

REPUBLIC OF KENYA



OFFICE OF THE AUDITOR-GENERAL

REPORT

OF

THE AUDITOR-GENERAL

ON

**THE FINANCIAL STATEMENTS OF
POLICY HOLDERS COMPENSATION FUND**

**FOR THE YEAR ENDED
30 JUNE 2018**



POLICYHOLDERS COMPENSATION FUND

ANNUAL REPORT AND FINANCIAL STATEMENTS

FOR THE FINANCIAL YEAR ENDED
30TH JUNE 2018

Prepared in accordance with the Accrual Basis of Accounting Method
under the International Public Sector Accounting Standards (IPSAS)

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1. KEY INFORMATION

(a) Background Information

The Policyholders Compensation Fund is a State corporation established under Section 179 of the Insurance Act and commenced its operations on 1st January, 2005.

(b) Principal Activities

The principal activities of the Fund are to protect the claimants of an insolvent insurer through provision of compensation for unpaid claims, participation in statutory management and liquidation of a wound up insurer.

(c) Key Management

The Fund's day-to-day operations are undertaken at a Secretariat overseen by a Managing Trustee who is accountable to a Board of Trustees which in turn is accountable to the Government of Kenya through the National Treasury.

(d) Fiduciary Management

The Fund operations are overseen by a Managing Trustee who is appointed by the Minister for Finance. The current Managing Trustee is the Retirement Benefits Authority (RBA) as contained in the Kenya Gazette Notice No. 3357 of 6th May, 2005.

The key management personnel who held office during the financial year ended 30th June, 2018 and who had direct fiduciary responsibility were:

#	Designation	Name
1	Representative of the Managing Trustee	Mr. Charles Machira
2	Head of Secretariat	Mr. John Keah
3	Internal Audit and Risk Management	Mrs. Elizabeth Waruingi

(e) Fiduciary Oversight Arrangements

The Audit and Risk Management Committee provides the Board of Trustees in their oversight role assurance for the integrity of the financial operations of the Fund, the performance of the Funds internal and external audit functions and compliance of the Fund with legal and statutory requirements.

I. KEY INFORMATION (CONT'D)

(f) Office

Policyholders Compensation Fund
Zep Re Place 2nd Floor
02 Longonot Road, Upper-Hill
P.O. Box 24203 -00100
Nairobi

(g) Contact

Telephone: (254)-020-4996236/7/8
Email: info@phcf.co.ke
Website: www.pcfkenya.org

(h) Bankers

Commercial Bank of Africa
Standard/Wabera Streets
P.O. Box 30457-00100
Nairobi

Co-operative Bank of Kenya
Upper Hill
P.O. Box 48231-00100
Nairobi

Kenya Commercial Bank
Moi Avenue
P.O. Box 30081-00100
Nairobi




(i) Independent Auditors

The Auditor - General
Office of the Auditor - General
Anniversary Towers, University Way
P. O. Box 30084 -00100
Nairobi

(j) Principal Legal Advisor

The Attorney - General
State Law Office
Harambee Avenue
P. O. Box 40112 - 00200
Nairobi

II. THE BOARD OF TRUSTEES

 <p>Mrs. Alice Nzioka Trustee</p>	<p>Mrs. Nzioka is the Manager, Technical Support Services at the Insurance Regulatory Authority with over 20 years' experience in insurance industry.</p> <p>As the alternate to the Commissioner of Insurance and Chief Executive Officer of the Insurance Regulatory Authority, she is an ex-officio member in the Board of Trustees and a member of the Finance & Management and Technical & Public Policy Committees.</p>
 <p>Mr Tom Gitogo Trustee BSc Eng, ACA,FCPA,CPS,MBA</p>	<p>Mr. Gitogo is the Group Chief Executive Officer of CIC Insurance Group. He has vast experience in Insurance, Accountancy and Audit professions spanning over 25 years.</p> <p>He was appointed as the trustee representing insurers carrying on long term business on 17th April 2015 and is the Chairman of the Finance & Management Committee until 16th April, 2018 when his term expired.</p>
 <p>Mr. Maurice Okumu Trustee LLM, LLB(HON) Dip ACII London</p>	<p>Mr. Okumu is a practicing advocate of the High Court of Kenya and a Chartered Insurer with over 15 years' experience in the insurance sector.</p> <p>He was appointed as a Trustee representing loss assessors on 17th April 2015 and is the Chairman of the Technical & Public Policy Committee until 16th April, 2018 when his term expired.</p>

POLICYHOLDERS COMPENSATION FUND






Representative of the Managing
Trustee
&
Secretary to the Board
MSc, BSc

Mr. Machira is an Actuary with over 20 years' experience in the Insurance and Pension sectors.

He was appointed on 15th November 2010 as the Representative of the Managing Trustee and Secretary to the Board

III. MANAGEMENT TEAM

 <p>Mr. Charles M. Machira MSc, BSc</p>	<p>Representative of the Managing Trustee and Secretary to the Board</p>
 <p>Mr. John S. Keah MBA, BSc</p>	<p>Head of Secretariat</p>
 <p>Mrs. Elizabeth Waruingi MBA, BA, CPA, CIA, CISA, CRMA</p>	<p>Internal Audit and Risk Management</p>

IV. BOARD OF TRUSTEES STATEMENT

It is our pleasure to present the annual report and financial statements of the Policyholders Compensation Fund for the financial year ended 30th June 2018.

