



## OFFICE OF INSPECTOR GENERAL

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# AUDIT OF USAID/INDONESIA'S URBAN WATER, SANITATION AND HYGIENE PROJECT

AUDIT REPORT NO. 5-497-15-002-P  
JANUARY 5, 2015

MANILA, PHILIPPINES



*Office of Inspector General*

January 5, 2015

**MEMORANDUM**

**TO:** USAID/Indonesia Mission Director, Andrew B. Sisson

**FROM:** Regional Inspector General/Manila, Matthew Rathgeber /s/

**SUBJECT:** Audit of USAID/Indonesia's Urban Water, Sanitation and Hygiene Project  
(Report No. 5-497-15-002-P)

This memorandum transmits our final report on the subject audit. In finalizing the audit report, we considered your comments on the draft report and have included them in Appendix II.

This report contains six recommendations to assist the mission in improving certain aspects of the Urban Water, Sanitation and Hygiene Project. According to the information you provided in response to the draft report, we acknowledge management decisions on Recommendations 1 through 5 and final action on Recommendation 6. Please provide the Audit Performance and Compliance Division of USAID's Office of the Chief Financial Officer with evidence of final action to close the recommendations with management decisions.

I appreciate the cooperation and courtesy extended to my staff during the audit.

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# SUMMARY OF RESULTS

Access to safe drinking water and sanitation in Indonesia is a problem in most urban areas of the country, affecting health, economic growth, and the environment. To increase access, in March 2011, USAID/Indonesia issued a \$33.7 million, 5-year contract with Development Alternatives Inc. (DAI) to implement Indonesia’s Urban Water, Sanitation and Hygiene Project. The project covers 54 cities and municipalities in five regions: North Sumatra, West Java/Banten, Central Java, East Java, and South Sulawesi/East Indonesia (shown below).

Map of Project Sites



Source: DAI.

In September 2013, the mission amended the contract, increasing the estimated costs by \$5 million. The amendment also increased two expected outcomes or targets (Table 1):

Table 1. Revised Targets

Indicator	Expected Outcome or Target	
	Original	Revised
People in urban areas that will gain access to improved sanitation facilities	200,000	250,000
People trained in project activities	50,000	75,000

As of March 31, 2014, the mission had obligated approximately \$29 million and spent \$19 million for the project.

The project has three main components:

1. **Mobilize demand for improved water and sanitation services.** Activities under this component are designed to expand water services with citizen involvement and advocacy.

2. **Improve capacity to provide sustainable safe water and sanitation services.** This component involves training managers of public water utilities in staffing, billing, planning, cost recovery, debt management, and performance monitoring so that they can attract private sector investment that will help sustain them.
3. **Create an enabling environment supporting equitable water and sanitation services.** This component includes assistance with policy reform to make long-term funding available to utilities and local governments (through revenue sharing) and to citizens (through microfinance).

The Regional Inspector General/Manila (RIG) conducted this audit to determine whether the project was helping expand access to safe water and sanitation and whether beneficiaries will be able to maintain desired results after the project ends.

DAI has made progress on two of the project's main components. As of March 31, 2014, the project had increased the number of people gaining access to improved sanitation facilities, approximately 58 percent of the target. The project's successful master meter activity, which provides low-income families with access to affordable, reliable, and safe water, contributed to this achievement (page 4). USAID/Indonesia and DAI were working with local governments to establish connections in more communities.

Local government officials, utility directors and staff, and community beneficiaries interviewed during the audit expressed satisfaction with the training and technical assistance provided by DAI. One trainee, a local government sanitarian in Tangerang, West Java, was recently nominated for an Indonesian presidential award for promoting sanitation and hygiene services in his community.

As of March 31, 2014, 38 of 50 utilities targeted for poor performance (76 percent) exhibited improved performance in technical skill, financial management, customer relations, human resource management, and governance. According to DAI, the utilities improved by at least 20 percent compared with the December 2012 baseline, as validated by a performance index tool that the project developed. The increase in the number of water connections by utilities in their respective areas demonstrated this improved overall performance.

Despite these successes, the audit identified the following weaknesses:

- The sustainability of community sludge management was not certain (page 5). Sludge removal equipment was not used as intended. Because there was no established schedule for the services or compensation plan for the operators, machines sat idle.
- The community sewer system activity fell behind schedule (page 7). Because local government institutions did not coordinate in siting donor activities, an Australian project and the USAID project ended up working in adjoining neighborhoods. Locals hesitated to buy into the USAID project when they saw the Australians were providing free installations. Only 24 of the 118 targeted connections were completed as of the audit.
- The contractor overstated training results (page 8). DAI counted its paid organizers and observers as trainees, inflating total trainees by about 20 percent.

