



**THE REPUBLIC OF UGANDA**

**REPORT OF THE AUDITOR GENERAL ON THE FINANCIAL STATEMENTS OF**  
**THE RURAL ELECTRIFICATION AGENCY**  
**FOR THE YEAR ENDED 30<sup>TH</sup> JUNE 2018**

**OFFICE OF THE AUDITOR GENERAL**  
**UGANDA**

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## **LIST OF ACRONYMS**

BECS	Bundibugyo Energy Cooperative Society
COSASE	Parliamentary Committee on Statutory Authorities and State Enterprises
ERA	Electricity Regulatory Authority
GOU	Government of Uganda
INTOSAI	International Organization of Supreme Audit Institutions
ISSAI	International Standards of Supreme Audit Institutions
KIL	Kilembe Investment Limited
KRECS	Kyegegwa Rural Electrification Cooperative Society
MEMD	Ministry of Energy and Mineral Development
MoFPED	Ministry of Finance, Planning and Economic Development
PACMES	Pader-Abim Community Multipurpose Electricity Cooperative Society
PFMA	Public Finance Management Act, 2015
REA	Rural Electrification Agency
REB	Rural Electrification Board
SP	Service Providers
UEDCL	Uganda Electricity Distribution Company Ltd
UETCL	Uganda Electricity Transmission Company Ltd
UGX	Uganda Shillings
USD	United States Dollar

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**OF THE RURAL ELECTRIFICATION AGENCY**  
**FOR THE YEAR ENDED 30<sup>TH</sup> JUNE, 2018**

**THE RT. HON. SPEAKER OF PARLIAMENT**

**Opinion**

I have audited the accompanying financial statements of the Rural Electrification Agency (REA) for the year ended 30<sup>th</sup> June 2018. These financial statements comprise the Statement of Financial Position as at 30<sup>th</sup> June 2018, the Statement of Financial Performance, Statement of Changes in Equity and Statement of Cash Flows for the period then ended, accompanying schedules and a summary of significant accounting policies and other explanatory notes, as set out on pages 7 to 37.

In my opinion, the financial statements of the Rural Electrification Agency for the year ended 30<sup>th</sup> June, 2018 are prepared, in all material respects in accordance with Section 51 of the Public Finance Management Act, 2015, and the Financial Reporting Guide, 2018.

**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 Organization of Supreme Audit Institutions (INTOSAI) Code of Ethics, the International Ethics Standards Board for Accountants Code of Ethics for Professional Accountants (Parts A and B) (IESBA Code), 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, were of most significance in my audit of the financial statements of the current period. These matters were addressed in

the context of my audit of the financial statements as a whole, and in forming my opinion thereon, and I do not provide a separate opinion on these matters. I have determined the matters described below to be key audit matters communicated in my report.

- **Implementation of Budget approved by Parliament**

Section 45 (3) of the Public Finance Management Act, 2015 states that “ An Accounting Officer shall enter into an annual budget performance contract with the Secretary to the Treasury which shall bind the Accounting Officer to deliver on the activities in the work plan of the vote for a Financial year, submitted under section 13 (15)” of the said Act. It has been observed over years that planned and budgeted for activities of a number of Government entities are not implemented thereby affecting service delivery.

In the overall office wide planning, I assessed risks of inadequate release of funds, and failure to undertake budget monitoring and supervision as the likely causes of failure to implement planned activities. The focus was put on the planned major outputs of the entities which greatly impact on the wellbeing of communities.

Consequently, I developed specific audit procedures which included the evaluation of the financial and annual physical performance by analysing government releases, testing consistency of planned outputs with the approved budget and verifying the accuracy and completeness of the reported actual outputs.

Based on the procedures performed, I observed that REA budgeted for UGX.124,816,000,000 however, by the close of the financial year, UGX 88,901,099,059 (71.22%) of the approved budget had been received which resulted in a budget shortfall of UGX.35,914,900,941 (28.7%).

Management implemented a number of planned activities during the year, the major ones being last mile connections of which, out of 240,000 planned connections, 123,787 (51%) consumers were connected to the grid. Under the planned construction of 2,100 km of low Voltage lines, 1529 km (78%) were completed.

I however noted that that out of the 240,000 planned last mile connections, 116,213 (48%) connections were not implemented. Under the grid extensions programme, 1,379km (43%) of the planned 3,200km of Medium Voltage (MV) lines were not constructed. I further noted

that only 39% of the planned financial support to the service territories was provided. Additionally, the completion of the Kanyantorogo switching station could not be achieved, since only 40% of the budgeted funds for the activity were released (**Appendix 1**).

