

REPORT OF THE AUDITOR-GENERAL ON TOURISM FINANCE CORPORATION FOR THE YEAR ENDED 30 JUNE, 2020

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Tourism Finance Corporation set out on pages 1 to 55, which comprise the statement of financial position as at 30 June, 2020, and the statement of profit or loss and other comprehensive income, statement of changes in equity, statement of cash flows and the 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 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 Tourism Finance Corporation as at 30 June, 2020 and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards (IFRS) and comply with the Tourism Act, 2011 and the Public Finance Management Act, 2012.

Basis for Qualified Opinion

1. Unsupported Balances

Supporting documents for the following balances reflected in the financial statements were not provided for audit:

Unsupported Balance	Amount (Kshs.)	Note to the Financial Statements
Administration Cost	106,913,648	26
Personnel Costs	146,621,726	27
Trade and Other Receivables	432,446,309	11
Trade Payables	193,649,807	16

In the circumstances, the accuracy of the balances reflected in the financial statements could not be confirmed.

2. Investments

The statement of financial position reflects investments of Kshs.406,285,081. The following observations were made regarding the balance:

2.1 Differing Values in Share Certificates and Financial Statements

As previously reported, the values reflected in the financial statements for various investments in subsidiaries and associates of the Corporation differed with the value reflected in the share certificates as shown in the table below:

Subsidiary/Associate	Value in Financial Statements (Kshs.)	Value as per the Share Certificates (Kshs.)	Difference (Kshs.)
Kenya Safari Lodges	116,061,176	83,237,100	32,824,076
Kabarnet Hotel Ltd	5,432,120	4,910,000	522,120
International Hotel Ltd	135,939,167	34,516,942	101,422,225

2.2 Valuation of Shares

As previously reported, the current value of Kshs.149,665,916 and Kshs.260,685,089 for the shares held in the subsidiaries and associates respectively, are based on historical values and thus do not reflect the current fair value of the shares. The Corporation had not carried out a revaluation of the investments since the time of acquisition dating as far back as the 1960s,1970s and 1980s.

In view of the above, it was not possible to confirm that the investments balance of Kshs.406,285,081 as at 30 June, 2020 was fairly stated.

2.3 Non-Compliance with IFRS Requirements

Paragraph 4 of IFRS 10 – Consolidated Financial Statements provides that an entity that is a parent shall present consolidated financial statements unless all the conditions listed under paragraph 4(a) are met. Paragraph 5 of the IFRS requires an investor, regardless of the nature of its involvement with an entity (the investee) to determine whether it is a parent by assessing whether it controls the investee. Further, Paragraph 9 of IFRS 12 – Disclosure of Interests in Other Entities requires an entity to disclose significant judgements and assumptions made in determining control over another entity, whether it is an agent or a principal and whether it has significant influence.

However, although the Corporation had several subsidiaries and associates as disclosed at Note 9 to the financial statements, the Corporation did not prepare consolidated financial statements and no evidence of the assessment as to whether it was a parent to the investees was provided.

In the circumstances, compliance with the IFRS could not be confirmed.

3. Investment Property

The statement of financial position reflects Kshs.3,144,843,261 for investment property. However, no evidence was provided that the properties were revalued within the last three (3) years. It could therefore not be confirmed that that the reported balance of Kshs.3,144,843,261 for investment property represented the fair value of the properties as at 30 June, 2020 as required under IAS 40 – Investment Property. In addition, as previously reported, the balance included capital work in progress amounting to Kshs.44,843,261 out of which Kshs.21,997,694 had been carried forward since the year 2011 and Kshs.21,632,976 being additions for the financial year 2016/2017.

Consequently, it was not possible to confirm that the investment property balance of Kshs.3,144,843,261 as at 30 June, 2020 was fairly stated.

4. Trade and Other Receivables

4.1. Long Outstanding Receivables

The statement of financial position reflects trade and other receivables of Kshs.290,190,725 which as disclosed at Note 11 to the financial statements included Kshs.151,131,411 owed from unit debtors and dividends due from Kenya Hotel Properties Ltd. amounting to Kshs.27,064,677. However, as previously reported, the receivables had been outstanding for more than three (3) years. In addition, the accuracy of the balances could not be confirmed since the outcome of the circularization of the debtors was not provided and adequate supporting documents to confirm the existence, ownership and the value of the receivables were not provided. Further, although Management explained that a provision of Kshs.59,741,242 had been made relating to the unit debtors, the adequacy of the provision could not be confirmed.