During the year under review, the Fund witnessed a growing insurance sector in terms of insurance business and gross written premiums. It is on this background that the Fund also grew its asset base by 21% to KShs. 8.9 billion. This growth presents the Fund with the stability to fulfil its mandate of providing adequate compensation and protection to all insurance claimants of insolvent insurers in line with article 46 of the Constitution of Kenya, 2010 which gives consumers the right to protection of their economic interests and to compensation for loss. The Fund remains focused on upholding these rights for every insurance consumer in Kenya by working towards the achievement of its key result areas of developing a comprehensive compensation framework, providing for financial sustainability and increasing institutional capacity.

While the Fund works towards these goals, it also continues playing a proactive role in insurance resolution through its statutory management function. As the statutory manager of four insurance companies, the Fund has made strides towards the resolution of these cases and will pay compensation for all verified claim liabilities. It is in this regard, that the review of the compensation settlement process is ongoing and the efforts towards increasing its competencies to enable it effectively deliver on this important role have been sustained.

In recognition of its role as an industry stakeholder, the Fund remains committed to delivering on its mandate as a contribution to the development of the Republic of Kenya.

We therefore take this opportunity to appreciate the continued support of the trustees, management, staff and stakeholders for their commitment towards the Fund's mandate.

BOARD OF TRUSTEES

V. STATEMENT OF THE MANAGING TRUSTEE

The Managing Trustee of the Policyholders Compensation Fund is the Retirement Benefits Authority which was appointed with effect from 9th December, 2004 vide Kenya Gazette Notice No. 3357 dated 6th May, 2005.

Since the commencement of its operations, the Fund has witnessed a steady growth. This trend was maintained during the year under review and this report highlights some of the notable aspects of growth as follows:

a) Mandate

The scope of the Fund's mandate remains the protection of insurance consumers through the payment of compensation to the claimants of an insolvent insurer, participation in statutory management, undertaking the liquidation of a wound up insurer and facilitating the formulation of related policy.

During the year under review, the Fund continued with its efforts towards reviewing the compensation settlement framework and is optimistic that regulations to guide the implementation of the same will be formulated within the following financial year.

The Fund maintained its status as Statutory Manager of Blue Shield Insurance, Concord Insurance Limited, Standard Assurance and United Insurance. The resolution processes of each of the four insurers is at an advanced stage and the Fund is keen to conclude them effectively. The unsettled claims of these four insurers represent the immediate potential liabilities to the Fund and in expectation of compensation payments to the claimants, the Fund is working closely with various stakeholders to ensure an efficient payment process.

In anticipation of the successful implementation of the above initiatives, the Fund is better placed to undertake a proactive role in the development and promotion of stability in the insurance sector.

b) Management

The Fund is administered by the Board of Trustees which has delegated the daily operations to the Managing Trustee which in turn has seconded four staff to man the Secretariat of the Fund. During the year under review, the tenure of two trustees expired consequently increasing the number of vacant board seats to six, a situation that adversely affected the operations of the

Fund. Despite concerted efforts to get the vacancies filled, the political mood dominating the country in the year under review may have contributed to the delay in appointments. However, we are optimistic that the vacancies shall be filled in the forthcoming financial year. Resulting from the above, implementation of the Fund's institutional capacity initiatives was hampered and therefore there were no changes in the Fund's institutional capacity.

c) Levy collection

The Fund's original mandate is the payment of compensation. The funds for this purpose are collected from a statutory levy which is calculated at 0.5% of the insurance premiums paid to an insurer. In addition, the Fund also collects penalties charged either by itself or the Insurance Regulatory Authority (IRA) on insurers defaulting on specific sections of the Insurance Act.

During the year, there was a growth in the collection of levy by 8% to KShs 798,095,303 from KShs 736,900,523 in the previous year. The growth on levy collection was largely due to the increased volume of insurance premiums as a result of industry growth but also due to correct computation of payable levy by insurers, timely payments and improved levy management. With increased enforcement of the law and close cooperation with the IRA, this trend is expected to continue in the next financial year.

d) Investments

The Fund invests its surplus assets primarily in Government securities. During the year under review, the Fund generated an investment return of KShs. 792,097,053 by investing in Treasury Bills which represents an 11% growth from the previous year.

e) Administration Expenses

During the year, the Fund continued to maintain low administration expenses due to the fact that it has not been enabled to exercise its primary mandate of compensation payments. Overall administration expenses comprising of Board, Staff and Operational costs amounted to KShs. 27,193,319 compared to KShs. 24,112,504 during the previous year.

STATEMENT OF THE MANAGING TRUSTEE (CONT'D)

f) Net Asset Value


The upshot in the improved performance in levy collection, investment returns and low administration costs is a notable 21% growth in the net asset value of the Fund translating to KShs 8,929,381,810 from KShs. 7,355,555,188 in the previous year. The Fund is keen on maintaining this performance in order to be able to offer to fulfil its mandate of paying claimants effectively.

g) Strategic Partnerships

Fostering strategic partnerships is one of the Fund's strategic objectives. In this regard, the Fund is a member of the International Forum for Insurance Guarantee Schemes (IFIGS). During the year under review, the Fund continued to contribute to various initiatives undertaken by IFIGS aimed at developing best practices. As the only member from the African continent, the Fund maintained its position as the continent's representative and is developing strategies aimed at creating awareness about the importance of insurance guarantee schemes in the continent.

