

**Direct Funding Agreement**

**between the**

**Government of Australia as represented by the Australian Agency for International Development  
and**

**Government of the Republic of Indonesia as represented by Directorate General of Debt Management, the Ministry of Finance**

**In relation to**

**Urban Household Water Supply and Sanitation Program**

**General**

1. This Agreement expresses understandings between the Government of the Republic of Indonesia as represented by Directorate General of Debt Management, Ministry of Finance hereafter referred to as the "Partner Government" and the Government of Australia as represented by the Australian Agency for International Development hereafter referred to as "GOA", hereafter referred to collectively as "the Parties".
2. This Agreement is related to the Subsidiary Arrangement between GOA and Partner Government regarding the Indonesia Infrastructure Initiative Facility (IndII) as amended by the Parties on 21 December 2009 and provides specific detail of the implementation of the Urban Household Water Supply and Sanitation Program.
3. This Agreement is made pursuant to the terms of Article IV of the General Agreement on Development Cooperation (GADC) that came into force on 21 July 1991.
4. The terms of the GADC between GOA and the Partner Government apply to this Agreement.
5. This Agreement represents the understanding of the respective responsibilities and contributions of both Parties with regard to the provision of two separate output-based aid programs in (1) urban household water connections or Water Hibah and (2) urban household sanitation connections or Sanitation Hibah ("the Program").

**Definitions**

6. Under this Agreement:
  - a) National Medium-Term Development Plan 2010-2014 refers to the Partner Government's five-year development plan;
  - b) Local Governments refers to district or municipal governments that participate in the Water Hibah and Sanitation Hibah program;
  - c) Local Water Utilities or PDAM refer to piped water supply providers owned by local governments;
  - d) IndII refers to GOA's funded Indonesia Infrastructure Initiative Facility that manages the implementation of the Urban Household Water and Sanitation Program;

- e) The Facility Management Board or Board refers to the highest management structure of Indll that guide the implementation of the Indll Facility including (i) Water Hibah and (ii) Sanitation Hibah;
- f) The On-Granting Agreement or Naskah Perjanjian Penerusan Hibah Daerah (NPPH) refers to a grant agreement between the Ministry of Finance and participating Local Governments;
- g) Designated Account (Special Account) refers to an account established by Gol into which GOA may, at the Partner Government request, deposit amounts for the purpose of paying for eligible expenses as they are incurred; and
- h) Program Design Document (PDD) refers to design document dated 9 November 2009 which has been agreed by GOA and Partner Government.

**Implementation Arrangements and responsibilities**

- 7. In matters pertaining to the implementation of this Agreement, the Partner Government Ministry with overall responsibility for implementing the Program will be the Directorate General of Human Settlements, Ministry of Public Works.
- 8. The Partner Government will be fully responsible for the implementation of the Program and for the management of GOA financial contributions.
- 9. The Partner Government will provide financial statements on the grant disbursement from the designated special account to show that grant proceeds have been or are being used to finance eligible expenses. Submission of financial statements will be aligned with the timing of the Facility Board meetings.
- 10. The Partner Government will immediately inform GOA in writing of any circumstance which may interfere or threaten to interfere with the successful implementation of the Program and, with a view to resolving the issue, will consult with GOA on remedial action to be taken.

**Implementing Principles**

- 11. The Parties agree that the implementation of the Program under this Agreement will be guided by the following principles:
  - (i) Implementation will be based on a partnership approach.
  - (ii) Partner Government leadership and ownership of the Program is maximised.
  - (iii) AusAID support is aligned to the Partner Government needs and priorities.
  - (iv) Fairness, transparency, openness, accountability and mutual trust in all dealings.
  - (v) A focus on sustainable and equitable development that meets the needs of the Partner Government and beneficiary communities.
  - (vi) The strategic orientation of policies and strategies.
  - (vii) The effective and efficient use of Program resources.
  - (viii) The monitoring and evaluation of the Program will be implemented in accordance with the monitoring and evaluation plan developed by Indll and to the extent possible will involve participation of the Partner Government.

- (ix) Ensuring the pace of implementation is appropriate and responsive to the absorptive capacity of the Partner Government and appropriate capacity building measures are implemented.
- (x) Be based on the Partner Government's sectoral policy and plans as detailed in the National Medium Term Development Plan 2010-2014 as may be amended from time to time.
- (xi) The Paris Declaration and Accra Action Agenda partnership commitments are reflected in implementation to the maximum extent possible.

**Goal and Strategic Objectives**

- 12. The overall goal of the Program is to support the Partner Government in achieving increased access to household water supply and sanitation services. The strategic objective of the Program is making water and sanitation services more sustainable by supporting sector reform and capacity building.
- 13. The key outputs of the program are:
  - a. Up to a maximum of 70,000 household water connections of which approximately 50% will be poor households; and
  - b. Up to a maximum of 10,000 household wastewater connections of which approximately 50% will be poor households.
- 14. A summary outline of the Program is attached as Annex 1. The Executive Summary of Program Design Document dated 9 November 2009 is attached as Annex 5.

**Duration of Program**

- 15. The duration of the Program is fifteen months commencing April 2010 and ending June 2011.
- 16. This Agreement will take effect from the date of its signature by the Parties and will conclude when all responsibilities and obligations of the Parties have been fulfilled unless the Agreement is terminated earlier.
- 17. Any changes to the Program including changes to the funding as shown in Table 1 or duration will be subject to the mutual agreement of the Parties and a formal amendment of this Agreement.

**GOA Funding**

- 18. Subject to annual parliamentary appropriations, GOA will contribute up to a maximum of **AUD25 million** through direct funding support to the Partner Government for the Program activities.
- 19. The indicative annual funding to be provided by GOA is shown in Table 1.
- 20. In addition to the indicative total amount as shown in Table 1, GOA will also provide up to an estimated AUD 1,250,000 for technical assistance and related support for the implementation of the Program through a separate contracted service provider.
- 21. In the event that GOA funding is not used in accordance with Clause 23 below and/or there is a finding of fraudulent or corrupt practice in respect of the Program, GOA may reduce or suspend its funding until such time as both Parties agree a mutual resolution.

