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UNITED STATES GOVERNMENT

Memorandum

TO : Mr. Thomas C. Niblock, Director
USAID/Indonesia

DATE: February 9, 1981

FROM : Geoffrey G. Fritzler, A/RIG/A/M

SUBJECT: Memorandum Audit Report No. 2-497-81-7
Rural Electrification Project - Indonesia
Grant No. 497-0267
Loan No. 497-T-052
Project No. 497-0267

INTRODUCTION

AID Project No. 497-0267 began with a three million dollar grant on March 30, 1978, which was increased as planned, to six million dollars on August 31, 1979. An additional increase of five million dollars is in process. AID Loan No. 497-T-052 was signed May 6, 1978 for 30 million dollars, with a project assistance completion date of May 6, 1983.

In addition to the AID funds, the Government of the Netherlands provided 10 million guilders (4.6 million U.S.) and Canada provided 23.5 million Canadian dollars (19.7 million U.S.) in loans for the project.

The purpose of the project was to design, install and begin operations of ten rural electrification systems which would provide electricity to the rural poor. Seven of the systems were to be located in Central Java and operated by PLN, the Government of Indonesia (GOI) national power agency. The remaining three systems were to be located in Outer Island provinces and operated as user -owned cooperatives under the regulatory control of PDO, a new GOI entity to be created for the express purpose of managing and regulating electrical cooperatives (coops).

PDO was to have management responsibility for the three AID-funded coops and was perceived as an agency which would be able to create and organize other electrical coops as the AID coops demonstrated their effectiveness in providing rural electricity. PDO was to operate as a direct line organization within the existing Directorate General of Cooperatives (DGC), which has had responsibility for existing agricultural coops, but no experience with electrical coops.

At the time of our audit the project was almost three years old, and grant disbursements were $3,626,000, but only $197,000 of loan funds had been disbursed. Offshore procurement of materials is expected to exceed 18 million dollars in CY 1981 as construction of transmission and distribution lines begins.

SCOPE

Our audit of the rural electrification project, which covered the period from inception through December 31, 1980, was to determine whether AID funds had been used effectively, economically and efficiently and in conformance with AID regulations.

Our examination was performed in accordance with government auditing standards and included field visits to two operating project sites, discussions with GOI and USAID officials and the review of appropriate documentation. We were unable to inspect the National Rural Electric Cooperative Association's cost records because all financial records are being maintained in its Washington office.

This was the first audit of the rural electrification project in Indonesia by the Inspector General'S Office.

The draft report has been discussed with Mission officials and their comments were considered and included in the report as appropriate.

RESULTS OF AUDIT

Overview

Our audit showed that the rural electrification project in Indonesia has been one of the best managed AID projects that we have seen. Faced with serious problems within the various GOI organizations and the consultants with whom they were working, USAID/Indonesia took direct, timely and strong actions, in an effort to avoid roadblocks and consequent delays.

The actions taken by the Mission were appropriate within the limits of the GOI political environment and organizational structure, but unfortunately, they were not always able to prevail against the policies of GOI agencies. As a consequence, the project is well behind schedule, with further delays probable.

Despite the setbacks and frustrations encountered, the project is moving ahead and major systems construction will begin by the end of CY 1981 as foreign procured materials and supplies begin to arrive.

During the course of our audit we came across problem areas which, inspite of USAID/Indonesia's awareness, need to be reported on and which require appropriate recommendations to be made.

Project Consultants' Performance

One of the problems that has hindered the project's progress from the beginning has been a generally unsatisfactory performance by the two consulting firms. AID/Washington entered into Contracts with C.T. Main, International (CTM) and the National Rural

Electric Cooperative Association (NRECA), to provide architectural and engineering (A&E) services, and organization, management and technical (OMT) services, respectively. Both CTM and NRECA are under direct supervision of USAID/Indonesia.

Both contractors have failed to perform in accordance with Mission expectations, specifically in the areas of management, manpower and coordination. Numerous problems have resulted. For instance:

1. Many of the delays in construction of the systems have occurred because the A&E contractor is consistently late with the preparation of Invitation for Bids (IFBs) for the procurement of materials.

2. There have also been problems with the A&E firms staffing, both in terms of quantity and quality. One key position at CTM remains unfilled and other positions are filled with a staff that USAID/Indonesia still considers marginal, but less so since its active intervention.

3. The A&E contractor has separated its operations into two teams, working with PLN and PDO, respectively. The two teams have in some cases, failed to coordinate actions, with each other, resulting in duplication of effort and inconsistency in materials and engineering specifications. This has caused delays and confusion in the critical procurement area.