Conclusion

Though the Fund has not been enabled to pay out compensation, its appointment as statutory manager for several insurers is testament of its importance in the insurance sector. As a result, the Fund will continue to undertake its mandate diligently to ensure that insurance claimants will be adequately protected thereby contributing to the industry development through promotion of confidence.



CHARLES MACHIRA
REPRESENTATIVE OF MANAGING TRUSTEE

VI. CORPORATE GOVERNANCE STATEMENT

The Policyholders Compensation Fund is a State Corporation established in 2004 under section 179 of the Insurance Act.

Board Composition

The management of the Fund is vested in the Board of Trustees. At the onset of the year, the composition of the Board in the year under review was as follows:

Name	Membership	Representation
Ms. Alice Nzioka	Trustee	Alternate to Commissioner of Insurance
Mr. Tom Gitogo	Trustee	Representative of Insurers carrying on long term business (up to 16 th April 2018)
Mr. Maurice Okumu	Trustee	Representative of loss assessors (up to 16 April 2018)

Members of the board other than statutory members hold office for a period of three years and are eligible for re-appointment for a further one term.

As at 30th June, 2018, the Board was not fully constituted as the following seats were vacant:

- i. Chairman;
- ii. Representative of insurers carrying on general business;
- iii. Representative of Insurers carrying on long term business;
- iv. Representative of Insurance Brokers;
- v. Representative of special interests;
- vi. Alternate to the Principle Secretary – National Treasury,
- vii. Representative of loss assessors.

However, the Fund continues to engage with the National Treasury on the appointment of the above Trustees.

Trustees are required to disclose any conflict of interest in relation to matters that are brought before them for deliberation as stipulated in the Board Charter.

CORPORATE GOVERNANCE STATEMENT (CON'D)**Board Committees**

The Board has delegated its authority to standing committees to enable it effectively carry out its mandate. These Committees are described below and each has its own Terms of reference setting forth the purposes, goals and responsibilities as well as qualifications for membership and operational procedures.

The committees meet at least four times in a year or at such times the Chairman of the committee shall require but due to the Board Composition, the Committees had only three (3) meetings in the financial year 2017/2018 as follows:

i) Finance and Management Committee

The terms of reference of the committee are to review and make recommendations to the Board on financials, operations, budget and the annual accounts.

In the year under review the members of the committee were;

1. Tom Gitogo – Chairman
2. Alice Nzioka
3. Maurice Okumu

The committee held three (3) meetings.

ii) Technical and Public Policy Committee

The Technical and Public Policy committee responsibility is to review the technical and policy related aspects of the Fund to ensure it operates within statutory and best practice requirements.

The membership to this committee was as follows:

1. Maurice Okumu – Chairman
2. Alice Nzioka
3. Tom Gitogo

The committee held no meetings.

CORPORATE GOVERNANCE STATEMENT (CON'D)

iii) Audit and Risk Committee

The role of the committee is oversight of integrity of the financial statements of the Fund, performance of internal and external auditors and compliance with legal and regulatory requirements.

Members of the committee were:

1. Ndiritu Muriithi – Chairman
2. Alice Nzioka
3. Maurice Okumu

The committee held one (1) meeting.

Board Attendance

During the financial year 2017/2018, four (4) committee meetings were held. Attendance by individual members for the period is tabulated below:

Trustee	Board meetings		Committee Meetings	
	Held	Attended	Eligible	Attended
Tom Gitogo	0	0	4	4
Alice Nzioka	0	0	4	4
Maurice Okumu	0	0	4	4

Statement of Compliance

The Funds operations are legally guided by The Constitution of Kenya, 2010, the provisions of the Insurance Act Chapter 487 of the Laws of Kenya, the State Corporation Act, Chapter 446 of the Laws of Kenya and by the principles of good corporate governance.

The Fund continues to comply with all statutory requirements relevant to its operations as a body corporate and complies with relevant Government circulars issued from time to time.

Board Oversight

The Board is responsible for the formulation, implementation and monitoring of the Fund's Strategic Plan therefore providing appropriate strategic direction for the Fund. In addition, the Board defines the Vision, Mission and Core Values that enable the realization of the set Strategic Plan.

CORPORATE GOVERNANCE STATEMENT (CON'D)

The day to day operations of the Fund have been delegated to the Management which is headed by the Managing Trustee through its representative. Periodically, the Board monitors and evaluates the implementation of its plans and strategies through reports received from Management through its Committees.

Board Remuneration

The Board is remunerated in accordance to the approved terms and conditions of service prescribed under Government circular Number OP/CAB.2/12A (9) of 29th August 2003.

Secretary to the Board

The Secretary to the Board co-ordinates the Boards activities and ensures, in conjunction with the Chairman, that the Board meetings are held procedurally. In addition, the Secretary links the flow of information between the Board and management as well as ensuring the Board receives adequate and timely information.

All Trustees have direct access to the Secretary who is also responsible for implementing and monitoring good corporate governance practices, ensuring that Board business meets all statutory requirements, keeps all legal and regulatory requirements under review and briefs the Board accordingly about these developments

VII. MANAGEMENT DISCUSSION AND ANALYSIS

Fund Overview

The Policyholders Compensation Fund is a State corporation established under Section 179 of the Insurance Act and commenced its operations on 1st January, 2005.

The Fund's overall mandate is to protect insurance consumers through the provision of compensation to claimants of insolvent insurers, participate in statutory management of insurers placed under statutory management by the regulator and undertake liquidation as appointed by the Court.