I advised the Accounting Officer to ensure adequate planning and implementation of planned activities, and to work with the relevant stakeholders to ensure timely release of appropriated budget funding.

### **Emphasis of matter**

Without qualifying my opinion, I draw your attention to the Statement of Arrears of Revenues in the financial statements that, in my judgement, is of such importance and fundamental to the users' understanding of the financial statements.

- **Revenue Arrears**

Disclosed in the statement of Revenue Arrears is an amount of UGX.10,358,804,214 relating to connection materials procured by REA and delivered to the service territory operators. The companies were supposed to remit on a monthly basis all monies received as payments from consumers, resulting from utilization of connection materials.

I however noted that implementation of connections using the materials was not undertaken in a timely manner, and no funds had been remitted by the service providers as at June 2018. This was attributed to the delay in the approval of a connection cost by the Electricity Regulatory Authority (ERA) and clearance of the materials by the Uganda National Bureau of Standards (UNBS).

The approval of the Electricity Connection Policy (ECP) implementation manual implies that the service providers (SPs) will no longer be required to reimburse or make monthly payments towards the use of the connection materials.

Management explained that with the approval of the connection cost, the SPs began implementing connections using the materials. The SPs had however made reimbursements for connections made as of July 2018 amounting to UGX 1.3 billion. A stock taking exercise for the materials is also underway to ascertain stock levels with the SPs. Following the approval of the ECP implementation manual, the remaining balance of the materials will be used to implement free connections under the policy.

I advised management to ensure adequate utilisation of the materials to accelerate the number of connections under the new free connections policy. I also advised that full accountability of the revenue arrears be made.

- **Escalating Receivables from the Uganda Electricity Transmission Company Limited 5% Levy**

A review of the financial statements revealed that monies owed by UETCL have increased by 44% from UGX.50,645,352,876 on 30<sup>th</sup> June 2017 to UGX.73,003,978,668 on 30<sup>th</sup> June 2018.

UETCL has in various engagements blamed the non-payment of the levy on UMEME's failure to pay for bulk energy purchases. This has affected REA's cash flows and the implementation of planned activities.

Management explained that UETCL has continued to withhold the Levy on account of non-payment by UMEME. REA has continued to engage UETCL, with the help of the Committee on Statutory Authorities and State Enterprises (COSASE), but the problem still persists.

I await the outcome of Management's action in engaging the relevant stakeholders to solve the matter on the non-payment of the 5% levy.

- **Failure to recover funds from Ferdsult Engineering**

Disclosed in the Statement of arrears of revenue under lease rentals is UGX.3,405,000,000 relating to unpaid lease rentals by Ferdsult Engineering dating back to 10 years. Ferdsult's lease agreements with REA expired in January 2017 and Uganda Electricity Distribution Company Limited (UEDCL) took over the operation of the territories in March 2017.

I noted that the recovery of these funds from Ferdsult is long over-due especially because the company had going concern issues at the time of the expiry of the lease agreements.

Failure to recover these funds would mean a significant loss of revenue to the agency and Government as a whole considering that the agency's activities are majorly donor funded.

Management explained that the arbitration proceedings have begun with the Solicitor General in charge of the process who has since served Ferdsult with a notice of dispute.

I advised management to follow up with the Solicitor General on the recovery of the funds from Ferdsult Engineering.

## **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.

- **Unpaid energy bills to Uganda Electricity Transmission Company Limited by the Service providers.**

A review of REA monitoring reports and financial statement for the period under review provided by the SPs indicated significant monies owed to UETCL for bulk energy purchases, as shown in the table below. I noted a total variance of UGX.558,851,527 between UETCL receivables records and the SPs' payables records.

<b>Company</b>	<b>UETCL Records (UGX)</b>	<b>SPs Records (UGX)</b>	<b>Variance</b>
PACMECS	751,022,115	686,859,841	64,162,274
KIL	665,297,314	480,782,083	184,515,231
BECS	1,365,761,609	1,292,231,819	73,529,790
KRECS	523,754,176	287,109,944	236,644,232
<b>TOTAL</b>	<b>3,305,835,214</b>	<b>2,746,983,687</b>	<b>558,851,527</b>

There is a risk that UETCL will discontinue electricity supply to the companies thus affecting the distribution networks. Further, such debts affect the company's ability to pay lease rental fees in future amounting to breach of contractual obligations.

Management explained that the SPs have been advised to ensure periodic reconciliations and agree on payment plans with UETCL. Plans are also underway to provide the SPs with prepaid meters to install prepaid metering systems for all customers.

I advised management to ensure that reconciliations between UETCL and the SPs are expedited and the prepaid meters are provided in due time.

