

REPORT OF THE AUDITOR-GENERAL ON NUMERICAL MACHINING COMPLEX LIMITED FOR THE YEAR ENDED 30 JUNE 2017

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Numerical Machining Complex Limited set out on pages 1 to 31, which comprise the statement of financial position as at 30 June 2017, and the statement of profit and loss & other comprehensive income, statement of changes in equity, statement of cash flows and the 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, the financial position of Numerical Machining Complex Limited as at 30 June 2017, 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 Companies Act, Cap 486 of the Laws of Kenya.

In addition, as required by Article 229(6) of the Constitution, except for the matters described in the Other Matter section of my report, based on the procedures performed, I confirm 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. Unconfirmed Value of Investment Property- Land

(i) As previously reported, the Government of Kenya in 1994 allocated the Company land measuring approximately 703.59 hectares under title LR No.63767 in Mavoko, Athi River. In 2001, the Company with the consent of the Government later sold part of land measuring 288.09 hectares to individuals and other entities whose titles have not been wholly processed and released. The Company continued to pay rates based on the original title deed up to 2009. Further, a net amount of Kshs.6,640,310 has remained unpaid since 2001 from the sale of Company's parcel of land situated at Athi River. Recoverability of the debt remains doubtful.

(ii) Further, the remaining portion of land measuring 415.5 hectares is not fenced and has been encroached by squatters and other parties who have put up permanent structures. Further, the said portion of the unsold land measuring 415.5 hectares was revalued at Kshs.290 million in 2009 and revaluation gain of Kshs.158,993,190 arising thereon approved by the Board for inclusion in the

financial statements in October 2016. However, the Company has not valued its assets in the last eight (8) years to take cognizance of the drastic change in value of its assets contrary to International Accounting Standard No.16 which stipulates that property, plant and equipment should be revalued after every five years.

Consequently, the accuracy, valuation and security of the investment property cannot be confirmed as fairly stated in the financial statements as at 30 June 2017.

2. Unconfirmed Status of Fixed Assets

As reported in the prior year, the property, plant and equipment balance of Kshs.424,620,155 is not supported with a fixed assets register to indicate the locality, condition and use of the assets, among other details, as stipulated in the Public Finance Management Act, 2012 regulations and the Company's Finance Policy Guidelines and Procedure Manual. As a result, it has not been possible to confirm the status and location of the Company's assets. Unless a proper and functioning asset management system is put in place, the Company's assets are exposed to abuse, misuse and may be lost through pilferage and theft.

It was further observed that apart from motor vehicles with a net book value of Kshs.2,098,197, other assets of the Company with an aggregate net book value of Kshs.422,521,958 as at 30 June 2017 were not insured. Under the circumstances, recoverability of assets remains doubtful should unforeseen unfavorable nature occur.

3. Doubtful Trade and Other Receivables

As reported in the previous year, the trade and other receivables balance of Kshs.86,610,332 as at 30 June 2017 includes an amount totaling Kshs.2,394,183 being accountable advances from staff who have since left the Company's service. The receivables balance also includes an amount of Kshs.1,844,762 being deposits for tenders and performance bonds the Company participated in and which have been outstanding for a considerable period of time.

Further, included in the trade debtors balance of Kshs.73,557,308 is a debt amounting to Kshs.17,019,282 owed to the Company by Ms. Rift Valley Railways. Recoverability of this long outstanding debt is doubtful since Rift Valley Railways is no longer in operation. In addition, a prepayment of Kshs.75,400 for renewal of payroll software was not recognized as a receivable.

Under the circumstances, it has not been possible to confirm that trade and other receivables balance of Kshs.86,610,332 as at 30 June 2017 is fairly stated.

4. Longstanding Tax Payable

As reported in the previous year, a tax liability of Kshs.26,264,885 has been reflected in the financial statements since 1999. Failure to pay the tax had culminated in penalties and interest totaling Kshs.31,517,862 as at 31 December

2013 as assessed by the Kenya Revenue Authority through their demand letter dated 24 September 2014. The amount remains outstanding and continues to attract further penalties and interest a situation which could have been avoided.

5. Longstanding Trade and Other Payables

The trade and other payables balance of Kshs.113,847,231 as at 30 June 2017 includes trade creditors amounting Kshs.10,486,280 which had no movement during the year under review. An advance of Kshs.3,000,000 due to University of Nairobi reflected under other payables did not also show any movement in the year under review. Although the Company has explained that the creditors were not cleared during the year due to inadequate funding, the Company risks being charged interest and penalties for not paying its creditors.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAI's). I am Independent of the Kenya National Trading Corporation 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 of my qualified opinion.

Emphasis of Matter

1. Lack of an Enabling Act.

The Company was incorporated in 1994 under Companies Act, Cap 446, but there is no enabling act enacted to strengthen the Company's mandate and objectives. As a result, the Company operates with a weak enabling framework which has not fortified its operations and mandate.

2. Unexplained Status of Ordinary Share Capital

Note 13 to the financial statements indicates that Kenya Railways Corporation owns 51% of the ordinary shares in Numerical Machining Complex Limited and the balance of 49% is owned by the University of Nairobi. The ownership is however not as a result of direct purchase of ordinary shares but shares held in trust by these institutions on behalf of the Government through the National Treasury.

Key Audit Matters

Key audit matters are those matters that, in my professional judgement, are of most significance in the audit of the financial statements. Except for the matter described in the Basis for Qualified Opinion section, of my report, I have determined that there are no Key Audit Matters to communicate in my report.

Other Matter

1. Failure to Use Software in Inventory Control

The Company uses Pastel Accounting Software to manage its financial and some other of its operational records. Although the software includes a module for inventory management and control, the Company does not utilize the module. Instead inventories are managed and controlled manually which practice is more prone to errors and fraud.

2. Below-average Financial Performance

The Company achieved sales of Kshs.53,078,401 against a target of Kshs.213,572,800, representing a 25% revenue performance rate during the year under review. In the year 2015/2016, the Company's total sales were Kshs.51,569,147 against a target of Kshs.189,187,000 thus equivalent to a 27% performance rate. This was despite major capital investments in the last two (2) years amounting to Kshs.350 million (Kshs.144.2 million in 2015/2016 and Kshs.205.8 million in 2016/2017), which were intended to accelerate output and sales.

3. Sales and Marketing Plan Lacking

The Company has not put in place adequate measures to market and publicize its operations and products to prospective customers. For example, the Company's internet and emails are not functional and further, there are no elaborate strategies to drive sales. If management do not establish elaborate strategies to manage the Company's affairs, including marketing its products, the Company will not succeed in delivering its mandate.

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

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such 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.

In preparing the financial statements, management is responsible for assessing the Company'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 the management intends to liquidate the Company or 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 Company'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. 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 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.
- 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 Company'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 Company'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 Company's to cease to continue as a going concern.
- 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 company 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 communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.

REPORT ON LEGAL AND OTHER REGULATORY REQUIREMENT.

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

- a) 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;
- b) In my opinion, adequate accounting records have been kept by the Company, so far as appears from examination of those records; and,
- c) The Company's financial statements are in agreement with the accounting records and returns.



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

Nairobi

11 October 2018