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OFFICE OF INSPECTOR GENERAL

AUDIT OF USAID/INDONESIA'S TSUNAMI RECOVERY AND RECONSTRUCTION PROGRAM ACTIVITIES IMPLEMENTED BY DEVELOPMENT ALTERNATIVES, INC.

AUDIT REPORT NO. 5-497-06-009-P
September 15, 2006

MANILA, PHILIPPINES

Office of Inspector General

September 15, 2006

MEMORANDUM

TO: USAID/Indonesia Director, William M. Frej

FROM: Regional Inspector General/Manila, Catherine M. Trujillo /s/

SUBJECT: Audit of USAID/Indonesia's Tsunami Recovery and Reconstruction Program Activities Implemented by Development Alternatives, Inc. (Audit Report No. 5-497-06-009-P)

This memorandum transmits our final report on the subject audit. In finalizing the report, we considered your comments to the draft report and included the comments (without attachments) in Appendix II.

This report contains two recommendations to improve USAID/Indonesia's recording of tsunami recovery and reconstruction expenditures. Based on your comments, we consider that management decisions have been reached on both recommendations. Please coordinate final actions on these recommendations with the Audit, Performance and Compliance Division of USAID's Office of the Chief Financial Officer.

I want to thank you and your staff for the cooperation and courtesy extended to us during the audit.

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SUMMARY OF RESULTS

RIG/Manila audited selected USAID/Indonesia tsunami recovery and reconstruction program activities implemented by Development Alternatives, Inc. (DAI) to determine whether the selected activities were completed or progressing as planned. (See page 2.)

The selected USAID/Indonesia tsunami recovery and reconstruction program activities implemented by DAI under its Support for Peaceful Democratization project were completed as planned and the selected activities under its Environmental Services Program (ESP) were progressing. Although the ESP activities were progressing, we could not assess whether they were progressing as planned toward yearly targets because the year had not ended and DAI had not set interim targets against which progress could be measured. (See page 3.)

In conducting our audit, however, we noted that USAID/Indonesia needed to improve its recording of expenditures for tsunami activities. (See page 6.)

This report made two recommendations intended to improve USAID/Indonesia's recording of tsunami recovery and reconstruction expenditures. (See page 9.) Based on USAID/Indonesia's comments, we consider that management decisions have been reached on both recommendations. (See page 10.) In addition, the Mission requested that we edit reported expenditures included in the report. We did not change the reported expenditures included in the report. However, we made the revisions to the report to further clarify the basis of these reported expenditures. USAID/Indonesia's comments are included as Appendix II to this report. (See page 13.)

BACKGROUND

On December 26, 2004, the largest earthquake to strike South and Southeast Asia since 1964 caused a devastating tsunami that killed several hundred thousand people and displaced about one million others. Additionally, whole communities, roads, and other infrastructure were obliterated. Of the countries affected, Indonesia was hit hardest.

On May 11, 2005, President Bush signed into law the "Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief, 2005" which provided funding for a number of purposes including assisting victims of the tsunami. Of the $656 million appropriated to USAID, about $400 million was provided to USAID/Indonesia. In turn, USAID/Indonesia used its funding to establish its Tsunami Recovery and Reconstruction Program to assist Indonesian victims of the tsunami.

In some cases, USAID/Indonesia used existing contractors to implement its Tsunami Recovery and Reconstruction Program. For example, the Mission added a total of $22.4 million in tsunami funding to its two contracts with Development Alternatives, Inc. (DAI). Under these contracts, DAI was already implementing two large projects: the Support for Peaceful Democratization (SPD) project and the Environmental Services Program (ESP). Through its SPD project, DAI was to use $18.2 million in tsunami funding to award small grants to indigenous and international organizations for cash-for-work and livelihood activities in the tsunami-affected areas of the country. Through its ESP, DAI was to use $4.2 million in tsunami funding to improve water quality and delivery in villages whose water systems had been wiped out by the tsunami.

