

REPORT OF THE AUDITOR-GENERAL ON NZOIA SUGAR COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Nzoia Sugar Company Limited set out on pages 20 to 62, which comprise the statement of financial position as at 30 June 2018, the statement of comprehensive income, statement of changes in equity and statement of cash flows 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 Nzoia Sugar Company 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 and comply with the Kenyan Companies Act, 2015.

Basis for Qualified Opinion

1. Property, Plant and Equipment

1.1. Inaccuracies in Depreciation Charge for the year 2018

It was noted the depreciation charge for the year of Kshs.624,143,000 under asset movement schedule note 15 on property, plant and equipment differs with the depreciation figure in the main financial statements of Kshs.637,152,000 comprising direct charge of Kshs.580,279,000 and operating charge of Kshs.56,873,000 by an unreconciled variance of Kshs.13,009,000.

1.2. Idle Plant

As reported in the previous year, included in the property, plant and equipment balance of Kshs.11,197,183,000 (2016/2017 – Kshs.12,069,771,000) as at 30 June 2018 is a plant with a carrying value of Kshs.295,697,000 based on a valuation carried out in June 2015 by Real Appraisal Limited. This plant was acquired in the period between 1990 and 1993 when the company undertook an expansion of the factory's cane crushing capacity from 3,000 TCD to 7,000 TCD. The expansion was financed by Arkel International LLC and guaranteed by the Government of Kenya. However, as previously reported, the expansion program was not completed and the plant has been lying idle since acquisition and has not generated any income for the Company. It was noted in the valuation report that a proportion of these items are in a deteriorated state. Further, the Company has not recorded possible impairment charge on this asset which has been lying idle for over 28 years.

In addition, the Company does not maintain a comprehensive fixed assets register which incorporates all pertinent fixed assets transactions, such as disposals, impairment of assets and transfer of capital work-in-progress items to other asset classes. A comprehensive and updated fixed assets register is an integral part of the fixed assets management systems.

1.3. Procurement of Unspecified Goods for the Guest House

Included in the property plant and equipment additions figure of Kshs.119,848,000 is an amount of Kshs.4,320,000 paid to a local supplier in respect of the cost of supplying and furnishing Guest House Cottages. However, detailed description of items to be supplied was not availed for audit verification.

In the circumstances, it was not possible to confirm that property, plant and equipment balance of Kshs,11,197,183,000 as at 30 June 2018 is fairly stated.

2. Long Term Borrowings

2.1. Non Servicing of Loans

Included in the borrowings figure of Kshs.39,577,342,000 under note 26 to the financial statements are two loans received from National Treasury, Kshs.37,106,797,000 and Agricultural Food and Fisheries Authority, Kshs.2,470,544,000. The Government of Kenya through the National Treasury reflects loans guaranteed to the Company of Kshs.37,406,797,000 as at 30 June 2018 (2016/2017: Kshs.36,289,427,000) comprising principal amount of Kshs.10,095,628,375 and accrued interest of Kshs.27,311,169,000. However, the cabinet sessional paper No.12 of 2012 on write off of excess Government of Kenya debt owed by the Company and earlier presented to Parliament in 2009 by the Finance Minister indicates a debt of Kshs.21,782,367,000. The figure is much lower than the outstanding loan liability of Kshs.37,227,320,000. The Company continues to default on repayments while there is no tangible evidence of write-off previously expected from the Government.

Further, it was noted that the two loans totaling Kshs.39,577,342,000 were not supported with relevant documents such as signed financing agreements and approved board paper on loans advanced and the interest charged. Further, independent confirmation of the outstanding loan balances was not obtained from both the National Treasury and Agricultural and Food Authority to confirm accuracy of the loan balances reported as at 30 June 2018.

2.2. Funds Received from Ministry of Agriculture without Financing Agreement

It was further noted that besides the loan balance of Kshs.39,577,342,000 is Kshs.300,000,000 under note 26(b) to the financial statements which was received from the Ministry of Agriculture during the year under review. However, no supporting documents such as terms of loan agreement were availed for audit verification.

