

# **REPORT OF THE AUDITOR-GENERAL ON KILIFI-MARIAKANI WATER AND SEWERAGE COMPANY LIMITED FOR THE YEAR ENDED 30 JUNE 2017**

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## **REPORT ON THE FINANCIAL STATEMENTS**

### **Adverse Opinion**

I have audited the accompanying financial statements of Kilifi-Mariakani Water and Sewerage Company Limited set out on pages 20 to 64, which comprise the statement of financial position as at 30 June 2017, 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 Kilifi-Mariakani Water and Sewerage Company Limited as at June 30, 2017, 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 Water Act, 2016.

In addition, as required by Article 229(6) of the Constitution, based on the procedures performed, I confirm that, public money has not been applied lawfully and in an effective way.

### **Basis for Adverse Opinion**

#### **1. Financial Performance**

As previously reported, the statement of profit and loss and other comprehensive income for the year ended 30 June 2017 reflects operating loss of Kshs.99,364,006 (2015/2016 - Kshs.42,578,465). This results to a cumulative retained deficit of Kshs.240,132,422 as at 30 June 2017. In addition, the statement of financial position as at 30 June 2017 reflects total current liabilities of Kshs.196,819,170 which exceeds total current assets balance of Kshs.150,696,407, resulting to a negative working capital of Kshs.46,122,763, an indication that the Company may be experiencing financial difficulties in settling financial obligations, as and when they may fall due. The Company's financial statements have therefore been prepared on the going-concern basis which assumes the continued financial support from the Government, bankers and creditors.

#### **2. Property, Plant and Equipment**

As previously reported, included in the property, plant and equipment figure of Kshs.144,727,256 (2015/2016 – Kshs.87,308,159) is an amount of Kshs.34,256,900 representing leased assets from Coast Water Services Board in accordance with clause 3 and 4 and schedules F and G of the unsigned Service Provision Agreement (SPA). The company neither availed ownership documents for these assets nor a professional valuation report in support of the values attached to them.

Consequently, it has not been possible to ascertain the ownership and valuation status of property, plant and equipment balance of Kshs.34,256,900.

### **3. Trade and Other Receivables**

#### **3.1. Trade Debtors**

As previously reported, the statement of financial position reflects trade and other receivables' balance of Kshs.126,087,608 as at 30 June 2017 (2015/2016 – Kshs.175,895,471). However, comparative trade and other receivables in the financial year 2015/2016 includes trade receivables balance of Kshs.162,602,234 which was supported by a schedule of Kshs.363,132,476, resulting to an unexplained and unreconciled variance of Kshs.200,530,242.

Under the circumstances, the validity and accuracy of trade and other receivables balance of Kshs.126,087,608 as at 30 June 2017 could not be confirmed.

#### **3.2. Other Receivables**

As previously reported, included in the trade and other receivables balance of Kshs.126,087,608 as at 30 June 2017 is other receivables' balance of Kshs.15,237,455. However, schedules in support of this balance were not availed during the audit review.

As such, the accuracy and completeness of other receivables balance of Kshs.15,237,455 could not be confirmed.

### **4. Trade and Other Payables**

#### **4.1. Long-term Customers' Deposits**

As previously reported, included in the statement of financial position as at 30 June 2017 is trade and other payables balance of Kshs.195,472,651. This amount includes long-term customers' deposits balance of Kshs.34,282,903. Scrutiny of bank confirmation certificates as at 30 June 2017 indicated a closing bank balance of Kshs.7,693,611.50, implying that customers' deposits amounting to Kshs.26,589,291.50 were not secured in the bank.

In the circumstances, the accuracy and validity of the customers' deposits balance of Kshs.34,282,903 could not be confirmed.

#### **4.2 Retirement Benefit Obligations**

Note 25 to the financial statements for the year ended 30 June 2017 reflects retirement benefit obligations balance of Kshs.1,346,519. However, support schedule for this amount was not availed for audit review.

In the circumstances, the accuracy and validity of the retirement benefit obligation balance of Kshs.1,346,519 could not be confirmed.

#### **5. Coast Water Services Board Liability**

Included in the statement of financial position as at 30 June 2017 is Coast Water Services Board (CWSB) liability of Kshs.77,273,343. However, details on the composition and basis of this liability was not availed for audit review during the audit exercise. Further, the provision has been incorrectly recognized as a component of equity, rather than a liability as required by IAS 37.

In the circumstances, the accuracy and validity of CWSB Liability amounting to Kshs.77,273,343 could not be confirmed.