As of December 31, 2005, USAID/Indonesia records showed that it had obligated $22.4 million and recorded disbursements of approximately $5.5 million for the tsunami activities that DAI was implementing on behalf of the Mission.[1] Under the SPD project, DAI began tsunami activities in December 2004 and it planned to complete them by the end of September 2007. Under the ESP, DAI began tsunami activities in February 2005 and it planned to complete them by the end of September 2009.

AUDIT OBJECTIVE

The Regional Inspector General/Manila conducted this audit as part of its fiscal year 2006 annual audit plan to answer the following question:

- Were selected USAID/Indonesia tsunami recovery and reconstruction program activities implemented by Development Alternatives, Inc. completed or progressing as planned?

Appendix I contains a discussion of the audit's scope and methodology.

[1] See the discussion at page 6 about the accuracy of the reported disbursements.

AUDIT FINDINGS

Selected USAID/Indonesia tsunami recovery and reconstruction program activities implemented by Development Alternatives, Inc. (DAI) under its Support for Peaceful Democratization (SPD) project were completed as planned and selected activities under its Environmental Services Program (ESP) were progressing. Although the ESP activities were progressing, we could not assess whether they were progressing as planned toward yearly targets because the year had not ended and DAI had not set interim targets against which progress could be measured.

USAID/Indonesia provided $22.4 million to DAI to implement tsunami recovery and reconstruction activities through the SPD project and the ESP. USAID/Indonesia obligated $14.2 million of the $22.4 million into the DAI contracts in September and October 2005. Under the SPD project, we reviewed 5 of 39 activities for which USAID/Indonesia had recorded reimbursements to DAI against the correct tsunami appropriation account.[2] Under the ESP, we reviewed 4 of 11 activities that were to be completed during the second year of the contract. Accomplishments under the two DAI projects are presented below.

Support for Peaceful Democratization Project - USAID/Indonesia modified DAI's existing SPD project contract to add tsunami recovery and reconstruction activities. For these added tsunami activities, USAID/Indonesia increased the contract's funding by $18.2 million and provided $10 million of the increase in October 2005. According to its reports, DAI had expended $7.7 million for tsunami activities as of December 31, 2005. According to the Mission's financial records, however, the total expenditures amounted to only $5.4 million. (This discrepancy in expenditures is discussed at page 6.)

DAI used grantees, mostly nongovernmental organizations, to carry out its tsunami activities. Initial grants focused on short-term relief activities, mainly cash-for-work programs to provide employment, clean up villages and agricultural land, and rehabilitate small infrastructure (e.g., schools, markets). Subsequent grants were awarded to carry out a longer-term community-based recovery initiative. Generally, these grants were of short duration—usually six months or less.

According to a USAID/Indonesia official, the SPD project was designed to be highly flexible to respond to events as they occurred. This allowed DAI to immediately react to the tsunami disaster and USAID to expeditiously assist local governments. Under this flexible design, DAI was not required to have detailed work plans for the project. Instead, DAI established planned outputs for each grant it awarded. The Mission's financial records included expenditures for 39 activities (grants) implemented. During our fieldwork, we selected the following five activities to determine whether they were completed or progressing as planned.

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[2] USAID/Indonesia did not record all of its reimbursements to DAI against the correct tsunami appropriation account. Consequently, we limited the scope of our testing of the SPD project to those activities for which the Mission did record reimbursements to DAI against the correct tsunami appropriation account. (This recording issue is discussed at page 6.)

- A $96,682 grant to Pemerintah Mahasiswa with planned outputs to rehabilitate several dormitories at Syiah Kuala University in Banda Aceh and, in doing so, employ 325 Indonesians. The grantee satisfactorily demonstrated that the work was completed and 325 people were assisted under this cash-for-work grant.

- A $93,822 grant to Mitra Sejati Perempuan Indonesia with planned outputs to provide 210 women with material support to re-start economic activities. The grantee satisfactorily demonstrated that it had assisted the planned number of beneficiaries. Furthermore, our testing at several locations demonstrated that the planned material support was given and used, e.g., sewing machines and cooking equipment provided to a woman's cooperative, whose members then generated income by producing and selling clothing and food.

- An $80,734 grant to Yayasan Flower Aceh with planned outputs to provide 153 families in the Kreung Kala village with kitchen kits and 150 women farmers in three villages with agricultural materials. The grantee satisfactorily demonstrated that it purchased the supplies. Furthermore our testing at selected locations demonstrated that the families received and were using the supplies.

