

REPORT OF THE AUDITOR-GENERAL ON MUNICIPALITY OF MALINDI FOR THE YEAR ENDED 30 JUNE, 2021

PREAMBLE

I draw your attention to the contents of my report which is in three parts:

- A. Report on the Financial Statements that considers whether the financial statements are fairly presented in accordance with the applicable financial reporting framework, accounting standards and the relevant laws and regulations that have a direct effect on the financial statements.
- B. Report on Lawfulness and Effectiveness in Use of Public Resources which considers compliance with applicable laws, regulations, policies, gazette notices, circulars, guidelines and manuals and whether public resources are applied in a prudent, efficient, economic, transparent and accountable manner to ensure Government achieves value for money and that such funds are applied for intended purpose.
- C. Report on Effectiveness of Internal Controls, Risk Management and Governance which considers how the entity has instituted checks and balances to guide internal operations. This responds to the effectiveness of the governance structure, the risk management environment, and the internal controls developed and implemented by those charged with governance for orderly, efficient and effective operations of the entity.

An unmodified opinion does not necessarily mean that an entity has complied with all relevant laws and regulations, and that its internal controls, risk management and governance systems are properly designed and were working effectively in the financial year under review.

The three parts of the report are aimed at addressing the statutory roles and responsibilities of the Auditor-General as provided by Article 229 of the Constitution, the Public Finance Management Act, 2012 and the Public Audit Act, 2015. The three parts of the report, when read together constitute the report of the Auditor-General.

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Municipality of Malindi set out on pages 19 to 39, which comprise of the statement of financial position as at 30 June, 2021 and the statement of financial performance, statement of changes in net assets, statement of cash flows and statement of comparison of budget and actual amounts and 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 Municipality of Malindi as at 30 June, 2021 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 Urban Areas and Cities (Amendment) Act, 2011, Kilifi County Subsidiary Legislation, 2019 and the Public Finance Management Act, 2012.

Basis for Qualified Opinion

1. Inaccuracies in Statement of Changes in Net Assets

The statement of changes in net assets reflects accumulated surplus of Kshs.187,269,991 which differs with the recalculated total of Kshs.187,043,367 resulting in an unexplained variance of Kshs.226,624 .

In the circumstances, the accuracy of the accumulated surplus of Kshs.187,269,991 could not be confirmed.

2. Unsupported Increase in Accounts Payable

The statement of cash flows reflects an increase in accounts payable of Kshs.4,524,943 which differs with the recalculated decrease in accounts payable in the statement of financial position of Kshs.3,096,905 resulting to an unexplained variance of Kshs.7,621,848.

In the circumstances, the accuracy and completeness of the increase in accounts payables of Kshs.4,524,943 could not be confirmed.

3. Inaccuracies in the Statement of Financial Position

The statement of financial position reflects total assets, total liabilities and net assets balances of Kshs.191,794,934, Kshs.4,524,943 and Kshs.187,269,991 respectively. However, the statement has not reflected the accumulated surplus balance of Kshs.187,043,369 and erroneously reflected total net assets and liabilities balance of Kshs.187,269,991 instead of the recalculated balance of Kshs.187,043,369 resulting to an unexplained variance of Kshs.226,622.

In addition, the statement reflects cash and cash equivalent balance of Kshs.187,269,991 which differs with the recalculated cash and cash equivalent balance in the cash flow statement of Kshs.179,421,520 resulting to an unexplained variance of Kshs.7,848,471.

In the circumstances, the accuracy and completeness of the above balances could not be confirmed.

4. Inaccuracies in the Statement of Cash Flows

The statement of cash flows reflects cash and cash equivalents as at 1 July, 2020 balance of Kshs.187,269,991 instead of Kshs.45,364,029 comparative balance for the previous year resulting to an unexplained variance of Kshs.141,905,962.

Further, the statement of cash flows reflects an increase in accounts payable of Kshs.4,524,943 however the recalculated amount is a decrease of Kshs.3,096,905 resulting to an unexplained variance of Kshs.7,621,848.