#### **6. Bulk Water**

As previously reported, the statement of financial position as at 30 June 2017 reflects bulk water balance of Kshs.188,379,735 (2015/2016 Kshs.165,746,844). However, the general ledger maintained by the Company revealed that the closing balance for bulk water as at 30 June 2016 was Kshs.170,196,873.35, resulting to unexplained difference of Kshs.4,450,029.35.

As a result, the validity and accuracy of bulk water balance of Kshs.188,379,735 could not be confirmed.

#### **7. Share Capital**

As previously reported, and reflected in the statement of financial position, the Company is registered as a limited company with an authorized share capital of Kshs.5,000,000. According to the Memorandum and Articles of association, share capital worth Kshs.100,000 had been fully subscribed and issued as at 30 June 2017 to the Kilifi County Government. Available information and documentation indicate that as at 30 June 2017, the County Government had not paid for the shareholding. Further, in accordance with the statement of corporate governance, the Company has not updated its new shareholding portfolio to the Registrar of Companies.

Under the circumstances, the accuracy of the share capital figure of Kshs.5,094,019 as at 30 June 2017 could not be ascertained.

## **8. Unaccounted for Water**

During the year, the Company produced 9,372,679 cubic metres (m<sup>3</sup>) of water), out of which 4,686,340 cubic metres (m<sup>3</sup>) or about 50% of water was billed to customers. The balance of 4,686,339 cubic metres (m<sup>3</sup>), approximately 50% of the water produced represents Unaccounted For Water (UFW) which is 25% over and above the allowable loss of 25% in accordance with the Water Service Regulatory Board (WASREB) guidelines. The UFW of 2,343,170 cubic metres (m<sup>3</sup>) or 25% may have resulted to loss of water estimated at Kshs. 238,768,972, using the current rate of Kshs.101.90 per cubic metre.

This significant level of UFW may negatively impact on the Company's profitability and long term sustainability.

## **9. Revenue**

Note 1 to the financial statements reflects sale of water revenue of Kshs.436,415,560 for the year ended 30 June 2017. However, the company had budgeted a revenue collection target of Kshs.520,000,000, thus failing to reach the target by Kshs.83,584,640 or 16%. Further, it was observed that the company failed to keep an updated register of receipt books used.

Under the circumstances, the accuracy and completeness of revenue balances of Kshs.436,415,360 could not be confirmed.

## **10. Cost of Sales**

Included in the statement of profit and loss and other comprehensive income and as disclosed in Note 2 to the financial statements for the year ended 30 June 2017 is cost of sales of Kshs.268,412,319. Included in this figure is cost of water of Kshs.187,453,570. Review of water bills attached to support monthly invoices from Coast Water Services Board for supply of bulk water revealed 3 water bills totaling Kshs.398,480 whose supply location is indicated as Mombasa Water and Sewerage Company (MOWASCO). Further, nine (9) water bills had supply location not indicated and had an accumulated outstanding balance of Kshs.1,136,578 as at 30 June 2017. This could point out to the possibility of the Company being billed for amounts owing to other water services provider.

Further, included in the cost of sales is cost of water infrastructure service of Kshs.21,553,886. However, the support schedule availed for audit reflected a balance of Kshs.22,649,912.46, resulting to unexplained an unreconciled variance of Kshs.1,096,026.46.

Consequently, it has not been possible to ascertain the accuracy and validity of cost of sales of Kshs.268,412,319.

### **10.1 Board of Directors Expenses**

Included in administration cost in Note 6 and Note 6(b) to the financial statements for the year ended 30 June 2017 is Board of Directors expenses of Kshs.6, 965,292. Review of the documents availed for audit revealed that the company has not held any general meeting since the year 2012, contrary to Company's Memorandum of Association (MOA). Further, despite the MOA stating that a third of directors should retire every year, no director has been retired since the year 2010. The company has six (6) directors; four (4) of whom joined the board on 1 December 2010 and two representing the County Government of Kilifi joined in the year 2013. Further, the Company has been operating for over 8 years without a substantive Chairman to the board.

Consequently, the propriety and validity of the expenditure of board expenses of Kshs.6,965,292 could not be confirmed.

### **10.2 Tax Expenses**

Note 6 to the financial statements for the year ended 30 June 2017 reflects administration cost of Kshs.269,914,706. Included in this figure are taxes of Kshs.27,325,619 and fines and penalties of Kshs.8,480,175. During the year under review, the company was audited by Kenya Revenue Authority for compliance with tax laws. The Company was found not to have complied with various aspects of tax segments. This resulted to an assessment of Kshs.35,800,794 broken into Kshs.27,325,619 as principal taxes defaulted and Kshs.8,475,175 being the penalties and interest. Failure to comply with taxation laws had led to loss of Kshs.8,475,175 in form of penalties and taxes which is an irregular charge to public fund. Consequently, the Company is in breach of the Law.