- A $250,000 grant to Mercy Corps with planned outputs to employ 2,369 tsunami survivors in a cash-for-work program to clean up 12 villages in Aceh province. Our observations and document reviews at one of the villages showed that the grantee satisfactorily demonstrated completion of this work.

- A $72,099 grant to Yayasan Peduli Hak Asasi Manusia, a local human-rights group, whose defined output was to monitor USAID-funded cash-for-work grants, including ensuring that USAID monies were accounted for, workers were paid in full, and the rehabilitation work was performed. Our visit to the grantee's headquarters satisfactorily demonstrated that it monitored the grants.

The Environmental Services Program - USAID/Indonesia modified DAI's existing ESP contract to add tsunami recovery and reconstruction activities. For these added tsunami activities, USAID/Indonesia increased the contract's funding by $200,000 and $4 million under two contract modifications effective March 29, 2005, and September 30, 2005, respectively. According to its reports, DAI had expended $689,567 for tsunami activities as of December 31, 2005. According to the Mission's financial records, however, the total expenditures amounted to only $73,487. (This discrepancy in expenditures is discussed at page 6.)

DAI was to use the $200,000 to conduct a needs assessment focusing on the rehabilitation and future development of key environmental services in Aceh Province. USAID/Indonesia issued DAI a letter to proceed prior to modifying the contract, which allowed DAI to complete and submit the assessment to the Mission by March 31, 2005.

For the $4 million it provided to DAI, USAID/Indonesia identified planned outputs under four technical components: watershed management and biodiversity conservation, environmental services delivery, environmental services finance, and environmentally sustainable design and implementation. DAI established annual targets for the planned outputs through fiscal year 2009, the projected end of the ESP.

At the time of our audit fieldwork in January 2006, four months had elapsed since USAID/Indonesia awarded the bulk of the funds for tsunami activities in Aceh province; consequently, the project was just getting started. The annual targets established were not yet due, and there were no interim targets available to assess progress conclusively. Nonetheless, DAI had commenced work and a number of planned outputs were in progress. From the four selected activities, we verified the progress of the following outputs, which were to be completed during the period from October 1, 2005, through September 30, 2006, the second year of contract performance:

- DAI's planned output under the watershed management and biodiversity conservation component was to improve watershed functions at four communities. Within the first four months of the second year, progress had occurred. For example, the ESP had completed several studies, maps and surveys to identify specific community-based rehabilitation activities for improving the watershed functions of various communities.

- One of the planned outputs under the environmental services delivery component was to increase revenues by 20 percent at one water utility agency by improving its technical and financial operations. Within the first four months of the second year, progress had occurred. For example, DAI provided $20,000 in laboratory equipment to two water treatment plants for testing water quality, trained 14 participants on the use of the equipment, and provided three computers to the financial department of one water utility agency.

- Another planned output under the environmental services delivery component was to provide five communities with improved water quality, sanitation, and solid waste practices. Within the first four months of the second year, progress had occurred. For example, the ESP improved water delivery at three village health facilities by providing a pump, reservoir, water tank, deep well, shallow well, drainage ditches, holding tank, septic tank, leaching field and other water-related equipment. The ESP also initiated assessments for return communities (areas resettled by Indonesians who had been displaced by the tsunami) targeted to receive the improved services.

OIG photograph of a USAID-funded pump system provided to a village health clinic in Desa Mibo, Banda Aceh District (Aceh Province, Indonesia, February 2006)

- One planned output under the environmentally sustainable design and implementation component was to develop a forum/network to address common

implementation issues and serve as a clearing house of best practices to mitigate any adverse environmental impact of post-tsunami reconstruction activities. Within the first four months of the second year, progress had occurred. For example, DAI held meetings with various organizations to establish the forum/network.

OIG photograph of a USAID-supplied water tank used to improve the water supply to a village health clinic in Desa Nusa, Aceh Besar District (Aceh Province, Indonesia, February 2006)

In determining whether selected USAID/Indonesia tsunami recovery and reconstruction program activities implemented by DAI were completed or progressing as planned, we noted that USAID/Indonesia needed to improve its recording of expenditures for tsunami activities. This issue is further addressed below.

