

OFFICE OF THE AUDITOR GENERAL



THE REPUBLIC OF UGANDA

REPORT OF THE AUDITOR GENERAL

ON THE FINANCIAL STATEMENTS OF THE RURAL ELECTRIFICATION AGENCY

FOR THE YEAR ENDED 30TH JUNE 2017

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UGANDA

REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS
OF RURAL ELECTRIFICATION AGENCY FOR THE
YEAR ENDED 30TH JUNE 2017

THE RT. HON. SPEAKER OF PARLIAMENT

Opinion

I have audited the accompanying Financial Statements of the Rural Electrification Agency, which comprise the Statement of Financial Position as at 30th June 2017, the Statement of Financial Performance, Statement of Changes in Equity and Statement of Cash Flows for the year then ended, and a summary of significant accounting policies and other explanatory notes, as set out on pages 9 to 37.

In my opinion, the financial statements of the Rural Electrification Agency for the year ended 30th June 2017 are prepared, in all material respects in accordance with section 51 of the Public Finance Management Act, 2015.

Basis of Opinion

I conducted my audit in accordance with International Standards of Supreme Audit Institutions (ISSAIs). My responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of my report. I am independent of the Agency in accordance with the Constitution of the Republic of Uganda (1995) as amended, the National Audit Act, 2008, the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (Parts A and B) (IESBA Code), the International Organization of Supreme Audit Institutions (INTOSAI) Code of Ethics and other independence requirements applicable to performing audits of Financial Statements in Uganda. I have fulfilled my other ethical responsibilities in accordance with the IESBA Code, and in accordance with other ethical requirements applicable to performing audits in Uganda. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.

Key Audit Matters

Key audit matters are those matters that, in my professional judgment, are of most significance in my audit of the financial statements of the current period. I have determined that there are no key audit matters to communicate in my report.

Emphasis of Matter

Without qualifying my opinion, I draw your attention to Note 21 to the financial statements;

- **Unpaid annual lease rentals**

Disclosed in the receivables under note 21 is a sum of UGX 65,078,348,321 which includes an amount UGX. 3,557,642,827 relating to unpaid lease rentals.

The Rural Electrification Agency (REA) signed lease agreements with various service territory operators to manage the various territories. Under the terms and conditions of the agreements, the Agency is supposed to collect annual lease fees from the operators on quarterly basis.

Audit however noted that as at 30th June, 2017, the operators owed the Agency UGX. 3,557,642,827 in unpaid lease rentals.

Additionally, audit noted that there were no external audit reports on the operations of the territory operators. This was majorly due to insufficient performance assessment review and audits by the Agency.

The unpaid amounts raise concerns on how the operators manage their costs and whether they can sustainably operate these territories. In the case of M/s Ferdult Engineering services Ltd, the company's contract ended before the amount was recovered, implying that REA may not recover the rentals due.

There is a risk that the information provided to REA by the operators on a quarterly basis could be misstated in terms of sales, revenues and expenses if a financial audit is not carried out to provide assurance. In addition, REA may not reasonably determine the viability of the service territories.

In response, management explained that;

- Going forward, financial audits would be undertaken as part of the regular monitoring activities of the operations of the service providers.
- One of the tasks for the consultant developing the master plans for the service territories is to assess the financial viability of the service territories, and this would guide REA in the future management of the service territories. Sections of the master plans will be presented in form of business plans highlighting the financial viability of the service territories.
- Much of the unpaid annual rent, UGX.3,405,000,000 was owed by Ferdult Engineering Services Limited (FESL) whose lease agreement was terminated, and the recovery process for the amount had been initiated by the Solicitor General.

I await the results of management's actions in this regard.

- **Outstanding Advances**

Contrary to Section 45(2) of the Public Finance and Accountability Act 2015 and section 10.21.17 of the Treasury Instructions 2017, a sum of UGX 224,233,000 paid to various REA staff on behalf of other staff and service providers through operational advances for various field activities, had not been accounted for. The sum is disclosed in the financial statements under Note 21; Operational Advances. The practice exposes the entity to the risk of loss of funds.

Management stated that some of the activities were unique and could not be predicted such as public relations promotional activities while in the field.

Management should submit accountability of the funds for verification. In the alternative the funds are recoverable from the concerned staff.

- **Other Matter**

In addition to the matter raised above, I consider it necessary to communicate the following matters other than those presented or disclosed in the financial statements.

- **Failure to achieve connection targets**

For the financial year under review, the Agency had a grid connection target of 40,748 connections within the various service territories and a 14,000 cumulative off grid connection target.

However, only 40% of the target was achieved for grid connections in the financial year and 31% for off grid cumulatively up to year end. The low performance was attributed to limited network coverage, high connection costs and inability of potential customers to wire their houses.

With such low connection rates, the majority of the rural population still has limited access to electricity contrary to the goals of the Rural Electrification Strategic Plan (RESP).

In response, management explained that a connection policy as well as grid densification and intensification projects have been designed in collaboration with various development partners to enable more connections.

