

REPORT OF THE AUDITOR-GENERAL ON KENYA LEATHER DEVELOPMENT COUNCIL FOR THE YEAR ENDED 30 JUNE, 2020

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Kenya Leather Development Council set out on pages 1 to 32, which comprise the statement of financial position as at 30 June, 2020, statement of financial performance, statement of changes in net assets, 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 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 the Kenya Leather Development Council as at 30 June, 2020 and of its financial performance and its cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (Accrual Basis) and comply with the Kenya Leather Development Council Order, 2011 and the Public Finance Management Act, 2012.

Basis for Qualified Opinion

1.0 Property, Plant and Equipment

The statement of financial position as at 30 June, 2020 reflects property, plant and equipment totalling Kshs.408,767,695. However, examination of records on the balance revealed the following unsatisfactory issues:

1.1 Unconfirmed Assets at Training and Production Centre

The property, plant and equipment balance includes land valued at Kshs.44,000,000 and other assorted equipment acquired by the Council when the Training and Production Centre for the Shoe Industry (TPCSI) located in Thika Town was acquired by the Council from Kenya Industrial Research and Development Institute (KIRDI). However, the handing over report did not disclose the values of the items of equipment, some of which were bought at inception of the Centre in 1994, or in earlier years, and were operational, and others that were obsolete and dysfunctional.

In addition, the handing over report, indicated that TPCSI campus was located on a 0.1096 hectare (0.271 acre) plot of land, as per Trustee Deed made on 25 February, 1994 and certificate of title issued on 25 April, 1996. However, the title deed had not been transferred to the Council as at 30 June, 2020.

In view of these issues, valuation of the Council's property, plant and equipment at Kshs.408,767,695 and ownership by the Council of the land on which the TPCSI is located could not be confirmed.

1.2 Delayed Construction of Effluent Treatment Plant

KLDC in a joint venture with the Export Processing Zone Authority (EPZA) in February, 2017 entered into a contract with a local contractor to build a modern common effluent treatment plant at Kenya Leather Park - Kenanie, Machakos Country at a contract sum of Kshs.2,265,324,226. Records provided for audit indicated that a feasibility study on the plant had before hand been procured by the EPZA and carried out in April, 2016.

However, audit review of procurement and management of the project contract raised the following concerns:

- (i) Records provided for audit indicated that, work commenced on 15 March, 2017 and was due for completion on 18 September, 2018 after 540 days but the date was revised on two occasions and eventually set for 28 June, 2021. At the time of conducting the audit in March, 2021, expenditure on the project totaled Kshs.629,827,310 equivalent to 27.8% of the contract price. Comparison of the work plan and targets revealed that the works were approximately 48% complete.
- (ii) In June, 2017, Management made an advance payment totalling Kshs.385,105,119 to the contractor and thereafter paid Kshs.90,000,000 on 1 March, 2018 for Works Certificate No.2 in 2018 and Kshs.40,000,000 for Works Certificate No.3 in 2019. Although Clause 13.2.2 of the contract indicated that the value of the performance security was to be amortized in proportion to the value of the work executed by and paid to the contractor until full recovery, the Council paid the contractor Kshs.25,718,920 during the year under review instead of recovering the amount from the advance payment as prescribed in Clause 13.2.2.
- (iii) Both KLDC and EPZA claim 50% stake in the project. However, the advance payment totalling Kshs.385,105,119 made by KLDC surpassed the 50% value of the venture costed at Kshs.226,532,435. The Council final stake in the project has not been clarified.
- (iv) After construction work commenced, approximately 60% of the project site measuring 500 acres was flooded by rain waters. As a result, the Department of Public Works recommended that the plant be built on the unflooded portion of the land. Consequently, the master plan was revised to accommodate two treatment plants and re-location and a re-design of effluent flow from the leather park to the

treatment plant. However, the agreement between the joint-venture partners and the contractor on the revised contract price following the changes had not been concluded at the time of the audit. In the absence of complete records on the revised works, it was not possible to confirm whether there was change in the value of the contract and how much the completed project would cost.

In view of these issues, it was not possible to confirm whether the property, plant and equipment balance totalling Kshs.408,767,695 reflected in the statement of financial position as at 30 June, 2020 was fairly stated,

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the Kenya Leather Development Council 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 are no key audit matters to report in the year under review.

