REPORT OF THE AUDITOR-GENERAL ON NUMERICAL MACHINING COMPLEX 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 Numerical Machining Complex Limited set out on pages 1 to 44, which comprise the statement of financial position as at 30 June, 2021, and the statement of profit and 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, the financial position of Numerical Machining Complex 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 (IFRS) and do not comply with the Public Finance Management Act, 2012 and Companies Act, 2015.

Basis for Adverse Opinion

1.0 Property, Plant and Equipment

1.1 Unconfirmed Value of Investment Property

As previously reported, the statement of financial position and as disclosed in Note 12 to the financial statements, reflects a balance of Kshs.290,000,000 in respect to investment property. However, the following observations were noted:

1.1.1 Long Outstanding Debtors

As previously reported, the Government of Kenya in 1994 allocated the Company land measuring approximately 703.59 hectares in Mavoko, Athi River. In 2001, the Company with the consent of the Government sold part of the land measuring 242.89 hectares to individuals and other entities whose title deeds have not been fully processed and released. The Company continued to pay rates based on the original title deed up to 2009. Further, a net amount of Kshs.6,640,310 due from the individuals from the sale of the land has remained unpaid since 2001. The recoverability of the debt therefore remained doubtful.

1.1.2 Encroached Land

The remaining portion of the unsold land measuring approximately 460.70 hectares was not fenced and had been encroached by informal settlers and other parties who had put up permanent structures. Further, the portion of land was revalued at Kshs.290 million in 2009 and the revaluation gain of Kshs.158,993,190 arising thereon approved by the Board for inclusion in the financial statements in October, 2016. However, the Company has not revalued its assets in the last twelve (12) years contrary to Paragraph 31 of International Accounting Standard No.16 – Property, Plant and Equipment which requires that revaluations be carried out regularly, so that the carrying amounts of assets do not differ materially from their fair values as at the reporting dates. In addition, the encroachment by the informal settlers had led to impairment of the land.

1.1.3 New Title Deed

On 14 January, 2003 a new title deed was issued to the Company for a parcel of land measuring approximately 202.4 hectares under unclear circumstances. A letter from the Ministry of Lands dated 17 February, 2009 indicated that the title deed had been subdivided and new Land References (LR's) numbers given. Further, Management did not provide the new title deed for audit verification.

In the circumstances, the accuracy, ownership, valuation and security of the investment property balance of Kshs.290,000,000 as at 30 June, 2021 could not be confirmed.

1.2 Lack of a Fixed Assets Register

The statement of financial position and as disclosed under Note 11 to the financial statements, reflects Kshs.255,260,032 in respect to property, plant and equipment. However, the balance was not supported with a fixed assets register indicating the address, area, dates of acquisition, capital expenditure and other pertinent details as required under Regulation 143(1) of Public Finance Management (National Government) Regulations, 2015.

In the circumstances, it could not be confirmed that the assets of the Company had been properly safeguarded and that the reported property, plant and equipment balance of Kshs.255,260,032 was fairly stated.

2.0 Variances Between the Financial Statements and the Supporting Schedules

Review of the balances reflected in the financial statements and the respective supporting schedules revealed variances as detailed below:

Component	Note	Financial Statements (Kshs.)	Supporting Schedules (Kshs.)	Variance (Kshs.)
Casting of Ferrous Foundry Products	4	10,688,718	12,607,889	(1,919,171)
Manufacture of General Spares and Components	4	16,360,289	16,984,720	(624,431)
Training and Sale of Engineering Software	4	10,533,674	10,932,891	(399,217)
Engineering Services	4	320,088	315,163	4,925
Trade and Other Payables	20	185,427,232	180,093,819	5,333,413

In the absence of reconciliations, explanations and analysis of the variances, the accuracy and completeness of the reported balances as at 30 June, 2021 could not be confirmed.

3.0 Unsupported Inventories

The statement of financial position reflects a balance of Kshs.66,726,189 for inventories as disclosed under Note 13 to the financial statements. However, the inventories schedules and stock-taking sheets were not provided for audit review.

In the circumstances, the existence of the inventories and the accuracy of the balance of Kshs.66,726,189 in respect to inventories as at 30 June, 2021 could not be confirmed.

4.0 Trade and Other Payables

4.1 Unsupported Debit Balances

The statement of financial position and as disclosed under Note 20 to the financial statements reflects a balance of Kshs.185,427,232 in respect to trade and other payables. However, the schedule provided for audit reflected debit balances amounting Kshs.8,776,865. Further, the trade and other payables balance includes a balance of Kshs.92,174,175 for which supporting documents were not provided for audit.

4.2 Long Outstanding Payables

As previously reported, Note 20 to the financial statements reflects a balance of Kshs.67,042,486 relating to other payables. Included in the balance, however, is an amount of Kshs.57,782,747 relating to a tax liability that had been outstanding since 1999 and which continued to attract penalties and interests.

