REPORT OF THE AUDITOR-GENERAL ON KATHIANI WATER AND SANITATION COMPANY LIMITED 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

Adverse Opinion

I have audited the accompanying financial statements of Kathiani Water and Sanitation Company Limited set out on pages 1 to 39, which comprise of the statement of financial position as at 30 June, 2021, and the statement of profit or loss and other 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, because of the significance of the matters discussed in the Basis for Adverse Opinion section of my report, the financial statements do not present fairly, in all material respects, the financial position of the Kathiani Water and Sanitation Company Limited as at 30 June, 2021, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards and do not comply with the Public Finance Management Act, 2012, the Companies Act, 2015 and the Water Act, 2016.

Basis for Adverse Opinion

1.0 Non-Compliance with the Public Sector Accounting Standards Board (PSASB)Template

Review of the financial statements presented for audit revealed the following errors:

i. The financial statements include two statements of changes in equity for the year ended 2021. Both statements have the same closing balance of Kshs.138,000,328. Further, the second statement relate to the year ended 30 June, 2022.

ii. The table of contents is incomplete as it does not include the statement of cash flows for the year ended 30 June, 2021 although the statement is included in the financial statements. Further, there is a mismatch between the pages indicated on the table of contents and actual page numbers.

iii. Appendix 1 on progress on follow up of auditor's recommendations is blank despite several audit issues having been raised in the previous year's audit report.

iv. The statement of Directors' responsibilities refers to Section 81 of the Public Finance Management Act, 2012 instead of Section 164 which is the applicable Section for County Government entities.

v. The statement of financial position does not indicate the Institute of Certified Public Accountants of Kenya (ICPAK) membership number of the Head of Finance.

In the circumstances, the presentation of the financial statements do not comply with the International Financial Reporting Standards (IFRS) and the Public Sector Accounting Standards Board (PSASB) template.

2.0 Inaccuracies in the Financial Statements

Review of the financial statements revealed the following unsatisfactory matters:

2.1 Statement of Profit or Loss and Other Comprehensive Income

The statement of profit or loss and other comprehensive income reflects Nil balance on remeasurement of net defined benefits liability (increase in provision for doubtful debt) comparative balance. However, Note 12 to the financial statements reflects an amount of Kshs.1,395,151 for the same item. Further, the statement and Note 10(a) to the financial statements reflects a balance of Kshs.373,521 relating to provision for bad debts during the year. However, Note 12(a) to the financial statements indicates that the provision decreased by Kshs.1,021,630 from the reported amount of Kshs.1,395,151, in the previous year to Kshs.373,521 in the current year. The decrease in provisions has not been recognized as income in the financial statements. Further, the statement reflects a deferred revenue balance of Kshs.2,451,280 which does not have a corresponding disclosure Note and was also not supported with relevant documents.

2.2 Statement of Financial Position

The statement of financial position reflects a balance of Kshs.140,433,885 for total non-current assets which has combined balances for both the current and non-current assets. Further, the statement reflects total assets balance of Kshs.140,433,885 and corresponding total equities and liabilities balance of Kshs.144,436,870 resulting to an unexplained variance of Kshs.4,002,985. In addition, the statement reflects a balance of Kshs.135,961,645 in respect of capital grants which does not have a disclosure Note and was not supported with relevant documents.

2.3 Statement of Cash Flows

During the year under review the Company recorded a trade receivables balance of Kshs.8,940,864 (2020:-Kshs.9,479,602). However, the statement of cash flows reflects a decrease in trade receivables balance of Kshs.638,738 instead of a re-computed balance of Kshs.538,738 resulting to an unexplained variance of Kshs.100,000. Similarly, the Company recorded trade payables balance of Kshs.8,810,063 (2020:-Kshs.6,428,629). However, the statement reflects a balance of Kshs.366,898 relating to decrease in trade and other payables while the re-computed amount is Kshs.381,433 resulting to an unexplained variance of Kshs.14,546.

Further, the statement reflects a balance of Kshs.2,374,351 in respect to cash and cash equivalents at the end of the year while the statement of financial position reflects a balance of Kshs.724,247 for the same item resulting to an unexplained variance of Kshs.1,650,104.