Operational and Financial Reviews

The Fund's operations during the year under review were severely affected by the lean composition of the Board of Trustees. Consequently, key programs were unable to be undertaken translating to underutilization of the approved budgets by 56%.

The financial performance of the fund however improved with respect to revenues which grew by 10% to KShs 1.6 billion. Notably, investments contributed to 49% of the revenues highlighting the growing reserves of the fund.

With respect to the above, the Fund assets grew by 21% to KShs 8.9 billion. This accounts for 23% of all claims settled by the industry in 2016. It is therefore important that the Fund ensures it maintains an adequate asset to claims ratio to assure adequate compensation cover.

Compensation Rate.

Following its review in 2016, the compensation rates was maintained at KShs. 250,000.00 per claim. The Fund is currently working on the regulations required to facilitate the compensation pay-outs and it is key that the Government support continues to fast track the outcome.

Statutory Management

The Fund is currently the appointed Statutory Manager of four insurance companies, Standard Assurance, Concord Insurance, Blue Shield Insurance and United Insurance. It is important that the process of statutory management is efficient and effective to increase the chances of an insurer's revival. To this end, the Fund is in the process of developing a manual to guide the function. Although this is not the case with the four insurers under statutory management, the Fund with the help of the industry regulator is in the process of ensuring the ongoing resolution initiatives are concluded and a way forward determined.

VIII. CORPORATE SOCIAL RESPONSIBILY STATEMENT

The Fund, owing to its mandate and nature of operations, collaborates with other State Corporations in undertaking Corporate Social Responsibility (CSR) activities.

However, during the year under review, the fund did not participate in any CSR activities.

POLICYHOLDERS COMPENSATION FUND

VIII. REPORT OF THE BOARD OF TRUSTEES

The Trustees submit their report together with Financial Statements of the Policyholders Compensation Fund for the period ending 30th June 2018.

ESTABLISHMENT

The Policyholders Compensation Fund is a State corporation established under Section 179 of the Insurance Act and commenced its operations on 1st January, 2005.

PRINCIPAL ACTIVITIES

The principal activities of the Fund are to protect the policyholders of an insolvent insurer through provision of compensation for unpaid claims, participation in statutory management and liquidation of a wound up insurer.

RESULTS

The results for the year ended 30th June, 2018 are set out on page 20 of this report

BOARD OF TRUSTEES

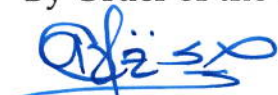
The Trustees who served during the current year are as follows:

Mrs. Alice Nzioka	Trustee - Alternate to Commissioner of Insurance
Mr. Tom Gitogo	Trustee - Representative of Insurers conducting Long term Business (up 16 April 2018)
Mr. Maurice Okumu	Trustee - Nominee of Insurance loss assessors (up to 16 April 2018)

AUDITORS

The Auditor General is responsible for the statutory audit of the Policyholders Compensation Fund in accordance with Section 12 of the Public Audit Act 2003 (Cap.12)

By Order of the Board



Charles Machira

Representative of the Managing Trustee and Secretary to the Board
POLICYHOLDERS COMPENSATION FUND

IX. STATEMENT OF THE BOARD OF TRUSTEES RESPONSIBILITIES

The Public Financial Management Act section 68 requires the Fund to prepare financial statements for each financial year. Financial statements include a statement of financial position showing in detail the assets and liabilities of the Fund, a statement of financial performance, a statement of cash flows and any other statements and accounts that may be necessary to fully disclose the financial position of the Fund. The State Corporations Act (Cap 446) requires the Fund to keep or cause to be kept proper books recording all the property, undertakings, funds, activities, contracts, transactions and other business of the Fund. Under the State Corporations Act, the Board of Trustees is responsible for the proper management of the affairs of a state corporation.

The Board of Trustees accepts responsibility for the annual financial statements, which have been prepared using appropriate accounting policies supported by reasonable and prudent judgments and estimates, in conformity with generally accepted accounting principles and in the manner required by the State Corporations Act. The Trustees are of the opinion that the financial statements give a true and fair view of the state of the financial affairs of the Fund and of its operating results. The Board of Trustees further accepts responsibility for the maintenance of accounting records which may be relied upon in the preparation of the financial statements, as well as adequate systems of internal control.

Nothing has come to the attention of the Board of Trustees to indicate that the Fund will not continue to operate as a "going concern" for at least the next twelve months from the date of this statement.



Managing Trustee



Trustee

Trustee

Date 28/09/2018



OFFICE OF THE AUDITOR-GENERAL

REPORT OF THE AUDITOR-GENERAL ON POLICYHOLDERS COMPENSATION FUND FOR THE YEAR ENDED 30 JUNE 2018

REPORT ON THE FINANCIAL STATEMENTS

Opinion

I have audited the accompanying financial statements of Policyholders Compensation Fund set out on pages 20 to 35 which comprise the statement of financial position as at 30 June 2018, and the statement of financial performance, statement of changes in net assets, statement of cash flows and statement of comparison of budget and actual amounts for the year then ended, and a summary of significant accounting policies and other explanatory information in accordance with the provisions of Article 229 of the Constitution of Kenya and Section 35 of the Public Audit Act, 2015. I have obtained all the information and explanations which, to the best of my knowledge and belief, were necessary for the purpose of the audit.