22. In the case of non-compliance with the terms of this Agreement and/or violation of the fundamental principles set out in this Agreement on the part of the Partner Government, GOA may suspend further disbursements to the Program and reclaim the funds already transferred in whole or part.
23. GOA funds will be used solely for the purposes of paying a portion of the Local Governments' costs for expanding services to a certain number of new household piped water and sanitation connections. The details of those payments will be stipulated in the on-granting agreement between the Ministry of Finance and individual participating Local Governments. The payments to local government have been set at 40% of the cost of expansion for water services and 60% of the cost of expansion of sewerage services.

**Partner Government Contribution and funding**

24. The GOA indicative funding for the Program is shown in Table 1.

**Table 1: Indicative Program Funding (AUD)**

<b>Year/Funding</b>	<b>2009-10</b>	<b>2010-2011</b>
GOA(Direct Funding) – Urban Household Water Supply Program (Water Hibah)	8 million	12 million
GOA(Direct Funding) – Urban Sanitation Program (Sanitation Hibah)	2 million	3 million

**Deposit and Disbursement of GOA funds**

25. The Schedule for payments by GOA to the Partner Government are detailed in Annex 2: (Payment of GOA funds)
26. GOA contributions to the Program will be deposited in 1 (one) Designated Account (Special Account), at the Bank Indonesia held in the name of the Directorate General of Treasury, the Ministry of Finance. The Partner Government will only use the GOA funds allocated to 2 (two) activities, the Urban Household Water Supply Program (Water Hibah) for urban household water connections and the Urban Sanitation Program (Sanitation Hibah) for urban household sanitation connections.
27. Table 2: Indicative Disbursement of GOA funds from the Special Account

<b>Year/Category</b>	<b>2010</b>	<b>2011</b>	<b>Total</b>
Urban Household Water Supply Program (Water Hibah)	14 million	6 million	20 million
Urban Sanitation Program (Sanitation Hibah)	3.5 million	1,5 million	5 million
<b>Total</b>	<b>17.5 million</b>	<b>7.5 million</b>	<b>25 million</b>

- 28. The Bank Indonesia will immediately acknowledge receipt of the funds, in writing, to GOA.
- 29. Any interest income attributable to GOA contribution(s) will be utilised by the Partner Government solely for the implementation of the Program.

**Management Arrangements**

- 30. The Parties acknowledge that regular consultation between the Parties is critical to the effective implementation of the Program.
- 31. Coordination between the Parties will be achieved through the Indonesia Infrastructure Initiative (IndII) Facility Management Board ("the Board") to ensure ongoing consultation, planning, coordination and implementation of the Program.
- 32. The role and responsibilities of the Board is stipulated in Clause 7.1, 7.2, 7.3 and 7.4 of the Amendment of the Subsidiary Arrangement for the Indonesia Infrastructure Initiative signed on 21 December 2009 attached as Annex 4.

**Monitoring, Review and Evaluation**

- 33. The primary monitoring of the Program will be the responsibility of IndII's water and sanitation team. An evaluation of the progress and/or outcome(s) of the Program may be made at times arranged between, and mutually convenient to, GOA and Partner Government. Such an evaluation will be undertaken jointly and will consider Program progress, quality and compliance with operational procedures and design specifications.

**Baseline Survey and Verification**

- 34. The Water Hibah and Sanitation Hibah will be implemented in designated areas which have a poverty focus and which have been agreed to as part of the project design. Payments will only be made for expansion of services within the designated areas. A baseline survey of the designated areas will be carried out by a GOA appointed consultant to identify unconnected households and their poverty status. After expansion of the services by local government and before payment of the grant, a verification survey will be carried out by a GOA appointed consultant to confirm the number of households that have been connected to piped water or sewerage services.

**Procurement**

- 35. The Procurement of the necessary supplies, materials and labour for the household water and sanitation connections is included in the fixed connection fee as charged by the Local Governments under the Program.
- 36. The Partner Government through Local Government/Local Water Utilities will be responsible for all procurement relating to Program preparation and construction in accordance with its established rules, procedures and legislation as may be amended by the Partner Government from time to time.

**Audit**

- 37. The Partner Government is responsible for ensuring that the Program and its associated funding are audited on an annual basis.

38. An annual audit of the Program will, wherever possible, be undertaken by the Partner Government's Financial and Development Supervision Board (BPKP).
39. Where circumstances arise that the BPKP advises that it will be unable to undertake the annual audit the Parties agree that an independent auditor will be engaged to undertake the annual audit.
40. The arrangements, including the terms of reference, selection method and costs, for the engagement of an independent auditor will be agreed by the Board.
41. The Partner Government agrees that AusAID may commission independent audits of the Program and acknowledges that it will cooperate fully with any such audits.
42. AusAID agrees to provide the Partner Government with a copy of any independent audit reports.

#### **Fraud**

43. 'Fraudulent activity' or 'fraud' means: Dishonestly obtaining a benefit by deception or other means.
44. The Parties are committed to preventing and detecting fraud.
45. The Partner Government is responsible for preventing and detecting fraud involving or relating to the Program.
46. The Partner Government must immediately report in writing to GOA any detected, suspected, or attempted fraudulent activity involving or relating to the Program.
47. The Partner Government is required to investigate any alleged fraud and must undertake an investigation in accordance with its own procedures and standards or, where requested by the Board, in accordance with procedures and standards as directed by the Board.
48. Following the conclusion of an investigation, where the investigation finds identified acts of a fraudulent nature Partner Government will:
  - i. initiate recovery action in accordance with recovery procedures, including if appropriate civil litigation, available in the Partner Country; and
  - ii. refer the matter to the relevant Partner Country police or other authorities responsible for prosecution of fraudulent activity; or
  - iii. where a Partner Government employee is involved in fraudulent activity, take the relevant disciplinary procedures in accordance with relevant Code of Conduct or similar Partner Government provisions where these exist.

