

# **REPORT OF THE AUDITOR-GENERAL ON NZOIA SUGAR COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE, 2023**

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## **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 the 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 Nzoia Sugar Company Limited set out on pages 1 to 56, which comprise of the statement of financial position as at 30 June, 2023, 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, 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 Nzoia Sugar Company Limited as at 30 June, 2023, 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 Public Finance Management Act, 2012 and the Companies Act, 2015.

## **Basis for Qualified Opinion**

### **1. Long Outstanding Goods in Transit**

The statement of financial position reflects a balance of Kshs.494,901,000 in respect of inventories which, as disclosed in Note 19 to the financial statements, includes a balance of Kshs.430,076,000 relating to consumables out of which Kshs.179,410,294 is in respect of goods in transit. Records available indicate that the goods have been in transit for the last eight (8) years. No explanation was provided for the long duration the goods have been in transit and whether the goods are still in existence or not.

In the circumstances, the accuracy, completeness, and correct valuation of the inventories balance of Kshs.494,901,000 could not be confirmed.

### **2. Unsupported Intangible Assets**

The statement of financial position reflects a balance of Kshs.149,679,000 in respect of intangible assets as disclosed in Note 16 to the financial statements. The intangible assets represent an Enterprise Resource Planning (ERP) system which was procured through a contract entered into in March, 2016 at a cost of Kshs.282,600,000 and a contract period of twelve (12) months. However, as at 30 June, 2023 the implementation was at 80% and Kshs.212,800,000 representing 75% of the project cost had been paid. Although Note 16 indicates that the ERP has been amortized over the years with amounts totaling Kshs.82,887,000, no explanation was provided on the basis of amortizing an incomplete project. Further, no justifiable explanation was provided for the inordinate delay in completing the project.

In the circumstances, the accuracy, completeness and fair valuation of the intangible assets balance of Kshs.149,679,000 as at 30 June, 2023 could not be confirmed.

### **3. Non-Servicing of Loans**

Included in the statement of financial position is a balance of Kshs.46,308,296,000 in respect of borrowings which, as disclosed in Note 26(a) to the financial statements, relates to loans of Kshs.43,984,629,000 and Kshs.2,823,589,000 from The National Treasury and Agriculture, Food and Fisheries Authority (AFFA) respectively. The total loan portfolio comprises of a principal amount of Kshs.12,544,135,000 and accrued interest of Kshs.34,264,083,000. No explanation was provided for the failure to clear the long outstanding loans which have attracted the huge accumulated interest. Further, supporting documents including financing agreements, repayment terms and Board approval were not provided for audit review. In addition, the balance of Kshs.46,308,296,000 shown in the statement of financial position differs from the balance

of Kshs.46,808,218,000 shown in Note 26. The variance of Kshs.499,922,000 has not been explained or reconciled.

In the circumstances, the accuracy, completeness, fair valuation of the loan balance of Kshs.46,308,296,000 could not be confirmed.

#### **4. Material Uncertainty Related to Going Concern**

The statement of profit or loss and other comprehensive income reflects a net operating loss of Kshs.4,165,153,000 for the year ending 30 June, 2023 (2021/2022: Kshs.4,437,177,000). This deteriorated further the shareholders' equity from a negative of Kshs.52,424,269,000 in 2021/2022 to a negative balance of Kshs.56,589,422,000 in the year under review.

Further, the current liabilities of Kshs.63,081,579,000 exceeded the current assets of Kshs.1,351,925,000 by Kshs.61,729,654,000, demonstrating that the Company is unable to meet its financial obligations as and when they fall due.

In addition, the Company had accumulated losses totaling Kshs.63,099,847,000 as at 30 June, 2023 as reflected in the statement of financial position and statement of changes in equity. This state of affairs is indicative of an acute financial challenge facing the Company which raises significant doubt on its ability to operate as a going concern. This material uncertainty that casts doubt on the Company's ability to continue as a going concern has, however, not been disclosed in the financial statements by the Management.

In the circumstances, the Company is technically insolvent and its continued existence as a going concern is dependent on the financial support from its creditors and the Government.