4.2. Other Debtors

The balance of Kshs.39,020,004 for other debtors reflected at Note 11 to the financial statements, included Kshs.13,149,656 owed to the Corporation by two (2) legal firms. This related to a balance outstanding from the initial deposit of Kshs.30,153,000 previously held in an escrow account in the name of the law firms. The deposit was in compliance with the High Court judgement ruled in favour of a Company that had sued the Corporation for damages resulting from a failed loan disbursement. After a successful appeal the advocate secured the release of the funds held in the escrow account which had accrued to Kshs.41,095,376 including interest. The advocate was instructed by the Corporation to transfer the funds to the Corporation net of professional fees of Kshs.419,700. However, as at the time of the audit in November, 2020, the advocate had only transferred Kshs.27,526,020 and was yet to transfer the remaining balance of Kshs.13,149,656. Further, the legal fees payable to the two (2) legal firms were neither recognized nor reported in the financial statements.

5. Unsupported and Irregular Security Allowances

The statement of profit or loss and other comprehensive income reflects administrative costs amounting to Kshs.106,913,646 which as disclosed at Note 26 to the financial statements, included security expenditure of Kshs.7,341,260. Examination of various payment vouchers and related records held at the Corporation's headquarters revealed that security allowances totalling to Kshs.1,908,000 were paid to police officers guarding Utalii House. However, payment schedules containing the list of the deployed officers and acknowledgement of receipt by the officers for the payments made in cash were not provided. In addition, Pay As You Earn (PAYE) tax was not deducted from the payments.

6. Fully Depreciated and Undisclosed Assets

As previously reported, the depreciation schedule and trial balance provided for audit reflected that the firefighting equipment, ERP system (software), standby generator and the pumps were fully depreciated. However, audit inspection and enquiries revealed that the items were in good condition and were still in use. The Corporation was therefore, still deriving economic benefit from the fully depreciated assets.

Additionally, the cost for other fixed assets in use comprising of cameras, gas cooker, fridge, television and ICT projector was not indicated.

In the circumstances, the accuracy and completeness of the property, plant and equipment balance of Kshs.8,836,875 as at 30 June, 2020 could not be confirmed.

7. Non-Performing Loans and Related Party Transactions

The statement of financial position reflects loans (assets) amounting to Kshs.806,267,316 which as disclosed at Note 10 to the financial statements included interest arrears amounting to Kshs.377,603,208. It was also noted that most of the clients were not repaying their loans as per the loan agreements and the balances due remained static or increased. In addition, as disclosed at Note 28(d) to the financial statements, balances due from related parties (investee companies) amounted to Kshs.681,483,277 as at 30 June, 2020. However, the terms and conditions, guarantees for the loans and the provision for doubtful receivables relating to the balances due from the related parties has not been disclosed as required under IAS 24 – Related Party Disclosures.

Although Management explained that most of the Corporation's borrowers were hotels whose business was greatly affected by the Covid -19 containment measures including cessation of movement and curfews and that a Government - sponsored economic stimulus package was being rolled out to ensure the sector did not crush, the recoverability of the loans could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the Tourism Finance Corporation 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.

Other Matter

1. Budgetary Control and Performance

As reflected in the statement of comparison of budget and actual amounts, the Corporation's actual revenue amounted to Kshs.220,048,000 against budgeted revenue of Kshs.267,500,000 resulting into a shortfall of Kshs.47,452,000 or 18%. Further, the Corporation's actual expenditure for the year amounted to Kshs.265,212,000 against budgeted expenditure of Kshs.260,644,000 resulting into an overall over-expenditure of Kshs.4,568,000 or 2%.

It was further observed that the Corporation overspent on security costs, local traveling costs and office expenses as illustrated below:

Items	Budgeted amount (Kshs.)	Actual Expenditure (Kshs.)	Over-expenditure (Kshs.)
Security	6,000,000	7,341,260	(1,341,260)
Local travelling costs	6,000,000	13,391,000	(7,391,000)
Office Expenses	9,850,000	12,786,268	(2,936,268)

Board approval for re-allocation of the funds was not provided.