- The project set an unrealistic performance target for access to microfinance: 40,000 households (page 9). Microfinance loans were to be made to help low-income urban communities pay for upfront water supply connection fees. Only 20 percent of expected microfinance loans had been made.

We recommend that USAID/Indonesia:

1. Direct DAI to work with community organizations to implement a schedule for sludge removal to maximize use of the equipment, and establish a fee structure and compensation plan for machine operators (page 7).
2. Work with DAI to implement a plan to expedite activities related to sewer system construction (page 8).
3. Work with DAI to coordinate its activities with those of local government institutions and other donors in areas with similar projects (page 8).
4. Conduct a data quality assessment of the project's performance indicators to ensure that performance data meet the data quality standards—validity, integrity, precision, reliability, and timeliness. (page 9).
5. Instruct DAI to provide and document training to its staff on how to enter project information into its training database (page 9).
6. Approve the microfinance action plan lowering the targeted number of low-income households with access to microfinance loans (page 10).

Detailed findings appear in the following section. Appendix I has information on the scope and methodology. Our evaluation of management comments is included on page 11, and the full text of management comments without attachments appears in Appendix II.

# AUDIT FINDINGS

## Master Meter Has Increased Access to Clean Water for Low-Income Families

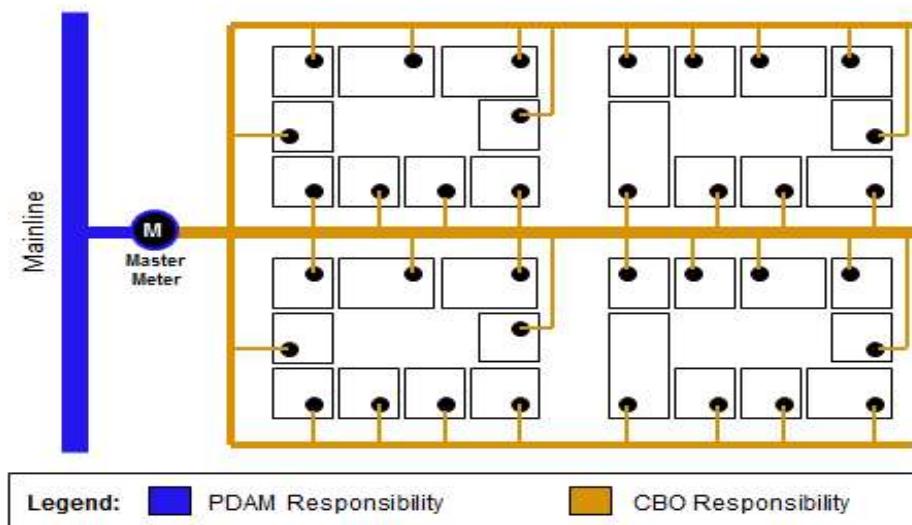
According to the contract, DAI would help expand water supply and sanitation services. To do so, it would build utility capacity through a successful model, such as a communal water-metering system, “that can bring communities together to engage with utilities to broker more affordable, reliable, and safe water supply access.”

The master meter activity, first implemented under USAID/Indonesia’s Environmental Services Program in 2008, has been successfully duplicated under the current project. Since July 2012, this activity has made clean water more accessible. As of March 31, 2014, 738 out of the 1,626 targeted households had access to a safe water supply through master meter connections, and the number should increase because more connections were planned.

The master meters, managed by community organizations, are installed at the entrance of neighborhoods, as shown in the figure below. Water is piped to households with individual water meters. The organization serves as a single water user for the utility and manages the community’s internal water supply system, monitoring meters and collecting payments, which go toward water usage, internal operations, and maintenance of the water metering system.

The master meter activity has especially benefited low-income communities. For them, land titling is problematic because settlements are informal. Even if they had titles, residents could not afford to install individual water connections to the utility. According to utility officials, the master meter approach has reduced the large number of illegal connections, especially in the Jakarta region.

### Master Meter and Connections to Individual Household Meters



Source: DAI. (PDAM represents Local Government Water Utilities)

According to members of the Semanggi community organization, they reached an agreement with the utility to access safe water at affordable (subsidized) rates. In exchange, community members provide labor to maintain the pipes. If the pipes need rehabilitation or neighborhoods require more connections, community members provide labor for those tasks too, and get grants from the project for materials.

In Sidoarjo District, East Java, using the master meter reduced the cost of water for individual households by 70 percent as illustrated in Table 2—even after increasing water consumption by 397 percent.