Management is advised to expedite finalization of the connection policy and the implementation of the new connection strategies, to enable achievement of set targets.

- **Delayed preparation of the service territory master plans**

The agency has not finalized the process of developing master plans for the thirteen service territories contrary to the requirements of the Rural Electrification Strategy and Plan (RESP 2013). The plans would allow for a consistent, integrated planning framework, whose level of detail ensures that no area or feature of the national program is under served. The delay was attributed to inadequate funding and the long process of hiring a consultant to design the plans.

As a result, REA has not adequately assessed the viability of the service territories.

In response, management explained that the consultant had presented draft reports of master plans for 6 out the 13 service territories and that the target is to have all the master plans completed by February, 2018.

Management is advised to prioritize completion of the master plans, as they will provide a framework for comprehensive rural electrification.

- **High indebtedness to UETCL by the service providers**

Review of the agency's monitoring reports and financial statements submitted by the service providers, revealed that various companies owed Uganda Electricity Transmission Company Ltd (UETCL) a sum of **UGX 3,053,775,462** for bulk energy purchases at the year end.

The service providers attributed the indebtedness to low levels of profitability.

There is a risk that UETCL may discontinue electricity supply to the service providers thus affecting the supply. Further, such debts affect the service provider's ability to pay lease rental fees and could amount to breach of contractual obligations.

In response, management explained that they were currently assessing the ability of the service providers to manage the service territories with the objective of strengthening their capacity.

Management should expedite the assessment process and provide necessary support, so as to ensure continuity of the service.

- **Funds budgeted under the Kerosene fund**

Under the Agency's budget for the financial year, **UGX 15 Billion** was expected to be realized from the Kerosene Fund, as a result of an extra excise duty charged on Kerosene imports. The funds were earmarked by government for use by REA for the roll out of solar PV lanterns for poor rural households.

It was however noted that ever since the fund was put in place, the Agency has never received any monies as budgeted for.

As a result the implementation of the solar lantern project is still on hold, which limits the rural population's ability to afford the product.

Management should liaise with the Ministry of Finance and ensure operationalization of the Kerosene fund to enable the Agency roll out the solar lanterns as envisaged in the setting up of the fund.

- **Diversion of Funds: USD 603,426.04**

On 28th October 2016, REA refunded USD 603,426.04 (an equivalent of UGX.2,092,657,370) to the World Bank in relation to funds misappropriated by companies contracted to distribute solar PV systems under Energy for Rural Transformation project phase II (IDA Cr.45540 and GEF TF94484).

It was however observed, that the funds in question were not budgeted for during the financial year 2016/2017 implying that REA had diverted funds from other planned activities to offset this amount. The matter of misappropriation of funds by the solar companies was raised in my report for the year 2015/16.

In response, management explained that this was a pre-condition for approval of the effectiveness of the ERT III project. They added that they were however in the process of recovering the money from the companies through the Solicitor General.

Management should expedite the process of recovery of the funds from the offending companies to enable implementation of affected activities.

- **Nugatory Expenditure**

A sum of UGX 63,906,575 was incurred on demurrage relating to delayed settlement of import duties on items by the Agency. The expenditure is considered nugatory as it would have been avoided with proper financial planning.

Management stated that the demurrage charges arose as a result of failure to settle import duties due to financial constraints at the time.

Management is advised to always set aside funds for statutory obligations, so that they are promptly settled.

Responsibilities of the Accounting Officer for the Financial Statements

Under Article 164 of the Constitution of the Republic of Uganda, 1995 (as amended) and Section 45 of the Public Finance Management Act, 2015, the Accounting Officer is accountable to Parliament for the funds and resources of the Agency.

The Accounting Officer is responsible for the preparation of the financial statements in accordance with the requirements of the Public Finance Management Act, 2015 and the Financial Reporting Guide, 2008, and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatements, whether due to fraud or error.

In preparing the financial statements, the Accounting Officer is responsible for assessing the Agency's ability to continue delivering its mandate, disclosing, as applicable, matters related to delivery of services, unless Government either intends to discontinue the Agency's operations, or has no realistic alternative but to do so.

Auditors' Responsibilities for the audit of the Financial Statements

My 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. 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, when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in 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 in accordance with ISSAIs, I exercise professional judgement and maintain professional scepticism 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, but not for the purpose of expressing an opinion on the effectiveness of the Agency'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 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 Agency's ability to deliver its mandate. If I conclude that a material uncertainty exists, I am required to draw attention in my 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 auditor's report. However, future events or conditions may cause the Agency to fail to deliver its mandate.
- 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.

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 I identify during my audit.

I also provide the 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.

From the matters communicated with management, I determine those matters that were of most significance in the audit of the financial statements of the current period

and are therefore the key audit matters. I describe these matters in my auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in my report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

A handwritten signature in black ink, appearing to read 'J. Muwanga', with a large, stylized flourish extending to the right.

John F.S. Muwanga

AUDITOR GENERAL

30th November 2017