In my opinion, the financial statements present fairly, in all material respects, the financial position of Policyholders Compensation Fund as at 30 June, 2018, and its financial performance and its cash flows for the year then ended, in accordance with International Public Sector Accounting Standards (accrual basis) and comply with Insurance Act 2017.

Basis for Opinion

The audit was conducted in accordance with International Standards of Supreme Audit Institutions (ISSAIs). I am independent of Policyholders Compensation Fund in accordance with ISSAI 30 on Code of Ethics. I have fulfilled other ethical responsibilities in accordance with the ISSAI and in accordance with other ethical requirements applicable to performing audits of financial statements in Kenya. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Emphasis of Matters

Use of the Budget as a Control Tool

I draw attention to Part XV, Statement of comparison of budget and Actual Amounts and Note 20 to the financial statements which indicates that during the year under review, the fund posted very impressive surpluses of Kshs.1,573,826,622 (2016/17-Kshs1,427,259,626). The total fund net worth has now reached Kshs 8,929,381,810 (2016/17 - Kshs.7,355,555,188). An analysis of the budget revealed that the Fund management has been budgeting for administrative functions only and not financing its core mandate of compensating the policyholders. This can be exemplified by the fact

Report of the Auditor-General on the Financial Statements of Policyholders Compensation Fund for the year ended 30 June 2018

that the fund did not make any payment to any policyholders of the companies already under statutory management, hence putting to question of the funds ability to meet its core mandate. My opinion is not modified in respect of this matter.

Key Audit Matters

Key audit matters are those matters that, in my professional judgment, are of most significance in the audit of the financial statements. There were no Key Audit Matters to report in the year under review.

Other Matters

1. Lack of a Functional Board

As provided for under the Insurance Act Chapter 179(4), the Fund did not have a functional board during the year under review. The Fund's Board of Directors constituted of three (3) members only instead of the required five (5). Apparently during the year, no proper meetings were held and therefore the board could not execute any of its mandate effectively.

2. Lack of Substantive Governance Structure

During the year under review the Fund personnel constituted of five (5) members of staff all of whom are on secondment from the Retirement Benefits Authority. While secondment is a stopgap measure bridging a vacant position pending substantive recruitment, the Fund management has not filled the existing substantive positions. PSC Guidelines require staffs on secondment not to serve for a periods of more than 3 years.

REPORT ON LAWFULNESS AND EFFECTIVENESS IN USE OF PUBLIC RESOURCES

As required by Article 229(6) of the Constitution, based on the audit procedures performed, I confirm that, nothing has come to my attention to cause me to believe that public resources have not been applied lawfully and in an effective way.

The audit was conducted in accordance with ISSAI 4000. The standard requires that I comply with ethical requirements and plan and perform the audit to obtain assurance about whether the activities, financial transactions and information reflected in the financial statements are in compliance, in all material respects, with the authorities that govern them. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

REPORT ON EFFECTIVENESS OF INTERNAL CONTROLS, RISK MANAGEMENT AND GOVERNANCE

As required by Section 7(1) (a) of the Public Audit Act, 2015, based on the audit procedures performed, I confirm that, nothing has come to my attention to cause me to believe that internal controls, risk management and governance were not effective.

Report of the Auditor-General on the Financial Statements of Policyholders Compensation Fund for the year ended 30 June 2018

The audit was conducted in accordance with ISSAI 1315 and ISSAI 1330. The standards require that I plan and perform the audit to obtain assurance about whether effective processes and systems of internal control, risk management and governance were operating effectively, in all material respects. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my conclusion.

Responsibilities of Management and Those Charged with Governance

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

In preparing the financial statements, management is responsible for assessing the Fund's ability to continue as a going concern disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the management either intends to cease operations of the Fund, or have no realistic alternative but to do so.

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

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

Auditor-General's Responsibilities for the Audit

The audit objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion in accordance with the provisions of Section 48 of the Public Audit Act, 2015 and submit the audit report in compliance with Article 229(7) of the Constitution. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISSAIs will always detect a material misstatement and weakness when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

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

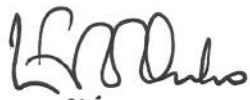
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from

fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances and for the purpose of giving an assurance on the effectiveness of the Fund's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the management.
- Conclude on the appropriateness of the management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Fund's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in the auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my audit report. However, future events or conditions may cause the Fund to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information and business activities of the Fund to express an opinion on the financial statements.
- Perform such other procedures as I consider necessary in the circumstances.

I communicate with the management regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that are identified during the audit.

I also provide management with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on my independence, and where applicable, related safeguards.



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

Nairobi

7 February 2019

**XI. STATEMENT OF FINANCIAL PERFORMANCE
FOR THE YEAR ENDED 30 JUNE 2018**

		2018	2017
	Notes	KSHS	KSHS.
Revenue from non-exchange transactions			
Contribution levy	3	798,094,303	736,900,523
Penalties	4	<u>2,078,584</u>	<u>508,301</u>
		<u>800,172,887</u>	<u>737,408,824</u>
Revenue from exchange transactions			
Investment income	5	792,097,053	704,963,306
Other Income	6	8,750,000	9,000,000
		<u>800,847,053</u>	<u>713,963,306</u>
Total Revenue		<u>1,601,019,940</u>	<u>1,451,372,130</u>
EXPENDITURE			
Board expenses	7	8,070,513	8,301,312
Employee cost	8	15,332,458	12,838,300
General expenses	9	2,998,289	1,990,077
Repairs & Maintenance	10	31,900	111,206
Contracted services	11	348,000	348,000
Finance cost	12	53,878	58,505
Depreciation	13	358,281	465,104
Total expenses		<u>27,193,319</u>	<u>24,112,504</u>
SURPLUS FOR THE PERIOD		<u>1,573,826,622</u>	<u>1,427,259,626</u>

The notes on page notes on page 25 to 35 form an integral part of these financial statements.

