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SPECIAL AUDIT REPORT OF THE AUDITOR-GENERAL ON
MUHORONI SUGAR COMPANY LIMITED
(MUSCO) - UNDER RECEIVERSHIP



AUGUST 2020

VISION

Accountability and effective management of public resources

MISSION

To audit and report on the management of public resources for improved service delivery to the Kenyan people.

CORE VALUES

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Objectivity
Professionalism Competence
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ABBREVIATIONS

Abbreviation	Full Name
AFA	Agriculture and Food Authority
Ag	Acting
B/Q	Bill of Quantities
CPA	Certified public accountant
DG	Director General
ERP	Enterprise Resource Planning
ERS	Economic Recovery Strategy
FM	Finance manager
F/S	Financial statement
GM	General manager
HR	Human resource
ICPAK	Institute of Certified Public Accountants of Kenya
ICT	Information and communications technology
JRMs	Joint Receiver Managers
KATC	Kenya Accounting Technicians Certificate
KPLC	Kenya Power and Lighting Company
KRA	Kenya Revenue Authority
LPO	Local Purchase Order
MA	Management Accountant
MT	Metric Ton
MUSCO	Muhoroni Sugar Company Limited
NVR	Network Video Recorder
OOC	Out Of Crop
PFMA	Public Finance Management Act
PFMR	Public Finance Management Regulations
PPADA	Public Procurement and Asset Disposal Act
PPDR	Public Procurement & Disposal Regulations
PS	Principal Secretary
PV	Payment Voucher
ROA	Return on Assets
SRA	Strategy for Revitalization of Agriculture
SRC	Salaries and Remuneration Commission
TC/TS Ratio	Ton cane per ton sugar ratio
TCD	Tons Cane per Day
TORs	Terms of reference

1. EXECUTIVE SUMMARY

1.1 Introduction and Background

- 1.1.1 The Agriculture and Food Authority (AFA) through the then Cabinet Secretary Ministry of Agriculture, Livestock and Fisheries, Hon Mwangi Kiunjuri wrote a letter Reference MOAL/FIN/3 dated 17 October, 2019 to the Office of the Auditor-General requesting for a forensic audit on operations of Muhoroni Sugar Company Ltd.
- 1.1.2 Muhoroni Sugar Company Limited (MUSCO) is owned by the Government of Kenya (82.78%), UKETA Ltd. (16.86%) and (0.36%) private shareholders. It has been under protective receivership since the year 2001 with the main objective of preserving the assets while restructuring the balance sheet with the intention of the Government divesting (privatization) to allow for private investment in its modernization.

1.2 Terms of Reference

- 1.2.1 The request for the special audit by the then Cabinet Secretary for Agriculture, Livestock and Fisheries required the Office of the Auditor-General (OAG) and the Management of Agriculture and Food Authority (AFA) to agree on the Terms of Reference to guide the special audit.
- 1.2.2 In this regard OAG and AFA agreed on the following Terms of References that guided this special audit:
 - Governance and Related Issues;
 - Financial Management Issues;
 - Asset Management and Factory Operations;
 - Procurement and Related Issues; and
 - ICT and related issues.

1.3 Scope of Work and Limitations

- 1.3.1 The special audit covered Financial Management Issues, Asset Management and Factory Operations, Procurement and related issues, IT and related issues, Governance and related issues for seven financial years; 2013/14 to 2019/20.
- 1.3.2 The audit was carried out at Muhoroni Sugar Company Limited (MUSCO) offices in Muhoroni.

1.3.3 We encountered the following limitations that affected our ability to give reasonable assurance on lawfulness and effectiveness of various expenditures incurred by Management of Muhoroni Sugar Company Limited:

- Challenges in obtaining documents relating to procurement process, sales process, assets and governance. We requested for documents listed in APPENDIX I but the same were not availed for the special audit, limiting our ability to give reasonable assurance on lawfulness and effectiveness of the mentioned business processes;
- As at the time of execution of the special audit, the management team had been ousted by Company employees. In the absence of the management team, we experienced challenges in obtaining historical background information on various business processes; and
- The Enterprise Resource Planning (ERP) System referred to as Ebiz system used at Muhoroni Sugar Company Limited didn't have an audit trail thereby posing a challenge in mining historical data necessary for effective execution of the special audit.

1.4 Structure of the Report

1.4.1 The special audit report has three sections; the executive summary, the detailed approach and the detailed findings. The report should be read in its entirety in order to comprehend fully the approach and the findings. The report has reported on facts as understood, with the aim of informing Public Investment Committee, Managements of Agriculture and Food Authority, Ministry of Agriculture, Livestock and Fisheries on their deliberations and decision making, cognizant of any limitations raised.

1.5 Key Findings

GOVERNANCE AND RELATED ISSUES

1.5.1 We reviewed Governance at Muhoroni Sugar Company Ltd alongside the following thematic areas:

	Thematic area	Key Parameters considered
1	Effectiveness and independence of the internal audit function	<ul style="list-style-type: none">• Qualification of Audit Staff• Internal Audit Charter• Independence & reporting of Internal Audit Function• Risk Based Internal Audit System
2	Human Resource Practices	<ul style="list-style-type: none">• Human Resource response to change• Appointment of unqualified employees to acting positions• SRC Job Evaluation
3	Performance of the Receiver Managers	<ul style="list-style-type: none">• Francis Makeni & Mr Asa Okoth (November 2012-September 2014 Mr. Fredrick Kebeney & Mr Asa Okoth-September 2014 -May 2018• Francis Ooko and Harun Kirui(July 2018-Current)
4	Sugar Regulations and contract between MUSCO and Miwani Sugar	<ul style="list-style-type: none">• Failure to gazette sugar regulations resulting in Cane Poaching Risks

1.5.2 We established existence of inefficient and ineffective Governance practices at Muhoroni Sugar Company characterized by ineffective internal audit function, human resource practices that do not adhere to laid down regulations and absence of regulations to protect the Company (Under Receivership) from Cane poaching related risks. There was therefore no adequate oversight on the amount of Kshs.447,507,727 loaned to Muhoroni Sugar Company by Agriculture and Food Authority.

1.5.3 Our findings were as follows:

Effectiveness and independence of the internal audit function

1.5.4 As at the time of Audit, Muhoroni Sugar Company had been placed under protective receivership and therefore the oversight role of the Board of Directors had been technically taken over by the Receiver Managers.

1.5.5 The Internal Audit function within State Corporations in Kenya is guided by Section 73 (1) of the Public Finance Management Act 2012, Sections 160-182 of the Public Finance Management Regulations, 2015, the Mwongozo Code of Governance for State Corporations of January 2015 and the International Standards for Professional Practices for Internal Auditors as issued by the Institute of Internal Auditors from time to time.

Unqualified Head of Internal Audit

1.5.6 Chapter 3 of the Mwongozo Code clause 3.4 .2 (h) Provides that the Board (*in this case receiver managers*) should ensure that the Head of Internal Audit holds a Senior position in the management team, is professionally qualified and is a member in good standing of the professional body responsible for regulating Auditors.

1.5.7 Though the Head of Muhoroni Sugar Company's Internal Audit Function was professionally qualified having passed the Final CPA examinations, there was no evidence of membership to professional bodies responsible for regulating Auditors contrary to clause 3.4 .2 (h) Chapter 3 of the Mwongozo Code of Conduct thereby exposing Financial and Non-Financial Operations at Muhoroni Sugar Company to oversight risks.

1.5.8 It was the responsibility of the receiver Managers and Head of Human Resources at MUSCO to ensure that the officer heading the internal audit function is properly qualified in accordance with relevant guidelines.

Failure to approve the Internal Audit Charter

1.5.9 We established that there was an Internal Audit Charter at Muhoroni Sugar Company Limited dated 2019. The charter did not indicate the name and signature of the preparer and there was also no evidence that it had been approved by both the management and those responsible for Governance (Receiver Managers) contrary to Chapter 3 clause 3. (2) (c)(e) of the Mwongozo Code of conduct for Government Owned Enterprises and the International Standards for Professional Practices for Internal Auditors number 1000.

1.5.10 It was the responsibility of the head of internal audit to ensure that the internal audit charter is approved by the joint receiver managers.

Failure to initiate an effective risk-based internal audit system

1.5.11 Chapter 3 of the Mwongozo Code clause 3.4 (2)(d) provides that the Board should ensure that there is an effective risk-based internal audit system. The 2013/2014 and 2014/2015 programmes were executed by the Internal Audit Manager with no indications as to the preparer nor provision as to approval of the same contrary to clause 3.4 (2)(d) of the Mwongozo Code of conduct for Government owned Enterprises.

1.5.12 Clause 3.2 sub-clause (1) (l) of the Mwongozo Code of conduct for Government owned Enterprises on Risk Management requires the Internal Audit Function to provide to the Board / those responsible for Governance a written assessment of the effectiveness of the system of internal controls and risk management. The Finance department of Muhoroni Sugar Company Ltd is fully automated. However, there was no evidence to show that the internal audit had ever carried out an audit of the controls in place within the information system and any risks thereof. There was only one internal memo prepared by the Internal Auditor on '*Risk Attached to Casual Labour & High Employee*'. Consequently, the information System related risks for the period under review were not identified, reported or mitigated as appropriate.

Human Resource Management Practices

Failure to address an imminent change in the establishment

1.5.13 On 14 June, 2019 a Memo ref REC/ADMIN/VOL.1/2019 was authored by the Joint Receiver Managers to the General Manager requiring him to take disciplinary action on the staff who spearheaded the eviction of fellow staff at the Company. It was however noted that engineer Francis Ooko, one of the Joint Receiver Managers did not append his signature hence it could not be implemented.

1.5.14 In a Memo ref REC/HR/03/2020 dated 20 January, 2020 the Acting Human Resource Manager requested for advice from the Joint Receiver Managers since the affected employees were not on duty and no communication had been given on how to solve the matter. The Joint Receiver Managers did not respond on the same, thereby failing to provide strategic direction on Human Resources Practices at the Company.

1.5.15 This resulted in the Company having in place two sets of Management comprising the ousted and the acting management teams both of whom were drawing salaries resulting in loss of Kshs.6,399,996 in form of salaries incurred on moribund Management team. Engagement of the acting managers was sanctioned by the Joint Receiver Managers.

1.5.16 The Joint Receiver Managers thus failed to address an imminent change in the establishment hence allowing two sets of management to continue drawing salaries.

Appointment of employees without the minimum qualifications to vacant positions

1.5.17 According to section 1.8.2 of the Human Resource Manual of Muhoroni Sugar Company dated 1 March, 2015, on acting capacity, an employee should have the minimum qualifications for a position in order to be appointed to act in an existing vacant position.

1.5.18 A review of the personnel files for the officers in acting capacity revealed that the following Officers were appointed to act in higher job cadres without having met the minimum requirements:

	Name	Remarks	Risk
1	Evaline Ruto	Appointed Acting Sales and Marketing yet both the Human Resource Manager and receiver Managers had indicated that she didn't have required qualifications	Inability of the Company to put in place appropriate Sales and Marketing strategies to navigate the turbulent Sugar Market leading to low revenue earnings
2	Gideon Angura	Appointed acting Planning and Project Engineer. This position required a university degree in mechanical engineering while he only held a degree in project planning and management and a diploma in business management.	Inability of the Company to put in place appropriate proactive and reactive technical strategies to mitigate against factory operation and maintenance risks
3	Manuel Omenyo	Appointed acting financial accountant. This position required the holder to have a bachelor's degree in finance or equivalent and a CPAK or	Inability of the Company to implement and monitor an effective internal control

Name	Remarks	Risk
	its equivalent. Manuel Omenyo only had a Kenya Accounting Technician Certificate	environment, maintain proper books of accounts and generate accurate and reliable financial reports that may result in imprudent management decisions

Failure to implement the job evaluation report issued by the Salaries and Remuneration Commission

1.5.19 The Salaries and Remuneration Commission (SRC) carried out a job evaluation exercise on Muhoroni Sugar Company in June 2017. The job evaluation exercise resulted in a fifteen (15)-tier grade structure encompassing five (5) skills levels for Muhoroni Sugar Company to allow for career progression of staff. The implementation of the SRC recommendations was to be effected by July 2017. There was no evidence that these recommendations had been implemented.

Performance of Receiver Managers

1.5.20 We reviewed the performance of the Receiver Managers in place during the period under review with a view to establish areas where they succeeded and where there were weaknesses. Our findings were as follows:

Receiver Manager	Key Achievements	Key Weaknesses
Francis Makeni & Mr Asa Okoth (November 2012-September 2014)	<ul style="list-style-type: none"> • Kshs.45m repaid to Kenya Sugar Board in settlement of loans in arrears. • Kshs.127million in tax arrears settled. • VAT and other Taxes paid within the stipulated settlement period of 20 October, 2014. • Area under cane in the nucleus estates increased from 941.35 ha to 1,784.00 ha 	There was no handing over by the previous Receiver Managers
Mr. Fredrick Kebeney & Mr	No major achievement noted	<ul style="list-style-type: none"> • Factory annual maintenance carried

Receiver Manager	Key Achievements	Key Weaknesses
Asa Okoth- September 2014 -May 2018		<p>out using a loan of Kshs.427M from AFA didn't realize increased productivity hence no Value for Money realized</p> <ul style="list-style-type: none"> • Suspension of factory operations due to Tax arrears of Kshs 1,107,558,654
Francis Ooko and Harun Kirui(July 2018-Current)	<ul style="list-style-type: none"> • Resumed factory operation after negotiations with KRA and KPLC on arrears • Replaced retired workers with contract staff in order to minimize pension costs • Monthly payment to KRA for the high tax debt 	<ul style="list-style-type: none"> • Cane from Miwani was sold to competitors to allow for cash flow • Failure to develop and implement a sustainable factory operation and maintenance plan • Failure to attend executive meetings

Failure to gazette sugar regulations

1.5.21 The Agriculture Fisheries and Food Authority is charged with the regulation of all the crops listed under First Schedule of the Crops Act, 2013. The Authority regulates the scheduled crops by administering the Crops Act, 2013. Section 40 of the Crops Act, 2013 read together with Section 46 of the Agriculture Fisheries and Food Authority Act, 2013 (AFA Act) gives power to the Cabinet Secretary in consultation with the Authority and County governments to make regulations for the better carrying into effect of the provisions of the Act.

1.5.22 However, to date the regulations have not been gazetted by the Ministry of Agriculture, Livestock, Fisheries & Co-operatives. This has raised concern over cane poaching by neighboring mills Kibos & Allied Industry and West Kenya Sugar Industry who had set up weigh bridges in MUSCO zone contrary to best practice. It was the responsibility of the Cabinet Secretary in the Ministry of Agriculture, Livestock, Fisheries & Co-operatives in consultation with AFA and County

governments to gazette and institute regulations to guide zoning and entry into other miller zones.

FINANCIAL MANAGEMENT ISSUES

1.5.23 We reviewed Financial Management practices at Muhoroni Sugar Company with a focus on disbursement and utilization of the factory rehabilitation loan amounting to Kshs.447,507,727. We noted the following irregularities that hindered our ability to give reasonable assurance on lawfulness and effectiveness of the loan amount of Kshs.447,507,727:

Failure to transfer lending function to the Commodities Fund

1.5.24 Section 9 (1) of the Crops Act, 2013 establishes the Commodities Fund whose function is to lend money to farmers. It was however, noted that Muhoroni Sugar Company (MUSCO) made an application to the Sugar Directorate on the 17 November, 2015 for a loan amounting to Kshs 600,000,000 for Factory maintenance.

1.5.25 It was noted that the loan was deliberated on in the 7th Meeting of the Loan Applications Vetting Committee of Agriculture and Food Authority Sugar Directorate, held on 30 March, 2016. The committee approved a loan of Kshs 447,507,727 to Muhoroni Sugar Company as budgeted by MUSCO. According to Section 9 (1) of the Crops Act, 2013 it was the responsibility of the Commodities Fund to lend money to MUSCO and not the Sugar Directorate.

Failure to open a separate bank account for factory rehabilitation loan

1.5.26 The funds were held in Kenya Commercial Bank account number 1168094887. The special audit established that this account was used as a fertilizer account before the Loan funds were deposited therein in 2016. As at 9 April, 2016, this account had a balance of Kshs 35,875 before the Loan funds were deposited therein. This was in contravention of Section X (g) of the loan agreement that provided that MUSCO must open a separate bank account for this project. The then Joint Receiver Managers F Kebeney and Asa Okoth were responsible for ensuring that a new bank account was opened as per the loan agreement.

Failure to maintain proper books of accounts on loan utilization

1.5.27 It was established that there were no proper books maintained by the Management of Muhoroni Sugar Company in form of either loan utilization expenditure schedules, and ledgers. In addition, the loan was deposited into an existing account therefore mixing up the loan with other funds and making accountability of these funds difficult contrary to Regulation 52 (1) of the Public Finance Management (National Government) Regulations, 2015. It was the responsibility of the Joint Receiver Managers and the General Manager to maintain a loan utilization schedule and AFA to monitor the utilization of the loan.

Failure by MUSCO to repay Loan

1.5.28 Section iii of the loan agreement between AFA and MUSCO provided that *“the repayment period was to be 24 months and the commencement date was to be determined by the programme schedule.”* The special audit, established that MUSCO had not made any repayment of the loan borrowed from the Sugar Directorate as at the time of the audit. In an interview with the Acting Finance Manager, it was established that MUSCO had not maintained a loan interest calculation schedule. The special audit requested for the same from AFA and it was not provided. The total loan of Kshs 447,507,727 was still outstanding. It was the responsibility of the JRM to ensure that the loan was repaid.

Financial performance of the company

1.5.29 We relied on the audited financial statements to analyze the financial performance of the company for the period 2013/2014 to 2017/2018. We established the financial performance of MUSCO is on declining trend with increasing financial distress brought about by accumulated losses, increasing liabilities, declining revenue and inefficient utilization of company's assets.

Sale of sugar to non-prequalified distributors

1.5.30 Section 4.2.5 of MUSCO's Work Instruction, for Sale of Sugar on credit requires that purchase orders shall be accepted only for the pre-qualified customers. However, a comparison of sales orders and approved list of prequalified customers established that there are supermarkets, distributors and individuals who were issued with sugar on credit totaling to Kshs 23,467,368 but were not

in the prequalified customer list contrary to Section 4.2.5 of MUSCO's Work Instruction for Sale of Sugar. It was the responsibility of the Sales and Marketing Manager to ensure that orders are raised to prequalified customers only.

Failure to use approved sugar prices

1.5.31 The special audit compared the approved price register with the raised sales orders for financial year 2017/18 and 2018/19 and noted that some orders were sold at less than the approved prices leading to a loss of Kshs.1,329,947. It was the responsibility of the Sales and Marketing Manager, the Financial Accountant and the Finance Manager to use the approved prices when raising, approving and authorizing the sales orders.

Failure to include revenue estimate in annual budget

1.5.32 Section 59 (1) of the Public Finance Management Regulations of 2015 requires that the estimates of revenues shall be in the format issued by the National Treasury and shall include—

- (a) the description of the source of revenue in terms of head code;
- (b) estimated revenues;

1.5.33 A review of MUSCO's approved annual budget submitted to the Permanent Secretary Ministry of Agriculture for the audit period did not include revenue estimates. It was the responsibility of the Head of Finance and JRMs to ensure that revenue estimates were included in the budget.

Variance between Ebiz System and Financial Statement revenue figures

1.5.34 The special audit noted that there was variance between systems generated revenue and audited financial statement amounts for the period under review amounting to Kshs.1,728,341,876 without explanation.

1.5.35 The Acting Finance Manager, Mr. Joseph Alai explained to the special audit that the variance was as a result of adjustments by the auditors. However, a review of the financial statements for the period under audit, did not indicate revenue adjustments by the auditors. Therefore, there was no explanation for the variances. This shows that the sales revenue for the financial years 2013/14 to 2016/17 was understated by Kshs.1,728,341,876.

Failure to maintain a cash receipts book for cash sales

1.5.36 Section 64 (1) of the Public Finance Management Regulations of 2015, provides that an accounting officer and a receiver of revenue are personally responsible for ensuring that— (a) adequate safeguards exist and are applied for the prompt collection and proper accounting for, all national government revenue and other public moneys relating to their Ministries, Departments or Agencies.

1.5.37 During an interview, the Acting Finance Manager informed the special audit that MUSCO had made cash sales of sugar and molasses to their prequalified customers but had not maintained a receipts ledger or cashbook. The special audit could not therefore determine the cash amounts collected for sugar and molasses for the period under audit review.

