

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

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## REPORT ON THE FINANCIAL STATEMENTS

### Qualified Opinion

I have audited the accompanying financial statements of Nzoia Water Services Company Limited set out on pages 18 to 54, which comprise the statement of financial position as at 30 June 2018, and the statement of 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 Nzoia Water Services Company Limited as at 30 June 2018, and its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and comply with the Companies Act, 2015.

### Basis for Qualified Opinion

#### 1. Cash and Bank Balances

The statement of financial position reflects cash and cash balance of Kshs.7,542,959 as at 30 June 2018. However, the management did not maintain cash books for the five (5) bank accounts operated by the company contrary to the provisions of Section 100 of the Public Finance Management (County Governments) Regulations, 2015 which requires accounting officers in all offices concerned with receiving cash or making payments to maintain a cash book showing the receipts and payments and maintain such other books and registers as may be necessary for the proper maintenance and production of the accounts of the budget for which he or she is responsible.

Consequently, the accuracy and existence of the cash and cash equivalent balance of Kshs.7,542,959 as at 30 June 2018 cannot be confirmed.

#### 2. Capital Works

The statement of financial position reflects property, plant and equipment balance of Kshs.77,412,736 as at 30 June 2018 which includes capital works figure of Kshs.32,135,465 as disclosed in note 15 to the financial statements. The management explained that this amount relates to receipts from Water Sector Trust Fund (WSTF) for construction of water kiosks and ablution blocks in Kitale and Bungoma respectively under the Urban Project

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Concept (UPC). However, no records or supporting schedules were available for audit review to show how the figure was arrived at. In addition, information available indicates that the projects were completed between 2013 and 2016 and are in use as per the completion certificates provided for audit. However, no reason was also given for not transferring the value of the completed projects to Lake Victoria North Water Services Board who are supposed to be the custodian of the completed projects.

Further, the project funds are managed independently by a fund accountant, but the project cashbook and other books of account were not available for audit review.

Consequently, the accuracy and authenticity of the capital works balance of Kshs.32,135,465 could not be confirmed as at 30 June 2018.

### **3. Deferred Tax Asset**

The statement of financial position reflects deferred tax asset balance of Kshs.10,106,651 under non-current assets indicated in note 17 to the financial statements as tax losses carried forward as compared to Kshs.15,949,061 in the previous year. However, the reconciliation (computation) giving details of the reconciling items was not provided for audit review. Consequently, the accuracy and validity of the deferred tax asset balance of Kshs.10,106,651 as at 30 June 2018 could not be ascertained.

### **4. Water Sector Trust Fund Grants**

Information available indicates that between 2016/2017 and July 2018, the Nzoia Water Services Company Limited received a total of Kshs.26,112,218 from the Water Sector Trust Fund to implement three programmes under the Up-Scaling Basic Sanitation for Urban Poor (UBSUP) namely Nzoia Bungoma Household Sanitation Project Phase II, Bungoma Town Household Sanitation project and Kitale Sanitation project and Chwele Public Sanitation Project funded under Urban Projects Concept (UPC) Call No.7.

The Nzoia Bungoma Household Sanitation Project Phase II was advanced Kshs.6,735,000, Bungoma Town Household Sanitation project got Kshs.7,017,710 and Kitale Sanitation project got Kshs.7,017,710 being subsidy for putting up 300 SafiSan Toilets each. In addition Chwele Public Sanitation Project funded under UPC Call No.7 received funding of Kshs.5,341,798 (Kshs.2,034,970 in July 2017 and the balance in July 2018).

However, the management has not provided records showing how the grants amounting to Kshs.26,112,218 was utilised and also the same has not been disclosed in the financial statements for the year ended 30 June 2018. Consequently, the accuracy and completeness of the financial statements cannot be confirmed for the year ended 30 June 2018.