In the circumstances, it was not possible to ascertain accuracy of the loan balance of Kshs.39,577,342,000 as at 30 June 2018.

2.3 Provisions and Contingent Liabilities

As at the time of audit, there was no independent confirmations from all the Company's lawyers with regard to on-going litigations. There were no alternative procedures that could be performed and it was therefore not possible to establish the impact, if any, that the

information held by Company's lawyers could have on these financial statements including whether additional provisions should be recognized or contingent liabilities disclosed.

3. Inventory - Idle Assets

Included in the inventories balance of Kshs.557,326,000 is an amount of Kshs.14,172,745 being the cost of idle inventories acquired on diverse dates during the year under review and prior period as detailed below. Some of these assets have been left in the open yards for approximately two years and may have significantly deteriorated in value as at 30 June 2018.

	Item Description	Goods Received Note	Date Items Delivered	Amount Kshs
1	Bare shaft boiler feed water pump	GR 23664	2/6/2017	4,646,107
2	Drive foot gear box MR 773-180 L/4	GR 49 - 11552	24/3/2017	3,067,141
3	Drive foot gear box MR 672-160 L/4	49- 11552	24/3/2017	2,684,912
4	Drive drum BC 6 H 10/0023	GR 1549	21/8/2017	517,192
5	Drive drum BC 7A H10/0029	1965	18/10/2017	376,640
6	Drive drum BC 5- H10/0019	1965	18/10/2017	327,000
7	Drive drum BC 7410/0026	1965	18/10/2017	285,000
8	Drive drum BC 8 – 410/0031	1965	18/10/2017	435,000
9	Steam pipe 8" 2 pieces	7834	8/4/2014	19,090
10	10" pipes 5 pieces	8850	9/7/2015	189,655
11	MS shaft 150 mm	2767	13/3/2018	221,440
12	MS shaft 100 mm	2767	13/3/2018	72,575
13	MS shaft 50 mm	2770	13/3/2018	14,603
14	Uni beam 203 * 133 *25	1121	6/6/2017	21,000
15	Uni beam 305 * 102 *25	832	25/4/2017	29,800
	Sub-total			12,907,155
			Timber	1,265,590
	Total			14,172,745

In the circumstances, it was not possible to confirm the carrying value of the inventories balance as at 30 June 2018.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Nzoia Sugar Company Limited in accordance with ISSAI 30 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance 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 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.

Material Uncertainty Related to Going Concern

I draw attention to the Company shareholders' deficit of Kshs.38,382,597,000 (2017: Kshs.34,695,375,000) and current liabilities which exceeded current assets by Kshs.44,683,068,000 (2016/2017: 43,097,259,000). In addition, the Company has defaulted on repayment of both principal and interest on borrowings due to the National Treasury and the Agriculture and Food Authority totaling to Kshs.39,877,342,000 , (2017: Kshs.38,693,301,000) as indicated in note 26(b).

This situation, along with other matters set forth in note 3, indicates the extent of material uncertainty which may cast doubt on the Company's ability to continue as going concern. However, the financial statements have been prepared on the going concern basis, on assumption that it will continue to get financial support from National Government and creditors.

Further, the company continued to incur losses in the current year, reporting an operating loss of Kshs.3,568,733,000 (2016/2017: Kshs.2,926,840,000). This state of affairs is indicative of the acute financial challenges facing the company and raises significant doubts on the Company's ability to operate as a going concern.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229(6) of the Constitution, based on the procedures performed, except for the matters described in the Report 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 money has not been applied lawfully and in an effective way.

Basis for Conclusion

1. Poor Maintenance of the Assets Register

Review of the assets register maintained by the Company revealed anomalies stated below:

- a) Location of movable assets are not stated in the register for ease of physical verification.
- b) Numbers indicated in assets identification tags are not the same as the ones in the assets register.

In the circumstances, information contained in the assets register do not serve the intended purpose.