4.3 Undeclared Trade Payables

Available information revealed that the Company received orders worth Kshs.26,597,000 for manufacture of machines for the Constituency Industrial Development Centres under the Ministry of Industrialization, Trade and Enterprise Development some years back. However, review of records showed that the Company had produced goods costing Kshs.9,496,329 against paid up orders of Kshs.26,597,000 resulting to a balance of Kshs.17,100,671 owed to the State Department of Industrialization. However, the liability has not been disclosed in the Company's financial statements for the year ended 30 June, 2021.

In the circumstances, the accuracy and completeness of trade and other payables balance of Kshs.185,427,232 as at 30 June, 2021 could not be confirmed.

5.0 Trade and Other Receivables

As previously reported, the statement of financial position and as disclosed in Note 14 to the financial statements, reflects a balance of Kshs.138,796,908 for trade and other receivables which is net of provision for bad and doubtful debts of Kshs.29,251,399. However, the following observations were noted.

(i) The balance includes an amount of Kshs.3,917,160 relating to staff receivables of which Kshs.1,971,336 related to unrecovered salary advances from staff who have since left the Company's service.

(ii) The balance also includes Kshs.6,753,214 in respect of other receivables comprising of Kshs.112,904 related to car loan to a former employee which had been outstanding since 2012 and receivables of Kshs.6,640,310 from Athi River land sales which remained unpaid since 2001.

(iii) The balance includes deposits and prepayments of Kshs.42,914,741 of which a balance Kshs.1,544,762 had been outstanding for a long period. Although the Management explained that the amount related to deposits for tenders and performance bonds the Company participated in, no evidence in support of the same was provided for audit.

(iv) The balance includes Kshs.113,047,243 in respect of trade receivables which further includes a debt of Kshs.17,019,282 due from the defunct M/s Rift Valley Railways. The recoverability of this long outstanding debt is therefore doubtful.

(v) The balance includes credit balances of Kshs.418,459 and Kshs.322,670 in respect of account advances and salary advances respectively. Management has not explained what these balances represent.

(vi) The reported receivables balance was net of a provision for bad and doubtful debts amounting to Kshs.29,251,399. However, evidence of Management review of all outstanding receivables, assessment for impairment and efforts of recovery were not provided for audit.

In the circumstances, the accuracy and completeness of the trade and other receivables balance of Kshs.138,796,908 as at 30 June, 2021 could not be confirmed.

6.0 Material Uncertainty in Relation to Going Concern

The statement of profit or loss and other comprehensive income reflects a loss of Kshs.40,004,498 (2019/2020 - loss Kshs.8,885,440) thus increasing the accumulated loss from Kshs.1,626,920,066 to Kshs.1,666,924,564 as at 30 June, 2021. However, evidence of Management's formal assessment of the Company's ability to continue as a going concern was not provided.

In the circumstances, the Company's ability to continue as a going concern without financial support from the Government and its creditors could not be confirmed.

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

Other Matter

1. Budgetary Control and Performance

As reflected in the statement of comparison of budget and actual amounts, the Company's budgeted revenue from both National Government grants and internally generated revenue was Kshs.513,418,000 while the actual revenue realized was Kshs.354,469,000 resulting to under-collection of Kshs.158,949,000 or 31% of the projected collection. Similarly, the Company projected to spend Kshs.505,331,000 on various budget lines but the actual expenditure was Kshs.394,473,000 resulting to an under-expenditure of Kshs.110,858,000 or 22% of the projected expenditure.

The revenue under-performance and the under-expenditure may have had a negative impact on the planned goals and objectives of the Company.

Further, the statement of comparison of budget and actual amounts reflects over-absorption of the budget totalling Kshs.130,797,144 under various budget items, as detailed below:

Item	Budget (Kshs.)	Expenditure (Kshs.)	Over Expenditure (Kshs.)
Training	7,200,000	25,485,506	18,285,506
Bank Charges and commissions	450,000	808,201	358,201
Legal Fees	0	2,924,084	2,924,084
Salaries and Wages of Sales Personnel	0	6,889,803	6,889,803
Marketing and Promotional Expenses	0	2,339,550	2,339,550
Total	**7,650,000**	**38,447,144**	**(30,797,144)**

There was no evidence that the Company sought and obtained approval to reallocate funds across the various budget lines reflected in the above table, contrary to Section 12 of the State Corporations Act which provides that no state corporation shall, without the prior approval in writing of the Minister and the Treasury, incur any expenditure for which provision has not been made in an annual estimates prepared and approved in accordance with section 11 of the Act.