Recording of Tsunami Expenditures Needs Improvement

Summary: Legislation providing funding for assistance to tsunami-affected countries required that the funding be accounted for on a project-by-project basis, and federal guidance required USAID to include tsunami expenditure data in its financial records using agreed upon line items. However, USAID/Indonesia's accounting records did not separately capture all tsunami expenditures incurred by DAI. This condition occurred because in some cases contract modifications authorizing DAI's tsunami activities did not contain clear provisions on the need to separately account for tsunami expenditures or, when such provisions were clear, they were not effectively enforced by USAID/Indonesia. As a result, USAID/Indonesia under-recorded the tsunami expenditures incurred by DAI by $2.9 million in its own financial records, and in its input to a report required by the U.S. Congress, USAID/Indonesia over-reported the tsunami expenditures incurred by DAI by $3.7 million based on its own financial records and by $793 thousand based on DAI's reports.

To provide accurate reporting to Congress, it is necessary for tsunami expenditures to be accounted for separately from general project expenditures. Section 4102 of the "Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Tsunami Relief, 2005" (Tsunami Supplemental) required the Secretary of State to report to Congress every six months on a project-by-project basis, the expenditure of funds appropriated under this act until all funds have been fully expended. In October 2005, the U.S. Department of State sent a cable to USAID and other federal

agencies involved in tsunami relief providing guidance on how the agencies should submit their input to the required semiannual Section 4102 report. For financial information, the cable required information on obligations and disbursements by implementing agreements. Additionally for USAID, the cable stated that the data should be entered into the Agency's financial system using previously agreed upon line items.

However, USAID/Indonesia did not separately capture all tsunami expenditures incurred by DAI so that it could report accurately to Congress its use of the funds provided by the Tsunami Supplemental. As shown in Table 1 at page 8, the Mission's accounting records showed that approximately $5.5 million had been expended under the Tsunami Supplemental at December 31, 2005. The Mission's recorded expenditures were $2.9 million short of the $8.4 million that DAI reported it had expended under the Tsunami Supplemental—an under-recording of 35 percent.

USAID/Indonesia's ability to fully capture expenditures under the Tsunami Supplemental was complicated by use of interim funding sources and the fact that DAI was already carrying out other activities in tsunami-affected areas of Indonesia, particularly Aceh province. Nonetheless, the Mission could have done more to ensure that its accounting records more accurately reflected the financial status of the Tsunami Supplemental funds it received and awarded to DAI.

USAID/Indonesia used interim funding sources to immediately assist Indonesian victims of the December 2004 tsunami. The Mission needed to use these other sources because the President did not sign the Tsunami Supplemental until May 11, 2005. In December 2004 and January 2005, USAID/Indonesia received $9.2 million from USAID's Office of Foreign Disaster Assistance (OFDA) and, in February 2005, it received $10 million from USAID's Asia and Near East (ANE) Bureau. Additionally, the Mission used $3.3 million of its own funding for urgently needed tsunami activities—funding that was originally intended for conflict mitigation in Aceh province.

To provide the assistance quickly, the Mission decided to utilize current partners as much as possible. For example, through contract modifications, the Mission allocated $8 million ($5 million in OFDA funding and $3 million in ANE funding) to DAI's existing SPD project and $200,000 in ANE funding to DAI's existing ESP. (These interim funding sources were subsequently reimbursed from the Tsunami Supplemental so that their expenditures became Tsunami Supplemental expenditures.) In September and October 2005, also through contract modifications, the Mission awarded $10.2 million and $4 million in funding directly from the Tsunami Supplemental to the SPD project and the ESP, respectively.