#### **Anti-Corruption**

49. The Parties are committed to preventing and detecting corruption and bribery. Both Parties through their employees, agents or representatives will not make or cause to be made, nor will they receive or seek to receive, any offer, gift or payment, consideration or benefit of any kind, which would or could be construed as an illegal or corrupt practice, either directly or indirectly to any party, as an inducement or reward in relation to the execution of this

Agreement or any arrangement or provision of funds in relation to the Program. The Parties will use their best endeavours to ensure that their respective employees, agents, representatives or other entities involved in the Program will also adhere to this provision.

50. For the purposes of this paragraph (Anti-Corruption), the term 'corrupt' includes (but is not limited to) any action or practice which would warrant disciplinary procedures being taken against an individual under applicable laws.
51. In the event of alleged misuse of Program funds involving fraudulent or corrupt behaviour as defined above, GOA may reduce or suspend its funding until such time as the matter is mutually resolved by the Parties.

#### **Status of Agreement**

52. This Agreement serves only as a record of the Parties' intentions and does not constitute or create (and is not intended to create) rights or obligations under domestic or international law and will not give rise to any legal process and will not be deemed to constitute or create any legally binding or enforceable rights or obligations (expressed or implied).

#### **Settlement of Disputes**

53. Any dispute, controversy, or claim, which arises out of the interpretation or application of this Agreement will not be subject to adjudication or arbitration, but will instead be dealt with through amicable consultations and negotiations as the only method of achieving the peaceful settlement of that dispute, controversy, or claim.

#### **Extraordinary Events**

54. Neither the Partner Government or GOA will be responsible for any failure to perform or any delay in performing their obligations under this Agreement where the cause of such failure or delay is beyond that Party's reasonable control (Force majeure). The Party claiming suspension of its obligations due to an extraordinary event will immediately notify the other Party in writing of its intent and the reason(s) for suspension.

#### **Indemnity and Insurance**

55. The Partner Government will indemnify GOA at all times against any actions, claims, liabilities, damages or expenses suffered or incurred by GOA as a result of, or arising from, the implementation of the Program.

#### **Use of Agreement Information**

56. Both Parties will respect the confidentiality of information provided by the other as "Confidential" or "In-Confidence". Neither Party will disclose such information to a third party without obtaining the written agreement of the other Party unless and except where the disclosure of such information is required by law or government convention.
57. GOA may disclose matters relating to the Agreement, including the Agreement to governmental departments and agencies, Ministers and Parliamentary Secretaries of the Commonwealth of Australia, and to the Parliament of the Commonwealth of Australia, including responding to requests for information from Parliamentary committees or inquiries. This clause will survive termination or expiration of the Agreement.
58. The Partner Government may disclose matters relating to the Agreement, including the Agreement to its governmental departments and agencies, Ministers and Parliamentary

Secretaries, and to the Parliament, including responding to requests for information from Parliamentary committees or inquiries.

**Amendment**

59. All changes to this Agreement must be mutually agreed in writing by the Parties, either in the form of a formal amendment to the Agreement, or an Exchange of Letters signed by both Parties.

**Termination**

60. Termination of this Agreement may be effected by one Party on giving 90 days written notice and reasons for the termination to the other Party.
61. In the event of any termination the Partner Government will provide an independently audited financial statement of the Program funding for the financial year during which termination occurred.

**Provisions to Prevent Financing of Terrorism**

62. The Partner Government will use its best endeavours to ensure that funds provided by GOA under the Agreement do not provide direct or indirect support or resources to organisations and individuals associated with terrorism or listed on a 'Relevant List' as defined at Clause 65 below.
63. If, during the course of this Agreement, the Partner Government discovers that an organisation or individual involved in the Agreement is listed on a 'Relevant List' or has any link whatsoever with any organisation or individual associated with terrorism it will inform GOA immediately.
64. GOA may terminate this Agreement immediately by notice in writing to the Partner Government if the Partner Government breaches any of its obligations to prevent the financing of terrorism.
65. Notwithstanding GOA's right to terminate this Agreement under **Clause 62** in the event of a breach of this clause, the Partner Government will use its best endeavours to recover an amount equivalent to the relevant funds which are found to have been paid to organisations and individuals associated with terrorism and refund that amount to GOA.
66. 'Relevant List' means the lists of terrorist organisations made under Division 102 of the *Criminal Code Act 1995* (Cth) and the *Charter of the UN Act 1945* (Cth) posted at: <http://www.nationalsecurity.gov.au/agd/www/nationalsecurity.nsf/AllDocs/95FB057CA3DECF30CA256FAB001F7FBD?OpenDocument> and [http://www.dfat.gov.au/icat/UNSC\\_financial\\_sanctions.html#3](http://www.dfat.gov.au/icat/UNSC_financial_sanctions.html#3)

**Exemption from Taxation**

67. The Partner Government agrees that all the provisions of the GADC that came into force on 21 July 1991 apply to this Program including taxation exemptions.

**Correspondence**

68. All correspondence related to the implementation of this Agreement should be addressed to:



GOA: AusAID  
Jl HR Rasuna Said Kav C15-16, Jakarta 12940  
Phone +62 21 2550 5582, Fax:+62 21 392 7274  
Attention: Unit Manager Infrastructure

Partner Government Directorate General of Debt Management, the Ministry of Finance  
Jl Lapangan Banteng Timur 2-4, Jakarta 10710  
+62 21 345 8289, Fax +62 21 381 2859  
Attention: Director General of Debt Management

ANNEXURES to this Agreement form an integral part of it.

IN WITNESS THEREOF, the undersigned have signed this Agreement.

