

REPUBLIC OF KENYA



KENYA NATIONAL AUDIT OFFICE



**REPORT**

**OF**

**THE AUDITOR-GENERAL**

**ON**

**THE FINANCIAL STATEMENTS OF**  
**THE MINISTRY OF DEFENCE**

**FOR THE YEAR ENDED**  
**30 JUNE 2014**

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# REPUBLIC OF KENYA

Telephone: +254-20-342330  
Fax: +254-20-311482  
E-Mail: [oag@oagkenya.go.ke](mailto:oag@oagkenya.go.ke)  
Website: [www.kenao.go.ke](http://www.kenao.go.ke)



P.O. Box 30084-00100  
NAIROBI

## KENYA NATIONAL AUDIT OFFICE

### REPORT OF THE AUDITOR-GENERAL ON THE MINISTRY OF DEFENCE FOR THE YEAR ENDED 30 JUNE 2014

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#### REPORT ON THE FINANCIAL STATEMENTS

I have audited the accompanying financial statements of the Ministry of Defence set out on pages 9 to 31 which comprise the statement of financial assets and liabilities as at 30 June 2014, and the statement of receipts and payments, statement of cash flows and statement of comparison of budget and actual amounts for the year then ended and a summary of significant accounting policies and other explanatory information in accordance with Article 229 of the Constitution of Kenya, and Section 8 of the Public Audit Act, 2003. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit.

#### **Management's Responsibility for the Financial Statements**

Management is responsible for the preparation and fair presentation of these financial statements in accordance with International Public Sector Accounting Standards (Cash Basis) and for such internal control as management determines is necessary to enable the preparation of the financial statements that are free from material misstatement whether due to fraud or error.

The management is also responsible for the submission of the financial statements to the Auditor-General in accordance with the provisions of Section 7 of the Public Audit Act, 2003.

#### **Auditor-General's Responsibility**

My responsibility is to express an opinion on these financial statements based on the audit and report in accordance with the provisions of Section 9 of the Public Audit Act, 2003. The audit was conducted in accordance with International Standards on Auditing.

Those standards require compliance with ethical requirements and that the audit be planned and performed with a view to obtaining reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Ministry's internal control. An audit also includes evaluating the appropriateness of

accounting policies used and the reasonableness of accounting estimates made, as well as evaluating the overall presentation of the financial statements.

I believe that the audit evidence obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

### **Basis for Qualified Opinion**

#### **1. Mismanagement of Imprests at the Ministry of Defence**

Examination of imprest records for the financial year 2013/2014 in respect of the Ministry of Defence shows that different officers were issued with imprest for foreign and local travel, training, clearance of KRA taxes and hospitality. However, unsatisfactory matters were observed as follows: -

##### **1.1 Unaccounted for Expenditure Relating to International Studies- Kshs.74,237,939.00**

Examination of records indicate that the Ministry of Defence issued imprests being per diem payments for international study tours amounting to Kshs.74,237,939.00 to officers travelling to United Kingdom (UK), Sweden, Canada, Cuba, South Korea, Malaysia, Oman and Kuwait. However, available information and records show that the forty two (42) officers did not travel outside the country during the purported period, an indication that a claim of Kshs.74,237,939.00 does not comply with principles of Public Finance Management, 2012 as stipulated in Article 201 (a) of the Constitution of Kenya, 2010.

In addition, no surrender vouchers have been availed for audit verification contrary to Section 37 of Public Audit Act, 2003.

##### **1.2 Unsupported Payment of Imprests Kshs.31,205,156.00**

Examination of records indicate that the Ministry issued imprests amounting to Kshs.11,003,556.00 for clearance of military goods imported through port of Mombasa and Kshs.20,201,600.00 for accommodation of Yugo Import SDPR J.P team from Serbia. However, no documentary evidence was obtained in terms of surrender payment vouchers to confirm that the total expenditure totalling Kshs.31,205,156.00 was authorized, lawful and that value for money was obtained as required under section 68 (1) and (2) of the Public Finance Management Act, 2012.