In the circumstances, the accuracy and completeness of the above balances could not be confirmed.

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

The statement of comparison of budget and actual amounts reflects final receipts budget and actual on a comparable basis of Kshs.309,967,704 and Kshs.256,959,772 respectively resulting to an under-funding of Kshs.53,007,932 or 17% of the budget. Similarly, the Municipality expended Kshs.114,490,195 against an approved budget of Kshs.304,784,400 resulting to an under-expenditure of Kshs.190,294,204 or 62% of the budget. The underfunding and underperformance affected the planned activities and may have impacted negatively on service delivery to the public.

2. Unresolved Prior Year Matters

In the audit report of the previous year, a number of paragraphs were raised. However, Management has not resolved and disclosed all the prior year matters as provided by the Public Sector Accounting Standards Board templates. Management has not provided satisfactory explanation 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. Delayed Projects Implementation

Review of contracts documents for Urban Development Grant Projects is an expenditure of Kshs.14,293,756 incurred in respect of contract for Design - Build Urban Renewal of Malindi Water Front Public Park and Tourism Infrastructure Project (Tender No. KCG/LEHPPUD/WORKS/004/2018/2019). However, the winning bid

documents and the performance bond of Kshs.8,919,011 which was to expire on 13 May, 2020 were not provided for audit verification.

Further, there was a delay in completion of work by four hundred and ten (410) days from the contract's expected completion date of 14 November, 2019 resulted in liquidated damages amounting to Kshs.8,200,000 which had not been recovered contrary to Regulation 133(1) of the Public Procurement and Asset Disposal Regulations, 2020, which provides that, "any ascertained liquidated damages shall be deducted from the amount of approved invoices due for payment or the performance security. Such damages may emanate from delayed completion of activities or poorly executed activities or both".

In the circumstances the delayed completion of the project has denied the citizens the benefits that could be derived from the projects.

2. Anomalies in the contract on Upgrading of Barclays/Mtangani Road

Review of contracts documents revealed an expenditure of Kshs.67,346,821 incurred on proposed upgrading to bitumen standard of Barclays/Mtangani Road. The contract No. KCG/MM/791257-1/2019/2020 dated 16 July, 2020 was awarded at a contract sum of Kshs.67,524,771. However, the following anomalies were noted:

- i. The winning bidder did not provide a bid bond of Kshs.1,296,000.
- ii. The bidder attained a technical evaluation score of 70 against a score threshold of 60 and therefore the only bidder supposed to proceed to financial evaluation. However, the other two bidders who did not meet the minimum technical evaluation score threshold were irregularly passed on to the financial evaluation with the bidder who had attained a technical score of 50 being awarded the contract.
- iii. The contractor raised invoice No.SWC003 on 25 August, 2020 amounting to Kshs.21,700,287.60 which was not supported by evidence of actual work done and inspection and acceptance report did not itemize the actual work inspected or supported the measured works valued at Kshs.21,700,287.
- iv. Payment certificate No.2 for Kshs.14,087,436 was not supported with details of actual work inspected by the inspection and acceptance committee.
- v. The summary of statement for payments on account No.1 issued by the Department of Roads, Transport and Public Works on 13 August, 2020 for Kshs.21,700,287 includes an amount of Kshs.7,361,300 for earthworks for which the cost as per Bill of Quantities was Kshs.6,345,000.
- vi. The payment on account No.2 for Kshs.12,357,400 issued on 25 September, 2020 includes earthworks amount of Kshs.3,980,000 which was not provided for in the Bill of Quantities, resulting to an unexplained variance of Kshs.4,996,300.
- vii. Remittance of the 2% Withholding VAT of Kshs.321,194 and retention money of Kshs.1,408,744 deducted on Certificate No.2 had not been made by November, 2021, which was a delay of 191 days. This is contrary to the VAT Act, 2021 which states that Withholding tax deducted should be remitted to KRA

by the 20th day of the month following the month in which the tax was deducted. A late payment penalty of 5% shall also apply on the tax due together with a late payment interest of 1% per month for the period that the tax remains unpaid.