Other Matter

1.0 Budgetary Control and Performance

The statement of comparison of budget and actual amounts reflects a revenue budget totalling Kshs.1,432,560,017 and actual revenue totalling Kshs.1,433,036,767 resulting to a revenue surplus of Kshs.476,660. The statement further reflects budget expenditure totalling Kshs.1,432,560,107 actual expenditure totalling Kshs.200,626,862 resulting in an under expenditure of Kshs.1,231,933,245. The surplus mainly resulted from recurrent and development capitation balances brought forward from the previous year.

2.0 Prior Year Issues

The report for the previous year highlighted several unsatisfactory issues relating to the property, plant and equipment balance reflected in the financial statements for the year. Management has in the report on progress made in resolving the issues indicated that two of the issues had since been resolved and two others were pending. The actual status of the issues shall be confirmed after they are discussed by the Legislature.

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, I confirm that, except for the matter described in the Basis for Lawfulness and Effectiveness in Use of Public Resources Section of my report , 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.

Unutilized Leather Products Manufacturing Equipment

As previously reported, the Council entered into a contract with local company in 2015/2016 for the supply, delivery, installation of footwear and leather goods manufacturing equipment, and training of artisans at a total cost of Kshs.83,038,539. Although Management had indicated that the venture was preceded by a concept paper and a Memorandum of Understanding (MoU) with the Company, the two documents were not provided for audit review. Further, a deposit amounting to Kshs.16,607,708 equivalent to 20% of the contract value was paid to the Company in 2015/2016.

Contrary to the terms in the signed contract, during the financial year 2016/2017, the Council made a further payment amounting to Kshs.59,787,745 to the supplier before the equipment was installed, commissioned and training of users conducted. In addition, during the year 2015/2016, the had Council engaged a local company at a contract price of Kshs.17,390,148 to supply, deliver, and install foot wear and leather goods manufacturing equipment and train artisans. As a result, the total costs of the equipment bought under the two contracts amounted to Kshs.100,428,687.

All the equipment was delivered and records provided for audit indicated that the Council paid a total of Kshs.92,046,586 out of Kshs.100,428,687 dues. However, the equipment had as at 30 June, 2020 been in storage at the Council's premises for more than three years and most of the items had not been installed, tested and put to their intended uses. As a result, the benefits the equipment was expected to provide in revitalizing local production of shoes and other leather products had not been realized. Management explained the delay in installing the equipment as having resulted from the need to modernize the working spaces the equipments were to be used in, including reconfiguring electrical installations.

Consequently, value for money on the expenditure totalling Kshs.92,046,586 incurred on their purchase had not been realized.

Basis for Conclusion

The audit was conducted in accordance with ISSAI 4000. The Standard requires that I comply with ethical requirements and plan and perform the audit to obtain assurance about whether the activities, financial transactions and information reflected in the financial statements are in compliance, in all material respects, with the authorities that

govern them. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

REPORT ON EFFECTIVENESS OF INTERNAL CONTROLS, RISK MANAGEMENT AND GOVERNANCE

Conclusion

As required by Section 7(1)(a) of the Public Audit Act, 2015, based on the audit procedures performed, I confirm that, nothing has come to my attention to cause me to believe that internal controls, risk management and overall governance were not effective.

Basis for Conclusion

The audit was conducted in accordance with ISSAI 2315 and ISSAI 2330. 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 Board of Directors

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Public Sector Accounting Standards (Accrual Basis) and for maintaining effective internal control as Management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error and for its assessment of the effectiveness of internal control, risk management and governance.

In preparing the financial statements, Management is responsible for assessing the Council's ability to continue to sustain services, disclosing, as applicable, matters related to sustainability of services and using the applicable basis of accounting unless Management is aware of the intention to dissolve the Council, or 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 Director is responsible for overseeing the Council's financial reporting process, reviewing the effectiveness of how Management 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 applicable basis of accounting, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Council's ability to continue 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 Council to cease 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 Council to express an opinion on the financial statements
- Perform such other procedures as I consider necessary in the circumstances.

I communicate with 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 communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.



CPA Nancy Gathungu, CBS
AUDITOR-GENERAL

Nairobi

22 February, 2022