In addition, no explanation has been given for the direct procurement of accommodation, transport and provision of food for the Yugo Import team through imprest.

##### **1.3 Direct Expenditure-Kshs.56,351,780.00**

Although, Section 5.6 (d) of the Government Financial Regulations and Procedures require the accountant in charge of imprest section to certify on the imprest warrant (form F.O 24) that the applicant does not have an outstanding imprest and that he has recorded in the imprest register the amount of imprest applied for, the Ministry of Defence expensed imprests totalling Kshs.56,351,780.00 without imprests warrants and authorization of the accounting officer as required under section 68 (1) of the Public Finance Management Act, 2012.

In the absence of an imprest warrant or any documentary evidence coupled with the fact that supporting documents attached to payment vouchers are not signed, it is not possible to confirm that listed officers received and used Kshs.56,351,780.00 for hotel

accommodation in Mombasa, Nakuru, Eldoret, Gilgil, Isiolo, Rwanda, Ethiopia, France, Tunisia, United Kingdom, Addis Ababa, Southern Sudan and China.

However, the Ministry later availed signed schedules in support of payment vouchers which reveal that same officers were receiving imprests using different Identification card numbers in different payment vouchers. In addition, our letter Ref NS/AUDIT/24/87 dated 11 December 2014 requesting for the Program of Work and reports submitted during the year under review that would justify the expenditure had not been responded to at the conclusion of the audit.

#### **1.4 Overpayment of Kshs.19,637,700.54**

Examination of documents attached to availed payment vouchers in support of expenditures relating to regional and local study tours has revealed that members of the four (4) teams were paid based on rates which were above the approved rates resulting in over payment amounting to Kshs.19,637,700.54. No explanation or evidence of recovery has been provided for audit review.

#### **1.5 Irregularities on Procurement of Library Books Costing Kshs.9,999,895.00 to Kenya Navy Training School**

Although books valued at Kshs.9,999,895.00 were procured through LPO number 216892 dated 26 May 2014 and paid through voucher number 586 on 26 June 2014, audit has revealed the following anomalies: -

- (a) The procurement process was done through Direct Procurement method despite the fact that Kenyatta University is not the only supplier who could urgently supply these books.
- (b) Verification on 10 October 2014 revealed that these books had not been delivered, an indication that invoice No. KU/BSHP/Inv/Mn4122014 dated 28 May 2014 purportedly issued by Kenyatta University may not be genuine.
- (c) Further, there are indications that there was no urgency in the procurement of these books as they have not been delivered as at the date of audit which is one hundred and thirty two (132) days later.

### **2. Proposed Completion of Married Officers Quarters (Mqs) at 9KR Eldoret**

#### **2.1 Award of Contract and Contract Period.**

Examination of contract documents for the proposed completion of Officers MQS at 9KR Eldoret, indicate that the contract was competitively awarded to a contractor through Tender No. DODWKS/005/09/10 at a Contract sum of Kshs.141,686,693.00 on 9 June 2010 for a contract period of 52 weeks ending on 1 July 2011.

However, due to delays occasioned by the contractor, works delayed by one (1) year three (3) months and were officially handed over on 5 October 2012. Meanwhile, the Project remained under the contractor for maintenance for another seven (7) months when all defects are reportedly rectified and the certificate for making good all defects was issued on 13 June 2013.

#### **Scope of Work**

The scope of works consists of completion of 2No. Commandants' and 10 No. Majors/Captains' Houses in Eldoret, which include Civil, Mechanical and Electrical works as per specifications and Bills of Quantities (BOQ).

## **2.2 Payments**

According to records, the project was handed over on 13 June 2013, but payment vouchers amounting to Kshs.141,686,693.00 were not availed for audit verification.

## **2.3 Audit Inspection**

An audit inspection undertaken on 22 May 2014 revealed the following unsatisfactory matters: -

### **(i) Open storm water drain**

Although Kshs.4,203,210.00 was spent on open storm water drain in accordance with the BOQ, the quality of workmanship does not meet required specifications as evidence of cracks was observed.