4. While NRECA has not experienced the staffing problems that CTM has, there has taken place insufficient coordination between NRECA, CTM, USAID/Indonesia and the GOI agencies involved. One of NRECA's most serious problems has been a lack of effective communication from NRECA to USAID and NRECA to GOI. This communications gap has prevented timely remedial action on NRECA-identified problems, and has impeded the transfer of ideas and expertise from NRECA to GOI.

While most of the contractors' problems have stemmed from their own management/manpower deficiencies, it should be noted that both contractors have sufferred from a lack of adequate GOI support. Examples of the GOI not living up to its agreement include:

1. Inadequate housing on a timely basis,

2. Failure to provide contractor personnel with transportation,

3. Inadequate office space, and

4. Failure to provide office supplies and materials.

USAID/Indonesia has previously notified the contractors of their performance deficiencies, and the Mission project manager stated that the contractors' inadequate performance had been the subject of numerous discussions between USAID/Indonesia and the CTM and NRECA teams, as well as their home offices.

Both CTM and NRECA have had recent changes in field management leadership which USAID/Indonesia feels represents a major improvement. Mission management has recently prepared letters to both contractors, restating previously noted deficiencies and again recommending specific corrective actions. In our opinion, considering the changes in contractor field management, the letters constitute the correct action at this time and therefore we make no formal recommendation.

GOI Organization

The rural electrification project was divided into two parts for implementation purposes. One part was to be managed and implemented by PLN, the national power company. The second part was to be composed of three privately owned and operated cooperatives under the supervisory management of the Project Development Office (PDO), a newly created GOI entity.

PDO was envisioned as an agency which would be responsible for organizing and managing electrical cooperatives throughout Indonesia. The three demonstration projects were designed to confirm that coops were a feasible medium for providing electricity to the rural population at low cost.

There already existed a GOI agency, the Directorate General of Cooperatives (DGC), which had responsibility for Indonesian coops, but the existing coops were primarily small agricultural units. USAID's original intent was to have PDO, as part of DGC, exercise direct authority over implementation and management of all electrical coops. Since electrical coops were far different in both scope and technical needs than anything that DGC had experience in, the creation of a special unit, PDO, was considered by USAID to be necessary for the success of the project.

After more than two years of project activity the organization of the GOI agencies is still not operating as planned. PDO is treated by DGC Provincial Offices as nothing more than a technical advisor and the actual line authority is exercised by DGC in Jakarta through the regional DGC coordinator in the province in which the coops is located. In one instance we are aware of, the coop employee was fired by the coop manager for incompetence, with the full concurrence of the NRECA advisor, but the manager was ordered by the DGC regional coordinator to reinstate the employee.

When we asked the DGC coordinator who had authority to direct and manage the coop, he replied that PDO was an advisor to DGC, and that the DGC coordinator was the only and exclusive source empowered to give the coops directives.

The division of organization that currently exists in the GOI with respect to coops has produced a state of management confusion at the coops. As an example, we noted a lack of written guidelines and operating instructions from DGC to the coops. Thus, when problems arise, the coops must wait for instructions to filter down to them. This confusion presents an obstacle to the coops' ability to demonstrate their effectiveness in providing electricity to the rural population at low cost. A failure to demonstrate conclusively that coops are a better instrument than the National Power Agency (PLN), in achieving rural electrification objectives, could result in the GOI's and potential donors' abandonment of the coop approach to rural electrification.

While the Mission and the contractors have attempted to rectify the organizational problems within the GOI, success has been limited, because of the resistance of DGC provincial officials to any perceived diminution of its charter to be the sole agency responsible for coops. This resistance has continued even though the grant agreement, Annex 1.3 states that the cooperative system will be managed by PDO.

Recommendation No. 1

USAID/Indonesia request a written definition by the Directorate General of Cooperatives (DGC) of the Project Development Office's (PDO's) responsibilities and authority. If the responsibility and authority to manage the coops has not been delegated to the PDO, as required by the grant agreement, USAID/Indonesia should again request that the grant agreement be complied with.

Recommendation No. 2

USAID/Indonesia request the Directorate General of Cooperatives (DGC) to instruct the Project Development Office (PDO) to prepare written guidelines for coops that will define policies and procedures to be followed.

Pole Procurement

One of the major impediments to the construction of distribution and transmission lines, at this time, is the procurement of poles. While materials and hardware for construction are not yet in country, the contracting process has progressed sufficiently to say with virtual certainty that these materials will begin arriving in the middle to late part of CY 1981.

Because of the long lead time involved in obtaining acceptable poles from local sources, and because of uncertainties in the ability of GOI to obtain adequate and timely procurement of wood poles, it is probable that poles will not be available in sufficient quantities when the foreign procured construction material start to arrive. Any delay in pole deliveries will further retard implementation of the project.