1.5.38 It was the responsibility of the Joint Receiver Managers (JRMs) to ensure adequate book keeping and proper safeguards for prompt collection and accounting of revenue.

Failure to bank proceeds from cash sales

1.5.39 MUSCO failed to bank a total of Kshs. 660,282,371, but instead utilized the same for factory operations. It was the responsibility of the Joint Receiver Managers (JRMs), General Manager (GM) and Finance Manager to ensure that proceeds from cash sales were deposited to a designated bank account.

1.5.40 Other Financial Irregularities noted include:

- MUSCO does not have a policy on presales or master file for the period under review. We could not establish what transactions were presales or cash sales from the system and therefore, we were unable to reconcile the figures with the quantities dispatched to the various distributors;
- A review of the sales orders and invoices indicated that MUSCO sold sugar on credit to distributors, wholesalers and individuals for the financial year 2013/14 to 2017/18 totaling to Kshs.68,326,422 contrary to MUSCO's Work Instruction Section 4.2.1 on Sale of Sugar on credit;
- MUSCO failed to bank a total of Kshs 660,282,371 generated from cash sales for sugar and molasses contrary to Section 64 (4) of the Public Finance Management Regulations of 2015; and

- MUSCO had a total of five bank accounts, however, reconciliation of these bank accounts was not done on a monthly basis as required by the financial operating procedures. Reconciliation for accounts payable (creditors) was not done while debtor's reconciliation was done only for various months.

PROCUREMENT AND RELATED ISSUES

- 1.5.41 The special audit established that, MUSCO did not maintain a loan utilization schedule as to show how the loan funds were utilized towards the repair works contrary to Section 1.2 of the loan offer letter Ref AFFA/SD/SCO/C/7/6/22 dated 6 April 2016 and Regulation 52 (1) of the Public Finance Management Regulations, 2015. It was the responsibility of AFA, Receiver Managers, General Manager and Finance Manager to ensure utilization reports were maintained.
- 1.5.42 In the absence of a loan utilization report, the we analyzed the transactions in the bank statement of the loan account number 1168094887, KCB Muhoroni to determine how the loan was utilized.
- 1.5.43 We established that, of the loan amount of Kshs.448,257,727 that was deposited in the bank account, an amount of Kshs.447,507,727 was loan disbursement from AFA in regard to factory repair and maintenance while Kshs.750,000 was an inward transfer from other Muhoroni Sugar Company Bank Accounts. The transfer of Kshs. 750,000 into this account went against the conditions of the Offer letter issued by AFA that required a separate account be maintained to manage loan utilization.
- 1.5.44 An amount of Kshs.340,945,055 was utilized by Muhoroni Sugar Company in paying suppliers while Kshs.101,400,000 was transferred to other Muhoroni Sugar Company Bank Accounts. Section VIII of the Loan agreement, provided that, "the loan was to be applied towards its intended purpose and should not be diverted to un-authorized use". There was no evidence that the transferred funds were used for factory maintenance nor was there authorization from AFA to transfer these funds to other MUSCO Accounts. Under the circumstances, the special audit could not provide an assurance that Kshs.101,400,000 transferred out of KCB Loan account number 1168094887 was utilized in a lawful and effective manner.

1.5.45 Out of the amount of Kshs.340,945,055 utilized by Muhoroni Sugar Company in paying suppliers, information availed by MUSCO Management indicated that MUSCO had issued Local Purchase Orders (LPOs), Quotations and Direct procurements totaling to Kshs.293,707,040. Out of the expenditure of Kshs.293,707,040, only Kshs.217,725,058.52 was supported by relevant documentation. We could not therefore, confirm the lawfulness and effectiveness of expenditure of Kshs.123,219,997 being the difference between Kshs.340,945,055 indicated in bank statement as payment to suppliers and Kshs 217,725,058 whose expenditure records were availed.

1.5.46 It was established that the following procurements amounting to Kshs.29,973,893 did not comply with provisions of Public Procurements and Asset Disposal Act, 2005 and Public Procurement and Disposals Regulations of 2006.

Procurement	Tender Sum (Kshs)
Procurement for Installation, Training and Commissioning of closed circuit television (CCTV) System	7,468,022
Procurement for the supply of Liquid Ring Vacuum Pump	2,204,000
Procurement for the purchase installation and commissioning of Rotary Screw Air Compressor C/W Refrigerated, Power 75KW	4,292,000
Procurement for supply of single stage split casing pump capacity 2000M ³	7,822,170
Procurement for rehabilitation of filter station roof, wall cladding, gutters and windows, roof area approximately 318 square meters	5,492,398
	2,150,632
Other procurements relating to goods / services paid for but not delivered	444,751
Total	29,873,973

ASSET MANAGEMENT AND FACTORY OPERATIONS

1.5.47 We established the following irregularities in relation to Asset Management:

- MUSCOs asset register had not been updated;
- MUSCOs assets were not tagged, this increases the chances of losses as it would be difficult to identify and trace assets estimated at Kshs.171,378,000.

- **Items procured vide LPOs number 5715 and 1681 amounting to Kshs 446,751 were paid for without evidence of the items being delivered; and**
- **There were motor cycles and motorcars that were not included in the assets register.**

ICT AND RELATED ISSUES

1.5.48 We reviewed ICT Systems relating to the Enterprise Resource Planning information system and the Payroll and identified the following weaknesses that pose a risk on Confidentiality, Integrity and Availability of information at the Company:

Weaknesses / Irregularities	Possible risk
1 Preparation of Financial Statements outside the ERP system	Misstatements of financial reports prepared manually as data is not validated
2 Inadequate Controls on System Administration	Data may be manipulated within the system or the system configuration may be fraudulently altered without the perpetrator being detected.
3 Conflict of interest	Existence of sugar farmers who are also employees of the company without evidence of declaration of conflict of interest and risk mitigation measures
4 Weaknesses within the sales module	Data may be manipulated within the system or the system configuration may be fraudulently altered without the perpetrator being detected.
5 Overpayment of Kshs. 603,768 on Acting Allowance	Loss of funds
6 Failure to maintain appropriate records to demonstrate recovery of Salary advance	Risk of the Company making losses due to its inability to consistently recover the advance payments.
7 Payment of normal Salary to staff who exited service.	Loss of funds

1.6 Managerial Responsibility

1.6.1 The special audit identified the following irregularities in financial and managerial responsibilities:

1	Irregularity	Law violated	Amount at risk (Kshs)	Responsibility
	Unqualified Head of Internal Audit Function	The Mwongozo Code Chapter 3 clause 3.4 2) (h)	447,507,727	Head of Human Resource Department
2	Failure to approve the Internal Audit Charter	The Mwongozo Code Chapter 3 clause 3. (2) (c)(e)	447,507,727	Joint Receiver Managers
3	Failure to initiate an effective risk-based internal audit system	The Mwongozo Code Chclause 3.4 (2)(d)	447,507,727	Joint Receiver Managers
4	Failure to carry out risk assessment	The Mwongozo Code clause 3.2 sub-clause (1) (l)5	447,507,727	Head of Internal Audit Function
5	Failure to address an imminent change in the staff establishment	The MUSCO Human Resource manual dated 1 March 2015 section 1.1.1	447,507,727	Joint Receiver Managers
6	Appointment of employees without to vacant positions the minimum qualifications	Section 1.8.2 of the MUSCO HR manual dated 1 march 2015 on acting capacity	447,507,727	Joint Receiver Managers
7	Failure to implement the job evaluation report issued by the Salaries and Remuneration Commission	Salaries and Remuneration Commission guidelines	447,507,727	Joint Receiver Managers

	Irregularity	Law violated	Amount at risk (Kshs)	Responsibility
8	Failure to invest in cane development	Receiver Managers Appointment letters	447,507,727	Joint Receiver Managers
9	Failure to pay taxes	Receiver Managers Appointment letters	1,107,558,654	JRM - Mr. Fredrick Kebeney & Mr Asa Okoth
10	Failure to develop and implement a sustainable factory operation and maintenance plan	Receiver Managers Appointment letters	447,507,727	Joint Receiver Manager - Engineer Francis Ooko
11	Failure to undertake managerial roles	Receiver Managers Appointment letters	447,507,727	Joint Receiver Managers - Engineer Francis Ooko and Harun Kirui
12	Failure to transfer lending function to the Commodities Fund	Section 9 (1) of the Crops Act 2013	447,507,727	Director-General AFA, Interim director Sugar directorate
13	Failure to open a separate account for loan proceeds	Section X (g) of the loan agreement	447,507,727	JRM - Mr. Fredrick Kebeney & Mr Asa Okoth
14	Failure to monitor loan utilization	Loan agreement section VIII	447,507,727	Director-General AFA
15	Failure to repay loan	loan agreement section iii	447,507,727	JRM - Mr. Fredrick Kebeney & Mr Asa Okoth
16	Sale of sugar to non-qualified distributors	MUSCO's Work Instruction for Sale of Sugar on credit 4.2.5	23,467,368	Sales and Marketing Manager

Irregularity	Law violated	Amount at risk (Kshs)	Responsibility
17 Failure to involve all the pricing committee members in approval of sugar prices	MUSCO's Work Instruction for Sale of Sugar on credit 4.2.5	447,507,727	Joint Receiver Managers
18 Failure to include revenue estimate in annual budget	Legal Notice No.34 National Government Regulations 59(1)	447,507,727	Joint Receiver Managers
19 Failure to bank and maintain receipts cashbook for cash sales	Legal No.34 National Government Regulations Section 64 (1)	660,282,371	Joint Receiver Managers
20 Reconciliation of bank accounts, accounts payables and receivables	MUSCOs operating procedure for financial accounts dated January 2017 Section 6.2.5,6.6.2 and 6.7.2	447,507,727	Finance Manager
21 Failure to maintain an updated asset register	Section 143 (1) of the Public Finance Management (National Government) regulations 2015	5,601,085	General Manager
22 Failure to tag and Improper storage of machinery	Section 72 (l) of the Public Finance Management Act 2012	910,471,000	General Manager
23 Payments made for goods/services not delivered	Section 146 of the Public Procurement and Asset Disposal Act, 2015	446,751	General Manager, Head of Procurement and the Finance Manager
24 Award of tender sum above the budget amount	PPR 2006 Section 10 (2) (a)	7,468,022	Tender committee
25 Preparation of Financial Statements outside the ERP system	Misstatements of financial reports prepared manually as data is not validated	Revenue - Kshs. 206,525,967 and	Management of MUSCO

Irregularity	Law violated	Amount at risk (Kshs)	Responsibility
		expenditure Kshs. 289,640,625	
26 Inadequate Controls on System Administration	Data may be manipulated within the system or the system configuration may be fraudulently altered without the perpetrator being detected.	Not applicable	Management of MUSCO
27 Conflict of interest	Existence of sugar farmers who are also employees of the company without evidence of declaration of conflict of interest and risk mitigation measures	Not applicable	Management of MUSCO
28 Weaknesses within the sales module of the ERP	Data may be manipulated within the system or the system configuration may be fraudulently altered without the perpetrator being detected.	77,163,850,347	Management of MUSCO
29 Overpayment of Acting Allowance	Loss of funds	603,768	Management of MUSCO
30 Failure to maintain appropriate records to demonstrate recovery of Salary advance	Risk of the Company making losses due to its inability to consistently recover the advance payments.	100,182,873	Management of MUSCO
31 Payment of normal Salary to staff who exited service.	Loss of funds	501,242	Management of MUSCO

1.7 Conclusion and Recommendations

1.7.1 The Special Audit established that Financial Operations at Muhoroni Sugar Company for the period under review were characterized by inefficient and ineffective Financial, Procurement, Human Resource Practices and ICT practices resulting in violation of the Public Finance Management Act (2012), Public Finance Management Regulations (2015), Public Procurement and Disposal Act (2005) and Public Procurement and Disposal Regulations (2006). Consequently, the company's financial health has significantly deteriorated as evidenced by the adverse financial ratios in regard to liquidity, asset utilization and debt.

Recommendations

- 1.7.2** The Receiver Managers should put in place an approved Internal Audit Charter, qualified Head of Internal Audit and an effective risk based internal audit plan. This will not only enable the Receiver Managers to address emerging risks but will also ensure compliance with the Public Finance Management Act 2012, the Mwongozo Code of Conduct and internal audit standards as earlier discussed.
- 1.7.3** Human Resource Department and the Joint Receiver Managers at Muhoroni Sugar Company should ensure implementation of SRC recommendations on Job Evaluations.
- 1.7.4** As part of Sustainability Strategy, Muhoroni Sugar Company should invest in its Sugar Cane nuclear estate to ensure constant supply of Raw Materials for Sugar Processing. This will mitigate the Company against going concern risks.
- 1.7.5** The management should ensure that all transactions are accurately captured in the ERP system and that the system is properly configured to generate reliable financial Statements.
- 1.7.6** The management should ensure that the system is configured to perform data validation. In addition, data clean up should also be done to ensure integrity of data maintained by the system.
- 1.7.7** The management should investigate and recover any excess amounts paid to staff and put in place proper mechanisms for all the payrolls to be processed through the system.
- 1.7.8** The Cabinet Secretary in consultation with the Authority and County governments should gazette the relevant regulations to protect sugar companies as per Section

40 of the Crops Act, 2013 and Section 46 of the Agriculture Fisheries and Food Authority Act, 2013. The Act provides for the formulation of various Regulations, Rules and Guidelines to operationalize the AFA and Crops Act.

- 1.7.9 A technical audit should be conducted on the machinery with a view of establishing its viability for continued production. The existing factory machinery at Muhoroni Sugar Company Limited seems to have worn out as a result of inefficient and ineffective factory maintenance strategy coupled with unqualified technical staff and weak human resource practices.
- 1.7.10 There is need for a total overhaul of the strategies at MUSCO, and consideration by allowing for public private partnership in the running the affairs of the company as the financial health of the Company is in a bad state with low liquidity and high gearing levels. Efforts by the Government through Agriculture and Food Authority to bail the Company through loans has been unsuccessful due to poor corporate governance issues at the company, that includes absence of oversight and disregard of procurement and financial management procedures.


Nancy Gathungu
AUDITOR-GENERAL

9 October, 2020

2. INTRODUCTION, METHODOLOGY AND SCOPE

2.1 Background

The Agriculture and Food Authority (AFA)

- 2.1.1 The Agriculture and Food Authority (AFA) is a State Corporation established through an Act of Parliament specifically, under section 3 of the Agriculture, Fisheries and Food Authority Act of 2013.
- 2.1.2 The establishment of AFA came after the Agriculture Sector Reforms which began in 2003 with the formulation of the Economic Recovery Strategy for Wealth and Employment Creation (ERS) and the Strategy for Revitalization of Agriculture (SRA). The Sector reforms were aimed at reviewing, updating and harmonizing the legal framework that would rationalize multiple legislation and regulations governing the sector.
- 2.1.3 The Agriculture sector reforms also led to the commencement of the Crops Act 2013 through which some institutions in the agricultural sector e.g. Kenya Sugar Board became Directorates of the Agriculture, Fisheries and Food Authority (AFA) known as Sugar Directorate. This Directorate regulates the sugar industry and their players. Muhoroni Sugar Company Ltd is a player in the Sugar industry.

Muhoroni Sugar Company Limited

- 2.1.4 Muhoroni Sugar Company Limited (MUSCO) is a Sugar Manufacturing firm engaged in sugarcane growing, processing and marketing of sugar. The Company was incorporated in 1964 under an Act of Parliament Cap 441; and started operations in 1966 with an initial factory capacity of 800 Tonnes of Cane per Day (TCD). The milling capacity was first expanded to 1,800 TCD in 1978 and further to 2,200 TCD in 1990.
- 2.1.5 The Company is owned by the Government of Kenya (82.78%), UKETA Ltd, (16.86%) and (0.36%) private shareholders. The company has encountered challenges brought about by liberation of the sugar industry and ageing machinery among others that led to it being placed under protective receivership in the year 2001.
- 2.1.6 The main objective of the protective receivership is preserving the assets while restructuring the balance sheet with the intention of the Government divesting (privatization) to allow for private investment in its modernization.

2.2 Introduction

- 2.2.1 The Agriculture and Food Authority (AFA) through the then Cabinet Secretary Ministry of Agriculture, Livestock and Fisheries Hon. Mwangi Kiunjuri wrote a letter reference MOAL/FIN/3 dated 17 October 2019 to the Office of the Auditor-General requesting for a forensic audit on operations of Muhoroni Sugar Company Ltd.
- 2.2.2 The letter required the Office of the Auditor-General and the Management of Agriculture and Food Authority to agree on the Terms of References. **(Letter reference MOAL/FIN/3 dated 17 October 2019 by the Cabinet Secretary attached as Exhibit ... 001.)**

2.3 Objective of the Audit

- 2.3.1 The objective of the special audit was to confirm whether public funds appropriated for Muhoroni Sugar Company for financial years 2013/14 to 2019/2020 were utilized and a lawful and effective manner.

2.4 Terms of Reference

- 2.4.1 The special audit was guided by the following terms of reference that were agreed upon between Office of the Auditor-General and the Agriculture and Food Authority: **(Letter from Management of AFA confirming Terms of References attached as Exhibit...002.)**
- Governance and Related Issues;
 - Financial management Issues;
 - Asset Management and Factory Operations;
 - Procurement and Related Issues; and
 - ICT and related issues.

2.5 Scope of Work and Limitation

Scope of Work

- 2.5.1 We covered Financial Management Issues, Asset Management and Factory Operations, Procurement and related issues, Information Technology and related issues, Governance and related issues for seven financial years, 2013/2014 to 2019/2020.
- 2.5.2 The audit was carried out at Muhoroni Sugar Company Limited (MUSCO) offices in Muhoroni.

Limitation

2.5.3 We experienced the following challenges which may have affected the quality of work;

- Challenges in obtaining documents relating to procurement process, sales process, assets and governance. We asked for documents listed in **APPENDIX I** but the same were not availed for special audit limiting our ability to give reasonable assurance on lawfulness and effectiveness of the mentioned business processes.
- As at the time of execution of the special audit, the management team had been ousted by the Union. In absence of the management team, we experienced challenges in obtaining information on historical background on various business processes.
 - The Enterprise Resource Planning (ERP) System (Ebizframe version 7.4) in used at Muhoroni Sugar Company Limited didn't have audit trail thereby posing a challenge in mining historical data necessary for effective execution of the special audit.

2.6 Audit Approach and Methodology

2.6.1 We adopted the following methodology in evidence gathering, analysis and reporting:

Document Examination

2.6.2 We reviewed and examined documents which include; Public Finance Management Act 2012, Public Procurement and Disposal Act 2005, Public Procurement & Disposal Regulations 2006, procurement records and budgets among others. **APPENDIX II** details all the documents reviewed by the special audit. This was done to ensure objectivity of the assignment and to provide practical recommendations towards the special audit.

Analytical Review

2.6.3 Financial and transactional records for the period under review was analyzed and the results used to arrive at conclusions.

Expert Opinion

- 2.6.4 We engaged a sugar expert and an engineer from the Sugar Directorate to provide expert opinion on various factory operations.

Interviews

- 2.6.5 We interviewed the following Officers involved in various operational processes within the company and their response have been incorporated in this report.