### **(ii) Internal plumbing works and Internal Drainage**

Although Kshs.3,435,306.00 was spent on internal plumbing works and Internal drainage in accordance with the BOQ, bathroom drainage was blocked while taps and pipes are leaking, thereby casting doubt on the quality of materials used. In the circumstances, therefore, the value for money obtained from the amount spent of Kshs.3,435,306.00 could not be confirmed.

### **(iii) Quality of paint work**

Although the BOQ provided an amount of Kshs.6,345,660.00 for paint work, audit inspection revealed that the paint is already peeling off.

### **(iv) Roofing and Rainwater Disposal**

Although BOQ provided for rainwater and disposal valued at Kshs.2,749,335.00 for all the twelve (12) houses, an audit inspection revealed that there is a leakage at the chimneys and gutters.

## **3.0 Proposed Mechanical Piping and Associated Civil Works for Strategic Fuel Tanks**

### **3.1 Background**

There was an urgent need to have sufficient and readily available fuel in strategic tanks for the ongoing "Operation Linda Nchi" to ensure the tempo of the Operation was not interrupted. However, the existing fuel pipes connecting them to the link span were corroded and unserviceable, therefore, it was necessary to replace the rotten pipes to enable direct delivery of fuel into the tanks.

### **3.2 Award of Contract**

Examination of contract documents for the proposed Mechanical Piping and Associated Civil Works For Strategic Fuel Tanks indicates that the contract was awarded to a contractor through Direct procurement of Tender No.DODWKS/076/11/12 at a Contract sum of Kshs.19,445,018.00 on 23 February 2012.

### **3.3 Scope of Work**

The scope of works consists of mechanical pipe installations including concrete supports, fencing for the strategic tanks, gates, road kerbs and channels, a new pump house and associated electrical works as per specifications and Bills of Quantities (BOQ).

The completion date for works was 11 June 2013 for a period of thirty (30) weeks starting from 23 February 2012.

#### **Audit Inspection**

An audit inspection undertaken on 28 May 2014 revealed the following unsatisfactory matters: -

##### **Leakage of fuel**

Examination of fuel records revealed that over 240,000 Litres of Diesel with a value of Kshs.23,254,000.00 was delivered to the tanks. However, due to serious fuel leakages from the outlet valves, it was not possible to confirm that the fuel was properly stored and utilized for the intended purposes. In addition, leaking fuel is polluting the local environment.

Further, the project is purported to have been handed over on 14 June 2013, however, payment vouchers amounting to Kshs.15,474,150.00 have not been availed for audit verification, therefore, the validity and value for money could not be confirmed.

### **4.0 Audit of Financial Statements**

#### **4.1 Inappropriate Presentation and Disclosure of the Statement of Receipts and Payments**

The Kenya Defence Forces was and is still in breach of Section 289 (1) and (2) of the Kenya Defence Forces Act, 2012, which requires that Defence Forces should keep all books and records of account of the Income and Expenditure, Assets and Liabilities and Cash flow Statement which have not been submitted to the Auditor-General.

Similarly, the Statement of Receipts and Payments for the current year 2013/2014 reflects total payments of Kshs.81,262,885,000.00 out of which payments totaling Kshs.73,290,247,000.00, or 90 % of the total payments are shown as a block figure relating to military expenditure. The nature of this expenditure was not disclosed in terms of compensation of employees, use of goods and services, transfers to other Government units, acquisition of assets and other payments as required by the IPSAS which provides that payments should be classified according to the nature and their function. Consequently, it is not possible to audit this expenditure to ascertain its accuracy and completeness.

In addition, the Ministry of Defence is in breach of section 37(a) (i) and (ii) of the Public Audit Act 2003, which requires that electronic documents in terms of soft copy of bank statements for Camp Administration Unit A/c No. 100100902600 where Kshs. Kshs.2,246,229,396.15 was transferred during the month of June 2014 from the Ministry's Recurrent Account No.1000181435 has not been availed for audit review.

