REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF
KAMPALA WATER - LAKE VICTORIA WATER AND
SANITATION PROJECT (NATIONAL WATER AND SEWERAGE CORPORATION)

FOR THE YEAR ENDED 30TH JUNE 2016

OFFICE OF THE AUDITOR GENERAL
UGANDA
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### LIST OF ACRONYMS

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<th>Acronym</th>
<th>Description</th>
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<tr>
<td>AFD</td>
<td>Agence francaise de Development</td>
</tr>
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<td>CPTA</td>
<td>Common Partnership Terms Agreement</td>
</tr>
<tr>
<td>EIB</td>
<td>European Investment Bank</td>
</tr>
<tr>
<td>EU-AIF</td>
<td>European Union Africa Infrastructure Fund</td>
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<td>GoU</td>
<td>Government of Uganda</td>
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<td>ISA</td>
<td>International Standards on Auditing</td>
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<td>KW-LV WATSAN</td>
<td>Kampala Water - Lake Victoria Water and Sanitation Project</td>
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<td>MDGs</td>
<td>Millennium Development Goals</td>
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<td>National Water and Sewerage Corporation</td>
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<td>PEA</td>
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REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF KAMPALA WATER - LAKE VICTORIA WATER AND SANITATION PROJECT (NATIONAL WATER AND SEWERAGE CORPORATION) FOR THE YEAR ENDED 30TH JUNE 2016

THE RT. HON. SPEAKER OF PARLIAMENT

I have audited the Fund Accountability Statements of the National Water and Sewerage Corporation (NWSC) - Kampala Water Lake Victoria Water and Sanitation Project (KW-LV WATSAN) which comprise of the Statement of receipts and expenditure, Statement of Fund Balance as at 30th June 2016 and a summary of significant accounting policies and other explanatory information for the period then ended, as set out on pages 10 to 15.

Management Responsibility for the Financial Statements

The management is responsible for the preparation and fair presentation of the Fund Accountability Statement in accordance with the NWSC project accounting guidelines, the Common Partnership Terms Agreement (CPTA) and conditions of funding. The responsibility includes designing, implementing and maintaining internal controls relevant to the preparation and fair presentation of the project Fund Accountability statement that is free from material misstatements, 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) and Sections 13 and 19 of the National Audit Act, 2008 is to express an opinion on the Fund Accountability Statement based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the Fund Accountability Statement is 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 judgment, 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 controls relevant to the entity’s preparation and fair presentation of the 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 Project Fund Accountability Statement.

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

Part “A” of my report sets out my opinion on the Fund Accountability Statement. 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 Fund Accountability statement presents fairly the financial position of National Water and Sewerage Corporation – Kampala Water Lake Victoria Water and Sanitation (NWSC-KW-LV WATSAN) Project as at 30th June, 2016 and of its receipts and expenditure for the year then ended in accordance with the NWSC accounting policies set out in Note 5 of the financial statements and the terms and conditions of funding.

John F.S. Muwanga

AUDITOR GENERAL

20th September, 2016
PART "B"


This section outlines the detailed audit findings, management responses, if any and my recommendations in respect thereof.

1.0 INTRODUCTION

I am mandated by Article 163 (3) of the Constitution of the Republic of Uganda, 1995 (as amended), to audit and report on the public accounts of Uganda and of 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. In accordance with the same provision, I appointed KPMG, Certified Public Accountants to audit the project on my behalf and report to me so as to enable me report to Parliament and the development partners.

2.0 BACKGROUND INFORMATION

In the recent years, Uganda’s Economy has undergone rapid growth and transformation and as such, the Economic boom has resulted into rapid urbanization across the major urban towns in the Country and thereby increasing demand for infrastructure for water and sewerage services. The increased demand for water and sewerage has also increased pressure on water resources and this has in turn aggravated water pollution.

The improvement of sanitation services, water availability and water quality in the major towns in Uganda, as well as the protection of water resources, forms part of the Government policies focused at eradicating poverty and continuing progress towards achieving the Millennium Development Goals (MDGs) on water and sanitation as well as improving water governance and management of water resources in Uganda.