Signed in duplicate on the 25<sup>th</sup> day of *May* in the year of 2010 in two (2) originals in the English language, both of the texts being equally authentic.

**FOR THE GOVERNMENT OF AUSTRALIA**



.....  
(Signature)

Peter Baxter, ~~Acting~~ Director General  
FMA Act s44 Delegate

**FOR THE GOVERNMENT OF THE  
REPUBLIC OF INDONESIA**



.....  
(Signature)

Rahmat Waluyanto, Director General of  
Debt Management

## **Annex 1: Summary outline of the Program**

### **Background**

The Urban Household Water and Sanitation Program is part of GOA's \$300 million Water and Sanitation Initiative (WSI) announced in December 2008. WSI core objectives are to: (i) expand access to water supply and sanitation services, particularly for the poor, women, and children in schools; (ii) make water and sanitation services more sustainable by supporting sector reform and capacity building; (iii) improve the health and quality of life of the poor and vulnerable by increasing their understanding of good hygiene practices, as well as by expanding their access to water supply and sanitation services; (iv) Enhance aid effectiveness and complement other programs.

Under the WSI, \$60.5 million is allocated to Indonesia for the following initiatives:

- \$20 million Urban Household Water Supply Program ("Water Hibah").
- \$11.2 million Urban Sanitation Program of which \$5 million will be provided to two local Governments of Banjarmasin and Surakarta for an extension of a piped sanitation system. Another \$5 million will be provided to support preparation of an Investment Plan for a sewerage system in 5 cities, and A\$1.2 million for baseline and verification survey.
- \$22.5 million for expanding the community-based water supply for low income communities program – PAMSIMAS.

In addition to funding the above initiatives, WSI will support Civil Society WASH Fund (up to \$4 million) and program management activities including monitoring and evaluation (\$2.8 million).

### **Urban Household Water Supply Program ("Water Hibah")**

The WSI Urban Household Water Supply Program is designed with the objective of expanding piped water coverage in urban areas (and especially areas with a high proportion of low-income households), and assisting GOI to pilot a much larger and broader *Water Hibah* program.

GOA funds will be provided to Local Governments (LG) using the output-based approach where the grants will be provided based on the number of new household piped water connections that have been constructed by the local water utilities (PDAMs) and verified as functioning for a minimum of three months. Selection of Local Governments is based against criteria including:

- a. having sufficient water treatment capacity available to serve the proposed customer base expansion;
- b. meeting the key eligibility requirements for the Central Government Debt Restructuring scheme;
- c. whether the LG has committed to inject equity into their PDAMs; and
- d. having a sound distribution expansion program prepared and ready for implementation in 2010.

In addition, LGs/PDAMs must be able to demonstrate their capacity and intent to pre-finance their programs.

The GOA grant will support the delivery during 2010 of 70,000 new connections of which no less than half are to be for poor households and serving a total of about 420,000 persons in at least 22 and up to 30 cities. The grant amount will be Rp2 million per connection for the first 1,000 connections and Rp3 million thereafter, to a ceiling connection limit per LG. For a program of 3,000 connections, the aggregate grant amount is expected to cover approximately 45 percent of the incremental investment cost.

The Program will pilot of the government's water supply incentives grant – an initiative to stimulate local government investment in the water sector. It is one component of a comprehensive restructuring of the water sector by the GoI which also includes tariff setting, credit finance to PDAMs and debt restructuring.

The higher level outcome of the Program is to increase investment from participating LGs in their respective PDAM as a first step towards greater responsibility by LGs for water services. The investment of LG budget funds as equity in the PDAM is an important step in the process to improve governance of the water sector. Acceptance of responsibility by LGs for their water sector achieves sustainable improvements in service coverage to the community and increased and better services for poor households.

#### **Urban Sanitation Program (“Sanitation Hibah”)**

The objective of the urban sanitation program (“Sanitation Hibah”) is to assist the local government of Banjarmasin to achieve its targeted 15,000 sewerage connections, and the local government of Surakarta to achieve its targeted 6,000 connections (refer to PDD for full details). The specific objectives of the WSI component will be to support the provision of sanitation services to a total of 10,000 households in Banjarmasin and Surakarta, of which approximately 5,000 are estimated to be poor. This will be achieved through a combination of direct sewerage connections and on-site communal facilities. The direct sewer connections will be for mixed poor and non-poor households in accordance with the PDD, while the communal systems will be exclusively for poor households.

The GOA grant will support the delivery of:

1. sewerage/sanitation services to approximately 10,000 households in Banjarmasin city from an identified demand of 4,000 new sewerage connections, and 2,000 connections to new communal on-site systems. In total, these are expected to serve around 60,000 people. The grant amounts will be Rp5 million per new sewerage connection and Rp2 million per communal on-site system connection, with individual aggregate grant limits being set for each city.

2. an additional 3,000 domestic connections to the existing sewer system in Surakarta city by expanding the secondary and lateral sewer network and optimising the use of the existing network. It will also support the provision by the city government of on-site communal sanitation facilities for 1,000 poor households that cannot be served by the sewerage system.

The GOA grant is expected to cover approximately 60 percent of the aggregate incremental investment cost.

#### **Grant Channelling Mechanism**

The GOA grant to Urban Water Supply and Sanitation Program will be delivered fully through the existing GOI administrative and regulatory framework using the recently established on-granting mechanism stipulated in the Ministry of Finance Decree PMK 168/169. The grant funds will be placed on budget in a Ministry of Finance designated special account in the Indonesia Central Bank (Bank Indonesia). Funds disbursement will be authorised by a GOI-appointed authorised signatory of the special account. The GOI will monitor and report on the disbursement of the funds of the special account to AusAID and to the IndII Facility Management Board.

