

REPORT OF THE AUDITOR-GENERAL ON NUMERICAL MACHINING COMPLEX LIMITED FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Numerical Machining Complex Limited set out on page 1 to 38, which comprise the statement of financial position as at 30 June 2018, and the statement of profit and loss and other 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 effects of the matter described in the Basis for Qualified Opinion section of my report, the financial statements present fairly, in all material respects, the financial position of Numerical Machining Complex Limited 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 (Accrual Basis) and comply with the Companies Act, 2015 of the Laws of Kenya

Basis for Qualified Opinion

1. Unconfirmed Value of Investment Property- Land

The investment property balance as at 30 June, 2018 reflects Kshs.290,000,000. However, the following anomalies were noted:

- (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 deeds 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 the parcel of land. Recoverability of the debt remains doubtful.
- (ii) In addition, 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 nine (9) years to take cognizance of the drastic change in value of its assets contrary to International Accounting Standard No.16 and 40 which stipulates that property, plant and equipment should be revalued after every five years and lease payments be recognized as an expense in the statement of

financial performance on a straight-line basis over the lease term, the leasehold property has not been amortized.

- (iii) On 14 January, 2003 a new title deed was issued to the Numeric Machining Complex Limited for 202.4 hectares under title No. I.R. 91216 land reference No.11895/22. It is not clear under which circumstances this new title deed was issued to the Company. A letter from the Ministry of Land Ref. No. VAL.1371/6 dated 17 February, 2009 to Numeric Machining Complex Limited on valuation of a parcel 11895/20 indicated that LR No.11895/20 had been subdivided and new LR's given. It is not clear why the company requested the Ministry on valuation of the land with reference 11895/20 while noting that the number had changed. During the 2017/2018 audit the management did not provide the title deed for the land for audit verification.

Consequently, it has not been possible to confirm the ownership, the accuracy, valuation and security of the investment property balance of Kshs.290,000,000 as at 30 June 2018.

2. Longstanding Tax Payable

The tax payable of Kshs.57,782,747 as reported in the previous years, relates to a tax liability of Kshs.26,264,885 which has been reflected in the financial statements since 1999. Failure to pay the tax had culminated to penalties and interest totaling to 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.

3. Trade Receivables

The trade and other receivables reflect a balance of Kshs.98,283,172 as at 30 June 2018. However, the following anomalies were noted;

- (i) Note 11 (a) to the financial statements reflects a figure of Kshs.2,992,354 for accountable advances and Kshs.1,109,296 for salary advances. Inclusive in this figure is Kshs.1,498,066 and Kshs.473,270 for accountable advances and salaries advances respectively from staff who have since left the Company's service.
- (ii) The figure of Kshs.112,904 for car loan had no movement since 2012. The management explained that the loan belongs to an employee who left the organization.
- (iii) The deposits figure of Kshs.8,773,010 includes Kshs.1,544,762 which as reported previously has been long outstanding. The management has explained these figures as deposits for tenders and performance bonds the Company participated in. The amount has been outstanding for a considerable period of time and no evidence was provided to support these outstanding balances.

- (iv) Further, the figure of Athi River land sales receivables of Kshs.6,640,331 have remained unpaid since 2001.
- (v) Further, included in the trade debtors balance of Kshs.101,323,324 is a debt amounting to Kshs.17,019,282 owed to the Company by M/s Rift Valley Railways. Recoverability of this long outstanding debt is doubtful since Rift Valley Railways is no longer in operation.
- (vi) Contrary to the Company's terms of credit and payment which stipulated that the credit period should not exceeded 60 days, it is observed that Kshs.79,182,421 owed to NMC has been outstanding for more than 60 days.
- (vii) Included in the trade debtors balance is Kshs.49,640,750.19 owed to the Company by 15 debtors which has been outstanding for more than 5 years.

Under the circumstances, it has not been possible to confirm that trade and other receivables balance of Kshs.98,283,172 as at 30 June 2018 is fairly stated.

4. Unconfirmed Status of Fixed Assets

As reported in the prior years, the property, plant and equipment balance of Kshs.369,711,482 is not supported with a fixed asset 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. 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. As a result, it has not been possible to confirm the status and location of the Company's assets.

It was further observed that apart from motor vehicles with a net book value of a Nil balance, other assets of the Company with an aggregate net book value of Kshs.369,711,482 as at 30 June 2018 were not insured. Under the circumstances, recoverability of assets remains doubtful should un-foreseen or unfavorable incident occurs.

5. Trade and Other Payables

The trade and other payables reflect balance of Kshs.127,322,840 as at 30 June 2018. However, note 14 to the financial statements reflects long outstanding accounts payables as follows;

Item	Amount Kshs.	Amount Outstanding for more than 1 year Kshs.
Trade payables	26,833,248	10,172,907
Accrued expenses	3,763,998	2,353,998
Other payables	96,725,594	67,466,818

Total	127,322,840	79,993,723
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In addition, the trade creditors amounting to Kshs.5,307,926 and an advance of Kshs.3,000,000 due to University of Nairobi did not show any movement in the year under review. Although the Company explained that the creditors were not cleared during the year due to inadequate funding, the Company could risk being charged interest and penalties for not paying its creditors.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Numerical Machining Complex 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.

Emphasis of Matter

1. Lack of an Enabling Framework

The Company was incorporated in 1994 under Companies Act, Cap 446, but there is no strong internal framework enacted to enhance 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 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. Budget Control and Performance

- (i) During the financial year 2017/2018, the Company forwarded for approval its budget to the parent Ministry for its revenues and expenditure. However, it was noted that the Company had budgeted sales of Kshs.255,287,000 but only realized Kshs.66,616,000 resulting to under collection of sales/revenues by Kshs.188,671,000 which represents 74% of the gross revenues estimates.
- (ii) The Company submitted budget to the parent ministry with cost of sales figure of Kshs.70,037,000. During supplementary budget, the figure was reduced to

Kshs.55,050,000 without any adjustment to the sales figure. The actual amount incurred for the cost of sales was Kshs.27,089,000. In the circumstances, the budgeting process of the Company may not be realistic.

2. Below-Average Financial Performance

The Company's statement of profit and loss and other comprehensive income for the year ended 30 June 2018 reflected net loss of Kshs.5,721,610, (2017 loss – Kshs.17,900,655)

The company achieved sales of Kshs.66,615,916 against a target of Kshs.255,287,000 representing 26% revenue performance rate in 2017/2018; (25% - Revenue Performance rate in 2016/2017). This has been despite major capital investments in the last three (3) years amounting to Kshs.375 million from the GOK which was intended to accelerate output and sales.

The company's continued operation is thus mainly dependent on the government support.

3. Failure to Use Software in Inventory Control

The Company uses Pastel Accounting Software to manage its financial and some other 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 is more prone to errors and fraud.

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.

Basis for Conclusion

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 Article 229(6) of the Constitution, based on the audit procedures performed, I confirm that, nothing 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 1315 and ISSAI 1330. 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 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 my 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 the audit;
- ii. In my opinion, adequate accounting records have been kept by the Company, so far as appears from the examination of those records; and,
- iii. The Company's financial statements are in agreement with the accounting records and returns.

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 Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the basis of accounting unless the management either intends to liquidate the Company 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, 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 Company's 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 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 Company'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 Company's ability to continue as a going concern or 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 Company 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 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

05 August 2019