National Water and Sewerage Corporation which is mandated to provide water supply and sewerage services in 34 major towns in Uganda, has in the recent years largely
relied on donor support to undertake major water supply and sewerage infrastructure development projects.

The Kampala Water - Lake Victoria Water and Sanitation Program (KW-LV WATSAN) is one of such developments. The Program is based on a long-term rehabilitation and extension strategy for the water supply system of Kampala (2003, updated 2010) and is closely linked to the on-going and future implementation of the Kampala Sanitation Master Plan (2004). The overall strategy aims at meeting Kampala’s water demand for the year 2035. It includes a systematic and phased approach to reduce water losses and operational costs while protecting the watershed, improving sanitary conditions and providing better services to the urban poor.

It is expected that these interventions, will in turn contribute towards improvements in public health including infant and maternal mortality rates and poverty reduction as well as achievement of national Poverty Eradication Action Plan targets and Millennium Development Goals. It will also ensure improvements in protection of Kampala’s natural environment, both land and water through pollution controls of the Lake Victoria water body.

The KW-LV WATSAN Project, is estimated to cost Euros 212 million, and is being implemented through funding from GoU (Contribution - 34 million Euros) and a consortium of European Development Banks comprising of;

- KfW Entwicklungsbank - German Financial Corporation (KfW) - Grant of 20 million Euros;
- Agence francaise de Development (AFD) - Loan of 75 million Euros;
- European Union Africa Infrastructure Fund (EU-AIF) - Grant of 8 million Euros; and
- European Investment Bank (EIB) - Loan of 75 million Euros.

The Financing agreements for the Project were signed by Government of Uganda (GoU) and the lenders on 28th April 2011. In addition to the Financing Agreements, the Borrower, Project Executing Agency (PEA) and the lenders signed Common Project Terms Agreement (CPTA) where the obligations of each party are detailed. KfW is the lead financier for purposes of implementation of the CPTA.
During the financial year under review an amount of Euros 16,047,583 (UGX 62,158,005,000) was spent on the project activities.

3.0 **PROJECT COMPONENTS**

The KW-LV WATSAN Program is being financed in 5 Components namely:

1) **Component 1** - Immediate measures for upgrading the Ggaba water treatment Plant complex and providing additional water transmission and storage capacity.

2) **Component 2** - Network restructuring and rehabilitation.

3) **Component 3** - Improvement and extension of water supply and sanitary services in informal settlements.

4) **Component 4** - Construction of new water treatment works in the east of Kampala.

5) **Component 5** - Project accompanying measures for institutional and operational capacity building.

For ease of Implementation, the above component work is being undertaken in 7 packages most of which are interlinked in their implementation. The packages can be detailed as follows:-

(i) **Package 1:**

The works under this package dubbed “Quick Win - No Regret” measures were proposed on the understanding that they would be quick to install, cheap, and yield high impact on completion. Whilst the KW-LV WATSAN project is expected to be implemented and completed over a five year period, the water supply shortages facing Kampala have reached critical levels, characterized by production shortfalls at Ggaba and increasing low pressure areas and dry zones, among others, a situation that calls for immediate attention. The works are to secure production at Ggaba water treatment works (part of component 3), increase reservoir storage capacity (part of component 2) and enable bulk water transfers to some critical low water supply areas in the Kampala water supply area (part of component 2).

(ii) **Package 2:**

Package 2 intends to deliver capital works mainly under Component 2 and transmission and storage facilities associated with Component 4. The infrastructure development under this package includes:-
a. Restructuring and extension of the existing distribution network through construction and rehabilitation of the transmission mains and primary distribution system and associated reservoirs, densification and extension of the secondary network and extension, as well as rehabilitation of the tertiary network.

b. Implementation of district metering zones and improved pressure management, including a Supervision Control And Data Acquisition (SCADA) system for network monitoring, and of activities for technical and administrative water loss reduction.

c. Transmission mains improvement and associated bulk storage facilities under component 4.

(iii) **Package 3:**
This package will address the works under Component 1 not tackled under package 1. Package 3 is now being implemented together with Package 1.