Consequently and due to absence of records, the validity and propriety of transferred amounts during the financial year 2013/2014 could not be confirmed.

#### **4.2 Inaccuracy of Statement of Assets**

The statement of assets for the year reflects a net financial position of Kshs.392,178,000.00 against cash and cash equivalents balance of Kshs.386,342,000.00 resulting in unexplained difference of Kshs. 5,836,000.00.

#### **4.3 Inaccuracy of Account Balance**

Note 5 to the financial statements on Use of Goods and Services indicates that a total expenditure of Kshs.159,562,000.00 includes Kshs.54,532,000.00 incurred under Other Operating Expenses. However, a verification of the ledger submitted for audit reveals that Kshs.6,046,000.00 relates to Other Operating Expenses while Kshs.40,889,000.00 relates to item 2630100, National Space Secretariat which has been established through a gazette notice number 5563 but is not operational.

In addition, there appears to be no justification for reserving huge financial resources to a Secretariat which is not operational as follows: -

<b>Financial Year</b>	<b>Amount in Budget (Kshs)</b>
2011/2012	500,000,000.00
2012/2013	550,000,000.00
2013/2014	558,000,000.00
2014/2015	605,000,000.00

Further, payment vouchers in support of these expenditures were not produced for audit verification, therefore, it was not possible to confirm the validity of the expenditure incurred in National Space Secretariat.

#### **4.4 Other Receipts from UN and Deposits**

Although, the Statement of Receipts and Payments reflects a receipt of Kshs.6,103,642,000.00 from UN Mission, evidence of actual transfer to the exchequer through bank statements and G-Pay records for the respective months of transaction have not been made available for audit review.

#### **4.5 Understatement of Revenue.**

The Statement of Receipts and Payments shows receipts from rent totalling Kshs.226,374,000.00 which differ by Kshs.52,137,391.85 from Kshs.278,511,392.15 reflected in the analysis of rent revenue provided. No explanation or reconciliation has been provided for audit review.

#### **4.6 Unsupported Clearances**

The Statement of Assets and Liabilities for Recurrent Vote 104 as at 30 June 2013 reflected balances under the Exchequer and G.A.V accounts of Kshs.4,740,017,784.00 and Kshs.4,529,149,068.86 respectively. Out of these balances, the Ministry only carried forward balances in respect of 2010/2011 of Kshs.258,661,000.00 and Kshs.66,067,000.00 for Exchequer and G.A.V accounts respectively, implying that 2012/2013 balances were cleared during the year. However no Treasury authority was sought for these clearances.

## **5.0 Prior Year Matters**

### **5.1 Purchase of Armoured Personnel Carriers (APCs)**

Audit of the procurement process of APCs has disclosed unsatisfactory matters summarized as follows: -

#### **(a) Purchase of Thirty Two (32) APCs**

The Ministry awarded the contract Ref. No. DOD/423/256/2005/2006 to a firm through restricted tendering at a contract sum of **USD 16,368,703.66** or Kshs.1,161,105,809.79 on 6 June 2006.

A final contract material inspection report which was to include a performance of quantitative, visual quality inspection and equipment serviceability state checks, has not been made available for audit review although the contract sum was fully paid.

#### **(b) Quality of Material Delivered**

The Ministry has explained through a letter Ref. No. DOD/FIN/218 VOL. I/005 dated 26 September 2013 and a letter Ref. No. MOSD/11/12A VOL. XV/70 dated 5 November 2013 that the firm won the tender competitively, the contract was signed and executed to the Ministry's satisfaction and firm was paid in full.

