THE REPUBLIC OF UGANDA

REPORT OF THE AUDITOR GENERAL

ON THE FINANCIAL STATEMENTS OF ENERGY FOR RURAL TRANSFORMATION PROJECT (ERT II) IDA CR. NO.4554-UG AND GEF TRUST FUND GRANT AGREEMENT NO. TF: 094484 IMPLEMENTED BY RURAL ELECTRIFICATION AGENCY

FOR THE YEAR ENDED 30TH JUNE, 2015

OFFICE OF THE AUDITOR GENERAL
KAMPALA, UGANDA
# TABLE OF CONTENTS

LIST OF ACRONYMS............................................................................................................................... iii

DETAILED REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF ENERGY
FOR RURAL TRANSFORMATION PROJECT II (ERT II) IMPLEMENTED BY REA FOR THE
FINANCIAL YEAR ENDED 30TH JUNE 2015....................................................................................... 5

1.0 INTRODUCTION ................................................................................................................................. 5

2.0 PROJECT BACKGROUND .................................................................................................................... 5

3.0 PROJECT ACTIVITIES ......................................................................................................................... 6

4.0 AUDIT SCOPE ..................................................................................................................................... 6

5.0 PROCEDURES PERFORMED ............................................................................................................... 7

6.0 FINDINGS ........................................................................................................................................... 8

6.1 Categorization of audit findings ......................................................................................................... 8

6.2 Summary of audit findings .................................................................................................................. 9

6.3 Non commitment of UMEME to the contact ..................................................................................... 9

6.4 Supply of PV solar systems by contracted companies ....................................................................... 9

6.4.1 Malpractices in the implementation of the solar subsidy program ............................................. 9

6.4.2 Non-compliance with contractual obligations by board and solar companies ...................... 10

6.4.3 Lack of an efficient solar subsidy awareness program .............................................................. 11

6.5 Improper management of Audits by end-user auditors ................................................................. 11

6.5 Failure to deliver the project to intended project areas ................................................................. 12
# LIST OF ACRONYMS

<table>
<thead>
<tr>
<th>ABBREVIATION</th>
<th>MEANING</th>
</tr>
</thead>
<tbody>
<tr>
<td>ERT II</td>
<td>Energy for Rural Transformation Project II</td>
</tr>
<tr>
<td>GAAPs</td>
<td>Generally Accepted Accounting Principles</td>
</tr>
<tr>
<td>GEF</td>
<td>Global Environment Facility</td>
</tr>
<tr>
<td>IDA</td>
<td>International Development Association</td>
</tr>
<tr>
<td>MEMD</td>
<td>Ministry of Energy and Mineral Development</td>
</tr>
<tr>
<td>OBA</td>
<td>Output Based Aid</td>
</tr>
<tr>
<td>PEAP</td>
<td>Poverty Eradication Action Plan</td>
</tr>
<tr>
<td>PPDA</td>
<td>Public Procurement and Disposal of Assets</td>
</tr>
<tr>
<td>PV</td>
<td>Photo Voltaic</td>
</tr>
<tr>
<td>PVTMA</td>
<td>Photo Voltaic Target Market Approach</td>
</tr>
<tr>
<td>REA</td>
<td>Rural Electrification Agency</td>
</tr>
<tr>
<td>REB</td>
<td>Rural Electrification Board</td>
</tr>
<tr>
<td>REF</td>
<td>Rural Electrification Fund</td>
</tr>
<tr>
<td>SDR</td>
<td>Special Drawing Rights</td>
</tr>
<tr>
<td>UG</td>
<td>Uganda</td>
</tr>
<tr>
<td>UGX</td>
<td>Uganda Shillings</td>
</tr>
<tr>
<td>USD</td>
<td>United States Dollars</td>
</tr>
<tr>
<td>WENRECO</td>
<td>West Nile Rural Electrification Company</td>
</tr>
</tbody>
</table>
REPORT AND OPINION OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF ENERGY FOR RURAL TRANSFORMATION PROJECT II (ERT II) RURAL ELECTRIFICATION AGENCY IDA CREDIT AGREEMENT NO.4554 - UG FOR THE YEAR ENDED 30TH JUNE, 2015

THE RT. HON. SPEAKER OF PARLIAMENT

I have audited the Financial Statements of Energy for Rural Transformation Project II (ERT II) implemented by Rural Electrification Agency (REA) for the year ended 30th June, 2015. These financial statements comprise of the Fund Balance Statement, Statements of Receipts and Payments and, a summary of significant accounting policies and other explanatory notes.