Table 1: Persons Interviewed

	Name	Designation	Status	Date Interviewed
1	Alex Odiaga	Factory Manager	Current	17/2/2020
2	James Ororo	Head of procurement	Current	18/2/2020
3	Evaline Ruto	Sales and Marketing	Current	19/2/2020
4	Raphael Muyonga	Management Accountant	Ousted	18/2/2020
5	Joseph Alai	Acting Finance Manager	Current	19/2/2020
6	Dalmas Akuro	Warehouse manager	Current	19/2/2020
7	Celine Chepkorir/ Rachael Mayaka	Acting Human Resource manager	Current	27/2/2020
8	Irene Abeti	Internal Auditor	Current	27/2/2020
9	Paul Omondi	Acting General Manger	Current	27/2/2020
10	Walter Odum	Factory Manager	Ousted	21/2/2020
11	Nashon Osieko	General Manager	Ousted	21/2/2020
12	Shadrack Cheruiyot	Acting Finance Manager	Resigned	26/2/2020
13	Michael Odhiambo	Acting Finance Manager	Ousted	25/2/2020
14	Dan Odongo	Sales and Marketing manager	Ousted	18/2/2020
15	Imelda Nubia	Acting Financial Accountant	Ousted	24/2/2020
16	Harun Kirui	Receiver Manager	Current	27/2/2020
17	Eng Francis Ooko	Receiver Manager	Current	27/2/2020

3. DETAILED FINDINGS

3.1 Governance and Related Issues

3.1.1 We reviewed Governance at Muhoroni Sugar Company Ltd alongside the following thematic areas:

Table 2 : Governance & related issues reviewed

	Thematic area	Key Parameters considered
1	Effectiveness and independence of the internal audit function	<ul style="list-style-type: none">• Qualification of Audit Staff• Internal Audit Charter• Independence & reporting of Internal Audit Function• Risk Based Internal Audit System
2	Human Resource Practices	<ul style="list-style-type: none">• Human Resource response to change• Appointment of unqualified employees to acting positions• SRC Job Evaluation
3	Performance of the Receiver Managers over the years	<ul style="list-style-type: none">• Francis Makeni & Mr Asa Okoth (November 2012-September 2014 Mr. Fredrick Kebeney & Mr Asa Okoth-September 2014 -May 2018• Francis Ooko and Harun Kirui(July 2018-Current)
4	Sugar Regulations and contract between MUSCO and Miwani Sugar	<ul style="list-style-type: none">• Failure to gazette Sugar Regulations resulting in Cane Poaching Risks

Effectiveness and independence of the internal audit function

3.1.2 The Internal Audit function within State Corporations is guided by Section 73 (1) of the Public Finance Management Act 2012, Sections 160-182 of the Public Finance Management Regulations, 2015, the Mwongozo Code of Governance for State Corporations of January 2015 and the International Standards for Professional Practices for Internal Auditors as issued by the Institute of Internal Auditors from time to time. Mwongozo guidelines were jointly issued by the Public Service Commission and State Corporations Advisory Committee in January 2015 to provide a Code of governance for Government Owned Entities.

3.1.3 We reviewed the Internal Audit Operations at Muhoroni Sugar Company alongside the aforementioned criteria and established the following non-compliance that pose a risk to the effectiveness of the Internal Audit Function. **As at the time of Audit,**

Muhoroni Sugar Company had been placed under protective receivership and therefore the oversight role of the Board of Directors had been technically taken over by the receiver managers.

Unqualified Head of Internal Audit

- 3.1.4 Chapter 3 of the Mwongozo Code clause 3.4 .2 (h) Provides that the Board (*in this case receiver managers*) should ensure that the Head of Internal Audit holds a Senior position in the management team, is professionally qualified and is a member in good standing of the professional body responsible for regulating Auditors.
- 3.1.5 At the time of audit, the Internal Audit Department had four members of staff i.e an Audit Assistant, two Audit Supervisors, and was headed by an Internal Auditor. Though the Head of Muhoroni Sugar Company's Internal Audit Function was professionally qualified having passed the Final CPA examinations by the Kenya Accountants and Secretaries National Examination Board (KASNEB) , there was no evidence of certification evidencing membership to professional bodies responsible for regulating Auditors such as Institute of Certified Public Accountants of Kenya (ICPAK) and / or Institute of Internal Auditors (IIA) contrary to clause 3.4 .2 (h) Chapter 3 of the Mwongozo Code of Conduct thereby exposing Financial and Non-Financial Operations at Muhoroni Sugar Company to oversight risks.
- 3.1.6 Similarly, the Audit Supervisors had completed the Final CPA examinations by KASNEB with no evidence of certification of membership to professional bodies responsible for regulating Auditors. The Audit Assistant availed transcripts indicating participation in CPA examinations up to Part II. It was the responsibility of the receiver Managers and Head of Human Resources at MUSCO to ensure that the officer heading the Internal Audit Function is properly qualified in accordance with relevant guidelines.

Failure to approve the Internal Audit Charter

- 3.1.7 An internal audit charter is a formal document that defines internal audit's purpose, authority, responsibility and position within an organization thereby defining its terms of reference and independency. Chapter 3 clause 3. (2) (c)(e) of the Mwongozo Code of conduct for Government Owned Enterprises requires the Board to establish an Internal Audit Function and approve the Internal Audit Charter. In

addition, the International Standards for Professional Practices for Internal Auditors number 1000 requires that *“The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the definition of Internal Auditing, the Code of Ethics, and the Standards. The chief audit executive must periodically review the internal audit charter and present it to senior management and the board for approval”*.

- 3.1.8 We established that there was an Internal Audit Charter at Muhoroni Sugar Company Limited dated 2019. The charter did not indicate the name and signature of the preparer and there was also no evidence that it had been approved by both the management and those responsible for Governance (Receiver Managers) contrary to Chapter 3 clause 3. (2) (c)(e) of the Mwongozo Code of conduct for Government Owned Enterprises and the International Standards for Professional Practices for Internal Auditors number 1000.
- 3.1.9 The Charter described the role, authority, responsibility and position of the Internal Audit function within the Company. The Charter further provided under Section 3.0 that it shall be revised every three years; however, earlier editions of the Charter were not availed. It was the responsibility of the head of internal audit to ensure that the internal audit charter is approved by the joint receiver managers. ([Un-Approved Internal Audit Charter dated 2019 attached as Exhibit....003.](#))

Reporting structure of the Internal Audit Department

- 3.1.10 Chapter 3 clause 3.4 of the Mwongozo Code of conduct for Government owned Enterprises provides that:
The Board should:
- Oversee the internal audit function and the external audits;
 - Ensure that the internal audit function is independent; and
 - Ensure that the internal audit function reports to the Board committee.
- 3.1.11 Muhoroni Sugar Company Limited being under receivership did not have a board committee hence the Joint receiver managers were expected to provide oversight on the operations of the company. Regulation 162 (1) of Public Finance Management Regulations (PFMR) 2015 also requires internal audit to report administratively to the Accounting Officer, and functionally to the Audit Committee.
- 3.1.12 We observed that the Head of Internal Audit administratively reported to the General Manager and technically reported to Joint Receiver Managers.

Failure to initiate an effective risk-based internal audit system

- 3.1.13 Chapter 3 of the Mwongozo Code clause 3.4 (2)(d) provides that the Board should ensure that there is an effective risk-based internal audit system. Internal Audit Programmes were availed for financial years 2013/2014, 2014/2015, 2018/2019, and 2019/2020. The 2013/2014 and 2014/2015 programmes were executed by the Internal Audit Manager with no indications as to the preparer nor provision as to approval of the same. **No audit programme for financial year 2017/2018 was availed contrary to clause 3.4 (2)(d) of the Mwongozo Code of conduct for Government Owned Enterprises exposing Operations at MUSCO to oversight risks.**
- 3.1.14 The internal audit programme availed was largely implemented but only to the extent that items contained therein were reported on only in part, coincidentally and intermittently as evidenced by the reports. There was no information provided as to what informed the subject of some of the reports availed with the exception of reports requested by the General Manager, a Head of Department or the Joint Receivers and Managers.
- 3.1.15 The structure of the internal audit reports availed was in the form of an internal memo, the subject of which was the subject matter of audit. In most instances, the auditor then provided a background to the subject matter sometimes with an introduction, highlighted the key findings sometimes with observations made, and concluded with recommendations. There was otherwise no set form and the reports would sometimes define the objective of the audit and at times simply be notes on observations or findings. No risks were identified or assessed as required by clause 3.4 (2) (d) of the Mwongozo code of conduct for Government Owned Enterprises which requires the Board (in this case Receiver Managers) to ensure that there is an effective risk-based internal audit system. It was the responsibility of the joint receiver managers and the head of internal audit to ensure that there is an effective risk-based internal audit system.
- 3.1.16 Clause 3.2 sub-clause (1) (l) of the Mwongozo Code of conduct for Government owned Enterprises on Risk Management requires the Internal Audit Function to provide to the Board / those responsible for Governance a written assessment of the effectiveness of the system of internal controls and risk management. The Finance Department of Muhoroni Sugar Company Ltd is fully automated. **However, there was no evidence to show that the internal audit ever carried out an audit of the**

controls in place within the information system and any risks thereof. There was only one internal memo prepared by the Internal Auditor on '*Risk Attached to Casual Labour & High Employee*'. Consequently, the information System related risks for the period under review were not identified, reported and mitigated as appropriate.

- 3.1.17 MUSCO's internal audit function failed through their reports or in any other written form to assess internal controls system effectiveness and risk management and thereafter provide the same to the Board contrary to clause 3.2 sub-clause (1) (l) of the Mwongozo Code of conduct. It was the responsibility of the internal audit manager to carry out an assessment of the effectiveness of the system of internal controls and risk management.
- 3.1.18 It is recommended that the receiver managers of Muhoroni Sugar Company should ensure there exists an approved internal audit charter, qualified Head of Internal Audit and an effective risk based internal audit plan capturing information system risks and linked to the Company's Strategic plan. This will not only enable the receiver managers to address emerging risks but will also ensure compliance with the Public Finance Management Act 2012, the Mwongozo Code of Conduct and internal audit standards as earlier discussed.

Human Resource Practices - Organizational Structure, Reporting and Staff Establishments

- 3.1.19 The organizational structure of Muhoroni Sugar Company Ltd (MUSCO) has the Joint Receiver Managers heading the organization with the General Manager heading the administrative function. There is an internal audit function that reports to The Joint Receiver Managers and the General Manager. The following issues were noted in relation to the human resource function.

Failure to address an imminent change in the establishment

- 3.1.20 The MUSCO Human Resource Manual dated 1 March 2015 Section 1.1.1 requires that no addition or change of establishment is allowed without prior written authority of the Joint Receiver Managers through the General Manager. As at 30 June 2019, MUSCO had a total of 806 employees against a staff establishment of 878 employees. Eight (8) employees were in acting capacity. Seven (7) of the employees on acting

capacity replaced employees who were ousted from their offices by fellow employees on 27 May 2019.

- 3.1.21 On 14 June 2019 a memo ref REC/ADMIN/VOL.1/2019 authored by the Joint Receiver Managers to the General Manager requiring him to take disciplinary action on the staff who spearheaded the eviction of fellow staff. It was however noted that Engineer Francis Ooko, one of the Joint Receiver Managers did not append his signature as it was claimed that he was in support of the eviction hence it could not be implemented. (Memo ref REC/ADMIN/VOL.1/2019 authored by the Joint Receiver Managers attached as Exhibit...004.)
- 3.1.22 In a memo ref REC/HR/03/2020 dated 20 January 2020 the acting Human Resource Manager requested for advice from the Joint Receiver Managers since the affected employees were not on duty and no communication had been given on how to solve the case. The Joint Receiver Managers did not respond on the same thereby failing to provide strategic direction on Human Resources Practices at the Company. (Memo ref REC/HR/03/2020 dated 20 January 2020 attached as exhibit...005.)
- 3.1.23 This resulted in the Company having in place two sets of Management comprising the ousted and the acting management teams both of whom were drawing salaries as detailed, resulting in loss of Kshs 6,399,996 inform of salaries incurred on moribund Management team. Engagement of the Acting Managers was sanctioned by the Joint Receiver Managers.

Table 3 : Salaries incurred on Moribund Management team

	Name of staff	Designation	Amount paid while not on duty (Kshs) June 2019 to January 2020
1	Raphael Muyonga	Management Accountant	659,876
2	Walter Odum	Factory Manager	1,280,000
3	Nashon Osieko	GM Ousted	1,680,000
4	Michael Odhiambo	Ag Finance Manager	635,480
5	Dan Odongo	Sales and Marketing manager	602,704
6	Imelda Nubia	Ag Financial Accountant	261,936
7	Rachael Mayaka	Human Resource Manager	1,280,000
	Total		6,399,996

3.1.24 The Joint Receiver Managers thus failed to address an imminent change in the establishment hence allowing two sets of management to continue drawing salaries.

Appointment of employees without the minimum qualifications to vacant positions

3.1.25 According to Section 1.8.2 of the Human Resource Manual of Muhoroni Sugar Company dated 1 March 2015, on acting capacity, an employee should have the minimum qualifications for a position in order to be appointed to act in an existing vacant position.

3.1.26 A review of the personnel files for the officers in acting capacity revealed that the following Officers were appointed to act in higher job cadres without meeting the minimum requirements:

Table 4 : Unqualified employees appointments

	Name	Remarks	Risk
1	Evaline Ruto	Appointed Acting Sales and Marketing yet both the Human Resource Manager and receiver Managers had indicated that she didn't have required qualifications	Inability of the Company to put in place appropriate Sales and Marketing strategies to navigate the turbulent Sugar Market leading to low revenue earnings
2	Gideon Angura	Appointed acting planning and project engineer. This position required a university degree in mechanical engineering while he only held a degree in project planning and management and a diploma in business management.	Inability of the Company to put in place appropriate proactive and reactive technical strategies to mitigate against factory operation and maintenance risks
3	Manuel Omenyo	Appointed acting financial accountant. This position required the holder to have bachelor's degree in finance or equivalent and CPAK or its equivalent. Manuel Omenyo only had a Kenya Accounting Technician Certificate	Inability of the Company to implement and monitor an effective internal control environment, maintain proper books of accounts and generate accurate and reliable financial reports that may result in imprudent management decisions

- 3.1.27 Evaline Ruto was employed temporarily on 14 May 2008 as a telephone operator. She was appointed to act as telephone supervisor on 19 February, 2009 and later appointed to same position on 20 April, 2010. An Interdepartmental transfer moved her from telephone supervisor to sales person on acting capacity from 24 December, 2015. In a review done on 6 June, 2016 the Human Resource Manager commented that the officer did not have the requisite qualifications. The Joint Receiver Manager warned against any additional responsibility being given to the officer. On 12 September, 2019 she was appointed as acting sales and marketing manager by the acting Human Resource Manager. It was however, noted that Eveline does not have any marketing background but instead participated in a one-week supervisory skills development course held on 28 November to 3 December 2016. (Correspondences from Human Resource Manager & Receiver Manager advising against appointing the Officer to the post and appointment letter to the post attached as Exhibit 006.)
- 3.1.28 Gideon Angura was employed as fitter general apprentice on 2 January, 1992 with a final craft certificate. He was confirmed to the position of shift superintendent on 1 June, 2008. He was promoted on acting capacity to maintenance engineer mills on 18 November 2014. On 12 October, 2015 he was appointed on acting position of maintenance manager mills and boilers. The human resource manager however stated that he could not be confirmed due to absence of prerequisite qualification.
- 3.1.29 On 3 December, 2018 he was appointed as planning and project engineer by the then Human Resource Manager and the General Manager. The position of planning and project engineer required a university degree in mechanical engineering while he held a degree in project planning and management and a diploma in business management. (Appointment letter attached as Exhibit...007...)
- 3.1.30 Manuel Omenyo was employed on 16 November, 1990 as a cashier grade F with a Kenya Accounting and Technician Certificate (KATC). On 10 April, 2008 he was re-designated to accounts supervisor cash office. He was transferred to financial accounts as acting financial accountant on 28 November, 2019. This position required the holder to have bachelor's degree in finance or equivalent and CPAK or its equivalent. Manuel Omenyo only had a KATC certificate hence he did not have the relevant qualifications to hold this position. This was despite the fact that there were other officers who had the relevant qualifications but they were not

considered for the same. It was the responsibility of the Human Resource Manager to ensure that the officers in acting capacity have the minimum qualifications to warrant appointment to their positions (Appointment letter attached as Exhibit...008...)

Failure to implement the job evaluation report issued by the Salaries and Remuneration Commission

- 3.1.31 The Salaries and Remuneration Commission (SRC) carried out a job evaluation exercise on Muhoroni Sugar Company in June 2017. The job evaluation exercise resulted in a fifteen (15)-tier grade structure encompassing five (5) skills levels for Muhoroni Sugar Company to allow for career progression of staff. The implementation of the SRC recommendations was to be effected by July 2017. (SRC Job evaluation report attached as Exhibit...009.)
- 3.1.32 The management constituted a committee of 10 members to conduct the exercise of reviewing the current staff establishment and mapping of the jobs in line with SRC grading structure. The committee gave a report on 6 December, 2017. The recommendations were forwarded to the General Manager on 15 May, 2018 for approval. However, there was no further communication hence the recommendations were not implemented. The management did not give any explanation or justification for failing to implement the SRC recommendations. It was the responsibility of the General Manager to ensure that SRC recommendations were implemented (Management committee report dated 06 December 2017 attached as Exhibit...010.)

Performance of the Receiver Managers over the years

- 3.1.33 Pursuant to Section 79 of the repealed Companies Act, Muhoroni Sugar Company Limited went under Receivership effective from 27 March, 2001 when two debenture holders; the Kenya Sugar Board and the National Bank of Kenya appointed Joint Receivers and Managers.
- 3.1.34 According to a brief prepared by MUSCO's Corporate Affairs Manager, as at the time of audit there was a single debenture holder, former Kenya Sugar Board (currently the Agriculture and Food Authority Sugar Directorate) with a debt amounting to Kshs.957,937,369.

3.1.35 During the period under review i.e. 2013/14-2018/19, Muhoroni Sugar Company had three receivership regimes as follows:

Table 5 : Receiver Managers-2013/14-2018/19

	Period	Receiver Manager
1	May 2018 - Current	Harun Kirui & Engineer Francis Ooko
2	September 2014 -May 2018	Fredrick Kebeney & Asa Okoth
3	November 2012-September 2014	Francis Makeni & Asa Okoth

3.1.36 Prior to September 2014, Eng. Martin Owiti & K.A.K Bett served as Receiver Managers for the period August 2005 - December 2012 while Jack Ranguma & Ndungu Gathinji served during the period March 2001 - August 2005. Operations for these periods were however outside the scope of the special audit.

3.1.37 We reviewed the performance of the Receiver Managers in place during the period under review with a view to establishing the areas where they succeeded and those where there were weaknesses. Our findings were as follows:

Table 6 : Analysis of performance of receiver managers

Receiver Manager	Key Achievements	Key Weaknesses
Francis Makeni & Mr. Asa Okoth (November 2012-September 2014)	<ul style="list-style-type: none"> • Kshs.45m repaid to Kenya Sugar Board in settlement of loans in arrears. • Kshs.127million in tax arrears settled. • VAT and other Taxes within the stipulated settlement period of 20th October 2014. • Area under cane in the nucleus estates increased from 941.35 ha to 1,784.00 	There was no handing over by previous receiver managers
Mr. Fredrick Kebeney & Mr. Asa Okoth-September 2014 - May 2018	No major achievement noted	<ul style="list-style-type: none"> • Factory annual maintenance carried out using a loan of Kshs.427M from AFA didn't realize increased productivity hence no Value for Money realized

Receiver Manager	Key Achievements	Key Weaknesses
		<ul style="list-style-type: none"> Suspension of factory operations due to Tax arrears of Kshs 1,107,558,654
Francis Ooko and Harun Kirui (July 2018-Current)	<ul style="list-style-type: none"> Resumed factory operation after negotiations with KRA and KPLC on arrears Replaced retired workers with contract staff in order to minimize pension costs Monthly payment to KRA for the huge tax debt 	<ul style="list-style-type: none"> Cane from Miwani was sold to competitors to allow for cash flow Failure to develop and implement a sustainable factory operation and maintenance plan Failure to attend executive meetings

3.1.38 APPENDIX III details the factory performance in relation to areas under cane development, quantity of cane crushed and quantity of sugar produced during the period under review.

Francis Makeni & Mr Asa Okoth-(November 2012-September 2014)

3.1.39 The Receivers & Managers Thomas N. Makeni and Asa Okoth were appointed vide letter reference KSB/EST/333/38 dated 13 November, 2012. The actual take-over by the two was effected on 7 December, 2012, supervised by the Kenya Sugar Board Chief Executive Officer and some Board Members. This was without handover by previous Receivers hence, the incoming Joint Receivers & Managers relied on information and records held by Senior Managers of the Company. At his request the Receiver & Manager Thomas N. Makeni was re-called to the Sugar Directorate vide the Interim Director-General letter of 9 September, 2014.

3.1.40 According to the hand over report from Receivers & Managers (Thomas N. Makeni and Asa Okoth) to Receivers & Managers (Fredrick Kebeney and Asa Okoth), at the time of Manager Thomas N. Makeni exit, Kshs.45m had been repaid to Kenya Sugar Board in settlement of loans in arrears. At the time of handing over, a total of Kshs.127million in tax arrears had been settled. VAT and other Taxes, arising after December 2012 was current in payment. The September 2014 Taxes were within the stipulated settlement period of 20th October 2014. (Hand Over report attached as Exhibit.....011.)