**Table 2. Increased Consumption and Decreased Cost of Safe Water With Master Meter Installation in Sidoarjo District (Unaudited)**

Type of Water Used	Consumption (m <sup>3</sup> )			Cost per Month (\$)		
	Before	After	Percent Change	Before	After	Percent Change
Pipe-connected safe water	1.16	5.77	397	6.25	1.90	-70
Water from other sources	0.39	0.26	-33	4.0	4.3	8
<b>Total</b>	<b>1.55</b>	<b>6.03</b>	<b>289</b>	<b>10.25</b>	<b>6.2</b>	<b>-40</b>

People have also improved their sanitation and hygiene practices. Before the master meter activity, the only sources of clean water were purchased bottled water, hand pumps connected to central tanks in communities, and water fetched from wells and streams that may be contaminated. Those with metered connections now avoid potential contamination.

Initially, it was challenging for most utilities to provide safe water to low-income communities; the utilities had financial difficulties because of poor management and operation. However, because of project training in good governance, customer relations, raw water treatment, long-term financial management, and accountability, among others, most utilities' operations have significantly improved. Thus, many utilities now connect and serve the poor more effectively through the master meter activity.

According to DAI, the master meter activity has made it affordable for users and providers to build new connections for the growing number of low-income residents, thereby increasing the demand for a safe water supply. In addition, having access to water through the master meter has encouraged communities to improve sanitation and hygiene. Further, the success of the master meter activity has encouraged other donors to support these communities. For example, the Asian Development Bank has plans to help communities in Jakarta install master meters.

## **Sustainability of Community Sludge Management Was Not Certain**

USAID's Automated Directives System (ADS) 200.3.1.5, "Build in Sustainability from the Start," states that projects should "make assistance investments where there is demonstrable local demand and ownership, and where a broad segment of the community has a stake in ensuring that the activity or service continues after the USAID program or project ends." However, the sustainability of the community-based sludge management activity was questionable.



Through a grant to Suluh Muda Indonesia<sup>1</sup>, the project provided septic sludge removal equipment to five pilot communities in Belawan, Medan, North Sumatra. The equipment empties septic tank waste from low-income communities whose narrow lanes are often impassable to government-owned sludge removal trucks. After receiving the equipment in September 2013, operators serviced two communities of about 300 households in just 4 months.

Thereafter the machines sat idle. Operators said that there was no established sludge removal schedule. The next round of sludge removal would not take place for another 2 years. Operators could have expanded service to other communities and raised revenue with the fees—increasing the likelihood of sustainability—but did not.

The operators, pictured below, expressed frustration over not being paid. Since this activity was a pilot, the project subsidized initial operations, and operators' fees were to be paid by the grantee until the activity's completion. Communities were supposed to cover subsequent payment. However, no plan for community payments and compensation for operators had been established.



**Wading in flooding from a heavy rain, operators in Belawan, Medan, in North Sumatra demonstrate their sludge pumps. (Photo by RIG/Manila, June 13, 2014)**

At another pilot community in Pademangan, North Jakarta, sludge removal equipment arrived early in 2014 under a grant to Mercy Corps but had remained unused since March. Residents had no clear understanding of the operating schedule, fee structure, or compensation payments. The three trained operators told auditors they had forgotten how to operate the equipment.

The machines sat idle because the grantee that DAI chose to provide the equipment and train and pay the operators did not do its job. According to a DAI official, the grantee did not submit the required documents—a sludge removal schedule, a fee structure, and an operator

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<sup>1</sup> This local infrastructure finance intermediary received a grant to provide sludge removal equipment.

compensation plan. Furthermore, DAI field staff did not monitor the grantee's activities to make sure it provided the documents because of lack of time as they had too many activities to monitor; the grantee admitted its negligence to DAI.

The mission cited an additional factor: target communities lacked tanks and piped water—the elements of a septic tank system. Officials said that because of raw water shortages in some communities (discussed on page 10), local government could not provide septic tanks to facilitate sludge removal. In addition, the plan for community payments and compensation for operators had not been established because the majority of target communities had not yet received piped water from the water utility. USAID/Indonesia officials did not proactively monitor the implementation of this activity, relying instead on DAI.

Much of the equipment has been sitting in storage although it could have benefited the surrounding communities, particularly those near Belawan, Medan. The inactivity may cause operators to lose interest in performing the service, reducing its odds of sustainability.

***Recommendation 1.*** *We recommend that USAID/Indonesia direct Development Alternatives Inc. to work with community organizations to implement a schedule for sludge removal to maximize the use of the equipment, and establish a fee structure and compensation plan for machine operators.*

## **Community Sewer System Activity Fell Behind Schedule**

USAID's ADS 202.3.6, "Monitoring Quality and Timeliness of Key Outputs," states that contracting officer's representatives, who monitor the quality and timeliness of outputs, should be alert to delays:

Delays in completing outputs or problems in output quality provide an early warning that results may not be achieved as planned. Timeliness of key outputs may affect the achievement of performance targets that the team presents in the Performance Report. Early action in response to problems is essential in managing for results.

The contract encourages the contractor to avoid duplicating effort by coordinating with the Indonesian Government and with other donors funding similar projects. The contract states, "USAID/Indonesia will take the lead in the donor coordination efforts and may designate the project for specific water and sanitation coordination."

