

# **REPORT OF THE AUDITOR-GENERAL ON SCHOOL EQUIPMENT PRODUCTION UNIT 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 School Equipment Production Unit set out on pages 1 to 13 which comprise the statement of financial position as at 30 June 2018, and the statement of comprehensive income, statement of changes in equity and statement of cash flows, 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 School Equipment Production Unit 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 Companies Act, 2015.

### **Basis for Qualified Opinion**

#### **1. Receivables and Prepayments**

As previously reported, the receivables and prepayments balance of Kshs.82,224,089 as at 30 June 2018, includes debts totalling to Kshs.32,076,205 out of which Kshs.21,816,268 have been outstanding for more than nine (9) years and whose supporting documents were not availed for audit review. Further, the figure of Kshs.82,224,089 also includes staff advances of Kshs.1,017,941 out of which Kshs.829,984 are in respect of staff advances due from deceased employees and those who have since left the Unit and whose recoverability is doubtful. The management has however, indicated that fire broke out in the Unit's headquarters in 2007 and destroyed supporting schedules relating to receivables and that recovery of debtors has been affected by lack of evidence.

In the circumstances, it has not been possible to confirm the validity, accuracy and full recovery of the receivables and prepayments balance of Kshs.82,224,089 as at 30 June, 2018.

#### **2. Trade and Other Payables**

As previously reported, the trade and other payables balance of Kshs.27,988,792 as at 30 June 2018 includes trade payables of Kshs.12,071,248 out of which payables totalling to Kshs.7,860,823 have been outstanding for more than nine (9) years and whose supporting documents were not availed for audit review. The management has however, indicated that fire broke out in the Unit's headquarters in 2007 and destroyed supporting schedules relating to the payables. The management also placed advertisement in the daily newspapers in November 2016 to inform relevant creditors to present documents supporting the services offered to the Unit but with little success. In the circumstances, it

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has not been possible to confirm the validity and accuracy of the trade and other payables balance of Kshs.27,988,792 as at 30 June 2018.

### **3. Land**

As previously reported, the property, plant and equipment balance of Kshs.94,936,307 as at 30 June 2018 includes land at a cost of Kshs.63,000,000. The piece of Land identified as plot No. LR.209/14009, measuring 5.1 hectares, is situated at Imara Daima Estate, Industrial area and is registered under the Unit's name. However, although the land was allocated to the Unit in 1996, the Unit has not been able to develop it due to subsequent invasion by squatters. The management has however indicated that a letter vide reference number SEPU/NLC/2018 of 23 February 2018 was written to the chairman, National Land Commission requesting for assistance to claim their land by evicting the squatters to develop the land. However, no response to the letter or evidence of possession of land has been available for audit review as at the date of this report. In the circumstances, it has not been possible to ascertain the ownership status of the piece of land and to confirm that the property, plant and equipment balance of Kshs.94,936,307 as at 30 June 2018 is fairly stated.

### **4. Supply of School Equipment**

As reported in the previous years, the Unit entered into a contract in the year 2006 with a local Company for the supply of various pieces of laboratory equipment, chemicals and teaching aids to 1,457 secondary schools across the country, at a contract price of Kshs.226,772,450. According to records available, the Unit in 2008/2009 financial year received an amount of Kshs.261,326,532 from the parent Ministry of Education for the purpose. However, and despite availability of other suitable methods, the Unit used direct procurement to identify the supplier, besides making an advance payment of Kshs.75,086,880 to the supplier.

Additional information indicate that the officials of the Ethics and Anti-Corruption Commission intercepted the funds immediately after the advance payment was made and various officers of the Unit have since been arraigned in a Court of Law and charged over the contract. A review of the matter in December 2017 revealed that judgement was entered in favour of the plaintiff Vulcan Lab Equipment on 7 December 2017 and against the 1<sup>st</sup> defendant School Equipment Production Unit (SEPU) for a sum of Kshs.150 million cost and interest and no stay of execution given to SEPU. The management has availed evidence that the Supplier made a refund of Kshs.70,000,000 to the National Treasury in 2013/2014 financial year leaving a balance of Kshs.5,086,880 and undetermined interest on the principle amount. A review of the matter in 2017/2018 indicated that the management expected the court would compel the plaintiff Vulcan Lab Equipment to pay the balance plus interest earned. However, the funds had not been paid and remitted to the Unit as at the date of this report.

Further, and as previously indicated under the Statement of changes in equity for year 2014/2015, out of the Kshs.261,326,532 received from the parent Ministry, for acquiring laboratory equipment, chemicals and teaching aids, Kshs.40,044,282 was paid to the

Kenya Revenue Authority to cover tax arrears and penalties. It was therefore not possible to ascertain whether the amount of Kshs.261,326,532 was expended as appropriated.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of School Equipment Production Unit 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 of my report, I have determined that there are no Key Audit Matters to communicate in my report.

## **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 has come to my attention to cause me to believe that public resources have not been applied lawfully and in an effective way.

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, GOVERNANCE AND RISK MANAGEMENT SYSTEMS**

### **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.

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.

### **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 disclosing, as applicable, matters related to going concern and using the applicable basis of accounting unless the management either intends to liquidate the Unit 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 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 Project'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 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 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 Unit 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.

#### REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Kenya 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, proper books of account have been kept by the Unit, so far as appears from my examination of those books; and,
- (iii) The Unit's statement of financial position and statement of comprehensive income are in agreement with the books of account



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

**Nairobi**

**21 March 2019**