3.1.41 During the tenure of Managers Thomas N. Makeni and Mr. Asa Okoth the area under cane in the nucleus estates increased from 941.35 hectares in December 2012 to 1,784.00 hectares as at September 2014.

Mr. Fredrick Kebeney & Mr Asa Okoth-September 2014 -May 2018

3.1.42 Receiver Manager Mr. Fredrick Kebeney took over from Mr. Thomas N. Makeni on 23 September, 2014. During their tenure, Agriculture and Food Authority disbursed a loan of Kshs.427 million to be utilized for Out of Crop (OOC) maintenance. The Factory annual maintenance was carried out in July-August 2016. Whereas improvement was expected after the factory maintenance, the quantity of sugar produced decreased from 29,363 MT in June 2016 to the lowest recorded of 15,876 MT in May 2018. **(Hand Over report Fredrick Kebeney & Asa Okoth to Engineer Francis Ooko & Harun Kirui attached as Exhibit.....012.)**

3.1.43 One of the mandates of the Joint Receiver Managers was to prepare and file statutory returns with both the Kenya Revenue Authority/KRA and the Company registry. At the time of handover by Mr. Thomas Makeni, the September 2014 Taxes were within the stipulated settlement period of 20 October, 2014. However as at May 2018 MUSCO tax arrears were at Kshs.1,107,558,654.

3.1.44 This shows that the JRMs failed in their duty to pay taxes as required by the appointment letters. Due to failure in payment of taxes, Kenya Revenue Authority (KRA) issued a demand notice and all bankers were issued with agency notices to recover and remit any monies paid through these accounts or held in these accounts to KRA. This led to the suspension of factory operations in May 2018 as the company could not operate without funds. **(KRA Notices to bankers attached as Exhibit.....013.)**

Engineer Francis Ooko and Harun Kirui(July 2018-Current)

3.1.45 As per letter ref AFA/ADM/GC/VOL IV/177 and letter ref AFA/ADM/GC/VOL IV/179 both dated 20 June, 2018, Harun Kirui and Engineer Francis Ooko were seconded from Horticultural Crops Directorate and Sony Sugar company respectively as Joint Receiver Managers for Muhoroni and Miwani sugar companies for three months up to 30 September, 2018. This secondment was renewed for another 3 months as per letter ref AFA/HRM/23/ (36) and letter ref AFA/HRM/23/ (37) respectively to run

from 1 October 2018 to 31 December, 2018. This was further renewed for an undefined period from 1 January, 2019 through letter ref AFA/HRM/33/183 and letter ref AFA/HRM/33/184 respectively. As at the period of audit (February, 2020) they were still holding the same position. The following were noted in relation to their performance;

Resumption of factory operations

- 3.1.46 When the JRMs reported in July 2018, the factory operations had stopped in May 2018 due to a cash flow crisis caused by an agency notice issued by KRA. The main immediate objective of the JRMs was to ensure the factory was reopened. They managed to negotiate with KRA for the removal of the agency notice and KPLC for power reconnection. Cane from Miwani was sold to competitors to allow for cash flow which was used to pay farmers weekly for cane delivery hence resuming factory operations in September 2018. Cane is considered a biological asset, disposal of biological assets to address the company's liquidity challenges adversely affects the Company's Balance Sheet (Current Assets) posing going concern risks to the company.

Other achievements

- 3.1.47 The current Receiver Managers improved the internal controls by instructing the internal audit to carry out post audits instead of pre-audits. They also resolved to replace retired workers with contract staff in order to minimize pension costs. The weigh bridge system was fully integrated with the payment system hence reducing cane payments complaints from farmers. The JRMs have also managed to maintain a monthly payment to KRA for the huge tax debt. (Bank statement and banking slips attached as exhibit...014.)

Failure to develop and implement a sustainable factory operation and maintenance plan

- 3.1.48 According to the Receiver Manager's job description from AFA Sugar Directorate, the Receiver Managers were to develop and implement a sustainable factory operation and maintenance plan, develop and implement a sustainable business plan and verify current debts before making payments and facilitate. It was noted

that the Joint Receiver Managers developed a business plan but did not develop Factory Operation and Maintenance Plans. It was the responsibility of the Joint Receiver Managers and the Interim Director AFA Sugar Directorate to ensure that the Joint Receiver Managers developed Factory Operation and Maintenance Plans. (Joint Receiver Managers job description from AFA Sugar Directorate attached as exhibit.....015)

Failure to undertake managerial roles

3.1.49 The current Receiver Managers held their inaugural extra ordinary Executive Management Meeting on 16 July, 2018. They held another executive meeting on 23 August 2018 and then a key risk discussion and mitigation meeting on 14 November 2018. It was noted that the Receiver Managers did not hold any other Executive Meeting. Subsequent executive meetings were held and chaired by the General Manager in the absence of the Receiver Managers. **The JRMs were not able to describe how they apportion their management time between Miwani and Muhoroni.** Even though the Joint Receiver Managers developed a sustainable business plan the implementation of the same may have been difficult due to their continued absence in executive meetings. It was the responsibility of AFA to ensure that the JRMs apportion their management time accordingly to both MUSCO and Miwani and to ensure that they attended and chaired executive meetings frequently.

Sugar Regulations and contract between MUSCO and Miwani Sugar

Failure to gazette Sugar Regulations

3.1.50 The Agriculture Fisheries and Food Authority is charged with the regulation of all the crops listed under First Schedule of the Crops Act, 2013. The Authority regulates the scheduled crops by administering the Crops Act, 2013. Section 40 of the Crops Act, 2013 read together with Section 46 of the Agriculture Fisheries and Food Authority Act, 2013 (AFA Act) gives power to the Cabinet Secretary in consultation with the Authority and County governments to make regulations for the better carrying into effect of the provisions of the Act. The Act provides for the formulation of various Regulations, Rules and Guidelines to operationalize the AFA and Crops Act.

3.1.51 According to the brief on Sugar Regulations 2020, the Sugar Regulations were developed with the first edition finalized in 2002 and then 2020. However, to date the same have not been gazetted by the Ministry of Agriculture. The JRMs expressed concern over cane poaching by neighboring mills Kibos & Allied Industry and West Kenya Sugar Industry who had set up weigh bridges in MUSCO zone contrary to best practice. It was the responsibility of the Cabinet Secretary in the Ministry of Agriculture in consultation with AFA and County governments to gazette and institute regulations to guide zoning and entry into other miller zones. ([Brief on sugar regulations 2020 attached as exhibit...016.](#))

[Farming contract with Miwani Sugar Company](#)

3.1.52 According to the business plan development by the Joint Receiver Managers (JRMs), Miwani has a valid farming contract with Muhoroni Sugar Company in its vast Nucleus Estate which is 3200 cane able land. Muhoroni has a working sugar plant and therefore is able to mill the cane from Miwani Sugar Company (1989) Ltd (In Receivership). It was also expressed that cane from Miwani which was to assist MUSCO achieve a maximum milling capacity as per the contract was being poached by Kibos and Allied Industry. In an interview with the JRMs and the GM they confirmed that there existed a farming contract between MUSCO and Miwani Sugar Company. However, the contract was not availed therefore the team could not ascertain this relationship.

3.2 Financial management issues

3.2.1 This section discussed financial management issues at Muhoroni Sugar Company as follows:

Table 7 : Financial Management issues

	Financial Management issue	Key aspects reviewed
1	Factory Rehabilitation Loan	<ul style="list-style-type: none"> • Legal framework for lending • Banking arrangements • Books of accounts • Monitoring loan utilization • loan repayment
2	Financial Health Analysis	<ul style="list-style-type: none"> • Financial Health of the company through Financial Ratio Analysis and interpretation
3	Factory Performance	<ul style="list-style-type: none"> • Efficiency of cane to Sugar/ Molasses conversation as compared to best practices
4	Sales & Revenue performance	<ul style="list-style-type: none"> • Sugar sales to non-prequalified distributors • Use of approved sugar prices • Revenue Budgeting • Revenue figures in financial statements as compared to those in ERP System • Cash Receipt Books • Banking of Cash Sales • Sugar pricing and ordering • Reconciliation of bank accounts, debtors and creditors
5	Purchases made vide imprests	<ul style="list-style-type: none"> • Review purchases made vide imprests

3.2.2 The Crops Act 2013 Section 9 (1) establishes a fund to be known as the Commodities Fund managed by a Board of Trustees to be appointed by the AFFA with the approval of the National Assembly. Section 10 (1) of the same Act the Fund shall be used to provide sustainable credit and advances to farmers for all or any of the following purposes; Farm Improvement, Farm Inputs, Farm operations, Price stabilization and any other lawful purposed approved by AFA.

3.2.3 For the period under review, financial years 2013/14 to 2018/19, AFA had extended to Muhoroni Sugar Company (MUSCO) loans totaling to Kshs.957,937,369 as tabulated below: The Crops Act, 2013 Section 9 (1) establishes a fund to be known as the Commodities Fund, managed by a Board of Trustees to be appointed by the AFFA

with the approval of the National Assembly. According to Section 10 (1) of the same Act the Fund shall be used to provide sustainable credit and advances to farmers for all or any of the following purposes; Farm Improvement, Farm Inputs, Farm operations, Price stabilization and any other lawful purposed approved by AFA.

Table 8: Loans disbursed to MUSCO by AFA

	Year	Purpose	Approved Amount (Kshs)	Date Disbursed	Disbursement (Kshs)
1	2013/14	Cane Development	79,392,549	1/10/2013	70,000,000
		Cane Development		2/10/2013	9,392,549
2	2013/14	Factory Rehabilitation	212,000,000	17/12/2013	212,000,000
3	2014/15	Farmers Arrears	219,037,093	3/09/2014	219,037,093
4	2015/16-2016/17	Factory Rehabilitation	447,507,727	11/5/2016	222,963,887
				20/7/2016	100,000,000
				9/8/2016	124,543,840
		TOTAL			957,937,369

3.2.4 The scope of this special audit was limited to disbursement and utilization of the factory rehabilitation loan amounting to Kshs.447,507,727.

Factory Rehabilitation Loan Kshs.447,507,727

Failure to transfer lending function to the Commodities Fund

3.2.5 Section 9 (1) of the Crops Act 2013 establishes the commodities Fund whose function is to lend money to farmers. It was however noted that Muhoroni Sugar Company (MUSCO) made an application to the Sugar Directorate on the 17 November 2015 for a loan amount of Kshs.600,000,000 for Factory maintenance (Loan application attached as Exhibit.....017).

- 3.2.6 It was noted that the loan was deliberated on in the 7th meeting of the Loan Applications Vetting Committee of Agriculture and Food Authority Sugar Directorate, held on 30 March 2016. The Committee approved a loan of Kshs.447,507,727 to Muhoroni Sugar Company as budgeted by MUSCO in its application under **APPENDIX IV**. According to Section 9 (1) of the Crops Act 2013 it was the responsibility of the Commodities Fund to lend money to MUSCO and not the Sugar Directorate. The Vetting Committee Members were Anthony Muriithi (Ag Chairman), Nancy Cheruiyot, Christine Yebei, Elias Kiragu and Frankie Welikhe ([Extract minutes of the loan application vetting committee and Section 9 \(1\) of the Crops Act 2013 attached as Exhibit.....018.](#))
- 3.2.7 In a letter Ref AFA/DG/MOA/SD/VOL.III (49) dated 1 April 2016 the then Interim Director-General for AFA, Alfred Busolo Tabu wrote to the PS State Department of Agriculture Dr Richard Lesiyampe seeking formal approval for the disbursement of Kshs.447,507,727 to Muhoroni Sugar Company. The request was approved on 4 April 2016. ([Letter Ref AFA/DG/MOA/SD/VOL.III \(49\) and Approval by PS State Department of Agriculture attached as exhibit...019.](#))
- 3.2.8 In a letter Ref AFA/SD/SCO/C/7/6/22 dated 6 April 2016 the then Interim Director General Alfred Busolo Tabu and Interim Head Sugar Directorate Andrew Osodo issued a loan offer letter to MUSCO. The then Joint Receiver Managers F Kebeney and Asa Okoth Ooko accepted the offer on 13 April 2016. The loan was secured by a debenture dated 6 June 2016. ([Loan offer letter and debenture attached as exhibit...020.](#))
- 3.2.9 It was the responsibility of the Director General of AFA to ensure that the responsibility of loan issuance was transferred to the Commodities Fund.
- 3.2.10 The terms of the loan were as summarized below and detailed in **APPENDIX V**
- The loan would be utilized toward critical item for the factory OOC maintenance in line with the provided budget;
 - MUSCO was required to provide tangible security to secure the loan to the extent of its exposure;
 - Valuation of the collateral was to be done at MUSCO's cost if necessary;
 - All procurement using proceeds of the fund shall be done using competitive bidding process;
 - MUSCO must open a separate bank account for this project;

- The loan was to be applied towards its intended purpose and should not be diverted to un-authorized use. AFA was to monitor to see that agreed covenants are adhered to; and
- MUSCO must provide monthly reports on the performance of the company to the AFA.

Failure to open a separate bank account for factory rehabilitation loan

3.2.11 The then General Manager for MUSCO, Anderson Oloo (Deceased), in a letter Referenced REC/FAM/A/6 dated 14 April 2016 forwarded bank details to AFA for the purposes of depositing the loan funds as per the loan agreement. The account was held in Kenya Commercial Bank Account Number 1168094887. The special audit established that this account was opened at KCB Muhoroni on 9 March 2015 and had been used as a fertilizer account. As at 9 April 2016, this account had a balance of Kshs.35,875 before the Loan funds were deposited therein. This was in contravention of Section X (g) of the loan agreement that provided that MUSCO must open a separate bank account for this project. The then Joint Receiver Mangers F Kebeney and Asa Okoth were responsible for ensuring that a new bank account was opened as per the loan agreement. (Bank Statement for Kenya commercial Bank account number 1168094887 as at 14 April 2016 attached as Exhibit...021.)

3.2.12 The loan was disbursed in three tranches as detailed below:

Table 9: Loan Disbursement

PV Date	PV NO	Payee	Particulars	Receipt date	Amount (Kshs)
11/5/2016	923	MUSCO	1 st tranche	18/05/2016	222,963,887
20/7/2016	1462	MUSCO	2 nd tranche	21/07/2016	100,000,000
09/8/2016	1472	MUSCO	3 rd tranche	16/08/2016	124,543,840
	TOTAL				447,507,727

Failure to maintain proper books of accounts on loan utilization

- 3.2.13 The Loan Agreement Section VIII provided that, “the loan was to be applied towards its intended purpose and should not be diverted to un-authorized use. AFA was to monitor to see that agreed covenants are adhered to.”
- 3.2.14 Regulation 52 (1) of the Public Finance Management Regulations, 2015 requires Government Entities to put in place appropriate Vote Control procedures to monitor expenditures.
- 3.2.15 It was established that there were no proper books maintained by Management of Muhoroni Sugar Company in form of either loan utilization/ expenditure schedule/ ledgers maintained. In addition, the loan was deposited into an existing account therefore mixing up the loan with other funds and making accountability of these funds difficult contrary to Regulation 52 (1) of the Public Finance Management Regulations, 2015. It was the responsibility of the Joint Receiver Managers and the General Manager to maintain a utilization schedule and AFA to monitor the utilization of the loan. (Bank Statement of the loan account attached as exhibit...021.)

Failure by AFA to monitor utilization of the Loan

- 3.2.16 Section 1.5.2 of the loan offer letter Ref AFFA/SD/SCO/C/7/6/22 dated 6 April 2016 states that, “MUSCO must submit to AFFA quarterly loan status report detailing how the loan is performing. No subsequent disbursement will be made unless this provision is strictly adhered to.” There was no evidence that AFA carried out any monitoring on how the loan was spent. It was the responsibility of the head of the AFA Sugar Directorate to ensure that monitoring of the loan utilization was done.

Failure by MUSCO to repay Loan

- 3.2.17 Section iii of the loan agreement between AFA and MUSCO provided that “the repayment period was to be 24 months and the commencement date was to be determined by the programme schedule.” The special audit established that MUSCO had not made any repayment of the loan from Sugar Directorate as at the time of the audit. In an interview with the Acting Finance Manager it was established that MUSCO had not maintained a loan interest calculation schedule. The special audit requested the same from AFA and it was not provided. The

total loan of Kshs.447,507,727 was still outstanding. It was the responsibility of the JRM to ensure that the loan was repaid.

Financial health / performance of the company

3.2.18 MUSCO's financial Statements for the period under review were audited by Mathenge and Associates [CPA (K)]. We relied on the audited financial statements to analyze the financial performance of the company for the period 2013/2014 to 2017/2018, as tabulated below;

Table 10: Financial Performance of MUSCO

	2013/2014 (KSHS '000')	2014/2015 (KSHS '000')	2015/2016 (KSHS '000')	2016/2017 (KSHS '000')	2017/2018 (KSHS '000')
Non-Current Assets	251,324	196,437	171,378	155,000	136,332
Current Assets	778,130	489,462	506,909	823,981	957,045
Non-Current Liabilities	158,893	132,817	138,178	238,281	238,281
Current Liabilities	25,260,772	25,576,556	26,097,503	26,619,094	27,079,548
Revenue	1,914,388	2,292,675	2,003,081	2,187,548	1,178,455
Profit/loss	(6,038,038)	(633,263)	(533,920)	(321,000)	(722,799)
Financial Ratio Analysis					
Current Ratio	0.03	0.02	0.02	0.03	0.04
Debt to assets ratio	24.69	37.48	38.68	27.43	24.98
Total assets turnover		2.67	2.94	2.64	1.14
Return on assets ratio	-5.87	-0.92	-0.79	-0.33	-0.66

3.2.19 **Current Ratio:** This is a liquidity ratio that measures a company's ability to pay short-term obligations or those due within one year. It compares all of a company's current assets to its current liabilities. A current ratio that is lower than the industry average may indicate a higher risk of distress or default. Similarly, if a company has a very

high current ratio compared to their peer group, it indicates that management may not be using their assets efficiently. When the current ratio is less than one then the company may have problems meeting its short-term obligations. Current ratios are calculated as Current Assets/Current Liabilities. **The current ratio of MUSCO is below one for the period under review meaning that the company has problems meeting its short-term obligations.**

3.2.20 **Debt to Asset ratio:** Is an indicator of a company's financial leverage. It tells you the percentage of a company's total assets that are financed by creditors. It is the total amount of a company's liabilities divided by the total amount of the company's assets. Debt is the total amount of all liabilities (Current Liabilities and Long-Term Liabilities). The higher the debt to total assets ratio, the greater the financial leverage and the greater the risk. **From the calculations it shows that MUSCO is a highly leveraged company as its debt to Asset ratio is above one.**

3.2.21 **Total Asset turnover:** this is a financial ratio that measures the efficiency of a company's use of its assets in generating sales revenue or sales income to the company. The higher the asset turnover ratio, the more efficient a company. Conversely, if a company has a low asset turnover ratio, it indicates it is not efficiently using its assets to generate sales. It is calculated as; Total asset turnover = Net Sales Revenue / Average Total Assets. **This ratio has been declining showing that MUSCO has not been using its assets efficiently in generating sales revenue.**

3.2.22 **Return on assets (ROA):** An indicator of how profitable a company is relative to its total assets. It gives an idea as to how efficient a company's management is at using its assets to generate earnings. The higher the ROA number, the better, because the company is earning more money on less investment. Return on assets = (Net Income / Total Assets) * 100. **From our calculations this ratio is negative. This means that MUSCO is not profitable relative to its assets.**

3.2.23 **In Conclusion and based on the aforementioned ratios, the financial performance of MUSCO is on declining trend with increasing financial distress brought about by accumulated losses, increasing liabilities, declining revenue and inefficient utilization of company's assets.**

Factory Technical Operation Performance

3.2.24 We measured factory performance through ratio analysis to determine the efficiency of conversion of cane into sugar thereby determining the quality of cane

produced and efficiency of factory machinery. The ratios were computed and interpreted by a Sugar Expert who was engaged to provide expert opinion to the special audit. Our findings were as discussed below and detailed in **APPENDIX VI: (Report by Sugar Expert attached as Exhibit...022.)**

Table 11: Factory Performance

FISCAL YEAR	TC / TS RATIO	CANE RECOVERY RATE	MOLASSES RECOVERY RATE
2013 - 2014	11.81	8.46%	3.60%
2014 - 2015	13.51	7.40%	3.65%
2015 - 2016	13.4	7.46%	3.65%
2016 - 2017	13.57	7.37%	4.76%
2017 - 2018	16.02	6.24%	4.67%
2018 - 2019	15.57	6.42%	4.78%

NB: TC-Tonne Cane, TS-Tonne Sugar

3.2.25 **Tonne cane per tonne sugar ratio;** this is a ratio of amount of cane crushed to the amount of sugar produced. It represents amount of cane crushed to produce a tonne of sugar and therefore the higher the TC / TS the lower the quality of cane crushed. The recommended ratio is 10:1

TC / TS Ratio = Cane Crushed / Sugar Produced.