#### **Management Arrangements**

It is intended that the implementation of the WSI including the above two programs will be overseen by an expanded Indonesia Infrastructure Initiative (IndII) Facility Managing Contractor team to ensure synergy with other AusAID funded water and sanitation activities being funded by IndII, and serve to minimise overhead costs. The Program will be executed under the coordination of the Directorate General of Human Settlements of the Ministry of Public Works.

**Annex 2: Payment of GOA funds**

GOA funds will be transferred to the designated special account through 3 tranches with the following schedules:

- **First tranche of 40% (AUD10 million) of the total GOA grant of A\$25 million (A\$20 million from Water Hibah and A\$5 million from Sanitation Hibah) will be made upon signing of this Funding Agreement.**
- **Second tranche of 30% (AUD7.5 million) will be made by 30 November 2010 or when the results of the verification for the first batch of new household connections became available, whichever is the earlier.**
- **Third tranche of 30% (AUD7.5 million) will be made by 31 March 2011 or when the results of the verification for the last batch of new household connections became available, whichever is the earlier.**

Payment of the tranches identified above will be subject to satisfactory verification of progress.

**Annex 3: Program Risk Management Plan**

	<b>Risk</b>	<b>Risk Mitigation Measure</b>	<b>Level of Risk after Mitigation</b>
1	LG cannot budget for FY 2010 because of late commitment of AusAID funds	<p>Gol uses the existing IndII SA and the IEG grant portion to enable the start of the budgeting process prior to final approval of WSI and availability of WSI funds.</p> <p>LGs can proceed with signing of Grant Agreements and use funds available from PDAMs. Selection of PDAMs has been made on availability of funds for initial pre-financing.</p>	L
2	Currency risk	The general mitigation measure will be to maintain the Special Account in Rupiah, and only transfer three months funding over 4 tranches.	
3	Currency risk – A fall in the value of the dollar will reduce funding available.	A fall in the dollar and steady demand for funding of components can be mitigated by using uncommitted IndII grant funds.	
4	Currency risk – A rise in the value of the dollar will result in excess funds available.	<p>A rise in the dollar and steady demand may be mitigated by amending the LG grant agreements for selected LG with capacity to absorb more funds.</p> <p>A rise in the dollar and weaker demand is mitigated by reducing transfers to the special account and applying the mitigation measures for “low demand”</p>	L
5	Low demand from some LG or slow uptake of connections by some LG. This is the most likely risk scenario.	The uptake will be reviewed at mid-term (August – September 2010) and a reallocation of grants will be made to those LG that are capable of installing more connections [ref item 3].	M
6	Low overall demand for water connections.	<p>This risk has been reduced by spreading the program over 25 LGs and by having approximately 50% spare demand. The identified demand from 25 LGs for water is 104,400 connections. Grant agreements will allocate 70,450 connections equivalent to \$ 20.7 million at an exchange rate of Rp 8,250. There is an unallocated demand of some 34,000 connections with a grant value of approximately \$10 million.</p> <p>If low demand cannot be mitigated by spare capacity funds will be reallocated to the PAMSIMAS component.</p>	L
7	Low demand from poor households for 8connection in some LG.	<p>The identified demand if 104,400 connections is for poor households. The program requires only 50% of the new connections to be for poor households. Therefore the target is approximately 35,000 poor households from an identified demand of 104,400 poor households.</p>	L
8	Low demand for sewer connections.	<p>Allow more funding for on-site sanitation services.</p> <p>Reallocate grant from Banjarmasin to Surakarta or vice versa.</p> <p>Allocate grant to Bandung as a back-up option.</p>	M

	Risk	Risk Mitigation Measure	Level of Risk after Mitigation
9	Low demand overall for sewerage and sanitation connections.	Transfer funding to <i>Water Hibah</i> program.	M
10	Lack of funds for Pre-financing by LG	The LGs will either allocate budgets by Dec 2009, or allocate revised budgets in August – September 2010. In the latter case the PDAMs will pre-finance the works. LGs and PDAMs have been selected on the basis of funds being available.  LGs/PDAMs will be able to claim the grant in tranches of 500-1000 connections to overcome cash flow problems.	L
11	Limited time to implement in one year.	Use of the PDAM and PDPAL budgets will allow carry-over into 2011 as late as March and allow verification in April.  Mid-term reallocation to fast implementing local governments will reduce the risk.	M
12	Construction Delays – water and sewerage. There is risk that the contracting and construction process may be delayed reducing the achievement of the targeted connections	The selection of the <i>Water Hibah</i> LGs is made on the basis of spare delivery capacity within candidate PDAMs and which require only distribution and reticulation pipe-work to effect the new connections. For the <i>Sanitation Hibah</i> , in Banjarmasin the connections will be effected within the existing main trunk sewer network and will only require lateral sewerage for new connections.	L
13	Fiduciary risk and contractor corruption.	Both the <i>Water Hibah</i> and <i>Sanitation Hibah</i> use an output based methodology. Grant funds are disbursed after works are completed. Verification of the completed works is done by an independent consultant appointed under WSI. The grant fund is set at about 45% of the average cost of a new water connection and about 60% of a new sewerage/sanitation connection.  The LG grant agreements have a mechanism for recovery of funds from LG should there be evidence of ineligible expenditure after the grant has been disbursed.	L
14	Sewerage Investment Plans – LGs do not commit to finance.	Criteria for proceeding will depend on commitment. A long list of 14 LGs is being screened and taken through a self selection process to arrive at 4 committed LGs.	L
15	There is insufficient funding by Gol to implement or no interest from Donor agencies to finance.	This component has the highest priority by Gol for implementation. World Bank, ADB, JICA, as well as AusAID and USAID have established a donor coordination group to manage and monitor the development pipeline for sanitation programs.	L

## **Annex 4: Indonesia Infrastructure Initiative (IndII) Facility Management Board Roles and Responsibilities**

### **7.1 Facility Management Board**

The Facility Management Board (the Board) will guide and direct the implementation of the IndII Facility. The Board will be co-chaired by the Bappenas Deputy responsible for infrastructure development and by the AusAID Minister/Counsellor for Indonesia, and will include five other members:

- a) A representative of the Coordinating Ministry of Economic Affairs;
- b) A representative of the Ministry of Finance;
- c) A representative of Indonesian civil society with acknowledged infrastructure knowledge and expertise;
- d) AusAID's Country Office Infrastructure Representative.
- e) One other Australian Government representative.