A contract for 16,000 of the 50,000 poles required for the PLN operations was awarded in February 1980 to a government controlled facility in Central Java. The poles were to be delivered in June of 1980, but due to poor selection and inadequate handling facilities, many of the poles were rejected either before or after treatment.

The problem is that Indonesia has not developed a pole treating industry which is able to produce poles of an acceptable quality, in sufficient quantities, at an internationally competitive price. The Mission had recommended that the pole IFB's be tendered internationally, at least for the first 10,000 to 20,000 poles required for immediate construction needs. The GOI has refused this suggestion, partly because it wants to develop a wood pole treating industry within Indonesia, and has thus prohibited the importation of wooden poles. Since the poles are being procured with GOI funds, USAID was unable to convince the GOI to go international. Because contracts for addditional poles have not yet been awarded, a delivery time cannot be accurately projected, but a delay in construction appears almost certain.

Mission management stated that at least two recent actions may eventually resolve this problem:

1. The contractor in Central Java has been authorized to purchase poles elsewhere on Java, and acceptably treated poles are beginning to arrive on site.

2. PLN has decided to order a combination of concrete and steel poles to fulfill remaining requirements. DGC/PDO has tendered for wood and concrete poles with a bid closing date of January 27, 1981.

Since the poles are paid for with GOI funds, and since the GOI policy prohibits importation of wood poles, there appear to be few, if any additional actions USAID/Indonesia can initiate that have not already been tried to solve this problem. Therefore we make no formal recommendation.

Lombok Coop Billing Procedures

One of the critical components in delivering electricity to rural areas concerns the availability of funds to finance housewiring costs. Since most of the target houses in the demonstration project areas did not have electricity available prior to the rural electrification project, they had no need to have houses wired. Now, with the advent of project electricity, the houses must be wired and the cost of wiring is generally beyond the financial means of the targeted disadvantaged population.

Anticipating this problem, USAID/Indonesia made available funds to purchase housewiring materials which the projects could install, and finance over a period of time, with repayments used to maintain a revolving fund for further expansion.

During our visits to the Lombok Coop, we noticed problems in housewiring billing procedures that are endangering the viability of the revolving fund concept. The coop has decided to prepare separate bills for electrical usage and for housewiring amortization and finance charges. Procedures currently in effect dictate that electricity be disconnected after a reasonable amount of time for non-payment of the usage bill, but houses are not disconnected for non-payment of the separate housewiring charges. We also noted that the amortization period for housewiring was either 3 or 6 months. Such a short amortization period produces monthly billings which could prevent needy customers from being able to pay.

As a result of the two-tier billing procedures for the separate charges, and the short amortization period, we noted that usage billings were being paid promptly by a large percentage of customers, but payments for housewiring amortization and finance charges had been made for only 20 percent of the houses wired.

While we were at the PLN demonstration project at Klaten, we noted that housewiring and usage charges were on one single bill and had to be paid in full, or customers would face disconnection. We also noted that the number of late payments in Klaten was small.

In our opinion, the cause of the low repayment of the housewiring amortization and finance charges in Lombok is due to the lack of incentive to pay, i.e. the threat of disconnect, and the short amortization time. In addition, the practice of preparing and accounting for separate billings for usage and housewiring costs appears unnecessarily cumbersome and inefficient.

Recommendation No. 3

USAID/Indonesia inform the Directorate General of Cooperatives (DGC) of the dual bill and short amortization period situations and request that it require the coops to consolidate their billings, initiate a uniform disconnect procedure on billings past due, and increase the amortization period.

Mission management informed us that a letter was being prepared by DGC, in response to the Mission's request, which, when acted upon, would satisfy this recommendation.

Material Inventories

During our examination of inventory procedures at the Lombok Coop we tested the inventory and found that stock control procedures were inadequate for safeguarding and the efficient use of stored materials. We found, specifically, that:

1. Inventory stock cards were not accurately maintained,

2. Amounts shown as received on stock cards did not agree with receiving reports, and

3. No reconciliation was made between amounts received per receiving reports and amounts per inventory.

The weakness in inventory procedures are, at this time, not a significant threat to loan funds, because materials to be purchased with loan funds have not yet arrived in Indonesia. The procedural weaknesses will become extremely important and serious during CY 1981, as up to 18 million dollars of material begins to arrive in Indonesia.

The lack of adequate warehousing procedures makes possible a wide range of undesirable effects, ranging from undetected theft to inefficient allocation of materials and supplies. In our opinion, the time between now and the arrival of this material should be used promptly to correct the noted deficiencies.

Recommendation No. 4

USAID/Indonesia direct NRECA to institute procedures at all project sites which will eliminate the various inventory and stock control deficiencies described in this report, and that NRECA periodically test the procedures for effectiveness.