In the circumstances, value for money may not have been obtained from the project and Management is in breach of the law

3. Anomalies in the consultancy contract of Solid Waste Recycling Facility at Casuarina Malindi

Review of the contract documents revealed that Kshs.3,080,000 was spent on the consultancy for design, construction and supervision of a solid waste recycling facility at Casuarina, Malindi contract Ref. No. KCG/MM/792669-2/2019/2020 dated 16 July, 2020 for a contract sum of Kshs.4,400,000. The agreed contract period was two (2) months starting from 20 July, 2020 and ending on 25 September, 2020. However, the following anomalies were noted:

- i. The winning bidder's site visit certificate was not provided for review yet it was a prequalification requirement.
- ii. The contractor raised a fee Note No.1 on 16 September, 2020 for Kshs.3,080,000, being 70% of the fees charged. However, according to the terms of the contract, 70% of the fees was payable upon completion of Phases 1 and 2 which involved submission of inception report, final designs drawings and costed Bill of Quantities and statutory approvals for the final design drawings.
- iii. The Bill of Quantities that was submitted and received by the Department of Lands on 30 September, 2020 did not have costing as per the contract agreement and the necessary statutory approvals.
- iv. The Inspection and Acceptance Committee appointed on 3 September, 2020 vide Letter Ref: KCG/LEHPP/PROC/AC-10/Vol.1/1) issued an inspection report on 3 September, 2020 while another inspection report was issued on 4 September, 2020 which indicated work completion at 70%, thus certifying Kshs.3,080,000 for payment. However, the final design drawings were submitted on 16 September, 2020 as per the letter of request for 1st certificate and the Bill of Quantities which were submitted and received on 30 September, 2020, it is not clear what work was certified by the committee on 4 September, 2020.

4. Unsupported Payments Certificate and Unrecovered Liquidated Damages

Review of contracts documents revealed that Kshs.6,689,404 was incurred on a project for Design-Build Commercial and Non-Commercial Motorized Transport, Street Upgrading in Barani in Malindi. The contract price was Kshs.64,639,788 for a contract period of 8 months from 15 March, 2019 to 14 November, 2019. However, certificate No.5 for Kshs.858,604 that was paid on 28 January, 2021 was not supported by itemized measured works while payment certificate No.5 for Kshs.5,830,800 was not provided for audit.

Further, Management failed to recover liquidated damages amounting to Kshs.7,640,000 for a delayed completion period of 382 days, contrary to the contract conditions.

In the circumstances, the value for money realized from the project could not be confirmed.

5. Lack of Integrated Development Plan

The Municipality was established without an approved Urban Area Integrated Development Plan. This is contrary to Section 9(3)(b) of the Urban Areas and Cities Act, 2011 which states that, a town is eligible for the conferment of municipal status under the Act if the town satisfies a number of criteria including having an integrated development plan in accordance with the Act.

In the circumstances, Management 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 matter 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

Failure to Appoint a Board Member

Review of documents revealed that during the year under review , there were only three Board Members instead of four Board Members as required under Section 9(1) of the Municipality Charter which provides for (4) Board members.

In the circumstances, failure to appoint a Board Member denied the Municipality the benefit of oversight and governance.

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 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.

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 Public Sector Accounting Standards (Accrual Basis) and for maintaining effective internal controls 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 controls, risk management and overall governance.

In preparing the financial statements, the Management is responsible for assessing the Municipality's ability to continue to sustain its 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 terminate the Municipality 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.

Those charged with governance are responsible for overseeing the Municipality'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 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 controls 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 controls would not necessarily disclose all matters in the internal controls 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 controls 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 controls may not prevent or detect misstatements and instances of noncompliance. 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 controls.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by Management.
- Conclude on the appropriateness of Management's use of the applicable 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 Municipality'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 Municipality to cease to continue 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 Municipality 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 controls 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

23 September, 2022