(iv) **Package 4:**
The works under this package entail development of a new water treatment plant to the East of Kampala. The location of the works to the East of Kampala follows recommendations made in the updated feasibility study which identified potential abstraction points along the Lake Victoria shoreline around Katosi in Mukono district. This package provides for the rest of works under component 4.

(v) **Package 5:**
This package of works is aimed at scaling NWSC previous interventions in providing water and sanitation services to the Urban Poor within Informal Settlements of Kampala. The project implementation is based on lessons learnt from previous projects of such nature. This Package of works provides for works under Component 3.

(vi) **Package 6:**
This package of works was proposed to address capacity gaps within the project implementation unit and the NWSC as a utility business. The works in this Package mainly consist of those entailed in Component 5.

(vii) **Package 7:**
This package is aimed at addressing the long-term water quality and limnological changes within Lake Victoria as part of the accompanying measures in component
4. The package involves works that shall include development of strategies to address deteriorating water quality and development of infrastructure. Part of the works under this Package is currently being undertaken in Package 4.

4.0 **PROJECT PROGRESS BY PACKAGE**

4.1 **Package 1&3: Rehabilitation and Water Production Capacity Optimization of Ggaba Water Treatment Complex and Transmission Mains Improvements**

The works under this package are to secure production at Ggaba I & II (part of component 3), increase reservoir storage capacity (part of component 2) and enable bulk water transfers to Muyenga Reservoir (part of component 2).

The design and supervision consultant engaged to undertake the works under this Package is CES Consulting Engineers Salzgitter GmbH in Association with Coda and Partners (Africa) Ltd, the works contractor for this assignment is Sogea-Satom.

Construction works under Packages 1 & 3 are nearing completion with the Transmission main to Namasuba now complete. At Ggaba 1, works on the raw water pipe, raw water inlet tank, microstrainer, reaction chambers, sludge recirculation system, clarifiers, old and new Mannesmann filters, filter control room, air blower station, backwash tank and pumping station, chlorine plant, chemical building, new treated water tank and pumping station, and gabions for protection of shore line are ongoing. Works on the clarifiers and pump station in Ggaba I are 95% complete.

Modification of all six lines of filters and on the clarifiers at Ggaba II has been completed; Construction of reservoir tanks at Namasuba is complete and the water tightness testing has been carried out successfully.

With Civil Works over 99% complete, M&E works on Ggaba I & II are being finalised with the installation of process pipework.

4.2 **Package 2A: Diagnostic Study, Network Modelling & Master Planning**

The overall objective of Package 2 is to carry out restructuring, rehabilitation and extension of the Kampala Water supply network including storage facilities and a transmission main from the planned Water Treatment Plant East of Kampala. This is to
ensure that the water produced is distributed to the customers in a sustainable, continuous, hygienic manner and at socially acceptable costs.

Package 2 has been sub-divided into two sub-packages; Package 2A and Package 2B. Package 2A addresses the network modelling and master planning for the Greater Kampala Water Supply Area, from which the necessary infrastructure requirements shall be realised, while Package 2B entails the design and construction of the infrastructure. At year end, modifications to the Package 2A Water Network Modelling and Master Planning contract, Addendum No.I & 2 have been prepared to prioritise and optimise the investment requirements realised out of the Master Plan. Addendum II was prepared to accommodate change in the water Reservoir site from Kyambogo to Sonde after addendum I had been prepared. Addendum draft contract is due for clearance from the Development Partners (DPs).

ToR for package 2B Consultancy and for the P.2B Tender Agent are being prepared. Furthermore, the exercise of identifying proposed sites for the various installations has been finalised. The respective Landlords have been contacted and the process to transfer ownership to NWSC is on-going.

4.3 Package 4A: Feasibility study and Water Quality Monitoring for New Water Treatment Plant East of Kampala

The works under this package entail development of a new water treatment plant to the East of Kampala and a transmission main to Naguru reservoir and a new reservoir proposed at Kyambogo. The location of the reservoirs was done under package 2A. The location of the works to the East of Kampala follows recommendations made under the feasibility study in package 4A. This study and water quality monitoring is being done by BRL Ingenierie IGIP/WE Consult. The Environmental and Social Impact Assessment together with Resettlement Action Plan were finalised.