### **5. Trade Receivables**

The statement of financial position reflects trade and other receivables balance of Kshs.257,780,546 as at 30 June 2018 which includes trade receivables of Kshs.231,565,270 as disclosed in note 19 to the financial statements. The trade receivables balance of Kshs.231,565,270 is net of provision for bad and doubtful debts of Kshs.12,187,646. The trade receivables figure include Kshs.149,380,405 which has been outstanding for over a year (Kshs.22,489,309 for over five years) and therefore may not be collectable as detailed below :

<b>Details</b>	<b>2017/2018 (Kshs)</b>	<b>2016/2017 (Kshs)</b>
Less than 1 year	94,372,513	72,534,706
Between 1 and 2 years	24,234,832	26,677,251
Between 2 and 3 years	34,005,718	22,794,055
Between 3 and 4 years	14,964,552	57,000,972
Between 4 and 5 years	53,685,994	4,047,733
Over 5 years	22,489,309	25,289,008
Total	243,752,917	208,343,726
Provision for bad and doubtful debts	(12,187,646)	(10,417,186)
<b>Net</b>	<b>231,565,270</b>	<b>197,926,539</b>

This is contrary to the company credit management policy of September 2016 which requires that on 121st day of debts outstanding, names of the defaulters be sent to Credit Reference Bureau (CRB) for defaulting and that on 151st day, legal action may begin after sending the notice of the outstanding bills and all administrative action has failed. However, no documentary evidence has been provided to confirm that the management adhered to this policy. Further, the provision for bad and doubtful debts rate of 5% has no supporting policy and has also not been disclosed under the significant accounting policies in the financial statements.

Consequently, the accuracy and validity of the trade receivables balance of Kshs.231,565,270 could not be confirmed as at 30 June 2018.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Nzoia Water Services Company Limited 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.

## **Emphasis of Matter**

### **1. Failure to Remit Pension Contributions**

The statement of financial position reflects retirement benefit obligations amount of Kshs.21,674,850 as at 30 June 2018 being employee retirement benefit contributions payable to LAPTRUST, LAPFUND and NSSF. Information available indicates that the amounts have been outstanding for over a year contrary to the provisions of section 53 A(1) of the Retirement Benefits Act, which provides that an employer, having with the agreement of an employee who is a member of a scheme, made a deduction from the employee's emoluments for remittance to the scheme, fails to remit the deduction within fifteen days of the deduction, the scheme may, after giving such employer not less than seven days' notice, institute proceedings for the recovery of the deduction.

Consequently, the management is in breach of the law, risk incurring penalties for non-remittance and also retiring employees may not be able to access their pension benefits when they retire.

### **2. Withholding Tax**

During the year under review, the Company did not deduct and withhold VAT tax from the respective suppliers even though it was appointed as VAT withholding tax agent in accordance with VAT Act, 2013 and the related regulations of 2017. Consequently, the management is in breach of the law.

### **3. Non Remittance of Administrative Levies**

The statement of profit and loss and other comprehensive income for the year ended 30 June 2018 reflects administrative levies amount of Kshs.34,131,691 in respect of administrative levies payable to Lake Victoria North Water Services Board (LVNWSB), Water Services Regulatory Board (WASREB), Water Resource Management Authority (WARMA) and administrative levies to Counties as disclosed in note 9 to the financial statements. The levies are in line with the Company's approved tariff agreement published in the Kenya Gazette Notice No. 34 of 5 January 2018 by Lake Victoria North Water Services Board, which requires the company to remit all the levies deducted to the relevant authorities. However, no reason has been provided for non-remittance of the administrative levies to the respective bodies.

In addition, the management has not provided a basis for accruing deductions amounting to Kshs.6,962,167 in respect of counties since the Water Act, 2016 provides that dividends or other payments shall not be paid to the owners of public water services providers as long as the universal rights of access to safe and clean water have not been achieved in the designated service areas.

Consequently, management is in breach of the law and compromises the ability of the beneficiary institutions to deliver on their regulatory functions and financing agreements.

