the receivables from exchange transactions balance of Kshs.21,748,369 as at 30 June 2018 includes analysis fees totalling Kshs.6,013,120 reflected as owed by Kenya Medical Supplies Authority (KEMSA), which has been outstanding for more than thirteen (13) years. However, this balance is not reflected as a payables under KEMSA financial statements as at the same date. In addition, the receivables balance includes other receivables from United Nations Development Programme and Government of South Sudan amounting to Kshs.1,613,197 which have been outstanding for more than three (3) years and other debtors amounting to Kshs.3,224,016 which have been outstanding for more than a year. A provision for bad and doubtful debts of Kshs.672,630 equivalent to 3% of total outstanding debtors has been made in these accounts in respect of the outstanding receivables but the provision appear inadequate.

Consequently, it has not been possible to confirm the validity and recoverability of the receivables from exchange transactions balance of Kshs.21,748,369 included in the statement of financial position as at 30 June 2018.

5. Unsupported Expenditure

Included in the statement of financial performance for the year ended 30 June 2018 is repairs and maintenance expenses of Kshs.12,719,968 and general expenses of Kshs.26,009,882. However, supporting documents for repairs and maintenance expenses amounting to Kshs.9,437,930 and general expenses amounting to Kshs.1,809,064 were not availed for audit verification.

Consequently it has not been possible to confirm the propriety of expenditure totalling to Kshs.11,246,994 for the year ended 30 June 2018.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of National Quality Control Laboratory 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 Section, I have determined that there are no other key audit matters to communicate in my report.

Other Matter

1. Budgetary Performance

During the year under review, National Quality Control Laboratory actual receipts amounted to Kshs.54,045,987 against budgeted receipts of Kshs.273,523,000 resulting in an shortfall of Kshs.219,477,013. Further, the Laboratory actual expenditure for the year amounted to Kshs.82,709,003 against budgeted expenditure of Kshs.531,463,000 resulting in an overall under absorption of Kshs.448,753,997. It is clear that the Laboratory failed to achieve its budget objectives hence failure to deliver the intended services to the public. Therefore, there is need for the Laboratory to review its budget making process with a view to coming up with a realistic budget.

2. Legal Status of National Quality Control Laboratory (NQCL)

The National Quality Control Laboratory was established under Section 35D of the Pharmacy and Poisons Act, Cap 244 of the Laws of Kenya on 28 October 1992 and came into operation on 6 November 1992. Since inception, the Laboratory has operated under the Division of Pharmacy in the Ministry of Health. However, in September 2014, it was recognized as a Semi-Autonomous Government Agency (SAGA) in the Ministry of Health. Further, in February 2016, the State Corporation Advisory Committee after evaluating its capacity categorized the Laboratory at category PC 4B and advised the Ministry of Health to proceed to form an Inter-Ministerial Task Force to advise on attainment of full parastatal status. However, as at the time of audit, no progress had been made by the ministry on formation of the Inter-Ministerial Task Force.

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 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.

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

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As required by Section 7 (1) (a) of the Public Audit Act, 2015, based on the audit procedures performed, except for the matters discussed in the Basis for Qualified Opinion 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 overall governance were not effective.

The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. The standards requires 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, risk management and governance.

In preparing the financial statements, management is responsible for assessing the Laboratory ability to continue as a going concern / sustain 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 Laboratory 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, revenue 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 Laboratory'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

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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 Laboratory 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 Laboratory 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 audit report. However, future events or conditions may cause the Laboratory to cease to continue to sustain its services.
- Evaluate the overall presentation, structure and content of the revenue 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 Laboratory 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.



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

Nairobi

24 April 2019