REPORT OF THE AUDITOR-GENERAL ON NZOIA SUGAR COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE, 2019

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Nzoia Sugar Company Limited set out on pages 1 to 45, which comprise of the statement of financial position as at 30 June, 2019, statement of profit or loss and other 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 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 the Nzoia Sugar Company Limited 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 and comply with the Kenya Companies Act, 2015 and the Public Finance Management Act, 2012.

Basis for Qualified Opinion

1. Material Uncertainty Related to Going Concern

The statement of comprehensive income reflects operating loss of Kshs.3,168,791,000 (2018: loss of Kshs.3,568,733,000). As at 30 June, 2019 the Company had a shareholder funds deficit of Kshs.41,551,388,000 (2018: Kshs.38,382,596,000) while the current liabilities of Kshs.49,626,556,000 exceed current assets of Kshs1,294,843,000 by Kshs.48,331,713,000, demonstrating that the Company is unable to meet its financial obligations as and when they fall due. This state of affairs is indicative of an acute financial challenge facing the Company which raises significant doubts on the its ability to operate as a going concern.

The Company is therefore technically insolvent and its continued existence as a going concern is dependent upon the financial support from its creditors and the Government.

2. Property, Plant and Equipment

As disclosed in Note 15 to the financial statements, the statement of financial position reflects property, plant and equipment balance of Kshs.10,631,169,000. The following unsatisfactory observations were made:

2.1. Idle Plant Valuation

The figure includes idle plants with carrying value of Kshs.295,697,000 based on a valuation carried out in June, 2015. The plants were acquired between 1990 and 1993 when the company undertook an expansion of the factory's cane crushing capacity from 3,000 tonnes of cane per day to 7,000 tonnes of cane per day. The expansion was financed by an international company and guaranteed by the Government of Kenya. The expansion program was not completed then and the acquired plant have been lying idle since acquisition and have not generated any income for the Company. Although the Management explained that the State Department for Public Works has given reserve prices for possible disposal of the idle plant, the written report by the Ministry was not availed for audit review. It was noted from the earlier valuation report that some of the items are in deplorable state and the Company has not recognised possible impairment charge on these assets which have been lying idle for over 29 years.

2.2. Installation of CCTV Surveillance System

The figure includes work in progress of Kshs.4,333,000 relating to installation, testing and commissioning of CCTV surveillance system at a contract sum of Kshs.7,179,850. The work was inspected and a completion certificate issued on 29 November, 2018. However, Management did not provide supporting documents of items inspected and certified and their related costs. There were indications that the work was not completed based on the bills of quantities.

In the circumstances, it was not possible to confirm the valuation of property, plant and equipment amounting to Kshs.300,030,000 included in the property, plant and equipment in the statement of financial position as at 30 June, 2019.

3. Inventory

As disclosed in Note 9 to the financial statements, the statement of financial position reflects inventory balance of Kshs.584,690,000. However, examination of records revealed the following unsatisfactory matters: -

3.1. Slow Moving and Unutilized Inventories

The balance constitutes huge inventory amounting to Kshs.137,499,816 which have never been utilized. A review of the store's ledger cards for the factory store indicated that Management has continued to maintain idle stock. In particular, Management signed a contract with a local dealer for the supply of syrup clarification chemicals at a contract price of Kshs.21,300,324 on 30 March, 2016. The goods were delivered on 20 February, 2017 and inspected on 9 March, 2017. However, the chemicals were not utilized and expired by 20 May, 2018.

3.2. Uncleared Goods

Further, the inventory balance includes uncleared goods worth Kshs.142,712,554 which had been held at the port of Mombasa awaiting clearance since 2017 with the charges having accumulated to Kshs.79,956,627 as at 30 June, 2019. Due to the long period that the goods have been held at the port, the charges are accumulating while the goods are subject to obsolescence. The Company is likely to fail to realise value for money on the expenditure as it continues to incur extra losses.

In the circumstances, it was not possible to confirm the accuracy, completeness and valuation of inventory of Kshs.280,212,370 included under the inventory reflected in the statement of financial position as at 30 June, 2019.