Although each of the interim funding sources and the Tsunami Supplemental had specific appropriation numbers and budget plan codes, DAI did not consistently account and bill for all tsunami expenditures by separate funding source on separate line items. For example, under the ESP, DAI did not separately report in its vouchers expenditures amounting to $281 thousand by funding source for tsunami activities covering the period March 2005 through September 2005. In October 2005, DAI began submitting vouchers noting the proper classification for the costs by funding source. Under the SPD project, DAI incurred $7.7 million on tsunami activities through December 2005, but separately reported in its vouchers expenditures only for OFDA grants amounting to $4.5 million. Of the $7.7 million tsunami expenditures, the Mission recorded a total of $5.4 million against the tsunami appropriations as of December 31, 2005.

A contributor to the problem was unclear language in the contract modifications that gave DAI funds for tsunami activities from the interim funding sources and the Tsunami Supplemental. Generally, the language stated that the Mission needed to account for the funds separately, but the language was not always clear. For example, Modification No. 10 to the SPD project, which added $10 million from the Tsunami Supplemental for tsunami activities, contained the following language: **"**This additional supplemental funding is earmark [*sic*] for Aceh and should be recorded and tracked separately**".** This language did not clearly state that the funds should be tracked and reported separately even from those funds supporting non-tsunami activities in Aceh, nor did it mention a requirement to "report" separately. Most other modifications did mention a requirement to report separately.

A second contributor to the problem was that USAID/Indonesia did not enforce the requirement in the ESP contract modifications for the separate reporting of tsunami expenditures. In a number of instances, the Mission paid DAI vouchers that did not separately report tsunami expenditures. For example, DAI did not separately report in its vouchers the expenditures for work performed on the tsunami activities under the ESP from March 2005 through September 2005. In such cases, Mission staff explained that they would first allocate the expenditures to appropriations that were funding DAI's older, non-tsunami activities. In other cases where DAI did report the tsunami expenditures separately, the Mission allocated the expenditures between tsunami and non-tsunami appropriations differently from how DAI had reported them in its vouchers.

One consequence of USAID/Indonesia not separately capturing all Tsunami Supplemental expenditures is that the amounts it reported to USAID/Washington for inclusion in the Section 4102 Report to the Congress on tsunami expenditures differed significantly from both the Mission's financial records and DAI's reports. Table 1 below shows these differences for the two DAI projects audited. In total, the $9.2 million that the Mission reported as tsunami expenditures for the Section 4102 Report to the Congress exceeded the amounts in its own financial records by $3.7 million and the amounts in DAI's reports by $793 thousand. Staff from the Mission's program office, who prepare the Mission's input to the Section 4102 report, explained that they decided to estimate expenditures in cases where they knew activities were taking place but where the Mission's accounting records did not show expenditures under the related appropriations. However, as noted earlier, the guidance from the U.S. Department of State made it clear that the data should be in USAID's financial system.

Table 1: Comparative Tsunami Supplemental Expenditures (As of December 31, 2005)[3]

Project	Obligated Amount	Reported Expenditures		
		Per 4102 Report	Per Mission Records	Per DAI Reports
SPD	$18,200,000	$8,521,433	$5,412,427	$7,738,827
ESP	4,200,000	700,000	73,487	689,567
Totals	**$22,400,000**	**$9,221,433**	**$5,485,914**	**$8,428,394**

Since USAID/Indonesia used other existing partners to carry out tsunami activities, this tsunami expenditure recording issue could extend beyond the two DAI projects.

[3] The amounts in this table were not audited.

Consequently, to ensure that all Tsunami Supplemental expenditures are separately captured and reported as intended by the Congress, we are making the following recommendations:

Recommendation No. 1: We recommend that USAID/Indonesia include in all its contracts, grants and cooperative agreements that have funding for tsunami recovery and reconstruction activities clear, specific language that requires the separate tracking and recording of tsunami expenditures and the separate reporting of those expenditures in the vouchers that implementing partners submit to USAID for payment.

Recommendation No. 2: We recommend that USAID/Indonesia develop and implement procedures to ensure that all past and future Tsunami Supplemental expenditures incurred by implementing partners are charged to the correct tsunami appropriations in the Mission's accounting records.

EVALUATION OF MANAGEMENT COMMENTS

In response to the draft report, USAID/Indonesia provided written comments that are included (without attachments) in Appendix II to this report. USAID/Indonesia accepted the report's two recommendations. The Mission's comments and our evaluation of those comments are summarized below.