POLICYHOLDERS COMPENSATION FUND


XII. STATEMENT OF FINANCIAL POSITION AS AT 30 JUNE 2018

	Notes	2018 KSHS	2017 KSHS
ASSETS			
CURRENT ASSETS			
Receivable from non-exchange transaction	14	47,763,448	47,633,866
Receivable from exchange transactions		-	-
Investments	15	7,601,068,713	7,092,400,895
Cash and cash equivalents	16	<u>1,280,701,745</u>	<u>215,640,381</u>
		<u>8,929,533,906</u>	<u>7,355,675,142</u>
NON CURRENT ASSETS			
Property, plant and equipment	17	60,560	419,983
TOTAL ASSETS		<u>8,929,594,466</u>	<u>7,356,094,124</u>
CURRENT LIABILITIES			
Payables from exchange transactions	18	212,656	190,936
Provisions	19	=	<u>348,000</u>
		<u>212,656</u>	<u>538,936</u>
NET ASSETS		<u>8,929,381,810</u>	<u>7,355,555,188</u>
RESERVES			
Government Grant	21	35,000,000	35,000,000
Accumulated surplus		<u>8,894,381,810</u>	<u>7,320,555,188</u>
		<u>8,929,381,810</u>	<u>7,355,555,188</u>

The Financial statements on pages 20 to 35 were signed on behalf of the Board of Trustee
by:



Managing Trustee



Trustee

Trustee

**XIII. STATEMENT OF CHANGES IN NET ASSETS
FOR THE YEAR ENDED 30 JUNE 2018**

FUND RESERVE	KSHS
1 July, 2016	5,928,295,562
Changes in reserves for 2017	
Surplus for the year	<u>1,427,259,626</u>
Balance at 30 June, 2017	<u>7,355,555,188</u>
1 July, 2017	7,355,555,188
Changes in reserves for 2018	
Surplus for the year	<u>1,573,826,622</u>
Balance at 30 June, 2018	<u>8,929,381,810</u>

Note:

The purpose of the reserves is for the payment of compensation to the claimants of insolvent and liquidated insurance companies.

XIV. STATEMENT OF CASHFLOWS FOR THE YEAR ENDED 30 JUNE 2018

	Notes	2018 KSHS	2017 KSHS
Cash flow from operating activities			
Surplus for the year		1,573,826,622	1,427,259,626
Adjustments for:			
Depreciation on property, plant & equipment	17	358,281	464,904
Interest income		<u>(792,097,053)</u>	<u>(704,963,306)</u>
Surplus before working capital changes		782,087,850	722,761,224
 Increase in Levy receivable	14	(129,582)	448,084
(Decrease)/ Increase in payables	18,19	<u>(326,280)</u>	=
Net Cash from Operating Activities		781,631,988	723,209,308
 Cash flow from investing activities			
Purchase of property, plant and equipment	17	-	(91,579)
Increase in investments		(508,667,677)	(1,273,730,911)
Investment income		<u>792,097,053</u>	<u>704,963,306</u>
Net cash used in investing Activities		<u>283,429,376</u>	<u>(568,859,184)</u>
Net increase in cash & cash equivalents		1,065,061,364	154,350,124
Cash & cash equivalent at the beginning		<u>215,640,381</u>	<u>61,290,257</u>
Cash & cash equivalent at the end		<u>1,280,701,745</u>	<u>215,640,381</u>

XV. STATEMENT OF COMPARISON OF ACTUAL AND BUDGET AMOUNTS

	2018 KSHS BUDGET	2018 KSHS ACTUAL	KSHS VARIANCE
INCOME			
*Contribution levy	831,699,000	798,094,303	33,604,697
*Interest Income	581,694,168	792,097,053	(210,402,885)
Penalties	-	2,078,584	2,078,584
Other Income	-	8,750,000	8,750,000
	1,413,393,168	1,601,019,940	187,626,772
OPERATING EXPENDITURE			
*Board expenses	18,946,200	8,070,513	10,875,687
Managing Trustee	13,165,000	12,100,200	1,064,800
*Statutory management	14,400,000	3,000,000	11,400,000
Insurance expenses	100,000	-	100,000
Repairs & maintenance	300,000	31,900	268,100
Official entertainment	240,000	138,080	101,920
*Travel and accommodation	6,682,000	2,207,898	4,474,102
Office expenses	335,000	177,384	157,616
*Printing & stationery	978,800	4,901	973,899
*Public Education & Publicity	3,080,000	121,824	2,958,176
*Training & Development	1,550,000	232,258	1,317,742
Library expenses	111,800	60,080	51,720
Post & telephone	466,000	164,960	301,040
*Professional charges	2,000,000	348,000	1,652,000
Information technology	200,000	123,071	76,929
Bank Charges	150,000	53,878	96,122
Depreciation	-	358,372	-
TOTAL EXPENDITURE	62,704,800	27,193,319	
SURPLUS FOR THE YEAR		1,573,826,622	

*The variances are explained in note 20.