#### **4. Disclosures and Notes**

The statement of compliance and basis of preparation on page 24 includes a note indicated as note xxx on areas involving a higher degree of judgement or assumptions instead of the actual note number. Also, it indicates that the statements were prepared in accordance with the Water Act, 2002, but silent to the updates in the Water Act, 2016. Further, there is no disclosure of the capital commitments of the Company during the year as required by the reporting framework prescribed by the International Public Sector Accounting Standards Board. In addition, the financial statements submitted for audit did not include progress report on follow up of auditor recommendations indicating the actions taken by the management to resolve/implement prior year audit recommendations. Consequently, the management has not complied with the prescribed reporting framework.

#### **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**

##### **Nugatory Payment**

The administrative costs amount of Kshs.191,990,742 for the year ended 30 June 2018 includes repairs and maintenance figure of Kshs.19,395,162 as disclosed in note 8 to the financial statements. The repairs and maintenance figure of Kshs.19,395,162 include plant and treatment works repairs amount of Kshs.4,416,146 and which in turn includes Kshs.780,000 paid to a supplies company on 22 November 2017 vide payment voucher number 1210 in respect of advance payment for supply of a water pump. Information available indicates that the supplies company was awarded the contract to supply the submersible water pump at a contract sum of Kshs.3,900,000 through local purchase order No.1589 being the second lowest bidder after the lowest bidder was unable to supply the pump. However, the pump supplied according to the management failed to meet the required technical specifications and therefore has remained unused. Further information available indicates that on 25 April 2018, the company vide letter reference No. NWSC/HO/MD/P/T(C-1)/2017-18(1) advised the supplier that the pump supplied did not meet the required specifications and that the same should be collected and that a process to recover the amount paid out of performance security with the bank had been initiated.

However, as at the time of audit in March 2019, there was no evidence that the supplier had collected the pump and the advance payment of Kshs.780,000 recovered.

Consequently, the expenditure of Kshs.780,000 amounts to nugatory payment.

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 INTERNAL CONTROLS EFFECTIVENESS, GOVERNANCE AND RISK MANAGEMENT SYSTEMS

### Conclusion

As required by Section 7(1)(a) of the Public Audit Act, 2015, because of the significance of the matters discussed in the Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance section of my report, based on the audit procedures performed, I confirm that internal controls, risk management and governance were not effective.

### Basis for Conclusion

#### 1. Water Sales Revenue

The statement of profit and loss and other comprehensive income reflects sales figure of Kshs.327,762,199 which includes water charge of Kshs.273,067,833 as disclosed in note 5 to the financial statements. However, the accuracy of the water charge figure of Kshs.273,067,833 could not be confirmed due to variances in water production and sales figures in cubic metres between the records maintained by the production unit and those maintained by the technical unit and which have not been explained or reconciled as below:

Details	Production Unit (M <sup>3</sup> )	Technical (M <sup>3</sup> )	Variance(M <sup>3</sup> )
Production Capacity	14,004,500	18,797,500	(4,793,000)
Produced Water	10,668,324	7,619,385	3,048,939
Water Supplied	9,443,501	4,278,055	5,165,446

Consequently, the accuracy of the water sales revenue or the quantity of water sales attributable to the value of water sales reflected in the financial statements cannot be confirmed for the year ended 30 June 2018.

#### 2. Non-Revenue Water

Information availed for audit review indicated that 7,619,385 cubic meters (M3) of water was produced during the year under review out of which 4,278,055 cubic metres (M3) was billed to customers for Kshs.327,762,199 to leave 3,341,330 cubic meters (M3) or approximately 44% unaccounted for water (UFW), which is 19% over and above the Water Services Regulatory Board (WASREB) guidelines allowable loss of 25%. The significant level of unaccounted for water (UFW) of 3,341,330 M3 at a rate of Kshs.76.61 per cubic metre may have resulted to a loss of sales estimated at Kshs.255,979,291 which may impact negatively on the company's profitability and long term sustainability.

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 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, except as explained in the basis for qualified opinion paragraph, adequate accounting records have been kept by the Company, so far as appears from the examination of those records;
- (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 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 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 Company's policies and procedures may deteriorate.

As part of an audit conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional scepticism 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 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.

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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**

**12 July 2019**