As at year end, negotiation minutes and the draft consultancy contracts were finalised and all approvals secured, after which, the Consultancy Services Contracts for both P4B Drinking Water Treatment Plant (DWTP) and Transmission Mains (TM) were signed. The project kick off meeting for P4B WTP was held on 15th June 2016 while that of P4B TM was held on 27th June 2016.
4.4 **Package 5A: Development of an Appropriate Sanitation Concept, Review of Water Supply Aspects in Informal Settlements and Feasibility Study**

The works under this package are designed to improve the water supply and sanitation situation within the informal settlements of Kampala where over 50% of the population reside.

Package 5 was subdivided into two sub-packages, i.e. Package 5A and Package 5B.

Package 5A: entailed the Development of an Appropriate Sanitation Concept, Review of Water Supply Aspects in Informal Settlements and Feasibility Study. Package 5A was under taken by Fichtner Water & Transportation GmbH/ GFA GmbH IM & E Associates Ltd and was successfully completed.

Package 5B is being executed in two parts i.e. 1) Technical Implementation - Detailed Design, Tendering, and Construction Supervision of Water and Sanitation Improvement Infrastructure in the Informal Settlements of Kampala" and 2). Accompanying Measures for the Promotion of Improved Private Hygiene and Sanitation and Corresponding Services in the Informal Settlements of Kampala."

As at year end, a No Objection for Technical Implementation Consultant (TIC) and Accompanying Measures Consultant (AMC) combined evaluation reports and negotiation plan from the Development Partners and NWSC Contracts Committee was secured. Contract negotiations were held on the 24th June 2016 for AMC and 23rd May 2016 for TIC. The Negotiation Report and Draft Contract for TIC were cleared by Contracts Committee and submitted to Development Partners (DPs) and Solicitor General for clearance.

4.5 **Package 6: Capacity Building**

This package was proposed to address capacity gaps within the project implementation unit and the NWSC as a utility business. Currently ongoing is the Project management support under P6A and the Capacity Needs assessment under P6B. Under P6A, the Consultant, CEEM, is carrying out Economic Analysis under the Priority Measures being carried out by Fichtner W &T under Addendum I of P2A. As at year end, the package 6A Consultant CEEM had handed over the core task of preparing the Quarterly Report to Project Implementation Unit (PIU).
CEEM also supported the PIU in preparing the ToRs for the technical Auditor, P4B and P5B. Draft ToRs for Technical Auditor and Long -Term Assistance were drafted, comments received during the MRI mission have been incorporated into the ToR and are currently being reviewed by the DPs. Also, comments on the final P6B accompanying measures report received during the MRI mission have been incorporated into the ToRs and the ToR is being finalized.

4.6 **Package 7: Addressing long-term water quality and limnological changes**

This package was developed to address the raw water quality and limnological changes. An initial study recommended undertaking a water quality monitoring programme and improving the water quality infrastructure.

The Water Quality analysis packaged under P4A has now been completed. Under Package1&3, construction of a new water quality Laboratory has also been completed.

5.0 **SCOPE OF THE AUDIT**

In conducting the Audit, special attention was paid to the following:-

(i) Whether all Funds had been used in accordance with the conditions of the Loan Agreement, with due attention to economy and efficiency and only for the purposes for which the funds were provided.

(ii) Whether counterpart Funds (Government Budget) and External Funds (in case of co-financing) had been provided and used in accordance with the conditions of the Loan Agreement, with due attention to economy and efficiency and only for the purposes for which they were provided.

(iii) Whether goods, works and services financed have been procured in accordance with the Financing Agreement and in accordance with the KfW rules and procedures, and have been properly accounted for.

(iv) Whether appropriate supporting documents, records and books of accounts relating to all the project activities were maintained. Clear linkages should exist between the books of accounts and the financial statements presented to the Financiers.