However, available records indicate that 32 APCs supplied in 2008 were deployed in Southern Sudan as part of the Kenyan contingent in UNMISS and are still there to date. The United Nations identified some flaws with the APCs in the field which included: -

- (i) The design of the vehicles on the top part allows water to enter into the vehicle which accumulates inside and has to be drained. The ingress of water could adversely affect the normal functioning of various systems in the vehicle which could only be corrected by covering them during rainy seasons by a canopy.
- (ii) The pneumatic system especially on the braking system was found to be faulty causing leakages in a few of the APCs because the manufacturer used plastic fiber at the pipe joints instead of using metallic parts which can withstand high pressure transmission.
- (iii) No provision was made for spare tyres for the APCs and the tyres available cannot withstand a puncture for any extra time as operational vehicles are expected to have self-sealing tyres which can go some distance after the puncture.
- (iv) The recovery vehicle lacks a rear door for easy access during stationery working, an omission which could only be corrected through modification to have a rear door for efficient use during recovery duties.
- (v) Faults in gear selection system and power source problems.
- (vi) Rust of some of internal parts which require greasing and repainting.

- (vii) The cover for the turret is worn out for all APCs and should be replaced with new ones to guard against damage as a result of direct exposure to sunlight and rain.

In the absence of a final inspection report together with the uncorrected flaws observed, it was not possible to confirm that the contract was executed to the satisfaction of the Ministry and that value for money was obtained from the expenditure amounting to US\$ 16,368,703.66 or Kshs.1,161,105,809.79.

**(c) Purchase of Seventy Five (75) APCs**

The Ministry awarded contract Ref. No. DOD/SYS/015/2007/2008 to a firm through restricted tendering at a contract sum of Euros 22,406,926.00 on 24 June 2008. Although the Ministry has now explained through article 19.2 of the Agreement that the contract lapsed because it was not fulfilled within four months, the explanation contradicts an earlier one which indicated that the contract was terminated due to lack of funds. In view of this, it is not clear how the contract could be awarded without funds and mutually wound without damages.

In addition, an examination of the Agreement indicates that a termination clause was not included among the General Contractual Conditions. Consequently, it has not been possible to confirm the circumstances under which the contract was terminated and that the Ministry did not incur any losses arising from contract claims.

**(d) Purchase of Seventy Six (76) APCs**

**(i) Award of Contract**

The Ministry awarded the contract Ref. No. MOD/SYS/029/2012/2013 to a firm through Direct Procurement at a contract sum of US\$ 51,584,235.00 on 15 October 2012. The Ministry has accepted that they used Direct Procurement method because APCs are Security items and are not off the shelf items and therefore, have to be tailored and manufactured as per specifications and that the contracted firm is the only entity which could supply APCs being procured in accordance with Section 74 (2) (a) of the Public Procurement and Disposal Act, 2005.

However, the Ministry has failed to justify the relevance of the initial purchases which were done through restricted tendering as required by Section 133 of the Public Procurement and Disposal Act, 2005 for procurement of security items, while the subsequent purchases of the same material were procured through direct procurement method. Although, the Ministry has explained that the firm is the only one which could supply APCs and had been tried and tested by KDF for the supply of the same in a UN Mission to South Sudan, the audit observed that the firm had earlier supplied 32 APCs which had numerous flaws and deficiencies, a confirmation that it was more logical to subject the contract to a competitive bidding process in accordance with the procurement law.

**(ii) Contract Payments**

The firm has so far been paid Kshs.3,982,824,974.46 in accordance with Article 6 on payment terms. However, the contract did not protect the interest of tax payers as

Kshs.3,107,337,338.05 was made based on the receipt of documents relating to delivery and not actual delivery of contracted materials.

These documents are listed as commercial invoice of equivalent sum; Bank guarantee of equivalent sum; Bill of Lading; Packing list; Insurance policy; Pre-shipment inspection certificate and Manufacturer's certificate of origin. Further US\$ 46,425,812 or 90% of the contract sum has so far been paid to the seller, an amount which is not commensurate with forty (40) APCs which have so far been delivered representing 52% of the contracted quantity.