The Board will meet formally at six-monthly intervals to:

- a) provide strategic direction and oversight, including on the desirable allocation of IFGI and CSI program resources;
- b) approve (or require revision of) the draft Facility Review and Planning Document (FRPD);
- c) consider and approve (or require revision of) proposals regarding activity selection criteria and management processes.

The Board may also hold supplementary meetings as appropriate for briefings or to consider urgent issues arising.

In considering materials tabled by the IndII FMC, the Board will take account of related inputs provided by the Technical Teams and AusAID staff. Decisions will be taken on the basis of consensus.

### **7.2 Bappenas**

Bappenas as the GOI Coordinating Authority will co-chair the Board and help ensure smooth and effective Facility implementation, including through: providing inputs to the Board, AusAID and the Impact Assessment Team; providing feedback to the Managing Contractor on draft Facility Review and Plan Documents and on outline activity proposals and workplans; and facilitating access to government institutions and to information held by government agencies. Bappenas may also act as the GOI Client Agency for certain technical assistance services which address high level cross-sector or thematic policy and planning issues.

### **7.3 Technical Team**

GOI will establish two Technical Teams to meet regularly with both AusAID and the IndII FMC to discuss progress, review proposed activities, and support the implementation of the Facility. Technical Team 1 (TT1) will deal with Component 1 (Water and Sanitation) and Technical Team 2 (TT2) will deal with Components 2 and 3 (Roads and Transport, Other Sectors, and Cross Sector).



TT1 will be chaired by the Bappenas Director responsible for water and sanitation matters, and comprise non-Bappenas members drawn from Central Government agencies having responsibilities directly related to water and sanitation policy formulation and program support. Bappenas will nominate the TT1 members after consultation with the agencies concerned.

TT2 will be chaired by the nominated representative of the Bappenas Co-Chair, and its other two members will comprise the nominated representatives of the other two GOI Board members.

#### **7.4 AusAID**

AusAID as the GOA Coordinating Authority will co-chair the Board and will designate representatives to work with the GOI Technical Teams. It will engage, manage, monitor and assess the performance of the IndII FMC; exercise financial oversight, including through the right of final approval of detailed activity designs, expenditure budgets and procurement decisions; and provide inputs to the Board and to the Impact Assessment Team.

AusAID will provide the Notice of Disbursement (NOD) quarterly to Bappenas.

## **Annex 5: Program Design Document (9 November 2009)**

### **Introduction and Background**

The Water and Sanitation Initiative (WSI) was announced by the Government of Australia (GoA) in December 2008. Its core objectives are to:

- Expand access to water supply and sanitation services, particularly for the poor, women, and children in schools;
- Make water and sanitation services more sustainable by supporting sector reform and capacity building;
- Improve the health and quality of life of the poor and vulnerable by increasing their understanding of good hygiene practices, as well as by expanding their access to water supply and sanitation services.
- Enhance aid effectiveness and complement other programs

The approved funding for WSI is A\$300 million, of which A\$100 million will be channelled through multilateral development agencies and A\$200 million to bilateral country programs. Implementation of bilateral programs is expected to be completed by end-June 2011. Indonesia will be one of the main beneficiary countries, with an increased allocation of \$60.5 million having been confirmed in June 2009.

Candidate components for an Indonesia WSI program totalling \$35 million were identified by an AusAID mission in June-July 2008. The resultant *Concept Document* was endorsed in December 2008 and a design consultant was engaged in February 2009. The subsequent decision to substantially increase the funding allocation, coupled with important and rapid developments in Indonesia's WATSAN sector required significant changes to this, with a revised concept document being considered at the Review Meeting held on August 26, 2009. This document proposed four core components:

- **Rural Water & Sanitation (\$22.5million)**; to be implemented through extension of the committed PAMSIMAS program, with indicative allocations of \$12 million for water supply, \$8 million for sanitation, and \$2.5 million for program socialisation;
- **Urban Water Supply (\$20 million)**: to pilot the implementation of a new output-based incentive grants scheme (the '*Water Hibah*') aimed at promoting increased and sustainable local government investment in expanding water connections;
- **Urban Sanitation (\$10 million)**: to prepare investment plans for sewerage systems in four large cities and to expand sewerage and sanitation services in Banjarmasin and Surakarta; and
- **A Sector-wide Civil Society component (\$5 million).**

In addition, provision of \$3 million was made for program management, monitoring & evaluation, and verification services.

The Review Meeting endorsed the amended concept and instructed, among other decisions, that designs be prepared for the urban water supply and urban sanitation components. The proposed designs, which address the first two WSI objectives, are described in this document. Responses to Review Meeting instructions relating to other components and to the overall management of the WSI Indonesia program are presented in separate documents.

## **Urban Water Supply**

### **Context**

The pace of Indonesia's urban growth over the past decade has outstripped its very limited investment in urban water supply infrastructure, with the percentage of urban population served by piped water having consequently declined from 39 percent to 31 percent, during the past ten years. Under-investment is attributable to several factors, including rapid decentralisation – with the pace of function transfer having outstripped the development of institutional capacities and the poor financial condition of many water utilities (PDAMs) in the wake of the 1997 financial crisis.