In April 2012, the project supported the design and construction of additional household connections in Karet Kuningan, South Jakarta. It did so in partnership with three local organizations—PD PAL Jaya, the provincial government company in charge of operating the centralized sewerage system in Jakarta; Forkami, a small nongovernmental organization; and a subcontractor, construction firm PT Tessa Express. The grants provided to Forkami and the fixed-price subcontract provided to PT Tessa Express were for installing 118 connections to the sewer system for 200 households. However, employees of PD PAL Jaya and Forkami acknowledged installing only 24 connections. The plan was to complete this activity in a year, but more than 2 years had passed, and work was not finished.

The mission and DAI said the main reason for delays in installing and connecting pipes to the sewer system was competition from another donor. The Australian Agency for International Development started implementing the same project after USAID's program had already started, and it offered connections in a neighboring community at no charge to households. USAID's project, on the other hand, provided pipes but required payment to cover the cost of installing them so that the community would take ownership of the system and sustain it. According to Forkami officials, the community was delaying coming up with the money for installation, hoping that the Australians would offer free connections.

USAID/Indonesia officials acknowledged that they did not take the lead in coordinating the construction with other donors including Australia. The officials said they believed PD PAL Jaya and Forkami were responsible for coordinating these efforts since they receive funding from other donors investing in similar infrastructures.

Because of poor coordination, the sewer system had not been installed, and the project was not advancing its goal of increasing access to better sanitation services. Therefore, we make the following recommendations.

***Recommendation 2.*** We recommend that USAID/Indonesia work with Development Alternatives Inc. to implement a plan that will expedite activities associated with construction of the sewer system.

***Recommendation 3.*** We recommend that USAID/Indonesia work with Development Alternatives Inc. to coordinate its activities with local government institutions and other donors in areas with similar projects, and document the results.

## **Contractor Overstated Training Results**

USAID's ADS 203.3.11.1, "Data Quality Standards," states that USAID missions should ensure that performance data meet five data quality standards—validity, integrity, precision, reliability, and timeliness.

As of March 2014, DAI reported 45,432 people participating in project training activities. However, attendance sheets for 2,662 participants showed the total was overstated. By counting as participants its own staff, who were training organizers and observers, DAI overstated the number by approximately 20 percent.

According to DAI officials, the fault lay with its accountants. The company's regional accountants review financial data and other documents to ensure that spending and the number of participants trained match the budget for completed activities such as training, workshops, focus group discussions, and study tours. DAI's finance staff confirmed that regional accountants did not exclude DAI staff when entering the number of participants trained into DAI's Technical and Administrative Management Information System.

DAI's monitoring and evaluation team members admitted that they did not verify data from source documents to ensure that regional accountants entered correct information into the database. Team members said there was a limited number of monitoring and evaluation staff assigned to verify data and a large number of training participants. Hence, DAI officials relied on the information entered in the database by the regional accountants. DAI officials thought that regional accountants needed additional training in entering training data.

Furthermore, because mission officials did not consider it a priority, the mission had not conducted a data quality assessment for 2 years to determine whether results met data quality standards. A data quality assessment was done for the first year of the project, but at that time, not all indicators had reported results.

Since the results did not meet the validity standard, meaning they do not reflect the results the project intended to achieve, they could keep management from making appropriate decisions about project priorities. We therefore make the following recommendations.

***Recommendation 4.** We recommend that USAID/Indonesia conduct and document a data quality assessment of the project's performance indicators.*

***Recommendation 5.** We recommend that USAID/Indonesia instruct Development Alternatives Inc. to provide and document training to its staff on how to enter project information into its database.*

## **Project Set Unrealistic Performance Target for Access to Microfinance**

ADS 203.3.9, "Setting Performance Baselines and Targets," emphasizes that targets should be achieved on time and should be ambitious yet realistic. The contract requires DAI to facilitate access to microfinance for the improved water and sanitation services to 40,000 low-income households.

According to DAI, since most poor urban community households cannot accumulate savings or gain easy access to bank loans, they cannot afford to pay water supply connection fees up front. Furthermore, because of the fragile microfinance system in Indonesia, most low-income households lack access to microfinance.

However, as of March 31, 2014, only 8,346 of 40,000 targeted households had access to microfinance loans. A midterm evaluation of the project noted this issue. In response to this finding, DAI developed a microcredit action plan in May 2014. It proposes reducing the target for low-income households with access to microfinance loans from 40,000 to 15,000.