4. Unsupported Loan on Long Term Borrowings

As disclosed in Note 26 to the financial statements, the statement of financial position reflects borrowings of Kshs.41,241,280,000. The balance includes Kshs.726,268,000 made up of Kshs.426,268,000 being direct payments to farmers for the year under review and Kshs.300,000,000 for 2017/2018 and prior years as detailed under Note 26(b) to the financial statements. The Company had received the loan from the Government of Kenya through the Ministry of Agriculture. However, Management did not provide a written loan agreement, setting out terms of the loan, for audit review.

In the circumstances, it was not possible to ascertain the accuracy, completeness and validity of the loan balance of Kshs.726,268,000 included in the borrowings in the statement of financial position as at 30 June, 2019.

5. Unsupported Deferred Income Taxation Liability

As disclosed in Note 27 to the financial statements, the statement of financial position reflects deferred income taxation liability of Kshs.3,885,282,000. The figure remained unchanged from the 2017/2018 financial year. Management was in the process of engaging a tax consultant to compute the deferred tax liability. However, Management did not provide supporting documents for the figure.

In the circumstances, it was not possible to ascertain the accuracy, completeness and validity of the deferred income taxation liability of Kshs.3,885,282,000 reflected in the statement of financial position as at 30 June, 2019.

6. Unsupported Administrative Expenses

As disclosed in Note 9 to the financial statements, the statement of profit or loss and other comprehensive income reflects administrative expenses balance of Kshs.2,065,167,000. The figure includes Directors' expenses of Kshs.29,404,000 which in turn includes Kshs.2,059,778 incurred on local travels comprising taxis and airfare. However, Management did not avail supporting documents such as receipts, air tickets and boarding passes for audit review.

In the circumstances, it was not possible to ascertain the accuracy, completeness and validity of the administrative expenses of Kshs.2,059,778 included under the administrative expenses in the statement of profit or loss and other comprehensive income for the year ended 30 June, 2019.

7. Unsupported Provisions and Contingent Liabilities

As disclosed in Note 34 to the financial statements, the statement of financial position reflects provisions and contingent liabilities of Kshs.121,200,200. However, Management did not provide independent confirmation statements or attestation from the Company's lawyers with regard to on-going litigations to ascertain the adequacy of the provisions and the impact, if any, on the financial statements.

In the circumstances, it was not possible to ascertain the adequacy and possible impact of provisions of Kshs.121,200,200 reflected in the statement of financial position as at 30 June, 2019.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the Nzoia Sugar Company Limited Management in accordance with ISSAI 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.

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. Unsupported Trade and other Receivables

As disclosed in Note 20 to the financial statements, the statement of financial position reflects trade and other receivables balance of Kshs.61,656,000. Included in the figure are advance payments to suppliers amounting to Kshs.7,461,274. However, Management did not support the advance payments with any contractual agreement. This is contrary to the Public Finance Management (National Government) Regulations 2015 section 98 (2) which provides that 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.

In the circumstances, the Company was in breach of the law.

2. Unpaid Salary and Wages

A review of the Company's Human Resource records revealed that the Company had not paid its employees salaries from the month of March, 2019 to October, 2019 resulting into salary arrears of Kshs.356,847,031 and wages of Kshs.45,682,130 payable to permanent employees and casuals respectively.

According to section 41 C (2) of the Public Service Commission Human Resources Policy and Procedures Manual of May, 2016, all officers should be paid salary on monthly basis in Kenya currency through their respective bank accounts.

In the circumstances, the Company was in breach of the law.

3. Unutilized Investment Property

As disclosed in Note 17 to the financial statements, the statement of financial position reflects investment of Kshs.250,000,000. The balance relates to a residential plot owned by the Company in Kileleshwa Estate, Nairobi under Registration and for which it has been paying an annual land rate of Kshs.112,600 from 2012. The house which is on the plot was last occupied seven (7) years ago at a monthly rent of Kshs.75,000. However, a review of the Company's internal audit report revealed that Management continues to incur land rates of Kshs.112,600 annually. The house has remained vacant resulting into cumulative loss of potential revenue amounting to Kshs.6,300,000.