GOI is now accorded a high priority to mobilising new investment, as is clearly evidenced by recent concerted policy reforms. These reforms include:

- **Improved tariff-setting guidelines** for PDAMs (*through Government Regulation 16/2005 and Minister of Home Affairs Regulation 23/2006*): these are designed to enable PDAMs to recover costs and earn a return on assets while also providing affordable lifeline tariffs for poor households (through cross-subsidy between customers);
- **Debt restructuring** for PDAMs which have defaulted on loan repayments to MoF (*through Minister of Finance Decree PMK 120/2008*): this provides for partial or full write-off of interest arrears and penalties, in return for specific governance improvements and other undertakings (including implementation of the tariff guidelines);
- **Central Government Loan Guarantee and Interest Subsidy scheme** to assist PDAMs seeking to obtain commercial loans (through Presidential Regulation 29/2009): this scheme is available to PDAMs which have a 'healthy' audit rating or have been approved to participate in the debt restructuring program;
- **Incentive grants ("Water Hibah") scheme** for new piped water connections (to be implemented using the new grants mechanism established by *Minister of Finance Regulations PMK 168 and 169/2008*); this will provide lump-sum grants to local governments for new piped water connections which have been independently verified to be delivering water.

The pace at which this strategy has been developed is impressive. The debt restructuring scheme was established shortly before the WSI Identification Mission in October 2008, while the *Water Hibah* and the Central Government Loan Guarantee and Interest Subsidy schemes were devised subsequent to the approval of the WSI Indonesia Concept Document and in parallel with the preparation of the Design Summary and Implementation Document (DSID).

### **WSI Urban Water Supply Component**

The WSI urban water supply component is designed with the triple objective of expanding piped water coverage in urban areas (and especially areas with a high proportion of low-income households), improving the financial sustainability of PDAMs,<sup>1</sup> and assisting GOI to pilot a much larger and broader *Water Hibah* program. The output-based design incorporates features developed by two small demonstration projects now being implemented in Jakarta and Surabaya with support from the Global Partnership for Output-Based Aid (GPOBA).

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<sup>1</sup> PDAM sustainability depends on having a mix of customers to enable cross-subsidy of lifeline tariffs for poor households. WSI funding will support connection programs in neighbourhoods with an above average proportion of low income households.

The WSI funds will support the delivery during 2010 of 70,000 new connections serving around 420,000 persons in up to 25 cities. The grant amount will be Rp.2 million per connection for the first 1,000 connections and Rp.3 million thereafter, to a ceiling connection limit per local government (*Kota /Kabupaten*). For a program of 3,000 connections, the aggregate grant amount is expected to cover approximately 45 percent of the incremental investment cost. The WSI funds will be channelled to local governments (PEMDAs) – referred to throughout as Local Governments or LGs – using the newly developed grant channelling procedures (*PMKs 168 and 169*) and will pioneer their use for channelling donor funds for output-based programs. Participation in the WSI-funded program is voluntary and is open to local governments which commit to injecting equity into their PDAMs in an amount at least equal to the grant they receive. To be eligible, their PDAMs must: (a) have sufficient water treatment capacity available to serve the proposed customer base expansion; (b) meet the key eligibility requirements for the Central Government Loan Guarantee and Interest Subsidy scheme; and (c) have a sound distribution expansion program prepared and ready for implementation in 2010. In addition, LGs/ PDAMs must be able to demonstrate their capacity and intent to pre-finance their programs. A screening process has been conducted by the Ministry of Public Works in consultation with MoF and AusAID and, as of end-October, 15 of the 25 invited local governments had already formally confirmed their intent to participate.

As indicated above, the WSI *Water Hibah* component was developed in parallel with – and contributed to – the development of GOI's water sector strategy, and it enjoys the strong and active support of BAPPENAS (the National Development Planning Agency) and the Ministries of Finance and Public Works. Its timing coincides with the first annual phase of a broader *Hibah* grant program that is expected, *inter alia*, to support delivery of circa 1.5 million new water connections over the period 2010-2014. Funding for this medium-term program is expected to be sourced from the *Anggaran Pendapatan dan Belanja Negara (APBN)* and donors.

## **Urban Sanitation**

### **Context**

The dominant form of sanitation in Indonesia's cities is still self-provision using septic tanks. These are often poorly constructed, resulting in seepage into aquifers and hence into shallow wells used for household water supplies. De-sludging tends to be conducted infrequently, with private contractors commonly dumping sludge in rivers or drains rather than proper disposal facilities.

Indonesia's kampung improvement projects, which were implemented in the 1980s and early 90s, featured construction of communal toilet and bathing facilities (MCKs), although these were not very successful. More recently, GOI through its SANIMAS program has been providing small matching grants to support construction of communal septic tanks and connections to small groups of households.

While the use of self-provided septic tanks is inappropriate in densely populated urban areas – and especially areas which lack access to piped water supplies – construction of sewerage systems is costly and households' willingness to pay is perceived to be low. This has led GOI to prioritise provision of drinking water services, while piped sanitation has received little attention or funding. Only 11 cities currently have some form of sewerage system, serving just one percent of Indonesia's urban population.

However, the GOI approach to sanitation is now changing rapidly, as evidenced by the *National Policy and Strategy for the Management of Wastewater Systems* issued by the Minister of Public Works (MPW) in December 2008. This document addresses five key themes: (i) increasing access to sanitation for urban and rural communities with priorities to low income households; (ii) increasing the role of the community and the private sector in provision of sanitation services; (iii) developing a regulatory framework for management of sanitation; (iv) building capacity for institutions and personnel involved in wastewater management; and (v) increasing investment and developing alternative funding sources for wastewater infrastructure.

The *Sanitation Road Map*, prepared jointly by BAPPENAS and the Ministries of Public Works, Health and Home Affairs, presents proposals for its initial implementation phase covering the period 2010-2014. Key targets for urban areas include increasing the number of cities with piped sewerage from 11 to 15; increasing the coverage urban sewerage systems to 20 percent of the respective populations; and engaging with 330 cities / towns to prepare sanitation strategies with sound financing plans. The SANIMAS program will continue, with the communal clusters later being connected to sewers (and their septic tanks being de-commissioned).