According to the action plan, the microfinance activity has not been successful because of these constraints:

- **Disengagement of the Bank Rakyat Indonesia (BRI).** BRI's disengagement, weakened the microfinance activity. It provided microfinance under USAID's Environmental Services Program, but during the considerable break in programming between projects, several key staff members at headquarters and at branch offices rotated to different positions. This affected the continuity of the microfinance initiative.
- **Availability of alternatives to cover connection charges.** The Indonesian Government and numerous international donor agencies provide subsidies to lessen the cost of connecting to the water supply for low-income communities. The availability of these subsidies has reduced the number of microfinance loan recipients.

- **Raw water shortages.** In many of Indonesia's low-income urban areas, raw water is in short supply. Not having enough, utilities are not able to add new customers without jeopardizing existing customers' continuous supply. This has decreased the number of utilities offering microfinance loans to potential customers.
- **Weak institutional capacity of local cooperatives.** The project approached other microfinance providers after the disengagement of BRI during the first half of the project; however, some of them operate on an ad hoc basis—not supported by any regulations or legal documentation. These types of institutions lack accountability, providing an opportunity for fraud.

DAI officials said the microcredit action plan addresses the above constraints in the following ways:

- Focusing the microfinance activity on large, well-established cooperatives that can act as lenders.
- Strengthening sanitation operations by involving small and medium-size enterprises.
- Assisting in the technical design of and conducting training for the cooperative facilitators who are already working with DAI to provide microfinance.

DAI also plans to work with local governments to pilot the model once it gets USAID's approval.

According to mission officials, they reviewed DAI's microcredit action plan but had not yet approved it. Mission officials were waiting for RIG/Manila's recommendation to determine whether to continue supporting microfinance activities.

The project has increased only slightly the number of recipients with access to clean water supply and sanitation through the microfinance partnerships. With only about 14 months left for the project, approving the action plan could help the mission further its goal to increase access to safe water and adequate sanitation.

***Recommendation 6.*** *We recommend that USAID/Indonesia approve the microfinance action plan lowering the targeted number of low-income households with access to microfinance loans.*

# EVALUATION OF MANAGEMENT COMMENTS

In its comments on the draft report, USAID/Indonesia agreed with all six recommendations. Having evaluated the comments and supporting documentation, we acknowledge management decisions on Recommendations 1 through 5 and final action on Recommendation 6. A detailed evaluation of management comments follows.

**Recommendation 1.** The mission decided to direct DAI to develop a sludge removal sustainability plan by December 31, 2014, for supported community based sludge removal activities. The contracting officer's representative will closely monitor the implementation of the plan, making sure it contains an established sludge removal schedule and fee structure, compensation for machine operators, and a link between the community-based service and a septic disposal enterprise for a better sewerage system. The mission stated that the plan would be effective by March 2, 2015. We acknowledge the mission's management decision.

**Recommendation 2.** The mission decided to work with DAI to develop a formal plan by December 31, 2014, that will expedite activities to ensure additional connections to the sewer system. Furthermore, to resolve the delay, the mission was working with key stakeholders operating the centralized sewerage system to ensure sustainability of all sewerage connections. The mission anticipated construction of the sewerage connections would be complete by March 2, 2015. We acknowledge the mission's management decision.

**Recommendation 3.** The mission decided to direct DAI to improve coordination to prevent investing in overlapping water and sanitation projects. DAI will be required to document its results in its Year 5 annual report, due October 15, 2015. The mission stated that final action would be taken by November 30, 2015. We acknowledge the mission's management decision.

**Recommendation 4.** The mission decided to conduct a data quality analysis by May 31, 2015, to ensure all its results are reported accurately. It did so after (1) an analysis the mission required DAI to conduct revealed that attendance for 8.6 percent of a representative sample of 4,500 trainees was overreported and (2) DAI revised the project's most recent annual report accordingly, reducing the total number of people trained by 3,894. We acknowledge the mission's management decision.

**Recommendation 5.** The mission decided to instruct DAI to provide an action plan to correct the reported performance data. One section of this plan, which the mission approved on November 19, 2014, outlines how DAI will administer training to its staff. The mission stated that final action—the training and documentation of it—would be complete by May 31, 2015. We acknowledge the mission's management decision.

**Recommendation 6.** The mission decided to issue a contract modification on September 11, 2014, reducing the targeted number of low-income households accessing microfinance loans from 40,000 to 15,000. The mission then approved the microfinance action plan on September 11, 2014. We acknowledge the mission's management decision and final action.

# SCOPE AND METHODOLOGY

## Scope

RIG/Manila conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions in accordance with our audit objective. We believe that the evidence obtained provides that reasonable basis.

The Regional Inspector General/Manila (RIG) conducted this audit to determine whether the project was helping expand access to safe water and sanitation and whether beneficiaries will be able to maintain desired results after the project ends.

According to the mission, as of March 31, 2014, it had obligated approximately \$29 million and spent \$19 million for the project. The mission later increased the total estimated cost of the project from \$33.7 million to \$38.7 million. Because this was a performance audit that looked at project implementation rather than specific financial transactions, the team did not audit the disbursements. The audit covered selected activities from the project's inception through March 31, 2014.