**XVI. NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018**

1. Statement of compliance and basis of preparation

The financial statements are prepared in accordance and comply with International Public Sector Accounting Standards (IPSAS). The financial statements have been prepared on a going concern basis and the accounting policies have been applied consistently throughout the period. The financial statements have been prepared on the basis of historical cost. The cashflow is prepared using the indirect method.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies adopted in the preparation of these financial statements are set out below.

(a) Income recognition

i) Revenue from non-exchange transactions

Contribution Levy and Penalties

The Fund recognizes revenues from levies and penalties when the event occurs and the asset recognition criteria are met. Other non-exchange revenues are recognized when it is probable that the future economic benefits or service potential associated with the asset will flow to the Fund and the fair value of the asset can be measured reliably.

ii) Revenue from exchange transactions

Interest income

Interest income is accrued using the effective yield method. The effective yield discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount. The method applies this yield to the principal outstanding to determine interest income each period.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018 (CONT'D)****(b) Budget information**

The annual budget is prepared on accrual basis, that is, all planned costs and income are presented in a single statement to determine the needs of the Fund.

As a result of the adoption of the accrual basis for budgeting purposes, there is no basis that would require reconciliation between the actual comparable amounts and the amounts presented as a separate additional financial statement in the statement of comparison of budget and actual amounts.

(c) Property, plant, equipment and depreciation

All property and equipment is initially recorded at cost and thereafter stated at historical cost less accumulated depreciation. Historical cost comprises expenditure initially incurred to bring the asset to its location and condition ready for its intended use.

Depreciation is calculated on the cost of each asset on a straight-line basis at annual rates estimated to write off the cost of the asset over its estimated useful life.

The Depreciation rates used are as follows.

Computers	33.3%
Office furniture & Equipment	12.5%

(d) Related parties

The Fund regards a related party as a person or an entity with the ability to exert control individually or jointly, or to exercise significant influence over the Fund, or vice versa. The Board of Trustees and members of key management, Retirement Benefits Authority and Insurance Regulatory Authority are regarded as related parties.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018 (CONT'D)

(e) Financial instruments

Financial assets and financial liabilities are recognised in the Fund's statement of financial position when the Fund becomes a party to the contractual provisions of the instrument.

Financial Assets

Receivables

Receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Fund provides money, goods or services directly to a debtor with no intention of trading the receivable.

Government securities

Government securities comprise treasury bills and treasury bonds which debt securities are issued by the Government of Kenya. Government securities are classified as held to maturity and are stated at amortised cost.

Short term deposits

Short term deposits are classified as held to maturity and are stated at amortised cost.

Financial liabilities

Trade payables

Trade payables are current and are stated at their nominal value.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018 (CONT'D)**

(f) Inventories

The Fund procures stationery and other inventories as and when need arises and are expensed in the period it relates.

(g) Provisions

Provisions are recognized when the Fund has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation.

(h) Nature and Fund reserve

The Fund maintains a general reserve which will be used to compensate policyholders of insurance companies that may be liquidated.

(i) Cash and cash equivalents.

For the purposes of the statement of cash flows, cash and cash equivalents comprise cash in hand, current account bank balances, and short term fixed deposits.

(j) Comparatives

Comparative figures have, where applicable, been adjusted to conform to changes in the current presentation.

(k) Provisions

Provisions are measured at the management's best estimate of the expenditure required to settle the obligation at the reporting date.

(l) Currency

The financial statements are prepared in Kenya Shillings (KShs.), rounded to the nearest shilling.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018 (CONT'D)**(m) Subsequent events**

There have been no events subsequent to the financial year end with a significant impact on the financial statements for the year ended June 30, 2018.

3. CONTRIBUTION LEVY

	2018 KShs	2017 KShs
Contribution Levy	<u>798,094,303</u>	<u>736,900,523</u>

As per section 179 (2) of the Insurance Act, Insurers are required to pay a levy on gross direct premiums written at a rate prescribed by the Cabinet Secretary. The rate is currently at 0.5%.

4. PENALTIES

	2018 KShs	2017 KShs
Penalties	<u>2,078,584</u>	<u>508,301</u>

The Insurance Act Section 179 requires insurers to pay a penalty of 2.5% of any overdue levy amount. Additionally, late submissions of return to the Insurance Regulatory Authority and delay in claims settlement also attract a penalty payable into the Fund.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018 (CONT'D)**

5. INVESTMENT INCOME

	2018	2017
	KShs	KShs
Interest from Treasury Bills	792,097,053	703,026,611
Interest from term deposit	-	<u>1,936,695</u>
	<u>792,097,053</u>	<u>704,963,306</u>

Nil interest earned from term deposit due to implementation of cash management guidelines in the National Treasury circular No.15/2016.

6. OTHER INCOME

	2018	2017
	Kshs	Kshs.
Other Income	8,750,000	9,000,000

This is income the Fund earned as management fees for Statutory Management services for the four insurers placed under statutory management by the Commissioner of Insurance. The four companies are Blue Shield Insurance Company, Concord Insurance Company, Standard Assurance Company and United Insurance Company.