GOI's policy and strategy for *urban* sanitation has evolved rapidly during the period in which the WSI Indonesia component was being developed and designed. However, implementation challenges for urban sanitation works are more formidable due to the more limited institutional capacities at the local level.

#### **WSI Urban Sanitation Component**

The urban sanitation component is designed to support the implementation of GOI's *Sanitation Road Map* and comprises two sub-components:

- support for connecting up to 10,000 households to improved sanitation facilities in Banjarmasin and Surakarta using a combination of sewerage and on-site sanitation; and
- preparation of sewerage investment plans for four cities to the standards required to secure financing from an MDB

#### **Sewerage Connections**

During preparation of the Design Summary and Implementation Document, GOI and GOA requested that a significant proportion of the WSI Indonesia allocation be used to finance increased access to improved sanitation for urban households. Following the decision in June 2009 to increase substantially the size of the Indonesia allocation, the design team was asked to explore ways of supporting the extension of existing sewerage systems during 2010. The only feasible option identified was to employ an output-based hibah scheme broadly similar to that developed for urban water supply.

The intent is that WSI will provide lump sum grants for new, working connections to existing piped sewerage systems and for connections of poor households to new communal on-site systems which are designed to be served later by sewerage extension. Within the tight design timeframe, it has been possible to identify three candidate cities – Banjarmasin and Surakarta – which have existing sewerage systems and also definite plans and available pre-financing for their extension during 2010.

The design envisages WSI supporting the delivery of: sewerage/sanitation services to approximately 10,000 households from an identified demand of 8,600 new sewerage connections, and 3,000 connections to new communal on-site systems. In total, these are expected to serve around 60,000 persons. The grant amounts will be Rp.5 million per new

sewerage connection and Rp 2 million per communal on-site system connection, with individual aggregate grant limits being set for each city. The WSI funding is expected to cover approximately 60 percent of the aggregate incremental investment cost. As with the *Water Hibah* scheme, WSI funds will be channelled to local governments using *PMK 168 / 169* procedures.

The characteristics of the existing sewerage systems and the institutional arrangements for their management are quite different in each of the cities. The **Banjarmasin** system was developed between 1995 and 2002 as part of the World Bank-funded Kalimantan Urban Development Project. It is now managed by a separate wastewater management company (PDAL), which is one of just two in Indonesia (the other is in Jakarta). The network currently serves central and northern areas of the city and has a total of around 3,200 connections. There is ample treatment plant capacity available, and the city has plans to add a further 15,000 connections. Preliminary screening being undertaken by IndII-funded consultants indicates that it will be possible to construct a total of 3,000 connections in 2010.

The **Surakarta** sewerage system was constructed during 1995-2001 as part of the Semarang Surakarta Urban Development Project with funding from the World Bank. The sewerage system consists of two wastewater treatment plants with capacity for 84L/sec, 12km of trunk sewer of diameter 600mm to 1300mm, and 70 km of secondary and lateral sewers of diameter 300 mm to 500 mm. The sewer system serves 10,800 connections. The PDAM is responsible for operating the sewerage system and includes a wastewater section and technical director in its organisation.

The proposed implementation arrangements are similar to those already developed for the *Water Hibah* scheme. While the timeframe for finalising these, compliant with prevailing budget management and grant channelling regulations, is extremely tight, the responsible GOI agencies have signalled their strong commitment to finding solutions that will enable the WSI funds to flow within the completion deadline.

### **Sewerage Investment Plans**

Preparation of sewerage investment plans for priority four cities supports the implementation of the *Sanitation Road Map* and needs to commence quickly if its targets are to be met. The Ministry of Public Works has already initiated screening of 17 candidate cities, with technical assistance being financed by the IndII Facility. To be eligible for assistance, local governments will be required to commit to proceeding with plan implementation on a pre-defined cost sharing basis with GOI, and to demonstrate that this commitment has been endorsed by the local parliament.

In preparing the sanitation investment plans, particular attention will be given to ensuring coverage of poor neighbourhoods. To this end, poverty assessments will be conducted and possible constraints to participation of poor households identified. Options for localised service provision and subsequent connection to the sewer network will be developed where appropriate. The findings of the assessments and the resultant plans will be disseminated at workshops with the local governments.

### **Safeguards**

Both components will have positive environmental, health, and gender equality impacts. During implementation, appropriate measures will be taken to optimise these, including through

socialisation and consultation processes. Efforts will also be made to ensure those with disabilities benefit from the investments, although it must be recognised that the government's role involves provision of connections and does not extend inside the home.

#### **Management Arrangements**

The WSI Indonesia allocation will be channelled to GOI through amendment of the existing IndII Facility Subsidiary Arrangement. A draft of the needed changes has already been tabled with the Ministry of Finance and it is anticipated these can be finalised rapidly once the design of the urban water and urban sanitation components is approved.

It is intended that the implementation of both components will be overseen by an expanded IndII Facility Managing Contractor team. In addition to being the only feasible option within the tight time constraint, this will also ensure synergy with other WATSAN activities being funded by IndII, and serve to minimise overhead costs. Extension of the scope of the managing contractor services is permitted by its contract, and the details of a proposed contract amendment are now being discussed. A key feature of the proposal is the creation of a new position of "Technical Director – Water & Sanitation" to oversee WSI- and IndII-funded WATSAN activities.

#### **Monitoring and Evaluation**

A monitoring and evaluation plan has been prepared for the two components and included in Section 5.

#### **Risks**

The main identified risks relate to the challenge of implementing the *Water and Sanitation Hibah* programs within the exceedingly tight timeframe. Addressing this will require continuing intensive interaction with GOI agencies during the programs' further preparation, and careful progress supervision. Fiduciary management risks will be addressed through the engagement of qualified and reputable firms to conduct baseline surveys and verify new connections.