Management Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the Financial Statements in accordance with the Government of Uganda and donor regulations and guidelines. This responsibility includes designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of Financial Statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies and making accounting estimates that are reasonable in the circumstances.

Auditor’s Responsibility

My responsibility as required by Article 163, of the Constitution of the Republic of Uganda, 1995 (as amended) is to express an opinion on the Financial Statements, based on my audit. I conducted my audit in accordance with International Standards on Auditing. Those Standards require that I comply with the ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the Financial Statements. The procedures selected depend on the Auditor’s judgment, including the assessment of 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 entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the
reasonableness of accounting estimates made by management as well as evaluating the overall presentation of the financial statements.

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

Part “A” of this report sets out my opinions on the financial statements and Special Accounts Statements. Part “B” which forms an integral part of this report presents in detail all the significant audit findings made during the audit which have been brought to the attention of management.

PART "A"

Opinion

In my opinion, the Financial Statements present fairly in all material respects, the financial position of Energy for Rural Transformation Project II – Rural Electrification Agency Component as at 30th June, 2015 and of its receipts and expenditure for the year then ended, in accordance with the basis of accounting set out in note 9.1 (a) to the financial statements and in conformity with the donor reporting guidelines and terms and conditions.

Other Matter

Without qualifying my opinion, I draw your attention to the following matter that I consider significant:-

- **Malpractices in the implementation of the solar subsidy program**
  
  An independent audit of the implementation of the solar subsidy program by the Internal Audit department of Rural Electrification Agency (REA) indicated a number of malpractices such as claims for non-existent installations and double billing.

John F.S. Muwanga

**AUDITOR GENERAL**

7th December, 2015
REPORT OF THE AUDITOR GENERAL ON THE SPECIAL ACCOUNTS OPERATIONS
ENERGY FOR RURAL TRANSFORMATION PROJECT II (ERT II)

RURAL ELECTRIFICATION AGENCY

FOR THE YEAR ENDED 30TH JUNE, 2015

During the course of audit of Energy for Rural Transformation Project II (ERT II) – Rural Electrification Agency together with the notes thereon for the year ended 30th June 2015, I examined the Special Accounts Statements of the Project under the Loan and Grant Agreements.

Management Responsibility for the Special Accounts Statements

Management is responsible for the preparation and fair presentation of the special accounts statements on the basis of cash deposits and withdrawals for the purpose of complying with the Financing Agreement and for such internal controls as Management determines is necessary to enable the preparation of the statement that is free from material misstatement whether due to fraud or error.

Auditor’s Responsibility

My responsibility is to express an opinion on the Special Account Statements, based on my audit. I carried out the audit in accordance with International Standards on Auditing. Those standards require that I comply with the ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the statement is free from material misstatement.

An audit involves performing audit procedures to obtain audit evidence about the amounts and disclosures in the Financial Statements. The procedures selected depend on the auditor’s judgment, including the assessment of 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 entity’s internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management as well as evaluating the overall
presentation of the financial statements. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

**Opinion**

In my opinion, the receipts were properly accounted for and withdrawals were made for the purposes of the programme in accordance with the Financing Agreements. The special accounts statements and notes thereon fairly present in all material respects the account operations for the year ended 30th June, 2015 in accordance with the basis of accounting described under note 9.1(a) to the financial statements and in conformity with the donor reporting guidelines and terms and conditions.

John F. S. Muwanga

**AUDITOR GENERAL**

7th December, 2015
This Section outlines the detailed audit findings, management responses, and my recommendations in respect thereof.