We assessed the following significant internal controls that USAID/Indonesia used to monitor project activities: the implementer's quarterly and annual progress reports, the performance monitoring and evaluation plan, and reports of meetings between mission officials and DAI. We also assessed monitoring by the implementer of grantees' activities, and site visits performed by the mission to validate project achievements. Additionally, we examined the mission's fiscal year 2013 annual self-assessment of management controls, which the mission is required to perform to comply with the Federal Managers' Financial Integrity Act of 1982, to check whether the assessment cited any relevant weaknesses.

RIG/Manila conducted audit fieldwork from June 9 to July 3, 2014, at USAID/Indonesia's office in Jakarta; the implementer's offices in Jakarta and Medan; and local government offices and utilities in three of the five project regions—Central Java, North Sumatra, and West Java.

## Methodology

To determine whether the project was achieving its main objectives, we reviewed relevant background documents—the cooperative agreement and modifications, annual work plans, site visit documents, and other records—to gain an understanding of the project and its activities. In addition, we examined the implementer's quarterly and annual progress reports to ascertain the status of activities as of March 31, 2014. The team also interviewed personnel at USAID/Indonesia and implementer officials. In addition, during site visits we interviewed officials of municipalities and water utilities, as well as beneficiaries.

In addition to reviewing records on file at USAID/Indonesia and the implementer's main office in Jakarta, the audit team traveled to eight districts in North Sumatra, West Java/Banten, and Central Java Provinces to visit selected activity sites.

The audit team visited activities in 8 of the project's 54 cities and municipalities. We judgmentally selected them based on their location and accessibility because traveling within the country is difficult. Audit work during site visits included interviewing local municipal officials and beneficiaries about the project's activities and the impact of the assistance. To the extent possible, we verified the planned deliverables and determined the extent to which DAI had achieved them. As part of our risk assessment, we obtained an understanding of the level of fraud awareness among the staff at each location.

In validating the project's reported achievements, the audit team reviewed all 21 indicators and tested data reported on them from the project's inception through March 31, 2014. This involved comparing the reported results with supporting records from the selected sites we visited to determine whether the reported data were accurate and reliable. Because we used a judgmental sample for site selection, results and overall conclusions are limited to the items tested and cannot be projected to all project sites.



# MANAGEMENT COMMENTS



December 5, 2014

## MANAGEMENT COMMENTS

**TO:** Matthew Rathgeber, Regional Inspector General/Manila

**FROM:** Derrick Brown, Acting Mission Director, USAID/Indonesia

**SUBJECT:** Audit of USAID/Indonesia's Indonesia Urban Water Sanitation and Hygiene Project (Report No. 5-497-15-XXX-P)

USAID/Indonesia appreciates the professionalism and thoroughness of the audit team from the Regional Inspector General's Office (RIG) in Manila in the conduct of the audit of the Indonesian Urban Water, Sanitation and Hygiene (IUWASH) Project. The audit findings are clear and will allow USAID/Indonesia to pursue effective management responses in a timely manner.

USAID/Indonesia agrees with all six recommendations. Based on input received during the RIG exit conference on July 3, 2014, USAID/Indonesia took swift action on a number of identified IUWASH program management and technical recommendations, all of which are captured in this document and reflect USAID/Indonesia's commitment to improving project sustainability, performance management and monitoring. The Mission's responses to the Regional Inspector General's recommendations are detailed below.

**Recommendation 1:** *We recommend that USAID/Indonesia direct Development Alternatives, Inc. to work with community organizations to implement a schedule for sludge removal to maximize the use of equipment, and establish a fee structure and compensation plan for machine operators.*

**Mission Response:** USAID/Indonesia **agrees** with this recommendation

The IUWASH project's Year 5 work plan, which is currently under final review, includes specific activities in the IUWASH supported sites of Belawan and Pademangang to address the above concerns raised in the RIG audit. However, no later than **December 31, 2014**, USAID/Indonesia will direct Development Alternatives, Inc. to develop a specific *Sludge Removal Sustainability Plan* for IUWASH-supported community based sludge removal activities. This plan will identify appropriate activities that can be undertaken during Project Year 5 to ensure that the IUWASH project's investments in these pilot community sludge

removal projects are as sustainable as possible. This will include, but is not limited to, assisting in establishing a sludge removal schedule, establishing a fee structure and compensation plan for machine operators and, where feasible, linking such community-based services to larger septic disposal enterprises such as those operated by Dinas Kebersihan (local government's sanitation division) in Medan and PD-PAL, the provincial government company in charge of operating Jakarta's centralized sewerage system.