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of the Kilifi-Mariakani Water and Sewerage Company Limited 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 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. Except for the matters discussed in the Basis for Adverse Opinion and Other Matter sections, I have determined that there are no other Key Audit Matters to communicate in my report.

### **Other Matter**

## 1.0. Budgetary Control and Performance

Comparison of approved budget of Kshs.520,297,297 against actual expenditure of Kshs.538,327,030 revealed that the company incurred an over expenditure of Kshs.18,029,733 or 3% as summarized below:

	Final Budget	Actual On Comparable Basis	Performance Difference	%
	2016-2017	2016-2017	2016-2017	
Expenses	Kshs	Kshs	Kshs	
Compensation of employees	163,068,747	147,113,827	15,954,920	10%
Use of goods and services	329,577,451	329,577,451	(24,906,100)	-8%
Finance cost	520,000	464,705	55,295	11%
Taxation Paid	11,043,099-	14,500,000	(3,456,901)	-31%
Rent Paid	1,800,000	1,488,480	311,520	17
BOD	9,050,000	6,965,292	2,084,292	23
Other Payments	5,238,000	13,311,175	(8,073,175)	-154
<b>Total expenditure</b>	<b>520,297,297</b>	<b>538,327,030</b>	<b>(18,029,733)</b>	<b>-3%</b>

The company therefore incurred expenditure contrary to Section 149(1) of Public Finance Management Act, 2012 which states that an accounting officer is accountable for ensuring that the resources of the entity for which the officer is designated are used in a way that is lawful and authorized.

There was no evidence availed for audit to confirm that the over expenditure of Kshs.18,029,733 or 3% was approved.

## 1.2 Revenue Budget

Comparison of approved budget against actual income revealed that the company had budgeted to receive income totalling Kshs.540,160,000 but actually ended up with an income of Kshs.448,400,923, resulting in a shortfall of Kshs.91,759,077 or 17% as summarized below:

	Budgeted	Actuals	Under Collection	% Variance
	Kshs.	Kshs.	Kshs.	
Sale of Goods	520,000,000	436,415,360	83,584,640	16%
Other Income	20,160,000	11,993,583	8,166,417	41
<b>Total</b>	<b>540,160,000</b>	<b>448,400,923</b>	<b>91,759,077</b>	<b>17%</b>

The above variance indicates that the budgeting process was not realistic and this shortfall could result in non - implementation of important projects..

## 2.0 Ethnic Composition

Examination of personnel records indicate that the Company has predominantly the local Mijikenda ethnic group in its workforce at the expense of other ethnic groups living within the County of Kilifi as summarised below:

	<b>Cadre</b>	<b>Mijikenda</b>	<b>Other Tribes</b>	<b>Total</b>	<b>Percentage Mijikenda</b>	<b>Percentage Others</b>
1	BOD	5	1	6	83	17
2	Management	4	1	5	80	20
3	Other Staff	190	17	207	92	8
	<b>TOTAL</b>	<b>218</b>	<b>19</b>	<b>218</b>		

This implies that in overall analysis, only 8.7% of the total workforce was filled by persons not from the dominant community in the County. This is in contravention of County Government Act, 2012, Section 65 (1) (e), which requires County Public Service Board to ensure that 30% of vacant posts are not from the dominant community in the County.

The Company was therefore in breach of the law

### **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 (IFRS) 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 Company's ability to continue to sustain its services, disclosing, as applicable, matters related to sustainability of services and using the applicable basis of accounting unless the management either intends to liquidate the Company's or 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 provisions of Section 47 of the Public Audit Act, 2015.

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

### **Auditor-General's Responsibilities for the Audit of the Financial Statements**

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 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 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.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances and for the purpose of giving an assurance on the effectiveness of the Company'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 Kilifi-Mariakani Water and Sewerage Company Limited's ability to continue to sustain its services. 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 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 of the entities 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.

#### REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

As required by the Companies Act, 2015 I report based on the 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, proper books of accounts have been kept by the Company, so far as appears from my examination of those books and,
- iii. The Company's statements of financial position and statement of profit and loss and other comprehensive income are in agreement with the books of account.



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

**Nairobi**

**11 July 2018**