A calculation of this ratio resulted into ratios above 10:1 for all the years under audit, this means that the production of sugar at MUSCO was above the recommended levels.

3.2.26 **Cane Recovery Rate;** this an indicator of how much sugar is produced by a tonne of cane i.e. inverse of TC / TS ratio.

Cane Recovery Rate = Sugar Produced / Cane Crushed

From the calculations in the table above the cane recovery rate for MUSCO has been consistently reducing throughout the period of the audit from 8.46% in 2013/2014 to 6.42% in 2018/2019, meaning the sugar produced has been consistently reducing too.

3.2.27 **Molasses recovery rate**; this is an indicator of how much molasses is produced by a ton of cane. The higher the amount of molasses produced compared to sugar, the lower the quality of cane.

$$\text{Molasses Recovery Rate} = \text{Molasses Produced} / \text{Cane Crushed}$$

This ratio has been increasing throughout the period under audit, this means that the quality of cane crushed has been consistently getting poor.

Sugar Sales and Revenue Management

Sugar sales to non-prequalified distributors

3.2.28 The process of prequalifying distributors requires prospective customers to fill approval forms which are recommended by General Manager based on certain terms like; tax compliance certificate, bank statements and confirmation of distributor's warehouse.

3.2.29 MUSCO keeps a list of prequalified customers categorized as distributor, retailer, wholesalers and supermarkets. (**Approved list of prequalified customers attached as Exhibit...023.**)

3.2.30 MUSCO's Work Instruction for Sale of Sugar on credit section 4.2.5 requires that purchase orders shall be accepted only for the pre-qualified customers. However, a comparison of sales orders and approved list of prequalified customers revealed that there are supermarkets, distributors and individuals who were issued with sugar on credit totaling to Kshs.23,467,368 but were not in the prequalified customer list contrary to Section 4.2.5 MUSCO's Work Instruction for Sale of Sugar as detailed in APPENDIX VII. It was the responsibility of the Sales and Marketing Manager to ensure that orders are raised to prequalified customers only.

Failure to involve all the pricing committee members in approval of sugar prices

3.2.31 The sales executive does market intelligence and sets the price of sugar based on the prices that other millers are selling as well as the distributors. They also liaise with Sugar Directorate every morning by making a call to Mr. Stanley Koech who is the Market and Research Officer at Sugar Directorate who recommends the sugar prices on phone. **The act of recommending prices on phone is susceptible to fraud**

since no audit trail is maintained for audit and future reference. A price list is then prepared and signed by Joint receiver managers, General Manager, Sales and Marketing manager, Finance and Administration Manager

- 3.2.32 According to Work Instructions for sale of sugar to pre-qualified customers' policy Section 4(4.1.1) states that MUSCO Pricing Committee shall set the prices on recommendation from Sales and Marketing Manager. The prices vary from time to time depending on prevailing market conditions.
- 3.2.33 The Sugar Pricing Committee comprises of;
- i. Joint Receiver Managers
 - ii. General Manager
 - iii. Sales and Marketing Manager
 - iv. Finance and Administration Manager
- 3.2.34 The special audit was provided with the price list for 14/11/2017 to 2/9/2019 that was approved by one Joint Receiver Manager, General Manager and Sales Manager. However, the price list for 1/7/2013 to 13/11/2017 was not availed. Mr. Dan Odongo the ousted Sales and Marketing Manager informed the team that prior to 14 November 2017, MUSCO did not keep price register contrary to Section 4(4.1.3) of the Work Instructions for sale of sugar to Pre-qualified customers' policy which states that Sales and Marketing Department shall announce to the customers the prevailing prices as approved by the Sugar Pricing Committee and relied on market intelligence to determine sugar prices. This pose a risk of collusion among various parties to make sales orders with prices less than the prevailing market prices leading to loss of revenue.
- 3.2.35 A review of the price approval register indicated that in most instances only the General Manager and either of the JRMs signed the price approval register from 14/11/2017 to 30/6/2019 hence excluding the Finance and Administration Manager contrary to section 4(4.1.2) Work Instructions for sale of sugar to pre-qualified customers' policy, which states that the Committee will comprise of the following; JRMs, General Manager, Sales and Marketing Manager and Finance and Administration Manager. It was the responsibility of the JRMs to ensure that all Committee members are involved in the approval of prices.

Failure to use approved sugar prices

- 3.2.36 The customers liaise with MUSCO to confirm availability of the sugar and set price. After agreeing on the quantity of sugar, they deposit the amounts to the bank accounts and present the deposit slip to the Sales office where a sales order is intimated.
- 3.2.37 The Sales and Marketing Manager raises a Sales Order indicating goods ordered for, quantity, unit price and the amount chargeable.
- 3.2.38 The Financial Accountant verifies the integrity of all modes of payment (cash or bank) before issuing receipts (sales authorization). The receipt indicates the money paid, quantity and price per quantity. The cashier prepares a register for all the receipts issued on the daily basis for comparison with cash book postings. All the receipts both cash and cheques are banked the same week.
- 3.2.39 If payment is by cash, the Financial Accountant approves sales order before the cashier receives the money for receipting. The cashier issues receipt indicating the customer name, amount paid, product units' price and quantity.
- 3.2.40 The Sales office then raises invoices to the customers and issue delivery notes to the warehouse. The warehouse manager through the system confirms that consignment for the customer tallies with the amount paid and initiates loading.
- 3.2.41 The special audit compared the approved price register with the raised sales orders for financial year 2017/18 and 2018/19 and noted that some orders were sold at less than the approved prices leading to a loss of Kshs.1,329,947 as detailed in APPENDIX VIII. It was the responsibility of Sales and marketing Manager, Financial Accountant and the Finance Manager to use the approved prices when raising, approving and authorizing the sales orders.

Failure to include revenue estimate in annual budget

- 3.2.42 Legal Notice No.34 National Government Regulations 59(1) States that the estimates of revenues shall be in the format issued by the National Treasury and shall include—
- (a) the description of the source of revenue in terms of head code;
 - (b) estimated revenues;
- 3.2.43 A review of MUSCO's approved annual budget submitted to the Permanent Secretary Ministry of Agriculture for the audit period did not include revenue estimates. It was the responsibility of the Head of Finance and JRMs to ensure

that revenue estimates were included in the budget. (Approved annual budget submitted to the National Treasury attached as Exhibit...024.)

Variance between Ebiz System and Financial Statement figures

3.2.44 The special audited noted that there were variances between systems generated figures and audited financial statement figures for the period under review as detailed in the table below; (Audited Financial Statements attached as Exhibit...025.)

Table 12: Sales Revenue

Year	Ebiz ERP Amount (Kshs)	FS Amount (Kshs)	Variance (Kshs)
2013/14	2,310,688,003	1,914,388,000	396,300,003
2014/15	2,765,071,605	2,292,675,000	472,396,605
2015/16	2,415,968,830	2,003,081,000	412,887,830
2016/17	2,634,305,438	2,187,548,000	446,757,438
2017/18	1,367,732,866	Not availed	-
2018/19	1,402,012,512	Not availed	-
Total			1,728,341,876

3.2.45 The Acting Finance Manager Mr. Joseph Alai explained to the special audit that the variance was as a result of adjustments by the auditors. However, a review of the financial statements for the period under audit did not indicate revenue adjustments by the auditors hence there was no explanation for the variances. This shows that the sales revenue for the financial years 2013/14 to 2016/17 was understated by Kshs.1,728,341,876. It was the responsibility of the finance manager to ensure that the system generated figures are used in the financial statements.

Failure to maintain a cash receipts book for cash sales

3.2.46 Legal No.34 National Government Regulations Section 64 (1) provides that an accounting officer and a receiver of revenue are personally responsible for ensuring that— (a) adequate safeguards exist and are applied for the prompt collection and

proper accounting for, all national government revenue and other public moneys relating to their Ministries, Departments or Agencies.

- 3.2.47 During an interview, the Acting Finance Manager informed the special audit that MUSCO allows for sale of sugar and molasses on cash basis to their prequalified customers but does not maintain a receipts ledger or cashbook. **The special audit could not therefore determine the cash amounts collected for sugar and molasses for the period under audit review.**
- 3.2.48 **It was the responsibility of the JRMs to ensure adequate booking keeping and safeguards for prompt collection and proper accounting of revenue.**

Failure to bank proceeds from cash sales

- 3.2.49 Legal No.34 National Government Regulations Section 64 (4) States that All public moneys collected by a receiver of revenue or collector of revenue or collected and retained by a national government entity, shall be paid into the designated bank accounts of the national government and shall not be used by any public officer in any manner between the time of their receipts and payment into the bank except as provided by law.
- 3.2.50 During an interview with the Ag. Finance Manager Mr. Joseph Alai explained that MUSCO utilized the monies to fund day to day activities at the factory because of cash flow problems and recorded such expenses in the daybook vouchers.
- 3.2.51 **In the absence of a cash book, the team analyzed the daybook vouchers for the period under audit review is as summarized in the table below. MUSCO thus failed to bank a total of Kshs.660,282,371 but instead utilized the same for factory operations. It was the responsibility of the JRMs, GM and Finance Manager to ensure that proceeds from cash sales were deposited to a designated bank account.**

Table 13 : Unbanked Cash Sales

Year	Amount (Kshs)
2013/14	172,834,431
2014/15	150,573,630
2015/16	121,570,751
2016/17	119,622,077
2017/18	54,993,930
2018/19	40,687,552
Total	660,282,371

Sugar Pricing and ordering

Lack of policy and master file for presales

- 3.2.52 The special audit established that MUSCO does not have a policy on presales or master file for the period under review. During an interview with the Ag. Finance Manager Mr. Joseph Alai he explained that presales are when prequalified customers pay for sugar in advance then collects sugar based MUSCO's production. However, we could not establish what transactions were presales or cash sales from the system and therefore we were unable to reconcile the figures with the quantities dispatched to the various distributors.
- 3.2.53 During an interview, the ousted Financial Accountant Ms. Imelda Nubia explained that identifying presales, presale balances and dispatched quantities were not captured in the system but that she used to maintain such records in excel sheets which were not availed.
- 3.2.54 Therefore, there is a risk that presales are open to abuse. MUSCO should therefore develop a policy and a master file to capture details of such transactions with an audit trail. It was the responsibility of the JRMs, General Manager and Finance Manager to ensure that there's a policy governing presale as well as a master file for ease of reconciling such transactions.

Order Cancellations and Reversals

- 3.2.55 The special audit noted that there were order cancellations in the system with reasons such as use of wrong of price, wrong order, double order and wrong intimation.

- 3.2.56 A comparison of the cancelled orders with dispatch register indicated that such orders were not dispatched and therefore no loss was incurred.
- 3.2.57 During an interview the Sales and Marketing Manager informed the special audit that sales reversals occur when orders are reversed as a result of use of wrong price or double allocation of an order. Reversals are usually realized after the product has been dispatched in the system and loaded to truck at times but because of other controls like delivery notes and gate pass they are able to identify such transactions.
- 3.2.58 The special audit sampled reversed orders from the system and did a comparison with dispatch register using sales orders which indicated that all the reversals were nullified in the system as detailed in **APPENDIX IX**. Since the dispatch order and the purchase order are not linked in the system there is a risk that all cancelled orders sampled totaling to 13,995 bags were loaded in the trucks and delivered as the cancellation is done after dispatch and loading. **It was the responsibility of the finance manager and the ICT manager to ensure that all sales documents were interlinked for accountability purpose.**

Unauthorized credit sales

- 3.2.59 According to MUSCO's Work Instruction Section 4.2.1 on Sale of Sugar on credit, Sales and Marketing Manager shall identify supermarkets where MUSCO shall sell sugar. Due to their nature of business and competition in this market segment, it is therefore necessary to provide credit to selected creditworthy supermarkets. Potential customers wishing to apply for credit fill the Credit Application Form.
- 3.2.60 Sales and Marketing Manager then either recommends or declines depending on the creditworthiness of the supermarket recommend and forward the Credit Application Forms to the Finance & Administration Manager's office for input. Thereafter the forms shall be forwarded to General Manager and finally the Joint Receivers and Managers for final approval.
- 3.2.61 After approval, Sales and Marketing Manager communicates informing them about the status of their application. During execution of a sale, the customer presents a purchase order for the quantity agreed upon to area Sales Executive on his visit or delivers it to the office.
- 3.2.62 The Purchase Orders are accepted only for the pre-qualified supermarkets with an acceptable maximum credit to selected supermarkets for the purchase of branded

sugar upon filling and approval of their application for the same through the Credit Application Form.

- 3.2.63 Warehouse Manager then loads the sugar in the company/hired truck for delivery and prepares the Delivery Notes/Invoices.
- 3.2.64 The due payments should be made either by cheques or through Real Time Gross Settlement, Electronic Transfer or cash deposit into our accounts.
- 3.2.65 A review of the sales orders and invoices indicated that MUSCO sold sugar on credit to distributors, Wholesalers and individuals for financial year 2013/14 to 2017/18 totaling to Kshs.68,326,422. Out of these credit sales, there was an outstanding amount of Kshs.34,884,434 as detailed in APPENDIX X. The Sales and Marketing Manager Ms. Evaline Ruto during an interview informed the special audit that there were no documents regarding the credit sales and therefore the special audit could not ascertain whether the due process was followed when issuing sugar on credit for the period under audit review. It was the responsibility of the Sales and Marketing Manager to ensure that only supermarkets are issued with sugar on credit.

Disparity between Dispatched quantities and ordered quantities

- 3.2.66 During an interview with the Acting Sales and Marketing Manager explained that once an order is raised and authorized, the Sales office then raises invoices to the customers and issue delivery notes to the warehouse. The warehouse manager through the system confirms that consignment for the customer tallies with the amount paid and initiates loading therefore a customer cannot be issued with quantities more than what was ordered.
- 3.2.67 The special audit carried out a comparison of quantities ordered and quantities dispatched and noted that there were instances where quantities dispatched were more than the quantities ordered as summarized in table below;

Table 14 : Disparity in sales orders and dispatch

No	Order No	Customer Name	Order Date	Order Qty (bags/bales)	Delivered Qty (Bags/bales)
1	13522	The Ultimate Point	13-05-2015	2	88
2	14542	Domtila A Osimbo	07-09-2015	5	15
3	014540	William Juma Ochiel	07-09-2015	6	13

3.2.68 It was the responsibility of the Warehouse Manager to ensure that quantities of sugar dispatched tally with the ordered quantities.

Missing Orders in the authorization status

3.2.69 The Sales and Marketing Manager raises a Sales Order indicating goods ordered for, quantity, unit price and the amount chargeable.

3.2.70 The Financial Accountant verifies/approves the integrity of all modes of payment (cash or bank) before issuing receipts (sales authorization) which is captured in the Ebiz System, which are considered as the authorized orders.

3.2.71 A comparison of dispatched orders and authorized orders revealed that there were orders in the dispatch register that were not in the authorized sales orders. During an interview the Ag. Finance Manager explained that all orders are authorized and the error was a result of system error.

3.2.72 The special audit took a sample from missing orders in the authorization status to confirm whether payments were made for such transactions using bank statements. We confirmed that the orders were paid for therefore no loss was incurred. However, the Ebiz system should be upgraded to ensure all transactions are captured. It was the responsibility of the ICT manager to ensure that the system did not have errors.

Reconciliation of bank accounts, debtors and creditors

Failure to carry out reconciliation of bank accounts

3.2.73 MUSCOs standard operating procedure for financial accounts dated January 2017 Section 6.2.5 provides that the financial accountant shall ensure that monthly

balance reconciliation of all running accounts are prepared and ready by 15th of the next month. The special audit established that MUSCO had a total of five bank accounts as tabulated below. However, it was noted that that reconciliation of these bank accounts was not done on a monthly basis as required by the financial operating procedures. It was the responsibility of the Finance manager to ensure that reconciliations are done on a monthly basis.

Table 15 Reconciliation of Bank Accounts

	Bank		Account Number	Authorized Signatories	Status
1	Kenya Bank	Commercial	1104058286	Paul Omondi Harun Kirui Francis Elisha Ooko Joseph Alai	Active
2	Kenya Bank	Commercial	1168004887	Walter Otieno Odum	Dormant
3	Kenya Bank	Commercial	Fixed Deposit	Paul Omondi Harun Kirui Francis Elisha Ooko Joseph Alai	Active
4	Standard Chartered		0102098543200	Harun Kirui Joseph Alai Raphael Muyonga Linet Achieng Owiti Paul Omondi Onyango Walter Otieno Odum	Active
5	National Bank		01020078885400	Harun Kirui Francis Ooko Michael Odhiambo	Active

Failure to carry out reconciliation of accounts payable

3.2.74 MUSCOs standard operating procedure for financial accounts dated January 2017 Section 6.6.2 provides that the accounts payable accountant shall maintain accurate creditor’s ledger and ensure that supplier’s accounts are periodically reconciled with suppliers’ statements. The special audit through an interview with the Ag, Finance Manager established that MUSCO does not carry out reconciliation for accounts payable (creditors). It was the responsibility of the Finance manager to ensure that reconciliations are done on a monthly basis.

Failure to carry out reconciliation of accounts receivables

3.2.75 MUSCOs standard operating procedure for financial accounts dated January 2017 Section 6.7.2 provides that the debtor supervisor shall maintain accurate debtor's ledger and ensure individual debtor's accounts are periodically reconciled. The special audit established that although debtor's reconciliation is done, it's not done monthly as required. APPENDIX XI shows the reconciliations done for various months. It was the responsibility of the Finance manager to ensure that reconciliations are done on a monthly basis.

Purchases (Payments) vide imprest

3.2.76 There was an allegation from the workers' union that MUSCO was using cash payment (imprest payment) to buy stock items at exorbitant prices. In an interview with the Ag. Finance Manager Mr Alai it was established that MUSCO made purchases of stock items vide imprests. He explained they issued imprests to purchase for example fuel to a staff member, once the staff member has purchased the same they surrender the imprest using obtained receipts. The team was not availed the imprest warrants and surrenders for the relevant period.

3.2.77 The special audit summarized all imprests issued during the scope of the audit from the imprest register as tabulated below. In the absence of the imprest warrants and surrenders we could not determine whether the total imprest of Kshs.132,134,278 was utilized in purchases of stock items. It was the responsibility of the Joint Receiver Managers to ensure that imprest was issued for the authorized purposes.

Table 16: Imprests issued to facilitate cash purchases

	Financial Year	Amount (Kshs)
1	2015-2016	36,374,057
2	2016-2017	59,593,660
3	2017-2018	18,808,383
4	2018-2019	17,358,177
	Total	132,134,278

3.3 Procurement and Related Issues

- 3.3.1 The special audit established that the Management of Muhoroni Sugar Company secured a loan amount of Kshs.447, 507,727 from Agriculture and Food Authority that was to be used to facilitate factory repairs and refurbishment.
- 3.3.2 According to the loan agreement / Offer letter, the following were among the terms and conditions that were to be complied by Muhoroni Sugar Company (MUSCO) in utilizing the loan facility: **(Loan Offer letter and budget attached as Exhibit...026.)**
- MUSCO must provide monthly reports on the performance of the company to the AFA;
 - MUSCO MUST open a separate bank account for this project;
 - The loan would be utilized toward critical item for the factory OOC maintenance in line with the provided budget; and
 - The loan was to be applied towards its intended purpose and should not be diverted to un-authorized use. AFA was to monitor to see that agreed covenants are adhered to All procurement using proceeds of the fund shall be done using competitive bidding process.
- 3.3.3 Regulation 52 (1) of the Public Finance Management Regulations, 2015 requires Government Entities to put in place appropriate Vote Control procedures to monitor expenditures. In addition, Section 1.2 of the loan offer letter Ref AFFA/SD/SCO/C/7/6/22 dated 6 April 2016 states that, "the funds shall be disbursed either in whole or in tranches depending on the cash flow of the fund and after every disbursement AFA shall expect a detailed return on the utilization of the funds which will be subject to verification by AFA officers prior to any further disbursements."
- 3.3.4 The special audit established that MUSCO did not maintain a loan utilization schedule as to how the loan funds were utilized towards the repairs works contrary to Section 1.2 of the loan offer letter Ref AFFA/SD/SCO/C/7/6/22 dated 6 April 2016 and Regulation 52 (1) of the Public Finance Management Regulations, 2015. It was the responsibility of AFA, Receiver Managers, General Manager and Finance Manager to ensure utilization reports were maintained.
- 3.3.5 We also established that the loan was disbursed to Kenya Commercial Bank Account Number 1168094887, Muhoroni. This account had previously been used as a fertilizer account before the Loan funds were deposited therein in 2016

3.3.6 In the absence of a loan utilization report, the team analyzed the transactions in the bank statement of the loan account number 1168094887, KCB Muhoroni to determine how the loan was utilized. Our findings were as summarized below and detailed in APPENDIX XII and summarized in the table below. (Kenya commercial Bank Statement for account number 1168094887, Muhoroni attached as Exhibit021.)