1.0 INTRODUCTION

Article 163 (3) of the Constitution of the Republic of Uganda, 1995 (as amended) requires me to audit and report on the public accounts of Uganda and all public offices including the courts, the central and local government administrations, universities, and public institutions of the like nature and any public corporation or other bodies or organizations established by an Act of Parliament. Accordingly, I carried out the audit of the project to enable me report to Parliament.

2.0 PROJECT BACKGROUND

The purpose of the ERT project is to develop and increase access to energy and information and communication technologies in rural Uganda. ERT also aims to develop Uganda’s energy and information/communication technologies sectors, so as to make a significant contribution to rural transformation.

ERT supplements the Poverty Eradication Action Plan (PEAP) and the National Development Action Plans. They depend in part upon provision of infrastructure and functioning social services to promote growth and reduce poverty.

ERT (REA Component) supplements the Rural Electrification Fund (REF) that is administered by the Rural Electrification Board (REB). The Rural Electrification Agency (REA) is the secretariat for the REB. Both REB and the REA are set up by a statutory instrument No.75, of 2001 under the Electricity Act, 1999.

In November 2001 the World Bank approved the Energy for Rural Transformation Project as a three-phase Adaptable Program Loan (APL). Phase One activities of the project were closed in February 2009, paving way for ERT II.

In August 2007, Government of Uganda and the World Bank signed two financing agreements; a credit agreement for SDR 49.5 million and a grant of USD 9 million for implementation of ERT II.

Project implementation is done under two components namely:

i.  *Component 1*: Rural Energy Infrastructure.

ii. *Component 2*: Information Communication techniques, energy development, cross sectional links and impact monitoring.

The Rural Electrification Agency is implementing Component 1.

3.0 PROJECT ACTIVITIES

The principal activity of the project is to provide supporting activities for the preparation and implementation of rural electrification projects in Uganda such as promotion campaigns, gathering information on rural investment opportunities and costs and promoting the productive uses of electricity.

4.0 AUDIT OBJECTIVES

The audit was carried out in accordance with International Standards on Auditing and accordingly included a review of the accounting records and agreed procedures as was considered necessary. In conducting my reviews, special attention was paid to the following:

a) Whether the Project managers are managing the Project in accordance with the Financing Agreement requirements;
b) Whether all donor funds have been used in accordance with conditions of the Financing Agreements, with due attention to economy and efficiency and only for the purposes for which the financing was provided;

c) Whether counterpart funds have been provided and used in accordance with the conditions of the Financing Agreements, with due attention to economy and efficiency and only for the purpose for which they were provided;

d) Whether goods and services financed have been procured in accordance with the Financing Agreements and in accordance with the donor rules and procedures;

e) Whether all necessary supporting documents, records and accounts have been kept in respect of all Project activities and whether linkages exist between the books of account and the financial statements;

f) Whether the special accounts have been maintained in accordance with the provisions of the Financing Agreements and in accordance with the donor regulations and procedures; and

g) Whether the financial statements present a true and fair view of project financial position as at 30th June 2014, and its receipts and expenditure incurred for the period, in conformity with Generally Accepted Accounting Principles (GAAP).

5.0 PROCEDURES PERFORMED

a. **Revenue**

   Obtained all schedules of funds provided by IDA, GEF and Government of Uganda and reconciled the amounts to the Project’s cashbooks and bank statements.

b. **Expenditure**

   Vouched transactions including Statements of Expenditure and Financial Monitoring Reports used for submission of withdrawal applications during the period to establish whether documentation in support of expenditure agreed with the amount and description on the vouchers and/or applications and bank statements, and was properly controlled and accounted for.

c. **Internal Control System**

   Reviewed the internal control system and its operations to establish whether sound controls were applied throughout the period.
d. **Procurement**

Reviewed the procurement of goods and services under the Project during the period under review and reconciled with the approved procurement plan.

e. **Fixed Assets Management**

Reviewed the use and management of the project assets during the period under review.

f. **Periodic Reports about the project Activities**

Reviewed the Agreement provisions, operational manual and reports and reconciled it with the Programme activities during the period under review.

g. **Project Financial Statements**

Examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements; assessed the accounting principles used and significant estimates made by management; as well as evaluating the overall financial statement presentation.