In response to Recommendation No. 1 USAID/Indonesia stated that it amended its contract with Development Alternatives, Inc. (DAI) under the Support for Peaceful Democratization (SPD) contract requiring the contractor to account and bill for all expenditures by separate funding source on separate line items. In addition USAID/Indonesia stated that the Contracting Officer reviewed other implementing agreements funded with tsunami assistance funds and modified the implementing documents to include language requiring expenditures to be identified and reported by funding source. Based on the actions the Mission stated it had taken, we consider that a management decision has been reached on Recommendation No. 1.

In response to Recommendation No. 2 USAID/Indonesia stated that in addition to the correction taken in response to Recommendation No. 1, it has also been working with DAI to reconcile the cumulative expenditures for its SPD project by funding source. This process has been ongoing since mid-February 2006. Based on the actions the Mission's stated it had taken, we consider that a management decision has been reached on Recommendation No. 2.

USAID/Indonesia will need to coordinate final actions on both recommendations with USAID's Audit, Performance and Compliance Division of USAID's Office of the Chief Financial Officer.

In its written comments, USAID/Indonesia did not agree with the amounts cited in the draft report as expended by DAI and recorded in USAID/Indonesia's financial records. We reviewed the Mission's comments and supporting documentation in detail. We did not change the reported expenditures included in the report. However, we made revisions to the final report to further clarify the basis of these reported expenditures. In addition, we made minor editorial changes to the final report based on the Mission's comments.

SCOPE AND METHODOLOGY

Scope

The Regional Inspector General/Manila conducted this audit in accordance with generally accepted government auditing standards. The purpose of the audit was to determine whether selected USAID/Indonesia tsunami recovery and reconstruction program activities implemented by Development Alternatives, Inc. (DAI) were completed or progressing as planned.

The audit covered the tsunami recovery and reconstruction program activities DAI was implementing on behalf of USAID/Indonesia during the period from January 13, 2005, to December 31, 2005. As of December 31, 2005, Mission records showed that it had obligated $22.4 million and recorded disbursements of $5.5 million to DAI for those activities. However, the Mission's 4102 Report and DAI's reports showed expenditures of $9.2 million and $8.4 million, respectively. Audit fieldwork was conducted from January 23, 2006, through February 16, 2006, at USAID/Indonesia and the offices of DAI, both in Jakarta, Indonesia. Additionally, we made site visits to the Banda Aceh and Aceh Besar districts of Aceh Province, where DAI and its numerous grantees were implementing tsunami activities.

During the period audited, DAI was carrying out tsunami activities under two contracts with USAID/Indonesia: the Support for Peaceful Democratization (SPD) project and the Environmental Services Program (ESP). Through its SPD project, DAI was to use $18.2 million in tsunami funding to award small grants to indigenous and international organizations for cash-for-work and livelihood activities in the tsunami-affected areas of the country. Through its ESP, DAI was to use $4.2 million in tsunami funding to improve water quality and delivery in villages whose water systems had been wiped out by the tsunami.

As explained on page 6 of this report, the Mission did not record all disbursements to DAI for tsunami activities against the correct tsunami appropriation account. Consequently, our testing under the SPD project was limited in scope to 39 activities (grants) for which the Mission did record disbursements for tsunami activities against the correct tsunami appropriation account. These 39 grants involved $4.5 million of the $7.7 million in SPD tsunami expenditures in DAI's reports at December 31, 2005. We judgmentally selected and tested 5 of the 39 grants, which had expenditures totaling to about $600 thousand. For the ESP, we judgmentally selected and tested 4 of 11 activities in progress during the second year of contract performance.

As part of the audit, we assessed the significant internal controls used by USAID/Indonesia to ensure that DAI's tsunami activities were completed or progressing as planned. The assessment included controls related to whether the Mission (1) conducted and documented site visits to evaluate progress, (2) required and approved DAI implementation plans, (3) required and approved DAI progress reports, and (4) ensured accurate recording and reporting of tsunami expenditures. We also reviewed the Mission's annual self-assessment of internal controls in accordance with the Federal Managers' Financial Integrity Act. Finally, we obtained and reviewed prior audit findings related to the Mission's tsunami recovery and reconstruction program.