Table 17: Receipts and payments as per bank statement

Transaction	Payments /Dr (Kshs)	Receipts /CR (Kshs)
Loan Amount received from AFA		447,507,727
Inward transfers-Muhoroni Sugar		750,000
Total receipts /Credits		448,257,727
Less payments:		
Payments to suppliers	340,945,055	
Outward SWIFT P AT-MHRNI RTGS SW-NBKEKENX MUHORO	42,000,000	
Transfer - MUHORONI SUGAR CO LT	59,400,000	
Transfer AT-MHRNI TRANSFER NYANDO COOPERATIVE	3,855,000	
Transfer - MUHORONI YOUTH FOOTBALL	1,955,662	
Bank Charges	101,407	
Tax amount due	601	
Total	448,257,727	

3.3.7 The team noted that of the Kshs.448,257,727 that was deposited in the bank account, Kshs.447,507,727 related to loan disbursement from AFA in regard to factory repair and maintenance while Kshs.750,000 was an inward transfer from other Muhoroni Sugar Company Bank Accounts. The transfer of Kshs.750,000 into this account went against the conditions of the Offer letter issued by AFA that required a separate account be maintained to manage loan utilization.

3.3.8 An amount of Kshs.340,945,055 was utilized by Muhoroni Sugar Company in paying suppliers while Kshs.101,400,000 (comprising outward swift of Kshs.42,000,000 and Kshs.59,400,000) was transferred to other Muhoroni Sugar Company Bank Accounts

its accounts. The Loan agreement section VIII provided that, “the loan was to be applied towards its intended purpose and should not be diverted to unauthorized use”. There was no evidence that the transferred funds were used for factory maintenance nor was there authorization from AFA to transfer these funds to other MUSCO Accounts. Under the circumstances, we could give assurance that Kshs.101,400,000 transferred out of KCB Loan account were utilized in a lawful and effective manner.

- 3.3.9 Out of the amount of Kshs.340,945,055 utilized by Muhoroni Sugar Company in paying suppliers, we established information availed by MUSCO Head of Finance and Procurement indicated that they had issued Local Purchase Orders (LPOs), Quotations and Direct procurements totaling Kshs.293,707,040 as summarized below and detailed in APPENDIX XIII .

Table 18: Quotations and direct procurements

	Particulars	Amount (Kshs)
1	Quotations /Competitive procurement	171,585,977
2	Direct procurements	122,121,063
		293,707,040

- 3.3.10 We reviewed expenditure records including payment vouchers availed by MUSCO Finance Department. Out of the expenditure totaling Kshs.293, 707,040, the special audit was able to confirm expenditure totaling to Kshs.217,725,058.52 whose expenditure records were availed as detailed in APPENDIX XIV. We could not confirm the lawfulness and effectiveness of Kshs.75,981,982 being the difference between Kshs.340,945,055 indicated in bank statement as payment to suppliers and Kshs.217,725,058 whose expenditure records were availed.
- 3.3.11 The special audit conducted a risk assessment that involved among others, discussions with various stakeholders including employees of the company and identified the following areas as high risk, based on allegations of procurement malpractices raised by stakeholders. **(Minutes of meeting attached as Exhibit....027.)**

Table 19: Procurements Reviewed

Procurement	Tender Sum (Kshs)
Procurement for Installation, Training and Commissioning of closed circuit television (CCTV) System	7,468,022
Procurement for the supply of Liquid Ring Vacuum Pump	2,204,000
Procurement for the purchase installation and commissioning of Rotary Screw Air Compressor C/W Refrigerated, Power 75KW	4,292,000
Procurement for supply of single stage split casing pump capacity 2000M ³ /	7,822,170
Procurement for rehabilitation of filter station roof, wall cladding, gutters and windows, roof area approx...318sq. mtrs.	5,492,398
Other procurements relating to goods / services paid for but not delivered	444,751
Total	29,873,973

3.3.12 We reviewed the aforementioned procurement items in line with the provisions of Public Procurement & Asset Disposal Act, 2015 and Public Procurement & Asset Disposal Regulations of 2006. Our findings were as follows:

Procurement for Supply, Installation, Training and commissioning of closed circuit television (CCTV) System REF: REC/PROC/CCTV/07/2015

3.3.13 The tender for the supply, Installation, Training and Commissioning of closed-circuit television (CCTV) System, under finance and administration department was provided for in the Annual procurement plan and budget for Financial Year 2015/2016 at Kshs.3,000,000. (Annual procurement plan and budget attached as Exhibit028.)

3.3.14 The ICT department raised a requisition on 11 September, 2015 for procurement for supply, installation and training and commissioning of a CCTV system. (Purchase Requisition attached as Exhibit029.)

Invitation to tender

3.3.15 Section 54(3), (4) of the Public Procurement Regulations 2006 requires the procuring entity to invite tenders from at least ten persons selected from the prequalified list

maintained and invite tenders from all the known suppliers of the goods, works or services where Restricted Tendering is used. We could not ascertain how bidders were invited, as there was no list of invited bidders or copies of letters sent to the same. It was the responsibility of the Procurement Manager and General Manager, to ensure the bidders were invited for the bid.

Failure to appoint a tender opening committee

- 3.3.16 Section 60 of the Public Procurement and Disposal Act, 2005 requires an Accounting Officer of a procuring entity to appoint a Tender Opening Committee specifically for the procurement in accordance with the requirements as may be prescribed.
- 3.3.17 The special audit observed that there was no Tender Opening Committee appointed and no tender opening minutes and register contrary to section 60 of the Public Procurement and Disposal Act, 2005. It was the responsibility of the Procurement Manager, and General Manager to nominate and appoint a tender opening committee.

Tender evaluation

- 3.3.18 The Tender Evaluation Committee was appointed by the General Manager through an internal Memo Ref: GM/PROC/08/2015 dated 7 August, 2015. The evaluation team members were; Edward Alango -Chairman, members Pius Onyango, Andrew Otieno, Raphael Muyonga , Gideon Birech, Jennings Oduor and Jeremiah Okelo - Secretary. (Internal Memo Ref: GM/PROC/08/2015 dated 7 August, 2015 attached as Exhibit...030.)
- 3.3.19 The following companies participated in the bidding as per the evaluation report signed on 14 August 2015.

Table 20: List of Bidders for supply of CCTV

	Company	Tender Sum (Kshs)
1	G4S Ltd	6,076,602
2	Riley Falcon Ltd	11,027,360
3	Capital Solutions Ltd	7,468,022
4	Kingsky Ltd (option 1)	9,196,118.08
5	Kingsky Ltd (option 2)	21,383,365

- 3.3.20 According to the tender evaluation report signed on 14 August 2015, the evaluation was done in two stages; technical and commercial. **(Tender evaluation report signed on 14 August 2015 Attached as Exhibit ...31.)**
- 3.3.21 Under the technical criteria the Evaluation Committee considered; types of camera, types of Network Video Recorder (NVR), video recording and backup, standby power, warranty and support, cabling, service contract proposal, training of MUSCO staff and provision of cabinets and switches.
- 3.3.22 The commercial criteria considered; legal status, referees, tender security, total volume of business in the last three years, terms of payments and price.
- 3.3.23 All the bidders were subjected to both technical and commercial evaluation and were scored as follows;

Table 21 Technical and Commercial Evaluation for supply of CCTV

	Bidder Name	Technical Score (60 Mrks)	Commercial Score (40 Mrks)	Combined Score (100 Mrks)	Overall Ranking
1	G4S Ltd	19	30	49	5
2	Riley Falcon Ltd	35	23.02	58.02	3
3	Capital Solutions Ltd	55	36.27	91.27	1
4	Kingsky Ltd (option 1)	35	24.22	59.22	2
5	Kingsky Ltd (Option 2)	40	16.68	56.68	4

- 3.3.24 The Committee recommended the award of the tender for supply, Installation and commissioning of CCTV system to M/s Capital solutions who was the lowest responsive bidder at a bid price of Kshs.7,468,022.

Tender Award

- 3.3.25 Section 10 (2) (a) of the Public Procurement and Disposal Regulations, 2006 provides that; The functions of the tender committee shall be to- review, verify and ascertain that all procurement and disposal has been undertaken in accordance with the Act, these Regulations and the terms set out in the tender documents.

- 3.3.26 The Tender Committee in a meeting held on 09 September 2015, awarded the tender for supply, Installation and commissioning of CCTV system to M/s Capital Solutions at a tender sum of Kshs.7,468,022 which was above the budgeted amount for Financial Year 2015/2016 of Kshs.3,000,000 contrary to Section 10 (2) (a) of the Public Procurement & Disposal Regulations, 2006. It was the responsibility of the tender committee to ensure that this tender was awarded within the budgeted amount. (Tender Committee minutes dated on 09 September 2015 Attached as Exhibit ...032.)
- 3.3.27 Notifications to both the successful and unsuccessful bidders were sent on 28 September 2015. (Notifications to successful and unsuccessful bidders Attached as Exhibit...033.)
- 3.3.28 The contract agreement between Muhoroni Sugar Company Limited and Capital Solutions was signed on 12 October, 2015 at a contract sum of Kshs.7,468,022.
- The considerations to the contract were as follows: The price of the service shall remain constant and valid for the entire duration of this contract that is 12 months effective 6 October, 2015;
 - The prices also include the cost of transportation to MUSCO premises at Muhoroni; and
 - First payment of 40% to be on completion of networking of the system and installation. The remaining 60% will be broken in two payments of 30% each, whereas the first 30% will be paid 7 days after completion and commissioning of the foresaid system and the balance 30% to be paid within 30 days from the date of commissioning (Contract agreement between Muhoroni Sugar Company Limited and Capital Solutions was signed on 12 October 2015 Attached as Exhibit...034.)

Failure to take necessary measures to realize Value for Money from the CCTV system

- 3.3.29 As at the time of audit the CCTV system had been installed except for the server which had not been linked to the live cameras. This meant that the system had no capability of storing recordings, thus MUSCO could not review any incidents that may have happened in the past. The Head of IT could not explain when the installation would be completed. Details of the installed equipment are as in APPENDIX XV. This CCTV system is not giving value to MUSCO as its installation is

still pending. it was the responsibility of the head of IT to ensure that the process was completed.

Payment

3.3.30 We established that a total of Kshs.4,480,811 had been paid the supplier as detailed below: **(Payment Vouchers for CCTV Attached as Exhibit ...035.)**

Table 22 Payments for CCTV

Date	Payee	Cheque no	Amount	Remarks
2/11/2015	Capital Solutions	Dm50124	2,987,208	Being 40% down payment
22/1/2016	Capital Solutions	dm00022	896,162	Being 20% of the contract amount.
11/2/2016	Capital Solutions	dm258	597,441	
Total			4,480,811	

3.3.31 As at the time of audit there was an outstanding balance of Kshs.2,987,211 to the supplier, the Ag Finance Manager explained that MUSCO had not paid the balance due to lack of money. The system had not been commissioned thus the vendor could not proceed to court to demand the outstanding balance.

Tender for Supply of Liquid Ring Vacuum Pump

Failure to Plan and Budget

3.3.32 Section 26 (3) (a) of the Public Procurement and Disposal Act, 2005 requires all procurements to be within the approved budget of the procuring entity and s be planned by the procuring entity concerned through an annual procurement plan. We reviewed the annual procurement plans for 2015/16 and found no evidence that the tender for the supply of liquid ring vacuum pump had been prioritized in the annual procurement plans for financial year 2015/2016. It was the responsibility of MUSCO Procurement Manager to ensure that no procurement process is done without adequate planning.

Absence of user requisition

3.3.33 The Public Procurement Regulations Section 22 (1) of 2006 requires every procurement to be initiated using a purchase requisition which shall include all necessary information pertaining to the procurement. Further Section 9 (a) provides that a user department shall be responsible for initiating procurement and disposal requirements and forwarding them to the procurement unit. **The special audit noted that there was no requisition for this item. It was the responsibility of Head of procurement to ensure that all procurements start with a requisition form user department. It was the responsibility of the Factory Manager and MUSCO Procurement Manager to ensure requisition was done to initiate the procuring process.**

Invitation to tender

3.3.34 Section 54(3), (4) of the Public Procurement Regulations, 2006 requires the procuring entity to invite tenders from at least ten persons selected from the prequalified list maintained and invite tenders from all the known suppliers of the goods, works or services where Restricted Tendering is used.

3.3.35 **The team could not ascertain how bidders were invited, as there was no list of invited bidders or copies of letters sent to the same provided. It was the responsibility of the Procurement Manager General Manager, to ensure the bidders were invited to bid**

Failure to appoint tender opening committee

3.3.36 Section 60 of the Public Procurement and Disposal Act, 2005 requires an accounting officer of a procuring entity shall appoint a tender opening committee specifically for the procurement in accordance with the requirements as may be prescribed.

3.3.37 **The special audit observed that there was no tender opening committee appointed, no tender opening minutes and register. It was the responsibility of the Procurement Manager to recommend for appointment and the General Manager to appoint a tender opening committee.**

Tender evaluation

3.3.38 The Evaluation Committee was appointed by the General Manager through an internal Memo Ref: GM/PROC/08/2015 dated 14 August, 2015. The evaluation team

members were; George Natembeya -Chairman, members Pius Onyango, Edward Alango, Linet Owiti, Julius Okello and Jeremiah Okelo - Secretary (**Internal Memo Ref: GM/PROC/08/2015 dated 14 August, 2015 Attached as Exhibit ...036.**)

3.3.39 The following companies participated in the bidding as per the evaluation report signed on 20 August 2015

Table 23 List of Bidders Liquid Ring Vacuum Pump

	Company	Tender Sum (Kshs)
1	Ms Soni Technical Ltd	2,204,000
2	Ms Usha Merchandise Ltd	2,349,000
3	Ms Riya Ltd	2,424,000
4	Ms Boiler and Steam Ltd	2,996,280
5	Ms Boiler and Steam Ltd	5,495,220

(Evaluation report signed on 20 August 2015 Attached as Exhibit...037.)

3.3.40 According to the tender evaluation report signed on 20 August 2015, Evaluation was done in two stages; Technical and Commercial phases.

3.3.41 Under the technical criteria the evaluation committee considered; Pump capacity, pump vacuum, material of construction, type of seal liquid, pumping medium, provision of specified accessories, air-water separator, auto drain valve and shaft sealing by stuffing box.

3.3.42 The commercial criteria the following were considered; price, payment terms, warranty, representation and delivery period.

3.3.43 All the bidders were subjected to technical and commercial evaluation phases and were scored as follows;

Table 24 Evaluation results Liquid Ring Vacuum Pump

S/ No.	Bidder Name	Technical Score (60 Mrks)	Commercial Score (40 Mrks)	Combined score	Overall Ranking
1	Ms Soni Technical Ltd	43	24.43	67.43	2
2	Ms Usha Merchandise Ltd	51	25.47	76.47	1
3	Ms Riya Ltd	43	23.03	66.03	3
4	Ms Boiler and Steam Ltd	42	18.38	60.38	4
5	Ms Boiler and Steam Ltd	42	13.19	55.19	5

3.3.44 The Evaluation Committee recommended the tender be awarded to Usha Merchandise Ltd for liquid ring vacuum pump complete with a motor at tender sum of Kshs.2,349,000.

Tender award

3.3.45 According to the Tender Award Committee Minutes of a meeting held on 01 July, 2015, the Committee recommended the tender for supply of liquid ring vacuum pump be re floated. The Committee advised that technical specifications to carry more marks than commercial when evaluating the bids and detailed and proper specifications to be furnished to the bidders. **(Tender award committee minutes of a meeting held on 01 July 2015 Attached as Exhibit ...038.)**

3.3.46 The special audit noted that the marks awarded for technical and commercial criteria in the evaluation report were 60 and 40 respectively. There was no evidence that the tender was re floated as per the Tender Committee's recommendation above.

3.4.47 Public Procurement and Disposal Regulations, 2006 Section 10 (2) (c) states that the functions of the tender committee shall be to-award procurement contracts in

accordance with thresholds prescribed in First Schedule. The audit team was not availed with tender committee award minutes, therefore there was no evidence that the tender committee awarded this tender to Usha Merchandise. It was the responsibility of the Tender Committee members, Head of procurement and general Manager to ensure that tender was duly awarded according to PPDA 2005.

- 3.4.48 Usha Merchandise in a letter Ref; MSC/UM/151/2015/2 dated 9 September 2015 revised its offer from Kshs.2,349,000 to Kshs.2,204,000. It was not clear how Usha Merchandise was contacted for price negotiation. (Letter Ref; MSC/UM/151/2015/2 dated 9 September 2015 Attached as Exhibit...039)
- 3.4.49 Notification to both successful and unsuccessful bidders were sent on 28 September 2015. (Notifications dated 28 September 2015 Attached as Exhibit ...040.)

Failure to enter into a Contract

- 3.4.50 Public Procurement and Asset Disposal Act, 2015, Section 68 (3) states that no contract is formed between the person submitting the successful tender and the procuring entity until the written contract is entered into. MUSCO did not enter into a contract with Usha Merchandise for this procurement. It was the responsibility of the head of procurement and General Manager to ensure that there was a contract to govern this relationship.

Failure to inspect and accept goods/service

- 3.4.51 The Public Procurement and Disposal Regulations, 2006, Section 17(1) state that, a procuring entity shall establish an inspection and acceptance committee. (3) (a) the inspection and acceptance committee shall immediately after delivery of the goods, works or services-inspect and where necessary, test the goods received. There was no evidence that the liquid ring vacuum pump complete with drive was inspected. It was the responsibility of the head of procurement to ensure that goods received are inspected.
- 3.4.52 Payment to Usha merchandise was paid Kshs.2,204,000 through payment Voucher No. BP007316 dated 25 May 2016.

**Tender for Supply Installation and Commissioning of Rotary Screw air compressor
C/W refrigerated, Power 75KW**

Failure to budget

- 3.4.53 Public Procurement and Asset Disposal Act, 2015, Section 45(3a) and 53(2) states that all procurement processes shall be within the approved budget of the procuring entity and shall be planned by the procuring entity concerned through an annual procurement plan. An accounting officer shall prepare an annual procurement plan which is realistic in a format set out in the Regulations within the approved budget prior to commencement of each financial year as part of the annual budget preparation process. Further the Public Procurement and Disposal Act 2015 Section 44(2a) provides that an accounting officer shall ensure that procurements of goods, works and services of the public entity are within approved budget of that entity.
- 3.4.54 The installation and commissioning of Rotary Screw Air Compressor C/W Refrigerated, Power 75KW was not provided for in the 2016/2017 procurement plan. It was the responsibility of the General Manager and head of procurement MUSCO to ensure that the procurement planned and budgeted for.

Failure to justify the procurement Method used

- 3.4.55 Public Procurement and Disposal Act, 2015, Section 102(1)(a) to (d) states that (a) competition for contract, because of the complex or specialized nature of the goods, works or services is restricted to prequalified tenderers resulting from the procedure under Section 94; (b) the time and cost required to examine and evaluate a large number of tenders would be disproportionate to the value of the goods, works or services to be procured; (c) or if there is evidence to the effect that there are only a few known suppliers of the whole market of the goods, works or services (d) an advertisement is placed, where applicable, on the procuring entity website regarding the intention to procure through limited tender.
- 3.4.56 The special audit noted that the procurement method used to procure rotary screw air compressor c/w refrigerated power 75KW was restricted tender. There was no justification given for the use of restricted tender method. It was the responsibility of the head of procurement to justify the use of restricted tendering method.