2. Unresolved Prior Year Matters

Various prior year audit issues remained unresolved as at 30 June, 2021. Management did not provide satisfactory reasons for the delay in resolving the prior year audit issues. Further, some of the unresolved prior year issues are not disclosed under the progress on follow up of auditor's recommendations section of the financial statements as required by the Public Sector Accounting Standards Board.

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, based on the audit procedures performed, I confirm that public resources have not been applied lawfully and in an effective way.

Basis for Conclusion

1.0 Understaffing

The Company had an approved staff establishment of two hundred (200). However, as at 30 June, 2021, only one hundred and thirty-eight (138) staff were in post staff, resulting to a shortfall of sixty-two (62) staff. Further, three (3) officers were placed at lower job groups than the ones provided under the staff establishment guidelines.

Inadequate staffing may give rise to inadequate segregation of duties which may impair effective service delivery to the citizens. Further the Management was in contravention of the established staff guidelines.

2.0 Lack of Approved Human Resource Instruments

The Company did not provide evidence that the organizational structure, staff grading and establishment, career guidelines and human resource policy and procedures manual had been approved as required by the State Corporations Advisory Committee's Circular No. OP/SCAC.9/21/1/1 of 15 May, 2017.

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

3.0 Failure to File Human Resource Compliance Reports

Section G and Paragraph 2 of the State Corporations Circular Ref: OP/CAB.9/1A dated 11 March, 2020 requires all State Corporations to file with the State Corporations Advisory Committee (SCAC) the Human Resource Compliance Reports, including payroll reports for all cadres of staff by 31 July of each year. However, the Company did not file the reports with the State Corporations Advisory Committee as required.

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

4.0 Payments to Suppliers not in the Prequalified List

The statement of profit or loss and other comprehensive income and as disclosed under Note 8 to the financial statements reflects an amount of Kshs.224,813,618 in respect to administration costs. However, the expenditure included an amount of Kshs.1,139,776 paid to various firms that were not in the Company's prequalified list of suppliers during the year under audit. This is contrary to Section 57(1) of the Public Procurement and Asset Disposal Act, 2015 which requires the head of the procurement function of a procuring entity to maintain and update lists of registered suppliers, contractors and consultants in the categories of goods, works or services according to its procurement needs.

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

5.0 Use of Manual Quotations

During the year under review the Company procured goods and services worth Kshs.22,083,874 using manual quotations. This is contrary to Part F IV(B) of Executive Order No.2 of 2018, which requires the National Treasury to ensure that by

1 January, 2019, all public procuring entities undertake all their procurement through the e-procurement module.

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

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 governance were not effective.

Basis for Conclusion

1.0 Lack of a Risk Management Policy

The Company did not have in place a risk management policy and, therefore, had no approved processes and guidelines on how to mitigate operational, legal and financial risks such as identifying business risks relevant to financial reporting objectives, estimating the significance of the risks, assessing the likelihood of their occurrence and deciding about actions to address those risks

In the circumstances, the Company may not be in a position to evaluate, rank and prioritize critical risks and channel resources towards mitigating identified risks.

2.0 Lack of Information Communication Technology (ICT) Strategic Plan

The Company did not have an approved ICT strategic plan. Further, the Company did not have an information technology continuity plan and a disaster recovery plan kept off site. Also, no evidence of backups stored in a secure offsite storage facility was provided. This is contrary to Section 3.6 the Code of Governance for State Corporations (Mwongozo), which requires the Board to establish an ICT Policy which is aligned to the objectives of the organization, establish an ICT function in the organization, integrate ICT in the operations of the organization, ensure an appropriate business continuity plan is in place and ICT related risks are identified and managed while utilizing ICT in monitoring the performance of the Organization.

Failure to develop business continuity plan and disaster recovery plan and establish off site backup facilities may expose the Company to possible loss of business in the event of disasters.

3.0 Non-Automation of the Financial Reporting Process

Review of the financial reporting processes revealed that the Company continued to have significant manual interventions in its financial processes. Similarly, review of the inventory records revealed that the Company did not have an Inventory Management System that describes the processes, documentation and responsibilities of persons involved in the management of inventory contrary to Regulation 23(1)(d) of the Public Finance Management (National Government) Regulations, 2015 which requires accounting officers to be accountable to the National Assembly for measures taken to prepare financial reports that reflect a true and fair financial position of the entity.

4.0 Lack of a Board Charter

The Company had not developed a Board Charter defining its roles, responsibilities and functions in the governance of the organization as required by the Code of Governance for State Corporations (Mwongozo). The Code requires the Board to develop and adopt a Board Charter and to periodically review the Charter.

In the circumstances, the effectiveness of the Board may have been negatively affected.

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, 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 Board of Directors

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards (IFRS) 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 overall 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 going concern basis of accounting unless Management is aware of the 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 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 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 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 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 Company 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

27 July, 2022