6.0 **FINDINGS**

6.1 **Categorization of audit findings**

The following system of profiling of the audit findings has been adopted to better prioritize the implementation of audit recommendations.

<table>
<thead>
<tr>
<th>Category</th>
<th>Description</th>
</tr>
</thead>
</table>
| 1 | **High significance**
Has a significant / material impact, has a high likelihood of reoccurrence, and in the opinion of the Auditor General, it requires urgent remedial action. It is a matter of high risk or high stakeholder interest. |
| 2 | **Moderate significance**
Has a moderate impact, has a likelihood of reoccurrence, and in the opinion of the Auditor General, it requires remedial action. It is a matter of medium risk or moderate stakeholder interest. |
| 3 | **Low significance**
Has a low impact, has a remote likelihood of reoccurrence, and in the opinion of the Auditor General, may not require much attention, though its remediation may add value to the entity. It is a matter of low risk or low stakeholder interest. |
6.2 Summary of audit findings

<table>
<thead>
<tr>
<th>No.</th>
<th>Title of finding</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Non-commitment of UMEME to the contract</td>
<td>High</td>
</tr>
<tr>
<td>2</td>
<td>Malpractices in the implementation of the solar subsidy program</td>
<td>High</td>
</tr>
<tr>
<td>3</td>
<td>Improper management of Audits by end-user auditors</td>
<td>High</td>
</tr>
<tr>
<td>4</td>
<td>Non-compliance with contractual obligations by board and solar companies</td>
<td>Moderate</td>
</tr>
<tr>
<td>5</td>
<td>Lack of an efficient solar subsidy awareness program</td>
<td>Moderate</td>
</tr>
</tbody>
</table>

7.0 DETAILED FINDINGS

7.1 Supply of PV solar systems by contracted companies

7.1.1 Malpractices in the implementation of the solar subsidy program

The Rural Electrification Board signed contracts with various solar PV companies with an objective of installing subsidized solar panels to various end-users (individual and commercial). Upon verification of the installations by the auditors, REA disburses the subsidy amounts to the companies.

An independent audit of the operations of the solar PV companies by the Internal Audit department revealed a number of anomalies, some of them with intention to defraud the Agency;

- Some companies invoiced REA for systems installed using the cash supply method contrary to the contracted credit facility method or pay-plan model. This increased the risk that a company would sell the panel at full cost and still invoice REA for the subsidy.
- Subsidies were claimed for beneficiaries reported as being members of SACCOs where as they were not so as to cover up the cash sales.
- Some companies claimed for non-existent installations.
- Some companies invoiced REA for systems at the commercial rate yet they were in fact solar home systems.
- REA was invoiced for solar panels that had been donated by third parties or fully sponsored by NGOs.
• Instances were found of the same systems billed twice with different names and phone numbers.
• Many beneficiaries continued to pay for after sales services even in the warranty period i.e. bulbs, transport, panel cleaning etc.

Despite the above findings it was noted that the companies implicated continued to operate under the solar subsidy program and were paid a total of UGX 732,428,850 during the year.

Doing business with service providers who are not truthful has a high reputation risk.

The Accounting Officer explained that;
• An investigative review was carried out and each of the companies with anomalies was asked to respond accordingly. The companies that had immaterial anomalies were then asked to rectify them before any further payments were made.
• Three (3) solar companies that were suspected to have committed fraud were given letters of intent to terminate the respective subsidy agreements and no further payments have been made to them.
• The Board terminated the services of the PVTMA Contract Management team for gross negligence and also instructed management to determine the full extent of the anomalies against the implicated companies as a basis of taking more measures against them.

I advised the Accounting Officer to strengthen the monitoring of these operations and hold the implicated companies accountable. All funds improperly invoiced and paid to these companies should be recovered.

7.1.2 Non-compliance with contractual obligations by board and solar companies
Clause 7.12 of the contract between the Rural Electrification Board and the solar companies requires representatives of the board and the Solar companies to meet on a quarterly basis to evaluate the progress or implementation of the project.
It was however noted that no quarterly meetings have been held by both parties. Without the expected meetings and regular monitoring, it is difficult to continuously
assess performance of the scheme and take any corrective measures in case of any shortcomings.

