

REPORT OF THE AUDITOR-GENERAL ON KENYA POST OFFICE SAVINGS BANK FOR THE YEAR ENDED 31 DECEMBER 2017

REPORT ON THE FINANCIAL STATEMENTS

Qualified Opinion

I have audited the accompanying financial statements of Kenya Post Office Savings Bank set out on pages 25 to 62, which comprise the statement of financial position as at 31 December 2017, 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 effects of the matters described in the Basis for Qualified Opinion section on my report, the financial statements present fairly, in all material respects the financial position of Kenya Post Office Saving Bank as at 31 December 2017, and of its financial performance and its cash flows for the year then ended, in accordance with International Financial Reporting Standards (IFRS) and comply with the Kenya Post Office Savings Bank Act, 493B, Public Financial Management (PFM) Act, 2012 of the Laws of Kenya.

Basis for Qualified Opinion

1. Accounts Receivable

The statement of financial position reflects accounts receivable amount of Kshs.2,723,077,613 (2016 Kshs.2,873,129,934) and as disclosed under Note 34 to the financial statements. Included in this amount is Kshs.60,203,935 (2016 Kshs.50,618,767) on account of rent receivable from let out office space. Of the amount, Kshs.47,113,844 is owed by tenants who have since vacated the Bank's premises without the recourse as provisioned for in the lease agreements being exercised. The likelihood of the amount being collected is doubtful; adjustments necessary by way of provisions for the uncertainty have not been incorporated in the financial statements. In the circumstances, I am unable to confirm the fair statement of the accounts receivable.

2. Interest Expense

The statement of profit or loss and other comprehensive income reflects interest expense amount of Kshs.567,955,405 (2016Kshs.562,788,544) and disclosed under Note 15 to the financial statements. However, the interest expense ledger in support reflects a balance of Kshs.589,083,108 resulting in a variance of Kshs.21,127,703. Of the variance amount, management has not been able to render explanations for the variance of

Kshs.4,853,513. In the circumstances, I am unable to confirm the accuracy of the reported interest expenses amount.

3. Encroached on Land without Title Deed

The statement of financial position indicates property and equipment balance of Kshs.1,714,988,172 as of statement date and disclosed under note 36(b) to the financial statements. Included in the balance, is parcel of land valued at Kshs.5, 000,000 located in Dandora Phase II allotted to the Bank in 1993. Management is yet to obtain title deed to the land parcel. In addition, the land has not been fenced off, consequently it had been encroached by squatters as at the time of finalizing this audit. In the circumstances, the Bank's ability to access the land as and when it needs is doubtful.

4. Motor Vehicle without Log Book

Also included in the property and equipment balance is motor vehicles valued at Kshs.29,123,656. Included in the motor vehicle schedule is a Mercedes Benz registration number KAJ 078Y whose log book has not been issued to the Bank by Kenya Revenue Authority (KRA). This is despite the Bank having paid the requisite duty to register the vehicle in its own name in November 1997. In the circumstances, the accuracy and fair statement of property and equipment as of the statement date cannot be confirmed.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Post Office Savings Bank in accordance with ISSAI 30 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 opinion.

Material Uncertainty Related to Going Concern

I draw attention to Note 1(e) (i) in the financial statements, which indicates that the Bank incurred a net loss of Kshs. Kshs.1,364,952,385 during the year ended 31 December 2017 (2016- 1,287,021,979), resulting into a reported accumulated deficit of Kshs.11,020,457,848 (2016- Kshs.9,599,351,297) and, as of that date, the Bank had a shareholder's equity deficit of Kshs.8,570,273,319 (2016- Kshs.7,171,095,436). These conditions, along with other matters as set forth in Note 1(e) (i), indicate that a material uncertainty exists that may cast significant doubt on the Bank's ability to continue as a going concern. My opinion is not qualified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that in my professional judgement were of most significance in the audit of the financial statements of the current year. There were no key audit matters to report in the year under review.

Other Matter

Prior Year Issues

1.0 Misstatement of Customer Savings and Deposits

The statement of financial position and note 38 to the financial statements reflects customer savings and deposits of Kshs.18,901,102,775 (2016 Kshs-17,944,664,853). As reported in the previous years, the customers savings and deposits then balance of Kshs.17,503,279.455 differed with the core banking system (CBS) balance of Kshs.17,515,289,289 by Kshs.12,009,845 as at 31 December 2014. This difference has remained unexplained over the years: 2015, 2016 and 2017.

2.0 GoK Pension Reserve Fund

The statement of financial position and note 40 to the financial statements indicates GoK Pension Reserve Fund asset of Kshs.74,381,227 (2016 liability- Kshs.183,942,031). As reported in the year 2016, the Pension Reserve Fund liability balance then of Kshs.Kshs.183,942,031 was made up of inactive accounts, accounts for deceased cases, Books on Hand (BOH) and suspected fraud cases over the years which should have been remitted back to the National Treasury upon confirmation. No explanations have been rendered on the account movements of Kshs.258,323,258 resulting into an asset closing balance as at 31 December 2017.

3.0 Interest Expense

As reported in 2014, interest expense for the year of Kshs.1,086,132,043 excluded CBS interest from Money Market of Kshs.656,264,332 and manual interest adjustments of Kshs.31,897,660.50 totaling to Kshs 688,161,992. Management subsequently explained the difference except for Kshs.3,137,356 which is outstanding to date. Consequently, the accuracy of the comparative shareholder's equity cumulative deficit of Kshs.7,171,095,436 as reflected in the financial statements could not be confirmed.

Report on Lawfulness and Effective in use of Public Resources

As required by Article 229(6) of the Constitution, based on the audit procedures performed, except for the matter described in the Basis for Lawfulness and Effectiveness in Use of Public Resources section of my report, I confirm that, nothing has come to my attention to cause me to believe that public money has not been applied lawfully and in an effective way

Basis for Conclusion

High Employee Cost

Contrary to the provisions of the Public Finance Management Regulations 2015, that requires compensation of employees not to exceed 35% of revenue, the Banks employee expenses amounted to Kshs.1,192,722,658 or 91% of the total revenue of Ksh.1,313,796,114).

Report on Internal Controls Effectiveness, Governance and Risk Management Systems

As required by Section 7(1) of the Public Audit Act, 2015 I confirm that, nothing has come to my attention to cause me to believe that internal controls were not operating in an effective way.

Responsibilities of Management and those Charged with Governance for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Financial Reporting Standards and for such 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.

In preparing the financial statements, management is responsible for assessing the bank'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 the management either intends to liquidate the bank or to cease operations, or have no realistic alternative but to do so.

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

Those charged with governance are responsible for overseeing the bank's financial reporting process.

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 of Kenya. 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 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.

As part of an audit 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.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the bank's 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 bank'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 Fund 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 of the entity or business activities 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.

I am independent of Kenya Post Office Savings Bank in accordance with ISSAI 30 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with other ethical requirements applicable to performing audits of financial statements in Kenya.



FCPA Edward R. O. Ouko, CBS
AUDITOR-GENERAL

Nairobi

17 June 2019