In addition, the statement of profit or loss and other comprehensive income reflects amount of Kshs.1,999,058 while Note 19 to the financial statements reflects profit before tax of Kshs.230,386 for the same item resulting to an unexplained variance of Kshs.1,768,672. Note 19 to the financial statements also reflects an amount of Kshs.2,457,280 relating to depreciation charge while the statement of profit or loss and other comprehensive income reflects an amount of Kshs.2,451,280 resulting to an unexplained variance of Kshs.6,000.

2.4 Statement of Comparison of Budget and Actual Amounts

The statement of comparison of budget and actual amounts reflects actual expenditure of Kshs.8,270,678 in respect to use of goods and services. However, this expenditure could not be traced to the statement of profit or loss and other comprehensive income. In addition, the statement reflects total expenditure amount of Kshs.13,014,178 while the statement of profit or loss and other comprehensive income reflects an amount of Kshs.11,418,648 resulting to an unexplained variance of Kshs.1,595,530.

Further, the statement reflects actual expenditure on compensation of employees amount of Kshs.3,461,616 while Note 10(b) reflects Kshs.1,927,862 for the same item resulting to an unexplained variance of Kshs.1,533,754. No explanation has been provided for variances of more than 10% as required by the reporting template.

In the circumstances, the accuracy and completeness of the financial statements for the year ended 30 June, 2021 could not be confirmed.

3. Unsupported Trade and Other Payables

The statement of financial position and the corresponding disclosure Note 18 to the financial statements reflects trade and other payables balance of Kshs.6,810,063. However, Management did not provide for audit a ledger and invoices to support the balance. Further, the balance includes an amount of Kshs.4,104,704 owed to the Tanathi Water Works Development Agency which has been outstanding since 2016.

In the circumstances, the accuracy and completeness of the trade and other payables balance could not be confirmed.

4. Long Outstanding Trade and Other Receivables

The statement of financial position reflects trade and other receivables balance of Kshs.8,940,864 which differs with a balance of Kshs.10,336,015 reflected in Note 12(a) to the financial statements resulting to an unexplained variance of Kshs.1,395,151. The balance of Kshs.10,336,015 is net of provision for bad and doubtful debt of Kshs.373,521. However, the computation for the provision and explanations for the decrease in provisions was not provided for audit verification. Further, Note 12(b) indicates that debts outstanding for over 120 days increased to Kshs.8,843,359 from the previous year balance of Kshs.6,975,754 representing an increase of Kshs.1,876,605 which implies that the provision for the bad debts and doubtful debts should have been increased to reflect a fair level of impairment on debts. Also, some of these debts have been outstanding for a long time and required a specific provision or be write-off from the books of the Company.

In addition, the balance of Kshs.8,843,359 includes an amount of Kshs.4,229,660 debt owed by Kathiani Level 4, Hospital the bulk of which had been outstanding for over 120 days. It has not been explained why the County Government of Machakos has failed to pay the debts. Further, Management has not demonstrated any efforts taken to recover the long outstanding debts.

In the circumstances, the recoverability of the trade and other receivables balance of Kshs.10,336,015 could not be confirmed.

5. Unaccounted for Customer Deposits

The statement of financial position reflects trade and other payables balance of Kshs.6,810,063 which includes an amount of Kshs.467,100 in respect to customer deposits . However, Note 18 to the financial statements reflects a Nil comparative balance for customer deposits despite the fact that the Company has been in operation since 2014 and had connected undisclosed number of customers over the years each of whom was required to pay connection deposits of between Kshs.2,800 and Kshs.5,000. The reported customers deposit only reflects amounts received during the year under review. Further, the bank account for customer deposits had a balance of Kshs.5,592 as at 30 June, 2021 resulting to an unexplained and an unreconciled variance of Kshs.461,508.

In the circumstances, the accuracy, completeness and accountability of the customers' deposits balance of Kshs.467,100 could not be confirmed.

6. Property, Plant and Equipment

The statement of financial position and as disclosed in Note 11 to the financial statements reflects property, plant and equipment (PPE) balance of Kshs.130,768,774 which is net of depreciation charge for the year of Kshs.2,451,280. However, the property, plant and equipment schedule reflected in Note 11 to the financial statements was not prepared in accordance with the Public Sector Accounting Standard Board's financial reporting templates. The net book balances brought forward from the previous year have been reflected as cost values while the accumulated depreciation have not been included in the schedule.