Absence of user requisition

3.4.57 Public Procurement Regulations Section 22 (1) 2006 which states that, " every procurement requirement shall be initiated using a purchase requisition which shall include all necessary information pertaining to the procurement". **The special audit noted that there was no user requisition for this procurement. It was the responsibility of the Head of Procurement to ensure that this procurement started with a requisition.**

Invitation to tender

3.4.58 Section 54(3), (4) of the Public Procurement Regulations 2006 which requires the procuring entity to invite tenders from at least ten persons selected from the prequalified list maintained and invite tenders from all the known suppliers of the goods, works or services where Restricted Tendering is used.

3.4.59 **The audit team could not ascertain how bidders were invited to place their bids, as there was no list of invited bidders or copies of letters sent to the same provided. It was the responsibility of the Head of Procurement to ensure that invitations to tender were done as per the law.**

Failure to appoint tender opening and evaluation committees

3.4.60 Section 78 (1) (a-b) of the Public Procurement and Asset Disposal Act, 2015, states that an accounting officer of a procuring entity shall appoint a tender opening committee specifically for the procurement in accordance with the following requirements and such other requirements as may be prescribed. **There was no evidence that a Tender Opening Committee was appointed. The General Manager and Head of Procurement should be held accountable for not appointing a Tender Opening Committee.**

3.4.61 Public Procurement and Assets Disposal Act, 2016 Section 46 (1) provides that, an Accounting officer shall ensure that an ad hoc evaluation committee is established in accordance with this Mt and Regulations made thereunder and from within the members of staff, with the relevant expertise. **There was no evidence provided to show the appointment of this Evaluation Committee. It was the responsibility of the General Manager to ensure appointment of the same.**

3.4.62 According to Evaluation Committee report dated 13 February 2017 the evaluation team members were; Zadlack Odhira-Chairman, members Julius Okello, Wilson

Ochien, Linet Owiti, Dan Owegi, Ronald Agumba and Jeremiah Okello -Secretary.
 (Evaluation committee report dated 13 February 2017 Attached as Exhibit...041.)

3.4.63 The following companies participated in the bidding as per the evaluation report.

Table 25 Bidders Rotary Screw air compressor

	Company	Tender Sum (Kshs)
1	Car and General Ltd	4,292,000
2	Metlex Ltd	5,546,596
3	Boiler and Steam Ent Ltd	5,293,338

Failure to provide tender evaluation criteria

3.4.64 Public Procurement and Asset Disposal Act, 2015 Section 70 (6) (i) provides that, the tender documents shall set out the following-- provides that the procedures and criteria to be used to evaluate and compare the tenders. **There was no evidence that MUSCO provided the evaluation criteria to the bidders as the bid document was not availed for the audit. It was the responsibility of the head of procurement to ensure that evaluation criteria were provided in the bid document.**

3.4.65 The Committee held meeting on 13 February, 2017 and came up with evaluation criteria, the bids were to be evaluated in two phases of technical and commercial. Under technical evaluation the maximum score was 60 Marks and the following were considered; Compressor Capacity, Type rotary screw, Drier incorporated, Type of Drive, Pressure. Under the Commercial evaluation the maximum score was 40 marks and the following were considered; price, payment terms, warranty, delivery period.
 (Committee minutes of meetings held on 13 February, 2017 Attached as exhibit....042.)

3.4.66 All the bidders were subjected to both technical and commercial evaluation and were scored as follows;

Table 26: Evaluation

	Bidder Name	Technical Score (60 Mrks)	Commercial Score (40 Mrks)	Combined Score (100 Mrks)	Overall Ranking
1	Car & General	60	35	95	1
2	Riley Falcon Ltd	60	29.22	89.22	2
3	Capital Solutions Ltd	55	30.48	85.48	3

3.4.67 The tender evaluation committee recommended the award of the tender to Car and General at a tender sum of Kshs.4,292,000 as it was the lowest most responsive bidder.

3.4.68 The Head of Procurement Mr. James Orori gave his professional opinion on 23 February, 2017 stating that he agreed with the evaluation results and recommended the award to Car and General at a tender sum of Kshs 4,292,000. [\(Professional opinion dated 23 February, 2017 Attached as Exhibit...043\)](#)

Failure to notify unsuccessful bidders

3.4.69 Public Procurement and Asset Disposal Act, 2015, Section 87(1,3) states that before the expiry of the period during which tenders must remain valid, the accounting officer of the procuring entity shall notify in writing the person submitting the successful tender that his tender has been accepted. (3) when a person submitting the successful tender is notified under subsection (1), the accounting officer of the procuring entity shall also notify in writing all other persons submitting tenders that their tenders were not successful, disclosing the successful tenderer as appropriate and reasons thereof.

3.4.70 Notification of award was sent to Car and General via letter dated 1 March, 2017. There was no evidence that the unsuccessful bidders were notified. This is contravention of Section 87(3) above. It was the responsibility of the General Manager to ensure that all bidders were notified as per the law.

Failure to enter into a Contract

3.4.71 Public Procurement and Asset Disposal Act, 2015, Section (134) (1) states that, the Accounting Officer shall be responsible for preparation of contracts in line with the award decision. There was no contract between MUSCO and Car and General for this contract. It was the responsibility of the General Manager to ensure that there was a contract.

Failure to inspect goods

3.4.72 The Public Procurement and Disposal Regulations, 2006 Section 17(1) requires that, a procuring entity shall establish an Inspection and Acceptance Committee. (3) (a) the inspection and acceptance committee shall immediately after delivery of the

goods, works or services-inspect and where necessary, test the goods received. There was no evidence that the Rotary Screw Air Compressor was inspected. It was the responsibility of the Head of Procurement to ensure that goods received are inspected.

Tender for the supply of single stage split casing pump capacity 2000M/HR

Failure to Plan and Budget

3.4.73 Public Procurement and Asset Disposal Act, 2015, Section 45(3a) and 53(2) states that all procurement processes shall be within the approved budget of the procuring entity and shall be planned by the procuring entity concerned through an annual procurement plan. An accounting officer shall prepare an annual procurement plan which is realistic in a format set out in the Regulations within the approved budget prior to commencement of each financial year as part of the annual budget preparation process. Further the Public Procurement and Asset Disposal Act, 2015 Section 44(2a) provides that an Accounting Officer shall ensure that procurements of goods, works and services of the public entity are within approved budget of that entity.

3.4.74 The supply of single stage split casing pump capacity 2000M³/Hr was not provided for in the 2016/2017 procurement plan. The General Manager and Head of Procurement of MUSCO should be held accountable for initiating procurement process without adequate planning.

Absence of user requisition

3.4.75 The Public Procurement Regulations Sec 22 (1) 2006 which states that," every procurement requirement shall be initiated using a purchase requisition which shall include all necessary information pertaining to the procurement". The special audit noted that there was no user requisition for this procurement. It was the responsibility of the Head of Procurement to ensure that all procurements are initiated using user requisition.

Failure to advertise tenders

3.4.76 Section 96(2) of the Public Procurement and Asset Disposal Act, 2015, states that if the estimated value of the goods, works or services being procured is equal to, or more than the prescribed threshold for county, national and international advertising, the procuring entity shall advertise in the dedicated Government tenders' portals or in its own website, or a notice in at least two daily newspapers of nationwide circulation. **This tender was not advertised. It was the responsibility of the General Manager and Head of Procurement to ensure that advertising was done.**

Failure to appoint a Tender Opening Committee

3.4.77 Section 78 (1) (a-b) of the Public Procurement and Asset Disposal Act, 2015, states that an accounting officer of a procuring entity shall appoint a tender opening committee specifically for the procurement in accordance with the following requirements and such other requirements as may be prescribed. **There was no evidence that a tender opening committee was appointed. The General Manager and head of procurement should be held accountable for not appointing a tender opening committee.**

Failure to appoint a Tender Evaluation Committee

3.4.78 The Public Procurement and Asset Disposal Act, 2015 Section 46 (1) provides that, an Accounting officer shall ensure that an ad hoc evaluation committee is established in accordance with this Mt and Regulations made thereunder and from within the members of staff, with the relevant expertise. **There was no evidence provided to show the appointment of this Evaluation Committee. It was the responsibility of the General Manager to ensure appointment of the same.**

3.4.79 According to Evaluation Committee report dated 13 February 2017 the evaluation team members were; Zadlack Odhira-Chairman, Timmy Ochieng -Member, Gabriel Odipo- Member, Linet Owiti- Member, John Odhiambo-Member, Ronald Agumba-Member, Jeremiah Okello- Secretary.

3.4.80 The following companies participated in the bidding as per the evaluation report.

Table 27 Bidders single stage split casing pump

	Company	Tender Sum (Kshs)
1	Ricana Enterprises Ltd	7,946,000
2	Riya Industrial Supplies Ltd	6,786,000
3	Boiler and Steam Ent Ltd	7,465,633
4	Usha Merchandise Ltd	6,930,000
5	Jos Hansen Ltd	8,456,400
6	Thantis Holding Ltd	8,062,580

Failure to provide tender evaluation criteria

- 3.4.81 Public Procurement and Asset Disposal Act, 2015 Section 70 (6) (i) provides that, the tender documents shall set out the following-- provides that the procedures and criteria to be used to evaluate and compare the tenders. The Evaluation Committee held meetings on 28 November, 2016 and 29 November, 2016 and came up with evaluation criteria that had the components of technical and commercial.
- (Tender evaluation committee minutes of meetings dated on 28 November, 2016 and 29 November, 2016 Attached as Exhibit ...044.)**
- 3.4.82 There was no evidence that MUSCO provided the evaluation criteria to the bidders as the bid document was not availed for the audit. It was the responsibility of the Head of Procurement to ensure that evaluation criteria were provided in the bid document.
- 3.4.83 The Evaluation Committee in meetings held on 28 November, 2016 and 29 November, 2016 and came up with evaluation criteria, the bids were to be evaluated in two phases of technical and commercial.
- 3.4.84 Under technical evaluation the maximum score was 60 Marks and the following were considered; pump type, pump casing, impeller mtrl, stuffing box, shaft mtrl, type of bearing, type of speed motor and country of origin.
- 3.4.85 Under the Commercial evaluation the maximum score was 40 marks and the following were considered; price, payment terms, warranty, representation and delivery period.
- 3.4.86 All the bidders were subjected to both technical and commercial evaluation and were scored as follows;

Table 28 Technical and Financial Evaluation single stage split casing pump

	Bidder Name	Technical Score (60 Mrks)	Commercial Score (40 Mrks)	Combined Score (100 Mrks)	Overall Ranking
1	Jos Hansen Ltd	49	20	61	1
2	Usha Merchandise Ltd	39	26.6	65.6	2
3	Boiler and Steam Ent Ltd	41	23.2	64.2	3
4	Riya Industrial Supplies Ltd	28	34	62	4
5	Ricana Enterprises Ltd	20	34.1	54.1	5
6	Thantis Holding Ltd	12	21.8	33.8	6

3.4.87 The Tender Evaluation Committee recommended the award of the tender to M/s. Jos Hansen Ltd at a tender sum of Kshs.8,456,400 as it was the lowest most responsive bidder.

3.4.88 In an email dated 26 January 2017 the Head of Procurement wrote to Andrew Thuku of Jos Hansen to request for a reduction of price to Kshs.7,400,000. Mr Thuku responded via email on 27 January, 2017 agreeing to a new negotiated price of Kshs.7,822,170. **(An email dated 26 January 2017 & response dated 27 January 2017 between head of procurement and Andrew Thuku of Jos Hansen Attached as Exhibit.....045)**

3.4.89 The Head of Procurement, Mr. James Orori gave his professional opinion on 30 January, 2017 stating that he agreed with the evaluation results and recommended the award to M/s. Jos Hansen Ltd at a tender sum of Kshs. 7,822,170.

(Professional Opinion dated 30 January, 2017, Attached as Exhibit...046.)

Failure notify unsuccessful bidders

3.4.90 Public Procurement and Asset Disposal Act, 2015 Section 87(1,3) states that before the expiry of the period during which tenders must remain valid, the accounting officer of the procuring entity shall notify in writing the person submitting the successful tender that his tender has been accepted. (3) When a person submitting the successful tender is notified under subsection (1), the accounting officer of the procuring entity shall also notify in writing all other persons submitting tenders that their tenders were not successful, disclosing the successful tenderer as appropriate and reasons thereof.

3.4.91 Notification of award was sent M/s. Jos Hansen to via letter dated 30 January 2017. There was no evidence that the unsuccessful bidders were notified. This

is contravention of Section 87(3) above. It was the responsibility of the General Manager to ensure that all bidders were notified as per the law. (Notification of award letter dated 30 January 2017 Attached as Exhibit047.)

Failure to enter into a Contract

3.4.92 Public procurement Act 2016 section (134) (1) states that, the accounting officer shall be responsible for preparation of contracts in line with the award decision. There was no contract between MUSCO and Car and General for this contract. It was the responsibility of the General Manager to ensure that there was a contract.

Failure to Inspect and Accept of goods/service

3.4.93 The Public Procurement and Disposal Regulations, 2006, Section 17(1) state that, a procuring entity shall establish an inspection and acceptance committee. (3) (a) the inspection and acceptance committee shall immediately after delivery of the goods, works or services-inspect and where necessary, test the goods received. There was no evidence that the split casing injection pump was inspected. It was the responsibility of the head of procurement to ensure that goods received are inspected. The special audit did not confirm payments to M/s. Jos Hansen Ltd as payment vouchers were not availed.

Procurement for Rehabilitation of Boiler roof & Gutters, Rehabilitation of mud filters station roof, wall claddings and windows.

Failure to Plan and Budget

3.4.94 Section 26 (3) (a) of the Public Procurement & Disposal Act 2005 which requires all procurements to be within the approved budget of the procuring entity and shall be planned by the procuring entity concerned through an annual procurement plan.

3.4.95 We reviewed the annual procurement plans for 2015/16. The rehabilitation of boilers' roof & gutters, rehabilitation of mud filter station roof and wall claddings and windows was not provided for in the 2015/2016 procurement. The General Manager and Head of Procurement MUSCO should be held accountable for initiating procurement process without adequate planning.

3.4.96 The procurement was requisitioned vide memo dated 7 September, 2015 (LPO NO.11401) MSL/2016 described as rehabilitation of boilers roofs and gutters, roof area in approx...1650sq mtrs as per the B/Q and scope of works and (LPO NO.11402) (MSL/2042) described as rehabilitation of filter station roof, wall cladding, gutters and windows, roof area approx...318sq. mtrs. as per the B/Q and scope of works.

Invitation to tender

3.4.97 Section 54(3), (4) of the Public Procurement Regulations of 2006 requires the procuring entity to invite tenders from at least ten persons selected from the prequalified list maintained and invite tenders from all the known suppliers of the goods, works or services where Restricted Tendering is used.

3.4.98 **The special audit team could not ascertain how bidders were invited, as there was no list of invited bidders or copies of letters sent to the same provided for audit.**

Failure to appoint a Tender Opening Committee

3.4.99 Section 60 of the Public Procurement and Disposal Act, 2005 which requires an accounting officer of a procuring entity shall appoint a tender opening committee specifically for the procurement in accordance with the requirements as may be prescribed.

3.4.100 **The special audit observed that there was no Tender Opening Committee appointed, no tender opening minutes and register. It was the responsibility of the Head of Procurement and General Manager to appoint a Tender Opening Committee.**

Failure to appoint a Tender Evaluation Committee

3.4.101 The Public Procurement and Asset Disposal Act, 2015 Section 46 (1) provides that, an Accounting officer shall ensure that an ad hoc Evaluation Committee is established in accordance with this Mt and Regulations made thereunder and from within the members of staff, with the relevant expertise. **There was no evidence provided to show the appointment of the Evaluation Committee. It was the responsibility of the General Manager to ensure appointment of the same.**

3.4.102 According to Evaluation Committee report dated 13 October, 2015 the Evaluation Committee Members were; Michael Odhiambo -Chairman, George Natembeya -

Member, ,Wycliffe Juma-Member, Dan Owegi -Member, Member, Jeremiah Okello-Secretary. (Evaluation committee report dated 13 October 2015 Attached as Exhibit.....048.)

3.4.103 The following companies participated in the bidding as per the evaluation report.

Table 29 Bidders for mud filters station roof, wall claddings and windows

	Company	Boiler Room (Kshs)	Mud Filter Roof (Kshs)
1	Homeshop	3,494,912.45	2,560,979.85
2	Pinket	3,236,563.20	1,328,008.50
3	Ipro	5,492,398.74	2,150,632.75

Failure to provide a tender evaluation criterion

3.4.104 The Public procurement and Asset Disposal Act, 2015 Section 70 (6) (i) provides that, the tender documents shall set out the following-- provides that the procedures and criteria to be used to evaluate and compare the tenders. There was no evidence that MUSCO provided the evaluation criteria to the bidders as the bid document was not availed for the audit. It was the responsibility of the Head of Procurement to ensure that evaluation criteria were provided in the bid document.

3.4.105 The committee held the meeting on 13 October, 2015 and came up with evaluation criteria, the bids were to be evaluated in two phases of technical and commercial. (Committee minutes of meeting dated 13 October, 2015 Attached as Exhibit ...049.)

3.4.106 Under technical evaluation the maximum score was 60 Marks and the following were considered; Past experience in similar jobs, Key personnel and qualification Past similar jobs in MUSCO, Tools and equipment, Delivery period, Safety gear.

3.4.107 Under the Commercial evaluation the maximum score was 40 marks and the following were considered; Price/cost, Registration and legal compliance, Payment terms, duly filled form of tender.

3.4.108 All the bidders were subjected to both technical and commercial evaluation and were scored as follows;

Table 30 Tender Evaluation- mud filters station roof & wall claddings

	Bidder Name	Boiler Roof Repair		Mud Filter Roof, Cladding and Window Repair	
		Technical Score	Rank	Technical Score	Rank
1	Ipro	45	1	50	1
2	Homeshop	10	2	10	2
3	Pinket	3	3	3	3

3.4.109 In view of the above scores the following two bidder's Homeshop and Pinket scored below the set Mark of 30 Marks and there were eliminated. Ipro proceeded for technical evaluation, where it scored as tabulated below;

Table 31 Tender evaluation mud filters station roof& wall claddings

	Bidder Name	Boiler Roof Repair		Mud Filter Roof, Cladding and Window Repair	
		Technical Score	Rank	Technical Score	Rank
1	Ipro	35	1	35	1

3.4.110 The Evaluation Committee recommended the award of both Boiler Roof Repair and Filter Roof, Cladding and Window Repair to Ipro Construction Company at a tender sum of Kshs.5,492,398 and Kshs.2,150,632 respectively

3.4.111 The Tender Committee in a meeting held on 21 October, 2015 awarded the tenders for Boiler Roof Repair and Mud Filter Roof, Cladding and Window Repair to Ipro Construction Company at a tender sum of Kshs.5,492,398 and Kshs.2,150,632 respectively. **(Tender committee minutes of meeting held on 21 October 2015 Attached as Exhibit...050.)**

3.4.112 The Public Procurement and Asset Disposal Act, 2015, Section 67 (1, 2) states; before the expiry of the period during which tenders must remain valid, the procuring entity shall notify the person submitting the successful tender that his tender has been accepted. (2) At the same time as the person submitting the successful tender is notified, the procuring entity shall notify all other persons submitting tenders that their tenders were not successful. **There was no evidence that notifications to both successful and unsuccessful bidders was done. It was**

the responsibility of the General Manager and Head of Procurement to ensure that all bidders were notified as per the law.

- 3.4.113 The contract between Ipro Construction Company and MUSCO was entered into on 30 October, 2015. (Contract between Ipro Construction Company and MUSCO dated 30 October 2015 Attached as Exhibit...051.)

Failure to Inspect goods

- 3.4.114 The Public Procurement Regulation, 2006, Section 17(1) state that, a procuring entity shall establish an inspection and acceptance committee. (3) (a) the inspection and acceptance committee shall immediately after delivery of the goods, works or services-inspect and where necessary, test the goods received. There was no evidence that the good supplied were inspected. It was the responsibility of the Head of Procurement to ensure that goods received are inspected.
- 3.4.115 The special audit did not confirm payments as no payment vouchers were availed.