USAID/Indonesia notes that several factors external to the IUWASH project also contributed to the underutilization of the sludge removal equipment in the two sites mentioned in the draft audit report. The Belawan, Medan site experienced severe raw water shortages, resulting in minimal water service provision to these communities. This in turn prohibited local communities from being able to utilize their new septic tanks, which need a consistent water supply to enable regular flushing and cleaning. Appreciating the negative impact of these raw water shortages on their water and sanitation investments, the local government of Medan then decided not to provide the communities in Belawan with an additional 1,000 septic tanks promised when IUWASH initiated the community sludge removal activity. As existing septic tanks fell into disuse and additional new septic tanks and customers never materialized, there was simply no demand for community based sludge removal services.

Recognizing these underlying challenges, IUWASH has been providing technical assistance to the local government of Medan to solve the raw water availability problems in Belawan. This has included facilitating and accelerating the development of a new water treatment plant that will supply clean water to 75,000 people, including residents of Belawan. The local government has further agreed to both provide the 1,000 septic tanks previously anticipated as well as to rehabilitate a substantial portion of the 4,000 household water connections that fell into disrepair due to lack of use and maintenance associated with insufficient water supplies. IUWASH specifically supported the detailed engineering design for the new water treatment plant's distribution network, and facilitated discussions ultimately resulting in the commitment of Rupiah 7 billion (approximately \$600,000) by the local government for the construction of the distribution network, and sufficient funding from the local water utility and central government to construct the new water treatment facility.

At the Pademangan, North Jakarta site, the local government also did not provide all of the septic tanks required and only 254 of the 450 promised were provided to local households. They also did not provide the temporary sludge storage (TSS) facilities in the locations needed, with one community receiving two TSS while another community did not receive any. As a result, there was not a critical mass of customers with septic tanks to create a sustainable market demand for regular desludging services nor the TSS storage facility needed in one of the areas. Moreover, it created a great degree of discontent in the targeted communities because, while a total of 254 households did receive new septic tanks, the remainder that had been promised such assistance did not. In response, the grantee (Mercy Corps) and IUWASH tried their best to lobby with all parties to arrive at an amicable solution, but by the time the grant ended, the issue remained unresolved. Though the grant program has ended, IUWASH is presently working with local stakeholders to resolve this issue and has already included related activities within the framework of its Annual Workplan for project year 5.

As part of the *Sludge Removal Sustainability Plan*, USAID will also request that IUWASH identify concrete actions that it is taking and will take to address the external factors identified above and that underlie the underutilization of the sludge removal equipment. This will document past actions taken, current actions being taken and future actions to be taken during the remainder of the IUWASH project lifecycle. The plan may require continued support to community based organizations in Belawan and Pademangan to ensure that the elements identified in the sustainability plan will be implemented. The IUWASH Contracting Officer's Representative (COR) will closely monitor the implementation of the *Sludge Removal Sustainability Plan* as part of her routine project oversight and monitoring practices, including verifying implementation during site visits, review of quarterly reports, and discussions with key stakeholders.

The target final action date for Recommendation 1 is **March 2, 2015**.

**Recommendation 2:** *We recommend that USAID/Indonesia work with Development Alternatives Inc. to implement a plan that will expedite activities in construction of the sewer system to avoid delays.*

**Mission Response:** USAID/Indonesia **agrees** with this recommendation

The IUWASH project has already undertaken some activities to redress the above situation and has also included additional activities in the draft Year 5 work plan. Actions taken have included intensive consultation with key stakeholders, including PD-PAL, the provincial government agency operating Jakarta's centralized sewerage system, to ensure sustainability of all sewerage connections made in this area. IUWASH is also working with a new partner with substantial reach into the target community, the Family Welfare Empowerment (PKK) organization, to assist in promotional activities to convince households to invest in connections to the centralized sewerage system. This will lead to a series of community meetings designed to address community concerns and find a mutual solution.

These actions together with the completion of the Australian Department of Foreign Affairs and Trade Agency for International Development activity, which had served as a major disincentive for households to participate earlier, is expected to increase the marketability of the targeted household connections. Nonetheless, and by no later than **December 31, 2014**, USAID/Indonesia will request that Development Alternatives Inc. provide a formal plan to expedite activities to ensure additional connections to the Karet Kuningan centralized sewerage system. This plan will identify actions the IUWASH project is taking and will take in the next year to ensure that as many connections as possible are constructed and in place by the time the project ends.

The target final action date is **March 2, 2015**.

**Recommendation 3:** *We recommend that USAID/Indonesia work with Development Alternatives Inc. to coordinate its activities with local government institutions and other donors in areas with similar projects and document the results.*

**Mission Response:** USAID/Indonesia **agrees** with this recommendation

In general, Development Alternatives Inc. coordinates IUWASH project activities closely with the target local government institutions related to water and sanitation in its 54 focus cities and districts. This is mainly due to the nature of the IUWASH project, which relies heavily on technical assistance to local governments and capacity building of local government institutions to accomplish project objectives. Where these local governments receive additional assistance from central government grants or loan programs or other donor investments, IUWASH strives to ensure close coordination with these activities as well. However, in the case of the Karet Kuningan, South Jakarta site highlighted in the draft audit report, it is clear that better coordination was needed with other donors implementing similar activities in the same geographic areas.

