

REPORT OF THE AUDITOR-GENERAL ON SCHOOL EQUIPMENT PRODUCTION UNIT 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 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 School Equipment Production Unit set out on pages 1 to 18, 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 and reserves, statement of cash flows and statement of comparison of budgets and actual amounts, 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 School Equipment Production Unit 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 comply with the Companies Act, 2015, and the Public Finance Management Act, 2012.

Basis for Qualified Opinion

1.0 Encroached Land - Property, Plant and Equipment

As previously reported, the statement of financial position reflects property, plant and equipment balance of Kshs.93,834,470 (2020: Kshs.95,178,293) which as disclosed in Note 14 to the financial statements constitutes a parcel of land at a historical cost of Kshs.63,000,000 which is situated at Industrial Area, Nairobi and registered under the Company's name . However, although the land was allocated in 1996, the Company has not developed it due to encroachment by informal settlers. Management has however sought for assistance from the National Land Commission in order to develop the land. No response has been provided to indicate the progress made by the end of the year.

Further, the balance of Kshs.93,834,470 is net of depreciation charge amounting to Kshs.22,891,100. However, a recomputation of depreciation yielded an amount of Kshs.22,841,679 resulting to a variance of Kshs.49,421 but Management has not explained or reconciled the variances.

In the circumstances, the beneficial value of the land and the accuracy of the property, plant and equipment balance of Kshs.93,834,470 could not be confirmed.

2.0 Unsupported Receivables and Prepayments

As previously reported and as disclosed in Note 16 to the financial statements, the statement of financial position reflects receivables and prepayments net balance of Kshs.78,079,585 (2020: Kshs.78,026,728) which includes trade receivables and staff advances amounting to Kshs.32,420,055 out of which a balance of Kshs.22,680,639 or 70% have been outstanding for more than ten (10) years. However, no supporting documents were provided for audit review. Further analysis of records revealed that an amount of Kshs.75,086,881 or 96% was due from the Ministry of Education - State Department for Early Learning and Basic Education and has been outstanding since financial year 2018/2019 but the same was not reflected as a pending bill in the State Department's financial statements for the year ended 30 June, 2021.

In addition, the receivables and prepayments balance of Kshs.78,079,585 includes staff advances balance of Kshs.1,001,361 out of which Kshs.940,484 or 94% relate to staff advances due from employees who have since left the service while others are deceased.

Management has however, indicated that a fire broke out at the Company's Headquarters in 2007 and destroyed supporting schedules relating to receivables. As a result, recovery of debtors has been affected by lack of evidence. Although a provision for bad and doubtful debts of Kshs.29,427,351 has been provided which represent a decrease of

Kshs.1,365,888 from the amount reported in the previous year balance of Kshs.30,793,239, the amount appears insufficient.

In the circumstances, the accuracy and full recovery of the receivables and prepayments balance of Kshs.78,079,585 as at 30 June, 2021 could not be confirmed.

3.0 Unsupported Trade and Other Payables

As previously reported, the statement of financial position reflects trade and other payables balance of Kshs.24,029,434 which, as disclosed in Note 20 to the financial statement includes trade payables balance of Kshs.7,657,450 out of which a balance of Kshs.7,209,566 or 94% has been outstanding for between fourteen (14) years and twenty-six (26) years and whose supporting documents were not provided for audit review. Management indicated that a fire broke out in the Company's Headquarters in 2007 and destroyed supporting schedules relating to the accounts payables. Management had also placed advertisement in the daily newspapers in November, 2016 to inform relevant creditors to present documents supporting the services offered to the Company but with little success.

Further, the balance constitutes balances of Kshs.15,751,984, Kshs.816,066, Kshs.1,500,000 and Kshs.11,681,848 in respect of retirement benefits (pensions), provision for dividend to The National Treasury and provision for corporate tax respectively, which had no movement over the last twelve months.

In the circumstances, accuracy, completeness and the validity of the trade and other payables balance of Kshs.24,029,434 as at 30 June, 2021 could not be confirmed.