Payments made for goods/services not delivered

- 3.4.116 The special audit also conducted a walk through in the factory accompanied by the Engineer (expert provided by AFA) to verify, where possible whether equipment that were to be refurbished or replaced in the 2016 OOC maintenance were refurbished. This was guided by a verification check list that was prepared during the audit based on procurement of goods and services that had been done during the period under review as detailed under APPENDIX XVI.
- 3.4.117 Section 146 of the Public Procurement and Asset Disposal Act, 2015 states that no works, goods or services contract shall be paid for before they are executed or delivered and accepted by the accounting officer of a procuring entity or an officer authorized by him or her in writing except where so specified in the tender documents and contract agreement.
- 3.4.118 The special audit noted that an LPO number 5715 dated 23rd August, 2016 shows that Triveni Engineering was paid a sum of Kshs.343,441 to supply SEV Steam Strainer. While conducting verification at the factory, it was noted that this item was not supplied. (LPO number 5715 dated 23rd August 2016 Attached as Exhibit052)

3.4.119 In addition, LPO number 1681 dated 27 July, 2016 shows that Ali Enterprises was paid a sum of Kshs.101,310 for servicing of the Central Mill Lubrication System. The special audit established that this was not done. It was the responsibility of the Receiver Managers, the General Manager, Head of Procurement and the Finance Manager to ensure that payment is done for of goods received and services rendered. (LPO number 1681 dated 27th July 2016 Attached as Exhibit.....053.)

3.5 Asset Management and Factory Operations

3.5.1 The special audit reviewed MUSCOs asset register against ownership documents and also physically verified existence of these assets and noted the following exceptions; (Asset Register Attached as Exhibit.....054.)

Failure to maintain an updated asset register

3.5.2 Section 143 (1) of the Public Finance Management (National Government) regulations 2015, requires the Accounting Officer to be responsible for maintaining a register of assets under his or her control or possession as prescribed by the relevant laws.

3.5.3 Verification of computer and accessories as well as office furniture and equipment valued at Kshs.5,601,085 proved challenging as most of items in the list of assets categorized under these sections, in the asset register provided, were obsolete and had been replaced and yet not been updated in the asset register. In addition, the existing ones had not been tagged hence identifying and tying them to the asset register proved difficult.

3.5.4 Some motor vehicles and motor cycles were not in the asset register as detailed in the table below but were owned by MUSCO.

Table 32: List of assets excluded from register

Motor cycles	Motor Vehicles	Motor vehicles
KAH 855 P	KAV 438E	KAS 929Y
KBL 974G	KAB 335T	KCE 301D
KMCQ 539X	KAJ 812S	KBR 495U
KDMW 599E	KAV 078E	KAJ 332S
KDMW 598E	KAV 077E	KAG 864F
KDMW 608E	KAJ 748S	KAR 720L
KDMW 607E	KBL439G	KAB 199T

Failure to tag assets

- 3.5.5 Section 72 (I) of the Public Finance Management Act 2012, requires the accounting officer to (a) be responsible for the management of the entity's assets and liabilities; and (b) manage those assets in a way which ensures that the entity achieves value for money in acquiring, using and disposing of those assets. In addition, section 139 (1) of the Public Finance Management (National Government) regulations 2015 requires the Accounting Officer to take full responsibility and ensure that proper control systems exist for assets.
- 3.5.6 During verification it was noted that MUSCOs assets valued at Kshs.171,378,000 as per audited Financial Statements dated June 2016 were not tagged, thereby increasing the chances of losses as it would be difficult to identify the assets. It was the responsibility of the General Manager to ensure proper tagging, listing and storage of the machinery entrusted to them in their specific departments.
- 3.5.7 It was also noted during the audit that trailers listed in the asset register were hired out to farmers for use in bringing cane to MUSCO, therefore none was available for verification.
- 3.5.8 We engaged an Expert from Agriculture and Food Authority to provide an expert opinion on factory average recovery rate after the rehabilitation done in 2016. The expert report concluded that the factory sugar recoveries did not meet the industry expectations. This was attributed to inadequate maintenance. (Letter to AFA requesting for an expert attached as Exhibit055.)

3.6 ICT and related issues

- 3.6.1 The special audit reviewed the following Information Communication Technology (ICT) Systems at Muhoroni Sugar Company covering the period 01 July, 2013 to 30 June, 2019 as follows:

Table 33: Scope of Information System Audit

	ICT System	Objective
1	Enterprise Resource Planning (ERP) System	Establish linkage between sales and marketing module and other modules to determine reliability and integrity of the data, any losses thereof and make recommendations;
2	Payroll System	Establish and Report on control weaknesses and losses thereof

Enterprise Resource Planning (ERP) Management Information System

3.6.2 The special audit established that Muhoroni Sugar Company (MUSCO) uses Ebiz Frame Enterprise Resource Planning Management Information System to manage the core business of the company. The system went live in March 2011 and has the following active modules;

- i. Sales - designed to process and manage sales activities from creation of sales orders to delivery of the product to the customer.
- ii. Finance - used to integrate all the financial and accounting functions of the institution.
- iii. Agriculture - designed to integrate all farmer related records and processes as well as farmer management.
- iv. Human Resource and Payroll - designed to integrate all human resource functions as well as the payroll function.
- v. Production - designed to integrate all production activities within the institution from receipt of sugarcane to keeping records of materials used and quantities manufactured to the eventual cane milling.
- vi. Farmer Accounting - used to process farmers' payments with reference to deliveries the farmers make to the factory.
- vii. Purchase - used to process acquisition of both goods and services in regards to the organization.
- viii. Maintenance - used for all the processes relating to maintenance of factory equipment from requisition of maintenance to preparation of a maintenance schedule and eventual job completion certificate production.
- ix. Fixed Assets - used for record keeping of all the assets of the institution.
- x. Inventory - used to handle each departments' internal requisitions such as stationery
- xi. Transport - used for management of information pertaining to vehicles owned by the organization as well as controlling their movement.
- xii. Executive Information System - This module is designed for Reporting purposes. It summarises reports from other modules for ease of evaluation and review by management.
- xiii. Administration - This module is designed for the overall administration of the system. It enables the system administrators to perform key system

administrative tasks such as: - creating users, assigning user roles and rights, disabling users and error handling.

3.6.3 The International Organization of Standardization (ISO) issues specification for an Information Security Management System (ISMS). The ISMS is a framework of policies and procedures that includes all legal, physical and technical controls involved in an organization's information risk management processes (www.iso.org).

3.6.4 We reviewed use of EbizFrame Enterprise Resource Planning Management Information System at Muhoroni Sugar Company with a view to identify level of compliance with ISO Information Security Management Standards and related policies. We identified the following weaknesses that pose a risk to Confidentiality, Integrity and Availability of information at Muhoroni Sugar Company Ltd.

Table 34: EbizFrame ERP Information System Risks

	Weakness	Risk
1	Preparation of Financial Statements outside the ERP system	Misstatements of financial reports prepared manually as data is not validated
2	Inadequate Controls on System Administration	Data may be manipulated within the system or the system configuration may be fraudulently altered without the perpetrator being detected.
3	Conflict of interest	Existence of sugar farmers who are also employees of the company without evidence of declaration of conflict of interest and risk mitigation measure
4	Weaknesses within the sales module	Data may be manipulated within the system or the system configuration may be fraudulently altered without the perpetrator being detected.

Preparation of Financial Statements outside the ERP system

3.6.5 ISO/IEC 27001:2005 specifies the requirements for establishing, implementing, operating, monitoring, reviewing, maintaining and improving a documented Information Security Management System within the context of the organization's overall business risks (www.iso.org). Section A.12.2.1 of ISO/IEC 27001:2005(E) provides that, data input to applications shall be validated to ensure that this data is correct and appropriate. A review of the ERP system established that financial statements at Muhoroni Sugar Company are prepared outside the ERP system

posing a risk of misstatement of the financial statements prepared manually as data is not validated.

- 3.6.6 Scrutiny of these actual financial statements and system generated financial statements established variances as summarized below;

Table 35: Financial Misstatement Information System Risks

Year	System Statements Total Income KSh.	Actual Financial Statements Total Income KSh.	Variance KSh.	System Statements Total Expenditure KSh.	Actual Financial Statements Total Expenditure KSh.	Variance KSh.
2014	2,396,300,825	2,013,501,000	382,799,825	2,970,704,039	2,716,405,000	254,299,039
2015	2,166,298,132	2,456,743,000	(290,444,868)	2,746,560,544	3,090,006,000	(343,445,456)
2016	2,482,148,010	2,367,977,000	114,171,010	2,701,402,792	2,901,897,000	(200,494,208)
	7,044,746,967	6,838,221,000	206,525,967	8,418,667,375	8,708,308,000	(289,640,625)

Inadequate Controls on System Administration

- 3.6.7 ISO/IEC 27002 provides best practice recommendations on information security controls for use by those responsible for initiating, implementing or maintaining information security management systems (ISMS). Section 10.10.1 of the ISO/IEC 27002 code of practice for information security management standard whose objective is to detect unauthorized information processing activities provides that, audit logs recording user activities, exceptions, and information security events should be produced and kept for an agreed period to assist in future investigations and access control monitoring. **We observed that; the system does not maintain an audit trail of two main modules; the human resource module and the system administration module. Audit trails for other modules are not reviewed or monitored. Therefore, data may be manipulated within the system or the system configuration may be fraudulently altered without the perpetrator being detected.**
- 3.6.8 The system should be configured to maintain an audit trail for all modules in use and the management should perform regular review of audit trails in order to identify any improper transactions and take corrective actions.

Conflict of interest

- 3.6.9 Section 12(1) of the Public Officer Ethics Act provides that a public officer shall use his best efforts to avoid being in a position in which his personal interests conflict with his official duties. A review of the farmers' registers against the organization's staff list established existence of sugar farmers who are also employees of the company. **No conflict of interest declaration was seen and neither was any mitigation measure put in place by the organization availed for audit review (APPENDIX XVII). A review of the list of distributors from the system together with the prequalified list of distributors against the organization's staff list revealed distributors to the company who are also employees (APPENDIX XVIII).**
- 3.6.10 Consequently, employees to the institution may use their positions to gain unfair advantage over external customers and farmers. And employees who are directly associated with the procurement and payment process may influence the process to their favor. The management should put in place adequate mitigation measures to mitigate the conflict of interest. For instance, a distributor should not approve his/her own payment or set the amount he/she should be paid and also all persons involved in such activities should declare conflict of interest.

Weaknesses within the sales module

- 3.6.11 Section A.12.2.1 of ISO/IEC 27001:2005(E) provides that, data input to applications shall be validated to ensure that this data is correct and appropriate. Analysis of data extracted from the sales module within the ERP for the period under review established the following anomalies amounting to Kshs.77,163,850,347
- i. Instances where the value of customer intimation is less than the value at which an order was made. For a customer to be intimated by the finance department, the customer has to make a deposit. This is the intimation value. The intimation value forms the basis of preparing a sales order. The intimation value can be more than the order value if a customer decides to order goods worth less than what he or she had deposited but the intimation value can never be less. This would mean a sales order was created based on a payment that had not been made. Analysis of the data revealed variance in which the intimation value is less than order value totaling Kshs.1,441,376,653 as detailed in APPENDIX XIX;

- ii. Sales orders were prepared before intimation of customers. The intimation value for which this was the case amounted to KSh.2,767,263,589 as detailed in APPENDIX XX;
- iii. Invoices worth Kshs.12,694,456 were prepared before sales orders were done as detailed in APPENDIX XXI;
- iv. Deliveries worth Kshs.15,113,876 were done before orders were made as detailed in APPENDIX XXII;
- v. Some invoices had missing invoice numbers as detailed in APPENDIX XXIII.
- vi. Missing/gaps in sales invoice numbers as detailed in APPENDIX XXIV;
- vii. Duplicate intimation receipt numbers totaling to Kshs.58,665,007,129 as detailed in APPENDIX XXV;
- viii. Missing/gaps in intimation receipt numbers as detailed in APPENDIX XXVI;
- ix. Quantity delivered was greater than quantity ordered with a total loss of Kshs.10,027,687 of amount paid less than the order value as detailed in APPENDIX XXVII;
- x. Value at intimation was more than the deposit value. A total difference of Kshs.13,920,010,345 as detailed in APPENDIX XXVIII;
- xi. Records in the system of invalid amounts paid and or quantities delivered as detailed in APPENDIX XXIX;
- xii. Gaps/Missing order numbers as detailed in APPENDIX XXX;
- xiii. Intimated customers where no sales orders were made as detailed in APPENDIX XXXI; and
- xiv. Invoice value was more than the deposit value. The invoice value is the amount the customer should have paid while the deposit value is the value which was actually paid. The difference amounted to Kshs.332,356,612 as detailed in APPENDIX XXXII.

3.6.12 The aforementioned weaknesses may result in data being fraudulently manipulated. The management should ensure that the system is configured to perform data validation. In addition, data clean up should also be done to ensure integrity of data maintained by the system.

Review of the Payroll

3.6.13 We observed that MUSCO uses Human Resource and Payroll module of the ERP to process the payroll of permanent staff. While MemorySoft Application Software is used to manage and process the payroll for contracted staff.

3.6.14 The following findings relate to processing of payroll:

Table 36: Payroll Information System Risks

	Weakness	Risk
1	Inadequate use of the Human Resource and Payroll module of the EbizFrame System	The payroll module may be underutilized leading to the organization not reaping full value for money for the investment.
2	Duplication of Resources	The EbizFrame application is cable of handling and integrating all the organization's functions but the company opted to use two systems to handle the payroll function.
3	Irregular allocation of official staff Residence	Company staff may miss houses within the company in case of shortage of houses, where non-staff members are allocated the company houses and Company spending more on staff cost in regards to house allowance even when staff are housed to reduce the cost.
4	Officers earning above their job groups/scales	The company may be overpaying staff hence incurring irregular expenditure.
5	Overpayment of Kshs. 603,768 on Acting Allowance	Loss of funds
6	Overpayment on Leave allowance	„
7	Unconfirmed payments of Salary advance/ flat rate salary advance	Risk of the Company making losses due to its inability to consistently recover the advance payments.
8	Payment of normal Salary to staff who exited service.	Loss of funds

Inadequate use of the Human Resource and Payroll module of the EbizFrame System

3.6.15 Section A.12.2.1 of ISO/IEC 27001:2005(E) provides that, data input to applications shall be validated to ensure that this data is correct and appropriate. We established that payments that involve salary advances and the executive payrolls are performed

outside the system. The executive payroll includes the following staff; The Finance Manager, Receiver Managers, IT Managers, Head of Agriculture, Head of Factory, Agronomist, Chief Accountant, ERP Project Coordinator, Sales, Marketing & Planning Manager, General Manager, Head of Human Resources, Engineering Manager and Head of Quality Assurance. This list may also vary from time to time.

- 3.6.16 **Consequently, there is possibility of payroll manipulation if this is not done through the system. The payroll module may be underutilized leading to the organization not reaping full value for money for the investment. The management should put in place proper mechanisms for all the payrolls to be processed through the system.**

Duplication of Resources

- 3.6.17 Section 79 (2) of the Public Finance Management Act of 2012 provides, among others, that without prejudice to provisions under subsection (1), a public officer employed in a national government state organ or public entity shall ensure that the resources within the officer's area of responsibility are used in a way which is effective, efficient, economical and transparent. The EbizFrame application is cable of handling and integrating all the organization's functions but the company opted to use two systems to handle the payroll function. EbizFrame system handles, among others, the management of payroll for permanent employees while the Memory Soft System handles the Contracted staff Payroll. **There is therefore a risk of misuse of company resources which could have been used for other purposes.**
- 3.6.18 The management should consider consolidating all its functions within one system to avoid wastage of resources.

Irregular allocation of official staff Residence

- 3.6.19 The Collective Bargaining Agreement -CBA of 2015 - 2017 on Housing section 22 (a) provides that employees shall be provided with rent free housing in accordance with the provisions of the Laws of Kenya. In case of couples who are employees, one shall be entitled to housing allowance. When sufficient housing is not available, those NOT housed will be entitled to house allowance.
- 3.6.20 **We established that there were 87 occupants from the Occupancy list of 2020 who are not in the master list of all employees provided. A review of the personal files/ employee numbers and the employee names in the master list did not**

confirm that the occupants are employees of the company as detailed in APPENDIX XXXIII.

- 3.6.21 There were thirty-three (33) occupants allocated more than one residence as detailed in APPENDIX XXXIV.
- 3.6.22 It was also noted that a total of 9 officers were earning house allowance and another 7 officers receiving house allowance in the periods they resided in the staff company houses as detailed in APPENDIX XXXV. This poses a risk of Company staff may miss houses within the company in case of shortage of houses, where non-staff members are allocated the company houses and Company spending more on staff cost in regards to house allowance even when staff are housed to reduce the cost. The management should investigate this matter and correct the anomaly.

Officers earning above their job groups/scales

- 3.6.23 The CBA 2015 - 2017 (37) on minimum rates and wage increment provides the predetermined rates at which officers may progress in their pay. We established that sixty-three (63) officers in the period under review were earning basic pay above the amounts approved for their job groups. Further, it was observed that 36 officers earned basic pay only once. We were unable to verify why this happened. (APPENDIX XXXVI). The company may be overpaying staff hence incurring irregular expenditure. The management should investigate this matter, recover the excess amounts paid and correct the anomaly.

Overpayment of Kshs. 603,768 on Acting Allowance

- 3.6.24 The CBA 2015 - 2017 on Acting appointment (sections 8 (e, f)) provides that (e) acting allowance payable shall be 22% of the employee's basic pay for management staff and (f) the employee acting on vacant position for a period of 3 months will be confirmed in that position. It was noted that 98 Officers were paid amounts above 22 % of their basic pay. No additional authority for the overpayment was availed for audit review. (APPENDIX XXXVII). In addition, it was noted that 72 officers have been on acting capacity for more than 12 months and have not been confirmed in the respective positions. (APPENDIX XXXVIII). The authority to act or extent the period of acting was not availed for audit review. The management should investigate and recover any excess amounts paid as acting allowance and

seek additional resources to confirm staff who are acting and qualify for the higher positions.

Overpayment on Leave allowance

- 3.6.25 Code of regulation Revised 2006 (J.11) states that an officer who takes a minimum of one-half of his annual leave entitlement will be eligible for leave allowance ONCE a year. There are 149 officers paid leave allowance more than once in a year as detailed in APPENDIX XXXIX. The management should recover the overpayments and strengthen controls governing payment of leave allowances.

Unconfirmed payments of Salary advance/ flat rate salary advance

- 3.6.26 The PFM Act 2012 (71(2, 3, 4) states that a public officer to whom cash advance is made shall account for the advance within a reasonable period and shall return balance with supporting documents for expenditure incurred. A total of 732 officers are being recovered an amount Kshs.100m as salary advance. Due to limitation of data provided we were not able to ascertain the amounts advanced since there were no schedules of payments availed from cash office. (APPENDIX XL)
- 3.6.27 From salary advances of senior management of April 2018, the 8 senior staff were paid each Kshs.10,000 in April 2018 out of which only 2 senior staff had their amounts recovered in full by December 2018. (APPENDIX XLI). This pose a risk of the Company making losses due to its inability to consistently recover the advance payments.

Payment of normal Salary to staff who exited service

- 3.6.28 The CBA 2015 - 2017 on Retirement (section 19 (c)) provides that final payments due shall be made together with the last wages due. An officer with staff number 2464 from the master data provided has current status marked as “retired” with detachment date “31/12/2017”. On analysis of net pay/ EFT bank details availed, it was noted the officer continued earning net pay till December 2018 where a total of KSh.501,242 was paid after the detachment date.

Other Observation: Inadequate segregation of system related processes

- 3.6.29 Section A.10.1.3 of ISO/IEC 27001:2005(E) provides that the duties and areas of responsibility shall be segregated to reduce opportunities for unauthorized or unintentional modification or misuse of the organization’s assets. A review of

MemorySoft application system revealed that the payroll officer has the right to create, edit and delete payroll records by herself without the need of any approval.

3.6.30 The Admin Account has access to all modules and can view, add, create and delete records. That is on the EbizFrame Software. All the users of the MemorySoft system can create, edit, view and delete critical employee records with regards to ability to change employee earnings and deductions, creating new employees and ability to change their own user rights as well as others. This is evidenced by logs showing the payroll officer performing all three functions as detailed in **APPENDIX XXXLII**. Where there is no adequate segregation of duties, fraud and error risks are less manageable. The management should enforce segregation of duties and allocate roles on a need to know basis. In situations where this is not possible the management should design appropriate compensating controls and monitor the efficacy of such controls closely.

CONTACTS


Office of the Auditor-General


Address: P.O. Box 30084-00100, NAIROBI.

Telephone: +254 796 52 85 60

E-mail: info@oagkenya.go.ke

Website: www.oagkenya.go.ke

 @OAG_Kenya

 Office of the Auditor-General Kenya