2. Intangible Assets - Enterprise Resource Planning (ERP) Software not Fully Implemented

The Company tendered for supply, implementation and commissioning of integrated enterprise resource planning with Agricultural Management System. The contract was awarded to a local consultant at a cost of USD 2,893,530, equivalent to Kshs.295,140,060 at the prevailing exchange rate as at 31st March 2016. However, it was noted that a total of Kshs.196,924,808 representing 67% of the contract amount had been paid to the supplier of the software, whereas out growers general ledger had not been integrated into the system as per the contract.

3. Debt Recovery

According to the Company's finance department policy manual, customers who fail to settle their accounts within the specified period will be given reminders each month for three months. Thereafter the debt collector will be engaged to initiate legal recovery proceedings. Further, it states that only debts which are uncollectable after legal recovery proceedings will be recommended to the Board for write-off.

However, review of the Company's debtors aging analysis report revealed that trade receivables balance of Kshs.24,914,482 as detailed below have remained outstanding for a period of over 120 days which is contrary to the stated credit policy. Although the Company has made a full provision of Kshs.24,914,000 in respect of the stated receivables, no meaningful progress has been reported towards recovery of the debt. The long overdue accounts are an indication of inadequate and ineffective debt collection measures.

Debtor	Details	Amount Kshs.
Magnum International Ltd	Sugar sales debtor	1,713,376
Ndichu/Nakumatt	Sugar sales debtor	8,920,000
Turbo	Sugar sales debtor	3,866,500
Kenmart	Sugar sales debtor	1,390,500
Spectre International Ltd	Molasses debtor	4,119,696
Mumias Sugar	Cane debtor	4,904,410
Total		24,914,482

In the circumstances, recoverability of the debtors balance could not be confirmed.

4. Trade and Other Receivables

4.1. Advance Payments

According to Section 98 (2) of the Public Finance Management Act, (Regulations 2015) advance payment shall not be paid to suppliers of services and goods unless provided for in the contractual terms and conditions contained in a valid contract signed between the procuring entity and the supplier.

However, it was noted that the trade and other receivables balance of Kshs.126,567,000 includes prepayments and deposits balance of Kshs.15,051,000 which is made up of an

advance payments to supplier of goods and services without a valid contract agreements signed with the Company.

Further, it was noted that some of the goods and services worth Kshs.7,034,378 though not supplied had already been paid for as detailed below;

Supplier	LPO Number	Payment Date	Cheque Number	Kshs
Polyflex Industries Ltd	F08589	2-Aug-16	103877/1036 74/75/77/78	1,358,632
Alloytech General Supplies	1000001463	24-Nov-17	108143	384,000
Alloytech General Supplies	1000001481	5-Dec-17	108260	384,000
Alloytech General Supplies	1000002144	11-May-18	110430	276,000
Alloytech General Supplies	1000002145	16-May-18	110460	240,000
Alloytech General Supplies	1000001689	2-Feb-18	109192	256,000
Amity Equipment Ltd	1000000532	18-Apr-17	106099	416,551
Amity Equipment Ltd	1000001602	11-Jan-18	108650	72,000
Crown Motors Ltd	1100000217	18-Jan-18	108873	111,870
Crown Paints Kenya	G05737	1-Dec-15	102335	293,680
Crown Paints Kenya	G06360	21-Feb-17	105665	160,651
East African Chains Ltd	F06155	3-Oct-12	35230	178,244
East African Portland Cement	1000001808	1-Mar-18	109731	278,015
Envertek Africa Consult Ltd	S02369	2-Mar-15	41054	100,920
Afritech General Supplies Ltd	1000001480	5-Dec-17	108259	126,000
Signode Packaging Systems Ltd	F08943	19-Dec-16	105045/45	52,200
Soni Technical Services Ltd	F08738	8-Jan-17	105203	275,463
Sucrotech (K) Limited	1100000238	9-Mar-18	109806	346,000
Sucrotech (K) Limited	1400000001	29-Mar-18	110076	485,000
Sukdan Ltd	1000001740	20-Feb-18	109537	466,674
Total Kenya Ltd	1000001309	17-Oct-17	107626	151,937
Total Kenya Ltd	NSC/PUR/AD M/01/30/17	3-Aug-17	106889	620,541
Total				7,034,378