#### **5. Unsupported Deferred Income Taxation Liability**

The statement of financial position reflects a deferred taxation liability balance of Kshs.3,885,282,000 as disclosed in Note 27 to the financial statements and which has remained the same from 2021/2022. However, supporting documents including schedules were not provided for audit review.

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

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the Nzoia Sugar 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 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. Idle Investment Property**

Included in the balance of non-current assets of Kshs.9,525,436,000 shown in the statement of financial position is a balance of Kshs.303,978,000 relating to investment property which, as disclosed in Note 17 to the financial statements, relates to the Company's residential property situated in Kileleshwa, Nairobi. The property attracts annual land rates of Kshs.112,600 and has a market monthly rental income of Kshs.75,000. However, as reported previously, the property has not been occupied for the last ten (10) years which translates to a loss of rental income totaling to Kshs.9,000,000.

Although attempts were made in 2017 to get approval from the Ministry to develop the property, no evidence was provided of any follow up on the matter.

In the circumstances, the Company has been denied income due from the property and therefore the fair presentation of the financial statements could not be confirmed.

### **2. Unresolved Prior Year Matters**

In the report for the previous year, several issues were raised under Report on the Financial Statements and Report on Lawfulness and Effectiveness in use of Public Resources. However, as at 30 June, 2023, thirteen (13) issues had not been resolved and Management did not provide satisfactory reasons for the delay in resolving the issues as required by the Public Sector Accounting Standards Board reporting template.

## **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. Long Outstanding Trade and Other Payables**

The statement of financial position reflects a balance of Kshs.16,335,495,000 in respect of trade and other payables which, as disclosed in Note 28 to the financial statements,

includes tax penalties amounting to Kshs.8,921,307,000. No explanation was provided for the failure to pay taxes which attracted the huge penalties. This was contrary to Section 37(1) of the Income Tax Act (Cap 470) and Section 19 of the Value Added Tax Act, 2013 (amended 2021) which require prompt payment of taxes.

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

## **2. Excess Wage Bill**

The statement of profit or loss and other comprehensive income reflects an amount of Kshs.3,080,948,000 in respect of administrative expenses which, as disclosed in Note 9 to the financial statements, includes Kshs.828,183,000 relating to staff costs representing 57% of the total revenue of Kshs.1,442,562,000. This is contrary to Regulation 26(1)(a) of the Public Finance Management (National Government) Regulations, 2015 which states that staff costs of a public entity should not exceed 35% of the revenue.

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

## **3. Lack of Ethnic Diversity in Staff Recruitment**

Review of Human Resource records including the payroll revealed that during the year under review, the Company had six hundred and forty (640) employees. However, out of this number, five hundred and forty-four (544) or 85% were from the same ethnic community. This is in contrary to Section 7(2) of the National Cohesion and Integration Act, 2008 which provides that no public establishment shall have more than one third of its staff from the same ethnic community.

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

## **4. Failure to Make Annual Returns**

Records available indicate that the last time the Company made returns to the Registrar of Companies was 31 March, 2021. No explanation was provided on the failure to make annual returns since as required. This is contrary to the provisions of Section 705(1) of the Companies Act, 2015 which requires a company to make annual returns to the Registrar.

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, I confirm that, nothing has come to my attention to cause me to believe that internal controls, risk management and overall governance were not effective.

### **Basis for Conclusion**

The audit was conducted in accordance with ISSAI 2315 and ISSAI 2330. The standards require that I plan and perform the audit to obtain assurance about whether effective processes and systems of internal control, risk management and 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 been kept by the Company, so far as appears from the examination of those records; and,
- iii. The Company's financial statements are 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 (IFRS) and for maintaining effective internal control as Management determines is necessary to enable the preparation of financial statements that are free from material misstatements, 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, 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 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 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 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 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 controls may not prevent or detect misstatements and instances of non-compliance. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

As part of an audit conducted in accordance with ISSAIs, I exercise professional judgement and maintain professional skepticism throughout the audit. I also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Management.
- Conclude on the appropriateness of the Management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the 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 to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence and, where applicable, related safeguards.



**FCPA Nancy Gathungu, CBS**  
**AUDITOR-GENERAL**

**Nairobi**

**12 February, 2024**