- **Failure to achieve annual connection targets**

The RESP 2013 – 2022 sets out connection targets to be achieved by the Agency on an annual and cumulative basis for both grid and off grid connections. For the financial year under review, the Agency had a total grid connection target of 38,499 connections within the various service territories.

I however observed that a total of 13,540 (35%) connections were achieved in the financial year. Service territories such as PACMECS, KRECS and UEDCL Eastern achieved 13%, 19%, and 14% respectively of their annual targets.

This was majorly due to low network coverage and inability of potential customers to wire their houses.

With such low connection rates, majority of the rural population still has limited access to electricity contrary to the agency's strategic plan.

Management explained that the ECP manual has been completed to guide the implementation of public financing for electricity connections. A number of initiatives for grid intensification are also in the pipeline that should enable the SPs make more connections.

I advised management to fast track the implementation of the new connections policy so as to complete as many free connections as possible that will achieve the targets.

- **Delayed Implementation of Mini-Grid projects**

During the financial year, the agency planned for the construction of 25 mini-grids in Lamwo district and 15 mini grid projects in Rakai and Isingiro districts. The financing of the projects is through GIZ/European Union and GOU.

I however noted that despite finalizing the shortlist of developers, project designs and selection of villages, the projects have not been completed.

This was attributed to delays in the finalization of Request for Proposal documents, master plans for the southern territory and the delayed clearance of the financing agreement.

As a result, the planned mini grid connection estimates for the financial year were not achieved.

Management explained that the financing agreement was signed and the subsidy agreement was approved by the Board and is to be submitted to GIZ for approval. The Request for Proposal (RFP) has also been completed and will be submitted to GIZ for approval.

I advised management to engage with the development partners to expedite the implementation of the mini grid projects.

- **Unapproved investments in the network by the service providers**

ERA approves all the investments to be made in the distribution networks by the licensees whereas line extensions and construction is undertaken by REA. A review of minutes for the quarterly meetings between ERA and REA on the performance of the SPs revealed that the SPs reported investments during the year, that were not approved by the regulator as shown below;

<b>Service provider</b>	<b>Category of investment</b>	<b>Period</b>	<b>Amount (UGX)</b>
BECS	Electricity line extensions	2015-2017	1,380,000,000
PACMECS	Network operations and maintenance	2010-2017	480,366,806
			<b>1,860,366,806</b>

This is attributed to inadequate monitoring by REA on compliance to the lease agreements or delayed extensions of the distribution network by the agency.

The SPs could plunge into deeper financial trouble as a result of the unapproved investments that will not be recovered through the tariff.

Management explained that the SPs have been guided to ensure that no network investments are made without the express approval of the regulator, ERA and REA. This will be addressed by the on-going grid densification and intensification projects.

I await the outcome of management’s action in this regard.

- **High rate of energy losses in the service territories**

ERA typically allows a distribution energy loss of up to 20% for tariff recovery. A review of the annual energy losses for the SPs revealed high energy losses above 20% in the various service territories as shown in the table below. KRECS, UEDCL Mid-west, UEDCL North-west and UEDCL South registered the highest energy losses of 32%, 37%, 35% and 38% respectively. This could be due to both technical and commercial losses as a result of power theft and poor distribution networks.

Such energy losses result in high operational costs since the losses over and above the threshold will not be recovered through the tariff.

Management explained that power losses are a regulatory matter and ERA is in the process of procuring a consultant to undertake a power loss study for all networks. The SPs have also been advised to undertake periodical energy and meter audits focusing on consumption trends to ascertain the possible causes of the energy losses.

I advised management to co-ordinate with ERA and investigate the losses and devise means with the SPs to minimise the losses.

- **Failure to set up a framework contract system for repairs and maintenance**

A review of REA's quarterly connection reports indicated that the co-operatives SPs (PACMECs, KRECs and BECs) reported challenges in network equipment repair and maintenance. Due to their small customer base, the SPs were unable to finance their repair and replacement. This results into power interruptions for extended periods especially if responses and interventions from REA are delayed.

The agency's work plan for the financial year emphasised the reduction of network downtime by 50% through enhanced supply reliability and real time responses to network requirements by framework supply and maintenance contracts. However, this has not been fully implemented.

As a result, the SPs will have continuous power supply interruptions due to the delayed response to network failures.

Management explained that the procurement for the framework contract system is on-going for poles and transformers with an objective to have on-call suppliers. Plans are also underway for framework contracts for labour and transport contractors to provide support to the smaller SPs.

I advised management to expedite the institution of the framework contract system for network repairs and maintenance.