Further, the property, plant and equipment balance includes an amount of Kshs.100,000,000 in respect to freehold land but no title deed was provided to confirm ownership and no document was provided to indicate when and how the value of the land was determined. In addition, the fixed asset register provided for audit was not updated and did not have details on individual assets such as date of acquisition, costs and depreciation charge.

In the circumstances, the fair statement, disclosure and ownership of property, plant and equipment balance of Kshs.130,768,774 could not be confirmed.

7. Unsupported Administration Costs

The statement of profit or loss and other comprehensive income and as disclosed in Note 10(a) to the financial statements reflects an amount of Kshs.4,817,202 in respect to administration costs. This expenditure includes general administrative expenses totalling to Kshs.2,889,340 which in turn includes an amount of Kshs.418,990 in respect of transportation, travelling and subsistence which was not supported by imprest warrants, imprests register and surrender documents.

Further, expenditure amounting to Kshs.210,390 was not supported with user requisition, supplier's invoices, inspection reports for goods delivered, stock sheets, request for quotations, local purchase orders, delivery notes and copies of attendance registers for meetings held.

In the circumstances, the accuracy and completeness of general administrative expenses amounting to Kshs.418,990 could not be confirmed.

8. Misstatement of Staff Costs

The Statement of profit or loss and other comprehensive income reflects staff costs amount of Kshs.4,817,202 which, as disclosed in Note 10(a) to the financial statements includes an amount of Kshs.1,411,500 in respect to salaries and allowances paid to permanent employees. However, the payroll provided in support of the expenditure indicated a total of Kshs.1,200,500 resulting to an unexplained variance of Kshs.211,000.

In the circumstances, the accuracy and completeness of the salaries and allowances expenditure of Kshs.1,411,500 could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the Kathiani Water and Sanitation Company Limited 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 adverse 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.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

Conclusion

As required by Article 229(6) of the Constitution, because of the significance of the matters discussed in the Basis for Adverse Opinion and Basis for Conclusion on Lawfulness and Effectiveness in Use of Public Resources sections of my report, I confirm that, public resources have not been applied lawfully and in an effective way.

Basis for Conclusion

1. Late Submission of the Financial Statements

The financial statements of the Company for the year ended 30 June, 2021 were submitted to the Auditor-General on 4 January, 2022, more than three months after the statutory deadline. This is contrary to Section 149(2)(k) of the Public Finance Management Act, 2012 which stipulates that Accounting Officer of a County Government entity shall not later than three months after the end of each financial year, prepare annual financial statements for that financial year and submit them to the Auditor-General for audit.

Consequently, Management was in breach of the law.

2. Non-Revenue Water

During the year under review, the Company produced 100,541 cubic meters (M^3) of water out of which only 70,381 M^3 were billed to customers. The difference of 30,160 M^3 or 30% represented Non-Revenue Water (NRW) worth Kshs.3,166,800 (at a rate of Kshs.105 per M^3). The NRW exceeded the threshold of 25% set in the Water Services Regulatory (WASREB) Guidelines by 5%. Further, Management did not demonstrate any tangible effort to address the loss from Non-Revenue Water.

In the circumstances, Management was in breach of the law.

3. Undisclosed Ownership of the Company

The background information to the financial statements indicate that Kathiani Water and Sanitation Company Limited was established as a limited company on 29 April, 2014. However, Note 14 to the financial statements indicate that the Company has an authorized share capital of Kshs.100,000 comprising of 1000 Ordinary Shares of Kshs.100 per value each. The Management did not provide share certificates to confirm the shareholders of the Company.

In the circumstances, it has not been possible to ascertain the ownership of the Company and its compliance with the requirements of the Water Act, 2016 and the Companies Act, 2015.

4. Non-Competitive Appointment of the Board Chair

During the year under review, the County Government of Machakos appointed the Chairperson of the Company in April 2021 through Gazette Notice. However, there were no documents to confirm that a competitive process was undertaken as required under Section 2(2) of the First Schedule of Water Act of 2016 which states that the Chairperson and Members shall be identified for appointment through an open competitive process.

In the circumstances, Management was in breach of the law.