4.2. Safari Imprest

Included in the trade and other receivables balance of Kshs.126,567,000 is an amount of Kshs.55,444,000 in respect of staff receivables which in turn includes Kshs.12,057,057 being balance of safari imprest overdue for accounting. This is contrary to Section 92(5) of Public Finance Management Act, 2012 which stipulate that imprest holders should account or surrender imprest within seven (7) working days after return to duty station.

Further, it was noted that the staff receivables balance of Kshs.55,444,000 includes a figure of Kshs.8,862,100 outstanding on account of former staff.

In the circumstances, it was not possible to ascertain accuracy of the trade and other receivables balance as at 30 June 2018.

5. Management of Out Growers (Farmers) Balances

5.1. Out Growers Balances

Included in the trade and other payables balance of Kshs.7,185,681,000 detailed under note 28 to the financial statements is an amount of Kshs.502,690,000 owing to out growers that significantly increased from Kshs.249,351,000 in 2017 by Kshs.253,339,000 (50%) yet the company operations were minimal during the year under review.

Further, it was noted that the out-growers balances may not have been accurately captured because the out growers (farmers) are managed using the Agricultural Management Software (AMS) systems which captures individual farmer records while the finance management records are under Systems Applications and Products (SAP) which maintains a control account of the total out growers balances and the two systems have not been integrated.

5.2. Sugar Development Levy

According to the Sugar Act No.10 of 2001 that every sugar company should remit 4% of the ex-factory price for locally produced sugar and this levy should be remitted to the Sugar Board not later than the tenth day of the following month during which the levy was collected.

Included in the trade and other payables figure of Kshs.7,185,681,000 detailed under note 28 of the financial statements is an amount of Kshs.856,603,000 in respect of outstanding sugar levy to be remitted as at 30 June 2018.

In the circumstances, the company has operated in contravention of the Sugar Act No. 10 of 2001.

5.3. Non Remittance of Retirement Benefits Deductions

Section 2 of the Company's retirement benefits scheme 2007, states that the main purpose of the scheme is to provide retirement benefits to the employees, where the members contribute at a rate of 6% of their salary while the sponsor contributes 12% of the member's salary to the fund.

Contrary to the investment policy of the scheme it was noted from the financial statements at Note 19(a) that Company limited has not remitted Kshs.212,627,000 to staff Retirement Benefit Scheme Fund. As such this amount is still accumulating on monthly basis.

Consequently, the retiring staff are not likely to access their pension upon retirement and the continued operation of the retirement benefits scheme fund is doubtful.

5.4. Tax Penalties

It is a requirement that the Company should remit its Value added Tax (VAT), Pay as You Earn (PAYE), Sugar Development Levy (SDL) and withholding taxes to the respective institutions in time. According to Regulations 145 of the Public Finance Management

(National Government) Regulations, 2015 any liability or expenditure which could have been avoided and need not have been incurred is a loss.

However, as at the time of audit, it was noted that the Company had delayed remittance of taxes and other Levies which has attracted penalties totaling to Kshs.2,524,265,973 as at 30 June 2018 as detailed below;

Tax Penalties

Item	Balance (Kshs)
Balance b/f	1,882,823,643
VAT	421,281,587
PAYE	220,160,744
Total	2,524,265,973

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, except for the matters described in the Basis for Qualified Opinion section of my report, 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 Companies Act, 2015, I report based on the audit that:

- (i) In my opinion, the information given in the report of the directors on page 10 is consistent with the financial statements.
- (ii) In my opinion the auditable part of the directors' expenses report on page 39 has been properly prepared in accordance with the Kenyan Companies Act, 2015.

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 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 ability to continue as a going concern/ sustain services, disclosing, as applicable, matters related to going concern and using the going concern 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 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 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 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

17 April 2019