The over expenditure therefore, constituted unauthorized expenditure.

2. Unresolved Prior Year Audit Matters

As disclosed under the progress on follow up of auditor recommendations section of the financial statements, some of the prior year audit issues remained unresolved as at 30 June, 2020. Management has not provided satisfactory reasons for the delay in resolving the issues.

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. Engagement of a Consultant and Legal Fees not Approved

The Corporation engaged the services of an external counsel without the prior concurrence or approval of the Attorney General and formal disclosure of the fee note.

Further, the advocate unilaterally deducted Kshs.13,149,656 as settlement of unagreed outstanding fee notes contrary to the Corporation's express instructions to remit the funds to the Corporation's loan account since as a matter of policy, the funds in that account could only be used for lending to borrowers pursuant to the Corporation's mandate and not for operational expenses.

In the circumstances, the regularity of the expenditure could not be confirmed.

2. Capital Work in Progress

As previously reported, the Corporation engaged a contractor for the proposed external repainting works and fire escape staircase in Utalii House at a contract sum of Kshs.21,922,810. The works were to start on 26 January, 2017 with a completion date of 31 May, 2017. By December, 2017, the repainting works were complete pending rectification of defects identified during an inspection exercise. However, as at the time of audit in November, 2020, the works were still pending and the contractor had already been paid a total of Kshs.18,098,959 while his demand for full payment was pending for arbitration.

Consequently, it was not possible to confirm that value for money would be obtained from the Project.

3. Employee Costs

Section 26(1)(a) of the Public Finance Management (National Government) Regulations, 2015 provides that expenditure on compensation of employees (including benefits and allowances) should not exceed 35% of the equitable share of the revenue raised plus other revenue generated by an entity.

However, as reflected in the statement of profit or loss and other comprehensive income, the Corporation incurred Kshs.146,621,726 for the employee costs representing 74% of the total revenues received of Kshs.198,415,057.

The Management was therefore, in breach of the law.

4. Failure to Maintain Imprest Register and Vote Book

During the year under review, it was noted that the Corporation did not maintain an imprest register as required under Regulation 93(4)(c) of the Public Finance Management (National Government) Regulations, 2015.

In addition, Regulation 52(1)(j) of Public Finance Management (National Government) Regulations, 2015 provides that each accounting officer shall cause records to be kept in such a form as will clarify at any time the total amount of expenditure sanctioned for service of the year, the amount of the expenditure charged and any further known liabilities in respect of the year for each of his or her votes. However, the Corporation did not maintain a vote book.

The Management was therefore, in breach of the law.

5. Borrowings from Loan Fund/Inter Account Borrowing

Due to cash flow constraints, the Fund had, in the financial years 2017/2018 to 2019/2020 borrowed Kshs.148.3 million from the Loan Fund to finance operational activities including payment of pending bills, salaries and medical expenses. The monies were to be borrowed upon board approval and on overdraft kind of facility and refunded upon collection of rental income. However, as at the time of audit in December, 2020 only Kshs.19.1 million translating to 13% had been refunded.

A board resolution of 18 December, 2017 approved inter-account borrowing upto a maximum of Kshs.10 million from the Loan Fund to the administration account to bridge the cash flow challenges. This was to run for one year upon which it would be reviewed. In addition, Management was to provide quarterly reports on the utilization and repayment of the facility. This approval by the Board does not resonate with the prudent cash management principles and does not absolve the Board and the Managing Director from seeking concurrence from the Parent Ministry, National Treasury and Parliament where applicable as required by National Treasury Circular No. 14/2018NB: Ref: DGIPE/A/1/10 dated 27 November, 2018.

6. Declaration of Internship Opportunities

Section 2.2 of the Internship Policy and Guidelines for the Public Service requires a public entity to declare any internship opportunity to the Public Service Commission. However, the Corporation did not submit the internship opportunities to the Public Service Commission. Instead, the recruitment was done by the Human Resource Department and a total of thirteen (13) interns recruited during the year under review.

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 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 the Board of Directors

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards 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 Corporation'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 the intention to liquidate the Corporation 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 Corporation's financial reporting process, reviewing the effectiveness of how the Corporation 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 Corporation'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 Corporation 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 Corporation 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.



CPA Nancy Gathungu, CBS
AUDITOR-GENERAL

Nairobi

10 February, 2022