Methodology

To answer the audit objective, we interviewed officials and staff from USAID/Indonesia, DAI, and DAI grantees. Additionally, we interviewed local Indonesian government officials and beneficiaries of DAI's tsunami activities. We also reviewed and analyzed documentation relevant to the establishment and achievement of outputs and milestones for DAI's tsunami recovery and reconstruction program activities under the SPD project and the ESP. The documentation reviewed included:

- The legislation providing funding to assist victims of the December 26, 2004 tsunami.
- The SPD and ESP contracts and modifications, as well as grant agreements awarded by DAI under its SPD project.
- Implementation plans, progress reports, site visit and other monitoring reports, and financial reports and records.

For the SPD project and the ESP, we made site visits to five and seven locations, respectively, where DAI or its grantees were operating to assess whether their tsunami activities were completed or progressing as planned.

We did not establish materiality thresholds for the audit objective.

MANAGEMENT COMMENTS

September 1, 2006

MEMORANDUM

TO: Catherine Trujillo, Inspector General, RIG/Manila

FROM: William M. Frej, Mission Director, USAID/Indonesia /s/

SUBJECT: Draft Report on the Audit of USAID/Indonesia's Tsunami Recovery and Reconstruction Program Activities Implemented by Development Alternatives, Inc.
Audit Report No. 5-497-06-00X-P

As requested in your August 4, 2006 e-mail message, following are the Mission's comments and suggested changes to the draft audit report. We would like the auditors to consider incorporating these comments into the final report.

On page 2 of the draft audit report, in the second paragraph, it states that DAI received $14 million of the $22.4 million in September and October 2005. We recommend that this be changed to "USAID obligated $14.2 million into the DAI contracts in September 2005 and October 2005." The chart in Attachment 1 shows the obligations made into the contract for DAI/SPD with $10.2 million obligated into the contract in September and October 2005. As far as DAI/ESP, $4 million was obligated into the contract on September 30, 2005.

Also on page 2 in the third paragraph, it states that DAI had expended $7.7 million for its tsunami activities as of December 31, 2005. Per the vouchers submitted by DAI for ESP, the cumulative expenditures through December 31, 2005 for tsunami activities were $536,000.01 and through April 30, 2006, the amount was $1,232,448.06. DAI/SPD reported cumulative expenditures through December 31, 2005 of $4,613,178.22. As is shown in Attachment 1, the cumulative expenditures for DAI/SPD through April 30, 2006 for tsunami activities total approximately $5.8 million. So the total expended figure of $7.7 million as of December 31, 2005 shown in the audit report is well in excess of the cumulative expenditures reported to USAID/Indonesia by DAI through December 31, 2005 and even above the cumulative expenditures reported as of April 30, 2006.

On page 4, under ESP, DAI has reported cumulative expenditures through December 2005 of $536,000.01 under four vouchers covering the period October through

December 2005, dated November 11, 2005 through January 26, 2006, and the Mission has recorded the same amount in the accounting records. Amendment number 2 to DAI/ESP stated "The Contractor is reminded that the additional funding in the amount of $7,018,000 (including $1 million CSH, $2.018 million Biodiversity, and $4 million tsunami supplemental) is provided for the post tsunami program and therefore this additional fund must be tracked and recorded separately." Attachment number 2 shows the fund cites attached to this amendment and also includes a copy of amendment number 1. Attachment 3 shows the four vouchers with the correct fund cites used by the Mission. There is no discrepancy between what was reported by DAI for ESP and recorded by USAID. The audit report shows $689,567 and states there is a discrepancy.

On page 6, we recommend that you delete the sentence "As a result, USAID/Indonesia under-recorded and under-reported tsunami expenditures by as much as $3 million for DAI" as well as the last paragraph on the page beginning with "However" as this data is not based on the financial vouchers received from DAI. The cumulative expenditures through December 31, 2005, recorded for DAI/ESP is the same for both USAID and DAI. The cumulative expenditures through December 31, 2005, recorded by USAID for DAI/SPD is $5,765,193.82 while DAI reported $4,628,963.24 so USAID over reported cumulative expenditures related to the tsunami funds by $1,136,230.58. It should be noted that the amounts charged to the DAI contract by USAID did not exceed the total as reported by DAI. For example, as is shown in Attachment 4, the total expenditures are $772,266.75. This amount was charged to the DAI contract; however, the tsunami related expenditures reported by DAI were $49,546.26 and those recorded by USAID were $418,741.75 for the same period.