(v) Whether special accounts had been maintained in accordance with the provisions of the Loan Agreement and in accordance with the disbursement rules and procedures.
(vi) Whether the financial statements had been prepared by project management in accordance with applicable accounting standards and give a true and fair view of the financial position of the Project as at the year end and of its receipts and expenditures for the period ended on that date.

(vii) Whether management put in place a sufficient Internal Control Structure and the internal controls worked as intended throughout the year and

(viii) Whether the project’s fixed assets are real and properly evaluated and project property rights or related beneficiaries’ rights are established in accordance with loan conditions; and ineligible expenditures identified during the audit were to be reflected in a separate paragraph of the audit report and if material, the point be reflected in the auditors’ opinion.

In accordance with International Standards on Auditing (ISA), audit also paid attention to the following:-

(i) **Fraud and Corruption:** In accordance with ISA 240 (The Auditor’s Responsibilities Relating to Fraud in an Audit of Financial Statements) audit was to identify and evaluate risks related to fraud, obtain or provide sufficient evidence of analysis of these risks and assess properly the risks identified or suspected;

(ii) **Laws and Regulations:** In preparing the audit approach and in executing the audit procedures, audit evaluated NWSC’s compliance with the provisions of laws and regulations that might impact significantly on the Project Financial Statements as required by ISA 250 (Considerations of Laws and Regulations in an Audit of Financial Statements);

(iii) **Governance:** Communicate with NWSC’s Management responsible for Governance regarding significant audit issues related to governance in accordance with ISA 260: (Communication with those charged with Governance); and

(iv) **Risks:** With a view to reducing audit risks to a relatively low level, audit was to apply appropriate audit procedures and handle anomalies/risks identified during their evaluation. This is in accordance with ISA 330 (The Auditor’s Responses to Assessed Risks).
6.0 **COMPLIANCE WITH TERMS OF THE FINANCING AGREEMENTS AS DOCUMENTED IN THE CPTA (Section 3.04)**

I confirm that management complied in all material aspects with the terms of the financing agreement.

7.0 **AUDIT FINDING – INTERNAL CONTROL**

7.1 **Categorization of Findings**

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

<table>
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<tr>
<th>Category</th>
<th>Description</th>
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<tbody>
<tr>
<td>High significance</td>
<td>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.</td>
</tr>
<tr>
<td>Moderate significance</td>
<td>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.</td>
</tr>
<tr>
<td>Low significance</td>
<td>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.</td>
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7.2 **Summary of findings**

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<tr>
<th>S/N</th>
<th>Title finding</th>
<th>Significance</th>
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<tr>
<td>1</td>
<td>Performance improvement observations - current year</td>
<td>Moderate</td>
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9.0 **DETAILED FINDINGS**

9.1 **Performance Improvement Observations - Current Year**

During my review of payments made by the Project, I noted an instance of a double payment to the private firm for works under package 1 and 3 relating to rehabilitation and water production optimization of Ggaba water treatment complex and transmission mains improvement, as per completion certificate No.18 on 14th June 2016.

The total amount paid to the private firm was Euro 124,851 (UGX.469,671,793). This was due to a Bank of Uganda system error, which led to the double posting of the payment.
There is a risk that the double payments to contractors may result into financial loss to the project.

Management explained that, payments made to contractors are prepared, reviewed and approved by independent persons. Double payment arose due to a BOU system error where an instant payment confirmation was not received for the initial payment instruction on the 13th JUNE 2016.

Management further explained that, the instruction was re-initiated and subjected to the same approval process on the 14th June, 2016 on the assumption that the earlier instruction had not been actioned by BOU. However, confirmation of double payment was received from the private firm and recoveries have been made on subsequent certificates.

I advised management, in future, to constantly reconcile and engage their bankers, Bank of Uganda, to ensure double payments do not occur as a result of system errors.

10.0 Implementation of prior year audit recommendations

Performance improvement Observations-Prior Year

<table>
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<th>No.</th>
<th>Observation</th>
<th>Observation</th>
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<tr>
<td>1.</td>
<td>Unexplained debits and credits on account</td>
<td>We noted that the project account had unexplained debits amounting to UGX.28million and credits of UGX.4million.</td>
<td>Resolved</td>
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FINANCIAL STATEMENTS