5. Lack of Approved Water Sales Tariff

The statement of profit or loss and other comprehensive income and as disclosed in Note 6 to the financial statements reflects water sales amounting to Kshs.9,559,672. However, the water tariff used in billing had not been approved by WASREB and was not gazetted as required.

In the circumstances, the regularity of the water tariff applied by the Company for the water billing could not be confirmed.

6. Irregularities in Procurement Process

Review of procurement process of the Company revealed instances of non-compliance with the Public Procurement and Asset Disposal Act, 2015 on the procurement of goods, works and services as detailed below:

i. The approved procurement plan for the year did not indicate the specific methods of procurement as stipulated in the Public Procurement and Asset Disposal Act, 2015.

ii. There were no user requisitions provided for audit and it was not possible to confirm how procurements were initiated.

iii. There were no records to confirm that the Accounting Officer appointed to various Procurement Committees such as the Tender/Quotation Opening, Evaluation and Inspection and Acceptance Committees.

iv. The professional opinions issued for procurements undertaken during the year were not provided for audit.

v. Documentary evidence on the inspection of goods and services and copies of receipt vouchers (S13) to confirm that purchased goods were taken on charge were not provided for audit verification.

vi. There was no segregation of duties since the Company had only one procurement officer who also acted as a Customer Care Officer.

In the circumstances, Management was in breach of the law.

7. Statement of Comparison of Budget and Actual Amounts

Review of the statement of comparison of budget and actual amounts for the year ended 30 June, 2021 revealed that the budget estimates were approved by the Board on 10 September, 2021, which was more than two months after commencement of the year to which the budget relates. In addition, Management did not provide documents confirming approval of the budget by the County Government of Machakos.

Further, the statement reflects budgeted expenditure on use of goods and services of Kshs.7,335,000 against actual amount incurred during the year of Kshs.8,270,678 resulting to unauthorized over expenditure of Kshs.935,678 or 12%. This is contrary to Regulation 43(2) of the Public Finance Management (County Governments) Regulations, 2015 which states that County government entities shall execute their approved budgets based on the annual appropriation legislation, and the approved annual cash flow plan with the exception of unforeseen and unavoidable spending dealt with through the County Emergency Fund, or supplementary estimates.

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, because of the significance of the matters discussed in the Basis for Adverse Opinion and Basis for Conclusion on Effectiveness of Internal Controls, Risk Management and Governance sections of my report, based on the audit procedures performed, I confirm that, internal controls, risk management and overall governance were not effective.

Basis for Conclusion

1. Lack of an Internal Audit Function and Audit Committee

Review of the Company's internal control structure revealed that the Company had no Internal Audit Function or an alternative and appropriate arrangements for conducting internal according to the guidelines issued by the Public Sector Accounting Standards Board (PSASB). Further, the Company did not have an Audit Committee.

In the circumstances, the existence of an effective internal control and risk management system could not be confirmed.

2. Lack of a Risk Management Policy and a Disaster Recovery Plan

During the year under audit, the Company did not have a Risk Management Policy and did not develop risk management strategies to identify, prevent and mitigate risks and disasters to ensure that its operations are not interrupted in case of unforeseen events. In addition, the Company did not maintain a risk register and did not have a Disaster Recovery and Business Continuity Plan

In the circumstances, the existence of an effective risk management system could not be confirmed.

3. Lack of a Human Resource Policy Manual and an Approved Staff Establishment

Review of records revealed that the Company did not have an approved Human Resource Policy Manual, staff establishment and a Scheme of Service to guide the operations of human resource function. The basis of employment and remuneration of staff was therefore not clear. In addition, the Company was understaffed in key Departments such as finance and administration and lacked the required checks and balances for a functional internal controls. Failure to formulate Human Resources Policy Manuals implies that the Company lacks basis for determination of staffing needs, recruitment, remuneration and management of employees for effective delivery of water services to the customers.

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 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.

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, adequate accounting records have not been kept by the Company, so far as appears from the examination of those records; and

iii. The Company's financial statements are not in agreement with the accounting records and returns.

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 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 applicable basis of accounting unless Management is aware of intention to liquidate the Company 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 Company's financial reporting process, reviewing the effectiveness of how the 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 Company'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 Company'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 Company to continue as a going concern or 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 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.

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

08 August, 2022