We suggest that you rewrite the narrative on page 7 and 8 to reflect that the accounting records for DAI/ESP accurately reflected the expenditures reported by DAI through the December 31, 2005 period according to the appropriate appropriations as shown in amendments number 1 and 2 to the DAI/ESP contract.

The chart shown on page 8 also needs to be corrected to include the correct expenditures. For ESP, the Mission and DAI records should show $536,000.01. For SPD, the Mission records should show $5,765,193.82 with DAI reporting $4,628,963.24. It appears that the figures used on the 4102 were higher than actual expenditures as the figures were based on estimated expenditures. The totals per Mission records would be $6,301,193.83 and the total per DAI records would be $5,164,963.25.

Recommendation No. 1: *We recommend that USAID/Indonesia take immediate steps to include in all its contracts, grants and cooperative agreements that have funding for tsunami recovery and reconstruction activities clear, specific language that requires the separate tracking and recording of tsunami expenditures and the separate reporting of those expenditures in the vouchers that implementing partners submit to USAID for payment.*

Response: USAID/Indonesia agrees with this recommendation in regards to the DAI/SPD contract. Though several amendments to the DAI/SPD contract stated funds should be recorded and tracked separately, the contractor did not report expenditures by all the funding sources separately on the vouchers as this was not specifically required by the contract amendments. DAI/SPD did record and track expenditures in their TAMIS database against all the funding sources.

The contract was further amended on March 10, 2006, requiring that the contractor account for all expenditures funded by regular SPD funds, Aceh tsunami relief and reconstruction efforts, Aceh Peace Funds, and private donations on separate line items and that such expenditures are required to be identified and reported by line item, in all vouchers submitted for payment.

The DAI/ESP contract amendment number 2 is attached for reference. This amendment, dated September 30, 2005, requests that contractor report on the funds separately. Beginning with their October 2005 voucher, DAI reported on expenditures by the funding sources separately as is shown in the attached vouchers covering the period October through December 2005.

The USAID/Indonesia Contracting Officers have reviewed other implementing agreements funded with tsunami assistance funds and have modified these implementing documents to include the language that expenditures are required to be identified and reported by funding source.

Mission Recommendation: Based on the actions undertaken, we recommend RIG/A/Manila determine that a mission management decision has been reached upon the issuance of this audit report recommendation. A closure request will be submitted to the Office of the Chief Financial Officer, Audit Performance and Compliance Division (M/CFO/APC) with supporting documents to substantiate the request for closure of this audit recommendation.

Recommendation No. 2: *We recommend that USAID/Indonesia develop and implement procedures to ensure that all past and future Tsunami Supplemental expenditures as incurred by implementing partners are charged to the correct tsunami appropriations in the Mission's accounting records.*

Response: USAID/Indonesia agrees with this recommendation in regards to the expenditures under DAI/SPD. As stated previously, DAI/ESP reports their expenditures by funding source. USAID and DAI records for ESP are in agreement.

The DAI/SPD contract was amended in March 2006 to required DAI to report expenditures by funding source on their vouchers. USAID has been working with DAI since mid-February 2006 to reconcile cumulative expenditures for SPD by funding source. See Attachment 1 for the latest correspondence in regards to this effort.

Mission Recommendation: Based on the actions undertaken, we recommend RIG/A/Manila determine that a mission management decision has been reached upon the issuance of this audit report recommendation. A closure request will be submitted to the Office of the Chief Financial Officer, Audit Performance and Compliance Division with supporting documents to substantiate the request for closure of this audit recommendation upon a final reconciliation with DAI for the SPD contract expenditures.

In summary, the mission accepts the two recommendations reported by the RIG/Manila audit team. We thank you for the opportunity to allow the mission to provide comments on the draft audit report.

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