7. BOARD EXPENSES

	2018	2017
	Kshs	Kshs
Honoraria	-	583,170
Sitting allowances	498,000	400,000
Lunch allowances and snacks	262,540	128,883
Seminars, travel and accommodation	7,092,753	7,189,309
Insurance	203,220	-
Airtime	<u>14,000</u>	-
	<u>8,070,513</u>	<u>8,301,312</u>

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018 (CONT'D)**

8. EMPLOYEE COST

Representative of Managing Trustee	600,000	600,000
Secretariat	11,500,200	8,635,100
Statutory management	3,000,000	3,000,000
Training	<u>232,258</u>	<u>603,200</u>
	<u>15,332,458</u>	<u>12,838,300</u>

9. GENERAL EXPENSES

	2018	2017
Travel and accommodation	2,207,898	1,114,228
Information technology	123,071	247,137
Office expenses	177,384	98,560
Official entertainment	138,080	102,245
Printing and stationery	4,901	46,838
Library	60,080	46,340
Postage and telephone	164,960	264,593
Public education and publicity	121,824	-
Insurance	-	70,136
	<u>2,998,198</u>	<u>2,630,588</u>

10. REPAIRS & MAINTANANCE

	2018	2017
General office repairs	31,900	111,206

11. CONTRACTED SERVICES

	2018	2017
Contracted services	348,000	348,000

12. FINANCE COST

	2018	2017
Bank charges	53,878	58,505

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018

13. DEPRECIATION	2018	2017
Fixed assets charge	358,281	465,104

14. RECEIVABLES FROM NON EXCHANGE TRANSACTIONS

	2018	2017
	KShs	KShs
Contribution levy	<u>47,763,448</u>	<u>47,633,866</u>

This is contribution levy for June 2018 receivable in July 2018.

15. INVESTMENTS	2018	2017
	KShs	KShs
Treasury bills	<u>7,601,068,713</u>	<u>7,092,400,895</u>

The interest rate was 11% as at 30th June 2018. Treasury bills are stated at cost plus accrued interest.

16. CASH AND CASH EQUIVALENTS	2018	2017
	Kshs	Kshs
Commercial Bank of Africa		
Operational	4,884,023	2,848,905
Fund	1,275,448,085	205,531,701
Kenya Commercial Bank	68,920	6,971,375
Cooperative Bank of Kenya	239,454	243,414
Cash on hand	38,663	44,986
Imprest	22,600	-
	<u>1,280,701,745</u>	<u>215,640,381</u>

The Fund account balance was awaiting investment in Treasury Bills.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018

17. PROPERTY, PLANT & EQUIPMENT

	Computer Equipment 33.3% Kshs.	Office Furniture & Equipment 12.5% Kshs.	Total Kshs.
Cost			
At 01 July 2016	2,654,419	384,153	3,038,380
Additions	91,579	-	91,579
Disposal	-	-	-
At 30 June 2017	2,695,817	384,143	3,129,959
Depreciation			
At 01 July 2017	1,390,901	355,167	1,746,068
Charge for the year	456,266	8,838	465,104
Disposal	-	-	-
At 30 June 2017	2,339,576	371,448	2,711,118
<u>Net book value</u>			
At 30 June 2017	407,423	13,898	419,983
At 30 June 2016	792,757	22,736	792,306
Cost			
At 01 July 2017	2,654,419	384,143	3,129,959
Additions	-	-	-
Disposal	-	-	-
At 30 June 2017	2,654,419	384,143	3,129,959
<u>Depreciation</u>			
At 01 July 2017	2,248,273	371,448	2,711,118
Charge for the year	345,586	12,695	358,281
Disposal	-	-	-
At 30 June 2018	2,593,859	384,143	3,369,399
<u>Net book value</u>			
At 30 June 2018	60,560	-	60,560
At 30 June 2017	407,423	13,898	419,983

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018

18. PAYABLES FROM EXCHANGE TRANSACTIONS

	2018 KShs	2017 KShs
Sundry creditors	<u>212,656</u>	<u>190,936</u>

19. PROVISIONS

	2018 KShs	2017 KShs
Audit fees	=	<u>348,000</u>

20. STATEMENT OF COMPARISON OF ACTUAL AND BUDGET AMOUNTS

INCOME	VARIANCE	NOTE
Interest Income	(210,402,885)	Due to increase in volumes invested in Treasury bills.
Contribution levy	33,604,697	The industry growth was projected at 10% but 8% was realized.
EXPENSES		
Board expenses	10,875,687	The Board of Trustees was not fully constituted due to vacancies arising from expiry of terms.
Statutory management	11,400,000	Recruitment of staff to increase capacity of this function affected by restrictions of employment in Government agencies.
Travel and accommodation	4,474,102	Affected by limited operational activities resulting from delayed compensation process and deferred training.
Printing & stationery	973,899	Delay in printing of annual accounts.
Public Education & Publicity	2,958,176	Various planned outreach activities related to compensation not undertaken due to delayed compensation process.
Training & Development	1,317,742	Training for anticipated new recruit's not undertaken following freeze of recruitment.
Professional charges	1,652,000	Services related to compensation process, recruitment and public education not undertaken due to above reasons.

**NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR
ENDED 30 JUNE, 2018**

21. GOVERNMENT GRANT

The Government grant was seed capital provided to the Fund by Government of Kenya in two financial years, Kshs. 15 million in 2005/2006 and Kshs 20 million in 2006/2007. The grant was not refundable and was immediately invested.

22. CONTINGENT LIABILITY

In anticipation the payment of compensation to claimants of insolvent insurers, the Fund acknowledges the amount payable as compensation as a contingent liability it will incur in future.

23. PROGRESS ON FOLLOW UP OF AUDITOR RECOMMENDATIONS

Audit recommendations for financial year 2016/2017 were cleared before issuance of the audit report.