As part of the IUWASH project Year 5 work plan development process, and no later than **December 31<sup>st</sup>, 2014**, USAID will direct Development Alternatives Inc. to improve coordination within IUWASH project assisted cities and districts with other stakeholders investing in related or overlapping water and sanitation projects. USAID will request that Development Alternatives Inc. submit documented results of this improved coordination as part of their Year 5 Annual Report, which will be submitted by **October 15, 2015**.

The target final action date for Recommendation 3 is **November 30, 2015**.

**Recommendation 4:** *We recommend that USAID/Indonesia conduct and document a data quality assessment of the project's performance indicators.*

**Mission Response:** USAID/Indonesia **agrees** with this recommendation

The COR of the IUWASH project will conduct a DQA of the IUWASH project's performance indicators, in coordination with USAID/Indonesia's Program Office, by **March 31, 2015**.

On **July 25, 2014**, the IUWASH COR directed Development Alternatives Inc. to develop a methodology to address the draft audit findings related to the overstatement of training results reported under IUWASH High Level Result (HR) 4 (See Attachment 1). On **September 5, 2014**, the IUWASH COR approved the proposed methodology, which suggested a sample size of 4,500, or approximately 10%, of the reported participants of IUWASH trainings from the beginning of the project through March 2014 (see Attachment 2). This sample is a representative cross section of the reported number of persons trained by IUWASH by type of training event and by region. On **November 19, 2014**, the IUWASH COR reviewed and approved the final IUWASH Report on Correction of IUWASH Training Participant Data (see Attachments 2 and 3). This report determined that 8.57% of the representative sample of 4,500 trainees was previously over reported. As a result of this analysis, the most recent IUWASH project Annual

Report presented a revised result for HR-4 that reduces the total number of people trained by 3,894 people. USAID now considers this new number the accurate representation of the total number of people trained by the IUWASH Project. However, as part of the larger DQA conducted by the IUWASH COR by March 31, 2015, USAID/Indonesia will also conduct a DQA of this specific HR-4 indicator to ensure that the reported number accurately reflects external project beneficiaries trained by the project, and does not count DAI staff members as participants in the training.

The final target action date for Recommendation 4 is **May 31, 2015**.

**Recommendation 5:** *We recommend that USAID/Indonesia instruct Development Alternatives, Inc. to provide and document training to its staff on how to enter project information into its database.*

**Mission Response:** USAID/Indonesia **agrees** with this recommendation

As mentioned above, on July 25, 2014 the USAID COR instructed Development Alternatives Inc. to develop the “IUWASH Report on Correction of IUWASH Participant Data”. This report, which was approved on November 19, 2014, includes a specific section (see page 4 of Attachment 3) outlining how IUWASH will provide and document training to its staff to ensure accurate entry of data related to this indicator into its database. USAID/Indonesia will ensure that Development Alternatives Inc. is following these procedures as part of the March 31, 2015 DQA process and will regularly review these procedures with DAI during routine project management and supervision activities such as site visits, review of performance reports, and regular biweekly management meetings with IUWASH project leadership. USAID/Indonesia believes that significant action has been taken on this recommendation.

The final target action date for Recommendation 5 is **May 31, 2015**.

**Recommendation 6:** *We recommend that USAID/Indonesia approve the microfinance action plan, lowering the targeted number of low-income households with access to microfinance loans.*

**Mission Response:** USAID/Indonesia **agrees** with this recommendation

On **September 11, 2014**, USAID/Indonesia issued Contract Modification No. 10 (see Attachment 4), which lowered the targeted number of low-income households accessing microfinance loans from 40,000 to 15,000. With the issuance of this contract modification, the IUWASH COR then also officially approved the microfinance action plan on **September 11, 2014** (see Attachment 5).

USAID/Indonesia believes that the above actions fully address Recommendation 6 and requests its closure.

USAID/Indonesia requests RIG/Manila's concurrence that management decisions have been reached on Recommendations 1-5 and closure of Recommendation 6. We look forward to strengthening the IUWASH Program through implementation of the audit's recommendations.

Attachments:

1. COR Request to Revise Outcome HR-4, Number of People Trained
2. COR Approval, IUWASH Correction on IUWASH Report on Correction of IUWASH Training Participant Data (Outcome HR-4)
3. IUWASH Report on Correction of IUWASH Training Participant Data
4. IUWASH Contract Modification No. 10
5. COR Approval, IUWASH Microfinance Action Plan

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