Further, the report indicates that there was outstanding rent arrears balance of Kshs.1,080,000 owed by the previous tenant. This is in breach of section 139 (1) (b) of the Public Finance Management Regulation, 2015 which provides that an Accounting Officer shall take full responsibility and ensure that proper control systems exist for assets and that movement and conditions of assets can be tracked.

In the circumstances, I am unable to confirm whether Management utilized public resources in an effective way and that value for money has been derived from the amounts paid as land rates.

4. Failure to Remit Statutory Deductions

As disclosed in Notes 28 and 29 to the financial statements, the statement of financial position reflects current liabilities of Kshs.8,561,170. The balance includes trade and other payables balance of Kshs.3,285,596,000 being tax penalties which the Company is required to settle as a result of delayed remittance of taxes and other levies as detailed below:

Description of Penalties	**Amount Kshs.**
Balance b/f - Tax penalties 2017/18	2,524,266,000
Pay As You Earn (PAYE)- 2018/19	228,963,000
Value Added Tax (VAT) – 2018/19	532,367,000
Total	**3,285,596,000**

This is contrary to a requirement as stipulated by the respective laws that the Company should remit its Value Added Tax (VAT), and Pay as You Earn (PAYE) to the respective institutions.

Further, the figure includes outstanding sugar development levy of Kshs.856,603,000. This was contrary to the Sugar Act No.10 of 2001 which provides that every sugar company should remit 4% of the ex-factory price for locally produced sugar to the Sugar Board not later than the tenth day of the following month during which the levy was collected.

In addition, Regulation 145 (e) of the Public Finance Management (National Government) Regulations, 2015 asserts that any liability or expenditure which could have been avoided and need not have been incurred is a loss.

In the circumstances, the Company is in breach of the law.

5. Unremitted Retirement Benefits Deductions

As disclosed in Note 29(a) to the financial statements, the Company had not remitted Kshs.201,993,000 to Staff Retirement Benefits Scheme Fund. This is contrary to section 2 of the Company's Retirement Benefits Scheme, 2007 which states that the main purpose of the scheme is to provide retirement benefits to the employees, where the members contribute 6% of their salary while the employer contributes 12% of the members' salary to the fund. Consequently, retiring staff are not likely to access their pension upon retirement and the continued operation of the retirement benefits scheme fund is doubtful.

In the circumstances, the Company was in breach of the law.

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 Conclusion on Effectiveness of Internal Controls, Risk Management and Governance section 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.

Basis for Conclusion

Long Outstanding Staff Receivables

As disclosed in Note 20 to the financial statements, the statement of financial position reflects a balance of Kshs.61,656,000 under trade and other receivables. The balance includes an amount of Kshs.34,114,000 in respect of staff receivables which in turn includes an amount of Kshs.8,862,097 held by former staff. This is contrary to the finance department policy manual that requires staff imprests be accounted for within 48 hours. Any unaccounted for imprest within the stipulated time will be recovered through the payroll. It also contravenes regulation 93(5) of the Public Finance Management (National Government) Regulations, 2015 which provides that a holder of temporary imprests to account or surrender the imprests within seven (7) days after returning from duty.

Further, a review of the debtors' ageing analysis revealed that the above balance includes trade receivables amounting to Kshs.67,613,896 that have remained outstanding for a period of over 120 days. This is contrary to the finance department's policy manual, which provides that customers who fail to settle their accounts within the specified period will be given reminders each month for three months, thereafter debt collectors 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. Management did not avail evidence on progress towards recovery of the debts.

I am therefore unable to confirm effectiveness in the implementation of internal controls and governance as designed.

The audit was conducted in accordance with ISSAI 2315 and ISSAI 2330. The standards require that I plan and perform the audit so as 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.

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Companies Act, 2015, except for maters reported in the Basis for Qualified Opinion, Basis for Conclusion on Lawfulness and Effectiveness in Use of Public Resources and Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance sections of my report, I report based on the 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 Board of Directors

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the 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 overall 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 going concern basis of accounting unless Management is aware of intention to liquidate the Company 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.

The Board of Directors is responsible for overseeing the financial reporting process, reviewing the effectiveness of how the Company 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 overall 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 overall 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. 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 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's 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

12 August, 2021