I advised Management to ensure that the quarterly meetings are convened and progress reports prepared and reviewed for any possible intervention.

7.1.3 **Lack of an efficient solar subsidy awareness program**

Under the PVTMA Manual and in their respective contracts, the solar companies were not obliged to create awareness of the subsidy. As a result it was noted that there were no sensitization programs to enable end users of the solar equipment to understand and appreciate the subsidy. It was also noted that the end-user auditors withheld information from the system owners.

Without the awareness programs, there are risks such as the consumers not being aware of the pricing and how much they were required to pay.

The Accounting Officer explained that this program targets a specific segment of the population (the rural poor) residing in locations distant from the national grid who cannot afford to meet the upfront cost of the initial installation. The most effective communication strategy was therefore to develop and distribute materials to these specific audiences. In addition the end-user auditors were also required to sensitize the beneficiaries usually at the time when they went out to undertake field verifications prior to making recommendations for subsidy disbursement.

I advised the Accounting Officer to put in place a proper sensitization program so as to mitigate the risks and possible losses.

7.2 **Improper management of Audits by end-user auditors**

The Rural Electrification Agency Board signed contracts with various private engineering consultants to undertake end-user auditing and verification of solar PV systems installed by PV companies through the PVTMA program to enable REA disburse consumer subsidies.
However, details from the review of the internal audit report indicated that the private auditors did not do what they were engaged to do. The following issues were particularly noted;

- The end-user auditors did not consistently verify the PV installations as a result, the consultants invoiced REA and got paid for services not done in respect of systems they did not actually inspect.
- REA was furnished with insufficient and inaccurate information about beneficiaries.
- Some consultants surrendered 19 of their audit system verification stickers to 2 PV companies for purposes of affixing them to installations without carrying out physical inspections.
- A number of inspection reports had beneficiary information that had been altered by the end user auditors or the company like phone numbers, names and locations.

As a result of not having this undertaking well executed, there were a number of anomalies as observed above in paragraph 6.4.

The Accounting Officer explained that the group of 3 (three) end-user auditors who were the subject of the investigative audit review had been identified and had pending claims for professional fees of UGX. 17.6 million which will not be paid to them because of their involvement in the mismanagement of the PV Subsidy Program. He also indicated that any payment that was made for non-existent installations will be refunded by the companies. As a way forward, Internal Audit was undertaking field verifications before payments for professional fees are effected.

I advised the Accounting Officer to strengthen the monitoring of these solar PV operations and ensure proper verification of the work of the end-user auditors before they are paid.

7.5 **Failure to deliver the project to intended project areas**

Given the fact that UMEME controls over 85% of the national coverage, the untimely withdraw from the program by UMEME implies that the benefits of the project will not be delivered to the public in the areas under the coverage of UMEME.
Management explained that UMEME was part of the initial process and their connection projections were included in the development of technical specifications but they were not responsive when the materials were delivered. Management later took a decision to redistribute the materials to other service operators. In addition, REA had created a department in charge of Service Territory Development and Operation to among other things supervise the storage and use of connection materials.

I advised Management to avoid commitment of public funds without binding agreements and commitment with private service providers. Meanwhile, I await the outcomes of Management efforts.

7.6 **Non commitment of UMEME to the contact**

Rural Electrification Agency (REA) signed contracts with the suppliers for the supply and delivery of electricity connection materials worth USD.5,358,943.28 to various service territory operators that include Kilembe Investments Ltd, PACMECS, Ferdsult Engineering Services Ltd, BECS, WENRECO and UMEME.

Each of the participating operators had submitted details and costing of the materials to be procured before the contracts were signed with suppliers. However, I noted that Management did not have agreements with the operators to take up the materials after delivery by suppliers. As a result, UMEME which was one of the main consumers of the connection materials (60%), pulled out of the program towards the delivery stages of the procurement process. The withdrawal by UMEME from the program created excessive supply of materials that were allocated to the other operators whose sectors coverage is limited (only 40%). Similarly, the withdrawal by UMEME meant that the intended beneficiaries under its territory missed out on the benefits of the programme.
FINANCIAL STATEMENTS