4.0 Unexplained Variance Cash Book and Financial Statements

The statement of financial position reflects cash and bank balances of Kshs.4,877,059 which, as disclosed in Notes 17(i) to the financial statements includes an amount of Kshs.4,773,188 held at local commercial bank. However, cash-book for the same account reflects a balance of Kshs.9,982,474 resulting in an unreconciled variance of Kshs.4,556,154.

In the circumstances, the accuracy and completeness of cash and bank balance of Kshs.4,877,059 reflected in the statement of financial position as at 30 June, 2021 could not be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the School Equipment Production Unit 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

1.0 Budgetary Control and Performance

The statement of comparative budget and actual amounts reflects final receipts budget and actual on comparable basis of Kshs.110,500,000 and Kshs.80,860,696 respectively resulting to an under-funding of Kshs.29,139,304 or 26.3% of the budget. Similarly, the Company expended Kshs.58,510,512 against an approved budget of Kshs.89,400,000 resulting to an under-expenditure of Kshs.30,889,488 or 34% of the budget.

The underfunding and underperformance affected the planned activities and may have impacted negatively on service delivery to the stake holders of the Company.

2.0 Unresolved Prior Year Matters

In the previous audit report, several issues were raised under the Report on Financial Statements and Report on Effectiveness of Internal Controls, Risk Management and Governance. However, Management has not resolved a number of issues and no explanation was given on the status of the unresolved 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

Irregular Contract of Legal Services

During the year under review, Management hired a legal firm to represent the Company in court in a case between the Company and another firm over the validity of a contract. It was however established that, the firm was not in the prequalified list of suppliers or a member of the Law Society of Kenya. Notwithstanding these anomalies, Management paid an amount of Ksh.1,200,000 to the firm for offering legal services.

This is contrary to Section 93 of the Public Procurement and Disposal Act, 2015 which requires the procuring entity to conduct a pre-qualification procedure as a basic procedure prior to adopting an alternative procurement method other than open tender for the purpose of identifying the best few qualified firms for the subject procurement.

Consequently, 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 matters 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

1.0 Irregular Staff Advances

As disclosed in Note 16 to the financial statements, the statement of financial position reflects an amount of Kshs.78,079,585, in respect of receivables and prepayments which includes staff advances amounting to Kshs.1,001,361 which constitutes an amount of Kshs.940,484 representing advances that were issued to officers who are now deceased while others have left the Company's service.

Further, a member of staff took a salary advance of Kshs.600,000 in February, 2021. However, the officer had just completed paying a previous salary advance. This is against the Company's Human Resource Policy Manual which states that an officer cannot take a salary advance immediately after clearing another one but must wait for a period of six months. In addition, the officer ceased to be an employee of the Company in February, 2021 with an outstanding balance of Kshs.100,000. The recoverability of this amount is doubtful.

In the circumstances, the existence of an effective internal control to safeguard against loss of public resources could not be confirmed.

2.0 Lack of Management Reports

The Company does not have an internal audit function despite the fact that the department is provided for in the Company's organizational structure where the Head of the Internal Audit should report directly to the Board of Directors. Management has however, indicated that an internal advertisement for the vacant post was done and interviews conducted but no applicant was successful. Management has further indicated that it is in the process of re-advertising by opening up to the general public to apply.

Consequently, the effectiveness of internal controls systems and risk management in the Company could not be confirmed.

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 Kenya 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 been kept by the Company, so far as appears from my examination of those records; and,
- iii. The Company's financial statements are 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 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 sustainability of services and using the going concern basis of accounting unless Management is aware of the intention to terminate the Company or cease operations.

Management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 47 of the Public Audit Act, 2015.

In addition to the responsibility for the preparation and presentation of the financial statements described above, Management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them, and that public resources are applied in an effective way.

The Board of Directors are responsible for overseeing the Company'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 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 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 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 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 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

19 September, 2022