- **High initial operational costs for areas taken over from Ferdsult Engineering**

The agreement between UEDCL (Uganda Electricity Distribution Company Limited) and REA provides for a provisional operational budget to meet the initial operational costs pending approval by ERA. As a result, REA provided UEDCL with start-up capital of UGX 1.3 Billion.

After 6 months of operation, UEDCL performed a full audit of the network to ascertain the required replacements and repairs to have a minimum level of operation. The audit revealed an additional capital requirement of UGX 10 Billion to cater for pole replacement and other faulty equipment.

This high cost could be due to inadequate line maintenance and supervision from the previous licensee and REA. This would amount to 11% of REA's current release, which is insufficient to cover these replacements in one financial year.

Without these replacements, the network will operate inefficiently and at a higher cost.

Management explained that a request was made to UEDCL to provide a detailed report on the faulty equipment on the network, highlighting aspects like location and cause of the faults. Once the report is provided, REA will undertake a further assessment of the equipment, which will guide the agency in providing the required replacements. UEDCL had however not responded at the time of audit (November 2018).

I advised management to follow up with UEDCL to ensure that the required replacements and repairs are done.

### **Other Information**

The Accounting Officer is responsible for the other information. The other information comprises the statement of responsibilities of the Accounting Officer and the commentaries by the Head of Accounts and the Accounting Officer, and other supplementary information. The other information does not include the financial statements and my auditors' report thereon.

My opinion on the financial statements does not cover the other information and I do not express an audit opinion or any form of assurance conclusion thereon.

In connection with my audit of the financial statements, my responsibility is to read the other information and, in doing so, consider whether the other information is materially consistent with

the financial statements or my knowledge obtained in the audit, or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude that there is a material misstatement of this other information, I am required to report that fact. I have nothing to report in this regard.

### **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 Rural Electrification Agency.

The Accounting Officer is also responsible for the preparation of financial statements in accordance with the requirements of the Public Finance Management Act 2015, and the Financial Reporting Guide, 2018, 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 affecting the delivery of the mandate of the Rural Electrification Agency, and using the Financial Reporting Guide 2018 unless the Accounting Officer has a realistic alternative to the contrary.

The Accounting Officer is responsible for overseeing the Agency's financial reporting process.

### **Auditor's 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 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 in accordance with ISSAIs, I exercise professional judgment 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 our 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 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 Rural Electrification 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 Accounting Officer 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 Accounting Officer with a statement that I have complied with relevant ethical requirements regarding independence, and to communicate with him/her 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 the Accounting Officer, 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.

**Other Reporting Responsibilities**

In accordance with sections 19(1) of the National Audit Act, 2008, I report to you, based on my work described on the audit of Financial Statements that the activities, financial transactions and information reflected in the financial statements that have come to my notice during the audit, are in all material respects, in compliance with the authorities which govern them.



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John F.S. Muwanga  
**AUDITOR GENERAL**

13<sup>th</sup> December 2018

## Appendix 1: Budget Performance on Program Outputs

Item Description	Planned Output/Quantity	Actual Output/Quantity	Variance Output/Quantity	Amount Budgeted (UGX) BN	Amount Released (UGX)	Amount spent (UGX) BN	Variance (UGX) BN	Management explanation	Audit Remarks
Accelerate Last Mile connections	240,000 last mile connections	123,787 connections achieved	117,539	54.0	20.1	20.1	33.90	The plan was to achieve the target mainly through Umeme where payment per connection is UGX 97,000, and the SPs connected at an average rate of UGX 330,000 per connection. Connection fees for Umeme are subsidized but those of SPs are not.	51% of the planned activities were achieved. Connections by umeme increased due to subsidized rates.
Support to Service Territories( commercial Viability)	100% CAPEX (Capital Expenditure)	39%	61%	4.5	1.75	1.75	2.75	Service Territories generate revenue that support most of their operations	38% of the Budgeted funds were received however 39% of out put was achieved. Inadequate funding affects operations of SPs
Grid Extensions	Construction& Commissioning of 3200km MV, 2100km LV	1821km MV** 1529Km LV** Constructed	1,379Km MV 571Km LV not constructed.	291.75	208.85	208.85	82.90	Delayed Procurement Process.	71.5% of Budgeted funds were achieved, however only 56% of planned activities under MV lines were achieved, due to delays in the procurement process.
Supply Quality& Reliable Projects	Completion of Kanyantorogo switching Station	Construction works on-going		2.0	0.79	0.79	1.21	Delayed release of Advance Payment	Only 40% of Budgeted funds were received. Hence delayed completion of construction work.