### **(iii) Lack of Market Survey**

The Ministry of Defence did not undertake a market survey as required by Section 8 (3) Z of the Public Procurement and Disposal Regulations 2006 which states that a procuring entity shall carry out periodic market survey to inform the placing of orders or adjudication by the relevant award committee. Instead, the contracted firm, also interested in winning the contract, purports to have established market prices for APCs which confirmed that its bid prices were cheaper.

In view of the foregoing, it is clear that the firm dictated prices of APCs and usurped the role and responsibilities of the Ministry's staff. It is therefore, not possible to confirm that Kshs.3,982,824,974.46 which has so far been paid is in excess of the prevailing market prices as required under Section 10(2)(e) of the Public Procurement and Disposal Regulations, 2006.

### **(iv) Variation of Spare Parts Price**

An examination of contract records show that the seller was single sourced to quote for the supply of spare parts for 76 pieces of APCs for three (3) years at a cost of US\$ 5,915,781.00. However, during an unspecified meeting, it is reported that the seller was advised to work out the cost of spare parts based on a one year period and present in a subsequent meeting. During a follow up meeting, the technical committee members authorized the firm to supply spare parts for the 76 pieces of APCs for 1 year at a cost of USD 2,995,235 without any justification.

## **6.0 Statement of Assets and Liabilities for Recurrent**

### **6.1 Variance between PMG balance and Board of Survey Report**

The statement of Assets and Liabilities for Vote R108 shows Paymaster General Account debit balance totalling Kshs.195,414,261.55 while the Board of Survey report as at 30 June 2013 reflects an amount of Kshs.255,423,214.30 resulting in a difference of Kshs.60,008,952.75 which has not been reconciled or explained.

In addition, the ministry has not availed soft copies of the bank statements despite several requests, therefore, it is not possible to confirm the correctness of the reconciled cashbook balance.

## **6.2 Outstanding Temporary Imprest**

The statement reflects outstanding imprests amounting to Kshs.5,959,850.00 as at 30 June 2013 in contravention of Section 5.6.5 of Government Financial Regulations and Procedures.

## **6.3 Agency Account**

The Statement reflects a balance of Kshs.78,758,520.80 against Agency Account, which includes an amount of Kshs.9,005,298.80 which was received in 2012/2013 but was not utilized since the projects had been closed. These amounts ought to have been surrendered to various agencies on or before 30 June 2013. No explanation has been given for failure to surrender the same to the respective Agencies.

## **6.4 General Account Vote**

The Statement reflects an uncleared General Account Vote (GAV) credit balance of Kshs.4,529,068.00 as at 30 June 2013.

## **6.5 Suspense Account/Bank Reconciliation**

Although analysis has been availed in support of Suspense Account balance of Kshs.188,498,393.34, the reasons provided for failure to honour cheques include invalid account number, invalid account name and difference in account name. These reasons are not adequate and relevant to justify failure to clear the huge outstanding balances.

## **6.6 Advances**

The Statement reflects a debit balance of Kshs.14,960,160.45 against advances which have not been recovered in accordance with Section H.11 of the Code of Regulations. No reasons have been given for failure to recover the advances.

## **6.7 Clearance Account**

The Statement also shows a salary clearance account balance of Kshs.27,395,422.50 which includes an amount of Kshs.22,204,409.00 relating to 2011/2012 and earlier years which has not been cleared. No reason has been given for non-clearance of these balances.

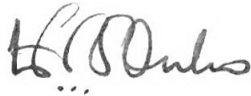
## **6.8 Excess Appropriation-In-Aid**

The Statement further shows Excess Appropriation-In-Aid amounting to Kshs.132,550,650.50 relating to 2010/2011 and previous years which has not been surrendered to the Treasury. No reasons have been provided for failure to surrender the excess Appropriation in Aid to the Exchequer.

## **Qualified Opinion**

In my opinion, except for the effect of the matters described in the Basis for Qualified Opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Ministry of Defence as at 30 June 2014 and of its financial

performance and its cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (Cash Basis of Accounting).



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

**Nairobi**

**2 April 2015**