Connection and Interest Fees

The PLN managed demonstration project in Klaten is one of seven planned electrification sites in Central Java. During our visit to the Klaten site we found that customers were being billed a 60,000 rupiah connection charge, instead of the 30,000 that had been agreed to with USAID. We also found that instead of the agreed upon four years connection charge amortization period, only six months was being allowed. The higher charge and shorter amortization period apply only to customers connected since September, 1980.

The increased connection fee and greatly reduced amortization period could make the monthly payments so high, that the targeted low income family would be unable to afford the connection fee.

We also found that customers at Klaten were being charged six percent interest on housewiring charges as agreed to in Implementation Letter No. 7. We found however, that the Lombok Coop was charging a 15 percent effective interest rate and the Lampung Coop had proposed charging 24 percent. These coop interest charges are high enough to discourage the rural poor from using electricity, and are higher than recommended by NRECA.

Recommendation No. 5

USAID/Indonesia require the Government of Indonesia to justify any increase in connection fees, and to extend the amortization period to insure that payments are not so high as to exclude low income customers from utilizing electric service.

Recommendation No. 6

USAID/Indonesia require the Government of Indonesia to reduce interest rates on AID-financed housewiring charges to no more than six percent, at all AID-funded projects, including the cooperative sites.

Monthly Reports

Grant Funds were used in part to pay for contract costs of two American consultants. One contract was with C.T. Main International, Inc., for architectural and engineering services, and one contract was with the National Rural Electric Cooperative Association, for organization, management and technical services.

Both contracts had provisions requiring the submission of monthly reports to USAID/Indonesia within 15 days of the end of the reporting period. Our review showed that monthly reports were not being submitted within the required 15 day period. In some instances reports were submitted more than 60 days after the end of the reporting period.

Staffing problems at both contractors' contributed to the late reports. Specific problems included unfilled positions, turnover of personnel and inadequate facilities. Because of the delays experienced in ordering materials, and because of USAID/Indonesia's continuous involvement on a day-to-day basis, the tardy reports have not been seriously detrimental so far. But the project is now entering the materials delivery and construction phase, and late reports could significantly impact upon the Mission's ability to respond quickly to operational and scheduling problems. The personnel problems of both contractors have been essentially solved. There is, in our opinion, no reason why future monthly reports should not be prepared and submitted on a timely basis.

Recommendation No. 7

USAID/Indonesia notify C.T. Main International, Inc. and the National Rural Electric Cooperative Association, in writing, that monthly reports are required within the specified 15 day period.

EXHIBIT A

RURAL ELECTRIFICATION PROJECT - INDONESIA

STATUS OF DISBURSEMENTS

GRANT FUNDS (12-31-80)

DESCRIPTION	AMOUNT COMMITTED	AMOUNT DISBURSED
CT Main	$2,600,000	$1,959,000
NRECA	2,000,000	1,279,219
Other Consultants	236,810	81,761
Other (Travel, etc.)	966,624	306,299
Total	$5,803,434	$3,626,279
Uncommitted Funds	196,566	
Authorized Grant	$6,000,000	

LOAN FUNDS (11-30-80)

DESCRIPTION	AMOUNT COMMITTED	AMOUNT DISBURSED
NRECA Training	$ 161,240	$ 90,751
Jeep Procurement	236,789	62,751
Materials	258,275	43,928
Trainer Travel	6,350	0
Citibank	323,878	0
	$ 986,532	$ 197,430
Uncommitted Funds	29,013,468	
Authorized Loan	$30,000,000	

REPORT RECIPIENTS

USAID/INDONESIA	
Director	5
AID/W	
Deputy Administrator	1
Bureau for Asia:	
Assistant Administrator	1
Deputy Assistant Administrator (Audit Liaison Officer)	1
Office of the Indonesia and South Pacific/ Asean Affairs (ASIA/ISPA)	1
Bureau of Development Support:	
Office of Development Information and Utilization (DS/DIU)	4
Bureau for Program and Management Services:	
Office of Contract Management (SER/CM)	3
Office of the Auditor General:	
Auditor General (IG)	1
Executive Management Staff (IG/EMS)	12
Plans, Policy & Programs (IG/PPP)	1
Area Auditor General:	
IG/W	1
IG/Africa (East)	1
IG/Egypt	1
IG/Near East	1
IG/Latin America	1
IGO/La Paz	1
IGO/New Delhi	1
Office of Legislative Affairs (LEG)	1
Office of Financial Management (FM)	1
Office of the General Counsel (GC)	1
Office of Legislative & Public Affairs (IDCA)	1
OTHER	
Inspector General, Inspections and Investigation Staff (IG/IIS/Manila)	1